FINANCIAL INTELLIGENCE *from* FHLBank Topeka

DEREK LAYTON
Lending Officer
785.478.8217
derek.layton@fhlbtopeka.com

Aug. 6, 2021

Strategies for Success

Earn extra income with FHLBank advances

Excess liquidity continues to linger for many of our members. It's becoming increasingly important for financial institutions to position their balance sheet for a rising rate environment.

Ask yourselves a few questions:

- Can your institution withstand sitting on extra liquidity only earning 5 to 15 basis points?
- Would it be beneficial for your institution to extend the duration of your assets and earn 10 times or greater on what you are earning now?
- When will rates rise? In 6-months? 1-year?
- How sticky are your deposits that grew due to customers stockpiling cash and pandemic monetary and fiscal policy decisions?

Most of our members would benefit from the extra income earned by extending out on the curve. With rates at historic lows, it's a great time to put aside liquidity blindness and address uncertainty before rates increase.

The Federal Open Market Committee has made it clear that tapering bond purchases will begin before any increase in its target for short-term rates. The purpose of this white-paper is to illustrate how to use FHLBank advances to prudently manage the many unknown variables holding you back from deploying a portion of the excess liquidity currently in overnight accounts into higher yielding assets to improve earnings growth.

Managing liquidity and interest rate risk associated with deploying excess cash into longer term fixed-rate securities is one of these unknown variables. Offering and holding longer term fixed-rate loans allows you to increase immediate and sustainable profitability and attract and retain quality customers.

FHLBank Topeka has an array of products and strategies to mitigate the risks associated with uncertainty and position you for long-term profitability.

Strategy 1: Staying Invested
This strategy deploys excess liquidity to higher yielding assets by using short-term advances for daily liquidity needs. Members using this strategy can take advantage of historically low advance rates to leverage addi-

... continued on page 2

Derek Layton is a Lending officer at FHLBank Topeka. Derek joined FHLBank in 2018 after working for a member financial institution. He is a graduate of Washburn University.

tional income. Our excellent dividend benefit further expands your investment options.

The graph below shows that when you factor in the 23bps dividend benefit* our advance rates are trading near or below treasury yields.

Strategy 2: Blended Funding

Blended funding is just like it sounds — blending deposits and advances to offset the risks associated with longer term assets or a pool of assets. This allows you to comfortably lengthen assets to accomplish higher yields and relinquish the drag that liquidity in overnight accounts has on earnings.

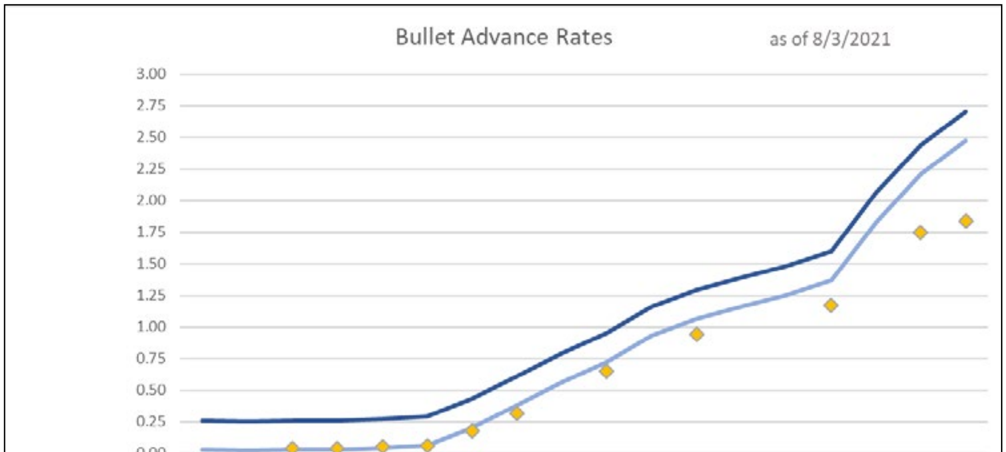
Amortizing and bullet advances are commonly used in this strategy. Amortizing advances can be customized to match any principal payment schedule and frequency, and bullet advances can be laddered to fill any maturity gaps. This is a great strategy to fund anything from agricultural, residential or commercial loans or investment portfolios.

Consider these key benefits to the blended funding strategy:

- Allows you to provide historically low long-term rates competitive with other lenders, especially a prominent ag lender competing in your market
- Deploys excess liquidity on your balance sheet
- Partially hedges interest rate risk by funding with a mix of FHLBank advances and deposits
- Protects you from prepayment risk by:
  - Covering partial prepayments with internal deposits
  - Reallocating low-cost funding to another asset
  - Adding a call option to the advance
  - Adding FHLBank's prepayment language to your note

Examples of blended funding strategies using an amortizing advance and a ladder of bullets are included on the next page. Keep in mind, every situation is different. Advances and strate-

... *continued on page 3*



	OLOC	1-wk	1-mo	3-mo	6-mo	1-yr	2-yr	3-yr	4-yr	5-yr	6-yr	7-yr	8-yr	9-yr	10-yr	15-yr	20-yr	30-yr
Advance	0.26	0.25	0.26	0.26	0.27	0.29	0.43	0.61	0.79	0.95	1.16	1.29	1.39	1.48	1.60	2.06	2.44	2.70
Dividend Adj.	0.03	0.02	0.03	0.03	0.04	0.06	0.20	0.38	0.56	0.72	0.93	1.06	1.16	1.25	1.37	1.83	2.21	2.47
Treasury Yields			0.04	0.04	0.05	0.06	0.18	0.32		0.65		0.94			1.17		1.74	1.84

* FHLBank Topeka's dividend lowers a member's effective advance rate up to 23 bps when supported by Class B stock.

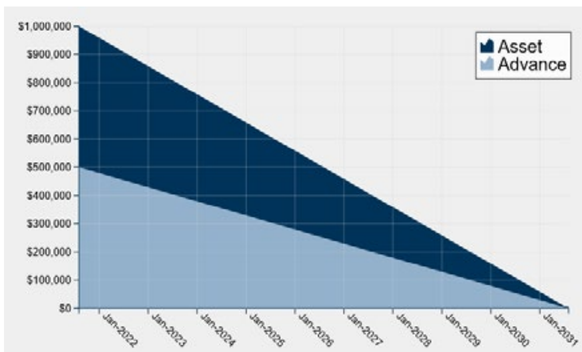
gies can be customized to fit your specific needs.

We understand a lot our membership is fairly liquid in this environment, and it may seem like you don't need any extra funding right now. I like to look at it like making personal investments in the stock market. As the most famous adage about making money in the stock market goes, "Buy low, sell high."

Of course, the intent is managing liquidity and interest rate risk, but the same concept can be applied to taking down an FHLBank advance in today's environment with historically low rates.

You may not need funding right now, but regulators will expect institutions to be prepared should the excess liquidity flow out as quickly as it came in. Although it may be unlikely that will occur, a robust liquidity risk management framework is needed along with a focus on interest rate risk management.

Taking down an FHLBank advance today can set you up for long-term performance and give you the peace of mind of having secured fixed funding or access to short-term funding to fill daily liquidity needs. Give us a call to learn more.

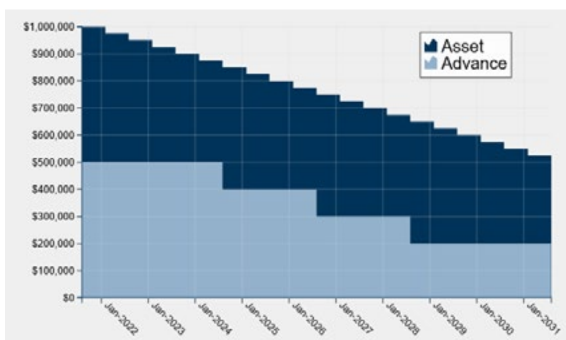


Asset	Advance	Deposit COF	Spread in bps
$1,000,000 Amort: 120 mo Maturity: 120 mo Yield: 4.000 % Principal: Monthly	$500,000 Amort: 120 mo Maturity: 120 mo Rate: 1.194 % Principal: Monthly	0.300 %	325 initial 325 adv life 325 asset life
		Interest is collected on the first business day of each month.	

Option 1: Amortizing advance

This graph illustrates a 50/50 split between deposits and an amortizing advance. With this split, you would be able to lock in 3.25% over the life of the asset, excluding the dividend benefit (+23bps*).

Loan: 10-year fully amortized at 4.00%
Advance: 10-year fully amortized
50% deposits | 50% advances
(indications as of 8/3/2021)



Advance Results	Bullet Rate and Spread	Asset Results
Average Advance Rate: 1.156 % Deposit COF: 0.300 % Initial Spread: 327 Asset Life Spread: 324	10yr: 1.55 %, $200,000.00 324 adv life 7yr: 1.22 %, $100,000.00 323 adv life 5yr: 0.90 %, $100,000.00 323 adv life 3yr: 0.56 %, $100,000.00 324 adv life	Yield: 4.000 % Par: $1,000,000 Start: Aug-21 Maturity: Aug-31 Amort: 240 mo Maturity: 120 mo Am: Semi-annually Type: Straight Line CPR: N/A

Option 2: Ladder of bullet advances

This graph illustrates a 50/50 split between deposits and a ladder of bullet advances. With this split you would be able to lock in a spread of 3.27% in the first year and 3.24% over the life of the asset, excluding the dividend benefit (+23bps*).

Loan: 20-year amortization with a 10-year maturity at 4.00%
Advance: Ladder of bullets (3, 5, 7, 10-year maturities)
50% deposits | 50% advances
(indications as of 8/3/2021)

Note: Adding a call option to the longest-term advance gives you greater flexibility in managing prepayment risk (prevent being overfunded) and opportunities to increase spreads by refinancing the advance at a lower rate without a prepayment fee.

CONTACT LENDING

We're here to discuss your options and will find the best funding solution for your situation.

800.809.2733

Lending@fhlbtopeka.com