MOODY'S INVESTORS SERVICE

CREDIT OPINION

20 December 2022

Update

Send Your Feedback

Contacts

Rita Sahu, CFA +1.212.553.1648
VP-Sr Credit Officer
rita.sahu@moodys.com

Siri Ginjupalli +1.212.553.3805
Associate Analyst
siri.ginjupalli@moodys.com

Allen Tischler +1.212.553.4541
Senior Vice President
allen.tischler@moodys.com

Jill Cetina, CFA +1.212.335.7000
Associate Managing Director
jill.cetina@moodys.com

Federal Home Loan Bank of Topeka

Update to credit analysis

Summary

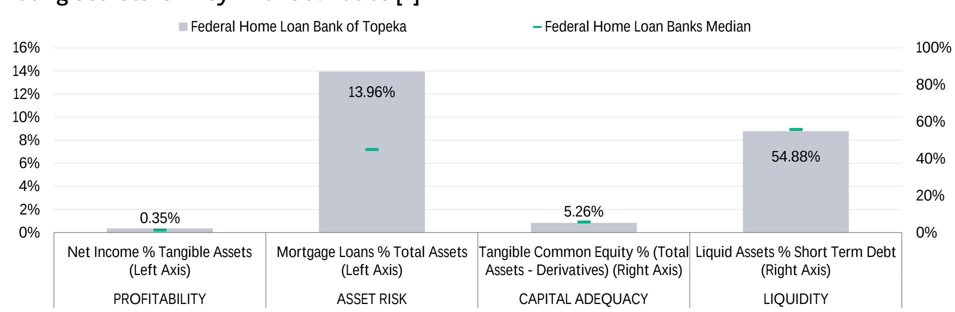
The Federal Home Loan Bank of Topeka's (FHLBank Topeka) Aaa long-term and Prime-1 short-term deposit ratings are in-line with the deposit ratings of the other ten regional FHLBanks. These ratings reflect the combination of FHLBank Topeka's a1 Baseline Credit Assessment (BCA) and our view that there is a very high likelihood of support from the US Government (Aaa stable) in the event that an individual FHLBank or the FHLBank System were in danger of default due to the FHLBanks' special role as providers of liquidity to the US banking system. The rating outlook is stable.

FHLBank Topeka's a1 BCA is based on the excellent asset quality of its advance portfolio, investment portfolio, and mortgage portfolio, along with its consistent earnings generation. FHLBank Topeka benefits from its core business of advancing funds to members, with $35.3 billion outstanding as of 30 September 2022. While the credit performance of the FHLBank Topeka's mortgage assets, which equal 12.6% of assets as of 30 September 2022, has been excellent, mortgage assets carry heightened operational complexity along with greater interest rate risk and credit risk relative to the FHLBank's core lending business.

The stable outlook is in line with the outlook on the ratings of the US Government. Any rating actions on the US Government would likely result in all individual FHLBanks' long-term deposit ratings, and the FHLBank System's Aaa long-term bond rating, moving in lock step with the US sovereign rating. FHLBank Topeka, and the ten other regional FHLBanks, have joint and several liability for the FHLBank System's consolidated issuance of bonds and discount notes.

Exhibit 1

Rating Scorecard - Key Financial Ratios [1]



[1] All ratios are as of 06/30/2022.
Source: Moody's Investors Service

Credit strengths

» Excellent credit quality of its advance, investment, and mortgage portfolios minimize asset risk

» Although narrowly focused, the FHLBanks, including FHLB Topeka, are central liquidity providers to US banks, underscoring their systemic importance

Credit challenges

» Narrow FHLB charter and bank consolidation limit growth

» Substantial single borrower concentrations

» Reliance on confidence-sensitive market funding, but market access is strong because of consolidated issuance and FHLB status as a government-sponsored enterprise (GSE)

Outlook

Our stable outlook for FHLBank Topeka's long-term deposit ratings reflects the stable outlook on the US government's Aaa debt rating.

Factors that could lead to an upgrade

At Aaa, an upgrade of FHLBank Topeka's long-term deposit rating is not possible. A higher BCA could occur if FHLBank Topeka increased its advances to approximately 70% of assets while it also displayed: 1) strong profitability, 2) a stable member risk profile, 3) continued strong asset risk, including modest asset-liability and operational risk, and 4) robust capital and liquidity.

Factors that could lead to a downgrade

Any negative rating action on the US Government would likely result in all individual FHLBanks' long-term deposit ratings moving in lock step with any US sovereign rating action.

Factors that could lead to a downgrade of FHLBank Topeka's BCA of a1 include elevated loss expectations on its investment or mortgage portfolio, multiple quarterly net losses or significant asset-liability mismatches. In addition, an expansion of its risk profile, for example due to a change in the FHLBanks' government mandate or self-initiated, could result in a lower standalone BCA. A lower BCA could result in a lower long-term deposit rating.

Key Indicators

Exhibit 2

Federal Home Loan Bank of Topeka (Consolidated Financials) [1]

	06-22[2]	12-21[2]	12-20[2]	12-19[2]	12-18[2]	CAGR/Avg.[3]
Total Assets (USD Billion)	57.5	48.0	52.6	63.3	47.7	5.5[4]
Net Income / Tangible Assets (%)	0.4	0.3	0.2	0.3	0.4	0.3[5]
Liquid Assets (GSE) / Short Term Debt (%)	54.9	55.1	49.2	42.4	19.8	44.3[5]
Tangible Common Equity / (Total Assets - Derivatives) (%)	5.3	5.5	5.0	4.4	5.1	5.1[5]
Mortgage Loans / Total Assets (%)	14.0	17.0	17.5	16.8	17.6	16.6[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel I; US GAAP. [3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime.
Sources: Moody's Investors Service and company filings

Profile

The FHLBanks are federally-chartered GSEs that were organized under the Federal Home Loan Bank Act of 1932. The FHLBanks together with the Office of Finance comprise the FHLBank System. Each of the FHLBanks and the Office of Finance operate under the supervisory and regulatory framework of the Federal Housing Finance Agency (FHFA). Each FHLBank operates as a separate entity with its own management, employees, and board of directors. The FHLBank of Topeka reported total consolidated assets of $63.5 billion as of 30 September 2022.

The FHLBanks' primary business is lending to member institutions, primarily banks, savings institutions and credit unions, in the form of advances, which are generally short-term and over-collateralized, minimizing the credit risk on these loans. In addition, the FHLBanks benefit from their statutory lien priority with respect to pledged member assets. The FHLBanks also purchase mortgage loans, principally 15-30 year conventional and government-guaranteed or insured fixed-rate loans. The FHLBanks also invest in securities, principally MBS, subject to an investment limit of three times regulatory capital without approval by the FHFA. Some FHLBanks offer correspondent services to their member institutions, including wire transfer, security safekeeping, and settlement services.

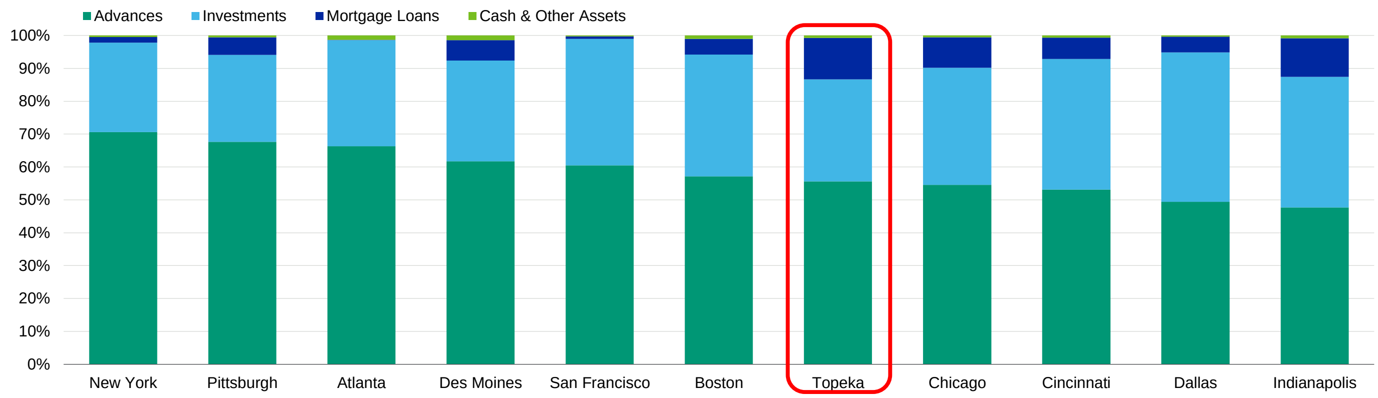
Detailed credit considerations

Asset quality and credit risk management

The asset quality of FHLBank Topeka is exceptional. Advances, which represented about 55.6% of total assets as of 30 September 2022, are over-collateralized and an FHLBank has never incurred a loss on an advance in its 90 year history. This is reflected in the aa2 assigned score for Asset Risk in our scorecard.

Similar to other FHLBanks, FHLBank Topeka's balance sheet composition is narrowly focused. Beyond its advance portfolio, investments, which are primarily high quality US government and agency guaranteed securities, comprise 31.1% of assets. FHLBank Topeka's mortgage portfolio, representing 12.6% of total assets as of 30 September 2022, has experienced far lower losses and delinquencies than industry averages. Nonetheless, asset-liability management of the mortgage portfolio can present challenges.

Exhibit 3
FHLBank Topeka's asset mix compared to those of the other FHLBanks



As of 09/30/2022.
Source: Company Filings

Similar to other FHLBanks, FHLBank Topeka has significant borrower concentrations, a long-term earnings risk. Its top five advance borrowers represented 26.8% of total assets as of 30 September 2022, an amount comparable to the average for all FHLBanks, which was approximately 26.0% as of 30 June 2022. This has not changed much from a year ago.

Interest rate risk management

FHLBank Topeka conservatively manages its interest rate risk exposures through the use of debt with similar characteristics to its assets, as well as derivatives. The FHLBank's primary asset is advances, which come in a variety of types, including fixed rate, variable rate, and callable by the member. Prepayment fees, which mitigate interest rate risk, are also a common feature of advances.

Capital adequacy

FHLBank Topeka is required by legislation to maintain minimum regulatory capital of 4.00% of its total assets. As of 30 September 2022, the capital ratio of the FHLBank was 5.27%, compared to 5.65% as of 31 December 2021. The aa2 assigned score for Capital in our scorecard incorporates our estimate of FHLBank Topeka's TCE ratio on a risk-weighted basis, which is very strong.

Profitability

FHLBank Topeka's low but consistent profitability as measured by return on average assets (ROAA) reflects the primarily low to moderate risk profile of its asset base. In the first nine months of 2022, the FHLBank Topeka's reported ROAA was 0.42%, higher than 0.31% reported in the same period in the prior year. The baa1 assigned score for Profitability in our scorecard reflects the extremely low earnings volatility owing to the company's low asset risk profile.

Liquidity and funding

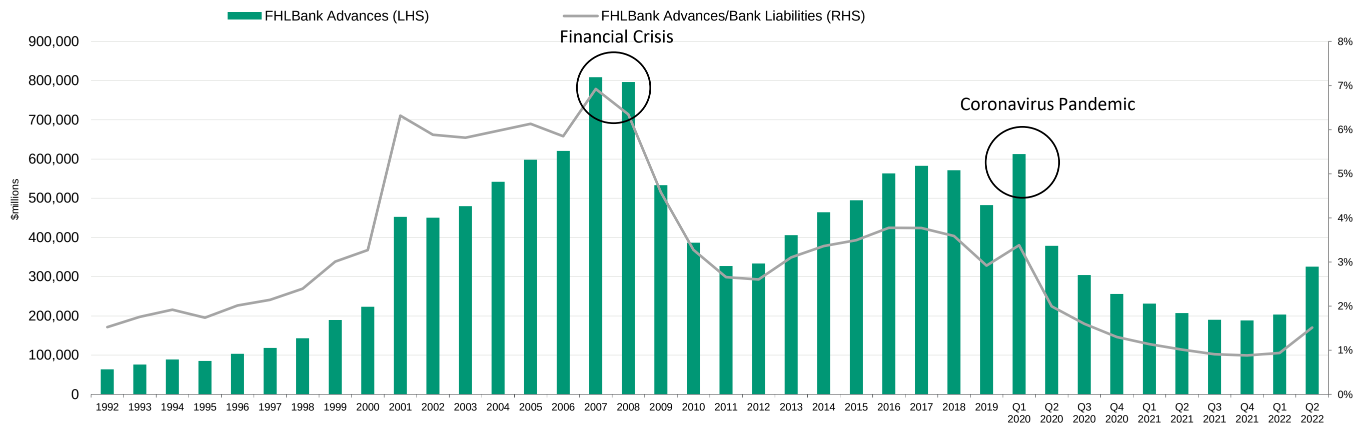
The FHLBanks' GSE status provides them with consistent and stable debt market access. Consequently, the FHLBanks generally maintain lower liquidity than non-GSE entities. As of 30 June 2022, FHLBank Topeka had liquid assets as a percentage of short term debt of 54.9%, as compared to 54.7% for the FHLBank system. This is not materially different from a year ago.

The FHFA issued updated liquidity guidance in the summer of 2018 that took full effect on 31 December 2019. Under the updated guidance, the FHFA established requirements for the FHLBanks' base case liquidity and implemented new funding gap metrics for three-month and one-year maturity horizons. In addition, the guidance addressed liquidity stress testing and contingency funding plans. The FHLBank Topeka continues to be in compliance with all its liquidity requirements.

Special role as a provider of liquidity to US financial institutions

As GSEs, the FHLBanks' ability to access funding throughout the cycle underpins their importance to the financial system. This is particularly true during times of extreme market disruption when they become a primary source of contingent liquidity for their members. As Exhibit 4 shows, at the height of the last financial crisis, advances to members climbed a few hundred billion dollars for the system as a whole before receding as the financial markets and overall economy recovered. Advances have also climbed in Q2 2022 as banks seek alternative funding as their deposit balances decline.

Exhibit 4
FHLB Advances have proven to be a stable source of funding, even during a crisis



Source: FDIC

GSE reform

In the fall of 2022, the FHLBank System's regulator, the Federal Housing Finance Agency (FHFA), began a comprehensive review of the System that could result in changes to its mission, organizational structure, membership criteria and/or other areas. The review will continue into 2023 and any recommendations or changes that result may not be known for several months.

Although the FHFA's review is broad and it remains unclear what will be proposed, for creditors, expansion of FHLBank membership will be a particular area of interest. In a scenario where firms with large non-depository and non-insurance operations, such as non-bank mortgage companies, are given access to FHLBank advances, that could increase the FHLBanks' asset risk. Other areas of the review center on the banks' mission, organization, efficiency, role in promoting a resilient housing market, ability and effectiveness in addressing the needs of rural and vulnerable communities, and the FHLBanks' products, services and collateral requirements.

ESG considerations

Federal Home Loan Bank of Topeka's ESG Credit Impact Score is Neutral-to-Low CIS-2

Exhibit 5
ESG Credit Impact Score

CIS-2
Neutral-to-Low

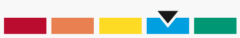
For an issuer scored CIS-2 (Neutral-to-Low), its ESG attributes are overall considered as having a neutral-to-low impact on the current rating; i.e., the overall influence of these attributes on the rating is non-material.

Source: Moody's Investors Service

FHLB Topeka's ESG Credit Impact Score is neutral-to-low (**CIS-2**), reflecting the limited credit impact of environmental and social factors on the rating to date. The bank faces neutral-to-low governance risks

Exhibit 6
ESG Issuer Profile Scores

ENVIRONMENTAL
E-2
Neutral-to-Low



SOCIAL
S-2
Neutral-to-Low

GOVERNANCE
G-2
Neutral-to-Low

Source: Moody's Investors Service

Environmental
FHLB Topeka faces low environmental risks. Its loan portfolio consists of wholesale advances to banks, insurance companies and credit unions. Although most of its bank customers face moderate carbon transition risks through their own loan portfolios, and many of its insurance companies face moderate physical climate risks through their client exposures, FHLB Topeka is only indirectly exposed to these risks and its advance portfolio is diversified.

Social
FHLB Topeka faces low social risks. Its clients are member institutions, such as banks, insurance companies and credit unions, and minimal interaction with retail clients mitigates the risks related to customer relations and demographic and societal trends. While FHLBank Topeka also faces high cyber risk similar to its banking peers, it faces lower risks of customer relations fallout than a typical bank because of its institutional client base.

Governance
FHLB Topeka faces low governance risks. The bank has never reported credit losses on advances, it primary product, highlighting its strong financial strategy and risk management. The bank's strategy and asset composition are based on its Congressional mission and reinforced by its regulators. Like its FHLBank peers, FHLB Topeka is a separately chartered cooperative owned by its respective members, with its own board of directors, management and employees. The bank's mandate, regulatory oversight and policies limit the ability of board members to act against the interest of bondholders, which mitigates the potential conflict of interest resulting from board members being executives of its borrowers.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Methodology and scorecard

Our Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The Scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Exhibit 7

Federal Home Loan Bank of Topeka

Macro Factors							
Weighted Macro Profile	**Very Strong -**	**100%**					

Factor	**Historic Ratio**	**Initial Score**	**Expected Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	0.2%	aa1	↔	aa2	Long-run loss performance	
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel I)				aa2	Risk-weighted capitalisation	
Profitability						
Net Income / Tangible Assets	0.3%	ba2	↔	baa1	Earnings quality	
Combined Solvency Score				aa3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	92.1%	caa3	↔	baa1	Market funding quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	32.6%	a1	↔	baa2	Expected trend	
Combined Liquidity Score		ba3		baa1		
Financial Profile				a1		
Qualitative Adjustments				Adjustment		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint				Aaa		
BCA Scorecard-indicated Outcome - Range				aa3 - a2		
Assigned BCA				a1		
Affiliate Support notching				-		
Adjusted BCA				a1		

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
Source: Moody's Investors Service

Ratings

Exhibit 8

Category	Moody's Rating
FEDERAL HOME LOAN BANK OF TOPEKA	
Outlook	Stable
Bank Deposits	Aaa/P-1
PARENT: FEDERAL HOME LOAN BANKS	
Outlook	Stable
Senior Unsecured	Aaa
ST Issuer Rating	P-1

Source: Moody's Investors Service

REPORT NUMBER 1348270

MOODY'S
INVESTORS SERVICE