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Ratings

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Federal Home Loan Bank of Topeka

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Federal Home Loan Bank of Topeka

Ratings Score Snapshot

Issuer Credit Rating
AA+/Stable/A-1+

SACP: aa

Anchor	bbb+	
Business position	Strong	+1
Capital and earnings	Very strong	+2
Risk position	Very strong	+2
Funding	Adequate	0
Liquidity	Adequate	
CRA adjustment		0

Support: +1

ALAC support	0
GRE support	+1
Group support	0
Sovereign support	0

Additional factors: 0

Issuer credit rating
AA+/Stable/A-1+

ALAC--Additional loss-absorbing capacity. CRA--Comparable ratings analysis. GRE--Government-related entity. ICR--Issuer credit rating. SACP--Stand-alone credit profile.

Credit Highlights

Overview

Key strengths	Key weaknesses
Very important role in the implementation of U.S. government housing policy	High exposure to the U.S. mortgage market
Important funding source for the U.S. banking system	Geographically restricted to a limited region of the U.S.
Very strong risk-adjusted capitalization	Uncertainty regarding the impact of potential legislative changes
Very strong loan asset quality and overcollateralized lending portfolio	Earnings dependent on advance volume and interest rate environment, though profitability is not a priority of the Federal Home Loan Banks (FHLBs)

S&P Global Ratings' issuer credit rating on Federal Home Loan Bank of Topeka (FHLB Topeka) reflects the wholesale bank's government-supported role in providing liquidity to member institutions, strong asset quality and capitalization, low funding costs, and conservative risk management. During the recent banking sector turmoil, when some banks experienced significant deposit outflows, FHLB Topeka and the other FHLBs immediately provided liquidity to their members and managed their own funding needs. We expect FHLB Topeka and the other FHLBs to maintain their strong financial profiles and controls, provide for members' additional liquidity needs, support the U.S. housing sector, stay profitable, and build retained earnings.

The rating on FHLB Topeka is one notch higher than the bank's stand-alone credit profile (SACP) of 'aa'. This reflects our expectation that the likelihood of the bank receiving extraordinary government support, if needed, is very high, because of the FHLB System's importance to the U.S. housing market and the U.S. banking system.

Outlook

The stable outlook on FHLB Topeka reflects our expectation that the company will continue to have a stable operating performance, provide liquidity, manage funding needs, build retained earnings, and execute its mission to support the U.S. housing sector over the next 12-24 months. The outlook also reflects our stable outlook on the U.S.

Downside scenario

If we change our rating or outlook on the U.S., we would likely reflect that change in our ratings on the FHLB System's debt and our ratings on FHLB Topeka. Although less likely, we could also lower the rating in the next two years if the role of the FHLB System in housing finance is diminished, thereby reducing its importance to the government.

Upside scenario

An upgrade would likely be contingent upon a higher rating on the U.S. sovereign.

Anchor: Adjusted To Reflect FHLB's Regulated Status, Strong Competitive Position, And Favorable Funding

Our anchor for our ratings on U.S. finance companies that we rate under our financial institutions criteria, including the FHLBs, is 'bb+'. Because of the FHLBs' public policy role and regulatory status, we apply a sector-specific anchor adjustment to raise the anchor for these entities by three notches to 'bbb+'. This is to account for the FHFA's regulatory oversight; the favorable funding FHLBs enjoy through their close relationship with the U.S. government; their strong competitive position alongside other housing-related government-sponsored enterprises (GSEs), including Fannie Mae and Freddie Mac in the U.S. housing finance market; and the statutory priority of liens in a bank wind-down situation.

Business Position: Stable Operating Model And Important Public Policy Role Offset Concentration Risks

FHLB Topeka has an established market position, recurring business volumes, and important role in public policy which we believe offset some of the risks associated with its relative lack of business diversification.

The FHLBs are wholesale lenders that help finance the U.S. housing industry. They provide secured loans, known as advances, to their members, which include commercial banks, savings institutions, credit unions, and insurance companies. Like the other FHLBs, Topeka's advance volumes and revenues are generally countercyclical, since members rely more on it in times of stress as a reliable funding source.

The recent banking turmoil highlighted the FHLB System's importance to the U.S. banking sector. When many member banks experienced significant deposit outflows, the FHLBs provided liquidity by extending advances to members. Advances grew to $1.05 trillion as of March 31, 2023, from $827 billion at year-end 2022.

We expect outstanding advances to decline as market liquidity normalizes; however, advances will remain elevated for the remainder of 2023 as the Federal Reserve keeps monetary policy tight to fight high inflation. The FHLB System's role during the COVID-19 pandemic in 2020 and the U.S. mortgage crisis of 2008 further illustrates its importance to the U.S. banking sector in times of uncertainty and economic disruption.

FHLB Topeka is one of the smallest of the 11 FHLBs, with $74.8 billion in assets and $46.5 billion in advances as of March 31, 2023, serving member institutions in Colorado, Kansas, Nebraska, and Oklahoma.

While FHLB Topeka has some diversity across its 669 members (as of year-end 2022)--including banks (79%), credit unions (13%), insurance companies (4%), savings and loan (3%), and community development financial institutions (1%)--member borrowing needs are highly correlated to the housing market and Topeka's business is concentrated exclusively in a limited region of the U.S. where local economic conditions play a significant role in the bank's business.

Additionally, most of the advances made by Topeka are to a relatively small number of its members, which we believe exposes the bank to concentration risk. As of March 31, 2023, FHLB Topeka's top five borrowers held around 53% of total advances, below the peer average of 55%. Around 29% of total advances were held by the bank's top borrower--MidFirst Bank--compared to 38% in March 2022.

While we consider advance exposures to be concentrated--with potential for asset, earnings, or even capital volatility--the bank's exposures are in line with peer FHLBs. In our view, the fully collateralized nature of the lending business also mitigates much of FHLB Topeka's concentration risk.

Capital And Earnings: Collateralized Lending To Financial Institutions And Member-Capitalized Co-op Structure Limit Risk

We believe FHLB Topeka is well-capitalized, reflecting the member-capitalized co-op structure and low-risk collateralized lending business. As of March 31, 2023, the bank had ample cushion to the FHFA's regulatory capital-to-assets ratio (5.3% versus 4%) and leverage ratio (7.7% versus 5%).

Given that advances make up a significant portion of FHLB Topeka's assets (around 62%), the bank's capital on a risk-adjusted basis is stronger than the regulatory ratio as we view advances as relatively low risk and all the exposures are to financial institutions. As of March 31, 2023, FHLB Topeka maintained a risk-adjusted capital (RAC) ratio of 20.4%, well in excess of 15%--a level we consider very strong.

We expect earnings to be higher this year as member demand for advances remains elevated. In first-quarter 2023, FHLB Topeka reported a net income of $85 million versus around $50 million for the same period last year. However, we do not consider the absolute level of Topeka's earnings to be an important consideration in our assessment given the bank's strong capital level and its co-op structure, both of which ensure that profit maximization is not a goal.

As a result, and since each district has somewhat unique needs, we do not anticipate any further consolidation in the FHLB System in the next 12-24 months.

Risk Position: No Losses On Member Advances And Minimal Interest Rate Risk

No FHLB has ever suffered a loss on a collateralized advance to a member.

Although the firm has a relatively homogenous lending portfolio, with all advances made to financial institutions backed by a majority of residential and commercial mortgages, all such advances are overcollateralized by loans and securities with an estimated value significantly in excess of loans extended.

FHLB Topeka had $46.7 billion of credit outstanding (primarily advances and letters of credit) as of March 31, 2023. Although we believe some of the collateral could be under strain as a result of economic headwinds, we believe the amount of collateral in place offsets the potential for losses.

We consider FHLB Topeka's approach to risk management as a credit positive. The company monitors the financial condition of its members, and manages collateral guidelines, advance rates, and security agreements to further mitigate credit risk.

In addition, any security interest that an insured depository institution grants to the bank generally has priority over the claims and rights of other parties, including depositors. For nondepositories, FHLB Topeka, like its peers, relies on stricter borrowing limits and collateral guidelines to mitigate associated credit risks for which an FHLB is not guaranteed priority status in liquidation.

The company's $19 billion investment portfolio has among the highest exposures to mortgages compared to its peers--around 11% of total assets, or $8 billion. The bank purchases residential mortgage loan products from participating financial institutions under the Mortgage Partnership Finance (MPF) program, a secondary mortgage market structure created and maintained by FHLB Chicago.

These assets have very limited credit risk, as they are either government-guaranteed or credit enhanced by the member institutions. Over 86% of the MPF portfolio has a FICO score greater than 700, and over 80% has a loan-to-value ratio less than 80. The company does not have exposure to private-label mortgage-backed securities.

The bank also takes little interest rate risk. It issues fixed-rate callable and non-callable bonds to fund and manage interest rate risk in its fixed-rate assets but swaps most of its fixed-rate exposures to floating rate.

Funding And Liquidity: Stable And Favorable Funding Supports The Business Model

The FHLB System has a diverse, global investor base, and it readily sells its debt at a small spread to U.S. Treasury obligations. For example, the demand for liquidity from borrowing members increased significantly in the first half of 2023 in response to the banking sector turmoil. The FHLBs were able to manage the surge in advances through their access to the capital markets. We view as positive that the banks have also been able to scale back quickly once the spike in demand for funds subsided.

We believe the FHLB System's transition from LIBOR-based funding toward funding based on the secured overnight financing rate (SOFR) could be smoother than for other issuers, given its larger percentage of short-term debt. The FHLBs have recently been moving toward floating-rate notes to address investor preferences amid rising interest rates, with a vast majority of issuance linked to SOFR since 2020. The LIBOR Act has also provided the necessary fallback provisions for any contract outstanding after June 30, 2023.

We consider FHLB Topeka's liquidity as adequate relative to its potential cash flow requirements over the next 12-24 months. The FHFA requires between 10 and30 days of liquidity--with a 20-day target--to cover a temporary inability to issue consolidated obligations. The bank's liquidity position complies with the FHLB Act and certain regulations and policies. We think FHLB Topeka is adequately prepared for these requirements.

Support: A Very Important Cog In The Policy Framework For U.S. Housing Finance

Our ratings on FHLB Topeka reflect our opinion that there is a very high likelihood that the U.S. government would provide the bank with timely and sufficient extraordinary support in the event of financial distress. Therefore, our issuer credit rating on the bank reflects a one-notch uplift from the SACP.

We base our opinion on:

- FHLB Topeka's very important role in providing low-cost funding to support housing and community development in the U.S., which we believe are key economic and political objectives of the U.S. government; and

- The bank's very strong link with the U.S. government, because a financially distressed or defaulted FHLB could significantly damage the government's reputation, and we believe the government has the administrative capacity and mechanisms (via the FHFA) for responding to an FHLB's financial distress in a timely manner.

Moreover, we view the government as having a track record of providing very strong and timely credit support to the FHLBs, for example, their inclusion in a U.S. Treasury GSE credit facility created in September 2008.

We continue to monitor legislative proposals and court rulings that could affect the FHLBs, which are regulated by the FHFA. That said, we do not anticipate any meaningful reform in the next 12-24 months.

In May 2022, the U.S. Senate confirmed Sandra Thompson as the director of the FHFA. While we don't expect the U.S.

government's policy with respect to the FHLBs to fundamentally change, Director Thompson announced in August 2022 that the FHFA would launch a comprehensive review of the FHLB System to consider and evaluate its mission, membership eligibility requirements, and operational efficiencies. The FHFA expects to issue a report in September 2023 summarizing the feedback received and recommendations for consideration by Congress.

Environmental, Social, and Governance

ESG Credit Indicators

E-1 **E-2** E-3 E-4 E-5	**S-1** S-2 S-3 S-4 S-5	G-1 **G-2** G-3 G-4 G-5
- N/A	- Social capital	- N/A

N/A--Not applicable. ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumerical 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicator Definitions And Applications," published Oct. 13, 2021.

Social factors are a positive consideration in our rating of FHLB Topeka. As a GSE with a mandate to support housing and community development, FHLB Topeka's public policy role and regulated status support its credit quality.

FHLB Topeka has an established a governance framework--including a climate change risk and environmental, social, and governance steering committee--to ascertain the implications of climate change for itself and its members.

Ratings Score Snapshot

Issuer credit rating: AA+/Stable/A-1+

Stand-alone credit profile: aa

- Anchor: bb+
- Sector-specific anchor adjustment: +3
- Business position: Strong (+1)
- Capital and earnings: Very strong (+2)
- Risk position: Very strong (+2)
- Funding and liquidity: Adequate and adequate (0)
- Comparable ratings analysis: 0

Support: +1

- Government-related entity (GRE) support: +1

- Group support: 0
- Sovereign support: 0

Additional factors: 0

Related Criteria

- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | Sovereigns: Sovereign Rating Methodology, Dec. 18, 2017
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Financial Institutions | General: Nonbank Financial Institutions Rating Methodology, Dec. 9, 2014

Ratings Detail (As Of July 31, 2023)*	
Federal Home Loan Bank of Topeka	
Issuer Credit Rating	AA+/Stable/A-1+
Issuer Credit Ratings History	
10-Jun-2013	AA+/Stable/A-1+
08-Aug-2011	AA+/Negative/A-1+
15-Jul-2011	AAA/Watch Neg/A-1+
Sovereign Rating	
United States	AA+/Stable/A-1+
Related Entities	
Federal Home Loan Bank of Atlanta	
Issuer Credit Rating	AA+/Stable/A-1+
Federal Home Loan Bank of Boston	
Issuer Credit Rating	AA+/Stable/A-1+
Federal Home Loan Bank of Chicago	
Issuer Credit Rating	AA+/Stable/A-1+
Federal Home Loan Bank of Cincinnati	
Issuer Credit Rating	AA+/Stable/A-1+
Federal Home Loan Bank of Dallas	
Issuer Credit Rating	AA+/Stable/A-1+
Federal Home Loan Bank of Des Moines	
Issuer Credit Rating	AA+/Stable/A-1+

Ratings Detail (As Of July 31, 2023)*(cont.)	
Federal Home Loan Bank of Indianapolis	
Issuer Credit Rating	AA+/Stable/A-1+
Federal Home Loan Bank of New York	
Issuer Credit Rating	AA+/Stable/A-1+
Federal Home Loan Bank of Pittsburgh	
Issuer Credit Rating	AA+/Stable/A-1+
Federal Home Loan Bank of San Francisco	
Issuer Credit Rating	AA+/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.