S&P Global
Ratings

RatingsDirect®

Federal Home Loan Banks

Primary Credit Analyst:
Igor Koyfman, New York + 1 (212) 438 5068; igor.koyfman@spglobal.com

Secondary Contact:
Gaurav A Parikh, CFA, New York + 1 (212) 438 1131; gaurav.parikh@spglobal.com

Table Of Contents

Credit Highlights

Outlook

Rationale

GRE Analysis: Critical Public Policy Role And Integral Link To The Government

Profile And Ownership: A Cooperative Owned By Its Member Institutions

Related Criteria

Federal Home Loan Banks

Credit Highlights

Issuer Credit Rating
None

Overview

Key strengths	Key risks
Government-related entity (GRE) with an almost certain likelihood of extraordinary government support	High exposure to the U.S. mortgage market
Important role in the implementation of U.S. government housing policy	Uncertainty regarding the impact of potential regulatory and legislative changes
Important funding source for the U.S. banking system	Earnings vary based on advance demand and interest rates, though profitability is not a priority
Very strong loan asset quality and overcollateralized lending portfolio	Exposure to nondepository financial institutions

We view the Federal Home Loan Bank (FHLB) System as one of the most important U.S. GREs. In our opinion, the FHLBs' exceptionally favorable funding advantages are likely to continue as long as their policy role remains critical and their link integral to the U.S. government.

Moreover, based on the history of ample funding for the FHLB System during periods of market stress in 2023, 2020, and 2008, we believe access to funding is unlikely to be problematic even in stress scenarios.

In our view, the FHLB System enjoys unusual advantages from its legal framework. These advantages include lien priority over other creditors (without perfected and priority liens) if an insured depository member to which the System had loans outstanding fails.

We also believe the Federal Housing Finance Agency (FHFA), the FHLBs' regulator, has clear and robust processes and procedures that enable effective governance, monitoring, and control of the FHLB System. These include administrative capacity and mechanisms for timely responses to any financial distress the System might encounter.

The System primarily relies on short-term funding in response to member demands. Given the generally match-funded approach to issuance, as well as the overcollateralization of advances to members, we believe the tenor of the System's funding remains manageable. The FHLBs' principal investments are GSE (government-sponsored enterprises) mortgage-backed securities, federal funds sold, interest-bearing deposits, reverse repurchase agreements, and municipal and Treasury securities.

Outlook

S&P Global Ratings' outlook on its debt ratings on the FHLB System is stable, in line with the stable outlook on the U.S. sovereign credit rating. We expect the likelihood of extraordinary government support for the FHLB System, if needed, to remain almost certain for at least the next two years. If we changed our rating or outlook on the U.S., we would reflect that change in our ratings and outlook on the FHLB System's debt.

In the long term, the FHLB System faces uncertainty related to potential legislative changes associated with broader U.S. housing finance reform. If initiatives were to gain momentum and target substantial changes to the FHLB System such that the role of the FHLB System in housing finance and as a liquidity provider for the U.S. banking system were diminished, we could lower our ratings on the System's debt. To date, however, such initiatives have neither succeeded in gathering substantial political momentum nor targeted the FHLB System.

Rationale

The FHLBs are GREs, federally chartered but privately capitalized and independently managed. The 11 FHLBs, together with the Office of Finance (a joint office of the FHLBs), make up the FHLB System.

We assign stand-alone credit profiles (SACPs) to each of the FHLBs but not to the System as a whole. Because the System issues consolidated debt obligations on behalf of its component FHLBs, and in light of their joint and several liability for these obligations, we have issue ratings on the System's debt.

The issuer credit ratings on the FHLBs are one notch higher than their 'aa' SACPs because, in our view, the likelihood of the government providing extraordinary support to them, if needed, is very high.

We view the FHLBs' business positions as strong, reflecting their established market positions in their districts, recurring business volumes, and public policy role, which we believe offset some of the risks associated with their lack of business diversity.

The FHLBs also acquire mortgage assets from their members--providing them liquidity. Through these programs, the FHLBs share credit risk with their members and housing associates and manage the interest rate and prepayment risks.

We view the FHLBs' capitalization as very strong based on their member-capitalized co-op structure and low-risk collateralized lending business. As of March 31, 2023, the regulatory capital-to-assets ratio at each of the banks exceeded the FHFA 4.0% minimum requirement.

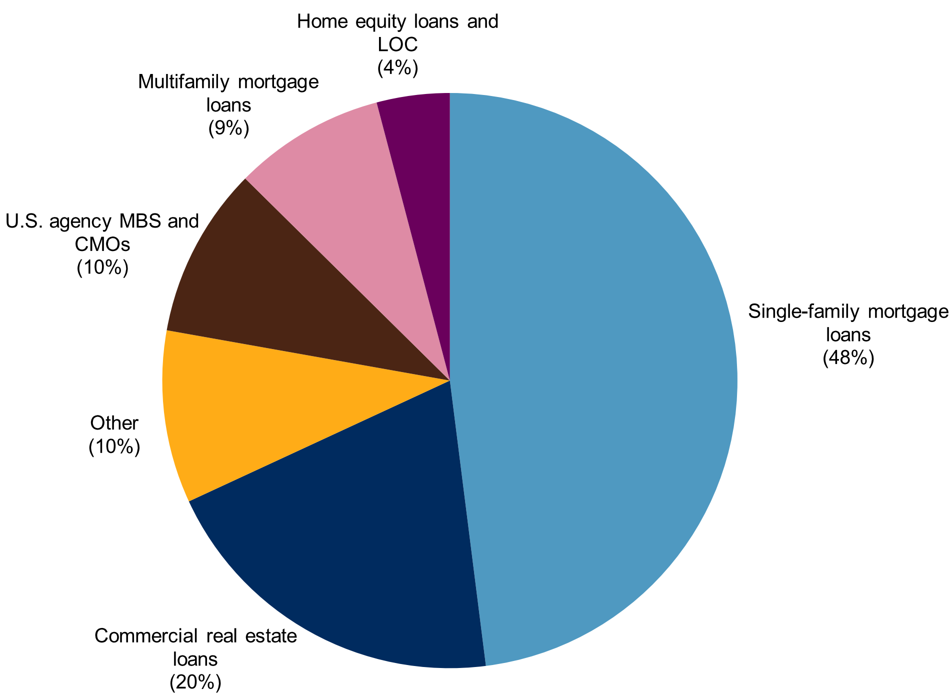
The bulk of the FHLBs' assets are advances to members, which we view as having relatively low risk because all of the exposure is to financial institutions. As a result, we view their capital, on a risk-adjusted basis, as stronger than it might otherwise appear. We expect their S&P Global Ratings risk-adjusted capital ratios to remain above 15% over at least the next two years.

Another factor supporting our ratings is that none of the FHLBs has ever suffered a loss on a collateralized advance to a member (reflecting both the lien priority and substantial collateral held against advances). At each of the 11 regional banks, a large proportion of advances is made to a relatively small number of members.

Still, concentration risk is substantially mitigated because all advances are overcollateralized with high-quality collateral. Although we believe some of the collateral could be under strain because of current economic headwinds, we believe the amount of collateral, at approximately $3.4 trillion as of March 31, 2023--or 2.8x outstanding advances and other credit of $1.2 trillion--offsets the potential for losses.

Chart 1

Federal Home Loan Banks--percentage of collateral securing advances
As of March 31, 2023



MBS--Mortgage-backed securities. CMO--Collateralized mortgage obligation. LOC--Letters of credit.
Source: S&P Global Ratings.

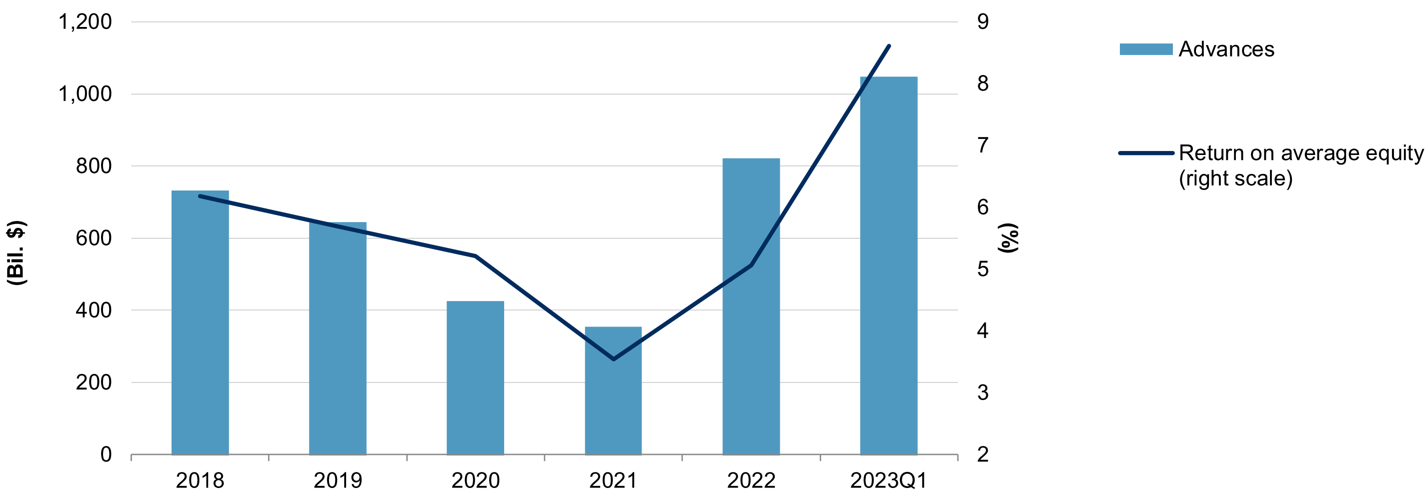
We continue to monitor legislative proposals and judicial decisions that could affect the FHLBs. In May 2022, the U.S. Senate confirmed Sandra Thompson as director of the FHFA. While we don't expect the U.S. government's policy with respect to the FHLBs to fundamentally change, Director Thompson announced 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.

We expect earnings to rise this year as member demand for advances will remain elevated while liquidity in financial markets normalizes and deposit balances decline. As such, we do not anticipate consolidation in the System over the next 12-24 months.

As of March 31, 2023, the System's total principal amount of advances increased to $1.05 trillion versus $827 billion at year-end 2022. The top 10 borrowers (by holding company) accounted for 31% of advances, or $326 billion, and the top member was 5.4%, or $56.7 billion.

Chart 2

Federal Home Loan Banks--advances and profitability
Advances have grown beyond pre-COVID-19 levels



Source: S&P Global Ratings.

GRE Analysis: Critical Public Policy Role And Integral Link To The Government

We view the FHLB System as one of the most important U.S. GREs. In our opinion, promoting homeownership is a central and long-standing U.S. policy, evidenced by the tax deductibility of mortgage interest and the activities of the U.S. Department of Housing and Urban Development.

Such policy has, arguably, contributed to past U.S. housing market excesses. However, we do not expect this essential policy orientation to substantially change, given its widespread political appeal and the importance of consumption to U.S. economic growth (and homeownership to consumption, through wealth effects).

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 dislocation.

We expect net interest income to rise in 2023, driven by increased member demand for advances and positive correlation to higher interest rates. As of March 31, 2023, the total principal advance amount was $1.05 trillion, of which commercial and savings banks made up 76%, versus 51% same time last year. Insurance companies (excluding captive insurance companies) declined to 14% from 34% for the same period.

Although the government does not guarantee the FHLB System's obligations, the System's status as a U.S. GSE provides several advantages:

- FHLB securities are eligible to be used for collateral that the U.S. Federal Reserve banks are required to hold against currency they put into circulation.
- The FHLB System is also exempt from almost all corporate taxation, and the securities it issues are exempt from state and local income tax.
- The U.S. legal framework gives the FHLB System lien priority over other creditors (including depositors) in the event of the failure of an insured depository member with outstanding loans.

Reinforcing these links to the government, the FHFA oversees all strategic decisions the System makes and closely monitors the System's financial condition.

We view the GSE Credit Facility, temporarily established by the U.S. Treasury Department in 2008, as a clear indicator of the government's willingness and ability to provide extraordinary support to the FHLB System in times of stress. Although it was never utitized, the facility proactively offered government loan liquidity to the FHLB System (along with Fannie Mae and Freddie Mac), if needed, asking for just the System's own advances as collateral.

Despite the absence of a government guarantee, a close association between the System and the government is well entrenched in the minds of investors and other financial market participants, in our view. Along with a substantial amount of System securities outstanding (almost $1.5 trillion as of March 31, 2023), this could mean that substantial financial distress for the System could harm the U.S. government's reputation, increasing the government's incentive to support its GSEs.

Supporting this belief, FHLB consolidated obligations continue to price at a narrow spread over U.S. Treasuries. This affords the FHLBs and their member institutions low funding costs despite the substantial volume outstanding.

We differentiate between the aggregate FHLB System and the individual FHLBs. The individual FHLBs' role is very important, and their link to the government is very strong. Because the 11 FHLBs have joint and several liability for the senior unsecured debt obligations that the FHLB's Office of Finance issues, we think weakness in a single FHLB could affect investors' perception of the strength of the FHLB System as a whole. On the other hand, we believe each FHLB is less important, from a policy perspective, than the FHLB System as a whole.

Because profit maximization is not a priority and each district has somewhat unique needs, we do not anticipate consolidation in the System over the next 12-24 months.

Profile And Ownership: A Cooperative Owned By Its Member Institutions

Each FHLB is owned by its member financial institutions. The member institutions are primarily commercial and savings banks (77.6% as of March 31, 2023), though they have expanded to include credit unions (8.5%), insurance companies (13.9%), and community development financial institutions (currently negligible).

A member institution must purchase capital to belong to an FHLB. The member institution's stock requirement is generally based on its use of FHLB products, subject to a minimum requirement. In return, the member institution may borrow on a secured basis at typically attractive rates from its FHLB.

Member institutions may also receive dividends on their shares in the FHLB, which helps lower their total transaction funding costs. Additionally, the System provides support for affordable housing and community investment programs.

FHLBs provide members with a reliable source of funding for housing finance, community lending, and asset-liability management, as well as liquidity for members' short-term needs. This funding is in the form of long-term and short-term secured loans called "advances."

These advances are primarily collateralized by residential mortgage loans and commercial real estate loans, as well as government and agency securities. Community financial institutions may also pledge small-business, small-farm, small-agribusiness, and community development loans as collateral for advances.

In addition to advances, FHLBs extend letters of credit (LOCs) to members--totaling $170 billion as of March 31, 2023. Members typically use LOCs to secure public unit deposits, and the LOCs would be converted to an advance in the rare event of a draw.

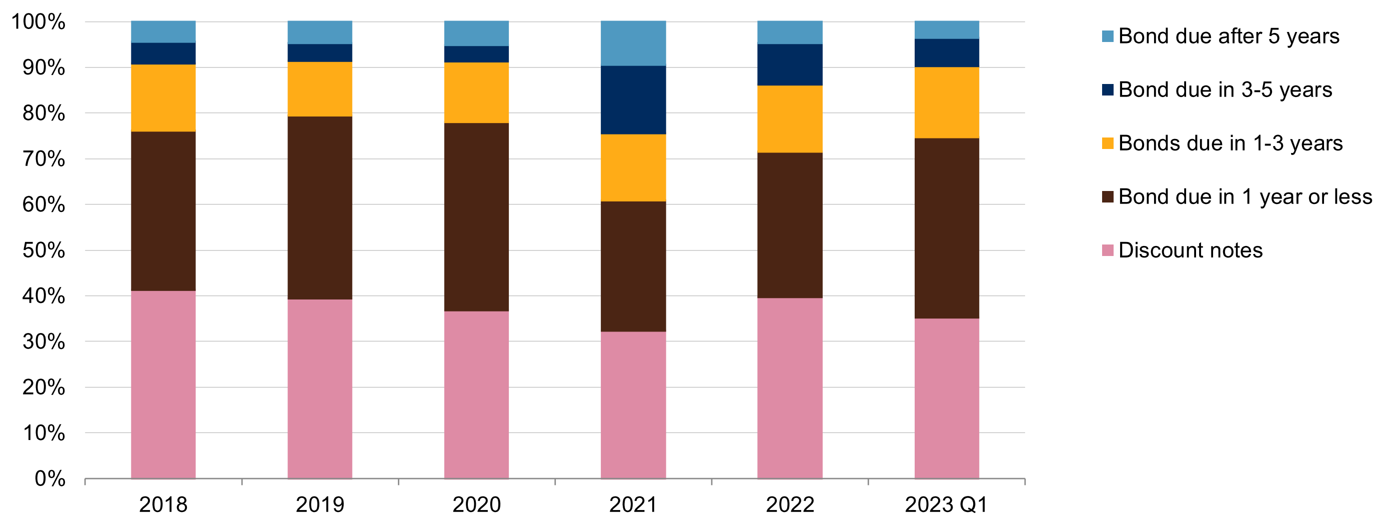
Although privately owned, the System is run as a cooperative for its member-owners. The System places more emphasis on retaining the capacity to quickly increase liquidity provisions, when needed, than on maximizing current profits. We believe the FHFA's close oversight reinforces this strategy.

We believe the System's transition from LIBOR-based funding toward funding based on the secured overnight financing rate (SOFR) has been smoother than for other issuers, given the System's larger percentage of short-term debt.

The FHLBs have been moving toward floating-rate notes to address investor preference amid rising interest rates, with the 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.

Chart 3

Federal Home Loan Banks--consolidated obligations by contractual maturity



Source: S&P Global Ratings.

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
- 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
- Criteria | Financial Institutions | General: Issue Credit Rating Methodology For Nonbank Financial Services Companies, Dec. 9, 2014
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings Detail (As Of July 31, 2023)*	
Federal Home Loan Banks	
Sovereign Rating	
United States	AA+/Stable/A-1+
Related Entities	
Federal Home Loan Bank of Atlanta	
Issuer Credit Rating	AA+/Stable/A-1+

Ratings Detail (As Of July 31, 2023)*(cont.)	
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+
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+
Federal Home Loan Bank of Topeka	
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.