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Federal Home Loan Bank of Topeka

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Federal Home Loan Bank of Topeka

Credit Highlights

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

Key strengths	Key risks
Important to the implementation of U.S. government housing policy	Concentrated 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
Solid loan asset quality, and super-lien position vis-à-vis depository institutions has historically prevented any losses on advances	Earnings dependent on advance volume and interest rates, though profitability is not a priority of the Federal Home Loan Banks (FHLBs)

Our issuer credit rating on the Federal Home Loan Bank of Topeka (FHLB Topeka) is based on 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. It also reflects the bank's regulated status, overseen by the Federal Housing Finance Agency (FHFA).

The rating on FHLB Topeka includes a one-notch uplift from the bank's stand-alone credit profile (SACP) of 'aa', owing to our expectation that there is a very high likelihood of the bank receiving extraordinary government support given the FHLB System's importance to the U.S. housing market and banking system.

Outlook

The stable outlook on FHLB Topeka indicates our expectation that the company will continue to have stable operating performance, provide liquidity and manage funding needs, build retained earnings, and execute on its mission to support the U.S. housing sector over the next 12-24 months. The stable outlook also reflects S&P Global Ratings' stable outlook on the U.S. (AA+/Stable/A-1+).

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 debt and our ratings on FHLB Topeka. Although less likely, we could also lower the rating in the next two years if, in the context of government-sponsored entity (GSE) reform, 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. government.

Anchor: Reflects Bank'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 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: A Unique And Strong Market Position With Long-Standing Members

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

The FHLBs are wholesale lenders that assist the financing of the U.S. housing industry. They provide secured loans, known as advances, to their members, which include commercial banks, savings and loans, credit unions, and insurance companies.

The COVID-19 pandemic illustrated the FHLB system's underlying importance to the U.S. banking sector in times of uncertainty and economic dislocation. At the onset of the pandemic in 2020, FHLBs' advances rose to $806.9 billion, a 25.8% increase from year-end 2019, as member companies shored up liquidity to manage the economic stress. Advances declined in the subsequent quarters because of elevated levels of liquidity in the markets due to Fed policy and the CARES Act, as well as increased deposit balances at member institutions. As of March 31, 2022, advances increased to $377 billion from $349 billion at year-end 2021 but remained lower than pre-COVID-19 levels ($422.6 billion in 2020 and $642 billion in 2019). As liquidity normalizes from historical highs and the Fed continues to tighten monetary policy to address inflation, we expect member demand for advances to increase this year.

As of March 31, 2022, FHLB Topeka's advances increased about 9% from year-end 2021 to $25.5 billion. We view FHLB Topeka, with assets of $50.7 billion, in the midrange asset size relative to other banks in the FHLB System. FHLB Topeka has some diversity across its 673 members (as of Dec. 31, 2021), which consist of 535 banks, 87 credit unions, 26 insurance companies, 21 savings institutions, and four community development institutions in Colorado, Kansas, Nebraska, and Oklahoma.

The member borrowing needs are highly correlated to the housing market. FHLB Topeka's business is exclusively in a limited region of the U.S. and, therefore, local economic conditions play a significant role in the bank's business. The firm's advance volume and revenue are typically countercyclical, since members rely more on FHLB Topeka in times of stress, which mitigates the effect of that concentration.

As of March 31, 2022, FHLB Topeka's top five borrowers held around 61% of total advances, higher than the peer average of 53%. Around 38% of total advances were held by the bank's top borrower--MidFirst Bank--compared to 37% in March 2021. While we consider advance exposures to be significantly concentrated--with potential for asset, earnings, or even capital volatility—-the bank's exposures are in line with peer FHLBs. The fully collateralized nature of the lending business mitigates much of FHLB Topeka's concentration risk, in our view.

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

FHLB Topeka's member-capitalized co-op structure and low-risk collateralized lending business support its capital.

As of March 31, 2022, FHLB Topeka reported a regulatory capital-to-assets ratio of 5.4%, exceeding the FHFA's 4% requirement, and a 7.9% leverage ratio, which exceeded the FHFA's 5% requirement. As of March 31, 2022, FHLB Topeka's risk-adjusted capital (RAC) ratio was 20.3%, which we expect to remain above our 15% threshold. The bank also continues to exceed all regulatory requirements and is expected to generate stable, though modest, earnings. Given that advances make up a significant portion of FHLB Topeka's assets, the bank's capital on a risk-adjusted basis is stronger than the regulatory ratio because advances are assigned a relatively low risk weight in our methodology and all the exposures are to financial institutions.

In first-quarter 2022, FHLB Topeka reported net income of $50 million, versus net income of about $44 million for the same period in the prior year. The increase stemmed from a rise in net interest income of $12 million, partially offset by an increase in net loss from other income of $4 million. In March 31, 2022, FHLB Topeka increased its quarterly cash dividend to a 4.88% annualized rate for a total of $20.5 million, versus $16.3 million (4.15% annualized rate) for the quarter ended March 31, 2021. We expect FHLB Topeka to remain profitable and grow retained earnings this year. As of March 31, 2022, retained earnings rose to $1.17 billion from $1.14 billion at year-end 2021.

Since most profits are returned to members in the form of dividends, and the FHLB prices its advances to be competitive with the relatively low rates banks pay on deposits, the FHLBs have lower profitability than do their banking members. As such, we do not anticipate consolidation in the system over the next 12-24 months. In 2015, FHLB Seattle merged with FHLB Des Moines--the only consolidation of the FHLB System in its 90-plus-year history.

Risk Position: No Losses On Member Advances, Low Interest Rate Risk, And Low Risk From Peripheral Activities

We consider FHLB Topeka's risk position very strong, reflecting that neither the company nor its sister FHLBs has ever suffered a loss on a collateralized advance to a member.

The bank has a relatively homogenous lending portfolio, with all advances made to financial institutions backed by a majority of residential and commercial mortgages. All advances to member institutions are collateralized by loans and securities with an estimated value significantly in excess of loans extended--FHLB Topeka had $25.6 billion of credit outstanding (primarily advances and letters of credit) as of March 31, 2022, that is backed by collateral value greater than its outstanding advances. Although 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 higher losses as a result.

FHLB Topeka monitors the financial condition of its members and manages collateral guidelines, advance rates, and security agreements to further mitigate credit risk. In addition, the FHLB has a super-lien position vis-à-vis depository members. For advances to non-depository members, the FHLBs rely on stricter borrowing limits and collateral guidelines to mitigate their risk, for which it is not guaranteed priority status in liquidation.

As of March 31, 2022, the investment securities portfolio totaled $16.9 billion, about one-third of total assets. Investments included $4 billion of U.S. Treasuries and agency debt and $6.2 billion of agency mortgage-backed securities. FHLB Topeka has no exposure to private-label mortgage-backed securities.

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. As of March 31, 2022, the bank has the highest exposure to these mortgages of its peers--16% of total assets or $8 billion. These mortgages carry very limited credit risk because 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 84% has a loan-to-value ratio greater than 60.

The bank takes little interest rate risk. It issues fixed-rate callable and non-callable bonds but swaps predominantly all 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. Both of these factors support FHLB Topeka's funding and liquidity. Also, we expect that, based on the availability of funding for the system in the 2008 liquidity crisis and COVID-19 pandemic, access to funding is unlikely to be an issue in stress scenarios. In our view, FHLB Topeka met the public policy role of supporting the funding and liquidity needs of its members during the pandemic by issuing discount notes to provide advances. Positively, the bank was also able to scale back quickly once the spike in demand for funds subsided.

We believe the 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 this larger percentage of short-term debt. The FHLBs have recently been moving toward floating-rate notes to address investor preferences amid a rising interest rate, with a majority of issuance linked to SOFR since 2020. All floating-rate bonds issued during 2021 and the first quarter of 2022 were indexed to SOFR. The bank continues to transition away from LIBOR and maintain its allocation of floating rate bonds funding short-term advances and short-term investments. As Of March 31, 2022, FHLB Topeka had $2 billion of SOFR-indexed advances outstanding.

We consider FHLB Topeka's liquidity as adequate relative to its potential cash flow requirements over the next 12-24 months. The FHFA requires 10-30 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. As of March 31, 2022, FHLB Topeka had $29 million of cash on balance sheet.

Support: Critical To U.S. Housing Policy

The 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 includes a one-notch uplift from our SACP.

Our opinion is based on our assessment of FHLB Topeka's:

- Very important role 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
- Very strong link with the U.S. government, because a financially distressed or defaulted FHLB could significantly affect 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, such as their inclusion in a U.S. Treasury GSE credit facility created in September 2008.

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

In May 2022, the U.S. Senate confirmed Sandra Thompson as director of the FHFA. We continue to monitor the outcome of Federal Home Loan Banks' Mission Implementation Act bill that was put forward by Senator Catherine Cortez Masto (D-Nev.) in May 2021. The proposed bill includes an increase in the annual percentage set aside for Affordable Housing Program obligations to 30% of net income, from 10% currently. As part of the subsequent Congressional budget reconciliation process, a legislative proposal is under consideration for the FHLBs to set aside 15% of net income for their affordable housing program. If passed, this could weigh on the FHLBs' earnings because of the associated increase in expenses.

On March 21, 2022, the SEC issued a proposed rule on climate-related disclosures that would require registrants, including the FHLBs, to expand the breadth, specificity, and rigor of climate-related disclosures in their periodic reports. Compliance would be phased in, with the FHLBs becoming subject to certain disclosure requirements in their annual reports for fiscal year 2024 and additional disclosures in 2025. If finalized as proposed, we expect the proposal will lead to increased operational costs.

We expect earnings to rise this year as member demand for advances increases while liquidity in the financial markets normalizes and deposit balances decline.

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 on FHLB Topeka. As a GSE with a mandate to support housing and community development, FHLB Topeka's public policy role and regulated status are supportive of its credit quality.

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

Ratings Score Snapshot

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

SACP: 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: Average and Adequate (0)

Support: +1

- 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

Related Research

- Federal Home Loan Banks, Aug. 1, 2022

Ratings Detail (As Of August 1, 2022)*	
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+
Federal Home Loan Bank of Indianapolis	
Issuer Credit Rating	AA+/Stable/A-1+

Ratings Detail (As Of August 1, 2022)*(cont.)	
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 Banks	
Senior Unsecured	AA+
Senior Unsecured	AA+/A-1+
Senior Unsecured	AA+/Stable
Short-Term Debt	A-1+
Short-Term Debt	AA+/Stable

*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.