

Credit Opinion: Federal Home Loan Bank of Des Moines

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Des Moines, Iowa, United States

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits	Aaa/P-1
Parent: Federal Home Loan Banks	
Outlook	Stable
Senior Unsecured	Aaa
Other Short Term	P-1

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Key Indicators

Federal Home Loan Bank of Des Moines

	[1]2009	2008	2007	2006	2005	2004
ROAA (%)	-0.03	0.18	0.21	0.20	0.48	0.21
ROAE (%)	-0.84	3.88	4.25	3.91	9.57	4.30
Net Interest Margin (%)	0.06	0.35	0.36	0.35	0.63	1.04
Advances (\$bil)	37.78	40.02	40.41	21.86	22.28	27.18
Investments (\$bil)	16.50	11.94	7.33	6.28	6.24	5.37
Assets	75.93	68.13	60.77	42.04	45.72	49.05
Equity (\$bil)	3.16	3.02	3.05	2.25	2.26	2.40
Liquid Assets/ST Debt (%)	34	65	24	21	29	10

[1] For the quarter ended March 31, 2009

Opinion

SUMMARY RATING RATIONALE

Federal Home Loan Bank of Des Moines' (FHLBank) Aaa/Prime-1 long- and short-term deposit ratings reflect the combination of the following factors: 1) a stand-alone Baseline Credit Assessment (BCA) of 5 (on a scale of 1 to 21, where 1 represents the lowest credit risk), 2) very high cooperative support from the FHLBank System, 3) very high support from the U.S. government (Aaa debt rating).

The FHLBank of Des Moines' BCA of 5, which is an A1 equivalent on Moody's long-term debt rating scale, reflects Moody's opinion about the FHLBank's intrinsic or stand-alone financial strength and exclude extraordinary support, either from the FHLBank System or the U.S. Government. The rating incorporates the FHLBank's modest risk-adjusted profitability, sound liquidity and excellent asset quality. The FHLBank of Des Moines' risk-adjusted profitability (ROAA as a percentage of the standard deviation of ROAA) is in the lower end relative to other FHLBanks. The FHLBank's exposure to private-label residential mortgage back securities is not sizable. Moody's believes the expected loss on the FHLBank's \$38.5 million private-label mortgage back securities is low.

The FHLBank of Des Moines' BCA of 5 does not benefit from support from the FHLBank System given the

FHLBank System's BCA of a 5 (A1 equivalent). On the other hand, Moody's very high U.S. government support assumption lifts the FHLBank of Des Moines' deposit ratings to Aaa.

Credit Strengths

Joint and several liability reduces default risk of Systemwide liabilities

Central role as liquidity provider for banks and other financial institutions

Excellent asset quality reflects conservative underwriting standards and quality-monitoring policies

Credit Challenges

Narrow charter and bank consolidation constrain growth and profitability

Substantial borrower concentration

Rating Outlook

Moody's stable outlook for the FHLBank of Des Moines' rating reflects the FHLBank's consistent returns and its low exposure to private-label MBS. Moody's expects the FHLBank of Des Moines to conservatively manage its business in achieving a modest but stable risk adjusted return.

In addition, Moody's expectation that the FHLBank System will continue to receive strong bipartisan political support, that there will be minimal changes, if any, to its government sponsored enterprise (GSE) status over the long - term.

What Could Change the Rating - Up

Factors that would lead to an upgrade of the FHLBank of Des Moines' baseline credit assessment include capital levels well in excess of regulatory requirements (e.g., capital-to-assets ratio consistently 50 bps above the regulatory requirement - currently 4.0%), consistent risk-adjusted returns while maintaining strong asset quality.

What Could Change the Rating - Down

Factors that could lead to a downgrade of the Aaa/Prime-1 long- and short-term deposit ratings and baseline credit assessment include a material decline in profitability (quarterly net losses over four quarters), significant asset-liability mismatches, or material changes in asset quality.

In addition, any regulatory or statutory changes to the System's mission or GSE status that alters the FHLBank's risk profile could also impact the ratings. However, Moody's views these potential events as highly unlikely to occur.

DETAILED RATING CONSIDERATIONS

The FHLBank of Des Moines lends to member institutions in the form of advances, which are generally short-term and over-collateralized, minimizing the credit risk on these loans. Moody's baseline credit assessment represents our opinion of the likelihood that the institution will require extraordinary support from an external party. The high BCA of 5 reflects FHLBank of Des Moines' strong credit culture, stable, though moderate, profitability, and the benefits associated with the joint and several liability of the FHLBank System. Below are the detailed rating factors that influence the FHLBank's ratings and outlook.

Baseline Credit Assessment

Profitability

FHLBank of Des Moines' modest but consistent profitability (as measured by ROAA) reflects primarily low risk profile of its asset base. ROAA was -0.03% for the three months ended March 31, 2009, compared to 0.18% and 0.24% for years end 2008 and 2007, respectively. At March 31, 2009, the five-year standard deviation of ROAA was 0.18%, which was well below the 0.40% standard deviation for banks rated Aa and higher. The net loss reported during the first quarter 2009 was impacted by lower net interest income (NIM declined to 6 bps from 43 bps), as well as increased call activity from early debt extinguishments.

Similar to many other FHLBanks, the FHLBank of Des Moines has significant borrower concentration: its top five advance borrowers represented 39.9% of advances outstanding as of March 31, 2009. Within the top five advance borrowers, the top one accounts for 14.8% of the FHLBank's the total advance at March 31, 2009. Also, bank

consolidation reducing demand for advances will further constrain the FHLBank of Des Moines' profitability.

Capital Adequacy

FHLBank of Des Moines is required by legislation to maintain minimum regulatory capital level of 4% of its total assets. At March 31, 2009, the capital ratio of the Des Moines Bank was 4.28%, down from 4.66% at year end 2008 and 5.14% at year end 2007. In Moody's view, capital levels reflect the low risk profile of the FHLBank's asset base which is largely comprised of advances to member banks (50% of total assets as of March 31, 2009).

Interest Rate Risk Management

The FHLBank of Des Moines conservatively manages its interest rate risk exposures through the use of debt with similar characteristics to the FHLBank's assets, as well as derivatives. The FHLBank's primary asset is advances (50% of total assets), which come in a variety of types, including fixed rate, variable rate, callable by the FHLBank as well as puttable advances. With a puttable advance, the FHLBank purchases a put option from the member that allows the FHLBank to terminate the fixed rate advance on specified dates and offer, subject to certain conditions, replacement funding at prevailing market rates. Prepayment fees, which mitigate interest rate risk, are also a common feature of advances.

A large component of the FHLBank's investment portfolio is short-term securities (41% of the investment portfolio of \$27.2 billion is fed funds, reversed repos, and interest bearing deposits), which reduces the FHLBank's risk exposure.

The FHLBank of Des Moines' policy limits, effective May 1, 2008, the market value of capital stock (MVCS) to 5% and 10% declines from the base case in an up and down 100 basis point and 200 basis point interest rate shift, respectively. During the first quarter of 2009 and a majority of 2008, the Bank's projected MVCS in the down 200 basis point rate shift scenario fell below the 10 percent policy threshold loss. However, The FHLBank's Board of Directors waived the 200 basis point down policy limit due to the low interest rate environment.

At March 31, 2009 and December 31, 2008, the Bank's projected MVCS in the down 100 basis point rate shift scenario were -22.3% and -29.7%, respectively which were below the 5 percent threshold loss. The in compliance was due to a lower level of interest rates combined with a lack of interest rate derivative hedging protection due to its high cost. The funding mismatch utilized to enhance the Bank's liquidity position also contributed to increased exposure to lower interest rates.

Asset Quality and Credit Risk Management

Moody's believes that the asset quality of the FHLBank of Des Moines is exceptional. Advances represent 50% of total assets as of March 31, 2009, while the FHLBank's investment portfolio represents 21%. Advances are over-collateralized and the FHLBank has never incurred a loss on an advance in its 76 year history. The FHLBank of Des Moines has member concentration, similar to other FHLBanks. The FHLBank's single highest member concentration is Transamerica Life Insurance Company, which represented 14.8% of advances as of March 31, 2009. The top five advance borrowers represented 39.9% of advances outstanding as of March 31, 2009 compared to 29.4% at year end 2006. The increase in single borrower concentration increases the FHLBank's counterparty risk.

The FHLBank participates in the MPF, which represents 13.9% of its total assets. The credit quality of MPF loans has been exceptional. The FHLBank of Des Moines charged off only \$9 thousand in mortgage loans during the first three months of 2009.

The FHLBank's \$27.2 billion in investments consists primarily of fed funds sold (\$9.2 billion) and agency MBS (\$9.3 billion). At March 31, 2009, the FHLBank held only \$38.5 million in private-label MBS securities.

Liquidity and Funding

U.S. Treasury securities. More recently, investor concerns regarding the U.S. housing and mortgage markets have affected the FHLBanks' debt pricing and funding. In addition, U.S. government actions in support of banks by guaranteeing their debt issuance has negatively impacted the FHLBanks' debt spreads. During 2008, demand for term agency debt weakened considerably. The decline in demand for debt issuances with maturities between one-year and 30-years resulted in a dramatic widening of the spread between the FHLBanks' debt and U.S. Treasury debt. Moreover, increased demand for short-term agency debt (i.e., debt with maturities of less than one year) resulted in lower yields on the FHLBanks' discount notes. As a result, the FHLBanks' funding needs were being met primarily through the issuance of discount notes, floating-rate notes, short-term callable bonds and short-term bullet bonds during the third quarter of 2008.

In September 2008, the FHLBanks entered into a lending agreement with the U.S. Treasury, which established the Government Sponsored Enterprise Credit Facility (GSECF), a secured lending facility, to serve as a liquidity backstop. The GSECF expires on December 31, 2009, but will remain in effect as to any loans outstanding on that date. Any funding to FHLBanks under the GSECF will be provided by the U.S. Treasury in exchange for eligible

collateral consisting of advances issued by FHLBanks and MBS issued by Fannie Mae and Freddie Mac. Collateral haircuts will be determined by the U.S. Treasury. Loans under the GSECF are intended to be for short durations of between one week and one month. Interest on borrowings will be set by the U.S. Secretary of the Treasury.

In November 2008, the Federal Reserve announced a plan to purchase up to \$400 billion of direct debt obligations of Freddie Mac, Fannie Mae and the FHLBanks, as well as \$1.25 trillion of MBS guaranteed by Freddie Mac, Fannie Mae and Ginnie Mae. The Federal Reserve announced this action in order to reduce the cost and increase the availability of residential mortgage credit. Moody's believes these actions reduce the FHLBank's funding risk. The FHLBank's access to the term debt markets improved during 2009.

The FHLBanks' internal sources of liquidity are modest. The FHLBanks are mandated by regulation to maintain a minimum of five days of liquidity without access to the capital markets (a tiny amount), though individual FHLBanks have the discretion to maintain longer periods of liquidity without access to the capital markets and generally do so. Internal sources include the FHLBank's short-term investments, as well as the FHLBank's investment portfolio.

As of March 31, 2009, the FHLBank of Des Moines had approximately \$47.5 billion in short-term consolidated obligations, which includes discount notes and bonds maturing within a one year period. In total, short-term debt comprised about 67% of total debt - a very high figure, compared to 57% at year end 2008. This amount has grown over the past year due to the limitations with long-term funding in the agency market. Liquid assets include cash, cash equivalents, interest-bearing deposits, reversed repos, federal funds as well as portfolios of trading and available-for-sale investment securities. These assets are of high quality, with the investment securities portfolio comprised of U.S. Treasury and agency securities, state and local housing agency obligations and MBS. Liquid assets were approximately 43% of short-term debt as of March 31, 2009.

Other

A significant underpinning of the Baseline Credit Assessments is the joint and several nature of the consolidated obligations. The financial strength of individual FHLBanks is very sound, and the joint and several liability contributes to the overall strength of the FHLBank System by narrowing any ratings differences among the individual Banks that could exist were ratings to exclude the joint and several feature. As a result, the ratings of the weakest FHLBanks are increased, and the ratings of the strongest are lowered.

Support and Dependence

The FHLBank's high dependence and support levels are based on the importance of the System to its member institutions, and their ability to support housing finance and community development.

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