



Moody's Investors Service

Global Credit Research

Credit Opinion

5 FEB 2009

Credit Opinion: Federal Home Loan Banks

Federal Home Loan Banks

Reston, Virginia, United States

Ratings

Category	Moody's Rating
Outlook	Stable
Senior Unsecured	Aaa
Other Short Term	P-1
Federal Home Loan Bank of Chicago	
Outlook	Stable(m)
Bank Deposits	Aaa/P-1
Subordinate	*Aa2

* Placed under review for possible downgrade on February 2, 2009

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Key Indicators

Federal Home Loan Banks

	[1]2008	2007	2006	2005	2004
ROAA (%)	0.19	0.25	0.26	0.26	0.23
ROAE (%)	4.58	6.01	5.80	5.84	4.93
Net Interest Margin (%)	0.40	0.42	0.43	0.45	0.48
Advances (\$bil)	1,012.7	875.1	640.7	619.9	581.2
Investments (\$bil)	316.0	298.7	270.7	266.5	224.9
Assets	1,428.7	1,274.5	1,016.5	997.4	924.8
Equity (\$bil)	57.1	53.6	45.0	44.5	41.9
Liquid Assets/ST Debt (%)	18.3	22.1	32.0	32.4	27.8

[1] For the 9 months ended September 30, 2008

Opinion

SUMMARY RATING RATIONALE

The Aaa rating of the Federal Home Loan Bank System (FHLBanks or System) reflects its consistent risk-adjusted earnings, superior asset quality, unique position as a key funding source to its member institutions, as well as the substantial support of the U.S. Government. The ratings of the FHLBanks reflect the combination of the following elements: 1) a baseline credit assessment (BCA) of 2 (on a scale of 1 to 21, where 1 represents lowest credit risk), 2) Aaa local currency deposit ceiling of the U.S. Government, 3) high dependence between the FHLBanks and the

U.S. Government, and 4) high support between the two.

The FHLBank System's baseline credit assessment reflects its excellent asset quality, consistent risk-adjusted profitability, as well as the benefits associated with the joint and several liability for the FHLBanks' debt. Asset quality remains a core strength of the FHLBank System, having never incurred a loss on an advance, which represents over 70.8% of total assets at September 30, 2008. The FHLBank System's profitability reflects the lower risk profile of the System. The System's ROAA has been very stable - standard deviation of 8.4% from YE04 through 9 months ended September 2008, a very low amount. The FHLBanks' standard deviation of ROAA compares with an 88% standard deviation of ROAA for all Aa-rated banks. Though, the FHLBank System's ROAA of .28% for the same period is much lower than the 1.22% ROAA of Aa-rated banks.

The FHLBanks maintain a combined \$75.7 billion private-label RMBS portfolio. Moody's believes the expected loss on this portfolio is low, approximately \$1.0 billion, and manageable when compared with its \$57.1 billion capital base. However, the FHLBanks are exposed to other-than-temporary impairments (OTTI). Substantial OTTI could reduce capital levels below regulatory requirements. Although Moody's considers the likely ultimate loss on this portfolio to be lower than that signified by its current market value, even small credit losses could result in significant accounting impairment. Declines in capital as a result of OTTI may put negative pressure on the FHLBanks' Baseline Credit Assessment (BCA).

All FHLBanks, as well as the FHLBank System have a BCA of 2 (on a scale of 1 to 21, where 1 represents lowest credit risk). A BCA of 2 is the equivalent default risk probability of a Aa1. The FHLBanks' BCA incorporates the joint and several liability of all FHLBank consolidated obligations. BCAs are intended to express an opinion about the institutions intrinsic or stand-alone financial strength and specifically exclude an assessment of the probability of extraordinary support.

In relation to the FHLBanks' BCA, Moody's will assess: (1) the magnitude of potential OTTI charges and their effect on regulatory capital, (2) the likely regulatory response to OTTI charges, which reduce capital below regulatory minimums, (3) the effects on the FHLBanks' franchise and business position, including their ability to continue to obtain stable, cost-effective funding, and (4) the effect of Moody's recently increased projected cumulative losses on Alt-A residential mortgage backed securities issued in 2006 and 2007. This will increase Moody's expected economic losses on the FHLBanks' Alt-A portfolios, which, in turn, will affect Moody's views on the potential for significant OTTI charges.

Moody's does not expect the Aaa and Prime-1 debt and deposit ratings to be affected even if its assessment of the FHLBanks' BCA falls.

Credit Strengths

Credit strengths include:

Joint and several liability reduces default risk of Systemwide liabilities

Central housing funding role for banks and other financial institutions, GSE status

Asset quality of advance and mortgage products remains excellent

Credit Challenges

Credit challenges include:

Narrow charter and bank consolidation constrain growth and profitability

Substantial borrower concentrations

Material private-label securities portfolio

Rating Outlook

The stable outlook for the FHLBanks' ratings reflects Moody's expectation that the System will continue to receive strong bipartisan political support, that there will be minimal changes, if any, to its GSE status over the long term,

and that the FHLBanks will retain their conservative risk temperament.

What Could Change the Rating - Up

An upgrade of the FHLBanks' BCA is unlikely. However, strong profitability reflected by a ROAA consistently in excess of 0.5%, as well as a stable member profile and continued strong asset quality would result in positive rating pressure.

What Could Change the Rating - Down

Factors that could lead to a downgrade of the System's baseline credit assessment (BCA) include material declines in capital, likely caused by other-than-temporary impairments. In evaluating the FHLBanks' BCA, Moody's will assess: (1) the magnitude of potential OTTI charges and their effect on regulatory capital, (2) the likely regulatory response to OTTI charges, which reduce capital below regulatory minimums, (3) the effects on the FHLBanks' franchise and business position, including their ability to continue to obtain stable, cost-effective funding, and (4) the effect of Moody's recently increased projected cumulative losses on Alt-A residential mortgage backed securities issued in 2006 and 2007. This will increase Moody's expected economic losses on the FHLBanks' Alt-A portfolios, which, in turn, will affect Moody's views on the potential for significant OTTI charges.

Moody's does not expect the Aaa and Prime-1 debt and deposit ratings to be affected even if its assessment of the FHLBanks' BCA falls.

DETAILED RATING CONSIDERATIONS

The FHLBanks' primary business is lending to member institutions in the form of advances, which are generally short-term and over-collateralized, minimizing the credit risk on these loans. The FHLBanks also purchase mortgage loans through either the Mortgage Partnership Finance® (MPF®) Program or the Mortgage Purchase Program (MPP). The Banks also invest in securities, principally MBS, subject to an investment limit of three times capital. Below are the detailed rating factors that influence the System's ratings and outlook.

Baseline Credit Assessment

Profitability

Profitability of the Federal Home Loan Bank System is modest but adequate on a risk-adjusted basis. The System's five-year average ROAA as of September 30, 2008 was 0.28% compared to 1.22% for Aaa- and Aa-rated U.S. domiciled banks. Over the same period, however, the System's 8.4% standard deviation of ROAA was much lower than the 88.0% standard deviation for Aaa- and Aa-rated U.S. banks. The lower volatility of the System's earnings is likely due to the superior credit quality of the FHLBanks' assets, particularly advances and the lower cost structure of the FHLBank System.

Interest Rate Risk Management

The FHLBanks conservatively manage their interest rate risk exposures through the use of debt with similar characteristics as the FHLBanks' assets, as well as derivative contracts. One of the measures the FHLBanks use to gauge their interest rate risk is the change in the duration gap between durations of assets and liabilities. The FHLBanks' interest-rate risk exposures are moderate and are not uniform, reflecting different exposure, risk management strategies and asset mix. At September 30, 2008, the FHLBanks' duration gap has ranged from a low of -0.8 months (FHLBank of Indianapolis) to a high of 2.3 months (FHLBank of San Francisco). In addition to duration measures, FHLBanks utilize value-at-risk measurements as part of their interest rate and market risk management. Growth in MPP and MPF® conforming mortgage programs in the first half of this decade elevated interest rate risks to those FHLBanks particularly active in this line of business. However, as FHLBanks decrease their MPP and MPF® activities, associated incremental interest rate risk should decline.

Asset Quality and Credit Risk Management

The FHLBanks' asset quality of advances has been consistently outstanding, and we expect this to continue. To date, no credit loss has ever been incurred on advances. The FHLBanks' assets consist primarily of advances, investments and mortgage loans purchased from members. Advances represented 70.8% of assets at September 30, 2008, compared to 68.8% at December 31, 2007. The FHLBanks' collateral requirements on advances, and their preferred creditor status, support credit quality in the event a member defaults on its advances. Each FHLBank has sole credit approval power and establishes its own underwriting standards and eligible collateral

within Federal Housing Finance Agency guidelines. Eligible collateral includes current first-lien residential mortgages (overwhelmingly single-family) or securities backed by such mortgages, Federal Agency securities, FHLBank deposits and other real estate-related assets approved by the relevant FHLBank's board of directors. Moody's expects FHLBanks' advance lending activities to increase as many Banks are renewing their focus on this core business line while continuing to shift away from growth strategies that centered on their mortgage purchase programs.

FHLBanks' investment portfolios consist primarily of MBS securities, chiefly Agency MBS or highly rated private label securities, so the loss likelihood is low, despite losses experienced by the FHLBank of New York in 2003. The FHLBanks' exposure to subprime is principally concentrated at two Banks, New York and Chicago that have some exposure to Aaa rated subprime mortgage securities. Holdings of non-MBS instruments consist of high quality liquid investments such as commercial paper, federal funds, resale agreements and U.S. Treasury securities. Agency and government debt purchased in the investment portfolios of all the of FHLBanks require the highest rating, Aaa, reflecting the System's conservative credit standards. Potential material OTTI charges represent the most significant credit risk to the FHLBanks, in Moody's view (see Summary Rating Rationale).

FHLBanks' conforming mortgage loan programs, MPF and MPP provide members with an alternative to Fannie Mae and Freddie Mac execution. MPF and MPP programs grew rapidly since their inception in 1999 through 2004. At September 30, 2008, mortgage assets comprised 6.2% of System assets, versus 12.3% as of year end 2004. Moody's expects MPF and MPP assets to continue to decline largely due to renewed focus on advance business and as FHLBank member mortgage origination activities fall in concert with the weak single-family market. FHLBanks mortgage assets are more susceptible to credit loss and in particular, carry heightened operational complexity relative to the FHLBanks' core lending business. Credit risks are being managed well however. Credit risk performance of MPF and MPP programs has been very good to date exceeding that of similar programs of Fannie Mae and Freddie Mac. This excellent track record reflects the high quality of mortgage assets purchased into the FHLBanks' MPF and MPP programs.

Liquidity and Funding

Historically, the FHLBanks' GSE status enabled it to fund its obligations at very tight margins to 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 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 \$100 billion of direct debt obligations of Freddie Mac, Fannie Mae and the FHLBanks, as well as \$500 billion 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 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. For example, several FHLBanks, such as Boston, San Francisco, Atlanta and Des Moines maintain policies to voluntarily maintain liquidity in excess of 90 days. Moody's believes FHLBanks are maintaining additional liquidity due to the disruptions in the credit markets. FHLBanks generally maintain levels of liquidity (as measured by the percentage of liquid assets to short-term debt) at or above the median level for Aaa/Aa rated banks, which is at 23.4%.

As of September 30, 2008, the FHLBanks had approximately \$876.6 billion in short-term debt, which includes deposits, repurchase liabilities, discount notes and bonds maturing within a one year period. In total, short-term

debt comprised about 65% of total debt - a very high figure. This amount increased 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, federal funds, repurchase agreements, as well as a portfolio 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 14.0% of short-term debt as of September 30, 2008. In addition, the FHLBanks \$4 billion line of credit with the U.S. Treasury provides modest liquidity support and is indicative of symbolic support from the U.S. Government.

Other

A significant underpinning of the Baseline Credit Assessment 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 the 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

High dependence and support levels for the FHLBank System reflect the importance of the System to its member institutions and their ability to support housing finance and community development.

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