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Federal Home Loan Banks

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Federal Home Loan Banks

Credit Highlights

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.	Some uncertainty regarding potential regulatory and legislative changes, although we expect the FHLB System to retain its importance.
Important funding source for the U.S. banking system.	Profitability can fluctuate, as a function of the cooperative structure.
Very strong asset quality and overcollateralized lending portfolio.	

We view the Federal Home Loan Bank (FHLB) System as one of the most important U.S. GREs. In our opinion, the FHLB System's exceptionally favorable funding advantages are likely to continue as long as its policy role and link remain critical and integral to the U.S. government. We think its ample access to funding amid market volatility in 2023, 2020, and 2008 demonstrated that it is unlikely to have any curtailment in its access to capital markets, even during stress periods.

In our view, the eleven FHLBs that make up FHLB System enjoy key advantages from their legal framework and regulation. We also think 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 have.

The system issues advances in response to member demands. As a result, total outstanding advance balances can fluctuate in line with market shifts. FHLB advances peaked in March 2023, as banks demanded more liquidity due to deposit outflows, then subsequently declined as banking sector volatility lessened. Similarly, advances grew rapidly during the global financial crisis of 2007-2009. Advance balances are funded through debt issued by the FHLB Office of Finance on behalf of the eleven FHLBs. In our view, the FHLB System's ability to provide liquidity to its members in times of industry shifts underscore its importance to the U.S. banking sector.

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, indicating that we do not expect to change the ratings in roughly the next two years.

We could lower or raise our ratings on the FHLB System if our sovereign rating on the U.S. was downgraded or upgraded.

We could also lower our ratings on the FHLB System if its policy role as a liquidity provider and supporter of the housing market were unexpectedly diminished, weakening its almost certain probability of receiving government support.

The FHLB System faces some uncertainty related to potential legislative and regulatory changes associated with reform that would update the System's mission to ensure it provides stable and reliable liquidity to its members as well as support housing and community development. Still, in our view these potential initiatives, which we do not see as imminent, are unlikely to meaningfully change the role of the FHLB System in housing finance and as a liquidity provider for the U.S. banking system. We will continue to monitor any proposed changes to the system and the possible effect they would have on our view of the likelihood of it receiving extraordinary government support if needed.

Rationale

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

We rate the System's debt in line with the government's rating based on our view that it almost certainly would receive extraordinary support from the government if needed.

In addition, we look favorably on the joint and several liability that the individual FHLBs have on the system's consolidated debt--which is used to provide funding to the FHLBs--as well as the strength of the business positions, capital, risk positions, and funding of the FHLBs.

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 considering 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 (though slightly less than the likelihood that the System as a whole would receive support).

We view the FHLBs' business positions as strong, reflecting their established market positions in their defined districts, recurring business volumes, and public policy role, which we think offsets 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, along with managing 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 June 30, 2024, the regulatory capital-to-assets ratio at each of the banks exceeded the FHFA's 4.0% minimum requirement.

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

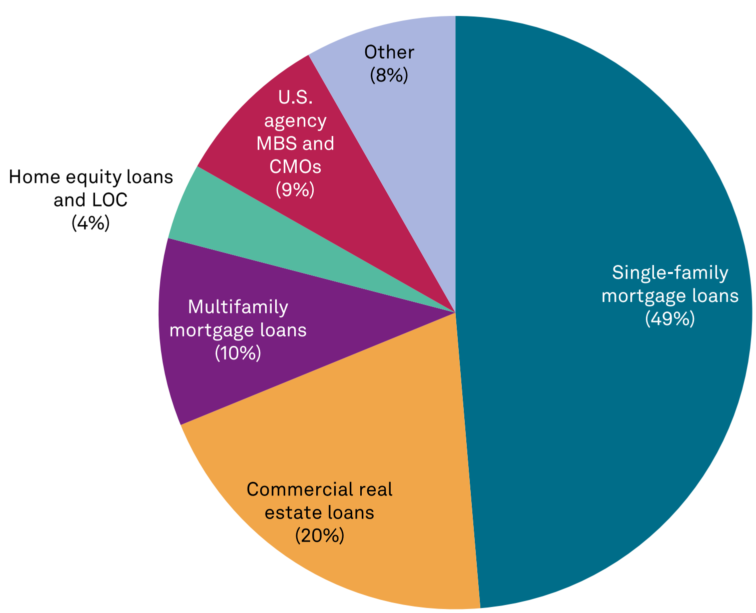
Another factor supporting our ratings is that none of the FHLBs has suffered a loss on a collateralized advance to a member (reflecting the substantial collateral held against advances). At each of the 11 regional banks, a large proportion of advances is made to a relatively small number of members.

Still, concentration risk is substantially mitigated because all advances are overcollateralized with high-quality collateral. Although we think some of the collateral could be strained because of current economic headwinds, we believe the amount of collateral, at approximately $3.7 trillion as of June 30, 2024--or 3.7x outstanding advances and other credit of $988 billion--offsets the potential for losses. Collateral can be in the form of blanket liens, listings, or delivery into the custody of the FHLB.

Chart 1

Federal Home Loan Banks--Percentage of collateral securing advances

As of June 30, 2024



Source: S&P Global Ratings.

We continue to monitor legislative proposals that could affect the FHLBs. In November 2023, the FHFA released its report (FHLBank System at 100: Focusing on the Future) containing the results of its year-long comprehensive review of the FHLB system, along with a series of proposed regulatory reforms. The FHFA proposed four categories of reform related to the FHLB Systems' mission of providing liquidity to members while supporting housing and community development, including:

- Updating and clarifying the mission of the FHLB System,
- The System's role in providing liquidity to its members relative to the Federal Reserve discount window in times of stress,
- Its role as a facilitator of affordable housing and community development,
- and the System's operational efficiency, structure, and governance.

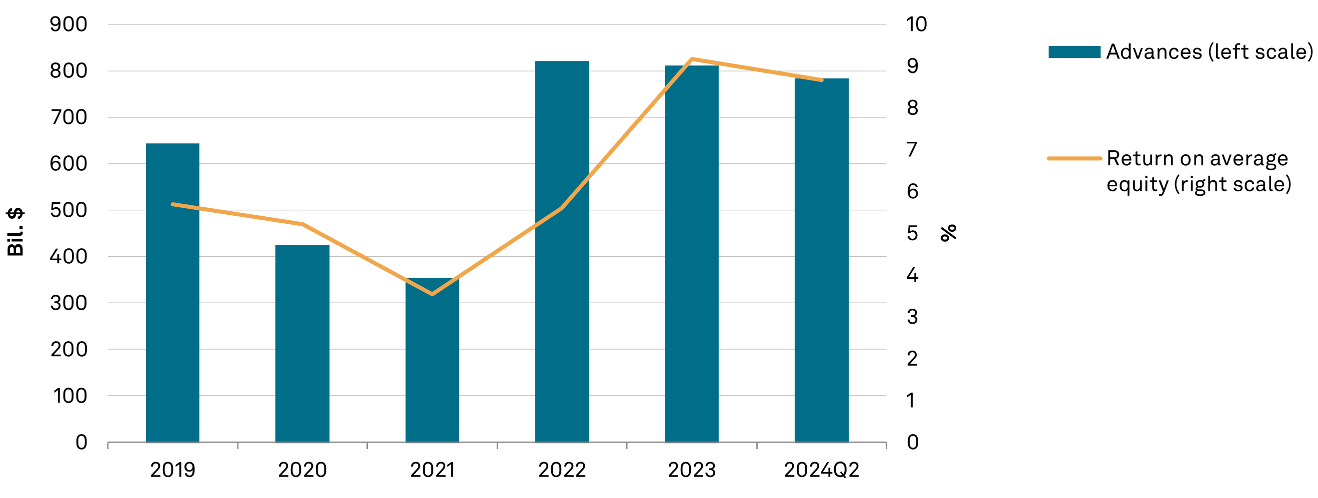
In our view, it remains unlikely that the proposed changes, some of which would likely require Congressional action, would meaningfully diminish the FHLBs' role in the U.S. housing market or as a liquidity provider to its member institutions. However, we will continue to evaluate details of any potential changes as they emerge.

As of June 30, 2024, the System's total principal amount of advances decreased to $780.8 billion from $809.6 billion at year-end 2023. Advances fluctuate in response to member demand. FHLB advances grew rapidly during the global financial crisis of 2007-2009, and peaked in March 2023 as banks demanded more liquidity due to deposit outflows. Advance balances subsequently declined as banking sector volatility lessened. As of June 30, 2024, the top 10 borrowers (by holding company) accounted for 26.8% of advances, or $212 billion, and the top member accounted for 4.5%, or $36 billion.

Chart 2

Federal Home Loan Banks--Advances and profitability

Advances have declined



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 banking turmoil in 2023 highlighted how important the FHLB System was to the U.S. banking sector. When many member banks had significant deposit outflows, the FHLBs provided liquidity by extending advances to members, with outstanding advances increasing to more than $1 trillion in first quarter 2023. The FHLB System's role in providing liquidity to its members 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 during uncertain times and economic dislocation.

Although the government does not guarantee the FHLB System's obligations, the system's status as a U.S. government-sponsored entity provides certain 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. In addition, the FHLB System is exempt from almost all corporate taxation, and the securities it issues are exempt from state and local income tax.

Reinforcing these links to the government, the FHFA oversees and closely monitors the System.

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 utilized, 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 $1.2 trillion as of June 30, 2024), 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 the FHLB's Office of Finance issues, we think weakness in a single FHLB could affect investors' perception of the strength of the System as a whole. Conversely, we think each FHLB is less important, from a policy perspective, than the FHLB System as a whole.

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 (73% of members as of June 30, 2024), though they have expanded to include credit unions (19.9%), insurance companies (6.3%), and community development financial institutions (0.8%).

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.

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."

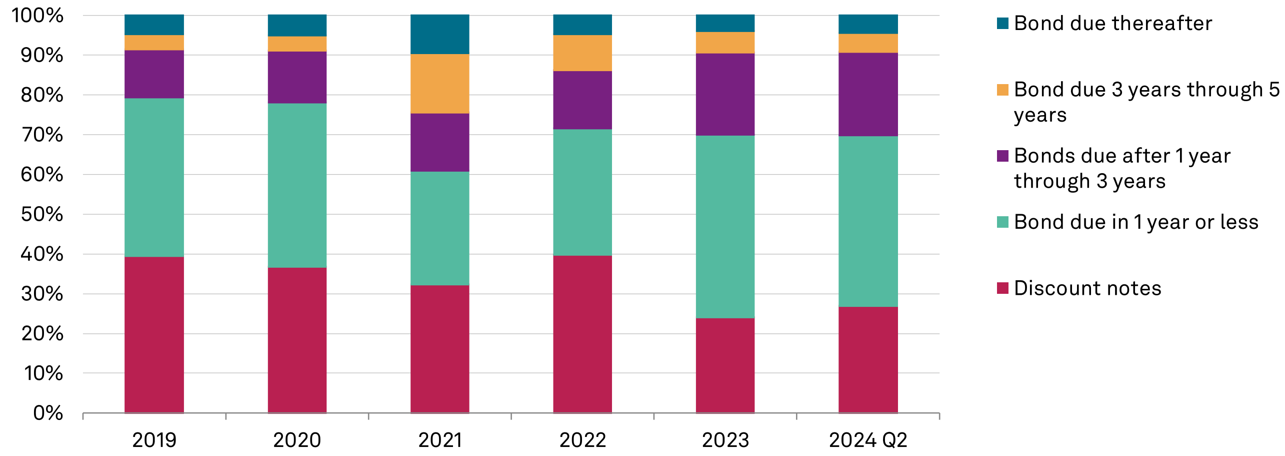
These advances are primarily collateralized by residential mortgage loans and commercial real estate loans, as well as government and agency securities. Community financial institutions may also pledge small-business, small-farm, small-agribusiness, and community development loans as collateral for advances.

In addition to advances, FHLBs extend letters of credit (LOCs) to members--totalling $217 billion as of June 30, 2024. 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.

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 its funding remains manageable.

Chart 3

Federal Home Loan Banks--Consolidated obligations by contractual maturity



Source: S&P Global Ratings.

Related Criteria

- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, April 30, 2024
- 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
- 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
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Federal Home Loan Banks Should Maintain Key Financing Role Despite Potential Reforms, Dec. 6, 2023

Ratings Detail (As Of August 16, 2024)*	
Federal Home Loan Banks	
Senior Unsecured	AA+
Senior Unsecured	AA+/A-1+

Ratings Detail (As Of August 16, 2024)*(cont.)	
Short-Term Debt	A-1+
Short-Term Debt	AA+/Stable
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+
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+

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