

Advances

OVERVIEW

The primary purpose of the Federal Home Loan Banks (FHLBs) is to provide members with liquidity. FHLBs offer a variety of credit products known as "advances" to meet the short- and long-term liquidity needs of their members. FHLB advances serve as a funding source for a variety of mortgage products, including those focused on very low- and low- and moderate-income households. Advances help members originate mortgages that they want to hold in portfolio or sell later. Some FHLB profits from advances are returned to members in the form of stock dividends or Affordable Housing Program funded business development opportunities.

Advances are the most popular products for the FHLBs, accounting for approximately 65 percent of their balance sheets. The Federal Home Loan Banks go to the debt markets several times a day to provide their members with funding. The size of the Federal Home Loan Bank System allows for flexible structuring of these advances, enabling each member to find a funding strategy to meet its needs. Maturities range from overnight to 30 years and include a variety of fixed and adjustable or floating rate structures. Advances are priced slightly over comparable maturity U.S. Department of the Treasury bonds. Advances of different terms and different structures are needed for different purposes, and the range of options that the FHLBs provide assists members in finding a funding strategy that is appropriate to their needs.

Advances are secured by mortgages held in portfolio and other eligible types of collateral that the FHLB holds. Collateral arrangements vary with member credit quality, capacity, and collateral availability, as well as the FHLB's overall credit exposure from the member. Each FHLB can require additional or substitute collateral during the life of an advance to protect its security interest. Therefore, if a mortgage that collateralizes an FHLB advance defaults, the FHLB will

look to the lender to either post additional collateral or reduce the advance outstanding. This means that lenders have to hold some capital buffer to cover this risk.

The FHLBs cap the amount of advance credit available to each member at between 20 and 60 percent of the member's total assets, with some exceptions available depending on member creditworthiness. The credit limit is typically calculated by dividing the member's total credit obligations to the FHLB by its total assets. Each financial institution should carefully review the impact of the income stream associated with advances as well as the obligations and assess the risks and benefits.

Bank Eligibility and Application Process

The FHLB Act⁹ requires that FHLBs obtain and maintain collateral from their members to secure the advances at the time the advances are originated or renewed. Each FHLB sets policies and procedures based on a variety of factors. The following is a general overview of FHLB advances.

In order to apply for advances, each member must pledge high-quality collateral in proportion to its borrowings from the FHLB. The amount of collateral required for an advance incorporates a collateral discount or "haircut," which is incorporated into the member's pledge and determined by the FHLB. The haircut calculation includes an estimate of the cost to sell or liquidate the pledged collateral and the risk of a decline in the asset's value due to market or credit volatility. Because of this haircut, the lending value of the collateral exceeds the amount owed to the FHLB.

To receive an advance, the member must also purchase and maintain additional stock¹⁰ in its FHLB. This minimum stock investment, established by each FHLB,

⁹ Federal Home Loan Bank Act, Pub. L. 72-304, 47 Stat. 725.

¹⁰ Each FHLB sets its own stock thresholds and structure.

serves as security above and beyond the member's established credit limit. FHLB stock may be held as a bank asset.

Once the FHLB approves the loan request, the bank advances those funds to the member, which then lends the funds out for housing and economic development activities and projects.

Collateral¹¹ eligible under statute or regulation to secure new or renewed advances includes, but is not limited to:

- one-to-four family and multifamily mortgage loans (no more than 90 days delinquent) and certain securities backed by these mortgages;
- loans and securities issued, insured, or guaranteed by the U.S. government (for example, loans backed by the U.S. Department of Veterans Affairs, the U.S. Department of Agriculture, and the U.S. Department of Housing and Urban Development) or securities issued or guaranteed by any U.S. government agency or government sponsored enterprise (GSE) (for example, mortgage-backed securities issued or guaranteed by Fannie Mae, Freddie Mac, or Ginnie Mae);
- cash or deposits at the FHLB;
- certain other collateral that is real estate related, provided that the collateral has a readily ascertainable value and that the FHLB can hold a security interest in it, such as certain privately issued mortgage-backed securities not otherwise addressed above, second mortgage loans including home equity loans, commercial real estate loans, and mortgage loan participations; and
- loans made by community financial institution (CFI) members or their affiliates, such as small business loans, small farm loans, small agri-business loans, or community development loans, in each case fully secured by collateral other than real estate, or securities representing a whole interest in such secured loans, provided that the collateral has a readily ascertainable value, can be reliably discounted to account for liquidation and other risks, can be liquidated in due course, and the FHLB can hold a security interest in the collateral.

There are three methods of pledging collateral that can be assigned to a member based on its financial condition: blanket lien status, listing status, or delivery status.

Blanket lien status: Blanket lien status is the least restrictive and is generally assigned to lower risk institutions that are pledging loans, not securities, as collateral. Under a blanket lien status, the member retains possession of the collateral and executes a written security agreement under which the member is required to hold the collateral for the benefit of the FHLB. The security agreement covers the majority of the

POTENTIAL BENEFITS

Advances provide members with a secure, low-cost source of funds.

The availability of advances in a number of short- and long-term structures with maturities ranging from one day to 30 years may give the bank more flexibility in structuring its mortgage-lending program than it might otherwise have.

Advances help members to manage interest rate and liquidity risk and manage their balance sheets.

Advances can help members bring new financial products to market.

POTENTIAL CHALLENGES

Members must have sufficient collateral to cover the credit risk on all advances provided by the FHLB.

Members may not exceed maximum credit limits for advances (typically calculated by dividing the member's total credit obligations to the FHLB by its total assets).

¹¹ See 12 CFR §1266.7 for a full list of collateral eligible to be pledged to support FHLB advances.

member's assets, whether or not they are acceptable as collateral. Members must inform their FHLB of any material changes to the amount of collateral available. The benefit of this method is that advances are tied to the general level of assets, not specific collateral, which reduces reporting requirements, and gives banks flexibility in seeking, using, and repaying advances. This differs from the other methods of pledging, which require members to pledge specific eligible collateral.

Listing status: Under listing status, the member provides listings of loans pledged to its FHLB with detailed loan information, such as the loan amount, payments, maturity date, interest rate, loan-to-value, collateral type, and credit scores. The member retains physical possession of the specific collateral pledged to an FHLB. From a member's perspective, the benefit of listing collateral in lieu of a blanket lien security agreement is that in some cases the discount or haircut applicable to that collateral may be lower than that for blanket lien collateral. From an FHLB's perspective, the benefit of listing collateral is that it provides more detailed loan information to arrive at a more precise valuation of collateral.

Delivery status: Under delivery status, an FHLB requires the member to place physical possession of eligible collateral with the FHLB or a third-party custodian to secure all outstanding obligations associated with advances. Typically, an FHLB would take physical possession or control of the collateral if the financial condition of the member was deteriorating or if the member exceeded certain credit product usage triggers. Delivery of collateral may also be required if regulatory action is taken against the member by its regulator, indicating inadequate controls or other conditions that would be of concern.

Training

Each FHLB offers training opportunities for members to learn more about FHLB products and business-related opportunities. See the individual FHLB summary for training information offered.

Quality Control and Reporting

Each FHLB evaluates members based on financial, regulatory, and other information, including examination and call reports. Members may also be required to

provide other financial data regarding the safety and soundness of operations. The FHLBs protect against credit and other risks by collateralizing all advances. Collateral arrangements vary with member credit quality and collateral availability, as well as the FHLB's overall credit exposure to the member. Each FHLB establishes individual member borrowing by determining the amount it will lend against each collateral type.

The amounts used in determining lending values are updated by each FHLB on a periodic basis, with some values updated as frequently as daily (e.g., securities collateral may be re-valued daily). An FHLB may conduct periodic collateral field reviews to establish the amount it will lend against each collateral type for each member, or to make additional adjustments to a member's pledged mortgage collateral. For instance, if it is determined that the pledged collateral on an outstanding advance has dropped in value, the member may be required to pledge additional collateral to bring the advance to a fully collateralized level needed to secure the outstanding pledge. The financial condition of a member will generally have a bearing on the frequency and degree of collateral reviews and the level of collateralization to secure advances. It also affects the level of haircut used in determining the amount of assets that are pledged.

Community Support Requirements

Members must also be compliant with the Federal Housing Finance Agency's Community Support Requirements,¹² which establish standards of community investment that each member must uphold in order to maintain continued access to FHLB long-term advances (those with maturities over one year). Community support compliance is determined by

¹² http://www.ecfr.gov/cgi-bin/text-idx?SID=a4384a1fd746c400b19fa3a0fde6b123&node=12:10.0.2.5.46&rgn=div5#se12.10.1290_12

¹³ CRA requires the federal financial institution supervisory agencies, in connection with their examinations of certain depository institutions, to assess the institutions' CRA performance. Upon completion of a CRA examination, an overall CRA rating is assigned using a four-tiered rating system. These ratings are Outstanding, Satisfactory, Needs to Improve, and Substantial Noncompliance. In the case of an interstate bank, the federal bank supervisory agencies are required by law to evaluate an institution's CRA performance in each state and metropolitan statistical area (MSA) in which it has a branch in addition to providing an overall rating for the bank's performance. See FFIEC at http://www.ffiec.gov/craratings/ratings_faq.htm.

a combination of the Community Reinvestment Act (CRA) rating (for depository institutions),¹³ and a track record of lending to, and explicitly marketing to, first-time homebuyers.

Members are required to submit a Community Support Statement every two years indicating their most recent CRA rating and in some cases, documenting their lending activities to first-time homebuyers. A member with a CRA rating of "outstanding" or "satisfactory" is deemed to meet the CRA requirement. Members with CRA ratings of "needs to improve" will be put on probation until the following CRA examination, during which time members will still have access to long-term funding. If the next CRA rating is less than "satisfactory," (needs to improve or substantial noncompliance), access to long-term funding will be restricted. Any member with a CRA rating other than "outstanding" must also provide specific data (as requested in the Community Support Statement) related to its lending activities to first-time homebuyers.

Potential Benefits

- Advances provide members with a secure, low-cost source of funds.
- The availability of advances in a number of short- and long-term structures with maturities ranging from one day to 30 years may give the bank more flexibility in structuring its mortgage-lending program than it might otherwise have.
- Advances help members to manage interest rate and liquidity risk and manage their balance sheets.
- Advances can help members bring new financial products to market.

Potential Challenges

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RESOURCES

Federal Home Loan Banks Office of Finance Lending

http://www.fhlb-of.com/ofweb_userWeb/pageBuilder/home

Federal Home Loan Banks Office of Finance Lending and Collateral Q&A

http://www.fhlb-of.com/ofweb_userWeb/resources/lendingqanda.pdf

Federal Home Loan Bank of Atlanta credit products brochure

<http://corp.fhlbatl.com/files/documents/credit-products-brochure.pdf>

Federal Home Loan Bank of Boston advances

<http://www.fhlbboston.com/rates/advances/index.jsp>

Federal Home Loan Bank of Chicago advances

<http://www.fhlbc.com/ProductsandServices/LiquidityandFunding/Pages/default.aspx>

Federal Home Loan Bank of Cincinnati advances

<https://www.fhlbcin.com/our-members/credit-services/advance-programs/>

Federal Home Loan Bank of Dallas advances

<https://www.fhlb.com/products/Pages/Advances.aspx>

Federal Home Loan Bank of Des Moines advances

<http://members.fhlbdm.com/advance-rates/>

Federal Home Loan Bank of Indianapolis advances

<https://www.fhlbi.com/products-services/credit-services>

Federal Home Loan Bank of New York advances

<http://www.fhlbny.com/business-lines/credit-products.aspx>

Federal Home Loan Bank of Pittsburgh advances

<http://www.fhlb-pgh.com/products-and-services/credit-products.html>

Federal Home Loan Bank of San Francisco advances

<http://www.fhlbsf.com/member/default.aspx>

Federal Home Loan Bank of Topeka advances

<https://www.fhlbtopeka.com/betterrates>