

Federal Home Loan Bank of Topeka

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Federal Home Loan Bank of Topeka

Major Rating Factors

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

Strengths:	Weaknesses:
<ul style="list-style-type: none">• Critical to the implementation of U.S. government housing policy• Strong risk-adjusted capitalization• High loan-asset quality and limited risk from peripheral activities• Stable and favorable funding	<ul style="list-style-type: none">• Concentrated exposure to the U.S. mortgage market• Geographically restricted to a limited region of the U.S.• Vulnerable to future potential legislative changes

Outlook

The stable outlook on the Federal Home Loan Bank of Topeka (FHLB Topeka) reflects S&P Global Ratings' view of the bank's strong and stable operating performance, as well as the rating on the U.S. If we changed our rating or outlook on the U.S., we would likely reflect that change in our ratings on the Federal Home Loan Bank System's (FHLB System's) debt and its individual banks, including FHLB Topeka, according to our government-related entity (GRE) criteria. We expect FHLB Topeka to maintain its strong financial profile, given its comprehensive and conservative governing policies and management's intention to maintain them. We could lower the rating if, in the context of government-sponsored enterprise (GSE) reform, the role of the FHLB System in housing finance is diminished, reducing its importance to the government.

Rationale

Our issuer credit rating on FHLB Topeka reflects our view of the wholesale bank's government-supported role in providing liquidity to member institutions, very strong loan-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). Based on our criteria for rating GREs, the rating on FHLB Topeka includes a one-notch uplift from the bank's stand-alone credit profile (SACP) of 'aa'. This reflects our expectation that the likelihood of the bank receiving extraordinary government support, if needed, is very high, because of the FHLB System's high importance to the U.S. housing market.

Anchor: Adjusted for an FHLB to reflect regulated status, strong competitive position, and favorable funding

Our starting point, or anchor, for our ratings on U.S. finance companies (fincos), which include FHLBs that we rate under our nonbank financial institutions (NBFI) criteria is 'bb+'. Because of FHLBs' public policy role and regulatory status, we raise the anchor for FHLB Topeka and its sister banks to 'bbb+' three notches above our anchor for U.S. fincos. This is to account for the FHFA's regulatory oversight, the favorable funding an FHLB enjoys through its close relationship with the U.S. government, its 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.

Table 1

Federal Home Loan Bank of Topeka -- Key Figures					
(Mil. \$)	Quarter ended March 31, 2018	--Year ended Dec. 31--			
		2017	2016	2015	2014
Adjusted assets	53,150	48,077	45,217	44,436	36,854
Customer loans (gross)	34,445	33,583	30,628	29,973	24,538
Adjusted common equity	2,457	2,484	1,962	1,861	1,601
Operating revenues	70	280	269	250	236
Noninterest expenses	15	67	64	58	53
Core earnings	40	197	162	93	106

Business position: A unique and strong market position

We believe FHLB Topeka's established market position, recurring business volumes, and public policy role offset some of the risks associated with its lack of geographical and business diversity. (All figures are as of March 31, 2018 unless mentioned otherwise.)

FHLB Topeka is the smallest of the 11 FHLBs with \$53.2 billion in assets and \$27.0 billion in advances. As of March 2018, it served 734 member institutions across Colorado, Kansas, Nebraska, and Oklahoma. Of its members, 82% are banks. FHLB Topeka is affected by the economic conditions in the four states in which it operates. The ongoing declines in the unemployment rates underscore the high degree of resource utilization in the labor market.

FHLB banks operate in a targeted business segment. They have maintained a unique and strong business position. They are highly dependent on spread income and lack diversity from a geographic and business line perspective.

FHLB Topeka's concentration in advances is high, with 53% of its advances to the top five borrowers and 40% to the top two borrowers. This concentration can increase the potential for asset, earnings, or even capital volatility. The bank's advance volume and therefore revenue are typically countercyclical, as members rely more on the bank in times of stress as a reliable source of funding. Moreover, members are concentrated within a limited region of the U.S. However, the fully collateralized nature of the lending business does mitigate much of that concentration risk, in our view.

Table 2

Federal Home Loan Bank of Topeka -- Business Position					
		--Year ended Dec. 31--			
(%)	Quarter ended March 31, 2018	2017	2016	2015	2014
Return on average equity	6.34	8.81	8.49	5.44	6.24

Capital, leverage, and earnings: Collateralized lending to financial institutions limits risk

We believe FHLB Topeka's capital is very strong, reflecting the member-capitalized co-op structure and low-risk collateralized lending business. The bank is mandatorily required to keep regulatory capital in excess of 4% of assets and a leverage ratio above 5%. As at March 31, these ratios stood at 4.6% and 6.8%, respectively. Because the majority of FHLB Topeka's assets are advances to financial institutions, we attach a relatively low risk weight in our methodology. We expect the bank to maintain its S&P Global Ratings' risk-adjusted capital ratio in the relatively stable 18–20% range because members must scale their capital contribution to support their borrowings.

FHLB Topeka's profitability also has been relatively stable, with a steady return on average assets of 0.28%, which is marginally lower than the peer average. However, we don't believe the absolute level of earnings is an important ratings consideration because of both the bank's strong capital level and co-op structure, the latter of which ensures that profit maximization is not a goal of the bank.

Table 3

Federal Home Loan Bank of Topeka -- Capital And Earnings					
		--Year ended Dec. 31--			
(%)	Quarter ended March 31, 2018	2017	2016	2015	2014
Adjusted common equity/total adjusted capital	100.00	100.00	100.00	100.00	100.00
Net interest income/operating revenues	95.25	95.80	94.86	94.89	94.40
Fee income/operating revenues	0.00	0.00	0.00	0.00	0.00
Market-sensitive income/operating revenues	(0.03)	(0.17)	(0.06)	0.00	0.00
Noninterest expenses/operating revenues	22.17	23.91	23.71	23.10	22.49
Provision operating income/average assets	0.43	0.46	0.46	0.47	0.52
Core earnings/average managed assets	0.31	0.42	0.36	0.23	0.30

Risk position: Limited peripheral activity

FHLB Topeka has faced limited risk as the bank (like its sister banks), in its eight decades of existence, has never suffered a loss on a collateralized advance to a member.

A member must own FHLB's capital stock based on its total assets as a condition of membership, and may be required to purchase additional activity-based capital stock as it engages in certain business activities with FHLB. As additional security for a member's indebtedness, FHLB has a statutory lien on that member's stock. All advances to member institutions are collateralized by loans (residential mortgage loans as the principal form of collateral) and securities with an estimated value significantly in excess of loans extended. FHLB Topeka monitors the financial condition of its members, and manages collateral guidelines, advance rates, and security agreements to further mitigate credit risk. Most importantly, any security interest that an insured depository institution grants to the bank generally has priority over the claims and rights of other parties, including depositors. FHLB Topeka's investment portfolio is smaller than

that of some of its peers. The investment securities portfolio totaled \$10.1 billion, including \$7.5 billion of mortgage-backed securities (MBS), of which only \$72 million are private-label MBS.

FHLB Topeka takes little interest rate risk. The bank primarily issues callable and non-callable fixed-rate bonds to fund its mortgage loan portfolio and a fair amount of its fixed rate advance portfolio and utilizes interest rate swaps to convert some cash flows (both assets and liabilities) to a desired short-term index.

The bank purchases various residential mortgage loan products from participating financial institutions under the MPF Program, a secondary mortgage market structure created and maintained by FHLB Chicago. The bank has one of the highest exposures to these mortgages of its peers (14% of total assets). We expect the MPF portfolio to continue to grow and for the bank to continue to manage its size, including through selling whole loans to other FHLB banks. These mortgages carry very limited credit risk because they are either government guaranteed or credit enhanced by the member institutions from which FHLB Topeka purchases them.

Table 4

Federal Home Loan Bank of Topeka -- Risk Position						
	--Year ended Dec. 31--					
(%)	Quarter ended March 31,	2017	2016	2015	2014	
	2018					
Growth in customer loans	10.26	9.65	2.19	22.15	4.94	
Total managed assets/adjusted common equity (x)	21.64	19.35	23.05	23.88	23.02	
New loan loss provisions/average customer loans	0.00	(0.00)	(0.00)	(0.01)	(0.01)	
Gross nonperforming assets/customer loans + other real estate owned	0.06	0.07	0.07	0.08	0.11	
Loan loss reserves/gross nonperforming assets	5.23	5.29	8.29	8.22	16.93	

Funding and liquidity: Stable and favorable funding

FHLB Topeka has adequate funding and liquidity in our view, reflecting the FHLB System's diverse and global investor base. It also reflects FHLBs' ability to issue debt at a small spread to U.S. Treasury obligations. The funding crisis from several years ago proved not to be an issue for FHLBs. We believe that their low-risk nature and funding markets' receptiveness will continue to benefit them in times of stress.

We consider FHLB Topeka's liquidity as adequate relative to its potential cash flow requirements for the upcoming year. The bank meets regulatory liquidity requirements. We view liquidity management as conservative.

Table 5

Federal Home Loan Bank of Topeka -- Funding And Liquidity						
	--Year ended Dec. 31--					
(%)	Quarter ended March 31,	2017	2016	2015	2014	
	2018					
Core deposits/funding base	1.24	1.02	1.39	1.79	1.70	
Customer loans (net)/customer deposits	5,525.87	7,272.52	5,113.54	3,946.86	4,117.85	
Long term funding ratio	40.19	34.21	27.26	29.81	44.34	
Stable funding ratio	59.10	46.98	38.72	42.07	64.14	
Short-term wholesale funding/funding base	62.76	69.43	76.05	73.24	58.18	

Table 5

Federal Home Loan Bank of Topeka -- Funding And Liquidity (cont.)					
	--Year ended Dec. 31--				
(%)	Quarter ended March 31, 2018	2017	2016	2015	2014
Broad liquid assets/short-term wholesale funding (x)	0.55	0.42	0.41	0.42	0.57
Net broad liquid assets/short-term customer deposits	(2,291.94)	(3,927.97)	(3,204.78)	(2,363.97)	(1,469.95)
Short-term wholesale funding/total wholesale funding	63.54	70.14	77.13	74.58	59.19

External influence: 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 reflects one-notch uplift from our SACP.

In accordance with our criteria on NBFIs, our view of government support on our assessment of FHLB Topeka reflects the following factors:

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.

Table 6

Federal Home Loan Bank of Topeka--Ratings Score Snapshot	
Issuer Credit Rating	AA+/Stable/A-1+
SACP	aa
Anchor	bb+
Entity-Specific Anchor Adjustment	3
Business Position	Strong (+1)
Capital, Leverage, and Earnings	Very Strong (+2)
Risk Position	Very Strong (+2)
Funding and Liquidity	Adequate and Adequate (0)
Comparable Ratings Adjustment	0
External Influence	1
Government Influence	1
Group Influence	0
Rating Above The Sovereign	0

Related Criteria

- 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 - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- Criteria - Financial Institutions - General: Issue Credit Rating Methodology For Nonbank Financial Institutions And Nonbank Financial Services Companies, Dec. 9, 2014
- Criteria - Financial Institutions - General: Nonbank Financial Institutions Rating Methodology, Dec. 9, 2014
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Financial Institutions - Banks: Commercial Paper I: Banks, March 23, 2004

Ratings Detail (As Of July 19, 2018)

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+

Ratings Detail (As Of July 19, 2018) (cont.)

Federal Home Loan Bank of Indianapolis

Issuer Credit Rating	AA+/Stable/A-1+
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Federal Home Loan Bank of New York

Issuer Credit Rating	AA+/Stable/A-1+
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Federal Home Loan Bank of Pittsburgh

Issuer Credit Rating	AA+/Stable/A-1+
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Federal Home Loan Bank of San Francisco

Issuer Credit Rating	AA+/Stable/A-1+
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Federal Home Loan Banks

Senior Unsecured	AA+
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Senior Unsecured	AA+/A-1+
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Senior Unsecured	AA+/Stable
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Short-Term Debt	A-1+
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*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.

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