S&P Global Ratings

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Federal Home Loan Bank of Topeka

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Major Rating Factors

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

Strengths:	Weaknesses:
• Vital to the implementation of U.S. government housing policy • Very strong risk-adjusted capitalization • Very strong loan-asset quality and limited risk from peripheral activities	• 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. Despite recent and possible future changes in the FHLB System, 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

S&P Global Ratings' counterparty credit ratings on FHLB Topeka reflect 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, low competitive risk, and favorable funding

Our starting point -- or anchor -- for our rating on FHLB Topeka is 'bb+', in line with U.S. finance companies that we rate under our NBFI criteria. We initially set the anchor for NBFIs three notches below our anchor for banks operating in the same country to reflect their typical lack of central bank access, less-stringent regulatory oversight, and greater competitive risk. We base the bank anchor for a given country on our view of the economic and industry risks in that country as part of our Banking Industry Country Risk Assessment. Our anchor for a bank operating only in the U.S. is 'bbb+'.

Because of FHLB Topeka's public policy role and its regulated status, we raise its anchor to 'bbb+' as we do for its sister banks, three notches above our anchor for U.S. NBFIs. 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 GREs including Fannie Mae and Freddie Mac in the U.S. housing finance market, and its statutory priority of liens in a bank wind-down situation.

Business position: A unique and strong market position

We view FHLB Topeka's business position as strong, reflecting its established market position, recurring business volumes, and public policy role, which we believe offset some of the risks associated with its lack of geographical and business diversity. (All figures mentioned are as of March 31, 2016.)

The 11 FHLB banks are GSEs and were set up under the authority of the Federal Home Loan Bank Act of 1932. Their mission is to provide their members with a reliable source of liquidity and support housing finance and community investment. FHLB banks provide long- and short–term secured loans to their members.

FHLB Topeka and its sister banks do not lend directly to homeowners, but provide secured, low-cost funding to their members. FHLBs have no high-risk business lines because their lending is backed by collateral, and the value of collateral backing loans typically exceeds loans by a significant margin.

FHLB Topeka is the smallest of the 11 FHLBs with $45.2 billion in assets and $25.4 billion in advances. It serves 769 member institutions including 636 banks, 77 credit unions, 23 insurance companies, 31 savings and loan institutions, and two community development financial institutions in Colorado, Kansas, Nebraska, and Oklahoma.

FHLB Topeka is affected by the economic conditions in the four districts in which it operates. Unemployment in these districts has been slightly lower than national levels; also the per capita income has shown a gradual increase since the 1990s with a slight drop in 2008. In Kansas, Nebraska, and Oklahoma, housing prices increased gradually since 2000 versus the national average, which experienced a spike during the 2005-2007 housing bubble. In Colorado, the housing price index trend has been similar to national levels though it is higher today. Overall, growth in FHLB Topeka's districts has tended to be less dynamic and diversified than in those of some of its peers, reflecting borrowing needs that are highly correlated with the housing market activities in their respective districts. The revenue trend is not particularly volatile, but it does vary with the economic cycle.

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

FHLB Topeka's concentration in advances is high, with 56% of its advances to the top five 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. This does somewhat mitigate the impact of the concentration exposure as well as the collateralized nature of the lending business.

FHLBs are regulated by the FHFA and any changes in regulation can affect the business of FHLBs. The FHFA announced its final FHLB membership rule in January 2016 with new captive insurers ineligible for membership. Captive insurance members admitted on or before Sept. 12, 2014, will have their membership terminated by Feb. 19, 2021; and those admitted after September 2014, will be ineligible for FHLB membership after Feb. 19, 2017. This rule will not have a material impact on FHLB Topeka because captive insurers form an insignificant part of its membership.

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

We believe FHLB Topeka's capital is very strong, reflecting its member-capitalized co-op structure and low-risk collateralized lending business. The bank is required to keep capital in excess of 4% of assets and a leverage ratio above 5% by the FHFA; its capital and leverage ratios were 4.5% and 6.5%, respectively. Because the majority of its assets are advances to financial institutions, this attracts a relatively low risk weight in our methodology. We expect the bank to maintain its S&P Global Ratings' risk-adjusted capital (RAC) ratio close to 20%, relatively stable because members must scale their capital contribution to support their borrowings.

FHLB Topeka's profitability is relatively stable, with a steady return on average assets of about 0.34% in line with the peer average. Net income in the first quarter increased 30% to $40.5 million compared with the previous year's quarter. This was primarily driven by an increase in net interest income (NII) and fair value fluctuations in derivatives and hedging activities. Higher NII reflected an increase in advances and investment securities with higher yields. 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.

Under the annual Dodd-Frank Stress Test, FHLB Topeka's regulatory capital ratio of 6.07% exceeded the minimum stressed regulatory capital requirement of 4.0% throughout nine quarters.

Risk position: Limited peripheral activity

We consider FHLB Topeka's risk position to be very strong, reflecting that the bank (like its sister banks) in its eight decades of existence has never suffered a loss on a collateralized advance to a member.

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 also 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. For non-depositories, FHLB Topeka, like peers, relies on more strict borrowing limits and collateral guidelines to mitigate the risk, for which they are not guaranteed priority status in liquidation. FHLB Topeka's investment portfolio is smaller than that of some of its peers. The investment securities portfolio totaled $7.7 billion, including $6.3 billion of mortgage-backed securities (MBS), of which $148 million are private-label MBS. Compared with its peers, FHLB Topeka has one of the lowest exposures to private-label MBS as a share of its balance sheet (0.33% of total assets), resulting in minimal other-than-temporary-impairment losses. In addition, the bank has a relatively homogenous lending portfolio, considering all advances are made to financial institutions backed by a majority of residential and commercial mortgages, though collateral does vary.

FHLB Topeka takes little interest rate risk. It primarily issues fixed-rate callable and non-callable bonds, as well as some step-up and floating bonds, and swaps most of its fixed-rate interest exposures to LIBOR-based floating exposures.

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. Mortgages held for portfolio totaled $6.4 billion or 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 risk as they are either government-guaranteed or credit-enhanced by the member institutions from whom FHLB Topeka purchases them. FHLB Topeka has strict underwriting standards and credit requirements. The MPF program has a minimum FICO score of 620 for conventional loans. The weighted average FICO score and loan to value recorded at origination for conventional mortgage loans were 750 and 74%, respectively. The bank, just like its peers, uses derivatives, largely to hedge the interest rate risk in its mortgage portfolio.

Funding and liquidity: Stable and cheap funding supports the business model

We view both FHLB Topeka's funding and liquidity as adequate, 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 continue to believe that FHLBs' 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.

External influence: An important cog in the U.S. housing market

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 a 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.

Related Criteria And Research

Related Criteria

- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- Issue Credit Rating Methodology For Nonbank Financial Institutions And Nonbank Financial Services Companies, Dec. 9, 2014
- Nonbank Financial Institutions Rating Methodology, Dec. 9, 2014
- Group Rating Methodology, Nov. 19, 2013
- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Methodology For Mapping Short- And Long-Term Issuer Credit Ratings For Banks, May 4, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Commercial Paper I: Banks, March 23, 2004

Ratings Detail (As Of July 25, 2016)	
Federal Home Loan Bank of Topeka	
Counterparty Credit Rating	AA+/Stable/A-1+
Counterparty 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 of America	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+

Ratings Detail (As Of July 25, 2016) (cont.)	
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 Banks	
Senior Unsecured	AA+
Senior Unsecured	AA+/A-1+
Senior Unsecured	AA+/Stable
Short-Term Debt	A-1+

*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.