MORE THAN MEETS THE EYE
FHLBank Topeka stock demystified

FHLBank Topeka is a member-owned cooperative and returns a majority of its profits to its members and their communities in the form of dividends and through housing and community development programs.

We strive to be your trusted financial partner and consistently deliver products, services and programs that create value for you and your communities. The dividend is an important source of value and often overlooked for its effect on lowering your all-in borrowing cost when comparing advance rates to alternative funding sources. How can your institution better quantify the value of the dividend?

CAPITAL STRUCTURE OVERVIEW
It all starts with the unique self-capitalizing capital structure. As advance demand increases, members supply additional capital. As advance demand diminishes, members can request redemption of their excess capital. Members purchase and hold capital stock as a condition of membership and only members are permitted to purchase capital stock to support their outstanding advances.

The capital structure consists of two classes of common stock. Both are purchased and redeemed at par value of $100 per share:

- **CLASS A STOCK** – Also referred to as asset-based or membership stock, this class of stock is based on your total assets and is required for membership. The requirement for each member is 0.1% of the member’s total assets with a minimum requirement of $1,000 (10 shares) and a cap of $500,000 (5,000 shares).

- **CLASS B STOCK** – Also referred to as activity-based stock, this stock class is purchased to support your activity. This is the stock you want to purchase and own, as it provides a higher dividend yield that reduces the cost of borrowing while...
returning a portion of FHLBank’s profits. The activity-based stock is required to support advances exceeding the amount of Class A stock held. The amount of activity-based stock required is equal to 4.5% of the principal amount of advances outstanding less the member’s asset-based requirement (Class A) (e.g., $100,000 advance = $4,500 or 45 shares of stock).

The activity-based stock purchase aligns with the cooperative structure. Members’ stock ownership requirements and the dollar amount of dividends paid to members generally increases as their activity with us increases. Activity-based dividend yields typically exceed the return available from other investments with similar terms and credit quality and further enhance the value of the products and services available to members.

OUTREACH TO YOUR COMMUNITIES
In addition to valuable products and attractive dividends, 10% of FHLBank’s earnings are set aside for the Affordable Housing Program.

The FHLBank System’s Affordable Housing Program is the largest private source of grant funds for affordable housing in the United States. Over the past five years, FHLBank Topeka has committed $84.6 million to support our members’ great work in their communities. Through this cooperative partnership, our members have been able to further support nearly 10,800 households in the communities they serve.

RETAINED EARNINGS
Due to the low cost of advances, coupled with the capital structure, members and their communities ultimately benefit from the income generated from increased use of products (i.e., advances, the Mortgage Partnership Finance® (MPF®) Program, letters of credit, etc.). A portion of these earnings are set aside for our affordable housing programs, with the remainder after the payment of dividends flowing to retained earnings.

As retained earnings accumulate, the earnings are returned to members in the form of dividends, which reduces the members’ effective borrowing rate. The dividend yield on activity-based stock is substantially higher than the membership stock dividend because members are rewarded for increased advance usage. Note: Retained earnings are maintained at sufficient levels for FHLBank to pay a stable and reliable dividend and as a risk mitigant for both investors and members, while also meeting regulatory requirements.

VALUE OF THE DIVIDEND
A quick starting point to estimate the dividend benefit is multiplying the capital requirement for advances (4.50%) by the dividend yield on the class of stock supporting a specific advance.

For example, an advance supported entirely by Class B stock, at the current dividend rate of 7.25%, effectively reduces the stated interest rate by nearly 33 basis points.

$$4.50\% \times 7.25\% = 32.625 \text{ bps}$$

continued from page 1

continued on next page

THE TRUE COST OF YOUR CAPITAL CONTRIBUTION

|$1,000,000$ Advance

$45,000$ Capital Stock Purchase

$1,045,000$

|$62,000$ Interest Paid on Advance

$6,525$ 7.25% Activity Stock Dividend Received

$55,475$ Net Interest Paid

$1,000,000 \times 3.10\% \times 730/365$ ($45,000 \times 7.25\% \times 730/365$)

($62,000 - $6,525$)

$3.10\%$ Interest Rate

$2.77\%$ All-in Advance Cost

$33$ bps Effective Advance Rate Reduction

($55,475/$1,000,000/(730/365))

The example above is based on a 2-yr fixed rate bullet advance at 3.10%
However, this may not yield (pun intended) a precise result because you would only purchase Class B stock after utilizing all Class A stock. If an advance is supported by Class A and Class B stock, you would use the weighted average dividend yield on both classes of stock held by your institution to calculate the effective yield reduction on the advance. This means the more you borrow, the more the dividend reduces the effective cost of your advances.

For simplicity, and the sake of keeping your attention, the example at the bottom of the previous page illustrates the math behind the dividend benefit estimate, considering a 2-yr fixed rate bullet advance at 3.10% supported solely with Class B stock – the class of stock that provides the greatest benefit to those who increase their activity with FHLBank.

The simplified dividend benefit calculation can be enhanced by factoring in the cost of funds supporting the stock purchase or the yield on alternative investments that could be held instead of FHLBank stock.

We created a comparison that shows the impact of the activity dividend when applying three assumptions of the cost of funds or alternative investment yields:

1. Your internal cost of funds
2. Cost of the advance
3. An alternative investment, such as fed funds rate

Regardless of the factors you consider in valuing the true/real benefit of the activity dividend, it lowers your overall cost of funds and should be considered when comparing cost of funding with an advance to alternative sources. View the comparison.

The three scenarios include the following assumptions to factor in the cost of capital used to support the advance:

1. Members internal cost of funds
2. Same cost as the advance. Assumes the member uses a portion of the advance to purchase the required activity-based stock.
3. Yield earned on an alternative investment. We use the effective federal funds rate of 2.40%.

The dividend is a very important factor to consider when comparing the cost of external funding, but these analyses don’t demonstrate the true value FHLBank Topeka provides to your institution and your community. Alternative funding sources do not distribute their earnings or give back to your community in the ways FHLBank Topeka does.

We value our long-term relationship with you and always are here to help you maximize the benefits of your FHLBank membership. I hope you take the opportunity to learn how you and your community benefit from our partnership and include these additional benefits when making your wholesale funding decisions. After all, we are a cooperative and working together is the most effective way to strengthen our communities.

Contact Michael today for solutions that work for you.

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