LONG-TERM AG LENDING

Compete effectively with help from your FHLBank Topeka membership

your
AGRICULTURE SPECIALIST

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Michael Young has done a little bit of everything in his four years at FHLBank Topeka, including Accounting and ERM. The CPA graduated from Washburn University.

Find out more about Michael and our funding experts at **FHLBTOPEKA.COM/INTELLIGENCE.**

Long-term agriculture financing continues to be a challenge for our members. The continued low-rate environment, coupled with alternative ag lending sources (i.e., Farm Credit) is putting pressure on lenders to extend out on the balance sheet at low rates to maintain or obtain business. These combined factors are creating increased interest rate risk for our member institutions.

A recent article published by the American Bankers Association states that farm banks in the Plains region increased farmland loans by 10.5% during 2015. With the increase in this sector, our lending desk has fielded more calls to discuss solutions for competing for these long-term assets. Recent long-term ag loans funded with a blend of advances and deposits have netted 200-350 basis points with loan rates competitive with alternative lending sources.

In this low-rate environment, your ag customers are requesting loans with long terms and fixed rates. As an FHLBank Topeka stockholder, you have access to competitive hedging strategies to capture these loans, and still maintain an acceptable spread. The above-market dividend earned on FHLBank stock lowers a member's advance cost by up to 27 bps (based on 4.50% stock requirement using Class B Stock at a 6% dividend).

When building your strategy, consider the following:

- Borrowers often repay loans faster than the agreed-upon amortization schedule, so take into account the estimated cash flow based on

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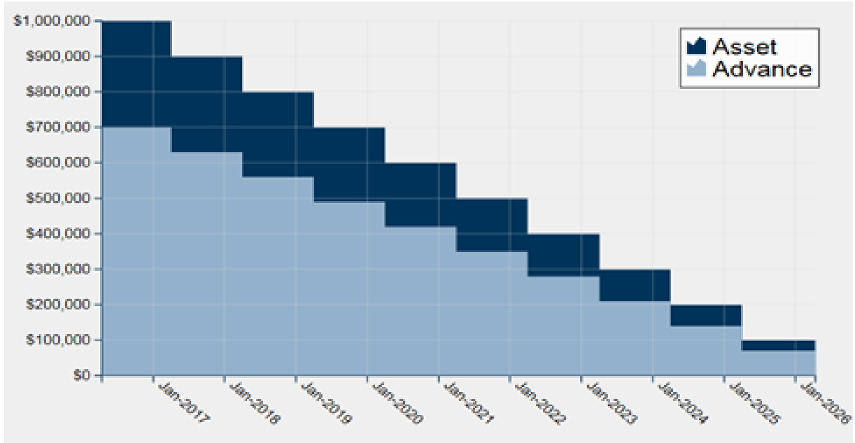
assumed prepayment speeds. The likelihood of additional prepayments decreases as interest rates move from lower to higher levels.

- Using deposits or short-term advances as part of the funding mix can help offset additional principal payments made by the borrower, plus they usually enhance your spread over the life of the loan because they are often lower costing and the repricing of deposits generally lag as interest rates rise.
- Always consider incorporating FHLBank's prepayment language into your note, making you indifferent if your customer decides to pay off the loan.
- Advance options/benefits:
  - Customize your advance cash flows
  - Eliminate prepayment risk by adding prepayment options to your advance
  - Remember to incorporate the impact of your FHLBank dividend into your spread calculation

Amount of funding needed

If your institution has excess liquidity, consider funding a larger portion of the loan with your deposit base. Institutions tighter on liquidity can simply increase their advance funding to accommodate their needs. Based on today's low cost of funds, the more deposit funding you use, the greater your potential spread. However, in a

How much funding do you need?



Asset	Advance	Deposit COF	Spread in bps
$1,000,000 Amort: 120 mo Maturity: 120 mo Yield: 4.500 % Principal: Annually	$700,000 Amort: 120 mo Maturity: 120 mo Rate: 2.120 % Principal: Annually	0.500 %	287 initial 287 adv life 287 asset life
		Interest is collected on the first business day of each month.	

rising rate environment, spread compression is a risk that should be considered as deposits reprice higher. Common advance to deposit funding ratios are 70%/30% or 50%/50%. The example above demonstrates a 70%/30% advance vs. deposit mix, with an average deposit cost of funds of 0.50%, and an initial spread of 287 bps.

Term

The term of your customer's loan can be matched exactly with the advance. This strategy protects your institution from interest rate risk, but could expose you to prepayment risk if you are unable to incorporate FHLBank's prepayment language into the note. While this risk is lower on transactions that are executed in a lower interest rate environment, other circumstances may also result in loans being prepaid earlier. If you are unsure of the reliability of the agreed-upon amortization schedule, funding the loan to anticipated life or average duration is a good alternative that may keep you from being over-funded or incurring an advance prepayment fee if the customer pays off early. Should your loan customer prepay their loan, you have the option to prepay the advance, potentially with a fee, or re-deploy the funds to support another loan or other assets. Advances can also be structured with call options that provide you the ability to prepay the advance without fee at agreed upon points during the term to maturity.

Our models can help you determine the rate you would need to charge to earn your desired spread. If your customer's rate has already been determined, your spread is calculated by comparing the yield to the blended cost of funding for all funding sources.

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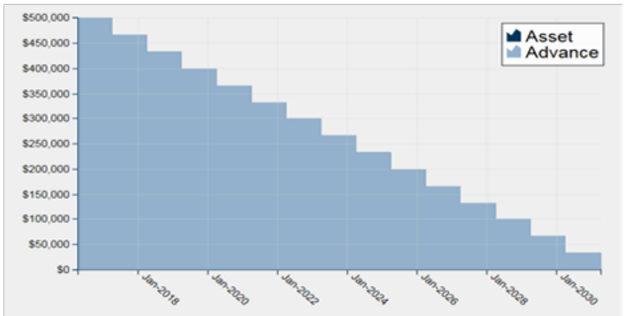
Match Funding Strategy

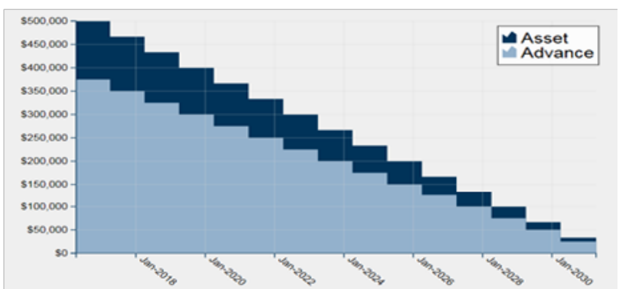
Matches the advance with the exact term and dollar amount of your customer's loan. This strategy provides you the most protection against rising interest rates, and therefore, earns you a smaller spread. In this specific strategy with a 100% match fund, you would earn a nice spread of 230 bps throughout the life of the advance.



Asset	Advance	Deposit COF	Spread in bps
$500,000 Amort: 180 mo Maturity: 180 mo Yield: 4.900 % Principal: Annually	$500,000 Amort: 180 mo Maturity: 180 mo Rate: 2.605 % Principal: Annually	0.500 %	230 initial 230 adv life 230 asset life
		Interest is collected on the first business day of each month.	

Blended Funding Strategy

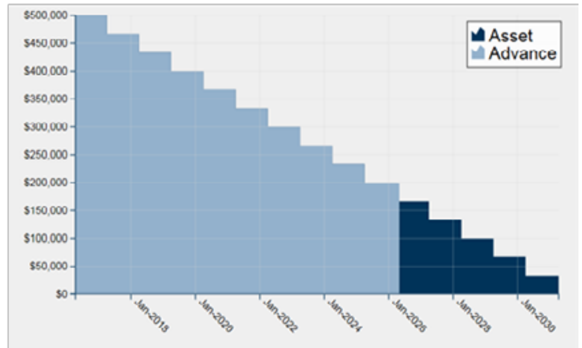
Matches the term of your loan with a portion of the loan funded by an advance and the remaining portion funded with your deposits. The mix of funding you choose depends upon your liquidity profile, risk tolerance and the reliability of your asset amortization. This example yields an initial spread of 282 bps.



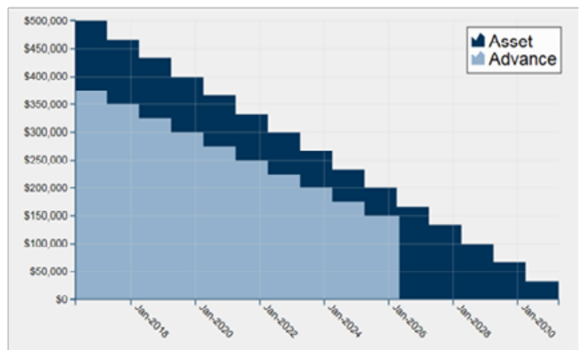
Asset	Advance	Deposit COF	Spread in bps
$500,000 Amort: 180 mo Maturity: 180 mo Yield: 4.900 % Principal: Annually	$375,000 Amort: 180 mo Maturity: 180 mo Rate: 2.605 % Principal: Annually	0.500 %	282 initial 282 adv life 282 asset life
		Interest is collected on the first business day of each month.	

Short Funding Strategy

This strategy can be used either by match funding or blended funding, by using an advance that is shorter in maturity than your customer's loan. If your loan remains on the books following the advance maturity, the remaining life is funded with your deposits or shorter term advances. The examples shown below are match funding and blended funding, both producing 250 bps plus spread.



Asset	Advance	Deposit COF	Spread in bps
$500,000 Amort: 180 mo Maturity: 180 mo Yield: 4.900 % Principal: Annually	$500,000 Amort: 180 mo Maturity: 120 mo Rate: 2.307 % Principal: Annually	0.500 %	259 initial 259 adv life 281 asset life
		Interest is collected on the first business day of each month.	



Asset	Advance	Deposit COF	Spread in bps
$500,000 Amort: 180 mo Maturity: 180 mo Yield: 4.900 % Principal: Annually	$375,000 Amort: 180 mo Maturity: 120 mo Rate: 2.307 % Principal: Annually	0.500 %	304 initial 304 adv life 321 asset life
		Interest is collected on the first business day of each month.	

Regardless of your liquidity profile, risk tolerance or cash flow needs, FHLBank Topeka's amortizing advance can suit just about any need you have when funding longer term ag real estate loans and aid you in competing with other lending sources.

Contact Michael today for solutions that work for you.

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