

New FHLBank Letter of Credit Authority

Council of Development Finance Agencies



Washington, DC
January 29, 2009

Agenda

- FHLBank System Background
- Eligible Purposes
- New Authority
- Types of:
 - LOCs
 - Bond Deals/Project
 - Bond Structures
- Terms/Pricing
- Impact of FHLBank LOC
- Example of a Bond Deal

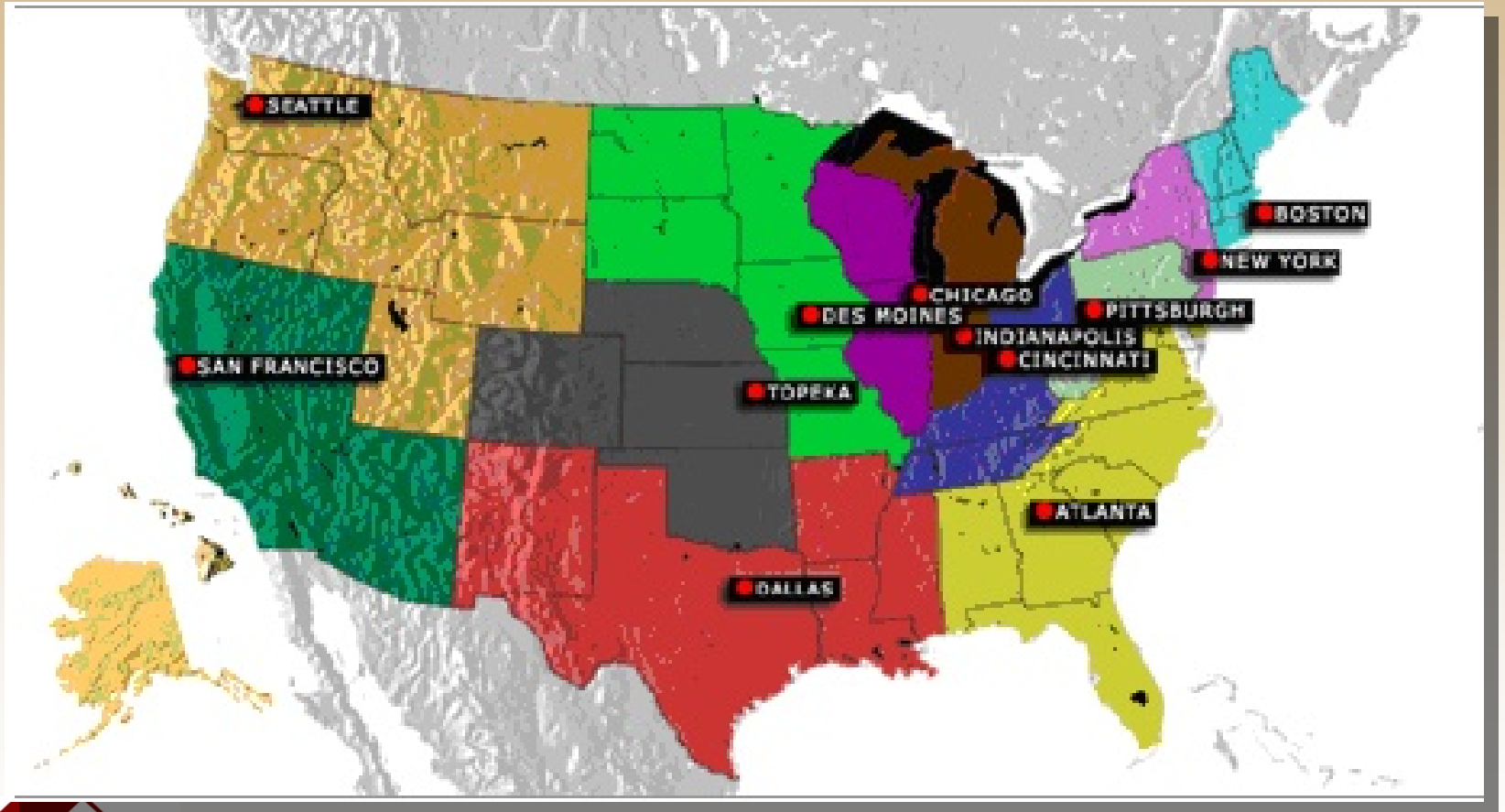
Mission of the FHLBank System

We assure the flow of credit and services that enhance members' businesses and vitalize their communities.

- A range of housing, community and economic development, and general banking needs.
- A proper balance between the Bank's responsibilities to members and the general public.



FHLBank System



Our Past

- **1932 FHLBank Act**
 - 12 Cooperative Banks
 - Government-Sponsored Enterprises (GSEs)
 - Tax Exempt
 - Promoting Housing Liquidity and Regulation for the S&L Industry

FHLBank Business

- Over 8,000 financial institutions are members of the FHLBank System
- Advances, or loans to members, are the main product
- Affordable Housing Program
- Secondary market mortgage programs
- Letters of credit



Types of Letters of Credit

- Standby Letter of Credit
 - FHLBank LOC performs if member doesn't perform its responsibilities
(public unit deposits – no member LOC)
- Confirming Letter of Credit
 - FHLBank LOC stands behind the member's LOC
 - Confirms member's LOC and improves credit rating of transaction

Types of Letters of Credit

- Direct Pay Letter of Credit
 - FHLBank LOC stands behind the member's LOC
 - FHLBank's LOC is drawn on first for:
 - non-performance,
 - Principal and interest payments,
 - Other transactional charges
 - FHLBank recovers from member and member from Bond Trustee.

Purposes for LOC Issuance

- Facilitate residential housing
 - Tax-exempt mortgage revenue bonds
- Community and economic development transactions
- Provide liquidity or funding, including public unit deposits

Public Unit Deposit LOCs

- FHLBank LOC secures municipal deposits
- Members take deposits from school districts, municipal governments, etc
- Over the \$100,000 FDIC insurance
- Keeps deposits working in communities
- Pittsburgh volume outstanding – \$5.6B
- Fifty-six (56) Users

Housing and Economic Recovery Act of 2008

Authority to issue Letters of Credit to support
Community Development for tax-exempt bond
transactions (sunsets the end of 2010):

Must meet one of the tests under the CICA
regulation

1. Income eligible housing;
2. 100% of area median family income;
3. If rural project – 115% of area median family income;
4. Small business test;
5. Project is in a federally designated zone or community;
6. Job creation or retention or services provided by the project are to lower income individuals.

Types of Bond Deals

- General Obligation
- Authority
- Healthcare – Hospitals, Senior Care
- Education – Student Loans, Housing, Development
- Industrial Development Authority
- Non-Profit

Types of Projects

- General Obligation
 - Municipal buildings
 - Recreation facilities
- Authority
 - Water filtration plant
 - Sewage processing plant
- Healthcare
 - Hospital additions
 - Senior care facilities

Types of Projects

- Education
 - Student housing
 - Classroom buildings
 - Research centers
 - Interim financing

Types of Projects

- Industrial Development Authority
 - New Manufacturing Plant
 - Industrial Parks
 - Warehouses
 - Stadiums
- Non-profit – promote the “public good”
 - Facilities
 - Land Conservation

Types of Bond Structures

- **Fixed-rate**
 - Higher credit quality issuers
 - Credit enhanced with bond insurance
 - Separate liquidity provider
- **Variable Rate Demand Bond (VRDB)**
 - Credit enhanced with member LOC and FHLBank confirming LOC
 - LOC providers act as liquidity providers
 - Can be sold back to Remarketing Agent

Types of Bond Structures

- **Variable Rate Demand Bond (VRDB)**
 - 7-day variable rate – sold to money funds
 - Interest rate tied to the SIFMA index
 - Issuers can purchase Interest Rate Caps

Bond Market Turmoil

- **Bond Insurers**

- Typically - AAA-rated and limited to insuring municipal bonds
- Expanded to newer, higher credit risk markets, like sub-prime mortgages
- Experiencing severe losses
- Downgraded below AAA
- Insured bonds have been downgraded
- Lower credit rating of little value in new deals

Bond Market Turmoil

- **Letter of Credit Providers**

- Traditionally, large highly-rated regional banks
- Banks have experienced credit rating downgrades due to mortgage exposure
- Low-rated LOCs of little value
- Higher-rated banks are at their LOC exposure limits

**AAA-Rated FHLBank LOC can help fill
the market void!!**



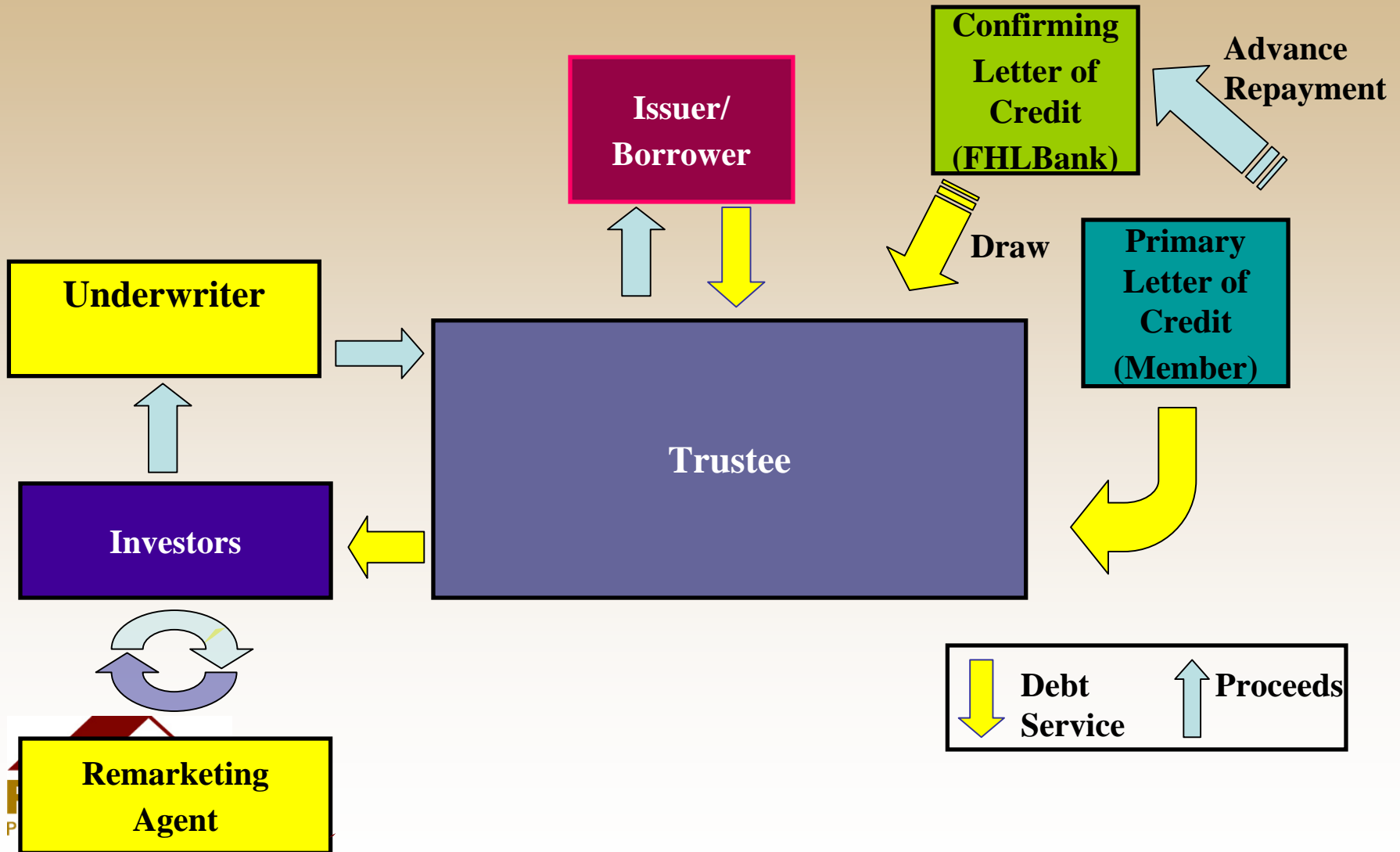
Impact of FHLBank LOC

- Alternative to AAA-rated Bond Insurance
 - Bond insurer downgrades
- Smaller Deals
 - \$3 - \$20MM bond offerings
- Rural Projects
 - Too small
 - No underwriter interest
- Larger deals with member consortium

Terms of LOC

- Offered in conjunction with a member institution that does the credit underwriting
- Maturities up to 20 years
- 3 - 5 year terms are desirable
- Typical LOC is annually renewable term

How a LOC Bond Deal Works



Financial Benefit to Issuers

20-Year VRD Bond Example

A tax-exempt yield (all-in) =	2.59%
AAA tax-exempt bond yield =	(0.31%)
Remarketing Fee =	(0.125%)
+ Member LOC cost =	(1.75%)
+ FHLBank LOC cost =	<u>(0.25%)</u>
All-In Cost =	<u>(2.435%)</u>
Pricing Benefit =	0.125%

Financial Benefit to Issuers

20-Year Fixed-Rate Bond Example

BBB-Rated Issuer vs FHLBank LOC

BBB tax-exempt bond yield =	8.10%
AAA tax-exempt bond yield =	(5.10%)
+ Member LOC cost =	(2.25%)
+ FHLBank LOC cost =	<u>(0.25%)</u>
All-In Cost =	<u>(7.60%)</u>
Pricing Benefit =	0.50%

Benefit of FHLBank LOC

- AAA-rating
 - Increases universe of eligible investors
- Lower interest rate for issuer
 - AAA yield vs A or unrated yield
- Bundled services pricing
 - Deposits
 - Lockbox
 - Other interim lending

Deal Sourcing

- Bond Underwriters
- Member Institutions
- Issuers
- Bond Counsel
- Accountants
- Issuer Trade Associations

How to Get Started

Contact:

- Local Financial Institution
- Bond Underwriter
- Legal Counsel
- Accountant
- FHLBank



Questions?

