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Getting to Know Another GSE: The Federal Home Loan Banks

Solutions for Affordable Housing Conference

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FHLB Chicago | Federal Home Loan Bank of Chicago

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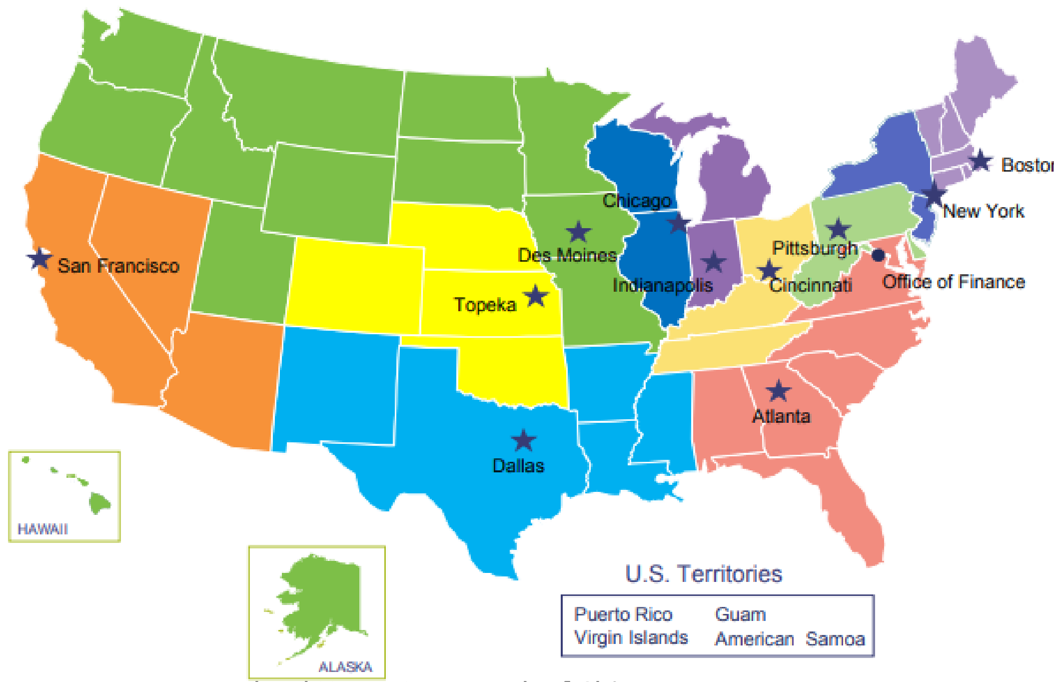
FHLB System- The Regional GSE

FHLB System Overview

The 11 FHLBanks are government-sponsored enterprises (GSEs) organized as cooperatives under an act of Congress (Federal Home Loan Bank Act of 1932)

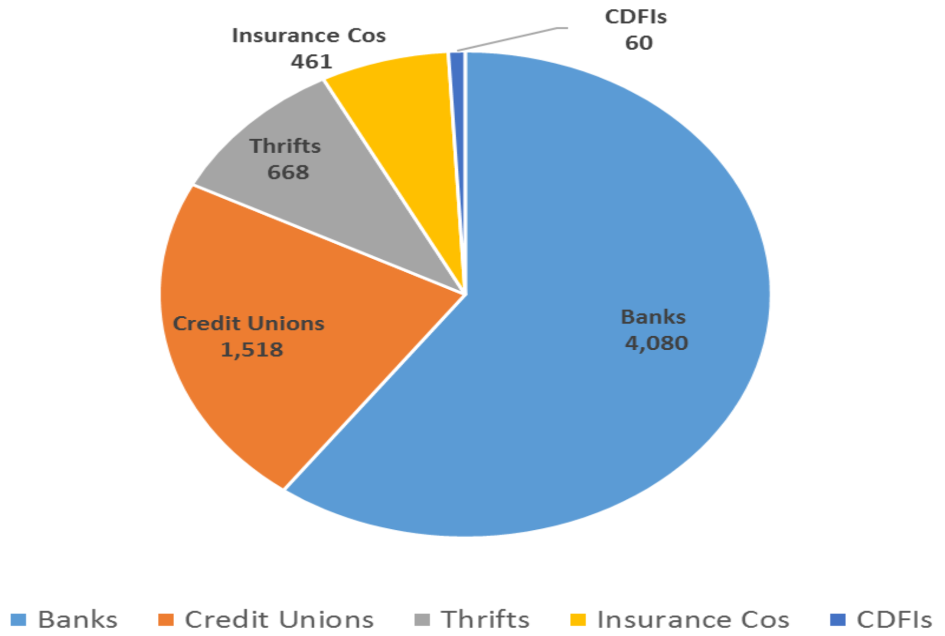
FHLBanks serve the general public by providing readily available, low-cost funding to approximately 6,800 members, thereby increasing the availability of credit for residential mortgage lending and investment in housing and community development

FHLBanks fund their operations principally through the sale of debt securities through the Office of Finance



FHLB System Membership- The Cooperative GSE

6,787 Financial Institutions are FHLB Members as of 9/30/2019



Source: FHLB Combined Financial Report, Q3 2019

★ No Credit Losses on Advances in System History ★

The "Super Lien" provides additional statutory support to the priority status of FHLBank security interests in member assets

FHLBanks perfect their secured interests in member assets and receive lien priority over other creditors, including any receiver, conservator, trustee, or similar lien creditor (Competitive Equality Banking Act of 1987)

The FHLB System- The Other GSE

($ in billions)	2014	2015	2016	2017	2018	2Q 2019
Advances (Secured Loans)	571	634	705	732	729	689
Cash & Liquidity	108	107	115	133	120	149
Term Investments	188	181	185	184	187	212
Mortgage Loans Held for Portfolio[1]	44	44	48	54	63	67
Total Assets	**913**	**969**	**1,056**	**1,103**	**1,103**	**1,122**
Retained Earnings	13.2	14.3	16.3	18.1	19.5	20.0
Total Capital (GAAP)	47	48	53	56	58	57
Regulatory Capital[2]	50	49	54	57	59	58
Regulatory Capital Ratio[3]	5.43%	5.10%	5.14%	5.17%	5.36%	5.16%
Net Income	2.3	2.9	3.4	3.4	3.5	1.6

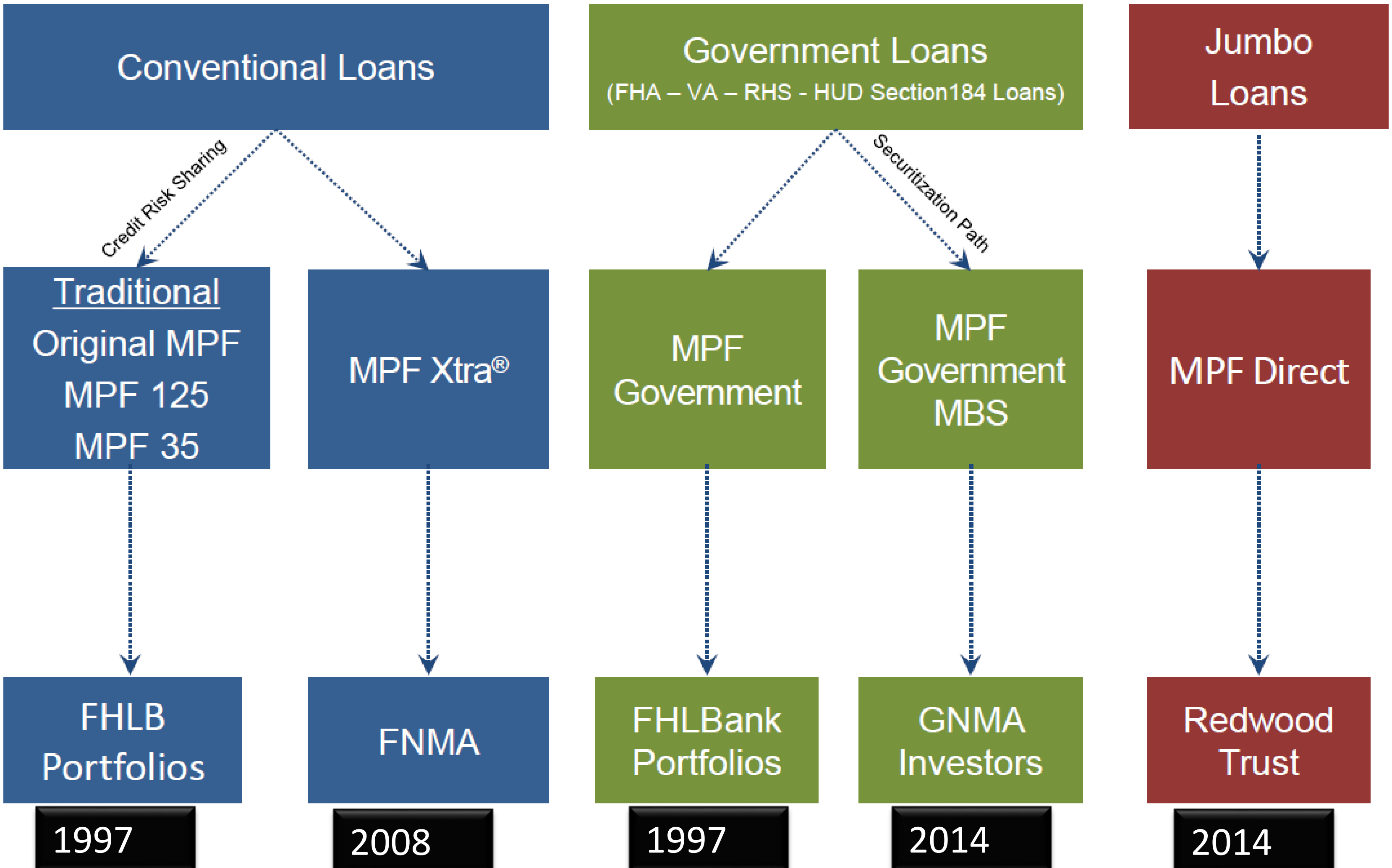
(1) MPF®/MPP

(2) The difference between total capital (GAAP) and regulatory capital relates primarily to accumulated other comprehensive income (loss), which is excluded from regulatory capital, and mandatorily redeemable capital stock, which is included in regulatory capital.

(3) Each FHLBank maintains a minimum 4% regulatory capital-to-asset ratio

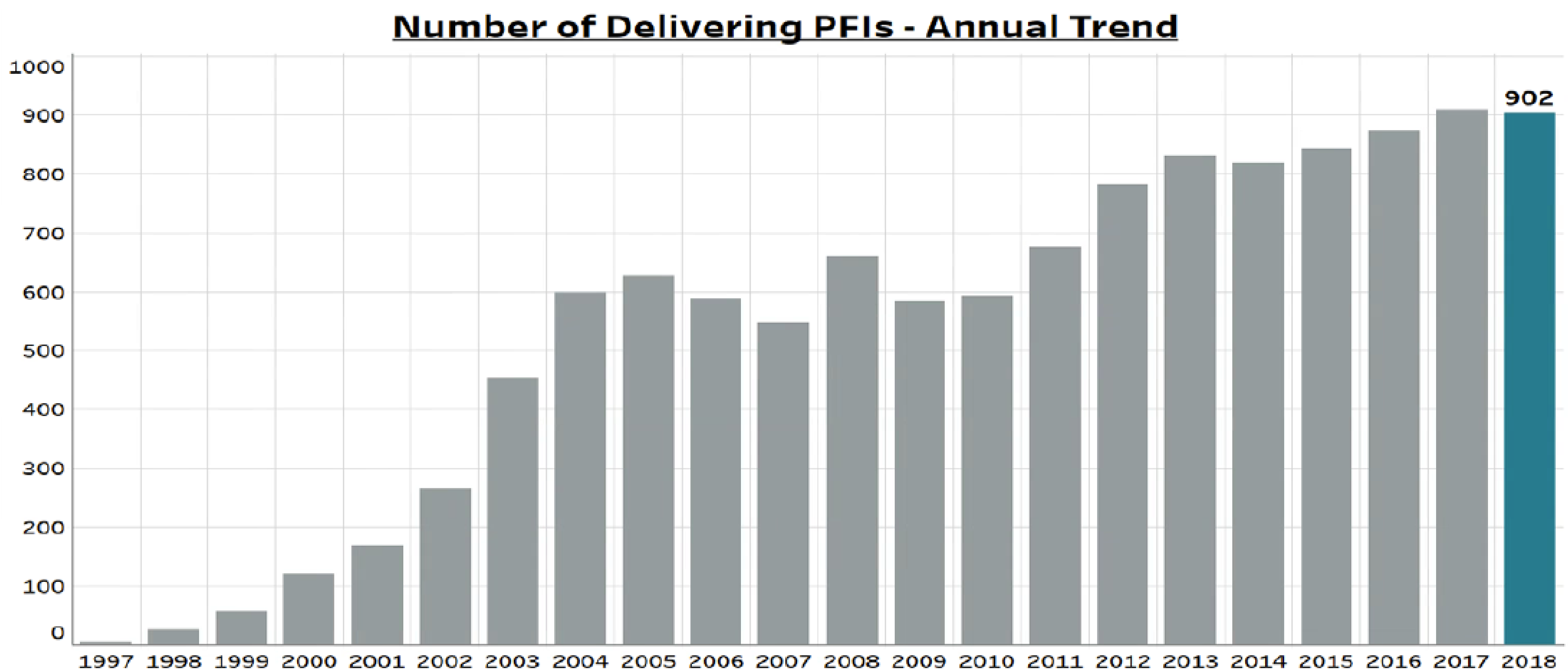
The MPF Program

MPF Products- A Broad GSE Products Platform



GSE- Active Residential Loan Sellers

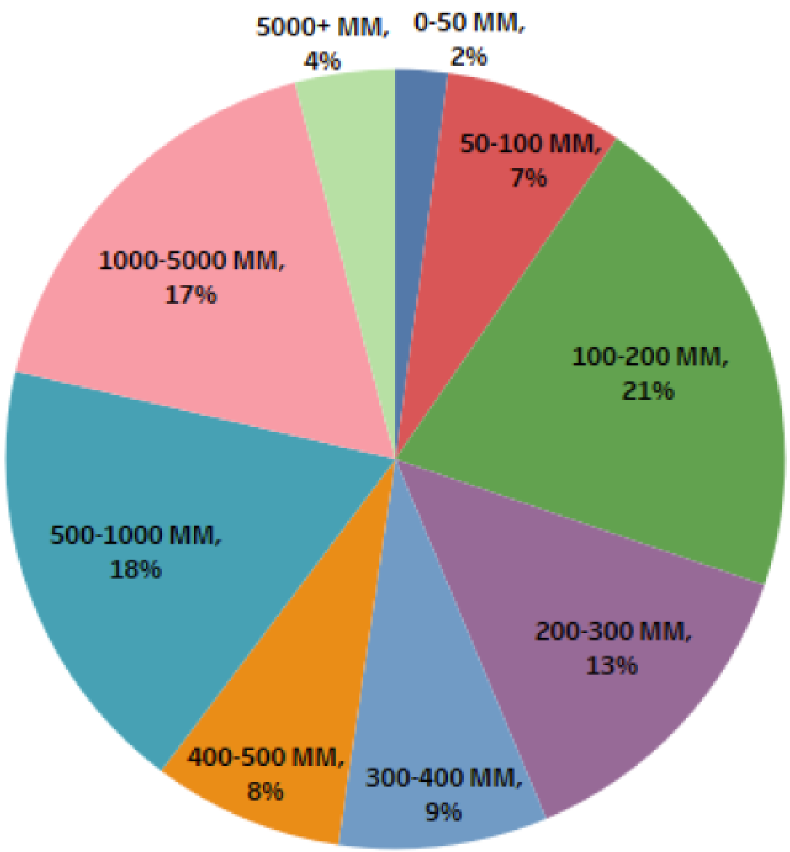
- In 2018, the FHLBanks combined had over 1000 annual loan sellers, on par with the Enterprises
- The main difference between the Banks and the Enterprises is in the average customer size and institution type (i.e. FHLBank System members only)



Source: MPF, FHLBC data; Fannie/Freddie: *Fannie Mae and Freddie Mac Single-Family Guarantee Fees in 2018*

MPF – Works for Many Different Originators

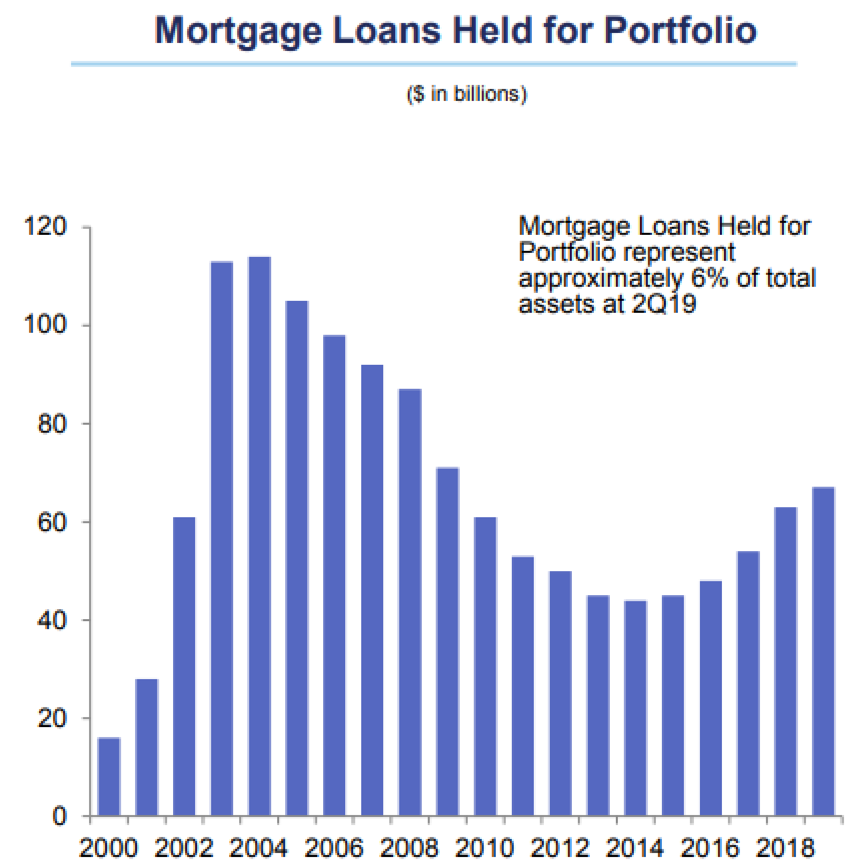
MPF Sellers by Asset Size
(January 2015- September 2019)



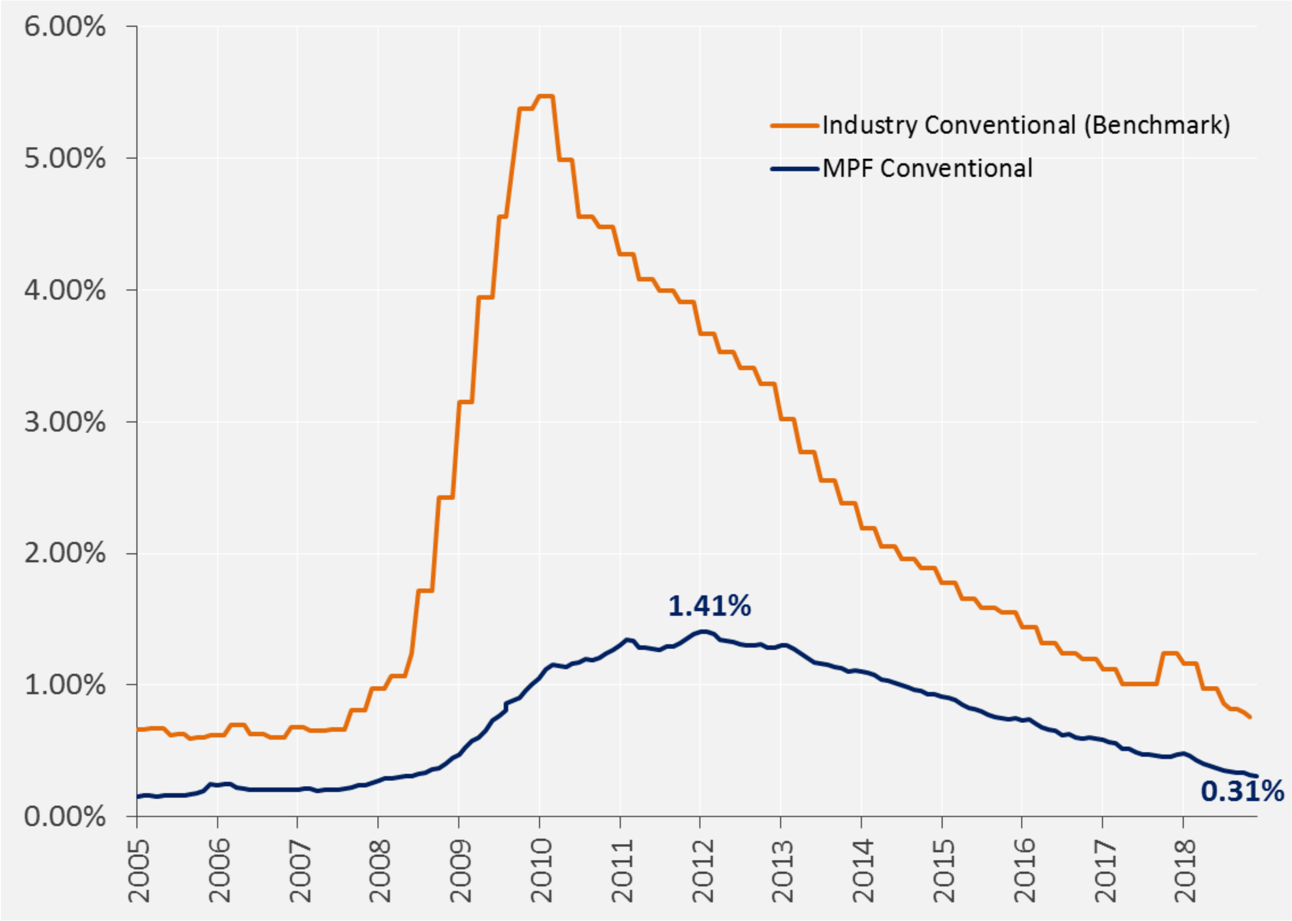
60% of PFIs are small lenders with assets of less than $500 million and a limited number of employees. The focus continues to be supporting community lending.

FHLBanks- Primarily a Portfolio (not MBS) based GSE

- MPF® (Mortgage Partnership Finance) and MPP (mortgage purchase program) were created as alternatives to traditional GSE guarantee programs
  - Members ***retain*** a portion of the credit risk and ***receive*** fees for doing so, while transferring the interest rate and funding risk to the FHLBanks
- Fund 15- to 30-yr conventional conforming and government-guaranteed fixed-rate mortgage loans secured by 1 to 4 family residential mortgages – no ARMs
  - Loans credit-enhanced to double-A equivalent
- Additional programs provide a conduit that enables members to leverage their FHLBank membership to transfer credit risk and gain access to liquidity for a variety of other loans
  - Programs available for non-agency jumbo, agency conforming, and government guaranteed loans



MPF Program Loan Performance



Community lenders produce high quality loans as can be seen in this simple snapshot of MPF delinquencies versus an industry benchmark.

MPF – A Lender Risk-Sharing Program

MPF Credit Enhancement Value for Members

(June 1997 – September 2019)

MPF Traditional loans funded	1,246,411
Loans with a Credit Loss	8,943
MPF Traditional UPB funded	$203 billion
Actual losses paid by PFIs	$38 million (2 bps)
CE fees received by PFIs	$861 million (43 bps)
Net Value for Communities	$823 million (41 bps)

MPF Risk-Sharing Products Interest-rate and Credit Risk Pricing

Best Execution Analysis - Illustrative

	MPF Original	Correspondent
Base Price	101.764	101.481
LLPAs	None	(0.75)
Credit Enhancement Fee income	0.446	None
All-In Price	**102.210**	100.731

148 bps pick-up

CE Fees and Loan Level Price Adjustments differentiate MPF Traditional products from correspondents and GSE cash windows

APPENDIX

- ❑ (My Dreams of) Housing Finance Reform via Lower Consumer Mortgage Rates by Leveling the GSE Playing Field

History of American Housing Finance

(as of November 2019)

	System	End Result
1	Building & Loan Societies	*Failed*
2	Commercial Bank Balloon Mortgages	*Failed*
3	Unhedged Residential Portfolio Lending	*Failed*
4	Private-label MBS	*Partial Fail*
5	Fannie Mae/Freddie Mac GSEs	*Partial Fail*
6	GNMA	*Successful (51 yrs)*
7	FHLB System MPF Program	*Successful (87 yrs)* *Successful (22 yrs)*

There's a difference between a plan, a proposal and a *System*

2018 Senate Draft Legislation

SEC. 402 FEDERAL HOME LOAN BANK GUARANTORS

(a) Organization.-The Agency may require each Federal Home Loan Bank to cooperate under the direction of the Agency to-

(1) jointly establish 1 or more single-family guarantors; and

(2) ensure the continued operation of any single-family guarantor established under this subsection.

(b) Activities.-Any single-family guarantor established under subsection (a) shall engage only in the business of securitizing guaranteed mortgage-backed securities secured by eligible single-family mortgage loans originated by smaller lenders or securities or other pools secured by such loans.

(c) Participation.-The Agency shall ensure that small lenders that are not eligible to become members of, or are not otherwise members of, a Federal Home Loan Bank may participate in any single-family guarantor established under subsection (a) in compliance with any regulations that the Agency might prescribe, including as to any required capital contribution or equity ownership.

(d) Joint and Several Liability.-Each Federal Home Loan Bank shall be jointly and severally liable for the obligations of any single-family guarantor established under subsection (a).

(e) Capital Structure.-The Agency may prescribe regulations governing the capital structure of any single-family guarantor established under subsection (a), including requirements or restrictions as to the ownership of equity or other interests of the guarantor by participating lenders or by entities that are not participating lenders.

2018 House of Representatives: Hensarling-Delaney-Himes Bill

Section 117. Lender Access to the Cash Window through the Federal Home Loan Banks – Requires the Federal Home Loan Bank System to operate a cash window function as a Ginnie Mae-approved issuer, allowing small- and medium-sized lenders that are members of the Home Loan Bank System to retain servicing for loans sold into the secondary mortgage market and maintain their customer relationships. A similar operational platform for issuing Ginnie Mae securities exists today via the Federal Home Loan Bank of Chicago, which currently provides access for 9 of the 11 Federal Home Loan Banks.

White House: Ginnie Mae

- Ted Tozer, GNMA's President during the Obama Administration, initially built the new partnership between GNMA and the FHLBanks
- On February 25, 2018 Michael Bright, then GNMA's EVP and COO, mentioned at the SFIG Vegas Conference that he could work with the Federal Home Loan Bank of Chicago on new GNMA risk-sharing transactions

MPF Program Product Innovations mirror GSE Reform Concepts

Concept	Product	Capital Markets Benefit
Front-end credit risk sharing (versus credit risk transfer)	**MPF Traditional products**	***Originator skin-in-the-game; originator/investor loan risk-sharing; fair credit pricing***
Expand the Ginnie Mae platform (initially through the addition of a small lender Cash Window)	**MPF Government MBS**	***More community bank and credit union servicing retained loans added into GNMA MBS (with slower prepayments and low defaults)***
Expand the non-agency Jumbo 2.0 market	**MPF Direct**	***Expanded borrower options and community bank and credit union expanded liquidity for jumbo mortgages***

Three Takeaways For Today:

1) **MPF-** The MPF Program continues to be a little-known secondary market success story
2) **GSEs**- The FHLBankss are playing an expanded role in the secondary markets mainly with community banks and credit unions, but many more lenders could benefit as well
3) **Housing Finance Reform-** Mortgage credit pricing is surprisingly uneven- and GSE Reform proposals have been surprisingly weak on *improving* the System for *borrowers*

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Q&A

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