Federal Home Loan Bank (FHLBank) Financial Data, Third Quarter, 2023

January 25, 2024

The Federal Housing Finance Agency (FHFA) has called for greater transparency in its report on FHLBank reform. The eleven FHLBanks are not normal banks – by a long shot, given their special privileges and congressional charters. Yet existing published reports from the FHLBanks make it difficult to fully understand their operations and sources of profitability. This lack of transparency makes understanding the contributions the Banks do – or don't – make to affordable housing and community development more difficult.

The data presented here were not easy to gather but should be. Going forward, quarterly reports will be published based on publicly available FHLBank financial data to support interested parties in joining a well-informed debate of the future FHLBanks' role, mission and outcomes. This quarter we have provided a very simple analysis of the FHLBanks' core business and the underpinnings of their income and dividends. The Coalition for FHLBank Reform (CFR) has published this same report at its website: https://fhlbreform.org/.

Q3 data from 2023 offers a simplified presentation of key data points for easy reference, and gives is the following insights about FHLBanks:

- They rely on a simple business model with one primary line of business (advances).
- Record profits in 2023 were driven by higher interest rates and the earnings from the investment of capital.
- Operating costs that seem on the surface efficient, but for such a simple business and with fewer than 7,000 customers, should be better explained.
- Dividend strategies varied widely by the banks.

In looking at FHLBank financials, it is important to keep in mind the following:

A simple business model

The FHLBs have one core business activity -- making secured loans (known as advances) to member financial institutions. Advances are funded through the issuance of debt in global capital markets with purchasers viewing the debt as implicitly guaranteed by the US government. Income generated by lending to members is augmented through significant investments (including investments required by the FHFA in order to meet liquidity requirements) and a relatively small program to purchase mortgage loans from members. Advances represent somewhere between 60 and 70 percent of assets, short and long-term investments between 20 and 30 percent of assets, and purchased mortgage loans comprising 4 percent of assets.

Income

Based on the $5 billion in earnings for the first nine months of 2023, the FHLBanks are projected to have annual earnings of approximately $7 billion in 2023 -- a record high. Employing a combination of published financial results and our general knowledge of the FHLBanks, we estimate that in the first three quarters of 2023, invested capital generated 41 percent of net interest income (NII). The advances portfolio, despite being 12 times larger, generated 33 percent of NII. Long-term investments were 18 percent of NII and purchased mortgages were 5 percent with short-term investments at 2 percent.

The tax-exempt FHLBanks' net interest income is the earned spread between the yield on assets and the government-supported cost of their debt. These assets and estimated spreads include:

> Advances: This spread is currently between 25 basis points and 30 basis points on loans to members. This spread varies from FHLBank to FHLBank and will impact, among other things, the contributions FHLBanks make under their Affordable Housing Program (AHP).
>
> Investments of capital: The largest share of income comes from the investment of capital which is comprised of member capital stock and retained earnings. Because FHLBanks do not have to issue debt for capital-supported investments, there is greater profit.
>
> Mortgages purchased from members: roughly 70 basis points on purchased mortgage loans.
>
> Long term investments: spread estimated at roughly 70 basis points.

Higher interest rates result in higher profit: Two years ago, when short-term rates were near zero, earnings on invested capital were low. Now, with short-term interest rates around 5 percent, the investment of capital has become the largest source of income.

Operating efficiency: The FHLBanks highlight that their operating expenses are roughly $1,000 per million dollars of assets. This seems impressive as a typical retail bank has costs 20 to 30 times that; however, FHLBanks have fewer than 7,000 financial institution customers, no branches and many tens of thousands fewer employees than traditional banks of the same size. It is not a fair comparison. FHLBanks spend almost $200,000 per customer!

Dividends: While FHLBanks all issue debt jointly and offer the same narrow range of products, the rate of dividends varies widely from FHLBank to FHLBank. Why do these dividends vary to such a degree? The current dearth of easily accessible data makes that determination very difficult to make.

The FHLBanks pay quarterly dividends to members. In the first nine months of 2023, $2.45 billion has been paid to stockholders. The rate of dividends when compared as a spread to short-term interest rates (Fed Funds) range from 25 to 350 basis points. Seven of the eleven banks pay at least Fed Funds plus 200 basis points. Clearly, the 'fee' for gaining access to the FHLB's invaluable services (as described by members and the FHLBs themselves) is not a fee at all, but another source of income.

George Collins, Consultant and former FHLBank Executive
Peter Knight, Cofounder of Policy Kinetics
Peggy Kuhn, Cofounder of Policy Kinetics