Federal Home Loan Bank of San Francisco — 1999 Annual Report

home

" We bring credit home."

Financial Highlights

(Dollars in thousands)	1999	1998	1997	1996	1995
Selected Items at Yearend					
Total Assets	$115,912,047	$81,123,903	$60,846,583	$52,186,715	$51,139,451
Advances	90,513,829	63,989,305	49,272,904	39,184,189	25,626,434
Mortgage-Backed Securities	7,048,793	5,670,246	5,639,169	5,609,517	5,334,496
Resale Agreements	2,558,885	2,226,625	1,174,920	3,227,395	7,471,471
Federal Funds Sold	8,636,000	4,894,000	2,329,000	1,640,000	6,997,000
Other Non-MBS Investments	5,035,236	2,705,565	1,116,618	1,455,557	4,684,857
Consolidated Obligations	107,402,435	73,960,601	55,380,528	47,431,088	45,752,887
Capital	5,438,399	4,435,302	3,544,880	3,150,392	2,718,994
Tangible Capital to Assets Ratio	4.69%	5.47%	5.83%	6.04%	5.32%
Average Annual Margins and Costs					
Net Interest Margin	0.41%	0.49%	0.56%	0.53%	0.46%
Adjusted Net Interest Margin*	0.42	0.51	0.58	0.56	0.49
Other Operating Expenses as a Percent of Average Assets	0.04	0.05	0.05	0.06	0.06
Annual Operating Results					
Net Income	$ 332,553	$ 294,066	$ 249,072	$ 219,457	$ 199,891
Return on Average Assets	0.35%	0.43%	0.46%	0.44%	0.42%
Return on Average Equity	6.87	7.54	7.44	7.60	7.42
Dividend Rate	5.36	5.76	6.10	6.11	4.90
Adjusted Annual Operating Results*					
Adjusted Net Income	$ 337,116	$ 279,925	$ 258,563	$ 226,906	$ 187,319
Adjusted Return on Average Assets	0.35%	0.41%	0.47%	0.45%	0.39%
Adjusted Return on Average Equity	6.96	7.18	7.73	7.86	6.95

*Adjusted financial performance measures reflect the recognition of advance prepayment fees over the term of prepaid advances rather than at the time of prepayment. Extraordinary and other nonrecurring gains and losses are similarly adjusted to provide financial performance measures that are more meaningful when comparing results to those from other time periods.

The mission of the Federal Home Loan Bank of San Francisco is to enable families and individuals of all income levels to obtain quality housing and become homeowners by providing wholesale products and services that help member financial institutions expand the availability of mortgage credit, compete more effectively in their markets, and foster strong and vibrant communities.

For the Federal Home Loan Bank of San Francisco, 1999 was a year of significant accomplishment.

The most important achievement of the year was our success in fulfilling our public policy mission, as demonstrated by the dramatic increase in credit extended to community-oriented housing lenders. Advances outstanding to members increased 41% in 1999, reaching a record $90.5 billion by yearend. In a year of continued prosperity, our members expanded their lending activities significantly and, once again, turned to the Bank to obtain low-cost funding needed to meet the credit needs of their communities. Not surprisingly, the Bank's largest members continued to account for most of the growth in member credit during the year. Of the Bank's 262 members, 189 had advances outstanding during 1999, and 121 increased their Bank borrowings between yearend 1998 and 1999.

Total assets grew 43%, to $115.9 billion at December 31, 1999, another historic record for the Bank. In addition to extending more credit to members, we increased our investment portfolio, primarily with short-term investments, to support the overall growth of the Bank and prepare for members' potential yearend liquidity needs.

As it turned out, there was no yearend liquidity crunch for our members, and Y2K posed no problems for the Bank. We maintained ample liquidity throughout the period and provided a full range of products and services before and after the century rollover. The hard work that went into that effort not only paid off in the short run, but will also yield long-term benefits as we build on this experience to enhance our standard disaster recovery program.

Because we fulfill our housing mission only with and through our members, we are always seeking to add new members that can use our products and services to serve their communities. We were pleased to welcome 51 new members to the Bank in 1999, representing a wide variety of communities throughout the 11th District. By yearend, our membership base had grown to 262, the largest number in the Bank's history, comprising 165 commercial banks, 50 savings institutions, 34 credit unions, and 13 industrial loan companies.

The Bank celebrated another significant milestone in 1999 — the tenth year of the Affordable Housing Program. In June, staff from the Bank and several of our members marked this occasion by teaming up with Habitat for Humanity — Los Angeles to raise the walls of one of the last homes to be built in a 26-home subdivision in Watts. Part of a Systemwide initiative, the effort exemplified the partnerships forged through the Affordable Housing Program to create affordable homeownership opportunities for lower-income families and individuals.

During the year, the Bank awarded $32.1 million in AHP subsidy to 130 projects, the largest amount of subsidy and the largest number of projects in the program's history. These awards will help over 5,800 very low- to moderate-income households obtain quality rental housing or purchase a home of their own. With the completion of the Affordable Housing Program's first decade, the Bank has awarded a total of $169 million to 844 innovative programs, helping to meet the housing needs of over 37,000 families and individuals in communities served by the Bank's members.

To improve return on equity, in April 1999 the Bank implemented a new policy requiring members to redeem surplus capital stock on a quarterly basis. Members redeemed a total of $575.5 million in capital stock in 1999, including $413.4 million redeemed as a result of the new policy. Because of the tremendous growth in advances outstanding, the addition of new members, and the retention of earnings in 1999, however, total capital grew $1.0 billion during the year and reached $5.4 billion at December 31, 1999.

In May 1999, the Bank sold its headquarters building in San Francisco and leased back the space it occupies for a term of ten years. The Bank realized a gain of $24.1 million, most of which will be recognized over the remaining term of the Bank's 10-year lease.

Composition of assets
December 31, 1999
(in billions)

The Bank turned in a solid financial performance in 1999. Net interest income was $387.0 million, an increase of 17% over 1998, primarily as a result of growth in advances, investments, and capital. Net income totaled $332.6 million for the year, an increase of 13% relative to 1998. Net income included net recognized gains of $4.6 million from the sale of the building and a net one-time gain of $10.5 million from the reversion of surplus assets from the Bank's pension plan. Adjusted net income totaled $337.1 million, a 20% increase from the $279.9 million earned in 1998. The Bank's adjusted return on equity for 1999 was 6.96%, declining from 7.18% in 1998 as a result of a lower net interest margin. These financial results, combined with a drop in the Federal Home Loan Bank System's REFCORP assessment rate, enabled the Bank to pay an annual dividend of 5.36% and retain earnings of $34.0 million in 1999.

During the year, we continued planning for the implementation of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," which will become effective for the Bank on January 1, 2001. The Bank has not yet determined the full effect that SFAS No. 133 will have on its earnings or statement of financial position. The accounting requirements of the new standard may, however, have a significant negative effect on earnings and other comprehensive income (a component of capital). As of December 31, 1999, the Bank's restricted retained earnings included $27.9 million voluntarily restricted by the Bank to provide financial flexibility and in anticipation of the possible effect of implementing SFAS No. 133.

The 1999 accomplishment that will have the greatest long-term effect on the Bank is the passage of the Federal Home Loan Bank System Modernization Act of 1999. Enacted on November 12, 1999, as Title VI of the Gramm-Leach-Bliley Act, the Modernization Act achieves key objectives the Bank has long supported — universal voluntary membership, increased access to Bank products and services, capital reform, revision of the REFCORP assessment formula, and reassignment of many corporate governance responsibilities from the Federal Housing Finance Board to the Federal Home Loan Banks. While the beneficial effects of this far-reaching law are numerous, it will pose immediate challenges for the Bank as we implement new membership and collateral requirements, come to terms with the immediate impact of a higher REFCORP assessment rate, and develop a new capital structure for the Bank.

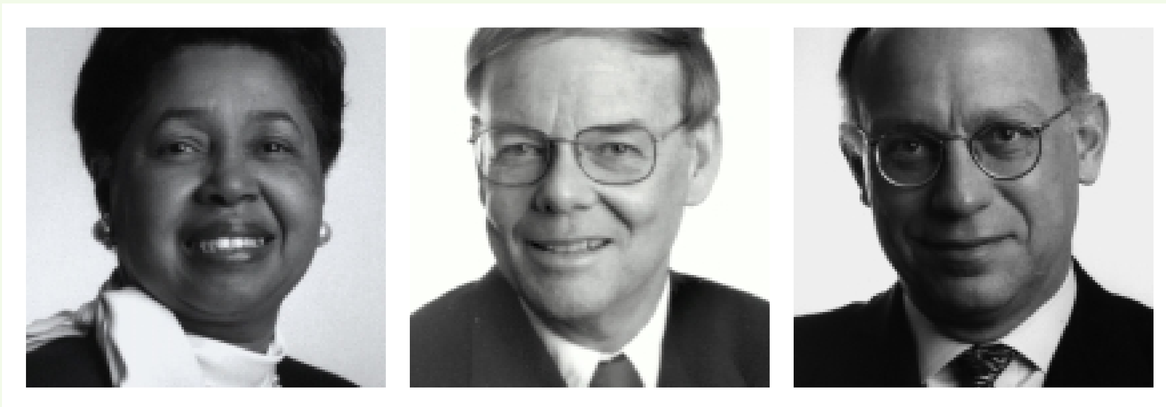
We expect that our greatest challenge over the next two years will be to develop a capital plan that allows us to provide an appropriate return to our members as shareholders while continuing to deliver competitively priced advances that support their lending efforts. Because we view providing advances to members as the primary way in which we fulfill our public policy mission, we seek to offer members the opportunity to borrow at consistently low advance prices while paying a dividend that represents a reasonable risk-adjusted return on their capital investment in the Bank. The parameters of the capital structure established by the law and the implementing regulations will present new opportunities and new complexities in how we meet our members' needs as shareholders and customers of the Bank.

We would like to express our deep appreciation to the Bank's directors for their leadership and guidance throughout the year. In particular, we would like to thank Charles R. Rinehart and David T. C. Wright, who left the board during the year, and to welcome John J. Gisi and D. Tad Lowrey.

In addition, we would like to acknowledge the invaluable contributions of the Bank's Affordable Housing Advisory Council to the ongoing development of our community investment programs. We thank outgoing member Bill Rumpf and welcome Carol Galante to the Council in 2000.

We also commend the Bank's employees for the extraordinary spirit of dedication and teamwork they displayed throughout the year. Their creativity, ingenuity, and hard work made the Bank's achievements in 1999 possible. We would also like to thank Patrick J. Conway for his 25 years of service to the Bank and congratulate him on his appointment as president of the Federal Home Loan Bank of Des Moines.

Above all, we thank you, our members, both as shareholders and as customers. Your investment in the Bank and your use of our credit products and services allow us to succeed financially and to achieve our public policy purpose. Through you, we bring credit home to the communities and people you serve throughout Arizona, California, and Nevada and in other regions nationwide.

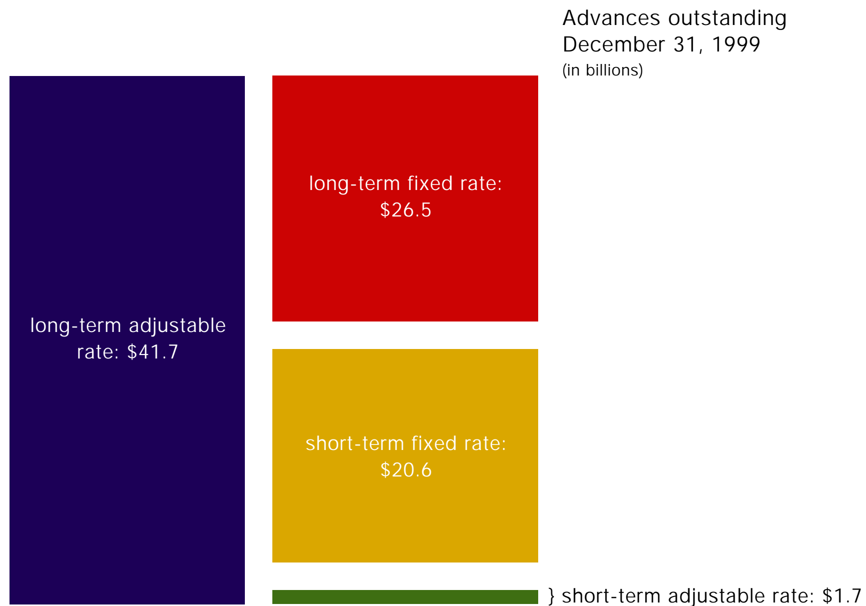


Mary Lee Widener
Chairman of the Board

J. Lance Erikson
Vice Chairman of the Board

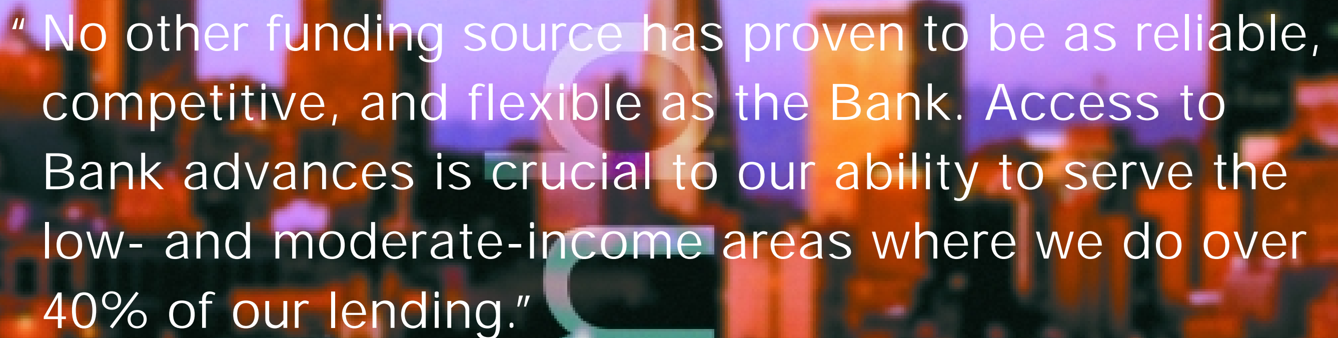
Dean Schultz
President and Chief Executive Officer

As credit demand continues to outpace deposit growth at many financial institutions, members turn to the Bank as an invaluable source of competitively priced wholesale funds to help them manage liquidity, finance asset growth, reduce interest rate risk, and meet community credit needs.



Headquartered in Whittier, California, Quaker City Bank has $1.1 billion in assets and offers a full range of deposit and credit products through 14 branches in northern Orange County and eastern Los Angeles County, including 3 slated to open in Wal-Mart stores early in 2000. "Most of our lending is urban lending," says Rick McGill, President of Quaker City. "In addition to single-family loans, we originate a significant amount of multifamily loans, mostly for small apartment complexes with 10 to 25 units. Low-cost, term advances from the Bank provide the critical liquidity we need to fund our operations."

Quaker City uses fixed, adjustable, and putable advances, and has used the Bank's standby letter of credit to support the issuance of tax-exempt bonds for earthquake rehabilitation loans. In 1999, Quaker City was one of 111 members that signed up for the Y2K Liquidity Commitment. "We trusted the Bank to meet our needs if there were a credit shortage," says Mr. McGill. "In prior periods of tight credit, we have seen other funding sources disappear, but the Bank has always been there for us."



“ No other funding source has proven to be as reliable, competitive, and flexible as the Bank. Access to Bank advances is crucial to our ability to serve the low- and moderate-income areas where we do over 40% of our lending.”

Rick McGill, President, Quaker City Bank

members

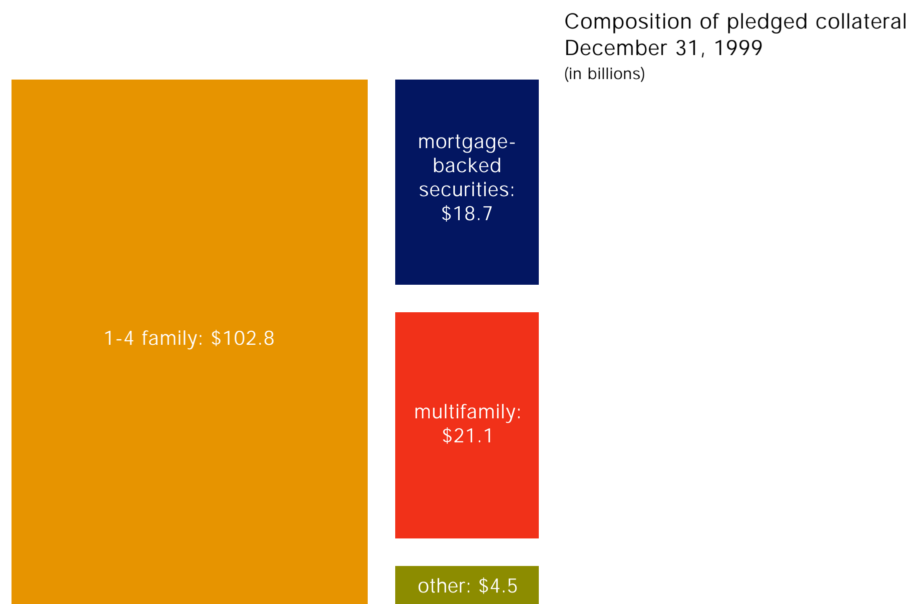
communities

" Rural communities are often hard-pressed to find the credit resources they need, and so are we. The Bank is our only source for long-term, fixed rate funds. We use Bank advances to finance loans that we just couldn't make without them."

Robert Lowery, President and Chief Executive Officer,
Kings River State Bank

Flexibility is essential in extending credit to diverse communities throughout the 11th District. Because Bank members can use loans held in portfolio as collateral for Bank advances, they can make loans that could not be readily sold into the secondary market but meet the needs of traditionally underserved communities.

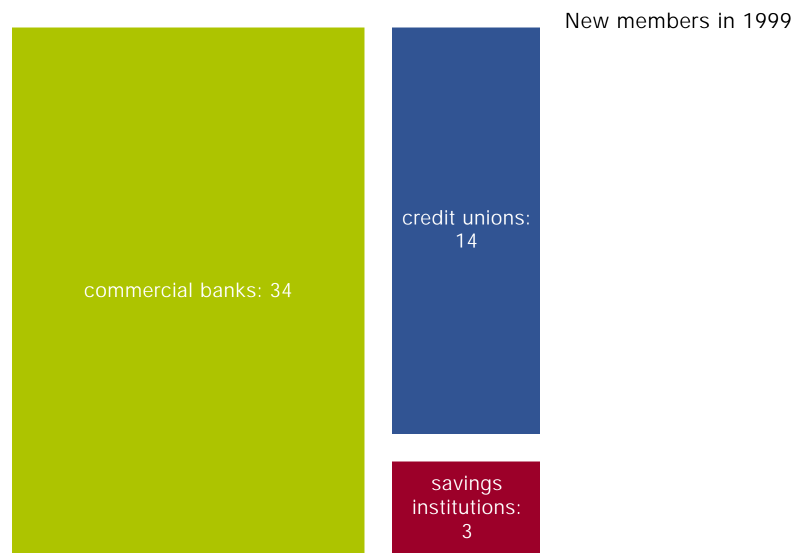
Composition of pledged collateral
December 31, 1999
(in billions)



While the nation enjoys an ongoing economic boom and the lowest unemployment rates in decades, many rural areas continue to experience double-digit unemployment and a lower median income than the national averages might imply. Access to credit is especially critical to rural communities like those served by Kings River State Bank in the central California counties of Fresno, Kings, and Tulare. With $108 million in assets and four branches, Kings River provides single-family, multifamily, and commercial real estate loans, small business and agricultural loans, and a complete range of consumer lending products. Kings River also makes relatively small, but indispensible, loans to small farmers to enable them to improve their fields, install irrigation systems, or purchase much-needed agricultural equipment.

"There's no easy credit out here for multifamily lending or agricultural equipment lending," says Robert Lowery, President and Chief Executive Officer of Kings River. "Thanks to the Bank, we can offer a full range of credit products, at reasonable rates, including options that no one else in our region is offering."

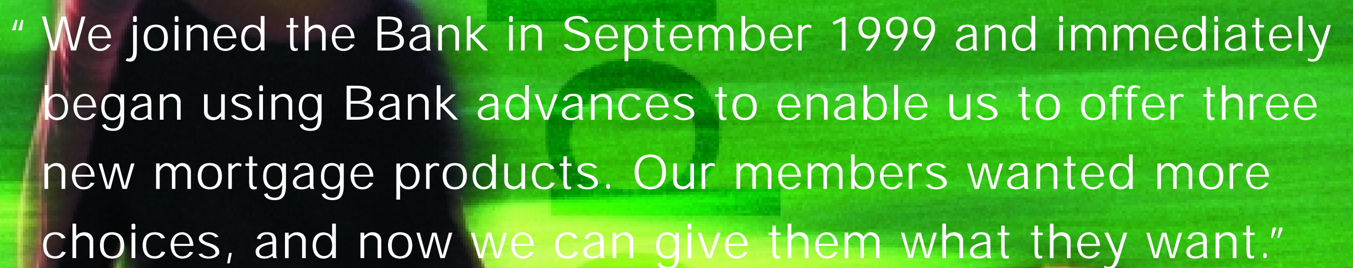
Each new member that joins the Bank represents a new opportunity to serve people in Arizona, California, and Nevada. These people — families and individuals of all income levels and all walks of life — are the ultimate beneficiaries of the Bank's public policy mission.



With assets of $83 million, USC Federal Credit Union provides a full range of deposit and credit services to the faculty, staff, and students of the University of Southern California. "Our members want very different things from us because they are at different stages in their lives or in different income brackets," says Steven Velasquez, Vice President and Chief Financial Officer at USC FCU. "One of the ways we are using Bank advances is to finance mortgages that convert from a fixed to an adjustable rate, a product in which our members had expressed strong interest."

USC FCU is also using Bank advances to manage the liquidity fluctuations associated with funding student loans. In addition, since joining the Bank, USC FCU has started retaining more mortgages in portfolio and retaining student loans longer, both of which are contributing to the institution's profitability. Because of the institution's cooperative nature, these improvements in financial management directly benefit its members. "We are very pleased that we joined the Bank," says Mr. Velasquez, "because access to the Bank's products and services is helping us do a better job of serving our members."

people



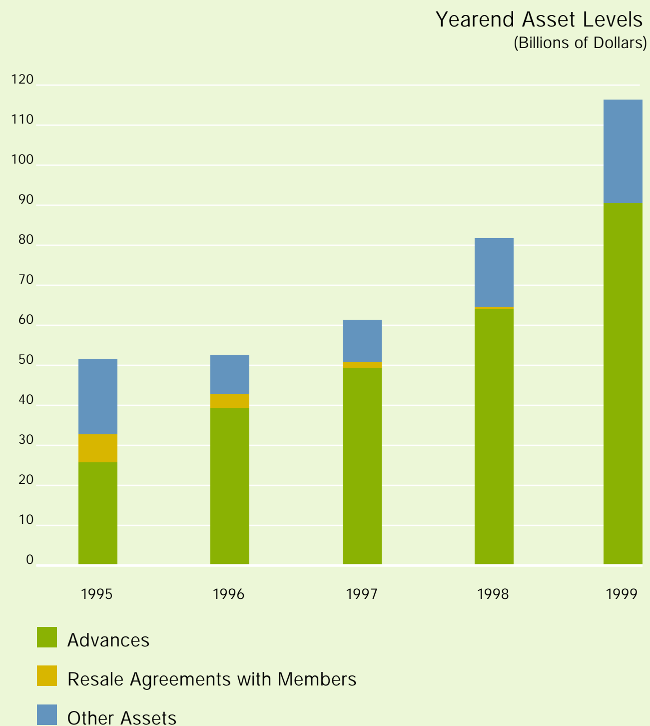
"We joined the Bank in September 1999 and immediately began using Bank advances to enable us to offer three new mortgage products. Our members wanted more choices, and now we can give them what they want."

Steven Velasquez, Vice President and Chief Financial Officer, USC Federal Credit Union

Statements contained in this report, including statements describing the objectives, projections, estimates, or predictions of the future of the Bank, may be "forward-looking statements." These statements may use forward-looking terms, such as "anticipates," "believes," "could," "estimates," "may," "should," "will," or their negative or other variations on these terms. The Bank cautions that, by their nature, forward-looking statements involve risk or uncertainty and that actual results could differ materially from those expressed or implied in these forward-looking statements or could affect the extent to which a particular objective, projection, estimate, or prediction is realized. These forward-looking statements involve risks and uncertainties including, but not limited to, the following: economic and market conditions; volatility of market prices, rates, and indices; political, legislative, regulatory, or judicial events; competitive forces; changes in investor demand for consolidated obligations and/or the terms of interest rate exchange agreements and similar agreements; timing and volume of market activity; and inflation.

The Year in Review

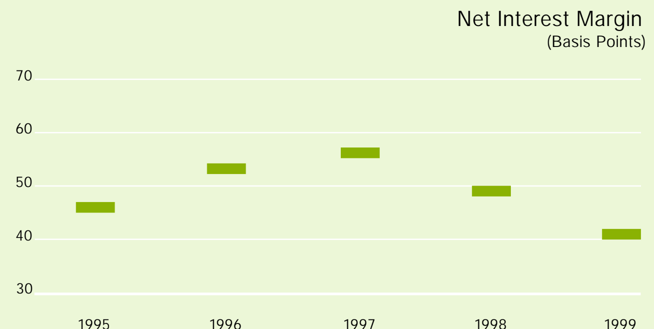
The Bank's advances and total assets grew in excess of 40% during 1999, to record levels of $90.5 billion and $115.9 billion, respectively. Advances increased $26.5 billion, or 41%, and assets increased $34.8 billion, or 43%. In addition to extending additional credit to members, the Bank increased short-term investment levels 65% during 1999, to $16.2 billion, to support the overall growth of the Bank and in preparation for the potential increase in members' yearend liquidity needs.



Net interest income increased by $55.7 million, or 17%, to $387.0 million, primarily as a result of the growth in advances, money market investments, and member capital. The Bank's net income also included a one-time gain of $10.5 million from the reversion of surplus assets from the spin-off/termination involving the Bank's cash balance plan. In addition, the sale of the Bank's San Francisco office building resulted in a gain of $24.1 million. A portion of this gain, $4.6 million, was recognized in 1999, and the remaining $19.5 million was deferred and will be amortized to other income over the remaining term of the Bank's 10-year leaseback of the space the Bank occupies. These factors, partially offset by a decrease of $22.6 million in advance prepayment fees, resulted in net income of $332.6 million, an increase of $38.5 million, or 13%, for the year. The return on equity (ROE) was 6.87%, 67 basis points lower than in 1998, primarily as a result of lower average interest rates and lower profit spreads on advances. The higher earnings of the Bank and of the other 11 Federal Home Loan Banks (FHLBanks) in the aggregate lowered the Bank's Resolution Funding Corporation (REFCORP) effective assessment rate relative to the prior year. These results enabled the Bank to pay an annual dividend of 5.36% for 1999 and retain earnings of $34.0 million.

Results of Operations

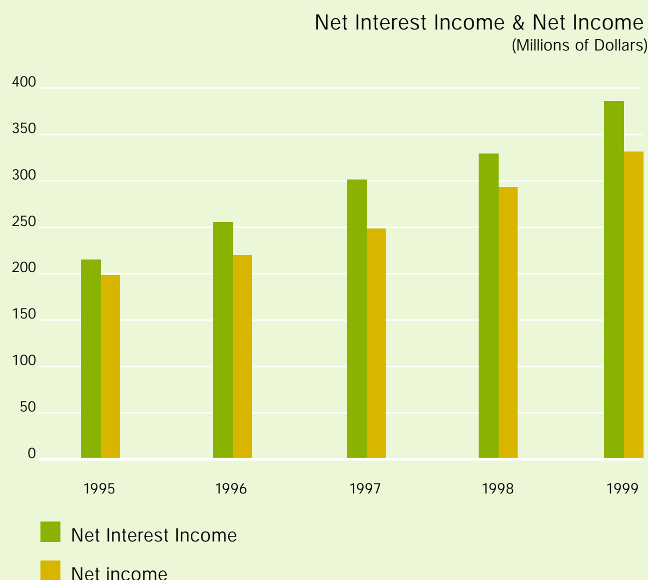
Net Interest Income. Net interest income rose $55.7 million, or 17%, to $387.0 million in 1999. Average interest-earning assets increased $26.9 billion, while the net interest margin decreased by 8 basis points, to 41 basis points in 1999 from 49 basis points in 1998. This decrease was primarily due to lower profit spreads on advances resulting from increased competition in the capital markets, lower earnings on invested capital as a result of lower average interest rates during 1999, and an increase in the ratio of assets to capital. The average yield on interest-earning assets in 1999 was 5.35%, compared to 5.68% in 1998, a decrease of 33 basis points. The average cost of interest-bearing liabilities decreased 29 basis points, to 5.23% in 1999 from 5.52% in 1998.



Non-Interest Income. Non-interest income consists primarily of prepayment fees collected from members, fees earned on letters of credit, lease income net of related expenses from the Bank's office building in San Francisco (before the building sale), and recognized gains from the spin-off/termination involving the Bank's cash balance plan and the sale of the Bank's office building. Non-interest income decreased to $20.0 million in 1999 from $30.4 million in 1998. Prepayment fees decreased to $2.1 million in 1999 from $24.7 million in 1998, as $0.5 billion of advances were prepaid in 1999, compared to $5.2 billion in 1998. The one-time gain from the spin-off/termination involving the Bank's cash balance plan totaled $10.5 million, and recognized gains from the sale of the Bank's building totaled $4.6 million in 1999, partially offsetting the lower prepayment fees.

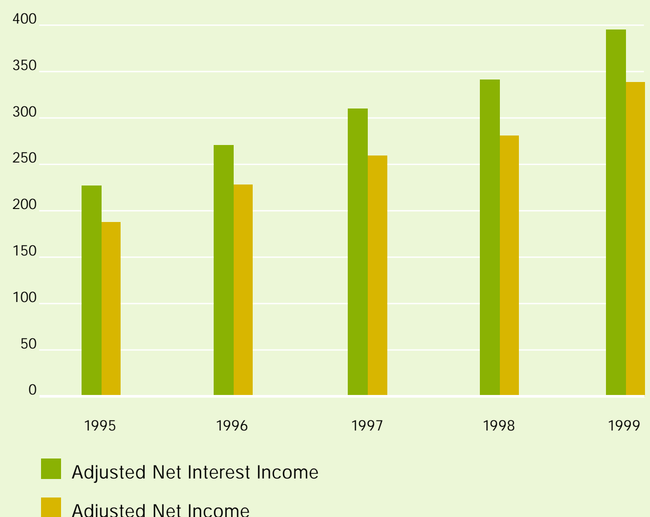
Non-Interest Expense. Non-interest expense increased to $75.8 million in 1999 from $67.7 million in 1998, primarily because of a $3.6 million increase in the Bank's operating expenses and a $4.3 million increase in the Bank's statutory contribution to the Affordable Housing Program (AHP), which resulted from higher earnings in 1999.

Operating expenses increased 10% in 1999, primarily as a result of a $2.7 million increase in salaries and benefits. In addition, occupancy expenses increased $0.5 million as a result of the sale of the Bank's office building and subsequent leaseback of space the Bank occupies. However, because average assets increased 40% in 1999, the Bank's ratio of operating expenses to average assets declined to 4.0 basis points in 1999 from 5.1 basis points in 1998.



Adjusted Financial Performance. The Bank also calculates adjusted financial performance measures that are used by the 12 FHLBanks to provide a more meaningful comparison of the FHLBanks' financial results over time. These measures reflect earnings before advance prepayment fees, extraordinary gains and losses associated with the early retirement of debt, and other nonrecurring gains and losses related to financial instruments, net of the current amortization of prior period prepayment fees, gains and losses on debt retirement, and other nonrecurring transactions. These adjustments are made in order to recognize prepayment fees, debt retirement gains and losses, and other nonrecurring transactions over the periods remaining through the related instruments' original maturity dates.

Adjusted net interest income rose to $394.0 million in 1999 from $339.9 million in 1998, a 16% increase. This improvement contributed to a 20% increase in adjusted net income, to $337.1 million in 1999 from $279.9 million in 1998. Adjusted ROE decreased by 22 basis points, to 6.96% in 1999 from 7.18% in 1998, primarily because of lower average interest rates during 1999, which resulted in lower earnings from invested capital.



REFCORP and AHP Assessments. Through 1999, the 12 FHLBanks combined were required to pay $300 million per year toward the interest charges on REFCORP debt. These REFCORP payments were recorded as distributions of capital. Initially, each FHLBank was assessed an equal percentage, up to 20%, of its annual net income. If the 20% assessment was not sufficient to pay the full $300 million, the "shortfall" was allocated among the FHLBanks according to each FHLBank's share of total System advances during the previous year to members of the Savings Association Insurance Fund. (See "Revised REFCORP Assessment" on page 20 for a discussion of the impact the Federal Home Loan Bank System Modernization Act of 1999 will have on the REFCORP assessment

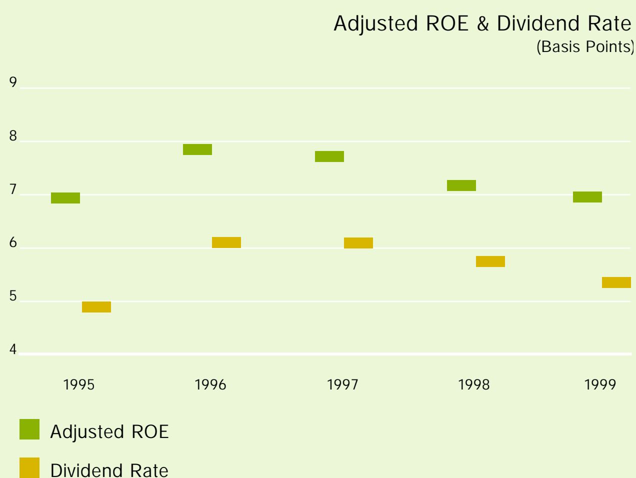
beginning in 2000.) The Bank's REFCORP assessment in 1999 totaled $47.7 million, 14.3% of the Bank's net income, compared to an assessment of $48.5 million in 1998, 16.5% of the Bank's net income. High earnings for the System as a whole in both 1999 and 1998 enabled the FHLBanks to meet the $300 million annual assessment without a shortfall allocation.

Annually, the FHLBanks must set aside for their AHPs, in the aggregate, the greater of $100 million or 10% of each year's income before charges for the AHP but after capital distributions to REFCORP. To the extent that the aggregate 10% calculation is less than $100 million, the shortfall is allocated among the FHLBanks based on the ratio of each FHLBank's income before AHP and REFCORP to the sum of the net incomes before AHP and REFCORP of the 12 FHLBanks. There was no shortfall in 1999 and 1998. The Bank set aside $31.7 million for the AHP in 1999, compared to $27.4 million in 1998, reflecting the higher earnings recognized by the Bank in 1999.

The Bank's total REFCORP and AHP assessments equaled $79.4 million in 1999, compared with $75.9 million in 1998, resulting in an effective "tax" rate on preassessment income of 22%, compared to 24% in the prior year.

Dividends. In 1999, the Bank paid $254.5 million in dividends, an average annual rate of 5.36%. In 1998, dividends totaled $220.9 million, an average annual rate of 5.76%. All dividends except fractional shares were paid in the form of capital stock. Although the total amount the Bank paid in dividends was higher in 1999, the dividend rate declined by 40 basis points because of lower average interest rates, which resulted in lower earnings on invested capital, and the retention of earnings in 1999.

Adjusted ROE & Dividend Rate
(Basis Points)



The Bank is required by Finance Board dividend policy to retain in restricted retained earnings that portion of income from prepayment fees that, if allocated on a pro-rata basis over the maturity of the advances prepaid, would be allocated to future dividend periods. In addition, other gains and losses related to the termination of interest rate exchange agreements and early retirement of consolidated obligations are similarly treated. These restricted retained earnings will be transferred to unrestricted retained earnings on a pro-rata basis over the original terms of the prepaid advances, interest rate exchange agreements, or consolidated obligations. Retained earnings restricted in accordance with this policy totaled $10.7 million and $14.4 million at December 31, 1999 and 1998, respectively.

To provide financial flexibility and in anticipation of the possible effect of implementing SFAS No. 133 (see "Recently Issued Accounting Standard" on page 19), the Board of Directors authorized the transfer of certain amounts from unrestricted retained earnings to restricted retained earnings in 1998 and 1999. During the fourth quarter of 1998, the Bank transferred $16.3 million, the amount of unrestricted retained earnings as of September 30, 1998, to restricted retained earnings. In addition, during 1999, the Bank transferred, net of applicable assessments, the one-time gain of $8.1 million from the spin-off/termination involving the Bank's cash balance plan and recognized gains totaling $3.5 million from the sale of the Bank's office building to restricted retained earnings. Retained earnings restricted by the Board of Directors totaled $27.9 million and $16.3 million at December 31, 1999 and 1998, respectively.

In addition to the retained earnings restricted by the Board of Directors, earnings of $22.3 million in 1999 and $3.1 million in 1998 were also retained in unrestricted retained earnings. If the Bank had paid the retained earnings restricted by the Board of Directors and the unrestricted retained earnings in dividends, the Bank's dividend rate would have been 6.08% for 1999 and 6.10% for 1998.

Financial Condition

Total assets grew 43% during the year, to $115.9 billion at December 31, 1999, from $81.1 billion at December 31, 1998, and average total assets rose 40% in 1999, to $95.9 billion from $68.6 billion in 1998.

Advances. Member advances outstanding increased 41% in 1999, from $64.0 billion at December 31, 1998, to $90.5 billion at December 31, 1999, a new all-time high for the Bank. This growth, which continued a trend that began in 1996, caused average advances to members to increase 41% compared to the prior year, to $74.7 billion in 1999 from $52.9 billion in 1998. Strong member asset growth, combined with the Bank's competitive pricing strategies, caused members to increase their Bank borrowings, primarily with long-term adjustable rate advances. While many members lengthened maturities and

Average Balance Sheets

For the Years Ended December 31, 1999 and 1998	1999			1998		
(*Dollars in millions*)	Average Balance	Interest Income/ Expense	Average Rate	Average Balance	Interest Income/ Expense	Average Rate
Assets						
Interest-earning assets:						
Interest-bearing deposits in banks	$ 1,306.2	$ 68.5	5.24%	$ 208.6	$ 11.4	5.48%
Resale agreements*	2,091.2	110.9	5.31	1,220.0	67.9	5.56
Federal funds sold	6,813.9	354.5	5.20	4,782.7	258.5	5.40
Investments held to maturity*	9,128.3	524.8	5.75	8,061.7	486.5	6.03
Advances to members*	74,689.3	3,970.1	5.32	52,876.0	2,987.4	5.65
Loans to other FHLBanks	8.2	0.4	4.87	11.1	0.6	4.98
Total interest-earning assets	94,037.1	5,029.2	5.35	67,160.1	3,812.3	5.68
Other assets	1,878.3	—		1,468.7	—	
Total Assets	$95,915.4	$5,029.2	5.24%	$68,628.8	$3,812.3	5.55%
Liabilities and Capital						
Interest-bearing liabilities:						
Consolidated obligations:						
Bonds*	$76,170.9	$3,962.1	5.20%	$53,523.3	$2,937.4	5.49%
Discount notes*	12,253.8	666.1	5.44	9,232.5	527.7	5.72
Deposits	237.2	11.5	4.87	292.1	14.9	5.11
Borrowings	48.0	2.5	5.14	19.2	1.0	5.14
Total interest-bearing liabilities	88,709.9	4,642.2	5.23	63,067.1	3,481.0	5.52
Other liabilities	2,364.4	—		1,662.8	—	
Total Liabilities	91,074.3	4,642.2	5.10	64,729.9	3,481.0	5.38
Total Capital	4,841.1	—		3,898.9	—	
Total Liabilities and Capital	$95,915.4	$4,642.2	4.84%	$68,628.8	$3,481.0	5.07%
Net Interest Income		$ 387.0			$ 331.3	
Net Interest Margin**			0.41%			0.49%
Total Average Assets/Capital Ratio	19.8x			17.6x		

* Interest income/expense and average rates include the effect of associated off-balance sheet items.

** Net interest margin is net interest income divided by average interest-earning assets.

locked in funding over yearend in preparation for the Year 2000 rollover, the century date change was apparently not a predominant factor in overall advances growth in 1999. The Bank's largest members accounted for most of the increase during the year; in all, 121 members increased their advance borrowings from yearend 1998 to yearend 1999.

Investments. The Bank invests in both short- and long-term instruments to maintain liquidity and provide additional earnings. The short-term investment portfolio is primarily composed of Federal funds sold, resale agreements, and commercial paper. In determining the amount of assets to invest in each class of securities, the Bank considers the yield, liquidity, and credit quality of each instrument. The long-term investment portfolio, which is composed of mortgage-backed securities (MBS), provides the Bank with higher returns than those available in the short-term money markets. These long-term investments generally have more interest rate risk than the short-term investments; however, the majority of these investments are either funded by long-term debt or hedged with interest rate exchange agreements that reduce the interest rate risk. Most of the fixed and adjustable rate MBS in which the Bank invests are guaranteed by Fannie Mae, Freddie Mac, or Ginnie Mae and are collateralized by residential mortgages. To a lesser extent, the Bank invests in publicly-registered AAA-rated non-agency MBS that are also collateralized by residential mortgages. These MBS are subject to prepayment risk, and the adjustable rate MBS are subject to

interest rate cap risk. The Bank has managed these risks by (i) funding the fixed rate MBS with non-callable and callable debt, and (ii) purchasing adjustable rate MBS that are structured with interest rate exchange agreements, which create a synthetic, floating rate asset with a lifetime interest rate cap but without periodic interest rate caps. This structure provides the Bank with a stable income stream over a wide range of interest rates.

During 1998, the Bank adopted a plan to expand its investment portfolio to enhance earnings and provide greater financial flexibility. The MBS investment limit was increased from 200% of capital to 300% of capital. The target investment level for non-MBS investments was increased from 100% of capital to approximately 300% of capital.

The Bank's MBS portfolio increased 24% in 1999, to $7.0 billion, or approximately 130% of capital, at December 31, 1999, from $5.7 billion, or approximately 156% of capital, at December 31, 1998. The increase in the Bank's capital and the lack of available MBS investments that met the Bank's risk and return profiles resulted in balances below the targeted level.

The Bank's non-MBS investment portfolio increased 65% during the year, to $16.2 billion, or approximately 298% of capital, at December 31, 1999, from $9.8 billion, or approximately 222% of capital, at December 31, 1998. Federal funds sold increased $3.7 billion, interest-bearing deposits with banks increased $1.3 billion, commercial paper investments increased $1.0 billion, and resale agreements increased $0.3 billion.

Borrowings. The Bank funds its assets through the use of FHLBank consolidated obligation bonds and discount notes, which are the joint and several obligations of the 12 FHLBanks. These instruments financed 92% and 91% of average total assets in 1999 and 1998, respectively. Consolidated obligation bonds are long-term, while discount notes are short-term instruments. The Bank uses interest rate exchange agreements to change the effective interest rate terms on many of its consolidated obligation bonds and discount notes.

To fund the Bank's asset growth, total consolidated obligations outstanding increased 45% in 1999, to $107.4 billion at December 31, 1999, from $74.0 billion at December 31, 1998. Average consolidated obligations in 1999 were $88.4 billion, 41% above the $62.8 billion average in 1998.

To meet the specific needs of certain investors, fixed and adjustable rate consolidated obligation bonds may contain embedded call options or other features that result in complex coupon payment terms. When such consolidated obligations are issued, the Bank simultaneously enters into interest rate exchange agreements with features that offset the complex features of the bonds and, in effect, convert the bonds to conventional adjustable rate instruments tied to an index, such as LIBOR. During 1999 and 1998, the Bank used fixed rate callable bonds that were usually offset with interest rate exchange agreements with a call feature mirroring the option embedded in the callable bond. This combined structure enables the Bank to meet its funding needs at costs not generally attainable solely through the issuance of callable debt.

Capital and Capital Ratios. Each member is required to purchase Bank stock based on the amount of its residential mortgage loans, its total assets, or its outstanding Bank advances. Average capital during 1999 was $4.8 billion, a 24% increase from $3.9 billion in 1998. This increase was net of redemptions of capital stock totaling $575.5 million, which primarily resulted from the Bank's new mandatory surplus capital stock redemption policy that went into effect in April 1999. Surplus capital is defined as any excess stock holdings above 115% of a member's statutory capital stock requirement, excluding stock dividends earned and credited for the current year. In accordance with this policy, the Bank redeemed $413.4 million in surplus capital stock during 1999. Fifty-one new members purchased capital stock in 1999, and a number of members purchased stock to support additional borrowings during the year.

The Bank's ratio of capital to total assets was 4.69% and 5.47% at December 31, 1999 and 1998, respectively. Finance Board regulations generally allow the FHLBank System to issue debt (senior unsecured liabilities, composed primarily of consolidated obligations and deposits) up to 20 times capital (leverage ratio). To facilitate Year 2000-related lending by the FHLBanks, the Finance Board temporarily increased the leverage ratio limit for the FHLBanks to 25 to 1 through June 30, 2000. For an FHLBank to exceed the 20 to 1 leverage ratio limit during this period, the FHLBank's net non-mortgage investments (defined as total investments less mortgage-backed securities, mortgage loan assets, member deposits, member capital investments in the FHLBank, retained earnings, and binding advances commitments) may not exceed 12% of outstanding consolidated obligations for which the FHLBank is the primary obligor. To meet the potential needs of its members, the Bank obtained a waiver from the Finance Board to increase the limit on its net non-mortgage investments to 14% of consolidated obligations and to increase its maximum leverage ratio to 22.5 to 1 through February 29, 2000. As of December 31, 1999, the Bank's leverage ratio was 20.3 times capital and its net non-mortgage investments were 9.9% of its consolidated obligations.

Off-Balance Sheet Financial Instruments. In the ordinary course of business, the Bank issues standby letters of credit and enters into various types of transactions that involve interest rate exchange agreements (interest rate swap agreements,

caps, and floors) with off-balance sheet risk. Letters of credit are issued on behalf of members to support their obligations to third parties. The Bank uses interest rate exchange agreements for several purposes. One purpose is to manage its overall interest rate risk profile by adjusting the interest rate sensitivity of its interest-bearing liabilities to be consistent with the interest rate sensitivity of its interest-earning assets. The Bank also provides a variety of products to meet the specific needs of borrowers. Because the financial characteristics of many of these products may not be consistent with the Bank's desired interest rate risk profile, the Bank uses interest rate exchange agreements to modify the financial characteristics of its products to meet the Bank's specific interest rate risk objectives. These instruments are generally negotiated, with terms tailored to meet the specific needs of the Bank and the customer. The Bank may also act as an intermediary between members and third parties for interest rate exchange agreement transactions.

The contractual amounts of letters of credit and notional amounts of interest rate exchange agreements are not recorded as assets or liabilities on the balance sheet. The fees earned by the Bank in connection with letters of credit are recorded as other income. Interest income and expense from interest rate exchange agreements used for risk management purposes are recorded with interest on the instrument being hedged. Interest income and expense from interest rate exchange agreements in which the Bank acts as an intermediary are recorded as other income. In general, gains or losses realized on the termination or redesignation of interest rate exchange agreements, where the related underlying financial instrument remains outstanding, are deferred and amortized over the shorter of the life of the financial instrument that was originally hedged or the period ending on the original maturity date of the interest rate exchange agreement. In general, gains or losses realized on the termination or redesignation of interest rate exchange agreements where the related underlying financial instrument has been terminated are included with the gain or loss on the termination of the underlying financial instrument.

In anticipation of SFAS No. 133 (see "Recently Issued Accounting Standard" on page 19), during 1999 and 1998, the Bank terminated certain interest rate exchange agreements that were hedging existing and anticipated future issuances of discount notes. The Bank realized losses of $32.3 million and $13.3 million during 1999 and 1998, respectively, on these terminations. Under SFAS No. 133, the Bank would have been required to mark these agreements to market on January 1, 2001, and periodically thereafter. The amount of the resulting gains and losses would have varied depending on interest rates. The Bank eliminated this accounting uncertainty by terminating the agreements and replacing them, in part, with certain fixed rate bonds, which will not have accounting volatility under SFAS No. 133. Because the future issuance of discount notes remains probable, the Bank is deferring these losses and amortizing them into interest expense over the remaining terms of the original interest rate swap agreements. The unamortized amount of these losses at December 31, 1999, was $32.6 million and is included in the carrying amount of discount notes.

As of December 31, 1999, the Bank had interest rate exchange agreements totaling $124.1 billion (notional amount). Of this amount, $90.4 billion hedged consolidated obligations, $31.1 billion hedged advances to members, $0.8 billion hedged MBS, $1.4 billion were for intermediated transactions, and $0.4 billion hedged investments. As of December 31, 1998, the Bank had interest rate exchange agreements totaling $113.5 billion (notional amount). Of this amount, $70.2 billion hedged consolidated obligations, $39.6 billion hedged advances to members, $1.4 billion hedged MBS, $2.2 billion were for intermediated transactions, and $0.1 billion hedged resale agreements.

Risk Management

Liquidity. The Bank is required to maintain liquidity in accordance with the Finance Board's Financial Management Policy, as well as with policies established by the Board of Directors. The Bank needs liquidity to satisfy member demand for short- and long-term funds and to repay maturing obligations. In their asset/liability management planning, members may look to the Bank to provide standby liquidity. The Bank seeks to be in a position to meet its customers' credit and liquidity needs without maintaining excessive holdings of low-yielding liquid investments, creating a funding shortfall, or being forced to incur unnecessary short-term borrowing costs. The Bank's primary sources of liquidity are consolidated obligation bonds and discount notes and short-term investments. Other short-term borrowings, such as Federal funds purchased, securities sold under agreements to repurchase, and loans from other FHLBanks, also provide liquidity.

Interest Rate Risk. Underlying the Bank's financial performance is a multifaceted asset/liability management strategy. The Bank monitors and evaluates the effects of interest rate movements on earnings and the market value of equity. Asset/liability strategies are adjusted to manage interest rate risks within prescribed policy limits. The Bank's financial policies establish guidelines and limits for net interest income sensitivity to interest rate changes, basis relationship changes, periodic and cumulative repricing gaps, the sensitivity of the market value of equity to interest rate changes (duration of equity), and liquidity. The Bank also complies with the duration of equity limits and other limits set forth in the Finance Board's Financial Management Policy.

Interest Rate Sensitivity

For the Year Ended December 31, 1999

(In millions)	Interest Rate Sensitivity Period: 6 Months or Less	6 Months to 1 Year	1 to 5 Years	Over 5 Years
Assets				
Interest bearing deposits in banks	$ 1,702	$ —	$ —	$ —
Resale agreements	2,559	—	—	—
Federal funds sold	8,636	—	—	—
Investments held to maturity	6,133	800	2,574	875
Advances	67,851	3,984	16,783	1,896
Other assets	2,101	—	—	18
Total Assets	$ 88,982	$ 4,784	$19,357	$ 2,789
Liabilities				
Consolidated obligations	$100,744	$ 1,673	$ 3,943	$ 1,042
Deposits	327	—	—	—
Other liabilities	2,607	—	—	138
Total Liabilities	$103,678	$ 1,673	$ 3,943	$ 1,180
Interest Rate Exchange Agreements	17,302	(2,414)	(13,442)	(1,446)
Periodic Gap/Invested Capital	$ 2,606	$ 697	$ 1,972	$ 163

One measure of interest rate risk is the extent to which the interest rates on the Bank's assets and liabilities reprice at different times. The table above shows the interest rate sensitivity of assets and liabilities by repricing periods. The periodic gaps shown in this table represent the net difference between total asset and liability repricings for a specified time period. For example, the periodic gap for the "6 months or less" time period indicates that as of December 31, 1999, there were $2.6 billion more assets than liabilities that would reprice during the six-month period beginning on December 31, 1999. As shown in the table above, the Bank's repricing gaps are concentrated in the "six months or less" and the "one to five years" categories.

The following table shows the expected percentage change in the net value of all assets, liabilities, and off-balance sheet items (market value of equity) that would result from a 100-basis-point change in interest rates under different interest rate scenarios. At December 31, 1999, the estimated percentage change in the Bank's market value of equity was 1.29%. If interest rates rose 100 basis points, the Bank's market value of equity would be expected to decline approximately 1.29%, and if interest rates fell 100 basis points, the Bank's market value of equity would be expected to increase approximately 1.29%. If interest rates were 200 basis points higher at December 31, 1999, a 100-basis-point additional shift in interest rates would be expected to either decrease or increase (depending on the direction of the interest rate movement) the Bank's market value of equity by approximately 1.95%. If interest rates were 200 basis points lower at December 31, 1999, a 100-basis-point additional shift in interest rates would be expected to alter the Bank's market value of equity by approximately 0.17%.

Market Value of Equity Sensitivity

As of December 31, 1999

Interest Rate Scenario	Average Percentage Change in the Market Value of Equity per 100-Basis-Point Change in Interest Rates
Actual rates at December 31, 1999	1.29%
Rates start 200 basis points higher	1.95%
Rates start 200 basis points lower	0.17%

Credit Risk. The Bank closely monitors the creditworthiness of the institutions to which it lends funds. The Bank also places great importance on the quality of both the assets that are pledged as collateral by its customers and the securities purchased under agreements to resell. The Bank emphasizes credit monitoring and collateral asset review and valuation to manage the credit risk associated with its lending activities. It also has procedures to assess the mortgage underwriting and documentation standards of its borrowing members. In addition, the Bank has collateral policies and restricted lending procedures in place to manage its exposure to those customers that experience difficulty in meeting their capital requirements or other standards of creditworthiness. The Bank has not experienced any losses on credit extended to any counterparty since its inception. Based upon the collateral held as security and prior repayment history, no allowance for losses is deemed necessary by management.

The Bank has adopted exposure limits for investments that ensure diversification and liquidity. These policies restrict the amounts and terms of the Bank's investment holdings according to the Bank's own capital position as well as the capital

and creditworthiness of the counterparty. In addition, the Bank has invested only in AAA-rated non-agency MBS and MBS that are guaranteed by government-sponsored enterprises (Fannie Mae, Freddie Mac, and Ginnie Mae) and are collateralized by pools of residential mortgages.

The Bank has also adopted policies and exposure limits for off-balance sheet credit exposure. Under these policies, the amount of unsecured credit that may be extended to an individual counterparty is the lower of (i) an amount commensurate with the counterparty's capital and its credit quality, as determined by rating agency credit ratings of the counterparty's debt securities or deposits, or (ii) an absolute credit exposure limit. In addition, the Bank has entered into bilateral security agreements with all active counterparties that provide for delivery of collateral at specified levels to limit credit exposure from off-balance sheet items.

Concentration Risk. At December 31, 1999, the Bank had a concentration of advances totaling $68.9 billion outstanding to two members, representing 76% of total advances outstanding (one member represented 50% and the other represented 26%). At December 31, 1998, the Bank had a concentration of advances totaling $49.0 billion outstanding to two members, representing 77% of total advances outstanding (one member represented 45% and the other represented 32%). Of the total capital stock outstanding at December 31, 1999, two members held 34.9 million shares, representing 65% of total capital stock outstanding (one member represented 43% and the other represented 22%). At December 31, 1998, two members held 24.9 million shares, representing 56% of total capital stock outstanding (one member represented 33% and the other represented 23%). The Bank manages concentration risk by, among other things, closely monitoring the credit and collateral quality and financial trends of the institutions to which it lends funds, charging market-based prepayment fees on most advances, and monitoring and managing the risks associated with any departure of a large member and the resulting capital redemption.

Recently Issued Accounting Standard

In June 1998, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS No. 133). In June 1999, the FASB issued SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities – Deferral of the Effective Date of FASB Statement No. 133," which amends SFAS No. 133, deferring its effective date. SFAS No. 133 is now effective for all fiscal quarters of all fiscal years beginning after June 15, 2000 (January 1, 2001, for the Bank). SFAS No. 133 requires that all derivative instruments be recorded on the balance sheet at their fair value. Changes in the fair value of derivatives will be recorded each period in current earnings or other comprehensive income (a component of capital), depending on whether a derivative is designated as part of a hedge transaction and, if it is, the type of hedge transaction. The gains and losses on the derivative instrument that will be reported in other comprehensive income will be reclassified as earnings in the periods in which earnings are affected by the variability of the cash flows of the hedged items. The gain or loss on the ineffective portion of all hedges will be recognized in current-period earnings.

The Bank has not yet determined the full effect that the implementation of SFAS No. 133 will have on its earnings or statement of financial position. However, the new standard may have a negative effect on earnings and other comprehensive income. To provide financial flexibility and in anticipation of the possible effect of implementing SFAS No. 133, retained earnings restricted by the Board of Directors totaled $27.9 million and $16.3 million at December 31, 1999 and 1998, respectively.

Recent Developments

Legislation. The Federal Home Loan Bank System Modernization Act of 1999 (the Modernization Act), enacted on November 12, 1999, as Title VI of the Gramm-Leach-Bliley Act, achieves several objectives the Bank has long supported. The major provisions of the Modernization Act are as follows:

Voluntary Membership for All Members

As of May 12, 2000, membership in the System will become voluntary for federally chartered savings institutions that were members of the System as of November 12, 1999. Membership is already voluntary for all other members and for federal savings institutions chartered after the effective date of the legislation. The lockout period for re-joining the System after withdrawal was reduced from ten years to five years.

Elimination of Qualified Thrift Lender (QTL) Distinctions in Extending Advances to Members

For advances to members and related stock purchases, there will no longer be a distinction between members that are qualified thrift lenders (defined as members with mortgage-related assets equal to at least 65% of total assets) and members that are not qualified thrift lenders.

Elimination of Collateral Restriction

Advances secured by certain real estate-related collateral (such as residential second mortgages, home equity lines of credit, commercial first mortgages, participation mortgages, mortgage-related municipal bonds, and home equity loan asset-backed securities) have been limited to 30% of a member's GAAP capital. The Modernization Act eliminated this restriction. The Finance Board will determine the timing and implementation of this change.

Expanded Access for Community Financial Institutions

The Modernization Act provides enhanced access to the System for community financial institutions (CFIs). CFIs are defined as FDIC-insured depository institutions with average total assets over the preceding three-year period of less than $500 million (to be adjusted each year by the annual percentage increase in the Consumer Price Index). The Modernization Act provides enhanced access for CFIs in the following areas:

- *Membership:* CFIs are exempt from the membership eligibility requirement that an institution must have at least 10% of its total assets in residential mortgage loans.
- *Long-term Advances:* CFIs may use long-term advances to finance small business, small farm, and small agribusiness loans in addition to residential housing finance.
- *Expanded Collateral:* CFIs may pledge secured small business or agriculture loans or securities representing whole interests in such loans as collateral for advances.

Revised REFCORP Assessment

Effective January 1, 2000, the System's annual REFCORP obligation was modified from a fixed annual assessment of $300 million for the System as a whole to 20% of each FHLBank's net earnings (after AHP assessments and operating expenses).

In 1999, the Bank's REFCORP payments represented approximately 14.3% of net income. The Bank's payments for this annual REFCORP obligation ranged as high as 56.5% of net income in the early 1990s. In recent years, high earnings throughout the System reduced the percentage of earnings necessary for the Bank to meet its share of the obligation.

With the new assessment, the amount of the Bank's REFCORP payments will rise and fall with its earnings. To the extent that the System's annual REFCORP payments are higher or lower than $300 million, the term of the REFCORP obligation will be shortened or lengthened so that the value of all payments made by the System is equivalent to the value of an annuity sufficient to pay the System's original REFCORP obligation.

The benefit of the new assessment formula is that, in years of lower earnings, the Bank's payment may be less than it would have been under the previous assessment formula. If the System maintains relatively strong earnings, as it has in recent years, the total number of years over which the REFCORP payments will be made may be reduced significantly.

New Capital Structure

The Modernization Act establishes a framework for implementation of a new capital structure for the FHLBanks. Once the Finance Board adopts implementing regulations, each FHLBank will develop its own capital plan, based on its business strategy and financial goals and its members' interests. Each FHLBank's capital plan must be approved by the Finance Board. The new capital structure provisions include the following:

- *Classes of Stock:* The Modernization Act defines two classes of capital stock: Class A, redeemable by members with six months' notice, and Class B, redeemable by members with five years' notice. Each FHLBank's capital plan will establish the terms, rights, and preferences of each class of stock issued by the Bank.
- *Capital Requirements:* The Modernization Act includes a leverage capital requirement and a risk-based capital requirement. Under the leverage requirement, each FHLBank must maintain a total capital-to-assets ratio of at least 5%, using a multiplier of 1.5 for permanent capital, and a total capital-to-assets ratio of at least 4%, without using a multiplier for permanent capital. Permanent capital is defined as Class B stock and retained earnings. The risk-based capital standard requires that each FHLBank hold enough permanent capital to meet credit risk and market risk (based on a rigorous stress test), with due consideration for the risk-based capital tests established for other government-sponsored enterprises under the Federal Housing Enterprises Financial Safety and Soundness Act of 1992. Each FHLBank's capital plan must specify how it intends to comply with these capital requirements.
- *Transition Period:* The Finance Board must establish new capital regulations within one year after the Modernization Act and the FHLBanks must submit their individual capital plans to the Finance Board for approval within 270 days after the final regulations are published. Capital plans may be implemented over a transition period not to exceed three years. In the meantime, the requirements for purchase and retention of FHLBank capital stock in place prior to November 12, 1999, remain in effect.

Corporate Governance

Many corporate governance functions that previously required Finance Board approval no longer require that approval. These functions include the declaration of dividends and approval of budgets and bylaws. The term of all elected and appointed directors is now three years, rather than two years for elected directors and four years for appointed directors. Terms will be staggered under rules to be established by the Finance Board. The Finance Board will also give the FHLBanks guidelines for determining whether to uphold the results of the 1999 election of directors or to set aside those results for the purpose of selecting directors to fill terms beginning on January 1, 2001. The Board of Directors now elects its own chair and vice chair for two-year terms from among the Bank's directors.

Regulation With the enactment of the Modernization Act, the Finance Board has published proposed, interim, and final rules implementing or relating to the statutory changes, including:

- A proposed rule defining the powers and responsibilities of the boards of directors and senior management of the FHLBanks.
- A proposed rule to implement changes in the calculation of the FHLBanks' annual REFCORP payments.
- An interim final rule amending the membership and advances regulations to conform certain provisions to the Modernization Act.
- A final rule devolving certain corporate governance responsibilities to the FHLBanks and removing regulations that required Finance Board approval for some corporate governance matters.

In 1999, the Finance Board also published a final rule establishing a framework for the orderly allocation of joint and several liability for consolidated obligations among the FHLBanks to provide for the continued timely payment of principal and interest on consolidation obligations in the unlikely event of the projected or actual inability of an FHLBank to meet its debt service payment obligations.

In 2000, the Finance Board published a proposed rule to reorganize the FHLBanks' Office of Finance and broaden its responsibilities in two key respects: the FHLBanks, rather than the Finance Board, would issue consolidated obligations through the Office of Finance, with the Office of Finance preparing the combined financial reports for the System. The Office of Finance would also serve as a vehicle to carry out joint activities for the FHLBanks. In connection with this proposed rule, the Finance Board also proposed changes to the Financial Management Policy of the FHLBank System, deleting the "Funding Guidelines," eliminating the Systemwide liability-based leverage limit, and replacing the current FHLBank liability-based leverage limit with a minimum total capital requirement that would, in effect, recast the leverage limit as a percentage of assets.

Year 2000

The Bank adopted a comprehensive Year 2000 Plan in 1997 to identify its mission-critical systems, assess the state of Year 2000 compliance of those systems, and repair or replace non-compliant systems. In 1999, the Bank completed the remediation and implementation of all systems identified as non-compliant and completed the testing of all mission-critical systems, including integrated testing and selected testing with key business partners. The Bank also completed its Year 2000 business resumption plan and its liquidity management plan on schedule in 1999. As a result of these efforts, the Bank maintained ample liquidity throughout the period and was able to provide a full range of products and services before and after the century date change.

The Bank incurred operating costs of $3.1 million in 1999 and $3.4 million in 1998 to address the Year 2000 compliance of the Bank's systems, to conduct individual and integrated systems testing, to develop contingency plans, and to monitor and address the Year 2000 compliance preparations of the Bank's key business partners. These costs include the use of consultants to supplement Bank staff, but exclude the cost of Bank staff and management assigned to the project. The costs incurred in 1999 and 1998 did not have material effect on the Bank's net income.

Comparison of 1998 to 1997

Net income was $294.1 million in 1998, compared to $249.1 million in 1997. The increase in net interest income to $331.3 million in 1998 from $301.2 million in 1997 was due to a 25% increase in average interest-earning assets outstanding during the year, partially offset by a 7-basis-point decrease in the net interest margin. The decrease in the net interest margin was primarily due to credit pricing policies established by the Bank to compete with other providers of wholesale funds, which decreased advance profit spreads, coupled with lower earnings on invested capital as a result of a lower interest rate environment during 1998.

Non-interest income was $30.4 million in 1998 and $2.7 million in 1997. The Bank collected $24.7 million in prepayment fees in 1998, compared to $17.9 million in 1997, as more advances were prepaid. The Bank also recognized $19.8 million in losses in 1997 from the termination of interest rate swaps that were no longer required to hedge short-term borrowings.

Net non-interest expense increased to $67.7 million in 1998 from $54.8 million in 1997. The increase was primarily due to an increase of $6.9 million in the Bank's operating expenses and an increase of $5.1 million in the statutory contribution to the AHP, which was assessed on higher earnings in 1998. Operating expenses as a percentage of average assets were 5.1 basis points in 1998 compared to 5.2 basis points in 1997.

The Bank's total REFCORP and AHP assessments equaled $75.9 million in 1998 and $71.3 million in 1997. These amounts reflected effective "tax" rates on income of 24% and 26%, respectively. The Bank's REFCORP assessment totaled $48.5 million in 1998 and $49.1 million in 1997. Higher earnings realized by the 12 FHLBanks combined in both 1998 and 1997 enabled the FHLBanks to meet the $300 million annual assessment without a shortfall allocation.

The Bank set aside $27.4 million for the AHP in 1998, compared to $22.2 million in 1997. The increase reflected higher earnings in 1998.

Adjusted net interest income increased 10%, to $339.9 million in 1998 from $308.9 million in 1997. This increase was the primary reason adjusted net income rose 8%, to $279.9 million in 1998 from $258.6 million in 1997.

In 1998, the Bank paid a total of $220.9 million in dividends, primarily stock dividends, an average annual rate of 5.76%. This rate was 34 basis points lower than in 1997, when dividends totaled $201.3 million and the average annual rate was 6.10%. All dividends except fractional shares were paid in the form of capital stock.

Statements of Condition

(In thousands, except par value)	December 31, 1999	1998
Assets		
Cash and due from banks	$ 1,424	$ 2,707
Interest-bearing deposits in banks	1,702,000	402,000
Securities purchased under agreements to resell	2,558,885	2,226,625
Federal funds sold	8,636,000	4,894,000
Investments held to maturity	10,382,029	7,973,811
Advances to members	90,513,829	63,989,305
Accrued interest receivable	2,099,622	1,521,982
Bank premises and equipment, net	4,324	73,249
Other assets	13,934	40,224
Total Assets	$115,912,047	$81,123,903
Liabilities and Capital		
Liabilities:		
Consolidated obligations, net		
Bonds	$ 76,725,689	$62,438,610
Discount notes	30,676,746	11,521,991
Total consolidated obligations	107,402,435	73,960,601
Deposits		
Demand and overnight	303,143	232,804
Term	23,810	245,411
Total deposits	326,953	478,215
Borrowings		
Other Federal Home Loan Banks	—	150,000
Securities sold under agreements to repurchase	—	150,000
Other	—	6,111
Total borrowings	—	306,111
Accrued interest payable	2,606,541	1,819,720
Affordable Housing Program	90,892	81,282
Payable to REFCORP	11,184	11,761
Other liabilities	35,643	30,911
Total Liabilities	110,473,648	76,688,601
Commitments and Contingencies: Note 14		
Capital:		
Capital stock ($100 par value) issued and outstanding 53,744 shares in 1999 and 44,016 in 1998	5,374,359	4,401,591
Retained earnings (subject to restrictions)	64,040	33,711
Total Capital	5,438,399	4,435,302
Total Liabilities and Capital	$115,912,047	$81,123,903

The accompanying notes are an integral part of these financial statements.

Statements of Income

(In thousands)	For the Years Ended December 31, 1999	1998	1997
Interest Income:			
Advances to members	$3,970,075	$2,987,482	$2,396,174
Interest-bearing deposits in banks	68,466	11,436	8,599
Securities purchased under agreements to resell	110,954	67,864	142,099
Federal funds sold	354,522	258,426	145,711
Investments held to maturity	524,809	486,508	431,559
Loans to other Federal Home Loan Banks	400	551	290
Total Interest Income	5,029,226	3,812,267	3,124,432
Interest Expense:			
Consolidated obligations	4,628,253	3,465,076	2,810,736
Deposits	11,552	14,921	11,314
Securities sold under agreements to repurchase	2,046	174	—
Borrowings from other Federal Home Loan Banks	72	22	144
Other borrowings	347	793	1,029
Total Interest Expense	4,642,270	3,480,986	2,823,223
Net Interest Income	386,956	331,281	301,209
Other Income:			
Prepayment fees, net	2,099	24,726	17,865
Services to members	852	702	599
Losses on interest rate exchange agreements, net	—	—	(19,768)
Gain on spin-off/termination involving Bank's Cash Balance Plan	10,507	—	—
Gain on sale of building	4,580	—	—
Other, net	2,007	5,017	3,969
Total Other Income	20,045	30,445	2,665
Other Expense:			
Operating expense	38,832	35,244	28,338
Federal Housing Finance Board and Office of Finance assessments	5,311	5,064	4,245
Affordable Housing Program	31,651	27,352	22,219
Total Other Expense	75,794	67,660	54,802
Income before extraordinary item	331,207	294,066	249,072
Extraordinary gain on early retirement of debt	1,346	—	—
Net Income	$ 332,553	$ 294,066	$ 249,072

The accompanying notes are an integral part of these financial statements.

Statements of Capital Accounts

(In thousands)	Capital Stock Shares	Capital Stock Par Value	Retained Earnings Restricted	Retained Earnings Unrestricted	Total
Balance, December 31, 1996	31,400	$3,140,010	$10,348	$ 34	$ 10,382
Proceeds from sale of capital stock	3,493	349,284			
Redemption of capital stock	(1,547)	(154,724)			
Net income				249,072	249,072
Transfers from restricted retained earnings			(7,295)	7,295	—
Dividends on capital stock (6.10%):					
Cash payment				(42)	(42)
Stock issued	2,013	201,288		(201,288)	(201,288)
Capital distribution to REFCORP				(49,102)	(49,102)
Balance, December 31, 1997	35,359	3,535,858	3,053	5,969	9,022
Proceeds from sale of capital stock	7,806	780,594			
Redemption of capital stock	(1,357)	(135,689)			
Net income				294,066	294,066
Transfers to restricted retained earnings			27,601	(27,601)	—
Dividends on capital stock (5.76%):					
Cash payment				(46)	(46)
Stock issued	2,208	220,828		(220,828)	(220,828)
Capital distribution to REFCORP				(48,503)	(48,503)
Balance, December 31, 1998	44,016	4,401,591	30,654	3,057	33,711
Proceeds from sale of capital stock	12,938	1,293,784			
Redemption of capital stock	(5,755)	(575,494)			
Net income				332,553	332,553
Transfers to restricted retained earnings			7,978	(7,978)	—
Dividends on capital stock (5.36%):					
Cash payment				(52)	(52)
Stock issued	2,545	254,478		(254,478)	(254,478)
Capital distribution to REFCORP				(47,694)	(47,694)
Balance, December 31, 1999	53,744	$5,374,359	$38,632	$ 25,408	$ 64,040

The accompanying notes are an integral part of these financial statements.

Statements of Cash Flows

(In thousands)	1999	1998	1997
	For the Years Ended December 31,		
Cash Flows from Operating Activities:			
Net Income	$ 332,553	$ 294,066	$ 249,072
Extraordinary gain on early retirement of debt	(1,346)	—	—
Income before extraordinary item	331,207	294,066	249,072
Adjustments to reconcile net income before extraordinary item to net cash provided by operating activities:			
Depreciation and amortization:			
Net premiums and discounts on consolidated obligations and investments	(130,137)	(126,648)	(64,221)
Concessions on consolidated obligations	7,949	2,689	2,736
Bank premises and equipment	2,203	4,480	4,926
Deferred net losses on interest rate exchange agreements	13,255	6,776	11,653
Affordable Housing Program (AHP) liability and discount on AHP advances	9,956	11,026	9,498
Gain on sale of building	(4,580)	—	—
Gain on spin-off/termination of Cash Balance Plan	(10,507)	—	—
Increase in accrued interest receivable	(577,640)	(325,015)	(233,097)
Increase in accrued interest payable	786,821	354,151	310,718
Decrease (increase) in other assets	26,290	(2,992)	(11,940)
Increase (decrease) in other liabilities	(4,280)	(25,153)	42,852
Total adjustments	119,330	(100,686)	73,125
Net cash provided by operating activities	450,537	193,380	322,197
Cash Flows from Investing Activities:			
Net (increase) decrease in interest-bearing deposits in banks	(1,300,000)	(303,000)	23,000
Net increase in Federal funds sold	(3,742,000)	(2,565,000)	(689,000)
Net (increase) decrease in securities purchased under agreements to resell	(332,260)	(1,051,705)	2,052,475
Net (increase) decrease in short-term investments held to maturity	(867,413)	(1,151,284)	369,834
Purchases of mortgage-backed securities	(3,000,359)	(1,766,428)	(887,469)
Maturities of mortgage-backed securities	1,613,926	1,726,628	857,205
Principal collected on advances	195,964,633	101,722,700	96,605,334
Advances made to members	(222,489,710)	(116,439,905)	(106,696,381)
Proceeds from sale of building	92,661	—	—
Net increase to premises and equipment	(1,840)	(2,155)	(2,375)
Net cash used in investing activities	(34,062,362)	(19,830,149)	(8,367,377)
Cash Flows from Financing Activities:			
Net (decrease) increase in deposits	(151,262)	161,731	(43,534)
Net (decrease) increase in securities sold under agreements to repurchase	(150,000)	150,000	—
Net (decrease) increase in loans from other FHLBanks	(150,000)	150,000	—
Net decrease in other borrowings	(6,111)	—	(2,105)
Proceeds from sale of consolidated obligations:			
Bonds	50,945,749	75,641,248	39,107,418
Discount notes	159,964,172	133,102,425	164,006,101
Payments for maturing and retiring consolidated obligations:			
Bonds	(36,689,650)	(59,382,516)	(33,544,058)
Discount notes	(140,822,323)	(130,783,654)	(161,620,805)
Proceeds from issuance of capital stock	1,293,784	780,594	349,284
Payments for redemption of capital stock	(575,494)	(135,689)	(154,724)
Cash dividends paid	(52)	(46)	(42)
Capital distribution to REFCORP	(48,271)	(48,816)	(50,926)
Net cash provided by financing activities	33,610,542	19,635,277	8,046,609
Net (decrease) increase in cash and cash equivalents	(1,283)	(1,492)	1,429
Cash and cash equivalents at beginning of year	2,707	4,199	2,770
Cash and cash equivalents at end of year	$ 1,424	$ 2,707	$ 4,199
Supplemental Disclosures:			
Interest paid during the year	$ 3,810,217	$ 3,118,914	$ 2,489,845
Stock dividends issued during the year	$ 254,478	$ 220,828	$ 201,288

The accompanying notes are an integral part of these financial statements.

Years Ended December 31, 1999, 1998, and 1997
(Dollars in thousands)

Background Information

The Federal Home Loan Bank of San Francisco (Bank), a federally chartered corporation, exempt from all federal, state and local taxation except for real property taxes, is one of 12 District Federal Home Loan Banks (FHLBanks), which together with their member institutions and the Office of Finance, under the supervision of the Federal Housing Finance Board (Finance Board), compose the FHLBank System (Bank System). The Bank is the largest of the 12 FHLBanks, and its assets and capital are each approximately one fifth of the combined assets and combined capital of the 12 FHLBanks as of December 31, 1999. The Bank System serves the public by enhancing the availability of residential mortgage and targeted community development credit by providing a readily available, low-cost source of funds to its member institutions. The Bank is a cooperative whose member institutions own the capital stock of the Bank and receive dividends on their investments. All regulated financial depositories and insurance companies engaged in residential housing finance are eligible to apply for membership. All members are required to purchase stock in their FHLBank.

The FHLBanks are supervised and regulated by the Finance Board, an independent federal agency in the executive branch of the United States Government. The Finance Board ensures that the FHLBanks operate in a safe and sound manner, carry out their housing finance mission, remain adequately capitalized, and can raise funds in the capital markets. Also, the Finance Board establishes policies and regulations governing the operations of the FHLBanks. Each FHLBank is operated as a separate entity with its own management, employees, and board of directors.

A primary source of funds for the FHLBanks is the proceeds from the sale to the public of Bank System debt instruments (consolidated obligations), which are the joint and several obligations of all FHLBanks. Other funds are provided by deposits, other borrowings, and the issuance of capital stock. All stock is owned by the FHLBanks' members.

In accordance with the Finance Board's regulations, the Bank has established a formal policy governing the compensation and expense reimbursement provided its directors. Directors are compensated based on the level of responsibility assumed. Fees are paid for attendance at certain meetings. In 1999, a retainer was also paid for the period the director was designated by the Finance Board as a director of the Bank. Directors are also reimbursed for reasonable and necessary Bank-related travel, subsistence, and other related expenses under a policy similar to the Bank's travel policy for employees. During 1999, meeting and retainer fees totaled $380 and reimbursed travel and related expenses totaled $81.

Note 1 – Summary of Significant Accounting Policies

Use of Estimates. The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates.

Investments Held to Maturity and Securities Purchased Under Agreements to Resell. Investments held to maturity and securities purchased under agreements to resell (resale agreements) are carried at cost, adjusted for amortization of premiums and accretion of discounts and for amortization of deferred gains and losses from associated interest rate exchange agreements using methods that approximate the level-yield method. All investments are classified as held-to-maturity securities because management has the positive intent and ability to hold these securities until maturity. Purchases of securities under agreements to resell the same securities are recorded as collateralized investments. Sales of securities under agreements to repurchase the same or substantially the same securities are treated as financings.

Advances to Members. The Bank presents advances to members, net of unearned commitment fees and discounts on advances for the Affordable Housing Program (AHP), as discussed below. In addition, the carrying value of advances is adjusted for the unamortized cost of deferred net gains and losses from associated interest rate exchange agreements, participation advances to other FHLBanks, as well as overdrawn demand deposit accounts. Interest on advances is credited to income as earned. Deferred gains and losses are recognized over the life of the underlying advance. As more fully discussed in Note 5, the Federal Home Loan Bank Act, as amended (the FHLB Act), limits eligible collateral to secure advances to certain investment securities, residential mortgage loans, deposits with the Bank, and other real-estate-related assets. In accordance with the Federal Home Loan System Modernization Act of 1999 (Modernization Act), the Bank will also be able to accept secured small business and agriculture loans as collateral from members that are "community financial institutions," defined as FDIC-insured depository institutions with average total assets over the preceding three-year period of less than $500 million. The Bank has never experienced any losses on advances since its inception. Based on the collateral held as security for advances, management's credit analyses, and prior repayment history, no

allowance for losses on advances is deemed necessary by management.

Affordable Housing Program. As more fully discussed in Note 6, the Bank is required to establish and fund an AHP. The Bank charges the required funding to earnings and establishes an offsetting liability. AHP funds provide subsidies to members to assist in the purchase, construction, or rehabilitation of housing for very low-, low-, and moderate-income households. Advances that qualify under the Bank's AHP are made at interest rates below the Bank's cost of funds. When an AHP advance is made, the net present value of the difference in the cash flows attributable to the difference between the interest rate of the AHP advance and the Bank's related cost of funds for comparable maturity funding is charged against the AHP liability and recorded as a discount on the AHP advance.

Prepayment Fees. The Bank charges its members a prepayment fee when certain advances are paid prior to original maturity. Such fees are credited to income when received. Gains and losses on terminated or redesignated interest rate exchange agreements associated with advances that have been prepaid are netted with prepayment fees in the Statements of Income.

Commitment Fees. Commitment fees for advances are deferred and amortized to interest income using the straight-line method. The Bank defers refundable fees until the commitment expires or until the advance is funded if material. Commitment fees for letters of credit are recorded as a deferred credit when received and amortized to other income over the term of the letter of credit.

Interest Rate Exchange Agreements. As more fully discussed in Notes 12 and 13, the Bank enters into interest rate swap, cap, and floor agreements (interest rate exchange agreements) to manage the Bank's exposure to changes in interest rates. These interest rate exchange agreements, when linked with a designated financial instrument, effectively alter the financial characteristics of the designated instrument. They may adjust the effective maturity, repricing frequency, or option-related characteristics of certain financial instruments to achieve certain risk management objectives. Interest rate exchange agreements are used by the Bank to hedge an underlying financial instrument or when acting as an intermediary for members.

The differentials of interest payments, received or paid, resulting from designated interest rate exchange agreements associated with financial instruments are recognized as adjustments to the yield or interest expense of the underlying financial instrument. The differentials of interest payments, received or paid, resulting from interest rate exchange agreements in which the Bank acts as an intermediary are recognized when incurred as other income. The intermediated interest rate exchange agreements are classified as other assets and other liabilities and measured at fair value in the Statements of Condition if material.

A designated interest rate exchange agreement's association with a designated underlying financial instrument ceases upon termination of the designated underlying financial instrument or when high correlation has not been met. Upon termination of the underlying financial instrument, the interest rate exchange agreement is marked to market (and the resulting gain or loss is included with the gain or loss on the termination of the underlying financial instrument) and is either terminated or redesignated as a hedge of other financial instruments. The Bank may also enter into new interest rate exchange agreements and designate them to the original interest rate exchange agreements to mitigate the economic effects of the original interest rate exchange agreements. Gains and losses on terminated interest rate exchange agreements and redesignated interest rate exchange agreements that were linked with a designated underlying financial instrument are deferred as long as the related underlying financial instrument remains outstanding. These deferred gains and losses are reported as adjustments to the carrying value of the designated underlying financial instrument. Deferred gains and losses related to interest rate exchange agreements are amortized over the shorter of the remaining life of the underlying financial instrument or the period ending on the original maturity date of the interest rate exchange agreement had it not been terminated. Unamortized costs, such as premiums paid for interest rate caps and floors and deferred gains and losses on these agreements, are reported as adjustments to the carrying value of the designated financial instrument and amortized, using a method approximating the level-yield method, over the remaining life of the interest rate exchange agreement.

Bank Premises and Equipment. The Bank records premises and equipment at cost less accumulated depreciation and amortization. Depreciation is computed on the straight-line method over the estimated useful lives of assets ranging from 3 to 10 years, and leasehold improvements are amortized on the straight-line method over the estimated useful life of the improvement or the remaining term of the lease, whichever is shorter. Improvements and major renewals are capitalized; ordinary maintenance and repairs are expensed as incurred. Gains and losses on disposal are included in other income. In May 1999, the Bank sold its San Francisco office building and realized a gain of $24,099. The Bank recognized $4,580 during 1999 and will defer and amortize the remaining $19,519 over the remaining term of the Bank's 10-year leaseback of the space the Bank occupies.

Concessions on Consolidated Obligations. The amounts paid to dealers in connection with the sale of consolidated obligation bonds are deferred and amortized using a method approximating the level-yield method over the term of the obligations or through the first call date for callable bonds. The amount of the concession is allocated to the Bank by the Office of Finance based upon the percentage of the debt issued that is assumed by the Bank. Concessions applicable to the sale of consolidated obligation discount notes are generally charged to interest expense as incurred because of the short-term maturities of these notes.

Discounts and Premiums on Consolidated Obligations. The discounts on consolidated obligation discount notes are amortized to expense using a method approximating the level-yield method over the term to maturity. The discounts and premiums on consolidated obligation bonds are amortized to expense using a method approximating the level-yield method over the term to maturity of the consolidated obligation bond or through the first call date for callable bonds.

Capital Distributions to Resolution Funding Corporation (REFCORP). Through 1999, the FHLBanks charged the $300 million annual capital distribution to the Resolution Funding Corporation (REFCORP) directly to retained earnings (see Note 10). Effective January 1, 2000, each FHLBank is required to pay 20% of net earnings to REFCORP. The FHLBanks will expense these amounts until the aggregate amounts actually paid by all 12 FHLBanks are equivalent to a $300 million annual annuity whose final maturity date is April 15, 2030, at which point the obligation of each FHLBank to REFCORP will be fully satisfied.

Assessments. Each FHLBank is assessed a share of the cost of operating the Finance Board and the Office of Finance, which manages the sale and servicing of consolidated obligations.

Estimated Fair Values. Many of the Bank's financial instruments lack an available trading market as characterized by a willing buyer and willing seller engaging in an exchange transaction. Therefore, significant assumptions and present value calculations have been used by the Bank for the purposes of determining estimated fair values. Thus, the fair values may not represent actual values of the financial instruments that could have been realized as of yearend or that will be realized in the future.

Carrying value is assumed to approximate fair value for financial instruments with three months or less to repricing or maturity. Fair values are based on quoted prices, market rates, or replacement rates for similar financial instruments as of the last business day of the year. The estimated fair values of the Bank's financial instruments and related assumptions are detailed in Note 13.

Cash Flows. For purposes of the Statements of Cash Flows, the Bank considers cash on hand and due from banks as cash and cash equivalents.

Recently Issued Accounting Standard. In June 1998, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS No. 133). In June 1999, the FASB issued SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities – Deferral of the Effective Date of FASB Statement No. 133," which amends SFAS No. 133, deferring its effective date. SFAS No. 133 is now effective for all fiscal quarters of all fiscal years beginning after June 15, 2000 (January 1, 2001, for the Bank). SFAS No. 133 requires that all derivative instruments be recorded on the balance sheet at their fair value. Changes in the fair value of derivatives will be recorded each period in current earnings or other comprehensive income (a component of capital), depending on whether a derivative is designated as part of a hedge transaction and, if it is, the type of hedge transaction. The gains and losses on the derivative instrument that will be reported in other comprehensive income will be reclassified into earnings in the periods in which earnings are affected by the variability of the cash flows of the hedged items. The ineffective portion of all hedges will be recognized in current-period earnings.

The Bank has not yet determined the full effect that the implementation of SFAS No. 133 will have on its earnings or statement of financial position. However, the new standard may have a negative effect on earnings and other comprehensive income (a component of capital).

Reclassification. Certain amounts in the 1998 and 1997 financial statements have been reclassified to conform with the 1999 presentation.

Note 2 – Cash and Due From Banks

Compensating Balances. The Bank maintains average collected cash balances with several commercial banks in consideration for certain services. There are no legal restrictions under these agreements as to the withdrawal of these funds. The average collected balances for the years ended December 31, 1999 and 1998, were approximately $5,253 and $5,124, respectively.

In addition, the Bank maintained average collected balances with various Federal Reserve Banks as required clearing balances and to facilitate the movement of funds to support the Bank's activities. There are regulations governing the with-

drawal of these funds; however, earnings credits on these balances may be used to pay for services received. The average balances for these accounts for the years ended December 31, 1999 and 1998, were approximately $999 and $243, respectively.

Note 3 – Securities Purchased Under Agreements to Resell

Securities purchased under agreements to resell (resale agreements) were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
December 31, 1999	$2,558,885	$1,144	$—	$2,560,029
December 31, 1998	$2,226,625	$ 162	$—	$2,226,787
Associated interest rate swaps	—	—	(4)	(4)
Total	$2,226,625	$ 162	$ (4)	$2,226,783

Redemption Terms. The amortized cost and estimated fair value of resale agreements, excluding associated interest rate swaps, by contractual maturity as of December 31, 1999 and 1998, are shown below.

	1999		1998	
Year of Maturity	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	$2,558,885	$2,560,029	$2,226,625	$2,226,787

The Bank engages in resale agreements with a limited number of securities dealers, all of which are "primary dealers," as designated by the Federal Reserve Bank of New York, and previously engaged in resale agreements with members that met certain credit eligibility criteria. The amounts advanced under these agreements represent short-term loans and are reflected as assets in the Statements of Condition. The collateral from resale agreements, all of which is highly rated, is held by the Bank's safekeeping custodian. Should the market value of the underlying securities decrease below the market value required as collateral, the counterparty is required to place an equivalent amount of additional securities in safekeeping in the name of the Bank. The Bank had rights to securities collateral with an estimated value in excess of the resale agreements outstanding at December 31, 1999 and 1998.

Resale agreements averaged $2,098,691 and $1,220,008 during 1999 and 1998, respectively. The maximum amounts outstanding at any monthend during 1999 and 1998 were $4,318,410 and $3,217,359, respectively. As of December 31, 1999 and 1998, resale agreements outstanding with members were $0 and $221,000, respectively.

Interest Rate Payment Terms. Interest rate payment terms for resale agreements and interest rate swap agreements associated with these agreements at December 31, 1999 and 1998, are detailed in the following table:

	1999	1998
Amortized cost of resale agreements:		
Fixed rate	$1,000,000	$2,005,625
Adjustable rate	1,558,885	221,000
Total	$2,558,885	$2,226,625
Notional principal of interest rate swaps associated with resale agreements	$ —	$ 75,000

The effect of these interest rate swaps on interest income is disclosed in Note 12.

Note 4 – Investments Held to Maturity

Major Security Types. Investments as of December 31, 1999 and 1998, were as follows:

December 31, 1999	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Commercial paper	$ 3,333,236	$ 1,787	$ —	$ 3,335,023
Mortgage-backed securities	7,048,793	—	(115,162)	6,933,631
Subtotal	10,382,029	1,787	(115,162)	10,268,654
Associated interest rate exchange agreements:				
Interest rate swaps	—	11,638	(1,343)	10,295
Total	$10,382,029	$13,425	$(116,505)	$10,278,949

December 31, 1998	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Commercial paper	$2,294,815	$ —	$ —	$2,294,815
Investments in consolidated obligations of other FHLBanks	8,750	98	—	8,848
Subtotal	2,303,565	98	—	2,303,663
Mortgage-backed securities	5,669,532	61,952	(23,909)	5,707,575
Subtotal	7,973,097	62,050	(23,909)	8,011,238
Associated interest rate exchange agreements:				
Interest rate swaps	—	—	(26,734)	(26,734)
Interest rate floors purchased	714	3,601	—	4,315
Total	$7,973,811	$65,651	$(50,643)	$7,988,819

Redemption Terms. The amortized cost and estimated fair value of investments held to maturity, excluding associated interest rate exchange agreements, by contractual maturity as of December 31, 1999 and 1998, are shown below. Expected maturities of certain mortgage-backed securities will differ from contractual maturities because borrowers may have the right to prepay obligations with or without prepayment fees.

	1999		1998	
Year of Maturity	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 3,333,236	$ 3,335,023	$2,303,565	$2,303,663
Mortgage-backed securities	7,048,793	6,933,631	5,669,532	5,707,575
Total	$10,382,029	$10,268,654	$7,973,097	$8,011,238

The amortized cost of the Bank's mortgage-backed securities, all of which are classified as held to maturity, included net premiums of $2,629 and $23,510 at December 31, 1999 and 1998, respectively.

Interest Rate Payment Terms. Interest rate payment terms for investments held to maturity and the notional principal of the interest rate exchange agreements associated with these investments at December 31, 1999 and 1998, are detailed in the following table:

	1999	1998
Amortized cost of investments held to maturity other than mortgage-backed securities:		
Fixed rate	$ 3,333,236	$2,294,815
Adjustable rate	—	8,750
Subtotal	3,333,236	2,303,565
Amortized cost of mortgage-backed securities held to maturity:		
Pass-through securities:		
Fixed rate	1,644,129	1,482,244
Adjustable rate	1,244,192	1,711,820
Collateralized mortgage obligations:		
Fixed rate	2,855,802	1,131,420
Adjustable rate	1,304,670	1,344,048
Subtotal	7,048,793	5,669,532
Total	$10,382,029	$7,973,097
Notional principal of interest rate exchange agreements associated with investments held to maturity:		
Interest rate swaps	$ 1,157,505	$ 984,144
Interest rate floors purchased	—	455,000
Total	$ 1,157,505	$1,439,144

The effect of these interest rate exchange agreements on interest income is disclosed in Note 12.

Note 5 – Advances to Members

Redemption Terms. The Bank had advances outstanding to members, including AHP advances (see Note 6), at interest rates ranging from 3.04% to 9.34% at December 31, 1999 and 1998, as summarized below:

December 31, 1999 Year of Maturity	Amount Outstanding	Contractual Weighted Average Interest Rate
Overdrawn demand deposit accounts	$ 1,529	5.99%
2000	49,134,618	5.82
2001	20,608,737	5.97
2002	7,762,001	5.71
2003	6,578,864	5.41
2004	4,046,355	5.87
2005 and thereafter	2,382,572	5.81
Subtotal	90,514,676	5.81%
Discount on AHP advances	(854)	
Deferred net gain on interest rate exchange agreements	(176)	
Unamortized fees on interest rate caps	183	
Total	$90,513,829	

December 31, 1999 Year of Maturity	Amount Outstanding	Contractual Weighted Average Interest Rate
Overdrawn demand deposit accounts	$ 288	6.07%
1999	27,847,584	5.30
2000	17,484,656	5.50
2001	5,954,813	5.42
2002	1,890,216	5.62
2003	8,298,639	5.37
2004 and thereafter	2,512,567	5.72
Subtotal	63,988,763	5.40%
Discount on AHP advances	(1,200)	
Deferred net loss on interest rate exchange agreements	2,075	
Unearned advance fees	(333)	
Total	$63,989,305	

Many of the Bank's advances to members are prepayable at the member's option. However, members are charged a prepayment fee when certain advances are prepaid. Other advances may be repaid on pertinent call dates without incurring prepayment fees (Callable Advances). At December 31, 1999 and 1998, the Bank had Callable Advances outstanding totaling $2,009,819 and $1,010,000, respectively.

The following table summarizes advances to members at December 31, 1999 and 1998, by year of maturity or next call date for Callable Advances:

Year of Maturity or Next Call Date	1999	1998
1999	$ —	$28,100,872
2000	49,887,847	17,734,656
2001	20,614,037	6,208,813
2002	7,762,001	1,890,216
2003	5,825,864	7,545,639
2004	4,046,355	—
2004 and thereafter	—	2,508,567
2005 and thereafter	2,378,572	—
Total par value	$90,514,676	$63,988,763

The Bank also provides below-market fixed rate advances in exchange for the right of the Bank to retain a "put" option. At the Bank's discretion, on pertinent put dates, the Bank may terminate the advance (Putable Advance/Termination Option) or convert the advance to an Adjustable Rate Credit advance of predetermined index and spread for the remaining term to maturity (Putable Advance/Conversion Option). The Bank's advances at December 31, 1999 and 1998, included $2,810,500 and $6,285,000, respectively, of Putable Advances/Termination Option. There were no Putable Advances/Conversion Option outstanding as of December 31, 1999 and 1998.

The following table summarizes advances to members at December 31, 1999 and 1998, by year of maturity or next put date for Putable Advances:

Year of Maturity or Next Put Date	1999	1998
1999	$ —	$30,861,373
2000	50,917,647	17,598,656
2001	21,005,237	6,438,313
2002	7,393,001	1,382,716
2003	5,812,364	5,960,138
2004	3,756,855	—
2004 and thereafter	—	1,747,567
2005 and thereafter	1,629,572	—
Total par value	$90,514,676	$63,988,763

Security Terms. The Bank lends to member financial institutions involved in housing finance that have a principal place of business in California, Arizona, or Nevada. The Bank is required by the FHLB Act to obtain sufficient collateral for advances to protect against losses and to accept only certain U.S. government or government agency securities, residential mortgage loans or privately issued mortgage-backed securities, deposits in the Bank, and other real-estate-related assets as collateral for advances. In accordance with the Modernization Act, the Bank will also be able to accept secured small business loans and agriculture loans as collateral from members that are "community financial institutions," defined as FDIC-insured depository institutions with average total assets over the preceding three-year period of less than $500 million.

The Bank requires each borrowing member to execute a written Advances and Security Agreement. The capital stock of the Bank owned by each borrowing member is pledged as additional collateral for the member's indebtedness to the Bank. The FHLB Act requires that the aggregate advances from the Bank to a member may not exceed 20 times the amount paid by the member for capital stock of the Bank. At December 31, 1999 and 1998, the Bank had a security interest in collateral with an estimated value in excess of outstanding advances for each member. Based upon the financial condition of the borrowing member, the Bank may either (i) allow the member to physically retain mortgage collateral assigned to the Bank provided that the member executes a written agreement and agrees to hold the collateral for the benefit of the Bank, or (ii) require the member to deliver physical possession of the mortgage collateral to the Bank or its safekeeping agent.

Credit Risk. The Bank has never experienced any credit losses on advances. Based on the collateral held as security for advances, management's credit analyses, and prior repayment history, no allowance for losses on advances is deemed necessary by management.

The Bank's potential credit risk from advances is concentrated in savings institutions. As of December 31, 1999, the Bank had a concentration of advances totaling $68,853,955 outstanding to two members, representing 76% of total outstanding advances (one member represented 50% and the other represented 26%). The income from advances to these members amounted to approximately $3,087,446 during 1999. The Bank held collateral with an estimated value in excess of advances to these institutions.

Interest Rate Payment Terms. Interest rate payment terms for advances and the notional principal of the interest rate exchange agreements associated with advances at December 31, 1999 and 1998, are detailed below:

	1999	1998
Par amount of advances:		
Fixed rate	$47,072,427	$43,403,023
Adjustable rate	43,442,249	20,585,740
Total	$90,514,676	$63,988,763
Notional principal of interest rate exchange agreements associated with advances:		
Interest rate swaps	$31,083,669	$39,540,498
Interest rate caps purchased	37,360	37,360
Total	$31,121,029	$39,577,858

The effect of these interest rate exchange agreements on interest income is disclosed in Note 12.

At December 31, 1998, the Bank had an outstanding participation in advances to members purchased from another FHLBank totaling $2,685. This participation matured in 1999, and the 1998 amount is included in advances to members in the Statements of Condition.

Prepayment Fees, Net. During 1999, 1998, and 1997, the Bank charged its members prepayment fees when the principal on certain advances was paid prior to original maturity. In addition, some of these advances were associated with interest rate exchange agreements. Upon termination of these advances, the associated interest rate exchange agreements were either marked to market and redesignated as hedges of other advances, or terminated, and the resulting gains or losses (see Note 12) were netted with the prepayment fees on the Statements of Income. These transactions during the years ended December 31, 1999, 1998, and 1997, are summarized in the following table:

	1999	1998	1997
Prepayment fees received	$ 1,398	$ 23,249	$ 17,910
Net gains/(losses) on interest rate exchange agreements associated with prepaid advances	701	1,477	(45)
Prepayment fees, net	$ 2,099	$ 24,726	$ 17,865
Advance principal prepaid	$537,000	$5,191,083	$624,896

Note 6 – Affordable Housing Program

Section 10(j) of the FHLB Act requires each FHLBank to establish an AHP. Each FHLBank provides subsidies in the form of direct grants and below-market-interest-rate advances to members, which use the funds to assist the purchase, reconstruction, or rehabilitation of housing for very low-, low-, and moderate-income families. Annually, the FHLBanks must set aside for their AHPs, in the aggregate, the greater of $100 million or 10% of the current year's income before charges for the AHP but after charges for REFCORP (see Note 10). To the extent that the aggregate 10% calculation is less than $100 million, the shortfall is allocated among the FHLBanks based on the ratio of each FHLBank's income before AHP and REFCORP to the sum of the net incomes before AHP and REFCORP of the 12 FHLBanks. There was no AHP shortfall in either 1999 or 1998. The Bank set aside $31,651, $27,352, and $22,219, during 1999, 1998, and 1997, respectively, for the AHP. These amounts were charged to earnings each year and recognized as a liability. As subsidies are disbursed, the AHP liability is reduced.

Note 7 – Deposits

The Bank maintained demand deposit accounts that are directly related to the extension of credit to members and offered short-term deposit programs to members.

Interest Rate Payment Terms. Interest rate payment terms for deposits at December 31, 1999 and 1998, are detailed in the following table:

	1999	1998
Deposits:		
Fixed rate	$ 23,810	$144,429
Adjustable rate	303,143	333,786
Total	$326,953	$478,215

Note 8 – Borrowings

At times the Bank enters into sales of securities under agreements to repurchase with a limited number of securities dealers, all of which are "primary dealers" as designated by the Federal Reserve Bank of New York. The amounts received under these agreements represent short-term borrowings and are reflected as liabilities in the Statements of Condition. The securities sold under agreements to repurchase (repurchase agreements) are delivered to the purchasing primary dealers. Should the market value of the underlying securities decrease below the market value required by the repurchase agreements, the Bank is required to deliver additional securities to the dealers. Repurchase agreements averaged $40,000 and $3,425 during 1999 and 1998, respectively, and the maximum amount outstanding at any monthend during 1999 and 1998 was $150,000. There were no repurchase agreements outstanding at December 31, 1999.

There were no borrowings due to other FHLBanks at December 31, 1999. The Bank had borrowings due to other FHLBanks at December 31, 1998, of $150,000, bearing interest at the overnight Federal funds rate.

There were no borrowings due to a member at December 31, 1999. The Bank had borrowings due to a member at December 31, 1998, of $6,111, bearing interest equal to the Bank's dividend rate.

Note 9 – Consolidated Obligations

Consolidated obligations are the joint and several obligations of the FHLBanks and consist of consolidated obligation bonds and discount notes. Bonds are issued by the Finance Board through the Office of Finance primarily to raise intermediate- and long-term funds for the FHLBanks. Usually the maturity of consolidated bonds ranges from one year to ten years, but the maturity is not subject to any statutory or regulatory limits. Discount notes are issued to raise short-term funds and are issued at less than their face amount and redeemed at par when they mature.

On December 14, 1999, the Finance Board proposed a regulation that would reorganize the Office of Finance. One of the proposed changes would be for the FHLBanks to issue consolidated debt through the Office of Finance under Section 11(a) of the FHLB Act. Currently, the Finance Board issues the consolidated debt on behalf of the FHLBanks through the Office of Finance under Section 11(c) of the FHLB Act. If the proposed regulation is adopted, the consolidated debt issued by the FHLBanks would continue to be the joint-and-several obligation of all of the FHLBanks.

The par value of the outstanding consolidated obligations of all of the FHLBanks was $549,370,500 and $398,188,782 at December 31, 1999 and 1998, respectively. Regulations require the FHLBanks to maintain, in the aggregate, unpledged "qualifying assets" in an amount equal to the consolidated obligations outstanding. "Qualifying assets" are defined as cash; secured advances; assets with an assessment or rating at least equivalent to the current assessment or rating of the consolidated obligations; obligations, participations, mortgages or other securities of or issued by the United States or an agency of the United States; and such securities as fiduciary and trust funds may invest in under the laws of the state in which the FHLBank is located. In addition, effective January 29, 1993, Finance Board regulations prohibit the issuance of senior bonds, other than bonds issued to refund consolidated bonds previously issued, if immediately following such issuance, the aggregate amount of senior bonds and unsecured senior liabilities of the FHLBanks exceeds 20 times the total paid-in capital stock, retained earnings, and reserves of all the FHLBanks.

To facilitate Year 2000-related lending by the FHLBanks, the Finance Board has temporarily increased the senior liability to capital leverage ratio limit for the FHLBanks to 25 to 1 through June 30, 2000. For an FHLBank to exceed the 20 to 1 leverage ratio limit, the FHLBank's net non-mortgage investments (defined as total investments less mortgage-backed securities, mortgage loan assets, member deposits, member capital investment in the Bank, retained earnings, and binding advances commitments) may not exceed 12% of outstanding consolidated obligations for which the FHLBank is the primary obligor. To meet the potential needs of its members, the Bank obtained a waiver from the Finance Board to increase the limit on its net non-mortgage investments to 14% of consolidated obligations and to increase its maximum leverage ratio to 22.5 to 1 through February 29, 2000. At December 31, 1999, the Bank's leverage ratio was 20.3 to 1 and its net non-mortgage investments were 9.9% of its consolidated obligations. At December 31, 1998, the Bank's leverage ratio was 17.2 to 1.

At December 31, 1999 and 1998, the ratio of total Bank System debt to total Bank System capital, as defined, was 19.1:1 and 17.9:1, respectively, and accordingly, the Bank System was in compliance with this regulation at December 31, 1999 and 1998.

On December 14, 1999, the Finance Board proposed a change to the leverage provisions of the Financial Management Policy (FMP). It would change the way the leverage ratio limit applicable to each FHLBank is stated. Currently, consolidated obligations and senior unsecured liabilities cannot exceed 20 times capital for any FHLBank. The proposal would limit assets to no more than 21 times capital.

To provide the holders of consolidated obligations issued prior to January 29, 1993 (prior bondholders), protection equivalent to that provided under the Bank System's previous leverage limit of 12 times Bank System capital, prior bondholders have a claim on a certain amount of the qualifying assets (Special Asset Account or SAA) if the FHLBanks' aggregate capital stock is less than 8.33% of consolidated obligations outstanding. The FHLBanks' capital stock at December 31, 1999 and 1998, was 5.2% and 5.6%, respectively, of the par value of consolidated obligations outstanding, and the SAA balance was approximately $67,300 and $151,500, respectively. The Bank's share of this SAA balance was approximately $14,300 and $26,600 at December 31, 1999 and 1998, respectively. Further, each FHLBank is required to transfer qualifying assets in the amount of its allocated share of the Bank System's SAA to a trust for the benefit of the prior bondholders if its individual capital-to-assets ratio falls below 2.0%.

General Terms. Consolidated obligations are generally issued with either fixed rate payment terms or adjustable rate payment terms, which use a variety of indices for interest rate resets, including the London Interbank Offered Rate (LIBOR), Federal funds, U.S. Treasury Bill, Constant Maturity Treasury (CMT), Prime Rate, and others. In addition, to meet the specific needs of certain investors, fixed rate and adjustable rate

consolidated obligation bonds may also contain certain embedded features, which may result in complex coupon payment terms and call options. Generally, when such consolidated obligations are issued, the Bank simultaneously enters into interest rate exchange agreements containing offsetting features to convert the terms of the bond, in effect, to the terms of a simple adjustable rate bond (tied to an index, such as those detailed above) or a fixed rate bond.

Consolidated obligations, in addition to having fixed rate or simple adjustable rate coupon payment terms, may also include "callable bonds," which the Bank may redeem in whole or in part at its discretion on predetermined call dates according to the terms of the bond offerings; "step-up bonds," which generally pay interest at increasing fixed rates for specified intervals over the life of the bond and can be called at the Bank's option on the step-up dates; "comparative index bonds," which have coupon rates that are determined by the difference between two market indices; "inverse floating bonds," which have coupons that increase as an index declines and decrease as an index rises; and "zero-coupon bonds," which are long-term discounted instruments that earn a fixed yield to maturity or to the specified call dates, and for which all principal and interest are paid at maturity or on the specified call dates, if the call option is exercised prior to maturity.

Redemption Terms. The following is a summary of the Bank's participation in consolidated obligation bonds at December 31, 1999 and 1998:

December 31, 1999 Year of Maturity	Amount Outstanding	Contractual Weighted Average Interest Rate
2000	$27,049,500	5.30%
2001	16,135,000	5.43
2002	13,091,000	5.51
2003	12,634,500	5.65
2004	6,225,000	6.10
2005 and thereafter	1,642,725	5.90
Total par value	76,777,725	5.50%
Concessions	(8,669)	
Bond premiums	14,881	
Bond discounts	(58,195)	
Deferred net loss on interest rate exchange agreements	(53)	
Total	$76,725,689	

December 31, 1999 Year of Maturity	Amount Outstanding	Contractual Weighted Average Interest Rate
1999	$26,251,000	5.15%
2000	6,538,000	5.55
2001	7,645,000	5.72
2002	4,765,000	5.90
2003	13,529,500	5.59
2004 and thereafter	3,698,375	5.73
Total par value	62,426,875	5.45%
Concessions	(3,973)	
Bond premiums	17,351	
Bond discounts	(846)	
Deferred net loss on interest rate exchange agreements	(483)	
Deferred fees relating to interest rate exchange agreements	(314)	
Total	$62,438,610	

The Bank's participation in consolidated obligation bonds outstanding at December 31, 1999 and 1998, includes callable bonds of $31,674,000 and $30,350,000, respectively. Contemporaneous with such callable debt issuance, the Bank usually enters into an interest rate swap (in which the Bank pays variable and receives fixed) with a call feature that mirrors the option embedded in the debt (a sold callable swap). The combined sold callable swap and callable debt enable the Bank to meet its funding needs at prices not otherwise directly attainable solely through the issuance of callable debt. The Bank also uses fixed rate callable bonds to finance callable advances (see Note 5) and mortgage-backed securities. Based on the prevailing interest rates at December 31, 1999, none of the Bank's callable bonds were in-the-money. If these conditions continue throughout 2000, the Bank estimates that almost none of the call options may be exercised. However, depending on the level and volatility of interest rates and other factors, actual results may differ.

The Bank's participation in consolidated obligation bonds was as follows:

	1999	1998
Par amount of consolidated bonds:		
Non-callable	$45,103,725	$32,076,875
Callable	31,674,000	30,350,000
Total par value	$76,777,725	$62,426,875

The following is a summary of the Bank's participation in consolidated obligation bonds outstanding at December 31, 1999 and 1998, by year of contractual maturity or next call date:

Earlier of Year of Contractual Maturity or Next Call Date	December 31, 1999	December 31, 1998
1999	$ —	$48,786,000
2000	48,939,500	7,343,000
2001	14,920,000	1,250,000
2002	6,911,000	35,000
2003	4,749,500	4,029,500
2004	265,000	—
2004 and thereafter	—	983,375
2005 and thereafter	992,725	—
Total	$76,777,725	$62,426,875

Interest Rate Payment Terms. Interest rate payment terms for consolidated obligations and the notional principal of the interest rate exchange agreements associated with consolidated obligations at December 31, 1999 and 1998, are detailed in the following table:

	1999	1998
Par amount of consolidated obligations:		
Consolidated bonds:		
Fixed rate	$ 63,743,325	$44,989,325
Adjustable rate	10,597,500	15,832,000
Zero-coupon	1,150,000	—
Step-up	910,000	1,075,000
Inverse floating	100,000	225,000
Comparative index	276,900	305,550
Total consolidated bonds, par	76,777,725	62,426,875
Consolidated discount notes, par	31,083,943	11,623,517
Total consolidated obligations, par	$107,861,668	$74,050,392
Notional principal of interest rate exchange agreements associated with consolidated obligations:		
Interest rate swaps	$ 90,337,556	$69,036,550
Interest rate floors purchased	—	645,000
Interest rate caps purchased	—	500,000
Total	$ 90,337,556	$70,181,550

The effect of these interest rate exchange agreements on interest expense is disclosed in Note 12.

The Bank's participation in consolidated obligation discount notes, all of which are due within one year, was as follows:

	1999		1998	
	Amount Outstanding	Contractual Weighted Average Interest Rate	Amount Outstanding	Contractual Weighted Average Interest Rate
Par value	$31,083,943	5.54%	$11,623,517	5.04%
Discounts	(373,581)		(74,654)	
Concessions	(1,022)		(439)	
Deferred net loss on interest rate exchange agreements	(32,594)		(9,104)	
Deferred fees relating to interest rate exchange agreements	—		(17,329)	
Total	$30,676,746		$11,521,991	

Section 11(i) of the FHLB Act authorizes the Secretary of the Treasury, at his discretion, to purchase certain obligations issued by the FHLBanks aggregating not more than $4.0 billion; terms, conditions and interest rates are to be determined by the Secretary of the Treasury. There were no such purchases by the U.S. Treasury during the two-year period ended December 31, 1999.

Extraordinary Item – Early Retirement of Debt. During 1999 and 1998, the Bank retired consolidated obligations either by purchasing such obligations in the open market or by selling its participation in certain obligations to other FHLBanks. Some of these obligations were designated to interest rate exchange agreements that were marked to market and terminated at the date of retirement. The resulting gain or loss (see Note 12), if material, was netted with the gain or loss on the early retirement of debt. The Bank did not retire any consolidated obligations during 1997. The 1999 and 1998 transactions are summarized in the following table:

	1999	1998
Gain on sale of consolidated obligations to other FHLBanks	$ 772	$ —
Gain on retirement of consolidated obligations	2,063	—
Loss on interest rate exchange agreements associated with consolidated obligations sold to other FHLBanks or retired in the market	(1,489)	—
Extraordinary gain	$ 1,346	$ —
Par value retired	$533,650	$680,000

Note 10 – Capital

The Modernization Act will lead to a number of changes in the capital structure of the FHLBanks. These changes will be phased in, and the Modernization Act requires the Finance Board to issue regulations prescribing a uniform capital structure for the FHLBanks by November 12, 2000. Until new capital regulations are in place, the current capital rules remain in effect. In particular, the FHLB Act requires each member to purchase capital stock equal to the greater of 1% of its mortgage-related assets or 5% of its outstanding FHLBank advances. However, the Modernization Act removed the provision that required a nonthrift member to purchase additional stock to borrow from its FHLBank if the nonthrift member's mortgage-related assets were less than 65% of its total assets. A member may, at the Bank's discretion, redeem at par value any capital stock greater than its statutory requirement or sell it to other Bank members at par value.

When the Finance Board adopts regulations implementing the recent statutory changes and capital structure plans have been approved by the Finance Board and implemented at each FHLBank, the FHLBanks will be subject to risk-based capital rules. Each FHLBank may offer two classes of stock. Members may redeem Class A stock by giving six months' notice, and members may redeem Class B stock by giving five years' notice. Only "permanent" capital, defined as retained earnings and Class B stock, can satisfy the risk-based capital requirement. In addition, the Modernization Act specifies a 5% minimum leverage capital ratio with a 1.5 weighting factor for permanent capital, and a 4% minimum leverage capital ratio without the 1.5 weighting factor.

The Modernization Act established voluntary membership for all members, but former mandatory members (federally chartered savings institutions regulated by the Office of Thrift Supervision) may not withdraw from membership before May 12, 2000. All other members may generally withdraw from membership and redeem their capital six months after giving notice. Members that withdraw from membership may not reapply for membership for five years.

At December 31, 1999, of the total capital stock outstanding, mandatory members held 44.7 million shares, or 84%, and voluntary members held 8.3 million shares, or 16%. Two mandatory members held 34.5 million shares, representing 65% of total capital stock outstanding (one member represented 43% and the other represented 22%).

The Bank is required by Finance Board dividend policy to retain in restricted retained earnings that portion of income from prepayment fees that, if allocated on a pro-rata basis over the maturity of the advances prepaid, would be allocated to future dividend periods. In addition, other gains and losses related to the termination of interest rate exchange agreements and early retirement of consolidated obligations are similarly treated. Retained earnings restricted in accordance with this Finance Board policy totaled $10,716, $14,366, and $3,053, at December 31, 1999, 1998, and 1997, respectively.

To provide financial flexibility and in anticipation of the possible effect of implementing SFAS No. 133, the Board of Directors authorized management to transfer certain amounts from unrestricted retained earnings to restricted retained earnings. During the fourth quarter of 1998, the Bank transferred $16,288, the amount of unrestricted retained earnings as of September 30, 1998, to restricted retained earnings. In addition, during 1999, the Bank transferred, net of applicable assessments, the one-time gain of $8,095 from the spin-off/termination involving the Bank's Cash Balance Plan and recognized gains totaling $3,533 from the sale of the Bank's office building to restricted retained earnings. Retained earnings restricted by the Board of Directors totaled $27,916 and $16,288 at December 31, 1999, and 1998, respectively.

Dividends may be paid in the form of cash or capital stock, as authorized by the Bank's Board of Directors and as approved by the Finance Board. In 1999, 1998, and 1997, the Bank was permitted to pay quarterly dividends out of unrestricted retained earnings and current year earnings, pursuant to Finance Board policy.

Through 1999, the FHLB Act required the 12 FHLBanks combined to pay $300 million annually through 2030 to fund a portion of the interest on REFCORP debt. Prior to the payment of any dividends, each FHLBank was initially assessed up to 20% of its net income (after AHP contributions) to meet the required $300 million assessment. To the extent that 20% of net income was insufficient to meet the required $300 million assessment in any year, the shortfall was allocated among all FHLBanks based on the percentage equal to the ratio of the FHLBank's average advances to members that were members of the Savings Association Insurance Fund (SAIF) during the preceding year to the FHLBank System's total average advances to SAIF-insured members during that year. The Bank's share of such advances was approximately 36.79% and 35.31% in 1999 and 1998, respectively. If the initial 20% assessment calculation exceeded the required $300 million, the $300 million was allocated among the FHLBanks based on their net income after their AHP contribution to the System net income after AHP contributions. Higher net earnings in 1999 and 1998 for the 12 FHLBanks combined enabled the FHLBanks to pay their $300 million annual assessment without a shortfall allocation. Retained earnings were charged $47,694 and $48,503 for REFCORP interest assessments in 1999 and 1998, respectively.

The Modernization Act changed this obligation to 20% of net earnings for each FHLBank, with the final payment adjusted so that the aggregate payments made by all 12 FHLBanks are equivalent to a $300 million annual annuity whose final maturity date is April 15, 2030. The cumulative amount to be paid to REFCORP by the Bank is not determinable at this time due to the uncertainty of the FHLBanks' future earnings.

Effective April 1999, the Bank implemented its new mandatory surplus capital stock redemption policy. Surplus capital stock is defined as any excess stock holdings above 115% of a member's statutory capital stock requirement, excluding stock dividends earned and credited for the current year. In accordance with this plan, the Bank redeemed $413,444 in surplus capital stock in 1999. At December 31, 1999, surplus capital stock subject to mandatory redemption in January 2000 was $45,606.

Note 11 – Employee Retirement Plans

Prior to January 1, 1996, the Bank was a participating employer in the Financial Institutions Retirement Fund (FIRF), a defined benefit plan. The Bank funded its share of FIRF's normal cost each plan year through June 30, 1987. In the plan year beginning July 1, 1987, the "full-funding limitation" (as defined by the Employee Retirement Income Security Act) became applicable to the Bank because of favorable investment and other actuarial experience in previous years. As a result, the Bank was no longer required or permitted to make payments to FIRF in subsequent plan years.

Effective January 1, 1996, the Bank ceased to be a participating employer in FIRF, and the Bank began providing retirement benefits through a new Bank-sponsored Cash Balance Plan, a defined benefit plan. The Cash Balance Plan covers all employees who have completed six months of Bank service. Under the plan, each eligible Bank employee accrues benefits annually equal to 6% of the employee's annual pay, plus 6% interest on the benefits accrued to the employee through the prior yearend. The Cash Balance Plan is funded through a trust established by the Bank. In general, the amount to be funded by the Bank each year is determined by an independent actuary. Because of the transfer of surplus assets from FIRF, the assets of the Cash Balance Plan have substantially exceeded the amount of accrued benefits, so the Bank has not made additional payments to the Plan since its inception. The funded status of the Cash Balance Plan was $15,878 and $15,220, at December 31, 1998 and 1997, respectively. The unrecognized net gain amounted to $12,355 and $12,811, resulting in prepaid pension costs of $3,523 and $2,409 at December 31, 1998 and 1997, respectively. For the years ended December 31, 1998 and 1997, the Bank recognized net periodic pension income of $1,114 and $1,200, respectively, primarily from the expected return on the excess funded status and the amortization of the unrecognized net gain.

In February 1999, with approval from the Internal Revenue Service, the Bank implemented a spin-off/termination involving the Cash Balance Plan. The benefits of all inactive Cash Balance Plan participants (individuals who no longer work for the Bank) as of February 28, 1999, along with most of the surplus assets in the Cash Balance Plan (plan assets that exceeded Cash Balance Plan liabilities) net of the 2000 funding requirement for active employees, were transferred to a separate spin-off plan, which was then immediately terminated. At that time, the Bank recognized the remaining unamortized deferred gain, or $10,507. The projected benefit obligation and the accrual pension cost of the Cash Balance Plan were $3,125 and $1,560, respectively, at December 31, 1999. The periodic pension cost for the year totaled $560.

The Bank also participates in the Financial Institutions Thrift Plan, a defined contribution savings plan. The Bank's contribution consists of elective participant contributions and a Bank matching contribution of up to 6% of those participant contributions (based on compensation). The Bank contributed approximately $521, $472, and $452, in 1999, 1998, and 1997, respectively, to the plan.

In addition, the Bank maintains a deferred compensation plan that is available to all officers and directors. The plan liability consists of the accumulated compensation deferrals and accrued earnings on the deferrals. The Bank's obligation for this plan at December 31, 1999 and 1998, was $6,500 and $4,723, respectively.

Note 12 – Interest Rate Exchange Agreements

In connection with the Bank's interest rate risk management program, the Bank uses interest rate swaps, caps, and floors. When the Bank enters into interest rate exchange agreements, certain assets and liabilities are normally identified and designated as financial instruments hedged by such agreements. The interest rate exchange agreement together with the hedged item create terms that support the Bank's risk management objectives. The Bank monitors both the interest rate exchange agreements and the related hedged items to ensure that their relationship has not changed. The Bank also may act as an intermediary between members and third parties for interest rate exchange agreement transactions.

Interest rate swap transactions generally involve the contractual exchange of an adjustable rate for a fixed or another adjustable rate interest payment obligation based on a notional principal amount as defined in the agreement. Interest rate swaps associated with discount notes may effectively increase the maturity of the underlying borrowings. Interest

rate caps and floors obligate one of the parties to the contract to make payments to the other if an interest rate index exceeds a specified upper "capped" level or if the index falls below a specified "floor" level. The Bank does not enter into speculative interest rate swaps, caps, or floors.

These off-balance sheet instruments may involve, to varying degrees, elements of credit and interest rate risk. The maximum credit risk may be in excess of the amount recognized in the Statements of Condition. The Bank has adopted policies related to credit and interest rate risk limits and monitors transactions and positions for adherence to these policies. The contract or notional amounts of these instruments reflect the extent of the Bank's involvement in particular classes of financial instruments. For interest rate exchange agreements, the notional amount does not represent the exposure to credit loss. The amount potentially subject to credit loss is the estimated cost of replacing the favorable interest rate exchange agreement if the counterparty defaults and is substantially less than the notional amount. The Bank is subject to credit risk relating to the nonperformance by a counterparty to a non-exchange-traded interest rate exchange agreement. However, based on management's credit analyses of its counterparties, all of which are highly rated, and on the Bank's collateral requirements, no allowance for losses is deemed necessary by management.

Maximum credit risk is defined as the estimated cost of replacement for favorable interest rate exchange agreements in the event of counterparty default if the related collateral proves to be of no value to the Bank. At December 31, 1999 and 1998, the Bank's maximum credit risk, as defined above, was approximately $153,000 and $113,000, respectively, including $106,427 and $73,400 of net accrued interest receivable, respectively. Accrued interest receivables and payables, and the legal right to offset assets and liabilities by counterparty, in which amounts recognized for individual transactions may be offset against amounts recognized for other transactions with the same counterparty, are considered in determining the maximum credit risk. The Bank held highly rated securities with a fair value of $120,000 and $79,000 as collateral where the credit risk exceeded the Bank's unsecured credit risk limits as of December 31, 1999 and 1998, respectively.

A significant number of the Bank's interest rate exchange agreements are transacted with financial institutions such as major banks and broker-dealers, with no single institution dominating the business. Some of these banks and dealers or their affiliates buy, sell, and distribute consolidated obligations. Assets pledged as collateral by the Bank to these counterparties are more fully discussed in Note 14.

The notional principal, amortized costs, and estimated fair values by class type of all interest rate exchange agreements outstanding at December 31, 1999 and 1998, are detailed in Note 13.

The notional principal by class type of designated interest rate exchange agreements associated with securities purchased under agreements to resell, investments held to maturity, advances, and consolidated obligations outstanding at December 31, 1999 and 1998, is detailed in Notes 3, 4, 5, and 9, respectively. The notional principal of interest rate exchange agreements by class in which the Bank is an intermediary is detailed below.

Intermediation. Interest rate exchange agreements in which the Bank is an intermediary may arise when the Bank enters into offsetting interest rate exchange agreements with members and other counterparties to meet the needs of members or when the Bank enters into interest rate exchange agreements to offset the economic effect of other interest rate exchange agreements that are no longer designated to advances, investments, or consolidated obligations. The agreements have expiration dates between January 2000 and September 2008. The notional principal of the interest rate swap agreements in which the Bank is an intermediary at December 31, 1999 and 1998, was $1,436,400 and $2,201,600, respectively.

Loss on Interest Rate Exchange Agreements, Net. During 1999, the Bank terminated $575,000 in notional principal of interest rate swaps, $1,100,000 in notional principal of interest rate floors, and $500,000 in notional principal of interest rate caps that were hedging the current and future issuance of discount notes. During 1998, the Bank terminated $150,000 in notional principal of interest rate swaps that were hedging the future issuance of discount notes. The unamortized balance of the resulting deferred loss at December 31, 1999 and 1998, totaled $32,646 and $11,102, respectively, and the loss is included in the carrying amount of discount notes. These deferred losses are being amortized over the original term to maturity of the terminated interest rate swaps. During 1997, the Bank terminated $385,000 in notional principal of its term interest rate swaps because the Bank determined that these swaps were no longer required to hedge anticipated issuances of discount notes. As a result, the Bank recognized a net loss of $19,768 in other income.

Income Effect. The effect of the Bank's interest rate exchange agreements for the years ended December 31, 1999, 1998, and 1997, was to increase (decrease) interest income, interest expense, and other income and to produce extraordinary gains (losses) on early retirement of debt as follows:

	1999	1998	1997
Interest income:			
Advances to members	$ (68,651)	$ (24,992)	$ (6,432)
Investments held to maturity	(7,549)	(7,592)	(9,514)
Resale agreements	(16)	(182)	(5,372)
Federal funds sold	—	26	(3)
Interest expense:			
Consolidated obligations	(143,583)	(100,007)	(85,314)
Deposits	—	—	1,061
Other income:			
Prepayment fees	701	1,477	(45)
Net loss on terminated and redesignated interest rate swaps	—	—	(19,681)
Other income	(60)	4	75
Extraordinary gain on early retirement of debt	$ 1,489	$ —	$ —

Note 13 – Estimated Fair Values

Cash and Due from Banks. The estimated fair values approximate the carrying values.

Resale Agreements and Federal Funds Sold. The estimated fair values of these instruments have been determined by calculating the present value of expected cash flows. The discount rates used in these calculations are the replacement rates for securities with similar terms.

Interest-Bearing Deposits in Banks and Investments Held to Maturity. The estimated fair value of these instruments, including mortgage-backed securities, has been determined based on quoted prices or by calculating the present value of expected cash flows as of the last business day of the year excluding accrued interest.

Advances to Members. For advances with more than three months to maturity or repricing, the estimated fair value has been determined by calculating the present value of expected cash flows from the advances and reducing this amount for accrued interest receivable. The discount rates used in these calculations are the replacement rates for advances with similar terms. Pursuant to the Finance Board's advances regulation, advances with a maturity or repricing period greater than six months generally require a prepayment fee sufficient to make the Bank financially indifferent to the borrower's decision to prepay the advances. Therefore, the estimated fair value of advances does not assume prepayment risk. For advances with three months or less to maturity or repricing, the recorded carrying value approximates the estimated fair valk

Accrued Interest Receivable and Payable. The recorded carrying value approximates the estimated fair value.

Deposits. For deposits with more than three months to maturity or repricing, the estimated fair value has been determined by calculating the present value of expected future cash flows from the deposits and reducing this amount for accrued interest payable. The discount rates used in these calculations are the cost of deposits with similar terms. For deposits with three months or less to maturity or repricing, the recorded carrying value approximates the estimated fair value.

Consolidated Obligations. The estimated fair value has been determined based on the estimated cost of raising comparable term debt. The estimated cost of issuing debt is determined daily based on the primary market for debt of government-sponsored enterprises and other indications from securities dealers; the estimated cost of issuing debt includes non-interest selling costs.

Borrowings. For borrowings with more than three months to maturity or repricing, the estimated fair value has been determined by calculating the present value of expected future cash flows from the borrowings and reducing this amount for accrued interest payable. The discount rates used in these calculations are the costs of borrowings with similar terms. For borrowings with three months or less to maturity or repricing, the recorded carrying value approximates the estimated fair value.

Commitments. The estimated fair value of the Bank's commitments to extend credit, including letters of credit, was immaterial at December 31, 1999 and 1998.

Interest Rate Exchange Agreements. The estimated fair values of these agreements are based on the estimated cost of interest rate exchange agreements with similar terms or available market prices, excluding accrued interest receivable and payable. However, active markets do not exist for many types of financial instruments. Consequently, fair values for these instruments must be estimated using techniques such as discounted cash flow analysis and comparisons to similar instruments. Estimates developed using these methods are highly subjective and require judgments regarding significant matters such as the amount and timing of future cash flows and the selection of discount rates that appropriately reflect market and credit risks. Changes in these judgments often have a material effect on the fair value estimates. Since these estimates are made as of a specific point in time, they are susceptible to material near-term changes. The estimated fair values of the Bank's financial instruments at December 31, 1999 and 1998, were as follows:

Fair Value of Financial Instruments – 1999

	Carrying Value	Net Unrealized Gains (Losses)	Estimated Fair Value
Assets			
Cash and due from banks	$ 1,424	$ —	$ 1,424
Interest-bearing deposits in banks	1,702,000	1,585	1,703,585
Federal funds sold	8,636,000	5,028	8,641,028
Resale agreements	2,558,885	1,144	2,560,029
Investments held to maturity	10,382,029	(113,375)	10,268,654
Interest rate exchange agreements associated with investments held to maturity	—	10,295	10,295
Investments held to maturity, net	10,382,029	(103,080)	10,278,949
Advances to members	90,513,646	(558,007)	89,955,639
Interest rate exchange agreements associated with advances to members	183	546,246	546,429
Advances to members, net	90,513,829	(11,761)	90,502,068
Accrued interest receivable	2,099,622	—	2,099,622
Other assets	18,258	—	18,258
Total	$115,912,047	$ (107,084)	$115,804,963
Liabilities			
Consolidated obligations:			
Bonds	$ 76,725,689	$ 1,420,795	$ 75,304,894
Discount notes	30,676,746	(38,013)	30,714,759
Interest rate exchange agreements associated with consolidated obligations	—	(1,214,172)	1,214,172
Consolidated obligations, net	107,402,435	168,610	107,233,825
Deposits	326,953	(7)	326,960
Accrued interest payable	2,606,541	—	2,606,541
Other liabilities	136,226	—	136,226
Interest rate exchange agreements in which the Bank is an intermediary	1,493	533	960
Total	$110,473,648	$ 169,136	$110,304,512

Fair Value of Financial Instruments – 1998

	Carrying Value	Net Unrealized Gains (Losses)	Estimated Fair Value
Assets			
Cash and due from banks	$ 2,707	$ —	$ 2,707
Interest-bearing deposits in banks	402,000	—	402,000
Federal funds sold	4,894,000	—	4,894,000
Resale agreements	2,226,625	162	2,226,787
Interest rate exchange agreements associated with resale agreements	—	(4)	(4)
Resale agreements, net	2,226,625	158	2,226,783
Investments held to maturity	7,973,097	38,141	8,011,238
Interest rate exchange agreements associated with investments held to maturity	714	(23,133)	(22,419)
Investments held to maturity, net	7,973,811	15,008	7,988,819
Advances to members	63,989,305	353,207	64,342,512
Interest rate exchange agreements associated with advances to members	—	(238,948)	(238,948)
Advances to members, net	63,989,305	114,259	64,103,564
Accrued interest receivable	1,521,982	—	1,521,982
Other assets	113,473	—	113,473
Total	$81,123,903	$ 129,425	$81,253,328
Liabilities			
Consolidated obligations:			
Bonds	$62,438,924	$(104,013)	$ 2,542,937
Discount notes	11,539,320	(14,917)	11,554,237
Interest rate exchange agreements associated with consolidated obligations	(17,643)	15,389	(33,032)
Consolidated obligations, net	73,960,601	(103,541)	74,064,142
Deposits	478,215	(111)	478,326
Securities sold under agreements to repurchase	150,000	—	150,000
Other borrowings	156,111	—	156,111
Accrued interest payable	1,819,720	—	1,819,720
Other liabilities	120,673	—	120,673
Interest rate exchange agreements in which the Bank is an intermediary	3,281	3,241	40
Total	$76,688,601	$(100,411)	$76,789,012

Fair Value Supplemental Tables

The Bank enters into some interest rate swap agreements that a counterparty may cancel at its option. While the counterparty generally may exercise this option to cancel at any specified cancellation date, the movement of interest rates usually determines whether the option will be exercised. If the interest rate exchange agreement has a positive fair value from the Bank's perspective, the counterparty is likely to exercise the option assuming interest rates and volatilities remain the same through the next cancellation date of the instrument. The following tables categorize interest rate swap agreements as non-cancelable, cancelable by the counterparty, and cancelable by the Bank:

Fair Value Supplemental Table – 1999

Interest Rate Exchange Agreements (by class)	Notional Principal	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Interest rate swaps:					
Non-cancelable:					
Bank pays fixed, receives adjustable	$ 22,460,523	$ (1,493)	$ 529,811	$ (12,514)	$ 515,804
Bank pays adjustable, receives fixed	46,640,398	—	7,902	(582,596)	(574,694)
Bank pays adjustable, receives adjustable	24,008,159	—	34,169	(38,362)	(4,193)
Cancelable by counterparty:					
Bank pays adjustable, receives fixed	27,059,000	—	530	(608,870)	(608,340)
Bank pays fixed, receives adjustable	2,808,500	—	31,176	(513)	30,663
Bank pays adjustable, receives adjustable	1,025,000	—	838	(19,048)	(18,210)
Cancelable by Bank:					
Bank pays fixed, receives adjustable	13,550	—	562	—	562
Subtotal	124,015,130	(1,493)	604,988	(1,261,903)	(658,408)
Interest rate caps purchased	37,360	183	—	(183)	—
Total	$124,052,490	$(1,310)	$604,988	$(1,262,086)	$(658,408)

Fair Value Supplemental Table – 1998

Interest Rate Exchange Agreements (by class)	Notional Principal	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Interest rate swaps:					
Non-cancelable:					
Bank pays fixed, receives adjustable	$ 27,045,205	$ 3,917	$ 25,088	$ (244,737)	$ (215,732)
Bank pays adjustable, receives fixed	19,616,800	46	136,615	(16,487)	120,174
Bank pays adjustable, receives adjustable	30,507,587	—	16,029	(54,680)	(38,651)
Cancelable by counterparty:					
Bank pays adjustable, receives fixed	27,000,000	—	52,587	(47,831)	4,756
Bank pays fixed, receives adjustable	6,187,000	—	485	(109,361)	(108,876)
Bank pays adjustable, receives adjustable	1,315,000	—	226	(1,200)	(974)
Cancelable by Bank:					
Bank pays fixed, receives adjustable	166,200	—	22	(2,938)	(2,916)
Subtotal	111,837,792	3,963	231,052	(477,234)	(242,219)
Interest rate caps purchased	537,360	9,409	—	(6,000)	3,409
Interest rate floors purchased	1,100,000	1,704	8,727	—	10,431
Total	$113,475,152	$15,076	$239,779	$(483,234)	$(228,379)

Note 14 – Commitments and Contingencies

As indicated in Note 9, all FHLBanks have joint and several liability for the consolidated obligations issued by the Finance Board. Accordingly, should one or more of the FHLBanks be unable to repay its participation in the consolidated obligations, the other FHLBanks could be called upon to repay all or a portion of such obligations.

Commitments that legally bind and obligate the Bank for additional advances totaled approximately $206,000 and $1,100,487 at December 31, 1999 and 1998, respectively. Commitments generally are for periods up to 12 months. Outstanding standby letters of credit were approximately $824,537 and $1,197,681 at December 31, 1999 and 1998, respectively. Based on management's credit analyses and collateral requirements, no allowance for losses is deemed necessary by management on these advance commitments and letters of credit. Advances funded under these advance commitments and letters of credit are fully collateralized at the time of issuance in a manner consistent with advances to members (see Note 5).

These credit-related financial instruments have off-balance sheet risk, which is essentially the same as that involved in extending advances to members. The credit risk amounts are equal to the notional amounts of the transactions assuming that the members completely fail to meet their obligations and the collateral or other security is of no value.

The Bank executes interest rate exchange agreements with major banks and broker-dealers that have a long-term credit ratings of single-A or better from both Standard & Poor's and Moody's. The Bank enters into bilateral security agreements with all counterparties. As of December 31, 1999 and 1998, the Bank had pledged as collateral securities of $638,600 and $181,000, respectively, to broker-dealers that have credit risk exposure to the Bank related to interest rate exchange agreements.

The Bank charged operating expenses net rental costs of approximately $2,047, $388, and $369 for the years ending December 31, 1999, 1998, and 1997. Future minimum rentals at December 31, 1999, were as follows:

Year	Premises	Equipment	Total
2000	$ 2,606	$255	$ 2,861
2001	2,623	31	2,654
2002	2,811	25	2,836
2003	2,811	14	2,825
2004	2,942	—	2,942
Thereafter	14,016	—	14,016
Total	$27,809	$325	$28,134

Lease agreements for Bank premises generally provide for increases in the basic rentals resulting from increases in property taxes and maintenance expenses. Such increases are not expected to have a material effect on the Bank's financial condition or results of operation.

The Bank is subject to various pending legal proceedings arising in the normal course of business. After consultation with legal counsel, management does not anticipate that the ultimate liability, if any, arising out of these matters will have a material effect on the Bank's financial condition or results of operations.

Other commitments and contingencies are discussed in Notes 6, 9, 10, and 12.

To the Board of Directors and Shareholders
of the Federal Home Loan Bank of San Francisco:

In our opinion, the accompanying statements of condition and the related statements of income, of capital accounts and of cash flows present fairly, in all material respects, the financial position of the Federal Home Loan Bank of San Francisco (the Bank) at December 31, 1999 and 1998, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 1999, in conformity with accounting principles generally accepted in the United States. These financial statements are the responsibility of the Bank's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

San Francisco, California

February 11, 2000

Financial Statements

The management of the Federal Home Loan Bank of San Francisco (the Bank) prepared the financial statements contained in the Annual Report in accordance with generally accepted accounting principles. Management has primary responsibility for the integrity and objectivity of the financial statements, which include amounts that are based on management's best estimates and judgments. Other information in the Annual Report is consistent with that contained in the financial statements.

The Bank's financial statements have been audited by PricewaterhouseCoopers LLP, independent accountants approved by the Federal Housing Finance Board. Management has made available to PricewaterhouseCoopers LLP all the Bank's financial records and related data, as well as the minutes of the meetings of the Bank's Board of Directors. The report of the independent accountants expresses an opinion as to the fairness of the financial position and results of operations of the Bank based on their audit conducted in accordance with generally accepted auditing standards.

Internal Control Systems

In meeting its responsibility for the integrity and objectivity of the financial statements, management of the Bank has established and relies upon a system of internal controls designed to provide reasonable assurance as to the integrity and reliability of the financial statements, the protection of assets from unauthorized use or disposition, and the prevention and detection of fraudulent financial reporting. The system of internal controls provides for appropriate division of responsibility and is documented by written policies and procedures that are communicated to employees with significant roles in the financial reporting process. Management monitors the system of internal controls for compliance, adequacy, and cost-effectiveness. Management believes that as of December 31, 1999, the Bank's system of internal controls was adequate to accomplish the objectives discussed herein.

The Bank maintains an internal auditing program and the Federal Housing Finance Board performs an examination function that independently assess the effectiveness of the Bank's internal controls and recommend possible improvements thereto. Corrective actions are taken to address control deficiencies and other opportunities for improving the system as they are identified. The Audit Committee of the Board of Directors is composed of independent directors and oversees the Bank's financial reporting and system of internal controls. In addition to meeting regularly with the Bank's management, the Committee met with the Bank's Director of Internal Audit, Federal Housing Finance Board examiners, and independent accountants, without management present, to discuss the results of their audits, their evaluations of the system of internal controls, and the overall quality of the Bank's financial reporting.

There are inherent limitations in the effectiveness of any system of internal controls, including the possibility of human error and the circumvention or overriding of controls. Accordingly, even an effective internal control system can provide only reasonable assurance with respect to financial statement preparation. Furthermore, the effectiveness of an internal control system can change with circumstances.

The Bank assesses its internal control system in relation to, among other things, criteria for effective internal control over financial reporting described in "Internal Control-Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on its assessment, the Bank believes that, as of December 31, 1999, its system of internal controls over financial reporting met those criteria.

Code of Conduct

Management also recognizes its responsibility for fostering a strong ethical climate so that the Bank's affairs are conducted according to the highest standards of personal and corporate conduct. This responsibility is characterized and reflected in the Bank's code of corporate conduct, which is communicated to employees.

Dean Schultz
President and Chief Executive Officer

Steven T. Honda
Senior Vice President and Chief Financial Officer

Vera Maytum
Senior Vice President and Controller

February 11, 2000

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Design: Levin Breidenbach Wade, Mill Valley, CA

Federal Home Loan Bank of San Francisco
600 California Street, San Francisco, California 94108 415.616.1000