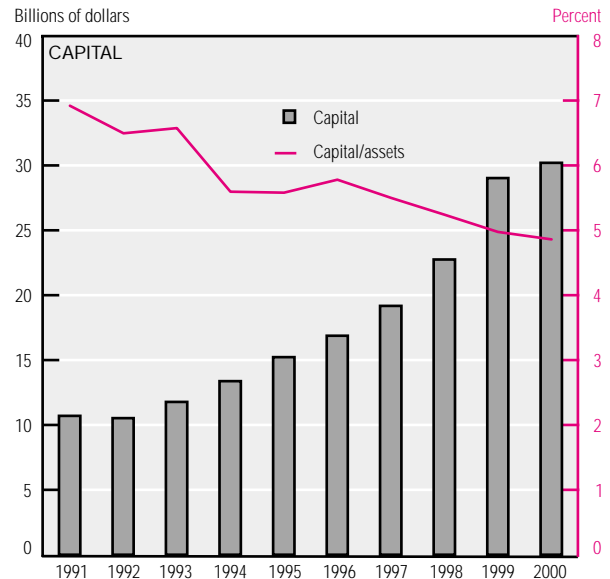
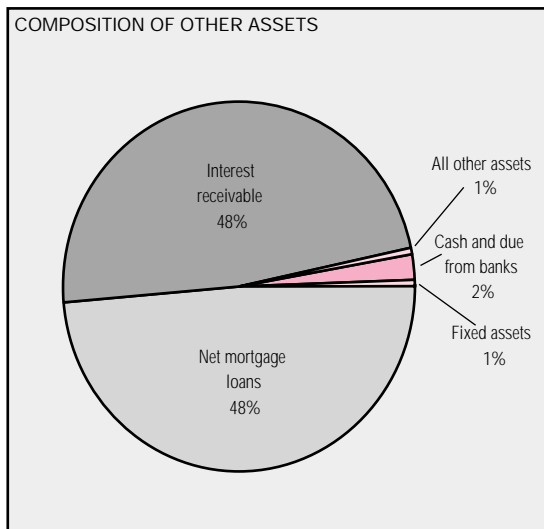
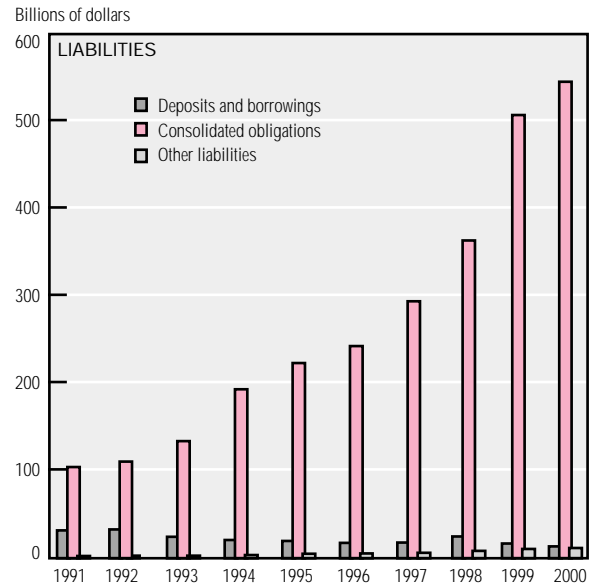
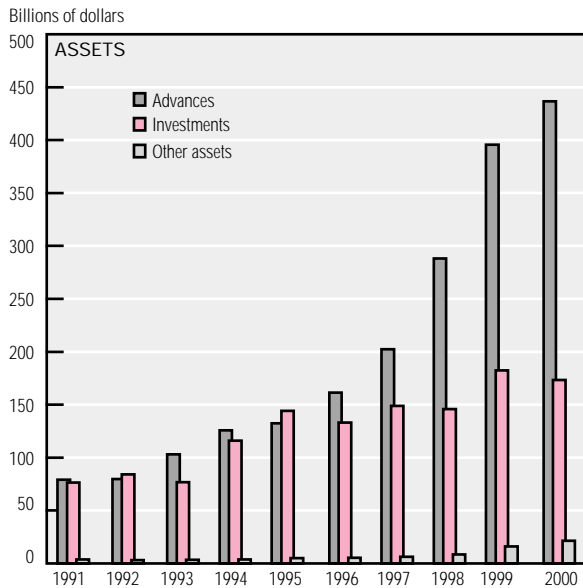


Federal Home Loan Banks



SOURCE: Federal Home Loan Bank System, *Quarterly Financial Report*, June 30, 2000, and annual reports.

The 12 Federal Home Loan Banks are stock-chartered, government-sponsored enterprises whose original mission was to provide short-term advances to member institutions, funded by deposits from those institutions. Membership was open to specialized housing-finance lenders, mostly savings and loan associations and mutual savings banks. As their traditional clientele has shrunk and the financial system has consolidated, the FHLB system has reinvented its role

in financial markets. FHLB advances now represent an important funding source for member institutions' mortgage portfolios, having risen to \$436 billion by the end of 1999:11Q and far outstripping all other FHLB investments and assets.

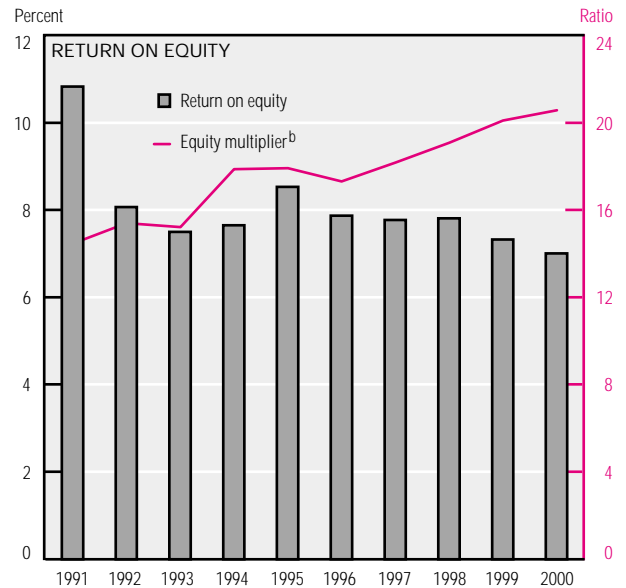
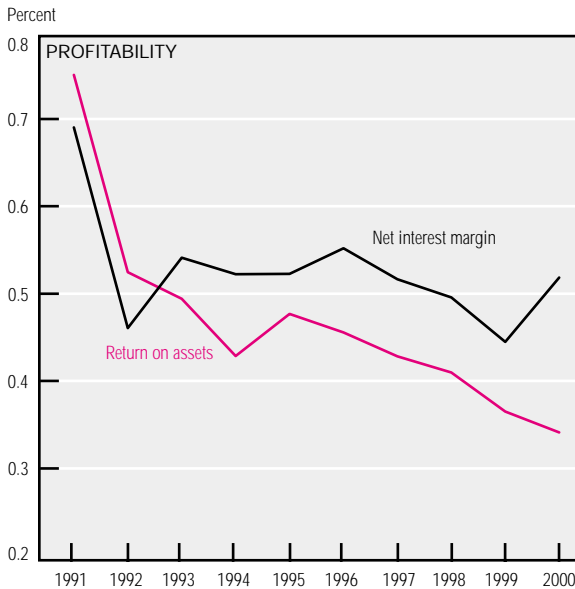
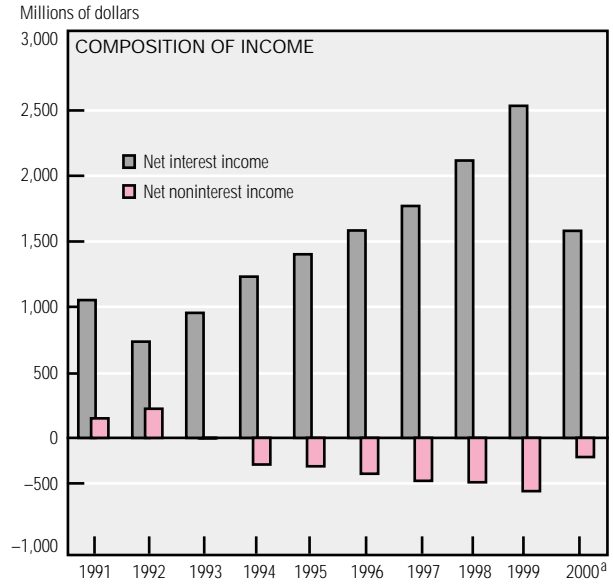
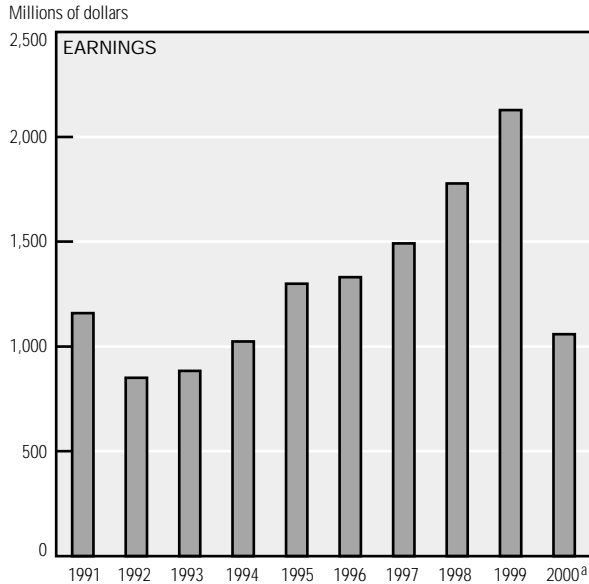
The lion's share of funding for FHLB assets came from \$564 billion in consolidated obligations of the FHLB system—bonds issued on behalf of the 12 banks collectively. The market views these bonds as implicitly backed by the U.S. government; hence, FHLBs

can raise funds at rates of return below those paid by AAA-rated corporations. Member institutions' deposits and short-term borrowings, along with other liabilities, contributed few funds. FHLBs have added to their capital as they have grown, although the pace of asset growth has outstripped capital growth since 1996, and the capital-to-asset ratio fell to 4.9% by mid-2000.

In 1997, the FHLB of Chicago initiated the Mortgage Partnership Finance Program, whereby it invests directly in mortgages, in addition to

(continued on next page)

Federal Home Loan Banks (cont.)



a. Data through first half of year.
 b. Equity multiplier is the ratio of total assets to equity.
 SOURCE: Federal Home Loan Bank System, *Quarterly Financial Report*, June 30, 2000, and annual reports.

supporting members' own portfolios through advances. Currently, most FHLBs offer this program; the \$10.4 billion in mortgages that they hold represents almost half of their other assets. This portfolio is projected to be a major source of asset growth for FHLBs and it represents a significant departure from their original mission.

FHLB's earnings have grown steadily since 1994. Their \$1,059 million in net income for the first half of 2000 compares favorably to \$974 million for the first half of 1999. Break-

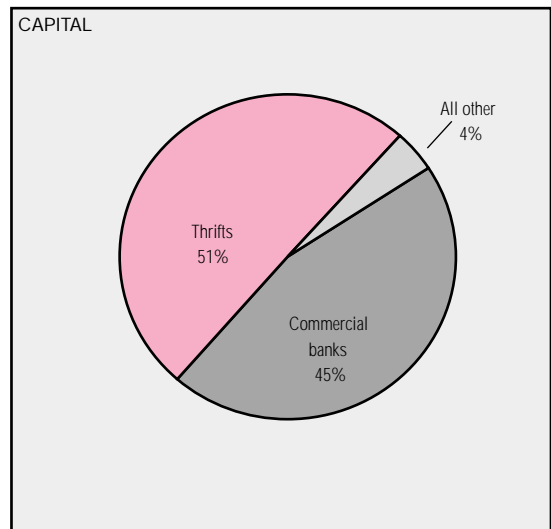
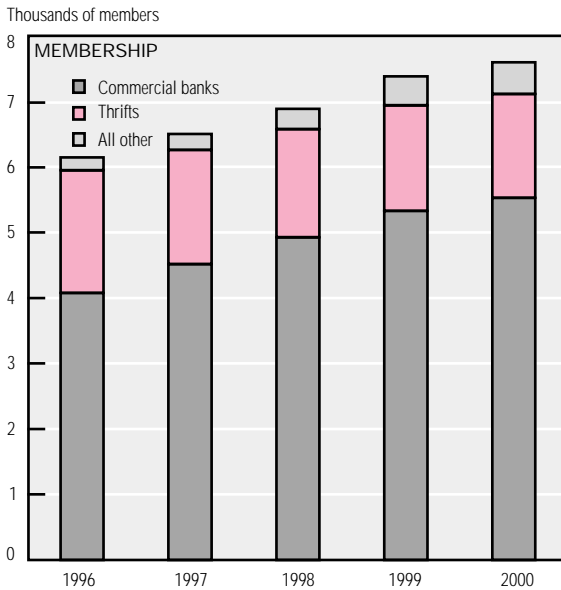
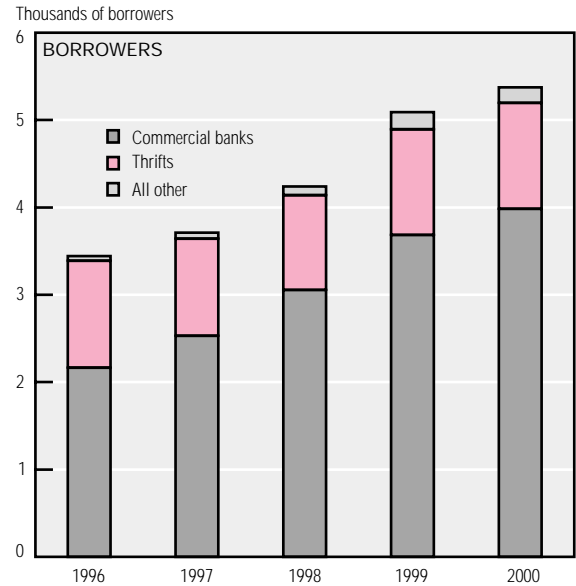
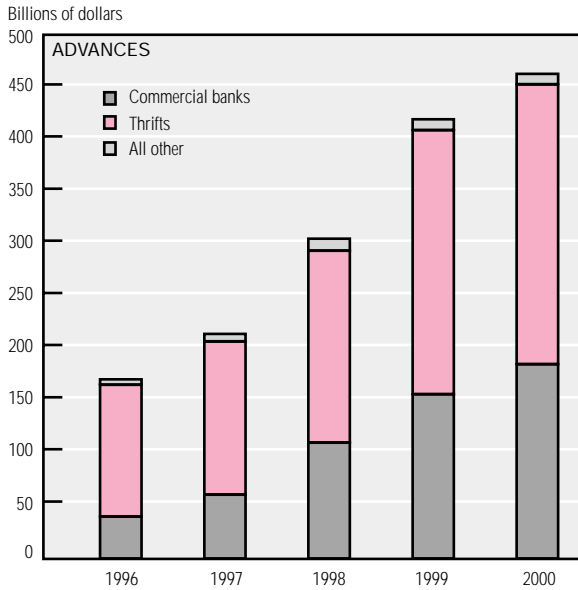
ing down earnings into interest and noninterest sources reveals that, like commercial banks and savings and loans, FHLBs' earnings come primarily from net interest income (interest income less interest expense). Net interest income grew steadily from \$735 million in 1992 to \$2,533 million at the end of 1999; for the first half of 2000 it measured \$1,581 million, up from \$1,163 million for the same period in 1999.

A steady increase in operating expenses, especially in employee compensation and benefits, has

driven an increasingly negative spread between noninterest income and noninterest expense since 1993. Improvements in earnings and net interest income have resulted from strong asset growth rather than improvements in underlying profitability. Return on assets declined during the 1990s from 75 basis points (bp) in 1991 to 36 bp at the end of 1999. The annualized return on assets through 2000:IIQ is 34 bp. The net interest margin rose from 44 bp at the end of 1999 to 52 bp in mid-2000, still a far cry from the

(continued on next page)

Federal Home Loan Banks (cont.)



SOURCE: Federal Home Loan Bank System, *Quarterly Financial Report*, June 30, 2000, and annual reports.

69 bp margin earned in 1991 and the 300–400 bp margins typical of depository institutions.

Despite continued increases in leverage since 1996, return on equity fell to 7.02% in the first half of 2000 from 7.33% at the end of 1999. Such persistently weak returns on assets and equity have put further pressure on FHLBs to undertake nontraditional lines of business.

The FHLBs' changing role is evident in its membership, which has increased steadily to a record

7,594 institutions at the end of 2000:IIQ. Notably, commercial banks now represent 73% of members, numbering 5,526 at midyear. Thrift institution membership continues to decline, reflecting the consolidation of the thrift industry. Another 486 members were drawn from other housing lenders, including credit unions and insurance companies, up nearly 10% at the end of June from the beginning of the year. Nevertheless, thrifts remain the heaviest users of FHLB

advances, accounting for 58% of the \$436.6 billion in advances at mid-year. Advances to commercial banks have increased over the past five years, reaching \$175 billion at 2000:IIQ. Provisions of the Financial Modernization Act of 1999 allow FHLBs to make advances against community banks' small business loan portfolios, which should stimulate banks' use of advances in the future.