FHLBank®
ATLANTA
A FEDERAL HOME LOAN BANK

Earnings: Quality or Quantity?
Rates: Exposed or Prepared?

FHLBank Atlanta Welcome and Overview

August 5, 2020

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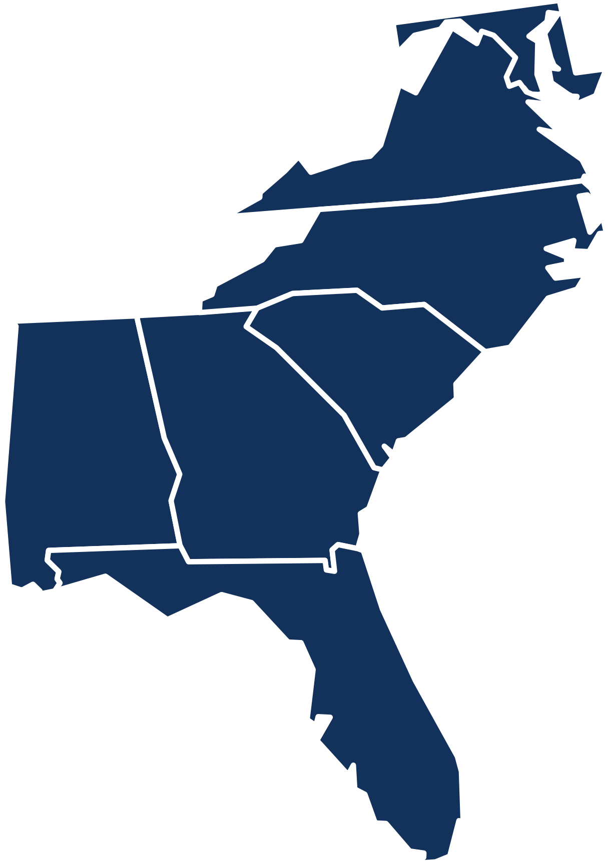
Agenda

- FHLBank Atlanta Overview
  - Financial Picture
  - Community Investment Program (CIP) and Economic Development Program (EDP)

- Scott Hildenbrand, Managing Director and Head of Balance Sheet Analysis and Strategy, Piper Sandler
  - Earnings: Quality or Quantity?
  - Rates: Exposed or Prepared?

FHLBank Atlanta – Financial Highlights

June 30, 2020

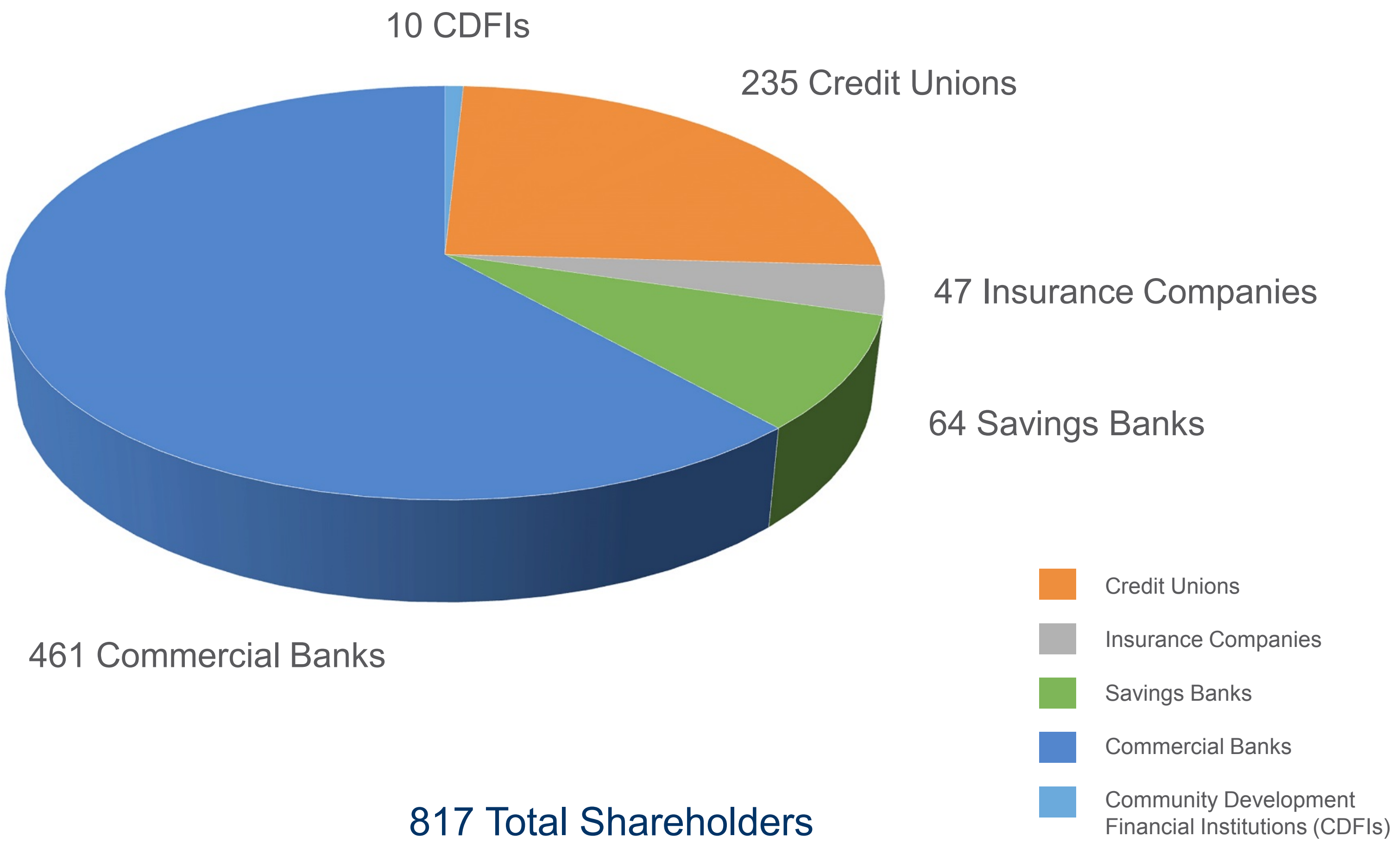


- **Total Assets: $126.6 billion***
- **Total Advances (loans): $67 billion***
- **Second Quarter Net Income: $56 million***
- **Retained Earnings: $2.2 billion***
- **Second Quarter 2020 Dividend: 4.35%**
- **Total Membership: 817 institutions**

*Figure is preliminary and approximate until the Bank announces unaudited financial results in its Form 10-Q filing with the Securities and Exchange Commission (SEC), which is expected to be filed on or about August 7, 2020.

FHLBank Atlanta Shareholders

As of June 30, 2020



817 Total Shareholders

CIP and EDP Details

Product	Description	Shareholder Benefits	Interest Rate	Key Requirements

Community Investment Program	• Advances to shareholders to assist low- and moderate-income families that seek affordable housing opportunities
	• Must be used for:
	  • purchase, construction, and rehabilitation; or
	  • refinancing of housing related projects or activities that benefit families with an income at or below 115 percent of area median income
		• Reduces funding costs
		• Supports a broad range of housing projects
		• Stimulates local housing sector
			• Discounted interest rate is based on the Bank's cost of funds, plus the administrative costs of the advance	• Subject to Bank's credit and collateral requirements
				• Prepayment fees may apply

Economic Development Program	• Advances to shareholders to assist with community economic development activities such as:
	  • **entities eligible for the SBA's Paycheck Protection Program- NEW!**
	  • business start-ups
	  • projects that create or maintain jobs
	  • redevelopment of federal disaster areas
	  • infrastructure improvement
	  • other economic development activities
		• Reduces funding costs
		• Supports small business and microenterprise lending
		• Stimulates local commercial, industrial, and manufacturing sectors
			• Discounted interest rate is based on the Bank's cost of funds, plus the administrative costs of the advance	• Advances subject to the Bank's credit and collateral requirements
				• Prepayment fees may apply

Thank You

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AUGUST 2020

FHLBank Atlanta

Earnings: Quality or Quantity? Rates: Exposed or Prepared?

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Overview

- Defining quality vs. quantity of earnings
- Recent balance sheet developments impacting earnings and A/L
- Tactics and their impact on earnings and A/L

Earnings: Quality or Quantity?

Net Interest Margin (Quality)

- Wider margins often indicate higher yielding assets and lower cost funding
- Banks that can keep risk in check while offering higher margins are generally considered high-quality

vs. Net Interest Income (Quantity)

- More NII is a good thing – more earnings always helps
- Delivering more quantity will show ability to grow, but is not enough to determine quality

- Note: stable non-interest income can be quality, unstable non-interest income would be quantity

ROA (Quality)

- How much can you earn on your assets – ROA is the standard in profitability quality

vs. ROE (Quantity)

- How much can you earn on your equity could be considered quality, but, highly-levered institutions can show high ROE without having a high quality earnings stream

Public Company Considerations: Trading Multiples

- There is little premium paid for excess capital, but there is a discount for not enough capital – be sure to strike a balance
- There is little premium paid for wholesale balance sheet – low cost core deposits are still the key to franchise value

Recent Balance Sheet Developments

- Excess liquidity
  - PPP, Prepayments, Slow Loan Pipelines

- Reduced risk tolerance
  - Also slows loan pipeline, shorter more liquid investments (typically lower yields), reduced business investment or new business lines

- Need for more capital / LLR
  - If asset quality issues are coming, LLR and capital build-up is occurring now

- Unprecedented low rates and flat curve
  - Little ability to extend and pick up yield, fewer attractive asset options

Recent Balance Sheet Developments

- Currently, 56% of domestic public banks have reported their metrics, which are catalogued below

Balance Sheet	FQ3'19	FQ4'19	FQ1'20	FQ2'20	Last 4 Quarters
Cash / Assets	5.1%	4.8%	5.4%	7.6%	**48.9%**
Cash & Sec. / Assets	19.5%	19.5%	19.8%	20.1%	**3.1%**
Liquid Assets / Assets	17.5%	17.2%	17.9%	18.9%	**7.8%**
Securities / Assets	14.5%	14.8%	14.9%	12.9%	**(11.0)%**
Loans / Deposits	90.8%	91.5%	91.3%	89.5%	**(1.4)%**

Capital	FQ3'19	FQ4'19	FQ1'20	FQ2'20	Last 4 Quarters
Total Capital Ratio	14.14%	14.17%	13.98%	14.37%	**1.6%**
Leverage Ratio	10.20%	10.20%	10.06%	9.37%	**(8.1)%**

Asset Quality	FQ3'19	FQ4'19	FQ1'20	FQ2'20	Last 4 Quarters
NPA+90 Days / Assets	0.56%	0.56%	0.56%	0.61%	**8.5%**
LLR / Gross Loans	0.96%	0.94%	1.12%	1.15%	**20.0%**

Profitability	FQ3'19	FQ4'19	FQ1'20	FQ2'20	Last 4 Quarters
Core ROAA	1.23%	1.16%	0.78%	0.87%	**(29.0)%**
Core ROAE	10.60%	9.81%	6.99%	8.18%	**(22.9)%**
Net Interest Margin	3.66%	3.59%	3.52%	3.31%	**(9.6)%**

Source: S&P Global
All domestic publicly traded banks that have reported metrics as of July 30, 2020

Summary Themes and Tactics

- Deploying excess liquidity
    - Short and liquid vs. long and illiquid
    - Sub Debt taking place of loans

- Deleverage the wholesale balance sheet

- More efficient releverage

- Pay Fixed Swap – Beat the Spread

- Receive Fixed Swap

- Back to Back Swaps

Securities Portfolio Strategies – Cash Deploy

Balance Liquidity, Stability, and Yield

- 20yr 2s or 2.5s for yield in the intermediate sector while providing stability, predictable cash flow, and liquidity
- Jumbo 2.5s for higher current yield. Consider prepay spike

Short Sequential CMOs to preserve liquidity and price volatility

- 2-3 average life for high cash flow
- Good option when current cash is high and future cash needs are uncertain
- Cash “alternative”

FRESB: Wider spreads, Freddie Mac backing

- Relative value – spreads approximately 20-25 bps wider than Freddie K
- Small balance multifamily loans in secondary, and tertiary markets with potential for CRA credit
- Multiple fixed, and hybrid ARM structures with 5, 7, and 10yr terms
- New deal issued each month

Single name sub debt issuers: good returns, often considered as loan proxies

- Consider your institution’s appetite for credit

Quality of Earnings	Quantity of Earnings	More Asset Sensitive	Less Asset Sensitive
	✖		✖

De-lever/Re-lever

	De-lever	De-lever/ Re-lever
Delever (Spread Removed)	30M (-40 bps)	30M (-40 bps)
Leverage (Spread Added)	-	30M (114 bps)
Balance Sheet Size	(30M)	-
One-time Gain/Loss	-	-
NII	120K	462K
NIM	0.05%	0.02%
Tier 1 Leverage Ratio	0.16%	-

Quality of Earnings	Quantity of Earnings	More Asset Sensitive	Less Asset Sensitive
✖		Usually	

Step 1: Unwind negative leverage and improve balance sheet efficiency

- Use gains from the sale of securities to offset the loss on FHLBank borrowings
- Note: gains can also be used to unwind losses on previous hedges

Step 2: Re-deploy the capital created to improve go-forward earnings

- Add leverage at a spread of over 100 bps
- **Leverage funding:** 5Y "Beat the Spread" at an all-in cost of 0.49%
- **Leverage purchases:**

Description	Allocation (%)	Est. Yield
Bank Sub Debt	10%	5.25
FN 20Yr 2.5	20%	1.30
2yr SEQ CMO	20%	0.80
FRESB	10%	1.07
5Yr GNMA Project Loan	10%	1.25
5% 2044 GM Muni	20%	1.52
FN Jumbo 2.5	10%	1.45
		1.63

Quality of Earnings	Quantity of Earnings	More Asset Sensitive	Less Asset Sensitive
	✖		Usually

Market valuation as of July 27, 2020, subject and indicative
Assumes 3mL = 0.27% and FHLB Des Moines 3mo advance (not dividend adjusted) = 0.38%

Beat the Spread – How Does It Work?

By leveraging an interest rate swap, the bank has opportunity to reduce interest expense relative to comparable FHLBank structures or CDs:

- Enter into a pay-fixed, receive 3-month LIBOR interest rate swap
- Take out 3-month advance, settling on the effective date of the swap
- Designate the swap as a cash flow hedge against changes in advance rates attributable to changes in benchmark interest rates (3-month LIBOR)
- Roll the 3-month advance each quarter matching the reset dates of the swap
- Test the hedging relationship for effectiveness and prove that the hedging relationship is highly effective

Rollover Strategy with 5 Year Pay-Fixed Swap

Pay Fixed + 3 Month Advance – 3 Month LIBOR = All-in Funding Cost

0.19% + 0.36% - 0.26% = 0.29%

Save 24bps compared to 0.53% FHLBank 5-year Term Advance

Quality of Earnings	Quantity of Earnings	More Asset Sensitive	Less Asset Sensitive
	Depends on Rates	✖	

FHLB Indy advance rate and swap rates as 7/21/20

Forward Swap – How Does It All Work?

The Bank has term debt set to mature at a future date, but likes the level of rates today

- Consider forward-starting pay fixed swaps as a tool to hedge against rising benchmark rates

The recent sharp drop in interest rates presents an opportunity to hedge the impact of rate increases on future borrowing needs

- A forward-starting swap is an interest rate swap that is executed today but is effective over a period of time starting in the future, customized to the Bank's needs
- The Bank can use forward starting swaps to manage the refinance risk of existing funding by scheduling the effective date of the swap to coincide with current funding's maturity date

Existing Term Wholesale Funding		
Notional	Rate	Maturity
$10,000,000	2.50%	3/29/2022

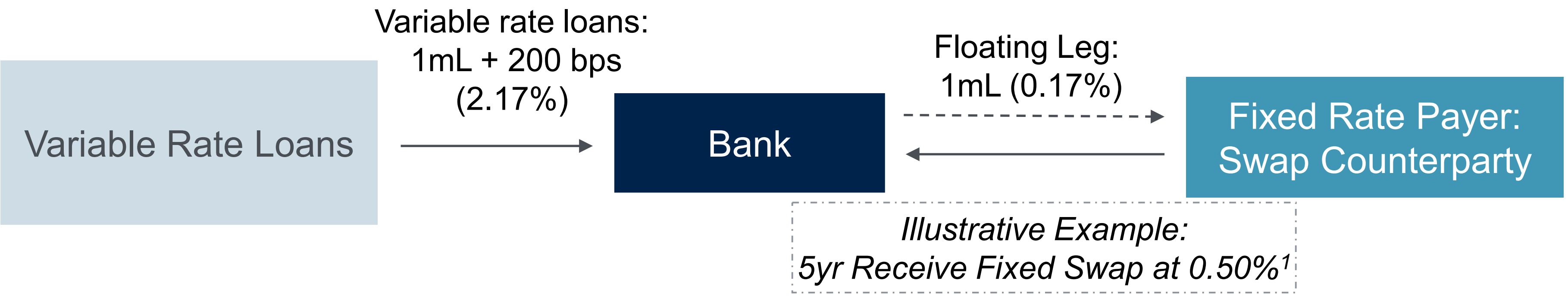
New Funding: Forward-Starting Swaps vs. 3mL				
Notional	Effective	3Y	5Y	7Y
$10,000,000	3/29/2022	0.40%	0.53%	0.66%

Quality of Earnings	Quantity of Earnings	More Asset Sensitive	Less Asset Sensitive
	Depends on Rates	✖	

Market valuation as of 7/27/2020, subject and indicative
Source: Piper Sandler Hedging Services, LLC

What’s Next? Receive Fixed with an Upward-Sloping Yield Curve

- Unfloored floating rate loans present an earnings drag for asset-sensitive institutions
  - Monitor rates for a yield curve bear steepening with growing Treasury supply forecasts
- Receive fixed on a swap to synthetically “fix” the floating loan yield and enhance earnings
  - Afraid of rates dropping further? Consider a 5yr receive fixed swap today
  - Expect the curve to steepen? Ladder into receive fixed swaps incrementally as intermediate swap rates move higher
- Structure the swap to qualify as a cash flow hedge with unrealized gains/losses flowing through OCI



Enhance earnings by converting 1mL+200bps (2.17%) to 2.50%

All-in Synthetic Yield Earned = Rec Fixed Swap Rate + Loan Yield – 1M LIBOR
2.50% = 0.50% + 2.17% – 0.17%

Quality of Earnings	Quantity of Earnings	More Asset Sensitive	Less Asset Sensitive
	Depends on Rates		✖

Source: Piper Sandler Hedging Services, LLC
[1] 0.50% is purely illustrative, the 5yr 1mL receive fixed swap is 0.39% as of 6/8/20

How Caps Work and Why We Use Them

Purchase upside rate protection while retaining the benefit of rates dropping further

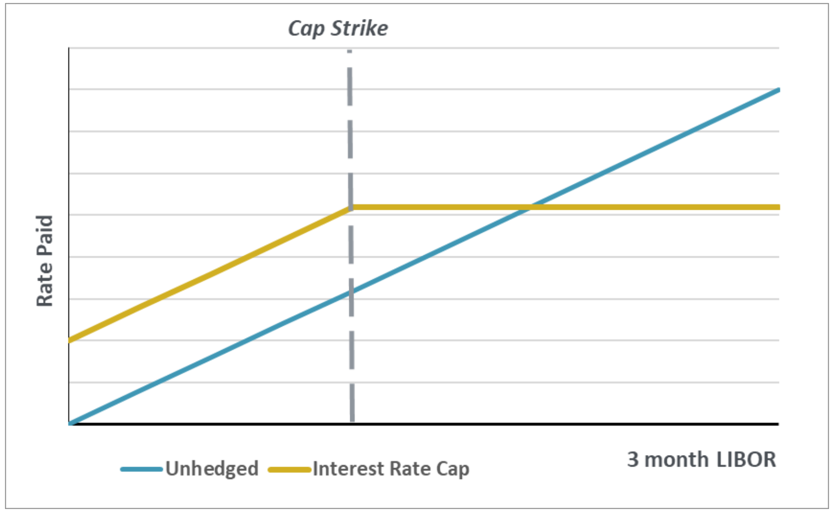
- A cap is an interest rate option that helps protect against rising short term interest rates (1mL, 3mL or PRIME)
- The cap buyer is compensated when the reference rate rises above the strike
  - No payments are exchanged when rates fall below the strike so the buyer's loss is limited to the premium paid
- An option is purchased via a one-time premium payment
  - When effectively documented as a cash flow hedge, the premium may be amortized into income straight-line over the cap term

Upfront Premium Paid

Option Buyer → Option Seller

Payment when the reference rate sets above the cap strike

Interest Rate Cap vs Unhedged Cost of Funds Profile

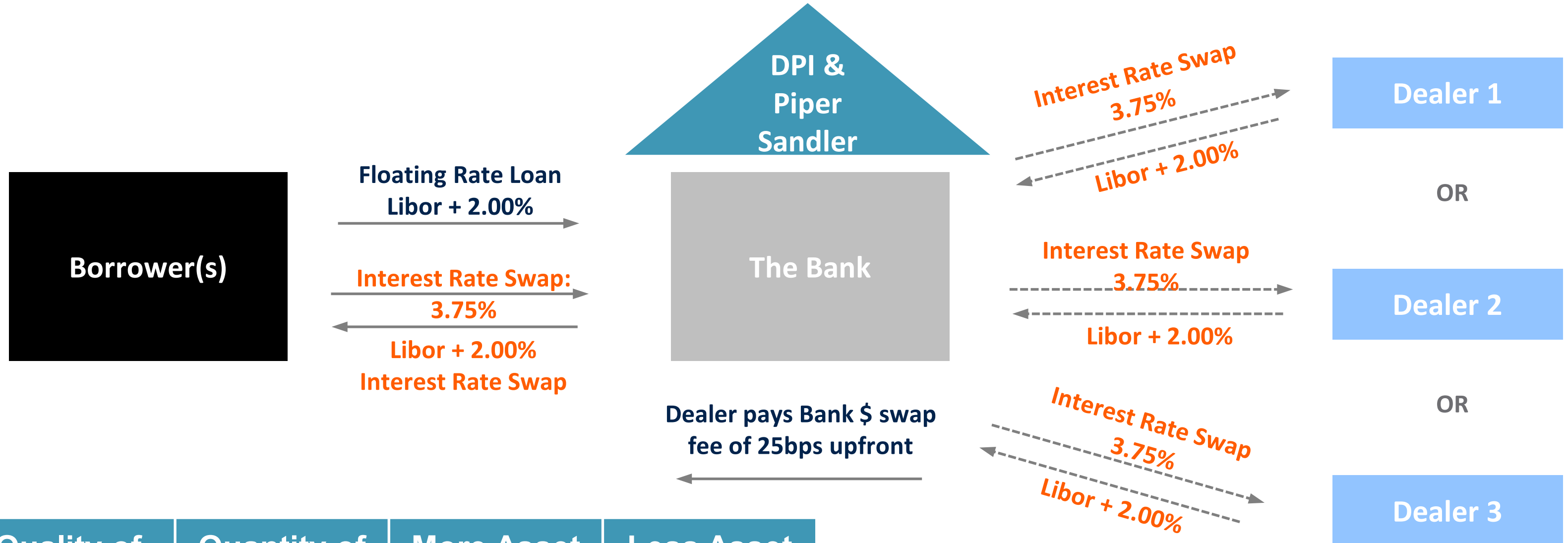


Quality of Earnings	Quantity of Earnings	More Asset Sensitive	Less Asset Sensitive
	Depends on Rates	✖	

Source: Piper Sandler Hedging Services, LLC

Back to Back Customer Swaps

- Creates lending opportunities for certain borrowers
- Remain competitive with peers offering swapped rates
- With a back to back swap program, banks have the opportunity to generate non-interest fee income by marking up the fixed rate of the swap
- Swap fee income is usually recognized entirely upfront, unlike loan origination fee income which is usually amortized over the life of the loan



Quality of Earnings	Quantity of Earnings	More Asset Sensitive	Less Asset Sensitive
✖	✖	Rate-Based	Rate-Based

Other Tactics and Considerations

- Issuing Sub Debt
- Buying loans
- Selling loans
- Last of Layer asset hedging
- Caps and cap corridors

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Scott Hildenbrand is a Managing Director and Head of Balance Sheet Analysis and Strategy in the Financial Services Group at Piper Sandler. Hildenbrand heads the Balance Sheet Analysis and Strategy Group, working with financial institutions on balance sheet strategy development, which includes interest rate risk management, investment portfolio strategy, retail and wholesale funding management, capital planning, budgeting, and stress testing. Hildenbrand also runs Piper Sandler Hedging Services, LLC, which is registered as a swap introducing broker with the Commodity Futures Trading Commission and is a member of the National Futures Association. In these capacities, Hildenbrand works closely with the firm's Investment Banking Group to identify and develop strategic opportunities for clients involved in mergers and acquisitions. Previously, he was a Principal and Chief Balance Sheet Strategist of Sandler O'Neill + Partners, L.P. Prior thereto, Hildenbrand worked in Sandler O'Neill's Interest Rate Products Group, focusing on developing and implementing structured wholesale funding strategies for financial institutions. He spent his first four years at the firm in the Asset/Liability Management Group. Prior to joining Sandler O'Neill in 2004, Hildenbrand worked as a financial analyst in asset/liability management at Tower Federal Credit Union in Maryland. Hildenbrand serves as Treasurer on the Board of Directors for Liam's Room, a not-for-profit organization that focuses on pediatric palliative care, a specialized approach to medical care for children with serious illnesses. He is a frequent speaker at industry conferences and seminars. He holds an M.B.A. in finance from Loyola College in Maryland and a bachelor's degree with a concentration in accounting and finance from Gettysburg College.

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