S&P Global Ratings

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Federal Home Loan Bank of Boston

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Major Rating Factors

Counterparty Credit Rating
AA+/Stable/A-1+

Strengths:	Weaknesses:
• Essential component of the U.S. government's housing policy • Very strong risk-adjusted capitalization • Very strong loan-asset quality and minimal credit risk from peripheral activities	• Monoline mortgage exposure and geographic concentration • Vulnerable to potential future legislative changes

Outlook

The stable outlook on the Federal Home Loan Bank of Boston (FHLB Boston) reflects its strong and stable operating performance, as well as the rating on the U.S. If we changed our rating or outlook on the U.S., we would likely reflect that change in our ratings on the FHLB System's debt and its individual banks, including FHLB Boston, according to our government-related entitiy (GRE) criteria. Nevertheless, we currently expect FHLB Boston to maintain its strong financial and funding profile--at least over the next two years, helped by its comprehensive and conservative governing policies and management's intention to maintain these policies. We could, however, lower the rating if, in the context of government-sponsored enterprise (GSE) reform, the role of the FHLB System in housing finance is diminished, thereby reducing its importance to the government.

Rationale

S&P Global Ratings' counterparty credit rating on FHLB Boston reflects the wholesale bank's government-supported role in providing liquidity to member institutions, very strong loan-asset quality, and loss history as well as good capitalization, low funding costs, and conservative risk management policies. It also reflects the bank's regulated status, overseen by the Federal Housing Finance Agency (FHFA). Based on our criteria for rating GREs, the rating on FHLB Boston includes a one-notch uplift from the bank's stand-alone credit profile (SACP) of 'aa'. This reflects our expectation that the likelihood of the bank receiving extraordinary government support, if needed, is very high, because of the FHLB System's importance to the U.S. housing market, among other factors. For a full analysis of the FHLB System, see "Federal Home Loan Banks," published Oct. 2, 2015, on RatingsDirect.

Anchor: Adjusted for an FHLB to reflect regulated status, low competitive risk, and favorable funding

Our starting point--or anchor--for our ratings on U.S. finance companies (fincos) that we rate under our nonbank financial institutions (NBFI) criteria is 'bb+'. We initially set the anchor for fincos three notches below our anchor for banks in the same country to reflect their typical lack of central bank access, less-stringent regulatory oversight, and greater competitive risk. We base the bank anchor for a given country on our view of the economic and industry risks in that country as part of our Banking Industry Country Risk Assessment. Our anchor for a bank operating only in the U.S. is 'bbb+'.

Because of the FHLBs' public policy role and regulated status, we raise the anchor for FHLB Boston to 'bbb+', three notches above our anchor for other U.S. fincos. This is to account for the FHFA's regulatory oversight, the favorable funding an FHLB enjoys through its close relationship with the U.S. government, its strong competitive position alongside other housing-related GREs, including Fannie Mae and Freddie Mac in the U.S. housing finance market, and its statutory priority of liens in a bank wind-down situation.

Business position: A unique and stable franchise with longstanding members

We view FHLB Boston's business position as strong (as our criteria define the term), reflecting the company's established market position, recurring business volumes, and public policy role, which we believe offset some of the risks associated with its lack of business diversity.

FHLBs are GSEs, set up under the authority of the Federal Home Loan Bank Act of 1932. They were established with a mission to provide their members with a reliable source of liquidity and support housing finance and community investment. FHLBs provide long- and short-term secured loans to their members (with the value of collateral typically exceeding loans by a significant margin), have minimal high-risk peripheral business lines, and exclusively serve member banks in their respective geographic region of the U.S.

FHLB Boston is among the midsized FHLBs, ranking eighth in the FHLB system with total assets of $58.7 billion and advances of $34.5 billion as of March 31, 2016. The bank, like its system peers, has a very strong market position within its district base, and sticky customer relationships because of a member-based cooperative structure. Still, the lack of business and geographic diversity weighs on our overall assessment of its business position.

FHLB Boston has 446 members (as of December 2015), including 190 thrifts, 159 credit unions, 41 insurance companies, and 4 community development institutions. The bank's business is highly dependent on the housing market of the New England region (Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, and Vermont), where most of its members are located. The region is expected to continue to grow at rates lower than the national average, but the housing market remains positive, with construction continuing to be the fastest growing employment sector.

Revenues at FHLB Boston are not particularly volatile (with spread income being the key driver contributing over 95% to operating revenues), but advance volumes and therefore revenue are typically countercyclical, as members rely more on the firm in times of stress as a reliable source of funding. As of first-quarter 2016, the bank's five largest borrowers held approximately 37.4% of advances (the second-lowest concentration in the system) versus a peer average of 55%, which we view positively.

FHLBs are regulated by the FHFA and we favorably view the member-owned structure and strong FHFA oversight. Still, changes in regulation can affect the business of the FHLBs. In January 2016, the FHFA announced its final FHLB membership rule, which makes new captive insurers ineligible for membership. Captive insurance members admitted prior to September 2014 will have their membership terminated by February 2021 and those admitted after September 2014 will be ineligible for FHLB membership after February 2017. Nonetheless, this rule will not have a material impact on FHLB Boston because the bank does not have any advances outstanding to captive insurance companies. Besides, the overall advances to insurance companies too, are low at less than 10% of total advances.

Capital and earnings: Collateralized lending to financial institutions limits risk

We believe FHLB Boston's capital is very strong owing to its member-capitalized co-op structure and low-risk collateralized lending business. FHLB Boston is required to keep capital in excess of 4% of assets and leverage capital in excess of 5% by the FHFA. As of first-quarter 2016, it maintained a capital ratio of 5.9% and a leverage ratio of 8.9%.

Given that the majority (around 59%) of its exposure consists of advances to its member financial institutions (which attract a relatively low risk weight in our methodology) the bank's S&P Global Ratings risk-adjusted capital (RAC) is very strong. We believe this is further cemented by an overcollateralized loan book, which reduces inherent credit risk. Despite modest dividend payout and repurchases of excess stock, we expect the company to maintain an S&P Global Ratings RAC ratio at around 25%, over the next two years.

We believe earnings at FHLB Boston are relatively stable and we expect steady profitability over our forecast period. Net income for the six months ended June 30, 2016, declined to $77 million from $183.2 million in the same period last year, which benefited from large litigation settlements of $134.7 million in second-quarter 2015; and also due to higher losses on derivatives and hedging activities. These were partially offset by higher unrealized gains (losses) on trading securities, and lower operating expenses. Though net interest spreads have been pressured by higher net premium amortization on agency mortgage-backed securities (MBS) resulting from a decrease in long-term interest rates, earnings have lately been benefiting from increased accretable yields on certain private-label MBS (PLMBS).

However, we don't believe the absolute level of earnings is an important ratings consideration because of both the bank's strong capital level, as well as its co-op structure, which ensures that profit maximization is not a goal.

Risk position: Limited risk from peripheral business activity

We consider FHLB Boston's risk position to be very strong, reflecting the fact that in its eight decades of existence, neither the company (nor its sister FHLBs) has ever suffered a loss on a collateralized advance to a member.

All advances to member institutions are collateralized by loans and securities with an estimated value significantly in excess of loans extended. FHLB Boston also monitors the financial condition of its members, and manages collateral guidelines, advance rates, and security agreements to further mitigate credit risk. Probably most importantly, any security interest that an insured depository institution grants to the bank generally has priority over the claims and rights of other parties, including depositors. For non-depositories, FHLB Boston, like peers, relies on stricter borrowing limits and collateral guidelines to mitigate associated credit risk, for which an FHLB is not guaranteed priority status in liquidation. Additionally, the company has in place strong underwriting standards and credit requirements from borrowers.

The bank takes little interest rate risk. It issues fixed-rate callable and non-callable bonds, and swaps most of its fixed-rate interest exposures to LIBOR-based floating exposures. As of first-quarter 2016, the bank's investment portfolio stood at $9.8 billion, which included $8.8 billion in MBS. FHLB Boston has more exposure to PLMBS than most FHLBs, as a share of its balance sheet. Still, at about $0.9 billion ($1.1 billion on an amortized cost basis) the PLMBS exposure forms about 1.6% of the banks total assets, and in our view, represents limited risk. We believe the bank has a relatively homogenous lending portfolio, considering all advances are made to financial institutions backed by a majority of residential and commercial mortgages, though collateral does vary.

Funding and liquidity: Stable and cheap funding supports the business model

We view both FHLB Boston's funding and liquidity as adequate, reflecting the FHLB System's diverse and global investor base and that it readily sells its debt at a small spread to U.S. Treasury obligations. The FHLBanks work collectively to manage the Systemwide liquidity and funding management. The FHLBs did not face an issue with access to funding markets during the 2008 liquidity crisis, and likewise we expect that funding is unlikely to be an issue in stress scenarios.

We consider FHLB Boston's liquidity as adequate compared with its potential cash flow requirements over the upcoming year. Regulatory liquidity requirements are relatively modest, and we believe the company has a good liquidity management system.

For the period ended March 31, 2016, the bank maintained a liquidity position in accordance with both FHFA regulations and policies established by its own board of directors.

Comparable ratings adjustment: None

We don't include an adjustment in our rating on FHLB Boston based on comparison with peers.

External influence: An important cog in the U.S. housing finance policy framework

Our ratings on FHLB Boston reflect our opinion that there is a very high likelihood that the U.S. government would provide the company with timely and sufficient extraordinary support in the event of financial distress. Therefore, our issuer credit rating on the bank reflects one-notch uplift from our SACP.

In accordance with our criteria for GREs, our view of government support is based on our assessment of FHLB Boston's:

- Very important role providing low-cost funding to support housing and community development in the U.S., which we believe are key economic and political objectives of the U.S. government; and
- Very strong link with the U.S. government, because a defaulted FHLB could significantly affect the government's reputation, and we believe the government has the administrative capacity and mechanisms (via the FHFA) for responding to an FHLB's financial distress in a timely manner. Moreover, we view the government as having a track record of providing very strong and timely credit support to the FHLBs, such as their inclusion in a U.S. Treasury GSE credit facility created in September 2008.

Related Criteria And Research

Related Criteria

- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- Issue Credit Rating Methodology For Nonbank Financial Institutions And Nonbank Financial Services Companies, Dec. 9, 2014
- Nonbank Financial Institutions Rating Methodology
- Group Rating Methodology, Nov. 19, 2013
- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Methodology For Mapping Short- And Long-Term Issuer Credit Ratings For Banks, May 4, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Commercial Paper I: Banks, March 23, 2004

Ratings Detail (As Of August 12, 2016)		
Federal Home Loan Bank of Boston		
Counterparty Credit Rating		AA+/Stable/A-1+
Counterparty Credit Ratings History		
10-Jun-2013	*Foreign Currency*	AA+/Stable/A-1+
08-Aug-2011		AA+/Negative/A-1+
15-Jul-2011		AAA/Watch Neg/A-1+
10-Jun-2013	*Local Currency*	AA+/Stable/A-1+
08-Aug-2011		AA+/Negative/A-1+
15-Jul-2011		AAA/Watch Neg/A-1+
Sovereign Rating		
United States of America		AA+/Stable/A-1+
Related Entities		
Federal Home Loan Bank of Atlanta		
Issuer Credit Rating		AA+/Stable/A-1+
Federal Home Loan Bank of Chicago		
Issuer Credit Rating		AA+/Stable/A-1+
Federal Home Loan Bank of Cincinnati		
Issuer Credit Rating		AA+/Stable/A-1+
Federal Home Loan Bank of Dallas		
Issuer Credit Rating		AA+/Stable/A-1+
Federal Home Loan Bank of Des Moines		
Issuer Credit Rating		AA+/Stable/A-1+
Federal Home Loan Bank of Indianapolis		
Issuer Credit Rating		AA+/Stable/A-1+
Federal Home Loan Bank of New York		
Issuer Credit Rating		AA+/Stable/A-1+
Federal Home Loan Bank of Pittsburgh		
Issuer Credit Rating		AA+/Stable/A-1+

Ratings Detail (As Of August 12, 2016) (cont.)	
Federal Home Loan Bank of San Francisco	
Issuer Credit Rating	AA+/Stable/A-1+
Federal Home Loan Bank of Topeka	
Issuer Credit Rating	AA+/Stable/A-1+
Federal Home Loan Banks	
Senior Unsecured	AA+
Senior Unsecured	AA+/A-1+
Senior Unsecured	AA+/Stable
Short-Term Debt	A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.