Investing in Community Development Bonds and the Role of FHLBank Atlanta in Public Finance

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FHLBank System Overview

FHLBank Atlanta is one of 12 district banks in the Federal Home Loan Bank System

The FHLBanks are government-sponsored enterprises, or GSEs, created by the Federal Home Loan Bank Act of 1932

FHLBank Atlanta's district comprises Alabama, Florida, Georgia, Maryland, North Carolina, South Carolina, Virginia, and the District of Columbia

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FHLBank System Overview

The Bank is a cooperative, owned by its shareholders

Shareholders purchase stock in the Bank, and they may receive dividends on their stock investments

Shareholders include commercial banks, savings and loan institutions, credit unions, community development financial institutions (CDFIs), and insurance companies

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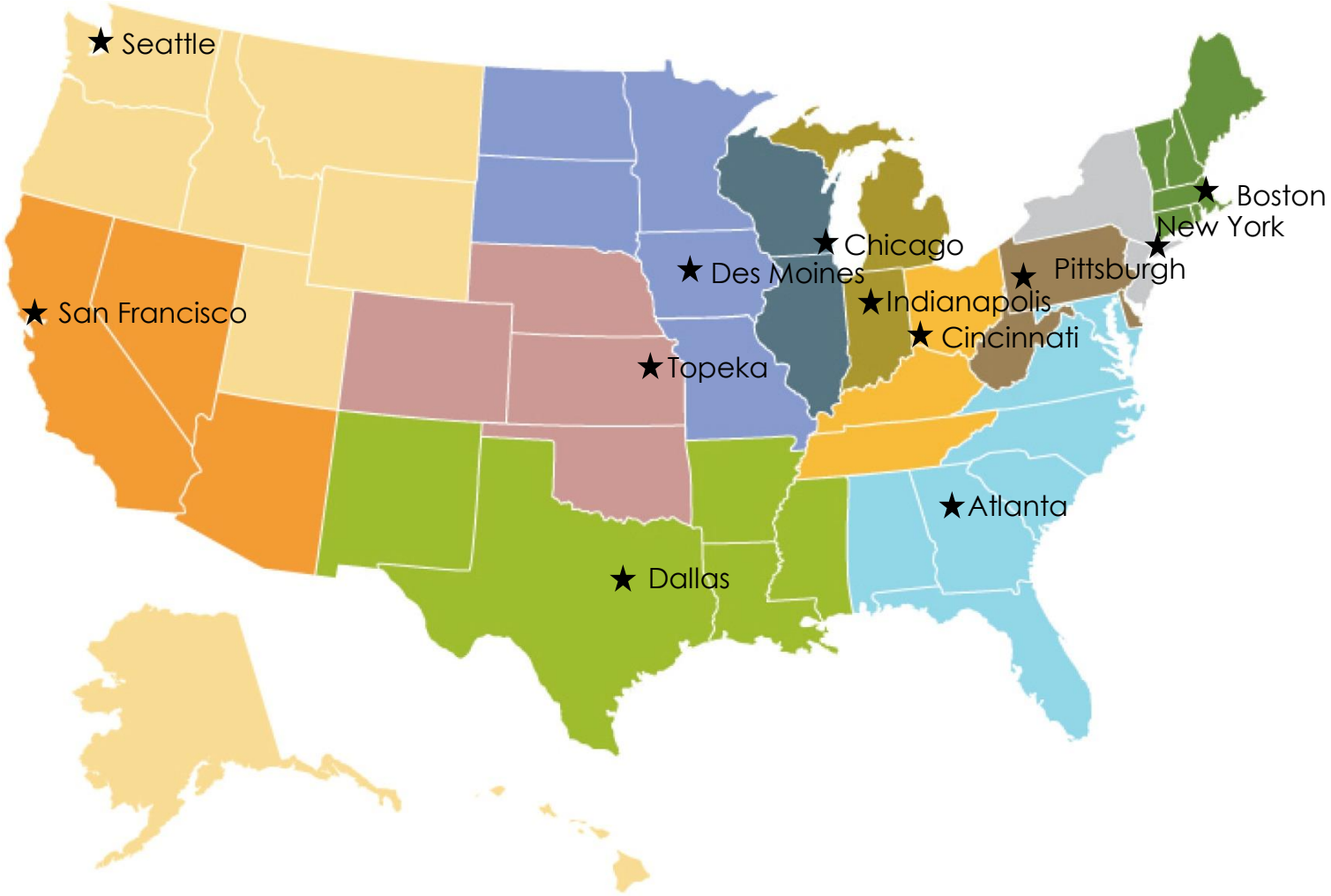
FHLBank System



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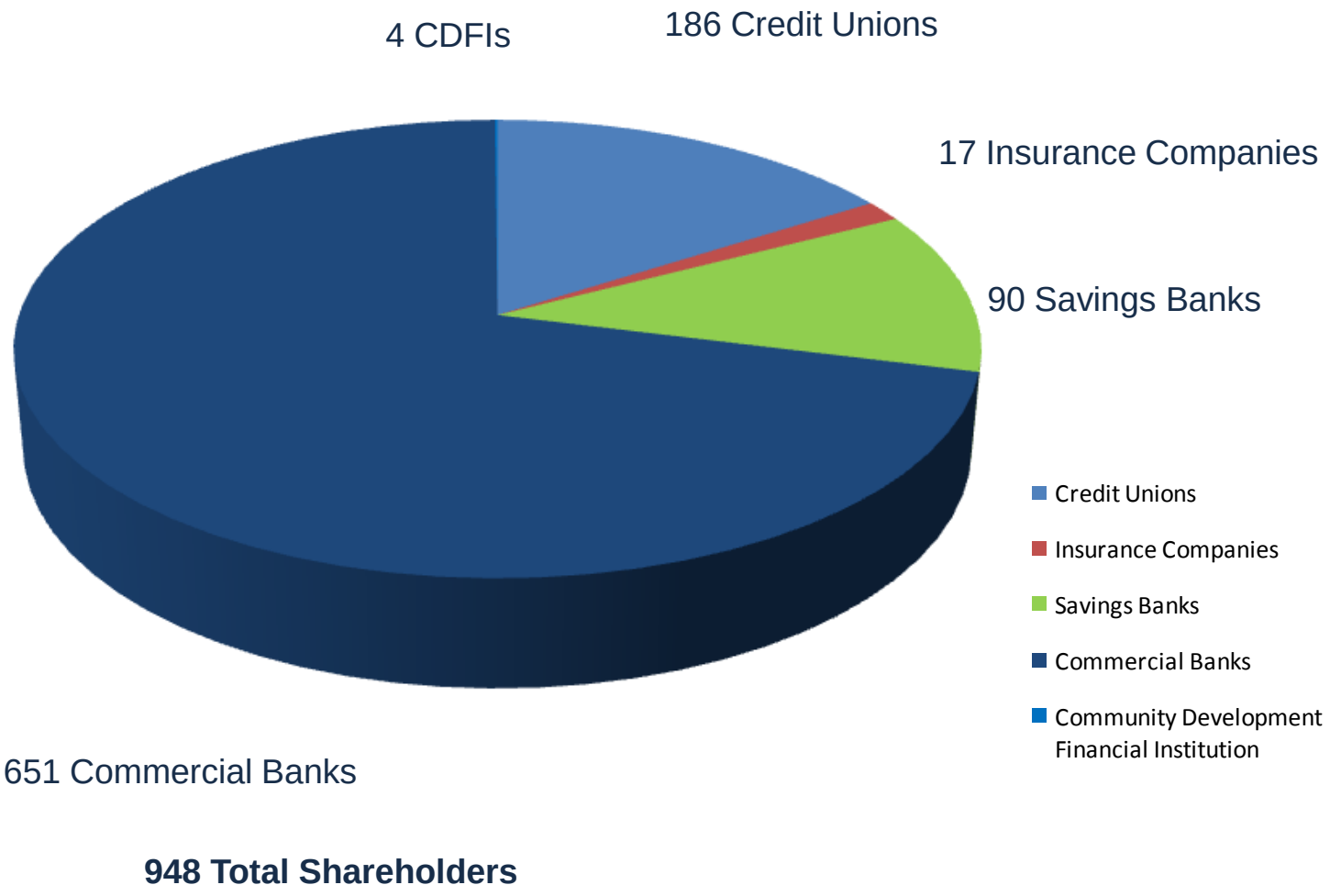
FHLBank Atlanta Shareholders

As of March 31, 2015



948 Total Shareholders

Products and Services

- Advances (Loans)
- Interest-rate risk management tools
- Cash Management services
- Affordable Housing Program (AHP) and Community Investment Program (CIP)
- Letters of Credit

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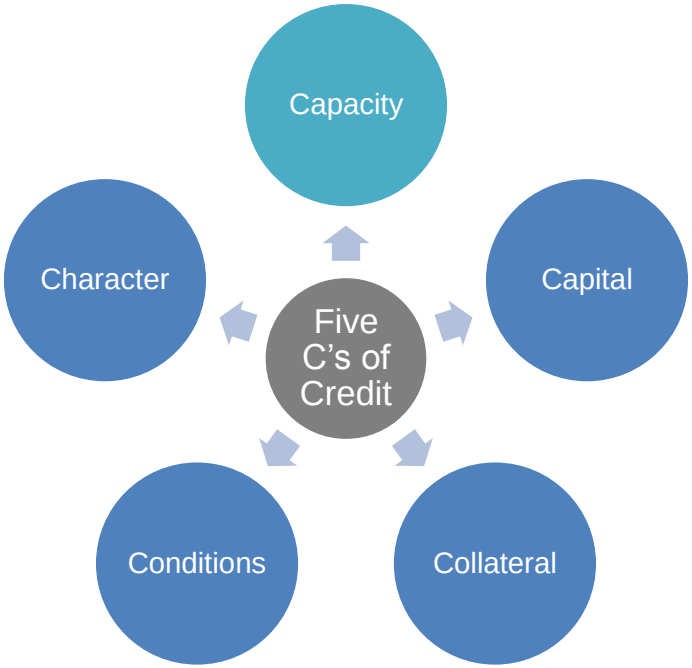
The Basics of Underwriting a Bond: The Five C's of Credit

1. Capacity *

- The ability to repay
- This is the primary source of repayment
- If a borrower or project cannot generate enough **cash** to repay the loan/bond/investment – then stop here. There is no mitigation tool for inability to repay



*Usually this is measured by debt service coverage (DSC). Different types of repayment sources warrant different DSC. An investor purchasing a revenue bond secured by electricity service revenues may be comfortable at 1.0x or 1.1x to 1 DSC while an investor purchasing a private activity bond may want 1.25x or higher DSC.

Example: Capacity

- **Company A**

- Revenues of $1,000,000
- Expenses of $800,000
- Net Income of $200,000
- Depreciation of $100,000

- Cash flow $300,000
- Debt Service of $250,000

- DSC: 1.20x

- **Company B**

- Revenues of $1,050,000
- Expenses of $750,000
- Net Income of $300,000
- Depreciation of $100,000

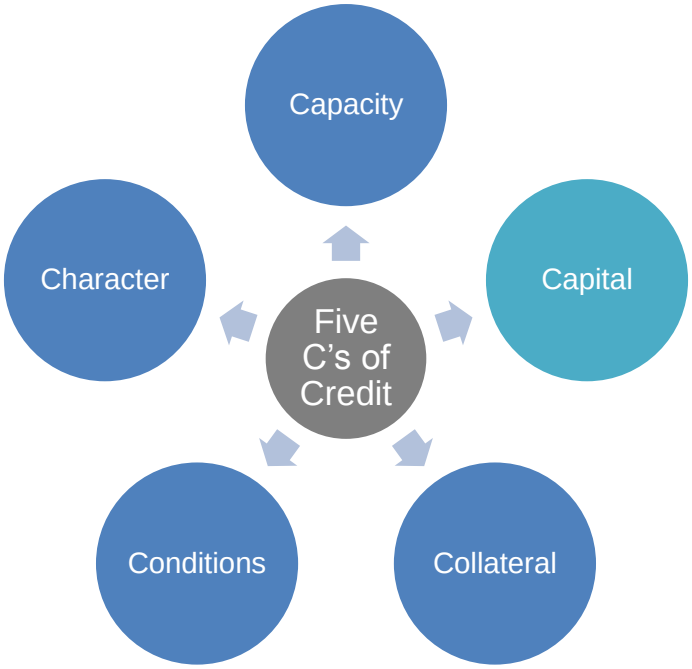
- Cash flow $400,000
- Debt Service of $250,000

- DSC: 1.60x

The Basics of Underwriting a Bond: The Five C's of Credit

2. Capital

- "Skin in the game"
- This is the money that the sponsor (or guarantor, developer, borrower, etc.) has invested in the project along with the purchaser of the bond
- As the investor, you want the sponsor to be at risk along with you – so that they have incentive to be successful and thus be able to generate your return



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Example: Capital

- **Company A**

- Land Cost $500,000
- Building Costs: $1,500,000
- Total: $2,000,000

- Equity/Downpayment:
  - $400,000

- Loan to COST: 80%

- **Company B**

- Land Cost $450,000
- Building Costs: $1,450,000
- Total: $1,900,000

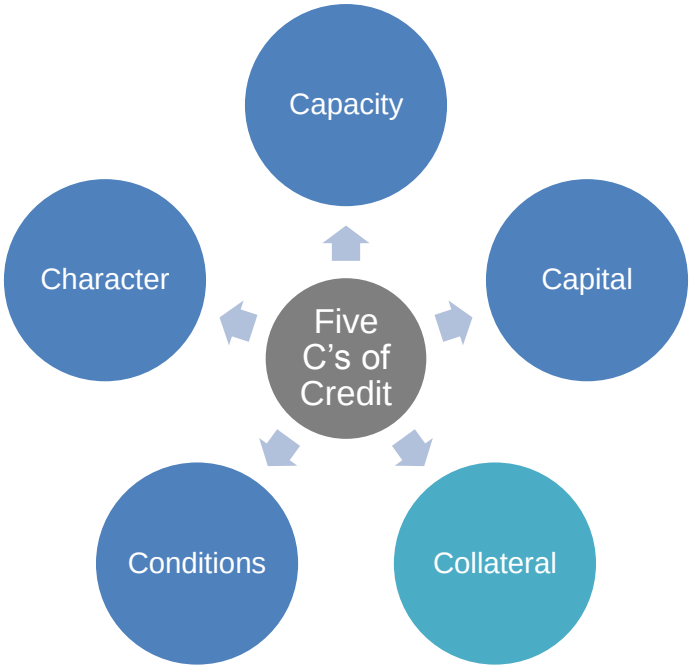
- Equity/Downpayment:
  - $500,000

- Loan to COST: 74%

The Basics of Underwriting a Bond: The Five C's of Credit

3. Collateral

- A common form is real estate.
- This is a mitigation for inability to repay and should not be the primary source of repayment. Can also be a guarantee
- There are many different types of collateral and the marketability, value, regulations, and loan-to-value limitations are different for each
- Appraisals are the most common tool to evaluate collateral



Example: Collateral

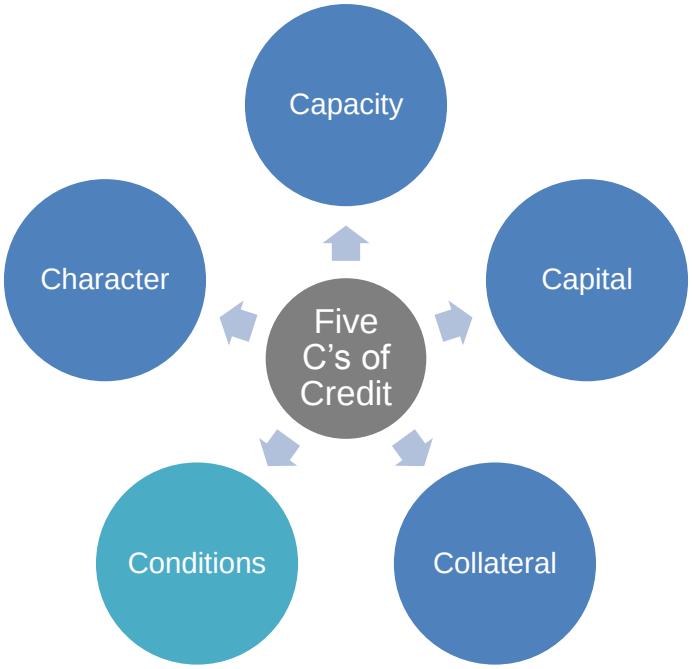
- **Company A**
- Cost: $2,000,000
- Appraised Value: $2,000,000
- Equity/Down payment:
  - $400,000
- Loan to VALUE: 80%

- **Company B**
- Cost: $1,900,000
- Appraised Value: $2,000,000
- Equity/Downpayment:
  - $500,000
- Loan to VALUE: 70%

The Basics of Underwriting a Bond: The Five C's of Credit

4. Conditions

- Difficult assessment to make, as conditions often change throughout the term of the bond
- Conditions are the intended purpose of the proceeds along with the economic conditions surrounding a project
- Feasibility studies can be used to ascertain whether or not conditions are favorable for a project



Example: Conditions (Condo Building)

- **Scenario A – 1,000 units**

- Total Available Condo Units in Market: 10,000
- Absorption Rate: 250 per month
- Absorption Period: 40 months
- 1 other condo building being constructed with 1,000 units
- 24 months construction

- Project hits the market with 5,000 units on the market

- **Scenario B – 500 units**

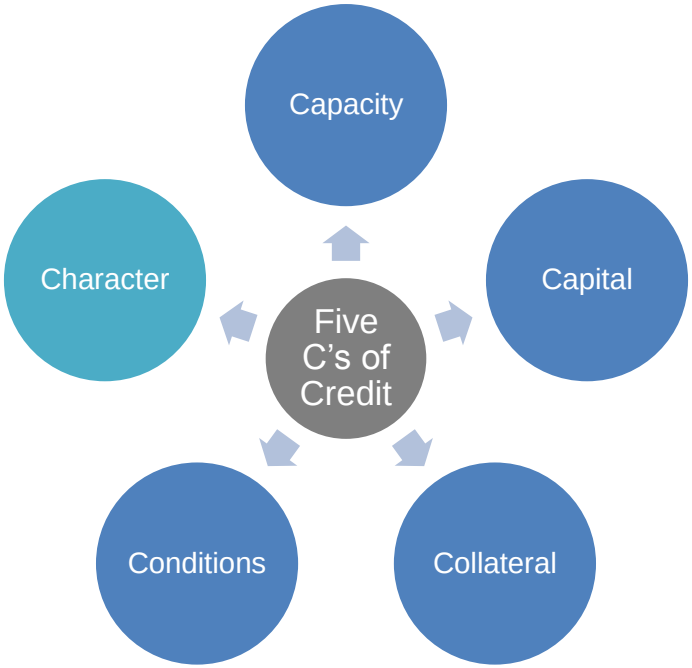
- Total Available Condo Units in Market: 5,000
- Absorption Rate: 500 per month
- Absorption Period: 10 months
- No other projects under construction
- 12 months to construct

- Project hits the market with a demand for 1,000 units

The Basics of Underwriting a Bond: The Five C's of Credit

5. Character

- Also very difficult to assess
- Much like capacity, this cannot be mitigated
- Most investors will not purchase an investment if they doubt the character of the sponsor/borrower
- Background, experience, references, and credit history are often used to form an opinion of character



Example: Character

- Company A:
- ENRON
- Company B:
- GOODWILL

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Investor Appetites

Investor appetites differ based upon:

- Tax Status of the Bond (Bank Qualification)
  - HERA – Housing and Economic Recovery Act – sunset at the end of 2010 and now FHLBank credit enhancements cannot be used to market tax exempt bonds, except for certain housing bonds
- Investor's risk profile (risk vs. reward)
- Investor's balance sheet profile or capital structure
- Desired, or even necessary, return on capital
- Other business relationships that come with the investment

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Capital Markets and Bond Ratings

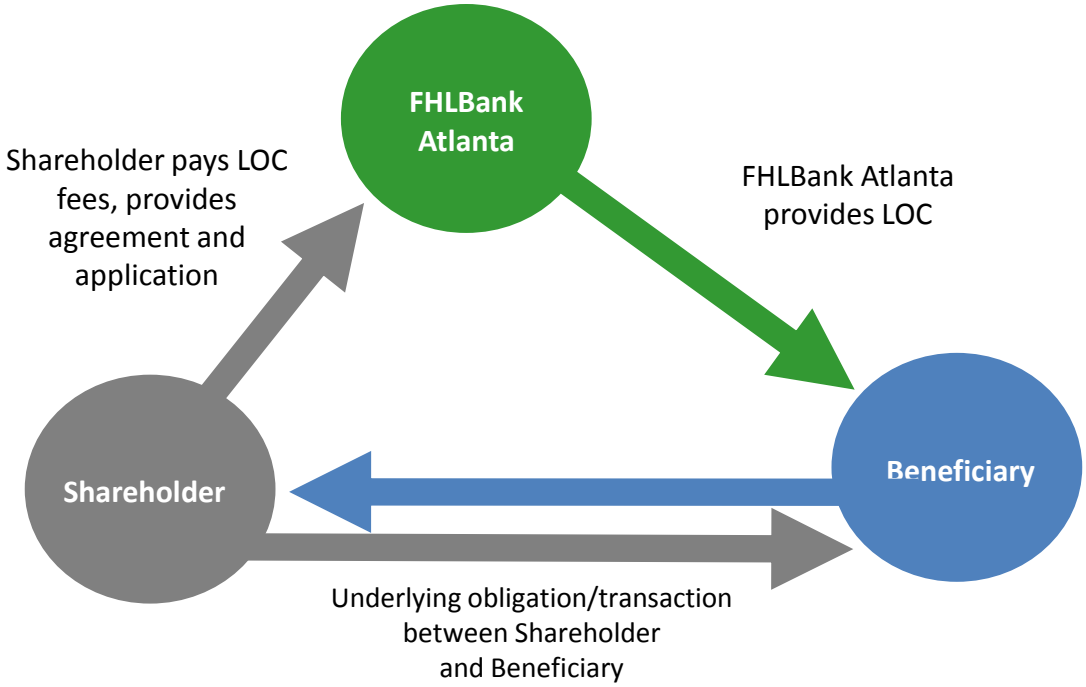
- The capital markets are divided into the equity (stock) market and debt (bond) market
- Investors in the bond market have different goals and investment strategies than investors in stock
- Bond market is divided into publicly marketed bonds and private placement transactions
- Bond Ratings:

	Moody's	S&P	Fitch	Meaning
Investment Grade	Aaa	AAA	AAA	Prime
	Aa1	AA+	AA+	High Grade
	Aa2	AA	AA	
	Aa3	AA-	AA-	
	A1	A+	A+	Upper Medium Grade
	A2	A	A	
	A3	A-	A-	
	Baa1	BBB+	BBB+	Lower Medium Grade
	Baa2	BBB	BBB	
	Baa3	BBB-	BBB-	
Junk	Ba1	BB+	BB+	Non Investment Grade Speculative
	Ba2	BB	BB	
	Ba3	BB-	BB-	
	B1	B+	B+	Highly Speculative
	B2	B	B	
	B3	B-	B-	
	Caa1	CCC+	CCC+	Substantial Risks
	Caa2	CCC	CCC	Extremely Speculative
	Caa3	CCC-	CCC-	In Default w/ Little Prospect for Recovery
	Ca	CC	CC+	
		C	CC	In Default
			CC-	
	D	D	DDD	

Source: learnbonds.com

Standby Letter of Credit
Overview

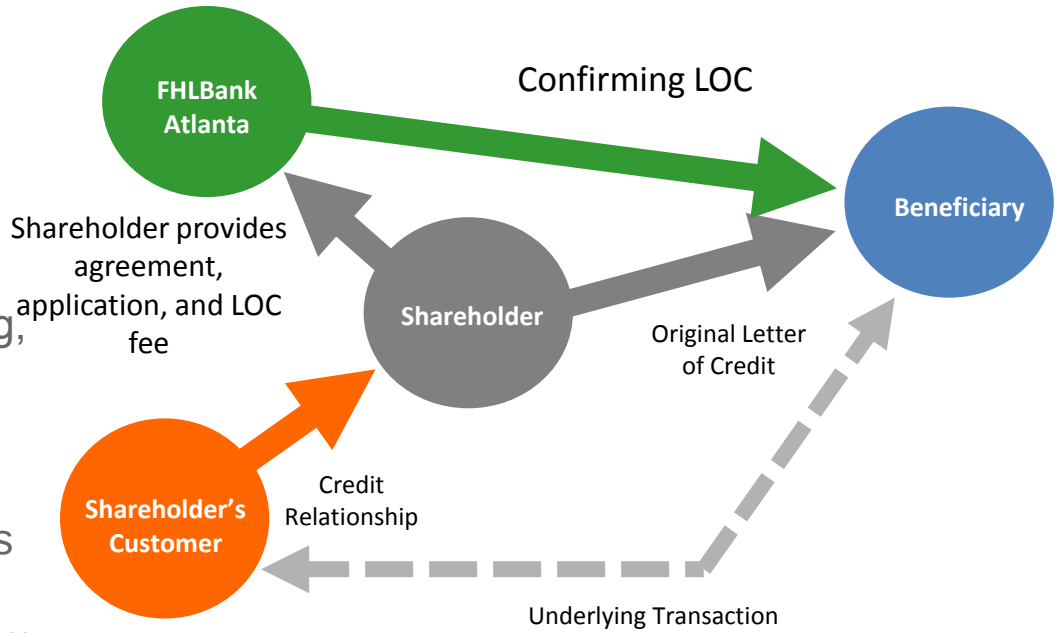
- Functions as an independent guaranty for a member's obligation
- Issued by FHLBank Atlanta to a third-party beneficiary on behalf of a member
- The member must have an obligation to the beneficiary
- Most common usage is Public Unit Deposit LOCs



Confirming Letters of Credit

Overview

- Support a shareholder's obligations with respect to the underlying LOC or credit transaction
- A Confirming LOC – sometimes called a 'wrap' – can help secure improved credit terms for community-focused bonds, enhancing the bond's credit rating, reducing borrowing costs, and improving marketability
- The LOC provides added benefits to small and medium-sized community banks as it allows them to compete for local business on a level playing field with larger, rated institutions



Example, from investor's standpoint

Underlying Project – Private School

- 1.35x historical and projected DSC (capacity)
- 70% LTV (addresses capital and collateral)
- High character of board, good reputation of school
- High local and regional demand for private education and recovering economy
- No credit rating

FHLBank Atlanta Shareholder

- Well capitalized
- Good earnings
- Growing
- Under no regulatory scrutiny
- Strong board of directors
- Either no credit rating, not investment grade, or not as highly rated as FHLBank Atlanta
- Shareholder underwrites the project

FHLBank Atlanta

- Rated Aaa by Moody's
- Rated AA+ by S&P
- FHLBank Atlanta is collateralized by shareholder
- Bondholder purchases bonds based on FHLBank Atlanta's credit rating

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Confirming Letter of Credit
Uses

- The debt is structured as **taxable (non-residential projects) or tax-exempt or taxable (residential)**
- Taxable variable-rate bonds backed by a confirming LOC trade at LIBOR
- Tax-exempt variable-rate bonds backed by a confirming LOC trade close to SIFMA

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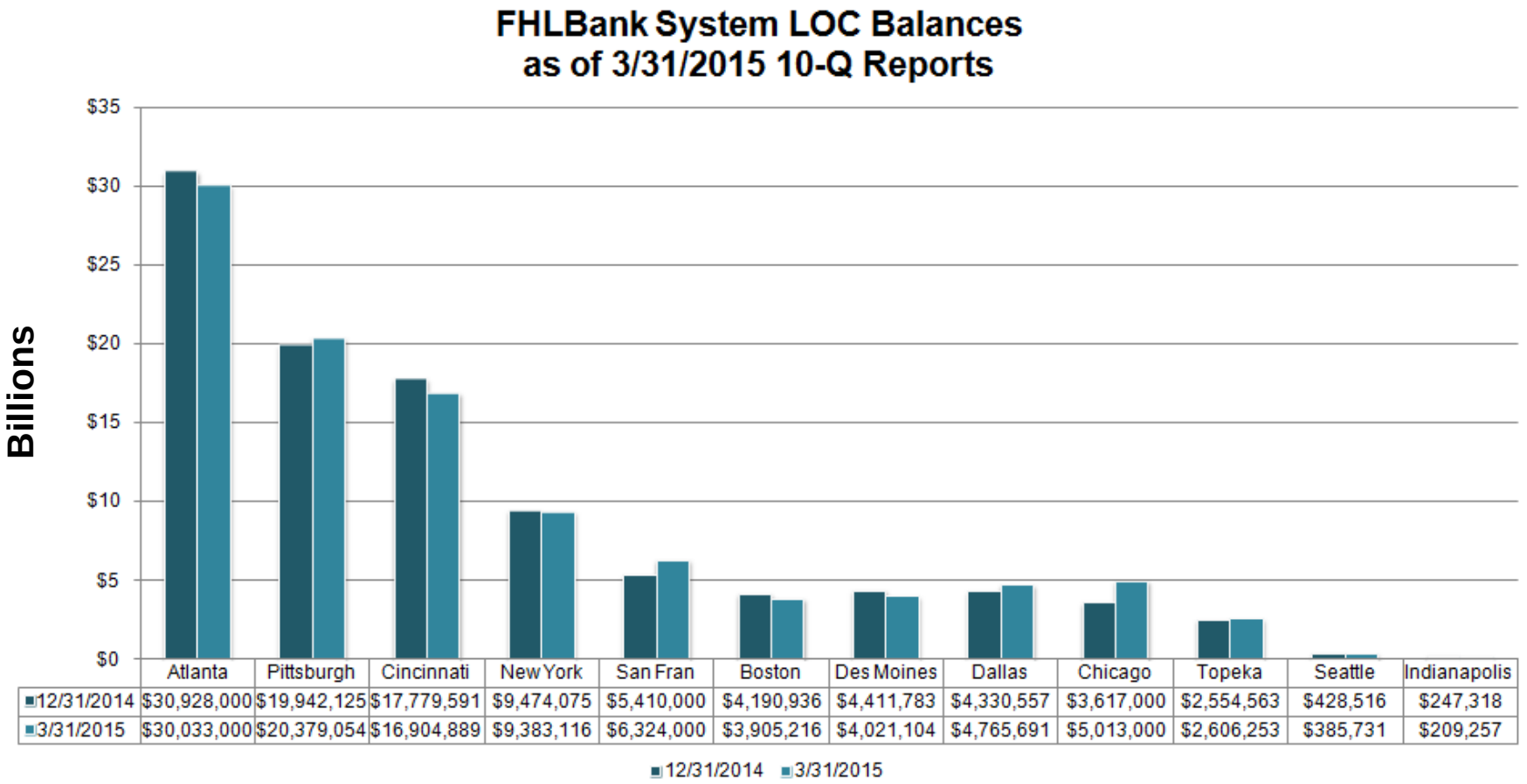
FHLBank Atlanta: The Leading FHLBank in LOCs



	Atlanta	Pittsburgh	Cincinnati	New York	San Fran	Boston	Des Moines	Dallas	Chicago	Topeka	Seattle	Indianapolis
12/31/2014	$30,928,000	$19,942,125	$17,779,591	$9,474,075	$5,410,000	$4,190,936	$4,411,783	$4,330,557	$3,617,000	$2,554,563	$428,516	$247,318
3/31/2015	$30,033,000	$20,379,054	$16,904,889	$9,383,116	$6,324,000	$3,905,216	$4,021,104	$4,765,691	$5,013,000	$2,606,253	$385,731	$209,257

- Total balances for the system were $103.9 billion and $103.3 billion in 3/31/2015 and 12/31/2014, respectively.
- FHLBank Atlanta represented 29% and 30% of the System's total LOC balance over the same respective time periods

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FHLBank Atlanta
Shareholder Testimonials

Shareholder: THE BANK OF TUSCALOOSA, A DIVISION OF SYNOVUS BANK
Letter of Credit: CONFIRMING

FHLBank Atlanta issued a confirming letter of credit on behalf of The Bank of Tuscaloosa (a division of Synovus Bank) to provide credit support for construction of a $31 million LEED-certified building that houses the offices of The Bank of Tuscaloosa. The building is part of the Tuscaloosa Riverfront Development, which connects downtown Tuscaloosa with its scenic riverwalk area.

"From an interest rate standpoint, FHLBank Atlanta's letter of credit was extremely important to the financial viability of the project. It allowed us to finance the building favorably for the long term."
MARK SULLIVAN, DIVISION PRESIDENT OF THE BANK OF TUSCALOOSA

Shareholder: BURKE & HERBERT BANK
Letter of Credit: CONFIRMING

Alexandria, Virginia-based Burke & Herbert Bank obtained a confirming letter of credit for a long-term client that is a retail operator in airports. The FHLBank Atlanta LOC enabled the community bank to offer its client the credit support required by the Port Authority of New York and New Jersey.

"Obtaining the letter of credit from FHLBank Atlanta was a very efficient and streamlined process. The LOC is reasonably priced and we were pleased to use our membership with the Bank to support our client's credit needs."
JEFFREY STRYKER, EXECUTIVE VICE PRESIDENT AND CASHIER, BURKE & HERBERT BANK

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The Opportunities:
Affordable Housing

- Fannie Mae and Freddie Mac do not take construction risk for new construction or substantial rehabilitation of affordable housing projects

- These GSEs take the long-term credit risk and the underlying wrapped LOC is extinguished when the project is placed in service

The Opportunities:
Economic Development

In many instances, a commercial project **can be financed at a lower cost** by issuing a bond with a credit enhancement from an FHLBank Atlanta LOC compared with financing the project with a conventional loan.

Key Takeaway: A tool for communities to utilize to enhance the credit quality of an underlying bank allowing them to compete head-to-head with larger communities that have larger and more banks

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The Opportunities
By Issuer – Nationally, Taxable Bonds Only

Issuers	2014 Volume ($ mill)	# of Issues	2013 Volume ($ mill)	# of Issues
State Agencies	8,649.30	153	15,184.90	200
Local Authorities	6,657.50	188	4,782.10	184
Cities & Towns	3,623.40	249	3,714.60	296
State Governments	2,638.80	30	3,401.50	41
District	2,054.60	195	4,694.20	349
Colleges & Universities	1,630.60	40	3,033.10	43
Counties & Parishes	1,133.50	56	2,151.90	90
Direct Issuer	117.9	7	1,308.50	12
Tribal Government	22.6	1	0	0
Cooperative Utilities	8	1	16.7	1
Total	**26,536.2**	**920**	**38,287.50**	**1216**

Source: The Bond Buyer , 2014 In Statistics Annual Review
http://www.bondbuyer.com/pdfs/2014-in-statistics.pdf

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The Opportunities
By Activity – Nationally, Taxable Bonds Only

Activities	2014 Volume ($ mill)	# of Issues	2013 Volume ($ mill)	# of Issues
General	6,960.80	267	8,303.00	323
Education	5,027.90	298	12,885.00	490
Transportation	3,366.50	44	2,000.70	43
Housing	2,910.20	70	4,603.80	96
Development	2,810.90	68	4,745.00	76
Utilities	1,710.30	57	1,238.90	76
Electric Power	1,342.10	18	1,859.00	23
Public	1,312.60	43	594	38
Healthcare	1,022.60	48	1,870.90	45
Environmental	72.4	7	187.2	6
Total	**26,536.30**	**920**	**38,287.50**	**1216**

Source: The Bond Buyer , 2014 In Statistics Annual Review
http://www.bondbuyer.com/pdfs/2014-in-statistics.pdf

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The Opportunities:
Bond Sales by States in FHLBank Atlanta district

States	2014 Volume ($ mil)	# of Issues	Rank	2013 Volume ($ mil)	# of Issues	Rank
FL	13,893.20	276	4	13,540.90	239	4
MD	7,036.50	84	12	6,515.50	86	13
VA	6,993.40	100	15	6,761.20	108	12
GA	5,334.10	123	19	5,940.70	159	17
NC	3,941.90	78	23	6,359.70	105	14
SC	3,918.10	88	24	5,039.00	96	20
AL	3,225.10	165	29	4,383.20	178	27
D.C.	3,073.80	21	30	1,480.30	13	37
Total	**47,416.10**	**935**		**50,020.50**	**984**	

Source: The Bond Buyer , 2014 In Statistics Annual Review
http://www.bondbuyer.com/pdfs/2014-in-statistics.pdf

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Questions?

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