What makes bonds marketable . . . or not! And - a program that can help.

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FHLBank Atlanta

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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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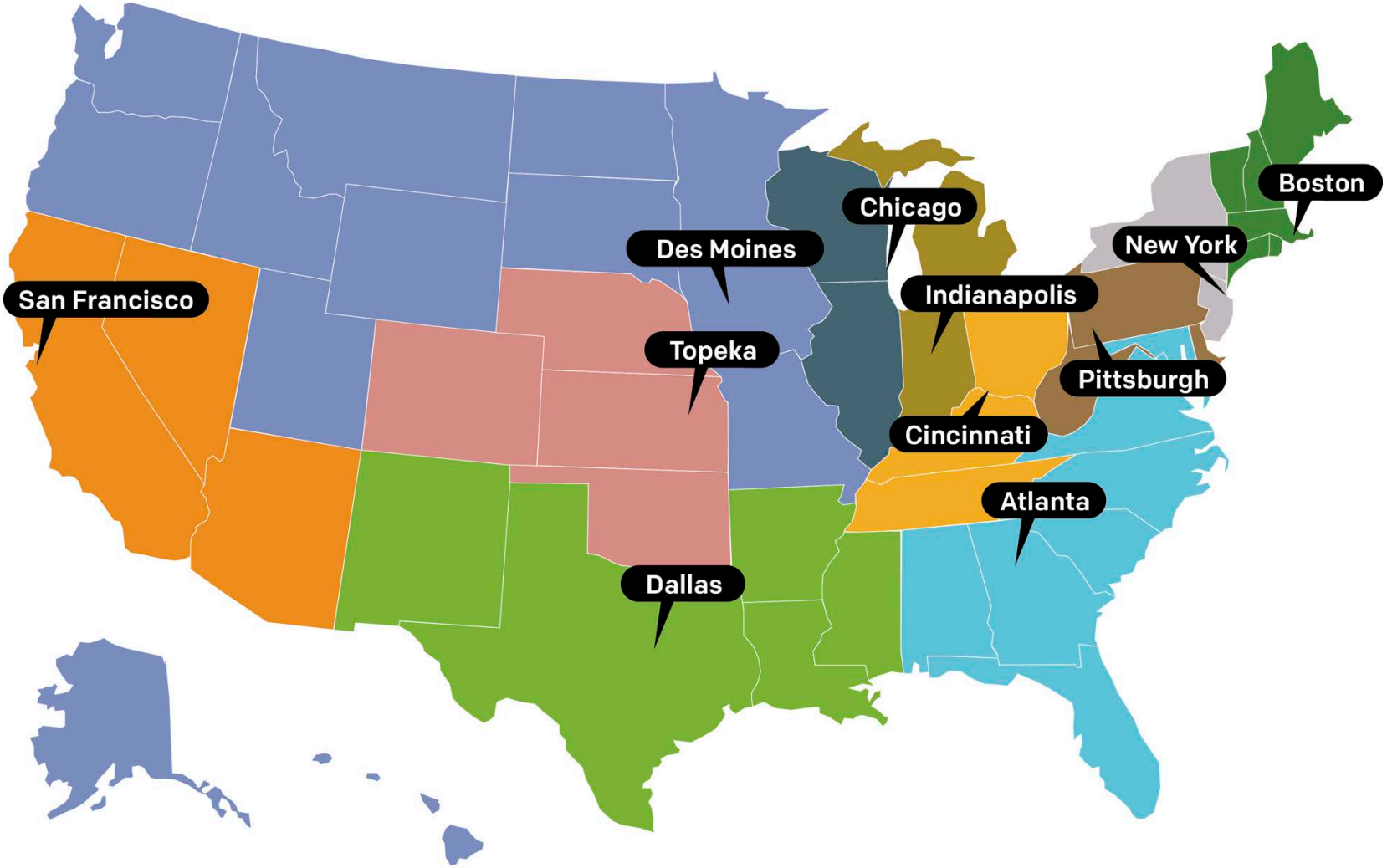
FHLBank System



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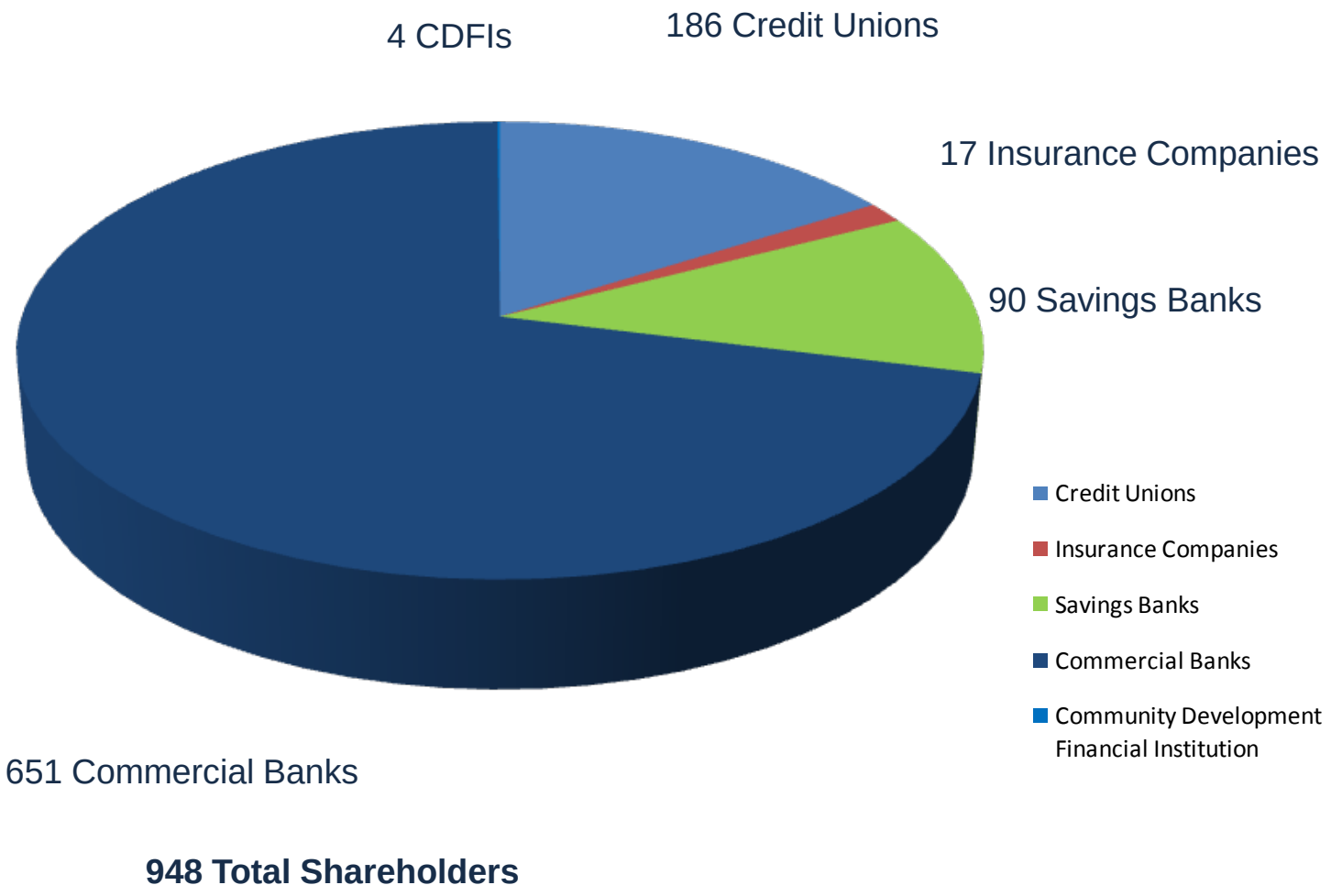
FHLBank Atlanta Shareholders

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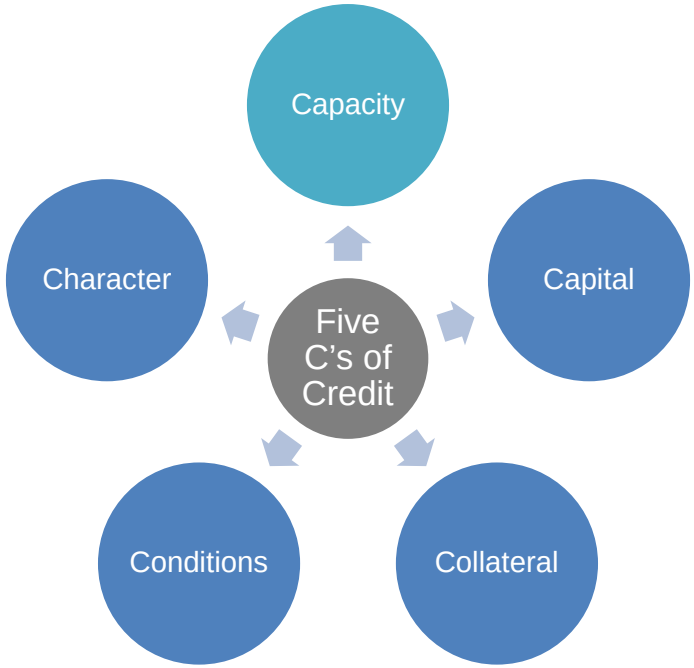
The Basics of Underwriting a Bond: The Five C's of Credit

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

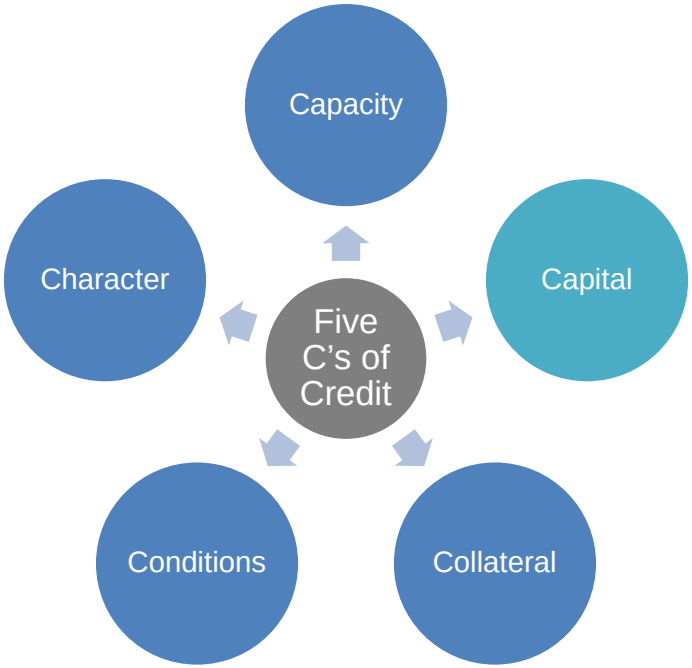
- Cash flow $400,000
- Debt Service of $250,000

- 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

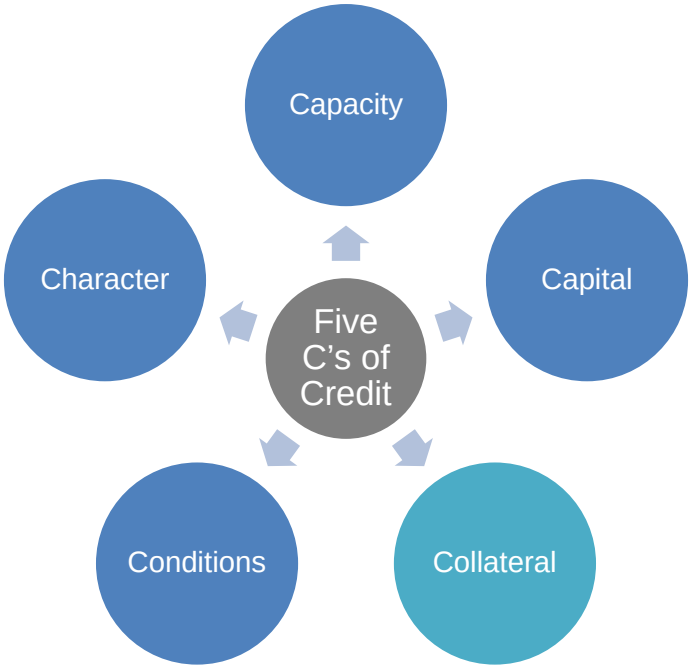
- Equity/Downpayment:
  - $500,000

- 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%

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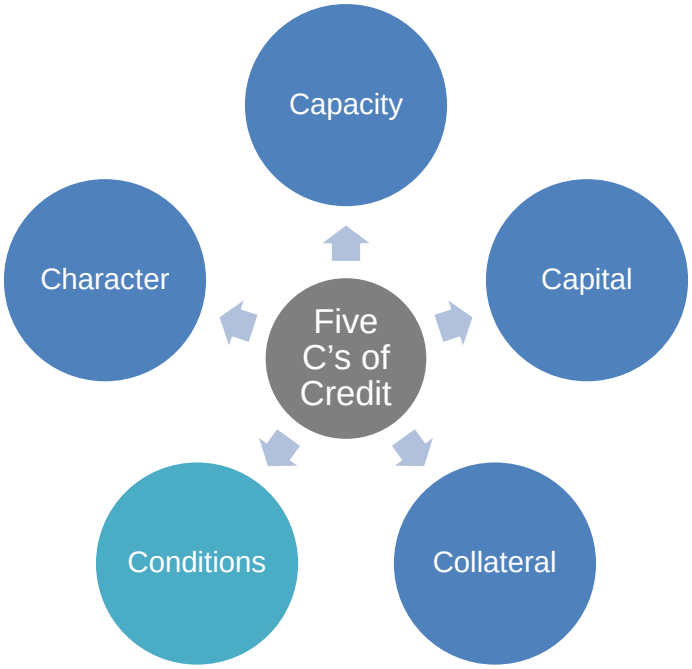
The Basics of Underwriting a Bond: The Five C's of Credit

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**

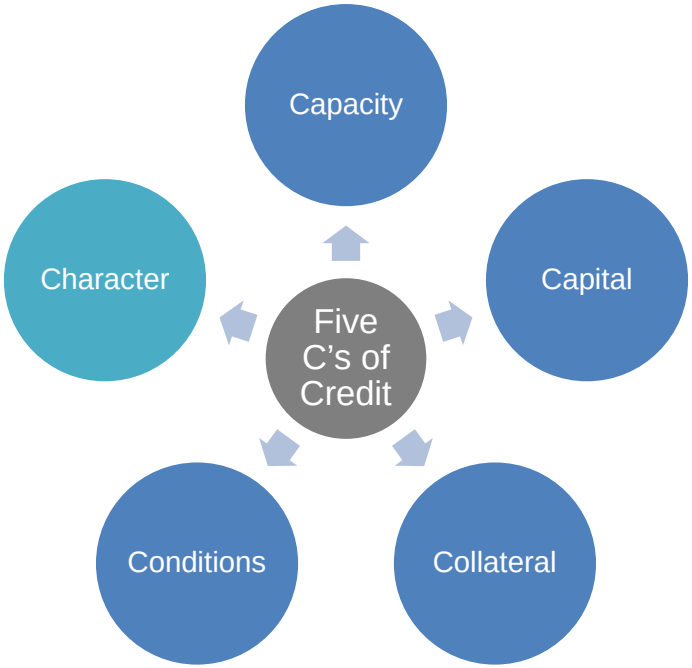
- Total Available Condo Units in Market: 5,000
- Absorption Rate: 500 per month
- Absorption Period: 10 months
- No other projects under construction
- 12 months to construct

- 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:
- JOHNSON & JOHNSON

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Investor Appetites

Investor appetites differ based upon:

- Tax Status of the Bond (Bank Qualification)
- 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

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. The bond market is divided into publicly marketed bonds and private placement transactions.

Bond Ratings

Investment Grade			
Moody's	S&P	Fitch	Meaning
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			
Moody's	S&P	Fitch	Meaning
Ba1	BB+	BB+	Prime
Ba2	BB	BB	Non-investment Grade
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 with Little Prospect of Recovery
Ca	CC	CC+	
	C	CC	In Default
		CC-	
D	D	DDD	

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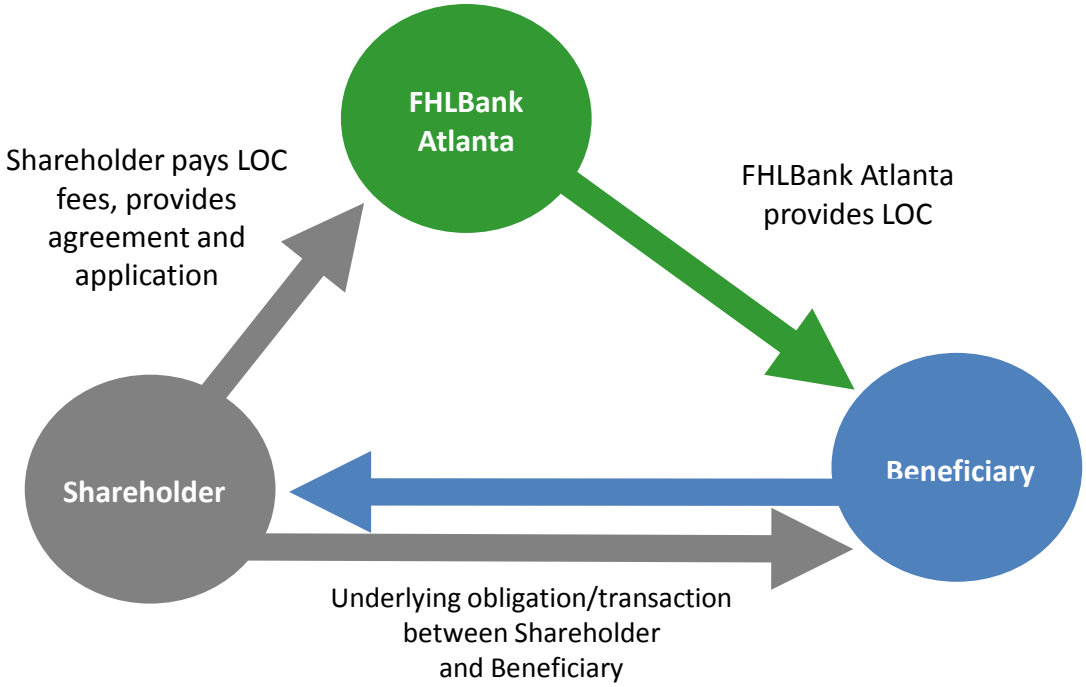
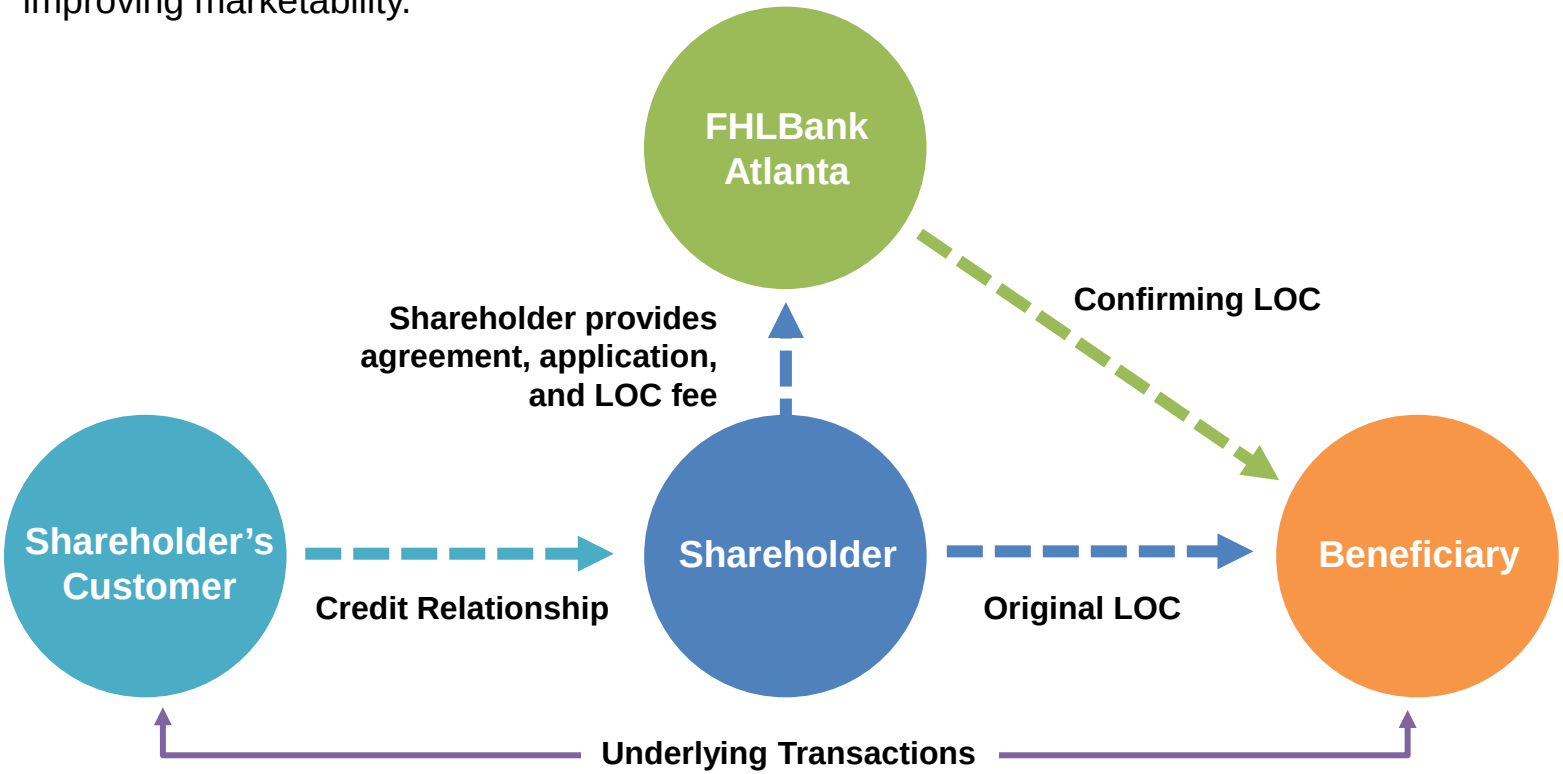
Standby Letter of Credit
Overview

- 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 LOC Overview

- 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 Confirming LOC allows borrowers to access financing from a broader range of institutions at a potentially lower LOC and/or interest cost.

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
- Still not investment grade

FHLBank Atlanta Shareholder

- Well capitalized
- Good earnings
- Growing
- Under no regulatory scrutiny
- Strong board of directors
- Shareholder underwrites the project
- Still not investment grade

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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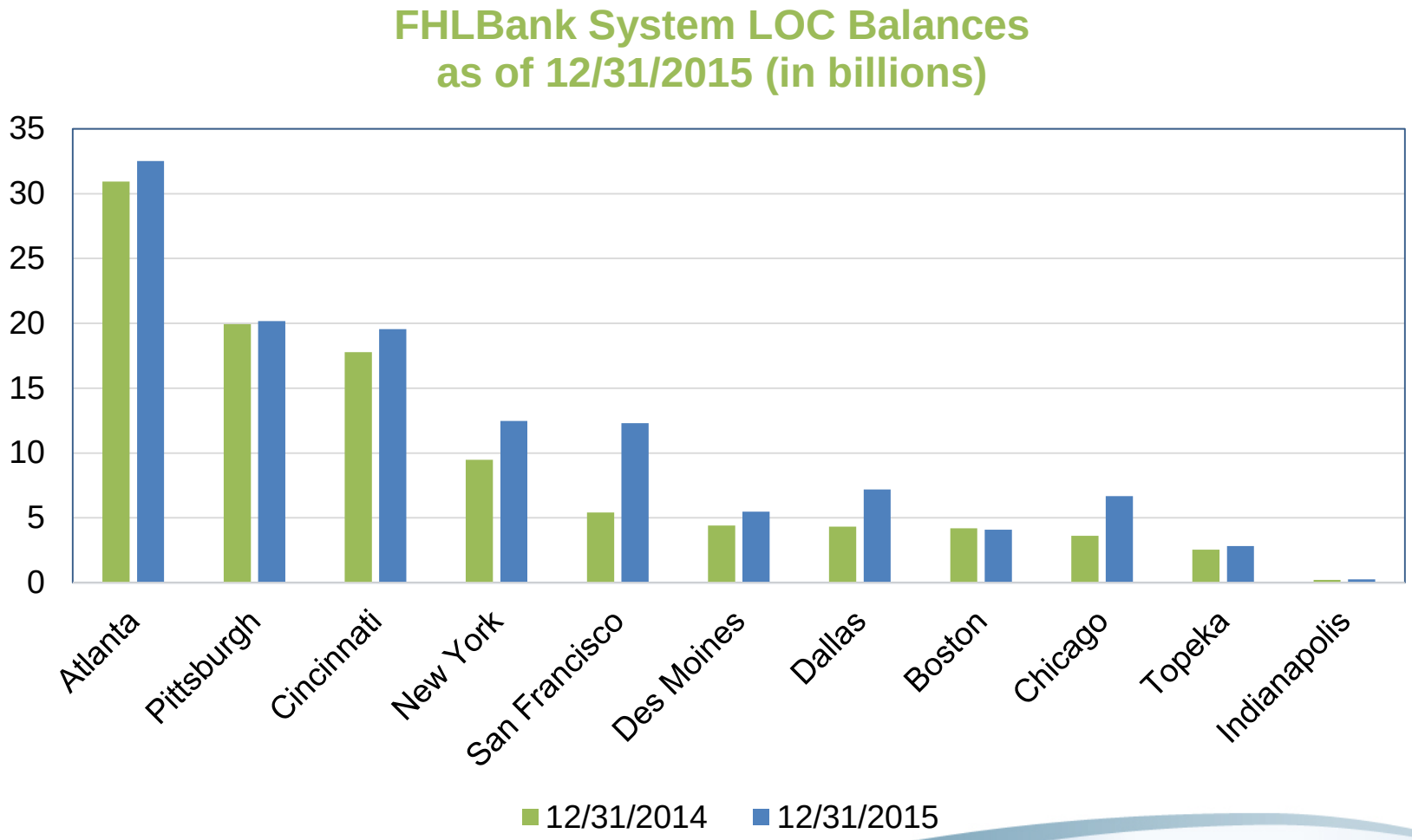
FHLBank Atlanta: The Leading FHLBank in LOCs



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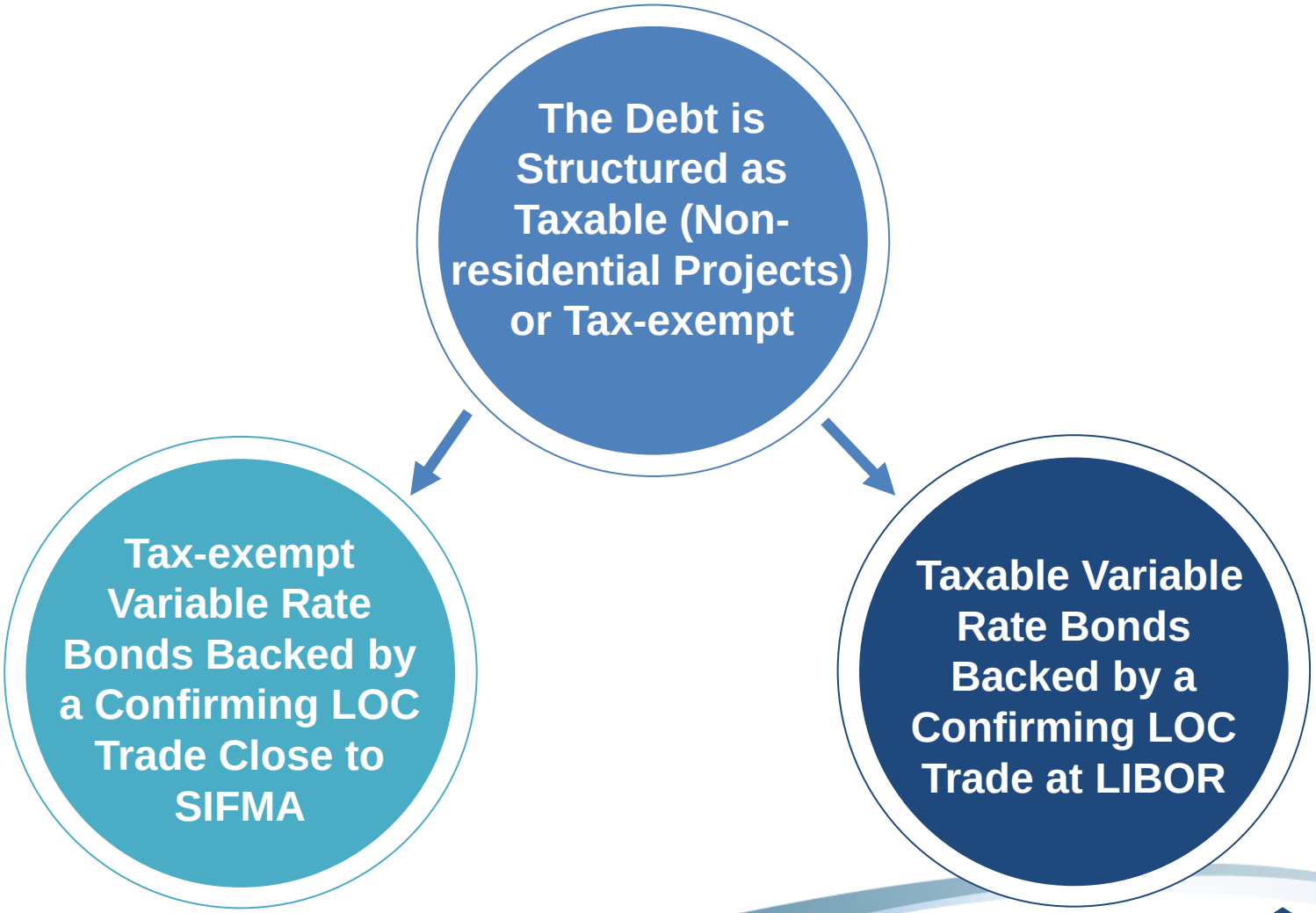
Confirming LOC Uses



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Shareholder Benefit

- Fee Income

Establishing or Retaining New Business Relationships

Balance Sheet Management

Interest-rate Risk Management

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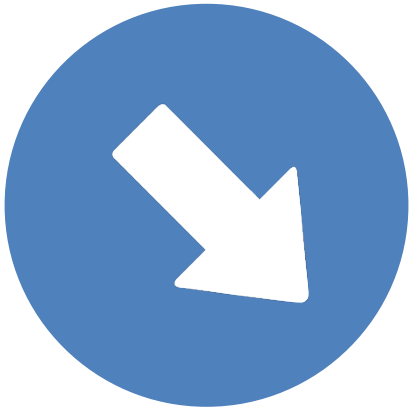
The Borrower's Benefit



Lower Cost of Borrowing

Wider Range of Available Financial Institution Partners

More Favorable Terms

Interest-rate Risk Management

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The Opportunities:
Affordable Housing Tax-exempt Bonds

- Certain GSEs and permanent debt investors do not take construction risk for new construction or substantial rehabilitation of affordable housing projects
- These investors take the long-term credit risk and the underlying wrapped LOC is extinguished when the project is placed in service

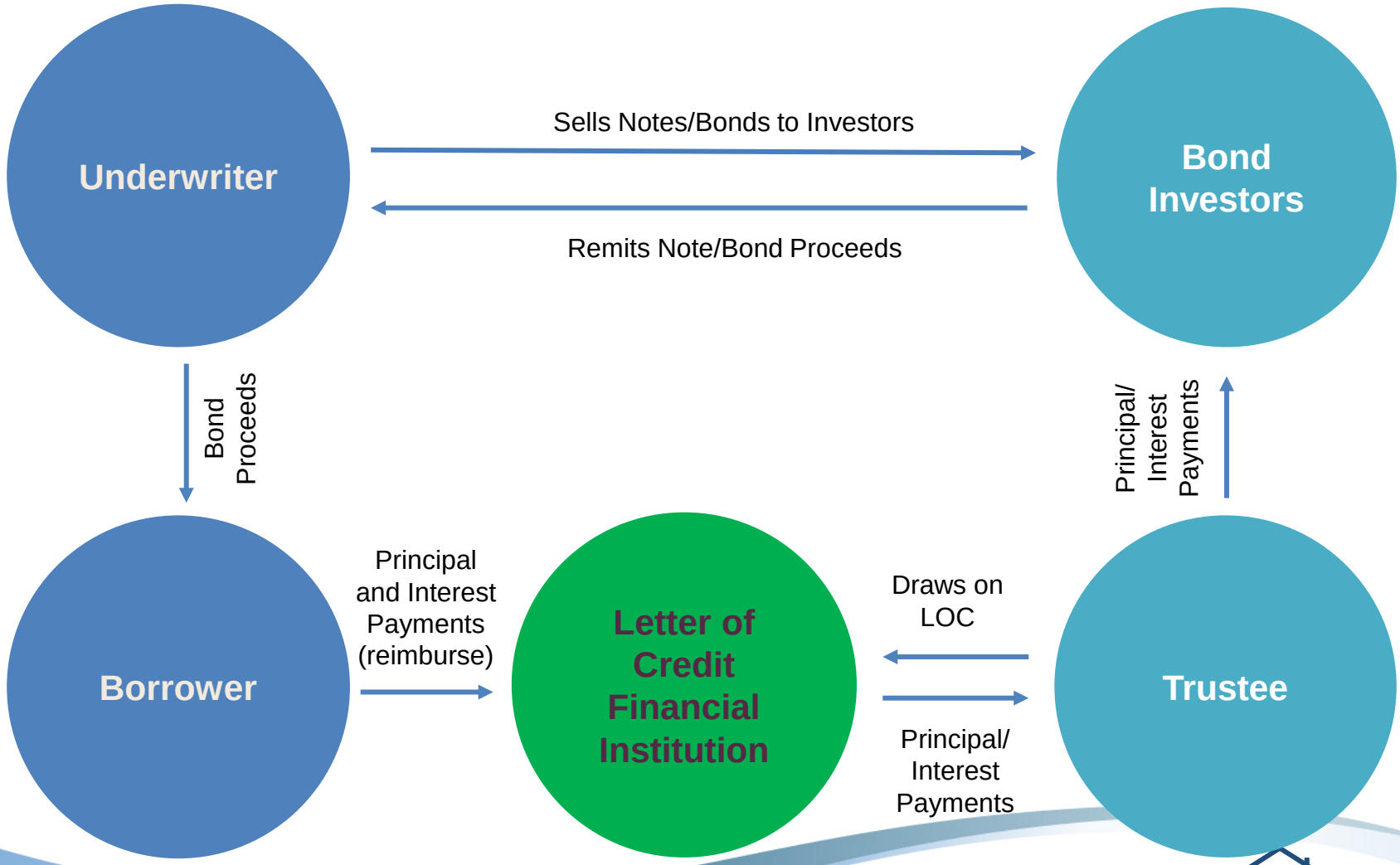
The Confirming LOC allows shareholders to compete for business they might not otherwise be able to win.

The Opportunities:
Economic Development – Taxable Bonds

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

The Confirming LOC allows shareholders to compete for business they might not otherwise be able to win.

Letter of Credit Bond Structure and Flow of Funds



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The Opportunities:
By Issuer – Nationally, Taxable Bonds Only

	2015		2014	
Activity:	**Volume ($ millions)**	**# Issues**	**Volume ($ millions)**	**# Issues**
State Agencies	8,660.6	210	8,704.3	154
Local Authorities	6,175.3	222	6,789.8	199
Cities and Towns	5,382.0	305	3,808.0	252
State Governments	1,855.2	31	2,638.8	30
District	2,681.0	234	2,065.0	197
Colleges and Universities	3,391.7	54	1,630.6	40
Counties and Parishes	1,578.0	55	1,180.2	57
Direct Issuer	578.6	5	117.9	7
Tribal Government	0.0	0	22.6	1
Cooperative Utilities	0.0	0	8.0	1
Total	**$30,302.40**	**1,116**	**$26,965.20**	**938**

Source: The Bond Buyer, 2015 In Statistics Annual Review
http://www.bondbuyer.com/pdfs/2015-in-statistics.pdf

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The Opportunities:
By Activity – Nationally, Taxable Bonds Only

	2015		2014	
Activity:	**Volume ($ millions)**	**# Issues**	**Volume ($ millions)**	**# Issues**
General Purpose	9,124.6	307	7,150.2	272
Education	7,996.1	372	5,064.6	301
Transportation	1,118.5	43	3,378.2	45
Housing	2,939.4	86	2,966.3	72
Development	3,514.5	119	2,887.2	73
Utilities	1,231.8	63	1,710.3	57
Electric Power	1,583.9	18	1,342.1	18
Public Facilities	1,694.3	43	1,312.6	43
Healthcare	1,088.6	62	1,081.4	50
Environmental Facilities	10.9	3	72.4	7
Total	**$30,302.60**	**1,116**	**$26,965.30**	**938**

Source: The Bond Buyer, 2015 In Statistics Annual Review
http://www.bondbuyer.com/pdfs/2015-in-statistics.pdf

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The Opportunities:
Bond Sales by State

	2015			2014		
States	**Rank**	**Volume ($ millions)**	**# Issues**	**Rank**	**Volume ($ millions)**	**# Issues**
Florida	4	20,729.0	347	4	17,005.1	287
Maryland	16	6,846.8	81	14	7,053.0	85
Virginia	15	7,127.6	113	12	7,146.5	102
Georgia	13	7,388.4	137	19	5,456.7	133
North Carolina	19	6,523.9	114	23	3,945	79
South Carolina	22	5,771.6	133	24	3,936.2	89
Alabama	29	3,632.6	199	29	3,225.1	165
District of Columbia	39	1,860.1	14	30	3,073.8	21
Total	**N/A**	**$59,880.0**	**1,138**	**N/A**	**$50,841.4**	**961**

Source: The Bond Buyer, 2015 In Statistics Annual Review
http://www.bondbuyer.com/pdfs/2015-in-statistics.pdf

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Questions?

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