

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

Patrick Rutledge, AVP / Public Finance Relationship
Manager
FHLBank Atlanta

Disclaimer

- Certain information contained herein has been prepared by FHLBank Atlanta from third-party and market data and using analytical tools it believes to be accurate and reliable. No warranty, expressed or implied, however, is made concerning the completeness or accuracy of such information. The analysis and applications contained herein are provided for illustrative purposes only and are based on certain assumptions that FHLBank Atlanta believes to be reasonable. Different assumptions, however, may lead to materially different results. Additionally, past performance and experience with respect to similar financial products may not necessarily be indicative of actual results.
- The information, analysis, and applications contained herein should not be relied upon as a substitute for your own business judgment and independent review. You should consult your own regulatory, tax, business, investment, financial, and accounting advisors, and should perform your own suitability analysis, before entering into any transaction or structure described herein. Sophisticated financial products are risky and are not appropriate for all persons. FHLBank Atlanta is not a registered investment advisor and does not advise persons on the advisability of investing in, purchasing, or selling sophisticated financial products or the means by which any such product may be utilized.
- Nothing in the information herein should be considered an offer to sell or a solicitation of an offer to buy any securities or derivative products. FHLBank Atlanta is not obligated to update or keep current the information or applications contained herein. FHLBank Atlanta may own or have a position relative to certain securities or other financial instruments discussed in this information or used in this analysis. Neither FHLBank Atlanta nor any of its directors, officers, employees, agents, attorneys, or representatives shall have any liability for any loss or damage arising out of the use of all or any part of this information.
- All information is indicative of the time this presentation was written.

Table of Contents

- Introduction to FHLBank Atlanta
- Basics of Underwriting
- Investor Appetites
- Capital Markets and Bond Ratings
- Credit Enhancement of Bond Issues
- The Opportunities
 - Affordable Housing
 - Economic Development
 - Sizing the Opportunity

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

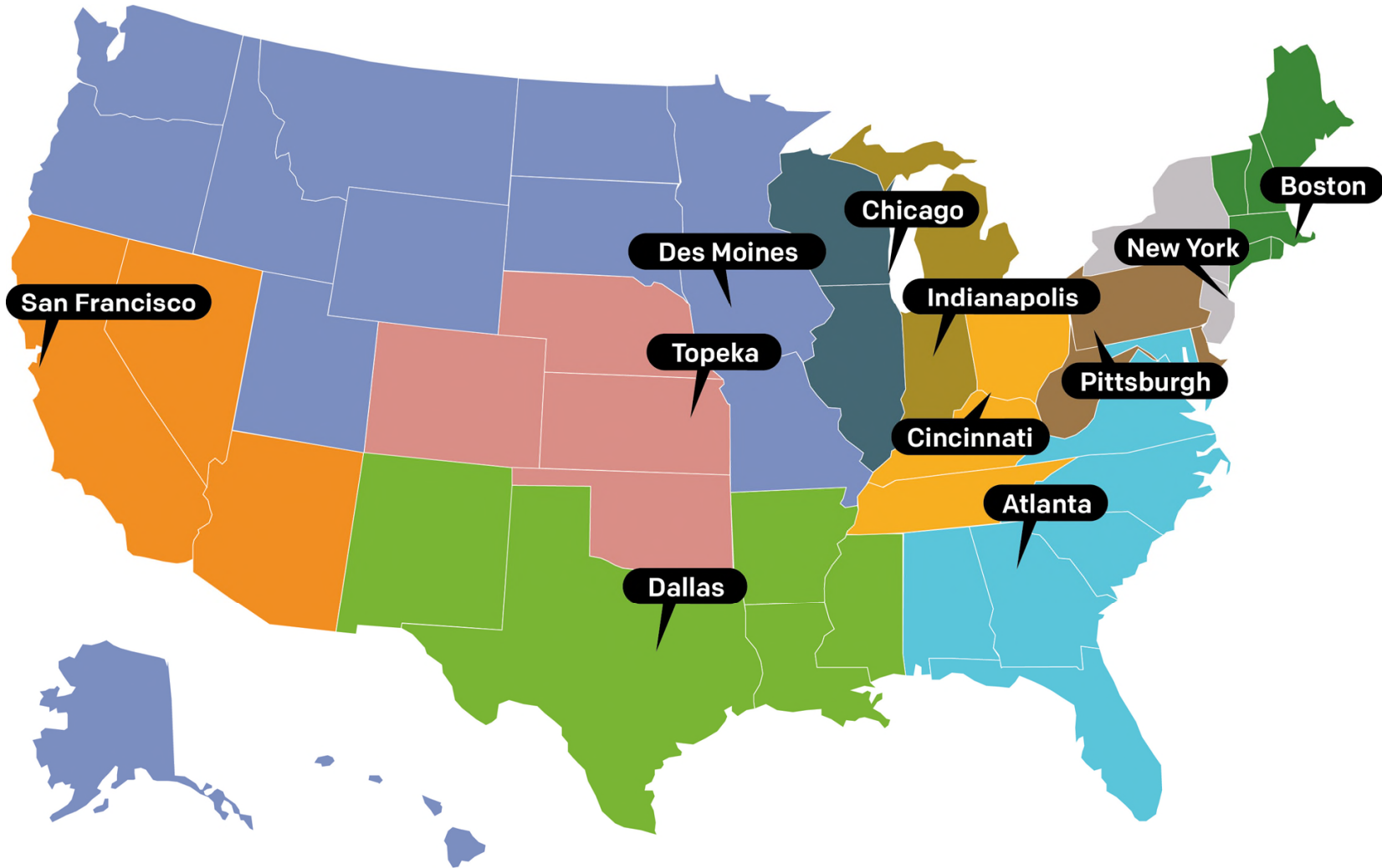
FHLBank System Overview

The Bank is a cooperative, owned by its shareholders

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

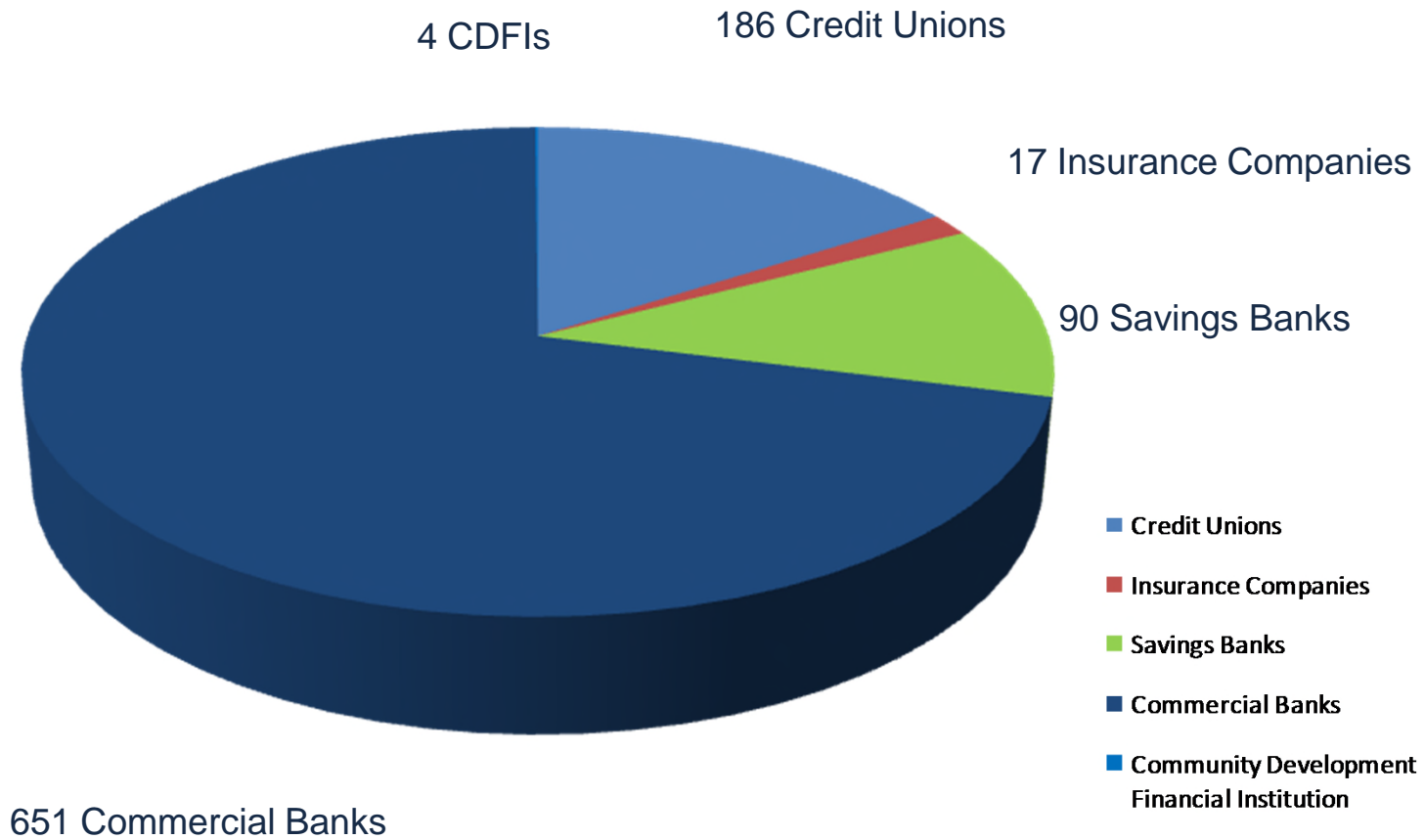
Shareholders include commercial banks, savings and loan institutions, credit unions, community development financial institutions (CDFIs), and insurance companies

FHLBank System



FHLBank Atlanta Shareholders

As of March 31, 2015



948 Total Shareholders

Products and Services

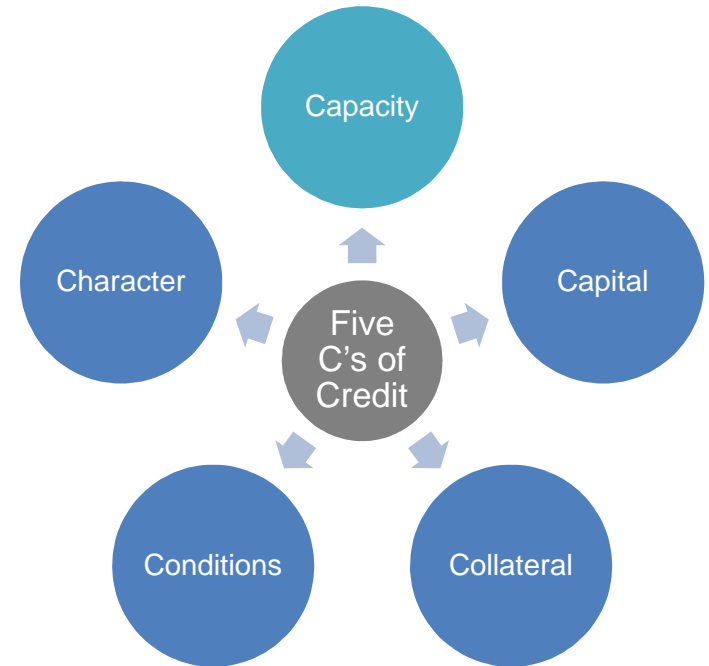
- Advances (Loans)
- Interest-rate risk management tools
- Cash Management services
- Affordable Housing Program (AHP) and Community Investment Program (CIP)
- Letters of Credit

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

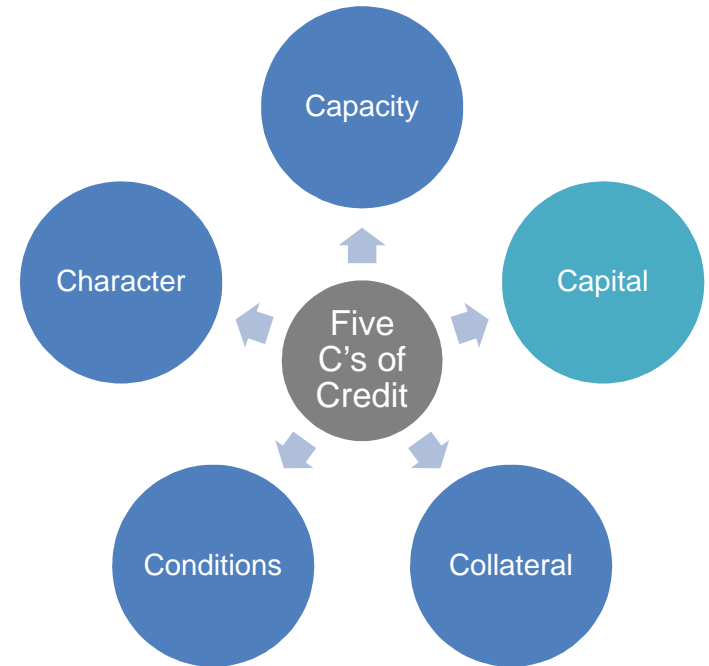
- Cash flow \$400,000
- Debt Service of \$250,000

- 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



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

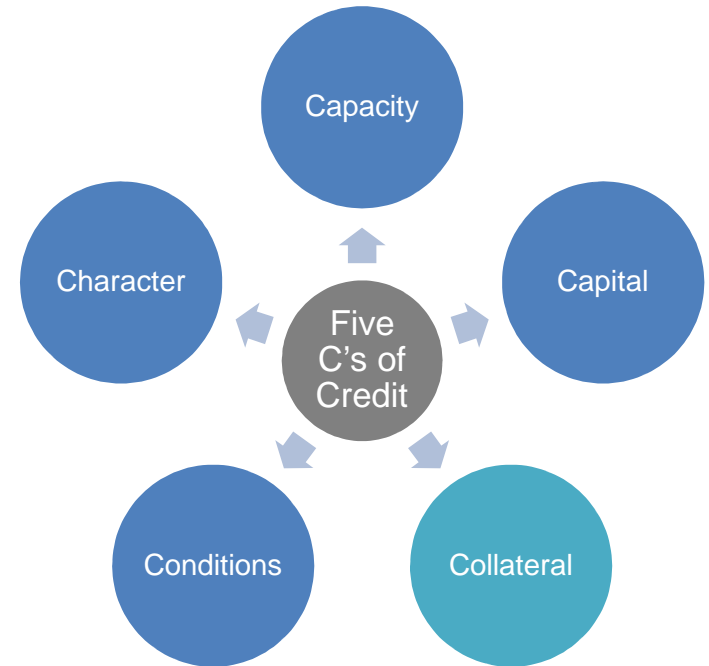
- Equity/Downpayment:
 - \$500,000

- 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%

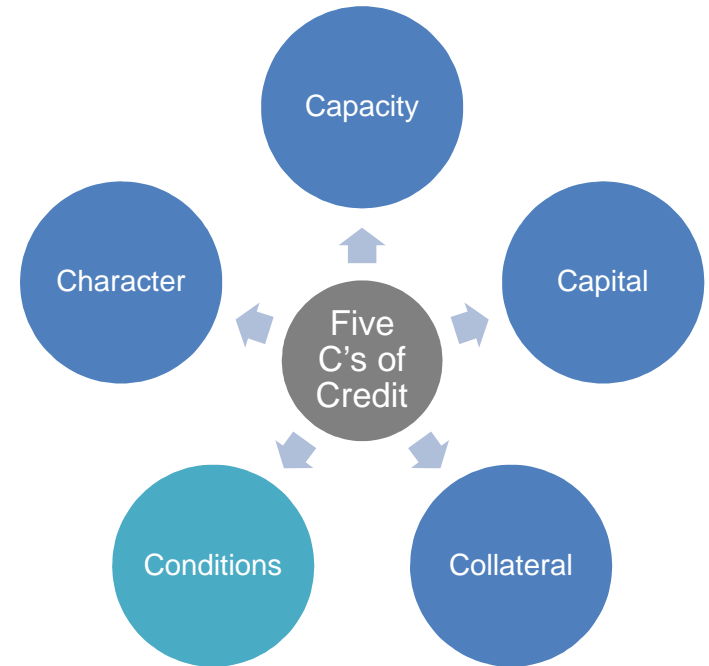
- **Company B**

- 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**

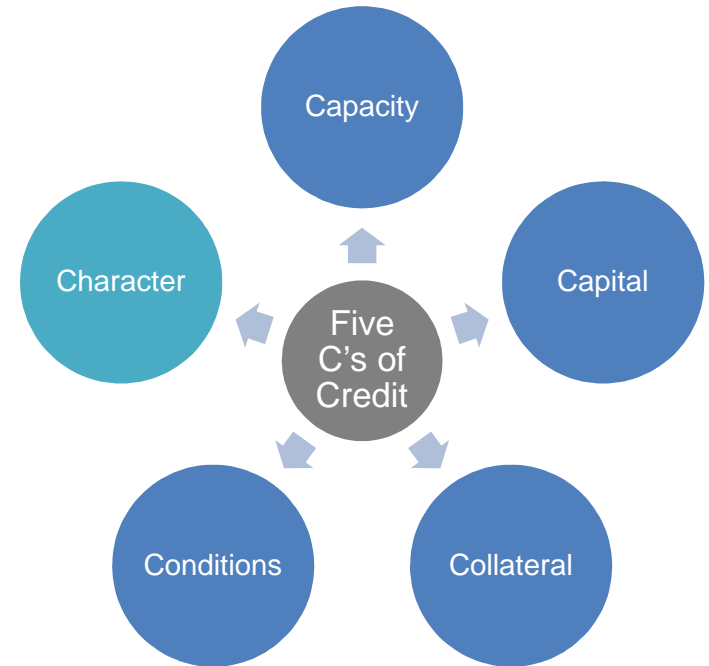
- Total Available Condo Units in Market: 5,000
- Absorption Rate: 500 per month
- Absorption Period: 10 months
- No other projects under construction
- 12 months to construct

- 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:

- JOHNSON & JOHNSON

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

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.

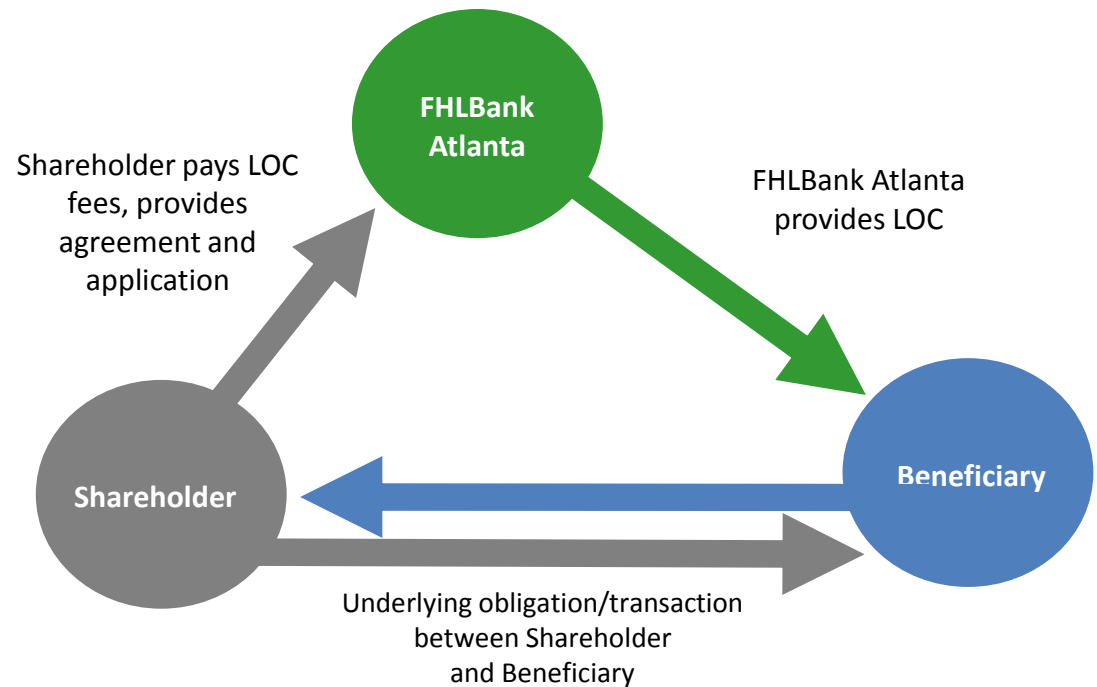
Bond Ratings

| 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 | |

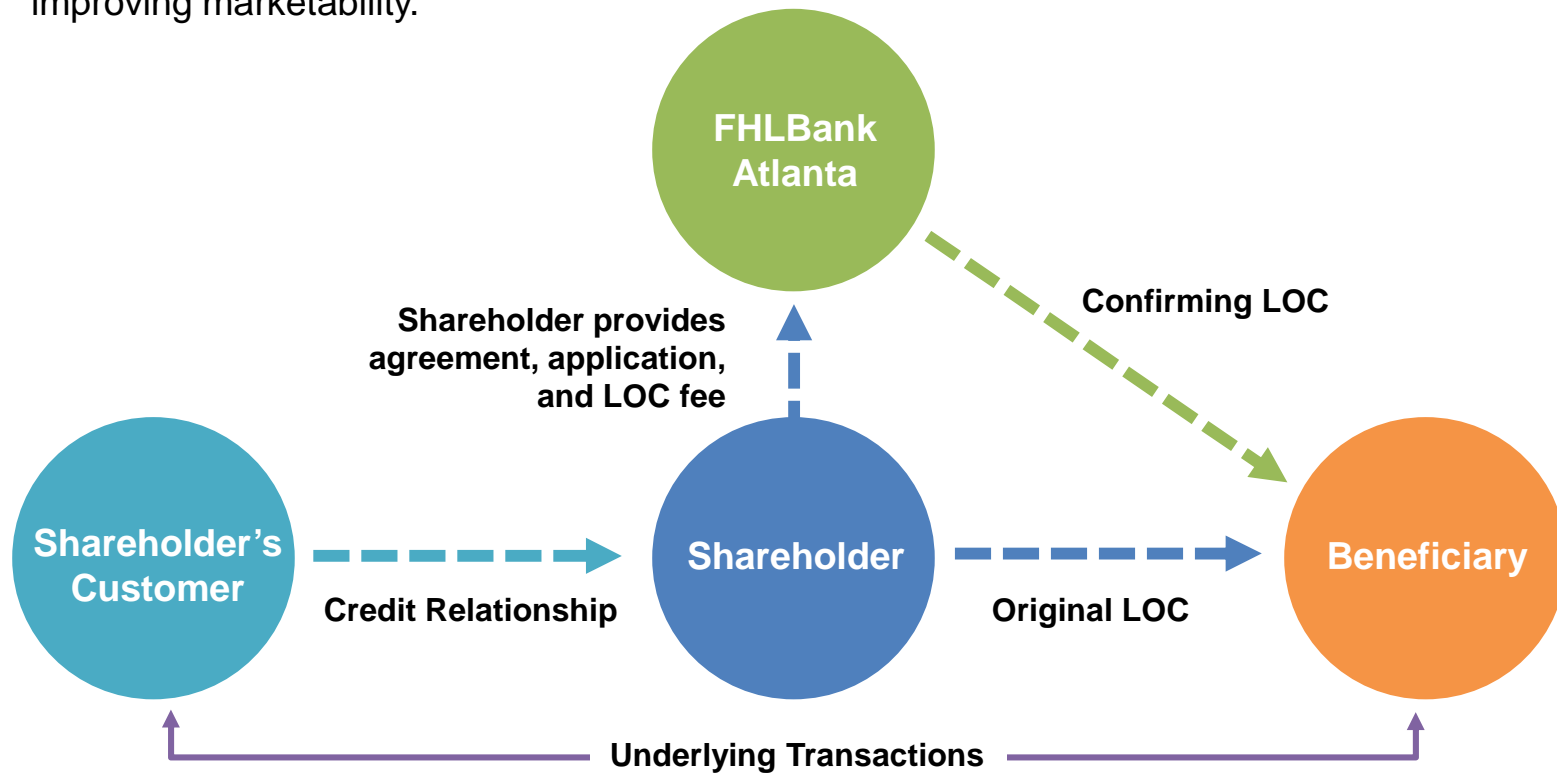
Standby Letter of Credit Overview

- 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

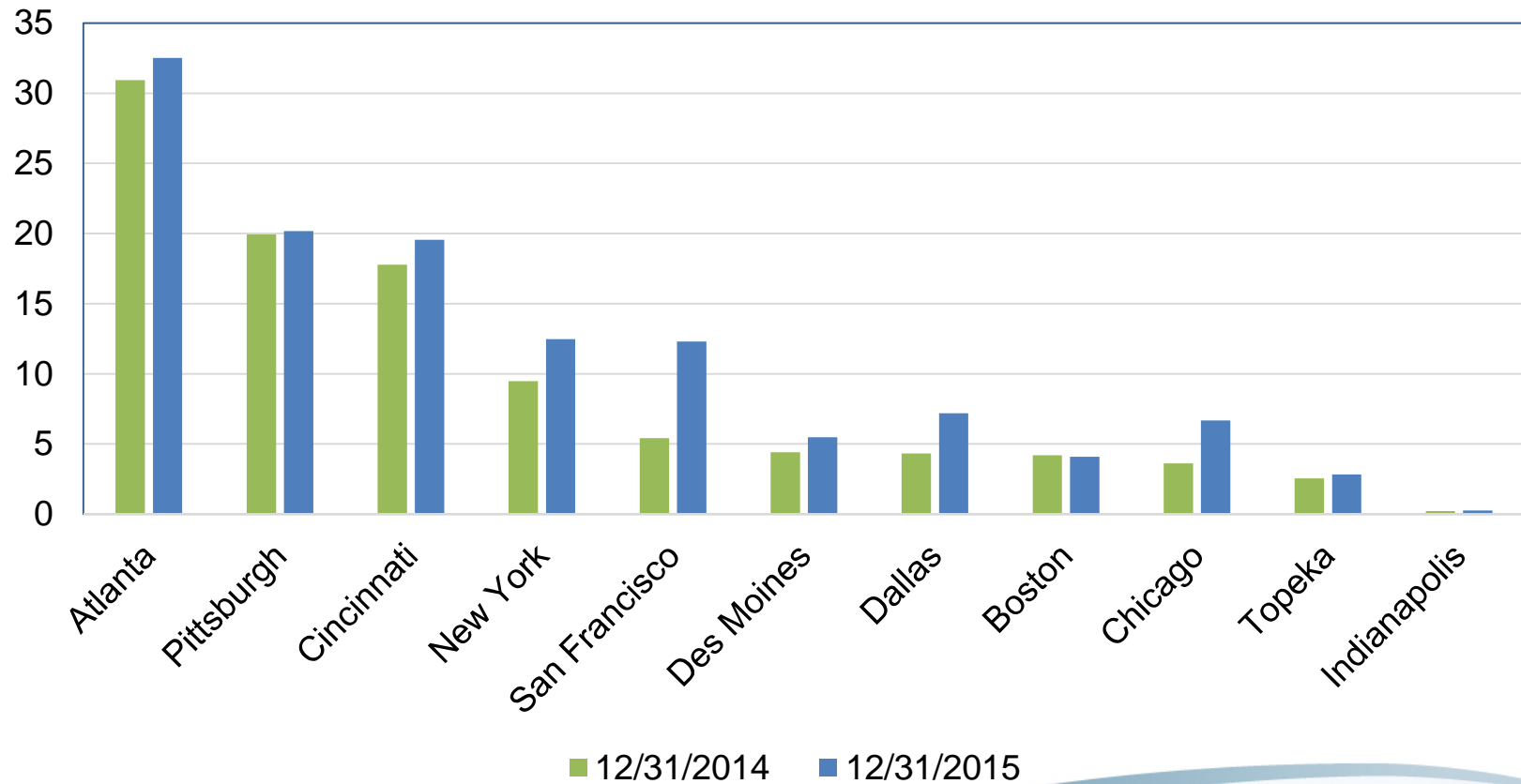
- Well capitalized
- Good earnings
- Growing
- Under no regulatory scrutiny
- Strong board of directors
- Shareholder underwrites the project
- Still not investment grade

FHLBank Atlanta

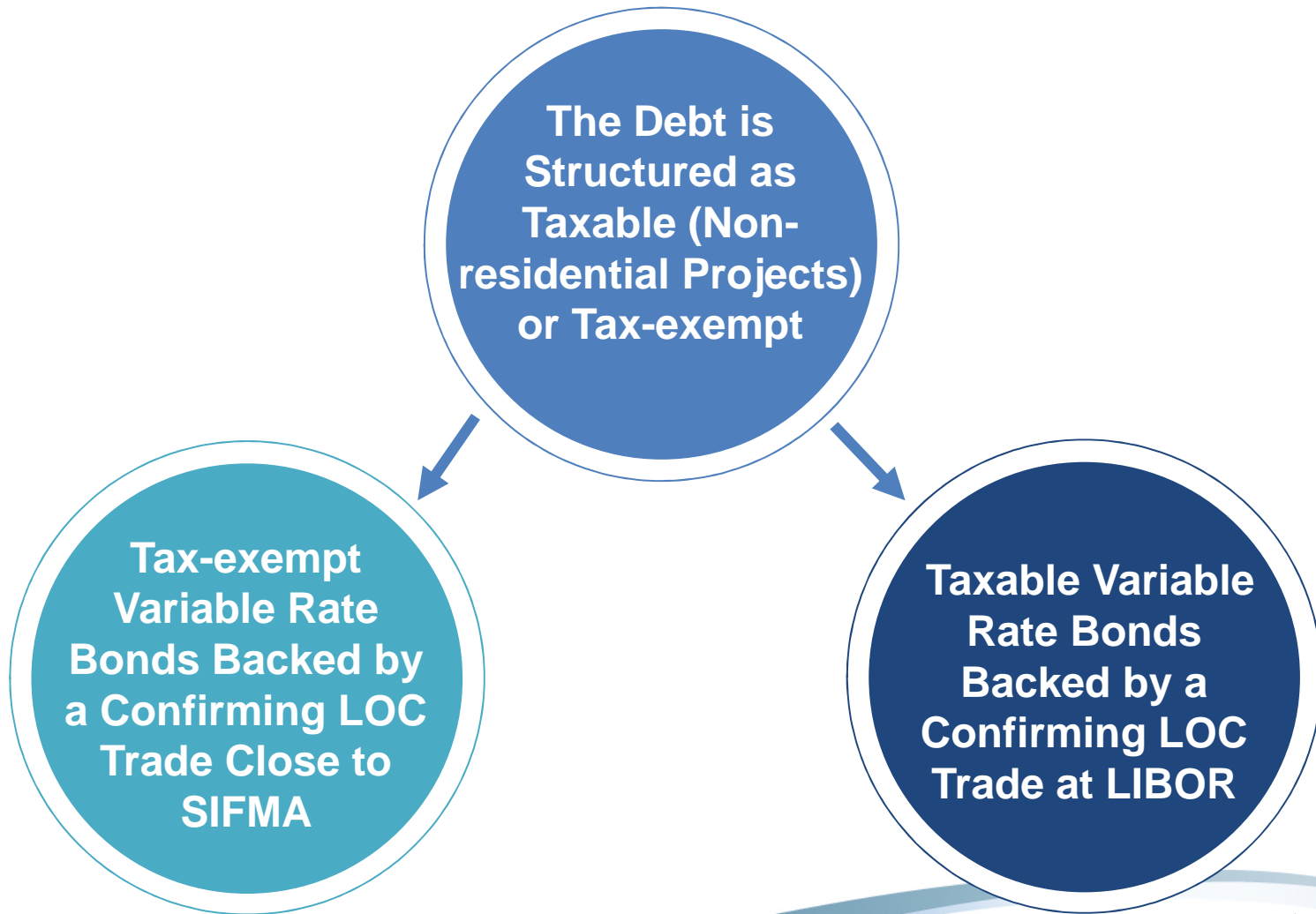
- Rated Aaa by Moody's
- Rated AA+ by S&P
- FHLBank Atlanta is collateralized by shareholder
- Bondholder purchases bonds based on FHLBank Atlanta's credit rating

FHLBank Atlanta: The Leading FHLBank in LOCs

FHLBank System LOC Balances
as of 12/31/2015 (in billions)



Confirming LOC Uses



Shareholder Benefit



- Fee Income



**Establishing
or Retaining
New Business
Relationships**

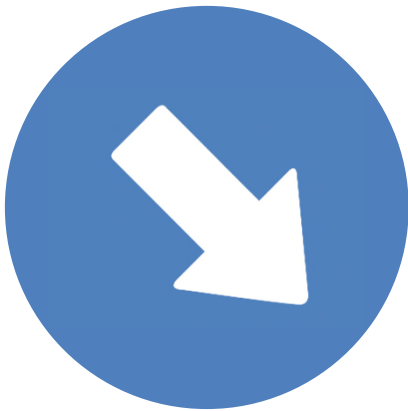


**Balance
Sheet
Management**



**Interest-rate
Risk Management**

The Borrower's Benefit



**Lower Cost
of Borrowing**



**Wider Range of
Available Financial
Institution Partners**



**More
Favorable Terms**



**Interest-rate
Risk Management**

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

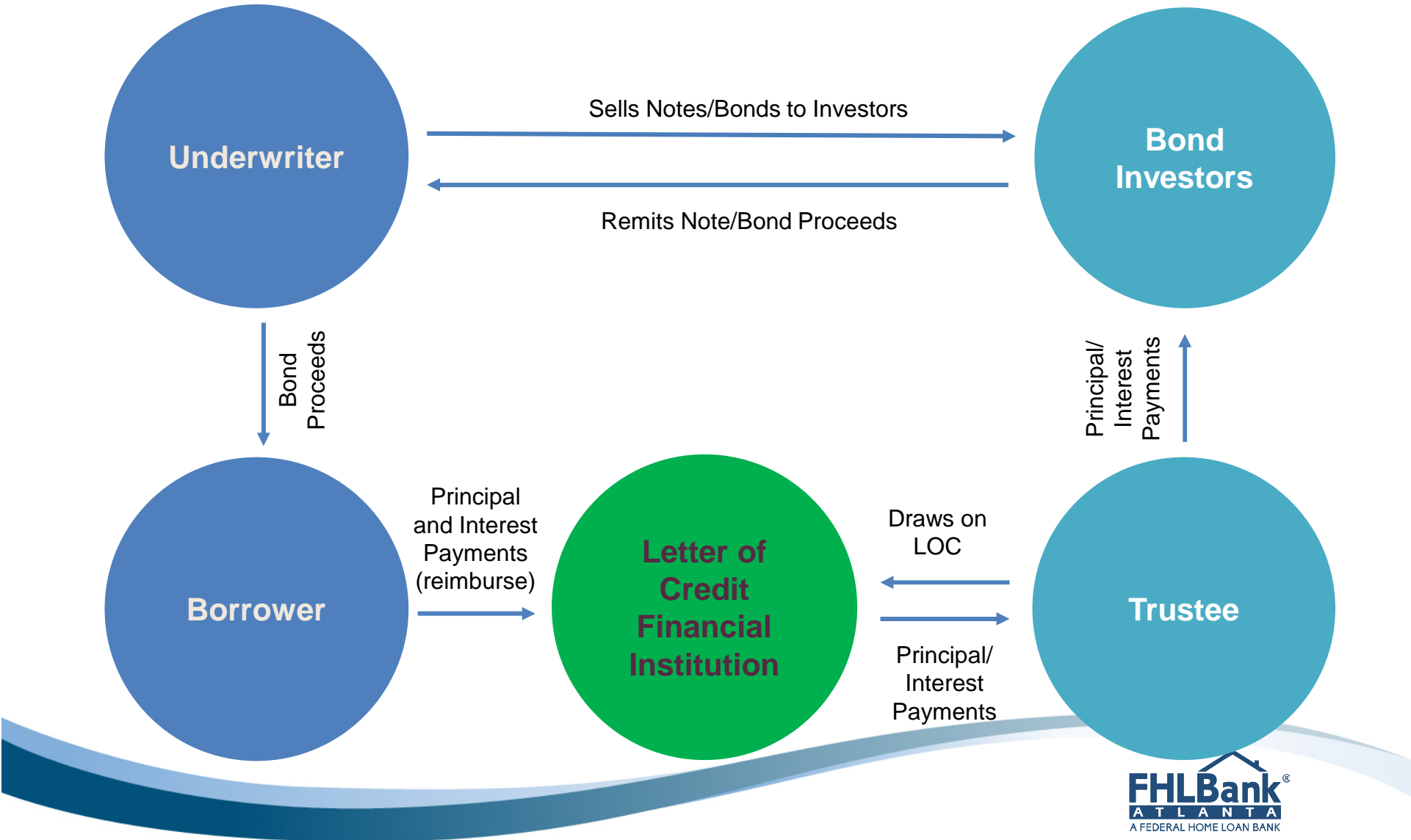


- In many instances, a commercial project can be financed at a lower cost by issuing a bond with a credit enhancement from an LOC compared with financing the project with a conventional loan



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



The Opportunities: By Issuer – Nationally, Taxable Bonds Only

| Activity: | 2015 | | 2014 | |
|---------------------------|----------------------|--------------|----------------------|------------|
| | 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>



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>



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>



Questions?

Patrick Rutledge

wrutledge@fhlbatl.com

Tel: 404.888.8328

Federal Home Loan Bank Atlanta

1475 Peachtree Street, N.E.

Atlanta, GA 30309