



BUILDING STRENGTH

Federal Home
Loan Bank of
San Francisco

2010
Annual
Report

The mission of the Federal Home Loan Bank of San Francisco is to enable families and individuals of all income levels to obtain quality housing and become homeowners by providing wholesale products and services that help member financial institutions:

- expand the availability of mortgage credit,
- compete more effectively in their markets, and
- foster strong and vibrant communities through community and economic development.



One of the toughest challenges for the Bank over the last few years has been balancing two potentially conflicting goals: meeting the credit needs of individual members and protecting all members' collective investment in the Bank. In an extremely difficult and volatile environment, with declining asset values and impaired credit quality a commonplace occurrence, the Bank had to adjust credit and collateral terms frequently to address changes in member creditworthiness and ensure that all advances remained fully collateralized. The Bank tackled this challenge by striving to be responsive to each member's particular circumstances without compromising the Bank's overall safety and soundness.

INDEPENDENCE BANK
NEWPORT BEACH, CALIFORNIA

“When the real estate bubble burst, we went through significant difficulties,” says Maria Arakaki, Executive Vice President and Chief Financial Officer of Independence Bank. “We had to write off a large amount, mostly on our construction loan portfolio. So we completely understood when the Federal Home Loan Bank, because of prudent credit management, wanted to reduce its exposure to us. But we are very grateful and appreciative for the way the Bank did it—they understood our situation and gave us time to work through our issues. Every quarter, we cut a certain percentage of our borrowings. We were right on target or sometimes ahead of target. The process gave us the time we needed.”

“In a time of crisis, the value of the Bank to us was tremendous. We were grateful that the Bank was there for us when we needed funds. We also appreciated the way the Bank worked with us when we ran into credit problems. The Bank puts in the effort to understand each member’s individual situation and craft individual solutions. That’s invaluable.”

MARIA ARAKAKI
EXECUTIVE VICE PRESIDENT AND CHIEF FINANCIAL OFFICER, INDEPENDENCE BANK

“At that time, we also had to start physically delivering our loan collateral to the Bank. We understood the reason for that change as well—our credit issues,” says Ms. Arakaki. “We were prompt in writing down the value of our problem assets. Compared to the industry, we recognized our issues earlier, took the hit earlier, and turned around earlier, towards the end of 2009. As our performance improved, we continued to keep the Bank informed. As we stabilized, we were able to get an increase in our financing availability, and we no longer had to deliver our pledged loans to the Bank.” She adds, “Now we are more of a community bank and a portfolio lender, lending to customers with whom we have a deposit relationship. We are much more involved in the communities where our branches are located. In a way, the market forced us to change, which is a good thing. We are doing well.”



FACILITATING ASSET / LIABILITY MANAGEMENT

During a sustained period of low interest rates and high liquidity levels, like the one we are now experiencing, financial institutions must continuously focus on asset/liability management, ensuring that they are adequately protected against adverse movements in funding costs and funds availability. Members evaluate their interest rate risk and liquidity risk on a regular basis, and many members consider Bank advances an essential financial tool for managing these risks.

STAR ONE CREDIT UNION
SUNNYVALE, CALIFORNIA

“Our lending is focused on consumer-based products, particularly residential mortgage loans. We keep all of our loans in portfolio, and we are conservative when it comes to managing interest rate risk,” says Brian Ross, Senior Vice President and Treasurer of Star One Credit Union. “Since most of our members want fixed rate loans, we offset the interest rate risk by using Bank advances to create a laddered portfolio of fixed rate advances, with a range of maturities. We go anywhere from two years all the way up to ten years. In 2010, we started using Callable Advances, which give us the right to prepay without a fee if rates go down or we no longer need the funds. We get the benefit of having a long-term funding source plus having the option to get out of the borrowing if needed. It’s nice to be in the driver’s seat for once.”

“Key benefits we get from Bank membership are the competitive pricing, same-day execution, and working with people who know us. But the most critical benefit is asset/liability management. Long-term borrowings from the Bank enable us to keep our longer-term assets, including our fixed rate residential mortgage loans, in portfolio. And that gives us greater flexibility in serving our members.”

BRIAN ROSS
SENIOR VICE PRESIDENT AND TREASURER, STAR ONE CREDIT UNION

“If I couldn’t borrow long-term advances from the Bank, I’d have to go to Wall Street,” Mr. Ross adds. “We can do that because we have a large securities portfolio. But then, you never know when the next financial crisis might hit—that source of funds could dry up pretty quickly. Back in 2008, in the midst of the crisis, the Bank was always there for us. So we continued to borrow from the Bank, and we were able to do what we needed to do during that crisis.”



ANTICIPATING FUTURE FUNDING NEEDS

In all economic environments, the Bank's member financial institutions face certain persistent challenges—controlling interest rate risk, managing liquidity, and keeping funding costs low. Many members are enhancing their contingent liquidity planning now by making sure that everything is in place to borrow from the Bank in the future. They are becoming more familiar with the Bank's credit products, working with the Bank to establish or increase their financing availability and expand the borrowing capacity of their pledged loans, signing up to use partial prepayment symmetry, and exploring the benefits of participation in the Bank's affordable housing and community economic development programs.

PROVIDENT SAVINGS BANK
RIVERSIDE, CALIFORNIA

“For many financial institutions, the poor economic environment was difficult to navigate,” says Donavon Ternes, Executive Vice President, Chief Operating Officer and Chief Financial Officer of Provident Savings Bank. “For us, we had an advantage when we made the decision to delever our balance sheet. The Bank’s partial prepayment symmetry product allowed us to reduce the size of our balance sheet by prepaying advances without taking significant losses. The fact that we had advances with embedded gains and were able to realize those gains through the prepayment of the PPS product helped us offset some advances that were prepaid at a loss, so that in many cases we could make it a revenue neutral and capital neutral transaction.”

“In a good economic environment, it’s important to know that the Bank is a source of credit for interest rate risk management purposes and contingent liquidity. But it was even more important and reassuring to know that in the worst moments of the recent economic downturn, the Bank was willing to work with us to meet our needs. The Federal Home Loan Banks performed admirably through that period and were a source of strength for their members.”

DONAVON TERNES

EXECUTIVE VICE PRESIDENT, CHIEF OPERATING OFFICER AND CHIEF FINANCIAL OFFICER, PROVIDENT SAVINGS BANK

According to Mr. Ternes, the Bank is important to Provident for contingent liquidity planning and interest rate risk management. “Sound liquidity management practices dictate that we know our available sources of liquidity. So we are managing these levels of availability with a higher degree of oversight than we once did, and documenting that capacity in our liquidity management and contingency funding plans. Also, we are always concerned about the interest rate risk embedded in our balance sheet. As a result, we expect that our demand for long-term fixed rate advances, within the context of good interest rate risk management practices, may increase in a rising rate environment. We know that the Bank is there for us if we choose to execute long-term fixed rate advances.”