

Federal Home Loan Bank of San Francisco
Third Quarter Report

To Our Members

As of September 30, 2001, the Federal Home Loan Bank of San Francisco had \$108.7 billion in advances, an increase of \$1.3 billion, or 1%, relative to June 30, 2001, and a decrease of \$1.3 billion, or 1%, relative to December 31, 2000. Total assets increased \$4.8 billion, or 4%, during the quarter, and decreased \$584 million, less than 1%, relative to yearend 2000. In addition to the modest growth in advances outstanding during the quarter, the Bank experienced increases of \$1.6 billion in interest-bearing deposits in banks and \$2.5 billion in held-to-maturity investments, including \$1.1 billion in other liquidity investments and \$1.4 billion in mortgage-backed securities.

Net interest income for the third quarter was \$136.5 million, a decrease of \$8.0 million, or 6%, relative to the year-earlier period. This decline was primarily due to lower earnings on capital as a result of the sharp drop in short-term interest rates during the quarter, as well as narrower interest rate spreads on advances and investments.

Net income totaled \$67.1 million for the quarter, a drop of \$30.9 million, or 32%, relative to the same period in 2000. Most of this decrease reflects the net effect of fair value adjustments made under SFAS No. 133, which reduced net income by \$24.4 million as a result of the significant decline in short-term interest rates during the third quarter. The effects of SFAS No. 133 are primarily a matter of timing. In the first and second quarters of 2001, the Bank retained \$16.4 million in earnings that reflected the favorable fair value adjustments made under SFAS No. 133 during those quarters. Assuming no further significant reductions in short-term interest rates, we expect the remaining adverse effects of \$8.0 million reflected in this quarter to be reversed in the near future.

For the third quarter of 2001, the Bank paid a dividend rate of 5.31% (annualized). The full impact of SFAS No. 133 on the amount available for dividends was partially offset by the payout of the \$16.4 million in retained earnings, which added 1.00% to the annualized dividend yield. As the remaining negative impact of SFAS No. 133 is reversed, additional amounts may be made available for future dividends. The dividend rate for the third quarter of 2000 was 6.64% (annualized), reflecting the higher interest rates prevalent during that period. The ongoing

impact of SFAS No. 133 on the Bank cannot be predicted. As in this quarter, the Bank's retained earnings in the future may not be sufficient to offset the full impact of SFAS No. 133, which may lead to increased volatility in future dividends.

The Bank measures its financial performance in terms of how well it achieves its investment objectives, which reflect the Bank's unique cooperative nature. The Bank invests its capital primarily in high-quality, short- and intermediate-term financial instruments. This strategy enables the Bank to grow and contract in response to member credit needs without risking substantial losses (which the Bank might incur if it had to liquidate long-term investments to redeem excess stock at par). To measure its financial performance, the Bank compares current period earnings after adjusting for nonrecurring items and the effects of SFAS No. 133 (the "potential dividend yield") to the Bank's benchmark, which is based on the actual returns of a predetermined combination of high-quality, short- and intermediate-term investments that reflect the Bank's capital investment strategy. For the third quarter, the Bank's potential dividend yield exceeded the benchmark by 1.15%, compared to 0.51% for the same quarter last year.

In these times of financial uncertainty, the Bank will remain focused on fulfilling your expectations as customers and shareholders, as you strive to foster the economic vitality of your communities.

Sincerely,



Dean Schultz
President and Chief Executive Officer

Statements in this report may be forward-looking and contain terms such as "may," "expect," and "will." The Bank cautions that actual results could differ materially from those expressed or implied in these statements.

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Statements of Condition

(In thousands—except par value)	Sept. 30, 2001 (Unaudited)	December 31, 2000	Sept. 30, 2000 (Unaudited)
ASSETS			
Cash and due from banks	\$ 1,109	\$ 4,584	\$ 2,353
Interest-bearing deposits in banks	4,640,000	2,698,000	2,848,000
Securities purchased under agreements to resell	1,150,000	400,000	1,095,000
Federal funds sold	6,037,000	8,376,000	8,713,000
Held-to-maturity securities (\$1,472,619, \$360,636, \$420,478, respectively, were pledged as collateral)	17,410,162	15,524,693	14,587,482
Held-at-fair-value securities	573,843	—	—
Advances	108,699,704	110,031,641	105,526,857
Accrued interest receivable ¹	489,823	3,136,776	2,726,694
Premises and equipment, net	4,457	4,326	4,566
Held-at-fair-value derivatives	582,636	—	—
Other assets	17,612	13,988	16,130
Total Assets	<u>\$139,606,346</u>	<u>\$140,190,008</u>	<u>\$135,520,082</u>
LIABILITIES AND CAPITAL			
Liabilities:			
Consolidated obligations, net:			
Bonds	\$ 98,981,909	\$ 97,365,608	\$ 93,187,840
Discount notes	31,525,073	32,097,431	32,347,518
Total consolidated obligations	<u>130,506,982</u>	<u>129,463,039</u>	<u>125,535,358</u>
Deposits:			
Demand and overnight	742,365	347,613	240,243
Term	41,000	28,800	27,405
Total deposits	<u>783,365</u>	<u>376,413</u>	<u>267,648</u>
Accrued interest payable ¹	1,016,307	3,888,254	3,305,857
Affordable Housing Program	119,485	109,630	102,136
Payable to REFCORP	16,766	25,315	24,486
Held-at-fair-value derivatives	348,246	—	—
Other liabilities	167,666	35,212	161,870
Total Liabilities	<u>132,958,817</u>	<u>133,897,863</u>	<u>129,397,355</u>
Capital:			
Capital stock outstanding (\$100 par value)	6,640,811	6,267,859	6,097,310
Retained earnings:			
Unrestricted retained earnings	46	107	135
Restricted retained earnings	14,198	24,179	25,282
Total retained earnings	<u>14,244</u>	<u>24,286</u>	<u>25,417</u>
Accumulated other comprehensive income	(7,526)	—	—
Total Capital	<u>6,647,529</u>	<u>6,292,145</u>	<u>6,122,727</u>
Total Liabilities and Capital	<u>\$139,606,346</u>	<u>\$140,190,008</u>	<u>\$135,520,082</u>

¹In accordance with SFAS No. 133, all derivatives are marked to fair value, netted by counterparty with any associated accrued interest, and included on the balance sheet as an asset when there is a net fair value gain or as a liability when there is a net fair value loss.

The financial information as of September 30, 2001 and 2000, is unaudited and should be read in conjunction with the audited financial statements for the year ended December 31, 2000, and the accompanying notes thereto. The audited financial statements may be obtained by calling 415.616.2610.

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Statements of Income

(In thousands)	Three Months Ended		Nine Months Ended	
	Sept. 30, 2001 (Unaudited)	Sept. 30, 2000 (Unaudited)	Sept. 30, 2001 (Unaudited)	Sept. 30, 2000 (Unaudited)
INTEREST INCOME:				
Advances	\$ 1,037,913	\$ 1,726,217	\$ 3,984,252	\$ 4,638,989
Interest-bearing deposits in banks	36,139	28,945	113,239	74,506
Securities purchased under agreements to resell	11,617	4,688	52,370	77,188
Federal funds sold	64,392	153,085	303,253	418,837
Held-to-maturity securities	199,241	250,606	624,144	645,667
Held-at-fair-value securities	6,028	—	23,754	—
Loans to other Federal Home Loan Banks	219	462	599	595
Total Interest Income	1,355,549	2,164,003	5,101,611	5,855,782
INTEREST EXPENSE:				
Consolidated obligations ²	1,214,889	2,015,695	4,666,846	5,429,918
Deposits	3,990	3,454	13,165	9,482
Securities sold under agreements to repurchase	—	300	—	11,887
Borrowings from other Federal Home Loan Banks	49	25	78	34
Other borrowings	119	73	202	137
Total Interest Expense	1,219,047	2,019,547	4,680,291	5,451,458
NET INTEREST INCOME	136,502	144,456	421,320	404,324
OTHER INCOME:				
Prepayment fees, net	631	66	3,734	187
Services to members	212	222	688	669
(Loss)/gain on financial instruments, net ²	(33,250)	—	(8,430)	—
Other, net	939	797	2,695	3,220
Total Other Income	(31,468)	1,085	(1,313)	4,076
OTHER EXPENSE:				
Operating expense	11,939	10,789	34,351	30,572
FHFB and Office of Finance expenses	1,815	1,533	5,498	4,422
Total Other Expense	13,754	12,322	39,849	34,994
INCOME BEFORE ASSESSMENTS, EXTRAORDINARY ITEMS, AND CUMULATIVE EFFECT OF ADOPTING SFAS NO. 133				
	91,280	133,219	380,158	373,406
REFCORP assessments	16,766	24,486	69,272	68,832
Affordable Housing Program assessments	7,451	10,883	30,788	30,592
Total Assessments	24,217	35,369	100,060	99,424
INCOME BEFORE EXTRAORDINARY ITEMS AND CUMULATIVE EFFECT OF ADOPTING SFAS NO. 133				
	67,063	97,850	280,098	273,982
Extraordinary gain/(loss) on early retirement of debt	—	94	(555)	1,346
Cumulative effect of adopting SFAS No. 133	—	—	(2,453)	—
NET INCOME	\$ 67,063	\$ 97,944	\$ 277,090	\$ 275,328
FINANCIAL RATIOS (ANNUALIZED)				
	Sept. 30, 2001	Sept. 30, 2000	Sept. 30, 2001	Sept. 30, 2000
Adjusted Return on Equity ³	5.55%	6.57%	5.90%	6.41%
Dividend Rate	5.31%	6.64%	6.00%	7.39%

²Certain amounts related to SFAS No. 133 for the nine months ended September 30, 2001, have been reclassified to conform with the presentation for the three months ended September 30, 2001.

³The Bank uses certain adjusted financial performance measures to provide more meaningful comparisons of the Bank's performance over time. Adjusted financial performance measures reflect earnings before nonrecurring items (advance prepayment fees, extraordinary gains and losses associated with the early retirement of debt, and other material nonrecurring gains and losses), net of the amortization of current and prior period nonrecurring items, in accordance with the Bank's retained earnings policy. In addition, adjusted financial performance measures reflect the reversal of any current period fair value adjustments made in accordance with SFAS No. 133, which was implemented on January 1, 2001.

The financial information for the periods ended September 30, 2001 and 2000, is unaudited and should be read in conjunction with the audited financial statements for the year ended December 31, 2000, and the accompanying notes thereto.