MOODY'S INVESTORS SERVICE

Credit Opinion: Federal Home Loan Bank of San Francisco

Global Credit Research - 05 Aug 2011

San Francisco, California, United States

Ratings

Category	**Moody's Rating**
Outlook	Negative
Bank Deposits	Aaa/P-1
Parent: Federal Home Loan Banks	
Outlook	Negative
Senior Unsecured	Aaa
Other Short Term	P-1

Contacts

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Key Indicators

Federal Home Loan Bank of San Francisco

	[1]**2011**	**2010**	**2009**	**2008**	**2007**
ROAA (%)	**0.16**	**0.24**	**0.21**	**0.14**	**0.25**
ROAE (%)	**3.26**	**6.13**	**5.83**	**3.54**	**5.80**
Net Interest Margin (%)	**0.69**	**0.79**	**0.73**	**0.44**	**0.36**
Advances ($bil)	**92.0**	**95.6**	**133.6**	**235.7**	**251.0**
Investments ($bil)	**52.4**	**52.6**	**47.0**	**60.7**	**64.9**
Assets ($bil)	**151.4**	**152.4**	**192.9**	**321.2**	**323.0**
Equity ($bil)	**8.1**	**6.9**	**6.2**	**9.8**	**13.6**
Liquid Assets/ST Debt (%)	**47.70**	**45.57**	**41.44**	**26.82**	**22.02**

[1] As of March 31.

Opinion

SUMMARY RATING RATIONALE

Federal Home Loan Bank of San Francisco (FHLBank) Aaa/Prime-1 long- and short-term deposit ratings reflect the combination of the following factors: 1) a stand-alone Baseline Credit Assessment (BCA) of 5 (on a scale of 1 to 21, where 1 represents the lowest credit risk), 2) very high cooperative support from the FHLBank System, 3) very high support from the U.S. government (Aaa debt rating).

On August 2, 2011, as a result of confirming the U.S. government's Aaa debt rating with a negative outlook , Moody's confirmed the Aaa long-term deposit ratings of all of the FHLBanks as well as the Aaa long-term bond rating of the FHLBank System with a negative outlook. At the same time, Moody's affirmed the Prime-1 short-term deposit ratings of all of the FHLBanks and the Prime-1 short-term bond rating of the FHLBank System.

The FHLBank of San Francisco's BCA of 5, which is an A1 equivalent on Moody's long-term debt rating scale, reflects Moody's opinion about the FHLBank's intrinsic or stand-alone financial strength and exclude extraordinary support, either from the FHLBank System or the U.S. Government. The rating incorporates the FHLBank's stable risk-adjusted profitability, sound liquidity and excellent asset quality of its advance and mortgage businesses. The FHLBank had an exposure of $13.2 billion (25% of the investment portfolio or 9% of total assets) to private-label residential mortgage back securities at March 31, 2011. Approximately 23% of the non-agency RMBS carried a Aaa rating while 63% had a credit rating below investment grade. Moody's views the FHLBank have the financial flexibility to absorb additional credit loss in the portfolio, though a more severe economic downturn could weak the FHLBank's over financial fundamental given the size of the private label RMBS.

The FHLBank of San Francisco's BCA of 5 does not benefit from support from the FHLBank System given the FHLBank System's BCA of a 5 (A1 equivalent). On the other hand, Moody's very high U.S. government support assumption lifts the FHLBank San Francisco's deposit ratings to Aaa.

Recent Developments

Regulatory Developments

The Federal Housing Finance Agency (FHFA), the regulator of the FHLBanks, as well as the U.S. Treasury have expressed support for several regulatory initiatives that would likely reduce the size and importance of the FHLBank System. The recommendations include: (1) limiting member banks to membership in one FHLBank; (2) limiting the level of outstanding advances to individual member banks; and (3) limiting the FHLBanks investment portfolio.

To date, specific regulatory rules have not been proposed by the FHFA. Furthermore, the FHFA has not indicated a time frame in which new regulatory rules might be proposed. Moody's does not expect these regulatory rules in the short-term (within one year).

GSE Reform

GSE reform has not progressed very far and Moody's expects very limited progress before the end of 2013, after the next presidential election. To date, the reform is primarily focused on the roles of Fannie Mae and Freddie Mac. However, the FHLBanks are likely to be included in the reform, though the impact remains uncertain. Moody's will monitor GSE reform as it progresses, as well as its impact on the FHLBanks.

U.S. Government Developments

On August 2, 2011, Moody's confirmed the Aaa government bond rating of the United States following the raising of the statutory debt limit on August 21. The rating outlook is now negative. Moody's placed the rating on review for possible downgrade on July 13 due to the small but rising probability of a default on the government's debt obligations because of a failure to increase the debt limit. The initial increase of the debt limit by $900 billion and the commitment to raise it by a further $1.2-1.5 trillion by yearend have virtually eliminated the risk of such a default, prompting the confirmation of the rating at Aaa.

In confirming the Aaa rating, Moody's also recognized that today's agreement is a first step toward achieving the long-term fiscal consolidation needed to maintain the US government debt metrics within Aaa parameters over the long run. The legislation calls for $917 billion in specific spending cuts over the next decade and established a congressional committee charged with making recommendations for achieving a further $1.5 trillion in deficit reduction over the same time period. In the absence of the committee reaching an agreement, automatic spending cuts of $1.2 trillion would become effective.

In assigning a negative outlook to the rating, Moody's indicated, however, that there would be a risk of downgrade if (1) there is a weakening in fiscal discipline in the coming year; (2) further fiscal consolidation measures are not adopted in 2013; (3) the economic outlook deteriorates significantly; or (4) there is an appreciable rise in the US government's funding costs over and above what is currently expected.

Credit Strengths

Credit strengths include:

- Joint and several liability reduces default risk of Systemwide liabilities

- Central housing funding role for banks and other financial institutions

- Excellent asset quality reflects conservative underwriting standards and strong quality-monitoring policies

Credit Challenges

Credit challenges include:

- Narrow charter and bank consolidation limit growth

- Substantial single borrower concentrations

- Material private-label securities portfolio

Rating Outlook

On August 2, 2011, as a result of confirming the U.S. government's Aaa debt rating with a negative outlook, Moody's confirmed the Aaa long-term deposit ratings of all of the FHLBanks as well as the Aaa long-term bond rating of the FHLBank System. The outlooks are negative. At the same time, Moody's affirmed the Prime-1 short-term deposit ratings of all of the FHLBanks and the Prime-1 short-term bond rating of the FHLBank System.

What Could Change the Rating - Up

Factors that would lead to an upgrade of the FHLBank of San Francisco's baseline credit assessment include capital levels well in excess of regulatory requirements (e.g., capital-to-assets ratio consistently 50 bps above the regulatory requirement - currently 4.0%), consistent risk-adjusted returns while maintaining strong asset quality.

What Could Change the Rating - Down

Factors that could lead to a downgrade of the Aaa/Prime-1 long- and short-term deposit ratings and baseline credit assessment include a material decline in profitability (quarterly net losses over four quarters), significant asset-liability mismatches, or material changes in asset quality.

In addition, any regulatory or statutory changes to the System's mission or GSE status that alters the FHLBank's risk profile could also impact the ratings. However, Moody's views these potential events as highly unlikely to occur.

DETAILED RATING CONSIDERATIONS

The FHLBank of San Francisco lends to member institutions in Arizona, California, and Nevada in the form of advances, which are generally short-term (60% of advances mature within one year) and over-collateralized, minimizing the credit risk on these loans. Moody's baseline credit assessment represents our opinion of the likelihood that the institution will require extraordinary support from an external party. The high BCA of 5 reflects FHLBank of San Francisco's strong credit culture, stable, though moderate, profitability, and the benefits associated with the joint and several liability of the FHLBank System. Below are the detailed rating factors that influence the FHLBank's ratings and outlook.

Profitability

FHLBank of San Francisco's modest but consistent profitability (as measured by ROAA) reflects primarily low risk profile of its asset base. ROAA was 0.16% for the three months ended March 31, 2011, compared 0.24% for year- end 2010. The standard deviation of ROAA for the period from 2007 to 1Q11 was 0.05%, which was well below the 0.52% five-year standard deviation for US banks rated Aa and higher for the period from 2006 to 2010.

Similar to many other FHLBanks, the FHLBank of San Francisco has significant borrower concentration: its top five advance borrowers represented 78% of advances outstanding as of March 31, 2011. The largest borrower, Citibank N.A., accounts for 29% of the FHLBank's total advance at March 31, 2011. This concentration is a long-term risk to FHLBank's earnings given the on-going consolidation in the US banking sector that will likely reduce demand for advances

Capital Adequacy

FHLBank of San Francisco is required by legislation to maintain minimum regulatory capital level of 4% of its total assets. At March 31, 2011, the capital ratio of the FHLBank was 8.76%, slightly up from 8.48% at March 31, 2010. In Moody's view, the FHLBank's capital levels reflect the low risk profile of the FHLBank's asset base which is largely comprised of advances to member banks (61% of total assets as of March 31, 2011).

Interest Rate Risk Management

The FHLBank of San Francisco conservatively manages its interest rate risk exposures through the use of debt with similar characteristics to the FHLBanks assets, as well as derivatives. The FHLBank's primary asset is advances (61% of total assets), which come in a variety of types, including fixed rate, variable rate, callable by the FHLBank as well as putable advances. With a putable advance, the FHLBank purchases a put option from the member that allows the FHLBank to terminate the fixed rate advance on specified dates and offer, subject to certain conditions, replacement funding at prevailing market rates. Prepayment fees, which mitigate interest rate risk, are also a common feature of advances.

The FHLBank uses net portfolio value of capital sensitivity as the primary metric for measuring the Bank's exposure to changes in interest rates. The FHLBank's net portfolio value of capital sensitivity policy limits the potential adverse impact of an instantaneous parallel shift of +/-100-basis-point change in interest rates from the base case to no worse than -3% of the estimated net portfolio value of capital. In addition, the policy limits the potential adverse impact of an instantaneous +/-100-basis-point change in interest rates measured from interest rates that are 200 basis points above or below the base case to no worse than - 4% of the estimated net portfolio value of capital. The Bank's measured net portfolio value of capital sensitivity was within the policy limit as of March 31, 2011.

Asset Quality and Credit Risk Management

Moody's believes that the asset quality of the FHLBank of San Francisco is exceptional. Advances represent 61% of total assets as of March 31, 2011, while the FHLBank's investment portfolio represents 35%. Advances are over-collateralized and the FHLBank has never incurred a loss on an advance in its 78 year history. The FHLBank of San Francisco has member concentration, similar to other FHLBanks. As discussed in the profitability section that the FHLBank has substantial single borrower concentrations which heighten its counterparty credit risk.

The Bank no longer participates in the MPF mortgage purchase program. FHLBank of San Francisco's run-off book of MPF business declined to $2.2 billion at March 31, 2011 from $2.9 billion as of March 31, 2010 and $4.1 billion as of year-end 2007. The credit quality of Bank's MPF portfolio remains excellent. Only about $32 million in mortgage loans acquired as a part of this program were classified as non-accruing or impaired at March 31, 2011.

The FHLBank's $ 52.4 billion in investments consists of high quality investments in fed funds sold ($15 billion or 29%), and US government and agency guaranteed securities, including TLGP ($16.2 billion or 31%). Included in the investment portfolio was $13.2 billion of private-label RMBS with approximately 23% of the portfolio carried a Aaa rating while 63% had a credit rating below investment grade. Moody's expects deterioration in the performance of the FHLBank's private label RMBS. Nonetheless, Moody's views the FHLBank's capital position will enable it to absorb addition credit losses.

Liquidity and Funding

The FHLBank's GSE status has provided it with consistent and stable access to the debt market. The FHLBank's internal sources of liquidity are modest as of March 31, 2011, the FHLBank of San Francisco had approximately $90.1 billion in short-term consolidated obligations, which includes discount notes and bonds maturing within a one year period. In total, short-term debt comprised about 65% of total debt, compared to 47% at March 31, 2010. Liquid assets were approximately 48% of short-term debt as of March 31, 2011. Liquid assets include cash, cash equivalents, federal funds as well as portfolio of trading securities, available for sale securities, and held to maturity securities less private label residential mortgage backed securities. These assets are of high quality.

The Federal Housing Finance Agency, the regulator of the FHLBanks, requires each FHLBank to maintain sufficient liquidity, through short-term investments, in an amount at least equal to an FHLBank's anticipated cash outflows under two different scenarios. One scenario assumes that an FHLBank cannot access the capital markets for a period of between 10 to 20 days, with initial guidance set at fifteen days and members do not renew any maturing, prepaid and called advances. The second scenario assumes that an FHLBank cannot access the capital markets for a period of between three to seven days, with initial guidance set at five days during which members will automatically renew maturing and called advances for all members except very large, highly rated members. In Moody's view the new liquidity requirement are modestly positive.

In addition, the FHLBank of San Francisco also met all other internal liquidity requirements at March 31, 2011.

Other

A significant underpinning of the Baseline Credit Assessments is the joint and several nature of the consolidated obligations of the System. The financial strength of individual FHLBanks is very sound, and the joint and several liability contributes to the overall strength of the FHLBank System by narrowing any ratings differences among the individual Banks that could exist were ratings to exclude the joint and several feature. As a result, the ratings of the weakest FHLBanks are increased, and the ratings of the strongest are lowered.

Support and Dependence

The FHLBank of San Francisco's high dependence and support levels are based on the importance of the System to its member institutions, and their ability to support housing finance and community development.