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CREDIT OPINION
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Update

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Federal Home Loan Bank of Cincinnati

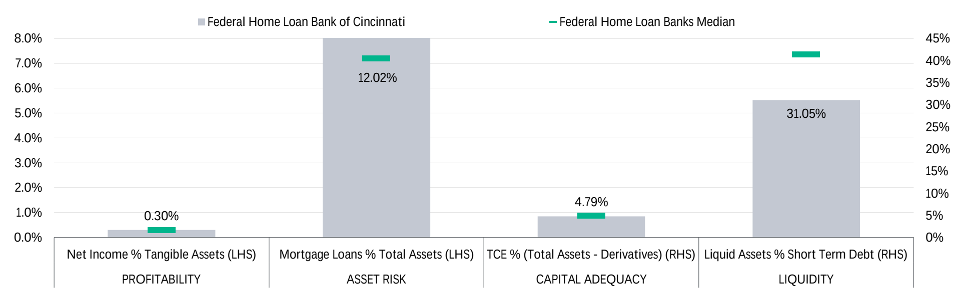
Update to credit analysis

Summary

The Federal Home Loan Bank of Cincinnati's (FHLBank Cincinnati) Aaa long term rating and Prime-1 short-term deposit ratings are in-line with the deposit ratings of the other ten regional FHLBanks. These ratings reflect the combination of FHLBank Cincinnati's a1 Baseline Credit Assessment (BCA) and our view that there is a very high likelihood of support from the US Government (Aaa stable) in the event that an individual FHLBank or the FHLBank System were in danger of default due to the FHLBanks' special role as providers of liquidity to the US banking system. The rating outlook is stable.

Like its peers, FHLBank Cincinnati has to contend with the global spread of the coronavirus, which is resulting in simultaneous supply and demand shocks that will materially slow economic activity, particularly through the first half of 2020. The full extent of the economic costs will be unclear for some time. Fear of contagion has dampened consumer and business activity and the longer it takes for a resumption of normal activity, the greater the economic impact. Fiscal and monetary policy measures will help limit the damage, and policy announcements so far suggest that policy response is strong in the US. However, the pandemic will have a direct negative impact on banks' asset quality and profitability, in some cases in a pronounced manner, including for many that are FHLBank Cincinnati borrowing members. Nonetheless, advances to members, an over-collateralized asset, are approximately two-thirds of FHLBank Cincinnati's balance sheet and have never resulted in a loss.

Exhibit 1
Rating Scorecard - Key Financial Ratios [1]



[1] All ratios are as of 12/31/2019
Source: Moody's Investors Service

The FHLBank Cincinnati's a1 BCA is based on the excellent asset quality of its advance, investment, and mortgage portfolios, along with its consistent, albeit modest, profitability. Its asset risk benefits from its advance business, which had $80.4 billion outstanding as of 31 March 2020, up from $47.4 billion at year-end 2019. While the credit performance of the FHLBank Cincinnati's mortgage assets, which equaled 9.7% of assets as at 31 March 2020, has been excellent, mortgage assets carry heightened operational complexity along with greater interest rate risk and credit risk relative to the FHLBank's core advance business.

Credit strengths

» Excellent credit quality of its advance portfolio, investment portfolio, and mortgage portfolio minimize asset risk

» Although narrowly focused, the FHLBanks, including FHLB Cincinnati, are central liquidity providers to US banks, underscoring their importance

Credit challenges

» Narrow charter and bank consolidation limit growth

» Substantial single borrower concentrations

» High reliance on confidence-sensitive market funding, but market access is strong because of status as a government-sponsored enterprise (GSE)

Outlook

Our stable outlook on FHLBank Cincinnati's long-term deposit ratings reflects the stable outlook on the US government's Aaa debt rating. Any rating actions on the US Government would likely result in all individual FHLBanks' long-term deposit ratings, and the FHLBank System's Aaa long-term bond rating, moving in lock step with any US sovereign rating. FHLBank Cincinnati, and the ten other regional FHLBanks, have joint and several liability for the FHLBank System's consolidated bonds and consolidated discount notes.

Factors that could lead to an upgrade

At Aaa, an upgrade of FHLBank Cincinnati's long-term deposit rating is not possible. A higher BCA could occur if FHLBank Cincinnati increased its advances to greater than 70% of assets while it also displayed: 1) strong profitability, 2) a stable member risk profile, 3) continued strong asset risk, including modest asset-liability and operational risk, and 4) robust capital and liquidity.

Factors that could lead to a downgrade

Any negative rating action on the US Government would likely result in all individual FHLBanks' long-term deposit ratings moving in lock step with any US sovereign rating action.

Factors that could lead to a downgrade of FHLBank Cincinnati's BCA of a1 include elevated loss expectations on its investment or mortgage portfolio, multiple quarterly net losses or significant asset-liability mismatches. In addition, an expansion of its risk profile, for example due to a change in the FHLBanks' government mandate or self-initiated, could result in a lower standalone BCA. A lower BCA could result in a lower long-term deposit rating.

Key indicators

Exhibit 2

Federal Home Loan Bank of Cincinnati (Consolidated Financials) [1]

	03-20[2]	12-19[2]	09-17[2]	12-16[2]	CAGR/Avg.[3]
Total Assets (USD Billion)	122.5	93.5	105.3	104.6	7.3[4]
Net Income / Tangible Assets (%)	0.3	0.3	0.3	0.3	0.3[5]
Liquid Assets (GSE) / Short Term Debt (%)	17.0	31.0	18.2	16.4	20.7[5]
Tangible Common Equity / (Total Assets - Derivatives) (%)	5.3	4.8	4.9	4.8	4.9[5]
Mortgage Loans / Total Assets (%)	9.7	12.0	9.0	8.7	9.9[5]

[1]All figures and ratios are adjusted using Moody's standard adjustments. [2]Basel I; US GAAP. [3]May include rounding differences because of the scale of reported amounts. [4]Compound annual growth rate (%) based on the periods for the latest accounting regime. [5]Simple average of periods for the latest accounting regime.
Sources: Moody's Investors Service and company filings

Profile

The FHLBanks are federally-chartered GSEs that were organized under the Federal Home Loan Bank Act of 1932. The FHLBanks together with the Office of Finance comprise the FHLBank System. Each of the FHLBanks and the Office of Finance operate under the supervisory and regulatory framework of the Federal Housing Finance Agency (FHFA). Each FHLBank operates as a separate entity with its own management, employees, and board of directors. As of March 31, 2020, FHLB Bank of Cincinnati reported total assets of $122.5 billion.

The FHLBanks' primary business is lending to member institutions, primarily banks, savings institutions and credit unions, in the form of advances, which are generally short-term and over-collateralized, minimizing the credit risk on these loans. In addition, the FHLBanks benefit from their statutory lien priority with respect to pledged member assets. The FHLBanks also purchase mortgage loans, principally 15-30 year conventional and government-guaranteed or insured fixed-rate loans. The FHLBanks also invest in securities, principally MBS, subject to an investment limit of three times regulatory capital without approval by the FHFA. Some FHLBanks offer correspondent services to their member institutions, including wire transfer, security safekeeping, and settlement services.

Detailed credit considerations

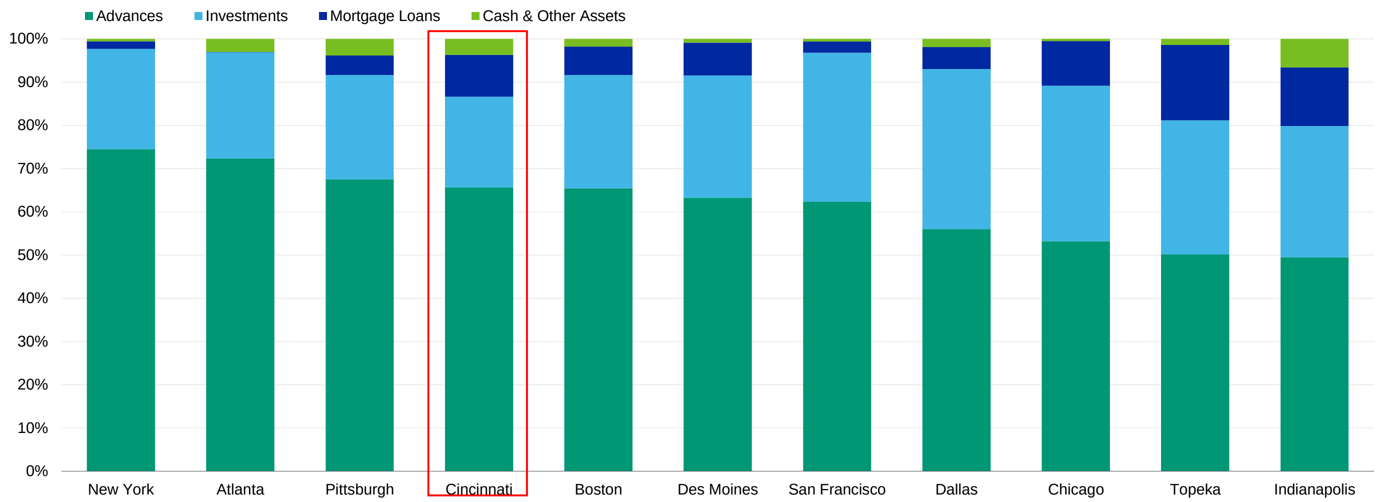
Asset quality and credit risk management

The asset quality of the FHLBank Cincinnati is excellent. Advances, which represent about 65.7% of total assets as of 31 March 2020, are over-collateralized and an FHLBank has never incurred a loss on an advance in its more than 80 year history. This is reflected in the aa2 assigned score for Asset Risk in our scorecard.

Similar to other FHLBanks, FHLBank Cincinnati's balance sheet composition is narrowly focused. Beyond its advance portfolio, investments, which are primarily high quality US government and agency guaranteed securities, comprise 21% of assets. FHLBank Cincinnati does not hold any non-agency mortgage-backed securities (MBS).

The FHLBank of Cincinnati's mortgage portfolio, representing 9.7% of total assets as of 31 March 2020, has experienced far lower losses and delinquencies than industry averages. Nonetheless, asset-liability management of the mortgage portfolio can present challenges.

Exhibit 3
FHLBank Cincinnati's asset mix compared to those of the other FHLBanks



As of 3/31/2020.
Source: Company Filings

The FHLBank of Cincinnati has significant borrower concentrations, a long-term earnings risk. Its top five advance borrowers represented 41.6% of total assets as of 31 March 2020, which is higher than the 28.4% at year-end 2019 because of coronavirus-related borrowing by its largest members. Additionally, the majority of its members are small community financial institutions, with up to $500 million in total assets.

Interest rate risk management

The FHLBank of Cincinnati manages its interest rate risk exposures through the use of debt with similar characteristics to its assets, as well as with derivatives. The FHLBank's primary asset is advances, which come in a variety of types, including fixed rate, variable rate, callable by the member, 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.

Capital adequacy

FHLBank Cincinnati is required by legislation to maintain minimum regulatory capital of 4.0% of its total assets. As of 31 March 2020, its capital ratio was 5.28%, compared to 4.79% at year-end 2019 and 4.95% at quarter end on 31 March 2019. The aa1 assigned score for Capital in our scorecard incorporates our estimate of FHLBank Cincinnati's TCE ratio on a risk-weighted basis, which is very strong.

Profitability

Profitability of FHLBank Cincinnati is low but consistent (as measured by ROAA) reflects the primarily low risk profile of its asset base. FHLBank Cincinnati’s ROAA was 0.34% for the first quarter of 2020, slightly higher than the 0.28% for the same period in 2019. This compares to a ROAA in excess of 1.0% for A-rated US Banks in 2019. The baa1 assigned score for Profitability in our scorecard reflects the extremely low earnings volatility owing to the company's low asset risk profile

Liquidity and funding

The FHLBanks’ GSE status provides them with consistent and stable debt market access. Consequently, the FHLBanks generally maintain lower liquidity than non-GSE entities. As of 31 March 2020, FHLBank Cincinnati had liquid assets as a percentage of short term debt of 17.01%.

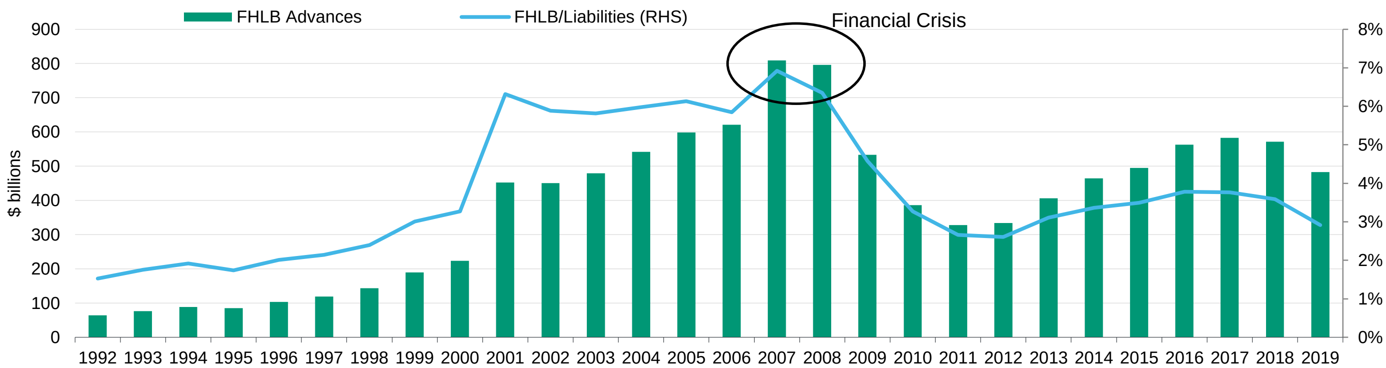
The Federal Housing Finance Agency (FHFA), the regulator of the FHLBanks, issued updated liquidity guidance in the summer of 2018 went into full effect on 31 December 2019. Under the updated guidance, the FHFA established requirements for the FHLBanks’ base case liquidity and implemented new funding gap metrics for three-month and one-year maturity horizons. In addition, the guidance addressed liquidity stress testing and contingency funding plans. We expect that FHLBank Cincinnati will remain in compliance with all its liquidity requirements.

Special role as a provider of liquidity to US financial institutions

As GSEs, the FHLBanks' ability to access funding throughout the cycle underpins their importance to the financial system. This is particularly true during times of extreme market disruption when they become a primary source of contingent liquidity for their members. As shown below, at the height of the financial crisis, advances to members climbed a few hundred billion dollars for the system as a whole before receding as the financial markets and overall economy recovered. FHLBank Cincinnati's advances climbed almost 70% from year-end 2019 to $80.4 billion at 31 March 2020. This spike, which largely occurred in March, is the latest example of members turning to the FHLBanks for liquidity at a time of heightened market stress.

Exhibit 4

FHLB Advances have proven to be a stable source of funding, even during a crisis



Source: FDIC

Environmental, social and governance considerations

FHLBank of Cincinnati's exposure to Environmental risks is low, consistent with our general assessment for the global banking sector. See our environmental risk heatmap for further information.

Overall, we consider banks to face moderate social risks. The most relevant social risks for banks arise from the way they interact with their customers. Social risks are particularly high in the area of data security and customer privacy, which is partly mitigated by sizeable technology investments and banks' long track record of handling sensitive client data. See our social risk heatmap for further information.

Governance is highly relevant for FHLBank Cincinnati, as it is to all players in the banking industry. Corporate governance weaknesses can lead to a deterioration in a bank's credit quality, while governance strengths can benefit a bank's credit profile. Governance risks are largely internal rather than externally driven, and for FHLBank Cincinnati we do not have any particular governance concerns. Nonetheless, corporate governance remains a key credit consideration and requires ongoing monitoring.

GSE reform

On 5 September, the U.S. Department of the Treasury published recommended housing reforms. Although the focus of the recommendations were centered on Fannie Mae and Freddie Mac, if implemented, the proposals would result in reduced market share for those entities. As a consequence, traditional banks' market share of US mortgages would increase, which would enhance the FHLBanks' market position.

The recommendations also suggested that the regulatory rule excluding captive insurance companies from FHLBank membership should be revisited in light of the continued evolution of the housing finance system. On 24 February 2020, a few months after the Treasury's report, the FHFA issued a request-for-input on the possibility of expanding the system's membership to nonbank institutions. By issuing the request-for-input, the FHFA is seeking public comment on safety and soundness issues associated with such a move.

Despite the potential growth opportunities for the FHLBank System, extending membership to nonbanks would be credit negative for the system because it would introduce elevated risks of lending to nonbank companies compared with lending to bank and traditional insurance company members. That is because nonbanks and their affiliates are financially weaker than traditional FHLBank members.

Methodology and scorecard

Our Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The Scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Exhibit 5

Rating Factors

Federal Home Loan Bank of Cincinnati

Macro Factors						
Weighted Macro Profile	Very Strong -	100%				

Financial Profile						
Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	0.0%	aa1	←→	aa2	Long-run loss performance	
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel I)	27.4%	aa1	←→	aa1	Risk-weighted capitalisation	
Profitability						
Net Income / Tangible Assets	0.3%	ba2	←→	baa1	Earnings quality	
Combined Solvency Score				aa3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	94.6%	caa3	←→	baa1	Market funding quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	22.4%	baa1	←→	baa2	Expected trend	
Combined Liquidity Score		b1		baa1		

Financial Profile	a1
Qualitative Adjustments	**Adjustment**
Business Diversification	0
Opacity and Complexity	0
Corporate Behavior	0
Total Qualitative Adjustments	0
Sovereign or Affiliate constraint	Aaa
Scorecard Calculated BCA range	aa3 - a2
Assigned BCA	a1
Affiliate Support notching	0
Adjusted BCA	a1

Source: Moody's Investors Service

Ratings

Exhibit 6

Category	Moody's Rating
FEDERAL HOME LOAN BANK OF CINCINNATI	
Outlook	Stable
Bank Deposits	Aaa/P-1
PARENT: FEDERAL HOME LOAN BANKS	
Outlook	Stable
Senior Unsecured	Aaa
ST Issuer Rating	P-1

Source: Moody's Investors Service

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