Federal Home Loan Bank of Cincinnati

Sep 17, 2020

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Major Rating Factors

Strengths:

Weaknesses:

- Critical to the implementation of U.S. government housing policy
- Important funding source for the U.S. banking system
- Very strong risk-adjusted capitalization
- Strong loan asset quality and limited risk from peripheral activities

- Concentrated exposure to the U.S. mortgage market
- Geographically restricted to a limited region of the U.S.
- Vulnerable to potential legislative changes

Current Ratings

Issuer Credit Rating

AA+/Stable/A-1+

Ratings Detail

Outlook

The stable outlook on Federal Home Loan Bank of Cincinnati reflects the company's stable operating performance, as well as S&P Global Ratings' stable outlook on the U.S. During the severe liquidity and credit challenges COVID-19 posed to the U.S. banking system in March and April, FHLB Cincinnati and the other FHLBs were fully able to immediately provide liquidity to their members and to manage their own funding needs. We expect FHLB Cincinnati, as well as the other FHLBs, to maintain its strong financial profile and strong controls, continue to provide for its members' additional liquidity needs, support the U.S. housing sector, stay profitable, and build retained earnings.

If we change our rating or outlook on the U.S., we would likely reflect that change in our ratings on the FHLB system debt and our ratings on its individual banks, including FHLB Cincinnati. Although less likely, we could also lower the rating in the next two years, if, in the context of government-sponsored entity (GSE) reform, the role of the FHLB System in housing finance was diminished, thereby reducing its importance to the government.

We see limited potential for an upgrade since that most likely would require a higher rating on the U.S. government.

Rationale

Our issuer credit rating on FHLB Cincinnati reflects the wholesale bank's government-supported role in providing liquidity to member institutions, very strong loan asset quality and capitalization, low funding costs, and conservative risk management. It also reflects the bank's regulated status, overseen by the Federal Housing Finance Agency (FHFA).

The rating on FHLB Cincinnati includes a one-notch uplift from the bank's stand-alone credit profile (SACP) of 'aa', reflecting our expectation there is a very high likelihood of the bank receiving extraordinary government support given the FHLB System's high importance to the U.S. housing market.

Anchor: Adjusted for an FHLB to reflect regulated status, strong competitive position, and favorable funding

Our starting point, or anchor, for our ratings on U.S. finance companies (fincos), which include FHLBs that we rate under our nonbank financial institutions criteria, is 'bb+'. Because of FHLBs' public policy role and regulatory status, we raise the anchor for FHLB Cincinnati and its sister banks to 'bbb+', three notches above our anchor for U.S. fincos. This is to account for the FHFA's regulatory oversight; the favorable funding an FHLB enjoys through its close relationship with the U.S. government; its strong competitive position alongside other housing-related GSEs, including Fannie Mae and Freddie Mac in the U.S. housing finance market; and the statutory priority of liens in a bank wind-down situation.

Business position: A unique and strong market position with long-standing members

FHLB Cincinnati has an established market position, recurring business volumes, and public policy role, which we believe offset some of the risks associated with its relative lack of business diversity. We expect FHLB Cincinnati to continue to have easy access to funding markets in order to support the funding and liquidity needs of its members as they weather the stresses brought on by the pandemic-induced recession.

With total assets of $90.6 billion, FHLB Cincinnati is the fifth–largest bank in the FHLB system as of June 30, 2020. Its revenues are not particularly volatile, but they do vary with the economic cycle, like those of other system banks. However, FHLB Cincinnati has some diversity across its 629 member institutions (as of June 30, 2020), which consist of commercial banks, credit unions, savings institutions, insurance companies, and community development financial institutions in Ohio, Kentucky, and Tennessee.

FHLB Cincinnati's member borrowing needs are all highly correlated to the housing market. Furthermore, its business is exclusively in a limited region of the U.S., and, therefore, the local economic conditions significantly affect the bank's business.

The firm's advance volume and, therefore, revenues are typically countercyclical, since members rely more on FHLB Cincinnati in times of stress as a reliable source of funding--which, however, does mitigate the impact of that concentration. Advances jumped 70% in the first quarter of 2020, to $80.4 billion from $47.4 billion at the end of 2019, and declined 39% in the second quarter of 2020, to $48.9 billion, as member banks temporarily made large draws on their FHLB lines to support their liquidity needs.

FHLB Cincinnati has the second-highest concentration in advances by borrowers among the FHLBs. Its top five and three largest borrowers held 65% and 56% of advances, respectively, as of June 30, 2020. Nevertheless, its fully collateralized lending mitigates much of that concentration risk, in our view, and is not a key credit weakness.

Capital, leverage, and earnings: Collateralized lending to financial institutions limits risk

We believe FHLB Cincinnati's capital is very strong based on its member-capitalized co-op structure and low-risk collateralized lending business. As of June 30, 2020, it had a 5.60% regulatory capital-to-assets ratio and a leverage ratio of 8.40%, well above the regulatory capital requirements of the FHFA.

Given that the majority of FHLB Cincinnati's assets are advances, which have a relatively low risk weight in our analysis because all of the exposure is to financial institutions, capital on a risk-adjusted basis is stronger than it might otherwise appear. We expect the S&P Global Ratings risk-adjusted capital (RAC) ratio to remain comfortably above our 15% threshold for a very strong capital and earnings assessment. We expect capital to remain relatively stable because members must scale their capital contribution to support their borrowings.

We believe earnings at FHLB Cincinnati are relatively stable, though low interest rates and declining demand for its core advance product may lead to a decrease in net income in 2020 versus 2019. FHLB Cincinnati derives its net income primarily from interest earned on advances made to its member financial institutions and from its portfolio of mortgage loans purchased from members.

For the six months ended June 30, 2020, FHLB Cincinnati's net income before affordable housing assessments jumped 30% to $199 million, from about $153 million in the corresponding period last year. Net interest income rose 5.5% in the same period, and total net revenues increased 24.5%, because of net gains on investment securities, resulting from the sharp decline in interest rates in March.

However, the absolute level of earnings is not a significant ratings consideration because of both the bank's strong capital level and its co-op structure--the latter ensures that profit maximization is not a goal of the bank.

Risk position: Limited risk from peripheral activity

We consider FHLB Cincinnati's risk position to be very strong, reflecting that in its nearly nine decades of existence neither the company nor its sister FHLBs has ever suffered a loss on a collateralized advance to a member.

All advances to member institutions are collateralized by loans and securities with an estimated value significantly in excess of loans extended. The company also monitors the financial condition of its members, advance rates, and security agreements to further mitigate credit risk. FHLB Cincinnati uses a proprietary credit scoring model to implement a risk-based approach to underwriting and monitoring. Probably most importantly, any security interest that an insured depository institution grants to the bank generally has priority over the claims and rights of other parties, including depositors (see "Federal Home Loan Banks"). In addition, the bank follows strict underwriting standards and credit requirements from borrowers.

The bank is exposed to interest rate risk primarily from the effect of interest rate changes on its interest-earning assets and on the funding sources that finance these assets. However, it manages the risk within appropriate limits using various derivatives, which may include interest rate swaps, interest rate cap and floor agreements, calls, puts, futures, and forward contracts.

As of June 30, 2020, the investment securities portfolio totaled $24 billion, about 27% of total assets, and included $12 billion of agency mortgage-backed securities. FHLB Cincinnati is among the few banks in the FHLB System to have no exposure to private-label mortgage-backed securities.

The bank has a relatively homogenous lending portfolio, considering all advances are made to financial institutions backed by a majority of residential and commercial mortgages, and its first-lien position with regard to Federal Deposit Insurance Corp.-backed institutions has prevented it from suffering any losses on advances. Therefore, we do not view the concentration of its portfolio as a material risk.

Funding and liquidity: Stable and cheap funding supports the business model

The FHLB System has a diverse and global investor base, and it readily sells its debt at a small spread to U.S. Treasury obligations. Both of these factors support FHLB Cincinnati's funding and liquidity. Based on the availability of funding for the system in the 2008 liquidity crisis, access to funding is unlikely to be an issue in stress scenarios. We believe that FHLB Cincinnati was able to sufficiently meet the public policy role of supporting the funding and liquidity needs of its members, brought on by the pandemic, by accessing the funding market by issuing discount notes and using it to provide advances. Positively, the bank was also able to scale back quickly once the spike in demand for funds subsided.

We consider FHLB Cincinnati's liquidity adequate compared with its potential cash flow requirements over our forecast horizon. After Dec. 31, 2019, the FHFA liquidity standard increased from 10 to 20 calendar days of liquidity sufficient to cover a temporary inability to issue consolidated obligations. Despite market stress in the first quarter resulting from the COVID-19 pandemic, FHLB Cincinnati was able to maintain sufficient liquidity to meet regulatory guidance. We believe FHLB Cincinnati is adequately prepared to be in compliance with these enhanced requirements.

Comparable ratings adjustment: None

We don't include an adjustment in our rating on FHLB Cincinnati based on comparison with peers.

External influence: Very important to U.S. housing policy

The ratings on FHLB Cincinnati reflect our opinion that there is a very high likelihood that the U.S. government would provide the bank with timely and sufficient extraordinary support in the event of financial distress. Therefore, our issuer credit rating on the bank reflects one-notch uplift from our SACP.

In accordance with our criteria on NBFIs, our view of government support on our assessment of FHLB Cincinnati reflects the following factors:

- Very important role providing low-cost funding to support housing and community development in the U.S., which we believe are key economic and political objectives of the U.S. government; and
- Very strong link with the U.S. government, because a financially distressed or defaulted FHLB could significantly affect the government's reputation, and we believe the government has the administrative capacity and mechanisms (via the FHFA) for responding to an FHLB's financial distress in a timely manner.

Moreover, we view the government as having a track record of providing very strong and timely credit support to the FHLBs, such as their inclusion in a U.S. Treasury GSE credit facility created in September 2008.

Ratings Score Snapshot

Issuer Credit Rating: AA+/Stable/A-1+

SACP: aa

- Anchor: bb+
- Entity-Specific Anchor Adjustment: +3
- Business Position: Strong (+1)
- Capital, Leverage, and Earnings: Very Strong (+2)
- Risk Position: Very Strong (+2)
- Funding and Liquidity: Average and Adequate (0)

External Influence: +1

- Government Influence: +1
- Group Influence: 0
- Rating Above the Sovereign: 0
- Additional Factors: 0

Related Criteria

- **Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology**, July 20, 2017
- **General Criteria: Methodology For Linking Long-Term And Short-Term Ratings**, April 7, 2017
- **General Criteria: Rating Government-Related Entities: Methodology And Assumptions**, March 25, 2015
- **Criteria | Financial Institutions | General: Issue Credit Rating Methodology For Nonbank Financial Institutions And Nonbank Financial Services Companies**, Dec. 9, 2014
- **Criteria | Financial Institutions | General: Nonbank Financial Institutions Rating Methodology**, Dec. 9, 2014
- **Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions**, July 17, 2013
- **Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions**, Nov. 9, 2011
- **General Criteria: Use Of CreditWatch And Outlooks**, Sept. 14, 2009
- **Criteria | Financial Institutions | Banks: Commercial Paper I: Banks**, March 23, 2004

Related Research

- **Federal Home Loan Banks**, Sept. 9, 2020

Ratings Detail (As Of Sep 17, 2020)*

Federal Home Loan Bank of Cincinnati	
Issuer Credit Rating	AA+/Stable/A-1+
Issuer Credit Ratings History	
10-Jun-2013	AA+/Stable/A-1+
08-Aug-2011	AA+/Negative/A-1+
15-Jul-2011	AAA/Watch Neg/A-1+
Sovereign Rating	
United States	AA+/Stable/A-1+
Related Entities	
Federal Home Loan Bank of Atlanta	
Issuer Credit Rating	AA+/Stable/A-1+
Federal Home Loan Bank of Boston	

Issuer Credit Rating	AA+/Stable/A-1+
Federal Home Loan Bank of Chicago	
Issuer Credit Rating	AA+/Stable/A-1+
Federal Home Loan Bank of Dallas	
Issuer Credit Rating	AA+/Stable/A-1+
Federal Home Loan Bank of Des Moines	
Issuer Credit Rating	AA+/Stable/A-1+
Federal Home Loan Bank of Indianapolis	
Issuer Credit Rating	AA+/Stable/A-1+
Federal Home Loan Bank of New York	
Issuer Credit Rating	AA+/Stable/A-1+
Federal Home Loan Bank of Pittsburgh	
Issuer Credit Rating	AA+/Stable/A-1+
Federal Home Loan Bank of San Francisco	
Issuer Credit Rating	AA+/Stable/A-1+
Federal Home Loan Bank of Topeka	
Issuer Credit Rating	AA+/Stable/A-1+
Federal Home Loan Banks	
Senior Unsecured	AA+
Senior Unsecured	AA+/A-1+
Senior Unsecured	AA+/Stable
Short-Term Debt	A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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