

New Funding Strategies and Solutions: Introducing the Floored Advance

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Agenda

- Using Interest Rate Floors as a Hedge Against a Prospective Decline in Interest Rates
- The Floored Advance: How it Works
- Applications: A Case Study of Limiting Exposure to Falling Rates

Interest Rate Floors – How They Work

An “insurance policy” against falling interest rates...

- Rate Floor = An option that has intrinsic value below a pre-specified strike rate.
 - If rates decline, the option increases in value.
 - At expiration, if the prevailing rate index is above the pre-specified strike rate, the option expires with no value.
- During the life of the rate floor, its value is determined by:
 - Volatility
 - Time-to-maturity
 - Distance of the rate index to the strike rate

Floored Advance Complements Seattle Bank's New Structured Advance Line

Advance	Description	Application	Advantages
Capped Floater Advance	Adjustable rate capped at a pre-determined strike rate	Interest-rate risk management; matched funding of capped floating-rate loans & loans held in portfolio	Address potential dual-rate sensitivity; benefit from lower borrowing costs if rates decline
FFC Advance	Floating rate that flips to fixed unless the Seattle Bank cancels	Macro balance sheet management	Sub-LIBOR pricing in exchange for selling right to convert to a fixed rate on a specified date
Pre-Payable Loan Advance	Subject to termination by the borrower on pre-determined dates	Funding assets not subject to prepayment penalty; loan & investment portfolio management; liquidity & balance sheet management	Address loan pre-payment issues in situations without pre-payment provisions; protect mortgage & MBS portfolio from accelerating prepayments
Floored Advance	Adjustable rate with option lower borrowing rate if rates drop below predetermined strike rate	Interest rate risk management; protection for asset-sensitive balance sheets; containment of exposure to falling rates	"2-for-1" rate reduction from lower rate index & option monetization if rates decline; avoid mark-to-market of contractual rate floor; no up-front premium

The Floored Advance – How It Works:

- A variable-rate advance that allows the borrower to purchase an interest rate floor based on 3-month LIBOR:
 - ***In a Declining Rate Scenario*** – Payout is magnified 2x, as the borrower benefits from: (a) lower rates, and (b) monetizing an interest rate floor that moves to “in-the-money” position.
 - ***In an Increasing Rate Scenario*** – The interest rate floor (which borrower purchases in the form of a coupon that is higher than a standard advance) would expire with no value if it has not been exercised while rates are below the strike rate.

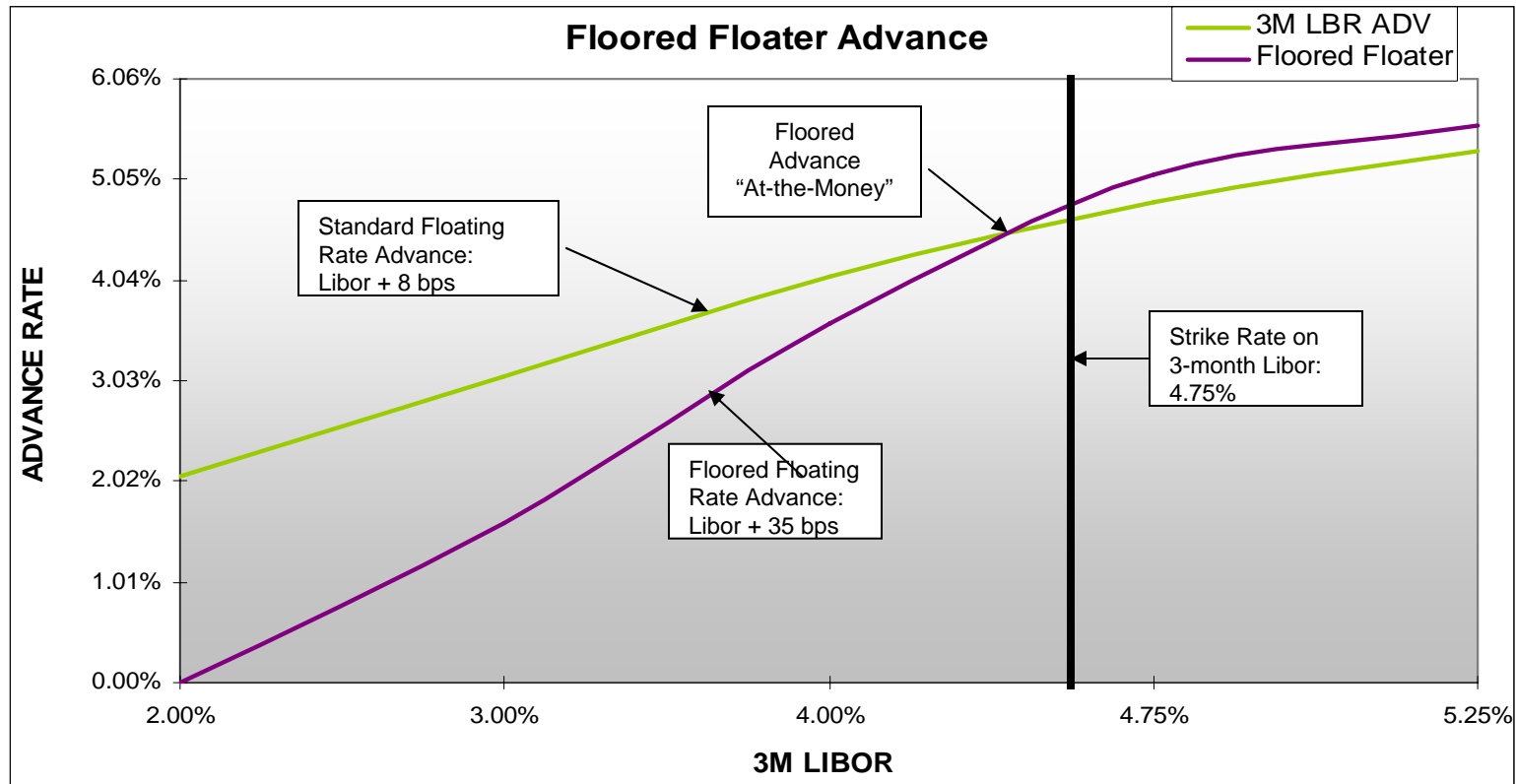
The Floored Advance – Additional Features:

- With the interest rate floor negotiated as a contractual feature within an advance, an interest rate floor would not be held on a stand-alone basis.
- Therefore... *subject to an institution's independent accounting assessment, mark-to-market accounting of the interest rate floor would likely not be required.*

The Floored Advance – An Example:

- Representative Indicative Terms:
 - Maturity: 5 years
 - Index: 3-month LIBOR (currently 5.35%)
 - Strike Rate: 4.75%
 - Assumed Floored Floating-Rate Pricing: 3-month LIBOR + 0.35%
 - Assumed Standard Floating-Rate Pricing: 3-month LIBOR + 0.08%
- **Assume 3-month LIBOR Drops to 4.00%:**
 - Rate on Floored Floating-Rate Advance = [(3-month LIBOR – Max. (-0-, Floor Strike Rate – 3-month LIBOR)) + Effective Annualized Interest Rate Floor/Advance Premium]
 - **Rate on Floored Advance = [(4.00% - (4.75% - 4.00%)) + 0.35%]
= 3.60%**

In this example, the Floored Advance is “in-the-money” when 3-month LIBOR < 4.48%.



“At-the-Money” = $[4.75\% - (0.35\% - 0.08\%)] = 4.48\%$

In this example, the Floored Advance is “in-the-money” when 3-month LIBOR < 4.48%.

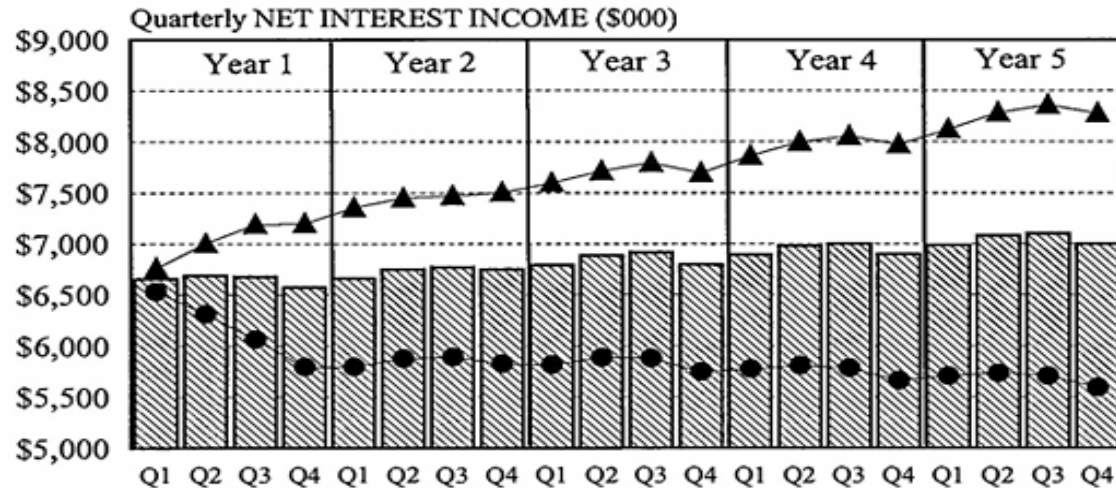
	3-Month LIBOR Scenario	Strike Rate	3-Month LIBOR Advance	Floored Floating-Rate Advance	Advantage over 3-Month LIBOR Advance
<i>Out-of-the-Money</i>	5.25	4.75	5.33	5.60	-27 bps
	5.00	4.75	5.08	5.35	-27 bps
<i>*At-the-Money</i>	4.48	4.75	4.56	4.56	-0-
<i>In-the-Money</i>	4.00	4.75	4.08	3.60	+48 bps
	3.00	4.75	3.08	1.60	+148 bps
	2.00	4.75	2.08	-0-	+208 bps

**At-the-Money* = $[4.75\% - (0.35\% - 0.08\%)] = 4.48\%$

Scenario Analysis: Floored Advance Impact on Interest Expense

	LIBOR Falls 200 bps Below Strike Price	LIBOR Rises 200 bps Above Strike Price
Current LIBOR	5.35	5.35
Strike Rate	4.75	4.75
LIBOR Shock Scenario	2.75	6.75
Assumed Floored Advance Premium	(0.35)	(0.35)
Floor Benefit	2.00	(0.00)
Floored Benefit – Assumed Premium	1.65	(0.35)
Rate Decline Benefit	2.00	-0-
Net Benefit of Rate Change	3.65	(0.35)

Base Case: Net Interest Income of An Asset-Sensitive Institution

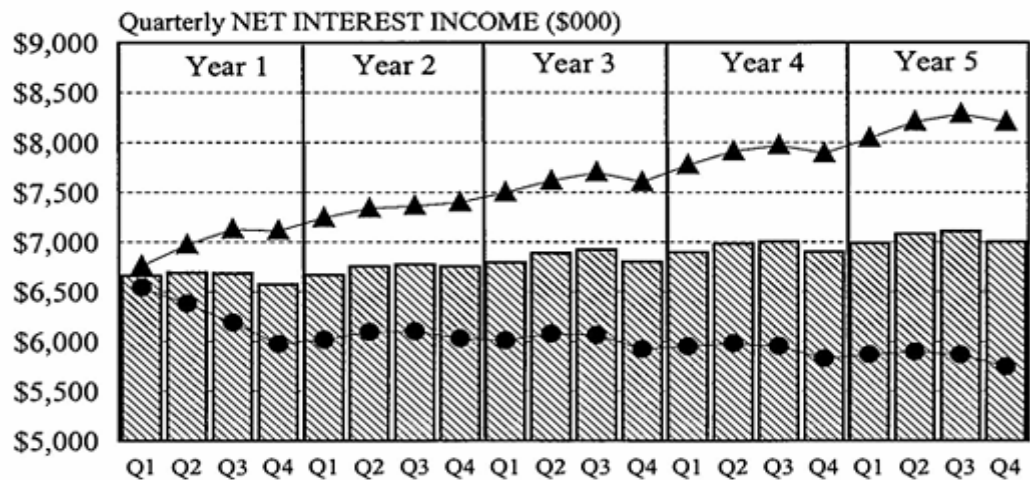


	● -200BP	▨ Base	▲ +200BP
Year 1:	\$24,696	\$26,597	\$28,149
Year 2:	\$23,381	\$26,936	\$29,771
Year 3:	\$23,322	\$27,388	\$30,800
Year 4:	\$23,028	\$27,769	\$31,894
Year 5:	\$22,742	\$28,171	\$33,044

Source: Jeff Reynolds, Darling Consulting – Seattle Bank “What Counts” December 2006

Floored Advance Case: Floored Advances Used to Fund 20-year MBS Yielding 5.90%

\$25 Million MBS Leverage w/Floating Rate Advance @ LIBOR + 50 bps
w/ Embedded Floor on LIBOR @ 5.25%



	Difference in Results		
	● -200BP	▨ Base	▲ +200BP
Year 1:	\$25,083	\$26,609	\$27,967
Year 2:	\$24,241	\$26,948	\$29,337
Year 3:	\$24,074	\$27,400	\$30,413
Year 4:	\$23,710	\$27,781	\$31,549
Year 5:	\$23,376	\$28,183	\$32,736

We will entertain *Customized Reverse Inquiries:*

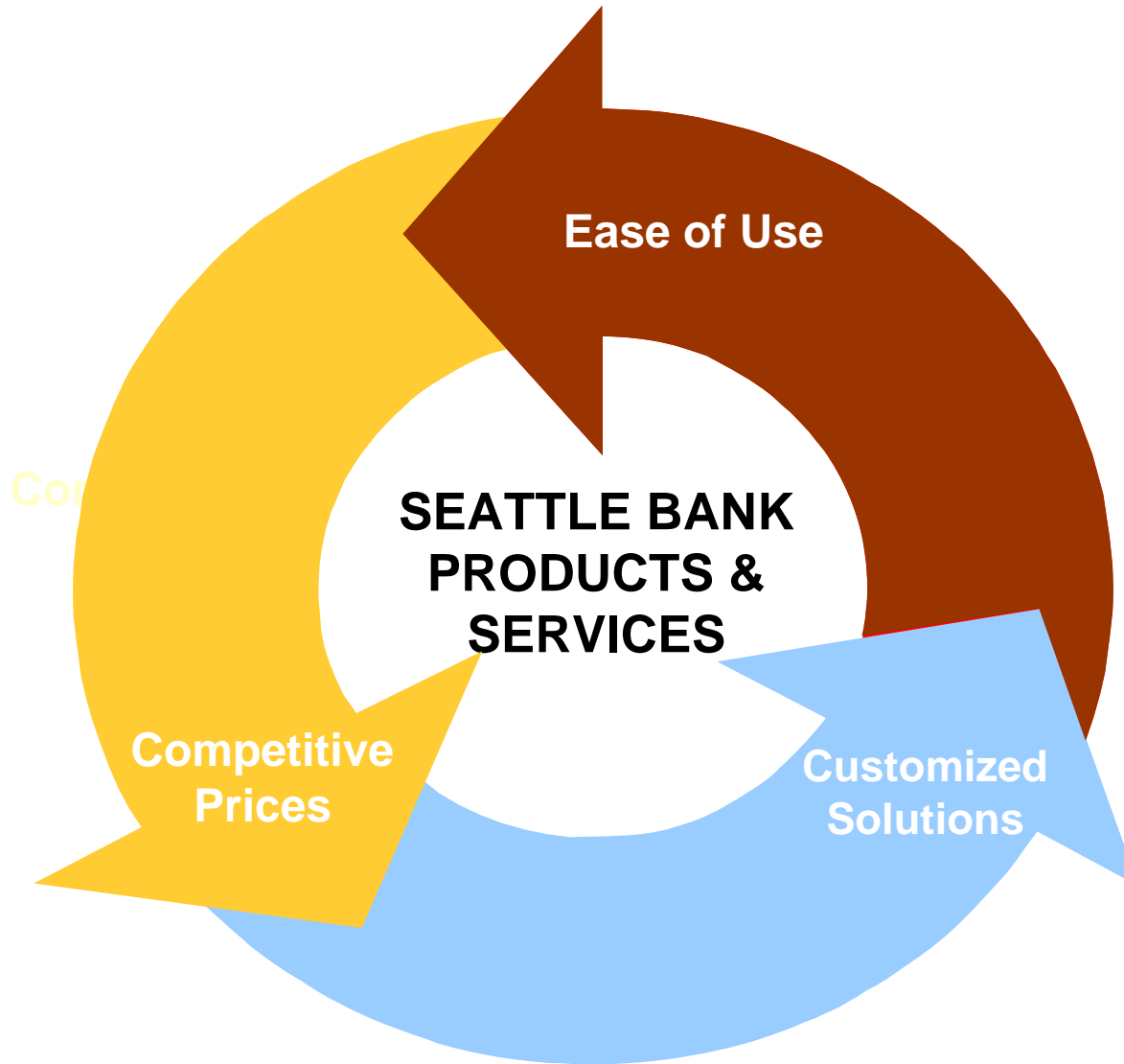
Indicative Floored Advance Rates (1/15/07)

	3-Year Maturity/3-Month LIBOR Strike Rate	5-Year Maturity/3-Month LIBOR Strike Rate
Strike Rate	Price	Price
5.25%	LIBOR + % (%)	LIBOR + % (%)
5.00%	LIBOR + % (%)	LIBOR + % (%)
4.75%	LIBOR + % (%)	LIBOR + % (%)
4.50%	LIBOR + % (%)	LIBOR + % (%)
4.25%	LIBOR + % (%)	LIBOR + % (%)
4.00%	LIBOR + % (%)	LIBOR + % (%)
3.75%	LIBOR + % (%)	LIBOR + % (%)
3.50%	LIBOR + % (%)	LIBOR + % (%)

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Why Consider the Floored Advance?

- Excellent balance sheet protection for asset-sensitive balance sheets.
- Should rates decline, an “in-the-money” interest rate floor can generate an advance rate that could be significantly lower than that of a standard floating rate advance.
- No upfront, out-of-pocket payments. The cost of the floor is blended into the rate of the advance.
- In a declining rate scenario, the borrower gains a “two-for-one” rate reduction, resulting from the decline in LIBOR as a rate index, and from monetization of the interest rate floor.
- Avoids the need to mark-to-market an interest rate floor because it is a contractual feature within the advance.



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