

**FEDERAL FINANCING BANK**

Financial Statements

September 30, 2016 and 2015

(With Independent Auditors' Reports Thereon)

# FEDERAL FINANCING BANK

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## **FEDERAL FINANCING BANK**

Management's Discussion and Analysis (unaudited)

September 30, 2016 and 2015

(Dollars in thousands)

### **Introduction**

The Federal Financing Bank (the Bank) is a government corporation under the general supervision and direction of the Secretary of the Treasury. The Congress created the Bank in 1973, at the request of the Department of the Treasury (Treasury). The Bank borrows from Treasury and lends to Federal agencies and to private entities that have Federal guarantees. The Bank also has a debt obligation to the Civil Service Retirement and Disability Fund (CSR&DF).

### **Mission**

The mission of the Bank is to reduce the costs of Federal and federally assisted borrowings, to coordinate such borrowings with the Government's overall fiscal policy, and to ensure that such borrowings are done in ways that least disrupt private markets. To accomplish this mission, the Bank exercises its broad statutory authority to purchase obligations issued, sold, or guaranteed by Federal agencies.

### **Objectives**

The Bank was formed to be the vehicle through which Federal agencies finance programs involving the sale or placement of credit market instruments, including agency securities, guaranteed obligations, participation agreements, and the sale of assets. This principle is applied in a manner consistent with the Federal Financing Bank Act of 1973 (12 U.S.C. 2281 et seq.) and its legislative history. However, guaranteed programs entailing large numbers of relatively small loans in which local origination and servicing are an integral part of the program are excluded from the Bank's activities.

The Bank makes funds available to Federal agencies and to guaranteed borrowers in accordance with program requirements. The Bank is capable of providing a lending rate for any amount required and for nearly any maturity. The rates charged by the Bank for terms such as prepayment provisions and service charges are applied consistently for all borrowers.

The lending policy of the Bank is flexible enough to preclude the need for any accumulation of pools of funds by agencies. This policy does not preclude the maintenance of liquidity reserves for those agencies that have such a need. In no case are funds provided by the Bank invested in private credit instruments or used to speculate in the market for public securities.

### **Organizational Structure**

The Bank is subject to the general supervision and direction of the Secretary of the Treasury. The Board of Directors is comprised of the incumbents of the following Treasury offices: the Secretary of the Treasury, who as provided by law, is the Chairman; the Deputy Secretary; the Under Secretary for Domestic Finance; the General Counsel; and the Fiscal Assistant Secretary.

The officers are incumbents of the following Treasury offices (corresponding Bank positions are in parentheses): the Under Secretary for Domestic Finance (President); the General Counsel (General Counsel); the Assistant Secretary for Financial Markets (Vice President); the Fiscal Assistant Secretary (Vice President); the Deputy Assistant Secretary for Public Finance (Vice President and Treasurer); and the Director, Office of Federal Lending (Secretary and Chief Financial Officer). As the office of Under Secretary for Domestic Finance is currently vacant, the Secretary of the Treasury, as Chairman of the Bank, has designated a temporary Bank President until the office of Undersecretary of Domestic Finance has been filled. A delegation by the Bank

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President authorizes any Bank Vice President, in consultation with any other Bank officer, to exercise the powers of the Presidency.

The staff of the Bank is organized into four units: accounting, information technology, lending, and operations. Each functional unit is headed by a Director that reports to the Chief Financial Officer. The Director of Accounting is responsible for loan transactions, including but not limited to overseeing loan disbursements and repayments as well as managing accounting and financial reporting. The Director of Information Technology is responsible for management and oversight of the IT infrastructure, including but not limited to software development and maintenance of mission critical applications that support lending and accounting functions. The Director of Lending is responsible for loan administration functions, including but not limited to loan origination, loan structuring, and managing customer relationships. The Director of Operations is responsible for general management functions, including but not limited to budgeting, procurement, human resources, strategic planning, and facilities.

### **Loan Programs Activity**

Under a provision in the 1987 enabling legislation for the U.S. Department of Agriculture's Rural Utilities Services (RUS) Cushion of Credit Payments Program (cushion of credit), the Bank receives considerably less interest each year on certain RUS loans that it holds than it is contractually entitled to receive. The shortfall in interest received by the Bank has resulted in substantial deficits in the past. The cumulative losses from interest credits taken by the RUS, beyond losses that were extinguished by appropriation in 1998, totaled \$2,336,738 through September 30, 2016. The interest shortfall is recorded on the statement of operations and changes in net position as a legislatively mandated interest credit (contra-revenue to interest on loans). The Bank has paid off all debt used to finance this program.

The Balanced Budget and Emergency Deficit Control Act of 1985, commonly known as Gramm-Rudman-Hollings Act, the Consolidated Omnibus Budget Reconciliation Act of 1985, and the Federal Credit Reform Act of 1990 included provisions that have prohibited or limited the Bank's financing of certain loans that are 100% guaranteed by Federal agencies.

### **Impact of Economic Conditions**

All Bank assets are, or have a commitment to be, full faith and credit obligations of the U.S. government and economic conditions do not affect repayments to the Bank. Certain borrowers have repaid their loans with the Bank early, while other borrowers have increased their borrowing activities with the Bank.

Loans backed by the full faith and credit of the U.S. government are the credit equivalent of Treasury securities. The Bank does not expect to suffer any credit losses from loans backed by the full faith and credit of the U.S. government.

### **United States Postal Service**

The United States Postal Service (USPS) is an independent establishment of the executive branch of the U.S. government, which borrows from the Bank to finance its capital improvements and operating expenses. The USPS has a total borrowing authority of \$15 billion. The USPS borrowed up to this debt ceiling on September 30, 2016. The USPS repaid \$4 billion of the outstanding amount on October 3, 2016. The USPS can be expected to borrow up to the ceiling amount at different times in the coming year.

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The Bank has not incurred any credit-related losses on its loans as of the date of these statements, and as stated above, all Bank assets are, or have a commitment to be, full faith and credit obligations of the U.S. government.

### Financial Highlights

#### *Statements of Operations and Changes in Net Position Highlights*

The following is a synopsis of the financial performance of the Bank for the fiscal year ended September 30, 2016. Interest on loans of \$2,227,847 for the fiscal year ended September 30, 2016 decreased compared to the interest on loans of \$2,645,901 for the fiscal year ended September 30, 2015, due to the prepayments for certain borrowers made in fiscal year 2015 and that ultimately affected the Bank's interest income, with no similar prepayments made in fiscal year 2016. The legislatively mandated interest credits reduced interest income by \$24,185 and \$60,363 for the fiscal years ended September 30, 2016 and 2015, respectively, and are related to RUS's "cushion of credit" loans. Revenue from servicing loans of \$1,305 for the fiscal year ended September 30, 2016 decreased from \$1,404 for the fiscal year ended September 30, 2015.

Interest on borrowings of \$1,948,086 for the fiscal year ended September 30, 2016 decreased from the interest on borrowings of \$2,227,179 for the fiscal year ended September 30, 2015 primarily due to prepayments on loans made in fiscal year 2015 that ultimately affected the Bank's interest expense with no similar prepayments made in fiscal year 2016. After administrative expenses of \$9,870, net income of \$247,038 for the fiscal year ended September 30, 2016 decreased from the net income of \$352,066 for the fiscal year ended September 30, 2015.

#### *Statements of Financial Position Highlights*

Funds with U.S. Treasury (cash equivalents) of \$599,075 at September 30, 2016, decreased from the September 30, 2015 balance of \$860,134 due primarily to a larger debt repayment to the CSR&DF in fiscal year 2016 compared to fiscal year 2015.

The loan portfolio (loans receivable) increased \$2,235,885 from \$74,045,999 at September 30, 2015 to \$76,281,884 at September 30, 2016. The change is primarily the result of a \$1,663,647 increase in loans to RUS, a \$451,334 increase in loans to the Department of Housing and Urban Development, a \$202,397 increase in loans to the Community Development Financial Institution Fund (CDFI Fund), and a \$49,048 increase to Historically Black Colleges and University, Department of Education. These increases were offset by a \$130,871 decrease in loan activity to the Department of Energy.

All of the loans in the Bank's portfolio are federally guaranteed or have a commitment to be full faith and credit obligations of the United States. The Bank's borrowings increased by \$1,679,468 due to increased lending activities.

The Bank's net position decreased to \$4,595,537 at September 30, 2016 from \$4,787,171 at September 30, 2015. The decrease is due to losses of \$438,672 incurred related to the October 15, 2015 debt exchange with the CSR&DF which were partially offset by a net income of \$247,038 for fiscal year 2016.

On October 15, 2015, the Bank exchanged certain special-issue Treasury debt obligations from the CSR&DF of \$2,684,997 to extinguish borrowings from the Treasury of \$2,052,783; related capitalized interest of \$189,954 and related accrued interest payable of \$3,588 for certain debt obligations issued by the Bank under Section 9(b) of the Federal Financing Bank Act of 1973 (such obligations of the Bank being the Bank's 9(b) Obligations), and

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held by the Treasury. The transaction resulted in the Bank owing debt to the CSR&DF instead of the Treasury and resulted in a loss of \$438,672 which represents a capital transaction with Treasury.

### ***Performance Highlights***

During fiscal year 2016, the Bank processed 875 new loan requests. The interest rate was set or reset on 3,860 loans in fiscal year 2016 for new loans and maturity extensions. The Bank processed 221 prepayments and 38,706 loan repayments in fiscal year 2016.

### **Management Controls**

The Bank completed an in-depth testing of its internal accounting and administrative control procedures in accordance with OMB Circular No. A-123, *Management's Responsibility for Internal Control*, as of June 2016. Accordingly, we believe that the Bank's systems of internal accounting and administrative controls fully comply with the requirements for agency internal accounting and administrative control systems, providing reasonable assurance that they are achieving the intended objectives.



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## Independent Auditors' Report

Inspector General, Department of the Treasury and  
the Board of Directors, Federal Financing Bank:

### Report on the Financial Statements

We have audited the accompanying financial statements of the Federal Financing Bank, which comprise the statements of financial position as of September 30, 2016 and 2015, and the related statements of operations and changes in net position and statements of cash flows for the years then ended, and the related notes to the financial statements.

### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditors' Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America, in accordance with the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and in accordance with Office of Management and Budget (OMB) Bulletin No. 15-02, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 15-02 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



***Opinion on the Financial Statements***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Federal Financing Bank as of September 30, 2016 and 2015, and the results of its operations, changes in net position, and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

***Other Matters***

***Other Information***

Our audits were conducted for the purpose of forming an opinion on the basic financial statements as a whole. The Management's Discussion and Analysis and Other Information included in Schedule 1 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

***Other Reporting Required by Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated November 9, 2016 on our consideration of the Federal Financing Bank's internal control over financial reporting and our report dated November 9, 2016 on our tests of its compliance with certain provisions of laws, regulations, and contracts and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the result of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Federal Financing Bank's internal control over financial reporting and compliance.

**KPMG LLP**

November 9, 2016





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## **Independent Auditors' Report on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards***

Inspector General, Department of the Treasury and  
the Board of Directors, Federal Financing Bank:

We have audited, in accordance with auditing standards generally accepted in the United States of America, in accordance with the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and in accordance with Office of Management and Budget (OMB) Bulletin No. 15-02, *Audit Requirements for Federal Financial Statements*, the financial statements of the Federal Financing Bank, which comprise the statements of financial position as of September 30, 2016 and 2015, and the related statements of operation and changes in net position and statements of cash flows for the years then ended, and the related notes to the financial statements, and have issued our report thereon dated November 9, 2016.

### **Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements as of and for the year ended September 30, 2016, we considered the Federal Financing Bank's internal control over financial reporting to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Federal Financing Bank's internal control. Accordingly, we do not express an opinion on the effectiveness of the Federal Financing Bank's internal control. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.



### **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and the result of that testing, and not to provide an opinion on the effectiveness of the Federal Financing Bank's internal control. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Federal Financing Bank's internal control. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

November 9, 2016



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## **Independent Auditors' Report on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards***

Inspector General, Department of the Treasury and  
the Board of Directors, Federal Financing Bank:

We have audited, in accordance with auditing standards generally accepted in the United States of America, in accordance with the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and in accordance with Office of Management and Budget (OMB) Bulletin No. 15-02, *Audit Requirements for Federal Financial Statements*, the financial statements of the Federal Financing Bank, which comprise the statements of financial position as of September 30, 2016 and 2015, and the related statements of operations and changes in net position and statements of cash flows for the years then ended, and the related notes to the financial statements, and have issued our report thereon dated November 9, 2016.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Federal Financing Bank's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 15-02.

### **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of compliance and the result of that testing, and not to provide an opinion on the Federal Financing Bank's compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Federal Financing Bank's compliance. Accordingly, this communication is not suitable for any other purpose.

**KPMG LLP**

November 09, 2016

**FEDERAL FINANCING BANK**

## Statements of Financial Position

September 30, 2016 and 2015

(Dollars in thousands)

|   | <u>2016</u>          | <u>2015</u>       |
|---|----------------------|-------------------|
| Assets:   |                      |                   |
| Fund balance with Treasury                              | \$ 559,075           | 860,134           |
| Investments held-to-maturity (note 2)                   | –                    | 494,273           |
| Loans receivable (note 3)                               | 76,281,884           | 74,045,999        |
| Accrued interest receivable                             | <u>169,737</u>       | <u>159,026</u>    |
| Total assets  | \$ <u>77,050,696</u> | <u>75,559,432</u> |
| Liabilities and Net Position:                           |                      |                   |
| Liabilities:  |                      |                   |
| Borrowings:   |                      |                   |
| Principal amount  | \$ 72,276,528        | 70,583,296        |
| Plus unamortized premium                                | <u>16,388</u>        | <u>30,152</u>     |
| Total borrowings (note 4)                               | 72,292,916           | 70,613,448        |
| Accrued interest payable                                | 161,431              | 158,118           |
| Other liabilities                                       | <u>812</u>           | <u>695</u>        |
| Total liabilities                                       | 72,455,159           | 70,772,261        |
| Loan and interest credit commitments (notes 7 and 1(j)) |                      |                   |
| Net position  | <u>4,595,537</u>     | <u>4,787,171</u>  |
| Total liabilities and net position                      | \$ <u>77,050,696</u> | <u>75,559,432</u> |

See accompanying notes to financial statements.

**FEDERAL FINANCING BANK**

## Statements of Operations and Changes in Net Position

September 30, 2016 and 2015

(Dollars in thousands)

|   | <u>2016</u>         | <u>2015</u>      |
|---|---------------------|------------------|
| Revenue:  |                     |                  |
| Interest on loans   | \$ 2,227,847        | 2,645,901        |
| Less legislatively mandated interest credit                                   | <u>(24,185)</u>     | <u>(60,363)</u>  |
| Net interest on loans   | 2,203,662           | 2,585,538        |
| Interest on investments   | 27                  | 115              |
| Revenue from servicing loans  | <u>1,305</u>        | <u>1,404</u>     |
| Total revenue   | <u>2,204,994</u>    | <u>2,587,057</u> |
| Expenses:   |                     |                  |
| Interest on borrowings  | 1,948,086           | 2,227,179        |
| Administrative expenses   | <u>9,870</u>        | <u>7,812</u>     |
| Total expenses  | <u>1,957,956</u>    | <u>2,234,991</u> |
| Net income  | \$ <u>247,038</u>   | <u>352,066</u>   |
| Net position:   |                     |                  |
| Beginning of year   | \$ 4,787,171        | 4,581,533        |
| Net income  | 247,038             | 352,066          |
| Loss on extinguishment of borrowings treated as capital transactions (note 5) | <u>(438,672)</u>    | <u>(146,428)</u> |
| End of year   | \$ <u>4,595,537</u> | <u>4,787,171</u> |

See accompanying notes to financial statements.

## FEDERAL FINANCING BANK

### Statements of Cash Flows

Years ended September 30, 2016 and 2015

(Dollars in thousands)

|   | <b>2016</b>  | <b>2015</b>  |
|---|--------------|--------------|
| Cash flows from operations:   |              |              |
| Net income  | \$ 247,038   | 352,066      |
| Adjustments to reconcile net income to net cash provided by operations:             |              |              |
| Amortization of premium on loans  | (13,764)     | (18,438)     |
| Capitalization of interest receivable   | (71,271)     | (37,903)     |
| Capitalization of interest payable  | 267,933      | 243,345      |
| Increase in accrued interest receivable   | (10,711)     | (18,498)     |
| Increase (decrease) in accrued interest payable                                     | 6,901        | (10,549)     |
| Increase (decrease) in other liabilities  | 117          | (428)        |
| Net cash provided by operations   | 426,243      | 509,595      |
| Cash flows from investing activities:   |              |              |
| Investment purchases  | –            | (136)        |
| Investment redemptions  | 494,273      | –            |
| Loan disbursements  | (61,092,957) | (60,414,675) |
| Loan collections  | 58,928,344   | 60,210,591   |
| Net cash used in investing activities   | (1,670,340)  | (204,220)    |
| Cash flows from financing activities:   |              |              |
| Borrowings  | 63,777,954   | 60,414,811   |
| Repayments of borrowings  | (62,794,916) | (60,420,538) |
| Net cash provided by (used in) financing activities                                 | 983,038      | (5,727)      |
| Net (decrease) increase in cash   | (261,059)    | 299,648      |
| Funds with U.S. Treasury – beginning of the period                                  | 860,134      | 560,486      |
| Funds with U.S. Treasury – end of the period  | \$ 599,075   | 860,134      |
| Supplemental disclosures of cash flow information:                                  |              |              |
| Interest paid (net of amount capitalized)   | \$ 1,686,476 | 1,797,157    |
| Supplemental schedule of noncash investing and financing activities:                |              |              |
| Decrease in loans for capitalized interest received                                 | \$ 74,177    | 60,192       |
| Increase in borrowings for capitalized interest paid                                | \$ 276,463   | 84,052       |
| Loss on early extinguishment of borrowings treated as capital transactions (note 5) | \$ (438,672) | (146,428)    |

See accompanying notes to financial statements.

## FEDERAL FINANCING BANK

Notes to Financial Statements

September 30, 2016 and 2015

(Dollars in thousands)

### (1) Summary of Significant Accounting Policies

The Federal Financing Bank (the Bank) was created by the Federal Financing Bank Act of 1973 (12 USC 2281) as an instrumentality of the U.S. government and a body corporate under the general supervision of the Secretary of the Treasury (the Secretary). The budget and audit provisions of the Government Corporation Control Act apply to the Bank in the same manner as they apply to other wholly owned government corporations.

The Bank was established by Congress at the request of the Department of the Treasury (Treasury), in order “to assure coordination of Federal and federally assisted borrowing programs with the overall economic and fiscal policies of the U.S. government, to reduce the cost of Federal and federally assisted borrowing from the public, and to assure that such borrowings are financed in a manner least disruptive of private financial markets and institutions.” The Bank was given broad statutory authority to finance obligations issued, sold, or guaranteed by Federal agencies so that the Bank could meet these debt management objectives.

The Bank is authorized, with the approval of the Secretary, to issue publicly and have outstanding at any one time obligations not in excess of \$15,000,000. Additionally, the Bank is authorized to issue obligations in unlimited amounts to the Secretary who, at the discretion of the Secretary, may agree to purchase any such obligations.

#### (a) *Basis of Presentation*

The Bank has historically prepared its financial statements in accordance with accounting principles generally accepted in the United States of America (GAAP), based on standards issued by the Financial Accounting Standards Board (FASB), the private-sector standards-setting body. The Federal Accounting Standards Advisory Board (FASAB) has indicated that financial statements prepared based upon standards promulgated by the FASB may also be regarded as in accordance with GAAP for those Federal entities, such as the Bank, that have issued financial statements based upon FASB standards in the past. Accordingly, consistent with historical reporting, the Bank’s financial statements are presented in accordance with accounting and financial reporting standards promulgated by the FASB.

#### (b) *Basis of Accounting*

The financial statements are presented on the accrual basis of accounting. The Bank recognizes loans when they are issued and related repayments when they are received. The Bank recognizes investments when they are made and investment redemptions when the proceeds are received. The Bank recognizes borrowings when they are received and repayments when they are made. In addition, the Bank recognizes interest on loans, interest on investments, and revenue from servicing loans when they are earned and recognizes interest on borrowings and expenses when they are incurred. Legislatively mandated interest credit is recorded in the period the cost is incurred as a contra-revenue to interest on loans in the statements of operations and changes in net position.

## FEDERAL FINANCING BANK

Notes to Financial Statements

September 30, 2016 and 2015

(Dollars in thousands)

(c) ***Funds with U.S. Treasury***

As a government corporation, the Bank maintains a Fund Balance with Treasury and does not hold cash. For the purposes of the statements of cash flows, the funds with Treasury are considered cash.

(d) ***Investments***

The Bank's investments consist of investments in U.S. Treasury securities for the Home Ownership Preservation Entity (HOPE) Fund. The securities are categorized as held to maturity, because the Bank has the ability and intent to hold the securities until maturity. The securities are recorded at par value.

(e) ***Loans Receivable***

The Bank issues loans to Federal agencies for their own use or to private sector borrowers whose loans are guaranteed by a Federal agency. When a Federal agency has to honor a guarantee because a private sector borrower defaults, the Federal agency must obtain an appropriation or use other resources to pay the Bank. All Bank assets are, or have a commitment to be, full faith and credit obligations of the U.S. government. Accordingly, the Bank has not recorded a reserve for default on any loans receivable.

The Bank has not incurred any credit-related losses on its loans as of the date of these statements.

(f) ***Interest on Loans***

The Bank's general policy is to capture the liquidity premium between Treasury securities and the private sector lending rates, and to charge a rate that reflects the risk inherent in a borrower or transaction, when such a rate will accomplish a broader goal. The income resulting from the interest spread covers the administrative expenses of the Bank. Under amendments to the Federal Credit Reform Act (FCRA), effective October 1, 1998, while the Bank is permitted to charge a spread on new lending arrangements with government-guaranteed borrowers, the margin is not retained by the Bank, but rather is retained by the loan guarantor. In the event that this requirement results in the Bank being unable to fund its administrative expenses related to these loans, FCRA, as amended, states that the Bank may require reimbursement from loan guarantors.

(g) ***Capitalized Interest***

In accordance with their loan agreements with the Bank, the Historically Black Colleges and Universities (HBCU), Department of Education, and the Department of Energy (DOE) have the option of deferring payments of interest on their loans until future periods. When HBCU or DOE elect, in advance, to defer interest payments, the accrued interest is recorded as capitalized interest receivable and added to the respective loan balance by the Bank. The Bank correspondingly capitalizes the interest payable on its related non-FCRA borrowings.



## FEDERAL FINANCING BANK

Notes to Financial Statements

September 30, 2016 and 2015

(Dollars in thousands)

**(h) Premium on Borrowings**

The Bank amortizes the premium on borrowings using the effective-interest method. The amortization is recorded as part of interest on borrowings on the statements of operations and changes in net position.

**(i) Interest on Borrowings from Treasury to Fund Amounts Treated as Lending to Financing Accounts**

The interest on borrowings from Treasury is based on the daily Treasury New Issue Curve (TNIC) for all borrowings, except for borrowings used to fund certain guaranteed loans that require the guaranteeing federal agencies to comply with FCRA (2 USC 661(d)(3)). The interest rate, interest payable, and interest expense for borrowings from Treasury that are used to fund certain guaranteed loans subject to FCRA are determined annually by the borrowing agencies using FCRA and Office of Management and Budget guidelines.

**(j) Legislatively Mandated Interest Credit**

In prior years, the Bank purchased certificates of beneficial ownership (i.e., loans reported as loans receivable on the statement of financial position) from the U.S. Department of Agriculture's Rural Utilities Services (RUS). RUS used the funds received from the Bank to issue loans to nonfederal entities, specifically private utility companies. In 1987, Congress passed legislation (7 USC Sec. 940c – Cushion of Credit Payments Program) that required RUS to develop and promote a program to encourage private utility companies to voluntarily make deposits into cushion of credit accounts established within RUS. The legislation also indicated that private utility companies may reduce the balance of their cushion of credit account only if the reduction is used to make scheduled payments on loans received from RUS. In accordance with the legislation, the private utility companies accrue interest at the higher of 5% per annum or the weighted average rate of the certificates of beneficial ownership on cash deposited into the cushion of credit accounts with RUS. The legislation also indicated that RUS shall receive an interest credit from the Bank equal to the amount of interest RUS pays to the private utility companies. The Bank records the interest credit in the period the cost is incurred as a legislatively mandated interest credit (contra-revenue to interest on loans) in the statements of operations and changes in net position.

**(k) Revenue from Servicing Loans**

The Bank charges certain RUS borrowers a loan service fee that is reported as revenue from servicing loans on the statements of operations and changes in net position. The Bank's loan servicing fee is equal to one-eighth of one percent more than the contractual interest rate with Treasury.

**(l) Administrative Expenses**

The Bank is subject to the general supervision and direction of the Secretary. As provided by law, the Secretary acts as chairman of the Board of Directors. Employees of Treasury's Departmental Offices perform the Bank's management and accounting functions, and its legal counsel is the General Counsel of the Treasury. The Bank reimburses Treasury for the facilities and services it

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(Dollars in thousands)

provides. The amounts of such reimbursements are reported as administrative expenses in the statements of operations and changes in net position.

**(m) Net Position**

The Bank can borrow from Treasury to meet its immediate cash needs and can also seek appropriations from Congress to make up for accumulated losses that will not be met by income.

Gains and losses related to early repayments of debt to the Secretary in which there is no related prepayment by the Federal agency borrower are recognized immediately and treated as capital transactions on the statements of operations and changes in net position.

**(n) Loan Commitments**

The Bank recognizes loan commitments when the Bank and the other parties fully execute the promissory notes and reduces loan commitments when the Bank issues loans or when the commitments expire. Most commitments of the Bank give a borrower the contractual right to a loan or loans immediately or at some point in the future. The Bank limits the time available for a loan under a commitment, where applicable.

**(o) Management's Use of Estimates**

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates.

**(p) Tax-Exempt Status**

The Bank is exempt from tax in accordance with Section 11(a) of the Federal Financing Bank Act of 1973 (12 USC 2281).

**(q) Related Parties**

The Bank conducts most of its financial transactions with other Federal entities, and therefore, the financial statement balances that represent transactions with other Federal entities include all assets; liabilities, except borrowings from the public; revenues; and expenses.

**(2) Investments Held to Maturity (the HOPE Bond Transaction)**

The Secretary is authorized to issue up to \$300,000,000 HOPE bonds under the HOPE for Homeowners Act of 2008, and the Bank purchased the HOPE bonds issued by the Secretary. The HOPE bonds purchased by the Bank were reported as investments held-to-maturity, and the related interest receivable was reported as accrued interest receivable in the Bank's statements of financial position.

On October 15, 2015, as allowed by the bond agreement, the Bank made a partial redemption of \$454,988 of the total \$494,273 outstanding HOPE bond investment balance. On April 15, 2016, the Bank redeemed

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### Notes to Financial Statements

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the remaining HOPE bond investment balance of \$39,285. The Bank repaid the funds borrowed from Treasury at the same time the HOPE bonds were redeemed.

The carrying amount for the HOPE bond at September 30, 2016 is \$0 and for September 30, 2015 is \$494,273. The interest rate is 0% and 0.010% as of September 30, 2016 and 2015, respectively, with floating interest rates reset quarterly. Prior to the redemption, the bonds had 30-year maturity dates starting on August 27, 2039 and ending on July 15, 2045.

### (3) Loans Receivable

Loans receivable represent the outstanding balances treated as loans to agencies. The Bank has the ability and intends to hold loans receivable until maturity or payoff. At September 30, 2016, the Bank had outstanding loans receivable of \$76,281,884. Certain of these loans were funded using FCRA borrowing procedures. The outstanding amount of loans funded using FCRA borrowing procedures was \$33,839,513 with interest rates ranging from 0.207% to 6.107% and maturity dates ranging from October 3, 2016 to October 15, 2056. The remaining non--FCRA loans receivable of \$42,442,371 had interest rates ranging from 0.267% to 11.367% and maturity dates ranging from October 3, 2016 to December 31, 2054.

At September 30, 2015, the Bank had outstanding loans receivable of \$74,045,999. The outstanding amount of loans funded using FCRA borrowing procedures was \$30,183,993 with interest rates ranging from 0.010% to 9.206% and maturity dates ranging from October 2, 2015 to October 15, 2055. The remaining non--FCRA loans receivable of \$43,862,006 had interest rates ranging from 0.010% to 11.367% and maturity dates ranging from October 1, 2015 to December 31, 2054.

Loans receivable at September 30, 2016 and 2015, consist of the following:

| Agency   | 2016          | 2015          |
|--|---------------|---------------|
| Rural Utilities Service, Department of Agriculture   | \$ 43,203,751 | \$ 41,193,204 |
| U.S. Postal Service  | 15,000,000    | 14,999,600    |
| Department of Energy   | 15,615,539    | 15,746,410    |
| Rural Utilities Service, Department of Agriculture<br>certificates of beneficial ownership | 135,000       | 481,900       |
| Historically Black Colleges and Universities, Department<br>of Education                   | 1,441,787     | 1,392,739     |
| Community Development Financial Institutions Fund  | 327,675       | 125,278       |
| Section 542 Risk Sharing, Department of Housing and Urban<br>Development                   | 553,671       | 102,337       |
| Veterans Administration Transitional Housing Program                                       | 4,461         | 4,531         |
| Total loans receivable   | \$ 76,281,884 | \$ 74,045,999 |

The loans receivable due within one year are \$16,283,860 and \$17,351,930 as of September 30, 2016 and 2015, respectively.

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### (4) Borrowings

Under the Federal Financing Bank Act of 1973, the Bank may, with the approval of the Secretary, borrow without limit from the Treasury.

For certain borrowings used to fund certain guaranteed loans based on FCRA, the interest rate is determined annually by the borrowing agencies using FCRA and Office of Management and Budget guidelines. At September 30, 2016, the Bank had \$33,620,638 of Treasury borrowings used to fund guaranteed loans based on FCRA with interest rates ranging from 0.52% to 4.723%, and a maturity date of September 30, 2050 to September 30, 2056. Under FCRA borrowing procedures, interest on borrowings from Treasury are not capitalized.

For the Bank's non-FCRA borrowings, repayments on Treasury borrowings generally match the terms and conditions of corresponding loans made by the Bank and bear interest at the respective rate, as determined by the Secretary, and are repayable at any time, except for loans with fixed-price call options in the no-call period. In November 2004, October 2013 and October 2015, certain borrowings from Treasury were refinanced under a debt limit transaction. At September 30, 2016, the Bank had \$25,631,978 of Treasury borrowings for non-FCRA related loans, with interest rates ranging from 0.142% to 8.307%, and maturity dates from October 3, 2016 to December 31, 2054.

At September 30, 2015, the Bank had \$29,965,412 of Treasury borrowings used to fund guaranteed loans based on FCRA with interest rates ranging from 1.000% to 4.723% and a maturity date of September 30, 2055. Treasury borrowings for non-FCRA related loans of \$28,302,891, with interest rates ranging from 0.00% to 8.307%, and maturity dates from October 1, 2015 to December 31, 2054.

Finally, at September 30, 2016 and 2015, the Bank had borrowings of \$13,023,902 and \$12,314,993, respectively, and an associated unamortized premium of \$16,388 and \$30,152, respectively, from the Civil Service Retirement and Disability Fund (CSR&DF), which is administered by the Office of Personnel Management. At September 30, 2016, these borrowings were at an interest rate range of 2.25% to 4.625%, an effective interest rate of 3.08%, and with maturity dates ranging from June 30, 2017 to June 30, 2029. At September 30, 2015, these borrowings were at an interest rate range of 2.875% to 4.625%, an effective interest rate of 3.430%, and with maturity dates ranging from June 30, 2016 to June 30, 2024.

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The scheduled principal repayments below reflect maturities of the Bank's borrowings and do not necessarily match the maturities of assets in the Bank's loan portfolio. Scheduled principal repayments of borrowings as of September 30, 2016 are as follows:

|                          | <u>Amount</u>        |
|--------------------------|----------------------|
| Repayment date:          |                      |
| 2017                     | \$ 16,351,774        |
| 2018                     | 2,688,786            |
| 2019                     | 5,884,715            |
| 2020                     | 3,147,559            |
| 2021                     | 3,759,778            |
| 2022 and thereafter      | <u>40,443,916</u>    |
| Total principal payments | 72,276,528           |
| Plus unamortized premium | 16,388               |
| Total borrowing          | <u>\$ 72,292,916</u> |

### (5) Capital Transactions

Total losses for capital transactions for the year ended September 30, 2016 totaled \$438,672 due to the loss recognized for the October 15, 2015 debt exchange with the CSR&DF.

On October 15, 2015, the Bank issued a debt obligation of \$2,684,997 under Section 9(a) of the Federal Financing Bank Act of 1973 to the CSR&DF in exchange for certain special-issue Treasury debt obligations (Specified Treasury Specials) issued by the Treasury and held by the CSR&DF. The Bank's 9(a) Obligations matched the coupon rates, the payment dates, the maturity dates and the redemption terms of the Specified Treasury Specials that the Bank receives from the CSR&DF.

On October 15, 2015 the Bank exchanged the Specified Treasury Specials received from the CSR&DF of \$2,684,997 to extinguish borrowings from the Treasury of \$2,052,783; related capitalized interest of \$189,954 and related accrued interest payable of \$3,588 for certain debt obligations issued by the Bank under Section 9(b) of the Federal Financing Bank Act of 1973 (such obligations of the Bank being the Bank's 9(b) Obligations), and held by the Treasury. Additionally, the Bank received \$17,710 in related interest which was paid to the CSR&DF on December 31, 2015.

As a result of this transaction, funds with Treasury increased by \$17,710, borrowings increased by \$446,260 and accrued interest payable increased by \$14,122. The transactions resulted in the Bank owing debt to the CSR&DF instead of the Treasury and resulted in a loss of \$438,672 which represents a capital transaction with Treasury and is reported on the statements of operations and changes in net position.

Total losses for capital transactions for the year ended September 30, 2015 were \$146,428. The loss resulted entirely from early repayments of debt of \$928,668. The repayments represent capital transactions,

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Notes to Financial Statements

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and the loss with Treasury is reported as a loss on extinguishment of borrowings treated as capital transaction on the statements of operations and changes in net position.

### (6) Capitalized Interest

Capitalized interest receivable was \$223,407 and \$226,313, and the related capitalized interest payable was \$209,633 and \$218,163 as of September 30, 2016 and 2015, respectively. Capitalized interest receivable and payable are reported as part of the loans receivable and borrowing balances, respectively, on the statements of financial position. The difference between capitalized interest receivable and capitalized interest payable is due to the effects of debt limit transactions on November 15, 2004, October 1, 2013, and October 15, 2015. These transactions altered the structure of existing debt and capitalized interest.

### (7) Loan Commitments

The Bank makes loan commitments to extend credit to Federal program agencies based on the loan agreements executed between the parties. The loan commitments are not reported on the statements of financial position and generally have fixed expiration dates or other termination clauses. Since many of the loan commitments are expected to expire without being completely drawn upon, the total loan commitment amounts do not necessarily represent future cash requirements. The Bank uses the same credit policies in making loan commitments as it does for loans receivable reported on the statements of financial position. The Bank funds the loan commitments with its borrowing authority from the Secretary. There is no exposure or credit risk related to these commitments.

The contract amounts and remaining loan commitments by program agency as of September 30, 2016, are as follows:

| Agency   | Contract<br>amounts | Remaining<br>loan<br>commitments |
|--|---------------------|----------------------------------|
| National Credit Union Administration –<br>Central Liquidity Facility     | \$ 2,000,000        | 2,000,000                        |
| Rural Utilities Service, Department of Agriculture                       | 12,478,504          | 6,649,654                        |
| Department of Energy   | 7,638,498           | 2,981,076                        |
| Community Development Financial Institutions Fund                        | 1,017,000           | 784,148                          |
| Historically Black Colleges and Universities, Department<br>of Education | 198,375             | 99,689                           |
| Total commitments  | \$ 23,332,377       | 12,514,567                       |

**FEDERAL FINANCING BANK**

Notes to Financial Statements

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**(8) Subsequent Events**

The Bank has evaluated subsequent events from the balance sheet date through November 9, 2016, the date at which the financial statements were available to be issued, and determined that there are no other items to accrue or disclose.

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### Other Information – Schedule 1

Unaudited – See Accompanying Auditors' Report

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In prior years, the Federal Financing Bank (the Bank) purchased certificates of beneficial ownership (i.e., loans reported as loans receivable on the statement of financial position) from the Rural Utilities Service (RUS), a component of the U.S. Department of Agriculture. RUS used the funds received from the Bank to issue loans to nonfederal entities, specifically private utility companies. In 1987, Congress passed legislation (7 USC Sec. 940c Cushion of Credit Payments Program) that required RUS to develop and promote a program to encourage private utility companies to voluntarily make deposits into cushion of credit accounts established within RUS. The legislation also indicated that a private utility company may reduce the balance of its cushion of credit account only if the reduction is used to make scheduled payments on loans received from RUS. In accordance with the legislation, the private utility companies accrue interest at a rate of 5% per annum or the weighted average rate of the certificates of beneficial ownership on cash deposited into the cushion of credit accounts with RUS. The legislation also indicated that RUS shall receive an interest credit from the Bank equal to the amount of interest RUS pays to the private utility companies. The Bank records the interest credit in the period the cost is incurred as a legislatively mandated interest credit (contra-revenue to interest on loans) in the statements of operations and changes in net position. As of September 30, 2016, the outstanding principal balance of the RUS loan subject to the certificates of beneficial ownership (CBO) legislation totaled \$135,000, with an interest rate of 7.951%, and a maturity date of September 30, 2021. In October 1998, the Bank received an appropriation that offset the RUS-CBO interest credits by \$917,699.

The interest credits that the Bank has provided RUS-CBO through September 30, 2016 are as follows:

|                        |                     |
|------------------------|---------------------|
| 1988–2012              | \$2,998,130         |
| 2013                   | 100,001             |
| 2014                   | 71,758              |
| 2015                   | 60,363              |
| 2016                   | 24,185              |
|                        | <hr/>               |
| Total interest credits | 3,254,437           |
|                        |                     |
| Less appropriation     | <u>(917,699)</u>    |
|                        |                     |
| Total                  | <u>\$ 2,336,738</u> |