Transcript of the Federal Home Loan Bank of Pittsburgh
Full Year 2020 Member Conference Call
March 2, 2021, at 9 a.m. EST

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[Operator introduction of call and of Mr. Watson]

WINTHROP WATSON

Good morning. This is Winthrop Watson, and I would like to thank you for joining our quarterly member call.

Slide 2 contains the agenda for today's call. I am joined by Ted Weller, our Chief Accounting Officer, and Dave Paulson, our Chief Operating Officer. Together, we will discuss the Bank's full-year 2020 performance and provide our outlook on the current year.

As always, please note – on slide 3 – that elements of this call are forward-looking, based on our view of prevailing housing, financial and other market conditions, and our business as we see it today. These elements can vary due to changes in the business environment and market conditions. Please interpret our presentation in that light.

Also note that a transcript of this call will be available tomorrow on our website.

I'll now move to slide 4.

Last year was an unprecedented year for all of us. While the Bank's 2020 overall financial performance was lower, it remained strong.

Our fourth-quarter dividend was paid last week at 5.75% and 2.50% annualized rates for activity and membership stock, respectively. This level is a reduction of 50 basis points from the previous three quarters and reflects the current business environment.

Bank financial performance was most impacted by advances or loan loans to members. Advance balances increased substantially in the first quarter in response to member's need for liquidity at the early onset of the pandemic. Advance balances ended first quarter 2020 at $78.1 billion, up 19% from the year-end 2019 balance of $65.6 billion.

However, those balances decreased following the influx of market liquidity generated by government actions – all of which were necessary and appropriate in the pandemic environment.

On slide 5, you will see the direct impact of those government programs on national bank deposit levels.

Although balances have trended upward over time, 2020 balances increased significantly because of the pandemic-related stimulus programs – rising nearly $3 trillion, or 22%. This increase directly impacts the need for advances, which we'll look at on the next slide.

Slide 6 presents a ten-year trend of System and Pittsburgh advance balances.

Both the System and Pittsburgh saw a sharp rise in first quarter 2020 advance levels, followed by a steady contraction through the remainder of the year.

Though our members' need for advances narrowed, our strong financial performance demonstrates the unique nature of our business model and capital structure that accommodates member needs in many economic conditions.

Before turning the call over to Ted to discuss the Bank's financial performance in greater detail, I want to conclude with a few additional comments on slide 7.

The combination of lower advance levels, and projected low interest rates will continue to impact the Bank's overall financial performance. Specifically, this means declining net income and dividend impact, which Dave will discuss later in the call.

Operational resilience remains a priority for the Bank. As I've said on prior calls this takes two forms – safeguarding our staff and serving our membership.

We are encouraged by the news of several viable vaccines and are beginning to plan a conservative approach for returning to the office at a time that is appropriate. For now, however, we remain nearly 100% remote.

With respect to our Board, I would like to thank Pat Bond – partner at Mountaineer Capital – for his many years of dedicated service to the Bank. Pat was a member of our Board from 2007 through 2020 and served as Board Chair from 2014 through 2019. Pat had also been active with the Bank's Affordable Housing Advisory Council for nine years providing the Bank's Board with insights into the needs of a variety of community stakeholders across West Virginia.

I would also like to thank Andy Hasley – President of Standard Bank – for his leadership on our Board. Both Pat and Andy's dedication and thoughtfulness made our entire organization stronger as a result.

I would like to welcome two new Board Members, Romy Diaz – the principal of Turtle on Post – and Jim Dionise – president and CEO of Mars Bank. Our entire organization is excited for their leadership as we continue into 2021.

With that, I will turn the call over to Ted to review our financial performance.

TED WELLER

Thanks Winthrop, and good morning.

I am glad to be with you today to provide an overview of our financial results and the key drivers behind them.

On slide 9, you will note that the Bank recorded net income of $210.4 million in 2020 compared to $316.9 million in 2019. This decrease was primarily driven by lower net interest income and other non-interest income.

For 2020, net interest income was $364.7 million, a decrease of $89.1 million compared to $453.8 million for 2019. The year-over-year decrease was primarily due to lower interest rates and a decrease in outstanding average advance balances.

The provision for credit losses was $4.4 million for 2020, compared to $1.3 million in 2019. The decrease, or increase rather was due to OTTI credit losses, which under the new "CECL" accounting standard now are recorded in the provision for credit losses, and additional reserves on the Bank's mortgage loans held for portfolio.

Other non-interest income was a loss of $19.2 million in 2020, compared to income of $3.0 million in 2019. This $22.2 million decrease was driven primarily by mark-to-market adjustments to derivatives and trading securities, which netted to a $21.5 million loss in 2020 compared to a $0.7 million gain in 2019. The mark-to-market net loss in 2020 is a non-cash item that largely reflects the significant decline in interest rates.

Other expense increased $4 million to $105.5 million in 2020 compared to $101.5 million in 2019. The increase was primarily due to higher compensation and benefit-related expenses and technology costs.

These results allowed the Bank to set aside $25.2 million for affordable housing programs.

On slide 10, total average assets for 2020 were $78.8 billion, down $23.7 billion or 23% from 2019 due to lower average advances.

Average advances were $47.9 billion in 2020, a decrease of $24.3 billion, or 34%, from 2019.

At December 31, 2020, total advances were $25 billion, down 62% from $65.6 billion at December 31, 2019.

Winthrop spoke to our advance levels and the drivers behind them in 2020 and Dave will provide additional color.

Retained earnings at December 31, 2020 totaled $1.4 billion, an increase of $51 million from December 31, 2019, reflecting earnings for 2020 less dividends paid.

Slide 11 provides a summary of the Bank's capital requirements.

At December 31, 2020, the Bank continues to be in full compliance with all regulatory ratios and permanent capital exceeds the risk-based requirement.

Also, at December 31, 2020, the ratio of Market Value of Equity to Capital Stock was 188.2%; up from 145.1% at year-end 2019. This increase was primarily due to the decrease in capital stock balances as a result of lower advances.

This concludes my portion of the presentation. Dave Paulson will now provide a business review.

DAVID PAULSON

Thank you, Ted.

Moving to a review of the Bank's businesses on slide 13, let me share some product use highlights.

As Winthrop noted, volatility in our advance portfolio resulted in Q1 ending at $78.1 billion and Q4 ending lower at $25 billion. Our ability to provide strong, though lower, financial performance is a testament to our unique structure which allows for balance sheet expansion and contraction with member need.

Letters of credit, or LC, activity increased throughout the year, from $16.4 billion at the end of the second quarter to $19.7 billion by the fourth quarter. This change tracks with the increase in municipal deposits at our member institutions and broader use of LCs by our members.

MPF Program performance in 2020 remains solid, and the portfolio sits close to $5 billion. Program fundings for the year were $1.3 billion.

With current market conditions, we anticipate some level of continued mortgage portfolio paydowns.

In December, our community investment team completed the scoring of Affordable Housing Program applications and announced funding recipients. Demand for our community investment products remains high, and we expect competition for those funds to become greater as lower Bank earnings contribute to lesser program funding.

In line with the Federal Home Loan Bank System broadly, the Pittsburgh Bank continues our transition away from LIBOR toward alternative rates that include SOFR. We have also issued SOFR-based advances to our members.

Additionally, we are collaborating with the System and will be accepting eNotes as collateral this year. Several teams Bankwide are working together, alongside members, on tools, technology and knowledge-sharing to make this process as user friendly as possible.

To this end, we are finalizing steps that will phase out our current Bank4Banks website to offer a new secure website portal informed by member feedback and timely industry standards.

Slide 14 shows historical trends for our advances, LCs and the MPF Program. There are a few items that I would like to highlight.

Advances continue to be the Bank's primary credit product and make up approximately 53% of our balance sheet.

As noted in the trend graph, advances continued to decline in the fourth quarter following the first quarter spike. Our advance balance neared ten-year lows.

LCs are most often used in lieu of pledged securities to secure public unit deposits. LC volumes have been consistent over time and we experienced an increase from the prior quarter for the reasons I noted – timing and broader use.

An additional source of member activity is the MPF Program. MPF offers members liquidity on their 30-year residential mortgages. MPF represents about 10% of our balance sheet. Volumes were solid throughout 2020, and we will continue to look for opportunities within the Program.

In addition to the value drawn from the Bank's credit products and services, we want to emphasize our continued focus on shareholder return on slide 15. For us, that is delivered to members in two forms – cash and community dividends.

The Bank committed $52.7 million in the form of community dividends. $37.1 million of that was our regulatorily required 10 percent.

These dividends were distributed to members through grants and other assistance available through our community investment products, which include:

- the Affordable Housing Program,
- Banking On Business,
- Blueprint Communities,
- the Community Lending Program,
- First Front Door and
- Home4Good.

That concludes the 2020 highlights. I would now like to spend some time talking about our 2021 outlook.

As we discussed in prior quarters and noted on slide 17, there are several drivers of our overall performance. These include:

- Member activity, primarily advances;
- Movement in interest rates;
- Performance of our mortgage investment portfolio;
- Yields from our MPF Program portfolio; and
- Strategic expense management.

Reflecting on 2020 and looking into 2021, we expect that these performance drivers will likely have a continued, cumulative impact of lowering our overall financial performance. The trend towards lower advance balances is anticipated as government actions may impact the economy.

Expected prolonged low interest rates will likely result in lower net income.

In addition, the continued paydown of the high-yielding mortgage-backed securities and MPF Program portfolios could weigh on financial performance.

On slide 19, we will move to our dividend outlook.

The first quarter dividend, which has historically been paid in April, will likely be paid at the same levels as the fourth quarter 2020 dividend. All of this, of course, is subject to market and business conditions.

Looking into 2021, lower interest rates and advance levels, along with mortgage paydowns, could further contribute to:

- Lower financial performance,
- Likely lower dividend capacity in 2021, and
- Lower Affordable Housing Program contribution.

Throughout the year, we will continue to assess the potential impact of these performance drivers on our business and keep you informed in future earnings calls.

Considering these variables just discussed, I wanted to share our dividend rate over time, as compared to the fed funds rate. As you can see on slide 20, the Bank's historical dividend rate and the spread to fed funds have tracked over time.

And, while there is not a one-to-one correlation between the two rates, the downward fed funds rate movement demonstrates that our current dividend rate remains healthy in this rate environment.

Before concluding my remarks, I would like to highlight some key dates and events for the year on slide 21.

Our community investment product availability and member reporting are moving forward in their usual cadence – we look forward to your participation.

We announced several enhanced member experience initiatives that are already under way. At our members' request, we are replacing our product-specific signature cards in favor of broader resolutions that will inform product access. We are also on track to launch our new website portal in the second quarter. As mentioned, these initiatives were informed by member feedback and bring the Bank in line with industry standards around user experience, process efficiency and online access.

With that, let me return the call to Winthrop.

WINTHROP WATSON

Thank you, Dave.

With that, Allie, let's open the lines to any questions or comments our members may have.

Thank you, Allie.

We did receive a question from Diane Rosler of First Keystone Community Bank in advance of the call. She asks, “How is the Bank planning to compete with the Federal Reserve Bank’s PPPLF for the remaining first and second round of PPP loans?”

Well the Federal Home Loan Bank does accept pledged PPP loans as collateral from its members.

The standards for pledging these loans, including our lending – lender value, are set forth in our Member Products Policy and are consistent with regulatory standards governing Federal Home Loan Bank acceptance of such loans as eligible collateral.

Unlike the Federal Reserve Banks, Federal Home Loan Banks are not authorized to lend to their members on a non-recourse basis; Federal Home Loan Banks cannot look solely to the underlying pledged collateral for repayment, even regarding pledged PPP loans. We’re just not allowed to.

Federal Home Loan Bank advance pricing remains attractive and advances may be an option for members to consider in funding business loans.

Diane, for you and others who might have questions about this, please reach out to your relationship manager -- business development manager – and we can go through these answers in more depth. And I hope that’s helpful to you and any others who are on the call.

Thank you so much for sending in the [question].

I’d like to thank everyone for attending today’s call and for your support. On slide 23, we’ve included contact information for our leadership and business development teams. Please reach out to any of us at any time.

Enjoy the rest of your day and stay well.