

To Our Members

Our corporate culture emphasizes excellent service to our members. That should not be surprising, given the cooperative structure of the Federal Home Loan Bank of San Francisco. Members are central to everything we do, because it is only with and through our members that we achieve our public policy mission.

The people featured in this year's report have frequent contact with members, even though you rarely meet them face to face. With the rest of our talented and dedicated employees, they share a commitment to serving our members, achieving our performance objectives, and fulfilling our mission.

Remarkable people focused on serving members well are one part of the equation, one example of the way we are structured for success. We have another distinct structural advantage – a unique business model that is unlike that of a typical private-sector financial institution.

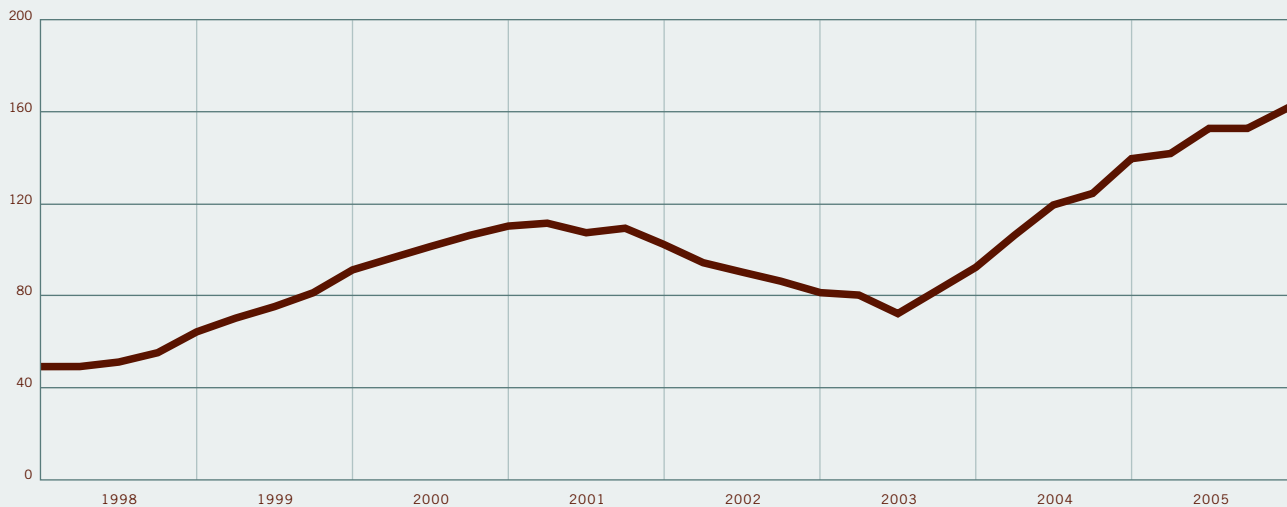
This business model reflects the unusual nature of a Federal Home Loan Bank, which is chartered by the U.S. government but funded with the capital provided by its financial institution members. Unlike most public companies, a Federal Home Loan Bank does not focus strictly on profits, dividends, or ROE. Instead, we seek to achieve a balance between our public policy mission – to promote housing, homeownership, and community development through our activities with members, and our objective to pay adequate returns on the capital provided by our members.

Our business model has proven very effective in allowing us to achieve this balance. The key for us is to retain the financial flexibility to provide our members with reliable access to low-cost funds from the capital markets through all phases of the economic cycle and emerging business, legislative, and housing market trends.

Since the late 1990s, the trend in advance demand, as demonstrated by our members' advances outstanding, has been quite volatile:

ADVANCES OUTSTANDING: 1998 – 2005

(BILLIONS OF DOLLARS)



Throughout this extended cycle of expanding and contracting advance demand, resulting from members' growing or declining credit needs, the Bank has shown consistent and strong financial performance, met the credit and liquidity needs of members, paid a reasonable return on their investment in the Bank, funded a variety of grant and loan programs to support affordable housing and community investment, and met high standards of safety and soundness.

The Bank has been successful in accomplishing its mission by consistently employing a straightforward business model that balances the interests of members: low credit prices and reasonable dividend yields. Our financial strategies are designed to enable us to safely expand and contract our assets, liabilities, and capital in response to changes in our membership base and our members' credit needs.

The basic components of our business model are:

- Capital stock ownership is linked to a member's level of activity with the Bank. Capital grows when members purchase additional capital stock as they increase their advance borrowings or sell more mortgage loans to the Bank. Capital decreases when we repurchase capital stock from members as their advances or mortgage loan balances decline.
- With our status as a government-sponsored enterprise (GSE), we are able to raise funds in the capital markets at rates that are close to U.S. Treasury yields.
- We price credit to all members at rates that are competitive with the cost of the wholesale borrowing alternatives available to our largest members, giving all members equal access to the same low rates.
- We generate a market rate of return on member capital by efficiently leveraging capital and making full use of our regulatory authority to invest in mortgage-related assets, such as mortgage-backed securities and mortgage loans, that have an attractive risk-adjusted return.
- We maintain strong risk management and internal controls.

This business model has worked well, and we have been able to meet member credit needs and pay market-rate dividends despite significant fluctuations in total assets, liabilities, and capital in recent years. In periods when advances grew rapidly, we successfully processed the expanded volume and complexity of transactions without a significant increase in staff. In periods when advances declined rapidly, we maintained our financial performance and our safety and soundness, as capital and total assets declined proportionately. This success during periods of expansion and contraction underscores the validity of our business model and the commitment of our employees to excellence in execution, efficiency, and flexibility.

We view growth in advances not as an end in itself, but as an indicator of our mission achievement and our responsiveness to the needs and preferences of our members. During 2005, advances outstanding grew \$22.6 billion. In total, 152 of our members increased their advance borrowings during 2005, while 82 decreased their advance borrowings.

We measure our dividend rate against a unique benchmark that not only reflects our interest rate risk management and capital management goals, but also serves as an indicator of the yields available to our members for investments of comparable risk. In 2005, we paid a dividend rate of 4.44%, which was 1.22% over our dividend benchmark.

Another indication that our business model is working and that we are meeting the market test is growth in membership. We welcomed 39 members in 2005, bringing the total number of members to 376 at yearend. As of December 31, 2005, our members included 244 commercial banks, 84 credit unions, 32 savings institutions, 12 thrift and loan companies, and 4 insurance companies.

In 2005, we awarded \$42.0 million in Affordable Housing Program grants to 102 projects, sponsored by 38 different members, to support the creation of 5,994 units of affordable housing. Twenty-seven members reserved \$6.6 million in grants under our two homeownership set-aside programs, the Individual Development and Empowerment Account Program and the Workforce Initiative Subsidy for Homeownership Program. In addition, members borrowed \$1.0 billion in Community Investment Program and Advances for Community Enterprise Program advances, and we issued \$107.4 million in standby letters of credit under these programs during the year.

Since the inception of the Affordable Housing Program in 1990, we have awarded \$382 million to support the development or rehabilitation of approximately 70,000 affordable homes.

We reached an important milestone in 2005 when we registered our capital stock with the Securities and Exchange Commission. Our registration became effective on August 29, 2005. We will continue to focus on maintaining our internal control environment and enhancing our disclosures as an SEC registrant.

Although we cannot predict all of the challenges the future may hold for the Bank and for our business model, we are acutely aware of certain issues that have surfaced in recent years: possible risks to our funding advantage as a GSE, the ongoing control and disclosure requirements of an SEC registrant, increased competition from other firms that could affect the pricing of FHLBank System debt or the pricing of our advances and other products, and pending legislative and regulatory initiatives, including the possible restructuring of the housing GSEs by Congress and possible changes to the Federal Home Loan Banks' capital and retained earnings requirements recently proposed by the Federal Housing Finance Board.

These challenges require us to continually re-examine our assumptions, our current activities, and our plans for the future to ensure that we can respond effectively to changes and continue to help you meet the credit needs of your communities.

Our Board of Directors performs an integral role in the development of our business model and the achievement of our goals. The directors have consistently supported our focus on achieving our mission and maintaining our financial flexibility. They have also made certain we have the resources necessary to maintain a first-rate control environment. We thank the directors for their insight and leadership in helping us create

and maintain a structure that has proven effective in meeting member funding needs, protecting members' capital investment, providing reasonable returns, and achieving our mission. In particular, we thank outgoing directors John F. Robinson, Connie R. Wilhelm, and Charlene Gonzales Zettel, and we welcome D. Tad Lowrey back to the Board.

We also thank the members of our Affordable Housing Advisory Council for their inspiration and support in helping us create and maintain programs that address the housing and economic development needs of our region.

Most of all, we thank you, our members, for working with us, investing in us, and using our products and services. We have created a business model and built a corporate culture that are intended to meet your needs as shareholders and customers, so that you, in turn, can meet the credit needs of your communities, helping families and individuals obtain quality housing and become homeowners and contributing to the economic health of the regions you serve.



Timothy R. Chrisman

TIMOTHY R. CHRISMAN
Chairman of the Board



James P. Giralдин

JAMES P. GIRALDIN
Vice Chairman of the Board



Dean Schultz

DEAN SCHULTZ
President and CEO