

REACTING TO RATES UP

This Day in History: Today is National Cook A Sweet Potato Day. On February 22, 1980, the United States hockey team, generally composed of college players, defeated the defending Olympic champion Soviet Union team 4-3. The team won the gold medal in its next game. In 1889, President Grover Cleveland signed a bill admitting North Dakota, South Dakota, Montana, and Washington as states.

Market Update: Term rates continued the upward march, with the 10-year LIBOR swap rate increasing 14bps. The 10-year LIBOR swap rate has increased 33bps over the last month. While long-term rates are climbing, short term rates remain anchored at extremely low levels. The 2/10 swap slope increased to levels not seen in many years.

Term	Swap Rates				Change		
	2/19/2021	2/12/2021	1/19/2021	8/4/2020	WoW	MoM	Since 8/4/2020
2y	0.20	0.21	0.20	0.18	0.00	0.00	0.02
3y	0.32	0.30	0.27	0.18	0.02	0.05	0.14
5y	0.71	0.62	0.52	0.24	0.09	0.19	0.46
7y	1.06	0.94	0.79	0.35	0.12	0.27	0.71
10y	1.42	1.29	1.09	0.51	0.14	0.33	0.92
20y	1.85	1.72	1.50	0.73	0.12	0.35	1.12
2s/10s slope	1.22	1.08	0.89	0.32	0.14	0.33	0.90

Borrowers have certainly noticed the sharp increase in term rates with a few borrowers electing to wait and see if levels will come back down before locking in their loan rates. We are locking 10-year loans back above 4%, which hadn't seen much of over the past year.

The first two months of the year have brought increased interest rate volatility with term rates increasing significantly while short rates have declined to record levels. The obvious result is a much steeper yield curve, with the 2/10 slope increasing to levels last seen in late 2015. In addition, we are approaching the 20 year average of the slope of approximately 130 bps. The speed of transition from the extremely flat swap curve of the last few years to an almost normally sloped curve is a reminder that rate changes are unpredictable. Banks must be prepared to react quickly to protect their operating results and interest rate risk position.

Interest rate swaps are the perfect tools to help banks flourish in quickly changing market conditions while continuing to offer customers the products they desire. The most obvious example is the use of swaps to make long term fixed rate loans, either commercial or mortgage loans. The fixed rate loan protects the customer against rising rates by locking in their debt service (which also reduces the credit risk of the bank by protecting against payment shock if rates are up significantly at a balloon date) while the swap protects the bank against rising interest rates.

A time of volatile and rising rates can have economic consequences not reflected in GAAP accounting records. Suppose a bank made a 5 year fixed rate balloon loan with 20 year amortization in mid December that yielded a spread of LIBOR plus 200. The fixed rate would have been 2.46%. Currently, the fixed rate on a loan with the same terms would be 2.70%. Most banks operate assuming limiting loan terms to 5 year balloons provides protection from rising rate risk but this loan is 24bps underwater in about 2 months. It is easy to see how a portfolio accumulated over the last few years, made in a historically low, flat rate environment, can hurt future earnings. In a time when every basis point is important, protecting the bank against future loss of earnings and value while offering customers what they want is vitally important.

We are available to help you implement a hedging program that can protect the long term results of your bank by using tools that are now common among community banks.

Have a great week!

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Interest Rate Swap Curves

LIBOR Swap Curve			
	Current	Last Week	Last Month
2-Year	0.204%	0.216%	0.201%
3-Year	0.327%	0.326%	0.266%
5-Year	0.718%	0.700%	0.527%
7-Year	1.068%	1.044%	0.806%
10-Year	1.424%	1.405%	1.113%
12-Year	1.578%	1.557%	1.255%
15-Year	1.721%	1.700%	1.394%
20-Year	1.843%	1.824%	1.522%

*Bloomberg mid-market quotations



Money Market Rates		3M LIBOR Forward Rates	
1M LIBOR	0.11488%	Mar-21	0.15750%
3M LIBOR	0.17550%	Jun-21	0.14500%
6M LIBOR	0.20400%	Sep-21	0.16500%
12M LIBOR	0.28550%	Dec-21	0.21500%
Prime	3.25000%	Mar-22	0.18500%
FFTR	0.2500%		
Eff FF	0.0700%		
SOFR	0.0200%		

Spot Start Loan Hedging

Rate Term (Years)	Floating Rate	Amortization Term (Years)							
		3-Year	5-Year	7-Year	10-Year	15-Year	20-Year	25-Year	Bullet
2-Year	LIBOR + 2.00%	2.26%	2.27%	2.27%	2.27%	2.28%	2.28%	2.28%	2.28%
3-Year	LIBOR + 2.00%	2.29%	2.34%	2.36%	2.37%	2.37%	2.38%	2.38%	2.38%
4-Year	LIBOR + 2.00%		2.44%	2.48%	2.51%	2.53%	2.54%	2.55%	2.56%
5-Year	LIBOR + 2.00%		2.48%	2.60%	2.66%	2.70%	2.71%	2.72%	2.74%
6-Year	LIBOR + 2.00%			2.68%	2.79%	2.85%	2.87%	2.88%	2.90%
7-Year	LIBOR + 2.00%			2.71%	2.89%	2.97%	3.00%	3.02%	3.07%
8-Year	LIBOR + 2.00%				2.96%	3.07%	3.12%	3.15%	3.20%
9-Year	LIBOR + 2.00%				3.00%	3.16%	3.22%	3.25%	3.31%
10-Year	LIBOR + 2.00%				3.01%	3.23%	3.30%	3.34%	3.42%
12-Year	LIBOR + 2.00%	Customer Pays Fixed, Monthly, Act/360				3.32%	3.42%	3.48%	3.56%
15-Year	LIBOR + 2.00%	Customer Receives 1-Month LIBOR + 2.00%				3.36%	3.52%	3.58%	3.69%

Forward Starting Swap Quotes

Rate Term (Years)	Floating Rate	20-Year Amortization		
		3-Month	6-Month	12-Month
2-Year	LIBOR + 2.00%	2.30%	2.33%	2.45%
3-Year	LIBOR + 2.00%	2.43%	2.49%	2.64%
4-Year	LIBOR + 2.00%	2.61%	2.68%	2.84%
5-Year	LIBOR + 2.00%	2.78%	2.86%	3.02%
6-Year	LIBOR + 2.00%	2.94%	3.01%	3.16%
7-Year	LIBOR + 2.00%	3.06%	3.13%	3.27%
8-Year	LIBOR + 2.00%	3.18%	3.25%	3.38%
9-Year	LIBOR + 2.00%	3.28%	3.34%	3.46%
10-Year	LIBOR + 2.00%	3.36%	3.41%	3.53%
12-Year	LIBOR + 2.00%	3.47%	3.52%	3.61%
15-Year	LIBOR + 2.00%	3.56%	3.60%	3.69%

Profitability Analysis

Rate Term (Years)	Profit Per Basis Point of Mark-up, Per \$1,000,000 of Notional							
	3-Year	5-Year	7-Year	10-Year	15-Year	20-Year	25-Year	Bullet
2-Year	\$140	\$167	\$178	\$186	\$193	\$196	\$198	\$203
3-Year	\$160	\$220	\$247	\$266	\$281	\$289	\$293	\$304
4-Year		\$254	\$301	\$337	\$364	\$377	\$385	\$405
5-Year		\$265	\$340	\$396	\$440	\$461	\$473	\$504
6-Year			\$364	\$446	\$508	\$539	\$557	\$602
7-Year			\$373	\$484	\$570	\$612	\$637	\$698
8-Year				\$512	\$625	\$680	\$712	\$793
9-Year				\$529	\$672	\$743	\$784	\$886
10-Year				\$535	\$712	\$799	\$850	\$976
12-Year	Fee Income Generation Only Possible With				\$770	\$896	\$969	\$1,152
15-Year	Back-to-Back Swaps and SMART Loan Products				\$803	\$1,000	\$1,115	\$1,402

Macro-Hedging

Protection Against Rising Rates							
3mL Pay Fixed Swap		3-Month LIBOR Caps - Premium in Basis Points					
2-Year	0.32%	Pay Fix, quarterly, act/360 both sides	Strike	2-Year	3-Year	4-Year	5-Year
3-Year	0.43%		0.30%	0.37%	0.81%	1.84%	3.22%
4-Year	0.62%		0.50%	0.32%	0.61%	1.49%	2.69%
5-Year	0.82%		0.75%	0.31%	0.49%	1.19%	2.19%

Protection Against Falling Rates							
Prime Rcv Fixed Swap		3-Month LIBOR Floors - Premium in Basis Points					
2-Year	3.18%	Receive fixed, monthly, act/365 both sides	Strike	2-Year	3-Year	4-Year	5-Year
3-Year	3.27%		0.25%	0.52%	0.77%	0.91%	1.07%
4-Year	3.43%		0.15%	0.43%	0.67%	0.79%	0.94%
5-Year	3.61%		0.10%	0.42%	0.65%	0.76%	0.91%

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