

LOWERING YOUR COST OF FUNDS

This Day in History: Today is National Napping Day (for return of daylight savings time). On March 15, 44 BC, Julius Caesar was stabbed to death by Brutus and other Roman senators on the Ides of March. In 1985, the world's first internet domain name, symbolics.com, was registered.

Market Update: Swap rates rallied during most of the week before reversing course on Thursday to end the week slightly higher. The curve continued to steepen – with the 2/10 slope now exceeding its 20-year average of 128bps.

Term	Swap Rates				Change		
	3/12/2021	3/5/2021	2/12/2021	8/4/2020	WoW	MoM	Since 8/4/2020
2y	0.25	0.24	0.21	0.18	0.01	0.05	0.07
3y	0.45	0.43	0.30	0.18	0.01	0.15	0.26
5y	0.93	0.90	0.62	0.24	0.03	0.31	0.69
7y	1.30	1.28	0.94	0.35	0.03	0.36	0.95
10y	1.64	1.62	1.29	0.51	0.02	0.35	1.13
20y	2.02	2.00	1.72	0.73	0.02	0.30	1.29
2s/10s slope	1.39	1.38	1.08	0.32	0.01	0.30	1.06

Desk activity was steady last week with loan and portfolio hedging driving activity. With the steepening of the curve, we are seeing renewed interest in receive fixed swaps. These types of transaction can actually help banks decrease the current cost of existing fixed rate funding. See below for strategy details.

According to the most recent *FDIC Quarterly Banking Profile*, community bank net interest margins declined 30 basis points from the fourth quarter of 2019. That is not a surprise to most bankers as asset yields have declined more than funding costs. While most banks have reduced their deposit rates significantly, it is important for banks to continue reducing these costs wherever possible.

While the recent back up in rates and steepening of the curve has been quite a shock, it does provide a new way for banks to quickly increase current earnings. For those with longer term (around 4 years or more) funding or fixed to floating subordinated debt, a **receive** fixed swap can immediately **lower your funding cost 40 to 90+bps**, depending on remaining maturity. The most likely candidates for this strategy consist of brokered CDs, FHLB advances or subordinated debt; the bank converts the fixed rate liabilities to a floating rate and immediately increases net interest income.

We will walk through a specific example we discussed with a customer this week. The bank has an FHLB advance with a fixed rate of 3.52% that matures in July 2028. The bank executes a receive fixed swap where they receive a fixed rate of 3.52%, offsetting the payment to FHLB. The swap requires them to pay a floating rate of 1-month LIBOR plus 248 bps, currently 2.59% (2.48% + .11%), resulting in an immediate savings of 93 bps (3.52% – 2.59%) on the borrowing!

The reward is obvious: increased margin at a time when every dollar of net interest income is precious. The risk is the floating rate will increase over the term of the swap but it takes four Fed increases (generally thought by the market to start no sooner than 2 years) of 25 basis points before the break-even point is reached for the FHLB funding described above. Importantly, this transaction adds earnings now while most bank interest rate risk profiles indicate improved earnings as rates rise.

We believe those with longer term, fixed rate wholesale funds or fixed rate subordinated debt should consider a receive fixed swap to improve current earnings.

Give us a call and we can provide you details and pricing related to your current situation.

Have a great week!

Vining Sparks Interest Rate Products, LLC

Toll-Free 800.786.2883

www.VSIRP.com

Rick Redmond

President

901-766-3382

rredmond@vsirp.com

Walt Robison, CPA, CFA

VP – Sales and Trading

901-766-3389

wrobison@vsirp.com

Katharine Bray

Director of Sales and Trading

901-766-3384

kbray@vsirp.com

Battle Beasley

VP – Sales and Trading

901-766-3383

bbeasley@vsirp.com

Tommy Warren, CPA

Senior VP – Sales and Trading

864-915-6675

twarren@vsirp.com

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Interest Rate Swap Curves

LIBOR Swap Curve			
	Current	Last Week	Last Month
2-Year	0.258%	0.241%	0.205%
3-Year	0.451%	0.432%	0.295%
5-Year	0.926%	0.901%	0.617%
7-Year	1.294%	1.276%	0.938%
10-Year	1.630%	1.620%	1.286%
12-Year	1.770%	1.763%	1.440%
15-Year	1.901%	1.895%	1.588%
20-Year	2.003%	1.995%	1.721%

*Bloomberg mid-market quotations



Money Market Rates		3M LIBOR Forward Rates	
1M LIBOR	0.10750%	Mar-21	0.18200%
3M LIBOR	0.18200%	Jun-21	0.17000%
6M LIBOR	0.19750%	Sep-21	0.19000%
12M LIBOR	0.28100%	Dec-21	0.25000%
Prime	3.25000%	Mar-22	0.21500%
FFTR	0.2500%		
Eff FF	0.0700%		
SOFR	0.0100%		

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%	2.31%	2.32%	2.32%	2.32%	2.32%	2.32%	2.33%	2.33%
3-Year	LIBOR + 2.00%	2.36%	2.44%	2.46%	2.48%	2.48%	2.49%	2.49%	2.50%
4-Year	LIBOR + 2.00%		2.57%	2.63%	2.67%	2.70%	2.71%	2.72%	2.73%
5-Year	LIBOR + 2.00%		2.62%	2.77%	2.85%	2.89%	2.91%	2.92%	2.94%
6-Year	LIBOR + 2.00%			2.86%	2.98%	3.05%	3.08%	3.09%	3.13%
7-Year	LIBOR + 2.00%			2.89%	3.08%	3.18%	3.22%	3.24%	3.28%
8-Year	LIBOR + 2.00%				3.15%	3.28%	3.33%	3.35%	3.41%
9-Year	LIBOR + 2.00%				3.19%	3.36%	3.42%	3.45%	3.51%
10-Year	LIBOR + 2.00%				3.21%	3.42%	3.49%	3.53%	3.61%
12-Year	LIBOR + 2.00%	Customer Pays Fixed, Monthly, Act/360				3.50%	3.60%	3.65%	3.75%
15-Year	LIBOR + 2.00%	Customer Receives 1-Month LIBOR + 2.00%				3.53%	3.69%	3.76%	3.88%

Forward Starting Swap Quotes

Rate Term (Years)	Floating Rate	20-Year Amortization		
		3-Month	6-Month	12-Month
2-Year	LIBOR + 2.00%	2.37%	2.43%	2.61%
3-Year	LIBOR + 2.00%	2.57%	2.66%	2.87%
4-Year	LIBOR + 2.00%	2.80%	2.89%	3.09%
5-Year	LIBOR + 2.00%	2.99%	3.08%	3.28%
6-Year	LIBOR + 2.00%	3.16%	3.24%	3.42%
7-Year	LIBOR + 2.00%	3.30%	3.37%	3.53%
8-Year	LIBOR + 2.00%	3.40%	3.47%	3.61%
9-Year	LIBOR + 2.00%	3.48%	3.55%	3.68%
10-Year	LIBOR + 2.00%	3.55%	3.61%	3.74%
12-Year	LIBOR + 2.00%	3.65%	3.70%	3.81%
15-Year	LIBOR + 2.00%	3.74%	3.79%	3.88%

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	\$141	\$167	\$178	\$186	\$193	\$196	\$198	\$203
3-Year	\$160	\$221	\$247	\$267	\$282	\$289	\$294	\$304
4-Year		\$254	\$301	\$336	\$364	\$377	\$385	\$404
5-Year		\$266	\$340	\$396	\$438	\$459	\$472	\$502
6-Year			\$364	\$444	\$507	\$537	\$555	\$599
7-Year			\$372	\$483	\$568	\$609	\$633	\$694
8-Year				\$510	\$621	\$676	\$708	\$787
9-Year				\$526	\$668	\$737	\$777	\$878
10-Year				\$532	\$707	\$792	\$842	\$967
12-Year	Fee Income Generation Only Possible With				\$763	\$887	\$959	\$1,138
15-Year	Back-to-Back Swaps and SMART Loan Products				\$796	\$989	\$1,101	\$1,382

Macro-Hedging

Protection Against Rising Rates							
3mL Pay Fixed Swap		3-Month LIBOR Caps - Premium in Basis Points					
2-Year	0.38%	Pay Fix, quarterly, act/360 both sides	Strike	2-Year	3-Year	4-Year	5-Year
3-Year	0.57%		0.30%	0.49%	1.14%	2.51%	4.15%
4-Year	0.82%		0.50%	0.42%	0.93%	2.13%	3.62%
5-Year	1.05%		0.75%	0.38%	0.76%	1.78%	3.07%

Protection Against Falling Rates							
Prime Rcv Fixed Swap		3-Month LIBOR Floors - Premium in Basis Points					
2-Year	3.19%	Receive fixed, monthly, act/365 both sides	Strike	2-Year	3-Year	4-Year	5-Year
3-Year	3.36%		0.25%	0.52%	0.74%	0.86%	0.99%
4-Year	3.59%		0.15%	0.43%	0.63%	0.73%	0.85%
5-Year	3.79%		0.10%	0.41%	0.60%	0.70%	0.81%

Contact Information - Toll Free 800-786-2883 or www.VSIRP.com

Rick Redmond (901) 766-3382 rredmond@vsirp.com	Katharine Bray (901) 766-3384 kbray@vsirp.com	Walt Robison (901) 766-3389 wrobison@vsirp.com	Tommy Warren (864) 915-6675 twarren@vsirp.com	Battle Beasley (901) 766-3383 bbeasley@vsirp.com
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