

## THROWING AWAY MARGIN

*This Day in History: Today is National Clean Out Your Refrigerator Day. On November 15, 1939, President Franklin Roosevelt laid the cornerstone for the Jefferson Memorial. In 1970, legendary football coach Paul Brown led the upstart Cincinnati Bengals to a 14-10 victory against his namesake Cleveland Browns.*

**The release of higher than expected CPI data had many implications for the financial markets: a terrible 10 year note auction and dramatically increased interest rate volatility as term rates increased. Swap rates closed the week sharply higher across the curve.**

Term	Swap Rates			Change	
	11/12/2021	11/5/2021	10/12/2021	WoW	MoM
2y	0.76	0.60	0.47	0.16	0.29
3y	1.05	0.86	0.76	0.19	0.28
5y	1.32	1.15	1.15	0.17	0.17
7y	1.48	1.33	1.39	0.16	0.09
10y	1.62	1.48	1.60	0.14	0.02
20y	1.77	1.68	1.85	0.10	-0.07
2s/10s slope	0.86	0.88	1.13	-0.02	-0.27

**Loan hedging and creating floating rate munis continue to dominate desk activity. We have seen increased interest in borrowers requesting to lock in future fixed rates as they are concerned this upward trend in rates will continue.**

Virtually any survey of community bankers reveals the greatest financial concern going into 2022 is margin compression. The reasons for the concern include record levels of liquidity earning virtually nothing, cash flow from existing assets being reinvested at lower rates, and deposit rates at or near floors. While there are steps that can be taken to improve margins even in this difficult environment, there exists a hidden detriment to margins that the volatility of last week brings into focus. Let's look at the primary loan for many community banks, the 5-year fixed rate commercial real estate loan and consider the interest rate volatility of last week to explore the hidden risk.

Most banks commit to a fixed rate at some point in the underwriting process and give the borrower 30 to 45 days to close. The offered rate is determined by considering several factors including competition, term, credit risk, borrower characteristics, etc. For simplicity, we will assume the rate is based on a spread to the 5-year swap rate, but the index used is irrelevant. Last week, the spread between the high and low of that rate was approximately 20 basis points. If a lender committed at the low of rates, a \$5 million loan closed a few days later could have been 20 basis points underwater at closing, resulting in a loss of interest income and margin of approximately \$10,000 per year for 5 years. A similar bond would have a market value loss that

recognizes this lower future income while the economic loss related to the loan is realized over its life via lower income.

Some bankers may argue there will be equal gains over time resulting from rates declining after the commitment of a fixed rate. We would disagree and reference an unhedged mortgage pipeline: mortgage lenders will tell you stable or rising rates result in most approved loans closing while fallout increases greatly if rates decline; the free option given to borrowers almost always results in negative impacts for the lender.

One of the benefits of a loan hedging program is the rate is set for the bank and borrower at closing. Consequently, the bank will receive a market rate based on rates at time of closing and not have a hidden loss that impacts earnings for years to come. Having a hedging program in place allows the lender to offer longer term loans, generally resulting in less competition and the potential to increase spreads and earnings.

Contact your relationship manager or us to set up a time to learn how we can help improve earnings by offering a well-priced product that meets customer demand.

Stay safe and have a great week!

**Vining Sparks Interest Rate Products, LLC**

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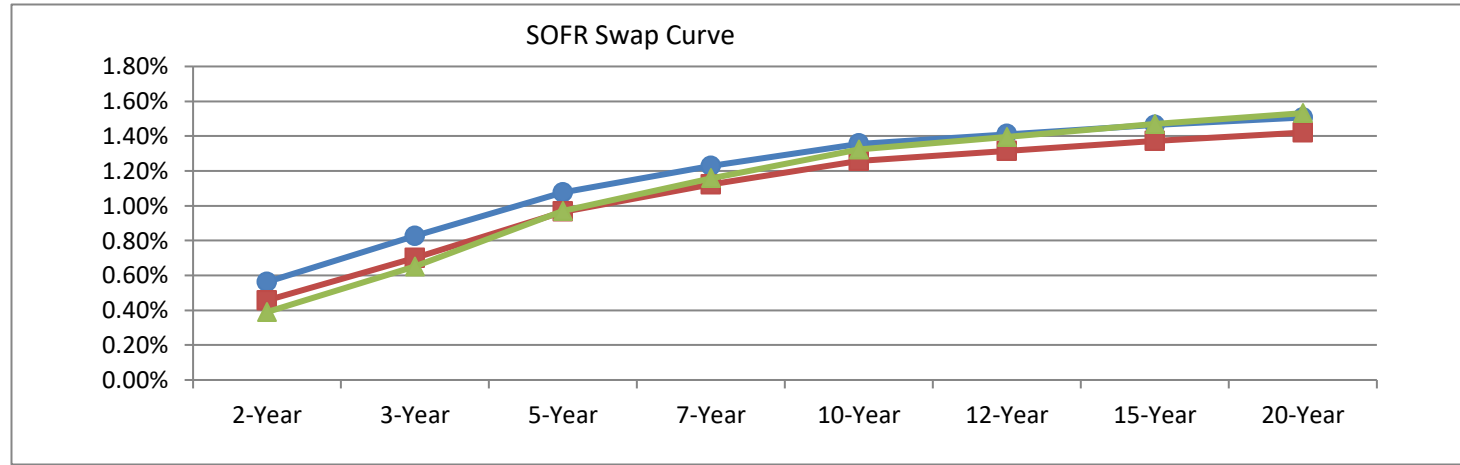
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### Interest Rate Swap Curves

	SOFR Swap Curve		
	Current	Last Week	Last Month
2-Year	0.563%	0.457%	0.390%
3-Year	0.827%	0.700%	0.651%
5-Year	1.076%	0.966%	0.970%
7-Year	1.230%	1.123%	1.158%
10-Year	1.356%	1.257%	1.323%
12-Year	1.411%	1.316%	1.396%
15-Year	1.463%	1.372%	1.469%
20-Year	1.507%	1.420%	1.532%

\*Bloomberg mid-market quotations



Money Market Rates		SOFR Forward Rates	
1M LIBOR	0.09113%	Sep-21	0.04750%
3M LIBOR	0.15788%	Dec-21	0.05750%
6M LIBOR	0.22538%	Mar-22	0.11000%
12M LIBOR	0.39425%	Jun-22	0.28000%
Prime	3.25000%	Sep-22	0.49000%
FFTR	0.2500%		
Eff FF	0.0800%		
SOFR	0.0500%		

### 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	SOFR	0.56%	0.62%	0.64%	0.65%	0.66%	0.66%	0.66%	0.67%
3-Year	SOFR	0.66%	0.82%	0.87%	0.90%	0.92%	0.93%	0.93%	0.94%
4-Year	SOFR		0.92%	0.99%	1.04%	1.06%	1.08%	1.08%	1.10%
5-Year	SOFR		0.95%	1.06%	1.12%	1.16%	1.17%	1.17%	1.19%
6-Year	SOFR			1.11%	1.19%	1.23%	1.24%	1.25%	1.27%
7-Year	SOFR			1.12%	1.23%	1.28%	1.30%	1.32%	1.34%
8-Year	SOFR				1.26%	1.33%	1.35%	1.36%	1.39%
9-Year	SOFR				1.27%	1.36%	1.39%	1.40%	1.43%
10-Year	SOFR				1.28%	1.38%	1.42%	1.43%	1.47%
12-Year	SOFR					1.41%	1.46%	1.48%	1.51%
15-Year	SOFR					1.43%	1.50%	1.52%	1.57%

Customer Pays Fixed, Monthly, Act/360  
Customer Receives SOFR

### Forward Starting Swap Quotes

Rate Term (Years)	Floating Rate	20-Year Amortization		
		3-Month	6-Month	12-Month
2-Year	SOFR	0.80%	0.95%	1.24%
3-Year	SOFR	1.03%	1.14%	1.35%
4-Year	SOFR	1.16%	1.25%	1.41%
5-Year	SOFR	1.25%	1.32%	1.46%
6-Year	SOFR	1.31%	1.38%	1.50%
7-Year	SOFR	1.37%	1.43%	1.53%
8-Year	SOFR	1.41%	1.46%	1.56%
9-Year	SOFR	1.44%	1.49%	1.58%
10-Year	SOFR	1.46%	1.51%	1.59%
12-Year	SOFR	1.50%	1.54%	1.62%
15-Year	SOFR	1.53%	1.57%	1.63%

### 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	\$187	\$193	\$196	\$198	\$202
3-Year	\$159	\$221	\$247	\$267	\$282	\$289	\$293	\$302
4-Year		\$254	\$301	\$336	\$363	\$376	\$383	\$400
5-Year		\$265	\$340	\$395	\$438	\$458	\$470	\$497
6-Year			\$364	\$444	\$506	\$536	\$553	\$592
7-Year			\$372	\$483	\$568	\$609	\$633	\$686
8-Year				\$511	\$623	\$677	\$708	\$778
9-Year				\$528	\$671	\$740	\$780	\$869
10-Year				\$534	\$712	\$798	\$847	\$958
12-Year					\$772	\$897	\$970	\$1,131
15-Year					\$807	\$1,007	\$1,123	\$1,381

Fee Income Generation Only Possible With Back-to-Back Swaps and SMART Loan Products

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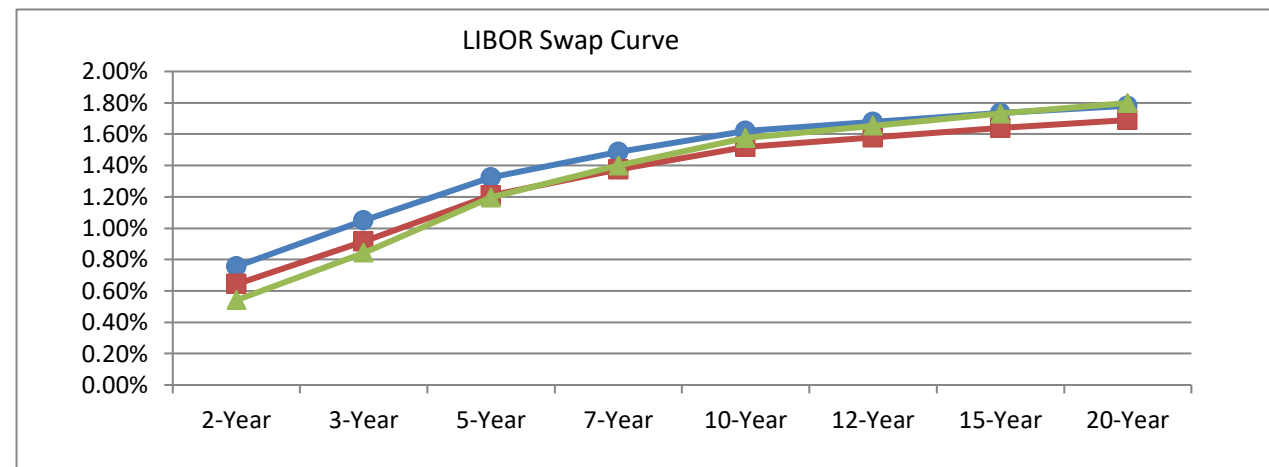
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### Interest Rate Swap Curves

	LIBOR Swap Curve		
	Current	Last Week	Last Month
2-Year	0.756%	0.643%	0.541%
3-Year	1.049%	0.916%	0.844%
5-Year	1.322%	1.208%	1.196%
7-Year	1.487%	1.376%	1.400%
10-Year	1.622%	1.517%	1.576%
12-Year	1.679%	1.579%	1.654%
15-Year	1.734%	1.639%	1.731%
20-Year	1.781%	1.690%	1.799%



Money Market Rates		3M LIBOR Forward Rates	
1M LIBOR	0.09113%	Dec-21	0.21000%
3M LIBOR	0.15788%	Mar-22	0.25500%
6M LIBOR	0.22538%	Jun-22	0.45000%
12M LIBOR	0.39425%	Sep-22	0.67000%
Prime	3.25000%	Dec-22	0.93500%
FFTR	0.2500%		
Eff FF	0.0800%		
SOFR	0.0500%		

\*Bloomberg mid-market quotations

### 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	Prime	3.76%	3.81%	3.83%	3.85%	3.86%	3.86%	3.86%	3.87%
3-Year	Prime	3.86%	4.02%	4.07%	4.10%	4.12%	4.13%	4.14%	4.15%
4-Year	Prime		4.11%	4.19%	4.22%	4.24%	4.25%	4.25%	4.26%
5-Year	Prime		4.14%	4.25%	4.29%	4.33%	4.35%	4.35%	4.37%
6-Year	Prime			4.29%	4.36%	4.41%	4.42%	4.43%	4.45%
7-Year	Prime			4.30%	4.41%	4.46%	4.48%	4.50%	4.53%
8-Year	Prime				4.44%	4.51%	4.54%	4.56%	4.60%
9-Year	Prime				4.45%	4.55%	4.59%	4.61%	4.60%
10-Year	Prime				4.46%	4.58%	4.61%	4.61%	4.62%
12-Year	Prime					4.62%	4.62%	4.64%	4.71%
15-Year	Prime					4.62%	4.67%	4.72%	4.73%

Customer Pays Fixed, Monthly, Act/360  
Customer Receives Prime

### Forward Starting Swap Quotes

Rate Term (Years)	Floating Rate	20-Year Amortization		
		3-Month	6-Month	12-Month
2-Year	Prime	4.02%	4.17%	4.43%
3-Year	Prime	4.24%	4.34%	4.52%
4-Year	Prime	4.34%	4.42%	4.57%
5-Year	Prime	4.42%	4.50%	4.63%
6-Year	Prime	4.49%	4.56%	4.67%
7-Year	Prime	4.55%	4.60%	4.70%
8-Year	Prime	4.60%	4.65%	4.74%
9-Year	Prime	4.64%	4.69%	4.77%
10-Year	Prime	4.66%	4.70%	4.78%
12-Year	Prime	4.67%	4.70%	4.77%
15-Year	Prime	4.70%	4.74%	4.80%

### 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	\$187	\$193	\$196	\$198	\$202
3-Year	\$159	\$221	\$247	\$267	\$282	\$289	\$293	\$302
4-Year		\$254	\$301	\$336	\$363	\$376	\$383	\$400
5-Year		\$265	\$340	\$395	\$438	\$458	\$470	\$497
6-Year			\$364	\$444	\$506	\$536	\$553	\$592
7-Year			\$372	\$483	\$568	\$609	\$633	\$686
8-Year				\$511	\$623	\$677	\$708	\$778
9-Year				\$528	\$671	\$740	\$780	\$869
10-Year				\$534	\$712	\$798	\$847	\$958
12-Year					\$772	\$897	\$970	\$1,131
15-Year					\$807	\$1,007	\$1,123	\$1,381

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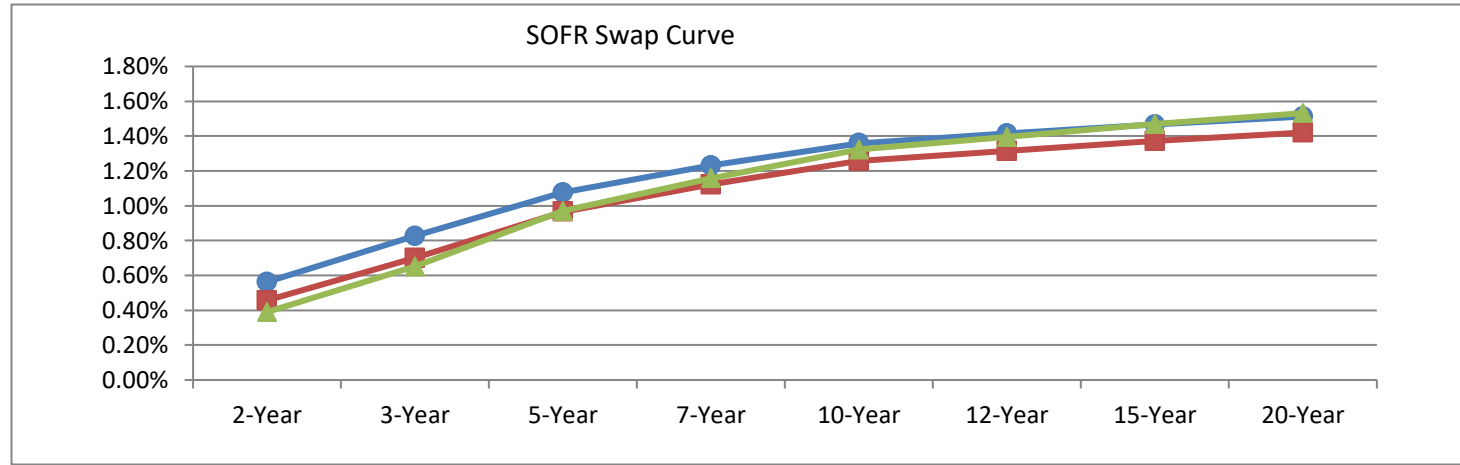
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### Interest Rate Swap Curves

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3-Year	0.826%	0.700%	0.651%
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\*Bloomberg mid-market quotations



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FFTR	0.2500%		
Eff FF	0.0800%		
SOFR	0.0500%		

### 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	EFF	0.62%	0.68%	0.70%	0.71%	0.72%	0.73%	0.73%	0.73%
3-Year	EFF	0.72%	0.88%	0.93%	0.96%	0.98%	0.99%	0.99%	1.00%
4-Year	EFF		0.98%	1.05%	1.10%	1.12%	1.14%	1.14%	1.16%
5-Year	EFF		1.01%	1.12%	1.18%	1.21%	1.23%	1.23%	1.25%
6-Year	EFF			1.16%	1.24%	1.28%	1.29%	1.30%	1.32%
7-Year	EFF			1.18%	1.28%	1.34%	1.36%	1.37%	1.39%
8-Year	EFF				1.31%	1.37%	1.40%	1.41%	1.43%
9-Year	EFF				1.32%	1.41%	1.43%	1.45%	1.47%
10-Year	EFF				1.33%	1.43%	1.47%	1.48%	1.52%
12-Year	EFF	Customer Pays Fixed, Monthly, Act/360				1.47%	1.51%	1.53%	1.56%
15-Year	EFF	Customer Receives Prime				1.48%	1.55%	1.57%	1.62%

### Forward Starting Swap Quotes

Rate Term (Years)	Floating Rate	20-Year Amortization		
		3-Month	6-Month	12-Month
2-Year	EFF	0.87%	1.01%	1.30%
3-Year	EFF	1.10%	1.20%	1.40%
4-Year	EFF	1.22%	1.31%	1.47%
5-Year	EFF	1.30%	1.38%	1.51%
6-Year	EFF	1.36%	1.43%	1.55%
7-Year	EFF	1.42%	1.48%	1.58%
8-Year	EFF	1.45%	1.51%	1.60%
9-Year	EFF	1.49%	1.54%	1.63%
10-Year	EFF	1.51%	1.56%	1.64%
12-Year	EFF	1.55%	1.59%	1.66%
15-Year	EFF	1.58%	1.62%	1.68%

### Profitability Analysis

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8-Year				\$511	\$623	\$677	\$708	\$778
9-Year				\$528	\$671	\$740	\$780	\$869
10-Year				\$534	\$712	\$798	\$847	\$958
12-Year	Fee Income Generation Only Possible With				\$772	\$897	\$970	\$1,131
15-Year	Back-to-Back Swaps and SMART Loan Products				\$807	\$1,007	\$1,123	\$1,381

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