A borrower's loan rate is composed of two inputs: A) index, plus B) spread.

INDEX

For example, if the borrower wants a floating rate loan, the index may be Prime or 1-month term SOFR. If the borrower wants a fixed-rate loan, the index is typically a hedge rate. The hedge rate would correspond to the borrower's fixed term. For example, if the borrower wants a 10-year fixed rate, the index would be the 10-year hedge rate. The index is a market-driven rate and cannot be controlled by banks.

SPREAD

The spread represents the margin that the bank is willing to accept for the loan and compensates the bank for possible credit losses, overhead costs, and return on capital (profit for the bank). The bank, subject to competitive forces, will establish the spread based on loan size, credit quality, and total customer relationship profitability (fee income and deposits that the bank expects to generate as ancillary business).

EXAMPLE

The table below demonstrates hedge rates at a moment in time for various commercial structures. For example, the 25-year amortizing, 10-year fixed hedge index is 3.75%. If the bank wants to price with a 2.50% spread, then the borrower's rate is 6.25%. The bank will earn 1-month SOFR plus 2.50%. If the bank wants to earn 1-month SOFR plus 2.00%, the borrower's fixed rate would be 5.75%. If the borrower's fixed rate for the same structure is 5.00%, then the bank will earn 1-month SOFR plus 1.25% (5.00% minus 3.75%).

Amort.	Maturity										
	3yr	4yr	5yr	6yr	7yr	8yr	9yr	10yr	12yr	15yr	20yr
3yr	4.73%	-	-	-	-	-	-	-	-	-	-
5yr	4.53%	4.39%	4.35%	-	-	-	-	-	-	-	-
7yr	4.47%	4.29%	4.19%	4.14%	4.11%	-	-	-	-	-	-
10yr	4.44%	4.23%	4.11%	4.02%	3.98%	3.95%	3.94%	3.93%	-	-	-
15yr	4.41%	4.20%	4.05%	3.97%	3.90%	3.86%	3.82%	3.81%	3.77%	3.77%	-
20yr	4.40%	4.17%	4.02%	3.93%	3.87%	3.81%	3.78%	3.77%	3.73%	3.73%	3.71%
25yr	4.40%	4.16%	4.01%	3.92%	3.85%	3.79%	3.76%	3.75%	3.72%	3.71%	3.68%
30yr	4.39%	4.16%	4.00%	3.90%	3.84%	3.78%	3.75%	3.72%	3.71%	3.71%	3.66%