Symmetrical Yield Maintenance

Explaining ARC Prepayment

November 30, 2022

SouthState

1. Symmetrical Yield Maintenance follows a simple formula based on: a) the term left in the loan, and b) the interest rate movement from the time the hedge rate was established at closing to a prepayment event.

2. The fee is the present value of the difference between the starting and ending hedge rate, multiplied by the loan amount for the remaining term of the loan.

3. The prepayment provision is invoked if the borrower prepays or terminates the loan. The borrower collects a fee if rates are higher, but pays a fee if rates are lower.

4. Indicative termination amounts can be quoted by contacting the ARC desk and can be calculated using a simple spreadsheet. The prepayment provision is defined in the Rate Conversion Agreement, and a prepay scenario table (like the one on this page) will be included in each borrower presentation and in the signed ARC Agreement.

Subject Loan: A $1,000,000 loan is structured as a 10 year final maturity with a 25 year mortgage amortization, with a 6.000% fixed rate where the initial hedge rate is 4.000%.

If 3 years into the loan, the then current 7 year hedge rate is 25 bps lower than the starting hedge rate and the borrower prepays the entire loan, the borrower will pay $13,506. Partial prepayments work similarly on a proportional basis. However, the borrower and lender will have the option to apply the loan to a new project/ property and the repayment will not apply.

If 3 years into the loan, the then current 7 year hedge rate is 25 bps higher than the starting hedge rate and the borrower prepays the entire loan, the borrower will receive $13,288. Partial prepayments work similarly on a proportional basis.

Initial Hedge Rate:	4.000%
Loan Spread:	2.000%
All-in Fixed Rate:	6.000%

Remaining Term	Prepayment Hedge Rate vs. Initial Hedge Rate -75 bps	-50 bps	-25 bps	0 bps	+25 bps	+50 bps	+75 bps
10 years	(58,061)	(38,274)	(18,924)	-	18,507	36,607	54,311
9 years	(52,801)	(34,840)	(17,242)	-	16,894	33,446	49,666
8 years	(47,005)	(31,047)	(15,381)	-	15,101	29,928	44,486
7 years	(41,185)	(27,233)	(13,506)	-	13,288	26,362	39,225
6 years	(35,332)	(23,388)	(11,611)	-	11,448	22,737	33,867
5 years	(29,452)	(19,518)	(9,701)	-	9,586	19,057	28,417
4 years	(23,538)	(15,616)	(7,770)	-	7,695	15,316	22,863
3 years	(17,635)	(11,713)	(5,835)	-	5,792	11,541	17,247
2 years	(11,739)	(7,806)	(3,893)	-	3,873	7,727	11,562
1 years	(5,862)	(3,903)	(1,949)	-	1,943	3,882	5,815

6. Borrower's views on rates- If the borrower believes that interest rates will rise or remain steady, this prepayment provision is an advantage.

7. Financing cost neutrality- If rates fall, upon the termination of the hedge, the borrower owes a fee, but that cost would be offset by the savings the borrower will realize by retaining the floating rate or locking in another fixed rate loan for the remaining life at the then prevailing lower rate.

8. Balance sheet financing for borrowers – With the bank's underwriting approval, the borrower can blend and extend new money, new term, or new amortization without invoking a prepayment. The borrower can also substitute collateral, bifurcate the loan or a new borrower can assume the loan. No other lending product offers such flexibility (but subject to bank approval).

9. 1031 exchange or assumption – Without invoking the prepayment provision, a borrower can substitute collateral using a 1031 exchange, or a new borrower can assume the loan and hedge (subject to the bank's credit approval). This is done via a simple amendment to the Rate Conversion Agreement. This hedge portability is not found in traditional ISDA swaps or most conventional loan products.

10. Alignment with the borrower's outlook - The borrower is given an option on the term that best suits their business needs. If held to maturity, borrower will not invoke the prepayment provision and may ignore market volatility. Giving borrowers the ability to choose loan terms is a positive differentiator.

11. A/B Structure- The loan principal balance is divided into two (or more) loans. Loan A is hedged and subject to the prepayment provision, and Loan B is unhedged, and typically is a shorter-term or adjustable facility, and subject to the bank's standard prepayment provision. The borrower now has the option to prepay Loan B when desired without invoking the ARC prepayment provision. When rates rise, either loan can be prepaid because the borrower would collect a fee when prepaying the hedged loan.

12. Convert to declining balance prepay - Option 1- ARC side agreement, your bank takes the mismatch between the symmetrical prepayment and declining balance payment. Option 2- For larger loans ($4MM and over) the borrower can purchase a prepayment option, but this increases the borrower's hedge rate.

13. Partial term hedge- Loan is hedged for less than the full term. (eg. a 10 year term, a hedge is 7 years, and the bank matches the fixed rate on in-house fixed for the remaining 3-year term)- the post-hedge portion of the loan will have a lesser balance and (presumably) carry a higher probability of prepayment, thereby posing less duration risk for the bank, and those final 3 years do not require a symmetrical prepayment provision.

Questions?

DISCLAIMER

In addition to any specific risks discussed herein, there are other factors that may influence the performance of an interest rate hedge product.

Counterparty Risk – the risk that the counterparty will not perform pursuant to the contract terms. Borrowers should carefully assess counterparty risk when engaging in such a transaction as described herein.

Basis Risk – the risk that the floating rate interest payments made on the loan and the floating rate interest payments received on the hedge contract could be mismatched, specifically if the floating rate indices, spreads, and other terms are not exact.

Amortization Risk – the risk of the potential mismatch between the outstanding principal amount of the loan and the outstanding notional amount of the hedge. Amortization mismatches could also result in termination of portions of the hedge prior to maturity and under unfavorable conditions.

Termination Risk – the risk that the hedge could be terminated as a result of certain events including payment default or other defined events of default. A termination of a hedge may result in payment received by the borrower or owed to the Bank depending on the market at the time of termination.

Prior to entering into any interest rate hedge transaction, recipients should determine, in consultation with their own legal, tax, regulatory, and accounting advisors, the economic risks and merits, as well as the legal, tax, regulatory and accounting characteristics and consequences of any transaction.

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