

Nashville Lender Lunch

Hosted by SouthState Bank



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Lending Strategies for the Current Environment





Meeting Agenda

- **Current Environment**
- **Strategies for the Current Environment**
- **ARC Program Overview**
- **ARC Strategies to Retain Profitable Relationships**

Current Environment

Inverted Yield Curve, Fed Rate Cuts are Already Priced In





Prime	8.50%
Fed Funds Target Overnight Rate	5.25% - 5.50%
1-month Term SOFR	5.32%
Swap Rates	
3 year	4.56%
4 year	4.41%
5 year	4.30%
7 Year	4.22%
10 year	4.17%
20 year	4.15%



Where are Rates Headed?

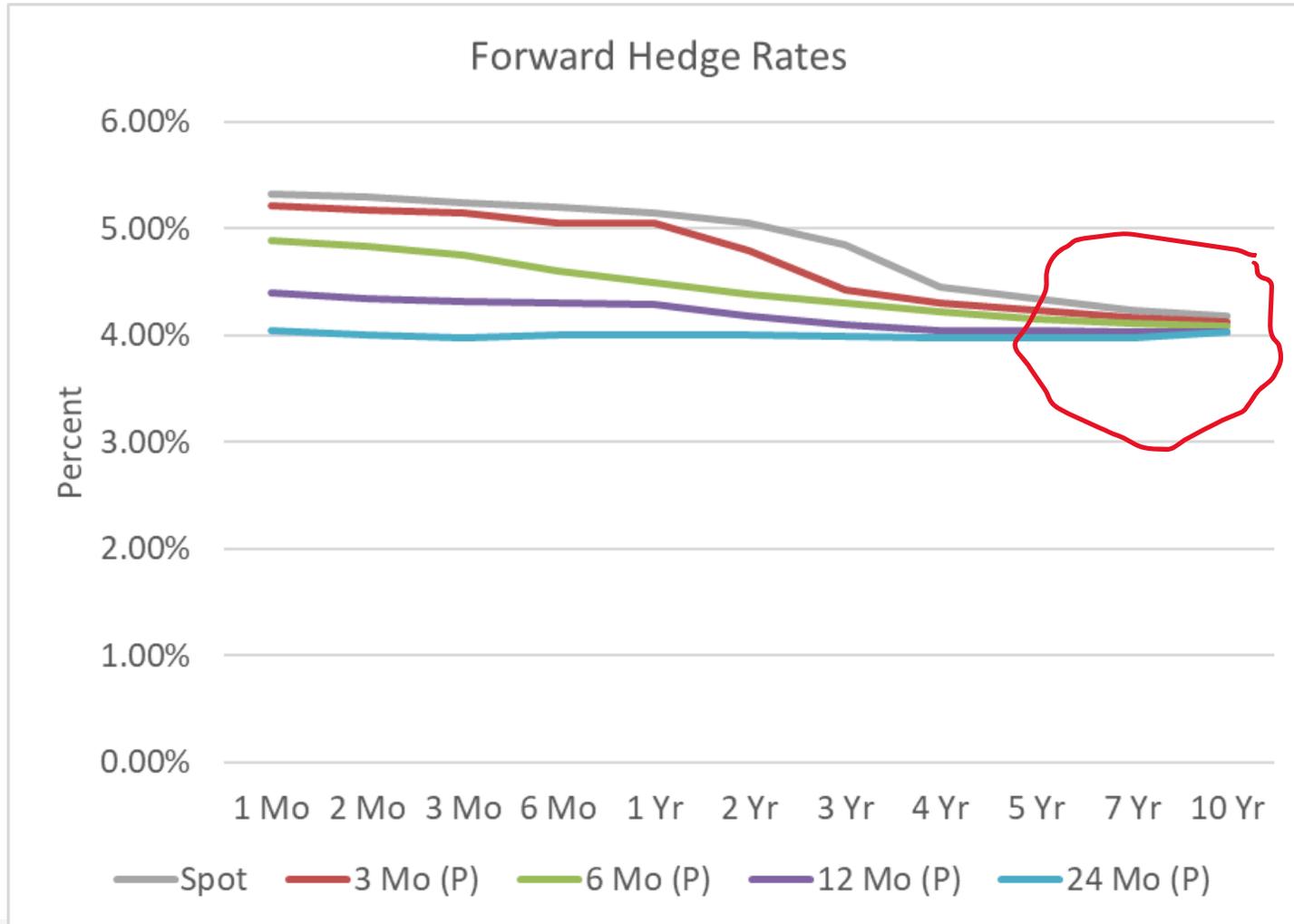
CME FEDWATCH TOOL - MEETING PROBABILITIES								
MEETING DATE	350-375	375-400	400-425	425-450	450-475	475-500	500-525	525-550
5/1/2024			0.0%	0.0%	0.0%	0.0%	3.9%	96.1%
6/12/2024	0.0%	0.0%	0.0%	0.0%	0.0%	0.5%	16.4%	83.0%
7/31/2024	0.0%	0.0%	0.0%	0.0%	0.2%	5.5%	37.1%	57.3%
9/18/2024	0.0%	0.0%	0.0%	0.1%	2.4%	18.7%	45.6%	33.2%
11/7/2024	0.0%	0.0%	0.0%	0.7%	6.6%	25.7%	42.4%	24.7%
12/18/2024	0.0%	0.0%	0.3%	3.5%	15.6%	33.5%	34.1%	13.1%
1/29/2025	0.0%	0.1%	1.4%	7.5%	21.5%	33.7%	27.1%	8.7%
3/19/2025	0.1%	0.7%	4.0%	13.5%	26.8%	30.9%	19.2%	5.0%
4/30/2025	0.2%	1.6%	6.7%	17.2%	27.9%	27.6%	15.2%	3.6%

Swap Rates	Yield Discount
3 year 4.56%	0.76%
4 year 4.41%	0.91%
5 year 4.30%	1.02%
7 year 4.22%	1.10%
10 year 4.17%	1.15%
20 year 4.15%	1.17%

<https://www.cmegroup.com/markets/interest-rates/cme-fedwatch-tool.html?redirect=/trading/interest-rates/countdown-to-fomc.html>



Future Fed Rate Cuts are Already Priced In



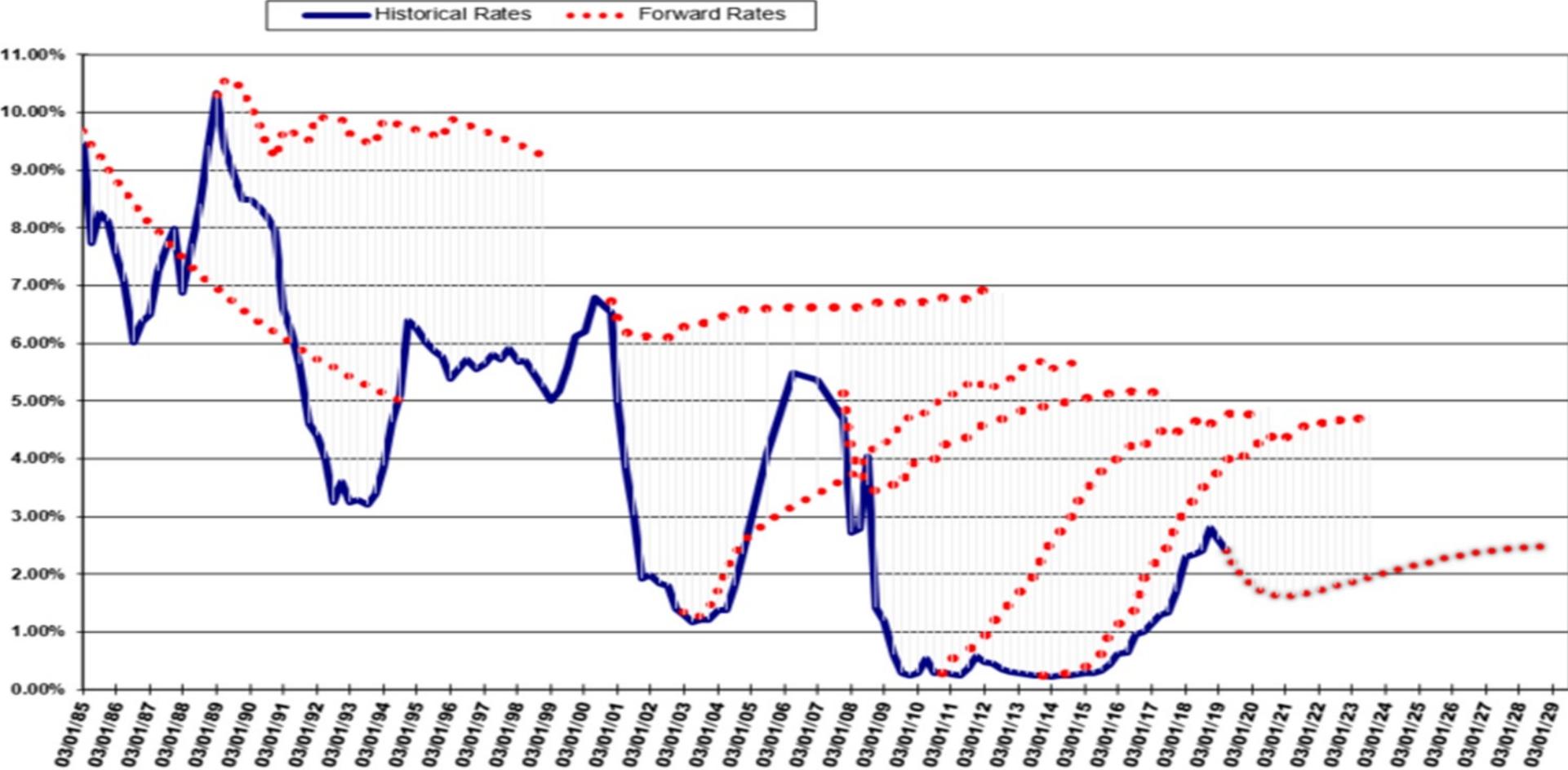
Term rates are expected to drop very little over the next 2 years.

In other words, *rate cuts are already priced in!*
There is no need to “wait”.



Market Expectations vs. Actual

Markets are historically bad at predicting the future



Strategies for the Current Environment



How Hedging can Help You Benefit From an Inverted Yield Curve





Traditional Fixed vs. Hedged Alternative

<u>Traditional In-House Fixed</u>		<u>Hedged Example Solving for 8% Yield to the Bank</u>	
Prime minus 1/2%		SOFR + 2.68%	
Fixed 2 to 5 years		Fixed 10 years	
25 year am		25 year am	
Yield to the Bank	8.00%	Yield to the Bank	8.00% (current SOFR 5.32%+2.68%)
Fixed Rate to Borrower	8.00%	<u>20 bp hedge fee income</u>	<u>1.40%</u> (pv of 20 bps over 10 years paid up front)
No additional fee income			9.40% (assuming 5.32% SOFR)
		Fixed Rate to Borrower	7.05%



Traditional Fixed vs. Hedged Alternative

<u>Traditional In-House Fixed</u>		<u>Hedged Example Solving for 8% Fixed for the Borrower</u>	
Prime minus 1/2%		SOFR +3.63%	
Fixed 2 to 5 years		Fixed 10 years	
25 year am		25 year am	
Yield to the Bank	8.00%	Yield to the Bank	8.95% (current SOFR 5.32%+3.63%)
Fixed Rate to Borrower	8.00%	20 bp hedge fee income	1.40% (pv of 20 bps over 10 years paid up front)
No additional fee income			10.35% (assuming 5.32% SOFR)
		Fixed Rate to Borrower	8.00%

ARC Program Overview

All the benefits of a large bank hedging program without the headaches





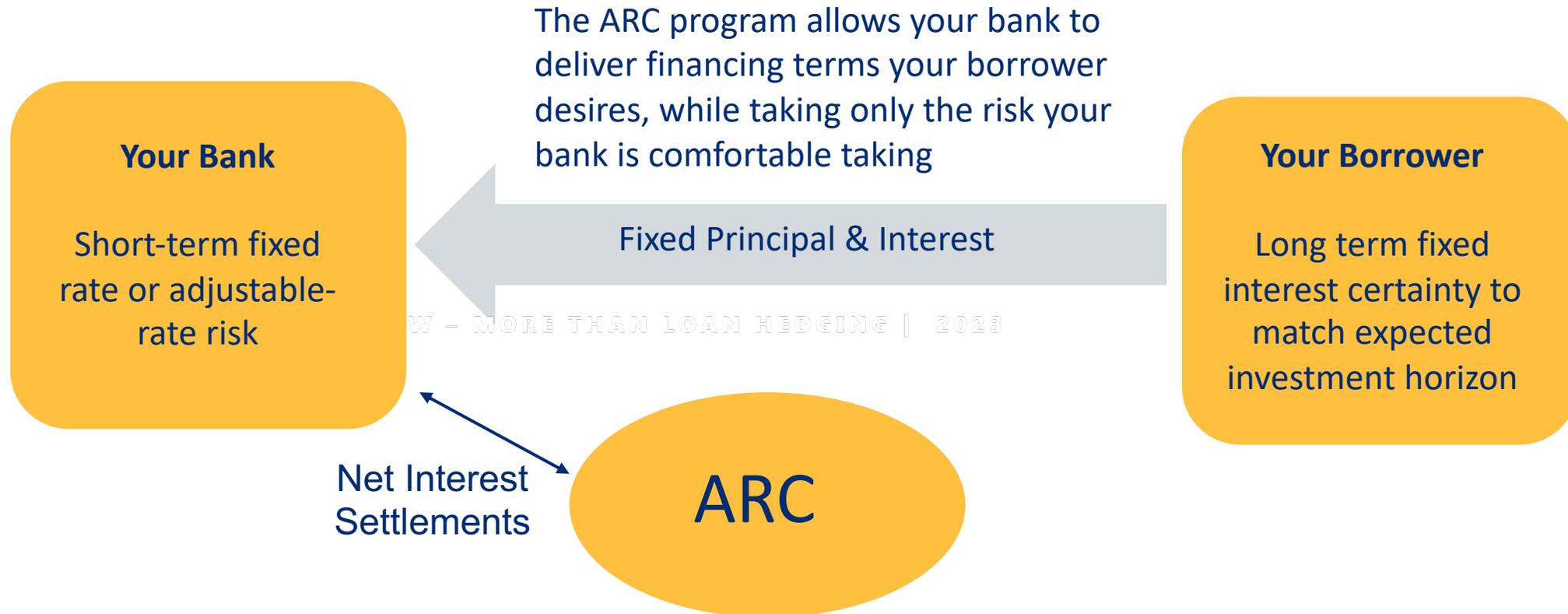
What if you had a tool that allowed you to...

- ✓ Earn up to 1% or more initial yield
- ✓ Expand your product offering
- ✓ Provided your lenders with a competitive advantage
- ✓ Compete for larger relationship loans
- ✓ Generate significant fee income of up to 2% or more
- ✓ Reduce risk for your bank and your borrower



Best Risk for your Bank ~~vs.~~ Best Risk for your Borrower

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ARC was Developed for Community Banks and Borrowers

All the benefits of a large bank hedging program without the headaches:

- ✓ No derivative on your books
- ✓ Simple and clear documentation (No ISDA)
- ✓ Plain English risk disclosures
- ✓ No daily collateral posting, accounting, regulatory reporting
- ✓ Borrowers make one payment to your bank
- ✓ Flexible prepayment and modification options
- ✓ Fee income



ARC Pricing

Bank Earns = 1-month Term SOFR + Credit Spread

Borrower Pays = Fixed ARC Rate + Credit Spread

Amort.	Maturity										
	3yr	4yr	5yr	6yr	7yr	8yr	9yr	10yr	12yr	15yr	20yr
3yr	4.82%	-	-	-	-	-	-	-	-	-	-
5yr	4.66%	4.57%	4.55%	-	-	-	-	-	-	-	-
7yr	4.62%	4.50%	4.44%	4.41%	4.39%	-	-	-	-	-	-
10yr	4.59%	4.46%	4.39%	4.33%	4.31%	4.29%	4.29%	4.28%	-	-	-
15yr	4.57%	4.43%	4.34%	4.29%	4.25%	4.23%	4.21%	4.21%	4.18%	4.19%	-
20yr	4.56%	4.41%	4.31%	4.26%	4.24%	4.20%	4.19%	4.18%	4.16%	4.17%	4.17%
25yr	4.56%	4.41%	4.30%	4.26%	4.22%	4.19%	4.17%	4.17%	4.15%	4.16%	4.15%
30yr	4.56%	4.40%	4.30%	4.26%	4.21%	4.18%	4.15%	4.15%	4.15%	4.16%	4.14%

Example: 25/10y Bank Note Priced at SOFR + 2.00% (Currently 5.32% + 2.00% = 7.32%)

Borrower Pays Fixed ARC Rate + 2.00% (4.17% + 2.00% = 6.17% Fixed)



Symmetrical Prepayment Provisions

Initial balance:	\$ 1,000,000
Amortization Term (yrs):	20
Commitment Term:	5
Initial Hedge Rate:	4.31%
Fixed Rate to Borrower:	6.31%
Starting Date:	4/3/24

Prepayment Hedge Rate vs. Initial Hedge Rate

Remaining Term	-0.75%	-0.50%	-0.25%	0%	0.25%	0.50%	0.75%
	3.560%	3.810%	4.06%	4.31%	4.56%	4.8100%	5.060%
5yrs	(\$32,504)	(\$21,540)	(\$10,706)	\$0	\$10,579	\$21,034	\$31,365
4yrs	(\$26,035)	(\$17,273)	(\$8,595)	\$0	\$8,512	\$16,942	\$25,291
3yrs	(\$19,538)	(\$12,977)	(\$6,464)	\$0	\$6,417	\$12,786	\$19,109
2yrs	(\$13,023)	(\$8,660)	(\$4,319)	\$0	\$4,297	\$8,573	\$12,827
1yrs	(\$6,506)	(\$4,331)	(\$2,163)	\$0	\$2,157	\$4,308	\$6,454



Fee Calculator

Basis points fee	0.25%	Input	% of loan amount	2.25%
Initial balance:	\$ 1,000,000			
Amortization Term (yrs):	25			
Commitment Term:	20			
Initial Hedge Rate:	4.87%			
Fixed Rate to Borrower:	6.87%			
Starting Date:	11/5/23			
Approximate ARC Referral Fee:	22,499	Output		



ARC Program Recent Deal Stats

Average Deal Size: \$2.71mm

Average Term: 4.5 years, before curve inversion this was 10.7 years

Credit Quality: 1.65x DSCR
62% LTV
Zero past due credits

Average ARC Fee: 1.4% of initial principal (\$37,940 current income)



ARC Advantage – Relationship Lending

- ✓ **Rate Portability** – borrower can replace collateral with another suitable property
- ✓ **Loan Assumability** – ARC hedges can be moved to a new borrower
- ✓ **Blend and Extend** – borrowers needing additional financing can keep their current hedge rate if rates are higher, or enjoy a lower blended fixed rate in a lower rate scenario
- ✓ **Symmetrical Prepayment Provisions** – borrower may choose to terminate the hedge and get paid the positive value of the remaining if rates are higher, or pay the negative hedge value if rates are lower, and the sale or refinancing opportunity outweighs the cost

ARC Strategies to Retain Profitable Relationships



Protect Your Most Valuable Relationship While Boosting Returns





Protect Your Valuable Relationships – Strategic Refinancing

Example: Focus borrower has a current fixed-rate loan on the books at 5%, maturing in 1 year

Current Loan \$3,000,000

Collateral: Long-term CRE

Fixed Rate: 5.00%

Matures: in 1 year

Current rate if refinanced today:

Prime – ½% = 8%

Where will Prime be in 1 year?

Proactive Refinance with ARC \$3,000,000

Terminate existing loan and replace with a 10 year Note that is fixed at 5% for 1 year, then converts to SOFR + 2.50% (approx. Prime – 1/2%)

Borrower pays 5% fixed, then 6.80% fixed for remaining 9 years

Pricing includes 25 bps for hedge fees = \$43,428 or 1.45% paid to you from ARC

- ✓ Bank gets additional 1.45% on a loan already funded, plus SOFR + 2.50% floating on remaining 9 years (currently 7.82% yield)
- ✓ Head off competitors and solidify relationship (deposits, credit quality, cross-sell opportunities)
- ✓ Secure DSCR and reduce credit exposure to increased inflation and further Fed rate hikes
- ✓ Being proactive positions lender as trusted advisor



Protect Relationships and Boost Yield Now – Step-up Refinance

Example: Focus borrower has a current fixed-rate loan on the books at 5%, maturing in 1 year

Current Loan \$3,000,000
Collateral: Long-term CRE
Fixed Rate: 5.00%
Matures: in 1 year

Step-up Structure allow your borrower to keep existing 5% fixed, and lock in an attractive refinancing rate 1 year forward, but ALSO converts the 5% fixed rate to a higher floating rate plus a spread for the lending bank.

Step-up Refinance Example: 6 year/ 25 year am, SOFR + 2.50% , +20 bp hedge fee

	Stream 1 (yr 1)	Stream 2 (yrs 2-6)
Borrower Pays	5.00% Fixed	6.95% Fixed
Bank Receives	SOFR + 0.75% (6.07% Currently, Plus \$29k hedge fee (~96 bps))	SOFR + 2.50%



Strategic Early Refinancing Action Steps

1. Identify your most valuable relationships with current loans maturing in the next 24 months
2. Reach out to ARC for indicative pricing – show at least 3 options
3. Consider changes to lender incentives as needed

Thank you!

Want more ideas and data?

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SouthStateCorrespondent.com



Disclaimer

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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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