FHLBank Boston

Exposed to Rising Rates?

Consider the Classic Plus Cap Advance

Federal Reserve officials have raised rates twice this year and upgraded their forecast to four total increases in 2018. The most recent "dot-plot" released also implied three increases in 2019. Within the past couple of years, 3-month LIBOR has increased over 200 bps.

Given the current rate environment, members looking for long-term protection, as well as the potential to decrease interest expense should short-term rates continue to rise, will find the Classic Plus Cap Advance a beneficial funding option to consider.

The Classic Plus Cap Advance combines a fixed-rate bullet advance with an embedded LIBOR-indexed interest rate cap. The interest rate paid on the advance will fall if the LIBOR index resets above the strike rate on the periodic reset dates. Members can choose the term, the strike level of the cap, the index and the notional amount of the cap.

The notional amount of the embedded interest-rate cap can be between one and three times the dollar amount of the advance. The embedded interest-rate cap is in effect over the term of the advance and its premium is included in the advance rate making it easier than purchasing the cap separately, should you need the funding. There is no need to mark-to-market the embedded cap.

Recently, some members have requested indications and have executed Classic Plus Cap Advances. The current interest rate environment makes the Classic Plus Cap an attractive addition to your advances portfolio, particularly, if you are exposed to rising rates. Liability sensitive members can use this product to extend their overall funding maturities, lock-in spreads and realize margin relief should short rates continue to move higher.

How Does It Work?

Although this is a fixed-rate advance, the rate is subject to adjust at a frequency equal to the index chosen (i.e. one- or three- month LIBOR*). The adjusted advance rate would then be calculated as follows:

Adjusted Advance Rate = Initial Advance Rate – notional amount x (LIBOR – strike rate)

Whenever LIBOR* exceeds the cap strike rate, the initial advance rate is reduced until the next reset date.

Current Indications**:

Term	Cap	LIBOR* Strike	LIBOR* Term	Rate	Regular Classic Advance Rate
2 Yr	1x	3.00%	1 mon	3.12	3.01
2 Yr	2x	3.00%	1 mon	3.23	3.01
3 Yr	1x	3.50%	3 mon	3.25	3.12
3 Yr	2x	3.50%	3 mon	3.28	3.12

Why Use It?

1. Using the Classic Plus Cap Advance in a rising interest rate environment can provide the member with an increase in net spread when using the product to fund long-term assets.

2. A member exposed to rising interest rates who wants to lock in some long-term funding but also wants to continue to take advantage of short-term rates, can execute a *blend* of the Classic Plus Cap with short-term funding and reduce the weighted average cost of the total funding.

   In the example below, as rates rise on the short end of the curve, the rate on the Classic Plus Cap decreases once LIBOR* exceeds the Cap strike rate of 3.50%, therefore reducing the overall cost of funds.

3-Year Classic Plus Cap
3mL Strike 3.50%

	Advance Amount $5MM (A)	Advance Amount $5MM (B)
	Notional Amount of Cap/Advance Rate	
3mL	1x	2x
2.33%	3.25%	3.28%
3.00%	3.25%	3.28%
3.50%	3.25%	3.28%
4.00%	2.75%	2.28%
4.50%	2.25%	1.28%
5.00%	1.75%	0.28%

3-Month Short-Term Special (***)
Estimated as 3mL - 9 bps

	Advance Amount $5MM (C)
3mL	3-Month Short Term %
2.33%	2.24%
3.00%	2.91%
3.50%	3.41%
4.00%	3.91%
4.50%	4.41%
5.00%	4.91%

Total Funding Amount

	(A+C)	(B+C)
3mL	Weighted Average Cost	
2.33%	2.75%	2.76%
3.00%	3.08%	3.10%
3.50%	3.33%	3.35%
4.00%	3.33%	3.10%
4.50%	3.33%	2.85%
5.00%	3.33%	2.60%

Learn More!

To learn more about the Classic Plus Cap,
please see the product primer and watch for an upcoming special offering.

(*) Or an alternative benchmark index.
(**) Rates are for indication only. Contact the Money Desk for current rates.
(***) Rate projected based on the current spread of 3mL and the 3-month short-term special.

FHLBank Boston