

Using Classic Advances to Fund 15-Year Mortgage Loans

U.S. mortgage origination volume is down more than 35 percent from late 2016 as refinancing activity has been hurt by recent rate hikes by the Fed while applications for new mortgages remain soft. Some members continue to see demand and are looking to hold mortgages in their portfolios.

We were recently contacted by a member who was originating 15-year fixed-rate mortgages at 3.29 percent. They were concerned about rising interest rates and wanted to protect net interest income if rates were to rise. We funded the mortgages with 80 percent long-term Classic advances and 20 percent of a 1-month Classic advance. The long-term advances were comprised of 10 percent of a 2-year Classic advance, 15 percent each of 3- and 4-year Classic advances, and 40 percent of a 5-year Classic advance. The initial cost of the term advances was 2.10 percent and had a weighted average life of slightly more than 4 years. The initial cost of funding, including the 1-month funding, was 1.95 percent. The initial net spread was 1.34 percent. The average cost of funds through seven years (given no change in rates), increases 6 basis points over the initial cost to 2.01 percent as the short-term Classic advances (with their lower cost) mature and the long-term advances remain outstanding. If interest rates increase 300 basis points, the long-term advances are effective in slowing down the increase in the cost of funds as it moves only 23 percent of the change in interest rates. The seven-year average cost of funds of 2.69 percent is only 68 basis points over the cost of funds in the base case. Note that these results are for years one through seven and the strategy is 100 percent funded with one-month advances in years six and seven at 300 basis points over the initial rate. The results of this funding solution can be seen in the table below.

15Y Fixed-Rate Mortgages	3.29%	Results Years 1 through 7			
		Cost of Funds	Net Interest Spread	Net Interest Income (\$000s)	
\$1.0M 1M Classic	1.38%	Down 100 basis points	2.02%	0.72%	\$ 141
\$0.5M 2Y Classic	1.77%	Down 50 basis points	2.01%	1.05%	216
\$0.75M 3Y Classic	1.94%	Rates Unchanged	2.01%	1.25%	279
\$0.75M 4Y Classic	2.09%	Up 100 basis points	2.21%	1.08%	255
\$2.0M 5Y Classic	2.24%	Up 200 basis points	2.45%	0.84%	206
\$5.0M Total Funding	1.95%	Up 300 basis points	2.69%	0.61%	153
Initial Net Spread	1.34%				

Loans as a percent of total assets are increasing as members shift out of investments. Are you interested in examining borrowing alternatives to fund your balance sheet growth? We can model funding ideas for the type of loans you are using to grow your balance sheet. Please contact me at kevin.martin@fhlbboston.com or 617-292-9644 to see what will work for your institution.