

Using Classic Advances and Deposits to Fund 30-Year Fixed-Rate Mortgage Loans

Members willing to hold 30-year fixed-rate mortgages can generate an average net interest spread of almost 200 basis points by funding them using FHLB Boston Classic advances combined with some of their own deposits.

Let's examine how \$5 million of 30-year fixed-rate mortgages with a coupon of 3.93 percent could be funded to generate a reasonable return while limiting exposure to rising interest rates. One possibility is to fund the mortgages with \$3.75 million of long-term Classic advances and \$1.25 million of non-surge, low beta core deposits. The long-term advances were comprised of \$1.25 million each of two-, three-, and five-year Classic advances. Core deposits of \$1.25 million were used. These had an initial cost of 50 basis points and a beta of 30 percent. The initial weighted average cost of the term advances was 2.21 percent and had an average life of slightly less than 3.5 years. The initial cost of funds was 1.79 percent and the initial net spread was 2.15 percent. The average cost of funds over seven years (in the base case; no change in rates), declines 17 basis points from the initial cost, to 1.62 percent. The funding mix between Classic advances and deposits shifts more toward the lower cost deposits over time. Initially, advances comprise 75 percent of the total funding but, over seven years, average about 62 percent of funding. Deposits increase from 25 percent to approximately 38 percent of the average funding. If interest rates increase 300 basis points, the cost of funds increases only five basis points, from 1.79 percent to 1.84 percent. On average, over seven years, the funding mix is almost equally split between advances and deposits. Net interest income is higher in the rising rate scenarios than in the base case (increasing from \$514 thousand in the base case to \$559 thousand in the plus 300 basis point scenario, as prepayments on the mortgages slow down and a larger pool of mortgages remains outstanding. The results of this funding solution can be seen in the following table:

30Y Fixed-Rate Mortgages		Results Years 1 through 7			
			Cost of Funds	Net Interest Spread	Net Interest Income (\$000s)
	3.93%				
\$1.25M 2Y Classic	2.04%				
\$1.25M 3Y Classic	2.17%	Down 100 basis points	2.04%	1.67%	\$ 272
\$1.25M 5Y Classic	2.43%	Down 50 basis points	1.84%	2.06%	380
\$1.25M Core Deposits (Beta 0.3)	0.50%	Rates Unchanged	1.62%	2.31%	514
\$5.0M Total Funding	1.79%	Up 100 basis points	1.59%	2.34%	603
		Up 200 basis points	1.71%	2.22%	588
Initial Net Spread	2.15%	Up 300 basis points	1.84%	2.09%	559

Thirty year mortgages continue to provide opportunities for profitable balance sheet growth and are one of the primary sources of collateral pledged to the Bank to secure advances and other activities with the Bank. Are you interested in examining borrowing alternatives to fund your balance sheet growth? We can work with you to model funding alternatives for the loans or investments 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.