

Using FHLB Boston Classic Advances to Fund Commercial Real Estate Loans

Loan growth continues at member institutions and commercial lending is often mentioned as an area where they are seeing strong demand when we speak with members. A common loan structure is a five-year fixed rate period with a 20-year amortization schedule. If your deposit growth isn't keeping pace with loan growth, don't curtail your lending activity; use your borrowing capacity at FHLB Boston to fund these loans for your creditworthy customers while also limiting your exposure to changing interest rates.

Let's examine how \$2 million of a 5/20 commercial mortgage with a coupon of 5.25 percent could be funded to generate steady returns across a wide range of interest rate scenarios. This lender was able to include a prepayment penalty in this loan so the cashflows should be predictable during the first five years. This loan will pay down by slightly more than \$300 thousand over this period. We funded about 90 percent of the balloon amount with \$1.5 million of a five-year Classic advance. The remaining \$500 thousand was funded with a one-month Classic advance. As the loan pays down, the amount of the one-month Classic advance declines and averages approximately \$260 thousand over five years. The initial cost of funds is 2.30 percent and due to the high proportion of fixed-rate funding, the cost of funds fluctuates only 51 basis points in different interest-rate scenarios, as seen in the table below. Net interest income falls to 2.41 percent (from 2.80 percent in the base case) if interest rates increase by 300 basis points. The results of this funding solution can be seen in the following table:

5/20Y Commercial Mortgage		Results Years 1 through 5			
	5.25%		Cost of Funds	Net Interest Spread	Net Interest Income (\$000s)
\$1.5M 5Y Classic	2.59%				
\$0.5M 1M Classic	1.43%	Down 100 basis points	2.33%	2.92%	\$ 280
\$5.0M Total Funding	2.30%	Down 50 basis points	2.39%	2.86%	275
		Rates Unchanged	2.45%	2.80%	269
Initial Net Spread	2.95%	Up 100 basis points	2.58%	2.67%	258
		Up 200 basis points	2.71%	2.54%	246
		Up 300 basis points	2.84%	2.41%	234

If your competition prevents you from including prepayment penalties in your commercial loans, FHLB Boston has a solution that can enable you to meet the competitive challenge. We can work with you to model funding alternatives for these loans. Please contact me at kevin.martin@fhlbboston.com or 617-292-9644 to see what will work for your institution.