FHN FINANCIAL

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WHAT'S WORKING

Great Opportunity to Earn Very Wide Wholesale Leverage Spread

We continue to see banks take advantage of very low long-term funding rates to put wholesale leverage strategies on the books at well over 100 bp spreads. The approach most are using is to borrow for 90 days from the FHLB (on a rolling basis) and use an interest rate swap to lock-in a fixed rate. For a 10-year borrowing, this approach allows you to reduce the funding cost over an outright long-term advance by as much as 100 basis points to .60%. Here is an example of how the approach works:

- Borrow 90 day funds from the FHLB at a current rate of .35% (with intention to roll every 90 days)
- Enter into a 10-year interest rate swap with FHN Financial:
  - Pay .75% for 10 years (fixed)
  - Receive floating of 3-month LIBOR flat (currently .50%)
- Net initial funding cost of 60 bp (receive LIBOR rate of .50 less FHLB cost of .35 and less pay fixed of .75)

Historically, the "receive" rate on the swap (3-mo LIBOR) has closely mirrored the 90-day borrowing rate from the FHLB, thus cancelling each other out. Over time, that would leave the "pay" fixed side of the swap of .75% as your net borrowing cost. The close correlation of the 90-day FHLB rate and 3-month LIBOR also allows this approach to qualify for hedge accounting, so changes in value are run through AOCI similar to the treatment of AFS bonds. That close correlation can be seen on the following page. It's noteworthy that the recent stubbornness of LIBOR to fall with other short-term rates resulted in very low, or even negative, initial funding costs over the last several months. With 3-month LIBOR now falling back in line with market rates, the overall funding cost over time should net out to be about the fixed-rate pay side of the swap, or .75%.

Given a net cost of well under 1.00%, there's a wide array of conservative investment options available to generate very attractive spreads, even on a duration matched basis. A number of banks have used this funding to target longer-term tax free municipals, generating TE spreads of close to 200 basis points. Longer-term CMBS are also a very good fit for this approach.

For more information, please reach out to your account representative.

PORTFOLIO STRATEGIES

Gray Bowles
901.435.8170
gray.bowles@fhnfinancial.com

Derick Garner
901.435.4784
derick.garner@fhnfinancial.com

David Howard, CFA
901.435.8217
david.howard@fhnfinancial.com

Curtis Knotts
901.435.8038
curtis.knotts@fhnfinancial.com

Tyler Williamson
713.435.4349
tyler.williamson@fhnfinancial.com

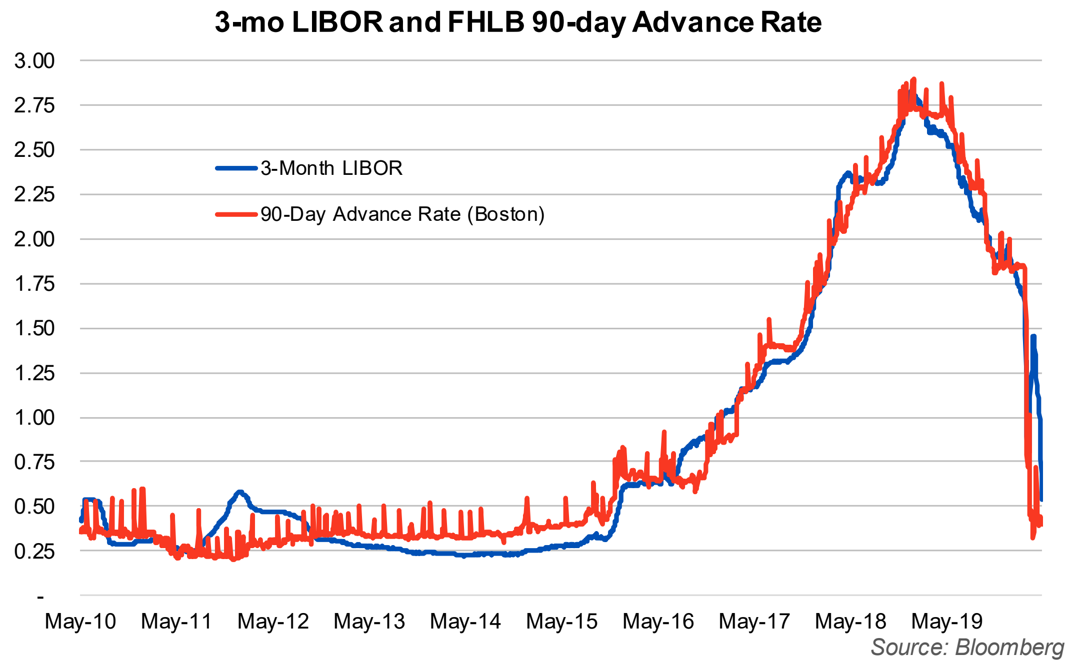
Ruben Rodriguez
713.435.4451
ruben.rodriguez@fhnfinancial.com

Price Yates
901.435.4733
price.yates@fhnfinancial.com

Kenneth Young
713.435.4454
kenneth.young@fhnfinancial.com

Steve Twersky, CPA
901.435.8703
steve.twersky@fhnfinancial.com

FHNFINANCIAL.COM
800.456.5460



– Steve Twersky