

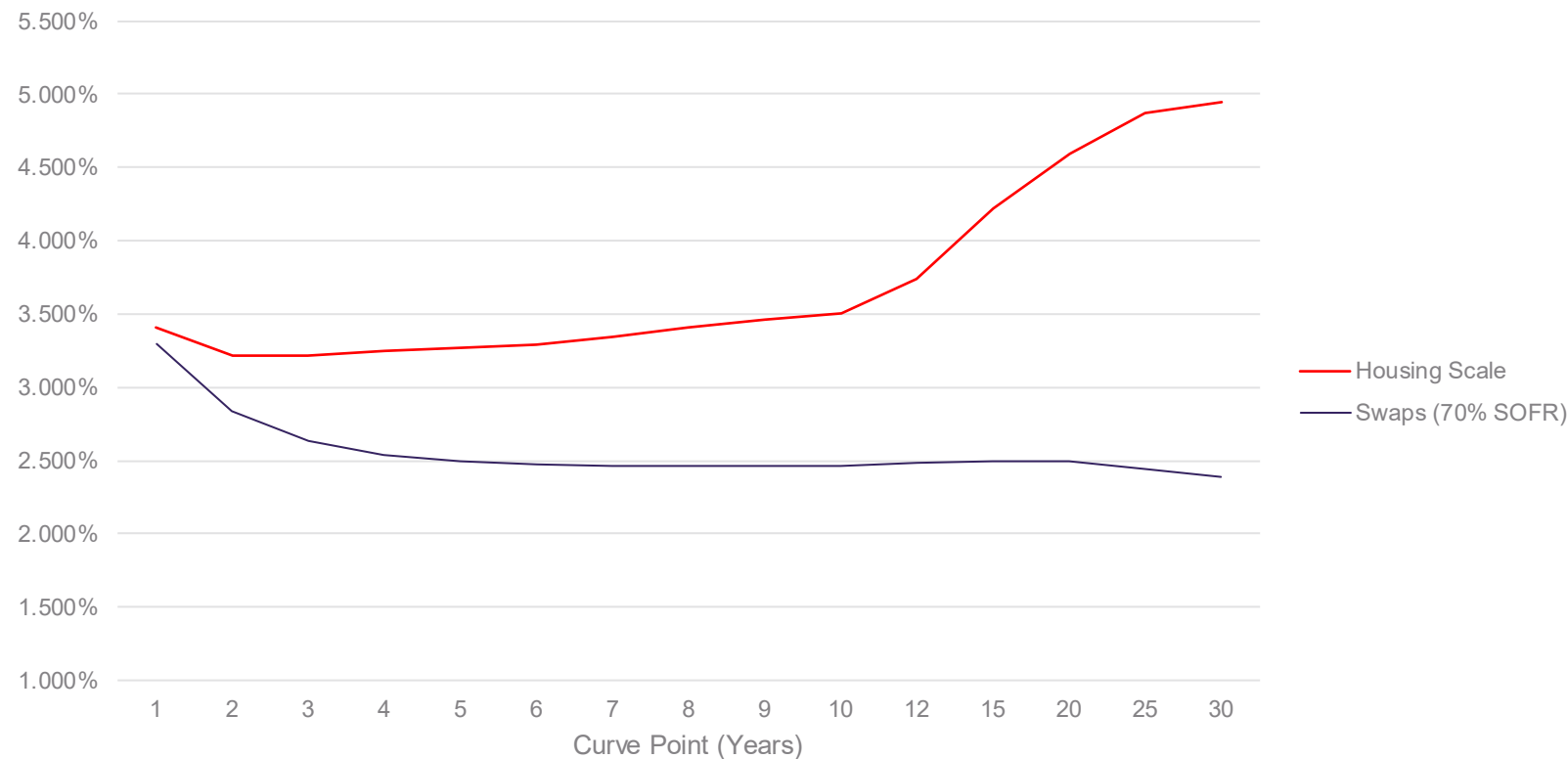


Kensington Capital Advisors

**Interest Rate Term Structure and Derivative
Usage in Housing Finance**



February 2024



- The term structure of the derivatives markets and the municipal markets can differ widely.
- Derivative markets tend to be reflective of rate expectations only, while markets that combine rate and funding concepts are influenced by investor demand, term credit conditions, etc.

TERM STRUCTURE IN PRACTICE – 4 PLACEMENTS IN 2023



	Case 1 – Perm Rate Swapped to Fixed	Case 2 – Perm Rate Swapped to Fixed	Case 3 – Traditional Perm Rate	Case 4 – Traditional Perm Rate
Principal Amt (Perm Loan):	\$40.0 Million	\$4.5 Million	\$17.5 Million	\$8.6 Million
Date of Rate Lock:	Q2 2023	Q3 2023	Q2 2023	Q2 2023
Perm Interest Rate:	4.77%	5.05%	4.875%	5.125%
10-Year UST Rate	<u>4.25%</u>	<u>4.32%</u>	<u>3.37%</u>	<u>3.79%</u>
Spread to 10-Year:	52 BPS	73 BPS	150 BPS	134 BPS
Weighted Avg Spread:	55 BPS		145 BPS	
Difference:	90 BPS			

This is a very small sample and should not be generalized over all markets and financings. Underlying differences in projects, markets, debt structures, amortization schedules, construction period duration and other factors can play a major role in establishing permanent rates.

GENERAL RISKS AND OPPORTUNITIES

	Counterparty	Basis	Termination	Tenor
Risks	Each party in the swap has risk related to default of their counterparty.	The index paid in the swap may not always match the underlying financing.	Early termination may result in significant costs.	Mismatches in the tenor of the hedge and financing can be problematic.
	Pricing	Structure	Termination	Tax
Opportunities	By pricing funding and risk components separately investor rate biases can be avoided.	The swap structure can provide flexibility unavailable in typical financings.	Swap termination is a bi-lateral make whole and can be structured to limit exposure.	If there is benefit to separating construction /perm periods, the hedge can accommodate.

- Risks and benefits inherent in derivative product usage are unique and dependent on each situation.
- The chart seeks to outline the high-level risks and benefits which do not include every scenario.
- Nothing contained in or conversations related to this material constitutes advice which is meant to highlight general concepts.