

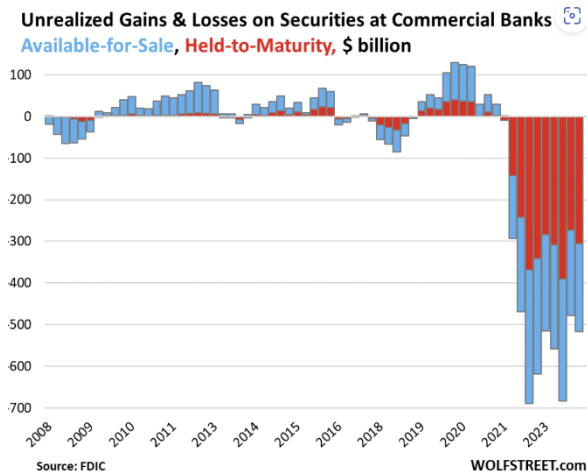
Breakeven Trade: Selling Loans with Unrealized Loss

Challenge

Research has found that many banks are currently holding loans that are underwater.

Unrealized loss in securities and loans, including HTM instruments, has adverse implications to balance sheet management.

Unrealized loss will lower future net income and reduce liquidity, as shown by Silicon Valley Bank Q4 2022



Proposal

Sell loans on the balance sheet and buy loans with higher yields to cover the realized loss and gain net profit.

Consider the example below: Sell 30-year fixed-rate residential loans at 95 and buy insured Home Improvement live Loans at 102. Back-of-the-envelope calculation: Buy yield of 7.719% and sell with coupon 4.923%, with a net 2.79% spread. Breakeven is 1.79 years (= 5/2.79).

Summary

More precisely, including CECL and prepayment speeds, the breakeven loss was in 17 months, with a net economic benefit of \$409,204.

Breakeven Analysis										
Benefits	Realized Gain	Horizon	Breakeven	Cum. NI	Net Profit					
	\$ (250,005)	4.25 yrs	17 Months	\$ 659,209	\$ 409,204					
Description	Instruments	Par Value	Maturity	Book TEY	Book Px	Book Value	Avg. Life	Base Speed	Gain/Loss	
	SELL	Resi Loan	\$ 5,000,000	2034/5/19	4.923%	100.0000	\$ 5,000,000	4.25	8.437%	\$ (250,005)
	BUY	Insured HIL Pool	\$ 4,616,555	2040/2/28			6.10	9.000%		
Analytics	Original Face	Coupon	Mkt TEY	Mkt Px	Market Value	Eff. Dur.	CECL%			
	SELL	\$ 5,000,000	5.200%	6.363%	94.9999	\$ 4,749,995	3.47	0.444%		
	BUY	\$ 4,616,555	10.250%	7.719%	102.8906	\$ 4,750,000	4.12	0.000%		

Notes:

Cum NI: cumulative net income

Mkt TEY: Tax equivalent yield

Base Speed: Conditional Prepayment Speed (CPR)

Horizon: Average life of the shorter of the buys or sells

Px: Price

Next Step: Actionable Decisions



Currently, there is a demand to buy discount 30-year fixed-rate mortgages. CFIs can apply break-even analytics to restructure lower-yielding loans off their balance sheets to buy higher-yielding loans, attaining economic benefit while managing risk exposure.

Evaluate what is on the balance sheet and what is available for sale. We will run the breakeven analytics and determine the best execution. You may consider insured home improvement loans as an option. When you are ready to execute, there are ready buyers in the market.

If you would like to receive Thomas Ho Company's additional analysis, learn more about Thomas Ho Company analytics, or arrange a demo of the Thomas Ho Platform, please get in touch with Megan Trillet, Director of Marketing, at megan.trillet@thomasho.com or 330-687-0608.