

BOND STREET CAPITAL NEWS

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Understanding Rate Locks

In a volatile financial market, an "early" rate lock can become a very important tool to bring certainty to the loan process. In addition to removing rate issues, locking the rate helps solidify the final loan amount and protects against overnight market increases that can cost the borrower a lot of money over the life of the loan.

When, or even whether, to rate lock is greatly dependent on the program you select. Most of our portfolio products offer rate locks for a deposit ranging from \$500 to 1% of the loan amount. On closing, the deposit is returned. Failing to close typically means a loss of the deposit.

Rate locking a conduit loan, however, is much more problematic. Conduits are typically reluctant to early rate lock because of the inherent risk to the borrower. In fact, I have only early rate locked three conduit loans out of the hundreds of conduit loans we have closed in the last ten years.

Here is why. An early rate lock in a conduit deal is accomplished by the purchase of a "hedge instrument." While there may be a cost, most of the time there is just a deposit of one to two points depending on how close you are to closing.

The value of the "hedge" moves with the market. An increase in rates has no impact during the lock period. A decrease, however, is another story. Typically a two point deposit will cover you for 30 basis points of rate drop. For example, if you locked when the Treasury was at 5%, you would be "underwater" on the hedge if the rate dropped below 4.70%. Most rate lock agreements require additional deposits when the rate drops fifteen basis points. The traders always want a deposit cushion.

This can become a harrowing situation if you have rate locked and rates plummet. The traders will call for an additional deposit and if you are unavailable to provide it your position can be sold out from underneath you. You would then have a loss and no rate lock at all.

Capital Markets Update

Early last week we received some positive news that the Capital Markets spigot was reopening. Some positive trades occurred on existing paper bringing confidence to the market. This confidence translated to lower spreads. Later in the week, we got some bad news and spreads popped up again.

I suspect that we will see this kind of volatility through the end of the year. Quotes will not be solid until money is up with many of the lenders utilizing the swap spread as a pricing benchmark to shift the risk to the borrower on spread movement.

With this kind of volatility, should a borrower with a discretionary refinancing sit on the sidelines or grab a deal while money is there?

If you are a regular reader of this newsletter, you know I am a big fan of getting money when it is available. If the deal works, grab it. There is no guarantee that

Close the deal, no problem ... but what happens if you don't close the deal? If the failure to close is no fault of the borrower and rates are the same or higher, the deposit less some transaction cost is returned. If rates are lower, then the deposit is used to offset the loss.

Where it really gets bad, however, is if the loss exceeds the deposit or the borrower has been a bad boy. The typical conduit rate lock agreement obligates the borrower to come out of pocket for all losses. In 1998 when the market collapsed and rates plunged, there was more than one borrower who came out of pocket for big money well in excess of his initial deposit. Further, many of the rate lock agreements give the lender the right to keep the deposit, even if there is no loss, if the borrower is at fault for the deal not closing.

To mitigate early rate lock risks in the conduit world, we suggest you never lock until third party reports are in. Once those reports are in and we know we have clean title, early rate locking is not nearly as risky.

There are many variations on the rate lock scenario described above. Ask for the rate lock documents when you begin the loan process and make sure you read them carefully!

money will be available at any price in the future. Right now, we have money so I strongly encourage anyone with a refinancing need to move forward now.

Join Team Bond Street

We are looking for experienced commercial loan originators that want to help service our growing customer base. We also offer Branch Office opportunities for select companies. Please contact **Ned Hosken at 818-336-4107** for information.

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Interest Rates	
Index	Current Rates
Prime	7.75%
2 Year T	3.802%
5 Year T	4.044%
10 yr. T	4.392%
30 yr. T	4.690%
1 Mo. Libor	4.87%
3 Mo. Libor	5.08%