Capital Solutions

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KEY MARKET INTEREST RATES

Index	December 1, 2015
Fed Funds	0.250%
Prime	3.250%
30 Day Libor	0.22%
90 Day Libor	0.36%
1 Year Libor	0.93%
5 Year Treasury	1.85%
10 Year Treasury	2.24%
10 Year SBA 504	4.40%
10 Year SBA 7A	6.00%
20 Year SBA 504	4.70%

How much does your bank make on your loan?

Lenders are not making as much on a business loan today than they were 20 years ago.

Back in the 1990s, it was common for banks to be earning more than 4.5% in spread between their cost of funds and their lending rate. The highest performing banks were above 5.00%.

Today it is more common for banks to report interest rate spreads closer to 3.5% in the aggregate, and the trend is toward further tightening. After allocating overhead costs and fixed expenses to each loan, banks expect to net at least 1% on its commercial loan portfolio, though many operate above and below this target.

For a $500,000 loan with an interest rate of Prime + 1.0%, or 4.25%, the annual interest would be $21,250, with the bank earning at least $16,250 in net interest, and likely earning between $5,000-$10,000 in pre-tax profit on the loan, depending on the lender's cost structure. These profit numbers illustrate how an informed borrower can drive a better deal on their lending rate.

Banking deregulation and the ensuing crowded lending market ushered in this new era of narrowing bank interest margins. Ironically, it is now increased banking regulation that is increasing the costs to be in the business that now has thinner loan margins brought on by the competition from deregulation.

Today, net interest spreads on the highest quality loans can be as low as 1.0%. On some type of loans banks earn surprisingly little in profits, even lose money, but are willing to do so in order to cross sell more profitable services.

Sometimes your bank will not know until the loan is repaid how profitable it was over its term. For fixed rate loans, particularly for smaller banks who do not have as many long term funding options or large pools of deposits to draw from, banks take a risk that interest rates will not rise significantly over the term of the loan. Some loans being fixed today for 5 years at less than 4% could become negative earning assets if inflation and growth push rates up by 2% or more.

The bet that rates will be stable has worked out fine since the Great Recession. The Prime lending rate, at 3.25%, has not changed for more than 7 years, one of the longest periods without an adjustment in modern economic times. And those rates used to build long term fixed rates, namely 5 and 10 year US Treasuries, have also been relatively stable, and low, for many years.

Going forward it will be trickier for banks to figure out how skinny of a margin they can accept while allowing for the possibility that rates start to move upward. Borrowers should want to fix long term debt for as long as possible today, while lenders will want to keep its rate commitments at 3 years or less where possible, or price in a rise in rates when fixing over a longer horizon.

Thanks for reading. Please let us know if you would like our help in improving your borrowing rate and terms.

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