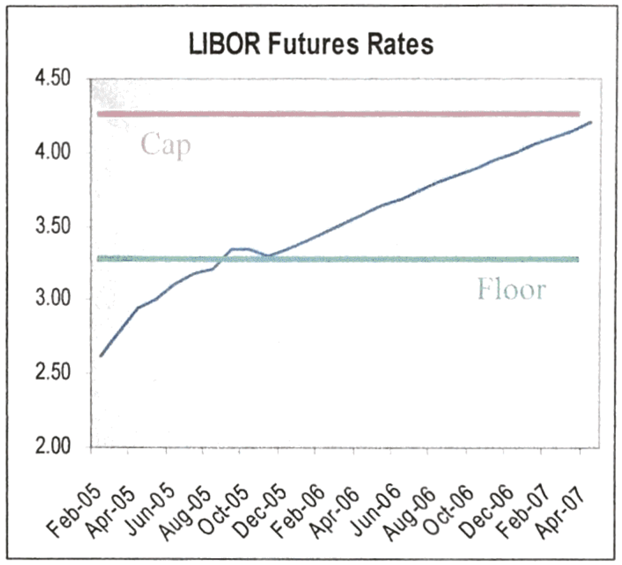
Interest Rate Hedging
Market Update
February, 2005
Caps & Collars

MARKET UPDATE

Blend & Extend strategies discussed in last month's newsletter continue to offer significant opportunities for clients to lower financing costs on existing debt. By restructuring existing debt with maturity dates within five years, clients can achieve lower rates and improve return on investments. As the yield curve continues to flatten this strategy becomes more appealing. In the past month, 2 year rates have increased by 30 basis points while 10 year rates have dropped by 10 basis points. Today, the difference between 2 year rates and 10 year rates stands at 80 basis points compared to 240 basis points one year ago. If anyone would like a copy of last months newsletter please email us or call to request a copy.

If you prefer to pay floating to take advantage of today's low short term rates but still want protection against rising rates, consider our hedge recommendations below.



HEDGE STRATEGY:

CAPS

Stand alone cap contracts guarantee that the floating rate on the financing will never exceed the set cap strike. Customers choose the strike level that suits their risk tolerance. A higher strike will result in a lower price to be paid for the hedge yet less protection against rising rates. Fees are paid upfront for the hedge with the cost indication typically expressed as a percent of the hedge, (or loan amount)

Example

The chart shows a 3 year cap with a strike of 5.0% at a price of 0.45%. For a $5 million hedge the required upfront payment would be $22,500. Caps are most often used to hedge financings during construction periods as insurance protection against rapid and unforeseen rate changes.

% OF NOTIONAL	CAP		
VS 3MO LIBOR	4.5%	5.0%	5.5%
2 YR CAP	0.24	0.15	0.10
3 YR CAP	0.68	0.45	0.30
5 YR CAP	2.03	1.45	1.05

	NO COST COLLARS (FLOOR STRIKE)		
CAP STRIKES >	4.5%	5.0%	5.5%
2 YR FLOOR	3.22	2.95	2.66
3 YR FLOOR	3.44	3.19	2.92
5 YR FLOOR	3.82	3.53	3.28

Source: HSBC

COLLARS

Collars are interest rate hedges that allow customers to continue paying floating rates on their loans enjoying the current low short term rates while gaining protection with a cap against significant increases in those rates. With collars, customers are protected against having to pay a higher rate than the cap strike. A no cost collar includes a floor where the customer does not benefit from the floating rate dropping before the floor strike yet by including the floor the hedge is able to be offered with no upfront cost. Collar pricing indications show the floor strikes that can be offered at a no cost proposition. For example, a 3 year collar with a cap of 5% will have a floor of 3.19%.

MARKET AT A GLANCE

		Current	Last mo	Change
PRIME		5.50	5.25	0.25
LIBOR	1 mo	2.59	2.40	0.19
LIBOR	1 yr	3.31	3.11	0.20
Treasury	5 yr	3.69	3.72	(0.03)
Treasury	10 yr	4.10	4.29	(0.19)
Swap	5 yr	3.69	4.04	(0.35)
Swap	10 yr	4.10	4.62	(0.52)