

Date: April 6, 2022

Subject: Higher SBA 504 Debenture Rates Expected in April



Higher Treasury Yields, Yield Curve Inversion, and Faster 504 Prepayment Speeds all to play a part in the rise.

Yields Rise and the Curve Inverts. As of April 6, the 10-year Treasury yield was 64 bps higher than when the 504 program set March debenture rates. In addition, expectation for more aggressive Fed “quantitative tightening” (QT) has inverted much of the yield curve including the key 7- to 10-year (7/10) segment. The 7-year Treasury now yields 10 bps more than the 10-year Treasury. On March 10 the 10-year yield was 3 bps above the 7-year yield.

Prepayment Speeds Are Important. Why does the inverted 7/10 segment of the curve affect setting the 504 debenture rates? The answer is rooted in the market-expected pace of 504 pool voluntary prepayments, known as “constant prepayment rates” or CPRs. Investors now expect 504 pools to prepay at a 10% CPR compared to the 5% long-term convention. This means the expected average lives of new 504 pools are in the 6 to 7 year range. Additional spread over the 10-year Treasury pricing benchmark must be offered to investors because yields in the 6- to 7-year part of the curve now are higher than the 10-year point. This additional spread will be at least 10 bps m/m.

Sharply Rates Higher Everywhere. The combination of sharply higher 10-year Treasury yield and wider 504 spread to Treasury means there will be materially higher debenture rates compared to last month, perhaps at least 75 bps higher. Interest rates are sharply higher everywhere since March. For example, the US average 30-year mortgage rate and the 25-year Morgan Stanley 504 1st lien rate today would be above 5%. Further, the market currently projects a Prime Rate of 5.5% by year end. It is some consolation that the credit markets have, thus far, adjusted in a very orderly fashion to the very aggressive QT signals from the Fed.

Narrative provided by Steve Van Order, Selling Agent for the 504 Loan Program.

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