Loan Growth Strategies for Highly Competitive Markets

February 24, 2016
Webinar
PRESENTERS

Jeff Morris joined Austin Associates’ Financial Management Division in 1998. He is responsible for profitability analysis services and works with clients who utilize the firm’s innovative software products, including its proprietary organization/product/customer profitability software and its loan and deposit pricing software. Jeff has over 35 years of experience in various financial management roles.

Andy Morgan joined the firm in 2001 and is responsible for the development and support of the firm’s proprietary software offered through the Financial Management Division. He has designed software applications for loan pricing, deposit pricing, customer information systems, organization / customer / product profitability, and other financial reporting systems designed exclusively for the community banking industry. He is also responsible for analytical services pertaining to the firm’s interest rate risk, EVE, profitability, and budgeting services.

Jeff Morris
Managing Director & Principal
Financial Management Division
jmorris@austinassociates.com
419-517-1775

Andy Morgan
Managing Director & Principal
Financial Management Division
amorgan@austinassociates.com
419-517-1777
AUSTIN ASSOCIATES, LLC
Financial Management Consultants for Financial Institutions

- Advisors to Financial Institutions for five decades
- Specialized consulting and advisory services
  - Asset / Liability Management
  - Profitability Measurement & Improvement
  - Loan & Relationship Pricing Systems
  - Balance Sheet Structuring
  - Regulatory Compliance
- Current owners are consultants/managers
- Over 200 financial institution clients in 2015
AGENDA

Loan Growth Strategies for Highly-Competitive Markets
February 24, 2016

- Challenges, Opportunities, and Trends Heading into 2016
- Growth Strategies
  - Creating a favorable mix variance
  - Cultivating existing relationships
  - Participation strategies
  - Managing extension risk
  - Gathering commercial deposits
  - Determining loan portfolio ROE targets
  - Assure proper pricing
  - Other loan growth strategies and goals
Challenges and Opportunities

**GROWTH & PROFITABILITY**

1. How does your bank plan to grow within the next 12 months?
   Respondents were asked to select all that apply.

- Organic loan origination: 82%
- Bank acquisition or merger: 41%
- De novo branch: 22%
- Investment in fee-based business such as insurance or trust: 21%
- Branch acquisition: 17%
- Other: 8%

Source: Bank Director August 2015 Research
Challenges and Opportunities

2. Where do you see your three greatest organic loan growth opportunities?
Respondents were asked to select no more than three.

- Commercial real estate: 85%
- C&I loans: 56%
- Residential mortgages: 45%
- Construction loans: 39%
- SBA loans: 24%
- Other consumer lending opportunities: 13%
- Indirect auto lending: 8%
- Direct auto lending: 3%

Source: Bank Director August 2015 Research
Greatest Challenges for 2016

- Community bank profitability was 7.5% higher in 2015 vs. 2014
- Improved net interest income, non-interest income, lower PFLI

Source: Computer Services, Inc. (CSI) 2016 Banking Priorities Study
Greatest Opportunities for 2016

- Community bank loan balances grew by 8.5% over last 12 months

Source: Computer Services, Inc. (CSI) 2016 Banking Priorities Study
Trends in Bank Lending Practices

- Tightening credit standards on CRE in 2015 Q4

Source: Federal Reserve January 2016 Senior Loan Officer Opinion Survey on Bank Lending Practices
Trends in Bank Lending Practices

- Tightening credit standards on C&I in 2015 Q4

Source: Federal Reserve January 2016 Senior Loan Officer Opinion Survey on Bank Lending Practices

- Less favorable or more uncertain economic outlook
- Worsening of industry-specific problems (energy, oil, gas)
- Reduced tolerance for risk
- Concerns about legislative changes, accounting standards
Trends in Bank Lending Practices

- Increased Demand for CRE in 2015 Q4

Source: Federal Reserve January 2016 Senior Loan Officer Opinion Survey on Bank Lending Practices
Trends in Bank Lending Practices

- Decreased Demand for C&I in 2015 Q4

- Decreased investment in plant or equipment
- Reduced need to finance accounts receivable and inventories
- Borrowers cash positions increased

Source: Federal Reserve January 2016 Senior Loan Officer Opinion Survey on Bank Lending Practices
### Loan Portfolios

**Commercial Banks’ Loan Portfolios in Dollars**

As of December 31, 2015

- **Total of $7,083**
  - Larger Banks (>$3 billion): $2,691
  - Community Banks (<$3 billion): $1,313, $1,247, $1,832, $274, $1,247, $28, $0

- **Total of $1,101**
  - $274
  - $13.5% of Market

All Amounts in Billions of US Dollars

**86.5% of the Market**

**13.5% of Market**

**LARGER BANKS > $3 BILLION**

**COMMUNITY BANKS < $3 BILLION**
Loan Portfolios

Commercial Bank Portfolio Composition - Percentages

December 31, 2015

- COMMUNITY BANKS < $3 BILLION
  - COMMERCIAL: 67.83%
  - ALL OTHER: 24.86%
  - CONSUMER: 4.78%
  - RES MORT: 2.53%

- LARGER BANKS > $3 BILLION
  - COMMERCIAL: 38.00%
  - ALL OTHER: 18.54%
  - CONSUMER: 17.61%
  - RES MORT: 25.87%

Community Banks have far less Consumer Loans than do larger banks.

Community Banks are much more dependent on Commercial Loans.

All Other Loans include Loans to States and Political Obligations, Loans to Banks, etc. – an area Community Banks do not specialize in.
Commercial Loan Profitability

Commercial Loans.....

- Account for **21 - 55%** of Total Assets
- Produce ROAs of **2.11% - 3.66%**
  - 2.5 – 4.5 Times the ROAA of the Bank
- ROEs of **11.42% - 18.5%**
  - 1.3 – 2.6 Times the ROAE of the Bank
- **Provides 55% - 162% of Bank-wide Profitability**

(Versions.....)

- < 1.0% Bank-wide
- < 9% Bank-wide

(Findings from Austin Associates’ Profitability Client Base - Actual Results from 4 Q, 2015)
Commercial Loan Portfolios

All Amounts in Billions of US Dollars

<table>
<thead>
<tr>
<th>Category</th>
<th>Larger Banks &gt; $3 Billion</th>
<th>Community Banks &lt; $3 Billion</th>
</tr>
</thead>
<tbody>
<tr>
<td>AG PROD</td>
<td>$27</td>
<td>$50</td>
</tr>
<tr>
<td>FARMS</td>
<td>$27</td>
<td>$62</td>
</tr>
<tr>
<td>MF</td>
<td>$230</td>
<td>$45</td>
</tr>
<tr>
<td>C&amp;D</td>
<td>$178</td>
<td>$80</td>
</tr>
<tr>
<td>CRE</td>
<td>$799</td>
<td>$343</td>
</tr>
<tr>
<td>C&amp;I</td>
<td>$1,432</td>
<td>$167</td>
</tr>
</tbody>
</table>

All Amounts in Billions of US Dollars
Commercial Loan Portfolios

CRE Loans Comprise a Major Portion of Community Banks’ Loan Portfolios

Community Banks hold less C&I Loans than do larger banks

LARGER BANKS > $3 BILLION

COMMUNITY BANKS < $3 BILLION

AG PROD
FARMS
MF
C&D
CRE
C&I
## Commercial Loans – Recent Rates of Growth

### Community Banks < $3 Billion

<table>
<thead>
<tr>
<th>Portfolio Size</th>
<th>CRE</th>
<th>C&amp;I</th>
<th>C&amp;D</th>
<th>FARMS</th>
<th>AG</th>
<th>MF</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>$343 B</td>
<td>0.19%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$167 B</td>
<td></td>
<td>1.48%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$80 B</td>
<td></td>
<td></td>
<td>6.59%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$62 B</td>
<td></td>
<td></td>
<td></td>
<td>4.52%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$50 B</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>6.00%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>$45 B</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>3.51%</td>
<td></td>
</tr>
<tr>
<td>$747 B</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>2.05%</td>
</tr>
</tbody>
</table>

### Rates of Growth

- **LAST 5 YRS**
  - CRE: -0.55%
  - C&I: 1.01%
  - C&D: 0.42%
  - FARMS: 4.49%
  - AG: 5.11%
  - MF: 3.14%
  - TOTAL: 0.83%

- **LAST 9 QUARTERS**
  - CRE: 0.19%
  - C&I: 1.48%
  - C&D: 6.59%
  - FARMS: 4.52%
  - AG: 6.00%
  - MF: 3.51%
  - TOTAL: 2.05%
Credit Unions Loan Composition

2015
- RE LOANS: 51%
- NEW & USED VEHICLES: 33%
- MBLs: 7%
- CREDIT CARDS: 6%
- ALL OTHER: 3%

Total of $796.5 Billion
One Year Growth Rate 10.49%

2014
- RE LOANS: 51%
- NEW & USED VEHICLES: 33%
- MBLs: 7%
- CREDIT CARDS: 6%
- ALL OTHER: 4%

Total of $720.8 Billion

MBLs = $60 Billion
12.4% Growth in 2015
Growth Strategies – Creating a Favorable Mix Variance

Scenario

$550 M Asset Bank
L/A Ratio 60%
0.80% ROA
PFLL @ 0.40%
Tax Rate = 34%
Organic Growth of $30 M of Loans @ 3.75%

**Before**
- Loans - $330 M
  - Investments - $140 M
  - Loan Yield – 4.00%
  - Investment Yield – 1.95%
  - Earning Asset Yield – 2.90%
- After Tax Profit - $4.4 M
  - ROA – 0.80%

**After**
- Loans - $360 M
  - Investments - $110 M
  - Loan Yield – 3.98%
  - Investment Yield – 1.95%
  - Earning Asset Yield - 2.99%
  - Increased PFLL – ($120 K)
- After Tax Profit - $4.68 M
  - ROA – 0.85%
Growth Strategies – Cultivating Existing Relationships

Search for opportunities in your existing portfolio

Steps:

1. Analyze existing loan portfolio for profitability.
2. Give each lender a customer profitability report.
3. Identify customers with significant balances that currently have below average ROEs.
4. Proactively engage these customers to determine any additional borrowing or additional service needs.

Example…..
### Growth Strategies – Cultivating Existing Relationships

- Existing customer profitability

<table>
<thead>
<tr>
<th>Customer Detail for Officer BDD (Annualized Results Based on Data as of June, 2016)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average Balance</td>
</tr>
<tr>
<td>-----------------</td>
</tr>
<tr>
<td>$1,562,246</td>
</tr>
<tr>
<td>$705,931</td>
</tr>
<tr>
<td>$429,405</td>
</tr>
<tr>
<td>$1,726,809</td>
</tr>
<tr>
<td>$1,485,404</td>
</tr>
<tr>
<td>$330,896</td>
</tr>
<tr>
<td>$352,560</td>
</tr>
<tr>
<td>$489,357</td>
</tr>
<tr>
<td>$1,113,889</td>
</tr>
<tr>
<td>$313,018</td>
</tr>
<tr>
<td>$489,948</td>
</tr>
<tr>
<td>$439,848</td>
</tr>
<tr>
<td>$333,175</td>
</tr>
<tr>
<td>$1,860,000</td>
</tr>
</tbody>
</table>

- Customers with larger balances, but lower that average ROE
Growth Strategies – Cultivating Existing Relationships

- Customer has existing term loan and business checking account

- Customer needs additional operating LOC
Growth Strategies – Cultivating Existing Relationships

- Additional LOC grows portfolio and increases ROE
Be active with loan participations

- Go after large lending opportunities in your market even if they exceed your lending limit
  - Result: Grows portfolio with higher ROEs

- Form relationships with banks in other markets and become a buyer and a seller of loan participations

Example.....
Growth Strategies – Participation Strategies

- $1mm In-house CRE Loan
  - 7 Year, Fixed-Rate @4.25%
  - ROE: 14.09%

- $5mm CRE Loan
  - 80% participated, 25bps fee
  - ROE: 21.41%
Growth Strategies – Managing Extension Risk

Be selective with loan terms

- Most borrowers are looking for long-term loans
  - 84 months, 120 months
- Be wary of longer amortization periods (25 years vs. 15 years)
  - Increased interest rate risk and decreased profitability
- Negotiate a shorter rate reset period to improve profitability and mitigate interest rate risk
  - 10-year balloon with a 5-year rate reset period

Example.....
Growth Strategies – Managing Extension Risk

- $1mm CRE Loan
- 10 Yr Fixed/20 Yr Amort
- Rate: 4.84% for 15% ROE

- $1mm CRE Loan
- 5 Yr Fixed/10 Yr Ball/20 Yr Amort
- Rate: 4.00% for 15% ROE
Growth Strategies – Gathering Commercial Deposits

Improve ROE by adding deposits to loan only relationships

- Some existing borrowers hold primary checking accounts elsewhere

- PROS: A full relationship leads to lower loan rates for customer
  - Higher ROE for Bank
  - More durable relationship

- CONS: None

Example: Impact of moderate operating checking account added.....
### Growth Strategies – Gathering Commercial Deposits

- **$500k CRE Loan Customer**
  - With NO deposits
  - Rate: **4.25%** for 60 Months

- **$500k CRE Loan Customer**
  - With $50K NIB-DDA
  - Rate: **4.25%** for 60 Months

---

<table>
<thead>
<tr>
<th>Loan Amount ($)</th>
<th>Profit</th>
<th>ROE</th>
<th>Minimum/Desired</th>
</tr>
</thead>
<tbody>
<tr>
<td>$458,085</td>
<td>$30,182</td>
<td>14.84%</td>
<td>12.00% 15.00%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Relationship</th>
<th>Profit</th>
<th>ROE</th>
<th>Minimum/Desired</th>
</tr>
</thead>
<tbody>
<tr>
<td>$50,000</td>
<td>$2,459</td>
<td>54.63%</td>
<td>12.00% 15.00%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Total</th>
<th>Profit</th>
<th>ROE</th>
<th>Minimum/Desired</th>
</tr>
</thead>
<tbody>
<tr>
<td>$508,085</td>
<td>$32,641</td>
<td><strong>15.50%</strong></td>
<td>12.06% 15.00%</td>
</tr>
</tbody>
</table>

#### Relationship: Customer & Related Customers

- **Include**: Account Description: NON-INTEREST BEARING CHECKING
  - Balance: $50,000
  - Credit %: 2.00
  - COF %: 0.00
  - Annual Fees: $0.00
  - Provision Exp %: 0.00
  - Origination Expense ($) : $125.00
  - Annual Var Exp ($) : $80.00
  - Annual Fix Exp ($) : $150.00
  - Capital Alloca: 1.80
Growth Strategies - Determining ROE Targets

- Analyze existing portfolio to determine existing product ROEs
  - Include product costs, funding curve, provision and capital allocation
- Segment portfolio into various tranches based on loan size
- Set ROE targets above current return levels
- Set minimum ROE target on smallest loan size tranche
Growth Strategies - Determining ROE Targets

Analyze existing portfolio

<table>
<thead>
<tr>
<th>PRODUCT DESCRIPTION</th>
<th>Number of Accounts</th>
<th>Average Account Size</th>
<th>Net Active Balance</th>
<th>Interest Income</th>
<th>Credit for Funding</th>
<th>Interest Expense</th>
<th>Cost of Funding</th>
</tr>
</thead>
<tbody>
<tr>
<td>COMMERCIAL REAL ESTATE LOC</td>
<td>155</td>
<td>$231,980</td>
<td>$35,956,950</td>
<td>$1,534,961</td>
<td>4.27%</td>
<td>$319,462</td>
<td>0.89%</td>
</tr>
<tr>
<td>COMMERCIAL</td>
<td>724</td>
<td>$81,680</td>
<td>$59,136,221</td>
<td>$2,656,588</td>
<td>4.49%</td>
<td>$779,079</td>
<td>1.32%</td>
</tr>
<tr>
<td>COMMERCIAL LOC</td>
<td>403</td>
<td>$138,537</td>
<td>$55,830,438</td>
<td>$2,237,031</td>
<td>4.01%</td>
<td>$314,755</td>
<td>0.56%</td>
</tr>
<tr>
<td>COMMERCIAL REAL ESTATE</td>
<td>1,270</td>
<td>$232,021</td>
<td>$294,666,300</td>
<td>$13,046,096</td>
<td>4.43%</td>
<td>$4,046,092</td>
<td>1.37%</td>
</tr>
<tr>
<td>COMMERCIAL CONSTRUCTION</td>
<td>38</td>
<td>$606,682</td>
<td>$23,053,903</td>
<td>$1,074,179</td>
<td>4.66%</td>
<td>$158,824</td>
<td>0.69%</td>
</tr>
<tr>
<td>LEASE LOANS</td>
<td>19</td>
<td>$236,028</td>
<td>$4,484,526</td>
<td>$187,928</td>
<td>4.19%</td>
<td>$65,172</td>
<td>1.45%</td>
</tr>
<tr>
<td>EDC/MUNICIPAL</td>
<td>9</td>
<td>$1,380,357</td>
<td>$12,423,211</td>
<td>$438,853</td>
<td>3.53%</td>
<td>$216,913</td>
<td>1.75%</td>
</tr>
<tr>
<td>AGRICULTURE RE LOC</td>
<td>27</td>
<td>$232,922</td>
<td>$6,288,900</td>
<td>$246,685</td>
<td>3.92%</td>
<td>$56,723</td>
<td>0.90%</td>
</tr>
<tr>
<td>AGRICULTURE</td>
<td>167</td>
<td>$70,924</td>
<td>$11,844,375</td>
<td>$444,846</td>
<td>3.76%</td>
<td>$132,433</td>
<td>1.12%</td>
</tr>
<tr>
<td>AGRICULTURE LOC</td>
<td>211</td>
<td>$117,945</td>
<td>$24,886,495</td>
<td>$1,007,627</td>
<td>4.05%</td>
<td>$130,584</td>
<td>0.53%</td>
</tr>
<tr>
<td>AGRICULTURE RE</td>
<td>184</td>
<td>$263,576</td>
<td>$48,497,960</td>
<td>$2,012,390</td>
<td>4.15%</td>
<td>$880,630</td>
<td>1.82%</td>
</tr>
<tr>
<td>AGRICULTURE CONSTRUCTION</td>
<td>3</td>
<td>$45,010</td>
<td>$135,031</td>
<td>$5,149</td>
<td>3.81%</td>
<td>$2,085</td>
<td>1.54%</td>
</tr>
<tr>
<td>PRIVATE BUSINESS MANAGER</td>
<td>1</td>
<td>$110,384</td>
<td>$110,384</td>
<td>-</td>
<td>0.00%</td>
<td>$740</td>
<td>0.67%</td>
</tr>
<tr>
<td>LETTER OF CREDIT</td>
<td>13</td>
<td>$-</td>
<td>$-</td>
<td>-</td>
<td>0.00%</td>
<td>$-</td>
<td>0.00%</td>
</tr>
<tr>
<td>Total Commercial and Ag Loans</td>
<td>3,224</td>
<td>$179,067.83</td>
<td>$577,314,695</td>
<td>$24,892,334</td>
<td>4.31%</td>
<td>$7,103,592</td>
<td>1.23%</td>
</tr>
</tbody>
</table>

Continued on next slide…
## Growth Strategies - Determining ROE Targets

Analyze existing portfolio

<table>
<thead>
<tr>
<th>PRODUCT DESCRIPTION</th>
<th>Net Interest Margin ($)</th>
<th>Margin</th>
<th>Total Expense (incl provision)</th>
<th>Profit</th>
<th>ROE</th>
<th>Previous Quarter ROE</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>COMMERCIAL REAL ESTATE LOC</td>
<td>$ 1,215,499</td>
<td>3.38%</td>
<td>$ 483,826</td>
<td>$ 482,905</td>
<td>11.19%</td>
<td>10.87%</td>
<td>0.32%</td>
</tr>
<tr>
<td>COMMERCIAL</td>
<td>$ 1,877,508</td>
<td>3.17%</td>
<td>$ 1,679,785</td>
<td>$ 130,498</td>
<td>1.84%</td>
<td>2.54%</td>
<td>-0.70%</td>
</tr>
<tr>
<td>COMMERCIAL LOC</td>
<td>$ 1,922,277</td>
<td>3.44%</td>
<td>$ 907,580</td>
<td>$ 669,700</td>
<td>10.00%</td>
<td>9.81%</td>
<td>0.19%</td>
</tr>
<tr>
<td>COMMERCIAL REAL ESTATE</td>
<td>$ 9,000,004</td>
<td>3.05%</td>
<td>$ 3,126,277</td>
<td>$ 3,876,660</td>
<td>10.96%</td>
<td>11.27%</td>
<td>-0.30%</td>
</tr>
<tr>
<td>COMMERCIAL CONSTRUCTION</td>
<td>$ 915,355</td>
<td>3.97%</td>
<td>$ 152,931</td>
<td>$ 503,200</td>
<td>18.19%</td>
<td>18.13%</td>
<td>0.06%</td>
</tr>
<tr>
<td>LEASE LOANS</td>
<td>$ 122,756</td>
<td>2.74%</td>
<td>$ 63,576</td>
<td>$ 39,059</td>
<td>7.26%</td>
<td>7.51%</td>
<td>-0.25%</td>
</tr>
<tr>
<td>EDC/MUNICIPAL</td>
<td>$ 221,940</td>
<td>1.79%</td>
<td>$ 17,100</td>
<td>$ 135,195</td>
<td>9.07%</td>
<td>8.76%</td>
<td>0.31%</td>
</tr>
<tr>
<td>AGRICULTURE RE LOC</td>
<td>$ 189,962</td>
<td>3.02%</td>
<td>$ 72,211</td>
<td>$ 77,716</td>
<td>10.30%</td>
<td>8.84%</td>
<td>1.46%</td>
</tr>
<tr>
<td>AGRICULTURE</td>
<td>$ 312,413</td>
<td>2.64%</td>
<td>$ 418,716</td>
<td>$(70,160)</td>
<td>4.94%</td>
<td>-5.63%</td>
<td>-0.69%</td>
</tr>
<tr>
<td>AGRICULTURE LOC</td>
<td>$ 876,463</td>
<td>3.52%</td>
<td>$ 459,213</td>
<td>$ 275,702</td>
<td>9.23%</td>
<td>9.27%</td>
<td>-0.03%</td>
</tr>
<tr>
<td>AGRICULTURE RE</td>
<td>$ 1,131,761</td>
<td>2.33%</td>
<td>$ 498,088</td>
<td>$ 418,224</td>
<td>7.19%</td>
<td>7.00%</td>
<td>0.18%</td>
</tr>
<tr>
<td>AGRICULTURE CONSTRUCTION</td>
<td>$ 3,064</td>
<td>2.27%</td>
<td>$ 5,700</td>
<td>$(1,740)</td>
<td>-10.74%</td>
<td>-12.31%</td>
<td>1.58%</td>
</tr>
<tr>
<td>PRIVATE BUSINESS MANAGER</td>
<td>$(740)</td>
<td>-0.67%</td>
<td>$ 1,900</td>
<td>$(1,742)</td>
<td>-13.15%</td>
<td>-10.20%</td>
<td>-2.95%</td>
</tr>
<tr>
<td>LETTER OF CREDIT</td>
<td>$ -</td>
<td>0.00%</td>
<td>$ 24,700</td>
<td>$ -</td>
<td>0.00%</td>
<td>0.00%</td>
<td>0.00%</td>
</tr>
<tr>
<td>Total Commercial and Ag Loans</td>
<td>$ 17,788,743</td>
<td>3.08%</td>
<td>$ 7,911,602</td>
<td>$ 6,535,215</td>
<td>9.43%</td>
<td>9.47%</td>
<td>-0.04%</td>
</tr>
</tbody>
</table>
Notes on analyzing existing portfolio

1. Assign a cost of funding to each loan based on term and origination date or last rate reset date.

2. Cost allocation should reflect institution’s actual expense structure. In other words, 100% of institution’s non-interest expense should be allocated amongst loans, deposits and treasury management.

3. Provision expense allocated by product type based on general reserves or loss history.

4. Capital should be allocated based on product risk weighting.

5. Compare ROE trends period-to-period to ensure trend is moving in a positive direction.
# Growth Strategies - Determining ROE Targets

<table>
<thead>
<tr>
<th>Loan Portfolio Targets</th>
<th>Total Portfolio</th>
<th>&lt; $250,000</th>
<th>&gt;= $250,000 and &lt; $1,000,000</th>
<th>&gt;= $1,000,000</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>PRODUCT DESCRIPTION</strong></td>
<td><strong>Number of Accounts</strong></td>
<td><strong>Current ROE</strong></td>
<td><strong>Number of Accounts</strong></td>
<td><strong>Current ROE</strong></td>
</tr>
<tr>
<td>Commercial Real Estate LOC</td>
<td>155</td>
<td>11.19%</td>
<td>117</td>
<td>2.57%</td>
</tr>
<tr>
<td>Commercial</td>
<td>724</td>
<td>1.84%</td>
<td>681</td>
<td>-8.91%</td>
</tr>
<tr>
<td>Commercial LOC</td>
<td>403</td>
<td>10.00%</td>
<td>358</td>
<td>-3.15%</td>
</tr>
<tr>
<td>Commercial Real Estate</td>
<td>1,270</td>
<td>10.96%</td>
<td>1,015</td>
<td>2.71%</td>
</tr>
<tr>
<td>Commercial Construction</td>
<td>38</td>
<td>18.19%</td>
<td>25</td>
<td>8.63%</td>
</tr>
<tr>
<td>Lease Loans</td>
<td>19</td>
<td>7.25%</td>
<td>14</td>
<td>-5.15%</td>
</tr>
<tr>
<td>EDC/Municipal</td>
<td>9</td>
<td>9.07%</td>
<td>2</td>
<td>-30.00%</td>
</tr>
<tr>
<td>Agriculture RE LOC</td>
<td>27</td>
<td>10.30%</td>
<td>22</td>
<td>2.45%</td>
</tr>
<tr>
<td>Agriculture</td>
<td>167</td>
<td>-4.94%</td>
<td>157</td>
<td>-12.93%</td>
</tr>
<tr>
<td>Agriculture LOC</td>
<td>211</td>
<td>9.23%</td>
<td>188</td>
<td>3.30%</td>
</tr>
<tr>
<td>Agriculture RE</td>
<td>184</td>
<td>7.19%</td>
<td>122</td>
<td>3.12%</td>
</tr>
<tr>
<td>Agriculture Construction</td>
<td>3</td>
<td>-10.74%</td>
<td>3</td>
<td>-10.74%</td>
</tr>
<tr>
<td>Private Business Manager</td>
<td>1</td>
<td>-13.15%</td>
<td>1</td>
<td>-13.15%</td>
</tr>
<tr>
<td>Letter of Credit</td>
<td>13</td>
<td>0.00%</td>
<td>13</td>
<td>0.00%</td>
</tr>
<tr>
<td>Total Commercial and Ag Loans</td>
<td>3,224</td>
<td>9.43%</td>
<td>2,719</td>
<td>-0.44%</td>
</tr>
<tr>
<td>Consumer Loan</td>
<td>1,574</td>
<td>-14.83%</td>
<td>1,573</td>
<td>-16.65%</td>
</tr>
<tr>
<td>Consumer Real Estate</td>
<td>1,165</td>
<td>6.91%</td>
<td>1,117</td>
<td>5.55%</td>
</tr>
<tr>
<td>Consumer Construction</td>
<td>21</td>
<td>10.55%</td>
<td>17</td>
<td>8.66%</td>
</tr>
<tr>
<td>Home Equity</td>
<td>1,280</td>
<td>-2.34%</td>
<td>1,278</td>
<td>-3.82%</td>
</tr>
<tr>
<td>Total Retail Loans</td>
<td>4,045</td>
<td>3.62%</td>
<td>3,985</td>
<td>1.74%</td>
</tr>
<tr>
<td>Total Loans</td>
<td>7,270</td>
<td>8.32%</td>
<td>6,704</td>
<td>0.45%</td>
</tr>
</tbody>
</table>
Growth Strategies – Assure Appropriate Pricing

Range of Pricing Offered

- Stop
- Caution
- Safe
- Risk

Below Market Pricing
- Growth in Balance
- Decreased Returns

In the Market
- Appropriate Pricing Zone

Out of the Market Overpricing
- Loss of Volume & Relationships
Growth Strategies – Assure Appropriate Pricing

**Objectively Manage Pricing Decisions**

- Rate Sheets

- Loan Pricing System
  - Loans only
  - Full relationship

- Profitability System
  - Customer
  - Product
  - Officer

- Good
- Better
- Best
Growth Strategies – Assuring Appropriate Pricing

The Problem with Rate Sheets

- One size fits all
- Doesn’t take into account size
- Not based on profitability / ROE
- Fails to give client credit for other profitable business
- Inaccurate
Growth Strategies – Assuring Appropriate Pricing

Benefits of Loan Pricing Systems

- Objective guidance
- Doesn’t take authority away from lenders, it increases it
- Profitability & ROE based
- Gives client credit for other profitable business
- Provides input to support negotiation process
  - Increase / decrease rate, fees, term, added business
- Accurate
Growth Strategies – Assuring Appropriate Pricing

A loan pricing system allows you to...

Find the **lowest possible rate / most favorable terms** to **achieve your target ROE**

---

**Total Relationship Summary**

<table>
<thead>
<tr>
<th>Description</th>
<th>Balance</th>
<th>Credit</th>
<th>COF</th>
<th>Fees</th>
<th>Provision</th>
<th>Orig</th>
<th>VE</th>
<th>FE</th>
<th>Profit</th>
<th>ROE</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Loan # 1A</td>
<td>$434,962</td>
<td>3.75 %</td>
<td>1.20</td>
<td>$250</td>
<td>0.69</td>
<td>$600</td>
<td>$1,500</td>
<td>$6,000</td>
<td>$29,491</td>
<td>15.07%</td>
</tr>
<tr>
<td>NON-INTEREST BEARING CHECKING</td>
<td>$20,000</td>
<td>2.00 %</td>
<td>0.00</td>
<td>$0</td>
<td>0.00</td>
<td>$125</td>
<td>$400</td>
<td>$750</td>
<td>$479</td>
<td>26.58%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$454,962</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td><strong>$29,970</strong></td>
<td></td>
</tr>
</tbody>
</table>

*Note: new loan detailed fee and cost data can be found on individual loan tabs or on the loan input report*

---

<table>
<thead>
<tr>
<th>Description</th>
<th>Balance</th>
<th>Equity %</th>
<th>Equity</th>
<th>Profit</th>
<th>ROE</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Loan # 1A</td>
<td>$434,962</td>
<td>9.00 %</td>
<td>$39,147</td>
<td>$29,491</td>
<td>15.07%</td>
</tr>
<tr>
<td>NON-INTEREST BEARING CHECKING</td>
<td>$20,000</td>
<td>1.80 %</td>
<td>$360</td>
<td>$479</td>
<td>26.58%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$454,962</strong></td>
<td><strong>9.00 %</strong></td>
<td><strong>$39,507</strong></td>
<td><strong>$29,970</strong></td>
<td><strong>15.17 %</strong></td>
</tr>
</tbody>
</table>

Yield Curves Updated: 2/5/2016

<table>
<thead>
<tr>
<th></th>
<th>Total Target</th>
<th>Loan Target</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Target</td>
<td>12.03 %</td>
<td>15.00 %</td>
</tr>
<tr>
<td>Loan Target</td>
<td>12.00 %</td>
<td>15.00 %</td>
</tr>
</tbody>
</table>
Growth Strategies – Assuring Appropriate Pricing

Benefits of Profitability System

- Provides Insights on Customer, Product & Officer Returns

<table>
<thead>
<tr>
<th>Officer</th>
<th>Balance</th>
<th>Interest Income</th>
<th>CFF%</th>
<th>Fee Income</th>
<th>Provision Expense</th>
<th>Profit</th>
<th>ROE%</th>
</tr>
</thead>
<tbody>
<tr>
<td>BDD</td>
<td>$64,402,555</td>
<td>$2,885,325</td>
<td>4.48</td>
<td>$134,548</td>
<td>$36,623</td>
<td>$1,205,220</td>
<td>18.07</td>
</tr>
<tr>
<td>KPP</td>
<td>$33,389,296</td>
<td>$1,662,322</td>
<td>4.98</td>
<td>$43,135</td>
<td>$14,317</td>
<td>$780,250</td>
<td>21.41</td>
</tr>
<tr>
<td>WMC</td>
<td>$51,332,466</td>
<td>$1,442,797</td>
<td>2.81</td>
<td>$249,937</td>
<td>$23,966</td>
<td>$411,107</td>
<td>16.34</td>
</tr>
<tr>
<td>PWL</td>
<td>$27,345,610</td>
<td>$864,771</td>
<td>3.16</td>
<td>$111,185</td>
<td>$8,308</td>
<td>$271,844</td>
<td>15.19</td>
</tr>
<tr>
<td>RHR</td>
<td>$14,719,237</td>
<td>$404,838</td>
<td>2.75</td>
<td>$30,982</td>
<td>$10,356</td>
<td>$139,871</td>
<td>14.33</td>
</tr>
</tbody>
</table>
Growth Strategies – Assuring Appropriate Pricing

Benefits of Profitability System

- Each lender knows their current portfolio ROE
- Recognize ROE trends
- Each lender understands what’s driving the profitability inside of each customer relationship (Loan / Deposit, Fees)
- Identifies Top 10 most profitable relationships (MUST RETAIN)
- Also, Bottom 10 least profitable relationships (MUST IMPROVE)
- Evaluate other client relationships needing improvement
Other Loan Growth Strategies & Goals

**Considerations for Lending in the Current Environment**
(Assumes Loan / Deposit Ratio is < 75% and the bank is sufficiently liquid to allow / fund loan growth)

- Make every loan that meets your credit standards
- Make every loan that exceeds your ROE targets
- Establish your Minimum ROE target at the lowest level possible which still represents improvement
- Consider interest rate swaps for long-term FR deals – smaller community banks are managing these with vendor assistance

DIAL BACK THE ABOVE TO YOUR BANK’S COMFORT LEVEL
Other Loan Growth Strategies & Goals

**Considerations for Lending in the Current Environment**

(Assumes Loan / Deposit Ratio is < 75% and the bank is sufficiently liquid to allow / fund loan growth)

- Be recognized in your marketplace as borrower friendly

- Be willing to take on a known / limited level of interest rate risk when you are being paid to do so

- Be willing to take on a known / limited level of credit risk when you are being paid to do so

DIAL BACK THE ABOVE TO YOUR BANK’S COMFORT LEVEL
Questions?

THANK YOU FOR ATTENDING TODAY’S WEBINAR!
Austin Associates 2016 Webinar Series

Upcoming Webinars

- Seven Secrets of Consistently High Performing Community Banks  
  March 22, 2016

- M & A Update & Case Studies  
  April 20, 2016

Stay tuned for more to follow…
We appreciate hearing from you.

If you have questions or comments, regarding today’s Webinar, or if you would like to see any of your bank’s current customer relationships modeled, please feel free to contact us at any time.

To receive a personalized demonstration of the Austin Profitability System - simply contact Jeff to arrange a date and time for your demonstration.

To receive a personalized demonstration of LoanPricingPRO® - simply contact Andy to arrange a date and time for your demonstration.

Jeff Morris
Managing Director & Principal
Financial Management & Consulting
jmorris@austinassociates.com
419-517-1775

Andy Morgan
Managing Director & Principal
Financial Management & Consulting
amorgan@austinassociates.com
419-517-1777