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May 6 & 7, 2024

Saltmarsh BankChat: Cost of Funds and Other Liquidity Issues

Josh Strickland, Shareholder

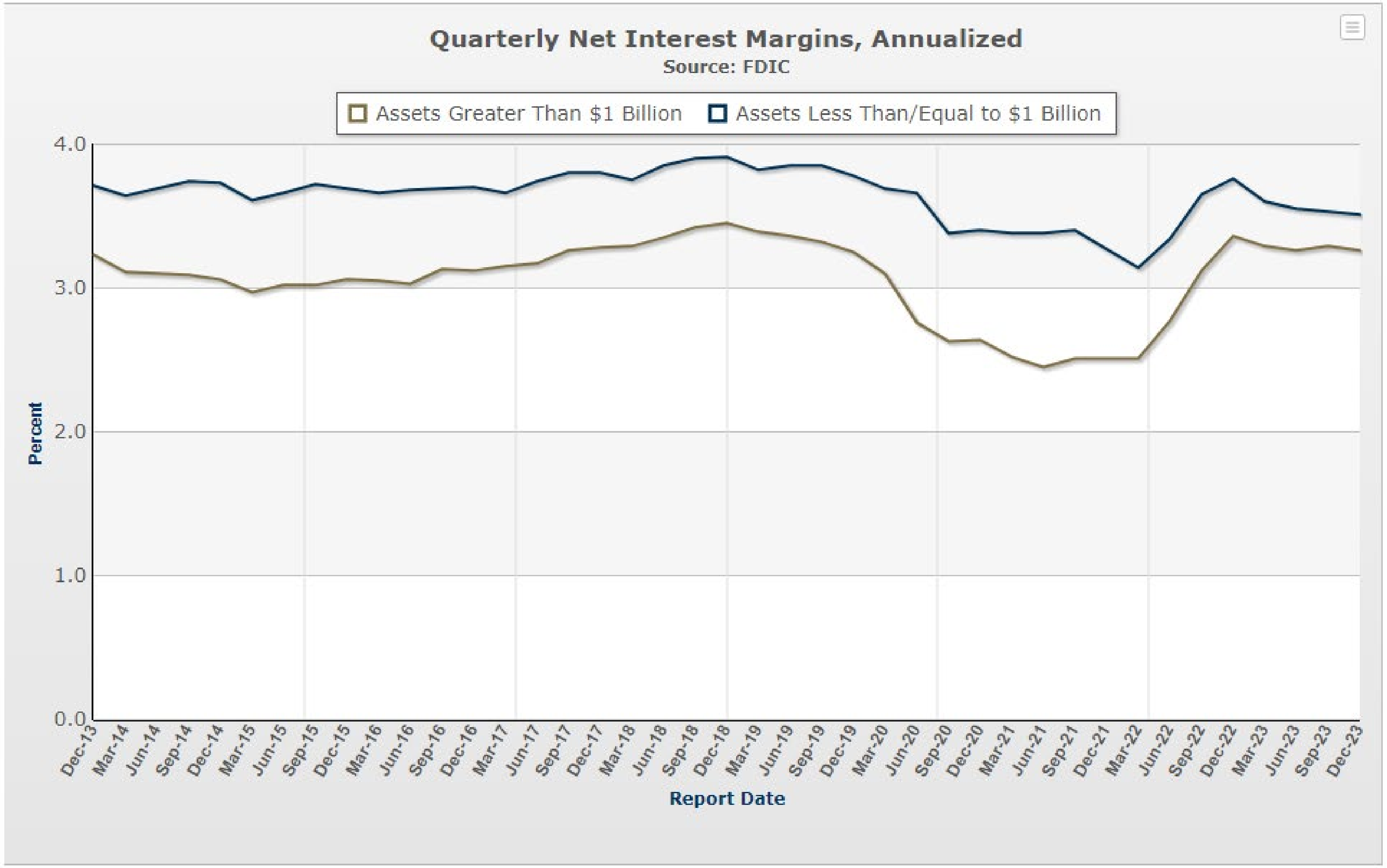
Paul Allen, Director

Can I have my 4% NIM back now….?

- The past few years have been historically unusual, as we worked through the COVID crisis and the impact on money supply and liquidity
- The most significant challenge the banking industry has dealt with recently has been the shrinking NIM, first due to significant reductions in asset yields, then compounded by the dramatic increase in cost of funds
- Adding to that stress, in early 2023, we had a liquidity crisis driven primarily by a concentration of funding issue

SELECT REPORT RANGE

BEGIN DATE December 31, 2013 END DATE December 31, 2023 REFRESH CHART



FDIC 12/31/2023 NIM
2013 to 2023

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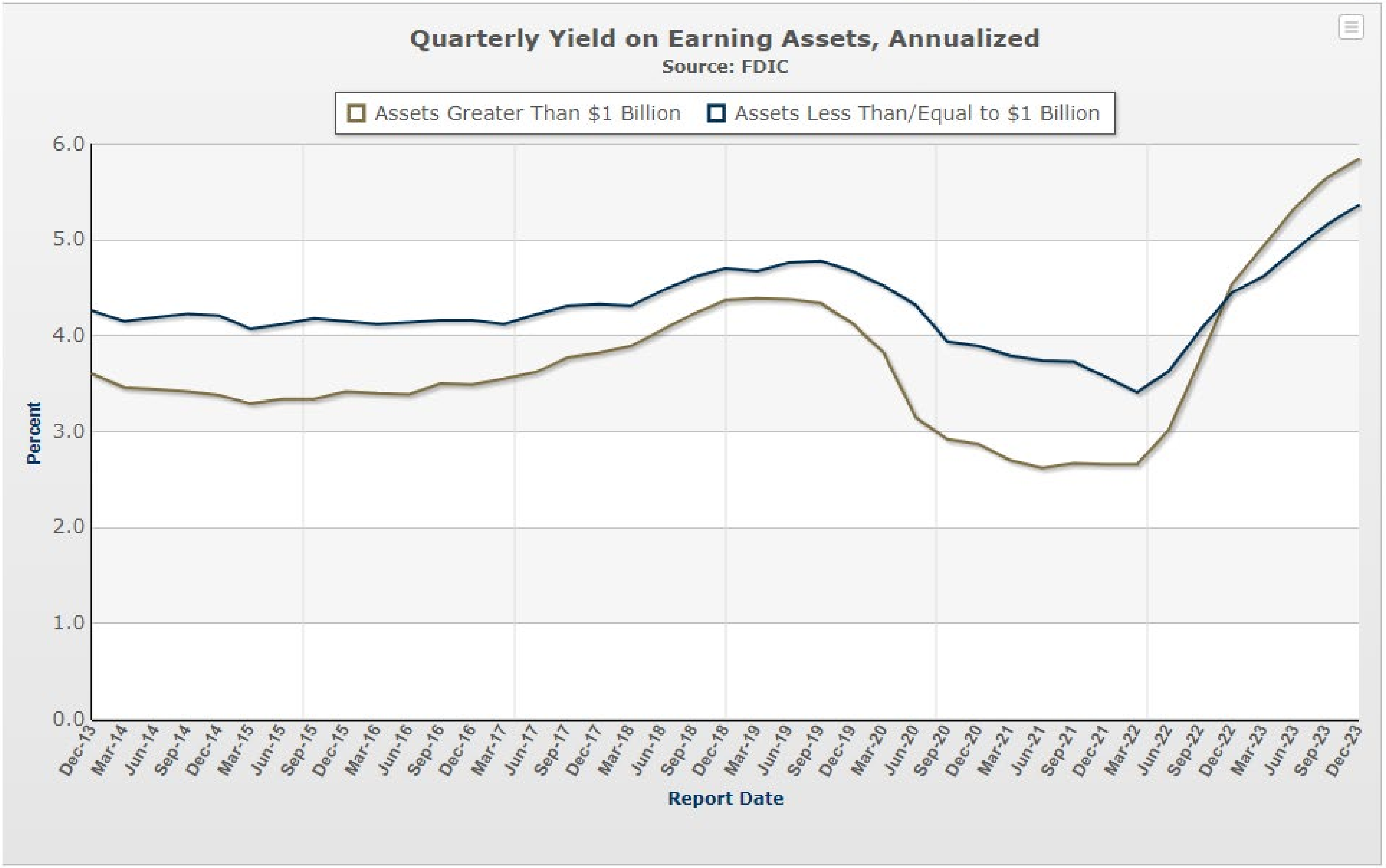

FDIC 12/31/2023
Asset Yields
2013 to 2023

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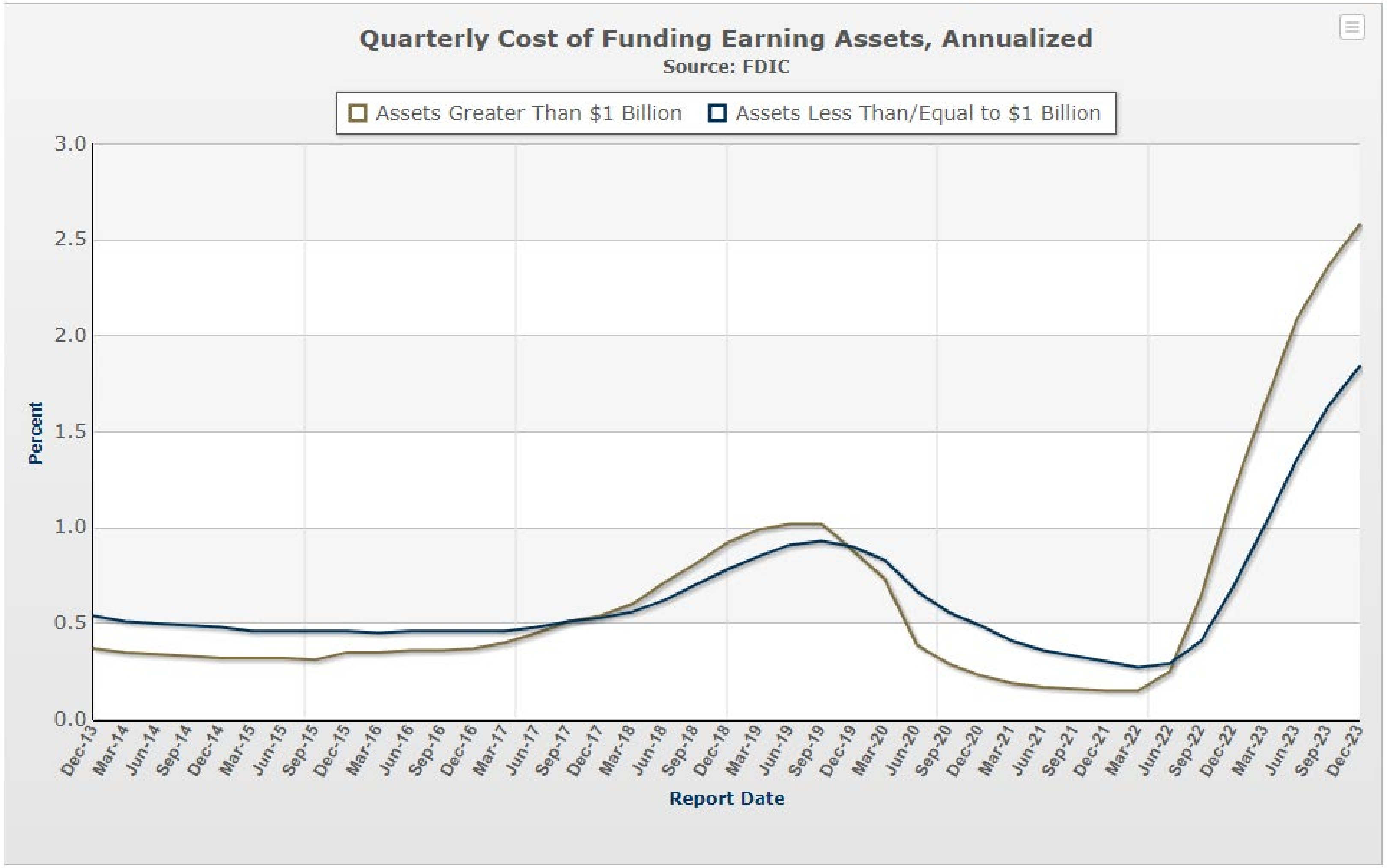

FDIC 12/31/2023
Cost of Funds
2013 to 2023

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What we are hearing from our client base…

- Funding and funding costs remain a very high priority to our community bank clients, as competition for deposits has risen dramatically, both from other banks as well as from “the Street” (broker MMDA accounts) and from other non-bank entities
- CDs have again become a strategic offering, and consumer demand for CDs has picked up dramatically
- Given the shape of the yield curve (inverted or flat), it is very challenging to match fund loans

Bits and pieces from industry analysts and media stories

- April 2024: Yield curves stay inverted for 94 consecutive weeks
- April 2024: Fed Reserve data shows Loans -0.3%, C&I -.2% and Deposits -.8% in 2024; Industry Loan to Deposit is 71% (versus 60% in April 2022), compared to community bank LTD 84% (versus 67% in April 2022).
- From 2011 to 2019, Core or nonmaturity funds averaged 72%, compared to 76% currently.
- Mix of funding has shifted, with levels of CDs and Borrowings back to pre-pandemic levels in 2019

YTD 2024 Growth Rates and Ratios for the U.S. Banking Industry: *Deposit Trends Have Been Positive*

$Dollar Change

	Total Deposits	Large Time Dep	Other Deposits	Borrowings
2Q-2024	(225.4)	14.0	(239.4)	88.5
1Q-2024	77.3	96.2	(18.9)	(32.4)
4Q-2023	338.3	99.4	238.9	37.6
3Q-2023	17.1	170.9	(153.8)	(36.8)
2Q-2023	(102.6)	144.0	(246.6)	(31.4)
1Q-2023	(577.2)	192.4	(769.6)	510.0
2023Y	(247.1)	606.7	(931.1)	479.4

This shares more Deposit detail for US Banking system in recent months *(Fed H.8 thru 4-26-24, 1-week lag)*

LOANS: -0.3% YTD '24, +2.4% 2023Y

DEPOSITS: -0.8% YTD '24, -1.9% 2023Y

A close look reveals Banks' CDs and Borrowings are back to pre-pandemic levels in 2019

% Mix: **Late 2019 to April 2024**

	Large Time Dep	Other Deposits	Borrowings (% Total Funding)
4Q-2019	13.7%	86.3%	12.5%
1Q-2020	12.3%	87.7%	13.5%
2Q-2020	10.9%	89.1%	10.2%
3Q-2020	9.9%	90.1%	9.6%
4Q-2020	9.0%	91.0%	9.1%
1Q-2021	8.6%	91.4%	8.6%
2Q-2021	8.3%	91.7%	8.0%
3Q-2021	7.9%	92.1%	8.5%
4Q-2021	7.6%	92.4%	8.2%
1Q-2022	7.8%	92.2%	7.9%
2Q-2022	8.1%	91.9%	8.3%
3Q-2022	8.8%	91.2%	8.9%
4Q-2022	9.2%	90.8%	9.4%
1Q-2023	10.6%	89.4%	12.0%
2Q-2023	11.5%	88.5%	11.9%
3Q-2023	12.5%	87.5%	11.7%
4Q-2023	12.8%	87.2%	11.7%
1Q-2024	13.3%	86.7%	11.5%
2Q-2024	13.5%	86.5%	12.0%

% Funding: **Late 2019 to April 2024**

	Core Funding	Non-Core Funding
4Q-2019	75.5%	24.5%
1Q-2020	75.9%	24.1%
2Q-2020	80.0%	20.0%
3Q-2020	81.5%	18.5%
4Q-2020	82.7%	17.3%
1Q-2021	83.5%	16.5%
2Q-2021	84.4%	15.6%
3Q-2021	84.2%	15.8%
4Q-2021	84.8%	15.2%
1Q-2022	84.9%	15.1%
2Q-2022	84.2%	15.8%
3Q-2022	83.1%	16.9%
4Q-2022	82.3%	17.7%
1Q-2023	78.7%	21.3%
2Q-2023	78.0%	22.0%
3Q-2023	77.3%	22.7%
4Q-2023	77.0%	23.0%
1Q-2024	76.7%	23.3%
2Q-2024	76.3%	23.7%

Source (all charts): Janney Research, Fed H.8 weekly data thru 4-26-24

Why the focus on IRR and Liquidity Management?

- Net interest income is 70 to 90 percent of most community banks' earnings.
- Value of Capital is also at risk due to changes in market interest rates, because the market value of capital is driven by the underlying cash flows from the bank's mix of assets and liabilities, discounted back at current market rates
- Liquidity levels are closely tied to interest rate movements, as the bank's liquidity cost represents the cost to fund the assets acquired. Liquidity management must be coordinated with interest rate risk management, along with consideration of external market forces that may impact liquidity.
- How can I prepare for the impact if the economic conditions in my market get worse? If my NPAs and charge-offs go up? How should I consider external crisis scenarios (for example, hurricanes or a pandemic)?

Regulatory Focus on Liquidity

- If you haven't yet…you'll be asked about liquidity stress testing, and about how you are tracking "large balance" customers; this is normally more detailed than just a request for uninsured deposit levels
- Should be discussing how best to track large balance customers and about reasons and details of (at least significant) deposit outflows
- Worth revisiting your CFP and Liquidity related policies
- Worth spending some time on your beta and decay assumptions in your ALM model, given recent market conditions

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FAST FACTS

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At Saltmarsh, we believe the way to achieve success is by contributing to the success of others, which is why we thrive in ***genuine relationships***. Our passion for people and ***excellence*** is more than a shared value; it's the foundation of our work.

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150+ PROFESSIONALS

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5

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Destin
Orlando
Pensacola
Tampa

TENNESSEE
Nashville

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AN AFFILIATE OF SALTMARSH, CLEAVELAND & GUND

THE BDO ALLIANCE USA

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