REDUCING YOUR LIABILITY AND FUNDING COSTS

by Steve Brown

Studies show human beings have to hear things over and over again until something new sinks in. Maybe that is why we have so many meetings in order to get things done. Whatever the reason, it can take awhile before things finally click in the brain. This crossed our minds when we took a closer look at the 2Q cost of deposits analysis (using FDIC data). The national average rate for a 12 month CD is about 27bp (as you can see in the yield box in this publication). Yet, using call report data we find that 50% of the banks in the country still have an interest bearing cost of funds above 81bp and 80% are still above 54bp. That means despite the extensive work your team has already done to cut funding costs - there is still probably room to go lower. Liquidity is plentiful, so grinding down the rate right now on what you will pay for deposits only makes sense. Loans are scarce, investment alternatives are low-yielding and deposits keep rolling in, so keep working to reduce your funding 1bp at a time and don't give up. We know that many readers are probably wondering really how much more can really come from this side of the margin equation. Well, we are here to tell you that unless your funding cost is below the national average, there is more work to be done to enhance profits by reducing funding costs. We know it takes time and significant effort, but as you work things down, profitability will follow. Even better, if you need more help in doing this or are just tired of it, give us a call and we can assist. If you are already near the bottom on funding and are skeptical you can push your costs any lower, consider the impact of even moving it down by 5bp. Take your overall deposit balance, multiply it by 5bp and you can see the impact on your bank can be substantial, so every bank should keep trying. As you scrape to save, the end result is worth the journey. Although the moves you will get now aren't as big as they were at the beginning, even small ones can help improve performance. Additionally, while deposit structures can vary widely and the average rate is just that, a hyper-focus on cutting funding costs generates results. Perhaps even more interesting, when you go deeper into the FDIC data, you find the rates offered for a given product can range over 100bp from the lowest to the highest. That means there is plenty of room to improve. The situation right now is that people know when they deposit money into your bank you just aren't going to pay them very much. They expect you to offer a very low rate and some even have a vague understanding that the Fed has done something recently that will pulling rates even lower. Depositors might not understand all nuances, but they also don't expect much for their deposit and you can't afford to pay much given such low loan demand. To help your customers understand, consider even showing some the rate they can get on short-maturity Treasuries (negative or very low right now). Many customers will complain about the rate banks will pay for deposits and some will be disappointed, but they also know their options are limited. As you continue the funding cost reduction journey, focus your efforts and give us a call if you want help. Then, stay the course as you aim for a below average score. Unlike when you were in school, when it comes to funding costs, the key really is to be below average when you get your test score. Good luck and let us know if we can help along the way. We believe there is a bottom to how much more you can cut, but if rates keep declining and you can finance your home and car at all-time low rates, deposit rates must follow. The question to ask is how your bank stacks up in relation to the average, since funding is a liability in more ways than one (so even small steps can reduce it).

BANK NEWS

Funding Dominance

The FDIC Summary of Deposits report finds institutions with $10B or more in assets now control 74.4% of all deposits (as of Jun 30) vs. 72.4% a year prior.

Weak Loan Growth

Since the recession ended in 2009, GDP has grown 2.2% on average. As loan growth opportunities follow the general economy for the most part, that means banks on average are able to grow their loan portfolios by 2.2%. It is no wonder loan opportunities seem so few and far between and that competition is running so high.

Multifamily Lending

Research firm Reis reports the rental apartment vacancy rate fell to 4.6% in 3Q from 4.7% in 2Q, as rents increased 0.8% in the quarter. This is slower than the 1.1% increase in 2Q and may show the sector could be slowing down as housing picks back up.

Magic Number

Chicago Fed President Charles Evans told CNBC that the Fed will continue to do everything it can until the unemployment rate drops below 7%.

Arrested

KY businessman Wilbur Huff has been arrested on charges he was the mastermind behind a $100mm scheme that led to the collapse of Park Avenue Bank (NY), tried to steal money from the TARP program and sold an OK insurer for $37.5mm that later went into receivership. Prosecutors say Huff bribed bank officials, failed to pay taxes and committed fraud.

Mortgage Yields

Since the Fed announced QE3, yields investors can get buying current coupon 30Y securities have fallen from about 2.4% to 1.9%.

Hole to Fill

Spain's banks need an extra $76.3B to prop up capital and address the economic downturn that has hammered the Eurozone.

Global Malaise

The IMF's Chief Economist said it will take at least 10Ys for countries to emerge from the financial crisis that began in 2008.