How CFIs Can Prepare For Rising Rates

hedging lending funding

Summary: Recently, several Fed speakers have indicated that rising inflation rates could lead to an increase in interest rates as early as late 2022. With the current economic uncertainty, how can community financial institutions prepare? We have four ways, including identifying opportunities in existing lending niches and adding more fee income.

London cabbies train longer than any of their peers. They first study 3-4Ys, then learn the shortest routes around the city on a motor scooter before finishing with intense oral exams. While this surely prepares cabbies for the uncertainties of London traffic, it is unlikely to help with disruptions like Uber and Lyft.

Similarly, even with the best training, most bank management couldn't have anticipated the current flux of economic conditions. Just as things started to feel normal, supply and labor shortages persisted, prompting inflation at a faster click than expected. To counter this rising inflation, rate hikes could now come as soon as 2023, according to the Federal Open Market Committee. Rates could even start rising in late 2022, according to Atlanta Fed President Raphael Bostic. He said, "*Given the upside surprise in recent data points, I pulled forward my projection.*" Both Fed President Bostic and Fed Governor Michelle Bowman generally believe recent price increases may not abate as quickly as first thought. "*Temporary is going to be a little longer than we expected initially... Rather than it being two to three months it may be six to nine months,*" continued Fed President Bostic.

Here's how community financial institutions (CFIs) can prepare for these potential rate hikes.

1. Stay close to your customers for lending opportunities. In January, 48% of CFI CEOs said growing their loan portfolios will be one of their biggest challenges for 2021 — an increase from 33% in 2020. This is still the case, as uncertainty swirls around inflation and rising interest rates. Yet, there may be some momentum building as businesses seek financing for immediate needs or longer-term financing at today's lower rates.

The Fed's Senior Loan Officer Opinion Survey in July reported overall more robust demand for C&I loans and across all CRE loan categories. Specifically, in C&I, businesses looking for loans were financing inventory and capital expenditures, among others. Knowing this, keep a watch out for your customers, as they may need additional funding to expand their businesses. This can provide growth in immediate lines of credit or longer-term loans.

2. Expand existing lending niches. Continue to expand specialized lending areas. Becoming the go-to financial institution for certain loans could make many borrowers less rate-sensitive, especially with top-notch service. Nearly every CFI has some kind of niche; how can you reasonably expand what you already know and do well?

One $1.7B asset CFI in WI makes luxury motor coach loans nationally both via referrals from manufacturers and through its search engine optimization (SEO) efforts. In fact, the institution's name is the first one listed on Google organically, when people search "motor coach loan." Once customers find this CFI, they are likely to stay for the service. As their website states, "*We're always here to help you get to your incredible, and if that's* *a motor coach, we'll do it fast, smoothly, and handle all the details."* The CFI CFO states, "*Some of our customers want to talk to a live person, so we accommodate them depending on their comfort level with the channel.*"

3. Gather operating accounts. As lending opportunities arise, continue to ask your customers for their operating accounts and other related cash management services. While some customers have expanded out to fintech providers, now is the time to continue to re-capture the share of wallet. On the other hand, it may also be time to review your lower profitable accounts and if not done already, make sure that your staff is contacting each client and asking for additional accounts. Where accounts are not added, you may want to consider pricing these accounts appropriately.

4. Diversify for more fee income. As you consider expanding existing niches, make sure to look at total profitability, not only the contribution to NIM. Some CFIs are leveraging wealth management services for additional fees. Review your in-house advisory services, then perform a customer profitability analysis to maximize fee opportunities within your customer base where possible.

Following these four steps should help prepare and protect your institution from rising interest rates, whether they come sooner or later. If you have other ideas, we'd love to hear them.

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ECONOMY & RATES

Rates As Of: 08/11/2021 05:33AM (GMT-0700)

Treasury	Yields	MTD Chg	YTD Chg
3M	0.05	-0.01	-0.04
6M	0.05	0.00	-0.04
1Y	0.08	0.01	-0.03
2Y	0.24	0.06	0.12
5Y	0.84	0.14	0.47
10Y	1.38	0.13	0.45
30Y	2.02	0.11	0.36

FF Market	FF Disc	IORB
0.10	0.25	0.15
SOFR	**Prime**	**OBFR**
0.05	3.25	0.08