FTN FINANCIAL
CAPITAL ASSETS CORPORATION

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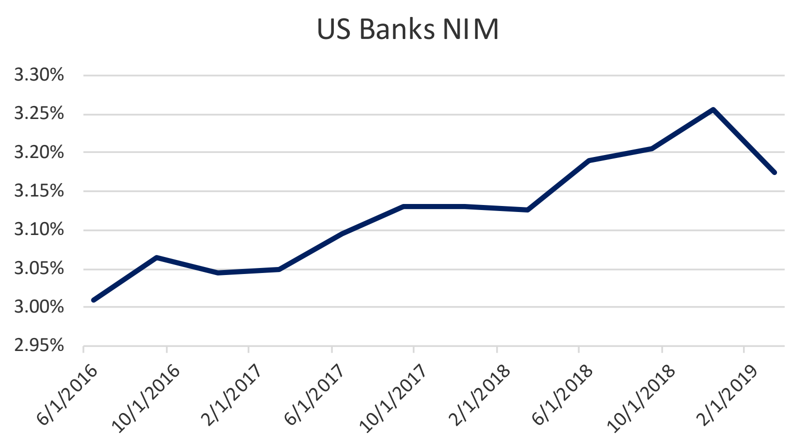
Weekly Comments by Rachael Leamon

FIRST QUARTER 2019 PUTS PRESSURE ON EARNINGS

While 2018 saw consistent improvement in NIM for most institutions, earnings in the first quarter of the new year made a pretty abrupt turn. Portfolio lenders will need to keep a sharp eye on maintaining the liquidity in the balance sheet as the year rolls on in case this trend continues.

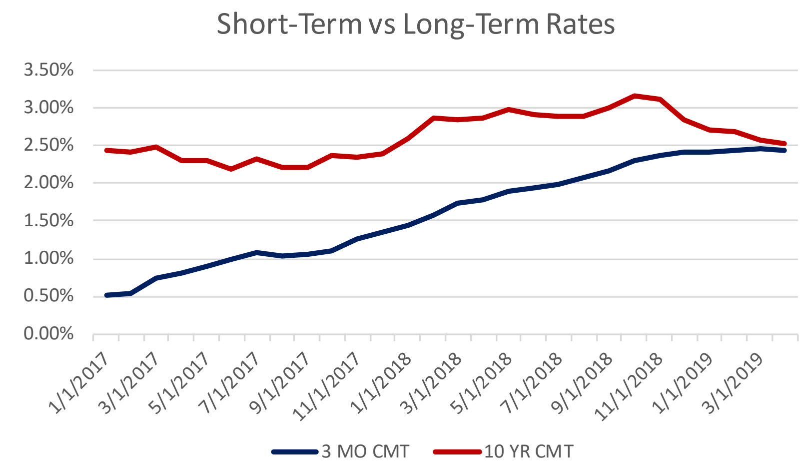
Net interest margins ("NIM") reached a historic low in the first quarter of 2015, at 2.95%. Since then, as the economy began to normalize and rates started to increase, depository institutions experienced a slow, but steady, improvement in NIM throughout the year.



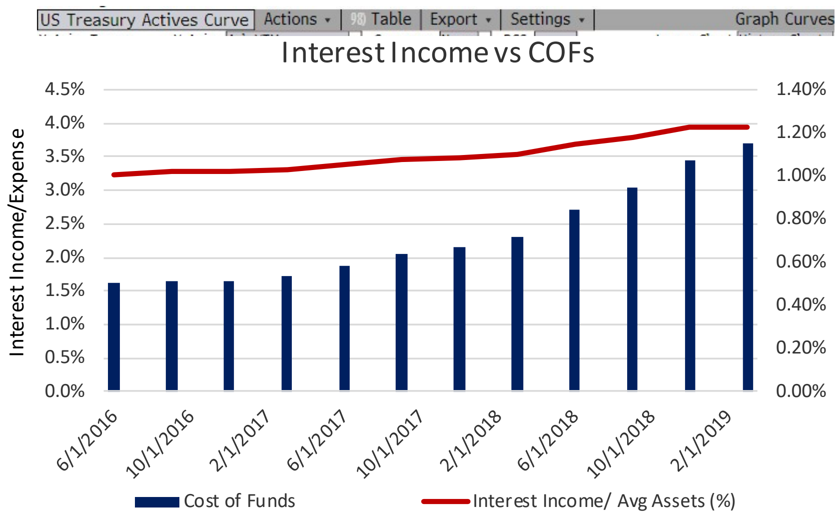
Source: S&P Global Market Intelligence

In Q1 2019, however, average margins took a drastic turn as the competition for deposits caused an increase in COFs industry-wide. The downward turn in NIM is not an isolated data point, but symptomatic of how liquidity needs can affect earnings. This situation could easily get worse before it gets better as we are less than half way through the year, which is why having a backup source of price-efficient liquidity is necessary in today's market.

The driver of the earnings crunch that depositories are experiencing into 2019 is, in part, market dynamics out of our control. As short-term rates have moved up and longer-term rates have dropped somewhat, the yield curve has begun to invert, putting further pressure on COFs.

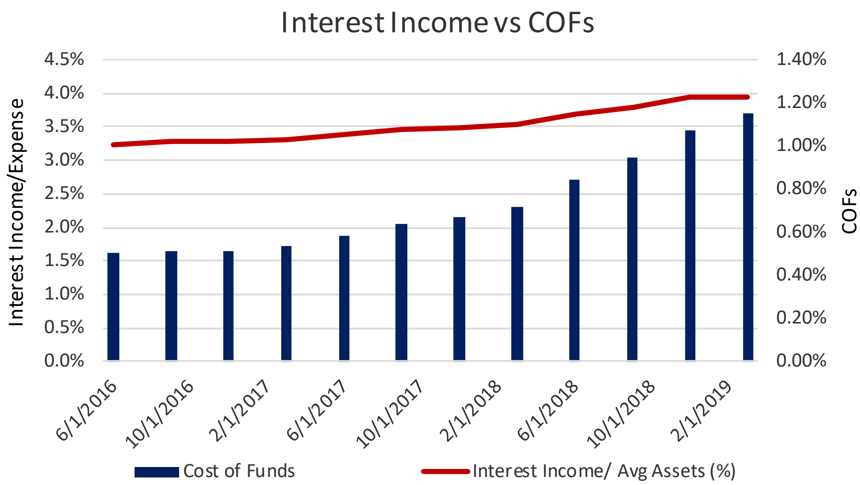


Source: Federal Reserve Economic Data



Source: S&P Global Market Intelligence
Source: Bloomberg

In tandem with market rates, liquidity also took a hit in Q1 as loan-to-deposit ratios spiked. The result of higher LTD ratios and lower liquidity ratios is that the already compressed NIM could continue to compress. Funding costs, escalating with short-term rates, is challenging to control due to the fierce competition for deposits.



Source: S&P Global Market Intelligence

We can control two things, however, to safeguard earnings in this market. One is when and how we can utilize the liquidity embedded in the retained loan portfolio. The second is how we add additional high-quality earning assets to the balance sheet to generate more earnings. FTN Financial Capital Assets Corporation ("Capital Assets") can help you develop liquidity contingency strategies that can produce liquidity very quickly should your institution experience an earnings pinch.

Most banks and credit unions own large portfolios of loans that are predominantly investment grade. As long-term rates have rallied, many institutions find that they can take advantage of the market to sell loans that not long ago priced at a big loss. In the majority of cases, these loan sales are part of a broader strategy to fund new loans and/or other initiatives. This type of "two-for-one" strategy (generate liquidity + IRR reduction) is unique to today's market. In markets where loan originations have continued to be sluggish, customers are looking to use the secondary market to supplement their originations. In addition to bulk purchases of prime credit loans to provide liquidity, we can arrange commitments whereby loans are originated on your documents to your credit specs (i.e., flow sales). This can be a highly effective way to meet budgeted growth goals.

At a minimum, you should have a good handle on the potential liquidity in the loan portfolio in order to demonstrate that you have the ability to access it, whether or not you need it in the immediate future. There is a reason Capital Assets is the oldest and largest loan advisory firm in the country specializing in bank and credit union portfolio lenders. Whether you want to get a good handle on your loan portfolio, document the embedded liquidity, or develop a growth strategy, contact your FTN Financial representative or Capital Assets directly at 800.456.5460.

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