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PRECISIONLENDER WEBINAR SERIES

2018 Commercial Banking Trends & 2019 Opportunities

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Methodology

- Primary data source: **PrecisionLender's proprietary database**; supplemented with **economic data** from several federal sources (FDIC, Federal Reserve, etc.)
- PrecisionLender's data reflects **actual commercial relationships** (loans, deposits and other fee-based business) from **over 200 banks**
- These banks are **geographically diverse**, with borrowers in all 50 states
- In order to provide an apples-to-apples comparison across banks, PrecisionLender has **aligned the risk rating systems** of all banks to a common scale and has built **mappings across products**
- PrecisionLender clients range from under $1B to over $1T in total assets, and are currently pricing more than **$600B in commercial loans** annually

Summary Points

1. **Anemic Loan Growth:** Despite strong economic indicators for much of 2018, commercial loan growth was surprisingly weak – particularly in the CRE market

2. **Demand Is the Issue:** The weak loan numbers weren't for a lack of bank effort; credit standards and pricing eased in 2018

3. **Spread Erosion:** Margin compression on commercial loans is happening throughout the product and deal size spectrum

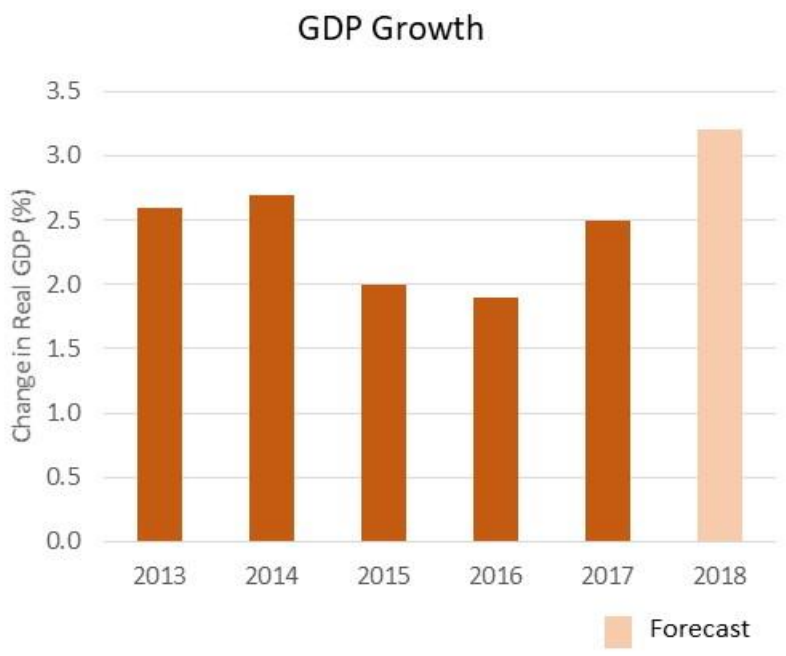
4. **Fees Are a Silver Lining:** Pricing declines in 2018 were partially mitigated by rising loan fee incidence on a variety of products

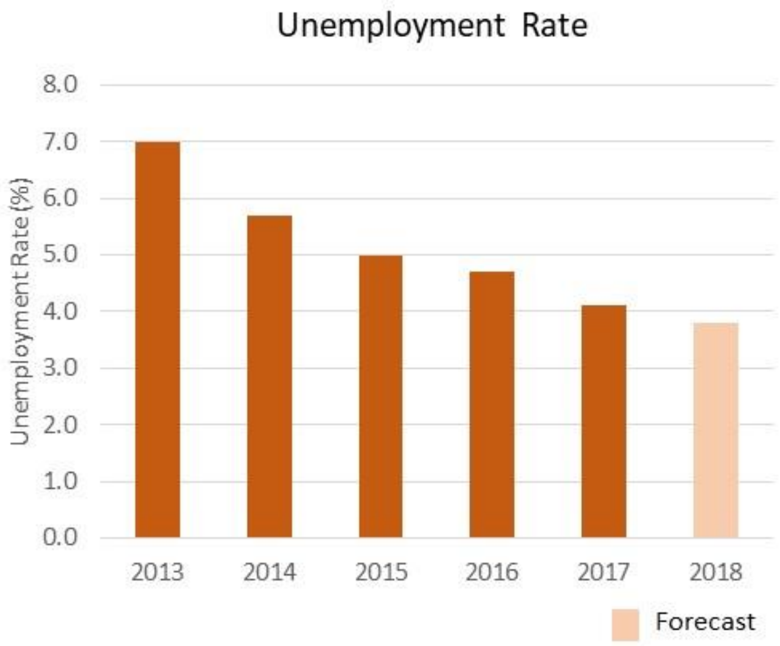
5. **Cross-Sell is Key:** More important than ever to focus on lucrative ancillary business

6. **Trends Can Be Bucked:** Some banks have shown that there are still ways to rise above the pack

Leading predictors of loan demand show encouraging signs…

Key economic indicators typically associated with loan demand

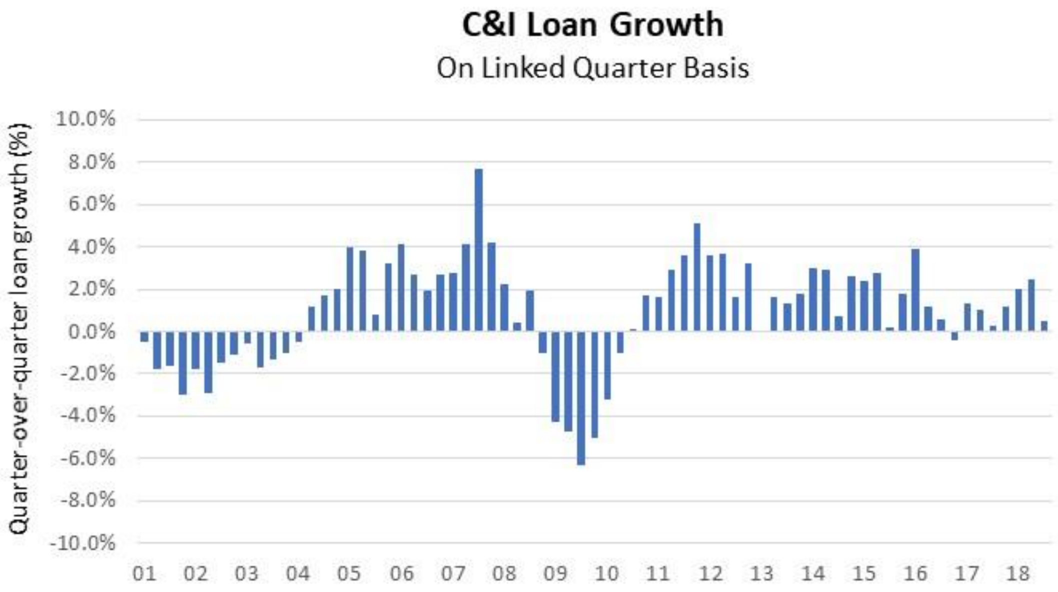


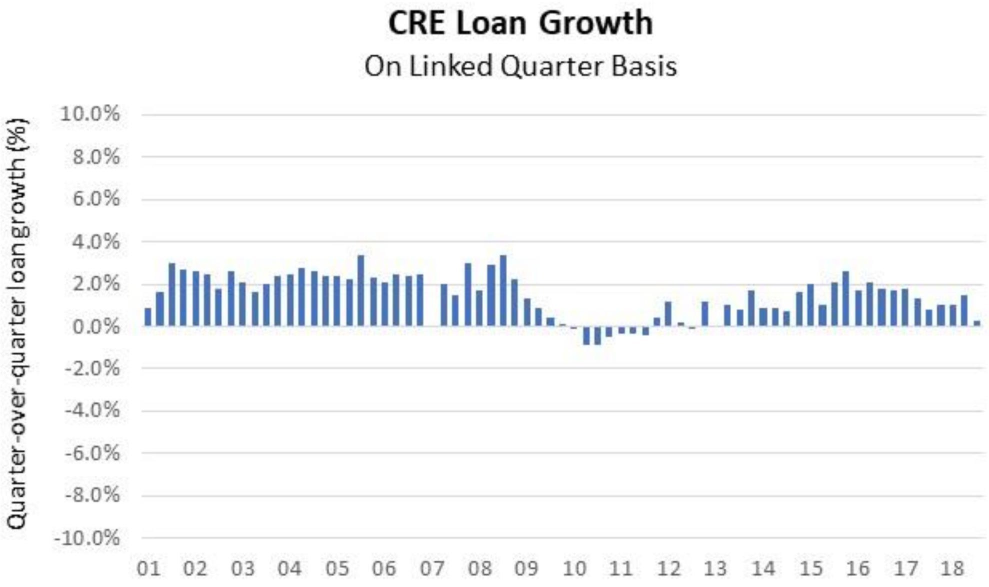


- Economic recovery moved into high gear in 2018, with declining unemployment and rising GDP
- Commercial loan volume was sure to follow. Or was it?

Source: Federal Reserve FOMC (Federal Open Market Committee) Projections

…yet volume remains anemic

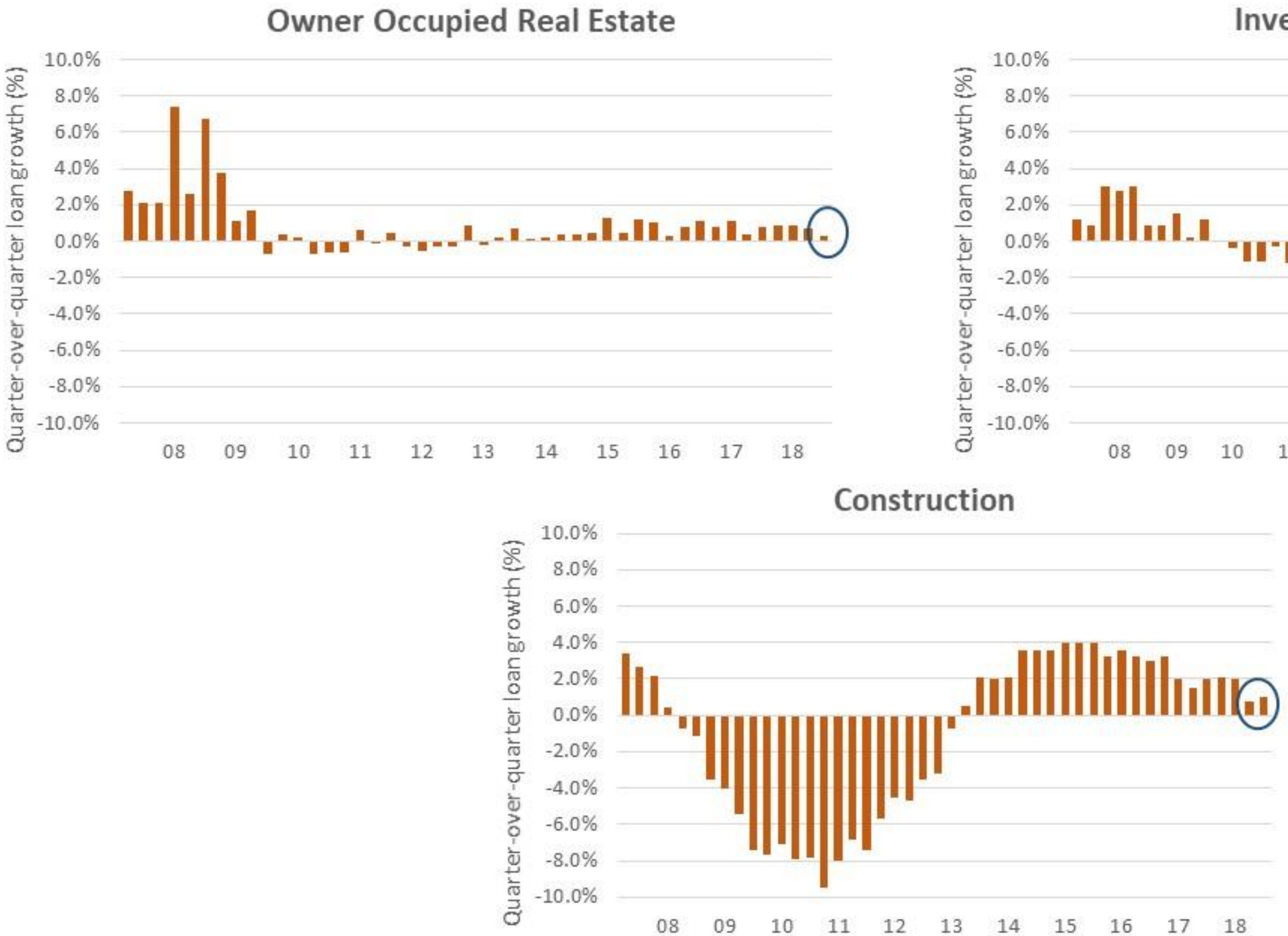




- Commercial loan growth has been remarkably weak for this point in the credit cycle
- Quarterly growth in C&I loans has not topped the 3% threshold since the first quarter of 2016
- Latest quarter barely positive in both C&I and CRE segments

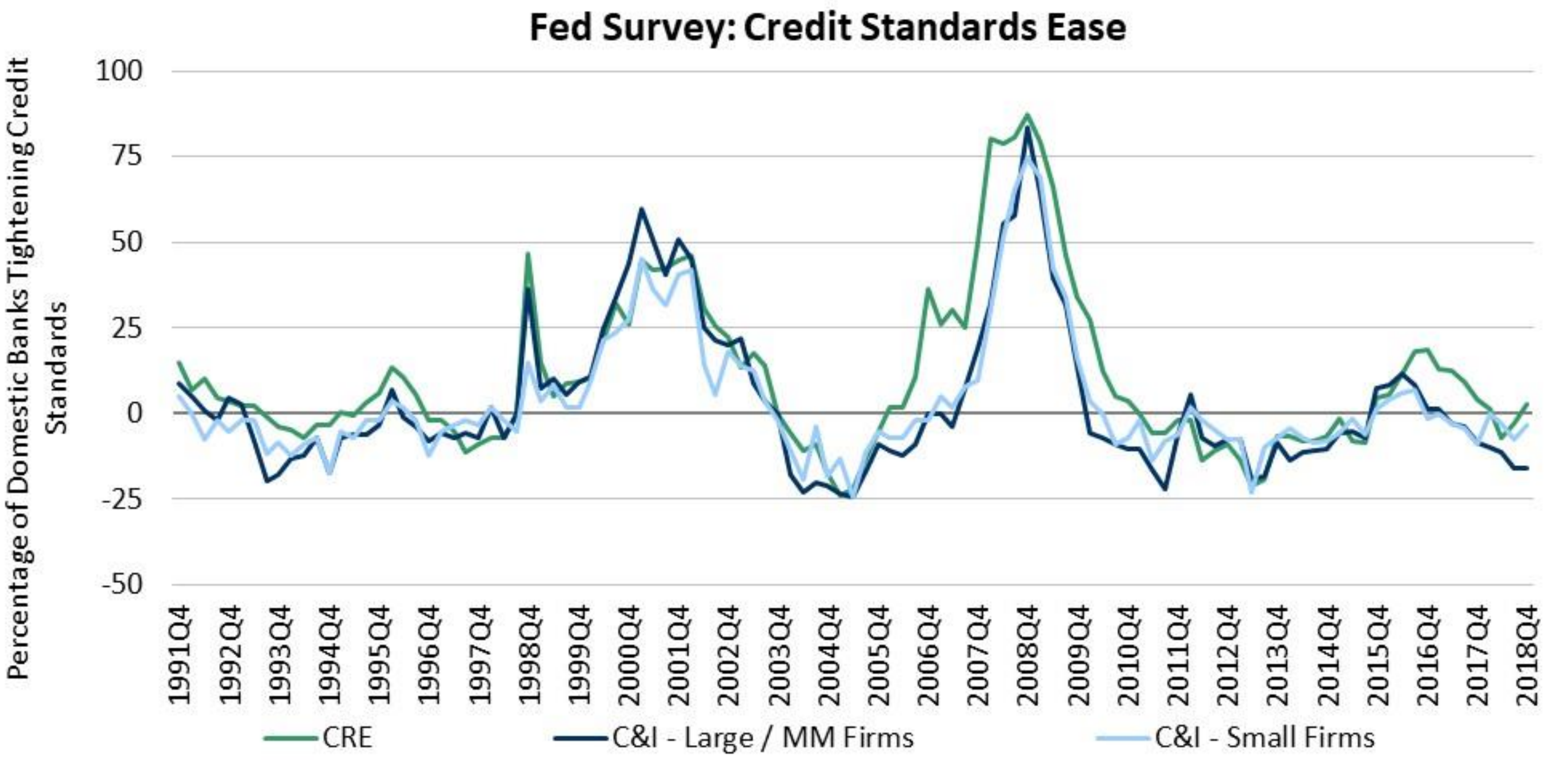
Source: FDIC. Criteria: All commercial banks irrespective of asset size. C&I reflects FDIC definition, which excludes owner-occupied real estate.

Declines span the CRE market



Source: FDIC. Criteria: All commercial banks irrespective of asset size. Real Estate categories reflect FDIC definitions.

Supply or Demand?



- Current slowdown not driven by the supply side – banks are open for business and are easing – not tightening
- Loosening of credit standards not limited to large, high-grade borrowers and spans all major business lines
- Lackluster volume reflection of weak loan demand

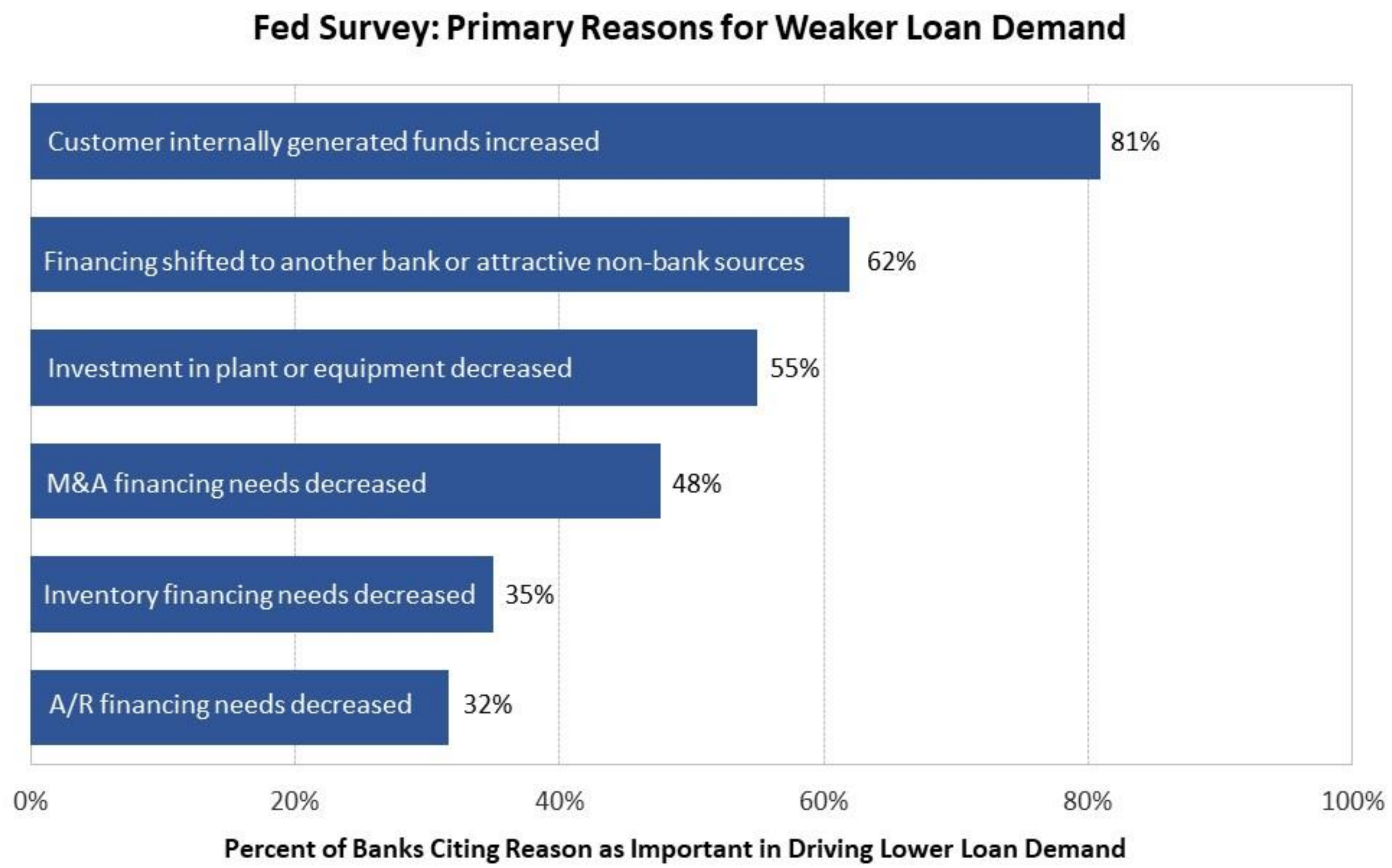
Source: Federal Reserve Senior Loan Officer Opinion Survey on Bank Lending Practices; CRE figures beginning in Q4 2013 exclude Construction and Land Development.

Cautious Borrowers, Rising Rates and Disintermediation

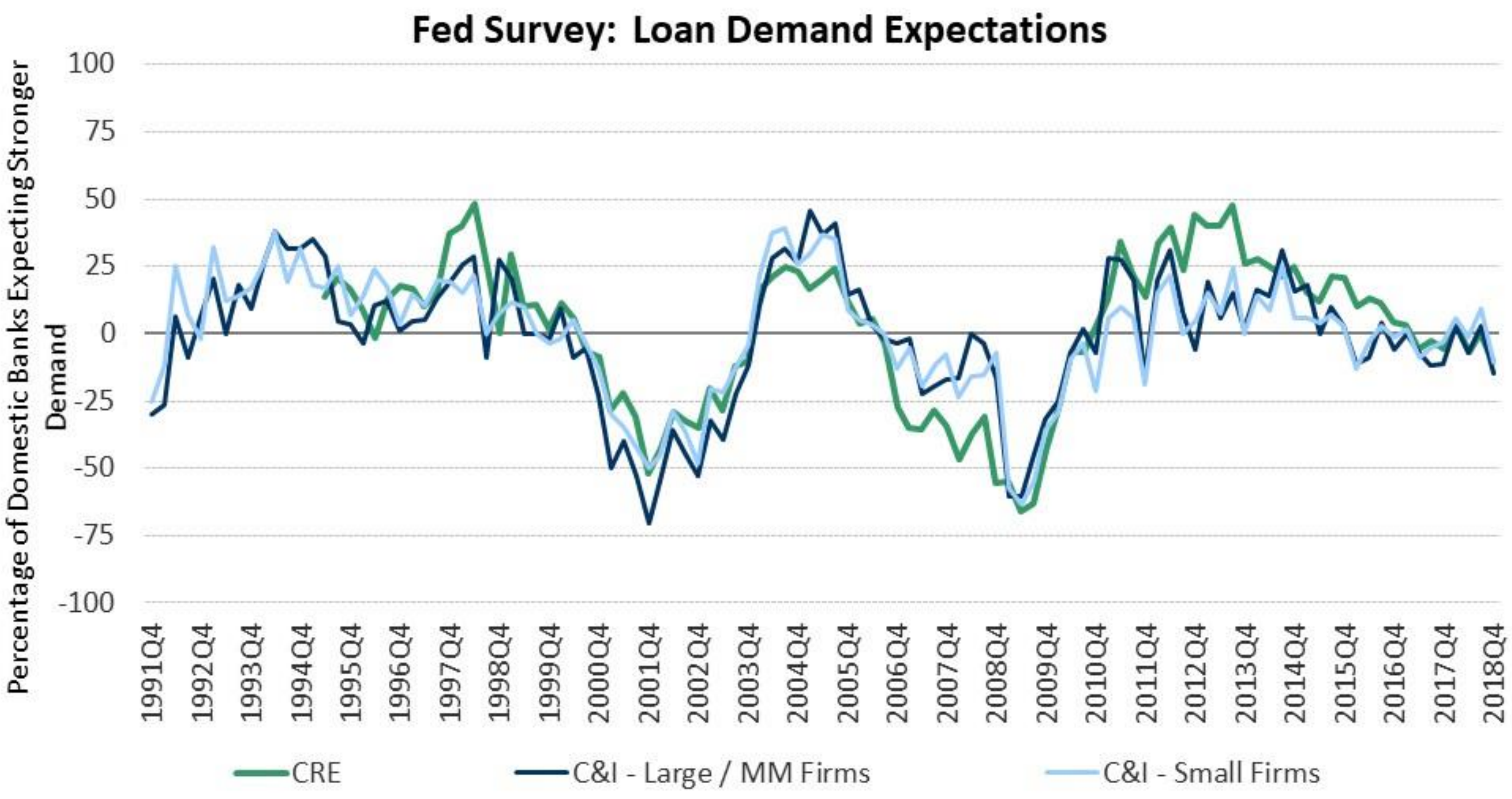
- Excess capital – driven by economic growth and recent tax cuts – reducing incentive to borrow, especially given rising cost of financing

- Disintermediation
  - Large Corporate: Bond and equity markets
  - Middle Market: Unregulated non-bank finance companies (NBFCs)
  - Business Banking: Fintechs

- Continued borrower conservatism, expenditures focused on strategic investments such as:
  - M&A
  - Efficiency gains (e.g. equipment)
  - Refinancings



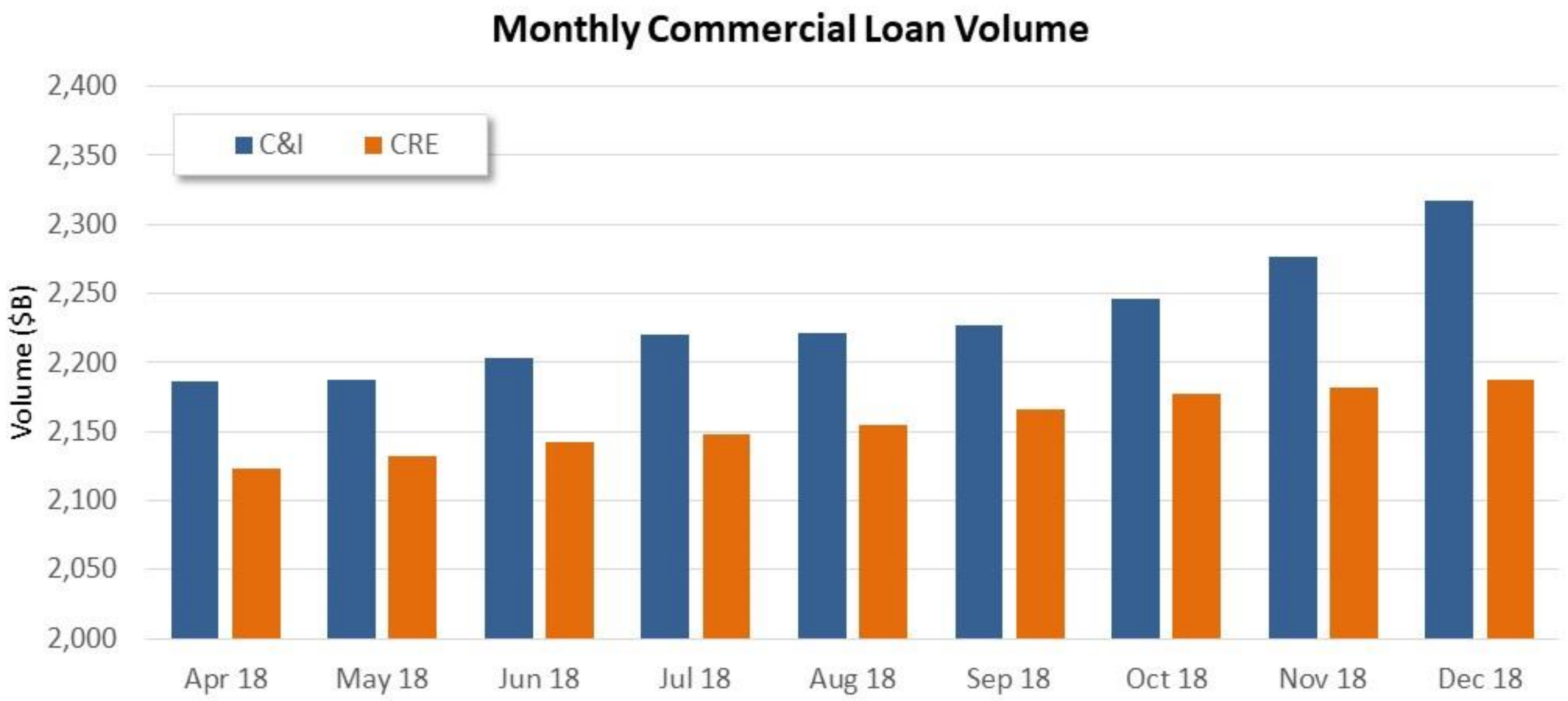
Bankers expect lower loan demand across business segments



- Senior lenders expect negative growth in both C&I and CRE markets
- Current expectations stand at the lowest levels since the start of the economic recovery

Source: Federal Reserve Senior Loan Officer Opinion Survey on Bank Lending Practices; CRE figures beginning in Q4 2013 exclude Construction and Land Development.

The late-year pickup – reason for optimism?



- C&I volume surged late in the year while CRE volume remained lackluster
- Some bankers take the rise in C&I volume as a positive sign for 2019, while others warn that the market dynamics leading to the weak results throughout most of the year are still at play

Source: Federal Reserve H8 Release.

Achieving Growth in a Declining Market

Some banks succeeding, against all odds, winning market share without eroding pricing or structure

Success factors include:

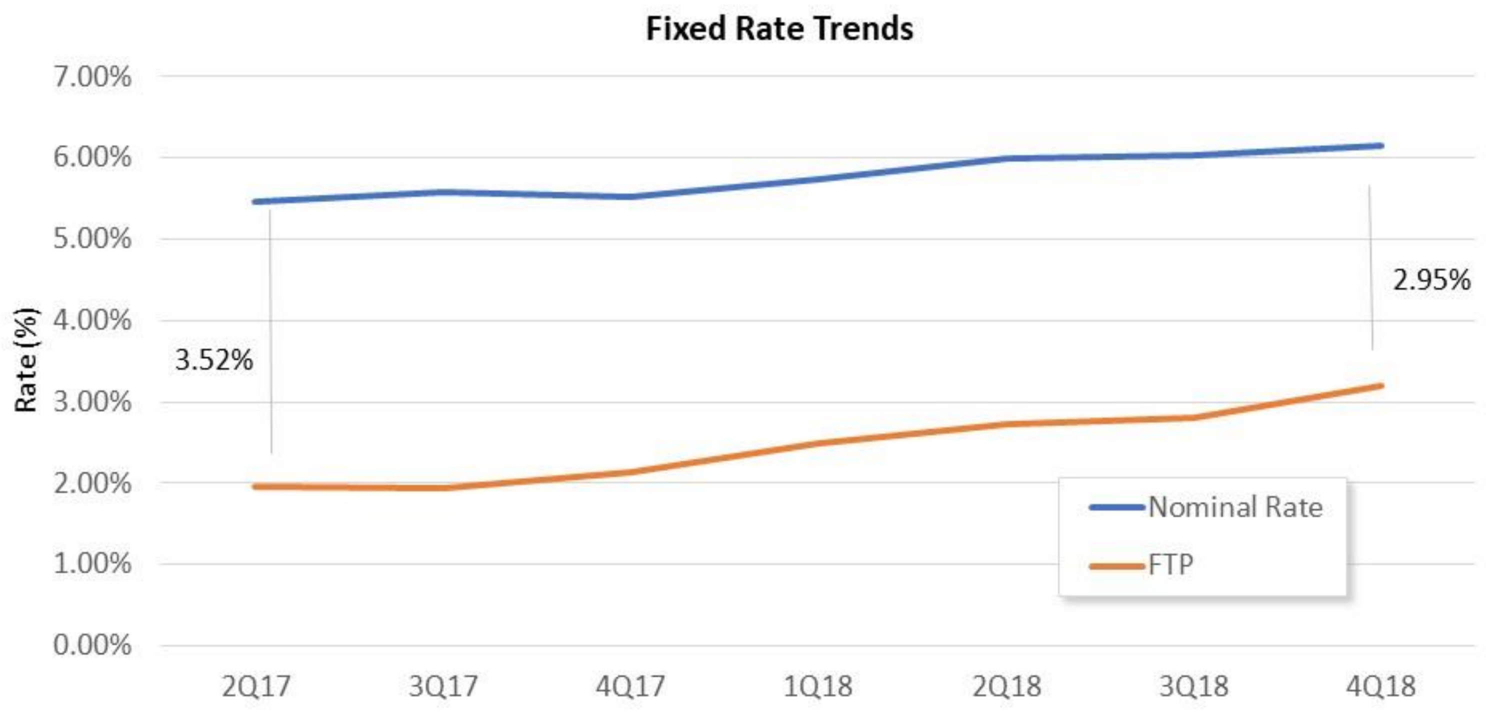
More tailored, value-added solutions to customers' business challenges

Understanding customer priorities and offering alternative structures

Delivering quicker turnaround and greater certainty of execution

In addition, by reducing the process burden on RMs and enabling them to spend more quality time with customers as a trusted financial partner, some banks have gained a competitive edge

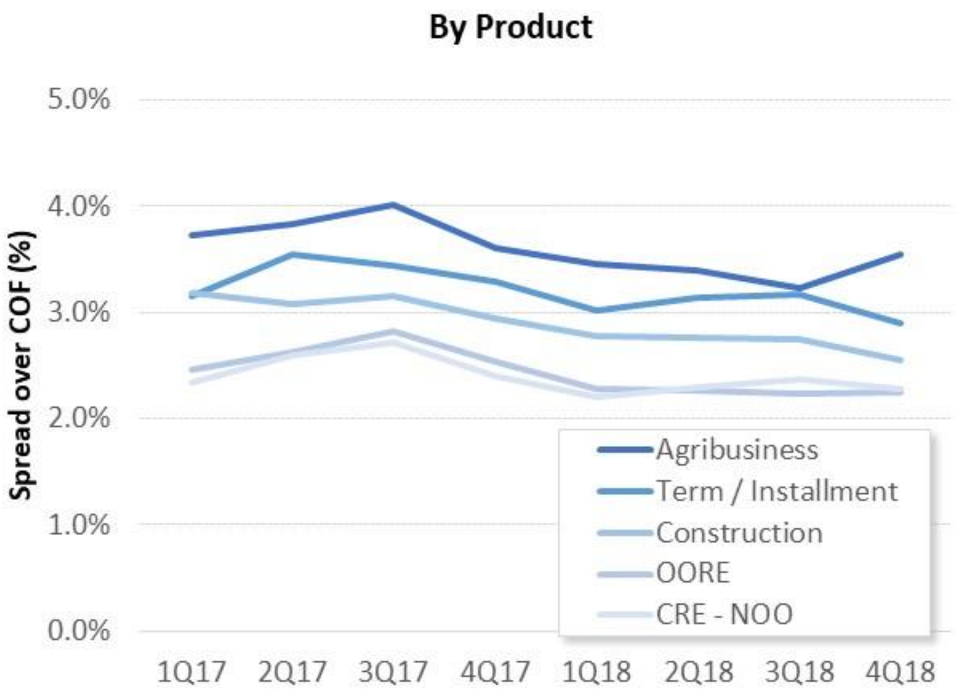
Pricing Trends: Rates Rise, Yet Margins Narrow

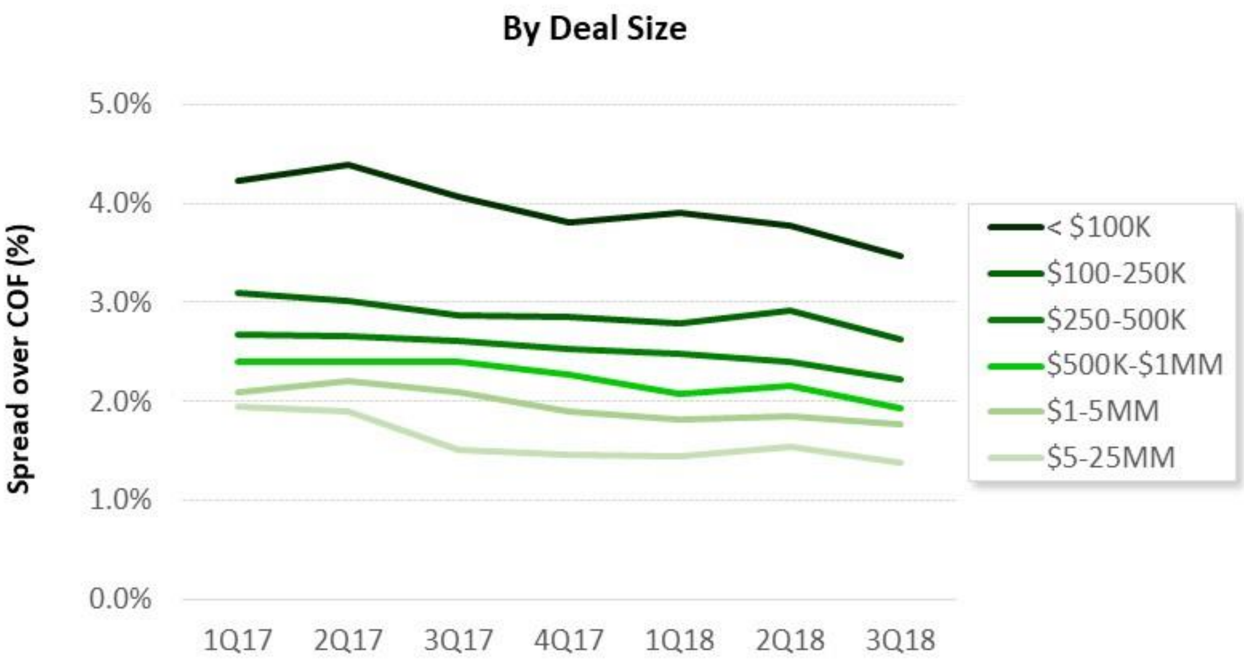


- Rise in nominal rates charged to borrowers has not kept pace with funding costs
- Declining margins attributed to: (1) Competitive climate; (2) Sticker shock; (3) Lack of understanding of FTP

Source: PrecisionLender. Analysis reflects fixed rate credits that originated or renewed in the indicated period.

Spreads erode across the fixed rate market

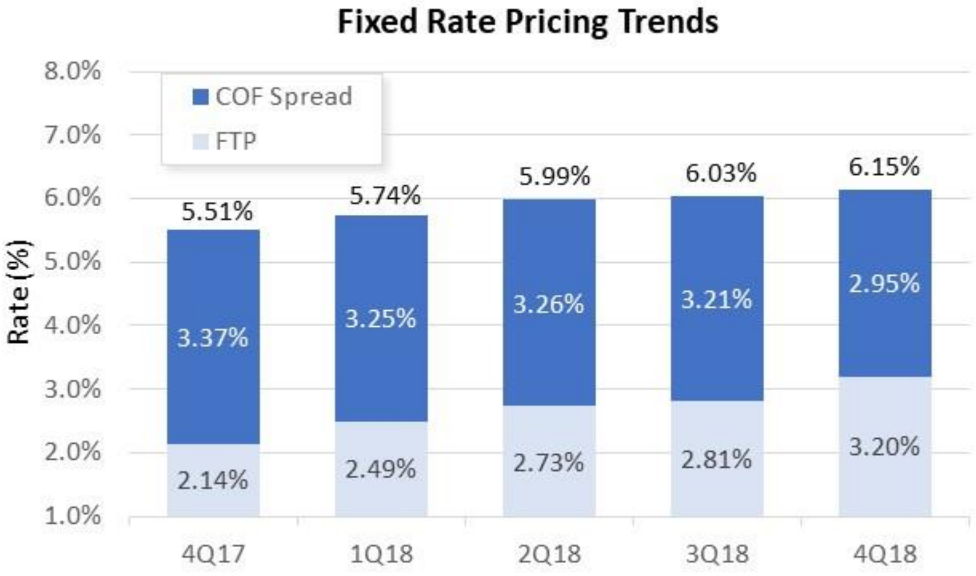


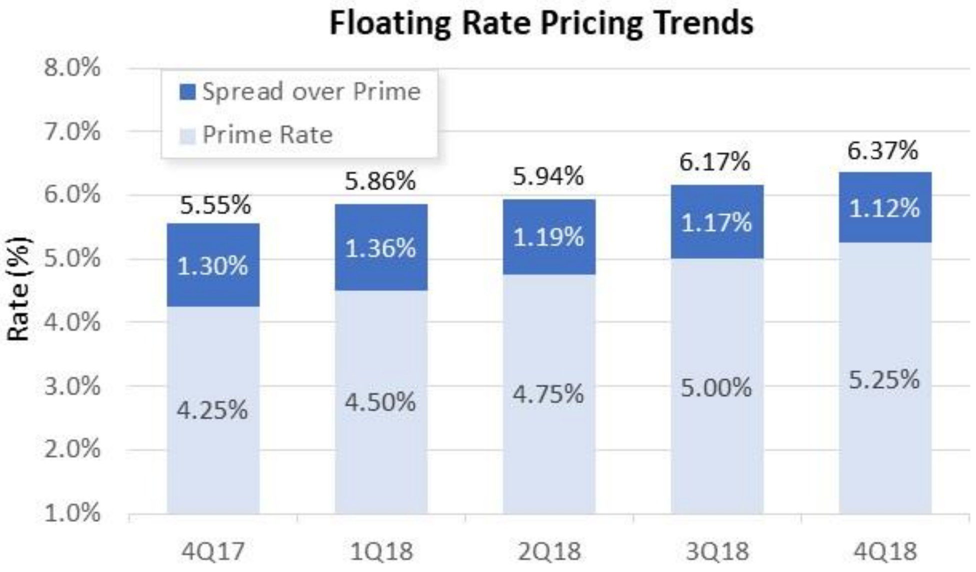


- Declines have spanned the market, with margins compressing across the product and deal size spectrum

Source: PrecisionLender. Analysis reflects fixed rate credits that originated or renewed in the indicated period.

Margins compress on fixed and floating rate deals





- Rates paid by borrowers on Prime-based deals have climbed more than 80 bps over the past year
- At the same time, Prime spreads have been squeezed nearly 20 bps

Source: PrecisionLender. Analysis reflects credits that originated or renewed in the indicated period. Floating Rate Pricing Trends reflects deals pegged to Prime.

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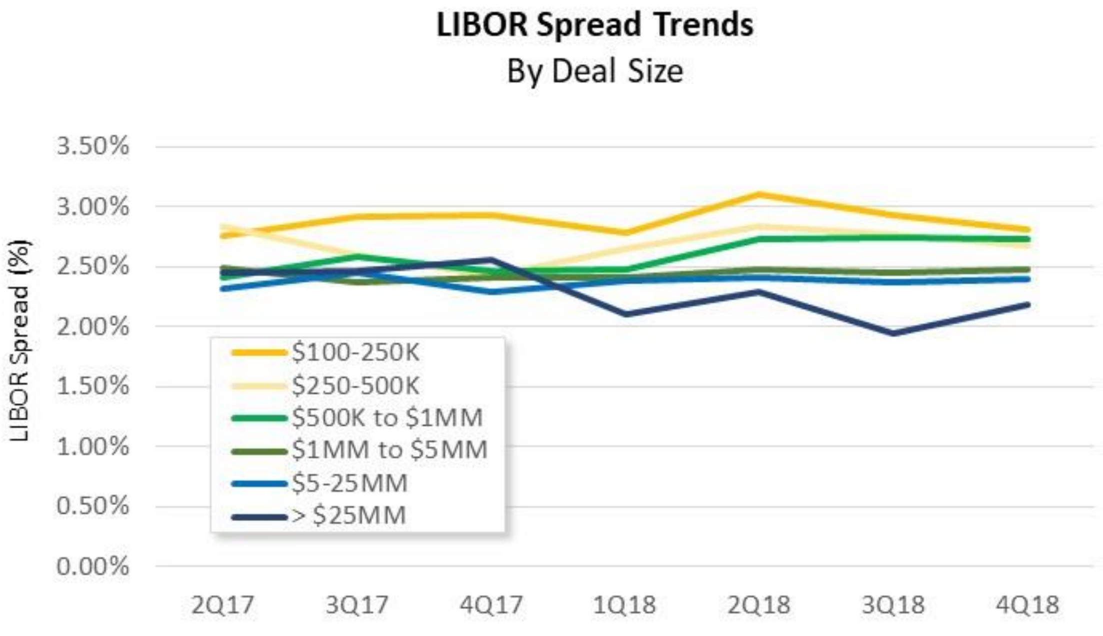
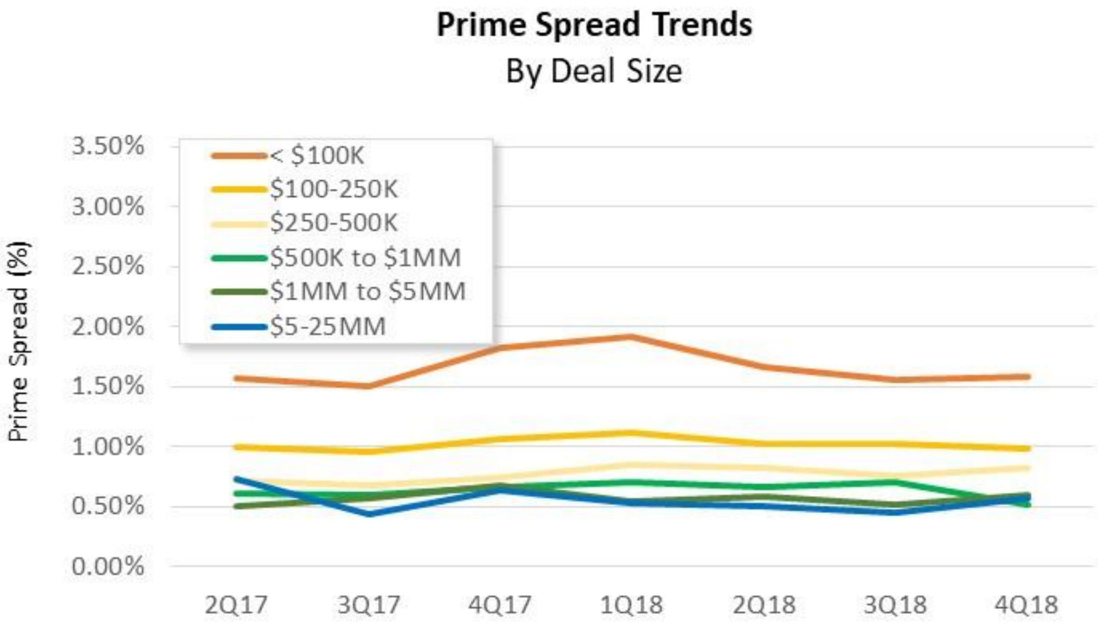
Floating rate spreads narrow across the size spectrum





- Unlike the “flight to quality” immediately following the economic downturn, more recently margins have been flat to declining across the size spectrum

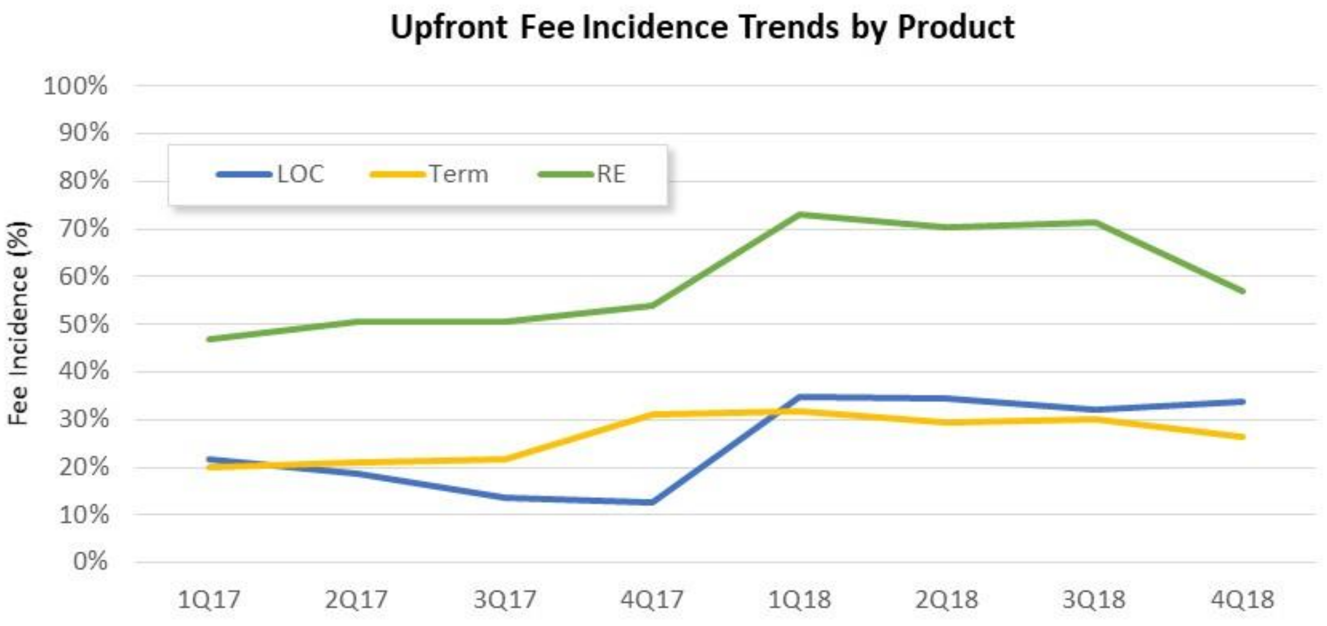
Source: PrecisionLender. Analysis reflects floating rate credits that originated or renewed in the indicated period.

Risk/return steepens

- Despite competition, evidence that banks have maintained some degree of discipline in pricing for risk
- Normalizing for deal size, the market's risk/return curve has actually steepened over the past year

Source: PrecisionLender. Analysis reflects LIBOR-based credits that originated or renewed in the indicated period.

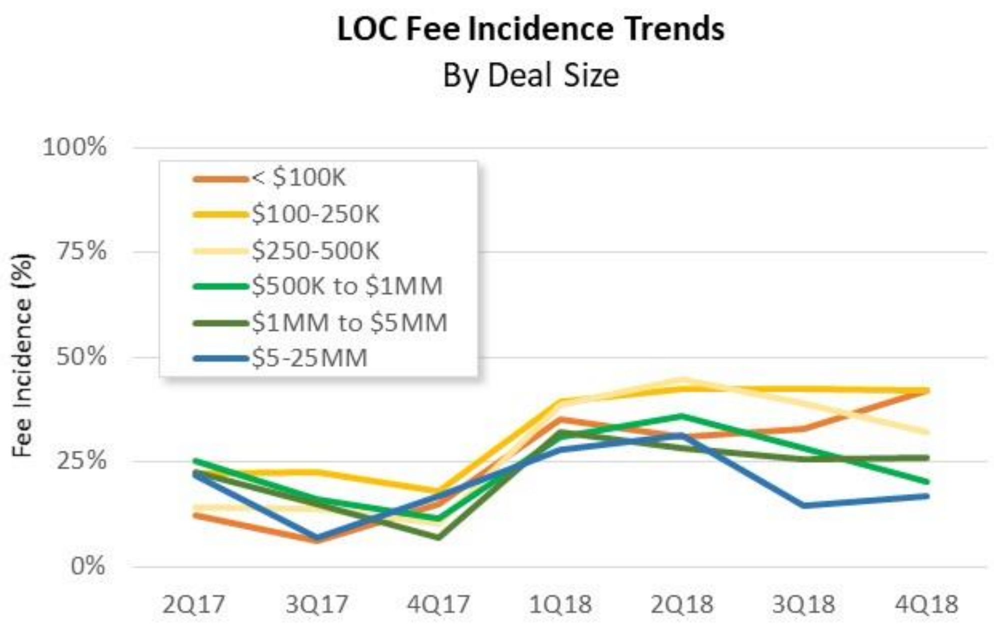
Fee discipline strengthened

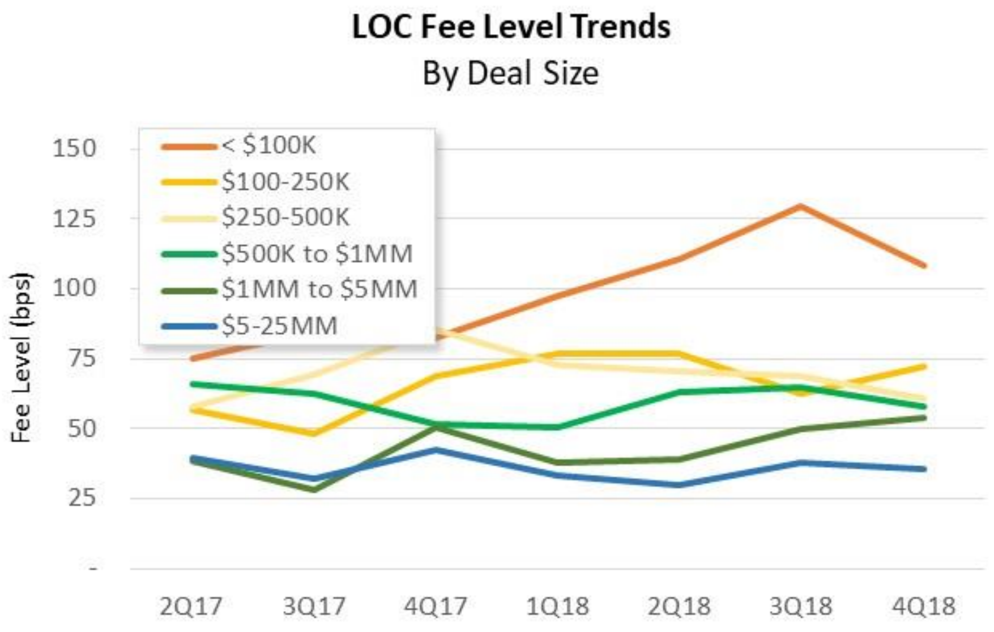


- Spread compression mitigated by improved fee discipline; fee penetration rates have risen across products
- RMs with the greatest gains in fee incidence report a change in banking culture rather than market conditions

Source: PrecisionLender. Analysis reflects the percentage of deals that originated or renewed in the indicated period and were priced with a fee, irrespective of the fee level.

Fee discipline strengthened





- Absence of tradeoffs between fee incidence and levels
- Fee penetration rates and levels have risen in tandem

Source: PrecisionLender. Fee Incidence chart reflects the percentage of deals that originated or renewed in the indicated period and were priced with a fee, irrespective of the fee level. Fee Level chart reflects the average fee collected on deals priced with fees, and excludes no-fee deals.

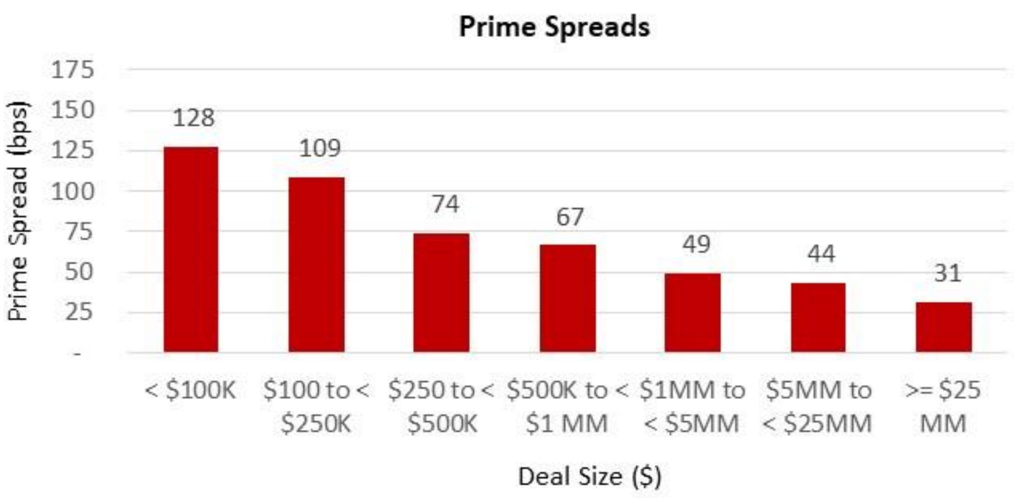
Key Tactics for Driving Loan-Related Fee Growth

Some banks have recognized that in a spread-tightening environment, fees may be one of the few havens for loan-related revenue growth

Success factors include:

- ✓ **Increased communication, emphasis on keeping fees top-of-mind**
- ✓ **Changing the mindset to propose fees on all term sheets**
- ✓ **Not apologizing for fees**
- ✓ **Including fees for modifications, covenant violation waivers, unused commitments and internally-prepared docs**
- ✓ **Offering modest concessions where needed instead of taking an "all or nothing" approach**
- ✓ **Implementing specific incentives around fee generation**

Where are deals being priced today?



- RMs cannot always pinpoint where a competitor will price the next deal, but there are clear dynamics in the current market
- Spreads and LIBOR incidence are highly sensitive to deal size, perhaps even more so than risk rating
- Banks that can preserve Prime pricing in the Business Banking and lower Middle Market space are normally better off than those that offer LIBOR or other money market rates

Source: PrecisionLender. Analysis reflects floating rate credits that originated or renewed in the fourth quarter of 2018. LIBOR Incidence reflects the percentage of credits pegged to LIBOR.

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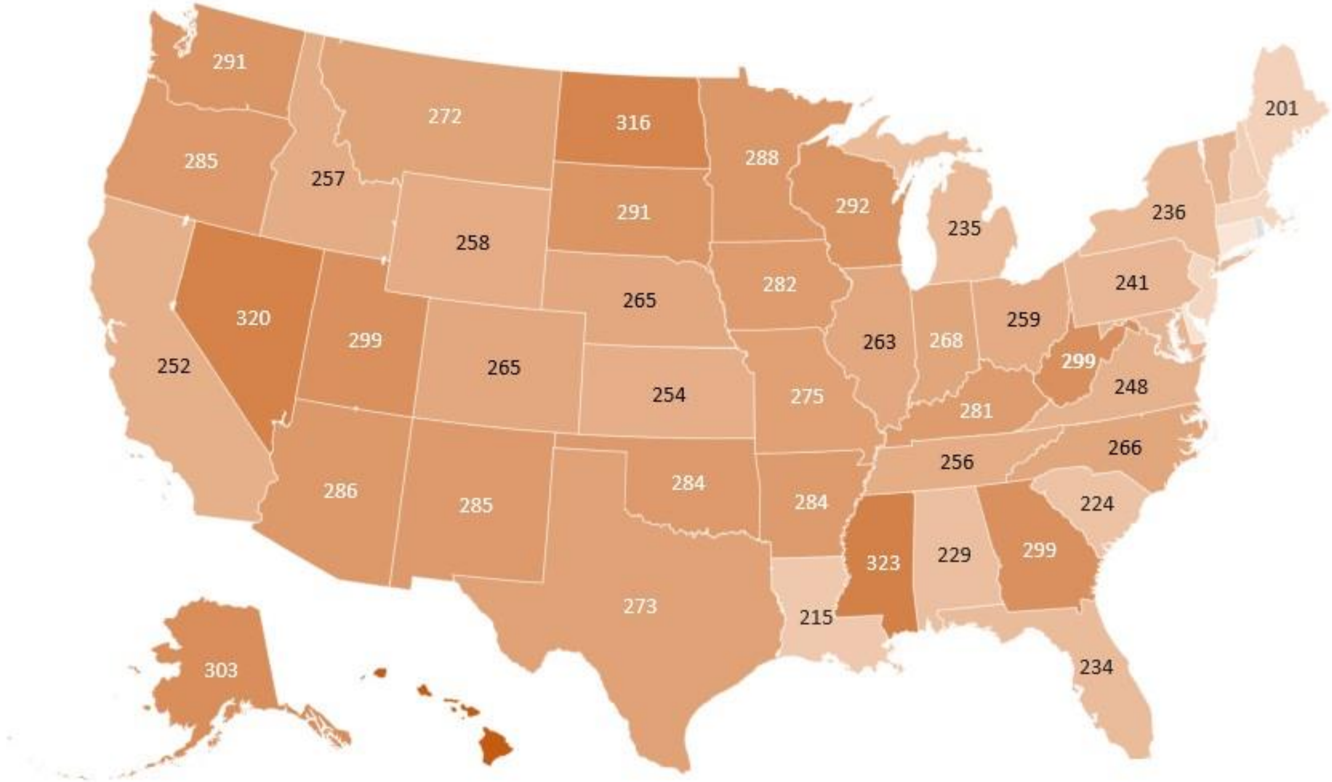
Where are deals being priced today?

- Fee levels vary considerably by both deal size and product
- Average origination fees range from about a point on the smallest deals to just 25 bps on the largest credits
- Fees also vary by term as well as origination status, with lower fees on renewals than on new facilities

Source: PrecisionLender. Analysis reflects floating rate credits that originated or renewed in the fourth quarter of 2018. Figures reflect the average fee collected and exclude facilities priced without fees.

Location, location, location

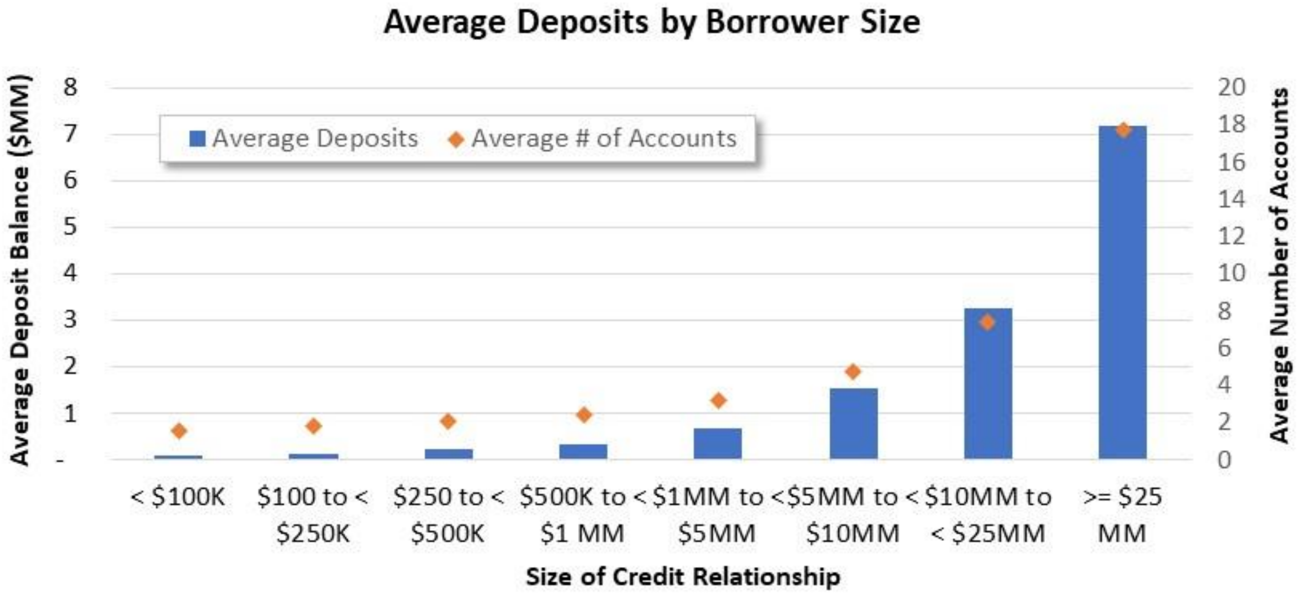


- As much as size and credit quality impact pricing, most bankers instinctively know that competitive conditions vary across the country
- The dispersion in pricing for similar deals is greatest in the smaller end of the market – reflecting the impact of community banks
- Within a given state, major metropolitan markets tend to see thinner spreads than rural markets
- In California, for instance, LIBOR spreads average 254 bps in Fresno but just 216 bps in Los Angeles

Source: PrecisionLender. Analysis reflects LIBOR-based credits that originated or renewed in 2018. Figures reflect average spread over LIBOR. Variation in pricing partly attributable to differences in loan mix.

The size of the prize: Deposits and other fee-based income

Leading with credit – how much ancillary business can be expected?



Credit Relationship Size	< $100K	$100 to < $250K	$250 to < $500K	$500K to < $1MM	$1MM to < $5MM	$5MM to < $10MM	$10MM to < $25MM	>= $25 MM
Average Deposit Balance	93,996	144,954	224,510	329,076	666,288	1,547,728	3,246,908	7,166,491
Avg Number of Accounts	1.6	1.8	2.1	2.4	3.2	4.8	7.4	17.7

Source: PrecisionLender. Figures reflect the aggregate deposit balances at the relationship level across all deposit products and the average number of deposit accounts. Size of credit relationship reflects total commitments, including undrawn credits. Credit-only relationships are excluded from this analysis.

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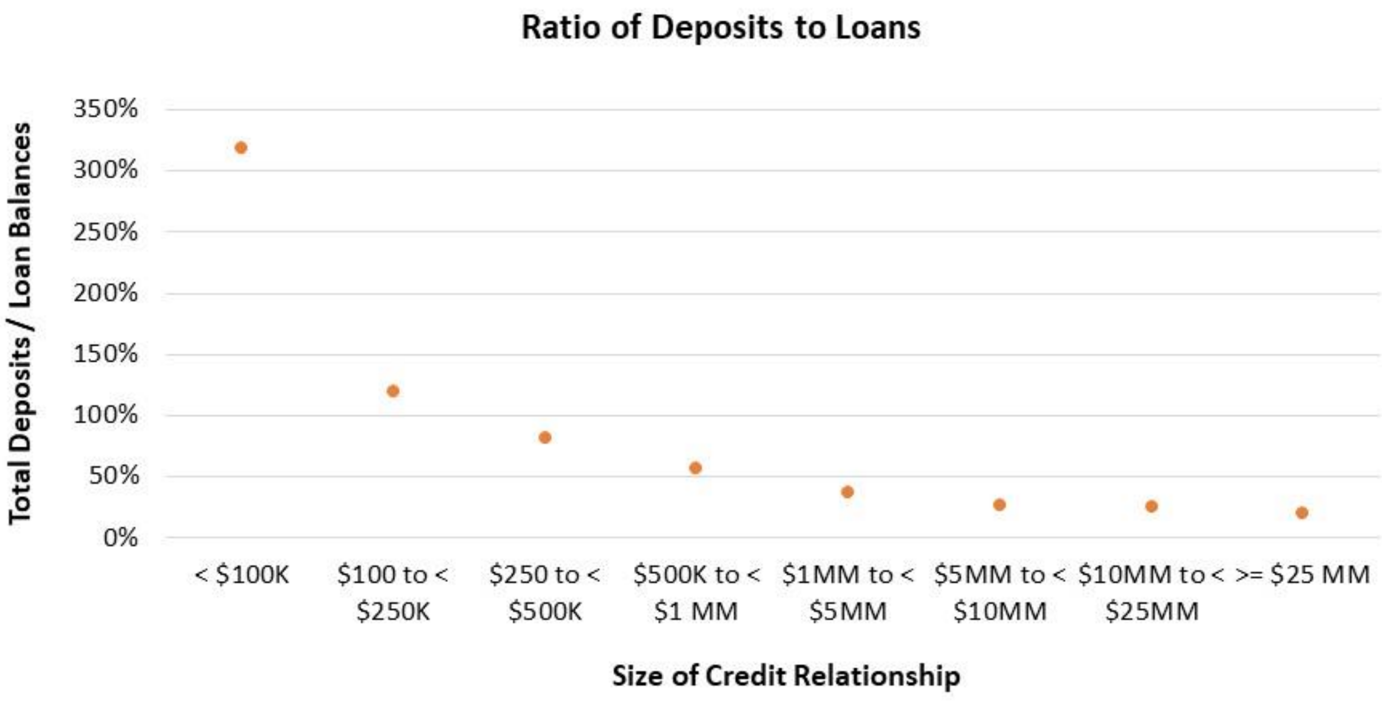
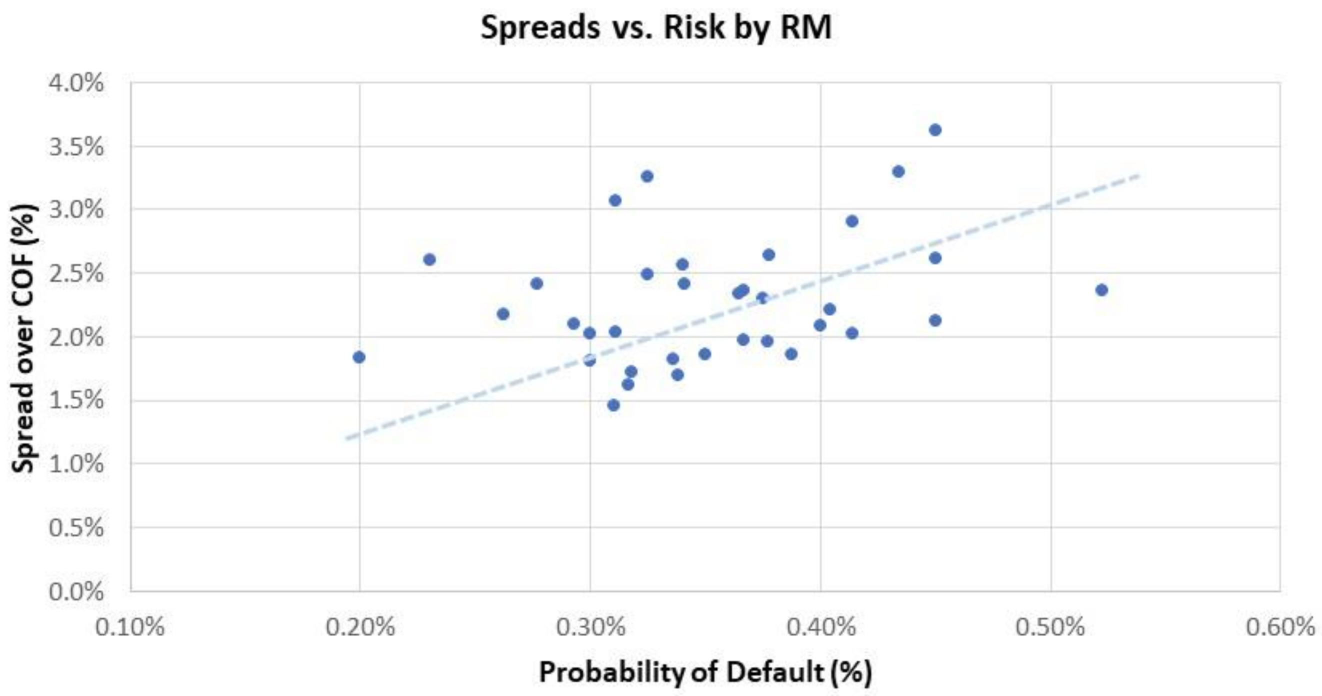
The size of the prize: Deposits and other fee-based income



- When achieved, deposit balances can be significant – in fact, many smaller credits are virtually self-funding
- Still, the promise of deposits or other lucrative cross-sell sometimes fails to materialize; **without a mechanism to track delivery to promise, banks are often left with underpriced credits and low-yielding relationships**

Source: PrecisionLender. Figures reflect the aggregate deposit balances at the relationship level across all deposit products divided by aggregate loan balances. Credit-only relationships are excluded from this analysis.

The devil is in the details: Some RMs do better than others



- Even banks that have adopted a uniform approach to measuring risk-adjusted profitability usually see a wide array of pricing across RMs
- In fact, some RMs negotiate higher spreads on a stronger quality portfolio than their peers achieve on a weaker-rated book

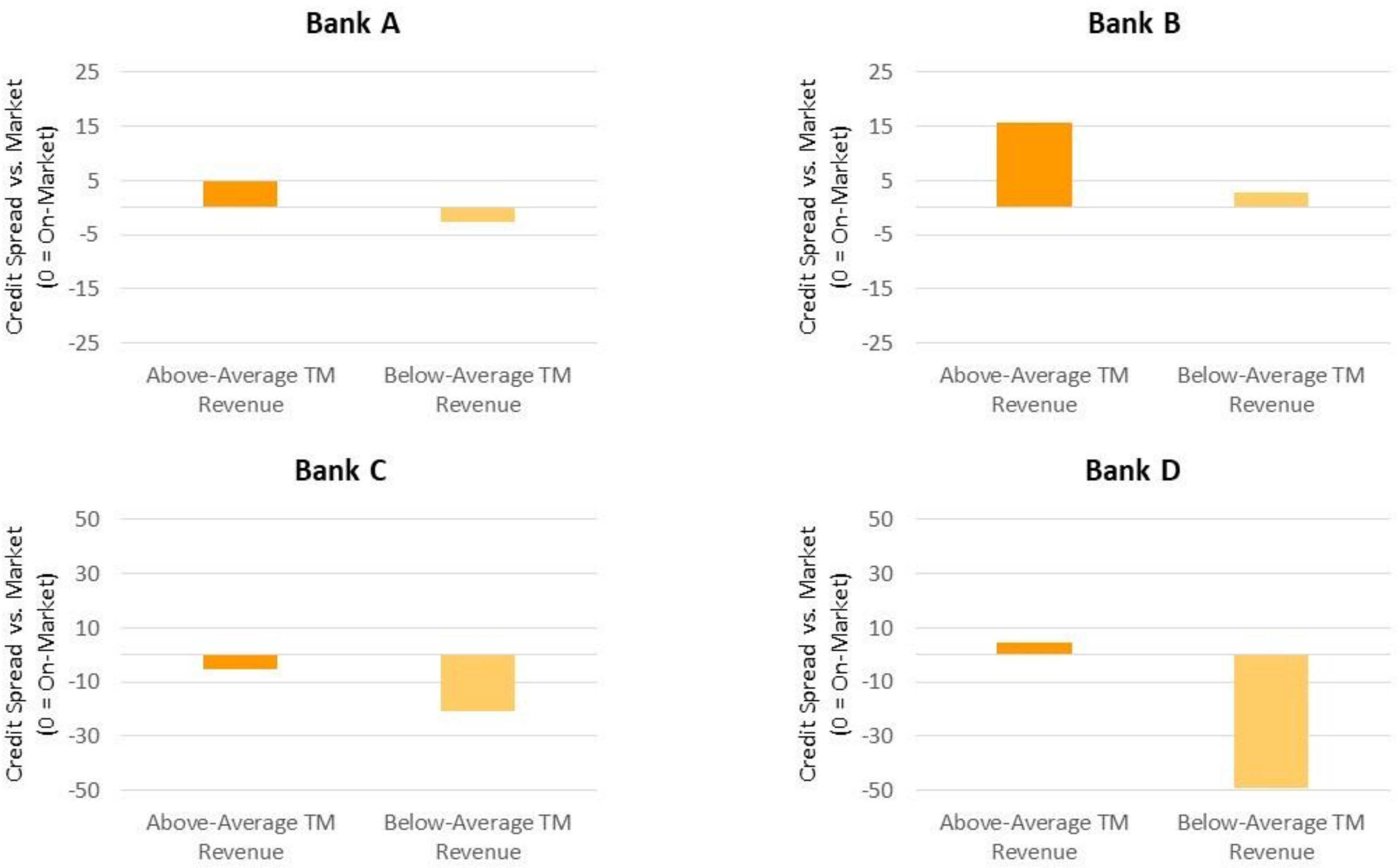
Source: PrecisionLender. Analysis reflects deals that originated or renewed in 2018 at a single commercial bank within a single geographic market. Probability of Default reflects the bank's internal rating system.

Bankers win on spreads, fees and credit quality concurrently

- Loans priced with fees actually carry higher – not lower – margins than those priced without fees
- Credit quality is comparable or even stronger on the deals priced with fees

Source: PrecisionLender. Analysis reflects credits that originated or renewed in 2018 and shows average spreads and credit quality of deals priced with vs. without fees. Spread figures do not include the impact of the fee.

Achieving cross-sell without leading with credit



- Banks consistently achieve better credit pricing on their deepest TM relationships than on their smaller TM or credit-only relationships
- The results underscore the tendency of some bankers to use credit as a loss-leader without adequate follow-through to ensure the TM business comes to fruition

Source: PrecisionLender. Analysis compares annualized revenue for each relationship to others of similar size and compares pricing on each credit relationship to similar deals in the market. Chart shows the credit spreads relative to market on the above-average vs. below-average treasury management relationships.

Bucking the trends: Winning in a highly competitive landscape

Key success factors:

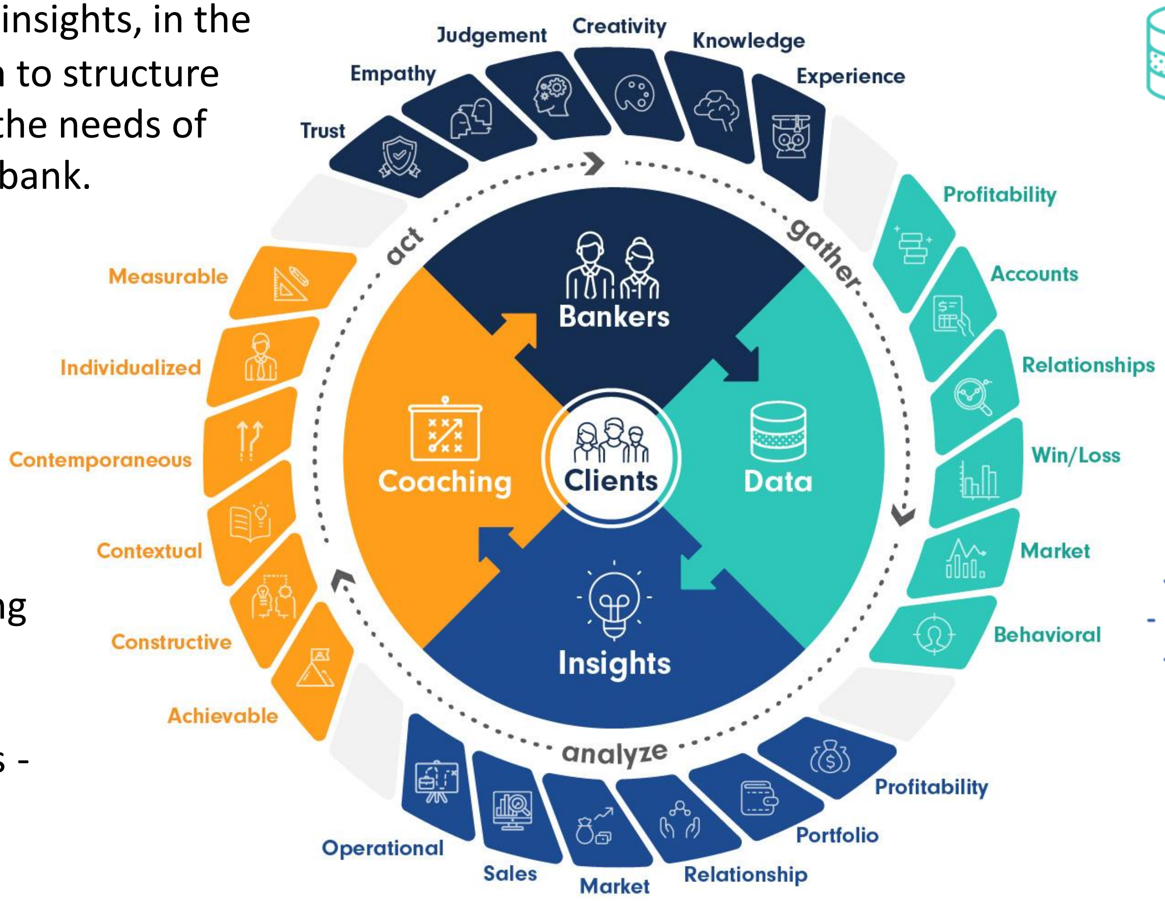
1. Being more proactive in identifying solutions to customers' business challenges
2. Delivering quicker turnaround and certainty of execution
3. Increasing the focus on deposit generation to lower funding costs and improve NIM
4. Placing greater emphasis on fee growth including event-based loan fees and ancillary business
5. Holding bankers accountable by tracking delivery to promise
6. Keeping abreast of current market conditions

Banks that are able to implement these approaches find that they can maximize volume growth, interest income, deposits, NIM, fees and relationship profitability within the context of market realities

Applied Banking Insights Flywheel

PrecisionLender has developed products for each stage of the Applied Banking Insights cycle.

Bankers are armed with insights, in the moment, that enable them to structure and price deals that meet the needs of the client and goals of the bank.



PrecisionLender Platform gathers valuable information without manual entry from bankers – from deal and relationship profitability, to market and competitive conditions, to behavioral data.

Andi® delivers insights to bankers when they're pricing and structuring deals, helping enrich the process and create better outcomes - for both the client and the bank.

Market Insights, Andi Skills Builder, and L3 (Insights Workbench) allow the bank to analyze this rich data and develop coaching and recommendations.

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