Weekly Post: Managing the Balance Sheet Loan Portfolio September 28, 2016

Dear Clients-

Today, the primary drivers of earnings and sources of risk are the balance sheet loan portfolio and the production of loans. Loan credit risk affects your loss provisions and target capital ratios. Loan amortization and prepayments affect your funding strategy and cash maintenance. Loan interest rate risk affects your balance sheet market risk management using your investment portfolio and FHLB funding. Competitive loan rate setting affects your loan production and product mix on your balance sheet.

Much of community banking is centered around managing your loan portfolio.Yet, it is standard practice for many banks to evaluate their entire balance sheet risk on a quarterly basis only, and often two months after the end of a quarter cycle. In addition to quarterly risk evalaution, ALCO typically uses the ALM report to evaluate the loan portfolio on an aggregated level. There are two problems with this approach. (1) The balance sheet loan portfolio is very dynamic. The loan portfolio risk profile continually changes. Monitoring the loan portfolio quarterly cannot lead to more timely and useful actionable decisions. (2) Quarterly ALM reports provide an overview of the balance sheet performance and not the specific loan management decisions.

I suggest that you consider taking a **proactive loan portfolio management** approach. This Post explains.

Challenges

- How should I prepare for funding new loan production next quarter?
- Home prices have recently increased resulting in lowering LTVs of many loans. How should I monitor the loss provision?

Solution

I suggest that you analyze your loan portfolio monthly and disaggregate the loan portfolio by product types. You can manage your loan portfolio proactively and efficiently using THC Risk Officer™.

Market Wisdom - Art Hilliard*

Supplement origination volume

Often banks and credit unions want to originate more loans but are unable to because of:

- Low loan demand
- Not enough capacity to originateloans
- Increased regulatory risk

Institutions can supplement loan originations with asset purchases to achieve their asset targets. Benefits of loan purchases would be:

- Controlled asset growth
- Choose assets to fit specific balance sheet needs
- Low cost way to originate loans
- Reduce operational risk

TFO gives banks and credit unions the ability to:

- Put out inquiries for the specific loans they are looking for.
- See loan inventory and choose loans that meet their needs.
- Perform analytics to determine best price and fit

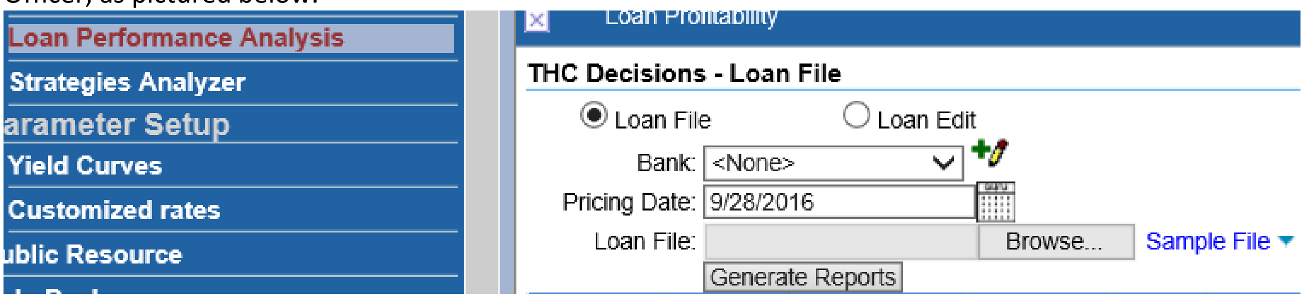
Art Hilliard has been in the mortgage industry for 29 years. He has originated, managed secondary marketing, securitizations and settlements, provided mortgage financial advisory and performed multiple mortgage portfolio sales and acquisitions.He was past president of the Illinois Mortgage Bankers Association.

Most core processors should be able to easily provide you with your loan data file on a monthly basis. For proactive loan portfolio management, you can create PATH files for 1-4 family, multi-family, commercial mortgages, non-performing loans and other segments. Further, each report has multiple sesubsectors such as FRM and ARMs allowing you to drill down further.

By evaluating your balance sheet loan portfolio monthly, you can compare the model projected cashflows to the actual experience of the loan cash flow characteristics, the inflow and outflow of funds, interest rate sensitivity of ARMs vs FRM, impact of callability of commercial mortgages and more. The results will influence your investment decisions, liquidity and funding strategies. The results will also allow you to anticipate the risk profiles of your quarterly regulatory reports. Indeed, most community banking and credit union actionable decisions are related to getting more frequent detail and loan portfolio reporting.

Numerical Example

To proceed with a proactive approach to loan portfolio management in Risk Officer ™ is simple. First, use Risk Officer ™ to access Loan Performance Analysis located under APPS in the lower left hand corner of Risk Officer, as pictured below.



Next, prepare your loan portfolio data input file, PATH, using your core processor data by segments, based on your design. A portion of the input data file is illustrated below. A sample file is available in Loan Performance Analysis App.

T002 Index Code	T001 Margin(BP)	T003 Reset Montl	T031 FICO Score	T032 LTV(%)	T036 Loan Size ($
1Y LIBOR	250	3|1	770	75	250,000
1Y LIBOR	250	5|1	730	75	250,000
1Y LIBOR	250	7|1	700	75	250,000
1Y LIBOR	250	10|1	670	75	250,000

Then upload the files and generate the reports. Risk Officer™ currently can provide three reports: Portfolio Analytics , Decrement Cash Flow and the Mortgage Prepayment Speed and Yield Table reports.

Name	Report	Portfolio	Template
R160928-4-3		P160928-3-LoanFile(09/28/2016)	Residential Mortgage Portfolio Anal...
R160928-4-2		P160928-3-LoanFile(09/28/2016)	Decrement Cash Flow
R160928-4-1		P160928-3-LoanFile(09/28/2016)	Mortgage CPR/Yield Table

These reports will enable you to identify the risk characteristics on each loan type and risk classfication, providing an better understanding of your loan portfolio for actionable decisions.

Conclusion:

Proactive loan portfolio management lets you focus on managing the primary drivers of your balance sheet performance. Funding, investments,and cash management in a large part are driven by the dynamics of the loan portfolio and loan production. THC Risk Officer™ provides you the in-depth analysis of your loan portfolio on a monthly basis. The Loan Performance Analysis App is a useful ALM tool to assist you in proactively managing your loan portfolio on a monthly basis.

If you have any questions regarding using Loan Performance Analysis, please do not hesitate to contact THC.

Regards,
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THC is NOT a broker-dealer. THC only offers an analytical platform for clients to work together to meet your customers' needs or your balance sheet requirements. THC does not collect any commission.

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