Weekly Post: **Managing NII: Your THC Competitive Edge** November 17, 2016

Dear Clients-

The September 19th Post discusses the importance of managing your loan portfolio to enhance the performance of your balance sheet. The October 20th Post describes how to best utilize the Loan Performance App in Risk Officer to implement effective loan management strategies. The Loan Performance app allows you to optimize both your loan pricing and loan sector allocation. It also provides you with the ability to create and originate customized loans for your customers.

Another feature of the Loan Performance App is the ability to generate on demand loan portfolio analysis. The Loan Performance App provides reports that depict your interest rate, liquidity and credit risks along with earnings thus becoming a powerful decision support tool to assist you in managing your loan portfolio.

The recent sudden increase in market rates underscores the importance in being able to monitor your loan portfolio risks. This Post will describe more precisely how Loan Performance App can provide you with a special competitive edge.

Challenges

- How well does my loan portfolio relate to my balance sheet performance?
- Can Loan Performance App depict my interest rate risk exposure?
- How useful is the loan analysis to my ALM strategies?

Solution

Net Interest Income (NII) measures your performance and is a popular metric. But the measure is backward looking. THC provides the forward looking 12 month NII enabling you to measure and better manage your future income.

Market Wisdom - Art Hilliard*

Hot Off the Press

I just got these 13 scratch and dent loans yesterday, and they are currently out for bid.

- Conforming and jumbo
- Fixed and one ARM
- Performing
- WAC 4.022
- WA LTV 76.13
- WA FICO 720
- WA DTI 38.89
- Geographically diverse

The issues on these loans are across the board. Too many to list. Here are a few, look at the tape to see them all.

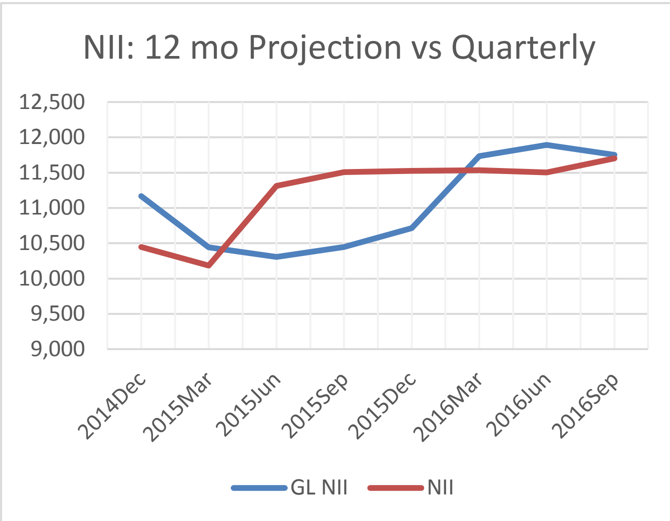
- Uninsurable FHA
- Closed without appraisal
- Early payment default
- Undisclosed liability
- Fraudulent bank statements
- Occupancy
- Ineligible gift donor

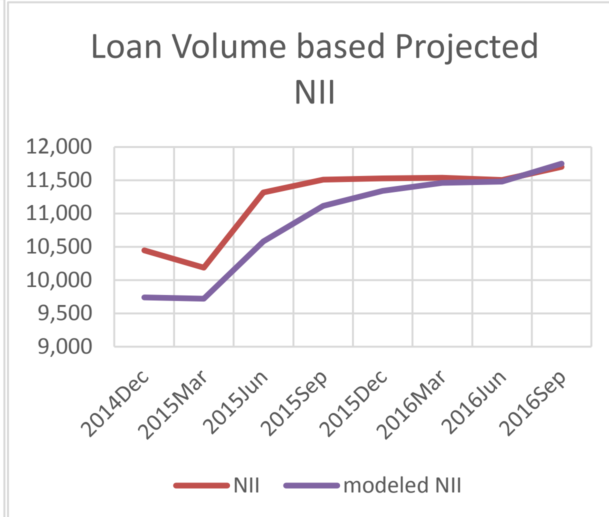
Pick and choose the loans that fit. Bids are due by 10:00 central on Thursday the 17th.

An interesting fact, one would think that bidders would be mostly funds, but my bidders are typically banks

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.

I use a hypothetical bank to show the efficacy of the THC NII model. Both the Trade Simulation summary report and the Peer Group reports provides eight cycles of your 12 projected NII and the GL NII respectively. The graph compares the two historical trends. The results show that the bank increased the loan volume in June 2015. The THC model immediate shows the increase of NII. The GL NII is adjusted to the new higher level of NII over 12 months. This results show the usefulness of the THC model in predicting the bank's future reported earnings.



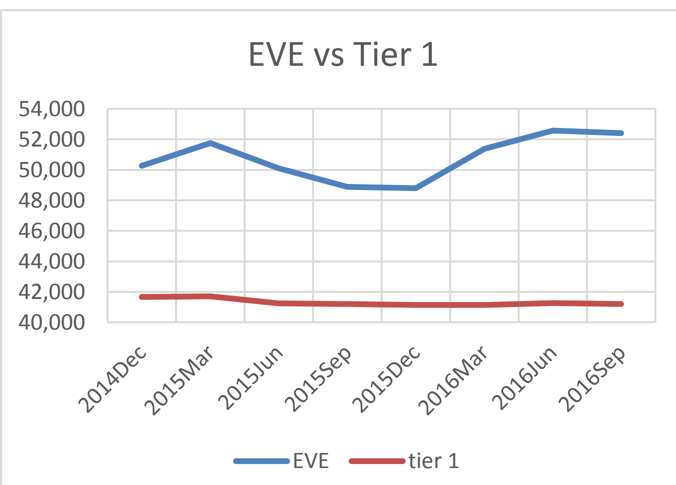


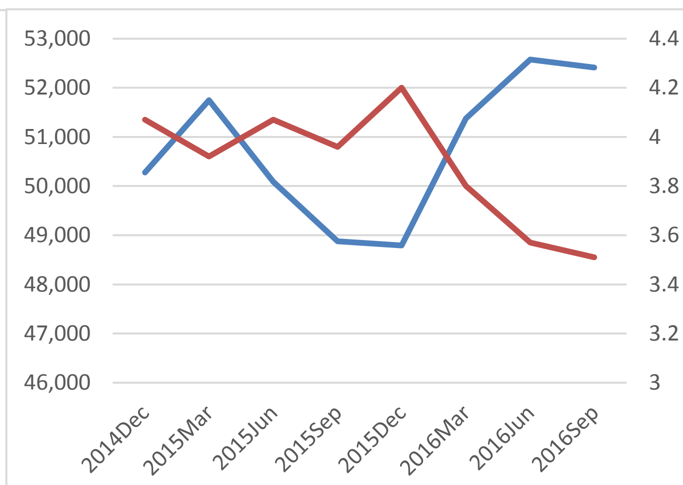
The Loan Performance App provides the historical loan balance trends. The NII can be modeled as the product of the loan balance and weighted average loan rate net of the funding cost. The graph on the right shows that the loan balance and the weighted average loan rate can explain the projected NII well.

These results show that proactively managing your loan portfolio based on volume and margin can significantly affect your institution's earnings.

Numerical Example

You can also use the Loan Performance App to manage your ALM interest rate risk. Regulators use the





economic value of equity (EVE) to measure long term risk, while interest rate risk does not affect the Tier 1 capital. The graph below on the left shows that the trends of EVE and Tier 1, showing that the EVE fluctuates while Tier 1 remains almost constant. Furthermore, the results show that EVE value is higher than the Tier 1 capital. This is mainly because of the intangible value of deposits, which provides the institution "cheap funding."

The graph on the right shows the trend of the EVE in blue and the weighted average loan market yield in red. The result shows that the EVE is clearly inverse to the market loan yield for this institution, which has a duration of seven, showing that the institution is liability sensitive. High EVE duration results in high fluctuation, sensitive to the market rate change. This result shows that the loan portfolio duration can directly affect your interest rate risk exposure.

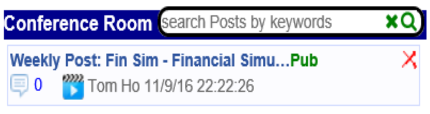
How To generate monthly loan performance trends:

- THC ALM clients can upload the loan ETL files and
- Other clients can upload the PATH+ loan files

in Self Generate Report section every month.

Conclusion:

THC Loan Performance App lets you monitor the performance of your loan portfolio on a continual basis enabling you to modify or implement many different loan portfolio strategies. This Post shows that your loan strategies directly affects your balance sheet performance. Therefore, the Loan Performance App gives you a unique competitive edge.



If you have any questions regarding the Loan Performance App, please do not hesitate to contact THC. Use the Conference Room, Homepage Risk Officer, to send us your comments and questions. All your posts are anonymous.

Regards,
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