90 Day Note
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Celebrating 40 Years of Serving Community Financial Institutions

On November 13, 2018, Young & Associates, Inc. will celebrate our 40th Anniversary. It's been a momentous year for the company – in January, the company was sold by founder, Gary J. Young, to Jerry Sutherin, a Senior Consultant who had worked with the company for nearly four years.

Mr. Sutherin's primary objective moving forward is to carry on the legacy that Gary has created. Says Mr. Sutherin, "From the outset of our acquisition discussion, Gary and I agreed that the greatest asset of the company is its employees. Over the years, not only has Gary developed unique servicing platforms for the community banking industry, he has assembled an employee base that is second to none. These employees provide a level of expertise and service to our clients that remains unparalleled in the community banking industry. They are truly the bedrock upon which the company is built."

Corporate History

Young & Associates, Inc. was founded by Gary J. Young in November 1978. The focus of the company reflected Mr. Young's background in banking — marketing/advertising, branch feasibilities, branch applications, and product development. Over the past 40 years, the company's vision has expanded to include all the services necessary to assist community financial institutions nationwide to compete with larger competitors. The company now employs more than 40 highly-qualified consultants and staff and is the consulting leader in strategic planning, capital planning, management reviews, interest rate risk reviews, lending and loan review, appraisal reviews, quality control, regulatory compliance, internal audit, expansion studies, and information technology. Over the years Young & Associates, Inc. has gradually expanded its geographic presence at a measured pace with clients as far west as Alaska, Hawaii, Guam, Arizona, and California and as far east as Maine and upstate New York.

Going Forward

The future is bright for Young & Associates, Inc. Mr. Young will remain with the company as Chairman of the Board until January 31, 2019, providing the same high-quality service while assisting with the transition. He remains committed to supporting Young & Associates indefinitely. "Young & Associates is my legacy, and I will continue to do everything possible to support the future of this wonderful company," Mr. Young concluded.

Now ten months into the transition, Mr. Sutherin remains committed to building on the solid foundation that Gary built over the years, providing strong leadership for the exemplary team, and providing effective, practical solutions to assist community financial institutions for years to come. Please join us in celebrating this important milestone for Young & Associates, Inc. ❑

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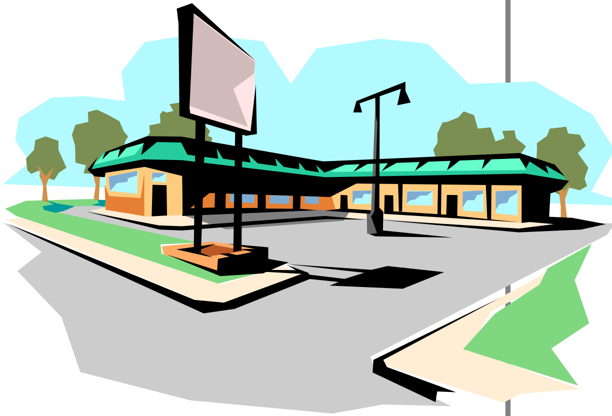
Three Keys to Successfully Manage Your Commercial Real Estate Portfolio

By: Bob Viering, Senior Consultant and Manager of Lending

Sears files bankruptcy and announces it will close 142 stores on top of 46 closings already announced; Mattress Firm files bankruptcy and announces it will close 700 locations; Office Max/Office Depot merge, closing 700 locations; banks close 1,700 branches in 2017; Amazon's sales revenue grows $42,000,000,000 in 2017 over 2016.

What does this have to do with community bank lending? A lot. In many of the community banks we review, the loan portfolio is often concentrated in commercial real estate (CRE). That's a broad category, but we see a significant number of strip centers and even smaller malls in the banks we review. The strength of many of these loans is the quality of the tenants and the perceived long-term stable cash flow they generate for the owner of the property. Many banks do a very good job of underwriting these loans upfront, including getting copies of leases and closely analyzing the leases. When originated these loans are often written with a 20 to 25-year amortization. However, in today's world, that is an eternity. Consider that 20 years ago Amazon's annual sales topped $511,000. To put that in perspective, that is what Amazon now sells in less than 90 seconds. There were no smart phones and no tablets, and Bill Clinton was President. Many of the studies I've read on retailing in today's digital, Millennial-focused world expect there to be even more rapid changes ahead.



The reality is that these changes and the continued disruption of the retail world make your job analyzing retail multi-tenant properties more complicated and even more important than before. The key for banks to be successful in continuing to lend to this sector of CRE is to improve the way loans are managed post-closing. All too often today we see banks getting an annual tax return ten or more months after the fiscal year-end of the borrower. The bank dutifully calculates the debt service coverage; then, if the debt service coverage is better than the loan covenant, it is put away and not thought about until the next year. But, in today's world of rapid change in the retail sector, that is no longer enough.

There are three key activities that are important for banks to do today as part of their annual review process for multi-tenant CRE loans.

First, it is critical to get a detailed rent roll from the borrower. This can provide you with insight about how the property is likely to perform in the next year, well ahead of getting the next year's tax return. A deeper review of the rent roll may provide some insight into any longer-term issues. You should be reviewing the tenants, including the potential impact e-commerce may or may not have on them, changing competition in close proximity to your collateral, and the length of the lease.

If there is an anchor tenant, consider the long-term viability of that tenant. Often, losing a key anchor tenant not only impacts cash flow, but can impact the rents the property can command going forward and the potential cost of re-purposing a large vacant space.

We recently saw a rent roll for an older strip center with increasing vacancies that had positive debt service coverage based on an annualized rent roll; but, a closer review showed that one of the tenants was a seasonal Halloween store with a short-term lease. The total for the rent roll per month looked adequate, but when considering the short-term nature of a larger tenant, it brought into question the long-term viability of the strip center absent longer-term tenants. That loan still has 18 years to go.

When there is tenant turnover, assess whether the new tenants are paying the same, more, or less in rent than the previous tenants. All too often we see lower rents as strip centers age and newer ones open up nearby.

Second, estimate the current market value of the property. We're not

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advocating getting new appraisals or even a new evaluation, but simply taking the property's Net Operating Income (NOI) multiplied by a current estimated CAP rate for similar properties and making an educated estimate of value. We recently reviewed a loan for a hotel where the appraised value at the time it was built was based on estimated sales and NOI. After five years, the hotel was grossing less than half its estimated revenue and was coming nowhere near the NOI projected. But, the bank in its annual review was still using the original appraised value and feeling good about its 60% LTV even as the property had disappointing cash flow. A more realistic estimate of value based on current, and even expected, NOI indicated a value less than the current loan balance. Thankfully, there was a guarantor with deep pockets that kept the loan payments current. Hopefully, the balance of his investments were doing better than this hotel, with 20 more years for this loan to pay-off.

Third, do a physical inspection of the property. Your eyes are often the best tool you have in credit analysis. Assess the level of upkeep of the property. Many consumers (and tenants) are turned off by weedy parking lots and trash bins overflowing. Look for signs of roof leaks in stores. Next, note the level of vacancies. Does your physical inspection verify that the tenants listed in your rent roll are still there? Take time to inspect other similar properties close to the property. Are there newer competitor properties opening? Are other properties upgrading nearby? Is the location still as good as it was when the property was built? Realistically, ask yourself how your property stacks up against its competitors.

"Your eyes are often the best tool you have in credit analysis."

As a bank, you have to constantly be analyzing the long-term success of your loan portfolio. If a more detailed review of a property leaves you with a sinking feeling about its long-term viability, think long and hard about what you will do at the next maturity. Sometimes the best decision is to let a loan go to a competitor and focus your resources on newer opportunities.

We still believe that CRE is and will continue to be a key part of many banks' loan portfolios; but we also believe that the key to your long-term success is working just as hard on analyzing your loans already on the books as when they are first underwritten. For more infomation on this article and/or how Young & Associates, Inc. can assist your bank in this area, give me a call at 330.422.3476 or send an email to bviering@younginc.com. ❑

Community Bank Leverage Ratio

By: Gary J. Young, CEO and Founder

The Economic Growth, Regulatory Relief and Consumer Protection Act was signed by President Trump on May 24, 2018. A major part of that bill was the requirement of federal regulators to develop a Community Bank Leverage Ratio. The law states that this ratio must be between 8% and 10%, and it would apply to all banks with less than $10 billion in consolidated assets. If a bank's tier-1 leverage ratio exceeds the Community Bank Leverage Ratio and is less than $10 billion in consolidated assets, the bank will automatically meet all other regulatory capital guidelines. Therefore, it would no longer be necessary to calculate the three risk-based capital ratios. These ratios are CET1, tier-1/risk-based assets, and total risk-based capital.

Based on my regulatory experience, I can't imagine that regulators would choose an amount at the low end of the range. I would anticipate the rate to be at least 9.0%, with my expectations of 9.5 to 10.0%. Furthermore, since this must be a Joint Policy Statement with all three federal regulators, I believe it will be well into 2019 before the Community Bank Leverage Ratio is announced.

The more important issue is how the Community Bank Leverage Ratio effects examinations. As bankers, all we have heard from regulators is that one capital ratio doesn't fit all banks. The amount of capital needed is based on the risk at the specific bank. Now, Congress is requiring regulators to determine one leverage ratio that means the bank is well-capitalized. Congress is certainly out-of-sync with banking regulators. In my opinion, the Community Bank Leverage Ratio

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will have little impact on banking. You are encouraged to follow developments, but you should continue to look at your bank's definition of Capital Adequacy based on risk, as regulators have strongly suggested. In this case, I totally agree with the regulators.

If you would like to discuss this article with me, please send me an email to gyoung@younginc.com or garyjyoung@prodigy.net. Or, you can call my cell at 330.283.4121. ❑

Capital Market Commentary

By: Stephen Clinton, President, Capital Market Securities, Inc.

October Market Update

The current economic expansion continues to march on. Strong job creation along with low unemployment indicates that the economy is near full employment. The Fed continues to move short-term interest rates higher, showing confidence that its long-held accommodative stance is no longer needed. The impact of tariffs or threatened tariffs, along with the risk of an escalating trade war, has not yet dampened the strength of the economy.

The following summarizes certain issues we think are worth watching:

- Gross domestic product rose at 4.2% in the second quarter. Strengths in consumer spending, net exports, and business investment were noted.
- Corporate profits rose 2.1% in the second quarter after rising 8.2% in the first quarter, aided in part from tax legislation that reduced corporate taxes from 35% to 21%.
- Oil prices are near a four-year high. This has moved gasoline prices to near $3.00 per gallon, a price that has not been reached since 2014.
- Pending home sales fell in August by 1.8%, the fourth decline in the last five months. This supports the belief that we are seeing a slowdown in the housing market. Increasing home prices and higher financing rates are cited as reasons for the slowdown, along with a low level of supply. Mortgage rates have moved to near 5%. While 5% is not high from a historical perspective, many home buyers have become accustomed to loan rates of 4% or less.
- The economy continues to create jobs. In September, the private sector added 230,000 jobs. The unemployment rate fell to a near 49-year low of 3.7%. This tight labor market has led to wage growth. The annual rate of increase in wages was calculated at 2.8%.
- $200 billion of Chinese goods have recently been targeted with U.S. tariffs, with $60 billion of U.S. products being retaliated with duties by China. This followed the $50 billion of products by each country that already had tariffs assessed earlier. This trade dispute between the world's two largest markets is worrisome to investors. Despite these actions and other protectionist trade actions with other nations, the U.S. trade deficit increased 6.4% to a six-month high in August. This activity may reflect actions to purchase foreign products before tariffs were assessed, but the deficit deserves watching as the new trade policies are fully implemented.
- The U.S. was able to reach an eleventh-hour trade agreement with Canada in October. A new trade pact was previously negotiated with Mexico. These agreements, subject to Congressional approval, will replace NAFTA and establish a new trade pact between the countries.
- Manufacturing activity remains at an elevated level. The Institute for Supply Management reported its manufacturing index at 59.8 in September (a level above 50 signals expanding activity). U.S. industrial production recorded its fourth consecutive increase in September.
- The U.S. federal deficit increased 17% in the 2018 fiscal year. This is the largest annual deficit in six years. A major contributing factor to the increased deficit is the $1.5 trillion tax cut enacted in December 2017. Higher

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government spending and higher interest rates are also contributing factors to the increase in the deficit.

- Consumer confidence hit an 18-year high in September. With consumer spending representing approximately two-thirds of GNP, this consumer confidence bodes well for economic growth.
- In the past several years home values have increased significantly more than inflation. Home prices rose 6% over the 12 months ending in July, according to the S&P CoreLogic Case-Shiller National Home Price Index.

Short-term interest rates moved up 80 basis points in 2018 as of September 30, with the 3-month T-Bill ending September at 2.19%. The 10-year T-Note ended September at 3.05%, up 65 basis points from year-end 2015. This reflects the narrowing of the slope in the yield curve that has occurred. In early October, the 10-year T-Note reached a new 7½ year high of 3.24%.

The stock market has recorded a strong first three quarters. The Dow Jones Industrial Index closed September up 7.04% for the year. The Nasdaq Index closed up 16.56%. The Nasdaq Bank index ended September down 1.73%. In October the market began a correction that lowered stock prices. By October 26, the correction had wiped out all of the Dow Jones' gains for 2018. The volatility occurring in the markets reflects international trade frictions, problems in the Eurozone, and uncertainty in emerging markets, along with the unknown impact of rising interest rates.

Interesting Tid Bits

Household Net Worth – The value of all assets, such as stocks and real estate less liabilities like mortgages and credit card debt, rose in the second quarter to a record $106.9 trillion. Included in the net worth was $9.6 trillion in deposits.

Consumer Debt – U.S. household debt was reported at an all-time high of $13.2 trillion. The personal saving rate of 2.4% is at its lowest level since the mid-2000s. The Federal Reserve recently reported the results of a survey that said 35% of U.S. adults indicated that they would not be able to pay all of their bills if faced with a $400 emergency.

Merger and Acquisition Activity

In the first nine months of the year, there were 200 bank and thrift announced merger transactions. This compares to 182 deals in the first three quarters of 2017. The median price to tangible book for transactions involving bank sellers was 172%.

Capital Market Services

Young & Associates, Inc. has been a resource for banks for 40 years. Through our affiliate, Capital Market Securities, Inc., we have assisted clients in a variety of capital market transactions. For more information on our capital market services, please contact Stephen Clinton at 1.800.376.8662. ❑

New and Updated Cybersecurity Resources

By: Mike Detrow, CISSP, Senior Consultant and Manager of IT

October was National Cyber Security Awareness Month, which is a collaborative effort between government and industry that is meant to raise awareness about the importance of cybersecurity. This is the fifteenth year for National Cyber Security Awareness Month, which was developed under leadership from the U.S. Department of Homeland Security and the National Cyber Security Alliance.

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The themes for this year were: online safety at home, cybersecurity careers, online safety at work, and critical infrastructure safety.

Numerous organizations and agencies produced new and updated cybersecurity documentation throughout the month that will be useful to financial institutions as they work to educate their employees, directors, and customers. Below you will find a summary of the resources that will be useful as you develop or enhance your cybersecurity education program.

Department of Homeland Security

2018 Toolkit: Key Messages, Articles, Social Media and Other Resources
https://www.dhs.gov/sites/default/files/publications/NCSAM_GeneralToolkit_final_1.pdf

Federal Trade Commission

Cybersecurity Resources for Small Businesses
https://www.ftc.gov/tips-advice/business-center/small-businesses/cybersecurity

Conference of State Bank Supervisors

Cybersecurity 101: A Resource Guide for Bank Executives
https://www.csbs.org/sites/default/files/2017-11/CSBS%20Cybersecurity%20101%20Resource%20Guide%20FINAL.pdf

Federal Deposit Insurance Corporation

Cybersecurity Awareness Directors' College Videos
https://www.fdic.gov/regulations/resources/director/technical/cybersecurity.html

Cyber Challenge: Three New Vignettes to Help Assess Operational Readiness
https://www.fdic.gov/regulations/resources/director/technical/cyber/purpose.html

Federal Bureau of Investigation

Each of Us Has a Role in Online Safety and Security
https://www.fbi.gov/news/stories/ncsam-2018

National Cyber Security Alliance

Stop. Think. Connect.
https://www.stopthinkconnect.org/

Stay Safe Online
https://staysafeonline.org/

Young & Associates, Inc. can assist your financial institution in evaluating, assessing, and securing its IT environment. For more information, contact Mike Detrow at mdetrow@younginc.com or 330.422.3447. ❑

The CFPB and Their Agenda

By: Bill Elliot, CRCM, Senior Consultant and Manager of Compliance

The Bureau of Consumer Financial Protection (CFPB) is an agency that appears to be struggling right now. Its long-time director quit. His replacement has been through congressional hearings, but her confirmation is not complete, and will certainly not be finished for a little while longer, possibly after the publication of this article. And the person in charge at the time of this writing is a short-timer at best, and is obviously not being proactive. With this sort of upheaval, it is not surprising that the CFPB has its problems right now.

Slow Movement

Although you may not be directly subject to the rule as it now stands, the CFPB receives many complaints regarding debt collection. They have promised a Notice of Proposed Rulemaking in the spring of 2019. While this should not have any significant impact on banks, remember that the CFPB still is in a position to "make" law without Congress, so we will have to wait and see.

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Congress did pass the Economic Growth, Regulatory Relief and Consumer Protection Act (EGRRCPA) and President Trump signed it in May 2018. There were numerous items that essentially require the CFPB to "back off" on some of their regulatory stances.

One of the requirements of the law is that the CFPB must change the escrow rule to exempt banks under $10 billion from Higher Priced Mortgage Loan escrow. Even though this seems clear cut and simple, they have delayed any action until June 2019, and they are calling that "Pre-Rule Activity." I personally would like them to explain why this is going to take so long, as the concept here is simple, and the changes to Regulation Z to accomplish this could easily fit on one page.

The original Notice of Proposed Rulemaking for Regulation CC was delivered by the Federal Reserve Board in 2011. Now, seven years later, the CFPB is threatening (not for the first time) to publish another Notice of Proposed Rulemaking, which is due shortly. The current rule was written during the era where all checks went through the system as paper items. So banks should be prepared for major changes to this regulation. The regulation is in serious need of updating.

The CFPB has already ordered the national credit bureaus to start offering all consumers the right to "lock" their credit reports. In the short term, there will be little impact, but over time this could be one of your bigger problems. If a consumer has locked their credit report with all three major companies, and you need a tri-merge credit report, there will be many more steps that will be the responsibility of the consumer to take so that you can receive your credit report. Even for a simple unsecured loan, you could have a situation where you cannot get the credit report due to a "lock," the consumer cannot remember their unlock password, and the result is a multi-day ordeal.

Also, you should remember that nothing in life is "free." To pay for this process, the cost of a credit report will go up. If you are a bank that has elected to pay that cost without directly passing it on to the consumer, you may be rethinking that position in the months and years ahead.

One item they have managed to finish is the update to the Privacy Rule – Regulation P. The new structure is that banks that do not share outside of the exceptions no longer have to send out any additional annual privacy notices. But banks that do share and have to offer an opt-out (either for Privacy or FCRA) must send a privacy notice to every customer on an annual basis. So if you decide to change your business model in a way that will result in having to send the annual notices, make sure that whatever you have decided to do is worth the expense (and aggravation) that will result from the annual notices.

Home Mortgage Disclosure Act

The real elephant in the compliance room is HMDA. The CFPB has issued information that essentially puts a band aid on the current regulation, and has given some major relief to smaller mortgage lenders, but they have not updated the regulation to comply with the EGGRRCPA. This has made 2018 data collection difficult and challenging for smaller mortgage producers, deciding what fields to report for what time period. It took the CFPB about four months to provide that information.

It appears that they do not intend to even start changing the regulation with a Notice of Proposed Rulemaking until March 2019; therefore it seems likely that data collection will probably remain problematic through at least 2019. Bankers should work with their regulators as necessary to assure that the bank is doing exactly what their prudential regulators are expecting.

Larger mortgage producers have to comply with the rule in full. That creates its own nightmare, as even with software help, on average it seems to take at least an additional employee hour per loan to comply.

Some issues discussed above will not have major impacts. However, some will create some major dislocations in the bank. As the regulations develop, Young & Associates, Inc. will continue to support banks with updated policies, on and off-site help, and anything else you may need to deal with what is yet to come. For more information, contact us at compliance@younginc.com or 1.800.525.9775. ❑

BANKERS WORKING FOR BANKERS
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Capital Planning System

Assess capital adequacy in relation to your bank's overall risk and develop a customized capital plan for maintaining appropriate capital levels in all economic environments. Addresses the impact of growing cybersecurity risks, as well as the impact of the tax reduction from a capital planning perspective.

Allows you to:

Develop a base case scenario in which minimum capital adequacy standards are established.

Identify and evaluate risk for your bank. Parameters in this analysis have been field-tested in our work with banks over the years and closely resemble adequacy standards established in consent orders.

Stress test capital by loan classification (as recommended by the FDIC and OCC).

Perform contingency planning for stressed events. All assumptions are stressed to determine the amount of capital needed and possibilities for increasing capital are examined.

Generate your capital plan in as little as 1 day. Data from the Microsoft® Excel spreadsheets can be easily transferred directly into a Word document that can be customized to fit the unique circumstances at your bank.

First Year License Fee (#304) – $1,095

Update/Annual License (#306) – $495

System Requirements: Microsoft® Excel 2007 or higher

Commercial Real Estate (CRE) Stress Testing Workbook (first year license) (#258) − $895

This Microsoft Excel workbook combines call report data with loan-level data characteristics that you enter about the CRE loans in your portfolio to estimate the level of CRE losses your institution might experience under two stress scenarios that you have the ability to define. The output of the workbook includes highlighting individual loans that may experience losses in a stress scenario as well as aggregate portfolio-level loss amounts.

This product provides an efficient solution for stress testing your CRE portfolio, and the results serve as important inputs into your concentration risk management, capital planning, and strategic planning processes.

Available in 3 versions for Banks, Banks with an existing SNL subscription, and Credit Unions.

System Requirements: Microsoft® Excel 2007 or higher

Liquidity Toolkit (#273) – $1,250

Includes:

- **Liquidity Cash Flow Planning Model (#271):** Forecast funding sources, funding needs, and cash flow gaps. Monitor availability of contingent liquidity. Monitor funding concentrations and dynamic cash flow ratios. Perform liquidity stress testing and multiple-scenario what-if analyses. (*regularly $950*)
- **Liquidity Contingency Funding Plan (#272):** Delineates strategies and actions addressing potential liquidity shortfalls in emergency situations. Includes identification of stress events, stress levels, early warning indicators, parameters for liquidity stress testing, sources of funds and funding strategies, lines of responsibility and communication, as well as a detailed crisis action plan. (*regularly $275*)
- **Liquidity Management Policy (#096):** Customizable policy designed to ensure that the bank is managed to provide an adequate level of liquidity to meet both predicted and unexpected cash needs while maintaining a planned net interest margin. (*regularly $225*)

System Requirements: Microsoft® Word 2007 and Excel 2007 or higher

Save $200 when you purchase the Liquidity Toolkit.

Customizable Bank Policies

Young & Associates, Inc. has developed over 95 practical bank policies designed specifically for community banks that will ease the burden of developing bank policies from scratch.

- **Bank Secrecy and Anti-Money Laundering Policy (#109) - $350**
- **Customer Identification Program Policy (#217) - $195**
- **ADA Website Accessibility Accommodations (#327) - $125**
- **Cybersecurity (#313) – $195**
- **Identity Theft (#224) – $250**
- **Complete List of Available Policies –** management, lending, and compliance topics

Practical Solutions Catalog

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