Balance Sheet Strategies for this Low Rate Environment

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COUNTRY CLUB BANK®
CAPITAL MARKETS GROUP

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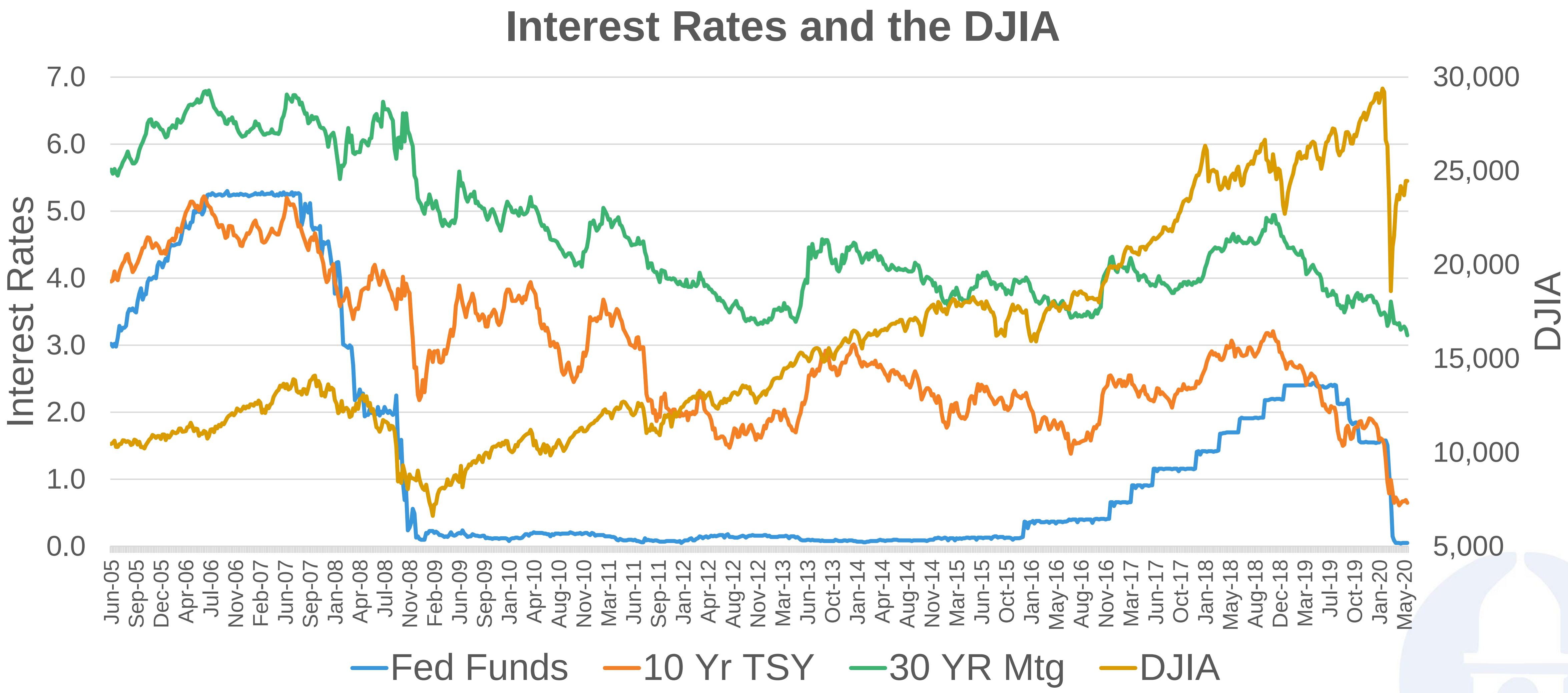
Background - David Farris

- **Spent the first 12 years of career consulting for community banks and S&L's**
  - Focus on mortgage-backed securities (MBS) and managing interest rate risk
- **Spent next 10 years as portfolio manager for a non-agency mortgage REIT**
  - Traded and managed portfolio of agency and non-agency MBS and managed interest rate risk
- **Partner at Credentia Group, LLC, a private hedge fund**
  - Trading agency and non-agency MBS products
  - Managed investment strategies and risk
- **Joined Asset Management Group with Country Club Bank in 2019**
  - Provides asset liability management advice
    - Interest rate risk
    - Liquidity risk
    - Investment and funding programs
    - Overall balance sheet strategies
- **Capital Markets Group, a Division of Country Club Bank**
  - Registered Investment Sales Officer
  - Providing Investment Portfolio Management and Sales to Institutional and retail accounts

The *Asset Management Group* and *Capital Markets Group* of **Country Club Bank** are comprised of seasoned professionals recognized in the industry for their expertise, integrity and service. Specializing in helping institutional and community banks across the country with investment advice, portfolio and balance sheet strategies, and efficient trade execution.

What Has Happened



Source: Board of Governors of the Federal Reserve System (US)/Freddie Mac/FRED, Bloomberg LLC

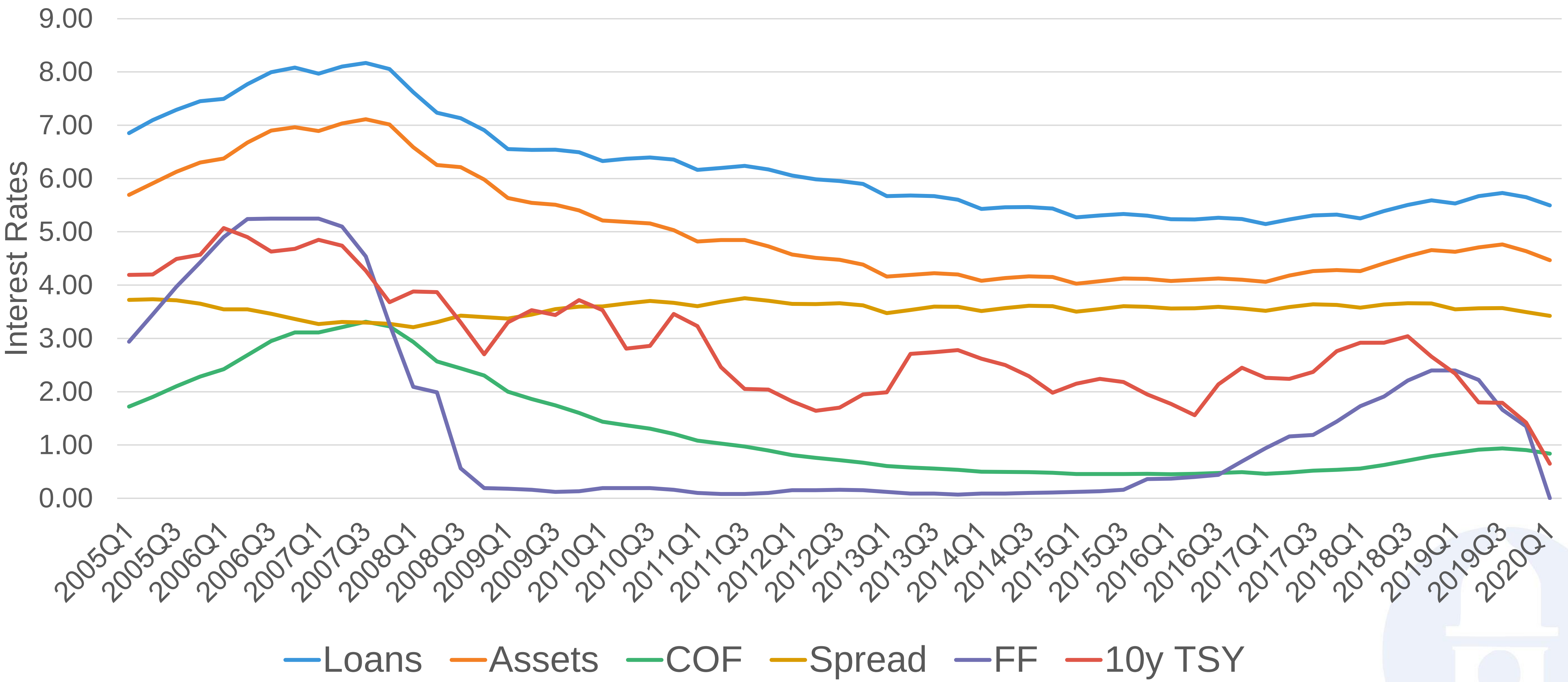
10 Year TSY Moved to 3 Standard Deviations Below the Mean

Source: Bloomberg, LLC.

Municipal Bond Spreads Widened Dramatically

Source: Bloomberg, LLC.

Bank Yields, COF & Spread vs Market Rates



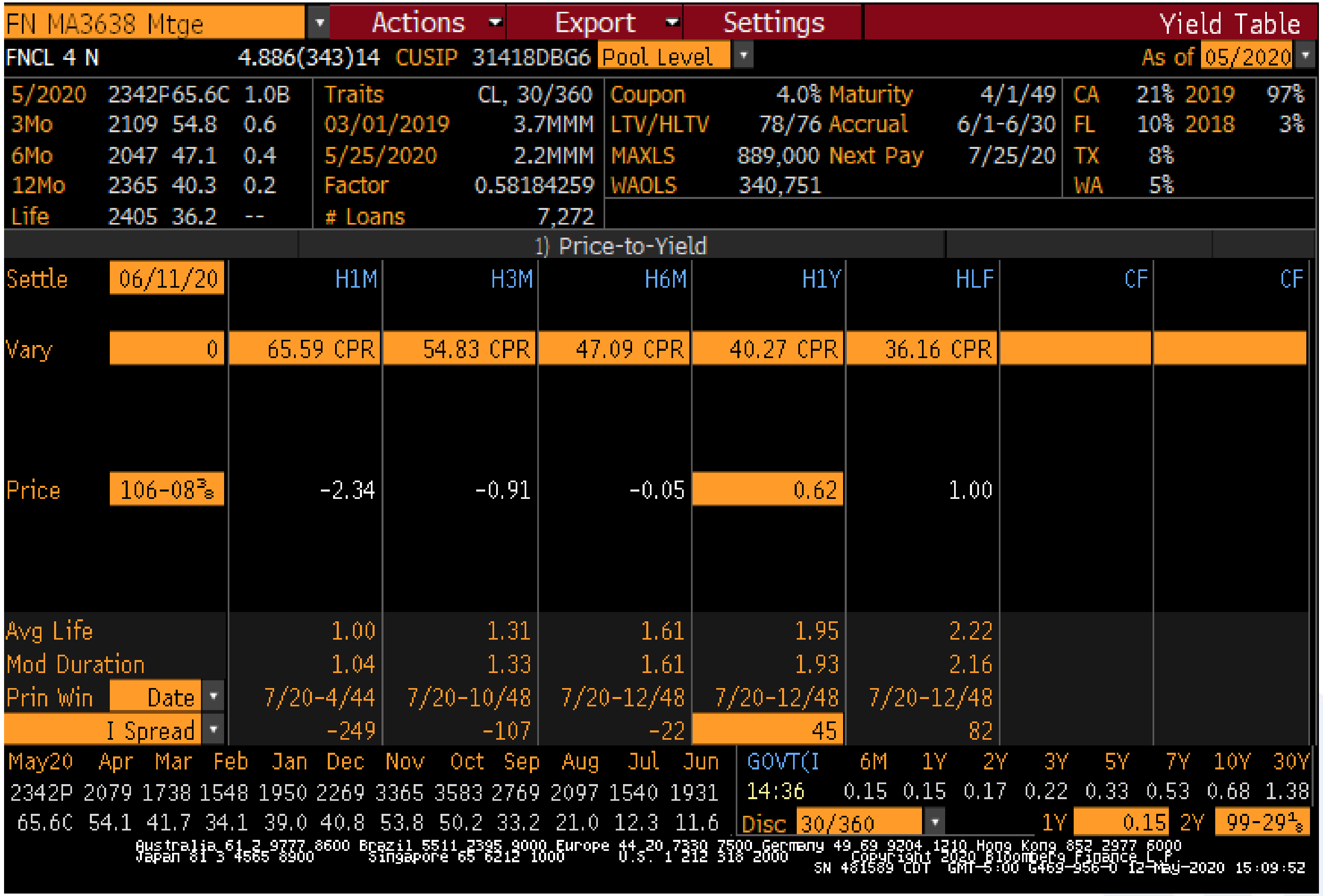
Source: S&P Global, Board of Governors of the Federal Reserve System (US)/Freddie Mac/FRED

Decision Matrix as Rates Move Further from the Mean

	Yield Curve	Liability Strategy	Loan Strategy	Credit Strategy	Investment Strategy	Off Bal Sheet Strategy	Leverage Strategy
+2 Std	Inverted	Shortest Specials; Shortest Adv	More Fixed; Prepay Penalty Prime Index	Tighter Credit Standards Don't Reach	Max Duration Min Optionality	Asset: Var > Fix Liab: Fix > Var	Max Leverage (Max Invest)
+1 Std	Flattening	Shorter Specials; Shorter Adv	Prefer Fixed;	Begin Tighter Credit	Extend Dur Less Options	Hedge Int. Rate Exposure as Needed	Incr Leverage (More Invest)
-1 Std	Steepening	Longer Specials; Longer Adv	Prefer Floating;	Begin Easier Credit	Shorten Dur More Options	Hedge Int. Rate Exposure as Needed	Incr Leverage (More Loans)
-2 Std	Very Steep	Longest Specials; Longest Adv	More Variable; Tsy Index; No Caps	Easiest Credit Standards	Min Duration Max Optionality	Asset: Fix > Var Dep: Var > Fix	Max Leverage (Max Loans)

Sell *Fast* Paying MBS

- FNMA 30 Year 4.00%
- Based on the 1, 3 and 6 month average speeds, the buyer of these bonds is willing to accept a NEGATIVE YIELD.
- You come out ahead even if you sell these now and stay in cash.



Source: Bloomberg, LLC.

Sell *Fast* Paying MBS

FNMA 30 Yr 4.00%

Original Face: $5,000,000

Current Face (Apr): $3,183,935

Current Face (May): $2,909,212

One Month Paydown: $274,722

Market Price: 106.26

Book Price: 102.26

Potential Gain: 4.00%

Income LOST to Prepayments:

4% X 274,722 = $10,989

We recommend selling MBS now at market prices rather than receiving principal returned in prepayments at Par

Other Potential Sale Targets

- US Treasury Securities
- Agency Bullets
- Agency ARMs with Short Months to Reset
- Pre-Refunded Municipal Bonds
- Shorter Term Municipal Bonds
- Longer Term Municipal Bonds to Reduce Exposures to Certain Credits

Reinvest in Lower Risk Higher Yield MBS

Reinvestment Option #1

- Buy FN 20Yr Fixed 2.50%
- Yield UP from < 0% to 1.50%
- Reduce Premium 2-08 Points
- Decrease Prepayment Risk
- Yield Still >0% Down 300 bps

FN MA4016 Mtge | Actions | Export | Settings | Yield Table

FNCT 2.5 N 3.334(238)1 CUSIP 31418DPA4 Pool Level As of 05/2020

5/2020	841P	1.7C	0.0B	Traits	CT, 30/360	Coupon	2.5%	Maturity	5/1/40	CA	22%	2020	99%
3Mo	--	--	--	04/01/2020	3.6MMM	LTV/HLTV	67/67	Accrual	6/1-6/30	TX	5%	2019	1%
6Mo	--	--	--	5/25/2020	3.6MMM	MAXLS	918,000	Next Pay	7/25/20	MI	5%		
12Mo	--	--	--	Factor	0.99563834	WAOLS	332,858			CO	4%		
Life	841	1.7	--	# Loans	12,715								

1) Price-to-Yield

Settle	06/11/20	+300 MED	+200 MED	+100 MED	0 MED	-100 MED	-200 MED	-300 MED
Vary	0	93 PSA	107 PSA	146 PSA	356 PSA	678 PSA	1136 PSA	1139 PSA
Price	104-00+	1.93	1.91	1.85	1.50	0.97	0.31	0.30
Avg Life		8.13	7.80	6.99	4.37	2.79	1.92	1.91
Mod Duration		7.17	6.91	6.26	4.10	2.70	1.88	1.88
Prin Win	Date	7/20-3/40	7/20-3/40	7/20-3/40	7/20-3/40	7/20-3/40	7/20-3/40	7/20-3/40
	I Spread	125	125	124	115	73	12	11

Source: Bloomberg, LLC.

Reinvest in Lower Risk Higher Yield MBS

Reinvestment Option #2

- Buy FN 30Yr 7/1 Hybrid ARM
- Yield UP from < 0% to 1.42%
- Reduce Premium 1-17
- Decrease Prepayment Risk
- 3.09% WAC
- 100% Tier 1 Servicer
- 7 Years to the Reset Borrowers Shouldn’t be Focused on Refi for awhile
- Max Loan Size 504k (lower than average)

Source: Bloomberg, LLC.

Reinvest in Lower Risk Higher Yield MBS

Reinvestment Option #3

- Buy FN CMBS SARM
- Yield UP from < 0% to 0.82%
- Reduce Premium 5-25
- Decrease Interest Rate Risk
- Bond Floats at 1m LIBOR + 68

Source: Bloomberg, LLC.

Affect of Trades on Interest Rate Sensitivity & Returns
Market Value of Equity (MVE)

Yield Pickup:
FN 2.5%
1.50%
FN ARM
1.42%
SARM
0.82%
Total
1.27%

Versus 0% to 0.50% on FN 4% Depending on Prepayments

		Face	DN 200	DN 100	BASE	UP 100	UP 200
1	**Rate Shift**	**Face**	**DN 200**	**DN 100**	**BASE**	**UP 100**	**UP 200**
2	**MVE Chg In Value $**	-	(4,089)	(3,557)	-	**6,335**	**11,323**
3	**Sell FN 4.00%**	20,000	(427)	(319)	-	574	1,297
4	**Buy FN 2.50%**	7,000	368	255	-	(342)	(724)
5	**Buy FN ARM**	7,000	258	183	-	(308)	(694)
6	**Buy SARM**	6,000	10	5	-	(5)	(10)
7	**Effect of Trade on MVE**		209	124	-	**(81)**	**(130)**
8	**New MVE Chg In Value $**		(3,880)	(3,433)	-	**6,253**	**11,193**

TRADE RESULTS:
- Take a Gain
- Pick Up Yield
- Reduce Prepayment Risk
- Interest Rate Risk is Unchanged

Common Interest Rate Sensitivity of a Bank
Market Value of Equity (MVE)

1		**Book**	**Avg Elas**	**DN 200**	**DN 100**	**BASE**	**UP 100**	**UP 200**
2	Assets	400,000		409,982	406,580	400,201	391,270	381,700
3	Asset Price			102.5%	101.6%	100.1%	97.8%	95.4%
4	Cum Change In Value $			9,782	6,379	-	(8,931)	(18,500)
5	Cum Change In Value %		1.9%	2.4%	1.6%	0.0%	-2.2%	-4.6%
6								
7	Liabilities	352,000		357,423	353,489	343,553	328,287	313,729
8	Liability Price			101.5%	100.4%	97.6%	93.3%	89.1%
9	Cum Change In Value $			(13,871)	(9,936)	-	15,266	29,824
10	Cum Change In Value %		3.7%	3.9%	2.8%	0.0%	-4.3%	-8.5%
11								
12	MV Equity	48,000		52,559	53,091	56,648	62,983	67,971
13	MV Equity %	12.0%		12.8%	13.1%	14.2%	16.1%	17.8%
14	Cum Change In Value $			**(4,089)**	**(3,557)**	**-**	**6,335**	**11,323**
15	Cum Change In Value %			**-7.2%**	**-6.3%**	**0.0%**	**11.2%**	**20.0%**

Take Advantage of Hedges Built into the Risk Position

- The Portfolio Gains as Rates Increase (Line 2)
- This Allows for the Portfolio to Lengthen Out on the Asset Side (Line 6)
- The Result is Lower Gains as Rates Increase (Line 8) But Gains Remain

1		**Avg Elas**	**DN 200**	**DN 100**	**BASE**	**UP 100**	**UP 200**
2	**MVE Chg In Value $**		(4,089)	(3,557)	-	**6,335**	**11,323**
3	**MVE Chg In Value %**		-7.2%	-6.3%	0.0%	11.2%	20.0%
4							
5	**Buy FN 20yr 2.50%**	20,000	21,851	21,528	20,800	19,822	18,732
6	**Cumulative Chg in Value**	4.1%	1,051	728		**(978)**	**(2,068)**
7							
8	**MVE Chg In Value $**		(3,038)	(2,829)	-	**5,357**	**9,255**
9	**MVE Chg In Value %**		-5.4%	-5.0%		9.5%	16.3%

Take Advantage of Hedges Built into the Risk Position

- Analyze the Bank's Overall Risk Position of their Balance Sheet
- A Risk Position Similar to our Example may Provide Opportunity to Invest Longer
- Longer Duration Investment will Even Out "Short" Position of Overall Risk Position
- Protects Income from a Further Drop in Rates
- Increases Income in the Base Case
- Extending from 0% in Funds to a 1.50% Yield on a Security adds $300k in Income
- Interest Rate Risk on the Security is $978k UP100 but Drops to $730 after One Year
- How Potential Investments Fit Into the Banks Overall Risk Position Provides an Important Piece of Information for Banks Deciding Whether to:
    1) Invest Now When Rates are Low, Increase Income & Interest Rate Risk OR
    2) Stay in Cash and Forego Current Earnings

balanCD

Maturity	TREASURY	Brokered CD Fixed	Brokered CD Callable	FHLB TOPEKA	FHLB DMOINES	QwickRate
36mo	0.22%	0.50%	0.55%	0.70%	0.61%	0.32%
39mo	0.22%	0.53%	0.58%	0.79%		
42mo	0.23%	0.55%	0.60%	0.79%		
46mo	0.26%	0.60%	0.65%	0.79%		
48mo	0.26%	0.65%	0.70%	0.79%	0.70%	0.40%
50mo	0.27%	0.67%	0.72%	0.86%		
52mo	0.28%	0.68%	0.73%	0.86%		
54mo	0.28%	0.70%	0.75%	0.86%		
5YR	0.32%	**0.75%**	**0.80%**	0.86%	0.80%	0.53%
5.5yr	0.34%	0.80%	0.90%	0.92%		
6YR	0.38%	0.90%	1.00%	0.92%	0.92%	
7YR	0.52%	**0.95%**	**1.05%**	1.08%	1.08%	
8YR	0.52%	1.05%	1.15%	1.20%	1.19%	
9YR	0.60%	1.15%	1.25%	1.31%	1.30%	
10YR	0.67%	**1.25%**	**1.35%**	1.40%	1.39%	
12YR	0.63%		1.50%		1.59%	
15YR			**1.65%**	1.96%	1.86%	

Indicative rates only, subject to change and availability. For illustration purposes only as of June 15, 2020

Advantages of Issuing CALLABLE CDs

- Allows the Bank to aggressively issue longer term funding at historically low rates with the ability to call and reissue if rates go even lower or funding is no longer needed
- Callable CDs are callable by the BANK, not the investor – this is the ONLY Call Option you control!
- Callable any time after initial lockout period, typically 6 months but can structure to banks needs
- The bank creates cheap, long-term options for its balance sheet
- Improved interest rate risk profile in down rate scenarios versus non-callable term funding
- No provision for early withdrawal. Can't redeem prior to maturity unlike QwickRate or other sources
- No collateral posting required
- No FHLB Stock purchase required
- Provides additional liquidity by keeping borrowing lines available
- No additional ongoing fees such as subscription fees for listing service deposits
- Target specific maturities or call schedules. Lock in spread on a loan that may prepay in future
- Customize interest payments, monthly, quarterly, other. Flexible settlement dates typically 2-4 weeks
- Doesn't cannibalize retail funding markets
- **THE MOST FLEXIBLE ASSET/LIABILITY TOOL IN YOUR TOOLBOX**

Advantages of Issuing CALLABLE CDs Now

- Improve Risk Position Now as Rates Go Up by Issuing Long-Term Callable CDs
- Issuing 5 Year Callable CDs will Improve Risk Profile in Up Rate Scenarios

Market Value of Equity (MVE) Adjusted for Addition of Callable CDs

1	**Rate Shift**	**Face**	**DN 200**	**DN 100**	**BASE**	**UP 100**	**UP 200**
2	**MVE Chg In Value $**		(4,089)	(3,557)	56,648	**6,335**	**11,323**
3	**MVE Chg In Value %**		-7.2%	-6.3%	0.0%	11.2%	20.0%
4							
5	**Five Yr Callable CD**	20,000	20,030	20,030	20,000	19,060	18,160
6	**CD Cum Chg In Value $**		(30)	(30)	-	940	1,840
7	**CD Cum Chg In Value %**		-0.15%	-0.15%	0.00%	4.70%	9.20%
8							
9	**MVE Chg In Value $**		(4,119)	(3,587)		**7,275**	**13,163**
10	**MVE Chg In Value %**		-7.3%	-6.3%		12.8%	23.2%

Interest Rate Swaps vs Callable Brokered CDs

Would an Interest Rate Swap Work as Well as a Callable Brokered CD?

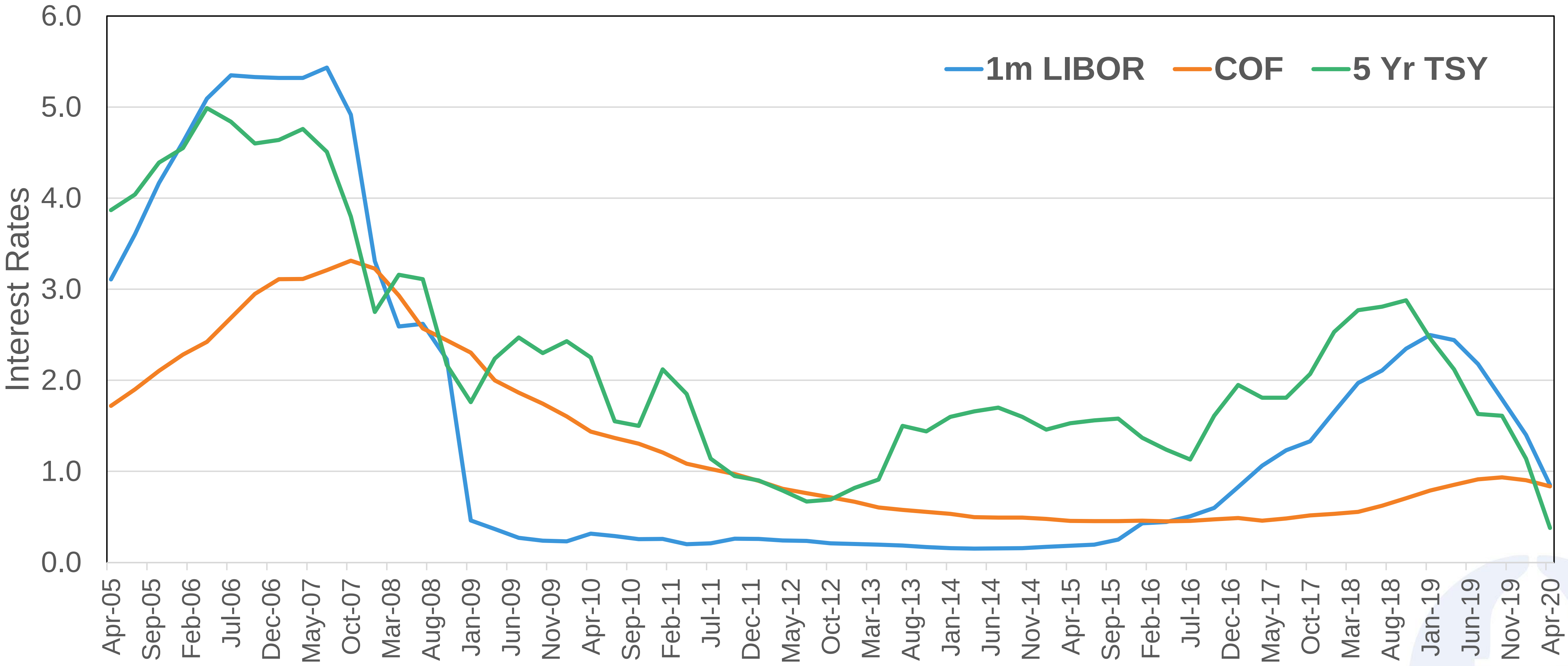
Instrument	Callable Brokered CD	Interest Rate Swap
Upfront Collateral Required	No	Yes
Additional Mark-to-Market Collateral Required	No	Yes
Margin Call Risk	No	Yes
ISDA Agreement in Place	No	Yes
Loses Value if Rates Decrease	No	Yes
LIBOR/SOFR Transition Issues	No	Yes
Independent Third Party Valuations	No	Yes
Board Reporting	No	Yes
Additional Accounting Requirements	No	Yes
Raises Liquidity	Yes	No
Interest Rate Risk Protection in Up Rate Scenario	Yes	Yes

Interest Rate Swaps vs Callable Brokered CDs

- The Mark-to-Market Risk of Each is Similar in the Up Rate
- In the Down Rate the Swap Loses vs the Callable CD Which is Called

		Face	DN 200	DN 100	BASE	UP 100	UP 200
1	**Rate Shift**	**Face**	**DN 200**	**DN 100**	**BASE**	**UP 100**	**UP 200**
2	**Five Yr Callable CD**	20,000	20,030	20,030	20,000	19,060	18,160
3	**Cum Chg In Value $**		**(30)**	**(30)**	-	**940**	**1,840**
4	**Cum Chg In Value %**		-0.2%	-0.2%	0.0%	4.7%	9.2%
5							
6	**Five Yr Swap**	20,000	**(2,060)**	**(1,020)**	-	**924**	**1,824**
7	**Cum Chg In Value %**		-10.3%	-5.1%	0.0%	4.6%	9.1%

1m LIBOR vs Bank COF vs 5 Year TSY



Interest Rates Source: Board of Governors of the Federal Reserve System (US)/Freddie Mac/FRED
Bank COF Source: S&P Global
Bank Cost of Funds shown represents average of all banks <$10B in assets.

Interest Rate Swaps vs Callable Brokered CDs

- From 2009 until the end of 2015 1m LIBOR was ~20 bps, Comparable to Fed Funds
- Bank COF Trended Down During this Time Period and Began to Rise Slowly with Funds in 2016
- 1m LIBOR and Fed Funds Began their Trend Up in 2016
- Other Market Rates Began to Rise Earlier, in 2013
- Entering Into an Interest Rate Swap Would Not Have Been Advantageous Until 2016
- Issuing Long Term CDs Would Have Been Advantageous in 2012 – At All Time Lows In Rates (Like Today!) with the Opportunity to Invest in Higher Market Rates Beginning in 2013

This may also Hold True Today:

- Issuing CDs will likely provide low cost funding for when better asset opportunities return
- It is Likely that Market Rates will Increase Before and in Anticipation of the Fed Raising the Funds Rate with the Fed Remaining Accommodative and Unlikely to Raise Prematurely
- Interest Rate Swaps will Provide Income Once the Fed Begins to Raise Rates Again BUT:

HOW LONG WILL THAT BE AFTER INVESTMENT OPPORTUNITIES HAVE ALREADY PRESENTED THEMSELVES?

Bank Liquidity

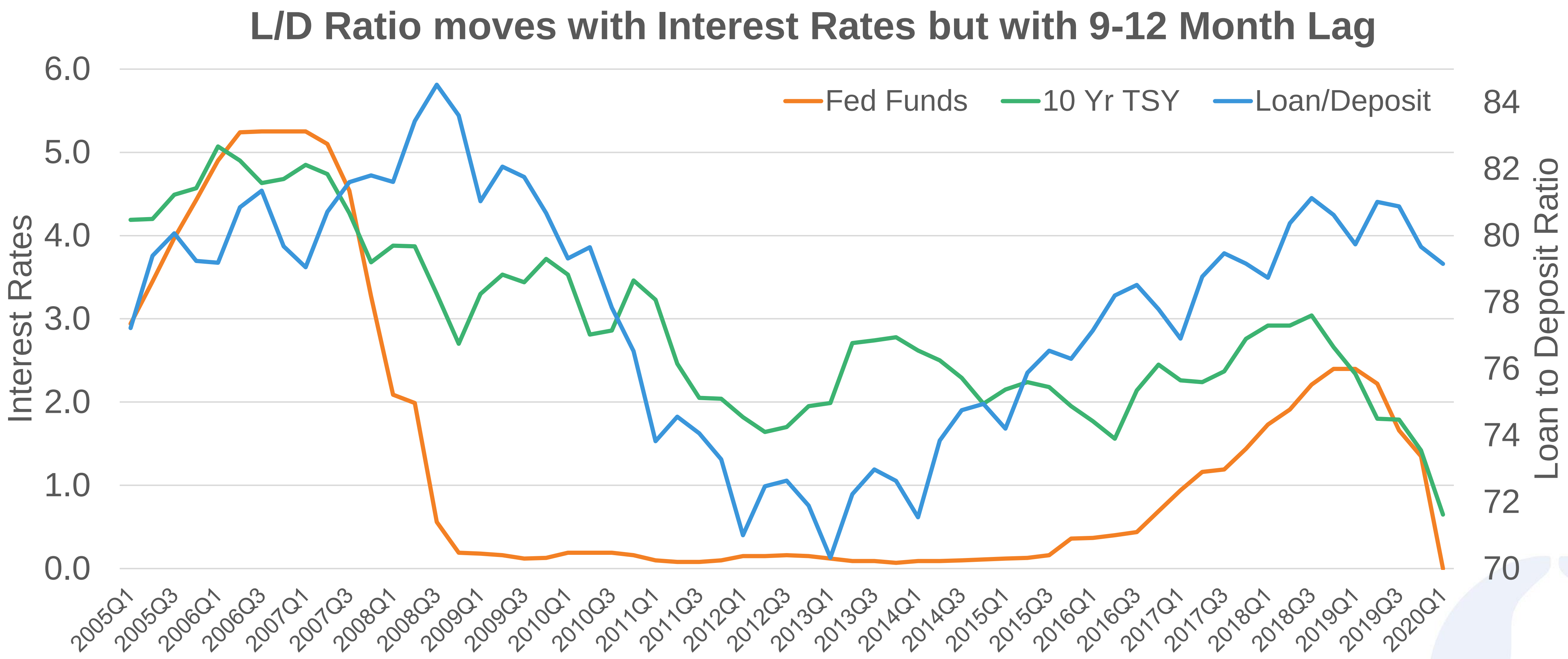
Bank Liquidity Trends Lower as Rates Increase

- Prepayments on Loans and Investments Slow
- Loan Demand Increases in a Stronger Economy with Higher Rates
- Deposits Turn Less Sticky when Market Rates Rise as Depositors Target Higher Returns

Bank Liquidity Trends Higher as Rates Decrease

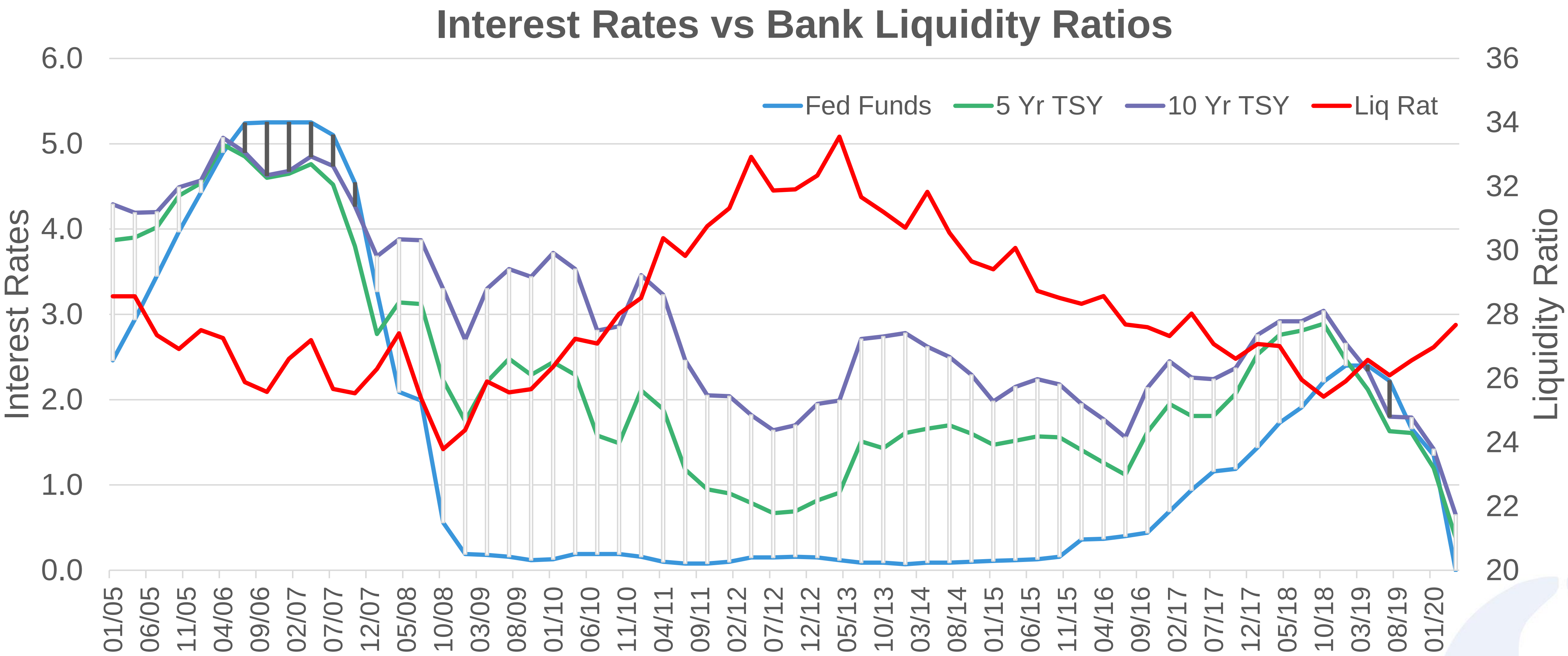
- Prepayments on Loans and Investments Increase
- Loan Demand Decreases in a Weaker Economy with Lower Rates
- Deposits are more Likely to Stay at the Bank and Wait for Higher Returns in Bonds or Opportunities to Invest in the Equity Markets

Loan to Deposit Ratio versus Interest Rates



Interest Rates Source: Board of Governors of the Federal Reserve System (US)/Freddie Mac/FRED
Loan to Deposit Ratio Source: S&P Global
Loan to Deposit Ratio shown represents average of all banks <$10B in assets.

Bank Liquidity Tends to Trend Lower as Rates Increase



Interest Rates Source: Board of Governors of the Federal Reserve System (US)/Freddie Mac/FRED
Liquidity Ratio Source: S&P Global
Liquidity Ratio shown represents average of all banks <$10B in assets.

Many Banks Have Had a Surge in Deposits Since March

Where did the Deposits Come From?

- Companies Have Deposited PPP Loan Proceeds into their Bank Accounts
- Companies Have Drawn on Short-Term Credit Facilities & Placed Those Funds in Bank Deposits
- Clients have Opened up Accounts at Other Banks to Segregate Funds…
- While Others have Moved More Deposits to Primary Banking Relationships
- Clients have held on to Cash that Might have Otherwise been Invested in the Business

Which of the Deposits are Core and Which are Transitory?

- Some Deposits Will get Drawn Down Quickly to Cover Operating Expenses/Losses
- Others Will Stay Longer as Companies Hold More Reserve Cash in Uncertain Times
- Some Deposits Leave the Bank for Higher Returns When Rates Go Back Up
- Clients Will put Money Back into their Businesses

Many Banks Have Had a Surge in Deposits Since March

Steps to Determine Which Commercial Deposits Might Remain with the Bank

- For each client, how many other bank relationships do they have?
- Is my bank the primary bank for that client?
- If not, where does my bank rank among the other banks used by that client?
- Is the client likely to change which banks they use for the services they need?
- Would the client change the mix of banks they do business with?
- Is my bank’s current position with the client stable?
- Am I able to improve my bank’s current position with the client?

Advantages of Issuing CALLABLE CDs Now

- Funds for Callable CD Issuance **WILL BE** at the Bank
- No Deposit Study Needed to Determine how Long they may Remain at the Bank
- Interest Rates are at Historic Lows
- If We are Cautious Extending Assets, We Should be Aggressive Extending Funding
- Liquidity will begin to Fall as Rates Increase and Loan/Deposit Ratios begin to Rise 9-12 Months from the Bottom in Rates
- When Rates Begin to Rise, the Opportunity to Raise Low-Cost Funding Goes Away
- You May Not Need Liquidity Now BUT WILL HAVE IT WHEN NEEDED AT ALL TIME INTEREST RATE LOWS

Conclusions

- Interest Rates are at Historic Lows
- Sell Fast Paying MBS
- Also Consider other Low Yielding Investments as Sale Candidates
- Consider a Reinvestment Mix of Higher Yielding, Lower Risk MBS
- Take into account the Banks Overall Risk Position when Making Investment Decisions
- Consider the Pros and Cons of Interest Rate Swaps versus Callable CDs
- Raise Additional Liquidity Now by Issuing Long Term Callable Brokered CDs
- Liquidity is Currently High but will begin to Fall as Rates Increase and Loan/Deposit Ratios begin to Rise 9-12 Months from the Bottom in Rates. When this happens, the Opportunity to take Advantage of Today's Rates will have Passed.
- **TODAY'S RATE ENVIRONMENT IS AN OPPORTUNITY TO POSITIVELY AFFECT THE BALANCE SHEET FOR YEARS INTO THE FUTURE**

Thank You for Participating!

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