One year on, our conversation with a community banker resumes. To read part one, visit bit.ly/shoptalkpart1

"Jim Reber speaking."

"Hi, Jim, this is Charlie Brown with Community Trust Bank. Do you have a minute?"

"Hi, Charlie, I sure do! How are you?"

"Well, it’s been a year since we talked, and a lot has changed at my bank since then. Loan demand is great, we’re watching our underwriting very closely and interest rates have jumped up. All of that helps our bottom line."

"You sound like a lot of ICBA members."

"That’s good, but there are some things that I haven’t had to think about in a decade, not the least of which is how to fund my loan demand. Can you give me some thoughts?"

"The fact you asked the question means that your investment portfolio isn’t keeping up with providing sufficient cash flow. That, too, sounds like a lot of ICBA members. Actually, the cash-flow train began slowing down in 2013, when rates stopped falling. But what hasn’t happened until just recently is a pickup in loans and a slowdown in deposits."

"So, Jim, what are my options?"

"You can certainly borrow from your friends at the Federal Home Loan Bank. That’s not always the cheapest, but they’ve always got money to lend, and they have a lot of different programs. What more community banks have been doing lately is taking down some floating-rate advances and turning them into longer-term fixed rates."
“How does that work?”

“By using a very simple, very generic interest-rate swap. Like most community banks, you’re chronically short of short assets and long liabilities, and this tool can quickly fix that problem. I should also mention that you could save as much as a quarter point [0.25 percent] on your cost compared to standard fixed-rate advances.”

“Jim, can you explain this strategy to my ALCO team and my board? This is going to sound mighty sophisticated to them. And the examiners will be here later this year and will be asking some questions, too.”

“Charlie, it should give you some comfort to know there are more than 1,000 community banks that already are using some form of rate swaps to hedge their risk. We’re very used to explaining this process, to the point that it’s almost a turnkey approach.”

“What can I do on the asset side to create some cash flow?”

“Two things come to mind. First, buy some mortgage-backed securities [MBSs] that are short enough and have high enough coupons so you’re assured of having some reliable cash flow. A prime example is a seasoned, 15-year MBS with a stated rate of 3.0 percent or higher. In my view, ‘seasoned’ means two or more years old.”

“What’s my other option?”

“You could buy a seasoned, adjustable-rate mortgage [ARM] pool that is about a year away from its first reset date. Some call this a ‘short roll date’ pool. Typically, the borrowers will really pick up their prepayment activity as that roll date gets closer, so you’ll get a wave of principal paydowns, which is exactly what you want. You’ll need to have an exit strategy with these pools, as they can get pretty small pretty quickly.”

“OK, Jim, here’s my last question. I’m happy to be paying fewer taxes, but do I really need as many municipal bonds as I’ve had in the past?”

“Charlie, we think yes. Munis still accomplish their objectives, which is to give you high-quality, still relatively high-yield liquid investments. And the market has adjusted so that you’re getting nearly the same spreads as before on maturities 10 years and out. So my suggestion is to keep your muni weightings near where they’ve been in the past, and enjoy the business cycle.”

“Thanks much, Jim. I’ll call again, as soon as something else confuses me about my balance sheet.”

Road trip

ICBA Securities and its exclusive broker, Vining Sparks, will be on the road this summer and fall, speaking at a number of ICBA state and regional partner events. For a full calendar of engagements, visit icbasecurities.com/seminarswebinars

2018 Bond Academy announced

ICBA Securities will host the 2018 edition of the ICBA Bond Academy, Oct. 22–23 in Memphis, Tenn. This event will equip attendees with the basic tools to plan, build and maintain a high-performing investment portfolio. Twelve hours of CPE credit are available. To register, visit the ICBA Securities website.