FHLBank Tenth District Financial Institution Trends

Quarterly Analysis for Member Banks and Credit Unions

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Issues in Focus for Members

- **EARNINGS!**/Margin management → Challenging conditions, top of mind
- Tangible capital positions → On watch
- Deposit funding environment → Persistent headwinds
- Uncertain economic outlook → More questions than answers
- Credit containment → Remains on solid footing (for now?)
- **LIQUIDITY!** → Access/contingency plans; emphasis for regulators

3rd Quarter Balance Sheet Key Takeaways

- **Continued** shift in share/deposit composition as customers seek higher rates
- Funding mix evolving as banks look to fill the liquidity gap with alternative funding sources … more so at banks than credit unions
  - Deposit flows mixed among members
- On-balance sheet liquidity positions decline **… more so at smaller institutions**
- Loan **slowed across all segments**
  - Growth offset by declines in cash and security balances at most institutions
- For many institutions, reserve build mode underway
  - Net charge-offs are on the rise
- Equity positions intact **and under pressure** but security portfolios remain underwater

Looking Ahead

- Attractive investment alternatives and the ability for consumers to move money quickly could lead to **continued deposit disintermediation**
- Uninsured deposit **exposure** will continue to gain attention from regulators, along with liquidity stress testing and cash flow monitoring
- Interest rate outlook of **higher for longer**, but quantitative easing discussions on the rise
- **Caution** for an economic downturn and tightening credit conditions could slow lending activity
- **Access** to liquidity and collateral capacity imperative going forward as the ability to sell securities to generate liquidity remains restricted due to underwater position of security portfolios
- Margin pressure to persist in near-term but expect some relief in later in 2024, more so for banks
- Continue to **monitor** for tangible signs of credit quality deterioration
- **Market volatility** is likely to remain heightened with both domestic (election year) and global uncertainties

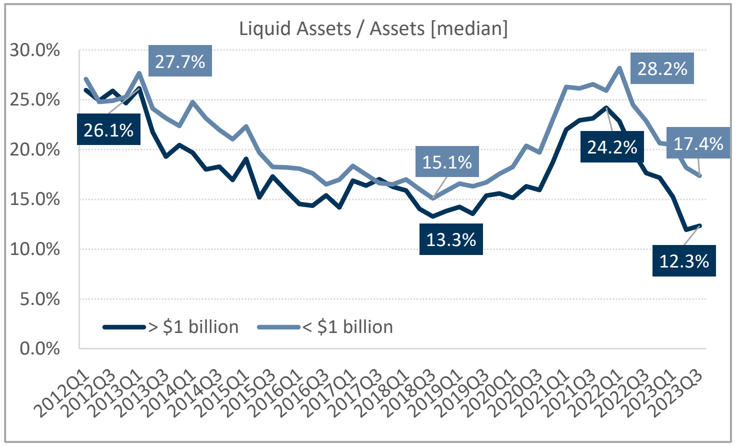
Q3 2023 Bank Member Trends

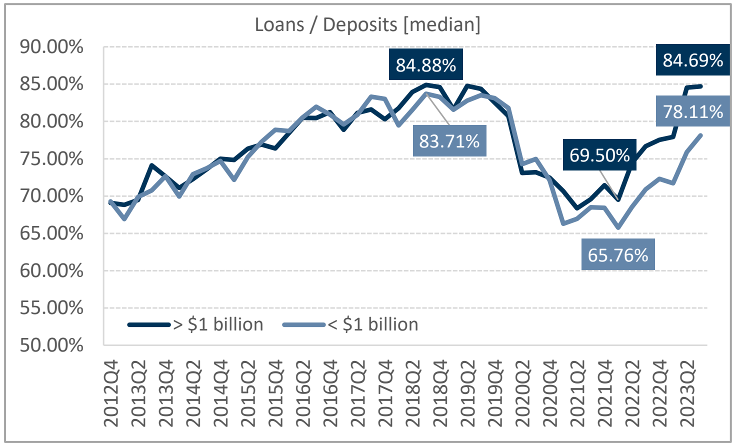
Graphs and Charts

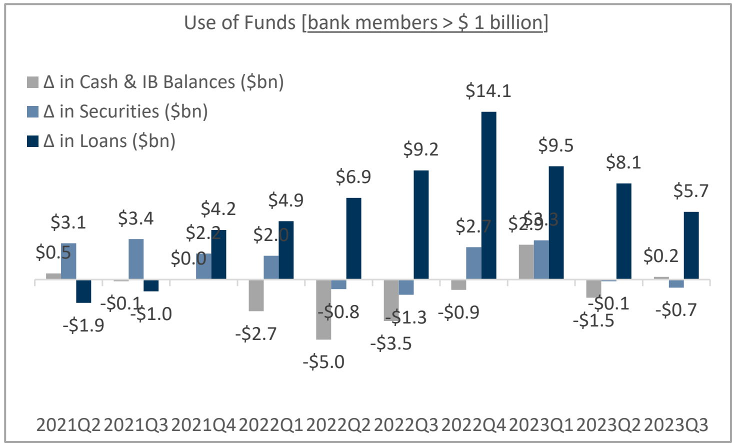
Liquidity Positions Mixed Among Members

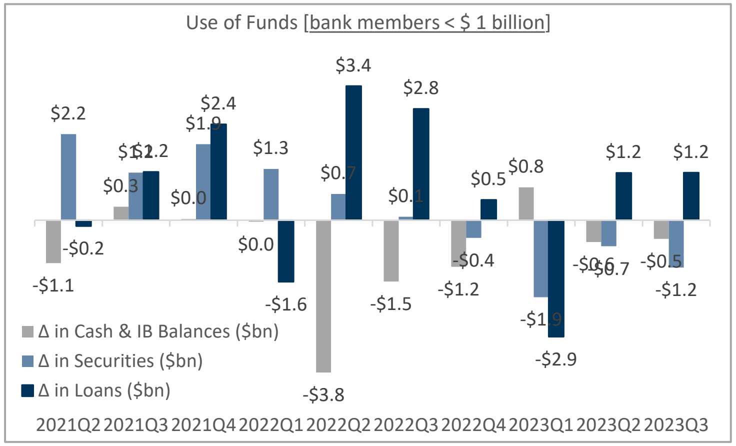
Cash flow from securities moving back into higher-yielding loans or paying down wholesale funding.

Pace of loan growth slowing across the District – CRE and ag lending activity primary sources of growth.









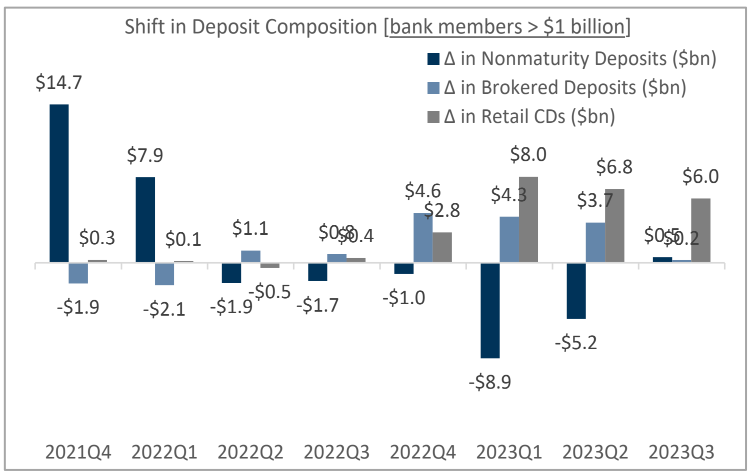
Deposit Composition Remix

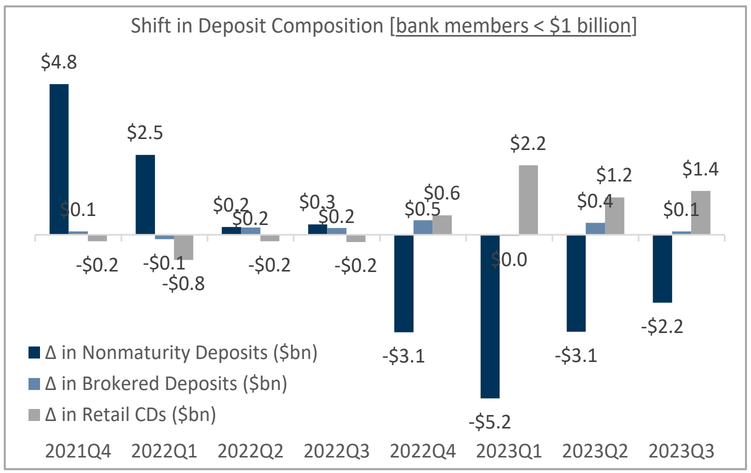
Low-cost, non-maturity accounts continue to migrate into higher-cost time deposits or out of the institution, shifting the makeup of the deposit portfolio. Retail CD balances at member banks with assets > $1 billion have doubled since the Fed began raising rates in 1Q22.

Noninterest-bearing deposits as a % of total deposits have reached or are nearing pre-Covid levels. The combination of reduced discretionary spending and higher costs related to inflation may leave consumers holding lower checking balances.

Smaller banks facing persistent outflow pressure as deposit gathering and retention remains challenging.

Although purchased deposits may not be the most cost-effective funding source, use has increased to help supplement deposit outflows and support loan-to-deposit ratios – more so at larger banks.





Note: Purchased deposits = net brokered deposits (excludes reciprocal brokered deposits) + listing service deposits.

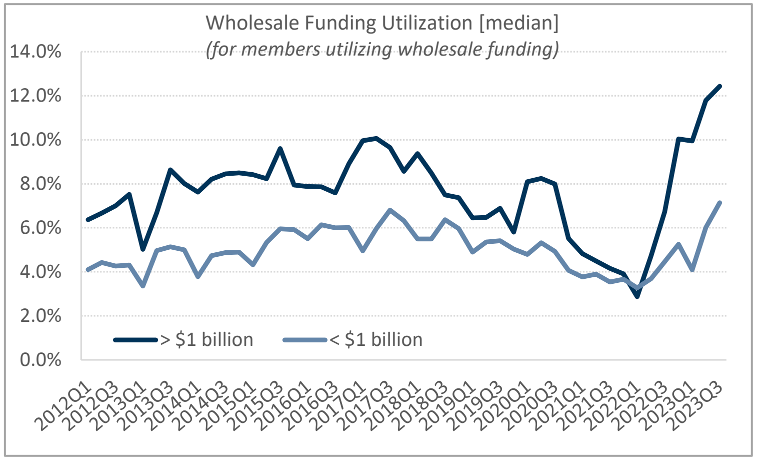
Alternative Funding Sources Fills Liquidity/Funding Needs

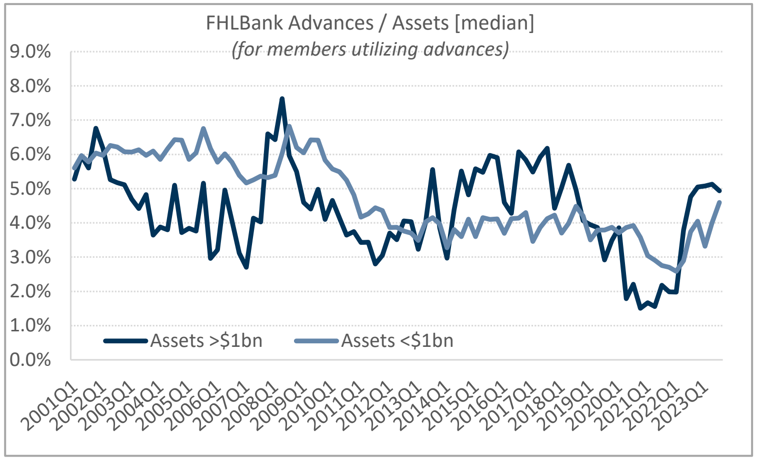
Just as the deposit mix is evolving at member banks, the overall funding mix is more reliant on wholesale funding sources.

Wholesale funding balances remain elevated, but activity moderated in the third quarter as funding gaps* narrowed. Additionally, as deposit costs push higher, members have looked to alternative funding options to help ease the pressure of higher core funding costs.

Advances continue to be a primary source of funding with over 70% of bank members actively borrowing throughout the year.

Members are also utilizing Bank Term Funding Program (BTFP), brokered deposits and repos to diversify wholesale funding sources and demonstrate access to various liquidity providers.





*Change in funding sources (loans, securities, cash) less change in core deposits (excludes jumbo CDs, brokered deposits and listing service deposits).
Note: Wholesale funding utilization = (total borrowings + net brokered deposits + listing service deposits) / (total borrowings + total deposits).

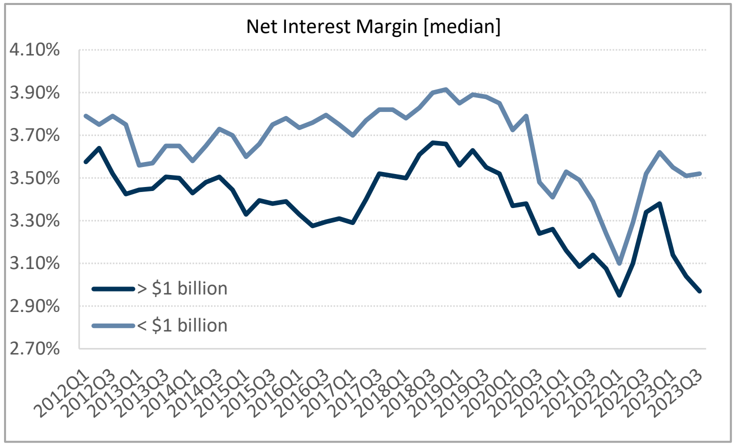
Margin Management in Focus

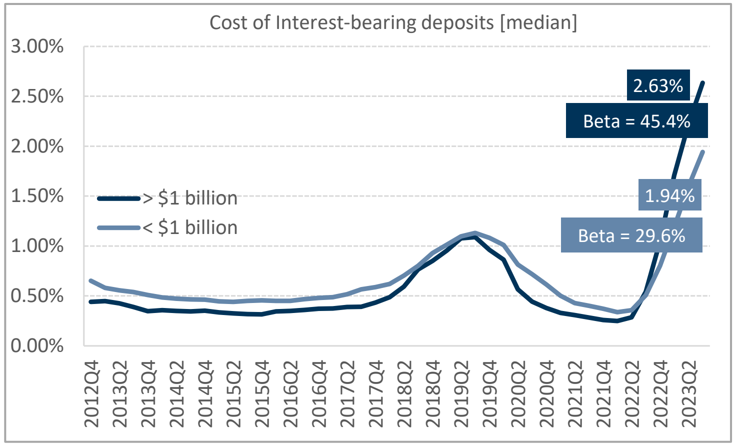
The change in funding profiles is reflected in both margin performance and deposit betas. The shift of deposits into interest-bearing accounts along with utilization of higher-cost brokered deposits and other wholesale funding to meet funding needs contributes earnings headwinds.

After rapid expansion of margins early in the rate cycle, margins at smaller banks have been more resilient compared to their larger peers in recent quarters; due in part to a lag in raising deposit costs. However, still room to run for deposit betas if rates remain higher for longer.

Smaller institutions also hold larger cash balances – currently a favorable alternative to improve both margin and liquidity positions as low-yielding security portfolios roll off.

While margin pressures will be felt into 2024, some relief may be on the horizon for larger members as low-yielding securities mature, loans re-price and high-cost funding can be paid down. A pivot in rate could also ease pressure on deposit costs.





Provisions and Net Charge-offs on the Rise

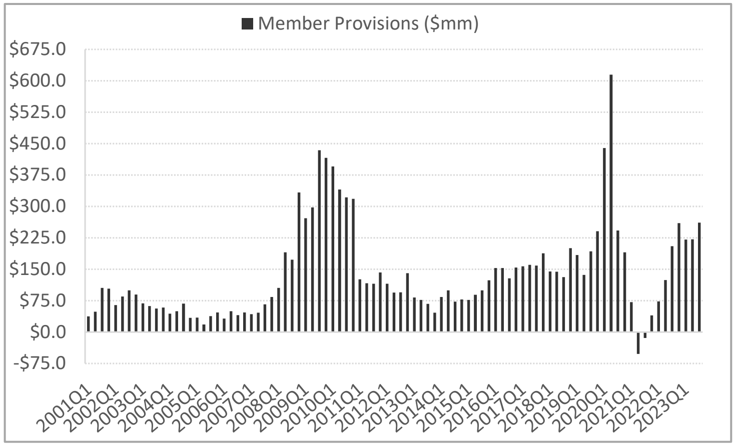
Many members are in reserve build mode even as strong asset quality persists.

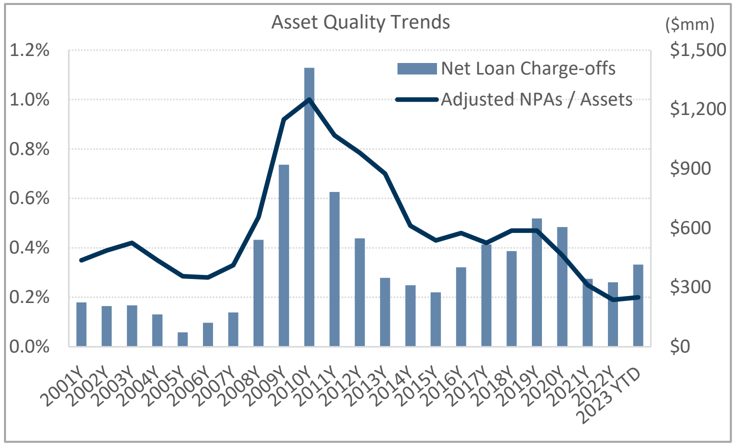
Like the second quarter, about half of our District members recorded provision expense in the third quarter, while the other half recorded no provision.

Credit containment concerns continue to linger, with more institutions noting more time spent on evaluating credits.

Nonaccruals ticked up in CRE, C&I and 1-4 family residential loans. Net charge-offs are on the rise – mostly within C&I, credit card, other consumer (e.g., cars) and nonowner-occupied CRE loan portfolios.

Restructured loans increased for the second consecutive quarter, up over 35% in the third quarter.





Note: Adjusted nonperforming assets excludes U.S. government guaranteed portion of nonaccrual loans.

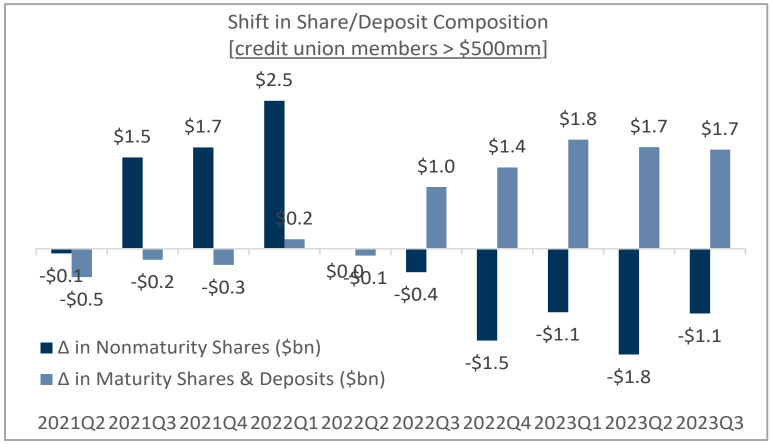
Q3 2023 Credit Union Trends

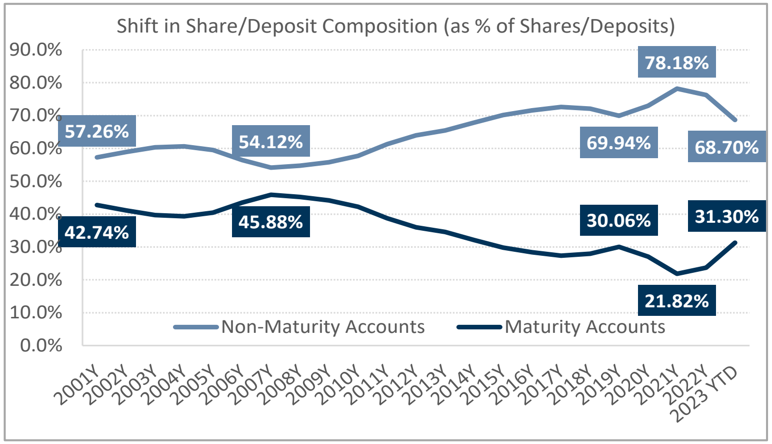
Graphs and Charts

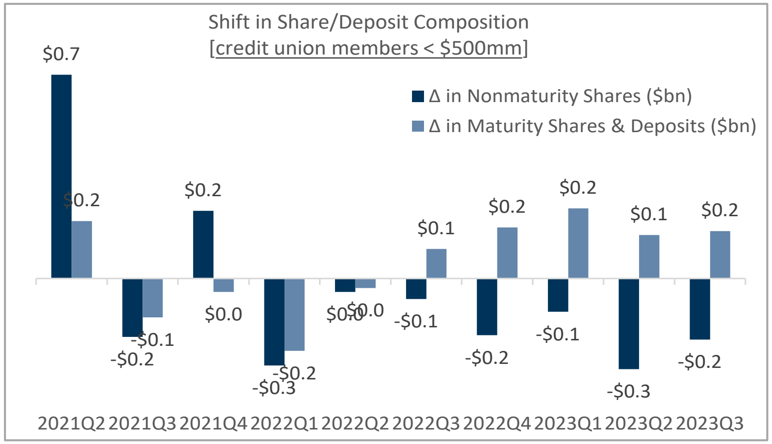
Share/Deposit Composition Remix

Low-cost, non-maturity accounts continue to migrate into higher-cost time deposits or out of the institution, shifting the makeup of the portfolio. Share certificates at member credit unions with assets > $500 million have doubled since the Fed began raising rates in 1Q22.

Larger and smaller credit unions alike are faced with persistent share/deposit retention and gathering challenges – playing defense against a competitive marketplace and attractive yields in money market funds and other investment alternatives, such as the Treasury market.



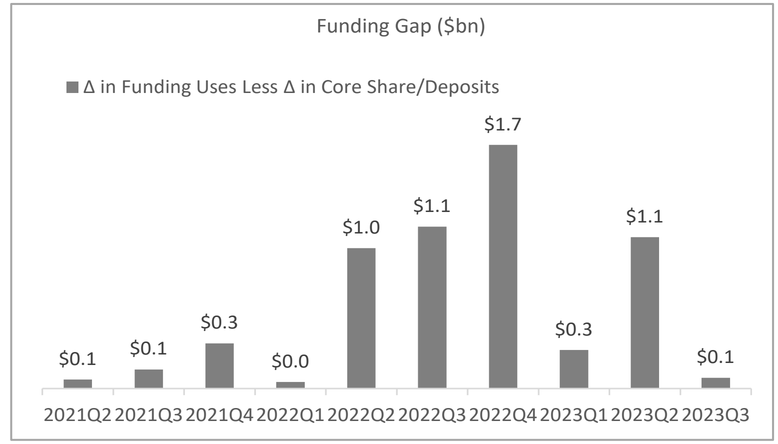


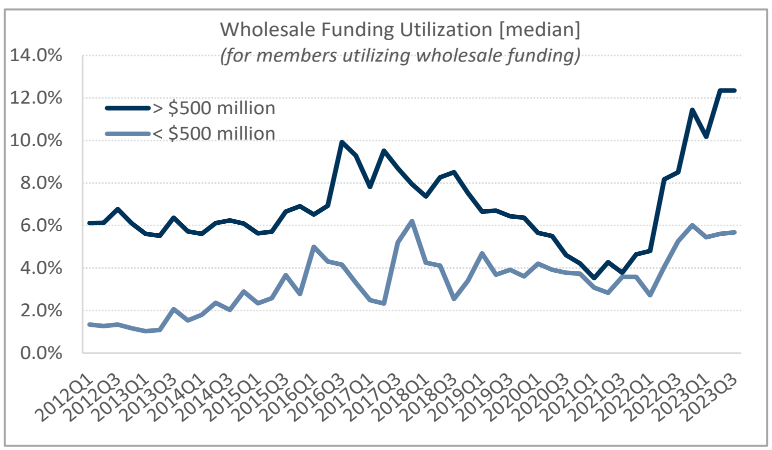


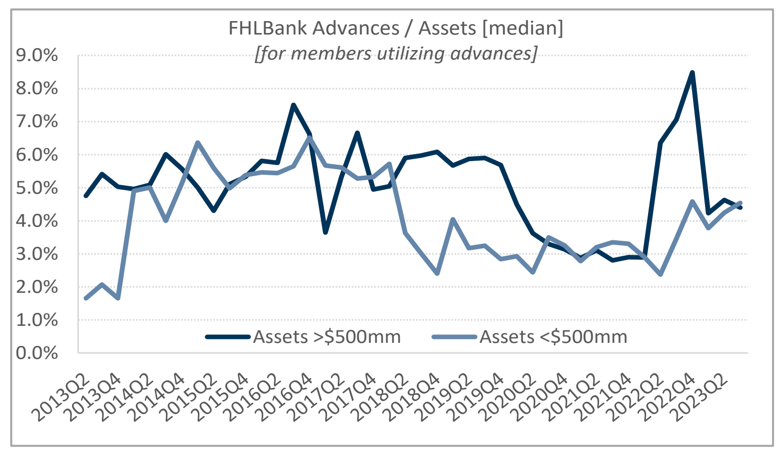
Advance Utilization Remains Elevated

Wholesale funding balances remain elevated, but activity moderated in the third quarter as funding gaps* narrowed. Additionally, as share/deposit costs push higher, members have looked to alternative funding options to help ease the pressure of higher core funding costs.

FHLBank advances continue to be the primary source of wholesale funding for member credit unions, although the BTFP has emerged as temporary alternative source.



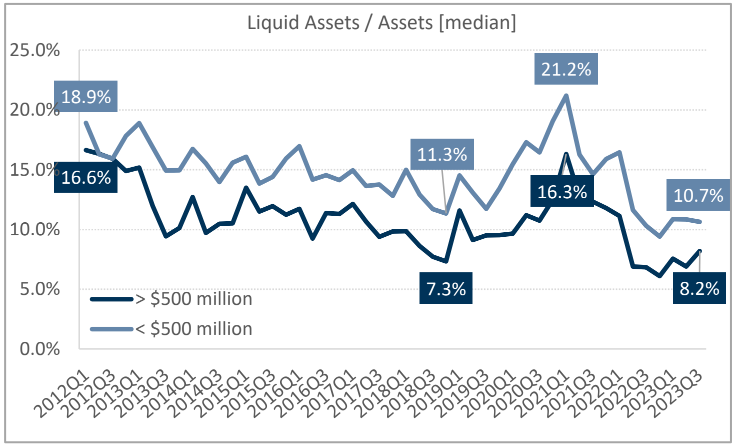


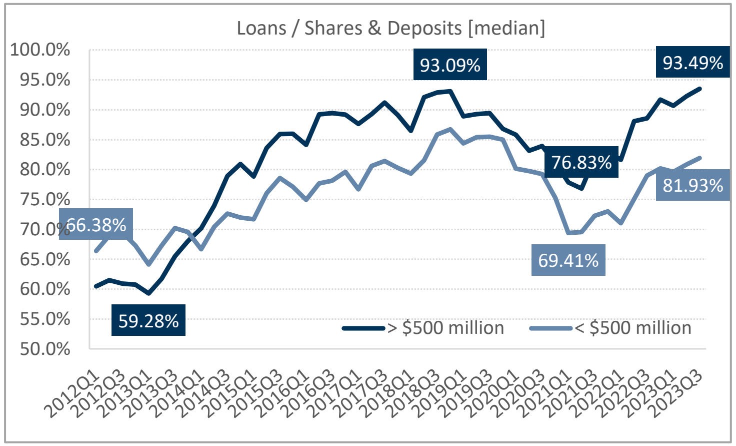


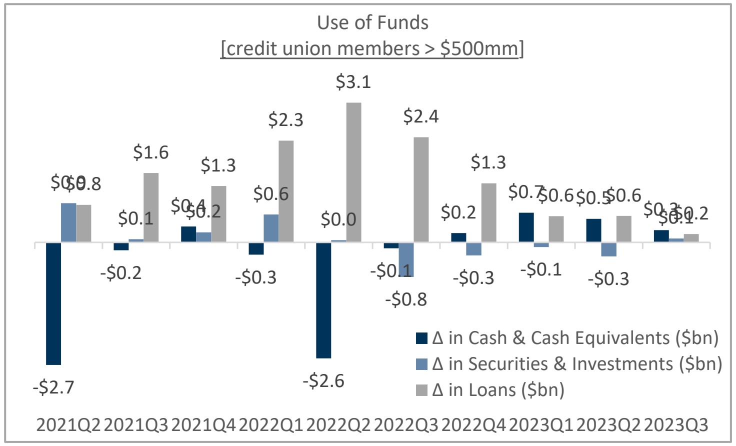
Note: Core shares = total shares/deposits less nonmember deposits.
Note: Wholesale funding utilization = (total borrowings + nonmember deposits) / (total borrowings + total shares/deposits).

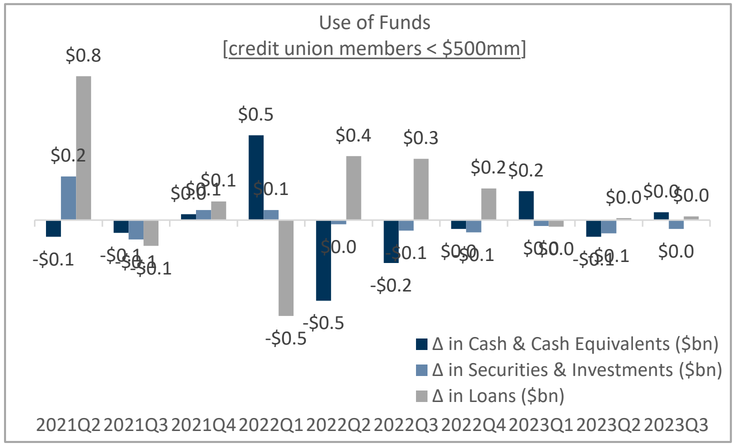
Liquidity Positions Stable

Activity on the asset side of the balance sheet was relatively muted in the third quarter with falling loan growth for the fifth consecutive quarter at larger members. On a year-to-date basis, assets have shrunk at smaller members as they're challenged to both grow loans and maintain or grow shares/deposits.

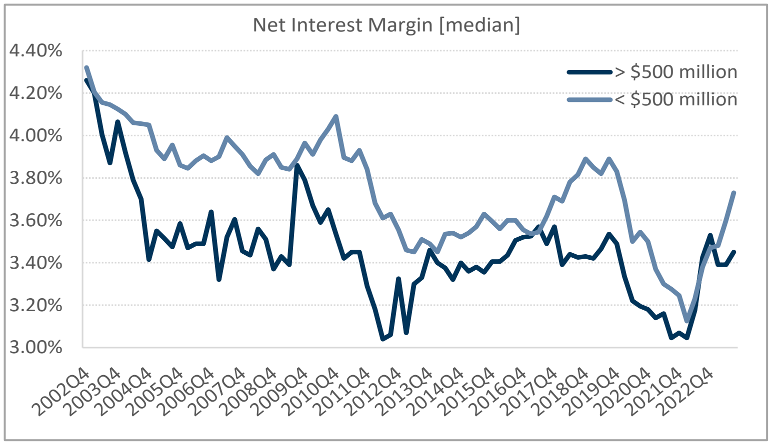








Margins Benefit from Strong Rise in Asset Yields

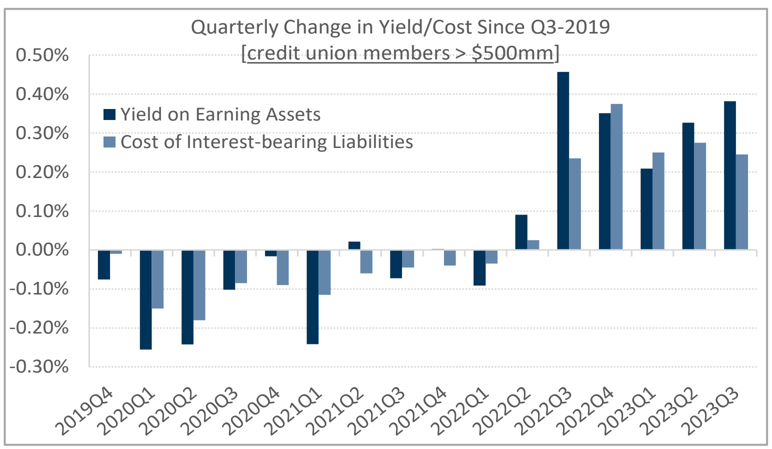


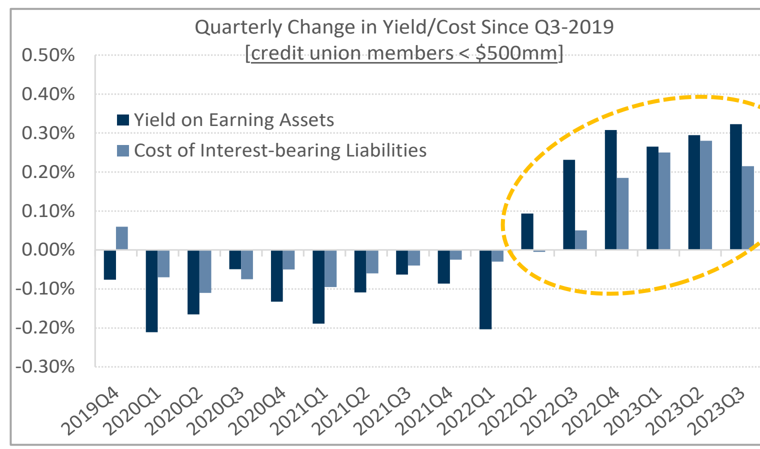
A lag in funding costs contributed to a rebound in margins during the third quarter.

Smaller members have seen six consecutive quarters of margin expansion, outperforming both their larger credit union peers and bank peers.

Smaller institutions also hold larger cash balances – currently a favorable alternative to improve both margin and liquidity positions.

Share/deposit pricing pressure expected to remain an area of focus as a challenging funding environment persists and rates stay elevated.





Provisions and Net Charge-offs on the Rise

Many members are in reserve build mode even as strong asset quality persists.

Nearly all District members recorded provision expense in the second quarter. Aggregate provisions are nearing the Covid peak and have increased for seven straight quarters.

Nonperforming assets have returned to pre-pandemic era levels.

The rise in delinquencies are mostly attributed to used vehicle loans, and to a lesser extent, first lien 1-4 family and new vehicle loans.