Bank Expansion via Interactive Loan Production Offices

STAR
Bank | Insurance | Private Advisory

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Contents

Executive Summary

It is the intent of this project to make a recommendation to STAR Financial Bank, specific to expansion via an LPO deployment, based on both the financial and non-financial components involved in such a strategy.

This capstone project would serve as the initial analysis that would be presented to both our executive committee and Board of Directors. A large portion of my research in this project will be based on the data contained in a recent analysis that was commissioned by STAR through Bancography, a research consulting firm based in Birmingham, AL. STAR has used Bancography in the past for the purposes of analyzing the competitive landscape and population demographics (past, present, and future) in both the markets that it currently owns assets in, as well as those markets that the bank may consider for future expansion. The most recent study leveraged by STAR, was completed in July 2017, with a focus on the bank's two largest markets, Indianapolis and Fort Wayne. Additionally, the firm provided STAR with analysis on three markets in which the bank does not own any assets: Bloomington, Lafayette, and South Bend.

Throughout the last 70 years, STAR has built a solid foundation as a community bank, serving the needs of its customers by offering a diverse retail product set throughout its branch network. As the bank began to expand into the state's two largest markets of Indianapolis and Fort Wayne, it was critical for the company to complement its existing retail product set with a robust commercial offering that would resonate with the bank's new customer base. Now, with nearly 65% of its loans and 57% of its revenue within the two growth markets of Indianapolis and Fort Wayne, it will be critical for the company to continue to identify opportunities for expansion as the demographics within the company's legacy markets continue to skew negatively.

Additionally, the company has continued to invest in technology capable of delivering engaging solutions to its clients. Given this investment, and its full suite of both retail and commercial products, the company now has the opportunity to marry these solutions into a loan production office (LPO) that could serve as a growth engine for the bank.

With a projected implementation schedule of approximately 90 days, the project would need to be executed in a manner that is consistent with the company's existing strategic initiatives. As recommended within this analysis, targeting downtown Indianapolis for the new location would allow STAR to continue its corporate commitment of investing in growth communities throughout the state with targeted, niche based products. Positioning the new office "close to home" would allow the company to mitigate the cost of market expansion while building on its already stable brand within the market. Potential setbacks such as lack of corporate buy in from the company's executive management team must be avoided if the new office is to succeed. Ultimately, if executed properly, the new office could serve as a template for further expansion into additional markets as well.

With a total estimated cost just shy of $760,000, the project represents a significant investment for STAR. However, the overall LPO investment is significantly less when compared to recent DeNovo branch deployments executed by the company, which have recently averaged approximately $1,500,000 to deploy. Based on the assumptions contained within this project, the LPO has the potential to bring in an additional $150MM in new loan originations, $80MM in commercial loan balances, and pre-tax revenue of $1.7MM in its first 36 months of operations. Recruitment and retention of engaged loan officers will be critical to achieving the targets laid out within this analysis.

In addition to staffing the newly designed office with highly skilled loan officers, it is the recommendation of this analysis to deploy an Interactive Teller Machine (ITM) within the space. By leveraging its current infrastructure used to service its existing fleet of 50+ ITM machines, the bank would have a mechanism within its new office to handle the majority of consumer transactions on a daily basis if needed. The ability to handle complex consumer banking transactions within a commercially focused office would provide the bank with a unique value proposition when compared to peer banks that operate in the same market.

If successfully implemented, an interactive LPO has the capacity to fundamentally change the way STAR Financial looks at market expansion. Corporate engagement, from the CEO down, will be critical for the new endeavor to succeed. If that engagement can be obtained, the company could embark on setting a course for prudent expansion, allowing the company to achieve the financial targets set forth within its established vision statement.

Introduction & Background

STAR Financial Bank (STAR) is an Indiana-based community bank known for a culture of delivering quality service, personalized banking solutions and innovative use of technology. In addition, two wholly owned subsidiaries, STAR Wealth Management and STAR Insurance Agency, offer licensed professional services in financial planning, trust and asset management, and insurance. STAR Financial Group, which serves as the parent company for STAR Bank, Insurance, and Wealth Management has grown to $1.86 billion in assets with 40 store locations in central and northeast Indiana. As one of the largest privately held community banks in the state, STAR is proud to offer innovative banking and financial solutions combined with STAR's personal, quality service. At a glance, the financial attributes of STAR as an institution are as follows:

- $1.86 Billion in Total Assets
- $1.30 Billion in Total Loans
- $1.56 Billion in Total Deposit
- Capitalized with more than $193 Million in Equity Capital
- Legal lending limit in excess of $31 Million

"Remaining Independent" is included in one of the company's nine core values, and nearly every one of the 550 employees throughout the bank understand that in order to remain independent, we must profitably grow the bank year over year.

Historical Branch Expansion Approach

To date, nearly every branch within STAR's existing network was built from the ground up. The company's overall growth has come organically, with the one exception being the purchase of an independent insurance agency in the early 2000s. Historically, given the bank's privately held structure, a growth strategy via acquisition has not aligned with the overall priorities of our executive management team and Board of Directors. Given the existing M&A landscape within the community bank space, I do not anticipate that trend to change.

Existing Branch Performance Criteria

Each one of STAR's 40 branches are evaluated via a monthly performance scorecard. The scorecard is made of up two main components:

- **Operations (25% Weight):** Evaluates the branch's ability to maintain a secure and sound storefront and includes items related to Cash Errors, BSA Compliance, and Security Procedures; Evaluated based on minimum thresholds established for each operational component
- **Sales (75% Weight):** Measures the financial results of the branch, specifically consisting of consumer loan origination, new checking account, mortgage referrals, and investment services referrals; Evaluated based on sales goals for each category that are set for each branch at the beginning of every fiscal year

Quarterly monetary incentives are paid out to those branches who are able to meet or exceed the benchmarks set for them. Branch Managers are responsible for the overall performance of their location.

Current Market Demographics

Generally speaking, STAR operates within the northeast quadrant of the state of Indiana. Logistically, our branch network tends to shadow Interstate I-69 as far north as the city of Angola, and south to the capital city of Indianapolis, with the majority of our branches falling within the northeast portion of Indianapolis.

Leveraging U.S. Census Bureau data in order to study the population of STAR's 13 operating counties, you can make a clear distinction between "Growth" counties, those whose population grew over the last five years, versus "Legacy" counties, or those counties who saw a decline over that same time span. Per the table below, within STAR's 13 county footprint, seven counties fit into the Growth County category, while six can be classified as Legacy Counties.

Population Growth by County, 2010 to 2015			
County	**2010**	**2015**	**Change**
Hamilton	274,569	309,697	12.8%
Marion	903,393	939,020	3.9%
Allen	355,329	368,450	3.7%
Hancock	70,002	72,520	3.5%
Steuben	34,185	34,372	0.6%
Noble	47,536	47,733	0.4%
Whitley	33,292	33,406	0.3%
Howard	82,752	82,556	-0.2%
Delaware	117,671	116,852	-0.7%
Henry	49,462	48,985	-1.0%
Madison	131,636	129,723	-1.5%
Grant	70,061	67,979	-3.0%
Tipton	15,936	15,267	-4.2%
Indiana	**6,483,802**	**6,619,680**	**2.1%**

Table 1: Population Growth by Indiana County, 2010 – 2015 (United States Census Bureau, 2017)

While most growth counties saw modest gains in their total population over the last five years, Hamilton County was the clear outlier, seeing double digit growth (12.8%) over that same time span. Conversely, both Grant and Tipton counties saw the largest dips in their population. It should be noted that statewide, Indiana saw a population growth of 2.1% from 2010 to 2015.

In terms of concentration, STAR's 13 county footprint constitutes 34.2% of the entire state's population. Of that 34%, the three counties of Marion (14.2%), Allen (5.6%), and Hamilton (4.7%) account for nearly a quarter (24.4%) of the entire state's population.

Current Competitive Analysis

When you begin to analyze the competitive landscape within STAR's 13 county footprint, it becomes evident that the market is mostly dominated by large, nationally chartered banks, who can leverage their size and scale in order to gain market share. Although there are 53 institutions within STAR's footprint per the FDIC's data, the top 4 banks own 50.25% of the market. The next nine banks on the list constitute 30.79% of the market, with the remaining 41 banks rounding out the remaining 18.96% of the deposit base. Currently, STAR ranks 12th within its market out of a total of 53.

Top 12 Institutions By Market Share for the Counties of: Allen, Delaware, Grant, Hamilton, Hancock, Henry, Howard, Madison, Marion, Noble, Steuben, Tipton, Whitley					
	Outside of Market		**Inside of Market**		
Institution Name (as of June 30, 2016)	**No. of Offices**	**Deposits ($000)**	**No. of Offices**	**Deposits ($000)**	**Market Share**
JPMorgan Chase Bank, National Association	5,328	1,143,916,977	85	11,268,041	22.00%
PNC Bank, National Association	2,619	241,139,958	68	7,361,125	14.37%
Fifth Third Bank	1,167	100,217,206	41	3,994,250	7.80%
Wells Fargo Bank, National Association	6,198	1,142,221,825	16	3,115,175	6.08%
The Huntington National Bank	759	54,188,196	36	2,868,995	5.60%
BMO Harris Bank National Association	569	80,129,224	30	2,186,192	4.27%
First Merchants Bank	74	3,303,401	38	2,144,447	4.19%
KeyBank National Association	933	76,178,352	28	2,061,387	4.03%
Merchants Bank of Indiana	2	530,831	3	1,717,067	3.35%
Regions Bank	1,571	97,428,369	28	1,691,850	3.30%
The National Bank of Indianapolis	1	80,190	12	1,549,214	3.03%
STAR Financial Bank	0	0	41	1,548,956	3.02%
Sub Total For Top 12 Institutions:	**19,221**	**$ 2,939,334,529**	**426**	**$ 41,506,699**	**81%**
Number of Institutions in the Market: 53 TOTALS	**20,865**	**$2,988,277,740**	**626**	**$51,213,352**	**100%**

Table 2: Top 12 Institutions by Market Share for NE Indiana (Federal Deposit Insurance Corporation , 2017)

While non-bank options (fin tech, dealer direct financing, etc.) continue to expand both nationally and locally, Credit Unions have and will continue to pose a substantial competitive threat to STAR and other traditional banking institutions.

According to data made available by CUNA, the Credit Union National Association (www.cuna.org), while the number of overall credit unions in the state of Indiana has decreased over the last 10 years, the asset base amongst the remaining institutions has nearly doubled.

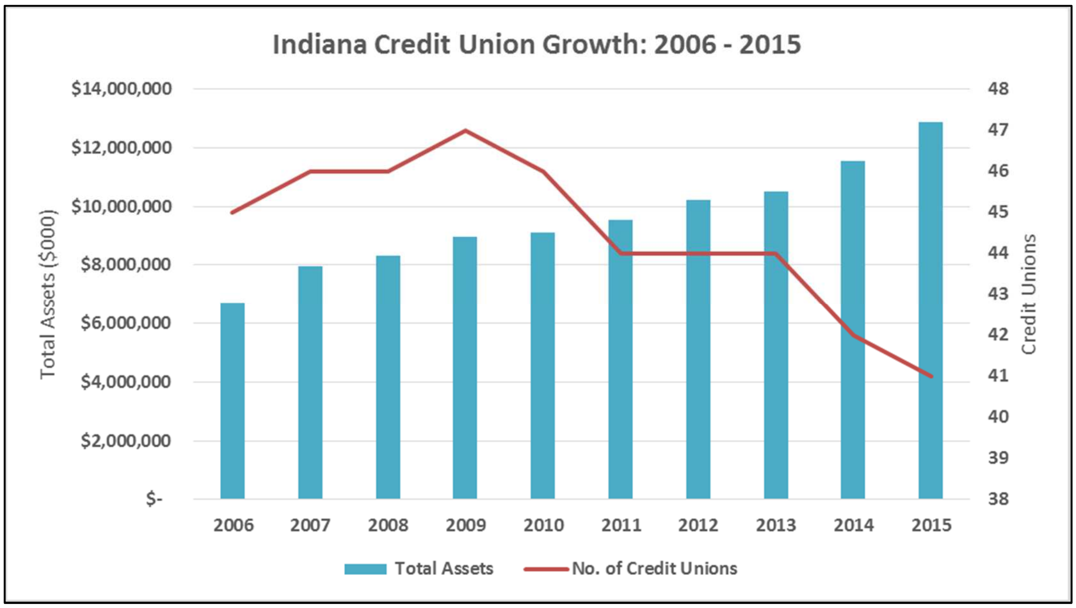


Table 3: Indiana Credit Union Growth (Credit Union National Association, 2017)

Locally, the majority of credit unions within STAR's market have done a very good job of marketing themselves as a low cost provider of consumer loans, and their asset growth is indicative of a message that resonates with customers.

Current Technology Stack

In an effort to equip our frontline staff with the most effective tools for transacting business on a daily basis, STAR has made continual capital investments specific to the technology stack deployed within our branch network. Those investments have allowed our branch staff to remain operationally sound, while allowing them to interact with our customers in a meaningful way during each transaction. Newly deployed assets within our branch network include:

- **Interactive Teller Machines (ITM):** With nearly 50 machines deployed, STAR employees currently handle approximately 40,000 customer sessions per month with an average session time of two minutes or less
- **Virtual Teller Capture**: Significantly reduces the amount of time required to post checks to a customer's accounts as well as errors caused by manual key entry
- **Cash Recyclers:** Automates both simple and complex cash transactions, resulting in few errors made by our front line staff
- **Instant Issue Debit Card Machines**: Provides the ability to create debit cards on the fly for customers who have lost their cards or had them stolen

Understanding the capabilities within our existing branch network from a technology perspective will be critical when evaluating how a potential LPO site could be configured. It is my belief that STAR is in the unique position to effectively couple its top-tier personnel with a best in suite technology stack, including an Interactive Teller Machine, in order to gain a competitive advantage over its peers. If successful, the bank could leverage this template for a newly designed LPO as a template to launch additional sites down the road.

Strategy & Implementation

STAR would like to explore the option of expanding its footprint through loan production offices as opposed to traditional, full service branches. Although the bank is positioned well in northeast Indiana, operating within the state's two largest markets of Fort Wayne and Indianapolis, there are additional areas that may be attractive for expansion via the LPO model. This project would explore both the financial and non-financial impacts of leveraging a LPO model for expansion.

From a financial standpoint, the primary goal of the LPOs would obviously be to lower our cost of entry into these new markets, while gaining an understanding of what each market can yield in terms of loans. Having recently built a new full service branch in the Fort Wayne market for approximately $1.5MM, the company has a firm grasp on the costs associated with building a traditional, free standing bank branch.

As a privately held community bank, expansion via a LPO model represents a fundamental cultural shift for the company. Part of the non-financial analysis contained in this report will focus on how the company must change its current cultural paradigm in order to align with a successful LPO deployment strategy, all while maintaining sound and prudent credit standards. Part of my focus within this report will revolve around the implementation of an Interactive Teller Machine within the newly proposed LPOs. To date, STAR has deployed over 50 ITMs throughout our existing branch network, and leveraging this technology stack could provide the company with a value proposition that does not exist within most traditional LPOs today. The ITM analysis will include both monetary and regulatory factors. Specifically, the project will analyze how current regulatory agencies view ITMs in terms of requiring a bank charter versus operating as a standard loan production office.

Strategic Relevance of a LPO to STAR

The establishment of a LPO coupled with an ITM could allow the bank to:

- Mitigate the cost of market expansion, be it intra-market or a new market altogether
- Bolster the bank's awareness and reputation within both new and existing customers
- Leverage existing capacity within both Credit and Operations teams currently employed within the bank

Historically, the attractiveness of an LPO model has been the institution's ability to establish a presence in a new market while mitigating its initial capital expenses. While STAR would incur some additional expenses through the placement of an ITM within the new production office, the bank would see significant cost savings when compared to a full service branch implementation. Additionally, the new office would require a significantly smaller footprint, resulting in additional cost savings to the bank. Flexible lease arrangements could be sought as STAR tests out its new model, ensuring that the company's long term real estate exposure could be lessened. Further details around the financial impact of obtaining and configuring a STAR-specific LPO will be covered in a later section.

Additionally, a strategically placed LPO would allow STAR to bolster its brand awareness and market position. In some instances, the company could see the potential to provide services to both new and existing customers alike. Based on a recent market analysis done for STAR, the Downtown Indianapolis market represents a unique opportunity for the company to expand its wallet share within its existing customer base, and grow organically due to recent residential housing expansion in the area. The study briefly touches on the organic growth potential for STAR due to the downtown area's new residents:

> *"Indianapolis has experienced a renewed uptick in downtown/midtown residential living, following a trend occurring in many large U.S. metros. Much of that residential growth has occurred in neighborhoods on the north and east sides of downtown…The factors driving urban regentrification –a desire for an authentic, distinctive, community-oriented lifestyle –align well with the value proposition of a community bank."* (Bancography, 2017)

Downtown Indianapolis also sees a large number of residents who commute daily from the city's upper northeast side, primarily from the communities of Carmel, Noblesville, and Fishers. Given that STAR currently has 14 branches situated throughout the city's northeast side, a downtown LPO outfitted with an ITM could serve as an effective location for current customers who make the trip to work downtown each day.

Finally, given the company's existing back room operations, STAR could establish a LPO without any significant human capital expenditures within its support teams. The current structure of the company's credit, processing, and documentation teams would allow for significant expansion of its current loan portfolio, both commercial and residential, without requiring additional staffing needs. Expansion of our loan portfolio without significant operational expenditures would fall in line with STAR's desire to continue to drive our efficiency ratio of approximately 68% to its stated goal of 60% or less.

Expected Outcomes of LPO Expansion

If STAR's LPO expansion is executed properly, the project would serve as a template for success for future LPO deployments, including markets where STAR does not currently have any established assets. While each market comes with its own set of unique characteristics, a prudent, repeatable model for a desired and effective LPO will allow the company to focus on more pressing matters, including recruitment of top talent.

Furthermore, a newly established Loan Production Office should help to drive organic loan and customer growth to STAR. As stated in an earlier section, only seven of the thirteen counties that STAR operates in showed population growth over a previous 5 year period. As these demographic trends continue, the company must find a way to reach new customers in a sustainable and sound manner.

Perhaps one of the most critical outcomes of this project will be to change the cultural paradigm within the executive management team pertaining to LPO expansion. Nearly every one of STAR's current 40 retail branches was built and established under a De Novo expansion strategy. As a family owned, non-public institution, STAR has remained focused on conservative and traditional expansion mechanisms. Yet, as the company looks to continue its recent trend of profitable growth, it must be open to various expansion mechanisms that differ from previous methods.

My Role within the Project

As SVP, Retail Banking, I'm currently tasked with managing sales and production for the following areas: Retail branch network (40 branches), Residential Mortgage, and STAR Investment Services (broker/dealer channel). My position with the Retail Bank is relatively new as I spent the first four years of my career at STAR as VP, Mortgage Banking, a role that included running all functional aspects (origination, underwriting, and processing) of our residential Mortgage Department.

My role in the project would include, but not limited to:

- Scouting viable sites for location of our new loan production offices
- Recruiting/Staffing of the new offices

- Setting goals and production responsibilities for any retail employees
- Managing the retail product set offered within the LPO

As this project represents a fundamental shift compared to our previous expansion model, I feel as though my involvement could prove to be integral to my future development within the organization, should the effort prove to be successful.

Mirroring LPO Expansion with STAR's Corporate Strategic Initiatives

The executive management team at STAR recently undertook the task of crafting a 10 year vision statement for the company. The statement was shared with our entire employee base and serves as a critical reference point for any initiatives within the company of strategic significance. Understanding components of that vision statement will help to correlate how a LPO expansion model aligns with the company's strategic initiatives.

Sustained Profitable Growth via a Niche Based Product Set

As with any other company, sustained profitable growth is a requirement to remain relevant in any industry. Recent financial metrics will show that STAR has generated record profits and returns when compared to its historical benchmarks.

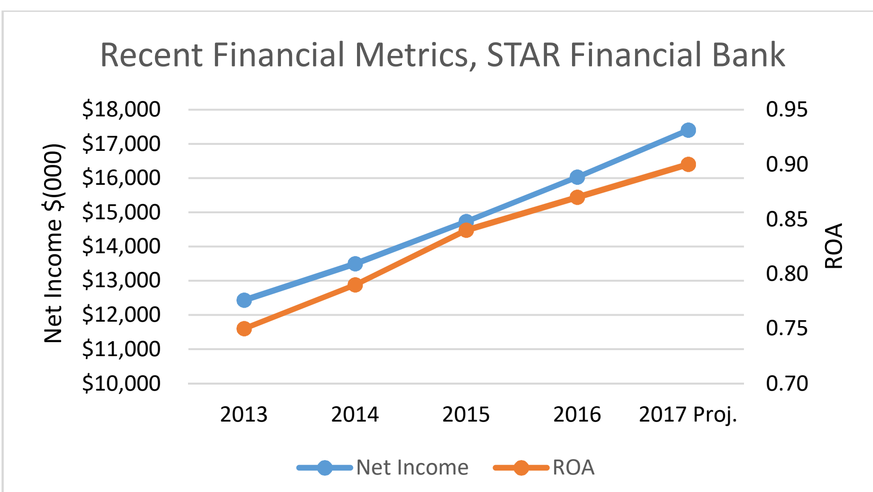


Table 4: STAR Financial Bank Financial Metrics

Within the newly crafted vision statement, the management team set forth specific growth targets for the company:

> *"We know that financial strength and profitable growth are critical to our long-term success in this ever changing financial services industry. To that end, by December 31, 2024, STAR Financial will have become a sustained high performer… At a minimum, we will have doubled in size to $3.5 billion with profitable compounded annual growth of 7% or greater."* (STAR Finanacial Bank, 2017)

In order to achieve the profitable growth targets set forth in the vision statement, the company must continue to evolve its tools used for expansion, including loan production offices.

Another tenant within our vision statement requires the company to continue its drive towards niche based products that focus on delivering additional value to our customers, and maximum return to the bank. Specifically, the statement reads:

> *"We intend to be rifle-focused relative to our niches of C&I, Private Banking, Small Business, Mortgage and Insurance. Deep, sustainable wallet share will be key with all customer relationships"* (STAR Finanacial Bank, 2017)

All of the products referenced in our statement align perfectly with the desired product set that of a future LPO. Furthermore, it would be prudent for STAR to leverage the defined product set as an entry point in order to expand wallet share within its newly obtained customer base.

Growth Market Focus and Investment

Relative to market focus and future investment around expansion, the vision statement defines STAR's strategy as the following:

> *"Our emphasis and investment will be on high potential urban markets where we expect to have 80% of our assets and 70% of our revenue."* (STAR Finanacial Bank, 2017)

As you can see by the graphs below, the composition of STAR's revenue and assets (loans only) within its Growth and Legacy markets was not in line with the expectations set forth in the company's vision statement.

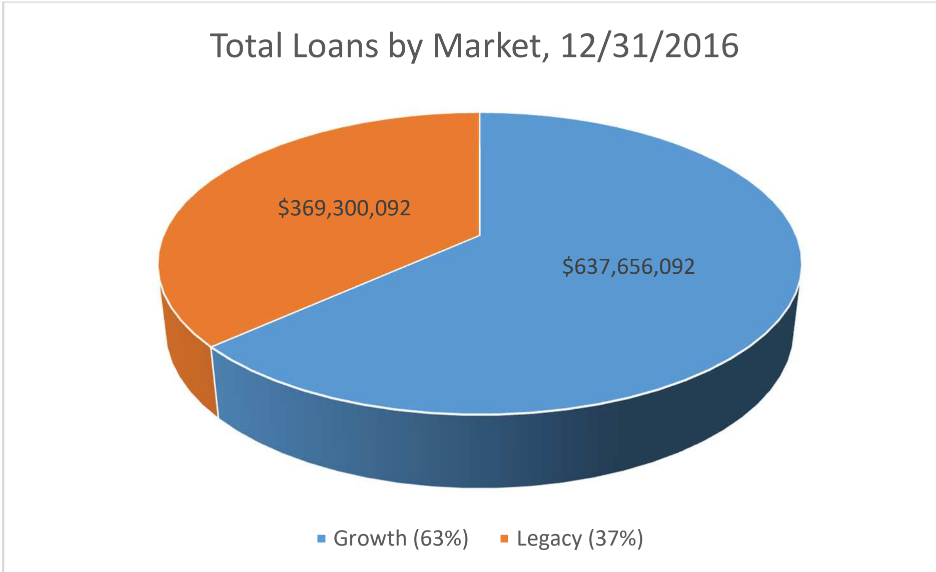


Table 5: Total Loans by Growth vs Legacy Markets

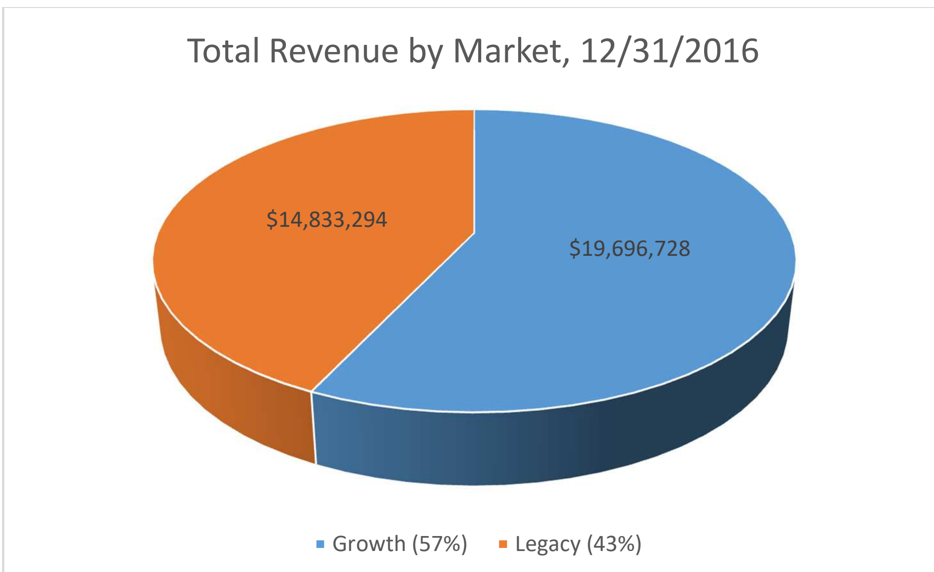


Table 6: Total Revenue by Growth vs. Legacy Market

By targeting high potential, aggressively growing markets for its LPO expansion model, the company can help drive its balance sheet and income statement to be more reflective of its stated goals within the vision statement.

Competitive Advantages of a LPO Type Expansion

While the advantages of LPO expansion may vary according to each organization's strategic focus, STAR believes that this approach will allow for the following:

- **Mitigate Cost of Market Entry:** While it has been discussed previously in this project, the cost savings of entering into a market via an LPO versus a full service branch cannot be understated. The dynamics of this savings will be expanded further in the Financial Impact section of the project
- **"Close to Home" Approach**: Given the current corporate culture at STAR, I do not believe it would be in the company's best interest to place future LPOs within markets that create significant geographical spreads between the new office and STAR's current hubs in Indianapolis and Fort Wayne. By strategically placing LPOs within a reasonable distance (50-100 miles) from its current hubs, STAR will still allow for its loan officers to have personalized access to the key decision makers of the company, which is an element of doing business that still resonates with many of our clients today
- **Stable Brand Promotion**: Despite the current M&A climate within the industry, STAR has been able to preserve its brand as a family owned and operated bank, with a core tenant of remaining independent. While clients in our current markets know and understand STAR as a brand, the company must continue to promote its likeness to new customers and markets if it wants to achieve the organic growth goals set forth in its vision statement. I believe that the STAR brand will continue to resonate with customers close to our newly established LPO

Future Opportunities & Potential Setbacks through LPO Expansion

Every strategic endeavor is not without its risk and rewards. The intent of this section is to explore some of the opportunities and potential setbacks of expanding via a LPO model.

Opportunities

As with any type of expansion efforts, one clear opportunity of LPO expansion is organic customer growth. As bank products become increasingly commoditized, and new electronic organizations have become formidable competitors in some lending spaces, banks must continue to seek out new customers in order to achieve their growth targets.

Should STAR be successful in its LPO expansion endeavor, the bank would have the unique opportunity to leverage the LPO template that was created during the project for future LPO sites. While understanding the fundamentals of each market's demographic and economic potential will always be vital to any LPO success, having a proven logical template to follow would provide the bank with a certain ease of mind as it expands its LPO network.

Ultimately, should the LPO yield the results that are deemed by STAR to be desirable, the bank would always have the opportunity to convert the office into a full service branch, complete with Personal Bankers, ready and willing to service all customer needs through a robust technology stack discussed earlier in the project. It should be noted that conversion of a LPO into a full service branch assumes that the existing LPO footprint could provide the necessary logistics to house additional employees and equipment. If the existing LPO could not provide the required resources, then additional financial implications would need to be discussed in order to carry out a conversion.

Potential Setbacks

Should the bank to decide to expand via an LPO within one of its larger existing markets like Indianapolis, then it would have the opportunity to staff that office with a sales force that was made up of existing STAR employees. However, if the bank were to set up a LPO in a completely new market, say Lafayette, Bloomington, or South Bend, then the bank would most likely be forced to bring on a new crop of loan officers. Should those new employees not reach the bank's desired results, or if the employees found the opportunity to be less than what was promised during the hiring stage, STAR could face the potential of employee turnover within its new LPO. As with any endeavor, stability within your workforce is a major component of success, but if STAR were forced to deal with instability within its LPO workforce, the bank's new location would struggle to succeed.

Corporate buy in, from executive management down, must be obtained in order for a strategic endeavor like LPO expansion to be successful. One potential snag in the model could arise if the company fails to properly communicate the direction and desired outcomes of establishing a LPO. It would be critical for the bank's PR and Marketing arms to execute a well thought out communication plan to both its external and internal stakeholders. The employees housed within the LPO must feel as though they have the full support of all functional areas of the bank. Without that support, the newly established office would struggle to achieve its desired goals.

Process Changes & Improvements via LPO Expansion

One process that would certainly need to be revised through this project would be STAR's current branch deployment practices. While the company is obviously well versed in the manners of deploying full scale brank branches, it would need to shift its methods and procedures in order to successfully deploy a LPO. While it's likely that there would be some carryover from STAR's current deployment model, planning for a LPO would require the bank to scale back its published project plan. The majority of planning for teller specific IT and security items would not be required for this LPO deployment. Additionally, the bank would most likely need to shift its planning mindset from one based on a customer's perspective, to one based on an employee's perspective. The LPO would obviously need to be accommodating to any customer who came into the office, however, the new office would undoubtedly see less foot traffic than a full scale branch.

Staffing procedures would also need to be scaled back in order to accommodate the new office. As the ITM would be the central point for nearly all customer service related items, STAR's branch administration team would not be tasked with ensuring that the LPO is staffed properly with tellers during all hours of operation. Lending officers would constitute the majority of the new office's staff, with an administrative assistant most likely rounding out the team.

Additionally, as there would be no currency present within the new office, save for what is securely stored within the ITM, STAR's branch admin team would not be required to setup proper security measures that are routinely executed within the forty other branches within the bank's network. Outside of standard alarm functions in order to secure the IT hardware deployed within the new office, no additional security measures would need to be monitored by the STAR support staff.

Proposed Project Timeline & Implementation

The timeline to launch a LPO would involve several different teams working together to configure a site that would be the first of its kind for the company. The executive management team would need to be involved in scouting various locations and negotiating the terms under which STAR would occupy the newly acquired space. The decision to buy versus lease and the financial ramifications of each will be discussed further in the Financial Impact section of this report. Once the site was selected, our Branch Administration team would need to work diligently to configure the space appropriately for STAR's employees that will be housed within the new space. Working in parallel with Branch Admin, the Human Resources team would need ample time to recruit and select the new crop of STAR employees tasked with working the newly designed LPO. Finally, teams from across the organization, including IT and Finance, must ensure that all of STAR's various core systems are updated with the proper parameters associated with the new office. Everything from our financial reporting system, to our core banking software must be updated in order to account for a new branch associated to the company. The following project timeline is intended to illustrate the previously discussed steps:

	Month 1				Month 2				Month 3			
	Week 1	2	3	4	Week 1	2	3	4	Week 1	2	3	4
Task Owners:												
Executive Mgmt	Site Selection & Lease Negotiation											
Branch Administation							Site Configuration					
Human Resources/LOB Owners							Staff Recruitment & Selection					
IT/Finance/HR/Branch Admin									Internal Setup			

Table 7: Proposed LPO Implementation Timeline

Overall, it is my assessment that a fully configured LPO would be implemented at STAR within a timeframe of 3 months, with site selection beginning at the start of Q2, 2018 at the latest. Obviously various obstacles may present themselves during the implementation of a newly designed office, however, based on previous full service branch deployments within the company, I believe that 90 days is a reasonable amount of time for STAR to accomplish its goal of going live by the start of Q3, 2018.

Financial Impact

The financial impact section of this project will attempt to define the size and scope of the investment required to start and fund the ongoing activities of a LPO. Additionally, the section will provide an analysis of a 36 month estimated pro forma for the office, and deliver an objective opinion on whether or not the overall investment and strategic direction would be advantageous for the bank moving forward. The projections within this section have assumed that the new office will be located in downtown Indianapolis. Currently, STAR does not have a branch within 30 miles of the proposed downtown site.

Initial Capital Expenditures

Based on recent market research, it would be safe to assume that STAR could find a suitable location to house a new LPO for approximately $35/sq. foot on an annual gross lease agreement. The table listed below attempts to provide the following information:

- **Initial LPO Cost Summary**: The numbers in the left hand column pertain to a location of 1324 square feet, which would be enough space to accommodate three commercial loan originators, one commercial loan admin, a conference room, and an ITM. Total expenditures for the project are based on a 10 year lease agreement with an annual rent accelerator of 3%
- **De Novo Branch Cost Summary**: The numbers in the right hand column pertain to a recently built De Novo branch that STAR completed in December, 2016. At 2500 square feet, the branch can accommodate a Branch Manager, two Universal Bankers, and three affiliate offices that can be used by STAR employees at any time (i.e. Mortgage Bankers, Commercial Loan officers, etc.)

	Proposed Loan Production Office		Recent STAR DeNovo Branch	
Office Build Out				
Branch SQFT		1324		2500
Price per SQFT (Gross Lease)	$	35.00	$	479.32
Construction Costs	$	40,000.00	$	1,134,652.00
Improvement Allowance	$	(13,240.00)	$	-
Year 1 Acquisition Costs	**$**	**73,100.00**	**$**	**1,134,652.00**
Average Annual Lease*	$	53,123.00	$	-
Annual Maintenance	$	2,000.00	$	3,500.00
10 Year Building Expense	**$**	**575,996.17**	**$**	**1,166,152.00**
One Time Setup Expenses				
Furniture Costs	$	25,000.00	$	29,891.40
IT Costs	$	45,000.00	$	47,468.30
Security Costs	$	4,000.00	$	27,788.16
Marketing	$	25,000.00	$	57,831.80
Branch Ops Equipment	$	85,000.00	$	125,302.80
Setup Total:	**$**	**184,000.00**	**$**	**288,282.46**
Total:	**$**	**759,996.17**	**$**	**1,454,434.46**
*Based on 10 year lease with annual 3% rent increase				

Table 8: Initial LPO Cost Analysis

As you can see, the initial acquisition cost of the office space is estimated to be $73,100. This assumes an annual lease payment of $46,340, and a net improvement cost of $26,760. Additionally, it's estimated that STAR would need to spend $184,000 in order to outfit the office with items required to conduct business. Total office expenses over the life of a 10 year lease are calculated at $759,996.17. While significant, that cost is estimated to be approximately half (52%) of the cost to acquire a full De Novo branch over the same 10 year time period.

Financial Analysis

This section will analyze the anticipated performance of the LPO over a 12, 24, and 36 month period.

Model Assumptions

Several assumptions were made in preparing the 36 month pro forma financial analysis of the proposed LPO. My assumptions are broken down into three main categories: Loan Portfolio Assumptions, Employee Expense Assumptions, and Miscellaneous Office Expense Assumptions.

The following assumptions were made specific to the performance of the commercial loan portfolio associated with STAR's new office:

- **Loan Production:** Based on Indianapolis's recent downtown growth and STAR's existing footprint within central Indiana, the model assumes each Commercial Loan Officer could produce approximately $27MM in outstanding loan balances over a 36 month period
- **Loan Utilization:** A flat utilization rate of 55% was used. While STAR's current utilization rate would hover around 65% - 70%, the model rate was lowered to account for a high percentage of Commercial Real Estate (CRE) loans that are expected to be produced by this office as significant draw periods may dampen utilization
- **Net Margin:** While portfolio composition can greatly affect margin, the model assumes a static net margin of 3.61%. This assumption was based on STAR's NIM located in the company's 9/30/17 UPBR report
- **CRE Loan Composition:** Currently, CRE loans account for 51% of STAR's current commercial loan portfolio. However, in order to meet the growth goals associated with the proposed LPO, the model has assumed that CRE loans will account for 80% of all production in year 1, 70% in year 2, and ease back to 50% in year 3

- **Fee Income:** STAR is currently commanding a 25bp commitment fee on all CRE loans and a 10bp commitment fee on all C&I loans

The following assumptions were made with regards to staffing the LPO:

- **Commercial Loan Officer Compensation:** A base salary of $125,000 was assumed for the model. That amount is reflective of the mid-point for the current salary grade at STAR for a Sr. Loan Officer. Additionally, Loan Officers are eligible for an annual incentive that can account for up to 25% of their base salary
- **Commercial Admin Compensation:** Similar to the LO compensation assumption, $45,000 is the current mid-point for a Commercial Loan Administrator at STAR.
- **Annual Salary Increase:** The model assumes 3% as that is what is currently budgeted for STAR employees in 2018
- **Benefits Expense:** The model assumes 25% of an employee's salary should account for annual benefits expense, which is in line with STAR's current benefits expense

The following assumptions were made with regards to expenses associated with operating the LPO on an annual basis:

- **Lease Expense:** Based off of a recent proposal submitted to STAR, building/lease expense is estimated to be $35 per square foot (gross lease), and assumes a 10 year lease agreement. The agreement would assume a 3% annual rent increase, and include a $10 per square foot improvement allowance
- **Miscellaneous Expenses:** All other estimated expenses used in the model are based off of current expenses associated with an existing branches within STAR's network, relative to the proposed office size and number of employees housed within the office

Year 1 Analysis

The first year projections for STAR's LPO assume that each Commercial Loan Officer can generate approximately $5MM in total outstanding loan balances. Given that these employees would be new to STAR, I've assumed a four month ramp up time before any loan origination was executed. Using the assumed utilization rate of 55%, loan originations would need to total $27MM in order to generate the required $15MM in loan balances.

	Year 1
Loan Origination	$ 27,000,000
Total Loan Oustandings	$ 14,850,000
Total Revenue	$ 231,477
Total Expenses	$ (618,960)
Pre-Tax Revenue/(Loss)	$ (387,483)

Table 9: LPO Year 1 Financial Summary

Interest income for year one would total $172,077 based of the assumed NIM of 3.61%. In addition to interest income, the fee income generated on the new loan balances would account for $59,400, bringing STAR's total revenue for the office to $231,477.

Non-Interest expenses for the new office in year one are assumed to be $51,580 per month, with salaries and benefits accounting for nearly 85% of the total spend. The cost associated with maintaining an Interactive Teller Machine at the LPO is estimated to be $900 per month, which would primarily cover the cost of cash replacement and software licensing expense for the machine.

Given a four month ramp up in loan production, my first year analysis shows that the LPO would show a net loss to the tune of $387,483. For purposes of consistency, I did not include any of the one-time setup costs associated with the office that was discussed in the previous section. Those expenses would most likely be amortized over a period of 5 – 8 years.

Years 2 & 3 Analysis

In the second and third years of the LPO, my projections assume that loan origination starts to pick up as the LOs become more accustomed to their new environment. Assuming consistent production amongst all three LOs, the model calls for each of them to grow their outstanding loan balances by $10MM in year two, and $12MM in year three. If those targets are met, the LPO would assume a commercial loan portfolio of approximately $81MM after three years of operation.

	Year 2	Year 3
Loan Origination	$ 54,500,000	$ 66,000,000
Total Loan Oustandings	$ 44,825,000	$ 81,125,000
Total Revenue	$ 1,209,541	$ 2,413,716
Total Expenses	$ (732,663)	$ (755,274)
Pre-Tax Revenue/(Loss)	$ 476,878	$ 1,658,442

Table 10: LPO Year 2-3 Financial Summary

As the loan portfolio increases, interest income would increase significantly, accounting for just shy of $1.1MM in year two, and approximately $2.3MM in year three. Loan fees would also see significant increases, showing $111k in year two and $115k in year three. While loan fees do increase year over year, the amount of fees relative to total outstanding loan balances would decrease due to expected decrease in CRE composition of the total loan portfolio.

Overall expenses would remain relatively flat, with two exceptions being Salaries/Benefits and Building Expenses, both of which would project to increase by 3% year over year. Additionally, STAR would expect to begin paying out annual commission incentives to the 3 LOs. That commission expense is expected to be 25% of the LOs annual base salary.

Based on these assumptions, the LPO would generate a net profit of approximately $475k in year two, and $1.6MM in year three. Additional details on the expected three year run rate for the office can be found in APPENDIX A.

Overall Estimated Results

While the estimates for year one do show a net loss to the company, the LPO would provide financial results that would be accretive to STAR's bottom line after years two and three. The thirty-six month timeline shows that the office would provide the company with a return of approximately $1.7MM. Additionally, STAR would be the beneficiary of nearly $150MM in new loan originations, and over $80MM in commercial loan balances.

	Year 1	Year 2	Year 3	Total
Loan Origination	$ 27,000,000	$ 54,500,000	$ 66,000,000	$ 147,500,000
Total Loan Oustandings	$ 14,850,000	$ 44,825,000	$ 81,125,000	$ 81,125,000
Total Revenue	$ 231,477	$ 1,209,541	$ 2,413,716	$ 3,854,734
Total Expenses	$ (618,960)	$ (732,663)	$ (755,274)	$ (2,106,897)
Pre-Tax Revenue/(Loss)	$ (387,483)	$ 476,878	$ 1,658,442	$ 1,747,837

Table 11: LPO Financial Summary over 36 Months

LPO Performance Evaluation

This section will shock the financial analysis laid out in the previous sections and analyze how different scenarios (market conditions, staffing augmentation, etc.) could alter those results. It should be noted that the previously discussed results are indicative of what I believe to be the potential baseline performance of the new office, or the most likely results achieved from a LPO expansion.

Best Case Scenario

Loan origination represents, by far and away, the largest variable when evaluating the estimated results of STAR's new LPO. On an individual basis, my baseline estimates assume the following annual production:

	Year 1	Year 2	Year 3	Total
Loan Origination	$ 9,090,909	$ 18,181,818	$ 21,818,182	$ 49,090,909
Total Loan Oustandings	$ 5,000,000	$ 10,000,000	$ 12,000,000	$ 27,000,000

Table 12: Best Case Scenario for LPO Production

However, given the new office's location in a large metropolitan market such as Indianapolis, and the initial strategic concentration on commercial real estate, it would not be unreasonable for a high performing loan officer to achieve better than desired results. An analysis of CRE deals originated by STAR in the greater Indianapolis market through the first half of 2017 produced an average commitment amount just north of $10MM. At that level, just a handful of deals could enable our staff to grow their individual loan portfolio to beyond the $27MM target.

The table below illustrates the bottom line impact (36 month total) should STAR be able to attain growth rates of 25% - 75% in loan balances above and beyond what was projected in the baseline estimates:

Growth Rate:	*Baseline*	*25%*	*50%*	*75%*
	36 Month Total	**36 Month Total**	**36 Month Total**	**36 Month Total**
Loan Origination	$ 147,500,000	$ 184,375,000	$ 221,250,000	$ 258,125,000
Total Loan Oustandings	$ 81,125,000	$ 101,406,250	$ 121,687,500	$ 141,968,750
Total Revenue	$ 3,854,734	$ 4,818,417	$ 5,782,101	$ 6,745,784
Total Expenses	$ (2,106,897)	$ (2,106,897)	$ (2,106,897)	$ (2,106,897)
Pre-Tax Revenue/(Loss)	$ 1,747,837	$ 2,711,521	$ 3,675,204	$ 4,638,888

Table 13: Best Case LPO Pro Forma

Assuming expenses remain flat and STAR is able to capture much larger loan commitments, the profitability of the LPO increases significantly.

Worst Case Scenario

Similarly, if you reduce the amount of loan production by factors of 25% - 75%, the feasibility of establishing the LPO becomes much less attractive:

Growth Rate:	*Baseline*	*-25%*	*-50%*	*-75%*
	36 Month Total	**36 Month Total**	**36 Month Total**	**36 Month Total**
Loan Origination	$ 147,500,000	$ 110,625,000	$ 73,750,000	$ 36,875,000
Total Loan Oustandings	$ 81,125,000	$ 60,843,750	$ 40,562,500	$ 20,281,250
Total Revenue	$ 3,854,734	$ 2,891,050	$ 1,927,367	$ 963,683
Total Expenses	$ (2,106,897)	$ (2,106,897)	$ (2,106,897)	$ (2,106,897)
Pre-Tax Revenue/(Loss)	$ 1,747,837	$ 784,154	$ (179,530)	$ (1,143,213)

Table 14: Worst Case LPO Pro Forma

Other factors besides loan production, such as staffing and margin compression, could have a negative impact on the success of the bank's LPO. The staffing model in my baseline case assumes that STAR would be able to hire and sufficiently train four new employees within a 45 day window without any external assistance from a staffing agency. If a staffing agency is leveraged in STAR's recruitment, the bank should expect to pay a onetime fee of up to 25% of each employee's first year salary, which could run up to $105,000 in year one. With the national rate of unemployment at 4.2% (United States Department of Labor, 2017), the likelihood of STAR finding quality employees on its own seems unlikely.

Margin compression within the commercial portfolio could also lead to less than desirable results. Although STAR has seen its overall NIM increase by 17 basis points from Q3 2016 to Q3 2017, if the bank saw its NIM reverse course and decrease, interest income within its LPO would decrease nearly $250,000 on an annual basis for every 25 basis point dip in its NIM.

It’s easy to see how a confluence of lack of loan production, recruitment issues, and NIM compression could lead to financial results that would not be deemed acceptable to the organization.

Investment Justification

Based on the overall financial analysis conducted for this proposed project, I firmly believe that the investment for STAR would be worthwhile for the institution for several reasons.

First and foremost, under my baseline assumptions, the operations of the LPO would show a positive cash flow in just under 12 months. Historically, most De Novo branches built by the bank would require a positive return duration of approximately 5-7 years, while the leased LPO office would show positive results in a much swifter fashion. With a total investment (~$759,000) that is just over half of what the company is accustom to paying for a new branch (~$1.45MM), the LPO strategy represents a prudent vehicle to for the company to seek significant loan growth at a fraction of the cost.

Additionally, the expenditures associated with the proposed project are isolated to the staff and equipment associated with the new office. Establishing a LPO would not require the institution to invest in any significant human capital to bolster the support teams that currently exist within STAR’s back room. The current staff within STAR’s Commercial Loan Administration, Underwriting, and Loan Services teams are in a position to handle the excess loan demand created by the new office. Furthermore, by isolating expenditures to just the staff and equipment associated with the new office, any fallout associated with an unsuccessful project would be minimalized. In other words, STAR would possess an exit strategy for the project that would not create substantial harm to company-wide employee morale.

Finally, an investment that is hyper focused on growing STAR's commercial loan portfolio is one that perfectly aligns with the company's strategic priority of leveraging a very well-positioned balance sheet to grow overall loan balances. As mentioned in a previous section, one tenant of the company's vision statement is to grow the institution to $3.5B in assets by 2024. In order to attain that goal via organic growth, STAR must be willing to put investments in place that allow for its already robust commercial team to expand its current business. It should be noted that maintaining sound credit discipline will be critical to execute this strategy successfully. If the company were to see deterioration in its new commercial loan balances, the consequences would be extremely detrimental to the financial performance of the bank.

Non-Financial Impact

The purpose of this section is to identify and address certain non-financial hurdles that could pose a threat to the success of the new STAR Financial Bank LPO. While some obstacles remain constant in the banking industry (i.e. regulation burden, increased competition, etc.), the items discussed within this section are intended to be specific to STAR and the proposed project.

Non-Branch Effect of Establishing a LPO

One of the most identifiable concerns with establishing a LPO is the lack of traditional banking services available to customers within the new office. While the primary goal of the office is to expand STAR's commercial loan portfolio, the bank must identify viable solutions to mitigate any concerns raised by its new commercial customers wanting to conduct "business as usual" transactions via the LPO office.

As discussed earlier in the project, the company believes that pairing its new LPO office with an Interactive Teller Machine, or ITM, would create an environment where commercial loan officers could focus on garnering new loans, while the ITM could handle the vast majority of daily customer transactions. STAR began using ITMs within its branch network nearly 2 years ago. With over 50 ITMs installed as of January 2018, these machines handle approximately 40,000 transactions per month, with an average customer wait time of fifteen seconds. Serviced by a team of 25 full time employees spread out over two call centers, the ITMs are capable of handling both commercial and retail deposits and withdrawals, and provide a live interactive experience for our customers.

Similar to other ITM installs done throughout STAR's network over the last 24 months, the bank would need to provide onsite consultations for first time users of the machine. As laid out within the Financial Impact section of the project, the LPO would be staffed with a Commercial Loan Administrator that could facilitate the task of allowing customers to become comfortable using the ITM. Based on previous experience, it would be recommended for the Admin to provide this guidance for approximately 2-3 weeks before repeat customers would be proficient in using the ITM.

While STAR is confident in the ITM's ability to handle the vast majority of transactions initiated by customers within the LPO, it should be noted that all consumer lending requests would need to be referred on to one of the bank's consumer loan officers. Additionally, the bank could explore the installation of a Tech Bar within the office if space was available. The Tech Bar would be equipped with tablets that allow customers to access our online consumer lending portals. These online portals would allow customers to submit their loan application via the web, with the expectation that a designated loan specialist would be following up with them once the application was received.

Each ITM is capable of providing robust reporting data to the organization that would be used to evaluate the performance of the machine within the LPO. On a per machine basis, the bank has the ability to track the following information:

- **Total Sessions**: Defined as an interaction initiated by a customer
- **Total Transactions**: Unique transactions conducted within each customer session
- **Transaction Types**: Deposits, Withdrawals, etc. by account type (retail, commercial)
- **Average Customer Wait Time**: Defined as the amount of time between a customer initiating a session and a banker appearing on the machine
- **Average Customer Session Time**: Defined as the amount of time of each session

As a current best practice at STAR, it will be critical for management to make informed decisions based on the data being presented by the new machine. While increased volume from the new machine could lead to expansion within the remote video banking team, a lack of volume could warrant a discussion on whether or not a LPO requires the installation of an ITM altogether.

Overall, the installation of an ITM within STAR's new LPO could serve as a way to easily mitigate the lack of traditional banking services offered within the location. The machine could provide STAR with a unique value proposition that is not readily available to customers of banks with similar offices. It will be critical for the bank's management team to effectively analyze machine data, ensuring that STAR is meeting its customer's needs within the new office. If the pairing is deemed successful, the bank could leverage the proposed setup for future expansion in similar endeavors. Employing an office setup that has been vetted by employees and customers alike would undoubtedly have a positive impact to the profitability of the institution.

Talent Acquisition & Retention

As with most new business ventures, talent acquisition and retention are critical issues that can greatly impact the success of the venture. Without the ability to staff its new LPO with a dynamic, motivated, and competent team, STAR would likely see its new office fail to succeed.

In order to ease the burden of recruiting four new employees in a relatively short amount of time, the bank would likely benefit from using the services of a local staffing agency, especially when it comes to the four commercial banking positions. While this practice would increase the year 1 costs associated with the office, the onetime fee (approximately 25% of the employee's base salary) could easily be offset by interest and fee revenue obtained by those new employees over time. Additional details concerning the cost of using a staffing agency can be found within the "Worst Case Scenario" portion of the Financial Impact section.

Additionally, STAR could see its talent acquisition and retention burden lessened by limiting, if feasible, the geographic distance between its new LPO and its closest hub office. Ultimately, the decision to establish a LPO should be driven by market demand for the bank's products, however, deploying a strategy to restrict the location of the office from its closest hub would ease the notion that the new staff is "on an island" with little to no corporate support. Specifically, I believe STAR would benefit from a geographical limitation of 50 miles from its nearest hub office. This would allow the bank to expand prudently in pockets of its largest growth markets of Indianapolis and Fort Wayne, while maintaining reasonable access to its larger hub offices for its new employees. Once the bank were to establish and implement a few successful LPO offices, it could look to expand its geographical restriction in order to reach new market segments that may be attractive to senior management.

Specific to retention, STAR could look to implement some form of a Long Term Incentive Plan, or LTIP, for its LPO employees. LTIPs can take on all sorts of shapes and sizes (i.e. deferred compensation, equity shares, etc.), but are commonly used by companies as retention tools for its most highly valued staff members. The bank would need to structure a plan that made financial sense to the organization, yet provided a benefit that was substantial enough to retain its employees. If implemented successfully, a LTIP can be viewed by the bank's employees as a very rewarding mechanism to remain at STAR, while providing the bank with a unique selling advantage to future prospective employees.

Ultimately, the measurement of whether or not these tools for talent acquisition and retention are successful will be the profitability of the individual LPO office. If the bank were to implement the right set of measures to effectively recruit and retain highly engaged staff members, I believe the profitability of the LPO should be reflective of the numbers laid out in the "Best Case Scenario" portion of the Financial Impact section of this report. Additionally, items such as the LTIP could be leveraged to extend beyond LPO employees, setting the stage for a bank wide program that has a positive ripple effect throughout the entire company.

Corporate Engagement & Support for New Office Structure

As identified earlier, STAR Financial Bank has seen its balance sheet grow to nearly $2B in assets through its first 70 years of doing business as a community bank. For the vast majority of the bank's existence, the bank employed a growth strategy through expansion of its retail, brick and mortar, operations. The retail bank served as the primary conduit for garnering business for the institution's other lines of business (i.e. Commercial Banking, Private Advisory, etc.). Furthermore, many of the bank's current C-Level executives played a substantial role in building out the bank's current branch network. Overall, the majority of these branches were built from the ground up, offering a full suite of banking products to our customers. While this strategy afforded the bank prudent and sound growth for many years, the recent commoditization trends of retail banking services has forced senior management to consider other innovative ways to seek growth. However, in order for these growth strategies to succeed, they must have the full support of the same C-Level executives who have become accustomed to growing the bank via its retail channels. As proposed, a newly designed loan production office represents a departure from the bank's conventional wisdom concerning its growth.

While old habits tend to die hard, studying the recent growth trends within the bank's outstanding loan portfolio over the last four years, may help bolster engagement for the LPO expansion strategy from senior management. Overall retail loans have seen a steady decline, primarily a result of the bank's defined strategy to exit the indirect auto lending market. Conversely, the bank's commercial lending portfolio has grown year over year, accounting for nearly 70% of the bank's total loan portfolio. The two tables below illustrate how the bank's loan categories have shifted throughout the last four years of operations.

	9/30/2017	9/30/2016	9/30/2015	9/30/2014
Retail Loans:	333,751,466	344,007,987	367,026,988	393,031,779
Agricultural Loans:	78,448,353	83,195,889	76,745,372	69,881,927
Commercial Loans:	892,296,817	843,933,706	786,294,344	740,425,887
Total Loans*:	1,304,496,636	1,271,137,583	1,230,066,704	1,203,339,593

*Table 15: Loan Composition by Dollar Amounts (*YTD AVG)*

	9/30/2017	9/30/2016	9/30/2015	9/30/2014
Retail Loans:	25.58%	27.06%	29.84%	32.66%
Agricultural Loans:	6.01%	6.54%	6.24%	5.81%
Commercial Loans:	68.40%	66.39%	63.92%	61.53%
Total Loans:	100%	100%	100%	100%

Table 16: Loan Composition as a Percentage of Total Loans

By studying the data contained within the bank's balance sheet, it's undeniable that the sole instrument for loan growth over the last four years has been the commercial line of business. While the bank must continue to maintain a balance between its various lines of business, developing a strategy to capitalize on the recent growth and momentum of its commercial team would seem to be an effective exercise for the bank's executive team.

Corporate adoption of a LPO expansion strategy, from the bank's C-Level executives down, would have a significant positive impact to the organization. Internally, the bank's employees would identify that senior management is capable of adapting its growth strategies based on its recent growth trends. Additionally, expansion into new markets through a LPO would allow for STAR employees to engage in markets that were previously deemed off limits. Externally, the bank would be able to expand its brand into new markets, setting the stage for even further growth. Once its commercial presence was established, the bank could then look to expand its product offering, allowing for other lines of business to follow suit.

While several non-financial hurdles associated with growing the bank through LPO expansion can be identified, I firmly believe that the bank is in a position to overcome these obstacles. The bank's new offices must provide a dynamic environment that meets the needs of its customers, including retail. The staff within the LPO must be highly engaged, and feel as though they have access to all of the tools and decisions makers needed in order to perform their job effectively. Finally, the bank's executive team must be fully supportive of the new venture, allowing the company to take advantage of its recent growth and momentum within its commercial sector.

Conclusion

If executed properly, a newly established LPO paired with the latest in interactive banking technology could serve as an incubator of expansion, allowing STAR Financial to explore new markets while mitigating the company's financial exposure when compared to its historical DeNovo branch strategy. The office would be staffed with individuals capable of partnering with our clients in order to meet their financial needs and equipped with a technology stack that can deliver world class customer service via our video banking resources. While risks with such a strategy do exist (staffing stability, lack of loan growth, etc.), the company is fully equipped to handle those challenges given its current financial health and overall support structure. Based on my analysis, I fully support the expansion strategy laid out within this project. Expansion is on the horizon for STAR Financial Bank…

Appendix A: Model Assumptions and Annual Pro-Forma

Assumptions:					
Portfolio Characteristics		**Employee Expense**		**Miscellaneous Office Expenses**	
Loan Utilization:	*55%*	*Commercial LO Salary:*	*$ 125,000*	*Lease Cost (Per Sq. Foot):*	*$ 35.00*
Net Margin:	*3.61%*	*Commercial LO Incentive (% of Salary):*	*25%*	*Office Size:*	*1324*
CRE Loan Composition:		*Admin Salary:*	*$ 45,000*	*Annual Lease Accelerator:*	*3%*
Year 1:	*80%*	*Number of Commercial LOs:*	*3*	*Monthly Supplies Exp (Per Emp):*	*$ 140*
Year 2:	*70%*	*Number of Admins:*	*1*	*Dues/Travel/Mileage (Per LO):*	*$ 225*
Year 3:	*50%*	*Total Employees:*	*4*	*Annual Advertising Budget:*	*$ 20,000*
C&I Fee Income:	*0.0010*	*Annual Salary Increase:*	*3%*	*ITM Ongoing Maintenance:*	*$ 900*
CRE Fee Income:	*0.0025*	*Benefits Costs (% Of Salary):*	*25%*	*Annual Maintenance:*	*$ 2,000*

	Year 1	Year 2	Year 3	Total
Loan Origination	$ 27,000,000	$ 54,500,000	$ 66,000,000	$ 147,500,000
Total Loan Oustandings	$ 14,850,000	$ 44,825,000	$ 81,125,000	$ 81,125,000
Net Interest Income	$ 172,077	$ 1,097,816	$ 2,298,216	$ 3,568,109
Non Interest Income				
Fee Revenue	$ 59,400	$ 111,725	$ 115,500	$ 286,625
Total Revenue	$ 231,477	$ 1,209,541	$ 2,413,716	$ 3,854,734
Non Interest Expense				
Salaries	$ (420,000)	$ (432,600)	$ (445,578)	$ (1,298,178)
Benefits	$ (105,000)	$ (108,150)	$ (111,395)	$ (324,545)
Commissions	$ -	$ (96,563)	$ (99,459)	$ (196,022)
Building Expense	$ (48,340)	$ (49,730)	$ (53,222)	$ (151,292)
Stationery & Supplies	$ (6,720)	$ (6,720)	$ (6,720)	$ (20,160)
Dues, Travel & Entertainment	$ (8,100)	$ (8,100)	$ (8,100)	$ (24,300)
Advertising & Promotional	$ (20,000)	$ (20,000)	$ (20,000)	$ (60,000)
ITM Maintenance	$ (10,800)	$ (10,800)	$ (10,800)	$ (32,400)
Total Non-Interest Expense	$ (618,960)	$ (732,663)	$ (755,274)	$ (2,106,897)
Pre-Tax Revenue/(Loss)	$ (387,483)	$ 476,878	$ 1,658,442	$ 1,747,837

Appendix B: Year 1 Base Case Results

	Year 1												
	Month 1	**Month 2**	**Month 3**	**Month 4**	**Month 5**	**Month 6**	**Month 7**	**Month 8**	**Month 9**	**Month 10**	**Month 11**	**Month 12**	**Total**
Loan Origination	$ -	$ -	$ -	$ -	$ 1,000,000	$ 2,500,000	$ 3,000,000	$ 4,000,000	$ 4,000,000	$ 4,000,000	$ 4,000,000	$ 4,500,000	$ 27,000,000
Total Loan Oustandings	$ -	$ -	$ -	$ -	$ 550,000	$ 1,925,000	$ 3,575,000	$ 5,775,000	$ 7,975,000	$ 10,175,000	$ 12,375,000	$ 14,850,000	$ 14,850,000
Interest Income	$ -	$ -	$ -	$ -	$ 1,655	$ 5,791	$ 10,755	$ 17,373	$ 23,991	$ 30,610	$ 37,228	$ 44,674	$ 172,077
Non Interest Income													
Fee Revenue	$ -	$ -	$ -	$ -	$ 2,200	$ 5,500	$ 6,600	$ 8,800	$ 8,800	$ 8,800	$ 8,800	$ 9,900	$ 59,400
Non Interest Expense													
Salaries	$ 35,000	$ 35,000	$ 35,000	$ 35,000	$ 35,000	$ 35,000	$ 35,000	$ 35,000	$ 35,000	$ 35,000	$ 35,000	$ 35,000	$ 420,000
Benefits	$ 8,750	$ 8,750	$ 8,750	$ 8,750	$ 8,750	$ 8,750	$ 8,750	$ 8,750	$ 8,750	$ 8,750	$ 8,750	$ 8,750	$ 105,000
Commissions	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Building Expense	$ 4,028	$ 4,028	$ 4,028	$ 4,028	$ 4,028	$ 4,028	$ 4,028	$ 4,028	$ 4,028	$ 4,028	$ 4,028	$ 4,028	$ 48,340
Stationery & Supplies	$ 560	$ 560	$ 560	$ 560	$ 560	$ 560	$ 560	$ 560	$ 560	$ 560	$ 560	$ 560	$ 6,720
Dues, Travel & Entertainment	$ 675	$ 675	$ 675	$ 675	$ 675	$ 675	$ 675	$ 675	$ 675	$ 675	$ 675	$ 675	$ 8,100
Advertising & Promotional	$ 1,667	$ 1,667	$ 1,667	$ 1,667	$ 1,667	$ 1,667	$ 1,667	$ 1,667	$ 1,667	$ 1,667	$ 1,667	$ 1,667	$ 20,000
ITM Maintenance	$ 900	$ 900	$ 900	$ 900	$ 900	$ 900	$ 900	$ 900	$ 900	$ 900	$ 900	$ 900	$ 10,800
Total Interest Expense	$ 51,580	$ 51,580	$ 51,580	$ 51,580	$ 51,580	$ 51,580	$ 51,580	$ 51,580	$ 51,580	$ 51,580	$ 51,580	$ 51,580	$ 618,960
Pre-Tax Revenue/(Loss)	$ (51,580)	$ (51,580)	$ (51,580)	$ (51,580)	$ (47,725)	$ (40,289)	$ (34,225)	$ (25,407)	$ (18,789)	$ (12,170)	$ (5,552)	$ 2,994	$ (387,483)

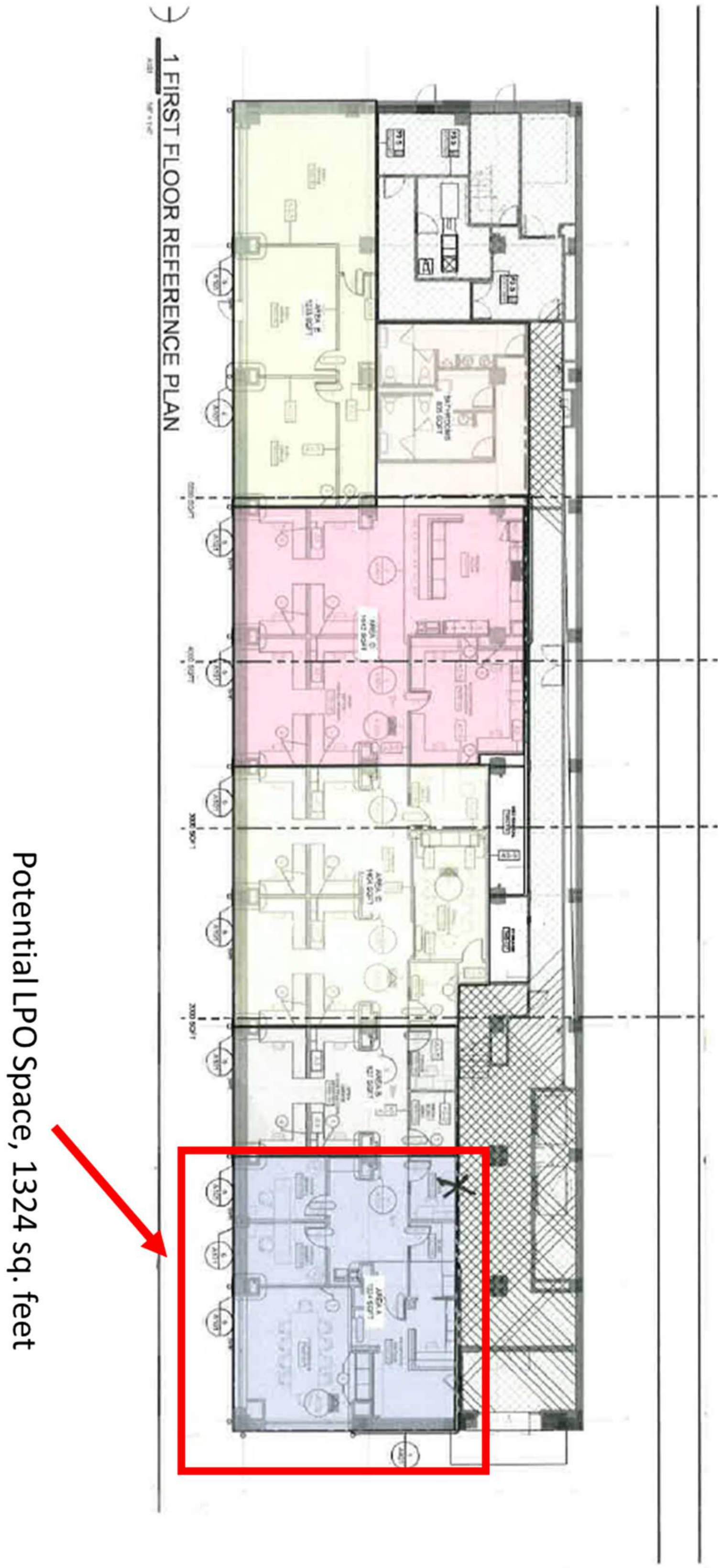
Appendix C: Year 2 Base Case Results

	Year 2												
	Month 1	Month 2	Month 3	Month 4	Month 5	Month 6	Month 7	Month 8	Month 9	Month 10	Month 11	Month 12	Total
Loan Origination	$ 4,000,000	$ 4,000,000	$ 4,000,000	$ 4,500,000	$ 4,500,000	$ 4,500,000	$ 4,500,000	$ 4,500,000	$ 5,000,000	$ 5,000,000	$ 5,000,000	$ 5,000,000	$54,500,000
Total Loan Oustandings	$17,050,000	$19,250,000	$21,450,000	$23,925,000	$26,400,000	$28,875,000	$31,350,000	$33,825,000	$36,575,000	$39,325,000	$42,075,000	$44,825,000	$44,825,000
Interest Income	$ 51,292	$ 57,910	$ 64,529	$ 71,974	$ 79,420	$ 86,866	$ 94,311	$ 101,757	$ 110,030	$ 118,303	$ 126,576	$ 134,849	$ 1,097,816
Non Interest Income													
Fee Revenue	$ 8,200	$ 8,200	$ 8,200	$ 9,225	$ 9,225	$ 9,225	$ 9,225	$ 9,225	$ 10,250	$ 10,250	$ 10,250	$ 10,250	$ 111,725
Non Interest Expense													
Salaries	$ 36,050	$ 36,050	$ 36,050	$ 36,050	$ 36,050	$ 36,050	$ 36,050	$ 36,050	$ 36,050	$ 36,050	$ 36,050	$ 36,050	$ 432,600
Benefits	$ 9,013	$ 9,013	$ 9,013	$ 9,013	$ 9,013	$ 9,013	$ 9,013	$ 9,013	$ 9,013	$ 9,013	$ 9,013	$ 9,013	$ 108,150
Commissions	$ -	$ 96,563	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 96,563
Building Expense	$ 4,144	$ 4,144	$ 4,144	$ 4,144	$ 4,144	$ 4,144	$ 4,144	$ 4,144	$ 4,144	$ 4,144	$ 4,144	$ 4,144	$ 49,730
Stationery & Supplies	$ 560	$ 560	$ 560	$ 560	$ 560	$ 560	$ 560	$ 560	$ 560	$ 560	$ 560	$ 560	$ 6,720
Dues, Travel & Entertainment	$ 675	$ 675	$ 675	$ 675	$ 675	$ 675	$ 675	$ 675	$ 675	$ 675	$ 675	$ 675	$ 8,100
Advertising & Promotional	$ 1,667	$ 1,667	$ 1,667	$ 1,667	$ 1,667	$ 1,667	$ 1,667	$ 1,667	$ 1,667	$ 1,667	$ 1,667	$ 1,667	$ 20,000
ITM Maintenance	$ 900	$ 900	$ 900	$ 900	$ 900	$ 900	$ 900	$ 900	$ 900	$ 900	$ 900	$ 900	$ 10,800
Total Interest Expense	$ 53,008	$ 149,571	$ 53,008	$ 53,008	$ 53,008	$ 53,008	$ 53,008	$ 53,008	$ 53,008	$ 53,008	$ 53,008	$ 53,008	$ 732,663
Pre-Tax Revenue/(Loss)	$ 6,484	$ (83,460)	$ 19,720	$ 28,191	$ 35,637	$ 43,082	$ 50,528	$ 57,974	$ 67,271	$ 75,544	$ 83,817	$ 92,090	$ 476,878

Appendix D: Year 3 Base Case Results

	Year 3												
	Month 1	Month 2	Month 3	Month 4	Month 5	Month 6	Month 7	Month 8	Month 9	Month 10	Month 11	Month 12	Total
Loan Origination	$ 5,000,000	$ 5,000,000	$ 5,000,000	$ 5,000,000	$ 5,000,000	$ 5,000,000	$ 6,000,000	$ 6,000,000	$ 6,000,000	$ 6,000,000	$ 6,000,000	$ 6,000,000	$ 66,000,000
Total Loan Oustandings	$ 47,575,000	$ 50,325,000	$ 53,075,000	$ 55,825,000	$ 58,575,000	$ 61,325,000	$ 64,625,000	$ 67,925,000	$ 71,225,000	$ 74,525,000	$ 77,825,000	$ 81,125,000	$ 81,125,000
Interest Income	$ 143,121	$ 151,394	$ 159,667	$ 167,940	$ 176,213	$ 184,486	$ 194,414	$ 204,341	$ 214,269	$ 224,196	$ 234,124	$ 244,051	$ 2,298,216
Non Interest Income													
Fee Revenue	$ 8,750	$ 8,750	$ 8,750	$ 8,750	$ 8,750	$ 8,750	$ 10,500	$ 10,500	$ 10,500	$ 10,500	$ 10,500	$ 10,500	$ 115,500
Non Interest Expense													
Salaries	$ 37,132	$ 37,132	$ 37,132	$ 37,132	$ 37,132	$ 37,132	$ 37,132	$ 37,132	$ 37,132	$ 37,132	$ 37,132	$ 37,132	$ 445,578
Benefits	$ 9,283	$ 9,283	$ 9,283	$ 9,283	$ 9,283	$ 9,283	$ 9,283	$ 9,283	$ 9,283	$ 9,283	$ 9,283	$ 9,283	$ 111,395
Commissions	$ -	$ 99,459	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 99,459
Building Expense	$ 4,435	$ 4,435	$ 4,435	$ 4,435	$ 4,435	$ 4,435	$ 4,435	$ 4,435	$ 4,435	$ 4,435	$ 4,435	$ 4,435	$ 53,222
Stationery & Supplies	$ 560	$ 560	$ 560	$ 560	$ 560	$ 560	$ 560	$ 560	$ 560	$ 560	$ 560	$ 560	$ 6,720
Dues, Travel & Entertainment	$ 675	$ 675	$ 675	$ 675	$ 675	$ 675	$ 675	$ 675	$ 675	$ 675	$ 675	$ 675	$ 8,100
Advertising & Promotional	$ 1,667	$ 1,667	$ 1,667	$ 1,667	$ 1,667	$ 1,667	$ 1,667	$ 1,667	$ 1,667	$ 1,667	$ 1,667	$ 1,667	$ 20,000
ITM Maintenance	$ 900	$ 900	$ 900	$ 900	$ 900	$ 900	$ 900	$ 900	$ 900	$ 900	$ 900	$ 900	$ 10,800
Total Interest Expense	$ 54,651	$ 154,111	$ 54,651	$ 54,651	$ 54,651	$ 54,651	$ 54,651	$ 54,651	$ 54,651	$ 54,651	$ 54,651	$ 54,651	$ 755,274
Pre-Tax Revenue/(Loss)	$ 97,220	$ 6,034	$ 113,766	$ 122,039	$ 130,312	$ 138,585	$ 150,262	$ 160,190	$ 170,117	$ 180,045	$ 189,972	$ 199,900	$ 1,658,442

Appendix D: Potential LPO Floor Plan



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