
Maintaining Growth in a Rural Community Bank

CAPSTONE PROJECT

ABA STONIER GRADUATE SCHOOL OF BANKING

2018

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Table of Contents

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Executive Summary

James Cash Penney, the founder of J.C. Penney, said "No company can afford not to move forward. It may be at the top of the heap today but at the bottom of the heap tomorrow, if it doesn't."

This quote accurately describes the current environment that Investors Community Bank (ICB) finds itself. American Banker Magazine has named the bank as one of the "Top 200 Community Banks"[2] for several years in a row and annual income continues to outperform earnings from the previous year. These are notable accomplishments for a one-branch bank in rural Missouri where the local population is less than 10,000 people.

However, the bank must consider growth opportunities to remain competitive in our market and to maximize value to the shareholders.

For this paper, the financial impacts of three areas for potential growth have been explored: an acquisition of another bank, expansion of online mortgage originations, and a stand-alone mortgage production office. This paper also identifies the non-financial impacts and associated risks of each idea and will recommend the direction the bank should take to sustain growth and marketplace relevance.
Naturally, one of the top ways for a bank to obtain almost immediate growth is by acquisition or merger of another bank by either selectively identifying banks within the

desired market or by an FDIC assisted purchase. FDIC assisted purchases are currently on the decline due to economic stabilization. Therefore, finding a bank to acquire in a community that ICB finds favorable is will need to be considered.

Cameron, Missouri presents itself as a candidate for expansion due to its geographic location to Kansas City. Research has identified one bank, in particular, that is currently underperforming in several areas when compared to the peer group and would be a candidate for acquisition. Historical merger and acquisition data has been used to calculate a range of price. Further analysis suggests that some of the underperforming areas could benefit from an acquisition by being able to streamline those departments with ours, explicitly bookkeeping. A sample merged balance sheet shows a simple reorganization or elimination of some asset groups would create a strong and well-capitalized bank. Furthermore, ICB has excess capital and funds available at the holding company level to make this a viable transaction.

If the bank were to enter into a purchase with the target bank, it would be of utmost importance that thorough due diligence is performed to identify potential regulatory and legal risks as well as identifying and closely monitoring employee morale and maintaining a culture within the new bank that aligns with the culture of ICB.

The expansion of online mortgage originations is an additional area that ICB should explore further. Although the majority of these mortgages are typically sold on the secondary market, they have little impact on asset growth but produce a fair amount of monthly fee income for the bank.

ICB could accomplish this expansion by maximizing exposure through social media platforms such as Facebook and Instagram. Using Facebook analytics, the marketing for this type of product can be as general or specific as the bank prefers and has little costs when compared to more conventional forms of advertising. Existing staff could easily handle loan volume for the time being and could be added if a significant increase in volume were to be realized.

Since this would offer our products in communities not now served by ICB, the unfamiliarity of these markets and the diversity of customers would create the need for additional training in underwriting and appraisal review and validation would be critical.

Finally, a mortgage loan production office (MLPO) located in St. Joseph was considered. However, compiled date suggest that due to the amount of established competition in that market, staffing requirements, operational expenses, and risk involved by not having direct oversight of the activities of the office would create a financial burden on ICB and would create little, if no value.

Maintaining Growth in a Rural Community Bank

In summary, the board of ICB should strongly consider the acquisition of a bank in a desirable market thereby allowing expansion of its geographical footprint and potentially allow the bank to fill customer or product gaps not currently being met. This should be considered immediately due to the current strength of ICB's balance sheet. An acquisition would not only create a stronger bank but would also ICB to gain access to additional funding sources (deposits) and a more extensive investment portfolio to work with to maximize income. Along with an acquisition, ICB should gradually expand online origination into broader markets what are desirable using targeted social media advertising to supplement fee income further.

Section I: Introduction and Background

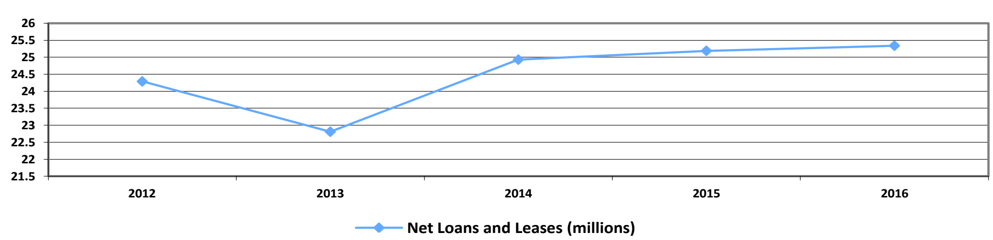
Investors Community Bank (ICB), a wholly owned subsidiary of IFB Holdings (IFBH), Chillicothe, Missouri, was founded in 1934 as Chillicothe Federal Savings and Loan Association. Since then, the bank has gone through two charter conversions. The first was in 1999 with a National charter and most recently to a State charter in July 2014. ICB is a community-oriented financial institution offering selected financial services to meet the needs of Chillicothe and the surrounding counties. The Bank attracts deposits from the general public and historically has used these deposits, together with other funds, to originate 1-4 family residential mortgage loans, non-residential real estate loans (primarily farm loans), and consumer loans consisting mainly of loans secured by

Maintaining Growth in a Rural Community Bank

automobiles. The bank currently has one location located in downtown Chillicothe, Missouri.

The peer group for Investors Community Bank consists of 386 banks between $50 million and $100 million in total assets with two or fewer full-service facilities with no facilities located within a metropolitan statistical area.[1]

As of June 30, 2017, Investors Community Bank had total assets of approximately $68.8 million.[1] The bank realized an increase of $4.03 million in assets compared to the June 30, 2016, Uniform Bank Performance Report. Of these assets, approximately $26.4 million is in loans.[1] Total deposits at this time are approximately $59.7 million. Therefore, the bank has an unusually low loan to deposit ratio of roughly 44%.
The bank has realized little loan growth and management has no set strategy to address this other than to "grow loans." However, quality loan growth is an area that all banks in this geographic area currently struggle.



Brian Englert
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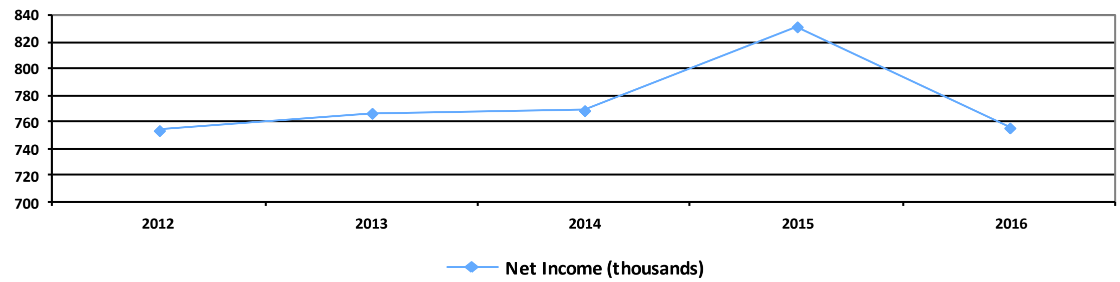
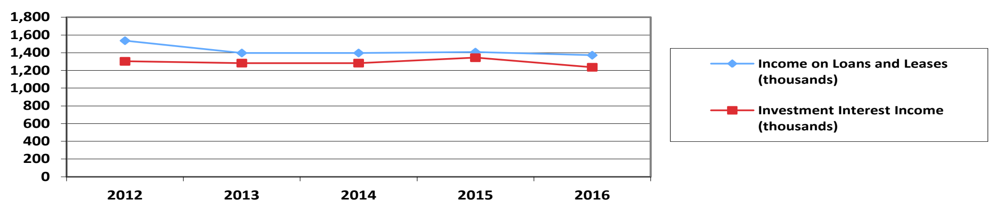
Capstone Project 2018

Maintaining Growth in a Rural Community Bank

Net income over the past five years has been steady.



Due to the low loan to deposit ratio and relatively flat loan growth, the bank is strategically relying on income from a substantial investment portfolio of approximately $37 million as of December 2016. This portfolio consists primarily of municipal bonds. In 2016, 48% of the earnings came from income on investments. The current yield received on a municipal bond at this time is almost equal to the equivalent margin if it were a loan funded with a deposit.



Maintaining Growth in a Rural Community Bank

The investment portfolio has grown from $36.9 million to $42.3 million from June 2016 to June 2017[1] and is a leading reason for the growth in asset size.

In 2001, the bank hired a business development officer to grow loans which ultimately resulted in explosive growth within the portfolio. Unfortunately, the business development offer did not have the best interests of the bank in mind and was able to persuade the loan officers and loan committee to originate loans that had credit deficiencies. Fortunately, the business development officer left in 2007 and the bank brought in a new senior lender that had an excellent background in problem loan workouts. With the help of this officer, the bank was able to force out or restructure the majority of the weaker credits before the financial crisis. However, this restructuring of assets resulted in a significant drop in the bank's loan portfolio. The bank remained strong through the financial crisis and loans have now grown back to a level where they were at before this period in the bank's history.

ICB is currently operating with the minimum number of directors as required by regulators. The board consists of five directors ranging in age from 63 to 81 years old. Four of these are outside directors with ties to local businesses. The remaining director is the President and CEO of the bank. These five board members currently own a majority interest of 59.7% of the bank through common stock. At this time, the board is not willing to diversify unless something was to happen to an existing board member. In that case, each member has a relative (daughter, son, spouse, or nephew) slated for succession. The ages of the successors range from approximately 45 to 55 years old.

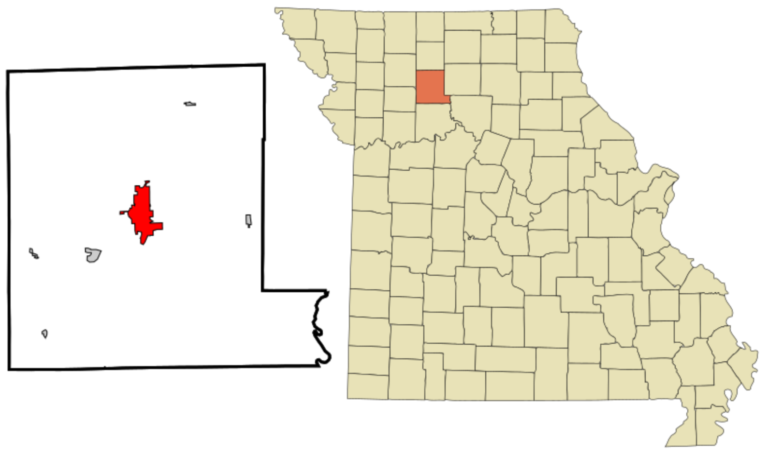
The board members serve on various committees within the bank typically found in most organizations such as a Credit Committee or Asset and Liability Management Committee. There is no rotation for directors on these committees other than the need to fill a vacancy if one of the directors is unavailable for a scheduled meeting. The board has historically not participated in any business development roles.

Strategic planning goals for the bank are set by comparing the actual performance of the bank compared to those of the other banks within the peer group and determining which areas need improvement. There are currently no long-term goals for the bank as long as the bank continues to recognize strong performance.

Investors Community Bank has been recognized as one of the *"Top 200 Community Banks and Thrifts"* by American Banker magazine for the fifth consecutive year.[2] This recognition is based solely on ROA of publicly traded community banks and thrifts.

Demographics

Chillicothe is the county seat of Livingston County Missouri and located approximately one-hour northeast of Kansas City. Chillicothe is the retail and industrial hub for the county.



The population within the city limits as of 2015 was 9,714.[3] Population for the entire county is 15,235.[3] Chillicothe has recognized a 2% population growth since 2000.

Top employers in the area include a hospital, state prison, school district, and approximately nine light industrial facilities, a large number of retail services, and agriculture. Livingston County has unemployment of 3.1%[4], which is currently lower than the national average of 4.4%.

The median household income for the area is $43,350, which is below the state median of $50,328.[5] Of all households in the county, 18.8% of those are considered living below the poverty line.[5]

The median home price is $95,472 with an owner occupancy rate of 69.9%.[5]

Competitive Dynamic

Currently, there are five banks including ICB and two non-bank lending institutions located in Chillicothe.

- Citizen's Bank and Trust-a branch of a regional Kansas City-based bank
- Bank Midwest-a branch of a regional Kansas City-based bank.
- BTC-a branch of a regional bank headquartered in Bethany, Missouri.
- Chillicothe State Bank-a family owned local bank.
- FCS Financial (formerly Farm Credit Services)
- Wells Fargo Home Mortgage

Loan growth within the area has been relatively flat for several years. It appears that the majority of the banks are doing what they can to maintain their current strong loan relationships while trying to move weaker credits off of their balance sheets. Therefore, with few exceptions, the banks have been extremely cautious in underwriting; especially when loan refinance requests come from other local institutions.

Investors Community Bank is the smallest bank in town in regards to total assets and a 12.49% market share in deposits.

Maintaining Growth in a Rural Community Bank

ICB has focused on the maintaining lasting relationships with existing customers and their extended families as well as the strength of our residential real estate lending. The bank heavily promotes the retained servicing of fixed-rate loans to differentiate itself within the market. The bank has found that customers prefer this to lenders that originate and sell off the servicing which is typical of most banks. Local staff can directly answer any questions that a customer may have

The bank struggles to compete with FCS Financial on agricultural loans because their funding sources allow that organization the ability to offer agricultural real estate rates that are much lower than traditional lenders can provide. Wells Fargo Home Mortgage tends to cater to customers with subprime credit primarily. ICB does not consider these types of loans to be desirable and therefore does not participate in that market.

Summary

Based on this information and past performance reports of the bank, it is indicative that the bank explores other growth opportunities outside of the local market area. Options to consider currently include an acquisition or merger of a bank, the expansion of online mortgage products marketed in the surrounding counties and towns along the Hwy 36, I-35 and I-29 corridors, and the possibility of opening a standalone mortgage office.

This project will focus on these three strategies that the bank has identified as ways to maintain growth as well as determining financial and non-financial impacts of each plan and ultimately a conclusion as to which direction the bank could look to for potential growth opportunities.

Section II: Strategy and Implementation

1. Bank Acquisition or Merger

Banks see an acquisition or merger as a chance to expand their market or scale up operations quicker. A merger can help an institution to grow and gain a large number of new customers quickly. An acquisition can give a bank more capital to work with and also more deposits to loan and make investments. Purchases can also provide a more substantial geographic footprint in which to operate and reach growth goals much faster.

An acquisition or merger may also help a bank to operate more efficiently, not only concerning the efficiency ratio but also regarding operations. All banks have departments in charge of compliance, risk management, accounting, lending, and information technology. A merger or acquisition can consolidate and administer these departments more efficiently by combining them into one. A merger or acquisition could also help a bank to fill product or market gaps.

A bank could also benefit from a merger or acquisition because of the diverse leadership available within both organizations.

UBPR (Uniform Bank Performance Report) data was analyzed to determine which banks might be candidates for an acquisition or merger in communities that could present opportunities for expansion. Cameron, Missouri has been identified as a possible area. Cameron is approximately forty-five miles from Chillicothe, MO and sits at the intersection of Highway 36 and Interstate 35. Current data shows that the population as of 2014 was 9,762[6] and has seen a population increase of 17.4% since 2000.[6] Cameron's largest employers are two correctional facilities, a hospital, and several manufacturing plants. Four banks currently serve Cameron. Three of the banks are locally owned, and one bank is a branch out of Kansas City.

An examination of the Uniform Bank Performance Report (UBPR)[7] for each bank in Cameron has been reviewed and one bank identified as a potential candidate for a merger or acquisition. The institution is not named in this paper and labeled as "Bank X."

Initially, a few critical indicators from this report: Net Income, Efficiency Ratio, and Return on Assets (ROA) of Bank X were compared to that of their peer group[7]. The numbers and ratios of ICB were added as well for comparison. A more in-depth analysis of the UBPR would need to be performed to try and identify specific weaknesses in their balance sheet.

NET INCOME	12/31/2016	12/23/2015	12/31/2014[7]
Bank X	$93,000	$71,000	-$51,000
ICB	$756,000	$832,000	$769,000

EFFICIENCY RATIO	12/31/2016	12/31/2015	12/31/2014[7]
Bank X	88.95	90.94	104.99
Peer Group	79.68	79.62	83.99
Investors Community Bank	57.41	53.88	57.44

RETURN ON ASSETS	12/31/2016	12/31/2015	12/31/2014[7]
Bank X	.45	.34	-.25
Peer Group	.80	.64	.46
Investors Community Bank	1.10	1.22	1.14

Based on this information, a quick determination can be made that Bank X has had difficulty generating income in the past three years, although they have recognized an increase since 2014. Their efficiency ratio is high and higher than that of their peer group. In this instance, a merger or acquisition may be desirable to help streamline the organization by consolidating departments. Return on Assets is also weak and substantially below peer group.

For this paper, the assumption is made that management of both banks has agreed that a merger would be mutually beneficial. Now it would be imperative to consider due diligence.

Due diligence is a term used to describe an appraisal of a bank. While it would be desirable to buy another bank, the buying bank does not want to acquire the other bank's problems. As one would not usually make a significant purchase without first doing research, the same rationale would apply to a bank purchase transaction where the potential costs and risks stand to be much higher. Regulatory agencies place a high emphasis on compliance, and it would be the responsibility of ICB to prove that due diligence was complete. Regulatory penalties could potentially be assessed if a problem or deficiency was to present itself that had not been identified during due diligence.

Areas to consider in the initial due diligence would be a review of the organizational structure of the bank itself, as well as risk management, capitalization indebtedness, and investments. Other areas would include regulatory issues, owned and leased real estate, personal property, information systems, accounting practices, contracts, transactions with affiliates, benefit plans, insurance, tax obligations, litigation, trust and non-deposit investment products, and most importantly, deposit base, lending, and collection activity.

Once the two boards enter into a definitive agreement due diligence would be performed to evaluate the feasibility of the merger or acquisition. The final step after due diligence would be to seek approval from the regulatory agencies.

2. Expansion of Online Mortgage Products

Currently, ICB offers MortgageBot as an online mortgage product. MortgageBot is an online application process that is tied externally to the bank's website. Through MortgageBot, customers can compare all of the loan products and also get rate and closing cost estimates. If the customer wishes to apply, they may do so online, and the application will then be approved or denied automatically through an automated underwriting system. Approved customers are provided with all necessary preliminary disclosures and preapproval letters. The request then passes through to an internal system for processing. Applications that do not qualify for automatic approvals are forwarded to a loan officer for manual approval or denial.

Online mortgage origination has become very competitive. This product could eventually be a service that customers-especially younger customers expect a bank to have, in much the same way that online banking has become today.

Currently, no outside marketing of this application process is being done. With the flexibility of MortgageBot, the bank could control specific areas where applications will be received. Currently, it set up to only accept requests within Livingston County and the five surrounding counties. As of right now, if a customer were to apply with a zip code not located in this preset geographical area, they are not allowed to proceed with the online application process.

The original plan was to market the product to local realtors directly, and a select group of realtors from neighboring communities whom the bank felt would drive the most volume. However, the program has not had the anticipated positive reception from the realtors. Therefore, an expansion of this program could be beneficial to help grow loan volume for the bank.

MortgageBot is a product that could be expanded very quickly and with little cost with our secondary market program through Freddie Mac and our in-house loan programs. The bank is currently contracted with MortgageBot for a period of three-years. The monthly expense of offering this program is $1,705 or $20,460 annually.

Typically, income generated on a secondary market loan is approximately $3,000 to $4,000 (or 3-4%) on a $100,000 mortgage. An expansion of the online mortgage business could easily pay for this system with as little as one extra loan generated per month, which is an easily attainable goal.

Marketing through social media platforms such as Facebook and Instagram is very inexpensive and gives a bank or any business the ability to market to a very diverse or direct demographic of their choosing. Experimentation with Facebook and Instagram marketing has successfully driven traffic “clicks” to the bank website with a budget as little as $75 per month.

Facebook Analytics can provide a customer with a wide range of data on who is interacting with the site and their responses to that interaction. Facebook allows a user to create an ad campaign targeted to specific demographics such as location, age, gender, language, and specific keywords.

It would be the intent to use the Facebook marketing interfaces to deliver ads directly to the desired geographic areas and demographic groups.

A sample ad with the following demographic information has estimated the following results:

1. Location-targeted within 30 miles of Chillicothe, Cameron and St. Joseph, MO.

2. Men and Women ages 22-50

3. Detailed targeting towards First Time Homebuyers

Facebook estimates delivery of 450-1100 reaches per day and a click thru rate (CTR) of 5-32 per day. Click thru rate or CTR is defined as the rate at which a person might click on an ad versus the number of times that the ad is viewed. The estimated cost of a marketing program similar to this criterion through Facebook is $140 per week.

3. Mortgage Loan Production Office (MLPO)

A Mortgage Loan Production Office is a separate office of a bank's operations that accept applications for loans and arranges for the financing of mortgages but is not allowed to take deposits or payments. Mortgage Loan production offices (LPOs) are primarily used for growth or expansion into other markets without the significant investment of offering conventional banking services.

St. Joseph, Missouri has been identified as a possible location for an MLPO. St. Joseph is located approximately one-hour west of Chillicothe, Missouri, and approximately one-hour from the Kansas City metro area.

Maintaining Growth in a Rural Community Bank

St. Joseph is intersected by an interstate (I-29) running north and south, and a major highway (Hwy 36) to the east and west.

The St. Joseph metropolitan area has a population of approximately 128,000 as of 2014 and has recognized a 4% population increase in the past fifteen years. Primary employers for St. Joseph are Mosaic Life Care, Triumph Food, St. Joseph School District, 139th Airlift Wing (Air National Guard), and Boehringer Ingelheim. Other employers in the area are a University and a large corporate office for a major insurance company. There are also several smaller industrial facilities. Unemployment is currently 4.2%.[8]

The median household income for St. Joseph is $46, 398, which is lower than the state median of $50,328.[8]

The most current data indicates that there are a total of three banks headquartered in St. Joseph and four other banks headquartered in other cities but have branches located in St. Joseph. There are approximately nine mortgage origination companies outside traditional banks.[8]

The most recent mortgage origination data for St. Joseph shows that there were a total of 356 purchases with an average of $92,402, 1,204 refinance transactions averaging $114,115, and 115 home improvement loans with an average of $35,041.[8]

Implementing an MLPO in the St. Joseph region could be attainted by renting a space in a high retail traffic area such as a strip mall or stand-alone office building and using a lease instead of a purchase. Staffing with three people, preferably a loan officer, a loan processor, and a CSR would be ideal.

Finding employees with local ties to the community would be ideal, as they would already know the local market and have possible existing civic and business connections. An MLPO would still be close enough to market the banks “local servicing” which has currently helped to generate loan volume in the current market.

An MLPO located in St. Joseph could also spur expansion further south to towards the Kansas City metropolitan area along the I-29 corridor for future growth.

Section III: Financial Impacts

Each proposed growth opportunity has its own distinct financial needs. This section will focus on the economic impact of implementing each scenario based on information available at this time.

1. Bank Acquisition or Merger

Determining the exact financial impact of an acquisition of a bank is a complicated calculation as there are several ways to determine the value of the bank. However, there are some tools available to provide a starting point in the negotiations. The most common methods use a multiplier based on the Price/Total Common Equity ratio (TCE) and a multiplier based on the Price/Earnings ratio (P/E ratio). Sometimes, determinate on the transaction, an additional premium on core deposits is also paid. These multipliers were obtained from historical data provided by *The Capital Group*, a firm that specializes in mergers and acquisitions.

Simply put, the tangible common equity (TCE) ratio is used to determine how much in losses a bank can take before the elimination of shareholder or owner equity. Investopedia.com further defines TCE as *"a ratio calculated by taking the value of the* *company's total equity and subtracting intangible assets, goodwill and preferred stock equity and then dividing by the value of the company's tangible assets. Tangible assets are the company's total assets less goodwill and intangibles".* Investopedia also states that this method has become more popular since the financial crisis of 2008 as it is a conservative way to evaluate worse case scenarios.

The P/E ratio is a ratio calculated by taking the share price or total price and dividing that number by the earnings.

Finally, some but not all acquisitions involve paying a premium on core deposits of the target bank. Core deposits are considered "local" deposits and used for the funding of loans.

Since the ownership of Bank X is private, there are no issued shares. However, all of the information needed to estimate a valuation of the bank can be calculated with information derived from the UBPR.

George Thompson of *The Capital Group*, a firm in Prairie Village, KS, that specializes in mergers and acquisitions has provided statistics on the number of transactions they have been involved with as of November 2017.

The following chart shows trends in the three main categories used for determining the value of a bank in regards to mergers and acquisitions.

Maintaining Growth in a Rural Community Bank

The information is based on banks with assets below $100 million. All data used in this section has been gathered from UBPR's for both banks using December 2016 data. A full report on median market statistics is located in *Appendix A*.

Number of Transactions	Price/TCE(x)	Price/Earnings(x)	Premium on Deposits
63	1.19	19.42	3.09

Based on information from the UBPR for Bank X, we can start to determine the approximate value of this bank.

	Bank X
Total Common Equity	$1,592,000
Net Income	$ 93,000

Since price is not known, we can calculate this with the following formula based on information provided by Mr. Thompson and the UBPR.

Total Common Equity(TCE) x Multiplying Factor(X) = Price(P)
$1,592,000x1.19=$1,867,680

A recalculation of the formula based on the Price/TCE method can be used to arrive at the average multiplier for this particular asset range to check the validity of the calculation.

Price(P)/Total Common Equity(TCE)=X
$1,867,680/$1,592,000=1.19

The following formula is used to determine the value using the P/E ratio:

Earnings x Multiplier = Price
$93,000x19.42=$1,806,060

Based on these calculations, the estimated valuations are relatively identical. However, Mr. Thompson has indicated that the majority of banks involved in mergers or acquisitions in this asset class rely on the Price/Earnings calculation to determine value. Therefore, it is assumed that Bank X has an approximate valuation of $1,806,060. This value is used for this project. However, the final sale price would be dependent on negotiations by both boards involved. One item to consider is approximately $120,000 in "Other Real Estate Owned" (ORE) that ICB would have no interest in acquiring. This would reduce the purchase price to $1,747,000.

Now that the value of Bank X is determined, it would have to be determined how the acquisition would be funded and what would be needed regards to capital requirements.

Total Assets ICB	$69,173,000
Total Assets Bank X	$20,172,000
Assets after Merger	$89,345,000

With the increased assets, a calculation would have to be completed to determine that the new bank would have adequate capitalization to meet regulatory requirements. Although capitalization can vary based on many factors within an organization, the board of ICB has the general rule of maintaining a capitalization of at least 10.5%. Currently, ICB has capitalization of over 12.5%. Bank X has a current capitalization of approximately 7.9%. The Holding Company (IFBH) has in excess of $3,000,000 in a stock portfolio consisting of blue chip stocks that could be sold in order to provide the necessary funding for this transaction. Structuring the sale in this manner would give ICB the ability to retain the capital of Bank X and maintain a healthy capitalization ratio of approximately 11.43%.

Reorganizing of some items on the balance sheet along with assistance from the holding company makes this a transaction that could be funded and completed. *Appendix B* shows a sample balance sheet of how this could be achieved.

After the transaction would be complete, it would then be necessary to locate areas where the bank may streamline departments so the newly formed bank can run more efficiently. Naturally, expenses would be the first area to explore for possible streamlining. The efficiency ratio is addressed in Section I. As of December 2016, the efficiency ratio of Bank X is approximately 9.27 as a percentage of average assets higher when compared to other banks in their peer group. The current *Assets per Employee* ratio is 1.84, whereas peer group is 3.99. This ratio ould indicate that Bank X is overstaffed.

Bank X currently operates the same core system as ICB. Theoretically, bookkeeping would be the first potential department that could benefit from streamlining as almost all functions can be localized to the main branch in Chillicothe. The loan department is another area that could be merged or reorganized based on the number and type of loan officers currently employed with Bank X.

Long-term contracts with service providers (data processing, debit card) would need to be taken into consideration as termination of these agreements will usually have very costly penalties.

Other factors that could have a significant impact on the future financial performance of the bank would be to determine current and future rate adjustments within the loan portfolio. Loans that are now generating a positive net return could create interest rate risk if adjustment periods are too long or if a bank were to have a large volume of long-term, fixed-rate loans on the bank's balance sheet.

2. Expansion of Online Mortgage Products

Development of online mortgage products is by far the least expensive option for potential growth. Typically, a company that offers the type of interface such as MortgageBot will require a lengthy contract for the use of their services. A contract period of three to five years is typical with such vendors. Additionally, a bank should consider the need for extra staff to handle additional loan traffic and loan review for quality control purposes. An example of other additional costs for this type of program could be broken down into three categories: operational expense, personnel costs, and advertising expense. Although the bank currently contracts with MortgageBot, it is included in this example to estimate as to whether the program could be entirely self-supported. Also for this project, it will be assumed the need for an additional loan officer and processor to handle online origination and closings and the monthly advertising budget as outlined in Section II. All estimated costs are on an annualized basis.

Operational Costs	\$20,460
Personnel (Loan Officer)[9]	\$39,860
Personnel (Processor)[9]	\$30,000
Advertising	\$ 7,280
Total Annualized	\$97,600

It is expected that the bank would have to rely on a smaller margin on loans generated entirely online to be competitive with other online lenders.

In Section II, Facebook Analytics suggests that a marketing campaign for the targeted demographics would generate 450-1100 views per day with a CTR of 5-32 (2%-3%) However, other online sources indicate that financial services have the second lowest CTR ratio of seventeen industries tracked of .56%[10]. This data suggests a more moderate CTR of just 2-6. Applying this information the bank could assume the following results for an online marketing campaign through Facebook and assuming a 10% actual application rate and a 50% approval rating of those applications submitted.

Annual Views	.56% CTR	10% Application Rate	50% Approval Rate	2.5% Margin
1,000	56	6	3	$ 7,000.00
2,000	112	11	6	$ 14,000.00
3,000	168	17	8	$ 21,000.00
4,000	224	22	11	$ 28,000.00
5,000	280	28	14	$ 35,000.00
6,000	336	34	17	$ 42,000.00
7,000	392	39	20	$ 49,000.00
8,000	448	45	22	$ 56,000.00
9,000	504	50	25	$ 63,000.00
10,000	560	56	28	$ 70,000.00
11,000	616	62	31	$ 77,000.00
12,000	672	67	34	$ 84,000.00
13,000	728	73	36	$ 91,000.00
14,000	784	78	39	$ 98,000.00

This table suggests that it would take 14,000 annual views (1,166 monthly views) for this program to break even. 1,166 views are at the extreme top of what the Facebook marketing sample in Section I estimate expected views to be.

There are a few considerations to reduce the budget for this program. Assuming that the above information is accurate, it appears that a separate full-time loan officer or processor would not be necessary for this program as it is ramped up. The implementation of this program could be divided among the existing staff. This reduction in cost would result in a budget of $28,000, or 11 funded loans per year for this program to break even. Any number of funded loans above this amount would be profit. The need for extra staff would become necessary if the bank were to recognize substantial loan volume through this program.

This data suggests that the only way to increase the reach of an online campaign would be to increase the advertising budget so that ads would place on Facebook feeds more often.

This program markets the banks in-house, variable rate loans and long-term, fixed-rate loans. There is some difficulty in getting a customer to choose a variable rate loan over a secondary market loan. A secondary market loan does not help the bank to grow assets as these loans are not kept on the balance sheet but have a direct impact on revenue.

3. Mortgage Loan Production Office (MLPO)

The implementation of a stand-alone MLPO has its own unique set of financial requirements for it to be successful. The two most significant expenses for an MLPO would be real estate and personnel costs. Theoretically, processing could be done in-house and not on site, but if volume were to be substantial, an additional processor would be needed either on-site or remotely. A simple annualized personnel budget for this type of program would be as follows[11].

Maintaining Growth in a Rural Community Bank

Mortgage Loan Officer	$40,000
Loan Processor	$35,000
Receptionist	$25,000
TOTAL	$100,000

A small office with excellent visibility to traffic would make an ideal location for this type of operation. An internet search for commercial property located within St. Joseph, Missouri has produced the following results[12].

Property	SQFT	Lease Amount	Term	Type	Misc. Expenses*	TOTAL
1311 Belt Hwy St. A	5600	$13.20	Annual	Mod. Gross		$73,920.00
1311 Belt Hwy St. C	2500	$11.00	Annual	Triple Net	$5,500.00	$33,000.00
2901 S Belt Hwy	2744	$9.72	Annual	Triple Net	$5,500.00	$32,171.68
2207 N Belt Hwy	3250	$9.00	Annual	Triple Net	$5,500.00	$34,750.00
139 N Belt Hwy St. H	1200	12.00	Annual	Triple Net	$5,500.00	$19,900.00

*Estimating costs of taxes, insurance, and maintenance for a triple net lease.

Looking at properties for lease, the price and size of the office available at 139 N Belt Hwy would be a logical choice. Total costs could be expected to be at minimum $119,900 for operation excluding such items as supplies, utilities, and advertising.

Based on current data, the bank is processing approximately 16 real estate loans per month between two loan officers and two processors. A general search for rates off of mortgage broker websites in St. Joseph suggests that due to competition, the majority of brokers or banks are currently advertising a rate that would indicate a 1% yield on long-term, fixed-rate loans. Naturally, a bank is going to have a loan portfolio in size from very small to very large. Based on this information and using the average home price in St. Joseph of $104,600 and a conventional loan amount of $83,680 (80% LTV), a sample income projection can now be produced.

Monthly Volume	1% Margin	Employee	Building	Profit/Loss
1	$ 836.00	$ (8,333.00)	$ (1,658.00)	$ (9,155.00)
2	$ 1,672.00	$ (8,333.00)	$ (1,658.00)	$ (8,319.00)
3	$ 2,508.00	$ (8,333.00)	$ (1,658.00)	$ (7,483.00)
4	$ 3,344.00	$ (8,333.00)	$ (1,658.00)	$ (6,647.00)
5	$ 4,180.00	$ (8,333.00)	$ (1,658.00)	$ (5,811.00)
6	$ 5,016.00	$ (8,333.00)	$ (1,658.00)	$ (4,975.00)
7	$ 5,852.00	$ (8,333.00)	$ (1,658.00)	$ (4,139.00)
8	$ 6,688.00	$ (8,333.00)	$ (1,658.00)	$ (3,303.00)
9	$ 7,524.00	$ (8,333.00)	$ (1,658.00)	$ (2,467.00)
10	$ 8,360.00	$ (8,333.00)	$ (1,658.00)	$ (1,631.00)
11	$ 9,196.00	$ (8,333.00)	$ (1,658.00)	$ (795.00)
12	$ 10,032.00	$ (8,333.00)	$ (1,658.00)	$ 41.00
13	$ 10,868.00	$ (8,333.00)	$ (1,658.00)	$ 877.00
14	$ 11,704.00	$ (8,333.00)	$ (1,658.00)	$ 1,713.00
15	$ 12,540.00	$ (8,333.00)	$ (1,658.00)	$ 2,549.00
16	$ 13,376.00	$ (8,333.00)	$ (1,658.00)	$ 3,385.00
17	$ 14,212.00	$ (8,333.00)	$ (1,658.00)	$ 4,221.00
18	$ 15,048.00	$ (8,333.00)	$ (1,658.00)	$ 5,057.00
19	$ 15,884.00	$ (8,333.00)	$ (1,658.00)	$ 5,893.00
20	$ 16,720.00	$ (8,333.00)	$ (1,658.00)	$ 6,729.00

This data suggest that after taking into account the staffing, rent, and reduced margin to maintain competitiveness in that market, the potential of increasing any profit or supporting any growth would be very inefficient based on these numbers. Also, a newly formed office could see several months before positive results could be recognized. Therefore, it is assumed that a standalone MLPO would operate at a loss for an indeterminate amount of time.

SECTION IV: Non-Financial Impacts

1. **Bank Acquisition or Merger**

The most critical non-financial impact to consider in this type of transaction would be the effect on current staff.

As evidenced Section II, it is noted that due to the inefficiency of Bank X, there is the strong possibility of the need to reassign staff or the unfortunate need to eliminate departments or employees entirely. This possible shift or elimination of departments or current employees would most likely lower morale among the retained staff and create negative rapport with new coworkers and management leading to challenges in effective leadership. Furthermore, it could also have a negative impact on the public image of the new bank if the first steps taken were to eliminate staff. Employees tend to create strong bonds amongst one another and disruption within this could create animosity within the organization. A drop in morale of the team would also most likely lead to a decrease in productivity which would have a direct impact on the income of the newly formed bank.

ICB does know that the daughter of the owners of Bank X is currently employed in a managing role. It would be important for ICB to try to retain this employee as the acting manager of that location during the transition. This serves two purposes. It will ensure good rapport with existing staff and customers as they have someone working with them that they know and feel comfortable with and it alleviates the need of taking someone out of Chillicothe to manage the day-to-day operations of the new location.

The second most crucial non-financial impact in regards to a bank merger or acquisition would be that of the current culture within the bank being acquired.

Culture is defined as *"the ideas, customs, and social behavior of a particular people or society."* Culture contributes to creating public trust in banks and a positive reputation among shareholders/owners and regulators. A merger of institutions with definitive different cultures could create a "culture clash" and create a challenging work environment for everyone involved.

Naturally, some indicators of the culture of an institution will present themselves before the transaction takes place and during the due diligence. An extensive examination of the loan portfolio will identify areas of risk created by a culture that might not necessarily be presented in a review of the UBPR or Call Report. This would create an ideal time to address whether or not a change in culture would be necessary. A review of the loan portfolio could expose items such as substandard loan originations, undesirable business practices, and could potentially identify illegal activity such as predatory lending or previously unrecognized regulatory violations.

Furthermore, extensive interviews of retained employees should be completed to determine that their values align with those of the buying bank. This identification of differences in culture is not all negative as it could expose potential inefficiencies within departments of the current organization. Thorough communication between management and staff should be maintained to determine that the alignment is working positively. Having a culture that is not in alignment has a tremendous risk on the acquisition being successful. It will be very important to continually define the values of the bank and monitor goals of operations.

2. Expansion of Online Mortgage Products

The most critical non-financial impact of expanding online mortgage products would be the necessity to maintain safe and sound underwriting practices.

Section I explains that the bank maintains strong underwriting and has a full relationship with the majority of customers by having both deposit and loan accounts.

Therefore, verification of income and employment is as simple as logging into the core system to gather this information. By expanding this product, the bank will be moving into areas where customers are not as well known, and the potential for a more diverse type of borrower will have to be met, meaning that the probability of having to underwrite different income sources that the bank does not typically see in its residential loan applications. As this is an automated underwriting system, loans are approved based on the information the customer inputs but manual verification of information is still necessary, or in the instance of a self-employed borrower, careful analysis of tax returns to calculate the actual repayment ability of a customer. It would also be necessary for the bank to make sure that loan officers and processors are kept current on training or retrained in origination, delivery, servicing, and post quality control procedures.

Also, expanding into areas outside of the current trade area would reduce or eliminate the "face-to-face" interactions and would reduce the effectiveness of advertising local servicing as there would be little personal interaction with customers.

Another non-financial impact would be that of collateral evaluations. As stated above, currently the majority of mortgages are originated in areas where knowledge of the housing market exists. Therefore, the familiarity of local trends can be helpful in evaluating or validating appraisals. As the bank expands its business outside of the trade area, the bank becomes more reliant on the validity of third-party evaluations to determine the value of the collateral. Additional training for officers on appraisal review would be highly encouraged.

3. Mortgage Loan Production Office (MLPO)

Opening a stand-alone MLPO would carry comparable non-financial impacts associated with both a merger or acquisition and expansion of online mortgage products. In addition to those same non-financial impacts, one would need to address finding a reliable officer that can work independently and originate loans that the bank considers desirable and whose values align with that of the organization.

The possibility of fraud can be a concern for someone working on their own without direct oversight. For instance, recently in St. Louis, MO, a loan officer that was in charge of a loan production office plead guilty to bank fraud. Many of the loans that the officer made were substandard and placed a high level of risk on the bank. Additionally, this officer engaged in unlawful self-dealing by originating loans to which he and other associated benefited by concealing their interest in the loans. The officer set up a straw party and directed more than $906,000 in loan proceeds to pay off obligations had been extended to the officer at another area bank[13]. Therefore, if the bank were to open this type of office, it would be imperative that dual controls be put in place to monitor loan activity to make sure that the bank limits exposure to such financial and legal risks.

CONCLUSION

After studying the financial and non-financial impacts of each scenario, the recommendation is made that the bank continue the search for a bank to acquire, whether it be Bank X or a yet to be identified bank in a desirable location where ICB can have the ability to expand into other markets. This gives the bank a greater footprint potentially open access to customers that ICB currently isn’t able to reach or products that aren’t currently offered.

In combination with this, it is recommended that the bank take the steps necessary to increase the origination of online mortgages by expanding the trade area that these loans are marketed in, but not a great enough distance that the bank cannot continue to advertise the offering of a "locally serviced" loan. This type of product has the potential to generate strong monthly income and can be done without a lot of added advertising expense and can easily be managed with existing loan staff.

Attaining these goals can make a larger, more profitable organization and would thereby create a stronger bank and continue to create increased value to the shareholders of Investors Community Bank well into the future.

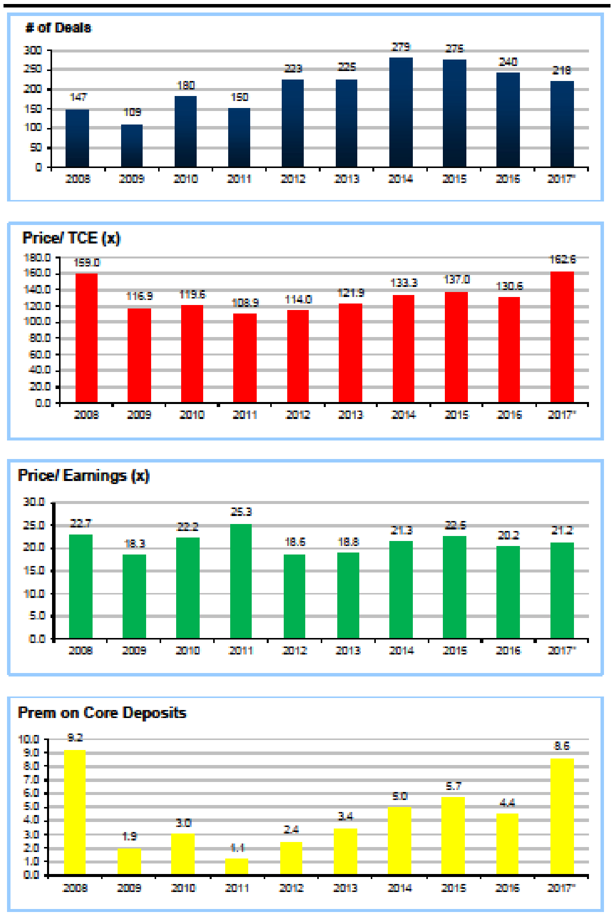
Maintaining Growth in a Rural Community Bank

APPENDIX A

Maintaining Growth in a Rural Community Bank

MEDIAN M&A MARKET STATISTICS
Prepared by The Capital Corporation
As of November 14, 2017

Target Assets Range Min ($M)	Target Assets Range Max ($M)	# of Deals	Price/ TCE (x)	Price/ Earnings (x)	Prem on Core Deposits
Below	100	63	119.00	19.42	3.09
100	250	61	138.94	24.55	6.09
250	500	45	168.27	18.28	9.34
500	1,000	17	178.84	18.40	12.34
Above	1,000	32	199.66	22.27	14.49



Country Club Financial Services, Inc. dba The Capital Corporation Member FINRA, SIPC 11/14/2017

Provided by SNL Financial

APPENDIX B

Maintaining Growth in a Rural Community Bank

SAMPLE ACQUISITION BALANCE SHEET

x 1,000	**Bank X**	**ICB**	**Combined**	**Adjustments**	**Final**
Loans	13675.00	25984.00	39659.00		39659.00
Reserve	-148.00	-641.00	-789.00		-789.00
Net Loans	13527.00	25343.00	38870.00		38870.00
Investments	5606.00	40298.00	45904.00		45904.00
Cash & Due Banks	444.00	1728.00	2172.00		2172.00
Premise	297.00	679.00	976.00		976.00
ORE	120.00	-	120.00	-120.00	0.00
Acceptances	178.00	1125.00	1303.00		1303.00
Total Assets	**20172.00**	**69173.00**	**89345.00**	**-120.00**	**89225.00**
Depostis	18546.00	57322.00	75868.00		75868.00
FHLB		2900.00	2900.00		2900.00
Acceptances	34.00	225.00	259.00		259.00
Total Liabilities	**18580.00**	**60447.00**	**79027.00**		**79027.00**
Capital	1592.00	8726.00	10318.00		10198.00
Total Liab & Capital	20172.00	69173.00	89345.00		89225.00
Capitalization	**7.89%**	**12.61%**			**11.43%**

All data gathered from 12/31/2016 UBPR.

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