2020 Community Bank Outlook

With robust consumer spending continuing to drive the economy, and with benefits from trade agreements with Mexico, Canada and China, prospects for continuing the longest economic expansion in U.S. history into 2020 appear favorable. This has supported the bullish stock market outlook. Yet, uncertainty remains as at least some economists are predicting a recession in coming months and a market selloff. Increased Mideast tensions may be a destabilizing force and could impact oil prices.

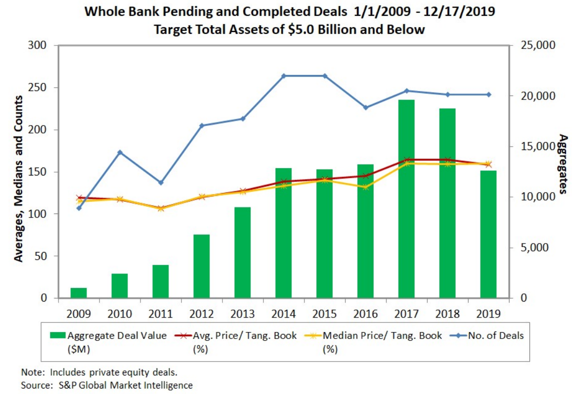
Political risk stemming from impeachment and the 2020 elections could result in a reversal of both the 2018 tax cuts and bank regulatory relief, and may cause business and consumer confidence to erode. At least currently, the prospect for higher interest rates with a greater positive yield curve slope seem less likely; thus, downward pressure on the net interest margin remains.

If there is a change in the administration and significantly increased social welfare spending is only partially offset by higher taxes, even greater budget deficits may be ushered in. Further ballooning the national debt will ultimately push interest rates higher, hampering economic growth.

In view of the moderate GDP outlook and favorable equities markets, strong regulatory capital ratios, robust credit quality and good profitability for the banking industry, one cannot help but think it is almost like having a CAMELS rating of "1" that can only go down. It is only a matter of time when the peak will be reached as the current economic expansion is already the longest on record. We find clients increasingly cautious in their planning and would be happy to assist with your planning.

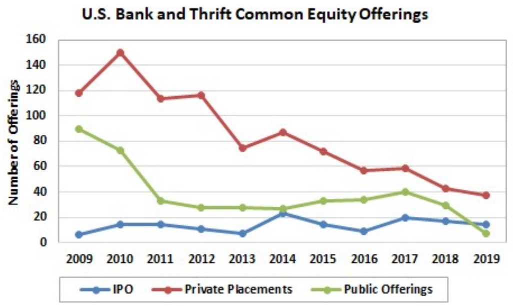
Merger Activity

The number of community bank mergers remains unchanged at 242 in both 2018 and 2019. The median P/TBV ratio was relatively unchanged at 160%. With increased community bank trading prices, buyers' currencies are stronger, which if sustained, should continue to entice potential sellers. This trend could accelerate further if political risk increases and/or economic growth declines, which could negatively impact asset quality, loan and deposit production and consequently, earnings.



Equity Offerings Decline

Common equity offerings decreased from 89 to 58 between 2018 and 2019. The decline included public offerings, which decreased sharply from 29 to 7, and private placements, which decreased from 43 to 37. IPOs decreased from 17 to 14. As market conditions remain favorable, the decline reflects strong bank capital levels and continued debt offerings given low interest rates. Conditions for mutual thrift conversions remain favorable.



Positioning for 2020 & Beyond

Below are a few of our thoughts on how to best position your bank in 2020:

- We continue to recommend considering potential political developments that could lead to higher corporate tax rates and increased regulation. Also, evaluate economic prospects in the context of political and international developments, and trade policy.
- Incorporate these risks in assessing projected future loan losses, the adequacy of the ALLL and earnings.
- Consider underwriting standards to safeguard against increasing credit risk in the portfolio and take advantage of currently strong credit performance overall to reduce the exposure to credits more vulnerable to potential declines in borrower cash flow and/or collateral valuation.
- Prepare for the likely sunset of Libor in 2021 by reviewing existing loan notes and developing a plan in 2020 to discontinue the use of Libor.
- Continuously assess deposit competition and rates and evaluate opportunities to lower rates to offset potential margin compression as asset yields decline.
- Focus on operating efficiency, including process reengineering and profitability of branches and business lines, to offset the impact of margin compression.
- Plan for continued tight short-to-intermediate term labor market conditions and further increases in health care costs.
- Consider the potential impact on projected earnings and capital ratios in more adverse economic and operating environments by running adverse planning scenarios against baseline financial projections. Potential declines in real estate values, higher loan losses, a less favorable mortgage banking environment and higher taxes are examples of items to consider in such scenarios.