alloya

CAPITAL MARKETS *monthly*

VOL 2 | MARCH 2023

GENERAL MARKET OVERVIEW

Last month, credit union liquidity remained tight as interest rates increased ever so slightly. The consensus agrees this trend will continue for the foreseeable future, but we are seeing a slight loosening of liquidity within the credit union system. While this is a welcomed sign, it's not the panacea we all would hope for.

To date, tax return refunds are less than in years past. This, coupled with high outstanding debt on the balance sheet, means that any incoming funds will be used to pay off those outstanding balances to reduce the interest expense that credit unions are combatting.

All things being equal, we are inching closer to normalized levels (pre-2020), and it is our hope that within the next two years, stabilization within the industry will occur.

In the meantime, let's do what we can with what we have; let's focus on what we can control and not fret over the rest.

Bank Term Funding Program

In light of what's already been said and published about the recent turmoil in the banking industry, we are choosing not to analyze the causes of the failures or the potential ramifications for our industry. Instead, let's unpack the Bank Term Funding Program (BTFP), which has been created in response to these failures. *Continued on page 2*

Here's the 10,000-foot view:

1. The financial institution pledges eligible securities to the Federal Reserve Banks (FRBs).
   - Acceptable collateral is only that which is eligible for purchase by the FRBs in open market conditions.
   - Collateral is pledged at a par value.
2. The financial institution receives a loan for up to one year (advance requests can be made no later than March 11, 2024).
   - Loans can be repaid at any time without penalty and are limited to available collateral pledged.
3. The advance rate is equal to the one-year overnight index swap rate plus 10 basis points.
4. There are no fees associated with this program other than the borrowing rate.

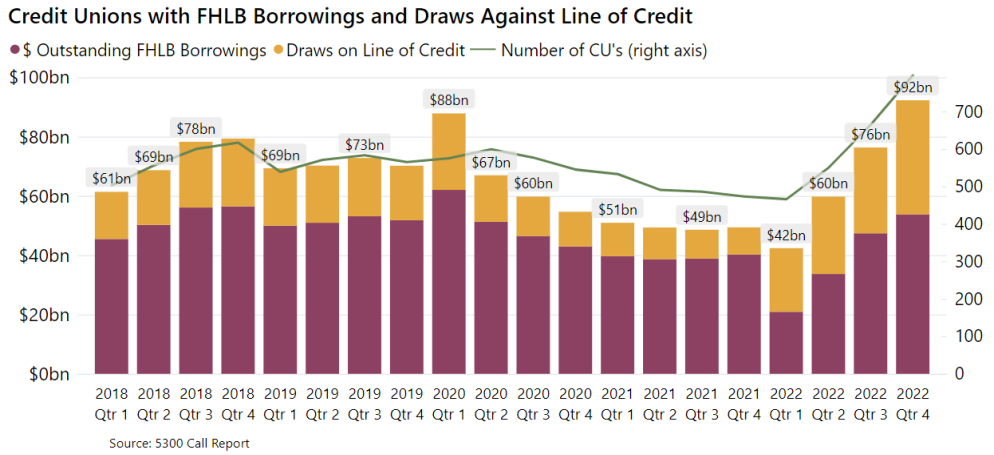
This is a good opportunity for credit unions with securities portfolios that are eligible to be pledged and who could use additional liquidity access. For a deeper dive into the BTFP, **visit the Federal Reserve's website**.

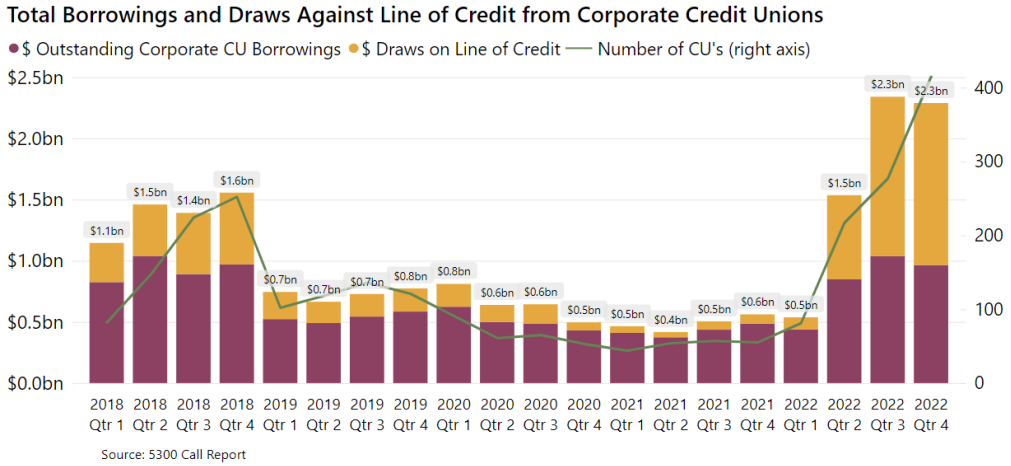
Non-Member Deposits + Funding (Borrowing)

As liquidity remains tight, there are two primary liquidity sources for credit unions to tap. Depending on the credit union's operations and current rates, one source might be preferable to the other.

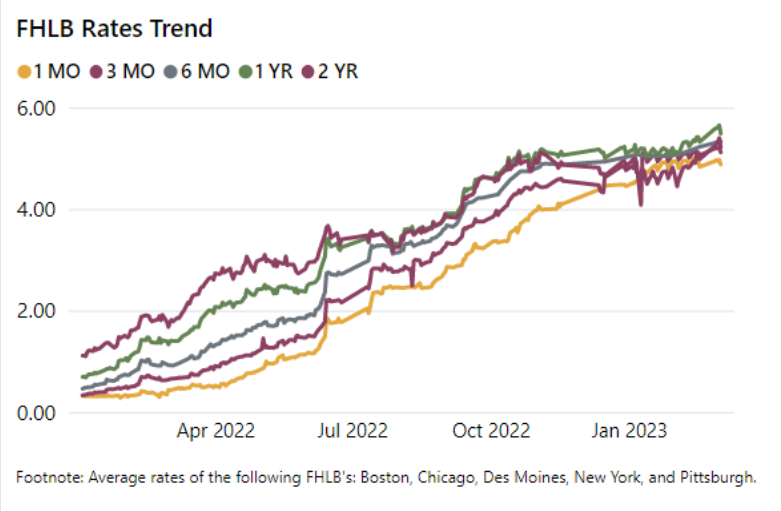
1. Issuing non-member deposits
2. Borrowing from other financial institutions

Credit unions have been tapping these sources in full force – so much so that outstanding corporate borrowings have returned to their all-time highs. Federal Home Loan Bank borrowings are the highest they've been years. Anecdotally, we believe it's been at least 15 years since total borrowings have been this high across the industry. *Continued on page 3*



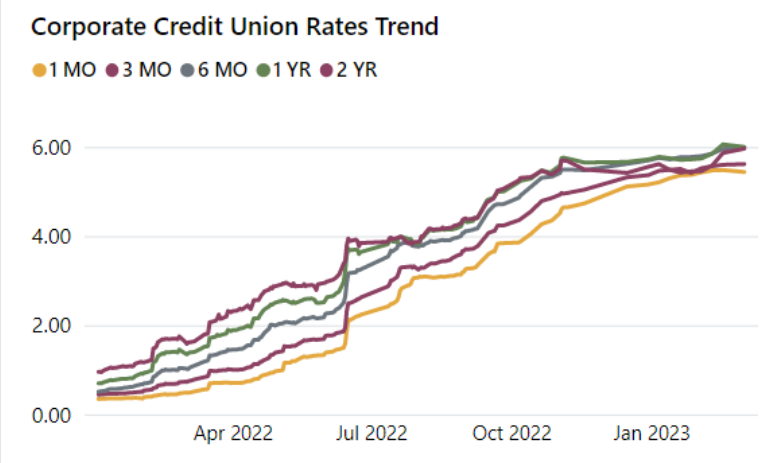


Non-member deposit rates are supplied by Primary Financial Company, LLC. Alloya is an owner of Primary Financial, the proprietor of SimpliCD, a brokered certificate program that helps credit unions efficiently issue and invest in non-member deposits. Rates are subject to change.



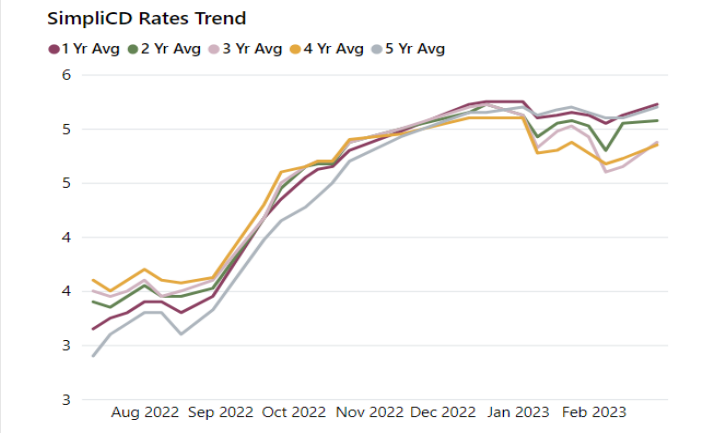
FHLB and Corporate CU Rates as of 3/3/2023

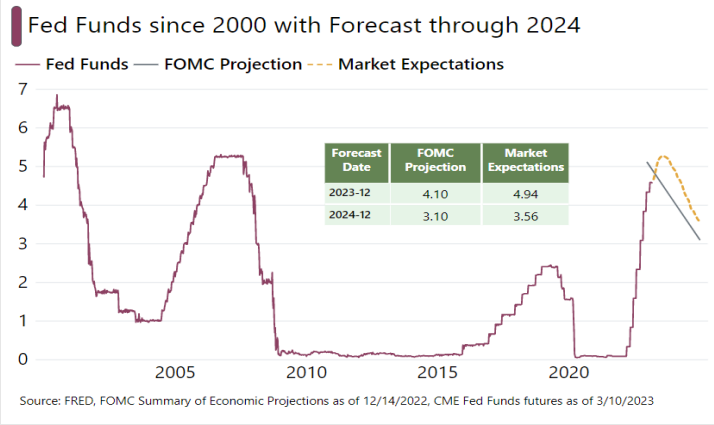
Term	Corp CU Avg	FHLB Avg
1 MO	5.44	4.88
3 MO	5.62	5.12
6 MO	6.00	5.34
1 YR	6.00	5.49
2 YR	5.96	5.22



SimpliCD Rates Trend

	Greater	Lesser
6 MO	4.43	4.29
1 YR	4.53	4.39
2 YR	4.55	4.38
3 YR	4.54	4.35
5 YR	4.53	4.37



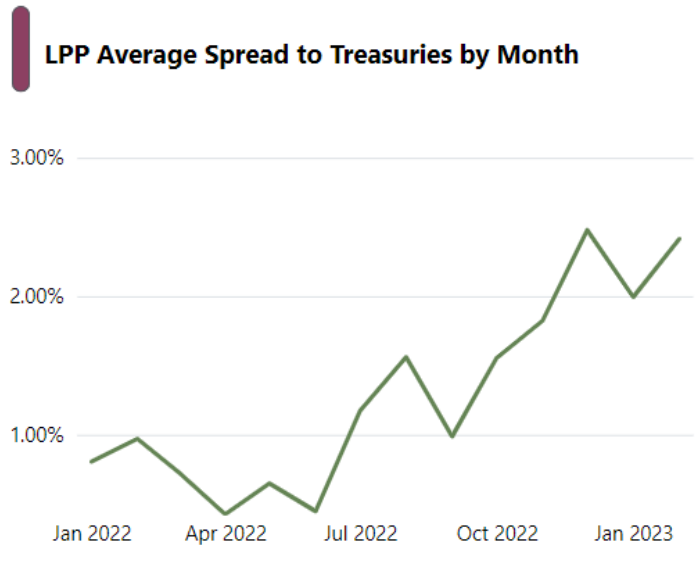


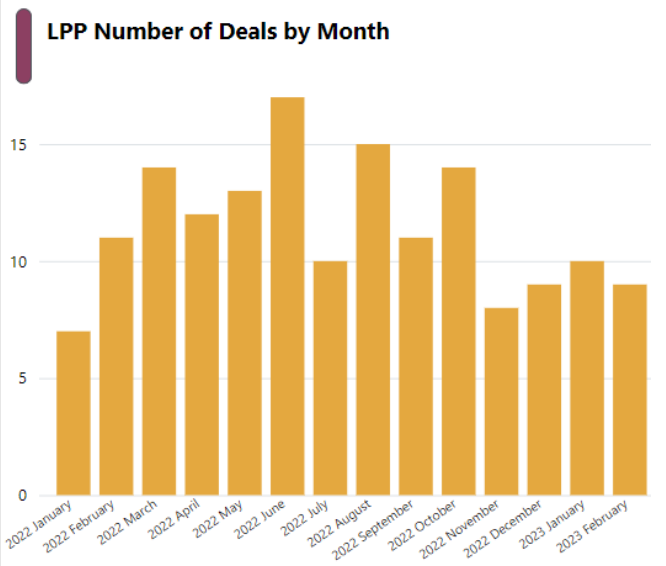
As you can see from these graphs, rates have continued to rise steadily no matter where you choose to source liquidity. As previously noted, with semi-loosening liquidity, credit unions are looking to pay off outstanding debt to reduce their interest expense. This means loan growth will likely continue to remain stagnant and in line with Q4 2022 levels. The same is likely for investment growth as well. Barring major changes, the industry is primed to remain even for the near future.

Interestingly enough, in the last graph, you'll notice the federal funds forecast is pricing a nice decrease at the end of 2023 and into 2024. It remains to be seen whether that will come true, but a lowered fed funds forecast is likely a welcomed reprieve to credit unions across the board.

LP MARKET OVERVIEW

While liquidity is still tight, there are signs of normalization in the loan participation space – a welcomed reprieve for credit unions looking to sell. Alloya continues to support our usual number of transactions, albeit at a lower volume than normal. We're also seeing an increase in smaller credit unions entering and supporting the market. In buying loan participations, these credit unions (generally under $100 million in assets) are picking up solid returns compared to other investments. As seen in the graph below (left), the average yield to investors in the past month has been 2.50% above the interpolated Treasury – 75% above historical spreads on a similar loan participation.





What does this mean? It's a call to action for any credit union with available funds: ***Get into the market ASAP!*** Yields are at all-time highs, and while they may fluctuate over the interim, we do not anticipate these yields staying this high for a long period.

Above is a graph of the transactions we've seen since the release of our last issue of *Capital Markets Monthly*. The average number of transactions remains unchanged; however, the deal sizes are on the smaller side. This makes sense, given that many smaller credit unions have more liquidity available than some of their larger counterparts.

It's good to see credit unions taking advantage of the market and utilizing their purchasing power to benefit both their balance sheet and other credit unions' liquidity positions.

SUB DEBT MARKET OVERVIEW

Subordinated debt is one of three ways credit unions can raise capital and boost future growth initiatives by increasing net worth. When considering subordinated debt issuance, keep in mind it can take up to six months to receive regulatory approval from the NCUA. Once approved, credit unions can issue the approved funds for up to two years, giving credit unions more flexibility to time the market appropriately to fit their strategic plan. There have been several notable issuances that have hit the market in 2023. Issuing credit union yields have been in the 7.75%-8.50% range depending on ratings received and the strength of the credit union.

Notable Deals (2023)

Region	WESTERN	SOUTHERN	SOUTHERN	WESTERN
ASSET SIZE	11,000,000,000	1,300,000,000	1,100,000,000	12,000,000,000
NET WORTH	~9.25%	~8.25%	~8.00%	~9.00%
ISSUANCE AMOUNT	100,000,000.00	40,000,000.00	18,000,000.00	100,000,000.00
FIXED TO FLOAT	Y	Y	Y	Y
RATE	7.75%	8.00%	7.50%	8.00%
RATING	BBB-	N/A	N/A	BBB-
CLOSING	23-Jan	23-Feb	23-Feb	23-Mar

While the Fed is expected to continue raising rates in 2023 to fight inflation, this also presents a great investment opportunity for credit unions in the subordinated debt market. Issuances are typically sold with a 10-year / 5-year no-call structure, enabling credit unions to lock in this longer-term investment at 7.75%-8.50% in the current rate environment. *Continued on page 6*

SUB DEBT MARKET OVERVIEW

In the past, investing credit unions have been hesitant to purchase subordinated debt due to limiting regulatory restrictions. These credit unions should look to invest in subordinated debt securities that have a CUSIP attached to the issuance, which increases marketability in the secondary market if they have the need to issue themselves in the future. Inventory has been relatively low in 2022 and thus far in 2023 due to consistent Fed rate hikes, but should rates stabilize, we expect more inventory to become available in the second half of 2023.

Current Market Rates

Issuance Size	IG Egan Jones	Kroll BBB-	Kroll BBB	Kroll BBB+	Unrated
50MM	8.000% +/-	8.000% +/-	8.000% +/-	8.000% +/-	**7.750%- 8.500% +/-**
50MM-100MM	8.000% +/-	8.000% +/-	8.000% +/-	8.000% +/-	
100MM+	7.500% +/-	7.500% +/-	7.500% +/-	7.500% +/-	

BALANCE SHEET STRATEGY

The NCUA is expected to more heavily focus on credit unions' contingency funding plans. What does that mean? Our suggestion is very simple: Perform a yearly review of your contingency funding plan. Ensure that you're meeting the minimum requirements set forth by the NCUA.

Not sure where to start? Visit **www.alloyacorp.org/liquiditysimplified** to request a liquidity check-up with our experts. Together, we'll ensure your credit union is up to date with what you need to comply with NCUA regulations. For additional details, **visit the NCUA website** for an overview of their contingency funding requirements.

CONCLUSION

No one knows where rates will be in the near term, so there's no reason to spend our time trying to guess. It's like drinking from a fire hose – an overwhelmingly impossible task! Instead, let's take the data we have and set our rates accordingly to ensure your credit union has the flexibility within its balance sheet to deal with turbulent markets.