PINNACLE BANK
Member FDIC

Loan Pricing

Our Mission Statement: To serve our community, to provide value to our clients, to respect employees and provide shareholders sustained growth and earnings with their investment.

Our Service Philosophy: We will build and promote valuable partnerships by providing outstanding service that consistently exceeds all expectations.

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Memo

Date: August 17, 2021
To: File
CC: Senior Loan Committee (SLC); Business & Branch Bankers
From: Loan Pricing Committee (LPC)
Subject: Loan Pricing

Description of Item
The purpose of this memorandum is to provide an update for commercial and consumer loan pricing strategy(ies) and periodically set key rates or targets. This information is valid until a new memo is published. Pricing will be reassessed periodically to determine the validity of return on rates and structures[1].

Pricing Standards
The Bank strives to obtain a Return on Equity (ROE) of twenty (20) percent when pricing commercial loan relationships. The sophistication of the Loan Pricing Model (LPM) allows for consideration of all inputs to generate the ending ROE. Two of the primary considerations the LPM uses to gauge return are the "Product Category" (consisting of a sub classification and NAICS code in most cases), and the Cost of Funds (COF). The product category is typically a C&I classification accompanied by a NAICS code. The NAICS classification is how the LPM gauges the risk of each industry by looking at historical loss experience in a market area. Some industries may require a higher yield due to higher risk, while others require less; differing credit quality of customers also determines the rate. ***Two or more customers in the same industry can price VERY differently and require a different rate.*** The COF is another driver in determining the profitability of a loan over its lifetime. The COF of a loan is determined by three components: (1) The expected life of the loan; multiple factors are taken into consideration through the LPM's prepayment module to determine the expected life of the loan, (2) The LIBOR/Swap curve, (3) The Spread Adjuster; this amount adds to, or subtracts from, the LIBOR/Swap curve rates and is intended to better calculate where the Bank will fund itself relative to LIBOR rates over the life of the instrument.

Loan/Relationship Repricing(s) – Margin Protection
In any type of market environment, the Bank aims to protect its yield on assets (primarily loan contracts) relative to deposit costs. The following should be considerations when negotiating rate:

- **Bottom Line** - Protect the Banks margin.
- **New Business** - Competition is implicit. On occasion, the Bank will go below a 20% ROE.
- **Refinance(s) of Non-Matured Loans** – Review the existing relationship and determine a rate that still adds value to the customer; protect existing yield (i.e. If currently at 5.50%, maybe a twenty-five (25) basis point reduction is appropriate). In these instances, ROE is a component, but just because the model hits 20% does not guarantee that a significant rate reduction will be approved.
    - Consider prepayment penalty language. What value does that add/protect against the need to match a competitor(s) quote?
    - ***REMEMBER:*** *The customer entered a contract with the Bank for a set rate and term. Repricing ahead of schedule breaks that contract and prepayment penalties may be enforced.*
- **Refinance(s) of Matured Loans** – The Bank still wants to add value. However, targeting lower rates given the ROE states 20% may not be necessary; ***it is okay to exceed a 20% ROE***. Target a rate close but lower than the existing rate. Unless it is a competitive situation, the best/lowest rate may not be necessary.
    - ***REMEMBER:*** *Relationship customers are with the Bank due to our relationship value.*

Rate Structures
The Bank tolerates long-term fixed loans[2] conscious that the Federal Deposit Insurance Corporation (FDIC) prefers banks to maintain a long-term asset pool no greater than forty (40) percent of total assets. The Bank mitigates a true fixed rate structure through use of its "Hybrid Pricing." This allows a borrower to lock in an initial fixed rate term, typically for five (5) years, thereafter, converting to an adjustable structure allowing for rate resets over the remaining life of the loan. The adjustable reset periods carry a rate floor and ceiling offering protection to the Bank and borrower. While the benefits of this structure offer interest rate risk protection for the Bank and fewer number of renewals for the borrower it does, however, expose the Bank to

[1] The LPC reserves the right to reassess pricing at any time given market movement and rate decisions made by the Federal Open Market Committee (FOMC).
[2] **Long-Term Fixed:** Loans and debt securities with remaining maturities or repricing intervals of over five (5) years.

a growing pool of long-term assets. While there are mitigating factors with a "Hybrid Pricing" structure, the Bank's conservative approach is preferably not to exceed the long-term asset limit. Therefore, the LPC prefers to limit structures to a 5-year balloon, with the life of the loan not to exceed its beneficial use. Hybrid rate structures may be utilized on individual loans of $2 million or less, and on any owner-occupied real estate loan regardless of size.

Poultry Rate Structures

Pinnacle Bank recognizes the unique structure of the poultry industry, and as such establishes pricing consistency for its poultry customer's/portfolio to avoid rate cannibalization/repricing of existing loans due to willing transparency of borrower's in the industry to communicate rates and terms. Given the market reaction to the coronavirus (COVID-19) Pinnacle Bank's Executive Management recognizes other financers in local markets are offering aggressive rates and terms. To combat and protect existing relationships, in addition to capitalizing on new loan activity, the following is to be adhered to when pricing poultry loans. The pricing updates contained herein act as a ***minimum standard***. The structures below will remain in effect for three (3) months from the date of this memorandum, at which time pricing will be reassessed to determine the validity of return on the rate(s) and structure(s)

Poultry Refinance/Modification of Existing Loans and New Loan Structures:

- Engage with customers and educate them on why we cannot reprice: potential short-term nature of this rate environment.
- If the customer(s) do not back down from a lower rate:
  - Confirm if this is their own request or if they have been pursued or received an offer from another Bank.
  - Document other bank(s) offer(s), (hard copy or verbal offer from the other bank(s)).
  - Discuss prepayment penalties, fees and refinancing costs.
    - Modification fees should be charged as follows:
      - 0.50% with a minimum of $375, whichever is **HIGHER.**
      - If the rate is reduced by more than 1%, a **MINIMUM** fee of 0.50% will apply with an additional fee of 0.25% for each 0.50% reduction in rate (i.e. A 2% rate decrease would require a 1% modification fee); **MAX of 1%.**
  - Stay short. However, long-term financing for poultry is an option given the repricing nature of the industry.
- ***5-Year Balloon:***
  - 4.00% for a ten (10) year amortization.
  - 4.25% for a fifteen (15) year amortization.
- ***Fully Amortizing:***
  - 4.50% for ten (10) years fully amortized.
  - 4.75% for fifteen (15) years fully amortized.
- ***Hybrid Structure[3] - Ten (10) and Fifteen (15) Year Fully Amortizing Loan:***
  - Initial fixed rate for the first five (5) years of the commitment should reflect the balloon rates above.
  - Adjustable rate of Prime + 1.00% for the remaining term(s); floor 4.00%, ceiling 6.00%. Resets every five (5) years.
- ***Construction to Permanent Structure[4]:***
  - The construction period may be priced with the same initial five (5) year rate for each structure above.

[3] **Hybrid Structure:** This structure will carry the same initial five (5) year fixed rate as the balloon structure for a ten (10) or fifteen (15) year loan. While there is a preset structure for the adjustable period, this portion of the loan may be structured differently dependent upon the specific borrower's credit/risk profile; spread to Prime, floor rate, ceiling rate, and rate change frequency may be negotiated **(ROE must meet the Bank's return requirements)**.

[4] **Construction to Permanent Structure:** Rate commitments are only good for the initial construction terms agreed upon. Any disagreements between the borrower and builder (or delays caused by the integrator) that delay progress of construction where permanent financing is delayed by three (3) months or more from the initial agreed upon terms will subject the loan to current market rates.

SBA Rate Structures

The following addresses the process flow for originating Small Business Association (SBA) loans, whereas the following should take place:

- Lender(s) will work in consultation with the SBA Lending Manager to determine appropriate pricing.
- Lender(s) will utilize the Pacific Coast Bankers Bank (PCBB) pricing model to ensure adequate profitability. Specifically:
  - For any/all SBA loans the "Product Category/Product Type" should be SBA.
    - This field impacts the assigned costs for origination and maintenance, the expected duration, and the credit risk.
  - The appropriate NAICS code will need to be assigned.
    - In combination with the SBA classification, these components allow the model to price to the appropriate risk.
- Lender to target a ROE of twenty (20) percent.
  - ***<u>DO NOT</u>*** input the guaranteed percentage in the model.
    - This methodology prices the loan risk absent the guarantee, which effectively risk base prices the loan in the case the SBA guarantee is void at a future time.
- All other pricing procedures and approval routes to be adhered to during the approval process.

Commercial Loan Pricing

- The target Return on Equity (ROE) is 20%.
- For Commercial Lines of Credit and floating rate loans the floor is set at 4.75% and the ceiling is set at 12.00%.
- Loans collateralized by Pinnacle Bank CDs, the rate is the current CD yield + 2.00%.
- For Letters of Credit a one (1) percent fee applies. In the event of a draw a default rate of Prime + 2.00% applies.
- Rate quotes are good for two (2) months. After two (2) months, a new LPM should be generated. Please contact the Finance Department if you need any assistance.

Consumer Loan Pricing

- Refer to the Consumer Loan Rate Calculator for current rates.
- The only floating rate for consumers is the HELOC, and there is no floor, but the ceiling is 12%.
- If there is more than one (1) type of collateral for a loan, a blended rate is required. Please contact the Finance Department for these rates. This includes partially collateralized and partially unsecured loans (i.e.: a loan for $10,000 collateralized by a car worth $9,000, leaving $1,000 unsecured).
- Rates published in the Consumer Loan Rate Calculator are applicable as of the stated date. If the loan application date is prior to the stated date on the Calculator, the lender must contact Finance for the historical rate.

Employee (Consumer Purpose) Pricing

- Prior to April 15, 2012, employees were given the lower of Prime (minimum of 5.50%) or the Consumer Rate Sheet.
- Employee tiers are established at 85% of the middle consumer pricing tier.
- The rate for PLCs is set periodically by the Loan Pricing Committee.
- Employee loans collateralized by Pinnacle Bank CDs, HELOCs, ARMs, long term fixed rate mortgages, and those using the FasTrack product will be priced at the prevailing rates on the Consumer Rate Sheet.

Notes

- There are no floors on HELOCs or loans secured by CDs.
- Consumer loans with multiple parties may use the best of the credit scores for the Consumer Loan Rate Calculator.
- A rate discount of twenty-five (25) basis points may be given on consumer loans if the payments are set up on Automatic Funds Transfer (AFT). The exceptions to this offer are HELOCs, ARMs, Fixed Rate Mortgages (FRM) 10 years or longer, and loans secured by Pinnacle Bank deposits.

*****This file will be located in the Finance Department for further reference*****

As developed initially on April 27, 2012; 1st revision on May 11, 2012; 2nd revision on August 24, 2012; 3rd revision on July 10, 2014; 4th revision on December 1, 2020; 5th revision on August 17, 2021.

<u>Revision Notes</u>

- **April 27, 2012:** Memo implementation.
- **May 11, 2012:** Added language to Commercial Loan Pricing for rate quote expiration (two (2) months from approval); added language to Consumer Loan Pricing for multiple collateral/blended rates.
- **August 24, 2012:** Added language to Consumer Loan Pricing regarding rate applicability/historical rates.
- **July 10, 2014:** Updated Consumer Loan Pricing regarding rates/explanation of PLCs and added language regarding FasTrack Unsecured Installment loans; added language to Notes regarding a rate discount for AFT.
- **December 1, 2020:** Inclusion/consolidation of components from the "Loan Pricing Update" and "Poultry Loan Pricing Update" memos (these memos will be retired); set forth/established guidelines for "Loan/Relationship Repricing(s) – Margin Protection"; updates/revisions to the following sections of the original memo: Commercial Loan Pricing, Consumer Loan Pricing, Employee Pricing and Notes.
- **August 17, 2021:** Implementation of SBA Rate Structures.