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THE ART OF POSITIONING

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New Branch Survey Finds Branch Costs Increasing, Size Decreasing

In 2003, Bancography surveyed financial institutions across the U.S. about their branch construction plans. We repeated the survey in 2006 and 2013 (deferring during the recessionary years when branch construction slowed dramatically), and recently completed another iteration. The study surveyed banks and credit unions across the U.S. about their branch deployment plans, including number of planned branches, cost, and size of those branches. Sixty institutions joined the survey, including 33 banks and 24 credit unions (three respondents replied anonymously), from all regions of the country and spanning all asset tiers except the largest national banks. The respondents maintain networks ranging from two to more than 300 branches. Our findings follow.

How many branches will your institution add next year?

Branching continues to increase incrementally rather than exponentially, as about three-quarters of the respondents plan to add only one or two branches in the next year, and only five respondents intend to build five or more branches. Across the survey panel (including institutions that reported they were not planning any branches in 2017), planned branch additions represented 5% growth relative to current branch counts. Although that statistic does not address net network change as it does not consider planned branch closings by the same institutions, it suggests that much of the branch contraction in recent years has arisen from the largest tier of banks. Seventy-five percent of institutions plan to build traditional branches, 52% plan to build inline branches (i.e., branches within 'strip' shopping centers), and 9% plan to build in-store branches (the proportions sum to more than 100% because some institutions plan to employ more than one format). Non-traditional branches, i.e., inline plus in-store, retirement home, and other specialty formats, represent 40% of planned new branches. These proportions remain similar to those reported in the 2013 iteration of the study.

What is the average square footage of the planned new branches?

The average size for planned freestanding branches was reported at 3,400 square feet, but this was skewed by three institutions planning branches of more than 12,000 square feet. Omitting those outliers, average square footage for freestanding branches was reported at 2,700 sf, down from 3,000 sf in 2013 and 3,500 sf in 2006; the median was 2,500 sf. Planned bank branches (excepting the 12,000+ sf outliers) averaged 2,400 sf versus 3,100 sf for planned credit union branches. Despite continuing declines in the average branch size, five respondents are designing branches in the 4,000 – 5,000 sf range. Among the planned inline branches, the average reported size was 2,100 sf, with the median at 1,700 sf, consistent with the 2013 survey and consistent across both banks and credit unions. Planned sizes ranged from 900 sf to 4,000 sf, with six responses exceeding 3,000 sf.

What is the average land cost of the planned freestanding branches?

Reflecting the wide regional disparities in land costs, this question always shows great variance. Responses ranged from $300,000 to $2M, with a median of $850,000 and an average of $930,000. Likely reflecting the rebounding of the real-estate market, the average well exceeds the $675,000 average in the 2013 study, but lags the $1.1M level from the 2006 survey in the peak of the branch-building boom.

(continued on page 2)

New Branch Survey Finds Branch Costs Increasing, Size Decreasing (continued from page 1)

What is the average construction cost of the planned branches
(including building, furniture and equipment, i.e., everything but land?)

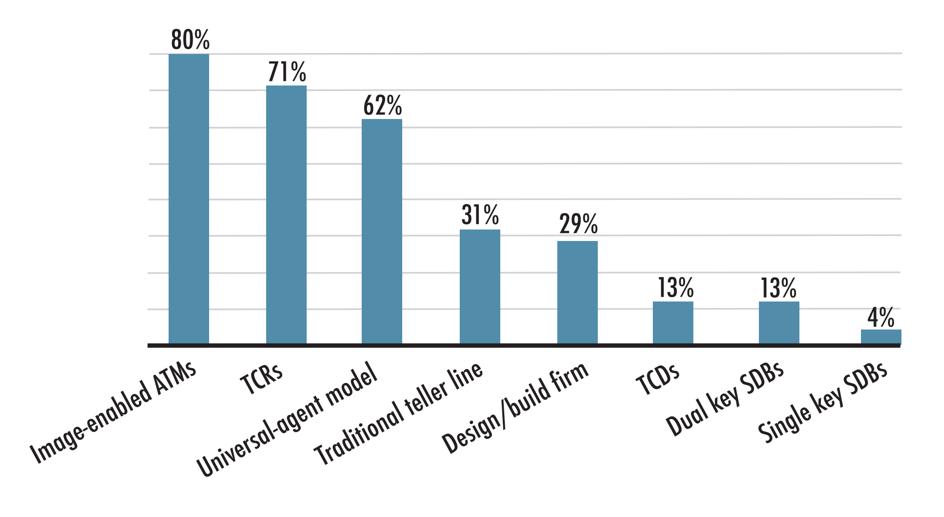
Reported freestanding branch costs ranged from $500,000 to $3M (with one response at $4.5M for a larger facility) and averaged $1.5M, up slightly from the $1.3M and $1.4M of the 2013 and 2006 surveys. However, recall that average square footage declined to 2,700. Accordingly, average cost per square foot increased to $570 from $440 in 2013; with a median of $530. Costs ranged from $200/sf to six responses at more than $800/sf.

For inline branches, reported costs ranged from $200,000 to six responses at more than $1.2M, with an average of $700,000 (up from $530,000 in 2013) and a median of $650,000. Cost per square foot ranged from $120 to six responses at more than $600, and averaged $360 (median $290), up from $275 in the 2013 survey.

What are the planned initial staff levels for new branches?

For freestanding branches, respondents reported an average starting staff of 6.1 full-time equivalent employees (FTEs), with two-thirds of responses falling in the 5 – 8 FTE range. For inline branches, respondents reported an average starting staff of 4.8 FTEs, with two-thirds of responses falling in the 3 – 5 FTE range.

% Respondents who will use these elements at most or all new branches



The survey also addressed various equipment and configuration elements:

- **Image-enabled ATMs** are becoming standard equipment, with 80% of respondents planning to use the technology in most or all new branches, compared to 68% in the 2013 survey.
- **Teller cash recyclers** (TCRs) are also becoming standard: 71% plan TCRs in most or all new branches; and only 13% have no plans to use TCRs. TCRs appear to have supplanted teller cash dispensers, as only 27% of respondents plan to use TCDs in any of their new branches.
- Only 36% of respondents plan to install **safe deposit boxes** at any new branches, with 13% planning boxes for all branches and another 23% planning to install boxes in some new branches. Traditional dual-key vaults remain twice as common as single key, self-service vaults.
- **Video remote tellers** are also gaining acceptance. Twenty-two percent of the surveyed institutions will use video remote tellers at all new branches, twice the level reported in the 2013 study; and 24% will use the technology at some new branches; but 46% have no plans for video tellers (compared to 57% in 2016).
- The **universal-agent model** is under consideration at many institutions: 49% of respondents plan integrated teller-CSR (universal agent) workstations in all new branches, up from 42% in 2013; and only 22% plan to install traditional teller lines in all new branches, down from 30% in 2013. The remaining institutions (21% of respondents) plan a mix of operating models.
- Thirty-six percent of respondents plan to outsource at least some proportion of **branch construction projects** to design/build firms, turnkey providers that manage all aspects of the construction process. Twenty percent will utilize design/build firms for all branch projects, 64% will hire and manage their architects and general contractors internally, and 16% plan a mix of construction management methods.

yield they may sacrifice to remain with (or join) a preferred provider.

Just as institutions will need to add deposit-price-negotiating skills into sales-training curricula, they will also need to build skills to address an unfamiliar borrowing environment, especially for mortgage loans. To young consumers – first time home buyers or first level move-up home owners – a 'normal' mortgage rate has always been around 3%; and those consumers may find rates in the 5% - 6% range inconceivable. To counter that, loan officers will need to be able to explain the term, payment and equity accrual implications of different rate levels, and financial providers may need to reintroduce adjustable-rate mortgage products to keep the offered rate at familiar levels. However, to successfully sell that product, bankers will need to be able to explain the benefits and risks of adjustable-rate instruments to young consumers who have never considered such options.

Releases from recent Federal Reserve Board meetings have already confirmed key factions of Fed leadership advocating rate increases, and continued economic improvement should continue to nudge the Fed toward that action. With implications for product sales of all types, financial institutions should immediately develop product and sales training programs to help bankers anticipate competitive challenges, address consumer questions, and deliver a brand, product and pricing proposition that protects current deposits while improving net interest margins.

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Welcome to Bancology, a Quarterly Journal from Bancography

Facing the Long Arriving, Finally Imminent, Inevitable Rate Rise

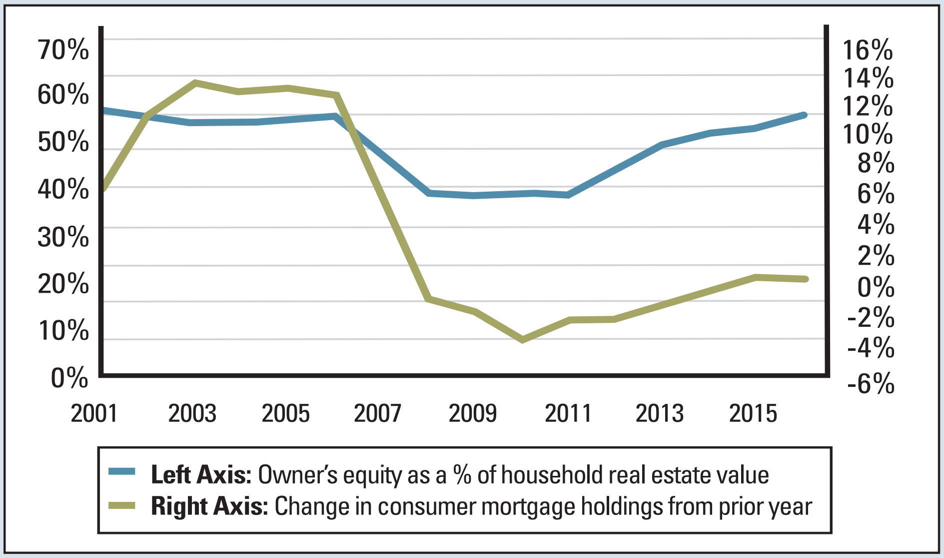
As the financial crisis of 2007 forced the economy into recession, the Federal Reserve Board began to ratchet interest rates downward, pushing the federal funds and discount rates to historic lows in late 2008. In the eight years since, those key rates have remained near zero, with the Fed repeatedly asserting that it would not enact significant rate increases without evidence of persistent, sustained economic health.

Most economic indicators reached their nadir in late 2009 or early 2010, and since then the economy has shown steady, albeit slow, improvement. A raft of economic indicators have demonstrated sustained, durable growth to reach or surpass pre-recession levels, almost certainly giving the Fed sufficient evidence to start nudging rates upward in 2017. Predicting the Federal Reserve Board's rate decisions is always challenging, but consider the following indicators of economic recovery that should likely provide sufficient evidence to warrant the long-deferred rate hikes.

In October 2016, the U.S. Bureau of Labor Statistics reported an 80th consecutive month of job growth, the longest such streak in U.S. history. As a result, the U.S. unemployment rate has been halved, falling from a peak of 10% in 2009 to less than 5% in the third quarter of 2016. Throughout the recovery, wage growth remained persistently sluggish, providing a counter-argument to advocates of rate hikes.

However, several indicators suggest the improved employment job market has absorbed enough idled workers to finally put upward pressure on wages. The U.S. Census Bureau recently reported that median household wage income (i.e., income from wages only, and not from non-wage sources such as investments) increased by 5.2% in 2015, the largest year-over-year increase in that measure since the Bureau began tracking median income statistics in the 1960s. Corroborating that, the Federal Reserve Board of Atlanta has reported hourly wage growth in the 3.0% - 3.5% (annualized) range for the past four quarters (starting in August 2015), the fastest clip since the 2009 trough of the recession.

With the job market in recovery, consumers are feeling increasingly confident about their economic prospects, as evidenced by the Conference Board's Consumer Confidence Index, which in September reached its highest level since the recession. That confidence is manifested in tangible consumer investment and borrowing decisions. U.S. auto sales have maintained an annualized pace of near 18 million units throughout 2016, almost twice the level of the 2009 recessionary lows (U.S. Department of Commerce, Bureau of Economic Analysis); and both mortgage borrowing and home values have rebounded significantly over the past five years. Sharp increases in home owners' equity levels have fueled increased willingness of consumers to borrow, and of institutions to lend for home mortgages.



In concert, the above factors indicate a rate hike as imminent and inevitable, and bankers must understand that planning for a rising-rate environment involves more than balance-sheet gymnastics. Keep in mind, the industry has remained mired in a near-zero rate environment for eight years, yielding the following stunning reality: a branch manager age 30 or younger (presuming the manager is a college graduate who entered the job market around age 22) has NEVER faced a positive rate environment. As such, many institutions will need to undertake specific training around the implications of this unfamiliar situation.

As rates rise, it will be imperative for financial institutions to build a metaphoric moat around their low-cost funds, their core checking and savings deposits. For as long as the column to the left of the decimal on the rate board has shown 'zero', consumers have focused on decision factors other than rate. But when rates inevitably creep upwards, rate-starved retirees on fixed incomes will start comparing offers on that dimension, and we may see funds rapidly move between institutions in response to premium-pricing offers. Understand though, the best indicator of brand strength lies in an institution's cost of funds: if someone chooses Bank A's money market account at 1.25% over Bank B's money market account at 1.50%, that choice is a confirmation of Bank A's brand strength. Why would a consumer sacrifice 25 basis points of yield to choose Bank A? It could be convenience, service, image in the community, or some other factor – but that consumer choice would provide direct confirmation of the bank's superior brand proposition.

In a rising-rate environment, every institution will face a temptation to emphasize rate, but that can erode any gains in the net interest margin that the rate increase would provide on the asset side of the balance sheet. Thus, at a time in which many competitors will follow a natural inclination to promote rate, it may be beneficial for some institutions to tout longer term, persistent advantages in breadth of locations, quality of service, hours of operation, or other non-price factors. But keep in mind, young managers will have little experience in negotiating the tradeoffs between rate and other non-price factors, in perceiving what each customer's price tolerance is in terms of how much *(continued on page 4)*

Altering branch design affects branch staffing levels.

Bancography offers a flexible, easy-to-manage model for evolving staffing needs.

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- Impact of lobby redesign on staffing
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Bancography's staffing models help institutions efficiently allocate branch personnel investments, ensuring that staff levels meet transaction, sales, service and security demands without compromising profitability.

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