

ITMs: A Drive-In Solution for Inline Branches

In a quest to reduce costs in recent years, banks and credit unions have embraced inline branches (i.e., storefront branches occupying a bay within a retail shopping center). The appeal of inline branches is readily apparent on several dimensions.

First, at a time when electronic channels have reduced in-branch transaction demand, many branches can address their transaction volume with only two or three teller stations, and that equipment can comfortably fit within the confines of a 1,600 - 2,000 square foot facility. Second, because inline spaces are almost always leased, they bring the flexibility of periodic no-cost exit opportunities at each renewal period; without the risk of the sizable write-downs of fixed assets associated with exiting owned facilities. And finally, inline branches bring a speed of entry versus freestanding branches, not only eliminating site preparation costs and much of the construction process, but also most zoning and permitting tasks.

It remains inefficient in most cases to build a freestanding facility for needs an institution can address in 1,600 - 2,000 sf, as the fixed costs of site acquisition and infrastructure amortized across such a small structure yield significantly greater per-square-foot construction costs than with an inline model. However, the inline model carries a significant drawback in its inability to host a drive-in, which can dissuade potential clients; especially within the small business segment, who may be reticent to select a provider lacking convenient drive-in access, or any drive-in access at all.

At best, an inline branch at the end of the shopping center (often referred to as an end cap) can accommodate a single drive-in lane. But even in those situations, access and circulation can prove challenging, and the branch may need to forego an 'escape lane,' – i.e., the vacant lane where a customer can opt out of the drive-in queue if the transaction process is taking too long.



Consider the overhead image shown above. In this case, the branch occupies that outermost end cap location, with a single drive-in lane. Note the entry path, through the rear of the shopping center, past the trash collection bin, with barely sufficient room for an escape lane (at least if you're driving a small sedan). Is this the experience you wish to present to your customers?

Now, consider the image below of the same shopping center, and note the prominent vacant part of the parking lot near the entrance, with visibility from the main road. *(continued on page 4)*



Once-in-a-Lifetime Deposit Growth, a Second Time: Findings from the 2021 FDIC/NCUA Deposit Statistics

When the FDIC released its annual branch-level deposit statistics as of June 30, 2020 (along with parallel data from the NCUA), we saw a staggering and unprecedented 13% increase in retail and small business deposits and a 21% increase in total deposits from the prior year. The change was not unexpected: the FDIC's reporting date coincided with a period when many consumers had received federal stimulus payments as part of the nation's COVID relief efforts; when consumer spending was still greatly constrained by reticence to travel, dine out, and engage in other public-facing activities during the height of the pandemic; and when many businesses had received Paycheck Protection Program loans but not yet disbursed those funds.

In concert, these factors yielded soaring deposits at most U.S. banks and credit unions, reflected in the June 2020 statistics. Even if deposit growth seemed unlikely to immediately return to the 3% - 4% annual levels more typical of the past two decades, surely growth rates would abate from the record levels of 2020? Yet even as consumer spending revived to pre-pandemic levels, a combination of real wage growth, a second round of stimulus payments, and reduced investment from the corporate sector yielded another year of robust deposit growth, unprecedented except by the prior year's performance.

In the 2021 FDIC reporting year (the 12-month period ending June 30, 2021), retail and small business deposits increased by 12%, and total deposits by 11%. So while the overall pace of deposit growth moderated from the prior year, that tally still eclipsed historic norms; and the pace of retail and small business deposit growth nearly replicated the stratospheric levels of one year prior. However, this raft of heightened liquidity can dilute earnings if not offset by loans. (See the **Absorbing the Excess Liquidity** article on page three for a discussion of the current environment for loan demand).

In addition to insights about deposits, the FDIC/NCUA data also allow analysis of branch counts. With the rise of online channels reducing in-branch transaction demand and regional bank

mergers bringing closures due to branch overlaps, the aggregate count of U.S. branches has declined steadily in recent years: from 106,000 deposit-reporting branches in 2017 to 99,000 in 2021, an erosion of 6%. By geography, the New York metropolitan area experienced the greatest absolute level of branch contraction – a net decline of 700 branches from 2017 to 2021. In that timeframe, the Chicago metro shed 350 branches, the Washington DC metro 200, and the Los Angeles metro 180. The Philadelphia and Miami markets each saw the net erosion of 150 branches since 2017, while the Atlanta, Phoenix, and Baltimore markets each reported 100 fewer total branches in 2021 than in 2017.

Not every major metro showed declining branch counts in recent years. The Austin, Texas metro, which posted the highest household growth rate over the past five years among the 55 U.S. metros with at least one million residents, saw a net gain of five branches since 2017. Other high-growth metros, such as Raleigh-Durham, Charlotte, San Antonio, Houston, and Nashville, showed either no change or minimal declines in their branch totals.

U.S. branch counts peaked at 113,000 in 2010 - 2011, so the present level represents a net reduction of 14,000 branches from peak levels. Across the nation, there is now one branch for every 1,350 households. While at peak branch counts that ratio was closer to one branch for every 1,050 households, a nationwide count of nearly 100,000 branches still confirms ample interest in that channel.

Finally, note that even amidst so many branch closures, banks and credit unions continue to deploy new branches, too; in effect bootstrapping the network to more effective positioning. The FDIC reported more than 10,000 new branch openings over the past four years; the net decline in that timeframe is simply the result of an even greater number of closings, too. Still, an average of more than 2,500 new branches per year confirms that, given an appropriate strategic rationale, bankers continue to view branches as a valuable tool for growth; and that a continual process of culling low-potential or overlapping branches while judiciously adding branches in high-potential markets can move an institution toward an optimal branch network.

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Absorbing the Excess Liquidity: The Culprits of Weak Loan Demand

As discussed in the prior article, deposit growth at U.S. banks and credit unions reached record levels since the onset of the COVID crisis. Typically, bankers appreciate deposit growth, as the increased deposits allow increased lending, and thus increased interest revenue, which is still the primary driver of profit in the industry. However, the pandemic curtailed loan demand on multiple fronts. Temporarily shuttered business had less need for working capital. And with furloughed-employee salaries funded through Paycheck Protection Program loans, there was less drawdown of cash reserves. Further, consumers refrained from credit card purchases for travel, dining, and entertainment, while also deferring large purchases (such as automobiles) due to concerns over the safety of the purchase experience.

The COVID crisis brought declines in aggregate loan demand in every major credit category except for consumer mortgages. Commercial and industrial loans, commercial real estate loans, consumer credit card borrowings, and consumer automobile loans all showed declines from the peak of the COVID crisis through the end of 2020.

Fortunately, loan demand has revived in 2021 in many sectors. But as of November 2021, aggregate bank loans still remain 2% below peak pre-pandemic levels. Looking a level deeper reveals the key cause of still-sluggish aggregate loan demand. Even as most loan categories have rebounded to all-time high levels, commercial and industrial (C&I) loan balances remain 21% below peak levels – a deficit of \$640B; and that category has historically accounted for 25% - 30% of all bank loans.

The other deficient category is in credit cards, where balances remain 7% below peak pre-pandemic levels. But credit card borrowing has apparently started a rebound, with aggregate balances now 6% greater than one-year prior; still not back to pre-pandemic peaks, but moving in a favorable direction. In contrast, C&I loan balances continued to erode through each of the first 10 months of 2021.

Other categories showed similar rebounds to credit cards. Automobile loan balances are up 10% since November 2020 and 11% above peak pre-pandemic levels. Overall consumer loans are up 8% in the past year, reaching record levels in October 2021 and then again in November. Even

on the commercial side, commercial real estate loans now sit at all-time highs, and 4% above the levels of a year ago. And consumer mortgage balances never showed a decline, instead remaining mostly stable through the worst of the pandemic period. Consumer loan balances increased by 2% in the past year, less than the 4.6% compound annual growth rate of 2014 to 2019 (i.e., the five years pre-COVID), but still positive. That noted, home equity borrowing continues a long period of decline that started during the financial crisis of 2008 - 2009. (See *Bancology Volume 63, July 2017*).

The table below lists the major categories of borrowing and the change in the last 12 months, the change from peak pre-pandemic levels, and the five-year, pre-pandemic average growth rates (note how C&I loans stand out in the magnitude of their decline). In a glimmer of positive news, C&I loans increased in November by 1.2% from October. But whether that represents a true turn from the bottom of the trough or a small statistical blip remains to be seen. Still, with that category representing such a sizable proportion of banks' balance sheets, until C&I demand revives, our industry's liquidity surplus will remain problematic.

Changes in the Last 12 Months for the Major Categories of Borrowing

Category of Loan	% of Bank Loan Balances	Change Versus Pre-Pandemic Peak	Change in Last 12 Months	Five-Year CAGR, 2014-2019
Total Bank Loans		-2.2%	2.1%	5.7%
Commercial and Industrial	23%	-20.8%	-7.4%	5.9%
Commercial Real Estate	24%	5.1%	4.2%	7.6%
Consumer Mortgage	19%	1.7%	2.1%	4.6%
Home Equity	2%	-21.4%	-12.4%	-6.8%
Consumer Non-mortgage	16%	1.9%	7.8%	6.0%
Credit Cards	8%	-7.4%	5.8%	6.3%
Auto Loans	5%	11.5%	9.5%	4.7%

Source: Federal Reserve Board; data as of November 2021 and include all U.S. banks.
Note: % of loan balances does not sum to 100% as some smaller categories are not listed.

The ITM-based drive-in provides advantages. The ITM is typically operated by centralized staff in the institution's call center, rather than branch-based staff; so, there is no consideration for where pneumatic tubes need to be placed, or for visual contact between the teller and transactor. And as with a remote ATM, an outside firm provides all cash servicing.

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What if, instead of the end cap with the single-lane drive-in, the bank instead added a two-lane drive-in powered by interactive teller machines (ITMs)? This would increase the branch's visibility and drive-in capacity, and add a smoother escape path for clients to opt out if needed. Of course, the advantages versus an inline space would be even greater if the branch sits inline between stores – i.e., not an end cap location.

But either way, the ITM-based drive-in provides advantages. The ITM is typically operated by centralized staff in the institution's call center, rather than branch-based staff; so, there is no consideration for where pneumatic tubes need to be placed, or for visual contact between the teller and transactor. Rather, the drive-in can sit on the opposite side of the parking lot, with easier circulation and room for multiple lanes. As with a remote ATM, an outside firm provides all cash servicing.

Most importantly, the consumer sees the ITM and thinks, "Great, they have a drive-in here, too!", wholly unaware the drive-in's operations are completely separate from the branch. It *looks* like the branch has a drive-in, when in actuality, these are two distinct channels of the institution that happen to be in close proximity.

Because centralized call center agents drive the ITM, the bank or credit union can open the ITM on weekends and/or beyond branch hours without the scheduling challenges extended operations present (call centers are geared for such scheduling), and without the dual control and other overhead costs branch drive-in operations bring.

Finally, the ITM provides a superior service experience in its audio and video quality versus the 'squawk box' effect at typical drive-ins. Thus, for an additional capital outlay of less than \$100,000 (and keep in mind, the median cost of inline branches is \$700,000, versus \$2.3M for freestanding branches), the hybrid inline / ITM model can overcome the

most severe drawback of small-format inline branches.

The Challenge of the First ITM

If your bank or credit union already operates ITMs, the marginal cost of adding another in the inline/ITM model would be modest – likely less than \$100,000. However, a critical challenge of implementing ITMs lies in the initial setup cost. The back-office infrastructure required to establish an initial ITM (building connectivity to the call center, systems integration, etc.) can cost \$300,000 - \$500,000. So, assuming the midpoint and \$85,000 for the machine itself, the first ITM costs \$485,000. But, if the bank deploys 10 ITMs in an initial rollout, that fixed infrastructure cost is amortized to more reasonable levels; as each machine would then cost $\$85,000 + \$400,000 / 10 = \$125,000$. Thus, the challenge of the first ITM: it is prohibitively expensive to pilot test a single unit, so the institution must commit to a multi-unit rollout to keep per-machine costs reasonable. The offsetting good news: once that infrastructure is in place, the marginal cost of adding ITMs is limited to the cost of the machines themselves, plus whatever incremental call center staff are needed to service the resulting transaction demand.

