Sources of Liquidity: Are You Prepared?

by Adam Johnson, SVP/Principal
c. myers corporation

Liquidity is an issue at the forefront for many credit unions today. While there are various stages of liquidity needs, it is inevitable that the more you need the liquidity, the *more expensive* and the *less accessible* it will be. Said differently, the point at which you address your *liquidity needs* is directly related to the number of viable options you have for solving them. Meaning, the longer you wait, the fewer options you have at your disposal.

The following table lists the basic options credit unions have for accessing liquidity. Some require careful evaluation before considering them as an affordable source you'll turn to when you find yourself in need of cash. Therefore, our list includes some things to consider first. Keep in mind that NCUA does not consider many sources valid unless you've already gone through the transaction at least once.

Sources of Liquidity	Things to consider *before* counting as an affordable source of liquidity
1. Cash 2. Short-term investments	▪ You have control over these forms of liquidity, but the opportunity cost may be high depending on the yield curve and where rates go in the future.
3. Lines of credit	▪ Are your lines of credit guaranteed? ▪ Do you know the point at which your corporate credit union or FHLB would charge a premium or say "no" to your request to draw or borrow more?
4. Structured borrowings	▪ What rate would you pay? ▪ Are they convertible? If yes, are they guaranteed to convert or do you have to requalify?
5. CD promotions	▪ What rate would you need to offer to get money in the door? ▪ What is the marginal cost of funds? For an example, see our *c. notes*, "Today's Earnings Challenges: Feeling the Squeeze," at www.cmyers.com/education/cnotes.html. ▪ Have you protected yourself with an appropriate early withdrawal penalty to prevent members from jumping ship when they find a better offer, leaving you high and dry? ▪ What is your plan to replace the money when the promo CDs mature?
6. Sale of investments	▪ Would such a sale mean a profit—or a loss?
7. Sale of mortgages	▪ If you decided to sell mortgages, would you make a profit or suffer a loss? ▪ Do you have actual experience with such a transaction?
8. Sale of auto loans	▪ As with selling mortgages and investments, you should know in advance whether selling auto loans will mean a hit to your earnings. ▪ Do you have ready, willing and able buyers? When many financial institutions simultaneously find themselves in need of funds, buyers for autos may be limited. Additionally, a flatter yield curve may make shorter-term investments more attractive for a financial institution looking to invest its money rather than purchasing auto loans.
9. Loan participations	▪ Do you have actual experience with the process of loan participations? ▪ Have you identified reliable buyers in advance?
10. Sale of buildings	▪ Would such a sale be at a gain or a loss? ▪ If the building is needed to continue branch operations, can you lease it back?

In addition to the previous options, raising loan rates and underwriting standards can help, yet many credit unions currently appear to be hesitant to exercise this option.

To better understand their position, we recommend that credit unions do a detailed liquidity analysis month by month for 12 months. The frequency should be determined by each credit union's unique situation. The analysis should start with a base case that assumes things will go as planned, but it certainly should not stop there. Prudence dictates the need to conduct various "what–if" scenarios; for example:

- What if loan growth increases by 10% and deposit growth remains constant?
- What if loan growth increases by the same 10% and lower-cost deposits *decline* by 10%?
- What if the short-term rate goes up 200 basis points and the long-term rate does the same, preserving a flatter yield curve and potentially causing many existing commitments on loans and investments to extend?

There are certainly many more scenarios to consider, but we have found that the three listed above are a good place to start.

When you're doing your liquidity analyses, don't forget to incorporate such variables as:

- Unfunded commitments; for example, HELOCs, credit cards and lines of credit
- The timing of one-time big cash outlays, such as purchasing land, building branches, funding bonuses and investments in technology

If you want to learn more about what to include in your liquidity analyses, call us—we'd be glad to help.

For more information on liquidity—specifically the squeeze on earnings—**see c. myers' *c. notes*, "Today's Earnings Challenges: Feeling the Squeeze," available at** www.cmyers.com/education/cnotes.html.

We welcome your questions and comments. You can contact me by telephone at 800.238.7475, or by email at ajohnson@cmyers.com.

Adam Johnson
Senior Vice President/Principal