

**Bonanza Valley State Bank  
Mission Statement**

Bonanza Valley State Bank will provide a reasonable return on the investment of its stockholders by the management of money and by providing secure safekeeping of financial assets for the people of Brooten and its surrounding communities.

**Bonanza Valley State Bank  
Statement of Goals**

The Bank will support the community by the involvement of its staff in community activities and in promoting and supporting the economic vitality and growth in the region.

The Bank will operate at a level of profitability comparable to that of other community (peer) banks and such that the bank can grow to meet the long-range plan of the bank.

The Bank staff will be highly customer oriented, understanding that only by exceeding the customer's expectations of service will the Bank be successful.

The Bank staff will be honest and fair in all dealings with customers. Bank management will seek to provide a respectful work environment for employees where they enjoy their work and are offered opportunities for professional development.

## **Strategic Planning Notes – August 17, 2023**

**Present: Allen Anderson, David Bohmer, Juli Bohmer, Bob Imsdahl, Byron Knutson, Candra Lieser, Ramon Rodriguez, Ben Tensen and Jamie Terres**

### **I. Places that we can see the Bank be helpful**

1. Promote and grow the business and industrial district in and near Brooten.
2. Keep existing farmers profitable and help them get through “down cycles”.
3. Promote and enable young farmers to enter farming.  
(Using FSA, RFA, or Farmer Mac)
4. Encourage accounting and marketing systems for farmers and businesses.  
(Using local accountants and SBA/FSA Specialists)
5. Promote population growth of our area and community.
6. Promote housing in the community.
7. Encourage customers to maximize technology usage.
8. Stability
9. Educate community on financial matters using the Banzai program.
10. Offer broad range of financial products.
11. Economic development such as using SBA-Initiative Fund-State Grant Programs and City Revolving Loan Fund to promote entrepreneurship.
12. Supportive of community as a whole.

### **II. Expectations of the Bank by Outside Interests**

#### **A. Vendors, Tourists, Visitors, Other Bank Regulators**

1. Purchase of products, provide income, convenient access to money, possible loan participants, fair competition, being successful, safety and soundness, compliant, invest in the community, profitability, well run and organized, BSA, Basel III.

#### **B. Municipal Governments, Local Community, Farm, and Business, Organizations, Individuals.**

1. A channel for local economic growth, revenue collection, promote a healthy local economic community, convenience, support local organizations, honesty, provide a broad range of financial products, professionalism, accuracy, sound financial advice, participate in the local community, be knowledgeable about the farm and business industries, easily accessible, stable, competitive, financially secure, confidentiality/privacy, attractive facility, technologically up-to-date, responsive, know our customers by name and have good leadership and be well connected.

### **III. Expectations of the Bank by Inside Interests**

#### **A. Shareholders**

1. Profitable, safety and soundness, strong financial performance, positive image, attractive facility.

#### **B. Board of Directors**

1. Profitable, safety and soundness, stability and security, same expectations as the “Local Community”, positive image, attractive facility, full disclosure of information from management and technologically up-to-date.

#### **C. Management**

1. Profitable, safety and soundness, strong financial performance, positive image, attractive facility, physical safety, stimulating work environment, opportunity for professional growth/development, job security, fairness, competitive wages and benefits, modern equipment, technologically up-to-date.

#### **D. Employees**

1. Profitable, safety and soundness, positive image, attractive facility, physical safety, stimulating work environment, opportunity for professional growth/development, job security, fairness, competitive wages and benefits, modern equipment, technologically up-to-date, respectful, and enthusiastic.

**IV. Situation Assessment (strengths, weaknesses, opportunities and threats)**

<b>Key Area</b>	<b>Strengths</b>	<b>Weaknesses</b>
Financial	Low fixed overhead, loyal local depositors, streamlined loan decisions, FHLB program service	Limited depositor base, pandemic low-interest loans and competitor high CD rates are impacting income
Employees	Capable, customer oriented, loyal, get along well, knowledgeable, stable, good telephone skills, mix of ages and tenure, professionalism, staff for growth	Lack sales culture, lack “technophile”, not promoting new products, fewer new opportunities
Facilities	Conductive to business, attractive, adequate for asset size, single location helps with overhead	Single location limits expansion
Technology	Correspondent communication, Fipco loan software, imaging and good core system, internet banking, bill pay, mobile banking, telephone banking, updated website, remote deposit capture, P2P, ACH	No IT expert on staff and limited interactive website, technology not as advanced as larger banks
Delivery	Responsive to customers requests, accuracy, flexibility, loan approval process, free checking, debit cards, ATM locations	
Products	Everyone is knowledgeable about products.	Limited products compared to larger institutions

<b>Key Area</b>	<b>Opportunities</b>	<b>Threats</b>
Competition	Mergers and consolidations, responsiveness niche, locally owned community bank, non-conforming loan niche	Local credit unions, national brokers, Compeer, local banks
Economy	Diverse manufacturing, diverse Ag industry, government support of Ag, government guarantees available, strong local real-estate market	Agriculturally dependent, geographically concentrated, small customer base, volatile interest rates
Geography	One bank in town, more commuters, expand trade territory, migrant laborers	Fewer geographical boundaries, more online offerings
Lenders	Farm Laborers, fewer geographical boundaries	
Public Image	Longevity of bank – 4 <sup>th</sup> generation, customer friendly.	

## **Plan Summary**

Bank management, staff, and the Board of Directors recently completed a strategic planning process. As part of that process, a self-assessment was made in several key areas of the bank. The results have provided the basis for long range decisions to be made by the management and Board of Directors. Several areas are addressed:

### **V. Competition and Market Conditions**

BVSB continues to be challenged by the increasing competition of financial service institutions, both bank and non-bank. Most of our farm customers have strong financial statements and can weather a sustained down-cycle. Mail and telephone solicitations are directed at our customers and the level of sophistication of our customers has grown. All of these conditions require a focused and intentional effort by the staff to build on the strengths of our current relationships and to exploit those opportunities presented with new customers. Our strength is in our relationship to our customers, the connection to our community, and our ability to act or change quickly. To meet these goals, over the next twelve months, management will consider the following:

1. Continuing training for staff in their areas of work
2. Training with an emphasis on customer service and regulatory compliance
3. Recognition of exemplary work by employees
4. Maintain a professional working environment
5. Regular communication with staff via staff meetings (Quarterly or as needed)
6. Adopt a “right the first time!” approach to all work within the bank
7. Continue referring mortgages on the secondary market to make more fee income and help our customers with their needs and requests.
8. Hedge loans with securities.
9. Work Construction referrals from mortgage brokers.
10. Work referrals from real estate

### **VI. Earnings and Financial Performance**

Downward pressure on net interest margins is due to:

1. Economic and political stress has caused interest rates to drop to historically low levels in 2019-2021 causing many Ag clients & some mortgage clients to refinance on the 30 year, resulting in close to a 2 million loan loss at BVSB. These existing legacy-term loans are causing compressed margins now which in turn lower our earnings.
2. Decisions made by bank management regarding interest rate risk management
3. Competitive nature of our local financial environment & local credit union expansion.
4. Outgrown local customer base (need outside funds from FHLB and brokered deposits).

To address these issues relating to earnings, management will consider the following:

1. Adherence to maintaining high standards of credit quality
2. Pricing loans and deposits profitably
3. Adherence to appropriate interest rate management as set forth in the bank's Funds Management Policy
4. Maintaining loan collection efforts
5. Miscellaneous items: Coupon books, Postage, Monitoring notices, More auto payments, Internet Banking

## **VII. Asset Quality**

Bank staff, Management, and the Board must continue to be vigilant in maintaining high standards for credit quality. The following are broad goals set by management that are ongoing:

1. Strict adherence to the approval process and levels as set forth in the bank's Loan Policy
2. We continue to use analytical software (Moody's) for new and renewed loans
3. Continuing training of lending staff on credit analysis, loan documentation, and proper loan structure.
4. Continuous good loan review process
5. Continued use of credit enhancements such as FSA, RFA and SBA in credit structure
6. Maintain a range of participating banks to facilitate the ability to service large credits and also diversify the bank's portfolio

In the areas of technology and growth of the bank, management feels that some improvements need to be made, however the changes are relatively minor. They are as follows:

### **1. Technology**

Continue to keep up with new technology and keep the website current.

### **2. Growth**

Expand deposit and loan growth. Our correspondent bank has increased our line of credit for capital growth. No buy-outs of other financial institutions at this time. Establishing a loan production office or holding company with other services may be considered.

# Strategic Plan Supplement

## August 17, 2023

**PURPOSE:** The purpose of this supplement is to provide guidance for growth and funding for Bonanza Valley State Bank (BVSb) into the future. There are a number of business models that have proven successful for community banks: The one being described here should be reviewed annually; more often if banking conditions change.

### **OPTIONS:**

- **Stagnation:** BVSb can remain at its current size, or even shrink its assets, to preserve capital and live with the limited pool of local depositors. This is a less desirable option since it keeps BVSb from reaching a more efficient size and may constrain BVSb from serving the needs of its local community. The bank contracted in the Covid environment and even though the volume of loans has increased, the impact from low rates continues to affect earnings.
- **Branching:** The traditional method of obtaining new sources of money once a bank has outgrown local deposits has been to open branches away from its home office. This is effective but quite expensive: The cost of opening a new branch includes not only the lease or purchase of a fairly expensive property, but the ongoing operational cost of maintaining a facility with at least three employees. In addition, aggressive deposit and loan pricing must be used at a new location to establish a large enough base of business to reach “break even”. This option should be considered by BVSb only in the event core deposit pricing becomes substantially lower than non-core funding. Also, upper management/directors should ensure that we have management skills to add new facility.
- **Purchasing:** Purchasing an existing bank requires a large amount of capital and significant management expertise to ensure that the larger, combined, operation is successful. This option will not be viable for BVSb unless a substantial amount of capital is accumulated or infused by the existing stockholder.
- **Internet Banking:** This has proved a successful strategy for larger banks that have more advanced technology than us. This area of banking is becoming more heavily saturated and also more competition from non-banks, such as apple and google. It seems that most people like to use the internet but also enjoy the option of visiting a “bricks and mortar” operation. BVSb currently has internet banking, mobile banking, mobile deposit, P2P Payments, and “remote deposit capture”.

- **Growing Existing Structure:** This seems to be the most desirable approach to assure the future success of BVSB. However, our existing capital level limits the amount of growth that can be attained: All Retained Earnings must be distributed to the shareholder each year to allow him to pay off a stock loan from United Bankers Bank (UBB) that was used to infuse capital into BVSB: This loan will take the stockholder a number of years to repay.

Growth will be limited by capital needs and aggressive competition. Basel III requires BVSB to maintain at least 9.0% as of 01/01/2022 Tier I capital and 10.0% Total Risk-Based capital. There will also be larger “haircuts” on loans in addition to the extra capital requirements Basel III requires. Competition from a neighboring credit union and Compeer is making it difficult to maintain better margins. BVSB is experiencing an increase in loan demand.

BVSB currently uses a credit score matrix which has several tranches, so our strongest customers get better rates. Also, so we are paid for the extra risk we take on our weaker customers.

#### **FUNDING:**

Funding may be achieved through a combination of core deposit growth (see Internet Banking and Remote Deposit Capture above) and non-core funding. Our low-overhead structure allows us to pay very competitive rates on our deposits. We will likely continue to fund a portion of our growth through FHLB borrowing and brokered deposits. Deposit rates may be increased to stay competitive with and comparable to peer banks.

Even though regulators discourage extensive use of non-core funding, it can safely be used if managed properly. The key to using brokered and non-core deposits safely is to match the maturities of deposits (liabilities) to the maturities of loans (assets). For example, if there are 1M dollars of brokered deposits maturing in 2024 and 1M dollars of loans maturing in 2024, funding cost and availability risks will be eliminated: Loan pricing and renewal will be based on funding costs and availability at that time, i.e. If brokered funds cost 2% for a 12-month period, the renewal rate quoted a borrower could be 6%. If the borrower declines the loan, he may move it to another bank and the funds will no longer be needed. The type of non-core funds (brokered, FHLB, CDARS, etc.) used should be based on which is the lowest cost and most stable (not callable). Brokered funds with a maturity of five or less years are stable since funds can only be removed because of death or incapacitation. Loan maturities greater than five years should be funded with FHLB since they cannot be called for any reason. A conversation with the FDIC regional office (Joe Herder) on September 10, 2015 confirmed that there is no automatic “trigger” indicating a problem when the ratio of non-core funding exceeds a certain percentage. However, there should be a good plan in place for liquidity if the brokered market constricts. This funding contingency plan should show multiple sources of liquidity and will be reviewed by the FDIC.



**STRUCTURE:**

BVSB currently has a single location which limits overhead cost, i.e. employee numbers and overhead are lower than a multi-location (branch) structure. This structure has demonstrated an advantage in net profit compared to our peer group and should continue to be an advantage as long as non-core funding is competitive with core funding costs. Since BVSB has outgrown its local depositor base, it must offer aggressive deposit rates and use brokered, FHLB, and other national funding sources to fund its loans and maintain adequate liquidity. For the past several years the increased cost of local deposits has been offset by the lower cost of non-core deposits and lower overhead costs. The use of non-core deposits has also given BVSB the ability of offer long-term, fixed-rate funding, offsetting the interest rate risk by matching with non-core deposits.

Lower income in 2022 and 2023, will be a result of narrow margins. Rates dropped in 2022 and until those loans mature or are refinanced, margins will remain compressed. Branching or purchasing another bank will require substantial amounts of additional capital and management experience so is not a good option for the current owner at this time.

The current stockholder has decided to limit total asset growth to a level our correspondent bank (UBB) feels comfortable with. Dividends will still be used to repay a stock loan with United Bankers Bank (UBB). “Farmer Mac”, participations and SBA lending will be used to help free up funds for local borrowers and new customers in the event UBB decides not to advance more capital funds.

**CURRENT OPPORTUNITIES:**

We have been doing a significant number of residential real estate loans and have found a niche in our local RE mortgages. We inspect houses before funding them to make sure they are in satisfactory condition. It is our opinion the single-family residential housing is one of the more stable loans, as people typically pay their mortgage before most other bills. Farming can be an extremely volatile industry and we feel it is good to have a diversified portfolio.

We have been taking advantage of FHLB’s Home\$tart grant program, which gives up to \$7,500 in grant money to qualified borrowers. This money can be used for down payment, closing costs, or even home improvements. This money is free to our customers who qualify, as long as they live in the house for a minimum of 5 years. If not, the money has to be paid back pro-rated for the time they have lived there. It is more time consuming for our lenders, but the customers who qualify really appreciate it.

For large loans & strong borrowers we make policy exceptions to keep the loan in house.

We have begun doing HELOC loans and hope to increase our residential real estate loan volume.

## **CURRENT EVENTS OF CONCERN:**

### **1. FARMING:**

The low interest rate environment of 2019-2021 has resulted in Ag customers moving loans to 30-year fixed rate mortgages. We are fortunate for the fact that most of our customers are well diversified in multiple areas of the ag sector. Many local farmers raise multiple combinations of grain, specialty crops, cattle, dairy, hogs, chickens, turkeys, goats, and sheep. Being diversified has typically made it easier to weather hard times. Often when grain is down, animals are up. Irrigation in the area has also made excellent crop yields a reality and also much more predictable. Most farmers have been farming for many years (the national median age of a farmer is currently 60 years old). Since most farmers have been farming for many years and land prices have increased dramatically over the last decade, they have substantial equity in their real estate and many also have significant equity in their equipment.

Farming has been cyclical throughout history. We are currently in a stable cycle. We have experienced this before and are familiar with this situation. We are being careful with the ag sector, but feel comfortable with it.

### **2. VOLATILE INTEREST RATES:**

We are in a rising interest rate environment. We mitigate our interest rate risk by locking in our money with FHLB and brokered deposits that closely match the duration of the funds we lend out. Sometimes we match up these funds 100%. Sometimes we match up funds shortly before the duration of our loans, as loan principal gets paid down and repriced ahead of the original maturity date, the risk on the last couple years is a lot smaller. We believe that interest rates will continue to rise & stay high for the rest of 2023 so we are positioning ourselves for this. BVSBS is raising rates in accordance with Fed rate hikes time line.