Top 12 Winning Strategies

for Community Banks in 2025

SouthState
CORRESPONDENT DIVISION

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Introduction

In the ever-evolving banking industry, community bankers face unique challenges and opportunities. As we look ahead to 2025, it is crucial for these institutions to adapt and implement strategies that will help them thrive in an increasingly competitive market. This eBook, "Top 12 Winning Strategies for Community Banks in 2025," is designed to provide valuable insights and actionable advice for community bank leaders who are seeking to enhance their organization's profitability and performance.

We will explore 12 key areas where community banks can focus their efforts to achieve success in loan production, deposit gathering, and relationship building. In the first section, we'll cover eight key strategies to enhance your bank's loan profitability. In the second section, we'll explore four strategies to increase deposits, fee income, and loan product value. We will also provide downloadable resources, including industry comparisons, playbooks, and analyses to support the implementation of these strategies within your organization.

By embracing these proven approaches and leveraging the tools provided, community banks can position themselves for success in 2025 and beyond. Let us dive in and discover how your institution can thrive in the coming year.

Click here if you would like to schedule a presentation to your bank's executive team (30 to 75 minutes, in-person or remotely) covering these key bank areas specific to your bank, geography, and competition.

Strategies to Enhance Loan Profitability

1.

Lend to the Right People

> **"Community banks can increase loan profitability in 8 important areas in 2025."**

The secret formula for success in banking is simple but not often followed – sell more profitable products to more profitable customers. While community banks will not exclusively focus on profitable products and profitable customers, they should consider allocating an above average amount of resources towards these products and customers to make the bank more profitable.

Certain industries demonstrate attractive credit profiles and are often not given enough focus in normal calling efforts. While most banks call on, and even have a specialty unit for healthcare professionals, many banks do not channel enough sales and marketing resources to schools and insurance companies (as an example) that can be more profitable. These industry segments are receptive to banking with local lenders but are often overlooked by community banks because they have historically been the domain of regional or national banks. By expanding exposure to these attractive industry segments, community banks may book profitable relationships with low default rates, high relationship value, and cheaper, more stable deposits.

Download a list of attractive industry segments for community banks here.

2. Review Your Loan Repricing Buckets

With the current inverted yield curve expected to remain through 2025, banks that can generate more adjustable-rate loans will recognize a wider net interest margin (NIM).

> **"An adjustable-rate loan can add 75 to 120 basis points (bps) of additional margin for most community banks over a fixed-rate loan."**

Community banks must find ways to offer acceptable credits indexed to short-term rates – this may include hedging on commercial real estate (CRE) loans, lines of credit, revolving loans for commercial and industrial (C&I) debt, or other acceptable alternatives.

Download an industry comparison showing how adjustable loans are helping banks increase NIM and boost profitability.

Contact us if you want to see a comparison of loan repricing buckets for your bank versus peers and top performing banks.

3.

Refinance Existing Loans with 12 to 24 Months to Maturity

> "At our bank, we spend almost as much time and resources maintaining our existing relationships and growing our share of wallet with existing customers as attempting to attract new ones."

All else equal (credit quality, loan, and deposit size, etc.), existing relationships are more profitable than new relationships. While a substantial part of most lenders' responsibilities is business development, retaining and enhancing existing accounts is a critical and efficient way to boost your portfolio's return on assets (ROA).

Competition for deposits is likely to continue in 2025, further hurting margins on a relative basis. Refinancing loans early and allowing the borrower to retain their credit spread for the remaining term helps increase margins now while helping the borrower take advantage of the current yield curve inversion.

Reaching out early to borrowers that have loans maturing in the next two years allows you to have an early conversation with the borrower, thereby limiting competition and providing certainty to the borrower. Negotiating new loan terms now also has the advantage of allowing your bank to shore up any credit issues before a credit shock happens in the next recession.

Download our playbook that further explains how to target, approach, and extend commitments on existing relationships.

4. Increase Your Average Loan Size

Because it costs the average community bank the same amount to generate a $250k credit relationship as a $2.5mm credit relationship, larger loans are more profitable for community banks (all else equal).

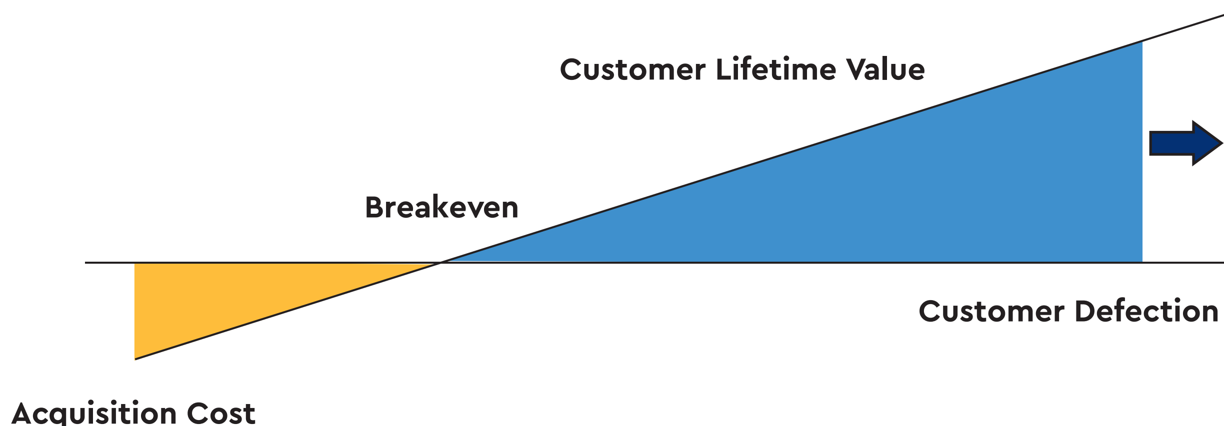
Banks should consider pricing loans below $400k at greater spreads to compensate for lower absolute revenue amounts. Conversely, banks should strive to prospect for larger loans to increase profitability.

Download an analysis showing the relationship between loan size and ROA/ROE. Contact us if your bank wants an analysis of loan size – ROA/ROE relationship for your bank considering specific efficiency ratio and balance sheet.

5. Focus on Long-Term Relationships

Commercial loan underwriting has a high upfront cost. The cost to source, underwrite, approve, document, and fund a loan is large compared to the expected profit margin of that loan. Because of thin margins and high origination cost, a loan ROE turns positive for a bank after substantial amount of seasoning. While the cost to book a loan is high, the ongoing maintenance cost is relatively low and as the loan continues to pay, the profitability to the bank increases. The graphic below demonstrates the negative return of a loan to a bank and how ongoing payments increase the ROA/ROE to the bank after a certain breakeven point. Bank performance is maximized by increasing loan retention and reducing customer defection.

Download an analysis showing the relationship between loan terms and ROA/ROE.



6.

Increase Loan Credit Quality

The three ways banks price their loans are:

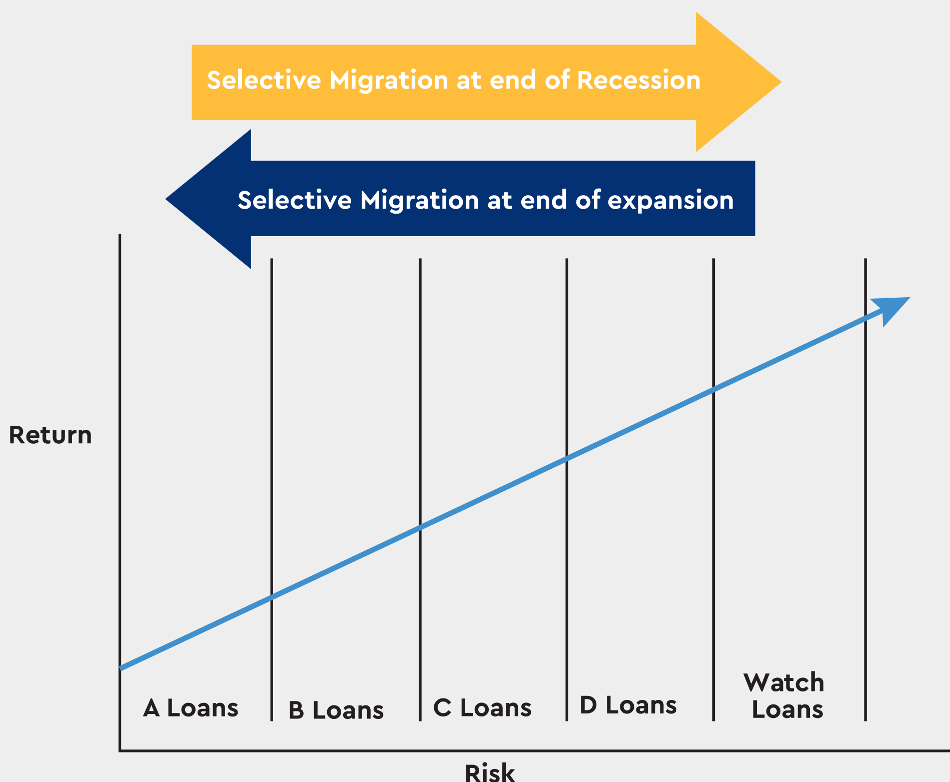
1) Price to competition. Banks determine where competitors are charging for similar loans in the marketplace and price accordingly.

2) Cost-plus pricing. Here banks calculate their cost of capital, funding costs, all direct and indirect costs and add a margin to determine the price.

3) Perceived value to the customer. While more subjective, the bank determines the maximum a borrower will pay for the perceived value of the banker's expertise and problem that the bank is solving. This is the optimal way for banks to price their loans to increase ROE.

Community banks that price on perceived value to their customers and migrate credit quality depending on the business cycle outperform the market. To optimize loan portfolio profitability, community banks must recognize how to migrate through the credit spectrum (see example of the concept in the graph below). During prolonged periods of expansion, banks misprice credit risk more severely. In a recession, better credit quality loans have a higher risk-adjusted ROE. By selecting the correct credit quality in anticipation of the change in the economy, banks can avoid negative selection bias.

Key Question: How is your bank currently pricing loans?



7. Build Relationships Not Transactions

Community banks can be profitable with both transactional and relationship customers. Some of the most profitable banks in the industry are purely transactional. However, most community banks desire to provide an array of products and services to attract relationships for both commercial and retail accounts. To do this and to overcome the cost, banks need to be good at effectively building a relationship utilizing a variety of products.

What is a relationship? It can be measured by the following parameters:

- **a)** Size of wallet
- **b)** Number of banking products used
- **c)** Commitment term
- **d)** Stickiness/switching costs
- **e)** Financing related to balance sheet instead of projects

> **"Longer loan commitment terms lead to more cross-sell opportunities in the form of low-cost and stable deposits."**

It takes time to build a relationship, and a short-term loan often does not give a bank enough time to cross-sell needed products. Borrowers with long-term commitments are less likely to prepay debt and more likely to deposit excess cash flow with their bank relationship.

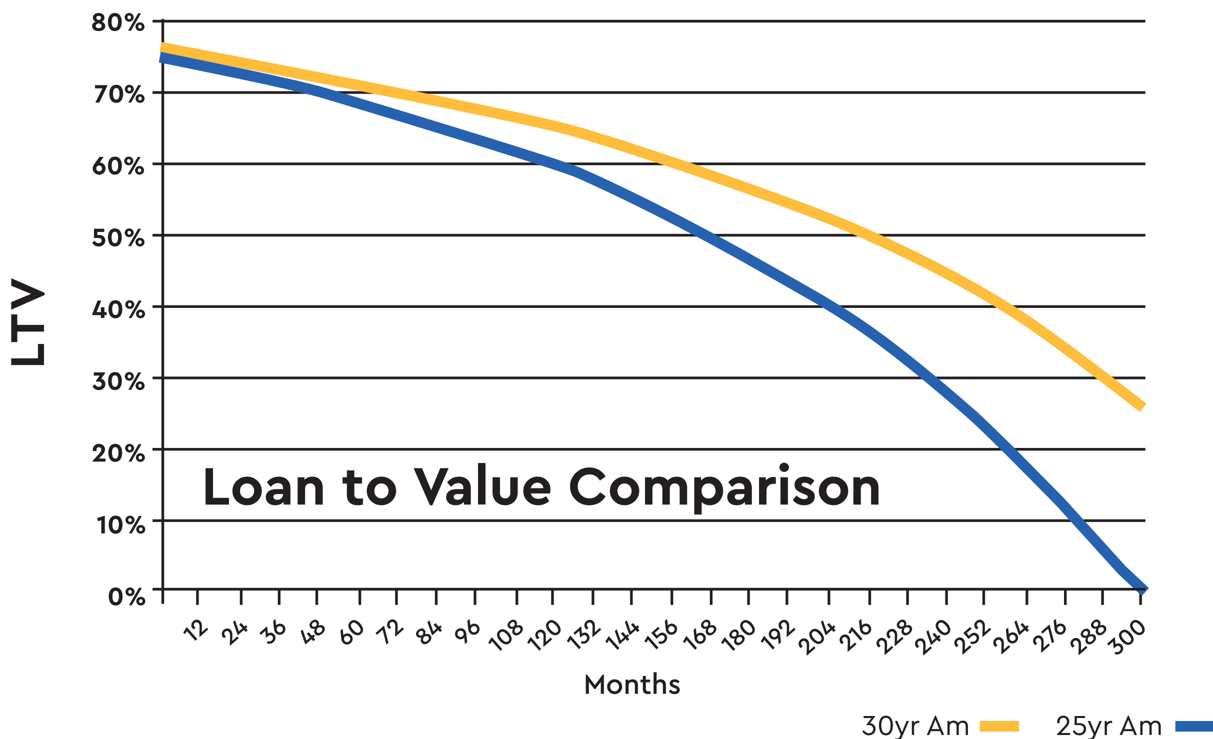
Project financing (credits that are callable when collateral is sold, substituted, or amended) lead to less stable relationships and higher defection rates. Community banks must identify ways of financing borrower's balance sheets and be collateral agnostic.

Download an explanation on how the ARC program leads to balance sheet financing.

8. Improve Credit Quality with Fixed Payment

The short-term loans to finance CRE projects or owner occupied commercial real estate (OOCRE) are inferior credit structures. If rates are higher in the future, the borrower's debt service coverage (DSC) ratio may not meet the bank's underwriting criteria, or the ratio may be below 1.0X. Further, on a 25-year amortization (am) schedule, the principal repayment in the first five years is less than 6% of the starting balance – the loan has not seasoned enough to reduce the loan to value (LTV) sufficiently to make up for the rate reset risk.

Below is a graph showing the LTV of two loans, one on a 25-year am (amortization) and one on a 30-year am and assumes no change in collateral value. Both loans start at 75% LTV. The critical point is that on a 25-year mortgage-style amortization, the loan principal reduction is very modest over the first few years – about 1% of the loan prepays each year over the first five years. Therefore, on an adjustable-rate loan, banks set a repricing feature that stresses the primary repayment capacity when the secondary source of repayment has not yet markedly improved. On the other hand, after 10 years, that 25-year amortizing loan is reduced from 75% to 60% LTV (assuming no change in collateral value) – offering substantially more equity cushion for the lender.



The other issue is credit decay. When a bank makes a loan, the chance of default is low as the bank has all the current information. However, as time goes by, credit quality can degrade. The average community bank loan has the highest probability of default between years three and six. This is one reason a bank wants to avoid a five-year balloon payment or rate reset. By year seven, normally the loan's amortization and appreciation of the collateral starts to lower the expected loss. This is why it is to a bank's benefit to not only structure longer term loans for profitability but for credit to lower the chance of a loss.

Key Question: Is your competitively priced loan also profitable for your bank? If you're not sure, we can assist by running the loan through our pricing model to find the Risk Adjusted Return on Capital. Simply provide us with the structure, credit quality and pricing of the loan.

Contact us here to price your scenario.

Section

Strategies to Increase Deposits, Fee Income, and Loan Value

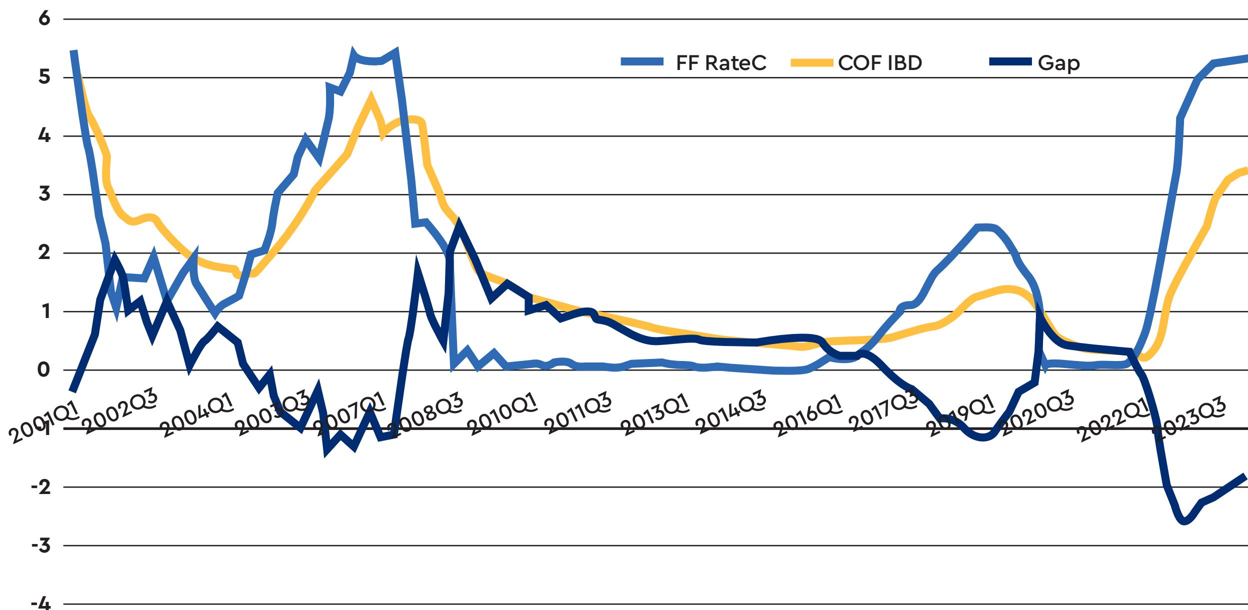
9.

Stabilize Your Cost of Funding

We expect that community banks will continue to experience decreasing demand deposit account (DDA) balances and funding pressure and deposit competition. In 2025, customers will continue to move money out of non-interest-bearing accounts and into interest bearing and investment accounts. This will continue to provide funding pressure at banks.

The graph below shows Fed Funds level, the banking industry cost of funds (COF) interest bearing deposits, and the gap between the two. That gap is the widest it has been in 23 years. As the Fed Funds rate stays constant, the industry's COF will increase to bring the gap to historical average. If the Fed does not move interest rates, banks should expect another 100bps rise in COF. To counter this impact, banks need to target (and price accordingly) cash rich retail and commercial relationships.

Download deposit pricing strategies.



10. Grow Deposits Through Strategic Marketing Campaigns

Longer-term loans allow banks to execute a multi-year marketing plan. If you are a bank manager, you might be wondering how to grow your business in a competitive and dynamic market. You might think that the key to success is to offer a better rate, lower fees, or more convenience. While these factors are important, they are not enough to differentiate your bank from others. You also need to invest in product development and marketing with the goal of creating and delivering value to your customers.

Marketing is not just about advertising or promotions. It is about understanding your customers' needs and preferences, segmenting them into groups, and targeting them with personalized messages and offers. Marketing is also about measuring the effectiveness of your campaigns and optimizing them for maximum impact. Marketing can help you attract new customers, retain existing ones, and increase their loyalty and satisfaction. Marketing can also help you enhance your brand reputation and image and create a competitive advantage in the market.

However, many banks are not doing enough to leverage the power of marketing. They are underinvesting in marketing budgets, undermanaging marketing teams, and underutilizing marketing tools and technologies. They are missing out on the opportunities that digital channels and creativity can offer to reach and engage customers in innovative ways. They are also failing to capture and analyze the data that can help them improve their marketing performance and return on investment.

In the download below, we will show you why marketing is a key source of value and growth for banks, and how you can improve your marketing strategy and execution. We will provide you with some best practices and examples of how banks can use digital channels and creativity to increase customer acquisition and retention, and to achieve high returns on investment. We will also give you some tips and recommendations on how to manage and measure your marketing activities and outcomes.

Here are the 15 most effective marketing campaigns.

11. Grow Fee Income Through Hedge Fees and Other Sources

The largest driver of bank performance as measured by ROA is fee income. The table below shows the top 12 variables that are statistically correlated to ROA for community banks. Non-interest income (fee income) is by far the biggest driver.

One of the biggest sources of fee income for community banks may be hedge fee income. Hedge fees represent the present value of a future hedge spread. A hedge fee is paid to the bank upfront and is recognized by the bank as upfront non-interest income.

Given a borrower's willingness to pay an acceptable all-in fixed rate, community banks may choose how much income to allocate to fees and how much to interest income.

Key Question: Does your bank have a plan to generate more fee income?

5yr Avg – Correlation to ROA – all banks $100mm to $10Bn assets		
1	Nonint Inc / Avg Assets	0.901
2	Nonint Exp / Avg Assets	0.424
3	Net Loan Charge-Offs / Avg Tot Lns & Lses	0.053
4	Average of Interest Exp / Avg Assets	-0.049
5	Average of Interest Income / Avg Assets	-0.033
6	Provision Exp / Avg Assets	0.032
7	Yield on Earning Assets (%)	-0.028
8	Realized Gains / Avg Assets	-0.026
9	Net Interest Income / Avg Assets	-0.020
10	Net Interest Margin	-0.014
11	Net Loan Charge-offs	0.013
12	Total Assets	-0.004

12. Increase Loan Value

Hedged CRE loans may provide the customer with alternatives that are hard to find in the market and may best match the customer's asset-liability position. These hedged loans provide the customer with a stable and predictable interest expense stream, and three additional benefits to borrowers.

a) Rate Portability

In the future, if the Borrower elects to sell the underlying property but wants to maintain the loan rate booked today, the existing loan and rate may be applied to a different property/project/purchase (subject to credit approval).

b) Loan Assumability

In the future, if the Borrower elects to sell the underlying property and the buyer perceives value in existing loan terms, the buyer may assume the loan and rate through closing (subject to credit approval).

c) Preservation of Low Rates for Future Growth

In the future, if rates are higher and the Borrower has additional financing needs to expand operations or facilities, the lower rate booked today may be blended into the larger loan amount to arrive at a below-market fixed rate (subject to credit approval).

Download a full explanation of the hedge prepayment provision.

Key Question: Could your bank and your customers benefit with long-term fixed rate payable by your customers while your bank receives floating without a derivative?

Conclusion

In conclusion, community banks have a wealth of opportunities to enhance their profitability and performance in 2025. By focusing on the key strategies outlined in this guide – increasing loan profitability, stabilizing cost of funding, growing deposits, generating fee income, and increasing loan product value – your institution can navigate the challenges of the current market and emerge stronger than ever.

Remember, the success of your community bank may depend on your ability to adapt, innovate, and execute these strategies effectively. By leveraging the downloadable resources provided and staying attuned to the evolving needs of your customers and the broader industry, you can position your organization for long-term growth and success.

As you embark on this journey, keep in mind that the path to success is not always easy, but with dedication, perseverance, and a commitment to excellence, your community bank can thrive in 2025 and beyond. Embrace the opportunities that lie ahead and continue to make a positive impact on the communities you serve.

Thank you for reading "Top 12 Winning Strategies for Community Banks in 2025." We wish you the best of luck and look forward to seeing your community bank flourish in the coming year.

– The end –

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