Hingham Institution for Savings (HIFS)

Summary

- Deposits are liabilities for banks and most of such liabilities have no limited maturity and can be withdrawn instantly through online banking. Perfect example was the tens billion withdrawal a day of the banking crisis March 2023.
- Bank was founded in 1834 with its first customer, US Senator and Secretary of State Daniel Webster. Bank financed the expansion of his farm in Marshfield with the amount of $1,500 dollars. https://www.hinghamsavings.com/assets/2017/04/1996-Annual-Report.pdf
- Also, Hingham Institution for Savings is one of America's oldest banks.
- HIFS is not a fast growing company. It is a family-run public company. It focuses on commercial residence loans (apartments etc) and commercial office loans which involve much higher risk.
- HIFS heavily utilized Federal Home Loans to fund its lending business.
- It is still a very small institution given the long history of the company.
- A summarized article about Hingham Institution for Savings. But there are some aspects of information from the article are not verified, such
    - Hand on the hot stove
    - No swaps/hedging
    - Market/Growth is very subjective, same as
    - Valuation
- **A cantor annual report.**

Business

- Traditional saving and loans bank.
- Primary focus is commercial real estate mortgage lending.
- 4 major categories of loans,
    - Residential real estate loans: Including homeowner occupied and line of equity. Generally, loan-to-value <= 80% without home loan insurance.
    - Commercial real estate loans: Loans primarily are secured by income producing properties, including income generating residential real estates, offices, and warehouses. Loan amounts do not exceed 75% of appraised value of the collateral.
    - Residential and commercial construction loans:
    - Commercial business and consumer loans.
        - Home equity loan
        - Commercial loan
        - Consumer loan
- More than 80% of loans are commercial real estate loans as 12/31/2022.
- 94% of loans are secured by properties in the Commonwealth of Massachusetts.
- Bank began lending to commercial real estate borrowers in the Washington DC metropolitan area in 2017 after two years of research and studies. Company believes in three major attractions in WMA.
    - Highest household **median** income of major metropolitan areas in the nation and concentration of young people
    - Real estate with the characters of high density, urban infill, scarcity and transit-oriented multifamily.
    - Small and mid-sized investors are underserved.
    - Bank has 60.1million and 62.1 million in commercial real estate loans in WMA in 2017, 2018 respectively.
    - All loans are reviewed and approved by the Bank's Executive Committee, and by Bank's full Board of Directors if loans are larger than $2.0 million. (at paragraph 3, page 5 of 2022 10-K filing).
    - **An Executive Committee member performs an on-site visit and the Executive Committee performs a collateral site visit at least twice annually.**

- Generally, commercial real estate loans have maturities of 15 years or less with fixed rate at first five years.
- HIFS defines a blanket lien that "principally as
    - 82% of the carrying value of first mortgage loans on certain owner-occupied residential property,
    - 82% of the market value of first mortgage loans on certain non-owner-occupied residential property,
    - 71% of the market value of first mortgage loans on certain multi-family residential property and
    - 68% of the market value of loans on certain commercial property,
    - The blanket lien is used to secure borrowings from the Federal Home Loan Bank".
- HIFS performs loan risk quality assessment quarterly or annual regarding loan amount.
    - Commercial loans are assigned an initial risk rating at origination of loans.
    - A quality control program performed by an independent third party.
    - All new loans with outstanding balances of $500,000 or more will be reviewed quarterly and assigned a risk rating.
    - Loans exposure of $850,000 or more and loans on Watch List will be reviewed on a quarterly rolling basis.
    - Loans with outstanding balance between $500,000 and $850,000 will at least be reviewed annually.
    - Watch List loans are two payments past due, borrower or sponsor file bankruptcy, impaired loans, modification loans experience financial difficulty, loans past contractual maturity, and loans risk rating are higher than four in previous review.
    - Loan rating:
        - 1-3B: consider "pass" with low to average risk
        - 4 : loans are "protected" but exhibit potential weakening condition
        - 5 : loans are not protected by collaterals, net worth, and/or paying capacity. Bank probably will sustain losses.
        - 6 : loans are considered doubtful in collection in full.
        - 7 : loans are considered uncollectible.

        - Detailed description of loan assessment at Asset Quality on last paragraph of page 6 and page 7 of 2022 10-K filing.
    - There are loans of $1.016 million that are rated 4 and above as of June 30, 2023.
- Company states "A member of the Executive Committee performs a site visit for every collateral property" in its financial filings (page 32, last paragraph).
- Wholesale deposit includes brokered and listing service time deposit which should be deemed unstable deposit (from a yield chasing, disloyal customer base), such Charles Schwab customers purchase CDs listed from banks on Schwab.com. Banks will usually pay higher interest plus other fees for the institutions that facilitate those transactions. Hence increase the cost for obtaining deposits.
- The growth of Hingham MA and Hingham Institution for Savings https://www.hinghamsavings.com/assets/2020/07/ThankYouHinghamForOurFirst150GreatYears.pdf

Note

- Reduced net income for 1Q and 2Q 2023 due to the declined interest margin which declined more than 50% compared to a year ago. However, this is a normal situation. When the Federal Reserve dramatically increases interest rates, banks have to pay out higher interest in order to compete for deposits, also to the Federal Home Loan Bank. At the same time, interest received from loans stays low because of older and lower rate loans. Hence the margin is compressed. The situation will be gradually reversed when the Federal fund rate stays at the same level for a longer period of time, or the Federal Reserve begins to lower the fund rate.
- **Deposits**
- HIFS has a high level of wholesale deposit which contains both sources of funding; though the level is declining in recent years.

- Internet Listing service deposit & Brokered deposit are deemed riskier funding sources for loans by FDIC and regulators because the nature of funds usually are non-local, non-relationship, and high interest and fee deposits. The risk resides on those depositors who are less likely to be loyal to the banks and will run away whenever there are better opportunities for return on investment. When huge quantities of CDs mature and are not renewed, how banks can find new sources of funding quickly enough to fulfill cash out flow (hence, it is like bank run).
    - Listing service definitions from FDIC which exclude the services facilitate deposits.
- To attract deposit customers with significant balance, including but not limited to institutions, municipalities, fiduciaries, the company offers **unlimited excessive deposit insuranc**e above FDIC limits through DIF (Massachusetts Depositors Insurance Fund).
- HIFS heavily utilized Federal Home Loans to fund its lending business. It provides the company a stable (the bank has more control over the in and out of funds) and better latitude to scale up and down lending business; nonetheless, HIFS has to pay a higher interest rate to the Federal Home Loan Bank.
  How the Federal Home Loan Bank works.
  Understanding borrowing from FHLB for bank business.
- HIFS participates in IntraFi's Insured Cash Sweep program and provides customers with up to $150 million deposit in FDIC insurance coverage. See how the ICS program works.
    - First Republic Bank (FRC) did not participate in similar programs and that was why First Republic Bank failed to protect wealthy client's deposits to avoid bank run. And we, in the softwaterinvestment.com, unwisely did not see it.
- At the end of 1Q 2023, Company had
    - deposit/total assets: 59.74%
    - cash/deposit: 14.50%
    - At the end of 2022, First Republic (Insolvent due to bank run) had
        - Deposit/total assets: 82.97%
        - Cash/deposit: 2.43%
    - At the end of 2022, JP Morgan Chase had

    - Deposit/total assets: 63.84%
    - Cash/deposit: 37.72%

- **<u>Lending</u>**
- At the end of 2022, the bank has over 80% of total loans in commercial real estate (including multifamily housing). It is considered riskier practice.
- Hingham has an average Loan-to-Value portfolio of loans. For example, loans are allowed up to 80% of appraised value, and mortgage insurances are required for which LTVs exceed 80%.
- **Avoid the temptation of fueling growth through acquisition of other banks (zero goodwill). Focus on the characters of borrowers. Gaughen's family rescued Hingham Institution for Savings from disaster without high debt buyout and made the wrong right and kept raiders away that are the characters.**
  - https://www.patriotledger.com/story/business/2015/11/20/hingham-savings-goes-big-goes/32974450007/
  - Proxy contest to nominate new directors of board. As in the contest proxy document, the stated proposed company direction still holds true today (page 4).
  - The result of contest proxy was 805,000 shares to 309,000 to replace management's directors and nominees
- CEO & Chairman Robert H. Gaughen Jr. and President & COO Patrick R. Gaughen and Gaughen family own approximately 17% of HIFS common stock. The portion of holding is significant; however, it is not huge enough to be significant as total amount to $65 million = $190*364964 shares. (page 30)
- One plus is that Gaughen family's holding of company stock increased 28% (79,940 shares) from 285,024 shares in 2009 to 364,964 shares in 2022.
- Banking industry is a sector of the economy that should always be regulated more tightly. The United States emphasizes boldness and adventure, from Europe to the new world, from coast to coast. Ambition usually runs on higher priority and takes on more risk. But the banking industry is an industry which uses others' money to make

money where it has a broader effect on other’s financial condition. When ambition is strong and safeguard is weak, trouble always follows. Banks meltdown caused the Great Depression; deregulation in the 1990s caused housing bubble and financial crisis 2008; more recently, releasing restrictions in 2018 caused little bank run of 2023.