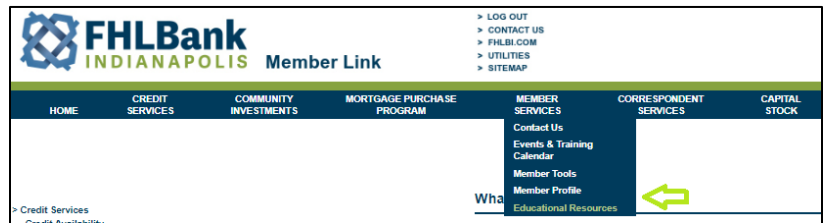# Marginal Cost Tool
Helping Evaluate the True Cost of Obtaining New Deposits

Many depository institutions are evaluating whether to raise deposits rates to generate additional funding (or to prevent deposits from leaving). Member Link provides members access to a tool that helps evaluate the impact of increasing deposit rates by calculating the marginal cost – the true cost of new deposits generated.

By clicking the Educational Resources link on Member Link, a member has access to view educational white papers and Member Tools, such as the Marginal Cost Tool.


To calculate marginal cost, the tool will ask for a few key assumptions, including the amount of new deposits projected to be generated and the amount of current deposits that may be moving to the higher deposit rate. Existing deposits that move from lower-paying accounts to higher promotional accounts are considered "cannibalized".

INPUTS	
Are you wanting to *increase* or *decrease* your deposit rates?	**Increase**
	SELECT
How much new deposits would you like to generate?	**$1,000,000**
	INPUT FIELD
What APY are you currently paying on deposits that will be cannibalized:	**1.00%**
	INPUT FIELD
New APY for deposits after increase:	**2.00%**
	INPUT FIELD
What is the expected life of the deposits? (Months):	**12**
	INPUT FIELD
Comparable FHLBank Indianapolis advance APR for a 12 month term:	**2.95%**
	INPUT FIELD
What percentage of new deposits do you anticipate cannibalizing with the higher rate? (1-99%):	**60.00%**
	INPUT FIELD

If you are repricing deposits that may not require a higher rate to stay, that will drive up the marginal cost of the new deposits that you do receive. Based on the above example, an institution might think that the $1,000,000 raised cost 2.00%. This would be incorrect. Due to cannibalization (increasing rates) on a certain amount of existing deposits (in this example 60%), the marginal cost of the $1,000,000 is **3.50%.**

The tool helps demonstrate how dramatically the marginal cost can increase given higher rates of cannibalization, or stated another way, if the proportion of new funds received is minimal.
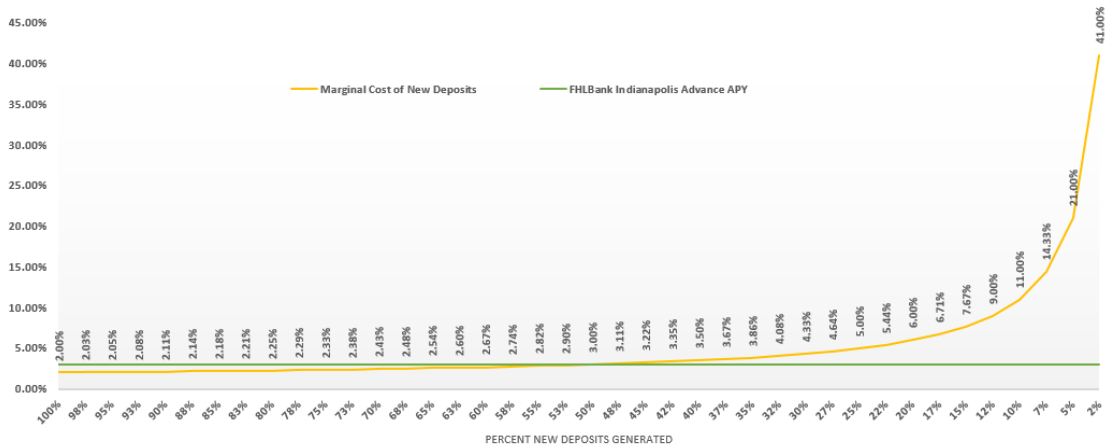
By knowing the factors that influence marginal cost of deposits, an institution can evaluate strategies to minimize cannibalization, such as segmenting accounts based on balance levels to help identify rate-sensitive depositors.

When raising deposit rates to generate new funding, an institution should compare the marginal cost of deposits to alternative funding costs – such as FHLBank Indianapolis advances. The marginal cost tool will compare the marginal cost, given assumptions, to the cost of borrowing the new funding needed.

In this environment of rising interest rates and increased deposit pressure, we want to equip our members with ways to evaluate and optimize their funding decisions.

Option 1: Increase rates to maintain deposits

	Weight	Deposit Value
Target new money generated:	40.0%	$1,000,000
Cannibalized money:	60.0%	$1,500,000
Total balance:	100.0%	$2,500,000
	Rate (APY)	Cost
Interest expense on new funds:	2.00%	$20,000
Interest expense on cannibalized funds:	2.00%	$30,000
Total interest expense:	2.00%	$50,000

Option 2: Use FHLBank Indianapolis advance to generate new funding

	Weight	Balance
FHLBank Indianapolis Borrowings:	40.0%	$1,000,000
Current money:	60.0%	$1,500,000
Total Balance:	100.0%	$2,500,000
	Rate (APY)	Cost
Interest expense on FHLBank Indianapolis borrowings:	3.03%	$30,300
Interest expense on current funds:	1.00%	$15,000
Total interest expense:	1.81%	$45,300
Annualized interest advantage by using FHLBank Indianapolis advance*:		$4,700

For additional assistance in analyzing funding strategies, contact FHLBank Indianapolis Member Services 800.442.2568 or memberservices@fhlbi.com