

## Rate Variance KPI

When budgeting interest income or interest expense, the formula is **ALWAYS** as follows:

Budget Average Balance X Budget Average Interest Rate = Budget Interest Income (or Expense)

Let's look at an example:

- Budget Average Balance = \$100,000
- Budget Average Interest Rate = 5.00%
- Budget Interest Income (or Expense) is \$5,000 (e.g., \$100,000 X 5.00% = \$5,000)

On most performance scorecards, there are KPIs for average balance. We also know where the budget average balance falls on the scorecard (hurdle four, for example). Based upon the forecast, we know if we are projected to meet the budget average balance (hurdle four), exceed the budget average balance (above hurdle four) or fall short of the budget average balance (below hurdle four). One could say that we are able to determine the "variance" to budget by simply looking at the scorecard.

	BUDGET										
	Baseline	+1	+2	+3	+4	+5	+6	+7	+8	+9	+10
<b>Meet Budget</b>											
Average Balance KPI	\$ 80,000	\$ 85,000	\$ 90,000	\$ 95,000	\$100,000	\$105,000	\$110,000	\$115,000	\$120,000	\$125,000	\$130,000
<b>Beat Budget</b>											
Average Balance KPI	\$ 80,000	\$ 85,000	\$ 90,000	\$ 95,000	\$100,000	\$105,000	\$110,000	\$115,000	\$120,000	\$125,000	\$130,000
<b>Fall Short of Budget</b>											
Average Balance KPI	\$ 80,000	\$ 85,000	\$ 90,000	\$ 95,000	\$100,000	\$105,000	\$110,000	\$115,000	\$120,000	\$125,000	\$130,000

So far we have only discussed the "balance" part of the  $Income = Balance \times Rate$  equation. What about rate? Are we running at budget, ahead of budget or behind budget on rates? This is what the rate variance KPI measures.

- If we budgeted a rate of 5.00% and we are realizing 5.00%, then we have a rate variance of 0.00% (e.g., Actual Rate of 5.00% - Budget Rate of 5.00% = 0.00% Variance).
- If we budgeted a rate of 5.00% and we are realizing 5.06%, then we have a rate variance of +0.06% (e.g., Actual Rate of 5.06% - Budget Rate of 5.00% = +0.06% Variance).
- If we budgeted a rate of 5.00% and we are realizing 4.95%, then we have a rate variance of -0.06% (e.g., Actual Rate of 4.95% - Budget Rate of 5.00% = -0.06% Variance).

These three scenarios are depicted in the graphic below:

	BUDGET										
	Baseline	+1	+2	+3	+4	+5	+6	+7	+8	+9	+10
<b>Meet Budget</b>											
Rate Variance KPI	-0.12%	-0.09%	-0.06%	-0.03%	0.00%	0.03%	0.06%	0.09%	0.12%	0.15%	0.18%
<b>Beat Budget</b>											
Rate Variance KPI	-0.12%	-0.09%	-0.06%	-0.03%	0.00%	0.03%	0.06%	0.09%	0.12%	0.15%	0.18%
<b>Fall Short of Budget</b>											
Rate Variance KPI	-0.12%	-0.09%	-0.06%	-0.03%	0.00%	0.03%	0.06%	0.09%	0.12%	0.15%	0.18%

The rate variance KPI combines the rates of all earning assets (e.g., loans and investments) and funding liabilities (e.g., deposits and borrowings) into one measure to view, on an overall basis, how we are performing on the pricing of our products versus what was budgeted. A positive variance means more income (or less expense) than expected (usually a good thing); a negative variance means less income (or more expense) than expected (usually a bad thing).