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Managing Through Uncertain Times

Banks are Part of the Solution, Not the Problem

April 16, 2020

Dear Shareholder,

As we live through these unprecedented times and attempt to navigate through one of the greatest health threats in living memory, our thoughts remain with communities globally, and especially with the brave healthcare workers and first responders at the front line of the crisis. We hope you and your families remain healthy and safe.

Trying to understand and predict the impact of the COVID-19 pandemic on the broader markets and global economy is extremely difficult at this juncture. However, we want to take the opportunity to discuss our current thoughts on the U.S. banking sector as it specifically pertains to EJF Investments Ltd ("EJFI"), given that much of the collateral backing EJFI's investments is debt and debt like instruments issued by U.S. community banks. Due to our belief that this is a crisis without a clear playbook, timely analysis and opinions from industry experts is extremely important. Therefore, while we fully acknowledge the severity of the economic impact of the crisis remains unknown, we choose to assess the current strength of the community banking sector and its inherent ability to cope with stress. We also evaluate its critical role in serving as an essential conduit for the regulatory and policy responses to the virus.

As such, we share our thoughts below on the status of the U.S. community banking sector and the regulatory initiatives taken by policymakers to help the U.S. and global economies to curtail the negative economic impacts of this health crisis.

We believe, the strength of the U.S. banking system will eventually act as an essential springboard to facilitate the economy getting back on track**.**

While the near-term economic outlook at this juncture appears dire, broadly speaking U.S. community banks entered this crisis with much stronger balance sheets than they entered the 2008 Global Financial Crisis ("GFC"). The implication for the economy from this point alone is immense given that the risk of the current situation also becoming a fully blown banking crisis in the U.S. remains low in our opinion.

Although the operating landscape is rapidly changing as a result of the virus, we believe bank-backed credit instruments including those that EJFI has invested in should continue to perform. Specifically, we believe measures taken by the United States Congress ("US Congress"), principally through the Coronavirus Aid, Relief and Economic Security ("CARES") Act, as well

as actions taken by the U.S. Federal Reserve System/Bank and regulatory agencies, should provide sufficient liquidity and a sound backstop to allow the financial system to weather the current crisis. Indeed, programs such as the $349 billion Paycheck Protection Program ("PPP"), administered by the United States Small Business Administration (the "SBA") and the United States Department of the Treasury ("US Treasury"), provide direct support to small businesses to maintain payroll, service rent or mortgage obligations, and pay utilities, in the form of a forgivable loan. The PPP allows banks to issue 1% interest bearing loans fully backed by the U.S. government and, most importantly for banks, impose up-front fees in the 3-4% range. We believe these fees act as an indirect stimulus to the community banks. In essence, the PPP allows banks to support their loan book as they have sought to provide PPP loans primarily if not exclusively to existing borrowers. Additionally, the facility allows issuing banks to pledge PPP loans as collateral at a rate of 35 basis points and no administrative fees. This alleviates community banks balance sheet constraint as a limiting factor for the issuance of PPP loans. It also improves the overall economics for the community banks as it can generate a spread of 65 basis points and removes the need to raise funding elsewhere or utilize valuable liquidity presently on balance sheet. Moreover, we believe that an additional $250 billion of funds will be made available for the PPP by Congress in the very near term given the initial success of the program as a delivery mechanism of relief to borrowers.

In addition to the PPP, there is broad-based mortgage payment forbearance in place. This forbearance allows borrowers to defer principal and interest payments for all agency mortgages for up to 180 days. In concert with these actions, the primary bank regulators including the Federal Reserve, Federal Deposit Insurance Corporation, Office of Comptroller Currency, National Credit Union Administration, Consumer Financial Protection Bureau and state regulatory agencies, issued a joint statement on March 22, 2020, explicitly outlining parameters that banks may modify loans without a punitive regulatory response. We believe these initiatives should substantially reduce near-term credit risk as they provide direct subsidisation to much of the collateral of the community banking system, while also encouraging banks to work liberally with borrowers. According to our estimates, approximately 75% of the collateral on commercial banks' balance sheets is real estate backed, which we believe will be well protected by the stimulus measures[1].

Although we believe there will be a period of stress, the interagency communique and recent legislation gives banks a degree of certainty without fear that exposures will become troubled debt restructurings ("TDRs") and face regulatory downgrades that negatively impact P&Ls. This is important as the health of a bank is largely measured by its credit quality. Additionally, the proposal to delay Current Expected Credit Loss ("CECL"), an accounting policy which requires banks to account for expected credit losses for the lifetime of a loan upfront, provides further relief to banks.

Banks under financial stress are subject to dividend restrictions between bank subsidiaries and holding companies which may limit their ability to service holding company obligations such as subordinated debt and trust preferred securities. However, due to the protections we outlined

[1] Source: S&P Global Market Intelligence and FDIC, as of December 31, 2019

above, we believe the most relevant metric assessing the near-term health of the banking system is industry data as of December 31, 2019. We note that the commercial banking system had low levels of nonperforming assets at just 0.59%, strong profitability as measured by a core return on average assets at 1.2%, and 9.5% tier 1 common equity ratios (vs. 6.75% in 2017) which is amongst the highest percentage in modern history[2]. We also note 'riskier' lending since the GFC has drastically come down with construction and development lending exposures being materially less at 3% on average vs. c.8% heading into the GFC.

In addition to fiscal and regulatory actions, the swift monetary policy response from the Federal Reserve in the form of interest rate cuts and expanded access to the Federal Reserve Discount Window and credit facilities, in our view, has significantly enhanced overall market liquidity while also allowing banks to lower their cost of funds.

Moreover, factors benefiting these investments prior to the pandemic, such as a favourable regulatory climate and robust merger & acquisition ("M&A") market should remain relevant when times return to being less stressed. Indeed, given the operating leverage improvements gained through M&A, we believe many bank management teams will continue to look for consolidation opportunities to allow them to become stronger and more efficient institutions, and thus even more resilient in the future. This is particularly true given the low interest rate environment. We feel that banks are incentivized to combine to achieve economic efficiencies as net interest margins compress.

Overview of Fed actions, CARES Act and Fiscal implications:

The Federal Reserve, US Treasury and US Congress have taken major policy actions to limit financial market stress and cushion household and business income losses from the pandemic. The policy response has exceeded the actions taken following the 2008 GFC. We believe the sheer amount of stimulus and support being injected in the market will help recover many of the losses we unfortunately anticipate to jobs, income, expenditure and GDP. We also believe certain policies and their structural nuances are specific to aid the banking sector and have galvanised our view that policymakers and the global economies can ill afford bank failures and a loss of systemic confidence at this time. Indeed, the CARES Act provides authority to the FDIC to not only insure deposits at banks, but also any debt issued by banks. Although we believe this authority of the FDIC will only be used judiciously in select situations, it could provide a backstop to debt instruments such as trust preferred securities and sub debt held by EJFI in its portfolio.

Alongside the recent stimulus proposals mentioned above, policymakers have been quick to act with regard to introducing further actions which we believe will help bring stability to the economy and markets. We discuss these further here: https://www.ejfi.com/media/1391/us-coronavirus-stimulus-proposals.pdf

In conclusion, as we anticipate severe deterioration in global economies and markets due to the COVID-19 pandemic and associated shutdowns and we expect banks to play a crucial role in the subsequent recovery of such markets. We believe that prior to the pandemic, the U.S. community

[2] Id.

banking sector was in a very healthy state with historic capital and liquidity buffers, and thus entered the crisis from a position of strength, underpinned by a robust prudential framework. We expect policy makers to underpin this healthy banking sector in order that it may act as a source of strength and serve as the mechanism to transmit the liquidity and credit they are injecting into the economy. These factors, namely an initially strong banking sector being an essential part of the response to the pandemic, are central to our belief that EJFI's regulated bank exposures will continue to perform even as the U.S. enters recessionary territory.

Neal J. Wilson

Chief Executive Officer

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