



# First Glance 12L (3Q19)



Economic and Banking Performance in the 12th Federal Reserve District (“12L”)

## Interest Rate Shift Helped Housing but Hurt Bank Net Interest Margins

**December 6, 2019**

This report is a product of the Financial Institutions Supervision and Credit Department. It is based upon preliminary data from 3Q19 and prior Condition & Income Reports as well as other examination and economic sources. Data has been prepared primarily for bank supervisors and bankers. The opinions expressed in this publication are those of the authors. Opinions are intended only for informational purposes, and are not formal opinions of, nor binding on, the Federal Reserve Bank of San Francisco or the Board of Governors of the Federal Reserve System.

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# 12th District Overview

## “Interest Rate Shift Helped Housing but Hurt Bank Net Interest Margins”

Quarterly job growth in the West slowed modestly, but continued to trend upwards from a mid-2018 trough as the region shrugged off trade tensions and slowing global growth. One-quarter annualized nonfarm job growth in the Federal Reserve’s 12th District (District) decelerated to 1.9% in 3Q19, from 2.4% a quarter earlier. The third-quarter deceleration was largely due to a slowdown in the pace of leisure/hospitality hiring, as well as a reversal of the 2Q19 spike in construction job growth. Meanwhile, the business/professional and education/health services sectors, which accounted for more than 30% of District employment, continued to perform well. At the state level, job growth in California and Washington moderated after a 2Q19 jump, while hiring in Utah accelerated significantly (see table at right). Unemployment rates also ticked down in most District states, and remained at or near post-recession lows amid a robust labor market. Furthermore, while purchasing managers indices suggested that manufacturing activity contracted at the national level in 3Q19, the California and Washington indices remained in expansion territory.

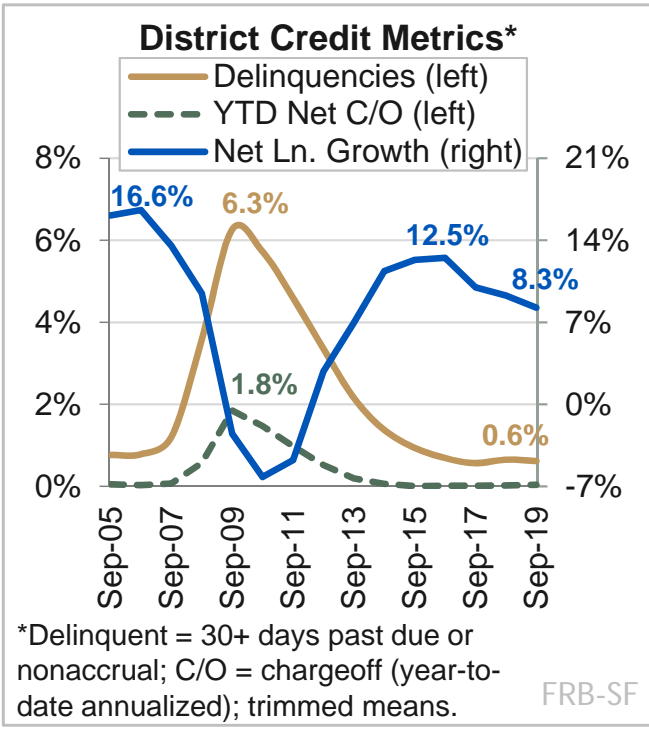
*Housing markets rebounded across the District, boosted by lower mortgage rates.* In 3Q19, the pace of home-price appreciation stabilized or increased slightly from the second quarter in most District states; although appreciation rates remained lower than in 3Q18. Home price gains in Nevada and California bucked the trend, cooling quarter-over-quarter. Single-family home sales and permitting activity across the District also strengthened following a late-2018/early-2019 lull. Encouragingly, housing affordability improved in all District states relative to 3Q18, owing to a combination of lower mortgage rates, growing household income, and slower home price growth.

*Commercial real estate (CRE) fundamentals in the District remained healthy, but CBRE Econometric Advisors (CBRE-EA) expected vacancies to rise in 2020 as new supply outpaces demand.* CBRE-EA forecasts suggest that the aggregate vacancy rate in the District will reach cyclical lows in 2019 across CRE property sectors, but will rise thereafter. The office and industrial sectors, in particular, have seen absorption rates well above completion rates since the end of the recession, but over the coming year, completions may continue to rise while absorption slows. CBRE-EA also expected net operating income (NOI) growth to remain positive, albeit slower, in nearly all District markets in 2020. CRE price trends reflected these forecasted fundamentals; although, commercial property price appreciation decelerated in the past year relative to previous years. The industrial sector, in particular warehouse properties, were the exception. Investors have favored industrial properties as defensive assets in the face of potentially slowing economic growth due to low required capital expenditures relative to NOI. Year-over-year, trailing 12-month average CRE capitalization rates in the West stabilized or ticked higher for most property types, but investor demand pushed capitalization rates for warehouses and downtown offices lower.

Nonfarm Job Growth & Unemployment			
State	Job Growth (annualized)		Unemp. Rate
	12 Qtr.	3Q19	Sep-19
UT		4.1%	2.7%
AZ		2.6%	4.9%
ID		2.5%	2.9%
WA		2.0%	4.6%
CA		1.9%	4.0%
NV		1.7%	4.1%
HI		0.6%	2.7%
OR		0.4%	4.1%
AK		-1.8%	6.2%
US		1.4%	3.5%

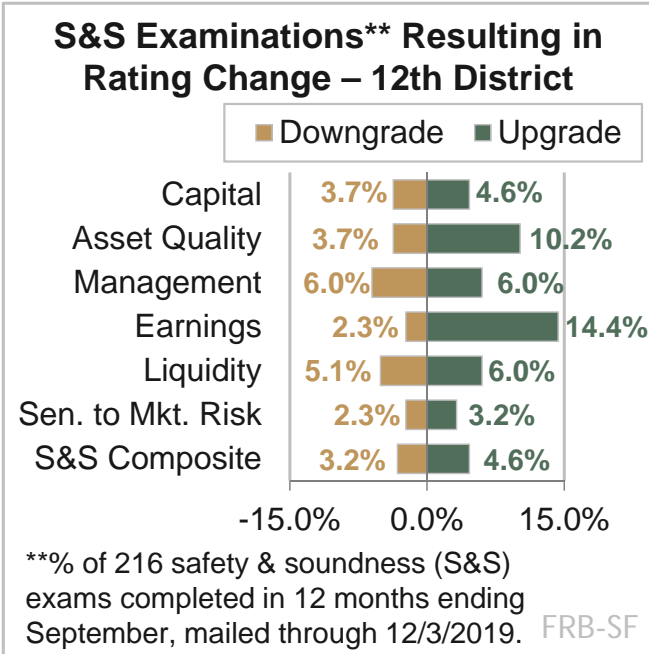
Seasonally adjusted. FRB-SF  
 Source: Bureau of Labor Statistics  
 via Haver Analytics.

# 12th District Overview, Continued



Bank profits inched higher year-over-year but moved little on a quarterly basis. District banks' average year-to-date 3Q19 ROAA ratio was 1.25%, up 2 bps from the same period in 2018 (adjusted for Subchapter S tax filers), owing mainly to wider net interest margins compared with the first nine months of 2018. Meanwhile, the average one-quarter annualized ROAA was 1.27%, similar to results in the prior and year-ago quarters. Compared with 2Q19, lower overhead burdens and higher noninterest income ratios often helped to offset narrowing quarterly net interest margins. Net interest margins may remain under pressure given additional short-term interest rate cuts in 4Q19.

Annual net loan growth slowed further but credit problems remained minimal. The District's annual net loan growth rate averaged 8.30%, down 42 bps from 2Q19, while the national average eased 57 bps to 4.90%. Average growth rates cooled among most major portfolio categories. Similar to prior periods, the C&LD and multifamily mortgage segments tended to grow fastest. In spite of continued CRE loan growth, the average nonowner-occupied CRE loan-to-capital ratio held steady at 227%, which was still more than 100 bps above the national average. Bankers surveyed by [Promontory Interfinancial Network](#) noted waning optimism about future loan demand and economic conditions, which may portend continued slowing. Favorably, District banks' average past-due loan rate, which inched down year-over-year to 0.62%, remained less than half the national average of 1.38% (see chart, upper left).



On-balance sheet liquidity and capital positions strengthened; jumbo CD reliance stabilized. Loan-to-asset ratios dipped quarter-over-quarter—owing partly to seasonal factors—and year-over-year. Meanwhile, the average mix of assets held in securities and other liquid instruments ticked up. The majority of assets at most banks continued to be supported by nonmaturity deposits and banks' shift towards jumbo CDs slowed somewhat in 3Q19. Capital ratios were generally steady-to-higher compared with 3Q18 and 2Q19. Continuing an earlier trend, small banks reported stronger levels of year-to-date capital accretion than mid- or large-sized firms because of comparatively modest dividend payouts.

Supervisory ratings upgrades generally outpaced downgrades. In the twelve months ending September, safety and soundness examination component and composite ratings continued to shift favorably, on net, at a small fraction of institutions (see chart, bottom left). Although Earnings component ratings were more frequently upgraded than other areas, 12.7% of banks continued to be rated less-than-satisfactory for Earnings, the highest among all components. Overall, 92% of safety and soundness ratings and 96% of consumer compliance and Community Reinvestment Act performance ratings were satisfactory or better in the District.

# **Section 1**

## **Spotlight Feature & Hot Topics**

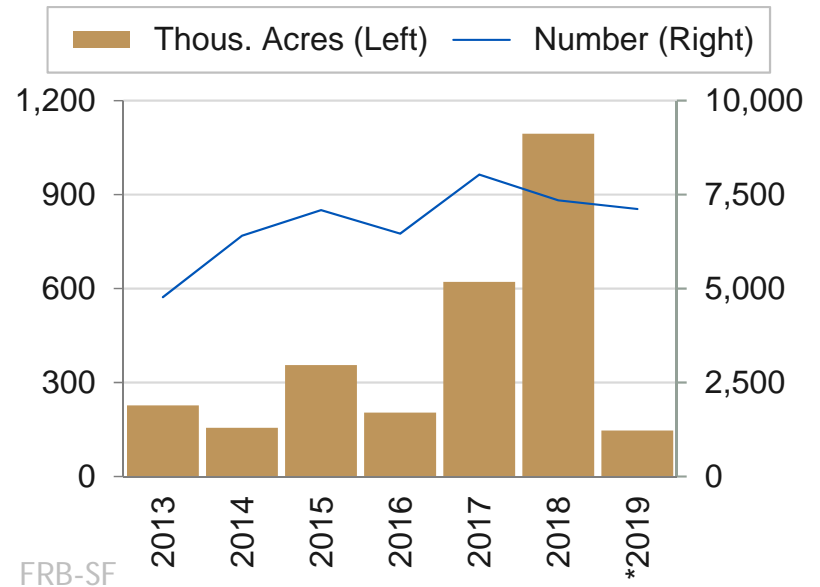
**California Wildfire Risks and Impacts**

**Hot Topics We Are Monitoring Most Closely**

# Spotlight: California Wildfire Risks and Impacts

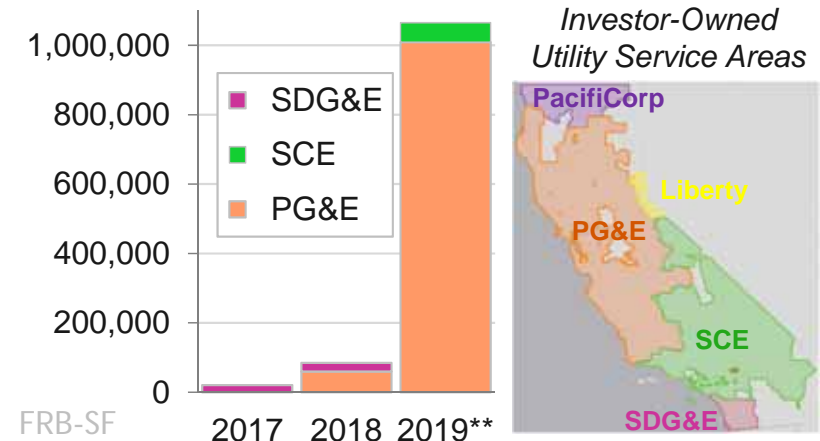
- California wildfire activity has been significant in recent years, amplified by climate change, drought-weakened vegetation, seasonal wind events, and increased development in the wildland-urban interface. Year-to-date (YTD) through December 5, 2019, the National Interagency Fire Center reported 7,177 wildfires involving 147 thousand acres in California (excluding U.S. Forest Service and prescribed burn activity).*
- Depositories and their staff and customers have been among those affected. For instance, 24 FDIC-insured depositories reported 81 offices within wildfire evacuation zones declared in September and October 2019. Nearly 80% of the offices were located in Sonoma County, where the Kincadee fire displaced 180 thousand residents and burned 77 thousand acres.*
- Although sizeable, YTD acreage trailed well behind the 2018 tally (see chart, upper right). Last year, more than one million acres were burned, led by the Mendocino Complex (459 thousand acres), Carr fire (227 thousand acres), and Camp blaze (153 thousand acres). These three incidents ranked as the first, seventh, and sixteenth largest in the state's history, respectively. The Camp fire was also California's most destructive wildfire on record, claiming 85 lives and consuming more than 18 thousand structures. According to the [California Department of Insurance](#), direct insured losses from wildfires in 2018 topped \$13 billion, exclusive of fire suppression costs, uninsured losses, and indirect economic impacts. For banks, insurance claims can mitigate credit losses and fuel deposit inflows as customers receive settlements.*
- A major complicating feature of California's 2019 fire season was utilities' expanded use of preemptive power shutdowns, or [Public Safety Power Shutoffs](#) (PSPS), in advance of dry, gusty weather. Increased use of PSPS was partly in response to the role of electrical equipment in destructive fires in recent years—and utilities' associated liabilities—and also because of several high-speed, low-humidity wind events. Through October 26<sup>th</sup>, PSPS events affected more than one million utility customers (see chart, lower right), which crimped economic activity, caused food spoilage, and challenged powered medical devices and refrigerated medicines. Pacific Gas & Electric (PG&E), which services 16 million people across 70,000 square miles, [noted](#) that PSPS events may continue for at least a decade.*

## California Wildland Fire Activity



Excludes U.S. Forest Service incidents and prescribed burns. Source: National Interagency Fire Center (\*YTD 12/5/19).

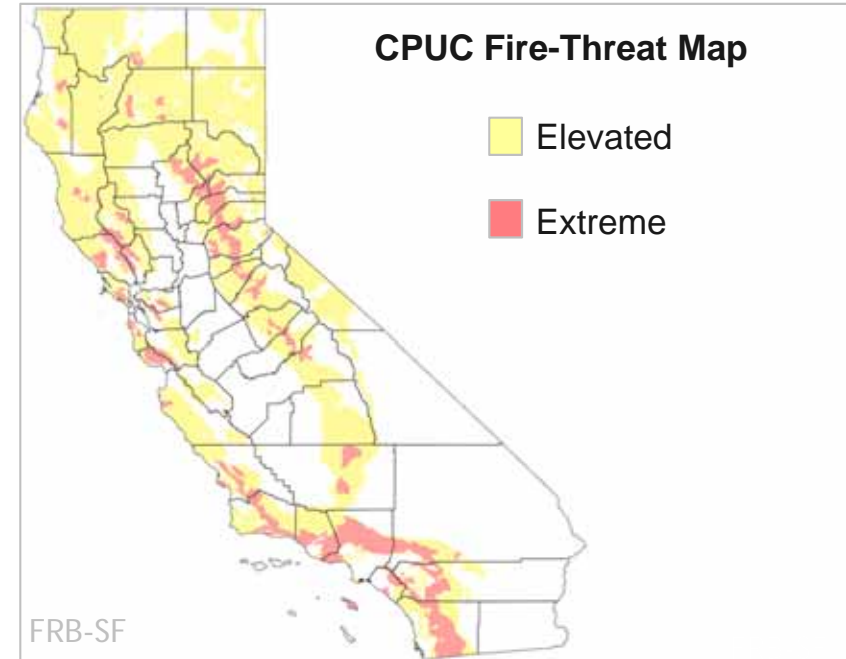
## Customers Affected by PSPS Events in CA



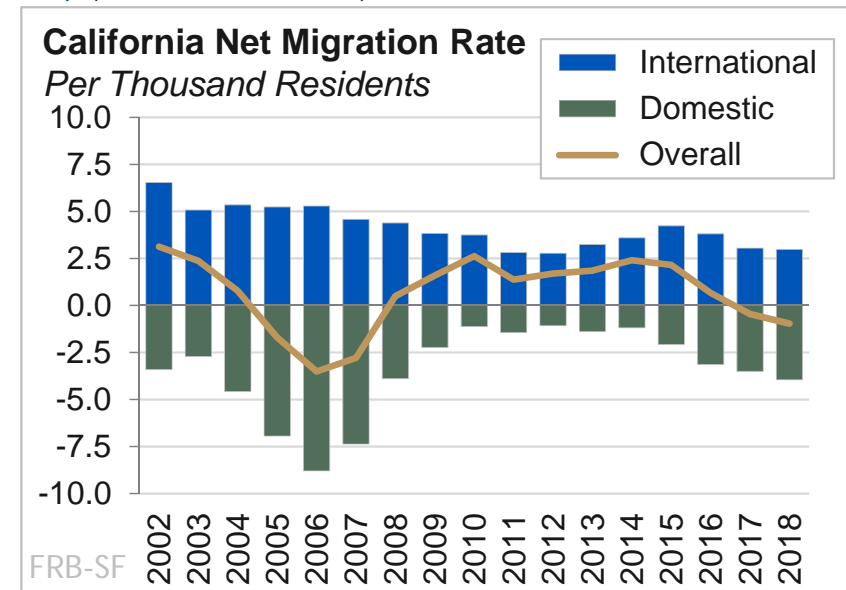
SDG&E = San Diego Gas and Electric; SCE = Southern California Edison; PG&E = Pacific Gas and Electric. Source: California CPUC (\*\*YTD 10/26/19)

# Spotlight: California Wildfire Risks and Impacts, Cont'd.

- *Power shutdowns have amplified operational risks to banks and thrifts.* Whereas wildfires are mainly a risk to firms operating in or near fire/evacuation zones, now, bank and thrift operations can be affected if located within a fire-prone area and there are significant, dry, gusty conditions, regardless of an actual fire event. Because of the time required to inspect equipment prior to re-energizing, power can become unavailable for days. Based on the California Public Utility Commission's [Fire-Threat Map](#), which may indicate areas at greater risk for shutdown (see map, upper right), 2,151 California branches of FDIC-insured depositories were within one mile of an area with elevated or extreme fire danger, nearly one-third of all such offices reported in the state. Back-office administrative and operational facilities could also be impacted.
- *Planned outages can also have liquidity and credit impacts.* PSPS events can cause increased demand for cash in advance of shutoffs and contribute to lost earnings and wages among affected consumers and businesses.
- *Increasingly, homeowners and businesses located in California face the prospect of higher priced or possibly unavailable insurance and electricity as a result of wildfire dangers.* Climate change, which contributed to wildfire risks, may also leave coastal areas prone to chronic flooding in the coming decades, threatening property values and insurance costs/availability in those areas.
- *The growing frequency of planned power shutdowns could compound California residents' concerns about living conditions in the state.* Prior to this Fall's extensive power shutdowns, a [report by Edelman](#), a public relations firm and consultancy, noted that among 1,500 residents surveyed, 62% felt that the best days of living in California were behind rather than ahead; 72% felt the cost and availability of housing were serious issues; and 53% were considering moving out of state because of the high cost of living. Wildfire, PSPS events, and climate change issues could spur additional outmigration from the state. On net, more people moved out of California than arrived here in 2017 and 2018 (see chart, lower right). Popular destinations for outmigration included neighboring states in the District as well as areas like Texas. Migration shifts could crimp real estate values, tax receipts, and various measures of economic output in California, and create affordability strains in the states to which residents relocate.



Source: California Public Utilities Commission [Fire-Threat Map](#) (accessed 12/4/2019).

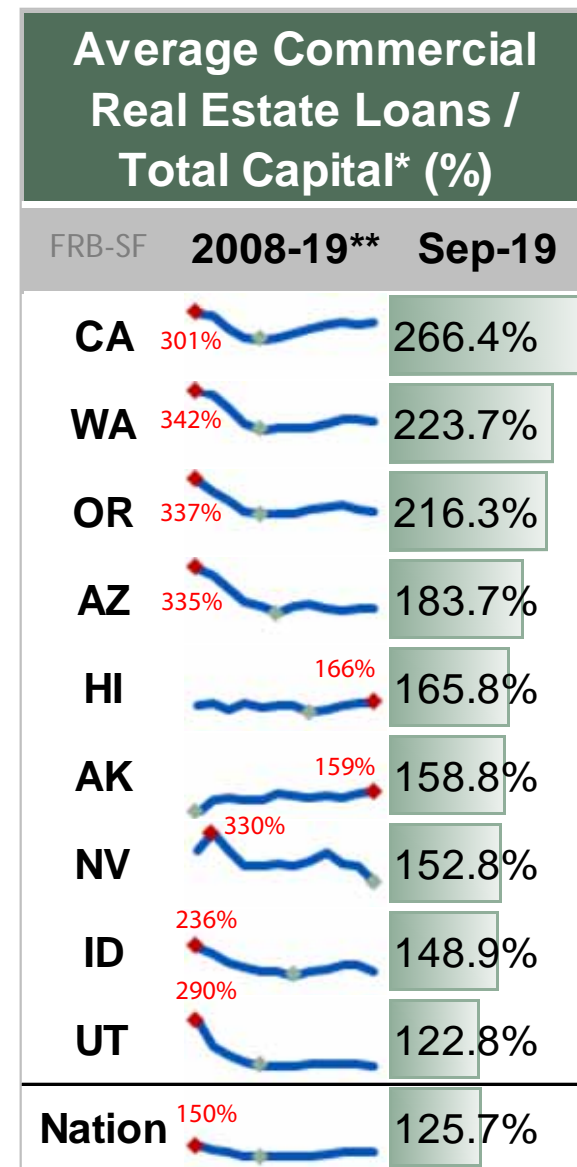


Source: Census Bureau.

# Hot Topics: Areas We Are Monitoring Most Closely

The following areas are drawing heightened attention and monitoring within the 12th District:

- Cyberthreats.** Attackers prey on the vulnerability of humans as well as systems, leaving bank networks, their employees, and their clients targets for cyberattacks. Attackers can leverage email to perpetrate attacks. According to Symantec's [Monthly Threat Report](#), during September 2019, 1 in 741 emails to the finance, insurance, and real estate sector globally were malicious and 1 in 5,813 contained phishing attempts. The sector's malicious email rate was lower than that reported across all sectors, but the phishing rate was higher than the overall average of 1 in 7,896. Strong staff and customer training and vendor management are key to cybersecurity. Notably, among cyber-related Suspicious Activity Reports filed by 12th District institutions during the first nine months of 2019, 85% involved activity against customers, 8% included actions against the institution, and the remainder were other types.
- Bank Secrecy Act (BSA)/Anti-Money Laundering (AML) compliance.** Even though the volume of BSA/AML-related supervisory criticisms at District institutions has moderated, this area remains a "hot topic" due to the District's role in the global economy and the array of activities being conducted by supervised institutions. BSA/AML compliance risks also continue to garner supervisory attention as more states legalize cannabis for medical and recreational purposes. These issues persist notwithstanding recent interagency guidance on providing services to permissible hemp-related businesses ([SR letter 19-14](#)).
- CRE lending concentrations.** Non-owner occupied CRE loan concentrations have eased from pre-crisis peaks because of lower C&LD lending volumes, but they remained above the U.S. average across most District states (see table at right). Concentration levels, combined with elevated property prices and potential competitive easing of underwriting standards, heighten regulatory concern. A significant shift in financing conditions and/or job markets could pressure CRE price appreciation. For risk management guidance, see the *Interagency Statement on Prudent Risk Management for CRE Lending* ([SR letter 15-17](#)).
- Quality of loan growth.** Since early 2014, banks based in the West have reported one of the fastest average annual rates of loan growth among the Federal Reserve's twelve districts. Above-average economic growth, real estate price appreciation, and merger activity contributed to portfolio expansion. However, many CRE loans are underpinned by historically high collateral values. Vulnerabilities extend to other segments such as C&I. The U.S. nonfinancial business debt-to-gross domestic product ratio is near record levels, propelled by subinvestment and near-subinvestment grade loans and bonds. Leverage, combined with loosened underwriting may amplify loan losses during the next recession.



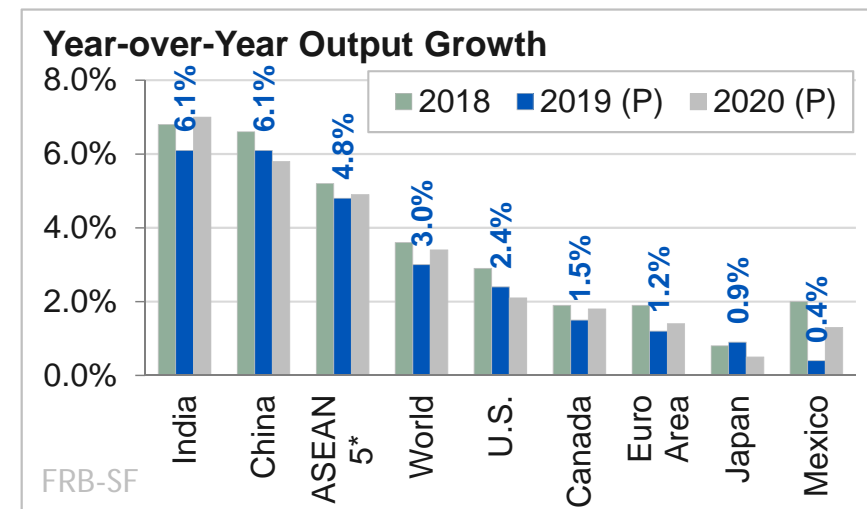
\*Trimmed means; excludes owner-occupied CRE; \*\*Sept. 30<sup>th</sup> of each year.

◆ = trough ◆ = peak



# Hot Topics: Areas We Are Monitoring Most Closely

- *Lengthened asset maturities.* In prior years, many banks increased their holdings of longer-term assets, driven by low short-term interest rates and a relatively steep yield curve. This trend moderated somewhat after 2014; however, the proportion of longer-dated assets remained elevated through 3Q19. Longer-term assets may be prone to refinancing, and thus downward repricing, during a period of declining interest rates, but slow to reprice as interest rates increase. If assets are not properly hedged or matched in terms of funding, these features could mute margin expansion in a changing interest rate environment.
- *Widening funding gap.* Subsequent to the financial crisis, strong, sustained loan growth was supported by an influx of NMDs, especially large NMD accounts, as well as a decline in on-balance sheet liquidity. However, in recent years, NMD growth has lagged asset and loan growth within the District and nationwide. Meanwhile, the share of District bank assets held in securities remained below cycle peaks. In the face of lagging NMD growth, banks have turned to pricier funding sources and deposit competition has intensified, pressuring net interest margins.
- *Consumer compliance issues.* In addition to redlining, overdraft practices, unfair or deceptive acts or practices, and recent changes to the Home Mortgage Disclosure Act, supervisors are monitoring risks posed by increased merger and acquisition activity. Expanding business volumes; changing operations, delivery channels, or market areas; and new products or business lines could amplify compliance risks.
- *Evolving financial technology (fintech) opportunities and risks.* Fintech includes a broad range of technologies and services involving digitization of lending and servicing, payments, wealth management, data aggregation, and other areas. Banks have increasingly partnered with fintech firms. Given the nontraditional origination methods that marketplace lenders may use, including interfaces with data aggregators, bank partners should closely evaluate transactions for credit, fair lending, privacy, and unfair/deceptive acts or practices.
- *Global economic slowing and geopolitical tensions.* In October, the [IMF](#) further downgraded its expectations for world output, projecting 3.0% annual growth in 2019, the slowest pace since the global financial crisis. Rising trade barriers, elevated geopolitical uncertainty, emerging market strains, and structural factors such as aging demographics have contributed to slowing. Broad-based declines in manufacturing and global trade have been notable features of the slowdown in 2019. Global growth may improve in 2020, but the rebound may be geographically uneven (see chart at right).
- *Overall financial stability issues and threats.* The [Federal Reserve's November 2019 Financial Stability Report](#) highlighted several systemic concerns, including but not limited to compressed yields on high yield bonds and leveraged loans, elevated CRE and farmland values, high corporate leverage amid weakened credit standards, recent increases in equity and bond market illiquidity, and potential liquidity risks among mutual funds that hold high yield bonds and corporate loans. The report also noted near-term risks posed by Brexit, global economic slowing, and trade frictions.



\*Association of Southeast Asian Nations (ASEAN) 5 includes Indonesia, Malaysia, Philippines, Thailand, and Vietnam; (P) = Projected. Source: International Monetary Fund, *World Economic Outlook Update*, October 2019.

# Section 2

## Economic Conditions

**Job Growth**

**Housing Market**

**Commercial Real Estate**

For more information on the District's economy, see:

*Banks at a Glance*

[\(https://www.frbsf.org/banking/publications/banks-at-a-glance/\)](https://www.frbsf.org/banking/publications/banks-at-a-glance/)

For more information on the national economy, see:

*FRBSF FedViews*

[\(https://www.frbsf.org/economic-research/publications/fedviews/\)](https://www.frbsf.org/economic-research/publications/fedviews/)

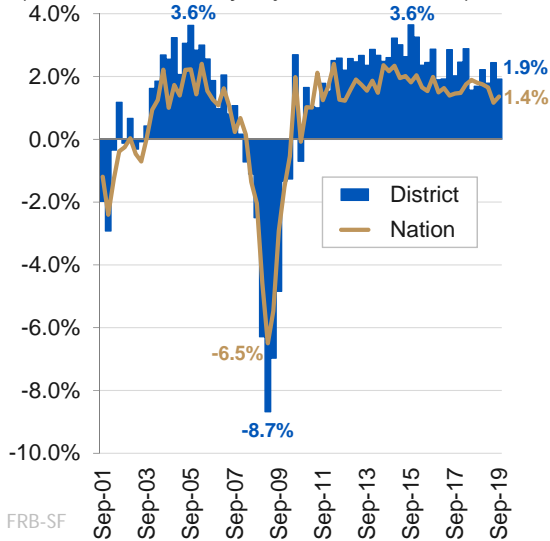
*FOMC Calendar, Statements, & Minutes*

<https://www.federalreserve.gov/monetarypolicy/fomccalendars.htm>

# 11 District hiring remained on an up-trend from mid-2018, despite slowing leisure and construction job growth.

## Nonfarm Job Growth

(1-Quarter Seasonally Adjusted Annual Rate)



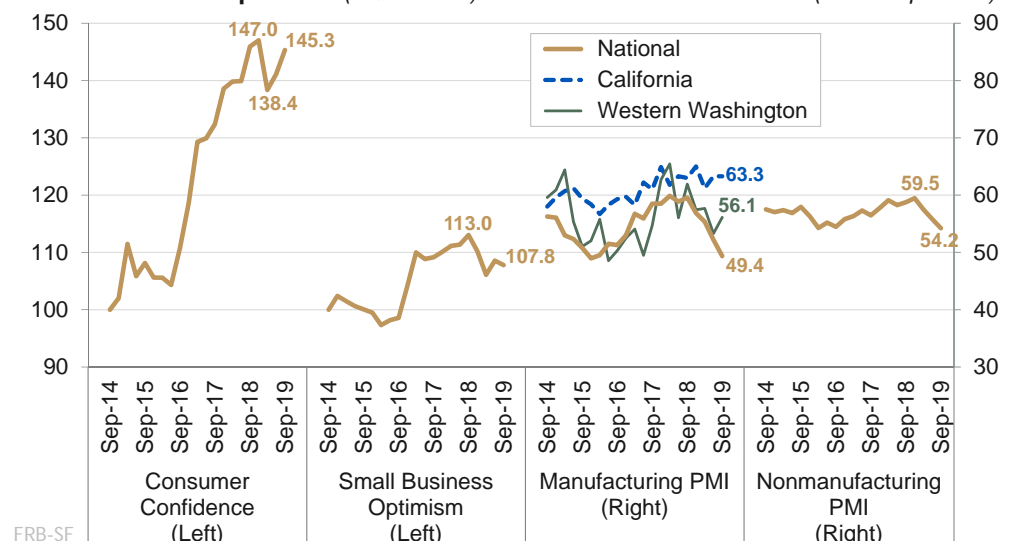
12th District Jobs by Sector			
Job Sector	% Change (annualized)		Share of Total Jobs (3Q19)
	4Q17-3Q19	3Q19	
Construction	4.03%	5.62%	5.62%
Edu. & Health Svcs.	3.56%	15.38%	15.38%
Financial Activities	3.52%	5.13%	5.13%
Prof. & Business Svcs.	3.30%	14.75%	14.75%
Information	3.25%	2.73%	2.73%
Transport. & Utilities	3.01%	3.93%	3.93%
Manufacturing	1.87%	7.56%	7.56%
Government	1.12%	15.25%	15.25%
Wholesale Trade	1.03%	3.77%	3.77%
Leisure & Hospitality	0.10%	12.02%	12.02%
Other Private	-0.32%	3.67%	3.67%
Retail Trade	-0.66%	10.17%	10.17%
<b>Total Nonfarm</b>	<b>1.92%</b>	<b>100%</b>	<b>100%</b>

Based on quarterly average nonfarm payroll levels, seasonally adjusted. Construction sector includes mining and logging in Hawaii; information sector excludes Hawaii and Nevada. Source: Bureau of Labor Statistics via Haver Analytics.

# 12 A strong labor market reinvigorated consumer confidence, while business sentiment eased further.

## Consumer Confidence & Small Business Optimism (3Q14 = 100)

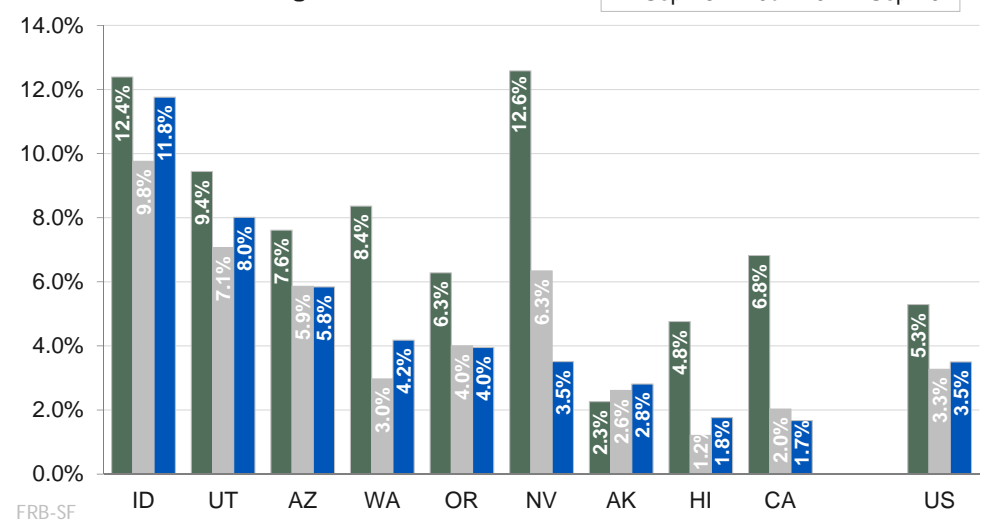
## Purchasing Managers Indices (PMI) (>50 = expansion)



Seasonally adjusted. Sources: Conference Board, National Federation of Independent Business, Institute for Supply Management, and Chapman University via Haver Analytics.

# 13 Home-price growth in several District states rebounded from 2Q19 levels, but remained below 3Q18 rates.

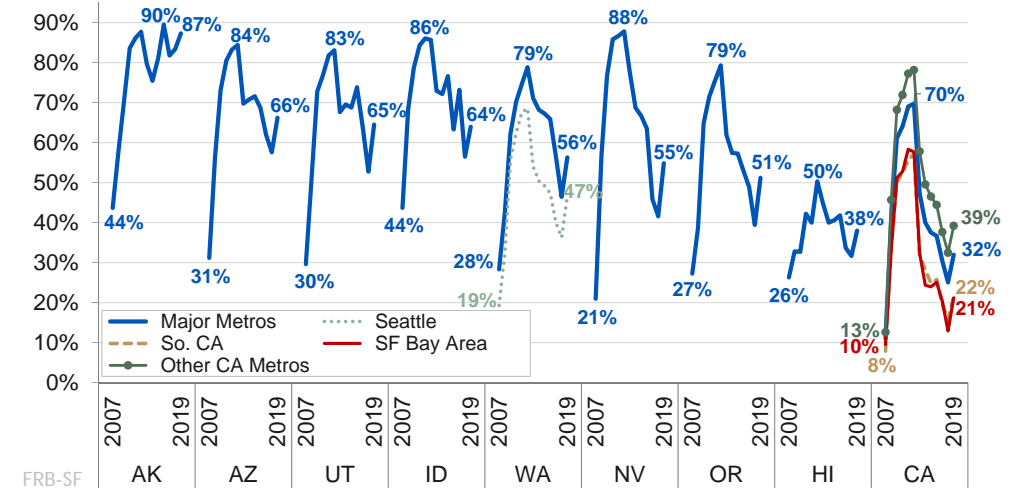
## Year-over-Year % Change in Home Price Index



Versus Pre-Crisis Peak: ID +31%, UT +35%, AZ -5%, WA +37%, OR +31%, NV -11%, AK +14%, HI +20%, CA +10%, US +9%. Home price index includes all detached and attached single-family homes, including distressed sales. Source: CoreLogic.

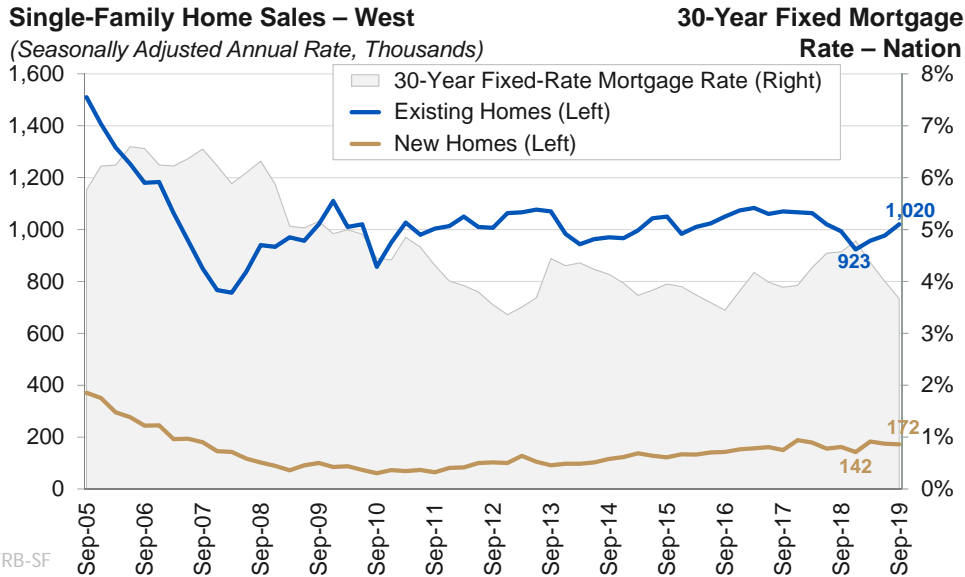
# 14 Housing affordability improved due to lower mortgage rates, slower price appreciation, and rising incomes.

## Un-weighted Average Metro Housing Opportunity Index, September Each Year (% of Home Sales Deemed Affordable to Median Family Income; Lower Ratio = Less Affordable)



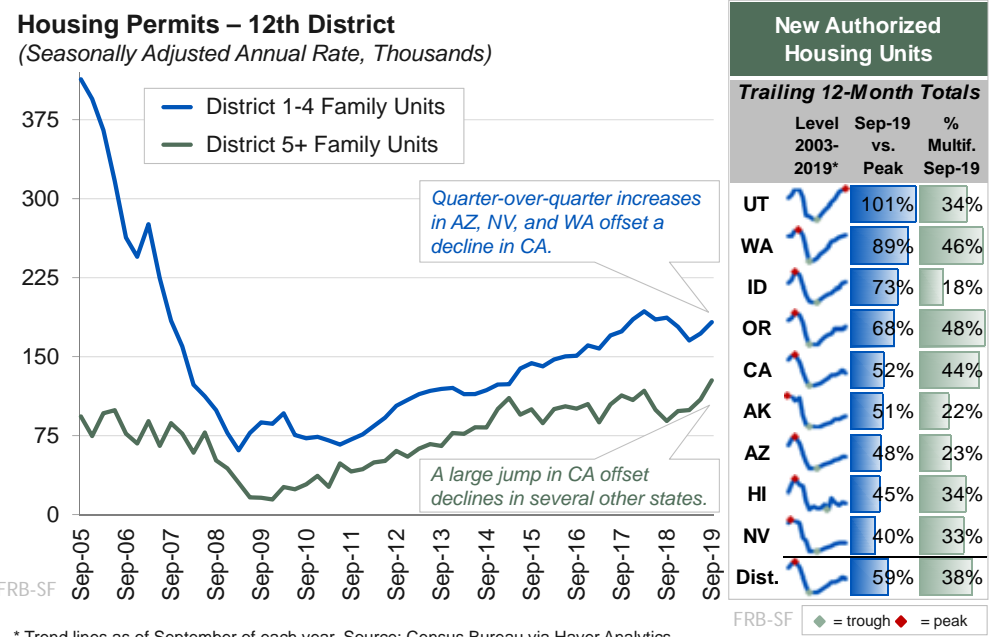
Assumes median income, 10% down payment, ratio of income-to-housing costs (principal, interest, taxes, and hazard insurance) of 28%, and a fixed-rate, 30-year mortgage; So. CA = Los Angeles, Orange, Riverside-San Bernardino, San Diego, and Ventura metros; SF Bay Area = San Francisco, Oakland, San Jose, Napa, Vallejo, and Santa Cruz metros. Sources: National Association of Homebuilders/Wells Fargo via Haver Analytics, FRB-SF calculations.

# 15 Mortgage rates continued to support overall home sales in the West, but new-home sales lagged.



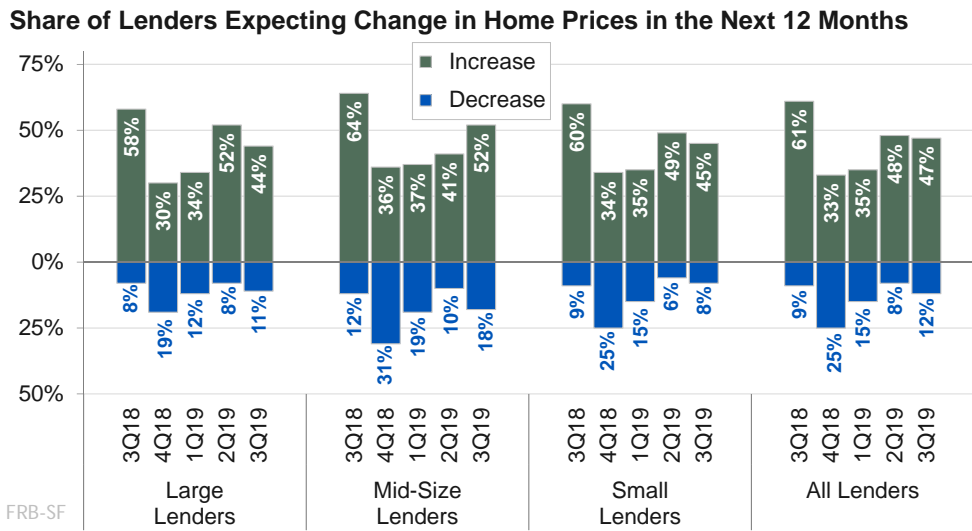
All data are quarterly averages. West = 12th District plus CO, MT, NM, and WY. Sources: NATIONAL ASSOCIATION OF REALTORS® (existing homes), Census Bureau (new homes), and Freddie Mac (mortgage rate) via Haver Analytics. Existing home sales data copyright ©2019 NATIONAL ASSOCIATION OF REALTORS®; all rights reserved; reprinted with permission.

# 16 Multifamily permits reached new highs, led by CA, and 1-4 family levels rebounded further.



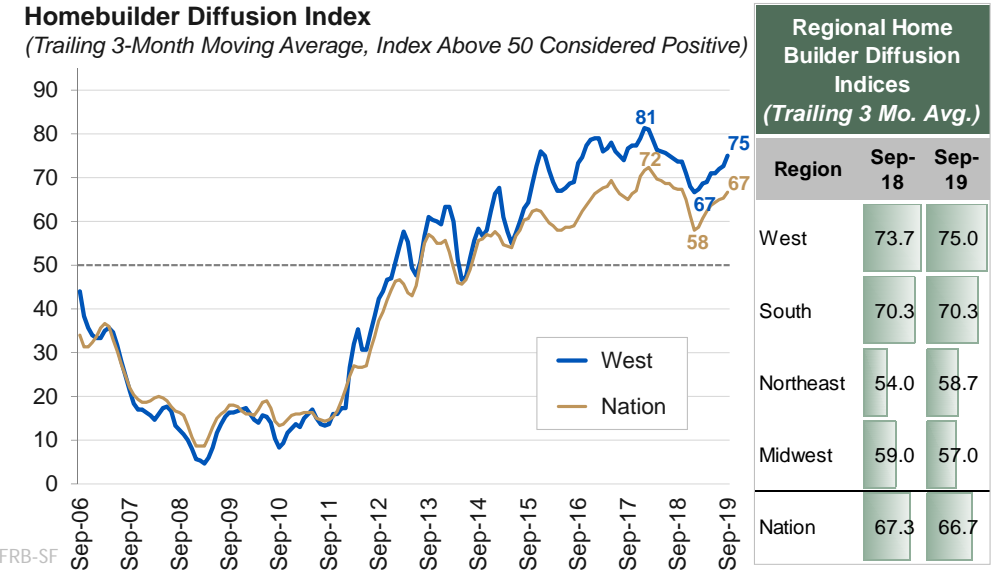
\* Trend lines as of September of each year. Source: Census Bureau via Haver Analytics.

# 17 Mortgage lenders' home price optimism moderated, but more than half expected stable-to-increasing prices.



Lender size based upon 2018 total loan originations: Large = lenders in the top 15% of lending institutions (volume above \$980 million); Mid-Size = lenders in the next 20% of lending institutions (volume between \$317.5 million and \$980 million); Small = bottom 65% of lending institutions (volume less than \$317.5 million); data for "All Lenders" is an average of the three size groupings; includes responses from nonbanks as well as banks, thrifts, and credit unions. Source: Fannie Mae Mortgage Lender Sentiment Survey.

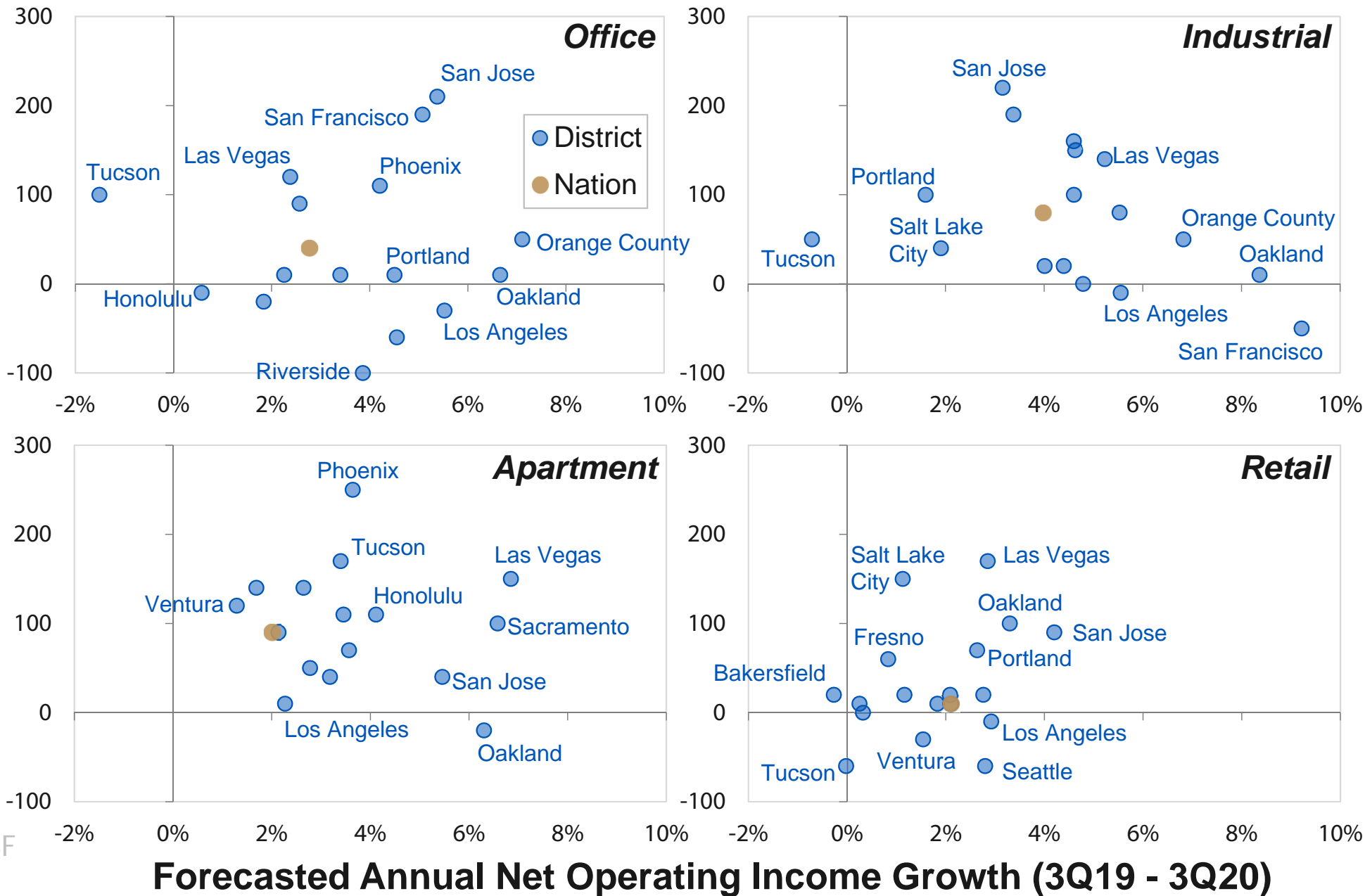
# 18 Homebuilder sentiment continued to improve from early-2019 lows, and the West region led the nation.



Data are seasonally adjusted; index is a weighted average of current sales (59.2%), sales in next six months (13.6%), and traffic of prospective buyers (27.2%). West = 12th District plus CO, MT, NM, and WY. Source: National Association of Home Builders (NAHB)/Wells Fargo Builders Economic Council Survey via Haver Analytics.

## Despite forecasted vacancy increases, CBRE-EA expected CRE NOI growth to persist in most District markets.

Forecasted Change in Vacancy Rate (3Q19-3Q20, basis points)

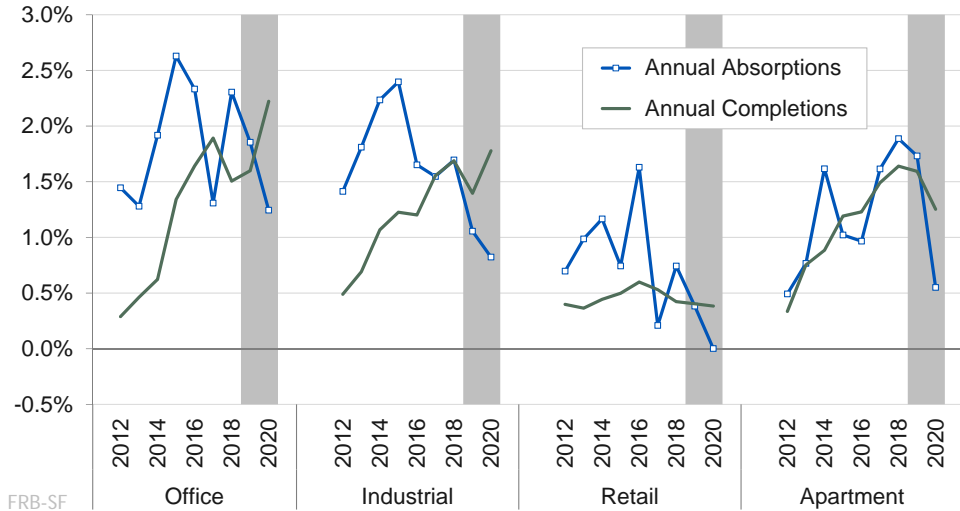


FRB-SF

## 20 CBRE-EA's vacancy rate forecast assumes that new construction will outpace absorption.

### 12th District Aggregate Annual Absorption and Completion Rates

(Net Absorptions and Completions as % of Beginning Stock)

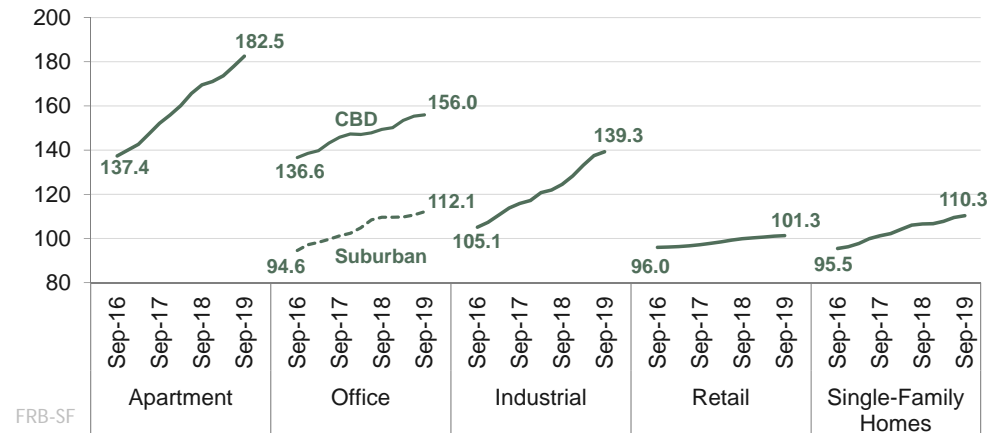


FRB-SF

Includes the 18 to 16 largest markets in the District depending on sector; shaded area = forecast. Source: CBRE-EA.

## 21 CRE price gains slowed generally, but industrial price appreciation exceeded historical averages.

### Commercial & Residential Property Price Indices – Nation (Dec-06 = 100)



FRB-SF

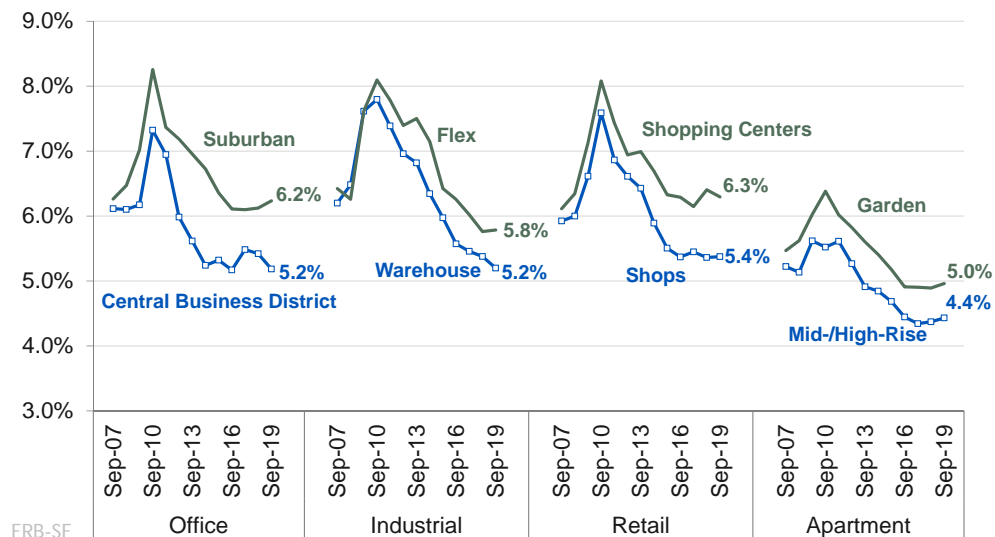
#### Average Annual Growth in Price Indices

Period	Apartment	Office	Industrial	Retail	Single-Family Homes
1-Yr.	7.7%	3.1%	11.9%	1.4%	3.5%
5-Yr.	10.7%	6.6%	9.1%	3.6%	5.1%
10-Yr.	9.5%	4.9%	6.0%	3.6%	4.1%

CBD = central business district (downtown); based upon repeat-sales transactions; 5- and 10-year rates reflect compound annual growth. Sources: Real Capital Analytics, Inc. for commercial real estate indices; CoreLogic for single-family homes index.

## 22 Capitalization rates in the West were stable-to-higher except CBD office and warehouse, which sank further.

### Western U.S. CRE Capitalization Rates (Trailing 12-Month Average %)

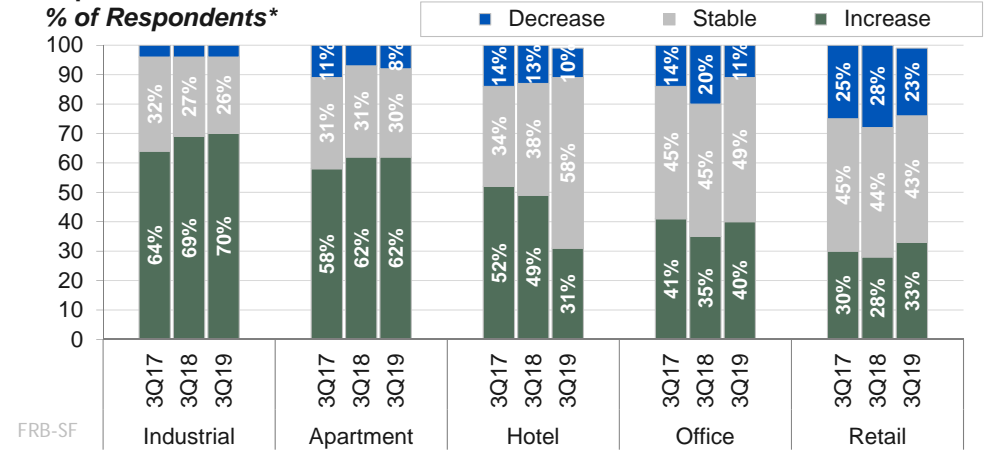


FRB-SF

Includes transactions in the West (AK, CA, HI, ID, MT, NV, OR, UT, WA, and WY, but not AZ); property sales > \$2.5 million with available capitalization rate data. Source: Real Capital Analytics, Inc.

## 23 Per NREI/M&M, most CRE investors expected property values to be stable-to-higher in the coming year.

### Expectations for Prices over Next 12 Months



FRB-SF

#### Average 1-Year Expected Change in Property Values

Year	Industrial	Apartment	Hotel	Office	Retail
3Q17	5.1%	3.8%	3.9%	1.6%	0.3%
3Q18	5.4%	3.5%	1.7%	1.3%	-0.7%
3Q19	4.5%	3.7%	1.6%	0.8%	0.4%

\* Columns may not sum to 100% due to rounding in original data. Source: National Real Estate Investor (NREI)/Marcus & Millichap (M&M) Commercial Real Estate Investment Outlook.

# Section 3

## Commercial Bank Performance

**Earnings**

**Loan Growth and Concentrations**

**Credit Quality**

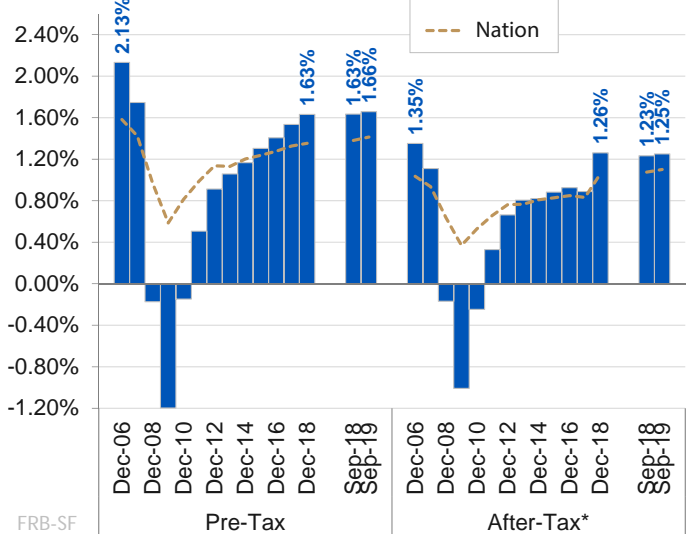
**Liquidity and Interest Rate Risk**

**Capital**

*Note: Bank size groups are defined as very small (< \$1B), small (\$1B - \$10B), mid-sized (\$10B - \$50B), and large (> \$50B) banks. The large bank group covers nationwide banks (a larger statistical population), while the other three groups cover 12th District banks.*

Year-to-date profits slightly outpaced 2018, led by stronger net interest income ratios.

Average YTD ROAA



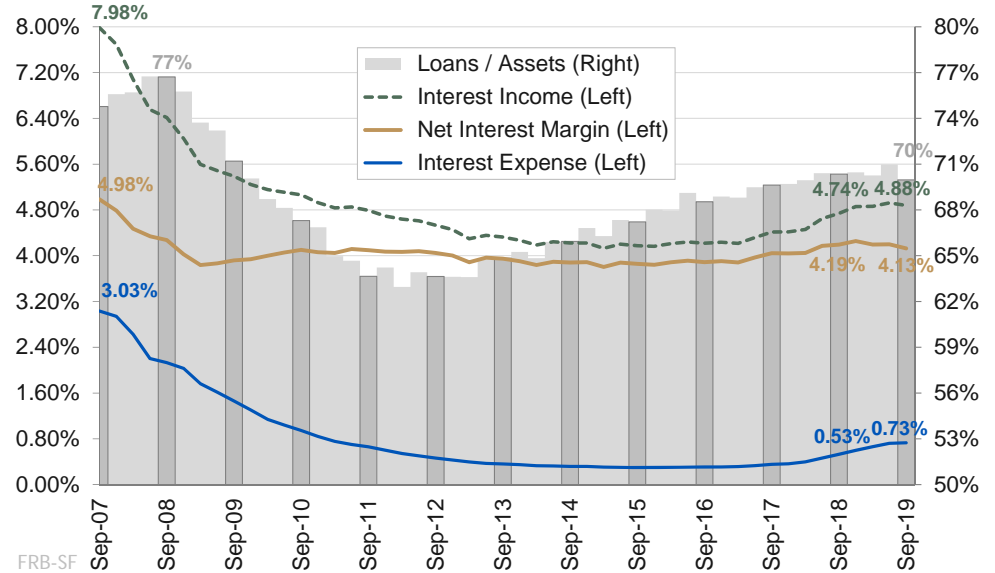
Average YTD as % of Average Assets 12th District (Expenses = Negative Values)

Profit Component	Sep-18	Sep-19
Interest Income (TE)	4.36%	4.64%
Interest Expense	-0.44%	-0.67%
Net Int. Income (TE)	3.92%	3.96%
Noninterest Income	0.61%	0.58%
Noninterest Expense	-2.89%	-2.88%
Provision Expense	-0.07%	-0.07%
Tax Expense (TE)	-0.35%	-0.36%

FRB-SF Average = trimmed mean; YTD = year-to-date (annualized); ROAA = return on average assets (net income/average assets); \*theoretical tax expense deducted from Subchapter S filers for after-tax ratio; TE = tax equivalent (yields and applicable tax expense adjusted for tax-exempt revenues).

But on a quarterly basis, margins eased as declines in interest rates and loan-to-asset ratios pressured yields.

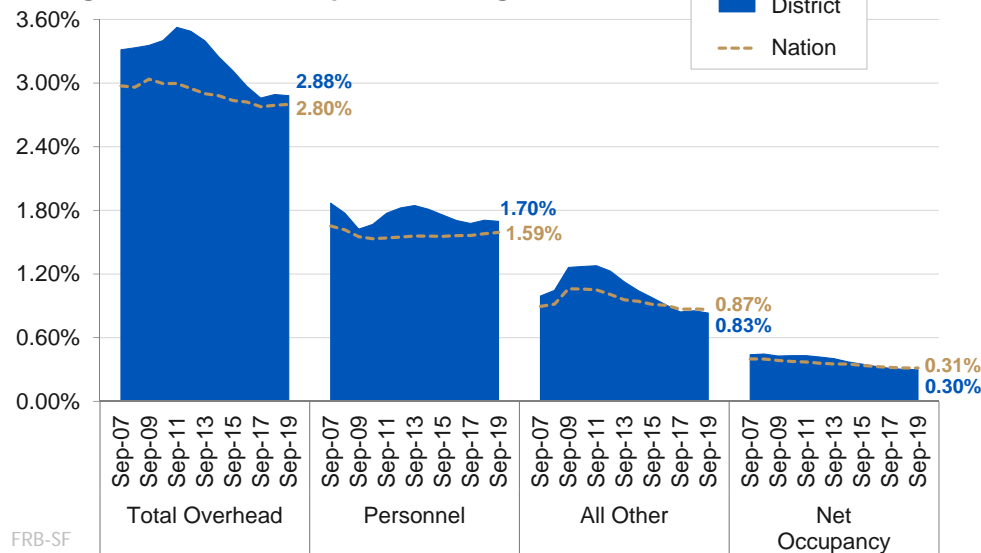
Avg. Quarterly as % of Avg. Earning Assets (TE)



FRB-SF Average = trimmed mean (12th District banks only); one-quarter annualized data; TE = tax equivalent.

Year-to-date overhead expense ratios eased from 2018 but topped the national average due to personnel costs.

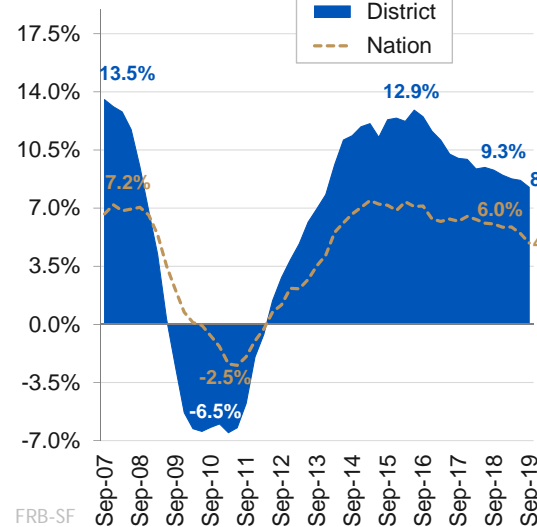
Average YTD Overhead Expense / Average Assets



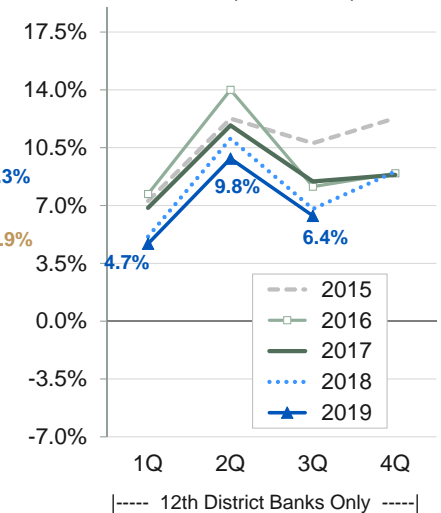
FRB-SF Average = trimmed mean; YTD = year-to-date (annualized); overhead = noninterest expense; components will not sum to overall overhead ratio because of trimmed average properties.

Annual loan growth dipped to the slowest pace since late 2013; seasonality pressured quarterly loan growth.

Average Year-over-Year Net Loan Growth



Average Quarter-over-Quarter Net Loan Growth (Annualized)

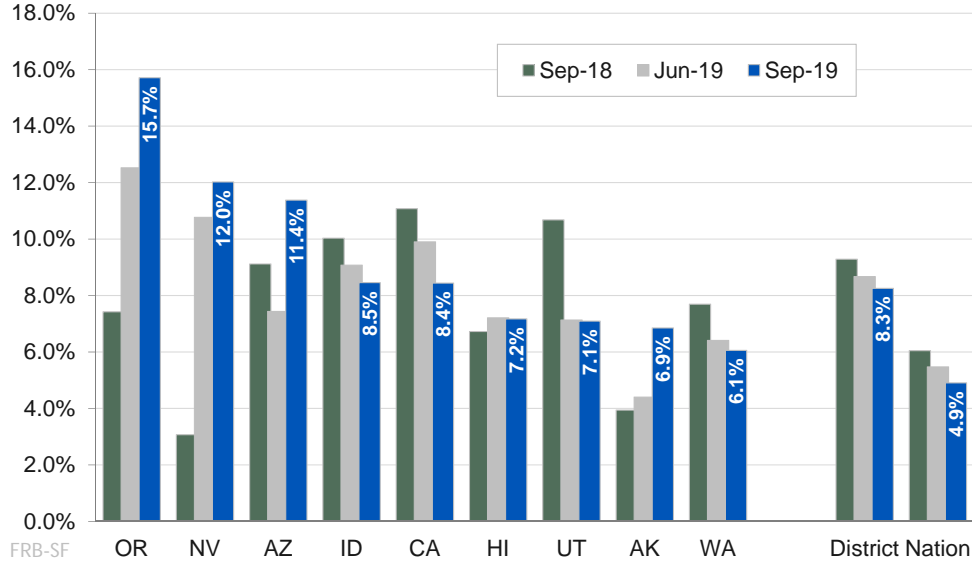


FRB-SF Average = trimmed mean; growth rates are not merger-adjusted; includes loans and leases held for sale and for investment, net of allowances for loan and lease losses.



# 29 Slowing loan growth in the District was led by banks based in California, Washington, and Idaho.

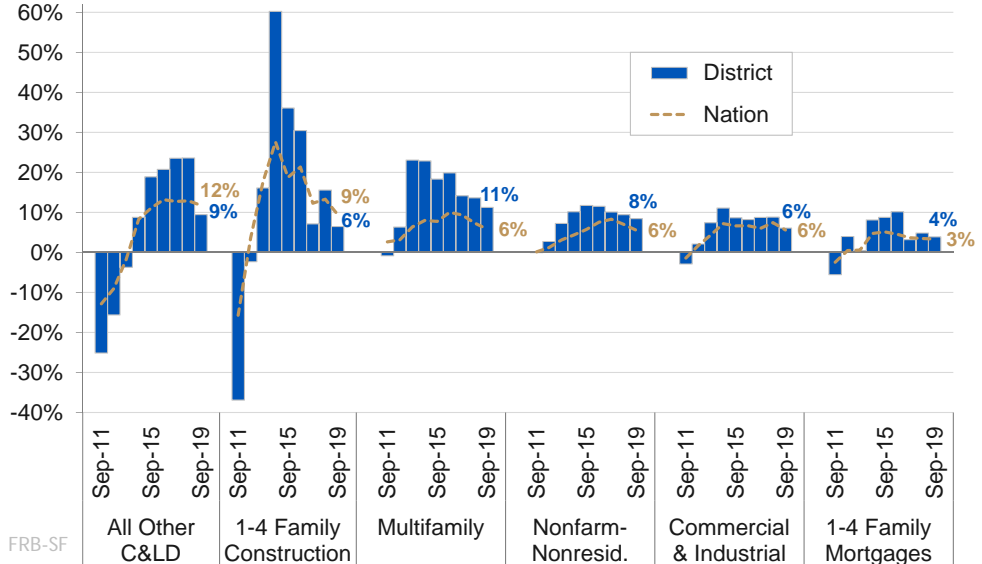
Average Year-over-Year Net Loan Growth (%)



Average = trimmed mean; growth for loans net of allowances for loan losses, not merger-adjusted; NV excludes zero loan and credit card banks; includes loans and leases held for sale and for investment, net of allowances for loan and lease losses.

# 30 Slowing loan growth was broad based across loan segments; the downshift in C&LD was especially notable.

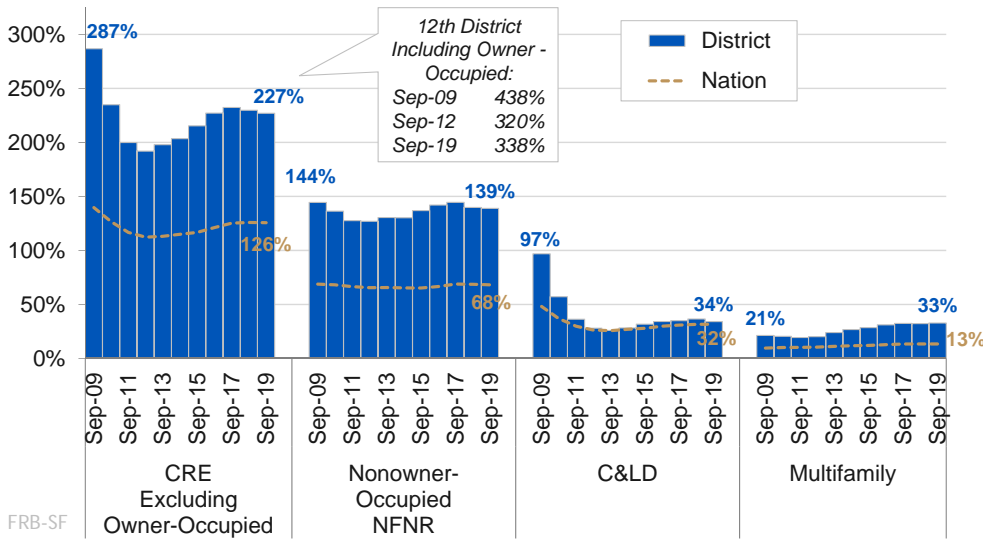
Average Year-over-Year Loan Growth, Selected Loan Categories



Average = trimmed mean; growth rates are not merger-adjusted; C&LD = construction and land development; nonfarm-nonresidential includes mortgages with owner-occupied collateral.

# 31 Although high, CRE loan concentration ratios edged lower as capital accretion outpaced CRE loan growth.

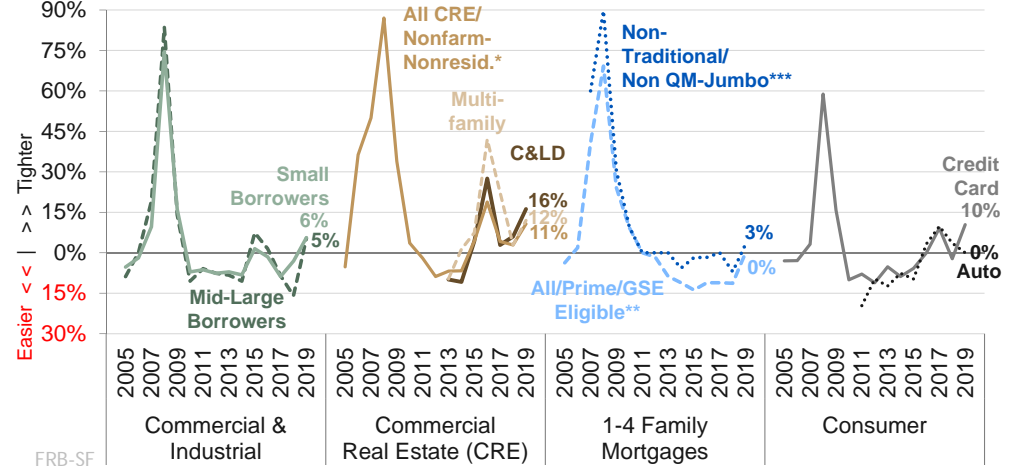
Average CRE Loans Outstanding / Total Capital



Average = trimmed mean; Commercial Real Estate (CRE) Excluding Owner-Occupied = nonowner-occupied nonfarm-nonresidential (NFNR), construction and land development (C&LD), multifamily, and other CRE-purpose loans; components will not sum to overall CRE concentration because of trimmed average properties and other CRE-purpose loans not itemized here.

# 32 By a slight margin, lenders noted tighter standards for CRE, credit card, C&I, and jumbo mortgage loans.

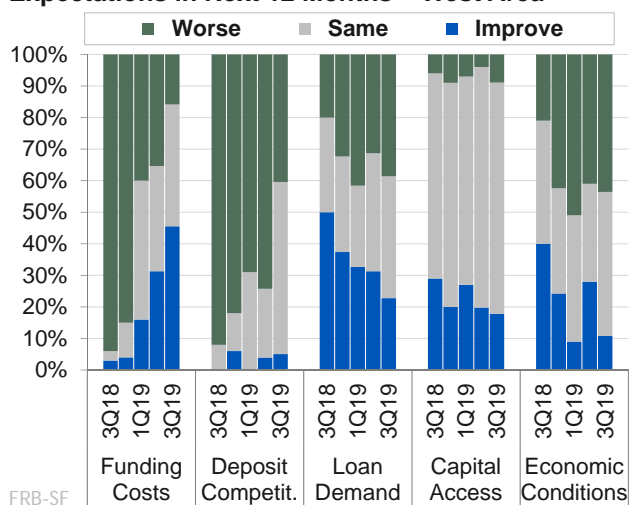
Net % of Lenders Reporting Tighter (Easier) Loan Standards during Quarter (October of Each Year)



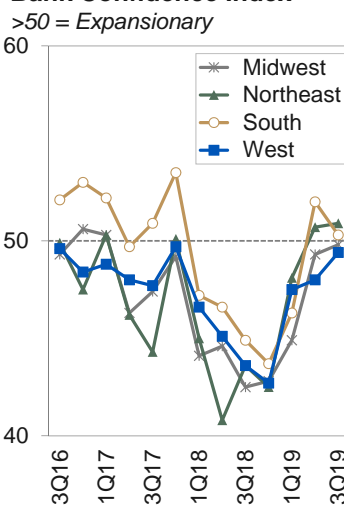
Based on a sample of 70+/- loan officers at domestic banks (number varies by period and loan type); C&LD = construction and land development; \*includes all CRE loans prior to Oct-13; \*\*includes all residential mortgages prior to Apr-07, "prime" mortgages Apr-07 to Oct-14, and GSE-Eligible starting Jan-15; \*\*\*includes "nontraditional" mortgages Apr-07 to Oct-14 and Non QM Jumbo mortgages starting Jan-15. Source: Federal Reserve Senior Loan Officer Opinion Survey, <https://www.federalreserve.gov/data/sloos.htm> via Haver Analytics.

More bankers expected deposit costs to ease, but economic and loan demand optimism waned.

Expectations in Next 12 Months – West Area



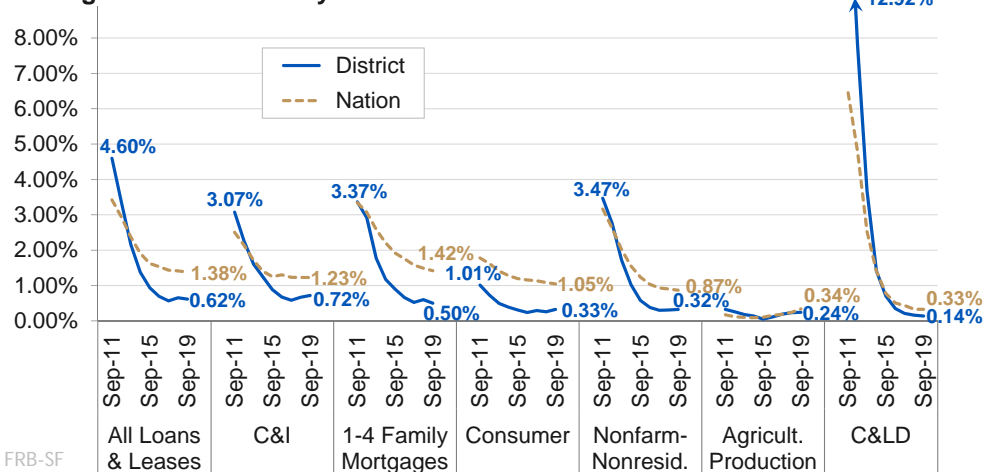
Bank Confidence Index



3Q19 data based on a nationwide survey of bank chief executive officers, chief financial officers, and presidents at 518 institutions, queried between October 1 and October 11, 2019; confidence was scored based on perceptions of funding costs, deposit competition, loan demand, and access to capital (but not economic conditions); West = Kansas City/San Francisco Districts; Midwest = Chicago/Cleveland/Minneapolis/St. Louis Districts; South = Atlanta/Dallas/Richmond Districts; Northeast = Boston/New York/Philadelphia Districts. Source: Promontory Interfinancial Network *Bank Executive Business Outlook Surveys*.

Overall, the average delinquency ratio remained low, but was above cycle lows among several categories.

Average Past Due 30+ Days or Nonaccrual / Gross Loans & Leases

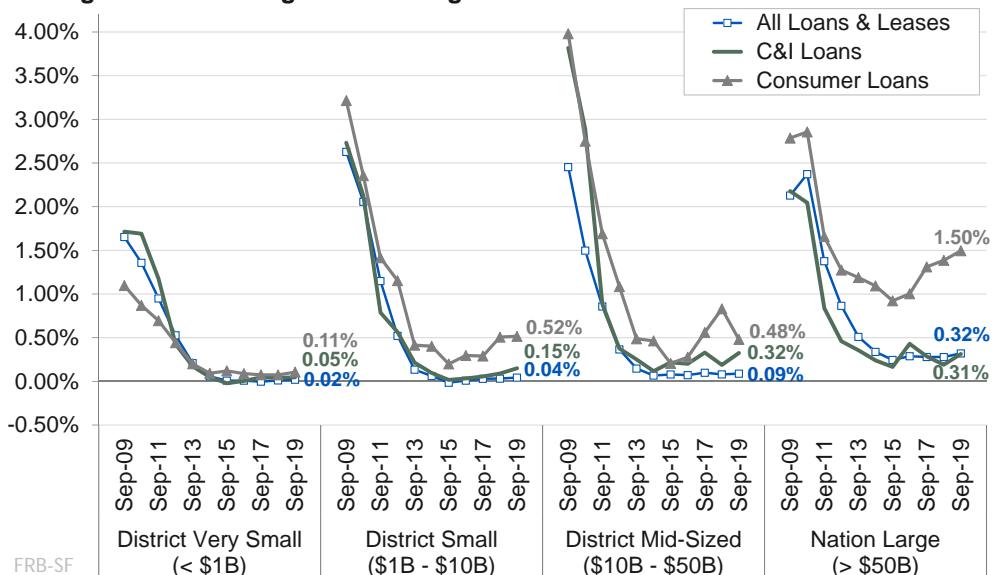


Category	District	Nation
All Loans & Leases	100.0%	100.0%
C&I	14.5%	12.5%
1-4 Family Mortgages	13.5%	24.3%
Consumer	1.3%	4.0%
Nonfarm-Nonresid.	43.6%	24.2%
Agricult. Production	0.7%	5.3%
C&LD	6.0%	5.4%

Average = trimmed mean; C&I = commercial & industrial; C&LD = construction & land development; average loan mix will not sum to 100% because of trimmed average properties and because not all loan categories are itemized above.

Net chargeoff activity was minimal; C&I and consumer losses affected levels at mid- and large-sized banks.

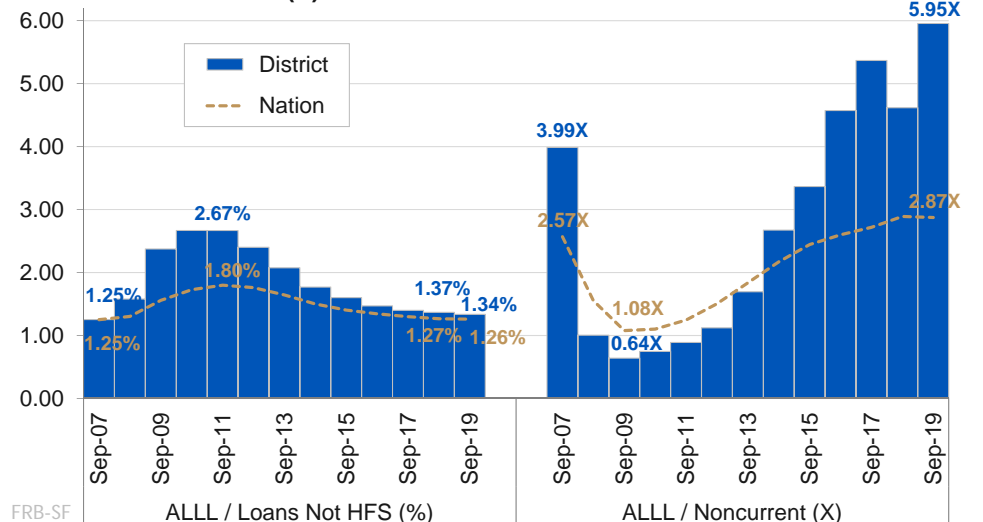
Average YTD Net Chargeoffs / Average Loans & Leases



Average = trimmed mean; YTD = year-to-date (annualized); C&I = commercial and industrial.

Growth in ALLL outpaced increases in noncurrent loans but not total loans held for investment.

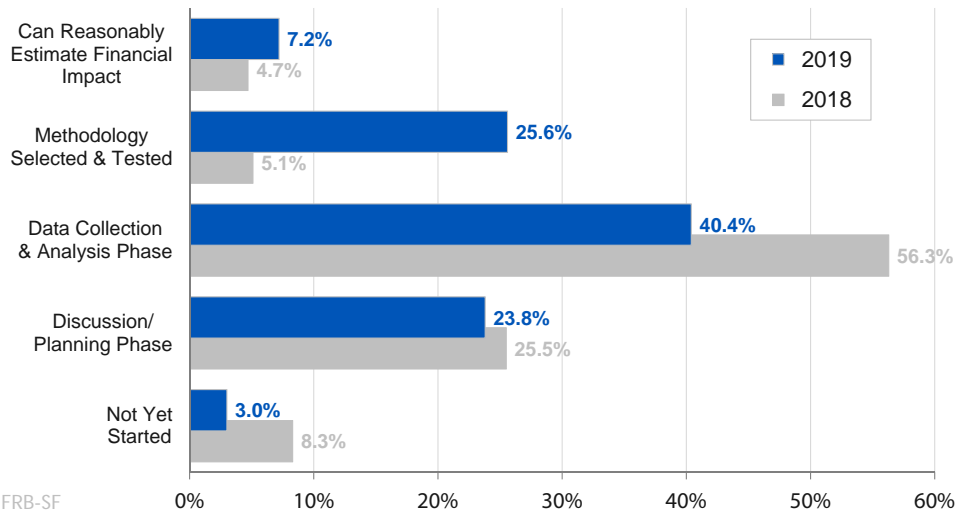
Average ALLL Coverage of Loans not HFS (%) and Noncurrent Loans (X)



Average = trimmed mean; ALLL = allowance for loan and lease losses; HFS = held for sale; noncurrent = loans past due 90+ days or on nonaccrual status.

# 37 Surveys suggested community banks have made progress with CECL readiness in 2019.

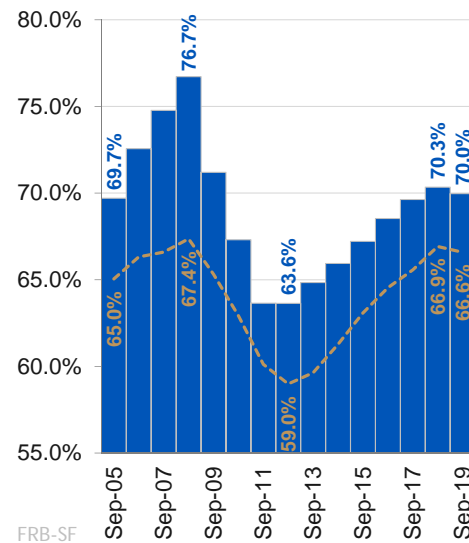
### Level of CECL Preparedness Among Surveyed Institutions



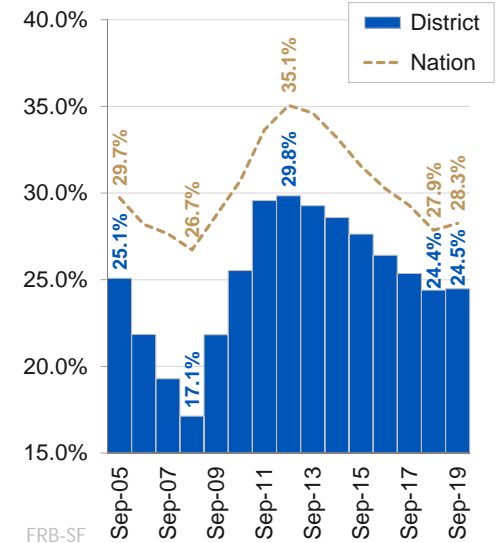
FRB-SF  
Based upon nationwide surveys of 521 and 571 banks and thrifts in 2018 and 2019, respectively; collected between April and July of each year by The Survey Research Institute at Cornell University on behalf of the Conference of State Bank Supervisors, Federal Reserve, and Federal Deposit Insurance Corporation; CECL = current expected credit losses. Source: [Community Banking in the 21st Century Surveys](#).

# 38 On-balance sheet liquidity improved slightly from 3Q18 levels, mirroring a nationwide trend.

### Avg. Net Loans and Leases/Assets



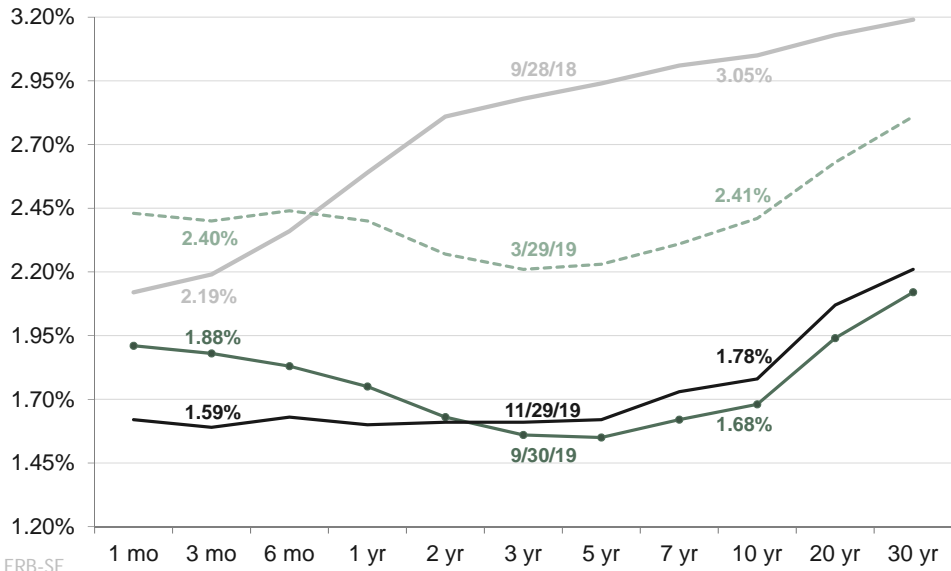
### Avg. Securities & Liquid Invest./Assets



FRB-SF  
\*All data are averages (trimmed means); net loans and leases = loans and leases held for sale and for investment, net of allowances for loan and lease losses; liquid investments = cash, due from balances, interest bearing balances, and federal funds sold & securities purchased under agreements to resell.

# 39 Interest rates declined and the yield curve inverted through 3Q19, but the curve twisted subsequently.

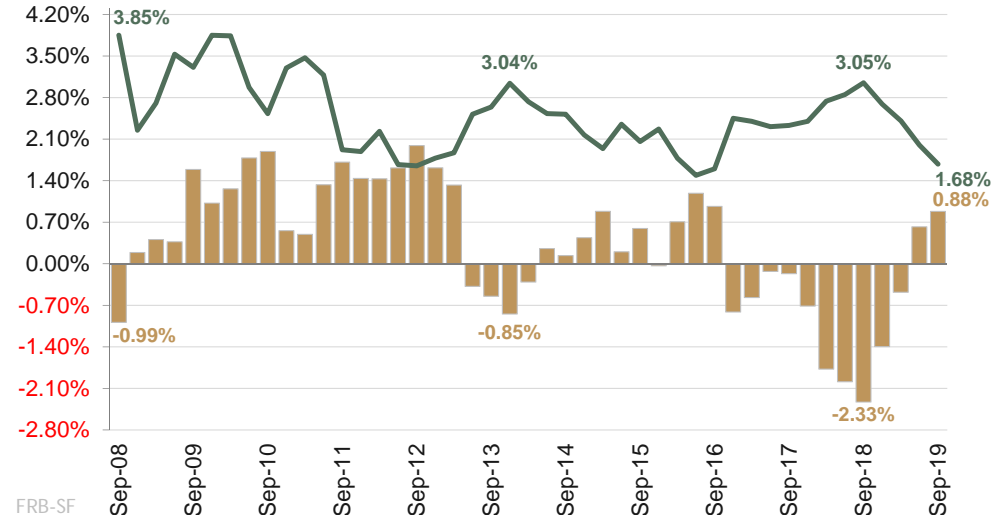
### End-of-Period U.S. Treasury Yield Curve (Constant Maturity)



FRB-SF  
Source: Department of the U.S. Treasury.

# 40 Bank bond portfolio values improved on average with further declines in long-term interest rates.

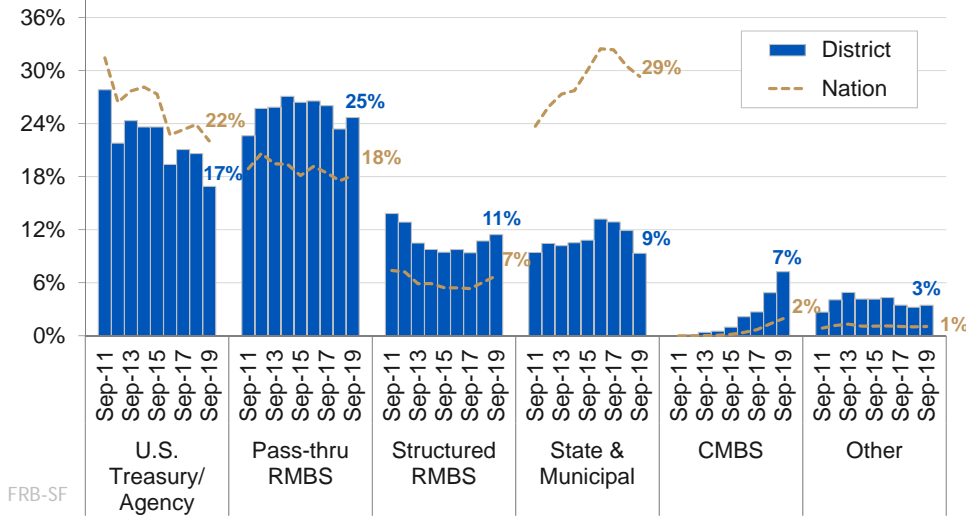
### Average Net Unrealized Gains (Losses) on AFS Securities / AFS Securities



FRB-SF  
Average = trimmed mean (12th District banks only); AFS = available-for-sale; changes in valuation reported net of deferred tax effects; UST = end of period U.S. Treasury yield at a constant maturity (from Federal Reserve via Haver Analytics); AFS securities excludes equities beginning with the March 2018 Call Report.

# 41 But risk within investment portfolios has increased as the mix shifted away from government bonds.

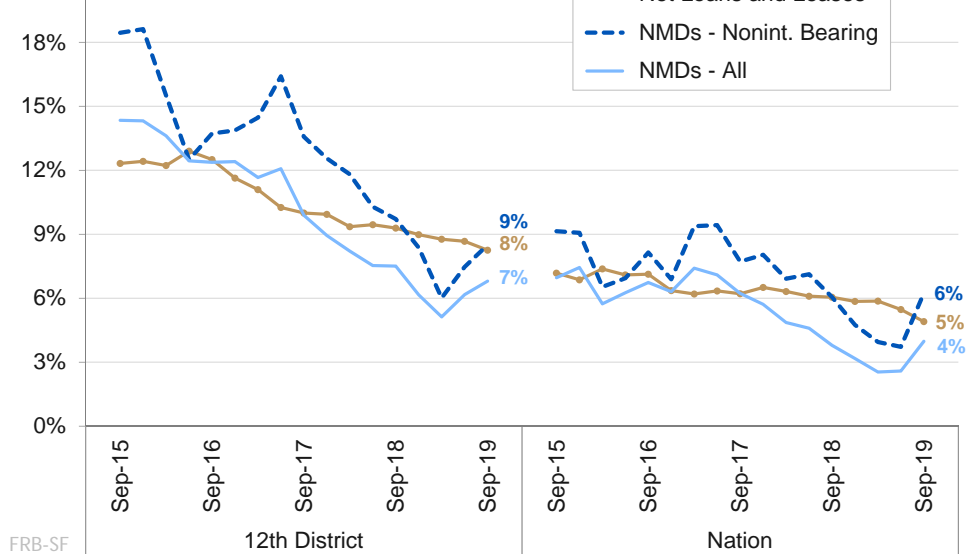
### Average Debt Securities as a Share of Total AFS and HTM Securities



Average = trimmed mean; AFS = available for sale; HTM = held to maturity; RMBS = residential mortgage-backed securities; CMBS = commercial mortgage-backed securities; other includes domestic debt securities exclusive of asset-backed securities and other structured financial products (e.g., corporate bonds, commercial paper, and redeemable preferred stock); components will not sum to 100% because of trimmed average properties and securities types not itemized here.

# 42 Average annual growth in NMDs continued to trail net loans, but accelerated in the District in 3Q19.

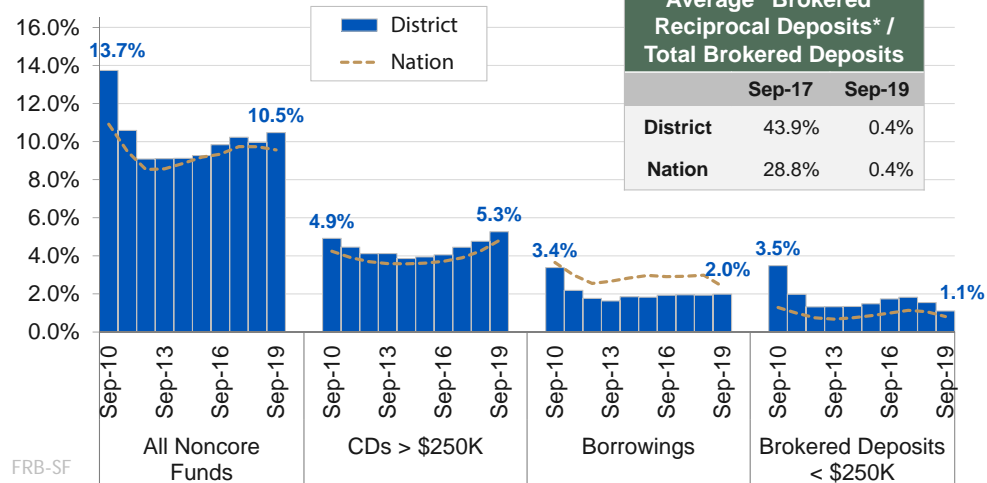
### Average Year-over-Year Change



Average = trimmed mean; net loans and leases = loans and leases held for sale and for investment, net of allowances for loan and lease losses; growth rates are not merger-adjusted.

# 43 Increased reliance on jumbo time deposits pushed District noncore funding ratios higher year-over-year.

### Average Noncore Funding / Assets

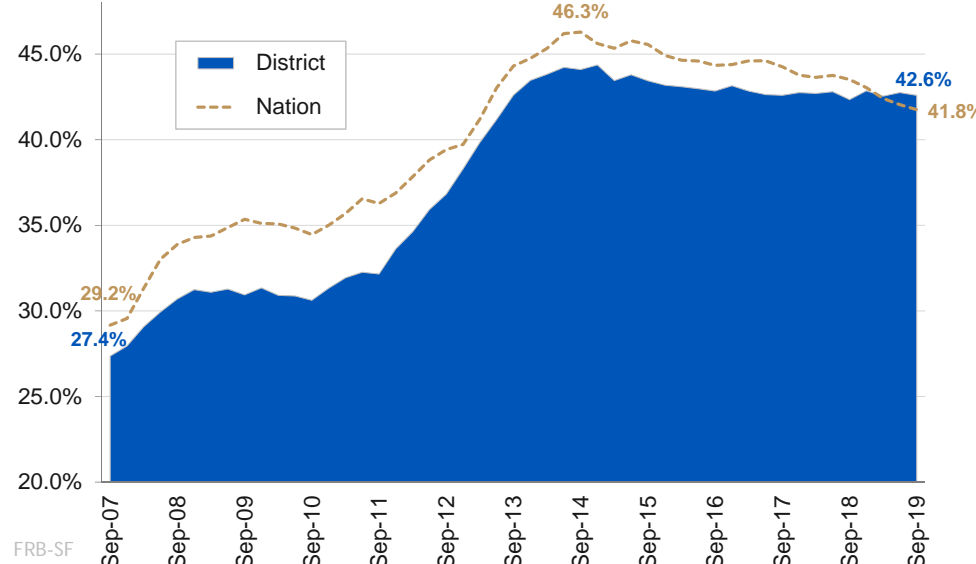


Average "Brokered" Reciprocal Deposits* / Total Brokered Deposits		
	Sep-17	Sep-19
District	43.9%	0.4%
Nation	28.8%	0.4%

Average = trimmed mean; noncore funds = sum of borrowings (e.g., federal funds purchased, repurchase agreements, and other borrowed money), foreign deposits, jumbo certificates of deposit (CDs) > \$250K, and brokered deposits < \$250K; \*beginning with the June 2018 Call Reports, qualifying (generally well-rated and well-capitalized) banks could discontinue reporting reciprocal deposits as brokered so long as they aggregated less than \$5 billion or 20% of total liabilities, as permitted under the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA) of 2018.

# 44 Average District bank investments in longer-term assets continued at high levels but eased nationally.

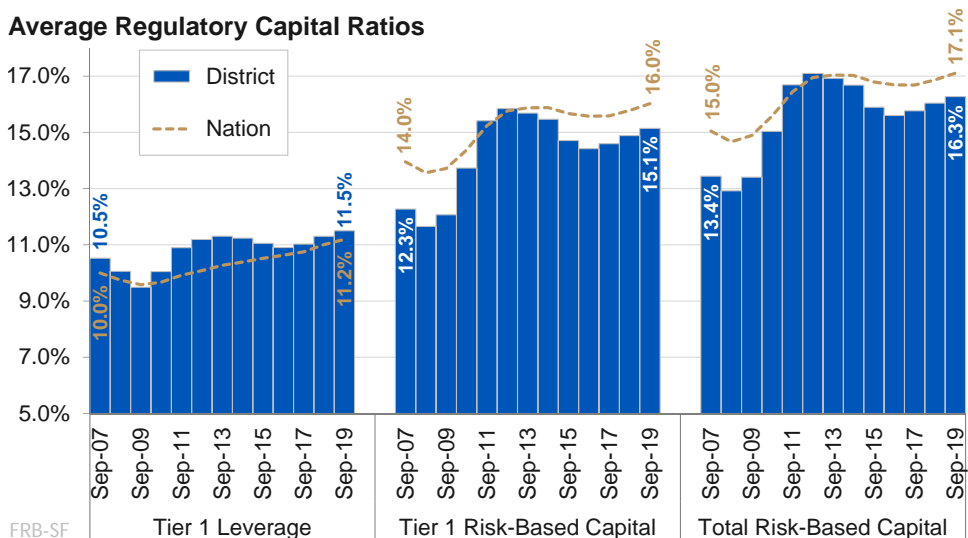
### Average % of Loans & Securities Repricing > 3 Years



Average = trimmed mean.

Regulatory capital ratios improved from 3Q18, but District risk-based capital levels still trailed the nation.

Average Regulatory Capital Ratios

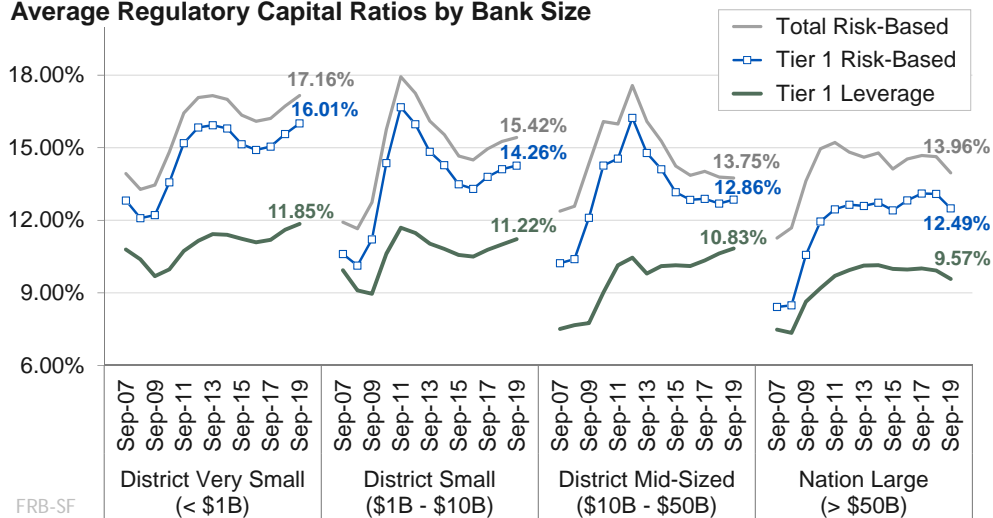


FRB-SF

Average = trimmed mean; new risk-based capital rules that became effective March 2015 for most banks (March 2014 for some larger/more complex banks) included the phase out of some capital instruments and higher risk weights on some asset and off-balance sheet commitment categories; beginning with the June 2018 Call Report, banks could opt to implement changes to the definition of high volatility commercial real estate (per the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018), which may have reduced risk weightings for a generally small subset of assets previously weighted at 150%.

In recent years, upticks in risk-based capital ratios were more pronounced at smaller banks.

Average Regulatory Capital Ratios by Bank Size

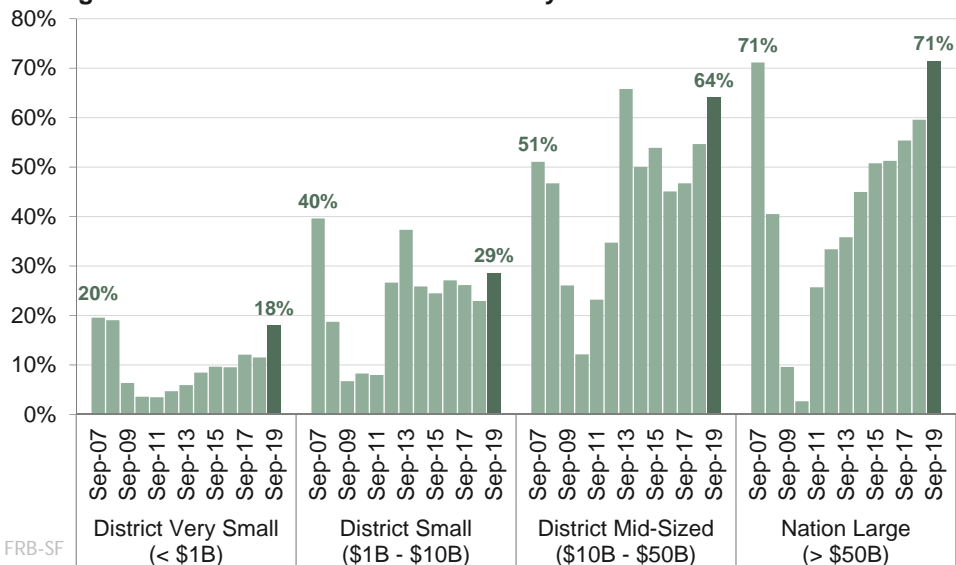


FRB-SF

Average = trimmed mean; new risk-based capital (RBC) rules that became effective March 2015 for most banks (March 2014 for some larger/more complex banks) included the phase out of some capital instruments and higher risk weights on some asset and off-balance sheet commitment categories; beginning with the June 2018 Call Report, the definition of high volatility commercial real estate shifted because of the passage of the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018, which may have reduced risk weightings for some assets previously weighted at 150%.

YTD dividend distributions exceeded 2018; mid-and large-sized banks paid out more than half of profits.

Average YTD Cash Dividends / Net Income by Bank Size

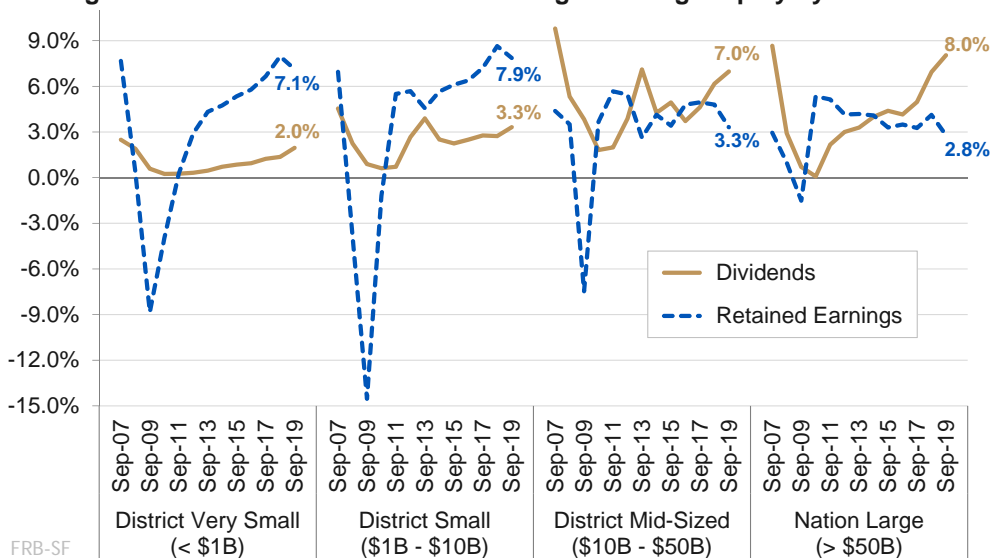


FRB-SF

Average = trimmed mean; YTD = year-to-date (annualized); as of 3Q19, roughly 17% of District very small banks, 5% of District small banks, and none of the mid-sized or large banks were Subchapter S tax filers.

Dividends constrained earnings-related capital accretion, especially at mid- and large-sized banks.

Average YTD Dividends and Retained Earnings / Average Equity by Bank Size



FRB-SF

Average = trimmed mean; YTD = year-to-date (annualized); as of 3Q19, roughly 17% of District very small banks, 5% of District small banks, and none of the mid-sized or large banks were Subchapter S tax filers.

# Appendices

**Summary of Institutions**

**Technical Information**

**Abbreviations**

# Appendix 1: Summary of Institutions

# Appendix 2: Technical Information & Abbreviations

Area	Commercial Banks (De Novos)		Industrial Banks (De Novos)		Savings Institutions (De Novos)	
	Sep-18	Sep-19	Sep-18	Sep-19	Sep-18	Sep-19
AK	4 (0)	4 (0)	-	-	1 (0)	1 (0)
AZ	15 (0)	15 (0)	-	-	-	-
CA	141 (2)	138 (2)	3 (0)	3 (0)	11 (0)	11 (0)
GU	2 (0)	2 (0)	-	-	1 (0)	1 (0)
HI	5 (0)	5 (0)	1 (0)	1 (0)	2 (0)	2 (0)
ID	12 (0)	10 (0)	-	-	1 (0)	1 (0)
NV	11 (0)	11 (1)	4 (0)	4 (0)	4 (1)	4 (1)
OR	15 (0)	14 (0)	-	-	2 (0)	2 (0)
UT	27 (0)	24 (0)	14 (0)	14 (0)	1 (0)	1 (0)
WA	36 (0)	32 (0)	-	-	10 (0)	9 (0)
12L	268 (2)	255 (3)	22 (0)	22 (0)	33 (1)	32 (1)
U.S.	4,747 (11)	4,560 (23)	24 (0)	24 (0)	703 (1)	668 (1)

Based on preliminary third quarter 2019 data.

**General:** This report focuses on the financial trends and performance of commercial banks headquartered within the 12th Federal Reserve District (“12L”). 12L includes nine western states: AK, AZ, CA, HI, ID, NV, OR, UT, and WA, as well as Guam.

**Banking Statistics:** Unless otherwise noted, all data are for commercial banks based upon headquarters location. Averages are calculated on a “trimmed” basis by removing the highest 10% and lowest 10% of ratio values prior to averaging to prevent distortion from outliers. Earnings figures are presented on an annualized year-to-date or quarterly basis, as noted. Growth rates are not adjusted for mergers. The latest quarter of data is considered preliminary. Other than the table to the left, most graphics exclude “De Novo” banks (i.e., less than five years old) and industrial banks and savings institutions, which have different operating characteristics.

**Groups by Asset Size:** “Very Small,” “Small,” and “Mid-Sized” bank groups are based on total asset ranges of <\$1 billion, \$1-\$10 billion, and \$10-\$50 billion, respectively. The “Large” bank group uses banks with assets >\$50 billion nationwide because these banks typically operate beyond the District’s geographic footprint and a larger statistical population is needed to construct trimmed means.

### Commonly Used Abbreviations:

<b>AFS</b>	Available for sale	<b>HFS</b>	Held for sale
<b>ALLL</b>	Allowance for loan and lease losses	<b>MMDA</b>	Money market deposit account
<b>BSA/AML</b>	Bank Secrecy Act / Anti-Money Laundering	<b>NFNR</b>	Nonfarm-nonresidential
<b>C&amp;I</b>	Commercial & industrial	<b>NMD</b>	Nonmaturity deposit
<b>C&amp;LD</b>	Construction & land development	<b>RMBS</b>	Residential mortgage-backed security
<b>CD</b>	Certificate of deposit	<b>ROAA</b>	Return on average assets
<b>CMBS</b>	Commercial mortgage-backed securities	<b>TE</b>	Tax equivalent
<b>CRE</b>	Commercial real estate	<b>YTD</b>	Year-to-date