Jobs declined in December amid surging COVID-19 infections, but case counts subsided in January.

- In aggregate, Twelfth District (District) payrolls shrank, and the unemployment rate rose in December for the first time since April. By early 2021, receding case counts, expanded vaccinations, and federal stimulus offered hope for a hiring turnaround.

- **Home price gains** continued to accelerate, propelled by low interest rates and a constrained supply of homes, but mortgage rates ticked up in Q21.

- **Commercial real estate** increasingly diverged across sectors, with the industrial and apartment sectors performing better than office and retail.

Bank loan growth and modification activity receded.

- Quarterly bank loan growth turned negative as Paycheck Protection Program (PPP) forgiveness got under way and loan demand softened. Federal relief measures passed in late 2020 and others pending in Congress may stimulate deposit and loan growth.

- District banks’ average quarterly return on average assets ratio improved further as PPP forgiveness accelerated recognition of fee income—lifting asset yields—while provision expense ratios edged down.

- **Problem loan ratios** were low but ticked up slightly and some surveyed loan officers expressed concern about 2021 loan performance in certain categories.

- Fiscal strains among state and local governments and their potential impacts are highlighted in this quarter’s “Spotlight” feature.

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Surging COVID-19 infections took their toll on the labor market in late 2020.
District nonfarm payrolls contracted in December 2020 for the first time since April and the year-over-year growth rate worsened to -6.7%, from -6.4% in November. The deterioration reflected the re-imposition of social distancing measures in several areas because of a massive surge in COVID-19 infections that peaked in mid-January. The renewed layoffs were most acute in the leisure & hospitality and “other services” (primarily personal & repair services) sectors. Weakness in the state and local government sector, discussed in the Spotlight section, also contributed. By yearend, unemployment rates rose in Washington, California, and Oregon, but improved elsewhere (see table, right). Utah and Idaho both achieved positive year-over-year job growth by December. Declining COVID-19 case counts starting in mid-January, ramped up vaccinations, and further federal stimulus suggested that labor markets may show improvement in early 2021.

The pandemic housing boom continued in all District states. Although single-family home sales plateaued in December, home-price growth continued to accelerate due to constrained supply and further declines in mortgage interest rates. One-to-four family permit activity in the District also reached new post-Global Financial Crisis (GFC) highs, but multifamily permits continued an overall downward trend as builders sought to meet demand for less-dense housing. Affordability across the District declined as falling median incomes and rising prices offset lower mortgage rates—except in the high-earning San Francisco Bay Area, where median incomes rose. Increases in fixed mortgage rates—which started to creep higher in early 2021—the removal of foreclosure moratoria, and the imposition of repayment requirements on loans in forbearance could affect future mortgage performance.

CRE conditions diverged across both markets and sectors. Nationally, CRE transaction volumes improved in the fourth quarter and price growth remained strong for industrial and apartment properties, while the office and retail sectors remained weaker. Likewise, CBRE-EA forecasted deeper and longer deteriorations in vacancy rates and rent growth in the office and retail sectors for District markets, on average. The San Francisco market experienced particularly large increases in vacancy rates and/or rent declines across sectors year-over-year. Generally, offices tended to experience larger swings in vacancy rates—a function of the shift towards work-from-home, while apartment markets had larger variations in rent growth or decline— influenced by the short tenor of apartment leases.

### Nonfarm Job Growth & Unemployment

<table>
<thead>
<tr>
<th></th>
<th>Job Growth (Y-o-Y %)</th>
<th>Unemploy. Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>12 Mo. Dec-20</td>
<td>12 Mo. Dec-20</td>
</tr>
<tr>
<td>HI</td>
<td>-13.8%</td>
<td>9.3%</td>
</tr>
<tr>
<td>NV</td>
<td>-6.8%</td>
<td>9.2%</td>
</tr>
<tr>
<td>CA</td>
<td>-8.0%</td>
<td>9.0%</td>
</tr>
<tr>
<td>AZ</td>
<td>-2.8%</td>
<td>7.5%</td>
</tr>
<tr>
<td>WA</td>
<td>-6.0%</td>
<td>7.1%</td>
</tr>
<tr>
<td>OR</td>
<td>-7.8%</td>
<td>6.4%</td>
</tr>
<tr>
<td>AK</td>
<td>-6.9%</td>
<td>5.8%</td>
</tr>
<tr>
<td>ID</td>
<td>0.6%</td>
<td>4.4%</td>
</tr>
<tr>
<td>UT</td>
<td>0.6%</td>
<td>3.6%</td>
</tr>
<tr>
<td>US</td>
<td>-6.1%</td>
<td>6.7%</td>
</tr>
</tbody>
</table>

PPP forgiveness and muted loan demand weighed on net loan growth. Although still high because of the 2020 rollout of PPP, average year-over-year net loan growth slowed to 18% by yearend (see chart). PPP forgiveness ramped up in 4Q20, more than offsetting growth in other categories, pushing the District’s average quarter-over-quarter net loan growth rate into negative territory for the first time since 2013. During the period, Twelfth District banks shed 23% of the dollar volume of PPP loans on average, a slower pace than most other districts, but from a comparatively higher base.

Although quarterly bank ROAAs continued to improve, full-year 2020 profits trailed 2019. District banks’ average 4Q20 annualized ROAA ratio was 108%, up 10 bps from 3Q20, and off only 2 bps from 4Q19. The District’s average quarterly net interest margin rebounded slightly—propelled by PPP-heavy smaller banks—as forgiveness activity accelerated the recognition of yield-enhancing fees. The average quarterly ROAA was also boosted by lower average provision expense ratios, which continued to recede from their 2Q20 peak. Full year ROAAs averaged 0.96% in the West, down 25 bps from 2019. Although weaker year-over-year, the average ROAA was better than GFC-era earnings performance, which reached an annual trough of -1.01% in 2009 under the weight of heavy loan losses. Earnings remain a concern, however, especially given uncertain credit prospects. Nearly 60% of community banks surveyed in December by the Conference of State Bank Supervisors expected profitability to worsen.

Loan modification volumes eased, but delinquency ratios ticked higher. Quarter-over-quarter, the District’s overall 30+ day delinquency ratio edged up slightly from 0.56% to 0.63%. Averages for both periods would have been 10 bps higher if not for PPP dilution in the denominator. Delinquency figures generally omit loans temporarily modified to accommodate borrowers’ COVID-related challenges, which represented a notable but declining multiple of past-due loans. Overall, an estimated 3% of District non-PPP loans and leases were either modified, restructured, or delinquent on average, down from roughly 7% in 3Q20 and 12% in mid-2020. Stimulus passed in 2020 and the pending American Rescue Plan Act of 2021 (ARPA) in Congress could mitigate delinquencies and losses for a period, but credit metrics may ultimately weaken. More than one-third of senior loan officers surveyed by the Federal Reserve in January expected nonfarm-nonresidential, small C&I, and prime consumer loan performance to slip in 2021.

Deposit-led balance sheet growth persisted. Banks continued to invest in securities and other liquid instruments against a backdrop of tepid loan demand. These types of investments edged up to nearly 29% of assets. Typically, the shift in asset mix helped risk-based capital ratios, which also benefitted from improved earnings. The District’s average tier 1 leverage capital ratio held roughly steady as stronger profits enabled tier 1 capital to keep pace with average assets. Quarterly dividends increased in line with a historical fourth quarter pattern, averaging 12% of quarterly net income among the District’s C-corp. banks, up from 8% in 3Q20, but down from 19% in 4Q19 and well below a national average of 34%.
Section 1
Spotlight Feature & Hot Topics

Spotlight: State & Local Government Trends and Risks

Hot Topics We Are Monitoring Most Closely
• Federal support and pandemic dynamics helped to mitigate fiscal pressure on state and local governments in 2020. Early in the pandemic, many observers expected that state and local government (S&LG) revenues would see declines comparable to the Great Recession. However, federal stimulus and supplemental unemployment insurance payments in 2020 supported sales and income tax revenues, while roughly $141 billion in exceptional federal support for education and transportation relieved some expenditure pressure. Additionally, the CARES Act included a $150 billion Coronavirus Relief Fund (CRF) that provided direct funding to S&LGs. CRF allocations amounted to a significant share of expenses in some District states (see chart, bottom). ARPA contemplates another $350 billion in direct funds to S&LGs as well as monies for education, transportation, housing, and other areas.

• The nature of job losses and resurgent stock and housing markets also buffered against steep drops in tax receipts. Job losses were highly concentrated among lower-income workers who generally face lower income tax rates, and the boom in home prices bolstered property tax revenues. Overall, initial data from the Bureau of Economic Analysis indicate that total S&LG tax receipts in the nation (excluding corporate income taxes, not yet available) rose by 1.3% in 2020, led by property (+3.8%) and income taxes (+3.1%), while sales tax receipts declined (-2.2%) relative to 2019.

• But revenue performance varied greatly across states. District states with highly progressive income tax structures (such as CA, which taxes capital gains as regular income) and that impose sales tax on groceries (HI, ID, and UT) generally saw more stable revenues, while those reliant on tourism and oil/gas taxes (AK, HI, and NV) reported large declines (see chart, right). Idaho also benefitted from in-migration during the pandemic. Less clear are impacts on local government revenues, which are not available with the same frequency, granularity, and consistency.

### Coronavirus Relief Fund (CRF) Allocations

<table>
<thead>
<tr>
<th>District</th>
<th>CRF Allocations as % of 2018 State &amp; Local Government Current Operations Expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>5%</td>
</tr>
<tr>
<td>CA</td>
<td>4%</td>
</tr>
<tr>
<td>OR</td>
<td>4%</td>
</tr>
<tr>
<td>WA</td>
<td>5%</td>
</tr>
<tr>
<td>UT</td>
<td>5%</td>
</tr>
<tr>
<td>NV</td>
<td>7%</td>
</tr>
<tr>
<td>AZ</td>
<td>9%</td>
</tr>
<tr>
<td>HI</td>
<td>10%</td>
</tr>
<tr>
<td>ID</td>
<td>12%</td>
</tr>
<tr>
<td>AK</td>
<td>17%</td>
</tr>
</tbody>
</table>

CRF allocations as of 2/8/2021, includes allocations to state, local, and tribal governments. Sources: Census Bureau, Congressional Research Service.
Nevertheless, S&LG job cuts have been deeper than during the Great Recession. As of December 2020, local governments in the District shed 8.7% of their pre-pandemic (i.e., Feb. 2020) payrolls, while state governments shaved 6.2% (see chart, bottom). Both rates were lower than peak losses of 5.5% and 17%, respectively, during the Great Recession. In aggregate, although S&LGs employed roughly 13% of the District’s job base, they drove 16% of overall job losses in 2020, contributing 11 percentage points of the District’s 6.6% decline in payrolls (not seasonally adjusted). Layoffs in education services dominated S&LG cuts during the year (see chart, right).

The nature and severity of S&LG layoffs may reflect the timing of budgeting decisions as well as new distance learning postures. Louise Sheiner of the Brookings Institution observed that most states were finalizing their budgets for fiscal year 2021 (ending June 30, 2021) during spring 2020, when employment was declining rapidly. Cognizant of steep revenue losses during the Great Recession, S&LG decision-makers may have cut costs preemptively to meet balanced budget requirements. Also, distance learning models and enrollment declines affected education-related staffing needs.

Recent budget forecasts suggest continued fiscal pressure and rising costs. In updated revenue forecasts more than half of states in the nation—including AK, HI, NV, and WA in the District—expected lower fiscal 2021 revenues than under their pre-pandemic forecasts. Additionally, home prices have risen so rapidly during the pandemic that there is a risk that a downshift in pricing may reduce property tax revenues in some jurisdictions in future periods. S&LG costs for pandemic mitigation and relief may remain high into fiscal 2022; although ARPA may blunt the impact.

• Fiscal strains can influence municipal bond default rates, which have been low historically. According to Fitch Ratings, the average 10-year cumulative default rate on U.S. public finance obligations through 2019 was low at only 0.25%. Defaults among investment grade bonds (0.15%) were much lower than among speculative grade issuances (6.19%). Both rates were less severe than among similarly-rated corporate bonds.

• Notably, these statistics omit defaults on non-rated bonds. In a broader study of 2,563 municipal bond defaults between 2009 and 2015, the count of non-rated defaults exceeded rated defaults, with non-rated defaults typically involving revenue bonds with smaller average par amounts. Higher default rates among non-rated issues reflected, in part, the self-selecting nature of rated bonds—an issuer is generally less willing to seek (pay for) a rating if the bond is unlikely to garner an investment grade.

• Municipal bonds remain vulnerable to downgrade and credit-related pricing risks. Since COVID-19 emerged, Fitch Ratings downgraded or placed negative Watch/Outlook actions on 14% of the 3,192 U.S. public finance bonds it covered—primarily during the first half of 2020—outpacing positive actions in the sector. Cities, school districts, public power entities, and states drove about half of the count of negative actions, in part because of the large overall number of bonds issued by these entities. Some categories were represented disproportionately in percentage terms, including housing agencies, states, and life plan/senior care bonds (see chart, right). Likewise, Moody’s Investors Service downgraded 309 municipal issuances in the U.S. during 2020, 22% of which were issued by instrumentalities of District S&LGs. The count of downgrades outpaced upgrades for the first time since 2014.

• Downgrades among District S&LG bonds were consistent with their share of the municipal bond market. Based upon data from the Municipal Securities Rulemaking Board and Refinitiv/SIFMA, Twelfth District instrumentalities accounted for roughly 23% of the volume of U.S. municipal bond trades and issuance in 2020, led by instrumentalities in the District’s largest state, California.

Twelfth District banks had relatively low direct exposures to municipal credit and deposits. On average, municipal loans and securities represented about 2.0% of assets while public deposits funded 2.5% of assets among District banks, which trailed averages among all other Federal Reserve Districts (see chart, right). Most municipal asset exposures were in the form of securities. Twelfth District banks have historically tended to favor residential and commercial mortgage-backed securities over municipal bonds, likely a function of yield. During 2020, municipal securities increased slightly a share of District bank investment portfolios, growing to nearly 14% by yearend 2020. About one-third of District institutions also made some level of direct loans to S&LGs, although such lending was more common among mid-sized and larger institutions. On the funding side, laws typically require depositories to pledge high-quality instruments, such as U.S. Treasury securities, against public deposits exceeding the deposit insurance limit. So, these funds may be unattractive to smaller banks in the West, where S&LGs may be larger and overhead demands encourage higher-yielding investments.

Bank vulnerabilities are not limited to bond defaults. Notwithstanding comparatively low municipal bond default frequencies and exposures, banks are still subject to credit- and interest rate-related bond pricing risks. As seen during the Spring 2020 market dislocation, credit spreads and total returns on municipal issues can move sharply in times of stress (see chart below). Market illiquidity prompted the Fed to offer the Municipal Liquidity Facility in April 2020 to purchase up to $500 billion in short-term municipal notes, although holdings never surpassed $6.4 billion. Further, S&LG expenditure cuts, layoffs, and/or tax increases may affect banks’ local economies and customers employed by or doing business with S&LG entities.

**S&P Municipal Bond Total Return Indices (3/2/2020 = 100)**

The following areas are a few areas drawing heightened monitoring within the Twelfth District:

- **Cyberthreats.** Ransomware, theft of confidential and customer data through breaches, and fraud remain the primary cyberthreats facing supervised institutions in this heightened threat environment. The SolarWinds compromise and the resulting impacts continue to be discovered, although supervised institutions do not appear to have been the intended target of the compromise. Nonetheless, supervised institutions and regulators are focused on the interconnectedness of technology networks through both third parties and fourth parties, since Microsoft President Brad Smith stated “supply chain” cyberattacks such as SolarWinds are ongoing in a recent interview with CBS News. Ransomware continues to pervade, and as American Banker noted, many of these ransomware attacks double as data breaches since threat actors exfiltrate the compromised data for sale on the dark web, providing a conduit for fraud by new threat actors.

- **Bank Secrecy Act (BSA)/Anti-Money Laundering (AML) compliance and fraud.** BSA/AML monitoring remains heightened because of the District’s role in the global economy, the array of activities being conducted by supervised institutions, and the expanding scope of cannabis legalization. All states and territories in the district except one, Idaho, have some form of legalized cannabis; six states now have legalized adult use. FinCEN SAR data reveals that occurrences of coronavirus and stimulus-related scams are increasing. For instance, nationwide, depository institutions filed over 12,700 SARs involving business loans in 2020, compared with just over 2,000 such filings in 2019, likely influenced by suspicious PPP applications. The count of filings also increased across payment-related fraud categories approximately 43% year-over-year. FinCEN provides continuous updates on emerging risks on its new coronavirus updates page, which most recently added an advisory on unemployment insurance scams.

- **Compliance challenges amid COVID-19 response.** The CARES Act and other pandemic responses, which are designed to provide relief for consumers and small business, continue to have an impact on financial institutions’ compliance responsibilities. For example, the foreclosure moratorium and mortgage forbearance protections were recently extended through June 30, 2021. In addition, as relayed through SR 20-18/CA 20-13, banks are encouraged to provide consumers with available options for making prudent changes to the terms of credit to support sustainable and affordable payments for the long term. For additional information and resources, refer to the Federal Reserve’s COVID-19 Resource Page.

- **Banking and financial technology (fintech) collaboration.** Consumer banks continue to be transformed as fintech firms increasingly partner with banks to offer co-branded digital banking account services. Google recently announced partnerships with several credit unions and banks as part of its Google Plex offering, an app co-branded with banks to offer checking and savings account services. The trend of increased fintech collaboration will likely increase the focus on partnerships as well as the impact to consumers. The Federal Reserve plans to issue range of practice white papers on community bank-fintech partnerships in 2021.
• **CRE concentrations.** Nonowner-occupied CRE loan concentrations entered the current recession below pre-Great Recession peaks, mainly because of lower C&LD lending volumes. However, most state average concentration ratios remained above the U.S. average (see table, right). Lending exposures, combined with mounting pressures on CRE cash flows—particularly among hotel, retail, and office properties—heighten regulatory concern. Risks also extend to owner-occupied CRE used by COVID-impacted businesses.

• **C&I concentrations.** Current stress on business borrowers is expected to amplify C&I loan losses. According to the Federal Reserve’s 2020 Survey of Small Business Credit, conducted in September and October, 80% of surveyed District employer firms reported revenue declines in 2020 and 41% expected further contraction in the coming 12 months. Although stimulus, PPP, and modifications have limited delinquencies and charge-offs to date, the eventual impact on District banks could be meaningful. As of 4Q20, non-PPP C&I balances averaged 69% of tier 1 capital plus loan and lease loss allowances in the District, slightly more than the national average of 63%.

• **Earnings pressures.** Low interest rates, excess liquidity, and the potential for mounting credit losses have increased earnings pressures, which could prompt alternative profit or yield seeking strategies that create credit, liquidity, interest rate, and/or operational risks.

• **Surge deposits.** The stability of recent deposit inflows is uncertain. Banks have invested some newfound funding in low-yielding, liquid instruments, pressuring yields.

• **Capital actions.** Many banks/holding companies resumed stock buyback activity in the second half of 2020, which may leave capital buffers thin—an unfavorable trend given the uncertain magnitude and duration of the current crisis.

**Drought-related risks.** According to the U.S. Drought Monitor, as of February 23, drought covered most of the land area in five District states (see chart, left). Drought was far less pronounced at the same time last year. Drier climate contributed to significant fire activity in the West during 2020, including record acreage in California. Wildfire, as well as other climate-related shifts, pose ongoing financial and operational risks for bank offices, employees, and customers.
Section 2
Economic Conditions

Job Growth
Pandemic and Social Distancing
Housing Market
Commercial Real Estate

For more information on the national economy, see:

FedViews
(https://www.frbsf.org/economic-research/publications/fedviews/)

FRBSF Economic Letters
(https://www.frbsf.org/economic-research/publications/economic-letter/)

FOMC Calendar, Statements, & Minutes
(https://www.federalreserve.gov/monetarypolicy/fomccalendars.htm)
District payrolls contracted in December for the first time since April, led by pandemic-sensitive leisure & hospitality.

Twelfth District Jobs by Sector

<table>
<thead>
<tr>
<th>Job Sector</th>
<th>% Change (Year-Over-Year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leisure &amp; Hospitality</td>
<td>-26.30%</td>
</tr>
<tr>
<td>Other Svcs.</td>
<td>-14.63%</td>
</tr>
<tr>
<td>Information</td>
<td>-7.21%</td>
</tr>
<tr>
<td>Government</td>
<td>-6.76%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>-6.45%</td>
</tr>
<tr>
<td>Wholesale Trade</td>
<td>-4.17%</td>
</tr>
<tr>
<td>Edu. &amp; Health Svcs.</td>
<td>-4.04%</td>
</tr>
<tr>
<td>Mining &amp; Logging</td>
<td>-3.58%</td>
</tr>
<tr>
<td>Retail Trade</td>
<td>-2.26%</td>
</tr>
<tr>
<td>Prof. &amp; Business Svcs.</td>
<td>-2.05%</td>
</tr>
<tr>
<td>Construction</td>
<td>-0.02%</td>
</tr>
<tr>
<td>Transport. &amp; Utilities</td>
<td>0.34%</td>
</tr>
<tr>
<td>Financial Activities</td>
<td>0.49%</td>
</tr>
<tr>
<td>Total Nonfarm</td>
<td>-6.66%</td>
</tr>
</tbody>
</table>

Seasonally adjusted; construction in Hawaii includes mining and logging; information sector excludes Hawaii and Nevada; Other Services includes salons, spas, and repair and laundry services. Source: Bureau of Labor Statistics via Haver Analytics.
Unlike the nation as a whole, the Districtwide unemployment rate ticked higher in December.

Unemployment Rate (% of Civilian Population)


Encouragingly, COVID-19 infection rates fell sharply across the District in early 2021 following the winter surge.

New COVID-19 Cases per Million of Population (7-day Rolling Average)


Although mobility remained well below pre-pandemic levels, movement increased after the Winter case surge receded.

Dallas Fed Mobility and Engagement Index
(Weekly average, lower = less mobility & engagement)

All indices are scaled relative to a national index, which averages zero during the January–February 2020 period and equals -100 for the week ended April 11, 2020; indices are based on aggregated, anonymized location data from mobile devices. Source: Federal Reserve Bank of Dallas via Haver Analytics.

The vaccination process remains in the early stages with full-course vaccination rates still in the single digits.

People Receiving COVID-19 Vaccine Doses, % of Population (As of 3/2/2021)

Population estimates as of mid-2019; "Dist." = Twelfth District. Sources: Center for Disease Control and Prevention and Census Bureau.
Existing home sales plateaued in December, but remained above postcrisis trends, and new home sales picked up.

**Home Price Index**

Home price growth across the District continued to surge amid constrained supply and low mortgage rates.

**Home Price Index by Price Tier**

Less expensive home prices continued to gain fastest across the District—except for WA—and slowed in UT, HI, and NV.

**Housing Permits – Twelfth District**

1-4 family permit activity reached a new post-GFC high as builders responded to constrained supply.
**Homebuilder sentiment eased moderately after peaking in November 2020 but remained elevated.**

### Homebuilder Diffusion Index
(Monthly, Index Above 50 Considered Positive)

- **West**: 83.3 in Feb-20, 93.0 in Feb-21
- **South**: 77.7 in Feb-20, 83.7 in Feb-21
- **Midwest**: 67.7 in Feb-20, 81.0 in Feb-21
- **Northeast**: 62.3 in Feb-20, 78.3 in Feb-21
- **Nation**: 75.0 in Feb-20, 84.3 in Feb-21

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 = Twelfth District plus CO, MT, NM, and WY. Source: National Association of Home Builders (NAHB)/Wells Fargo Builders Economic Council Survey via Haver Analytics.

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

- **SF Fed**: Assumes median income (minus an assumed 7% haircut in 2020), 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.

**CRE investors continued to report adverse but improving conditions as of 1Q21 and optimism about the coming year.**

### CRE Investor Sentiment Regarding 1-Year History/Forecast*
(% of Respondents)

- **General Market Conditions**
  - Better: 8%, 10%, 9%, 9%, 9%, 9%, 9%, 9%, 9%, 9%, 9%, 9%
  - Same: 75%, 79%, 77%, 79%, 77%, 77%, 76%, 75%, 74%, 73%, 72%, 71%
  - Worse: 17%, 12%, 14%, 12%, 14%, 14%, 15%, 16%, 17%, 18%, 19%, 20%

- **Asset Values**
  - Better: 8%, 10%, 9%, 9%, 9%, 9%, 9%, 9%, 9%, 9%, 9%, 9%
  - Same: 75%, 79%, 77%, 79%, 77%, 77%, 76%, 75%, 74%, 73%, 72%, 71%
  - Worse: 17%, 12%, 14%, 12%, 14%, 14%, 15%, 16%, 17%, 18%, 19%, 20%

- **Equity Availability**
  - Better: 94%, 96%, 95%, 95%, 95%, 95%, 95%, 95%, 95%, 95%, 95%, 95%
  - Same: 4%, 5%, 5%, 5%, 5%, 5%, 5%, 5%, 5%, 5%, 5%, 5%
  - Worse: 2%, 0%, 0%, 0%, 0%, 0%, 0%, 0%, 0%, 0%, 0%, 0%

- **Debt Availability**
  - Better: 8%, 10%, 9%, 9%, 9%, 9%, 9%, 9%, 9%, 9%, 9%, 9%
  - Same: 75%, 79%, 77%, 79%, 77%, 77%, 76%, 75%, 74%, 73%, 72%, 71%
  - Worse: 17%, 12%, 14%, 12%, 14%, 14%, 15%, 16%, 17%, 18%, 19%, 20%

Survey data was collected in the first month of each quarter; *denotes expectations as of 1Q21 for the year ahead. Source: Real Estate Roundtable Sentiment Index reports.

**The number of CRE deals in 4Q20 trailed 4Q19 but improved from 3Q20 levels.**

### National CRE Transactions
(Number of properties sold)

Includes transactions of properties valued $2.5 million and above. Source: Real Capital Analytics.
As with sales, industrial & apartment price growth remained strong, while office & retail prices lagged.

Commercial & Residential Property Price Indices - Nation (Dec-2017 = 100)

**Average Annual Growth in Price Indices**

1Yr. | 5Yr. | 10Yr.
---|---|---
Office | 15% | 5.0% | 5.8%
Industrial | 7.8% | 8.9% | 3.8%
Retail | -4.3% | 0.7% | 10.4%
Apartment | 8.3% | 9.9% | 10.4%
Single-Family Homes | 9.2% | 5.8% | 5.6%

**Central Business District (CBD)**

- **Suburban**
  - 1Yr.: 104.5
  - 5Yr.: 100.0
  - 10Yr.: 104.5

**Cap rates for retail, downtown office, and mid-/highrise apts. drifted higher; spreads widened to declining Treasury rates.**

Western U.S. CRE Capitalization Rates & Spreads

(Trailing 12-Month Averages)

**Districtwide, vacancy rates continued to climb in 4Q20, and CBRE-EA expects them to remain elevated for offices.**

**CRE Rents have declined and are expected to weaken further in all sectors but industrial.**

**CRE Vacancy Rates - Twelfth District Markets**

(Historical from 4Q05 through 4Q20, forecast from 1Q21 to 3Q23)

**CRE Real Rent Indices - Twelfth District Markets**

(4Q20 = 100; historical from 4Q05 through 4Q20, forecast from 4Q20 to 3Q23)
Wide disparities in CRE fundamentals were evident across District markets, particularly in office & apartment sectors.

Effective rent is asking rent minus concessions offered; includes the 16 to 18 largest markets in the District, depending on the sector. Source: CBRE-EA.
Section 3
Commercial Bank Performance

Loan Growth
Earnings
Allowances and Credit Quality
Liquidity and Interest Rate Risk
Capital

For ongoing supervisory perspectives and guidance on COVID-19, please visit https://www.federalreserve.gov/covid-19.htm

Note: Bank size groups are defined by total assets as “Very Small” (<$1B), “Small” ($1B - $10B), “Mid-Sized” ($10B - $50B), and “Large” (> $50B), which, for analytical reasons, differ slightly from supervisory asset thresholds. The “Large” bank group covers banks based nationwide—given their broader geographic footprint and to afford a larger statistical sample—while the other three groups include banks headquartered in the Twelfth District.
Annualized quarterly loan growth sank in 4Q20 as PPP forgiveness ramped up and loan demand weakened.

Average Year-over-Year Net Loan & Lease Growth

Average Quarter-over-Quarter Net Loan & Lease Growth (Ann'l'd.)

The average pace of decline in Twelfth District PPP holdings trailed most other parts of the nation.

Average Quarter-over-Quarter Change in PPP Volumes and Counts, 4Q20

Full year bank ROAAs trailed 2019 notably, but the average 4Q20 ratio was only slightly below 4Q19.
Accelerated PPP fee recognition at PPP-heavy smaller banks and lower provision expenses boosted quarterly ROAAs.

Quarterly net interest margins edged up as PPP forgiveness fueled accelerated recognition of yield-enhancing fees.

Year-to-date, asset growth outpaced constrained increases in overhead, diluting overhead-to-asset ratios.

An increasing share of District institutions reported zero provision expenses; some reversed prior allowance builds.
Still, allowances for loan and lease losses increased in relation to loans, partly because of negative loan growth.

Although slowing, annual growth in severely delinquent loans remained elevated (from a low base).

At least one in three lenders expected credit quality to slip, for nonfarm-nonresidential, small C&I, and consumer loans.

Expectations for Loan Performance* in 2021

<table>
<thead>
<tr>
<th>Category</th>
<th>Better</th>
<th>Same</th>
<th>Worse</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nonfarm-Nonresid.</td>
<td>33%</td>
<td>43%</td>
<td>44%</td>
</tr>
<tr>
<td>Small C&amp;I</td>
<td>39%</td>
<td>37%</td>
<td>44%</td>
</tr>
<tr>
<td>Credit Card**</td>
<td>9%</td>
<td>52%</td>
<td>39%</td>
</tr>
<tr>
<td>Auto**</td>
<td>7%</td>
<td>59%</td>
<td>34%</td>
</tr>
<tr>
<td>Revol. 14 Fam.</td>
<td>12%</td>
<td>60%</td>
<td>29%</td>
</tr>
<tr>
<td>GSE Elig. 14 Fam.</td>
<td>13%</td>
<td>59%</td>
<td>28%</td>
</tr>
<tr>
<td>Multifamily</td>
<td>13%</td>
<td>62%</td>
<td>27%</td>
</tr>
<tr>
<td>C&amp;LD</td>
<td>13%</td>
<td>60%</td>
<td>27%</td>
</tr>
<tr>
<td>Jumbo 14 Fam.</td>
<td>13%</td>
<td>66%</td>
<td>23%</td>
</tr>
<tr>
<td>Mid-Large C&amp;I**</td>
<td>31%</td>
<td>52%</td>
<td>17%</td>
</tr>
</tbody>
</table>

Based on a sample of loan officers at 46-70 domestic banks (count varies by loan type); C&LD = construction and land development; GSE = government sponsored enterprise; *delinquencies and net chargeoffs; **excludes syndicated and subprime. Source: Federal Reserve Senior Loan Officer Opinion Survey, January 2021.
District bank 2020 net chargeoff ratios remained subdued; average C&I losses were up notably among large banks.

Although receding, average PPP exposures remained highest in the West.

A declining share of commercial lenders tightened standards into late 2020, unlike residential/consumer loans.
A portion of lenders expected standards to change in 2021, with consumer and commercial outlooks differing.

### Expectations for Lending Standards in 2021

<table>
<thead>
<tr>
<th>Category</th>
<th>Tighter</th>
<th>Same</th>
<th>Easier</th>
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</thead>
<tbody>
<tr>
<td>Credit Cards</td>
<td>2%</td>
<td>61%</td>
<td>37%</td>
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<tr>
<td>Jumbo 14 Fam.</td>
<td>5%</td>
<td>76%</td>
<td>19%</td>
</tr>
<tr>
<td>Auto Loans</td>
<td>0%</td>
<td>82%</td>
<td>18%</td>
</tr>
<tr>
<td>GSE-Elig. 14 Fam.</td>
<td>0%</td>
<td>86%</td>
<td>14%</td>
</tr>
<tr>
<td>Mid-Large C&amp;I</td>
<td>11%</td>
<td>79%</td>
<td>4%</td>
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<tr>
<td>Small C&amp;I</td>
<td>14%</td>
<td>77%</td>
<td>9%</td>
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<tr>
<td>Multifamily</td>
<td>14%</td>
<td>79%</td>
<td>7%</td>
</tr>
<tr>
<td>Nonfarm-Nonresid.</td>
<td>10%</td>
<td>80%</td>
<td>3%</td>
</tr>
<tr>
<td>C&amp;LD</td>
<td>17%</td>
<td>80%</td>
<td>3%</td>
</tr>
<tr>
<td><strong>SF Fed</strong></td>
<td>0%</td>
<td>50%</td>
<td>100%</td>
</tr>
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</table>

Based on a sample of loan officers at 49-73 domestic banks (count varies by loan type); C&LD = construction and land development; C&I = commercial and industrial; GSE = government sponsored enterprise. Source: Federal Reserve Senior Loan Officer Opinion Survey, January 2021.

On-balance sheet liquidity accumulated further as the continued influx of deposits outstripped loan demand.

### Average Liability Category / Assets - Twelfth District Banks

- **Jumbo NMDs**: Average of 35.8% in 2018, 41.5% in 2019, 22.5% in 2020.
- **CDs (Including Brokered)**: Average of 4.9% in 2018, 3.8% in 2019, 2.8% in 2020.
- **Borrowings**: Average of 2.3% in 2018, 15% in 2019, 0.9% in 2020.

Average = trimmed mean; liquid investments = cash, due from balances, interest bearing balances, and federal funds sold & securities purchased under agreements to resell; securities includes available for sale and held to maturity investments at fair value and amortized cost, respectively.
Although banker optimism improved in the West, concerns increased about deposit competition in the coming year.

Expectations in Next 12 Months - West Area

Bank Confidence - West

Data based on nationwide surveys of bank chief executive officers, chief financial officers, and presidents queried two weeks after each quarter; 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. Source: Intrafi Network Bank Executive Business Outlook Surveys.

PPP and deposit-fueled growth hurt leverage ratios in 2020; RBC was helped by low weights on PPP and liquid assets.

Average Regulatory Capital Ratios by Bank Size

Although lower in the District than elsewhere, 4Q dividend payouts increased akin to a historical pattern.

Average Quarterly Dividends / Net Income Among C-Corp Banks

Average = trimmed mean; excludes Subchapter-S banks, which tend to report higher payout ratios to support shareholder tax obligations.
Appendices

Summary of Institutions

Technical Information

Commonly Used Abbreviations
General: This report focuses on the financial trends and performance of commercial banks headquartered within the Twelfth 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), 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 preferred for trimmed means.

Appendix 1: Summary of Institutions

<table>
<thead>
<tr>
<th>Area</th>
<th>Commercial Banks (De Novos)</th>
<th>Dec-19</th>
<th>Dec-20</th>
<th>Industrial Banks (De Novos)</th>
<th>Dec-19</th>
<th>Dec-20</th>
<th>Savings Institutions (De Novos)</th>
<th>Dec-19</th>
<th>Dec-20</th>
</tr>
</thead>
<tbody>
<tr>
<td>AK</td>
<td>4 (0)</td>
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<td>-</td>
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<tr>
<td>AZ</td>
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<td>-</td>
<td>-</td>
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<tr>
<td>NV</td>
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<td>4 (0)</td>
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<td>OR</td>
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<td>UT</td>
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<td>14 (0)</td>
<td>15 (1)</td>
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<td>1 (0)</td>
<td></td>
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<tr>
<td>WA</td>
<td>32 (0)</td>
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<td>9 (0)</td>
<td>9 (0)</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>12L</td>
<td>250 (3)</td>
<td>246 (3)</td>
<td>22 (0)</td>
<td>23 (1)</td>
<td>32 (1)</td>
<td>30 (1)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>U.S.</td>
<td>4,492 (26)</td>
<td>4,345 (30)</td>
<td>24 (0)</td>
<td>25 (1)</td>
<td>659 (1)</td>
<td>627 (1)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Based on preliminary 4Q20 data.

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Commonly Used Abbreviations:

- AFS: Available for sale
- MBS: Mortgage-backed security
- ACL: Allowance for credit losses
- MMDA: Money market deposit account
- ALLL: Allowance for loan and lease losses
- NFNR: Nonfarm-nonresidential
- BSA/AML: Bank Secrecy Act / Anti-Money Laundering
- NMD: Nonmaturity deposit
- C&I: Commercial & industrial
- PPP: Paycheck Protection Program
- C&LD: Construction & land development
- ROAA: Return on average assets
- CD: Certificate of deposit
- TDR: Troubled debt restructuring
- CRE: Commercial real estate
- TE: Tax equivalent
- HFS: Held for sale
- YTD: Year-to-date