FEDERAL RESERVE BANK OF SAN FRANCISCO

# First Glance 12L (2Q18)

Financial Performance of Banks in the 12th Federal Reserve District ("12L")

## Bank Profits Buoyed Capital but Deposit Growth Slowed

**August 28, 2018**

***Note: some slides have been revised since the original publication of this file***

*A Product of the Surveillance and Analysis and Data Analytics Units*



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First Glance 12L: https://www.frbsf.org/banking/publications/first-glance-12l/

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# 12th District Overview
## “Bank Profits Buoyed Capital but Deposit Growth Slowed”

*Job growth slowed across most of the District but accelerated nationwide.* Year-over-year, nonfarm jobs grew by 2.1% in the 12th District (District), down from 2.4% in 1Q18 but above an improving national aggregate of 1.6%. Growth rates were flat or down compared with the first quarter across most District states except Arizona and Hawaii (see table at right). Outside of Alaska, unemployment remained below 5.0%, and was especially low in Hawaii, Idaho, and Utah. The construction sector continued to be an outsized job growth driver.

*The pace of annual home price appreciation eased, but remained well above long term historical averages.* District states continued to lead the nation in price gains. Nevada, Washington, Idaho, Utah, and California once again occupied the top five spots. Higher interest rates may have begun to take potential buyers out of the market, but any slowdown in sales was still mostly a function of lack of inventory. Homebuilding picked up, but permit volumes remained well below pre-financial crisis levels, and multifamily building accounting for a heightened share of activity. Existing single family homes for sale remained below three months of supply in every District state except Hawaii (four to six months is considered a balanced market). With so little new inventory and only nascent signs of a slowdown in demand, affordability worsened, dipping below 2008 levels in Idaho, Nevada, and California.

*Commercial real estate (CRE) investors continued to favor apartment and industrial properties over office and retail.* 2Q18 apartment fundamentals were impressive considering the amount of supply added to the market in the last few years. Strong job gains and a lack of affordable home purchase inventory fueled demand. E-commerce growth remained a key driver of industrial demand, typically at the expense of retail properties. However, growing trade tensions posed some uncertainty for warehouse space in port areas and distribution hubs. The office sector posted respectable although slowing fundamentals. Some tech-heavy markets, including San Jose, Seattle, and San Francisco, got a second wind with exceptionally healthy absorption. Investors surveyed by the Real Estate Roundtable indicated some concern over future CRE price appreciation and debt availability.

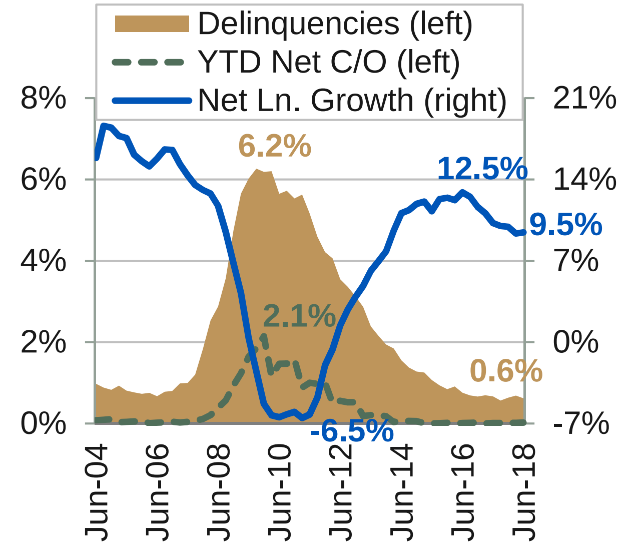
*Foreign trade and capital flows faced headwinds.* Exporters and importers ramped up shipments in 2Q18, partly in response to impending tariff increases. Interactions with China, Mexico, Canada, and the European Union will bear watching given the amount of District trade transacted with these countries/regions. In some of the District's markets, a large share of employment may relate to products that face increased tariffs by China, in particular. Separately, China's 2017 capital controls dampened capital flows into District CRE markets. In residential markets, cross-border home purchases in the U.S. sank 21% in the trailing 12-months ending March because of tighter inventories, higher prices, and political uncertainties.

### Nonfarm Job Growth & Unemployment (%)

| | Year-Over-Year Job Growth | | Unemp. Rate |
|---|---|---|---|
| | 12 Mos. | 2Q18 | Jun-18 |
| ID | | 3.17% | 2.90% |
| UT | | 3.10% | 3.00% |
| NV | | 3.01% | 4.70% |
| WA | | 2.83% | 4.70% |
| AZ | | 2.44% | 4.70% |
| OR | | 2.10% | 4.00% |
| CA | | 1.83% | 4.20% |
| HI | | 1.55% | 2.10% |
| AK | | -0.47% | 7.10% |
| US | | 1.61% | 4.00% |

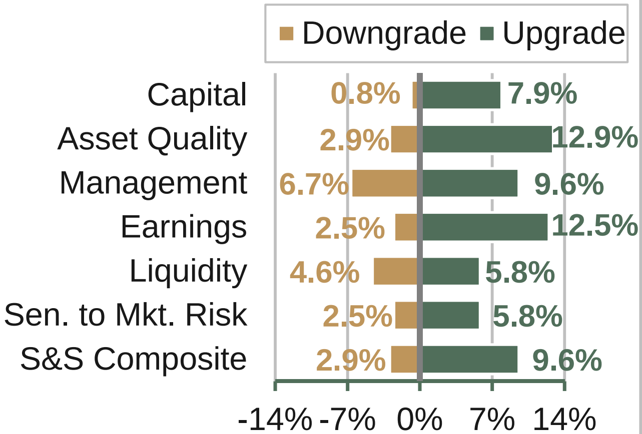
Growth based on change in 3-month moving average; all data seasonally adjusted. Source: Bureau of Labor Statistics / Haver Analytics.

**District Credit Metrics***




*Delinquent = 30+ days past due or nonaccrual; C/O = chargeoff (year-to-date annualized); trimmed means. FRB-SF

**S&S Examinations** Resulting in Rating Change – 12th District**




**% of safety & soundness (S&S) exams completed in 12 months ending June, mailed through 8/21/18. FRB-SF

*Profits among District banks strengthened.* District banks' average, year-to-date (YTD) return on average assets (ROAA) ratio (adjusted for Subchapter S tax filers) improved to 1.21%, up 24 bps year-over-year and above a national average of 1.05%. Although the average after-tax ROAA neared the 1.24% reported in the first half of 2007, pre-tax profits remained well below. The average after-tax ROAA would have been roughly 15 basis points lower, or 1.06%, if not for tax cuts. Asset yields continued to outpace funding costs, pushing up the average net interest income-to-average assets ratio by 19 bps in the past year. Higher overhead ratios and weaker noninterest income ratios offset some of the ROAA gains from wider margins and lower tax rates.

*District bank loan growth ticked up and loan delinquencies and losses remained low.* The District's average annual net loan growth rate was 9.5% in 2Q18, up from 9.4% in 1Q18, but down from 10.3% in mid-2017. Growth continued to outpace the national average, which decelerated to 6.1%. State-level results were mixed, with annual growth accelerating on a linked-quarter basis in four District states (Utah, Arizona, Nevada, and California), and slowing in five others. On average, construction and land development (C&LD) and multifamily loans had the fastest segment-level growth rates, but multifamily growth cooled. Although expanding, CRE loan levels edged down in relation to total capital, diluted by earnings-fueled increases in equity. Average past-due loan and net chargeoff rates remained low (see chart on left), in particular among smaller banks.

*As in 1Q18, liquidity tightened but capital ratios improved.* The District's average loan-to-asset ratio notched higher in the past quarter and year as investments in liquid assets and securities waned as a share of bank balance sheets. Meanwhile, average growth in nonmaturity deposits (NMDs) slowed, and the gap between NMD growth and asset growth turned negative for some banks, especially mid-sized and large ones. One concern is that banks with weakening NMD growth may turn to costlier forms of funding or sell liquid instruments to sustain loan growth rates. On average, noncore funding ratios eased in 2Q18, led by a recent law change which permitted banks to re-classify reciprocal deposits as non-brokered under certain conditions. Improved earnings retention and slower asset growth buoyed regulatory capital ratios.

*Safety and soundness (S&S) examination upgrades continued to outpace downgrades by a wide margin*. In the twelve months ending June, the pace of upgrades exceeded downgrades for all components (see chart on left). More than 93% of District banks were rated satisfactory or strong for safety and soundness, comparable to early 2008 and far better than a crisis-era low of less than 40%. A similar share of District banks were rated satisfactory or better for consumer and/or Community Reinvestment Act compliance.

# <u>Hot Topics</u>: Areas We Are Monitoring Most Closely

The following areas are drawing heightened supervisory attention within the 12th District based on risk exposures and metrics of Federal Reserve-supervised institutions:

- *Cyberthreats*. Attackers prey on the vulnerability of humans as well as systems, leaving bank networks, their employees, and their clients targets for cyberattacks. According to Symantec's July 2018 *Monthly Threat Report*, for the financial, insurance, and real estate sector (globally), one in every 2,379 emails was a phishing attempt, and one in every 371 email messages contained malware. Such statistics reinforce the need for both staff and customer training and strong vendor management programs. All firms are vulnerable, regardless of size, complexity, and scale, but a bank's inherent risk can vary depending upon these dimensions.

- *Bank Secrecy Act (BSA)/Anti-Money Laundering (AML) compliance*. Although most banks in the District have satisfactory BSA compliance programs, BSA/AML continues to be a significant "hot topic" due to the District's role in the global economy and the array of activities being conducted by supervised institutions. Regulatory requirements in this area continue to evolve, such as new Customer Due Diligence rules that took effect in May 2018. BSA/AML-related criticisms noted at bank examinations most often related to internal controls (e.g., institutional risk assessments, customer due diligence, and suspicious activity monitoring). Weak program oversight and ineffective independent tests continued to be noted at examinations as well.

- *CRE lending concentrations*. Non-owner occupied CRE loan concentrations remained at or above the U.S. average across all District states (see table at right). Increased loan concentrations, combined with potential competitive easing of underwriting standards and elevated property prices, heighten regulatory concern. A rising interest rate environment could negatively impact debt service coverage ratios and pressure commercial property price appreciation, all else equal. For risk management-related guidance, see the 2015 *Interagency Statement on Prudent Risk Management for Commercial Real Estate Lending* (SR letter 15-17, available at [https://www.federalreserve.gov/supervisionreg/srletters/sr1517.htm](https://www.federalreserve.gov/supervisionreg/srletters/sr1517.htm)).

- *Lengthening 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 as the yield curve flattened; however, the proportion of longer-dated assets remained elevated through mid-2018. In a rising interest rate environment, longer-term assets may be slower to reprice and could mute margin expansion if not appropriately matched, hedged, or managed.

**Average Commercial Real Estate Loans / Total Capital* (%)**

| FRB-SF | 2008-18** | Jun-18 |
|---|---|---|
| CA | 302% | 264.3% |
| WA | 334% | 235.4% |
| OR | 380% | 234.4% |
| NV | 385% | 215.6% |
| AZ | 378% | 177.5% |
| ID | 251% | 172.7% |
| HI | 173% | 157.1% |
| AK | 188% | 151.0% |
| UT | 337% | 128.2% |
| Nation | 222% | 126.0% |

*Trimmed means; excludes owner-occupied ; **June of each year.

◆ = trough ◆ = peak

# Hot Topics: Areas We Are Monitoring Most Closely

- *Consumer compliance issues.* In addition to redlining, overdraft practices have gained attention. Overdraft fees generate a significant share of deposit service charges, but are not without legal, regulatory, and reputational risk. Litigation and/or regulatory action have been taken for a variety of overdraft-related practices.
- *Quality of loan growth*. The average annual net loan growth rate continued to outpace the national average in most District states. Economic expansion fostered growth; however, many loans are underpinned by near-historic high collateral values and some lenders have loosened standards in the face of competition, including from non-bank lenders. If collateral values prove unsustainably high and/or rising interest rates increase debt service on variable rate loans, the risk of default and/or loss increases. Closely monitoring credit performance will be important as banks approach the implementation of new accounting rules for Current Expected Credit Losses (CECL).
- *Emergent funding gap.* In recent years, strong, sustained loan growth has been supported by an influx of NMDs as well as a decline in on-balance sheet liquidity. Large NMD accounts helped fuel the growth, especially in the District (see table at right). However, NMD growth has slowed recently, increasingly lagging asset growth at some banks. Meanwhile, securities and liquid assets declined to their lowest level relative to assets since 2009 and the risk profile of bond portfolios has generally increased as banks sought yield in the low-rate environment. Though the use of noncore funds remained relatively modest, banks may be near or at an inflection point, with the above trends serving as an impetus for banks to increase pricier noncore funding to fill the gap left by lagging NMD growth and diminished on-balance sheet liquidity.
- *Balancing overhead expense pressures with risk management requirements*. Asset growth and technology have led to some economies of scale and efficiency gains, helping to boost profitability. The risk is that banks may not be devoting sufficient resources to back-office operations, internal controls/audit, and compliance programs commensurate with their increasing size and complexity.
- *Financial technology (fintech) opportunities and risks*. Depository institutions have increasingly partnered with fintech companies, and with marketplace lenders in particular. Given the different origination and underwriting methods that consumer fintech lenders may use, and since credit decisions may use nontraditional data sources, banks should closely evaluate transactions for credit risk, fair lending, and unfair/deceptive acts or practices. Further, the fintech regulatory landscape continues to evolve. In July, the Office of the Comptroller of the Currency announced it would begin accepting applications from fintech companies (fintechs) for a special purpose national bank charter. The charter would not require federal deposit insurance, though it would subject fintechs to capital and liquidity standards and require them to address financial inclusion.

**Average Jumbo NMD / Assets* by Federal Reserve District**

| District | Jun-10 | Jun-18 |
|---|---|---|
| San Francisco | 19.6% | 35.4% |
| New York | 21.0% | 30.8% |
| Dallas | 16.2% | 28.2% |
| Boston | 15.8% | 24.1% |
| Atlanta | 12.5% | 24.0% |
| Philadelphia | 12.9% | 21.8% |
| Kansas City | 12.2% | 21.2% |
| Minneapolis | 11.2% | 20.5% |
| Richmond | 11.1% | 20.5% |
| Chicago | 11.3% | 20.3% |
| Cleveland | 10.9% | 18.7% |
| Saint Louis | 10.6% | 18.4% |

*Trimmed means; NMD = nonmaturity deposit; jumbo = balance > $250,000.

# Section 1
# Economic Conditions

## Job Growth

## Housing Market

## Commercial Real Estate

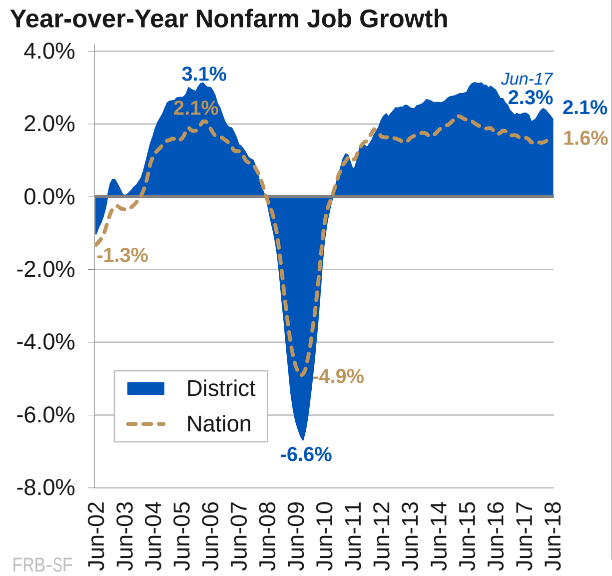
## Cross-Border Activity

## Wildfires

For more information on the District's real estate markets and economy, see:
*Real Estate Lending Risks Monitor*
(https://www.frbsf.org/banking/publications/real-estate-lending-risks-monitor/)
*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/)
*FOMC Calendar, Statements, & Minutes*
(https://www.federalreserve.gov/monetarypolicy/fomccalendars.htm)

## 8 District Job Growth Slowed Relative to 1Q18 and 2Q17; Only a Few Sectors Quickened Versus Year-Earlier Rate




**Year-over-Year Growth by Sector 12th District Jobs**

| Job Sector | Percentage Change 2008-18* | Percentage Change 2Q 2018 |
|---|---|---|
| Construction | | 6.22% |
| Transport. & Utilities | | 3.65% |
| Educ. & Health Svcs. | | 3.43% |
| Information | | 2.94% |
| Leisure & Hospitality | | 2.44% |
| Prof. & Business Svcs. | | 2.30% |
| Manufacturing | | 1.61% |
| Financial Activities | | 1.41% |
| Retail Trade | | 1.27% |
| Government | | 0.58% |
| Other Private | | 0.50% |
| Wholesale Trade | | 0.40% |
| Total | | 2.13% |

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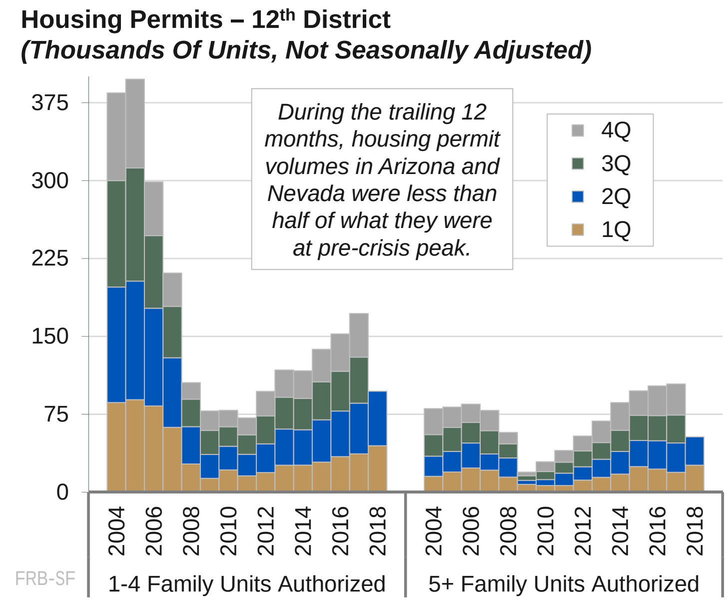
Based on average nonfarm payroll levels over trailing three months; data are preliminary estimates; *year-over-year change trend lines in sector table as of second quarter of each year. Source: Bureau of Labor Statistics via Haver Analytics.

## 9 Housing Permits Still Below Pre-Crisis Levels Except in UT; Multifamily Drove New Units in OR, HI, WA, & CA




**New Authorized Housing Units**

*Trailing 12-Month Totals*

| | Level 2005-2018* | Jun-18 vs. Jun-06 | % Multif. Jun-18 |
|---|---|---|---|
| UT | | 100% | 26% |
| WA | | 88% | 44% |
| ID | | 71% | 19% |
| OR | | 67% | 49% |
| CA | | 65% | 44% |
| HI | | 53% | 46% |
| AK | | 53% | 17% |
| AZ | | 47% | 24% |
| NV | | 39% | 28% |
| Dist. | | 64% | 37% |

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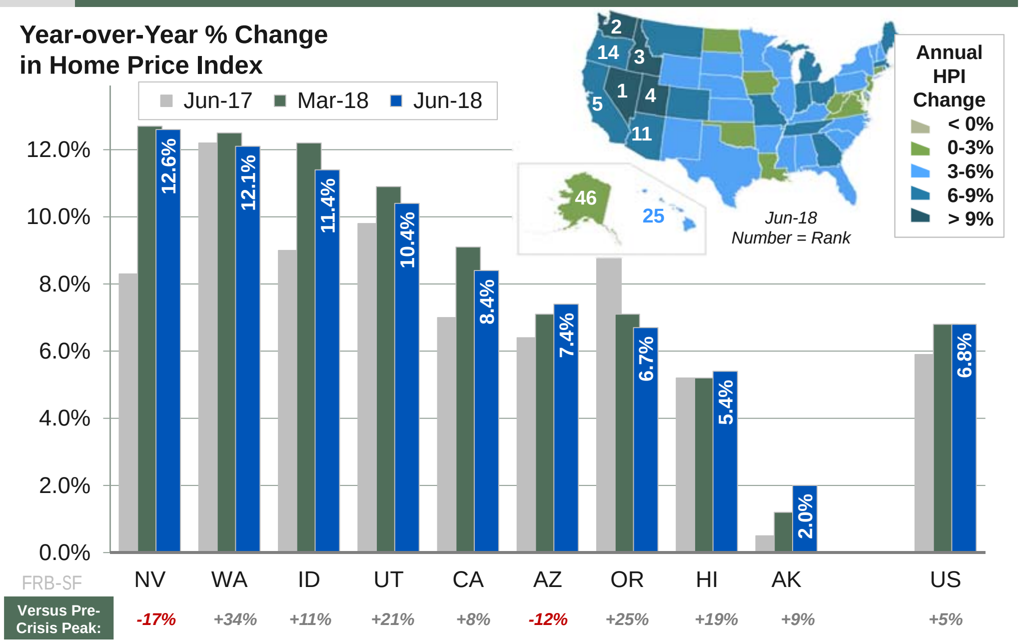
◆ = trough ◆ = peak

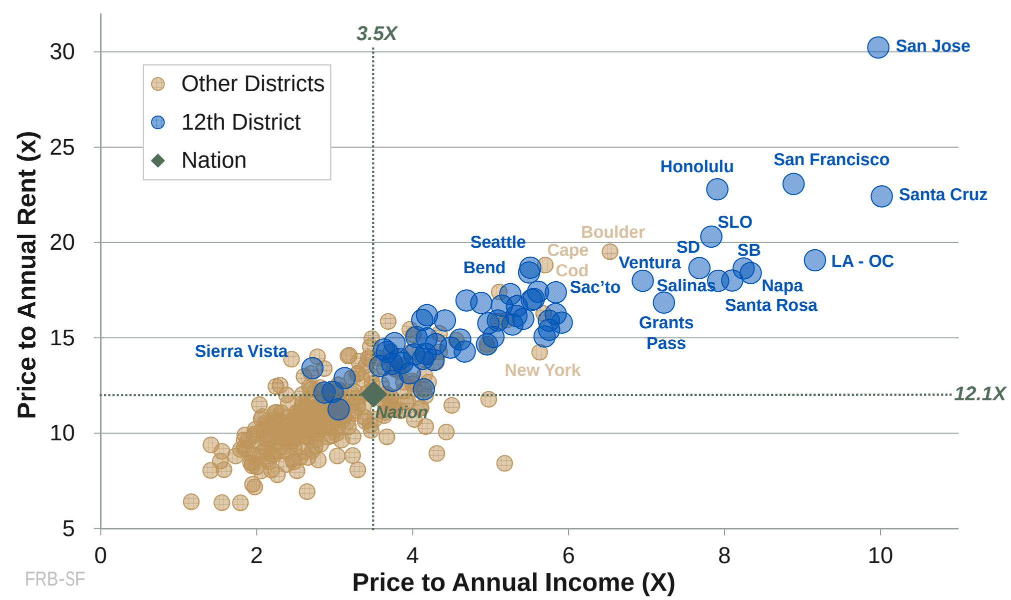
*year-over-year change trend lines as of June of each year. Source: Census Bureau/Haver Analytics.

## 10 In General, Price Appreciation Remained Above-Average but Eased Under the Weight of Higher Mortgage Rates




HPI = home price index (includes all detached and attached homes, including distressed sales). Source: CoreLogic.

## 11 Home Prices Remained High in Relation to Both Income and Rent in Most District Markets

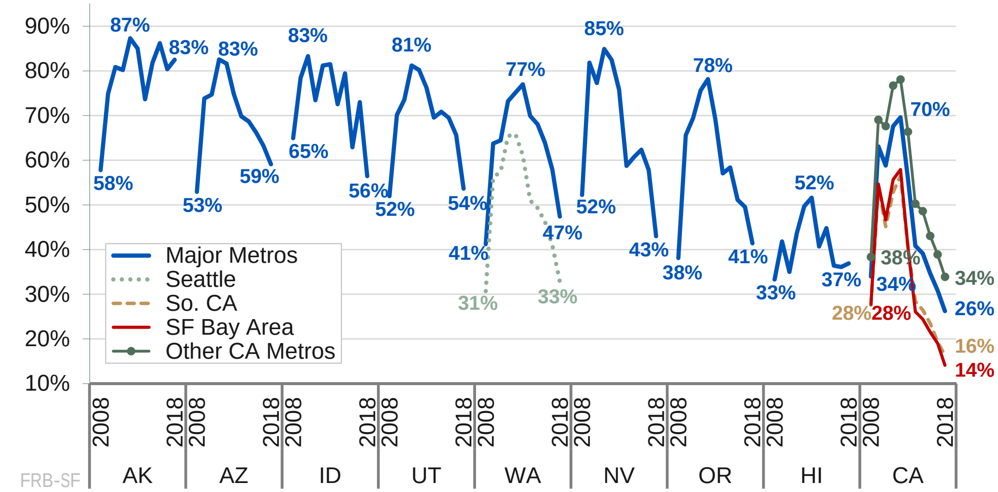



LA = Los Angeles; OC = Orange County; SB = Santa Barbara; SD = San Diego; SLO = San Luis Obispo. Source: Zillow.

## 12 Mid-2018 Average Affordability Was Worse Than Mid-2008 in Idaho, Nevada, and California

**Un-weighted Average Metro Housing Opportunity Index, June Each Year**

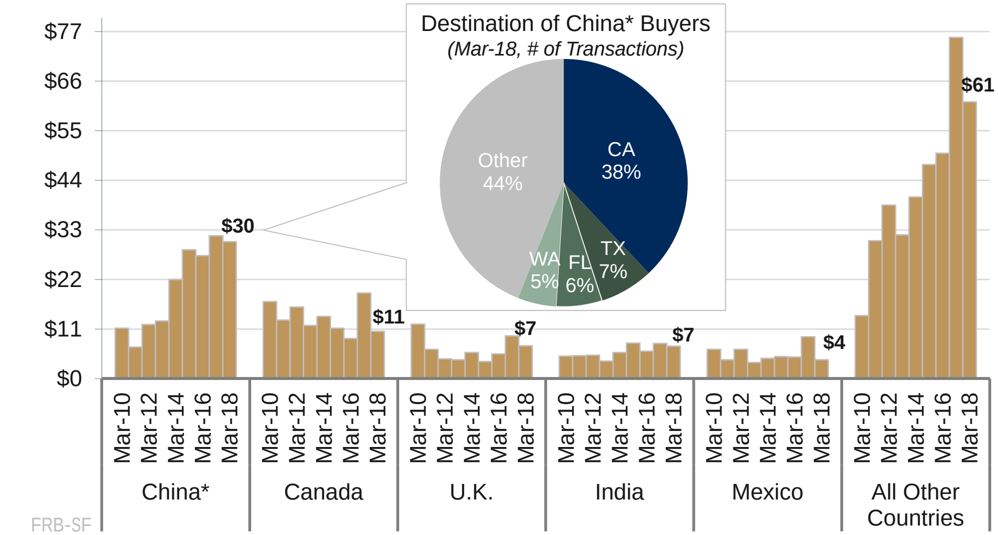
*(% of Home Sales Deemed Affordable to Median Family Income; Higher Ratio = More Affordable)*




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.

## 13 Low Inventories, Higher Prices, and Political Uncertainty Muted Cross-Border Home Buying

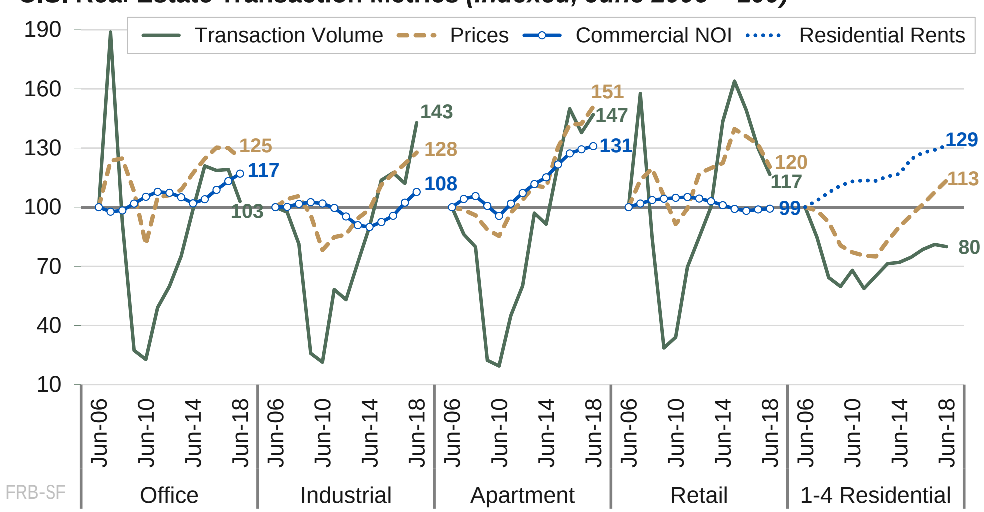
**Annual U.S. Residential Real Estate Purchases by Foreign Buyers ($Billions)**




Based upon a survey of REALTORS® through March each year; *includes mainland China, Hong Kong, and Taiwan; data for 2010 through 2015 includes some commercial transactions. Source: National Association of REALTORS® *2018 Profile of International Activity in U.S. Residential Real Estate*.

## 14 Commercial Property Prices Outpaced NOI Growth; Office and Retail Transaction Volumes Slid Further

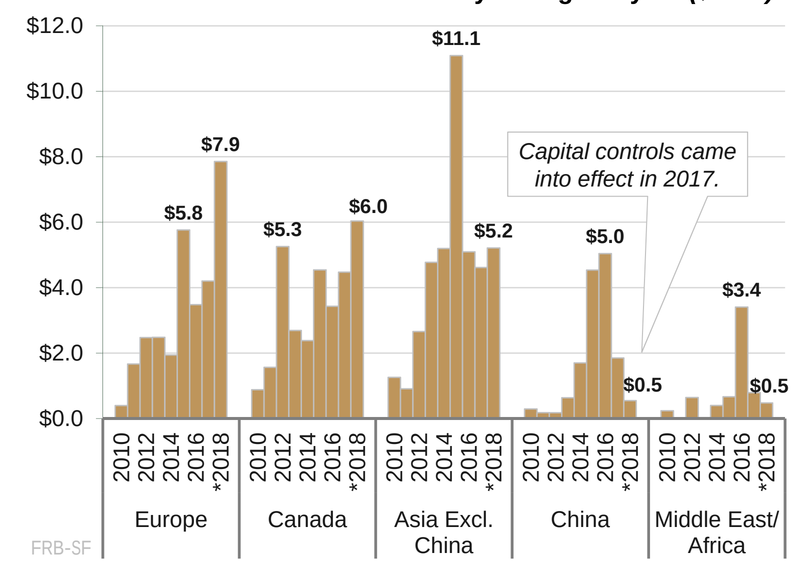
**U.S. Real Estate Transaction Metrics *(Indexed, June 2006 = 100)***




All but 1-4 residential rent index based upon 4-quarter moving averages; commercial transaction index reflects dollar volume of deals, residential transaction index reflects number of sales; price indices based on average price per square foot or unit (for commercial) and median prices (for residential); NOI = net operating income. Sources: Real Capital Analytics (commercial transactions and prices), CBRE-EA (NOI), National Association of REALTORS®/Haver Analytics (home transactions and prices), and Zillow (residential rents).

## 15 Cross-Border Purchases of District CRE Eased Among Chinese Investors in the Past Twelve Months

**Annual 12th District CRE Purchases by Foreign Buyers *($Bils.)***



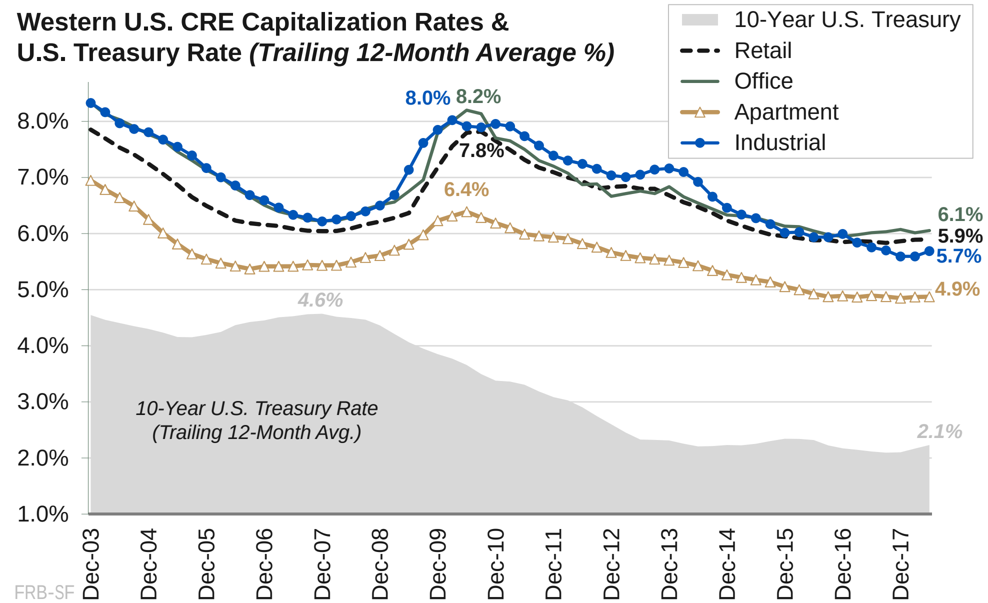

**Cross-Border $ Vol./Total $ Vol.**
***All Transactions***

| Market | 2017 |
|---|---|
| San Francisco | 23% |
| San Jose | 15% |
| Seattle | 11% |
| Los Angeles | 11% |
| Phoenix | 8% |
| San Diego | 8% |
| East Bay | 8% |
| Portland | 6% |
| Salt Lake City | 5% |
| Las Vegas | 5% |
| Inland Empire | 3% |
| Orange Co | 3% |
| Sacramento | 2% |
| Nation | 11% |

*2018 data for trailing four-quarter period; includes transactions above $2.5 million each within nine District states. Source: Real Capital Analytics.

## 16 Average Annual Cap Rates in the West Were Mostly Flat in Spite of Higher Long-Term U.S. Treasury Rates

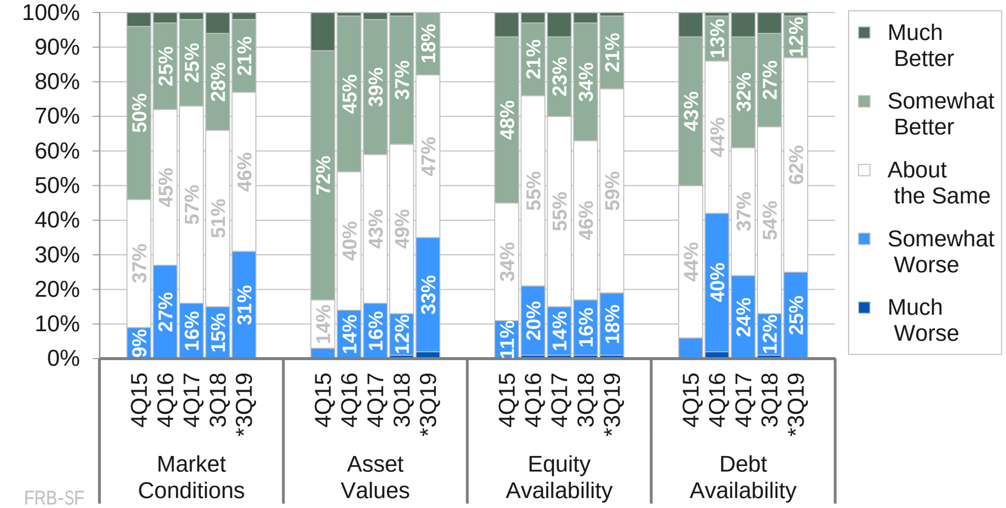
**Western U.S. CRE Capitalization Rates & U.S. Treasury Rate *(Trailing 12-Month Average %)***




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; U.S. Treasury rate at constant maturity. Sources: Real Capital Analytics, Federal Reserve.

## 17 CRE Investors Showed Signs of Caution About Future Property Values and Credit Availability

**CRE Investor Sentiment Compared with Year Ago* *(% of Survey Respondents)***

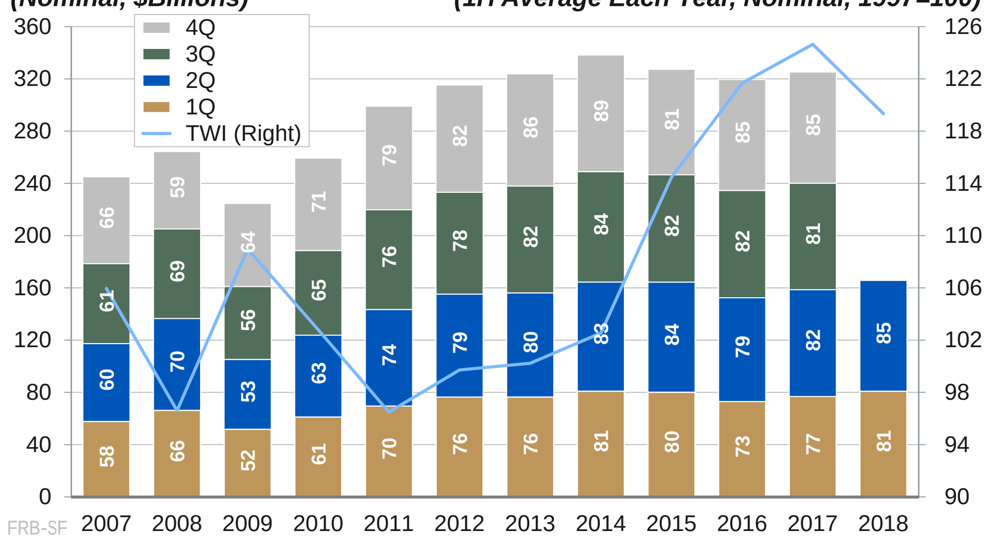



*3Q19 reflects expectations for the next 12 months; survey was conducted by FPL Advisory Group on behalf of The Real Estate Roundtable and measures the views of chief executives, presidents, and other top CRE industry executives regarding conditions in the past 12 months and expectations for the next 12 months; 4Q surveys were conducted in October of each year; 3Q18 survey was conducted in July. Source: Real Estate Roundtable Sentiment Index Reports.

## 18 First Half Exports Were Above Prior Year Levels, Driven by Weaker Dollar and Shipments Ahead of Tariffs

**12th District Exports *(Nominal, $Billions)***

**Trade Weighted Index, Exchange Value of $US *(1H Average Each Year, Nominal, 1997=100)***




Export based on origin of movement; TWI = trade-weighted index of exchange value of $US. Sources: WISER Trade, Bureau of Economic Analysis, and Federal Reserve via Haver Analytics.

## 19 China, Mexico, Canada, and the EU, Which Imposed Retaliatory Tariffs, are Key District Trade Partners

| Mix of 2017 Counterparties | Imports U.S. | Imports District | Exports U.S. | Exports District |
|---|---|---|---|---|
| **World ($Bils)** | **$ 2,342** | **$ 567** | **$ 1,546** | **$ 325** |
| Asia | 45% | 64% | 31% | 50% |
| *China** | *24%* | *37%* | *13%* | *22%* |
| *Japan* | *6%* | *9%* | *4%* | *7%* |
| *So. Korea* | *3%* | *4%* | *3%* | *5%* |
| North America | 26% | 20% | 34% | 22% |
| *Mexico* | *13%* | *11%* | *16%* | *12%* |
| *Canada* | *13%* | *9%* | *18%* | *10%* |
| Europe | 22% | 11% | 22% | 21% |
| *European Union* | *19%* | *9%* | *18%* | *16%* |
| South/Central Amer. | 5% | 4% | 10% | 4% |
| Africa | 1% | 1% | 1% | 1% |
| Australia/Oceania | 1% | 1% | 2% | 2% |

**Includes territories of Hong Kong and Taiwan.*

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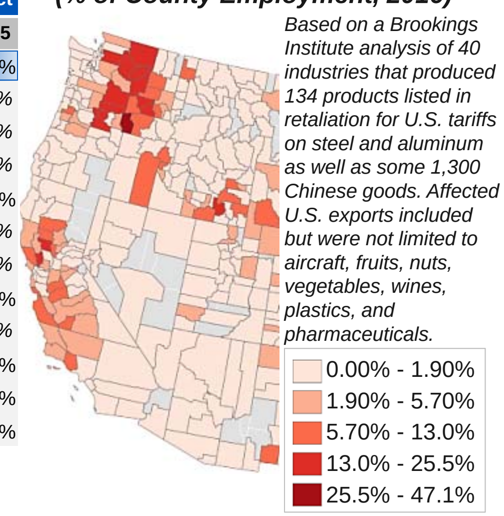
***Share of Jobs That Might be Affected by China's Retaliatory Tariffs (% of County Employment, 2016)***

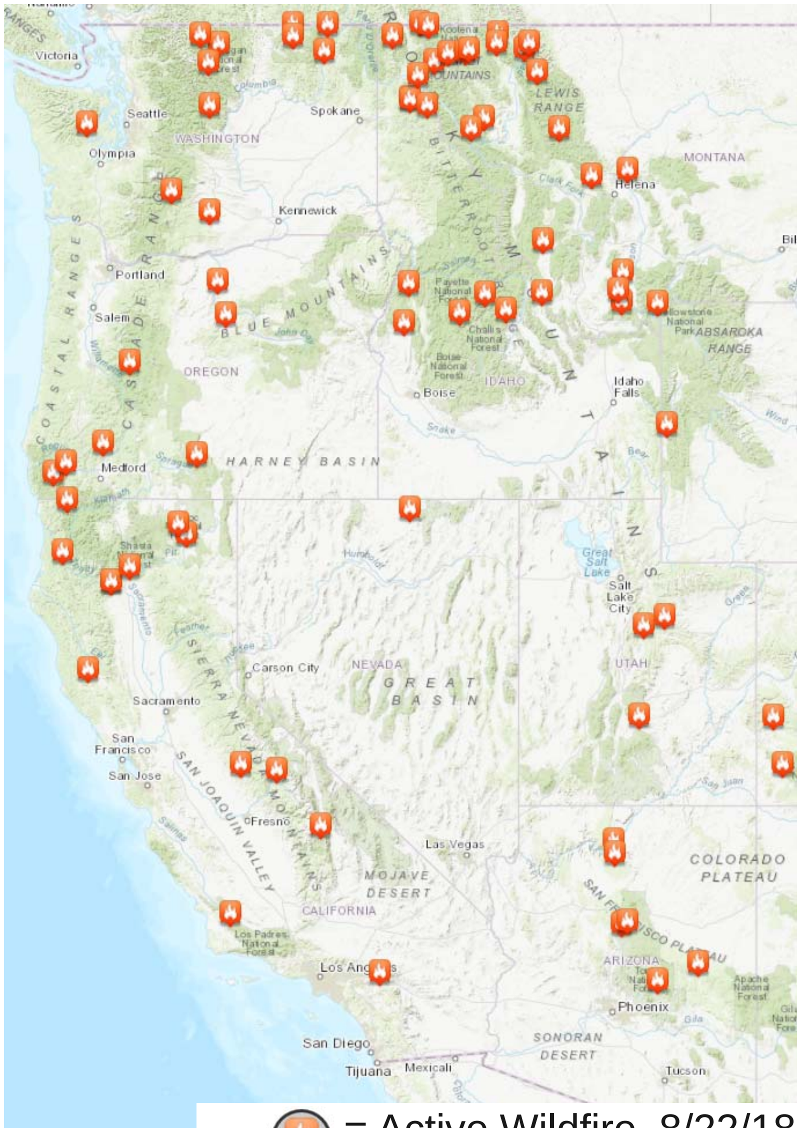
*Based on a Brookings Institute analysis of 40 industries that produced 134 products listed in retaliation for U.S. tariffs on steel and aluminum as well as some 1,300 Chinese goods. Affected U.S. exports included but were not limited to aircraft, fruits, nuts, vegetables, wines, plastics, and pharmaceuticals.*




Percentages may not sum to 100% because of rounding. Sources: U.S. Census Bureau | Economic Indicators Division (table); Brookings Institute, *How China's Proposed Tariffs Could Affect U.S. Workers and Industries*, April 9, 2018 (map).

# 20 Wildfires Were Active Across the District; Above-Average Vulnerability Was Expected in the Near Term

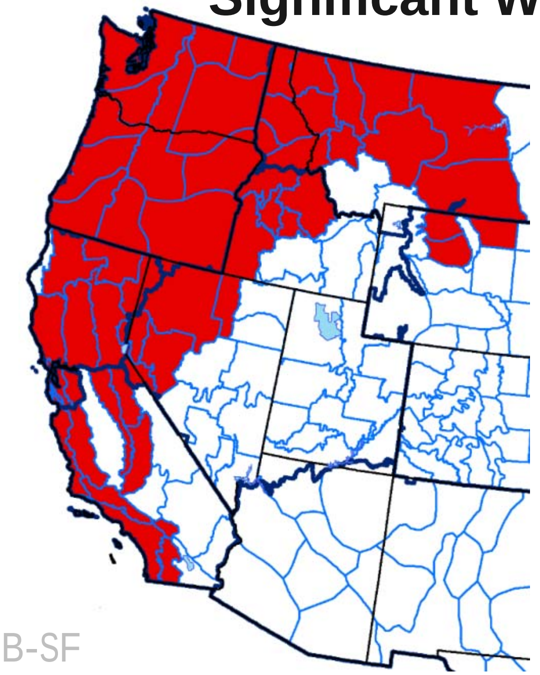
## Wildfire Map, August 22, 2018




= Active Wildfire, 8/22/18

Sources: National Interagency Fire Center, ESRI.

## Significant Wildland Fire Potential Outlook, Sept. 2018



**Significant Wildland Fire Potential**

- Above Normal
- Below Normal
- Normal
- Geographic Area Boundary
- Predictive Services Area Boundary
- State Border

PREDICTIVE SERVICES

NATIONAL INTERAGENCY FIRE CENTER Boise, Idaho

Map produced by
Predictive Services,
National Interagency Fire Center
Boise, Idaho
Issued August 1, 2018
Next issuance September 1, 2018

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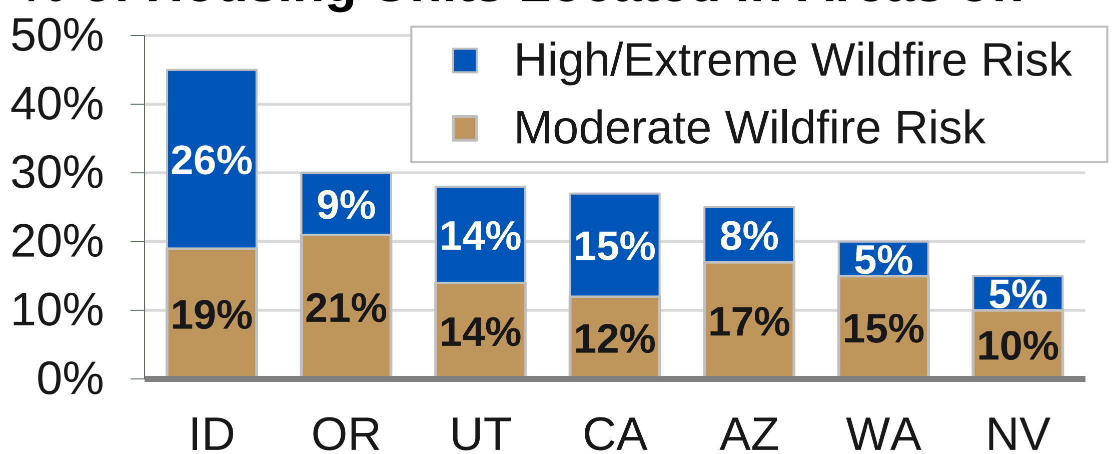
## % of Housing Units Located in Areas of:




Source: Verisk State FireLine State Risk Reports, 2017 (AK and HI not available).

# Section 2
# Commercial Bank Performance

**Earnings**

**Loan Growth and Concentrations**

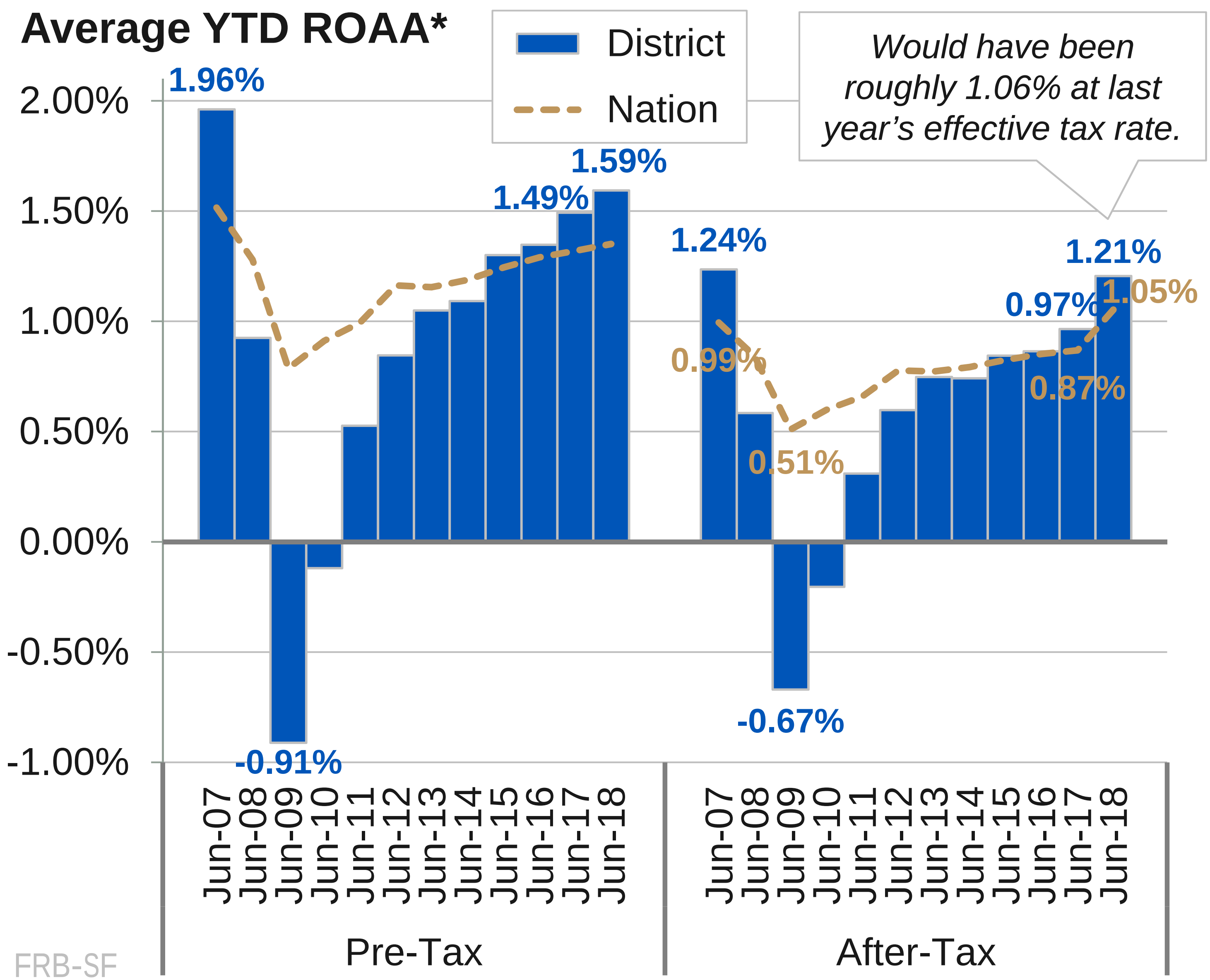
**Credit Quality**

**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.*

# 22 Profits Strengthened Year-over-Year on Wider Net Interest Margins and Lower Tax Rates

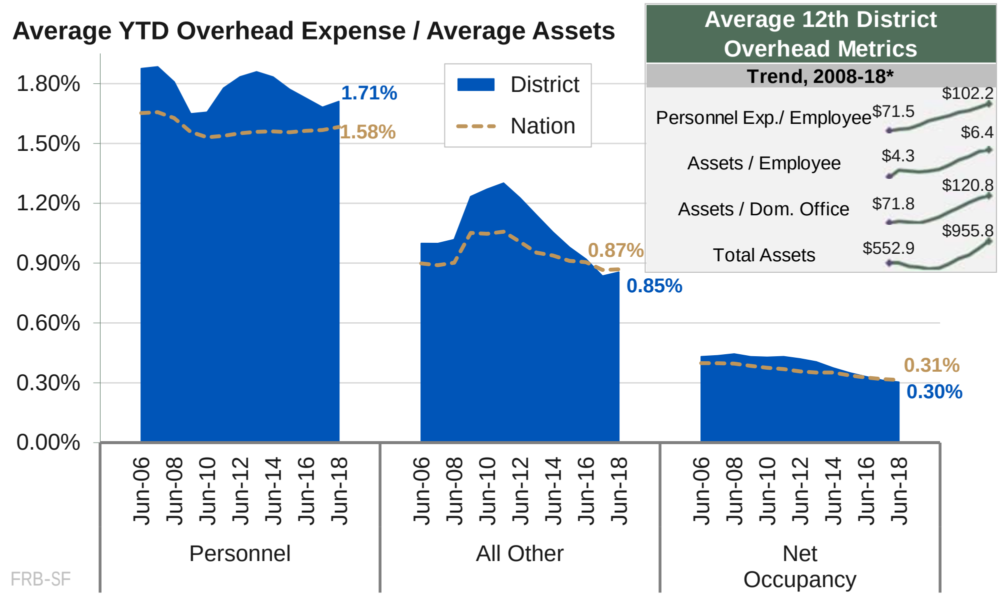



**Average YTD as % of Average Assets 12th District**
*(Expenses = Negative Values)*

| Profit Component | Jun-17 | Jun-18 |
|---|---|---|
| Interest Income (TE) | 4.03% | 4.32% |
| Interest Expense | -0.31% | -0.41% |
| Net Int. Income (TE) | 3.71% | 3.90% |
| Nonint. Income | 0.62% | 0.59% |
| Nonint. Expense | -2.86% | -2.90% |
| Provision Expense | -0.06% | -0.06% |
| Tax Expense (TE) | -0.45% | -0.35% |

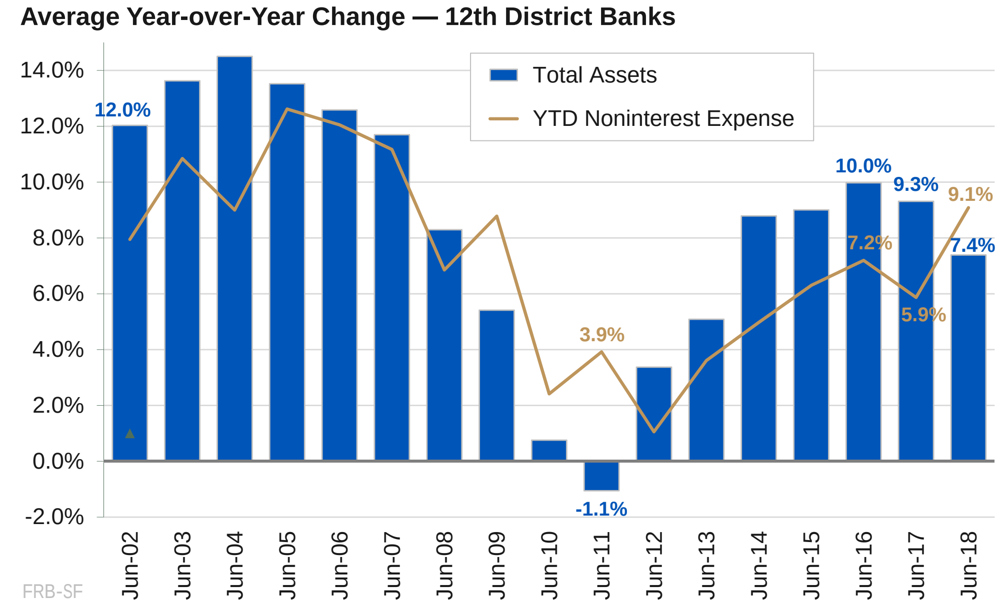
Average = trimmed mean; YTD = year-to-date (annualized); *ROAA = return on average assets (net income/average assets, with theoretical tax expense deducted from Subchapter S filers for after-tax ratio); TE = tax equivalent (yields and applicable tax expense adjusted for tax-exempt revenues).

## 23 On Average, Personnel and Non Occupancy-Related Overhead Increased as a Share of Average Assets



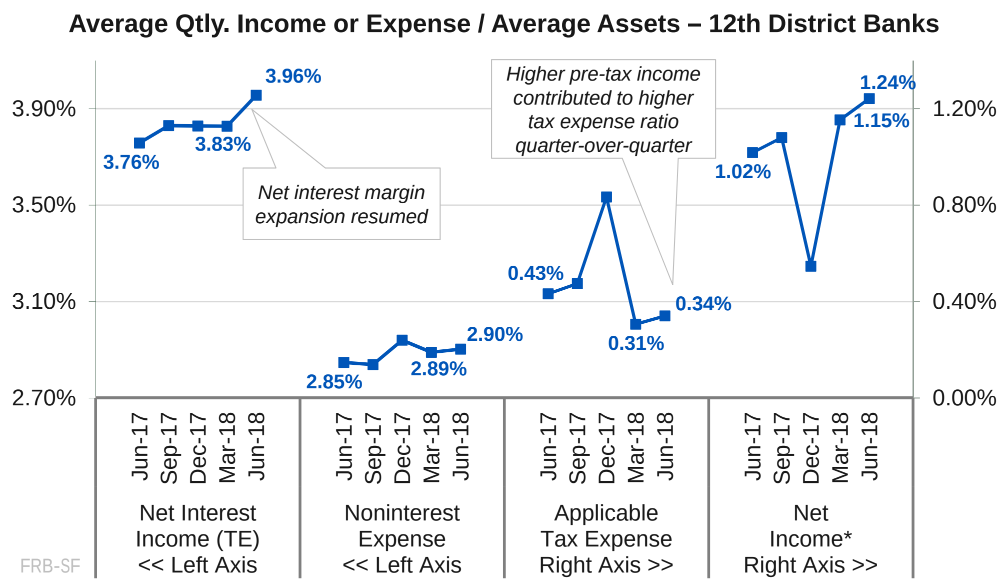

Average = trimmed mean; YTD = year-to-date (annualized); overhead = noninterest expense; *June each year (personnel expense is YTD annualized in thousands, other table figures in millions).

## 24 Growth in Year-to-Date Noninterest Expenses Eclipsed Increases in Assets, Causing Overhead Ratios to Rise



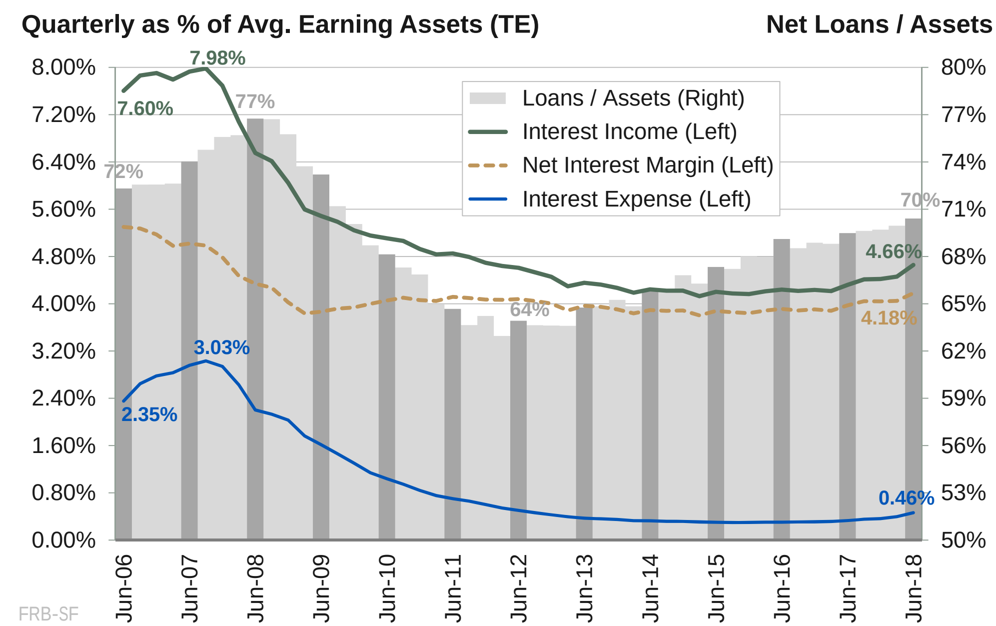

Average = trimmed mean (12th District banks only); growth rates not merger-adjusted; YTD = year-to-date.

## 25 Margins Led an Upswing in Quarterly ROAAs



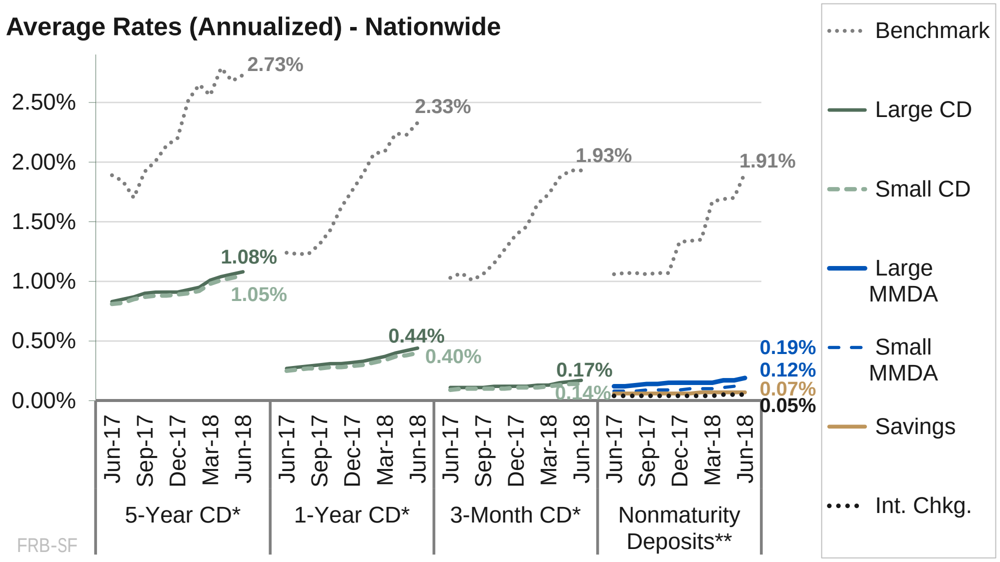

Average = trimmed mean; quarterly figures are annualized; TE = tax equivalent (theoretical tax benefit added to yields on tax-exempt investments and loans); *Net Income adjusted for Subchapter S filers (theoretical tax expense deducted for comparability); deferred tax asset write-downs flowed through income tax expense in 4Q17.

## 26 Asset Yields Continued to Rise Faster Than Funding Costs, Lifted in Part by Higher Loan-to-Asset Ratios



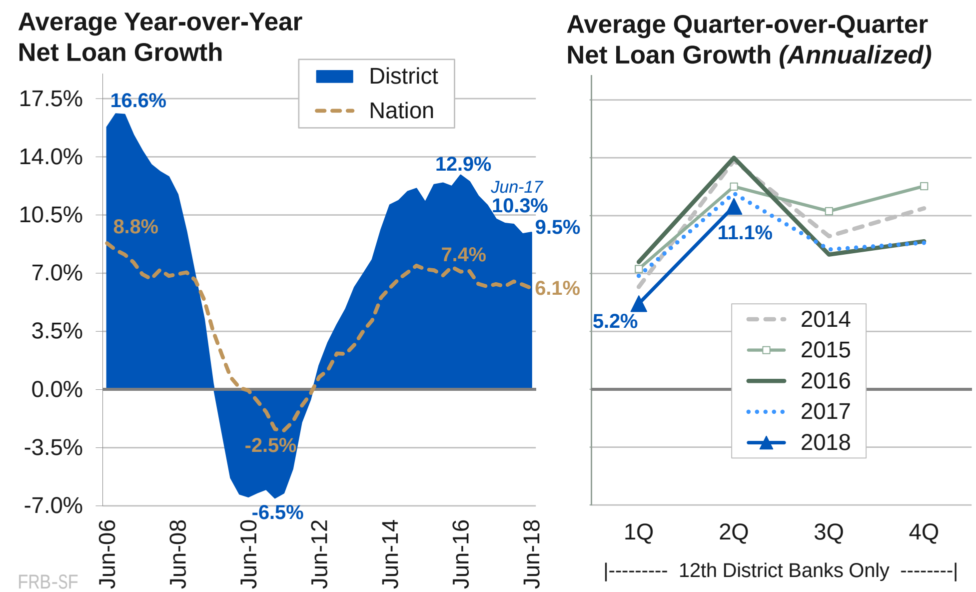

Average = trimmed mean (12th District banks only); 1-quarter annualized data; TE = tax equivalent.

## 27 National Average Deposit Pricing Showed Only Slight Increases Versus Comparable-Maturity Benchmarks



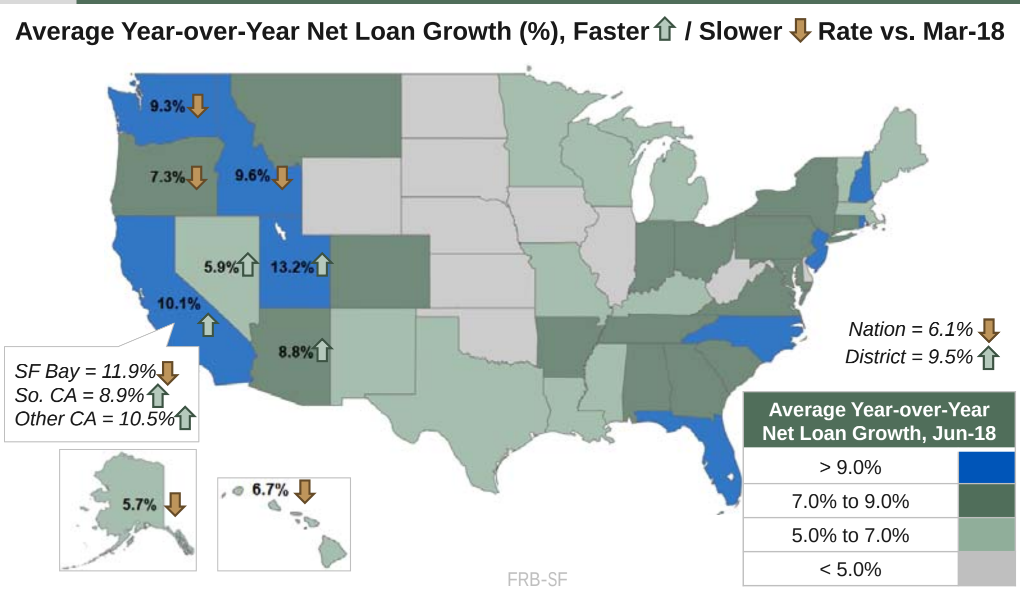

*For certificates of deposit (CDs), small minimum is $10K, large minimum is $100K, and benchmark rate is constant-maturity for similar-maturity U.S. Treasury Bill or Note; **for nonmaturity deposits, large money market deposit account (MMDA) minimum is $100K, minimum for other types = $2.5K, and benchmark rate is the federal funds rate; all data as of month end; includes FDIC-insured banks, thrifts, and branches but excludes credit unions. Source: RateWatch/FDIC via Haver Analytics.

## 28 District Bank Annual and Quarterly Loan Growth Were Up Compared with 1Q18 but Trailed Year-Ago Rates



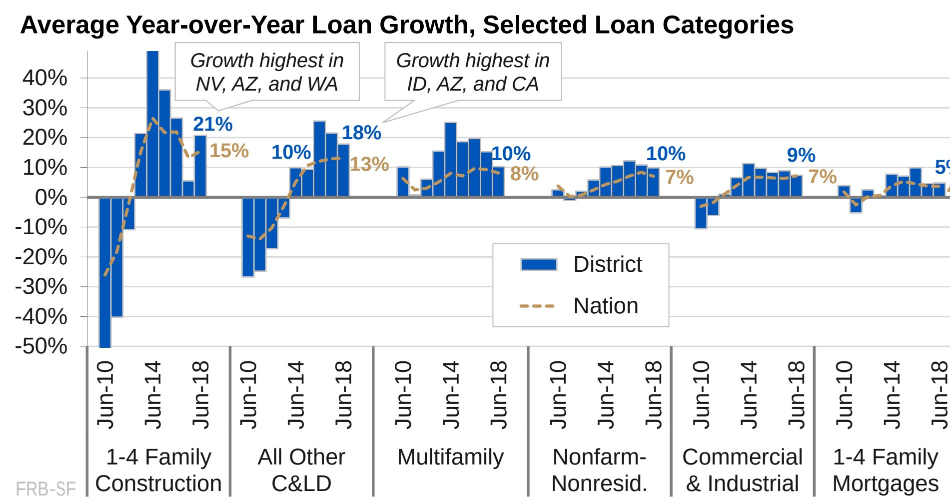

Average = trimmed mean; growth rates are not merger-adjusted; includes loans and leases held for sale and for investment, net of allowances for loan and lease losses.

## 29 Average Annual Loan Growth Accelerated in Four District States; Remained Above U.S. Average in Most




Average = trimmed mean; growth for loans net of allowances for loan losses, not merger-adjusted; NV excludes zero loan and credit card banks. SF Bay = 39 banks based in San Francisco-San Jose Consolidated Statistical Area (CSA); So. CA = 75 banks based in Los Angeles CSA + San Diego Metropolitan Statistical Area; Other CA = 34 banks based in all other areas.

## 30 Commercial Real Estate Portfolios Expanded Strongly; Residential Construction Rebounded



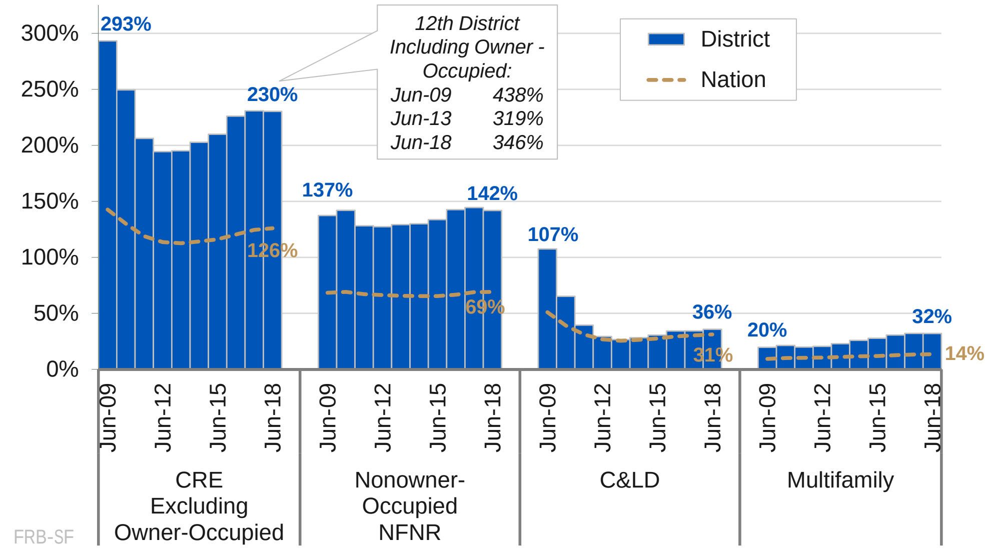

**Memo: Average Concentration to Total Capital, Jun-18**

| | 1-4 Family Construction | All Other C&LD | Multifamily | Nonfarm-Nonresid. | Commercial & Industrial | 1-4 Family Mortgages |
|---|---|---|---|---|---|---|
| District | 10.64 | 22.69 | 32.04 | 253.87 | 84.13 | 77.77 |
| Nation | 9.98 | 18.95 | 13.52 | 142.47 | 71.34 | 138.44 |

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

## 31 Robust Capital Accretion Muted the Effects of Solid CRE Loan Growth on Supervisory Concentration Ratios

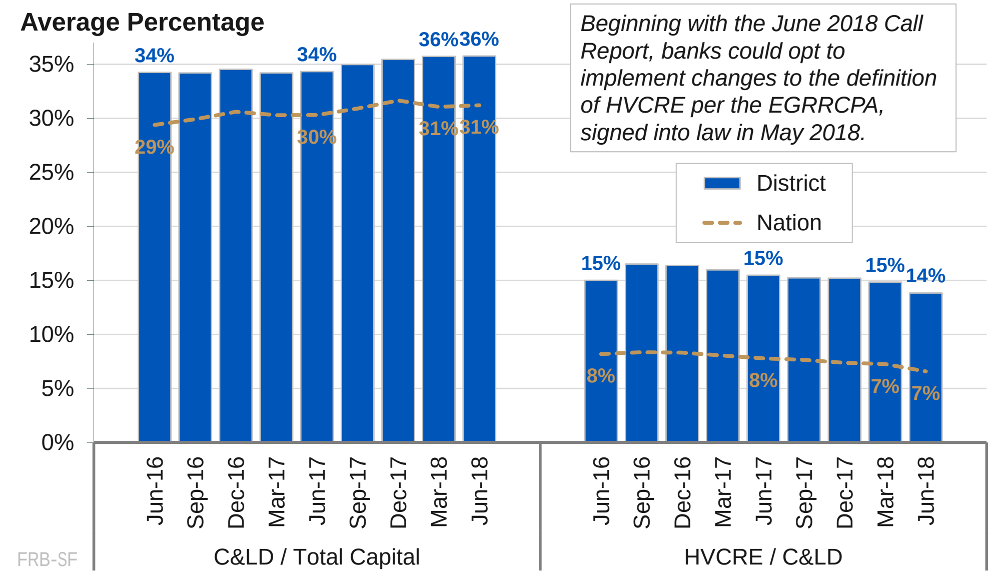
**Average CRE Concentrations / Total Capital**




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.

## 32 Adjustments to HVCRE Designations Were Only Slight through 2Q18; Further Changes May Come with Time

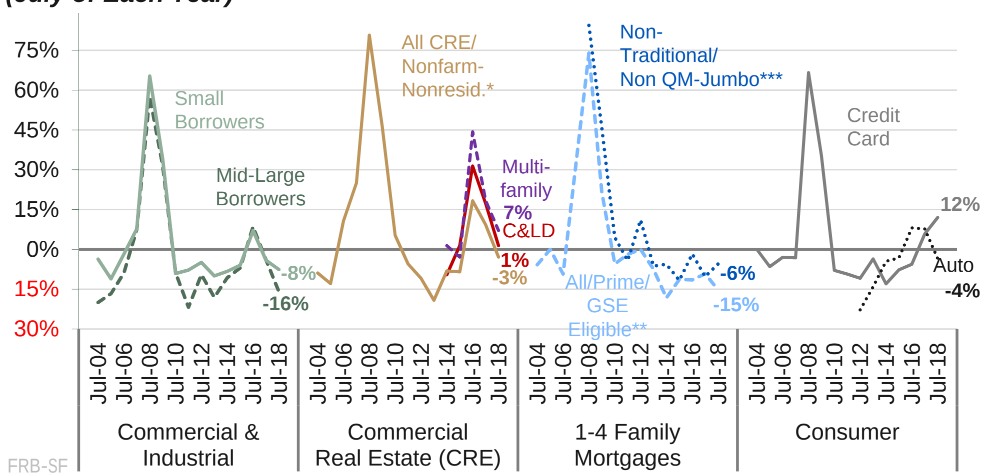
**Average Percentage**




Average = trimmed mean; high volatility commercial real estate (HVCRE) is a higher-risk segment of non residential construction and land development (C&LD) that is generally subject to higher risk-weighting (150%) for risk-based capital purposes; EGRRCPA= Economic Growth, Regulatory Relief, and Consumer Protection Act.

## 33 Except for Credit Cards, More Lenders Reported Looser Standards Compared with 2Q17

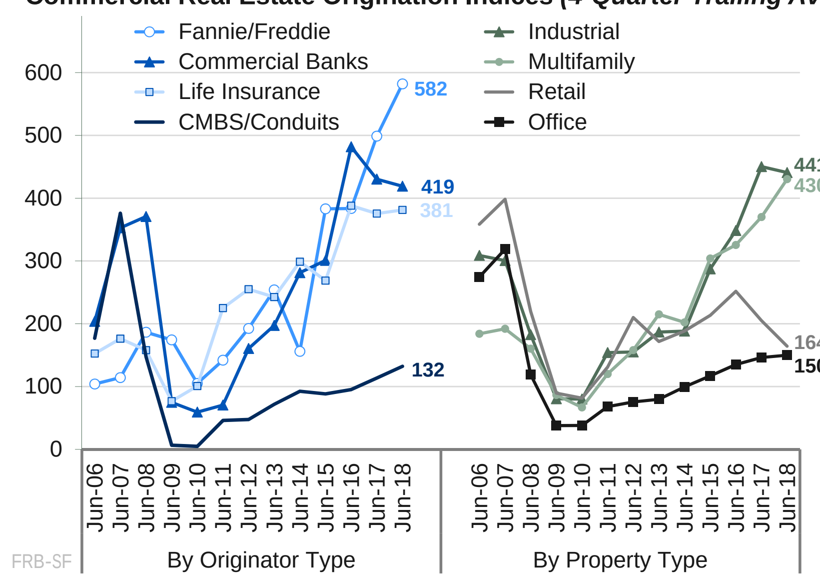
**Net % of Lenders Reporting Tighter (Looser) Loan Standards vs. 3 Months Prior *(July of Each Year)***




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).

## 34 GSEs Fueled Multifamily Originations; Lending Backed by Industrial Properties Eased, Retail Sank Further

**Commercial Real Estate Origination Indices *(4-Quarter Trailing Avg., 2001 = 100)***

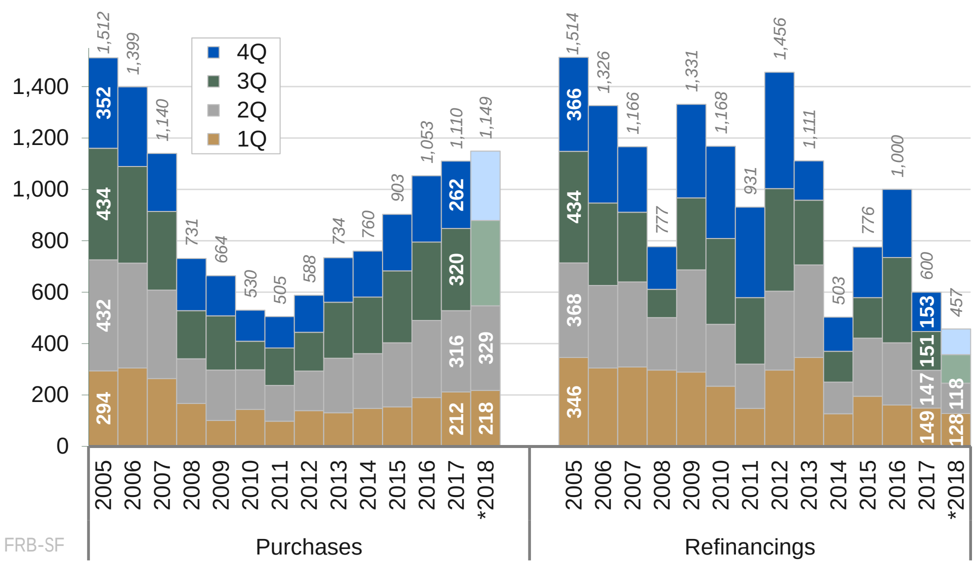



*Per MBA, first half 2018 CRE originations were 2% above first half of 2017. Rising interest rates and a recovery from the "wall of maturities" likely weighed on refinancing-related activity. As of May, MBA expected 2018 CRE originations to be 2% below 2017 volumes by year-end.*

GSE = government sponsored enterprises (Fannie/Freddie) specialize in multifamily. Source: Mortgage Bankers Association (MBA).

## 35 MBA Expects Declines in Rate-Sensitive Refis to Exceed Uptick in Purchase Lending, a Challenge for Originators

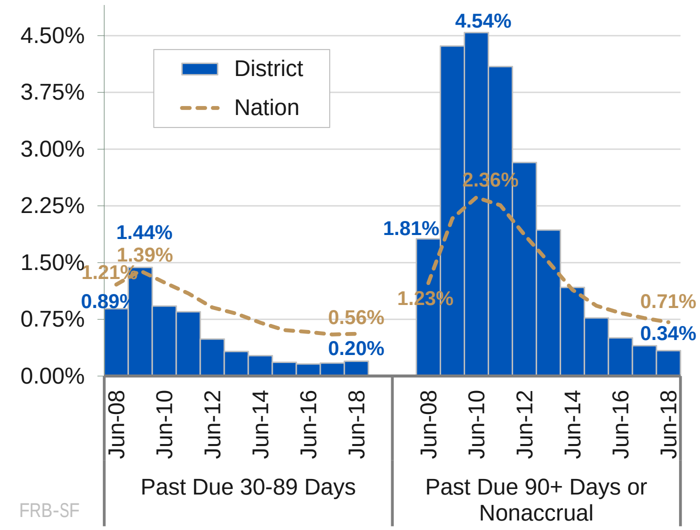
**Mortgage Origination Volumes & Forecast *($ Billions)***




*3Q18-4Q18 forecast per Mortgage Bankers Association (MBA) *Mortgage Finance Forecast* as of 8/14/18. Source: MBA/Haver Analytics

## 36 Average Overall Delinquency Ratios Declined; C&I Past Dues Edged Higher

**Average Past Due or Noncurrent / Gross Loans & Leases**



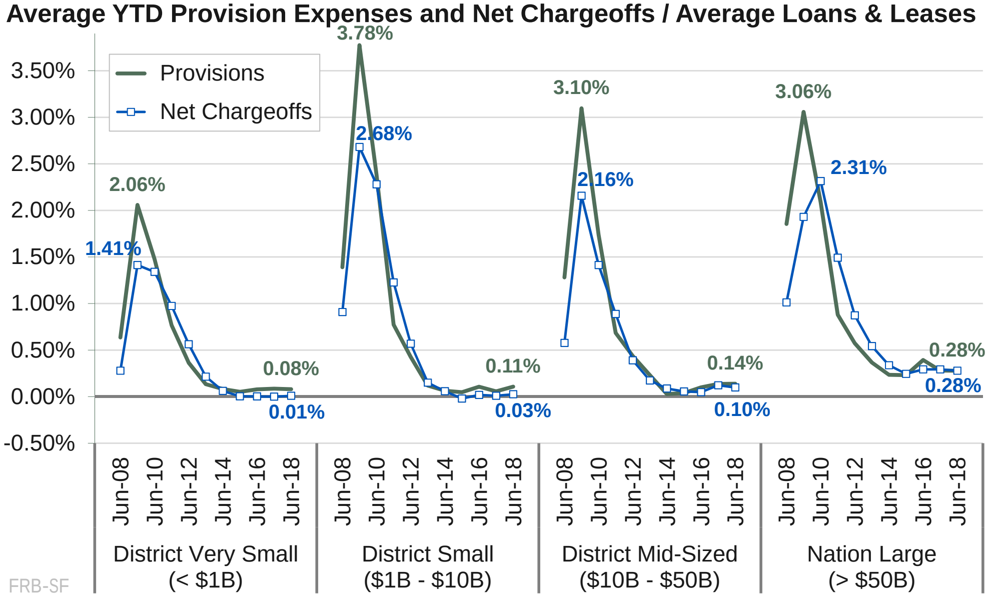

*Revised*

| Average % Past Due 30+ Days or Nonaccrual 12th District | | | |
|---|---|---|---|
| Loan Type | Jun-17 | Mar-18 | Jun-18 |
| C&I | 0.59 | 0.69 | 0.74 |
| 1-4 Family | 0.59 | 0.62 | 0.50 |
| Agriculture | 0.18 | 0.41 | 0.33 |
| NFNR | 0.34 | 0.34 | 0.30 |
| *Owner-Occ* | *0.43* | *0.41* | *0.38* |
| *Other* | *0.15* | *0.12* | *0.09* |
| Consumer | 0.28 | 0.24 | 0.23 |
| *Credit Card* | *0.55* | *0.84* | *0.58* |
| *Auto* | *0.17* | *0.17* | *0.12* |
| *Other* | *0.31* | *0.16* | *0.16* |
| C&LD | 0.26 | 0.21 | 0.12 |
| All Loans | 0.67 | 0.69 | 0.62 |

Average = trimmed mean; loans past due 30-89 days are delinquent but still accruing interest (early-stage); noncurrent = loans past due 90+ days or on nonaccrual status; C&I = commercial & industrial; NFNR = nonfarm-nonresidential mortgages; C&LD = construction & land development; average overall past due ratio differs from the sum of the average 30-89 day rate plus the average noncurrent rate because each ratio is trimmed and averaged separately.

## 37 Large Banks Were Less Likely to Augment Loan Loss Allowances in Excess of Net Chargeoffs

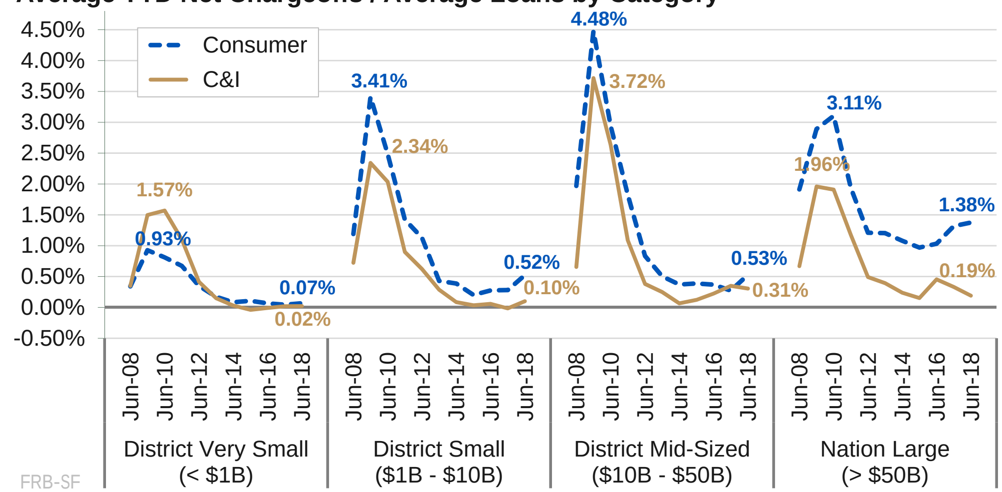
**Average YTD Provision Expenses and Net Chargeoffs / Average Loans & Leases**




Average = trimmed mean; YTD = year-to-date (annualized).

## 38 Mid- and Large-Size Bank Chargeoff Rates Reflected Higher Concentrations/Losses in C&I and Consumer

**Average YTD Net Chargeoffs / Average Loans by Category**

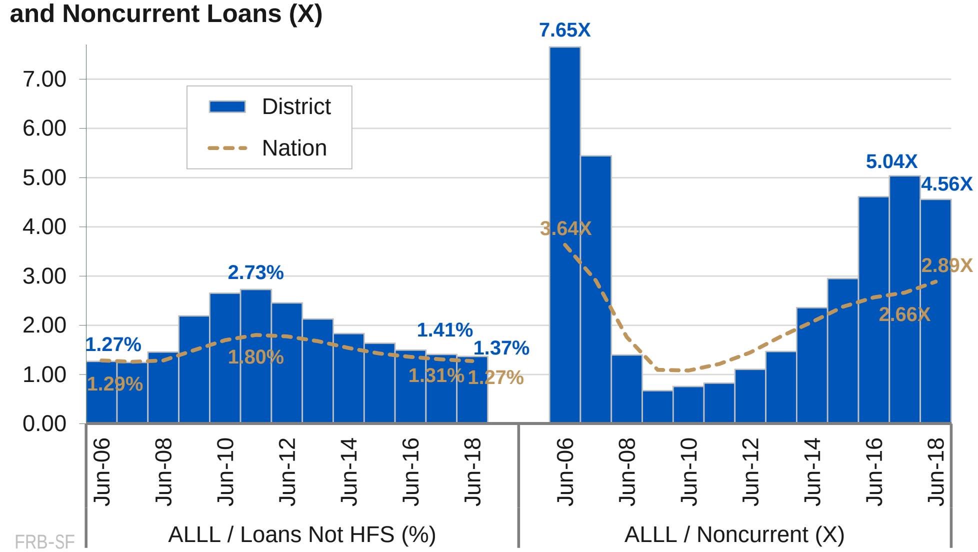



| Memo: Average Concentration to Total Capital, Jun-18 | | | | |
|---|---|---|---|---|
| Consumer | 4.70 | 9.61 | 6.88 | 84.94 |
| C&I | 81.58 | 75.24 | 123.42 | 134.15 |

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

## 39 On Average, ALLL Continued to Lag Loan Growth and Dipped as a Multiple of Noncurrent Loans

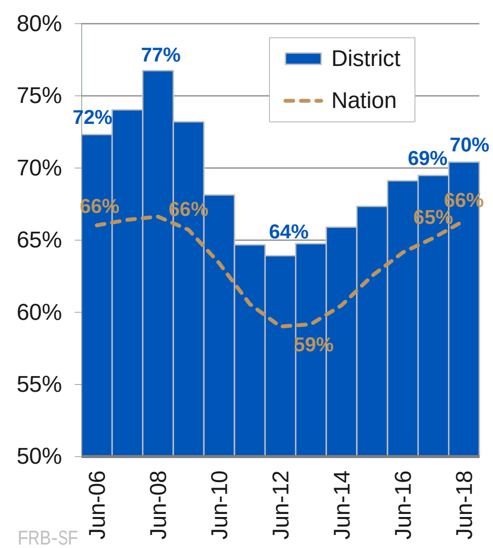
### Average ALLL Coverage of Loans not HFS (%) and Noncurrent Loans (X)



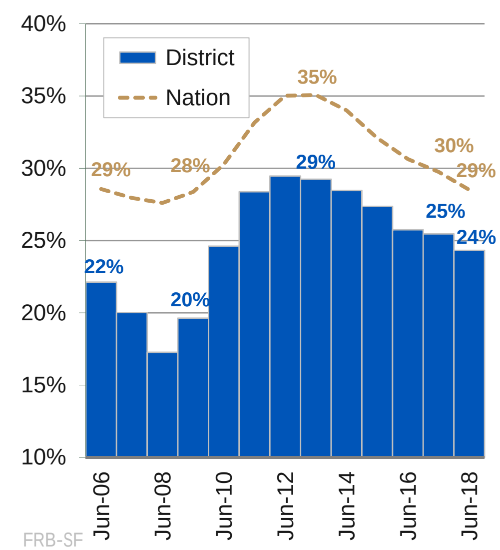

Average = trimmed mean; ALLL = allowance for loan and lease losses; HFS = held for sale; noncurrent = loans past due 90+ days or on nonaccrual status.

## 40 Banks Continued to Devote More of the Balance Sheet to Less Liquid Loans and Leases

### Net Loans and Leases / Assets*



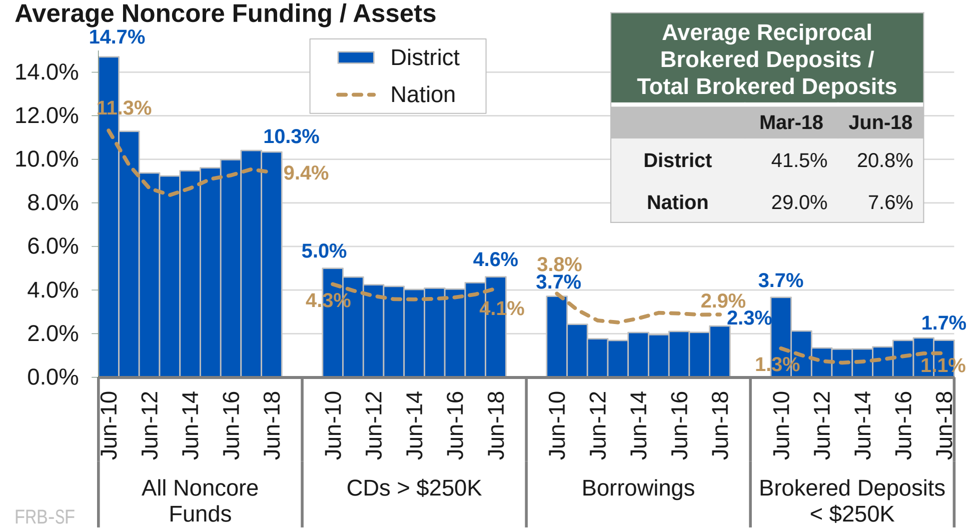

### Securities + Liquid Invest. / Assets*




*All data are averages (trimmed means); liquid investments = cash, due from balances, interest bearing balances, and federal funds sold & securities purchased under agreements to resell.

## 41 Average Noncore Funding Ratios Eased as Some Banks Reclassified Small Reciprocal Deposits as Non-Brokered

### Average Noncore Funding / Assets



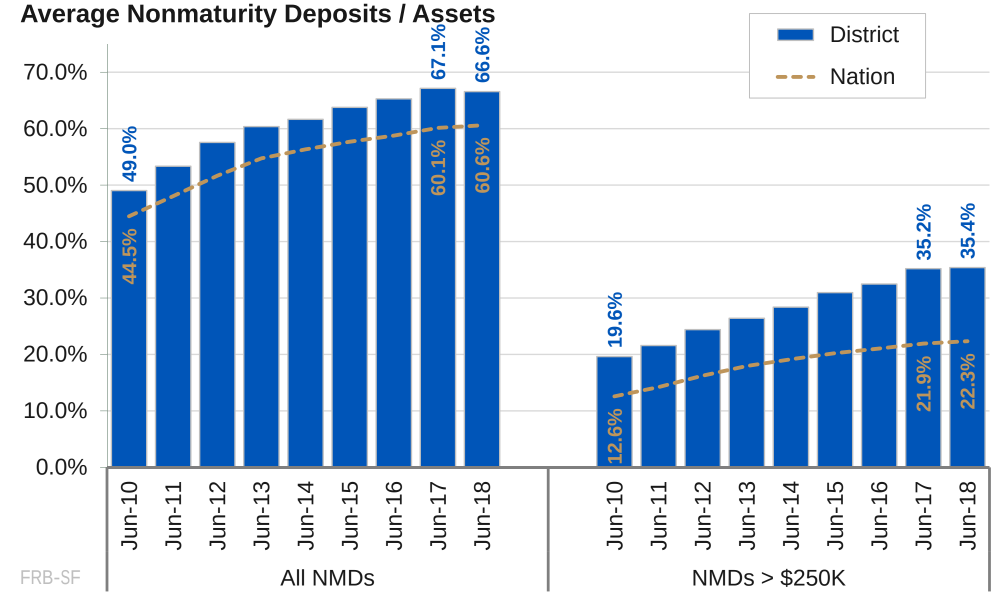

**Average Reciprocal Brokered Deposits / Total Brokered Deposits**

| | Mar-18 | Jun-18 |
|---|---|---|
| **District** | 41.5% | 20.8% |
| **Nation** | 29.0% | 7.6% |

Average = trimmed mean; noncore liabilities = sum of borrowings (e.g., federal funds purchased, repurchase agreements, and other borrowed money), foreign deposits, certificates of deposit > $250K, and brokered deposits < $250K; beginning with the June 2018 Call Reports, qualifying (generally well-rated and well-capitalized) banks could opt to discontinue disclosing reciprocal deposits as brokered so long as they were below $5 billion or 20% of total liabilities, as permitted under the Economic Growth, Regulatory Relief, and Consumer Protection Act signed into law on 5/24/18.

## 42 Total and Jumbo NMDs Stabilized as a Share of Balance Sheet Funding after Edging Higher for Several Years

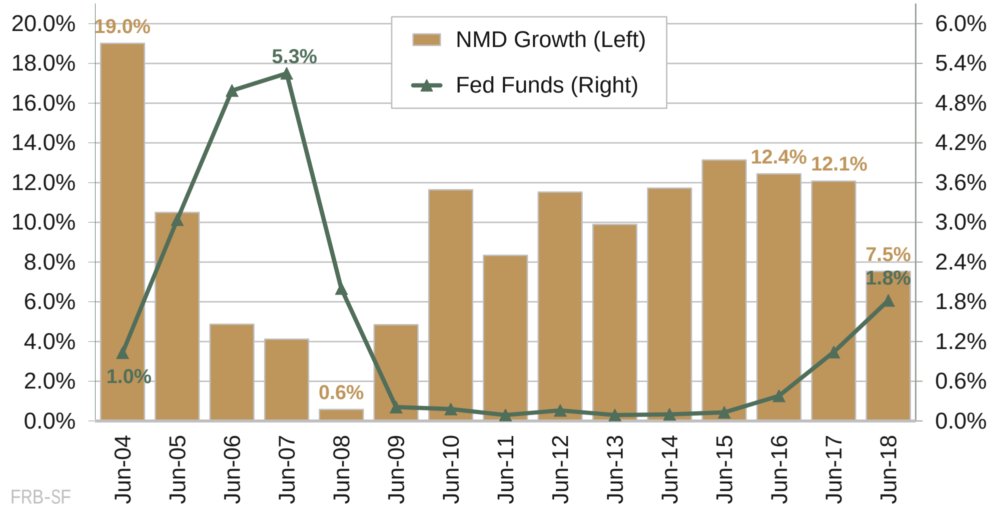
### Average Nonmaturity Deposits / Assets




Average = trimmed mean; NMD = nonmaturity deposits (all deposits excluding time deposits); Jumbo = > $250K.

## 43 Growth in Nonmaturity Deposits Slowed as Short-Term Interest Rates Increased

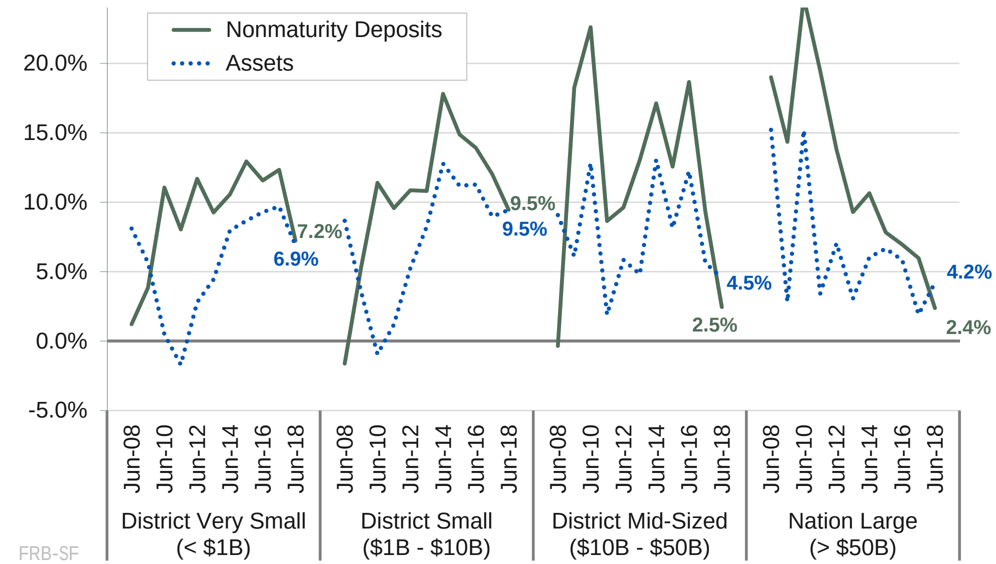
**Average Year-over-Year Growth in Nonmaturity Deposits—12th District Banks** **Effective Federal Funds Rate**




Average = trimmed mean; growth rates are not merger-adjusted; NMD = nonmaturity deposits; federal funds rate from Federal Reserve via Haver Analytics; as part of a coordinated response to market dislocation, the FDIC provided an unlimited guarantee on certain transaction accounts between Oct-08 and Dec-10, which was extended with modification through Dec-12.

## 44 The Gap Between Asset and NMD Growth Narrowed; Inverted at Mid- and Large-Sized Banks

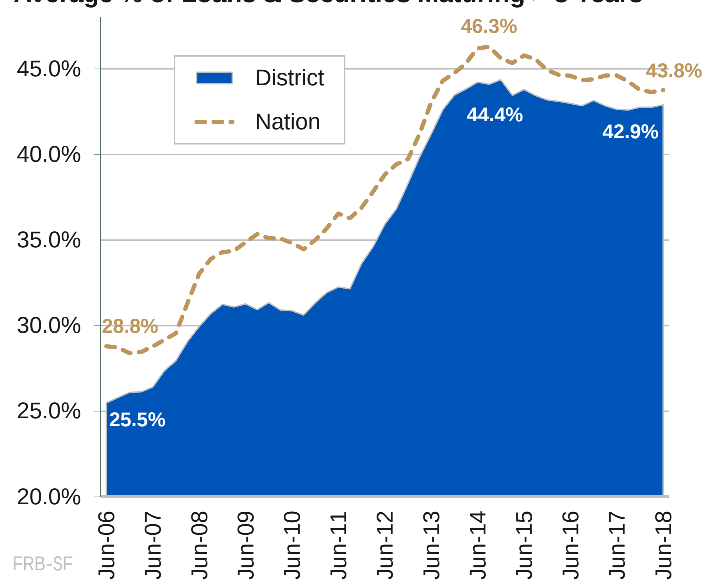
**Year-over-Year Growth in Funding Sources and Assets**




Average = trimmed mean; growth rates are not merger-adjusted; nonmaturity deposits = all deposits excluding time deposits.

## 45 Average Long-Term Asset Ratios Ticked Up; Reached New Second Quarter Peaks in Four States

**Average % of Loans & Securities Maturing > 3 Years**




*Revised*

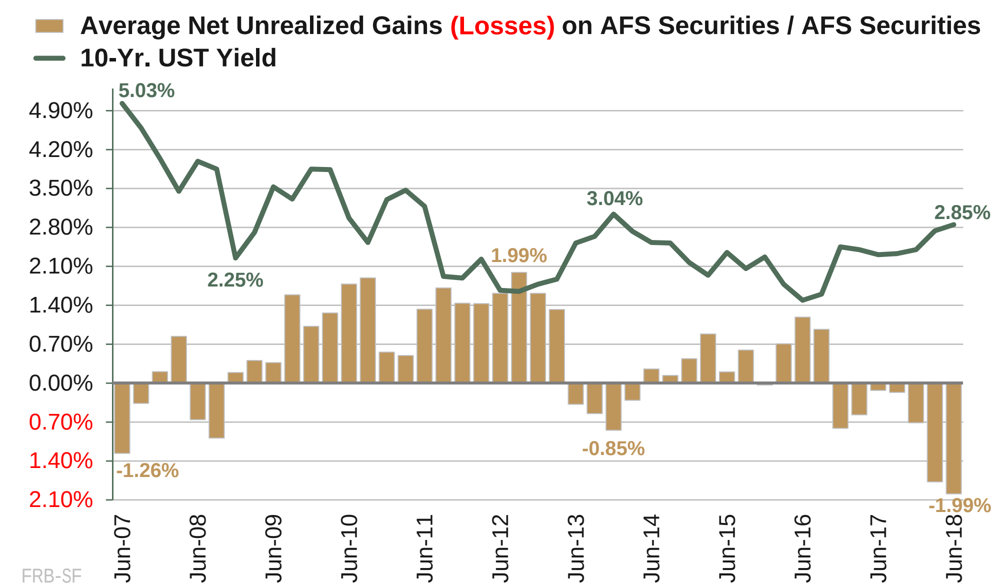
**Average % of Loans & Securities > 3 Years**

| | 2006-18* | Jun-18 |
|---|---|---|
| AK | | 54.3% |
| OR | | 53.5% |
| HI | | 48.7% |
| WA | | 48.0% |
| AZ | | 46.8% |
| CA | | 43.4% |
| NV | | 38.4% |
| ID | | 34.1% |
| UT | | 29.6% |
| Nation | | 43.8% |

◆ = trough ◆ = peak

Average = trimmed mean; *June of each year; NV excludes credit card and zero-loan banks.

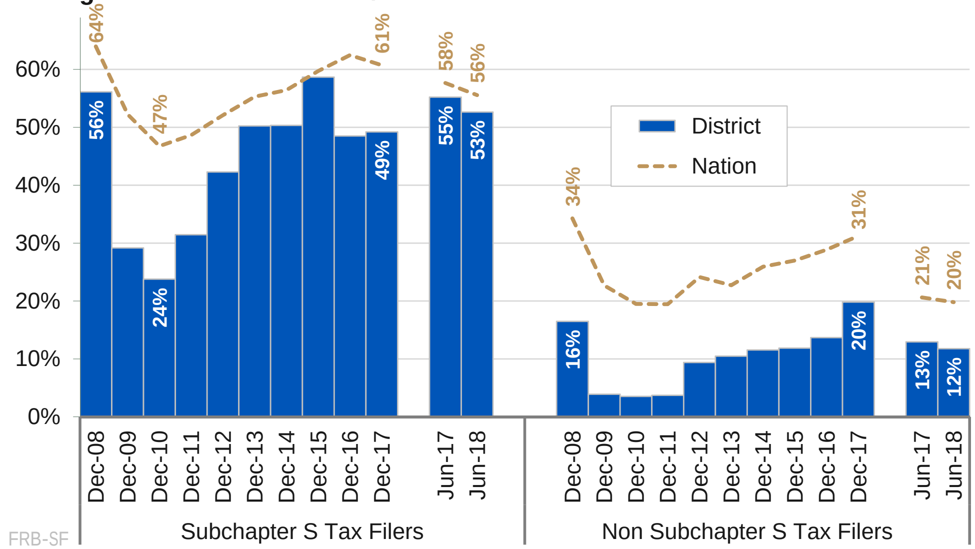
## 46 Higher Long-Term Interest Rates Weighed on Valuations of Available for Sale Securities




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.

## 47 Year-over-Year, First Half Dividend Payout Ratios Were Diluted by Strong Growth in Net Income

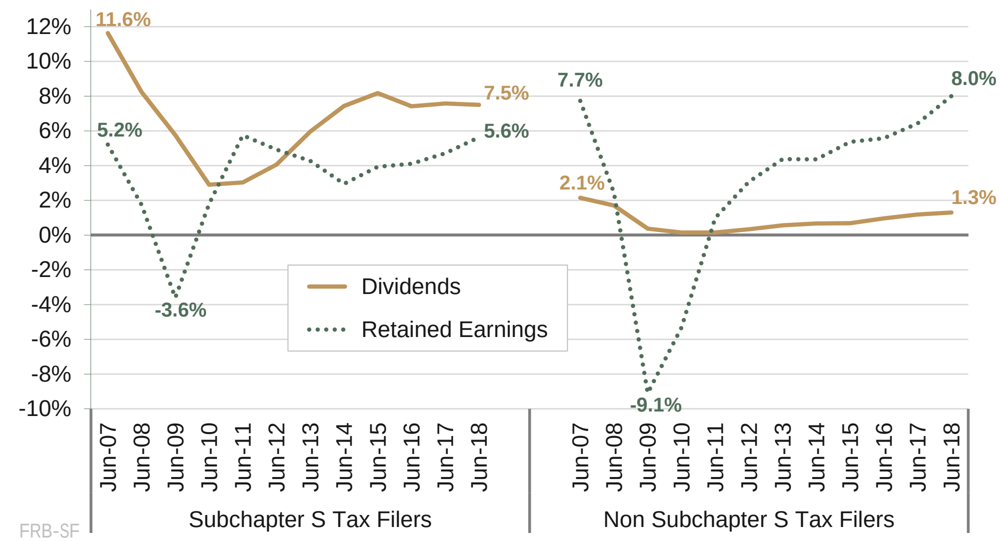
### Average YTD Cash Dividends / Net Income




Average = trimmed mean; YTD = year-to-date; Subchapter S filing banks (13% of banks in the 12th District, 38% of banks nationwide) pay taxes at the shareholder rather than corporate level and typically have higher dividend payout rates (also known as distributions) so that shareholders can cover tax obligations.

## 48 Dividends Increased as a Share of Equity; Dwarfed by Retained Earnings at Non Subchapter S Banks

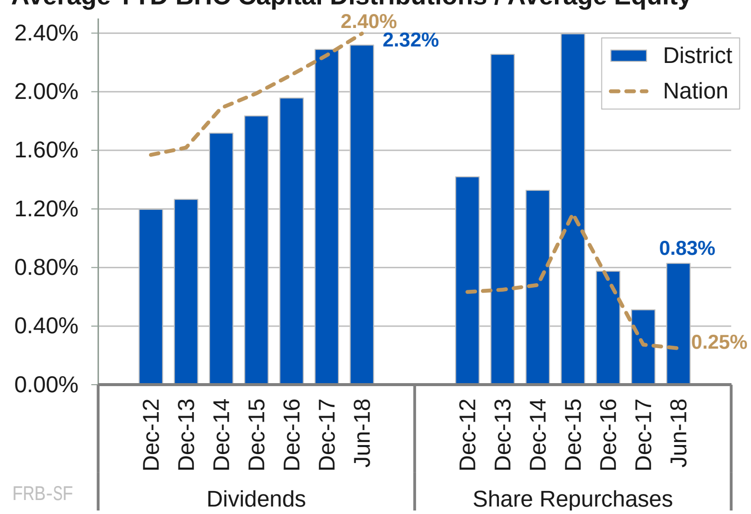
### Avg. YTD Dividends and Retained Earnings / Avg. Equity – 12th District




Average = trimmed mean (12th District banks only); YTD = year-to-date (annualized); Subchapter S filing banks (13% of banks in the 12th District) pay taxes at the shareholder rather than corporate level and typically have higher dividend payout rates (also known as distributions) so that shareholders can cover tax obligations.

## 49 Subsidiary Bank Dividends Increasingly Funded Parent Capital Distributions, Especially at Larger BHCs

### Average YTD BHC Capital Distributions / Average Equity



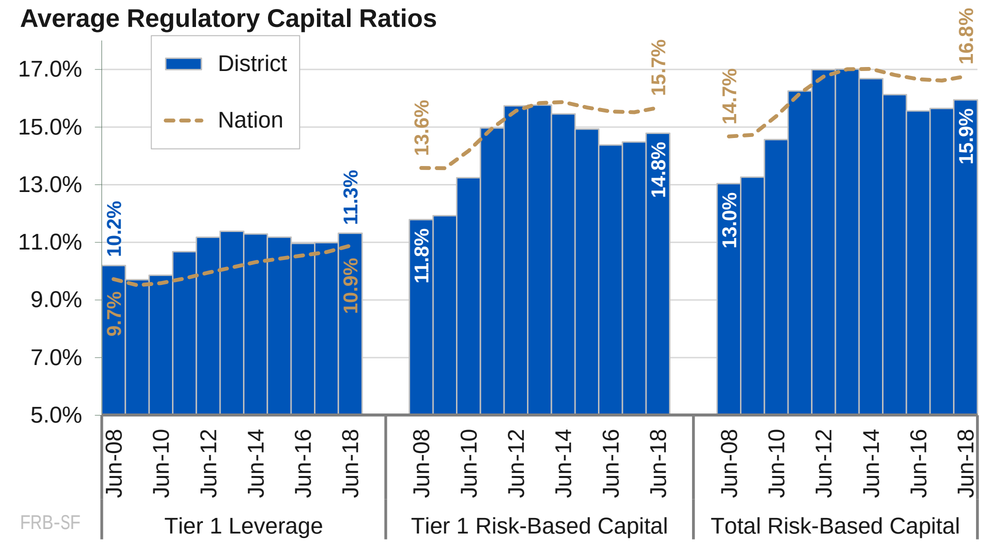

**Average YTD BHC Capital Distributions/ Avg. Equity *Jun-18, Nation***

| Asset Size | Divi-dends | Re-purch. |
|---|---|---|
| < $1 Bil. | 1.35% | 0.02% |
| $1 to $10 Bil. | 2.84% | 0.08% |
| $10 to $50 Bil. | 2.90% | 0.85% |
| > $50 Bil. | 2.18% | 2.50% |
| All | 2.40% | 0.25% |

Average = trimmed mean; BHC = bank holding company; YTD = year-to-date (June 2018 data annualized); includes both common and preferred dividends and share repurchases reported on consolidated cash flow statements (may differ from declared); limited to a sample of 321 BHCs with publicly-reported consolidated cash flow and balance sheet data available consistently between 2011 and 2Q18; mix of BHCs by count: < $1 billion (23.4%), $1 - $10 billion (48.3%), $10 - $50 billion (15.0%), and > $50 billion (13.4%). Source: S&P Global Market Intelligence, Federal Reserve Bank of San Francisco.

## 50 Year-over-Year, Capital Increases Outpaced Asset Growth, Lifting Regulatory Capital Ratios

### Average Regulatory Capital Ratios




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), which may have reduced risk weightings for some assets previously weighted at 150%.

# Appendices

## Summary of Institutions

## Technical Information

# Appendix 1: Summary of Institutions

| Area | Commercial Banks (De Novos) | | Industrial Banks (De Novos) | | Savings Institutions (De Novos) | |
|---|---|---|---|---|---|---|
| | *Jun-17* | *Jun-18* | *Jun-17* | *Jun-18* | *Jun-17* | *Jun-18* |
| **AK** | 4 (0) | 4 (0) | - | - | 1 (0) | 1 (0) |
| **AZ** | 15 (0) | 15 (0) | - | - | 1 (0) | - |
| **CA** | 161 (1) | 148 (3) | 3 (0) | 3 (0) | 10 (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) | 12 (0) | - | - | 1 (0) | 1 (0) |
| **NV** | 9 (0) | 10 (0) | 4 (0) | 4 (0) | 2 (0) | 2 (0) |
| **OR** | 20 (0) | 16 (0) | - | - | 3 (0) | 2 (0) |
| **UT** | 28 (0) | 27 (0) | 15 (0) | 14 (0) | 2 (0) | 1 (0) |
| **WA** | 38 (0) | 36 (0) | - | - | 10 (0) | 10 (0) |
| **12L** | 294 (1) | 275 (3) | 23 (0) | 22 (0) | 33 (0) | 31 (0) |
| **U.S.** | 4,983 (4) | 4,805 (12) | 25 (0) | 24 (0) | 776 (1) | 709 (0) |

Based on preliminary second quarter 2018 data.

# Appendix 2: Technical Information

**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 (banks 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.