



FEDERAL RESERVE BANK
OF SAN FRANCISCO

First Glance 12L (2Q19)



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

Banks in Sound Condition but Face Global Slowing and Inverted Yield Curve

August 30, 2019

This report is a product of the Financial Institutions Supervision and Credit Department. It is based upon preliminary data from 2Q19 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

“Banks in Sound Condition but Face Global Slowing and Inverted Yield Curve”

Job growth in the West rebounded on a quarterly basis. Seasonally-adjusted nonfarm jobs grew at a quarterly annualized rate of 2.4% during 2Q19 in the Federal Reserve’s 12th District (District), up from 1.8% in 1Q19. The construction sector led the acceleration, and growth in the educational/health and professional/business services also quickened. In contrast, retail trade employment contracted. At the state level, California and Washington contributed most to the District-wide acceleration in hiring. Although concurrent slowdowns in Utah, Oregon, and Nevada weighed on District job growth, these states also reported significant decreases in their unemployment rates, suggesting labor market constraints. Unemployment rates declined or were stable in all nine District states (see table to right). Notwithstanding mid-year bright spots, slowing global economic growth and ongoing trade tensions may create economic headwinds prospectively.

Lower long-term interest rates aided home sales, permitting activity, and housing affordability recently, but price appreciation slowed further. In 2Q19, home price gains eased relative to the pace reported in the prior quarter and year-ago periods in all District states except Alaska. In Washington and California, annual price appreciation rates slowed sharply year-over-year, tumbling by more than 10 percentage points in several Puget Sound and Bay Area markets. Idaho again posted the fastest valuation gains in the nation at nearly 10%, and Utah and Nevada ranked second and third. The volume of existing single-family home sales in the West improved on the heels of lower interest rates, and new home sales in the region held steady at well above their late-2018 pace. Homebuilder sentiment and mortgage lenders’ expectations for home-price growth also improved, and housing-permit issuance picked up in the District. Lower mortgage rates, in combination with higher household incomes, benefited affordability, but the West remained the least affordable region in the nation.

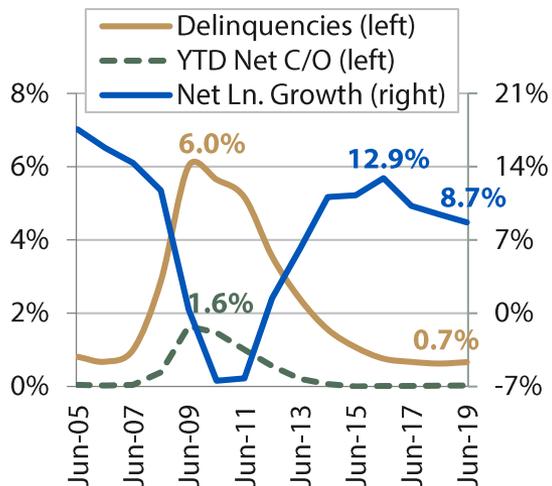
CRE fundamentals were healthy, but forecasts from CBRE Econometric Advisors (CBRE-EA) suggested softer demand in coming quarters. Office sector supply has been volatile as developers responded to unexpected surges in demand. But demand has cooled once again, just as completions are rising. Tech-centric San Jose, San Francisco, Seattle and Salt Lake are expecting elevated completion rates. The rate of industrial sector absorption has tapered gradually since 2015. The sector’s net operating income (NOI) growth, although strongest among CRE property types thanks to rents commanded by a slew of newly constructed warehouses, is slowing. The apartment sector, which has experienced a steady influx of supply and demand, may see absorptions soften in 2020. Still, annual apartment NOI growth is forecasted to top two percent in most District markets in the coming year. CBRE-EA expects the retail sector to have a low but increasing rate of completions, just as absorptions weaken further. CRE prices improved, although trailing 12-month capitalization rates edged higher for some types. Sentiment among CRE watchers surveyed by [RCLCO](#) improved modestly year-to-date.

Nonfarm Job Growth & Unemployment			
State	Job Growth (annualized)		Unemp. Rate
	12 Qtr.	2Q19	Jun-19
WA		4.0%	4.6%
ID		3.0%	2.8%
AZ		2.6%	4.9%
CA		2.4%	4.2%
NV		1.9%	4.0%
AK		1.7%	6.4%
OR		1.6%	4.0%
UT		1.6%	2.8%
HI		0.2%	2.8%
US		1.2%	3.7%

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

12th District Overview, Continued

District Credit Metrics*



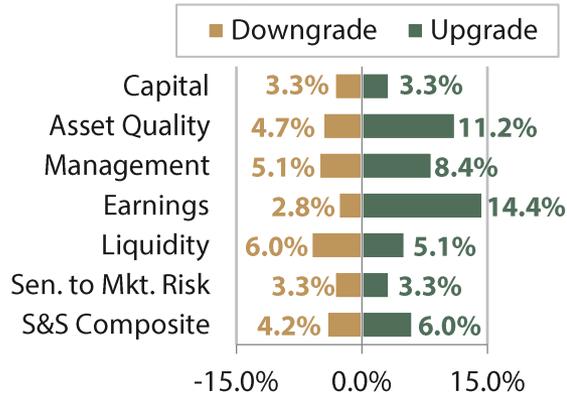
*Delinquent = 30+ days past due or nonaccrual; C/O = chargeoff (year-to-date annualized); trimmed means.

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Bank profits improved year-over-year and quarter-over-quarter. District banks' average year-to-date ROAA ratio was 1.24%, up 4 bps from the first half of 2018 (adjusted for Subchapter S tax filers), led by wider net interest margins. Meanwhile, the average quarterly ROAA was 1.26%, up 3 bps from 1Q19, lifted mainly by seasonally higher noninterest income-to-average asset ratios. Quarterly asset yields also benefited from seasonal factors, but higher funding costs offset the trend, leaving quarterly net interest margins relatively unchanged on a linked-quarter basis.

Annual net loan growth continued to slow but problem loan ratios remained low. Compared with 1Q19, the District's average annual net loan growth rate edged down 10 bps to 8.67%, while the national average eased 40 bps to 5.47%. Relative to 1Q19, most major portfolio categories expanded at a moderating pace. C&I and multifamily mortgages were notable exceptions, growing at an accelerating year-over-year rate. The average nonowner-occupied CRE loan-to-capital ratio was stable at 228%, but the District's average concentration ratio still exceeded the nation by more than 100 percentage points. The average delinquency ratio crept up 4 bps from the year-ago rate to 0.66%, but ended at less than half the national average of 1.42% (see chart at left). Bankers surveyed by [Promontory Interfinancial Network](#) in early July expressed improving optimism about deposit costs and competition on the eve of the Fed's target rate cut, mixed with caution about forward loan demand. Notably, the survey predated intensifying trade tensions and yield curve inversions.

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



**% of 215 safety & soundness (S&S) exams completed in 12 months ending June, mailed through 8/20/2019.

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Asset and liability mixes have shifted in the past twelve months as banks and depositors searched for yield. Loan-to-asset ratios ticked higher, lifted year-over-year by sustained, albeit slowing loan growth, and quarter-over-quarter by seasonal lending patterns. On the funding side, NMDs, including noninterest bearing accounts, rebounded slightly as a share of assets quarter-over-quarter. However, compared with 2Q18, noninterest bearing accounts declined as a share of funding, in particular among mid-sized and large banks. Meanwhile, bank reliance on costly jumbo time deposits increased, pressuring noncore funding ratios. Capital levels improved year-over-year, but average risk-based measures moderated quarter-over-quarter, driven by heavier exposures to loans and concurrent increases in dividend payouts. As noted in the *Spotlight* section of this report, bank dividend distributions have been used to support increased holding company share buybacks.

Supervisory ratings continued to improve. In the twelve months ending June, upgrades outpaced downgrades in most component areas. One exception was Liquidity, where downgrades were more dominant. Although Earnings and Management component ratings were frequently upgraded, the share of banks rated less-than-satisfactory tended to remain higher for these areas. Overall, 93% of safety and soundness ratings and 97% of consumer compliance and Community Reinvestment Act performance ratings were satisfactory or better in the District.

Section 1

Spotlight Feature & Hot Topics

Holding Company Stock Buyback Trends

Hot Topics We Are Monitoring Most Closely

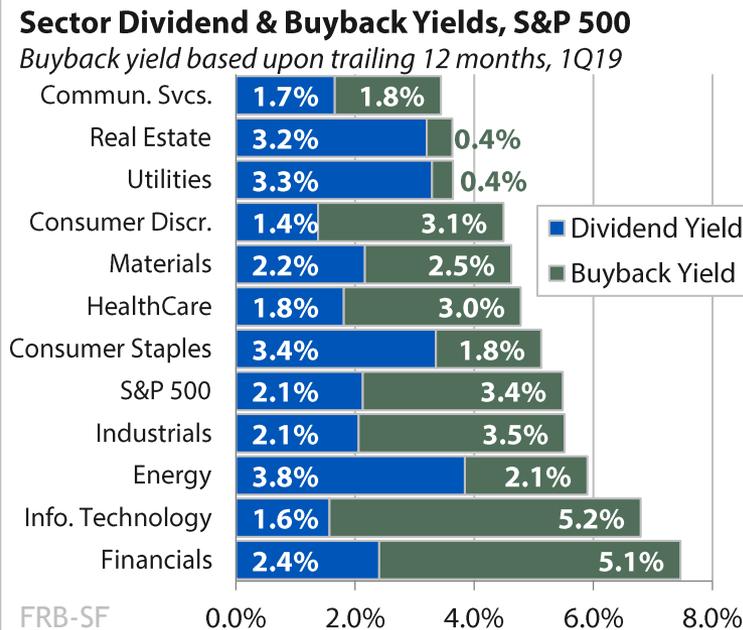
Spotlight: Holding Company Stock Buyback Trends

On the heels of tax reform, the proportion of firms engaging in share repurchases increased. Among S&P 500 firms, nearly one-third reported a year-over-year reduction in shares outstanding in [1Q19](#) (latest data available as of this writing). Repurchases ramped up in 2018 and into early 2019 across several sectors, including financial services. In aggregate, the quarterly dollar volume of share buybacks among S&P 500 firms surpassed the level of dividends between mid-2010 and 1Q19. In the 12 months ending March, aggregate S&P 500 firm buybacks totaled \$823 billion, versus \$464 billion in dividends. Dividends and buybacks were up 8.5% and 43.0%, respectively, compared with the 12-month period ending March 2018. Activity peaked in 4Q18. Relative to the market capitalization of companies, capital distributions tended to be highest among financial firms (see chart, upper right).

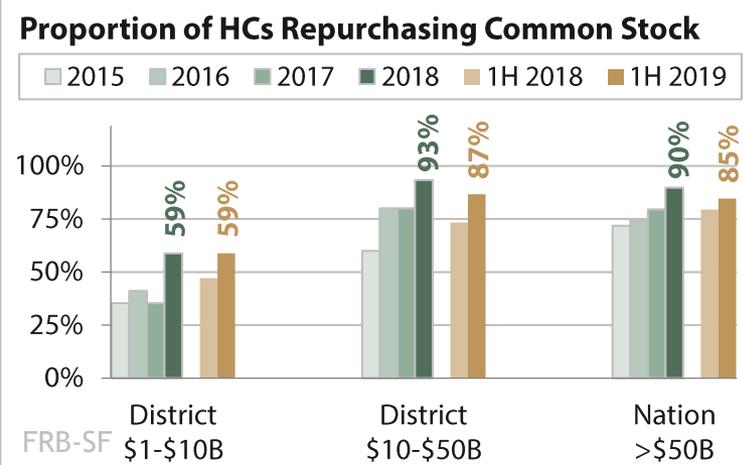
Common share buybacks can be appealing to firms for a variety of reasons. Motivations can include a perceived undervaluation of share price, the tax advantaged status of buybacks versus dividends for investors, the desire to create liquidity for a thinly-traded stock, or limited opportunities for deploying capital. In 2018, tax reform-driven increases in profits and cash flows amplified distributions to shareholders.

All else equal, a buyback will reduce the number of outstanding shares and lift earnings per share and stock prices, but benefits to shareholders can be uneven over time. Data from the [S&P 500 Buyback Index](#), which tracks 100 index firms with the highest share repurchase activity, suggests that total return performance, including price swings as well as dividends, has not consistently outperformed the broader S&P 500 Index. As of March 2019, the Buyback Index's 10-year total return of more than 16% outpaced the 14% total return of the full S&P 500 Index; however, in the five- and one-year horizons, the Buyback Index underperformed.

Share repurchases have not been limited to bank and thrift holding companies within the S&P 500. Holding companies (HCs) across the size spectrum increased year-to-date buyback activity compared with mid-2018; although, the propensity to repurchase tended to be highest among mid- and large-sized HCs (see chart, lower right).¹ Through mid-2019, 85% of the nation's largest HCs and 87% of mid-sized firms based in the District reported year-to-date cash outflows for common stock repurchases. More than half of smaller HCs bought back shares during the same period.



Source: S&P Dow Jones Indices, a Division of S&P Global.



Based upon a nationwide, fixed set of 325 HCs reporting cash flows on Form FR Y-9LP.

Spotlight: Holding Company Stock Buyback Trends, Cont'd.

In addition, the relative size of HC buyback activity has increased. As a share of average book equity, the annualized dollar volume of common stock repurchases remained higher among larger holding companies (see chart, top right). Although comparatively modest among community-sized HCs, the proportion of average equity paid out in the form of buybacks increased for that group as well, especially when comparing the first half of 2019 to the same period last year.

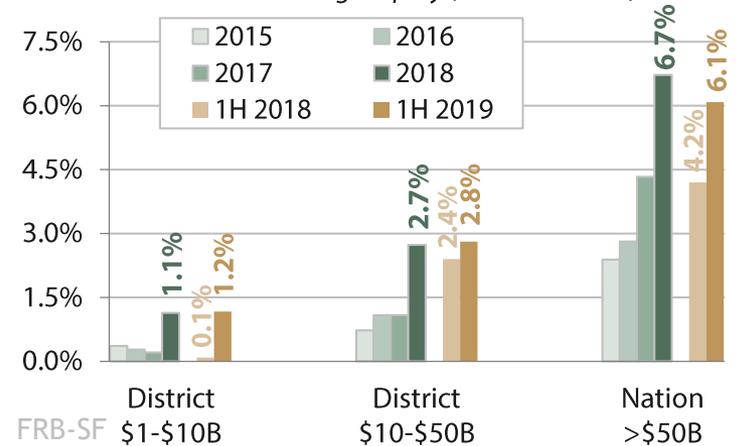
Holding company capital distributions increased dividend pressures on subsidiary depository institutions. The effects of increased parent company share buyback and dividend distributions were evident in the rate of earnings retention and capital formation among subsidiary depositories. For instance, in the first half of 2019, dividends represented 3.3% of average equity among all District banks holding total assets between \$1 billion and \$10 billion, up from 2.7% in the year-earlier period. Likewise, the average ratio of bank dividends-to-average equity among the District's mid-sized banks increased from 6.0% to 6.7%, and among banks with assets exceeding \$50 billion nationwide, the ratio jumped from 6.3% to 7.9% year-over-year. Within the District, common and preferred stock dividend payouts tended to be higher among the 62% of banks that were controlled by a HC, by a factor of four-to-one (see chart, lower right). The pace of subsidiary bank dividends may not be sustainable if changing interest rate or credit conditions crimp earnings and dividend paying capacity.

In addition to creating subsidiary dividend pressures, share repurchases can distort stock-based executive compensation. According to a [June 2018 speech](#) by Securities and Exchange Commissioner Robert Jackson, a study of 385 buyback transactions in 2017 and 1Q18 found that, on average, about twice as many company insiders sold stock during the days following the buyback announcement—and at about five times the transaction value—compared to the days prior to the announcement. While stock-based compensation is generally seen as a means for aligning executives' incentives with long-term value creation, insider stock sales shortly following buyback announcements may undermine that goal.

¹Due to changes in asset thresholds for HC regulatory filings over time, a fixed set of 325 bank and thrift holding companies with current total assets of at least \$1 billion was used in this analysis. Only a handful of firms between \$1 billion and \$3 billion in consolidated assets had available data. Given limitations, data was not merger-adjusted.

Average HC Common Stock Buybacks

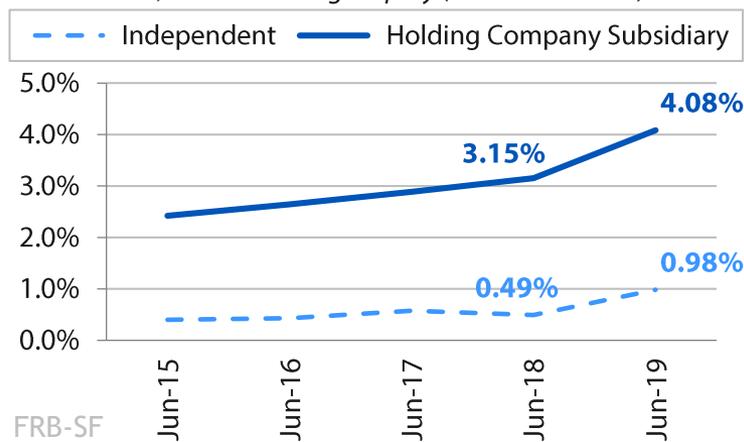
As % of Consolidated Average Equity (1H Annualized)



Average = trimmed mean; common share repurchase dollar volume from FR Y-9LP statement of cash flows; consolidated average equity derived from FR Y-9C data.

Average Bank Common & Preferred Dividends

12th District, as % of Average Equity (YTD Annualized)

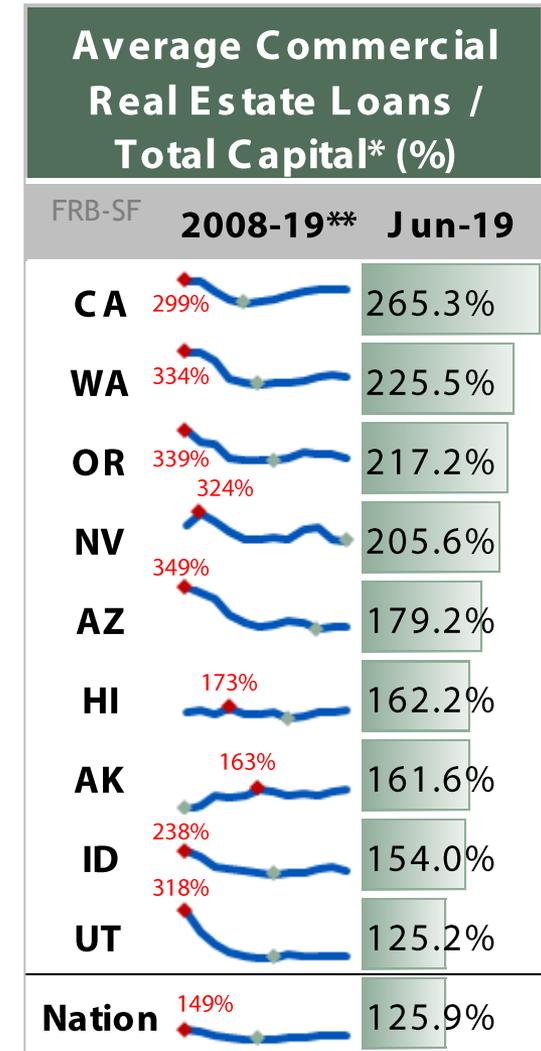


Average = trimmed mean; includes common and preferred dividends paid by a fixed panel of 254, 12th District banks.

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. For instance, according to Symantec's [Monthly Threat Report](#), during July 2019, 1 in 861 emails to the finance, insurance, and real estate sector globally were malicious and 1 in 7,348 contained phishing attempts. The sector's malicious email rate was lower than that reported across all sectors (1 in 632), but the phishing rate was higher than the overall average (1 in 9,633). Also, Capital One's recent cloud breach served as a reminder that vendors remain a potential attack vector. Strong staff and customer training and vendor management are key to cybersecurity. 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.** Even though related supervisory criticisms at District institutions have started to moderate, 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 and cannabis sales in District states increase. Ensuring that BSA/AML strategies evolve remains a key factor in maintaining a satisfactory compliance program.
- CRE lending concentrations.** Although non-owner occupied CRE loan concentrations have eased from pre-crisis peaks because of lower C&LD loan content, 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, all else equal. For risk management guidance, see the 2015 *Interagency Statement on Prudent Risk Management for Commercial Real Estate 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 expanding loan portfolios. However, many credits are underpinned by historically high collateral values. Some lenders eased standards to achieve growth targets, particularly in the case of C&I loans. Adding to C&I concerns is a historically high ratio of nonfinancial corporate debt-to-gross domestic product, propelled in part by increasing levels of subinvestment and near-subinvestment grade debt. Rapid growth with loosened lending standards may leave banks vulnerable to elevated losses during the next economic downturn.

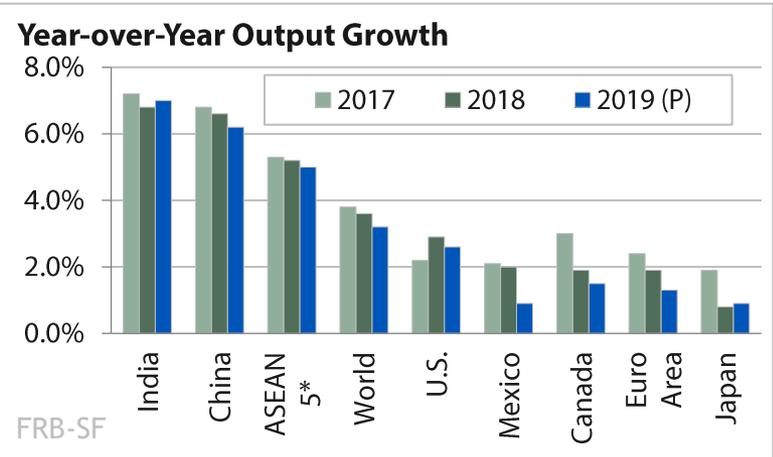


*Trimmed means; excludes owner-occupied CRE; **June 30th of each year.

◆ = 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 as the yield curve flattened; however, the proportion of longer-dated assets remained elevated through mid-2019. 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, NMD growth has slowed, increasingly lagging asset and loan growth within the District and nationwide. Meanwhile, the share of District bank assets held in securities and liquid assets declined to its lowest midyear level since 2009. In the face of slowing NMD growth, in particular noninterest bearing deposits, banks have turned to pricier funding sources, 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, and other areas. Banks have increasingly partnered with fintech firms, including marketplace lenders, which have rapidly expanded their footholds across multiple loan types. Given the nontraditional origination methods that fintech lenders may use, bank partners should closely evaluate transactions for credit risk, fair lending, and unfair/deceptive acts or practices.
- Global economic slowing and geopolitical tensions.** The IMF expects growth in world output to slow this year, weakening across multiple economies (see chart at right). In addition, tensions with U.S. trade partners have continued, and the U.S. has announced further, albeit partially delayed tariffs on additional goods imported from China. The District's many sea ports and international borders leave it particularly exposed to international developments.
- Declining interest rates and yield curve inversion.** In response to slowing growth abroad, several central banks have lowered interest rates, in some cases into negative territory. This has lured investors to comparatively high-yielding U.S. debt instruments. Investor demand from abroad, in combination with muted market expectations for future inflation and growth, has contributed to lower U.S. long-term interest rates and an inverted yield curve. In addition to stoking debate about the potential for a U.S. economic slowdown, recent rate shifts could lead to bank net interest margin pressures, triggering loan re-pricing and refinancings at a time when already-low deposit yields and high noninterest bearing account levels may leave funding costs less responsive to rate declines.



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

Section 2

Economic Conditions

Job Growth

Housing Market

Commercial Real Estate

For more information on the District's real estate markets and economy, see:

Real Estate Lending Risks Monitor

[\(https://www.frbsf.org/banking/publications/real-estate-lending-risks-monitor/\)](https://www.frbsf.org/banking/publications/real-estate-lending-risks-monitor/)

Banks at a Glance

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

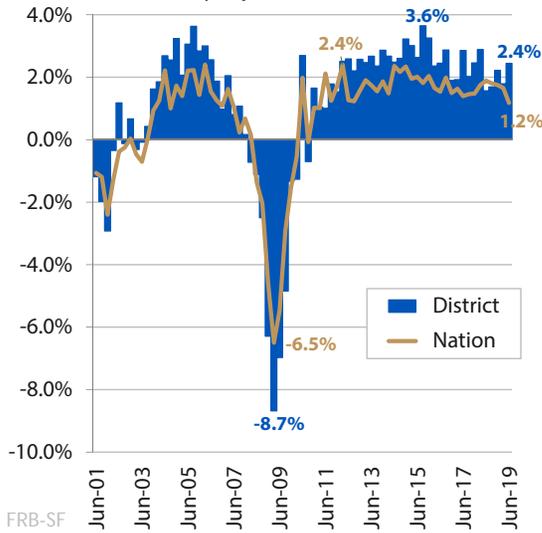
FOMC Calendar, Statements, & Minutes

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

11 District hiring reaccelerated, led by a surge in construction jobs, but retail employment declined.

Nonfarm Job Growth

(1-Quarter Seasonally Adjusted Annual Rate)



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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 and Haver Analytics.

12th District Jobs by Sector

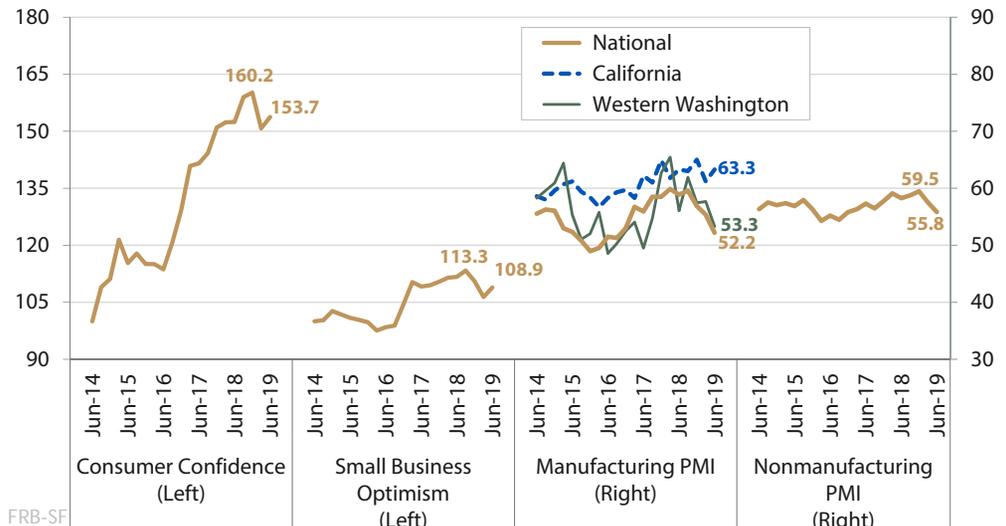
Job Sector	% Change (annualized)		Share of Total Jobs (2Q19)
	3Q17-2Q19	2Q19	
Construction	8.81%	5.59%	
Edu. & Health Svcs.	4.08%	15.32%	
Prof. & Business Svcs.	3.21%	14.71%	
Other Private	2.91%	3.69%	
Leisure & Hospitality	2.65%	12.08%	
Information	2.33%	2.72%	
Transport. & Utilities	2.00%	3.92%	
Manufacturing	1.85%	7.56%	
Government	1.17%	15.28%	
Wholesale Trade	1.03%	3.78%	
Financial Activities	1.01%	3.11%	
Retail Trade	-0.98%	10.24%	
Total Nonfarm	2.44%	100%	

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12 Lower interest rates and improved stock market returns helped sentiment, but trade weighed on PMI measures.

Consumer Confidence & Small Business Optimism (2Q14 = 100)

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



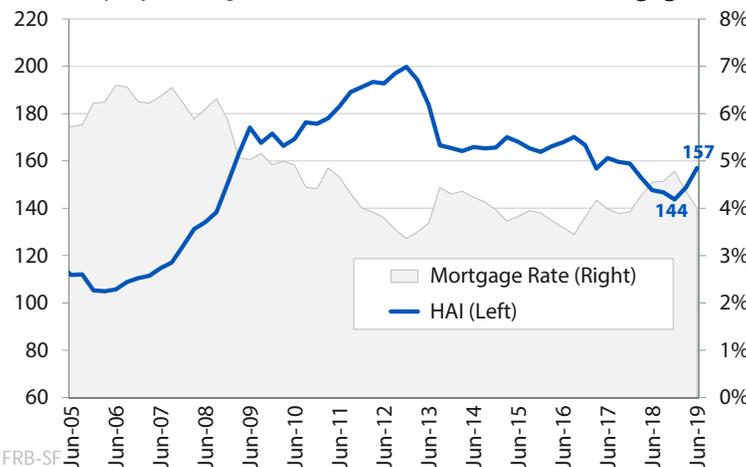
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Seasonally adjusted. Sources: Conference Board, National Federation of Independent Business, Institute for Supply Management, and Chapman University via Haver Analytics.

13 The recent decline in mortgage rates and uptick in incomes slightly benefited the West's low affordability.

U.S. Housing Affordability Index (HAI)

(Seasonally Adjusted, Higher Index = More Affordable)



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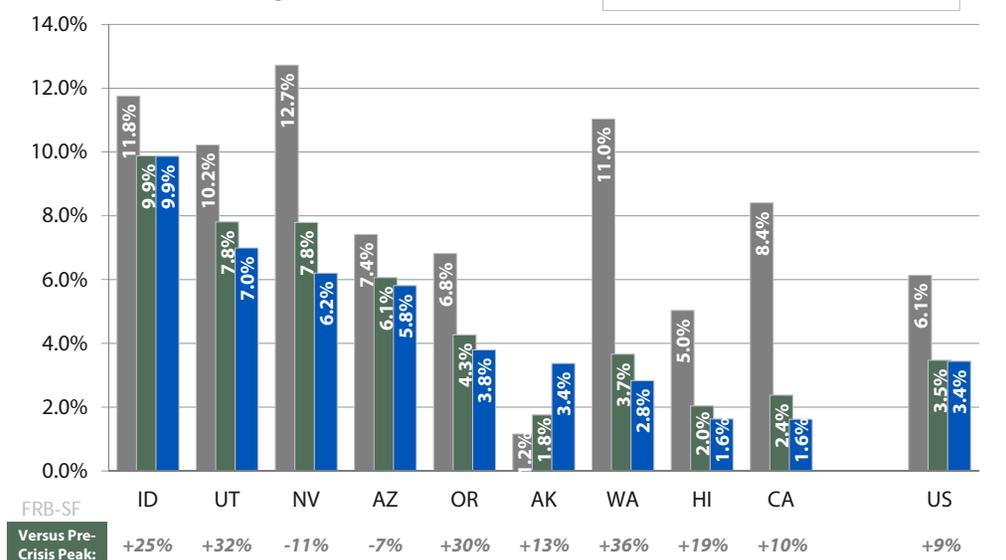
HAI measures whether a family earning the median income would qualify for a conventional mortgage on a median-priced home, assuming a 20% down payment and a 25% qualifying ratio (monthly principal and interest payment cannot exceed 25% of monthly family income); West = 12th District plus CO, MT, NM, and WY. Sources: NATIONAL ASSOCIATION OF REALTORS® (HAI) and Freddie Mac (mortgage rate) via Haver Analytics. HAI data copyright ©2019 NATIONAL ASSOCIATION OF REALTORS®; all rights reserved; reprinted with permission.

30-Year Fixed Mortgage Rate

Region	Regional Housing Affordability Indices	
	Jun-18	Jun-19
West	101.0	113.1
Northeast	143.6	154.2
South	141.4	156.9
Midwest	170.6	186.0

14 Although slower, home-price growth in ID, UT, and NV led the nation; appreciation weakened notably in WA and CA.

Year-over-Year % Change in Home Price Index



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Versus Pre-Crisis Peak: +25%, +32%, -11%, -7%, +30%, +13%, +36%, +19%, +10%, +9%

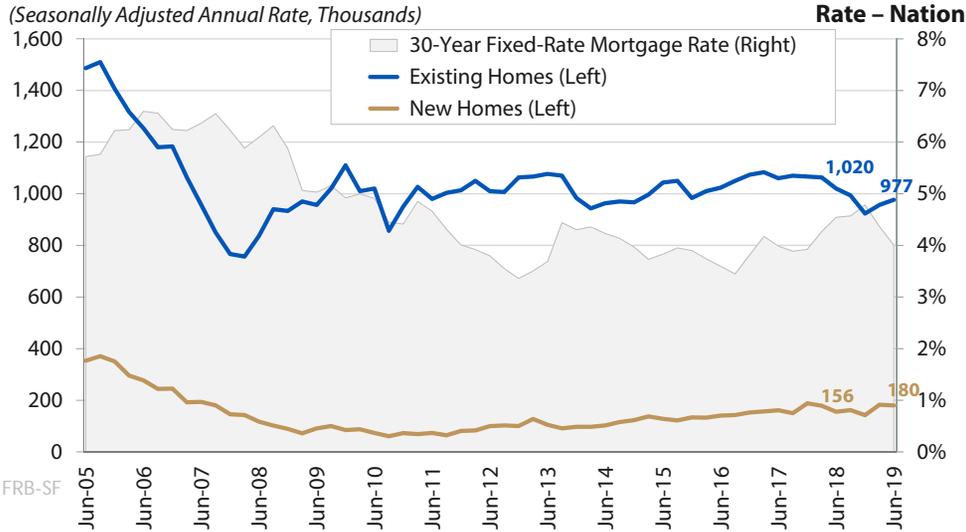
Home price index includes all detached and attached single-family homes, including distressed sales. Source: CoreLogic.

15 Existing home sales rebounded further in 2Q19 on lower mortgage rates; new home sales outpaced 2Q18.

Single-Family Home Sales – West

(Seasonally Adjusted Annual Rate, Thousands)

30-Year Fixed Mortgage Rate – Nation

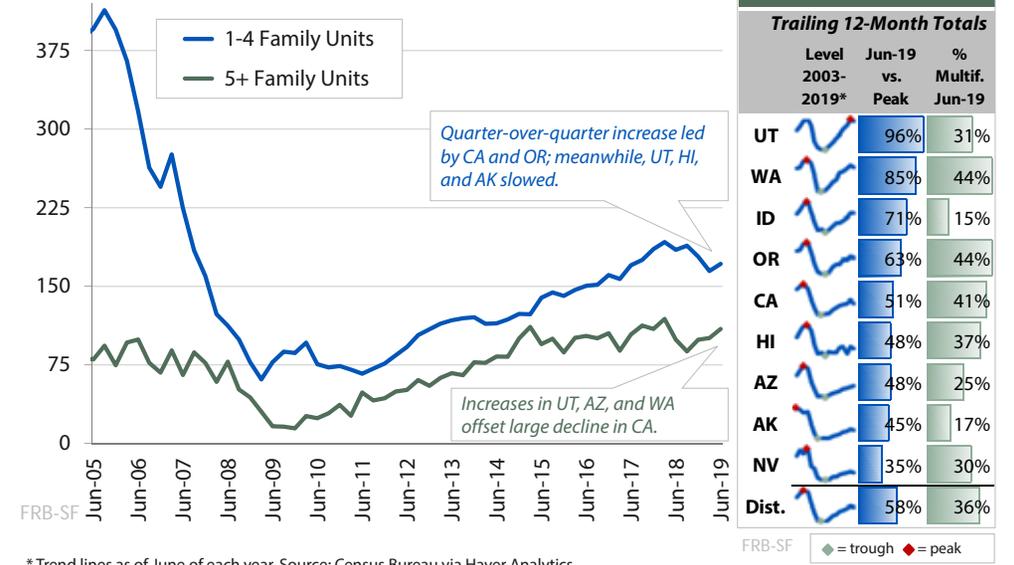


All data are quarterly averages. West = 12th District plus CO, MT, NM, and WY. Sources: NATIONAL ASSOCIATION OF REALTORS® (existing homes), Census Bureau (new homes), and Freddie Mac (mortgage rate) via Haver Analytics. Existing home sales data copyright ©2019 NATIONAL ASSOCIATION OF REALTORS®; all rights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

16 1-4 family permitting rebounded slightly in 2Q19, and multifamily permitting continued to accelerate.

Housing Permits – 12th District

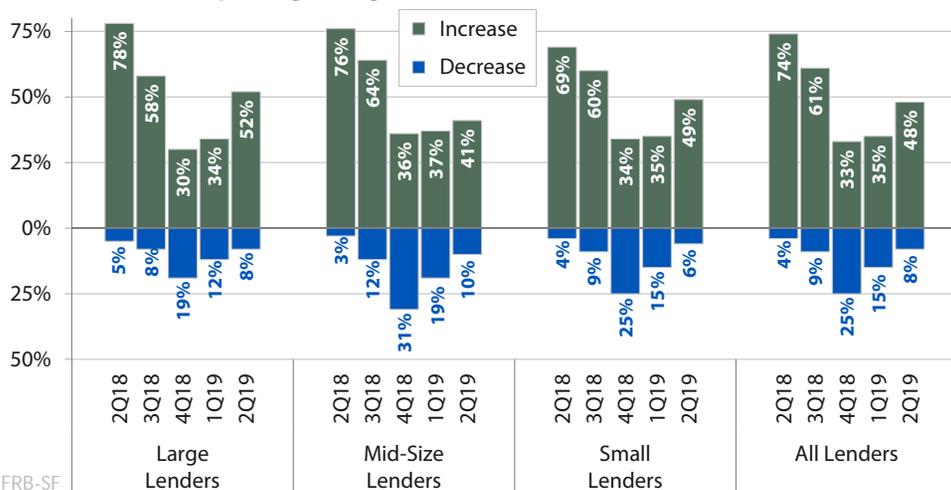
(Seasonally Adjusted Annual Rate, Thousands)



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

17 Mortgage lenders' home price expectations recovered further from late-2018 lows.

Share of Lenders Expecting Change in Home Prices in the Next 12 Months

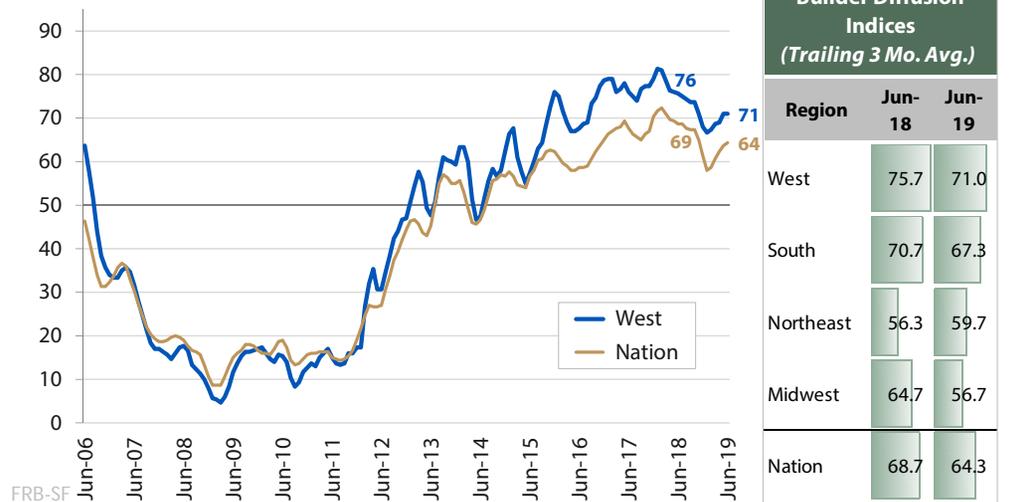


Lender size based upon 2018 total loan originations: Large = lenders in the top 15% of lending institutions (volume above \$980 million); Mid-Size = lenders in the next 20% of lending institutions (volume between \$317.5 million and \$980 million); Small = bottom 65% of lending institutions (volume less 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 improved further in 2Q19, concurrent with declines in long-term mortgage rates.

Homebuilder Diffusion Index

(Trailing 3-Month Moving Average, Index Above 50 Considered Positive)

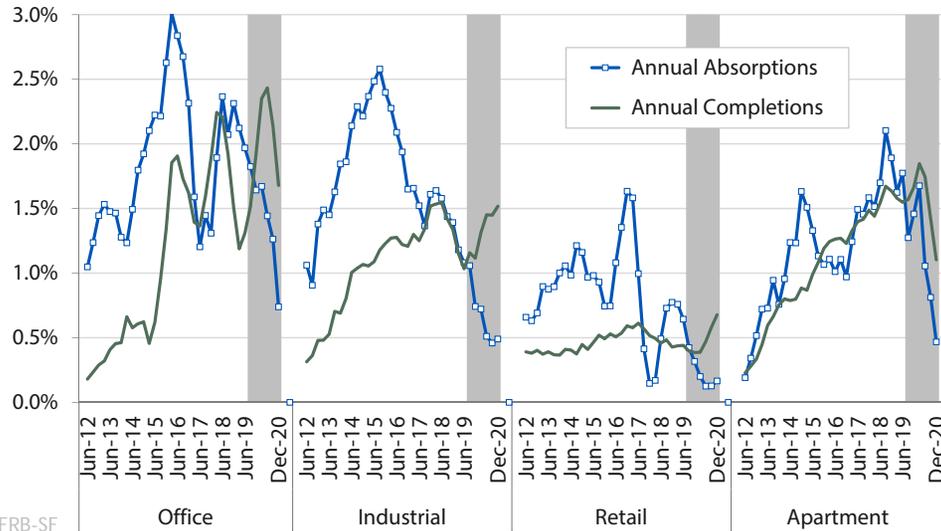


Data are seasonally adjusted; index is a weighted average of current sales (59.2%), sales in next six months (13.6%), and traffic of prospective buyers (27.2%). West = 12th District plus CO, MT, NM, and WY. Source: National Association of Home Builders (NAHB)/Wells Fargo Builders Economic Council Survey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

20 Demand had been outpacing new supply, but absorptions may trail completions over the next year.

12th District Aggregate Annual Absorption and Completion Rates

(Trailing 4-Quarter Net Absorptions and Completions as % of Beginning Stock)

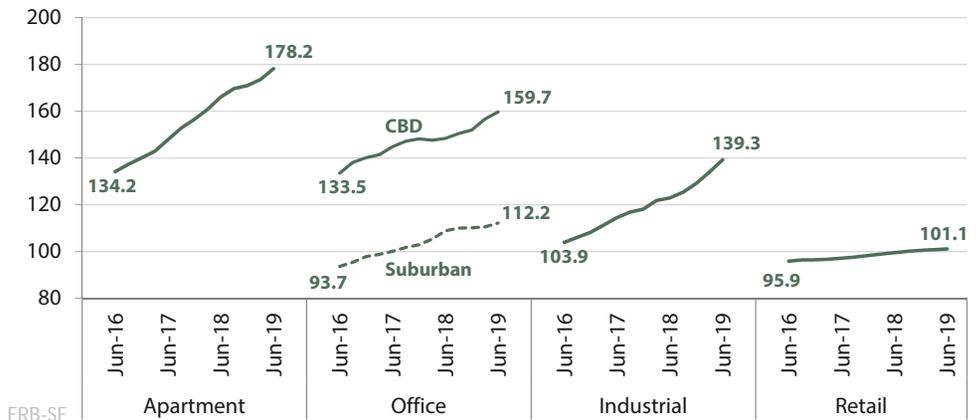


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Includes the 18 to 16 largest markets in the District depending on sector; shaded area = forecast. Source: CBRE-EA.

21 Nationally, CRE price gains continued to be strongest among industrial and apartment properties.

Value of Commercial Property Price Index – Nation (Dec-06 = 100)



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	Cumulative Change in CPPI			
1 Yr.	7.3%	4.0%	13.3%	1.6%
5 Yrs.	67.4%	39.9%	59.2%	21.6%
10 Yrs.	130.0%	47.9%	70.6%	35.3%

CPPI = Commercial Property Price Index; CBD = central business district (downtown); based upon repeat-sales transactions. Source: Real Capital Analytics, Inc.

22 Capitalization rates in the West were stable or ticked higher for most CRE types; sank further among industrial.

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



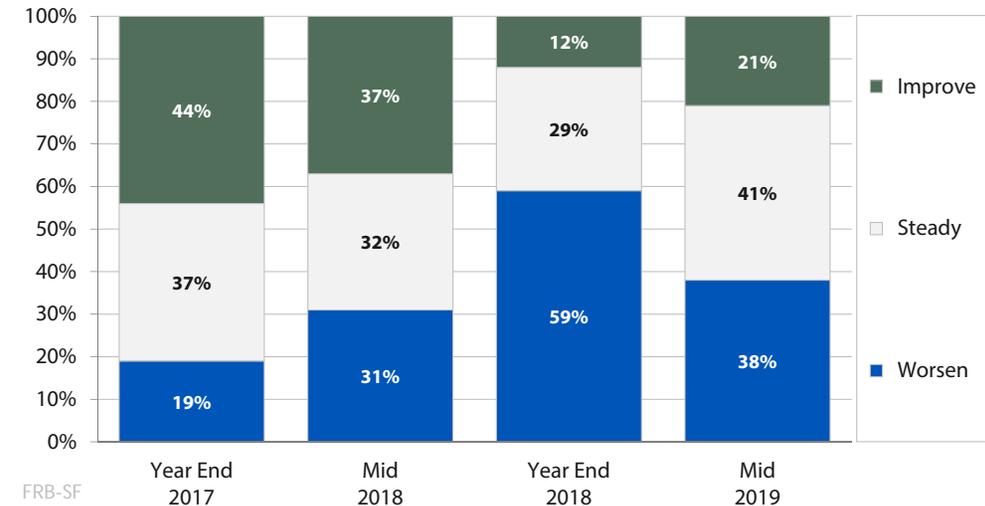
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Includes transactions in the West (AK, CA, HI, ID, MT, NV, OR, UT, WA, and WY, but not AZ); property sales > \$2.5 million with available capitalization rate data. Source: Real Capital Analytics, Inc.

23 4Q18 CRE investor worries about rising interest rates and market turmoil eased by mid-2019.

Participants' Views on Real Estate Market Conditions in the Next 12 Months

(% of Respondents)



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Respondents included developers and builders (35%-38%), investors or capital allocators (17-20%), design and architecture firms (9%-12%), and a variety of other private and public organizations (32%-38%), with mix varying by survey period. Source: RCLCO Real Estate Advisors Sentiment Survey Reports.

Section 3

Commercial Bank Performance

Earnings

Loan Growth and Concentrations

Credit Quality

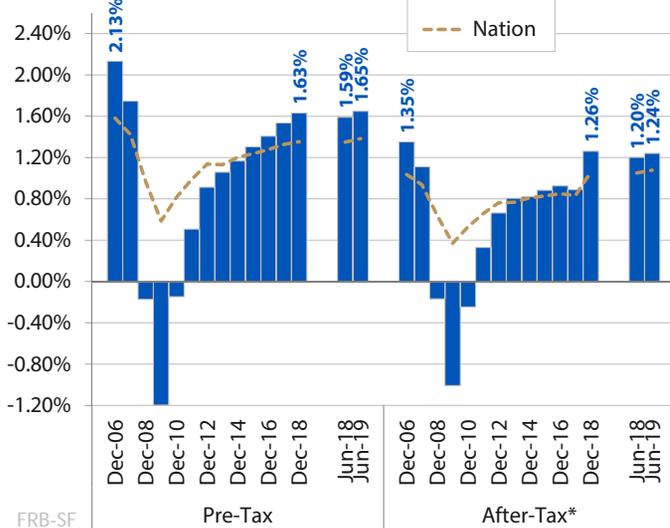
Liquidity and Interest Rate Risk

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.

25 Stronger margins led year-to-date profits higher compared with the first half of 2018.

Average YTD ROAA



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

Profit Component	Jun-18	Jun-19
Interest Income (TE)	4.32%	4.64%
Interest Expense	-0.41%	-0.66%
Net Int. Income (TE)	3.90%	3.98%
Noninterest Income	0.59%	0.56%
Noninterest Expense	-2.90%	-2.89%
Provision Expense	-0.07%	-0.07%
Tax Expense (TE)	-0.35%	-0.36%

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Pre-Tax

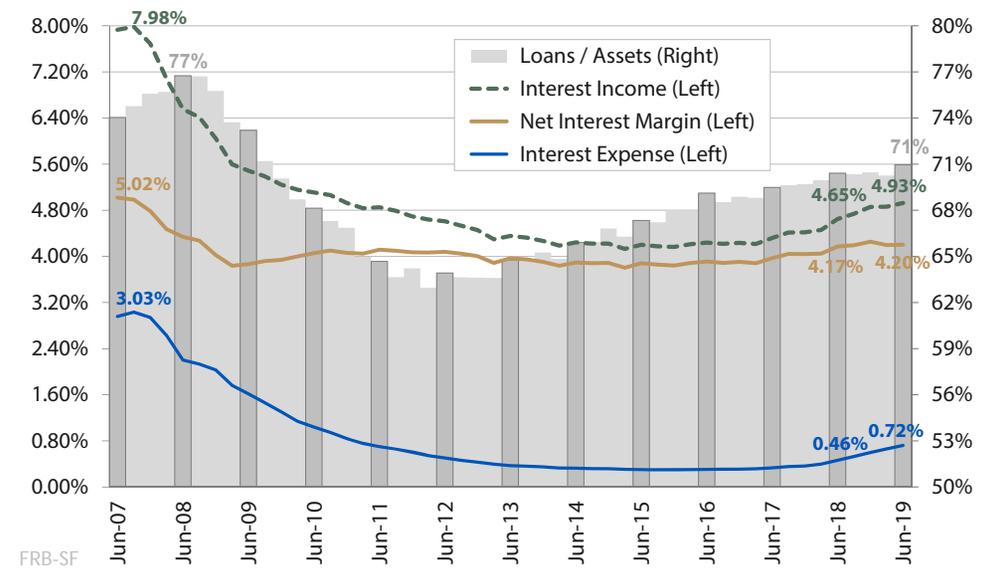
After-Tax*

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).

26 On a quarterly basis, seasonality helped 2Q19 asset yields, but rising funding costs constrained margins.

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

Avg. Net Loans / Assets

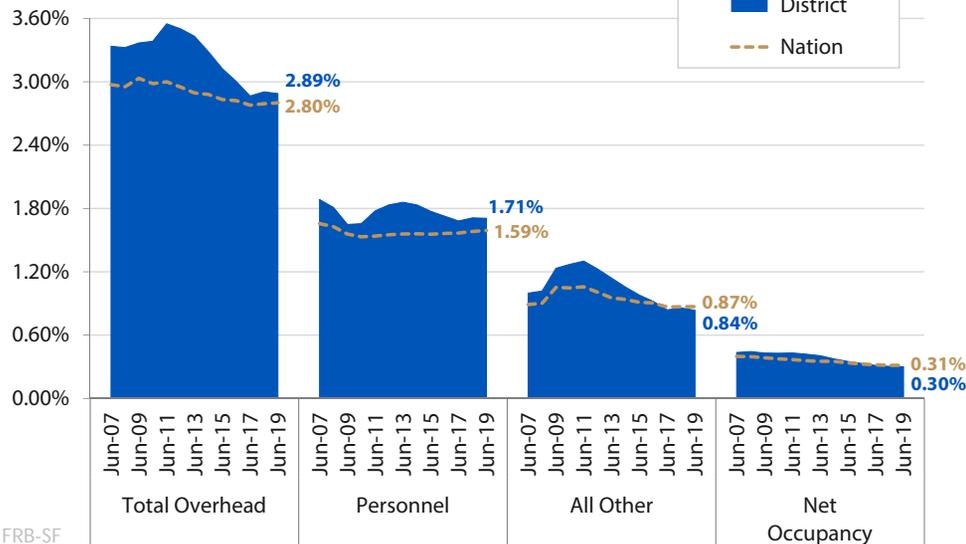


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Average = trimmed mean (12th District banks only); one-quarter annualized data; TE = tax equivalent.

27 Overhead expense ratios were stable year-over-year as growth in personnel expenses slowed.

Average YTD Overhead Expense / Average Assets



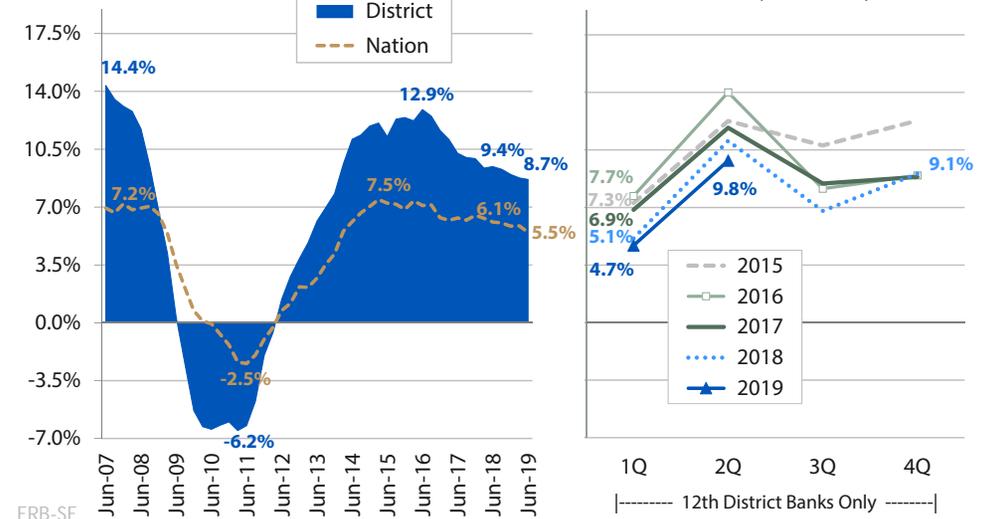
FRB-SF

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

28 Annual net loan growth continued to decelerate, but seasonality boosted linked-quarter growth.

Average Year-over-Year Net Loan Growth

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

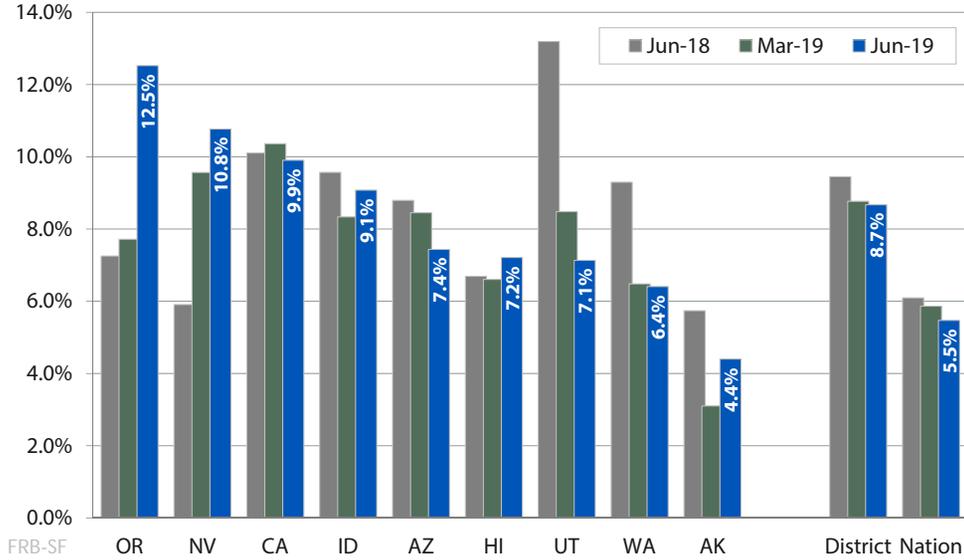


FRB-SF

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.

Decelerating annual loan growth was most notable in CA, AZ, UT, and WA; other states bucked the trend.

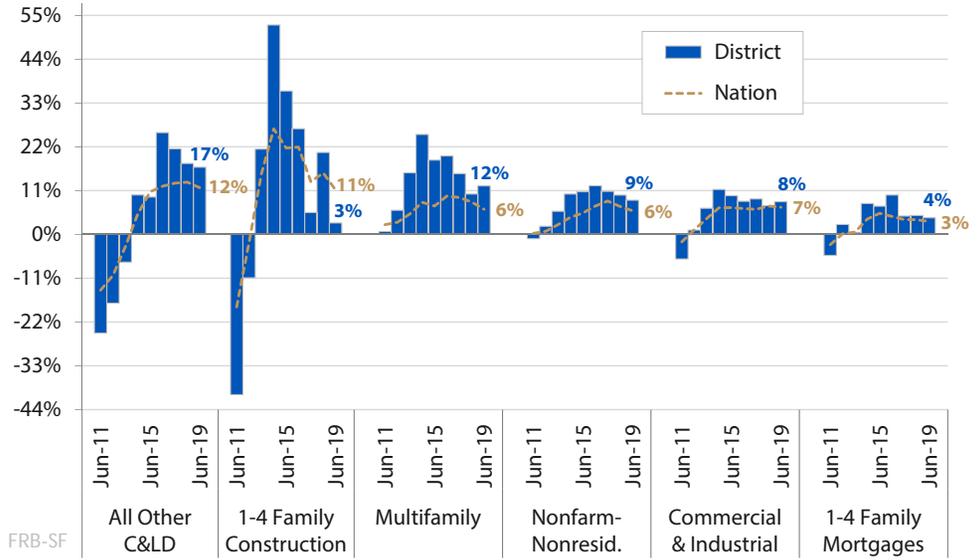
Average Year-over-Year Net Loan Growth (%)



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.

Growth slowed across several major loan categories; multifamily and C&I were exceptions.

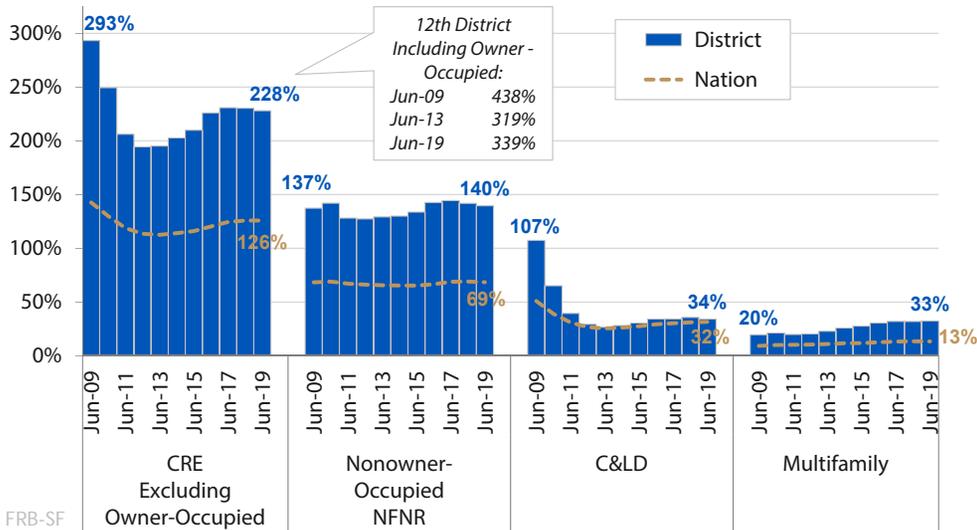
Average Year-over-Year Loan Growth, Selected Loan Categories



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

CRE lending continued to expand, but solid earnings retention kept a lid on concentrations relative to capital.

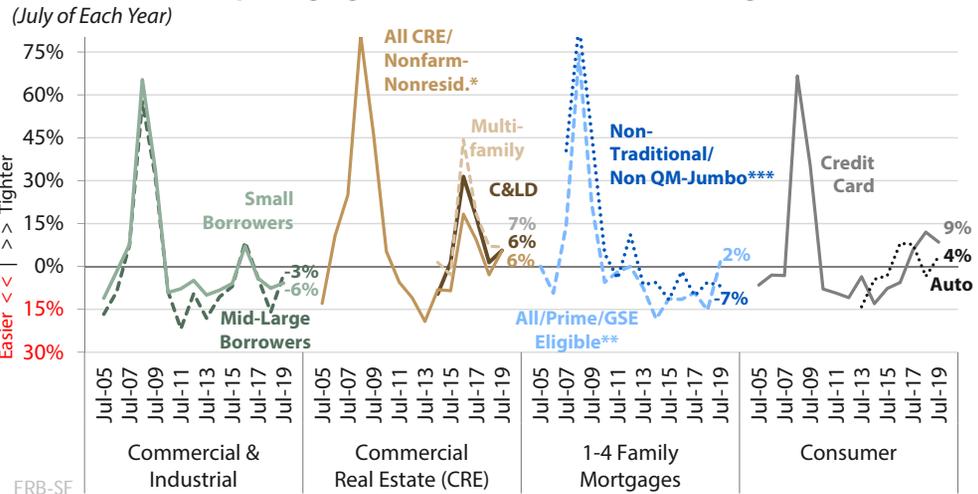
Average CRE Loans Outstanding / Total Capital



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.

On net, lenders noted modest tightening for CRE and consumer; some easing for C&I and non QM mortgages.

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

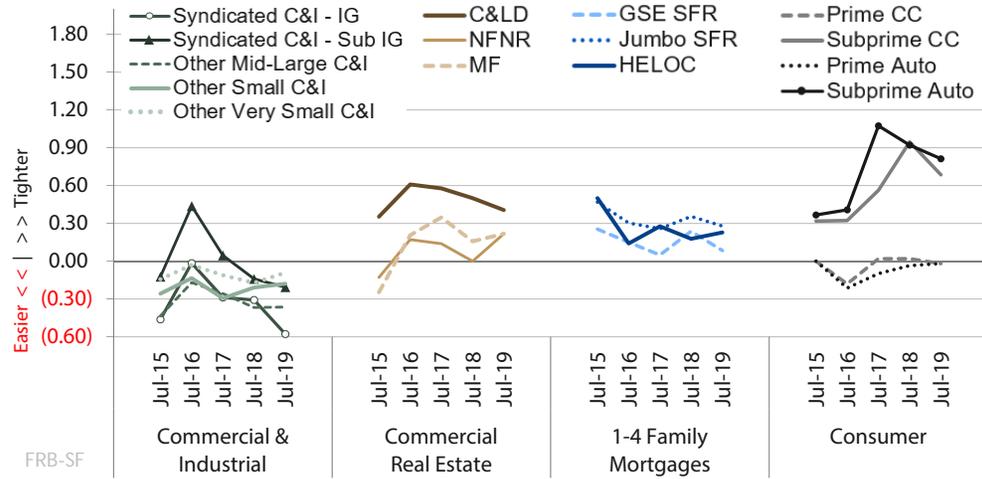


Based on a sample of 70+/- loan officers at domestic banks (number varies by period and loan type); C&LD = construction and land development; *includes all CRE loans prior to Oct-13; **includes all residential mortgages prior to Apr-07, "prime" mortgages Apr-07 to Oct-14, and GSE-Eligible starting Jan-15;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

33 In relation to post-2005 midpoint, recent C&I terms were loose; CRE, SFR, and subprime consumer were tight.

Current Loan Standards in Comparison to Midpoint Since 2005

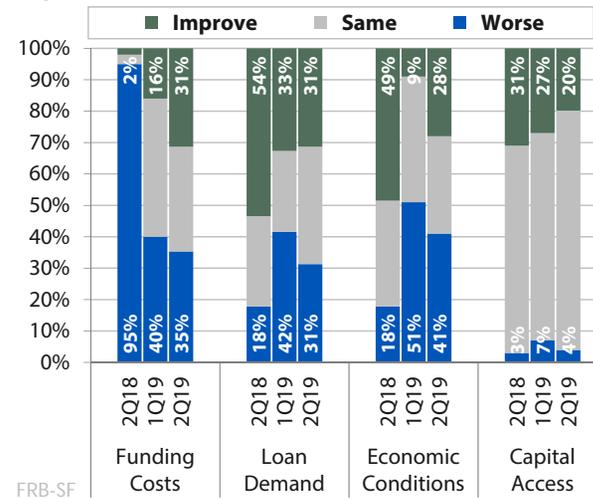
Weighted Avg. Response: 3 = near the tightest; 2 = significantly tighter; 1 = somewhat tighter; 0 = same; -1 = somewhat easier; -2 = significantly easier; -3 = near the easiest



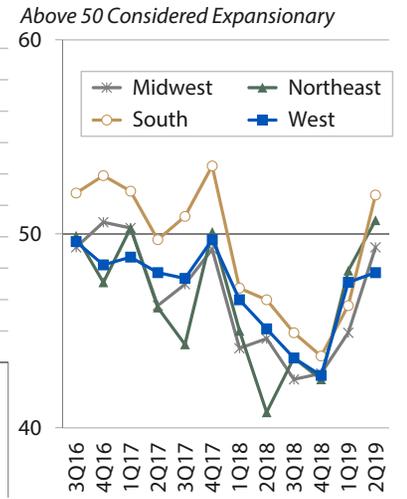
C&I = commercial and industrial; IG = investment grade; RE = real estate; C&LD = construction and land development; NFNR = nonfarm nonresidential; MF = multifamily; GSE = government sponsored enterprise; SFR = single-family residential; HELOC = home equity line of credit; CC = credit card. Source: Federal Reserve Senior Loan Officer Opinion Surveys.

34 Funding cost concerns eased, but Western bankers' confidence was constrained by their loan demand outlook.

Expectations in Next 12 Months – West Area



Bank Confidence Index

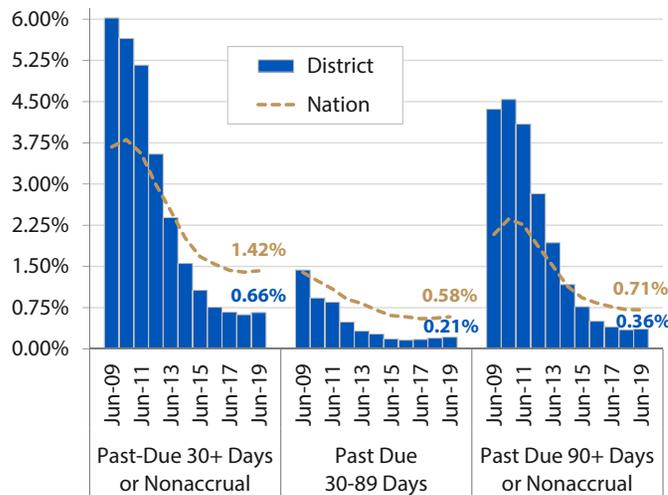


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2Q19 data based on a nationwide survey of bank chief executive officers, chief financial officers, and presidents at 484 institutions, queried between July 1 and July 12, 2019; confidence was scored based on perceptions of deposit competition, funding costs, loan demand, and access to capital (economic conditions are not a factor); 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.

35 The average 2Q past-due rate edged up from 2018, led in part by 1-4 family, owner-occupied NFNR, and consumer.

Average Past Due or Noncurrent / Gross Loans & Leases



FRB-SF

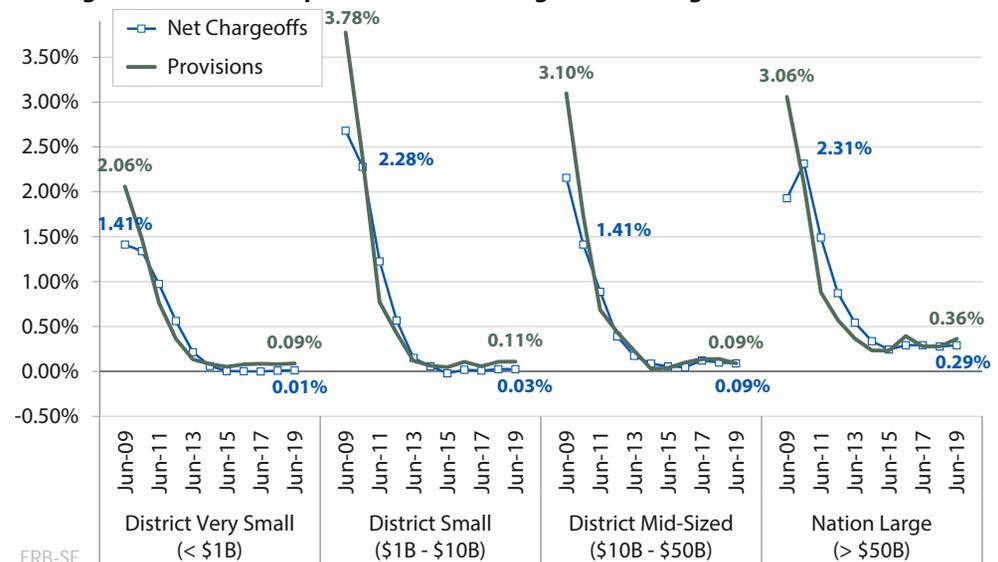
Average = trimmed mean; loans past due 30-89 days are delinquent but still accruing interest (early-stage); noncurrent = loans past due 90+ days or on nonaccrual status; C&I = commercial & industrial; NFNR = nonfarm-nonresidential mortgages; C&LD = construction & land development; average overall past 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.

Avg. % Past Due 30+ Days or Nonaccrual 12th District

Loan Type	Jun-18	Mar-19	Jun-19
C&I	0.77	0.78	0.72
1-4 Family	0.50	0.49	0.55
NFNR	0.31	0.34	0.31
Owner-Occ	0.38	0.41	0.41
Other	0.09	0.11	0.08
Consumer	0.23	0.28	0.30
Credit Card	0.58	0.79	0.94
Other	0.16	0.22	0.20
Auto	0.12	0.14	0.14
Agriculture	0.33	0.40	0.28
C&LD	0.11	0.13	0.13
All Loans	0.62	0.68	0.66

36 Consumer and C&I loan exposures tended to cause provision and loss ratios to be larger at bigger banks.

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

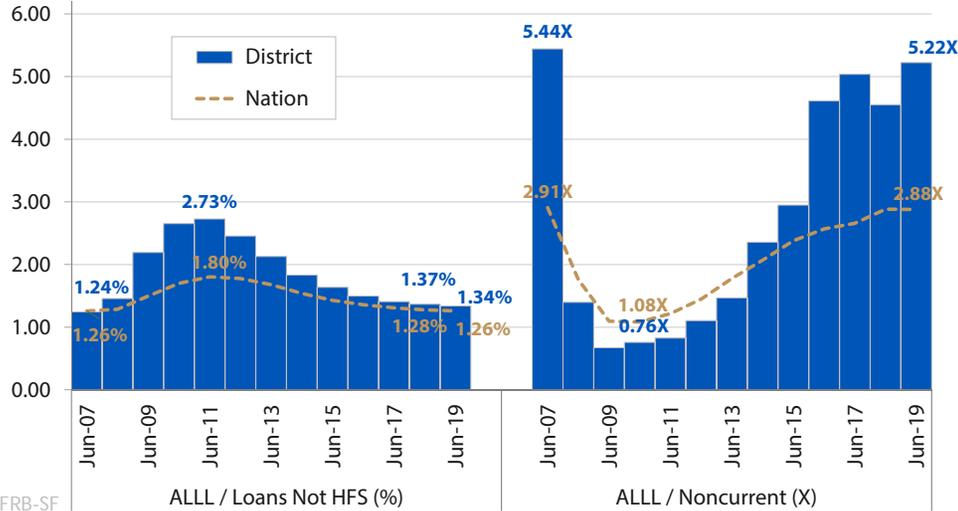


FRB-SF

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

37 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)



FRB-SF

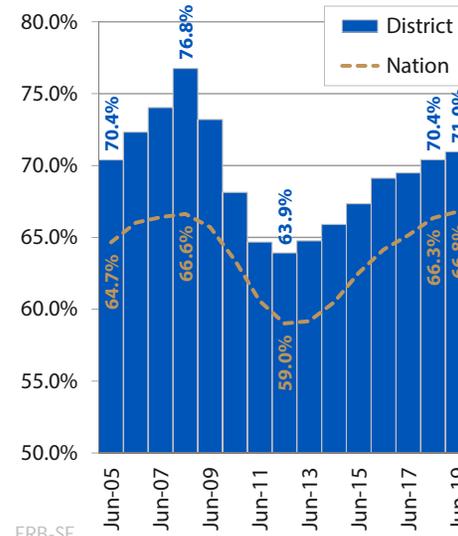
ALLL / Loans Not HFS (%)

ALLL / Noncurrent (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.

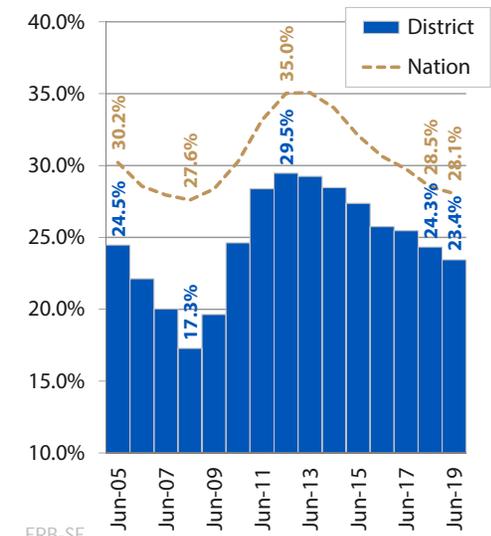
38 On-balance sheet liquidity continued to narrow.

Avg. Net Loans and Leases/Assets



FRB-SF

Avg. Securities & Liquid Invest./Assets

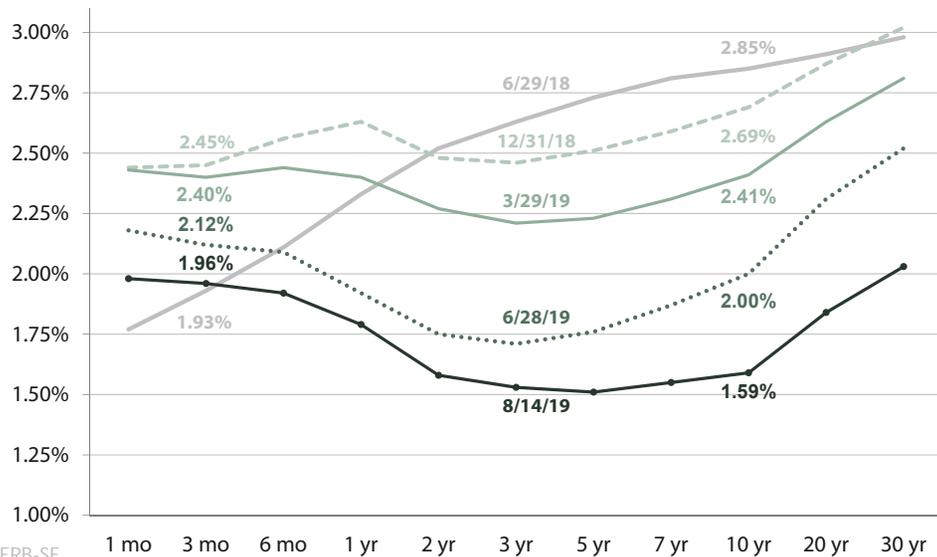


FRB-SF

*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 The yield curve inverted further after 2Q19, posing a potential challenge to bank net interest margins.

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

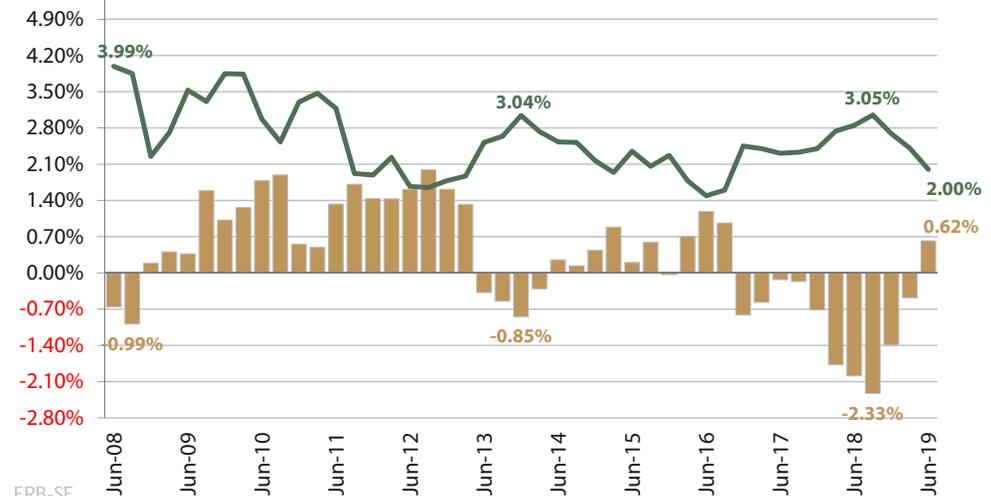


FRB-SF

Source: Department of the U.S. Treasury.

40 On the plus side, bond values rebounded further in response to declining long-term interest rates.

Average Net Unrealized Gains (Losses) on AFS Securities / AFS Securities
10-Yr. UST Yield

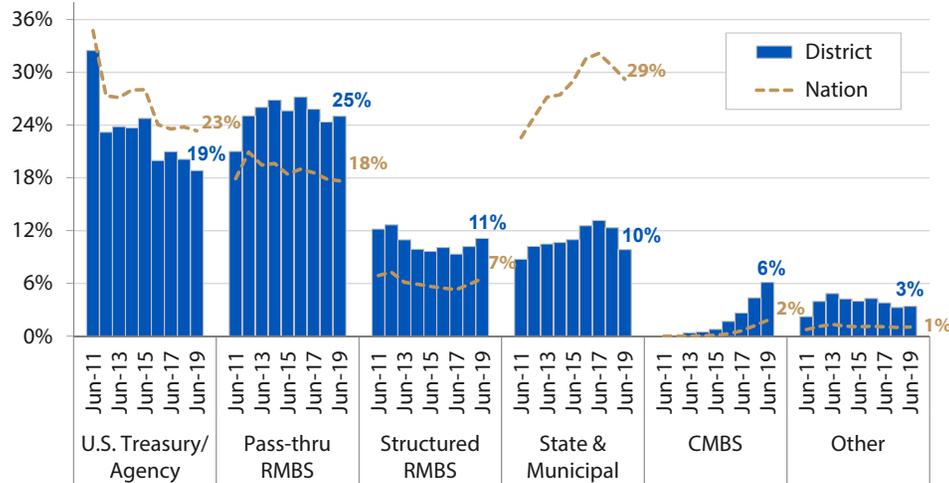


FRB-SF

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

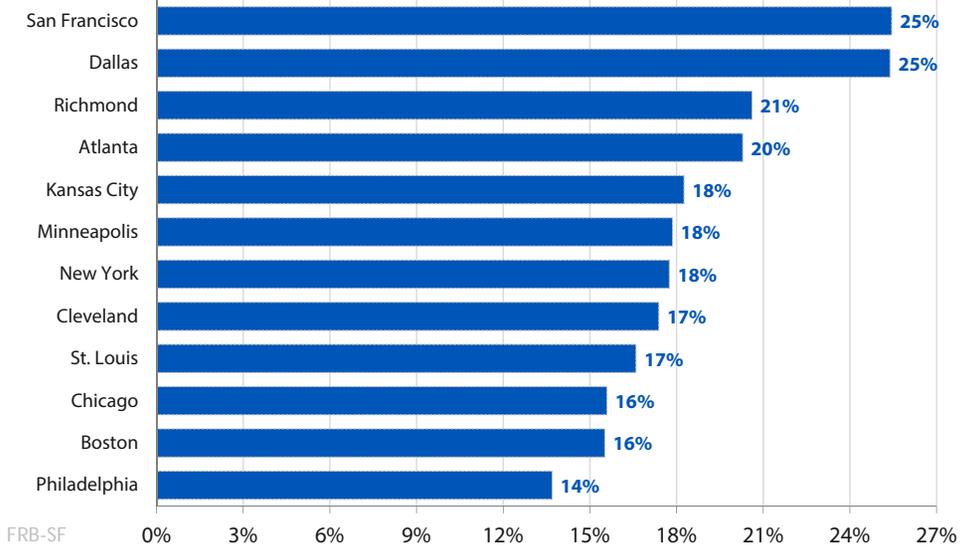


FRB-SF

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 Higher noninterest bearing deposits may mute the response of 12th District funding costs to interest rate declines.

Average Noninterest Bearing Deposits / Total Assets

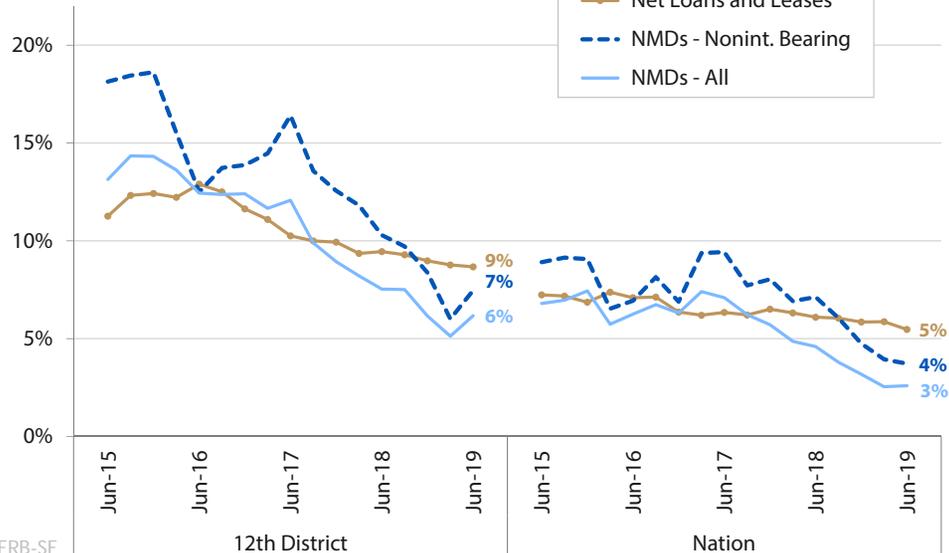


FRB-SF

Average = trimmed mean.

43 Average annual growth in NMDs still trailed loans but perked up slightly in 2Q19.

Average Year-over-Year Change

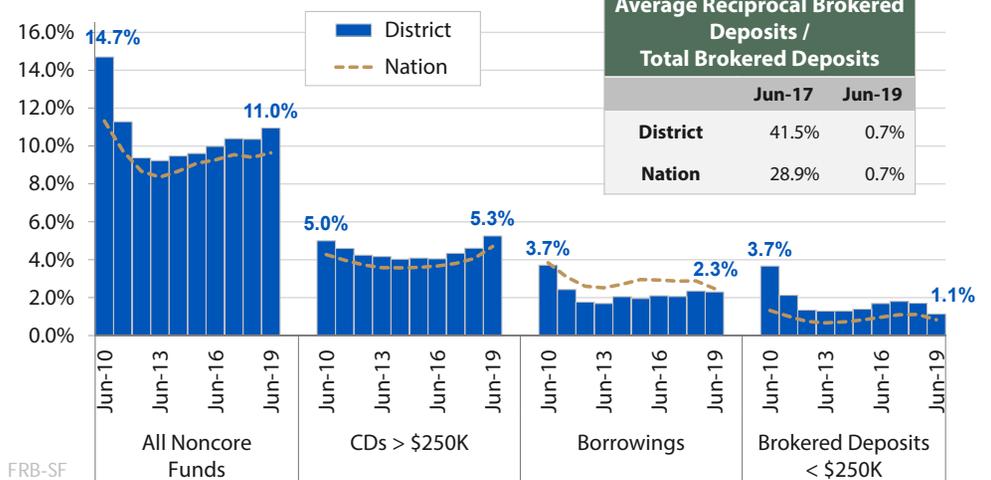


FRB-SF

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.

44 In spite of changes to reciprocal deposit treatment, noncore funding ratios drifted higher, led by jumbo CDs.

Average Noncore Funding / Assets



FRB-SF

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 (EGRPCPA) of 2018.

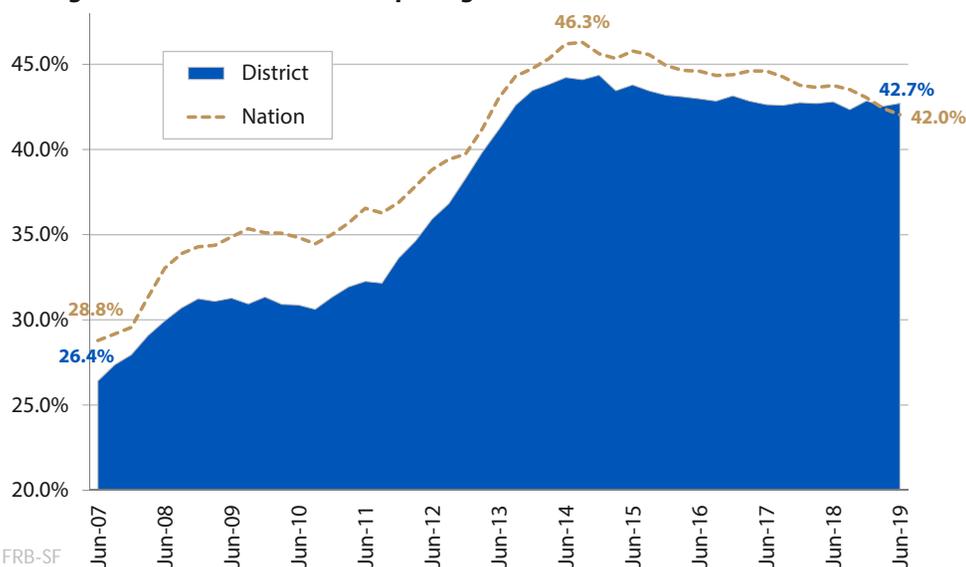
Average Reciprocal Brokered Deposits / Total Brokered Deposits

	Jun-17	Jun-19
District	41.5%	0.7%
Nation	28.9%	0.7%

45

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

Average % of Loans & Securities Repricing > 3 Years



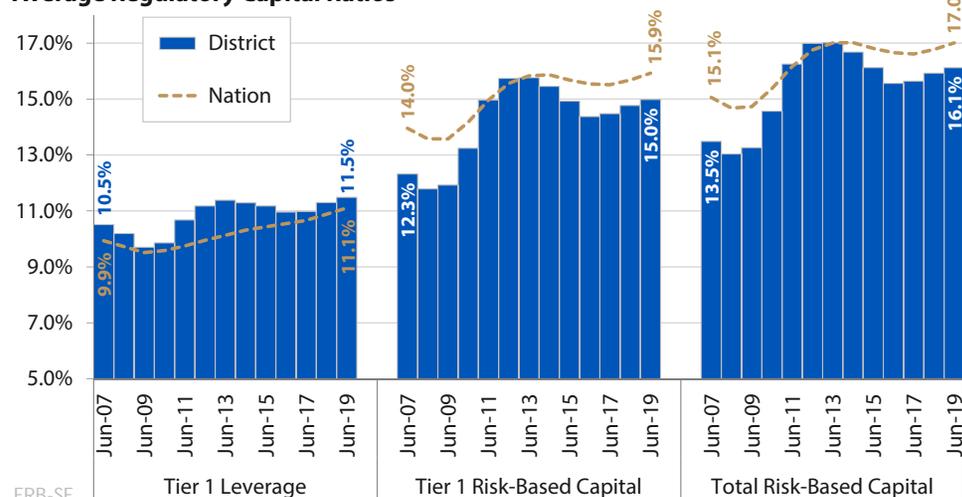
FRB-SF

Average = trimmed mean.

46

Average capital ratios edged higher year-over-year as capital formation outpaced asset growth.

Average Regulatory Capital Ratios



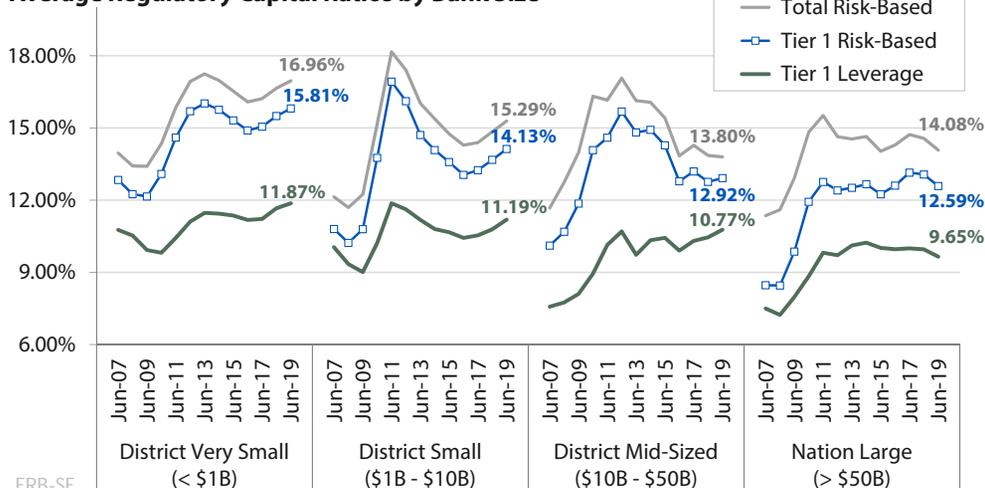
FRB-SF

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%.

47

Smaller banks tended to lead; some capital ratios remained under pressure at mid- and large-sized banks.

Average Regulatory Capital Ratios by Bank Size



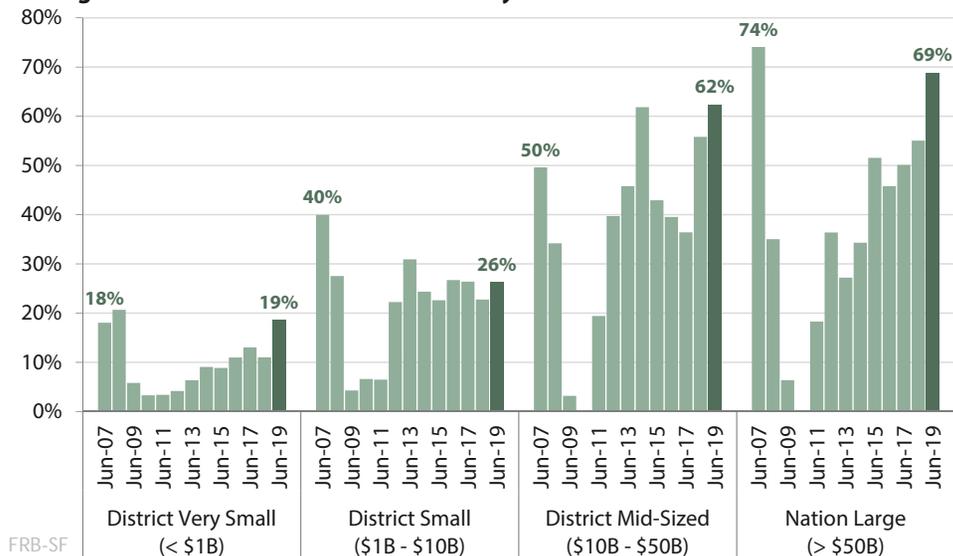
FRB-SF

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%.

48

YTD dividend payouts were highest in relation to net income at mid- and large-sized banks.

Average YTD Cash Dividends / Net Income by Bank Size

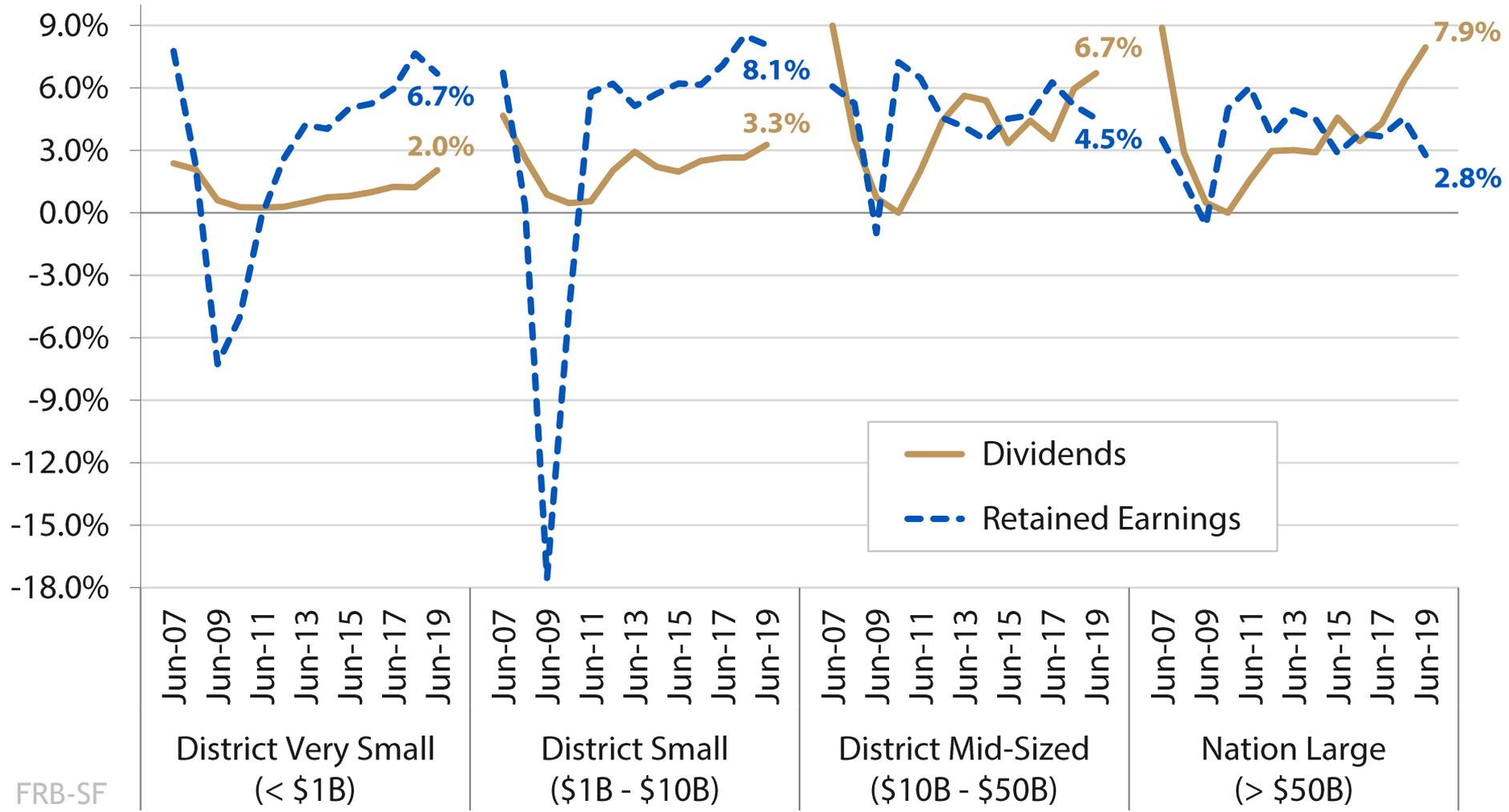


FRB-SF

Average = trimmed mean; YTD = year-to-date (annualized); as of 2Q19, roughly 16% of District very small banks, 5% of District small banks, and none of the mid-sized or large banks were Subchapter S tax filers.

Higher dividend payouts enabled holding company share buybacks, but slowed bank equity formation rates.

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



FRB-SF

Average = trimmed mean; YTD = year-to-date (annualized); as of 2Q19, roughly 16% 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)	
	Jun-18	Jun-19	Jun-18	Jun-19	Jun-18	Jun-19
AK	4 (0)	4 (0)	-	-	1 (0)	1 (0)
AZ	15 (0)	15 (0)	-	-	-	-
CA	148 (3)	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 (0)	4 (0)	4 (0)	3 (0)	4 (1)
OR	16 (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	276 (3)	255 (2)	22 (0)	22 (0)	32 (0)	32 (1)
U.S.	4,807 (12)	4,603 (19)	24 (0)	24 (0)	709 (0)	673 (1)

Based on preliminary second 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:

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