

Economic and Banking Performance
in the Twelfth Federal Reserve District

First Glance 12L

Rate and Funding Shifts Pressured Bank Earnings

2Q23

September 22, 2023

 Federal Reserve Bank
of San Francisco

Key Takeaways

First Glance 12L provides a quarterly look at economic and banking conditions within the Twelfth District.

Economy: Overall, District job growth was solid but slowed mildly during 2Q23, and unemployment rates were generally stable-to-lower in most District states. Home prices, permit activity, and homebuilder sentiment were boosted by limited resale inventories, which sustained demand for newly built homes. Commercial real estate (CRE) markets remained a concern, particularly in the office sector. Many CRE owners continued to face flat or declining property prices, weakening fundamentals, tightening credit conditions, and/or rising debt service costs and operating expenses.

Banking Conditions: Although most of the District’s banks remained profitable, increases in funding costs outpaced improvements in asset yields, weighing on net interest margins. Continued, albeit slowing, growth in costlier time deposits and noncore funding sources drove much of the trend in earnings. Meanwhile, District banks’ bond portfolio values weakened slightly because of rising intermediate-term interest rates, causing persistent pressure on banks’ liquidity options and “book” equity. Regulatory capital ratios generally improved, but performance varied somewhat by bank size. Loan delinquencies and losses in the District remained low overall and median loan growth was positive. Still, some surveyed bankers expected credit standards to tighten slightly in the second half of 2023 given economic uncertainties and concerns around collateral valuations and CRE credit quality.

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This report is based upon preliminary data from commercial bank Condition & Income (Call) Reports, Uniform Bank Performance Reports (UBPRs) as well as other public sources. Data have 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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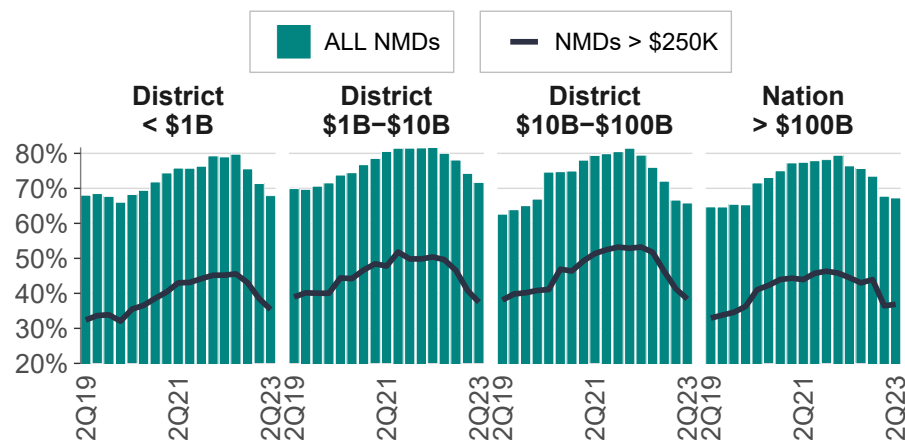
Press inquiries: <https://www.frbsf.org/our-district/press/>

Issues on Our Radar | Liquidity + Market Risk

Shifts in funding mix and cost

- + Low yielding nonmaturity deposits (NMDs) declined at most District banks as depositors responded to rising interest rates in 2022. NMD attrition picked up amid bank turmoil in Spring 2023. Large accounts contributed to the magnitude of NMD growth and runoff (see chart).
- + NMDs were often replaced with costlier “noncore” sources (e.g., CDs above \$250 thousand, smaller brokered deposits, foreign deposits, federal funds purchased, repurchase agreements, and other borrowings), which increased from 4.5% to 12.5% of District banks’ assets in the 12 months ending June. Among Mid-Sized District banks (assets of \$10 billion to \$100 billion), the median ratio reached 20.8%.
- + This funding shift, combined with higher interest rates, pushed the District’s median cost to fund earning assets from 0.16% in 2Q22 (the lowest among the Federal Reserve’s twelve districts) to 1.30% by 2Q23 (fourth highest and above a nationwide bank median of 1.21%).

Median Nonmaturity Deposits / Total Assets by Bank Size

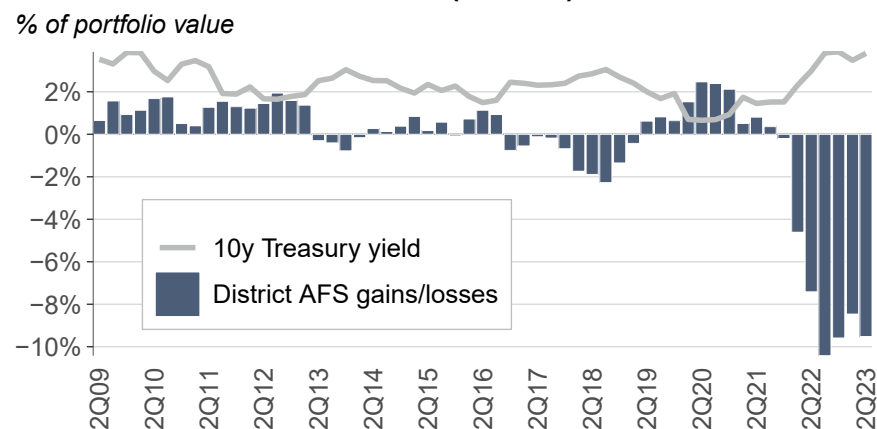


Nonmaturity deposits (NMDs) include checking, money market, and passbook type accounts but excludes time deposits. Source: Bank Call Reports.

Investment portfolio valuation trends

- + In 2022, rising interest rates reduced the fair value of banks’ available-for-sale (AFS) and held-to-maturity (HTM) bond holdings, adding to cumulative net unrealized losses.
- + At 9.5% of fair value, net unrealized losses on AFS securities were notable because they reduced accumulated other comprehensive income (AOCI) within “book” capital per accounting rules (see chart). For most banks, AOCI declines do not affect regulatory capital ratios because of [opt-out election provisions](#) within capital statutes.
- + Still, practical risks to capital posed by declining investment portfolio values increasingly caught the attention of investors and depositors beginning in March 2023. At the same time, unrealized losses on investments narrowed options for funding deposit outflows in the Spring since liquidating securities would force the recognition of losses.

Median Net Unrealized Gains (Losses) on AFS Securities



AFS = available for sale. Sources: U.S. Treasury via Haver Analytics; Bank Call Reports/Uniform Bank Performance Reports (UBPRs).

Issues on Our Radar | Credit

Real estate loan concentrations

- + Banks in the West engage heavily in real estate lending, in particular commercial real estate (CRE) mortgages. The District's median CRE loan-to-capital and allowances ratio of 324%, led by banks based in California and Arizona, remained well above a national median of 203% (see table). Income producing, nonowner-occupied (NOO) collateral backed most of the lending.
- + Rising interest rates may pressure repayment capacity or hamper CRE collateral values if higher financing costs are not offset by a corresponding increase in net operating income. In particular, loans with balloon payments maturing in the near-term may face refinancing risk. Challenges may be most pronounced among office collateral, particularly if located in downtown areas, as further discussed on pages 9 to 11.
- + 1-4 family mortgage (SFR) lending also exposes banks to real estate markets. At 165%, median SFR exposures were more than three times higher among the District's Mid-Sized than its community banks (assets below \$10 billion). Slowing economic conditions could affect demand for and performance of existing SFR mortgages.
- + Real estate loan performance has held up well notwithstanding interest rate and pricing pressures. But given vulnerabilities posed by concentrations, the Federal Reserve, along with other regulators, issued guidance on [Prudent CRE Loan Accommodations and Workouts](#) (SR 23-5) in June 2023. The statement updates and supersedes previous guidance and provides examples of how to classify and account for loans subject to short-term accommodation or longer-term workout.

C&I credit risks

- + As of mid-2023, District banks' commercial and industrial (C&I) loan balances eased further to 52% of tier 1 capital plus allowances on a median basis. C&I exposures generally trail CRE by a wide margin but can be more rate-sensitive and feature less tangible collateral protection. Leveraged C&I loans, which are extended to more heavily levered borrowers and usually feature adjustable-rate pricing, continue to pose heightened risks (see [Shared National Credit](#) results).
- + C&I loan delinquencies and net chargeoffs have edged higher among some District banks in the past year, but overall remain very low. Economic slowing or rising input and debt service costs may challenge some C&I borrowers.

Median CRE Loan Concentration % of tier 1 capital + allowance June 30, 2023		
	Total CRE	NOO CRE
California	372%	266%
Arizona	343%	224%
Washington	324%	234%
Oregon	312%	215%
Nevada	288%	173%
Alaska	254%	174%
Idaho	241%	178%
Hawaii	223%	177%
Utah	184%	112%
Nation	203%	131%

Based upon state of bank headquarters; commercial real estate (CRE) includes owner- and nonowner-occupied (NOO) non-farm-nonresidential (NFNR), multifamily (MF), construction and land development (C&LD), and other CRE purpose loans; NOO CRE excludes owner-occupied (OO) NFNR mortgages. Sources: Call Reports/UBPRs.

Issues on Our Radar | Operations

Cybersecurity

- + Cyber remains a top risk given an ever-growing multitude of threats, particularly amid nation-state sponsored cyber activity. Ransomware with double extortion, phishing campaigns, API security, cloud misconfiguration, patch management, rising cyber insurance premiums, and supply chain compromises are the primary cyber issues facing supervised institutions, their customers, and their suppliers.
- + The increase in digital financial services and mobile banking has exponentially expanded the attack surface that criminals can exploit. In addition, cybercrime tools backed by artificial intelligence have paved the way for sophisticated and convincing phishing campaigns and malware mutations, leading to increased risk.
- + The MOVEit vulnerability was initially identified on May 31, and posed widespread [potential exposure](#) to banking and other organizations. Progress Software, the owner of the MOVEit file transfer product, has issued patches and service packs to address the vulnerability.
- + On July 26, the Securities and Exchange Commission adopted a [final rule](#) requiring the disclosure of material cybersecurity incidents as well as cybersecurity risk management, strategy, and governance by public companies and foreign private issuers. This is in addition to the [banking agencies' 2022 incident notification rule](#), which requires a depository to notify its primary federal regulator of any significant computer-security incident within 36 hours of detection.

Enterprise complexity due to novel activities

- + Networks of multiple complex third/fourth party relationships stemming from the adoption of crypto-asset services, bank-fintech partnerships (such as Banking-as-a-Service models), and other novel activities are drivers for heightened concern. Vulnerabilities can be compounded if revenues, funding, or assets are concentrated in a novel business line or if the risk appetite for engaging with nonbank partners gets ahead of the control environment.
- + On June 7, the banking agencies issued [Interagency Guidance on Third-Party Relationships: Risk Management](#) (SR 23-4), which applies to all types of third-party relationships, including those with new or novel structures or features. The guidance offers principles that banks should consider when developing and implementing risk management for all stages in the life cycle of third-party relationships.
- + In August, the Federal Reserve announced a [Novel Activities Supervision Program](#) (SR 23-7) to enhance the supervision of novel activities conducted by Federal Reserve-supervised banking organizations.



Issues on Our Radar | Compliance + Other

Real time payment (RTP) adoption

- + The [FedNow® Service](#), launched by the Federal Reserve in July, has been adopted by more than [50 depositories](#). An [IntraFi Network survey](#) found that most bankers were either considering or planned to implement the service.
- + RTP activity has increased significantly in recent years. For instance, in 2Q23 alone, the number and dollar volume of transactions on The Clearing House’s [RTP® Network](#) grew 12% and 18% to 58 million and \$29 billion, respectively.
- + As noted in an [Atlanta Fed article](#), the instantaneous and irrevocable nature of RTPs requires heightened risk controls around liquidity, third-party vendor relationships, fraud, and BSA/AML and consumer compliance.

Bank Secrecy Act/Anti-Money Laundering (BSA/AML) compliance and fraud

- + BSA/AML monitoring remains heightened because of the District’s role in the global economy, the array of activities being conducted by institutions, including digital asset related services, and the evolving nature of threats and regulatory guidance.
- + On May 19, FinCEN and the Department of Commerce’s Bureau of Industry and Security (BIS) issued a [supplemental alert](#) urging financial institutions to be vigilant against efforts to evade BIS export controls vis-a-vis Russia’s invasion of Ukraine. The alert contains new BIS restrictions, evasion typologies, and red flags, and emphasizes nine high priority import/export control codes that can be used to inform customer due diligence.
- + On June 27, the Financial Action Task Force (FATF) – a global standard-setting body – [updated](#) its anti-money laundering and counter terrorist financing standards to include virtual assets and virtual asset service providers (VASPs). FATF found that jurisdictions continue to struggle with fundamental requirements such as risk assessments, VASP regulation, and supervisory inspections.

Consumer compliance regulatory developments

- + In March 2023, the Consumer Financial Protection Bureau (CFPB) finalized its [Small Business Lending Data Collection](#) rule, which will have a phased-in effective date based upon the number of covered originations in 2022 and 2023. Larger originators are required to begin collecting data on October 1, 2024.
- + Also pending is the [Interagency Community Reinvestment Act](#) (proposed in May 2022), which is expected to be finalized this year.
- + The CFPB launched an initiative to identify “exploitative [junk fees](#),” which resulted in guidance related to [debt collection “pay-to-pay” fees](#) and [overdraft/returned deposited item fees](#) in 2022. Relatedly, in early February 2023, the agency proposed a rule to curb [excessive credit card late fees](#).



To learn more about key issues, see the Federal Reserve’s semi-annual reports on [Supervision and Regulation](#) and [Financial Stability](#).

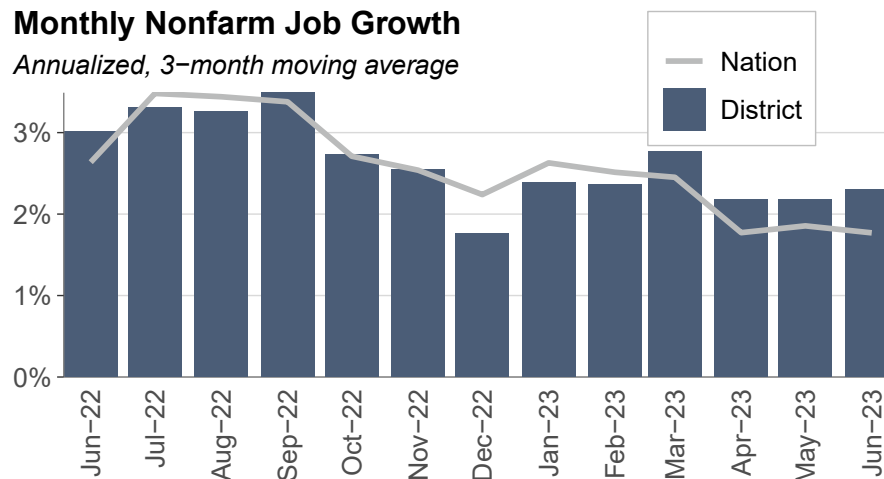
Twelfth District Economy | Employment

Trailing monthly job growth was solid but slowed between March and June.

- + On average, monthly job growth cooled during 2Q23, easing to 2.33% (annualized, three-month moving average basis). However, the District outpaced a slowing national rate of 1.56% (see chart).
- + The education/health, leisure/hospitality, and government sectors remained important drivers of net new hiring in the District. In contrast, average payrolls in the wholesale trade, manufacturing, and information (media and some tech-related jobs) declined quarter-over-quarter.
- + Among the District's states, 2Q23 job growth was strongest (on an average monthly annualized basis) in Utah (+2.83%), California (+2.66%), and Washington (+2.62%). Average job gains were positive but cooled in previously fast-growing Idaho (+2.02%) and Nevada (+1.48%). Meanwhile, average growth was negative in Hawaii (-0.82%) and Alaska reported very modest payroll gains (+0.26%).

Monthly Nonfarm Job Growth

Annualized, 3-month moving average

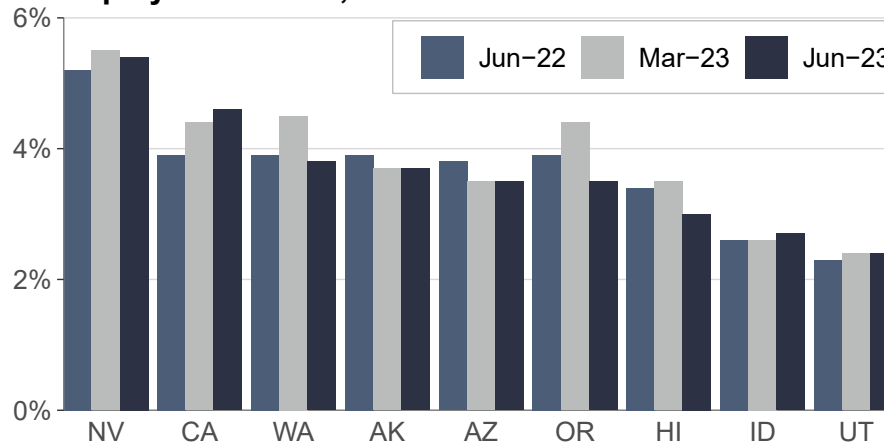


Seasonally adjusted. Source: Bureau of Labor Statistics.

Unemployment rates were flat-to-lower with the exception of California and Idaho.

- + On a seasonally-adjusted basis, the Districtwide unemployment rate eased to 4.13% in June, down slightly from 4.21% in March. The District's aggregate jobless rate remained above a nationwide average of 3.60%, which edged up 10 bps quarter-over-quarter.
- + Other than California and Idaho, state level unemployment rates in the District were stable-to-lower over the three month period, particularly in Washington, Oregon, and Hawaii (see chart).
- + Jobless rates in Nevada and California, which topped 4.40%, remained among the highest in the nation, while Utah's continued to rank among the lowest in the U.S.
- + Unemployment claims increased in some states after June. In particular, Hawaii experienced more than a three-fold increase in initial claims between June and August following Maui's wildfires.

Unemployment Rates, Twelfth District States



Seasonally adjusted. Source: Bureau of Labor Statistics.

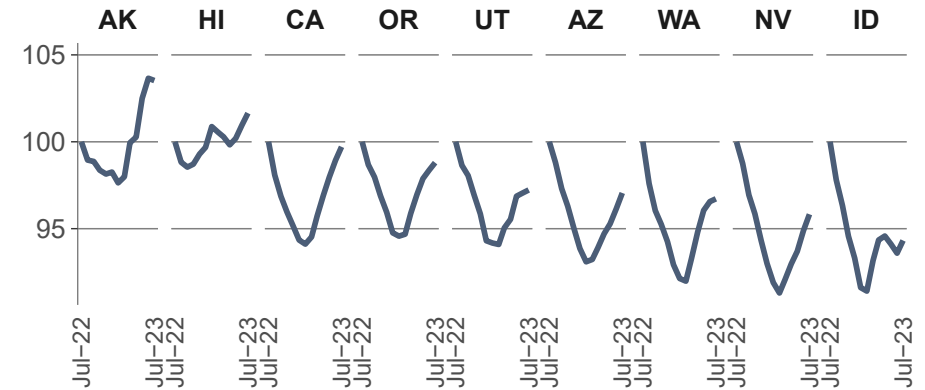
Twelfth District Economy | Housing

Home prices continued to recover in most District states despite higher mortgage interest rates.

- + Per CoreLogic, single-family home price indices (HPIs) peaked in most District states around mid-2022 and then weakened during the second half of the year. By early 2023, prices started to improve slightly month-over-month, influenced by tight for-sale inventories (see chart).
- + Although stronger on a monthly basis, July 2023 HPIs trailed year-ago levels in most District states, most notably in Idaho (-6%), Nevada (-4%), and Washington (-3%). California's statewide HPI had nearly recovered to prior year levels, but some of the state's more expensive markets – primarily in the San Francisco Bay Area – remained down 4% to 6% year-over-year.
- + Prices remained well above July 2020 levels, most notably in Arizona (+50%), Utah (+39%), and Nevada (+38%), where gains were influenced in part by people moving in from higher cost markets.

Home Price Index, Twelfth District States

Jul-22 = 100



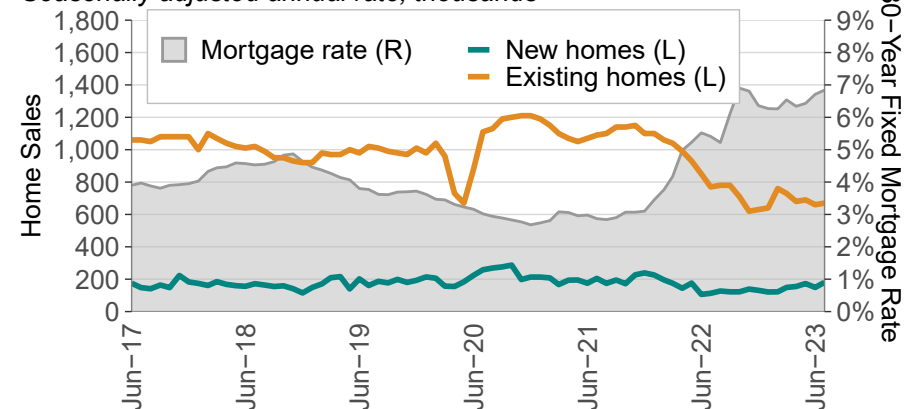
Index covers attached and detached single-family homes, including distressed sales. Sources: CoreLogic, SF Fed calculations.

Existing home sales volumes remained subdued amid relatively tight for-sale inventories.

- + The number of existing single-family home sales in the West softened during 2Q23 after edging up earlier in the year. The count of new home sales gained some traction, but both series remained below pandemic-era peaks (see chart).
- + Tighter inventories likely contributed to weaker sales volumes and upward price pressures in 2023. Data from [Redfin](#) (not seasonally adjusted) suggests aggregate for-sale inventories in the District averaged 2.1 months' worth of sales during the three months ending July, down from 3.2 months in the final quarter of 2022.
- + The July 2023 [National Association of REALTORS®](#) pending home sales index for the West, which leads finalized sales by one to two months, remained below prior-year levels. Low for-sale inventories were a factor. Future sales will remain reliant on the volume of listings, the path of mortgage interest rates, and the health of the economy.

Single-Family Home Sales, West Region

Seasonally adjusted annual rate, thousands



West = District plus CO, MT, NM, and WY. Sources: National Association of REALTORS® (© 2023; all rights reserved; reprinted with permission), Census Bureau, Freddie Mac.

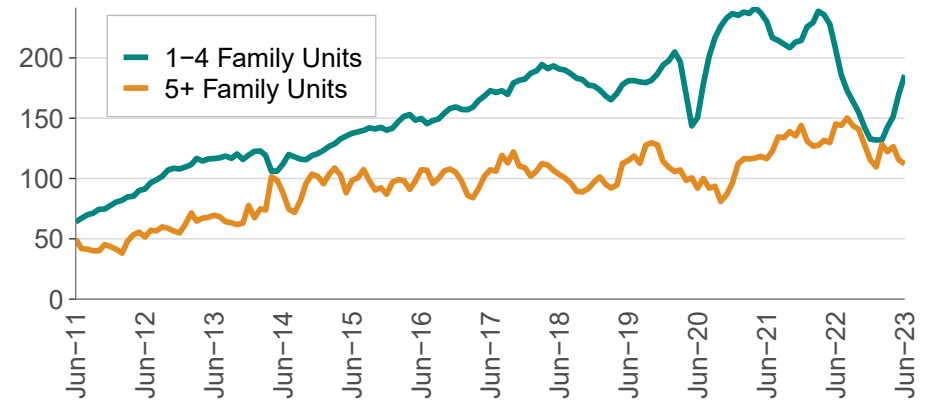
Twelfth District Economy | Housing + Commercial Real Estate

1-4 family permit activity heated up in the first half of 2023.

- + The District's average 1-4 family housing permit volume continued to rebound (see chart). Limited resale inventory increased demand for new homes according to the [National Association of Home Builders \(NAHB\)](#). Although 1-4 family permit activity approached pre-pandemic levels, it lagged robust pandemic-era volumes.
- + Multifamily (5+ unit) permit issuance remained comparatively volatile, trending lower overall in the past quarter and year, both in the District and nationally. Reduced multi-housing permit volumes in Arizona, Utah, and Washington led the District's quarterly trend.
- + The West's August 2023 [NAHB/Wells Fargo Housing Market Index](#), a measure of homebuilder confidence, was 46. The measure dipped 8 points from the prior month but was 21 points above its prior trough in December 2022. Although improved year-to-date, the sub-50 index indicated slightly more homebuilders were bearish than bullish.

Housing Permits, Twelfth District

Seasonally adjusted annual rate, 3-month avg., thousands



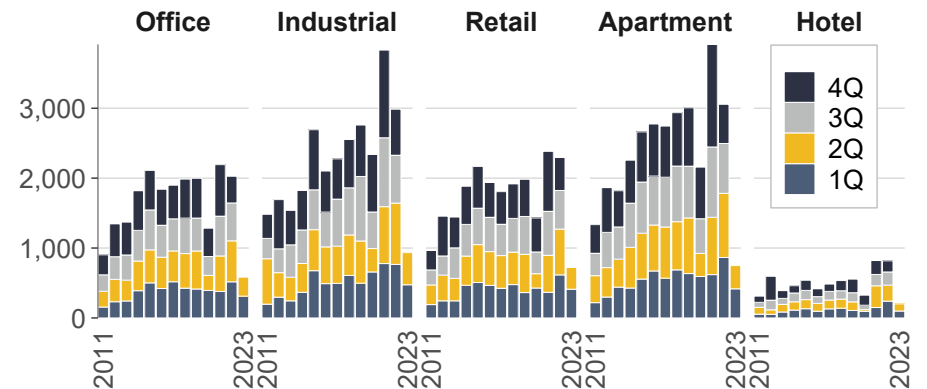
Source: Census Bureau via Haver Analytics.

CRE sales transaction volumes remained weak amid higher interest rates and subdued investor and lender appetite.

- + Per MSCI/Real Capital Analytics (RCA), CRE transaction volumes in the West lagged prior quarter, year ago, and pre-pandemic (2Q19) levels (see chart). The aggregate number of property sales in the region during the first half of 2023 (all sectors) was down nearly 50% year-over-year. However, 2022's record high first half deal counts partly contributed to the magnitude of year-over-year decline.
- + In addition to a normalizing pace, sales trends likely reflected higher interest rates, rising capitalization (cap) rates, slowing economic activity, tighter lending, and divergent buyer-seller expectations.
- + CRE investor appetite was subdued but improving. A 2Q23 [CRE Finance Council](#) survey noted overall cautious sentiment amid concerns over mortgage and cap rates and CRE fundamentals. Likewise, the 3Q23 [Real Estate Roundtable](#) CRE sentiment survey reported challenging conditions for property values and debt and equity availability but a slight improvement in overall outlook.

CRE Transactions, West Region

Number of properties sold



Includes transactions of properties valued \$2.5 million and above; West = District plus CO, MT, NM, and WY. Source: MSCI/Real Capital Analytics.

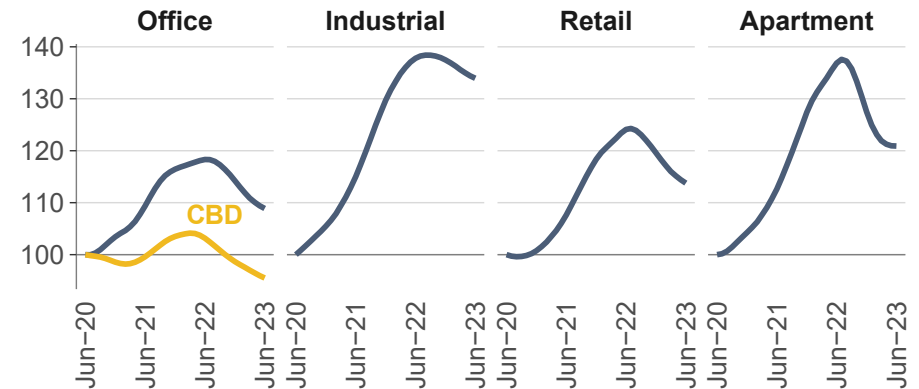
Twelfth District Economy | Commercial Real Estate

Commercial property price indices receded further.

- + MSCI/RCA's national office price index ended June down 8% from its 2022 peak, with central business district (CBD) offices losing further ground from their price level three years ago (see chart). Persistent hybrid/remote work has weighed heavily on the sector.
- + Nationally, MSCI/RCA's apartment and retail property price indices shed 12% and 8%, respectively, from their 2022 peaks (see chart). Industrial property prices, which have been comparatively resilient, have dipped 2% since peaking in Fall 2022.
- + Likewise, the 2Q23 [CoStar Commercial Repeat-Sales Index](#) declined year-over-year in the West (District plus Colorado and New Mexico), led by weakness in the multifamily (-14%) and office (-8%) sectors.
- + Rising interest rates/capitalization rates, pressures on rents and net operating incomes, and ongoing secular shifts (e.g., retail, office) contributed to pricing trends.

Commercial Property Price Indices, Nation

Jun-20 = 100



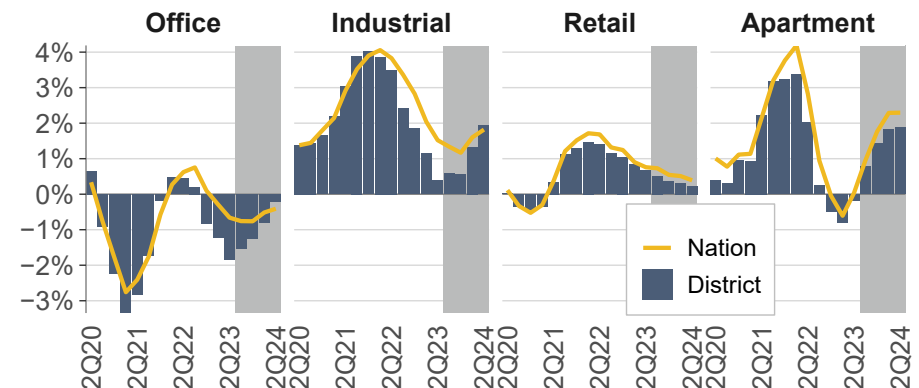
Based upon repeat-sales transactions; CBD = central business district. Sources: MSCI/Real Capital Analytics, SF Fed calculations.

Demand for commercial space weakened, especially in the office sector.

- + The trailing four-quarter absorption rate remained negative in the District's office sector in 2Q23 (see chart). CBRE-EA expects that more office space will be vacated than newly leased, on net, over the near term given hybrid/remote work trends and weaker economic prospects.
- + Most major District apartment markets also experienced negative absorption on net in the 12 months ending June, albeit at a slower pace than recent quarters. Forecast data from CBRE-EA suggests net absorption for apartments will turn positive in the coming year.
- + Industrial and retail absorption rates also slowed in the second half of 2022/first half of 2023, but remained positive on net. In aggregate, retail absorption is more likely than industrial to weaken in the coming twelve months per CBRE-EA.

CRE Absorption Rates

Rolling 4-quarter absorption as % of ending stock, shaded area = forecast



Includes the 16 to 18 largest markets in the District, depending on the sector. Sources: CBRE-EA, SF Fed calculations.

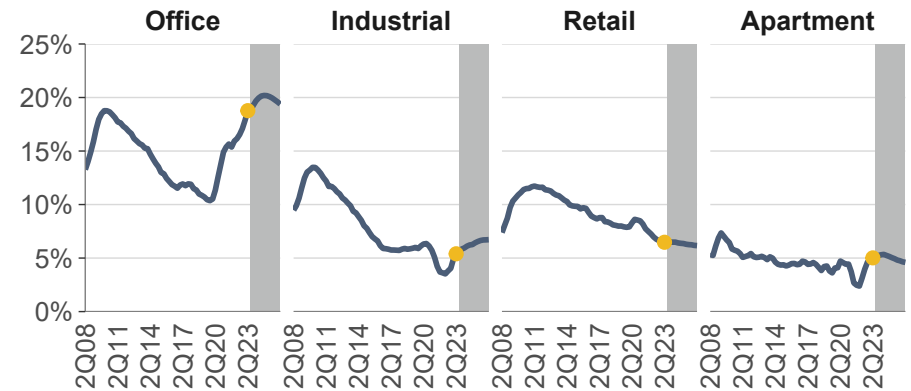
Twelfth District Economy | Commercial Real Estate

Vacancy rates increased among office, industrial, and apartment properties; retail occupancy was relatively stable.

- + Office vacancy rates increased across most District markets during the quarter and reached Great Recession peaks (1Q10) in aggregate (see chart). CBRE-EA expects office vacancy rates to move higher in the near term as tenants re-calibrate space needs.
- + Although still in the low-to-mid single digits, apartment vacancies edged up in most major District markets. CBRE-EA expects an elevated pace of completions in the coming quarters to be absorbed, limiting the impact on aggregate vacancy rates.
- + Industrial availability continued to move up from very low levels amid new construction. Industrial availability rates may edge higher as new construction outpaces absorption.
- + Retail property vacancy rates were generally stable-to-lower quarter-over-quarter amid limited new supply. Availability rates may improve slightly in coming quarters per CBRE-EA.

Avg. CRE Vacancy Rates, Twelfth District, 2Q08 – 2Q26

Weighted by stock, shaded area = 3-year forecast



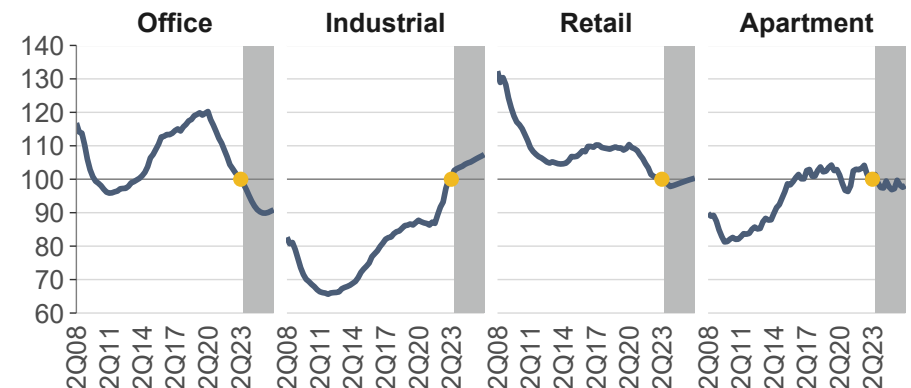
Weighted across 16 to 18 large District markets; office/apartment = vacancy rate; industrial/retail = availability rate. Sources: CBRE-EA, SF Fed calculations.

Real commercial property rents remained under pressure, other than in the industrial sector.

- + Inflation-adjusted (real) rents for office space contracted further across nearly all major District markets. CBRE-EA expects office rents to decline further – generally another 4% to 10% depending upon the market – in the coming year.
- + Real retail rents also continued to dip in most of the District’s major metros. CBRE-EA forecasts suggest that retail property rents may slip modestly in the near term and then stabilize (see chart).
- + Average real apartment rents declined year-over-year across the District’s major markets and may ease further in the coming year.
- + Meanwhile, CBRE-EA expects real industrial rents to strengthen in the near term in most District markets, albeit at a slowing pace.

CRE Real Rent Indices, Twelfth District, 2Q08 – 2Q26

Weighted by stock, shaded area = 3-year forecast, 2Q23 = 100



Weighted across 16 to 18 large District markets; office/industrial = asking rents; retail/apartment = effective rents. Sources: CBRE-EA, SF Fed calculations.

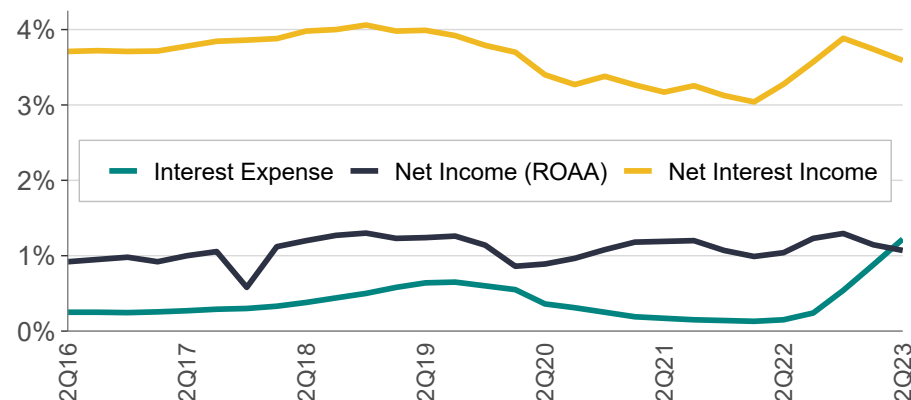
Twelfth District Banking Conditions | Earnings

Profit ratios generally weakened among the District's banks.

- + During 2Q23, District banks earned a median quarterly return on average assets (ROAA) of 1.07%, down 8 bps from 1Q23 and up only slightly from 2Q22 (adjusted for Subchapter S effects). Although weakening, quarterly earnings performance was slightly better than a nationwide median of 1.00%.
- + A full quarter of elevated noncore funding, in tandem with rising short-term interest rates and deposit pricing competition pressured funding costs, margins, and profits (see chart).
- + The 2Q23 Conference of State Bank Supervisors (CSBS) [Community Bank Sentiment Survey](#) found a growing share (44%) of bankers in the West (Twelfth District plus Montana) expected profits to weaken in the coming year, up 5 percentage points from 1Q23. Profit concerns were likely influenced by recent margin compression and sentiment about business conditions and monetary policy.

Median Earnings Ratios, Twelfth District

% of avg. assets, 1-quarter annualized



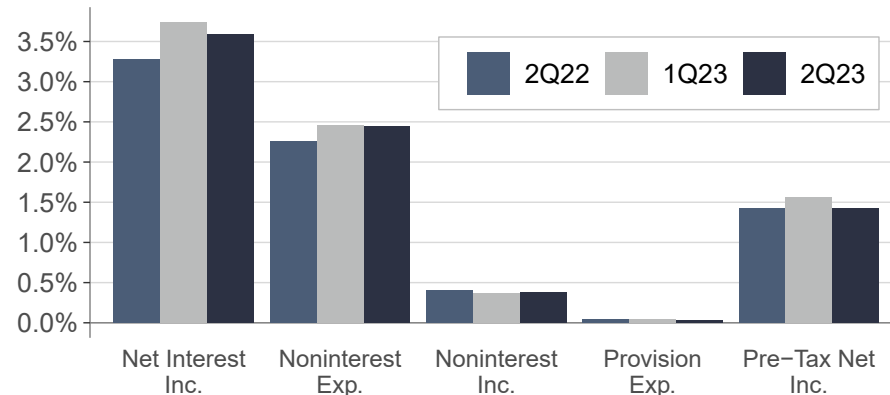
ROAA (net income / average assets) for Subchapter-S filing banks is adjusted for theoretical tax expense. Sources: Bank Call Reports/UBPRs.

Funding costs drove banks' earnings trends.

- + Increases in funding costs typically outpaced changes in asset yields. District banks' median one-quarter (annualized) net interest income-to-average assets ratio eased to 3.59%, down 15 bps from 1Q23 (see chart). Quarter-over-quarter, the median interest income ratio expanded 19 bps but the median interest expense ratio increased 34 bps to 1.22%, a level not seen since Fall 2009.
- + Quarterly noninterest income and expense items generally held steady in relation to average assets.
- + Loan loss provision activity declined at some firms. Overall, 58% of District banks incurred (generally mild) provision expenses during the quarter, down from 65% in 1Q23. The share releasing reserves nearly doubled quarter-over-quarter – albeit from a low level – to 11%.

Median Pre-Tax Net Income Breakdown, Twelfth District

% of avg. assets, 1-quarter annualized



Sources: Bank Call Reports/UBPRs.

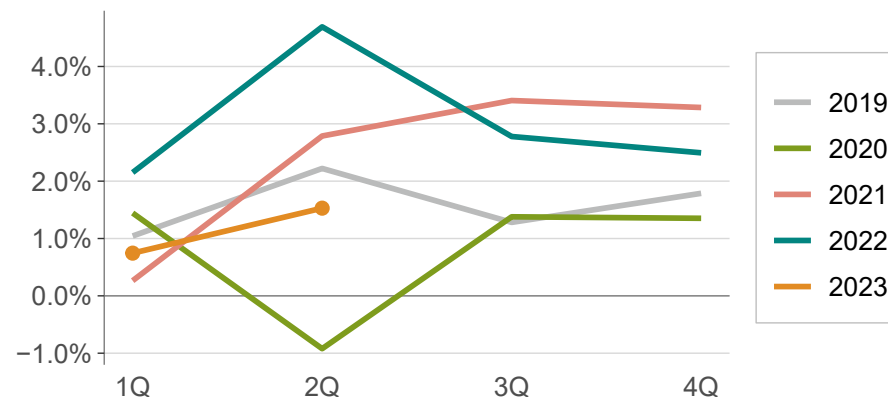
Twelfth District Banking Conditions | Growth + Concentrations

Annual and quarterly loan and lease growth were positive.

- + Year-over-year, most District banks expanded their loan portfolios but growth decelerated to 9.4% on a median basis, which trailed a likewise-easing nationwide rate of 10.8%.
- + Meanwhile, median quarterly loan growth improved to 1.52% (not annualized), up slightly from 1Q23. Given historical trends, seasonal factors likely led the acceleration and may tamp gains in 3Q23 (see chart). The pace of net new lending among C&LD, nonfarm nonresidential, and SFR loan portfolios tended to offset weakness among the multifamily, C&I, and consumer loan categories.
- + Respondents to the Fed’s July [Senior Loan Officer Opinion Survey \(SLOOS\)](#) and IntraFi Network’s 2Q23 [Bank Executive Business Outlook Survey](#) tended to report weakening loan demand. The IntraFi survey also found that 46% expected future loan demand to soften, a slight improvement from surveys in the second half of 2022.

Median Net Loan Growth, Twelfth District

1-quarter % change (not annualized), excluding PPP



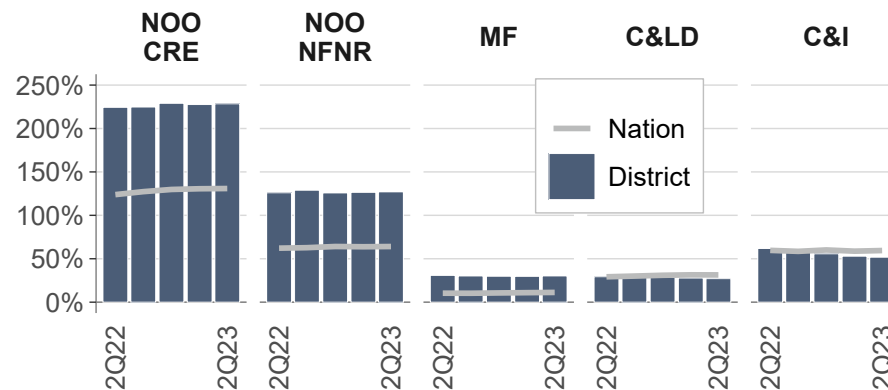
Growth rates are not adjusted for merger-related growth; excludes Paycheck Protection Program (PPP) loans. Sources: Bank Call Reports.

CRE loan exposures remained high and stable; C&I concentrations continued to recede.

- + At 228%, the District’s median nonowner-occupied (NOO) CRE concentration ratio – including NOO NFNR, multifamily (MF), C&LD, and other CRE purpose loans – remained nearly 100 points above the nation (see chart).
- + Separately, owner-occupied (OO) CRE mortgages edged up slightly to 83% of tier 1 capital plus allowances, also above a nationwide median (58%).
- + SFR loan concentration ratios, which had been edging higher since mid-2021, hovered near 56% of capital and allowances on a median basis, still less than half of what banks typically report nationwide.
- + C&I loan exposures continued to slip in relation to capital and allowances, settling at 52%, which was below the national median by 6 percentage points.

Median Loan Concentrations

% of tier 1 capital + ALLL or ACL



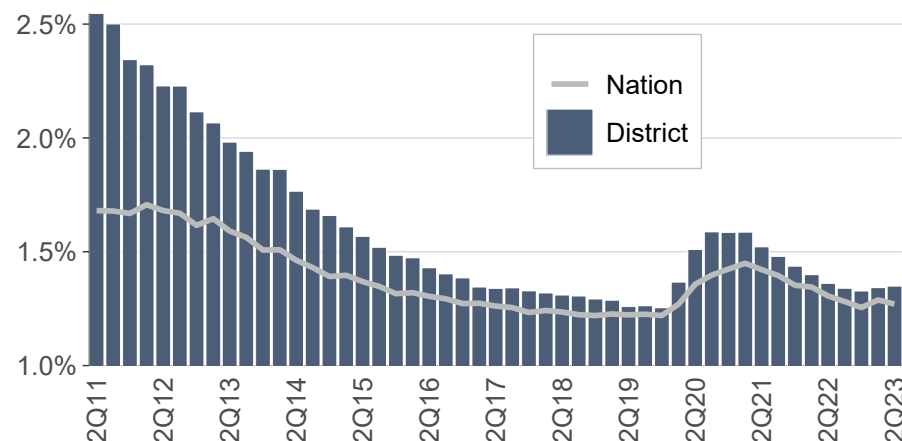
Sources: Bank Call Reports/UBPRs.

Twelfth District Banking Conditions | Allowances + Underwriting

Median allowance-to-loan ratios were stable; bankers remained concerned about prospective credit conditions.

- + The median ratio of ACL (or ALLL)-to-non-PPP loans among District banks was 1.35%, similar to the prior quarter and year-ago levels. District banks' allowance ratios remained slightly above the nationwide bank median, which slipped 2 bps to 1.27% (see chart).
- + Allowances were roughly 3.9 times the volume of noncurrent loans, comparable to a nationwide median, but down somewhat steadily from a peak multiple of 5.3 times in 3Q22.
- + According to the 2Q23 [CSBS Community Bank Sentiment Survey](#), more than two-thirds (69%) of bankers in the West expected business conditions to weaken in the coming year, up slightly from the prior and year-ago quarters.

Median ALLL or ACL / Non-PPP Loans & Leases not HFS

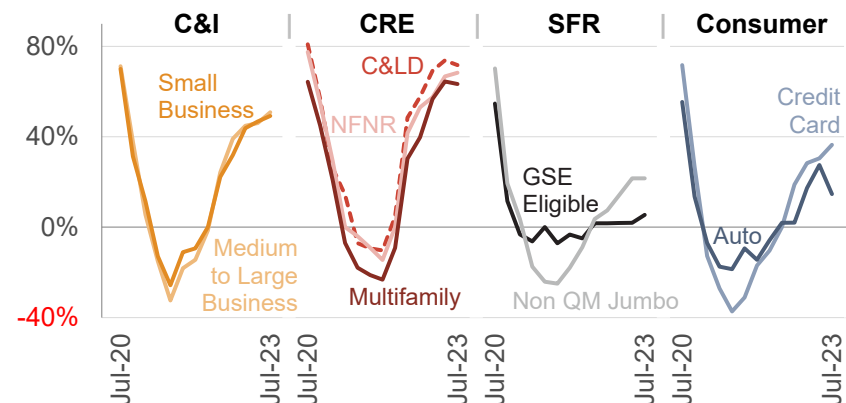


Limited to loan and lease related allowances. Sources: Bank Call Reports.

Credit standards tightened further at many banks while demand weakened.

- + Per the Federal Reserve's [July 2023 SLOOS](#), the share of lenders that reported tightening standards for C&I and CRE loans remained elevated (see chart). About half of respondents also noted ebbing CRE and C&I loan demand. Historically, tighter credit and weaker demand have preceded recessions.
- + Outside of GSE-eligible mortgages, more than 10% of lenders on net also tightened standards on loans to households.
- + Across major loan categories, underwriting was, on balance, near the stricter end of the range relative to the "midpoint" since 2005.
- + At least 40% of surveyed bankers expected to toughen commercial lending terms during the second half of 2023. Those respondents commonly cited a less favorable or more uncertain outlook, expected deterioration in collateral values, and/or worsening CRE credit quality as "somewhat" or "very important" to their plans.

Net Percent Reporting Tighter (Easier) Loan Standards % of surveyed loan officers



Share reporting tighter minus share reporting easier standards; QM = qualified mortgage; GSE = government sponsored enterprise. Source: Federal Reserve.

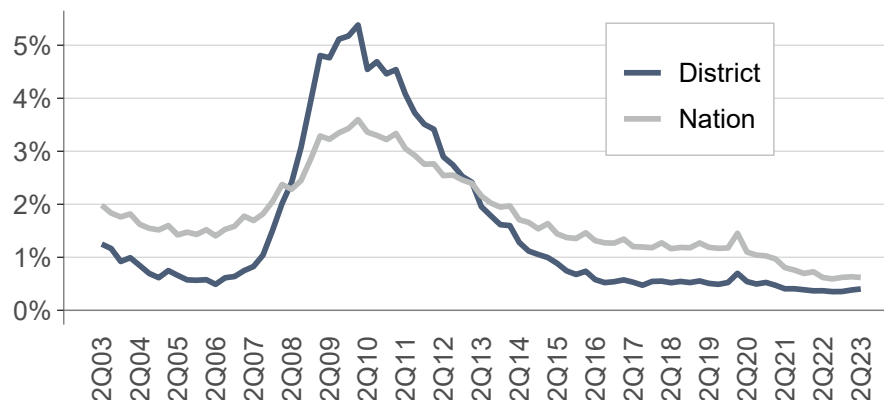
Twelfth District Banking Conditions | Loan Performance

Loan and lease delinquencies were low and relatively stable at most banks.

- + District banks' median noncurrent loan ratio – which includes credits 90+ days delinquent or on nonaccrual – ticked up 1 bp to 0.18% during 2Q23. This continued to trail pre-pandemic levels and ranked as the lowest median noncurrent loan rate among all twelve districts.
- + Including credits 30-89 days past due, the overall delinquency rate moved up 2 bps to 0.40% of gross loans. Although increasing, the ratio also remained below a national median of 0.62% (see chart).
- + Districtwide, median past-due ratios among major loan categories were generally low or eased quarter-over-quarter. C&I was the only category where delinquencies tended to be both elevated (in relation to other loan types) and increasing on a median basis.

Median Past Due Loan Rates

Excluding PPP loans



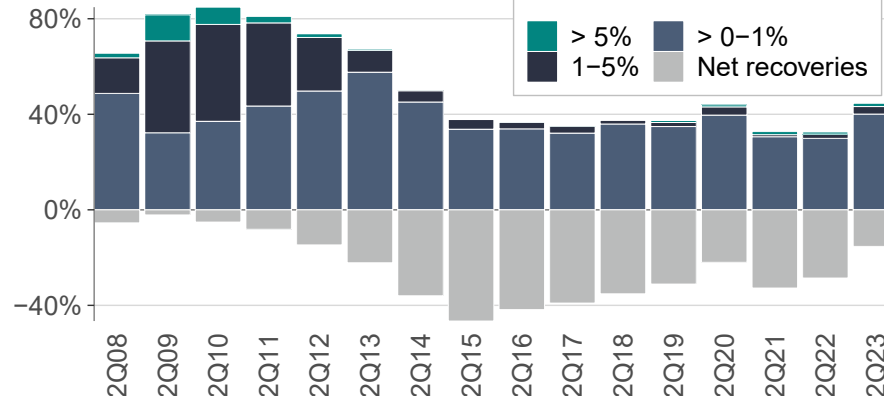
Past due includes 90+ days or nonaccrual (noncurrent) plus 30-89 days past due; excludes Paycheck Protection Program (PPP). Source: Bank Call Reports.

First half net chargeoff activity edged higher year-over-year.

- + Roughly 45% of the District's banks recorded net loan losses year-to-date through June, up from 33% in the first half of last year. Meanwhile, 15% reported net recoveries, down from 29% in 2022. Although the share incurring net chargeoffs increased year-over-year, annualized loss rates generally remained below 1% (see chart).
- + Write-downs among C&I and consumer loan portfolios tended to drive the year-over-year increase in net chargeoffs.
- + The trajectory of the economy could affect future loss rates. Two-thirds of community bankers in the West surveyed by [CSBS](#) in June expected business conditions to weaken prospectively. Similarly, more than half (55%) of bankers surveyed by [IntraFi Network](#) in early July were not upbeat about future conditions. The [Association of International Certified Professional Accountants](#) and [National Federation of Independent Business](#) found cautious albeit improving economic expectations among businesses in August.

Share of Banks with Net Chargeoffs, Twelfth District

Year-to-date, second quarter of each year, as % of avg. loans & leases



Sources: Bank Call Reports/UBPRs.

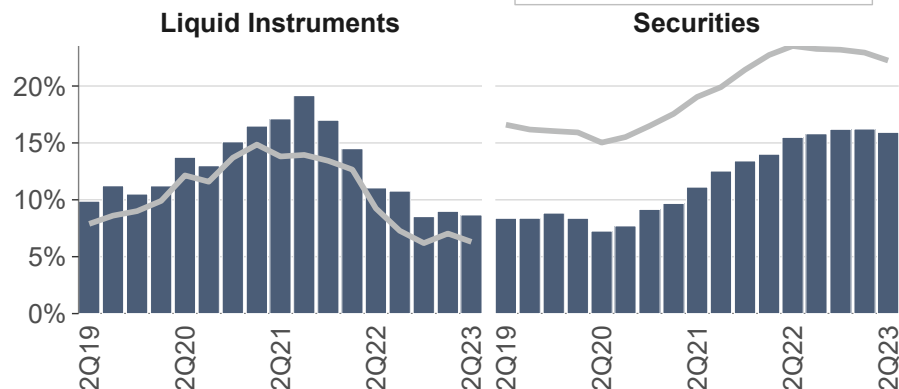
Twelfth District Banking Conditions | Liquidity

Liquid asset buffers dipped quarter-over-quarter.

- + By mid-2023, liquid instruments (i.e., cash, due from accounts, federal funds sold, and reverse repurchase agreements) represented 8.7% of assets on a median basis, down slightly from 9.0% in 1Q23, and well off of a pandemic-era peak of 19.2%. Some banks used cash to pay down borrowing lines that were drawn during turmoil in the Spring.
- + Securities also eased as a share of District banks' assets, in part a function of paydowns on amortizing securities such as MBS. The trend was also likely influenced by declines in the fair value of AFS securities amid higher intermediate-term interest rates.
- + Combined, accumulated other comprehensive losses and tax-adjusted net unrealized losses on HTM securities represented roughly 10% of District banks' tier 1 capital on a median basis. This median level of "paper" losses was the lowest among the Fed's twelve districts, due mainly to comparatively smaller securities portfolios.

On-Balance Sheet Liquidity

Median % of total assets

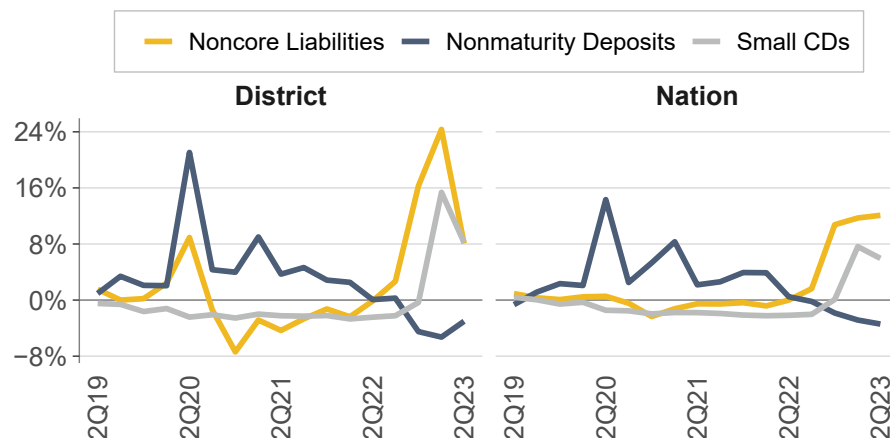


Liquid instruments include cash, due from accounts, federal funds sold, reverse repurchase agreements. Sources: Bank Call Reports.

NMD runoff and growth in small certificates of deposit (CDs) and noncore liabilities continued, but at a slowing pace.

- + Outflows of NMDs (i.e., deposits other than CDs) persisted, but at a more moderate rate than in 1Q23. On a median basis, NMD balances declined 3.0% across the District's banks versus a runoff rate of 5.3% in the prior quarter. By midyear, NMDs backed just under 70% of District banks' assets, down 10 percentage points from a mid-2022 peak, but similar to pre-pandemic levels.
- + NMD runoff was replaced with small CDs (less than \$250 thousand each) and/or noncore liabilities, also at a slowing pace. Quarter-over-quarter, growth in small CDs slowed to 8.2% and noncore funding decelerated to 8.1%. Swings in funding within the District were generally more pronounced than seen nationally (see chart).
- + By mid-2022, noncore liabilities and small CDs funded 12.5% and 6.4% of District bank assets, respectively, on a median basis, up from less than 5.0% each one year prior.

Median Quarterly Liability Growth



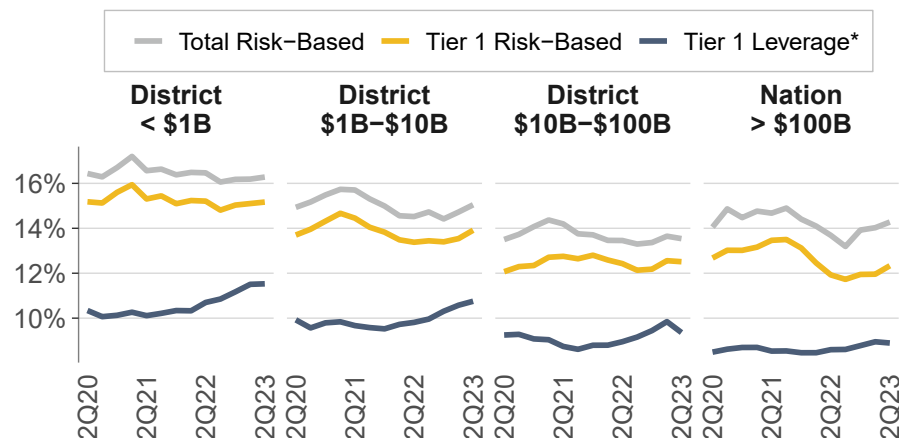
Noncore includes large CDs, small brokered accounts, foreign deposits, federal funds purchased, repurchase agreements, and borrowings; nonmaturity deposits exclude CDs. Sources: Bank Call Reports/UBPRs.

Twelfth District Banking Conditions | Capital

Regulatory capital measures were generally stable-to-higher, with some variation by bank size.

- + District banks' median tier 1 leverage ratio was 10.86%, up 13 bps quarter-over-quarter. Improvement was more common among the District's community banks (assets under \$10 billion) than its Mid-Sized firms (assets \$10 billion to \$100 billion) (see chart).
- + Median tier 1 and total risk-based capital (RBC) ratios also increased slightly overall. As with the leverage ratio, however, median RBC measures dipped mildly among Mid-Sized banks.
- + Negative AOCI continued to weigh on "book" capital ratios. Nearly all banks avoid AOCI inclusion in regulatory capital measures via an [opt-out](#) election provision within capital statutes.

Median Regulatory Capital Ratios by Bank Size



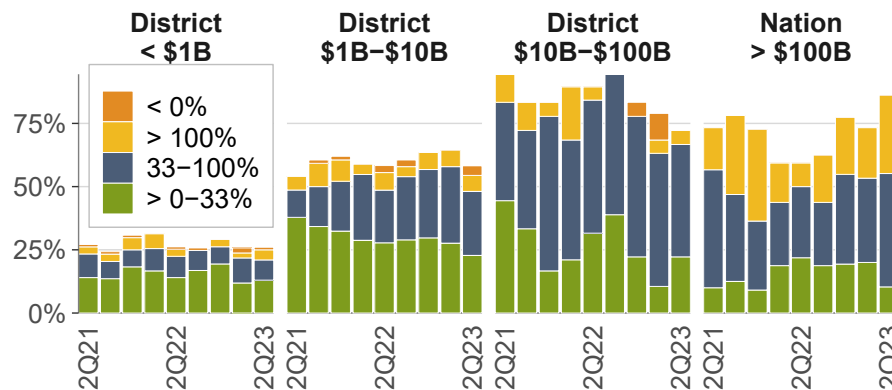
*Includes community bank leverage ratio (CBLR) reporters; CBLR banks excluded from RBC ratios beginning in 2020. Sources: Bank Call Reports/UBPRs.

The share of banks paying dividends varied by tax status and bank size.

- + Less than half (43%) of the District's non-Subchapter S banks paid dividends during 2Q23, comparable to the same quarter last year.
- + The frequency and magnitude of dividend payouts remained higher with increasing bank size (see chart).
- + For banks that are under a holding company, dividend payments upstreamed to the parent company are typically used to fund corporate dividends or repurchase shares at the consolidated firm. Holding companies that are larger tend to be publicly traded and more likely to engage in capital actions.
- + Payout rates tend to be high among Subchapter S tax filing banks, which use distributions to fund pass-through shareholder tax obligations atop investor returns. The District's 25 Subchapter S tax filing banks paid out a median 62% of profits during the quarter compared with 49% among Subchapter S-filing banks nationwide.

Cash Dividends by Bank Size

Share of C-corp banks paying dividends, as % of quarterly net income



Excludes banks with Subchapter-S tax treatment, which distribute funds to cover owners' taxes atop investor returns. Sources: Bank Call Reports/UBPRs.

Appendix | Technical Information + Abbreviations

Summary of Institutions by State & Technical Notes

Area	Commercial Banks (De Novos)		Industrial Banks (De Novos)		Savings Institutions (De Novos)	
	Jun-23	Jun-22	Jun-23	Jun-22	Jun-23	Jun-22
Alaska	4 (0)	4 (0)	-	-	1 (0)	1 (0)
Arizona	13 (3)	16 (3)	-	-	1 (0)	1 (0)
California	116 (4)	120 (2)	3 (0)	3 (0)	9 (0)	9 (0)
Guam	2 (0)	2 (0)	-	-	1 (0)	1 (0)
Hawaii	4 (0)	4 (0)	1 (0)	1 (0)	2 (0)	2 (0)
Idaho	10 (0)	10 (0)	-	-	1 (0)	1 (0)
Nevada	11 (0)	11 (1)	4 (0)	4 (0)	1 (0)	2 (0)
Oregon	13 (0)	13 (0)	-	-	2 (0)	2 (0)
Utah	25 (1)	26 (1)	15 (2)	15 (2)	1 (0)	1 (0)
Washington	33 (0)	34 (0)	-	-	7 (0)	7 (0)
District	231 (8)	240 (7)	23 (2)	23 (2)	26 (0)	27 (0)
Nation	4,046 (28)	4,154 (30)	24 (2)	24 (2)	574 (1)	592 (0)

Based on preliminary 2Q23 data (Call Reports filed through August 14, 2023).

Common Abbreviations

AFS	available for sale
ACL	allowance for credit losses
ALLL	allowance for loan and lease losses
BSA/AML	Bank Secrecy Act/anti-money laundering
C&I	commercial & industrial
C&LD	construction & land development
CBLR	community bank leverage ratio
CD	certificate of deposit
CECL	current expected credit loss
CRE	commercial real estate

- + General: This report focuses on the financial trends and performance of commercial banks supervised by or headquartered within the Twelfth Federal Reserve District (“12L”). 12L includes nine western states: AK, AZ, CA, HI, ID, NV, OR, UT, and WA, as well as Guam.
- + Banking Statistics: Unless otherwise noted, all data are for commercial banks based upon headquarters location. 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 (less than three years old), industrial banks, and savings institutions, which have different operating characteristics. Also other than the table to the left, Twelfth District banking statistics include banks that are either supervised by or physically located within the Federal Reserve’s Twelfth District.
- + Groups by Asset Size: “Very Small”, “Small”, and “Mid-Sized” bank groups are based on total asset ranges of less than \$1 billion, \$1 to \$10 billion, and \$10 to \$100 billion, respectively. The “Large” bank group uses banks with assets exceeding \$100 billion nationwide because these banks typically operate beyond the District’s geographic footprint and a larger statistical population is preferred for medians.

HFS	held for sale
MF	multifamily (5+ unit housing)
MMDA	money market deposit account
NFNR	nonfarm-nonresidential
NMD	nonmaturity deposit (excludes CDs)
PPP	Paycheck Protection Program
ROAA	return on average assets (net income/average assets)
SFR	single-family residential (1-4 family)
TE	tax equivalent
YTD	year to date