Banking

Intelligence Report

California Bankers Association
Established 1891

Beacon Economics


BANK OF CALIFORNIA, SAN FRANCISCO.

Banking Intelligence Report

This publication was prepared for:

California Bankers Association

This publication was prepared by:

Beacon Economics

Christopher Thornberg
Founding Partner
5777 West Century Boulevard, Suite 895
Los Angeles, California 90045
310.571.3399
Chris@BeaconEcon.com

Jordan Levine
Economist and Director of Economic Research
5777 West Century Boulevard, Suite 895
Los Angeles, California 90045
424.646.4652
Jordan@BeaconEcon.com

Rafael De Anda
Research Project Manager
Rafael@BeaconEcon.com

Erica Comp
Research Associate
Erica@BeaconEcon.com

For further information about this publication please contact:

Victoria Pike Bond
Director of Communications
Beacon Economics, LLC
415.457.6030
Victoria@BeaconEcon.com

Rick Smith
Director of Business Development
Beacon Economics, LLC
858.997.1834
Rick@BeaconEcon.com

Or visit our website at www.BeaconEcon.com.

Reproduction of this document or any portion therein is prohibited without the expressed written permission of Beacon Economics. Copyright ©2015 by Beacon Economics LLC.

Executive Summary

Activity at California banks has grown along side the state's economy and, in particular, with the state's real estate market. In 2015, lending volumes were estimated at record highs and growth was broad based across multiple categories.

- Loans in California reached nearly $900 million as of the second quarter of 2015.
- California banks increased lending by 7.7% from the second quarter of 2014 to the second quarter of 2015, while banks throughout the United States increased lending by 6.3%.
- Loans to individuals (including credit cards) from banks in California were up over 30% over the year.
- The delinquency rate in California dipped below 2% at the start of 2015.

Single-family real estate loans were the only type to decline in 2015 compared to 2014. Nevertheless, the residential real estate market continued to accelerate in the first half of the year with a bounce-back in sales activity. With mortgage rates remaining at historic lows, home prices remain affordable to many households and are expected to continue to grow at an elevated pace. There have already been permits for 71,500 new units this year (single-family and multifamily) and all signs point towards single-family home lending growing in the second half of the year.

Meanwhile, the stock market recently demonstrated signs of volatility that were cause for concern to many investors. There has been no definitive explanation to what caused the volatility, but we can certainly rule out talk of a bubble. The fundamentals, like corporate profits and real GDP, indicate that the economy is growing robustly and are not showing any signs of weakness.

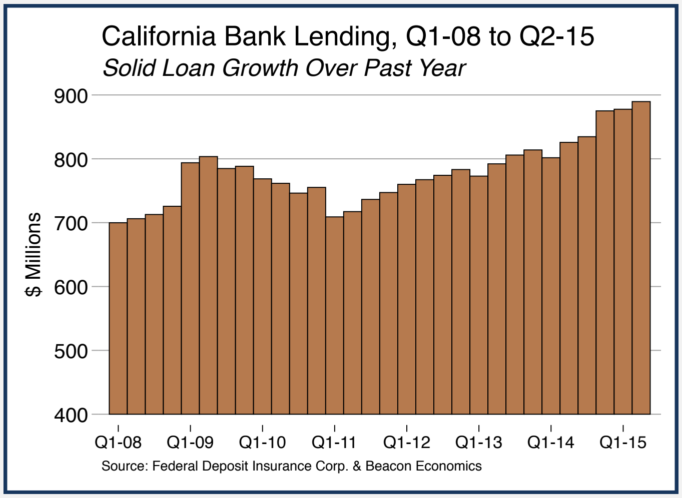
About the Banking Data

Banking data is notoriously difficult to interpret given that lending is reported based upon the location of each institution's headquarters rather than based upon the location of the borrower. This can be particularly problematic in California, where, in addition to a significant number of California-based banks, the state, also home to a large number of financial institutions based outside the state, but which also provide a significant number of loans to California businesses and residents.

Beacon Economics has constructed a unique database that provides a holistic picture of lending in the state that includes both loans made by California-based banks, as well as an estimate of lending in the state made by out of state institutions. Using data on branch locations and deposit information from the FDIC's *Summary of Deposits*, in conjunction with Call Reports from the FDIC and Federal Financial Institutions Examination Council (FFIEC), this dataset uses the physical presence of each institution within the state as a proxy for its lending activities in each state —regardless of where that institution is based.

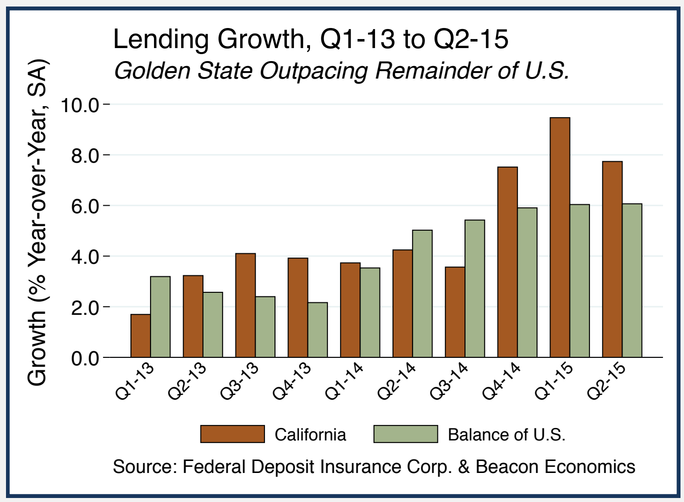
Our estimates demonstrate that the volume of lending in California is much higher than the $400 billion reported by the FDIC on California-based banks. Indeed, the nation's five largest banks (Wells Fargo, Bank of America, JPMorgan Chase, Citibank, and U.S. Bank) are all technically based outside of California and are not reflected in the $400 billion figure reported by the FDIC as a result. However, Beacon Economics' analysis shows that a significant portion of their operations are based in California, with anywhere between 16% and 40% of their deposits located in the state. Including these estimates of loans by institutions based outside the state raises the volume of lending in California to nearly $900 billion. All of the analyses presented in this report pertain to this larger pool of lending by institutions based inside and outside of the state.

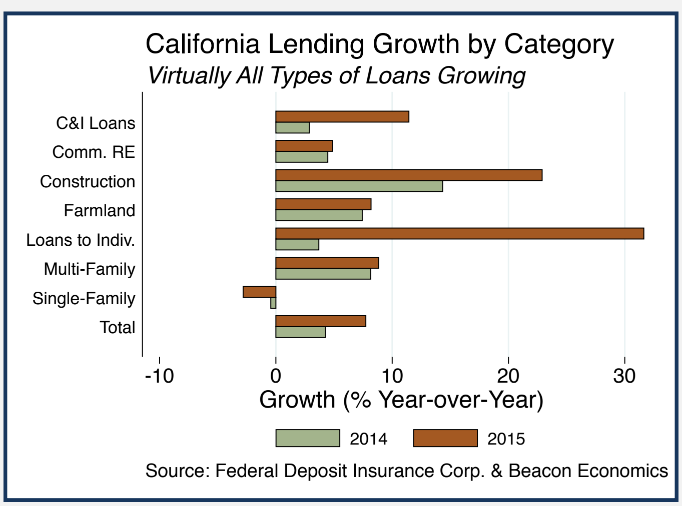
Bank Lending and Health



Bank lending in California has been rising solidly over the past five years, and the pace of growth has started to accelerate during the first half of 2015. Beacon Economics estimates that **total lending in California has now surpassed its pre-recession peak, with nearly $900 billion in outstanding credit**. This growth has enabled California residents to purchase new homes and replace older vehicles. The uptick in credit has also benefitted the state's home builders and businesses through a variety of loans for construction, commercial & industrial equipment, and commercial real estate.

California remains a driver of growth nationwide, and that is clear in the banking sector as well. As our economy has outpaced the expansion in the rest of the nation, **both the supply of and demand for loans has risen faster in the Golden State**. The expansion of loan volumes has ranged between 8% and 10% in 2015 compared with 6% in the rest of the U.S. and a recent survey of senior loan officers show that bankers remain optimistic. This survey shows easing credit standards for a broad swath of loan categories, stronger demand for loans by borrowers —particularly in the area of mortgages.





Virtually every major category of lending has been increasing, and **2015 is shaping up to be a better year for lending growth than 2014**. Consumers have played a large role in the current recovery and Loans to Individuals, which includes both credit cards and auto loans, have surged. Businesses are also tapping in to this growth, with C&I loans in California up more than 10% this year while loans for commercial real estate are up nearly 5% in 2015. Importantly, strong demand for loans has been spread across the economy, with bankers reporting net increases in demand by both large/medium and small businesses alike.

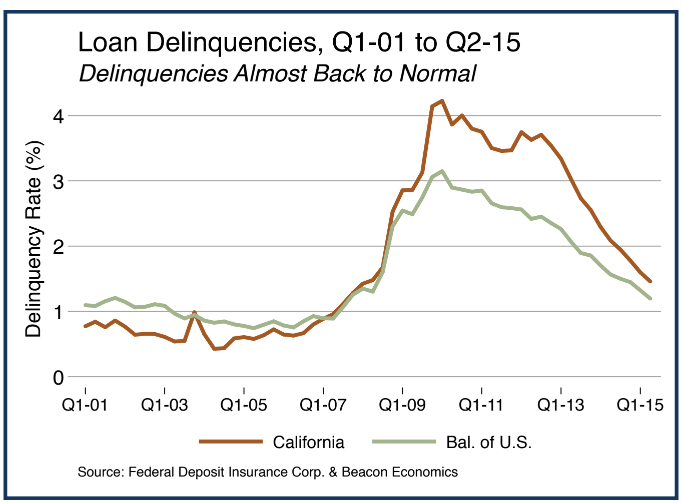
California Lending by Type, Loan Growth, and Delinquency Rates

Category	California Loan Volumes Q2-14 ($Mill.)	California Loan Volumes Q2-15 ($Mill.)	Growth, YoY (%) California	Growth, YoY (%) United States	California Delinquencies (Q-15, $Mill.)	Delinquency Rate (%) California	Delinquency Rate (%) United States
Total Loans/Leases	825,685.2	889,568.3	7.74	6.25	12,983.4	1.46	1.23
Construction Loans	17,274.0	21,228.9	22.90	14.63	99.5	0.47	0.61
Farmland	6,753.4	7,306.1	8.18	7.89	19.5	0.27	0.66
Single-Family Mortgages	306,491.6	297,861.7	-2.82	0.59	12,339.5	4.14	3.46
Multi-Family Mortgages	35,410.6	38,544.1	8.85	12.10	54.6	0.14	0.20
Commercial Real Estate	129,900.7	136,207.5	4.86	4.46	357.0	0.26	0.42
C&I Loans	167,700.3	186,883.8	11.44	9.61	76.0	0.04	0.14
Loans to Individuals	79,419.2	104,546.6	31.64	5.04	24.9	0.02	0.47

Sources: Federal Deposit Insurance Corp. & Beacon Economics

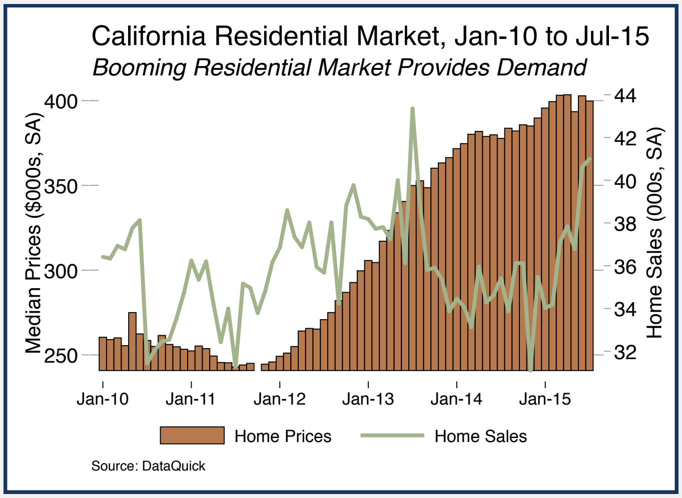
Overall lending in California is up by nearly 8% over the same point in 2014 compared with 6% in the U.S as a whole. With the exception of mortgages, California has seen a larger expansion in loan volumes across every major category than the rest of the nation —a testament to the strong economic expansion currently underway in the state.

Several types of lending are increasing at an impressive rate: **construction loans, C&I loans, and loans to individuals have all seen double-digit growth this year**. California also has fewer delinquencies across these categories than in other states, underscoring the fact that not only are more loans being issued/offered, but that those loans are actually performing much better this year.



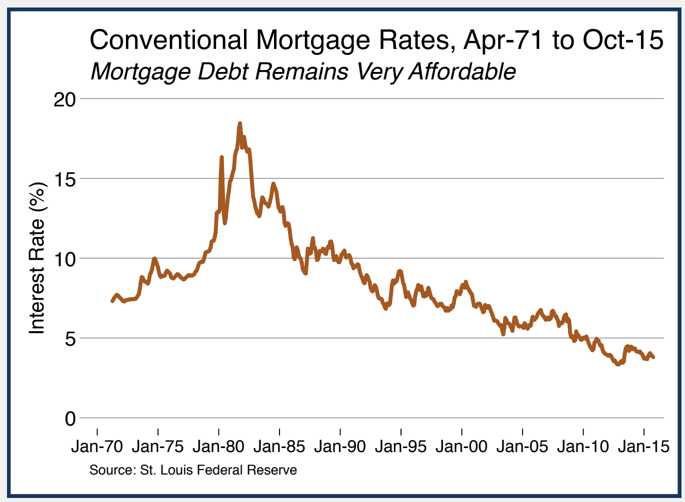
It is also important to note that **the banking sector itself is much healthier than at any point over the past five years.** Banks today are better capitalized, more liquid, and delinquency rates in California have dipped below 2%. In addition, delinquencies in California have fallen at a faster rate than in the rest of the nation. At ground zero in the recent real estate bubble and subsequent collapse, California saw a much larger spike in delinquencies during the Great Recession, but has chipped away at that bad debt more quickly than other areas such that the gap between delinquencies here and in other parts of the U.S. have been converging for several quarters.

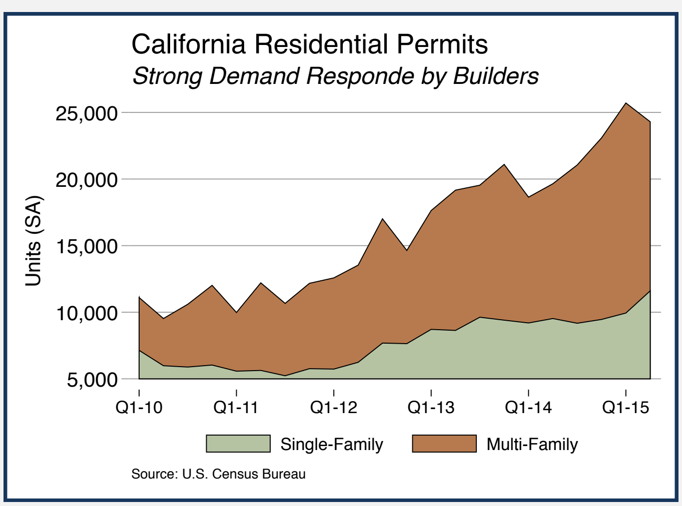
Real Estate Driven Growth



California's booming real estate market has provided a strong source of demand for loans, and the increasing supply of loans has helped to facilitate additional growth in these areas. Improving economic conditions have helped to generate demand for housing and the increasing supply of mortgage loans and easing credit standards have provided Californians with the opportunity to get back into the market. As demand has improved, real estate prices and sales have both been on the uptick this year, which should provide for additional growth in the remainder of 2015 and into 2016.

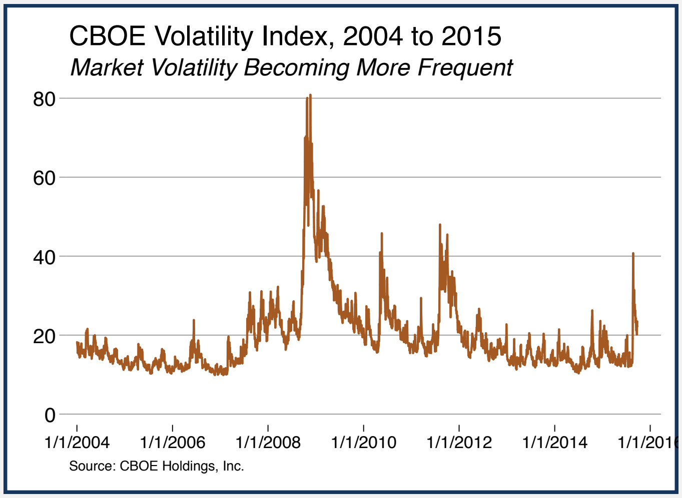
Despite concerns over when and how high the Federal Reserve will increase its target interest rate, the cost of mortgage debt remains near historic lows, which has helped to bolster the demand already being created by better economic conditions. Although the 3.8% rate for an conventional mortgage in October is slightly higher than the 3.35% reached at the end of 2012, **mortgage rates are lower than they have been at any other time in the past 40 years.**





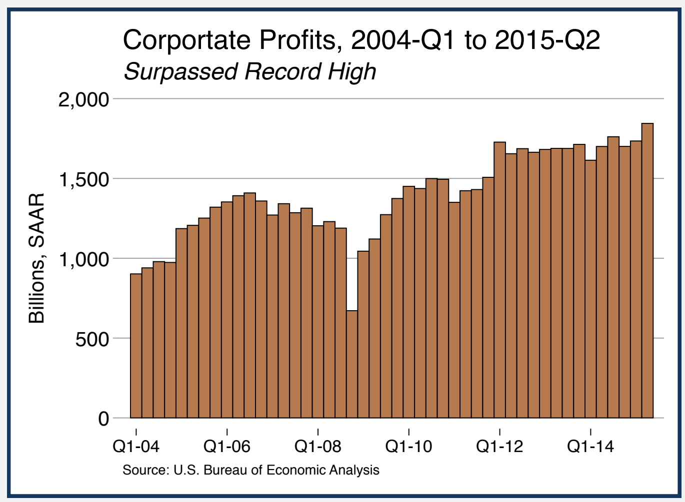
With the aid of strong growth in construction lending, California's builders have significantly increased residential construction activities across the state. Builders have already received permit approval for more than 71,500 units this year, split roughly 70/30 between multi- and single-family properties. And, while much of the new construction to date has been concentrated in the multi-family sector, single-family permits saw exceptional growth during the second quarter of this year. As the market begins to turn back toward the retail owner-occupied market, single-family loans are expected to begin to rise as well.

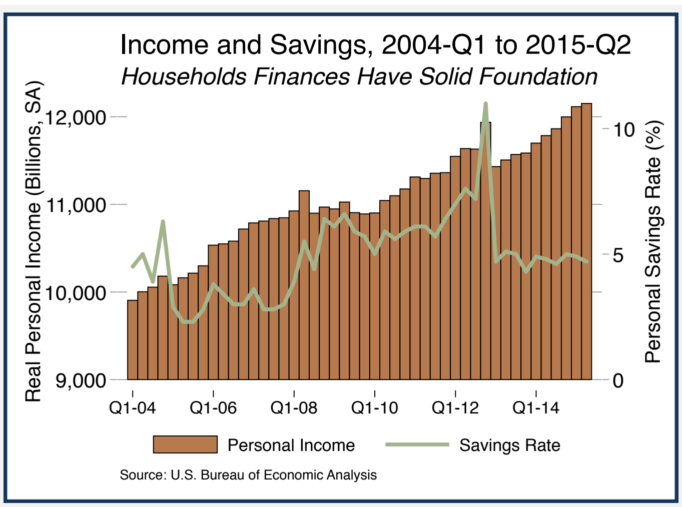
Turbulent Equity Markets



The stock market is far above its previous peak set back in 2008 and remains near a record high. The effects of the recent recession still linger in the minds of many households and investors, many of which have started to speculate that we are in new bubble. These beliefs have been further fueled by the recent volatility in the stock market. But the growth in asset prices and volatility are not evidence of a bubble. The fundamentals of the economy, including those that affect equity markets have a solid foundation.

Corporate profits reached a record high in the second quarter of 2015 —totaling $1.84 trillion (without inventory valuations and capital consumption adjustments). In fact, **corporate profits are now growing at their fastest pace in several years —expanding by 8.5% from a year ago —and are more than 30% higher than they were before the downturn**. Add that to ultra low interest rates and the market actually looks undervalued at the moment.





The real economy has shown signs of growth throughout the recovery and in recent quarters. **U.S. real GDP has averaged 2.0% annualized growth in the first, second, and third quarters of 2015**. Furthermore, GDP's largest contributor, consumer spending, has grown at a normal level relative to income. Indeed, consumers today are saving at a rate that bodes well for long-term economic growth, while incomes continue to grow.

About Beacon Economics

Beacon Economics, LLC is a leading provider of economic research, forecasting, industry analysis, and data services. By delivering independent, rigorous analysis we give our clients the knowledge they need to make the right strategic decisions about investment, growth, revenue, and policy. Learn more at **www.BeaconEcon.com**.

Services

- Economic, revenue and occupational forecasting
- Economic impact analysis
- Regional economic analysis
- Economic policy analysis
- Real estate market analysis
- Industry and market analysis
- EB-5 Economic analysis
- Public Speaking
- Expert Testimony

Contacts

- **Christopher Thornberg**
  Founding Partner
  (310) 571-3399
  Chris@BeaconEcon.com
- **Sherif Hanna**
  Managing Partner
  (424) 646-4656
  Sherif@BeaconEcon.com
- **Victoria Pike Bond**
  Director of Communications
  (415) 457-6030
  Victoria@BeaconEcon.com
- **Rick Smith**
  Director of Business Development
  (858) 997-1834
  Rick@BeaconEcon.com