Banking Conditions Survey

Federal Reserve Bank of Dallas

October 2017

Data for this report were collected Sept. 19–27, and 72 financial institutions—12 credit unions and 60 banks—responded.

Over the past six weeks, the Eleventh District financial sector has strengthened but at a slower pace compared with the previous period. Banking leaders indicated that loan volume and loan demand continued to expand at a slower pace. The loan volume index was 19.7, down from 42.6. Similarly, the loan demand index moved to 7.0 from 29.9.

The survey suggests that nonperforming loans did not change over the past six weeks overall. Consumer lending was the only area that experienced an increase in nonperforming loans. Loan pricing continued to increase at a slower pace, with an index of 13.9, down from 29.6. Overall, credit standards and terms continued to tighten, and this tightening was seen across the spectrum of lending categories. General business activity expanded over the past six weeks but at a much slower rate compared to the previous period, with a reading of 8.7, down from 36.7.

The gains in loan volume were driven by commercial real estate (CRE) and residential real estate loans. CRE loan volume continued to increased, with an index of 21.5, up from 21.0. For residential real estate loans, loan volume increased but at a slower pace, moving from an index value of 24.6 to 11.5. Commercial and industrial loans also experienced increases in loan volume at a slower pace compared with the previous period, moving from an index value of 16.1 to 3.0. Consumer loans were the only loan class that experienced a decrease in loan volume over the past six weeks.

Core deposit volumes continued to expand over the past six weeks. Cost of funds also increased but at a slower pace, down to 39.4 from 50.7. According to the respondents, net interest margins have remained the same as they were in the previous period. Noninterest income continued to expand and at a faster pace, with a reading of 11.4, up from 5.8.

The outlook for the Eleventh District financial sector is slightly less optimistic. The expectation of general business activity and total loan demand points to expansion but at a slower pace compared to the previous period. Nonperforming loans are still expected to decline six months from now, but at a slower pace.

Next Release: Nov. 29, 2017

The Federal Reserve Bank of Dallas conducts the Banking Conditions Survey twice each quarter to obtain a timely assessment of activity at banks and credit unions headquartered in the Eleventh Federal Reserve District. CEOs or senior loan officers of financial institutions report on how conditions have changed for indicators such as various loan types, deposits and loan pricings. Respondents are also asked to report on their banking outlook and how they perceive broader economic conditions to have changed (general business activity).

The answers serve a dual function: They provide supplemental anecdotal information for the Eleventh District Beige Book and supply timely information on banking conditions in preparation for monetary policy deliberations before the eight Federal Open Market Committee meetings each year.

Participants are asked whether they are seeing changes in a series of indicators. In addition, participants are given the opportunity to submit comments on current issues that may be affecting their business.

Survey responses are used to calculate an index for each indicator. Each index is calculated by subtracting the percentage of respondents reporting a decrease (or tightening or worsening) from the percentage reporting an increase (or easing or improvement). When the share of firms reporting an increase exceeds the share of firms reporting a decrease, the index will be greater than zero, suggesting the indicator has increased over the prior reporting period. If the share of firms reporting a decrease exceeds the share reporting an increase, the index will be below zero, suggesting the indicator has decreased over the prior reporting period. An index will be zero when the number of firms reporting an increase is equal to the number reporting a decrease. Note: Percentages may not add to 100 due to rounding.

1. Total loans: Over the past six weeks, how have the following changed?

Indicator	Current index	Previous index	Percent reporting increased	Percent reporting no change	Percent reporting decreased
Loan volume	19.7	42.6	40.8	38.0	21.1
Loan demand	7.0	29.9	32.4	42.3	25.4
Nonperforming loans	0.0	–12.7	17.4	65.2	17.4
Loan pricing	13.9	29.6	20.8	72.2	6.9

Indicator	Current index	Previous index	Percent reporting eased	Percent reporting no change	Percent reporting tightened
Credit standards and terms	–6.3	–12.1	3.2	87.3	9.5

2. Commercial and industrial loans: Over the past six weeks, how have the following changed?

Indicator	Current index	Previous index	Percent reporting increased	Percent reporting no change	Percent reporting decreased
Loan volume	3.0	16.1	21.5	60.0	18.5
Nonperforming loans	–6.4	–7.2	8.1	77.4	14.5

Indicator	Current index	Previous index	Percent reporting eased	Percent reporting no change	Percent reporting tightened
Credit standards and terms	–7.8	–9.7	1.6	89.1	9.4

3. Commercial real estate loans: Over the past six weeks, how have the following changed?

Indicator	Current index	Previous index	Percent reporting increased	Percent reporting no change	Percent reporting decreased
Loan volume	21.5	21.0	41.5	38.5	20.0
Nonperforming loans	–12.9	–5.5	4.8	77.4	17.7

Indicator	Current index	Previous index	Percent reporting eased	Percent reporting no change	Percent reporting tightened
Credit standards and terms	–12.5	–16.4	1.6	84.4	14.1

4. Residential real estate loans: Over the past six weeks, how have the following changed?

Indicator	Current index	Previous index	Percent reporting increased	Percent reporting no change	Percent reporting decreased
Loan volume	11.5	24.6	32.8	45.9	21.3
Nonperforming loans	–1.7	0.0	6.8	84.7	8.5

Indicator	Current index	Previous index	Percent reporting eased	Percent reporting no change	Percent reporting tightened
Credit standards and terms	–8.2	–5.0	1.6	88.5	9.8

5. Consumer loans: Over the past six weeks, how have the following changed?

Indicator	Current index	Previous index	Percent reporting increased	Percent reporting no change	Percent reporting decreased
Loan volume	–6.0	–3.0	19.4	55.2	25.4
Nonperforming loans	3.0	–3.3	10.6	81.8	7.6

Indicator	Current index	Previous index	Percent reporting eased	Percent reporting no change	Percent reporting tightened
Credit standards and terms	–6.1	–4.7	3.0	87.9	9.1

6. Other banking developments: Over the past six weeks, how have the following changed?

Indicator	Current index	Previous index	Percent reporting increased	Percent reporting no change	Percent reporting decreased
Volume of core deposits	21.1	21.7	36.6	47.9	15.5
Cost of funds	39.4	50.7	40.8	57.7	1.4
Net interest margin	0.0	14.5	21.1	57.7	21.1
Noninterest income	11.4	5.8	20.0	71.4	8.6

7. Banking outlook: What is your expectation for the following items six months from now?

Indicator	Current index	Previous index	Percent reporting better	Percent reporting no change	Percent reporting worse
Total loan demand	38.9	44.1	48.6	41.7	9.7

Indicator	Current index	Previous index	Percent reporting more	Percent reporting no change	Percent reporting fewer
Nonperforming loans	–16.7	–20.5	11.1	61.1	27.8

8. General business activity: What is your evaluation of the level of activity?

Indicator	Current index	Previous index	Percent reporting improved	Percent reporting no change	Percent reporting worsened
Over the past six weeks	8.7	36.7	23.2	62.3	14.5
Six months from now	30.4	44.1	42.0	46.4	11.6

9. Issues of concern: Please feel free to comment on any issue that may be affecting your business.

These comments are from respondents' completed surveys and have been edited for publication.

- We are concerned over instability in Washington D.C.
- We are seeing a slowdown in memory care and apartments.
- We are expecting an increase in both loans and deposits directly related to Hurricane Harvey.
- The gridlock in Washington D.C. is stifling growth and creating more uncertainty.
- The Current Expected Credit Loss (CECL) rule seems like a huge waste of time, effort and money. More regulatory relief would help keep delinquent loans better under control than creating a regulation that takes staff time and business money that could better be spent helping the people.
- I have owned control of a state bank and a national bank for over 35 years. Previously, I told the bank personnel at both banks that the "bank regulatory personnel were not looking for trouble, they just want to do their jobs and be home on Friday to dinner with their families." In fact, the last thing the regulatory personnel want is to find a problem because it requires changing schedules and extending examinations. Additionally, examinations were an opportunity to learn ways to improve our banks from the examiners that had been to other banks. My recent experience with the Texas Department Banking, Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC) has caused me to change my opinion. Examinations have changed over the past three years. Everything is a "got you." The laws, regulations, rules and "best practices" have multiplied, everything is about compliance. Historically, the examination and examiners were substantive. Now the first thing bank examiners say is, "there are civil money and criminal penalties for non-compliance with laws, regulations, rules and 'best practices.'" Each of the banks with which I am associated spend over $65,000 a year on third-party audits and independent evaluations (approximately 5 percent of non-interest expense). Between the added compliance and the "got you" mentality, more people are deciding to pursue other careers. Additionally, many experienced bankers are choosing to work in branches where the compliance is "handled" at the main office and they never need deal with an examiner. Lastly, many bankers have adopted the "mushroom theory" in dealing with examiners. The FDIC leaders are "mystified" as to why there are very few charter applications. The "new normal" for leverage capital is 10 percent and the expected return on equity is 7.5 percent. A well-run back makes 7.5 percent on "risk capital." I cannot recall an investor deciding to invest "risk capital" where the upside is 7.5 percent and the downside is a 100 percent loss. Surely the FDIC leaders understand the concept that knowledgeable investors will require the rewards be commensurate with the risk.

- The general level of economic activity in our market areas very much depends upon the activity in the oil and gas exploration and the production industry. Consequently, the price of crude oil and natural gas have a significant impact on the level of future economic activity.

- Hurricane Harvey-related issues are surfacing slowly, and we will need more time to assess the impact, either positive or negative, to the bank.

- We have a serious lack of young talent in all areas of the bank, cyberrisks continue to intensify, and the cost of doing business is affecting us—information technology security, retention of employees, health care coverage, fraud.

- We have lowered our minimum credit score from 660 to 640 to keep exceptions lower—bad but makes fair lending examiners happy. Compliance continues to be a very central focus.

- The level of general business activity as well as the outlook for banking is dependent upon the price of oil. If oil prices increase, we expect the general business activity in our economy to increase. As it pertains to residence loans, the bank's loans have decreased while the loan volume on the secondary market has increased over the past six weeks.

- The impact of Hurricane Harvey on the Houston market remains a key concern.

- The suffocating wet blanket that regulatory has put on the banking industry as well as the business of all of our customers continues to limit growth opportunities. In my opinion, this country will fail to ever again achieve our historical economic growth of 3 percent given the regulations we all deal with. My personal estimates are that economic growth will probably not exceed 1.5 percent to 2 percent growth from this point forward in the good years. Too many wasted dollars in compliance and regulatory burden to jumpstart a true recovery. Much the pity.

- We have determined that indirect automobile lending is no longer a product line that we will offer and have closed our indirect lending department. The cost of regulatory compliance, the uncertainty and fog of regulations no longer make this product line an acceptable risk.

- Community banks should have different examination and capital standards than the large mega-banks. Community banks do not represent a significant risk to our national economy if they suffer problems, and they provide more opportunity for economic expansion than large banks. I believe everyone would agree with this statement and Congress should listen. The new real estate disclosures and Home Mortgage Disclosure Act (HMDA) requirements are so burdensome I believe it will drive most community banks out of the mortgage markets. The requirement to have an error-free HMDA report is unfair and unrealistic and to attempt to assess civil money penalties for such is unfair.

- Our primary concerns are: cybersecurity, the Houston economy post-Harvey, more micro-management via compliance and Dodd-Frank for small community banks by trying to compartmentalize every banking customer and eliminating the ability of bankers to stretch and help customers on a case-by-case basis.

- Our business climate and activity stalled over the last month as the community adjusts to the aftermath of Hurricane Harvey. We expect increased activity over the next year to 18 months as the community rebuilds both in the commercial and residential areas. Commercial banks will be participating alongside the insurance companies to provide funds for rebuilding the impacted areas.

- Hurricane adjustments, including inflated building costs throughout the state.

- Declines in volume, business conditions and demand are Harvey-related. We believe it is only temporary and will return to normal or increase as the market returns to normalcy. Still looking for regulatory relief and a delay in new Home Mortgage Disclosure Act data collection.

- Due to increased demand on deposits and increased loan demand, liquidity is becoming a challenge

- Due to Hurricane Harvey, I'm not sure you can place any faith in anything that happened recently with regard to banking activity or happens for the next few months in our eight counties of southeast Texas. Loan demand is off the charts. We are offering disaster terms and loans that do not reflect normal business. One branch is completely closed due to water damage. Others were closed or operated on short hours in late August and early September. Basically, we'll know the impact in 2–3 months, in retrospect. In the long run we would expect conditions to improve due to money coming into the area for disaster relief and repairs/reconstruction. It should be interesting. It should also be noted that the regulatory requirement that mortgage loan applications be addressed within 72 hours has caused us to stop taking applications because there are too many mortgage applications coming in. Another example of regulations going haywire, as virtually all of them do, and hurting the consumer, not helping them.

- In our market, deposit inflows appear to be picking up, but it is difficult to put this money to work. Loan demand appears to be flat to slightly decreasing, and putting this money into securities could be tricky given the uncertainty of how markets will react to Fed balance sheet unwinding and a possible rate hike again in the near future. On top of that, our competitors in our market have begun to start raising rates on core deposits, but given the exceptional low-rate environment for a number of years, not by much. Information technology is a topic on regulators' radar given the frequency of cyberattacks in recent months. Increased pressure by regulators in the IT arena make it difficult to find qualified information technology professionals in community banks. Also, increased cost for new or upgraded software and hardware is expensive for community banks and is starting to become something the board has noticed. Washington appears to continue to struggle to get any sort of reform done, whether it is tax reform or health care. Daily changes in this

aspect will make it difficult to budget and plan for the upcoming year. This also appears to be on the minds of our customers.

- Due to most recent natural disasters, the increased cost associated with construction projects may discourage future expansion for small business along with construction of residential homes. Also have concerns regarding the undecidedness in Washington and its negative impact on necessary change related to health care, tax reform and Dodd-Frank. Community banks spend too many man-hours fulfilling unproductive and unnecessary regulatory requirements, which inevitability prevents time spent benefiting its present and potential future customers.