Summary of Discussions Among Members of the
Community Depository Institutions Advisory Council
April 10, 2025

1. Economic Discussion:

a. Overall Economic Conditions: *How do Council members assess overall economic conditions in their regions?*

The Council reported that economic conditions remain mixed, with ongoing inflationary pressures from labor costs, insurance, and potential tariffs. Low- and moderate-income households are adjusting by shifting to more affordable, lower-quality options. Rising insurance costs and property taxes are straining households as well as businesses. While wage growth has stabilized, labor shortages persist in sectors like construction and manufacturing. Consumer confidence is subdued, but spending remains resilient, supported by credit. Overall, inflation and uncertainty continue to impact the economic outlook, with regional variations in labor, housing, and consumer behavior.

b. Particular Indicators:

i. Inflation: Are the prices of products and services rising (or declining) more or less quickly than in the recent past? Are the prices for the products and services Council members purchase rising more or less quickly?

Council members report that inflation has moderated from its peak but remains at an elevated level, attributed to labor costs and businesses' preparation for tariffs. Inflation continues to hurt low- and moderate-income families the most. These households have adjusted their spending habits by shifting away from discretionary spending, buying groceries and items in bulk, and switching to generic brands. There remains some lingering frustration over price increases, stemming from a misconception that lower inflation will translate into lower prices.

Higher food prices are a concern; for example, in the Atlanta area, revenues at an independently owned fast-food restaurant were flat, but the number of transactions had declined. Total spending was unchanged, but the volume of business was down.

The Council discussed sources of inflationary pressure, such as labor costs, insurance, property taxes, and tariffs. Council members pointed out that while wage growth has largely stabilized, there is a continued imbalance between labor availability and open positions. Insurance costs continue to put upward pressure on inflation due to higher weather-related risks and rising property values, putting additional financial strain on consumers and businesses. Higher insurance costs have caused households' monthly mortgage payments to increase significantly, straining their finances. All Council members agreed that rising insurance costs, along with property taxes, are affecting households and businesses.

The uncertainty regarding the full impact of potential tariffs is affecting businesses. For example, in the construction business, suppliers have reduced the amount of time before their offers for specific materials expire, which does not leave contractors enough time to get confirmations from their customers. One Council member shared that a pipe manufacturer offered a price that lasted only an hour, in contrast to the conventional 3-4 days that contractors previously had to accept an offer. In numerous cases, businesses have shifted to cost-plus contracts, thus shifting the price risk to the customer.

Council members highlighted that some businesses were raising prices in anticipation of tariffs. One District reported that providers of armored-vehicle courier services were already increasing their prices, as they expect vehicle costs to increase, as a result of new tariff policies. Businesses were also hoarding inventory of imported parts and supplies in anticipation of these new policies.

ii. <u>*Housing*</u>*: How have home prices changed in recent months? Have there been any changes in overall housing activity in Council members' Districts?*

In the housing market, Council members noted a growing mismatch, with lower-income households increasingly being priced out of the market. Entry-level home prices continue to rise due to strong demand and limited inventory. The housing market is bifurcated between those on the lower and higher ends of the income distribution, and this gap will continue to widen as construction costs increase.

Lower-wage earners are seeing a growing portion of their income being consumed by rent and utility expenses. In the West, it was reported that some areas have experienced approximately 9% increases in both rental and home prices since the last quarter. At the national level, high mortgage rates have further priced out many potential homebuyers. Current homeowners that have low mortgage rates are reluctant to sell, knowing that purchasing a new home would come with a higher rate. This reluctance further limits an already strained housing inventory.

Housing insurance is also adding upward pressure on homeownership costs, with premiums for coverage continuing to climb. One Council member noted that the increasing frequency and severity of weather-related disasters are putting significant strains on insurance companies, leading to higher premiums and more selective coverage. Homeowners were once accustomed to contacting insurance agents shortly before their closing date but now need to secure insurance as soon as their loan is approved.

One Council member noted that 50% of housing in Oahu is condominiums and, given the complexity of building there, construction defects are common. After the collapse of a condo building in Miami in 2021, insurance companies have tightened their underwriting standards, making it difficult for condos to obtain insurance. Consequently, banks have also tightened underwriting standards for condo loans.

iii. *<u>Labor Markets</u>: How have the labor markets in which Council members operate changed in recent months? In particular, please assess the degree of job loss or gain (and in which industries). Please comment on the changes to wages that Council members have observed over the past year.*

Council members agreed that while labor costs have stabilized, the labor market is still unbalanced, with differences by region and industry. One of the constraints facing labor availability is the rising cost of childcare, forcing some parents to exit the workforce or avoid entry. Rising healthcare costs are also impacting the labor force, as employers must either dial back their healthcare options or reduce hiring.

Despite many companies pushing for a return to the office, hybrid work remains the most popular option among employees, leading to an imbalance between demand and supply for skilled positions. Many employers are quite keen for higher-skilled staff to be in the office more often.

Council members noted that immigration policy could exacerbate labor supply issues in construction, manufacturing, and restaurants. A Council member described the case of a contractor in Texas who has decided to hire excess workers in case deportations or ICE raids reduced the workforce significantly in the middle of a project. In the past, the contractor has had construction projects interrupted by ICE raids, leaving the business with fewer workers and severely impacting its customers. One District reported that the healthcare industry is also being constrained by low labor availability, with the national shortage of nurses leading to patients waiting in emergency rooms for up to 2-3 days before they can be assigned a bed in a fully staffed unit.

iv. *<u>Consumer Confidence</u>: Are Council members seeing any signs of improved (or declining) consumer confidence? What is the outlook for consumer credit losses?*

Council members agreed that consumer confidence remains subdued, driven by heightened uncertainty over employment stability and potential inflationary pressures due to tariffs. There appears to be a divergence between consumer sentiment and actual spending behavior. While sentiment is down and marked by pessimism, consumption activity continues at a resilient pace, supported in part by increased reliance on credit cards. Although loan delinquencies remain historically low, some Council members are observing extended times for customers to clear overdrafts.

2. **Current Banking Conditions:** *What is the Council's view of the current condition of, and the outlook for, loan markets and financial markets in general? Please describe any significant changes in the creditworthiness of applicants for loans, loan demand, underwriting, and lending standards in general.*

The Council observed that regional differences exist across the different loan categories but agreed that overall loan demand in most categories remained steady. Community institutions have seen large, regional banks scale back on certain lending categories in different regions, opening more opportunity for community banks. However, community institutions are constrained by available liquidity, leading them to be more selective in the deals they are willing to underwrite.

a. ***Small Business Lending:*** *Has credit availability for, and demand for credit from, small businesses changed significantly? Have lending standards for these borrowers changed? Do Council members see evidence that prevailing economic uncertainty is slowing economic activity in this sector?*

Council members noted a significant increase in loan demand for Small Business Administration (SBA) loans. However, processing and underwriting times have lengthened considerably, compounded by workforce reductions at the SBA and the U.S. Department of Agriculture. Larger regional banks have scaled back their lines of credit to small businesses, pushing these deals toward community banks. Council members also reported that banks are broadly tightening lending standards. Consequently, in areas with weak economic growth, such as Alaska, small businesses are either contracting or being acquired.

b. ***Commercial Real Estate Lending:*** *Have there been any changes in the Council's view of challenges in the commercial real estate market since the Council's last meeting in November 2024? How are commercial real estate loans performing compared to the Council's expectations?*

Council members reported differences in commercial real estate (CRE) lending by District. One Council member noted lending levels were strong in the fourth quarter of 2024, with demand carrying into the first quarter of 2025. Multifamily housing continued to perform well, and the warehousing and manufacturing sectors remained strong. However, urban office spaces continue to be problematic, with conditions worsening due to rising cap rates, which in turn lead to lower appraisals. Another Council member stated that lower appraisals would impact the ability to close deals, and without a 40% equity contribution, finalizing most deals would be difficult.

The New Jersey region is experiencing robust demand for CRE, but elevated concentrations at many banks are prompting heightened risk management expectations. The Southeast office market is also showing signs of stress: class B and C office spaces face rising vacancies, with tenants migrating to newer, higher-quality buildings, which is negatively affecting B and C credit quality. One Council member highlighted the growing competition from private credit firms, which are willing to offer borrowers more attractive terms than banks. Some Council members expressed optimism, noting that as more people return to the office, the increase in occupancy rates will lead to improvements in credit quality.

c. ***Construction Lending:*** *What are Council members' perspectives on the availability of credit for construction and development projects? Have Council members seen any* *changes in the demand for construction loans since the Council's November 2024 meeting?*

While Council members concurred that general construction lending remains strong, the availability of workers, particularly those within skilled trades, remains a limiting factor. In addition to labor concerns, contractors face rising costs due to price volatility for materials and uncertainty regarding supplier quotes. These conditions have led some developers to adjust their project plans or pull back altogether. Lenders are responding by tightening underwriting standards, with some banks introducing covenants to restrict developers from taking on multiple projects simultaneously. Despite these challenges, construction lending remains strong, with some areas seeing competition from private equity firms and other nonbank lenders.

While multifamily development remains strong in some markets, there are signs of a slowdown, particularly in areas like Missouri, where land availability is limited by environmental factors like flood plains. In other areas, multifamily development is reportedly overbuilt especially as completed properties come to market. Additionally, the liquidity challenges faced by banks in raising and maintaining deposits in certain regions, such as Las Vegas, are making them more cautious in their lending practices, further constraining the availability of financing for new construction projects.

d. ***Home Mortgage Lending:*** *What changes have Council members seen in the mortgage market? How, if at all, is regulation impacting the participation of community depository institutions in this market?*

Activity in mortgage lending remains low in most of the country, as mortgage rates persist in the high 6% to low 7% range and inventory remains low. From the bank perspective, home mortgage lending is very competitive, and the value prospect for banks is at the service level in establishing new customer relationships. Consumers have been very sensitive to mortgage rates, so as rates have fallen, refinances of recent mortgages have seen a slight pickup. With high rates, current homeowners are increasingly pursuing home equity lines of credit (HELOC) to keep their original low mortgage rate and fund renovations or other expenditures. The dollar amount and volume, as well as usage levels, of HELOCs have been rising.

e. ***Consumer Lending:*** *What changes have Council members seen in consumer lending? Please comment specifically on credit card and auto lending.*

Community bankers agreed that delinquency rates are starting to increase on consumer loans. Credit card delinquency rates and net charge-offs are rising; however, members pointed out that this increase reflects a return to historical levels rather than a significant rise in credit issues in the last few years. Still, bankers are increasingly seeing consumers make minimum payments on their credit card balances, accumulate higher debt, and pay balances off more slowly. Relatedly, a Council member shared that some companies are providing payroll advances to employees to help them fund payments for any emergency home repairs or health care costs.

f. ***Agricultural Lending****: Have there been any changes in agricultural lending?*

The Council shared that agricultural lending remains challenging, with variation by commodity and region. Most farmers in different farming communities are getting by, but sentiment going forward is negative. One Council member reported that some of the key inputs for farms, including fertilizers and farm machinery, are imported into the U.S. and would be subject to potential tariffs. As a result, there is significant uncertainty about costs and, consequently, future earnings. The general expectation is that while the current year will be manageable, farmers are quite nervous about 2026.

The cattle market has been strong, and ranchers are receiving solid earnings. However, row crop producers face a lot of uncertainty from the new tariff policy, since China is a significant buyer of soybeans from the U.S. There is concern that once overseas customers shift to other countries for their crop purchases, it will be a permanent loss for U.S. farmers. Additionally, the avian flu has impacted poultry farmers in many areas. It was also noted that in Oregon, La Niña weather patterns and cooler weather were making it more difficult to manage livestock and crops.

In the St. Louis area, there are instances of farms being purchased by solar companies and larger businesses looking to expand. In the Dallas region, farms closer to urban areas were being sold as land to build housing, while ranches were being sold for hunting and other recreational activities.

Lastly, labor continues to be a significant concern in the farm industry. The potential mass deportations of undocumented immigrants can affect the supply of farm labor. North Dakota farmers use the H-2A temporary visa program to help fill agricultural jobs with foreign workers and provide them with housing, which is nota feasible option without the government program.

g. ***Deposits****: What changes have Council members seen in local deposit markets? Describe these changes by segment (retail, small business, and corporate). What are Council members' expectations with respect to deposit levels?*

The Council was in broad agreement that deposits were competitive in the first quarter and banks must adjust their deposit rates actively and strategically to retain their deposit base. Customers are very attentive to rates on certificates of deposits (CDs), and given the inverted yield curve, most invest in shorter-term CDs. While previous volatility has stabilized, several Council members noted that the playing field is changing, with greater competition from money market mutual funds, credit unions, and larger banks. Council members noted that relationship banking is essential in this environment.

Council members also discussed the need for deposit insurance modernization, including a need for increased coverage, and noted that an expensive “shadow industry” offering sweep accounts has grown that community banks utilize for liquidity in times of stress. Council members generally noted that unlimited coverage would be helpful for business operation accounts.

Council members briefly discussed the need for diverse funding sources, including brokered deposits, and noted that banks need funding that fits with their goals and risk tolerances. In addition, specific types of funding should not be stigmatized by supervisors. Council members are supportive of the FDIC's decision to withdraw its brokered deposit proposal.

Several Council members noted competition from state-owned investment funds, which attract public deposits. In at least one state, these funds can be invested in foreign sovereign debt instruments. Such policies, along with the standard portfolio bias of these funds towards U.S. Treasuries, deprive banks of an important source of local liquidity that could support loans to households and businesses in the community.

Council members are closely watching the payment stablecoin legislation working its way through the U.S. Congress. They view these nonbank-issued payment stablecoins as a potential source of risk for deposits to leave the banking system–much like the huge diversion of banking deposits to money market mutual funds that occurred in the 1970s-1980s. As rulemaking and supervision of bank and nonbank stablecoin issuers is implemented, Council members expect regulatory bodies to consider consumer protection, financial stability, and attacks on traditional funding sources for banks.

Council members noted the deposit-outflow concerns shared at a past Council meeting in the context of its consultation on central bank digital currencies (CBDCs). While the concern then was about deposits leaving the banking system to be parked in CBDCs, the same concern arises about potential deposit outflows to payment stablecoins. Both of these digital instruments will crowd out banks' funding, causing them to pull back the amount of credit they provide to Main Street.

h. ***Mergers and Acquisitions Activity****: What trends are Council members observing with respect to mergers and acquisitions among depository institutions and their holding companies?*

The current environment for mergers and acquisitions (M&A) reflects increasing pressures from the boardroom and institutional investors to "grow the bank." Council members believe that deregulation and favorable M&A terms could accelerate activity and lead to faster closings. In particular, the Midwest may see significant consolidation due to its high concentration of smaller community banks–about 2,200 banks, with a median asset size of around $200 million–that are facing increasing pressure to merge. Pent-up demand and improved earnings forecasts suggest that M&A activity could accelerate in 2025, particularly if interest rates decline and accumulated other comprehensive income (AOCI) losses are reduced. While optimism exists, deal volumes in 2025 are still expected to be roughly in line with 2024's figures. In New England, mutual banks are pursuing mergers while retaining their charters under mutual holding companies. Meanwhile, some banks have opted out of potential deals in anticipation of regulatory rollbacks that could ease operational burdens.

Council members also noted with concern that about 25% of M&A deals in 2024 involved credit unions acquiring banks. The former are exploiting their tax-exempt status, and banks are unable to match their all-cash offers.

There is broad consensus among Council members that resolution of accumulated unrealized losses will lead to an explosion in M&A activity in the U.S. banking industry. Reflecting the strong interest, M&A transactions are being engineered to strip a bank's underwater securities portfolio and leave it with the seller to absorb the risk.

3. **Fraud:** *To what extent are community depository institutions seeing changes in fraud? How are your institutions and your customers impacted, and what steps are being taken to prevent fraud and mitigate its impacts? How are your institutions helping to ensure that customers have timely access to their funds? How does your institution partner with law enforcement to learn of and remediate fraud events? How can regulators effectively engage and facilitate solutions? In what ways could interagency efforts support these solutions?*

Fraud is an ongoing problem in the banking sector for both banks and their customers. The two most prominent types of fraud that cause losses at financial institutions are check fraud and debit card fraud. Check fraud has been particularly challenging due to the insecurity of the mail system, the ease with which checks can be altered or counterfeited, the lack of law enforcement engagement and its inability to make a significant difference in preventing check fraud, and the challenges around the claims process for check fraud.

There is particular concern among community banks that the majority of the beneficiary accounts for check fraud are hosted by large institutions. Many smaller institutions have direct experience with implementing online account opening-procedures but then having to deny accounts to more than 50% of applicants due to discrepancies or flags in the application file. Council members raised the question of whether large institutions are doing appropriate due diligence on their online account-opening procedures and if this potential gap was an area for regulator engagement.

Several banks stated that while debit card fraud may account for a higher percentage of their losses, the majority of time staff expends on anti-fraud activities is actually for check fraud. Council members described the time-consuming nature of preventing, investigating, and resolving check fraud, including reviewing incoming checks, validating with customers that the checks drawn on their accounts are legitimate, and following the challenging claims process.

Council members noted that the claims process for check fraud is governed by the Uniform Commercial Code and that the lack of timelines and an agreed-upon set of principles surrounding how claims should be handled (such as whether notarizations are required for customer affidavits, how long a bank should take to process a claim, acceptance of electronic claims and signatures, interpretations regarding altered versus counterfeit checks) have created very significant challenges. Council members are of the view that these challenges have created an opportunity for regulatory engagement to help the industry reach consensus-based standards. While Council members discussed various ongoing efforts by trade organizations, there is broad consensus that active engagement by regulators may be helpful to ensure banks of all sizes are responsive to the issue.

Additionally, check fraud could be mitigated if real-time information sharing were enabled and if features--such as the ability for the bank of first deposit to reach out to the issuing bank to determine the validity of a check--were encouraged and supported by all banks. There can be ambiguity among banks on what information is and is not allowed to be shared, both in the normal course of business and when fraud on a transaction is suspected. Council members believe that regulatory clarity about when information between banks can and cannot be shared should be stated explicitly and that regulators should also provide clear guidance on what can be shared when fraud is indicated. Regulators should then encourage banks to share information to the maximum extent possible to reduce fraud losses both for banks and their customers.

Council members noted that the scamming of bank customers is another area that financial institutions deal with on a daily basis. Many times, the banks do not absorb the loss from these scamming transactions since the customer has authorized payments. But Council members noted that these transactions pose reputational risk to their banks and threaten overall confidence in the financial system. Council members described the myriad ways in which they attempt to protect their customers from these scams, including robust consumer and business education campaigns and customer callback procedures for staff executing large-dollar transactions. In addition, bank staff question customers who are sending large amounts of funds or withdrawing large amounts of cash, and banks may even close accounts when fraud is strongly suspected. But these efforts are frustrated many times, as the customer truly believes the criminal who is scamming them and who has coached the customer on the mitigation measures the bank has in place. Financial institutions tell customers to only send money to people they know and trust--but by the time customers are ready to make a payment, they believe and trust the criminal, and intervention at that point is too late.

Council members are of the view that a national strategy is needed, one that focuses on preventing scams and interagency involvement. The Council emphasized the need to engage telecommunications companies to stop the use of spoofed caller IDs that fraudulently show a bank's name or number, to stop the mass fake fraud-alert text messages criminals send, or to stop the social media companies that allow impersonated accounts to convince people to invest in crypto investment scams. An ounce of prevention is worth a pound of cure, and focusing on the point of payment is too late. Efforts must be undertaken to stop the consumer from engaging with the criminal in the first place. While financial institutions have multiple layers of fraud controls, they cannot tackle these threats alone. Council members recommend a strong public-private partnership to combat fraud.

4. **Examination Practices***: What has been the experience of Council members in recent examinations? Have you seen examination practices impact the flow of credit? How can supervisors improve their communications (both formal and informal) with supervised institutions?*

Council members noted that some supervised institutions have experienced challenges during recent exams, particularly in the context of staffing changes. Council members cited concerns that examiner staffing shortages have impacted exam consistency and communication, occasionally resulting in extended timelines and less clarity during the exam process.

The consensus view among Council members is that the banking agencies have lost, and will continue to lose, many experienced examiners through retirements and federal job cuts. Bankers are concerned because it takes a long time to train examiners, and they feel that the shortage of experienced examiners will only get worse. Lack of experienced and informed examiners leads to errors and inaccurate exam conclusions that take a lot of banker time to resolve or correct.

Council members noted efficiencies from a hybrid examination format, while emphasizing the importance of on-site exam components to allow essential beneficial conversations and facilitate relationship development.

Council members remain concerned about a perceived pendulum swing in supervisory expectations, in which evolving standards and interpretations create uncertainty and retrospective judgment.

5. **Regulatory and Payments Matters:** *How are recent changes in the regulatory and payments landscape affecting the ability of community depository institutions to innovate as well as continue providing services to their customers?*

Council members noted that regulation is diverting resources from innovation to risk management. Council members discussed the need for more tailored regulations, as well as the need to reduce and better think through various regulatory thresholds and thereby allow smaller institutions to get back into loan markets they were forced to exit due to disproportionately high regulatory compliance burdens.

Council members discussed the recent prohibition by the Federal Housing Administration (FHA) on accepting mortgages made to non-resident aliens. Members are concerned that the Federal Housing Finance Agency might follow the FHA's lead and prohibit Freddie and Fannie from purchasing mortgages made to non-resident aliens and/or prohibiting the Federal Home Loan Banks (FHLBs) from accepting such loans as collateral. An immediate concern is that the FHLBs may devalue collateral backed by Individual Taxpayer Identification Numbers or other loans made to non-resident aliens.

Council members raised concerns related to fair lending risk. For example, if banks choose to continue to make these loans to non-resident aliens (and hold them in portfolios, but collect a higher down payment to offset risk), such an approach could lead to fair lending claims.

Council members raised concerns over the recent executive order limiting the Community Development Financial Institutions (CDFI) Fund to statutory minimum activities. While both the Treasury Department and bipartisan congressional responses indicate strong continued support for the CDFI Fund, Council members expect that the current administration may seek to reduce it through limited appropriations or through restrictions on contracts that make it more difficult for the Fund to distribute funding to applicants. The Fund still has strong bipartisan support and is statutorily authorized, but Council members expect continued tensions, as the administration might view the Fund and the CDFI industry as sufficiently mature to be able to exist without federal support. Council members believe that the CDFI Fund remains critical for vulnerable communities and requires continued federal government support.

Council members are supportive of ongoing legislative efforts to overturn the Consumer Financial Protection Bureau (CFPB) overdraft rule, as well as to repeal CFPB's section 1071 rule, including a recent statement by the CFPB leadership to rewrite the 1071 rule. Council members are also supportive of the recent announcement by the federal banking agencies to rescind the 2023 Community Reinvestment Act (CRA) final rule–this action would be consistent with the feedback the Council shared in past meetings on the rule's adverse impact on community banks and their ability to serve their customers. Finally, Council members support the Access to Credit for our Rural Economy Act (ACRE) legislation, as they believe it will level the playing field with the Farm Credit System for certain types of lending activities.