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These findings showed the same pattern from 2010 to 2013 as from 2007 to 2010: wealth concentration increasing, equity lending and CDs decreasing, drivers of institution choice remaining constant.

2014 Demographic Update

The latest demographic statistics yield an interesting portrait of the United States. The U.S. now contains 317 million residents in 120 million households. That population base is highly skewed geographically; 12% of the U.S. population, or almost one in eight residents, live in California, and the four largest states (California, Texas, New York and Florida) contain one-third of all residents. For decades the U.S. population has become increasingly urbanized, and more than 85% of U.S. residents now live in metropolitan areas.

Nationwide, median household income reached $61,000 last year, led by Maryland at $85,000 and New Jersey at $82,000. Median income also exceeds $75,000 in Connecticut, Washington, DC, Alaska, Hawaii and Massachusetts. Housing values are closely correlated with income and among the states with the five highest median home values, only California is not a top-ranking state in terms of income. Hawaii shows the highest median home value in the nation, followed by Washington, DC, California, (continued on page 2)

Findings from the 2013 Survey of Consumer Finances

In September, the Federal Reserve Board released the findings from its Survey of Consumer Finances (SCF). Now in its ninth iteration, the SCF is a triennial comprehensive study of the finances of U.S. households. The study addresses savings, investment and borrowing behavior, as well as income and wealth levels. The SCF offers an abundance of fascinating insights for bankers, but four of the most interesting trends in the 2013 edition involve consumer borrowing behavior, migration away from certificates of deposit, wealth concentration and drivers of institution choice.

Home equity borrowing has declined steeply in recent years. In 2013 only 16% of homeowners held home equity loans or lines, down from a peak of 27% in the 2007 version of the study, just before the recession. Further, among those with home equity lines, 66% are carrying balances, compared to 70% from 2004 through 2010. Credit card borrowing has decreased in recent years, too, as only 38% of U.S. households now carry credit card debt; down one percentage point since 2010, but dramatically less than the 46% levels seen in 2004 and 2007. Interestingly, despite the change in home equity and credit card borrowing, installment-loan use has remained constant over the past 12 years, with about 47% of households using that instrument in each survey from 2001 through 2013.

Money market accounts have supplanted CDs, and stock market participation has declined in recent years. In the high and even moderate rate environments of prior times, certificates of deposit offered an easy way for financial institutions to raise funds, and many banks and credit unions would address funding shortages with a simple newspaper ad touting a special offering with top-of-market yields. Once a staple of consumer retirement portfolios owned by more than one-third of retirement-age households and by as many as 17% of all households, today only 8% of households own CDs. Even among retirement-age households, only 15% hold CDs. Money market accounts have captured most of the balances previously held in CDs. Consumers have also withdrawn from the risk of stock holdings, cautious after the volatile swings of the recession years. From 2007 to 2013, the proportion of households directly owning stocks declined from 18% to 14%, and the proportion of households owning mutual funds declined from 11% to 8%.

Stock market gains have accrued primarily to the wealthiest households, increasing the wealth disparity across socioeconomic tiers. The declining participation in the stock market occurred even as stock prices enjoyed a tremendous rebound from lows at the start of the recession. However, since many moderate wage earners shunned riskier (continued on page 2)

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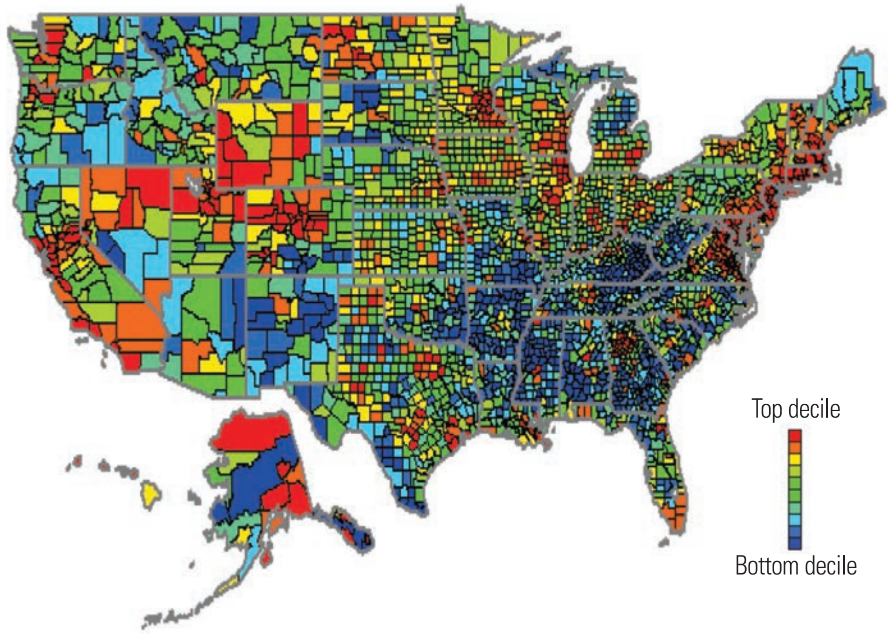
New Jersey and Massachusetts. Housing prices remain lowest in West Virginia, Mississippi, Arkansas, Oklahoma and Kentucky.

Although larger markets generally show greater affluence, the small metro of Los Alamos, New Mexico boasts the highest median income in the U.S. at $116,000. That affluence reflects the presence of Los Alamos National Laboratory and its highly educated workforce.

Median Houshold Income



Other high-income metros include San Jose and San Francisco in California; Washington, DC; and several outer suburban markets on the fringe of major metros. These exurban communities, including Lexington Park, MD just beyond Washington; Summit Park, UT outside of Salt Lake City; Oxnard outside of Los Angeles; and Bridgeport, CT outside of New York City, reflect a more dispersed workforce, as telecommuting technologies allow some employees to work from home bases farther removed from corporate offices.

The U.S. population continues to age, and nationwide median age (head of household) is now 51. West Virginia, Maine, Florida and Hawaii show the oldest household bases, each with median age of 54 or older. Washington, DC, Utah, Texas and Alaska show the youngest household bases, all with median age younger than 49.

Reflecting an economy that only recently emerged from recession, household growth forecasts remain moderate, with the U.S. overall household base projected to increase by 3.6% over the next five years. Seven states show five year household growth forecasts greater than 5%, with most of the group enjoying strong economic growth from the energy sector: North Dakota, Washington, DC, Utah, Alaska, Texas, South Dakota and Colorado. At the opposite end of the spectrum, six states show household growth forecasts of 2.5% or less, with all but one in the northern part of the country: West Virginia, Maine, Pennsylvania, Rhode Island, Ohio and Alabama.

For specific statistics about the markets where your bank or credit union operates, please contact Bancography at info@bancography.com or (205) 251-3227.

The highest income areas in the U.S. are concentrated along the Northeast corridor, in California, and in the large metros of the Midwest and Texas.

Findings from the 2013 Survey of Consumer Finances continued from page 1

investments while others simply lacked the disposable income to devote to investments, much of the benefit of the stock market revival accrued to the wealthiest households. From 2007 to 2013, median holdings of stocks, mutual funds and retirement accounts increased by more than 25% for households ranking in the top net worth quartile, but remained constant for households in the lower three quartiles. The skewed distribution of stock market gains furthered the disparity between the wealthiest and least wealthy households in the U.S.: the top net worth decile now hold 76% of all financial assets (including bank deposits, securities and retirement accounts, but excluding non-financial holdings such as real estate), compared to 72% in 2007 and 65% in 1995. The increasing concentration of wealth is a source of much political discussion, but for bankers one key implication is the majority of U.S. households derived only limited benefits from the stock market surge, and thus still face challenges in retirement planning. As household income growth continues to rebound and frees additional cash for saving, bankers should assist their customers in building appropriate investment strategies.

Location convenience remains paramount in institution selection. Beyond balance sheet data, the SCF also includes information on consumer preferences, including shopping behavior. Despite the growing availability of online channels for transaction use, location convenience remains the predominant driver of institution choice. In the 2013 survey, 44% of consumers cited "location of branch offices" as the primary reason for selecting their checking provider. That proportion has hovered between 44% and 46% in every edition of the survey since 1992. Notably, the

Keeping Score: How to Compare the Benefits of Potential Branch Projects

New branches represent costly investments, with capital costs for freestanding offices averaging more than $2 million and annual operating costs exceeding $550,000. Accordingly, prospective new branch projects must compete for capital not just among other possible branch investments, but across an institution's entire spectrum of potential capital investments. To facilitate such comparisons, it is beneficial to select specific measures that can summarize a project's likely financial impact. There are several summary measures that bankers use to evaluate proposed branch investments.

Total deposits represents the simplest measure by which to quantify projected branch performance, but that simplicity carries drawbacks. Based on market demographics and competition, each branch will attract a different deposit mix and thus carry a different cost of funds, so the profit impact of $40M in deposits can vary across branches. Loan-to-deposit ratios, capital costs and operating costs vary, too, so the deposit revenue will tell only part of the story. Further, summarizing by total deposits would preclude comparisons to other non-branch financial investments.

Net income also affords a simple comparative measure, but it too carries shortcomings, most notably in its inability to relate that income to associated costs. A branch that generates $200,000 in annual income on a $500,000 capital investment carries markedly different implications than a branch generating the same income on a $2M capital investment. Thus, a more effective summary measure must impound revenue, cost and capital components.

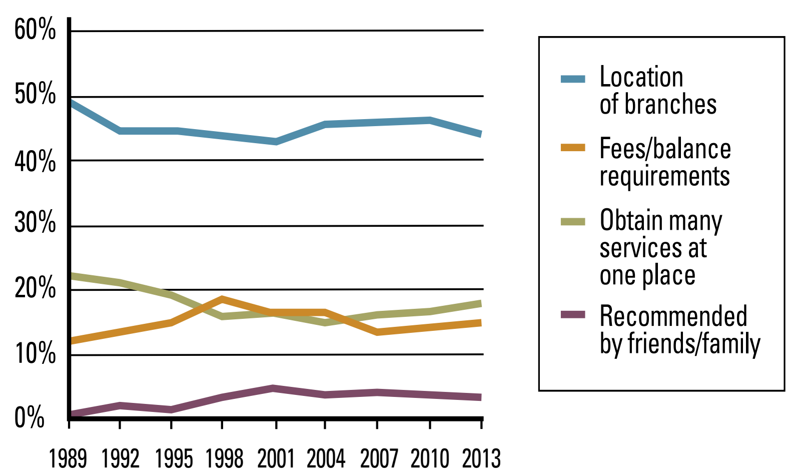
Internal rate of return (IRR) is the discount rate at which the sum of all cash flows from a project will have a net present value of zero. It can be viewed as the growth rate of the investments in a project, and thus can be compared to benchmark investments for the same capital (e.g., investing the capital into securities). Projects where IRR exceeds the institution's cost of capital will have a positive net present value, and thus be beneficial. IRR offers the benefit of a uniform measure that institutions can apply across all capital projects, not just branch investments. Further, because it relates income flows to capital investment, it brings investments of differing sizes to a common footing. Internal rate of return can thus allow comparison of a $2M branch investment to a $5M call center investment. Banks typically seek pre-tax internal rates of return in the 12% - 15% range for capital projects. Credit unions often target levels a few percentage points lower, reflecting their different tax treatment and non-profit ownership structure. Note though that because the initial 'year zero' cash outflow heavily affects the IRR calculation, the measure can create a bias toward leased versus owned branches, due to the former's lower upfront capital requirement. Thus, if directly comparing an owned and leased branching option, it can be beneficial to capitalize the lease payment; i.e., convert the lease payment stream to a purchase price equivalent and remove rental payments from the income statement, to compare sites on a basis independent of financing costs.

Return on liabilities (ROL) offers another viable summary measure. Calculated similarly to return on assets (but as net income divided by average deposits instead of by average assets), return on liabilities provides a statistic that bankers can compare to familiar benchmarks for the ROA calculation. Branches typically show loan-to-deposit ratios in the 25% - 40% range, so branches are deposit heavy and asset light. Thus, the ROA calculation that uses a branch's small asset base for the denominator often yields values in the 6% - 8% range, a level so removed from the norm of ROA outcomes as to lose any usefulness. In contrast, using the liability or deposit base as the denominator will yield values more in line with typical ROA expectations. Typical year five ROL forecasts for viable branches fall in the 1.6% - 2.0% range, with the gap from typical ROA levels reflecting the omission of local and corporate overhead from the standard new branch pro forma income statement. *(continued on page 4)*

second-most-cited reason, "able to obtain many services at one place," impounds a location aspect, too; 18% of respondents cited that factor as their primary reason for selecting their checking provider. The third-ranking reason, "lowest fees and/or minimum balances requirements," drove 15% of respondents' decisions, while no other factor captured more than 4% of responses. Thus, while in-branch transaction volumes continue to wane, the branch remains imperative for new account acuisition, raising cautions for institutions that might consider responding to transaction erosion with branch closures.

These findings showed the same pattern from 2010 to 2013 as from 2007 to 2010 (wealth concentration increasing, equity lending and CDs decreasing, drivers of institution choice remaining constant); that is, the past three years saw a continuation in incumbent trends rather than radical changes in consumer behavior. Future issues of Bancology will explore other findings from the SCF and their implications for the marketing of banking services.

Most Important Reason for Selecting Primary Institution



NEWS

Bancography will exhibit at the **BAI Retail Delivery Expo November 12-14, 2014** in Chicago. Visit us at Booth 4430.

Keeping Score: How to Compare the Benefits of Potential Branch Projects continued from page 3

The efficiency ratio answers "how many cents of expense does it take to generate one dollar of revenue?", deriving its name from the fact that it quantifies how efficiently the branch's expense base is performing in terms of generating revenue. Calculated as non-interest expense divided by the sum of net-interest margin plus non-interest revenue, the efficiency ratio falls under 55% at the highest-performing banks, but is more typically in the 65% - 75% range. To compare branch projects to corporate efficiency ratio levels, add 15 to 20 percentage points to account for overhead not impounded in the branch income statement. Thus, a branch project with a year five efficiency ratio of 35% would equate to corporate performance in the best practice 50% - 55% range, while a project with a year five efficiency ratio of 50% would equate to corporate performance near the U.S. bank median.

Each of these measures carries different benefits; and while institutions may prefer different measures, it remains important to select one or two primary measures so that each institution can allocate its investments only in those projects delivering the best returns.

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