71st Annual Field Meeting
Scranton
Welcome

• Speakers:
  • Keith Morales – Cybersecurity
  • Bill Spaniel – Banking Trends and Supervisory Update
  • Chris Henderson – Economic Outlook

• Dinner

• Closing remarks by President Pat Harker

• Post-meeting package (questionnaire results, presentations, & links to resources)

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Banking Trends and Supervisory Update

William Spaniel
Senior Vice President and Lending Officer
Overview

• Third District Banking Conditions
  – Earnings performance
  – Liquidity and non-core funding dependence
  – Commercial real estate (CRE) in the Third District

• Current expected credit loss (CECL) and impact to community banking organizations

• Regulatory updates
Third District Banking Conditions

* The charts on the following slides uses call report data as of 2016Q1 and 2016Q2 (when possible). The universe of community banks in this analysis consist of commercial banks with less than $10 billion in assets. This report utilizes a 10 percent capped mean, or winsorized mean, to compute the average district and national ratios, unless otherwise identified.
Third District Community Banks’ Earnings Performance

Net Interest Margin

- Third District
- Nation

2004: 3.75%
2005: 3.75%
2006: 3.75%
2007: 3.75%
2008: 3.75%
2009: 3.75%
2010: 3.75%
2011: 3.75%
2012: 3.75%
2013: 3.75%
2014: 3.75%
2015: 3.75%
Jun-16: 3.75%
Third District Community Banks’ Yield on Assets

Yield on Assets

- 3.0%
- 3.5%
- 4.0%
- 4.5%
- 5.0%
- 5.5%
- 6.0%
- 6.5%
- 7.0%
- 7.5%

Nation Yield on Assets

3D Yield on Assets

- 2004
- 2005
- 2006
- 2007
- 2008
- 2009
- 2010
- 2011
- 2012
- 2013
- 2014
- 2015
- Jun-16

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Third District Community Banks’ Cost of Funding

Cost of Funds

- 3D Funding Costs
- Nation Funding Costs

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Third District CRE Highlights

• Generally, Third District community banks have experienced stronger CRE growth than community banks throughout the nation

• Third District community banks are reporting improvements in asset quality metrics
  – Third District metrics have recovered significantly since the Great Recession
  – Examination staff focuses on compliance with supervisory guidance and reviewing CRE, high volatility CRE, and construction and land development (C&LD) loans

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Third District Community Banks’ CRE Concentrations Based on Bank Size*

* This graph uses median concentrations for each of the asset categories and will therefore not compute to the total CRE exposure.

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Third District Community Banks’ Overall CRE Loan Composition*

* This graph includes categorical CRE loans as a percentage of total CRE loans within the Third District at each time interval.
Current Expected Credit Loss (CECL)
CECL Model

- FASB issued ASU 2016-13
  - CECL recognizes expected credit losses on financial instruments
  - Applies to all banks, savings associations, and holding companies
  - Effective for SEC filers in 2020 and for other entities in 2021
- Regulators issued a joint statement on the New Accounting Standard on Financial Instruments
  - Federal Reserve issued supervisory (SR) letter 16-12
Preparing for CECL

- Review existing allowance model, systems, and practices and leverage as appropriate
- Engage all relevant business lines in planning and implementation efforts
- Identify and collect historical data to estimate life of loan expected losses
- Discuss plans with auditors, industry peers, and regulators
Regulatory Updates
Banking Agencies’ Efforts to Reduce Regulatory Burden

• Interagency efforts to alleviate regulatory burden
  – Use of evaluation in lieu of appraisal for real estate related financial transactions
  – Proposal to reduce Call Report requirements for small financial institutions

• FAST Act changes
  – Extended examination cycle for institutions under $1 billion
  – Annual privacy notice under Regulation P
  – Community bank exemption for certain mortgage rules

• Economic Growth and Regulatory Paperwork Reduction Act Review Process
  – Regulators continue to address comments based on 2014 and 2015 outreach meetings
Regulatory Updates

• Consumer Financial Protection Bureau’s pending proposed rules
  – Prepaid cards
  – Mortgage servicing
  – Payday lending/title loan proposal

• Federal Reserve 2016 efforts
  – Off-site loan review during examinations
  – Expectations for relying on work of insured depository institution regulators
Banking Trends and Supervisory Update

William Spaniel
Senior Vice President and Lending Officer
Report on Economic and Financial Developments

Chris Henderson*
Assistant Vice President

*The views expressed today are my own and not necessarily those of the Federal Reserve Bank of Philadelphia or the Federal Reserve System.
GROWTH AND FORECAST FOR U.S. REAL GDP

Annualized quarterly growth rate (SAAR)

Source: BEA via Haver Analytics and FRB Philadelphia SPF
Quarters plotted (actual): 2005:Q1 - 2016:Q2 (third estimate)
GDP GROWTH BY SECTOR OVER LAST 4 QUARTERS
Black lines indicate historical averages from 1980:Q1 to 2016:Q2

Annualized quarterly growth (SAAR)

Source: BEA via Haver Analytics
Last quarter included: 2016:Q2
Black lines indicate sector averages from 1980:Q1 to 2016:Q2
Employment
CHANGE IN MONTHLY U.S. PAYROLL EMPLOYMENT

Black lines indicate annual averages (in thousands)

Source: BLS via Haver Analytics

Months plotted: Jan 2011 - Sep 2016

Black lines indicate annual averages.

Sep 2016: 156
YEAR-OVER-YEAR PAYROLL EMPLOYMENT GROWTH
U.S. and Tri-State Region

Source: BLS via Haver Analytics
Last month plotted: US (Sep 2016): States (Aug 2016)
YEAR-OVER-YEAR PAYROLL EMPLOYMENT GROWTH
U.S., PA, and Scranton-Wilkes-Barre-Hazelton MSA (most recent values labeled)

Source: BLS via Haver Analytics
Last month plotted: US (Sep 2016): States and MSAs (Aug 2016)
TRI-STATE METRO AREA EMPLOYMENT GROWTH

Year-over-year percentage change (3-month moving average)

Source: Calculations from BLS data via Haver Analytics.
YEAR-OVER-YEAR EMPLOYMENT GROWTH BY SECTOR
U.S. AND Scranton-Wilkes-Barre-Hazelton MSA

Source: Calculations from BLS via Haver Analytics.
Last month included: US (Sep 2016); Scranton MSA (Aug 2016)
U.S. AND TRI-STATE UNEMPLOYMENT RATES
Monthly, seasonally adjusted (most recent value labeled)

Percent (seasonally adjusted)

Source: BLS via Haver Analytics
Last month plotted: US (Sep 2016); States (Aug 2016)
TOTAL NUMBER OF WELLS IN PENNSYLVANIA
By well type, 2000 – 2016 (2016 data through July)

Number of Wells

- **Conventional**
- **Unconventional**

Source: PA Dept. of Environmental Protection
Years plotted: 2000 – 2016 (2016 data through July)
Housing conditions
YEAR-OVER-YEAR STATE HOME PRICE GROWTH

Core Logic Index, 3-month moving average (nominal)

Source: Calculations from Core Logic
Last month included: Aug 2016
FORECLOSURE ACTIVITY
As a share of all active loans (maximum and most recent values labeled)

Percentage of active loans (seasonally adjusted)

Source: McDash-HMDA via RADAR
Months plotted: Jan 1997 - Aug 2016
REO ACTIVITY
As a share of all active loans (maximum and most recent values labeled)

Percentage of active loans (seasonally adjusted)

Source: McDash-HMDA via RADAR
Months plotted: Jan 1997 - Aug 2016
MORTGAGE BALANCES AT COMMUNITY BANKS
Third District and the Nation (Quarterly data from 2010 to 2016Q2)

The decline in the Third District between 2015 and 2016Q2 was primarily the result of National Penn Bank’s merger with BB&T. National Penn reported $1.2 billion in outstanding 1-4 family first lien mortgages as of 2015Q4.
Monetary Policy
U.S. PCE INFLATION
Year-over-year (seasonally adjusted)

Year-over-year percent change (seasonally adjusted)

-2% -1% 0% 1% 2% 3% 4%


PCE PCE Core FOMC Target

Source: BEA via Haver Analytics
Months plotted: Jan 2000 - Aug 2016
FEDERAL FUNDS RATE DOT PLOT COMPARISON
June 2016 vs September 2016

Source: FOMC Projections, June 2016 and September 2016
MARKET-IMPLIED PROBABILITY OF A RATE HIKE
Based on CME Fed Funds Futures Contracts (as of Oct. 14, 2016)

Source: Bloomberg
Shading represents FOMC meeting dates.
Private forecasters expect GDP growth to accelerate in the second-half of 2016 and to return to around 2% next year.

Excluding energy-related industries, employment growth continues to be steady in the nation and in our region.

Home price growth will likely be below average in the near-term in regions with larger REO volumes to clear, but the long-term trend in housing is positive.

Both the data from FOMC members and the market seem to suggest a single hike of the federal funds rate in 2016.
U.S. UNEMPLOYMENT RATE
Monthly, seasonally adjusted (most recent and last year's values labeled)

Percent (seasonally adjusted)

Source: BLS via Haver Analytics
Months plotted: Jan 2000 to Sep 2016
Dotted lines indicate average from 2002-2007.
DELINQUENCY RATE
Scranton-Wilkes-Barre-Hazelton MSA

Percentage of active loans (Seasonally Adjusted): maximum and most recent observation labeled

Source: McDash-HMDA via RADAR
Months plotted: Jan 1997 - Aug 2016
Report on Economic and Financial Developments

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