BANKING BRIEF

FOR PENNSYLVANIA, NEW JERSEY, AND DELAWARE

Second Quarter 2001

Following the pattern from last quarter, community banking organizations continued to outperform their larger counterparts in terms of loan and deposit growth, and at the national level, average return on assets (ROA). Notwithstanding declines in consumer loans, total loan volume at community banks in the tri-state area and the nation rose at a healthy rate during the first half of the year. Total loans originated by large banks have declined, especially within the tri-state area. The decline was particularly pronounced in commercial and industrial loans. As mentioned in the previous issue of *Banking Brief*, an increase in nonperforming loans occurred primarily at large banks. We are devoting this issue to the topic of nonperfoming loans.

The Issue of Credit Quality Revisited

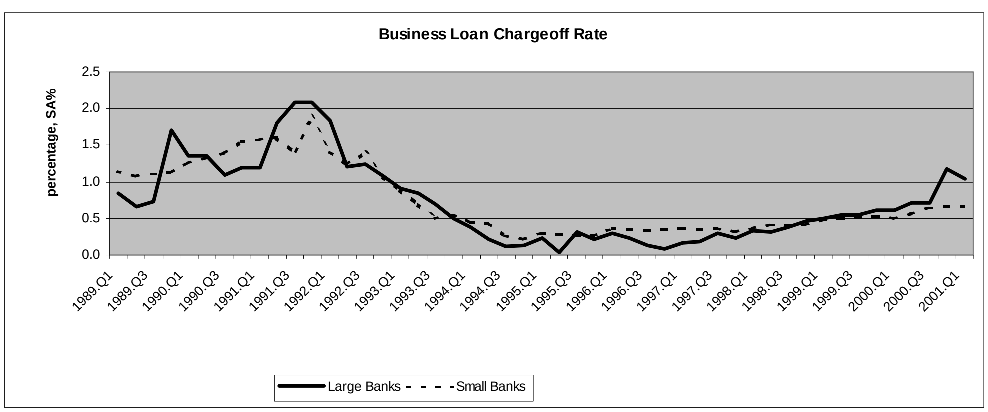
Federal Reserve data indicate that nonperforming loans are on the rise, particularly at large banks. As of June, 2.9 percent of commercial and industrial loans for the 100 largest banks were more than 30 days past due on interest or principal payments, compared with 1.9 percent during the first quarter of 2000.[1] This percentage has been rising every quarter since the second half of 1998; however, this rate remains below levels reached in the early 1990s.

Over the first half of the year large banking companies tried to rid themselves of problem loans. This is reflected in the rising chargeoff rate for commercial loans at the 100 largest banks, which reached 1.2 percent during the first quarter of the year, its highest level since the end of 1992 (see Figure). Recent underwriting surveys conducted by the Federal Reserve Board indicate that many banks tightened credit terms on business loans for larger borrowers, but some loans originated in the late 1990s have not yet seasoned and could potentially pose credit quality problems as the economic slowdown continues.[2]

Consumer loans are a growing concern for some banking companies with large credit card businesses. The chargeoff rate for credit cards rose one percentage point from one year ago to 5.4 percent for all banks. Filings for personal bankruptcies in the first half of 2001 were 21 percent higher than in the first half of 2000. This increase is likely the result of the weakening economy. The bankruptcy rate can be explained in part by the frequency of insolvency events, including layoffs, loss of overtime hours, failure of a small business, and other interruptions in income or unexpected expenses that result in repayment problems.[3] But it has also been suggested by some in the financial press that the recent spike in bankruptcies might, in part, be due to people scrambling to file ahead of proposed new legislation.

It is interesting to note that so far most of the credit quality problems have been limited to large banks. During the second quarter, while large banking organizations in the tri-state area and the nation reported a rise in the nonperforming loan ratio to 1.5 percent from 1 percent a year ago, community banks in the tri-state area reported a nonperforming loan ratio of 0.7 percent — a decline of 0.1 percent from a year ago. The answer might lie in the fact that community banks concentrate more heavily on real estate loans (especially residential loans) than larger banks. In contrast to C&I and consumer loans, delinquency rates in real estate loans have been hovering around 2 percent for the past four years. Over the past decade, smaller community banks have been shifting their assets away from business and consumer loans to real estate loans, particularly at the tri-state area banks. In this District, community banks rely primarily on real estate loans (more than 70 percent of their loan volume last quarter came from real estate loans, compared with about 40 percent for large banks). The share of real estate loans at tri-state banks increased from 63.4 percent of total loans in 1991 to 72 percent at the end of 2000.

Continuing weakness in the economy can potentially threaten the health of the real estate market. Already, residential mortgage loan delinquencies for all banks rose in the second quarter from 2 percent a year ago to 2.4 percent. But banks in this area are well positioned to weather an economic slowdown because they maintain relatively high loan-loss reserves. The loan-loss coverage ratios for community banks remained relatively stable nationally, rising from 144 percent in 1994 to 165.3 percent in 2000. For the tri-state area's community banks, the same ratio rose from 118 percent in 1994 to 202 percent in 2000.



[1] See the Federal Reserve Board's Charge-Off and Delinquency Rates on Loans and Leases at Commercial Banks for June 2001.

[2] Federal Reserve Board, Senior Loan Officer Opinion Survey on Bank Lending Practices, May and August 2001.

[3] J. Barron, G. Elliehausen, and M. Staten, "Monitoring the Household Sector with Aggregate Credit Bureau Data," *Business Economics* (January 2000).

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Second Quarter 2001

Community Banking Organizations

	Tri-State			*Nation*		
	$Bill	**% change from**		**$Bill**	**% change from**	
	01Q2	**01Q1**	**00Q2**	**01Q2**	**01Q1**	**00Q2**
Total Assets	77.7*	11.6	8.6	1194.0	7.8	10.1
Total Loans	47.7	12.1	8.1	769.9	11.6	10.0
Business	6.5	14.2	10.8	141.0	11.9	11.1
Real Estate	34.6	13.6	8.6	498.4	11.7	11.8
Consumer	5.1	-3.5	0.6	82.7	2.1	0.7
Total Deposits	60.8	10.5	9.2	971.9	6.5	10.3
Ratios (in %)	**01Q2**	**01Q1**	**00Q2**	**01Q2**	**01Q1**	**00Q2**
Net Income/ Avg Assets (ROA)	1.1	1.1	1.2	1.2	1.2	1.2
Net Interest Inc/ Avg Assets (NIM)	3.6	3.6	3.7	3.9	4.0	4.1
Noninterest Inc/ Avg Assets	1.1	1.1	1.1	1.0	1.0	1.0
Noninterest Exp/ Avg Assets	3.0	3.0	3.0	3.1	3.1	3.2
Loans/Deposits	78.5	78.2	79.3	79.2	78.3	79.4
Equity/Assets	8.8	8.8	8.4	9.4	9.4	9.0
Nonperforming Loans/ Total Loans	0.7	0.7	0.8	1.0	1.0	0.8

Large Banking Organizations

	Tri-State			*Nation*		
	$Bill	**% change from**		**$Bill**	**% change from**	
	01Q2	**01Q1**	**00Q2**	**01Q2**	**01Q1**	**00Q2**
Total Assets	859.0	-3.8	-3.2	4696.9	0.7	3.3
Total Loans	530.7	-5.7	-3.8	2789.0	-0.2	1.1
Business	182.7	-12.0	-7.2	851.8	-11.1	-3.2
Real Estate	215.6	-2.3	-2.6	1174.3	6.3	3.6
Consumer	47.0	9.0	-3.4	344.1	8.3	6.1
Total Deposits	563.9	-2.3	-1.2	3023.1	4.7	3.2
Ratios (in %)	**01Q2**	**01Q1**	**00Q2**	**01Q2**	**01Q1**	**00Q2**
Net Income/ Avg Assets (ROA)	1.4	1.1	1.1	1.1	1.1	1.2
Net Interest Inc/ Avg Assets (NIM)	3.2	3.2	3.3	3.1	3.1	3.2
Noninterest Inc/ Avg Assets	2.8	2.8	2.9	2.3	2.3	2.4
Noninterest Exp/ Avg Assets	3.4	3.7	3.9	3.2	3.3	3.4
Loans/Deposits	94.1	95.0	96.7	92.3	93.4	94.1
Equity/Assets	9.0	9.0	8.1	8.3	8.3	7.9
Nonperforming Loans/ Total Loans	1.5	1.5	1.2	1.5	1.5	1.0

A banking organization is an independent bank or all the banks within a highest-level bank holding company; however, banks less than five years old and those whose credit card loans make up greater than 50 percent of their total loans are excluded. The large banking organization sample is based on banking organizations whose total assets were at least as large as those of the 100th largest banking organization in the United States as of December 31, 2000. The community banking organization sample is based on the remaining banking organizations. Tri-state large banking organizations are those large banking organizations that have either at least 5 percent of the deposits of the region or any state therein or at least 5 percent of their deposits in the region. Tri-state community banking organizations are those community banking organizations that are headquartered in the region. The numbers of banking organizations in the categories are as follows: (1) community banking organizations —191 for the tri-state area and 6060 for the nation; (2) large banking organizations —17 for the tri-state area and 95 for the nation. Ratios are aggregates, that is, the numerators and denominators are summed across all banks in the group, then divided.

*Total assets for tri-state community banks in the second quarter is about $2 billion less than we reported for the first quarter. Due to a reorganization completed in the second quarter, FNB Corp. is no longer included in our sample of tri-state community banks. We resample every quarter to account for mergers and consolidations completed in the previous quarter and adjust past samples accordingly.

Any questions or comments should be directed to Victoria Geyfman at (215) 574-6431 or victoria.geyfman@phil.frb.org. Detailed documentation on the methodology used in constructing this document, back issues, and the current issue of *Banking Brief* are available on our web site at www.phil.frb.org/econ/bb/index.html. To subscribe to this publication, please contact the Publications Desk at (215) 574-6428 or lois.newell@phil.frb.org.