BANKING BRIEF

FOR PENNSYLVANIA, NEW JERSEY, AND DELAWARE

First Quarter 2003

Banks in the tri-state area and the nation continued to report an impressive average rate of return on assets of 1.2 percent. Loan quality remained favorable at tri-state community banks compared with other community banks and large banks in the nation. The average ratio of nonperforming loans to total loans at smaller banks in the District has fallen to 0.9 percent, compared with 1.6 percent at large banks in the nation. The Federal Reserve Board recently stated that delinquency rates in the nation for most loan categories decreased from last quarter. One exception was the delinquency rate of commercial real estate loans, which rose from 1.59 to 1.77 percent—still lower than the rate reported in the first quarter of last year. The charge-off rate for credit card loans rose slightly over the quarter, with large banks contributing to the rise. On a year-over-year basis, the charge-off rates for all other loans have fallen.

The total volume of loans generated by all banks increased over the quarter, with real estate loans driving the growth. Both large and small banks reported gains in real estate lending. Business loans increased at community banks but fell at large banks. The national trend is consistent with the evidence from the most recent Senior Loan Officer Opinion Survey. Demand for C&I loans weakened over the past few months because of a decline in the need to finance capital expenditures and inventories. Even though banks continue to tighten lending standards on business loans, the fraction of banks surveyed that reported tightening credit standards declined significantly since the last report.

Consumer loans to individuals were down for the quarter and the year except at the 100 largest banks in the nation.

Real Estate Lending Trends at Community Banks

The Beige Book for April 2003 reports that residential building remained strong and commercial building remained sluggish during the first quarter of 2003. Banks reported high levels of residential building activity and sales. Still, some home builders suggested there was a slight softening in their markets. Nationwide, building permits in April were 2.8 percent higher than a year ago. But in the tri-state area, the number of housing permits was 8.2 percent lower than a year ago. According to the Census Bureau, April housing starts in the nation were 6.8 percent lower than in March but 2.7 percent higher than a year ago.

Home lending activity, fueled mainly by refinancing, remained strong across the nation. Mortgage refinancing has become popular for many reasons, including lower interest rates that allow consumers to reduce monthly mortgage payments; lower mortgage transaction costs because of new technologies; and gains in home values and equity that allow consumers to use funds in cash-out refinancings to make home improvements, repay existing debt, or purchase other goods and services.

A recent Federal Reserve *Bulletin* article presented the results of a survey of homeowners conducted in 2002. The survey found that about 63 percent of U.S. homeowners had an outstanding mortgage on their primary residence and owed, on average, about $100,000.

Between 16 and 23 percent of homeowners with mortgages refinanced their loans between the beginning of 2001 and early 2002, which coincides with a period of relatively low and declining long-term interest rates. Homeowners with comparatively large mortgage balances were more likely to take advantage of lower rates because the potential interest savings from refinancing was more likely to exceed the transaction costs. Homeowners refinance for a variety of reasons: to lower interest rates, to convert from adjustable- to fixed-rate mortgages (or the reverse), to change the repayment period, or to access some of the equity in their homes.

The health of the real estate market is of particular interest to community banks because their loan portfolios consist mostly of real estate loans, especially residential loans. During the 1990s, smaller community banks increased their concentration on real estate lending at the expense of business and consumer loans. In this District, more than 70 percent of the loan volume of community banks last quarter came from real estate lending, compared with about 48 percent for large banks. The share of real estate loans at tri-state banks increased from 63 percent of total loans in 1992 to 75 percent at the end of 2002.

So far, the weakness in the economy has had little effect on the health of community banks, in part because of low interest rates and increased residential loan production over the last few years. Lower mortgage rates supported the growth in mortgage origination as well as sales into the secondary market. (In the secondary market, a primary lender typically sells loans to large institutional investors, which retain a selection for their own purposes and/or package and sell the rest to other investors. The largest of these institutions are Fannie Mae, Freddie Mac, and Ginnie Mae.) According to the trade association America's Community Bankers (ACB), 72 percent of community banks surveyed sold residential mortgages into the secondary market in 2002, compared with 49 percent in 2000. ACB reports community banks are becoming more efficient in selling their loans as a result of using advanced home mortgage technology to underwrite and originate residential mortgage loans. The top three challenges in mortgage lending, as cited by community bankers surveyed by the ACB, were competition from specialized and unregulated lenders, mortgage pricing and profitability, and staffing to meet demand.

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First Quarter 2003

Community Banking Organizations

	Tri-State			*Nation*		
	$Bill	**% change from**		**$Bill**	**% change from**	
	03Q1	**02Q4**	**02Q1**	**03Q1***	**02Q4**	**02Q1**
Total Assets	94.4	9.1	11.1	1369.8	8.3	10.4
Total Loans	56.2	6.4	7.8	864.7	4.6	9.2
Business	8.5	15.6	3.5	150.5	5.2	5.1
Real Estate	40.3	5.8	9.5	591.6	7.6	12.5
Consumer	5.1	-7.1	-0.9	75.8	-7.2	-2.7
Total Deposits	71.9	7.1	10.5	1101.4	8.7	9.5
Ratios (in %)	**03Q1**	**02Q4**	**02Q1**	**03Q1**	**02Q4**	**02Q1**
Net Income/ Avg Assets (ROA)	1.2	1.2	1.2	1.2	1.2	1.1
Net Interest Inc/ Avg Assets (NIM)	3.6	3.6	3.6	3.9	3.9	3.9
Noninterest Inc/ Avg Assets	1.3	1.3	1.3	1.1	1.1	1.1
Noninterest Exp/ Avg Assets	3.1	3.1	3.2	3.1	3.1	3.1
Loans/Deposits	78.1	78.2	80.1	78.5	79.3	78.7
Equity/Assets	9.5	9.5	9.1	9.7	9.7	9.5
Nonperforming Loans/ Total Loans	0.9	0.9	1.1	1.1	1.0	1.2

Large Banking Organizations

	Tri-State			*Nation*		
	$Bill	**% change from**		**$Bill**	**% change from**	
	03Q1	**02Q4**	**02Q1**	**03Q1**	**02Q4**	**02Q1**
Total Assets	973.4	9.8	9.2	5326.3	8.0	10.7
Total Loans	565.7	1.8	2.0	3000.2	3.7	6.6
Business	151.4	-3.4	-13.1	728.0	-4.8	-8.8
Real Estate	283.8	12.1	17.1	1438.5	8.1	16.9
Consumer	54.1	-0.5	-0.1	409.1	-1.5	8.8
Total Deposits	647.2	12.9	9.0	3432.9	8.4	10.1
Ratios (in %)	**03Q1**	**02Q4**	**02Q1**	**03Q1**	**02Q4**	**02Q1**
Net Income/ Avg Assets (ROA)	1.2	1.3	1.1	1.2	1.2	1.1
Net Interest Inc/ Avg Assets (NIM)	3.2	3.3	3.2	3.2	3.2	3.1
Noninterest Inc/ Avg Assets	2.4	2.5	2.4	2.3	2.3	2.2
Noninterest Exp/ Avg Assets	3.3	3.3	3.2	3.2	3.2	3.2
Loans/Deposits	87.4	89.7	93.4	87.4	88.4	90.3
Equity/Assets	9.2	9.2	9.5	8.5	8.5	8.8
Nonperforming Loans/ Total Loans	1.5	1.5	1.5	1.6	1.6	1.8

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, 2002. 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—207 for the tri-state area and 6106 for the nation; (2) large banking organizations—18 for the tri-state area and 99 for the nation. Ratios are aggregates, that is, the numerators and denominators are summed across all banks in the group, then divided. Data are adjusted for mergers. Quarterly percentage changes are compound annualized rates.

* This quarter's sample excluded one bank that changed its charter from a thrift to a bank.

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.