Banking Brief

For Pennsylvania, New Jersey, and Delaware

Fourth Quarter 2004

Average return on assets and most other performance ratios remained unchanged since the last quarter at both large and community banks. However, large banks reported a slightly lower average interest margin and noninterest income ratio compared with year-earlier levels. Asset quality indicators continued to improve in the fourth quarter, with the ratio of nonperforming loans remaining below the levels of last year. This improvement was led by a decline in the industry's net charge-off rate to 0.51 percent, the lowest level since the mid-1990s.

Banks posted strong growth in assets. Small banks reported a 9 percent rise in total assets; large banks reported a 7 percent rise.[1] Reinvigorated growth in real estate lending helped to boost strong asset growth. Real estate lending at community banks was 14 percent higher than in the third quarter of 2004. Large banks saw a 13 percent increase in this loan category during the same period. Growth in business loans was also significant, particularly at tri-state area community banks. Community banks reported a general slowdown in consumer lending of about 6 percent; large banks reported robust growth of almost 9 percent.

Trends in Community Banking

In 2003, a timely question was posed by a conference titled "Whither the Community Bank?"[2] Over the past two decades the number of U.S. banks has declined from around 14,400 banks in 1980 to about 7700 banks in 2003. The trend in bank consolidation has been fueled by advances in technology and deregulation at the federal and state levels, which tore down barriers to geographic expansion. Most affected were community banks, commonly defined as banks with less than $1 billion in assets.[3] While community banks still represent roughly 95 percent of the banking industry in terms of the number of institutions — a figure essentially unchanged since the 1980s – they account for a smaller share of assets, about 15 percent in 2003, down from 30 percent in 1985. However, there is ample evidence that community banks remain important in various communities and economic sectors, particularly in small-business and agricultural lending.

In addition to providing services in rural communities, community banks specialize in "relationship banking," where bankers' understanding of local business conditions and personal knowledge of borrowers' creditworthiness create informational efficiencies that facilitate lending.[4] This distinguishes community banks from large banks that rely more on quantitative financial information and centralized decision-making. Community banks generally make loans to small businesses, farmers, and households in local or regional markets. Small businesses play a critical role in the U.S. economy, so community banks' lending to this sector is very important.

Community banks have a higher loans-to-assets ratio than large banks: 65 percent compared with 55 percent. Furthermore, the composition of community banks' loan portfolios differs from that of large banks (see Figure). More than two-thirds of community bank loans at the end of 2003 were secured by real estate, as compared to about 50 percent for large banks.

Although their asset share has declined since the 1980s, community banks continue to provide a healthy share of real estate and small-business loans. Community banks' performance remains strong, and they will likely continue to play an important role in the economy in the years ahead.[5]

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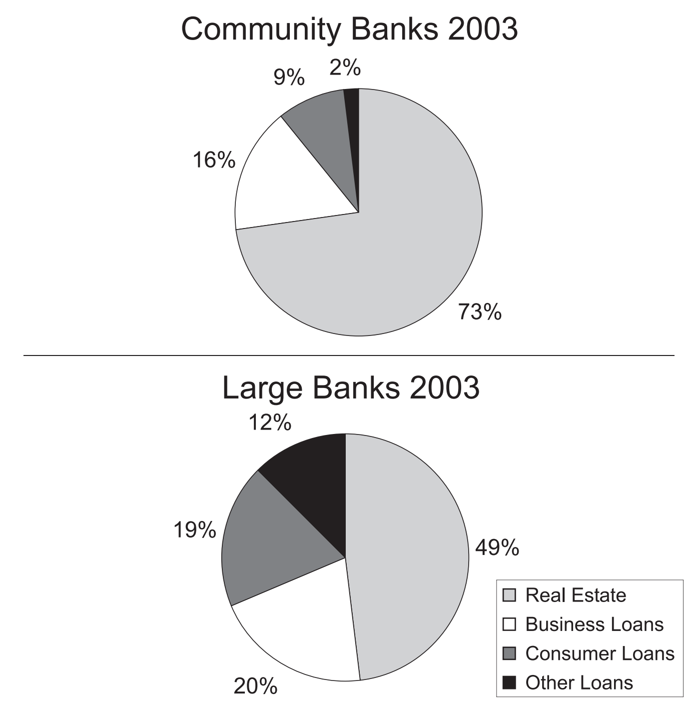
[1] The increase in assets and deposits at large banking organizations is primarily attributable to growth at the largest three banks in the sample.

[2] A special issue of the *Journal of Financial Services Research* 25:2/3 (April 2004) contains selected academic proceedings from the conference.

[3] The definition of community banks used in *Banking Brief* does not limit them to assets of less than $1 billion (see notes to Table on reverse).

[4] A. Berger, N. Miller, M. Petersen, R. Rajan, and J. Stein, "Does Function Follow Organizational Form? Evidence from the Lending Practices of Large and Small Banks," National Bureau of Economic Research Working Paper 8752, 2002.

[5] T. Critchfied et al. "Community Banks: Their Recent Past, Current Performance, and Future Prospects," FDIC Future of Community Banking Study, 2004.



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	Community Banking Organizations						*Large Banking Organizations*						
	Tri-State			*Nation*				*Tri-State*			*Nation*		
	$Bill	**% change from**		**$Bill**	**% change from**			**$Bill**	**% change from**		**$Bill**	**% change from**	
	04Q4	**04Q3**	**03Q4**	**04Q4**	**04Q3**	**03Q4**		**04Q4**	**04Q3**	**03Q4**	**04Q4**	**04Q3**	**03Q4**
Total Assets	85.9	5.0	7.3	1564.1	9.3	11.3	Total Assets	2002.8	11.1	14.6	6213.3	7.3	10.2
Total Loans	54.0	10.1	11.9	1025.9	11.4	14.6	Total Loans	1054.2	8.9	6.3	3435.4	4.0	9.0
Business	7.6	16.1	15.1	165.8	10.5	10.3	Business	215.1	8.0	-0.2	703.1	6.6	3.1
Real Estate	41.8	11.7	12.9	736.3	14.4	18.1	Real Estate	605.6	12.0	10.5	1775.2	13.2	13.8
Consumer	2.9	-10.2	-3.2	70.9	-5.9	-1.8	Consumer	96.3	8.7	0.3	490.5	8.8	8.3
Total Deposits	66.8	5.0	7.5	1234.2	10.7	10.1	Total Deposits	1372.4	14.5	14.4	4079.7	15.0	11.4
Ratios (in %)	**04Q4**	**04Q3**	**03Q4**	**04Q4**	**04Q3**	**03Q4**	**Ratios (in %)**	**04Q4**	**04Q3**	**03Q4**	**04Q4**	**04Q3**	**03Q4**
Net Income/ Avg Assets (ROA)	1.1	1.1	1.1	1.2	1.2	1.2	Net Income/ Avg Assets (ROA)	1.4	1.4	1.4	1.2	1.2	1.3
Net Interest Inc/ Avg Assets (NIM)	3.4	3.4	3.4	3.7	3.7	3.7	Net Interest Inc/ Avg Assets (NIM)	2.8	2.8	3.0	2.7	2.8	3.0
Noninterest Inc/ Avg Assets	1.1	1.2	1.2	1.1	1.1	1.2	Noninterest Inc/ Avg Assets	2.0	2.0	2.3	2.1	2.1	2.3
Noninterest Exp/ Avg Assets	2.9	3.0	3.0	3.0	3.0	3.1	Noninterest Exp/ Avg Assets	2.8	2.9	3.1	3.0	3.0	3.1
Loans/Deposits	80.8	79.8	77.6	83.1	83.0	79.9	Loans/Deposits	76.8	77.8	82.6	84.2	86.4	86.0
Equity/Assets	9.8	9.8	9.4	9.8	9.8	9.7	Equity/Assets	9.9	9.9	8.6	9.4	9.4	8.4
Nonperforming Loans/ Total Loans	0.6	0.6	0.8	0.7	0.8	0.9	Nonperforming Loans/ Total Loans	0.6	0.5	1.0	0.8	0.8	1.2

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, 2003. 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 5895 for the nation; (2) large banking organizations—19 for the tri-state area and 93 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.

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 go to www.philadelphiafed.org/forms/orderform.htm and scroll down to Economic Research Publications.