Banking Brief

For Pennsylvania, New Jersey, and Delaware

Second Quarter 2005

Commercial banks in the nation reported continued strong performance in the second quarter of 2005. Profits were fueled in part by sustained strength in real estate loans and growing demand for commercial and industrial loans. Real estate lending at community banks was almost 18 percent higher than in the first quarter of 2005. Large banks experienced a 13 percent increase in this loan category during the same period. In the nation, the total volume of business loans grew 14 percent in the second quarter at large banks and almost 15 percent at community banks. The growth of total assets was hampered by slow growth in total securities, which rose only 1.7 percent. By comparison, the book value of securities rose almost 8 percent in the second quarter of 2004 and 17.5 percent during the same period in 2003.

The average return on assets (ROA) for both large and community bank organizations in the nation remained unchanged at 1.2 percent. Asset quality remained favorable, although large banks in the nation and small banks in the tri-state area experienced a slight increase in the percentage of nonperforming loans, although it still remains below 1 percent for all banks. Net chargeoffs declined to 0.49 percent, a level last observed in 1995. The percentage of business loans charged off fell to 0.27 percent, well below the most recent peak of 2 percent in 2001 and 2002.

Commercial Real Estate Lending at Community Banks

During the first half of 2005, small banks, commonly defined as banks with less than $1 billion in assets, reported a strong average return on assets of 1.2 percent. Small banks experienced particularly strong growth in commercial real estate (CRE) lending, a continuation of the trend that began in 2001.

CRE lending is a traditional activity of community banks and one of the areas in which they can effectively compete with larger banks. Since 2001, CRE lending has been growing faster at small banks and has accounted for more than half of their total asset growth every year. During the second quarter of 2005, CRE lending reached 28 percent of aggregate small bank loans, while such loans made up only about 11 percent of the loans at large banks (see Figure). This is a remarkable pace of growth and something that regulators have warned about repeatedly in recent months.* The Fed and other financial services regulators are expected to propose guidelines that would reinforce sound practices for CRE lending and credit risk management.

At this time, there is no sign of deterioration in the credit quality of CRE exposures at community banks. The charge-off rate for CRE loans hovered around 0.07 percent during 2004 and was 0.06 percent in the second quarter of 2005, a level last observed in 2000. Similarly, the delinquency rate remained well below levels of the early 1990s. Nonetheless, according to the January Senior Loan Officers Opinion Survey, it appears that intense competition for these loans has induced some banks to ease their lending standards. As always, managing credit risk in rapidly growing business lines is essential for the long-term success of any community banking organization.

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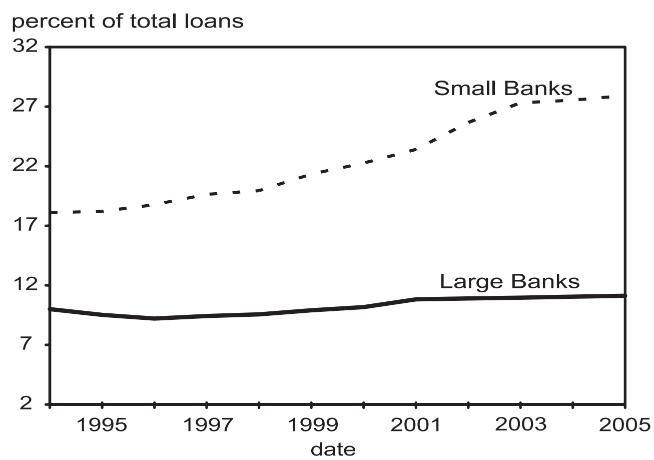
* See, for example, the speech by Federal Reserve Governor Susan Bies at the North Carolina Bankers Association 109th Annual Convention, Kiawah Island, South Carolina, June 14, 2005.

Commercial Real Estate Loans



Note: Large banks are defined as having $1 billion or more in total assets; small banks are those with less than $1 billion in total assets.

Research Department Federal Reserve Bank of Philadelphia
Ten Independence Mall, Philadelphia, PA 19106-1574 • 215-574-6428 • www.PhiladelphiaFed.org

Second Quarter 2005

Community Banking Organizations

	Tri-State			*Nation*		
	$Bill	**% change from**		**$Bill**	**% change from**	
	05Q2	**05Q1**	**04Q2**	**05Q2**	**05Q1**	**04Q2**
Total Assets	87.0	10.0	6.7	1591.2	11.6	10.3
Total Loans	55.7	13.3	11.2	1059.5	17.0	13.5
Business	7.9	16.1	10.5	170.1	14.8	9.9
Real Estate	43.3	13.6	12.8	767.5	17.8	16.3
Consumer	2.7	2.9	-2.6	69.0	7.7	0.2
Total Deposits	67.2	8.5	6.6	1253.7	9.5	9.9

Ratios (in %)	**05Q2**	**05Q1**	**04Q2**	**05Q2**	**05Q1**	**04Q2**
Net Income/ Avg Assets (ROA)	1.1	1.1	1.1	1.2	1.2	1.2
Net Interest Inc/ Avg Assets (NIM)	3.4	3.4	3.4	3.8	3.7	3.7
Noninterest Inc/ Avg Assets	1.2	1.1	1.2	1.0	1.0	1.1
Noninterest Exp/ Avg Assets	2.9	2.9	3.0	2.9	3.0	3.0
Loans/Deposits	83.0	82.1	79.6	84.5	83.1	81.8
Equity/Assets	9.9	9.9	9.2	9.8	9.8	9.6
Nonperforming Loans/ Total Loans	0.6	0.5	0.7	0.6	0.6	0.8

Large Banking Organizations

	Tri-State			*Nation*		
	$Bill	**% change from**		**$Bill**	**% change from**	
	05Q2	**05Q1**	**04Q2**	**05Q2**	**05Q1**	**04Q2**
Total Assets	2147.6	3.0	10.7	6546.2	3.9	7.4
Total Loans	1132.5	9.6	9.6	3663.5	10.1	8.1
Business	231.1	14.7	9.0	767.4	14.1	11.2
Real Estate	666.4	5.9	14.1	1953.4	13.0	13.4
Consumer	93.3	4.4	-2.4	492.7	-6.0	6.8
Total Deposits	1432.6	5.5	8.6	4281.3	4.6	7.6

Ratios (in %)	**05Q2**	**05Q1**	**04Q2**	**05Q2**	**05Q1**	**04Q2**
Net Income/ Avg Assets (ROA)	1.5	1.4	1.4	1.2	1.2	1.2
Net Interest Inc/ Avg Assets (NIM)	2.8	2.7	2.8	2.7	2.7	2.9
Noninterest Inc/ Avg Assets	2.0	1.9	2.1	2.1	2.1	2.3
Noninterest Exp/ Avg Assets	2.7	2.7	2.9	2.9	2.9	3.1
Loans/Deposits	79.1	78.3	78.3	85.6	84.5	85.2
Equity/Assets	10.1	10.1	9.5	9.6	9.6	8.6
Nonperforming Loans/ Total Loans	0.4	0.4	0.5	0.7	0.6	0.8

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, 2004. 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—189 for the tri-state area and 5893 for the nation; (2) large banking organizations—19 for the tri-state area and 100 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.PhiladelphiaFed.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.