BANKING BRIEF

FOR PENNSYLVANIA, NEW JERSEY, AND DELAWARE

Fourth Quarter 2008

Profitability and asset quality continued to decline at both large organizations and community banks (see table on last page). Total loans at large organizations declined 2.2 percent nationally and 2.0 percent locally in the fourth quarter. On an annualized basis, this represents a decline of 8.7 percent nationally and 7.7 percent locally. At community banks, however, total loans increased 0.9 percent nationally and 3.1 percent locally in the fourth quarter. This represents an increase of 3.4 percent nationally and 13.1 percent locally on an annualized basis.

The number of institutions reporting negative net income continued to increase as well. At large organizations, 32 out of 98 organizations nationally reported a loss in the fourth quarter, up from 22 in the third quarter. Locally, two out of 17 institutions reported a loss in the fourth quarter, which is the same number as in the third quarter. At community banks, 960 out of 5,558 banks nationally reported a loss in the fourth quarter of 2008, up from 833 in the third quarter. Locally, the number was 35 out of 171 organizations, up from 33 in the third quarter. In addition, the Federal Deposit Insurance Corporation (FDIC) reported 12 bank failures in the fourth quarter of 2008, and there have been an additional 14 failures so far in the first quarter of 2009. However, none of these failures involved a tri-state area bank.

At large banking organizations, profitability as measured by return on average assets (ROA) fell from 0.37 percent to 0.22 percent nationally and from 0.35 percent to 0.33 percent locally. As has been the case for over a year, these banks have asset-quality problems stemming from residential real estate lending (RRE loans; see below). However, large organizations both locally and nationally are also incurring losses from commercial real estate (CRE) loans, trading activities, and asset sales, and in their securities portfolios.[1] Nonperforming loans continued to rise in every category of loan: real estate, commercial, and consumer.[2] Capital ratios also decreased both locally and nationally: from 9.48 to 9.21 percent at banks nationally and from 10.36 to 9.83 percent at banks locally.

Community banks continued to have substantial problems with CRE loans. These constitute nearly half of the loan portfolios of banks nationally and over 45 percent of those at tri-state area banks; so as CRE loans go, so go the community banks' balance sheets. Nonperforming loans in most other categories increased as well, but these loans make up a much smaller portion of their balance sheets. There are other concerns besides CRE lending. First, the securities portfolios of community banks are heavily weighted toward mortgage-backed securities, debt securities issued by government-sponsored enterprises, and state and municipal bonds, all of which have seen substantial decreases in value in the previous two quarters. Also, as discussed below, reserves at

[1] RRE loans are defined as loans secured by one- to four-family properties (secured by both first and junior liens) plus home equity lines of credit (HELOCs). CRE loans are defined as the sum of construction loans, loans secured by multifamily properties, and loans secured by nonfarm, nonresidential real estate (commercial mortgages).

[2] Nonperforming loans are defined as those past due 90 days or more plus nonaccruing loans.

community banks both locally and nationally have fallen to their lowest level since the early 1990s. Finally, while deposits are growing at a good pace at these banks, much of the deposit growth has been in high-cost deposits.

Community Banks

Community banks in the tri-state area continue to outperform community banks nationally by a substantial margin, but both types of banks have significant problems. ROA at community banks nationally fell 21 basis points, to 0.45 percent, in the fourth quarter. At tri-state area banks, ROA fell only five basis points, to 0.64 percent. Ninety-nine out of 5,558 community banks nationally now have equity-to-assets ratios of under 6 percent, an increase of 32 from the third quarter of 2008.[3] The comparable number for tri-state area banks is eight out of 171, an increase of only one from the third quarter. Overall capital ratios were fairly stable, falling slightly nationally and rising slightly locally. Nonperforming loans continued to increase; as a percentage of total loans they have reached 1.89 percent locally and 2.65 percent nationally.[4] Net charge-offs as a percentage of average assets nearly doubled (Figure 1).[5]

As mentioned above, the primary driver of asset quality and charge-offs at community banks is CRE lending. CRE loans outstanding were nearly flat in the fourth quarter, increasing 0.1 percent nationally and 3.5 percent locally. Nonperforming CRE loans represent 72 percent of all nonperforming loans nationally and just under 70 percent locally. The ratio of nonperforming CRE loans to total CRE loans has now increased to over 4 percent nationally and nearly 3 percent locally (Figure 2). Net charge-offs on CRE loans also increased substantially in the fourth quarter.

Commercial mortgages account for the bulk of CRE lending at banks both locally (72.1 percent) and nationally (61.2 percent). The ratio of nonperforming commercial mortgages to total commercial mortgages is still relatively low, 1.70 percent nationally and 1.57 percent locally, but the ratio of net charge-offs on commercial mortgages to average commercial mortgages nearly tripled nationally and nearly doubled locally in the fourth quarter (Figure 3). Overall, net nonperforming loans and net charge-offs increased substantially in the fourth quarter.

Most of the problem CRE loans continue to be construction loans. Although they comprise only about one-third of CRE loans nationally and less than one-fourth locally, they account for nearly 70 percent of nonperforming CRE loans nationally and 57.2 locally. In addition, they represent 79 percent of charge-offs on CRE loans nationally and 73.8 percent of charge-offs on CRE loans locally. Nonperforming construction loans and charge-offs on construction loans continued to increase at a substantial rate in the fourth quarter both nationally and locally. The ratio of nonperforming construction loans to all construction loans is now over 8.5 percent nationally and nearly 7.5 percent locally, and it continues to increase (Figure 4). Moreover, the ratio of net charge-offs on construction loans to average construction loans nearly doubled nationally and more than quadrupled locally in the fourth quarter (Figure 5).

Community banks have also had problems with RRE loans. These loans make up 22.7 percent of all loans at banks nationally and 33.8 percent locally. The ratio of nonperforming RRE loans to total RRE is still relatively moderate — 1.68 percent nationally and 1.05 percent locally — but it continues to increase. Overall, nonperforming RRE loans grew at roughly the same pace as nonperforming CRE loans in the fourth quarter. Net charge-offs on RRE loans had much higher increases. This happened after the community banks reported decreases in RRE net charge-offs in the third quarter. The ratio of net charge-offs on RRE loans to total RRE loans more than doubled nationally in the fourth quarter, from 0.07 percent to 0.16 percent, and more than tripled locally, from 0.02 percent to 0.07 percent. The vast majority of community banks' RRE loan portfolios are mortgages secured by first liens, which is where most of the problems have been. But nonperforming loans and net charge-offs on home equity lines of credit

[3] Regulation Y defines an institution as well-capitalized if it has a tier 1 leverage ratio of over 6 percent. Total equity contains some items not included in tier 1 capital, so this is not the same as saying they are well-capitalized for regulatory purposes. However, for most institutions, it is a close proxy.

[4] For historical perspective, the ratio of nonperforming loans to total loans for all commercial banks between 1997 and 2007 was 1.09 percent. At the bottom of the last real estate cycle in 1991, this ratio was 3.80 percent. Source: FDIC Historical Statistics on Banking, http://www2.fdic.gov/hsob/index.asp.

[5] Except for the data on the last page, income statement items are quarterly. That is, they include only the income or expense incurred in this quarter.

Figure 1

Quarterly Net Charge-offs/Average Assets

Community Banks

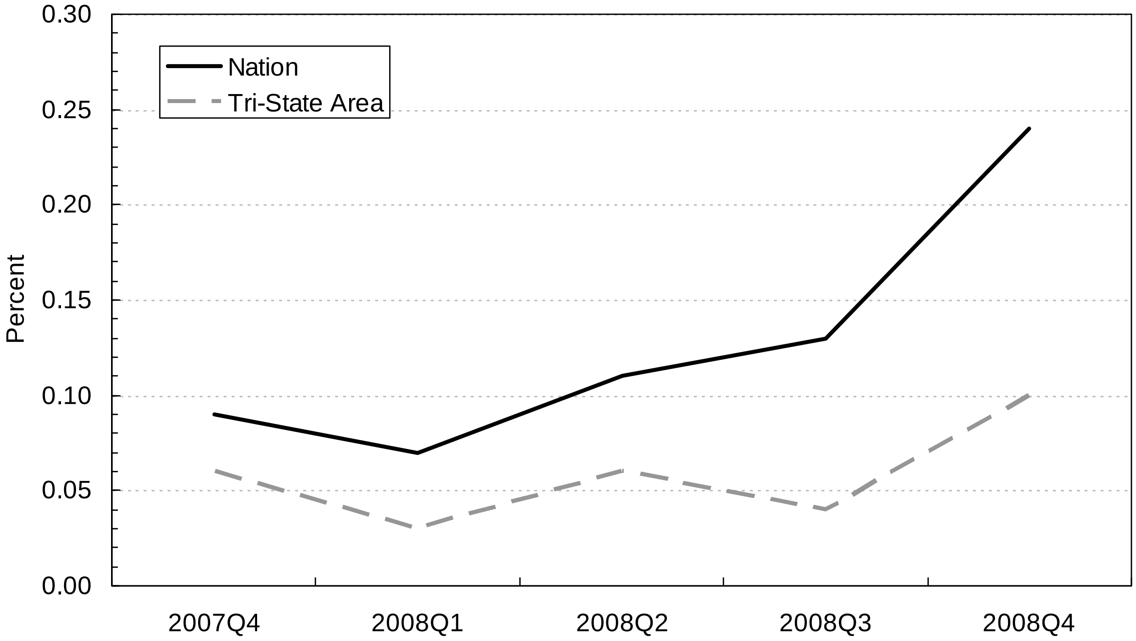
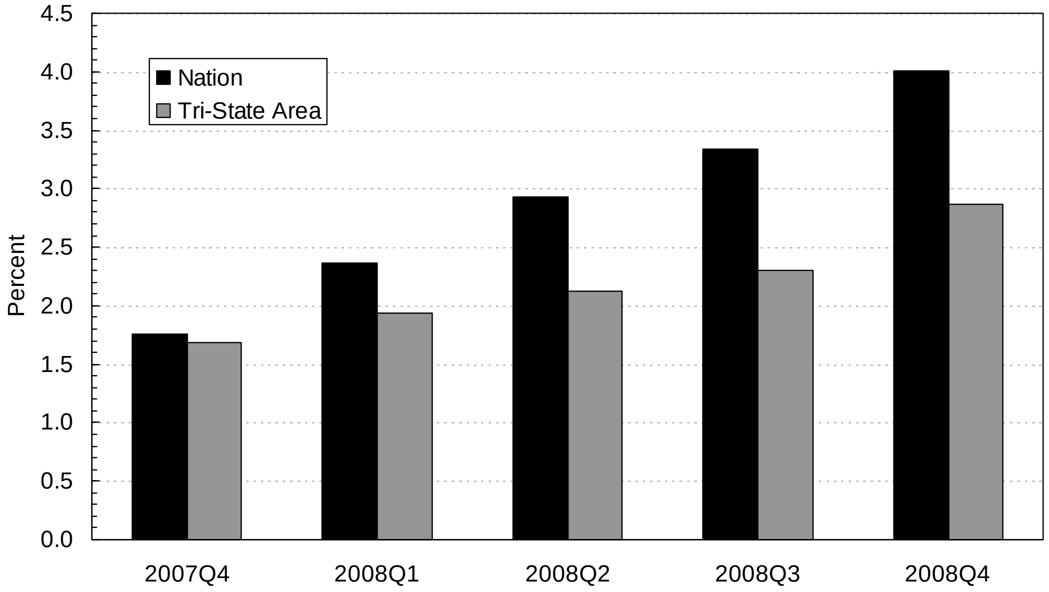


Figure 2

Nonperforming CRE* Loans/Total CRE Loans

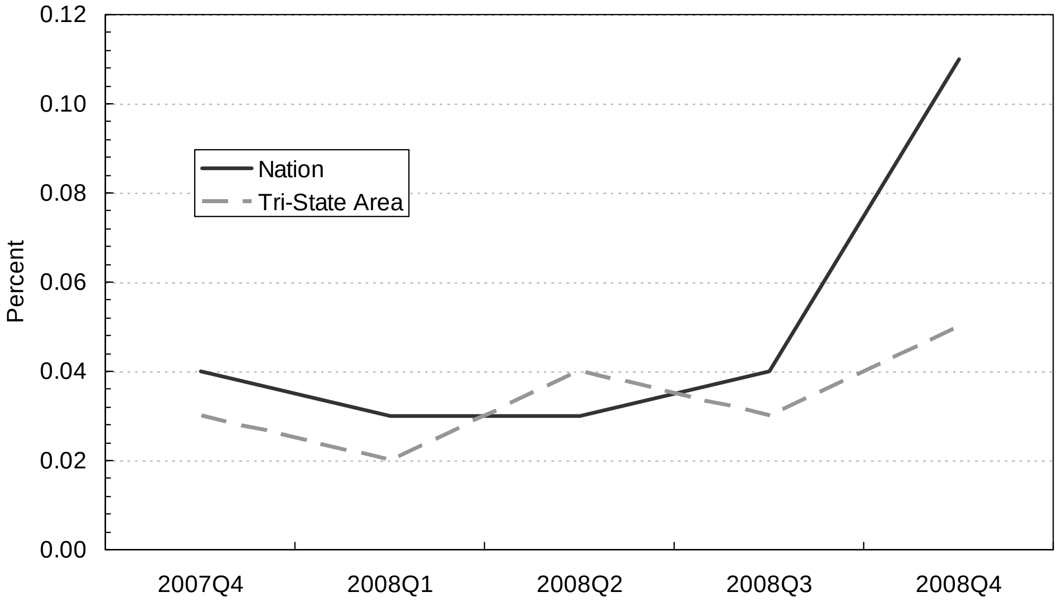
Community Banks



*Commercial real estate

Figure 3

NCOs* on Commercial Mortgages/ Avg Commercial Mortgages



*Net charge-offs

Figure 4

Nonperforming Construction Lns/Construction Lns

Community Banks

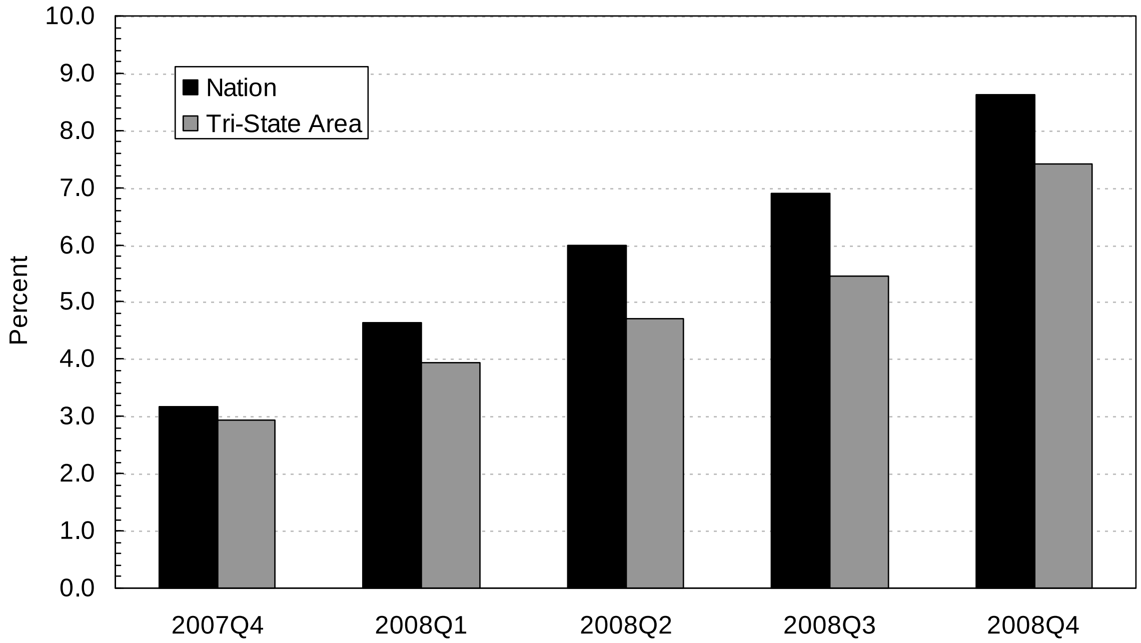
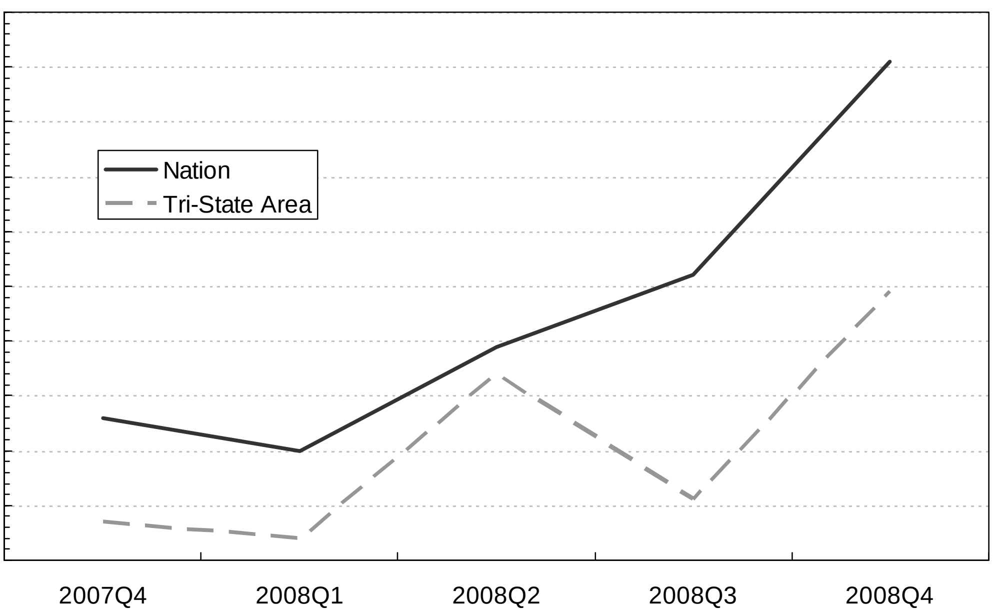


Figure 5

NCOs* on Construction Lns/Avg Construction Lns



*Net charge-offs

(HELOCs) also increased substantially in the fourth quarter.

In other types of lending, the situation is worsening. Commercial and industrial (C&I) loans make up approximately 15 percent of loans nationwide and 12 percent of loans at banks in the tri-state area. The ratio of nonperforming C&I loans to total C&I loans increased from 1.35 to 1.53 percent nationally and from 1.23 to 1.32 percent locally. The ratio of net charge-offs on C&I loans to average C&I loans increased from 0.25 to 0.41 percent nationally and from 0.12 to 0.28 percent locally.

Consumer loans represent an even smaller percentage of community banks' loan portfolios, roughly 5.7 percent nationally and 3.6 percent locally. Nonperforming consumer loans and charge-offs on consumer loans are increasing as well. Compared with large organizations, the ratio of nonperforming consumer loans to total consumer loans at community banks is low both locally and nationally, 0.47 percent and 0.93 percent, respectively, as is the ratio of net charge-offs on consumer loans to total consumer loans: 0.69 percent nationally and 0.26 percent locally.

The large increase in net charge-offs has exacerbated a problem that has been troubling community banks for over a year: loan-loss provisioning. Loan-loss reserves and provisions have failed to keep up with charge-offs, and now community banks both locally and nationally are significantly under-reserved.[6] The ratio of net charge-offs to loan-loss provision was already quite high nationally and increased substantially at tri-state area banks in the fourth quarter (Figure 6). Additionally, declining revenues and increasing loan-loss provisions have nearly doubled the ratio of loan-loss provision to operating income both locally and nationally (Figure 7).[7] Loan-loss reserves did increase in the fourth quarter – 8.6 percent at banks nationally and 5.25 percent at banks locally – but these modest increases have not been nearly enough to keep pace with the

[6] For the purposes of this document, loan-loss reserve refers to the balance-sheet item; loan-loss provision is what is added to it in the quarter, i.e., the income statement item.

[7] Operating income is defined as net interest income plus noninterest income.

Figure 6

Net Charge-offs/Loan-Loss Provision

Community Banks

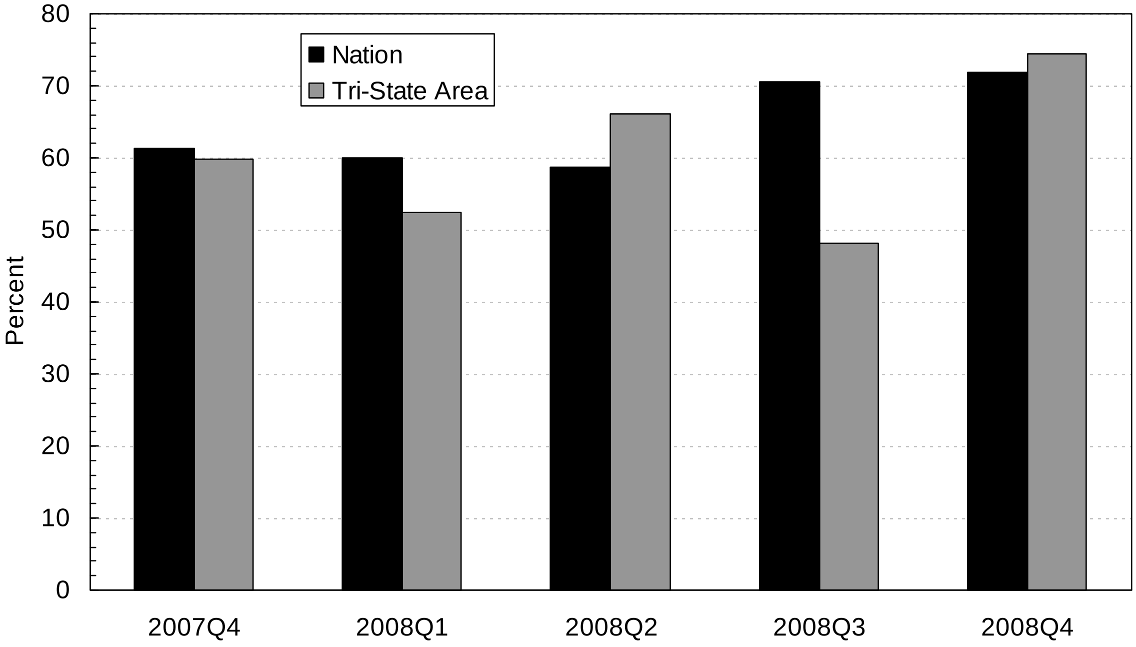


Figure 7

Loan-Loss Provision/Operating Income

Community Banks

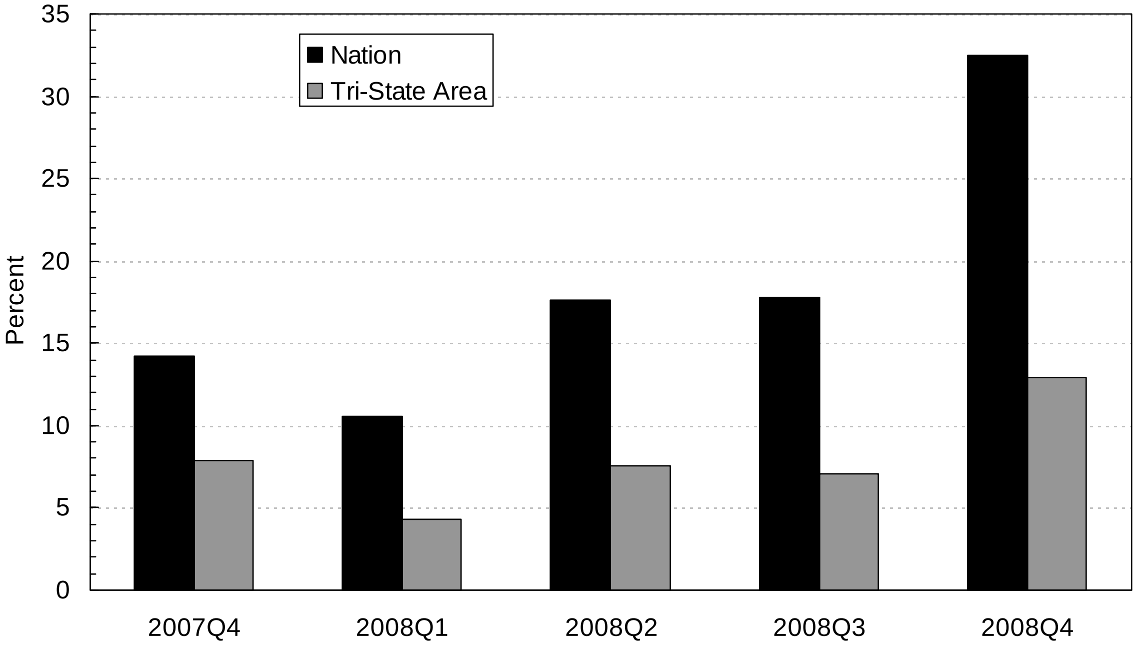


Figure 8

Loan-Loss Coverage Ratios

Community Banks

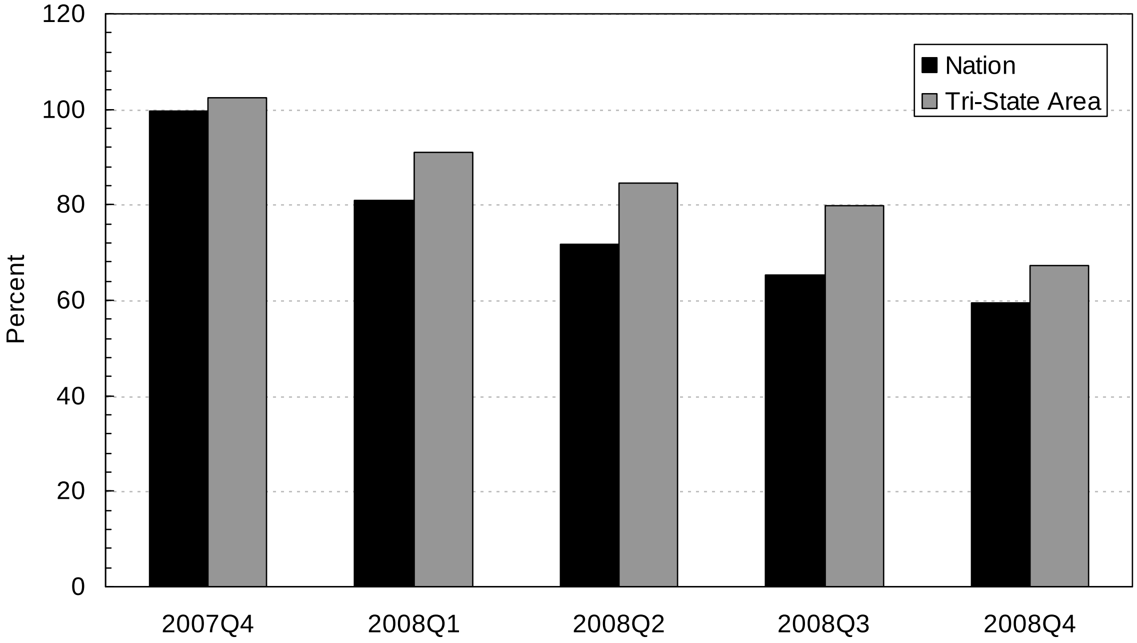


Figure 9

Dividend Payout Ratios

Community Banks

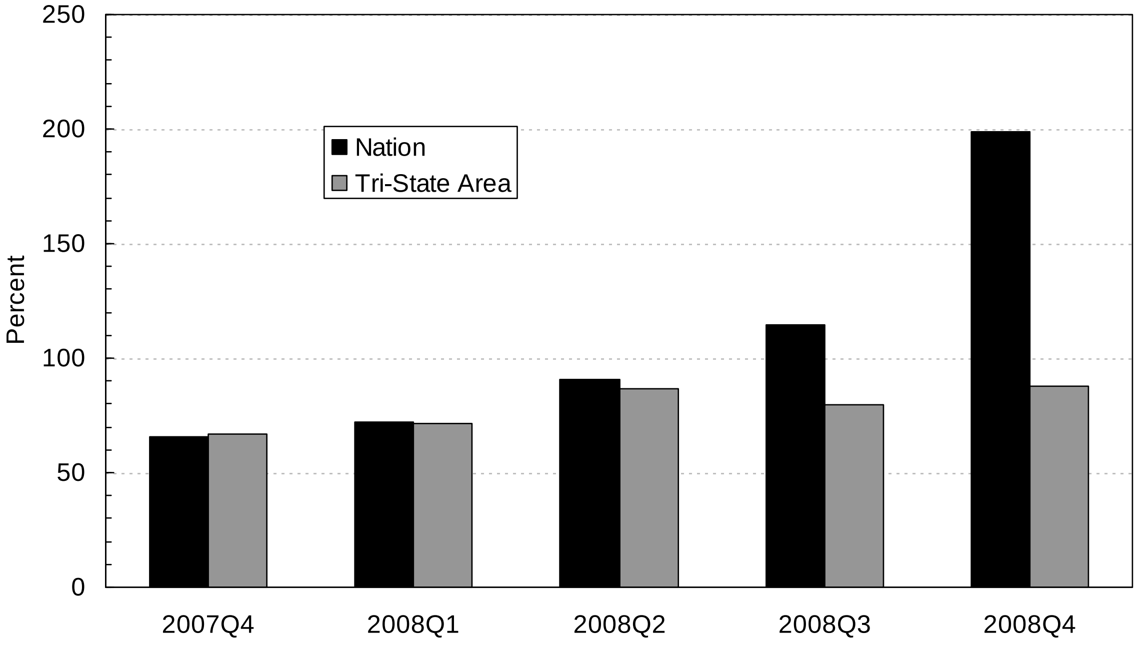
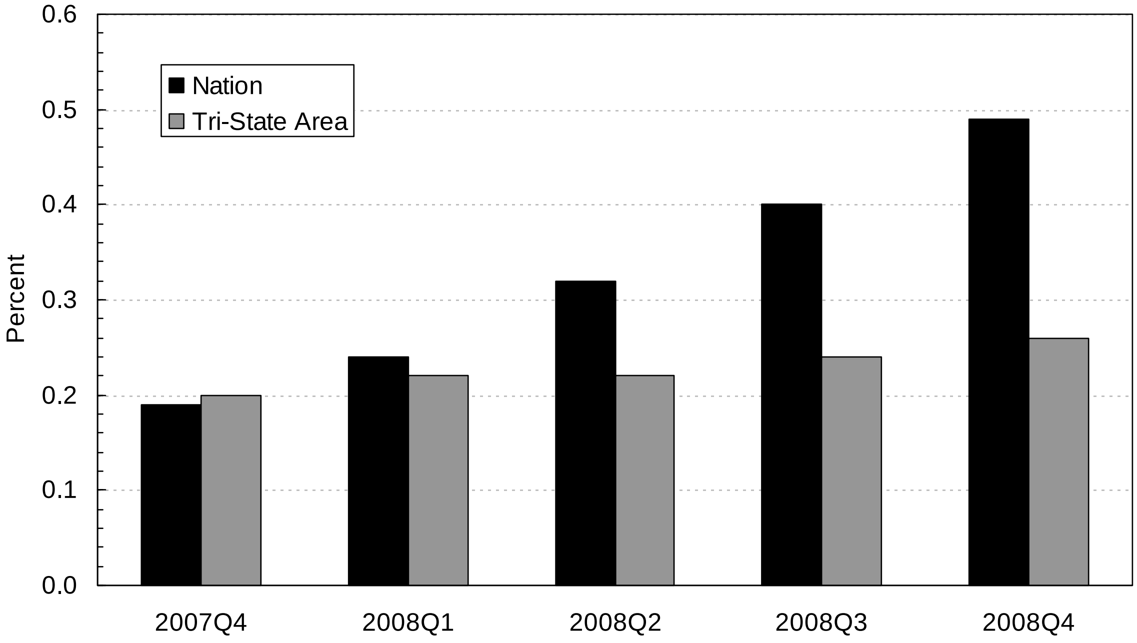


Figure 10

Other Real Estate Owned/Total Assets

Community Banks



increases in nonperforming loans. As a result, the loan-loss coverage ratio is now below 60 percent nationally and at 67.4 percent locally (Figure 8).[8] If every loan now classified as nonperforming were to be charged off, community banks would not have sufficient reserves to charge against, and the remaining charge-offs would have to be made against their capital. The necessary additions to loan-loss reserves will have to be made at the expense of net income; therefore, we should expect profits to decline substantially at these banks in the future.

One reason reserves continued to decline, particularly at community banks nationwide, is that they are paying out a larger share of their decreasing net income as dividends. Dividends are necessary to attract capital from investors, especially at smaller institutions, but at this time they are hampering banks' ability to build up reserves. The dividend payout ratio is nearly 200 percent at banks nationwide and about 88 percent at banks in the tri-state area (Figure 9).[9]

While loan quality and reserves are declining, commitments to lend in the future at national community banks are increasing. Total unused commitments – that is, lines of credit not yet used – increased 10.8 percent at banks nationwide and decreased 2.7 percent at local banks. Most of this increase at banks nationwide has been for commercial loan commitments, which increased 39 percent nationwide but decreased 3.3 percent locally, while unused credit card lines increased 4.9 percent nationally and decreased 4.4 percent locally. Commitments to fund real estate decreased 12.4 percent nationally and 2.5 percent locally.

Another lingering problem at community banks is their stock of foreclosed real estate, known as other real estate owned (OREO). OREO is a nonperforming asset; that is, it is currently earning the institution

[8] The loan-loss coverage ratio is defined as the ratio of loan-loss reserves to nonperforming loans. For a historical perspective, the average loan-loss coverage ratio for all banks between 1997 and 2007 was 154.6 percent. At the bottom of the last real estate cycle in 1991, this ratio was 72.6 percent. Source: FDIC Historical Statistics on Banking: http://www2.fdic.gov/hsob/index.asp.

[9] The dividend payout ratio is defined as dividends paid on common stock divided by net income. For historical perspective, the average dividend payout ratio for all banks between 1997 and 2007 was 69.3 percent. Source: FDIC Historical Statistics on Banking: http://www2.fdic.gov/hsob/index.asp.

Figure 11

Realized Gains (Losses) on Securities/Avg Assets

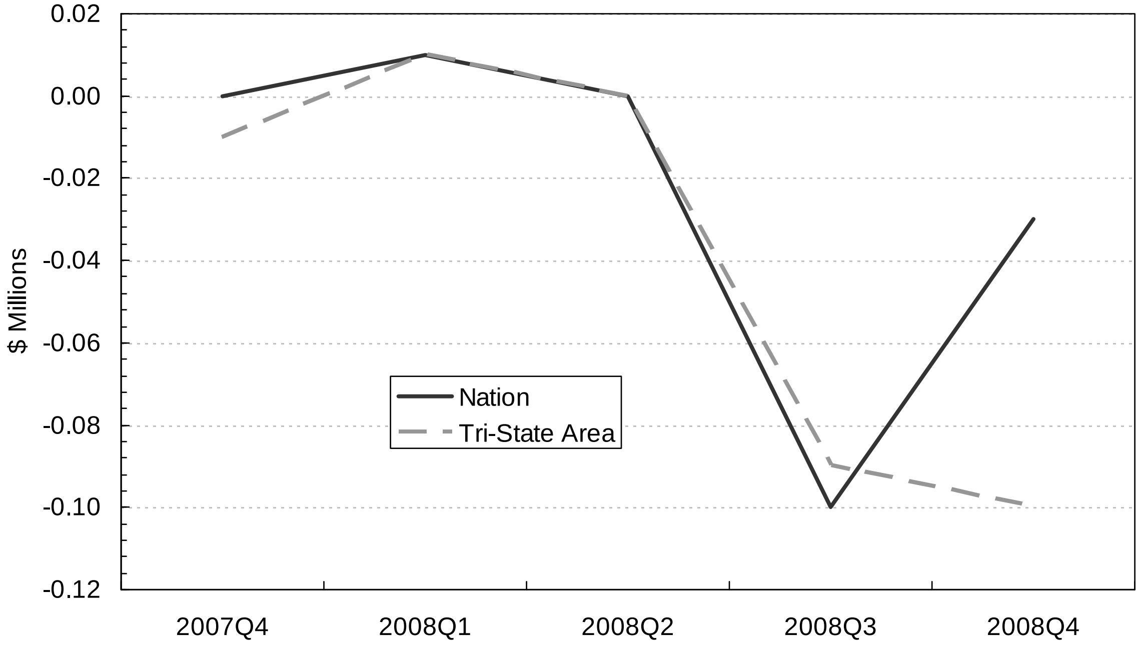
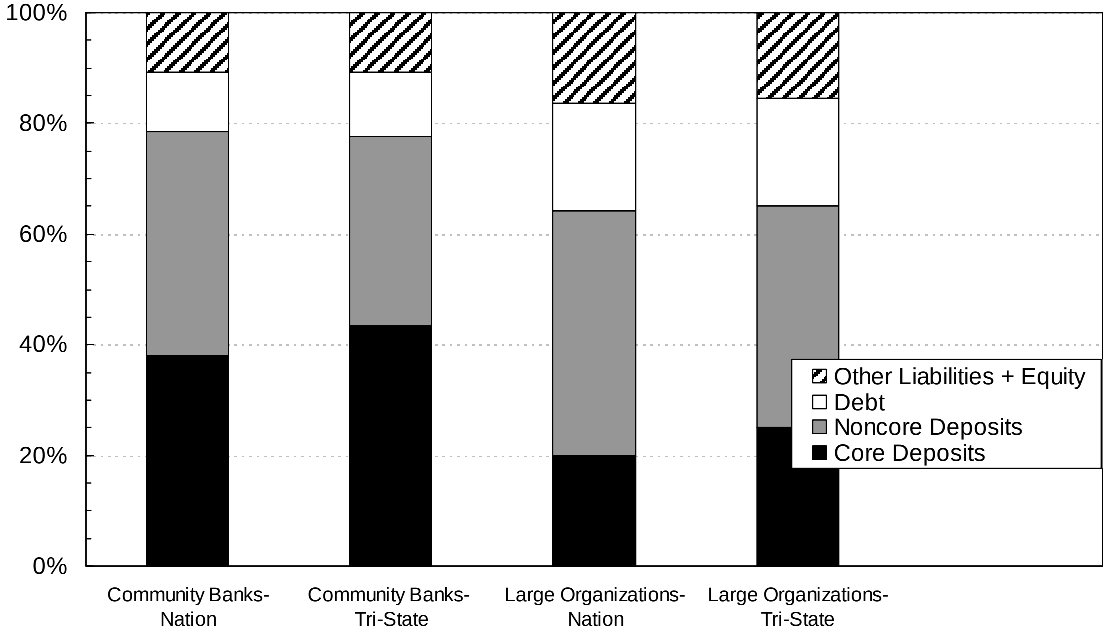


Figure 12

Main Sources of Funding as a Pct of Assets

Fourth Quarter 2008



nothing and will likely be sold at a loss. OREO increased 26.1 percent nationally and 9.0 percent locally in the fourth quarter. As a percentage of total assets it continues to increase (Figure 10).[10] Compared with larger organizations, community banks in general have much higher percentages of assets that are OREO (see below).

Community banks both locally and nationwide may also be beginning to experience problems in their securities portfolios. Securities make up 17.9 percent of community bank assets nationwide and 20.6 percent of assets at tri-state area banks. However, the securities portfolios of both sets of banks are heavily weighted in three particular areas: mortgage-backed securities (MBS), the vast majority of which are issued by government-sponsored enterprises (GSEs) such as Fannie Mae and Freddie Mac; the debt securities of these GSEs; and state and municipal bonds. MBS make up 45.7 percent of securities at banks nationwide, GSE securities about 27.0 percent, and state and local bonds 20.1 percent. The corresponding figures for tri-state area banks are 45.9 percent for MBS, 22.9 percent for GSE debt securities, and 20.3 percent for state and local bonds. The first two categories are closely tied to the residential real estate market, which has now been in decline for more than two years. State and local bonds are also experiencing problems as these governments struggle to cope with declining tax revenues. Thus, banks both locally and nationwide have been realizing losses on their securities for nearly a year now (Figure 11).

While the asset-quality problems of community banks are worsening, deposits are growing at a healthy rate. Total deposits grew 2.6 percent nationwide and 4.1 percent in the tri-state area during the fourth quarter.[11] However, core deposits – that is, those deposits that are stable and low cost – shrank slightly during the quarter nationwide and grew only 2.5 percent at tri-state area banks, while other, less stable, and more expensive deposits (noncore deposits) grew 5.2 percent nationwide and 6.3 percent locally.[12] Core deposits haven't grown very much for at least a year. At banks nationally, noncore deposits now make up a larger percentage of assets than core deposits do (Figure 12). Debt funding, which is generally regarded as more expensive than deposits, also shrank during the quarter but had been growing during the previous year.[13]

The largest growth in deposits was in time deposits of greater than $100,000, about 80 percent of which will mature within one year.[14] These grew nearly 5 percent nationally and 15 percent locally, while the same deposit products at large organizations declined 9.3 percent nationally and 2.0 percent locally. For these deposits, community banks nationally pay on average 3.86 percent annual interest, compared with 2.89 percent paid by large organizations.[15]

Brokered deposits of all types grew 15.4 percent nationally and 29.6 percent locally. In contrast, demand deposits grew 3.1 percent nationally and shrank 0.6 percent locally. Thus, it appears that much of the deposit growth community banks have been experiencing is in what bankers refer to as "hot money," and the banks' more relatively inexpensive and stable sources of deposits are barely growing at all.

Community banks are also heavy users of Federal Home Loan Bank (FHLB) advances, which currently account for 62.5 percent of their debt funding nationally and 73.2 percent locally. Partly because of recent capitalization problems at several FHL banks, the growth of FHLB advances has stopped or decelerated in the last quarter. FHLB advances shrank 1.6 percent nationally and grew only 3.4 percent locally in the fourth quarter. Fortunately, roughly 70 percent of FHLB advances will not mature for – at the

[10] For historical perspective, the average ratio of OREO to total assets at all banks from 1997 to 2007 was 0.09 percent. Source: FDIC Historical Statistics on Banking: http://www2.fdic.gov/hsob/index.asp.

[11] These numbers are not annualized and therefore do not correspond to the numbers in the table on the last page.

[12] Core deposits are total domestic deposits less the sum of all deposits greater than $100,000 and brokered deposits less than $100,000. Noncore deposits are the sum of all deposits greater than $100,000 and brokered deposits less than $100,000. Brokered deposits represent deposits that the reporting bank receives from brokers or dealers for the accounts of others either directly or ultimately.

[13] Debt funding is the sum of fed funds purchased, securities sold under agreements to repurchase (repos), Federal Home Loan Bank advances, subordinated debt, and other borrowings.

[14] Currently, banks only report deposits in denominations of less than $100,000 and greater than $100,000. However, this may change, since Congress recently raised the limit for FDIC insurance on an account from $100,000 to $250,000.

[15] These interest rates are derived by dividing annual interest expenses on the type of deposits by average balances outstanding. While not exact, they are a close proxy and illustrate the difference in funding costs between community banks and large organizations.

earliest – more than a year. Fed funds and repos declined 5.1 percent nationally and 18.6 percent locally. These have been shrinking for the past four quarters as well. Subordinated debt, the most expensive way of financing debt, increased 12.0 percent nationally and 0.7 percent locally, but it accounted for only 1.1 percent of debt funding nationally and 1.2 percent locally.

In summary, while it appeared for a while that community banks may be less affected by the general economic conditions than large banks, this has not been the case. Asset quality is declining in all categories of assets, and nonperforming assets are increasing. Reserves have fallen to very low levels and are continuing to decline. At the same time, relatively inexpensive sources of funds, such as core deposits, are not growing, increasing the community banks' dependence on more expensive deposit products and debt. While the community banks in the tri-state area are less affected than banks nationwide, they are affected in many of the same ways.

Large Organizations

Profitability continued to fall at large banks as asset-quality problems increased. The number of organizations reporting losses rose by 10 from the third quarter of 2008, to 32 (out of 98) nationally. Locally, only two (out of 17) reported losses, which is the same as in the third quarter. Additionally, capital ratios decreased roughly 27 basis points nationally and 53 basis points locally. Until the third quarter of 2008, this ratio had been relatively stable. While the ratio of equity to assets continued to decrease, the number of institutions that have a ratio of less than 6 percent decreased nationally, from five to three, and was unchanged locally at one. Part of the drop in equity is attributable to write-downs in goodwill of $9.7 billion. As of the end of the fourth quarter, goodwill was 30.7 percent of equity nationally and 36.3 percent locally. These represent drops of 12.3 percent and 16.5 percent, respectively.

The ratio of nonperforming loans to total loans increased substantially in the fourth quarter, from 2.33 percent to 3.04 percent nationally and from 2.32 percent to 2.80 percent locally. Net charge-offs barely grew nationally and dropped locally, but this was the result of the accounting treatment involving the acquisition of two troubled institutions.[16] Excluding the two acquiring institutions from the data, nonperforming loans and net charge-offs continued to increase at a substantial rate. Exclusion of these two institutions also has a substantial effect on the ratio of net charge-offs to average loans (Figure 13).

Real estate lending, particularly RRE loans, continues to be the main problem at large organizations. RRE loans make up about one-third of all loans both nationally and locally, and the vast majority of these loans are mortgages. However, nonperforming RRE loans comprise 48.4 percent of nonperforming loans nationally and 53.1 percent locally. The ratio of nonperforming RRE loans to total RRE loans is now over 4.5 percent both nationally and locally (Figure 14). Excluding PNC and Wells Fargo to remove accounting-related distortions, the ratio of net charge-offs on RRE loans to average RRE loans continues to increase (Figure 15).

In addition to their losses from RRE lending, large organizations have substantial problems with CRE loans. CRE loans account for about 19 percent of loans nationally and 17.2 percent locally, yet they represent 24.2 percent of nonperforming loans nationally and 19.7 percent locally. The ratio of nonperforming CRE loans to total CRE loans is now nearly 4 percent nationally and over 3 percent locally (Figure 16). Also, the ratio of net charge-offs on CRE loans to average CRE loans continues to climb (Figure 17).

As with the community banks, much of the problem with CRE lending is in the area of construction loans. The percent of construction loans that are nonperforming is more than double that for all construction loans, 8.5 percent nationally and 7.1 percent locally (Figure 18). In no other type of CRE lending is this percentage over 1.7 percent.

Large organizations haven't had many problems with C&I lending, but this could change soon. Nonperforming C&I loans are increasing at a higher

[16] Wells Fargo & Co. acquired Wachovia Corporation, and PNC Financial Services Group acquired National City Corporation. In both cases, the acquiring institutions were permitted by purchase accounting rules to write down some nonperforming assets and to adjust equity capital and reserves when transferring ownership. These adjustments were not reflected on income statements and have the tendency to make changes in nonperforming loans and net charge-offs seem unrealistically low.

Figure 13

Quarterly Net Charge-Offs/Average Loans

Large Organizations

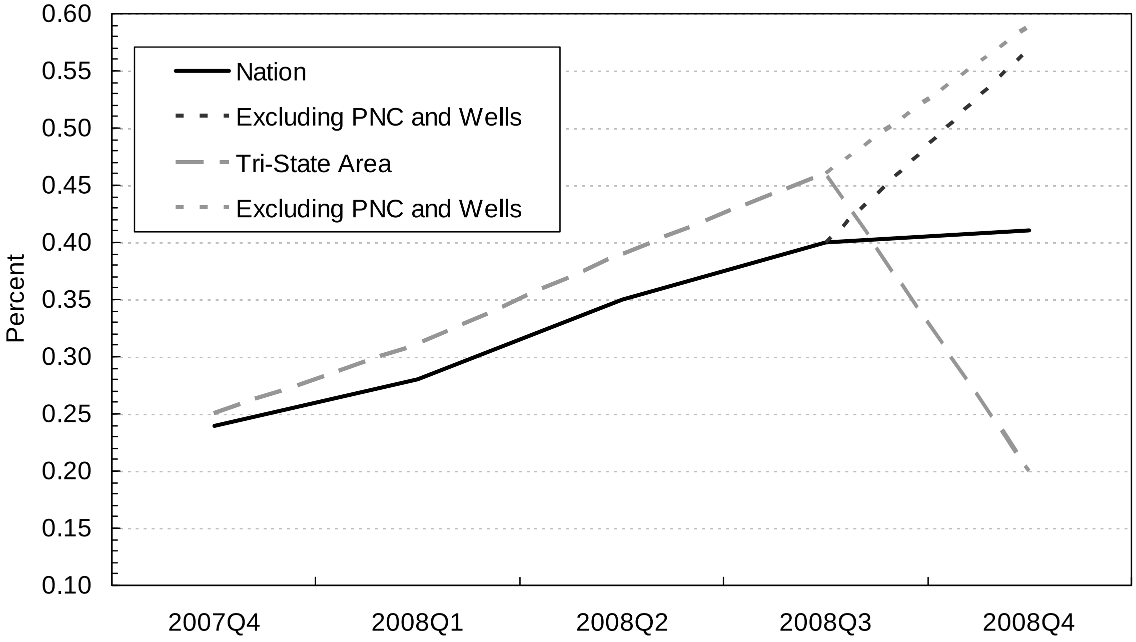
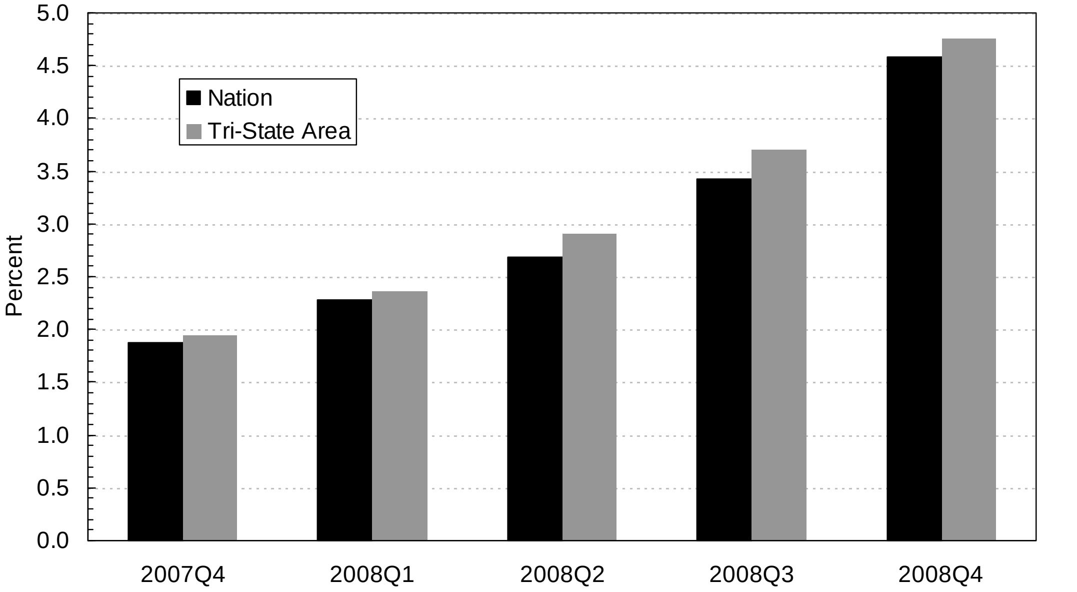


Figure 14

Nonperforming RRE* Loans/Total RRE Loans

Large Organizations

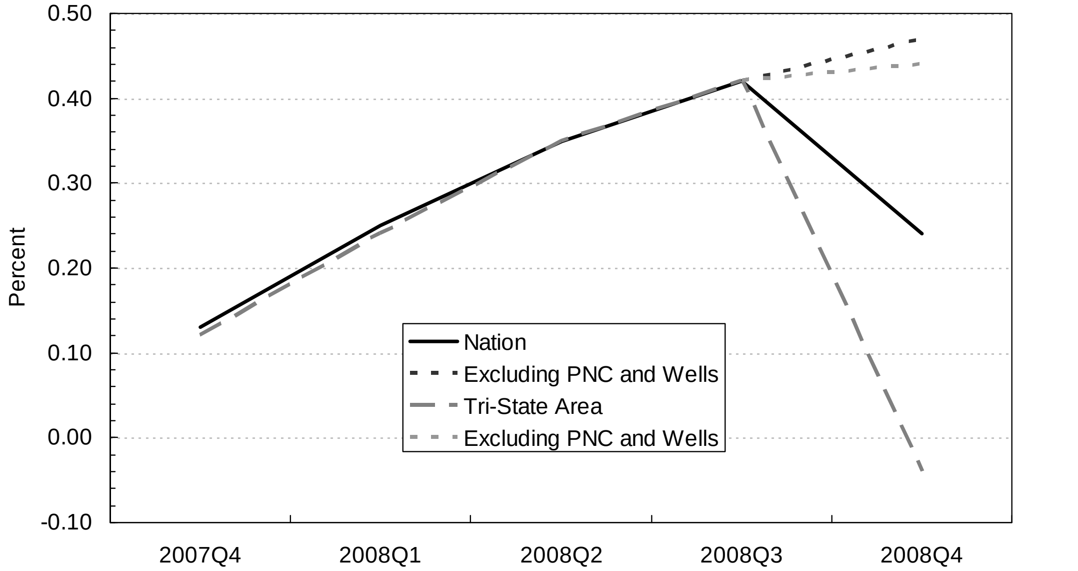


*Residential Real Estate

Figure 15

Net Charge-Offs on RRE* Lns/Avg RRE Lns

Large Organizations

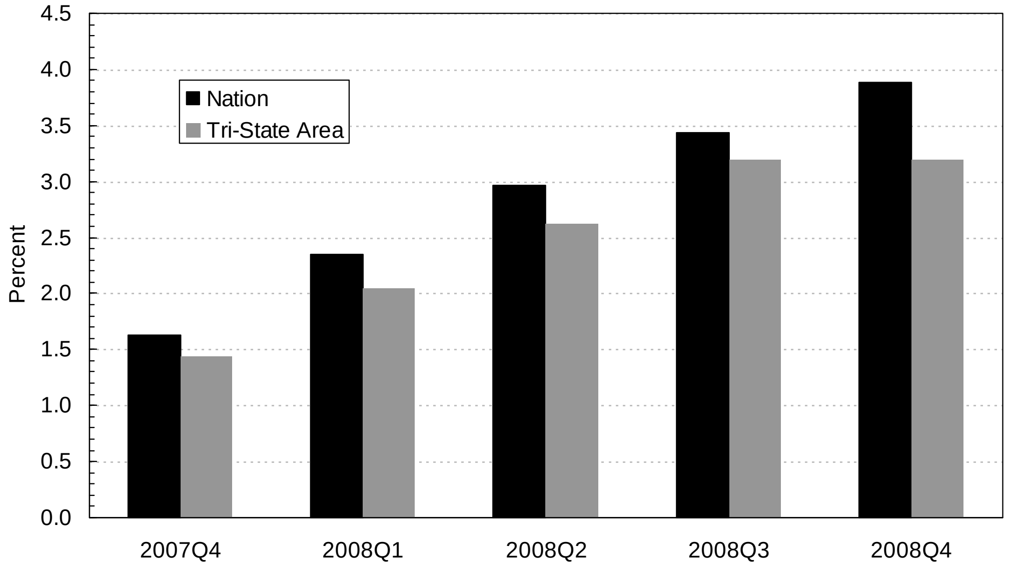


*Residential Real Estate

Figure 16

Nonperforming CRE* Loans/Total CRE Loans

Large Organizations

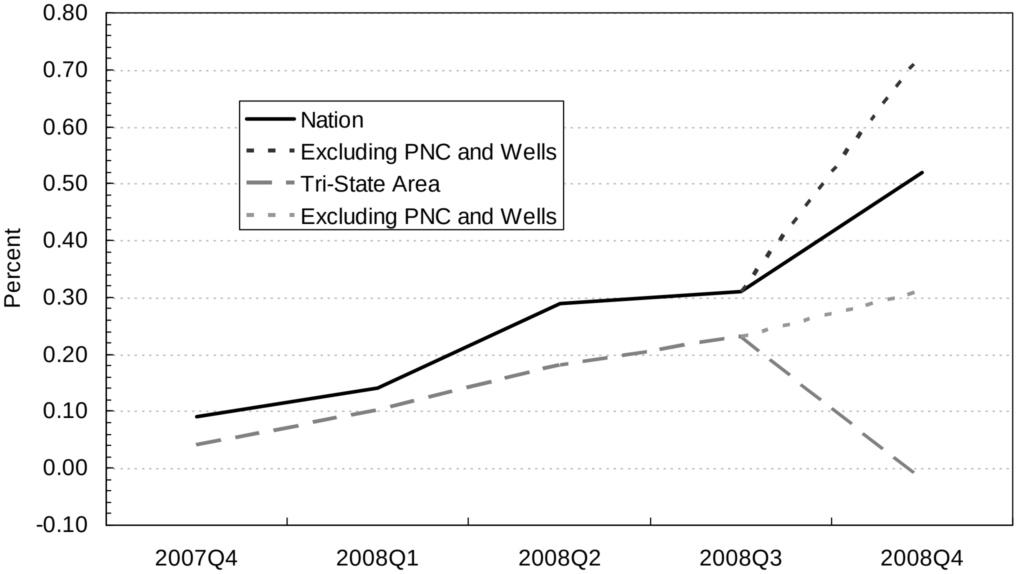


*Commercial Real Estate

Figure 17

Net Charge-Offs on CRE* Lns/Avg CRE Lns

Large Organizations

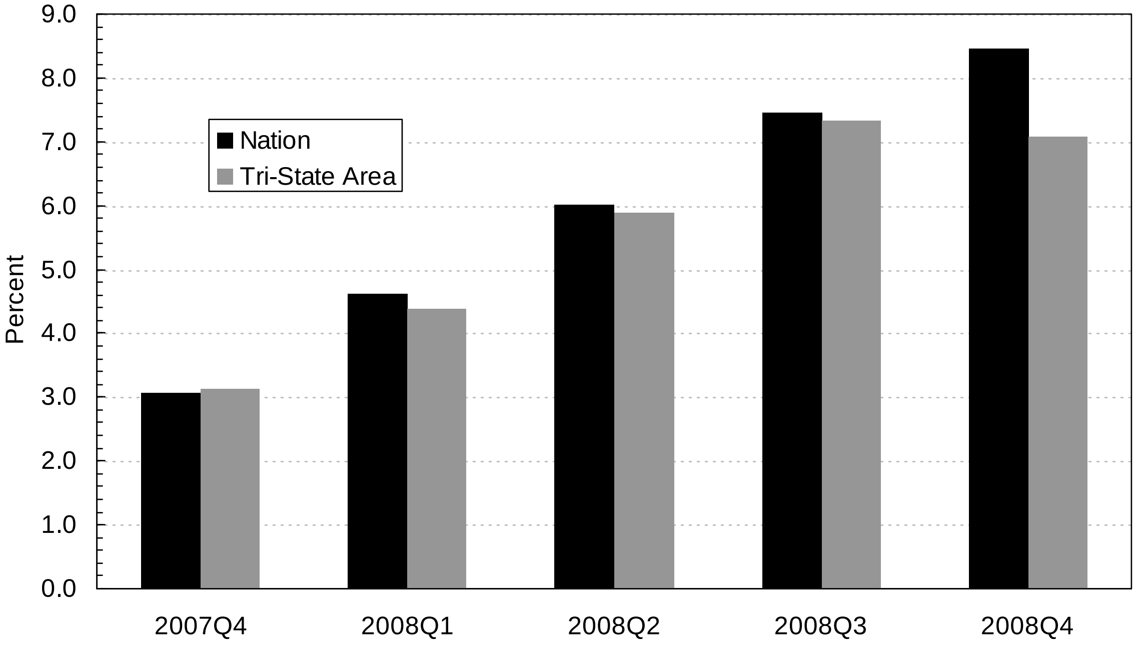


*Commercial Real Estate

Figure 18

Nonperforming Construction Lns/Construction Lns

Large Organizations



rate than nonperforming real estate loans. Excluding PNC and Wells, the ratio of nonperforming C&I loans to all C&I loans has tripled nationally and doubled locally in the last year, and it is now 2.0 percent for the nation and 1.5 percent for the tri-state area. Net charge-offs are up both locally and nationally as well.

Consumer lending by large organizations, including credit card lending, is having problems too. Nationally, credit card loans outstanding increased by about $15 billion, or 5.3 percent, but credit card loan commitments decreased by $214 billion, or about 9.6 percent. Nonperforming credit card loans increased 21.2 percent nationally and 15.8 percent locally, while net charge-offs increased 15.1 percent nationally and 11.6 percent locally.

Like community banks, large organizations are under-reserved. Loan-loss reserves increased only 13.5 percent nationally in the fourth quarter and 7.3 percent locally. The ratio of net charge-offs to loan-loss provision now stands at 60.3 percent nationally and 84.1 percent locally. Worse, the ratio of loan-loss provision to operating income was 47.4 percent nationally and 41.8 percent locally, compared with 31.3 and 31.8 percent, respectively, in the third quarter of 2008. Thus, over 40 percent of revenues at large organizations are going into loan-loss reserves. In spite of this, the loan-loss coverage ratio continues to decrease, and it is now well below 100 percent (Figure 19).

Total loans outstanding declined 2.2 percent nationally and 2.0 percent locally over the fourth quarter. However, large organizations still have substantial unused commitments to lend. It appears that this is where most new *gross* lending is coming from, since total unused commitments (excluding securities lent) decreased 7.8 percent nationally and 4.9 percent locally.[17] These total about 50 percent of total assets nationally and nearly 60 percent locally. The largest portion of unused commitments are credit cards, totaling 20.2 percent of assets nationally and 27.2 percent locally, followed by business lines of credit, totaling 17.6 percent of assets nationally and 18.2 percent locally. Both categories declined by about 10 percent, or roughly $200 billion, in the fourth quarter. Securities lent make up about 10 percent of assets both nationally and locally, and they have dropped nearly $1 trillion in the last year. This decline was most likely caused by reduced demand from hedge funds.

OREO continues to accumulate on large organizations' balance sheets, increasing 15.4 percent nationally and 26.7 percent locally. As a percentage of assets it has nearly doubled in the past year (Figure 20). However, large banks' OREO to assets ratios are much smaller than those of community banks.

Large organizations suffered losses on most of their other operations as well in the fourth quarter. After several quarters of positive income from their trading accounts, the net trading income at large banks fell 217 percent nationally and 283 percent locally, with losses totaling $9 billion and $3 billion, respectively. Both locally and nationally, banks' ratio of trading assets to trading liabilities is roughly two to one. In spite of the losses, the ratio of trading assets to total assets continued to grow (Figure 21). Net trading income as a percentage of average trading assets fell steeply in the fourth quarter (Figure 22).[18] As a percentage of equity, trading losses were 1.0 percent nationally and 0.8 percent locally. Nearly all of the trading losses have come from interest rate contracts and foreign exchange contracts. Asset sales were another source of negative income. Large organizations lost $820.7 million nationally and $212.0 million locally on asset sales last quarter, both mostly from sales of loans, with OREO also contributing to the losses.

For the second consecutive quarter large organizations also sustained some losses on securities outside the trading accounts. Given the condition of the securities markets, this was not unexpected, and compared to the previous two quarters the losses were small. Securities make up 14.2 percent of large organizations' assets nationally and 14.8 percent locally. The vast majority of these securities, nearly two-thirds nationally and over three-quarters locally, are MBS, with other asset-backed securities (ABS) accounting for roughly 10 percent of each group's

[17] "Securities lent" includes the book value of all securities lent against collateral (other than cash) or on an uncollateralized basis. In addition, for customers indemnified against any losses by the reporting bank or bank holding company or any consolidated subsidiary, the market value as of the report date of such customers' securities is reported, including customers' securities held in the reporting bank's trust department that have been lent.

[18] Net trading income includes interest from trading assets.

Figure 19

Loan-Loss Coverage Ratios

Large Organizations

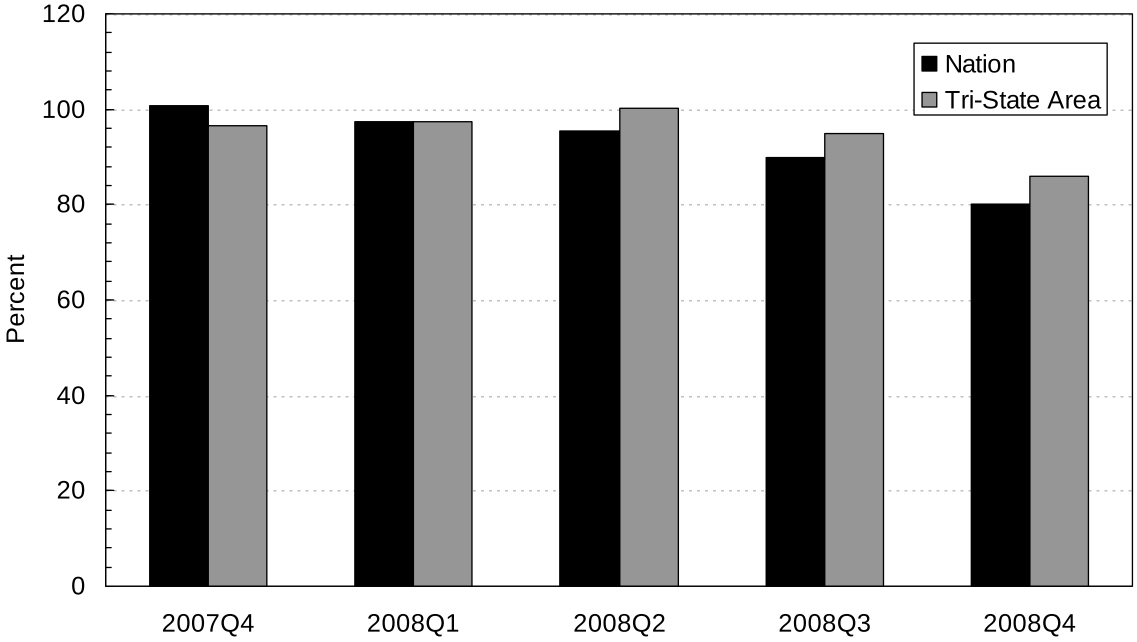


Figure 20

Other Real Estate Owned/Total Assets

Large Organizations

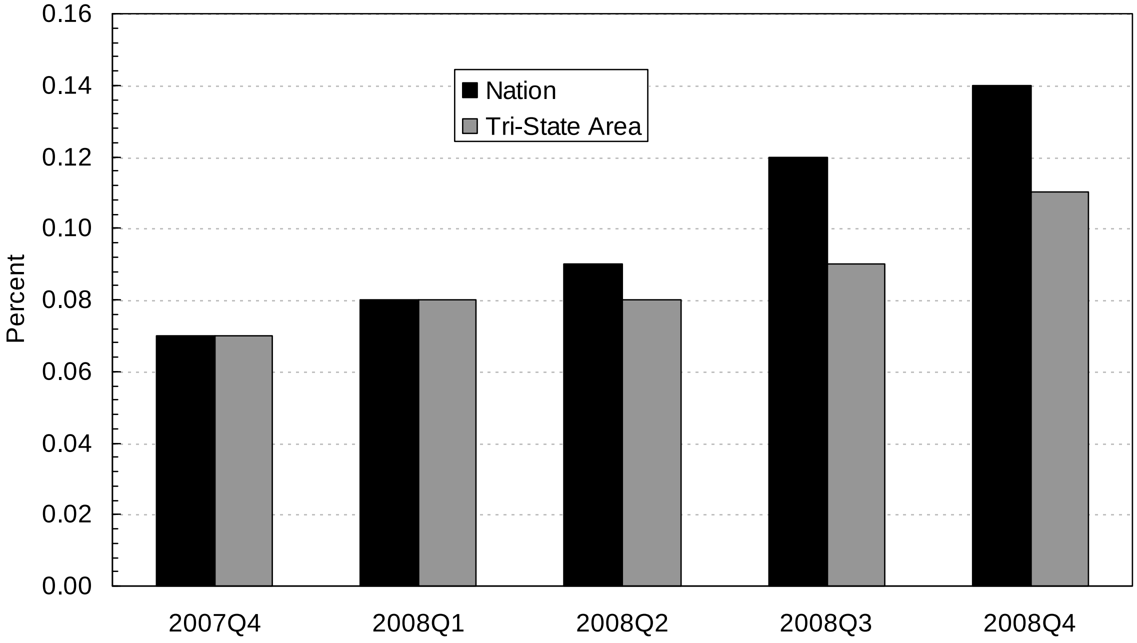


Figure 21

Trading Assets/Total Assets

Large Organizations

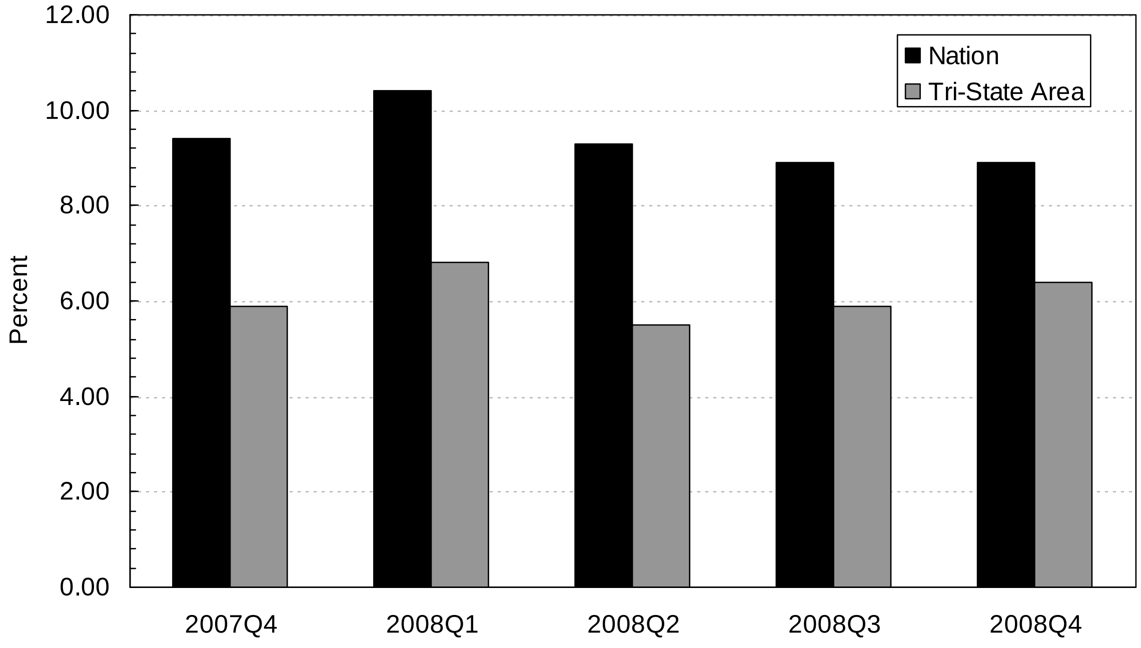


Figure 22

Net Trading Income/Average Trading Assets

Large Organizations

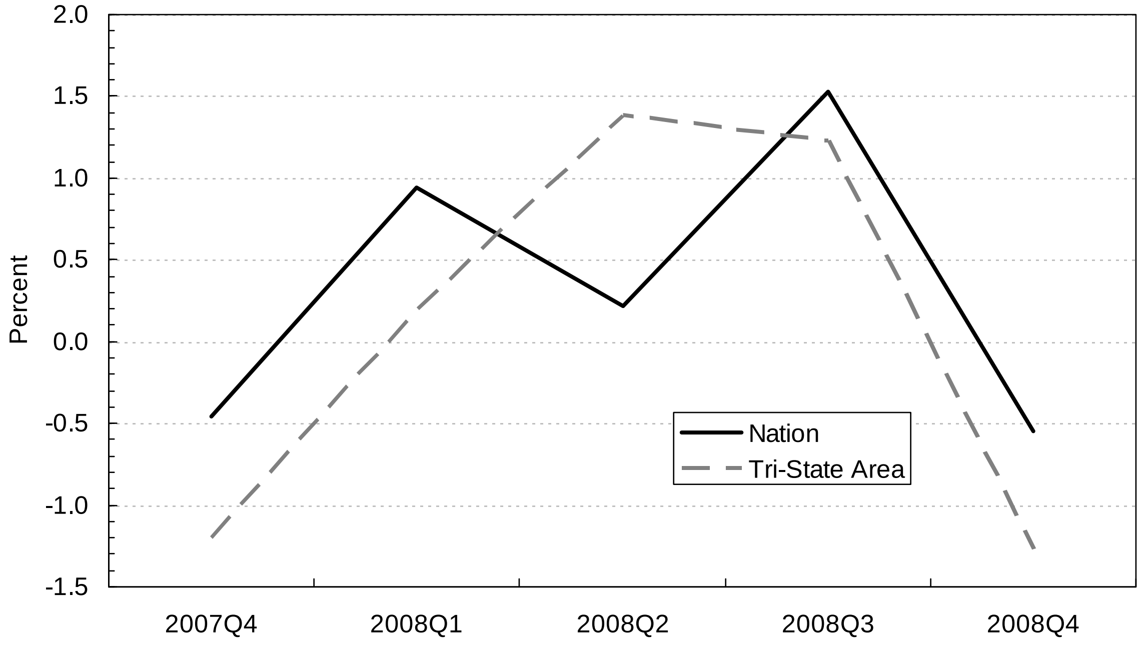
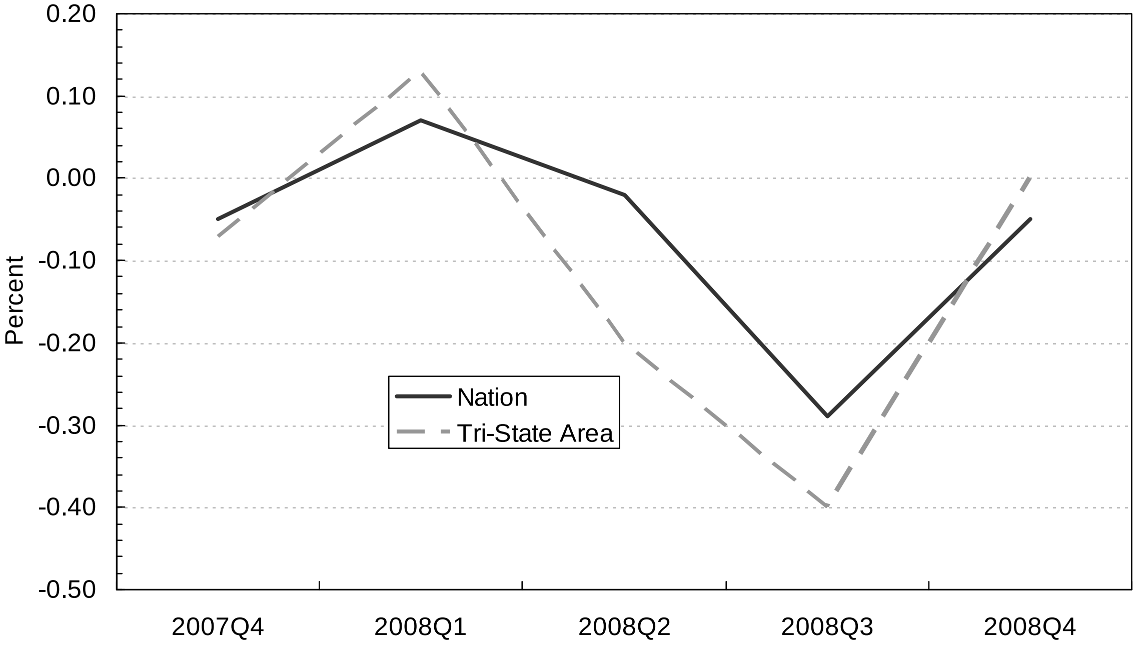


Figure 23

Realized Gains (Losses) on Securities/Average Securities



portfolio. Large banks nationwide realized losses of $672.0 million in the fourth quarter, while the loss in the tri-state area was $23.3 million. As a percentage of average securities these losses are fairly negligible (Figure 23), but it does mean that nearly 15 percent of the large banks' assets are effectively earning nothing.[19]

The funding sources of large banks are somewhat different from those of community banks. The ratio of core deposits to assets at large banks is only about 20 percent nationally and 25 percent locally, with noncore deposits representing about 44 percent nationally and 40 percent locally. Additionally, the large organizations carry roughly double the debt (as a percentage of assets) of the smaller institutions, nearly 20 percent both locally and nationally. None of these sources are growing much. Core deposits increased only 0.9 percent nationally and 1.5 percent locally in the fourth quarter. Noncore deposits increased 4.4 percent nationally and 3.6 percent locally, and debt funding decreased 7.4 percent nationally and 1.6 percent locally.

The largest source of deposits for the large organizations is nontransaction accounts, basically time and savings accounts, representing 66.0 percent of total deposits nationally and 73.6 percent locally. These are not growing, however. For the nation, nontransaction accounts increased only 1.6 percent in the fourth quarter and locally the increase was 3.2 percent. In particular, time deposits greater than $100,000 are shrinking. The fastest growing segment of deposits is demand deposits (checking accounts), which increased 22.1 percent nationally but only 7.8 percent locally; the growth is the result of a full guarantee by the FDIC. Also growing are brokered deposits, up 10.7 percent nationally and 27.0 percent locally.

The only part of debt funding that is growing is subordinated debt, but it rose only 2.5 percent nationally and 10.0 percent locally. The largest sources of debt at large organizations, fed funds and repos (36.4 percent of debt nationally and 41.9 percent locally) and other borrowings, basically commercial paper and medium-term notes (35.2 percent nationally

[19] Average securities were calculated using book value if the securities were held-to-maturity and market value if the securities are available-for-sale.

and 41.0 percent locally), either barely grew or shrank during the quarter.

In summary, large banking organizations clearly have substantial problems. In addition to the losses from RRE lending that they have been experiencing for the past year and a half, they now have nearly as many difficulties with CRE lending. They are also under-reserved and their capital ratios are shrinking. In addition to losses from lending, most of their other operations are losing money as well.

Fourth Quarter 2008

Community Banking Organizations

	Tri-State			*Nation*		
	$ Bill	**% Change From**		**$ Bill**	**% Change From**	
	08Q4	**08Q3**	**07Q4**	**08Q4**	**08Q3**	**07Q4**
Total Assets	84.8	12.34	9.66	1883.9	8.40	-0.72
Total Loans	59.6	13.11	12.56	1337.8	3.46	1.58
Business	7.6	4.82	10.42	209.1	5.39	1.33
Real Estate	48.0	17.25	13.48	987.1	3.51	1.97
Consumer	2.2	-19.06	2.21	76.8	5.35	0.24
Total Deposits	65.8	17.63	9.89	1479.3	10.58	-1.05

Ratios (in %)	**08Q4**	**08Q3**	**07Q4**	**08Q4**	**08Q3**	**07Q4**
Net Income/Avg Assets (ROA)	0.64	0.79	0.97	0.24	0.45	0.86
Net Interest Inc/Avg Assets (NIM)	3.21	3.25	3.22	3.33	3.37	3.29
Noninterest Inc/Avg Assets	1.22	1.29	1.36	0.90	0.95	0.94
Noninterest Exp/Avg Assets	3.07	3.11	3.12	3.00	3.00	2.75
Loans/Deposits	90.56	91.46	88.41	90.43	91.95	88.09
Equity/Assets	9.56	9.52	10.07	10.05	10.11	10.65
Nonperforming Loans/Total Loans	1.89	1.57	1.19	2.65	2.24	1.31

Large Banking Organizations

	Tri-State			*Nation*		
	$ Bill	**% Change From**		**$ Bill**	**% Change From**	
	08Q4	**08Q3**	**07Q4**	**08Q4**	**08Q3**	**07Q4***
Total Assets	4000.6	1.69	7.29	9751.8	2.06	6.99
Total Loans	2197.6	-7.72	1.21	5163.9	-8.70	0.08
Business	504.6	-2.84	10.18	1154.4	-4.65	3.98
Real Estate	1111.2	-8.12	-3.69	2718.8	-4.05	-0.66
Consumer	375.9	7.38	9.74	802.3	-5.99	1.35
Total Deposits	2600.3	11.72	11.16	6266.0	14.05	8.66

Ratios (in %)	**08Q4**	**08Q3**	**07Q4**	**08Q4**	**08Q3**	**07Q4**
Net Income/Avg Assets (ROA)	0.33	0.35	1.02	0.22	0.37	0.89
Net Interest Inc/Avg Assets (NIM)	2.41	2.84	2.89	2.58	2.73	2.76
Noninterest Inc/Avg Assets	1.65	2.01	2.19	1.70	1.84	2.07
Noninterest Exp/Avg Assets	2.23	2.82	2.95	2.66	2.81	2.96
Loans/Deposits	84.51	88.65	92.82	82.41	87.13	89.38
Equity/Assets	9.83	10.36	10.63	9.21	9.48	10.08
Nonperforming Loans/Total Loans	2.80	2.32	1.36	3.04	2.33	1.34

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, 2007. 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 — 171 for the tri-state area and 5,558 for the nation; (2) large banking organizations — 17 for the tri-state area and 98 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.

* Annual deposit and loan growth numbers at large banks nationally were affected by the acquisition of Washington Mutual Bank by JPMorgan Chase & Co. Therefore, JPMorgan Chase is excluded from the annual growth rate calculations.

Any questions or comments should be directed to Jim DiSalvo at (215) 574-3820 or jim.disalvo@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 website at www.philadelphiafed.org/research-and-data/publications/banking-brief. To subscribe to this publication, please go to www.philadelphiafed.org/philscriber/user/dsp_content.cfm.