BANKING BRIEF

FOR PENNSYLVANIA, NEW JERSEY, AND DELAWARE

Second Quarter 2010

Profits improved slightly at large banks and local community banks in the second quarter, while community banks nationwide experienced a small loss.[1] During the quarter, assets, loans, and deposits all shrank at the large banks and grew only slightly at community banks. Nonperforming loans (NPLs) began to shrink, but they are still at historically high levels, especially at the large banks. Capital ratios and net interest margins increased at all categories of banks. An increasing number of banks failed during the quarter. There were 44 bank failures in the second quarter, compared with 41 in the first quarter of this year and 24 during the second quarter of 2009.[2] So far in the third quarter (through August 18), an additional 24 banks have failed, bringing the total number of failures to 109 for this year. There were a total of 141 failures in 2009. There still has yet to be a failure among banks headquartered in the tri-state area.

The condition of large organizations showed some signs of improvement in the second quarter. Of the 100 organizations in the sample, 77 reported positive profits in the quarter, up from 71 in the first quarter. Also, 98 reported an equity-to-assets ratio greater than 6 percent, and 91 reported a ratio of at least 7 percent, both showing small increases from last quarter.[3] The gross amounts of NPLs and net charge-offs (NCOs) both decreased.[4] Additionally, the ratio of NPLs to total loans (NPL ratio) decreased 21 basis points, to 6.04 percent. However, this is still very high by historical standards.[5] It also appears that the ratio of NCOs to average loans (NCO ratio) has leveled off and even begun to fall slightly (Figure 1). Capital also continued to

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[1] See Summary Table of Bank Structure and Conditions (summary table) on page 2. Unless otherwise noted, all data presented here are from Federal Financial Institutions Examination Council Call Reports. Also, unless otherwise noted, all growth rates are annualized. Except on the summary table or except otherwise noted, all income statement items are for the current quarter only. On the summary table, income statement items are annualized, that is, they are the sum of the current quarter plus the three preceding quarters.

[2] Source: Federal Deposit Insurance Corporation (FDIC) failed bank list: http://www.fdic.gov/bank/individual/failed/banklist.html.

[3] Regulation Y defines an institution as well capitalized if it has a total capital-to-assets ratio above 7 percent and as undercapitalized if this ratio falls below 6 percent. While total equity and regulatory capital are not identical, they are close proxies. For further information on capital guidelines, see http://www.federalreserve.gov/bankinforeg/reglisting.htm#Y.

[4] NPLs are defined as the sum of loans past due 90 days or more and nonaccruing loans.

[5] For historical perspective, the average NPL ratio for all commercial banks between 1999 and 2009 was 1.67 percent. At the bottom of the last real estate cycle in 1991, this ratio was 3.70 percent.

Summary Table of Bank Structure and Conditions – Second Quarter 2010

Community Banking Organizations

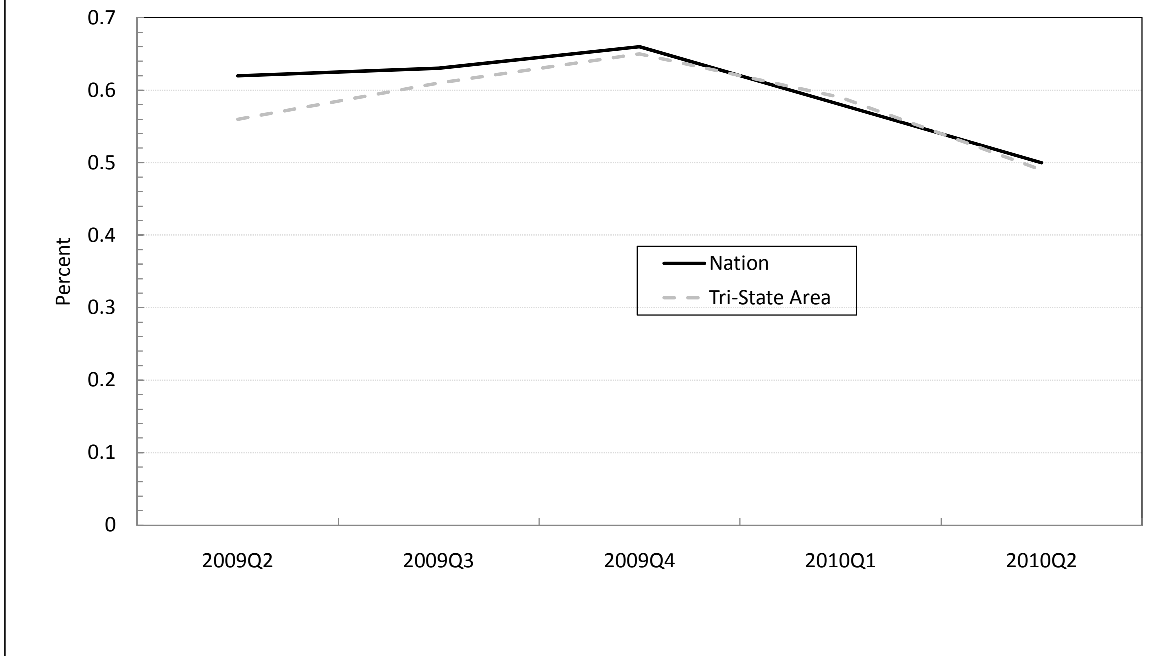
	Tri-State			*Nation*		
	$ Bill	**% Change From**		**$ Bill**	**% Change From**	
	10Q2	**10Q1**	**09Q2**	**10Q2**	**10Q1**	**09Q2**
Total Assets	90.4	4.19	4.77	1,826.6	2.87	2.41
Total Loans	61.4	4.64	2.58	1,207.3	0.85	-2.88
Business	8.0	9.63	1.65	179.3	1.31	-5.01
Real Estate	49.4	4.28	3.03	907.9	-0.49	-2.55
Consumer	2.2	-0.85	-1.08	57.1	-1.95	-5.81
Total Deposits	74.3	4.11	7.10	1,503.4	2.48	4.11
Ratios (in %)	**10Q2**	**10Q1**	**09Q2**	**10Q2**	**10Q1**	**09Q2**
Net Income/Avg Assets (ROA)	0.18	0.09	0.03	-0.06	-0.19	-0.12
Net Interest Inc/Avg Assets (NIM)	3.26	3.21	3.17	3.40	3.35	3.31
Noninterest Inc/Avg Assets	1.15	1.16	1.14	0.90	0.91	0.85
Noninterest Exp/Avg Assets	3.40	3.35	3.20	3.13	3.18	3.14
Loans/Deposits	82.61	82.50	86.25	80.30	80.62	86.08
Equity/Assets	9.76	9.65	9.41	10.16	9.95	9.97
Nonperforming Loans/Total Loans	3.09	3.03	2.28	3.80	3.86	3.35

Large Banking Organizations

	Tri-State			*Nation*		
	$ Bill	**% Change From**		**$ Bill**	**% Change From**	
	10Q2	**10Q1**	**09Q2**	**10Q2**	**10Q1**	**09Q2**
Total Assets	485.1	-3.73	-0.85	8,954.6	-4.36	-0.89
Total Loans	254.4	-4.31	-2.08	4,593.6	-4.87	-5.39
Business	46.5	-7.20	-16.45	859.5	-4.95	-15.94
Real Estate	151.6	-6.33	1.14	2,659.8	-6.96	-4.36
Consumer	33.9	-0.23	10.61	633.0	-2.91	6.08
Total Deposits	336.2	-1.81	0.33	6,218.4	-3.23	1.26
Ratios (in %)	**10Q2**	**10Q1**	**09Q2**	**10Q2**	**10Q1**	**09Q2**
Net Income/Avg Assets (ROA)	0.66	0.59	0.54	0.39	0.20	-0.05
Net Interest Inc/Avg Assets (NIM)	3.04	3.02	2.13	2.83	2.82	2.46
Noninterest Inc/Avg Assets	2.19	2.34	1.75	1.97	2.04	1.74
Noninterest Exp/Avg Assets	2.92	2.91	2.09	2.85	2.85	2.73
Loans/Deposits	75.68	76.17	77.54	73.87	74.19	79.06
Equity/Assets	10.84	10.61	9.86	10.93	10.60	9.94
Nonperforming Loans/Total Loans	7.38	7.56	5.04	6.04	6.25	4.64

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 special purpose banks such as credit card banks 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, 2009. The community banking organization sample is based on the remaining banking organizations. Tri-state large banking organizations are the balance sheet or income statement items of large banking organizations that have deposits in the region weighted by the percentage 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 — 183 for the tri-state area and 5,627 for the nation; (2) large banking organizations — 27 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.

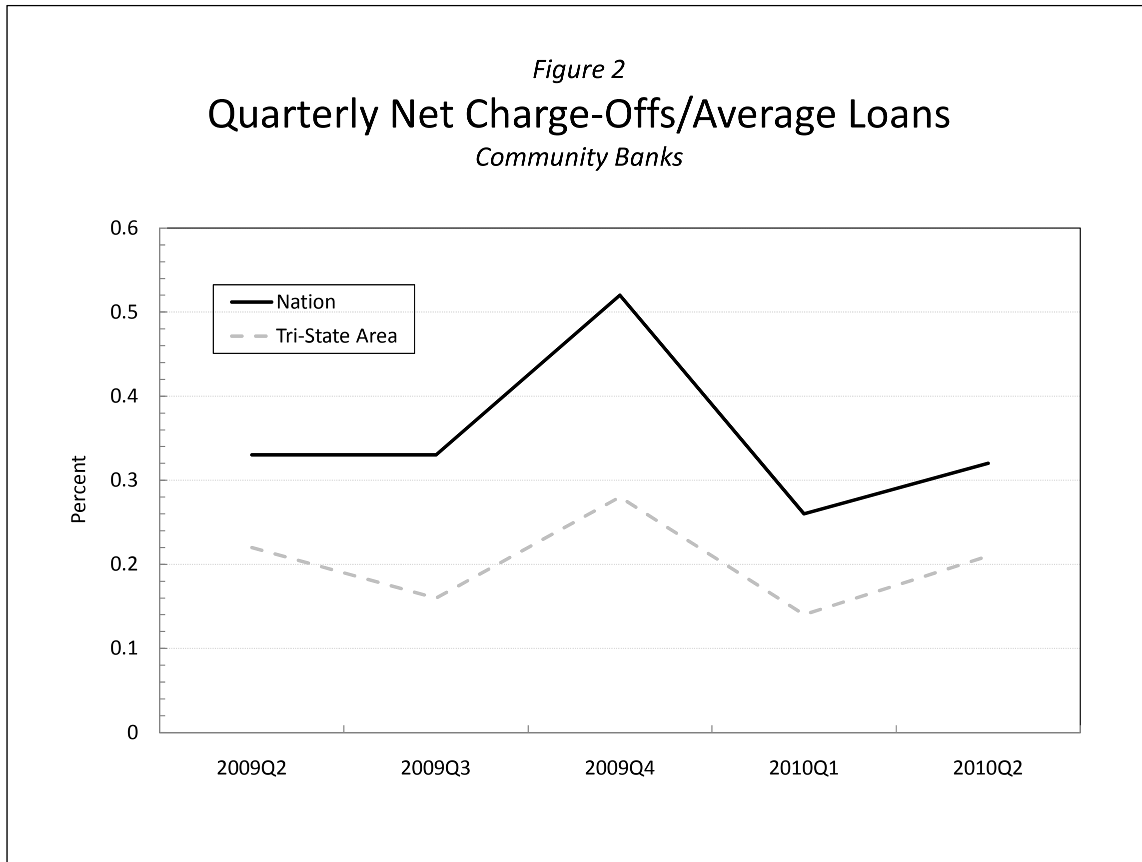
Any questions or comments should be directed to Jim DiSalvo at (215) 574-3820 or jim.disalvo@phil.frb.org. Detailed documentation on the methodology used in constructing this document, back issues, and the current issue of *Banking Brief* are available on our website at www.philadelphiafed.org/research-and-data/publications/banking-brief. To subscribe to this publication, please go to www.philadelphiafed.org/philscriber/user/dsp_content.cfm.



improve, as both total equity and the equity-to-assets ratio increased. However, these small improvements in asset quality cannot mask the significant problems remaining at large institutions. First, the large institutions are still far short of having adequate loan-loss reserves, and their ability to increase reserves is somewhat hampered at the moment (see the Provisioning and Reserves section below). Also, both loan and deposit balances are shrinking due to continued weakness in overall demand.

The situation at community banks is less clear. Community banks continued to have better asset quality than the larger organizations, but this also masks some underlying problems. Of the 5,627 community banks in the national sample, 4,525 reported positive profits in the second quarter. This represents a decrease of 101 from the first quarter. Also, 5,411 reported an equity-to-assets ratio of at least 6 percent, and 5,297 reported a ratio of at least 7 percent. These numbers represent a decrease of 19 from the second quarter and an increase of 36, respectively. Locally, out of 183 banks in the sample, 159 showed a profit, an increase of seven. Also, 178 had equity-to-assets ratios of at least 6 percent and 172 had a ratio of at least 7 percent, increases of two and five, respectively. Both nationally and locally, the NPL ratio was a little less than half that of the larger organizations, although this ratio did grow at tri-state area banks. Total NPLs increased locally but shrank nationally. Locally and nationally, both total NCOs and the NCO ratio decreased, but this appears to be at least partly due to quarterly fluctuations in the data (Figure 2). While community banks never had asset quality problems to the degree that the large organizations did (and still do), the community banks are having more difficulty returning to any consistent profitability. This is partially because they are at a substantial cost disadvantage. The

ratio of noninterest expense to average assets is substantially higher both locally and nationally than the large organizations (see page 2). Moreover, the community banks pay a substantially higher rate on both deposits and debt funding (see the Funding Sources section below).



Residential Real Estate Lending

Figure 3
Summary of Residential Real Estate Lending

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Total RRE Loans ($Millions)	1,694,231.9	19,820.7	297,410.1
Change from Last Quarter	-4.2%	9.7%	6.5%
Change from Last Year	-1.3%	2.0%	0.5%
Pct. of Total Loans	36.7	32.3	24.6
Nonperforming RRE Loans	159,220.3	362.4	7,741.2
Change from Last Quarter	-10.8%	-9.1%	6.7%
Change from Last Year	45.6%	36.4%	21.2%
Pct. of Nonperforming Loans	57.4	19.1	16.9
Nonperforming RRE/RRE Lns	9.40	1.83	2.60
Net RRE Charge-offs	9,715.9	14.7	579.2
Change from Last Quarter	-54.0%	59.8%	73.5%
Change from Last Year	-15.8%	51.0%	20.7%
Pct. of Net Charge-offs	41.5	11.3	14.6
Pct. of Avg. RRE loans	0.57	0.08	0.20

Most of the large organizations' asset quality problems are due to residential real estate (RRE) lending.[6] In spite of decreases in both NPLs and NCOs, RRE loans continue to be the largest drag on asset quality at large organizations. RRE loans represent 36.7 percent of all loans, but nearly 60 percent of NPLs and 42 percent of NCOs. The RRE NPL ratio actually decreased by 17 basis points from the first to the second quarter. This was the first quarterly decrease in this ratio in nearly two years (Figure 4). The RRE NCO ratio decreased as well, by 13 basis points (Figure 5). The continued weakness in the RRE market throughout much of the country will drag down demand for RRE loans for some time yet.

Community banks both locally and nationally are less reliant on RRE lending, and their asset quality is much better. The RRE NPL ratio was basically flat nationally and fell slightly locally (Figure 6). However, both local and national banks had fairly large increases in RRE NCOs. At banks nationally, this was primarily due to increases in NCOs of traditional mortgages secured by first liens, and it is likely due to the continued weakness of RRE markets in many areas. However, at local banks, NCOs on HELOCs grew substantially, as did mortgages secured by junior liens, while NCOs on mortgages secured by first liens were flat (Figure 7). This is especially discouraging because it is much more difficult to recover any part of a loss on a loan when one doesn't have first claim on the collateral.

[6] RRE loans are defined as the sum of mortgages secured by first or second liens and home equity lines of credit (HELOCs).

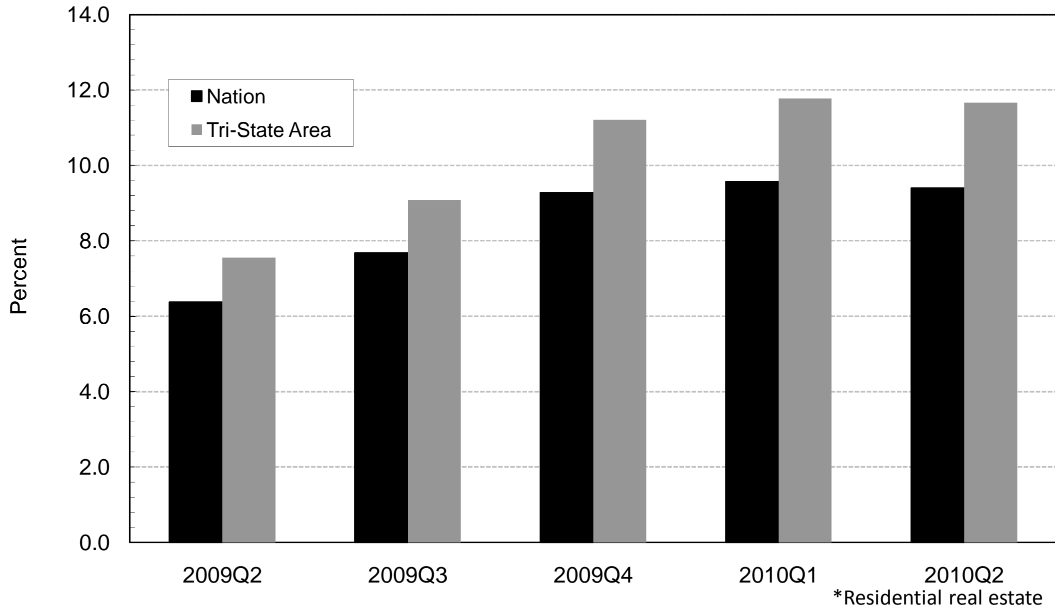


Figure 4
Nonperforming RRE* Loans/Total RRE Loans
Large Organizations
Nation
Tri-State Area
Percent
14.0
12.0
10.0
8.0
6.0
4.0
2.0
0.0
2009Q2
2009Q3
2009Q4
2010Q1
2010Q2
*Residential real estate

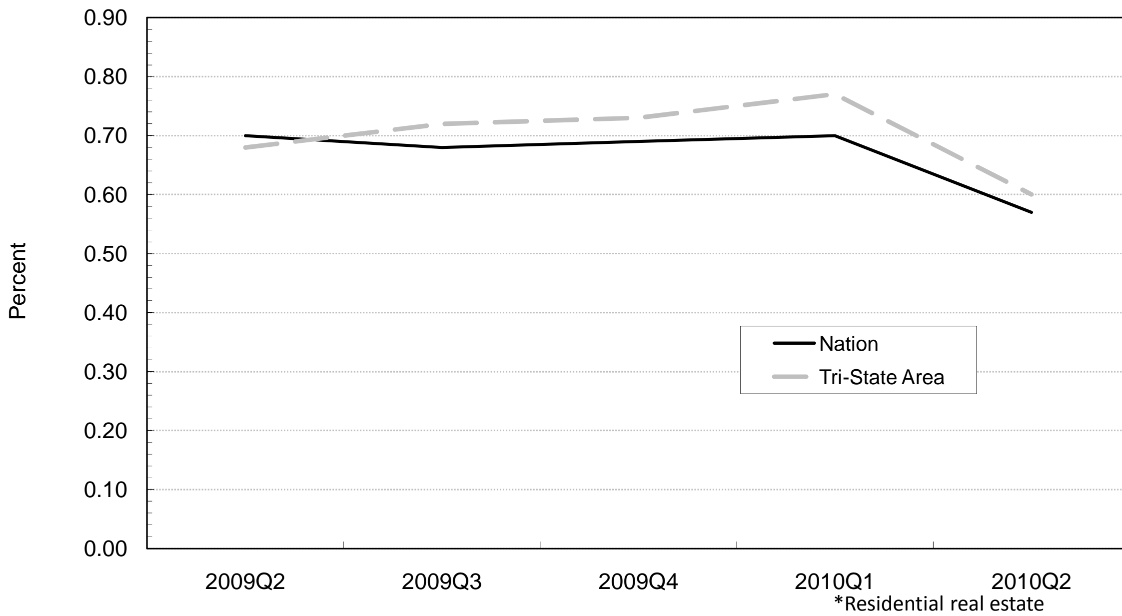
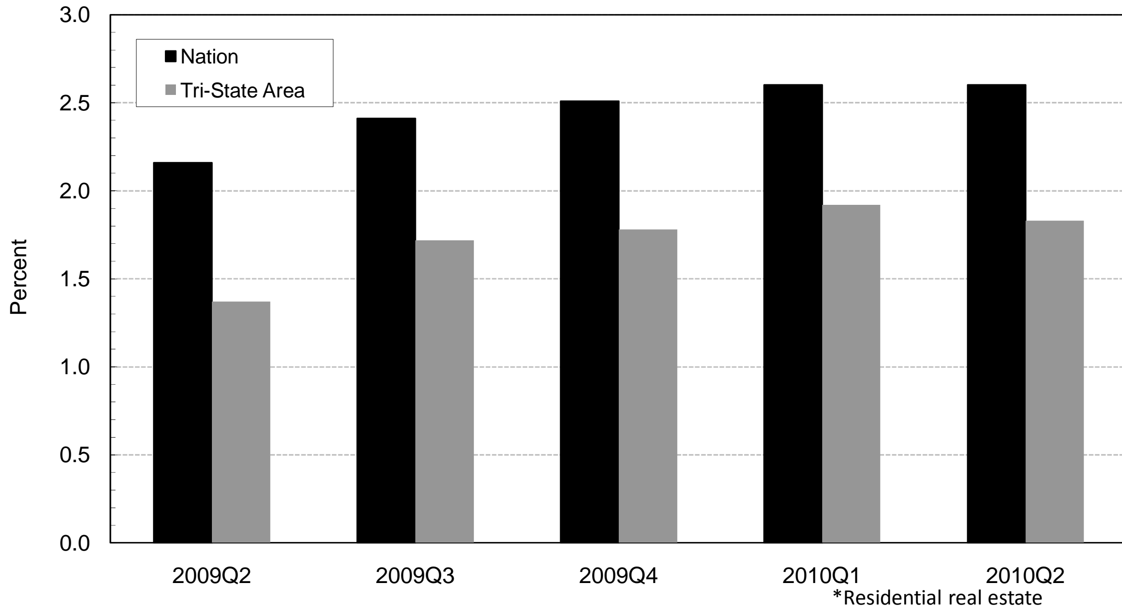


Figure 5
Net Charge-Offs on RRE* Lns/Avg RRE Lns
Large Organizations
Percent
0.90
0.80
0.70
0.60
0.50
0.40
0.30
0.20
0.10
0.00
Nation
Tri-State Area
2009Q2
2009Q3
2009Q4
2010Q1
2010Q2
*Residential real estate

Figure 6

Nonperforming RRE* Loans/Total RRE Loans

Community Banks

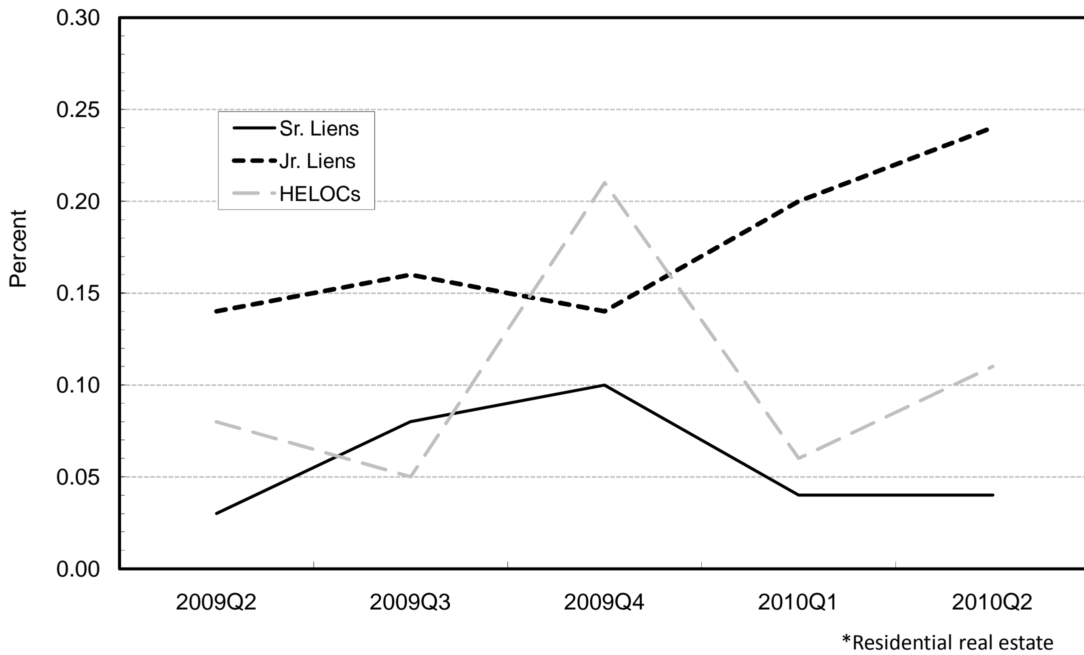


*Residential real estate

Figure 7

RRE NCO Ratio by Loan Type

Tri-State Area Community Banks



*Residential real estate

Commercial Real Estate Lending

Figure 8
Summary of CRE Lending

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Total CRE Loans ($Millions)	888,391.6	28,964.7	561,493.1
Change from Last Quarter	-11.6%	0.8%	-4.5%
Change from Last Year	-9.7%	3.6%	-4.7%
Pct. of Total Loans	19.3	47.2	46.5
Nonperforming CRE Loans	72,671.7	1,335.2	31,724.1
Change from Last Quarter	-21.8%	19.5%	-9.0%
Change from Last Year	11.2%	45.1%	6.9%
Pct. of Nonperforming Loans	26.2	70.3	69.2
Nonperforming CRE/CRE Lns	8.18	4.61	5.65
Net CRE Charge-offs	5,645.1	88.5	2,408.3
Change from Last Quarter	-14.6%	967.9%	180.8%
Change from Last Year	-11.6%	177.6%	5.7%
Pct. of Net Charge-offs	24.1	68.0	60.7
Pct. of Avg. CRE loans	0.60	0.31	0.42

Large organizations' commercial real estate (CRE) loans also showed some slight improvement, but there are still major quality problems.[7] The primary contributor to the large banks' problems with both NPLs and NCOs is construction lending. This represents about a quarter of all CRE lending, but 56 percent of CRE NPLs and 55 percent of CRE NCOs. While there are weaknesses in the quality of other components of CRE lending, they are dwarfed by those of construction lending (Figure 9). The situation is improving slightly as total NPLs and NCOs for all components of CRE lending shrank in the quarter, even while some NPL and NCO ratios continued to rise.

At community banks, CRE loans represent nearly half of the loan portfolios both locally and nationally. They are also the weakest part of their portfolios, with both national and tri-state area banks showing large increases in NCOs. Also, NPLs increased at tri-state area banks and showed only a slight decrease at banks nationally. As a result, the CRE NPL ratio was nearly flat nationally and increased somewhat locally, while the CRE NCO ratio rose in both areas (Figures 10 and 11). As with the large organizations, the majority of problems at community banks both locally and nationally are in construction loans. The construction NPL ratio was 13.5 percent nationally and 12.4 percent locally. Construction NPLs declined nationally but continued to increase at tri-state area banks. The vast majority of community banks' CRE loans are in commercial mortgages. Both NPLs and NCOs on these types of loans continued to increase nationally and locally, leading to increases in the NPL ratio and NCO ratio, though they are still relatively low (Figures 12 and 13).

[7] CRE loans are defined as the sum of construction and land development loans, loans secured by multifamily properties, and loans secured by nonfarm, nonresidential properties (commercial mortgages).

Figure 9

CRE NPL Ratio by Loan Type

Large Organizations Nationally

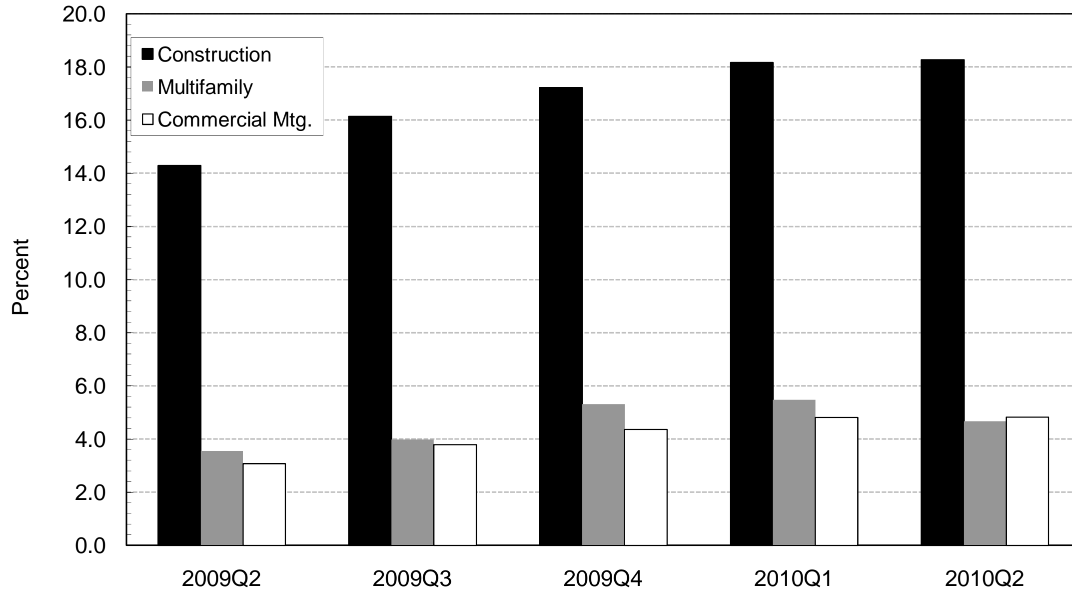
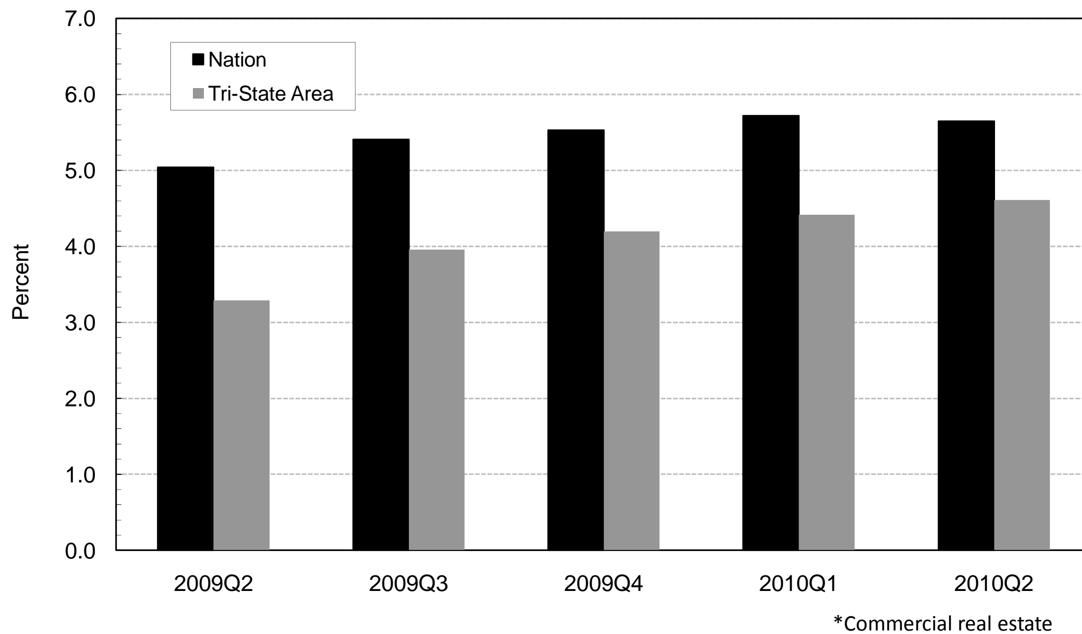


Figure 10

Nonperforming CRE Loans/CRE Loans

Community Banks



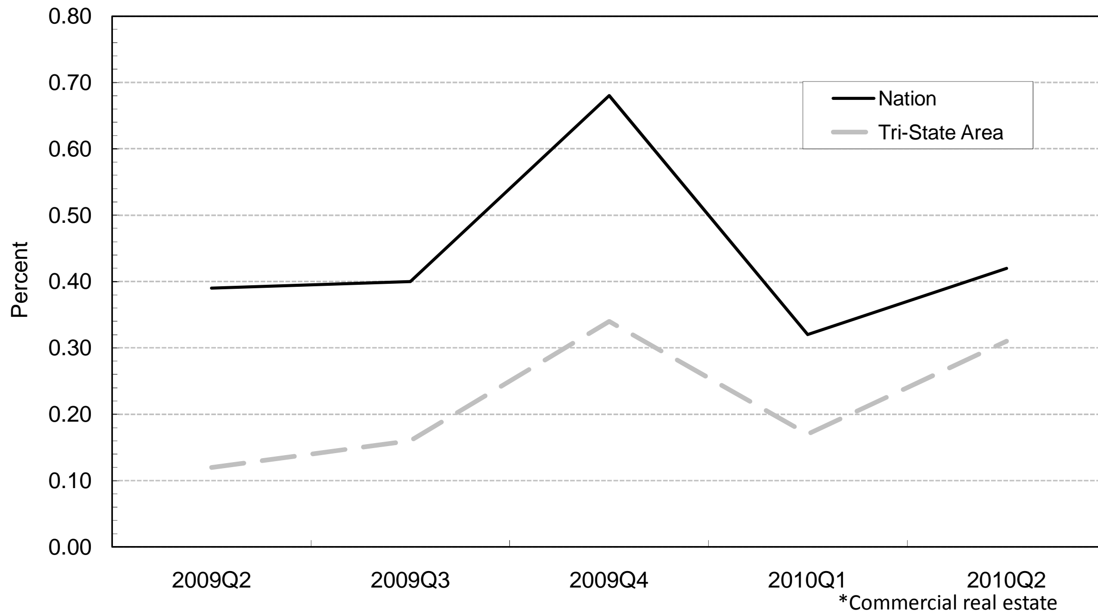


Figure 11
Net Charge-Offs on CRE* Lns/Avg CRE Lns
Community Banks
Percent
0.80
0.70
0.60
0.50
0.40
0.30
0.20
0.10
0.00
Nation
Tri-State Area
2009Q2
2009Q3
2009Q4
2010Q1
2010Q2
*Commercial real estate

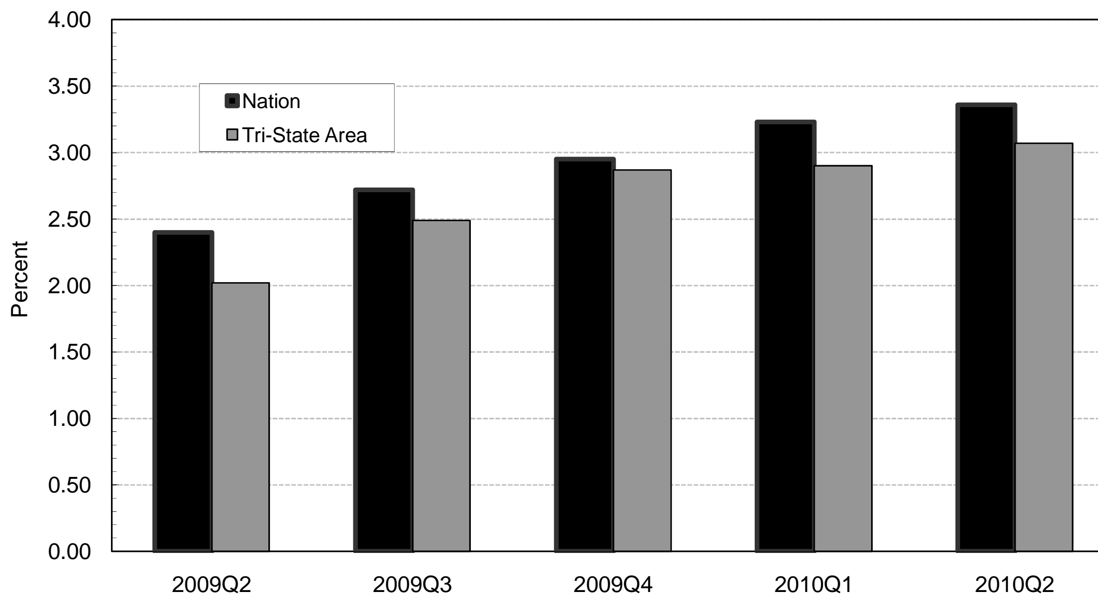
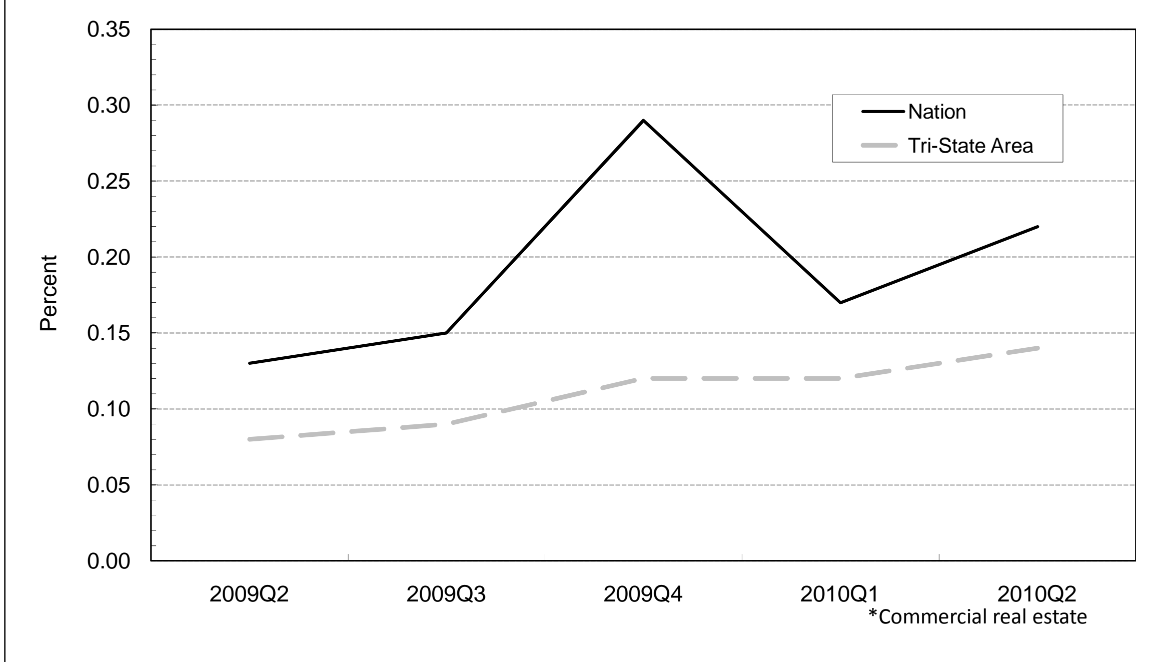


Figure 12
Nonperforming Commercial Mortgages/
Commercial Mortgages
Community Banks
Percent
4.00
3.50
3.00
2.50
2.00
1.50
1.00
0.50
0.00
Nation
Tri-State Area
2009Q2
2009Q3
2009Q4
2010Q1
2010Q2



Commercial & Industrial Lending

Figure 14
Summary of Commercial & Industrial Lending

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Total C&I Loans ($Millions)	859,508.3	8,041.4	179,286.8
Change from Last Quarter	-5.0%	9.6%	1.3%
Change from Last Year	-15.9%	1.7%	-5.0%
Pct. of Total Loans	18.7	13.1	14.9
Nonperforming C&I Loans	26,160.1	155.4	4,288.8
Change from Last Quarter	-28.5%	30.0%	1.3%
Change from Last Year	-9.1%	7.7%	9.8%
Pct. of Nonperforming Loans	9.4	8.2	9.4
Nonperforming C&I/C&I Lns	3.04	1.93	2.39
Net C&I Charge-offs	2,791.2	20.7	801.5
Change from Last Quarter	-63.1%	49.7%	86.9%
Change from Last Year	-48.1%	-56.4%	-16.0%
Pct. of Net Charge-offs	11.9	15.9	20.2
Pct. of Avg. C&I loans	0.30	0.26	0.44

Commercial and industrial (C&I) loans are performing much better than real estate loans at both large and small banks, but they represent a relatively small percentage of total loans at both large organizations and community banks. In addition, C&I loan portfolios at large organizations continue to decline in size. At the large banks, both NPLs and NCOs dropped substantially in the second quarter. Total C&I loans also dropped, but not as fast, leading to a 23-basis-point drop in the C&I NPL ratio and a decrease of 7 basis points in the C&I NCO ratio.

At community banks, overall C&I lending increased somewhat locally and was flat nationally. Unfortunately, this was also the case for C&I NPLs. However, the NPL ratios both locally and nationally are relatively low. NCOs increased substantially both locally and nationally but have decreased since last year.

Consumer Lending

Figure 15
Summary of Consumer Lending

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Total Co. Loans ($Millions)	632,950.5	2,175.7	57,074.0
Change from Last Quarter	-2.9%	-0.9%	-2.0%
Change from Last Year	6.1%	-1.1%	-5.8%
Pct. of Total Loans	13.8	3.5	4.7
Nonperforming Co. Loans	10,484.7	12.0	401.3
Change from Last Quarter	-28.8%	98.5%	-15.9%
Change from Last Year	-4.8%	2.1%	-8.7%
Pct. of Nonperforming Loans	3.8	0.6	0.9
Nonperforming Co/Co Lns	1.66	0.55	0.70
Net Co Charge-offs	4,612.4	5.7	141.0
Change from Last Quarter	-43.1%	305.8%	-56.8%
Change from Last Year	-20.7%	12.6%	-32.5%
Pct. of Net Charge-offs	19.7	4.4	3.6
Pct. of Avg. Co loans	0.75	0.26	0.24

Of all types of loans, consumer loans are performing the best at the moment. At large organizations, most problems — if there are any — are in the credit card portfolio. Part of this is due to accounting changes that require banks to bring items that were previously off balance sheet onto their balance sheets. However, even with these changes, both credit card NPLs and NCOs have been dropping for several quarters. Community banks engage in very little credit card lending, which thus explains the disparity in the NPL and NCO ratios between community banks and large organizations.

Provisioning and Reserves

Figure 16
Provision for Loan Losses and Loan Loss Reserves

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Loan-loss Reserve ($Millions)	149,790.0	1,005.1	24,546.0
Change from Last Quarter	-11.1%	-1.4%	4.6%
Change from Last Year	8.0%	16.0%	14.0%
Net Charge-Offs/LL Provision	113.2	102.8	90.1
LL Provision/Operating Inc.	19.3	12.5	22.3
Loan-loss Coverage Ratio	54.0	52.9	53.6

Despite decreasing NPLs and NCOs, large organizations are still under-reserved and are likely to be that way for a while. Total loan-loss reserves actually decreased because the large organizations set aside less for them.[8] Thus, the ratio of NCOs to loan-loss provision is now well over 100 percent (Figure 17), and the loan-loss coverage ratio was flat (Figure 18).[9] If NCOs and NPLs continue to shrink at their current rate, large organizations would need to add $143.1 billion to loan-loss reserves to bring their coverage ratios up to 100 percent. This number represents 133.6 percent of their total operating income and 14.6 percent of their total equity.[10] Large banks are anticipating reduced loan losses and provisioning accordingly. The reduction in loan-loss provisions has led to a fall in the ratio of loan-loss provision to operating income (Figure 19).[11]

Operating income at community banks both nationally and locally is increasing, but they are also under-reserved. At banks nationally, loan-loss reserves increased, but so did NCOs. At local banks, despite a quarterly increase in loan-loss provision, reserves decreased. The ratio of NCOs to loan-loss provision is now over 100 percent at local banks and over 90 percent nationally (Figure 20). This is partly due to the fact that community banks have put aside less of their operating income for loan losses in the past (Figure 21). The decline in NPLs did lead to a slight improvement in loan-loss coverage nationally, but locally the ratio continued to fall (Figure 22). Thus, if NPLs and NCOs continue to grow at their current

[8] For purposes of this document, loan-loss reserves refer to the item reported on the banks' balance sheets, while loan-loss provision refers to what is reported on the income statements, that is, what was added to loan-loss reserves in the quarter.

[9] Loan-loss coverage ratio is defined as the ratio of loan-loss reserves to NPLs. For historical perspective, the average loan-loss coverage ratio for all commercial banks between 1999 and 2009 was 132.7 percent. The average for the same period for the ratio of NCOs to loan-loss provision was 88.3 percent. At the bottom of the last real estate cycle in 1991, these numbers were 72.6 and 95.8 percent, respectively. Source: FDIC Historical Statistics on Banking: http://www2.fdic.gov/hsob/index.asp.

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

[11] The average ratio of loan-loss provision to operating income for all commercial banks from 1999 to 2009 was 12.9 percent. At the bottom of the last real estate cycle in 1991, this number was 18.9 percent. Source: FDIC Historical Statistics on Banking: http://www2.fdic.gov/hsob/index.asp.

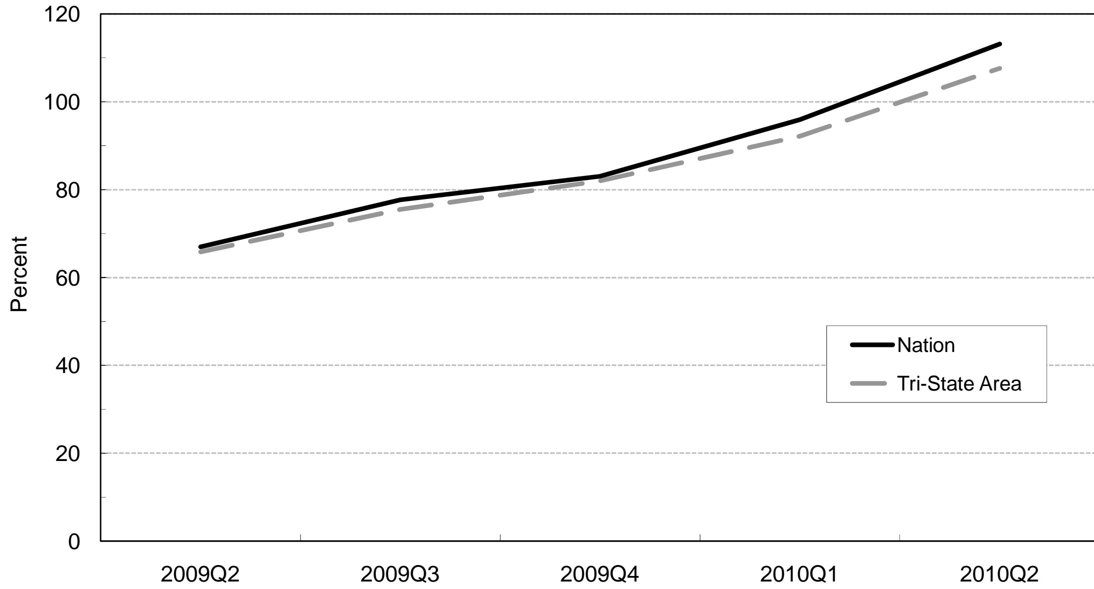


Figure 17
Net Charge-Offs/Loan-Loss Provision
Large Organizations
120
100
80
60
40
20
0
Percent
Nation
Tri-State Area
2009Q2
2009Q3
2009Q4
2010Q1
2010Q2

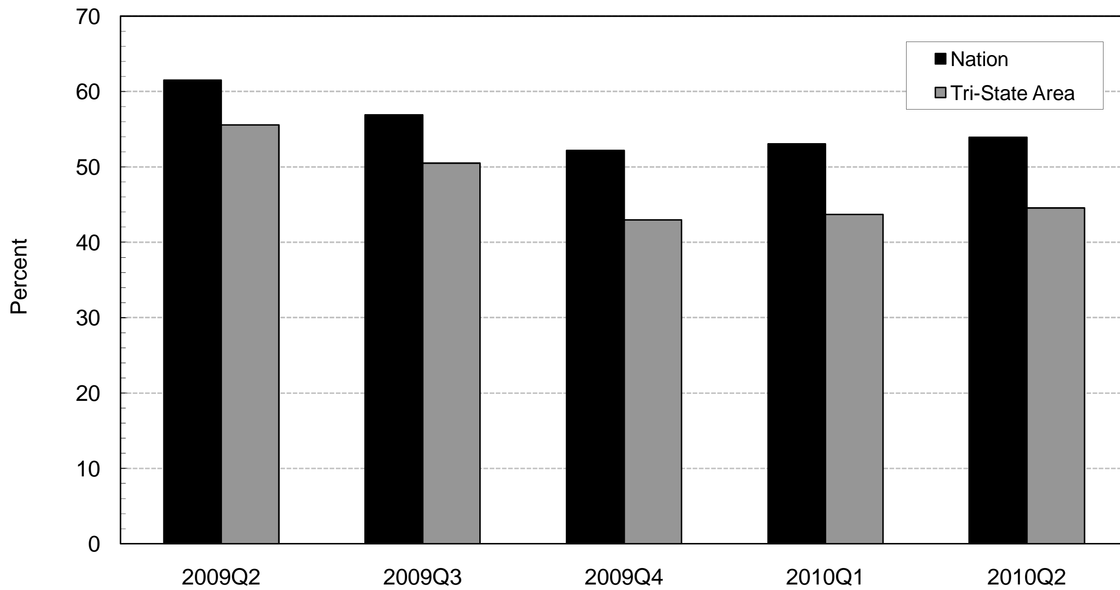


Figure 18
Loan-Loss Coverage Ratios
Large Organizations
70
60
50
40
30
20
10
0
Percent
Nation
Tri-State Area
2009Q2
2009Q3
2009Q4
2010Q1
2010Q2

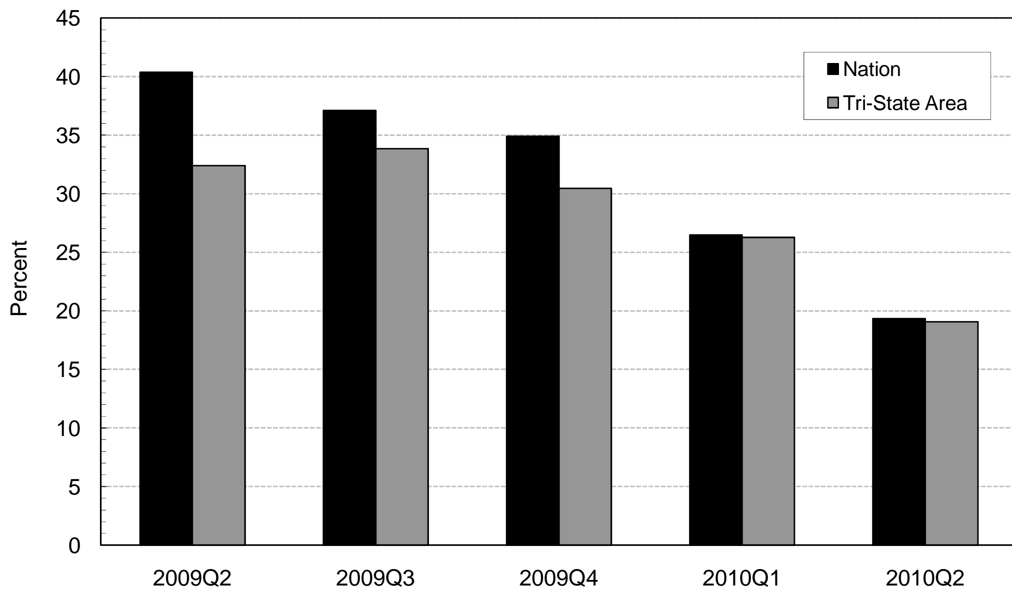


Figure 19
Loan-Loss Provision/Operating Income
Large Organizations
45
40
35
30
25
20
15
10
5
0
Percent
Nation
Tri-State Area
2009Q2
2009Q3
2009Q4
2010Q1
2010Q2

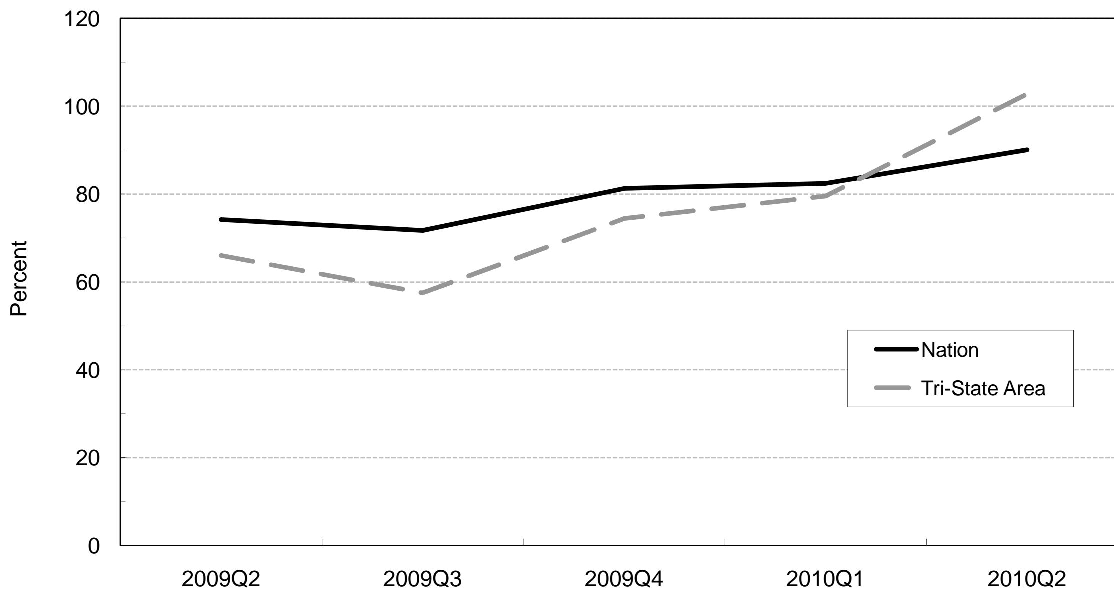


Figure 20
Net Charge-Offs/Loan-Loss Provision
Community Banks
120
100
80
60
40
20
0
Percent
Nation
Tri-State Area
2009Q2
2009Q3
2009Q4
2010Q1
2010Q2

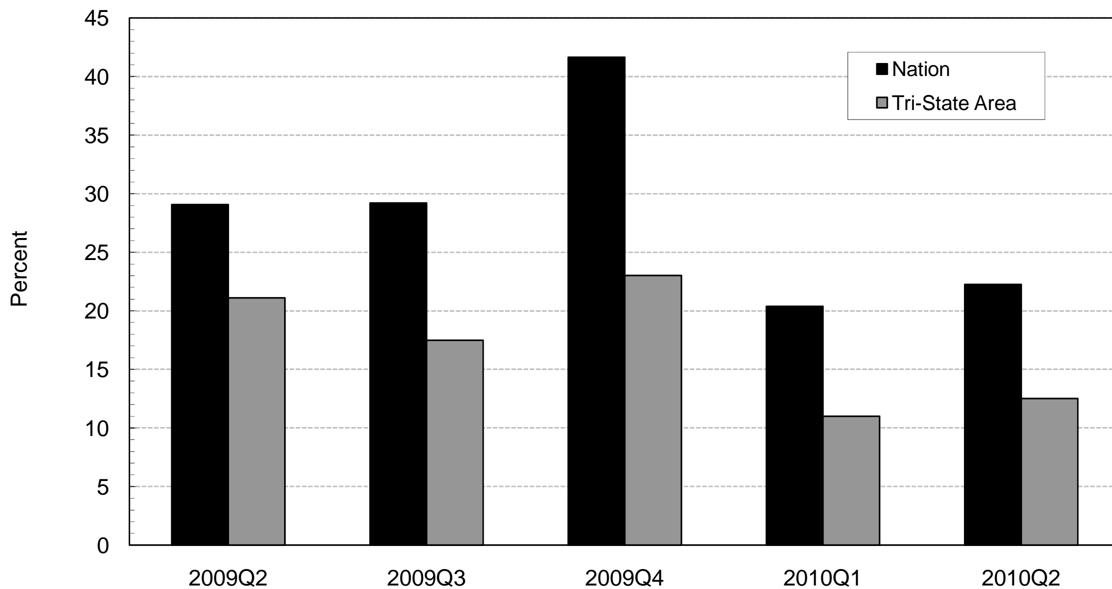


Figure 21
Loan-Loss Provision/Operating Income
Community Banks
Percent
45
40
35
30
25
20
15
10
5
0
Nation
Tri-State Area
2009Q2
2009Q3
2009Q4
2010Q1
2010Q2

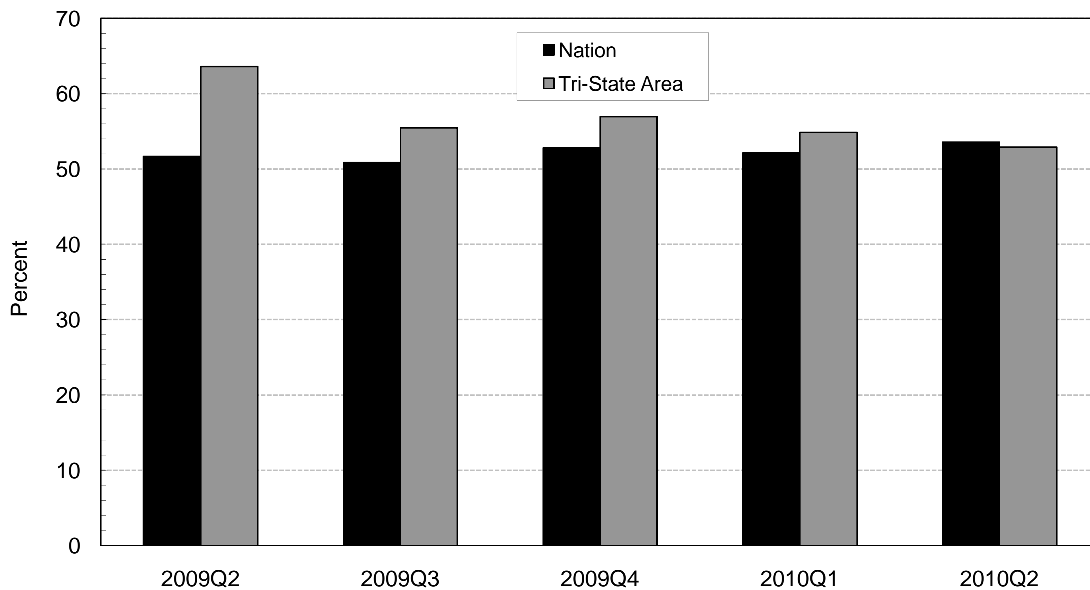


Figure 22
Loan-Loss Coverage Ratios
Community Banks
Percent
70
60
50
40
30
20
10
0
Nation
Tri-State Area
2009Q2
2009Q3
2009Q4
2010Q1
2010Q2

rate, community banks nationally would need to add $23.8 billion to their loan-loss reserves in order to bring loan-loss coverage up to 100 percent next quarter. This represents 120.1 percent of their operating income and 12.8 percent of their equity.

Tri-state area banks are slightly better off. They would need to add a little more than $1.0 billion to loan-loss reserves, which is 103.2 percent of operating income and 11.8 percent of equity.

Securities

Figure 23
Summary of Securities Portfolios

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Securities/Assets	19.9	20.2	19.6
Market Value ($Millions)	1,779,365.0	18,342.0	358,532.7
Change from Last Quarter	-2.1%	4.4%	14.3%
Change from Last Year	10.6%	7.3%	10.5%
Realized Gain/Loss	1,513.4	13.1	272.8
Pct of Average Securities	0.08	0.07	0.08
MarketValue/Book Value	101.72	101.31	101.88

At large organizations, Treasury securities and securities of government-sponsored enterprises (GSEs) had fairly large gains in value, while mortgage-backed securities (MBS) and state and local government bonds showed substantial losses.[12] MBS make up over 56 percent of the large organizations' portfolios, with foreign securities making up about 12 percent. Large organizations have substantially increased their holdings of Treasury securities in the past year, from under 3 percent of their portfolios to over 7 percent.

At community banks in the nation, nearly all types of securities gained value, with Treasuries, MBS, and state and local government securities having the largest gains. At tri-state area community banks, Treasuries, state and local government securities, and other domestic securities posted substantial increases in value, while the value of their portfolio of MBS and GSE securities decreased slightly.[13] At community banks both locally and nationally, MBS make up about 42 percent of the securities portfolios, followed by GSE securities at about 28 percent, and state and local government securities at about 22 percent. Both large organizations and community banks had relatively high realized gains on securities.[14]

[12] This figure uses the value of securities as reported on the bank balance sheet. The reported value of securities uses the book value if the security is to be held to maturity and the market value if the security is available for sale.

[13] Changes in market value of classes of securities can be indicative of increases in the value of the securities that were already there or due to purchases or sales of certain securities.

[14] Realized gain/loss is a net position. Therefore, the number reported in the tri-state area sample can be larger or smaller than that for the nation, even though the tri-state sample is a subset of the national sample.

Funding Sources

Figure 24
Structure of Liabilities

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Deposits ($millions)	6,218,401.9	74,319.4	1,503,441.6
Pct. of Assets	69.4	82.2	82.3
Change from Last Quarter	-3.2%	4.1%	2.5%
Change from Last Year	1.3%	7.1%	4.1%
Debt ($millions)	1,226,046.1	6,336.4	123,626.0
Pct. of Assets	13.7	7.0	6.8
Change from Last Quarter	-26.9%	-4.8%	-5.6%
Change from Last Year	-16.9%	-19.4%	-15.7%
Core Deposits/Deposits	40.7	70.1	68.9
Implicit Rate on Deposits	0.70%	1.57%	1.60%
Implicit Rate on Debt	1.63%	3.13%	2.86%

At large organizations, the loss of deposits was mainly due to foreign deposits. Domestic deposits were basically flat in the quarter, with demand deposits growing about 10 percent and time deposits shrinking about 25 percent (both figures annualized). The large organizations rely much less on core deposits than the community banks do.[15] The implicit interest rate that the large banks pay on deposits continued to fall (Figure 25).[16] The large organizations' debt obligations continued to fall. As shown from the implicit interest rate on debt, using debt for funding is more than twice as expensive as using deposits.

Community banks both locally and nationally had small increases in deposits. In both samples, this was due to increases in demand deposits and savings deposits, while time deposits shrank slightly. The local banks have also cut back on their use of "hot money" as brokered deposits shrank. The implicit interest rate on deposits shrank somewhat (Figure 26). This rate and the implicit rate on debt demonstrate one of the cost disadvantages of small banks and one of the reasons why they have been slower to return to profitability. Despite relying on more stable deposits and less debt, their cost of funds for both deposits and debt is about twice that of the large organizations.

[15] Core deposits are defined as total domestic deposits less the sum of brokered deposits in denominations less than $100,000 and all deposits in denominations greater than $100,000. Core deposits are desirable for banks because they are very stable.

[16] Implicit interest rate is defined as the annualized quarterly interest expense divided by the quarterly average balance.

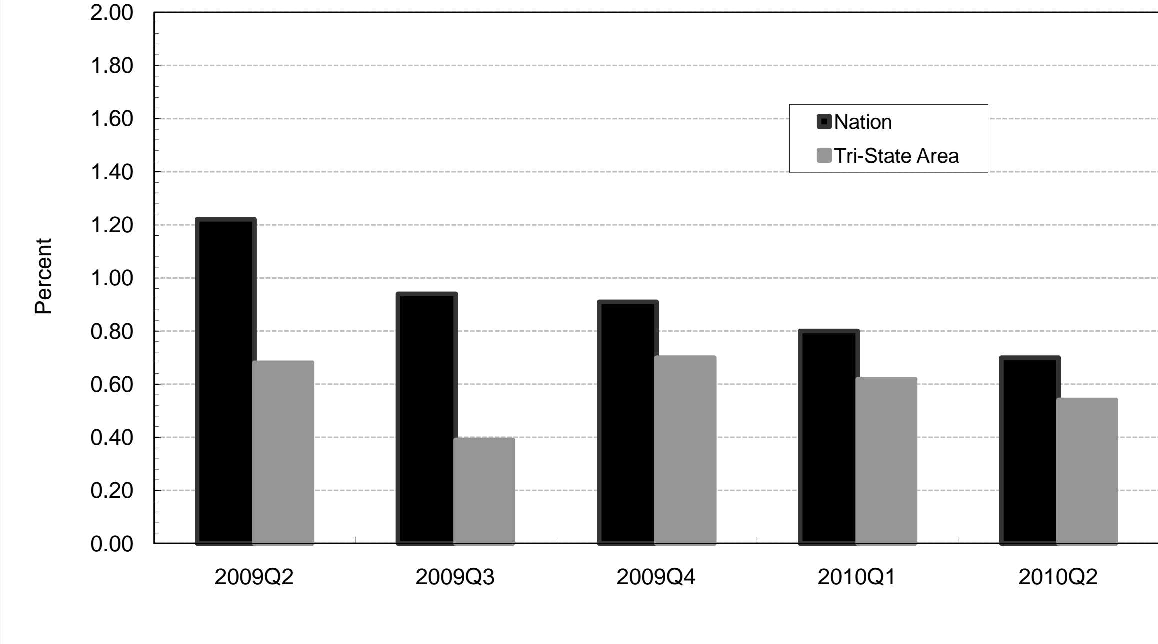


Figure 25
Implicit Interest Rate on Deposits
Large Organizations
2.00
1.80
1.60
1.40
1.20
1.00
0.80
0.60
0.40
0.20
0.00
Percent
Nation
Tri-State Area
2009Q2
2009Q3
2009Q4
2010Q1
2010Q2

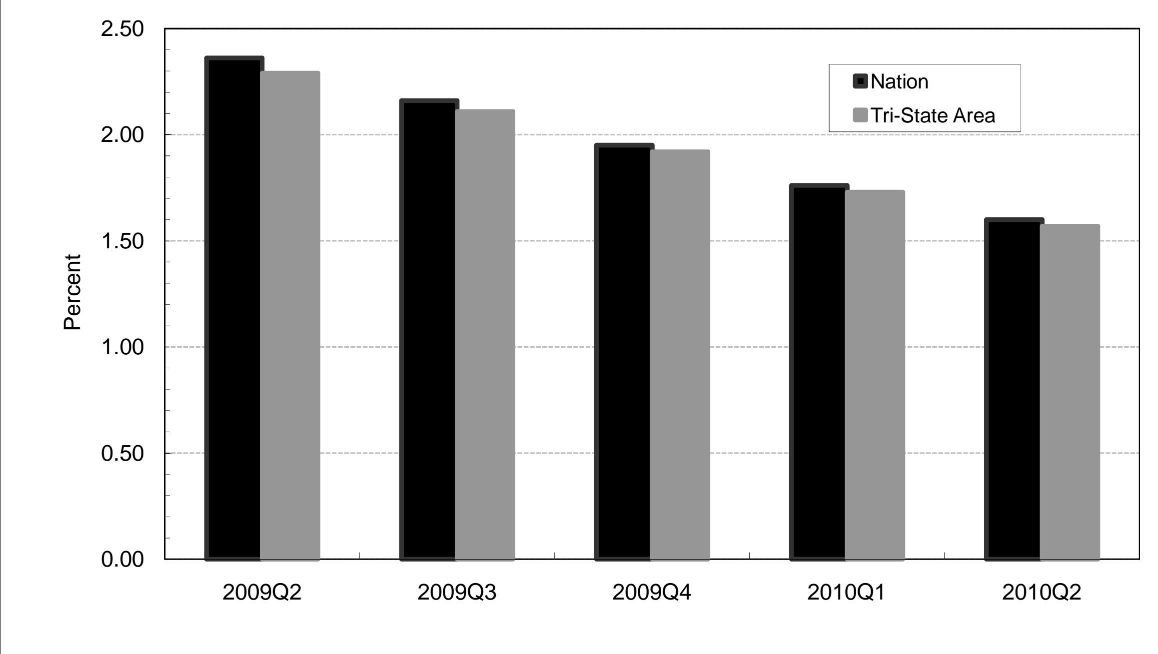


Figure 26
Implicit Interest Rate on Deposits
Community Banks
2.50
2.00
1.50
1.00
0.50
0.00
Percent
Nation
Tri-State Area
2009Q2
2009Q3
2009Q4
2010Q1
2010Q2

Small Business Lending

Figure 27
Annual Report of Small Business Lending

	Large Organizations		Community Banks			
	Nation		Tri-State Area		Nation	
Commercial Real Estate	Number	Amount*	Number	Amount	Number	Amount
<$100,000	116,353	549,347.4	13,325	22,067.8	389,383	395,559.7
Change from 2009	-34.2%	-2.2%	-3.6%	8.9%	5.8%	3.5%
$100,000-250,000	164,983	21,560.5	12,559	1,656.2	226,540	30,819.4
Change from 2009	-20.9%	-23.4%	0.4%	1.7%	-4.9%	-2.4%
$250,000-1 million	257,460	107,165.1	16,649	6,925.7	290,889	121,726.2
Change from 2009	-11.6%	-14.2%	4.2%	5.3%	-4.1%	0.3%
C&I Loans						
<$100,000	4,436,799	59,723.8	42,370	1,152.2	1,312,729	29,945.6
Change from 2009	-3.1%	-3.6%	-6.8%	-8.8%	-14.4%	-11.7%
$100,000-250,000	230,767	23,364.8	9,158	946.7	218,838	22,700.7
Change from 2009	-7.9%	-7.5%	-4.0%	-4.6%	-5.7%	-6.5%
$250,000-1 million	192,960	58,777.4	8,844	2,233.5	172,909	50,926.1
Change from 2009	-9.3%	-10.0%	3.6%	-0.2%	-15.9%	-5.8%

* The left-hand column denotes the original amount of the loans. The entry in the "Amount" column is the balance still outstanding as of June 30, 2010, and is in millions of dollars. Thus, if a $240,000 loan was made on December 1, 2009, and paid off on June 1, 2010, it would appear in the "Number" column but not in the "Amount" column.

In both the number of loans made and the balances outstanding, small business lending has contracted since last year. It appears that demand is quite slack, and as a consequence, banks are making fewer loans to businesses. The Federal Reserve Board's Senior Loan Officer Opinion Surveys for the past year have reported relatively weak demand for C&I and CRE loans. While some banks have been easing their lending standards slightly — which may portend an increase in future lending — most have not made any changes.