BANKING BRIEF
FOR PENNSYLVANIA, NEW JERSEY, AND DELAWARE

Third Quarter 2010

Profits continued to improve at both large and small organizations, and all segments of the industry posted some profit in the third quarter. At large organizations, return on average assets (ROA) increased 17 basis points, to 0.56 percent. At community banks, banks nationally posted their first positive profits in about a year, with an ROA of 0.05 percent, up 12 basis points from the second quarter (see page 2).[1] Community banks locally had a small gain in ROA, from 0.18 to 0.21 percent. Part of the increase in net income came from asset sales, as large organizations reported over $1.14 billion in net asset sales, up from $44 million last quarter, and community banks' asset sales quadrupled nationally and doubled locally. Additionally, large organizations and community banks nationally decreased their loan-loss provisioning substantially, but that was not the case at local community banks. However, this increase in profits did not improve the rate of bank failures. There were 41 bank failures in the third quarter, compared to 44 in the second quarter. Also, there have been an additional 19 failures in the fourth quarter as of November 12, 2010. Thus, the total number of failures so far this year is now 128. The tri-state area experienced its first bank failure in the third quarter when a small bank in southern New Jersey failed in September.[2]

The condition of large organizations continued to improve at a slow pace in most areas in the third quarter. As mentioned above, profitability improved somewhat. Also, of the 99 institutions in the large organizations sample, 79 reported a profit, an increase of two from the second quarter. The ratio of nonperforming loans (NPLs) to total loans (the NPL ratio) decreased 12 basis points, to 5.92 percent.[3] This is the second straight quarter that the NPL ratio has decreased and the third straight quarter that overall NPLs have decreased, so it appears that the large organizations are getting a handle on their problem loans. NPLs have increased 5.2 percent from the third quarter of 2009, however. Net charge-offs (NCOs) also decreased for the third consecutive quarter, and they have decreased 28.7 percent from last year. The ratio of NCOs to average loans (the NCO

[1] Unless otherwise noted, all data presented here are from Federal Financial Institutions Examination Council (FFIEC) call reports. Also, unless otherwise noted, all income statement items except those presented on the Summary Table of Bank Structure and Conditions on page 2 are for the quarter only, and all growth rates, including those on page 2, are annualized.

[2] The bank in question was not closed, but its assets and deposits were sold to another institution.

[3] Nonperforming loans are defined as loans past due 90 days or more plus nonaccruing loans. 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. Source: FDIC Historical Statistics on Banking, http://www2.fdic.gov/hsob/index.asp.

Summary Table of Bank Structure and Conditions – Third Quarter 2010

Community Banking Organizations

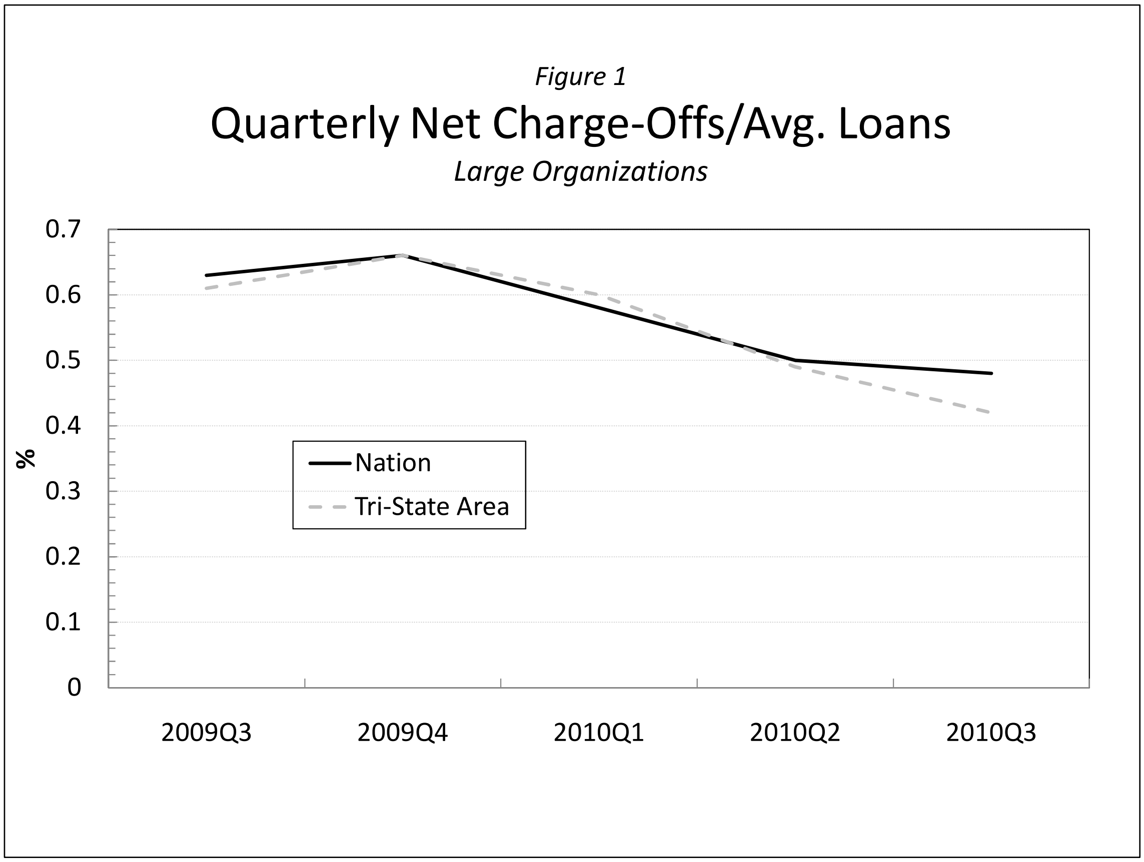
	Tri-State			*Nation*		
	$ Bill	**% Change From**		**$ Bill**	**% Change From**	
	10Q3	**10Q2**	**09Q3**	**10Q3**	**10Q2**	**09Q3**
Total Assets	92.0	7.12	4.93	1,854.7	6.68	3.33
Total Loans	62.1	4.38	2.93	1,216.8	3.55	-1.41
Business	8.0	-2.01	2.44	177.9	-2.64	-3.47
Real Estate	50.2	6.64	3.60	918.0	5.16	-0.74
Consumer	2.1	-9.56	-5.58	56.5	-4.01	-6.97
Total Deposits	76.0	9.48	7.11	1,527.6	6.96	4.83
Ratios (in %)	**10Q3**	**10Q2**	**09Q3**	**10Q3**	**10Q2**	**09Q3**
Net Income/Avg Assets (ROA)	0.21	0.18	-0.04	0.05	-0.07	-0.18
Net Interest Inc/Avg Assets (NIM)	3.29	3.26	3.14	3.42	3.40	3.30
Noninterest Inc/Avg Assets	1.21	1.15	1.13	0.90	0.90	0.90
Noninterest Exp/Avg Assets	3.41	3.40	3.21	3.11	3.13	3.18
Loans/Deposits	81.62	82.60	84.94	79.66	80.30	84.70
Equity/Assets	9.85	9.75	9.71	10.31	10.15	10.10
Nonperforming Loans/Total Loans	3.17	3.09	2.78	3.77	3.78	3.62

Large Banking Organizations

	Tri-State			*Nation*		
	$ Bill	**% Change From**		**$ Bill**	**% Change From**	
	10Q3	**10Q2**	**09Q3**	**10Q3**	**10Q2**	**09Q3**
Total Assets	489.5	2.89	0.32	9,102.6	6.68	0.53
Total Loans	251.9	-4.81	-1.09	4,570.6	-2.12	-3.13
Business	46.3	0.25	-11.62	862.9	4.00	-9.52
Real Estate	149.5	-6.46	2.50	2,623.5	-5.47	-2.87
Consumer	32.1	-9.92	0.64	607.4	-7.01	-0.45
Total Deposits	339.9	3.61	2.20	6,300.4	5.25	1.90
Ratios (in %)	**10Q3**	**10Q2**	**09Q3**	**10Q3**	**10Q2**	**09Q3**
Net Income/Avg Assets (ROA)	0.76	0.64	0.60	0.56	0.39	-0.10
Net Interest Inc/Avg Assets (NIM)	3.02	3.04	2.22	2.82	2.83	2.49
Noninterest Inc/Avg Assets	2.15	2.19	1.80	1.94	1.97	1.76
Noninterest Exp/Avg Assets	2.96	2.93	2.09	2.87	2.85	2.74
Loans/Deposits	74.10	75.69	76.56	72.54	73.87	76.31
Equity/Assets	10.82	10.83	10.28	10.92	10.93	10.29
Nonperforming Loans/Total Loans	7.29	7.38	6.06	5.92	6.04	5.46

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 — 181 for the tri-state area and 5,593 for the nation; (2) large banking organizations — 27 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.

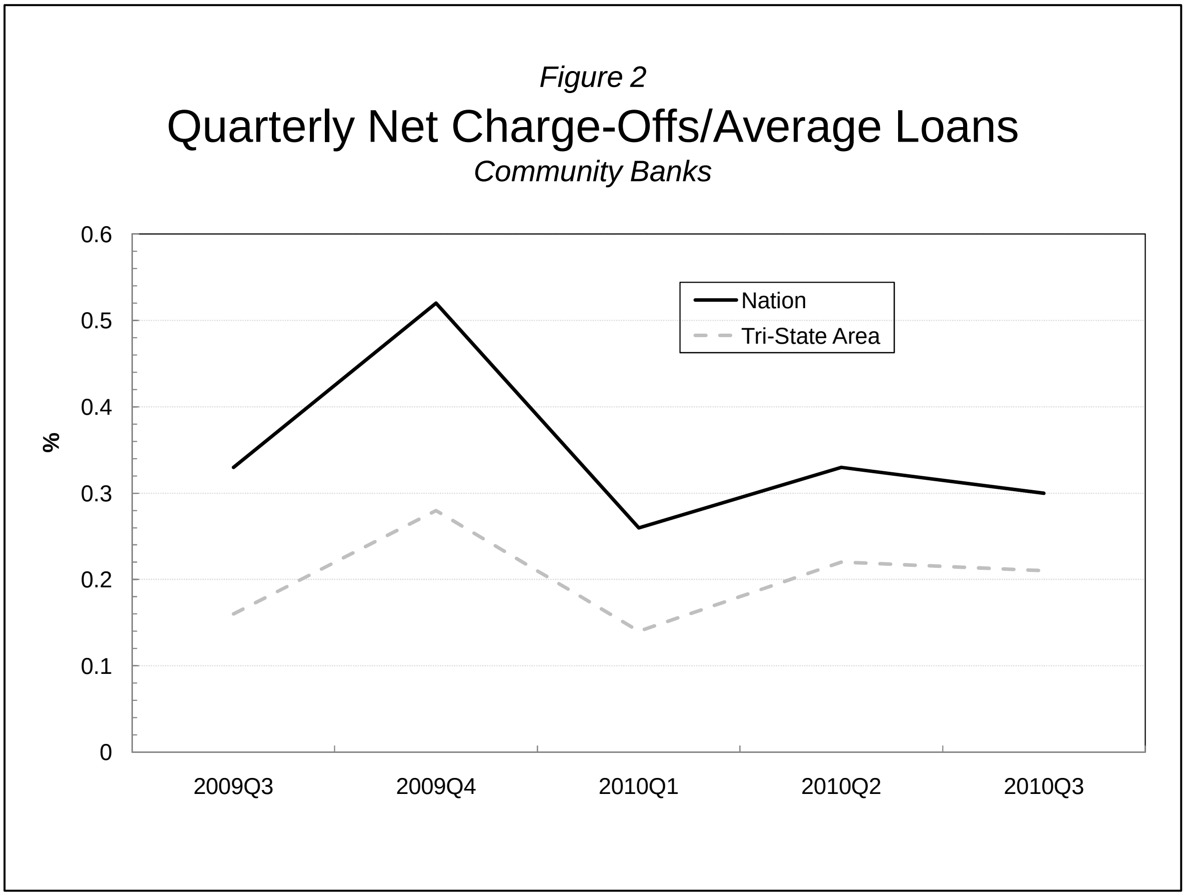
Any questions or comments should be directed to Jim DiSalvo at (215) 574-3820 or jim.disalvo@phil.frb.org. Detailed documentation on the methodology used in constructing this document, back issues, and the current issue of *Banking Brief* are available on our website at www.philadelphiafed.org/research-and-data/publications/banking-brief.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



ratio) also fell for the third straight quarter (Figure 1). Net interest margins, the ratios of noninterest income and noninterest expense, and capital ratios were basically unchanged from the second quarter. The number of undercapitalized institutions also shrunk. All 99 organizations in the sample had capital ratios of at least 6 percent, and all but two of them had ratios of at least 7 percent.[4]

The condition of community banks is not improving as much as that of the larger banks, and tri-state area community banks continued to worsen relative to banks nationally. While profits and capital ratios improved, asset quality, as measured by the NPL ratio, was flat nationally and worsened locally. While asset quality at community banks continues to be much better than that at the larger organizations, they have not yet turned the corner. Also, while profits improved both nationally and locally, the number of institutions reporting positive profits actually decreased in the third quarter. Out of the 5,593 institutions in the national sample, 4,472 reported positive net incomes, a decline of 13 from the second quarter. Locally, out of 181 tri-state area banks, 154 reported positive profits, a decrease of three from the second quarter. Capital ratios increased by 16 basis points nationally and 10 basis points locally, but

[4] Regulation Y defines capital in terms of zones. Institutions in Zone 1 have capital-to-assets ratios above 7 percent, those in Zone 2 have ratios between 6 and 7 percent, and those in Zone 3 have ratios below 6 percent. An institution is considered well-capitalized if it is in Zones 1 or 2 and undercapitalized if it is in Zone 3. 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.



again the results were mixed. A total of 5,380 institutions nationally had capital ratios of at least 6 percent, a drop of 20 from nine from the second quarter, and 5,285 had ratios of at least 7 percent, an increase of nine. Locally, 176 institutions had a capital-to-assets ratio of at least 6 percent, unchanged from the second quarter, and 172 were well capitalized, an increase of one. Total NPLs increased both nationally and locally, by 2.7 and 16.4 percent, respectively. NCOs decreased 32.9 percent nationally and 15.9 percent locally as did the NCO ratio, but the data fluctuate from quarter to quarter, so it is premature to declare a trend (Figure 2).

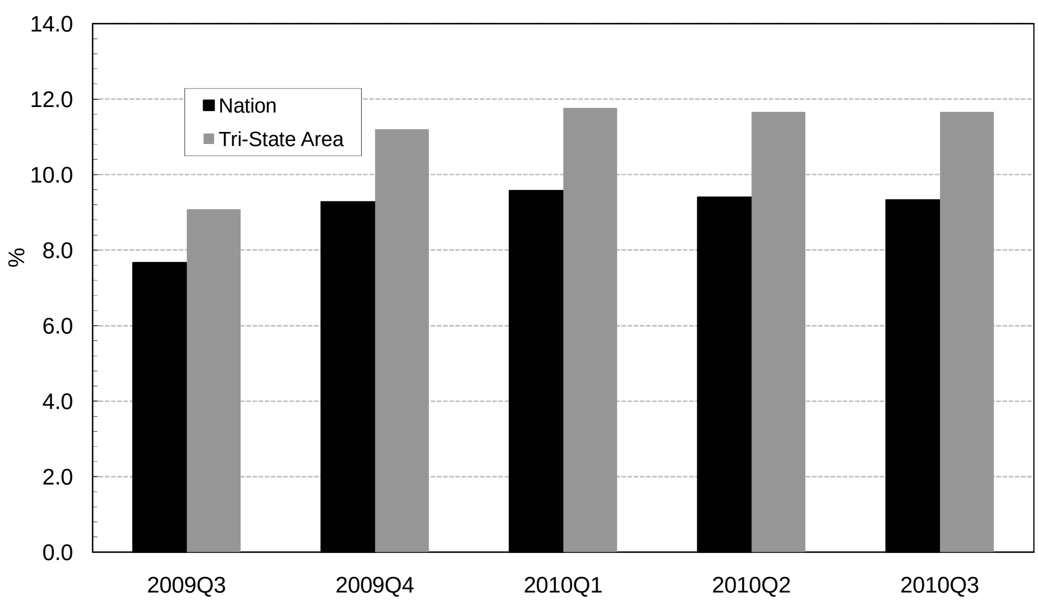
Residential Real Estate Lending

The RRE loan portfolios at large organizations showed some signs of improvement this quarter as NPLs dropped for the third consecutive quarter and NCOs dropped for the second consecutive quarter (Figure 3). However, clearly some significant hurdles remain. RRE loans are the largest single segment of the large organizations' loan portfolios, representing nearly 37 percent of all loans, 58 percent of NPLs, and 38 percent of NCOs. The RRE NPL ratio is 9.33 percent, a drop of seven basis points, but it is still 166 basis points higher than in the third quarter of 2009 (Figure 4). The RRE NCO ratio also dropped, and it is now 18 basis points lower than at this time last year (Figure 5). Part of the drop in NCOs may be attributable to a freeze on foreclosures adopted by some large organizations after flaws were found in their foreclosure procedures, but it is likely that the main impact of this moratorium will be seen in the fourth quarter rather than the

Figure 3
Summary of Residential Real Estate Lending

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Total RRE Loans ($Millions)	1,685,883.6	20,464.0	311,665.9
Change from Last Quarter	-2.0%	13.6%	21.3%
Change from Last Year	1.8%	5.8%	5.9%
Pct. of Total Loans	36.9	33.0	25.6
Nonperforming RRE Loans	157,351.6	401.8	7,968.9
Change from Last Quarter	-4.7%	51.5%	14.4%
Change from Last Year	23.9%	20.9%	12.8%
Pct. of Nonperforming Loans	58.1	20.4	17.4
Nonperforming RRE/RRE Lns	9.33%	1.96%	2.56%
Net RRE Charge-offs	8,471.6	20.2	566.2
Change from Last Quarter	-42.5%	240.4%	-13.5%
Change from Last Year	-26.0%	21.9%	0.7%
Pct. of Net Charge-offs	38.4	15.7	15.4
Pct. of Avg. RRE loans	0.50	0.10	0.19

Figure 4
RRE NPL Ratios*
Large Organizations



*Residential real estate

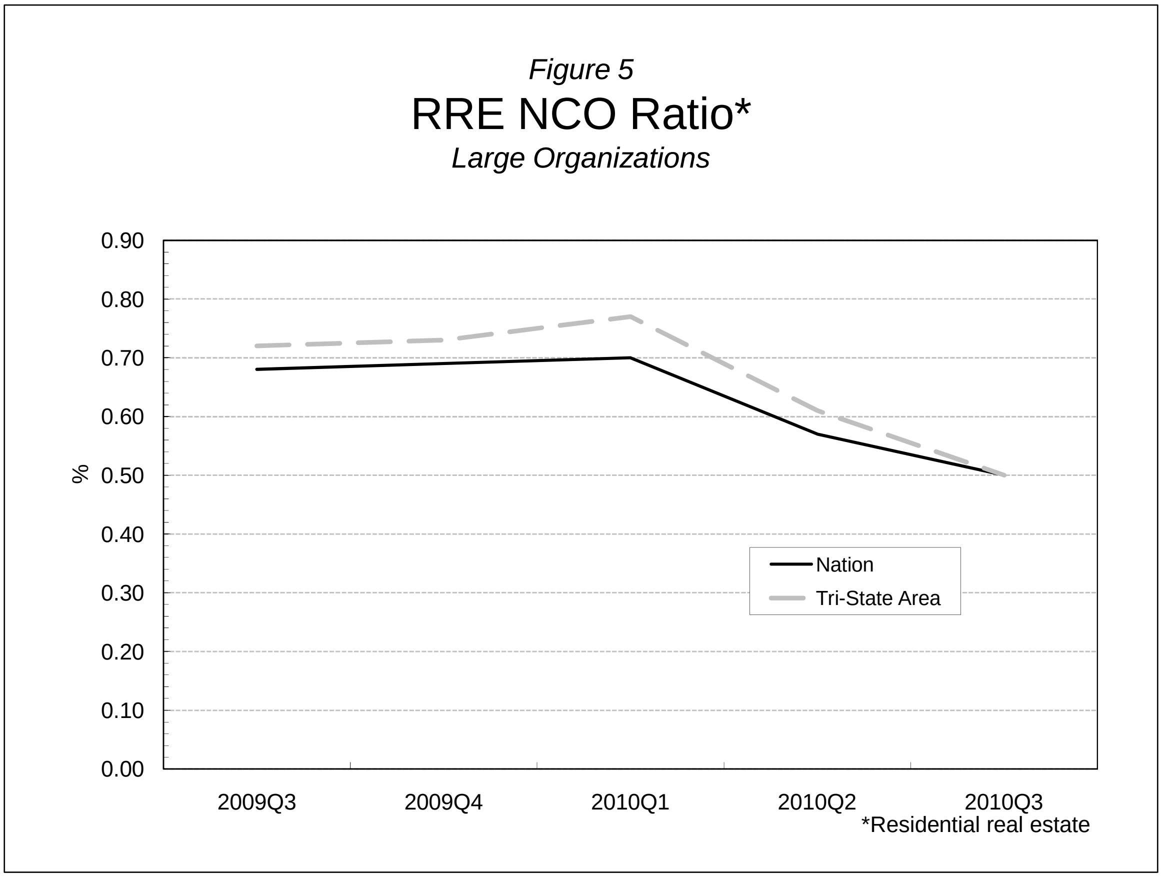


Figure 5
RRE NCO Ratio*
Large Organizations
0.90
0.80
0.70
0.60
0.50
0.40
0.30
0.20
0.10
0.00
%
Nation
Tri-State Area
2009Q3
2009Q4
2010Q1
2010Q2
2010Q3
*Residential real estate

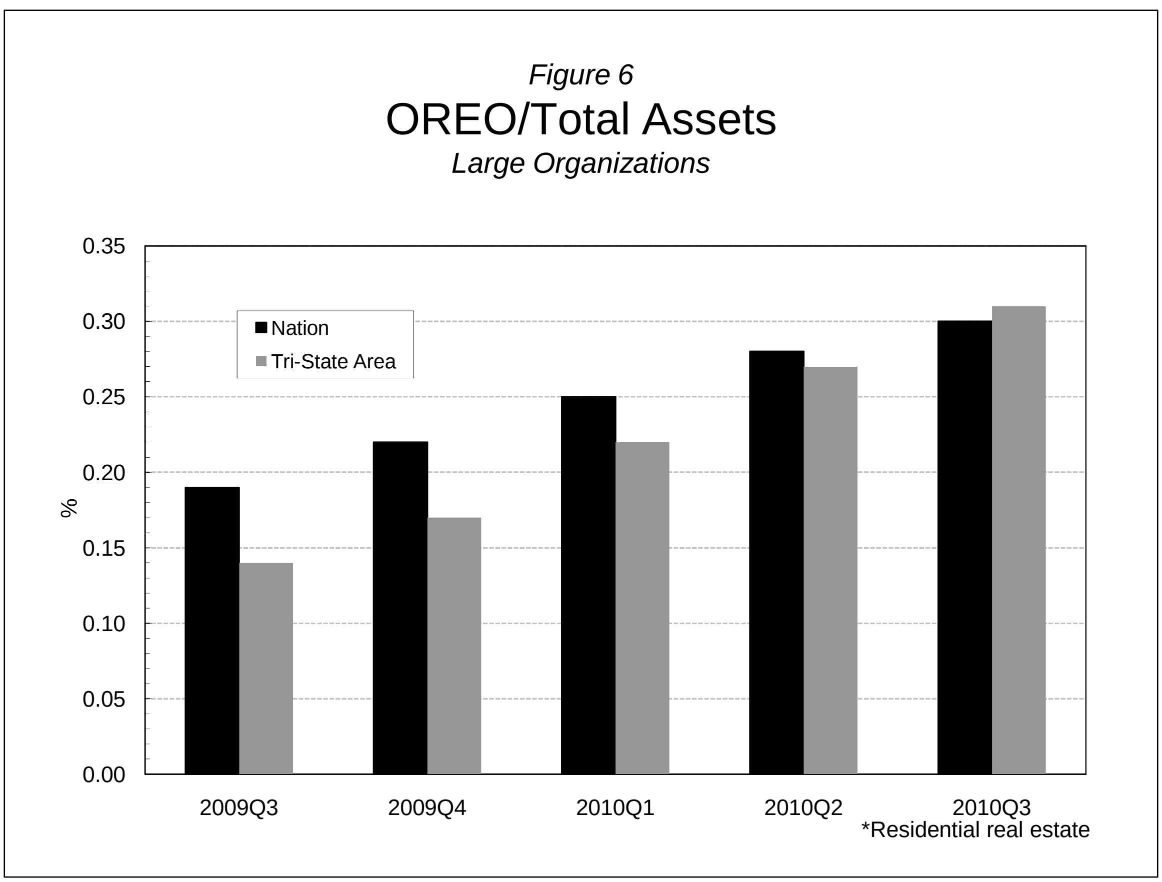
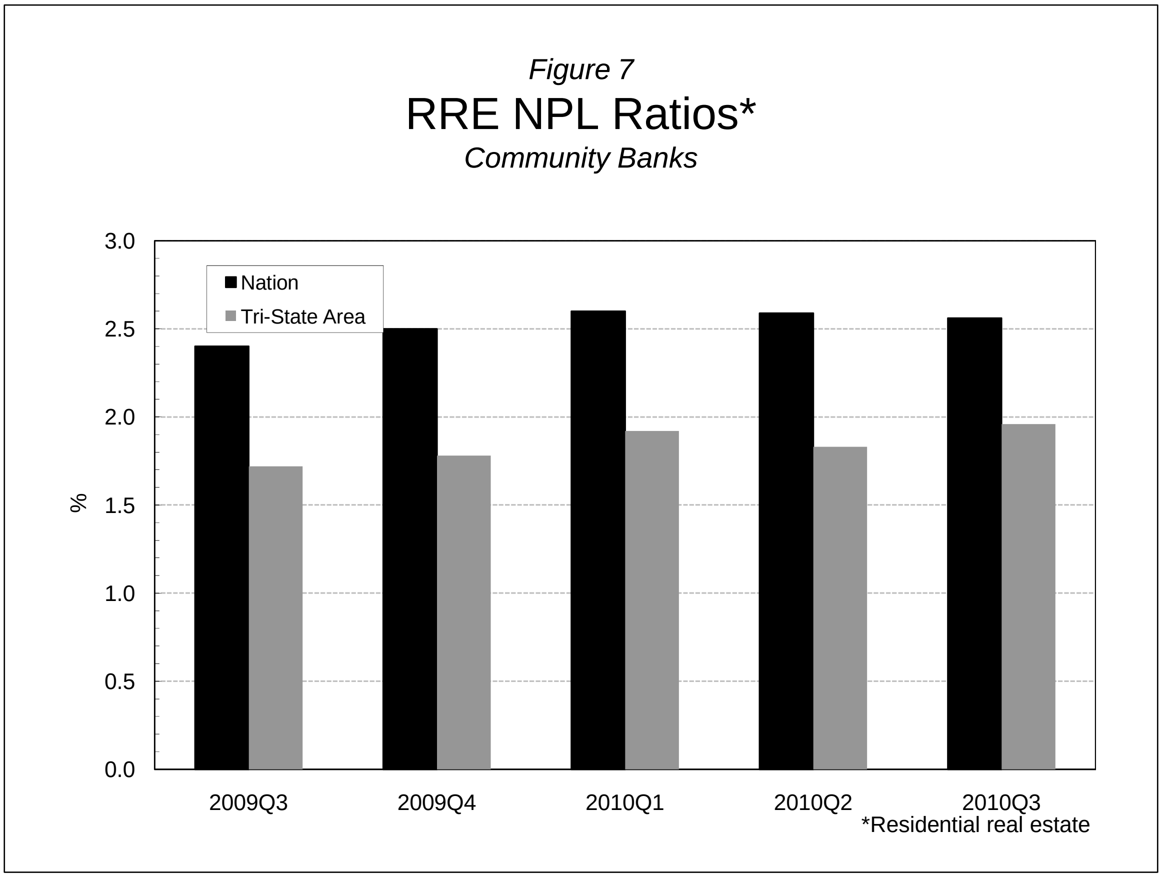
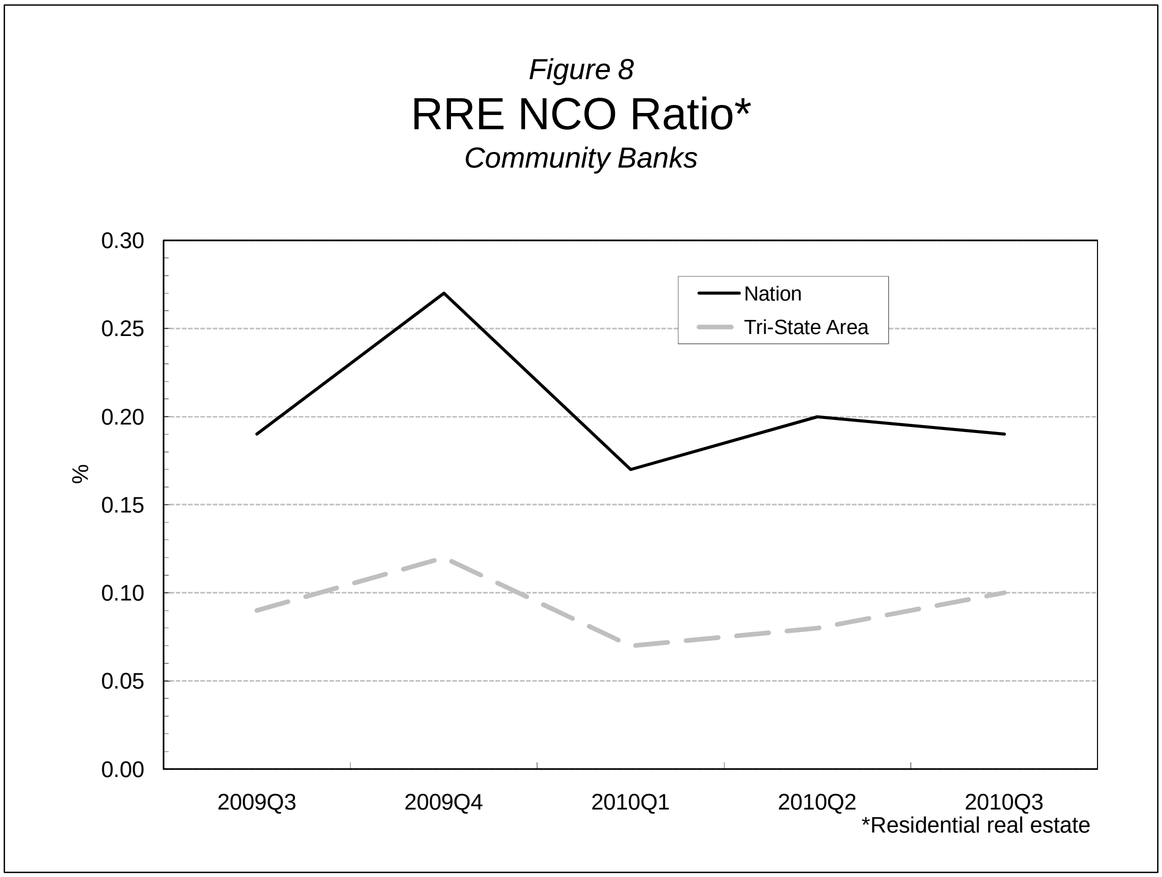


Figure 6
OREO/Total Assets
Large Organizations
0.35
0.30
0.25
0.20
0.15
0.10
0.05
0.00
%
Nation
Tri-State Area
2009Q3
2009Q4
2010Q1
2010Q2
2010Q3
*Residential real estate



third because the moratorium didn't go into effect until the last week or so of the third quarter. Moreover, foreclosed real estate (known as other real estate owned, or OREO) increased nearly 32 percent in the quarter. As a percent of total assets, OREO is 0.3 percent, up 11 basis points from last year but only two from the second quarter (Figure 6). Another factor that helps explain the drop in NCOs is that banks are recovering more from foreclosed real estate as their recovery ratio – the ratio of recoveries to charge-offs – has increased from 5.7 to 10.1 percent in the past year.

Community banks have had and continue to have fewer problems with RRE loans than the larger organizations, but while the large organizations are showing signs of improvement, the community banks' portfolios both locally and nationally continued to deteriorate. RRE NPLs increased over 50 percent locally and nearly 15 percent nationally (annualized growth rates). NCOs dropped somewhat nationally but increased 240 percent locally. The increase in local RRE NPLs most likely occurred because the decline in the local RRE market began later than in other parts of the country. Nationally, the RRE NPL and NCO ratios decreased slightly. However, these ratios have been increasing at tri-state area banks (Figures 7 and 8). While local banks appear to be significantly outperforming banks nationally, they carry a higher percentage of less than secure loans, such as mortgages secured by junior liens and HELOCs, than do banks nationally. Banks nationally have 23.6 percent of their RRE loans in junior lien mortgages and HELOCs, while for tri-state area banks that figure is 28.7 percent. Because senior liens have priority in any foreclosure, it is much more difficult to recover anything on these types of loans. The recovery ratio on RRE loans at local banks is 46 basis points lower than banks nationally, 7.47 to 7.93 percent.



Commercial Real Estate Lending

Large organizations' CRE portfolios continued to show improvement in the third quarter, primarily due to write-offs of construction loans (Figure 9). However, other types of CRE lending showed increasing weakness. Construction loans represent 23.7 percent of CRE loans, but 52.2 percent of CRE NPLs and 56.7 percent of CRE NCOs. Overall construction lending decreased over 30 percent in the third quarter, while construction NPLs decreased 38 percent and NCOs increased nearly 15 percent. Some of the decline in construction loans is due to NCOs, but most of it appears to be a decline in new loans.[5] NPLs on multifamily properties increased 126.6 percent, while those on commercial mortgages were basically unchanged. In spite of the improving situation in construction lending, nearly one in five construction loans is still nonperforming, and the ratio is increasing for other CRE loans as well (Figure 10).

At community banks both locally and nationally, CRE loans represent nearly half of total loans. Nationally, NPLs were flat, but locally they showed a small increase. Both locally and nationally, NCOs showed large decreases. Like the large organizations, the community banks' primary problems have been in construction lending. Construction loans represent about 21 percent of CRE loans nationally and 17 percent locally, yet they account for 51 and 64 percent of CRE NPLs, respectively, and 59 and 34 percent of CRE NCOs, respectively. The construction NPL ratio continued to increase nationally but was flat locally (Figure 11). Community banks are also experiencing deterioration in other parts

[5] Construction loans outstanding decreased $19.05 billion in the third quarter, while construction NCOs were $3.3 billion.

Figure 9
Summary of CRE Lending

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Total CRE Loans ($Millions)	858.584.6	29,113.3	556,933.6
Change from Last Quarter	-13.1%	2.1%	-2.6%
Change from Last Year	-10.9%	2.0%	-4.4%
Pct. of Total Loans	18.8	46.9	45.8
Nonperforming CRE Loans	69,103.7	1,345.6	31,533.3
Change from Last Quarter	-18.1%	4.3%	-0.3%
Change from Last Year	-3.9%	19.0%	0.3%
Pct. of Nonperforming Loans	25.5	68.4	68.7
Nonperforming CRE/CRE Lns	8.05%	4.62	5.66%
Net CRE Charge-offs	5,782.9	65.6	2,113.7
Change from Last Quarter	9.8%	-74.4%	-47.9%
Change from Last Year	-2.1%	51.3%	-10.7%
Pct. of Net Charge-offs	26.2	51.1	57.6
Pct. of Avg. CRE loans	0.63	0.23	0.37

Figure 10
CRE NPL Ratio by Loan Type
Large Organizations Nationally

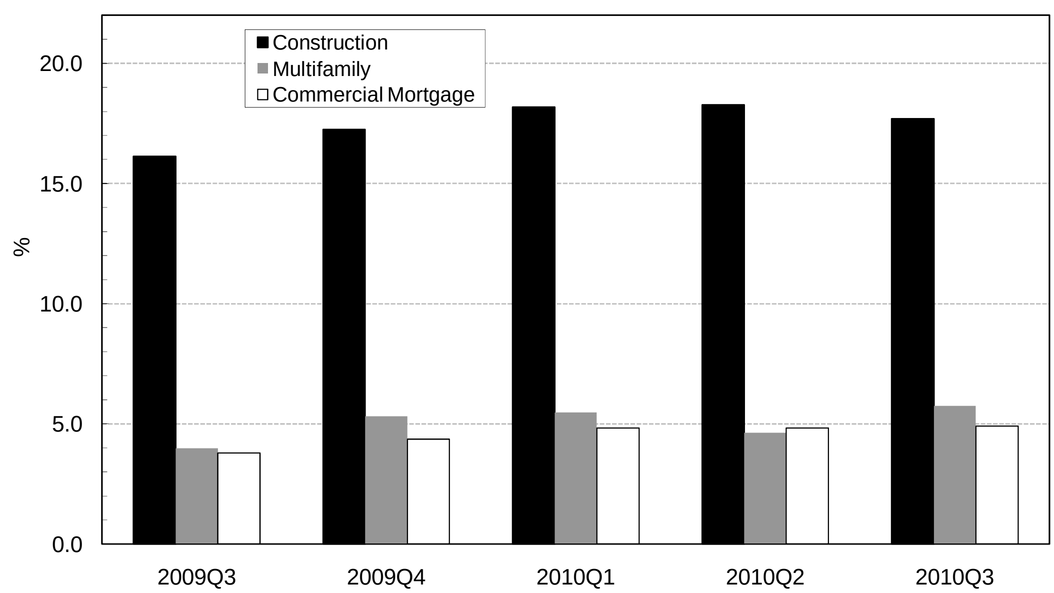


Figure 11

Construction NPL Ratios

Community Banks

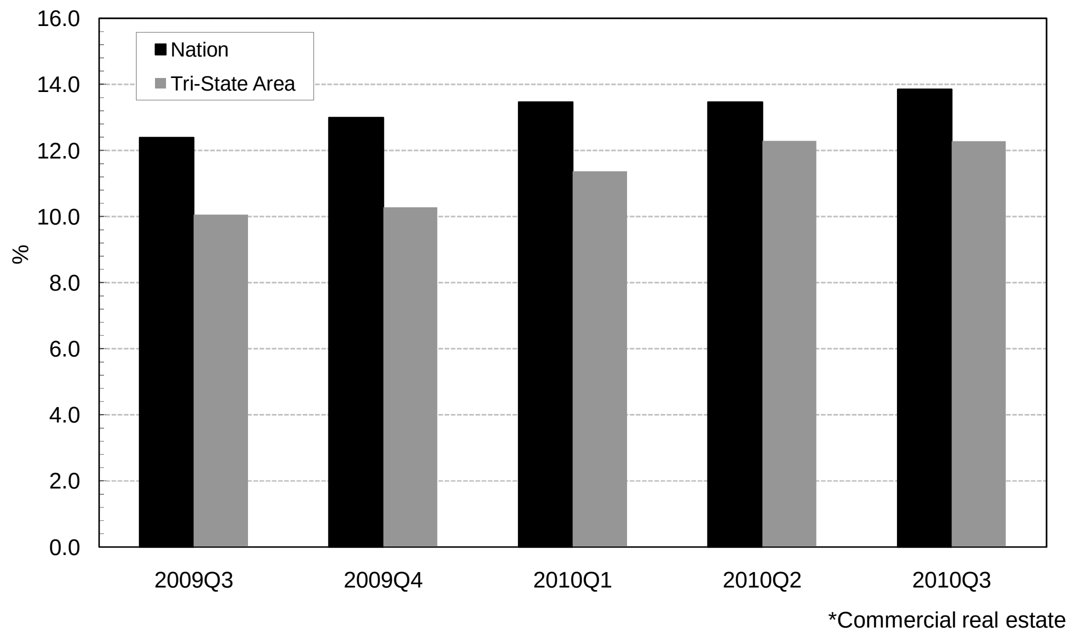


Figure 12

Commercial Mortgage NPL Ratios

Community Banks

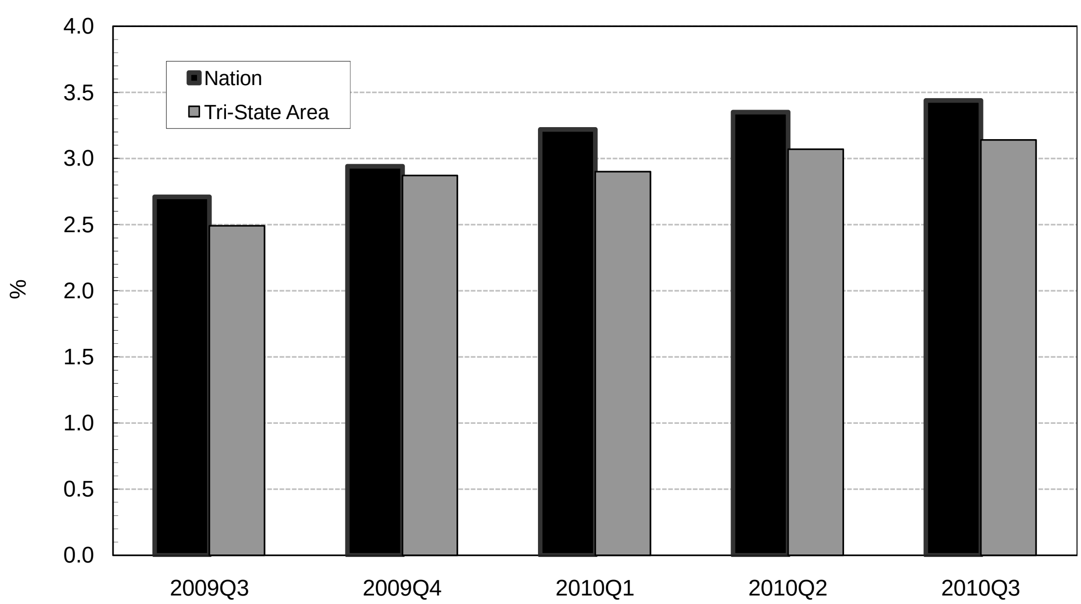
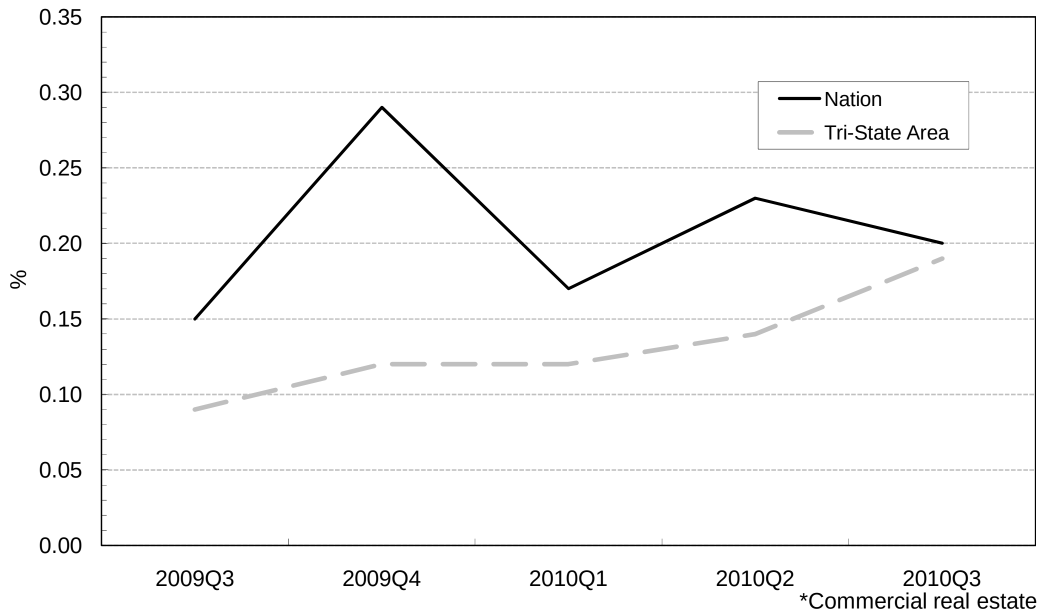


Figure 13

NCO Ratios for Commercial Mortgages

Community Banks



of their CRE loan portfolios. Commercial mortgages represent 71.2 percent of all CRE loans nationally and 76.3 percent locally. Commercial mortgage NPLs increased 13.6 percent nationally and 13.1 percent locally in the third quarter and have increased over 30 percent in the last year in both areas. The commercial mortgage NPL ratio is still low relative to construction loans, but it continues to increase (Figure 12). The NCO ratio is still relatively low and flat as well, but with the increases in NPLs, this ratio will most likely increase in the near future (Figure 13).

Commercial & Industrial Lending

Commercial and industrial (C&I) lending remains quite weak (Figure 14). C&I loans barely grew at large organizations, and they have decreased nearly 10 percent from last year. At this stage in a recovery one would expect C&I lending to be increasing, but that is not the case. From an asset quality standpoint, 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. At large organizations, C&I NPLs have been declining for more than a year, and although NCOs showed a small increase this quarter, they have still decreased 49 percent in the last year.

At community banks nationally the story is much the same. C&I loans shrank slightly during the quarter and have basically been flat for at least the past year. C&I NPLs were flat for the quarter and have been flat for the past year, while NCOs have decreased substantially. However, at tri-state area banks, while overall C&I NPLs showed a slight decrease in the last year, they were up nearly 41 percent in the third quarter. This follows similar large increases in the previous two quarters, and NCOs have likewise increased substantially this year. While the C&I NPL ratio at local banks remains low, it has jumped 19 basis points this quarter.

Figure 14
Summary of Commercial & Industrial Lending

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Total C&I Loans ($Millions)	862,906.9	8,000.6	177,917.1
Change from Last Quarter	4.0%	-2.0%	-2.6%
Change from Last Year	-9.5%	2.4%	-3.5%
Pct. of Total Loans	18.9	12.9	14.6
Nonperforming C&I Loans	24,867.8	169.3	4,278.2
Change from Last Quarter	-18.1%	40.8	-0.5%
Change from Last Year	-31.3%	-2.8	0.2%
Pct. of Nonperforming Loans	9.2	8.6	9.3
Nonperforming C&I/C&I Lns	2.88%	2.12%	2.40%
Net C&I Charge-offs	2,843.2	34.7	765.8
Change from Last Quarter	7.6%	683.6%	-17.9%
Change from Last Year	-49.1%	28.9%	-9.7%
Pct. of Net Charge-offs	12.9	27.0	20.9
Pct. of Avg. C&I loans	0.32	0.44	0.42

Consumer Lending

Of all types of loans, consumer loans are performing the best at the moment (Figure 15). They also represent the smallest portion of the banks' portfolios. Large organizations have much higher NPL and NCO ratios due to credit cards. While credit cards make up an insignificant part of consumer loans at community banks both locally and nationally, at large organizations they are about 21 percent of consumer loans. Any problems with credit card loans are moderating for the large organizations; the credit card NPL ratio was 2.66 percent in the third quarter, a fall of 28 basis points from the second quarter and 87 from the last year. Additionally, credit card NPLs and NCOs have been falling for at least a year now.

Figure 15
Summary of Consumer Lending

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Total Co. Loans ($Millions)	607,362.1	2,121.8	56,450.2
Change from Last Quarter	-7.0%	-9.6%	-4.0%
Change from Last Year	-0.5%	-5.6%	-7.0%
Pct. of Total Loans	13.3	3.4	4.6
Nonperforming Co. Loans	10,632.4	13.4	416.3
Change from Last Quarter	5.7%	52.9%	17.2
Change from Last Year	-3.4%	26.5%	-7.5
Pct. of Nonperforming Loans	3.9	0.7	0.9
Nonperforming Co/Co Lns	1.75%	0.63%	0.74%
Net Co Charge-offs	4,138.4	4.5	145.3
Change from Last Quarter	-35.2%	-60.3%	14.3%
Change from Last Year	-31.9%	1.0%	-32.8%
Pct. of Net Charge-offs	18.7	3.5	4.0
Pct. of Avg. Co loans	0.67	0.21	0.25

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)	144,562.4	1,032.4	24,635.1
Change from Last Quarter	-13.4%	9.7%	0.3%
Change from Last Year	-1.3%	11.2%	8.3%
Net Charge-Offs/LL Provision	125.8%	74.3%	90.6%
LL Provision/Operating Inc.	16.8%	16.1%	23.2%
Loan-loss Coverage Ratio	53.39%	52.4%	53.63%

While NPLs and NCOs are decreasing, reserves at large organizations are still well below their historical average. Total loan-loss reserves decreased 13.4 percent because provisioning decreased almost $3 billion (Figure 16).[6] Thus, the NCO to loan-loss provision ratio is over 125 percent (Figure 17), and the loan-loss coverage ratio is flat (Figure 18).[7] It is plausible that the slow adjustment toward more normal coverage levels reflects both banks' optimism about future losses and their desire to

[6] 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.

[7] The 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 NCOs to loan-loss provision ratio for the same time period 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.

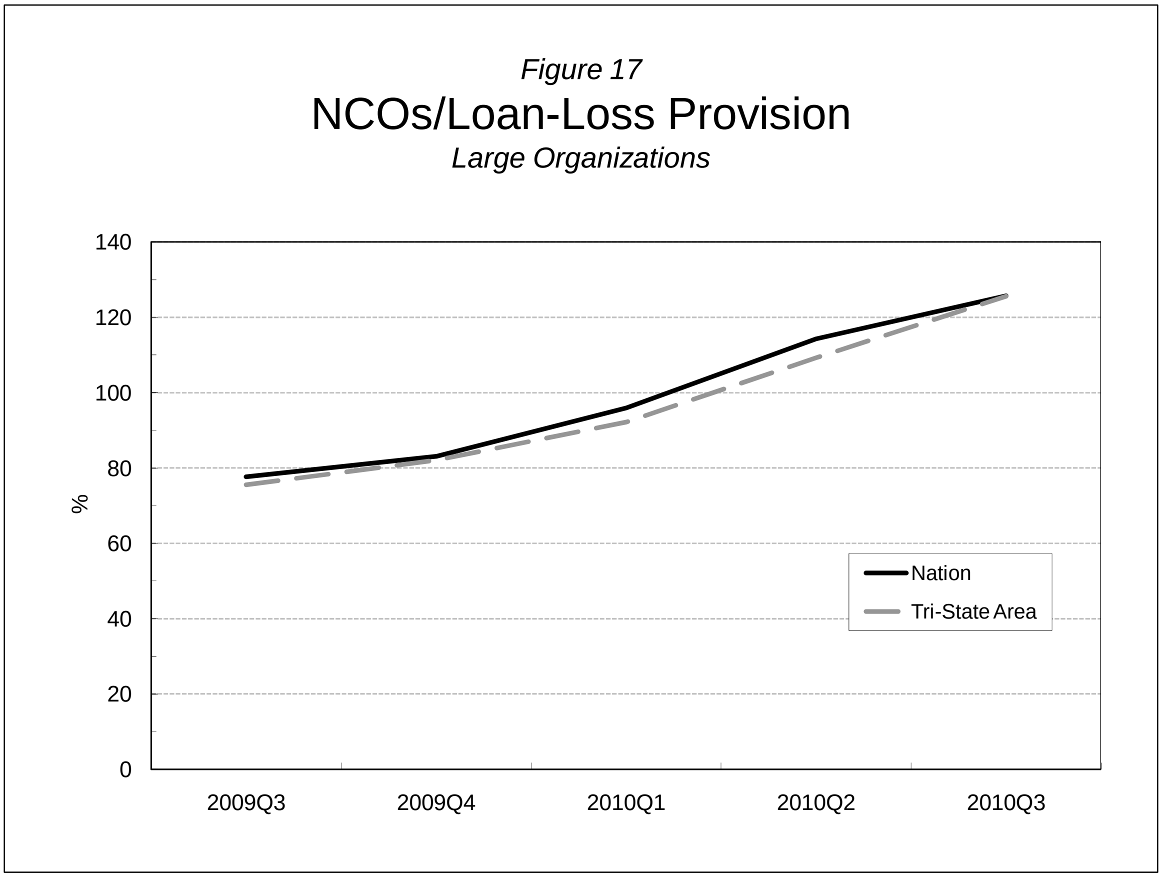


Figure 17
NCOs/Loan-Loss Provision
Large Organizations
%
0
20
40
60
80
100
120
140
2009Q3
2009Q4
2010Q1
2010Q2
2010Q3
Nation
Tri-State Area

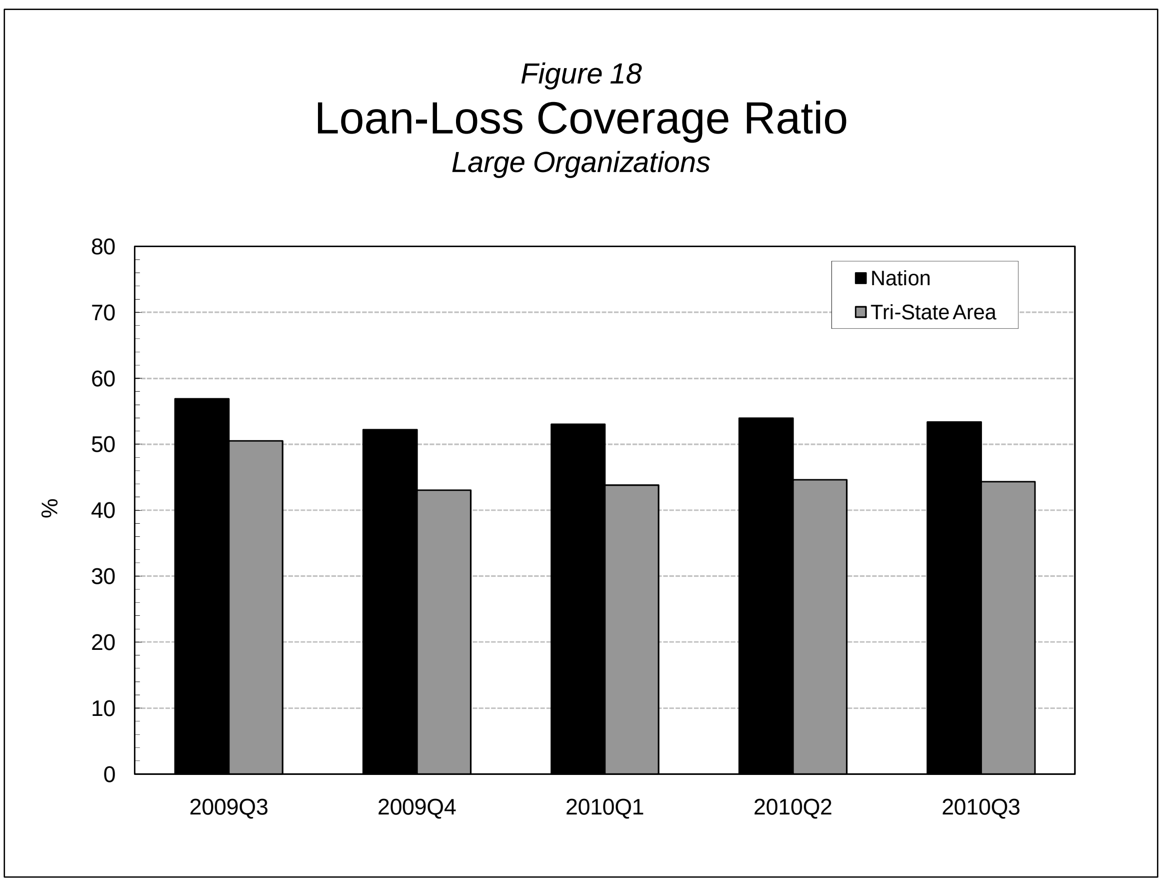
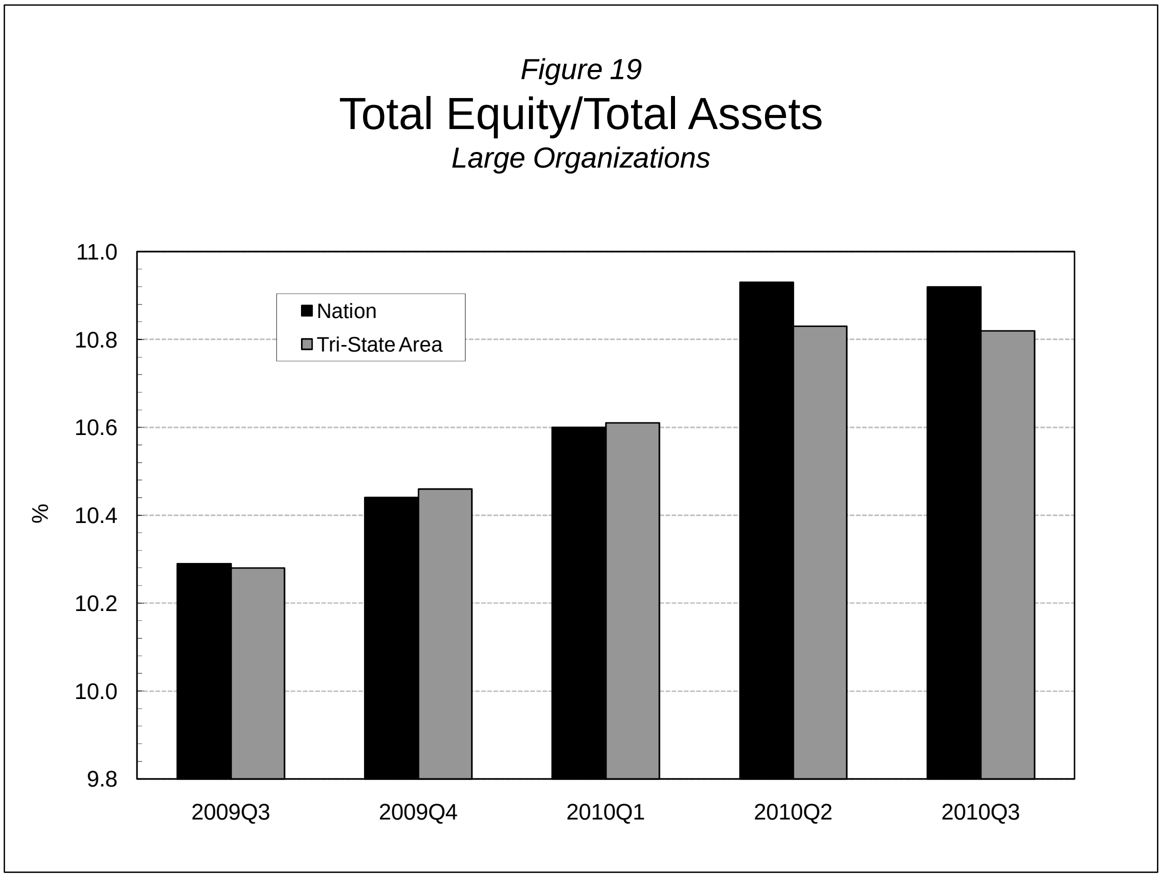


Figure 18
Loan-Loss Coverage Ratio
Large Organizations
%
0
10
20
30
40
50
60
70
80
2009Q3
2009Q4
2010Q1
2010Q2
2010Q3
Nation
Tri-State Area



beef up capital rather than to reserve against losses. Total equity increased nearly $16 billion at large organizations, a rise of 6.4 percent. The ratio of equity-to-assets leveled off in the third quarter, but it has been slowly increasing for the last year (Figure 19).

At community banks nationally, loan-loss reserves were flat because loan-loss provisions fell more than $500,000. At local banks, reserves increased nearly 10 percent (annualized) due to decreased NCOs and a $40,000 increase in loan-loss provision. The ratio of NCOs to loan-loss provision fell substantially at local banks and grew slightly nationally (Figure 20). Loan-loss coverage ratios decreased both locally and nationally due to higher NPLs (Figure 21). As is the case with the large organizations, it is likely that community banks are less concerned about reserves than capital. One problem they face is that it is more difficult for community banks to raise capital – most of them aren't traded on any exchange. Nonetheless, equity capital increased about $6 billion at banks nationally, a rise of 13.4 percent. Tri-state area banks had a similar experience; equity capital increased over $240 million, a rise of 11.4 percent. Thus, after falling somewhat steeply last year, equity-to-assets ratios have risen for three straight quarters (Figure 22).

Figure 20

Net Charge-Offs/Loan-Loss Provision

Community Banks

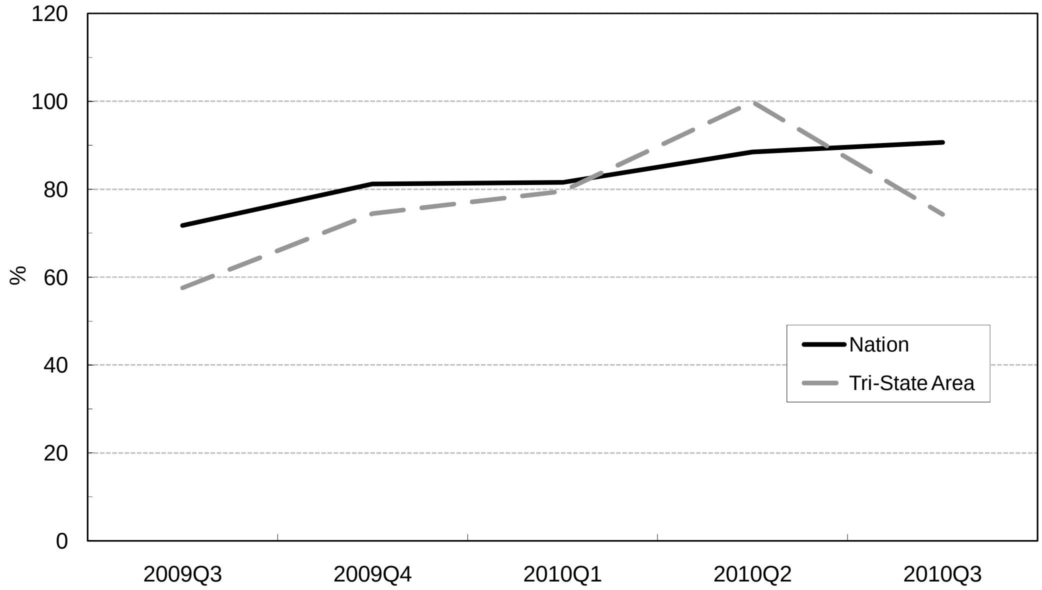
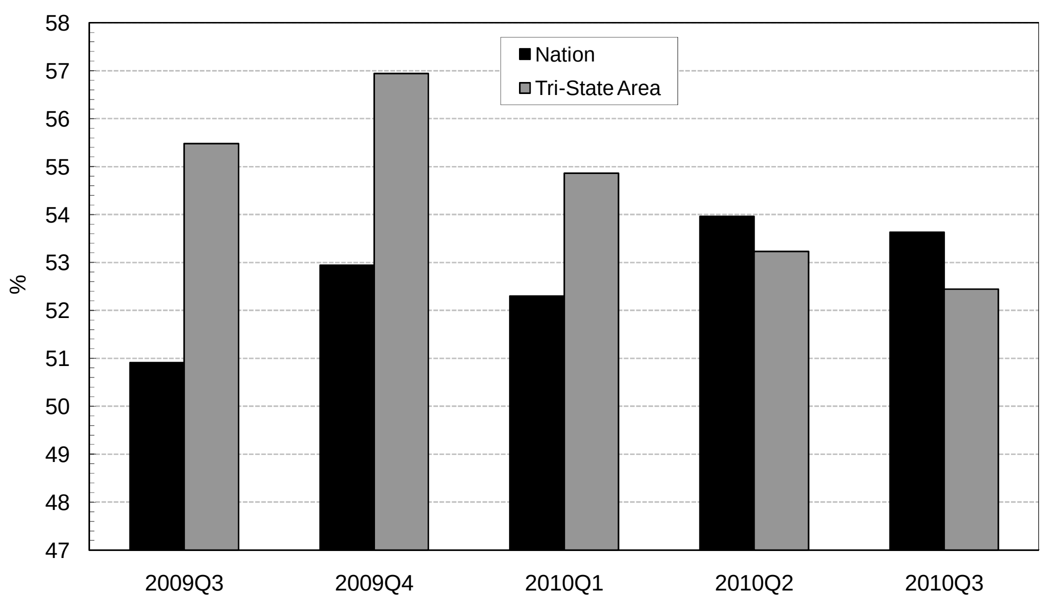
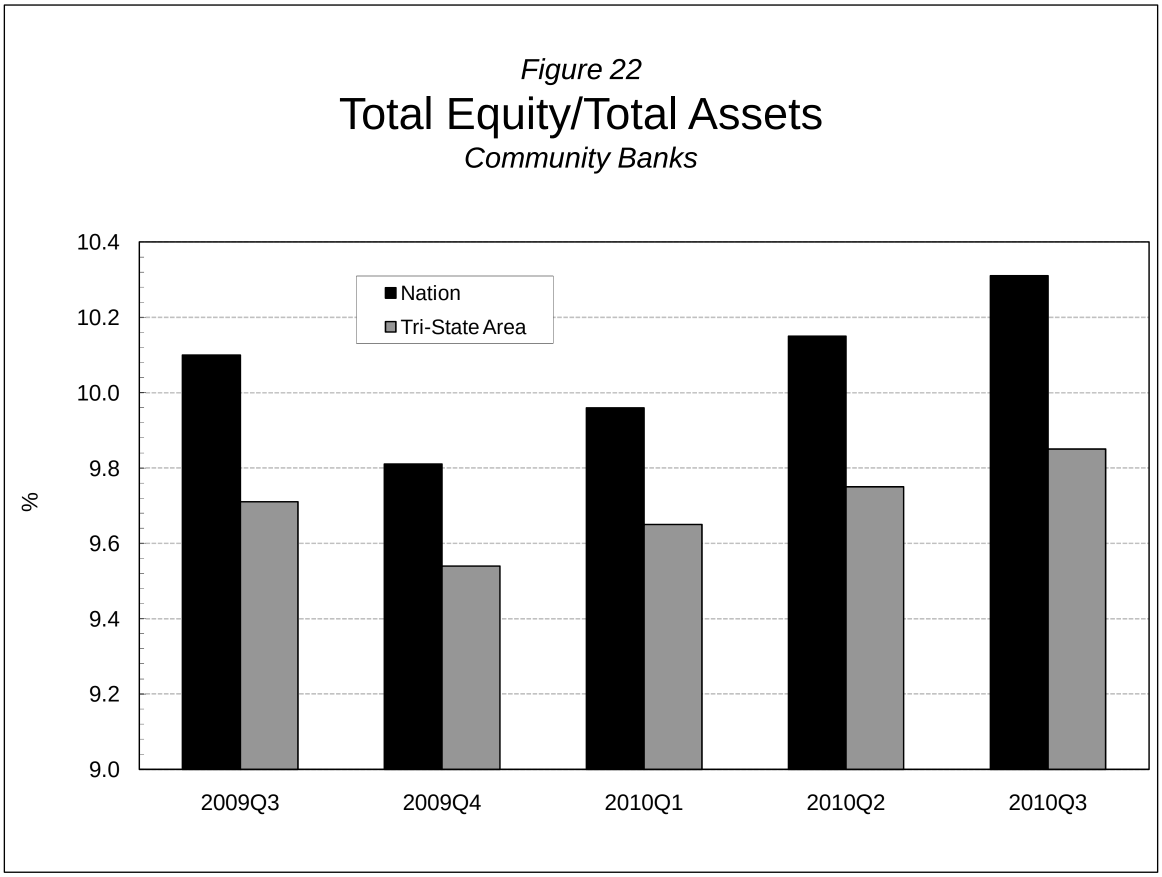


Figure 21

Loan-Loss Coverage Ratios

Community Banks





Securities

Figure 23
Summary of Securities Portfolios

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Securities/Assets	20.6	20.4	19.6
Market Value ($Millions)	1,881,447.3	18,810.1	365,072.8
Change from Last Quarter	24.9%	10.6%	7.6%
Change from Last Year	13.2%	6.0%	9.2%
Realized Gain/Loss	2,232.0	-10.4	414.2
Pct of Average Securities	0.12	-0.06	0.11
MarketValue/Book Value	101.94	101.99	102.32

At large organizations, nearly all classes of securities showed gains, with U.S. Treasury securities, mortgage-backed securities (MBS), asset-backed securities (ABS), and U.S. agency securities all showing double-digit gains in value (Figure 23).[8] The only securities that shrank in value were mutual funds, a relatively small part of the banks' portfolios, while foreign securities and those of government-sponsored enterprises (GSEs) were nearly flat. MBS make up over 56 percent of the large organizations' portfolios, with foreign securities making up about 13 percent. Large organizations continued to increase their holdings of Treasury securities, and they now make up nearly 8 percent of the organizations' portfolios.

At community banks in the nation, most types of securities gained value, with Treasuries, U.S. agency securities, MBS, and state and local government securities having the largest gains. At tri-state area community banks, Treasuries, U.S. agencies, state and local government securities, and MBS posted substantial increases in value.[9] At community banks both locally and nationally, securities of GSEs had double-digit decreases in value. MBS make up about 43 percent of the securities portfolios of both local and national banks, followed by GSE securities at about 25 percent nationally and 23 percent both locally and nationally. Nationally, both large organizations and community banks had relatively high realized gains on securities, while local community banks realized a small loss.[10]

[8] This figure uses the value of securities as reported on the banks' 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.

[9] 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.

[10] 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 ($millions)	6,300,411.9	76,021.1	1,527,568.6
Pct. of Assets	69.2	82.6	82.4
Change from Last Quarter	5.3%	9.5%	7.0%
Change from Last Year	1.9%	7.1%	4.8%
Debt ($millions)	1,217,929.3	5,915.4	120,259.5
Pct. of Assets	13.4	6.4	6.5
Change from Last Quarter	-2.7%	-24.1%	-10.2%
Change from Last Year	-13.1%	-18.2%	-14.9%
Core Deposits/Deposits	39.6%	68.7%	68.3%
Implicit Rate on Deposits	0.63%	1.42%	1.46%
Implicit Rate on Debt	1.61%	3.08%	2.78%

At large organizations, the small gain in deposits (Figure 24) was mainly due to foreign deposits, which increased 18.3 percent in the third quarter and now represent nearly 24 percent of all deposits at these institutions. There were also smaller gains in demand deposits (checking accounts) and time deposits, but overall, core deposits decreased 6.3 percent.[11] Debt also continued to shrink, mainly due to large decreases in Federal Home Loan Bank (FHLB) advances. The implicit interest rate on deposits also continued to shrink (Figure 25).[12]

Community banks both locally and nationally had increases in deposits. Both nationally and locally, this was due to increases in demand deposits and savings deposits, while time deposits shrank. Banks nationally continued to decrease their use of "hot money" as brokered deposits shrank, but locally brokered deposits increased over 8 percent. Debt continued to shrink at community banks. As with the larger organizations, this was primarily due to substantial decreases in FHLB advances. 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.

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

[12] Implicit interest rate on deposits is defined as the annualized interest on deposits divided by average total deposits.

Figure 25

Implicit Interest Rate on Deposits

Large Organizations

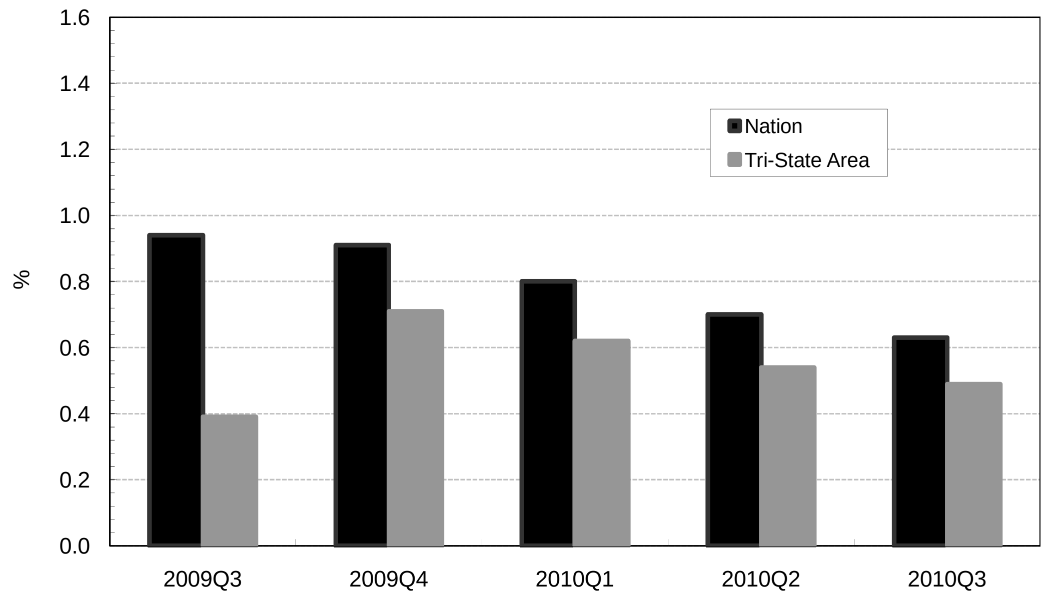


Figure 26

Implicit Interest Rate on Deposits

Community Banks