BANKING BRIEF

FOR PENNSYLVANIA, NEW JERSEY, AND DELAWARE

First Quarter 2011

The condition of banks continued to improve modestly in most areas of the country during the first quarter of 2011, while the condition of community banks in the tri-state area declined. Despite this decline in asset quality at local banks, they continued to outperform banks nationally. At large organizations, return on average assets (ROA) increased a few basis points, to 0.70 percent.[1] Both nonperforming loans (NPLs) and net charge-offs (NCOs) decreased during the quarter and have decreased for at least a year now.[2] At community banks nationally, ROA increased 7 basis points, to 0.27 percent, while, locally, ROA was basically flat. NPLs and NCOs decreased nationally both for the quarter and the year, while NPLs increased at local banks. For large organizations, the main problem areas continued to be residential real estate (RRE) loans and construction loans.[3] At community banks, the main problem area was commercial real estate (CRE) lending.[4] Net interest margins at both large and small organizations were essentially flat during the quarter, while capital ratios increased (see discussion in "Regulatory Capital" section below). There continued to be a high level of bank failures in the first quarter, with 26 banks failing.[5] An additional 14 banks have failed so far in the second quarter (as of May 6). No tri-state area bank has failed as of yet this year.

Of the 100 large organizations in the sample, 90 reported a positive profit in the first quarter of 2011. This was an increase of eight over the fourth quarter of 2010. Additionally, all of the firms had at least adequate capital ratios, with equity-to-assets ratios of at least 6 percent, and all but five of

[1] See the Summary Table of Bank Structure and Conditions on page 2. Unless otherwise noted, all data are from Federal Financial Institutions Examination Council (FFIEC) call reports. Ratios presented are aggregates. That is, the numerator and denominator are summed then divided. All growth rates are annualized unless otherwise noted. Also, with the exception of the data on page 2, all income statement items reported are for the quarter only.

[2] NPLs 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 stood at 3.70 percent. Source: FDIC Historical Statistics on Banking, http://www2.fdic.gov/hsob/index.asp.

[3] RRE loans are defined as the sum of loans secured by 1-4 family properties (first and junior liens) and home equity lines of credit (HELOCs).

[4] 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).

[5] See the Federal Deposit Insurance Corporation's (FDIC) failed bank list: http://www.fdic.gov/bank/individual/failed/banklist.html.

Summary Table of Bank Structure and Conditions – First Quarter 2011

Community Banking Organizations

	Tri-State			*Nation*		
	$ Bill	**% Change From**		**$ Bill**	**% Change From**	
	11Q1	**10Q4**	**10Q1**	**11Q1**	**10Q4**	**10Q1**
Total Assets	97.6	1.76	2.98	1,859.9	1.37	2.24
Total Loans	65.2	-3.88	1.07	1,178.6	-7.98	-2.45
Business	8.7	-3.08	-0.52	177.4	-3.53	-1.30
Real Estate	52.0	-4.48	1.62	888.4	-7.45	-2.43
Consumer	2.6	-10.50	-3.53	53.3	-14.46	-7.72
Total Deposits	81.4	3.26	5.25	1,547.4	2.90	3.27
Ratios (in %)	**11Q1**	**10Q4**	**10Q1**	**11Q1**	**10Q4**	**10Q1**
Net Income/Avg Assets (ROA)	0.37	0.38	0.11	0.27	0.20	-0.21
Net Interest Inc/Avg Assets (NIM)	3.33	3.31	3.23	3.44	3.42	3.34
Noninterest Inc/Avg Assets	1.20	1.17	1.15	0.92	0.91	0.92
Noninterest Exp/Avg Assets	3.26	3.24	3.26	3.10	3.09	3.18
Loans/Deposits	80.15	81.60	83.47	76.17	78.32	80.64
Equity/Assets	9.97	9.82	9.68	10.23	10.08	9.95
Nonperforming Loans/Total Loans	3.11	2.92	3.05	3.67	3.70	3.89

Large Banking Organizations

	Tri-State			*Nation*		
	$ Bill	**% Change From**		**$ Bill**	**% Change From**	
	11Q1	**10Q4**	**10Q1**	**11Q1**	**10Q4**	**10Q1**
Total Assets	606.3	2.24	1.91	9,328.9	5.35	1.27
Total Loans	315.6	-3.86	-2.63	4,527.7	-3.71	-2.91
Business	62.9	6.44	2.01	897.4	8.52	3.50
Real Estate	185.1	-8.40	-5.01	2,544.1	-8.95	-6.05
Consumer	37.0	-7.66	-5.94	572.2	-6.68	-8.57
Total Deposits	452.7	5.31	4.80	6,657.2	9.43	4.75
Ratios (in %)	**11Q1**	**10Q4**	**10Q1**	**11Q1**	**10Q4**	**10Q1**
Net Income/Avg Assets (ROA)	0.69	0.64	0.35	0.70	0.66	0.23
Net Interest Inc/Avg Assets (NIM)	2.99	3.02	3.10	2.70	2.73	2.78
Noninterest Inc/Avg Assets	1.79	1.82	2.00	1.91	1.93	2.05
Noninterest Exp/Avg Assets	2.99	2.96	3.02	2.93	2.89	2.81
Loans/Deposits	69.72	71.32	75.04	68.01	70.22	73.38
Equity/Assets	11.98	11.78	11.64	11.01	10.97	10.69
Nonperforming Loans/Total Loans	5.42	5.55	5.98	5.37	5.59	6.33

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, 2010. 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 — 185 for the tri-state area and 5,566 for the nation; (2) large banking organizations — 25 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.

them had equity-to-assets ratios of over 7 percent.[6] Both of these numbers were unchanged from the fourth quarter of 2010. At community banks nationally, 813 out of 5,566 institutions failed to report a profit in the first quarter. This was a decrease from the 1,196 that reported losses in the fourth quarter of 2010. All but 218 of the community banks were at least adequately capitalized, and 5,203 of them had equity-to-assets ratios over 7 percent. At local community banks, 161 out of 185 institutions reported positive profits, an increase of eight from the fourth quarter of 2010. All but three of the institutions had equity-to-assets ratios of at least 6 percent, and 176 of them had ratios over 7 percent.

With the exception of commercial and industrial (C&I) loans at large organizations, loan volume was down in all categories. Total NPLs decreased 17.9 percent at large organizations and 10.6 percent at community banks nationally but increased over 24 percent at local community banks. The ratio of NPLs to total loans (NPL ratio) dropped 22 basis points at large organizations, to 5.37 percent. At community banks, the NPL ratio was basically flat nationally, and it increased 19 basis points locally. It should be noted that the NPL ratio at local community banks is still lower than that at either community banks nationally or at large organizations. Community banks continue to have increasing inventories of foreclosed real estate, but the problem is abating somewhat at large organizations. In the first quarter, foreclosed real estate, referred to as other real estate owned (OREO), decreased 8.2 percent at large organizations but at community banks, OREO increased 6.6 percent nationally and 11.6 percent locally. Indeed, the nonperforming asset ratio is actually higher at community banks in the nation (although not for community banks in the region) than at large banks (Figure 1).[7]

NCOs decreased substantially at all classes of organizations during the first quarter. NCOs decreased 54.0 percent at large organizations, 87.0 percent at community banks nationally, and 59.3 percent at community banks locally. However, while NCOs at both large organizations and community banks nationally also showed substantial decreases from the first quarter of 2010 (35.5 and 18.7 percent, respectively), at local community banks NCOs have increased 67.7 percent from last year. The decline nationally was primarily due to decreased NCOs on both CRE and RRE loans at large organizations and community banks nationally, while tri-state area banks showed substantial increases in NCOs on CRE loans. Thus, the ratio of NCOs to average loans (the NCO ratio) decreased by 7 basis points at large organizations, 14 basis points at community banks nationally, and 6 basis points locally in the quarter (Figure 2).[8] However, the year-over-year numbers show substantial improvement only at large organizations. The NCO ratio decreased 20 basis points at the large banks from the first quarter of

[6] Regulation Y defines capital in terms of zones. Institutions in Zone 1 have capital-to-assets ratios above 7 percent, those in Zone 2 are 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 capital 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.

[7] Nonperforming assets are defined as NPLs plus OREO.

[8] For historical perspective, the average annual NCO ratio for all banks between 1999 and 2009 was 0.97 percent. Source: FDIC Historical Statistics on Banking: http://www2.fdic.gov/hsob/SelectRpt.asp?EntryTyp=10.

Figure 1

Nonperforming Assets/Assets

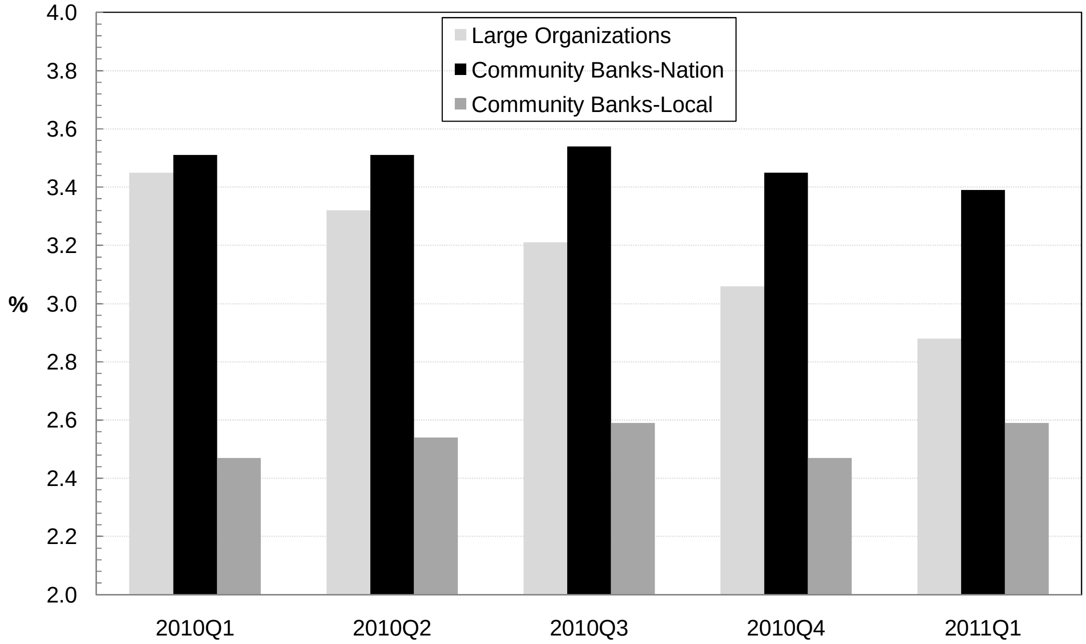


Figure 2

Quarterly NCOs/Average Loans

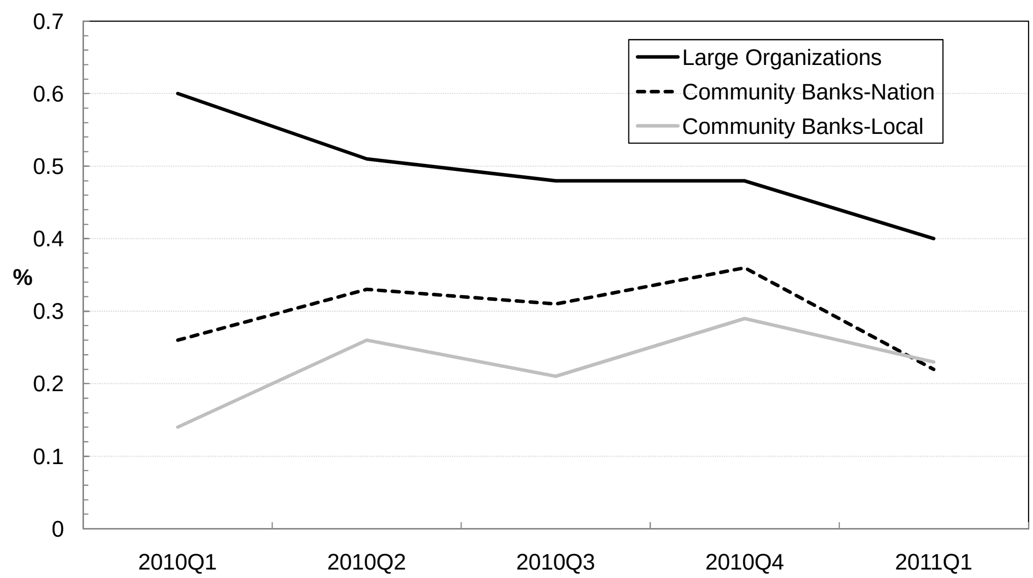
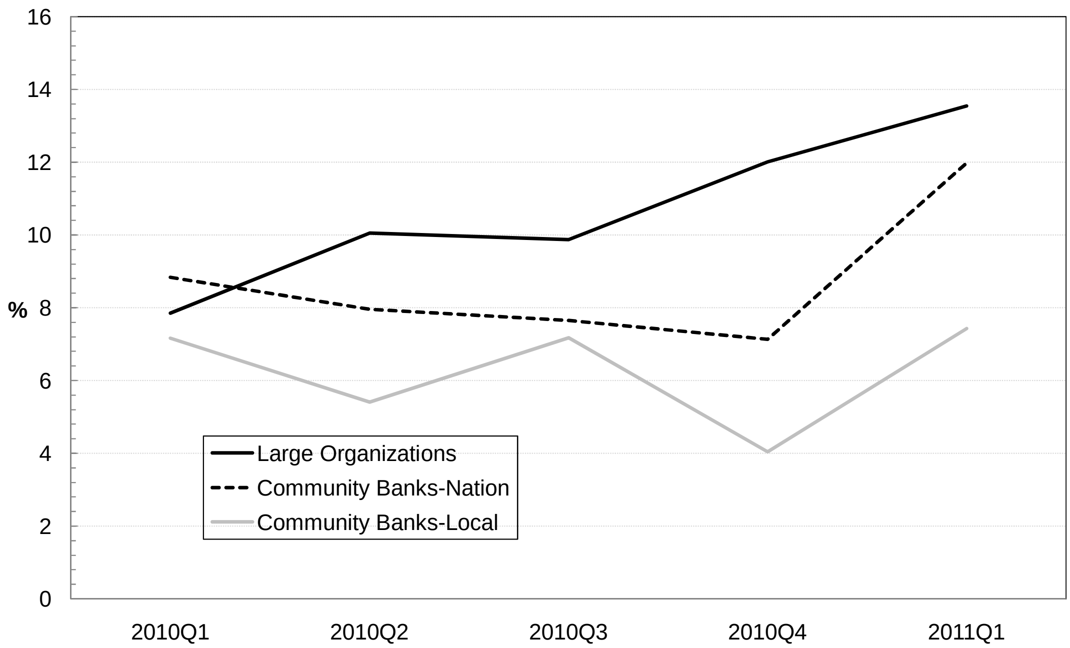


Figure 3
Recoveries/Charge-Offs



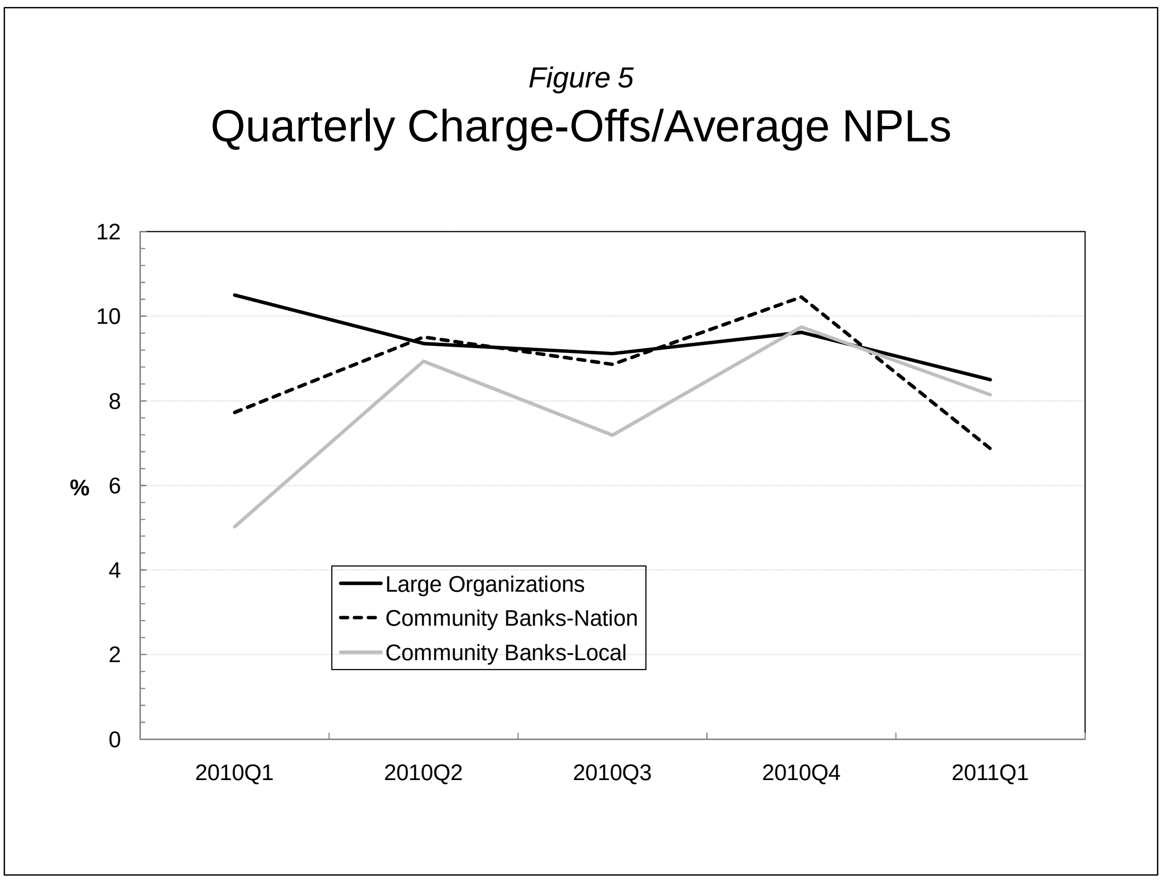
2010, but only 4 basis points at community banks nationally. At local community banks, the NCO ratio increased 9 basis points. A contributing factor to the quarterly decrease in NCOs is that banks are recovering more of the loans they charge off. The recovery ratio — that is, the ratio of recoveries to charge-offs — increased substantially at all categories of banks, but it is still low by historical standards (Figure 3).[9]

While asset quality at large organizations and community banks nationally continued to show some improvement in the first quarter, asset quality at tri-state area community banks declined. This decline in quality was more pronounced in western Pennsylvania and northern New Jersey, but banks in other parts of the region showed deterioration as well. In part, this relative decline may simply reflect a slower adjustment by community banks in the region than in the nation. However, it may also reflect relatively strong loan growth for community banks in the tri-state region — compared with community banks in the rest of the nation — in the face of continuing weakness in real estate markets. The data show that the banks with higher rates of loan growth over the past two years also have higher rates of growth in NPLs. The data in Figure 4 are divided into quartiles by the growth rate of loans over the previous two years. For comparison's sake, the aggregate loan growth rate for community banks in the nation over the previous two years was -5.5 percent.

[9] The average recovery ratio for all banks between 1999 and 2009 was 17.69 percent.

Figure 4
Growth of Loans Outstanding and NPLs at Tri-State Area Community Banks

	Loan Growth 2009Q1-2011Q1		Change in NPLs 2010Q1-2011Q1		Change in NPLs 2010Q4-2011Q1 (not annualized)	
Quartile	Median	Mean	Median	Mean	Median	Mean
Lowest loan growth	-12.1%	-13.8%	-15.0%	-4.5%	-1.6%	-2.1%
↓	0.8%	1.3%	7.2%	28.1%	-2.9%	-0.5%
	13.6%	14.0%	9.8%	36.6%	0.0%	6.1%
Highest loan growth	65.4%	108.5%	26.3%	29.0%	5.6%	15.8%



Residential Real Estate Lending

Figure 6
Summary of Residential Real Estate Lending

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Total RRE Loans ($Millions)	1,658,530.3	20,929.3	300,200.5
Change from Last Quarter	-9.7%	-8.3%	-10.8%
Change from Last Year	-3.1%	3.4%	2.1%
Pct. of Total Loans	36.6	32.1	25.5
Nonperforming RRE Loans	153,406.3	408.1	7,932.5
Change from Last Quarter	-6.4%	12.6%	-5.0%
Change from Last Year	-8.8%	10.1%	4.4%
Pct. of Nonperforming Loans	63.1	20.1	18.3
Nonperforming RRE/RRE Lns	9.25%	1.95%	2.64%
Net RRE Charge-offs	8,051.0	13.1	460.5
Change from Last Quarter	-44.5%	-93.3%	-79.6%
Change from Last Year	-33.7%	-5.4%	-9.0%
Pct. of Net Charge-offs	43.9	8.8	17.4
Pct. of Avg. RRE loans	0.48%	0.06%	0.15%

RRE loan quality improved somewhat at large organizations and community banks nationally but weakened at local community banks. However, because RRE loans are the single largest component of the large organizations' loan portfolios, representing 36.6 percent of loans, any problems in that area continue to be a drag on earnings (see Figure 6). NPLs decreased at both large organizations and community banks nationally but increased 12.6 percent at local community banks in the quarter. There is some evidence to suggest that these decreases in NPLs will continue as delinquency rates on mortgages have been trending downward for the past several quarters (Figure 7).[10] In spite of the decreases in NPLs, the NPL ratio increased at all categories of banks because of decreases in loans outstanding. At large organizations, the NPL ratio increased 8 basis points, to 9.25 percent; at community banks nationally, the increase was 4 basis points, to 2.64 percent; and locally there was a 10-point increase, to 1.95 percent in the past year (Figure 8).

Although NCOs on RRE loans decreased at all categories of banks during the first quarter, this represents a persistent trend only for large banks. Year-over-year, the NCO ratio at community institutions has remained essentially constant (Figure 9). Additionally, the recovery ratio on RRE NCOs showed substantial increases. At community banks, the ratio increased from 7.13 to 11.98 percent nationally and from 4.04 to 7.43 percent locally. At large organizations, the recovery ratio increased from 12.01 to 13.55 percent.

[10] Data in Figure 7 are from the Mortgage Bankers Association as compiled by Haver.

Figure 7

Delinquencies and Foreclosures

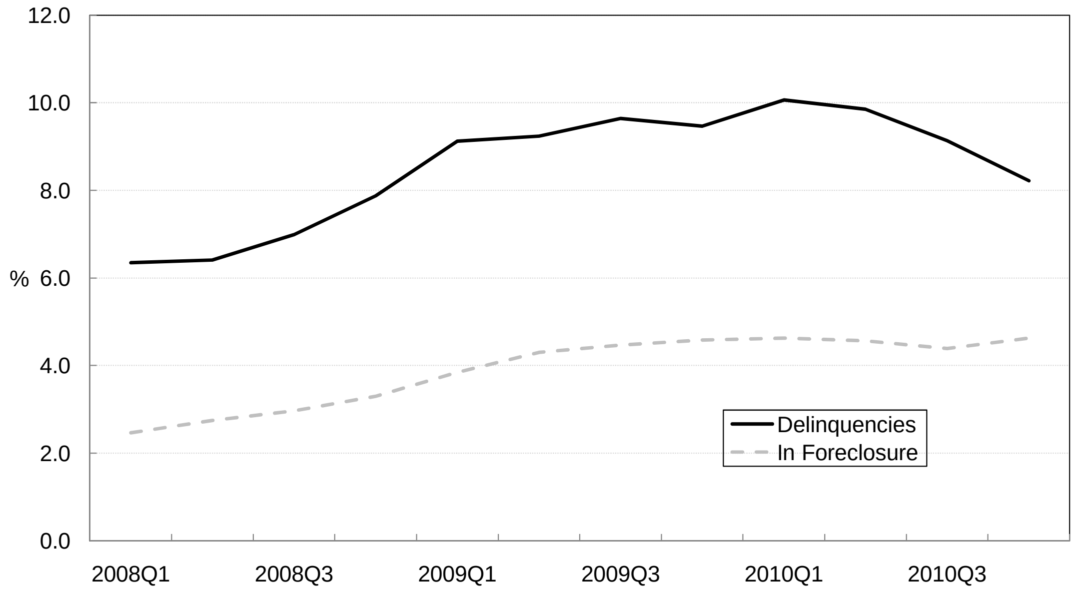
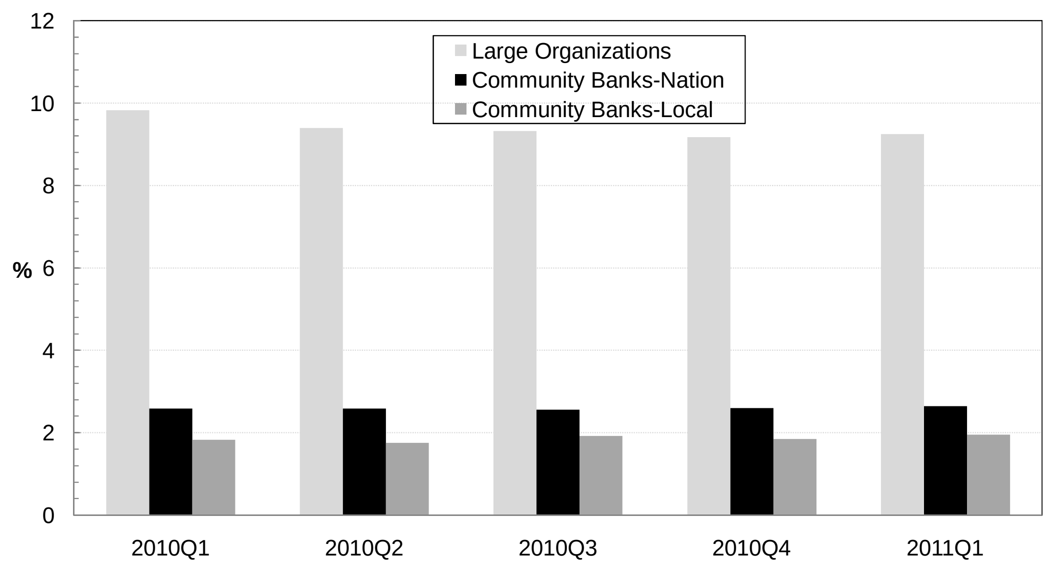
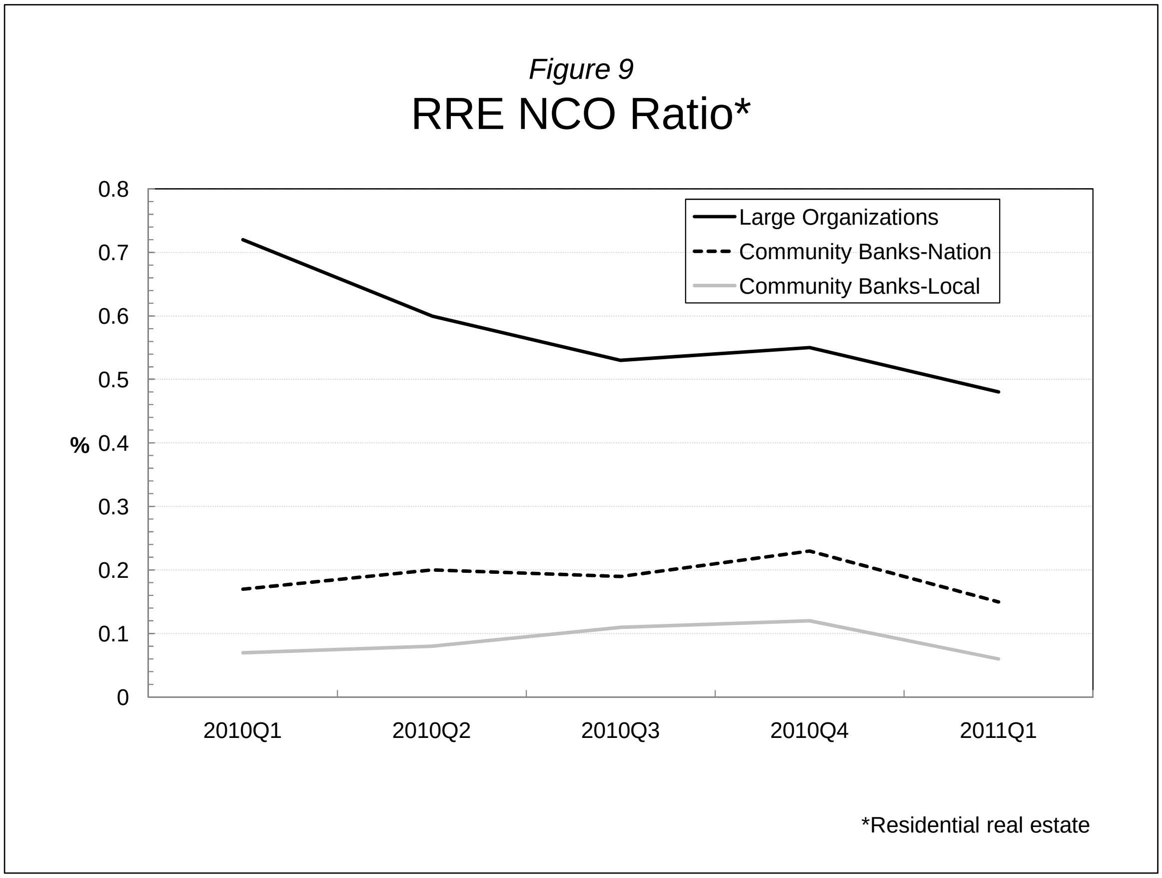


Figure 8

RRE NPL Ratio*



*Residential real estate



Commercial Real Estate Lending

Figure 10
Summary of CRE Lending

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Total CRE Loans ($Millions)	811,721.8	30,393.1	539,211.8
Change from Last Quarter	-8.8%	-2.0%	-5.9%
Change from Last Year	-11.4%	0.3%	-5.2%
Pct. of Total Loans	17.9	46.6	45.8
Nonperforming CRE Loans	57,343.6	1,372.6	29,258.4
Change from Last Quarter	-17.7%	30.1%	-12.0%
Change from Last Year	-25.4%	1.5%	-10.6%
Pct. of Nonperforming Loans	23.6	67.6	67.6
Nonperforming CRE/CRE Lns	7.06%	4.52%	5.43%
Net CRE Charge-offs	3,507.7	106.3	1,543.5
Change from Last Quarter	-85.6%	20.9%	-86.1%
Change from Last Year	-40.1%	109.9%	-17.5%
Pct. of Net Charge-offs	19.1	71.4	58.1
Pct. of Avg. CRE loans	0.41%	0.35%	0.28%

CRE NPLs and NCOs decreased at large organizations and community banks nationally but increased substantially at local community banks. CRE loans make up nearly half the portfolios of community banks both locally and nationally and therefore have a significant impact on their earnings. CRE loan volumes dropped at all banks, so even though there were decreases in NPLs, the CRE NPL ratios only decreased slightly at large organizations and community banks nationally. However, the increase in NPLs at local community banks resulted in an increase in the NPL ratio (Figure 11). The large drops in CRE NCOs at large organizations and community banks nationally caused the steepest drop in the CRE NCO ratio in several years, while the ratio at local community banks is now higher than that at community banks nationally (Figure 12).

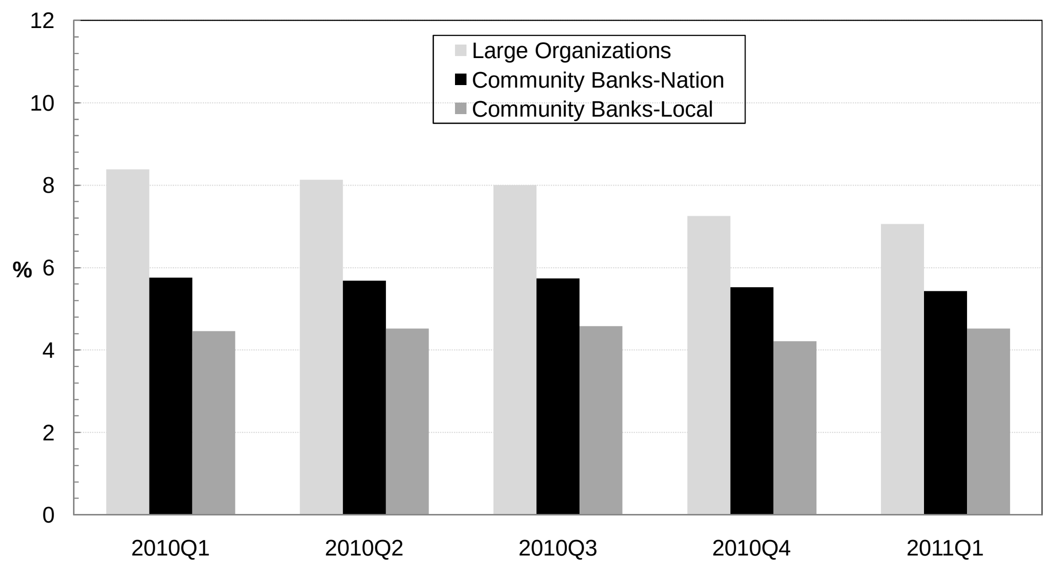
Most of the problems in CRE lending, especially at large organizations, are due to construction loans. These make up 20.4 percent of CRE loans at large organizations, 18.9 percent at community banks nationally, and 14.9 percent at tri-state area community banks. However, at these institutions they account for 46.3, 47.8, and 40.1 percent of CRE NPLs and 52.4, 50.9, and 29.1 percent of CRE NCOs, respectively. There has been some improvement in the quality of construction loans as NPLs fell at all categories of banks. At large organizations, construction NPLs have fallen 36.7 percent in the past year. At community banks, they've fallen 23.4 percent nationally and 15.5 percent locally. Construction NPLs decreased 32 percent at large organizations and 24.5 percent at community banks nationally and were basically flat at local community banks. However, due to decreases in loans outstanding (the denominator of the NPL ratio), the construction NPL ratio at large organizations was 16.69 percent in the first quarter, a drop of only 7 basis points (Figure 13). At community banks, the ratio decreased just 4 points nationally, to 13.72 percent, and increased 86 points locally, to 12.19 percent.

The most important segment of CRE lending to community banks is commercial mortgages. These loans make up about 73 percent of all CRE loans nationally and 77 percent locally. They are also the largest segment of large organizations' CRE loan portfolios, but CRE lending is not as important to the large organizations. In this area, the news is not very good. While commercial mortgages outstanding at both local and national community banks didn't grow at all in the first quarter, NPLs increased 3.6 percent nationally and by over 54 percent locally. Thus, the commercial mortgage NPL ratio increased both nationally and locally (Figure 14).

An increase in commercial mortgage NPLs, together with a 71.4 percent increase in NPLs on loans secured by multifamily properties was a major factor in the overall decrease in asset quality at local community banks. The underlying problem was weakness in the CRE market. Several of the larger institutions in the sample reported delinquencies for several projects they were financing. Some of these projects were out of state, but there were also some in western and central Pennsylvania and southern New Jersey. The most recent issue of the Federal Reserve's *Beige Book* cites the Third District (eastern and central Pennsylvania, southern New Jersey, and Delaware) as one of the weaker commercial real estate markets in the country.

Figure 11

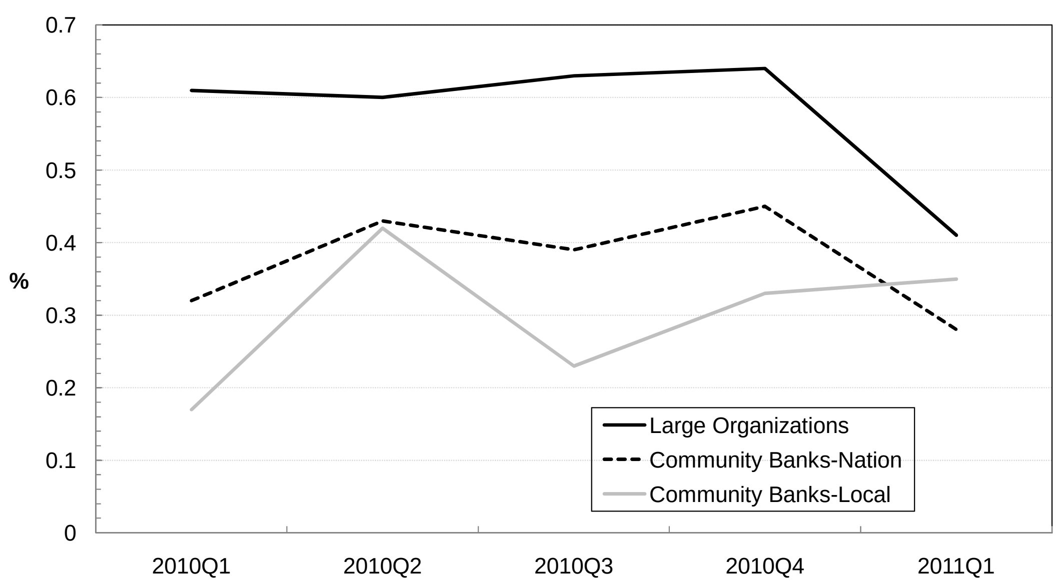
CRE NPL Ratio*



*Commercial Real Estate

Figure 12

CRE NCO Ratio*



*Commercial real estate

Figure 13

Construction NPL Ratios

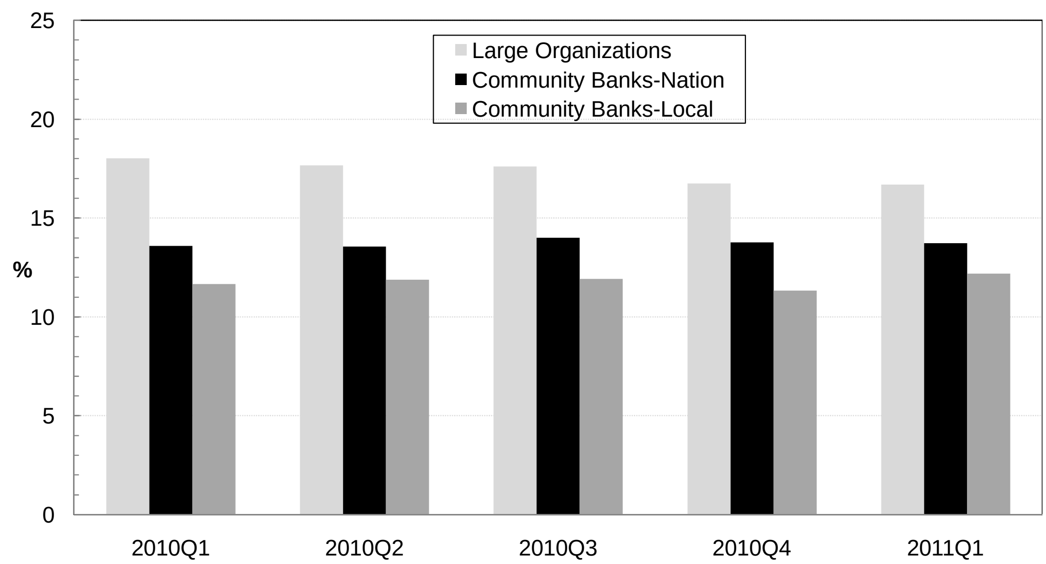
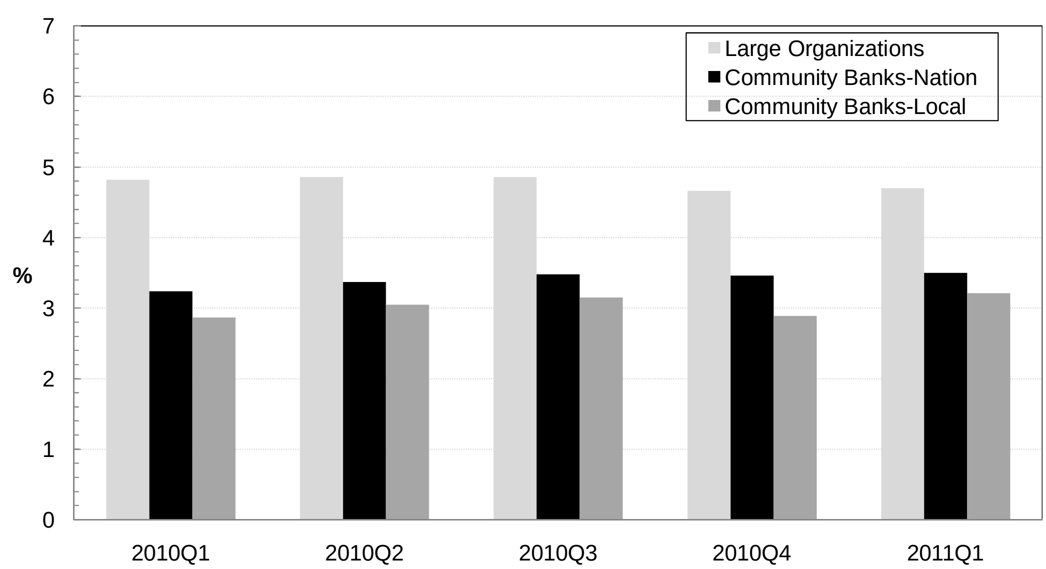


Figure 14

Commercial Mortgage NPL Ratio



Commercial & Industrial Lending

Figure 15
Summary of Commercial & Industrial Lending

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Total C&I Loans ($Millions)	897,441.8	8,661.3	177,384.9
Change from Last Quarter	8.5%	-3.1%	-3.5%
Change from Last Year	3.5%	-0.5%	-1.3%
Pct. of Total Loans	19.8	13.3	15.1
Nonperforming C&I Loans	15,581.9	193.7	4,128.1
Change from Last Quarter	-72.3%	40.3%	-9.6%
Change from Last Year	-43.3%	-2.4%	-6.2%
Pct. of Nonperforming Loans	6.4	9.5	9.5
Nonperforming C&I/C&I Lns	1.74%	2.24%	2.33%
Net C&I Charge-offs	1,974.4	21.8	563.1
Change from Last Quarter	-58.8%	-97.2%	-87.2%
Change from Last Year	-45.1%	16.1%	-19.0%
Pct. of Net Charge-offs	10.8	14.7	21.2%
Pct. of Avg. C&I loans	0.23%	0.25%	0.31%

C&I lending, which has been slumping for the past several quarters, is starting to show signs of life. Although C&I lending at both large and small institutions has been basically flat for the past year, C&I loans at large institutions increased modestly in the first quarter. Because of this increase at large organizations, total C&I lending was up. Except at tri-state area community banks, loan quality continued to improve as well, with decreases in both NPLs and NCOs. The NPL ratio at large organizations decreased 70 basis points. There was also a slight decrease at community banks nationally, while the ratio increased 20 basis points at local community banks. NPLs at local community banks have decreased from last year but showed a large increase in the first quarter. The NCO ratio decreased at all categories of institutions due to decreases in charge-offs. However, NCOs at tri-state area community banks posted a substantial gain from the first quarter of 2010, while NCOs at nation community banks and large organizations had large decreases.

Consumer Lending

Figure 16
Summary of Consumer Lending

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Total Co. Loans ($Millions)	572,203.8	2,572.5	53,307.4
Change from Last Quarter	-6.7%	-10.5%	-14.5%
Change from Last Year	-6.6%	-3.5%	-7.7%
Pct. of Total Loans	12.6	3.9	4.5
Nonperforming Co. Loans	8,932.7	15.8	390.2
Change from Last Quarter	-19.6%	-50.8%	-24.8%
Change from Last Year	-20.0%	36.4%	-6.9%
Pct. of Nonperforming Loans	3.7	0.8%	0.9
Nonperforming Co/Co Lns	1.56%	0.61%	0.73%
Net Co Charge-offs	4,123.4	6.0	121.1
Change from Last Quarter	-7.6%	310.5%	-75.9%
Change from Last Year	-23.2%	20.8%	-30.5%
Pct. of Net Charge-offs	22.5	4.0	4.6
Pct. of Avg. Co loans	0.69%	0.23%	0.22%

Consumer loan volume continued to shrink both nationally and locally. At large organizations, this was partly due to decreased credit card borrowing, as credit card outstandings dropped nearly 15 percent. Credit card loans make up nearly a quarter (22 percent) of consumer loans at large organizations, but they are practically insignificant at community banks where they make up 2.8 percent of consumer loans nationally and 2.3 percent locally. The difference in credit card lending also accounts for the disparity in the NPL and NCO ratios between large organizations and community banks because a higher proportion of credit card loans are nonperforming and have to be charged off. Still, credit card loans are performing reasonably well. At large organizations, credit card NPLs decreased nearly 31 percent, but credit card NCOs increased over 42 percent. The credit card NPL ratio dropped 13 basis points, to 2.40 percent, and the NCO ratio increased 16 basis points, to 1.82 percent.

Provisioning and Reserves

Figure 17
Provision for Loan Losses and Loan Loss Reserves

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Loan-loss Reserve ($Millions)	133,582.9	1,102.1	24,451.8
Change from Last Quarter	-15.6%	4.3%	-6.1%
Change from Last Year	-13.4%	0.5%	-0.1%
Net Charge-Offs/LL Provision	146.0%	92.7%	106.7%
LL Provision/Operating Inc.	11.8%	14.5%	12.3%
Loan-loss Coverage Ratio	54.9%	54.3%	56.5%

One possible reason for the increases in net income is that many banks appear to be forgoing increasing their loan-loss reserves.[11] With improvements in asset quality and the increasing recovery rate, it appears that banks expect their NCOs will continue to decline in the foreseeable future. Large organizations decreased their loan-loss provision by over 27 percent, and community banks nationally decreased theirs by over 48 percent. This is why, even with declining NCOs, loan-loss reserves still decreased at large banks and community banks in the nation. Loan-loss reserves at local banks increased slightly in the quarter and over the past year, but the increase is significantly smaller than the increase in NPLs.

Thus, the ratio of loan-loss provision to operating income is now at its lowest point in at least a year at all three categories of institutions (Figure 18).[12] This occurred despite the fact that operating income decreased at large organizations and was essentially flat at community banks nationwide. At tri-state area community banks, operating income increased about 6 percent. Thus, at large organizations and community banks nationally, the ratio of NCOs to loan-loss provision is now over 100 percent, and it is in the mid-90 percent at tri-state area banks (Figure 19). This could indicate that the banks anticipate even fewer NCOs in the future and would rather use their revenues to shore up their capital. Retained earnings increased at all three categories of banks, but not by as much as loan-loss provisions fell.

Despite the decreases in reserves, loan-loss coverage actually improved slightly, except at tri-state area community banks due to declining NPLs. At large organizations, the loan-loss coverage ratio increased 37 basis points, to 54.91 percent (Figure 20).[13] At community banks nationally, the increase was 69 basis points, to 56.48 percent, and locally the ratio decreased 144 basis points, to 54.29 percent. Note that in all cases the banks were sufficiently reserved to be able to charge off only a little more than half of their NPLs. Thus, it appears that banks expect that the quality of their loan portfolios will continue to improve, and therefore large additions to reserves are unnecessary.

[11] As reported here, loan-loss reserves are the balance-sheet item, and loan-loss provisions are from the income statement.

[12] Operating income is defined as the sum of net interest income and noninterest income.

[13] Loan-loss coverage ratio is defined as the ratio of loan-loss reserves to NPLs.

Figure 18

Loan-Loss Provision/Operating Income

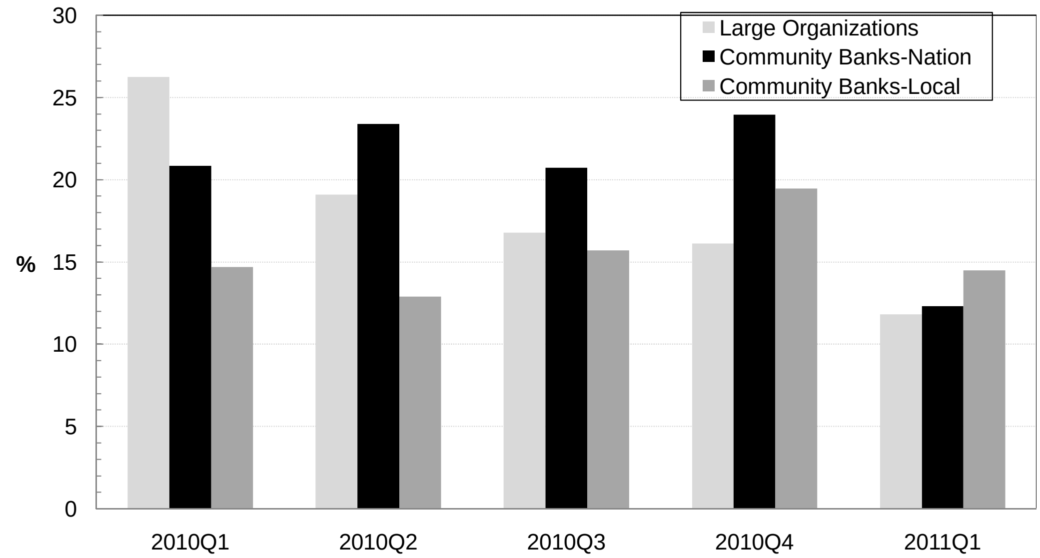


Figure 19

NCOs/Loan-Loss Provision

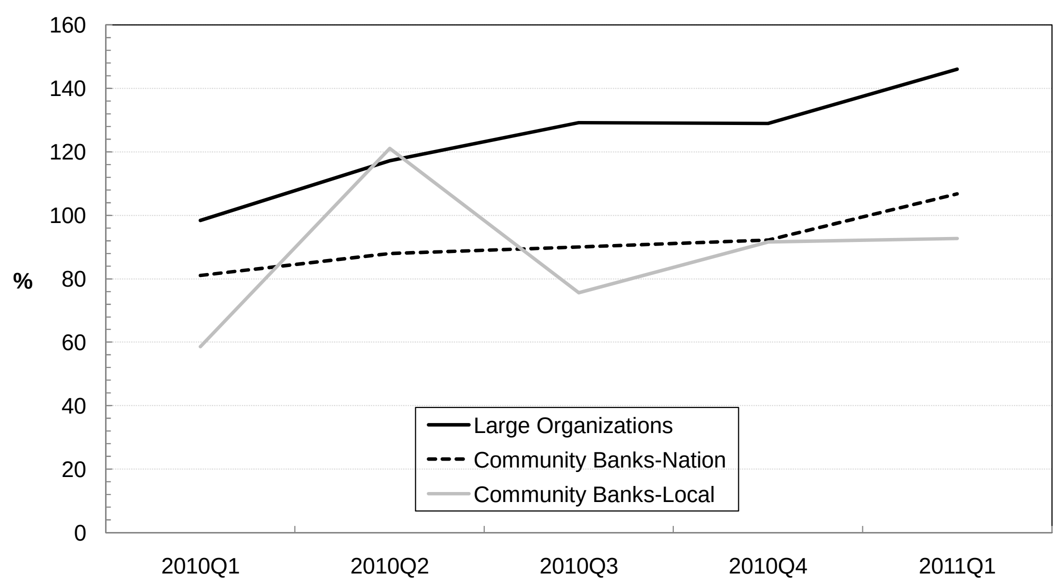
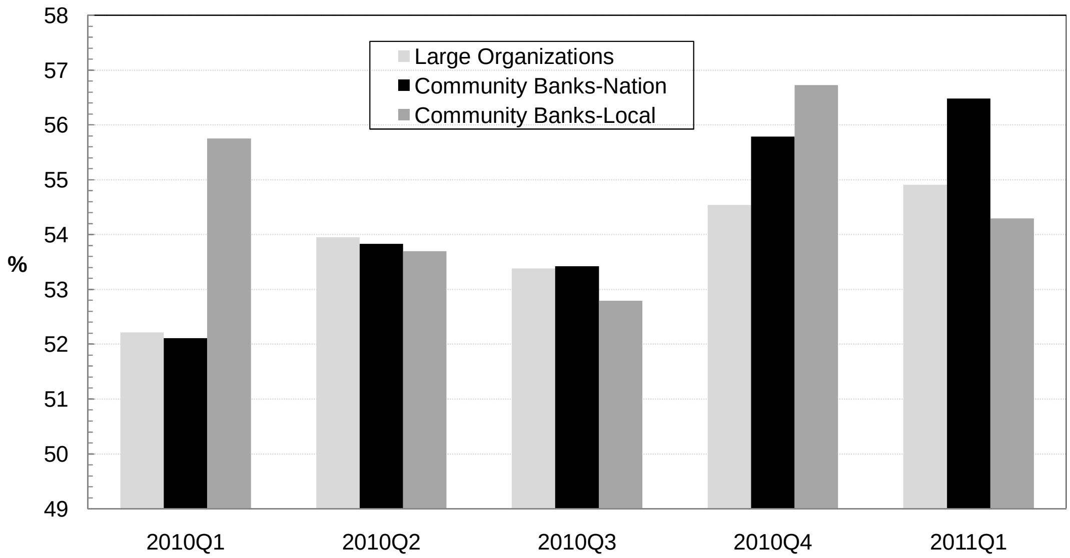


Figure 20

Loan-Loss Coverage Ratio



Securities

Figure 21
Summary of Securities Portfolios

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Securities/Assets	20.7%	21.7%	21.6%
Market Value ($Millions)	1,934,508.9	21,203.3	401,274.7
Change from Last Quarter	7.9%	27.1%	22.3%
Change from Last Year	7.0%	11.3%	15.9%
Realized Gain/Loss	-521.0	6.3	115.5
Pct of Average Securities	-.02%	0.03%	0.03%
MarketValue/Book Value	100.8%	100.1%	100.6%

The market value of the securities of all categories of banks increased in the first quarter.[14] At large organizations, there were substantial gains in the value of their mortgage-backed securities (MBS) and foreign securities, while debt securities of government-sponsored entities (Fannie Mae and Freddie Mac), securities of state and local governments (munis), and structured financial products also increased in value. The large organizations also posted a realized loss of over $500 million.[15]

At community banks nationally, nearly every class showed an increase in market value. MBS, debt securities of government-sponsored enterprises (GSEs – Fannie Mae and Freddie Mac), and munis all showed substantial gains in value in the first quarter. The only class of securities to lose value was Treasuries. Community banks nationally reported a realized gain of $115.5 million on securities in the first quarter.

At tri-state area banks, Treasuries, securities of U. S. government agencies, MBS, munis, other domestic securities, and mutual funds all showed substantial gains, while debt securities of GSEs and Treasuries decreased in value. Local community banks reported a realized gain of $6.3 million on their securities.

[14] The figure for percent of assets uses the value of securities as reported on the banks' balance sheets. Securities there are reported at book value if they are held to maturity and market value if they are available for sale. Changes in market value can either be indicative of increases in the value of securities that were already owned or due to purchases or sales of securities.

[15] Realized and unrealized gains and losses are net positions. Thus, the tri-state area sample can have larger gains or losses than the national sample, even though the tri-state sample is a subset of the national sample.

Funding Sources

Figure 22
Structure of Liabilities

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Deposits ($millions)	6,657,162.9	81,390.4	1,547,436.6
Pct. of Assets	71.4	83.4	83.2
Change from Last Quarter	9.4%	3.3%	2.9%
Change from Last Year	4.8%	5.2%	3.3%
Core Deposits/Deposits	54.5%	84.0%	82.0%
Implicit Rate on Deposits	0.55%	1.19%	1.22%
Nondeposit Debt ($millions)	1,078,803.6	5,394.6	108,292.2
Pct. of Assets	11.6	5.5	5.8
Change from Last Quarter	-12.2%	-29.0%	-23.9%
Change from Last Year	-19.8%	-25.9%	-14.2%
Implicit Rate on Debt	1.62%	2.73%	2.59%

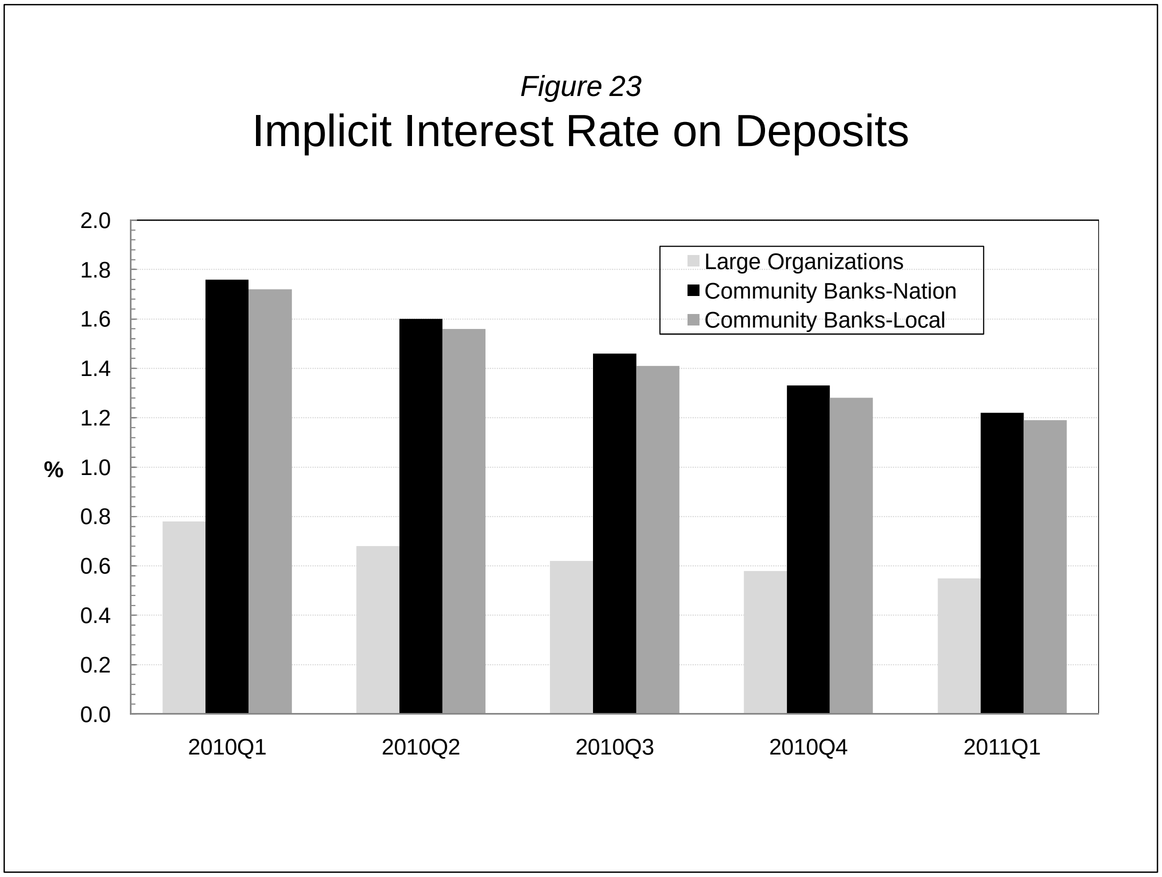
Deposits rose modestly in the first quarter, while banks in all categories continued to shed nondeposit funding. The growth in deposits differed by institution class, however. At community banks nationally, much of the growth was generated by core deposits, especially demand deposits.[16] This is a positive development for the community banks because core deposits are a stable and relatively inexpensive source of funding. At these banks, there was a decline in less stable sources of funding, including large decreases in brokered deposits. At local community banks, the story was somewhat different. Core deposits contributed to much of the deposits' growth, but the main area of growth was time deposits. At large institutions, not only did transaction accounts rise substantially, but savings deposits, foreign deposits, and deposits in denominations of $100,000 or more increased as well. Banks in all categories continued to become less reliant on nondeposit funding.[17]

Large organizations continue to have a funding advantage over community banks both in terms of deposits and debt funding. The implicit interest rate on deposits continued to fall at all categories of banks, but large organizations pay only about 60 percent of what community banks both nationally and locally pay (Figure 23).[18] This ratio is roughly the same for debt funding as well.

[16] 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.

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

[18] Implicit interest is computed by dividing the annualized interest paid by the average total balance.



Regulatory Capital

Figure 24
Capitalization Measures

	Large Organizations	Community Banks	
Ratios	Nation	Tri-State Area	Nation
Total Equity/Total Assets	11.01%	9.97%	10.23
Change fr. Last Qtr. (basis pts)	+4	+15	+15
Change fr. Last Yr. (basis pts)	+32	+31	+28
Tier 1 Leverage Ratio	8.49%	9.39%	9.49%
Change fr. Last Qtr. (basis pts)	+25	+14	+19
Change fr. Last Yr. (basis pts)	+46	+37	+30
Risk-Based Capital Ratio	14.98%	14.34%	15.03%
Change fr. Last Qtr. (basis pts)	+19	+31	+37
Change fr. Last Yr. (basis pts)	+64	+93	+101

Capital levels and most ratios increased somewhat in all categories of banks, both from the fourth to first quarter and year-over-year. At large organizations, the equity-to-assets ratio increased 4 basis points, the tier 1 leverage ratio increased 14 basis points, and the risk-based capital ratio increased 19 basis points.[19] At community banks nationally, the equity-to-assets ratio increased 15 basis points, the tier 1 leverage ratio increased 19 basis points, and the risk-based capital ratio increased 37 basis points. Locally, the equity-to-assets ratio increased 15 basis points, the tier 1 leverage ratio increased 14 basis points, and the risk-based capital ratio increased 31 basis points.

In each case, the primary drivers of these capital increases were additional retained earnings and surplus. Also, large organizations and community banks nationally had relatively large unrealized gains on available-for-sale securities. Tri-state area community banks had an unrealized loss on these securities, but the amount has decreased since the fourth quarter of 2010. All categories of banks also cut their dividends in the first quarter, a move likely calculated to allow them to retain more earnings. The dividend payout ratio – that is, the ratio of dividends paid to net income – decreased from 66.88 to 51.89 percent at large organizations.[20] At community banks, this ratio decreased from 156.18 to 45.80 percent nationally and from 93.81 to 78.78 percent locally. This is further evidence that institutions are trying to build up their capital bases.

[19] Tier 1 leverage and risk-based capital are the two main ratios regulators use to determine if a bank is adequately capitalized. For further information, see the call report instructions at http://www.ffiec.gov/forms031.htm.

[20] Dividends paid include dividends on both common and preferred stock.