BANKING BRIEF
FOR PENNSYLVANIA, NEW JERSEY, AND DELAWARE

Second Quarter 2011 Highlights

- *Year over year, profitability (ROA) continued to improve at all banking organizations, including large banks and national and local community banks.*

- *Year over year, loan growth at large organizations and local community banks essentially stayed flat but shrank further at community banks nationally.*

- *Relative to a year ago, C&I lending and credit card lending were further expanded at large organizations but had little growth at community banks.*

- *Outstanding principal of nonperforming residential real estate loans (RRE NPL) at large organizations declined substantially from a year ago, but the RRE NPL ratio appeared to be modestly improved.*

- *Year over year, total volume of nonperforming commercial real estate (CRE NPL) loans dropped substantially at all organizations, but only large institutions saw meaningful improvement in the CRE NPL ratio.*

- *Relative to the second quarter of 2010, capitalization at community banks continued to improve, while capital ratios generally remained flat at large organizations.*

- *This issue also includes a special discussion on the annual report on small business lending.*

RESEARCH DEPARTMENT FEDERAL RESERVE BANK OF PHILADELPHIA
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Summary Table of Bank Structure and Conditions – Second Quarter 2011

Community Banking Organizations

	Tri-State $ Bill	*Tri-State* % Change From		*Nation* $ Bill	*Nation* % Change From	
	11Q2	**11Q1**	**10Q2**	**11Q2**	**11Q1**	**10Q2**
Total Assets	98.3	2.68	2.90	1,857.5	3.02	2.11
Total Loans	65.4	1.05	0.40	1,179.7	3.56	-1.89
Business	8.8	5.78	-0.62	178.3	5.51	-0.90
Real Estate	52.1	0.62	0.85	886.5	2.17	-1.79
Consumer	2.5	-6.94	-5.61	52.6	0.79	-7.05
Total Deposits	81.6	1.21	4.37	1,538.3	0.96	2.73
Ratios (in %)	**11Q2**	**11Q1**	**10Q2**	**11Q2**	**11Q1**	**10Q2**
Net Income/Avg Assets (ROA)	0.48	0.37	0.19	0.38	0.27	-0.08
Net Interest Inc/Avg Assets (NIM)	3.33	3.33	3.28	3.45	3.44	3.39
Noninterest Inc/Avg Assets	1.20	1.20	1.14	0.93	0.92	0.91
Noninterest Exp/Avg Assets	3.17	3.26	3.35	3.10	3.10	3.12
Loans/Deposits	80.11	80.14	83.28	76.69	76.21	80.31
Equity/Assets	10.16	9.97	9.82	10.56	10.22	10.17
Nonperforming Loans/Total Loans	3.08	3.11	3.05	3.55	3.66	3.80

Large Banking Organizations

	Tri-State $ Bill	*Tri-State* % Change From		*Nation* $ Bill	*Nation* % Change From	
	11Q2	**11Q1**	**10Q2**	**11Q2**	**11Q1**	**10Q2**
Total Assets	613.4	9.28	4.24	9,566.7	9.80	4.86
Total Loans	318.9	10.45	1.17	4,627.3	8.17	0.29
Business	64.2	15.11	7.77	925.7	12.51	8.14
Real Estate	181.1	-1.75	-3.71	2,526.8	-3.78	-5.23
Consumer	40.8	52.72	5.23	589.9	12.27	-4.80
Total Deposits	457.0	8.72	7.15	6,884.0	13.42	9.08
Ratios (in %)	**11Q2**	**11Q1**	**10Q2**	**11Q2**	**11Q1**	**10Q2**
Net Income/Avg Assets (ROA)	0.83	0.80	0.44	0.70	0.70	0.42
Net Interest Inc/Avg Assets (NIM)	2.95	2.99	3.13	2.66	2.70	2.80
Noninterest Inc/Avg Assets	1.76	1.77	1.91	1.88	1.89	1.97
Noninterest Exp/Avg Assets	2.98	2.96	2.99	2.95	2.92	2.82
Loans/Deposits	69.78	69.51	73.90	67.22	68.02	73.11
Equity/Assets	11.94	12.04	11.95	10.88	11.00	11.02
Nonperforming Loans/Total Loans	4.83	5.24	5.68	4.92	5.38	6.03

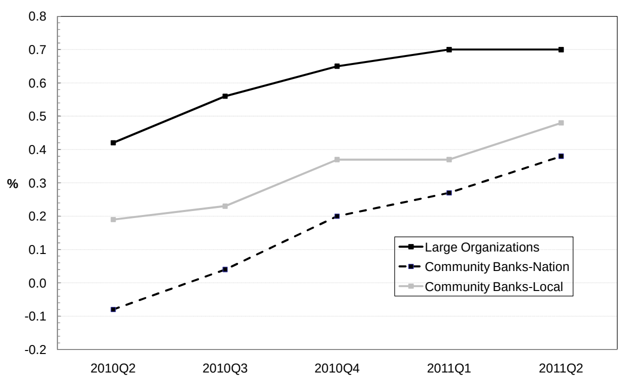
A banking organization is an independent bank or all the banks within a highest-level bank holding company; however, banks less than five years old and special purpose banks such as credit card banks are excluded. The large banking organization sample is based on banking organizations whose total assets 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 5,536 for the nation; (2) large banking organizations — 25 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 by e-mail at 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.

Second Quarter 2011

Profitability increased at all organizations from the second quarter of 2010 but barely changed at large organizations (Figure 1).[1] Return on assets (ROA) at large organizations have increased by 28 basis points, to 0.70 percent, since last year. At community banks nationally, ROA increased to 0.38 percent, a rise of 46 basis points from the second quarter of 2010. At local community banks, ROA have increased 29 basis points, to 0.48 percent, from a year ago. These also represent improvements at community banks from the previous quarter.

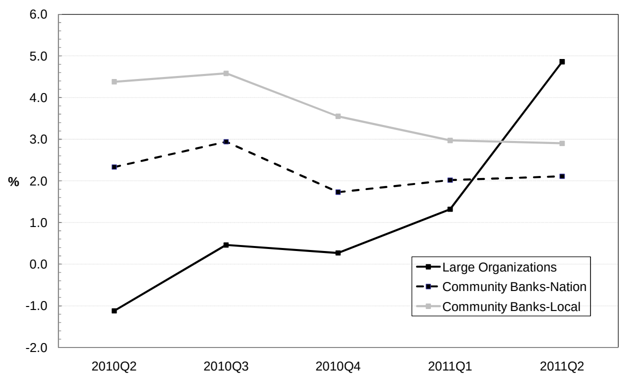
Figure 1
Return on Average Assets



There are several reasons for the improved profitability. At large organizations, the increase can mainly be attributed to lower net charge-offs and generally improved loan and other asset quality (see below). At community banks, the drivers are more mixed. First, loan quality has improved at these banks as well. Second, net interest margins have increased in the past year, nationally by six basis points and locally by five. Third, overhead, as measured by the ratio of noninterest expense to average assets, fell or was flat. Last, community banks have seen increases in realized gains on securities.

While community banks seemed to show substantial improvement, signs of problems remain. Among community banks both locally and nationally, about 15 percent of banks continued to operate at a loss.[2] The figures are somewhat better for large organizations.

Figure 2
Year-Over-Year Asset Growth



Assets at large organizations grew quickly relative to community banks both from the second quarter of last year and from the first quarter of 2011 (Figure 2).

Loan growth continued to be stagnant in most sectors (Figure 3). Over the past year, total loans have been essentially flat at large organizations and local community banks, while they shrank slightly at community banks nationally. Consumer lending and real estate lending continued to shrink. Commercial lending shrank slightly at community banks both locally and nationally but showed a year-over-year increase at large organizations, with an even larger increase in the most recent quarter.

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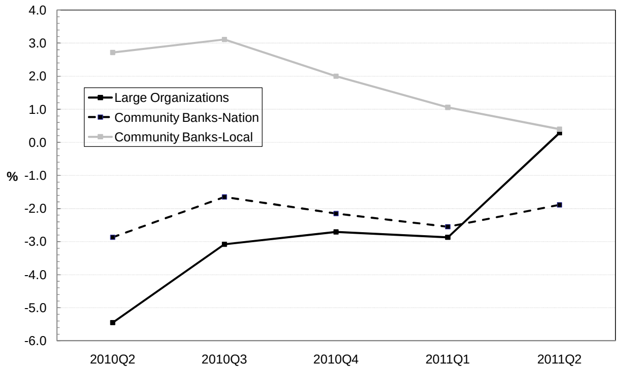
[1] See the Summary Table of Bank Structure and Conditions on page 2 for some of the numbers cited in this section. Unless otherwise noted, all data are from Federal Financial Institutions Examination Council (FFIEC) call reports. Ratios presented are aggregates. That is, the numerator and denominator 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] Of the 5,536 community banks in the national sample, over 85 percent showed a positive profit in the second quarter. In the tri-state area, of the 185 banks in the sample, the figure was 86 percent. For large organizations, 92% of them were profitable.

Figure 3

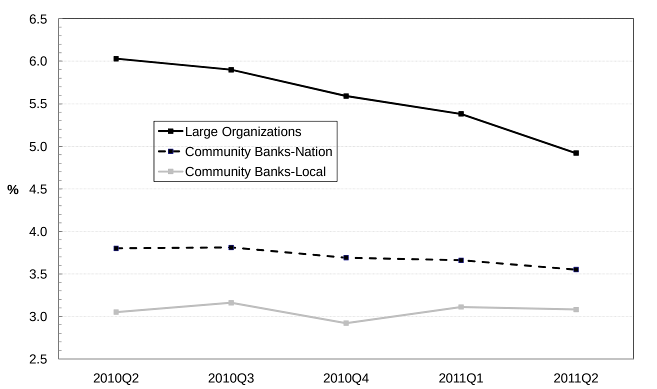
Year-Over-Year Loan Growth



Loan quality at large organizations continued to improve with decreases in both nonperforming loans (NPLs) and net charge-offs (NCOs).[3] In the nation, the ratio of NPLs to total loans (the NPL ratio) decreased 111 basis points from last year, to 4.92 percent (Figure 4). In the second quarter alone the decrease was 46 basis points. Total NPLs continued to decrease as well, by 18.2 percent from the second quarter of last year and 24.4 percent from the first quarter. At community banks, nationally the NPL ratio has decreased 25 basis

Figure 4

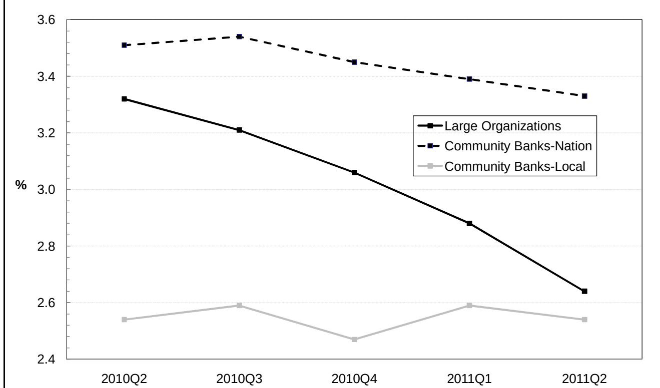
Nonperforming Loans/Total Loans



points since last year, to 3.55 percent. Locally, the NPL ratio largely remained flat, rising by merely 3 basis points during the year, to 3.08 percent. Total NPLs at community banks have fallen 8.4 percent nationally but have increased 1.2 percent locally since the second quarter of 2010. From the previous quarter, they fell both nationally and locally.

Figure 5

Nonperforming Assets/Total Assets



Although community banks seem to have better loan quality than large organizations, the picture on overall nonperforming assets looks different due to the performance of other real estate owned (OREO).[4] The ratio of nonperforming assets to total assets at large organizations has decreased since the second quarter of 2010, to 2.64 percent (Figure 5), slightly higher than that of community banks locally (2.54 percent) but substantially lower than the ratio at community banks nationally (3.33 percent). While the NPL ratios at community banks shrank slightly, OREO has increased 3.7 percent nationally and 10.1 percent locally from a year ago. At large organizations, on the other hand, OREO decreased 8.3 percent along with the decline in the NPL ratio. As has been the case for several years,

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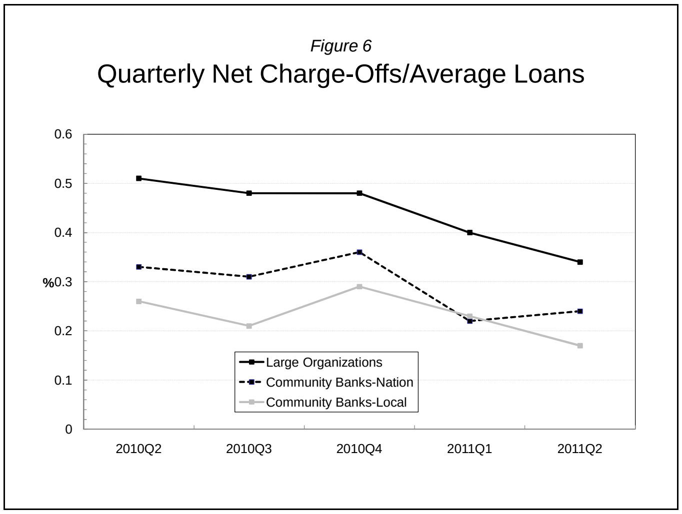
[3] NPLs are defined as loans past due 90 days or more plus nonaccruing loans. For historical perspective, the average NPL ratio for all commercial banks between 2000 and 2010 was 2.24 percent. At the bottom of the last real estate cycle in 1991, this ratio stood at 3.70 percent. Source: FDIC Historical Statistics on Banking, http://www2.fdic.gov/hsob/index.asp.

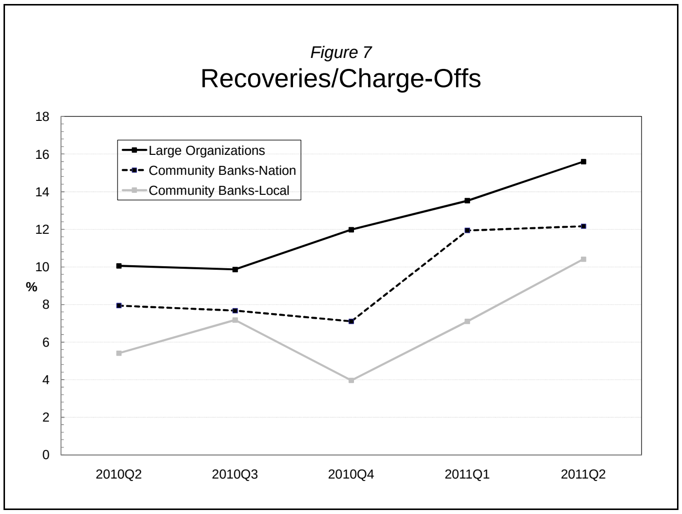
[4] Loan quality refers to NPLs only, while asset quality refers to nonperforming assets. These are the sum of NPLs and other real estate owned (OREO), which is basically foreclosed real estate. For historical perspective, the average ratio of nonperforming assets to total assets for all commercial banks between 2000 and 2010 was 1.43 percent. At the bottom of the last real estate cycle in 1991, this ratio stood at 3.02 percent. Source: FDIC Historical Statistics on Banking, http://www2.fdic.gov/hsob/index.asp.

asset quality problems at large organizations are mainly concentrated in residential real estate (RRE) loans and construction loans.[5] At community banks, the main problem area has been commercial real estate (CRE) lending.[6]

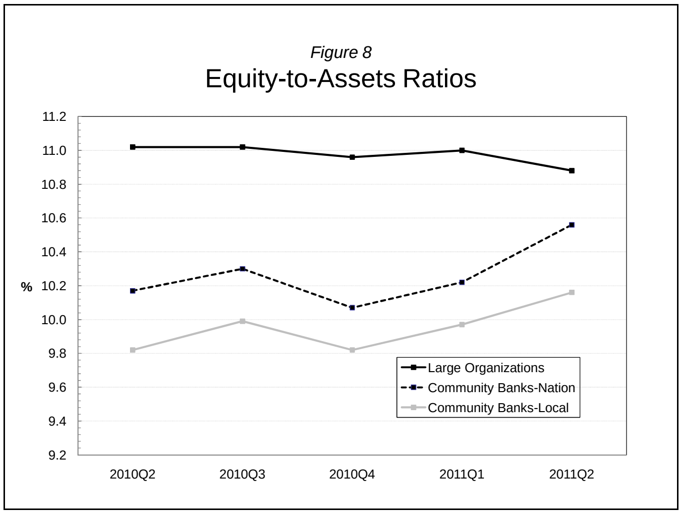


Compared with a year ago, NCOs are also down substantially, both in total and as a ratio of average loans (NCO ratio). The NCO ratio has decreased at every category of bank since the second quarter of 2010 (Figure 6). At large organizations, the NCO ratio decreased 17 basis points, to 0.34 percent. At community banks nationally, the ratio decreased 9 basis points year over year, to 0.24 percent. Locally, the ratio decreased 9 basis points, to 0.17 percent. Total NCOs have decreased substantially as well since last year at all categories of banks.

One reason for the drop in NCOs is that banks continued to recover more of the loans they had previously charged off. In the last year, the ratio of recoveries to charge-offs (the recovery ratio) increased 574 basis points at large organizations, to 15.6 percent (Figure 7). At community banks, nationally the recovery ratio rose by 422 basis points, to 12.16 percent, and locally the increase was 500 basis points, to 10.41 percent.



Capital ratios, defined as the ratio of total equity to assets, rose substantially from a year ago at community banks both locally and nationally but fell 12 basis points from the first quarter of 2011 at large organizations (Figure 8). This decrease appears localized to a few organizations and will be discussed in more detail in the “Regulatory Capital” section below.



There continued to be a high level of bank failures in the nation in the second quarter leading into the third. In the second quarter there were 22 bank failures, down from 26 in the first quarter.[7]

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

[6] 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).

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

Additionally, 16 banks have failed in the third quarter as of August 16. The up-to-date total for the year is 64. However, the pace so far is well below what is necessary to match last year's total of 139. No institution in the tri-state area has failed yet this year.

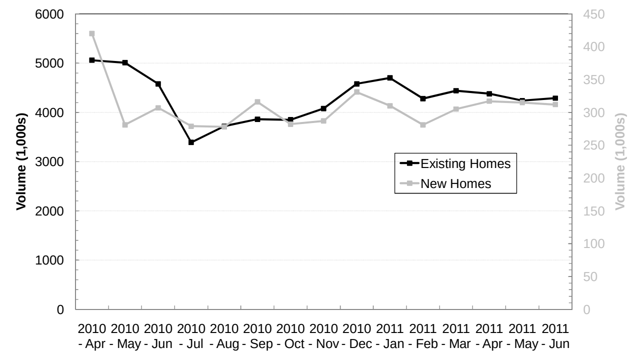
Residential Real Estate Lending[8]

Overall, the RRE market remained weak nationwide. The Federal Reserve Board's Beige Book as of June 8 reported decreasing prices and low sales activity in most Federal Reserve Districts.[9] Sales of single-family homes, both new construction and existing homes, appear to have leveled off (Figure 9). The Beige Book did find some signs of future improvement though, as several Districts, including Philadelphia, reported increased traffic at homes for sale. Supply may be tightening slightly, since the inventory of foreclosed homes has decreased a little, while the Beige Book reported very little new construction. However, the percentage of delinquent mortgages also increased slightly (Figure 10).

RRE loan quality improved at large organizations, but at community banks both nationally and locally, there was no sign of improvement in loan quality. At large organizations, the NPL ratio has decreased 44 basis points since a year ago. At community banks, over the past year nationally the NPL ratio remained virtually unchanged, and it increased slightly, by 25 basis points, at local community banks (Figure 11). The NPL ratio at community banks is still low relative to the larger banks, however, and community banks in the tri-state area still have better RRE loan quality than community banks in the nation as a whole. It is also worth noting that RRE NPLs still make up a relatively small portion of total NPLs at community banks both nationally and locally (18.9 and 21.0 percent, respectively).

Figure 9

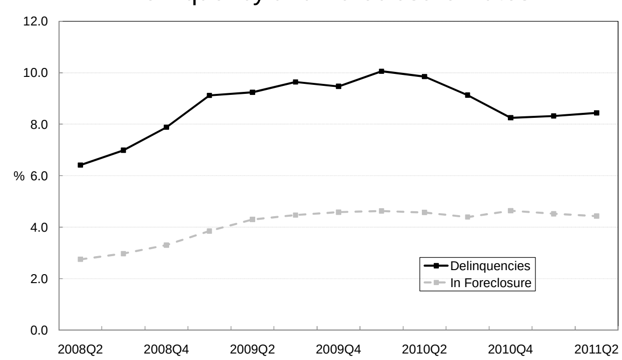
Sales of New and Existing Homes



Source: Haver Analytics

Figure 10

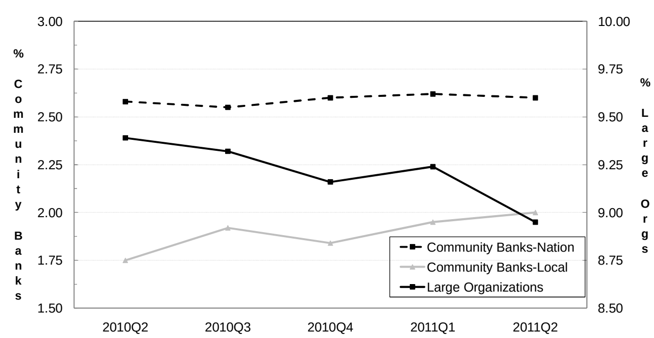
Delinquency and Foreclosure Rates



Source: Mortgage Bankers Association/Haver Analytics

Figure 11

Nonperforming RRE* Loans/Total RRE Loans



*Residential real estate

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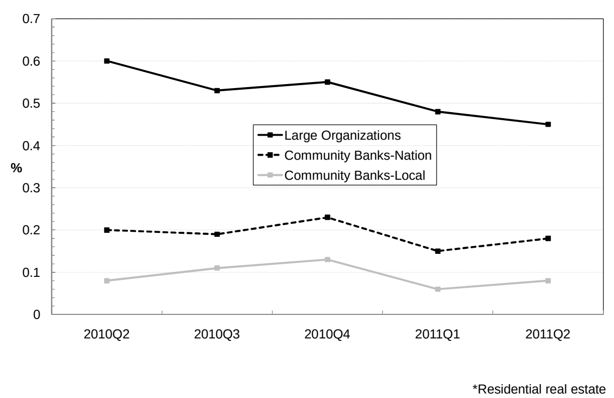
[8] See Table 1 in the Appendix for a full summary of the data used in this section.

[9] For further information, see http://www.federalreserve.gov/fomc/beigebook/2011/20110608/default.htm.

In terms of outstanding volume, RRE NPLs have been decreasing at large banks for nearly a year, although they remained at a very high level. At community banks nationally, NPLs increased by a small amount both in the quarter and in the year, while local banks experienced somewhat higher growth in NPLs.

Much the same can be said for NCOs on RRE loans. At large organizations, NCOs decreased for the second consecutive quarter, and they have decreased by over 25 percent from a year ago. Again, community banks' RRE loan problems are dwarfed by those of large organizations. As further reflected in RRE NCO ratios, despite the recent decline in loan quality, local community banks still outperformed community banks in the nation as a whole. As of the end of second quarter of 2011, local banks' NCO ratio is less than half that of community banks nationally, which in turn is well below half that of the large organizations (Figure 12).

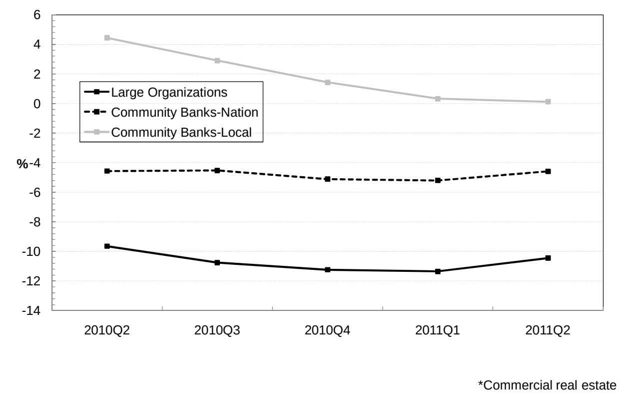
Figure 12
Net Charge-offs on RRE* Loans/Avg. RRE Loans



Commercial Real Estate Lending[10]

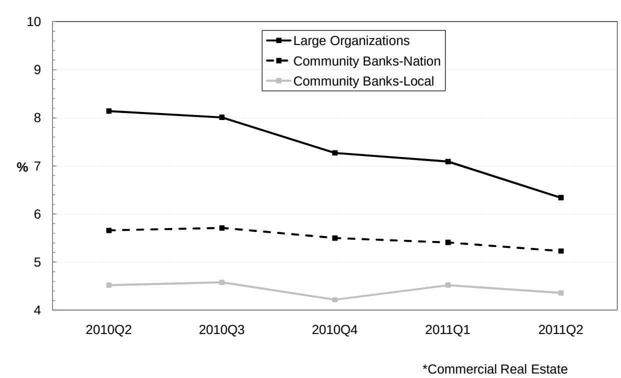
Overall CRE lending continued to decrease except at tri-state area community banks, where it was basically flat (Figure 13). Nevertheless, there are some signs of a turnaround in the CRE market. This is especially important to community banks because CRE loans make up 46.4 percent of all loans at banks nationally and 45.1 percent at tri-state area banks. so their overall condition is highly dependent on their CRE portfolios. The Beige Book reported CRE markets nationwide as either holding steady or moderately improving both in terms of rents and vacancy rates. For the most part the Third District held steady, with some slight signs of improvement as companies whose leases are expiring are relocating to higher-end properties.

Figure 13
Year-Over-Year CRE* Loan Growth



The quality of CRE loans improved in the second quarter at all categories of banks. First, CRE NPLs decreased at all categories of banks both during the quarter and the year. Second, at large organizations the CRE NPL ratio decreased 75 basis points in the second quarter to 6.34 percent and is down 180 basis points from one year ago (Figure 14). The CRE NPL ratio decreased 18 basis points

Figure 14
Nonperforming CRE* Loans/Total CRE Loans



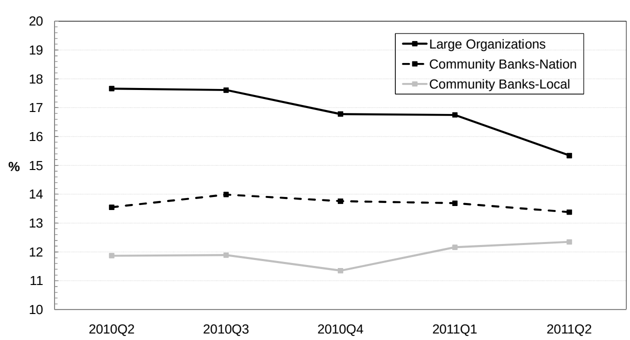
[10] See Table 2 in the Appendix for a full summary of the data used in this section.

at community banks nationally, and 16 basis points at community banks locally from last year. Similar to the case of RRE loans, tri-state area banks continued to have better loan quality than both community banks nationally and large organizations.

Much of the reason for the improving quality of CRE loans at large organizations is due to their continued efforts to clean up their construction loan portfolios. Construction loans represent about 19 percent of all CRE loans but over 46 percent of CRE NPLs and about 44 percent of NCOs. Construction loans outstanding at large organizations have deceased over 31 percent in the past year as bad loans made previously were charged off. The construction loan NPL ratio at these institutions dropped 141 basis points, to 15.34 percent, in the second quarter, and although it has decreased 232 points since last year, it is still over 15 percent (Figure 15).

Figure 15

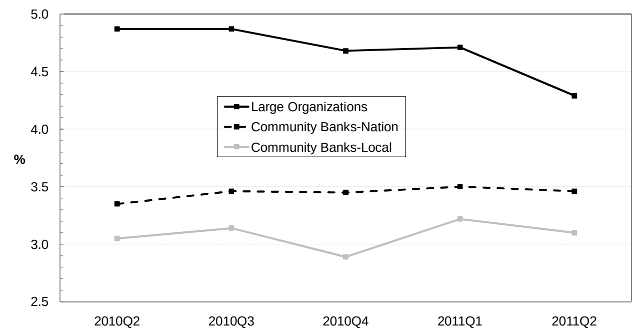
Nonperforming Construction Lns/Construction Lns



At community banks, the CRE loan quality problems are more concentrated in commercial mortgages. Making up nearly three quarters of all CRE loans at community banks both locally and nationally, commercial mortgages are the largest single type of loan in these banks' portfolios. The NPL ratio on commercial mortgages is now higher both nationally and locally than it was a year ago. It now stands at 3.46 percent nationally and 3.10 percent locally (Figure 16). These represent year-over-year increases of 11 basis points at banks nationally and 5 basis points at local banks.

Figure 16

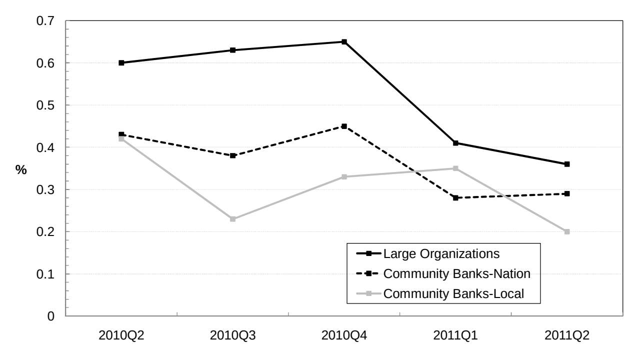
Nonperforming Commercial Mortgages/ Commercial Mortgages



NCOs for CRE loans were also down from last year at all categories of banks. Specifically, the CRE NCO ratio has decreased by 24 basis points since last year at large organizations, by 14 basis points at community banks nationally, and by 22 basis points at tri-state area community banks (Figure 17).

Figure 17

Net Charge-offs on CRE* Loans/Avg CRE Loans



*Commercial real estate

Commercial & Industrial Lending[11]

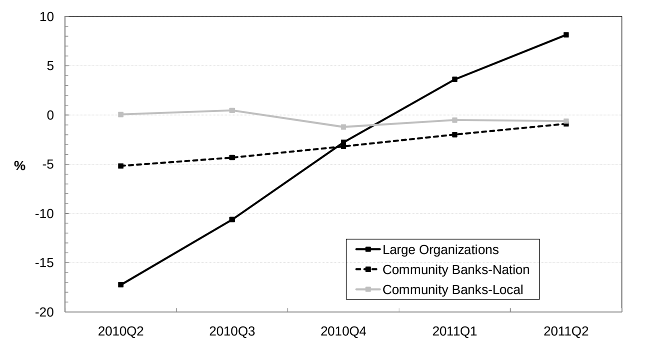
At large organizations C&I lending is showing fairly solid growth numbers, increasing 8.1 percent over the last year (Figure 18). It should be noted that C&I lending had been decreasing for more than a year, so this growth began from a very low level.

[11] See Table 3 in the Appendix for a full summary of the data used in this section.

Moreover, at least so far, this growth has been accomplished without compromising loan quality, as both NPLs and NCOs fell substantially. C&I loans are generally short term, ranging in length from a month to a year or so. Therefore, any problems with new loans will show up fairly quickly after the loan is made.

Figure 18

Year-Over-Year C&I* Loan Growth



*Commercial and Industrial

The C&I NPL ratio at the large organizations has been falling while lending has expanded for the last year (Figure 19). It now stands at 1.48 percent, a decrease of 26 basis points from the first quarter and 142 basis points from last year. Likewise, the NCO ratio has also fallen, by 7 basis points from the first quarter and 14 basis points from last year (Figure 20).

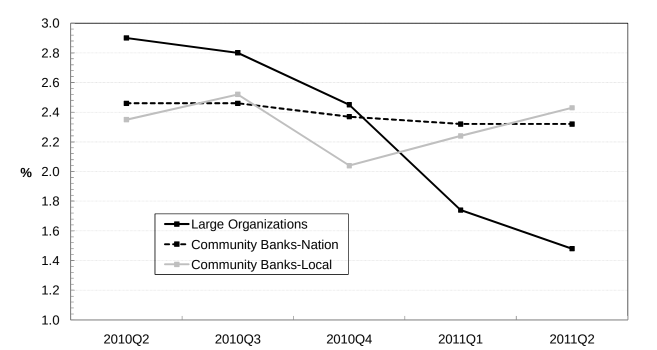
The picture at community banks is not so rosy. First, C&I loans have shown no growth in the last year (Figure 18), despite a modest increase in the second quarter. Also, the modest increase in lending in the quarter was accompanied by increases in both NPLs and NCOs. In the case of tri-state area banks, while banks nationally showed decreased NPLs and NCOs from last year, local banks saw increases in both items.

More important, the trends and levels of quality-related ratios at community banks seem worrisome relative to those of large organizations. At community banks nationally, the NPL ratio was flat during the quarter and shrank 14 basis points from last year, while the NCO ratio increased 2 basis points during the quarter and fell 11 points from last year. At local banks, the NPL ratio increased 19 basis points from the first quarter and 8 basis points from a year ago (Figure 19), and the NCO ratio increased 10 basis points from the first quarter and 11 basis points from last year (Figure 20). Last, both the NPL ratio and the NCO ratio at community banks significantly exceed those at large organizations.

Part of this disparity between large organizations and community banks might be due to the difference in their customer bases. The Federal Reserve Board's Senior Loan Officer Opinion Survey for July 2011 reported that demand for C&I loans had increased modestly at large and medium-sized firms but saw no change in demand at smaller firms.[12] The reason cited for the increase at the larger firms was that they were shifting to bank loans from other forms of borrowing such as bonds and commercial paper. The survey also found that banks had loosened their lending standards to all business borrowers, but more so to the large and medium-sized firms. Smaller banks generally lend to smaller businesses, where the survey reported the weakest demand and the least loosening of standards.

Figure 19

Nonperforming C&I* Loans/C&I Loans

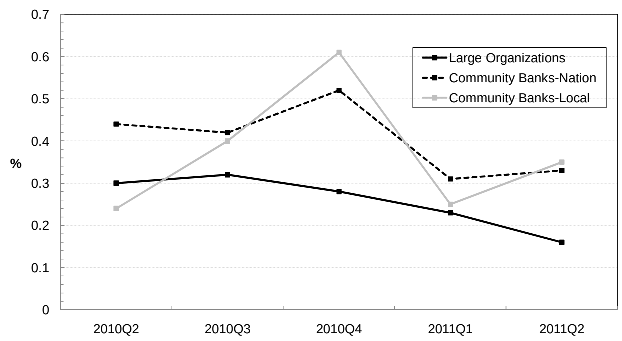


*Commercial and Industrial

[12] See http://www.federalreserve.gov/boarddocs/SnLoanSurvey/201108/default.htm for further information.

Figure 20

Net Charge-offs on C&I* Loans/Avg C&I Loans



*Commercial and Industrial

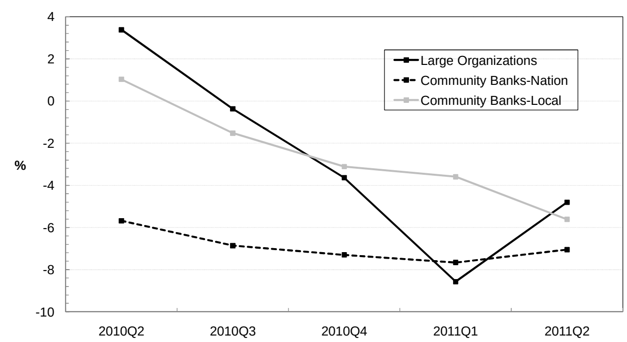
Consumer Lending[13]

After several years of declines, consumer lending is beginning to show signs of life, at least at large organizations. Although consumer loans have still decreased at these institutions from the second quarter of last year, they have shown the first sign of improvement in over a year (Figure 21). This was led by a nearly 22 percent (annualized) increase in credit card loans, but the Senior Loan Officer Opinion Survey found that banks had also eased terms on auto lending.[14]

Consumer lending at community banks has dropped both locally and nationally from a year ago (Figure 21). Much of this can be attributed to the difference in the composition of consumer loan portfolios between community banks and large organizations. Credit card lending at large organizations makes up 22.5 percent of consumer loans. At community banks, credit cards represent 2.9 percent of consumer loans nationally and 2.1 percent locally. As mentioned above, the increase in consumer lending at large organizations was mainly due to credit card lending; changes in credit card lending at community banks wouldn't have much of an impact on their overall lending.

Figure 21

Year-Over-Year Growth in Consumer Loans



*Commercial real estate

Provisioning and Reserves[15]

Banks continued to cut back on their provisioning and reserves in the second quarter.[16] Loan-loss reserves decreased in the second quarter at both large organizations and community banks due to decreases in provisioning and continued relatively high charge-offs. With the exception of community banks nationally, loan-loss provisions decreased in the second quarter, both overall and as a percentage of operating income.[17] Over the year, the ratio of loan-loss provision to operating income fell 815 basis points, to 11.03 percent, at large organizations; decreased by 1,079 basis points, to 12.75 percent, at community banks nationally; and fell 304 basis points, to 9.85 percent, at local community banks (Figure 22).

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13 See Table 4 in the Appendix for a full summary of the data used in this section.

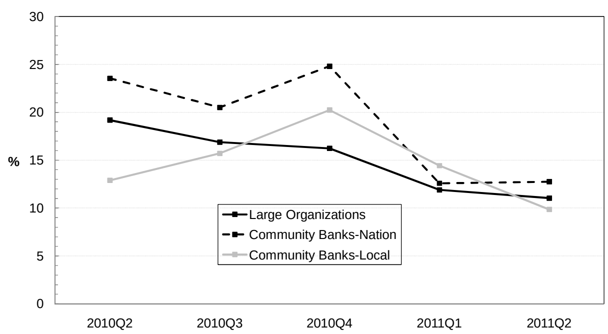
14 The FFIEC call reports began itemizing auto lending as a separate category of consumer loans in the first quarter of 2011, but there is currently insufficient data for a meaningful interpretation of whether this type of lending is increasing or decreasing.

15 See Table 5 in the Appendix for a full summary of the data used in this section.

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

17 Operating income is defined as the sum of net interest income and noninterest income.

Figure 22
Loan-Loss Provision/Operating Income



One possible reason for banks' feeling comfortable about cutting back on their provisioning is that additions to nonaccruing loans have been falling for at least a year. New nonaccruals at large organizations were $28.8 billion in the second quarter, down from $30.6 billion in the first quarter and $42.3 billion last year. At community banks, new nonaccruals were $8.0 billion in the second quarter, $8.3 billion in the first quarter, and $11.2 billion in the second quarter of 2010. Locally, these numbers were $319.2 million, $366.9 million, and $398.3 million. This decrease in nonaccruals combined with the increase in recoveries discussed above and declining NPLs may have led banks to expect that their charge-offs will decline in the future.

A question remains, though, as to whether banks have cut back on provisioning too far too soon. The ratio of NCOs to loan-loss provision exceeded 100 percent at all categories of banks in the second quarter (Figure 23). In the case of community banks, this ratio has been climbing for nearly a year.

Despite the decreases in reserves, declining NPLs imply that banks in all categories may actually be in a better position to cover their future losses.[18] The loan-loss coverage ratio increased at large organizations and community banks nationally and was basically flat at local community banks (Figure 24).[19] Loan loss coverage increased 103 basis points at large organizations, to 56.91 percent. At community banks nationally, the increase was 40 basis points, to 57.24 percent, and locally the ratio increased 10 basis points, to 54.58 percent. Note that in all cases, the banks were sufficiently reserved to be able to charge off only slightly 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 may not be necessary.

Figure 23
Net Charge-offs/Loan-Loss Provision

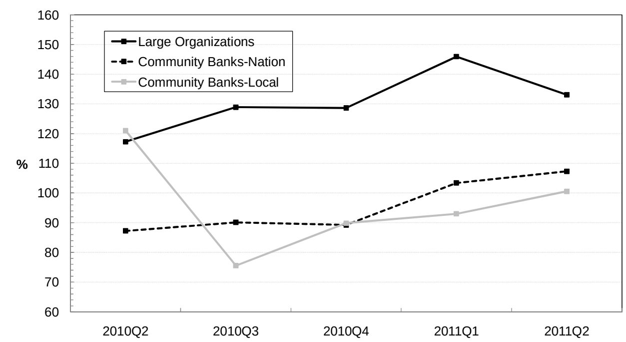
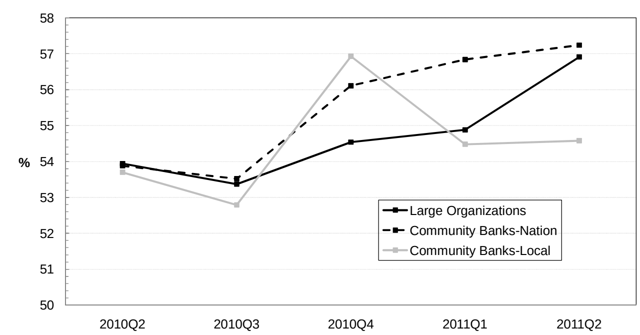


Figure 24
Loan-Loss Coverage Ratio



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[18] See earlier discussion on Figure 4.

[19] 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 2000 and 2010 was 89.2 percent. At the bottom of the last real estate cycle in 1991, this ratio stood at 72.6 percent. Source: FDIC Historical Statistics on Banking, http://www2.fdic.gov/hsob/index.asp.

Securities[20]

The market value of the securities at community banks increased both locally and nationally in the second quarter, and it fell slightly at large organizations.[21] At large organizations, there were modest gains in the value of their mortgage-backed securities (MBS), foreign securities, securities of state and local governments (munis), and securities of U.S. agencies, but these were more than offset by decreases in Treasuries, securities of government-sponsored agencies (GSEs such as Fannie Mae and Freddie Mac), and asset-backed securities (ABS). The large organizations also posted a realized gain of about $235 million.[22]

At community banks both nationally and locally, U.S. agency securities, munis, and MBS showed a respectable increase in market value, and Treasuries and GSE securities decreased in value. Community banks nationally reported a realized gain of $275.3 million on securities in the first quarter, and local community banks reported a realized gain of $14.9 million on their securities.

Funding Sources[23]

Deposits at large organizations rose, and those at community banks both locally and nationally were basically flat. Also, while large organizations continued to shed nondeposit funding, community banks both locally and nationally increased their nondeposit funding in the quarter.[24] Nondeposit funding at these institutions is still down substantially over the second quarter of 2010, so whether this increase in nondeposit funding in the second quarter is an aberration or an indication that community banks are having difficulties attracting deposits is not yet known. If the latter is true, it could have detrimental effects on their profitability as nondeposit funds are substantially more expensive than deposits. A worrisome development for both the community banks and the large organizations was that core deposits basically were flat.[25] Banks depend on core deposits as their most stable and inexpensive source of funding.

Demand deposits and other transaction accounts grew substantially at large organizations, experienced modest growth at community banks nationally, and shrank slightly at local community banks. Time deposits shrank somewhat at community banks both locally and nationally and grew substantially at large organizations. At community banks, there was a decline in less stable sources of funding, including decreases in brokered deposits, but at large organizations, brokered deposits increased substantially.

In terms of nondeposit funding, community banks both locally and nationally increased their holdings, but in different ways. Nationally, the main increase was in Federal Home Loan Bank (FHLB) advances. Locally, FHLB advances were flat, while fed funds and repos increased substantially.

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[20] See Table 6 in the Appendix for a full summary of the data used in this section.

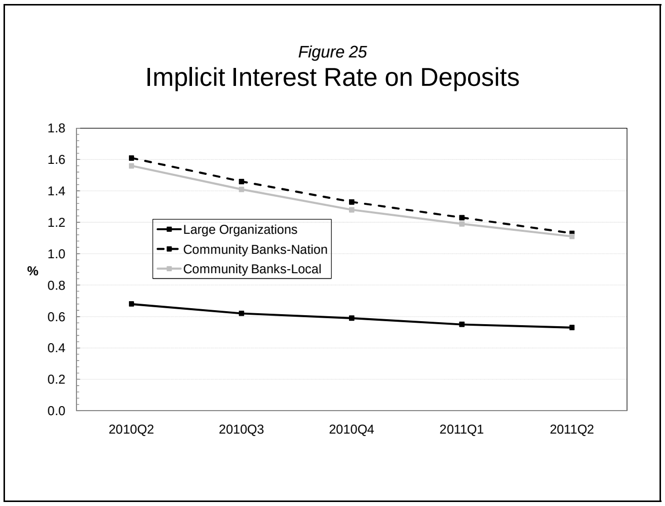
[21] The figure for percent of assets uses the value of securities as reported on the banks' balance sheets. Securities there are reported at book value if they are held to maturity and market value if they are available for sale. Changes in market value can either be indicative of increases in the value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

[22] 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.

[23] See Table 7 in the Appendix for a full summary of the data used in this section.

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

[25] 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.



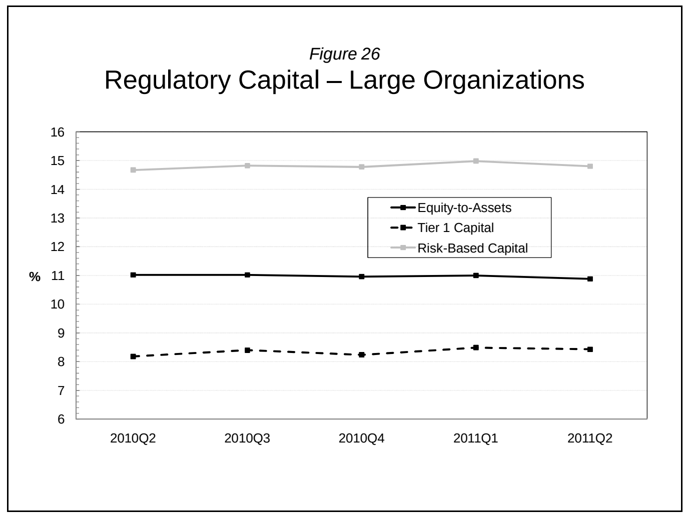
Large organizations continue to have a funding advantage over community banks both in terms of deposits and nondeposit funding. The implicit interest rate on deposits continued to fall at all categories of banks, but large organizations pay only a fraction of what community banks both nationally and locally pay (Figure 25).[26] This holds true for nondeposit funding as well.

Regulatory Capital[27]

Overall, of the 99 large organizations in the sample, all of them had equity-to-assets ratios of at least 6 percent, unchanged from the first quarter, and all but two had equity-to-assets ratios of over 7 percent, an increase of two from last quarter.[28] At community banks, nationally 96.2 percent of the institutions had equity-to-assets ratios of at least 6 percent, and 94.4 percent had ratios of at least 7 percent. Locally, 97.8 percent of the institutions had a capital ratio of at least 6 percent and 95.1 percent had a ratio of at least 7 percent.

Year over year, the equity-to-assets ratio decreased 14 basis points, the Tier 1 leverage ratio increased 25 basis points, and the risk-based capital ratio increased 13 basis points.[29] Capital ratios at large banks have been fluctuating over the past several quarters. All of the capital ratios at large organizations decreased in the quarter, mainly due to increases in assets rather than decreases in capital (Figure 26).

Community banks have continued to increase their capitalization. At banks nationally, the equity-to-assets ratio has increased 39 basis points since last year; the Tier 1 capital ratio has increased 40 basis points since last year; and the risk-based capital ratio has increased 102 basis points since last year (Figure 27). At local banks, the equity-to-assets ratio has increased 34 points since last year; the Tier 1 leverage ratio has increased 32 basis points since last year; and the risk-based capital ratio has increased 83 basis points for the year (Figure 28). All of these ratios both locally and nationally showed quarterly increases as well.



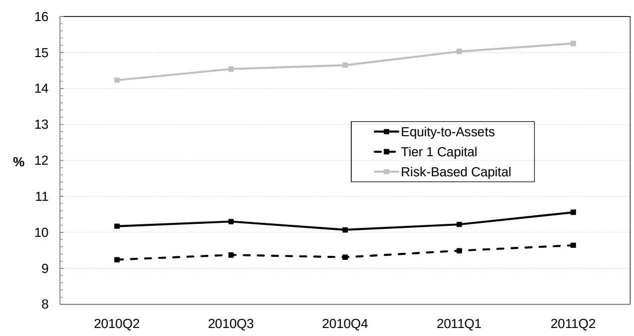
[26] The implicit interest is computed by dividing the annualized interest paid by the average total balance.

[27] See Table 8 in the Appendix for a full summary of the data used in this section.

[28] 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.

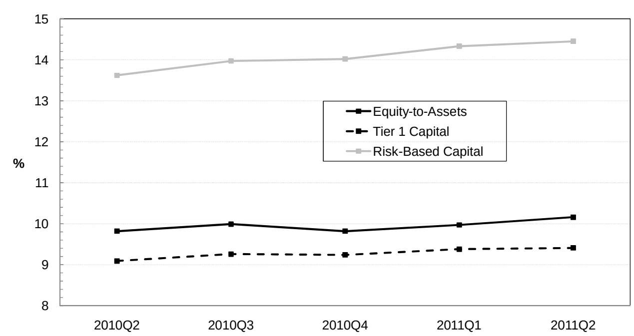
[29] Tier 1 leverage and risk-based capital are the two main ratios regulators use to determine if a bank is adequately capitalized. For further information, see the call report instructions at http://www.ffiec.gov/forms031.htm.

Figure 27
Regulatory Capital – All Community Banks



The primary drivers of these capital increases at community banks were additional retained earnings and surplus. Also, large organizations and community banks had relatively large unrealized gains on available-for-sale securities. Large organizations and community banks nationally also increased their dividends, while local community banks continued to cut theirs. At large organizations the dividend payout ratio increased

Figure 28
Regulatory Capital – Local Community Banks



nearly 20 percentage points, to 72 percent; at community banks nationally, the ratio increased 2.7 percentage points, to 48.9 percent; and at community banks locally, the ratio decreased nearly 20 percentage points, to 57.3 percent.[30]

Small Business Lending[31]

Given the changes in reporting rules cited above, any comparison of the 2011 and 2010 lending numbers would be speculation at best. However, much of the data is consistent with the Senior Loan Officer Opinion Survey findings summarized above in the "Commercial and Industrial Lending" section, with larger loans, i.e., those more likely to go to larger firms, experiencing less of a decrease in both number and amount than smaller loans. It should also be noted that the "C&I Loans" category of loans under $100,000 includes company credit cards, thus the reason for the large number of loans.

[30] The dividend payout ratio is the ratio of dividends on common stock to net income.

[31] See Table 9 in the Appendix for a full summary of the data used in this section.

Appendix – Data Tables for Each Section

Table 1 -Summary of Residential Real Estate Lending

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
1. Year–over–year growth			
Total RRE loans	-2.6%	1.8%	2.8%
RRE NPLs	-7.2%	16.7%	3.5%
RRE NCOs	-25.5%	3.1%	-5.2%
2. Shares			
RRE Lns/Total Lns	35.7%	32.2%	25.8%
RRE NPLs/Total NPLs	65.0%	21.0%	18.9%
RRE NCOs/Total NCOs	48.9%	14.7%	19.8%
3. Performance Ratios			
RRE NPLs/Total RRE Lns	8.95%	2.00%	2.60%
RRE NCOs/Avg. RRE Lns	0.45%	0.08%	0.18%
4. Outstandings ($millions)			
Total RRE Lns	1,652,373.2	21,082.0	304,375.5
RRE NPLs	147,856.6	422.3	7,914.4
RRE NCOs	7,589.9	16.2	557.9

Table 2 - Summary of Commercial Real Estate Lending

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
1. Year–over–year growth			
Total RRE loans	-10.5%	0.1%	-4.6%
RRE NPLs	-30.3%	-3.5%	-11.8%
RRE NCOs	-47.0%	-51.2%	-34.7%
2. Shares			
RRE Lns/Total Lns	17.3%	46.4%	45.1%
RRE NPLs/Total NPLs	22.3%	65.8%	66.5%
RRE NCOs/Total NCOs	19.4%	55.5%	57.0%
3. Performance Ratios			
RRE NPLs/Total RRE Lns	6.34%	4.36%	5.23%
RRE NCOs/Avg. RRE Lns	0.36%	0.20%	0.29%
4. Outstandings ($millions)			
Total RRE Lns	799,578.4	30,358.0	532,492.9
RRE NPLs	50,693.0	1,323.1	27,854.7
RRE NCOs	3,020.6	61.1	1,604.0

Table 3 - Summary of Commercial & Industrial Lending

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
1. Year –over –year growth			
Total RRE loans	8.1%	-0.6%	-0.9%
RRE NPLs	-44.7%	2.9%	-6.8%
RRE NCOs	-49.5%	45.7%	-25.7%
2. Shares			
RRE Lns/Total Lns	20.0%	13.4%	15.1%
RRE NPLs/Total NPLs	6.0%	10.6%	9.9%
RRE NCOs/Total NCOs	9.1%	27.6%	21.1%
3. Performance Ratios			
RRE NPLs/Total RRE Lns	1.48%	2.43%	2.32%
RRE NCOs/Avg. RRE Lns	0.16%	0.35%	0.33%
4. Outstandings ($millions)			
Total RRE Lns	925,715.2	8,765.8	178,267.0
RRE NPLs	13,743.9	213.4	4,131.5
RRE NCOs	1,410.3	30.4	594.0

Table 4 - Summary of Consumer Lending

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
1. Year–over–year growth			
Total RRE loans	-4.8%	-5.6%	-7.1%
RRE NPLs	-18.9%	-1.4%	-5.6%
RRE NCOs	-36.6%	-52.0%	-33.5%
2. Shares			
RRE Lns/Total Lns	12.8%	3.9%	4.5%
RRE NPLs/Total NPLs	3.7%	0.6%	0.9%
RRE NCOs/Total NCOs	19.5%	2.8%	3.3%
3. Performance Ratios			
RRE NPLs/Total RRE Lns	1.41%	0.51%	0.71%
RRE NCOs/Avg. RRE Lns	0.51%	0.12%	0.17%
4. Outstandings ($millions)			
Total RRE Lns	589,872.7	2,525.1	52,592.9
RRE NPLs	8,344.9	12.9	375.5
RRE NCOs	3,027.2	3.1	93.5

Table 5 - Provision for Loan Losses and Loan Loss Reserves

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Loan-loss Reserve ($Millions)	129,493.7	1,098.1	23,974.0
Change from Last Quarter	-12.6%	-2.8%	-6.1%
Change from Last Year	-13.7%	2.8%	-2.7%
Net Charge-Offs/LL Provision	133.1%	100.6%	107.3%
LL Provision/Operating Inc.	11.0%	9.9%	12.8%
Loan-loss Coverage Ratio	56.9%	54.6%	57.2%

Table 6 - Summary of Securities Portfolios

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Securities/Assets	20.2%	21.8%	22.0%
Market Value ($Millions)	1,932,006.7	21,517.2	408,679.2
Change from Last Quarter	-1.5%	6.1%	12.5%
Change from Last Year	7.2%	12.4%	15.3%
Realized Gain/Loss	235.0	14.9	275.3
Pct of Average Securities	0.01%	0.07%	0.07%
Market Value/Book Value	101.4%	101.3%	101.7%

Table 7 - Structure of Liabilities

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Deposits ($millions)	6,884,030.7	81,634.7	1,538,293.7
Pct. of Assets	72.0	83.1	82.8
Change from Last Quarter	13.4%	1.2%	1.0%
Change from Last Year	9.1%	4.4%	2.7%
Core Deposits/Deposits	38.0%	69.7%	68.1%
Implicit Rate on Deposits	0.53%	1.11%	1.13%
Nondeposit Debt ($millions)	1,040,645.6	5,583.7	108,651.2
Pct. of Assets	10.9	5.7	5.9
Change from Last Quarter	-13.9%	14.8%	6.3
Change from Last Year	-16.7%	-18.0%	-11.4%
Implicit Rate on Debt	1.69%	2.71%	2.48%

Table 8 - Capitalization Measures

	Large Organizations	Community Banks	
Ratios	Nation	Tri-State Area	Nation
Total Equity/Total Assets	10.88%	10.16%	10.56%
Change fr. Last Qtr. (basis pts)	-12	19	34
Change fr. Last Yr. (basis pts)	-14	34	39
Tier 1 Leverage Ratio	8.43%	9.41%	9.64%
Change fr. Last Qtr. (basis pts)	-6	3	15
Change fr. Last Yr. (basis pts)	25	32	40
Risk-Based Capital Ratio	14.80%	14.45%	15.25%
Change fr. Last Qtr. (basis pts)	-18	12	22
Change fr. Last Yr. (basis pts)	13	83	102

Table 9 - 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	104,799	535,291.5	12,981	23,556.7	324,420	391,647.9
Change from 2010	-14,472	-17,278.2	-690	746.3	-87,094	-1,357.4
$100,000-250,000	152,264	20,274.4	13,011	1,657.7	226,939	29,612.4
Change from 2010	-15,637	-1,687.6	25	-55.9	2,401	-961.2
$250,000-1 million	251,564	102,800.9	17,724	7,422.0	282,868	117,490.0
Change from 2010	-10,612	-6,442	857	465.3	-5,424	-3,313
C&I Loans						
<$100,000	4,269,520	65,067.6	45,332	1,195.2	1,219,142	29,558.9
Change from 2010	-177,384	3,358.7	-508	9.6	-83,406	-188.8
$100,000-250,000	214,133	21,306.4	9,585	937.4	215,261	21,172.4
Change from 2010	-18,369	-2,170.3	158	-34.8	-1,735	-1,387
$250,000-1 million	185,009	56,225.8	10,017	2,401.8	166,070	48,135.8
Change from 2010	-7,920	-2,123.3	965	120.7	-5,682	-2,463.1

* Year-to-year comparisons may not be valid this year due to a reporting rule change for banks' small business lending. Previously, a loan was reported if it was originated in the period between June 30 of the previous year and June 30 of the current year. Staring from 2011, banks are required to report loans that are outstanding as of June 30 of the current year. As a result, loans originated after June 30, 2010 and paid off before June 30, 2011 are not included in the reported number. Conversely, loans originated before June 30, 2010 and still outstanding will be counted. This applies to both the number of loans made and the amount outstanding. As before, the "amount" column represents the outstanding balance on the loans rather than the original principal.