BANKING BRIEF
FOR PENNSYLVANIA, NEW JERSEY, AND DELAWARE

Fourth Quarter Highlights

- *Year over year, profitability (ROA) continued to improve at both large and community banking organizations.*
- *Year over year, loan growth was basically flat at community banks nationally, increased slightly at community banks locally, and increased somewhat more at large organizations. This growth at large banks can be attributed to increases in C&I lending.*
- *Outstanding principal of nonperforming residential real estate loans (RRE NPL) at large organizations and community banks in the nation declined slightly from a year ago, while it increased slightly at local banks. The RRE NPL ratio was basically flat at community banks and increased somewhat at large organizations.*
- *Year over year, total volume of nonperforming commercial real estate loans (CRE NPL) dropped substantially at community banks nationally and fell slightly at local community banks and large organizations, and the CRE NPL ratio fell at all categories of banks.*
- *Loan-loss coverage increased at community banks but decreased at large organizations. In both cases, it is well below historical norms and has been for several years.*
- *Relative to the fourth quarter of 2010, capitalization at community banks improved slightly, while capital ratios generally remained flat at large organizations.*

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Summary Table of Bank Structure and Conditions – Fourth Quarter 2011

	Community Banking Organizations						***Large Organizations***		
	Nation			***Tri-State***			***Nation***		
	$ Bill	**% Change From**		**$ Bill**	**% Change From**		**$ Bill**	**% Change From**	
	11Q4	**11Q3**	**10Q4**	**11Q4**	**11Q3**	**10Q4**	**11Q4**	**11Q3**	**10Q4**
Total Assets	1,894.1	3.84	3.50	99.5	7.54	5.33	9,899.6	1.71	5.61
Total Loans	1,181.9	1.54	-0.60	64.9	5.52	1.91	4,862.7	8.76	2.93
C&I	179.2	4.32	1.39	9.1	16.38	7.23	1,028.2	24.52	15.84
Real Estate	884.8	1.14	-1.13	50.5	2.17	-0.18	2,525.6	0.39	-3.45
Consumer	52.0	-2.65	-4.71	2.5	-2.88	-4.53	706.8	8.66	1.02
Total Deposits	1,567.8	3.92	3.31	82.6	6.32	5.41	7,206.3	7.91	9.55
Ratios (in %)	**11Q4**	**11Q3**	**10Q4**	**11Q4**	**11Q3**	**10Q4**	**11Q4**	**11Q3**	**10Q4**
Net Income/Avg Assets (ROA)	0.62	0.44	0.18	0.55	0.58	0.38	0.79	0.79	0.65
Net Interest Inc/Avg Assets (NIM)	3.48	3.46	3.41	3.34	3.35	3.35	2.70	2.72	2.86
Noninterest Inc/Avg Assets	0.92	0.92	0.91	1.18	1.20	1.20	1.82	1.89	1.92
Noninterest Exp/Avg Assets	3.07	3.10	3.08	3.23	3.21	3.28	2.96	2.96	2.90
Loans/Deposits	75.39	75.83	78.36	78.50	78.65	81.19	67.48	67.35	71.82
Equity/Assets	10.70	10.72	10.06	10.06	10.27	9.83	10.91	11.01	11.05
Nonperforming Loans/Total Loans	3.20	3.43	3.73	2.84	3.06	2.99	4.55	4.68	5.49

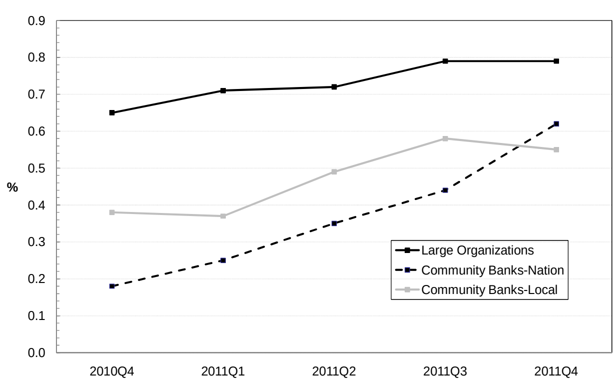
A banking organization is an independent bank or all the banks within a highest-level bank holding company; however, banks less than five years old and special purpose banks such as credit card banks are excluded. However, some numbers were skewed by Citigroup's third quarter reorganization involving the merger of its credit card operation (Citibank South Dakota) into its lead commercial bank subsidiary (Citibank N.A.). Thus, this credit card operation is included in the numbers for large banking organizations for the entire length of the sample, even though it was a credit card bank and would normally not be included. 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 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 — 182 for the tri-state area and 5,449 for the nation; (2) large banking organizations — 98 for the nation. Ratios are aggregates; that is, the numerators and denominators are summed across all banks in the group, then divided. Data are adjusted for mergers. Quarterly percentage changes are compound annualized rates.

Fourth Quarter 2011

Year-over-year profitability improved at all organizations (Figure 1).[1] Return on assets (ROA) at large organizations has increased 14 basis points, to 0.79 percent, since last year. At community banks nationally, ROA increased to 0.62 percent, a rise of 44 basis points from the fourth quarter of 2010. At local community banks, ROA has increased 17 basis points, to 0.55 percent, from a year ago.

Figure 1

Return on Average Assets



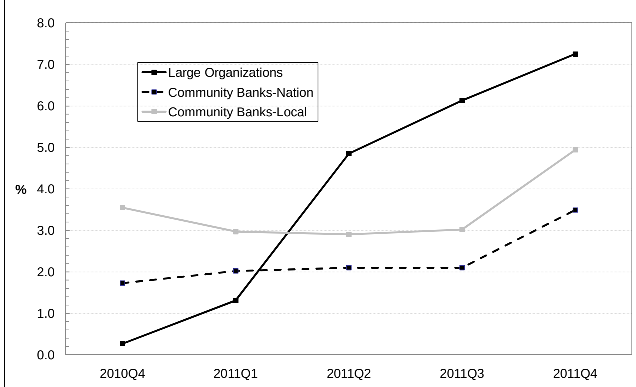
There are several reasons for the improved profitability. At large organizations, the increase can mainly be attributed to lower net charge-offs (NCOs), decreases in loan-loss provisioning, and generally improved loan and other asset quality (see Figures 4 and 5 below). The same can be said for community banks, and there are several other drivers as well. First, net interest margins have increased in the past year, nationally by 4 basis points and locally by 7. Second, community banks have seen increases in realized gains on securities. Realized gains on securities have increased 31 percent nationally and more than tripled locally from last year. Third, community banks both locally and nationally had large gains on sales of assets due to increasing loan sales and fewer losses on foreclosed real estate (other real estate owned – OREO).

While community banks seemed to show substantial improvement, signs of problems remain. Among community banks nationally, about 15 percent of banks continued to operate at a loss, and 14 percent of local community banks were also unprofitable.[2] The figures are somewhat better for large organizations.

Assets at large organizations grew quickly relative to community banks, both from the fourth quarter of 2010 and from the third quarter of 2011 (Figure 2). Leading this growth has been expansion in lending, particularly in commercial loans.

Figure 2

Year-Over-Year Asset Growth

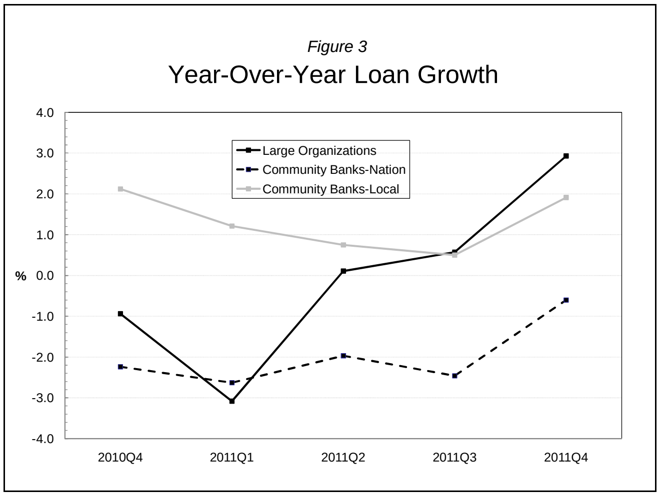


After several years of flat or negative growth, loans at large organizations have started to grow (Figure 3). Over the past year, total loans have grown at about 3 percent, and the quarterly change is even larger. Most of this growth in loans was from commercial loans. At community banks, lending shrank slightly in the nation and grew about 2 percent locally. In both cases, there was some growth in commercial loans but none at all in other

[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.

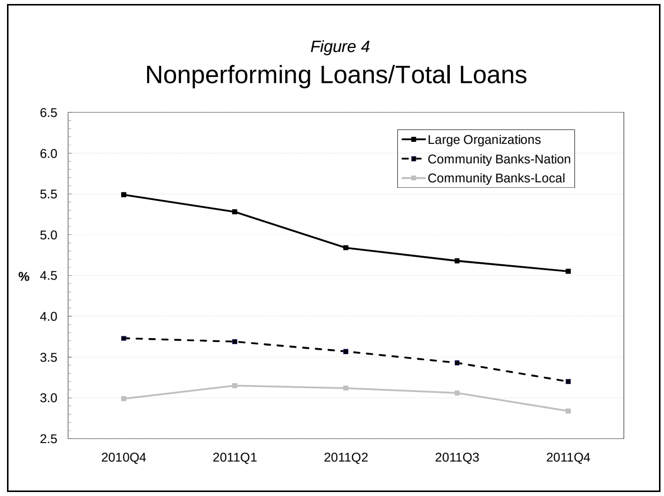
[2] Out of 5,449 community banks in the nation, 4,632 had positive profits in the fourth quarter. Locally, 156 out of a sample of 182 institutions reported positive profits. For the 98 institutions in the large organizations sample, 91 of them reported positive profits.

sectors. In all categories of banks, real estate lending was essentially flat or shrinking.

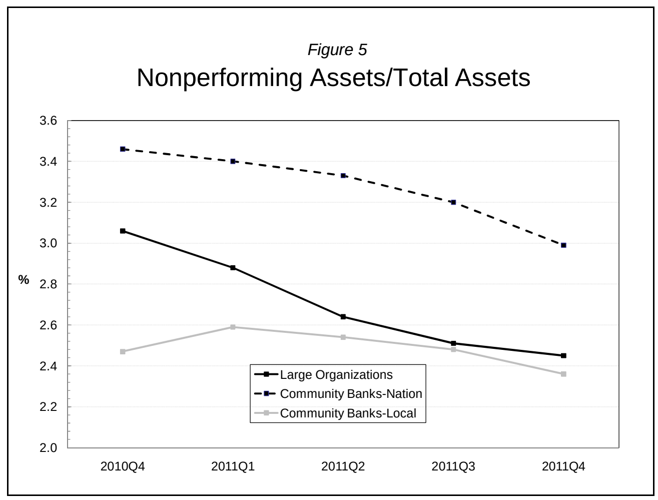


Loan quality at large organizations continued to improve with decreases in both nonperforming loans (NPLs) and NCOs.[3] The ratio of NPLs to total loans (the NPL ratio) decreased 94 basis points from last year, to 4.55 percent (Figure 4). The quarter-to-quarter decrease was 13 basis points. Total NPLs continued to decrease as well, by 14.6 percent from the fourth quarter of last year and 2.9 percent from the third quarter.

At community banks nationally, the NPL ratio has decreased 53 basis points since last year, to 3.20 percent. The change from the third to fourth quarter was a decrease of 23 basis points. Locally, the NPL ratio fell as well, by 15 basis points during the year and 22 basis points during the quarter, to 2.84 percent. Total NPLs at community banks have fallen 14.6 percent nationally but only 3.3 percent locally since the fourth quarter of 2010. From the



previous quarter, they fell substantially both nationally and locally, by 22.9 and 21.7 percent, respectively. For community banks both nationally and locally, the main problem area continued to be commercial real estate (CRE) lending.[4]



Although community banks seem to have better loan quality than large organizations, the picture on overall nonperforming assets (NPAs) looks different due to the performance of other real estate owned (OREO).[5] The ratio of NPAs to total

[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] 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] Loan quality refers to NPLs only, while asset quality refers to NPAs. These are the sum of NPLs and 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.

assets at large organizations has decreased 59 basis points since the fourth quarter of 2010, to 2.45 percent (Figure 5). Tri-state area community banks experienced a smaller drop in this ratio, from 2.52 percent last year to 2.37 percent in the fourth quarter of 2011. National community banks continued to have the highest NPA ratio at 3 percent; however, this ratio has fallen 48 basis points since last year. OREO continued to rise at local community banks, increasing 6.2 percent from last year and 19.1 percent during the fourth quarter, while at national community banks and large organizations, OREO fell substantially. OREO represents 1.0 percent of total assets at community banks nationally and 0.5 percent locally, but at large organizations, OREO represents only about 0.2 percent of assets.

Compared with a year ago, NCOs at large organizations and community banks in the nation are down substantially, both in total and as a ratio of average loans (NCO ratio – Figure 6). At large organizations, the NCO ratio has decreased 21 basis points, to 0.32 percent, since last year. At community banks nationally, the ratio decreased 11 basis points year over year, to 0.26 percent. Locally, the ratio decreased only 2 basis points, to 0.28 percent. Total NCOs have decreased substantially at large organizations and community banks nationally as well, in both cases over 30 percent, but have fallen only 5.1 percent at local community banks.

Figure 6
Quarterly Net Charge-Offs/Average Loans

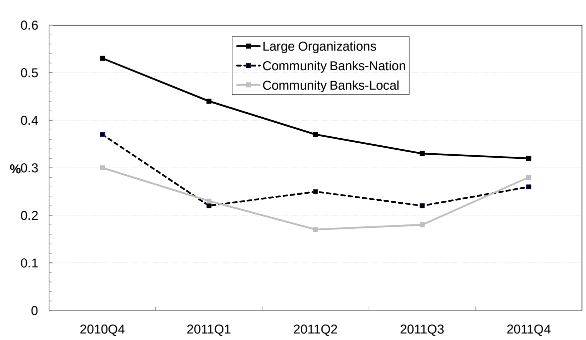
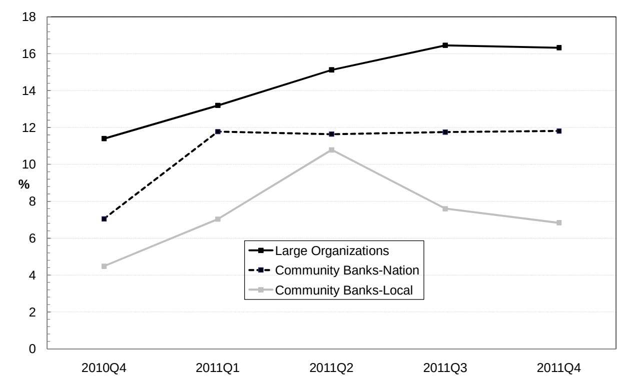


Figure 7
Recoveries/Charge-Offs

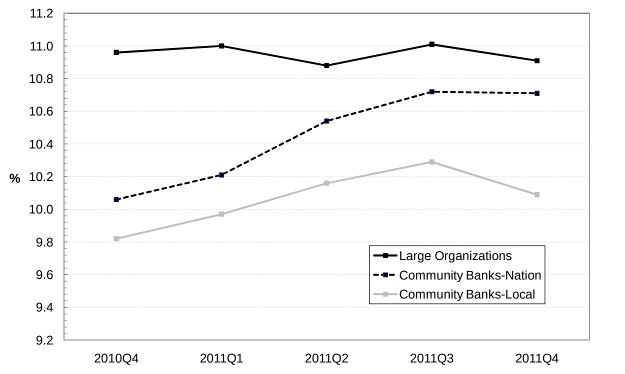


One reason for the drop in NCOs is that banks continued to recover more of the loans they had previously charged off. In the past year, the ratio of recoveries to charge-offs (the recovery ratio) increased 493 basis points at large organizations, to 16.33 percent (Figure 7). At community banks nationally, the recovery ratio rose 476 basis points, to 11.81 percent, and locally the increase was 235 basis points, to 6.83 percent. However, while the recovery ratio from the third to the fourth quarter was nearly flat at large organizations and rose slightly at national community banks, local community banks saw a 77-basis-point drop in this ratio. This follows a larger drop in the third quarter as well.

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 14 basis points from the fourth quarter of 2010 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.

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.

Figure 8
Equity-to-Assets Ratios

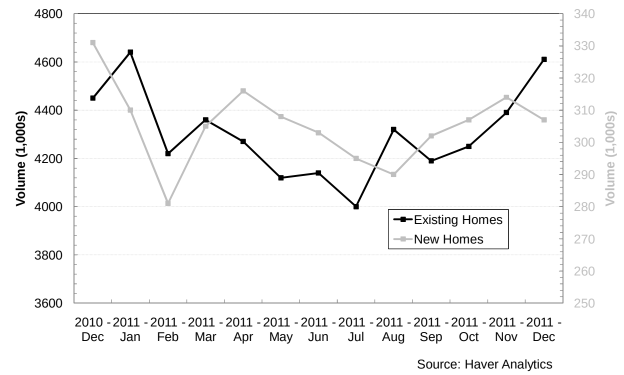


There continued to be a high level of bank failures in the nation in the fourth quarter leading into 2012. In the fourth quarter there were 18 bank failures, down from 26 in the third quarter.[6] Additionally, 12 banks have failed in the first quarter of 2012 as of the beginning of March, including one Pennsylvania bank. In 2011, there were 92 bank failures, an improvement on the total of 139 reported in 2010. Two institutions in the tri-state area failed in 2011, one in New Jersey and the other in Pennsylvania.

Residential Real Estate Lending[7]

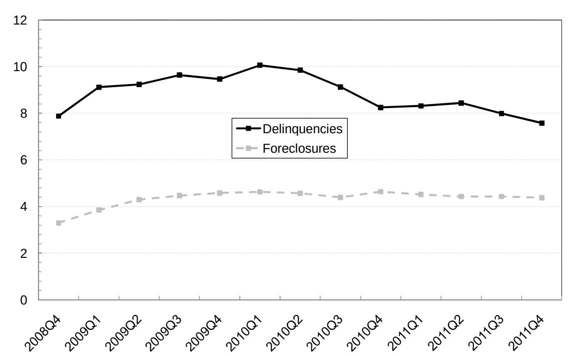
Overall, the residential real estate (RRE) market remained weak nationwide, but there are signs that this is changing. The Federal Reserve Board's *Beige Book* as of November 30 reported flat or decreasing prices and low sales activity in seven of the 12 Federal Reserve Districts.[8] However, the other five Districts, including Philadelphia, reported slightly increased activity. Sales of existing single-family homes increased in the fourth quarter, but they are still at about the same level as last year (Figure 9). Sales of new homes remained weak. The *Beige Book* did find increases in construction and sales of new multifamily units in several Districts, including Philadelphia. The percentage of delinquent mortgages decreased from both the third quarter of 2011 and the fourth quarter of 2010 (Figure 10). The *Beige Book* reported very little single-family home construction, however.

Figure 9
Sales of New and Existing Homes



Source: Haver Analytics

Figure 10
Delinquency and Foreclosure Rates



After improving for the previous several quarters, RRE loan quality at large organizations is little changed from last year and actually declined from the third to fourth quarter. At large organizations, the NPL ratio has decreased only 2 basis points since a year ago, and it increased 26 basis points in the fourth quarter, to 9.12 percent (Figure 11 – Note that there are different scales for

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

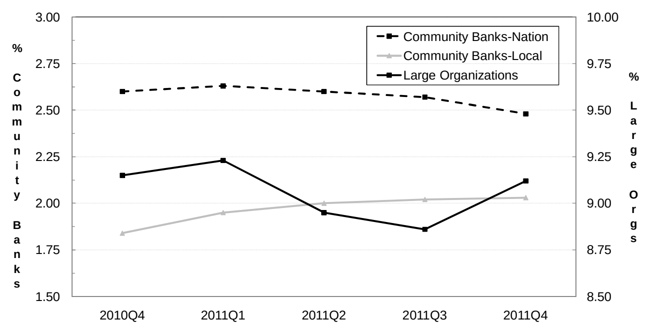
[7] See Table 1 in the Appendix for a full summary of the data used in this section.

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

community banks on the left y-axis and large organizations on the right y-axis). At community banks nationally, the situation is somewhat better. Over the past year nationally, the NPL ratio fell 11 basis points. It also fell 8 basis points in the fourth quarter. Local community banks have better RRE loan quality than either the large organizations or community banks nationally, but the quality of their portfolios is still declining. The RRE NPL ratio has increased 15 basis points in the past year, to 2.04 percent, stabilizing in the fourth quarter after increasing in every quarter of the past year.

Figure 11

Nonperforming RRE* Loans/Total RRE Loans



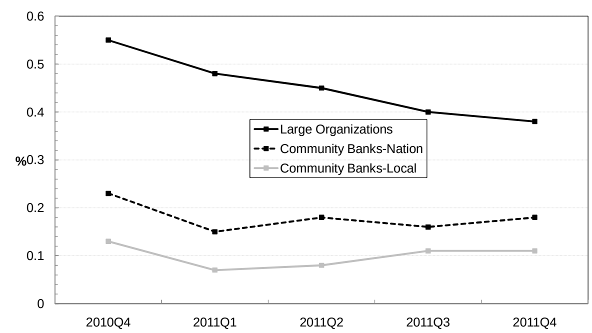
*Residential real estate

In terms of outstanding volume, RRE NPLs have decreased at large banks in the past year, but they increased in the fourth quarter for the first time in at least a year, in part because fewer RRE loans are being charged off (see below). At community banks nationally, NPLs have decreased somewhat in the past year and decreased by a somewhat larger amount during the quarter. Local community banks have seen RRE NPLs increase 8.1 percent in the past year, and they have grown in each of the last four quarters.

NCOs on RRE loans continued to drop in the fourth quarter. At large organizations, NCOs decreased for the fourth consecutive quarter, and they have decreased by over 31 percent from a year ago. The RRE NCO ratio is down 17 basis points from one year ago, to 0.38 percent (Figure 12). Again, community banks' RRE loan problems are dwarfed by those of large organizations. Despite the recent decline in their loan quality, local community banks still had lower NCO ratios than community banks in the nation as a whole. As of the end of the fourth quarter of 2011, local community banks' NCO ratio is 0.11 percent, while that for community banks nationally is 0.18 percent.

Figure 12

Net Charge-Offs on RRE* Loans/Avg. RRE Loans



*Residential real estate

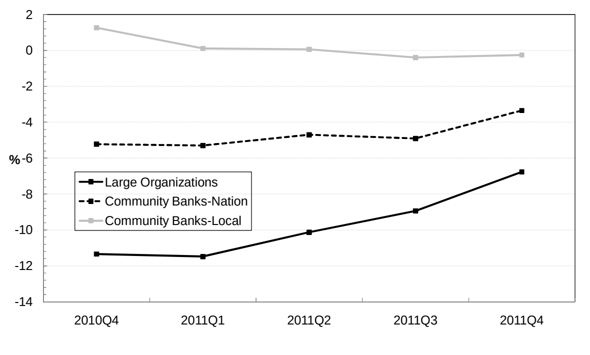
Commercial Real Estate Lending[9]

Year over year, overall commercial real estate (CRE) lending continued to decrease except at tri-state area community banks, where it was basically flat (Figure 13). Also, given the state of CRE markets in much of the country, this situation may not improve in the near future. The *Beige Book* reported CRE markets nationwide as either holding steady or slightly deteriorating, both in terms of rents and vacancy rates. For the most part, the Third District reported mixed results, with little or no new construction and weak demand for retail space and warehouses but somewhat stronger demand for high-end office space and for laboratories. CRE lending is especially important to community banks because CRE loans make up 44.2 percent of all loans at banks nationally and 45.3 percent at tri-state area banks. Thus, community banks' overall lending condition is highly dependent on their CRE portfolios.

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

Figure 13

Year-Over-Year CRE Loan Growth

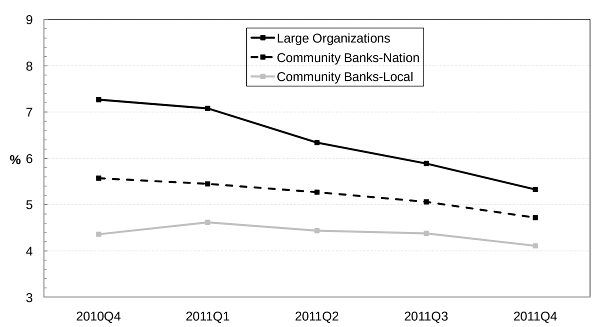


*Commercial real estate

The quality of CRE loans improved in the fourth 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 56 basis points in the fourth quarter, to 5.33 percent, and is down 192 basis points from one year ago (Figure 14). The CRE NPL ratio decreased 85 basis points

Figure 14

Nonperforming CRE* Loans/Total CRE Loans



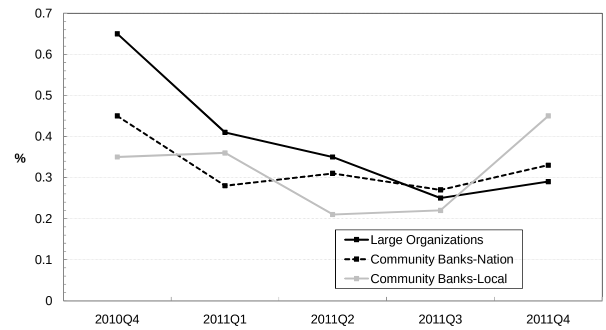
*Commercial Real Estate

at community banks nationally from last year, to 4.72 percent, and 25 basis points at community banks locally, to 4.11 percent. 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.

NCOs for CRE loans were also down from last year except in the tri-state area. Specifically, the CRE NCO ratio has decreased 36 basis points since last year at large organizations and 12 basis points at community banks nationally. However, this ratio rose 10 basis points at local community banks (Figure 15).

Figure 15

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

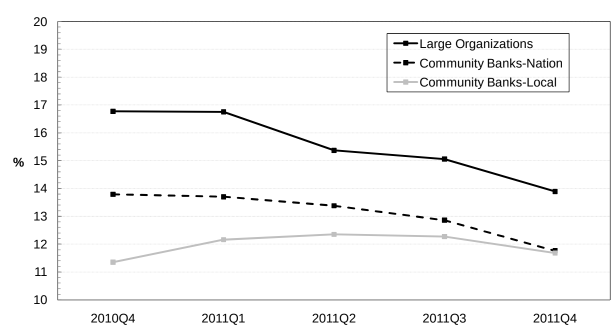


*Commercial real estate

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 17 percent of all CRE loans but make up nearly 45 percent of CRE NPLs and about 40 percent of NCOs. Construction loans outstanding at large organizations have decreased over 28 percent in the past year as bad loans made previously were charged off. The construction loan NPL ratio at these institutions dropped 285 basis points, to 13.87 percent, in the past year (Figure 16).

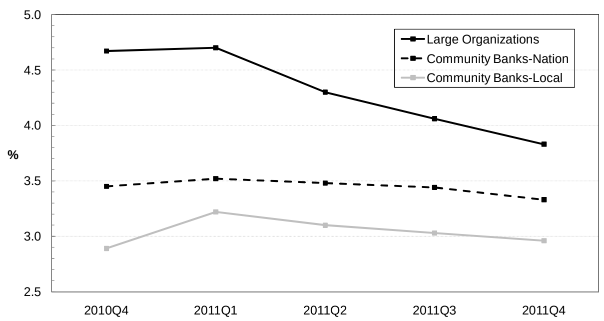
Figure 16

Nonperforming Construction Lns/Construction Lns



At community banks, the CRE loan quality problems are more concentrated in commercial mortgages. Commercial mortgages make up nearly three quarters of all CRE loans at community banks nationally and over 78 percent of CRE loans locally. Moreover, they are the largest single type of loan in these banks' portfolios. The NPL ratio on commercial mortgages has been falling for three consecutive quarters at both national and local community banks. It now stands at 3.33 percent nationally and 2.96 percent locally (Figure 17).

Figure 17
Nonperforming Commercial Mortgages/ Commercial Mortgages



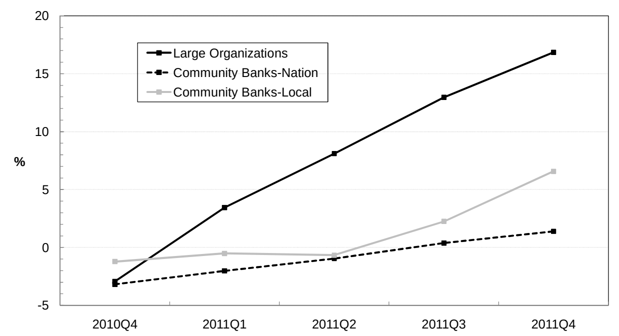
Commercial & Industrial Lending[10]

At large organizations, C&I lending is growing at a fairly healthy rate, increasing 15.8 percent over the past year and even faster in the fourth quarter (Figure 18). There has also been growth at community banks after a year of contraction or flat growth. This is especially true for local community banks where C&I loans grew 7.2 percent from last year. At community banks nationally, the rate was only 1.4 percent.

The main reason for the growth of C&I lending is increased demand. The Federal Reserve Board's *Senior Loan Officer Opinion Survey* for January 2012 reported that loan demand from large firms has been increasing for several quarters, and in the fourth quarter, many institutions reported increased demand from small firms as well. Most institutions had not loosened their standards for loans, but they had eased their pricing terms.[11] This bodes well for C&I lending at community banks whose customers are mainly smaller firms.

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

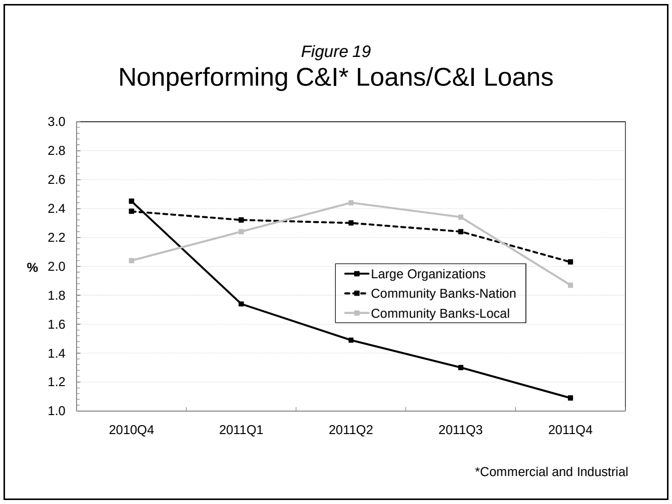


*Commercial and Industrial

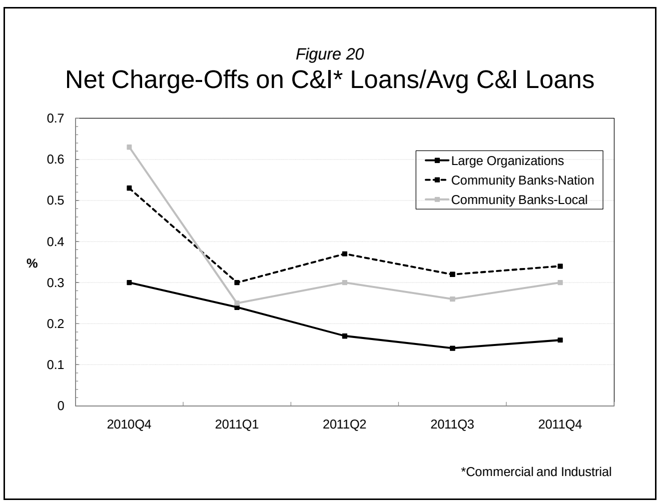
The C&I NPL ratio at both the large organizations and community banks has been falling, while lending has expanded for the past year (Figure 19). It now stands at 1.09 percent at the large organizations, a decrease of 136 basis points from last year and 20 basis points from the third quarter. At community banks nationally, the NPL ratio is 2.04 percent, a decrease of 34 basis points from last year and 20 basis points from the third quarter. Locally, the ratio is 1.87 percent, a decrease of 14 basis points in the year and 50 basis points in the quarter.

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

[11] An exception was branches of foreign banks, which tightened lending standards substantially. See http://www.federalreserve.gov/boarddocs/SnLoanSurvey/201108/default.htm for further information.



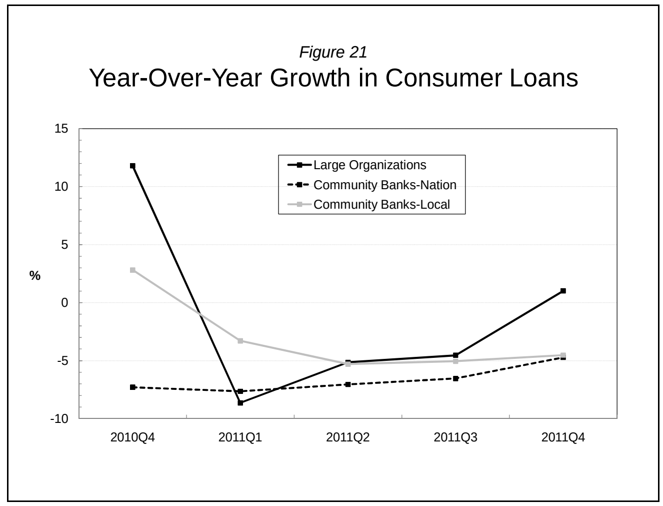
Likewise, the NCO ratio has also fallen significantly at all categories of banks (Figure 20). At large organizations, the C&I NCO ratio has fallen 12 basis points in the past year. At community banks it has fallen 19 basis points nationally and 32 basis points locally.



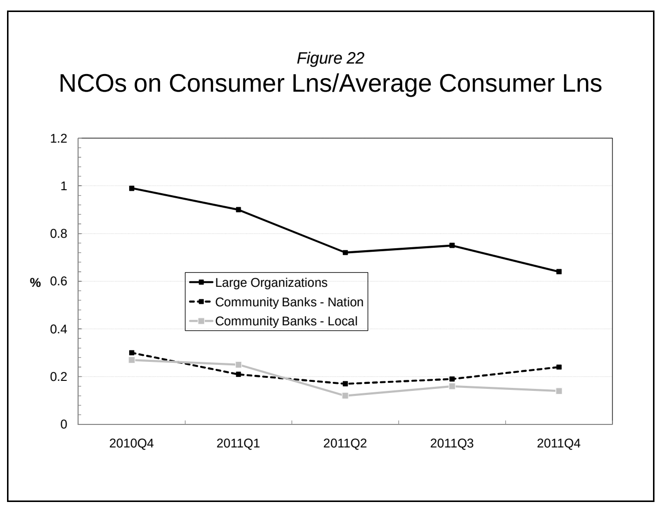
Consumer Lending[12]

Overall, consumer lending has been weak in the past year. At community banks, consumer lending has been shrinking for over a year (Figure 21). At large organizations, consumer lending is barely expanding after shrinking for the past year.

Consumer loans represent a smaller portion of all banks' portfolios than other types of loans, especially at community banks where it represents under 5 percent of all loans both locally and nationally. NPL ratios on consumer loans are very low, at 1.45 percent for large organizations, 0.73 percent for community banks nationally, and 0.55 percent for community banks locally. The main reason for the disparity is credit card lending. Credit cards represent about 3 percent of consumer loans at community banks but over a third at large organizations. Charge-offs of credit card loans are



usually greater than those on other types of loans in default, as they are seldom collateralized. Thus, at community banks the NCO ratio is relatively low, while at large organizations it is among the highest for any type of loan (Figure 22).

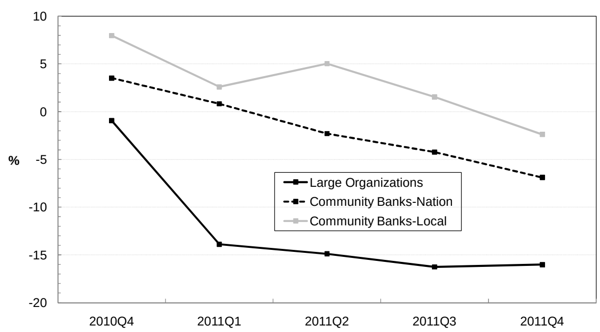


[12] See Table 4 in the Appendix for a full summary of the data used in this section.

Provisioning and Reserves[13]

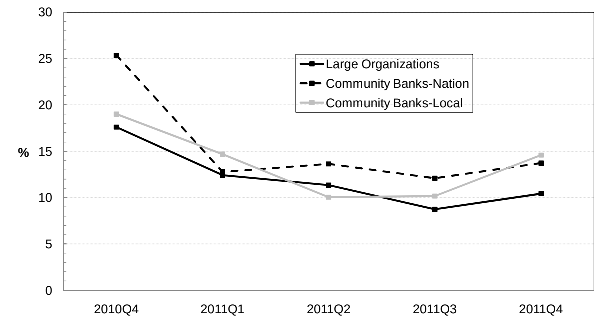
Reserves failed to keep pace with charge-offs in the fourth quarter, as all categories of banks continued to cut back on their provisioning.[14] At both large organizations and community banks, loan-loss reserves decreased from the third quarter and for the year as well, due to continued relatively high charge-offs (Figure 23).

Figure 23
Year-Over-Year Growth in Loan-Loss Reserves



In all categories of banks, loan-loss provisions are less than they were last year, both overall and as a percentage of operating income.[15] Over the year, the ratio of loan-loss provision to operating income fell 718 basis points, to 10.43 percent, at large organizations; decreased 1,173 basis points, to 13.72 percent, at community banks nationally; and fell 441 basis points, to 14.59 percent, at local community banks (Figure 24).

Figure 24
Loan-Loss Provision/Operating Income



It is possible that banks have been cutting their reserves because of falling NPLs and lower additions to nonaccruing loans. However, the ratio of NCOs to loan-loss provision exceeded 100 percent at all categories of banks in the fourth quarter (Figure 25).[16]

Even though NCOs are decreasing, declining loan-loss provisions might hamper large banks' willingness to recognize losses going forward. The loan-loss coverage ratio increased year over year at community banks nationally, but it was basically flat locally and decreased at large organizations (Figure 26).[17] Loan-loss coverage fell 100 basis points at large organizations, to 58.54 percent. It also fell in the quarter by 153 basis points. Loan-loss provisioning at large banks has fallen over 40 percent in the past year, in part due to a 25.5 percent

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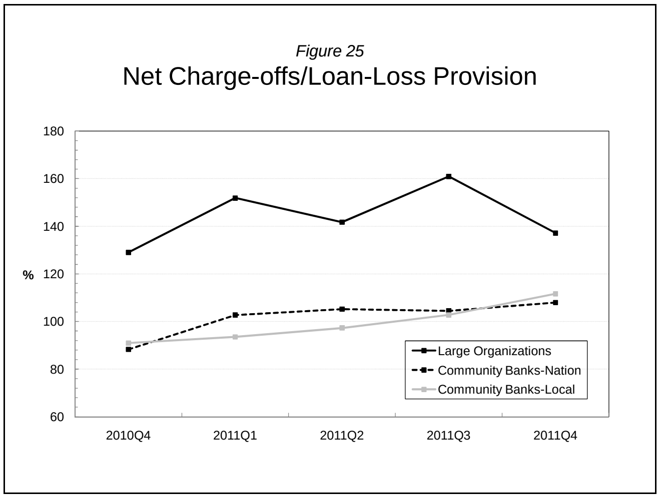
[13] See Table 5 in the Appendix for a full summary of the data used in this section.

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

[15] Operating income is defined as the sum of net interest income and noninterest income. For historical perspective, the aggregate ratio of loan-loss provision to operating income for all commercial banks between 2000 and 2010 was 15.8 percent. At the bottom of the last real estate cycle in 1991, this ratio was 18.9 percent. Source: FDIC Historical Statistics on Banking, http://www2.fdic.gov/hsob/index.asp.

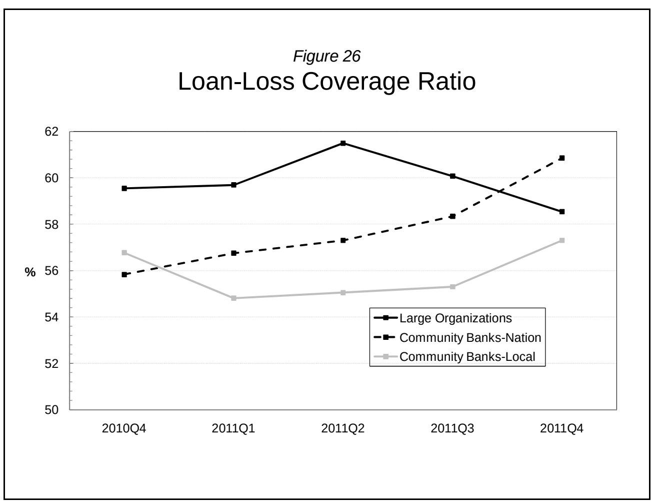
[16] For historical perspective, the aggregate ratio of NCOs to loan-loss provision for all commercial banks between 2000 and 2010 was 85.4 percent. At the bottom of the last real estate cycle in 1991, this ratio was 95.8 percent. Source: FDIC Historical Statistics on Banking, http://www2.fdic.gov/hsob/index.asp.

[17] 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.



drop in net additions to nonaccruing loans.[18] Thus, it appears that large banks expect that the quality of their loan portfolios will continue to improve, and therefore large additions to reserves may not be necessary.

At community banks nationally, the year-over-year increase was 499 basis points, to 60.84 percent, and locally the ratio was basically flat, rising 54 basis points to 57.31 percent. In both cases, the loan-loss coverage ratio increased from the third quarter.



Securities[19]

The market value of securities increased at all categories of banks in the fourth quarter, both from the third quarter and year over year.[20] Large organizations had 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. These gains were somewhat offset by decreases in Treasuries and securities of government-sponsored agencies (GSEs such as Fannie Mae and Freddie Mac). The large organizations also posted a realized gain of about $1.41 billion.[21]

At community banks both nationally and locally, U.S. agency securities, munis, MBS, and asset-backed securities (ABS) increased in market value, and Treasuries decreased in value. Community banks nationally reported a realized gain of $235.3 million on securities in the fourth quarter, and local community banks reported a realized gain of $15.9 million on their securities.

Funding Sources[22]

Deposits rose at all categories of banks, both over the year and from the previous quarter. This growth was faster at large organizations (Figure 27). Nondeposit funding continued to fall year over year at all categories of banks (Figure 28). However, from the third to the fourth quarter large

[18] Net nonaccruing loans are defined as additions to nonaccruing loans minus nonaccruing loans sold during the quarter.

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

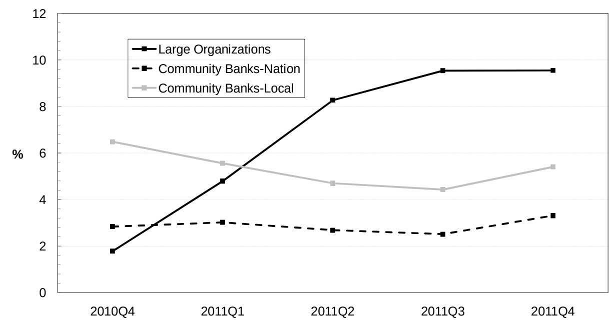
[20] The figure for percent of assets uses the value of securities as reported on the banks' balance sheets. Securities there are reported at book value if they are held to maturity and market value if they are available for sale. Changes in market value can either be indicative of increases in the value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

[21] 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.

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

organizations continued to shed nondeposit funding, while community banks both locally and nationally increased their nondeposit funding.[23]

Figure 27
Year-Over-Year Growth in Deposits



Combined with the slow deposit growth, this could be an indication of funding problems at community banks. In addition, core deposits basically fell slightly or were flat over the quarter (Figure 29).[24] Banks depend on core deposits as their most stable and inexpensive source of funding.

Figure 28
Year-Over-Year Growth in Nondeposit Funding

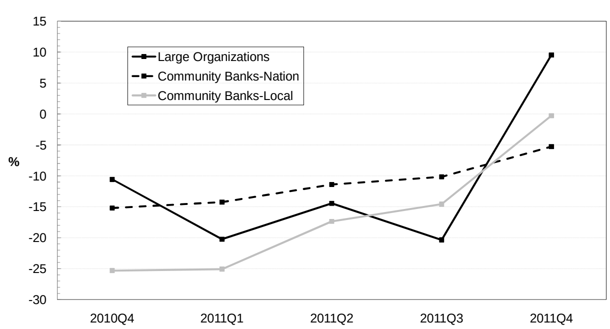
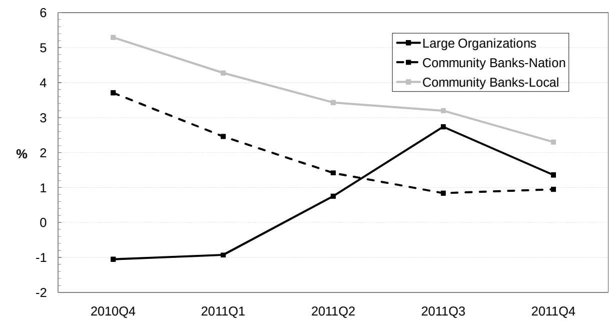
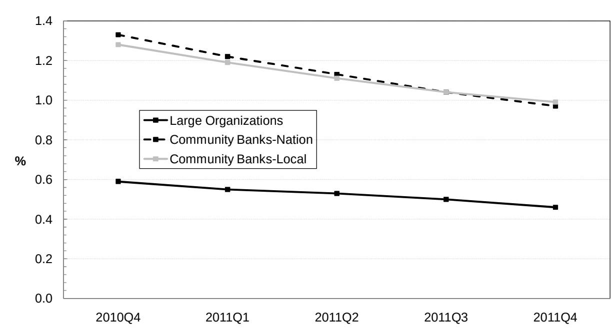


Figure 29
Year-Over-Year Growth in Core Deposits



Large organizations continue to have a funding advantage over community banks in terms of both 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 pay both nationally and locally (Figure 30).[25] This holds true for nondeposit funding as well.

Figure 30
Implicit Interest Rate on Deposits



[23] 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.

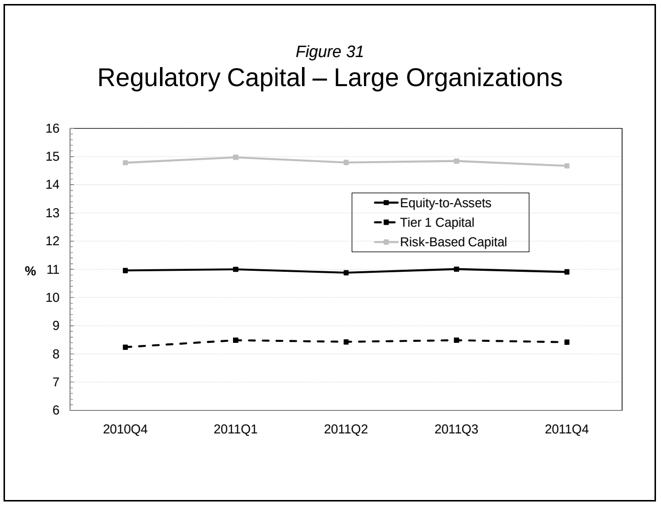
[24] Core deposits are defined as total domestic deposits less the sum of brokered deposits in denominations of less than $100,000 and all deposits in denominations greater than $100,000.

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

Regulatory Capital[26]

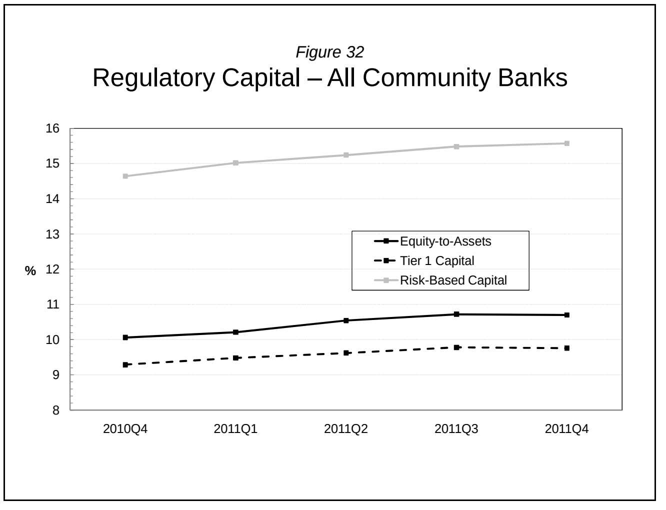
Overall, of the 98 large organizations in the sample, 97 of them had equity-to-assets ratios of at least 6 percent, and all but three had equity-to-assets ratios of over 7 percent.[27] At community banks nationally, 96.3 percent of the institutions had equity-to-assets ratios of at least 6 percent, and 94.8 percent had ratios of at least 7 percent. Locally, 96.7 percent of the institutions had a capital ratio of at least 6 percent and 94.5 percent had a ratio of at least 7 percent.

Year over year, the equity-to-assets ratio at large organizations decreased 14 basis points, the tier 1 leverage ratio increased 11 basis points, and the risk-based capital ratio decreased 13 basis points.[28]



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 31).

Community banks have increased their capitalization from last year, but it appears that increases in their capital ratios have leveled off. At banks nationally, the equity-to-assets ratio has increased 64 basis points since last year; the tier 1 capital ratio has increased 47 basis points since last year; and the risk-based capital ratio has increased 93 basis points since last year (Figure 32). At local banks, the equity-to-assets ratio has increased 23 points since last year; the tier 1 leverage ratio has increased 24 basis points since last year; and the risk-based capital ratio has increased 48 basis points for the year (Figure 33). However, both locally and nationally, all of these ratios were either flat or showed small quarterly decreases.



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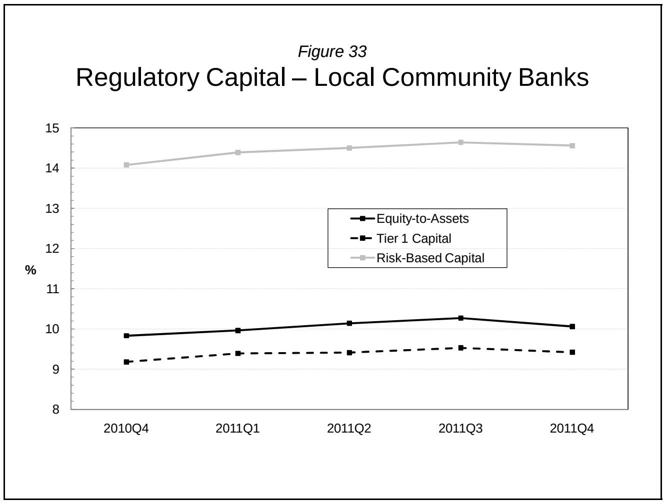
26 See Table 8 in the Appendix for a full summary of the data used in this section.

27 Regulation Y defines capital in terms of zones. Institutions in Zone 1 have tier 1capital-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 tier 1 capital are not identical, in most cases they are close proxies. For further information on capital guidelines, see http://www.federalreserve.gov/bankinforeg/reglisting.htm#Y.

28 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.



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.

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	-1.9%	-0.1%	2.2%
RRE NPLs	-2.3%	8.1%	-2.3%
RRE NCOs	-31.3%	-18.1%	-19.1%
2. Shares			
RRE Lns/Total Lns	34.4%	31.8%	26.4%
RRE NPLs/Total NPLs	68.9%	22.8%	20.6%
RRE NCOs/Total NCOs	42.0%	12.0%	18.3%
3. Performance Ratios			
RRE NPLs/Total RRE Lns	9.12%	2.04%	2.50%
RRE NCOs/Avg. RRE Lns	0.38%	0.11%	0.18%
4. Outstandings ($millions)			
Total RRE Lns	1,707,301.0	20,597.6	311,973.6
RRE NPLs	152,531.8	420.4	7,791.3
RRE NCOs	6,415.0	21.5	554.7

Table 2 - Summary of Commercial Real Estate Lending

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
1. Year–over–year growth			
Total CRE loans	-6.8%	-0.3%	-3.4%
CRE NPLs	-31.5%	-6.1%	-18.1%
CRE NCOs	-59.5%	29.0%	-30.4%
2. Shares			
CRE Lns/Total Lns	16.0%	45.3%	44.2%
CRE NPLs/Total NPLs	18.8%	65.5%	65.1%
CRE NCOs/Total NCOs	15.3%	72.7%	57.9%
3. Performance Ratios			
CRE NPLs/Total CRE Lns	5.33%	4.11%	4.72%
CRE NCOs/Avg. CRE Lns	0.29%	0.43%	0.33%
4. Outstandings ($millions)			
Total CRE Lns	779,263.5	29,361.5	522,450.4
CRE NPLs	41,551.6	1,205.6	24,646.9
CRE NCOs	2,328.8	130.6	1,753.0

Table 3 - Summary of Commercial & Industrial Lending

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
1. Year–over–year growth			
Total C&I loans	15.8%	7.2%	1.4%
C&I NPLs	-47.9%	-2.6%	-12.9%
C&I NCOs	-38.8%	-51.7%	-36.7%
2. Shares			
C&I Lns/Total Lns	21.2%	13.9%	15.2%
C&I NPLs/Total NPLs	5.1%	9.2%	9.7%
C&I NCOs/Total NCOs	10.0%	14.3%	19.7%
3. Performance Ratios			
C&I NPLs/Total C&I Lns	1.09%	1.87%	2.04%
C&I NCOs/Avg. C&I Lns	0.16%	0.29%	0.34%
4. Outstandings ($millions)			
Total C&I Lns	1,028,231.2	9,075.6	179,209.4
C&I NPLs	11,232.3	170.1	3,658.3
C&I NCOs	1,519.1	25.8	594.7

Table 4 - Summary of Consumer Lending

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
1. Year–over–year growth			
Total Consumer loans	21.2%	-4.6%	-4.7%
Consumer NPLs	10.1%	-20.4%	-8.3%
Consumer NCOs	5.4%	-43.1%	-25.5%
2. Shares			
Consumer Lns/Total Lns	14.5%	3.8%	4.4%
Consumer NPLs/Total NPLs	4.6%	0.7%	1.0%
Consumer NCOs/Total NCOs	29.0%	1.9%	4.2%
3. Performance Ratios			
Cons NPLs/Total Cons Lns	1.45%	0.55%	0.73%
Cons NCOs/Avg. Cons Lns	0.71%	0.14%	0.24%
4. Outstandings ($millions)			
Total Consumer Lns	706,791.1	2,507.2	51,952.5
Consumer NPLs	10,247.5	13.8	380.6
Consumer NCOs	4,439.0	3.5	128.3

Table 5 - Provision for Loan-Losses and Loan-Loss Reserves

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Loan-loss Reserve ($Millions)	129,589.3	1,055.0	23,037.5
Change from Last Quarter	-12.5%	-9.8%	-8.7%
Change from Last Year	-16.0%	-2.4%	-6.9%
Net Charge-Offs/LL Provision	137.1%	111.6%	108.0%
LL Provision/Operating Inc.	10.4%	14.6%	13.7%
Loan-loss Coverage Ratio	58.5%	57.3%	60.8%

Table 6 - Summary of Securities Portfolios

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Securities/Assets	20.7%	22.4%	22.7%
Market Value ($Millions)	2,047,805.1	22,316.0	431,012.1
Change from Last Quarter	9.5%	8.4%	18.9%
Change from Last Year	7.6%	12.3%	14.5%
Realized Gain/Loss	1,413.1	15.9	235.3
Pct of Average Securities	0.07%	0.07%	0.06%
Market Value/Book Value	101.7%	102.0%	102.2%

Table 7 - Structure of Liabilities

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Deposits ($millions)	7,206335.5	82,647.7	1,567,771.2
Pct. of Assets	72.8%	83.1%	82.8%
Change from Last Quarter	7.9%	6.3%	3.9%
Change from Last Year	9.6%	5.4%	3.3%
Core Deposits/Deposits	49.6%	81.1%	80.5%
Implicit Rate on Deposits	0.46%	0.99%	0.97%
Nondeposit Debt ($millions)	994,894.6	5,748.8	108,290.6
Pct. of Assets	10.1%	5.8%	5.7%
Change from Last Quarter	-17.2%	53.3%	5.3%
Change from Last Year	-15.7%	-0.3%	-5.3%
Implicit Rate on Debt	1.70%	2.61%	2.32%

Table 8 - Capitalization Measures

	Large Organizations	Community Banks	
Ratios	Nation	Tri-State Area	Nation
Total Equity/Total Assets	10.91%	10.06%	10.70%
Change fr. Last Qtr. (basis pts)	-10	-21	-2
Change fr. Last Yr. (basis pts)	-14	23	64
Tier 1 Leverage Ratio	8.42%	9.42%	9.76%
Change fr. Last Qtr. (basis pts)	-7	-11	-2
Change fr. Last Yr. (basis pts)	11	24	47
Risk-Based Capital Ratio	14.67	14.56%	15.57%
Change fr. Last Qtr. (basis pts)	-17	-8	9
Change fr. Last Yr. (basis pts)	-13	48	93