BANKING BRIEF

FOR PENNSYLVANIA, NEW JERSEY, AND DELAWARE

Second Quarter 2012 Highlights

- *Year over year, profitability (ROA) continued to improve at both large and community banking organizations.*

- *Year over year, loans grew at all categories of banks, mainly driven by commercial and industrial lending. Loan growth accelerated at community banks, particularly local banks, and it continued at large organizations as well. Loan quality improved at all categories of banks.*

- *Residential real estate (RRE) loans grew substantially at community banks nationally, less so at local community banks and large organizations. Nonperforming RRE loans grew at large organizations and shrank at community banks.*

- *Commercial real estate lending remained weak at all categories of banks, with sluggish growth. However, both nonperforming loans and net charge-offs dropped substantially at community banks and large organizations.*

- *Both loan-loss provisions and reserves fell. Loan-loss coverage increased at community banks but decreased at large organizations. In both cases, it has remained well below historical norms for several years.*

- *Over the year, capitalization at all banks improved. Overall, capitalization remains high compared with historical standards.*

- *The annual report on small business lending shows that commercial and industrial (C&I) loans with face value less than $100,000 increased significantly at large banks. Small business lending at community banks remained flat.*

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.

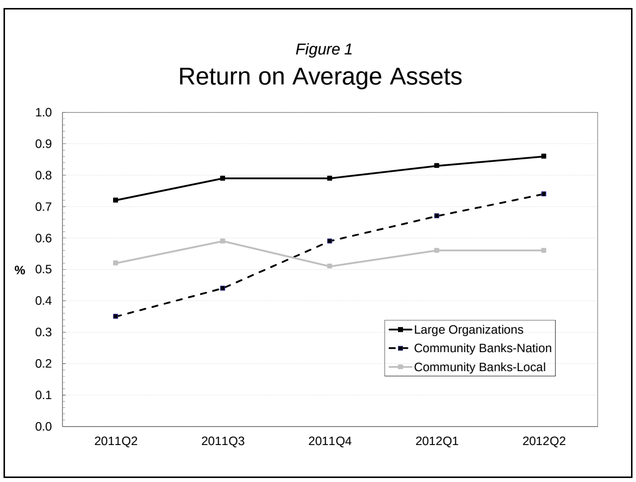
Summary Table of Bank Structure and Conditions – Second Quarter 2012

	Community Banking Organizations						Large Organizations			
	Nation			Tri-State				Nation		
	$ Bill	% Change From		$ Bill	% Change From			$ Bill	% Change From	
	12Q2	12Q1	11Q2	12Q2	12Q1	11Q2		12Q2	12Q1	11Q2
Total Assets	1,934.2	1.17	5.60	94.7	3.49	5.28	Total Assets	10,098.7	3.43	3.96
Total Loans	1,200.1	7.84	3.35	62.2	7.83	5.10	Total Loans	4,979.0	4.76	4.49
C&I	188.0	11.35	7.76	8.4	11.95	8.48	C&I	1,107.9	16.14	18.39
Real Estate	893.5	4.87	2.28	49.0	5.28	2.91	Real Estate	2,544.1	-2.27	0.07
Consumer	51.6	12.27	1.15	1.9	-0.90	-4.03	Consumer	698.8	0.36	0.04
Total Deposits	1,610.4	2.43	6.15	79.3	2.82	6.18	Total Deposits	7,322.5	1.48	6.03
Ratios (in %)	**12Q2**	**12Q1**	**11Q2**	**12Q2**	**12Q1**	**11Q2**	**Ratios (in %)**	**12Q2**	**12Q1**	**11Q2**
Net Income/Avg Assets (ROA)	0.74	0.67	0.35	0.56	0.56	0.52	Net Income/Avg Assets (ROA)	0.86	0.83	0.72
Net Interest Inc/Avg Assets (NIM)	3.48	3.49	3.45	3.32	3.34	3.36	Net Interest Inc/Avg Assets (NIM)	2.65	2.68	2.78
Noninterest Inc/Avg Assets	0.93	0.91	0.91	1.21	1.21	1.29	Noninterest Inc/Avg Assets	1.80	1.84	1.88
Noninterest Exp/Avg Assets	3.05	3.05	3.08	3.28	3.28	3.27	Noninterest Exp/Avg Assets	2.93	2.98	2.97
Loans/Deposits	74.52	73.57	76.54	78.44	77.51	79.24	Loans/Deposits	68.00	67.46	69.00
Equity/Assets	10.90	10.71	10.56	10.06	9.99	9.99	Equity/Assets	11.11	11.08	11.00
Nonperforming Loans/Total Loans	2.84	3.13	3.57	2.66	2.88	3.10	Nonperforming Loans/Total Loans	4.39	4.60	4.86

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 2011 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, 2011. 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 — 177 for the tri-state area and 5,408 for the nation; (2) large banking organizations — 100 for the nation. Ratios are aggregates; that is, the numerators and denominators are summed across all banks in the group, then divided. Data are adjusted for mergers. Quarterly percentage changes are compound annualized rates.

Second Quarter 2012

With the exception of tri-state area community banks, the industry as a whole continued to improve in the second quarter. Year-over-year profitability improved substantially at community banks nationally, somewhat at large organizations, and only slightly at local community banks (Figure 1).[1] Since last year, return on assets (ROA) at large organizations has increased 14 basis points, to 0.86 percent. At community banks nationally, ROA increased to 0.74 percent, a rise of 39 basis points from the second quarter of 2011. At local community banks, ROA has increased only 4 basis points, to 0.56 percent, from a year ago. The number of community banks nationally that reported losses rose slightly both nationally and locally in the second quarter, but overall, only a little over 10 percent of community banks nationally reported losses in the quarter, and 13.6 percent of local community banks were unprofitable.[2] For large organizations, all except five were profitable.



At large organizations, quarterly net income has increased over 23 percent since last year, or about $4 billion. This increase can be attributed primarily to the continued improvement in loan quality. Net charge-offs (NCOs) and nonperforming loans (NPLs) have both decreased substantially, thus enabling large organizations to cut back on their loan-loss provisions by $4.9 billion (see "Provisioning and Reserves" below).[3] In addition, realized gains on securities have increased $1.6 billion (see "Securities" below).

At community banks in the nation, quarterly net income has increased over 60 percent since last year, about $1.6 billion. Decreased loan-loss provisioning due to improved loan quality accounts for $1 billion of this increase in profits. Increased noninterest income accounts for about $600 million.[4] The increase in noninterest income was primarily due to asset sales, specifically loan sales and sales of other assets, while losses on the sale of foreclosed real estate decreased.

At local community banks, quarterly profits increased by $7.5 million, or about 4.8 percent. Unlike the other categories of banks, local community banks did not make substantial cuts to their loan-loss provisions. The major contributing factor to their increased profits was increased noninterest income. Noninterest income at local community banks increased $15.9 million, of which $14.4 million was due to asset sales.

Year over year, assets of community banks both locally and nationally grew at rates above 5 percent, while at large organizations asset growth was just under 4 percent (Figure 2). While the market value of securities increased at

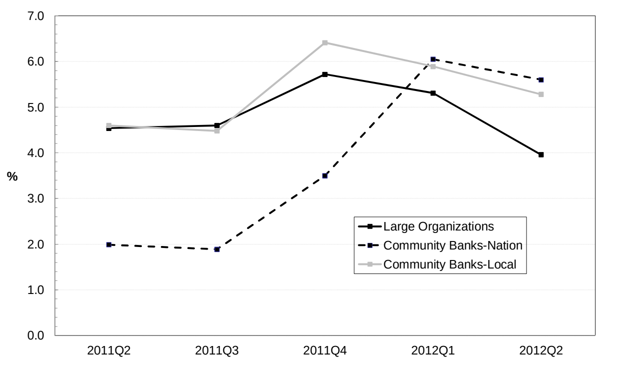
[1] See Summary Table of Bank Structure and Conditions on page 2.

[2] Out of 5,408 community banks in the national sample, 4,861 reported positive profits. This was a decrease of 14 from the first quarter of 2012. Locally, 153 out of 177 banks reported positive profits, a decrease of six from the first quarter of 2012. For large organizations, 95 out of 100 were profitable, a decrease of one bank.

[3] NPLs are defined as loans past due 90 or more days plus nonaccruing loans.

[4] Noninterest income includes all fee income, trading revenue, and gains or losses on asset sales, excluding securities sales.

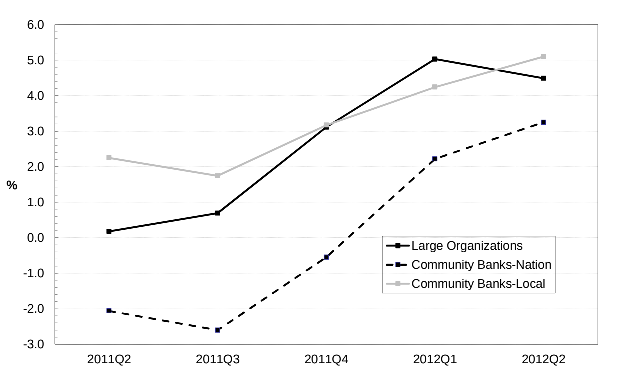
Figure 2
Year-Over-Year Asset Growth



double-digit rates at large banks and community banks nationally, with a less dramatic increase in securities at local community banks, much of the expansion can be attributed to loan growth, most notably commercial and industrial (C&I) lending.

Loan growth accelerated at community banks both locally and nationally, and loans at large organizations continued to grow as well (Figure 3). Over the past year, total loans at large organizations grew at about 4.5 percent. Most of this growth in loans was in commercial loans, whereas real estate lending and consumer loans stayed generally flat. At community banks, lending grew 3.4 percent in the nation

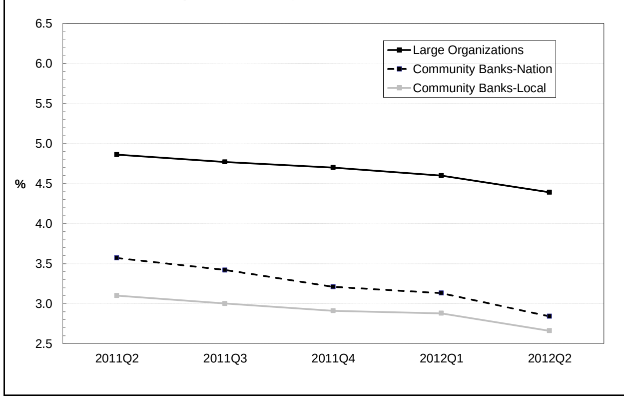
Figure 3
Year-Over-Year Loan Growth



and 5.1 percent locally. In both cases, the main area of growth was in commercial loans, with some growth in real estate loans as well.

Loan quality at large organizations continued to improve substantially over the year, with the ratio of NPLs to total loans (the NPL ratio) decreasing by 47 basis points, to 4.39 percent (Figure 4).[5] Total NPLs have decreased 5.7 percent since the second quarter of 2011, but they did show an annualized quarterly increase of 4.4 percent.

Figure 4
Nonperforming Loans/Total Loans



At community banks nationally, the NPL ratio has decreased 73 basis points since last year, to 2.84 percent. There was also a decrease of 29 basis points from the first quarter to the second quarter of 2012. Locally, the NPL ratio fell over the past year as well, by 44 basis points, to 2.66 percent. Over the quarter, the NPL ratio fell 12 basis points.

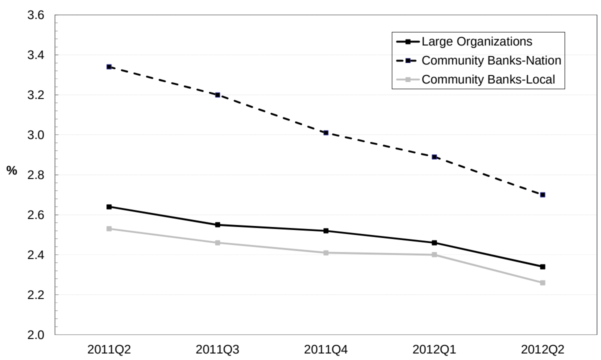
Overall, asset quality has also improved at all categories of banks.[6] Foreclosed real estate, known as other real estate owned (OREO), fell

[5] 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.

[6] Asset quality refers to nonperforming assets. These are defined as NPLs plus other real estate owned.

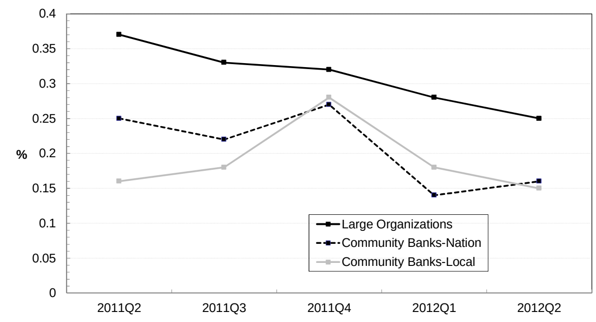
at large organizations and community banks nationally, by 25.4 and 7.1 percent, respectively, but rose 5.8 percent locally. The ratio of nonperforming assets (NPAs) to total assets has fallen at all three categories of banks in the past year (Figure 5).[7]

Figure 5
Nonperforming Assets/Total Assets



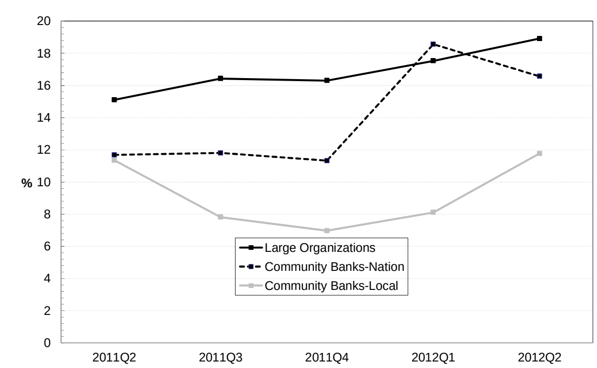
The ratio of NCOs to average loans (NCO ratio) fell over the year as well (Figure 6). At large organizations, the NCO ratio is now 0.25 percent, after declining by 12 basis points from the second quarter of 2011 and by 3 basis points over the quarter. It has, however, remained higher than that of community banks. For community banks in the nation, the NCO ratio fell 9 basis points over the year but rose 2 points in the last quarter, to 0.16 percent. At tri-state area community banks, the NCO ratio has been basically flat over the past year, falling just 1 basis point since a year ago and only 3 points since last quarter. The good news is that local community banks' NCO ratios have fallen for two consecutive quarters after rising for several quarters before that. For all categories of banks, the decrease in NCO ratios was driven by lower charge-offs, which more than offset declining recoveries.

Figure 6
Quarterly Net Charge-Offs/Average Loans



As a result of declining charge-offs, the ratio of recoveries to charge-offs (the recovery ratio) increased at all categories of banks. At large organizations, the recovery ratio increased 381 basis points, to 18.92 percent (Figure 7). At community banks nationally, the recovery ratio rose 489 basis points, to 16.57 percent, but it did decrease from the last quarter by 199 points. Locally, the recovery ratio increased 42 basis points from last year, to 11.78 percent.

Figure 7
Recoveries/Charge-Offs



Capital ratios, defined as the ratio of total equity to assets, rose at all categories of all banks from a year ago (Figure 8). Over the past

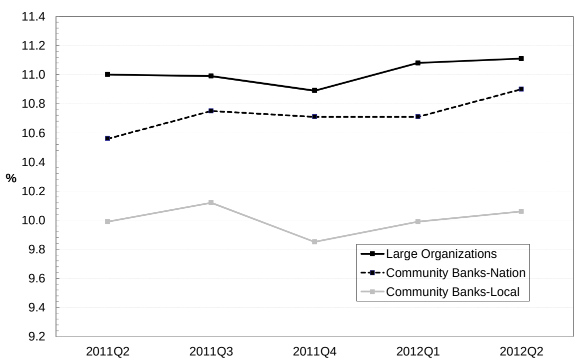
[7] Loan quality refers to NPLs only, while asset quality refers to NPAs. These are the sum of NPLs and OREO. For historical perspective, the average ratio of NPAs to total assets for all commercial banks between 2000 and 2010 was 1.43 percent. At the bottom of the last real estate cycle in 1991, this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

year, capital ratios appear to be more or less stable at large organizations, while they have increased modestly at community banks. Capital levels at local community banks remain significantly lower than those at both community banks in the nation and large banks.

The number of bank failures remained high relative to historical levels. In the second quarter of 2012, the Federal Deposit Insurance Corporation reported 15 bank failures, including one in New Jersey. This represents a decrease both from the first quarter of 2012, when there were 16 failures, and from the second quarter of 2011, when there were 22 failures.

Figure 8

Equity-to-Assets Ratios



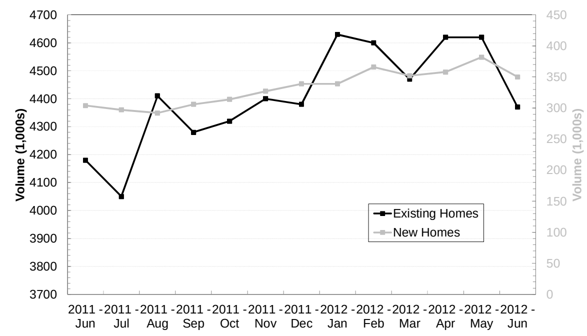
Additionally, nine other banks have failed so far in the third quarter (as of August 15, 2012). In all of 2011, there were 92 bank failures, including two in the tri-state area. In addition to the New Jersey institution mentioned above, two other local savings banks have already failed so far in 2012.

Residential Real Estate Lending[8]

The nationwide and local residential real estate (RRE) markets have been showing signs of improvement recently, although the data have been mixed. The Federal Reserve Board's *Beige Book*, as of July 18, reported that sales were improving in most Federal Reserve Districts.[9] However, locally, the results were at best mixed, as both Philadelphia and New York (which includes northern New Jersey) reported slightly disappointing sales. New York did report increased construction activity, though, but in the Philadelphia District construction was basically flat in the second quarter.

Figure 9

Sales of New and Existing Homes



Source: Haver Analytics

Sales of both new and existing homes have increased since the second quarter of last year, but both declined from the first to the second quarter of 2012 (Figure 9). Sales of new homes have grown modestly over the past year. The percentage of delinquent mortgages decreased from a year ago; however, the percentage has increased in the past quarter (Figure 10).

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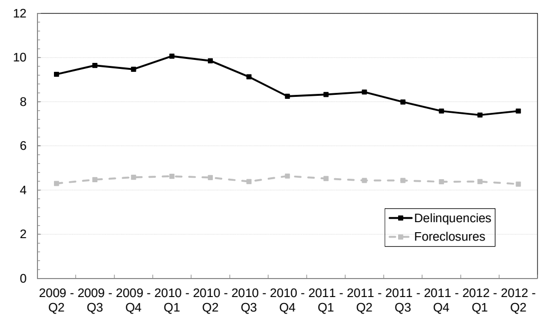
[8] See Table 1 in the Appendix for a full summary of the data used in this section.

[9] For further information see http://www.federalreserve.gov/monetarypolicy/beigebook/beigebook201207.htm.

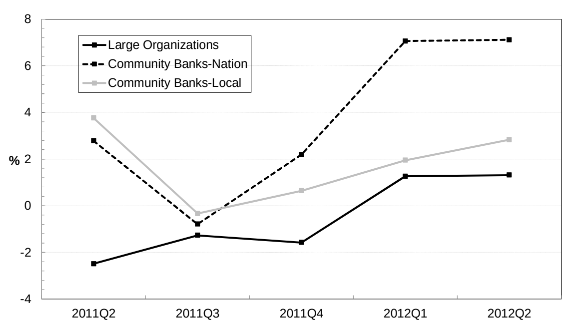
Figure 10
Delinquency and Foreclosure Rates



Source: Haver Analytics

RRE loans outstanding increased, particularly at community banks nationwide (Figure 11). At large organizations, RRE loans showed an annual increase for the second straight quarter, by 1.3 percent. In the second quarter of 2012, RRE loan growth at community banks increased 7.1 percent nationally and

Figure 11
Annual Change in RRE* Loans Outstanding

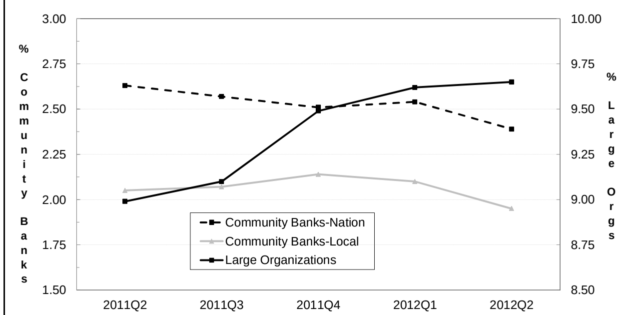


*Residential real estate

2.8 percent locally. All of this growth at all categories was in mortgages secured by first liens.

RRE loan quality at large organizations declined from the second quarter of 2011, although the decline shows signs of moderating. The NPL ratio now stands at 9.65 percent, 66 basis points higher than a year ago (Figure 12 – note the different scales for community banks (left y-axis) and large organizations (right y-axis)).

Figure 12
Nonperforming RRE* Loans/Total RRE Loans



*Residential real estate

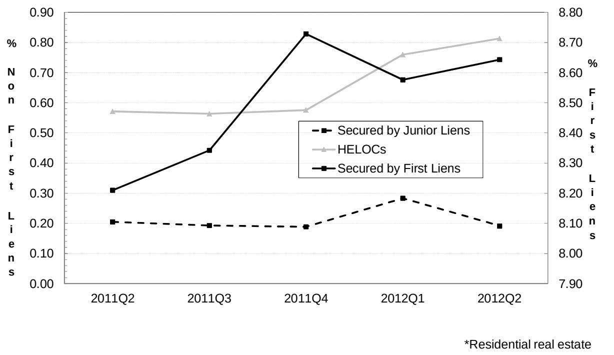
As with the last quarter, the increase in the NPL ratio at large organizations was due to a sharp increase in NPLs. RRE NPLs at large organizations have increased 8.8 percent since the second quarter of 2011. This increase was mainly driven by mortgages secured by first liens, which represent about two-thirds of all RRE loans. NPLs for home equity lines of credit (HELOCs) also rose, but those on mortgages secured by junior liens did fall slightly (Figure 13 – note that the scales are different on each axis).

RRE loan quality at community banks showed some improvement, both nationally and in the region (Figure 12). Over the past year nationally, the NPL ratio fell 24 basis points, to 2.39 percent. Local community banks have better RRE loan quality than either the large organizations or national community banks. The RRE NPL ratio at local community banks decreased 10 basis points in the past year, to 1.95 percent, and it fell 15 points in the second quarter, the second consecutive quarterly drop after rising in the second half of 2011.

Figure 13

RRE NPLs as a Percent of Total RRE Loans by Type of Loan

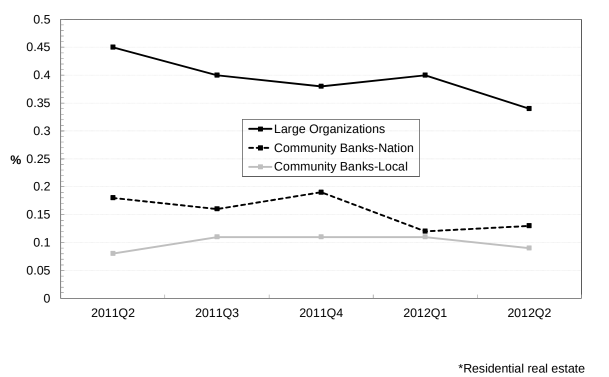
Large Organizations



The RRE NCO ratio at large organizations is down 11 basis points from one year ago, to 0.34 percent (Figure 14), mainly due to falling NCOs. NCOs at community banks nationally fell substantially year over year but increased in the second quarter. This is reflected in the NCO ratio, which at 0.13 percent is down 5 basis points from last year but rose slightly in the quarter. After rising for the past several quarters, NCOs at local community banks have largely remained stable over the preceding year.

Figure 14

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

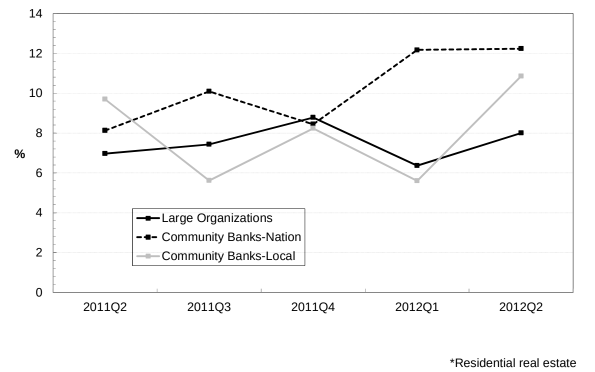


The recovery ratio on RRE loans at large organizations increased 104 basis points over the year (Figure 15). At community banks nationally, the recovery ratio has increased 411 basis points. The recovery ratio at local banks has increased 116 basis points since a year ago.

In all categories of banks, charge-offs have decreased and recoveries have increased.

Figure 15

Recovery Ratio on RRE Loans



Commercial Real Estate Lending[10]

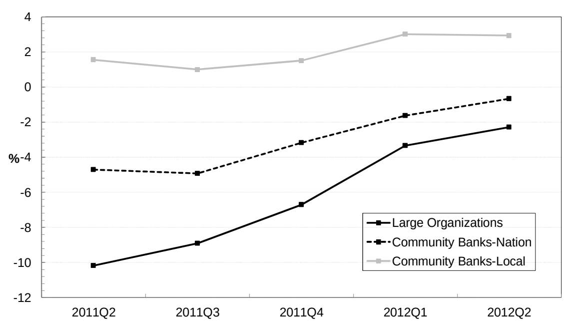
Conditions in the commercial real estate (CRE) market were mixed both locally and nationwide. The *Beige Book* reported most CRE markets nationwide as either improving slowly or holding steady, both in terms of construction and demand for existing space. For the most part, in the Third District both construction and demand for properties were nearly unchanged from the first quarter, when the outlook was for slow growth. However, the *Beige Book* did report that some builders believed activity would increase soon.

CRE lending also reported mixed results in the second quarter, with loan quality increasing while loan growth remained weak. Year over year, overall growth in CRE lending continued to be negative except at tri-state area community banks, where it grew only 2.9 percent (Figure 16). CRE lending is especially important to community banks because CRE loans make up over 43 percent of all loans at banks nationally and about 46 percent at tri-state area banks. Thus, community banks' overall lending

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

condition is highly dependent on their CRE portfolios.

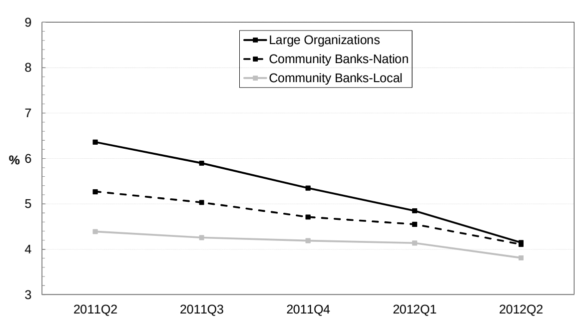
Figure 16
Annual Change in CRE* Loans Outstanding



*Commercial real estate

The quality of CRE loans improved at all categories of banks as CRE NPL ratios continued to decline in the second quarter. NPL ratios have been declining for at least a year at all categories of banks. At large organizations, the CRE NPL ratio decreased 70 basis points in the second quarter, to 4.15 percent, down 221 basis points from one year ago (Figure 17). The CRE NPL ratio decreased 116 basis points at community banks nationally from last year, to 4.11 percent, and 58 basis points at community

Figure 17
Nonperforming CRE* Loans/Total CRE Loans

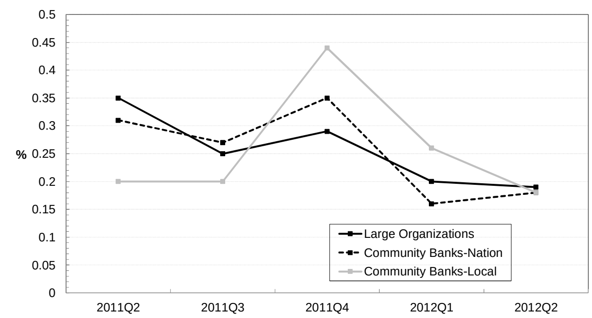


*Commercial Real Estate

banks locally, to 3.81 percent. Similar to the case of RRE loans, CRE loan quality at tri-state area banks continued to be better than loan quality at both community banks in the nation and large organizations.

Overall, NCOs for CRE loans were down substantially from last year at all categories of banks, though community banks nationally experienced a substantial increase during the last quarter. The CRE NCO ratio has decreased 16 basis points since last year at large organizations, 13 basis points at community

Figure 18
Net Charge-Offs on CRE* Loans/Avg CRE Loans

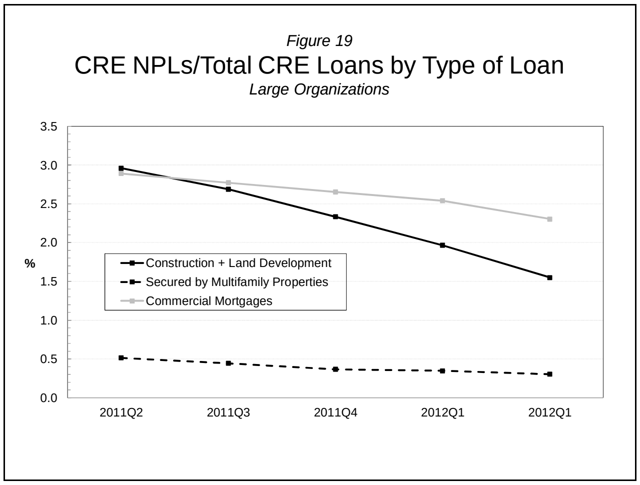


*Commercial real estate

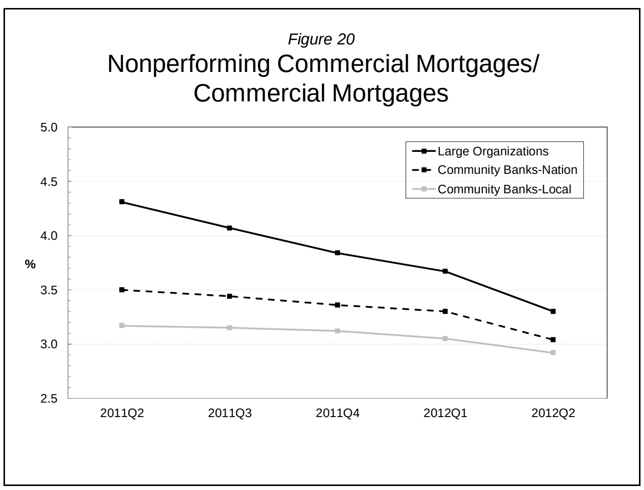
banks nationally, and 2 basis points at local community banks (Figure 18).

CRE loans can be broken down into three categories: construction loans (14.8 percent of total CRE loans), loans secured by multifamily properties (15.4 percent), and commercial mortgages (69.8 percent). Large organizations have improved loan quality in all of these categories, but the improvement in overall CRE loan quality at large organizations was driven by banks' continued cleanup of both their construction loan and commercial mortgage portfolios.

For the past several years, while commercial mortgages have made up the bulk of large organizations' CRE loan portfolios, construction loans have made up a vastly disproportionate share of CRE NPLs. As shown in Figure 19, the ratio of construction NPLs to total CRE loans has dropped markedly in the past year and that of commercial mortgage NPLs to total CRE loans has dropped as well.



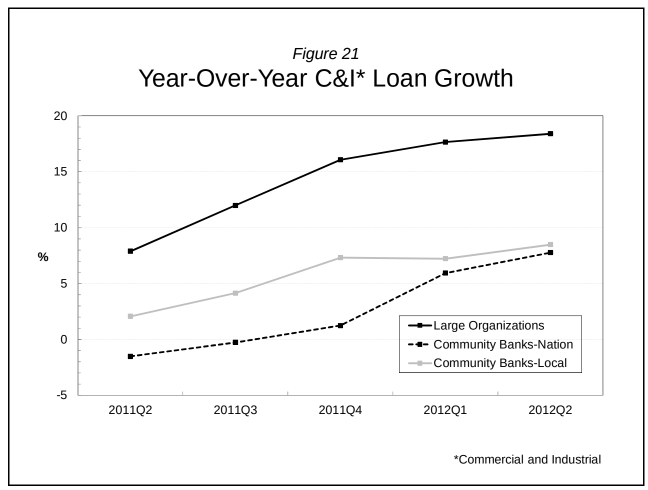
The NPL ratio on commercial mortgages has been falling continuously for four quarters at all categories of banks. It now stands at 3.3 percent for large organizations, 3.04 percent for community banks nationally, and 2.92 percent for local community banks (Figure 20).



Commercial & Industrial Lending[11]

Over the past several quarters, C&I lending accounted for nearly all of the loan growth at both large organizations and community banks. At large organizations, C&I loans grew 18.4 percent in the past year and 16.1 percent in the last quarter (Table 1 and Figure 21). C&I lending also led loan growth at community banks, although not at a rate as high as that of large banks. However, it has been accelerating at an increasing rate over the past two quarters at community banks nationally.

Supply-related factors and, to a lesser extent, demand-side factors appear to be driving C&I lending. The Federal Reserve Board's Senior Loan Officer Opinion Survey for July 2012 reported that loan demand was relatively unchanged from the first quarter for most types of borrowers, but a fraction of respondents did report increased demand. On the supply side, most domestic institutions reported that they had begun to loosen their lending standards on



large and medium-sized businesses but not on small businesses.[12] Many lenders also noted that the reason for easing terms was more aggressive competition from other firms.

Both NPLs and NCOs fell substantially at all categories of banks, both year over year and from the fourth quarter of 2011. This suggests that the recent C&I loan growth has so far been achieved without compromising loan quality.

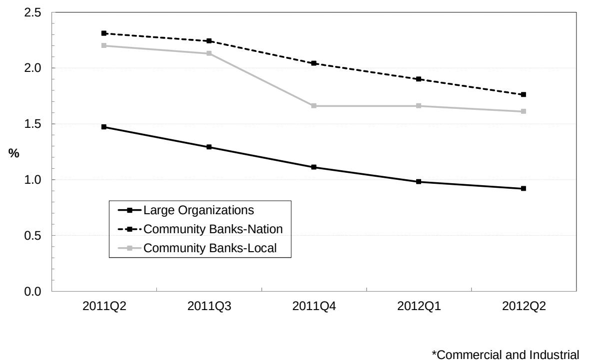
[11] See Table 3 in the Appendix for a full summary of the data used in this section.

[12] An exception was branches of foreign banks, which tightened lending standards substantially. See http://www.federalreserve.gov/boarddocs/SnLoanSurvey/201208/default.htm for further information.

The C&I NPL ratio at both the large organizations and community banks fell over the year as well (Figure 22).

Figure 22

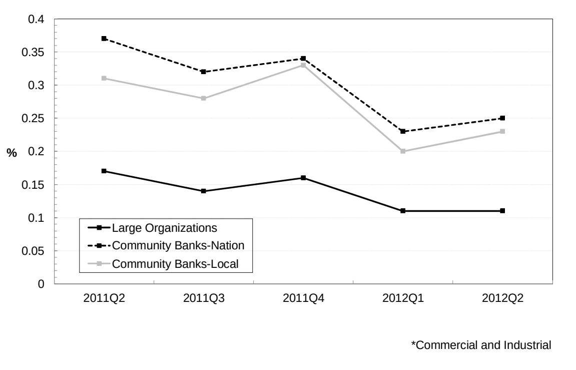
Nonperforming C&I* Loans/C&I Loans



Likewise, the NCO ratio has also fallen at all categories of banks over the past year (Figure 23). At large organizations, the C&I NCO ratio

Figure 23

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



has fallen 6 basis points since a year ago. At community banks it has fallen 12 basis points nationally and 8 basis points locally. However, it increased from the first quarter both locally and nationally.

In addition to data on all C&I loans, the June Call Report annually contains data on the level of small business lending activity.[13] Overall, small business lending has been basically flat at community banks, while it has increased significantly at large organizations. Much of the increase at large banks was in the smallest category of loans (<$100,000), which, as noted below, includes company credit cards. The data are also consistent with the findings of the Senior Loan Officer Opinion Survey summarized above in the "Commercial and Industrial Lending" section, with larger loans, i.e., those more likely to go to large and medium-sized firms, experiencing small increases at large organizations.

Consumer Lending[14]

Overall, consumer lending has mainly been weak in the past year, although large organizations have experienced some growth. At community banks, consumer lending has been shrinking for over a year locally, while nationally it began to grow slightly in the second quarter after shrinking for the previous several quarters (Figure 24). At large organizations, year-over-year consumer lending also flattened out in the second quarter.

At large organizations, consumer loans represent about 14 percent of all loans. At community banks nationally, the share of consumer loans is 4.3 percent, and locally it's about 3.1 percent. NPL ratios on consumer loans have been low: 1.25 percent for large

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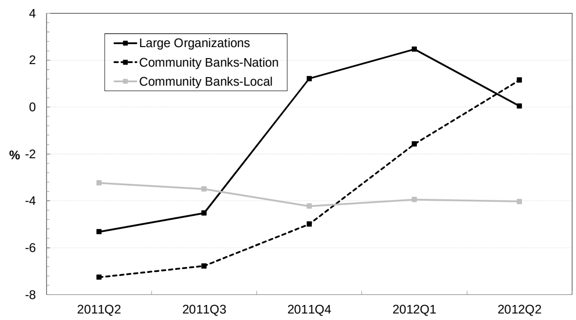
[13] See Table 9 for a full summary of the data used in this paragraph. It should also be noted that the "C&I Loans" category of loans under $100,000 includes company credit cards, thus the reason for the large number of loans, particularly at large organizations since they are the major credit card issuers. The title "small business lending" is somewhat of a misnomer because banks report all commercial loans and CRE loans with original amounts under $100,000, $250,000, and $500,000 regardless of the size of the borrower.

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

Figure 24

Year-Over-Year Growth in Consumer Loans

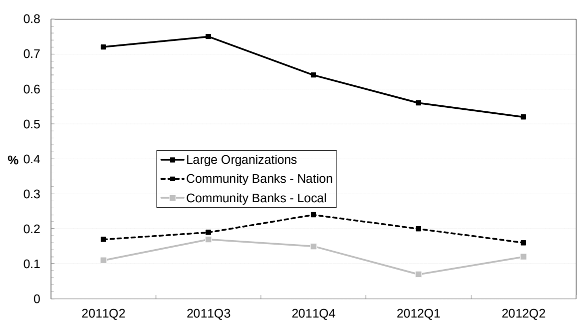


organizations, 0.73 percent for community banks nationally, and 0.61 percent for tri-state area community banks.

The NCO ratio for large organizations is about triple that for community banks nationally and more than quadruple that of local community banks (Figure 25).

Figure 25

NCOs on Consumer Lns/Average Consumer Lns

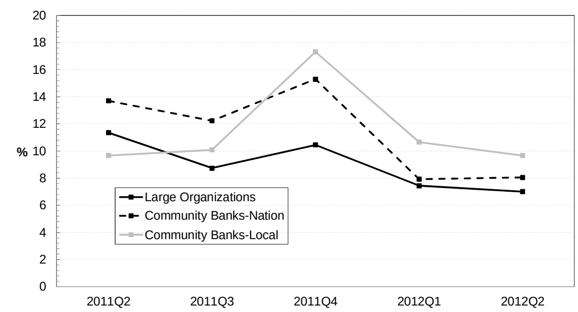


Provisioning and Reserves[15]

With the improving situation with NPLs, NCOs, and recoveries (see above), many banks are easing up on their loan-loss provisioning. Also, additions to nonaccruing loans have fallen substantially in the past year, giving the banks further incentive to ease up on provisioning. Except at tri-state area community banks, loan-loss provisions have decreased from a year ago. This is true both overall and as a percentage of operating income.[16] Over the year, the ratio of loan-loss provision to operating income fell 434 basis points, to 7.01 percent at large organizations; decreased 565 basis points, to 8.05 percent, at community banks nationally; and was unchanged at 9.66 percent at local community banks (Figure 26).

Figure 26

Loan-Loss Provision/Operating Income



There is a question as to whether this cutting of loan-loss provisions is happening too soon and too fast. While NPLs are shrinking, there is still a substantial amount of NCOs. As a result, except at local community banks, the ratio of NCOs to loan-loss provision has increased from last year (Figure 27).[17] At large organizations,

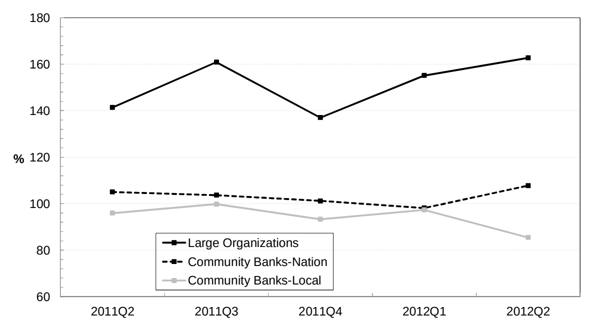
[15] See Table 5 in the Appendix for a full summary of the data used in this section.

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

[17] 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

the ratio is 162.7 percent, an increase of 21.3 percentage points from last year. At community banks, the situation is somewhat better.

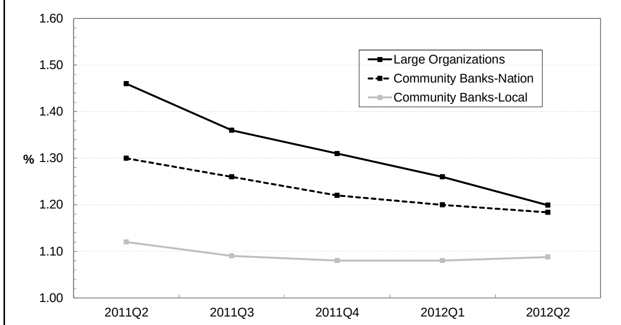
Figure 27
Net Charge-offs/Loan-Loss Provision



Nationally, the ratio has risen 268 basis points, to 107.75 percent. Only local community banks are actually ahead of their NCOs, with a ratio of 85.40 percent. This represents a decrease of 10.5 percentage points in the past year.

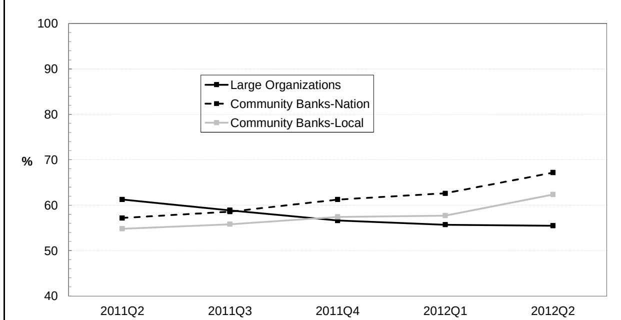
The decrease in provisioning has resulted in a drop in overall reserves. Loan-loss reserves as a percent of total assets have decreased from the first quarter of last year at all categories of banks (Figure 28). At community banks, the decrease in this ratio has flattened somewhat in the past several quarters, but the downward trend continues. At large organizations, the trend appears to be accelerating. With the exception of local community banks, total loan-loss reserves also decreased from last year. In terms of quarterly growth, at community banks nationally reserves shrank slightly, locally they grew modestly, while at large organizations they fell substantially.

Figure 28
Loan-Loss Reserves/Assets



Even though NCOs are decreasing, declining loan-loss reserves might limit banks' capacity to recognize losses going forward. Over the year, loan-loss coverage fell 5.8 percentage points at large organizations, to 55.45 percent (Figure 29). It also fell in the quarter, but only by 26 basis points.

Figure 29
Loan-Loss Coverage Ratio



The loan-loss coverage ratio increased year over year at community banks both nationally and locally.[18] At community banks nationally,

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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.

[18] 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.

the year-over-year increase in loan-loss coverage was nearly 10 percentage points, to 67.15 percent, and locally the increase was 7.5 percentage points, to 62.35 percent.

Securities[19]

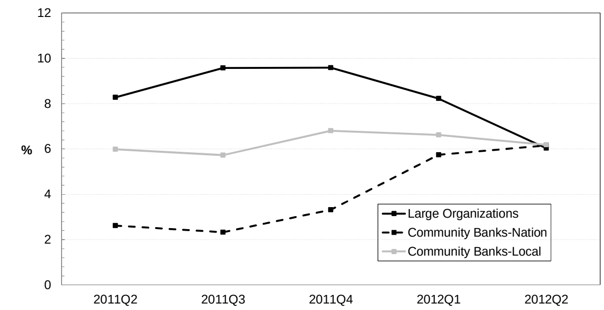
The market value of securities has increased year over year at all categories of banks.[20] Large organizations also posted a realized gain of about $1.87 billion.[21] Community banks nationally reported a realized gain of $432.2 million on securities in the second quarter. Local community banks reported a realized gain of $32.2 million on their securities.

Funding Sources[22]

Deposits rose at all categories of banks, both over the year and from the previous quarter. The annual growth rate was higher at community banks, but only slightly (Figure 30). Transaction accounts, particularly demand deposits, were responsible for much of the growth in deposits at all categories of banks. Savings accounts also increased, while time deposits declined somewhat. Brokered deposits were down at community banks but increased at large organizations.

Figure 30

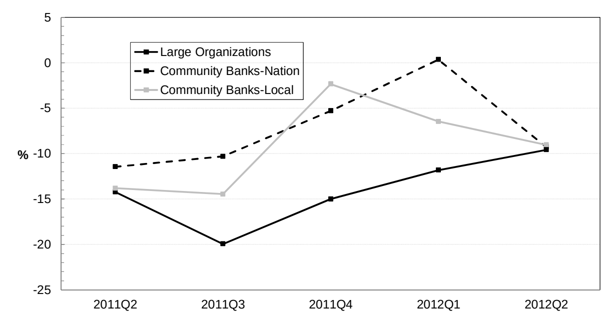
Year-Over-Year Growth in Deposits



Nondeposit funding continued to fall year over year at all categories of banks (Figure 31).[23] The main reason for both quarterly increases was Federal Home Loan Bank (FHLB) advances.

Figure 31

Year-Over-Year Growth in Nondeposit Debt



Not only did overall deposits increase year over year at all categories of banks, but core deposits increased as well (Figure 32).[24] This is

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

[20] 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.

[23] Nondeposit funding consists of fed funds purchased, securities sold under agreements to repurchase (repos), subordinated debt, 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.

good news for community banks because core deposits are the least expensive and most stable form of funding.

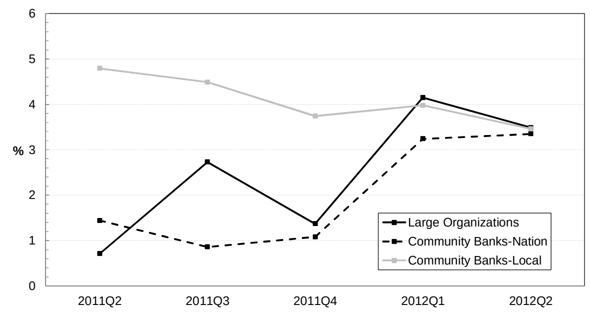


Figure 32
Year-Over-Year Growth in Core Deposits

However, core deposit growth was basically flat in the second quarter at community banks and decreased at large organizations.

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 33).[25] This holds true for nondeposit funding as well.

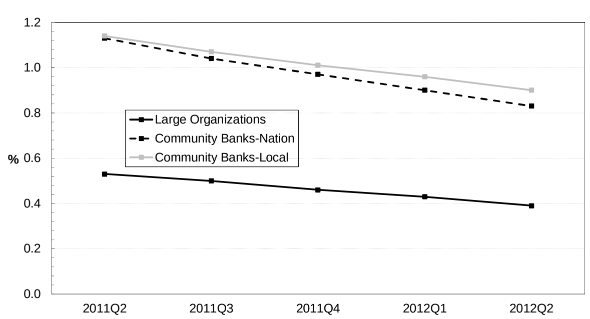


Figure 33
Implicit Interest Rate on Deposits

Regulatory Capital[26]

Overall, of the 100 large organizations in the sample, 99 of them had equity-to-assets ratios of at least 6 percent, and all but two had equity-to-assets ratios of over 7 percent.[27] At community banks nationally, 97 percent of the institutions had equity-to-assets ratios of at least 6 percent, and 95.3 percent had ratios of at least 7 percent. Locally, 97.7 percent (173 out of 177) of the institutions had a capital ratio of at least 6 percent, and only one of those 173 institutions had an equity-to-assets ratio of less than 7 percent.

Year over year, capitalization at large organizations has improved slightly in all categories but risk-based capital. Also, capitalization is high by historical standards.[28] The equity-to-assets ratio at large organizations increased 11 basis points, the tier 1 leverage ratio increased 12 basis points, and the risk-based capital ratio decreased 25 basis points.[29]

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

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

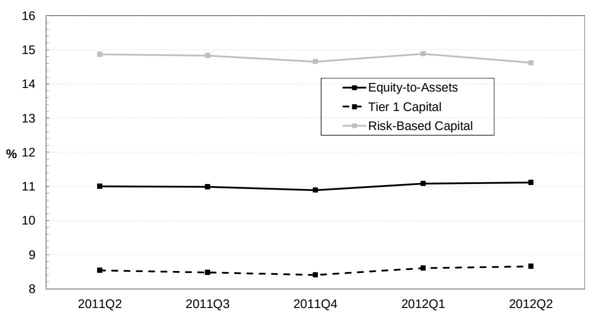
[27] Regulation Y defines capital in terms of zones. Institutions in Zone 1 have tier 1 capital-to-assets ratios above 7 percent, those in Zone 2 are between 6 and 7 percent, and those in Zone 3 have ratios below 6 percent. An institution is considered well capitalized if it is in Zones 1 or 2 and undercapitalized if it is in Zone 3. While total equity capital and 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] The average ratio of total equity to total assets at all commercial banks from 2000 to 2010 was 9.80 percent. Source: FDIC Historical Statistics on Banking, http://www2.fdic.gov/hsob/index.asp.

[29] Tier 1 leverage and risk-based capital are the two main ratios regulators use to determine if a bank is adequately

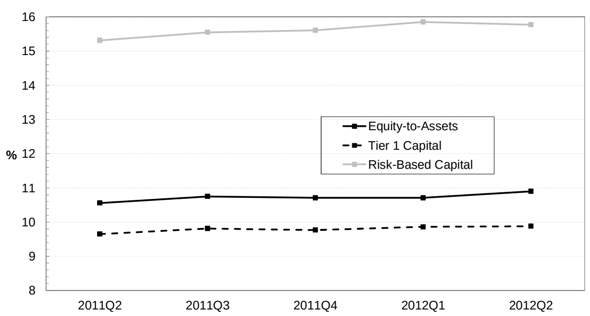
Capital ratios at large banks have been fairly stable for more than a year now (Figure 34).

Figure 34
Regulatory Capital – Large Organizations



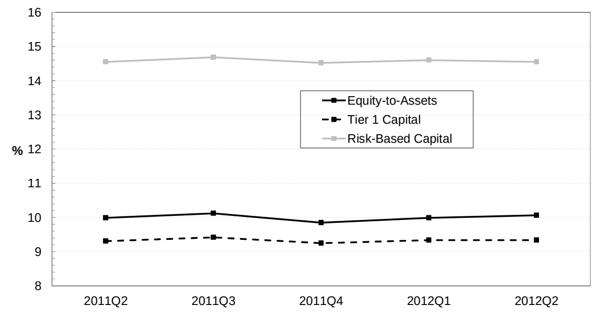
Community banks nationally have increased their capitalization from last year, but it appears that the increases in their capital ratios have leveled off. Since last year, the equity-to-assets ratio at these banks has increased 34 basis points; the tier 1 capital ratio has increased 23 basis points; and the risk-based capital ratio has increased 46 basis points (Figure 35). At local banks, capital ratios were basically flat both

Figure 35
Regulatory Capital – All Community Banks



year over year and between the first and second quarters. Since last year, the equity-to-assets ratio at local banks has increased 7 basis points; the tier 1 leverage ratio has increased 3 basis points; and the risk-based capital ratio was unchanged (Figure 36).

Figure 36
Regulatory Capital – Local Community Banks



The primary drivers of these capital increases at community banks were additional retained earnings, other accumulated income, and perpetual preferred stock. Also, all categories of banks had relatively large increases in unrealized gains on available-for-sale securities.

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capitalized. For further information, see the Call Report instructions at http://www.ffiec.gov/forms031.htm.

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	1.3%	2.8%	7.1%
RRE NPLs	8.8%	-2.4%	-2.4%
RRE NCOs	-24.5%	12.0%	-25.1%
2. Shares			
RRE Lns/Total Lns	33.8%	31.9%	26.8%
RRE NPLs/Total NPLs	74.3%	23.3%	22.5%
RRE NCOs/Total NCOs	46.3%	19.8%	21.9%
3. Performance Ratios			
RRE NPLs/Total RRE Lns	9.65%	1.95%	2.39%
RRE NCOs/Avg. RRE Lns	0.34%	0.09%	0.13%
4. Outstandings ($millions)			
Total RRE Lns	1,681,309.9	19,835.4	321,038.4
RRE NPLs	162,222.3	385.9	7,681.5
RRE NCOs	5,729.0	17.4	406.6

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	-2.3%	2.9%	-0.7%
CRE NPLs	-36.2%	-10.6%	-22.6%
CRE NCOs	-49.7%	-7.9%	-42.4%
2. Shares			
CRE Lns/Total Lns	15.9%	45.9%	43.4%
CRE NPLs/Total NPLs	15.0%	65.8%	62.7%
CRE NCOs/Total NCOs	12.2%	56.5%	51.2%
3. Performance Ratios			
CRE NPLs/Total CRE Lns	4.15%	3.81%	4.11%
CRE NCOs/Avg. CRE Lns	0.19%	0.18%	0.18%
4. Outstandings ($millions)			
Total CRE Lns	789,243.7	28,557.1	520,863.2
CRE NPLs	32,790.9	1,088.2	21,385.5
CRE NCOs	1,509.4	49.8	952.5

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	18.4%	8.5%	7.8%
C&I NPLs	-26.3%	-20.8%	-18.2%
C&I NCOs	-24.0%	-21.6%	-32.0%
2. Shares			
C&I Lns/Total Lns	22.3%	13.4%	15.7%
C&I NPLs/Total NPLs	4.7%	8.1%	9.7%
C&I NCOs/Total NCOs	9.5%	21.1%	23.7%
3. Performance Ratios			
C&I NPLs/Total C&I Lns	0.92%	1.61%	1.76%
C&I NCOs/Avg. C&I Lns	0.11%	0.23%	0.25%
4. Outstandings ($millions)			
Total C&I Lns	1,107,893.8	8,365.6	188,034.1
C&I NPLs	10,147.1	134.6	3,300.6
C&I NCOs	1,172.8	18.6	441.3

Table 4 - Summary of Consumer Lending

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
1. Year–over–year growth			
Total Consumer loans	0.0%	-4.0%	1.2%
Consumer NPLs	-13.6%	13.0%	1.0%
Consumer NCOs	-28.1%	5.0%	-10.3%
2. Shares			
Consumer Lns/Total Lns	14.0%	3.1%	4.3%
Consumer NPLs/Total NPLs	4.0%	0.7%	1.1%
Consumer NCOs/Total NCOs	29.6%	2.7%	4.4%
3. Performance Ratios			
Cons NPLs/Total Cons Lns	1.25%	0.61%	0.73%
Cons NCOs/Avg. Cons Lns	0.52%	0.12%	0.16%
4. Outstandings ($millions)			
Total Consumer Lns	698,849.8	1,896.4	51,597.9
Consumer NPLs	8,729.3	11.6	374.2
Consumer NCOs	3,662.1	2.3	81.7

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

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Loan-loss Reserve ($Millions)	121,115.5	1,031.1	22,902.5
Change from Last Quarter	-15.0%	6.1%	-2.6%
Change from Last Year	-14.6%	2.6%	-3.5%
Net Charge-Offs/LL Provision	162.70%	85.40%	107.75%
LL Provision/Operating Inc.	7.01%	9.66%	8.05%
Loan-loss Coverage Ratio	55.45%	62.35%	67.15%

Table 6 - Summary of Securities Portfolios

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Securities/Assets	21.3%	22.4%	21.9%
Market Value ($Millions)	2,148,917.1	21,287.3	451,229.5
Change from Last Quarter	3.4%	-6.3%	-1.6%
Change from Last Year	10.9%	4.9%	12.1%
Realized Gain/Loss	1,872.9	32.2	432.2
Pct of Average Securities	0.09%	0.15%	0.10%
Market Value/Book Value	102.1%	102.4%	102.4%

Table 7 - Structure of Liabilities

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Deposits ($millions)	7,322,519.5	79,328.3	1,610,407.1
Pct. of Assets	72.5%	83.8%	83.3%
Change from Last Quarter	1.5%	2.8%	2.4%
Change from Last Year	6.0%	6.2%	6.2%
Core Deposits/Deposits	36.8%	67.5%	66.3%
Implicit Rate on Deposits	0.39%	0.90%	0.83%
Nondeposit Debt ($millions)	1,024,472.3	4,814.9	97,080.4
Pct. of Assets	10.1%	5.1%	5.0%
Change from Last Quarter	7.7%	5.0%	-28.9%
Change from Last Year	-9.6%	-9.0%	-9.3%
Implicit Rate on Debt	1.64%	2.57%	2.21%

Table 8 - Capitalization Measures

	Large Organizations	Community Banks	
Ratios	Nation	Tri-State Area	Nation
Total Equity/Total Assets	11.11%	10.06%	10.90%
Change fr. Last Qtr. (basis pts)	+3	+7	+19
Change fr. Last Yr. (basis pts)	+11	+7	+34
Tier 1 Leverage Ratio	8.66%	9.34%	9.88%
Change fr. Last Qtr. (basis pts)	+5	0	+2
Change fr. Last Yr. (basis pts)	+12	+3	+23
Risk-Based Capital Ratio	14.62%	14.55%	15.77%
Change fr. Last Qtr. (basis pts)	-26	-5	-8
Change fr. Last Yr. (basis pts)	-25	0	+46

*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	94,394	551,111.9	11,082	22,507.1	278,356	391,811.6
Change from 2011	-13,613	9333.4	-765	904.2	-42,763	6,231.4
$100,000-250,000	148,774	19,026.4	11,443	1,474.0	217,304	28,374.1
Change from 2011	-10,408	-1,644.8	-489	-55.0	-6,701	-871.9
$250,000-1 million	242,841	97,920.6	16,065	6,646.1	287,735	114,140.7
Change from 2011	-12,358	-6,682.3	-411	32	8,301	-1,630.9
C&I Loans						
<$100,000	6,709,860	81,462.3	39,101	1,148.7	1,173,919	29,129.4
Change from 2011	704,380	11,882.4	-83	9	-25,779	-129.4
$100,000-250,000	229,162	22,182.3	8,834	878.0	202,239	20,612.3
Change from 2011	9,277	403.2	20	6.5	-9,703	-251.1
$250,000-1 million	192,474	57,671.6	9,813	2,241.5	164,370	47,263.9
Change from 2011	4,172	454.0	496	107.5	956	19.2

* Number of loans is the number of loans reported; amounts are in $millions. Starting 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.