BANKING BRIEF

FOR PENNSYLVANIA, NEW JERSEY, AND DELAWARE

Third Quarter Highlights

- *Year over year, profitability (ROA) continued to improve nationally at both large and community banking organizations. Local banks' earnings were flat.*

- *Year over year, loan growth accelerated at all categories of banks, mainly driven by commercial and industrial lending.*

- *Loan quality improved year over year at all categories of banks, as both nonperforming loans and net charge-offs decreased. However, loan quality at large organizations has deteriorated for the second straight quarter.*

- *Residential real estate (RRE) loan quality declined at large organizations but improved at community banks. RRE loans grew substantially at community banks nationally, less so at local community banks, and not at all at large organizations.*

- *Commercial real estate (CRE) lending remained weak at community banks nationally and large organizations, with little or no growth. Local banks did see some increase in CRE lending. Nonperforming loans and net charge-offs dropped substantially at all categories of banks.*

- *Loan-loss coverage increased at community banks but decreased at large organizations. It is still below historical norms. Reserves are down at community banks nationally and large organizations but increased a bit at local community banks. Loan-loss provisions decreased at community banks but increased at large organizations.*

- *Over the year, most measures of capitalization increased at all banks. Overall, capitalization remains high compared with historical standards.*

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Summary Table of Bank Structure and Conditions – Third Quarter 2012

	Community Banking Organizations							**Large Organizations**		
	Nation			***Tri-State***				***Nation***		
	$ Bill	**% Change From**		**$ Bill**	**% Change From**			**$ Bill**	**% Change From**	
	12Q3	**12Q2**	**11Q3**	**12Q3**	**12Q2**	**11Q3**		**12Q3**	**12Q2**	**11Q3**
Total Assets	1,942.8	3.32	5.20	94.7	6.38	4.73	Total Assets	10,252.9	5.95	3.65
Total Loans	1,206.9	3.89	4.26	62.3	6.66	5.74	Total Loans	5,034.7	4.17	5.20
C&I	188.5	2.72	8.64	8.3	4.10	7.41	C&I	1,138.1	11.02	16.64
Real Estate	897.1	3.28	3.31	48.7	4.51	4.03	Real Estate	2,546.6	-0.16	0.18
Consumer	52.4	6.47	3.32	1.9	11.65	-1.34	Consumer	706.8	4.62	1.86
Total Deposits	1,615.4	2.83	5.73	79.7	8.00	5.55	Total Deposits	7,479.5	8.48	5.42
Ratios (in %)	**12Q3**	**12Q2**	**11Q3**	**12Q3**	**12Q2**	**11Q3**	**Ratios (in %)**	**12Q3**	**12Q2**	**11Q3**
Net Income/Avg Assets (ROA)	0.78	0.74	0.44	0.58	0.58	0.58	Net Income/Avg Assets (ROA)	0.86	0.86	0.79
Net Interest Inc/Avg Assets (NIM)	3.46	3.48	3.45	3.30	3.32	3.36	Net Interest Inc/Avg Assets (NIM)	2.64	2.65	2.72
Noninterest Inc/Avg Assets	0.96	0.93	0.90	1.26	1.23	1.25	Noninterest Inc/Avg Assets	1.80	1.80	1.89
Noninterest Exp/Avg Assets	3.06	3.05	3.08	3.29	3.27	3.27	Noninterest Exp/Avg Assets	2.93	2.93	2.97
Loans/Deposits	74.71	74.52	75.76	78.17	78.42	78.04	Loans/Deposits	67.31	68.00	67.45
Equity/Assets	11.04	10.89	10.75	10.19	10.08	10.13	Equity/Assets	11.17	11.11	10.99
Nonperforming Loans/Total Loans	2.67	2.84	3.41	2.58	2.63	2.99	Nonperforming Loans/Total Loans	4.39	4.39	4.77

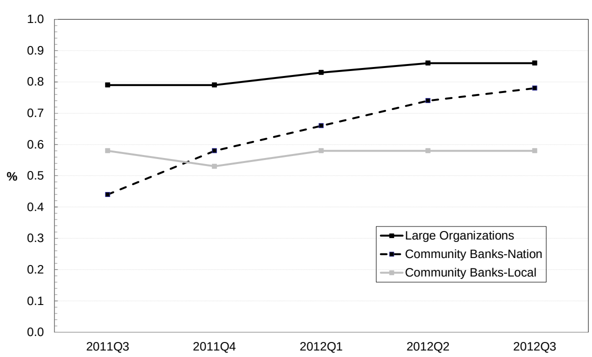
A banking organization is an independent bank or all the banks within a highest-level bank holding company; however, banks less than five years old and special purpose banks such as credit card banks are excluded. However, some numbers were skewed by Citigroup's third quarter of 2011 reorganization involving 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 — 175 for the tri-state area and 5,362 for the nation; (2) large banking organizations — 101 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.

Third Quarter 2012

The industry as a whole continued to improve in the third quarter, while tri-state area banks showed only modest improvement. Year-over-year profitability as measured by return on average assets (ROA) increased by 34 basis points at community banks nationally, to 0.78 percent; increased by 7 basis points at large organizations, to 0.86 percent; and remained unchanged at 0.58 percent at local community banks (Figure 1).[1] The number of banks that reported positive profits increased at all categories of banks in the third quarter.[2]

Figure 1

Return on Average Assets



At large organizations, quarterly net income has increased a little over 3 percent since last year, from $24.5 to $25.3 billion. This increase can be attributed primarily to the continued improvement in loan quality. Net charge-offs (NCOs) and nonperforming loans (NPLs) continued to decrease.[3] As a result, large organizations have decreased their loan-loss provisions by about $1.6 billion (see "Provisioning and Reserves" below). In addition, operating income has increased due to increases in noninterest income.[4]

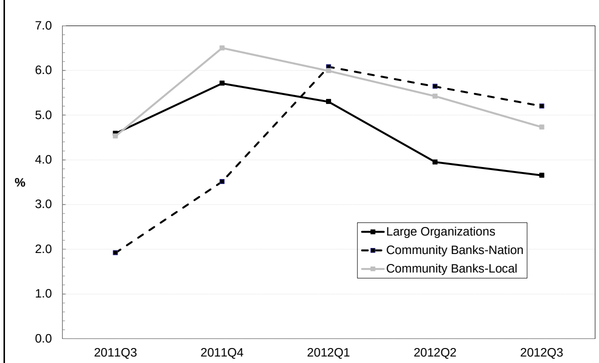
At community banks in the nation, quarterly net income has increased over 32 percent since last year, a little over $1.0 billion. Most of this increase is accounted for by decreased loan-loss provisioning due to improved loan quality. There has also been an increase in asset sales, specifically loan sales. Also, losses on the sale of foreclosed real estate decreased.

At local community banks, quarterly profits increased by $4.3 million, or about 2.1 percent. Like the other categories of banks, local community banks did make cuts to their loan-loss provisions due to increased loan quality, and they also saw a rise in asset sales. Additionally, noninterest income has increased somewhat.

Year over year, assets of community banks nationally grew at a rate above 5 percent, while asset growth at local community banks was 4.7

Figure 2

Year-Over-Year Asset Growth



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

[2] Out of 5,362 community banks in the national sample, 4,822 reported positive quarterly profits. This was an increase of 26 from the second quarter of 2012. Locally, 160 out of 175 banks reported positive profits, an increase of eight from the second quarter of 2012. For large organizations, 97 out of 101 were profitable, an increase of two banks.

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

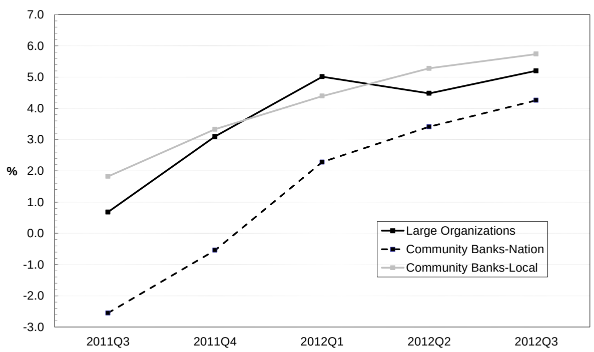
[4] Noninterest income includes all fee income, trading revenue, and gains or losses on asset sales, excluding securities sales.

percent. At large organizations, asset growth was 3.7 percent (Figure 2). The growth in assets was fueled by increases in securities and loans. The market value of securities increased 11.4 percent at community banks nationally, 9.2 percent at large organizations, and only 3.0 percent at local community banks.

Loan growth accelerated at all categories of banks (Figure 3). Over the past year, total loans at large organizations grew at about 5.2 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 4.3 percent in the nation and 5.7 percent locally. In both cases, the main area of growth was in commercial loans, with some growth in real estate loans as well.

Figure 3

Year-Over-Year Loan Growth

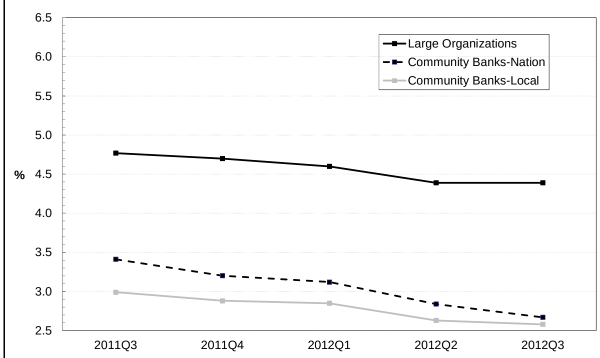


Loan quality at large organizations continued to improve substantially over the year, with the ratio of NPLs to total loans (the NPL ratio) decreasing by 38 basis points, to 4.39 percent (Figure 4).[5]

At community banks nationally, the NPL ratio has decreased 74 basis points since last year, to 2.67 percent. There was also a decrease of 17 basis points from the second quarter to the third quarter of 2012. Locally, the NPL ratio fell over the past year as well, by 41 basis points, to 2.58 percent. Over the quarter, the NPL ratio fell 5 basis points.

Figure 4

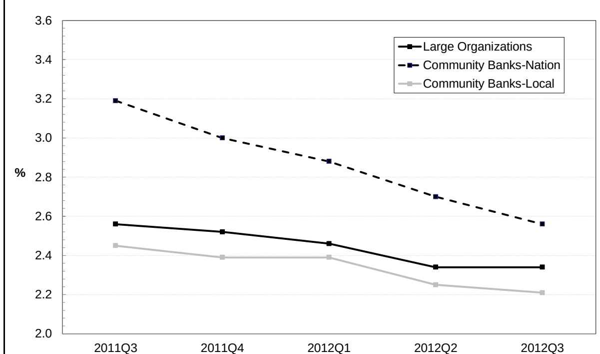
Nonperforming Loans/Total Loans



Overall, asset quality has also improved at all categories of banks.[6] Foreclosed real estate, known as other real estate owned (OREO), fell at large organizations and community banks nationally, by 11.8 and 7.1 percent, respectively, and it was basically flat locally. The ratio of nonperforming assets (NPAs) to total assets has fallen at all three categories of banks in the past

Figure 5

Nonperforming Assets/Total Assets

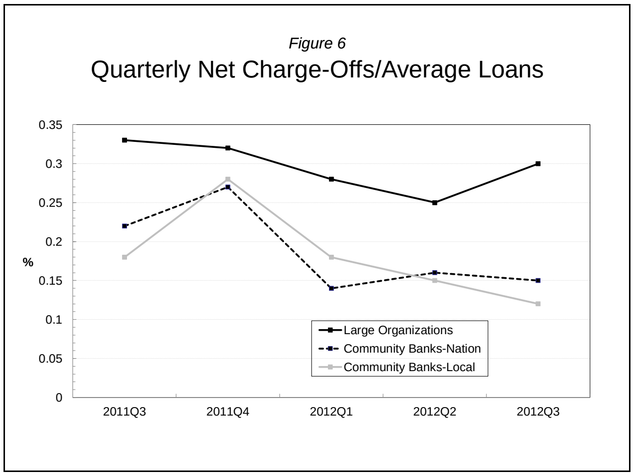


[5] For historical perspective, the average NPL ratio for all commercial banks between 2001 and 2011was 2.31 percent. At the bottom of the last real estate cycle in 1991, this ratio stood at 3.70 percent. Source: FDIC Historical Statistics on Banking, http://www2.fdic.gov/hsob/index.asp.

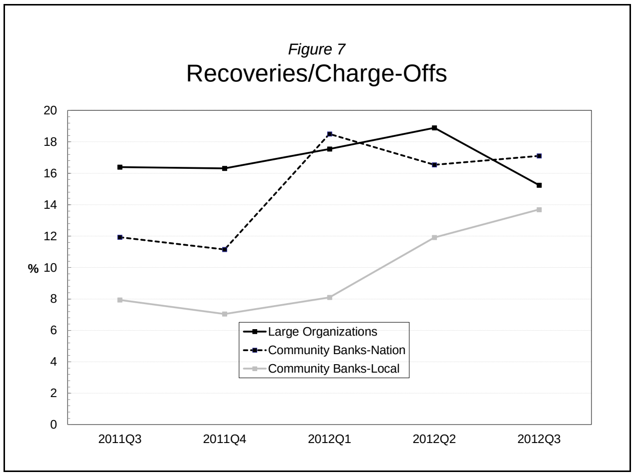
[6] Asset quality refers to nonperforming assets. These are defined as NPLs plus other real estate owned.

year (Figure 5).[7] It should be noted that from the second to the third quarter, OREO fell at community banks nationally and was nearly unchanged at local community banks, but it rose at an annualized rate of 5.7 percent at large organizations.

The story is much the same with the ratio of NCOs to average loans (NCO ratio). The NCO ratio fell slightly over the year at large organizations but increased from the second to the third quarter (Figure 6). At large organizations, the NCO ratio is now 0.30 percent, after declining by 3 basis points from the third quarter of 2011 but increasing by 5 basis points over the quarter. As discussed below, this rise was driven by an increase in NCOs in residential real estate. Community banks both locally and nationally continued to have a lower NCO ratio than the large organizations. For community banks in the nation, the NCO ratio has fallen 7 basis points over the year, but only 1 point in the last quarter, to 0.15 percent. At tri-state area community banks, the NCO ratio has fallen 6 basis points over the past year and 3 points from the second quarter, to 0.12 percent. Local community banks' NCO ratios have fallen now for three consecutive quarters, after rising for several quarters before that.



Although NCOs are decreasing at all categories of banks, the reasons are different for large and small banks. At large organizations, gross charge-offs have fallen nearly 6 percent in the past year, but recoveries have also fallen. For the quarter, charge-offs also rose, primarily because of residential real estate loans (see below). At community banks nationally, charge-offs have fallen over 26 percent, while recoveries have increased 6 percent. The story is the same at local community banks, where charge-offs fell 23 percent and recoveries have increased by nearly a third. Thus, after increasing for several quarters, the ratio of recoveries to charge-offs decreased to 15.24 percent in the third quarter at large organizations, while it increased at community banks, to 17.1 percent nationally and 13.7 percent locally (Figure 7).



Capital ratios, defined as the ratio of total equity to assets, rose at all categories of all banks from a year ago (Figure 8). Capital levels at local community banks remain significantly lower than those at both community banks in the nation and large banks.

[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 2001 and 2011 was 1.44 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.

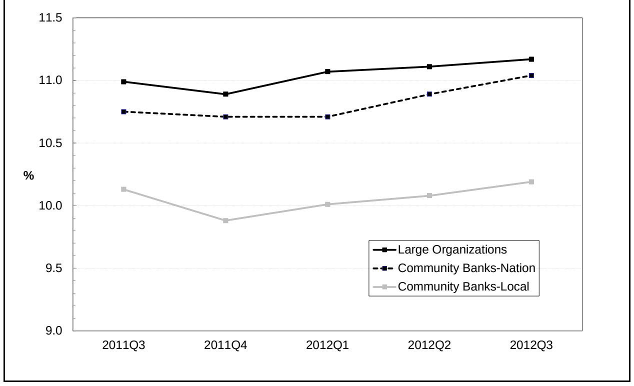


Figure 8
Equity-to-Assets Ratios

The number of bank failures remained high relative to historic levels. In the third quarter of 2012, the Federal Deposit Insurance Corporation reported 12 bank failures, but none were in the tri-state area. This represents a decrease both from the second quarter of 2012, when there were 15 failures, and from the third quarter of 2011, when there were 25 failures.

Additionally, six other banks have failed so far in the fourth quarter (as of November 14, 2012). This includes one bank in Pennsylvania. In all of 2011, there were 92 bank failures, including two in the tri-state area. In addition to the Pennsylvania institution mentioned above, three 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 continued their modest recovery in the third quarter. The Federal Reserve Board's *Beige Book*, as of October 10, reported that existing home sales were improving in most Federal Reserve Districts and that construction was beginning to pick up as well.[9] However, locally, the results were at best mixed, as both Philadelphia and New York (which includes northern New Jersey) reported slower increases in sales compared with other regions. Both areas reported a continued preference on the part of consumers for renting rather than buying. Construction activity also remains relatively slow across the tri-state area.

Sales of both new and existing homes have increased since the third quarter of last year, but existing home sales declined from the second to the third quarter of 2012 (Figure 9). Sales of new homes have grown modestly over the past

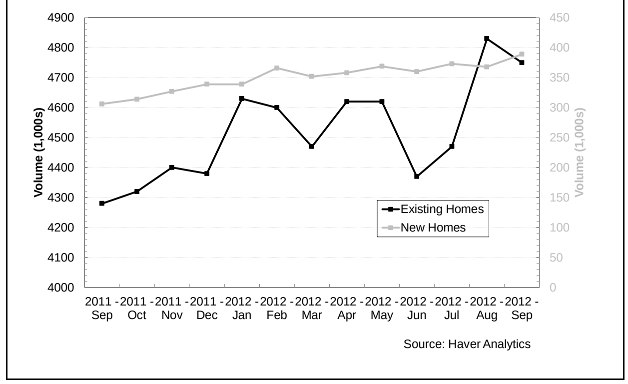


Figure 9
Sales of New and Existing Homes

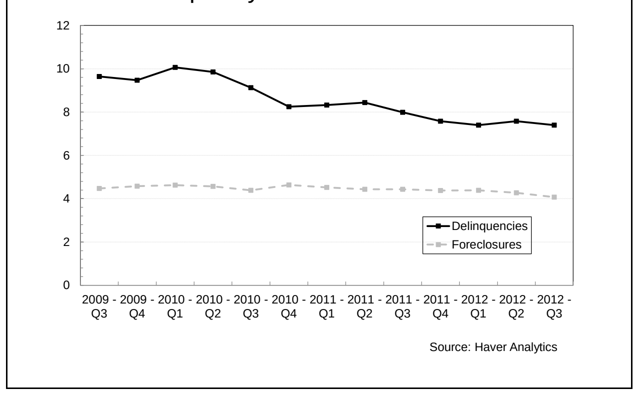


Figure 10
Delinquency and Foreclosure Rates

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

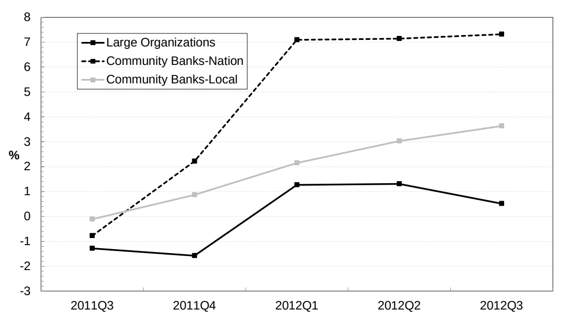
[9] For further information, see http://www.federalreserve.gov/monetarypolicy/beigebook/beigebook201207.htm.

year. The percentage of delinquent mortgages decreased slightly from a year ago, as has the percentage of mortgages in foreclosure (Figure 10).

RRE loans outstanding increased substantially at community banks nationwide but grew only modestly locally and were flat at large organizations (Figure 11). In the third quarter of 2012, RRE loan growth at community banks increased 7.3 percent nationally and 3.6 percent locally. At large organizations, loans outstanding have increased only 0.5 percent since last year.

Figure 11

Annual Change in RRE* Loans Outstanding

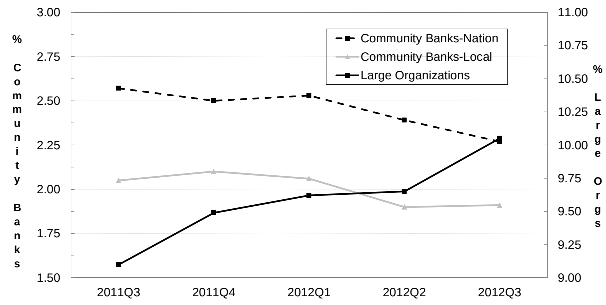


*Residential real estate

The RRE NPL ratio at large banks has increased in each of the last four quarters. Since the third quarter of last year, the NPL ratio has increased 95 basis points, to 10.05 percent (Figure 12 – Note the different scales for community banks (left y-axis) and large organizations (right y-axis)). In addition, nonperforming RRE loans have increased 11 percent in the past year and almost 18 percent from the second to the third quarter. Some of this decline in RRE loan quality at large organizations is due to two of the larger organizations, both of which continue to experience problems with their mortgage portfolios. [10] Also, the Office of the Comptroller of the Currency (OCC), which

Figure 12

Nonperforming RRE* Loans/Total RRE Loans



*Residential real estate

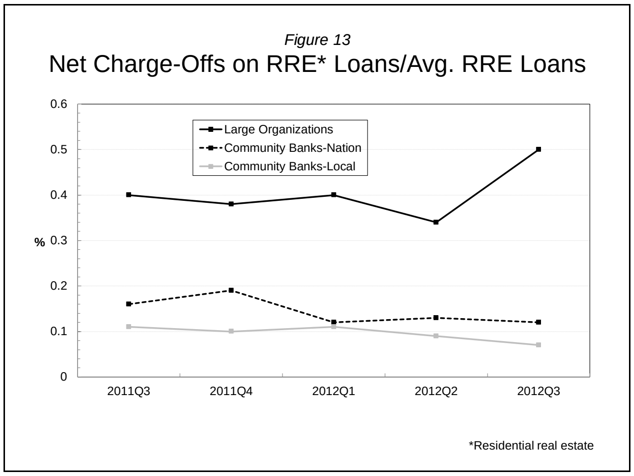
regulates national banks, issued new guidelines regarding accounting for troubled debt and nonaccruing loans, which may have resulted in an increase in reported NPLs.[11] Nonetheless, 32 of the 101 organizations experienced significant year-over-year increases in RRE NPLs, and 47 of them had an increase from the second to the third quarter.

Year-over-year 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 30 basis points, to 2.27 percent.   National community banks also had a 12-point drop in their RRE NPL ratio from the second to the third quarter. 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 14 basis points in the past year, to 1.91 percent. However, it was basically flat from the second to the third quarter.

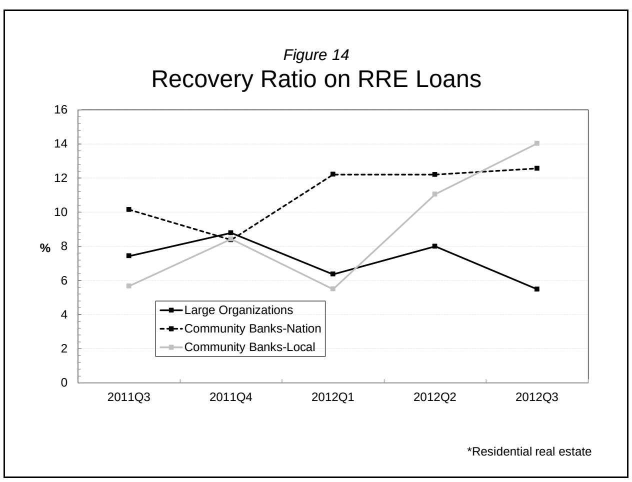
The RRE NCO ratio at large organizations has increased by 10 basis points from one year ago, to 0.50 percent (Figure 13). This was primarily due to a large increase in charge-offs, which have increased nearly 23 percent in the past year, while recoveries have decreased 9.5

[10] Excluding these organizations, the RRE NPL ratio is 6.78 percent, an increase of 21 basis points from last year.

[11] See http://www2.occ.gov/publications/publications-by-type/other-publications-reports/baas.pdf for further information.



percent. Thus, NCOs have increased over 25 percent from last year and, after falling for several quarters, increased nearly 400 percent from the second to the third quarter.[12] Again, this is partly due to the aforementioned two organizations and the OCC accounting rules change. However, 29 of the 101 large organizations in the sample experienced a substantial increase in NCOs from last year, and 38 organizations had a quarterly increase in NCOs. Combined with the increase in NPLs, this is a development that could affect the large organizations' profitability in the near future.



NCOs at community banks both nationally and locally fell substantially both year over year and from the second to the third quarter. This is reflected in the NCO ratio, which is down 4 basis points from last year both locally and nationally.

The increasing charge-offs and decreasing recoveries have led to a fairly steep decline in the recovery ratio on RRE loans at large organizations. It has decreased 1.9 percentage points since last year and 2.5 percentage points from the second to the third quarter (Figure 14). At community banks nationally, the recovery ratio has increased 2.4 percentage points. The recovery ratio at local banks has increased 8.4 percentage points since a year ago. In both of these cases, charge-offs have decreased and recoveries have increased.

Commercial Real Estate Lending[13]

Commercial real estate (CRE) market conditions were mixed both locally and nationwide. The *Beige Book* reported that most CRE markets nationwide are holding steady both in terms of construction and demand for existing space. For the most part, in the Third District construction decreased from the second to the third quarter, although it still improved from last year. Also, demand for office space remained weak. However, the *Beige Book* did report an increase in demand for industrial properties.

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 nearly flat, except at tri-state area community banks where it grew 4.3 percent (Figure 15).

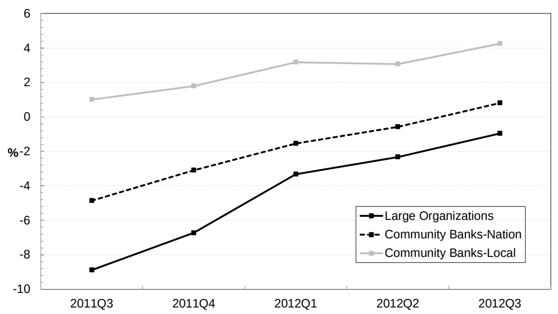
The quality of CRE loans improved at all categories of banks, as CRE NPL ratios continued to decline in the third quarter. NPL ratios have been declining for more than a year

[12] Again, excluding the organizations mentioned above, the RRE NCO ratio is up 9 basis points, to 0.46 percent. NCOs have increased 26 percent. Charge-offs increased by 25 percent, and recoveries increased 12.4 percent.

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

Figure 15

Annual Change in CRE* Loans Outstanding

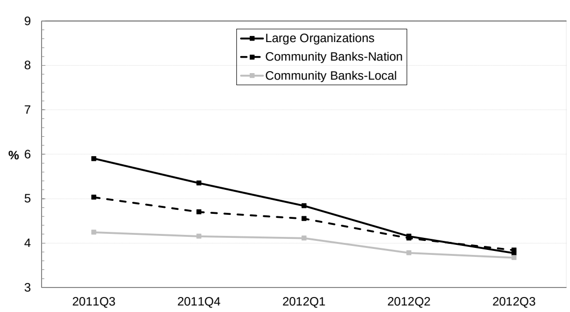


*Commercial real estate

at all categories of banks. At large organizations, the CRE NPL ratio decreased 1.1 percentage points from the third quarter of 2011, to 3.77 percent (Figure 16). The CRE NPL ratio decreased 1.2 percentage points at community banks nationally from last year, to 3.84 percent, and 57 basis points at community banks locally, to 3.67 percent. Thus, both large organizations and community banks nationally have now nearly caught up to local banks in terms of CRE loan quality.

Figure 16

Nonperforming CRE* Loans/Total CRE Loans



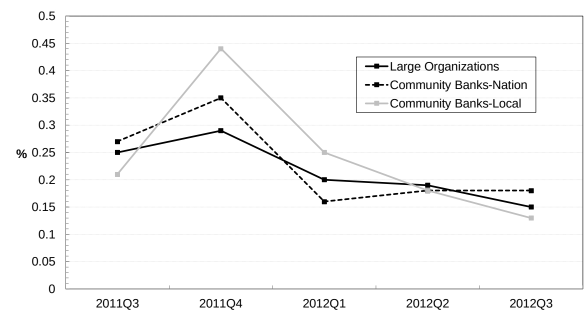
*Commercial Real Estate

Total NPLs on CRE loans are also down substantially. At large organizations, NPLs decreased nearly 37 percent in the past year. At community banks, NPLs are down 23 percent nationally and a little under 10 percent locally.

NCOs for CRE loans also decreased substantially in the past year at all categories of banks, and this is reflected in the NCO ratios. Since last year, the CRE NCO ratio at large organizations has decreased by 10 basis points, to 0.15 percent. At community banks, there was a decrease of 9 basis points nationally, to 0.18 percent, and a decrease of 8 basis points locally, to 0.13 percent (Figure 17).

Figure 17

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

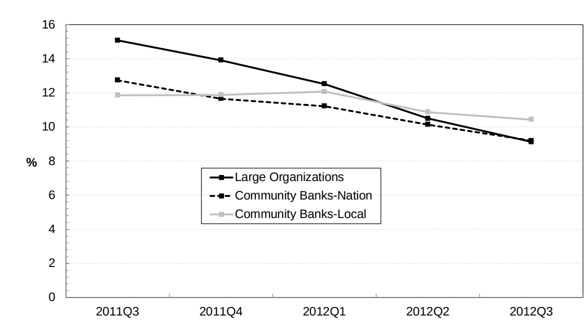


*Commercial real estate

CRE loans can be broken down into three categories: construction loans, loans secured by multifamily properties, and commercial mortgages. At both large organizations and community banks, commercial mortgages make up the vast majority of their CRE loan portfolios, but the worst loan quality problems have been in construction loans. This is improving somewhat, but the construction NPL ratio is still nearly 10 percent at all categories of

Figure 18

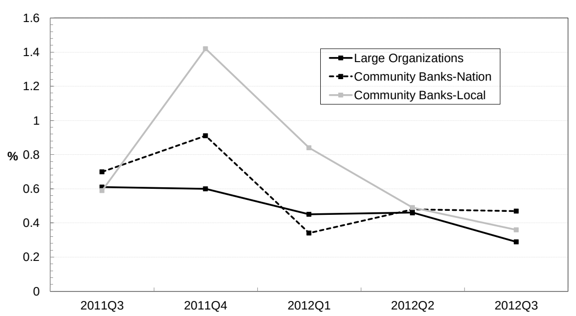
Construction Loan NPL Ratios



banks (Figure 18).

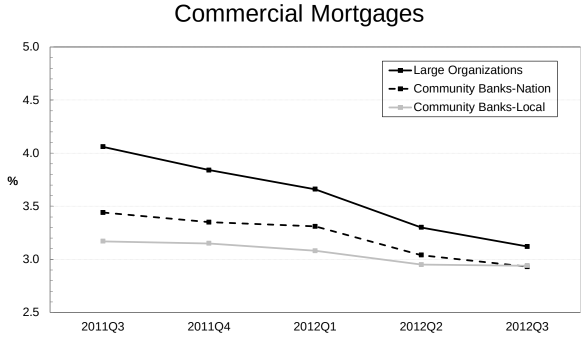
Construction loans have also figured heavily in banks' CRE NCOs. This situation has improved greatly, with construction loan NCOs decreasing nearly 50 percent in the past year at community banks and over 60 percent at large organizations. However, the NCO ratio for construction loans is still much higher than for nearly any other category of loans (Figure 19).

Figure 19
Construction Loan NCO Ratios



As noted above, the vast majority of CRE loans are commercial mortgages. Given the importance of CRE lending to community banks, the performance of commercial mortgages is a significant determinant of the community banks' overall performance. Although still at a somewhat high level, the NPL ratio on commercial mortgages has been falling continuously for more than four quarters at all categories of banks. It now stands at 3.12 percent for large organizations, 2.93 percent for community banks nationally, and 2.94 percent for local community banks (Figure 20).

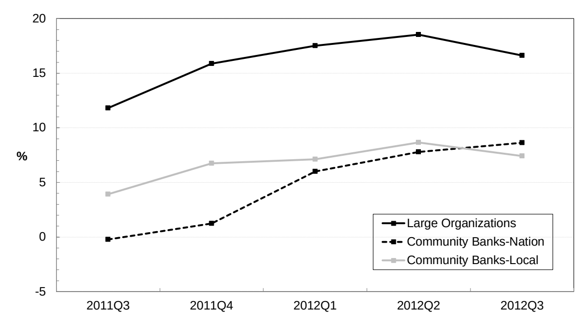
Figure 20
Nonperforming Commercial Mortgages/
Commercial Mortgages



Commercial & Industrial Lending[14]

Over the past several quarters, commercial and industrial (C&I) lending accounted for nearly all the loan growth at both large organizations and community banks. At large organizations, C&I loans grew 16.6 percent in the past year and 10.9 percent in the last quarter (Table 3 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.

Figure 21
Year-Over-Year C&I* Loan Growth



*Commercial and Industrial

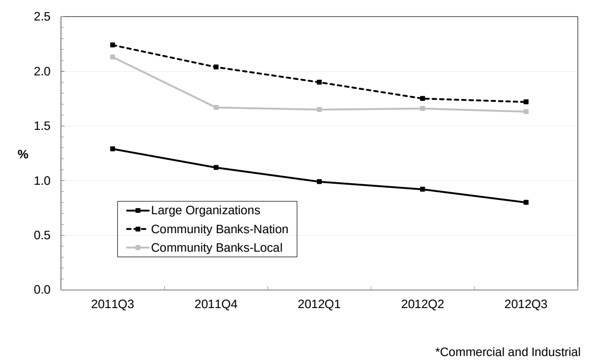
Supply-related factors appear to be driving C&I lending. The Federal Reserve Board's *Senior Loan Officer Opinion Survey* for October 2012 reported that loan demand was relatively unchanged from the second quarter for nearly all types of borrowers, but on the supply side, a fraction of domestic institutions reported that they had loosened their lending standards on all

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

types of borrowers.[15] Many lenders also noted that the reason for easing terms was more aggressive competition from other firms.

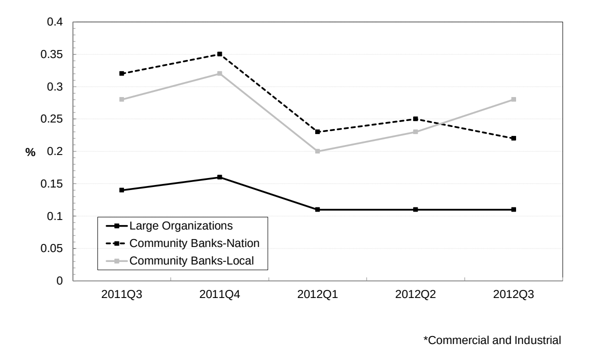
Both NPLs and NCOs fell substantially at all categories of banks, both year over year and

Figure 22
Nonperforming C&I* Loans/C&I Loans



from the second quarter of 2012. This suggests that the recent C&I loan growth has so far been achieved without compromising loan quality. The C&I NPL ratio has fallen at all categories of banks since last year, but since the second quarter, the ratio has remained relatively unchanged at community banks, while still falling at large organizations (Figure 22).

Figure 23
Net Charge-offs on C&I* Loans/Avg C&I Loans



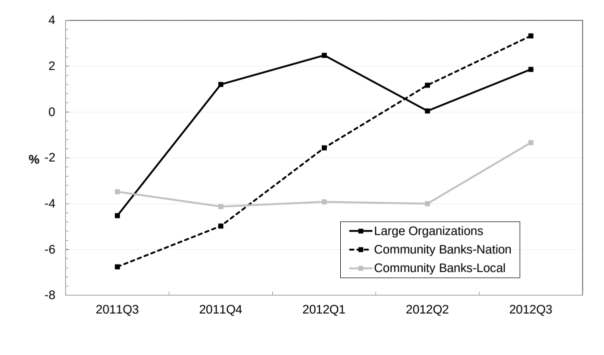
[15] See http://www.federalreserve.gov/boarddocs/SnLoanSurvey/201208/default.htm for further information.

Year over year, the NCO ratio has also fallen at all categories of banks except local community banks over the past year (Figure 23). At large organizations, the C&I NCO ratio has fallen 3 basis points since a year ago. At community banks, it has fallen 10 basis points nationally and remained unchanged locally.

Consumer Lending[16]

Overall, consumer lending has mainly been weak in the past year. At large organizations, consumer lending flattened out year over year, but there was some growth from the second to the third quarter (Figure 24). At community banks nationally, consumer lending grew slightly year to year, while locally it was nearly flat. In both cases, there was moderate growth from quarter to quarter.

Figure 24
Year-Over-Year Growth in Consumer Loans

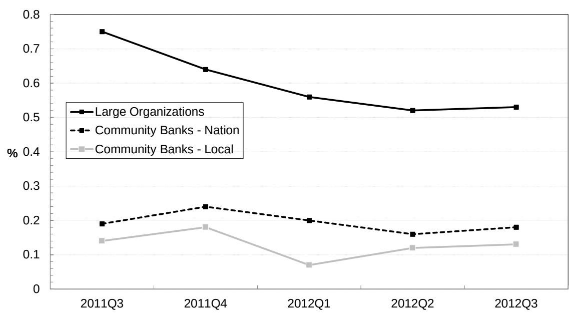


At large organizations, consumer loans represent about 14 percent of all loans. At community banks, the share of consumer loans is 4.3 percent nationally and about 3.1 percent locally. NPL ratios on consumer loans have been low: 1.28 percent for large organizations, 0.75 percent for community banks nationally, and 0.74 percent for tri-state area community banks.

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

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). The main reason is that large organizations engage in credit card lending to a much greater extent than community banks.

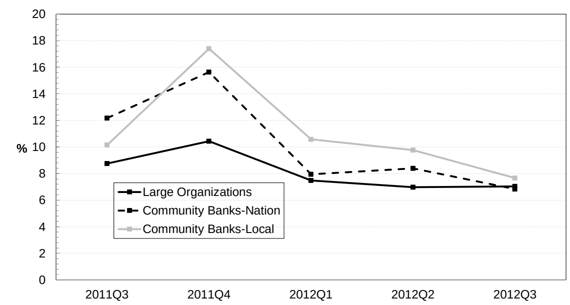
Figure 25
NCOs on Consumer Lns/Average Consumer Lns



Provisioning and Reserves[17]

With the improving situation with NPLs, NCOs, and recoveries (see above), many banks are easing up on their loan-loss provisioning. At large organizations, loan-loss provisions have fallen 17 percent in the past year.[18] At community banks, loan-loss provisions have fallen by over 40 percent nationally, and locally the decrease is 19 percent. Loan-loss provisions have also decreased as a percentage of operating income.[19] Over the year, the ratio of loan-loss provision to operating income fell 1.7 percentage points, to 7.04 percent, at large organizations; decreased 5.3 percentage points, to 6.83 percent, at community banks nationally;

Figure 26
Loan-Loss Provision/Operating Income



and fell 2.5 percentage points, to 7.66 percent, at local community banks (Figure 26).

In part, this is a response to better loan quality, but it is possible that provisions have been lowered too much and too quickly. Even though loan performance has improved, all the measures of coverage against losses remain outside of historical norms. As a result, at all categories of banks the ratio of NCOs to loan-loss provision has increased from last year (Figure 27).[20] At large organizations, the ratio is 185 percent, an increase of over 24 percentage points from last year. At community banks, the ratio is somewhat lower, but it is also increasing. The NCOs to loan-loss provision ratio has increased 17 percentage points, to 120 percent, at community banks nationally. Local community banks are actually ahead of

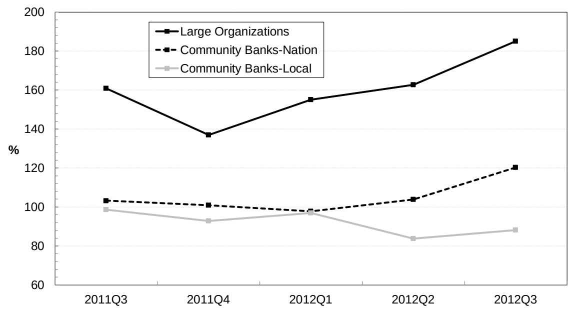
[17] See Table 5 in the Appendix for a full summary of the data used in this section.

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

[19] Operating income is defined as the sum of net interest income and noninterest income. For historical perspective, the average ratio of loan-loss provision to operating income for all commercial banks between 2001 and 2011 was 14.84 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.

[20] For historical perspective, the average ratio of NCOs to loan-loss provision for all commercial banks between 2001 and 2011 was 97.03 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.

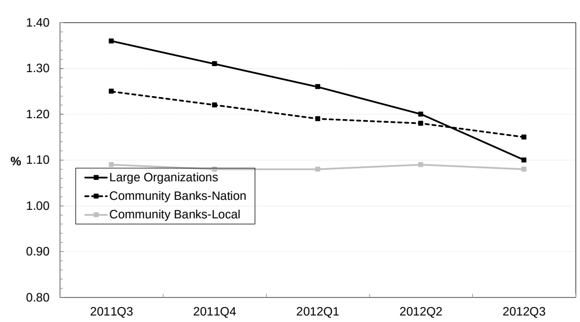
Figure 27
Net Charge-offs/Loan-Loss Provision



their NCOs, with a ratio of 88 percent. This represents a decrease of 10.5 percentage points in the past year, but the ratio increased over the last quarter.

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 in 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 is accelerating. With the exception of local community banks, total loan-loss reserves also decreased from last year. In terms of quarterly growth, reserves shrank at community banks nationally, grew modestly at local community banks, and fell substantially at large organizations.

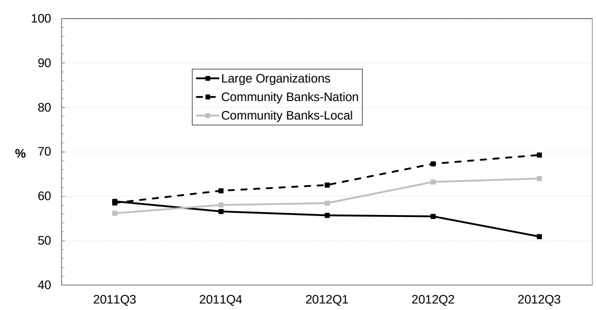
Figure 28
Loan-Loss Reserves/Assets



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 almost 8 percentage points at large organizations, to 50.97 percent (Figure 29). It also fell in the quarter by nearly 4.5 percentage points.

In contrast, improving loan quality has enabled community banks to increase their loan-loss coverage. The loan-loss coverage ratio at community banks nationally has increased nearly 9 percentage points in the past year, to 69.3 percent. Locally, loan-loss coverage increased almost 8 percentage points, to 64 percent.[21] In both cases, there were quarterly increases as well.

Figure 29
Loan-Loss Coverage Ratio



[21] 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 2001 and 2011 was 114.8 percent. At the bottom of the last real estate cycle in 1991, this ratio stood at 72.6 percent. Source: FDIC Historical Statistics on Banking, http://www2.fdic.gov/hsob/index.asp.

Securities[22]

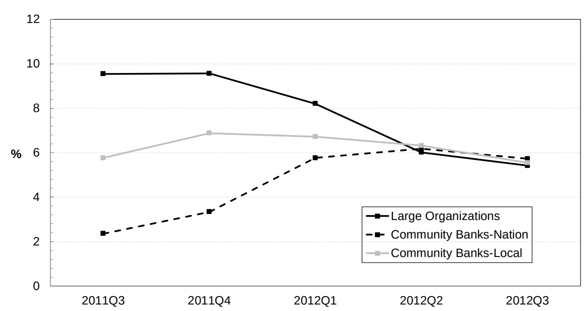
The market value of securities has increased year over year at all categories of banks.[23] Large organizations also posted a realized gain of over $2 billion.[24] Community banks nationally reported a realized gain of $352.2 million on securities in the second quarter. Local community banks reported a realized gain of $19.6 million on their securities.

Funding Sources[25]

Deposits rose at all categories of banks, both over the year and from the previous quarter. The annual growth rate was nearly equal across all categories of banks as well (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, and time deposits declined somewhat. Brokered deposits were down at community banks nationally but increased at local community banks and large organizations. Foreign deposits also showed a substantial decline.

Figure 30

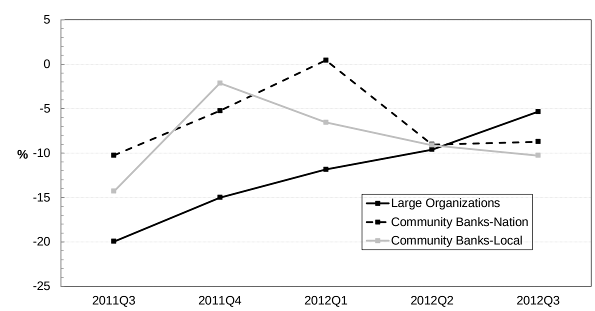
Year-Over-Year Growth in Deposits



Nondeposit funding continued to fall year over year and quarterly at all categories of banks (Figure 31).[26]

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).[27] Core deposits are the least expensive and most stable form of funding for banks. However, core deposit growth was basically flat from the second to the third quarter at all categories of banks.

[22] 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.

[23] 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.

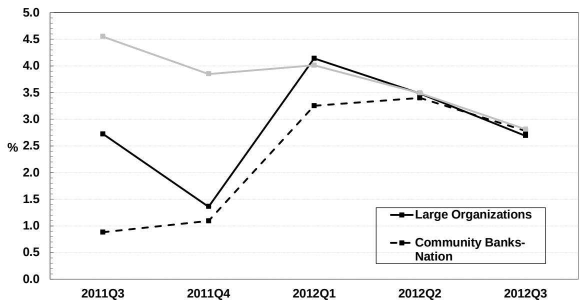
[24] Realized and unrealized gains and losses are net positions. Thus, the tri-state area sample can have larger gains or losses than the national sample, even though the tri-state sample is a subset of the national sample.

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

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

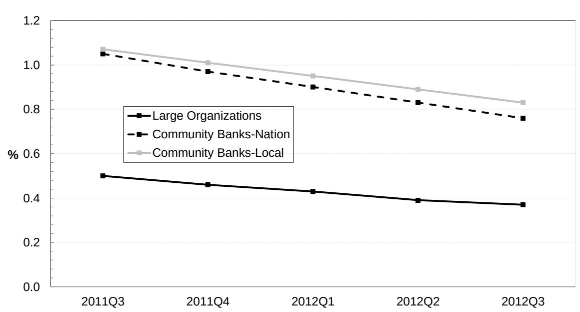
[27] Core deposits are defined as total domestic deposits less the sum of brokered deposits in denominations of less than $100,000 and all deposits in denominations greater than $100,000.

Figure 32
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 33).[28] This holds true for nondeposit funding as well.

Figure 33
Implicit Interest Rate on Deposits



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

Regulatory Capital[29]

Both large organizations and community banks appear to be in fairly good shape as far as their capitalization goes. All of the 101 large organizations in the sample had equity-to-assets ratios of at least 6 percent, and all but one had equity-to-assets ratios of over 7 percent.[30] At community banks nationally, 97.3 percent of the institutions had equity-to-assets ratios of at least 6 percent, and 95.6 percent had ratios of at least 7 percent. Locally, 97.7 percent (171 out of 175) of the institutions had a capital ratio of at least 6 percent, and only three of those 171 institutions had an equity-to-assets ratio of less than 7 percent.

Year over year, capitalization at large organizations has improved slightly in all but risk-based capital. Also, capitalization is high by historical standards.[31] Year over year, the equity-to-assets ratio at large organizations has increased 18 basis points, the tier 1 leverage ratio has increased 21 basis points, and the risk-based capital ratio has decreased 32 basis points.[32] Capital ratios at large banks have been

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

[30] 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.

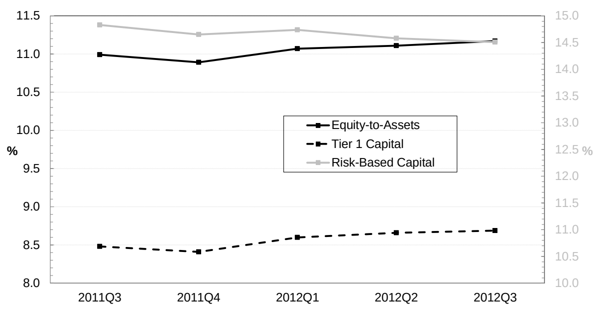
[31] The average ratio of total equity to total assets at all commercial banks from 2001 to 2011 was 10.03 percent. Source: FDIC Historical Statistics on Banking, http://www2.fdic.gov/hsob/index.asp.

[32] 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.

fairly stable for more than a year now (Figure 34).

Figure 34

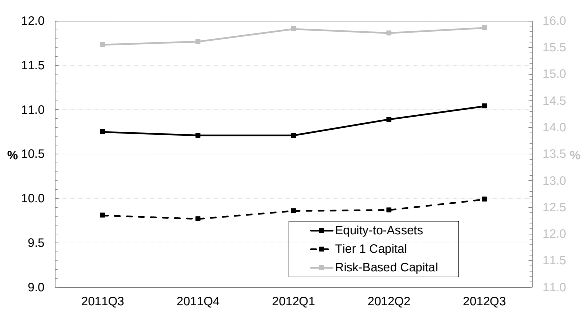
Regulatory Capital – Large Organizations



Community banks nationally have increased their capitalization from last year. Since last year, the equity-to-assets ratio at these banks has increased 29 basis points; the tier 1 capital ratio has increased 18 basis points; and the risk-based capital ratio has increased 32 basis points (Figure 35). At local banks, capital

Figure 35

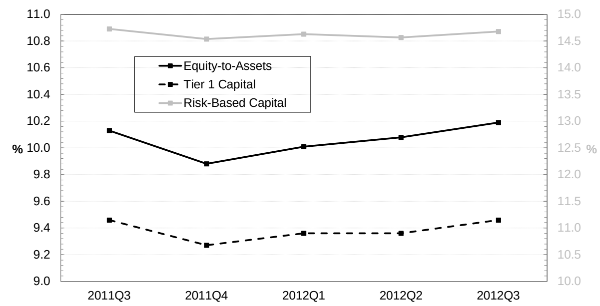
Regulatory Capital – All Community Banks



ratios were basically flat year over year, but there has been some positive growth between the second and third quarters. Since last year, the equity-to-assets ratio at local banks has increased 6 basis points; the tier 1 leverage ratio has remained unchanged; and the risk-based capital ratio has fallen 5 basis points (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, while common stock decreased at all but local community banks. Also, all categories of banks had relatively large increases in 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	0.52%	3.6%	7.3%
RRE NPLs	11.0%	-3.4%	-5.2%
RRE NCOs	25.2%	-30.0%	-21.2%
2. Shares			
RRE Lns/Total Lns	33.4%	31.7%	27.0%
RRE NPLs/Total NPLs	76.5%	23.5%	22.9%
RRE NCOs/Total NCOs	57.3%	19.4%	21.9%
3. Performance Ratios			
RRE NPLs/Total RRE Lns	10.05%	1.91%	2.27%
RRE NCOs/Avg. RRE Lns	0.5%	0.07%	0.12%
4. Outstandings ($millions)			
Total RRE Lns	1,682,784.1	19,713.4	325,450.0
RRE NPLs	169,064.8	376.3	7,388.3
RRE NCOs	8,473.8	14.3	386.2

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	-1.0%	4.3%	0.8%
CRE NPLs	-36.7%	-9.8%	-23.1%
CRE NCOs	-42.7%	-36.4%	-34.3%
2. Shares			
CRE Lns/Total Lns	15.6%	45.6%	43.1%
CRE NPLs/Total NPLs	13.4%	65.1%	61.9%
CRE NCOs/Total NCOs	8.2%	48.0%	52.2%
3. Performance Ratios			
CRE NPLs/Total CRE Lns	3.77%	3.67%	3.84%
CRE NCOs/Avg. CRE Lns	0.15%	0.13%	0.18%
4. Outstandings ($millions)			
Total CRE Lns	787,676.1	28,426.2	519,510.6
CRE NPLs	29,687.1	1,044.2	19,954.2
CRE NCOs	1,205.3	35.4	921.4

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	16.6%	7.4%	8.6%
C&I NPLs	-28.3%	-17.6%	-16.7%
C&I NCOs	-12.0%	9.1%	-29.1%
2. Shares			
C&I Lns/Total Lns	22.6%	13.4%	15.6%
C&I NPLs/Total NPLs	4.1%	8.5%	10.0%
C&I NCOs/Total NCOs	7.9%	31.0%	22.3%
3. Performance Ratios			
C&I NPLs/Total C&I Lns	0.79%	1.63%	1.72%
C&I NCOs/Avg. C&I Lns	0.11%	0.28%	0.22%
4. Outstandings ($millions)			
Total C&I Lns	1,138,093.9	8,345.7	188,452.5
C&I NPLs	9,046.5	136.3	3,234.1
C&I NCOs	1,167.4	22.9	393.8

Table 4 - Summary of Consumer Lending

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
1. Year–over–year growth			
Total Consumer loans	1.9%	-1.3%	3.3%
Consumer NPLs	-8.0%	27.6%	4.7%
Consumer NCOs	-29.7%	-7.4%	-7.9%
2. Shares			
Consumer Lns/Total Lns	14.0%	3.1%	4.3%
Consumer NPLs/Total NPLs	4.1%	0.9%	1.2%
Consumer NCOs/Total NCOs	25.0%	3.4%	5.2%
3. Performance Ratios			
Cons NPLs/Total Cons Lns	1.28%	0.74%	0.75%
Cons NCOs/Avg. Cons Lns	0.53%	0.13%	0.18%
4. Outstandings ($millions)			
Total Consumer Lns	706,820.5	1,947.4	52,370.4
Consumer NPLs	9,053.3	14.4	393.7
Consumer NCOs	3,698.0	2.5	91.5

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

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Loan-loss Reserve ($Millions)	112,668.4	1,027.6	22,363.3
Change from Last Quarter	-25.5%	3.4%	-7.8%
Change from Last Year	-16.2%	3.9%	-3.3%
Net Charge-Offs/LL Provision	184.98%	88.11%	120.22%
LL Provision/Operating Inc.	7.04%	7.66%	6.83%
Loan-loss Coverage Ratio	50.97%	64.03%	69.32%

Table 6 - Summary of Securities Portfolios

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Securities/Assets	21.3%	22.2%	23.2%
Market Value ($Millions)	2,192,936.0	21,090.2	451,551.3
Change from Last Quarter	8.1%	3.6%	1.8%
Change from Last Year	9.2%	3.0%	11.4%
Realized Gain/Loss	2,005.3	19.6	352.2
Pct of Average Securities	.09%	.09%	0.08%
Market Value/Book Value	102.84	102.98	102.82%

Table 7 - Structure of Liabilities

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Deposits ($millions)	7,479,536.3	79,673.3	1,615,414.6
Pct. of Assets	73.0%	84.1%	83.2%
Change from Last Quarter	8.5%	8.0%	2.8%
Change from Last Year	5.4%	5.6%	5.7%
Core Deposits/Deposits	36.0%	66.0%	65.6%
Implicit Rate on Deposits	0.37%	0.83%	0.76%
Nondeposit Debt ($millions)	993,129.7	4,322.9	95,987.4
Pct. of Assets	9.7%	4.6%	4.9%
Change from Last Quarter	-11.7	-29.3%	-4.4%
Change from Last Year	-5.4	-10.3%	-8.7%
Implicit Rate on Debt	1.62%	2.44%	2.13%

Table 8 - Capitalization Measures

	Large Organizations	Community Banks	
Ratios	Nation	Tri-State Area	Nation
Total Equity/Total Assets	11.17%	10.19%	11.04%
Change fr. Last Qtr. (basis pts)	6	11	15
Change fr. Last Yr. (basis pts)	18	6	29
Tier 1 Leverage Ratio	8.69%	9.46%	9.99%
Change fr. Last Qtr. (basis pts)	3	10	12
Change fr. Last Yr. (basis pts)	21	0	18
Risk-Based Capital Ratio	14.51%	14.68%	15.87%
Change fr. Last Qtr. (basis pts)	-7	11	10
Change fr. Last Yr. (basis pts)	-32	-5	32