BANKING BRIEF
FOR PENNSYLVANIA, NEW JERSEY, AND DELAWARE

Fourth Quarter Highlights

- *Year over year, profitability (ROA) continued to improve at all categories of banks.*
- *Year over year, loans grew modestly at all categories of banks, with commercial and industrial lending showing rapid growth.*
- *Loan quality improved year over year at all categories of banks, as both nonperforming loans and net charge-offs decreased.*
- *Residential real estate (RRE) loan quality declined at large organizations but improved at community banks. RRE loans grew substantially at community banks nationally, more modestly at local community banks, and barely 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.*
- *Construction lending remains a problem, with shrinking outstandings and large amounts of nonperforming loans at all categories of banks. Net charge-offs have dropped substantially.*
- *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 and virtually unchanged at local community banks. Loan-loss provisions decreased for all types of banks as well.*

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 – Fourth Quarter 2012

	Community Banking Organizations							*Large Organizations*		
	Nation			*Tri-State*				*Nation*		
	$ Bill	**% Change From**		**$ Bill**	**% Change From**			**$ Bill**	**% Change From**	
	12Q4	**12Q3**	**11Q4**	**12Q4**	**12Q3**	**11Q4**		**12Q4**	**12Q3**	**11Q4**
Total Assets	1,983.7	8.86	6.30	97.4	11.77	5.57	Total Assets	10,503.5	10.11	5.69
Total Loans	1,226.3	6.69	5.40	63.7	9.73	6.54	Total Loans	5,145.9	9.10	5.23
C&I	195.0	14.65	10.92	8.5	9.49	6.63	C&I	1,180.0	15.65	14.48
Real Estate	907.4	4.77	4.07	49.7	8.26	5.12	Real Estate	2,582.2	5.67	1.37
Consumer	52.4	0.32	4.23	2.0	8.52	2.41	Consumer	717.7	6.28	1.30
Total Deposits	1,655.5	10.45	7.14	81.9	11.45	6.39	Total Deposits	7,807.8	18.71	7.96
Ratios (in %)	**12Q4**	**12Q3**	**11Q4**	**12Q4**	**12Q3**	**11Q4**	**Ratios (in %)**	**12Q4**	**12Q3**	**11Q4**
Net Income/Avg Assets (ROA)	0.88	0.78	0.58	0.64	0.57	0.52	Net Income/Avg Assets (ROA)	0.91	0.86	0.79
Net Interest Inc/Avg Assets (NIM)	3.44	3.46	3.47	3.27	3.30	3.34	Net Interest Inc/Avg Assets (NIM)	2.61	2.64	2.70
Noninterest Inc/Avg Assets	0.99	0.96	0.89	1.29	1.26	1.22	Noninterest Inc/Avg Assets	1.83	1.78	1.82
Noninterest Exp/Avg Assets	3.05	3.06	3.05	3.27	3.29	3.27	Noninterest Exp/Avg Assets	2.90	2.93	2.96
Loans/Deposits	74.07	74.72	75.30	77.87	78.17	77.76	Loans/Deposits	65.91	67.31	67.62
Equity/Assets	10.83	11.04	10.70	9.87	10.18	9.87	Equity/Assets	10.94	11.17	10.89
Nonperforming Loans/Total Loans	2.40	2.68	3.20	2.29	2.58	2.88	Nonperforming Loans/Total Loans	4.07	4.40	4.70

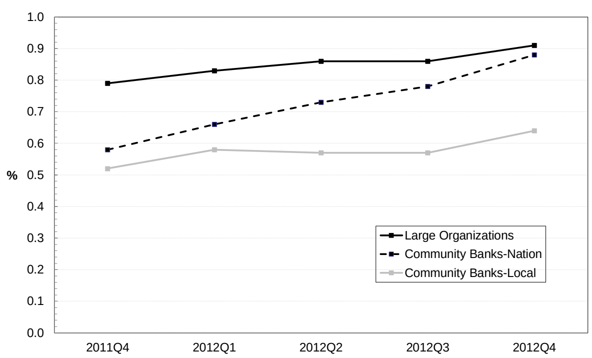
A banking organization is an independent bank or all the banks within a highest-level bank holding company; however, banks less than five years old and special purpose banks such as credit card banks are excluded. However, some numbers were skewed by Citigroup's reorganization in the third quarter of 2011 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 — 174 for the tri-state area and 5,296 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.

Fourth Quarter 2012

The industry as a whole reported mixed results in the fourth quarter, as the number of banks reporting losses increased; however, profitability still increased at all categories of banks.[1] Year-over-year profitability as measured by return on average assets (ROA) increased 30 basis points at community banks nationally, to 0.88 percent; increased 12 basis points at community banks locally, to 0.64 percent; and increased 12 basis points at large organizations, to 0.91 percent (Figure 1).[2]

Figure 1

Return on Average Assets



The increased profitability can be attributed primarily to the continued improvement in loan quality, which resulted in lower loan-loss provisions, and increased asset sales also contributed to increasing income. Net charge-offs (NCOs) and nonperforming loans (NPLs) continued to decrease.[3] As a result, large organizations have seen a 41 percent increase in quarterly net income since the fourth quarter of 2011 and a 16 percent decrease in their loan-loss reserves (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 107 percent since last year, a little over $2 billion. This increase is attributed to decreased loan-loss provisioning due to improved loan quality. There has also been an increase in asset sales, specifically loan sales. In addition, losses on the sale of foreclosed real estate decreased. These factors more than made up for decreases in net interest margins.

At local community banks, quarterly profits increased by over 150 percent. Like other categories of banks, local community banks did have increased loan quality. However, unlike the other categories of banks, local community banks' loan-loss provisioning was basically flat. Increased income locally was due to increased asset sales and higher noninterest income.

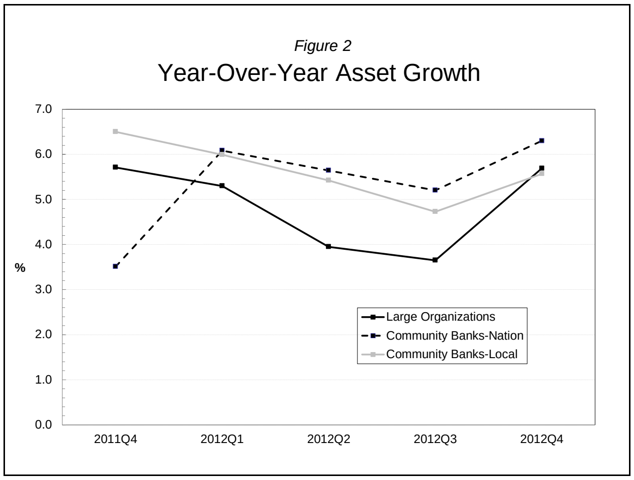
Year over year, assets of community banks nationally grew at a rate of 6.3 percent, while the rate of asset growth at local community banks was 5.6 percent (Figure 2). At large organizations, asset growth was 5.7 percent. The growth in assets was fueled by increases in securities and loans. The market value of securities increased 7.3 percent at national community banks, 8.8 percent at large organizations, and only 1.1 percent at local community banks.

[1] Out of 5,296 community banks in the national sample, 4,554 reported positive quarterly profits. This was a decrease of 213 from the third quarter of 2012. Locally, 150 out of 174 banks reported positive profits, a decrease of 10 from the third quarter of 2012. For large organizations, 95 out of 100 were profitable, a decrease of one bank.

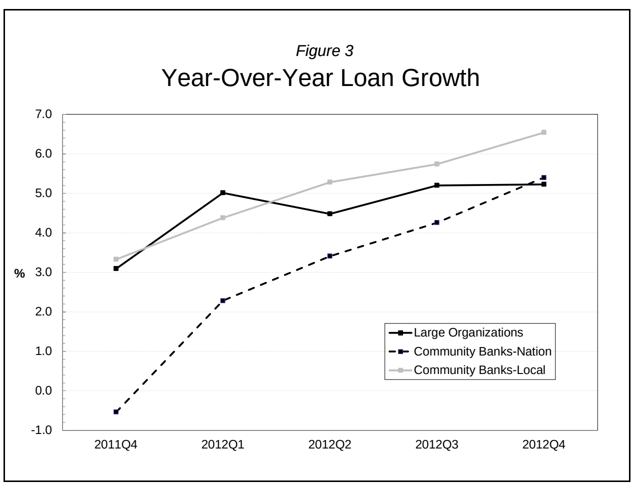
[2] See Summary Table of Bank Structure and Conditions on page 2.

[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.

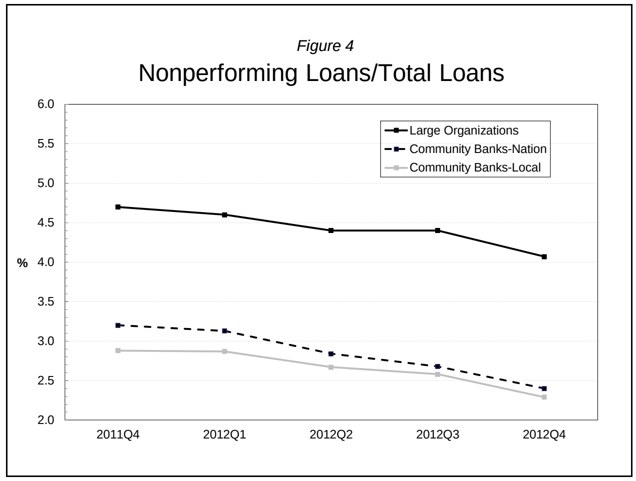


Loan growth accelerated at all categories of banks (Figure 3). Over the past year, total loans at large organizations grew at about 5.2 percent. The fastest growing category of loans was commercial loans, which increased almost 15 percent in the past year, whereas real estate lending and consumer loans grew less than 1.5 percent. At community banks, lending grew 5.4 percent in the nation and 6.5 percent locally. In both cases, the main area of growth was in commercial loans, with some growth in real estate loans; in addition, consumer lending showed the beginnings of a recovery.



Loan quality at large organizations continued to improve substantially over the year, with the ratio of NPLs to total loans (the NPL ratio) decreasing 63 basis points, to 4.07 percent (Figure 4).[5]

At community banks nationally, the NPL ratio has decreased 80 basis points since last year, to 2.40 percent. Locally, the NPL ratio



fell by 59 basis points over the past year, to 2.29 percent. Over the quarter, the NPL ratio fell 29 basis points.

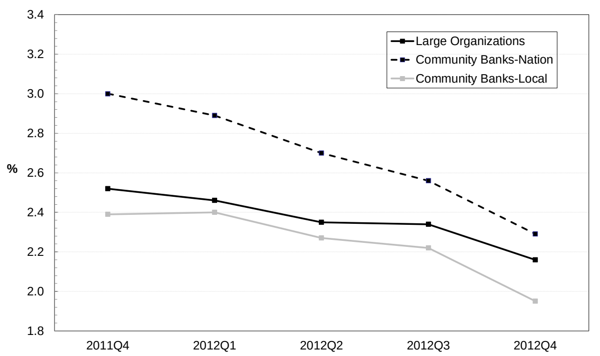
Overall, asset quality has also improved at all categories of banks.[6] Foreclosed real estate, known as other real estate owned (OREO), fell substantially from last year at all categories of banks. At large organizations, OREO decreased 13.1 percent. At community banks, the decrease was 14.1 percent nationally and 9.2 percent locally. Combining the decrease in OREO with the improved loan quality, the ratio of nonperforming assets (NPAs) to total assets has fallen at all three categories of banks in the past

[5] For historical perspective, the average NPL ratio for all commercial banks between 2001 and 2011 was 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.

Figure 5

Nonperforming Assets/Total Assets



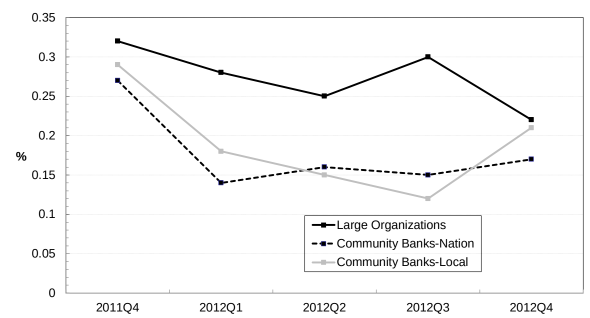
year (Figure 5).[7] At large organizations, the NPA ratio has fallen 36 basis points over the past year and 18 basis points in the fourth quarter, to 2.16 percent. At community banks nationally, the decrease was 71 basis points for the year and 27 points for the quarter, to 2.29 percent, and locally the NPA ratio fell 44 basis points for the year and 27 points for the quarter, to 1.95 percent.

NCOs tell a similar story, although the numbers are choppier. The ratio of NCOs to average loans (NCO ratio) fell 10 basis points over the year at large organizations, to 0.22 percent, and 8 basis points from the third quarter after rising last quarter (Figure 6). NCOs on RRE loans had been rising over the past several quarters, but they dropped substantially in the fourth quarter (see "Residential Real Estate Lending" below).

Community banks both locally and nationally continued to have a lower NCO ratio than the large organizations. However, even though the ratio is lower this year than it was in the fourth quarter of 2011, it rose in the fourth quarter both locally and nationally. For community banks in the nation, the NCO ratio has fallen 10 basis points over the year but rose 2 points in the last quarter, to 0.17 percent. This was due to increases in charge-offs of RRE loans and C&I loans. At tri-state area community banks, the NCO ratio has fallen 8 basis points over the past year but rose 9 basis points in the fourth quarter, to 0.21 percent. This was due to increases in NCOs on RRE, CRE, and C&I loans.

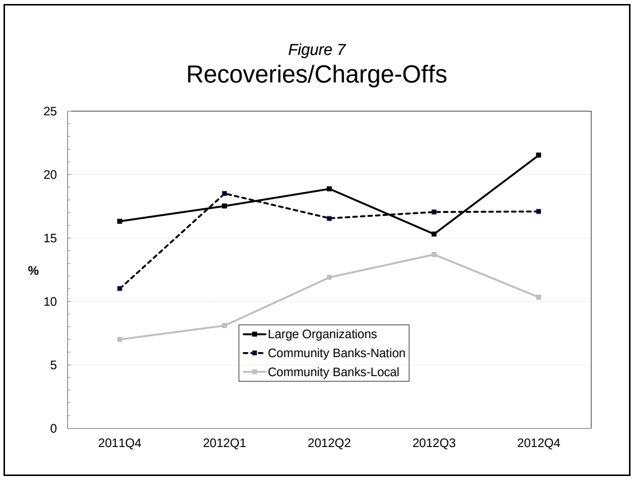
Figure 6

Quarterly Net Charge-Offs/Average Loans

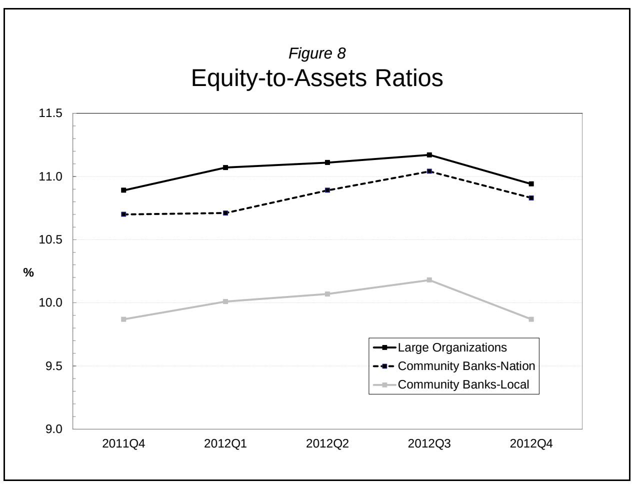


At large organizations, gross charge-offs have fallen 23.5 percent in the past year, and recoveries have risen 8.3 percent. At community banks nationally, charge-offs have fallen over 33 percent, while recoveries have increased 3.5 percent in the past year. The story is essentially the same at local community banks, where charge-offs have fallen 20 percent and recoveries have increased over 18 percent since last year. However, it is worth noting that charge-offs have increased substantially at local community banks from the third quarter. This increase occurred in both the commercial real estate and C&I components of their loan portfolios and was fairly widespread throughout the sample, with roughly a third of institutions reporting increased NCOs on either CRE or C&I loans (or both).

[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.



Capital ratios, defined as the ratio of total equity to assets, are nearly the same as they were a year ago, but they fell at all categories of banks from the third to the fourth quarter (Figure 8). At large organizations and local community banks, this decrease was due to relatively small decreases in total capital, which in turn were due to smaller retained earnings, coupled with modest asset growth. At national community banks, total equity increased, but at a lower rate than that of assets.

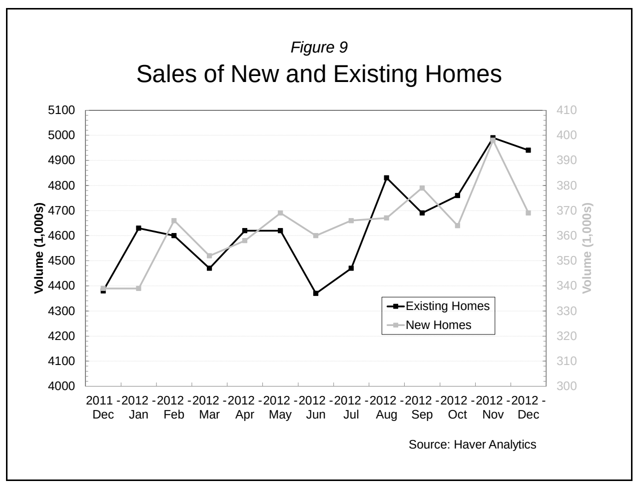


The number of bank failures fell substantially in the fourth quarter. The Federal Deposit Insurance Corporation reported only eight bank failures for the entire quarter, the lowest total in several years. One of these failures occurred in Pennsylvania. This represents a decrease both from the third quarter of 2012, when there were 12 failures, and from the fourth quarter of 2011, when there were 18 failures.

Additionally, three other banks have failed so far in the first quarter of 2013 (as of February 21, 2013). 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 also failed 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 January 13, 2013, reported that existing home sales were either improving or holding steady in nearly all Federal Reserve Districts and that construction was increasing in most Districts as well.[9] However, locally, the results were mixed at best,



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

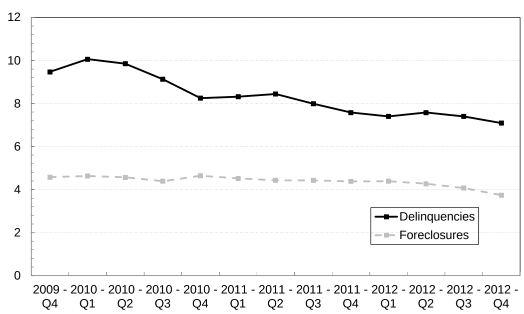
[9] For further information, see http://www.federalreserve.gov/monetarypolicy/beigebook/beigebook201301.htm.

as both Philadelphia and New York (which includes northern New Jersey) reported erratic sales compared with other regions.

Sales of both new and existing homes have increased since both the fourth quarter of last year and the end of the third quarter (Figure 9). Sales of new homes have grown modestly over the past year. The percentage of delinquent mortgages has decreased 49 basis points from a year ago, and the percentage of mortgages in foreclosure has decreased 64 basis points (Figure 10).

Figure 10

Delinquency and Foreclosure Rates

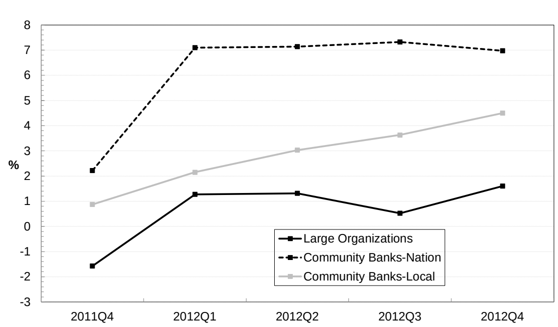


Source: Haver Analytics

RRE loans outstanding increased substantially at community banks but have shown little growth at large organizations (Figure 11). From the fourth quarter of 2011 to the fourth quarter of 2012, RRE loans outstanding grew 7.0 percent at community banks nationally and 4.5 percent locally. At large organizations, loans outstanding were basically flat, increasing only 1.6 percent since last year.

Figure 11

Annual Change in RRE* Loans Outstanding

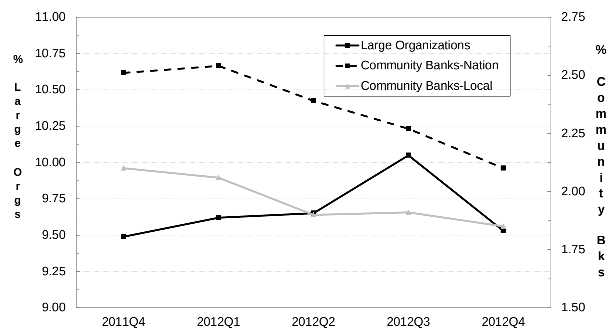


*Residential real estate

The quality of RRE loans continued to improve as well, but large organizations especially are still carrying a lot of bad loans. After increasing for the past several quarters, the RRE NPL ratio at large banks fell to 9.53 percent, a 52-basis-point drop from the third quarter, but remained nearly the same as it was last year (Figure 12 – Note the different scales for community banks (left y-axis) and large organizations (right y-axis)).

Figure 12

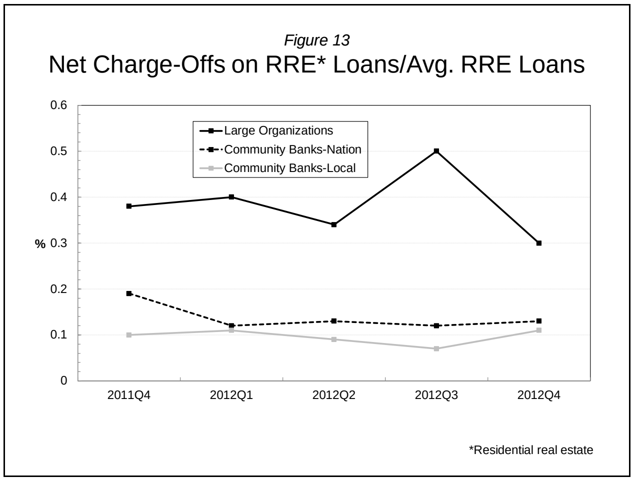
Nonperforming RRE* Loans/Total RRE Loans



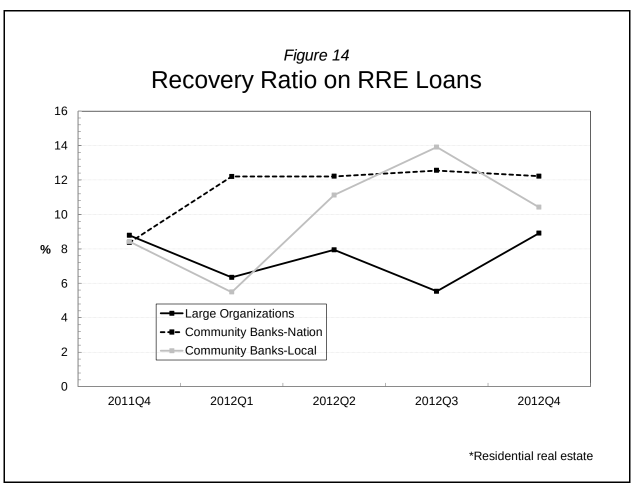
*Residential real estate

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 39 basis points, to 2.10 percent. Nationally, community banks also had a 17-point drop in their RRE NPL ratio from the third to the fourth 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 has decreased 25 basis points in the past year, to 1.85 percent.

The improvement in loan quality at large organizations is also reflected in the RRE NCO ratio. This ratio has been somewhat erratic, decreasing 8 basis points in the past year and 20 basis points in the fourth quarter, to 0.30 percent (Figure 13).



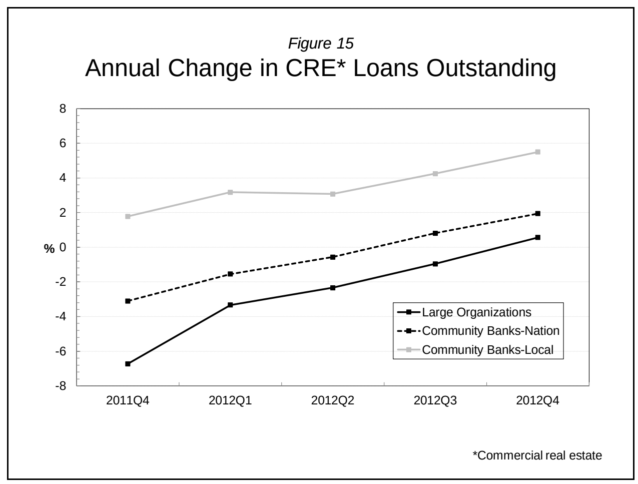
NCOs at community banks nationally have fallen substantially in the past year, but locally they rose slightly. The reason is that gross charge-offs decreased at local community banks nationally, while they increased locally. As a result, the RRE NCO ratio has decreased 6 basis points nationally but increased 1 point locally. In both cases, however, the ratio increased from the third to the fourth quarter.



Commercial Real Estate Lending[10]

Commercial real estate (CRE) market conditions were mixed both locally and nationally. The *Beige Book* reported that most CRE markets nationwide are showing slight improvement in demand for commercial space, with construction still very weak. For the most part, in the Third District demand for office and warehouse space was flat or increased slightly, with construction lagging in part due to Hurricane Sandy. However, the *Beige Book* did report more optimism on the part of both builders and landlords for slow but steady growth going forward.

CRE lending results were average at best in the fourth quarter, with loan quality increasing, while loan growth remained anemic except at local community banks. Year over year, overall growth in CRE lending was nearly zero at large organizations, grew at less than 2 percent at community banks nationally, but showed a 5.5 percent growth rate at tri-state area community banks (Figure 15). One possible reason cited in the *Beige Book* is that housing construction demand is slightly higher locally than in most of the country.



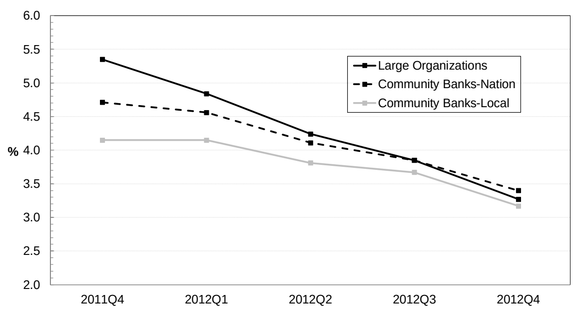
The quality of CRE loans improved substantially at all categories of banks, as CRE

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

NPL ratios continued to decline. NPL ratios have been declining for more than a year at all categories of banks. At large organizations, the CRE NPL ratio has decreased more than 2 percentage points from the fourth quarter of 2011, to 3.27 percent (Figure 16). The CRE NPL ratio decreased 1.3 percentage points at community banks nationally from last year, to 3.40 percent, and 98 basis points at community banks locally, to 3.17 percent.

Figure 16

Nonperforming CRE* Loans/Total CRE Loans

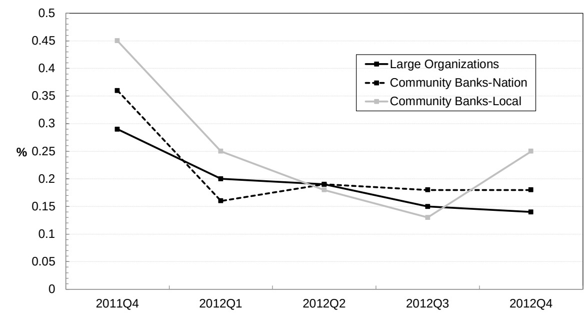


*Commercial Real Estate

Since last year, the CRE NCO ratio at large organizations has decreased 15 basis points, to 0.14 percent. At community banks, there was a decrease of 18 basis points nationally, to 0.18 percent, and a decrease of 20 basis points locally, to 0.25 percent (Figure 17). Total CRE NCOs have also been down substantially at all categories of banks since last year. However, from the third to the fourth quarter of 2012, total NCOs on CRE loans increased somewhat at community banks nationally and substantially at local community banks. Considering that NPLs continued to drop, this increase in NCOs doesn't appear to be a cause for concern at this time. Both the *Beige Book* and the *Senior Loan Officer Opinion Survey* report that credit quality is improving.

Figure 17

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

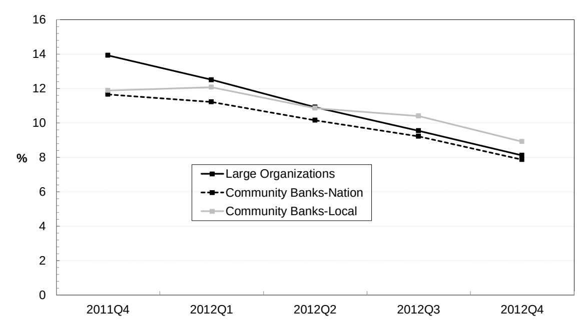


*Commercial real estate

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. In the past year, construction loan quality has vastly improved, with NPL ratios dropping 4-5 percentage points in nearly all categories of banks (Figure

Figure 18

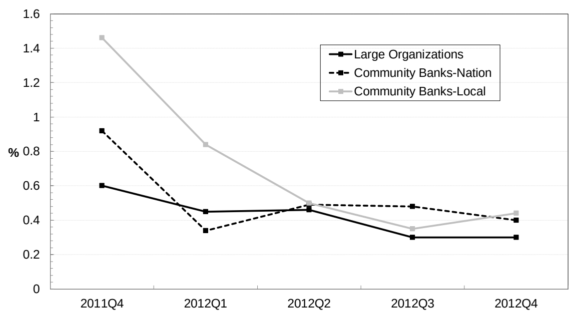
Construction Loan NPL Ratios



18). Total NPLs have also dropped over 30 percent at community banks and over 50 percent at large organizations. However, the NPL ratio at all categories remains over 8 percent, so there is still a lot of improvement to be had.

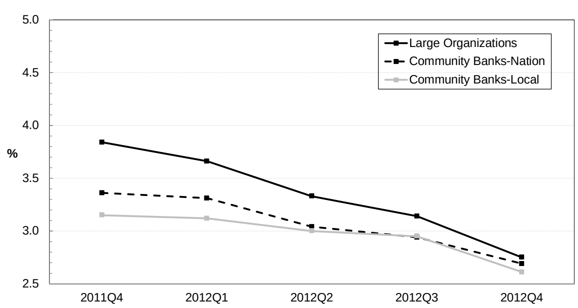
Construction loans have also contributed heavily to banks' CRE NCOs. This part of bank portfolios is performing significantly better, with construction loan NCOs decreasing over 60 percent at all categories of banks in the past year. However, the NCO ratio for construction loans is still much higher 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

Figure 20
Nonperforming Commercial Mortgages/ Commercial Mortgages

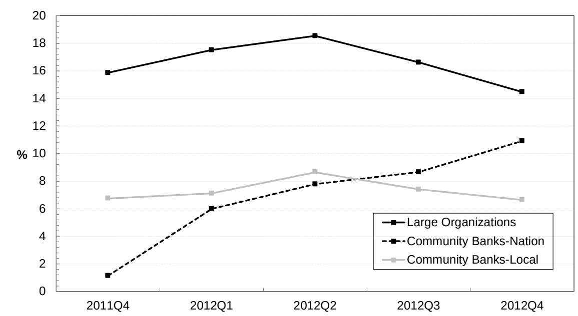


at all categories of banks. It now stands at 2.75 percent for large organizations, 2.69 percent for community banks nationally, and 2.61 percent for local community banks (Figure 20).

Commercial & Industrial Lending[11]

At large organizations, C&I loans have grown 14.5 percent in the past year and 15.7 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 at large banks. However, its rate of growth slowed at local community banks.

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



*Commercial and Industrial

The Federal Reserve Board's *Senior Loan Officer Opinion Survey* for January 2013 reported that loan demand had increased slightly from the third 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 types of borrowers.[12] Many lenders also noted that the reason for easing terms was more aggressive competition from other firms.

The loosening of credit standards has not had an adverse effect on loan quality. The C&I

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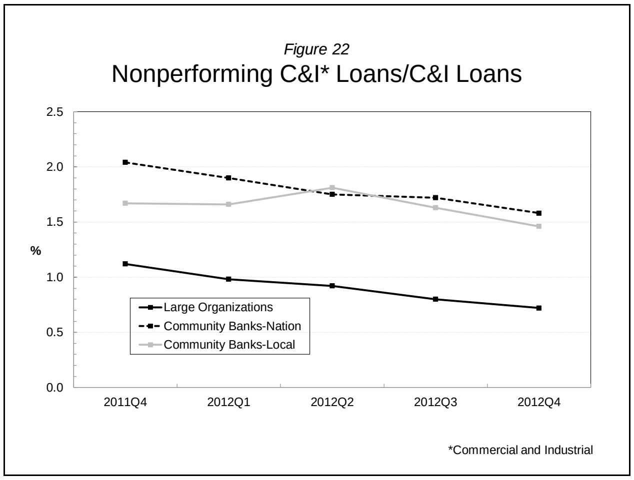
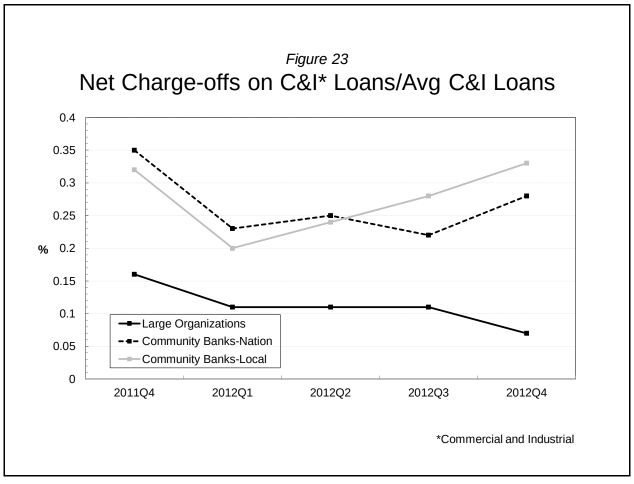
[11] See Table 3 in the Appendix for a full summary of the data used in this section.

[12] See http://www.federalreserve.gov/boarddocs/SnLoanSurvey/201302/default.htm for further information.

NPL ratio has fallen at all categories of banks since last year (Figure 22).

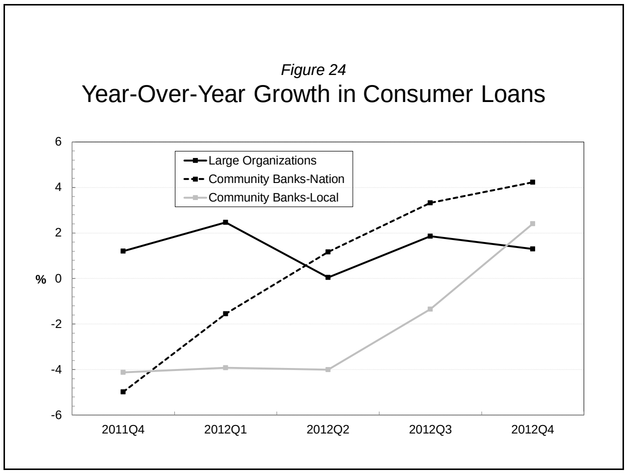


The NCO ratio has also fallen at all categories of banks except local community banks over the past year (Figure 23). At large organizations, the C&I NCO ratio has fallen 9 basis points since a year ago. At community banks, it has fallen 7 basis points nationally and increased 1 basis point locally. Total NCOs increased year over year at local community banks, and community banks locally and nationally had a sharp increase in NCOs from the third to the fourth quarter.



Consumer Lending[13]

Overall, consumer lending has mainly been weak in the past year. At large organizations, consumer lending was basically flat, growing only 1.3 percent year over year (Figure 24). Large organizations conduct the vast majority of consumer lending. At community banks nationally, consumer lending grew about 4 percent, while locally growth was only 2.4 percent.

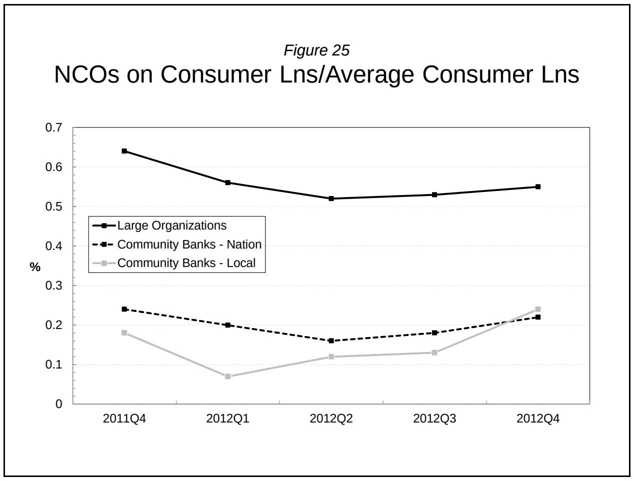


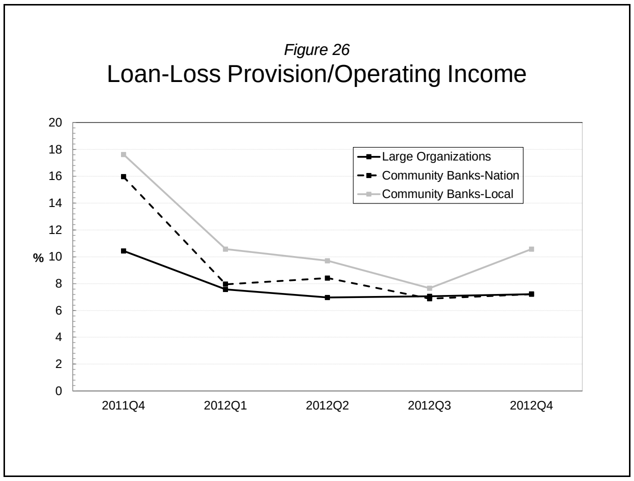
NPL ratios on consumer loans have been low: 1.13 percent for large organizations, 0.74 percent for community banks nationally, and 0.59 percent for tri-state area community banks.

The NCO ratio for large organizations has fallen in the past year, but not for community banks. This ratio for large organizations is still about double that for community banks both nationally and locally. The main reason is that large organizations engage in credit card lending to a much greater extent than community banks.[14]

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

[14] The NCO ratio on credit cards at large organizations is nearly double that for total consumer loans (1.02 percent for credit card loans versus 0.55 percent for all consumer loans). The disparity is even greater at community banks, but credit cards make up a negligible share of their consumer loans.





Provisioning and Reserves[15]

As loan quality and recoveries continue to improve (see above), many banks are continuing to ease up on their loan-loss provisioning and reserves. At large organizations, loan-loss reserves have fallen 16.4 percent in the past year.[16] At community banks, loan-loss reserves have fallen nearly 5 percent nationally, and locally they were nearly flat. Loan-loss provisions have also decreased, both overall and as a percentage of operating income.[17] Over the year, quarterly loan-loss provisions are down 27 percent at large organizations, 51 percent at community banks nationally, and 36 percent at local community banks. The ratio of loan-loss provision to operating income fell over 3 percentage points, to 7.22 percent, at large organizations; decreased over 8 percentage points, to 7.21 percent, at community banks nationally; and fell 7 percentage points, to 10.57 percent, at local community banks (Figure 26). It should be noted that in each category the ratio did increase from the third to the fourth quarter.

Even though loan performance has improved substantially in the past several quarters, 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 is over 100 percent (Figure 27).[18] In other words, each quarter banks are charging off (net of recoveries) more loans than they are provisioning for. Large organizations have the highest ratio at 134.2 percent, but the ratio has decreased in both the past year and the last quarter. At community banks, the ratios are somewhat lower, but they have increased in the past year. The NCOs to loan-loss provision ratio has increased 28 percentage points, to 127 percent, at community banks nationally. At local community banks, the

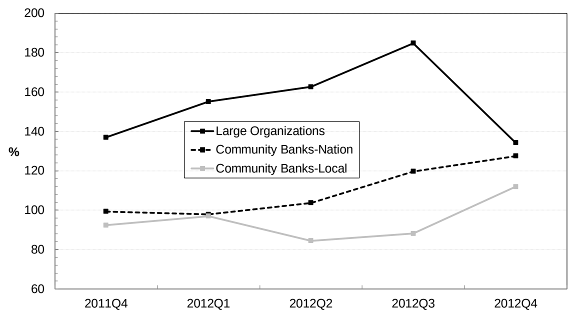
[15] See Table 5 in the Appendix for a full summary of the data used in this section.

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

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

[18] 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.

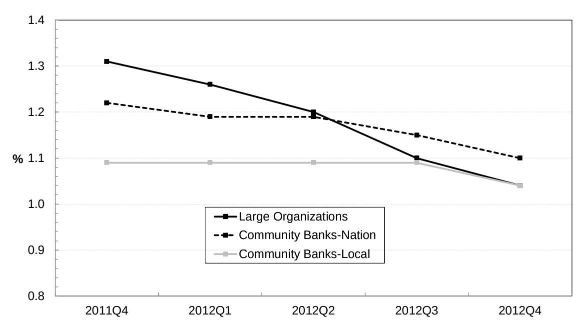
Figure 27
Net Charge-offs/Loan-Loss Provision



ratio increased 20 percentage points, to 112 percent. These also represent substantial quarterly increases.

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 fourth quarter of last year in all categories of banks (Figure 28). At large organizations, the ratio has fallen 27 basis points since last year, to 1.04 percent. At community banks, the drop was 12 basis points nationally and 5 points locally.

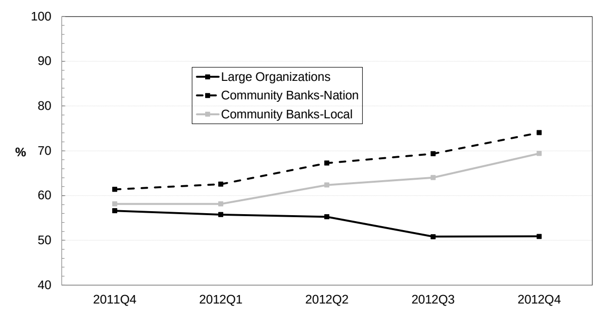
Figure 28
Loan-Loss Reserves/Assets



Even though NCOs are decreasing, declining loan-loss reserves might limit banks' capacity to recognize losses going forward. Loan-loss coverage remains well outside historical norms at all categories of banks. At large organizations, loan-loss coverage fell almost 5 percentage points from last year, to 51.9 percent (Figure 29). It did increase in the fourth quarter by 1 percentage point.

The situation is somewhat better at community banks, as 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 13 percentage points in the past year, to 74.1 percent. Locally, loan-loss coverage increased over 11 percentage points, to 69.4 percent.[19] In both cases, there were quarterly increases as well.

Figure 29
Loan-Loss Coverage Ratio



Securities[20]

The market value of securities has increased year over year at all categories of banks, but

[19] The loan-loss coverage ratio is defined as the ratio of loan-loss reserves to NPLs. For historical perspective, the average loan-loss coverage ratio for all commercial banks between 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.

[20] 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.

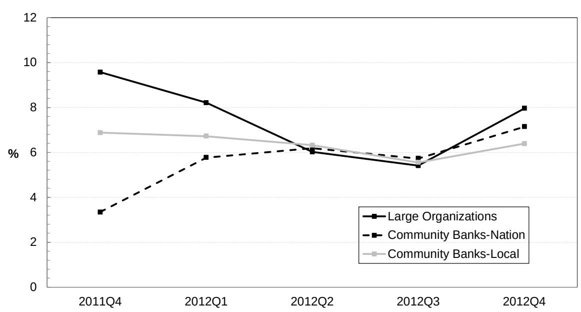
growth at local community banks was very low, and they lost value from the third to the fourth quarter.[21] Large organizations also posted a realized gain of over $789.2 million.[22] Community banks nationally reported a realized gain of $282.5 million on securities in the fourth quarter. Local community banks reported a realized loss of $1.5 million on their securities.

Funding Sources[23]

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

Figure 30

Year-Over-Year Growth in Deposits

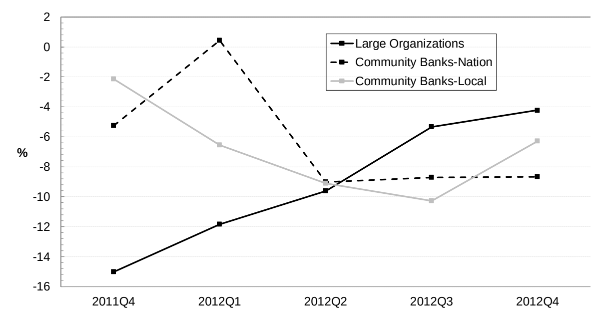


grew somewhat at community banks both nationally and locally and grew substantially at large organizations. Foreign deposits also showed a substantial decline.

Nondeposit funding continued to fall year over year at all categories of banks but grew from the third quarter at community banks both locally and nationally (Figure 31).[24]

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).[25] Core deposits are the least expensive and most stable form of funding for banks.

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

[21] Changes in market value can either be indicative of increases in the value of securities that were already owned or due to purchases or sales of securities.

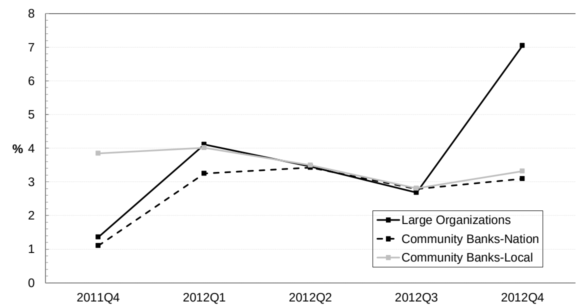
[22] Realized and unrealized gains and losses are net positions. Thus, the tri-state area sample can have larger gains or losses than the national sample, even though the tri-state sample is a subset of the national sample.

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

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

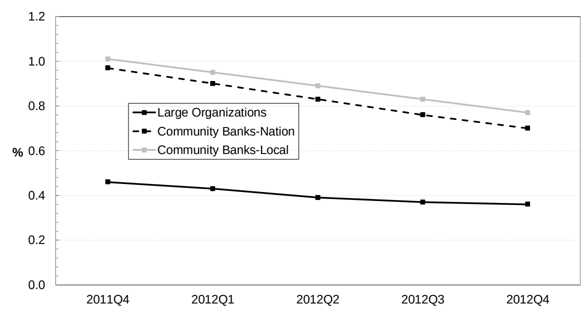
[25] Core deposits are defined as total domestic deposits less the sum of brokered deposits in denominations of less than $100,000 and all deposits in denominations greater than $100,000.

Figure 32
Year-Over-Year Growth in Core Deposits



organizations pay only a fraction of what community banks pay both nationally and locally (Figure 33).[26] This holds true for nondeposit funding as well.

Figure 33
Implicit Interest Rate on Deposits



Regulatory Capital[27]

Both large organizations and community banks appear to be in fairly good shape as far as their capitalization goes. All of the 100 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.[28] At community banks nationally, 97.4 percent of the institutions had equity-to-assets ratios of at least 6 percent, and all but two of these banks had ratios of at least 7 percent. Locally, 97.7 percent (170 out of 174) of the institutions had capital ratios of at least 6 percent, and all of those institutions had equity-to-assets ratios of at least 7 percent. As shown below, capital ratios have improved since last year but decreased from the third to the fourth quarter.

Year over year, capitalization at large organizations has improved slightly in all but risk-based capital. Also, capitalization is high by historical standards.[29] Year over year, the equity-to-assets ratio at large organizations has increased 5 basis points, the tier 1 leverage ratio has increased 15 basis points, and the risk-based capital ratio has decreased 14 basis points.[30] Capital ratios at large banks have been fairly stable for more than a year now (Figure 34).

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

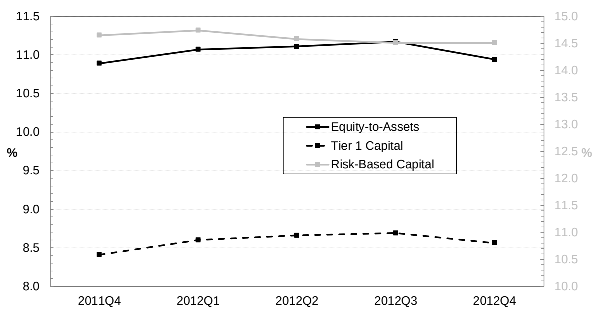
[27] See Table 8 in the Appendix for a full summary of the data used in this section.

[28] Regulation Y defines capital in terms of zones. Institutions in Zone 1 have 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.

[29] 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.

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

Figure 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 13 basis points; the tier 1 capital ratio has increased 14 basis points; and the risk-based capital ratio has increased 7 basis points (Figure 35). At local banks, capital ratios were basically flat year over year. Since last year, the equity-to-assets ratio at local banks was unchanged; the tier 1 leverage ratio has increased by 1 basis point; and the risk-based capital ratio has fallen 13 basis points (Figure 36).

Figure 35
Regulatory Capital – All Community Banks

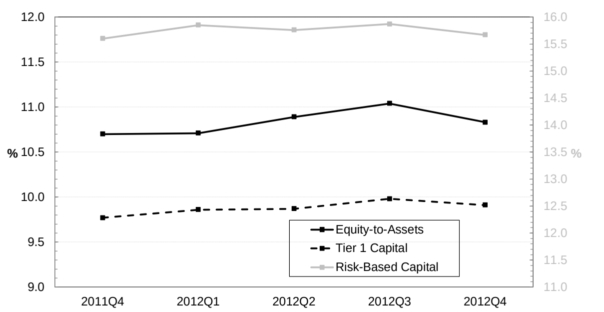
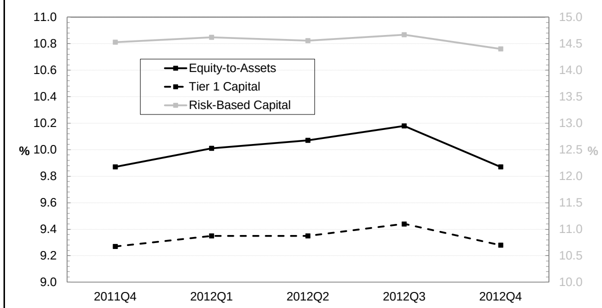


Figure 36
Regulatory Capital – Local Community Banks



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	1.6%	4.5%	7.0%
RRE NPLs	2.0%	-7.9%	-10.3%
RRE NCOs	-21.2%	3.8%	-28.7%
2. Shares			
RRE Lns/Total Lns	33.3%	31.5%	26.9%
RRE NPLs/Total NPLs	77.8%	25.5%	23.5%
RRE NCOs/Total NCOs	46.0%	15.9%	20.7%
3. Performance Ratios			
RRE NPLs/Total RRE Lns	9.53%	1.85%	2.10%
RRE NCOs/Avg. RRE Lns	0.30%	0.11%	0.13%
4. Outstandings ($millions)			
Total RRE Lns	1,711,508.2	20,099.0	329,207.7
RRE NPLs	163,054.4	372.3	6,912.2
RRE NCOs	5,056.7	20.6	408.3

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	0.6%	5.5%	1.9%
CRE NPLs	-38.5%	-19.5%	-26.3%
CRE NCOs	-53.8%	-41.7%	-48.7%
2. Shares			
CRE Lns/Total Lns	15.4%	45.5%	42.7%
CRE NPLs/Total NPLs	12.4%	63.1%	60.7%
CRE NCOs/Total NCOs	10.0%	54.9%	48.5%
3. Performance Ratios			
CRE NPLs/Total CRE Lns	3.27%	3.17%	3.40%
CRE NCOs/Avg. CRE Lns	0.14%	0.25%	0.18%
4. Outstandings ($millions)			
Total CRE Lns	793,175.8	29,000.6	524,020.4
CRE NPLs	25,949.2	919.8	17,837.7
CRE NCOs	1,095.2	70.9	956.5

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	14.5%	6.6%	10.9%
C&I NPLs	-26.4%	-6.8%	-16.7%
C&I NCOs	-52.2%	9.8%	-13.8%
2. Shares			
C&I Lns/Total Lns	22.9%	13.4%	15.9%
C&I NPLs/Total NPLs	4.0%	8.5%	10.5%
C&I NCOs/Total NCOs	6.6%	21.0%	26.3%
3. Performance Ratios			
C&I NPLs/Total C&I Lns	0.72%	1.46%	1.58%
C&I NCOs/Avg. C&I Lns	0.07%	0.33%	0.28%
4. Outstandings ($millions)			
Total C&I Lns	1,180,028.9	8,536.9	195,016.2
C&I NPLs	8,474.0	124.3	3,089.1
C&I NCOs	727.4	27.1	519.1

Table 4 - Summary of Consumer Lending

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
1. Year–over–year growth			
Total Consumer loans	1.3%	2.4%	4.2%
Consumer NPLs	-20.6%	-1.0%	4.1%
Consumer NCOs	-12.7%	30.6%	-10.3%
2. Shares			
Consumer Lns/Total Lns	14.0%	3.1%	4.3%
Consumer NPLs/Total NPLs	3.9%	0.8%	1.3%
Consumer NCOs/Total NCOs	35.3%	3.5%	5.6%
3. Performance Ratios			
Cons NPLs/Total Cons Lns	1.13%	0.59%	0.74%
Cons NCOs/Avg. Cons Lns	0.55%	0.24%	0.22%
4. Outstandings ($millions)			
Total Consumer Lns	717,665.7	1,987.6	52,407.1
Consumer NPLs	8,145.3	11.8	389.0
Consumer NCOs	3,879.2	4.6	111.1

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

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Loan-loss Reserve ($Millions)	108,770.5	1,011.8	21,750.7
Change from Last Quarter	-13.2%	-6.1%	-10.8%
Change from Last Year	-16.4%	1.0%	-4.8%
Net Charge-Offs/LL Provision	134.2%	111.9%	127.5%
LL Provision/Operating Inc.	7.2%	10.6%	7.2%
Loan-loss Coverage Ratio	51.9%	69.4%	74.1%

Table 6 - Summary of Securities Portfolios

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Securities/Assets	21.3%	21.5%	22.8%
Market Value ($Millions)	2,237,666.8	21,034.6	454,963.7
Change from Last Quarter	8.3%	-1.1%	3.4%
Change from Last Year	8.9%	1.0%	7.4%
Realized Gain/Loss	789.2	-1.5	282.5
Pct of Average Securities	0.04%	-0.01%	0.06%
Market Value/Book Value	102.5%	102.7%	102.5%

Table 7 - Structure of Liabilities

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Deposits ($millions)	7,807,799.3	81,864.0	1,655,538.5
Pct. of Assets	74.3%	84.1	83.5
Change from Last Quarter	18.7%	11.5%	10.5%
Change from Last Year	8.0%	6.4%	7.1%
Core Deposits/Deposits	35.9%	65.1%	64.2%
Implicit Rate on Deposits	0.36%	0.77%	0.70%
Nondeposit Debt ($millions)	961,884.6	4,903.2	97071.2.3
Pct. of Assets	9.2	5.0	4.9
Change from Last Quarter	-12.1%	65.5%	5.1%
Change from Last Year	-4.2%	-6.3%	-8.7%
Implicit Rate on Debt	1.55%	2.38%	2.07%

Table 8 - Capitalization Measures

	Large Organizations	Community Banks	
Ratios	Nation	Tri-State Area	Nation
Total Equity/Total Assets	10.94%	9.87%	10.83%
Change fr. Last Qtr. (basis pts)	-23	-31	-19
Change fr. Last Yr. (basis pts)	5	0	13
Tier 1 Leverage Ratio	8.56%	9.28%	9.91%
Change fr. Last Qtr. (basis pts)	-13	-16	-7
Change fr. Last Yr. (basis pts)	15	1	14
Risk-Based Capital Ratio	14.51%	14.40%	15.67%
Change fr. Last Qtr. (basis pts)	0	-27	-20
Change fr. Last Yr. (basis pts)	-14	-13	7