BANKING BRIEF
FOR PENNSYLVANIA, NEW JERSEY, AND DELAWARE

Second 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. Loan growth was a bit stronger locally than in the nation as a whole. All of the loan growth at large organizations was in commercial loans, while smaller banks saw increases in both commercial and real estate loans.*

- *Loan quality improved year over year at all categories of banks, as both nonperforming loans and net charge-offs decreased substantially.*

- *Residential real estate (RRE) loan quality improved at all categories of banks, but quality is still well below historical norms at large organizations. RRE loans grew slightly at community banks nationally and somewhat faster at local community banks, but were flat at large organizations.*

- *Commercial real estate (CRE) lending showed some growth at community banks nationally, improved at local community banks, but was flat at large organizations. Nonperforming loans and net charge-offs dropped substantially at all categories of banks.*

- *Loan-loss coverage increased at all categories of banks despite decreases in both loan loss provisions and reserves. In all cases, it is still below historical norms.*

- *Deposit growth slowed substantially from the first to the second quarter but it is still fairly strong year over year.*

- *The annual report on small business lending shows that CRE loans for the most part decreased over the year, while commercial and industrial loans increased at nearly all categories of banks.*

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Summary Table of Bank Structure and Conditions – Second Quarter 2013

Community Banking Organizations

	Nation $ Bill	Nation % Change From		Tri-State $ Bill	Tri-State % Change From	
	13Q2	**13Q1**	**12Q2**	**13Q2**	**13Q1**	**12Q2**
Total Assets	1,889.6	-0.38	2.18	103.2	3.28	4.04
Total Loans	1,183.7	8.83	4.00	69.6	8.41	6.33
C&I	192.1	10.60	6.85	9.6	-0.63	4.51
Real Estate	868.8	5.79	3.19	53.8	10.25	5.97
Consumer	50.9	9.82	1.82	2.6	3.38	3.91
Total Deposits	1,580.0	-1.77	2.43	86.0	2.59	4.12
Ratios (in %)	**13Q2**	**13Q1**	**12Q2**	**13Q2**	**13Q1**	**12Q2**
Net Income/Avg Assets (ROA)	0.91	0.88	0.72	0.72	0.69	0.58
Net Interest Inc/Avg Assets (NIM)	3.36	3.38	3.46	3.22	3.25	3.32
Noninterest Inc/Avg Assets	1.01	1.00	0.93	1.33	1.30	1.20
Noninterest Exp/Avg Assets	3.04	3.05	3.06	3.25	3.27	3.24
Loans/Deposits	74.92	73.02	73.79	80.88	79.77	79.20
Equity/Assets	10.69	10.86	10.81	10.06	10.22	10.22
Nonperforming Loans/Total Loans	2.09	2.34	2.89	1.98	2.12	2.63

Large Organizations

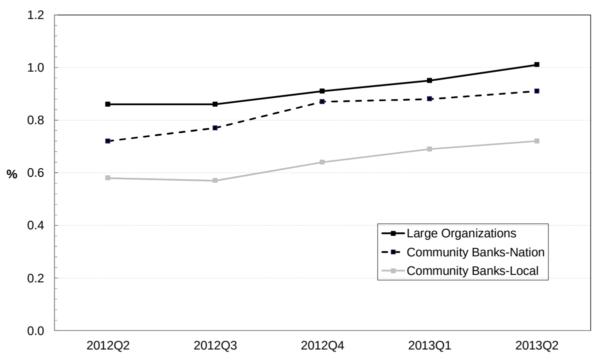
	Nation $ Bill	Nation % Change From	
	13Q2	**13Q1**	**12Q2**
Total Assets	10,559.5	-0.28	3.69
Total Loans	5,258.4	3.64	4.31
C&I	1,236.1	8.10	10.73
Real Estate	2,596.4	-1.95	0.03
Consumer	714.2	4.00	1.96
Total Deposits	7,839.4	-1.77	6.08
Ratios (in %)	**13Q2**	**13Q1**	**12Q2**
Net Income/Avg Assets (ROA)	1.01	0.95	0.86
Net Interest Inc/Avg Assets (NIM)	2.53	2.57	2.66
Noninterest Inc/Avg Assets	1.89	1.84	1.78
Noninterest Exp/Avg Assets	2.78	2.82	2.93
Loans/Deposits	67.08	66.18	68.21
Equity/Assets	10.99	11.06	11.13
Nonperforming Loans/Total Loans	3.49	3.81	4.37

A banking organization is an independent bank or all the banks within a highest-level bank holding company; however, banks less than five years old and special purpose banks such as credit card banks are excluded. The large banking organization sample is based on banking organizations whose total assets were at least as large as those of the 100th largest banking organization in the United States as of December 31, 2012. 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 — 172 for the tri-state area and 5,225 for the nation; (2) large banking organizations — 102 for the nation. Ratios are aggregates; that is, the numerators and denominators are summed across all banks in the group then divided. Data are adjusted for mergers. Quarterly percentage changes are compound annualized rates.

Second Quarter 2013

Profitability at all categories of banks continued its steady growth, both year over year and from the first to the second quarter.[1] In addition, except at local community banks, the number of firms showing positive net income increased as well. Year-over-year profitability, as measured by ROA, increased 19 basis points at community banks nationally, to 0.91 percent; increased 14 basis points at community banks locally, to 0.72 percent; and increased 15 basis points at large organizations, to 1.01 percent (Figure 1).[2]

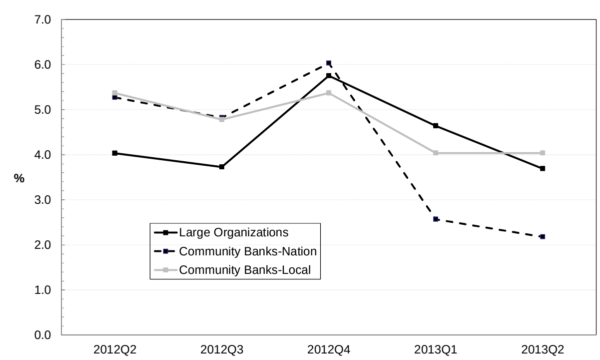
Figure 1
Return on Average Assets



As has been the case for the previous several quarters, the increased profitability can be attributed primarily to the continued improvement in loan quality, which resulted in lower loan-loss provisions; increased asset sales and trading income also contributed to increasing income. Net charge-offs (NCOs) and nonperforming loans (NPLs) continued to decrease.[3] Improved loan quality continued to make up for decreasing net interest margins. As a result, large organizations have seen a 33.5 percent increase in quarterly net income from the second quarter of 2012, while loan-loss reserves shrank 18.4 percent (see "Provisioning and Reserves" below). Community banks experienced similar results, with net income increasing 17.2 percent nationally and 23.1 percent locally, while reserves dropped 7.2 percent nationally and were flat locally.

Year over year, assets of community banks nationally grew at a 2.2 percent rate, while asset growth at local community banks was 4.0 percent (Figure 2). At large organizations, asset growth was 3.7 percent. However, total assets at large organizations and national community banks shrank slightly from the first to the second quarter. This was mainly due to declines in the market value of bank securities portfolios, although large organizations had a decline in RRE lending as well.

Figure 2
Year-Over-Year Asset Growth



The year-over-year growth in assets was fueled mainly by increases in loans as growth in banks' securities portfolios slowed. Loans increased 4.3 percent at large organizations, 4.0 percent at national community banks, and 6.3 percent at local community banks (Figure 3).

[1] Out of 5,225 community banks in the national sample, 4,826 reported positive quarterly profits. This was an increase of two from the first quarter of 2013. Locally, 155 out of 172 banks reported positive profits, a decrease of four from the fourth quarter of 2012. For large organizations, 99 out of 102 were profitable, up three from the previous quarter.

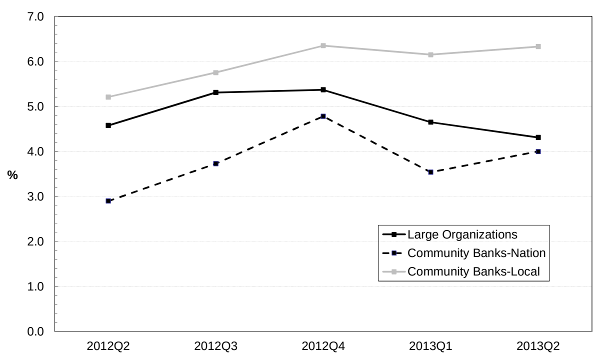
[2] See Summary Table of Bank Structure and Conditions above.

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

The reported value of securities increased only 1.6 percent at national community banks, 1.4 percent at local community banks, and was flat at large organizations.[4]

Figure 3

Year-Over-Year Loan Growth

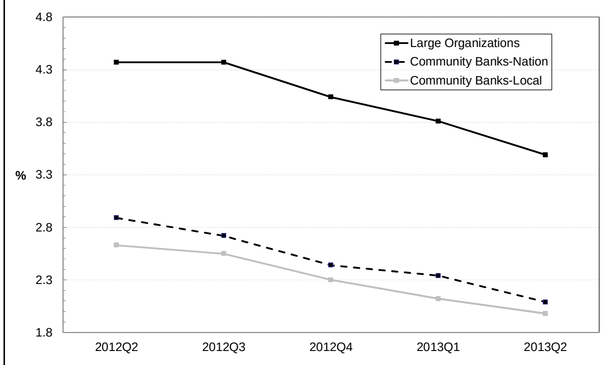


While all categories of banks showed similar growth rates for total loans, growth within types of loans has begun to diverge. At large organizations, nearly all of total loan growth was due to commercial and industrial (C&I) lending. C&I loans grew nearly 11 percent, while both real estate lending and consumer lending growth were flat. At community banks, C&I lending grew at a healthy rate, nearly 7 percent nationally and 4.5 percent locally, but real estate lending picked up as well. This was especially true at local banks. Consumer loans also are showing signs of life at community banks (see "Consumer Lending" below).

Loan quality continued to improve at all categories of banks. At large organizations, the ratio of NPLs to total loans (the NPL ratio) decreased by 88 basis points from last year, to 3.49 percent (Figure 4).[5] Community banks showed similar decreases, and their NPL ratios were much lower than those of large organizations to begin with. At community banks nationally, the NPL ratio has decreased 80 basis points since last year, to 2.09 percent. Locally, the NPL ratio fell by 65 basis points, to 1.98 percent.

Figure 4

Nonperforming Loans/Total Loans



Overall, asset quality also has 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 by 22 percent. At community banks, the decrease was 18.6 percent nationally and 15.3 percent locally. Combining the decrease in OREO with improved loan quality, the ratio of nonperforming assets (NPAs) to total assets has fallen at all three categories of banks in the past year (Figure 5).[7]

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[4] Reported value is the sum of the market value of available-for-sale securities and the book value of held-to-maturity securities.

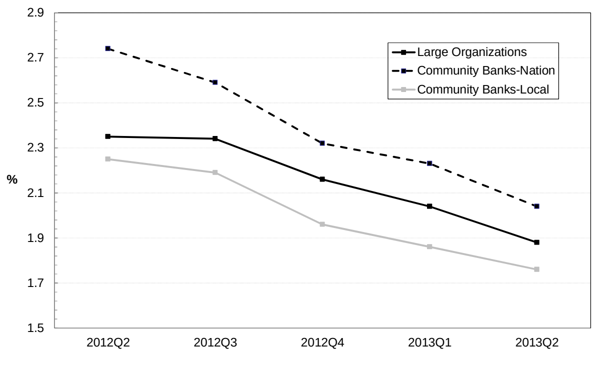
[5] For historical perspective, the average NPL ratio for all commercial banks between 2001 and 2011 was 2.31 percent. At the bottom of the last real estate cycle, in 1991, this ratio stood at 3.70 percent. Source: FDIC Historical Statistics on Banking, http://www2.fdic.gov/hsob/index.asp.

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

[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.

At large organizations, the NPA ratio has fallen 47 basis points in the past year, to 1.88 percent. At community banks nationally, the decrease was 70 basis points, to 2.04 percent,

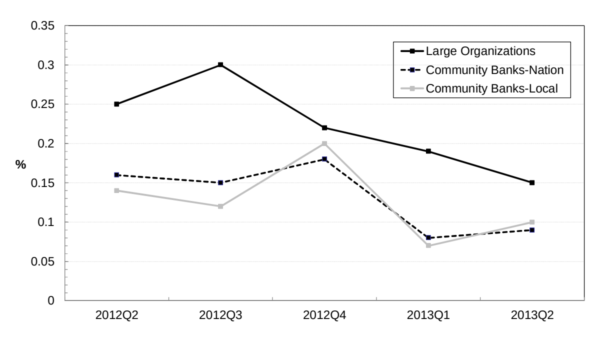
Figure 5
Nonperforming Assets/Total Assets



and locally the NPA ratio fell 49 basis points, to 1.76 percent.

NCOs tell a similar story, with all categories of banks experiencing significant decreases. The ratio of NCOs to average loans (the NCO ratio) fell 10 basis points over the year at large organizations, to 0.15 percent (Figure 6).

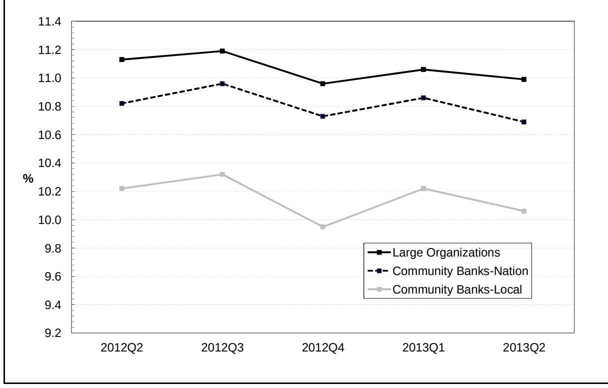
Figure 6
Quarterly Net Charge-Offs/Average Loans



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, to 0.09 percent. At tri-state area community banks, the NCO ratio has fallen 4 basis points over the past year, to 0.10 percent. Community banks both locally and nationally did show a slight increase in the NCO ratio from the first to the second quarter. Gross charge-offs fell at all categories of banks and recoveries increased at community banks, but were flat at large organizations.

Capital ratios, defined as the ratio of total equity to assets, fell slightly at all categories, both from a year ago and from the first quarter (Figure 7).

Figure 7
Equity-to-Assets Ratios



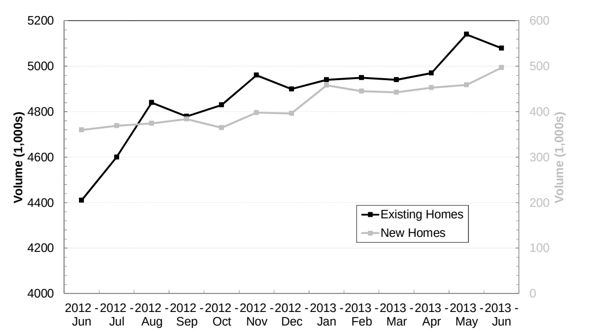
The number of bank failures in the second quarter of 2013 fell from the second quarter of 2012 but tripled from the first quarter of 2013. The Federal Deposit Insurance Corporation (FDIC) reported 12 bank failures in the second quarter, up from four in the first quarter. In the second quarter of 2012, 15 failures were reported. There have been only two additional failures so far in the third quarter (as of August 15), bringing this year's total up to 18, as compared with 51 for all of 2012. None of the failures so far this year has involved a tri-state area bank.

Residential Real Estate Lending[8]

The nationwide and local residential real estate (RRE) markets continued their modest recovery in the second quarter, with most areas reporting increased activity from last year. The Federal Reserve Board's *Beige Book*, as of July 17, 2013, reported that sales of existing homes increased moderately in most Federal Reserve Districts and at a slightly higher pace in the others. It also reported that construction, for the most part, improved across the country, but much of this increase was in apartment buildings rather than single-family homes.[9]

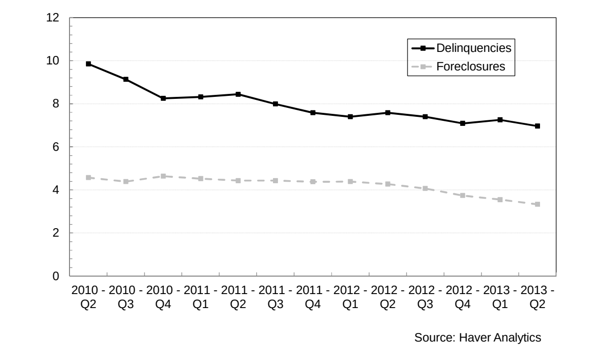
By most measures, local real estate markets continued to improve in the first quarter. In the Philadelphia region, existing home sales grew moderately in most areas and strongly in some. Homebuilders also reported moderate growth. The New York region (including northern New Jersey) reported the same, but also that home prices are still being restrained by a sizeable backlog of foreclosed and distressed properties.

Figure 8
Sales of New and Existing Homes



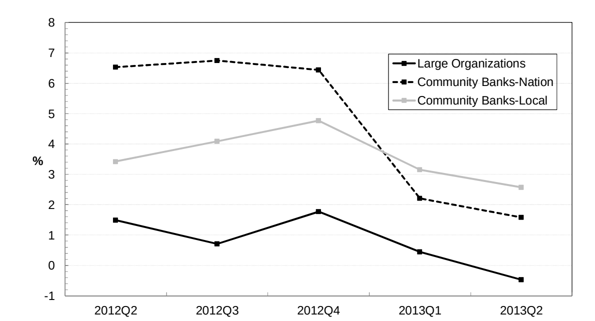
Sales of both new and existing homes have increased since both the second quarter of last year and the end of the first quarter this year (Figure 8 – note the different scales on the left and right axes). Sales of new homes have grown modestly over the past year. The percentage of delinquent mortgages decreased 62 basis points from a year ago, and the percentage of mortgages in foreclosure has decreased 94 basis points (Figure 9).

Figure 9
Delinquency and Foreclosure Rates



RRE loans outstanding increased modestly year over year at community banks nationally, a little stronger at local banks, but were flat at large organizations (Figure 10). From the second quarter of 2012 to the second quarter of 2013, RRE loans outstanding grew 1.6 percent at community banks nationally and 2.6 percent locally. Community banks both locally and nationally showed somewhat stronger growth from the first to the second quarter, while loans

Figure 10
Annual Change in RRE* Loans Outstanding



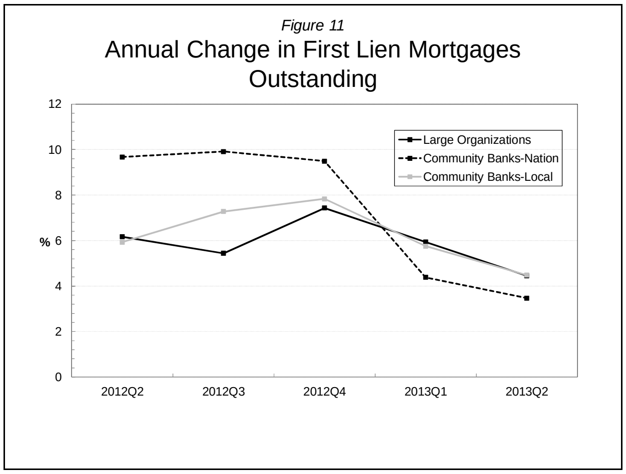
*Residential real estate

[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/files/Beigebook_20130717.pdf.

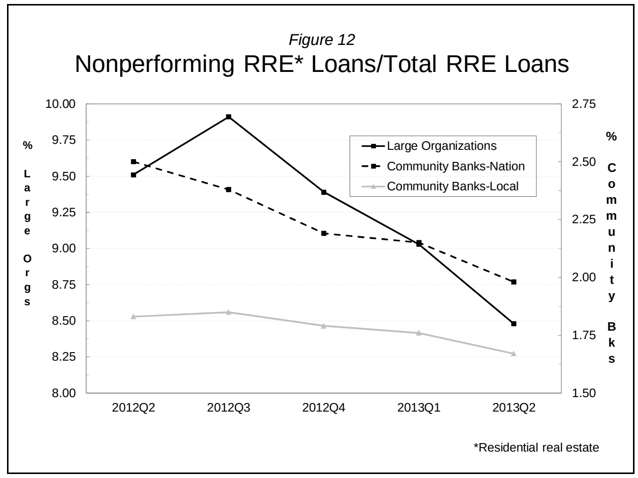
outstanding shrank about 5 percent at large organizations over the same time period.

Any growth in RRE loans has been completely due to mortgages secured by first liens, as those secured by junior liens and home equity lines of credit (HELOCs) have been declining. First lien mortgages make up most RRE loans in all categories of banks. They had



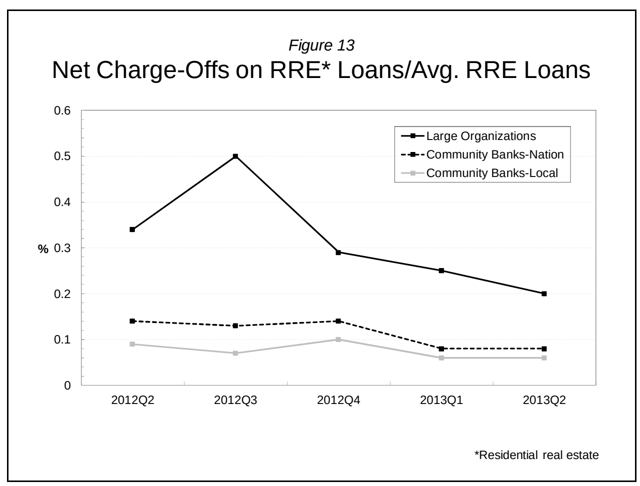
been rising strongly until last quarter, and that growth continued to slow in the second quarter at all categories of banks (Figure 11).[10]

The quality of RRE loans continued to improve, but large organizations are still carrying a substantial portfolio of NPLs. The RRE NPL ratio at large banks fell 55 basis points, to 8.48 percent [Figure 12 -- note the different scales for community banks (right y-axis) and large organizations (left y-axis).]



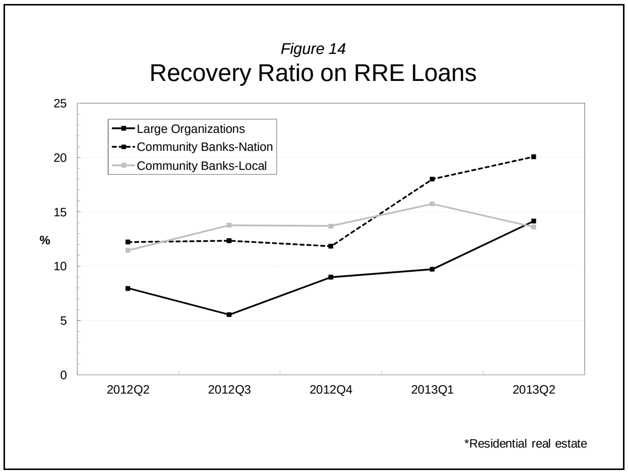
Community banks have much better RRE loan quality, with NPL ratios of 1.98 percent nationally and 1.67 percent locally. These also dropped from the first to the second quarter.

The improvement in loan quality at large organizations also is reflected in the RRE NCO ratio. At large organizations, this ratio fell for the third consecutive quarter, decreasing 14 basis points, to 0.20 percent in the last year (Figure 13).



NCOs at community banks continued to fall as well. The RRE NCO ratio has decreased 6 basis points nationally, to 0.08 percent, and 3 points locally, to 0.06 percent. In the cases of both large organizations and community banks nationally, charge-offs decreased and recoveries

[10] Mortgages secured by first liens make up 69.8 percent of all RRE loans at large organizations, 80 percent of RRE loans at community banks nationally, and 74.3 percent at local community banks.

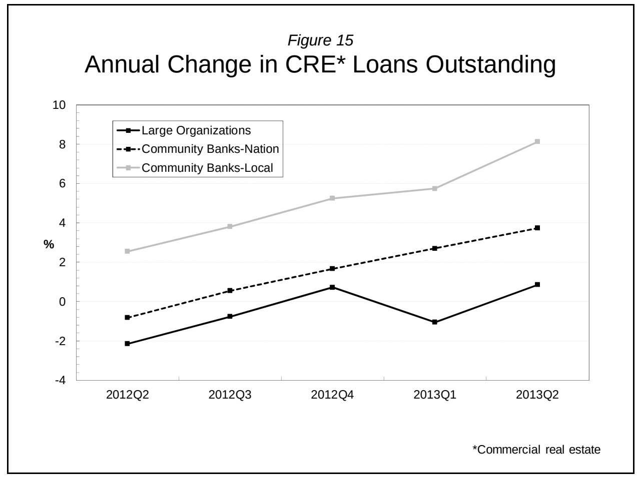


increased. At local community banks, recoveries decreased modestly in the second quarter but recovery ratios have increased in the past year (Figure 14).

Commercial Real Estate Lending[11]

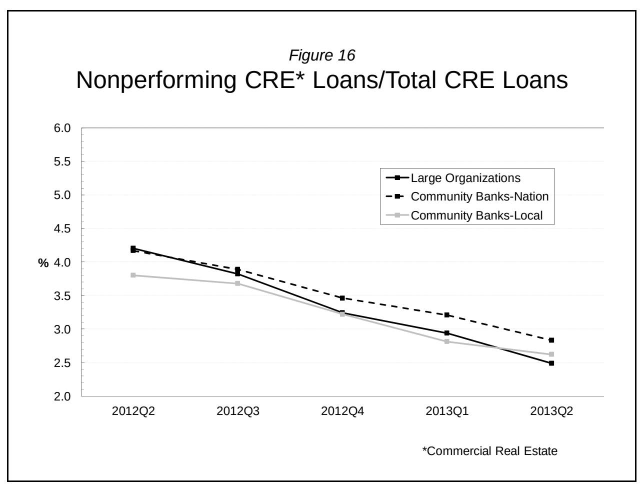
Commercial real estate (CRE) market conditions remained mixed both locally and nationally. The *Beige Book* reported that most CRE markets nationwide showed modest increases in construction, particularly multifamily properties and public works projects, and demand for commercial space. For the most part, in the Philadelphia district there was modest growth in commercial leasing activity and some growth in construction.

CRE lending results improved in the second quarter, with loan quality improving at all categories of banks, while loan growth was strong at local community banks, increased at national community banks, and stayed flat at large organizations. Year over year, CRE loans outstanding grew less than 1 percent at large organizations, grew about 3.7 percent at community banks nationally, and grew 8.1 percent at tri-state-area community banks



(Figure 15). Much of this growth can be attributed to loans on multifamily properties (see below).

The quality of CRE loans improved substantially at all categories of banks, and in each category of CRE loans. At large organizations, the CRE NPL ratio decreased over 1.7 percentage points from the second quarter of 2012, to 2.49 percent (Figure 16). The CRE NPL ratio decreased over 1.3 percentage points at community banks nationally from last year to 2.83 percent, and nearly 1.2 percentage points at community banks locally to 2.62 percent.

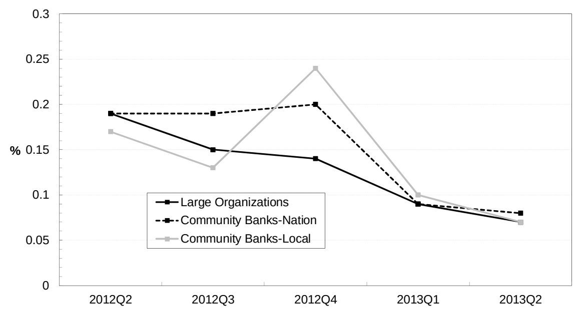


NCO ratios have decreased at all categories of banks as well. Since last year, the CRE NCO ratio at large organizations has decreased by 12

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

Figure 17

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



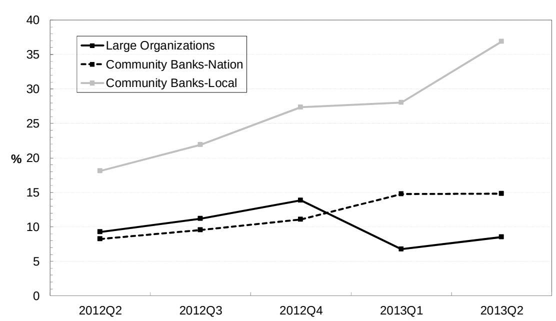
*Commercial real estate

basis points, to 0.07 percent. At community banks, there was a decrease of 11 basis points nationally, to 0.08 percent, and a decrease of 10 basis points locally, to 0.07 percent (Figure 17).

As noted above, much of the growth in CRE lending can be attributed to loans on multifamily housing. This is especially true at community banks, particularly at local community banks, where loans outstanding have grown almost 37 percent in the last year, and growth is accelerating (Figure 18).

Figure 18

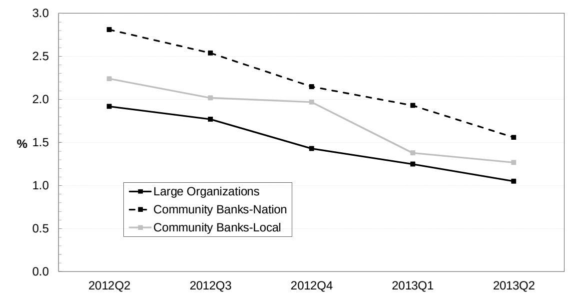
Annual Change in Multifamily Loans Outstanding



The high growth of multifamily loans hasn't adversely affected loan quality though, as NPL ratios at all categories are not only falling but well below those for all CRE loans (Figure 19).

Figure 19

Multifamily Loan NPL Ratios

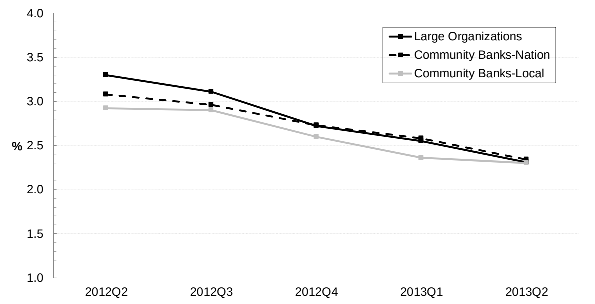


In spite of the recent high growth, multifamily loans still make up a small part of total CRE lending.[12] By far the largest share of CRE lending is in commercial mortgages.

Since CRE lending is by far the largest part of community banks' loan portfolios, the quality of their commercial mortgage portfolios has a lot to say in determining the health of those banks. Commercial mortgage quality has improved significantly in the last year. At large organizations, the NPL has decreased nearly 1 percentage point, to 2.31 percent. At community banks nationally the ratio has decreased 74 basis points, to 2.34 percent, and at community banks locally the ratio has decreased 62 basis points, to 2.30 percent (Figure 20).

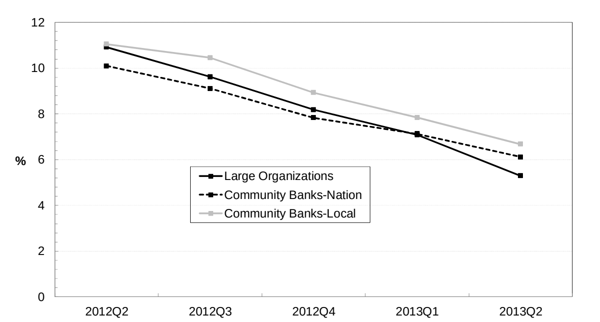
[12] The components of CRE loans break down as follows: large organizations – 69 percent commercial mortgages, 17 percent multifamily properties, and 13 percent construction; community banks nationally – 78 percent commercial mortgages, 12 percent multifamily properties, and 10 percent construction; local community banks – 76 percent commercial mortgages, 9 percent multifamily, and 15 percent construction.

Figure 20
Nonperforming Commercial Mortgages/ Commercial Mortgages



Construction lending continues to be a drag on CRE loan quality. Although the quality of construction loan portfolios has improved substantially in the past year or two, particularly at large organizations, NPL ratios remain high. The construction loan NPL ratio for large organizations has dropped almost 5.7 percentage points in the last year, to 5.29 percent (Figure 21). Community banks have experienced similar drops -- nearly 4 points nationally and 4.3 points locally.

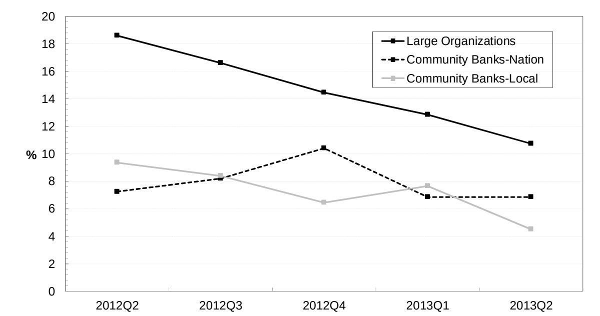
Figure 21
Construction Loan NPL Ratios



Commercial & Industrial Lending[13]

C&I lending continued to be a bright spot for bank lending in the second quarter, both in terms of growth and quality. Lending growth started to slow somewhat last quarter, and that trend continued into the second quarter. At large organizations, C&I loans grew 10.7 percent in the past year (Table 3 and Figure 22).

Figure 22
Year-Over-Year C&I* Loan Growth



*Commercial and Industrial

At community banks, C&I lending grew 6.9 percent nationally and 4.5 percent locally. However, locally, loan growth was slightly negative from the first to the second quarter.

The Federal Reserve Board's *Senior Loan Officer Opinion Survey* for July 2013 reported that loan demand was mixed, with most firms reporting increased demand but some reporting a weakening in demand.[14] On the supply side, most firms reported they had eased their lending standards on both large and small borrowers.

Regardless of the easing of standards, loan quality continued to improve at all categories of banks (Figure 23). At large organizations, the NPL ratio has fallen 33 basis points in the past year, to 0.59 percent. Quality is somewhat

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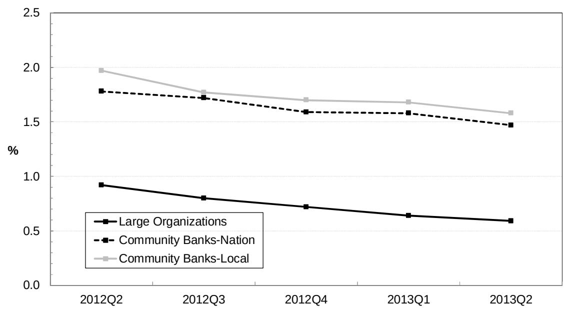
[13] See Table 3 in the Appendix for a full summary of the data used in this section.

[14] See http://www.federalreserve.gov/boarddocs/snloansurvey/201308/fullreport.pdf for further information.

worse at community banks, with NPL ratios of 1.47 nationally and 1.58 locally, but both of these ratios still fell substantially in the past year.

Figure 23
Nonperforming C&I* Loans/C&I Loans



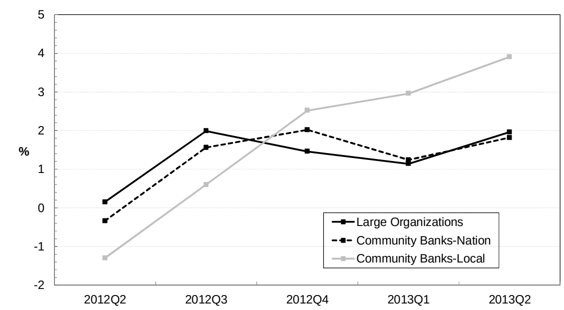
*Commercial and Industrial

In addition to data on all C&I loans, the June Call Report annually contains data on the level of small business lending activity.[15] Overall, real estate loans reported decreases in most categories of loans and at all categories of banks, except community banks, at which small business real estate lending increased modestly for the smallest loans (less than $100 thousand) and remained flat otherwise. However, C&I loans grew, with increases in outstandings and the number of loans made in the two largest size categories. C&I loans at large organizations showed increases in all sizes of loans.

Consumer Lending[16]

Overall, consumer lending remained weak, but it did begin to grow at community banks. Also, there are few quality problems. Large organizations conduct the vast majority of consumer lending. Their consumer lending increased slightly, growing about 2 percent year over year (Figure 24). At community banks

Figure 24
Year-Over-Year Growth in Consumer Loans



nationally, consumer lending grew only 1.8 percent, while at community banks locally, consumer lending grew 3.9 percent. Consumer loans at community banks nationally did increase nearly 10 percent from the first to the second quarter. The main area of growth at these banks was in the category of "other loans."[17]

NPL ratios on consumer loans have been low: 1.06 percent for large organizations, 0.69 percent for community banks nationally, and 0.46 percent for tri-state area community banks.

The most reliable measure of quality for consumer loans is NCOs. Many consumer loans are lines of credit with flexible repayment

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

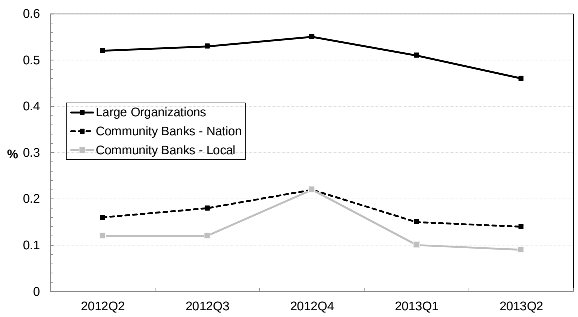
[16] See Table 4 in the Appendix for a full summary of the data used in this section.

[17] Consumer loans can be broken down into four components: credit cards, other revolving credit, auto loans, and other consumer loans. The fourth category is basically amortizing personal loans for things other than buying an automobile.

schedules, so NPLs are difficult to calculate, and when consumer loans go bad, they are often a total loss. NCO ratios fell at all categories of banks (Figure 25). For large organizations, the ratio fell 6 basis points, to 0.46 percent. For community banks, the ratio fell 2 basis points, to 0.14 percent nationally, and locally the ratio fell 3 basis points, to 0.09 percent.

Figure 25

NCOs on Consumer Loans/Avg Consumer Loans

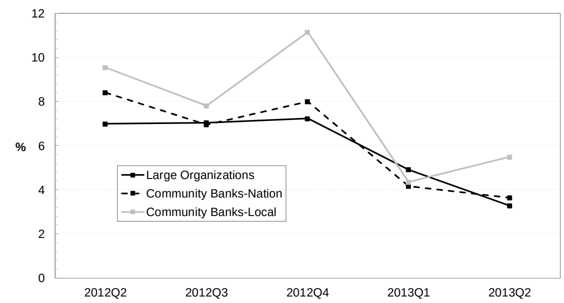


Provisioning and Reserves[18]

Banks continued to ease up on their provisioning and reserves in response to falling NPLs and charge-offs. At large organizations, loan-loss reserves have fallen over 18 percent in the past year.[19] At community banks, loan-loss reserves have fallen by over 7 percent nationally, and locally they were nearly flat, falling 0.4 percent. Loan-loss provisions also have decreased, both overall and as a percentage of operating income. Over the year, quarterly loan-loss provisions were down nearly 51 percent at large organizations, 56 percent at community banks nationally, and 40 percent at local community banks. The ratio of loan-loss provisions to operating income fell 3.7 percentage points, to 3.28 percent, at large organizations; decreased 4.7 percentage points, to 3.64 percent, at community banks nationally;

Figure 26

Loan-Loss Provision/Operating Income



and fell 4.1 percentage points, to 5.49 percent, at local community banks (Figure 26).[20] It should be noted that in each category this ratio is somewhat bumpy, rising in some quarters and falling in others.

As noted above, the falling loan-loss provisions and consequent decreases in reserves can be justified as a reaction to improving loan quality, but at the same time all the measures of coverage against losses remain outside of historical norms. At all categories of banks the ratio of NCOs to loan-loss provisions is over 100 percent, and at large organizations that figure is now over 200 percent (Figure 27).[21] In

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

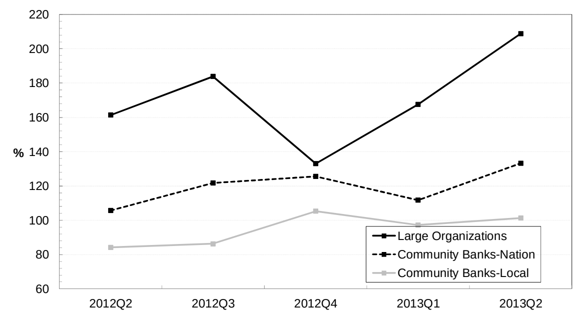
[19] As reported here, loan-loss reserves are the balance-sheet item, and loan-loss provisions are from the income statement.

[20] 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.

[21] 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.

other words, last quarter large organizations charged off (net of recoveries) twice as many loans as they provisioned for. At community banks, the ratios are somewhat lower, but they also have increased in the past year. The NCOs to loan-loss provision ratio has increased slightly under 28 percentage points, to 133.2

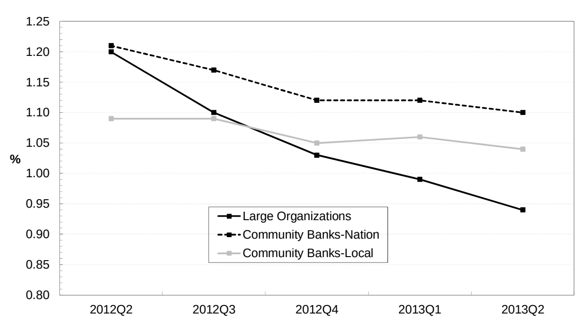
Figure 27
Net Charge-offs/Loan-Loss Provision



percent, at community banks nationally. At local community banks, the ratio increased 17 percentage points, to 101.2.

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, though the drop was small at local community banks (Figure 28). At large

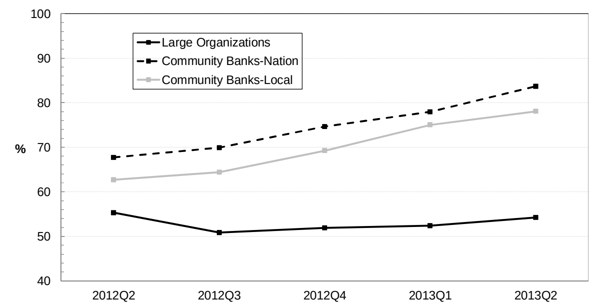
Figure 28
Loan-Loss Reserves/Assets



organizations, the ratio has fallen 26 basis points since last year, to 0.94 percent. At community banks, the drop was 11 basis points nationally and 5 basis points locally.

Loan-loss coverage remains well outside of historical norms at all categories of banks. At large organizations, loan-loss coverage fell a little over 1 percentage point from last year, to54.2 percent (Figure 29). It did increase in the past quarter and has been increasing for several quarters.

Figure 29
Loan-Loss Coverage Ratio



The situation is somewhat better at community banks, as improving loan quality has enabled community banks to increase their loan-loss coverage in each quarter since last year. The loan-loss coverage ratio at community banks nationally has increased almost 16 percentage points in the past year, to 83.7 percent. Locally, loan-loss coverage increased over 15 percentage points, to 78.1 percent.[22]

[22] 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.

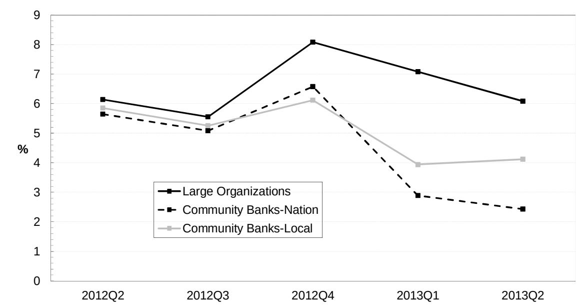
Securities[23]

The market value of banks' securities portfolios has increased slightly year over year at community banks nationally, was flat locally, and fell at large organizations. In all categories except local community banks, securities portfolios lost value from the first to the second quarter of 2013.[24] This decrease in market value is partly due to the decline in the value of securities as interest rates rose during the latter half of the second quarter, but also due to asset sales, as 1arge organizations posted a realized gain of over $1 billion and community banks nationally reported a realized gain of $202.9 million on securities in the first quarter.[25] Local community banks reported a realized gain of $14.5 million on their securities in the quarter after realizing a loss last quarter.

Funding Sources[26]

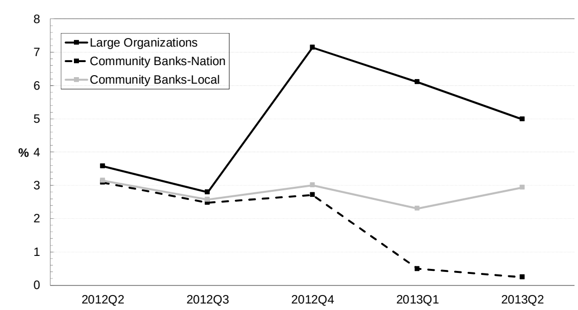
Year over year, deposit growth was slower at community banks both locally and nationally, and it was basically flat at large organizations (Figure 30). Additionally, deposit growth from last quarter was negative at community banks nationally and at large organizations. The shrinkage was fairly consistent across all categories of banks, with demand deposits and savings deposits showing increases and time deposits showing substantial decreases.

Figure 30
Year-Over-Year Growth in Deposits



Core deposits grew at a slower pace than overall deposit growth, and at community banks nationally it was flat (Figure 31).[27] Core deposits are the least expensive and most stable form of funding for banks, so this slowdown in growth could adversely affect interest margins going forward.

Figure 31
Year-Over-Year Growth in Core Deposits



The slow growth in core funding has forced banks, especially community banks, to seek more expensive types of funding in the form of

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[23] 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 sheet. Securities there are reported at book value, if they are held to maturity, and at market value, if they are available for sale.

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

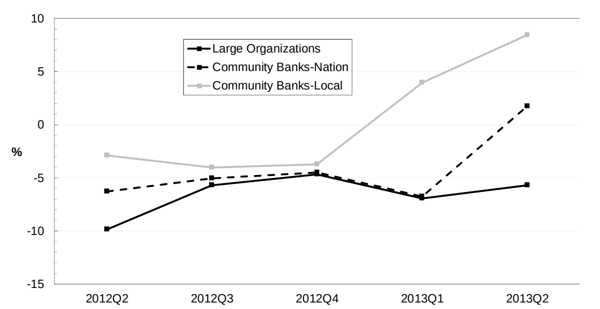
[25] Realized and unrealized gains and losses are net positions. Thus, the tri-state area sample can have larger gains or losses than the national sample, even though the tri-state sample is a subset of the national sample.

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

[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.

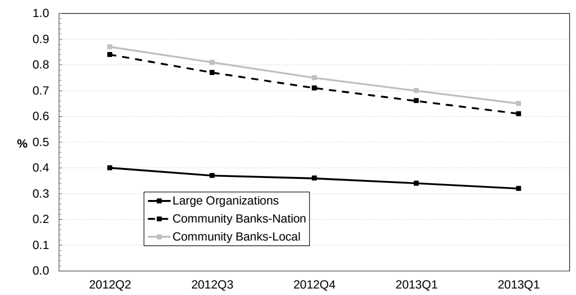
nondeposit debt. After falling for more than a year, nondeposit debt funding increased at community banks both nationally and locally (Figure 32).[28] The year-over-year increases were relatively small (1.7 percent nationally and 8.4 percent locally), but from the first to the second quarter nondeposit debt increased 48.3 percent nationally and 38.2 percent locally. At large organizations nondeposit debt fell 5.7 percent from the second quarter of 2012, but it also increased 9.2 percent from the first quarter of 2013.

Figure 32
Year-Over-Year Growth in Nondeposit Debt



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

Figure 33
Implicit Interest Rate on Deposits



Regulatory Capital[30]

Both large organizations and community banks appear to be meeting regulatory capital standards, for the most part. All of the 102 large organizations in the sample had equity-to-assets ratios of at least 6 percent, and all but three had equity-to-assets ratios of over 7 percent.[31] At community banks nationally, 97.0 percent of the institutions had equity-to-assets ratios of at least 6 percent, and 95.0 percent of those banks had ratios of at least 7 percent. Locally, 95.9 percent (165 out of 172) of the institutions had a capital ratio of at least 6 percent, and 92.4 percent (159) had an equity-to-assets ratio of at least 7 percent. These percentages for community banks represent drops both locally and nationally, but overall capitalizations are still above historical averages.

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

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

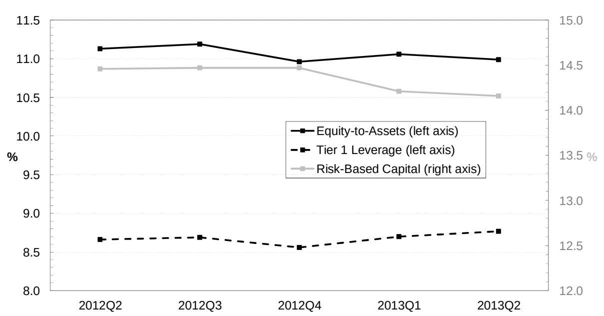
[30] See Table 8 in the Appendix for a full summary of the data used in this section.

[31] 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 Zone 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.

Year over year, capitalization at large organizations was a mixed bag, with equity-to-assets ratios and risk-based capital ratios falling and tier 1 leverage ratios increasing. Regardless, capitalization remained somewhat higher than historical norms.[32] Year over year, the equity-to-assets ratio at large organizations has fallen 14 basis points, the tier 1 leverage ratio has increased 11 basis points, and the risk-based capital ratio has decreased 30 basis points (Figure 34: Note the different scales on the y-axes).[33] The equity-to-assets and tier 1 leverage

Figure 34

Regulatory Capital – Large Organizations

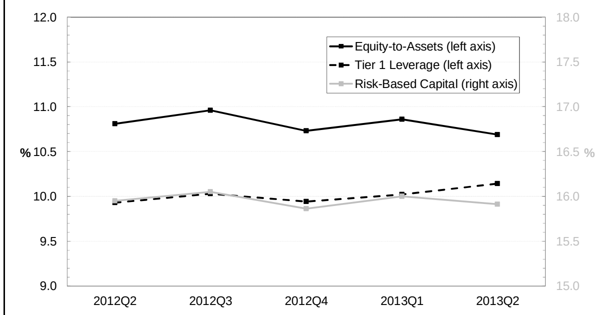


ratios have been fairly stable for the past year, but the risk-based ratio has been falling the last several quarters.

Community banks both locally and nationally reported similar results, with equity-to-assets and risk-based capital ratios falling and tier 1 leverage ratios increasing. Since last year, the equity-to-assets ratio at national community banks has decreased 12 basis points; the tier 1 leverage ratio has increased 21 basis points; and

Figure 35

Regulatory Capital – All Community Banks

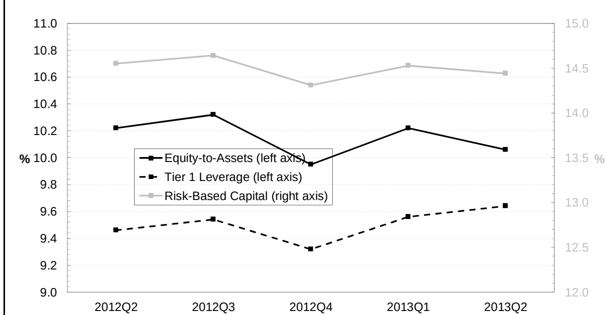


the risk-based capital ratio has decreased 4 basis points (Figure 35: Note the different scales on the y-axes).

At local community banks, year over year the equity-to-assets ratio has fallen 16 basis points, the tier 1 leverage ratio increased by 18 basis points, and the risk-based capital ratio has fallen 11 basis points (Figure 36: Note the different scales on the y-axes).

Figure 36

Regulatory Capital – Local Community Banks



The main reason for the falling capital ratios at all categories of banks was unrealized losses, mainly on cash flow hedges but also on some securities. Cash flow hedges are not reported as ordinary income but are reported in the capital accounts.

Large organizations and community organizations nationally also had declining levels of both common and preferred stock.

[32] 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.

[33] 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.

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	-0.5%	2.6%	1.58%
RRE NPLs	-11.3%	-6.8%	-19.4%
RRE NCOs	-40.0%	-26.8%	-41.4%
2. Shares			
RRE Lns/Total Lns	32.4%	30.7%	25.2%
RRE NPLs/Total NPLs	78.7%	25.8%	23.9%
RRE NCOs/Total NCOs	43.4%	19.8%	23.3%
3. Performance Ratios			
RRE NPLs/Total RRE Lns	8.48%	1.67%	1.98%
RRE NCOs/Avg. RRE Lns	0.2%	0.06%	0.08%
4. Outstandings ($millions)			
Total RRE Lns	1,700,913.4	21,363.1	298,018.5
RRE NPLs	144,237.4	355.8	5,901.2
RRE NCOs	3,445.3	12.8	232.3

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	0.9%	8.1%	3.7%
CRE NPLs	-40.2%	-25.7%	-29.6%
CRE NCOs	-64.0%	-56.4%	-55.1%
2. Shares			
CRE Lns/Total Lns	15.6%	45.5%	43.6%
CRE NPLs/Total NPLs	11.1%	60.1%	59.0%
CRE NCOs/Total NCOs	6.9%	32.6%	42.4%
3. Performance Ratios			
CRE NPLs/Total CRE Lns	2.49%	2.62%	2.83%
CRE NCOs/Avg. CRE Lns	0.07%	0.07%	0.08%
4. Outstandings ($millions)			
Total CRE Lns	819,740.9	31,688.3	515,935.4
CRE NPLs	20,424.8	828.7	14,589.9
CRE NCOs	548.0	21.1	423.5

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	10.7%	4.5%	6.9%
C&I NPLs	-28.9%	-16.0%	-11.9%
C&I NCOs	-39.3%	37.4%	-20.6%
2. Shares			
C&I Lns/Total Lns	23.5%	13.8%	16.2%
C&I NPLs/Total NPLs	4.0%	11.0%	11.4%
C&I NCOs/Total NCOs	9.1%	44.0%	33.6%
3. Performance Ratios			
C&I NPLs/Total C&I Lns	0.59%	1.58%	1.47%
C&I NCOs/Avg. C&I Lns	0.06%	0.30%	0.18%
4. Outstandings ($millions)			
Total C&I Lns	1,236,146.4	9,616.1	192,070.4
C&I NPLs	7,320.5	152.0	2,818.7
C&I NCOs	724.3	28.4	335.2

Table 4 - Summary of Consumer Lending

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
1. Year-Over-Year Growth			
Total Consumer loans	2.0%	3.9%	1.8%
Consumer NPLs	-14.7%	-6.8%	-4.8%
Consumer NCOs	-11.7%	-20.7%	-10.6%
2. Shares			
Consumer Lns/Total Lns	13.6%	3.7%	4.3%
Consumer NPLs/Total NPLs	4.1%	0.9%	1.4%
Consumer NCOs/Total NCOs	40.8%	3.7%	7.1%
3. Performance Ratios			
Cons NPLs/Total Cons Lns	1.06%	0.46%	0.69%
Cons NCOs/Avg. Cons Lns	0.46%	0.09%	0.14%
4. Outstandings ($millions)			
Total Consumer Lns	714,155.9	2,567.7	50,883.9
Consumer NPLs	7,592.6	11.9	350.0
Consumer NCOs	3,239.4	2.4	71.1

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

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Loan-Loss Reserve ($millions)	99,439.6	1,076.2	20,697.0
Change from Last Quarter	-16.9%	-2.6%	-7.8%
Change from Last Year	-18.4%	-0.4%	-7.2%
Net Charge-Offs/LL Provision	208.82%	101.20%	133.15%
LL Provision/Operating Inc.	3.28%	5.49%	3.64%
Loan-Loss Coverage Ratio	54.23%	78.07%	83.70%

Table 6 - Summary of Securities Portfolios

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Securities/Assets	20.5%	21.6%	23.5%
Market Value ($millions)	2,160,265.9	22,279.8	443,646.1
Change from Last Quarter	-10.1%	-0.1%	-1.8%
Change from Last Year	-0.1%	1.1%	1.3%
Realized Gain/Loss	1,018.2	14.5	202.9
Pct of Average Securities	.05%	0.07%	0.05%
Market Value/Book Value	100.26%	99.58%	99.58%

Table 7 – Funding Sources

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Deposits ($millions)	7,839,447.6	86,036.1	1,579,984.9
Pct. of Assets	74.2%	83.4%	83.6%
Change from Last Quarter	-1.8%	2.6%	-1.8%
Change from Last Year	6.1%	4.1%	2.4%
Core Deposits/Deposits	36.6%	67.1%	65.2%
Implicit Rate on Deposits	0.32%	0.65%	0.61%
Nondeposit Debt ($millions)	971,486.4	5,707.1	92,946.2
Pct. of Assets	9.2%	5.5%	4.9%
Change from Last Quarter	9.2%	38.2%	48.3%
Change from Last Year	-5.7%	8.4%	1.7%
Implicit Rate on Debt	1.43%	2.01%	1.94%

Table 8 - Capitalization Measures

	Large Organizations	Community Banks	
Ratios	Nation	Tri-State Area	Nation
Total Equity/Total Assets	10.99%	10.06%	10.69%
Change fr. Last Qtr. (basis pts)	-7	-16	-17
Change fr. Last Yr. (basis pts)	-14	-16	-12
Tier 1 Leverage Ratio	8.77%	9.64%	10.14%
Change fr. Last Qtr. (basis pts)	+7	+8	+12
Change fr. Last Yr. (basis pts)	+11	+18	+21
Risk-Based Capital Ratio	14.16%	14.44%	15.91%
Change fr. Last Qtr. (basis pts)	-5	-8	-9
Change fr. Last Yr. (basis pts)	-30	-11	-4

*Table 9 - Annual Report of Small Business Lending**

	Large Organizations		Community Banks			
	Nation		Tri-State Area		Nation	
Commercial Real Estate	Number	Amount	Number	Amount	Number	Amount
<$100,000	86,368	574,831.4	11,215	24,688.8	260,809	389,722.0
Change from 2012	-10,406	+7,767.6	-594	1,574.6	-15,163	+13,887.6
$100,000-250,000	143,163	17,711.7	12,102	1,543.0	211,644	27,364.9
Change from 2012	-10,095	-1,898.7	+79	+10.9	-1,099	-411.4
$250,000-1 million	238,312	94,722.9	16,823	6,916.4	274,988	111,067.2
Change from 2012	-12,424	-6,405.8	+507	+211.2	-4,468	+129.9
C&I Loans						
<$100,000	7,033,750	94,179.0	42,494	1,215.9	1,098,453	29,022.0
Change from 2012	+288,193	+12,086.7	-1,260	+11.8	-42,077	+503.3
$100,000-250,000	243,905	23,557.3	9.229	913.3	198,138	20,067.4
Change from 2012	+9,391	+7,504.8	-29	-1.2	+2,221	+70.3
$250,000-1 million	206,833	61,208.3	10,386	2,361.5	163,548	46,893,564
Change from 2012	+8,920	+1,939.5	+399	+65.2	+5,068	1,264.5

* Number of loans is the number of loans reported; amounts are in $millions. Starting from 2011, banks are required to report loans that are outstanding as of June 30 of the current year. As a result, loans originated after June 30, 2012, and paid off before June 30, 2013, are not included in the reported number. Conversely, loans originated before June 30, 2012 and still outstanding will be counted. This applies to both the number of loans made and the amount outstanding. As before, the "amount" column represents the outstanding balance on the loans rather than the original principal.