BANKING BRIEF
FOR PENNSYLVANIA, NEW JERSEY, AND DELAWARE

Third Quarter Highlights

- *Year over year, profitability (ROA) continued to improve at all categories of banks. Quarterly, ROA was nearly flat at community banks and decreased at large organizations, in part due to one-time charges from litigation.*

- *Year over year, total loans grew modestly at all categories of banks. Loan growth was a bit stronger locally than in the nation as a whole. Most of the loan growth at large organizations was in commercial loans, with some growth in consumer loans as well. Smaller banks saw increases in commercial and real estate loans, with weaker growth in consumer loans.*

- *Loan quality improved year over year at all categories of banks, as both nonperforming loans and net charge-offs decreased substantially. Large organizations still lag behind community banks in loan quality.*

- *Residential real estate (RRE) loan quality improved at all categories of banks, but quality is still well below historical norms at large organizations. RRE loan growth slowed to nearly a standstill at community banks both nationally and locally, and loans at large organizations shrank.*

- *Commercial real estate (CRE) lending accelerated at all categories of banks, with local community banks showing the most growth and large organizations the least. 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 increased substantially from the second to the third quarter, and it showed fairly strong growth year over year.*

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Summary Table of Bank Structure and Conditions — Third Quarter 2013

	Community Banking Organizations					
	Nation			***Tri-State***		
	$ Bill	**% Change From**		**$ Bill**	**% Change From**	
	13Q3	**13Q2**	**12Q3**	**13Q3**	**13Q2**	**12Q3**
Total Assets	1,910.1	7.16	3.19	105.3	7.92	4.48
Total Loans	1,199.2	8.52	5.23	70.7	6.05	6.19
C&I	193.9	6.90	8.14	9.5	-1.99	2.83
Real Estate	879.1	8.19	4.42	55.0	8.55	6.97
Consumer	52.0	11.58	3.00	2.6	4.58	2.48
Total Deposits	1,595.1	6.51	3.39	88.0	8.47	4.30
Ratios (in %)	**13Q3**	**13Q2**	**12Q3**	**13Q3**	**13Q2**	**12Q3**
Net Income/Avg Assets (ROA)	0.94	0.92	0.78	0.74	0.72	0.57
Net Interest Inc/Avg Assets (NIM)	3.35	3.36	3.45	3.20	3.22	3.30
Noninterest Inc/Avg Assets	1.00	1.01	0.97	1.30	1.32	1.24
Noninterest Exp/Avg Assets	3.03	3.04	3.07	3.23	3.25	3.27
Loans/Deposits	75.18	74.83	73.87	80.37	80.83	78.95
Equity/Assets	10.72	10.68	10.96	9.98	10.04	10.31
Nonperforming Loans/Total Loans	1.92	2.08	2.71	1.79	1.98	2.54

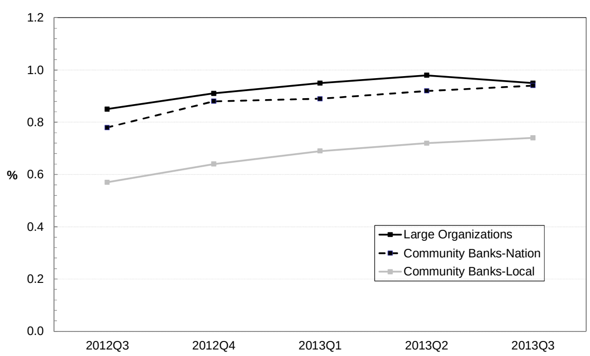
	Large Organizations		
	Nation		
	$ Bill	**% Change From**	
	13Q3	**13Q2**	**12Q3**
Total Assets	10,735.2	6.47	3.77
Total Loans	5,310.6	3.37	4.09
C&I	1,243.8	1.97	8.48
Real Estate	2,598.7	-0.70	-0.12
Consumer	725.8	6.58	2.41
Total Deposits	8,070.8	11.77	6.87
Ratios (in %)	**13Q3**	**13Q2**	**12Q3**
Net Income/ Avg Assets (ROA)	0.95	0.98	0.85
Net Interest Inc/Avg Assets (NIM)	2.50	2.53	2.65
Noninterest Inc/Avg Assets	1.83	1.89	1.78
Noninterest Exp/Avg Assets	2.80	2.81	2.93
Loans/Deposits	65.80	67.10	67.56
Equity/Assets	10.88	10.96	11.19
Nonperforming Loans/Total Loans	3.18	3.49	4.38

Unless otherwise noted, all data are from Federal Financial Institutions Examination Council call reports. The data are adjusted for mergers. Quarterly percentage changes are compound annualized rates except where noted. 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 with total assets of 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 5,191 for the nation; (2) large banking organizations — 103 for the nation. Ratios are aggregates; that is, the numerators and denominators are summed across all banks in the group then divided.

Third Quarter 2013

Profitability at all categories of banks continued its year-over-year steady growth, but growth leveled off from the second to the third quarter. In addition, except at community banks nationally, the number of firms showing positive net income increased.[1] At large organizations, ROA increased 10 basis points from the third quarter of 2012, to 0.95 percent, but decreased 3 basis points from the second quarter of 2013 (Figure 1).[2] This was in part due to litigation expenses resulting from lawsuits over the quality of mortgages sold to Fannie Mae and Freddie Mac in the mid-2000s, but it was also the result of operations. At community banks nationally, ROA was 0.94 percent; up 16 basis points from last year but only 2 basis points from the second quarter. Local banks saw increases of 17 basis points for the year.

Figure 1
Return on Average Assets



and 2 for the quarter, to 0.74 percent. This ROA is substantially lower than both community banks nationally and large organizations.

There are several reasons for the lower profitability of area banks. First, for the past several years, loans have been growing faster at area banks than at their counterparts nationwide, particularly CRE loans (see "Commercial Real Estate Lending" below). As shown in the table on page 2, loan-to-deposit ratios at area banks are substantially higher than both community banks nationwide and large organizations. This expansion of CRE lending has led to higher loan losses than other categories of banks. Third, as a result of this increased lending, area banks had to be more aggressive in loan-loss provisioning. Area banks' ratio of loan-loss provision to operating income is much higher than other categories of banks, thus reducing net income. Area banks may also be more conservative in their provisioning practices. Their ratio of net charge-offs to loan-loss provision is much lower than other categories of banks (see "Provisioning and Reserves" that follows).

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. Decreased expense ratios also contributed to increasing income, while asset sales shrank and trading income was down except at local community banks. Asset sales and trading income had been reliable contributors to overall net income until this quarter, so this development bears further monitoring.

Net charge-offs (NCOs) and nonperforming loans (NPLs) dropped substantially in the third quarter, and both loan-loss provisions and reserves continued to drop as well (see "Provisioning and Reserves" that follows). This allowed community banks to show increases in profits from last year despite falling net interest margins. However, at large organizations, total

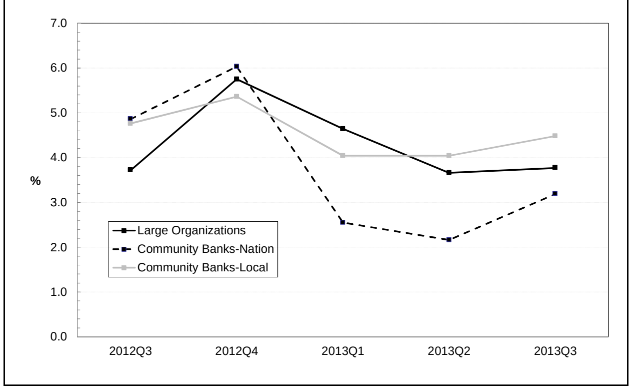
[1] Out of 5,191 community banks in the national sample, 4,785 reported positive quarterly profits. This was a decrease of seven from the second quarter of 2013. Locally, 156 out of 172 banks reported positive profits, an increase of one from the second quarter of 2013. For large organizations, 100 out of 103 were profitable, up one from the previous quarter.

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

net income dropped 10.2 percent from the third quarter of 2012.

Year over year, assets of community banks nationally grew at a 3.2 percent rate, while asset growth at local community banks was 4.5 percent (Figure 2). At large organizations, asset growth was 3.8 percent. Quarterly growth was also strong at all categories of banks after shrinking the past two quarters.

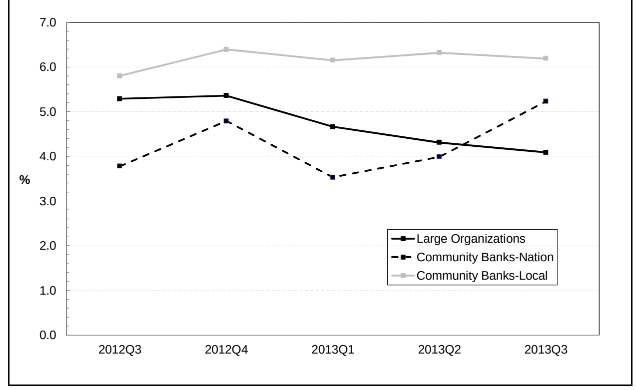
Figure 2
Year-Over-Year Asset Growth



The year-over-year growth in assets was fueled mainly by increases in loans as growth in banks' securities portfolios slowed. Loans increased 4.1 percent at large organizations, 5.2 percent at community banks nationally, and 6.2 percent at local community banks (Figure 3). The reported value of securities increased only 2.5 percent at community banks nationally, 3.2 percent at local community banks, and decreased 1.8 percent at large organizations.[3]

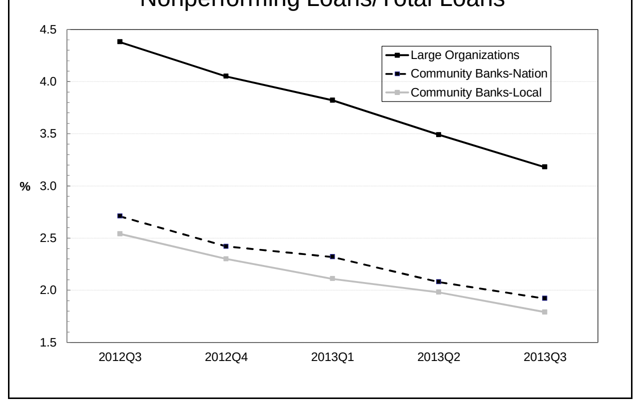
While all categories of banks showed similar growth rates for total loans, growth within types of loans has begun to diverge. At large organizations, most of total loan growth was due to commercial and industrial (C&I) lending, with a small boost from consumer loans. C&I loans grew nearly 8.5 percent, consumer loans grew 2.4 percent, and real estate lending was flat. At community banks, C&I lending grew at a rate of 8.1 percent nationally and 2.8 percent locally, but real estate lending picked up as well. Consumer loans also grew faster (see "Consumer Lending" that follows).

Figure 3
Year-Over-Year Loan Growth



The main factor driving the growth of real estate loans was CRE loans, as RRE lending grew modestly at best at community banks and shrank slightly at large organizations. Community banks both locally and nationally have a much higher percentage of their real estate loans in CRE lending, while large organizations concentrate heavily on RRE loans (see the "Residential Real Estate Lending" and "Commercial Real Estate Lending" sections that follow, and Tables 1 and 2 in the Appendix).

Figure 4
Nonperforming Loans/Total Loans

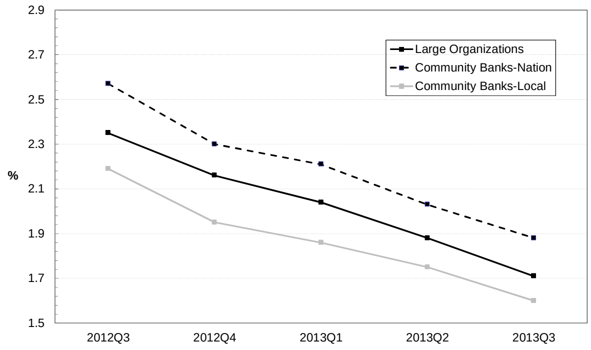


[3] Reported value is the sum of the market value of available-for-sale securities and the book value of held-to-maturity securities.

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 1.2 percentage points from last year to 3.18 percent (Figure 4).[4] 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 79 basis points since last year, to 1.92 percent. Locally, the NPL ratio fell by 75 basis points, to 1.79 percent.

Overall, asset quality has also improved at all categories of banks.[5] 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 16.1 percent. At community banks, the decrease was 16.7 percent nationally and 7.5 percent locally. It should be noted that OREO increased nearly 8 percent in the quarter at large organizations, while falling substantially at community banks. 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).[6]

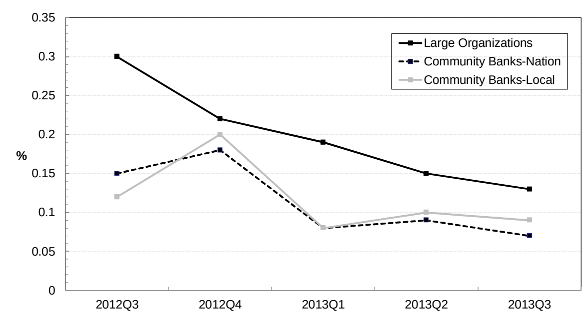
Figure 5
Nonperforming Assets/Total Assets



At large organizations, the NPA ratio has fallen 64 basis points in the past year, to 1.71 percent. At community banks nationally, the decrease was 69 basis points, to 1.88 percent, and locally the NPA ratio fell 59 basis points, to 1.60 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 17 basis points over the year at large organizations, to 0.13 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 nationally, the NCO ratio has fallen 8 basis points over the year, to 0.07 percent. At tri-state area community banks, the NCO ratio has fallen 3 basis points over the past year, to

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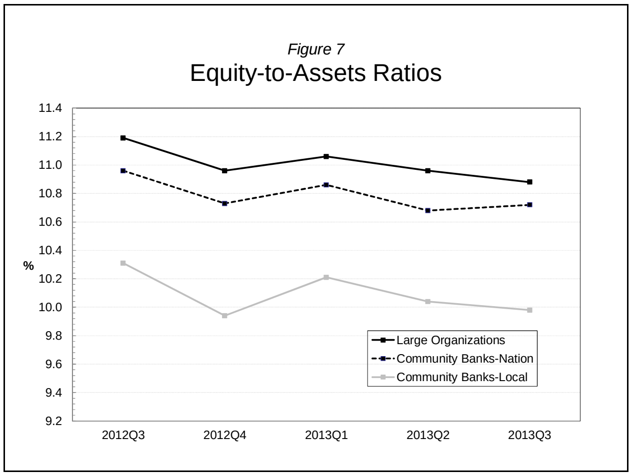
[4] For historical perspective, the average NPL ratio for all commercial banks between 2001 and 2011 was 2.31 percent. At the bottom of the last real estate cycle, in 1991, this ratio stood at 3.70 percent. Source: FDIC Historical Statistics on Banking, http://www2.fdic.gov/hsob/index.asp.

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

[6] 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.

0.09 percent. Gross charge-offs fell at all categories of banks, while recoveries increased at community banks but fell slightly at large organizations.

Capital ratios, defined as the ratio of total equity to assets, fell at all categories from a year ago and, except for community banks nationally, also from the first quarter (Figure 7).

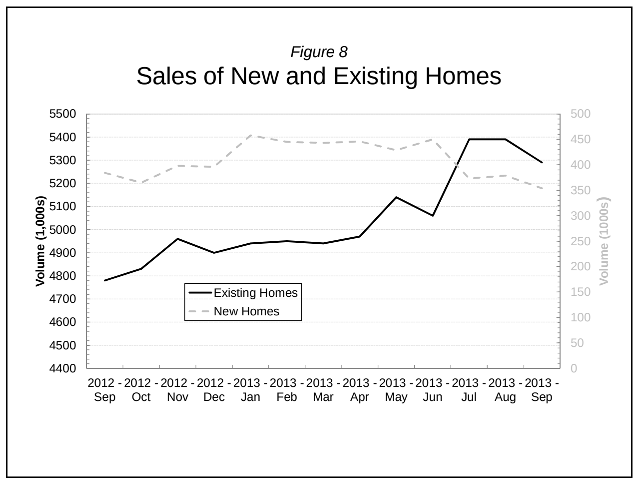


The number of bank failures in the third quarter of 2013 fell from both the third quarter of 2012 and the second quarter of 2013. The Federal Deposit Insurance Corporation (FDIC) reported six bank failures in the third quarter, down from 12 in the second quarter. In the third quarter of 2012, 12 failures were reported. There has only been one additional failure so far in the fourth quarter (as of November 14), bringing this year's total up to 24, 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[7]

The nationwide and local RRE markets continued their modest recovery in the third quarter, with most areas reporting increased activity from last year. The Federal Reserve Board's *Beige Book*, as of October 16, 2013, reported that sales of existing homes increased moderately in most Federal Reserve Districts, but Philadelphia and North Jersey reported slower growth.[8] It also reported that construction, for the most part, improved across the country, and much of this increase was in apartment buildings.

By most measures, local real estate markets continued to improve in the third quarter. In the Philadelphia region, the *Beige Book* reported that existing home sales grew but at a slower pace than last year. Homebuilders also reported moderate growth. The New York region (including northern New Jersey) reported the same but also noted that home prices are still being restrained by a sizable backlog of foreclosed and distressed properties.



Sales of both new and existing homes have increased since the third quarter of last year as well as the end of the second 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 99 basis points from a year ago, and the percentage of mortgages in foreclosure has decreased 99 basis points (Figure 9).

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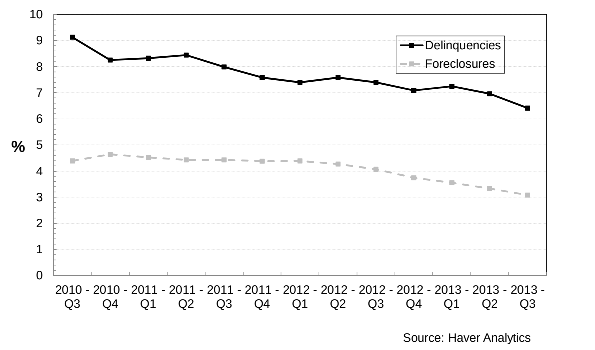
[7] See Table 1 in the Appendix for a full summary of the data used in this section.

[8] For further information, see http://www.federalreserve.gov/monetarypolicy/beigebook/beigebook201310.htm?full_report.

Figure 9

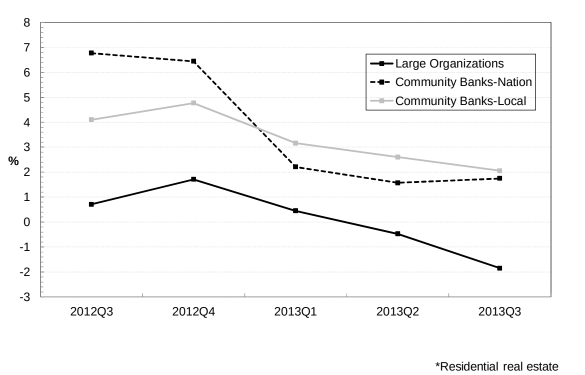
Delinquency and Foreclosure Rates



RRE loans outstanding showed little year-over-year growth at community banks and shrank at large organizations (Figure 10). From the third quarter of 2012 to the third quarter of 2013, RRE loans outstanding grew at a rate of 1.8 percent at community banks nationally and 2.1 percent locally. Community banks nationally showed somewhat stronger growth from the second to the third quarter, and a slight decline at local community banks. At large organizations, loans shrank 1.9 percent year over year and 5.1 percent in the third quarter.

Figure 10

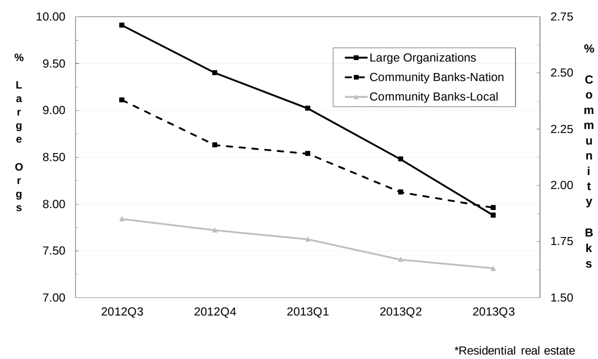
Annual Change in RRE* Loans Outstanding



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 over 1.1 percentage points, to 7.88 percent, in the last year [Figure 11: note the different scales for large organizations (left y-axis) and community banks (right y-axis).] Community banks have much better RRE loan quality, with NPL ratios of 1.90 percent nationally and 1.63 percent locally. These represent drops of 48 and 22 basis points, respectively, in the past year.

Figure 11

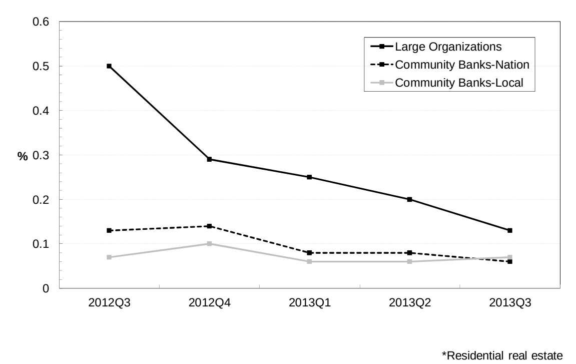
Nonperforming RRE* Loans/Total RRE Loans



The improvement in loan quality at large organizations is also reflected in the RRE NCO ratio. At large organizations, this ratio fell for the fourth consecutive quarter, decreasing 37 basis points, to 0.13 percent in the past year (Figure 12).

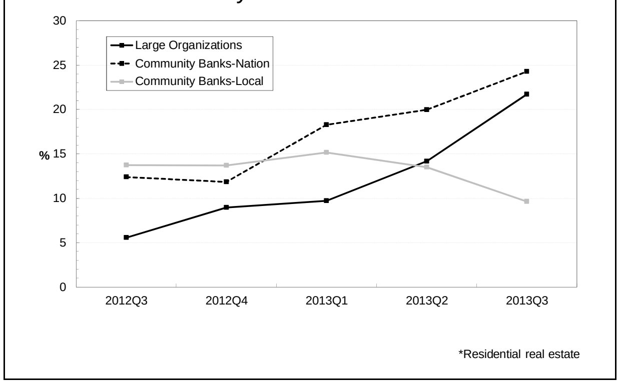
Figure 12

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



NCOs at community banks remained flat. The RRE NCO ratio has decreased 7 basis points nationally, to 0.06 percent, and was unchanged locally at 0.07 percent. In the cases of both large organizations and community banks nationally, charge-offs decreased and recoveries increased. At local community banks, charge-offs decreased modestly in the third quarter, and recovery ratios have decreased in the past year due to a falloff in recoveries (Figure 13).

Figure 13
Recovery Ratio on RRE Loans

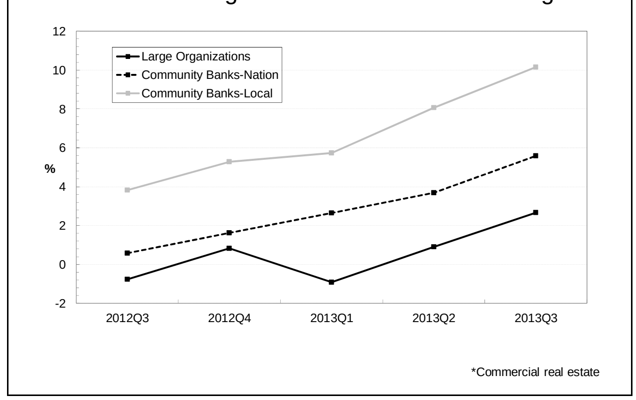


Commercial Real Estate Lending[9]

Commercial real estate (CRE) market conditions improved modestly both locally and nationally. The *Beige Book* reported that most CRE markets nationwide continued to show modest increases in construction, particularly multifamily properties. Demand for leased commercial space picked up in many areas. For the most part, in the Philadelphia district, there was modest growth in commercial leasing activity, but leasing agents are more optimistic than in previous quarters. There was slight growth in construction. North Jersey was somewhat worse off, with little growth in leases and construction limited to renovations and improvements on existing properties.

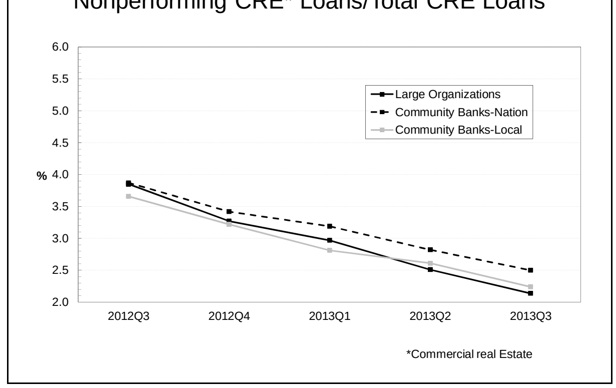
CRE lending results improved in the third quarter, with both loan quality and growth improving at all categories of banks. Loan growth was especially strong at local community banks. Year over year, CRE loans outstanding grew at a rate of 2.7 percent at large organizations, 5.6 percent at community banks nationally, and 10.2 percent at tri-state-area community banks (Figure 14). Much of this growth can be attributed to loans on multifamily properties, while construction lending continued to be weak (see below).

Figure 14
Annual Change in CRE* Loans Outstanding



The quality of CRE loans improved 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 third quarter of 2012, to 2.14 percent (Figure 15). The CRE NPL ratio decreased nearly 1.4 percentage points at community banks nationally from last year to 2.50 percent and over 1.4 percentage points at community banks locally to 2.24 percent.

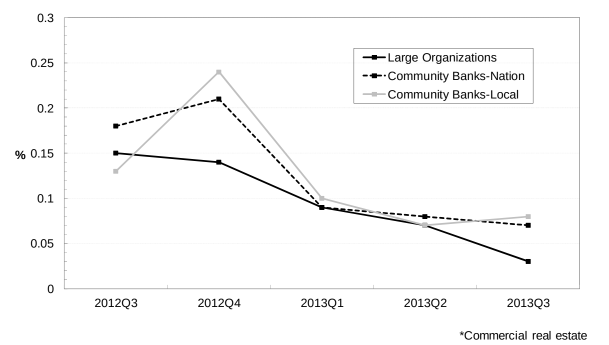
Figure 15
Nonperforming CRE* Loans/Total CRE Loans



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

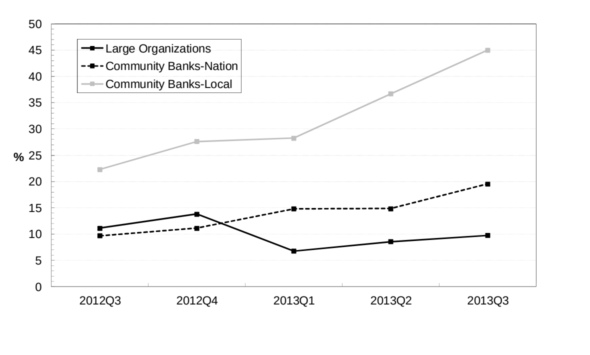
NCO ratios have decreased at all categories of banks as well. Since last year, the CRE NCO ratio at large organizations has decreased by 12 basis points, to 0.03 percent. At community banks nationally, there was a decrease of 11 basis points, to 0.07 percent, and a decrease of 5 basis points locally, to 0.08 percent (Figure 16).

Figure 16
Net Charge-Offs on CRE* Loans/Avg CRE Loans



As noted above, much of the growth in CRE lending can be attributed to loans on multifamily housing, and growth is accelerating (Figure 17). Community banks in general saw double-digit growth in multifamily loans; this was especially true at local community banks, where loans outstanding have grown 45 percent in the past year. Large organizations weren't far behind.

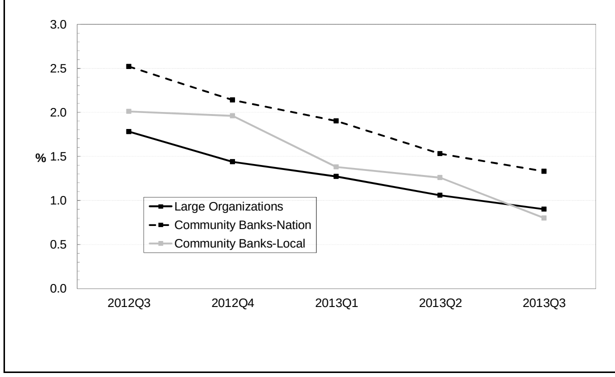
Figure 17
Annual Change in Multifamily Loans Outstanding



This growth in multifamily housing is due to two factors. First, there has been a lot of construction and conversions in New Jersey, particularly northern New Jersey. There is also substantial conversion activity in the Philadelphia area, where, similar to northern New Jersey, excess office space is being converted into multifamily housing. However, this growth appears to have come at a price, as NCOs on loans secured by multifamily properties at local community banks have increased by 45 percent for the year. NCOs had been falling until the third quarter at local banks, and they continued to fall at other categories of banks.

In spite of the high growth and NCO problems, loan quality hasn't been adversely affected, as NPL ratios at all categories are not only falling, but they are well below those for all CRE loans (Figure 18).

Figure 18
Multifamily Loan NPL Ratios



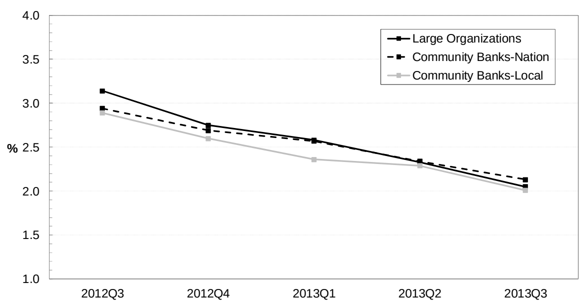
Even though they have been growing at a high rate recently, multifamily loans still make up a small part of total CRE lending.[10] By far, the largest share of CRE lending is in commercial mortgages.

Since CRE lending is the largest part of community banks' loan portfolios, the quality of their commercial mortgage portfolios has a significant role in determining the health of those banks. Commercial mortgage quality has

[10] At local community banks, 77 percent of CRE loans are commercial mortgages, 13 percent are multifamily loans, and 10 percent are construction loans.

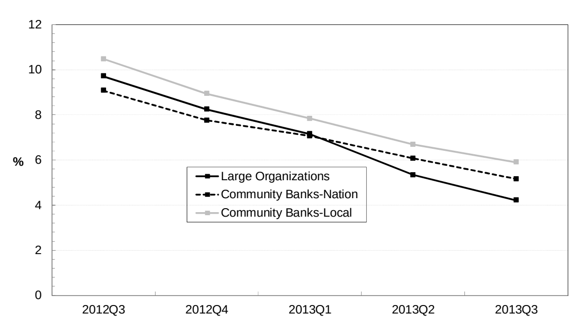
improved significantly in the past year. At large organizations, the NPL has decreased nearly 1.1 percentage points, to 2.05 percent. At community banks nationally, the ratio has decreased 81 basis points, to 2.13 percent, and at community banks locally, the ratio has decreased 88 basis points, to 2.01 percent (Figure 19). NCOs on these loans have also dropped substantially.

Figure 19
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 nearly 5.5 percentage points in the last year, to 4.21 percent (Figure 20). Community banks have experienced similar drops — nearly 4 points nationally and 4.5 points locally.

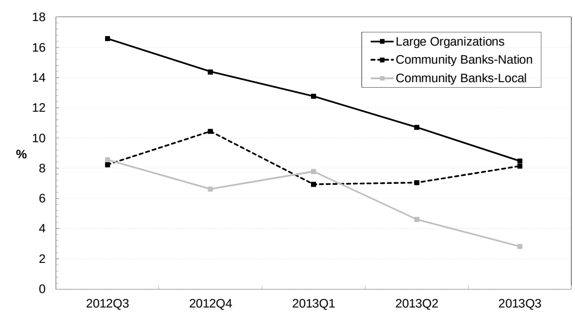
Figure 20
Construction Loan NPL Ratios



Commercial & Industrial Lending[11]

C&I lending has been the bright spot for bank lending in recent quarters, both in terms of growth and quality, but this is changing somewhat. Lending growth has slowed in the past several quarters at large organizations and local community banks, with only modest growth at community banks nationally. At large organizations, C&I loans grew 8.5 percent in the past year (Figure 21 and Table 3 in the Appendix). At community banks, C&I lending grew 8.1 percent nationally and 2.8 percent locally. Locally, loans shrank 2 percent from the second to the third quarter. This was the second consecutive quarter of negative loan growth. Quarterly loan growth also slowed at other categories of banks but remained positive.

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



*Commercial and Industrial

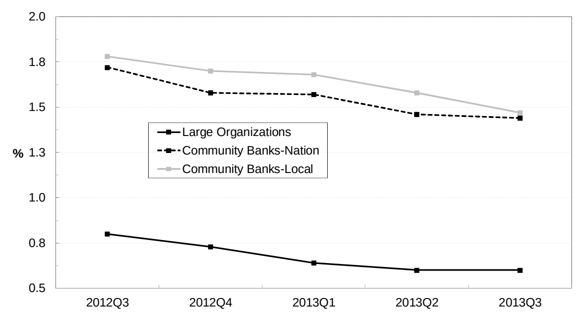
The Federal Reserve Board's *Senior Loan Officer Opinion Survey* for October 2013 reported that loan demand was mixed, with about half the firms reporting increased demand

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

and half reporting a weakening in demand.[12] 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 remained high at all categories of banks (Figure 22). At large organizations, the NPL ratio has fallen 20 basis points in the past year, to 0.60 percent, but it was unchanged from the second to the third quarter. Quality is somewhat worse at community banks, with NPL ratios of 1.44 nationally and 1.47 locally. Again, both of these ratios fell substantially in the past year but are roughly flat from last quarter.

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

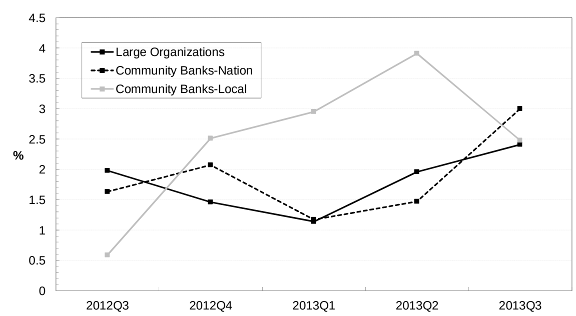


*Commercial and Industrial

Consumer Lending[13]

Overall, consumer lending strengthened somewhat in the third quarter, but it is still relatively weak. Also, there are relatively few quality problems. Large organizations conduct the vast majority of consumer lending. Their consumer lending increased slightly, growing about 2.4 percent year over year (Figure 23). At community banks nationally, consumer lending grew 3 percent, while at community banks locally, consumer lending grew 2.5 percent. In all categories of banks, consumer loans grew at a higher rate from last quarter than year over year. For large organizations and community banks nationally, the main area of growth in consumer lending was in auto loans, with community banks also seeing growth in personal loans.[14] At local community banks, growth was in "other revolving credit (i.e., revolving credit not due to credit cards)."

Figure 23
Year-Over-Year Growth in Consumer Loans



NPL ratios on consumer loans have been low: 1.06 percent for large organizations, 0.75 percent for community banks nationally, and 0.49 percent for tri-state area community banks.

The most reliable measure of quality for consumer loans is NCOs. Many consumer loans – particularly at large organizations — are lines of credit with flexible repayment schedules, so NPLs are difficult to calculate. Also, except for automobiles, items purchased with consumer loans are difficult to repossess and resell, so when consumer loans go bad they are often a total loss.[15] NCO ratios fell somewhat at large

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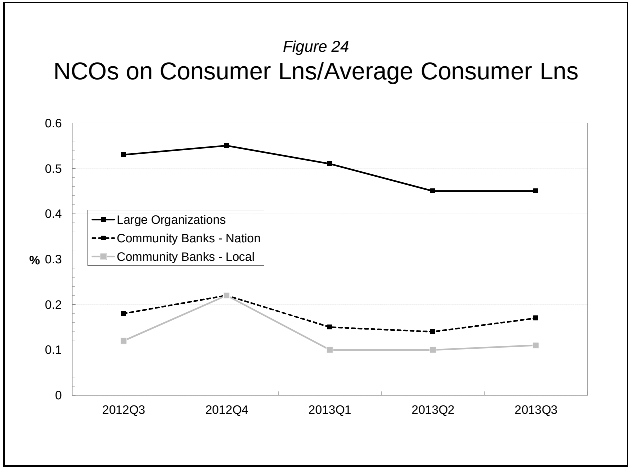
[12] See http://www.federalreserve.gov/boarddocs/snloansurvey/201308/fullreport.pdf for further information.

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

[14] Consumer loans can be divided 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.

[15] The breakdown of consumer loans is as follows: At large organizations — credit cards, 32.8 percent; other

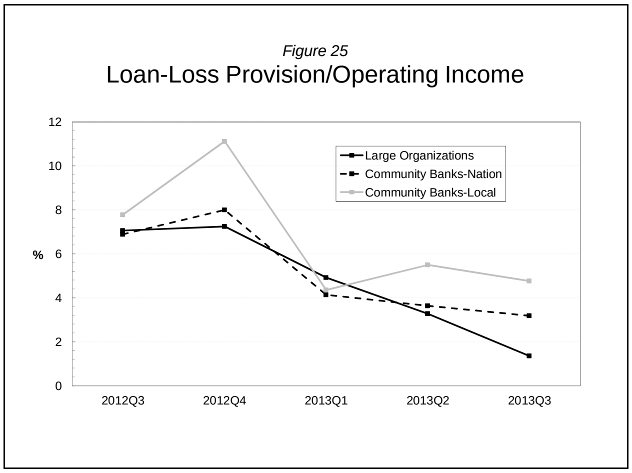
organizations year over year, and they were basically flat at community banks both nationally and locally (Figure 24). For large organizations, the ratio fell 8 basis points, to 0.45 percent. For community banks, the ratio fell 9 basis points, to 0.17 percent nationally, and locally the ratio fell 1 basis point, to 0.11 percent.



Provisioning and Reserves[16]

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 17 percent in the past year.[17] At community banks, loan-loss reserves have fallen by over 6 percent nationally and 2 percent locally. Loan-loss provisions also have decreased substantially, both overall and as a percentage of operating income. Over the year, quarterly loan-loss provisions were down over 81 percent at large organizations, 53 percent at community banks nationally, and 38 percent at local community banks.

The ratio of loan-loss provisions to operating income fell 5.7 percentage points, to 1.36 percent, at large organizations; decreased 3.7 percentage points, to 3.18 percent, at community banks nationally; and fell 3.0 percentage points, to 4.76 percent, at local community banks (Figure 25).[18] It should be noted that in each category this ratio is somewhat bumpy, rising in some quarters and falling in others. However, except at local community banks this ratio has been falling consistently for nearly a year.



As noted above, the falling loan-loss provisions and consequent decreases in reserves can be justified as a reaction to improving loan

revolving credit, 7.1 percent; auto loans, 36.5 percent; other consumer loans, 23.7 percent; at community banks nationally — credit cards, 3.2 percent; other revolving credit, 4.5 percent; auto loans, 44.9 percent; other consumer loans, 47.4 percent; and at local community banks — credit cards, 2.1 percent; other revolving credit, 14.2 percent; auto loans, 37.3 percent; other consumer loans, 46.3 percent. Figures may not equal 100 due to rounding.

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

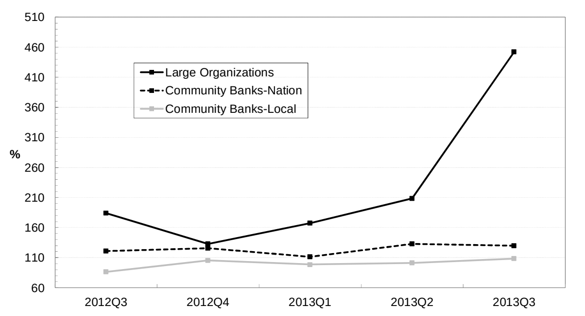
[17] As reported here, loan-loss reserves are the balance-sheet item and loan-loss provisions are from the income statement.

[18] 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.

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 450 percent (Figure 26).[19] In other words, last quarter large organizations

Figure 26

Net Charge-offs/Loan-Loss Provision

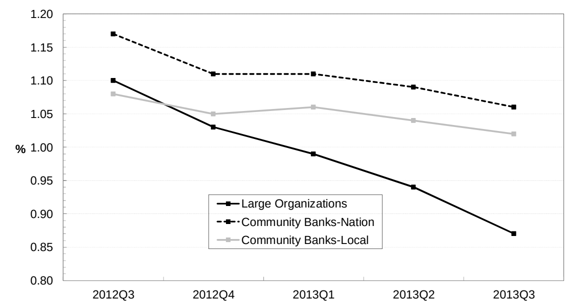


charged off (net of recoveries) $4.50 for every $1 of loan-loss provision. At community banks, the ratios are somewhat lower, but they also have increased in the past year. The NCOs to loan-loss provision ratio has increased slightly less than 9 percentage points, to 129.9 percent, at community banks nationally. At local community banks, the ratio increased about 22 percentage points, to 108.4.

The decrease in provisioning has resulted in a drop in overall reserves, particularly at large organizations. Total loan-loss reserves fell over 6 percent at community banks nationally, approximately 2 percent at local community banks, and over 17 percent at large organizations. As a percent of total assets, reserves have decreased from the second quarter of last year in all categories of banks, though the drop was relatively small at local community banks (Figure 27). At large organizations, the ratio has fallen 23 basis points since last year, to 0.87 percent. At community banks, the drop was 11 basis points nationally and 6 basis points locally.

Figure 27

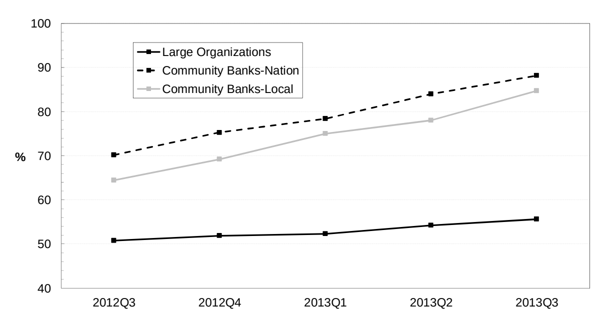
Loan-Loss Reserves/Assets



Loan-loss coverage continued to improve in the third quarter at all categories of banks, but it still remains well outside of historical norms. At large organizations, loan-loss coverage increased a little less than 5 percentage points from last year, to 55.6 percent (Figure 28). It has been increasing for the past year now.

Figure 28

Loan-Loss Coverage Ratio



The situation has been somewhat better at community banks, and it continued to improve there as well. The loan-loss coverage ratio at

[19] 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.

community banks nationally has increased over 18 percentage points in the past year, to 88.2 percent. Locally, loan-loss coverage increased over 20 percentage points, to 84.7 percent.[20]

Securities[21]

Community banks, both locally and nationally, saw small year-over-year increases in the market value of their securities portfolios, while large organizations had a small loss in value. Also, large organizations had a larger loss in value from the second to the third quarter.[22]

All categories of banks saw their realized gains on securities decline substantially.[23] Large organizations posted gains of approximately $530 million. Community banks nationally reported a realized loss of $26.6 million in the quarter. Local community banks reported a realized gain of about $7 million. All of these figures are down substantially from both last year and the second quarter.

[20] 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.

[21] 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.

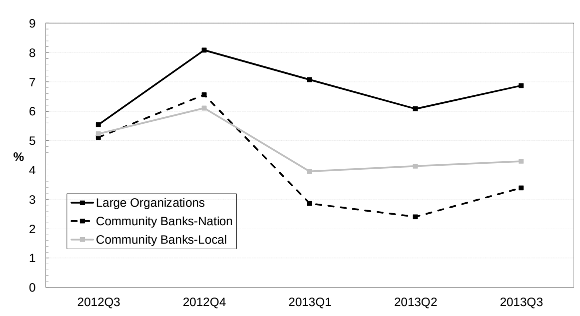
[22] Changes in market value can be indicative of either increases in the value of securities that were already owned or increases due to purchases or sales of securities.

[23] 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.

Funding Sources[24]

Year over year, deposit growth accelerated slightly at all categories of banks from the second quarter (Figure 29). Deposit growth from last quarter was much stronger after shrinking for the previous two quarters. The growth was fairly consistent across all categories of banks with demand deposits and savings deposits showing substantial increases, and time deposits showing substantial decreases.

Figure 29
Year-Over-Year Growth in Deposits



Reliance on brokered deposits has grown somewhat at large organizations and local community banks, particularly in the past quarter or two. At large organizations, brokered deposits have increased 23 percent from last year with a similar quarterly increase. Their share of total deposits has risen from 5.0 to 5.8 percent since last year. At community banks nationally, brokered deposits have decreased 9.7 percent in the past year but increased 15 percent in the third quarter. However, their share of total deposits decreased from 4.3 to 3.7 percent since last year. At local community banks, brokered deposits are up over 13 percent in the past year with a quarterly increase of 5.9

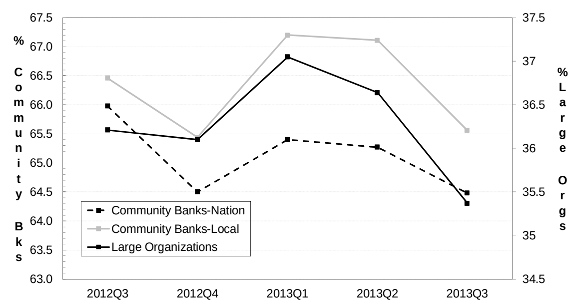
[24] See Table 7 in the Appendix for a full summary of the data used in this section.

percent. Their share of total deposits has increased in the last year by about 0.3 percentage point, to 4 percent.

The reliance on brokered deposits is reflected in the growth of core deposits as opposed to all deposits. Core deposits grew at a slower pace than overall deposit growth.[25] Core deposits are the least expensive and most stable

Figure 30

Core Deposits/Total Deposits

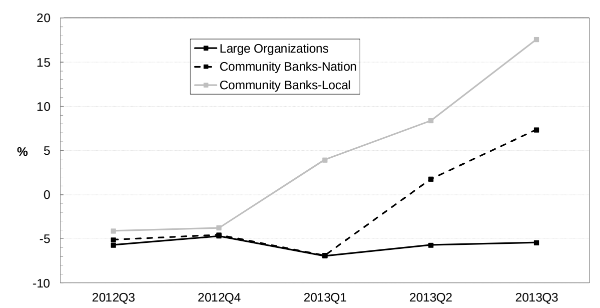


form of funding for banks, so this slowdown in growth could adversely affect interest margins going forward. Their share of total deposits has decreased at all categories of banks in the past year, and this decrease is especially dramatic in the past two quarters (Figure 30).

The slow growth in core funding has forced banks, especially community banks, to seek more expensive types of funding in the form of nondeposit debt. After falling for more than a year, nondeposit debt funding increased at community banks both nationally and locally (Figure 31).[26] The year-over-year increases grew substantially from last quarter, and at community banks nationally the quarterly increase was more than double the annual increase (15.7 percent quarterly and 7.3 percent annually). Local community banks had a large annual increase (17.6 percent), but nondeposit debt was basically flat from the second to the third quarter. Large organizations have not had to seek out nondeposit funding. For large organizations, nondeposit debt fell 5.4 percent from the third quarter of 2012, and 10.4 percent from the second quarter of 2013.

Figure 31

Year-Over-Year Growth in Nondeposit Debt



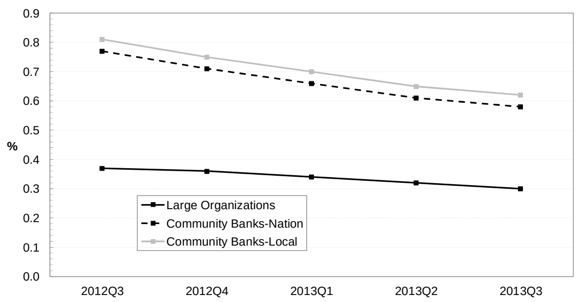
Large organizations continue to have a funding advantage over community banks in terms of both deposits and nondeposit funding. The implicit interest rate on deposits continued to fall at all categories of banks, but large organizations pay only a fraction of what community banks pay both nationally and locally (Figure 32).[27] This holds true for nondeposit funding as well.

[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.

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

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

Figure 32
Implicit Interest Rate on Deposits

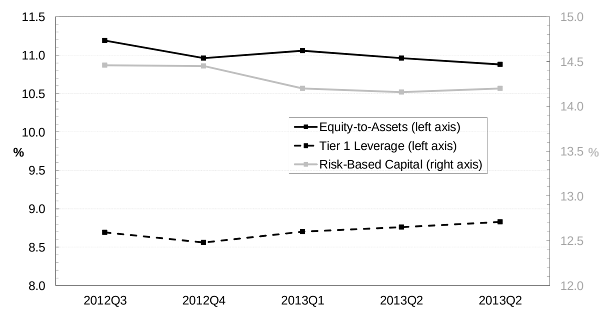


Regulatory Capital[28]

Both large organizations and community banks are meeting regulatory capital standards, for the most part. All but one of the 103 large organizations in the sample had equity-to-assets ratios of at least 6 percent, and all but two had equity-to-assets ratios of over 7 percent.[29] At community banks nationally, 97 percent of the institutions had equity-to-assets ratios of at least 6 percent, and nearly 95 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 90.7 percent (156) had an equity-to-assets ratio of at least 7 percent. Overall capitalizations are still above historical averages.

Year over year, at large organizations, capitalization was a mixed bag, with equity-to-assets ratios and risk-based capital ratios falling and tier 1 leverage ratios rising. Regardless, capitalization remained somewhat higher than historical norms.[30] Year over year, the equity-to-assets ratio at large organizations has fallen 31 basis points, the tier 1 leverage ratio has increased 14 basis points, and the risk-based capital ratio has decreased 26 basis points (Figure 33: Note the different scales on the left and right axes).[31] From the second quarter to the third, all of these ratios rose slightly.

Figure 33
Regulatory Capital – Large Organizations



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 24 basis points, the tier 1 leverage ratio has increased 22 basis points, and the risk-based capital ratio has decreased 13

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

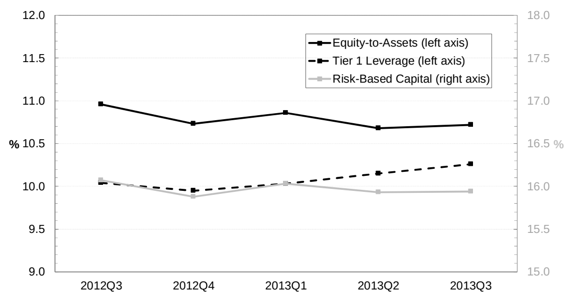
[29] Regulation Y defines capital in terms of zones. Institutions in Zone 1 have tier 1 capital-to-assets ratios above 7 percent, those in Zone 2 are between 6 and 7 percent, and those in Zone 3 have ratios below 6 percent. An institution is considered well capitalized if it is in Zone 1 or 2 and undercapitalized 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.

[30] 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.

[31] 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.

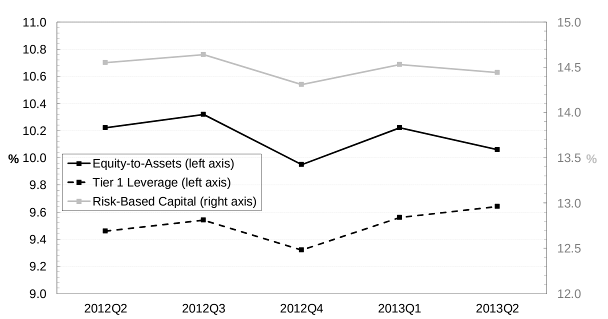
basis points (Figure 34: Note the different scales on the left and right axes).

Figure 34
Regulatory Capital – All Community Banks



At local community banks, year over year, the equity-to-assets ratio has fallen 33 basis points, the tier 1 leverage ratio increased by 11 basis points, and the risk-based capital ratio has fallen 17 basis points (Figure 35: Note the different scales on the left and right axes).

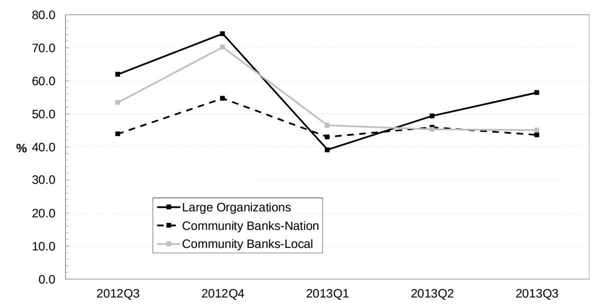
Figure 35
Regulatory Capital – Local Community Banks



As was the case last quarter, the main reason for 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.

All categories of banks also had declining levels of both common and preferred stock. These were offset by increases in surplus and retained earnings. The percentage of institutions paying dividends on their stock has increased at all categories of banks, but the dividend payout ratios at all categories except national community banks has fallen substantially (Figure 36).[32]

Figure 36
Dividend Payout Ratios



[32] The dividend payout ratio is defined as the ratio of dividends paid on common and preferred stock to net income.

Appendix – Data Tables for Each Section

Table 1 - Summary of Residential Real Estate Lending

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
1. Year-Over-Year Growth			
Total RRE Loans	-1.9%	2.1%	1.8%
RRE NPLs	-21.9%	-10.0	-18.7%
RRE NCOs	-74.3%	-7.3	-48.8%
2. Shares			
RRE Lns/Total Lns	31.6%	30.3%	25.2%
RRE NPLs/Total NPLs	78.5%	27.7%	24.9%
RRE NCOs/Total NCOs	32.5%	23.0%	22.5%
3. Performance Ratios			
RRE NPLs/Total RRE Lns	7.88%	1.63%	1.90%
RRE NCOs/Avg RRE Lns	0.13%	0.07%	0.06%
4. Outstandings ($millions)			
Total RRE Lns	1,679,758.3	21,421.8	301,935.0
RRE NPLs	132,401.7	349.9	5,736.7
RRE NCOs	2,180.9	13.9	192.7

Table 2 - Summary of Commercial Real Estate Lending

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
1. Year-Over-Year Growth			
Total CRE Loans	2.7%	10.2%	5.6%
CRE NPLs	-42.8%	-32.6%	-31.6%
CRE NCOs	-77.7%	-33.3%	-58.1%
2. Shares			
CRE Lns/Total Lns	15.7%	46.4%	43.5%
CRE NPLs/Total NPLs	10.6%	58.2%	56.6%
CRE NCOs/Total NCOs	4.2%	42.3%	43.9%
3. Performance Ratios			
CRE NPLs/Total CRE Lns	2.14%	2.24%	2.50%
CRE NCOs/Avg CRE Lns	0.03%	0.08%	0.07%
4. Outstandings ($millions)			
Total CRE Lns	835,437.9	32,809.7	521,001.9
CRE NPLs	17,917.7	735.6	13,048.0
CRE NCOs	278.4	25.5	376.2

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	8.5%	2.8%	8.1%
C&I NPLs	-19.7%	-15.1%	-9.4%
C&I NCOs	-42.7%	-10.9%	-62.8%
2. Shares			
C&I Lns/Total Lns	23.4%	13.5%	16.2%
C&I NPLs/Total NPLs	4.4%	11.1%	12.1%
C&I NCOs/Total NCOs	10.2%	33.4%	30.3%
3. Performance Ratios			
C&I NPLs/Total C&I Lns	0.60%	1.47%	1.44%
C&I NCOs/Avg C&I Lns	0.06%	0.21%	0.14%
4. Outstandings ($millions)			
Total C&I Lns	1,243,753.4	9,521.4	193,878.0
C&I NPLs	7,406.9	139.8	2,786.1
C&I NCOs	683.8	20.2	259.1

Table 4 - Summary of Consumer Lending

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
1. Year-Over-Year Growth			
Total Consumer Loans	2.4%	2.5%	3.0%
Consumer NPLs	-16.7%	-18.1%	1.7%
Consumer NCOs	-12.0%	-13.0%	-2.3%
2. Shares			
Consumer Lns/Total Lns	13.7%	3.7%	4.3%
Consumer NPLs/Total NPLs	4.6%	1.0%	1.7%
Consumer NCOs/Total NCOs	48.5%	4.5%	10.2%
3. Performance Ratios			
Cons NPLs/Total Cons Lns	1.06%	0.49%	0.75%
Cons NCOs/Avg Cons Lns	0.45%	0.11%	0.17%
4. Outstandings ($millions)			
Total Consumer Lns	725,766.6	2,596.7	52,015.9
Consumer NPLs	7,689.8	12.9	391.0
Consumer NCOs	3,253.3	2.7	87.3

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

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Loan-Loss Reserve ($millions)	93,885.3	1,070.8	20,313.7
Change from Last Quarter	-21.1%	-1.7%	-3.9%
Change from Last Year	-17.3%	-2.0%	-6.1%
Net Charge-Offs/LL Provision	452.1%	108.4%	129.9%
LL Provision/Operating Inc.	1.4%	4.8%	3.2%
Loan-Loss Coverage Ratio	55.6%	84.7%	88.19%

Table 6 - Summary of Securities Portfolios

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Securities/Assets	20.1%	21.7%	23.4%
Market Value ($millions)	2,159,900.0	22,887.2	447,031.3
Change from Last Quarter	-0.4%	9.8%	4.6%
Change from Last Year	-2.1%	2.7%	2.1%
Realized Gain/Loss	531.9	7.0	-26.6
Pct of Average Securities	0.02	0.03	-0.01
Market Value/Book Value	100.28%	99.22	99.23%

Table 7 - Structure of Liabilities

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Deposits ($millions)	8,070,768.3	87,966.1	1,595,149.2
Pct of Assets	75.2%	83.5%	83.5%
Change from Last Quarter	11.8%	8.5%	6.5%
Change from Last Year	6.9%	4.3%	3.4%
Core Deposits/Deposits	35.4%	65.6%	64.5%
Implicit Rate on Deposits	0.30%	0.62%	0.58%
Nondeposit Debt ($millions)	946,055.1	5,709.1	95,362.6
Pct of Assets	8.8%	5.4%	5.0%
Change from Last Quarter	-10.4%	0.5%	15.7%
Change from Last Year	-5.4%	17.6%	7.3%
Implicit Rate on Debt	1.42%	1.89%	1.87%

Table 8 - Capitalization Measures

	Large Organizations	Community Banks	
Ratios	Nation	Tri-State Area	Nation
Total Equity/Total Assets	10.88%	9.98%	10.72%
Change fr Last Qtr (basis pts)	-8	-6	+4
Change fr Last Yr (basis pts)	-31	-33	-24
Tier 1 Leverage Ratio	8.83%	9.64%	10.26%
Change fr Last Qtr (basis pts)	+7	+1	+11
Change fr Last Yr (basis pts)	+14	+11	+22
Risk-Based Capital Ratio	14.20%	14.46%	15.94%
Change fr Last Qtr (basis pts)	+4	+3	+1
Change fr Last Yr (basis pts)	-26	-17	-13