BANKING BRIEF

FOR PENNSYLVANIA, NEW JERSEY, AND DELAWARE

Third Quarter 2014 Highlights

- *Year over year, profitability (ROA) improved at community banks. Profitability is near historical norms at all categories of banks. Net interest margins dropped at large organizations and were flat at community banks.*

- *Year over year, total loans grew at an accelerating rate at community banks, but growth was more modest at large organizations. Most of the loan growth at large organizations was in commercial loans. Smaller banks saw increases in all categories of loans, with commercial loans growing the fastest nationally and consumer loans leading locally.*

- *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 loan growth was particularly strong at community banks nationally, while it shrank at large organizations.*

- *Commercial real estate (CRE) lending accelerated at all categories of banks, with local community banks showing the most growth and large organizations the least. Construction lending has been increasing at an accelerating rate for several quarters. 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. It is still below historical norms at large organizations but nearly normal at community bank.*

Any questions or comments should be directed to Jim DiSalvo at 215-574-3820 or at jim.disalvo@phil.frb.org. Detailed documentation on the methodology used in constructing this document, back issues, and the current issue of *Banking Brief* are available on our website at www.philadelphiafed.org/research-and-data/publications/banking-brief. To subscribe to this publication, please go to www.philadelphiafed.org/philscriber/user/dsp_content.cfm.

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Summary Table of Bank Structure and Conditions — Third Quarter 2014

Community Banking Organizations

	Nation			*Tri-State*		
	$ Bill	**% Change From**		**$ Bill**	**% Change From**	
	14Q3	**14Q2**	**13Q3**	**14Q3**	**14Q2**	**13Q3**
Total Assets	2,024.9	6.12	7.59	113.1	8.34	7.60
Total Loans	1,318.2	11.38	11.56	78.7	10.65	11.44
C&I	216.2	9.44	14.21	10.4	3.49	9.78
Real Estate	961.2	10.35	10.86	60.9	10.51	10.97
Consumer	55.5	16.30	8.40	3.0	19.90	15.81
Total Deposits	1,675.1	5.34	6.49	91.6	6.93	4.26
Ratios (in %)	**14Q3**	**14Q2**	**13Q3**	**14Q3**	**14Q2**	**13Q3**
Net Income/Avg. Assets (ROA)	0.97	0.97	0.93	0.83	0.82	0.75
Net Interest Inc./Avg. Assets (NIM)	3.38	3.38	3.35	3.15	3.19	3.20
Noninterest Inc./Avg. Assets	0.90	0.91	0.99	1.22	1.23	1.30
Noninterest Exp./Avg. Assets	2.97	2.99	3.04	3.14	3.17	3.23
Loans/Deposits	78.69	77.60	75.12	85.92	85.19	80.38
Equity/Assets	11.02	10.95	10.72	10.18	10.18	9.98
Nonperforming Loans/Total Loans	1.39	1.51	1.92	1.30	1.40	1.80

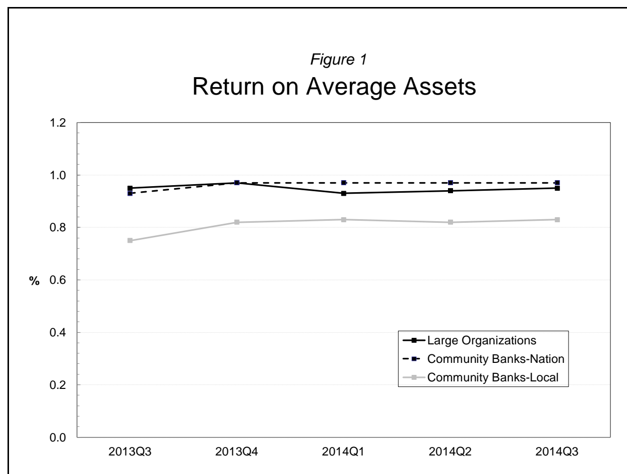
Large Organizations

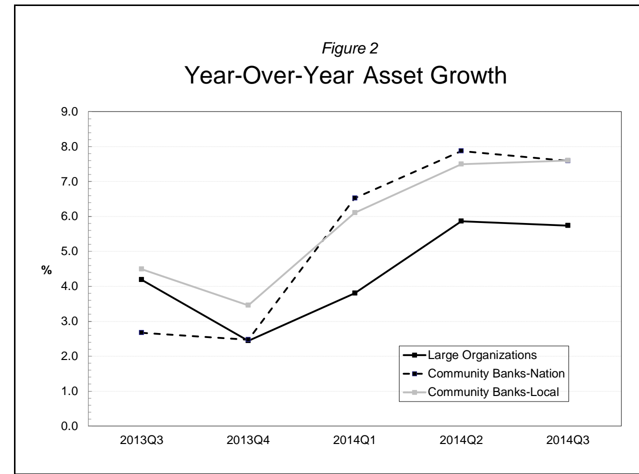
	Nation		
	$ Bill	**% Change From**	
	14Q3	**14Q2**	**13Q3**
Total Assets	11,415.3	5.98	5.74
Total Loans	5,552.2	0.56	3.82
C&I	1,315.8	1.93	8.02
Real Estate	2,635.1	-0.87	0.18
Consumer	753.9	1.13	3.76
Total Deposits	8,594.3	5.04	5.97
Ratios (in %)	**14Q3**	**14Q2**	**13Q3**
Net Income/Avg. Assets (ROA)	0.95	0.94	0.95
Net Interest Inc./Avg. Assets (NIM)	2.41	2.43	2.51
Noninterest Inc./Avg. Assets	1.68	1.65	1.83
Noninterest Exp./Avg. Assets	2.61	2.64	2.80
Loans/Deposits	64.60	65.31	65.94
Equity/Assets	10.93	11.03	10.87
Nonperforming Loans/Total Loans	2.33	2.48	3.18

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 at least as large as those of the 100th largest banking organization in the United States as of December 31, 2013. 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 number of banking organizations in the categories are as follows: 1) community banking organizations — 162 for the tri-state area and 5,002 for the nation; 2) large banking organizations — 101 for the nation. Ratios are aggregates; that is, the numerators and denominators are summed across all banks in the group, then divided.

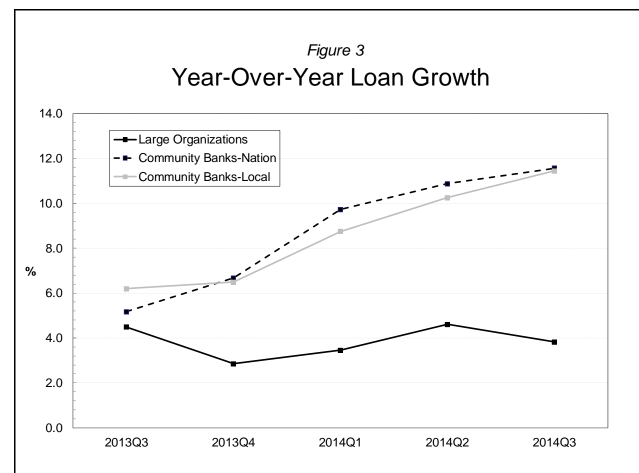
Third Quarter 2014

Banks in all categories reported fairly strong results in the third quarter, with community banks both locally and nationally showing strong profits, loan growth, and asset quality. Large organizations also reported strong profitability, but they lagged the community banks in terms of asset and loan growth and asset quality. Year-over-year profitability has reached historical norms for the first time since the financial crisis in 2008.[1] Profits this quarter were virtually unchanged. At large organizations, return on average assets (ROAA) was 0.95 percent, which was unchanged from last year and an increase of 1 basis point from the second quarter.[2] ROAA at local community banks increased 8 basis points since last year, to 0.83 percent (Figure 1).[3] At community banks nationwide, ROAA increased 4 basis points from last year to 0.97 percent.





The factors that contributed to the relatively high profitability for the quarter were different for large organizations and community banks. At community banks both locally and nationally, there was high asset growth (Figure 2). The main growth in assets came from loans. Loans outstanding grew about 11.5 percent both locally and nationally, while those at large organizations grew only 3.8 percent (Figure 3).



[1] In the past 20 years, the average ROAA was 1.04 percent. Source: FDIC Historical Statistics on Banking, https://www2.fdic.gov/hsob/index.asp

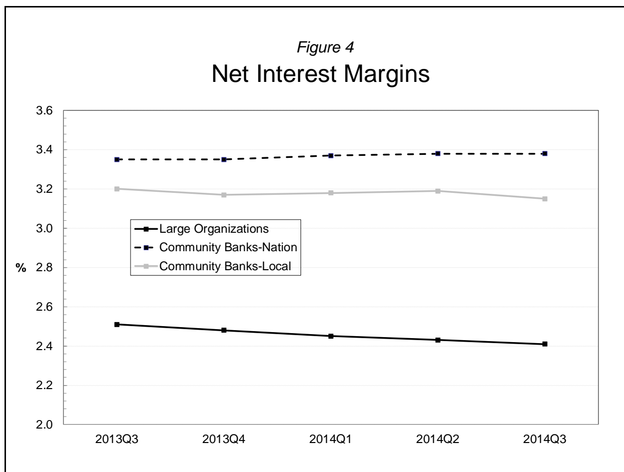
[2] Unless otherwise mentioned, all data used in this report are from Federal Financial Institutions Examination Council (FFIEC) call reports. Also, unless otherwise mentioned, all growth rates and changes in ratios or amounts are annual, that is, from the third quarter of 2013 to the third quarter of 2014. Finally, unless otherwise noted, any quarterly percentage changes are compound annual rates.

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

Additionally, loan growth at large organizations was basically flat from the second to the third quarter. While community banks experienced strong growth in all categories of loans, large organizations only experienced growth in C&I loans.

Asset growth at community banks was fueled mainly by loan growth; at large organizations, it was due to growth in securities. The market value of securities at large organizations grew 9.1 percent from 2013, while at community banks, it grew 2 percent nationally and shrank 2 percent locally.

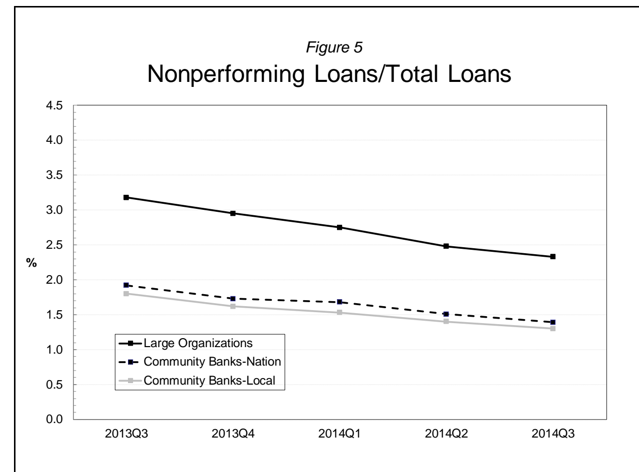
In addition to asset growth, community banks maintained relatively high net interest margins, while those at large organizations have fallen steadily for the past year (Figure 4).



The ratio of noninterest income to average assets has decreased at all categories of banks, but this decrease is greater at large organizations. Offsetting this decrease was a decrease in the ratio of noninterest expense to average assets, and the decrease was larger at large organizations than at community banks. Net trading income fell at community banks both locally and nationally, with local banks reporting a small net loss, while large organizations saw a strong gain in trading income from last year. All categories of banks saw fairly strong growth in income from asset sales, particularly loan sales. Also, all categories of banks had year-over-year increases in realized gains on securities, though these fell during the quarter.

Profitability at area banks continued to lag other banks in the nation as it has for several quarters now (Figure 1). Local banks have lower net interest margins than community banks elsewhere due to their funding mix, which is more heavily dependent on relatively expensive nondeposit debt (see "Funding Sources" on page 14). In addition, banks in the region continued to have the highest expense ratios of any category of banks.

Another main reason for high profitability was continued improving loan quality, which allowed banks to lower their loan-loss provisions. The ratio of nonperforming loans (NPLs) to total loans (the NPL ratio) continued to shrink substantially at all categories of banks (Figure 5). Community banks continued to have higher loan quality than large organizations, and local banks have higher quality than banks nationally.



Overall, asset quality has also improved for all categories of banks.[4] Foreclosed real estate, known as other real estate owned (OREO), decreased from last year at all categories of banks. At large organizations, OREO decreased

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

by 21.4 percent. At community banks, the decrease was 15.1 percent nationally and 8.0 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 6).[5]

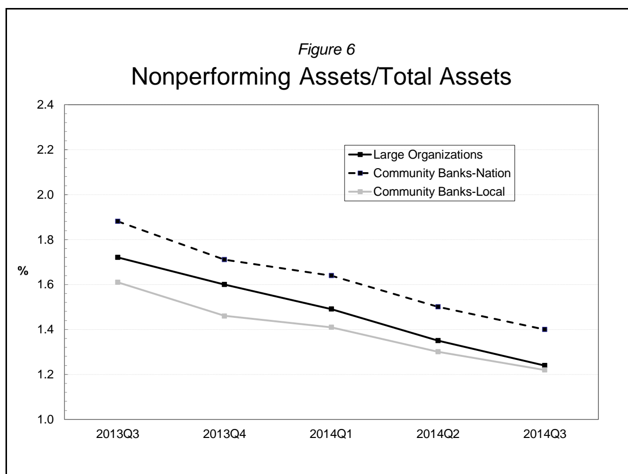


Figure 6
Nonperforming Assets/Total Assets

At large organizations, the NPA ratio has fallen 48 basis points in the past year, to 1.24 percent. At community banks nationally, the decrease was 48 basis points, to 1.40 percent, and locally the NPA ratio fell 39 basis points, to 1.22 percent.

Mainly in response to increasing loan quality, banks have been charging off fewer loans and decreasing loan-loss provisioning. The ratio of net charge-offs (NCOs) to average loans (the NCO ratio) fell 4 basis points over the year at large organizations, to 0.09 percent (Figure 7).

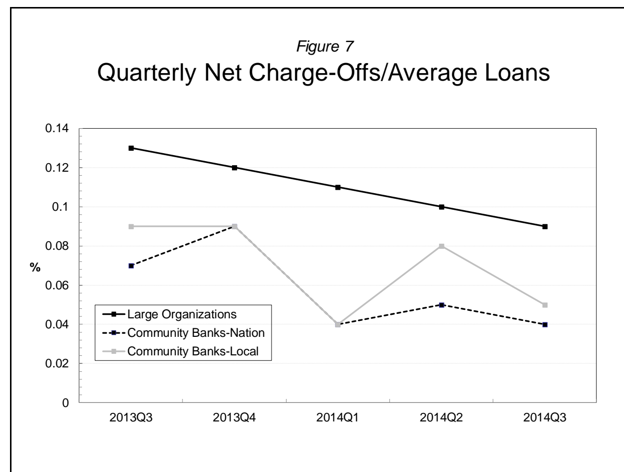


Figure 7
Quarterly Net Charge-Offs/Average Loans

Community banks both locally and nationally continued to have a lower NCO ratio than large organizations. For community banks nationally, the NCO ratio has fallen 3 basis points over the year, to 0.04 percent. At tri-state area community banks, the NCO ratio has also fallen 4 basis points over the past year, to 0.05 percent.

Capital ratios, defined as the ratio of total equity to assets, increased at all categories of banks, although in the third quarter, this ratio was flat locally and fell at large organizations (Figure 8). Bank failures are becoming rare, with only two in the third quarter and an additional three since September 30, for a total of 17 in 2014. Only one of these was in the tri-state area. There were 25 total failures in 2013.

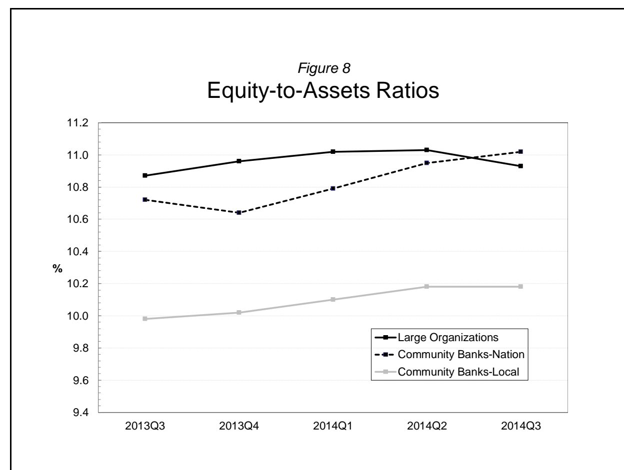


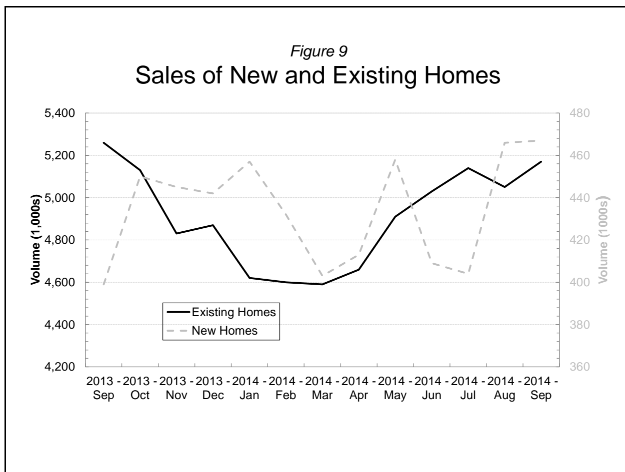
Figure 8
Equity-to-Assets Ratios

[5] 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 2002 and 2012 was 1.56 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, https://www2.fdic.gov/hsob/index.asp

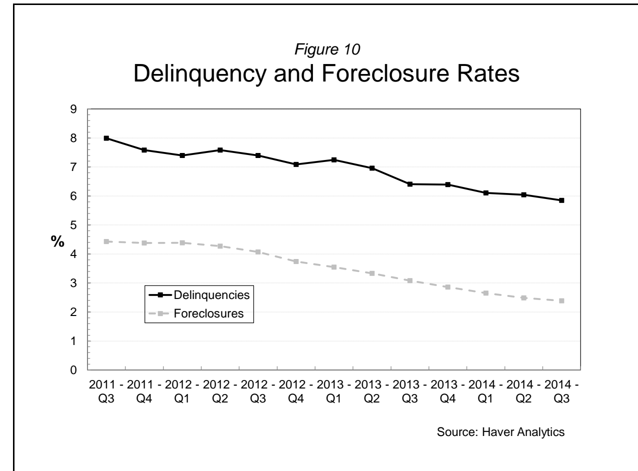
Residential Real Estate Lending[6]

Nationwide, RRE markets continued to recover at a sluggish rate, and local results were generally worse than other areas. The Federal Reserve Board's *Beige Book,* as of October 15, 2014, reported that sales of both new and existing homes increased strongly in some areas, weakly in other areas, and decreased slightly elsewhere.

Philadelphia and North Jersey reported slower growth than the rest of the nation.[7] One problem reported in the *Beige Book* for the Philadelphia area is that, although more sales contracts are being signed, fewer people can qualify for a mortgage, so the deals are falling through. This is a bit of an anomaly, as the Federal Reserve Board's *Senior Loan Officer Opinion Survey* reported that large banks had eased their mortgage standards and small and medium sized banks hadn't changed theirs. The *Beige Book* also reported only slight growth in residential construction in the region, though the rest of the country appears to be improving.



While sales of existing homes are down somewhat from last year, sales of new homes have been increasing since last March (Figure 9: Note the different scales on the left and right axes).[8] The percentage of both delinquent mortgages and mortgages in foreclosure has decreased steadily for several years (Figure 10).

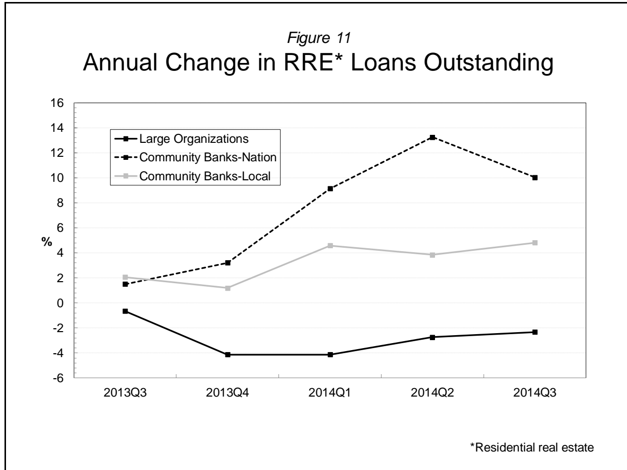


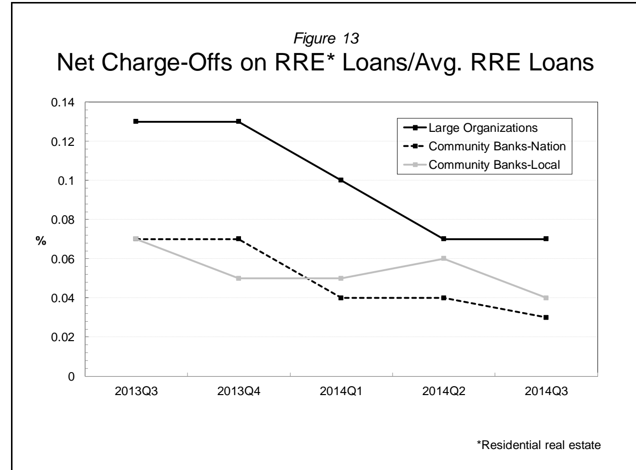
Total RRE loans outstanding decreased from last year as increases in lending at community banks were offset by larger decreases at the large organizations, but total RRE loans did increase from the second quarter to the third, and lending at community banks continued to strengthen (Figure 11). From the third quarter of 2013 to the third quarter of 2014, RRE loans outstanding grew at a rate of 12.0 percent at community banks nationally and 4.8 percent locally. Large organizations, by contrast, had a 2.3 percent drop in RRE loans. RRE lending has been decreasing at large organizations for some time now, and it had a quarterly drop as well. Most of the increase in lending at community banks both nationally and locally has been in mortgages secured by first liens, though home equity lines of credit (HELOCs) at those institutions continued to increase as well.

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

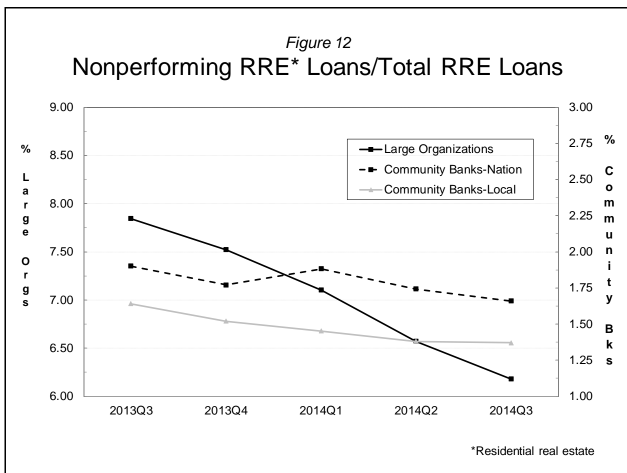
[7] For further information, see http://www.federalreserve.gov/monetarypolicy/beigebook/files/BeigeBook_20141015.pdf.

[8] Sales of existing homes dropped about 90,000 units from September 2013 to September 2014. For the entire third quarter, existing sales decreased by about 203,000 units. New home sales increased by about 68,000 units from September 2013 to September 2014. For the quarter, new home sales increased by about 64,000 units.

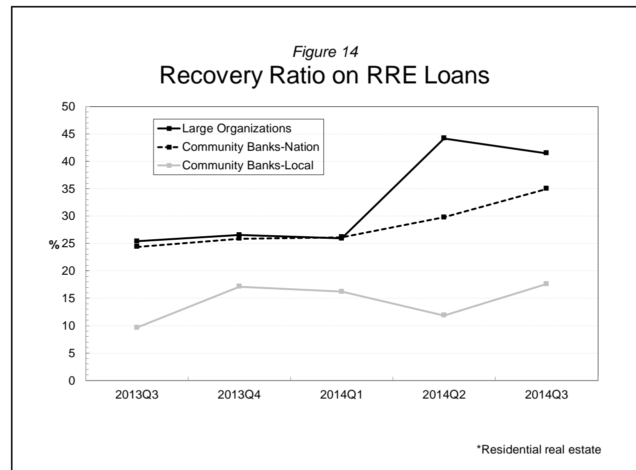




The quality of RRE loans continued to improve at all categories, but large organizations are still carrying a substantial portfolio of NPLs. The RRE NPL ratio at large banks fell more than 1.6 percentage points, to 6.18 percent, in the past year (Figure 12: Note the different scales for large organizations (left y-axis) and community banks (right y-axis)). Community banks have much better RRE loan quality, with NPL ratios of 1.66 percent nationally and 1.37 percent locally. These represent drops of 24 and 27 basis points, respectively, in the past year.



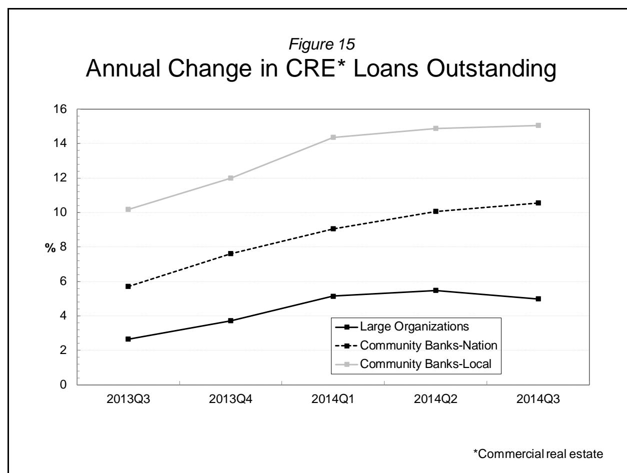
The improvement in loan quality is also reflected in the RRE NCO ratio. At large organizations, this ratio decreased 6 basis points in the past year, to 0.07 percent (Figure 13). At community banks, the RRE NCO ratio decreased 4 basis points nationally in the past year, to 0.03 percent, and it fell 3 points locally, to 0.04 percent. In the cases of community banks locally and large organizations, charge-offs decreased and recoveries increased. At community banks nationally, charge-offs decreased substantially and recoveries fell slightly. As a result, recovery ratios have increased at all categories of banks in the past year (Figure 14).



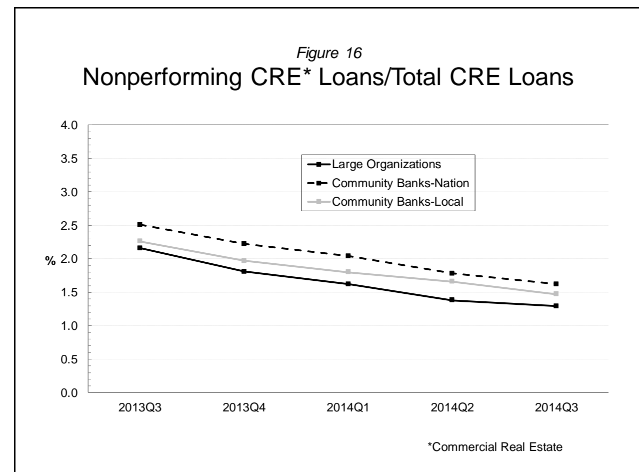
Commercial Real Estate Lending[9]

Commercial real estate (CRE) market conditions continued to strengthen both locally and nationally. Continuing the trend of the past several quarters, the *Beige Book* reported that in most of the CRE markets nationwide, construction activity has increased. Most of the increased activity was in multifamily properties. Construction of commercial buildings was steady in most areas. Demand for leased commercial space picked up in many areas. The Philadelphia district reported generally worse performance than the rest of the country, with construction activity virtually unchanged and only slight growth in leasing activity. Northern New Jersey, which has lagged Philadelphia, reported a slight pickup in both construction and leasing, but both remain at fairly low levels.

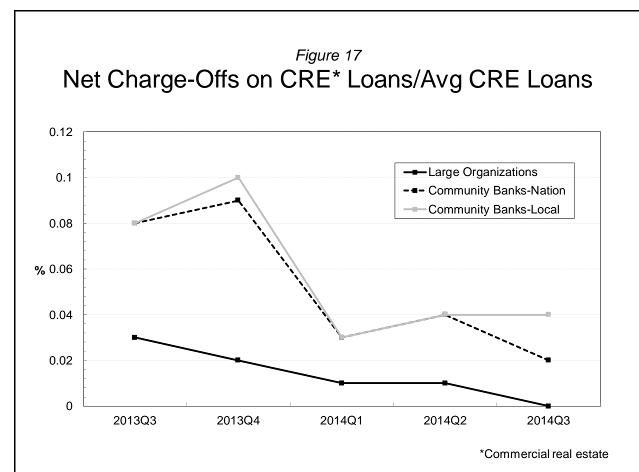
CRE lending results were fairly strong among all categories of banks, with both loan growth and quality improving. Loan growth was especially strong at local community banks. Year over year, CRE loans outstanding grew at a rate of 5.0 percent at large organizations, 10.6 percent at community banks nationally, and 15.1 percent at tri-state-area community banks (Figure 15). The strongest area of growth was in loans on multifamily properties, with construction lending increasing as well. The weakest growth was in commercial mortgages.



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 87 basis points from the third quarter of 2013, to 1.29 percent (Figure 16). The CRE NPL ratio decreased by 89 basis points at community banks nationally from last year to 1.62 percent, and it decreased 79 basis points at community banks locally to 1.47 percent.



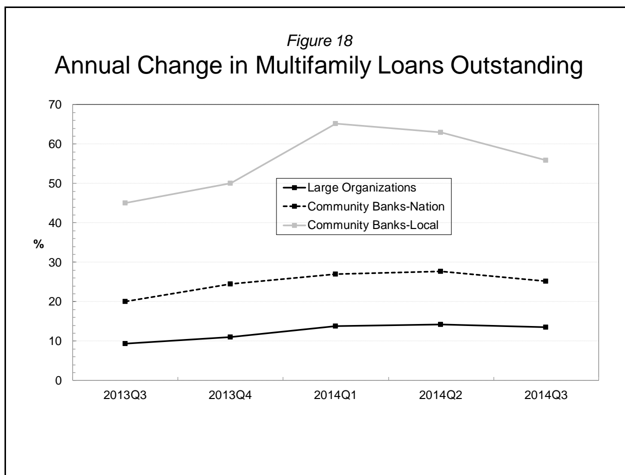
NCO ratios have decreased at all categories of banks as well. The NCO ratio on CRE loans at large organizations decreased 3 basis points to less than 0.1 percent (Figure 17). At community banks, there was a decrease of 6 basis points nationally, to 0.02 percent, and a



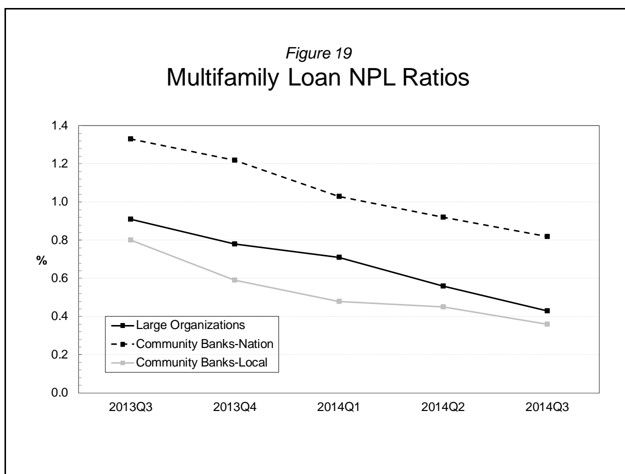
[9] See Table 2 in the Appendix for a full summary of the data used in this section.

decrease of 4 basis points locally, to 0.04 percent (Figure 17). NCOs did grow substantially at local community banks in the third quarter.

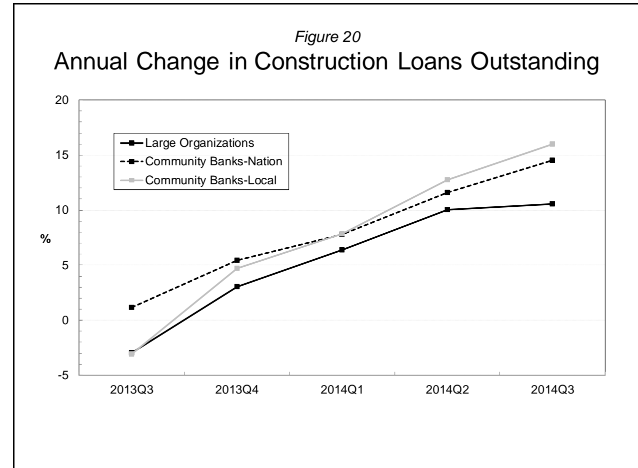
As noted previously, much of the growth in CRE lending can be attributed to growth in multifamily housing (Figure 18). All categories of banks saw double-digit growth in multifamily loans; this was especially true at local community banks. Multifamily loans grew 13.5 percent at large organizations, 25.1 percent at community banks nationally, and 55.9 percent at community banks locally.



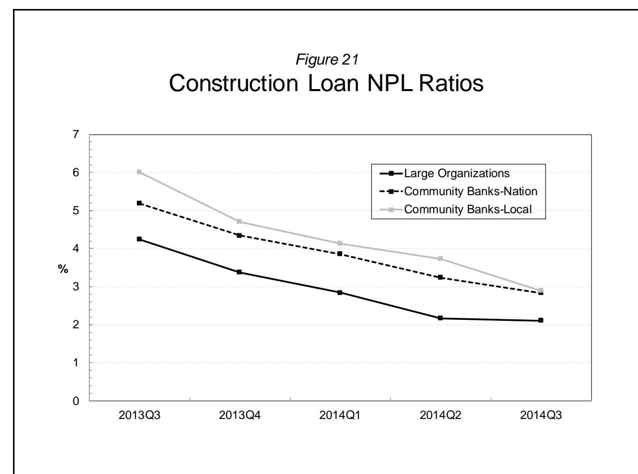
In spite of the high growth, loan quality has yet to be adversely affected, as NPL ratios at all categories are not only falling, but they are well below those for all CRE loans (Figure 19).



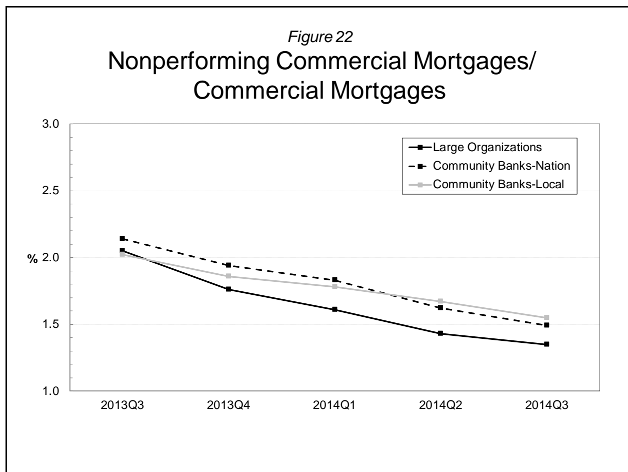
After shrinking for a long time, construction lending has made a comeback, and it has been growing at a substantial rate for the past three quarters (Figure 20).



The quality of construction loan portfolios has improved substantially as well, but it is still the weakest of the categories of CRE loans. The construction loan NPL ratio for large organizations has dropped 2.14 percentage points in the past year, to 2.10 percent (Figure 21). Community banks have experienced similar drops — more than 2.4 percentage points nationally, to 2.83 percent, and more than 3.1 percentage points locally, to 2.89 percent.



By far, the largest share of CRE lending is in commercial mortgages.[10] 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 improved significantly in the past year. At large organizations, the NPL has decreased 70 basis points, to 1.35 percent. At community banks nationally, the ratio has decreased 65 basis points, to 1.49 percent, and at community banks, locally, the ratio has decreased 47 basis points, to 1.55 percent (Figure 22). NCOs on these loans have also dropped substantially in the past year. However, this is also the weakest growing area, with growth of about 7.8 percent at community banks both locally and nationally and 1.9 percent at large organizations.

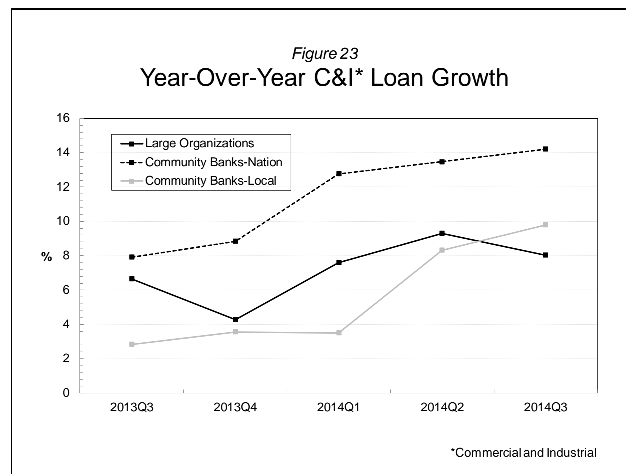


[10] At large organizations, 67.8 percent of CRE loans are commercial mortgages, 18.1 percent are multifamily loans, and 14.1 percent are construction loans. At community banks nationally, 73.7 percent of CRE loans are commercial mortgages, 11.4 percent are multifamily loans, and 15.3 percent are construction loans. At local community banks, 71.8 percent of CRE loans are commercial mortgages, 18.0 percent are multifamily loans, and 10.1 percent are construction loans.

Commercial & Industrial Lending[11]

C&I lending continued to grow at a good pace at all categories of banks, though growth slowed somewhat at large organizations. At large organizations, C&I loans grew 8.4 percent in the past year (Figure 23 and Table 3 in the Appendix). At community banks, C&I lending grew 14.2 percent nationally and 9.8 percent locally. The growth rate at community banks nationally has been increasing every quarter for the past year.

The Federal Reserve Board's *Senior Loan Officer Opinion Survey* for October 2014 reported that loan demand had for the most part increased somewhat, with a small fraction of respondents reporting a strong increase in demand.[12] The increase in demand was nearly all from medium- and large-sized firms, with demand from small firms unchanged. On the supply side, a modest percentage of responding firms reported that they had eased standards on C&I loans. The main terms eased were spreads, but some lenders expanded credit lines. The main reason cited for easing standards was increased competition from both banks and nonbank lenders. A smaller percentage of

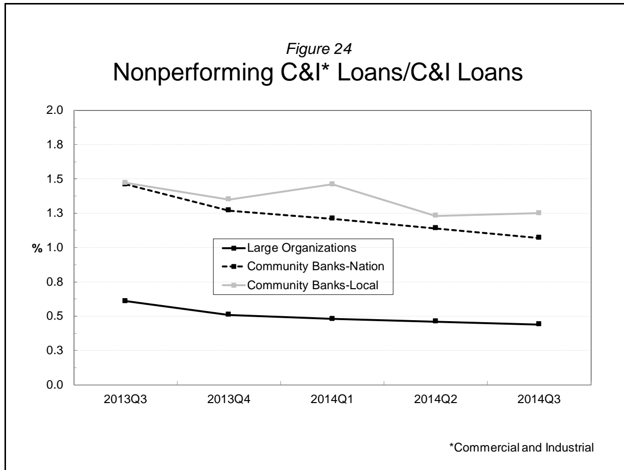


[11] See Table 3 in the Appendix for a full summary of the data used in this section.

[12] For further information, see http://www.federalreserve.gov/publications/default.htm.

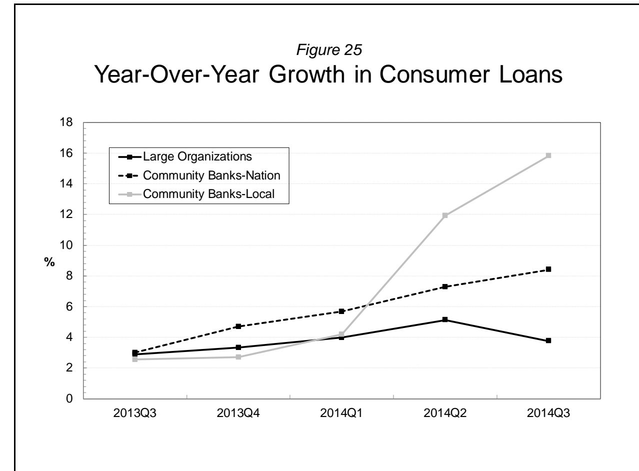
lenders reported easing standards due to a more favorable economic outlook.

Loan quality remained high at all categories of banks (Figure 24). At large organizations, the NPL ratio has fallen 17 basis points in the past year, to 0.44 percent. Quality is somewhat worse at community banks, with NPL ratios of 1.07 nationally and 1.25 locally. Both of these ratios fell substantially in the past year.



Consumer Lending[13]

Overall, consumer lending continued to strengthen in the third quarter, particularly at community banks, with strong growth and relatively few quality problems. Large organizations conduct the vast majority of consumer lending. Their consumer lending grew about 3.8 percent year over year (Figure 25). At community banks nationally, consumer lending grew 8.4 percent, while at community banks locally, consumer lending grew 15.8 percent. At large organizations, auto loans and installment loans grew substantially, while all revolving credit either shrank or was flat.[14] At community banks both locally and nationally, growth was in auto loans as well, with "other revolving credit" (i.e., revolving credit not associated with a credit card) growing also. Growth in installment loans slowed substantially.



NPL ratios on consumer loans have been low: 0.91 percent for large organizations, 0.79 percent for community banks nationally, and 0.44 percent for tri-state area community banks.

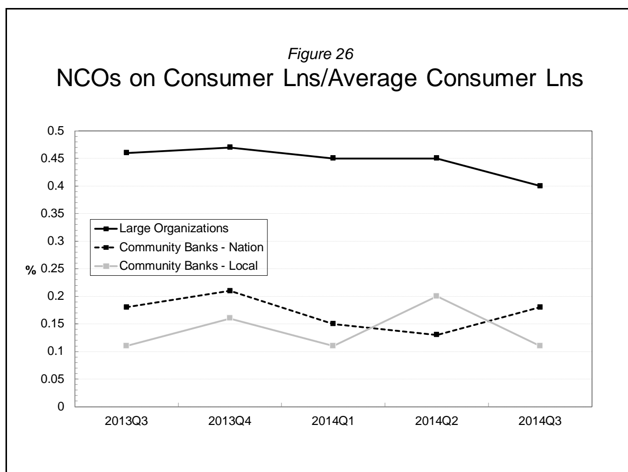
The most reliable measure of quality for consumer loans is NCOs. Many consumer loans — particularly at large organizations — are lines of credit with flexible repayment schedules, so NPLs are difficult to calculate. Also, except for automobiles, items purchased with consumer loans are difficult to repossess and resell, so when consumer loans go bad, they are often a total loss.[15] NCO ratios fell 6 basis

[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.

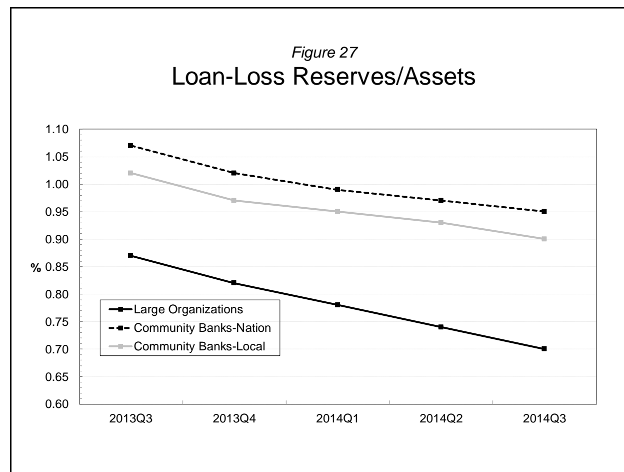
[15] The breakdown of consumer loans is as follows. Large organizations: credit cards, 31.7 percent; other revolving credit, 7.2 percent; auto loans, 37.8 percent; and other consumer loans, 23.2 percent. Community banks nationally: credit cards, 3.1 percent; other revolving credit, 5.3 percent; auto loans, 44.8 percent; and other consumer loans, 46.6 percent. Local community banks: credit cards, 1.8 percent; other revolving credit, 19.9 percent; auto loans, 35.0 percent; and other consumer loans, 43.2 percent. Figures may not equal 100 percent due to rounding.

points at large organizations, to 0.40 percent (Figure 26). At community banks both nationally and locally, the NCO was flat at 0.18 percent nationally and 0.11 percent locally. Nationally, this ratio rose 5 basis points during the quarter, but there is a lot of noise in this data as NCOs tend to have considerable variability.

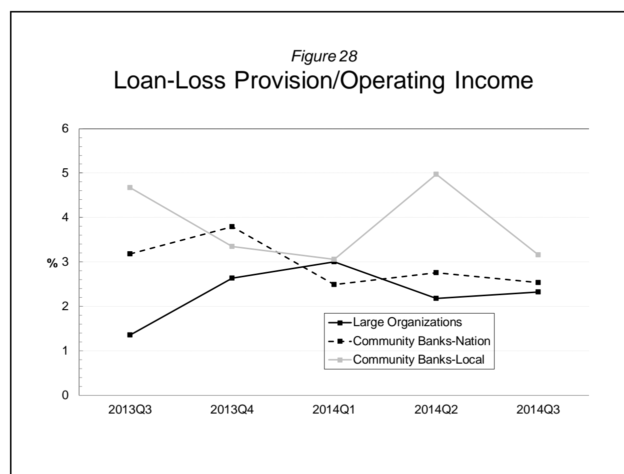


Provisioning and Reserves[16]

The large drops in both NPLs and NCOs have allowed banks to continue to reduce their loan-loss provisions and reserves. Loan-loss provisions continued to fall at all categories of banks, both overall and as a percent of assets.[17] As a percent of assets, loan-loss reserves fell 17 basis points at large organizations, to 0.70 percent, 12 points at community banks nationwide, to 0.95 percent, and 12 basis points at local community banks, to 0.90 percent (Figure 27).



Loan loss provisions as a percent of operating income continued to fall at community banks, but they have increased at large organizations.[18] The ratio of loan-loss provision to operating income increased 96 basis points, to 2.32 percent, at large organizations. At community banks nationally, the ratio has decreased 64 basis points, to 2.54 percent, and it fell 1.5 percentage points, to 3.16 percent, at local community banks (Figure 28).[19]



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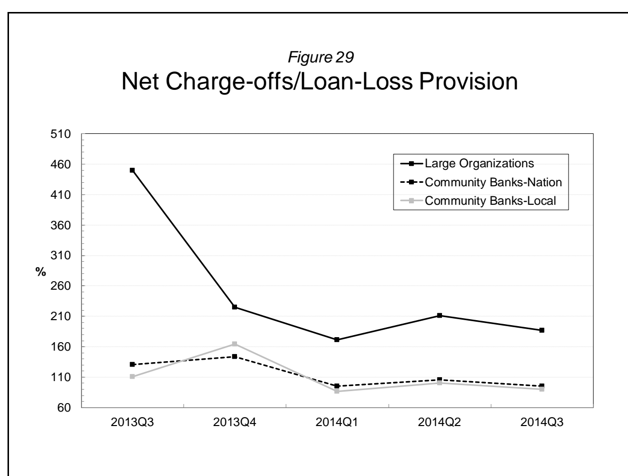
[16] See Table 5 in the Appendix for a full summary of the data used in this section.

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

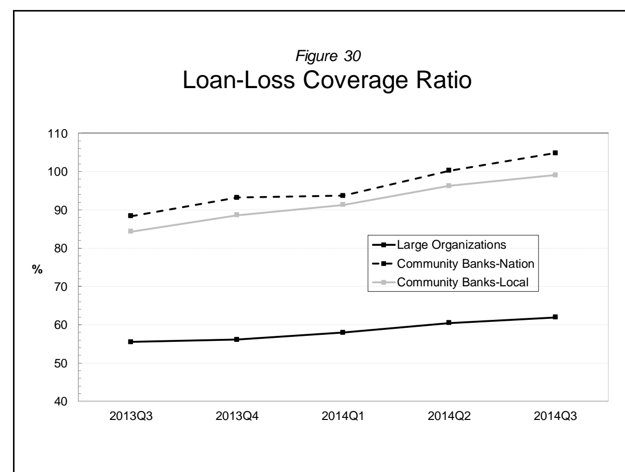
[18] Operating income is defined as the sum of net interest income and noninterest income.

[19] For historical perspective, the average ratio of loan-loss provision to operating income for all commercial banks between 2002 and 2012 was 14.57 percent. At the bottom of the last real estate cycle in 1991, this ratio was 18.9 percent. Source: FDIC Historical Statistics on Banking, https://www2.fdic.gov/hsob/index.asp

As noted previously, the falling loan-loss provisions and consequent decreases in reserves can be justified as a reaction to improving loan quality. This is demonstrated by the ratio of NCOs to loan-loss provision. At community banks, this ratio has now fallen below historical norms, to 95.2 percent nationally and 90.4 percent locally (Figure 29).[20] These also represent significant year-over-year drops. At large organizations, this ratio continued to be well over this norm, but it has fallen more than 260 percentage points in the past year.



Because NPLs have fallen so much, loan-loss coverage continued to improve at all categories of banks.[21] At community banks, it is now approaching the historical average, but at large organizations, it remains well outside of historical norms. At large organizations, loan-loss coverage increased about 6.5 percentage



points from last year, to 62.0 percent (Figure 30). It has been increasing for more than a year now. Community banks both locally and nationally also continued to improve their loan-loss coverage. The loan-loss coverage ratio at community banks nationally has increased more than 16 percentage points in the past year, to 104.8 percent. Locally, loan-loss coverage increased almost 15 percentage points, to 99.1 percent.

Securities[22]

Community banks nationally saw small year-over-year increases (2.0 percent) in the market value of their securities portfolios. Locally, securities portfolios decreased by about 2 percent. Community banks both locally and nationally had small quarterly decreases in their securities portfolios. As noted previously, much

[20] For historical perspective, the average ratio of NCOs to loan-loss provision for all commercial banks between 2002 and 2012 was 102.50 percent. At the bottom of the last real estate cycle in 1991, this ratio was 95.8 percent. Source: FDIC Historical Statistics on Banking, https://www2.fdic.gov/hsob/index.asp

[21] The loan-loss coverage ratio is defined as the ratio of loan-loss reserves to NPLs. For historical perspective, the average loan-loss coverage ratio for all commercial banks between 2002 and 2012 was 108.03 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, https://www2.fdic.gov/hsob/index.asp

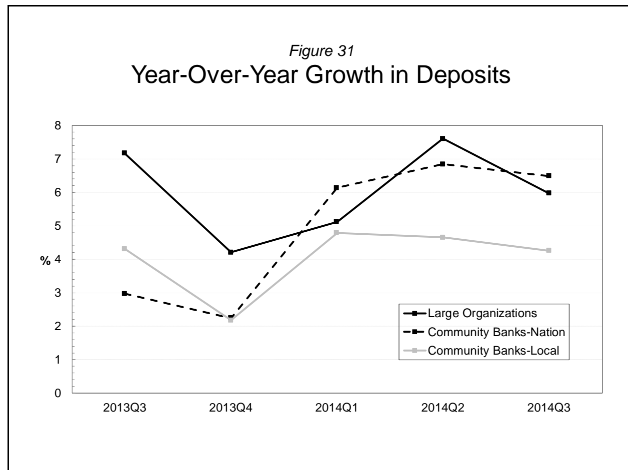
[22] See Table 6 in the Appendix for a full summary of the data used in this section. The figure for percent of assets uses the value of securities as reported on the banks' balance sheet. Securities there are reported at book value if they are held to maturity, and at market value if they are available for sale.

of the asset growth at large organizations was in securities, which gained 9.1 percent in value.[23]

All categories of banks saw quarterly decreases in realized gains on securities, but year-over-year realized gains increased.[24] Large organizations posted gains of approximately $558.5 million. Community banks nationally reported a realized gain of $92.2 million in the quarter. Local community banks reported a realized gain of about $8.7 million.

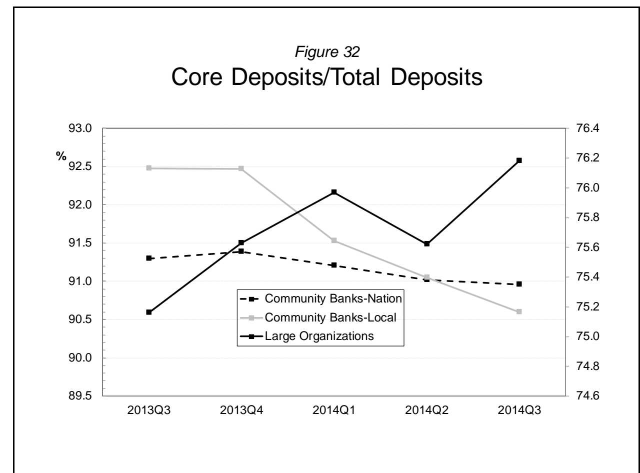
Funding Sources[25]

Year-over-year deposit growth was relatively strong across all categories of banks (Figure 31), but deposit growth at community banks is not keeping pace with loan growth. Deposit growth was fairly consistent across banks and account types, with all categories of banks seeing transaction and savings accounts rise, and time deposits fall.



Reliance on brokered deposits continued to increase at all categories of banks. At large organizations, brokered deposits as a percent of total deposits have increased 17 basis points from last year. At community banks nationally, this ratio has increased 44 basis points in the past year. At local community banks, brokered deposits as a percent of total deposits are up nearly 2 percentage points in the past year.

Core deposits grew faster than total deposits at large organizations and nearly as fast as total deposits at community banks nationally, but at local banks, core deposit growth remained slow.[26] Core deposits as a percent of total deposits has decreased at community banks in the past year, but increased at large organizations (Figure 32: Note the different scales for community banks and large organizations). Local community banks have a much lower ratio than those nationally.



The slower growth in deposits in general and core funding in particular has forced banks, especially community banks, to seek more expensive types of funding in the form of nondeposit debt. Nondeposit debt funding has

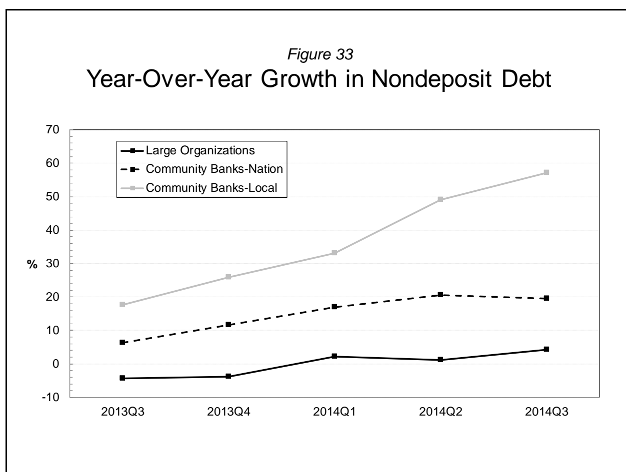
[23] Changes in market value can be indicative of either increases in the value of securities that were already owned or increases due to purchases or sales of securities.

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

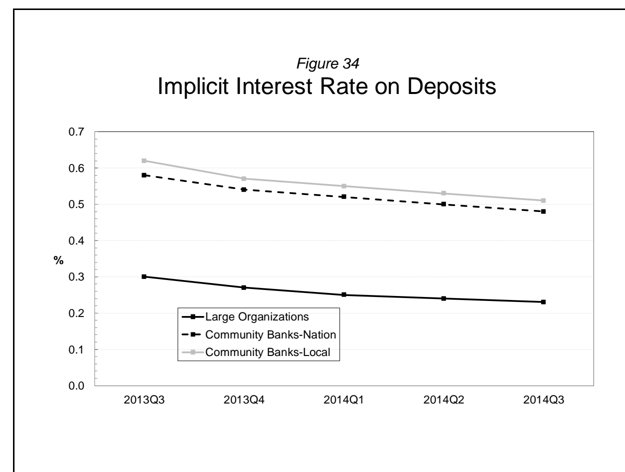
[25] See Table 7 in the Appendix for a full summary of the data used in this section.

[26] Core deposits are defined as the sum of transaction accounts, money market accounts, other savings deposits, and time deposits of less than $250,000, less all brokered deposits. This is a change from the definition used in previous editions of this publication, which did not include time deposits between $100,000 and $250,000 as core deposits.

been increasing substantially for the past several quarters at community banks both nationally and locally (Figure 33).[27] Nondeposit debt funding increased 19.5 percent at community banks nationally and 57.1 percent locally. Quarterly growth did slow somewhat. Large organizations saw much more modest increases in nondeposit debt funding. For large organizations, nondeposit debt grew 4.2 percent from the third quarter of 2013, and growth in the quarter was flat. Nondeposit debt still represents a larger share of large organizations' assets than that of community banks, about 8.8 percent for the large organizations compared with 5.5 percent for community banks nationally and 7.9 percent locally. The combination of lower core deposits and more debt is a major factor in explaining why community banks nationally have a higher net interest margin than local banks and large organizations have a lower net margin than community banks.



Large organizations continue to have a substantial funding price 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 34).[28] This holds true for nondeposit funding as well.



Regulatory Capital[29]

Large organizations saw quarterly decreases in all of their capital ratios. Due to the new capital standards intended to implement the Basel III accords that were implemented for certain large banks in the first quarter of this year, annual changes in tier 1 leverage and risk-based capital are not directly comparable.[30] The

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

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

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

[30] The banking organizations currently affected are JPMorgan Chase & Co., Bank of America Corp., Citigroup, Wells Fargo & Co., Goldman Sachs Group, Morgan Stanley, Bank of New York Mellon Corp., U.S. Bancorp, PNC Financial Services Group, Capital One Financial Corp., HSBC North America Holdings, State Street Corp., TD Bank US Holding Company, Union BanCal Corp., and Northern Trust Corp. These institutions are known as "core" banking organizations because they have either $250 billion or more in assets or at least $10 billion in on-balance-sheet foreign exposures. All other banks will be subject to the new regulations beginning January 1, 2015. See the first quarter 2014 *Banking Brief* for a summary of the new regulation.

one ratio whose definition did not change, the equity-to-assets ratio, was relatively stable year over year, increasing 6 basis points to 10.93 percent. This represents a quarterly drop of 10 basis points (Figure 35: Note the different scales on the left and right axes). The tier 1 leverage and risk-based capital ratios have both fallen slightly since the beginning of the year, and both had small quarterly drops as well. The tier 1 leverage ratio fell 5 basis points from the first quarter and 8 points from the second quarter, to 9.00 percent, and the risk-based capital ratio fell 6 points from the first quarter and 2 points from the second quarter, to 13.81 percent.

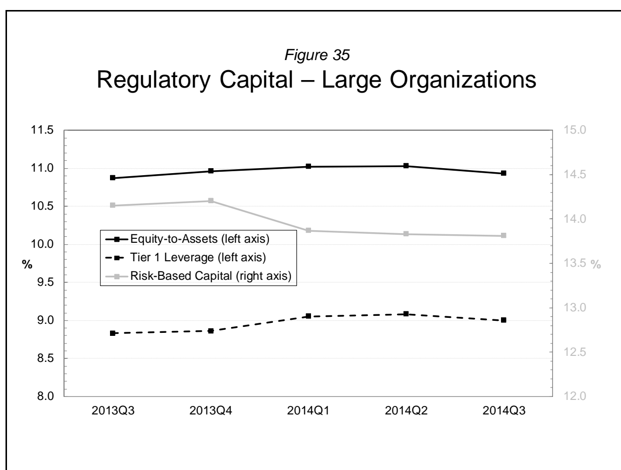


Figure 35
Regulatory Capital – Large Organizations

At community banks nationally, equity-to-assets and tier 1 leverage ratios increased slightly both year over year and in the quarter, while the risk-based capital ratio decreased in both periods. Since last year, the equity-to-assets ratio at community banks nationally increased 30 basis points, to 11.02 percent; the tier 1 leverage ratio increased 3 basis points, to 10.30 percent, and the risk-based capital ratio decreased 31 basis points, to 15.66 percent (Figure 36: Note the different scales on the left and right axes).

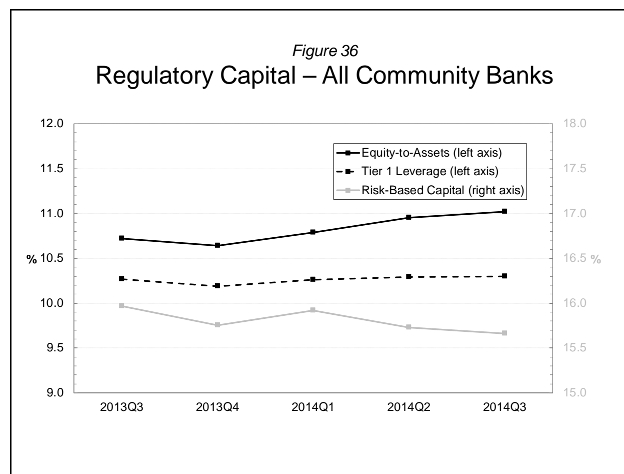


Figure 36
Regulatory Capital – All Community Banks

At local community banks year over year, the equity-to-assets ratio has risen 20 basis points, to 10.18 percent; the tier 1 leverage ratio decreased 12 basis points, to 9.52 percent; and the risk-based capital ratio decreased 24 basis points, to 14.22 percent (Figure 37: Note the different scales on the left and right axes). The tier 1 and risk-based ratios had substantial quarterly drops as well.

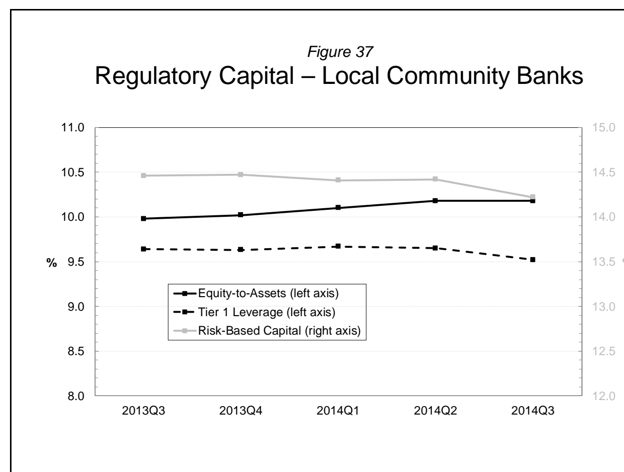


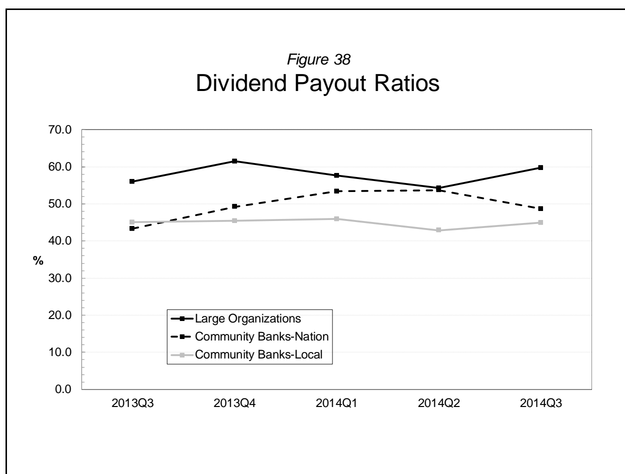
Figure 37
Regulatory Capital – Local Community Banks

Large organizations and community banks nationally had large unrealized gains on securities, while local community banks continued to have unrealized losses.

Large organizations saw increases in common stock, preferred stock, surplus, and retained earnings. Community banks nationally had decreases in both common and preferred stock, and these were offset by increases in

surplus, retained earnings, and accumulated other income. Local community banks had increases in common stock, preferred stock, surplus, and retained earnings.

The percentage of community banks and large organizations paying dividends on their stock has increased in the past year. Dividend payout ratios rose year over year at large organizations and community banks nationally and fell at local community banks (Figure 38).[31]



[31] 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	-2.3%	4.8%	12.0%
RRE NPLs	-23.0%	-12.8%	-2.0%
RRE NCOs	-45.8%	-43.5%	-43.5%
2. Shares			
RRE Loans/Total Loans	30.0%	28.5%	25.3%
RRE NPLs/Total NPLs	79.4%	30.0%	30.1%
RRE NCOs/Total NCOs	23.8%	22.8%	21.0%
3. Performance Ratios			
RRE NPLs/Total RRE Loans	6.18%	1.37%	1.66%
RRE NCOs/Avg. RRE Loans	0.07%	0.04%	0.03%
4. Outstandings ($ millions)			
Total RRE Loans	1,664,238.8	22,433.0	333,335.8
RRE NPLs	102,795.5	306.3	5,541.9
RRE NCOs	1,195.6	7.8	110.0

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	5.0%	15.1%	10.6%
CRE NPLs	-37.2%	-25.1%	-28.6%
CRE NCOs	-85.5%	-49.8%	-67.6%
2. Shares			
CRE Loans/Total Loans	15.9%	47.9%	43.1%
CRE NPLs/Total NPLs	8.8%	54.1%	50.0%
CRE NCOs/Total NCOs	0.8%	37.2%	23.5%
3. Performance Ratios			
CRE NPLs/Total CRE Loans	1.29%	1.47%	1.62%
CRE NCOs/Avg. CRE Loans	<0.01%	0.04%	0.02%
4. Outstandings ($ millions)			
Total CRE Loans	884,820.1	37,660.0	567,586.7
CRE NPLs	11,415.1	553.5	9,184.8
CRE NCOs	40.4	12.8	122.9

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	8.0%	9.8%	14.2%
C&I NPLs	-21.0%	-6.6%	-16.4%
C&I NCOs	-22.6%	-38.0%	-2.4%
2. Shares			
C&I Loans/Total Loans	23.7%	13.3%	16.4%
C&I NPLs/Total NPLs	4.5%	12.8%	12.6%
C&I NCOs/Total NCOs	10.6%	36.0%	46.5%
3. Performance Ratios			
C&I NPLs/Total C&I Loans	0.44%	1.25%	1.07%
C&I NCOs/Avg. C&I Loans	0.04%	0.12%	0.12%
4. Outstandings ($ millions)			
Total C&I Loans	1,315,849.3	10,442.9	216,232.7
C&I NPLs	5,826.5	130.4	2,311.3
C&I NCOs	534.0	12.4	243.4

Table 4 – Summary of Consumer Lending

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
1. Year-Over-Year Growth			
Total Consumer Loans	3.8%	15.8%	8.4%
Consumer NPLs	-10.9%	3.6%	13.8%
Consumer NCOs	-8.2%	8.6%	8.2%
2. Shares			
Consumer Loans/Total Loans	13.6%	3.8%	4.2%
Consumer NPLs/Total NPLs	5.3%	1.3%	2.4%
Consumer NCOs/Total NCOs	59.4%	8.5%	8.2%
3. Performance Ratios			
Cons NPLs/Total Cons Loans	0.91%	0.44%	0.79%
Cons NCOs/Avg. Cons Loans	0.40%	0.11%	0.18%
4. Outstandings ($ millions)			
Total Consumer Loans	753,904.1	3,007.1	55,510.6
Consumer NPLs	6,858.1	13.3	437.6
Consumer NCOs	2,984.0	2.9	96.3

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

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Loan-Loss Reserve ($ millions)	80,232.3	1,013.5	19,270.4
Change from Last Quarter	-13.5%	-7.7%	-1.9%
Change from Last Year	-15.0%	-5.2%	-4.1%
Net Charge-Offs/LL Provision	187.0%	90.4%	95.2%
LL Provision/Operating Inc.	2.32%	3.16%	2.54%
Loan-Loss Coverage Ratio	62.0%	99.1%	104.8%

Table 6 – Summary of Securities Portfolios

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Securities/Assets	20.7%	19.8%	22.3%
Market Value ($ millions)	2,360,509.0	22,395.1	452,879.6
Change from Last Quarter	10.0%	-0.5%	-0.5%
Change from Last Year	9.1%	-2.0%	2.0%
Realized Gain/Loss	558.5	8.7	94.2
Pct. of Average Securities	0.02%	0.04%	0.02%
Market Value/Book Value	100.8%	100.4%	100.5%

Table 7 – Structure of Liabilities

	Large Organizations	Community Banks	
	Nation	Tri-State Area	Nation
Deposits ($ millions)	8,594,310.6	91,565.8	1,675,146.5
Pct. of Assets	75.3%	80.9%	82.7%
Change from Last Quarter	5.0%	6.9%	5.3%
Change from Last Year	6.0%	4.3%	6.5%
Core Deposits/Deposits*	76.2%	90.6%	91.0%
Implicit Rate on Deposits	0.23%	0.51%	0.48%
Nondeposit Debt ($ millions)	999,337.9	8,962.3	110,876.1
Pct. of Assets	8.8%	7.9%	5.5%
Change from Last Quarter	0.7%	23.8%	10.6%
Change from Last Year	4.2%	57.1%	19.5%
Implicit Rate on Debt	1.23%	1.45%	1.54%

Table 8 – Capitalization Measures

	Large Organizations	Community Banks	
Ratios	Nation	Tri-State Area	Nation
Total Equity/Total Assets	10.93%	10.18%	11.02%
Change from Last Qtr. (basis pts.)	-10	0	7
Change from Last Yr. (basis pts.)	6	20	30
Tier 1 Leverage Ratio	9.00%*	9.52%	10.30%
Change from Last Qtr. (basis pts.)	-8	-7	1
Change from Last Yr. (basis pts.)	17	-12	3
Risk-Based Capital Ratio	13.81%*	14.22%	15.66%
Change from Last Qtr. (basis pts.)	-2	-20	-7
Change from Last Yr. (basis pts.)	-34	-24	-31

* The definition of these items was changed in the first quarter of 2014 for several of the largest organizations, and the new numbers are *not* directly comparable with the same ratio in previous quarters. See "Regulatory Capital" on page 15.