

The condition of Pennsylvania community banking at mid-year 2011

The state of the banking industry, specifically community banking, in Pennsylvania at mid-year 2011 clearly reflects many of the regional and national conditions impacting banking.

Like banks everywhere, during the first half of 2011 Pennsylvania's community banks continued to struggle with the after effects of the financial crisis, a deep and prolonged recession and an anemic economic recovery that is now almost two years old. These effects include businesses still struggling to achieve profitability, low consumer and business confidence, reduced business borrowing due to low demand for products and services, high levels of unemployment and underemployment, new legislation that will impact future bank profitability and a more challenging bank regulatory environment.

However, there are some elements of the current environment that make banking in Pennsylvania, and specifically the north central region, markedly stronger than the rest of the banking industry. This strength in Pennsylvania banks is nowhere more starkly illustrated than in a recent ranking by US Banker magazine of the Top 200 Community Banks in America.

In that annual ranking, based on three-year average return on shareholder equity, Pennsylvania had more top performing banks than any other state in the nation. In the 2011 ranking, 44 of the Top 200 Community Banks in the country were located in Pennsylvania. That is a sharp increase from 31 in 2010, when Pennsylvania also ranked first. Even as some of the key performance ratios for Pennsylvania banks have declined, their relative performance compared to the rest of the community banks in the country has continued to separate Pennsylvania's banks from the pack.

Pennsylvania's community banks have weathered the current economic challenges better than the industry for several reasons. Community banks in Pennsylvania were simply more conservatively managed. They entered this difficult period with stronger and more diversified balance sheets, higher earnings and stronger capital ratios. Pennsylvania banks did not have the significant credit concentrations in real estate development that marked community banks in other parts of the country.

Pennsylvania did not experience a "go go" period for its economy and real estate markets, and therefore did not suffer the sharp declines experienced elsewhere. For



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Guest Commentary

instance, since the onset of the recession, there have been 65 bank failures in Georgia due in many cases to real estate development exposure. This compares to just three failures of very small banks in Pennsylvania, two in the Philadelphia area and one in Pittsburgh. Although Pennsylvania has witnessed some notable mergers in that time period, even that measure compares favorably with other regions of the country.

The good news for Pennsylvanians is that community banking in Pennsylvania remains strong, diversified, profitable and well-capitalized. Most importantly, with bank capital at its highest levels in history, banks are aggressively looking for opportunities to make loans. Interest rates remain near historic lows so it is an attractive environment for businesses and consumers to borrow.

Against this backdrop there are an increasing number of emerging economic

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opportunities. The most significant for this region, of course, is the natural gas exploration

and drilling boom that, even in its earliest stages, has already provided for significant wealth creation and employment growth. Most importantly, the development of this natural resource represents an unprecedented engine for future growth and employment. Pennsylvania banks are well positioned to participate in and fund this unfolding new chapter in Pennsylvania's economic history.

As we look out at the balance of 2011 and into 2012, there is no doubt that many challenges continue to face banking in this difficult environment. But if we step back from this dark period from which we are hopefully now emerging, there is little question that Pennsylvania's banks, and the communities they serve, will benefit from the health of the industry and the strong base for future expansion that only a strong, competitive banking system can support.

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