Condition of the Texas State Banking System

A Report to the Finance Commission of Texas

March 31, 2008

Prepared by:

Texas Department of Banking

Texas Department of Savings and Mortgage Lending

Financial Data as of December 31, 2007

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Key for Symbols Used Throughout this Report:	**Abbreviations Used Throughout this Report**:
⇧ Improving or strong conditions ⇩ Deteriorating or weak conditions ⇳ Mixed conditions ❖ Interest item	FDIC - Federal Deposit Insurance Corporation OCC - Office of the Comptroller of the Currency FRB - Federal Reserve Board OTS - Office of Thrift Supervision

For more information about this publication you may contact:
Wendy Buitron, Director of Strategic Support,
Texas Department of Banking, 2601 North Lamar Blvd., Austin, Texas 78705
(512) 475-1320 or wendy.buitron@banking.state.tx.us

This publication is also located on the website of the Texas Department of Banking: www.banking.state.tx.us

ECONOMIC REVIEW AND OUTLOOK
STATE BANKING SYSTEM OF TEXAS

BANKING SYSTEM OVERVIEW

The Texas banking industry's performance in 2007 was generally favorable and the overall condition remains sound in spite of a weakening national economy. Operating results for 2007 reflect a profitable year overall for Texas commercial banks and savings institutions, with steady loan and deposit growth during the year despite increased competition and national concerns of the fallout from the subprime mortgage crisis.

A summary of important performance ratios shows mixed results for the state's banking system. The percentage of unprofitable banks, both state-chartered and federally-chartered, increased to 8.50% in 2007, up significantly from 5.76% in 2006. For thrifts the change was more significant as 25.53% are now unprofitable, compared to 4.76% in 2006. Net interest margins (NIM) for banks and thrifts remained acceptable despite an increase in cost of funds for the year. Banks reported a NIM of 4.13%, down slightly from 4.20% in 2006. Thrifts' NIM was 2.79% in 2007, up from 2.65% in 2006. The return on assets for banks dropped only slightly during 2007, from 1.28% to 1.25%, while the return on assets for thrifts dropped more significantly from 1.03% in 2006 to 0.63% in 2007. Nonperforming assets plus other real estate owned showed some deterioration during 2007 primarily for thrift institutions. The ratio of equity capital to total assets remained relatively unchanged from 2006 to 2007 and was higher than the national average for banks, but lower than the national average for savings institutions.

The combined assets of state and federally chartered banks and savings institutions operating in Texas totaled $601.2 billion as of year-end 2007, up 26% or $124.8 billion from 2006. Texas state-chartered banks and savings institutions accounted for $164.3 billion of the total assets in 2007, or 27%. This is a significant increase over 2006, with total assets up $71 billion. Year-end totals for the number of Texas state-chartered banks and thrifts reflect an increase from 2006 of 12 institutions. De novo charter and conversion activity has been steadily increasing throughout 2007, surpassing merger activity. The conversion of Comerica Bank into a Texas state-chartered bank in the fourth quarter of 2007 has had a significant impact on the size and complexity of Texas state-chartered banks.

TEXAS ECONOMIC PROFILE

The Texas economy expanded moderately in 2007 despite the national concerns of a recession. While the growth was slower than in 2006, Texas added more jobs than any other state in the nation. Preliminary data indicates that over 200,000 new jobs were added in 2007 compared to 2006, representing a 2.1% increase. The oil and natural gas industry ranked first among Texas industries in job creation followed by the professional and business services industry. The state's unemployment rate dropped below the national average and was down from 2006. An underlying strength in the Texas economy comes from the oil and gas industry. As energy prices have risen, so has the activity in the oil and gas industry, benefiting our economy with additional job creation.

Costs continued to rise in 2007 for most industries, particularly for metals, shipping, and energy. Industries where diesel and gasoline are a large component of production costs, like farming, petrochemical, transportation and tourism industries, will continue to be stressed by elevated fuel costs. Merchants and manufacturers have passed some of the added product delivery costs to consumers. Strong demand and rising production costs for agricultural commodities and food products continue to push up prices.

The manufacturing industry continued to soften in 2007 as demand for materials to supply residential construction weakened. Retail and automobiles sales also softened in 2007. Companies with national stores in Texas, however, reported that sales were stronger in Texas than the rest of the country. Automobile sales were weaker in 2007, though demand was stronger for parts and service. The decline in the housing market was modest, and much lower than the national average. Texas appears to be less vulnerable to the declining real estate prices than the rest of the nation, however, new home starts are down and the single family housing sector is weak. With much tighter credit standards currently in place, fewer people are able to qualify for mortgage loans. Many of these would-be home buyers are looking to the apartment market to meet their needs. With the increased demand for apartments, multi-family construction is growing steadily and is expected to continue in 2008. The demand for consumer loans declined in 2007 as credit standards tightened and energy prices continued to rise. The financial services sector faces 2008 with a bit more caution, given the recent reductions in the federal funds rate and the disruptions to the credit markets. However, the outlook for Texas remains positive in 2008. Although it is expected to grow at a slower pace than 2007, the Texas economy is still expected to be stronger than the national economy.

SUPERVISORY CONCERNS

Weaknesses in the economy, stresses in a particular industry, or movements in interest rates can place pressure on the state's banking system. Deterioration in bank performance typically lags behind unfavorable conditions as the effects of economic pressures on bank borrowers can be concealed for months. Consequently, bank and thrift supervisors must continue to look ahead for potentially damaging factors that may weaken borrowers' repayment ability and subsequently erode the asset quality of financial institutions. Financial institutions that recognize these factors early and are quick to respond can dramatically improve their chances to minimize the loss exposure. However, if problem loans are not identified in a timely manner, or interest rate risk is not properly managed, then failure could result if these conditions go unchecked. Currently, no clear economic stresses have been identified and no systemic decline in loan quality or poor management of interest rate risk has been detected.

The financial industry's management of interest rate risk has been satisfactory, although net interest margins are narrowing as asset yields decline more than funding costs. The low rate environment limits short and intermediate term investment opportunities. Institutions holding large volumes of longer term, lower yielding assets during an increasing rate environment are particularly vulnerable. Investment managers must balance their asset maturities and not commit significantly to longer terms while rates are generally low. A continued environment of low rates may tempt institutions to waiver from established plans and raise the risk profile of their institution. If interest rates increase, the credit quality of adjustable-rate products could deteriorate leading to an increase in noncurrent loans and loss provisions. Financial institutions must be prepared for additional movements in interest rates.

During a strong economic climate, the availability of liquidity sources is abundant. During periods of economic downturn, liquidity can become more critical to the solvency of a distressed financial institution. If a financial institution maintains strong asset quality, earnings, and capital but is unable to satisfy its liquidity needs, it runs the risk of failure. Liquidity management in banks and thrifts varies based on the size and sophistication of the institution and the nature and complexity of its activities and must be continually monitored, not just during times of stress. Good management information systems, strong analysis of funding requirements under alternative scenarios, diversification of funding sources, and contingency planning are crucial elements of strong liquidity management. Given the natural disasters that have impacted the nation over the past few years, such as hurricanes, tornadoes and flooding, and the attention towards pandemic preparedness, it is considered prudent for bankers to review operational and contingent funding plans, particularly those who rely substantially on wholesale funds. Supervisors will remain alert to emerging trends.

Though increased fuel costs will encourage further oil and gas exploration in Texas, it also places additional stress on industries where fuel is a large component of production, for example Texas farmers. Restaurants and hotels that are dependent upon tourism may also see a drop in business if higher fuel prices cause consumers to scale back or eliminate travel plans because they have less disposable income. In addition, merchants are expected to pass along the added product delivery costs to consumers, which in turn may lead to higher levels of inflation.

In recent years, the Texas economy has benefited from a vibrant housing market and healthy consumer spending. Recent trends indicate that the housing market is cooling off, although at a much slower pace in Texas than in other parts of the nation. There are signs that consumer spending is slowing down as well, caused in part by higher fuel costs and the uncertainty about the economy. Consumers continue to carry high debt loads while personal savings rates suffer. A weakening economy will cause some borrowers to experience difficulties in their ability to repay debt, resulting in higher past due and default rates.

Competition in the marketplace among banks, thrifts and credit unions continues to be strong. There is considerable pressure on banks to build more branches, offer new and innovative products, and generally be more aggressive in seeking additional lending opportunities - consumer, commercial and real estate based. Banks that have expanded their operations by adding new branches are committed to maintain that additional overhead and attract new business. As a result, the competition for new customers, low-cost deposit accounts and quality loans is intense. Financial institutions are offering additional incentives to lure new customers, while at the same time maintaining or increasing fees associated with those deposit accounts. Financial institutions also need seasoned lending, customer contact and operations personnel to operate these new branches, which results in a higher level of competition and wage pressures for experienced and educated bankers. Taken all together, this increased level of competition requires Texas bankers to exercise higher levels of diligence in all banking activities to ensure prudent decisions are made and sound practices followed.

Other issues that remain a supervisory concern include: corporate governance; bank holding company strength; Bank Secrecy Act and USA Patriot Act compliance; identity theft; fraud; and home equity lending. Supervisors will remain alert to recognize significant changes in the areas described above and initiate prompt corrective action for those institutions that are unable to monitor and manage these threatening circumstances.

SUPERVISORY MEASURES BEING TAKEN BY THE DEPARTMENT OF BANKING

New state banks opening in the last six months were Access 1st Capital Bank, Denton; Lone Star Bank of West Texas, Lubbock; and Allegiance Bank Texas, Houston. In addition, The Trust Company, San Antonio, previously a trust-only state bank, obtained deposit insurance and opened as a full-service bank in September. On October 31, Comerica Bank, Detroit, Michigan, completed its move to Dallas, Texas. The impact of the addition of this $60 billion bank to the state banking rolls was primarily responsible for the increase in supervised assets from $86.7 billion on June 30, 2007, to a year-end amount of $154.3 billion.

In the new year, Memorial City Bank, Houston, and Collin Bank, Frisco, opened. Based on applications currently in process, we expect four new banks to open before or shortly after mid-year; three in the Dallas area, and one in Austin. One conversion application is in-process, but will not materially affect supervised assets. Finally, Texas State Bank, McAllen, previously our second largest bank with assets of $8.5 billion, completed its merger into Compass Bank, Birmingham, Alabama, in March.

Currently, no systemic factors are present that cause supervisory concern. The number of problem institutions is considered manageable, and the level is well below that of previous periods of concern. Although the majority of institutions are meeting the current economic challenges, the number of problem financial institutions will increase if the economy should stall and consumer spending drop.

The Department's objective is to be responsive to economic conditions and the news about the mortgage crisis and fraud issues. The supervisory practices of the agency are designed to identify trends in the industry as a whole, and practices of individual banks that could threaten the safety and soundness of an institution or the industry. Changes in the real estate markets, natural disasters, economic conditions, interest rates fluctuations, weaknesses in key industries, and fraud all influence the Department's actions. Problem status can sometimes be prevented, or a quick turnaround implemented, by timely regulatory identification and positive management response. Enhanced staff training is also important along with continued diligence in off-site monitoring the asset quality of our institutions.

The Department continues to closely monitor and identify concerns surrounding subprime mortgage lending. The Department will be sensitive to identifying individual banks that demonstrate difficulty in this area. Also, to the extent that banks are reliant upon mortgage originations or refinancings, examiners will gauge the impact of decreased activity on our supervised institutions. Examiners will review institutional exposure to this activity and take action to limit risk, when necessary.

The Department's staff is performing the following:

- Frequent conference calls with other state and federal regulators;
- Monthly calls to state banks to obtain industry input on prevailing economic conditions;
- On-site bank visitations by Regional Directors to discuss industry related issues in a non-examination environment;
- Revised bank examination review procedures with a greater focus on risk assessment;
- Monitoring and evaluating asset concentrations, liquidity, and funding sources;
- Increased scrutiny of bank contingency plans that may be implemented during a catastrophic event;
- Internal monitoring of state, national, and world political and economic events;
- Increased review of compliance with Bank Secrecy Act and USA Patriot Act provisions;
- Enhanced assessment of information technology security risks; and
- Increased internal communication for examiner awareness of issues.

SUPERVISORY MEASURES BEING TAKEN BY THE DEPARTMENT OF SAVINGS AND MORTGAGE LENDING

State-chartered thrift assets under the Department's jurisdiction totaled $9.97 billion and increased by 8.5% or $797.9 million from the December's 2006 balance of $9.4 billion. The total number of state chartered savings banks increased to twenty-six at December 2007, up from twenty-two at December 2006. Six new charters were added during the year with five *de novo* charters and one conversion from a federal institution. *De novo* charters and effective dates included: (1) Oasis Bank, ssb, Houston, May 10, 2007; (2) Pioneer Bank, ssb, Dripping Springs, May 14, 2007; (3) Providence Bank of Texas, SSB, Southlake, August 27, 2007; (4) Founders Bank, SSB, Sugar Land, November 9, 2007; and (5) Integrity Bank, SSB, Houston, November 21, 2007. A conversion of First Federal Savings and Loan Association of Littlefield into First Federal Bank Littlefield, TX ssb, occurred on October 1, 2007. Two charters exited through mergers, acquisitions and/or conversions: (1) Royal Oaks Bank, SSB – merged into First Bank, Creve Coeur, Missouri, a Missouri State Chartered Trust Company, effective February 28, 2007; and (2) Olympic Savings, SSB, Refugio, acquired by the Woodforest Financial Group, Inc., the Woodlands, converted to a federal savings bank, effective April 23, 2007.

Two other charter applications have been completed since year-end 2007: (1) *de novo* Third Coast Bank, ssb, Humble, chartered February 20, 2008, effective February 25, 2008; and, a conversion of Colorado Valley Bank, La Grange, to Colorado Valley Bank ssb, effective January 29, 2008. Other charter changes include Beal Bank, SSB, Plano, converting to a federal savings bank on February 1, 2008. Additionally, on March 17, 2008, a conversion application was filed by The Bank of Crowley to convert to a state savings bank to be known as Texas Exchange Bank, ssb. Discussions continue to be held with several potential *de novo* applicants and/or charter conversions. Total institutions are projected to be twenty-eight and total assets are estimated to approximate $8.8 billion.

The Departments' supervisory monitoring and enforcement staff will continue to emphasize:

- Regular conference calls and close coordination with other state and federal regulators;
- Quarterly analysis of Call Report financial data including telephone inquiries of thrift management for explanation of unusual items and variation in quarterly operating results;
- Maintaining an ongoing monitoring of each institution's activity (i.e., regulatory correspondence and approvals, independent audit reports, reports of examination, and institution responses to examination comments, criticisms and recommendations);
- Continuing on-going joint review by the FDIC and the Department of savings bank's contingency / disaster recovery plans;
- Conducting regular assessments of each institution's activities, strengths and weaknesses, and revising the Department's plan of examination and monitoring for the institution;
- Monitoring increased foreclosure activity and changes in the housing market demand and the various financing products offered, especially non-traditional or subprime, as well as continued monitoring of loan delinquency ratios;
- Working with various community groups on foreclosure prevention / education;
- Reviewing concentrations in commercial real estate and monitor with recent Commercial Real Estate Lending Joint Guidance, issued December 12, 2006; and
- Internal monitoring of local, state, national and world political and economic events impacting the industry.

PERFORMANCE SUMMARY AND PROFILE
TEXAS BANKING SYSTEM

The majority of Texas financial institutions fared well in 2007 given the economic problems and fears of a recession. Capital protection has increased and remains strong exceeding the highest regulatory capital standards. This is evidenced by the reduction in the number of banks with capital adequacy less than 6% from four in 2006 to two as of December 2007. Both state-chartered banks and thrifts report increased core capital protection from one year ago. State banks experienced a 57 basis point increase in their leverage capital ratio of 9.33%, while thrifts experienced a larger increase of 148 basis points from 10.26% to 11.74%.

Texas banks continue to show resistance to adverse economic trends that have affected other parts of the United States primarily because the Texas economy has outperformed the nation in those areas. The return on assets (ROA) for state-chartered banks of 1.22% in 2007 was a slight improvement from year-end 2006 of 1.20%. The immaterial change in ROA demonstrates that state banks are in a strong position to enter the current economic scenario.

Reductions in the federal funds rate have squeezed net interest margins at numerous small-to-midsize financial institutions where asset returns have declined more than the cost of funds. The rate-cutting that started in September 2007 began affecting community banks by the end of the year. State-chartered banks did not experience the typical effects seen by these reductions and managed to slightly improve their net interest margin to 4.02% at year-end 2007, up from 3.95% in December 2006. Interest income and interest expense, as a percent of average earning assets, increased proportionately in 2007, resulting in an 89.6% increase of net interest income over 2006. Provisions to the allowance for loan losses in 2007 increased to $332 million from only $95 million at year-end 2006.

In contrast, state-chartered thrifts experienced a substantial reduction in earnings performance; posting a 0.79% ROA compared to the 2.31% in December 2006. Significant contributing factors to the ROA reduction are the planned asset reduction of a thrift; impairment of goodwill; additional loan and lease loss provisions; *de novo* institutions with high initial operational expenses due to start up costs; and compression of the net interest margin. Thrift interest income, as a percentage of average assets, dropped 36 basis points from December 31, 2006 while interest expense to average assets increased 33 basis points. Net interest income was reduced $51 million from the previous year, the equivalent of a 69 basis point reduction in net interest income to average assets of 3.39%. Noninterest expense increased, as a percent of average assets, 81 basis points to 2.98% of average assets, while noninterest income declined 12 basis points. Net loan charge-offs remained consistent with the prior year.

Most of the typical measures of asset quality show modest negative trends from one year ago. The trend of noncurrent, or past due loans, as a percent of total loans, seems to imply that asset quality is weakening. Banks exhibited an increase over year-end 2006 from 0.34% to 0.55% in noncurrent loans. Thrifts demonstrated a significant increase from 1.30% at year-end 2006 to 2.67% as of December 2007. Noncurrent assets plus other real estate owned to total assets increased 27 basis points to 0.65% for banks, and 158 basis points to 3.40% for thrifts.

Loss reserves appear to be adequate for both banks and thrifts; however, this position is contingent upon economic conditions. Reserves now represent 1.07% of loans for banks and 0.97% for savings institutions. This is a slight decrease for state banks, but a 38 basis point rise for savings institutions. Net charge-offs increased dramatically for banks and only slightly for thrifts. Overall, charge-off levels for both banks and thrifts are not unreasonable.

Number of Institutions and Total Assets

	12-31-2007 No. of Institutions	12-31-2007 Assets	12-31-2006 No. of Institutions	12-31-2006 Assets	Difference No. of Institutions	Difference Assets
Texas State-Chartered Banks	330	$154.3	322	$83.9	+8	+$70.4
Texas State-Chartered Thrifts	26	$10.0	22	$9.4	+4	+$0.6
	356	$164.3	344	$93.3	+12	$71.0
Other states' state-chartered:						
Banks operating in Texas*	18	$15.2	17	$16.3	+1	-$1.1
Thrifts operating in Texas*	0	0	0	0	0	0
	18	$15.2	17	$16.3	+1	-$1.1
Total State Chartered Activity	374	$179.5	361	$109.6	+13	+$69.9
National Banks Chartered in Texas	282	$107.3	286	$97.9	-4	+$9.4
Federal Thrifts Chartered in Texas	21	$74.3	20	$64.7	+1	+$9.6
	303	$181.6	306	$162.6	-3	+$19.0
Other states' federally-chartered:						
Banks operating in Texas*	22	$165.1	21	$194.4	+1	-$29.3
Thrifts operating in Texas*	12	$75.0	10	$9.8	+2	+$65.2
	34	$240.1	31	$204.2	+3	+$35.9
Total Federally-Chartered Activity	337	$421.7	337	$366.8	0	+$54.9
Total Banking/Thrift Activity	711	$601.2	698	$476.4	+13	+$124.8

Assets in Billions

**Indicates estimates based on available FDIC information.*

Ratio Analysis

As of December 31, 2007

Number of Banks-------------------------→	*State-Chartered Banks* 330	*Texas National Banks* 282	*All Texas Banks* 612	*State-Chartered Thrifts* 26	*Texas Federal Thrifts* 21	*All Texas Thrifts* 47
% of Unprofitable Institutions	9.70%	7.09%	8.50%	26.92%	23.81%	25.53%
% of Institutions with Earnings Gains	59.39%	63.48%	61.27%	46.15%	33.33%	40.43%
Yield on Earning Assets	7.07%	7.16%	7.10%	7.71%	6.72%	6.83%
Net Interest Margin	4.02%	4.31%	4.13%	3.74%	2.67%	2.79%
Return on Assets	1.22%	1.31%	1.25%	0.79%	0.61%	0.63%
Return on Equity	10.89%	11.07%	10.96%	5.70%	7.97%	7.52%
Net Charge-offs to Loans	0.24%	0.19%	0.22%	0.27%	0.51%	0.48%
Earnings Coverage of Net Loan C/Os	12	16	13	6	5	5
Loss Allowance to Loans	1.07%	1.12%	1.09%	0.97%	1.04%	1.03%
Loss Allowance to Noncurrent Loans	131.96%	185.57%	149.12%	25.30%	85.00%	66.86%
Noncurrent Assets+OREO to Assets	0.65%	0.45%	0.57%	3.40%	0.89%	1.19%
Net Loans and Leases to Core Deps	120.40%	99.92%	111.52%	139.99%	135.09%	135.67%
Equity Capital to Assets	11.09%	11.90%	11.42%	13.77%	7.57%	8.31%
Core Capital (Leverage) Ratio	9.33%	9.02%	9.21%	11.74%	7.77%	8.23%

Data for other state chartered institutions doing business in Texas is not available and therefore excluded.

Comparison Report

Select Balance Sheet and Income/Expense Information

As of December 31, 2007

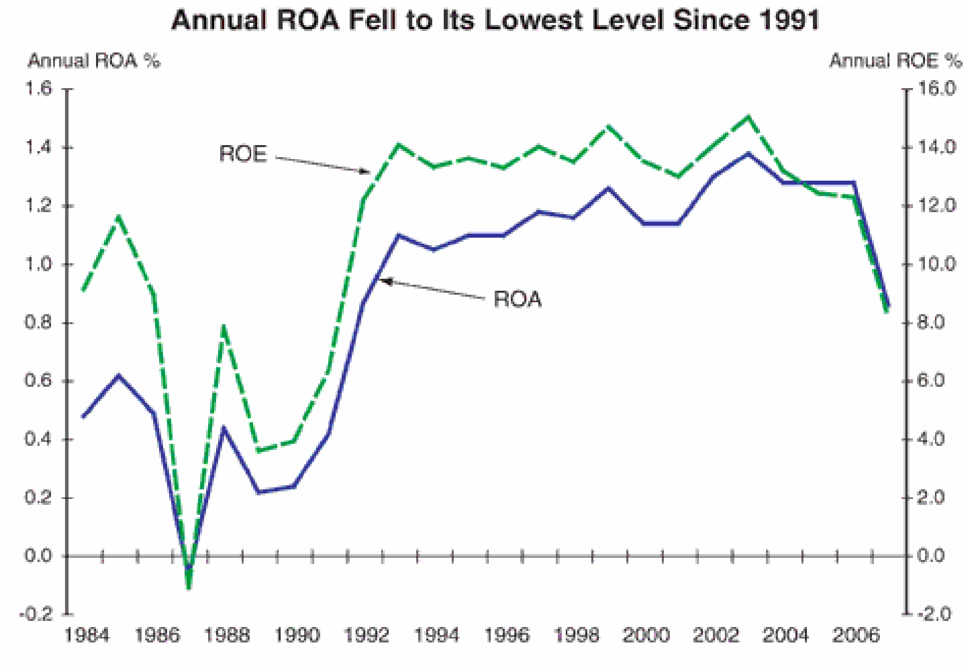
	State Banks*		State Thrifts	
	End of Period	% of Total Assets	End of Period	% of Total Assets
Number of Institutions	330		26	
Number of Employees (full-time equivalent)	36,941		1,748	
(In millions)				
Total Assets	$154,292		$9,968	
Net Loans and Leases	$104,193	67.53%	$6,839	68.61%
Loan Loss Allowance	$1,129	0.73%	$67	0.68%
Other Real Estate Owned	$145	0.09%	$82	0.82%
Goodwill and Other Intangibles	$3,578	2.32%	$229	2.30%
Total Deposits	$116,643	75.60%	$6,164	61.84%
Federal Funds Purchased and Repurchase Agreements	$5,255	3.41%	$8	0.08%
Other Borrowed Funds	$10,687	6.93%	$2,331	23.39%
Equity Capital	$17,112	11.09%	$1,372	13.77%
Memoranda:				
Noncurrent Loans and Leases	$856	0.55%	$266	2.67%
Earning Assets	$137,971	89.42%	$9,000	90.29%
Long-term Assets (5+ years)	$26,205	16.98%	$2,818	28.28%
	Year-to Date	% of Avg. Assets	Year-to Date	% of Avg. Assets
Total Interest Income	$9,308	6.34%	$666	6.99%
Total Interest Expense	$4,020	2.74%	$34	3.60%
Net Interest Income	$5,288	3.60%	$323	3.39%
Provision for Loan and Lease Losses	$332	0.23%	$46	0.49%
Total Noninterest Income	$1,907	1.30%	$63	0.66%
Total Noninterest Expense	$4,415	3.01%	$284	2.98%
Securities Gains	-$9	-0.01%	$19	0.20%
Net Income	$1,786	1.22%	$76	0.79%
Memoranda:				
Net Loan Charge-offs	$239	0.16%	$18	0.19%
Cash Dividends	$1,234	0.84%	$16	0.17%

* *Excludes branches of state-chartered banks of other states doing business in Texas. As of 12-31-07 an estimate is eighteen institutions with $15.2 billion in assets. No branches of state-chartered thrifts of other states conducted business in Texas as of 12-31-07.*

Quarterly Banking Profile – National Level
Fourth Quarter 2007
Federal Deposit Insurance Corporation

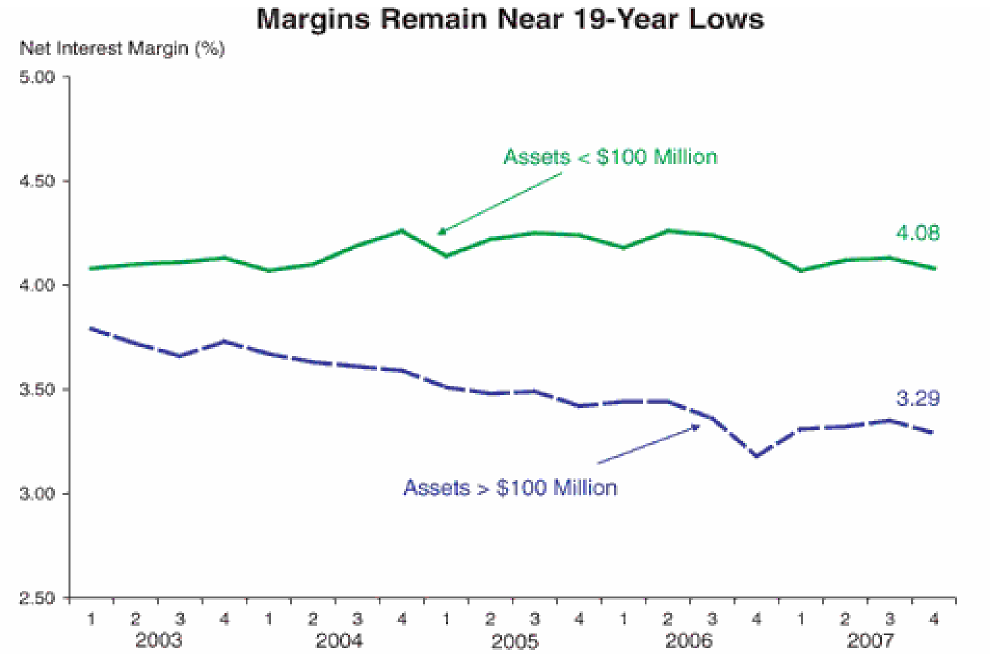
⇩ **Earnings Performance** - Earnings weakness was fairly widespread in the fourth quarter. More than half of all institutions (51.2%) reported lower net income than in the fourth quarter of 2006, and 57.1% reported lower quarterly ROAs. However, the magnitude of the decline in industry earnings was attributable to a relatively small number of large institutions. In contrast to the steep 102 basis-point drop in the industry's ROA, the median ROA fell by only 14 basis points, from 0.93% to 0.79%. Seven large institutions accounted for more than half of the total year-over-year increase in loss provisions. Ten large institutions accounted for the entire decline in trading results. Five institutions accounted for three-quarters of the increase in goodwill and intangibles expenses, and sixteen institutions accounted for three-quarters of the year-over-year decline in quarterly net income. One out of every four institutions with assets greater than $10 billion reported a net loss for the fourth quarter. Institutions associated with subprime mortgage lending operations and institutions engaged in significant trading activity were among those reporting the largest earnings declines.

For all of 2007, insured institutions earned $105.5 billion, a decline of $39.8 billion (27.4% from 2006. This is the lowest annual net income for the industry since 2002 and is the first time since 1999-2000 that annual net income has declined. While much of the decline in industry earnings was concentrated among some of the largest institutions, evidence of broader weakness in earnings bespoke an operating environment that was less favorable than in previous years. Fewer than half of all insured institutions--49.2%--reported improved earnings in 2007, the first time in at least 23 years that a majority of insured institutions have not posted full-year earnings increases. The percentage of institutions that were unprofitable in 2007--11.6% --was the highest since 1991. The average ROA for the year was 0.86%, the lowest yearly average since 1991, when it was 0.42%, and the first time in 15 years that the industry's annual ROA has been below 1%. More than half of all institutions--59.2%--reported lower ROAs in 2007 than in 2006. Sharply higher loss provisions and a very rare decline in annual noninterest income were primarily responsible for the lower industry profits. Insured institutions set aside $68.2 billion in provisions for loan losses in 2007, more than twice the $29.5 billion they set aside in 2006. Loss provisions represented 11.6% of net operating revenue (net interest income plus total noninterest income), the highest proportion for the industry since 1992. Total noninterest income of $233.4 billion was $7.0 billion (2.9%) less than in 2006, as trading revenue fell from $19.0 billion in 2006 to only $4.1 billion in 2007, and net gains on loan sales fell by $5.1 billion (68.5%). This is the first time since the mid-1970s that full-year noninterest income has declined. Noninterest expenses were $30.2 billion (9.1%) higher than a year earlier. Net interest income increased by $22.7 billion (6.9%) in 2007, even though the industry's full-year net interest margin declined to its lowest level since 1988, because interest-earning assets grew by 9.4% during the year.

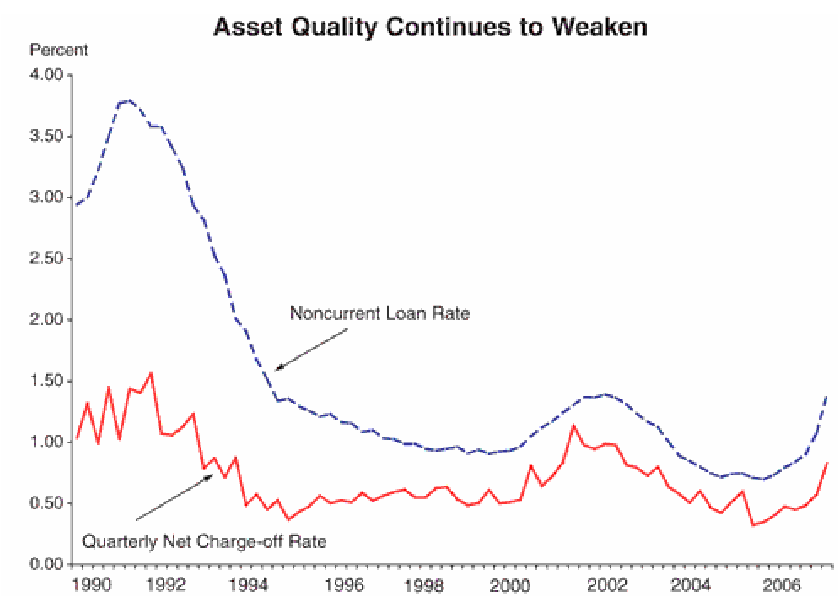


⇧ **Capital Protection** - Total equity capital increased by $25.1 billion (1.9%) during the fourth quarter. This increase lagged behind the 2.6% increase in assets during the quarter, and the industry's equity-to-assets ratio declined from 10.44% to 10.37%. Goodwill accounted for almost one-third ($7.9 billion) of the increase in equity, despite large write-downs of goodwill at several institutions. The industry's leverage capital ratio registered a larger decline during the quarter, because leverage capital does not include goodwill. The leverage ratio fell from 8.14% to 7.98%, a four-year low. In contrast, the industry's total risk-based capital ratio, which includes loss reserves, increased from 12.74% to 12.79%.

⇩ **Net Interest Margins** - As interest rates fell during the quarter, average asset yields declined more than average funding costs, and net interest margins (NIMs) narrowed slightly from third-quarter levels. The average NIM in the fourth quarter was 3.30%, compared to 3.36% in the third quarter. Except for the fourth quarter of 2006, when the accounting treatment of a few large corporate restructurings resulted in a reduction in reported net interest income, this is the lowest quarterly NIM for the industry since 1989. Almost 60% of all institutions had their margins decline from third-quarter levels. Margin erosion was especially pronounced at large mortgage lenders. (See chart on next page.)

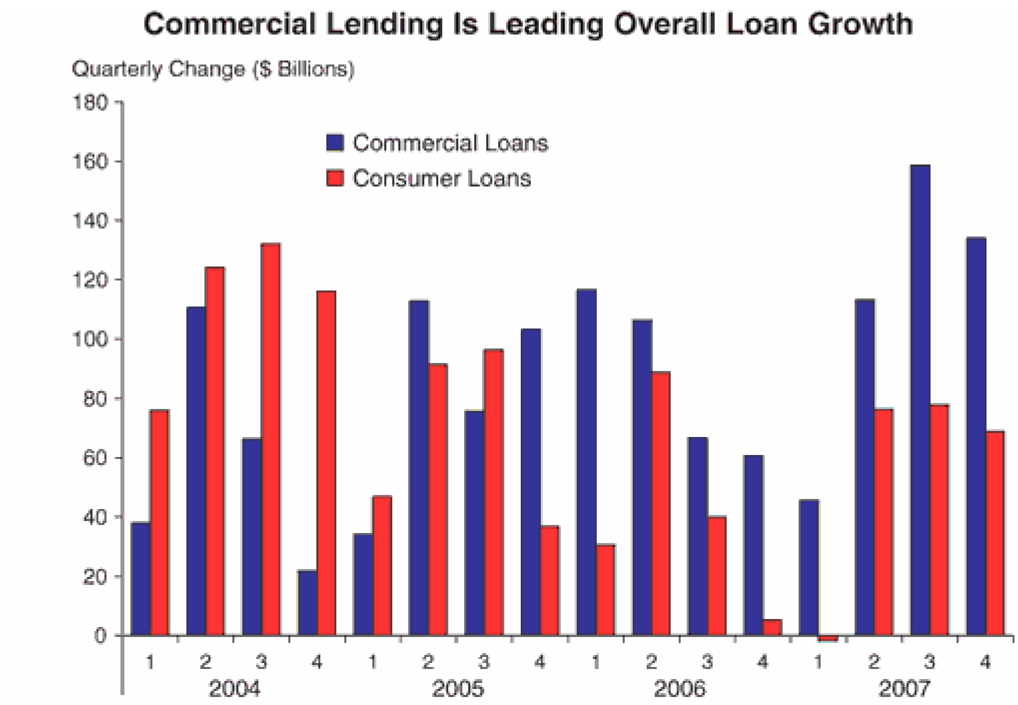


⇩ **Loan Charge-offs and Other Real Estate** - Net charge-offs registered a sharp increase in the fourth quarter, rising to $16.2 billion, compared to $8.5 billion in the fourth quarter of 2006. The annualized net charge-off rate in the fourth quarter was 0.83%, the highest since the fourth quarter of 2002. Net charge-offs were up year-over-year in all major loan categories except loans to the farm sector (agricultural production loans and real estate loans secured by farmland). Net charge-offs of loans to commercial and industrial (C&I) borrowers were $1.6 billion (104.5%) higher than in the fourth quarter of 2006. Net charge-offs of residential mortgage loans were up by $1.3 billion (144.2%), and charge-offs of home equity lines of credit were $1.0 billion (378.4%) higher. Credit card charge-offs were up by $1.0 billion (33 %), and charge-offs of other loans to individuals increased by $1.1 billion (58.4%).



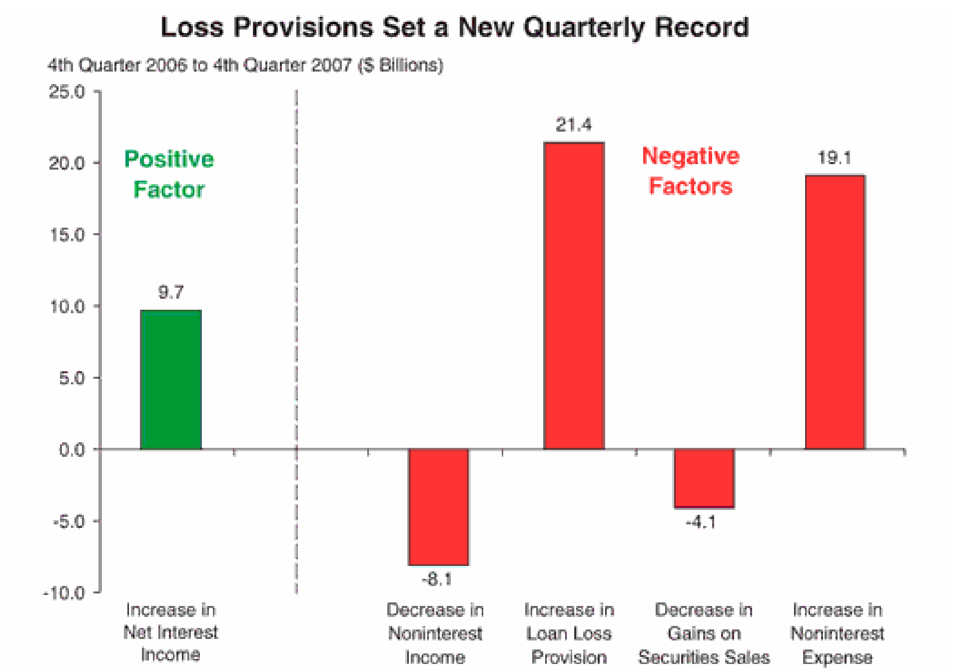
⇩ **Past Due Loans** - Despite the heightened level of charge-offs, the rising trend in noncurrent loans that began in mid-2006 continued to gain momentum in the fourth quarter. Total noncurrent loans -- loans 90 days or more past due or in nonaccrual status -- rose by $26.9 billion (32.5%) in the last three months of 2007. This is the largest percentage increase in a single quarter in the 24 years for which noncurrent loan data are available. Eight institutions accounted for half of the total increase in noncurrent loans in the fourth quarter, but noncurrent loans were up at half of all insured institutions. The percentage of loans that were noncurrent at year-end was 1.39%, the highest level since the third quarter of 2002. The fourth-quarter increase in noncurrent loans was led by noncurrent residential mortgage loans, which grew by $11.1 billion (31.7%). The percentage of residential mortgage loans that were noncurrent rose from 1.57% to 2.06% during the quarter and is now at the highest level in the 17 years that noncurrent mortgage data have been reported. Noncurrent real estate construction and development loans increased by $8.4 billion (73.2%), noncurrent credit card loans rose by $1.9 billion (26.0%), noncurrent home equity loans were up by $1.6 billion (43.1%) and noncurrent other loans to individuals increased by $1.2 billion (26.7%). Only the farm loan categories registered declines in noncurrent amounts.

⇧ **Loan Growth** - Assets continued to grow strongly in the fourth quarter, but the focus of growth shifted away from residential mortgage loans. Total assets increased by $331.8 billion (2.6%) during the quarter. Fed funds sold and securities purchased under resale agreements increased by $71.5 billion (11.5%), assets in trading accounts grew by $64.6 billion (8.0%), C&I loans increased by $51.5 billion (3.7%), and credit card loans grew by $38.0 billion (9.9%). The industry's portfolio of mortgage-backed securities rose by $36.9 billion (3.1%). Real estate loans secured by nonfarm nonresidential properties increased by $29.0 billion (3.1%). Residential mortgage loans rose by only $7.1 billion (0.3%), compared to a $30.8-billion increase in the third quarter. Real estate construction and development loans increased by only $12.5 billion (2.0%) during the fourth quarter. This is the smallest quarterly increase since the fourth quarter of 2003. Despite the slowdown in growth of construction lending, the number of institutions with concentrations of exposure to construction lending continued to rise. During the fourth quarter, the number of institutions whose construction loans exceeded their total capital increased from 2,348 to 2,368 out of 8,553.



⇧ **Deposit Growth** - Deposits in domestic offices of insured institutions increased by $170.6 billion (2.5%), the largest quarterly dollar increase ever reported by the industry. Deposits in noninterest-bearing accounts rose by $64.9 billion (5.8%), time deposits grew by $53.5 billion (2.1%), and deposits in other interest-bearing accounts increased by $49.1 billion (1.6%). Brokered deposits increased by $63.3 billion (12.4%). Nondeposit liabilities rose by $74.0 billion (2.3%), led by advances from Federal Home Loan Banks (up $38.4 billion, or 5.0%). Deposits in foreign offices grew by $62.2 billion (4.3%). The industry's ratio of deposits to total assets, which hit an all-time low of 64.4% at the end of the third quarter, rose slightly to 64.5% at year end.

⇩ **Loss Provisions Rise Significantly** - Insured institutions' loss reserves posted their largest increase in 20 years in the fourth quarter, but this growth did not keep pace with the growth in noncurrent loans. The industry's $31.3-billion loss provision exceeded the $16.2 billion in net charge-offs by a considerable margin, and reserves grew by $14.8 billion (17.0%). The ratio of reserves to total loans and leases rose from 1.13 % to 1.29% during the quarter, its highest level since the first quarter of 2005. But the "coverage ratio" of reserves to noncurrent loans fell from $1.05 in reserves for every $1.00 of noncurrent loans to 93 cents at the end of 2007. This is the first time since 1993 that the industry's noncurrent loans have exceeded its reserves. At year end, one in three institutions had noncurrent loans that exceeded reserves, compared to fewer than one in four institutions a year earlier.



⇩ **"Problem List" Registers Modest Increase** - The number of FDIC-insured institutions reporting financial results declined from 8,559 to 8,533 during the fourth quarter. Fifty newly chartered institutions were added during the quarter, while 74 institutions were absorbed by mergers. One insured commercial bank failed in the fourth quarter. For the full year, 181 new insured institutions were chartered, 321 charters were absorbed in mergers, and three insured institutions failed. In the previous two years, there were no failures of FDIC-insured institutions, an interval unprecedented since the inception of the FDIC. In 2004, four insured institutions failed. Five mutually owned savings institutions, with combined assets of $4.8 billion, converted to stock ownership in the fourth quarter. For the entire year, ten insured savings institutions with total assets of $10.1 billion converted from mutual ownership to stock ownership. At the end of 2007, there were 76 FDIC-insured commercial banks and savings institutions on the "Problem List," with combined assets of $22.2 billion, up from 65 institutions with $18.5 billion at the end of the third quarter.

Bank and Thrift Closures Nationwide
Federal Deposit Insurance Corporation

Dates Covered: January 2004 to December 2007	**Charter**	**Date Closed**	**Total Assets**
Miami Valley Bank, Lakeview, Ohio	State	10-04-2007	$86.7 Million
NetBank, Alpharetta, Georgia	Federal Thrift	09-28-2007	$2.5 Billion
Metropolitan Savings, Pittsburgh, Pennsylvania	State	02-02-2007	$15.8 Million
Bank of Ephraim, Ephraim, Utah	State	06-25-2004	$46.4 Million
Reliance Bank, White Plains, New York	State	03-19-2004	$30.3 Million
Guaranty National Bank of Tallahassee, Tallahassee, Florida	National	03-12-2004	$74.1 Million
Dollar Savings Bank, Newark, New Jersey	National	02-14-2004	$12.3 Million

(Highlighted banks closed in second half of 2007.)

Stock Performance
Southwest Regional Banks

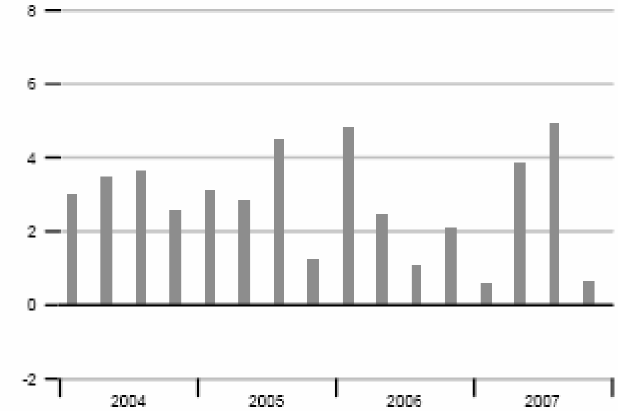
Name	Last Trade		52 Wk Range		PE	EPS	Mkt Cap	Div/Shr	Div Yld
Bancfirst Corporation	03/14	**42.89**	38.75	48.95	12.74	3.41	652.66B	0.20	1.84%
Banco Bilbao Vizcaya Argentaria	03/20	**21.55**	18.72	25.70	8.07	2.63	80.43B	1.61	7.80%
Bok Financial Corporation	03/14	**52.15**	45.90	56.00	15.98	3.24	3.51B	0.20	1.54%
Cass Information Sys Inc	03/14	**28.59**	25.01	40.55	15.07	1.95	263.26M	0.12	1.63%
Cobiz Incorporated	03/14	**11.95**	11.17	20.20	12.16	0.98	274.77M	0.07	2.35%
Comerica Inc.	03/25	**39.19**	34.51	63.89	8.85	4.426	5.90B	2.64	6.70%
Commerce Bancs Inc	03/14	**41.98**	38.00	47.495	14.57	2.86	3.02B	0.25	2.40%
Community Shores Bank Corp	03/13	**6.70**	5.25	13.00	22.33	0.27	9.84M	0	0
Cullen Frost Bkrs Incorporated	03/14	**50.46**	42.90	55.97	14.07	3.60	2.96B	0.40	3.17%
Enterprise Fin Serv Corp	03/14	**21.08**	17.99	29.01	14.62	1.44	261.52M	0.0525	1.00%
First Comnty Corp S C	3/11	**15.40**	12.00	18.99	11.38	1.23	43.54M	0.08	2.29%
First Federal Bankshares Inc	3/11	**12.89**	10.91	21.55	22.22	0.58	42.59M	0.105	3.26%
First Financial Bankshares	03/14	**38.99**	35.19	44.00	16.66	2.38	809.86M	0.32	3.23%
First ST Bancorporation	03/14	**11.60**	9.15	23.01	9.68	1.21	233.52M	0.09	3.07%
Firstcity Finl Corp	03/20	**6.72**	7.05	11.07	15.03	0.45	72.48M	N/A	0.00%
Franklin Bank Corporation	03/20	**3.43**	3.01	19.02	N/A	-1.87	87.02M	N/A	N/A
Great South Bancorp Inc	03/14	**17.87**	15.68	30.15	8.27	2.16	239.46M	0.18	4.03%
Guaranty Fed Bancshares Inc	03/14	**26.15**	24.45	30.85	11.02	2.38	71.60M	0.16	2.75%
Heartland Financial USA Inc	03/14	**19.23**	15.98	27.52	13.57	1.45	315.89M	0.10	2.03%
International Bancs Cor	03/14	**22.10**	18.25	27.691	12.60	1.76	1.52B	0.66	2.98%
Landmark Bancorp Inc	03/12	**25.40**	23.50	27.61	11.14	2.28	60.99M	0.19	2.99%
Liberty Bancorp Inc	03/12	**10.31**	9.93	11.39	24.55	0.42	42.21M	0.025	0.97%
Mackinac Finl Corp	03/14	**8.89**	7.55	10.02	2.97	2.91	30.48M	0.00	0.00%
Metrocorp Bancshares Inc	03/14	**13.00**	12.08	22.08	11.47	1.11	140.74M	0.04	1.26%
Midwestone Finl Group Inc	03/13	**16.60**	15.64	24.00	11.40	1.46	61.49M	0.18	4.32%
Osage Bancshares Inc	03/14	**9.30**	7.47	10.02	25.83	0.36	33.52M	0.085	3.66%
Prosperity Bancs Inc	03/14	**28.04**	21.96	37.11	14.09	1.96	1.24B	0.125	1.81%
Qcr Holdings Inc	03/13	**15.35**	13.76	17.75	14.56	1.03	70.66M	0.08	0.53%
Sterling Bancshares Inc	03/14	**9.48**	8.50	12.70	12.85	0.73	694.14M	0.055	2.35%
Team Financial Inc	03/11	**13.46**	12.10	17.20	11.13	1.15	48.12M	0.08	2.50%
Tex Capital Bancs Inc	03/14	**15.74**	14.40	23.49	13.12	1.20	416.40M	0.00	0.00%
Tierone Corporation	03/14	**11.85**	10.11	33.02	13.67	-0.74	214.01M	0.08	2.68%
Umb Financial Corporation	03/14	**39.17**	34.95	47.06	22.04	1.78	1.62B	0.15	1.53%
West Bancorp Incorporated	03/14	**12.09**	11.79	16.60	11.83	1.08	210.41M	0.16	5.01%
Zions Bancorp	03/20	51.34	39.31	87.07	11.62	4.42	5.50B	1.72	3.60%

Source: BDC Investor.com (March 14, 2008)
NA – Indicates information was not available.

National Economic Trends

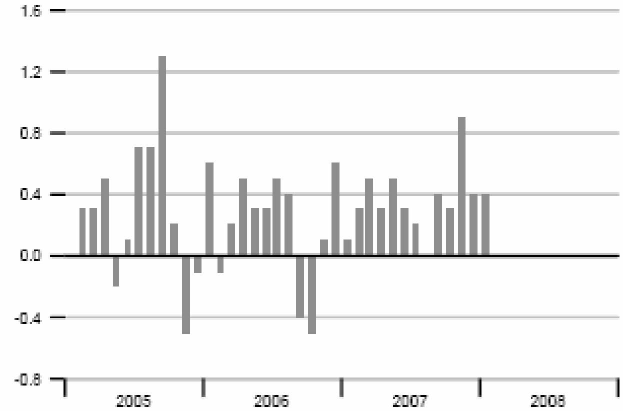
Real GDP Growth

Compounded annual rates of change



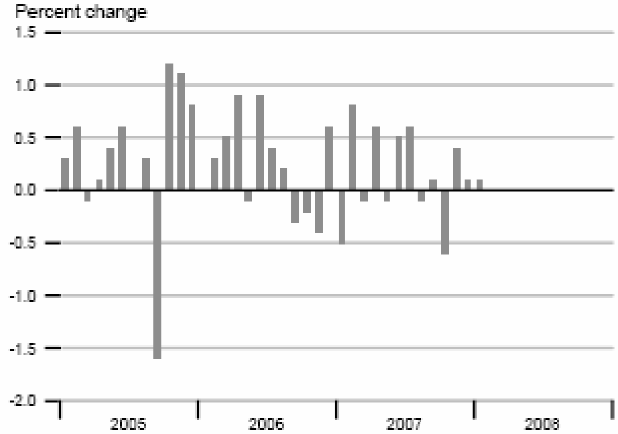
Consumer Price Index

Percent change



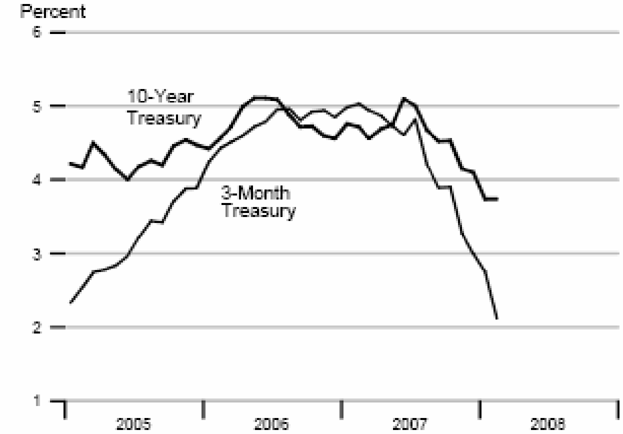
Industrial Production

Percent change



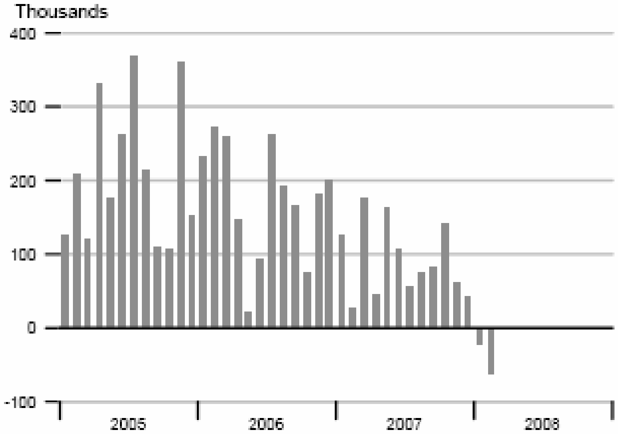
Interest Rates

Percent



Change in Nonfarm Payrolls

Thousands



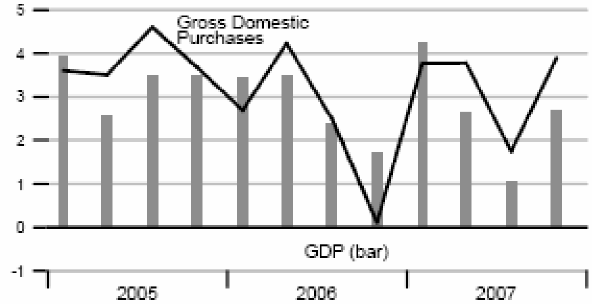
Unemployment Rate

Percent of labor force

Provided by the Federal Reserve Bank of St. Louis, National Economic Trends. Updated March 7, 2008.

NIPA Chain Price Indexes

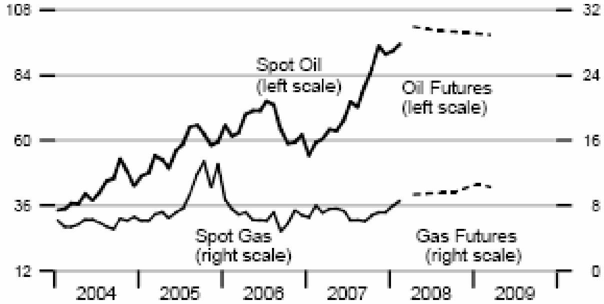
Compounded annual rates of change



Oil & Natural Gas Prices: Spot & Futures

Dollars per barrel

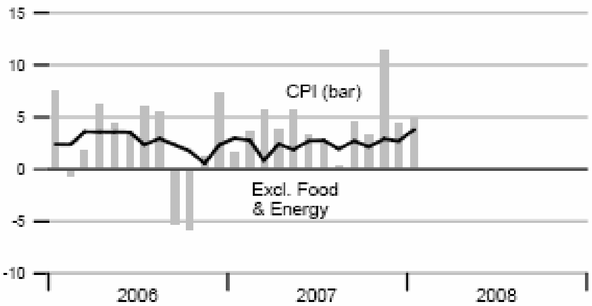
Dollars per million btu



Note: Futures prices as of 02/29/2008.

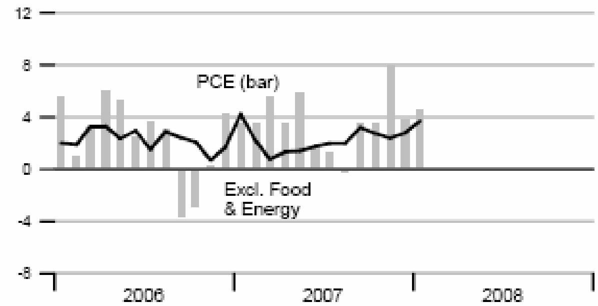
Consumer Price Index

Compounded annual rates of change



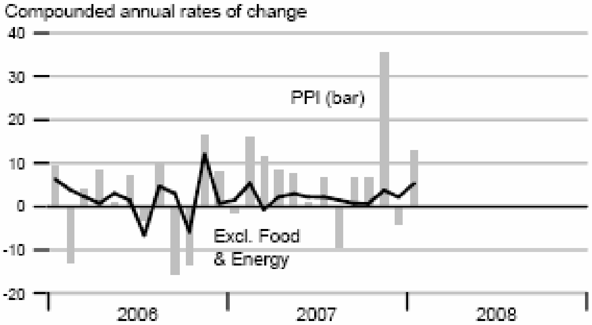
Consumption Chain Price Index

Compounded annual rates of change



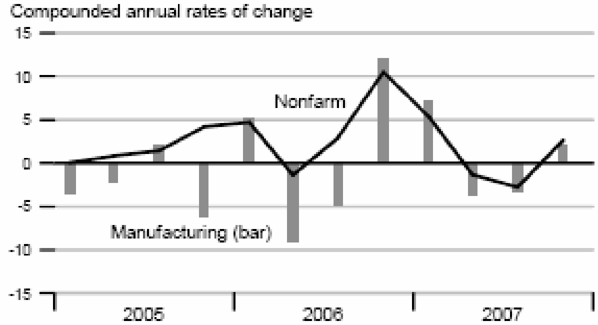
Producer Price Index, Finished Goods

Compounded annual rates of change



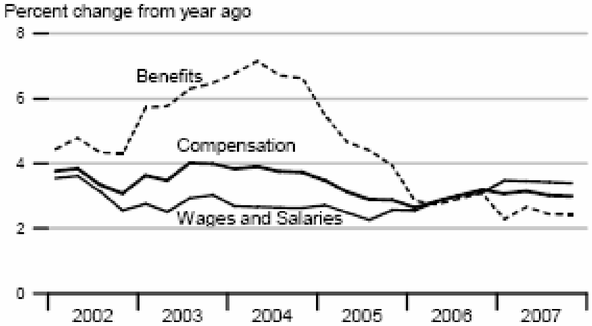
Unit Labor Cost

Compounded annual rates of change



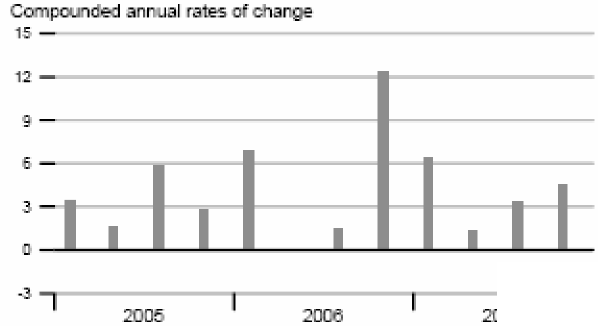
Employment Cost Index

Percent change from year ago



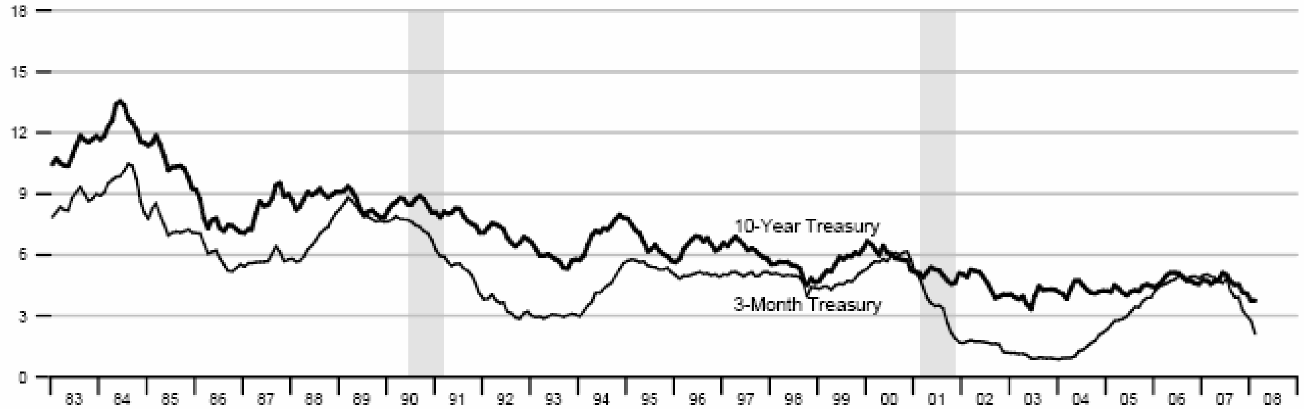
Compensation per Hour

Compounded annual rates of change

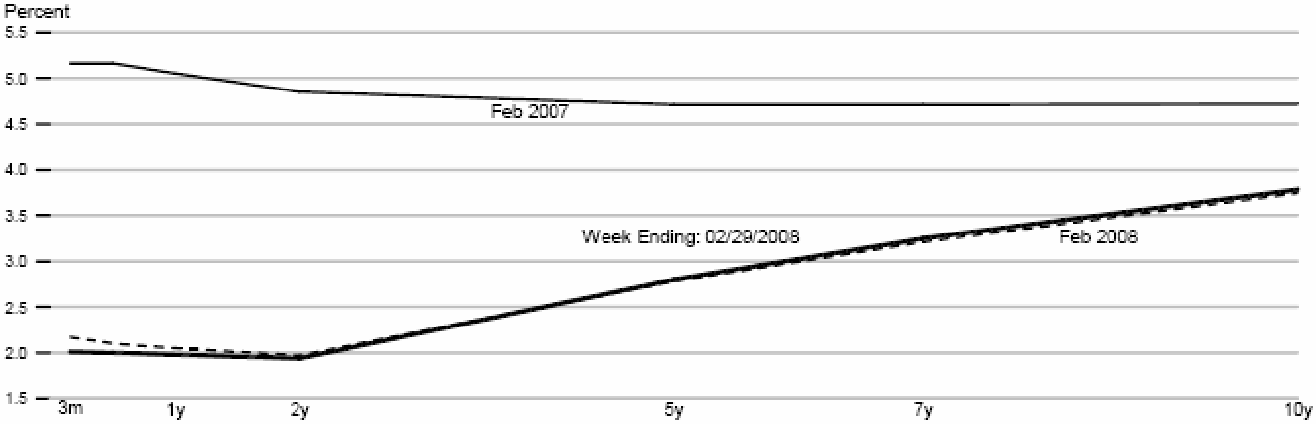


Provided by the Federal Reserve Bank of St. Louis, National Economic Trends. Updated March 7, 2008.

Interest Rates



Treasury Yield Curve



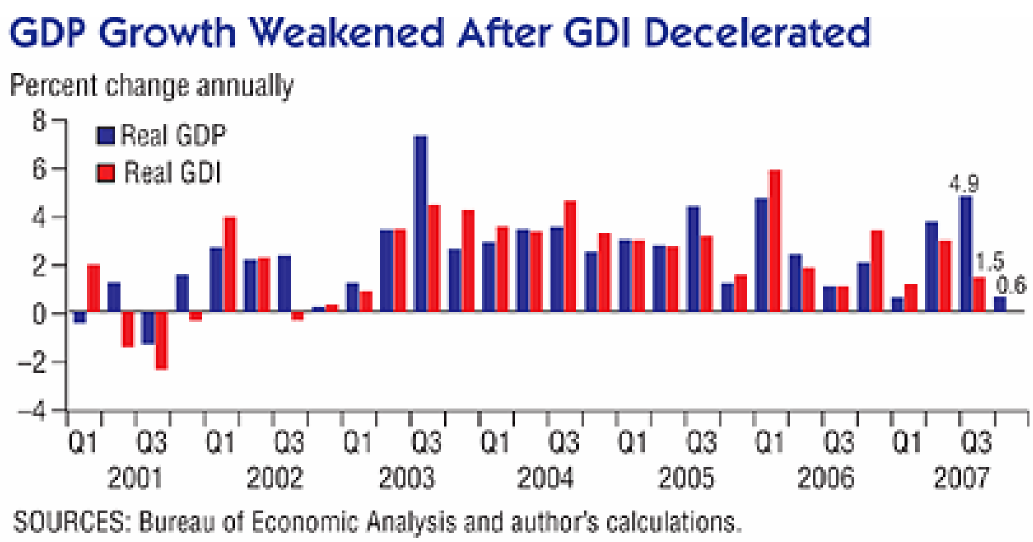
Standard and Poor's 500 Index with Reinvested Dividends

Provided by the Federal Reserve Bank of St. Louis, National Economic Trends. Updated March 7, 2008.

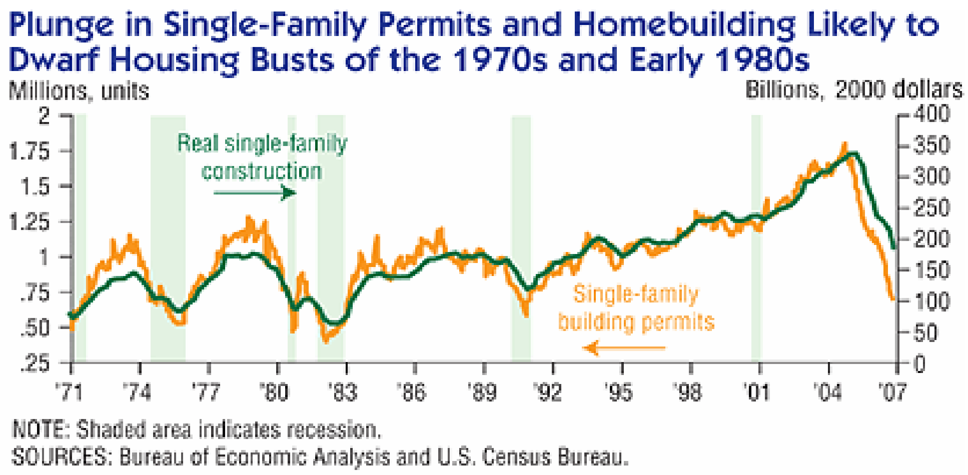
National Update – February 2008
Federal Reserve Bank of Dallas

⇳ **Overall Economy** - On balance, consumer spending rose at a modest pace, although a number of Districts indicated that sales were mixed or below expectations. Several reports indicated that capital spending increased, and expenditures for most business services continued to rise. Employment increased further in most regions and in many sectors of the economy. Most Districts said that residential construction and real estate activity continued to decline. Commercial construction and real estate markets were generally more active than during the previous reporting period. District reports indicated that manufacturing activity continued to expand during June and early July. Household lending declined in most regions, while commercial and industrial lending expanded at a modest pace. Contacts generally reported ongoing input cost pressures, particularly for petroleum-related inputs, while prices at the retail level continued to increase at a moderate rate. Energy and natural resource activity remained at high levels, or in some instances, rose further. Many Districts described overall wage gains as moderate and/or similar to the previous reporting period. Agricultural conditions varied widely, as the impacts of drought were felt east of the Mississippi River and heavy rains affected the Dallas and Kansas City Districts.

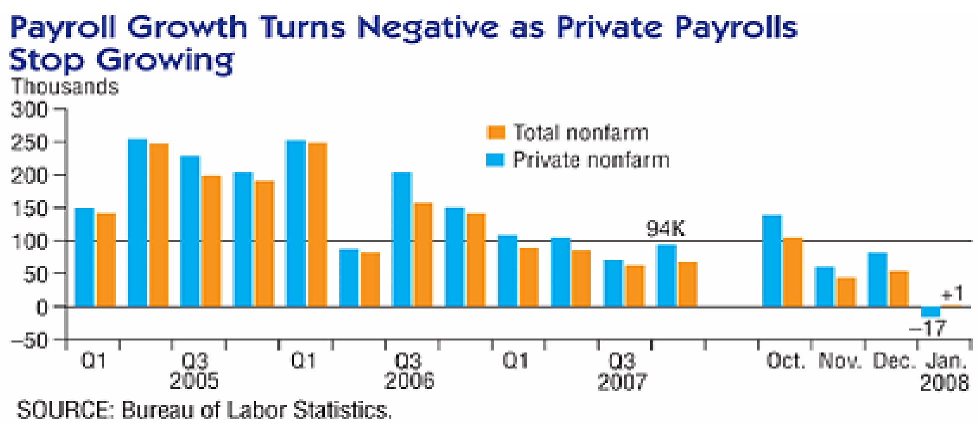
⇩ **Gross Domestic Product** - Recent reports point to an outlook of sluggish economic growth and continued upward price pressures from food, energy and imports. Real GDP growth slowed from its 4.9 percent annual rate in the third quarter to a weak 0.6 percent in the fourth quarter. Another measure of overall economic activity, gross domestic income (available through 2007:Q3), had shown a deceleration in growth one quarter earlier. For all of 2007, real GDP grew 2.2 percent, slower than the 2.9 percent pace of 2006. All major components of GDP weakened in the fourth quarter. While housing continued its drag on growth, net inventories turned even more negative than housing, with the two together reducing overall GDP growth by 2.4 percentage points. Contributions from both consumption and net exports slowed notably, compared with the third quarter, by 0.6 and 1 percentage points, respectively. To some extent, the smaller net export contribution reflected an outsized third-quarter surge in export growth.



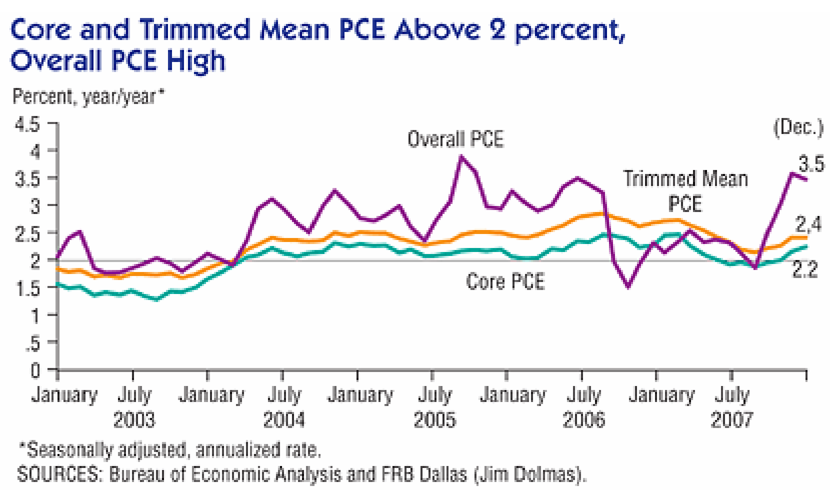
⇩ **Housing** – Construction indicators weakened more than markets had expected in December. In particular, single-family housing permits fell 8.8 percent, and new-home sales fell 4.7 percent, following November's downwardly revised 12.6 percent decline. Overall, indicators still point to further home-price declines and deterioration in this sector. In addition, outside of housing, significantly tighter credit standards on commercial real estate loans are likely to constrain future commercial construction. (See chart on next page.)



⇩ **Employment** - According to the monthly survey of payrolls at firms, nonfarm employment dipped in January following sluggish growth in the fourth quarter. Although weakness was largely concentrated in manufacturing, housing and mortgage-related industries, service-sector job growth decelerated. Job losses were notable in manufacturing (28,000) and home construction (28,000), the latter of which does not include declines at real estate firms (5,000) or at lenders (4,000).



⇩ **Inflation** - Inflation rates picked up in the fourth quarter and remained elevated in December. Core and trimmed mean PCE inflation posted 2.2 and 2.4 percent rates in December, respectively. Hurt by rising food and energy prices, prices rose by 3.5 percent from a year earlier.



Economic Statistics
U. S. Bureau of Labor Statistics

Data Series	Sept 2007	Oct 2007	Nov 2007	Dec 2007	Jan 2008	Feb 2008
Unemployment Rate [(1)]	4.7	4.8	4.7	5.0	4.9	4.8
Change in Payroll Employment [(2)]	81	140	60	41	-22 [(P)]	-63 [(P)]
Average Hourly Earnings [(3)]	17.57	17.59	17.64	17.70	17.75 [(P)]	17.80 [(P)]
Consumer Price Index [(4)]	0.4	0.3	0.9	0.4	0.4	
Producer Price Index [(5)]	0.5	0.5 [(P)]	2.6 [(P)]	-0.3 [(P)]	1.0 [(P)]	
U.S. Import Price Index [(6)]	0.6	1.5 [(9)]	3.1 [(9)]	-0.2 [(9)]	1.7 [(9)]	
Employment Cost Index [(7)] [(10)]	0.8	0.8				
Productivity [(8)]	6.3	1.9				

Footnotes:
[(P)] Preliminary
[(1)] In percent, seasonally adjusted.
[(2)] Number of jobs, in thousands, seasonally adjusted
[(3)] For production and nonsupervisory workers on private nonfarm payrolls, seasonally adjusted
[(4)] All items, U.S. city average, all urban consumers, 1982-84=100, 1-month percent change, seasonally adjusted
[(5)] Finished goods, 1982=100, 1-month percent change, seasonally adjusted
[(6)] All imports, 1-month percent change, not seasonally adjusted
[(7)] Compensation, all civilian workers, quarterly data, 3-month percent change, seasonally adjusted
[(8)] Output per hour, nonfarm business, quarterly data, percent change from previous quarter at annual rate, seasonally adjusted
[(9)] Revised
[(10)] Includes wages, salaries, and employer costs for employee benefits.

Data extracted on: March 7, 2008

The Beige Book – March 5, 2008
The Federal Reserve Board

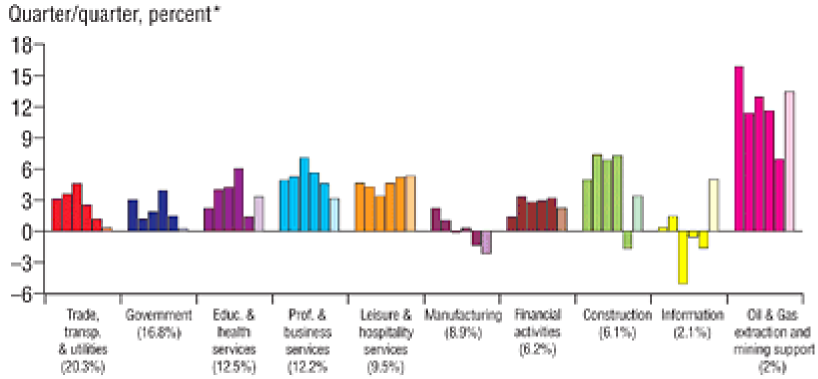
⇩ **Economy** – Reports from the twelve Federal Reserve Districts suggest that economic growth has slowed since the beginning of the year. Two-thirds of the Districts cited softening or weakening in the pace of business activity, while the others referred to subdued, slow, or modest growth. Retail activity in most Districts was reported to be weak or softening, although tourism generally continued to expand. Services industries in many Districts, including staffing services in Boston, port activity in New York, and truck freight volume in Cleveland, appeared to be slowing, but activity in services provided some positive news in Richmond and Dallas. Manufacturing was said to be sluggish or to have slowed in about half the Districts, while several others indicated manufacturing results were mixed or trends were steady. Residential real estate markets generally remained weak; reports on commercial real estate markets were somewhat mixed, but also suggest slowing, on balance, in many Districts. Most Districts reporting on banking cite tight or tightening credit standards and stable or weaker loan demand. Districts reporting on the agriculture and energy sectors said activity is generally strong.

Regional Economic Update – December 2007
Federal Reserve Bank, Dallas

⇳ **Overall Economy** - The Texas economy has weakened in recent weeks, but Texas is still performing better than the nation. Employment growth slowed in the first half of 2007. Manufacturing and housing are the most fragile sectors, but growth has moderated in other areas as well.

⇧ **Employment -** Texas employment growth continues to best the nation's, but the rate of increase has slowed. After robust growth of 3.9% in the first half of 2007, employment growth in the third quarter was 1.9%, and October's figure was 2%. Although slowing job growth is broad-based across sectors, the goods sector has been the major drag on economic activity, reflecting the downturn in housing and related weakness in manufacturing. Manufacturing jobs have been declining for the past three months across many sectors, although employment gains remain positive in the wood, cement, petrochemical, machinery, paper, and food sectors.

Employment Slowing Across Sectors
(Quarterly growth, 2006:Q3–2007:Q4)**
Quarter/quarter, percent*

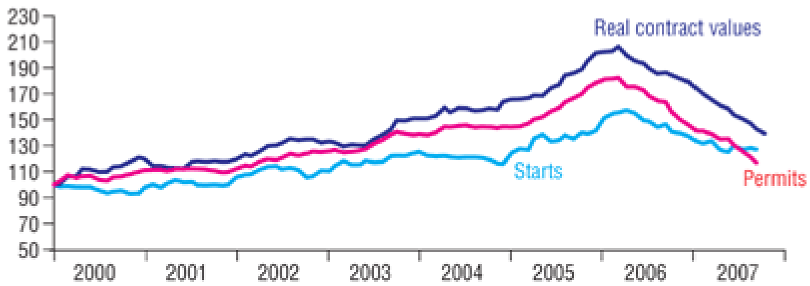


*Seasonally adjusted; annualized rate.
**Q4 2007 value October 2007, annualized.
NOTE: Percent is industry employment share of total employment in October 2007.
SOURCE: Bureau of Labor Statistics, Texas Workforce Commission, seasonal and other adjustments by the Dallas Fed.

⇩ **Housing** - The single-family housing sector remains weak. Builders continue to pull back on the construction of new homes as evidenced by the persistent fall in single-family building permits, contract values and housing starts. Sales of existing homes remain on a downward trend and inventories have risen to just over the equilibrium mark of 6 months. Inventories for new homes are somewhat higher, ranging from 7.6 months in Austin to 6.1 months in San Antonio. As in the nation, subprime delinquent mortgages continue to inch up in Texas. Texas' delinquency rate is higher than the national average, but its foreclosure rate remains below average.

Texas Builders Pull Back

Index, January 2000 = 100*

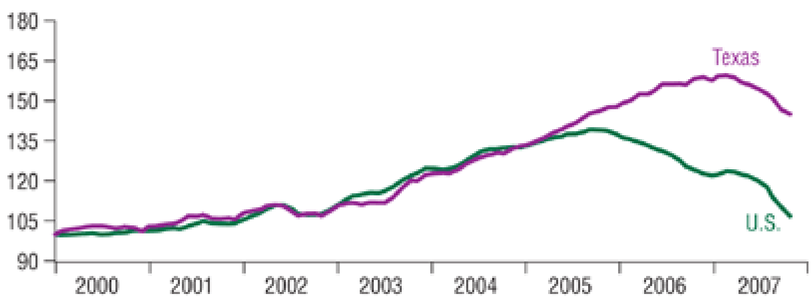


*Seasonally adjusted, five-month moving average.

SOURCE: Bureau of the Census, McGraw-Hill Construction F.W. Dodge, Bank of Tokyo-Mitsubishi UFJ, seasonal and other adjustments by the Dallas Fed.

Existing Home Sales Down

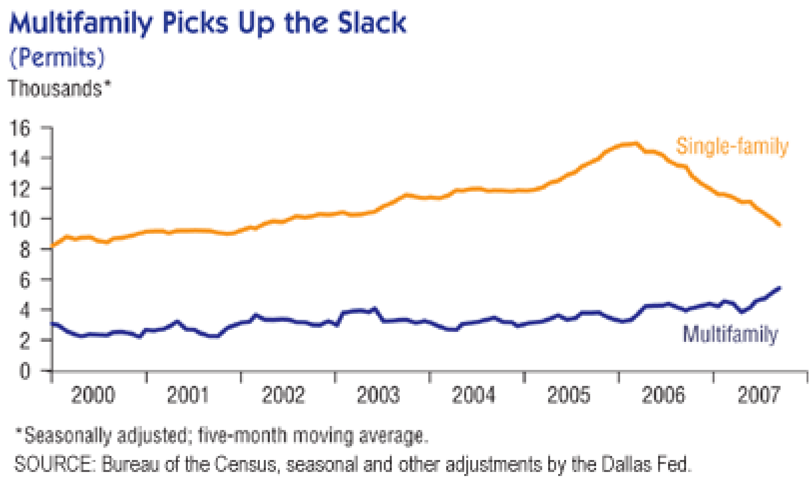
Index, January 2000 = 100*



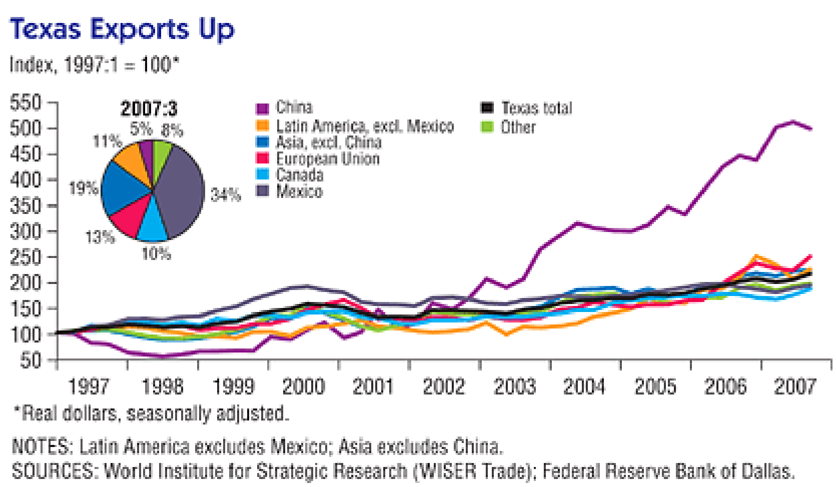
*Six-month moving average.

SOURCE: Texas Real Estate Center, seasonal and other adjustments by the Dallas Fed.

On a more positive note, demand for apartments has picked up, and multifamily construction is robust, as evidenced by the increase in multifamily permits. Given tighter credit conditions, people who do not qualify for mortgages are seeking apartments. Moreover, nonresidential and nonbuilding construction have held up well despite recent troubles in the housing sector.



⇧ **<u>Exports</u>** - Texas exports were up 5.5 % in the third quarter. The largest increases were 12%to the European Union and 9.5% to Latin America. Exports to Asia were up a meager 2.2%, while exports to China declined in the third quarter. The dollar has maintained its strength relative to the peso, and exports to Mexico rose a modest 3.2% in the third quarter.



⇧ **Energy** - As oil prices have climbed, activity has increased in the energy sector. Even though the oil and gas extraction sector is less than 2% of total employment in Texas, it has added 16,400 jobs year-to-date—making up 6.3% of the total job gains in 2007. The rig count stands at 860 rigs, with almost 85% of domestic rigs exploring for natural gas.

⇳ **Outlook** - Overall, employment data and anecdotal sources point to a weaker Texas economy, but one that is still quite healthy and stronger than the national economy. While housing woes are beleaguering the national economy, Texas housing markets have held up better than many other areas of the country. Although high oil prices pinch Texas consumers as much as those in other states, Texas gets an offset because it is the top producer of oil and gas in the nation. Hence, the Texas economic outlook is positive moving into 2008. *(Mine Yücel and Michael Nicholson)*

Texas Economic Statistics
U. S. Bureau of Labor Statistics

Data Series	Aug 2007	Sep 2007	Oct 2007	Nov 2007	Dec 2007
Civilian Labor Force [1]	**11,509.7**	**11,520.8**	**11,532.1**	**11,554.3**	**11,557.6**
Employment [1]	**10,217.3**	**10,220.1**	**10,293.7**	**10,280.0**	**10,280.2**
Unemployment Rate [2]	**4.3**	**4.3**	**4.3**	**4.2**	**4.2**
Unemployment Rate [2]	**6.6**	**6.7**	**6.6**	**6.8**	**6.5**
Total Nonfarm [3]	10303.9	10322.9	10349.2	10371.3	10389.9
12-month % change -- Total Nonfarm	0.0	0.0	0.1	0.1	0.2
Natural Resources and Mining [3]	204.3	206.1	207.0	208.5	209.0
12-month % change -- NR & Mining					
Construction [3]	621.4	621.7	626.1	627.5	628.8
12-month % change – Construction					
Manufacturing [3]	927.1	924.8	925.4	925.8	927.4
12-month % change – Manufacturing					
Trade, Transportation, and Utilities [3]	2066.3	2073.8	2076.4	2080.3	2078.3
12-month % change – TTU					
Financial Activities [3]	641.1	643.6	649.7	649.8	652.1
12-month % change -- Financial Activities					
Professional & Business Services [3]	1292.4	1293.8	1294.0	1299.9	1308.8
12-month % change – PBS					
Educational & Health Services [3]	1247.08	1249.2	1253.1	1257.0	1262.8
12-month % change – EHS					
Leisure & Hospitality [3]	984.4	992.3	997.4	999.5	1001.7
12-month % change -- L&H					
Government [3]	1744.9	1743.8	1744.9	1748.2	1748.4
12-month % change – Government	1.8	1.9	1.9	1.8	1.9
Layoff events, all industries	36	25	30	55	40
12-month net change -- Layoff events, all ind.					
12-month % change -- Layoff events, all ind.	28.6	-16.7	66.7	48.6	-34.4
Initial claimants, all industries					
12-month % change -- Initial claimants, all ind.	45	-10.6	28	24.4	3.2
12-month % change -- Initial claimants, all ind.	13.8	-16.2	-35.5	-25.7 (P)	-1.0 (P)

Footnotes:
[1] Number of persons, in thousands, seasonally adjusted.
[2] Percent.
[3] Number of jobs, in thousands, seasonally adjusted.

Data extracted on: March 7, 2008
Source: U. S. Bureau of Labor Statistics
December 2007 numbers are preliminary

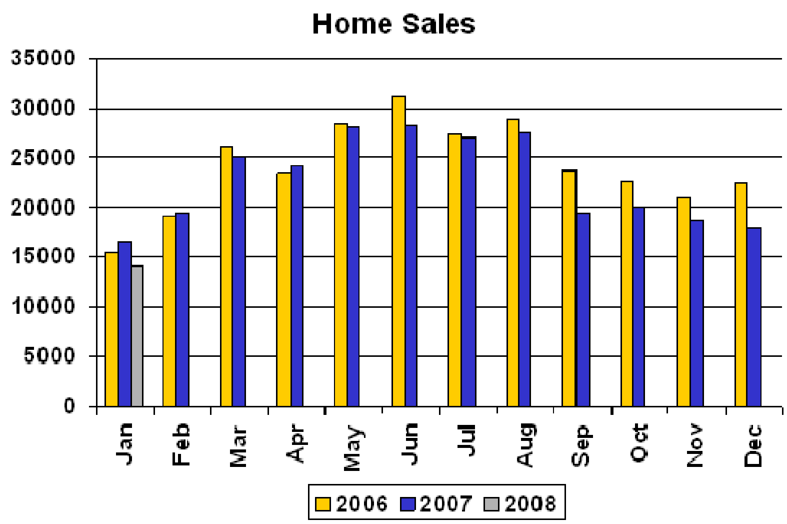
Texas Exports
November 2007
Federal Reserve Bank, Dallas

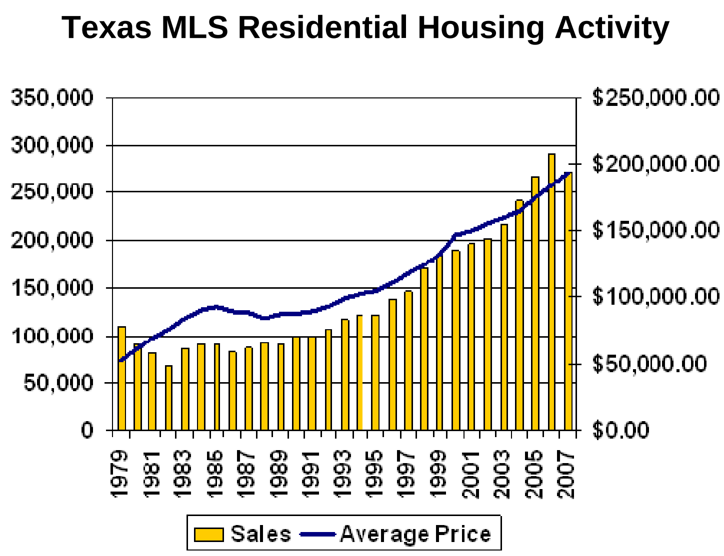
⇧ Real Texas exports picked up in third quarter 2007, rising a solid 5.5% following growth of 2.4% in the second quarter. The increase helped offset the 3.3% dip recorded in the first quarter, and Texas exports are 7.5% above last year's levels.

Healthcare along the Mexican Border
January/February 2008
Federal Reserve Bank, Dallas

⇧ The Texas cities along the Mexican border have sustained relatively strong job growth in recent years. A key factor has been a booming health care industry, driven by rising population and the large share of the population covered by government-sponsored health insurance. Since 2000, health care's share of total jobs has risen faster than the state average in every border metro except El Paso. By 2006, health care jobs accounted for 22 percent of employment in Brownsville, 21 percent in McAllen and 14% in Laredo. El Paso matched the state as a whole at 12%. The industry has become an important source of well-paying jobs in a region that has a higher than average share of low-paying jobs. High-skill health care workers earn wages comparable to the state average. For some occupations, such as pharmacists, the median border wage is higher than the state's. Several factors are boosting the health care sector along the border. First, strong population growth has occurred over the past 20 years. From 1990 to 2006, it increased 49% in Brownsville, 83% in McAllen and 74% in Laredo, all well above Texas' 38%. Residents used to travel outside the region for many surgical procedures, but the larger population base makes it financially feasible to open local medical offices and hospitals to provide those services. Second, health care demand isn't wholly dependent on income. According to industry contacts, a significant number of border residents are eligible for government programs. Medicare covers many of the elderly who retire in the Lower Rio Grande Valley or stay there in the winter. Medicaid is available to the relatively large portion of the population with low incomes. Population and job growth have been strong on the Mexican side of the border as well, and some Mexicans cross the Rio Grande for medical services. Contacts report, however, that most of the industry's recent growth has come from the U.S. side.

Texas MLS Residential Housing Activity
Real Estate Center – Texas A&M University





Globalizing Texas
September/October 2007
Federal Reserve Bank, Dallas

⇧ A key factor in globalization has been expanding trade, which has made Texas the top exporting state. Compared with the nation, Texas exports a larger share of its output, depends on exports for more of its jobs, sends more sophisticated products overseas and employs higher-skilled workers in export-related jobs. The state has been instrumental in the surge of overall U.S. trade; its port activity has grown more than twice as fast as the nation's in the past decade. Texas, however, hasn't diversified its export markets, continuing to depend heavily on Mexico. It also hasn't done as much as the nation in penetrating some of the large, emerging markets that will grow rapidly in coming decades. Globalization has been spreading and deepening in the past decade or two. Economists are still trying to understand how the cross-border movement of goods, services, people and money is affecting national economies.

TEXAS BANKER AND BUSINESS ECONOMIC SURVEY

❖ **Survey of Banking and the Economy** – The Banker and Business Economic Survey is conducted monthly by the Texas Department of Banking and reflects the opinions of executives of state-chartered banks throughout Texas. The banker selection varies but is intended to provide a good cross-section of state-chartered banks in Texas, both in size and location. Bankers who are asked to participate in the survey are selected from rural and metropolitan markets alike, and each state-chartered bank is sent a survey once each year. The December 2007 survey includes responses from 20 bankers.

- **Local Economy -** Bankers view the local business climate as generally positive. Two bankers reported deteriorating economic conditions, while fourteen reported conditions about the same, and four reported improving conditions. However, significantly more bankers reported decreases in residential property sales than reported increases, indicating softening in the residential real estate market. Commercial real estate sales activity is about the same for 65% of the respondents but viewed as decreasing by 30%. Statewide employment appears to be relatively stable.

- **Economic Indicator Forecasts –** 95% of the respondents believe that interest rates will decline over the next six months, and almost half believe that the stock market will also decline. Though increasing fuel prices may have a positive effect on the local economies that will benefit from increased oil and gas production, other sectors of the economy where fuel prices impact production and consumer spending, like farming and tourism, may be stressed by increased prices.

- **Competition –** Bankers indicate that competition remains strong.

Rated Area	*Significantly Increasing*	*Increasing*	*About the Same or Decreasing*
Consumer Loans	5%	60%	25%
Commercial Loans	5%	65%	30%
Deposits	15%	75%	10%

- **Bank Growth Characteristics from the Fourth Quarter 2007 as compared to the Fourth Quarter 2006 –** Overall, bankers report satisfactory growth with 45% indicating an increase in total assets and 45% remaining the same. Loan growth also appears healthy with 40% reporting an increase.

- **Earnings – Fourth Quarter Versus Third Quarter 2007 –** Earning projections are slightly more pessimistic compared to the previous quarterly survey – 20% expect improving performance; 50% about the same; and 25% deteriorating. Most respondents (65%) indicate that the margin stayed about the same; and 25% reported a decrease.

- **Asset Quality Indicators -** Bankers experienced increases in nonaccrual loans, repossessed assets, and foreclosed real estate compared to the previous quarter. However, asset quality remains good with five bankers noting a decrease and only three bankers reporting an increase in credits on the internal watch list.

- **Summary -** The banking industry benefits from a stable economic environment and state banks continue to grow and post sound financial results. Bankers' primary concern continues to be competition from not only other banks, but also from credit unions and nonbank financial service providers. The deteriorating housing market is an increasing concern.

- **Bankers Note That –** Competition in the banking business remains the most significant concern of most respondents. The other concern noted by bankers this quarter is the cost of various forms of fraud. Only one banker mentioned a concern regarding a "possible recession."

FEDERAL RESERVE BANK SURVEY

- **<u>Senior Loan Officer Opinion Survey</u>** - The Federal Reserve's January 2008 survey of lending practices addresses changes in the supply of, and demand for, bank loans to businesses and households over the past three months.

  - **Lending to Businesses** – Domestic and foreign institutions reported having tightened their lending standards and terms for a broad range of loan types over the past three months. Demand for bank loans reportedly had weakened, on net, for both businesses and households over the same period.

  - **Commercial and Industrial Loan Demand -** In the January survey, one-third of domestic institutions—a larger net fraction than in the October survey—reported having tightened their lending standards on C&I loans to small as well as to large and middle-market firms over the past three months. Significant net fractions of respondents also noted that they had tightened price terms on C&I loans to all types of firms, including raising the cost of credit lines and the premiums charged on riskier loans over the survey period. About two-fifths of domestic banks—a higher net fraction than in the October survey—reported having increased spreads of loan rates over their cost of funds over the previous three months. Smaller net fractions of domestic banks also indicated that they had tightened non-price terms on C&I loans to all types of firms. Large majorities of domestic and foreign institutions that reported having tightened lending standards and terms on C&I loans over the past three months pointed to a less favorable or more uncertain economic outlook, a worsening of industry-specific problems, and a reduced tolerance for risk as reasons for their more-restrictive lending policies. Smaller but significant fractions of domestic and foreign respondents noted that a deterioration of their banks' current or expected capital or liquidity positions had contributed to the tightening of lending standards and terms over the past three months.

  - **Commercial Real Estate -** About 80% of domestic banks reported tightening their lending standards on commercial real estate loans over the past three months, a notable increase from the October survey. The net fraction of domestic banks reporting tighter lending standards on these loans was the highest since this question was introduced in 1990. About 55% of foreign banks—up from about 40% in the October survey—indicated that they had tightened their lending standards on such loans. Concerning loan demand, about 45% of both domestic and foreign respondents, on net, reported weaker demand for commercial real estate loans over the past three months.

  - **Lending to Households** - In the January survey, significant numbers of domestic respondents reported that they had tightened their lending standards on prime, nontraditional, and subprime residential mortgages over the past three months; the remaining respondents noted that their lending standards had remained basically unchanged. About 55% of domestic respondents indicated that they had tightened their lending standards on prime mortgages, up from about 40% in the October survey. Of the thirty-nine banks that originated nontraditional residential mortgage loans, about 85% reported a tightening of their lending standards on such loans over the past three months, compared with about 60% in the October survey. Finally, five of the seven banks that originated subprime mortgage loans noted that they had tightened their lending standards on such loans, a proportion similar to that in the October survey. About 60% of domestic respondents, on net, indicated that demand for prime residential mortgages had weakened over the past three months, and 70% of respondents, on net, noted weaker demand for nontraditional and subprime mortgage loans over the same period. The net fractions reporting weaker demand for each of the three types of mortgage loans increased relative to the October survey.

Deposit Growth

Deposit Growth at 10 Large Texas Banks and Thrifts			
Data as of December 31, 2007. Dollars in millions*			
Company name	City	2007 4Q total deposits	Annualized 4Q deposit growth rate
Frost National Bank	San Antonio	10,680	0.66
International Bank of Commerce	Laredo	6,057	2.38
Texas State Bank	McAllen	6,018	0.01
Prosperity Bank	El Campo	4,978	3.53
Laredo National Bank	Laredo	3,747	5.46
Sterling Bank	Houston	3,685	0.44
First National Bank	Edinburg	3,394	9.08
Bank of Texas NA	Dallas	3,260	3.24
PlainsCapital Bank	Lubbock	2,396	-5.88
Woodforest National Bank	Houston	2,259	1.64

- Deposit growth rate is determined using previous quarter's deposits. Source: Federal Financial Institutions Examination Council.

* Listed in order of total assets size.

Subprime Mortgage Lending

National

- **Subprime Mortgage Lending** - The four federal financial regulatory agencies (the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency and the Office of Thrift Supervision) issued statements encouraging institution mortgage servicers to utilize the HOPE NOW alliance's loan modification reporting standards for subprime adjustable rate residential mortgages. HOPE NOW is an alliance between counselors, mortgage market participants and mortgage servicers to create a unified, coordinated plan to reach and help as many homeowners as possible. This standard reporting format will help investors in securitization trusts, including financial institutions, monitor foreclosure prevention efforts related to subprime mortgage loans. Consistent loan modification reporting will foster transparency in the securitization market and provide standardized data across the mortgage industry. The agencies also encourage institution mortgage servicers to be responsive to other ongoing data and information requests designed to track loss mitigation efforts, including the State Foreclosure Prevention Working Group. The State Foreclosure Prevention Working Group was formed in the summer of 2007 by the offices of 37 state attorneys general and several state banking regulators to encourage solutions to the growing foreclosure crisis. *(FDIC Press Release, March 3, 2008)*

Acknowledgements

Information used throughout this report originated from the following sources:

- Administrative Office of the U.S. Courts
- American Banker, American Banker/Bond Buyer, Thomson Financial Company, New York, NY
- Associated Press, New York, NY
- BBC News, London, England
- BDCInvestor.com
- Business Roundtable, Washington, D.C.
- The Consumer Confidence Board, New York, NY
- CNNMoney.com
- Consumerist.com
- Federal Deposit Insurance Corporation, Washington, D.C.
- Federal Reserve Bank of Dallas, Dallas, TX
- Federal Reserve Bank of St. Louis, St. Louis, MO
- Federal Reserve Board, Washington D.C.
- Grubb & Ellis, Northbrook, IL
- Manpower, Inc., Milwaukee, WI
- Real Estate Center, Texas A&M University, College Station, TX
- RealtyTrac, Inc., Irvine, CA
- Reuters News Service, London, England
- Texas Department of Banking, Austin, TX
- Texas Department of Savings and Mortgage Lending, Austin, TX
- Texas Workforce Commission, Austin, TX
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- U.S. Department of Housing and Urban Development, Washington, D.C.
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- Wall Street Journal and WSJ Online, New York, NY
- Washingtontimes.com
- Sheshunoff & Co. Investment Banking, Austin, TX