Condition of the Texas State Banking System

A Report to the Finance Commission of Texas

September 30, 2009

Prepared by:
Texas Department of Banking
Texas Department of Savings and Mortgage Lending

Financial Data as of June 30, 2009

Table of Contents

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

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ECONOMIC REVIEW AND OUTLOOK
STATE BANKING SYSTEM OF TEXAS

BANKING SYSTEM OVERVIEW

Generally, financial institutions in Texas remain profitable, and have stronger asset quality and capital levels than the rest of the nation. Underwriting standards employed in the Lone Star State have been more stringent than other parts of the nation, limiting the losses experienced by the Texas banking industry. With the exception of some areas of high loan concentrations in CRE, the diversification of Texas bank loan portfolios has enabled many to weather the national economic crisis with limited affects.

While isolated markets in the Dallas/Fort Worth and Houston areas have experienced return on average assets below that of national and Texas levels, financial institutions outside those metropolitan areas appear to be performing better.

Overall, a stable and resilient economy, along with healthy profit margins continues to make Texas a desirable market for banks in and out of the state to do business. Although new charter activity is down nationally, banks selecting Texas in 2009 as their home state is comparable to last year's activity for the same period. The Federal Deposit Insurance Corporation (FDIC) recently announced that five out of the 28 new banks that opened this year chose Texas as their home state. Four of the five banks are state-chartered institutions operating in the Gulf Coast and Central Texas regions.

The current period of prolonged economic stress throughout the nation will continue to be monitored very closely by regulators and bank boards to ensure institutions are able to respond to the changing environment. The nation's housing crisis, which did not affect Texas as severely as the rest of the nation, has begun to show signs of stabilization; however, the banking industry and regulators are monitoring exposure in the CRE sector. Tenants for existing commercial space have declined and vacancies in newly completed commercial construction space may lead to increased delinquency rates around the state in the foreseeable future.

Since the recession began last year, Texas has been fortunate to have only four banks fail, two state-chartered banks, one state-chartered thrift and one federally-chartered thrift. Of the four, two failed in late 2008 and two failed in 2009. An analysis of the failures shows that two of the banks failed because of their business activities conducted outside Texas.

The general synopsis of the performance of institutions regulated by the Texas Department of Banking and the Texas Savings and Mortgage Lending Department below provides detailed information and insight into the condition of the Texas banking industry.

STATE-CHARTERED BANKS

While down, bank earnings during the last year show relative strength and stability. Key indicators associated with asset quality reflect deterioration but do not reflect serious concerns. In light of management precautions and additional loan loss reserves, Texas banks are generally strong, with asset quality better than the rest of the country.

Strong financial balance sheets have also enabled our state-chartered banks to expand their role in and out of our state's borders, presenting yet another opportunity for Texas institutions to expand their customer base. Texas state-chartered banks remain critical to the financial prosperity of Texas as they control almost 22% of the state's banking deposits.

In the second quarter, Texas banks reported profitability that surpassed the rest of the country, generating a 0.69% return on assets, compared to the national median of 0.49%. However, bank management watched their net interest margins erode 24 basis points due to a decreasing yield on their earning assets. Overall, 49% of our state-chartered banks reflect earnings gains as of June 30, 2009. The percentage of unprofitable state-chartered banks increased slightly to 15.6% as of June 30, 2009, up slightly from 14.9% in December 2008.

STATE-CHARTERED THRIFTS

State-chartered thrifts reported $531 thousand in net income year-to-date at June 30, 2009, compared to a $130 million loss a year earlier. Losses for the year-to-date period ended June 30, 2008 were contributed primarily by one institution. Excluding that one institution, year-to-date earnings would have been $7.3 million, reflecting a $6.8 million decline in earnings contrasted with the year-to-date earnings at June 30, 2009. Contributing factors decreasing earnings for the comparable periods include increased overhead expenses and provisions for loan and lease losses, despite a healthy increase in net interest income and a small gain in the sale of securities.

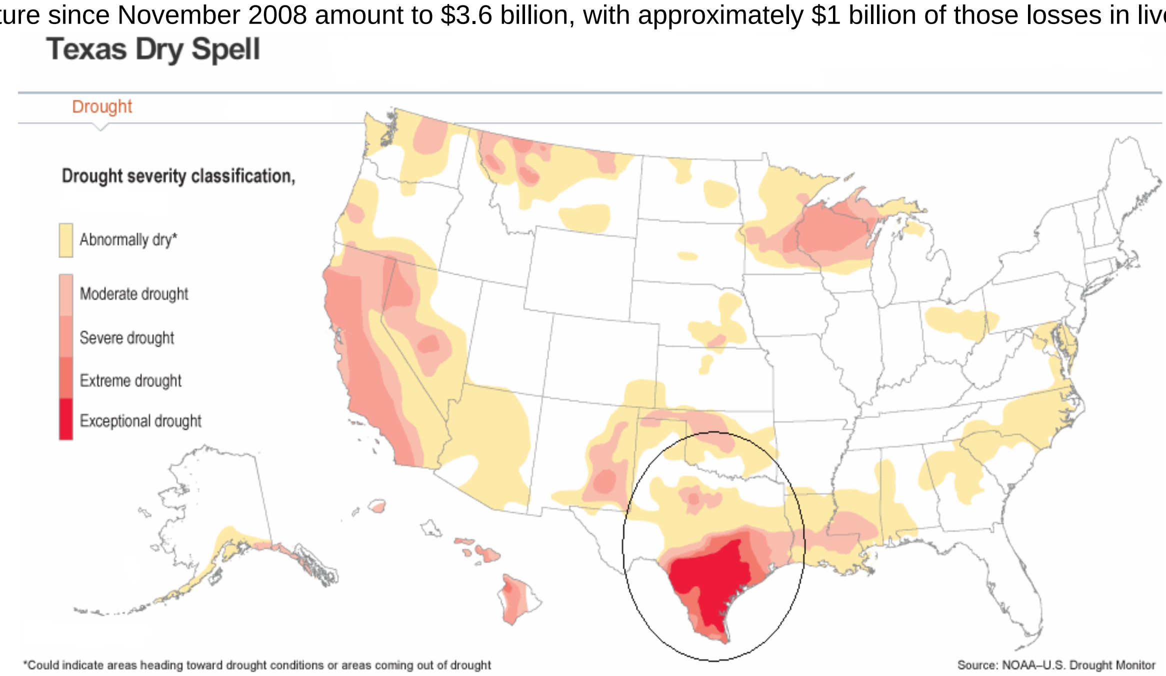
Currently, 50% of state-chartered thrifts are unprofitable, compared to 37% in June 2008. Thrift net interest margins have improved from 2.42% at June 2008 to 3.71% at June 2009.

The return on assets for thrifts at June 2009 is 0.03%, improved from a negative 2.87% at June 2008. Nonperforming and nonaccrual loans and other real estate owned to assets is 1.97% at June 2009, reduced from June 2008's 6.05%, and nonaccrual loans and leases to total loans and leases is 1.81% at June 2009, declining from 7.65% at June 2008. Noncurrent, nonaccrual, and other real estate owned continue to be closely monitored. Institutions that are engaged heavily in real estate construction and development financing are being encouraged to either limit their risk or contribute additional capital.

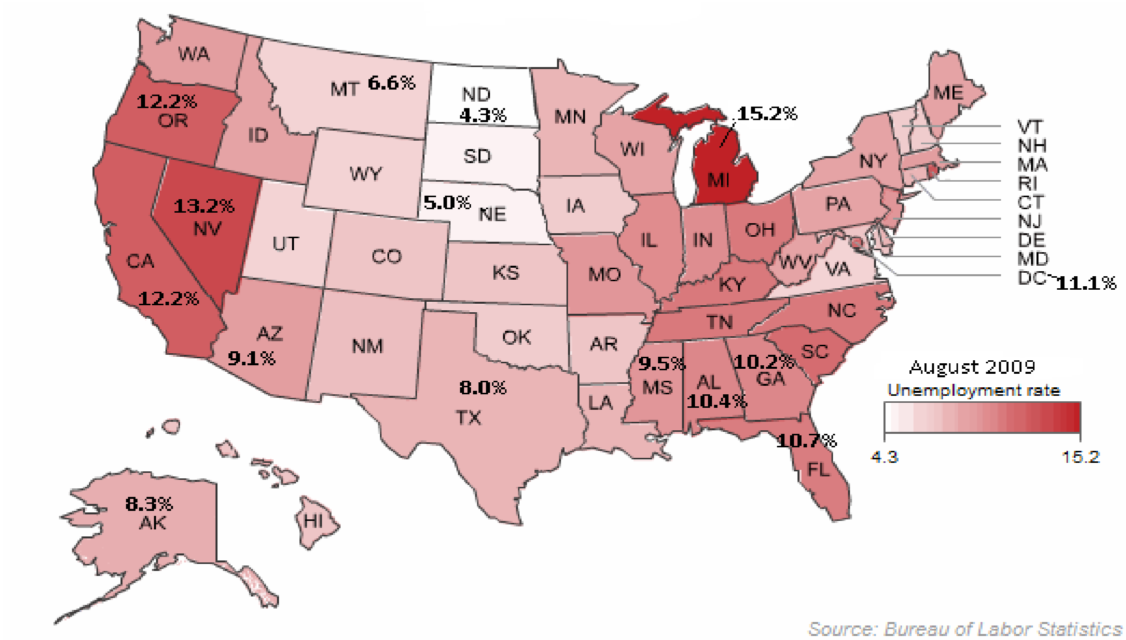
TEXAS ECONOMIC PROFILE

In spite of being in a recessionary period along with the rest of the nation, the Texas economy performed relatively better than the nation. The economic progress report recently issued by the Texas Comptroller of Public Accounts shows that the state economy contracted in 2009 and it is estimated that the state's gross state product will decrease by 1.7% for the calendar year. In comparison, the rest of the nation is estimated to shrink by 2.8%.

The Texas economy has been affected by the recession; however, it has also been impacted by the worst drought in 50 years. As of September 2009, South and Central Texas remains in a severe drought, with over 80 of Texas' 254 counties classified as in "extreme" or "exceptional" drought. This weather anomaly is impacting the Texas tourism and agricultural industries. Tourism in areas affected by the drought declined this year due to lower water levels in lakes and rivers, impacting tax revenues and businesses. Texas is the nation's top producer of cattle. Due to the drought, farmers have reported selling cattle at lower prices due to dry pastures that cannot sustain the livestock. Cotton production has also been affected, further impacting farmers in West and South Texas. In July, the Texas AgriLife Extension Service, which is linked to Texas A&M University, estimated that the losses to Texas agriculture since November 2008 amount to $3.6 billion, with approximately $1 billion of those losses in livestock.



Unemployment in the United States is reported at 9.7%. Several states, including Michigan at 15.5%, Nevada at 13.2%, and California and Oregon each at 12.2%, report unemployment levels higher than the national rate. Although the Texas unemployment rate rose to 8% in August 2009, it remains below the national level. The chart below contains select state unemployment rates as reported by the U.S. Bureau of Labor Statistics.



In the 12-month period beginning July 2008, Texas lost 222,000 jobs. In August 2009, the state lost 62,000 jobs after gaining 27,600 jobs in July, which was the first month-to-month increase since October 2008. Texas is a recipient of federal stimulus money, which has trivially aided in retaining jobs. The first quarterly report issued by the Council of Economic Advisers, who is responsible for quarterly reports to the President on the effects of the Recovery Act on overall economic activity, asserts that the federal stimulus money received by Texas saved or created 71,900 jobs.

The state has also weathered the national real estate crunch without significant impact to property values in many areas; however, sales and construction activity have slowed. Both single- and multi- family building permits declined over last year, as well as existing single-family home sales. Although these areas of the real estate market have been impacted, other aspects have been holding steady. For example, the median home value increased 0.6% between July 2008 and July 2009. Additionally, as of August 2009, the Texas foreclosure rate was one in every 838 mortgages. Comparable rates in other states include Nevada's one in 62, California's one in 144 and Florida's one in 140.

Consumer confidence throughout the nation is weak; however, Texas is again faring better only dropping 8% for the year.

STATE-CHARTERED BANKING PROFILE

The level of Texas state bank activity for first six months exceeded our projections. Four de novo charters opened including Charter Alliance Bank, Corpus Christi; Bandera First State Bank, Bandera; Houston Business Bank, Houston; and R Bank, Round Rock, Texas. Security Bank, Odessa, acquired through merger an additional $238 million in assets from the First National Bank of Monahans. On March 20, 2009, Herring Bank, Amarillo, purchased $85 million in assets of the failed Colorado National Bank, Colorado Springs, CO, from the FDIC. Two Texas bank charters were merged into out-of-state banks to facilitate their entrance into Texas. Those out-of-state banks are American Momentum Bank, Tampa, Florida, and Shinhan Bank America, New York, New York. Three state banks merged into other state banks, with no resulting decrease in assets. The net decrease of one in Texas commercial state bank charters brings the total of state banks as of June 30, 2009, to 326.

A significant increase in assets occurred in July 2009 as Texas state banks acquired the assets of failed banks from the FDIC. See the following chart.

Acquiring Bank	Failed Bank Acquired	Assets Acquired (millions)
State Bank of Texas, Irving	Millennium State Bank, Dallas, TX	$118,601
Herring Bank, Amarillo	First State Bank of Altus, Altus, OK	$90,867
United Central Bank, Garland	Mutual Bank, Harvey, IL	$1,595,657

STATE-CHARTERED THRIFT PROFILE

State-chartered thrift assets under the Savings and Mortgage Lending Department's jurisdiction totaled $4.33 billion as of June 30, 2009, increasing by $342.2 million or 8.6% from December 31, 2008's balance and declining by 52.6% or $4.81 billion from June 30, 2008's balance of $9.14 billion. The total number of state-chartered savings banks at June 30, 2009, remains at twenty-eight that being the same number of state-chartered savings banks at December 31, 2008.

Major application activities include three change of control applications: (1) Pioneer Bank, SSB by Whit H. Hanks, filed March 13, 2009, and approved April 16, 2009; (2) Colorado Valley Bank, SSB by Austin Bancshares, Inc., a Texas corporation filed June 18, 2009, pending approval; and (3) Synergy Bank, S.S.B., by James Edward Baxter, II, filed June 22, 2009 and approved September 11, 2009. Additionally, seven branch office applications were received with four applications pertaining to The Bank and Trust, s.s.b., Del Rio, for three branches in Bryan and one in College Station; one branch application by Providence Bank of Texas, SSB for a courier service branch in the Dallas/Fort Worth area; an application by the Spirit of Texas Bank, SSB for a branch in Houston; and, an application by Third Coast Bank, SSB for a branch in Beaumont. Subsequent to the quarter ended June 30, 2009, a purchase and assumption application has been filed by the Spirit of Texas Bank, SSB to purchase two Third Coast Bank, SSB branches. The total number of savings bank is projected to remain at the current level in number and in total assets. Two applications for proposed Wholesale Savings and Loan Associations have been filed: (1) by ActivoFirst Savings Association, and (2) by All Trust Savings and Loan Association. The Department continues to have discussions with other potential applicants for Wholesale Savings and Loan Association charters.

SUPERVISORY CONCERNS

Most Texas banks did not participate in the high risk lending practices that fueled the financial crisis; however, Texas banks are experiencing some the effects of the national recession. Federal Reserve Board Chairman Ben Bernanke recently stated that the recession may likely be over, however, some borrowers are still experiencing difficulties in repaying debt obligations, which in turn is resulting in higher past due and default rates. Competition for quality consumers will require Texas bankers to implement higher levels of diligence to ensure prudent lending decisions are made and sound practices followed.

Regulators are continuing to monitor the changing economic and financial conditions, especially in CRE. Although the housing market is showing signs of stabilization, the commercial market remains vulnerable. On September 15, 2009, the U.S. Treasury Department adopted rules that will make it easier to extend the maturity of potentially troubled CRE loans as part of its efforts to stem defaults. Regulators will carefully monitor the effects that declining collateral values may have on CRE exposures and assess the extent to which banking organizations have been complying with the CRE guidance.

Both the Department of Banking and the Department of Savings and Mortgage Lending continue to participate with the FDIC in targeted examinations of financial institutions with high levels of CRE in their portfolios. It is noted that deterioration in the CRE lending area has increased over the last six months. This is further supported by the Texas Department of Banking's quarterly survey of bankers, with 59% reporting decreased lending activity. We have observed a significant correlation between financial institutions that have a high concentration in CRE and those that have suffered significant asset quality problems. Prudence and caution in situations regarding concentration risk is recommended for institutions heavily engaged in real estate construction and land development financing. Bankers are encouraged to counter concentrated risk with additional capital support should economic stresses intensify in Texas. Overcoming problems in the financial sector is central to achieving economic recovery.

Another area receiving close attention is bank funding sources. Institutions are expected to match their liquidity measurement tools to their funds management strategies and ensure that the board of directors are being given a comprehensive view of the bank's liquidity risk. Examiners are assessing not only the level of liquidity sources, but also the quality of those sources. A heavy reliance on off-balance-sheet sources (lines of credit) for liquidity, versus balance sheet asset sources (unpledged securities and federal funds sold), may prompt criticism. Examiners are also reviewing the stability of the bank's deposit base. A heavy reliance on brokered deposits, out-of-territory Internet originated funds, or local deposits which were obtained through a special marketing program at high or above market rates, will be closely scrutinized. In some cases bankers may contend that a large depositor is more stable than may be evident because the deposit is related to a bank shareholder or director or is a long time customer of the bank. In this case, it may be appropriate for management to track the tenure of its deposit customer to provide support for this contention. Bank policies should address risk limits, or tolerances, that are appropriate for the complexity and risk profile of the institution.

The Texas Department of Banking and the Department of Saving and Mortgage Lending also conduct targeted examinations of banks that have significant holdings of private label collateralized mortgage obligations (PL CMO). These examinations focus on determining the adequacy of a Board's review of the bank's PL CMO and the associated risks. A Board's responsibility of adequately identifying any "credit portion" loss within the other than temporary impairment amount is also considered during the review.

Supervisory concerns not only involve the latest problem areas, they also include fraud, home equity lending, corporate governance, compliance, and bank holding company strength. Both the Texas Department of Banking and the Department of Saving and Mortgage Lending diligently monitor all these areas to ensure that any changes or disruptions receive prompt corrective action. Bank management's ability to identify, monitor and control these various risk elements significantly influences how each Department responds to these supervisory concerns.

SUPERVISORY MEASURES BEING TAKEN

The supervisory practices of the agencies 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. Each Department is sensitive to the repercussions of the economic downturn and the challenges that lie ahead. It is imperative to identify individual banks that demonstrate difficulty in the current economic situation. The number of problem financial institutions is likely to increase over the next six to twelve months as financial problems in institutions often lag behind economic instability. Problem status can sometimes be minimized and turnaround measure implemented by timely regulatory identification, oversight, and positive management response.

Some measures being taken by each agency to ensure that safe and sound banking practices are being followed are listed below:

THE DEPARTMENT OF BANKING

- Communicating and coordinating on a frequent basis with other state and federal regulators;
- Monthly calls to state banks to obtain industry input on prevailing economic conditions;
- Conducting targeted reviews of high risk area, such as CRE and exposure to the devaluation of private-label collateralized mortgage obligations; asset concentrations, liquidity, and funding sources;
- Expanded off-site monitoring to include areas of greatest concerns;
- Developing a more defined risk-focused examination process to free up resources;
- Internal monitoring of state, national, and world political and economic events impacting the industry such as federal programs designed to stabilize the financial markets; and
- Increasing internal communication for examiner awareness of issues.

THE DEPARTMENT OF SAVINGS AND MORTGAGE LENDING

- 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;

- Off-site 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);
- Joint review by the FDIC and the Department of savings bank's contingency/disaster recovery plans;
- Regular assessments of each institution's activities, strengths and weaknesses, and revising the Department's plan of examination and monitoring for the institution, including the downgrading of institutions, if deemed necessary by the Department and the FDIC;
- Monitoring increased foreclosure activity and changes in the housing market;
- Working with various community groups on foreclosure prevention and education;
- Reviewing concentrations in CRE and monitor with Commercial Real Estate Lending Joint Guidance, issued December 12, 2006;
- Monitoring of any state savings banks' participation in the U.S. Treasury's Troubled Asset Relief Program and Capital Purchase Program, and the FDIC's Temporary Liquidity Guarantee Program, and other effects of the Emergency Economic Stabilization Act of 2008, and proposals for increased FDIC assessments.

Performance Summary and Profile
Texas Banking System

State-Chartered Banks

Overall, state-chartered banks continue to perform satisfactorily considering the sustained economic problems in key sectors of the Texas and global economy. Capital levels are favorable and remain stable. State-chartered banks report stable core capital protection from a year ago, which continues to exceed the minimum regulatory standards. State-chartered banks reflect a leverage capital ratio of 9% compared to 9.02% a year ago. The national average as of June 30, 2009 is 8.15%. Considering the economic environment over the last 18 months, this position is holding up relatively well.

As of June 30, 2009, Texas banks reported profitability that surpassed the rest of the country, generating a 0.69% return on assets (ROA), compared to the national median of 0.49%. However, net interest margins eroded 24 basis points due to a decreasing yield on earning assets. Overall, 49% of our state-chartered banks reflect earnings gains over the prior year. Conversely, 15.6% of the banks ended the year unprofitable, which is up slightly from 14.9% last year.

As expected, net charge-offs increased during the last 12 months. Bank charge-offs increased to 1.09% of total loans from 0.53% a year ago. This compares favorably to the nationwide average of 2.32%. State-chartered banks appear to have adequate reserves to absorb potential losses as their loss allowance to loan account is now at 1.5%.

In spite of weaknesses in the Texas economy, state banks maintain a sound asset structure to date with only slight deterioration noted in some key ratios over last year. Noncurrent loans—those 90 days or more past due, plus those no longer accruing interest—continued to increase for banks to 2.11% from 1.30%. In conjunction, noncurrent assets plus other real estate owned to total assets has increased 52 basis points to 1.69%. While the rest of the nation was experiencing negative residential loan growth, Texas numbers reflect loan growth of 46.2% and 16.7% in multifamily residential and 1-4 family real estate loans respectively from June 2008 to June 2009.

Total assets for Texas state-chartered banks are $163.2 billion, up $9.3 billion over last year. This growth occurred despite a reduction by two in the total number of institutions. The reduction is primarily due to merger activity and one state-chartered commercial bank failure which occurred in late 2008. In addition, total state asset volume is elevated through branches of out-of-state, state-chartered banks, which also grew by $28.2 billion to now total $50.5 billion in assets during the same period. Based upon available FDIC information, total assets of banks operating in Texas, both state and federal charters, is $504.4 billion.

State-Chartered Thrifts

As of June 30, 2009, state thrifts earned $531,000 year-to-date as compared to earnings of $7.7 million year-end December 31, 2008. Total assets, during the same period increased $342 million or 8.6%. As of June 30, 2009, ROA for thrifts declined to 0.03%, down from 0.21% at year-end 2008. This was primarily from increased noninterest expenses and provisions for loan and lease losses.

The level of unprofitable thrifts increased slightly from 46.4% at December 31, 2008 to 50% at June 30, 2009. Nearly 29% of state thrifts are newly chartered, reorganized or converted which further influences the profitability ratio. Thrifts posted a 12 basis point decline in net interest margin, since December 31, 2008, to 3.71% at June 2009. Provisions for loan and lease losses to average assets increased from 0.48% to 0.59%, and total noninterest expenses increased from 3.18% to 3.33% from December 31, 2008 to June 30' 2009. Non-interest income to assets increased slightly from 0.48% to 0.52%, while gains on securities to total assets increased from negative 0.09% to 0.09% during the same respective time period. Net charge-offs to total assets increased from December 2008's 0.23% to 0.27% at June 30, 2009.

State thrift's core capital totaled 10.10%, declining by 54 basis points from the December 2008 level, due to the continued asset expansion activity of de novo savings banks. Thrifts also continue to exceed the national core capital ratios for all savings institutions, that was 9.11% for the year-to-date ending June 30, 2009.

Year-to-date provisions to the allowance for loan and lease losses increased for thrifts. Provisions were $12.2 million, up from the $9.1 million contributed during the six month period ending December 31, 2008, and the $8 million for the period ending June 2008. Thrift allowances for loan and lease losses to noncurrent loans and leases increased to 69.32% from 48.21% at December 2008.

Overall, asset quality remains satisfactory, although the volume of other real estate increased and the volume of loans 90 days past due and on nonaccrual declined. Thrifts' noncurrent loans plus other real estate owed to total assets ratio decreased 7 basis points to a total of 1.97% at June 2009. Additionally, thrifts experienced a decrease in noncurrent loans to total loans from 2.36% at year-end December 2008 to 1.81% at June 2009.

Thrift net charge-offs were $5.6 million, for the six months ended June 2009, compared to the previous six month period of $5.7 million and year-end December 31, 2008 net charge-offs of $8.1 million. Thrift net charge-offs for the current quarter are primarily (70%) related to construction and land development loans. Loss reserves to gross loans are presently adequate for thrifts given the present asset size and structure, currently representing 1.26%, an increase of 16 basis points since December 2008. This is in-line with the nationwide ratio of 1.19% for all FDIC regulated savings banks. A review of loan loss reserves adequacy will continue to be closely monitored.

Number of Institutions and Total Assets

	6-30-2009* No. of Institutions	6-30-2009* Assets	6-30-2008 No. of Institutions	6-30-2008 Assets	Difference No. of Institutions	Difference Assets
Texas State-Chartered Banks	326	$163.2	328	$153.9	-2	+$9.3
Texas State-Chartered Thrifts	28	$4.3	27	$9.1	+1	-$4.8
	354	$167.5	355	$163.0	-1	+$4.5
Other states' state-chartered:						
Banks operating in Texas*	23	$50.5	20	$22.3	+3	+$28.2
Thrifts operating in Texas*	0	0	0	0	0	0
	23	$50.5	20	$22.3	+3	+$28.2
Total State Chartered Activity	377	$218.0	375	$185.3	+2	+$32.7
National Banks Chartered in Texas	264	$109.0	272	$104.3	-8	+$4.7
Federal Thrifts Chartered in Texas	22	$85.7	22	$84.5	0	+$1.2
	286	$194.7	294	$188.8	-8	+$5.9
Other states' federally-chartered:						
Banks operating in Texas*	21	$181.7	20	$164.1	+1	+$17.6
Thrifts operating in Texas*	11	$73.6	12	$75.0	-1	-$1.4
	32	$255.3	32	$239.1	0	+$16.2
Total Federally-Chartered Activity	318	$450.0	326	$427.9	-8	+$22.1
Total Banking/Thrift Activity	695	$668.0	701	$613.2	-6	+$54.8

Assets in Billions
**Indicates estimates based on available FDIC information through 8-31-09*

Ratio Analysis

As of June 30, 2009

	State-Chartered Banks	Texas National Banks	All Texas Banks	State-Chartered Thrifts	Texas Federal Thrifts	All Texas Thrifts
Number of Banks------------------------→	*326*	*264*	*590*	*28*	*22*	*50*
% of Unprofitable Institutions	15.64%	10.23%	13.22%	50.00%	31.82%	42.00%
% of Institutions with Earnings Gains	49.08%	39.39%	44.75%	57.14%	59.09%	58.00%
Yield on Earning Assets	4.75%	5.26%	4.95%	5.89%	4.15%	4.22%
Net Interest Margin	3.42%	3.92%	3.62%	3.71%	2.47%	2.53%
Return on Assets	0.66%	-0.58%	0.17%	0.03%	-3.97%	-3.79%
Return on Equity	6.59%	-5.31%	1.59%	0.24%	-59.46%	-55.23%
Net Charge-offs to Loans	1.09%	0.56%	0.88%	0.42%	1.49%	1.43%
Earnings Coverage of Net Loan C/Os	2.08	0.99	1.81	2.21	1.65	1.66
Loss Allowance to Loans	1.50%	1.67%	1.57%	1.26%	2.29%	2.23%
Loss Allowance to Noncurrent Loans	71.24%	92.30%	78.81%	69.82%	60.65%	60.89%
Noncurrent Assets+OREO to Assets	1.69%	1.58%	1.64%	1.97%	2.40%	2.38%
Net Loans and Leases to Core Deps	113.17%	98.57%	106.90%	107.97%	109.23%	109.16%
Equity Capital to Assets	10.14%	10.96%	10.47%	10.51%	6.45%	6.64%
Core Capital (Leverage) Ratio	9.00%	8.99%	9.00%	10.10%	6.14%	6.33%

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 June 30, 2009

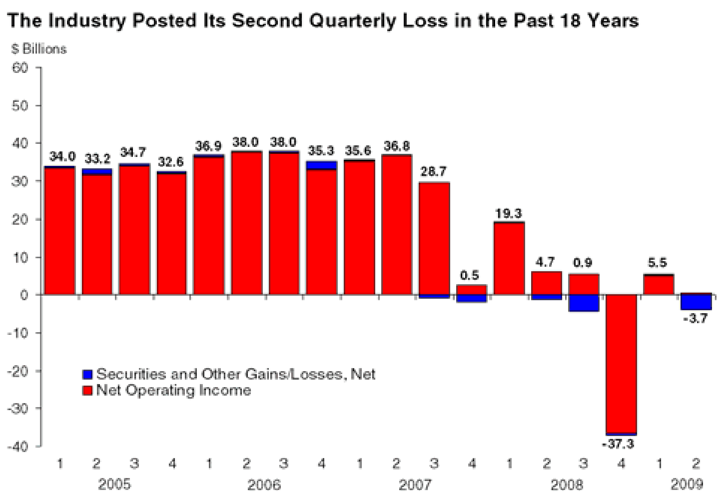
	State Banks*		State Thrifts	
	End of Period	% of Total Assets	End of Period	% of Total Assets
Number of Institutions	326		28	
Number of Employees (full-time equivalent)	35,827		1,055	
(In millions)				
Total Assets	$163,230		$4,330	
Net Loans and Leases	$104,812	64.21%	$2,774	64.05%
Loan Loss Allowance	$1,600	0.98%	$35	0.82%
Other Real Estate Owned	$500	0.31%	$35	0.80%
Goodwill and Other Intangibles	$2,202	1.35%	$190	0.45%
Total Deposits	$120,802	74.01%	$3,518	81.25%
Federal Funds Purchased and Repurchase Agreements	$4,914	3.01%	$7	0.15%
Other Borrowed Funds	$16,269	9.97%	$327	7.54%
Equity Capital	$16,545	10.14%	$455	10.51%
Memoranda:				
Noncurrent Loans and Leases	$2,247	1.38%	$51	1.17%
Earning Assets	$147,827	90.56%	$3,982	91.97%
Long-term Assets (5+ years)	$31,896	19.54%	$1,210	27.93%
	Year-to Date	% of Avg. Assets	Year-to Date	% of Avg. Assets
Total Interest Income	$3,552	4.30%	$113	5.41%
Total Interest Expense	$992	1.20%	$42	2.00%
Net Interest Income	$2,560	3.10%	$71	3.41%
Provision for Loan and Lease Losses	$745	0.90%	$12	0.59%
Total Noninterest Income	$1,047	1.27%	$11	0.52%
Total Noninterest Expense	$2,388	2.90%	$69	3.33%
Securities Gains	$185	0.22%	$2	0.09%
Net Income	$541	0.66%	$1	0.03%
Memoranda:				
Net Loan Charge-offs	$585	0.71%	$6	0.27%
Cash Dividends	$363	0.44%	$4	0.21%

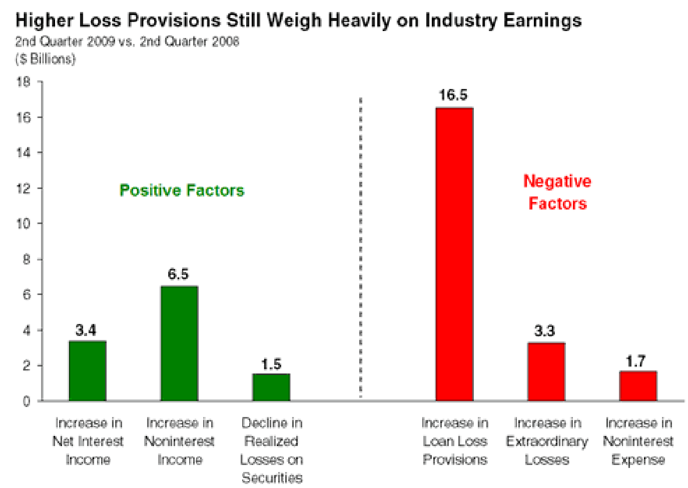
* *Excludes branches of state-chartered banks of other states doing business in Texas. As of 8-31-09 an estimate is twenty three institutions with $50.5 billion in assets. No branches of state-chartered thrifts of other states conducted business in Texas as of 6-30-09.*

PERFORMANCE SUMMARY
UNITED STATES BANKING SYSTEM

Quarterly Banking Profile – National Level
Second Quarter 2009
Federal Deposit Insurance Corporation

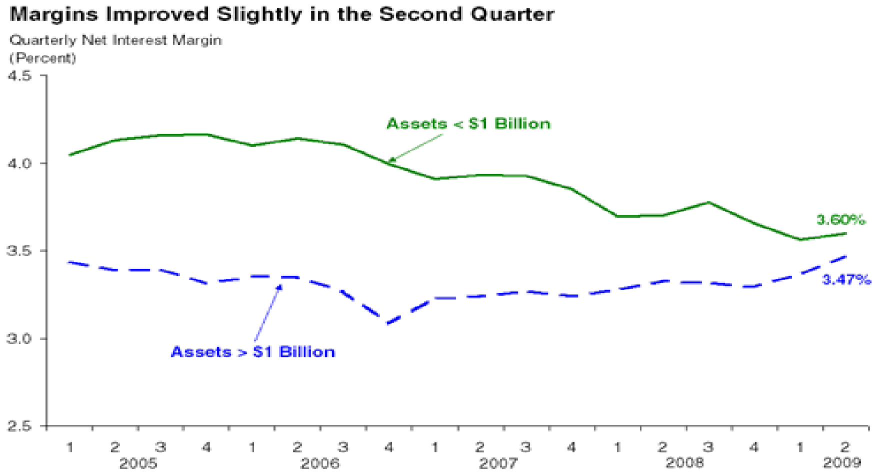
⇩ **Earnings Performance -** Burdened by costs associated with rising levels of troubled loans and falling asset values, FDIC-insured commercial banks and savings institutions reported an aggregate net loss of $3.7 billion in the second quarter of 2009. Increased expenses for bad loans were chiefly responsible for the industry's loss. Insured institutions added $66.9 billion in loan-loss provisions to their reserves during the quarter, an increase of $16.5 billion (32.8 percent) compared to the second quarter of 2008. Quarterly earnings were also adversely affected by writedowns of asset-backed commercial paper, and by higher assessments for deposit insurance. Almost two out of every three institutions (64.4 percent) reported lower quarterly earnings than a year ago, and more than one in four (28.3 percent) reported a net loss for the quarter. A year ago, the industry reported a quarterly profit of $4.7 billion, and fewer than one in five institutions (18 percent) were unprofitable. The average return on assets (ROA) was -0.11 percent, compared to 0.14 percent in the second quarter of 2008.





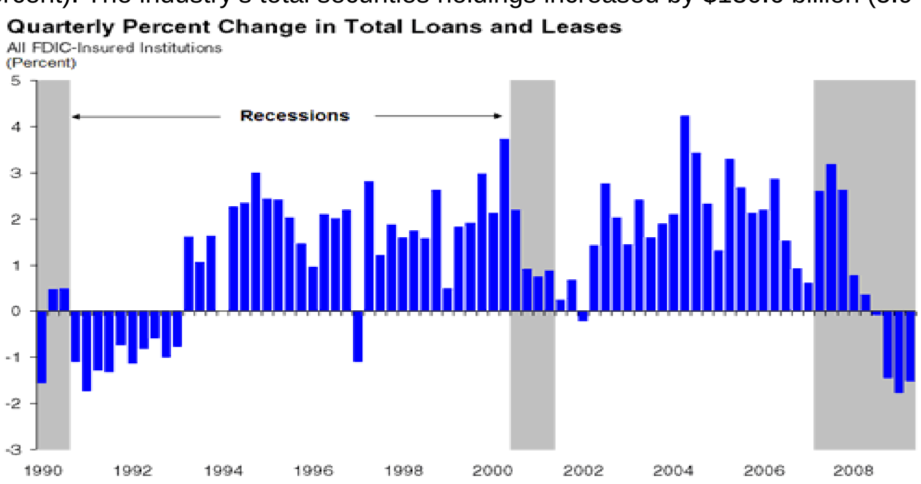
⇳ **Noninterest Income and Expense -** In addition to the $16.5-billion increase in loss provisions, the industry reported a $3.3 billion increase in extraordinary losses and a $1.7 billion (1.7 percent) year-over-year increase in noninterest expenses. The extraordinary losses stemmed from asset-backed commercial paper writedowns, while the increased noninterest expenses primarily reflected higher deposit insurance assessments. These negative factors were partially offset by higher noninterest income (up $6.5 billion, or 10.6 percent), increased net interest income (up $3.4 billion, or 3.5 percent), and a $1.5-billion reduction in realized losses on securities and other assets. Gains on asset sales (up $4.5 billion), increased trading revenue (up $4.5 billion), and higher servicing fees (up $3.6 billion) were the largest contributors to the year-over-year improvement in noninterest income.

⇧ **Net Interest Margins -** Average net interest margins (NIMs) improved slightly from first quarter levels, as average funding costs fell more rapidly than average asset yields. The average margin increased to 3.48 percent from 3.39 percent in the first quarter and 3.37 percent in the second quarter of 2008. The consecutive-quarter improvement was relatively broad-based: more than half (56.5 percent) of all institutions reported higher NIMs than in the first quarter. However, the year-over-year improvement was concentrated among larger institutions. Only 45.3 percent of insured institutions reported year-over-year NIM improvement. Despite the widening in margins, net interest Income growth has been limited by recent shrinkage in earning asset portfolios. Interest-earning assets declined by $149.6 billion during the second quarter, following a $163.7 billion decline in the first quarter. In the 12 months ended June 30, the industry's earning assets increased by only $18.3 billion (0.2 percent).

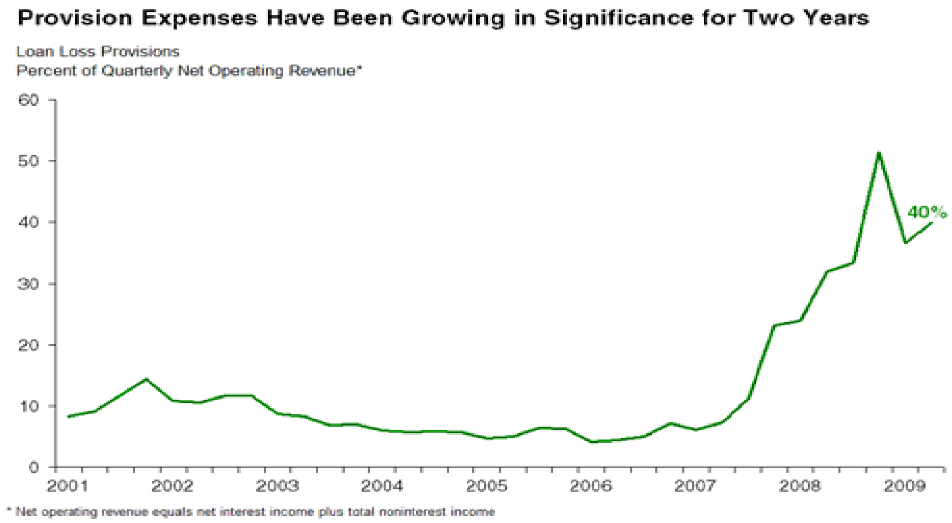


⇧ **[Overall Capital Levels Register Improvement]** - Equity capital increased by $32.5 billion (2.4 percent), raising the industry's equity-to-assets ratio from 10.13 percent to 10.56 percent, the highest level since March 31, 2007. Average regulatory capital ratios increased as well. The leverage capital ratio increased from 8.02 percent to 8.25 percent, while the total risk-based capital ratio rose from 13.42 percent to 13.76 percent. However, fewer than half of all institutions reported increases in their regulatory capital ratios. Only 43.2 percent reported increased leverage capital ratios, and 47.0 percent had increased total risk-based capital ratios. Insured institutions paid $6.2 billion in dividends in the quarter, about two-thirds less than the $17.7 billion in dividends paid in the second quarter of 2008.

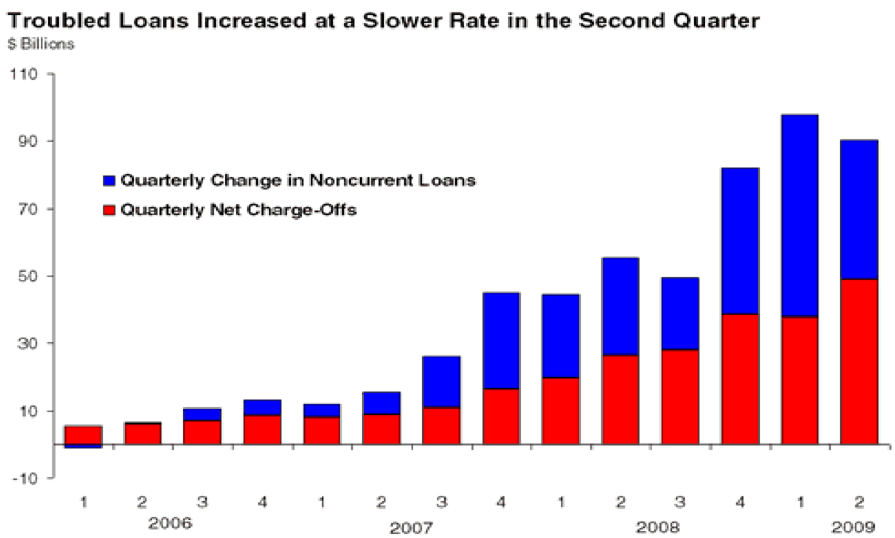
⇩ **Industry Assets Decline for a Second Consecutive Quarter** - Total assets declined by $238.1 billion (1.8 percent), following a $303.2-billion decline in the first quarter. Loans and leases accounted for more than half of the decline ($125.5 billion, or 52.7 percent of the total), while the industry's balances at Federal Reserve banks fell by $99.4 billion (a 20.4 percent decline). As was the case in the first quarter, much of the decline in industry assets was concentrated at a few large institutions. More than 57 percent of institutions increased their assets during the second quarter, and a similar majority increased their loan balances. Among the loan categories registering the largest declines during the quarter were C&I loans (down $67.7 billion, or 4.7 percent), 1-4 family residential mortgage loans (down $33.2 billion, or 1.6 percent), and real estate construction and development loans (down $31.0 billion, or 5.5 percent). Assets in trading accounts declined by $65.5 billion (7.9 percent). The industry's total securities holdings increased by $130.6 billion (5.9 percent).



⇩ **Provisions for Loan Losses** –Insured banks and thrifts set aside $69.3 billion in provisions for loan and lease losses during the fourth quarter, more than twice the $32.1 billion that they set aside in the fourth quarter of 2007. Loss provisions represented 50.2 percent of the industry's net operating revenue (net interest income plus total noninterest income), the highest proportion since the second quarter of 1987 when provisions absorbed 53.2 percent of net operating revenue.

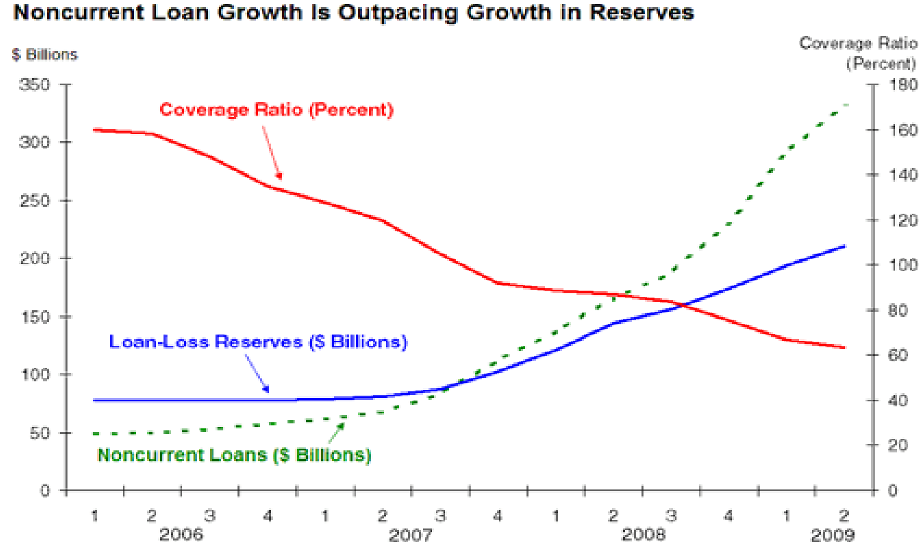


⇩ **Net Charge-Offs** - Net charge-offs continued to rise, propelling the quarterly net charge-off rate to a record high. Insured institutions charged-off $48.9 billion in the second quarter, compared to $26.4 billion a year earlier. The annualized net charge-off rate in the second quarter was 2.55 percent, eclipsing the previous quarterly record of 1.95 percent reached in the fourth quarter of 2008. The $22.5 billion (85.3 percent) year-over-year increase in net charge-offs was led by loans to commercial and industrial (C&I) borrowers, which increased by $5.3 billion (165.0 percent). Net charge-offs of credit card loans were $4.6 billion (84.5 percent) higher than a year earlier, and the annualized net charge-off rate on credit card loans reached a record 9.95 percent in the second quarter. Net charge-offs of real estate construction and development loans were up by $4.2 billion (117.0 percent), and charge-offs of loans secured by 1-4 family residential properties were $4.0 billion (41.1 percent) higher than a year ago.



⇩ **Noncurrent Loans** - The amount of loans and leases that were noncurrent (90 days or more past due or in nonaccrual status) increased for the 13th consecutive quarter, and the percentage of total loans and leases that were noncurrent reached a new record. Noncurrent loans and leases increased by $41.4 billion (14.3 percent) during the second quarter, led by 1-4 family residential mortgages (up $15.4 billion, or 12.7 percent), real estate construction and development loans (up $10.2 billion, or 16.6 percent), and loans secured by nonfarm nonresidential real estate properties (up $7.1 billion, or 29.2 percent). Noncurrent home equity loans and junior lien mortgages fell for the first time in three years, declining by $1.7 billion and $1.5 billion, respectively. Noncurrent levels rose in all other major loan categories. Although the increase in total noncurrent loans was almost one-third smaller than the $59.7 billion increase in the first quarter, the average noncurrent rate on all loans and leases rose from 3.76 percent to 4.35 percent. This is the highest level for the noncurrent rate in the 26 years that insured institutions have reported noncurrent loan data. On a more positive note, loans that were 30-89 days past due declined by $16.7 billion (10.6 percent). This is the largest quarterly decline in dollar terms in the 26 years that these data have been reported, and the largest percentage decline since the first quarter of 2004, when 30-89 day past due loans were one-third the current level. The decline in past due loans occurred across all major loan categories, but real estate loans accounted for 83.5 percent ($13.9 billion) of the total improvement. Restructured loans and leases that were in compliance with their modified terms increased by $13.7 billion (41.6 percent) at commercial and savings banks that file Call reports, as restructured 1-4 family residential real estate loans rose by $10.2 billion (55.4 percent).

Noncurrent Loan Growth Is Outpacing Growth in Reserves

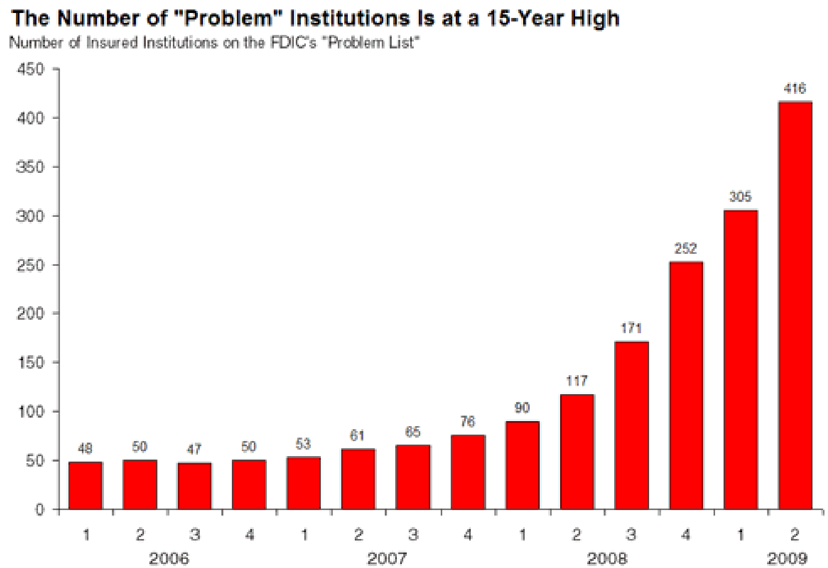


⇩ **Institutions Continue to Add to Reserves** - The industry's reserves for loan losses increased by $16.8 billion (8.6 percent) during the second quarter, as loss provisions of $66.9 billion exceeded net charge-offs of $48.9 billion. The ratio of reserves to total loans and leases set another new record, rising from 2.51 percent to 2.77 percent. However, the pace of reserve building fell short of the rise in noncurrent loans, and the industry's ratio of reserves to noncurrent loans fell from 66.8 percent to 63.5 percent, the lowest level since the third quarter of 1991.

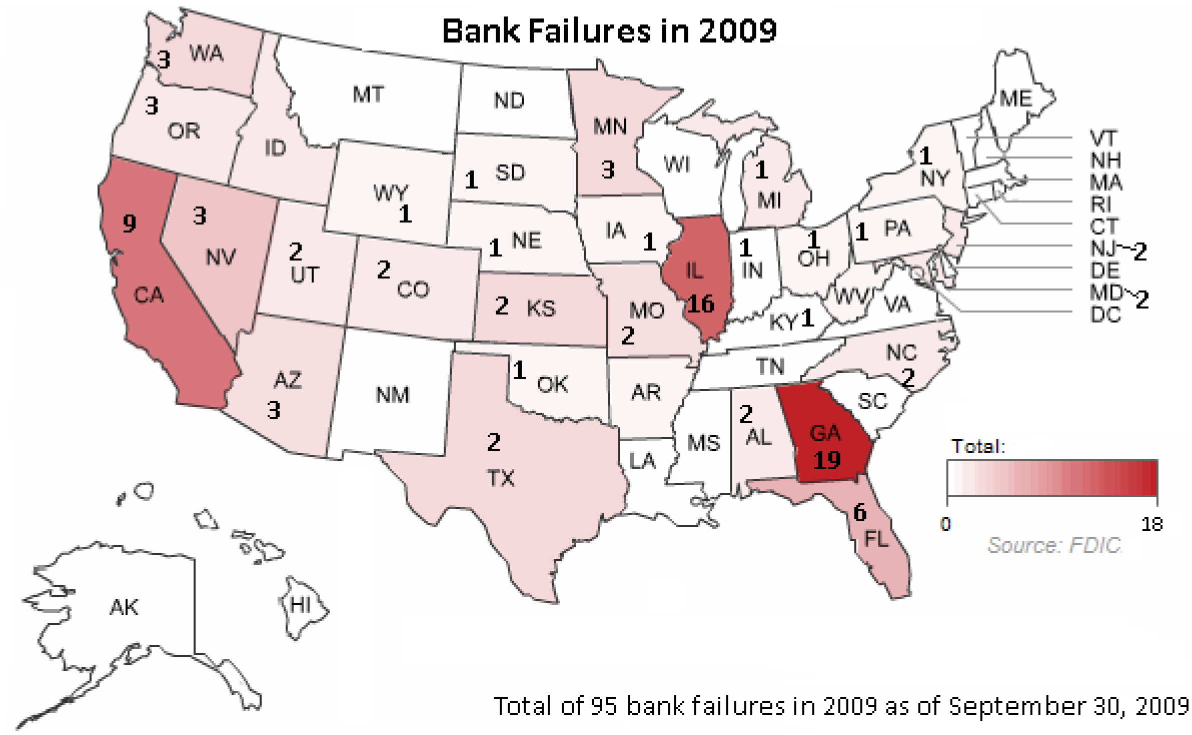
⇳ **Small Business Loan Balances Declined Over the Past 12 Months** - Annual data on loans to small businesses and farms indicate that the industry's balances of these loans experienced shrinkage during the twelve months ended June 30 while loans to larger borrowers had a slight increase. Small commercial and industrial, agricultural, and nonresidential real estate loans declined by $14.8 billion (1.9 percent) between June 30, 2008 and June 30, 2009, compared to an increase of $2.2 billion (0.1 percent) in larger business and farm loans.

⇧ **Institutions Reduce Their Reliance on Nondeposit Funding Sources** - In contrast to the decline in industry assets, total deposits of insured institutions increased by $66.7 billion (0.7 percent). Deposits in foreign offices accounted for more than three quarters ($51.0 billion, or 76.5 percent) of the increase in deposits. Domestic office deposits increased by only $15.7 billion (0.2 percent), as deposits in large denomination in excess of $250,000 noninterest-bearing transaction accounts increased by $42.0 billion (4.9 percent), and deposits in interest-bearing accounts fell by $16.9 billion. Nondeposit liabilities declined by $337.3 billion (10.6 percent), as trading liabilities fell by $85.0 billion (23.7 percent), and FHLB advances dropped by $62.2 billion (8.9 percent). At the end of June, deposits funded 67.8 percent of the industry's assets, the highest proportion since March 1998.

⇩ **"Problem Institutions" Expands to 15-Year High** - The number of insured commercial banks and savings institutions reporting financial results fell to 8,195 in the quarter, down from 8,247 reporters in the first quarter. Thirty-nine institutions were merged into other institutions during the quarter, twenty-four institutions failed, and there were twelve new charters added. During the quarter, the number of institutions on the FDIC's "Problem List" (risk rated "4" or "5") increased from 305 to 416, and the combined assets of "problem" institutions rose from $220.0 billion to $299.8 billion. This is the largest number of "problem" institutions since June 30, 1994, and the largest amount of assets on the list since December 31, 1993.



Bank and Thrift Closures Nationwide
Federal Deposit Insurance Corporation



Texas Failures in 2009	**Charter**	**Date Closed**	**Total Assets**
Guaranty Bank, Austin, TX	Federal Thrift	08-21-09	$13.5 Billion
Millennium State Bank of Texas, Dallas, TX	State Bank	07-02-09	$118.6 Million

Texas Failures in 2008	**Charter**	**Date Closed**	**Total Assets**
Sanderson State Bank, Sanderson, TX	State Bank	12-12-08	$38.2 Million
Franklin Bank, SSB, Houston, TX	State Thrift	11-07-08	$5.1 Billion

Stock Performance
Southwest Regional Banks

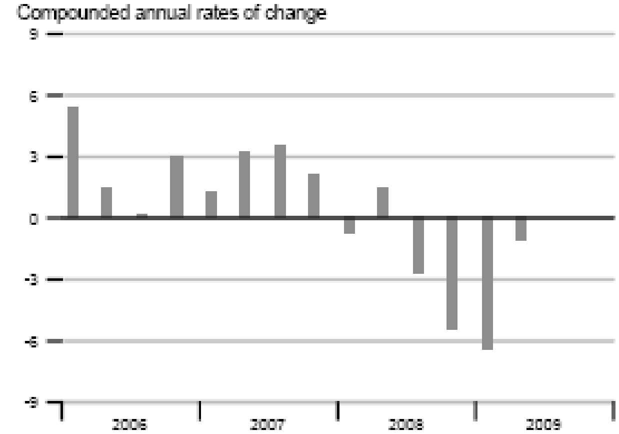
Name	Last Trade		52 Wk Range		PE	EPS	Mkt Cap	Div/Shr	Div Yld
Bancfirst Corporation	09/11	**25.88**	0.00	26.00	N/A	N/A	N/A	N/A	N/A
Banco Bilbao Vizcaya Argentaria	09/14	**17.94**	5.68	18.34	N/A	N/A	67.13B	0.50	2.80%
Bok Financial Corporation	09/14	**45.15**	22.53	60.20	15.29	2.95	3.06B	0.96	2.10%
Cass Information Sys Inc	09/14	**30.67**	23.20	39.15	15.94	1.92	283.02M	0.52	1.70%
Cobiz Incorporated	09/14	**4.49**	4.00	15.20	N/A	-2.99	162.22M	0.04	0.90%
Comerica Inc.	09/14	**27.60**	11.72	42.00	N/A	-0.06	4.17B	0.20	0.70%
Community Shores Bank Corp	09/14	**1.75**	1.16	5.97	N/A	-1.82	2.57M	N/A	N/A
Cullen Frost Bkrs Incorporated	09/14	**48.68**	35.40	73.00	15.65	3.11	2.91B	1.72	3.60%
Enterprise Fin Serv Corp	09/14	**11.18**	7.44	24.00	N/A	-4.24	143.47M	0.21	1.90%
First Comnty Corp S C	09/14	**5.77**	5.05	11.17	N/A	-1.20	18.71M	0.16	2.90%
First Federal Bankshares Inc	09/04	**0.6501**	0.00	6.39	N/A	-5.749	2.15M	N/A	N/A
First Financial Bankshares	09/14	**48.83**	36.49	67.00	18.96	2.58	1.02B	1.36	2.80%
First ST Bancorporation	09/14	**1.13**	0.60	8.67	N/A	-3.42	23.30M	N/A	N/A
Firstcity Finl Corp	09/14	**7.91**	0.88	8.75	N/A	-2.84	77.76M	N/A	N/A
Franklin Bank Corporation	11/07	**1.50**	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Great Southn Bancorp Inc	09/14	**22.62**	7.03	22.96	12.33	1.83	302.77M	0.72	3.20%
Guaranty Fed Bancshares Inc	09/14	**5.35**	3.29	14.63	N/A	-2.36	14.04M	N/A	N/A
Heartland Financial USA Inc	09/14	**15.56**	8.50	27.14	30.39	0.51	253.77M	0.40	2.60%
International Bancs Cor	09/14	**15.67**	6.55	35.80	8.42	1.86	1.07B	0.34	2.20%
Landmark Bancorp Inc	09/09	**15.80**	0.00	20.50	9.56	1.65	37.46M	0.76	4.80%
Liberty Bancorp Inc	09/09	**7.50**	0.00	9.00	13.39	0.56	27.16M	0.10	1.30%
Mackinac Finl Corp	09/11	**4.50**	0.00	8.00	29.77	0.151	15.37M	N/A	N/A
Metrocorp Bancshares Inc	09/14	**3.63**	2.29	13.38	N/A	-0.42	39.66M	N/A	N/A
MidWest One Finl Group Inc	09/14	**9.00**	5.90	14.90	N/A	-3.27	77.44M	0.20	2.20%
Osage Bancshares Inc	09/10	**7.70**	0.00	10.25	N/A	-0.89	21.43M	0.34	4.40%
Prosperity Bancs Inc	09/14	**33.49**	20.04	46.48	17.17	1.95	1.54B	0.55	1.60%
QCR Holdings Inc	09/14	**9.79**	7.12	16.20	53.21	0.18	44.51M	0.08	0.80%
Sterling Bancshares Inc	09/14	**7.61**	4.30	14.01	33.52	0.23	621.69M	0.22	2.90%
Team Financial Inc	09/01	**0.0010**	N/A	N/A	N/A	-6.352	0.00	N/A	N/A
Tex Capital Bancs Inc	09/14	**15.99**	6.55	22.00	27.81	0.57	570.80M	N/A	N/A
Tierone Corporation	09/14	**3.74**	1.13	6.18	N/A	-1.63	67.45M	N/A	N.A
UMB Financial Corporation	09/14	**39.72**	33.65	69.60	19.44	2.04	1.61B	0.70	1.80%
West Bancorp Incorporated	09/14	**4.96**	4.36	16.21	N/A	-1.08	86.32M	N/A	N/A
Zions Bancorp	09/14	**16.36**	5.90	54.90	N/A	-12.00	2.07B	0.04	0.30%

Source: Yahoo Finance (September 2009)
NA – Indicates information was not available.

National Economic Trends

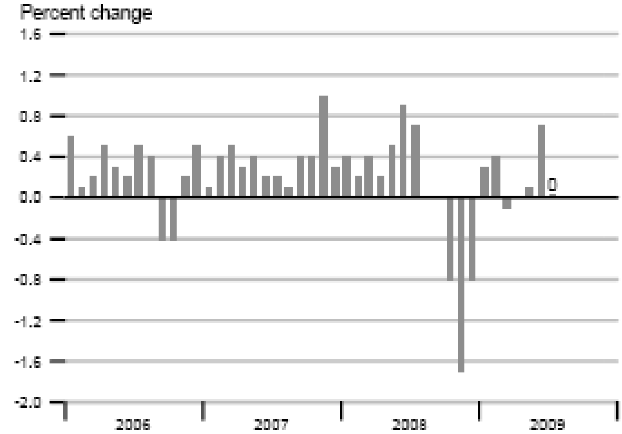
Real GDP Growth

Compounded annual rates of change



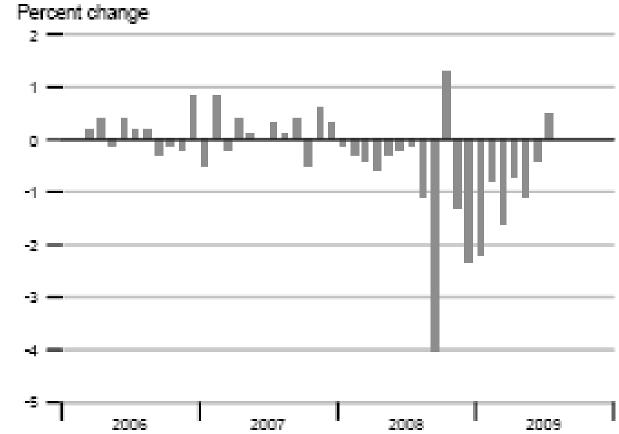
Consumer Price Index

Percent change



Industrial Production

Percent change

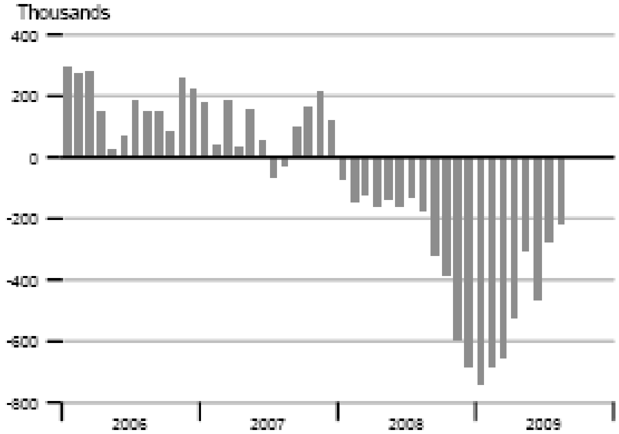


Interest Rates

Percent

Change in Nonfarm Payrolls

Thousands



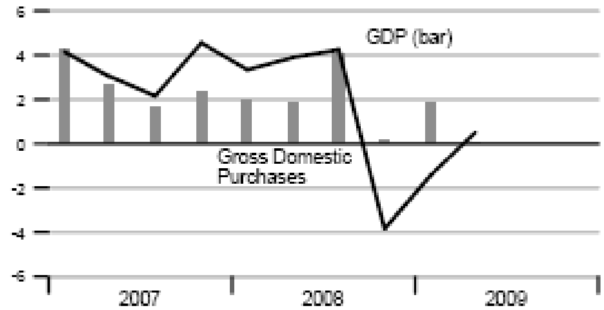
Unemployment Rate

Percent of labor force

Provided by the Federal Reserve Bank of St. Louis, National Economic Trends. Updated September 4, 2009.

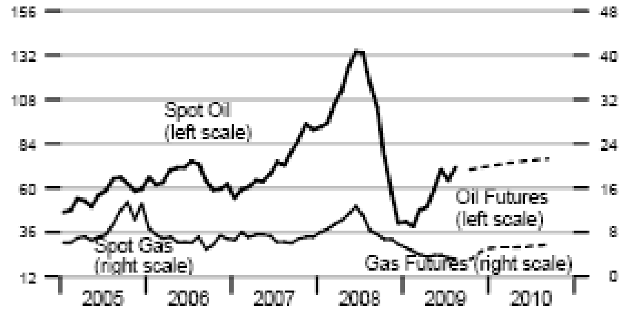
NIPA Chain Price Indexes

Compounded annual rates of change



Oil & Natural Gas Prices: Spot & Futures

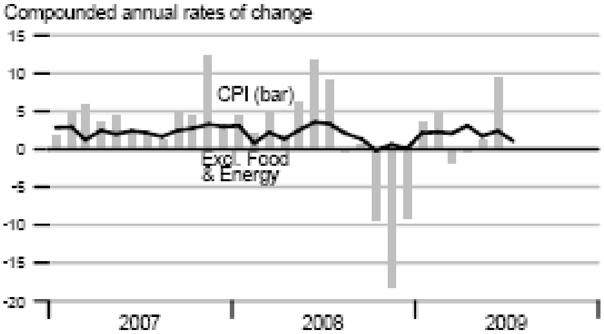
Dollars per barrel | Dollars per million btu



Note: Futures prices as of 8/31/2009.

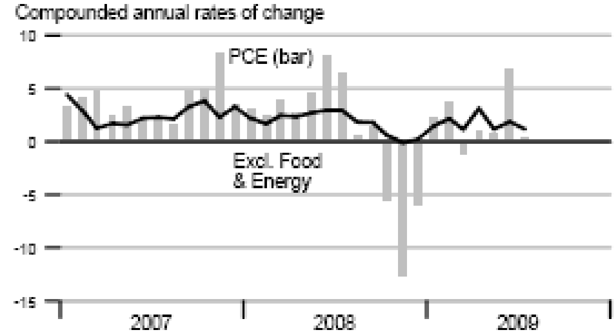
Consumer Price Index

Compounded annual rates of change



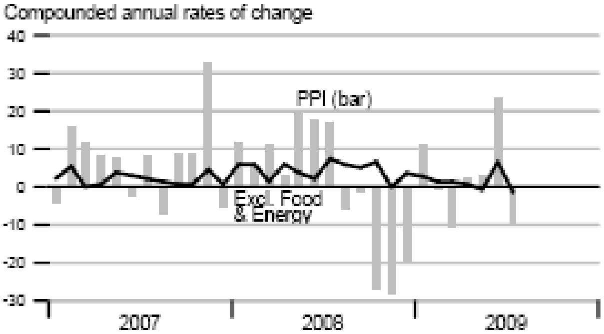
Consumption Chain Price Index

Compounded annual rates of change



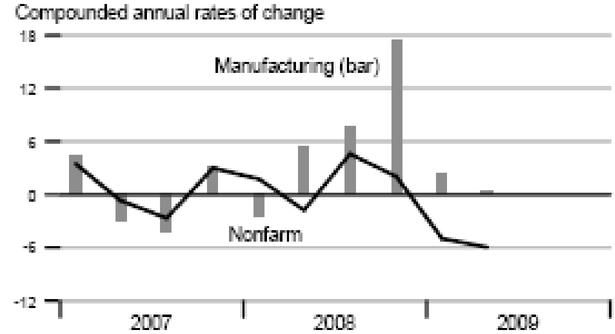
Producer Price Index, Finished Goods

Compounded annual rates of change



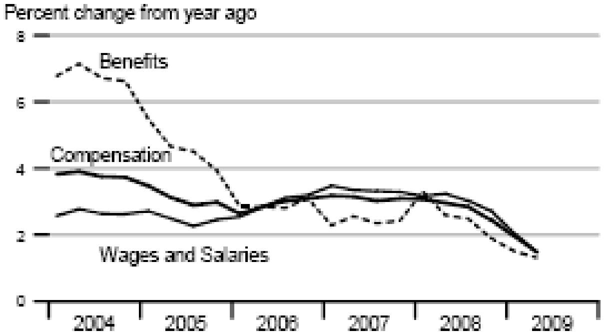
Unit Labor Cost

Compounded annual rates of change



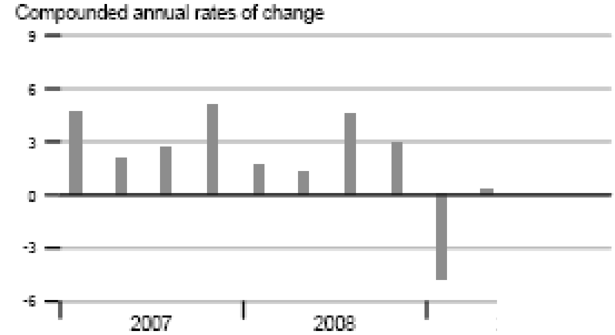
Employment Cost Index

Percent change from year ago



Compensation per Hour

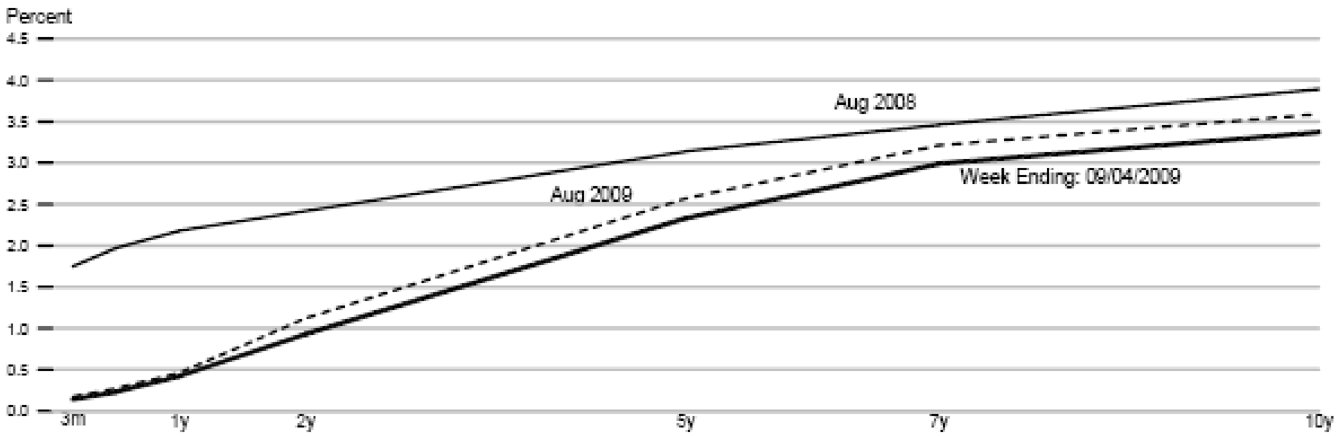
Compounded annual rates of change



Provided by the Federal Reserve Bank of St. Louis, National Economic Trends. Updated September 4, 2009.

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 September 4, 2009.

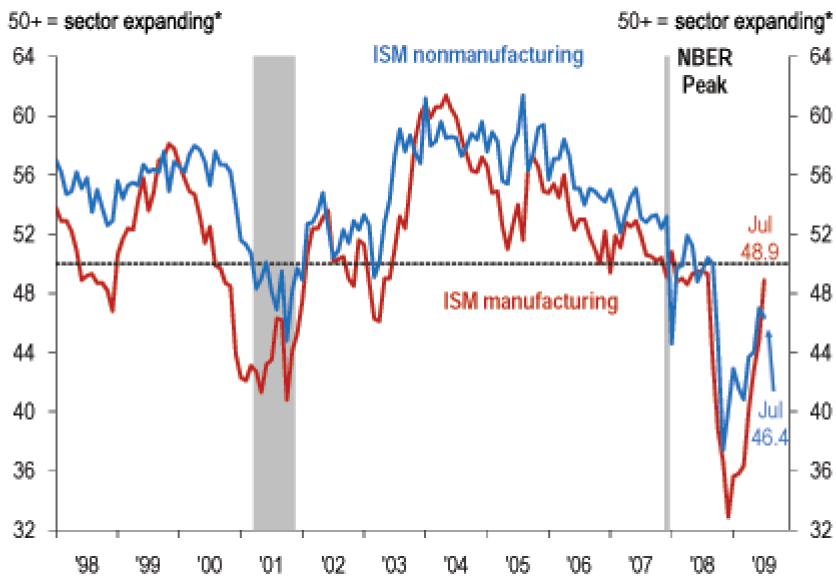
National Update – August 2009
Federal Reserve Bank of Dallas

⇳ **Overall Economy** - Recent data revisions show that output fell much more steeply last year than was first thought. Newly available monthly indicators suggest, though, that the downturn will soon end, or has in fact already ended. Production is stabilizing, new orders are rising, and firms are making progress in controlling their inventories. Long-leading financial indicators signal that growth is likely through at least the end of 2009. The big question is whether the economy will gain enough upward momentum to sustain growth once fiscal stimulus begins to fade, first-time homebuyer tax credits expire and the inventory correction runs its course. Household spending will undoubtedly not return to its prerecession path. Consumption growth may, nevertheless, normalize, which would go a long way toward supporting continued economic expansion.

⇩ **Gross Domestic Product** - Estimates of real gross domestic product (GDP) released late last month show a much steeper decline in economic activity during the 2008–09 recession than was previously indicated. From 2007:Q4 to 2008:Q4, the new data show a cumulative GDP decline of 1.86 percent—a full percentage point larger than the prior estimate (0.85 percent). From 2007:Q4 to 2009:Q1, similarly, the new data show a 3.48 percent decline, against 2.24 percent previously. Real activity dropped further in second quarter 2009, and the cumulative fall in real GDP now stands at nearly 3.75 percent.

⇧ **Manufacturing** - The latest monthly indicators suggest that output declines may be ending. After hitting lows late last year, the Institute for Supply Management's composite manufacturing and nonmanufacturing indexes both have risen to levels consistent with expansion of the overall economy. The manufacturing composite index rose to 48.9 in July, suggesting approximate stability in manufacturing output. The nonmanufacturing index eased down from 47 to 46.4.

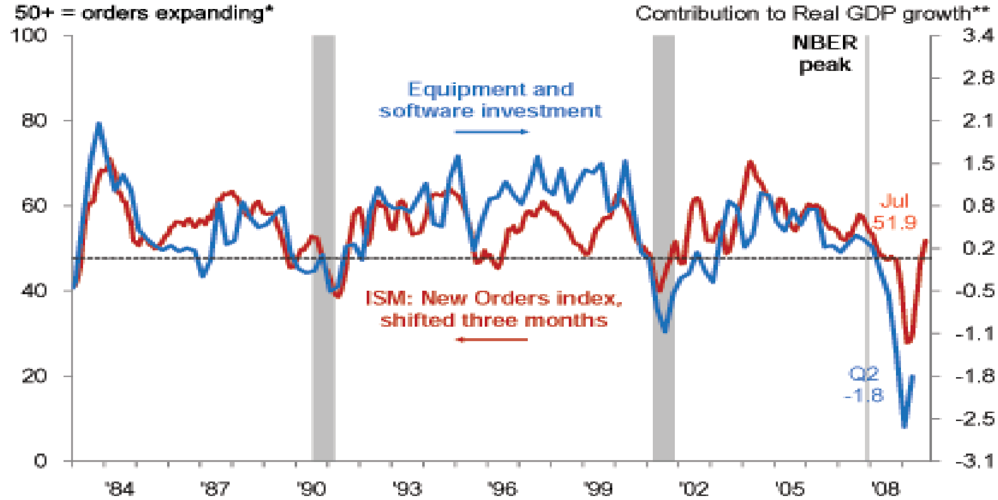
ISM Manufacturing and Nonmanufacturing Signal Economy Bottoming Out



*Seasonally adjusted.
NOTE: Shaded areas indicate recession.
SOURCE: Institute for Supply Management.

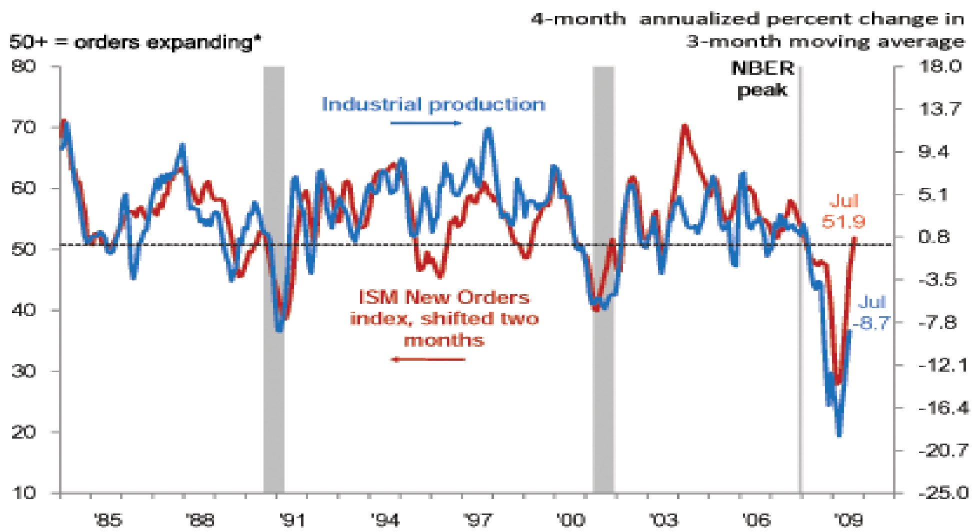
⇧ **New Orders** - The various ISM subindexes provide valuable advance information on the near-term course of important segments of the economy. Movements in the New Orders index from the ISM's manufacturing survey, for example, lead swings in equipment and software investment, changes in the growth rate of industrial output, and changes in the rate of job growth in the goods-producing sector of the economy. The latest readings on the index signal that equipment and software investment will soon begin making a positive contribution to real GDP growth, that industrial production is about to expand, and that jobs growth in the goods-producing sector is normalizing.

New Orders Predict Rebound in Nonresidential Equipment and Software

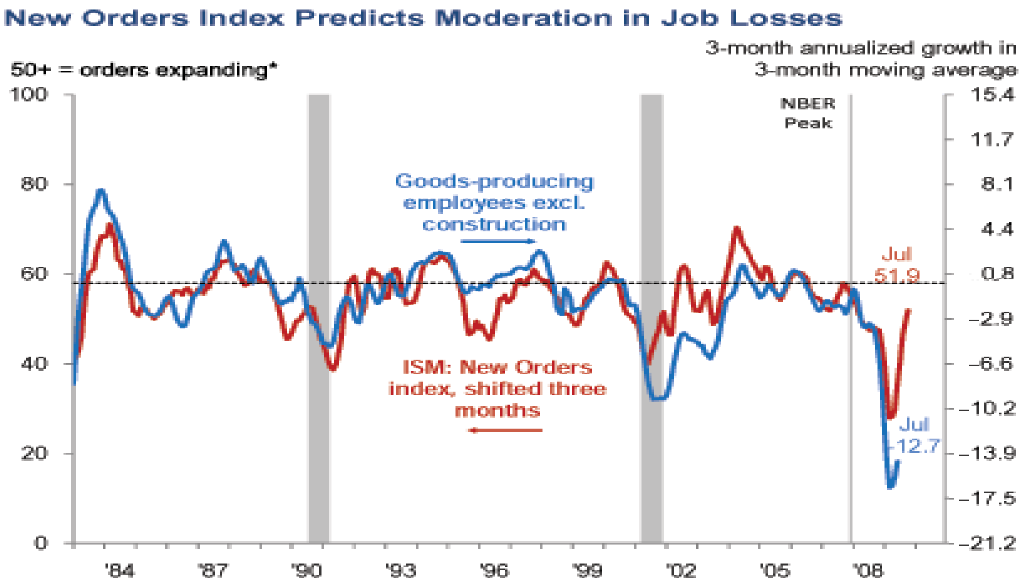


*Seasonally adjusted, three-month moving average.
**Two-quarter moving average.
NOTE: Shaded areas indicate recession.
SOURCES: Bureau of Economic Analysis; Institute for Supply Management.

New Orders Signal Stabilization of Industrial Production

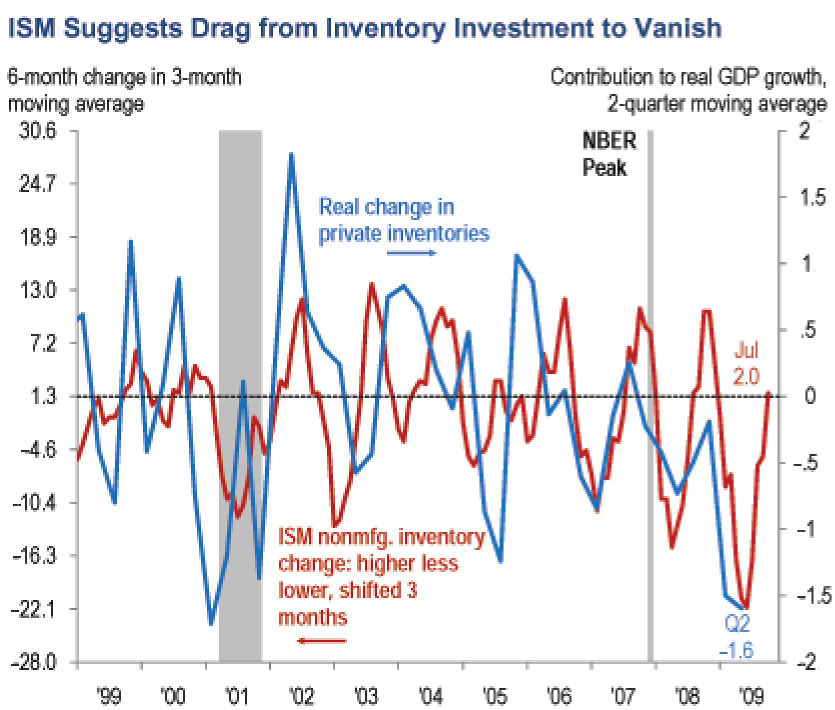


*Seasonally adjusted, 3-month moving average.
NOTE: Shaded areas indicate recession.
SOURCES: Federal Reserve Board; Institute for Supply Management.



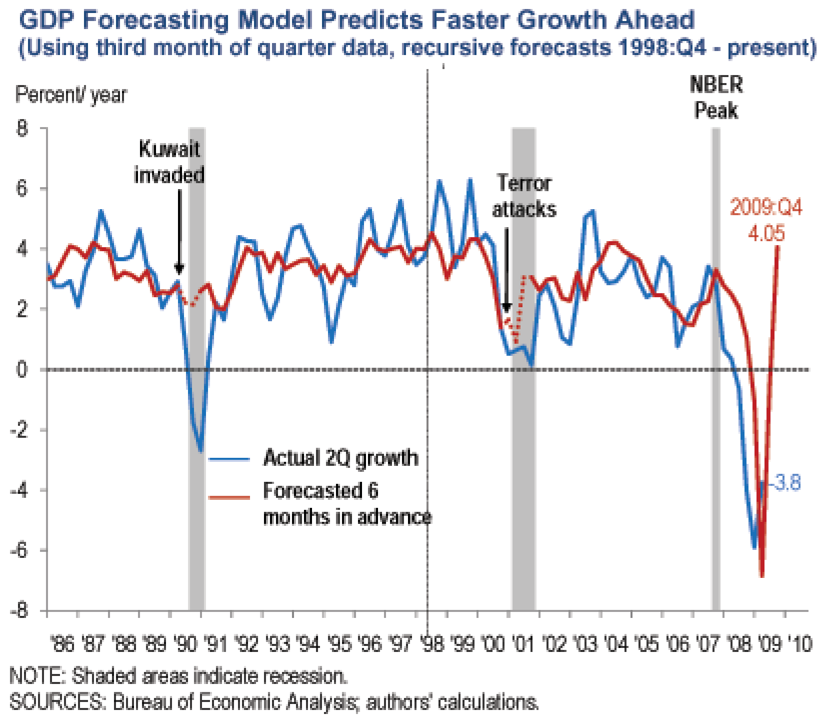
*Seasonally adjusted, three-month moving average.
NOTE: Shaded areas indicate recession.
SOURCES: Bureau of Economic Analysis; Institute for Supply Management

⇳ **Investments** - Inventory investment subtracted 0.8 percentage points from GDP growth in the second quarter of 2009. Forecasts of a turnaround in the economy assume that the rate of inventory disinvestment will stabilize or moderate, causing this drag on GDP growth to disappear. Recent changes in the balance between ISM respondents reporting rising and reporting falling inventories suggest that these forecasts are on the mark.



NOTE: Shaded areas indicate recession.
SOURCES: Bureau of Economic Analysis; Institute for Supply Management.

⇳ **GDP Forecasting** - The monthly indicators examined so far provide insight into the likely direction of the economy over the current quarter, at best. For guidance over a longer horizon, it's useful to consider financial and market indicators like (1) changes in the level of real short-term interest rates, (2) changes in the junk-bond spread, (3) changes in stock prices, (4) the slope of the yield curve, and (5) any rise in the real price of oil not attributable to increases in U.S. oil demand. Using these indicators, two-quarter average GDP growth can be forecasted a full two quarters in advance. The latest forecast—updated early last month—calls for 4 percent annualized average GDP growth during the second half of 2009. The specifics of this forecast shouldn't be taken too seriously: The forecasting model's errors are sometimes large, and its timing has sometimes been off by a bit. Still, it's fair to conclude that we are likely to see a couple of quarters of above-trend growth beginning sometime this summer or fall.



U.S. Economy at a Glance
U. S. Bureau of Labor Statistics

Data Series	Mar 2009	Apr 2009	May 2009	June 2009	July 2009	Aug 2009
Unemployment Rate (1)	8.5	8.9	9.4	9.5	9.4	9.7
Change in Payroll Employment (2)	-652	-519	-303	-463	-276 (P)-	-216 (P)
Average Hourly Earnings (3)	18.50	18.50	18.53	18.54	18.59 (P)	18.65 (P)
Consumer Price Index (4)	-0.1	0.0	0.1	0.7	0.0	
Producer Price Index (5)	-0.9	0.2(P)	0.2(P)	1.8(P)	-0.9(P)	
U.S. Import Price Index (6)	0.5	1.1 (	1.7	2.7(R)	-0.7(R)	2.0(R)

Footnotes:

(1) In percent, seasonally adjusted. Annual averages are available for not seasonally adjusted data.
(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.
(R) Revised
(P) Preliminary

Data Series	2nd Qtr 2007	3rd Qtr 2008	4th Qtr 2008	1st Qtr 2009	2nd Qtr 2009
Employment Cost Index (1)	0.7	0.6	0.6	0.3	0.4
Productivity (2)	3.1	-0.1	0.8	0.3	6.6

Footnotes:

(1) Compensation, all civilian workers, quarterly data, 3-month percent change, seasonally adjusted.
(2) Output per hour, nonfarm business, quarterly data, percent change from previous quarter at annual rate, seasonally adjusted.

Data extracted on: September 11, 2009

The Beige Book – August 31, 2009
The Federal Reserve Board

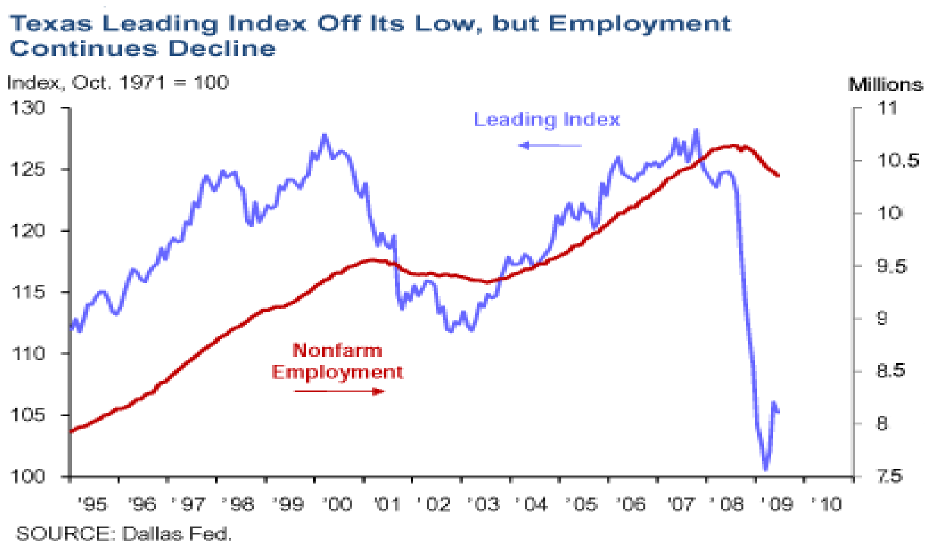
⇳ **Economy** - Reports from the twelve Federal Reserve Districts indicate that economic activity continued to stabilize in July and August. Relative to the last report, Dallas indicated that economic activity had firmed, while Boston, Cleveland, Philadelphia, Richmond, and San Francisco mentioned signs of improvement. Atlanta, Chicago, Kansas City, Minneapolis, and New York generally described economic activity as stable or showing signs of stabilization; St. Louis remarked that the pace of decline appeared to be moderating. Most Districts noted that the outlook for economic activity among their business contacts remained cautiously positive.

The majority of Districts reported flat retail sales. Richmond, Philadelphia, Chicago, Atlanta, and Boston remarked that retailers continued to carefully manage inventories, keeping them in line with low sales levels. A majority of Districts confirmed that the "cash-for-clunkers" program boosted traffic and sales. Richmond, Atlanta, Chicago, and Minneapolis also noted increases or planned increases in automobile-related production. Most regions reported some improvement in residential real estate markets. Downward pressure on home prices continued in most Districts, although Dallas and New York noted that local prices were firming. Reports on commercial real estate suggest that the demand for space remained weak and that nonresidential construction-related activity continued to decline. San Francisco, Philadelphia, and St. Louis noted that the demand for nonfinancial services remained soft, although the pace of the decline was described as slowing in the latter two Districts. Loan demand was described as weak and many Districts reported that credit standards remained tight. Most Districts reported improvements in manufacturing production. For instance, Philadelphia, Richmond, Atlanta, Cleveland, and Chicago reported moderate increases in new orders. Labor market conditions remained weak across all Districts. However, staffing firms in Atlanta, Dallas, Richmond, Cleveland, Philadelphia, Boston, New York, and Chicago did report a slight pickup in the demand for temporary workers.

Wage pressures remained minimal across all Districts. Consumer prices were described as being steady in most Districts, although Kansas City and San Francisco noted some downward pressure on retail prices.

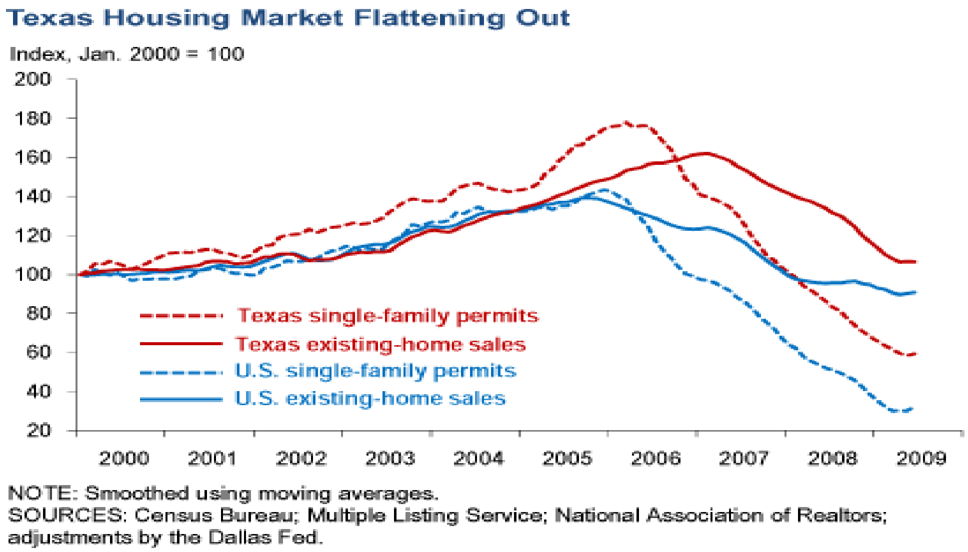
Regional Economic Update – August 2009
Federal Reserve Bank, Dallas

⇳ **Overall Economy** - According to broad-based indicators, the Texas economy remains in recession. However, recent data show some improvement and coincide with anecdotal reports that suggest a bottom may be forming. The Texas Leading Index ticked down 0.8 percent in June but remains 4.6 percent above the low reached in March. Despite the signs of stabilization, employment continues to decline, though there is evidence of improvement on this front as well. The most recent employment forecast estimates that Texas will see a decline of 2.8 percent in 2009. While not especially encouraging, it is a significant improvement from the previous forecast of –3.5 percent.

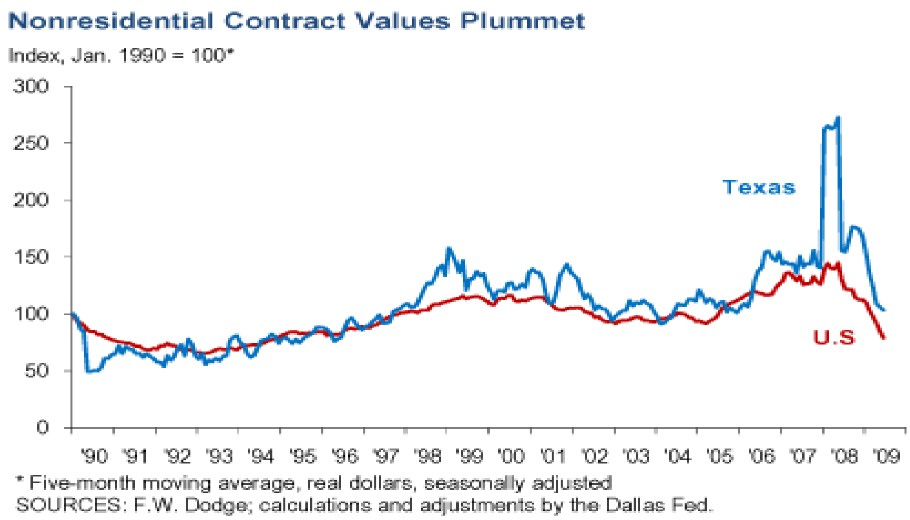


⇩ **Employment Decline Slows** - Texas employment fell at a rapid pace through the first half of the year. During the first six months, employers cut payrolls at a 4.3 percent annualized rate. In the second quarter, payrolls shrank at a 3.4 percent annualized rate compared with a 5.2 percent rate in the first quarter. As initial claims have continued to trend down, the rate of employment decline is expected to slow further in the third quarter.

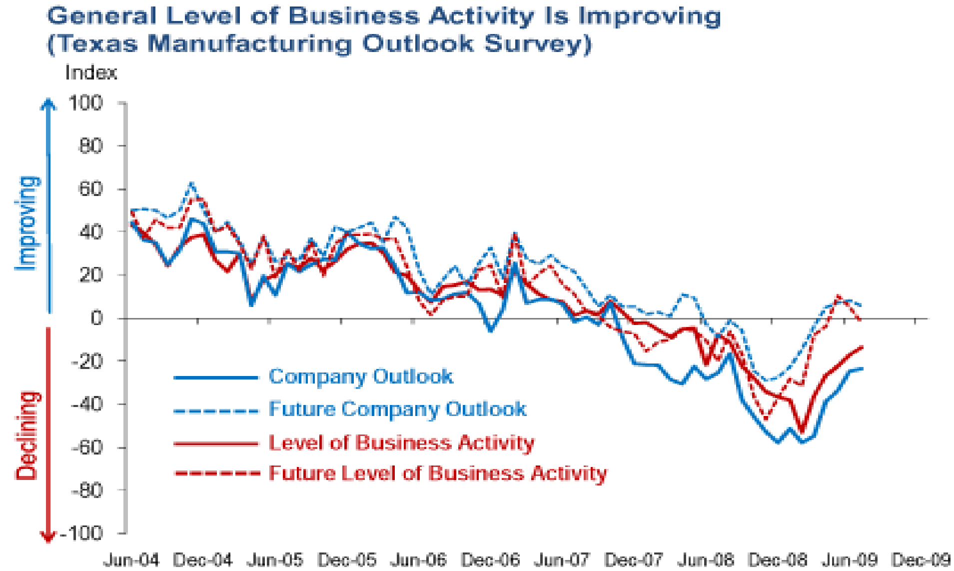
⇳ **Real Estate Activity** - Home sales seem to be bottoming out, with volume rising 3.5 percent in June after a small increase in May. However, sales volume is still down 14.1 percent year over year. A majority of the increase in home sales has been attributed to the first-time homebuyer tax credit, which expires Nov. 30. After the tax credit ends, a clearer view of the housing market should emerge, although recent signs are encouraging. The median sales price of Texas homes climbed 1.1 percent in June, increasing for the third month in a row. Year-over-year median prices were up as well, gaining 2 percent. New home construction also appears to be picking up. Single-family permits were up 13 percent in June but are still down 18.8 percent year over year. Single-family contract values are fairing slightly better, increasing 30 percent in June and only declining 11.1 percent year over year.



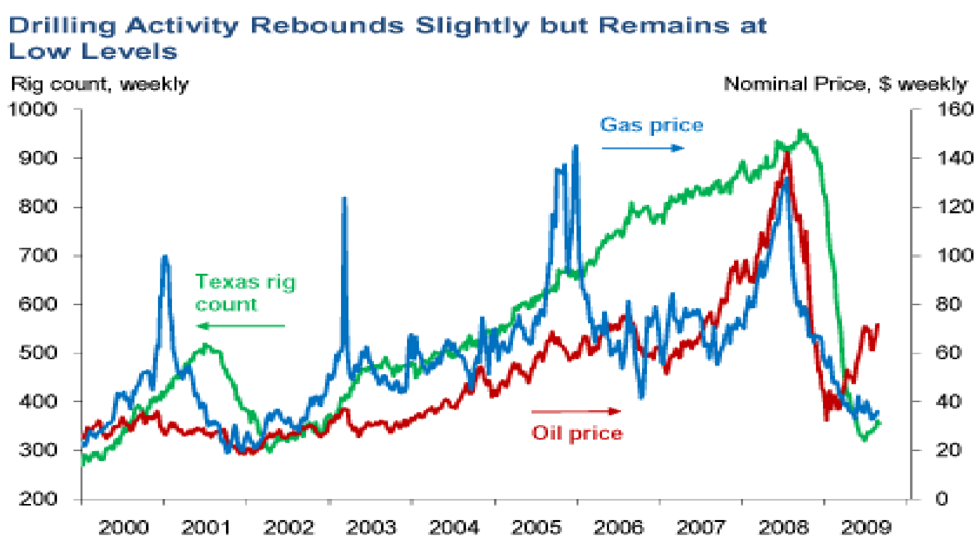
⇩ **Commercial Real Estate Market** - Commercial real estate markets remain weak, buffeted by both the decline in economic activity and reduced financial activity. Vacancy rates continued to rise, affecting a broad swath of property types and metro areas. Transactions involving commercial properties remain subdued, with the expectation of some increase through the end of the year. A depressed commercial real estate market is taking its toll on nonresidential construction. Contract values increased slightly in the second quarter but are down 29.5 percent from the comparable period in 2008



⇧ **Manufacturing Outlook Improving** - The July Texas Manufacturing Outlook Survey showed that declines in factory activity moderated in recent months. The general level of business activity continues to improve, and expectations of future activity appear to be stabilizing.



⇳ **Energy Sector Shows Signs of Life** - Since mid-June the rig count has gradually increased, following nine straight months of decline. Year to date, the rig count has fallen 54.9 percent (–440 rigs). With oil prices hovering around $70 per barrel, some oil rigs have been coaxed back into operation. However, natural gas prices remain low and inventories bloated, subduing drilling activity.

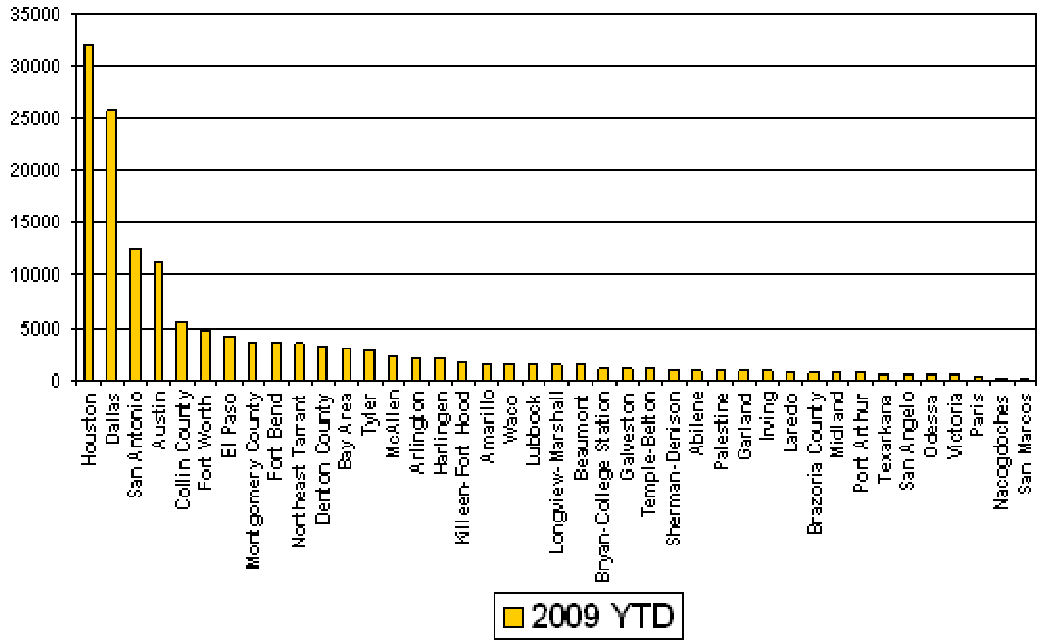


Data Series	Feb 2009	Mar 2009	Apr 2009	May 2009	June 2009	July 2009
Civilian Labor Force (1)	11,839.6	11,861.2	11,924.8	11,955.4	11,972.8	(P) 12,017.5
Unemployment Rate (2)	6.5	6.7	6.6	7.1	7.5	(P) 7.9
Total Nonfarm (3)	10,522.9	10,474.1	10,426.6	10,399.3	10,378.9	(P) 10,416.8
Mining and Logging (3)	233.0	225.0	217.3	210.4	209.1	(P) 207.7
Construction (3)	635.4	618.0	615.6	604.6	594.3	(P) 597.3
Manufacturing (3)	890.0	876.7	867.6	855.5	847.4	(P) 846.5
Trade, Transportation, and Utilities (3)	2,103.3	2,106.0	2,085.1	2,076.0	2,054.0	(P) 2,042.6
Information (3)	210.0	207.6	207.2	205.7	204.3	(P) 201.4
Financial Activities (3)	644.0	645.4	640.5	641.9	646.7	(P) 648.5
Professional & Business Services (3)	1,312.3	1,302.2	1,276.9	1,275.8	1,270.3	(P) 1,289.0
Educational & Health Services (3)	1,332.9	1,333.8	1,338.6	1,343.2	1,345.0	(P) 1,359.4
Leisure & Hospitality (3)	1,010.8	1,006.6	1,016.0	1,017.3	1,019.6	(P) 1,022.4
Other Services (3)	352.6	351.1	352.7	357.2	362.1	(P) 363.1
Government (3)	1,798.6	1,801.7	1,809.1	1,811.7	1,826.1	(P) 1,838.9
Layoff events, all industries (4)	113	112	74	135	93	75

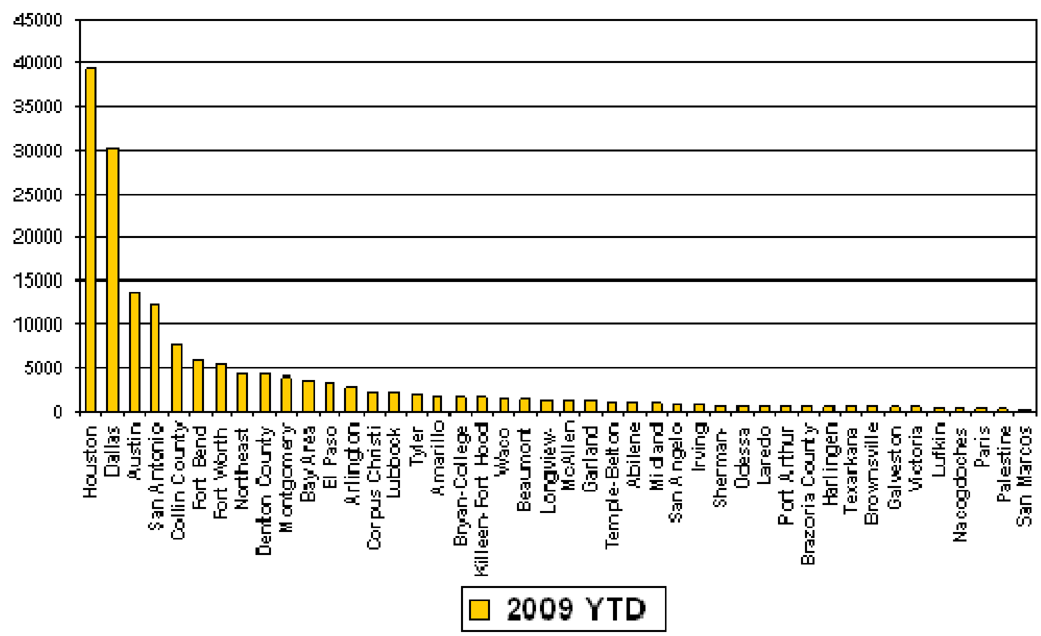
Footnotes:
(1) Number of persons, in thousands, seasonally adjusted.
(2) Percent, seasonally adjusted
(3) Number of jobs, in thousands, seasonally adjusted.
(4) See About the data.
(P) Preliminary

Data extracted on: September 09, 2009
Source: U. S. Bureau of Labor Statistics

Texas Residential MLS Activity
Number of Houses for Sale



Texas Residential MLS Activity
Number of Homes Sold



- **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 from rural and metropolitan markets alike, and each state-chartered bank is included in a survey once each year. The second quarter 2009 survey includes responses from 63 bankers.

  - **Local Economy -** The survey continues to reflect sluggish economic conditions, though nominally improved from the last quarter: 27% of the bankers report a decrease in general business activity, compared to 42% in the first quarter of 2009 and 37% in the fourth quarter of 2008. Bankers who either reported that economic activity remains the same or increased totaled a combined 73%, compared to the previous quarter total of only 58%. Narrative comments provided by bankers echo similar sentiments of the last quarter, as many institutions plan to stay within their current business plan and do not anticipate adding new branches or business lines. Many express a commitment to control credit risk and closely monitor adverse economic trends, noting that the Texas economy is fairing much better than other parts of the nation. Bankers located in areas that directly benefit from increased oil and gas production believe that higher crude oil prices will positively impact their institutions, whereas bankers not directly affected expressed the opposite view. Survey responses continue to reflect concern of a softening residential real estate market. Approximately half of the bankers (49%) report a decrease in residential property sales activity, while 51% report sales at about the same level. For the fifth straight quarter, survey results relating to commercial real estate sales activity is more pessimistic: 59% report decreasing sales activity; 36% report sales activity at about the same level; and only 2% report increasing sales activity. By comparison, in the second quarter of 2008, only 12% of the respondents reported decreasing commercial real estate sales activity. A much higher percentage of respondents believe that area wide employment is deteriorating: 48% believe that area wide employment is decreasing, compared to 45% of respondents in the first quarter of this year and 17% in fourth quarter of last year. In addition, those who believe that area wide employment remained about the same decreased from 52% last quarter to 47% this quarter. By comparison, only 2% of the respondents for the survey issued in the second quarter of 2008 believed that area wide employment was decreasing.

  - **Economic Indicator Forecasts -** A significant change is observed with regard to the direction of interest rate movements. In the fourth quarter 2008 survey, 62% of the bankers believed that rates would decrease over the next six months. In the first quarter of 2009, only 17% believed that rates would decrease. In this survey, only 3% predicted that rates would decrease, and 19% believed that rates would increase, confirming a shift in bankers' expectations that market interest rates will continue to trend upward. An equal percentage (78%) of the bankers in this survey believed that rates would stay constant over the next six months, compared to the last quarter. Optimism in the equity markets, as reflected in the Dow Jones Industrial Average (DJIA), is improved, as 42% of the bankers believed that the DJIA would increase over the next six month period, and 37% believed that the average would remain the same. An overwhelming majority of bankers (81%) predicted that fuel prices would increase compared to 53% in the last survey and only 24% in the fourth quarter 2008 survey. A much larger percentage of respondents (46%) believed that inflation would increase over the next six months, compared to only 24% in the previous survey, possibly reflecting the additional pressure on inflation brought about by federal government programs to stimulate the economy. Still, about half (52%) of respondents believe the inflation will stay about the same. In the narrative comments, many bankers expressed concern about the national economy, increasing unemployment, and increasing crude oil prices.

  - **Competition -** Bankers indicate that competition remains high, but it is reduced from previous reporting periods.

Rated Area (percentages rounded)	*Significantly Increasing*	*Increasing*	*About the Same or Decreasing*
Consumer Loans	3%	10%	85%
Commercial Loans	3%	14%	81%
Deposits	3%	40%	57%

- **Bank Growth Characteristics from the Second Quarter 2009 as compared to First Quarter 2009 -** Bankers continue to report very good asset growth in the second quarter compared to the first quarter of 2009: 13% significantly increasing; 37% increasing; 40% about the same; and 10% decreasing. Loan growth continues to be healthy with more bankers reporting increases than decreases: 3% reporting significant increases; 32% reporting increases; 43% about the same; and 22% decreases
- **Earnings -** Expectations of earnings performance is more pessimistic than the previous quarter. Less than half of the bankers (46%) expected to post a return on average assets of greater than 1% for the second quarter. Bankers expectations about their ROA compared to last quarter were evenly balanced: 37% expected an increased ROA for the second quarter; 34% expected their ROA to be about the same; and 29% expected a reduced ROA. In the narrative comments, some bankers expressed concern that the increased FDIC assessment will significantly hurt their profitability. Respondents expressed through their responses slightly more stability in their net interest margins compared to the previous survey: 32% expect an increasing margin over the previous quarter; 44% anticipate their margin will remain about the same; and 23% believe their margin will be reduced.
- **Asset Quality Indicators -** Asset quality weaknesses expressed by bankers in the last five surveys were again pronounced this quarter: 40% of the respondents indicate that internal watch list loans have increased, while 47% report them to be about the same, and only 10% indicate they are decreased. In addition, 44% of the bankers indicate they are increasing their loan loss provisions, compared to 48% that are keeping provisions about the same and 8% that are decreasing provisions. More bankers (18%) reported increases in nonaccrual loans than reported decreases (10%), with the majority (62%) reporting little to no change. Expectations about past dues were similar with 27% expecting increases, 63% reporting about the same, and only 8% anticipating decreases. Responses concerning repossessions and customer bankruptcies showed similar results. Concerns about credit quality continues to affect loan underwriting standards as 49% of the respondents indicate that they are tightening loan underwriting standards, and 49% reported keeping standards about the same and only 2% were loosening their standards.
- **Summary -** Weaknesses in general economic conditions, residential and commercial real estate, asset quality, and bank earnings reported by bankers in previous economic surveys, are again reflected in the second quarter survey results. Few areas show improvement, and in general, the results are about the same as the first quarter with respondents continuing to indicate significant pressure on asset quality and bank earnings performance. The Department will continue to closely monitor these critical areas.

❖ **Senior Loan Officer Opinion Survey** - The Federal Reserve's July 2009 survey of lending practices addresses changes in the supply of, and demand for, bank loans to businesses and households over the past three months. The survey is based on responses from 53 domestic banks and 23 U.S. branches and agencies of foreign banks

- **Commercial and Industrial Lending -** About 30% of domestic respondents, on net, reported tightening standards on C&I loans to large firms over the past three months. That percentage is roughly 10 percentage points lower than the April survey, continuing the declining trend that began after the measure reached a peak of roughly 85% in the November 2008 survey. Standards on commercial and industrial (C&I) loans to small firms were reported as having been tightened by a net fraction of about 35% of domestic respondents, down from more than 40% in April and from 70% in January.

  Tightening of the various terms on C&I loans by domestic respondents continued, but in general, the net fractions that reported tightening continued to fall from their late-2008 highs. Approximately 60%, on net, reported increasing spreads of loan rates for large firms, compared with 80% in April. For small firms, about 65% reported increasing spreads, compared with 75% in April. These movements contrast with the narrowing in corporate bond spreads over the same period. Significant net fractions of respondents continued to report tightening of other price terms on loans to firms of all sizes; in particular, the costs of credit lines and the premiums charged on riskier loans were reported as having been tightened by net fractions in excess of 50% of respondents.

  U.S. branches and agencies of foreign banks also reported tightening their business lending stance further over the past three months. For C&I lending, the net percentage that reported having done so was again lower than in the previous survey. About 15% of foreign banks, on net, reported tightening credit standards for C&I loans, compared with 30% in April and 65% in January. Regarding lending terms, about 30% of foreign banks, on net, reported increasing the costs of credit lines, compared with 65% in April. The net percentage of foreign respondents that reported increasing premiums on riskier loans was 30%, down from 70% in April. In addition, about 15% of foreign banks reported increasing spreads of loan rates over their cost of funds, down from about 60% in April.

  The predominant reasons that banks gave for tightening credit standards or terms for C&I loans resembled those reported in the previous two surveys. Both domestic and foreign respondents nearly unanimously cited a less favorable or more uncertain economic outlook, and large majorities cited a reduced tolerance for risk. Domestic respondents also widely noted a worsening of industry-specific problems, while foreign respondents were more likely to cite an increase in defaults by borrowers in public debt markets, as well as deterioration in their banks' current or expected capital positions. The net fraction of foreign banks reporting decreased liquidity in the secondary market for C&I loans fell substantially, to 30% from about 70% in the April survey.

  Considerable net fractions of domestic respondents again reported weaker demand for C&I loans from firms of all sizes. About 45% of domestic respondents reported weaker demand for C&I loans from large firms, on net, and 55% indicated weaker demand from small firms; these figures are somewhat lower than the April figures of 60% and 65% for large and small firms, respectively. About one-fourth of reporting foreign banks, on net, indicated weaker demand for C&I loans, in contrast to the April survey, in which these banks reported that demand was about unchanged, on net.

  Foreign and domestic respondents that reported weaker demand unanimously cited their customers' decreased financing needs for investment in plant or equipment as a reason for weaker demand for C&I loans over the past three months. The other predominant reasons for weaker demand included decreased needs to finance inventories, accounts receivable, and mergers or acquisitions. On net, about 25% of domestic banks reported that inquiries from potential business borrowers had declined during the survey period, a slightly smaller percentage than was reported in April. A little more than 15% of foreign banks reported a decline in such inquiries, a higher fraction than in the April survey.

  The July survey included a special question on C&I lending. To gather information about the effects of changes in supply and demand in the market for C&I loans, the survey asked banks to rank the relative importance of five potential sources of the decline in C&I lending this year. According to domestic banks, the most important factor, on average, was lower loan demand from creditworthy borrowers because their funding needs had declined, followed by a deterioration in the credit quality of potential borrowers. Foreign banks, in contrast, ranked lower loan demand due to reduced funding needs third and listed deteriorating credit quality as the most important reason, followed by tighter bank lending standards. Despite strong corporate bond issuance over the past few months and improved functioning in the commercial paper market, both domestic and foreign banks indicated that one of the two least important factors (among those listed on the survey) was the ability of borrowers to tap other sources of funding. Respondents also indicated that higher loan spreads and fees were relatively unimportant.

- **Commercial Real Estate** - The fraction of domestic respondents that reported tightening standards on CRE loans fell to about 45%, compared with 65% in April. Still, this fraction is higher than that reported for C&I loans and all consumer lending categories except nontraditional residential mortgages. About 45% of foreign banks also reported tightening standards on CRE loans, a slight increase from the figure reported in April. The net percentage of domestic respondents that reported weaker demand for CRE loans fell slightly--to roughly 65% -- but it remained large by historical standards and relative to other loan categories. About 45% of foreign respondents also reported weaker demand, a slight increase from the April survey.

- **Residential Real Estate Lending** - After holding nearly flat in the April survey, the net percentage of domestic banks that tightened standards on prime residential real estate loans fell to roughly 20%. This measure peaked at a level of about 75 % one year ago. For the second consecutive survey, domestic banks reported increased demand from prime borrowers for residential mortgages; however, the net fraction fell to 15% from 35% in April. The net fraction of respondents that tightened standards on nontraditional residential mortgages fell to roughly 45%, from 65% in April. The net fraction that reported weaker demand for such mortgages was little changed at around 15%. The net fraction of domestic banks that reported tightening their lending standards on home equity lines of credit fell to roughly 30%, from 50% in the April survey; and the fraction of banks reporting weaker demand for home equity lines of credit decreased to about 15%, from 30% in the April survey.

- **Consumer Lending** - For the second consecutive survey, domestic banks reported little change in their willingness to make consumer installment loans. The net fraction of domestic banks that reported tightening credit card lending standards fell significantly from nearly 60% to around 35%. Similarly, the net fraction of domestic banks that reported tighter standards on consumer loans other than credit cards declined to 35%, from 45% in April. For both credit card and other consumer loans, domestic banks continued to report tightening of loan terms and conditions, although the net fractions of banks that tightened were not as high as in April. The net fraction of domestic banks reporting weaker demand for all types of consumer loans rose a few percentage points, to about 20%.

- **Use of Interest Rate Floors** - The January survey also included special questions regarding the use of interest rate floors in floating-rate loan agreements during 2008. Eighty percent of domestic banks cited an increase in their use of interest rate floors in such agreements with businesses last year, while about 45% of domestic banks cited an increase in the use of such rate floors on loans to households over the same period. No domestic bank reported a reduction in the use of interest rate floors on loans to businesses or households last year. Large fractions of domestic banks, however, noted that less than 5% of their outstanding loans--to both households and businesses--currently had interest rate floors that were binding, and only a small number of respondents indicated that the majority of their outstanding loans to households or businesses had binding rate floors.

- **Current Lending Standards** - A set of special questions asked domestic banks about the levels of their current lending standards relative to their average levels over the past decade (the levels are referred to below as longer-term averages) and about their expectations for these relative levels in the future. Most of the recurring survey questions ask banks about changes in the levels of their lending standards over the past three months rather than about the levels of their lending standards. Because recent survey responses have indicated a widespread tightening of standards, these special questions were intended to elicit information about whether banks have responded to the current economic downturn by increasing the levels of their lending standards above longer-term averages and, if so, whether the elevated levels of standards are expected to persist for some time. For C&I loans to investment-grade firms, 55% of the respondents reported that their standards were tighter than longer-term average levels but were expected to return to average levels by the end of 2011 or earlier. In addition, 25 %of respondents indicated that standards on investment-grade C&I loans were not tighter than longer-term averages. Around 20% of respondents indicated that they expected C&I lending standards for both investment-grade and non-investment-grade C&I loans to remain tighter than their longer-term average levels for the foreseeable future. With respect to CRE lending standards, nearly all banks indicated that current standards were tighter than their longer-term average levels. Around 40% expected standards to return to longer-term average levels by the second half of 2010 or in 2011 for both investment-grade and non- investment-grade lending. However, 40% indicated that standards for investment-grade CRE lending would remain tighter than their longer-term average levels for the foreseeable future, and about 55% expected this outcome for non-investment-grade CRE loans.

For prime and nonprime residential real estate lending (including home equity lines of credit), roughly 90% of respondents reported that lending standards were currently tighter than longer-term average levels. Of the respondents that reported that standards were currently tighter than longer-term average levels for prime residential real estate lending, about one-half expected standards to return to average levels by the end of 2011, with most expecting a return by the second half of 2010. The fraction that indicated standards would remain tighter than their longer-term average levels for the foreseeable future was slightly more than 40%. The comparable measure for nonprime standards was about 60%.

With respect to prime credit card borrowers, roughly one-third of respondents expected standards to remain tighter than their longer-term average levels for the foreseeable future, whereas one-fourth expected a return to longer-term average levels in 2011, and one-fourth expected a return earlier than 2011. Lending standards for nonprime credit card borrowers were expected to remain tight for a longer period, with two-thirds of respondents not expecting a return to longer-term average levels for the foreseeable future.

When asked about expected lending standards for other consumer loans, 25% of respondents reported that standards for such loans to prime borrowers were not tighter than longer-term average levels, and about 20% reported the same for nonprime borrowers. Another 50% of respondents indicated that standards for other consumer loans to prime borrowers were tighter than longer-term average levels but would return to such levels by the end of 2011 or earlier, and another 25% said the same applied to such loans to nonprime borrowers.

Acknowledgements

Information used throughout this report originated from the following sources:

- The Council of Economic Advisers, Washington, D.C.
- 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.
- Real Estate Center, Texas A&M University, College Station, TX
- RealtyTrac, Inc., Irvine, CA
- Texas AgriLife Extension Service
- Texas Comptroller of Public Accounts, Austin, TX
- Texas Department of Banking, Austin, TX
- Texas Department of Savings and Mortgage Lending, Austin, TX
- Texas Workforce Commission, Austin, TX
- The White House, Washington D.C.
- U.S. Bureau of Labor Statistics, Washington, D.C.
- U.S. Department of Housing and Urban Development, Washington, D.C.
- U.S. Department of the Treasury, Washington, D.C.
- U.S. Drought Monitor
- Yahoo Finance