September 30, 2010

Condition of the Texas State Banking System

Prepared by:

Texas Department of Banking
Texas Department of Savings and Mortgage Lending

Financial Data as of June 30, 2010

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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

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BANKING SYSTEM OVERVIEW

Several reasons have been given by economists for Texas' above average performance during this recessionary period, including its relatively stable residential real estate markets, the energy boom that began in 2008, and its diverse industries (energy, education and high-tech, healthcare, and military). Over the last few years, Texas has received several accolades from the media for being a business-friendly environment, which is evidenced by its claim of 57 Fortune 500 companies – as well as being ranked as the top state for business for the second time in three years by CNBC. Despite favorable recognition, the state has not escaped without experiencing economic problems, nor have Texas banks.

The state's economy contracted in 2009, but today the Texas economy is experiencing modest economic growth as it begins recovering with the rest of the nation. Employment trends historically lag other indicators in a recovery; however, after several months of job losses, the state's economy experienced its third month of positive annual employment growth. Researchers and economists alike believe that all the conditions are in place to begin a slow recovery.

With over 800 problem banks being reported by the FDIC nationally, regulators are closely monitoring movements in the national and local economies, as well as legislative changes. Regulatory concerns continue over the state's banking industry's high loan concentrations in commercial real estate. Across the state, increased listings of foreclosed commercial properties are occurring reinforcing the weakness in this sector. One report indicates that the largest surge in foreclosure postings this year is on buildings occupied by small businesses, compared to office and retail properties last year. Bank regulators have encouraged financial institutions to work with borrowers where appropriate. Legislatively, regulators are reviewing and analyzing the new regulatory framework laid out by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 in an effort to estimate the impact it will have on the banking industry.

Taking into account the noted economic factors, the general synopsis provided below of the performance of institutions regulated by the Texas Department of Banking and Texas Department of Savings and Mortgage Lending provides insight into the condition of the Texas banking industry.

STATE-CHARTERED BANKS

The Texas banking system is generally sound, stable and performing adequately given the economic condition of the nation. As of June 30, 2010, there were 318 of Texas state-chartered banks operating with total assets of $162.2 billion. Reporting a return on assets of 0.80% at the end of the second quarter for 2010, state banks outpaced the national average by twenty basis points. As of the same date, core capital is also above the national average at 9.73%.

The overall balance sheet for state banks reflects nominal increases in other real estate owned and noncurrent loans from the previous year, which is reflective of the general economic condition. Noncurrent loans and leases and other real estate increased $682 million or 43 basis points during this period. However, signs of improvement are evident as provisions for loan losses decreased from $749 million as of June 30, 2009, to $526 million as of June 30, 2010. Improvement is further suggested in net loan and lease losses, which decreased $97 million compared to last year. Overall, net loans and leases decreased 5% for the period between June 2009 and June 2010 reflecting a flat trend.

Texas state-chartered financial institutions as a group continue to perform better than most of their national peers. However, a small number of banks in Texas have credit issues that will consume their resources for at least the remainder of 2010. All institutions face an emerging financial services environment that will require all the managerial, technological, and financial means that can be mustered to maintain the momentum built over the last decade.

STATE-CHARTERED THRIFTS

Overall, the state-chartered thrift industry indicates improved earnings gains, and increased profitable institutions compared to the prior year. While state-chartered thrifts overall remain sound and stable, non-current assets plus other real estate owned to total asset levels still must be addressed. State-chartered thrifts report $68.32 million in net income through mid-2010, compared to net income of $503,000 through mid-2009. Most of the increase is attributed to the addition of a federal savings bank, which converted to a state savings bank in early 2010. Excluding this institution, the mid-2010 net income for Texas thrifts was $12.6 million. Total interest income decreased slightly from $112.7 million to $109.3 million as yield on earning assets declined from 5.89% to 5.20%. Additionally, net interest margin declined by 6 basis points, decreasing from 3.71% to 3.65%. Provisions for loan losses decreased from $12.2 million to $6.6 million. Total assets increased from $4.3 billion to $4.7 billion, and to $8.2 billion with the converted institution. Total deposits increased approximately 9.4% to $3.8 billion. Non-current loans increased from $50.7 million to $78.3 million, or over 54%, and continue to be monitored closely by regulators. Net charge-offs have declined from $5.6 million to $3.3 million, primarily due to reduced charge-offs in construction loans. Most of the more recent *de novo* charters have almost grown into their initial capital. The number of thrift charters increased to twenty-nine with the above mentioned conversion.

TEXAS ECONOMIC PROFILE

Economic Progress Report
(Change from previous year)

Texas Unemployment	o Stable
Texas Nonfarm Employment	↑ Increasing
Sales Tax Collections, Retail Establishments	↑ Increasing
Texas Leading Indicator Index	↑ Increasing
Gasoline and Diesel Retail Prices	↑ Increasing

Source: Texas Comptroller of Public Accounts

The U.S. economy is exhibiting economic growth; however, it recently showed signs of slowing down. Texas is also experiencing modest economic growth aided by stable industries located in our state's major cities. For example: Houston as the nation's energy hub, Austin as an education and high-tech leader, and San Antonio as a health care, education, and military spending city.

Although job growth lags the renewed economic expansion, the Texas Comptroller's office estimates the state's gross state product will grow from a reduced base by 3.0 percent during calendar 2010.

The state's unemployment rate has stabilized and remains at 8.2%, a figure that has been at or below the national level for 43 consecutive months. Unemployment rates are adjusted for seasonal trends in hiring and firing, which most economists believe give a more accurate picture of the job market. Without the seasonal adjustment, the state unemployment rate remained unchanged from June at 8.5 percent.

Over the last year, Texas added jobs in mining and logging, manufacturing, trade, transportation and utilities, financial activities, professional and business services, leisure and hospitality, educational and health service and government industries.

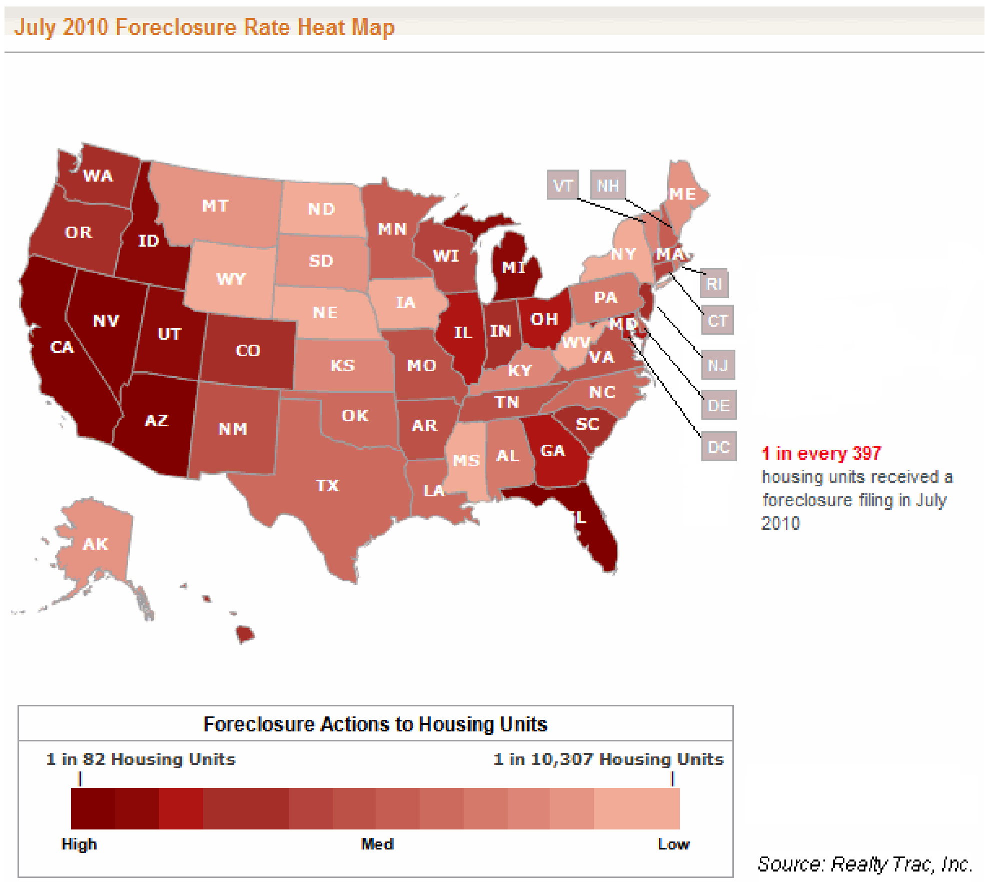
Changes in the state's population demographics continue to influence growth in the government, education, health care, and high tech sectors of the economy. Approximately 9 million or 38% of Texans are of Hispanic descent, 2.8 million or 12% are African Americans, and 1 million or 4% are other (non-Anglo mainly of Asian descent). Within the decade, it is expected that the Texas' population will have more persons of Hispanic descent than any other racial or ethnic background.

Growth in the government sector can be partly attributed to an increased demand for agents along the border as a result of the violence in Mexico. Further emphasizing the demand is the Governor's Spillover Violence Contingency Plan, which provides for an increase in law enforcement in affected areas. The violence in and around the border, as well as Mexico's economic status has also affected the education system. An influx of Mexican students is being reported in various universities across the state.

Health care demand increases are projected as the population ages. Texas, as well as other parts of the nation, is seeing strong construction levels in the medical arena as hospital and other medical care facilities continue to expand. Austin and Dallas have solidified their positions in the high tech industry and continue to add high tech jobs – specifically computer systems design and related services followed by engineering services, and research and development.

For the month of August 2010, tax collections were 0.8% higher than August 2009. Sales tax is a key source of state revenue, providing more than half the money which pays for public education, prisons and other basic state services. Despite five months of modest increases, at the end of the state's fiscal year, tax collections were short $1.5 billion of the original projections for 2010. Consumer purchasing patterns indicate the focus is on necessities and not luxury items. Texas consumer confidence is down 11.2% from its level in August 2009. To curtail some of the collection shortfall, state agencies have been asked to cut spending for fiscal year 2011.

Property values held relatively well during the national real estate crunch. In 2009, home sales were greatly influenced by the homebuyer tax credit that was initiated during the year and later extended to April 2010. Analysts note that comparing 2010 sales figures to those in 2009 will show significant variances as buyers were heavily inclined to make purchases before the tax incentive expired. It is estimated that a true assessment of the housing market conditions will not be possible until sometime in 2011 when sales can be compared without an anomaly.



Source: RealtyTrac, Inc.

Foreclosures remain a concern around the nation. In July 2010, Texas had 11,727 foreclosure filings. Since Texas entered the recession in late 2008, the number of monthly foreclosures has been trending upward. In July 2010, the Texas foreclosure rate was one in every 819 mortgages. This was substantially better than Nevada's one in 82, Arizona's one in 167, Florida's one in 171, and California's one in 200.

In a August 2010 press release from the Railroad Commission of Texas, the Texas average rig count was listed as 717, representing approximately 45 percent of all active land rigs in the United States. The release indicates in the last 12 months, total Texas reported production was 347 million barrels of oil and 7.3 trillion cubic feet of natural gas. Texas natural gas production represents approximately 29 percent of total U.S. natural gas demand.

Crude oil prices have fluctuated from a high of $145.29 in July 2008 to $74.25 as of September 4, 2010. Natural gas has followed a similar pattern, peaking in July 2008 at $13.58 and falling to $2.51 on September 3, 2010. The Texas Comptroller's records indicate that in fiscal 2010, production tax collections for natural gas were down 49 percent over fiscal 2009; however, tax collections for oil were up 14 percent.

A Snap Shot of Texas Weather and Agriculture

As of September 8, 2010

Source: Texas AgriLife Extension Service

SOUTH: Prior to tropical storm Hermine's arrival, hot and dry weather continued, with temperatures above 100 degrees and only a few scattered showers. Soil-moisture levels were adequate in the eastern and southern parts of the region, short in the western part and very short in the northern part of the region. Rangeland and pastures were suffering from the lack of rainfall but were still in good to fair condition. There was concern about high risk of wildfires as grasses were drying out rapidly. In the northern parts of the region, the corn harvesting was wrapped up, the cotton harvesting began in the few acres planted this year, and peanuts were developing. In the eastern part of the region, cotton maturity lagged with most of the crop unharvested and cotton stalk destruction deadlines extended because of the delay. In the western part of the region, the corn and sorghum harvests were completed, the cotton harvest was delayed due to scattered showers, and producers were preparing land for fall crops. In the southern part of the region, the cotton harvest wound down, sugarcane planting was under way and hay harvesting continued. Most farmers in that area made preparations for fall planting, but those in areas that flooded after Hurricane Alex will not be able to do so this year.

COASTAL BEND: Tropical storm Hermine brought rain and increased soil-moisture levels. The cotton harvest began for some while others were waiting to defoliate. Cotton yields were good, but rainfall may have hurt quality. Hay was plentiful, and pastures were looking better after the rain.

SOUTHEAST: Conditions were dry during the reporting period for some counties, while others had frequent rains. Livestock remained in good condition. Brazoria County, for example, had rain every day, which stopped hay harvesting. Armyworm activity was moderate, but numbers of the moth form of the pest were reported at high levels.

NORTH: Soil-moisture levels ranged from very short to adequate. Dry weather continued to plague many producers in the region. Cooler temperatures and spotty showers brought some needed relief and a welcomed break from several days of 100-degree-plus temperatures. Heat and no rain took their toll on crops and pastures. Hay harvest was limited, and some producers had to start feeding hay. Most of the corn crop has been harvested, with yields below average. Many fields were being cut and rolled into hay, and many farmers were just taking insurance on the crop. The grain sorghum harvest was about 75 percent to 80 percent complete. Yields varied, with average yields on good fields and below average on the poorer fields. Soybean harvest began, but there were no yield reports as yet. Wheat growers were preparing fields for planting. Cotton was in fair to good condition while peanuts were in very poor condition. Feral hogs were on the move again, damaging pastures and hay meadows. Rangeland and pastures were in fair to poor condition.

FAR WEST: Scattered rains improved soil-moisture levels and rangeland conditions. The fifth cutting of alfalfa was completed. Chiles were growing pods. Pecans were at the gel stage. Cotton bolls were growing, and stinkbug pressure was increasing. Because watermelons were damaged earlier in the year, the harvest was expected to extend into October. Corn and sorghum were still being harvested. Producers were preparing fields for an early planting of wheat.

CENTRAL: Some counties received rain, which raised the chances for another cutting of hay. Aflatoxin was still a problem for corn farmers. Producers were gearing up to plant wheat and cool-season forages. Pecans dropped nuts due to heat stress, scab and black spot. Many producers were defoliating cotton and servicing cotton strippers in preparation for harvest.

EAST: Parts of the area received as much as three inches of rain. However, much of the region did not receive measurable moisture, and hay harvest totals fell further behind. Relief from triple-digit temperatures came as a cold front pushed through. Armyworms and grasshoppers continued to be a problem. Feral hog activity was up in some counties. Livestock were in fair to good condition.

SOUTHWEST: Remnants of tropical storm Hermine soaked San Antonio and counties to the east, with the more western parts of the region receiving less moisture. The rains came at the right time for early planted small grains and increased the prospects for cool-season forages. The cotton harvest was in full swing before the rains, with excellent yields and quality reported. The corn and sorghum harvests were completed. The harvesting of sesame and peanuts gained momentum. The sweet corn harvest was ongoing, and green beans were making good progress except where whiteflies invaded fields. The pecan harvest was expected to begin near the end of September.

PANHANDLE: The region was hot and dry -- average for the region this time of the year. Soil-moisture levels varied from short to surplus with most reporting adequate. Corn, cotton and sorghum were rated mostly fair to good. Wheat planting continued. Rangeland and pastures were mostly in fair condition. Cattle were in good condition.

ROLLING PLAINS: Scattered showers helped replenish soil-moisture levels. Producers began sowing wheat and oats after the rain. Overall, wheat producers were reported as being more optimistic than they were in June about putting the crop in. However, a number of producers were thinking about grazing wheat out instead of harvesting it for grain after last year's disappointing market. Hay fields perked up after the showers, and many growers were expecting a least one more cutting. Cotton was in better shape thanks to the rains, but the crop needed warmer temperatures to finish maturing. Growers were harvesting grain sorghum. Peanuts were nearly ready for harvest, and producers were expecting a good crop. Cattle on pasture were in good condition.

SOUTH PLAINS: Hot conditions were the norm, with temperatures mostly in the mid 90s, but dropped to the upper 70s and lower 80s late in the reporting period. Precipitation ranged from a trace accumulation to 1.5 inches. Soil moisture was short to adequate. Corn was in good condition, starting to turn color, and the harvest was expected to be in full swing within a few days. However, rain from tropical storm Hermine was expected to delay the corn harvest. Cotton was in good condition with bolls opening. Pastures and rangeland were in fair to good condition with rain needed in most locations. Livestock were mostly in good condition.

WEST CENTRAL: Temperatures were a little cooler, and many counties reported rain showers. Cotton continued to mature. Producers were preparing fields for fall planting. Some grain sorghum was being harvested, and growers continued cutting and baling hay. Rangeland and pasture conditions improved where there was rain. Most hay producers expected to have an adequate hay supply this year. Armyworms invaded pastures in many areas, and producers were applying insecticides. Livestock remained in fair to good condition. Pecan orchards were in better than average condition, and growers were heavily irrigating.

State-Chartered Banking Profile

The number of Texas state-chartered banks remained unchanged at 318 during the first half of 2010, with the addition of Heritage Bank, Pearland, a conversion of Heritage Bank, N.A., and the loss of Medina Valley State Bank, Devine, which merged into Security State Bank, Pearsall. Assets of Texas state banks at the end of the period were $162.2 billion, a decline of less than 0.5% from the end of 2009.

Prosperity Bank, El Campo, was the acquiring bank in two transactions which materially increased Texas state bank assets. In the first, Prosperity purchased the three Texas branches of U.S. Bank, Cincinnati, Ohio. These branches were a result of the acquisition by U.S. Bank of the North Houston Bank, Houston, Madisonville State Bank, Madisonville, and Citizens National Bank, Teague, a larger transaction involving the nine failed banks owned by FBOP Corporation, Oak Park, Illinois. In the second, Prosperity acquired 19 Texas branches of First Bank, Creve Coeur, Missouri.

The continuing lack of vitality in the national economy makes short term predictions difficult. But, as reflected in the last report, we expect little chartering activity until a sustainable economy recovery is evident. Although state bank assets remained essentially unchanged the first half of 2010, equity capital exhibited a strong 4.4% increase. State banks continue to be well positioned for strategic acquisitions of whole banks, or branches, as opportunities become available.

State-Chartered Thrift Profile

State-chartered thrift assets under the Texas Department of Savings and Mortgage Lending’s jurisdiction totaled $8.2 billion as of June 30, 2010, due to the conversion of a federal savings bank with $3.5 billion in assets, an increase of approximately 74.4%. The total number of state-chartered savings banks as of June 30, 2010, increased by one from the prior year to twenty-nine.

The Department continues to receive and process a fair volume of applications. During the past six months there have been four change of control applications and various other types of applications.

Other than the recent conversion from a federal savings bank to a state savings bank, the total industry is projected to remain at current level in number and total assets.

Supervisory Concerns

World and national events, like the Gulf oil spill, the economic condition, and weaknesses in key industries, all influence supervisory responses. With problems banks and other systemic problems continuing to lurk in the market, both the Texas Department of Banking and the Texas Department of Savings and Mortgage Lending are working diligently with regulated entities to ensure compliance with banking laws and to ensure operations are handled in a safe and sound manner. Texas has been fortunate to only have one bank failure in 2010. The Departments continue to proactively address regulatory and compliance issues before they become severe.

A sweeping financial regulatory reform bill known as the Dodd-Frank Wall Street Reform and Consumer Protection Act was passed in July 2010. Much remains to be determined and guidance will be needed before the law's effects are known. A comprehensive review of the law is underway; however, a growing concern of regulators includes the increased cost of compliance to financial institutions as a result of the new law.

Highlights of Departmental Concerns/Actions	
Concerns	**Responses**
★ Concentrations in: ▪ Interim construction ▪ Land development ▪ Lots loans ▪ Commercial Real Estate (CRE) (non-owner occupied) ★ State banking system liquidity ★ Bank management's risk management practices	★ Participating in joint horizontal or targeted reviews ★ More frequent examinations ★ Enhanced off-site monitoring ★ Increased use of enforcement actions ★ Expanded use of supervisor program

Supervisory concerns not only involve the latest problem areas but also include Bank Secrecy Act /Anti-Money Laundering compliance, fraud, home equity lending, corporate governance, compliance, and bank holding company strength. Bank management's ability to identify, monitor and control these various risk elements significantly influences how each Department responds to these supervisory concerns.

OTHER AREAS RECEIVING INCREASED ATTENTION

HB 2491 was enacted in the 79th Texas Legislative Session, which pertained to ad valorem tax liens and contracts for foreclosure of tax liens. Years later, financial institutions are experiencing the impact of this legislation. Lenders that do not escrow for taxes, and do not ensure property taxes are paid directly by the borrower may discover that their lien position has been superseded by a tax lien, and in a few cases lost their collateral. Institutions have discovered that if the property is sold at a tax lien nonjudicial foreclosure without their intervention, they must pay a statutorily mandated redemption penalty in order to recover the property after the sale. Additionally, financial institutions have an increased risk of losing the collateral pursuant to Section 32.065(g) of the Texas Tax Code, which appears to allow tax lien lenders for liens established prior to September1, 2005, to foreclose without any notice to existing lienholders. The Texas Department of Banking and the Texas Department of Savings and Mortgage Lending continue to monitor this situation and the impact of this legislation.

The agencies investigate consumer complaints and inquiries that are generally related to compliance related issues. Over the years, guidances and new regulations relating to overdraft protection programs and associated fees have been released by federal agencies. In 2010, changes to federal regulations affecting overdraft services were implemented and financial institutions across the nation are discovering its impact on fee income. The Texas Department of Banking and the Texas Department of Savings and Mortgage Lending are monitoring the affects this is having on its regulated entities.

Focusing on adverse asset classifications, account and recognition of losses, both agencies continue to conduct targeted examinations of banks that have significant holdings of private label collateralized mortgage obligations (PL CMO).

SUPERVISORY MEASURES BEING TAKEN

A bank's problem status can sometimes be minimized and improved by timely regulatory identification, intervention oversight, and positive management responses. It is imperative to identify individual banks that demonstrate difficulty in the current economic situation. Some measures being taken by each agency to ensure that safe and sound banking practices are being followed are noted below:

THE TEXAS DEPARTMENT OF BANKING

- Conducting frequent on-site examinations of problem institutions;
- Communicating and coordinating joint enforcement actions and other supervisory activities with other state and federal regulators;
- Initiating enforcement actions early in the detection of deteriorating trends;
- Placing 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;
- Expanding off-site monitoring to include follow-up of examination criticisms;
- Utilizing a more defined risk-focused examination process to free up resources for problem institutions;
- 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 and training to improve examiner awareness of pertinent issues.

THE TEXAS DEPARTMENT OF SAVINGS AND MORTGAGE LENDING

- Conducting regular conference calls and closely coordinating with other state and federal regulators;
- Conducting regular, full scope examinations of state savings banks jointly with the FDIC;
- Corresponding regularly with state savings banks regarding institution specific issues and industry issues;
- Analyzing Call Report financial data quarterly, 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);
- Reviewing savings bank's contingency / disaster recovery plans jointly with the FDIC;
- Assessing each institution's activities regularly, 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;
- Monitoring foreclosure prevention / education;
- Reviewing concentrations in commercial real estate and monitoring compliance with Commercial Real Estate Lending Joint Guidance, issued December 12, 2006;
- Monitoring local, state, national and world political and economic events impacting the industry;
- Monitoring of any state savings bank's 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; and,
- Conducting targeted examinations of high risk areas of state savings banks.

STATE-CHARTERED BANKS

The Texas banking system is generally sound, and despite some hardships, challenges and uncertainties sustained over the last year our bankers and the Texas economy, managed to perform with moderate strength. State-chartered banks in Texas continue to outperform their counterparts across the country.

As of June 30, 2010, there were 318 Texas state-chartered banks operating in the state. Total assets remained stable at $162.2 billion. Federally chartered banks diminished by three since year end, with the number of national banks now at 260. Overall, the number of state and federal charters, in-state and branches of out-of-state institutions, decreased by only three and total footings decreased by approximately $1.9 billion.

Texas state-chartered institutions reported an aggregate profit of $649 million in the second quarter of 2010, a $114 million improvement from the $535 million earned during the same period in 2009, but still below historical norms for quarterly profits. The average return on assets (ROA) rose to 0.80%, from 0.65% a year ago. This is the highest quarterly ROA for the industry since June 2008. More than half of our state-chartered banks (63.2 %) reported year-over-year improvements in their quarterly net income while 13.2% reported net losses for the quarter, compared to 16.6% a year earlier. Core capital ratios increased from 9.00% to 9.73% during the last 12 months, and net interest margins grew 26 basis points due to a decreasing cost of funding sources during the same period.

After holding essentially flat for three quarters, asset quality weakened slightly during the second quarter with the ratio of noncurrent assets plus other real estate to total assets rising to 2.12% from 1.69% from the same period last year. The increase was driven primarily by increased delinquencies in Dallas/Fort Worth, Houston and El Paso. Despite the rise in noncurrent assets, the median ratio for Texas banks is 123 basis points less than the national average.

State-chartered banks appear to have increased reserves to absorb potential losses as their allowance for loan and leases loss allowance to loan account remains at 1.89%. In addition, net charge-offs decreased slightly during the last 12 months to 0.96% from 1.09% a year ago. This compares favorably to the nationwide average of 2.88%.

STATE-CHARTERED THRIFTS

Through the first half of 2010, state thrifts had $68.3 million in net income, and an increase of $3.8 billion in assets primarily due to the conversion of a $3.5 billion asset federal savings bank. Return on assets for thrifts increased from a 3 basis point loss to 1.69%; however, without the large conversion, the increase was to 0.55%. The level of unprofitable savings banks has decreased from approximately 50% to approximately 25%. The balance of allowances for loan and lease losses has increased $1.65 million to $37.07 million without the large conversion. Non-interest income and non-interest expense to earning assets have increased 59 and 36 basis points, respectively. Excluding the one new institution, capital ratios increased 7 basis points.

Net interest margins, without the largest institution, decreased a slight 6 basis points from 3.71% to 3.65%. The Texas thrift allowance for loan and lease losses to non-current loans and leases, presently at 47.33%, excluding the largest institution, has decreased from 64.25%. Thrifts noncurrent assets plus other real estate owned to total assets, without the largest institution, increase 53 basis points to 2.69%. Noncurrent loans to total loans increased from 1.81% to 2.67%.

Net charge-offs increased from 0.42% to 0.49% for thrifts, but only if the largest institution is included. This was caused by the supervisory acquisition of a failing institution with poor asset quality in single family residential properties. The pace of charge-offs for the rest of the state savings bank industry decreased approximately 40% from 2009. A considerable portion (50%) for the rest of the industry losses continue to be related to construction and land development loans. The loss allowance to total loans for the entire industry is now 1.17%, which is only a slight 4 basis point decrease during the first six months of 2010.

Number of Institutions and Total Assets

	6-30-2010 No. of Institutions	6-30-2010 Assets	6-30-2009 No. of Institutions	6-30-2009 Assets	Difference No. of Institutions	Difference Assets
Texas State-Chartered Banks	318	$162.2	326	$163.2	-8	-$1.0
Texas State-Chartered Thrifts	29	$8.2	28	$4.3	+1	+$3.9
	347	$170.4	354	$167.5	-7	+$2.9
Other states' state-chartered:						
Banks operating in Texas*	21	$36.9	23	$50.5	-2	-$13.6
Thrifts operating in Texas*	0	0	0	0	0	0
	21	$36.9	23	$50.5	-2	-$13.6
Total State Chartered Activity	**368**	**$207.3**	**377**	**$218.0**	**-9**	**-$10.7**
National Banks Chartered in Texas	260	$152.5	264	$109.0	-4	+$43.5
Federal Thrifts Chartered in Texas	19	$50.9	22	$85.7	-3	-$34.8
	279	$203.4	286	$194.7	-7	+$8.7
Other states' federally-chartered:						
Banks operating in Texas*	19	$220.2	21	$181.7	-2	+$38.5
Thrifts operating in Texas*	8	$1.0	11	$73.6	-3	-$72.6
	27	$221.2	32	$255.3	-5	-$34.1
Total Federally-Chartered Activity	**306**	**$424.6**	**318**	**$450.0**	**-12**	**-$25.4**
Total Banking/Thrift Activity	**674**	**$631.9**	**695**	**$668.0**	**-21**	**-$36.1**

Assets in Billions

**Indicates estimates based on available FDIC information.*

Ratio Analysis

As of June 30, 2010

Number of Banks	*State-Chartered Banks* 318	*Texas National Banks* 260	*All Texas Banks* 578	*State-Chartered Thrifts* 29	*Texas Federal Thrifts* 19	*All Texas Thrifts* 48
% of Unprofitable Institutions	13.21%	11.92%	12.63%	24.14%	31.58%	27.08%
% of Institutions with Earnings Gains	63.21%	53.46%	58.82%	62.07%	78.95%	68.75%
Yield on Earning Assets	4.55%	4.74%	4.64%	6.35%	5.41%	5.54%
Net Interest Margin	3.68%	4.06%	3.86%	5.19%	4.18%	4.32%
Return on Assets	0.80%	0.94%	0.87%	1.69%	0.87%	0.98%
Return on Equity	7.48%	8.67%	8.06%	10.92%	9.72%	9.99%
Net Charge-offs to Loans	0.96%	1.13%	1.04%	0.49%	2.13%	1.92%
Earnings Coverage of Net Loan C/Os	2.57	2.78	2.69	6.33	1.84	1.98
Loss Allowance to Loans	1.89%	2.31%	2.10%	1.17%	2.58%	2.41%
Loss Allowance to Noncurrent Loans	70.03%	57.10%	62.23%	10.93%	301.17%	119.59%
Noncurrent Assets+OREO to Assets	2.12%	3.24%	2.66%	8.61%	0.81%	1.88%
Net Loans and Leases to Core Deps	98.43%	109.24%	103.58%	82.89%	88.17%	87.51%
Equity Capital to Assets	10.96%	10.93%	10.95%	15.84%	8.78%	9.75%
Core Capital (Leverage) Ratio	9.73%	9.18%	9.46%	15.14%	8.71%	9.61%

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
June 30, 2010

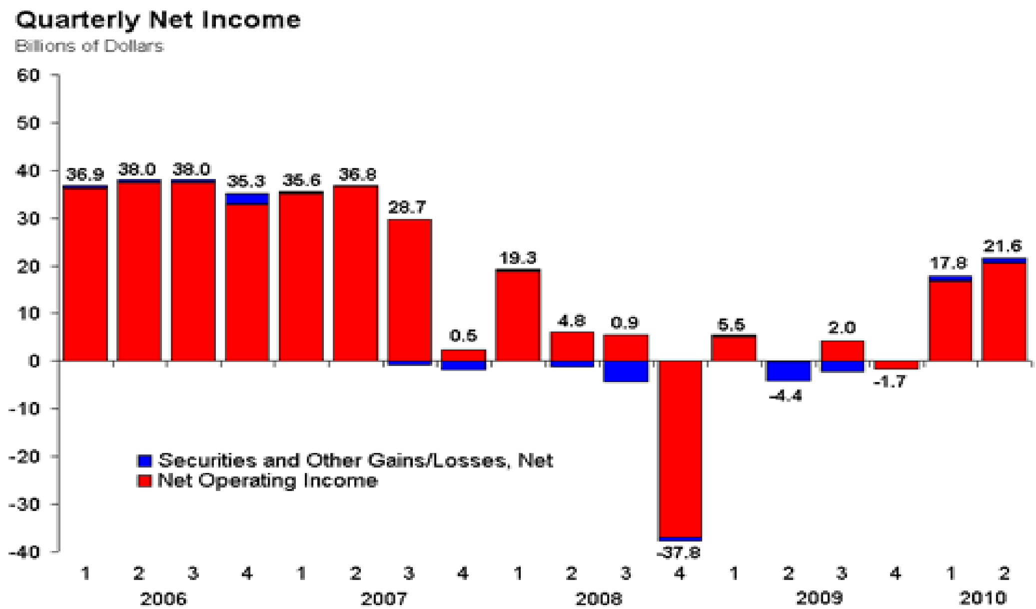
	State Banks*		State Thrifts	
	End of Period	***% of Total Assets***	**End of Period**	***% of Total Assets***
Number of Institutions	318		29	
Number of Employees (full-time equivalent)	36,303		1,607	
(In millions)				
Total Assets	$162,201		$8,164	
Net Loans and Leases	$99,282	61.21%	$5,306	64.99%
Loan Loss Allowance	$1,913	1.18%	$63	0.77%
Other Real Estate Owned	$698	0.43%	$130	1.59%
Goodwill and Other Intangibles	$2,175	1.34%	$18	0.22%
Total Deposits	$126,700	78.11%	$6,402	78.41%
Federal Funds Purchased and Repurchase Agreements	$3,132	1.93%	$25	0.31%
Other Borrowed Funds	$10,414	6.42%	$344	4.21%
Equity Capital	$17,775	10.96%	$1,293	15.84%
Memoranda:				
Noncurrent Loans and Leases	$2,731	1.68%	$573	7.01%
Earning Assets	$146,102	90.07%	$7,399	90.63%
Long-term Assets (5+ years)	$36,621	22.58%	$3,066	37.55%
	Year-to Date	***% of Avg. Assets***	**Year-to Date**	***% of Avg. Assets***
Total Interest Income	$3,324	4.10%	$233	5.74%
Total Interest Expense	$633	0.78%	$43	1.05%
Net Interest Income	$2,691	3.32%	$190	4.69%
Provision for Loan and Lease Losses	$526	0.65%	$20	0.50%
Total Noninterest Income	$1,026	1.26%	$42	1.04%
Total Noninterest Expense	$2,461	3.03%	$146	3.60%
Securities Gains	$73	0.09%	$3	0.07%
Net Income	$649	0.80%	$68	1.69%
Memoranda:				
Net Loan Charge-offs	$488	0.60%	$14	0.34%
Cash Dividends	$183	0.23%	$4	0.10%

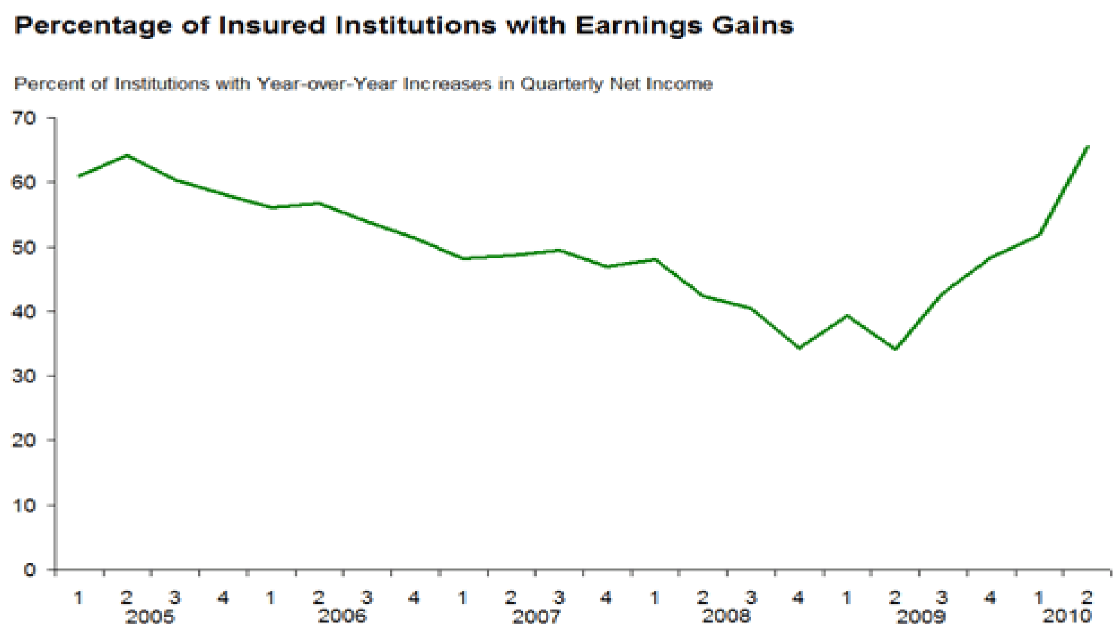
**Excludes branches of state-chartered banks of other states doing business in Texas. As of 6-30-10, there are an estimated twenty-one out-of-state state-chartered institutions with $36.9 billion in assets.*

No branches of state-chartered thrifts of other states conducted business in Texas as of 6-30-10.

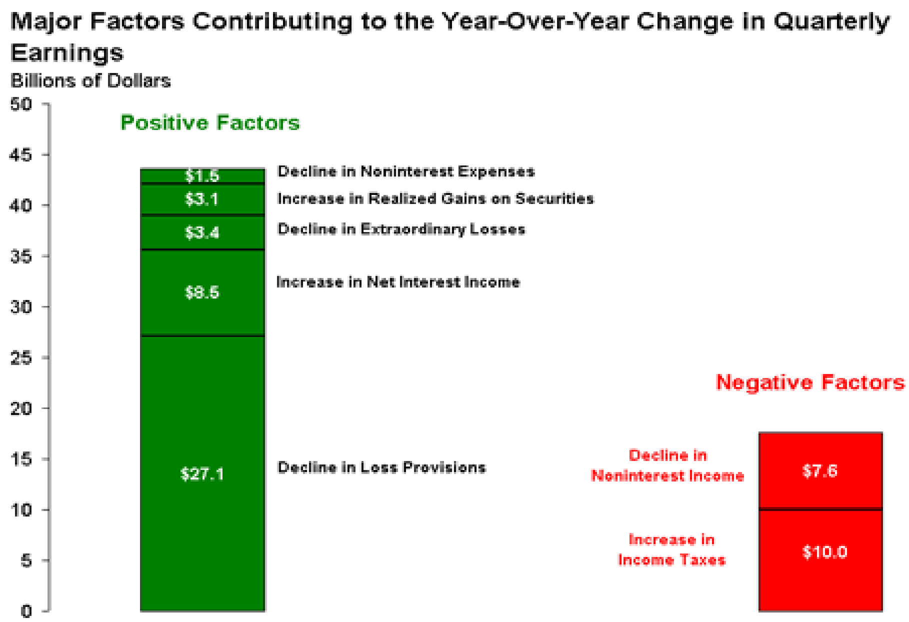
Quarterly Banking Profile – National Level
Second Quarter 2010
Federal Deposit Insurance Corporation

⇧ **Earnings Performance** - Reductions in loan-loss provisions underscored improvement in asset quality indicators during second quarter 2010. The industry's quarterly earnings of $21.6 billion are up dramatically from the year-ago loss of $4.4 billion and represent the highest quarterly earnings since third quarter 2007. Almost two out of three institutions (65.5 percent) reported higher year-over-year quarterly net income. The proportion of institutions reporting quarterly net losses remained high at 20 percent but was down from more than 29 percent a year earlier.



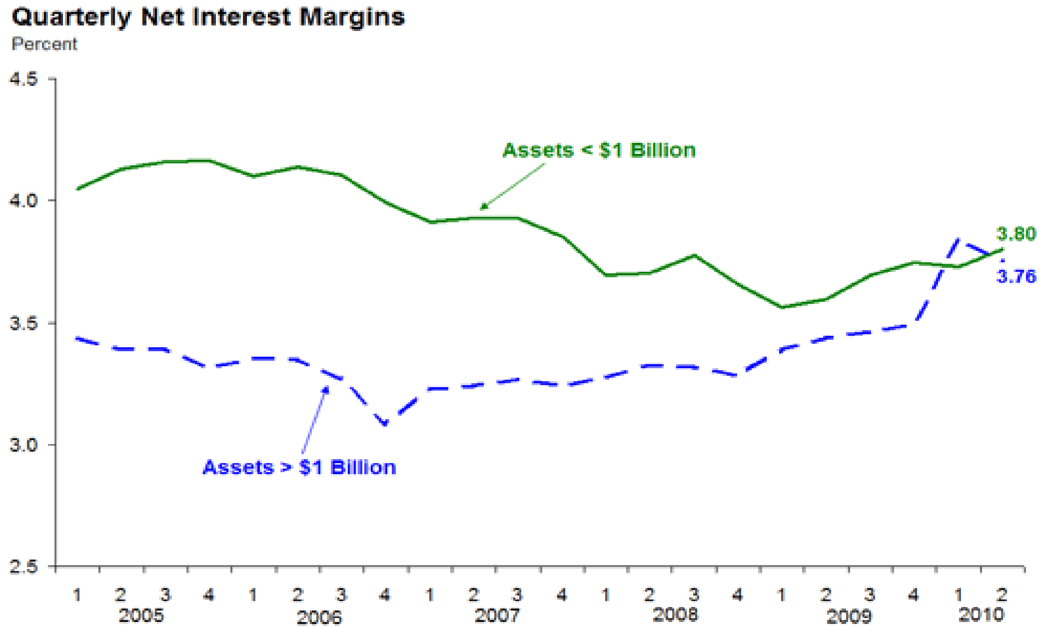


⇧ **<u>Reduced Loan-Loss Provisions Boost Net Income</u> -** Insured institutions added $40.3 billion in provisions to their loan-loss allowances in the second quarter. While still high by historic standards, this is the smallest total since the industry set aside $37.2 billion in first quarter 2008 and is $27.1 billion (40.2 percent) less than the industry's provisions in second quarter 2009. Fewer than half of all institutions (41.3 percent) reported year-over-year reductions in quarterly loss provisions. Only 40 percent of community banks (institutions with less than $1 billion in assets) reported year-over-year declines. Reductions were more prevalent among larger institutions. More than half (56.2 percent) of institutions with assets greater than $1 billion had lower provisions in the second quarter.



⇩ **<u>Noninterest Expense Decreases</u> -** Noninterest expense was $1.5 billion (1.5 percent) less than in second quarter 2009, when insured institutions paid $5.6 billion in a special assessment to bolster the Deposit Insurance Fund. More than half of all institutions (52.1 percent) reported year-over-year reductions in quarterly noninterest expense.

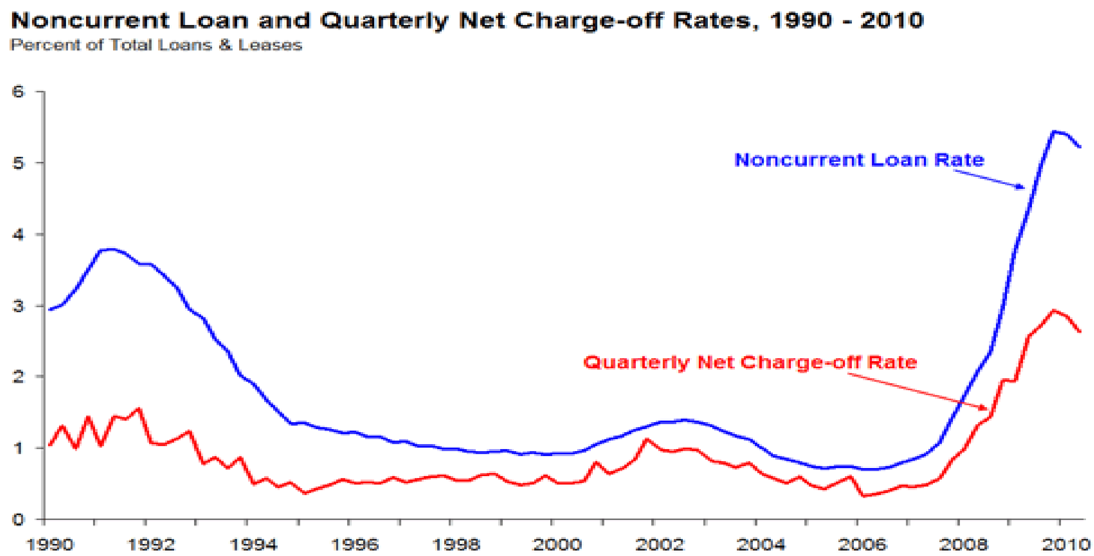
⇧ **<u>Margins Register Improvement</u> -** Net interest income was $8.5 billion (8.6 percent) higher than a year ago, as more than 70 percent of all institutions reported year-over-year increases. Net interest margins at almost 60 percent of institutions (58.6 percent) improved from a year earlier, as average funding costs fell more rapidly than average asset yields. The magnitude of the increase in net interest income was largely attributable to the application of Financial Accounting Standards Board (FASB) Statements 166 and 167 in 2010 at a small number of institutions with significant levels of securitized consumer loans; among other things, the new rules require that revenues from securitized loan pools that had previously been included in noninterest income be reflected in net interest income. (See chart on next page.)



⇩ **<u>Noninterest Income is Lower</u> -** Noninterest income was $7.6 billion (11.0 percent) lower than a year earlier, with some of the decline reflecting reporting changes attributable to FASB 166 and 167. The components of noninterest income that registered the largest year-over-year declines were servicing income (down $6.9 billion, or 63.9 percent) and gains on sales of loans and other assets (down $4.4 billion, or 89 percent). Income from service charges on deposit accounts was $752 million (7.1 percent) lower than a year earlier at banks that filed Call Reports. This is the seventh consecutive quarter that service charge income has declined year-over-year.

⇳ **<u>Charge-offs Fall for First Time Since 2006</u> -** Net charge-offs totaled $49 billion in the second quarter, a $214-million (0.4 percent) decline from a year earlier and the first year-over-year decline since fourth quarter 2006. Charge-offs were lower than a year ago in most major loan categories except for credit cards and real estate loans secured by nonfarm nonresidential properties. Charge-offs on loans to commercial and industrial (C&I) borrowers were $3.1 billion (37.0 percent) lower than a year ago, while charge-offs on real estate construction and development (C&D) loans were $2.7 billion (34.6 percent) lower. Charge-offs of one-to-four family residential mortgage loans were down by $1.4 billion (16.0 percent). Credit card charge-offs were $8.6 billion (86 percent) higher than in second quarter 2009. Most, if not all, of this increase was attributable to the inclusion of charge-offs on securitized credit card balances, which were not included in reported charge-offs in previous years. The change in reporting was the result of the application of FASB 166 and 167. In contrast, the $1.8 billion (107.2 percent) year-over-year increase in charge-offs of nonfarm nonresidential real estate loans reflected further deterioration in commercial real estate portfolios. Almost half (49.1 percent) of insured institutions with more than $1 billion in assets reported lower net charge-offs, while only 43.6 percent of community banks reported year-over-year declines.

⇧ **<u>Noncurrent Loans Post First Decline in More than Four Years</u> -** The amount of loans and leases that were noncurrent (90 days or more past due or in nonaccrual status) declined by $19.6 billion (4.8 percent) during the second quarter. This is the first quarterly decline in noncurrent loans since first quarter 2006. Noncurrent levels declined in most major loan categories during the quarter. The sole exception was nonfarm nonresidential real estate loans, where noncurrents increased by $547 million (1.2 percent), the smallest quarterly increase in three years. The largest reduction in noncurrent loans in the quarter occurred in real estate C&D loans, where noncurrents fell by $5.9 billion (8.3 percent). This is the third consecutive quarter that noncurrent C&D loans have declined. Noncurrent C&I loans also declined for a third straight quarter, falling by $2.7 billion (7.3 percent), while noncurrent residential mortgage loans declined by $4.7 billion (2.5 percent) and noncurrent credit cards fell by $4.2 billion (19 percent). Slightly fewer than half of all institutions (48.9 percent) reported declines in their noncurrent loan balances during the quarter. Noncurrent loan balances fell by 5.3 percent at institutions with more than $1 billion in assets and rose by 0.3 percent at community banks.

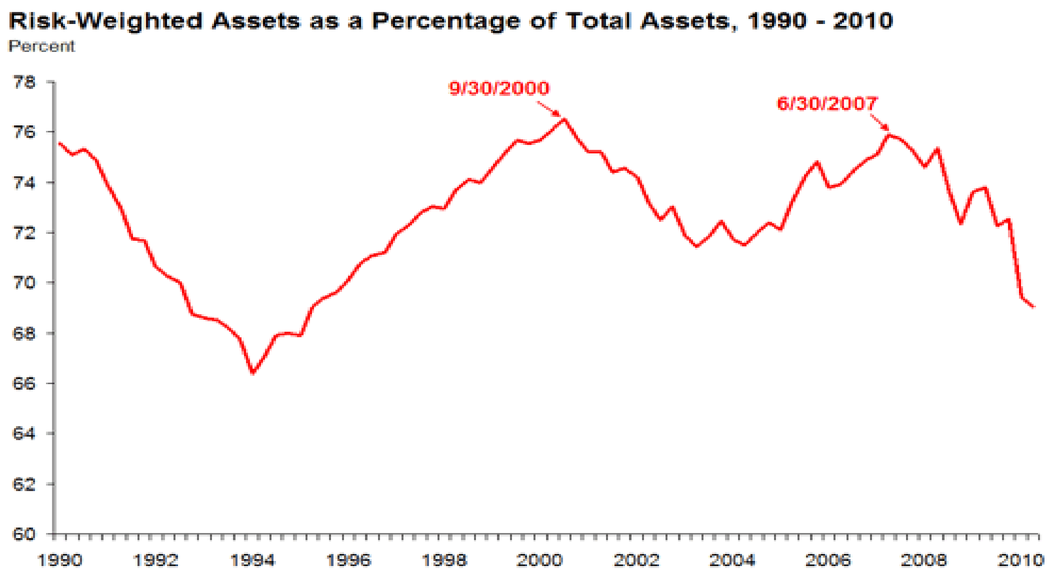


⇳ **<u>Reserves Fall as Large Banks Reduce Loan-Loss Provisions</u> -** Total loan-loss reserves of insured institutions fell for the first time since fourth quarter 2006, declining by $11.8 billion (4.5 percent), as net charge-offs of $49 billion exceeded loss provisions of $40.3 billion. Almost two out of three institutions (61.7 percent) increased their loss reserves in the second quarter, but a number of large banks reduced their loss provisions, producing net declines in their reserve balances. In particular, some institutions that converted equity capital into reserves in the first quarter in accordance with the requirements of FASB 166 and 167 reported lower provisioning in the second quarter. Although the industry's ratio of reserves to total loans fell from 3.50 percent to 3.40 percent during the quarter, it is still the second-highest level for this ratio in the 63 years for which data are available. The industry's "coverage ratio" of reserves to noncurrent loans improved for a second consecutive quarter, from 64.9 percent to 65.1 percent, as the reduction in noncurrent loans slightly outpaced the decline in loss reserves.

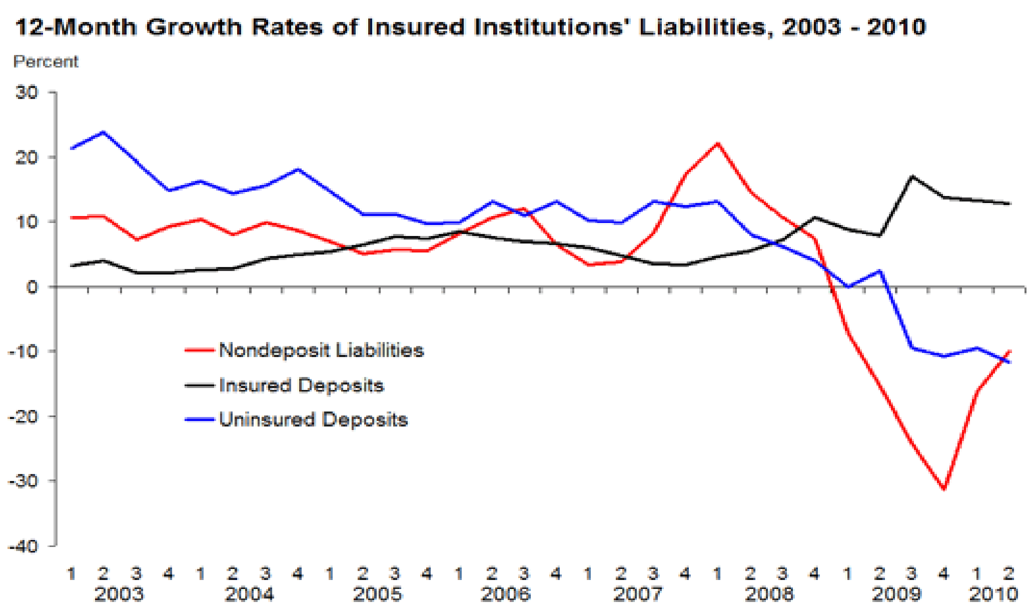
⇧ **<u>Rising Securities Values Contribute to Equity Capital Growth</u> -** Bank equity capital increased by $27.4 billion (1.9 percent), as retained earnings contributed $8.7 billion and appreciation of securities holdings added $13.7 billion. More than half of all institutions (52.7 percent) increased their leverage capital ratios during the quarter, while an even larger percentage (57.6 percent) increased their total risk-based capital ratios. Insured institutions paid $12.9 billion in dividends in the second quarter, more than double the $6.1 billion they paid a year earlier.

⇩ **<u>Loan Balances Continue to Decline</u> -** Industry assets declined for the fifth time in the past six quarters. Total assets fell by $136.2 billion (1 percent), as net loan and lease balances declined by $95.7 billion (1.3 percent). All major loan categories had reduced balances during the quarter. Real estate C&D loans fell by $34.7 billion (8.3 percent), credit card balances dropped by $17.6 billion (2.5 percent), residential mortgage loans declined by $13.2 billion (0.7 percent), and C&I loans were down $12.1 billion (1 percent). Loans to small businesses and farms declined by $13.3 billion (1.8 percent) during the quarter, while loans to larger businesses and farms fell by $5.3 billion (0.4 percent). Balances at Federal Reserve banks declined by $49 billion (8.2 percent) during the quarter at banks that filed Call reports. Intangible assets fell by $15.1 billion (3.6 percent), led by a $13.9 billion (18.7

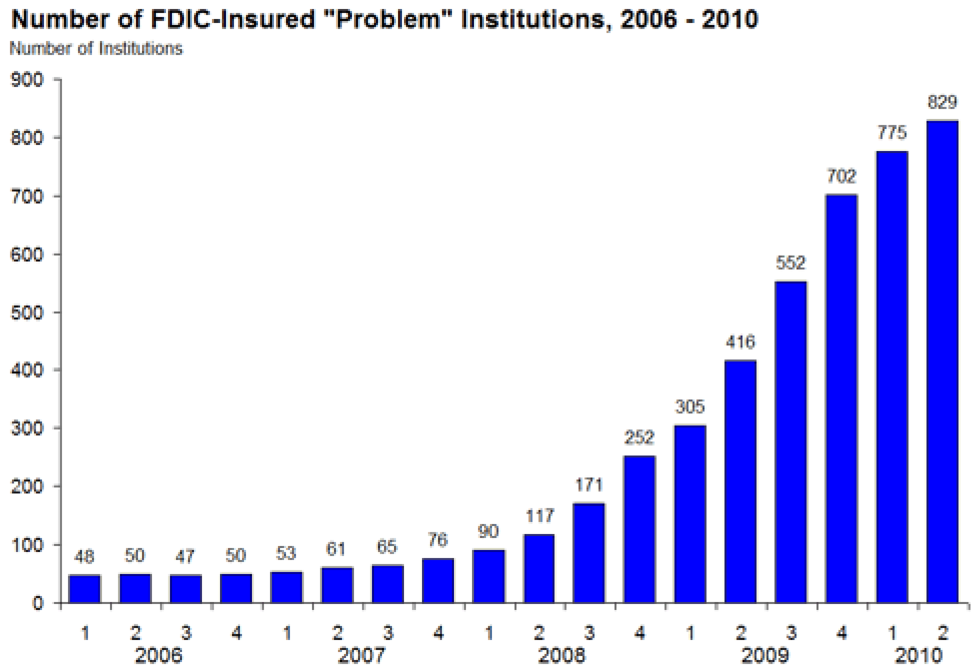
percent) decline in mortgage servicing assets. The few areas of asset growth in the second quarter included federal funds sold and securities purchased under resale agreements (up $11.3 billion, or 2.7 percent), and U.S. Treasury securities (up $8.1 billion, or 5.2 percent). The industry continued to reduce holdings of riskier assets; the ratio of risk-weighted assets (as defined for risk-based capital purposes) to total assets fell from 69.4 percent to 69.1 percent during the quarter. This is the lowest level for this ratio since the second quarter of 1995.



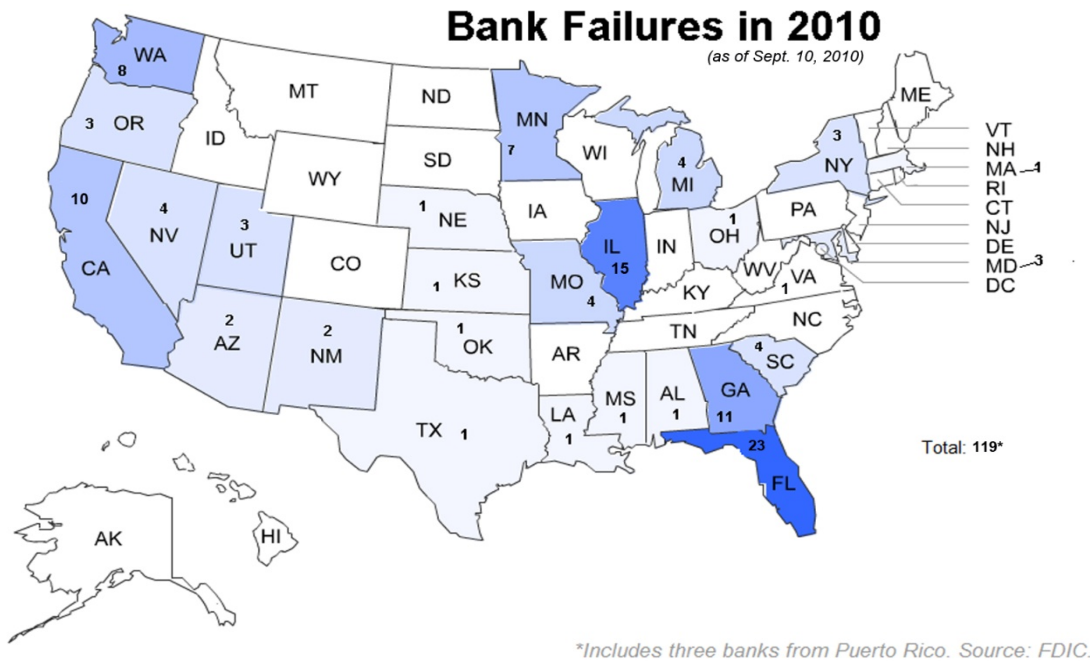
⇧ **<u>Banks Reduce Nondeposit Funding</u>** - Deposits fell for the second quarter in a row, declining by $57.8 billion (0.6 percent). Interest-bearing deposits in domestic offices were down by $45.4 billion (0.7 percent), while noninterest-bearing domestic deposits increased by $20.8 billion (1.4 percent). Deposits in foreign offices declined by $33.2 billion (2.2 percent). Nondeposit liabilities fell by $105.4 billion (3.9 percent), as institutions reduced Federal Home Loan Bank advances by $35 billion (7.3 percent) and short-term unsecured borrowings by $48.2 billion (23 percent).



⇩ **<u>No New Charters Were Added During the Quarter</u> -** The number of FDIC-insured institutions reporting financial results fell by 104 in the second quarter, from 7,934 to 7,830. This is the first time in almost ten years that the number of reporting institutions has fallen by more than 100 in a single quarter (the number declined by 113 in third quarter 2000). During the quarter, 57 institutions were absorbed by mergers into other charters, including 29 charters that were consolidated as part of a single corporate reorganization, and 45 insured institutions failed. For the first time in the 38 years for which data is available, no new insured institutions were added during the quarter. The number of institutions on the FDIC's "Problem List" increased from 775 to 829 during the quarter. Total assets of "problem" institutions fell, from $431 billion to $403 billion.

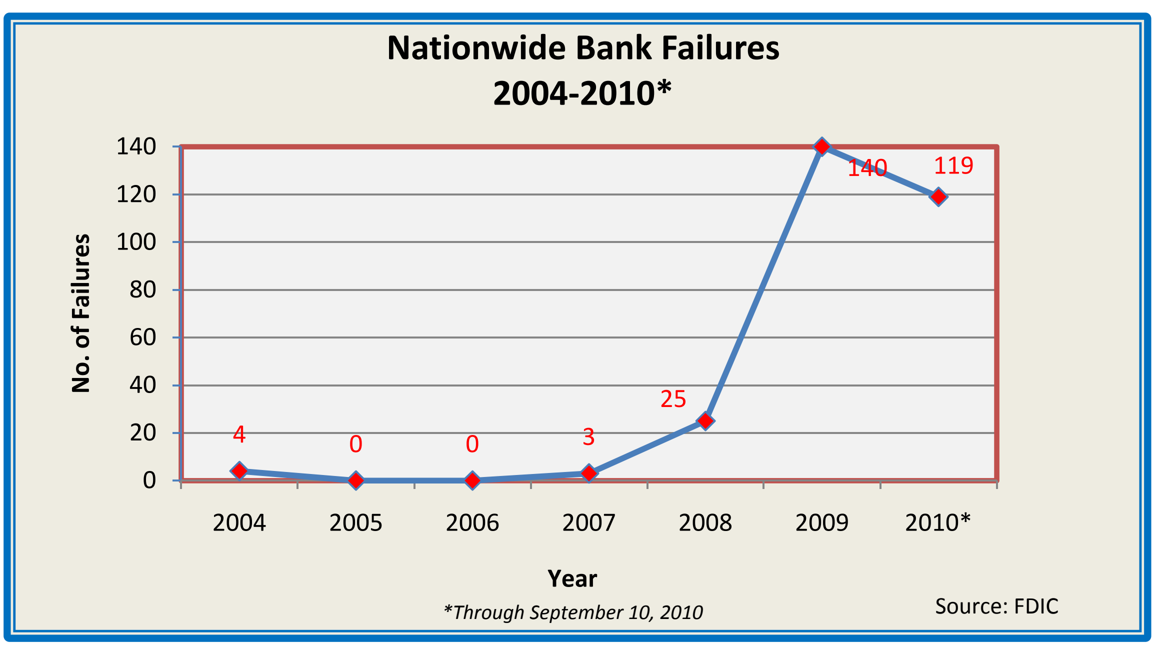


Bank and Thrift Closures Nationwide
***Federal* Deposit Insurance Corporation**



Texas Failures in 2009 and 2010*	Charter	Date Closed	Total Assets
The La Coste National Bank, La Coste, TX	National	02-19-10	$53.9 Million
North Houston Bank, Houston, TX	State	11-30-09	$325.5 Million
Madisonville State Bank, Madisonville, TX	State	11-30-09	$256.3 Million
Citizens National Bank, Teague, TX	National	11-30-09	$118.2 Million
Guaranty Bank, Austin, TX	Federal Thrift	08-21-09	$13.5 Billion
Millennium State Bank of Texas, Dallas, TX	State	07-02-09	$118.6 Million

**Through September 10, 2010*

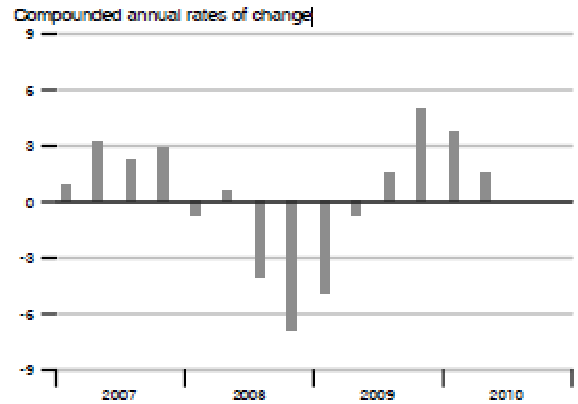


Stock Performance
Southwest Regional Banks

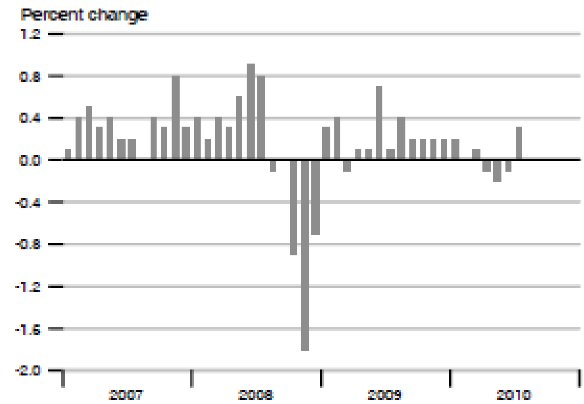
Name	Last Trade		52 Wk Range		PE	EPS	Mkt Cap	Div/Shr	Div Yld
Bancfirst Corporation	09/03	**26.40**	24.00	27.10	N/A	N/A	N/A	N/A	N/A
Banco Bilbao Vizcaya Argentaria	09/08	**12.47**	8.65	19.78	9.41	1.33	48.63B	0.37	2.80%
Bok Financial Corporation	09/08	**45.12**	41.06	56.12	14.15	3.19	3.07B	1.00	2.20%
Cass Information Sys Inc	09/08	**33.10**	27.46	35.29	17.06	1.94	310.94M	0.56	1.70%
Cobiz Incorporated	09/08	**5.33**	3.99	8.29	N/A	-0.91	196.27M	0.04	0.70%
Comerica Inc.	09/08	**36.60**	25.53	45.85	N/A	-0.50	6.45B	0.20	0.50%
Community Shores Bank Corp	09/08	**0.95**	0.50	2.24	N/A	-3.39	1.39M	N/A	N/A
Cullen Frost Bkrs Incorporated	09/08	**52.82**	45.67	60.78	16.17	3.27	3.20B	1.80	3.40%
Enterprise Fin Serv Corp	09/08	**8.31**	7.00	12.28	N/A	-0.06	123.43M	0.21	2.50%
First Comnty Corp S C	09/08	**5.45**	5.26	7.00	N/A	-7.92	17.78M	0.16	2.90%
First Financial Bankshares	09/08	**46.04**	43.55	55.94	17.64	2.61	959.89M	1.36	2.90%
First ST Bancorporation	09/08	**0.19**	0.11	1.43	N/A	-7.59	3.96M	N/A	N/A
Firstcity Finl Corp	09/08	**7.64**	5.23	9.00	4.25	-1.80	77.83M	N/A	N/A
Great Southn Bancorp Inc	09/08	**20.48**	19.37	26.32	7.06	2.90	275.13M	0.72	3.30%
Guaranty Fed Bancshares Inc	09/03	**5.78**	4.80	6.75	N/A	-0.10	15.29M	N/A	N/A
Heartland Financial USA Inc	09/08	**14.10**	11.99	20.85	293.75	0.05	230.89M	0.40	2.70%
International Bancs Cor	09/08	**16.11**	14.77	25.14	8.65	1.86	1.09B	0.34	2.00%
Landmark Bancorp Inc	09/02	**16.00**	14.01	18.48	29.68	0.54	40.06M	0.76	4.80%
Liberty Bancorp Inc	09/08	**9.00**	6.11	10.06	14.24	0.63	33.82M	0.10	1.10%
Mackinac Finl Corp	08/31	**5.15**	4.00	7.39	7.42	0.69	17.61M	N/A	N/A
Metrocorp Bancshares Inc	09/08	**2.62**	2.54	3.85	N/A	-1.05	32.14M	N/A	N/A
MidWest One Finl Group Inc	09/08	**13.10**	7.57	17.00	18.22	-0.72	112.83M	0.20	1.50%
Osage Bancshares Inc	08/31	**7.00**	6.75	9.99	28.69	0.24	18.50M	0.34	4.60%
Prosperity Bancs Inc	09/08	**31.05**	28.07	43.66	11.83	2.63	1.45B	0.62	1.90%
QCR Holdings Inc	09/07	**9.60**	7.06	14.40	31.37	0.31	44.16M	0.08	0.80%
Sterling Bancshares Inc	09/08	**4.90**	4.34	8.27	N/A	-0.32	499.43M	0.06	1.20%
Team Financial Inc	08/25	**0.0001**	N/A	N/A	N/A	-6.35	359.70	N/A	N/A
Tex Capital Bancs Inc	08/11	**7.24**	N/A	N/A	N/A	N/A	N/A	N/A	N/A
TierOne Corporation	09/08	**0.0080**	N/A	0.01	N/A	-1.63	N/A	N/A	N.A
UMB Financial Corporation	09/08	**33.33**	31.77	44.68	13.88	2.40	1.35B	0.74	2.20%
West Bancorp Incorporated	09/08	**6.16**	4.28	9.04	12.78	0.48	107.20M	N/A	N/A
Zions Bancorp	09/08	**19.79**	12.50	30.29	N/A	-4.00	3.43B	0.04	0.20%

Source: Yahoo Finance (September 2010)
NA – Indicates information was not available.

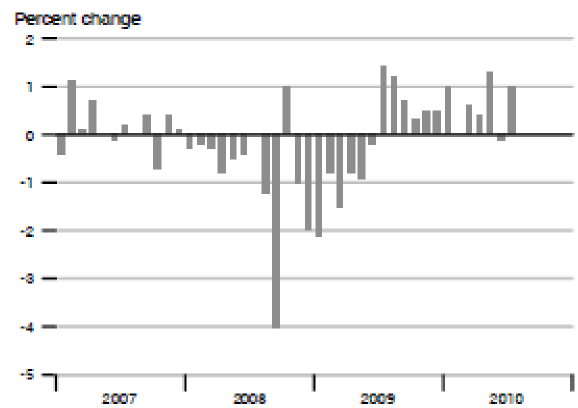
Real GDP Growth



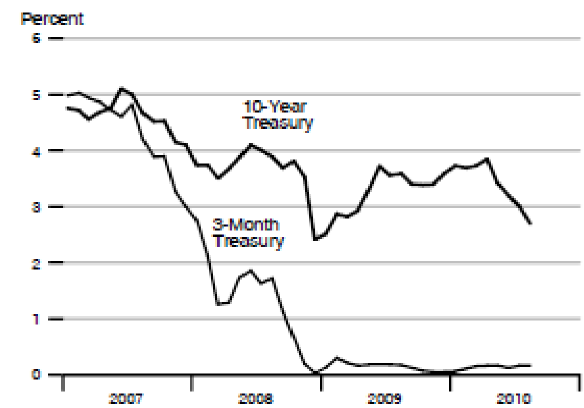
Consumer Price Index



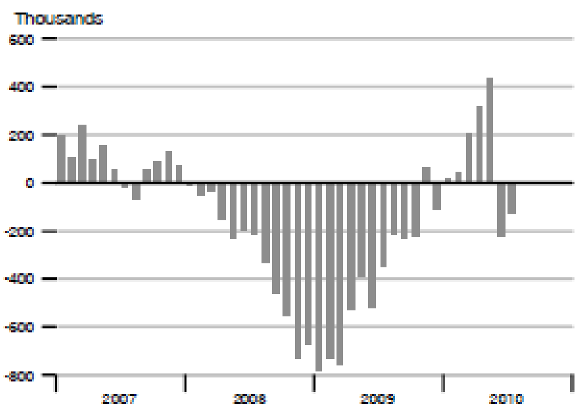
Industrial Production



Interest Rates



Change in Nonfarm Payrolls

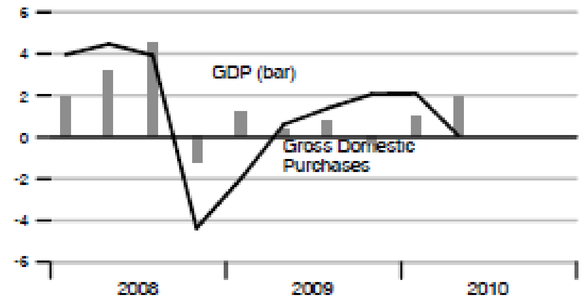


Unemployment Rate

Provided by the Federal Reserve Bank of St. Louis, National Economic Trends. Updated September 1, 2010.

NIPA Chain Price Indexes

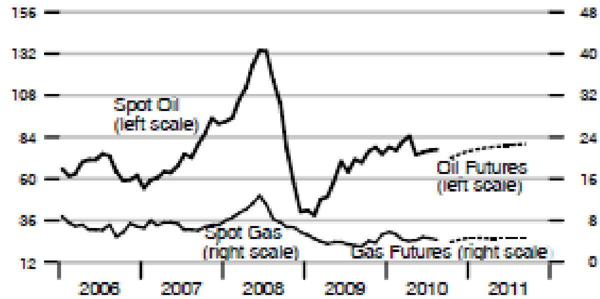
Compounded annual rates of change



Oil & Natural Gas Prices: Spot & Futures

Dollars per barrel

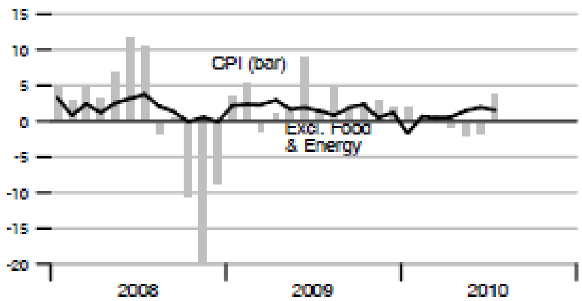
Dollars per million btu



Note: Futures prices as of 8/31/2010.

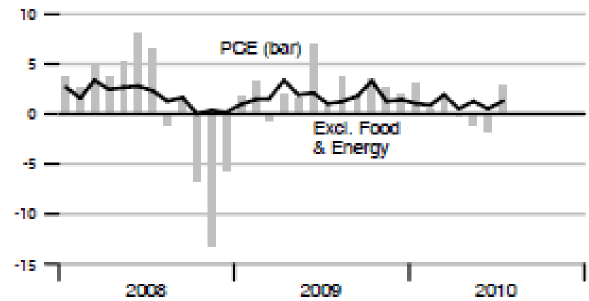
Consumer Price Index

Compounded annual rates of change



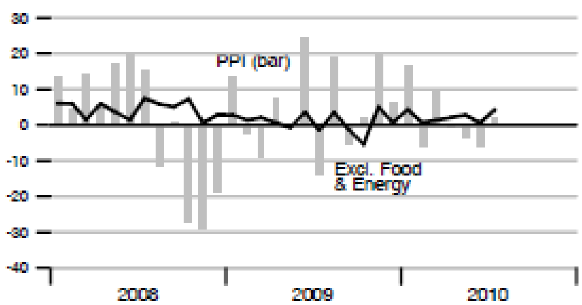
Consumption Chain Price Index

Compounded annual rates of change



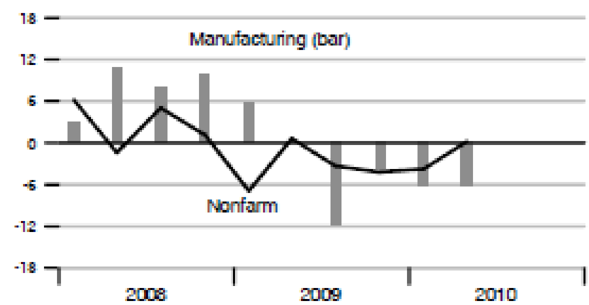
Producer Price Index, Finished Goods

Compounded annual rates of change



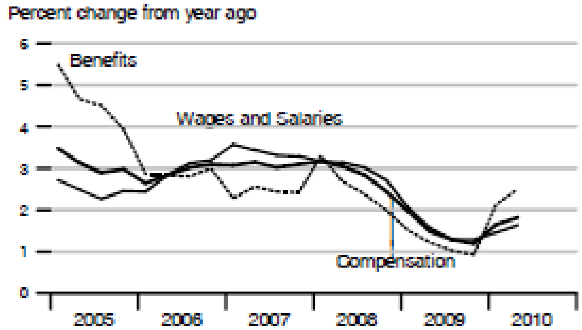
Unit Labor Cost

Compounded annual rates of change



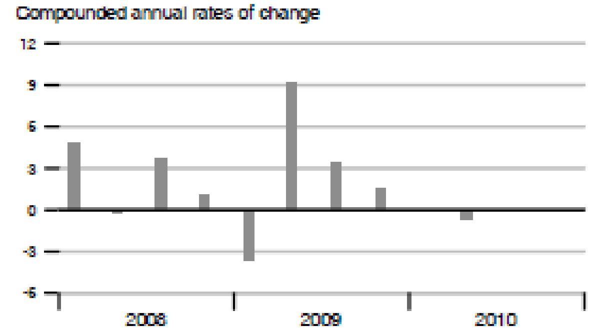
Employment Cost Index

Percent change from year ago



Compensation per Hour

Compounded annual rates of change



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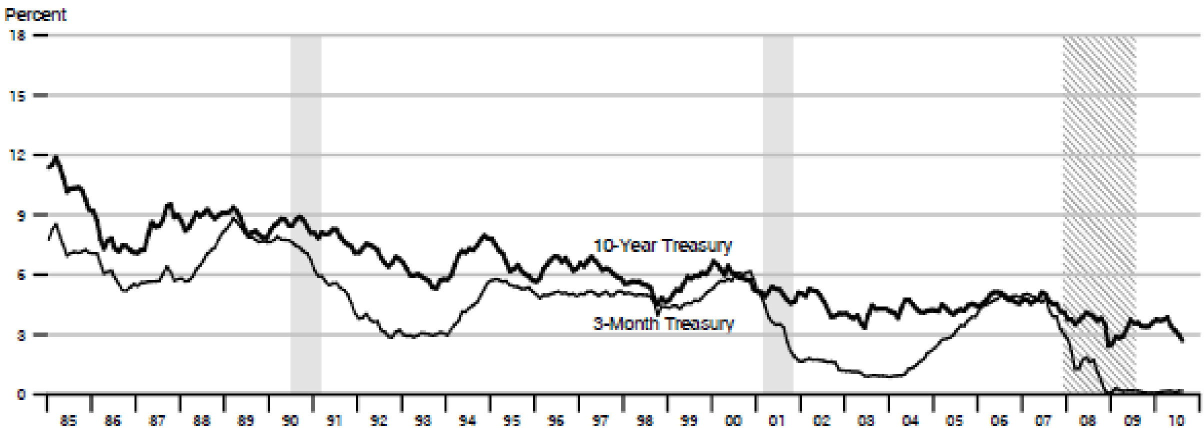
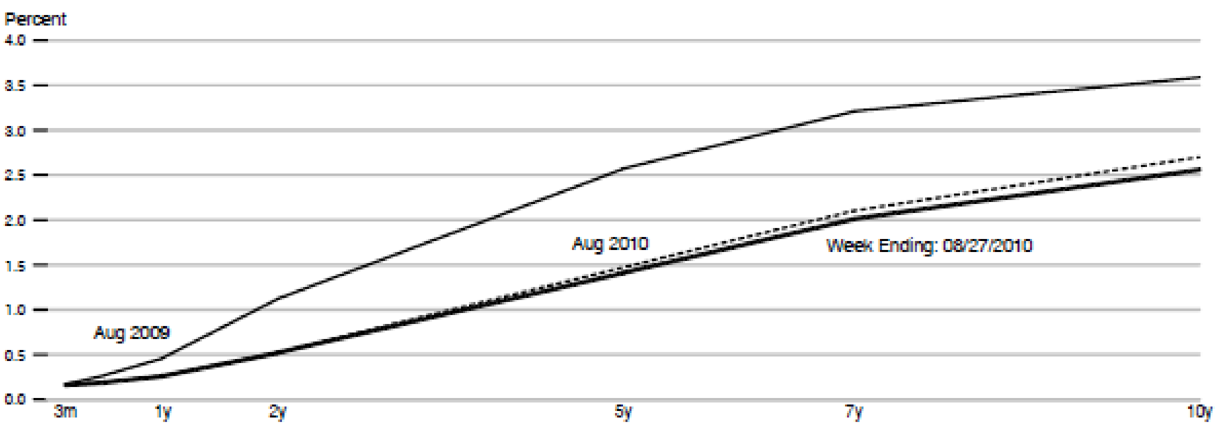
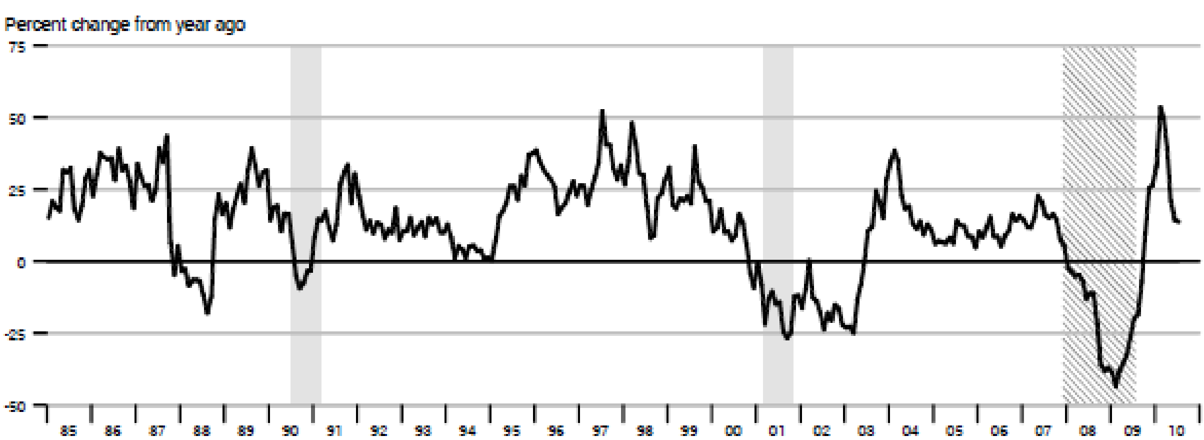
Interest Rates



Treasury Yield Curve



Standard and Poor's 500 Index with Reinvested Dividends

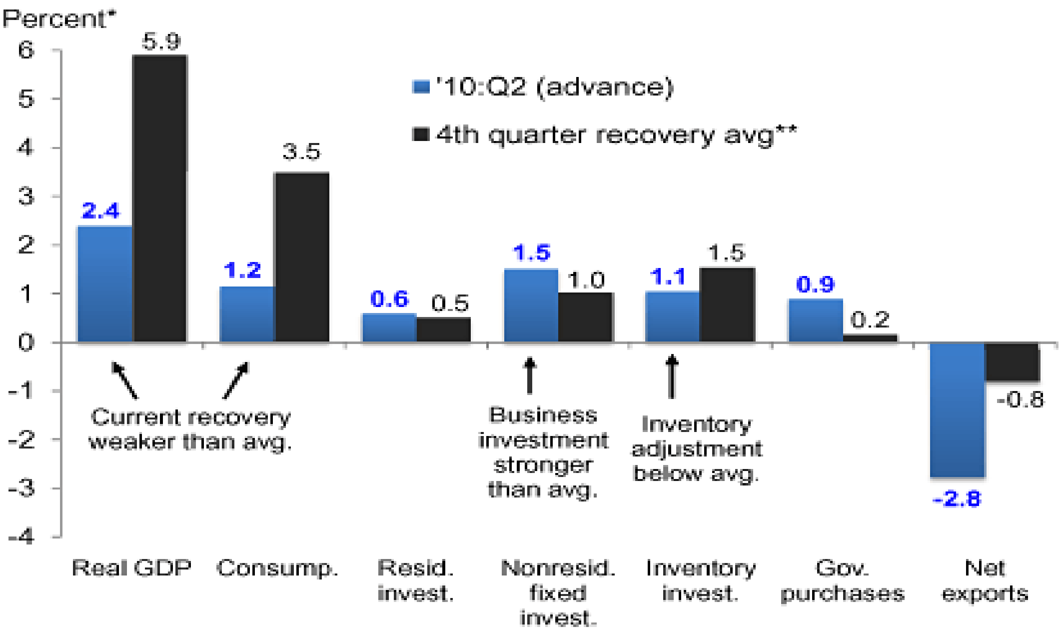


Provided by the Federal Reserve Bank of St. Louis, National Economic Trends. Updated September 1, 2010.

National Update – August 2010
Federal Reserve Bank of Dallas

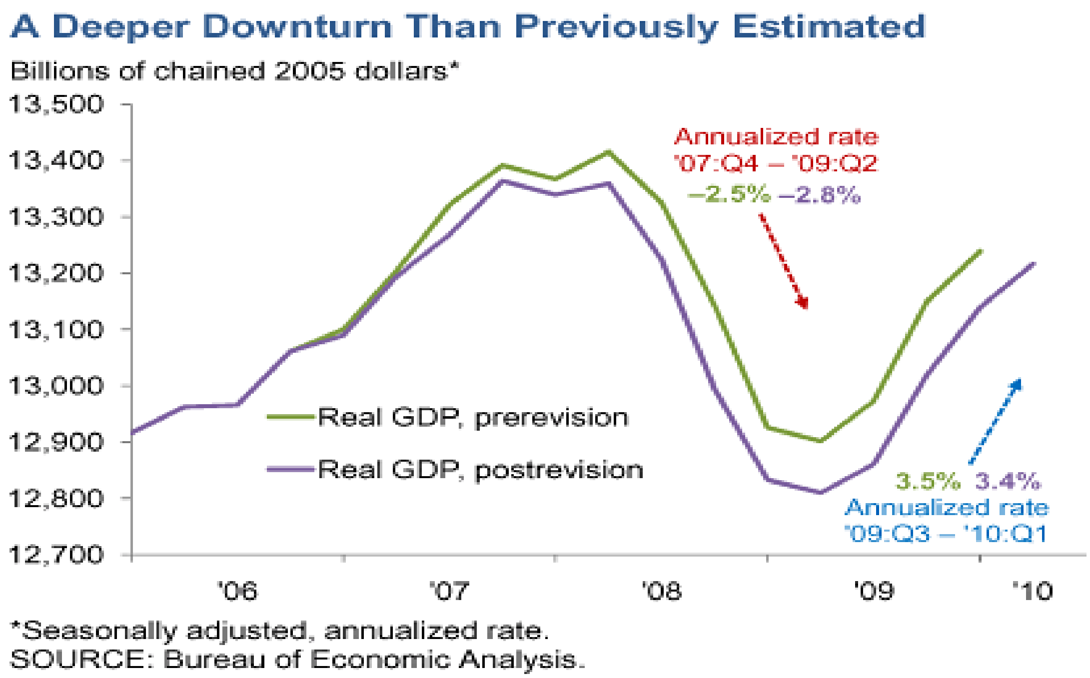
⇩ **Overall Economy** - Data released in the past six weeks suggest a slowing pace of growth in the national economy. In second quarter 2010, real gross domestic product (GDP) grew at a 2.4 percent seasonally adjusted, annualized rate—a significant step below first quarter's 3.7 percent pace. The advance estimate released by the Bureau of Economic Analysis showed that a full percentage point of growth was attributable to inventory investment, leaving final demand growth at a tepid 1.4 percent.

Less-than-Robust Recovery Growth

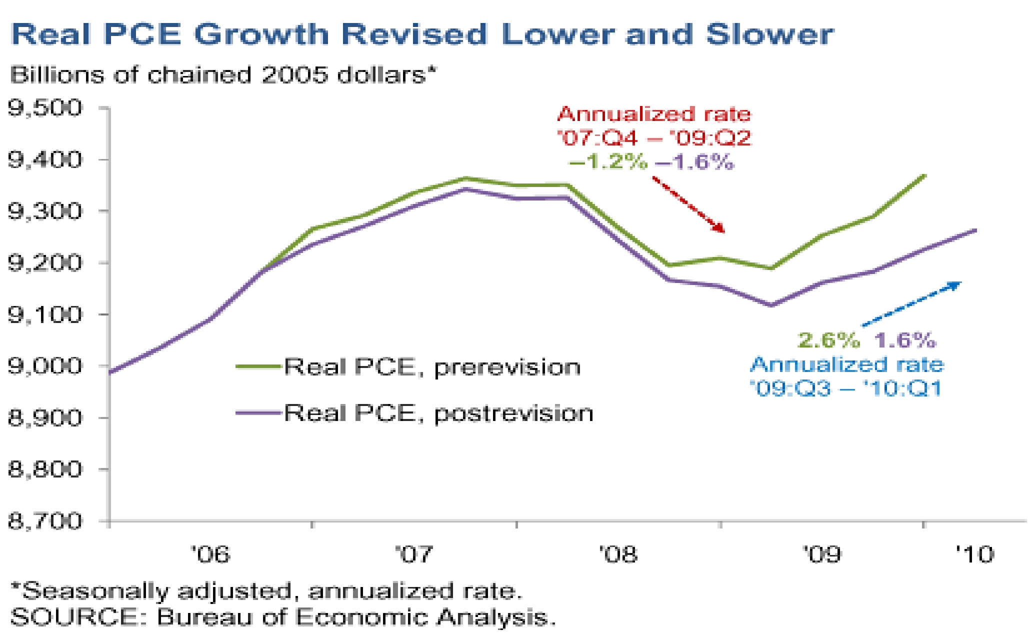


*Seasonally adjusted, annualized rate.
**Components' real GDP contribution in the fourth quarter after NBER-dated recession trough. Average of post-WWII recoveries excluding 1980 recession.
SOURCE: Bureau of Economic Analysis.

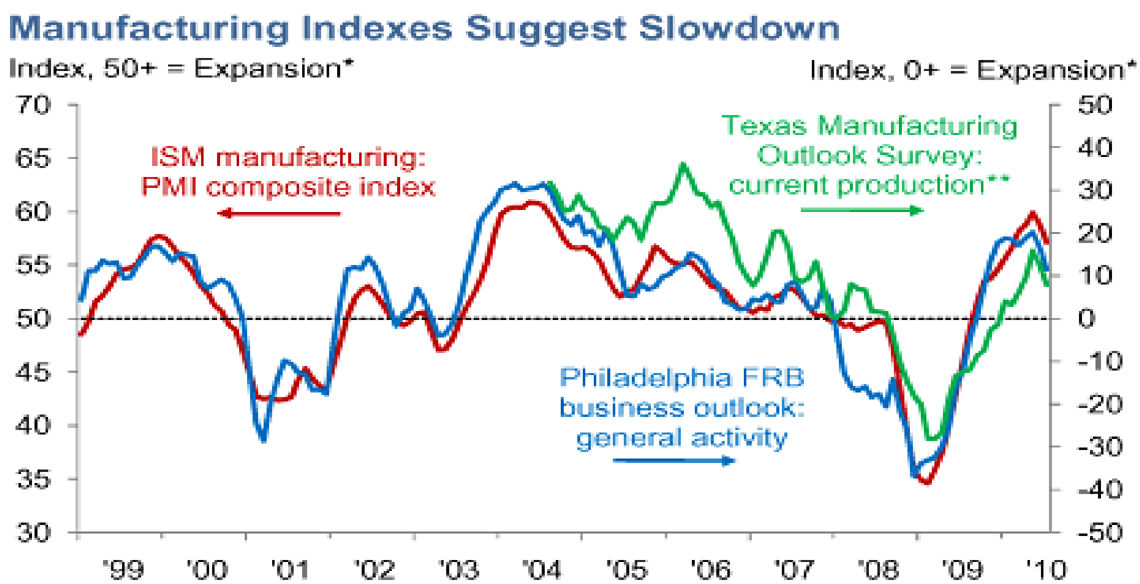
Moreover, the revision to the past several years of national income and product accounts data showed that the contraction in real GDP from late 2007 to mid-2009 was deeper than previously estimated. As of second quarter 2010, real GDP now stands 1.1 percent below its fourth quarter 2007 level; in effect, the revisions set the pace of recovery back a full quarter.(See chart on next page.)



⇩ **Real Spending Shifts Lower and Grows Slower** – As with real output, the contraction in real personal consumption expenditures (PCE) is now estimated to have been deeper—a 1.6 percent annualized decline from fourth quarter 2007 to second quarter 2009 versus the earlier estimate of a 1.2 percent annualized decline. Further, the growth rate since second quarter 2009 is now estimated at an average 1.6 percent annualized pace, a full percentage point below the prerevision growth rate. The pace of consumer spending has tapered off—real PCE growth over the three months ending in June averaged just a 0.7 percent annualized rate compared with a 2.6 percent annualized rate over the three months ending in March.



⇩ **Manufacturing** - Weak final demand growth and the waning inventory cycle have slowed manufacturing sector growth as producers pare back inventories due to slower shipments. Excluding contributions to growth from inventories, final demand growth has been a modest 1.25 percent in the first half of this year. This weakness is corroborated by June's 0.4 percent decline in manufacturing output, a 4.2 point drop in the Institute for Supply Management (ISM) manufacturing index over June and July, and the slower pace of expansion indicated in the Texas manufacturing and Philadelphia Fed business outlook surveys. Buttressed by seven consecutive months of manufacturing employment gains, the manufacturing sector is expanding, but at a slower pace.



*Seasonally adjusted, three-month moving average.
**The Texas Manufacturing Outlook Survey begins in June 2004.
SOURCES: Institute for Supply Management; Federal Reserve Bank of Dallas; Federal Reserve Bank of Philadelphia.

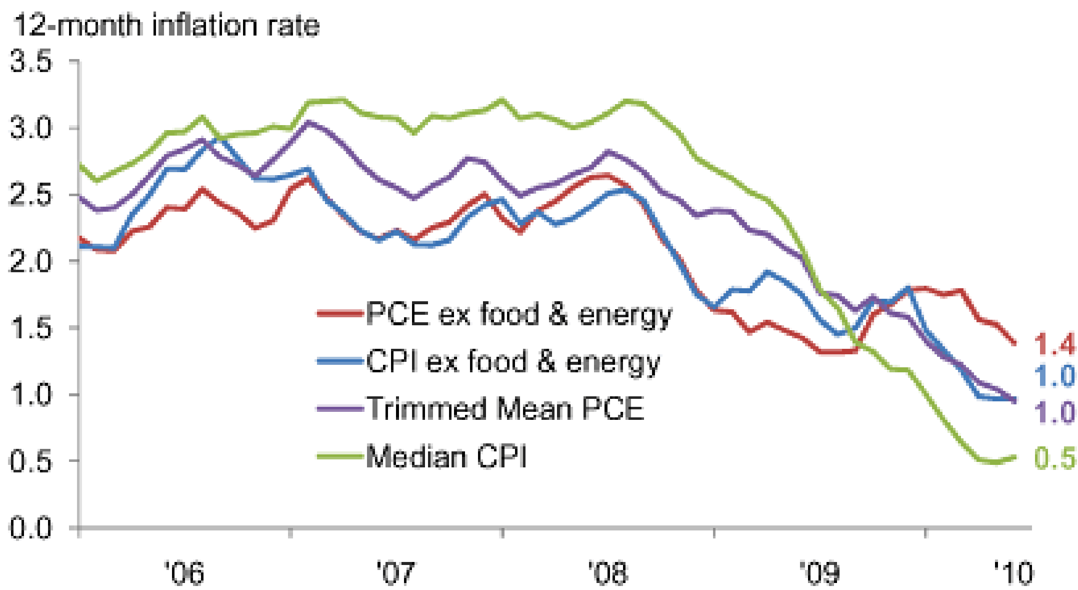
⇧ **Strong Business Investment** - Bright spots in the current GDP release included increased contributions to output from nonresidential fixed investment, government purchases and residential investments. Specifically, the equipment and software category of nonresidential fixed investment increased by more than a 20 percent annualized rate in the first two quarters—the strongest growth rates in a decade. Moreover, business investment seems poised to continue growing in light of recent strength in new orders for core capital goods. Will investment in new capital be the driver for growth going forward? Optimism should remain tempered, given the size of this component of final demand—just 10 percent of GDP. Furthermore, government purchases and residential investment contributions to growth will likely be constrained as fiscal austerity pressures mount and residential investment tax-incentive programs expire.

⇩ **Labor Market Remains Sluggish** - One possible explanation for the deceleration in consumption is the still-sluggish labor market. Private nonfarm payroll gains have increased by 630,000 jobs so far in 2010, with two-thirds of the year-to-date increase occurring in March and April. In July, private payroll employment increased by 71,000 jobs compared with June's downwardly revised 31,000 and May's 51,000 jobs. Private sector jobs have increased in eight of the past nine months, generating sustained but modest increases in employment. However, the household survey's unemployment rate remains at 9.5 percent, given three consecutive months of decline in the following measures: employment, labor force participation and the employment-to-population ratio. The labor market has yet to show sustained employment gains suggestive of a robust recovery.

⇩ **Net Exports Plunge** - At first glance, the recent release of GDP emphatically lowered optimism regarding net exports leading the recovery. Although subject to large revisions, exports contributed roughly the same to growth as in the previous quarter, while imports *subtracted* a record 4.0 percent from final demand. Net exports are in fact likely to be revised lower, considering June's widening of the U.S. trade deficit. Stronger demand for non-U.S. goods and falling import prices relative to export prices contribute *negatively* to overall output, although such a trend may actually point to strengthening in underlying domestic demand.

⇳ **Price Pressures Level Off for Now** - Falling energy prices have kept headline PCE inflation in negative territory for three consecutive months. Given more recent movements in the price of gasoline, this trend will likely be broken. Meanwhile, core consumer inflation measures appear to be stabilizing. This pause in core disinflation reflects a steady pickup in growth rates for rent and owners' equivalent rent so far this year.

Consumer Disinflation Pauses at a Low Level



SOURCES: Bureau of Labor Statistics; Bureau of Economic Analysis; Federal Reserve Bank of Dallas; Federal Reserve Bank of Cleveland.

⇳ **Economic Outlook** – The economy remains on track to continue to expand, though the second half of 2010 will likely be characterized by slowing growth and subdued underlying inflation. U.S. households and businesses remain cautious, partly restrained by uncertainty regarding fiscal and regulatory policy. Though immediate financial market frictions appear to have abated with the improved sentiment concerning European sovereign debt and banking issues, the outlook for investment confidence remains vulnerable to a fragile economic recovery. It remains to be seen whether established job growth and private-sector demand can drive a sustainable economic recovery in the place of diminishing federal stimulus and the temporary impetus of the inventory cycle.

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

Data Series	March 2010	April 2010	May 2010	June 2010	July 2010	August 2010
Unemployment Rate (1)	9.7	9.9	9.7	9.5	9.5	9.6
Change in Payroll Employment (2)	208	313	432	-175	-54(P)	-54 (P)
Average Hourly Earnings (3)	22.48	22.50	22.55	22.55	22.60 (P)	22.66 (P)
Consumer Price Index (4)	0.1	-0.1	-0.2	-0.1	0.3	
Producer Price Index (5)	0.8	-0.1(P)	-0.3(P)	-0.5(P)	0.2(P)	
U.S. Import Price Index (6)	0.4	1.1	-0.8(R)	-1.3(R)	0.2(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 2009	3rd Qtr 2009	4th Qtr 2009	1st Qtr 2010	2nd Qtr 2010
Employment Cost Index (1)	0.4	0.4	0.4	0.6	0.5
Productivity (2)	8.4	7.0	6.0	3.9	-1.8

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 8, 2010

The Beige Book – September 8, 2010
The Federal Reserve Board

⇳ Reports from the twelve Federal Reserve Districts suggested continued growth in national economic activity during the reporting period of mid-July through the end of August, but with widespread signs of a deceleration compared with preceding periods. Economic growth at a modest pace was the most common characterization of overall conditions, as provided by the five western Districts of St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco. The reports from Boston and Cleveland also pointed to positive developments or net improvements compared with the previous reporting period. However, the remaining Districts of New York, Philadelphia, Richmond, Atlanta, and Chicago all highlighted mixed conditions or deceleration in overall economic activity.

Consumer spending appeared to increase on balance despite continued consumer caution that limited nonessential purchases, while activity in the travel and tourism sector picked up relative to seasonal norms. Activity was largely stable or up slightly for professional and other nonfinancial services. Reports on manufacturing activity pointed to further expansion, although the pace of growth eased according to several Districts. Agricultural producers and extractors of natural resources reported continued gains in demand and sales. Home sales slowed further following an initial drop after the expiration of the homebuyer tax credit at the end of June, prompting a slowdown in construction activity as well. Demand for commercial real estate remained quite weak but showed signs of stabilization in some areas. Reports from financial institutions pointed to generally stable or slightly lower loan demand and noted some modest improvements in credit quality.

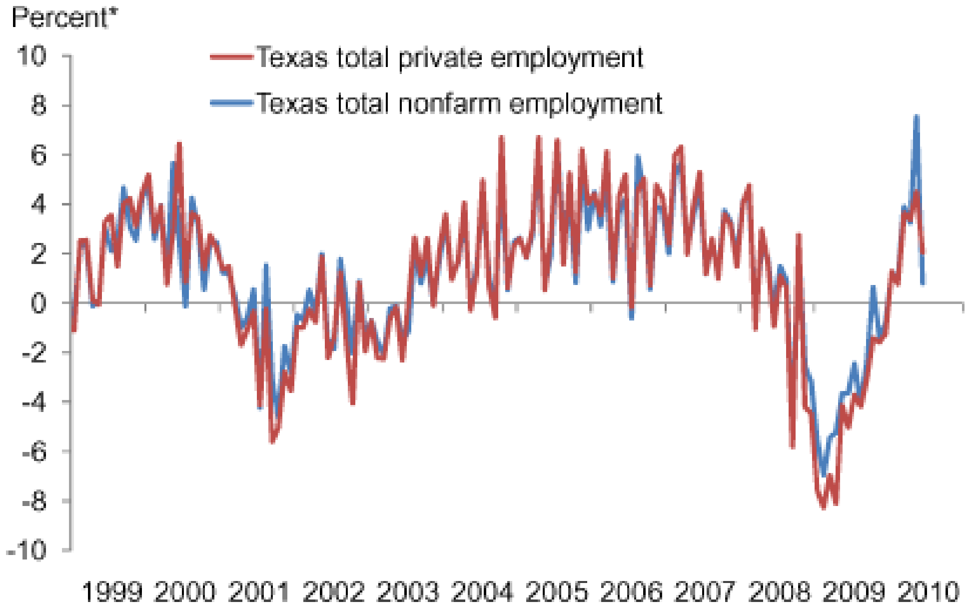
Upward price pressures remained quite limited for most categories of final goods and services, despite higher prices for selected commodities such as grains and some industrial materials. Wage pressures also were limited, although a few Districts noted increased upward pressures in a narrow set of sectors experiencing a mismatch between job requirements and applicant skills.

Regional Economic Update – August 2010
Federal Reserve Bank, Dallas

⇳ **Overall Economy** - Recent data and Federal Reserve Bank of Dallas surveys suggest that the regional economy continues to expand, although there are indications the pace may be slowing. Some sectors of the economy weakened recently. The Texas Manufacturing Outlook Survey's production index, a key indicator of manufacturing conditions, fell below zero in June before moving back into positive territory in July. Other indexes in the Dallas Fed survey, including volume of new orders, posted negative values in July. The housing sector faltered following the expiration of the homebuyer tax credits. Home sales and home construction activity have declined from April's levels. On a more positive note, high-tech orders remain robust, and the energy sector is contributing strongly to economic growth.

⇧ **Job Growth Positive but Slower** - Texas employment grew in June at an annualized rate of 0.8 percent. This is a sizeable slowdown from May's annualized growth of 7.5 percent; however, May's figure was driven in part by Census hiring. Private employment (which excludes government) fared better, expanding at a 2.1 percent annualized pace in June, compared with over 3 percent the previous three months.

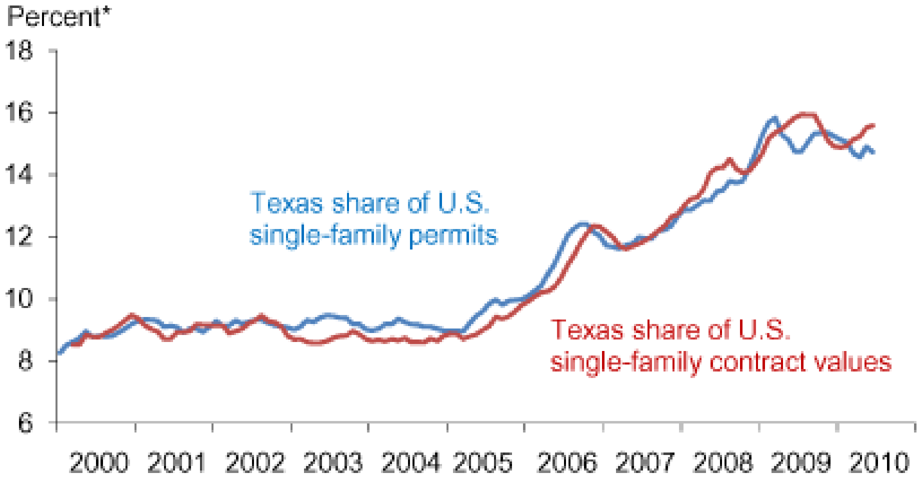
Monthly Payroll Data Show Slowdown in June



*Month/month; seasonally adjusted, annualized rate.
SOURCES: Texas Workforce Commission; seasonal and other adjustments by the Federal Reserve Bank of Dallas.

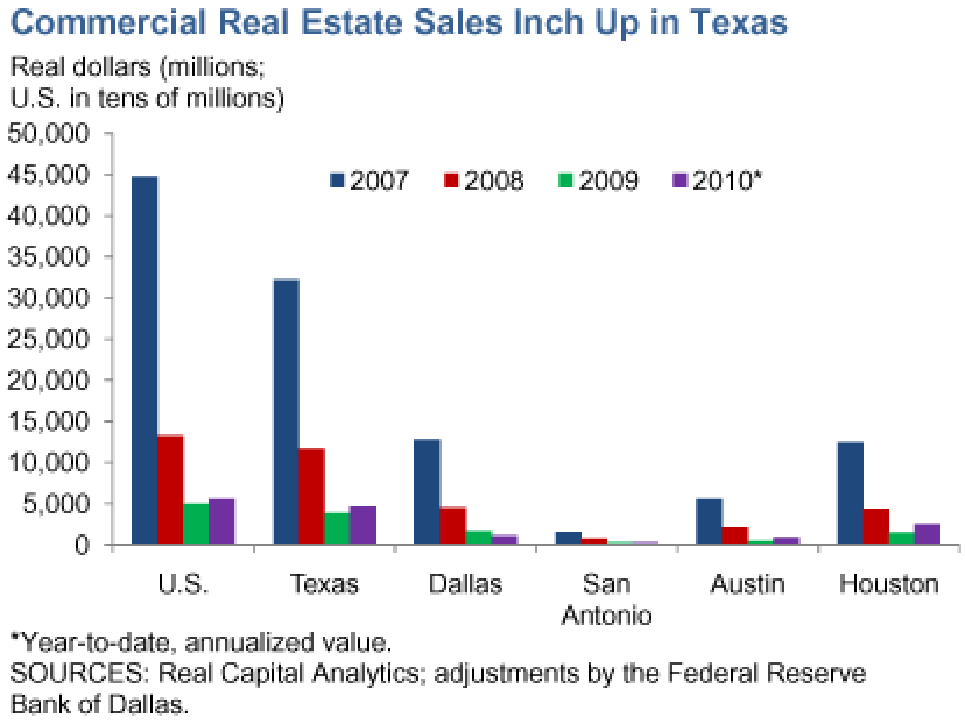
⇩ **Housing Falters After Tax Credits Expire** - As expected, the Texas housing market weakened after the most recent homebuyer tax credits expired in April. Month-over-month existing-home sales fell 11 percent in June but remain 10 percent above a year ago. Home price indexes suggest the tax credits may have helped to prop up housing prices, at least in the short term. Inflation-adjusted single-family contract values for new homes in Texas fell 18.3 percent from April to June, and single-family permits fell 12 percent over the same period. Despite the declines, Texas represented 15.6 percent of U.S. single-family contract values and 14.7 percent of single-family permits in June.

Texas Share of U.S. Housing Construction Still Large

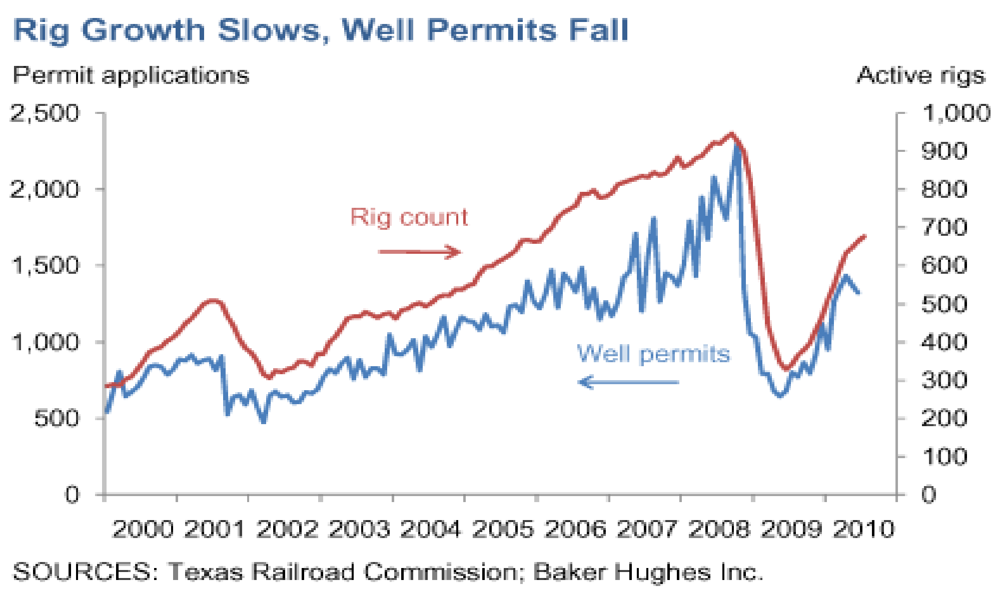


*Seasonally adjusted.
NOTE: Series smoothed using five-week moving average.
SOURCES: Census Bureau; F.W. Dodge; calculations and adjustments by the Federal Reserve Bank of Dallas.

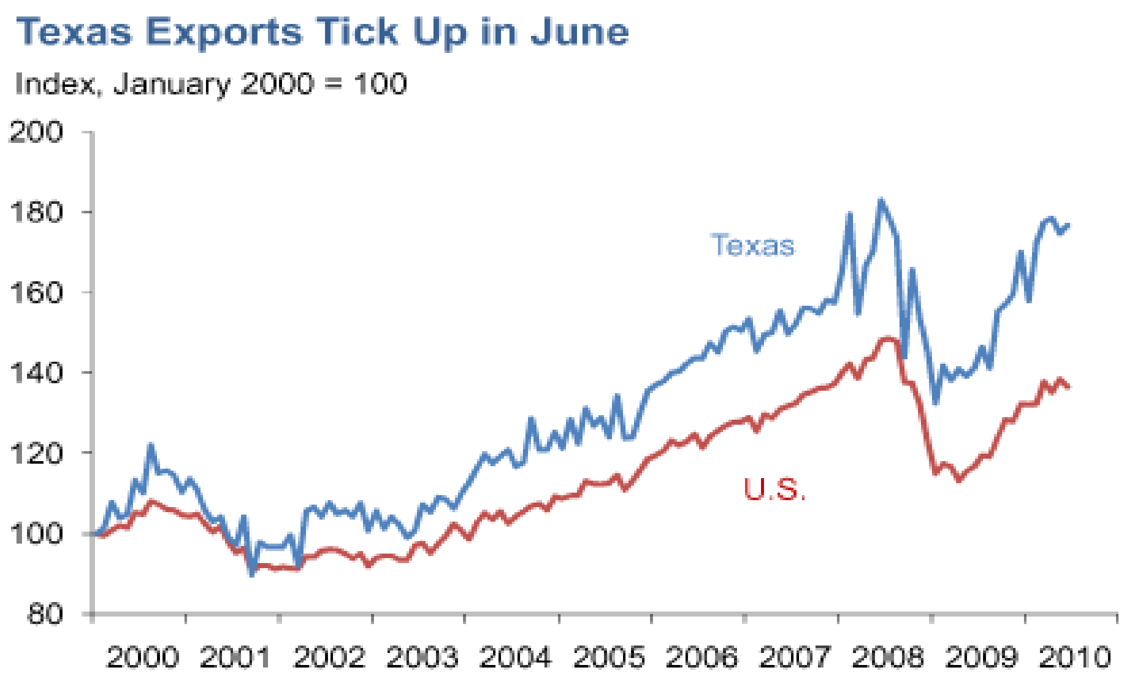
⇧ **Commercial Real Estate Struggles -** Private nonresidential construction levels remain depressed at near historic low levels, with public projects accounting for most new nonresidential construction. Office, industrial and retail leasing activity remains soft, and vacancy rates are still elevated across these sectors. Commercial property sales offer a glimmer of hope for nonresidential markets in the U.S. and Texas as volumes inched up in the first quarter. Although newer data are not yet available, respondents to the Dallas Fed's Beige Book, an anecdotal report on economic conditions, suggest that positive sales growth continued into the second quarter. (See next page.)



⇧ **<u>Energy Sector Boosts Texas</u> -** A strong energy sector heavily contributed to the Texas economy's positive first-half growth. Oil prices above $77 per barrel and natural gas prices at $4.6 per thousand cubic feet have resulted in oil-focused drilling, although natural gas drilling has been stable despite low prices. Rig counts have risen steadily since June 2009 to nearly double the number in operation a year ago. Well permits had also trended upward before falling slightly in June.



⇧ **Texas Exports Rise Again** - Strong global demand has lifted Texas exports from their 2009 lows. The inflation-adjusted value of Texas exports dipped 2.2 percent in May but rebounded in June to rise 1.1 percent. Texas exports are now 25.1 percent above year-ago levels.

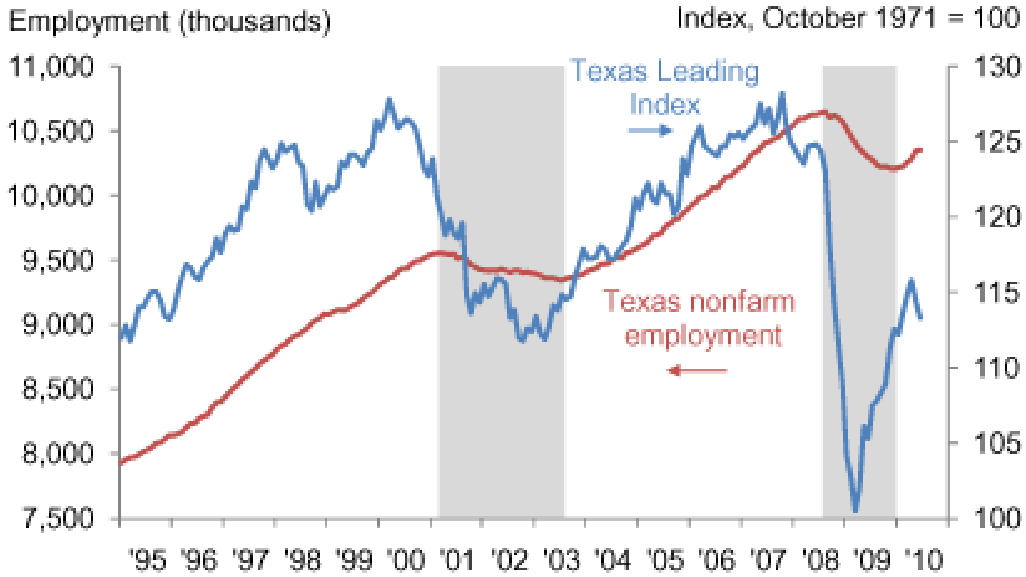


SOURCES: Census Bureau; adjustments by the Federal Reserve Bank of Dallas.

⇳ **Retail Sales Rise, Confidence Falls** - The Dallas Fed's estimate of Texas retail sales in May rose nearly 1 percent from the previous month, while the U.S. retail sales estimate fell by a similar amount. The Dallas Fed Beige Book noted retailers expect gradual improvement in sales through year-end. Consumer confidence for the West South Central region, which includes Texas, dipped in June and July, but is up from lows recorded in 2009. At a seasonally adjusted level of 66.1 in July, the West South Central index exceeds the national level of 50.4.

⇩ **Slight Slowdown Seen Ahead** - After nearly reaching a two-year high in April, the Texas Leading Index—the Dallas Fed's composite of leading economic indicators—fell 1.2 percent in May and 0.9 percent in June. The trend suggests somewhat slower growth is on the horizon. The Dallas Beige Book and TMOS noted in July that uncertainty is a large factor in businesses' less-optimistic outlooks. (See chart on next page.)

Slower Growth Ahead for Texas



NOTE: Shaded areas represent Texas recessions.
SOURCES: Texas Workforce Commission; Federal Reserve Bank of Dallas.

Texas Economic Statistics
U.S. Bureau of Labor Statistics

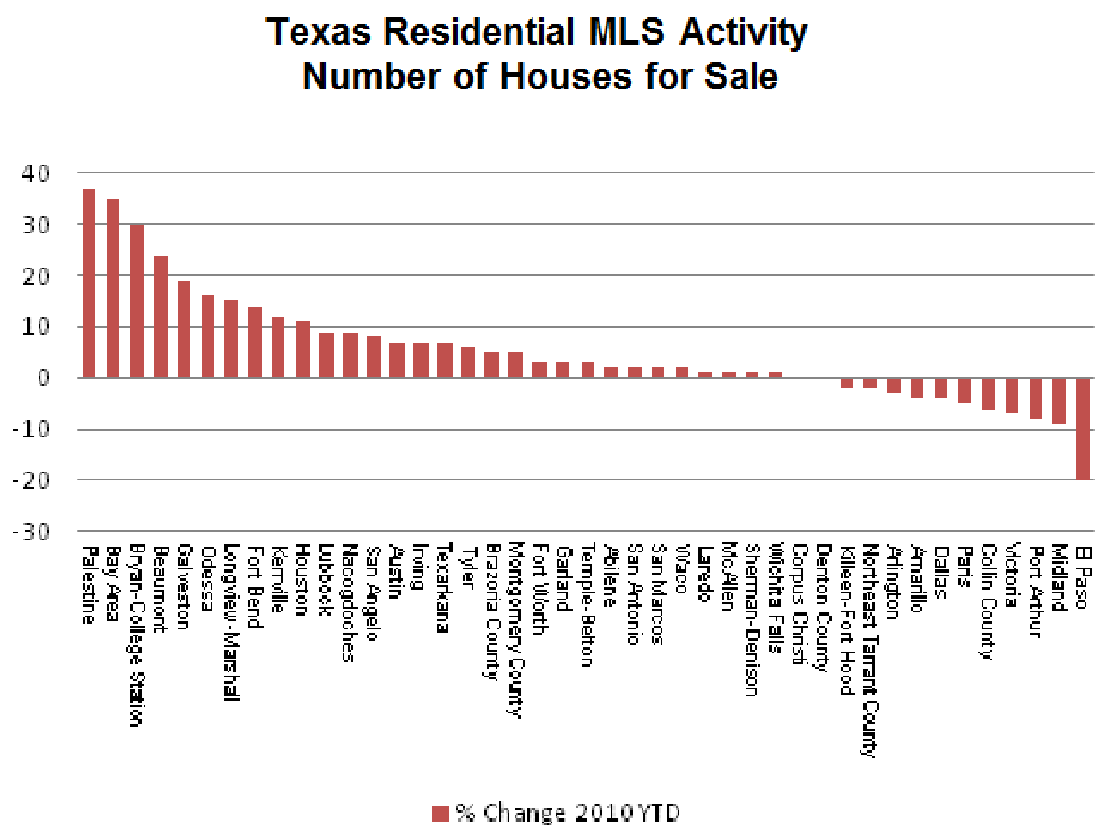
Texas

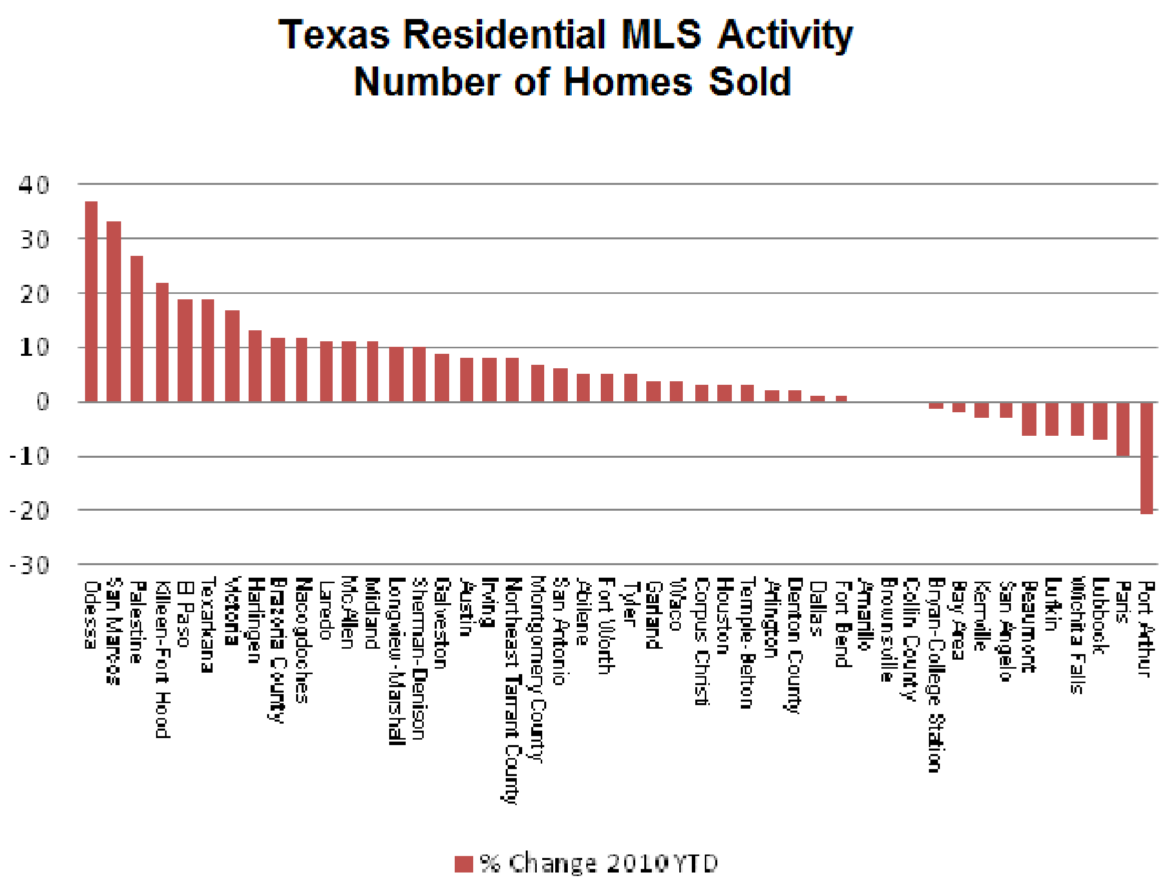
Data Series	Feb 2010	Mar 2010	Apr 2010	May 2010	June 2010	July 2010
Labor Force Data						
Civilian Labor Force (1)	12,131.5	12,160.0	12,210.8	12,223.8	12,177.1	(P) 12,133.3
Employment (1)	11,131.2	11,157.5	11,202.2	11,215.0	11,178.1	(P) 11,134.0
Unemployment (1)	1,000.4	1,002.6	1,008.7	1,008.9	999.0	(P) 999.3
Unemployment Rate (2)	8.2	8.2	8.3	8.3	8.2	(P) 8.2
Nonfarm Wage and Salary Employment						
Total Nonfarm (3)	10,235.8	10,278.0	10,311.7	10,383.6	10,395.8	(P) 10,400.4
12-month % change	-2.1	-1.2	-0.4	0.6	1.1	(P) 1.3
Mining and Logging (3)	199.8	204.6	208.1	215.2	218.3	(P) 222.9
12-month % change	-9.9	-5.6	-0.7	4.6	8.3	(P) 11.3
Construction (3)	550.0	543.8	556.5	561.1	564.0	(P) 568.3
12-month % change	-13.4	-12.5	-8.6	-6.8	-5.2	(P) -4.3
Manufacturing (3)	817.4	821.0	823.7	829.6	832.4	(P) 836.7
12-month % change	-7.2	-5.4	-3.6	-1.7	0.1	(P) 1.7
Trade, Transportation, and Utilities (3)	2,045.5	2,045.5	2,042.4	2,047.9	2,056.6	(P) 2,056.4
12-month % change	-2.5	-1.9	-1.6	-0.9	-0.1	(P) 0.2
Information (3)	199.2	197.7	194.4	191.8	191.1	(P) 188.6
12-month % change	-5.4	-5.6	-6.5	-6.9	-6.7	(P) -7.5
Financial Activities (3)	623.4	621.8	622.6	624.9	624.4	(P) 628.1
12-month % change	-2.0	-1.8	-1.3	-0.7	-0.4	(P) 0.4
Professional & Business Services (3)	1,232.7	1,241.1	1,243.6	1,254.3	1,266.2	(P) 1,278.8
12-month % change	-4.1	-2.7	-1.2	0.2	1.6	(P) 3.2
Education & Health Services (3)	1,365.8	1,373.5	1,385.8	1,383.6	1,387.3	(P) 1,385.1
12-month % change	4.2	4.4	4.8	4.2	4.1	(P) 3.3
Leisure & Hospitality (3)	1,004.5	1,018.6	1,013.3	1,020.8	1,014.5	(P) 1,015.8
12-month % change	-0.6	0.9	0.6	1.3	0.8	(P) 1.2
Other Services (3)	356.9	360.3	367.0	367.8	363.1	(P) 365.1
12-month % change	-1.9	-0.6	1.6	1.6	0.3	(P) 0.8
Government (3)	1,840.6	1,850.1	1,854.3	1,886.6	1,877.9	(P) 1,854.6
12-month % change	2.0	2.4	2.2	3.9	3.1	(P) 1.8
Mass layoffs						
Layoff events, all industries	56	49	73	77	63	51
Initial claimants, all industries	4,894	7,243	7,116	7,037	6,711	4,667

Footnotes
(1) Number of persons, in thousands, seasonally adjusted.
(2) In percent, seasonally adjusted.
(3) Number of jobs, in thousands, seasonally adjusted.
(P) Preliminary

Data extracted on: September 08, 2010

Source: U.S. Bureau of Labor Statistics


Texas Residential MLS Activity
Number of Houses for Sale
40
30
20
10
0
-10
-20
-30
Palestine
Bay Area
Bryan-College Station
Beaumont
Galveston
Odessa
Longview-Marshall
Fort Bend
Kerrville
Houston
Lubbock
Nacogdoches
San Angelo
Austin
Irving
Texarkana
Tyler
Brazoria County
Montgomery County
Fort Worth
Garland
Temple-Belton
Abilene
San Antonio
San Marcos
Waco
Laredo
McAllen
Sherman-Denison
Wichita Falls
Corpus Christi
Denton County
Killeen-Fort Hood
Northeast Tarrant County
Arlington
Amarillo
Dallas
Paris
Collin County
Victoria
Port Arthur
Midland
El Paso
% Change 2010YTD


Texas Residential MLS Activity
Number of Homes Sold
40
30
20
10
0
-10
-20
-30
Odessa
San Marcos
Palestine
Killeen-Fort Hood
El Paso
Texarkana
Victoria
Harlingen
Brazoria County
Nacogdoches
Laredo
McAllen
Midland
Longview-Marshall
Sherman-Denison
Galveston
Austin
Irving
Northeast Tarrant County
Montgomery County
San Antonio
Abilene
Fort Worth
Tyler
Garland
Waco
Corpus Christi
Houston
Temple-Belton
Arlington
Denton County
Dallas
Fort Bend
Amarillo
Brownsville
Collin County
Bryan-College Station
Bay Area
Kerrville
San Angelo
Beaumont
Lufkin
Wichita Falls
Lubbock
Paris
Port Arthur
% Change 2010YTD

❖ **Senior Loan Officer Opinion Survey -** The July 2010 Senior Loan Officer Opinion Survey on Bank Lending Practices addressed changes in the supply of, and demand for, bank loans to businesses and households over the past three months. The survey included a set of special questions that asked respondents about lending to European firms and their affiliates and subsidiaries. This summary is based on responses from 57 domestic banks and 23 U.S. branches and agencies of foreign banks.

- **Commercial and Industrial Lending** - The results of the July survey indicated that a modest net fraction of domestic respondents had eased standards for lending to large and middle-market firms over the previous three months--the second consecutive survey showing such an easing. For the first time since 2006, banks reported having eased their lending standards on C&I loans to small firms. In particular, around one-fifth of large domestic banks reported having eased lending standards for small firms, which offset a net tightening of standards by a small fraction of other banks.

  - **C&I loans.** Many banks indicated that they had eased terms on C&I loans, with especially sizable net fractions of domestic banks reporting that they had reduced spreads of loan rates over their bank's cost of funds and had trimmed the costs of credit lines. On net, large domestic banks had eased each of the seven surveyed loan terms for firms of all sizes. Other domestic banks reported a net easing of the spread of loan rates over their own cost of funds and of the costs associated with credit lines, but small net fractions of those banks had increased premiums for riskier borrowers and had tightened the majority of nonprice loan terms, particularly loan covenants. Domestic banks also reported that they had stopped reducing the size of existing credit lines for commercial and industrial firms, on net--the first time that banks had not reported cutting such lines since these questions were added to the survey in January 2009. Nearly all of the respondents that reported having eased standards or terms on C&I loans cited more aggressive competition from other banks or nonbank lenders (other financial intermediaries or the capital markets) as an important reason for doing so, and about one-half of the respondents that eased pointed to a more favorable or less uncertain economic outlook. Respondents that had tightened lending policies--primarily smaller banks in the sample--generally attributed the move to a less favorable or more uncertain economic outlook, rather than bank-specific factors such as concerns about their capital or liquidity positions. On balance, demand for C&I loans from large and middle-market firms and from small firms changed little in the July survey. In the April survey, banks had reported weaker demand from firms of all sizes. A shift in customer borrowing to their bank from other credit sources and customers' increased financing needs for inventory and receivables were the most common reasons cited in the current survey by banks that had experienced higher loan demand. The net percentage of respondents that pointed to customers' increased investment in plant or equipment as an important reason for stronger demand for C&I loans also edged up relative to the April survey. In the July survey, U.S. branches and agencies of foreign banks reported that their standards for approving C&I loans had remained basically unchanged, after having reported a net easing of such standards in April. Small net fractions of foreign respondents still reported having eased most loan terms in the current survey, but the reported easing was much less widespread than in the April survey. Moreover, branches and agencies had tightened premiums charged on riskier loans, on balance. A modest net fraction of branches and agencies of foreign banks reported that demand had been stronger over the previous three months.

  - **Commercial real estate lending.** In the July survey, most respondents reported no change in their bank's standards for approving commercial real estate loans. The net percentage of banks that reported that their standards had tightened was small, and it dropped slightly relative to the April survey. Overall, the net fraction of banks that reported that demand for CRE loans had decreased continued to be small.

  - **European firms and their affiliates and subsidiaries.** A set of special questions asked respondents about lending to firms headquartered in Europe--both nonfinancial companies and banks, as well as their affiliates and subsidiaries. Only about 22 of the 57 domestic respondents indicated that they made loans or extended credit lines to European firms. While only small net percentages of domestic and foreign respondents indicated that their standards and terms on loans to European nonfinancial companies had tightened, somewhat larger net fraction indicated that they had tightened their policies for lending to European banks. Both domestic and foreign respondents indicated, on net, almost no change in demand for loans from European firms or their affiliates or subsidiaries. However, modest net percentages of respondents of both types reported that the number of inquiries regarding the availability of new or increased lines of credit from European borrowers had risen over the past three months.

- **Lending to Households** -
  - **Residential real estate lending.** On net, a small fraction of domestic banks reported having eased standards on prime residential mortgage loans; the few respondents that had eased standards were all large banks. The increase in demand over the past few months for prime residential mortgage loans reported by several respondents to the current survey marked a reversal of the net weakening of demand for such loans reported in the April survey. Fewer than one-half of survey respondents indicated that their bank originated nontraditional mortgage loans. Of these respondents, nearly all reported no change in their bank's standards for extending such loans. The small number of banks that reported an increase in demand for nontraditional mortgage loans balanced the number of banks that reported a decrease in demand. In the April survey, one-third of banks, on net, reported that demand for nontraditional mortgage loans had weakened. A small share of respondents reported that their bank's standards for approving home equity lines of credit (HELOCs) had eased over the past three months. However, a similar fraction of respondents indicated that they had decreased the size of HELOCs for existing customers over the same period. A small net percentage of banks reported that demand for HELOCs had weakened, on net, down sharply from the April survey.
  - **Consumer lending.** The net percentage of respondents that reported an increased willingness to make consumer installment loans increased relative to three months ago, extending the upward trend that it has exhibited in recent quarters, reaching the upper end of its range over the past decade. Consistent with this increased willingness, respondents, on net, reported a net easing of standards for approving consumer loans other than credit card loans. However, terms on consumer loans other than credit card loans were reported to have been roughly unchanged, on net, in the July survey. Indicators of changes in standards and terms for approving applications for credit card loans were mixed. A few banks reported having eased standards, but small net fractions of respondents indicated that they had tightened terms and conditions on credit card accounts. Moreover, a small fraction of banks, on net, reported having reduced the size of credit card lines for existing customers, though that fraction has decreased noticeably over the past few surveys. Large banks reported a net easing of terms on credit card loans, while other banks reported a net tightening. On balance, a small percentage of respondents indicated that demand for consumer loans of all types had weakened. A modest net percentage of large banks reported an increase in demand for the second consecutive quarter, but a slightly larger net percentage of other banks reported a decrease in such demand.

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