# Condition of the Texas State Banking System

September 2012

Financial Data as of June 30, 2012

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

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| **Symbols Used Throughout this Report:** | **Abbreviations Used Throughout this Report:** |
|---|---|
| ⇧ Improving or strong conditions<br>⇩ Deteriorating or weak conditions<br>⇳ Mixed conditions<br>❖ Interest item | FDIC – Federal Deposit Insurance Corporation<br>OCC – Office of the Comptroller of the Currency<br>FRB – Federal Reserve Board |


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This publication is also located on the Texas Finance Commission website: www.fc.texas.gov


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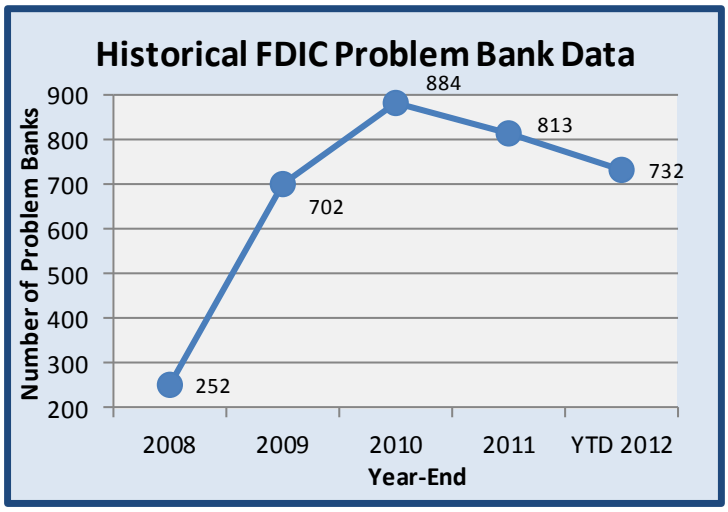
## BANKING SYSTEM OVERVIEW

The banking industry is making gradual but steady progress toward recovery as the national economy continues its slow recuperation from the recession. Nationally, financial institution profits are improving. Levels of troubled assets and troubled institutions remain high, but are slowly shrinking. Loan growth improved in the first six months of the year and loan loss provisions are on the decline.

With improving conditions, some banks are looking to grow and expand into new markets. Across the nation industry analysts are attributing an increase in mergers and acquisitions (M&A) of smaller banks due to the increased regulatory burden and competition from larger institutions. Further fueling the M&A arena are concerns over the proposed rules in BASEL III, which analysts say could hurt the valuations of some banks by lowering their book values. However, in Texas the overall size and relatively healthy marketplace makes it an attractive state for lenders, leaving growth-minded banks to pursue mergers and acquisitions to fuel expansion. The healthier financial performance of Texas' financial institutions is partly due to the strong local economies experiencing stable job and population growth and the overall effects of the thriving energy industry. While M&As are more common today, new charters have all but ceased. FDIC reports that no new charters have been opened in one year. The Texas Department of Banking has not had a new de novo charter since June 2009, while the Texas Department of Savings and Mortgage Lending has not had a new de novo charter since February 2008.




*Source: FDIC* *Data as of June 30, 2012*

The improving economic environment has also led to a decrease in the number of FDIC problem banks[1], which has steadily declined since 2010. The number of failed banks is at its lowest level since the beginning of the financial crisis. Between January 2012 and September 30, 2012, 43 financial institutions had failed, 31 less than the number of failures during the same period in 2011.

As of September 30, 2012, the Texas Department of Banking reported 41 problem banks[2], an improvement of eight banks from year-end 2011. The Texas Department of Savings and Mortgage Lending listed six state-savings banks as problem thrifts[3] as of September 30, 2012, improving from the 10 reported in September 30, 2011. State and federal regulators remain diligent in monitoring problem institutions.

However, the improved conditions do not come without some uneasiness. Quarterly surveys conducted by the Department of Banking indicate that bankers are persistently concerned over regulatory burden and the low interest rate environment that continues to squeeze net interest margins (NIM).

Bankers express concerns over the costs of complying with the growing number of compliance regulations, which can cut into revenues for smaller community banks. Noninterest income has been affected by regulatory changes, and banks are trying to find other sources of income. Further pressures are being placed on earnings due to the low interest rate environment. Concerns are growing with regard to the proposed BASEL III rules that may take effect next year. The proposed rule could raise capital requirements and target loan loss reserves. Analysts indicate this could curtail financial institution lending.

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[1] *The FDIC defines problem banks as any financial institution with a composite rating of "4" or "5".*
[2] *The Texas Department of Banking defines problem banks as any financial institution with a composite rating of "3", "4" or "5".*
[3] *The Texas Department of Savings and Mortgage Lending defines problem savings banks as any financial institution with a composite rating of "3", "4" or "5".*

## STATE-CHARTERED BANKING PROFILE (DEPARTMENT OF BANKING)

The number of Texas state-chartered banks declined from 302 to 300[4] in the first half of the year, primarily due to mergers. However, total assets and total deposits grew dramatically as a result of Frost Bank's June 2012 conversion to a Texas state-chartered bank. Over the last six months, total assets of state-chartered banks grew by over $25.9 billion to $196.3 billion while total deposits increased by $21.3 billion to $159.8 billion. This dramatic increase is the result of Frost Bank's conversion and the normal growth in total assets and deposits. Exclusive of the Frost Bank charter conversion, total assets and deposits increased with annualized growth rates of 5.9% and 5.6% respectively.

The agency has noted an elevated interest in conversions to a Texas state-charter following Frost Bank's conversion in June. Additionally, the Department continues to exhibit a measured flow of merger applications as Texas state-chartered banks take advantage of opportunities to grow and position themselves for the future.

## STATE-CHARTERED THRIFT PROFILE (DEPARTMENT OF SAVINGS AND MORTGAGE LENDING)

Increased profitability occurred in 73% of the thrift institutions during the first half of 2012, due to an increase in the level of loans, a decreased cost of funds, an increase in noninterest income, and a decline in provisions needed for loan and lease losses. Nonperforming loans and other real estate decreased in state-chartered thrifts during the first half of 2012 by $50 million. Past due and nonaccrual loans, and foreclosed real estate continue to be monitored closely by state and federal regulators.

State-chartered thrift assets under the Department's jurisdiction totaled $9.5 billion as of June 30, 2012, and increased by 2% or $173 million from the end of last year. The total number of state-chartered savings banks at mid-2012 decreased from thirty-one to thirty, with one charter merging out of the industry.

The Department continues to receive and process a fair volume of applications as the industry continues to expand. During the first half of the year, there have been four charter conversion applications received from a federal savings bank and three national banks, two branch office applications, one merger application between two state savings banks, one merger application between three converted national banks, and various other types of applications. Due to the merger of the Office of Thrift Supervision into the Office of Comptroller of the Currency as of July 21, 2011, further conversion activity to a state thrift charter is anticipated.

## TEXAS ECONOMIC PROFILE

Texas continues to be recognized for having a stable economy, some job growth, and a business-friendly environment. The state's strength has been the energy industry, while sectors, such as healthcare and technology, provide additional support to the economy. Recently, Business Facilities magazine ranked Texas' business climate as the best in the nation. Additionally, the U.S. Chamber of Commerce-National Chamber Foundation's Enterprising States study named Texas a leader in job growth and one of the states most likely to grow.

### WORKFORCE

At last year-end, economists predicted continued job growth for Texas in 2012. Through the first six months of 2012, nonagricultural jobs were added. According to the July 2012 labor market data released by the Texas Workforce Commission, six of the 11 major industries added jobs from June to July.

- 12,600 jobs in education & health services
- 8,700 positions in government
- 8,500 in professional and business services
- 4,200 in manufacturing
- 300 jobs in mining and logging
- 200 in construction

[4] *FDIC financial data does not include one state-chartered bank that has fiduciary activities only and does not have the power to accept or pay deposits. Therefore, the institution is not required to report financial information to the FDIC.*

At the height of the recession in December 2010, Texas' unemployment reached 8.3%. Although the unemployment rate has been at or below the national rate for the last five and a half years, it still remains higher than prerecessionary levels. As of July 2012, the state's unemployment rate was at 7.2%, which is much higher than the 4.8% it was in July 2008.

### Energy Sector

The state has benefited from oil drilling and production operations. Advances in drilling technologies continue to lead to new drilling opportunities. Various parts of the state are experiencing economic stimulus from the latest oil boom. Data suggest that the boom's impact on jobs, income and spending has been profound, particularly in and around the Eagle Ford Shale formation. The influx of businesses and residents in these areas assist with the overall economy of the region and directly benefit existing hotels, restaurants, real estate, healthcare, education and retail services. However, housing and infrastructure needs remain high in these areas. Reports indicate that companies are reluctant to invest in long-term projects that rely on the energy companies' presence in South Texas.

Crude oil futures closed at $94.62 on August 30, 2012**,** approximately $13.00 less than it was trading at the beginning of March 2012. Natural gas futures prices reached a summer 2008 high of $13.58, however it has trended downward since then closing at $2.75 on August 30, 2012.

### Tax Revenue

According to the Texas Comptroller of Public Accounts, tax collections are on the rise, signaling that the Texas economy has emerged from the recession. Texas sales tax receipts for July 2012 were 10.1% higher than in July 2011. Sales tax collections have increased for 28 consecutive months (year-over-year), boosted by strong business spending in the oil/natural gas and manufacturing sectors, and to a lesser extent by retail sales activity. Oil and natural gas production tax collections in the first 11 months of fiscal 2012 were 44% higher than during the same period in 2011.Texas motor vehicle sales and rental tax collections for July 2012 were up 29.4% from July 2011.

**Foreclosure Rates**

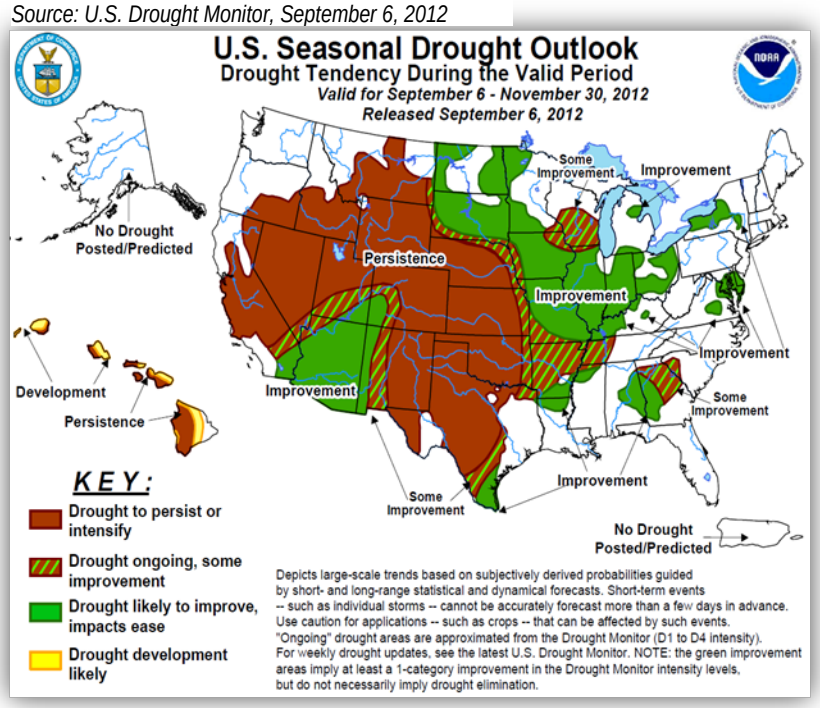
| State | Rate |
|---|---|
| California | 1 in 325 |
| Arizona | 1 in 346 |
| Florida | 1 in 352 |
| Georgia | 1 in 376 |
| Texas | 1 in 1,001 |

*July 2012*
*Source: Texas Comptroller of Public Accounts*

### Housing

An increase in homes sales, construction permits, and apartment leasing is yet another signal that the state has emerged from the recession. Experts indicate that home sales, prices, and new construction statewide for the remainder of 2012 and into 2013 will continue to improve. Employment and population gains are driving the housing markets. Foreclosure rates remain higher in other states. In July 2012, the Texas foreclosure rate was one in every 1,001 mortgages.

*Source: U.S. Drought Monitor, September 6, 2012*




## Drought Continues to Impact Economy

The high temperatures and dry conditions from the 2011 drought continued to impact Texas and the economy in 2012. Texas Governor Rick Perry has renewed his proclamation to extend the drought emergency seven times this calendar year.

The most recent report from the National Weather Service outlook predicts the drought is expected to persist through at least November.

Relief is anticipated later in the year as an El Niño weather pattern develops, increasing the odds that there will be some degree of improvement across a large portion of the Southwest and southern Texas.

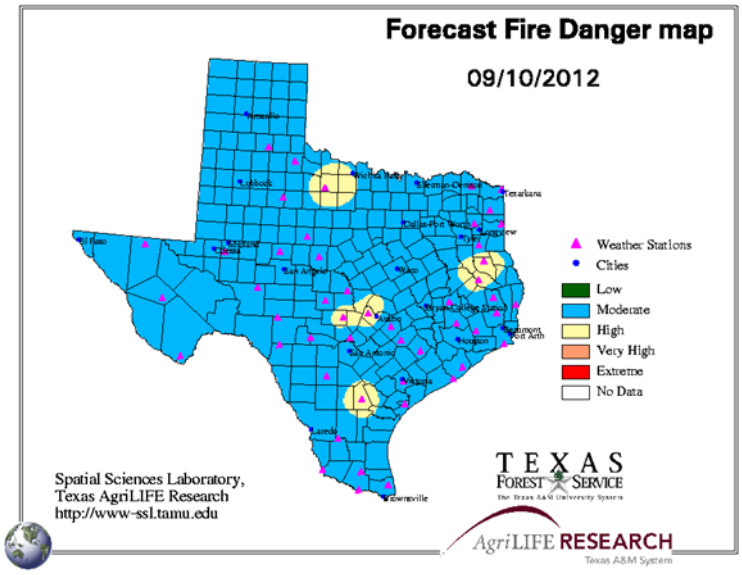
The lack of rainfall has added to the hardships faced by farmers and ranchers. The drought has parched grazing land for Texas livestock. Farmers and their agricultural crops, including citrus, corn, cotton and rice industries, have been virtually destroyed this season by the drought. According to the Texas AgriLife Extension Service, the damaged corn crop is reportedly costing Texas $7.62 billion.

Corn plants were not able to consume the proper fertilizer needed to grow at the normal pace making the leaves and stalks poisonous to use as livestock feed, all but eliminating the possibility of using them as a source of feed for livestock. Farmers and ranchers have been forced to sell their land and equipment, and auction off livestock in high numbers in West Texas. Some farmers and ranchers view the effects on farming and livestock as irreversible on their family livelihood.

Consumers will be impacted financially by this drought. They can expect a dip in beef prices at the grocery stores toward the end of the year because of the increase in livestock auctions. However, drought-driven beef price increases are likely to happen at the beginning of calendar 2013 as livestock supplies fall short of demand.

In Southeast Texas, rice farmers are mostly affected by the low lake levels. Many farmers receive their water supply from the Highland Lakes, however, due to the drought the Lower Colorado River Authority was forced to reduce the supply of water to rice farmers. Other agricultural products suffering from the drought include cotton and citrus crops. Both crops did not have sufficient ground moisture to properly grow and provide an adequate harvest.

The shortage of rainfall throughout the state is also affecting tourism. Many lakes and reservoirs have experienced reduced water levels, slowing business in and around recreational areas.




Even the oil and gas industry is facing challenges during the extended drought. Hydraulic fracturing or fracking requires a significant amount of water, with most fracked wells using 1 million to 5 million gallons over three to five days. As a result of the drought, the industry is being pressured to recycle water. The industry has expressed its concerns over recycling, as it increases costs.

Prolonged dry conditions continue to increase the opportunity for fires according to Texas A&M Forest Service. Any increase in winds yields another opportunity for wildfire activity.

## Supervisory Concerns Based on National Events and Mandates

Earlier in September, the Federal Reserve announced its plans to keep rates low through mid-2015 in an effort to stimulate the economy by purchasing $40 billion per month of mortgage-backed securities. Revenue growth for many financial institutions has become a challenge due to historically low interest margins. Low interest rates may encourage institutions to hold assets for a longer term in order to obtain higher yields. Although holding longer-term assets can improve yields in the short-term, these assets have the risk of NIM compression and loss of liquidity if rates rise. Regulators will need to diligently monitor financial institution portfolios and the associated interest rate risk with longer-term assets.

Another factor impacting earnings has been the decline of noninterest income partly resulting from

relatively new legislation affecting fee income, such as deposit service charges. In the search to sustain or seek higher profits, banks may be persuaded to take on more risk by relaxing underwriting standards to compete for higher earning assets or offering new products the bank may be less familiar with. It is essential that bank management perform proper due diligence when changing their lending strategy or standards.

Banks have seen an influx of deposits over the last several years, providing ample liquidity. Although interest rates are expected to remain low and the potential for deposit flight is minimal at this time, it is important that bank management monitor these deposits and the effects that could arise if and when interest rates rise and products begin to reprice. Having a more immediate impact on deposits is the possible expiration of the Transaction Account Guarantee program or TAG on December 31, 2012. Banks could see depositors withdrawing funds that surpass the FDIC insurance limit if Congress does not extend the program. Some bankers have reported that they are not fully prepared for the end of this program. The Departments encourage bank management to prepare to deal with the possibility of deposits exiting their institutions and the effects it could have on managing a bank's cost of funds.

New mandates in the post-financial crisis era are not uncommon in the banking industry. The BASEL III proposal released by U.S. regulators effectively adopts new international capital standards set by the Basel Committee on Banking Supervision, which are designed to prevent a repeat of the financial crisis. The proposal tightens the definition of capital, increases banks' minimum ratios and tightens how risk is defined in calculating those ratios. The major concern raised by community banks is the proposal to change the risk-weighting calculation for certain assets, including U.S. government securities, corporate exposures and residential mortgages. Should the proposal be fully implemented, community banks could be negatively impacted and credit availability diminished.

The Departments are continuing to monitor the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) and the various provisions and rules which will become effective in the coming years. The creation of the Consumer Financial Protection Bureau and the implementation of its rulemaking authority over numerous consumer protection laws will apply to all financial institutions regardless of size. Changes in regulations and laws will impact management and expenses.

In connection to Dodd-Frank, the Volcker Rule is anticipated to be finalized by the end of 2012. The rule is aimed at preventing banks from speculative trading for their own gain rather than on behalf of their customers. Banks will be required to divest themselves of proprietary trading activities, hedge funds, and private equities. In this regard, the Department does not anticipate any material regulatory issues to arise once the rule is implemented.

Effective January 2013, a rule required by Dodd-Frank strips credit rating references from quality standards. Investment purchase decisions and ongoing portfolio due diligence processes will be required to determine whether a security is investment grade. Banks will no longer be able to rely exclusively on external credit ratings, and will be subject to conducting due diligence and independent analyses that are appropriate for the institution's risk profile and for the size and complexity of the security. This will pose a challenge for smaller financial institutions that do not have the expertise or staffing resources to adequately evaluate bank portfolios independent of a credit rating. It may also force institutions into limiting the portfolio diversification due to the lack of familiarity or expertise.

## Supervisory Concerns Based on Texas Events

For Texas state-chartered entities, asset quality, past dues, and foreclosed real estate continue to be monitored. On a positive note, the Departments have observed that the levels of classified assets have peaked and are now on a decline as are loan concentrations. For most banks, loans comprise the majority of their assets and carry the greatest risk to earnings and capital. With lower interest rates, regulators are concerned with the potential credit risk that financial institutions may consider in order to obtain higher yields.

An analysis of financial data for the last 18 months indicates that state-banks are moving away from commercial real estate (CRE) lending and increasing lending on commercial loans. Whether the move is

a result of regulatory pressure or the general stigma attached to CRE lending, too great of a shift in the other direction can be just as worrisome. CRE loans are collateralized by real estate, offering a quantitative value. However, commercial loans are generally collateralized by account receivables or inventory, making it difficult to quantify a value and requiring more servicing and monitoring by bank management. Changes in the local economies can affect borrowers and impact an entire group of loans causing asset and earnings problems.

Problem institutions are on a decline, but remain elevated. Both the Texas Department of Banking and the Texas Department of Savings and Mortgage Lending are actively working with these institutions by offering regulatory guidance as they continue to face challenges. The Departments have devoted considerable time to monitoring bank management's ability to oversee concentrations of credit and reduce troubled, nonperforming assets while maintaining earnings and capital levels. When needed, each agency utilizes informal and formal enforcement actions detailing the corrective actions necessary for the bank to perform in order to improve its condition. Other regulatory tools being utilized by the Departments to ensure that banks operate in a safe and sound manner include on-site supervisors, off-site monitoring activities, and targeted reviews and examinations.

## Other Areas Receiving increased Attention

Other areas receiving additional attention during examinations include: Bank Secrecy Act/Anti-Money Laundering compliance, risk management practices, capital levels, the composition of classified assets, corporate account takeovers, fraud, internal watch lists, overdraft programs, private-label collateralized mortgage obligations, tax liens and issues affecting reputational risk. Bank practices on issues such as fair lending, deceptive trade practices, and foreclosures are also evaluated as they can impact a bank's reputation. Regulators assess both management and the board of directors' abilities at every examination.

The agency jointly with the U.S. Secret Service announced efforts to assist financial institutions in adopting practices designed to reduce the risks of corporate account takeover, including the formation of the Texas Bankers Electronic Crimes Task Force. The Texas Department of Savings and Mortgage Lending similarly advised its state savings banks to be diligent. The Conference of State Bank Supervisors has taken an interest in the Texas Department of Banking's efforts on corporate account takeovers and has shared the initiative with other states in an effort to establish a nationwide initiative.

## Supervisory Measures Being Taken

Early detection of problems can help minimize the impact on the bank's overall condition; each Department takes measures to ensure safe and sound banking practices are being followed. Timely identification of problems, implementation of oversight measures, and open communication with management can hasten a problem bank's progress towards becoming a strong and stable financial institution.

The Texas Department of Banking is concentrating in the following areas:

- Focusing on practices and other conditions that can lead to problem institutions;
- Initiating enforcement actions early in the detection of deteriorating trends;
- Conducting frequent on-site examinations of problem institutions;
- Communicating and coordinating joint enforcement actions and other supervisory activities with other state and federal regulators;
- Placing monthly calls to state banks to obtain industry input on prevailing economic conditions;
- Expanding off-site monitoring to include follow-up of examination concerns;
- Utilizing a risk-focused examination process to free up resources for problem institutions;
- Monitoring state, national, and world political and economic events impacting the industry such as federal programs designed to stabilize the financial markets and new regulations;
- Performing targeted reviews of specific troubled areas; and,

- Increasing internal communication and training to improve examiner awareness of pertinent issues.

The Texas Department of Savings and Mortgage Lending's supervisory monitoring and enforcement staff are taking the following actions:

- Regular conference calls and close coordination with other state and federal regulators;
- Regular correspondence with state savings banks regarding institution-specific issues and industry issues;
- Conducting targeted examinations of high risk areas of state savings banks;
- Enforcement actions and placement of supervisory agents when deemed necessary;
- 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 a 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;
- Reviewing concentrations in commercial real estate and monitoring compliance with Commercial Real Estate Lending Joint Guidance, issued December 12, 2006;
- Internal monitoring of local, state, national and world political and economic events impacting the industry;
- Monitoring of any state savings bank's participation in the FDIC's Temporary Account Guarantee Program scheduled to conclude December 31, 2012; and,
- Monitoring of any state savings bank's participation in the Small Business Lending Fund as part of the Small Business Jobs Act of 2010.

## FDIC INSURED STATE-CHARTERED BANKS

Texas state-chartered banks improved their performance in the first six months of 2012. Although merger activity has reduced the number of state-banks, total assets in the state banking system have increased by $31.6 billion since June 2011. Further consolidations are possible into 2013 as institutions consider growth opportunities and future compliance costs.

The percentage of unprofitable institutions in Texas fell to 6.67% from 9.71% a year ago and from 16.56% in June 2009. This improvement is reflective of an improving Texas economy and bank management's ability to improve their respective balance sheets.

The number of problem institutions remains elevated; however, there are signs of continuing improvement as banks appear to be managing their troubled assets appropriately. Asset quality has improved as net charge offs continue to decline. Additionally, the percentage of assets past due 30-90 days has improved consistently over the last several quarters. Bank's noncurrent loans to total loans were 1.95% in June 2012 as opposed to the 2.64% a year earlier. Bank's noncurrent assets plus other real estate owned to total assets decreased 60 basis points (BP) to 1.52% for the same period.

The low interest rate environment continues to take a toll on earnings as NIMs continue to narrow. As of June 2012 state-bank NIMs were at 3.43%, a 16 BP decline from one year ago. Aiding earnings are the declining provisions for loan and lease losses, which have resulted in improving the return on average assets (ROA) for state-chartered banks to 1.10%, a 14 BP increase from year-end and 18 BP better than June 2011.Overall, the ROA for Texas state-chartered banks is higher than commercial banks nationwide.

Capital protection remains healthy for state-chartered banks. The leverage capital ratio at 9.85% is only incrementally lower than the 9.99% level at year-end 2011.

## FDIC INSURED STATE-CHARTERED THRIFTS

For the first half of 2012, state thrifts had $78.6 million in net income. ROA for thrifts increased to 1.66% at mid-2012, up from 0.60% at the previous mid-year. The level of unprofitable savings banks has decreased from 26.67% to 16.67%. Most recently chartered, reorganized or converted institutions have reached profitability, and are slowly beginning to grow into overhead expenses and most have been able to decrease provisions for loan losses. Provisions for loan and lease losses to average assets have decreased 113 BP on an annualized basis. Noninterest income to earning assets increased by 10 BP, while noninterest expense to earning assets has decreased by 3 BP.

State thrifts experienced a 75 BP increase in their regulatory core capital levels so far during 2012 from 15.88% to 16.63%. The increase in the thrift capital ratio is due to the increasing income, the industry raising over $17 million in capital, offset by $9.5 million in common stock dividends declared. Texas state thrifts also continue to exceed the national capital ratios for all savings institutions, which was 10.83% at June 2012 and 10.74% for year-end 2011.

NIMs for state thrifts posted an 18 BP decrease from 5.21% to 5.03% at mid-year 2012. Year-to-date provisions to the allowance for loan losses decreased for thrifts from $56 million at this time last year to $13.23 million through mid-2012. The Texas thrift allowances for loan and lease losses to non-current loans and leases, presently at 25.19%, is below the ratio of 40.72% for all FDIC-regulated savings institutions nationwide; however, the Texas thrifts ratio includes a large volume of covered assets (assets acquired from a failed bank, with downside loss protection from the FDIC), which if removed from this calculation would reflect a ratio for Texas thrift stronger than the national average.

Thrifts' noncurrent assets plus other real estate owned to total assets decreased to a total of 6.96% as of June 30, 2012. Thrifts also experienced a decrease in noncurrent loans – those 90 days or more past due, plus those no longer accruing interest to 8.22%. Net charge-offs decreased for thrifts to $23.7 million for the first half of 2012. Almost all of these are related to residential property loans. Loss reserves have decreased, and now represent 2.07% for savings institutions. While this is a 19 BP decrease from year-end, it is a 30 BP increase since this time last year.

## Number of Institutions and Total Assets

*FDIC financial data is reflective of FDIC insured institutions only*

| | 6-30-2012 | | 6-30-2011 | | Difference | |
|---|---|---|---|---|---|---|
| | *No. of Institutions* | *Assets* | *No. of Institutions* | *Assets* | *No. of Institutions* | *Assets* |
| Texas State-Chartered Banks | 300 | $196.3 | 309 | $164.7 | -9 | +$31.6 |
| Texas State-Chartered Thrifts | 30 | $9.5 | 29 | $8.5 | +1 | +$1.0 |
| | 330 | $205.8 | 338 | $173.2 | -8 | +$32.6 |
| Other states' state-chartered: | | | | | | |
| Banks operating in Texas* | 26 | $36.1 | 21 | $35.5 | +5 | +$0.6 |
| Thrifts operating in Texas* | 0 | 0 | 0 | 0 | 0 | 0 |
| | 26 | $36.1 | 21 | $35.5 | +5 | +$0.6 |
| Total State-Chartered Activity | 356 | $241.9 | 359 | $208.7 | -3 | +$33.2 |
| National Banks Chartered in Texas | 244 | $142.1 | 249 | $140.6 | -5 | +$1.5 |
| Federal Thrifts Chartered in Texas | 13 | $61.7 | 18 | $57.8 | -5 | +$3.9 |
| | 257 | $203.8 | 267 | $198.4 | -10 | +$5.4 |
| Other states' federally-chartered: | | | | | | |
| Banks operating in Texas* | 22 | $245.9 | 19 | $214.0 | +3 | +$31.9 |
| Thrifts operating in Texas* | 10 | $0.9 | 12 | $1.3 | -2 | -$0.4 |
| | 32 | $246.8 | 31 | $215.3 | +1 | +$31.5 |
| Total Federally-Chartered Activity | 289 | $450.6 | 298 | $413.7 | -9 | +$36.9 |
| Total Banking/Thrift Activity | 645 | $692.5 | 657 | $622.4 | -12 | +$70.1 |

*Assets in Billions*

**Indicates estimates based on available FDIC information.*

### Ratio Analysis

*As of June 30, 2012*

*FDIC financial data is reflective of FDIC insured institutions only.*

| *Number of Banks* | *State-Chartered Banks* 300 | *Texas National Banks* 244 | *All Texas Banks* 544 | *State-Chartered Thrifts* 30 | *Texas Federal Thrifts* 13 | *All Texas Thrifts* 43 |
|---|---|---|---|---|---|---|
| % of Unprofitable Institutions | 6.67% | 5.33% | 6.07% | 16.67% | 7.69% | 13.95% |
| % of Institutions with Earnings Gains | 67.67% | 68.03% | 67.83% | 73.33% | 84.62% | 76.74% |
| Yield on Earning Assets | 3.87% | 4.19% | 4.01% | 5.85% | 4.48% | 4.66% |
| Net Interest Margin | 3.43% | 3.80% | 3.59% | 5.03% | 3.83% | 3.99% |
| Return on Assets | 1.10% | 1.31% | 1.19% | 1.66% | 1.46% | 1.49% |
| Return on Equity | 9.47% | 11.91% | 10.64% | 10.00% | 16.58% | 15.08% |
| Net Charge-offs to Loans | 0.35% | 0.54% | 0.44% | 0.77% | 1.44% | 1.35% |
| Earnings Coverage of Net Loan C/Os | 7.41 | 5.65 | 6.41 | 4.04 | 3.07 | 3.14 |
| Loss Allowance to Loans | 1.55% | 1.93% | 1.72% | 2.07% | 2.01% | 2.02% |
| Loss Allowance to Noncurrent Loans | 79.69% | 87.35% | 83.45% | 25.19% | 173.99% | 97.48% |
| Noncurrent Assets+OREO to Assets | 1.52% | 1.98% | 1.71% | 6.96% | 0.87% | 1.68% |
| Net Loans and Leases to Core Deps | 74.99% | 85.21% | 79.36% | 113.20% | 88.99% | 91.52% |
| Equity Capital to Assets | 11.35% | 11.03% | 11.21% | 16.98% | 8.94% | 10.02% |
| Core Capital (Leverage) Ratio | 9.85% | 9.75% | 9.81% | 16.63% | 8.88% | 9.92% |

*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
*FDIC financial data is reflective of FDIC insured institutions only.*
June 30, 2012

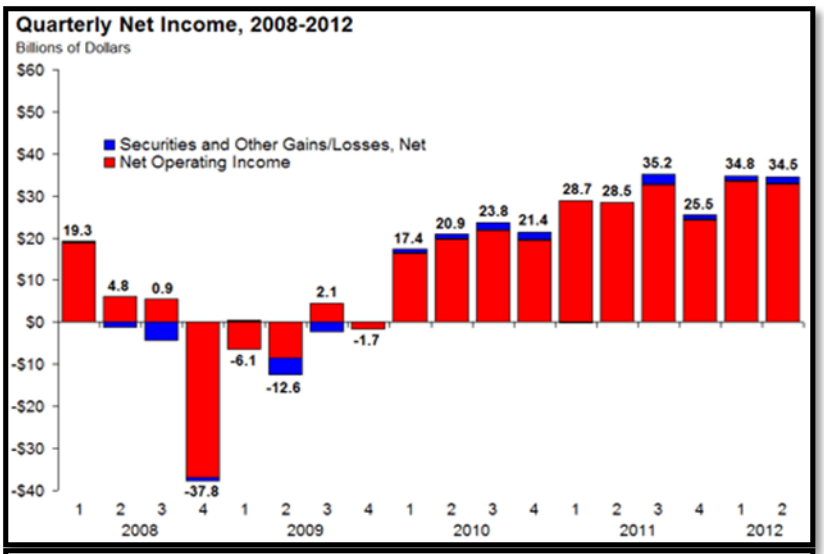
| | State Banks* | | State Thrifts | |
|---|---|---|---|---|
| | **End of Period** | ***% of Total Assets*** | **End of Period** | ***% of Total Assets*** |
| Number of Institutions | 300 | | 30 | |
| Number of Employees (full-time equivalent) | 39,859 | | 1,823 | |
| *(In millions)* | | | | |
| Total Assets | $196,322 | | $9,510 | |
| Net Loans and Leases | $109,468 | 55.76% | $6,090 | 64.04% |
| Loan Loss Allowance | $1,725 | 0.88% | $129 | 1.35% |
| Other Real Estate Owned | $827 | 0.42% | $151 | 1.58% |
| Goodwill and Other Intangibles | $3,069 | 1.56% | $35 | 0.36% |
| Total Deposits | $159,793 | 81.39% | $7,126 | 74.93% |
| Federal Funds Purchased and Repurchase Agreements | $3,841 | 1.96% | $5 | 0.05% |
| Other Borrowed Funds | $5,535 | 2.82% | $595 | 6.26% |
| Equity Capital | $22,279 | 11.35% | $1,621 | 17.05% |
| Memoranda: | | | | |
| Noncurrent Loans and Leases | $2,165 | 1.10% | $511 | 5.38% |
| Earning Assets | $178,091 | 90.71% | $8,712 | 91.61% |
| Long-term Assets (5+ years) | $53,777 | 27.39% | $3,708 | 38.99% |
| | **Year-to Date** | ***% of Avg. Assets*** | **Year-to Date** | ***% of Avg. Assets*** |
| Total Interest Income | $3,401 | 3.50% | $253 | 5.33% |
| Total Interest Expense | $384 | 0.40% | $35 | 0.75% |
| Net Interest Income | $3,017 | 3.10% | $217 | 4.58% |
| Provision for Loan and Lease Losses | $124 | 0.13% | $13 | 0.28% |
| Total Noninterest Income | $1,370 | 1.41% | $44 | 0.92% |
| Total Noninterest Expense | $2,960 | 3.04% | $165 | 3.48% |
| Securities Gains | $101 | 0.10% | $2 | 0.03% |
| Net Income | $1,068 | 1.10% | $79 | 1.66% |
| Memoranda: | | | | |
| Net Loan Charge-offs | $193 | 0.20% | $24 | 0.50% |
| Cash Dividends | $557 | 0.57% | $10 | 0.20% |

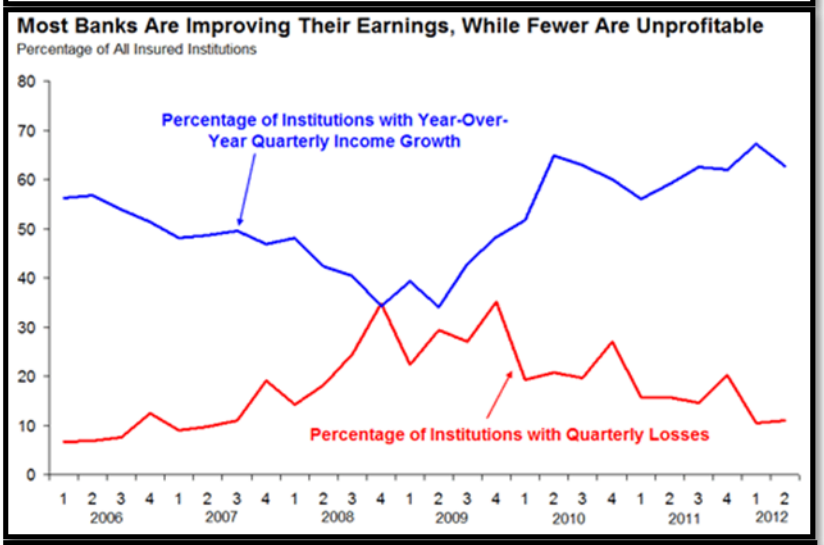
**Excludes branches of state-chartered banks of other states doing business in Texas. As of June 30, 2012, there are an estimated twenty six out-of-state state-chartered institutions with $36.1 billion in assets.*

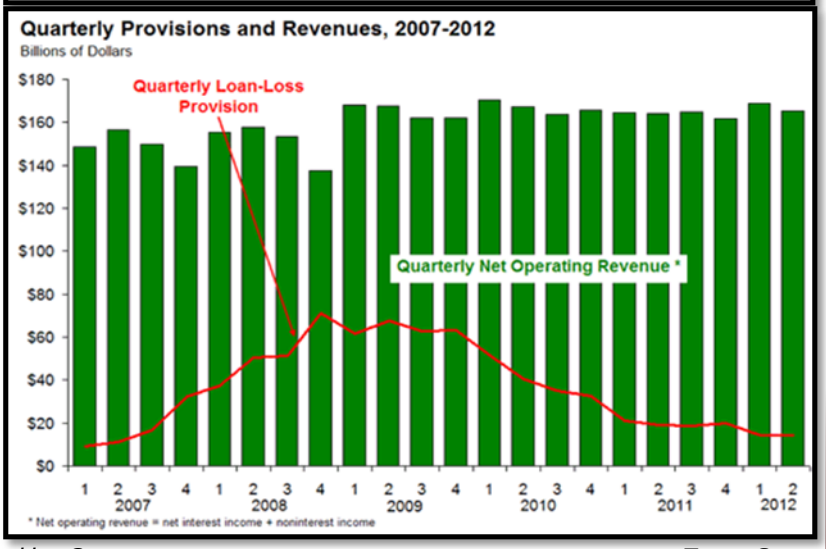
*No branches of state-chartered thrifts of other states conducted business in Texas as of June 30, 2012.*

***Quarterly Banking Profile – National Level***
***Second Quarter 2012***
***Federal Deposit Insurance Corporation***

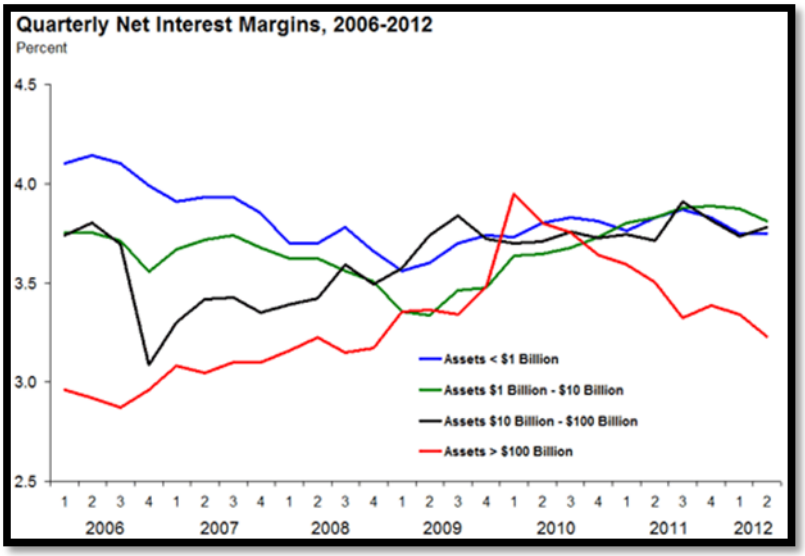
⇧ **Earnings Improvement Trend Reaches Three-Year Mark** - The benefits of reduced expenses for loan losses outweighed the drag from declining NIMs, as insured institutions posted a 12th consecutive year-over-year increase in quarterly net income. Banks earned $34.5 billion in the quarter, a $5.9 billion (20.7%) increase compared with second quarter 2011. Almost two out of every three banks (62.7%) reported higher earnings than a year ago. Only 10.9% were unprofitable, down from 15.7% in second quarter 2011. The average return on assets (ROA) rose to 0.99% from 0.85% a year earlier. This is the third-highest quarterly ROA for the industry since second quarter 2007.



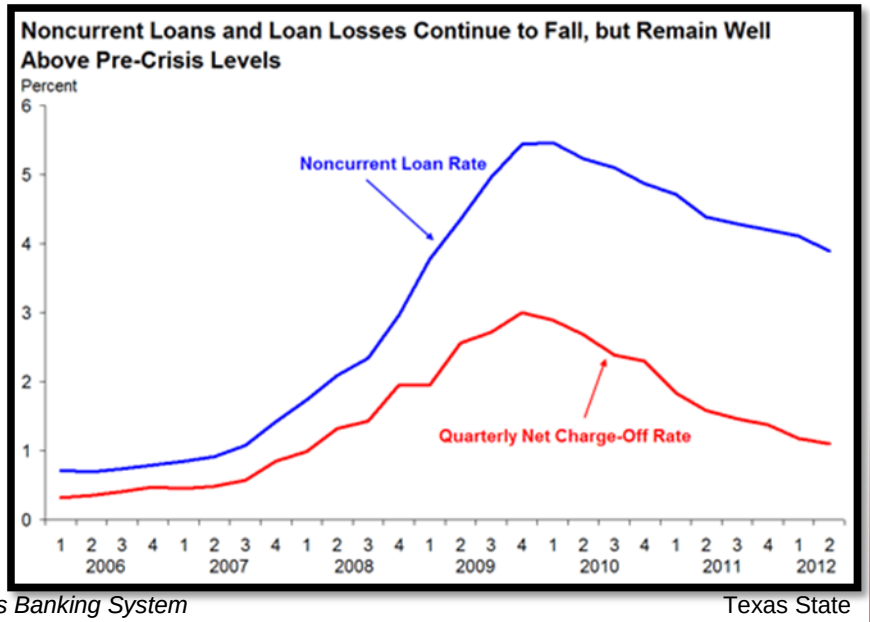



⇧ **Banks Reduce Loan Loss Provisions to Five-Year Low** - Banks set aside $14.2 billion in provisions for loan losses in the second quarter. This amount represents a $5 billion (26.2%) decline from second quarter 2011, and is the smallest quarterly total in five years. The reduction in provision expenses helped offset a $287 million (0.3%) decline in net interest income, as the industry's average NIMs fell to a three-year low. The average NIM was 3.46%, compared with 3.61% a year earlier, because average asset yields declined faster than average funding costs. Noninterest income made a positive contribution to the increase in earnings, rising by $1.6 billion (2.8%) from second quarter 2011. Gains on loan sales and on fair values of financial instruments contributed to the rise in noninterest income, while a $4.7 billion decline in trading income limited the year-over-year improvement. Net operating revenue (the sum of net interest income and total noninterest income) was only $1.3 billion (0.8%) higher than in second quarter 2011. Realized gains on securities and other assets were $1.7 billion (208.2%) higher than a year ago. A few large banks accounted for most of the dollar amounts of the decline in trading results, increased gains on loan sales and higher realized gains on securities.




⇧ **Net Charge-offs Decline Across All Loan Categories** - Net charge-offs totaled $20.5 billion in the second quarter, an $8.4 billion (29.1%) reduction from second quarter 2011. This is the eighth consecutive quarter that charge-offs have declined from year-earlier levels and represents the lowest quarterly charge-off total since first quarter 2008. The year-over-year improvement was led by a $2.2 billion (24.6%) decline in credit card charge-offs, a $1.5 billion (25.2%) decline in charge-offs of residential mortgage loans, and a $1.2 billion (51.5%) drop in real estate construction loan charge-offs. All major loan categories posted lower charge-offs compared with a year ago. Half of all insured institutions (50.6%) reported year-over-year declines in charge-offs.

⇧ **Noncurrent Loan Balance Continue to Fall** - Noncurrent loan balances (loans 90 days or more past due or in nonaccrual status) declined for a ninth consecutive quarter, falling by $12.9 billion (4.2%). Noncurrent levels fell in all major loan categories. The largest declines occurred in real estate construction and development loans, where noncurrent balances fell by $5.1 billion (17.8%), and in real estate loans

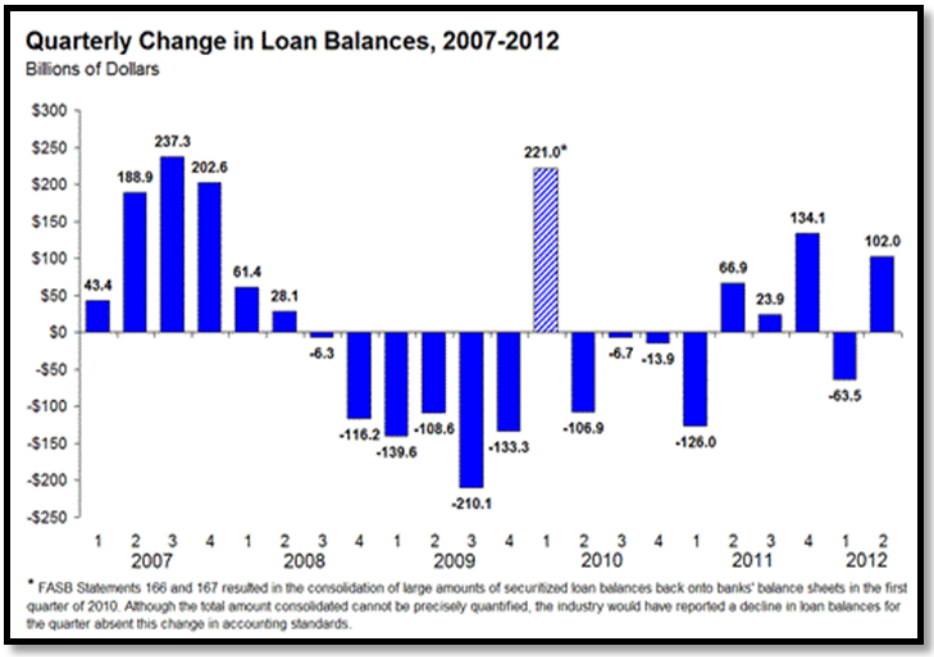


secured by nonfarm nonresidential properties, where noncurrents declined by $3.6 billion (9.2%). Well over half of all institutions (58%) reported reductions in noncurrent balances during the quarter.

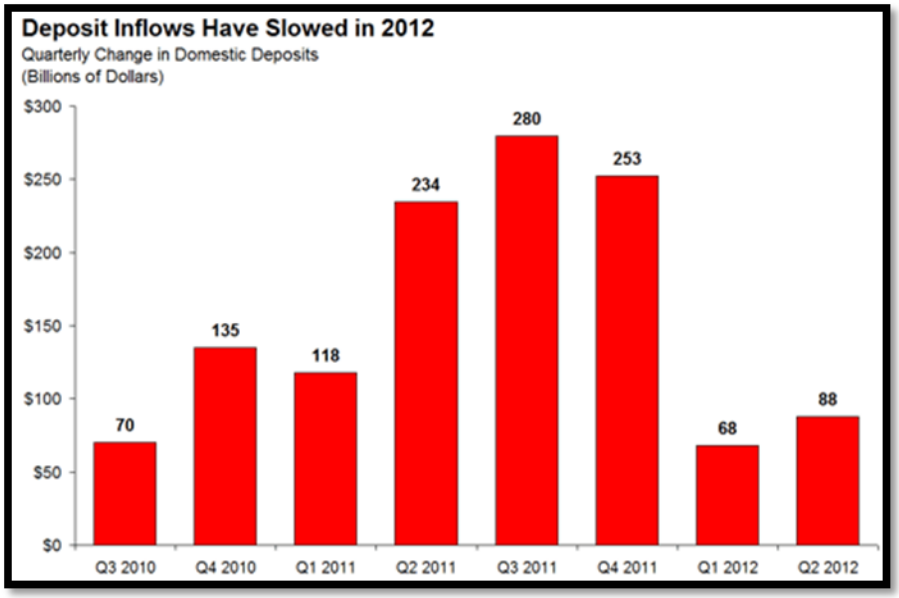
⇧ **Reserve Drawdowns at Large Banks Surpass Reserve Buildups at Smaller Institutions** - Reserves for loan losses fell by $6.7 billion (3.6%) during the quarter, as the $14.2 billion in loss provisions that banks added to reserves were less than the $20.5 billion in net charge-offs. More banks (54.4%) reported reserve increases than reported reductions (38.2%), but the reductions were concentrated among larger institutions, and added up to more than the additions. Eight of the 10 largest banks (and 34 of the 50 largest) reduced their reserves in the second quarter. Reserve balances have fallen for nine consecutive quarters, and are $86.7 billion (32.9%) below the peak level reached at the end of first quarter 2010. Even with the reduction in reserves, the larger drop in noncurrent loan balances during the quarter meant that the industry's "coverage ratio" of reserves to noncurrent loans inched up from 60% to 60.4% between March 31 and June 30.

⇧ **Retained Earnings Provide a Boost to Capital** - Insured institutions continued to build their capital in the second quarter. Total equity capital increased by $20.3 billion (1.3%), with retained earnings contributing $14.9 billion to capital growth. This is the second-highest quarterly total for retained earnings since third quarter 2006. Dividends were $763 million (3.8%) lower than in the second quarter of 2011. Tier 1 regulatory capital rose by $14 billion (1.1%), but total risk-based capital was basically unchanged (up $524 million, or 0.04%), due to the decline in reserves, declines in deferred tax assets, and declines in intangible assets. At mid-year, almost 97% of all insured institutions, representing more than 99% of insured institution assets, met or exceeded the requirements for "well-capitalized" institutions as defined for Prompt Corrective Action purposes.

⇧ **Loans Increase for Fourth Time in Last Five Quarters** - Total assets increased by $105.3 billion (0.8%), as loan balances rose for the fourth time in the last five quarters. Total loans and leases grew by $102 billion (1.4%), with loans to commercial and industrial (C&I) borrowers increasing by $48.9 billion (3.6%), residential mortgage loans rising by $16.6 billion (0.9%), and credit card balances growing by $14.7 billion (2.3%). Balances of real estate construction and development loans fell for a 17th consecutive quarter, declining by $10.9 billion (4.8%), while home equity lines of credit declined for the 13th quarter in a row, falling by $10.2 billion (1.7%). Loans to small businesses and farms posted a $1.5 billion (0.2%) increase, driven primarily by seasonal demand for agricultural credit. More than 60% of institutions reported growth in total loan balances during the quarter. Banks reduced their mortgage-backed securities holdings by $33.1 billion (1.9%), and increased their holdings of U.S. Treasury securities by $20.1 billion (12%).

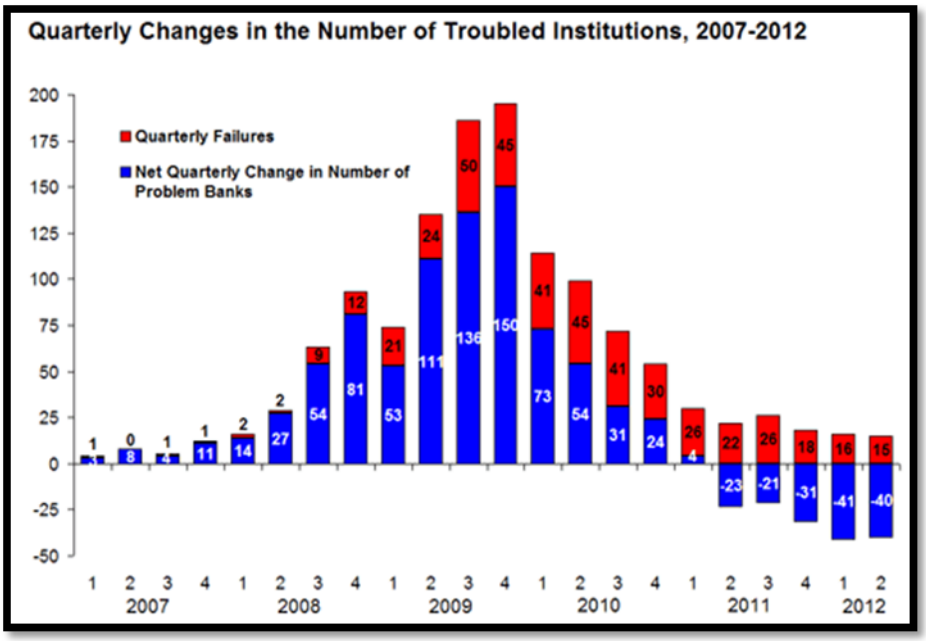


⇧ **Nondeposit Liabilities Increase** - Deposits increased by $61.6 billion (0.6%) during the quarter. Deposits in domestic offices rose by $88.1 billion (1.0%), while foreign office deposits fell by $26.5 billion (1.8%). Much of the growth in domestic deposits ($71.7 billion) consisted of noninterest-bearing transaction accounts with balances greater than $250,000 that are temporarily fully covered by the FDIC. The portion of these deposits that is above the $250,000 basic coverage limit increased by $65.7 billion (5.0%). In addition to the increase in large-denomination domestic deposits, insured institutions increased their nondeposit liabilities for the first time in seven quarters. Securities sold under repurchase agreements increased by $28 billion (6.7%), and Federal Home Loan Bank advances rose by $19.8 billion (6.5%).



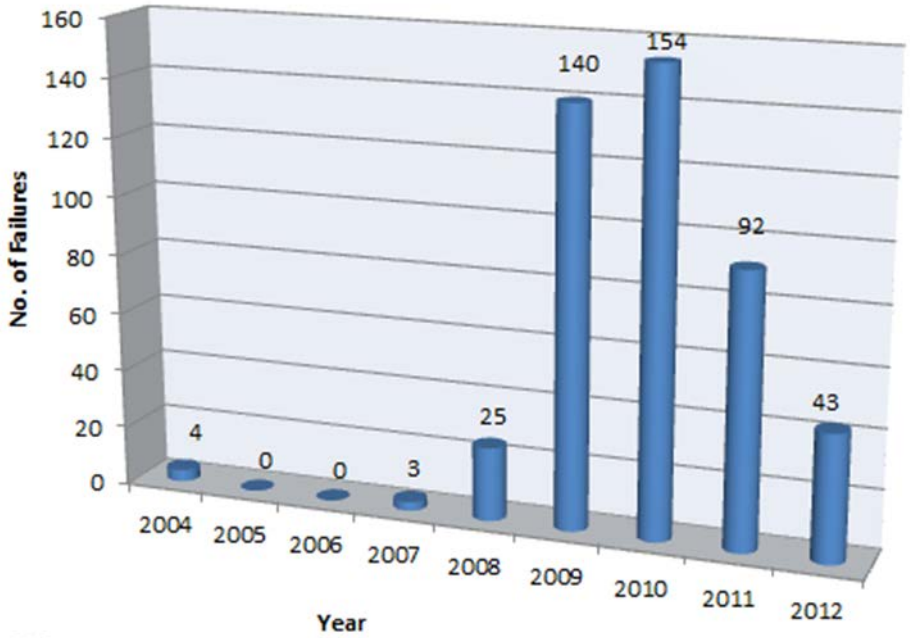

⇧ **More than a Year Since Last New Charter** - During the second quarter, the number of insured institutions reporting financial results declined from 7,308 to 7,246. Forty-five institutions were merged into other institutions, and 15 institutions failed. No new charters were added during the quarter. This is the fourth quarter in a row in which no new charters have been added. It has been more than six quarters since a new charter was created other than to absorb a failing bank.

The number of full-time equivalent employees at FDIC-insured institutions increased from 2,102,280 to 2,108,200. The number of institutions on the FDIC's "Problem List" fell for a fifth consecutive quarter, from 772 to 732. Total assets of "problem" institutions declined from $291 billion to $282 billion.



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

## Nationwide Bank Failures 2004-2012*




Source: FDIC

**As of September 30, 2012*

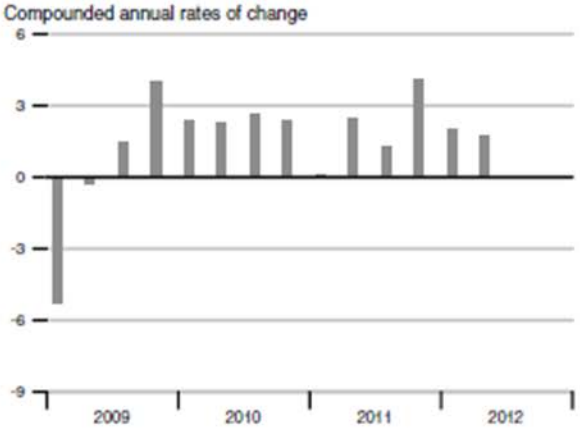
***Snapshot Stock Performance***
***Southwest Regional Banks***

| Name | Last Trade | | 52 Wk Range | | PE | EPS | Mkt Cap | Div/Shr | Div Yld |
|---|---|---|---|---|---|---|---|---|---|
| ACNB Corporation | 09/05 | **15.00** | 13.34 | 15.60 | 10.74 | 1.40 | 89.32M | 0.76 | 5.10% |
| BancFirst Corporation | 09/06 | **42.83** | 30.50 | 44.00 | 13.26 | 3.23 | 649.35M | 1.16 | 2.70% |
| Banco Bilbao Vizcaya Argentaria | 09/06 | **8.04** | 5.30 | 9.94 | 14.28 | 0.56 | 41.86B | 0.49 | 6.40% |
| BOK Financial Corporation | 09/06 | **58.42** | 43.82 | 60.00 | 12.00 | 4.87 | 3.98B | 1.52 | 2.60% |
| Cass Information Sys, Inc. | 09/06 | **41.09** | 29.76 | 42.86 | 18.34 | 2.24 | 426.80M | 0.68 | 1.70% |
| CoBiz Incorporated | 09/06 | **7.14** | 4.22 | 7.32 | 8.38 | 0.85 | 278.64M | 0.08 | 1.10% |
| Commerce Bancshares, Inc. | 09/06 | **40.80** | 33.06 | 41.28 | 13.84 | 2.95 | 3.58B | 0.92 | 2.20% |
| Comerica, Inc. | 09/06 | **31.68** | 21.48 | 34.00 | 13.34 | 2.37 | 6.13B | 0.60 | 2.00% |
| Community Shores Bank Corp | 08/29 | **0.15** | 0.05 | 0.85 | N/A | -0.65 | 220.20K | N/A | N/A |
| Cullen Frost Bankers, Inc. | 09/06 | **57.67** | 43.57 | 61.11 | 15.50 | 3.72 | 3.54B | 1.92 | 3.40% |
| Enterprise Fin Serv Corp | 09/06 | **13.01** | 9.94 | 16.45 | 9.31 | 1.40 | 232.54M | 0.21 | 1.70% |
| First Community Corp S C | 09/06 | **8.34** | 4.69 | 8.85 | 8.95 | 0.93 | 43.54M | 0.16 | 1.90% |
| First Financial Bankshares, Inc. | 09/06 | **36.00** | 24.56 | 37.25 | 15.80 | 2.28 | 1.12B | 1.00 | 2.80% |
| Firstcity Financial Corp | 09/06 | **8.078** | 5.79 | 10.83 | 3.04 | 2.66 | 85.27M | N/A | N/A |
| Great Southern Bancorp, Inc. | 09/06 | **30.32** | 15.01 | 30.94 | 9.10 | 3.33 | 410.84M | 0.72 | 2.40% |
| Guaranty Fed Bancshares, Inc. | 09/06 | **7.15** | 3.84 | 9.50 | 8.11 | 0.88 | 19.43M | 0.00 | 0.00% |
| Heartland Financial USA, Inc. | 09/06 | **27.02** | 12.21 | 27.19 | 13.48 | 2.00 | 445.42M | 0.40 | 1.50% |
| International Bancshares Corp | 09/06 | **19.27** | 12.41 | 21.89 | 12.48 | 1.54 | 1.30B | 0.40 | 2.10% |
| Landmark Bancorp, Inc. | 09/06 | **19.73** | 14.33 | 21.49 | 8.69 | 2.27 | 54.91M | 0.76 | 3.70% |
| Liberty Bancorp, Inc. | 08/31 | **10.30** | 9.30 | 10.50 | 12.83 | 0.80 | 32.78M | 0.10 | 1.00% |
| Mackinac Financial Corp | 09/05 | **7.91** | 4.63 | 8.00 | 5.36 | 1.48 | 27.04M | 0.00 | 0.00% |
| Metrocorp Bancshares, Inc. | 09/06 | **10.50** | 4.15 | 11.82 | 27.49 | 0.38 | 162.68M | 0.00 | 0.00% |
| MidWest One Finl Group, Inc. | 09/06 | **21.85** | 13.66 | 23.25 | 12.56 | 1.74 | 185.35M | 0.38 | 1.70% |
| OmniAmerican Bancorp, Inc. | 09/06 | **21.95** | 13.01 | 22.19 | 51.05 | 0.43 | 228.72M | N/A | N/A |
| Osage Bancshares, Inc. | 08/27 | **10.36** | 7.10 | 10.50 | 42.46 | 0.24 | 27.38M | 0.34 | 4.50% |
| Prosperity Bancshares, Inc. | 09/06 | **44.34** | 30.91 | 47.66 | 14.35 | 3.09 | 2.49B | 0.78 | 1.80% |
| QCR Holdings, Inc. | 09/06 | **13.80** | 8.42 | 14.50 | 10.92 | 1.26 | 67.01M | 0.08 | 0.60% |
| Southwest Bancorp, Inc. | 09/06 | **11.02** | 3.75 | 11.45 | N/A | -3.23 | 214.31M | 0.00 | 0.00% |
| Texas Capital Bancshares, Inc. | 09/06 | **47.14** | 21.39 | 47.30 | 17.51 | 2.69 | 1.80B | N/A | N/A |
| UMB Financial Corporation | 09/06 | **49.78** | 30.49 | 52.61 | 16.10 | 3.09 | 2.02B | 0.82 | 1.70% |
| West Bancorp Incorporated | 09/06 | **10.79** | 7.31 | 10.80 | 12.40 | 0.87 | 187.78M | 0.40 | 3.90% |
| Zions Bancorp | 09/06 | **19.73** | 13.18 | 22.81 | 19.12 | 1.03 | 3.63B | 0.04 | 0.20% |

*Source: Yahoo Finance (September 2012)*
*NA – Indicates information was not available.*

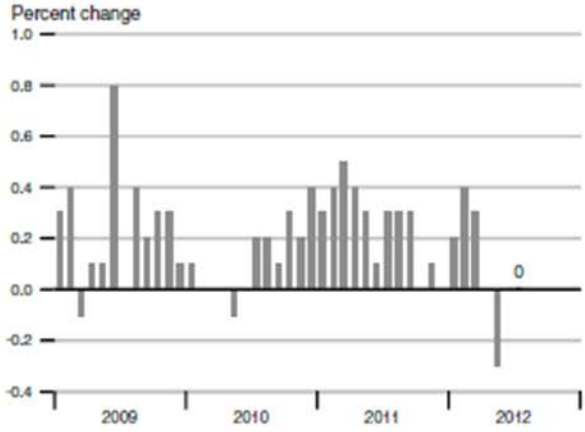
## Real GDP Growth

Compounded annual rates of change



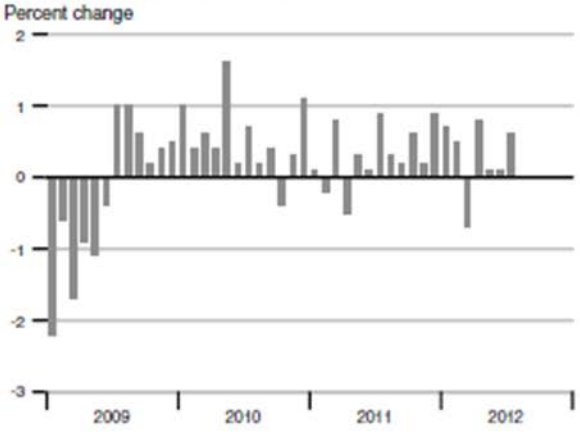

## Consumer Price Index

Percent change




## Industrial Production

Percent change

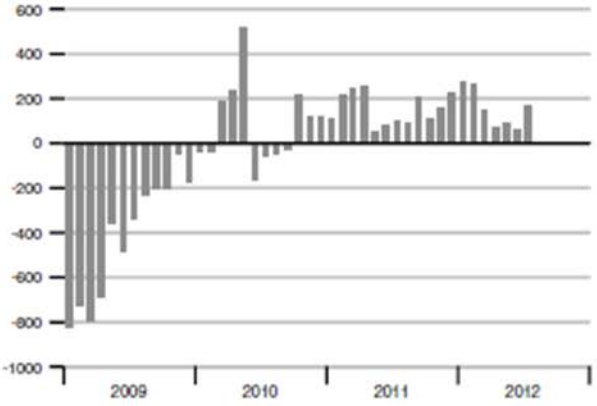



## Interest Rates

Percent

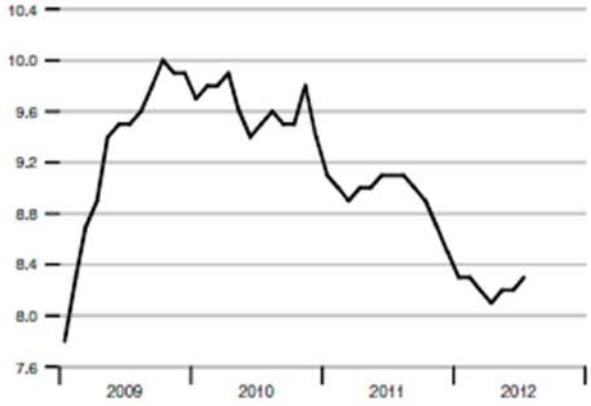
## Change in Nonfarm Payrolls

Thousands




## Unemployment Rate

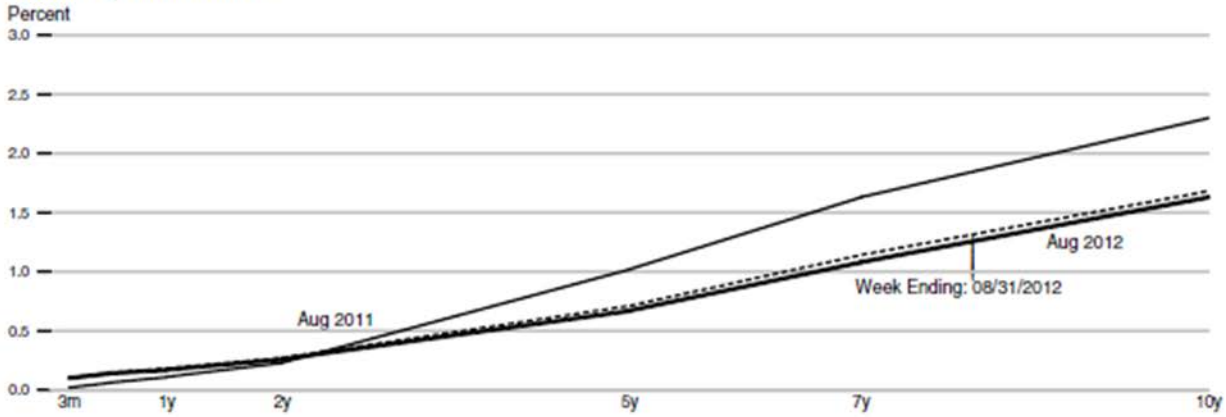
Percent of labor force




*Provided by the Federal Reserve Bank of St. Louis, National Economic Trends.*
*Updated September 5, 2012.*

## Interest Rates

## Treasury Yield Curve

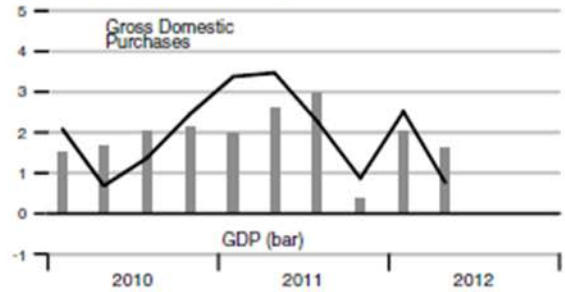



## Standard and Poor's 500 Index with Reinvested Dividends

*Provided by the Federal Reserve Bank of St. Louis, National Economic Trends.*
*Updated September 5, 2012.*

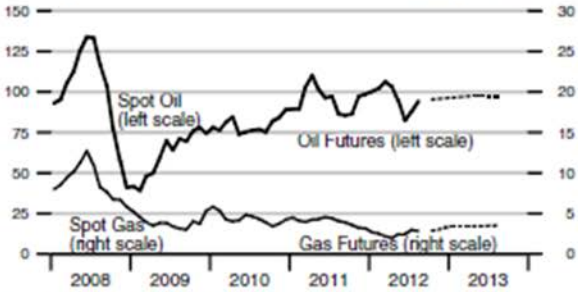
## NIPA Chain Price Indexes

Compounded annual rates of change




## Oil & Natural Gas Prices: Spot & Futures

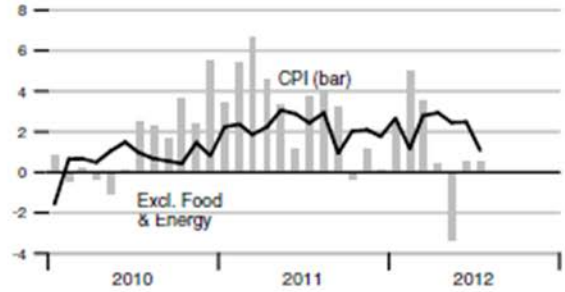
Dollars per barrel | Dollars per million btu




Note: Futures prices as of 9/4/2012.

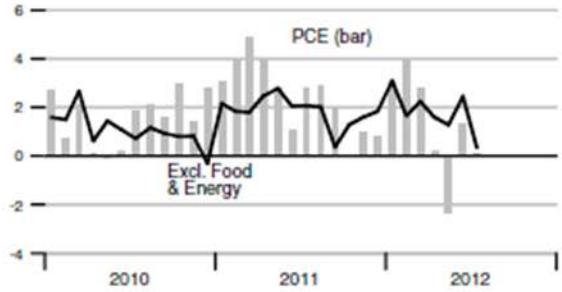
## Consumer Price Index

Compounded annual rates of change



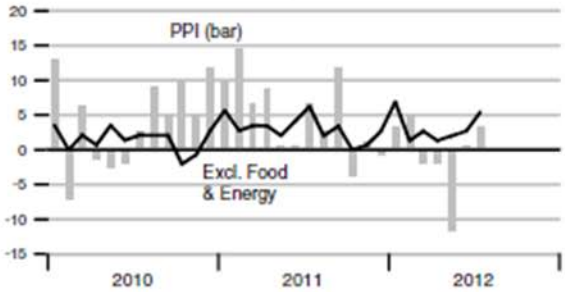

## Consumption Chain Price Index

Compounded annual rates of change



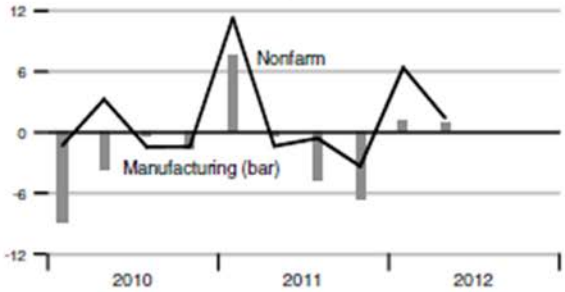

## Producer Price Index, Finished Goods

Compounded annual rates of change



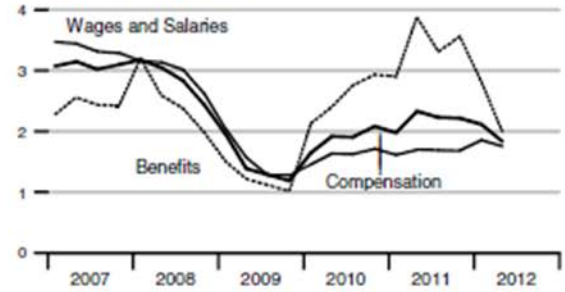

## Unit Labor Cost

Compounded annual rates of change



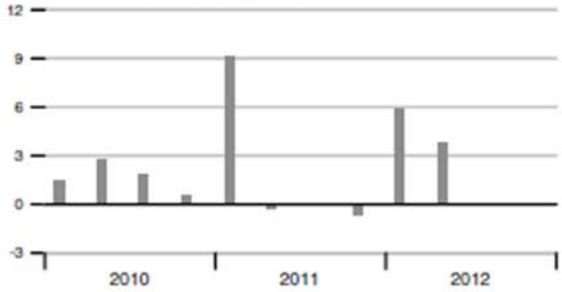

## Employment Cost Index

Percent change from year ago




## Compensation per Hour

Compounded annual rates of change

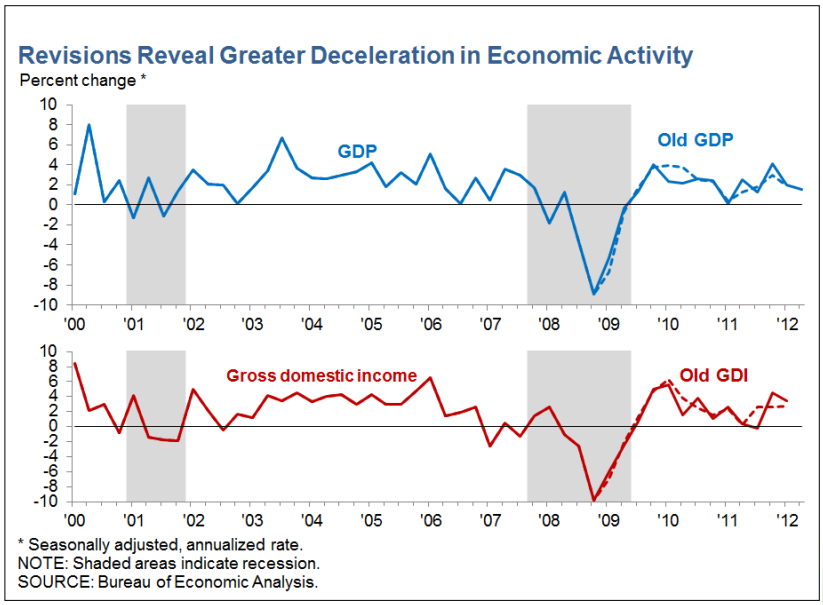



*Provided by the Federal Reserve Bank of St. Louis, National Economic Trends. Updated September 5, 2012.*

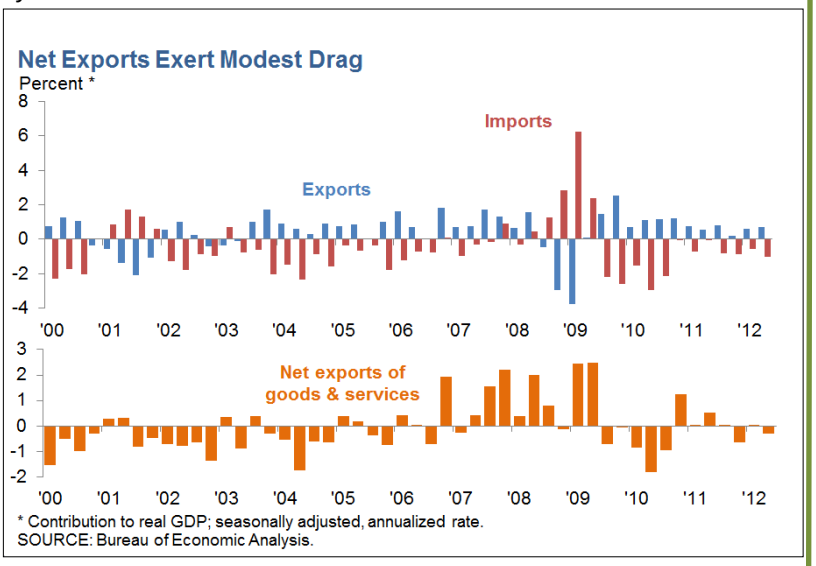
***National Update – August 2012***
***Federal Reserve Bank of Dallas***

- **Economy** - The U.S. economic recovery is facing a mid-year pause. In the first half of 2012, real gross domestic product (GDP) grew at a 1.8% pace. Fears of a global slowdown and the sovereign debt situation in Europe remain big downside risks to the recovery and have the potential to drive down net exports while also negatively affecting financial markets. Government spending continues to be a drag on economic activity; yet anemic job growth remains the main concern in this phase of the recovery. In contrast to the employment figures, the core personal consumption expenditures (PCE) inflation rate remains just below the Federal Open Market Committee's (FOMC) 2% target rate. The recent national income and product accounts (NIPA) revisions—NIPA measures domestic product and income—may shed some light on the state of the economy.

- **Net Effect of NIPA Revisions Limited** - In its July 27 release, the Bureau of Economic Analysis published revisions dating back to first quarter 2009. The overall picture given by the data has not changed—the reported level of economic activity is only slightly below its pre-revision level—although it appears that the initial stages of the recovery were in fact weaker, while growth in 2011 proved to be stronger than previously thought. This implies that the slowdown in the first half of 2012 is an even greater deceleration than first observed. Much of the weakness has been concentrated in durable goods, where nominal spending has fallen for four consecutive months. Gross domestic income (GDI)—another measure of domestic economic activity that theoretically should be equivalent to GDP but differs due to differences in measurement—shows a story similar to that seen in GDP. The new data, along with the revisions, are consistent with an economy growing very modestly, and one that may be facing a number of headwinds limiting growth potentially.

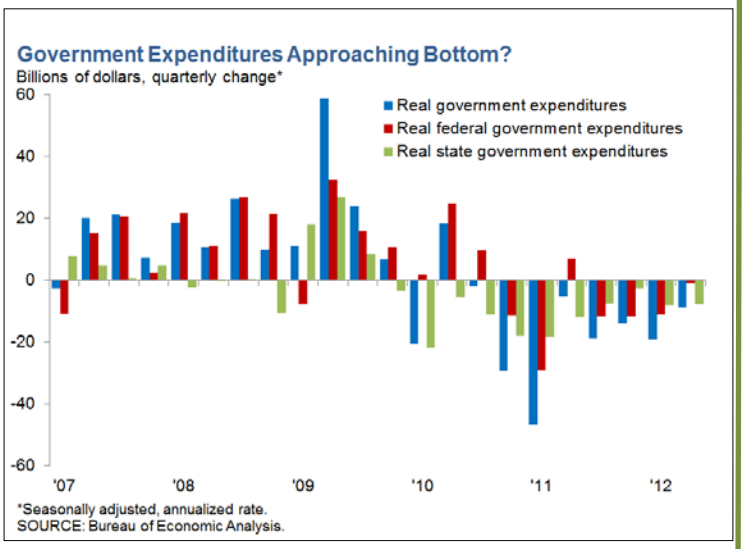



- **Can Exports Continue to Be a Boon?** - Net exports have tended to be a moderate drag on the economy during the recovery. While imports have been less of a drag on the economy over the past two years, the positive contribution of exports has been fairly consistent, with a slight downward trend. Over the past three years, real exports of goods and services have contributed an average of 1 percent to real GDP growth, though fourth quarter 2010 is

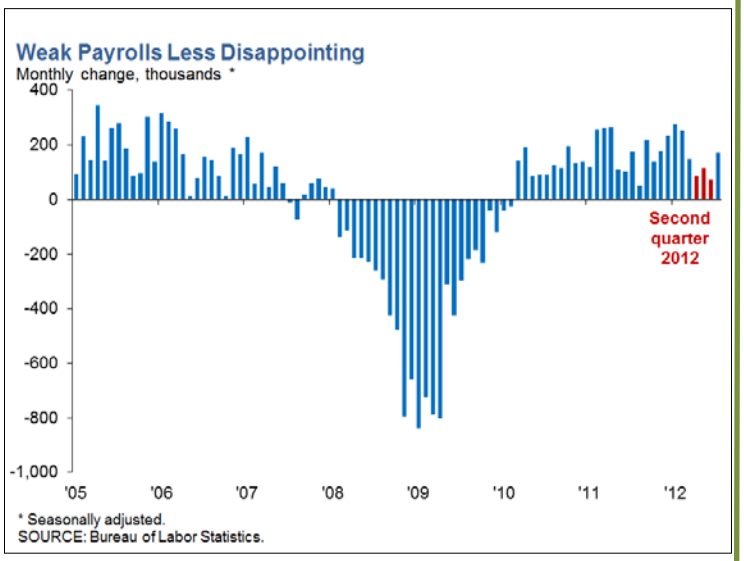


the last quarter the annualized contribution was greater than 1 percent (coming in at 1.2 percent). With the current conditions in Europe, it seems unlikely that exports will be able to continue to contribute to economic growth. Meanwhile, the drag caused by government spending may be bottoming out.

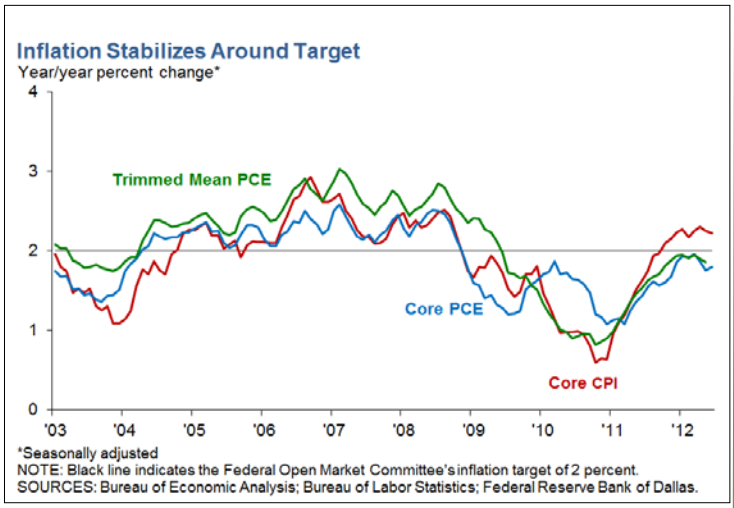
⇧ **Government Sector Less of a Drag** - Real government spending and investment has fallen for eight consecutive quarters, subtracting an estimated average of 0.6 percentage points from GDP growth each quarter. Real federal government consumption and gross investment has slowed its decline. The way in which the looming fiscal cliff is resolved will affect fiscal policy. A positive outcome may continue the current trend and lead to small increases—or at least no more decreases—in government spending. Reduced government spending is also hurting the job market; since the recovery began in June 2009, government employment has fallen by 698,000 jobs.




⇩ **Stalled Improvement in the Labor Market** - In its July snapshot of the labor market, the Bureau of Labor Statistics counted 172,000 more jobs on total nonfarm private payrolls than it did in June, slightly less disappointing than readings in recent months. Second quarter 2012 was a substantial slowdown from the average monthly gain of 226,000 jobs in first quarter 2012—the average second quarter gain was only 91,000 jobs per month. Sluggish employment growth bumped the unemployment rate up to 8.3 percent.

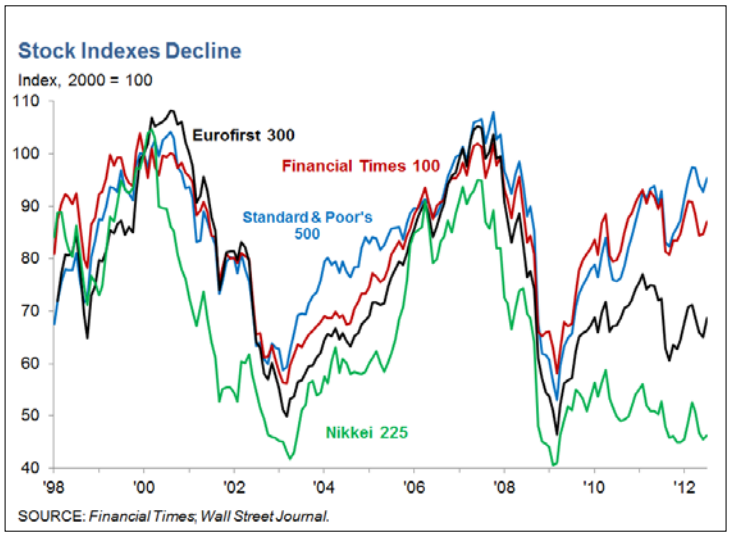



⇧ **Inflation on Target** - While achieving maximum employment has been elusive; it seems that prices have stabilized. After the FOMC in January officially announced a long-run inflation target of 2 percent in the PCE index, core PCE has remained very close to the target. The core consumer price index (CPI) increased by 0.2 percent for the fourth consecutive month, and the change from a year ago dipped to



2.2 percent. The core PCE index held steady at 1.8 percent. The Dallas Fed's Trimmed Mean PCE measure has also been very consistent with core PCE over the past year. Despite the price stability, other uncertainties loom as financial market weakness increased in second quarter 2012 concurrently with growing economic and political uncertainty.

- **Uncertainty Plagues Financial Markets** - A deterioration in sentiment toward the U.S. and Europe significantly decreased equity prices in second quarter 2012, yet there was a surprising bounce back in July. Uncertainty surrounding the upcoming election, the approaching fiscal cliff at year-end and the issues plaguing the euro area has manifested itself in stock prices; stock indexes almost all declined throughout second quarter 2012 (for instance, the Standard and Poor's 500 Composite was down 4.7 percent after being up 11.7 percent in first quarter 2012). Whether stock prices can continue their recent upward momentum in the face of significant headwinds is unknown.




With the U.S. economy muddling along, the NIPA revisions reinforced the perception of weakness so far in 2012. Exports and financial markets both face headwinds coming from Europe; financial markets likely will also face domestic uncertainty in much of the second half of 2012. While net exports and the financial markets could be pulling back growth, government spending may become less of a drag once some of the political uncertainty recedes. Although employment has been very weak of late, there has been considerable strength in price stability.

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

| Data Series | March 2012 | April 2012 | May 2012 | June 2012 | July 2012 | Aug 2012 |
|---|---|---|---|---|---|---|
| **Unemployment Rate** (1) | 8.2 | 8.1 | 8.2 | 8.2 | 8.3 | 8.1 |
| **Change in Payroll Employment** (2) | 143 | 68 | 87 | 45 | 141(P) | 96 (P) |
| **Average Hourly Earnings** (3) | 23.37 | 23.40 | 23.43 | 23.5 | 23.53 (P) | 23.52 (P) |
| **Consumer Price Index** (4) | 0.3 | 0.0 | -0.3 | 0.0 | 0.0 | |
| **Producer Price Index** (5) | -0.2 | -0.2(P) | -1.0 (P) | 0.0 (P) | 0.3 (P) | |
| **U.S. Import Price Index** (6) | 1.4 | -0.1 | -1.5 (R) | -2.4 (R) | -0.6 (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) Average hourly earnings for all employees on private nonfarm payrolls.
(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 2011 | 3rd Qtr 2011 | 4th Qtr 2011 | 1st Qtr 2012 | 2nd Qtr 2012 |
|---|---|---|---|---|---|
| **Employment Cost Index** (1) | 0.6 | 0.3 | 0.5 | 0.4 | 0.5 |
| **Productivity** (2) | 1.2 | 0.6 | 2.8 | -0.5 | 2.2(R) |

**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.
(R) Revised.

*Data extracted on: September 7, 2012*

### *The Beige Book – August 2012*
### *The Federal Reserve Board*
### *Excerpt*

⇧ Reports from the twelve Federal Reserve Districts suggest economic activity continued to expand gradually in July and early August across most regions and sectors. Six Districts indicated the local economy continued to expand at a modest pace and another three cited moderate growth; among the latter, Chicago noted that the pace of growth had slowed from the prior period. The Philadelphia and Richmond Districts reported slow growth in most sectors and declines in manufacturing, while Boston cited mixed reports from business contacts and some slowdown since the previous report.

Most Districts indicated that retail activity, including auto sales, had increased since the last Beige Book report, although Cleveland, Chicago, St. Louis, Dallas, and San Francisco noted the retail improvements were small. Atlanta said that retail growth had slowed, while Philadelphia indicated growth in retail sales was somewhat faster than in the previous report. Boston, New York, Richmond, Atlanta, Minneapolis, and San Francisco recorded strong performance in tourism. Many Districts reported some softening in manufacturing, either a slowdown in the rate of growth or a decline in the level of sales, output, or orders; among those with declining shipments and orders, Philadelphia noted that the rate of decline was tempering.

Districts mentioning nonfinancial services noted increased activity, although at a slowing pace in Boston, softening in New York, and "flattening" in Philadelphia; Kansas City reported that sales of high-tech services declined slightly. Several Districts cited declining demand for staffing services. According to District reports, bankers in New York, Philadelphia, Cleveland, Atlanta, Chicago, and Kansas City saw increases in demand for most loan types in recent months; by contrast, St. Louis, Dallas, and San Francisco indicated that loan demand was mixed, softening, or slightly weaker.

Real estate markets were generally said to be improving. On the residential side, all 12 Districts cited increases in home sales, home prices, or housing construction. Reports on commercial real estate markets were also generally positive, although San Francisco noted stable demand, Boston indicated conditions were not much changed since the last report, and Richmond, Chicago, and St. Louis said commercial real estate conditions were mixed.

District reports indicated that energy and mining activity was generally high and increasing. However, Cleveland noted softening demand for coal, while Minneapolis and Kansas City had some energy sectors up and some down. The Midwest drought has reduced actual and expected farm output, especially cotton, soybean, and/or corn crops in the Chicago, Kansas City, and St. Louis Districts.

Most Districts reported that the selling prices of manufacturing and retail products were largely stable. By exception, several Districts noted concerns about rising agricultural commodity prices, and Richmond mentioned a small uptick in retail prices. Hiring was said to be modest across the Districts, and wage pressures were characterized as contained.

### *The Dallas Beige Book – August 2012*
### *Federal Reserve Bank of Dallas*
### *Excerpt*

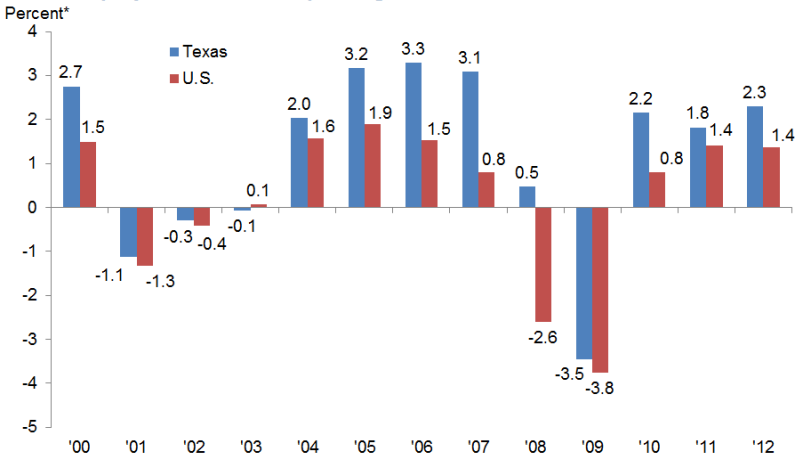
⇧ The Eleventh District economy grew at a moderate pace over the past six weeks. Manufacturing activity continued to expand, demand for business services remained solid, and transportation services activity increased. Respondents said retail sales edged up, while automobile sales held steady. The housing and commercial real estate markets remained healthy. Financial firms noted softening loan demand. Energy activity remained robust, and agricultural conditions improved slightly. Employment levels were steady to slightly higher. Wage and price pressures were modest. Most contacts noted that European debt issues and the upcoming national elections added uncertainty to their outlooks.

***Regional Economic Update – August 2012***
***Federal Reserve Bank, Dallas***

⇕ **Overall Economy** - Regional indicators point to a slowing in economic growth. Texas employment growth was more modest in the second quarter than in the first, although growth is still outpacing the nation due in part to strength in the energy sector. The recent slowdown appears to be related to weaknesses in the global economy and general uncertainty about the pace of the current U.S. expansion.

⇧ **Labor Market Growth Slows but Outpaces U.S. Average** - Texas started off 2012 with strong job growth of 3.2 percent in the first quarter, but the pace slowed to 1.4 percent in the second, for a growth rate of 2.3 percent so far this year. In the first half of the year, Texas private employment rose at an annualized rate of 3.0 percent, while the government sector contracted. Of note, the construction sector, which had been a drag on the Texas economy since 2008, posted robust employment growth of 9 percent (annualized) in the first half of 2012. Of the major industries, oil- and gas-related jobs have grown at the fastest pace this year, at a 9.5 percent annualized rate. The Texas unemployment rate inched up to 7 percent in June from 6.9 percent in May, as more people entered the labor force than those who found employment. Temporary hiring, which generally leads overall employment, edged down in June following very strong growth in May. However, strong growth in temporary hiring year-to-date may reflect firms' reluctance to add to permanent payrolls given the high level of economic uncertainty.

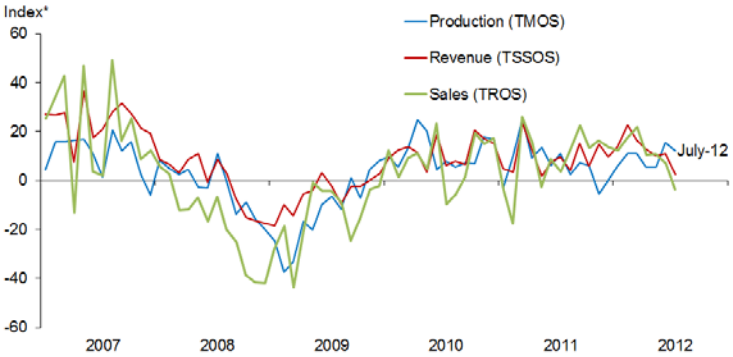
**Texas Employment Growth Improving**




*December/December; seasonally adjusted, annual rate. The 2012 figures are annualized rate of growth from December to June.
SOURCE: Bureau of Labor Statistics.

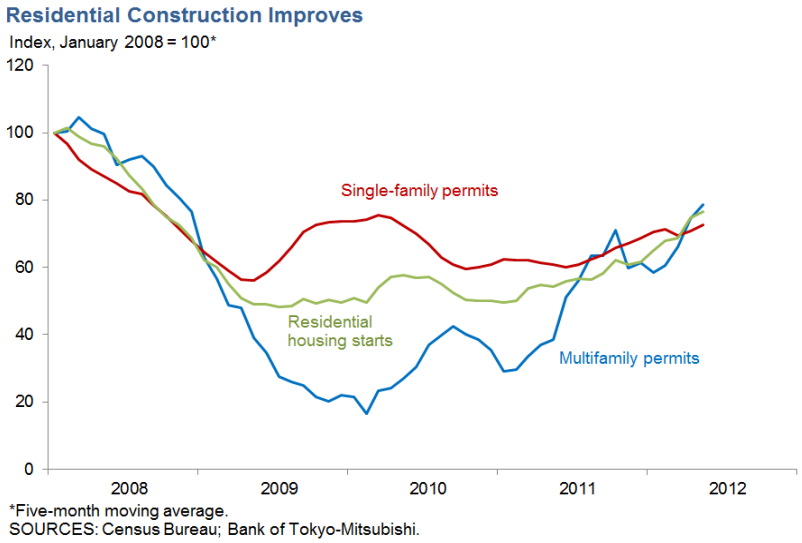
⇕ **Other Measures of Regional Activity Suggest Slower Growth** - The Dallas Fed's Texas Business Outlook Surveys (TBOS) suggest a modest expansion. Manufacturing activity moderated slightly in July, according to the Texas Manufacturing Outlook Survey's (TMOS) production index. Service sector activity, represented by the Texas Service Sector Outlook Survey's (TSSOS) revenue index, also expanded at a slower pace. Retail executives responding to the Texas Retail Outlook Survey (TROS) said sales fell in July, the first negative reading since May 2011. Although Texas economic activity remains positive for the most part, firms responding to the Dallas Fed surveys suggest that U.S. business conditions have worsened, with many citing heightened uncertainty.

**Service and Manufacturing Headline Indexes Suggest Modest Expansion, While Retail Declines**

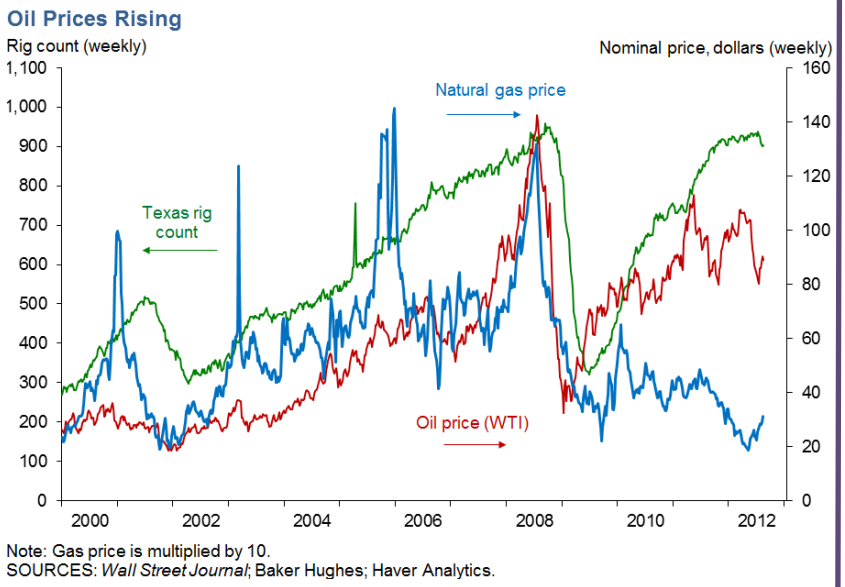



*Seasonally adjusted.
NOTE: Positive readings in the surveys generally indicate expansion of activity, while readings below zero generally indicate contraction.
SOURCES: Federal Reserve Bank of Dallas' Texas Manufacturing Outlook Survey (TMOS), Texas Service Sector Outlook Survey (TSSOS) and Texas Retail Outlook Survey (TROS).

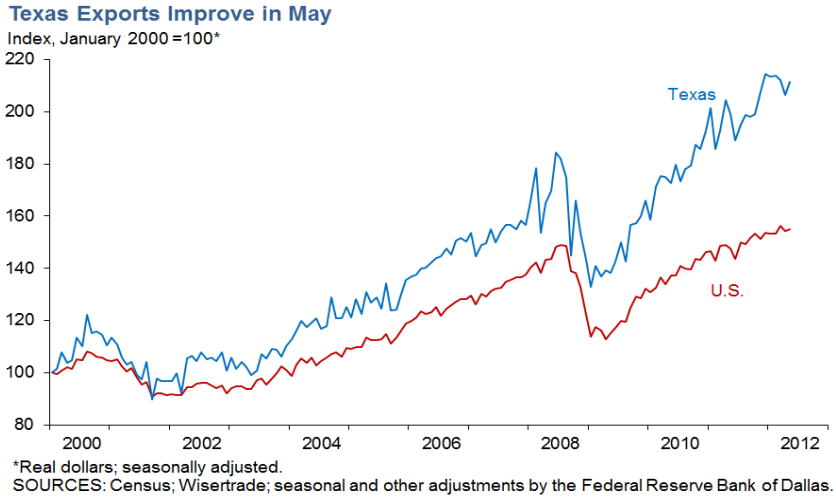
⇧ **Housing Recovery Spurs Construction** - Increases in housing demand have led to rising construction levels this year. Texas single-family permits rose at an annualized pace of 34 percent year-to-date through June, and residential construction activity is up 42 percent from levels in May 2011, when activity started to pick up. Through June, existing home sales are up 18.5 percent, and home prices have begun to rise this year. Texas single-family existing home inventories are at 5.7 months of supply at the current sales pace. Inventories below about six months of supply are historically consistent with rising home prices. Several Texas metros, including Austin, Dallas and Fort Worth, have inventories close to four months of supply, suggesting room for further price increases. The foreclosure rate is still elevated in Texas at 4.4 percent but remains well below the national average of 7.4 percent. The share of seriously delinquent Texas mortgages continues to decline, which signals that the foreclosure rate should improve with time. Texas apartment markets remain healthy. Strong demand in the first half of 2012 has pushed apartment vacancy rates down below 10 percent in Texas' major metros despite an upswing in multifamily construction.




⇧ **Energy Activity Still Strong; Oil Prices Edging Up** - The price of West Texas Intermediate crude oil recently ticked up to just over $90 per barrel, and the Texas rig count remained high in June at 951 rigs. Dallas Fed contacts at energy-related firms said activity remains strong and that the rapid shift from dry-gas drilling to oil-directed drilling has not reduced the overall pace of activity.




⇩ **Exports are Sluggish as Global Demand Weakens** - Texas exports (adjusted for inflation) increased in May after falling in April.

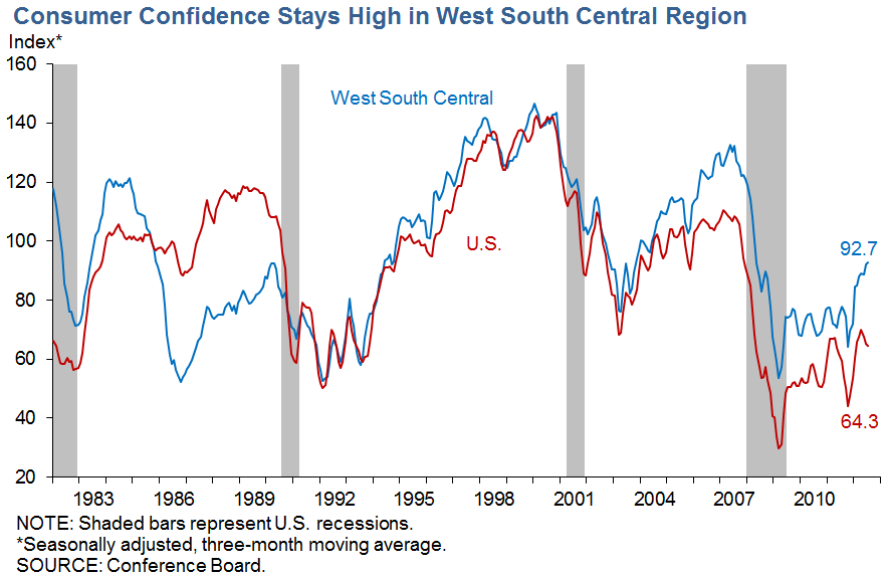


However, real Texas exports have decreased 2.8 percent this year through May, consistent with slowing global growth. In the July Dallas Fed Beige Book, contacts noted slower demand for high-tech products and petrochemicals, two of Texas' largest exporting industries.

⇧ **Price Pressures are Minimal** - Price pressures are relatively low according to Texas firms responding to the TBOS surveys and the Dallas Beige Book. The majority of manufacturers and retailers surveyed for TBOS noted declines in selling prices in July. The most recent Dallas Beige Book reported little price pressure and an overall decline in input costs.

⇩ **Agriculture Remains a Concern** - Agricultural conditions deteriorated slightly in recent months due to hot and dry weather, although drought conditions are improved from a year ago. Livestock producers have seen pastures dry out, cattle prices fall and feed costs increase, mainly as prices for corn and other grains have increased.

⇧ **Outlook Reflects National Uncertainties** - The regional economy continues to expand, but employment growth has slowed. Despite the slowdown, Texas continues to outperform many other areas of the U.S. On a positive note, although consumer confidence declined at the national level in June, the index continued to rise in the West South Central Region, of which Texas makes up a significant share.




The Texas Leading Index, the Dallas Fed's barometer of future employment activity, edged down in April and May, suggesting slower growth ahead. The current forecast is for a slowdown in job growth in the second half of the year, although annual growth is expected to come in slightly higher than in 2011.

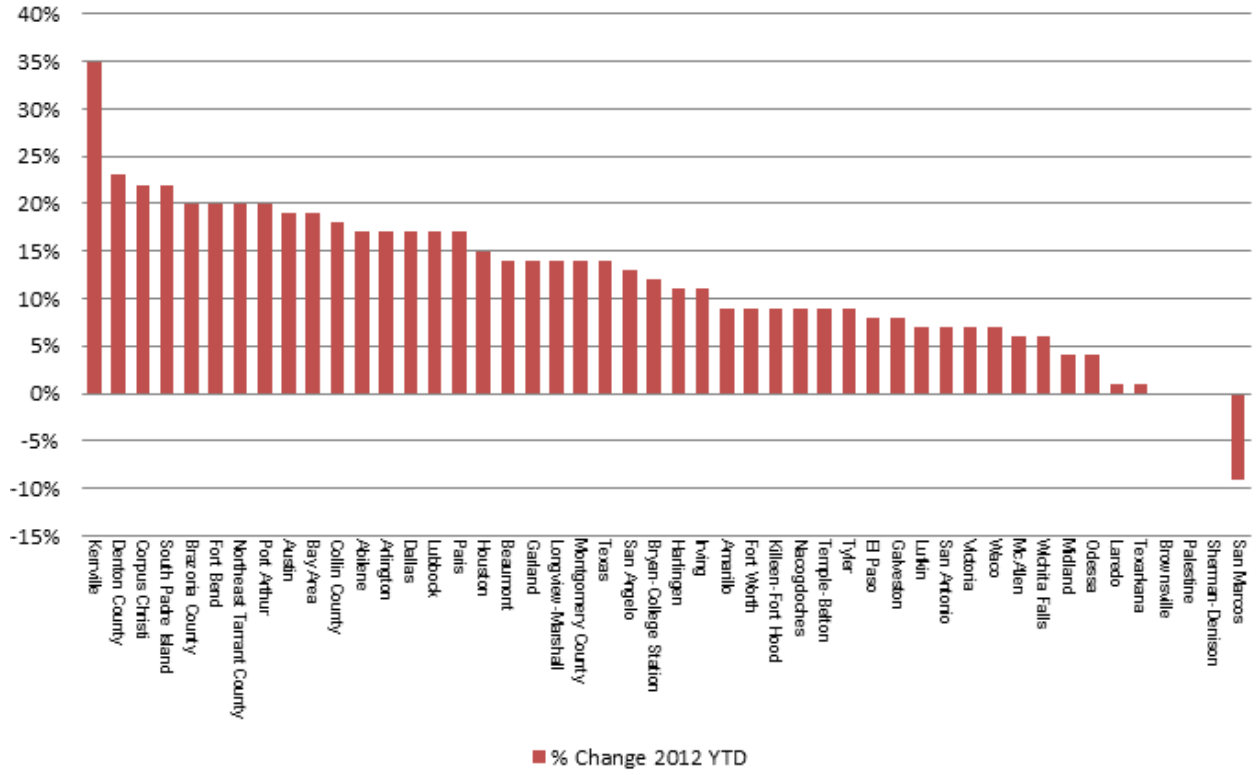
***Texas Economic Statistics***
***U. S. Bureau of Labor Statistics***

| Data Series | Feb 2012 | Mar 2012 | Apr 2012 | May 2012 | June 2012 | July 2012 |
|---|---|---|---|---|---|---|
| Labor Force Data | | | | | | |
| Civilian Labor Force (1) | 12,517.7 | 12,539.2 | 12,568.5 | 12,610.4 | 12,634.4 | (P) 12,642.8 |
| Employment (1) | 11,626.3 | 11,658.2 | 11,705.8 | 11,740.8 | 11,751.1 | (P) 11,738.5 |
| Unemployment (1) | 891.4 | 881.0 | 862.7 | 869.6 | 883.3 | (P) 904.3 |
| Unemployment Rate (2) | 7.1 | 7.0 | 6.9 | 6.9 | 7.0 | (P) 7.2 |
| Nonfarm Wage and Salary Employment | | | | | | |
| Total Nonfarm (3) | 10,730.8 | 10,742.4 | 10,757.2 | 10,770.8 | 10,786.2 | (P) 10,804.0 |
| 12-month % change | 2.5 | 2.3 | 2.2 | 2.3 | 2.2 | (P) 2.1 |
| Mining and Logging (3) | 259.9 | 261.4 | 263.5 | 262.7 | 259.8 | (P) 260.1 |
| 12-month % change | 16.4 | 15.9 | 15.6 | 14.4 | 11.9 | (P) 9.3 |
| Construction (3) | 568.8 | 565.6 | 572.9 | 575.2 | 582.2 | (P) 582.4 |
| 12-month % change | 1.6 | 1.0 | 2.5 | 2.8 | 3.9 | (P) 4.1 |
| Manufacturing (3) | 847.5 | 850.2 | 856.6 | 856.0 | 853.7 | (P) 857.9 |
| 12-month % change | 3.0 | 2.8 | 3.1 | 2.8 | 2.2 | (P) 2.3 |
| Trade, Transportation, and Utilities (3) | 2,147.4 | 2,143.8 | 2,147.3 | 2,150.4 | 2,153.7 | (P) 2,148.8 |
| 12-month % change | 3.1 | 2.6 | 2.0 | 2.4 | 2.4 | (P) 2.0 |
| Information (3) | 193.2 | 196.2 | 196.6 | 196.0 | 192.0 | (P) 192.0 |
| 12-month % change | -0.9 | 0.8 | 0.9 | 0.5 | -1.5 | (P) -2.4 |
| Financial Activities (3) | 650.1 | 652.5 | 648.6 | 649.3 | 652.6 | (P) 649.0 |
| 12-month % change | 2.5 | 2.6 | 1.9 | 2.0 | 2.7 | (P) 1.9 |
| Professional & Business Services (3) | 1,373.5 | 1,370.8 | 1,366.3 | 1,374.9 | 1,376.5 | (P) 1,385.0 |
| 12-month % change | 4.5 | 3.6 | 2.8 | 3.2 | 3.1 | (P) 3.7 |
| Education & Health Services (3) | 1,451.7 | 1,458.7 | 1,460.8 | 1,458.6 | 1,458.3 | (P) 1,470.9 |
| 12-month % change | 3.4 | 3.7 | 3.4 | 3.2 | 3.0 | (P) 3.2 |
| Leisure & Hospitality (3) | 1,078.4 | 1,084.8 | 1,084.1 | 1,090.8 | 1,092.3 | (P) 1,085.8 |
| 12-month % change | 5.3 | 4.9 | 4.5 | 5.0 | 4.8 | (P) 3.8 |
| Other Services (3) | 381.6 | 378.2 | 379.0 | 378.3 | 383.2 | (P) 381.5 |
| 12-month % change | 5.3 | 3.9 | 3.9 | 3.7 | 4.9 | (P) 3.2 |
| Government (3) | 1,778.7 | 1,780.2 | 1,781.5 | 1,778.6 | 1,781.9 | (P) 1,790.6 |
| 12-month % change | -3.4 | -3.1 | -2.8 | -2.8 | -2.8 | (P) -2.0 |
| Mass layoffs | | | | | | |
| Layoff events, all industries (4) | 33 | 50 | 45 | 53 | 76 | 40 |
| Initial claimants, all industries (4) | 2,714 | 7,962 | 4,621 | 5,130 | 9,341 | 3,333 |

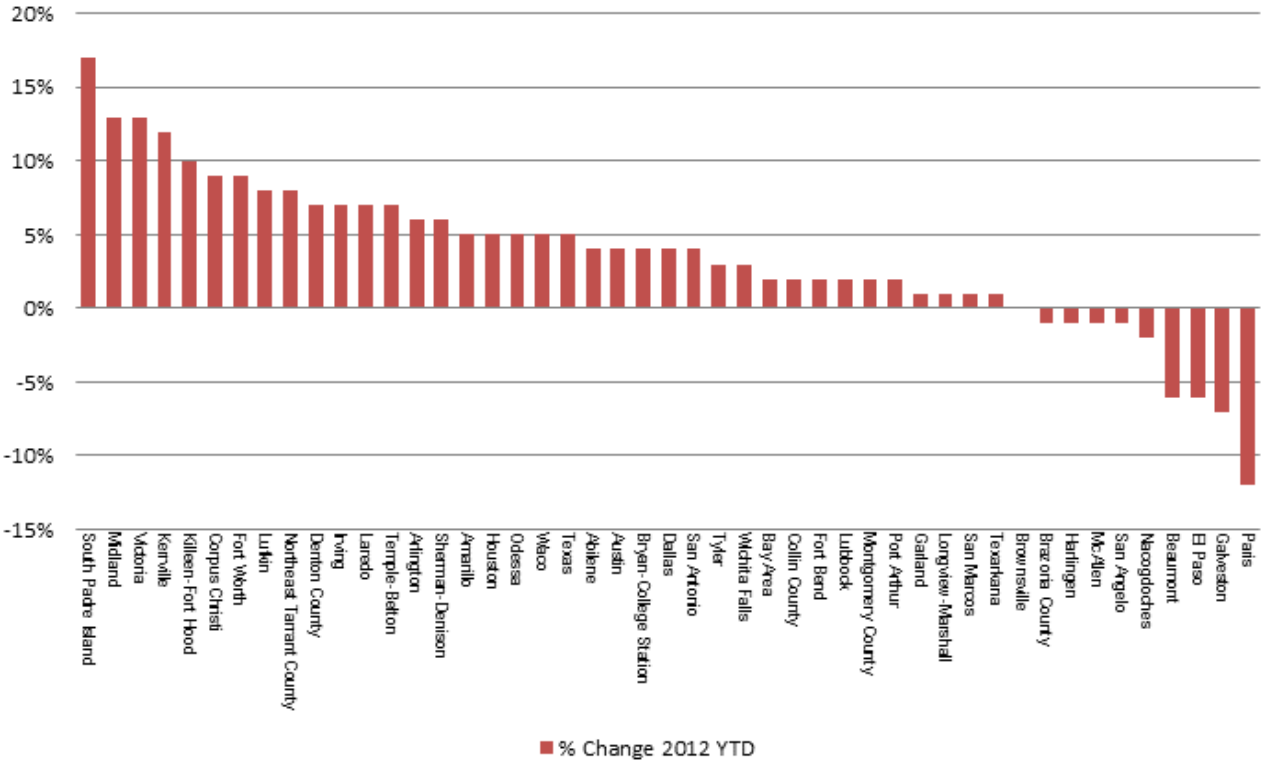
Footnotes
(1) Number of persons, in thousands, seasonally adjusted.
(2) In percent, seasonally adjusted.
(3) Number of jobs, in thousands, seasonally adjusted.
(4) See about the data.
(P) Preliminary

*Data extracted on September 7, 2012*
*Source: U.S. Bureau of Labor Statistics*

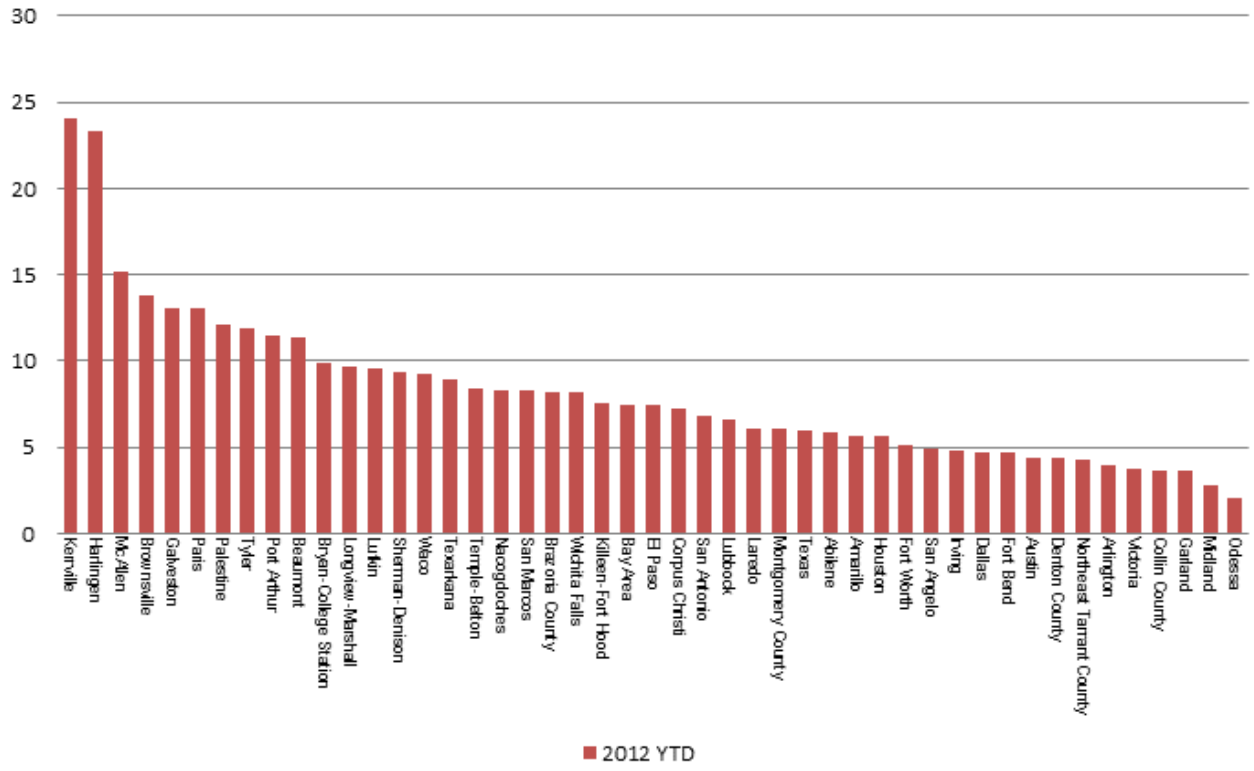
## Home Sales



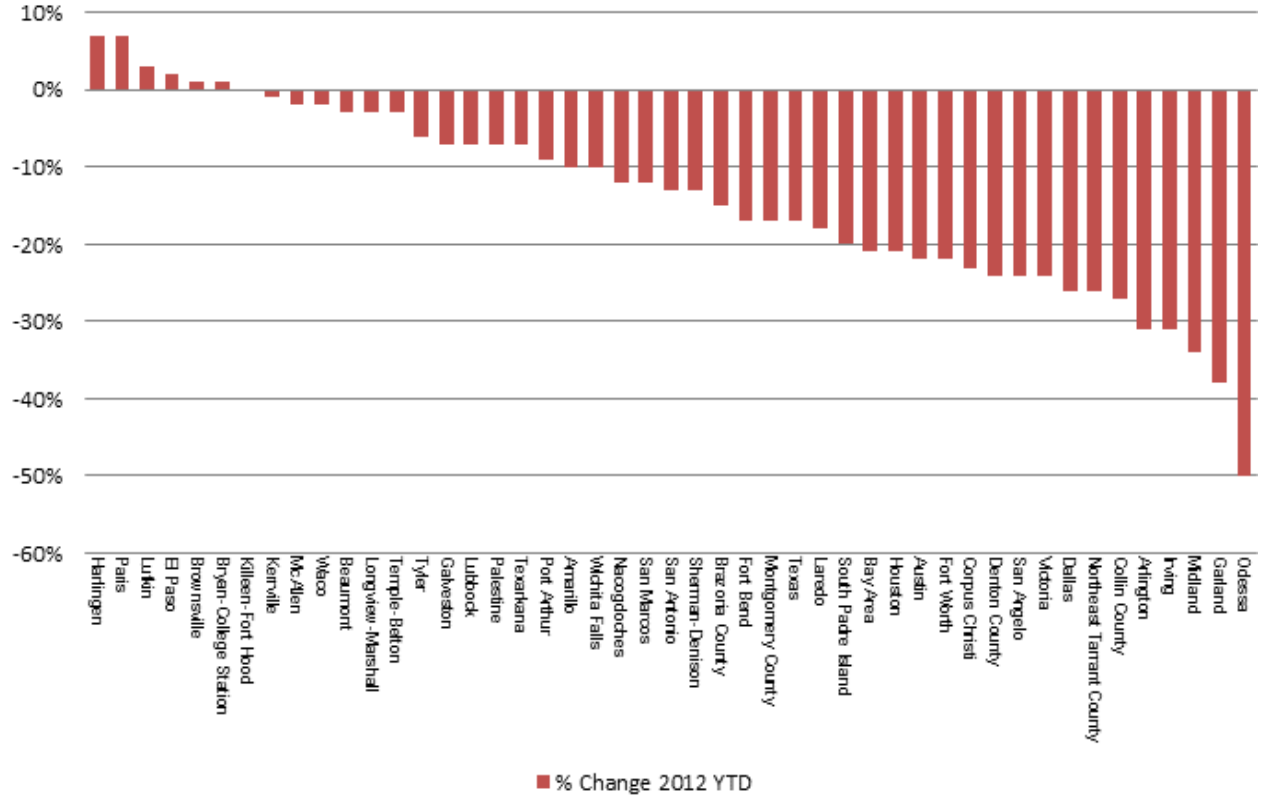

## Average % Change in Home Prices



## MLS Months Inventory




## MLS Total Listings



The July 2012 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. This summary is based on responses from 64 domestic banks and 23 U.S. branches and agencies of foreign banks. In the July survey, modest fractions of domestic banks, on balance, continued to report having eased their lending standards across most loan types over the past three months.

Relatively large fractions reported stronger demand for many types of loans over that period. In contrast, lending standards at U.S. branches and agencies of foreign banks continued to tighten for commercial and industrial (C&I) loans and were unchanged for commercial real estate (CRE) loans; demand for both types of loans reportedly weakened, on net, at those institutions.

At domestic banks, lending policies for loans to businesses generally eased over the past three months, and demand increased somewhat. Although a modest fraction of domestic banks reported having eased standards on C&I loans to large and middle-market firms, standards on loans to small firms were little changed on balance.

In addition, domestic banks continued to ease many terms on C&I loans to all types of firms. While loan demand from large and middle-market firms strengthened somewhat further over the past three months, loan demand from small firms was unchanged, in general, over this period. A modest fraction of domestic banks reported that they had eased lending standards on CRE loans over the past three months, while a relatively sizable fraction, on net, continued to indicate that demand for such loans had strengthened.

Regarding loans to households, reported changes in standards were mixed across loan categories, while demand increased somewhat. Lending standards over the past three months were little changed, on net, for prime mortgages and tightened somewhat for nontraditional mortgages. However, a relatively large fraction of respondents reported having experienced stronger demand for prime mortgages over the same time period. Modest fractions of domestic banks, on net, indicated that they had eased standards on auto loans and on credit card loans. Standards on other consumer loans remained little changed. Small net fractions of banks reported increased demand for credit card and other consumer loans, while a relatively large fraction of banks reported an increase in demand for auto loans.

The July survey also contained three sets of special questions: The first set asked banks about lending to, and competition from, European banks; the second set asked about the revised Home Affordable Refinance Program (HARP 2.0); and the third set repeated a number of special questions from one year ago on the current level of standards relative to their range since 2005 for a broad variety of loan categories. In response to the first set, large fractions of both domestic and foreign banks that extend credit to banks headquartered in Europe or their affiliates or subsidiaries indicated that they had tightened standards on such loans over the past three months. A sizable fraction of domestic banks reported that their business had increased due to decreased competition from European banks and that they remain willing to accommodate additional such business. In response to the second set of special questions, about one-third of the respondents that are participating in HARP 2.0 reported that HARP refinance applications accounted for a significant share of total refinance applications over the past three months, and a large majority of respondents indicated that they anticipate that more than 60 percent of received HARP applications will be approved and successfully completed. Significant fractions of banks reported a number of factors limiting their participation in the program. Responses to the third set of questions suggested that lending standards for most categories of loans remained at least somewhat tighter, on balance, than the middle of their respective ranges since 2005.

## Business Lending

**C&I Loans.** A modest fraction of domestic banks continued to report having eased standards on C&I loans to large and middle-market firms; standards on loans to small firms were little changed, on balance, for the fourth consecutive survey. In contrast, a small number of U.S. branches and agencies of foreign banks reported having tightened their standards on C&I loans for the fourth consecutive quarter.

Domestic banks continued to ease many terms on C&I loans, on balance, regardless of firm size. In particular, relatively large fractions of respondents continued to indicate that they had narrowed the spreads on C&I loan rates over their cost of funds and had reduced their use of interest rate floors. In

contrast, small fractions of foreign banks reported increasing the cost and reducing the maximum size of credit lines as well as raising premiums charged on riskier loans, while other C&I lending terms at those institutions changed little over the past three months.

Almost all domestic banks that reported having eased standards or terms on C&I loans continued to cite more-aggressive competition from other banks and nonbank lenders as a reason. Only about one-fourth of the banks that had eased lending policies had done so because of a more favorable or less uncertain economic outlook. Meanwhile, large majorities of the few banks, both domestic and foreign, that reported having tightened C&I credit standards or terms cited a less favorable or more uncertain economic outlook as the reason.

A significantly smaller net fraction of banks than in the previous survey reported stronger demand for C&I loans over the past three months. Only a modest fraction of domestic banks indicated that the demand for C&I loans by large and middle-market firms had been stronger, while demand for loans by small firms was unchanged on net. Domestic banks, on balance, also continued to report a rise in the number of inquiries from potential business borrowers regarding new or increased credit lines. In contrast, demand for C&I loans at foreign banks reportedly had weakened somewhat further for the second consecutive survey.

A large majority of the domestic banks that reported stronger demand for C&I loans cited increases in customers' funding needs related to inventories, accounts receivable, investment in plant or equipment, and mergers and acquisitions as important factors underlying the increase. At the same time, about one-fifth of domestic and foreign banks indicated weaker demand for C&I loans in the July survey, and most of those institutions reported that a decrease in investment in plant or equipment was an important factor.

**European Exposure.** A set of special questions in the July survey asked respondents about lending to, and competition from, banks headquartered in Europe and their affiliates and subsidiaries (regardless of the location of the affiliates or subsidiaries). Many of these questions were also asked in the previous three surveys. A large fraction of both domestic and foreign banks that extend credit to European banks had tightened standards on such loans over the past three months; a fraction that was significantly higher than that in the April survey. Loan demand from European banks, however, was little changed on net. About one-half of domestic banks that compete with European banks reported that business had increased due to decreased competition from such banks. Furthermore, a very large majority of domestic respondents reported that they were willing to accommodate additional business in the second half of 2012 arising from decreased European competition. Slightly less than one-fourth of the domestic banks that experienced increases in C&I loans over the first half of this year indicated that either a moderate or a small portion of that increase had been attributable to purchases of loans from European banks.

**CRE lending.** A modest fraction of domestic banks, on balance, reported having eased standards on CRE loans over the past three months, while a relatively sizable fraction, on net, continued to indicate having experienced stronger demand for such loans. In contrast, foreign survey respondents indicated that standards on such loans were unchanged for the second straight survey and that demand had been noticeably weaker, on net, over the past three months.

## Lending to Households

**Residential real estate lending.** On balance, domestic banks continued to report little change in lending standards for prime mortgages and having tightened standards somewhat for nontraditional mortgages over the past three months. Meanwhile, a relatively large net fraction of respondents reported having experienced stronger demand for prime and nontraditional mortgages over the same time period. In contrast, changes in both lending standards and demand for home equity lines of credit (HELOCs) were relatively muted on net over the past three months.

**Home Affordable Refinance Program.** A set of special questions asked domestic survey respondents about HARP 2.0. A majority of the large banks indicated that they had participated in HARP during the past three months, though only one-third of the other banks reported having done so. About one-third of the respondents that had participated in HARP reported that over the past three months between 30 percent and 70 percent of all refinance applications were attributable to HARP, while an additional one-third reported that between 10 percent and 30 percent were HARP applications. In addition, about two-thirds of those participating in HARP anticipate that more than 60 percent of these applications will be approved and successfully completed.

The July survey also asked banks to indicate to what extent various factors were affecting their willingness or ability to offer additional refinance loans through HARP. A large majority of banks reported that they had restricted their participation in HARP to those mortgages that they already serviced or held, while a smaller majority also indicated that the high volume of refinance applications had exceeded processing capacity. Many banks also reported that credit overlays that they had imposed on top of the HARP requirements were at least somewhat important factors in limiting their participation; a significant fraction of respondents reported having been unwilling to offer HARP refinance loans to some customers with high loan-to-value (LTV) ratios, limited or nonstandard documentation of income or assets, or low FICO scores. Almost all of the respondents that reported "Other" as being the most important factor for having been unwilling to offer HARP refinance loans specified that they did not participate in the program at all.

**Consumer Lending.** Moderate fractions of domestic banks reported that standards on auto loans had eased, on net, while somewhat smaller net fractions indicated that standards on credit card loans had eased. Standards on other consumer loans were about unchanged. Banks again reported having narrowed spreads on auto loans, while other terms across the three categories of consumer loans remained relatively little changed on net. The fraction of respondents that indicated that they were more willing to make consumer installment loans now as opposed to three months ago remained elevated by historical standards, for the second consecutive survey.

A relatively large fraction of banks reported stronger demand for auto loans, on balance, while only modest net fractions of banks reported stronger demand for credit card loans and for other consumer loans. However, the share of banks that indicated that they had experienced higher demand was slightly smaller, on net, for all three loan categories than in the previous survey.

**Levels of Lending Standards Relative to Longer-Term Norms**

The July survey repeated a set of special questions from July 2011 that asked respondents to describe the current level of lending standards at their bank, rather than changes in standards over the survey period. Specifically, banks were asked to consider the range over which standards have varied between 2005 and the present for each loan category and to report where standards for such loans reside relative to the midpoint of that range.

Regarding loans to businesses, large fractions of both domestic and foreign banks reported that lending standards on four different categories of C&I loans (investment-grade syndicated loans, below-investment-grade syndicated loans, other loans to large firms, and loans to small firms) were about at the middle of the range that those standards have occupied since 2005. A significant net fraction of domestic banks also reported that the current standards on all types of CRE loans (construction and land development loans; loans secured by nonfarm, nonresidential structures; and loans secured by multifamily structures) were tighter than the middle of the range that those standards have occupied since 2005, with very few banks reporting that standards were easier than the midpoint.

With respect to loans to households, a majority of the banks reported that lending standards for all five categories of residential mortgage loans included in the survey (prime conforming mortgages, prime jumbo mortgages, subprime mortgages, nontraditional mortgages, and HELOCs) were at least somewhat tighter than the middle of the range that those standards have occupied since 2005, while smaller but still significant fractions of domestic banks also reported that standards were tighter than the midpoint for prime credit card, subprime credit card, auto, and other consumer loans.

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