Condition of the Texas State Banking System

March 2014

Texas Department of Banking
Texas Department of Savings and Mortgage Lending

Financial Data as of December 31, 2013

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

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Banking System Overview

Texas banks and thrifts balance sheets have improved since emerging from the recession. Better asset quality, and reduced credit losses have led to healthier net incomes being reported at year-end 2013. The Texas' resilient economy and managements' dedication to controlling expenses are aiding the improvement in balance sheets. State-chartered financial institutions are expected to continue to improve and strengthen their operations despite the challenges of new regulations, the persistent drought, and low-interest rate environment.

The Texas economy continues to outperform the national economy. State sales tax collections are nearly 6% ahead of the previous year. At 5.7%, Texas unemployment is not only improving but remains well below the national average of 6.7%. Texas, with roughly 8% of the United States' population, had 15% of all housing starts in the U.S. in 2013, per National Association of Home Builder statistics.

In the last three years, the Department of Banking has experienced an increase in conversions from national charters to state charters. Since 2010, there have been thirteen financial institutions convert from a national charter to a Texas state-chartered bank. The Texas Department of Savings and Mortgage Lending had similar activity with nine financial institutions converting from national banks or federal thrifts to a state savings bank charter between 2010 and 2013.

Another sign of improvement for community banks and thrifts is the reducing number of problem banks, or those that receive an overall CAMELS rating during an on-site examination of "3," "4," or "5." As of March 2014, only 6% of our state banks and thrifts were classified as problem institutions; a manageable number at a level well below the peak reached in November 2010. The problem institutions that remain have specific and isolated issues. Further, bank failures have also slowed for the nation, with only 24 failing in 2013 compared to 51 in 2012 and 92 in 2011. Of the failures in 2013, Texas accounted for two, both were national charters.

Although the economy is growing stronger, the banking environment is still facing regulatory challenges as provisions of Dodd-Frank are finally being implemented and bankers learn to work under these new constraints. Community bankers express sustained concerns over the level of regulatory burden and the one-size-fits-all regulatory approach by Washington D.C. Others are looking forward to opportunities to differentiate themselves from larger banks by deploying new technologies and services. At the most recent conference held by the Federal Reserve, discussions centered on each of these regulatory issues, along with the overall financial market crisis and cyber security.

One particular challenge banks of all sizes in the nation are dealing with relates to the mortgage lending sector. During the first three months of 2014, several national banks announced hundreds of layoffs due to reduced mortgage lending activities, including mortgage refinancing. Many state banks have reported that they are contemplating withdrawing or reducing their mortgage lending due to the new stricter lending guidelines.

State-Chartered Banking Profile (Department of Banking)

The number of Texas state-chartered banks continued to trend downward in the second half of the year, with 283 banks as of December 31, 2013. The decline was due primarily to mergers, but was partially offset by charter conversions. Between July and December of 2013 there were four national banks and one federal savings bank that converted to a Texas state-charter. Interest in conversions to a Texas state-charter remains high.

There were 135 new bank branches and 14 new Loan Production Offices opened in the second half of 2013. During this same period, total assets of Texas state-chartered banks increased by $13.3 billion, while net loans and leases grew by $5.9 billion. Merger activity reflects the current banking landscape, as some banks look for growth while others seek economies of scale in a rapidly changing regulatory environment.

State-Chartered Thrift Profile (Department of Savings and Mortgage Lending)

Increased profitability occurred in 46.7% of the thrift institutions during 2013, due to an increase in the volume of loans, and lesser provisions for loan and lease losses. Only 3.3% of the thrift charters were unprofitable for 2013, compared to 6.7% in 2012. Nonperforming loans and other real estate foreclosed decreased in state-chartered thrifts during 2013 from 6.0% of total assets to 4.9%. Based on institution specific information obtained through examinations, an approximate majority of nonperforming assets in the industry were purchased as troubled as a business strategy and not organically originated. As such, they are either covered assets by the FDIC or guaranteed by other federal governmental agencies against loss and therefore do not pose a supervisory risk. 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 $10.27 billion as of December 31, 2013, an increase of 2.3% or $228.8 million from last year. The total number of state-chartered savings banks at year-end 2013 remains at thirty, with the addition of one federal savings bank conversion and the merger out of one thrift merging with a national charter.

The Department continues to receive and process a fair volume of applications as the industry continues to expand. During the year, there has been one charter conversion application, from a federal thrift, seven branch office applications, four merger/reorganization applications, and various other types of applications.

Texas Economic Profile

The Federal Reserve's Beige Book released in early March 2014 reports that the Dallas district's economy, which includes Texas, and parts of New Mexico, and Louisiana, grew at a moderate pace. Texas accounts for approximately 95% of the economic activity reported. This is no surprise as Texas continues to perform at or better than the nation. The Texas economy is diverse and encompasses industries such as agriculture, defense, computer technology, energy, tourism, entertainment, and healthcare. The energy sector is the strongest of these sectors.

Workforce

As mentioned previously, the national unemployment rate was at 6.7% as of February 2014, with 92% of recession-hit jobs recovered. In Texas, the unemployment rate decreased 0.8% between January 2013 and January 2014 to 5.7%. For over seven years, the state's unemployment rate has been below the national level. Job growth is steady in the state with 11 out of the 12 major industries adding jobs in the last year.

Energy

Sustaining activity in the energy sector are the hydraulic fracturing and horizontal drilling technologies that have allowed oil companies to open up huge deposits, especially in the Eagle Ford Shale formation in South Texas. Analysts are optimistic that the boom will continue into the future. Reports indicate that the Wolfcamp, Spraberry and Cline fields in West Texas are still developing, and it is rumored that the Permian Basin formation could soon surpass the Eagle Ford Shale. This would stimulate the U.S. oil and gas shale boom even further.

The Texas Railroad Commission reported the average rig count as of February 21st at 843, representing about 50% of all active land rigs in the United States. All this activity has led to increased oil and natural gas production tax collections, generating considerable revenue for the Lone Star State.

- Preliminary data for Texas as of December 2013 indicates crude oil production averaged 1.8 million barrels daily, up 22% from the daily average of December 2012. Crude oil futures reached a settle price of $101.56 on March 6, 2014, $43.73 below the high closing price of $145.29 per barrel in July 2008.

- Texas oil and gas wells produced 552.8 million Mcf (thousand cubic feet) of gas based upon preliminary production figures for December 2013, up 5% from December 2012. Texas preliminary December total gas production averaged 17.8 million Mcf a day. Natural gas futures reached a settle price of $4.66 on March 6, 2014, $8.92 lower than the high set in July 2008.

Agriculture

Winter was not kind to the agricultural industry. The easing of drought conditions last fall dried up again in January and February. The roller coaster temperatures from warm to cold this past winter season had a profound impact on vegetation and soil moisture.

Pasture conditions deteriorated, leaving farmers to consider other alternative crops. Some counties report that the harsh winter may have damaged early budding trees and shrubs. The cotton crop is expected to be larger this year as farmers have turned to planting this crop instead of corn. This is partly due to declining corn prices and rising cotton prices.

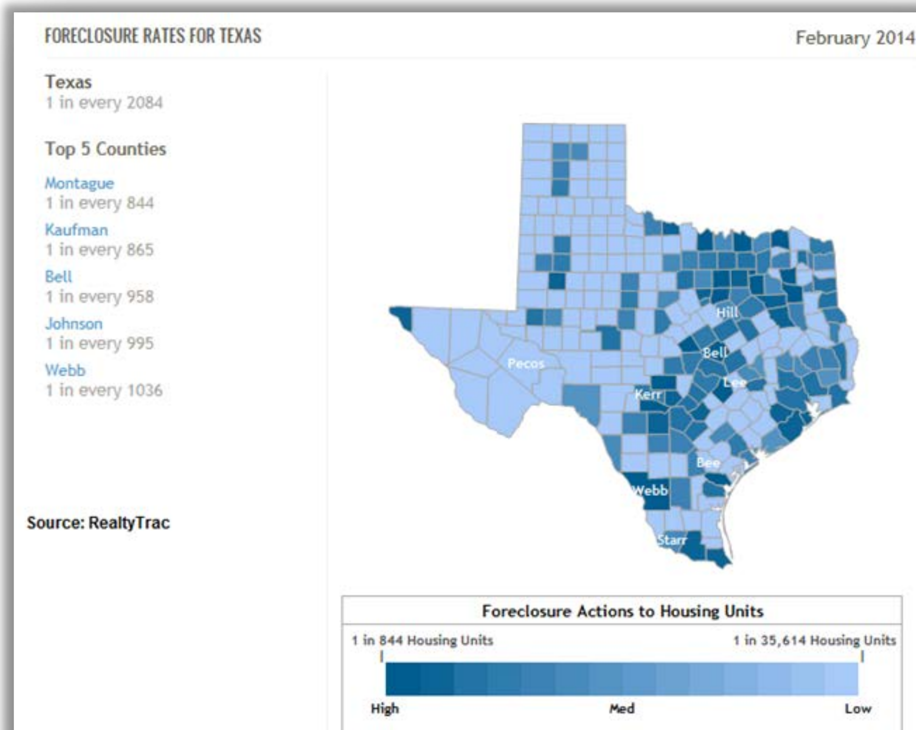
Some livestock producers had to dramatically increase the feeding of hay and supplements due to the cold, icy weather around the state. Despite the effects of the cold weather, livestock continues to be reported in good condition.

Tax Revenue

Sales tax collections for the state have increased steadily as a result of business spending in the oil and gas and manufacturing sectors. Year-end statistics reflect that tax revenues were up 7.2% from 2012. Also contributing was an increase in the sales tax revenue from vehicle sales in 2013. Overall, tax revenues should continue this pattern in 2014.

Housing

Single-family and multi-family construction is up for the state, showing that the improved economy is motivating individuals to become homeowners. There were 15,225 sales of existing single-family homes in January 2014, a 2.1% increase over the same period last year. The median price for these homes grew 10.5% from January 2013 to $165,000.

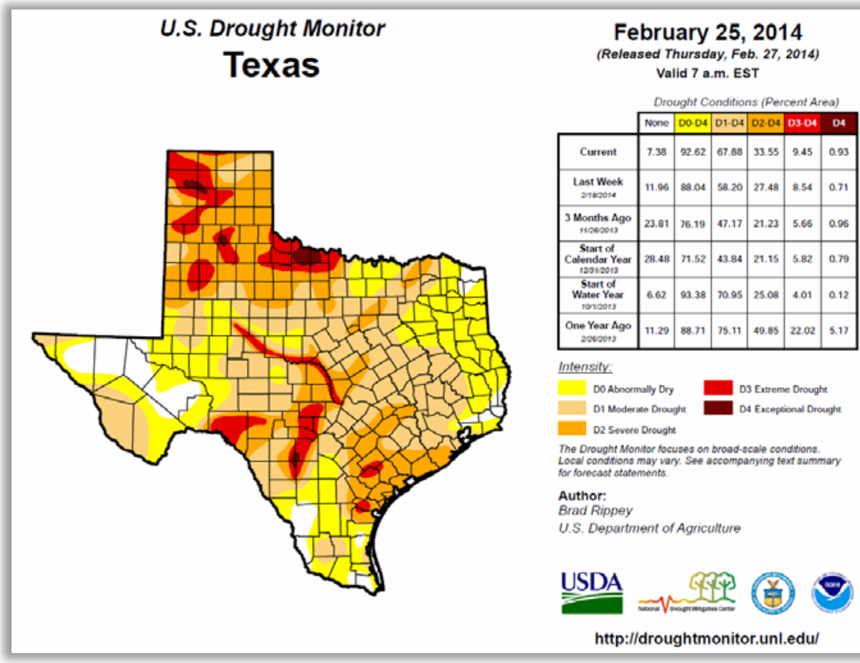


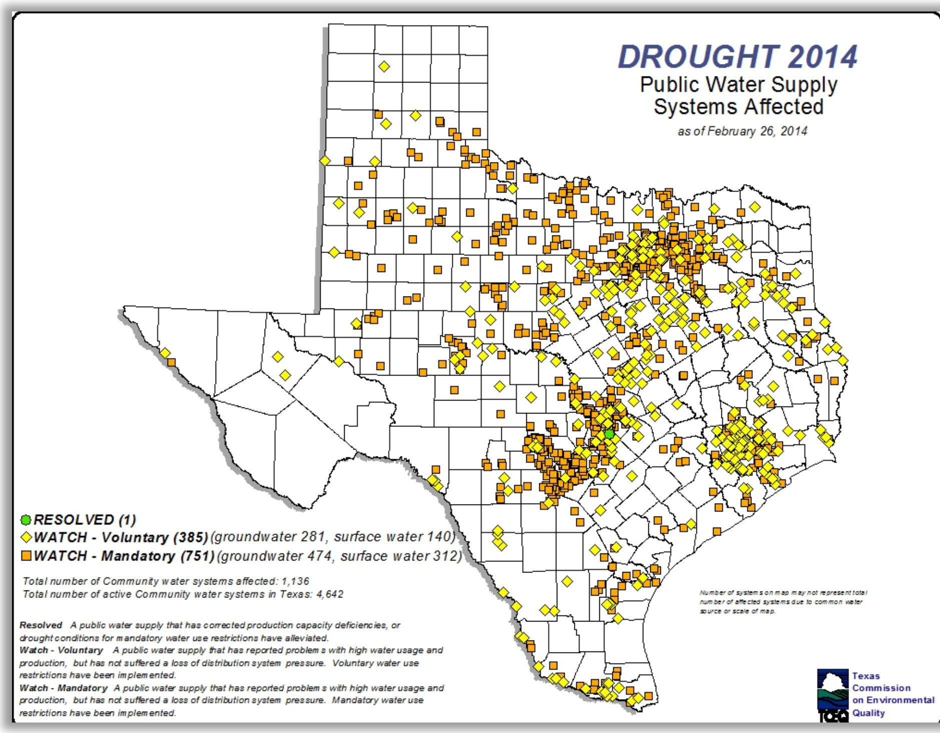
Although mortgage rates are predicted to rise in 2014, the year started with lower than expected rates. Analysts believe that as the Federal Reserve tapers its quantitative easing (QE) program, rates will rise. In addition to the tapering of this program, new mortgage compliance regulations that became effective in January 2014 may increase rates as institutions try to recoup increased costs associated with increased regulations.

RealtyTrac lists Texas' foreclosure rate as 1 in every 2,084 homes as of February 2014. Nationally, Florida's foreclosure rate is reported to be 1 in every 372 homes, with Maryland, Nevada, New Jersey, and Illinois rounding out the top five states in the nation with the highest foreclosure rates.

Persistent Drought

Mother Nature has caused devastating and possibly irreparable damage to the Texas economy, forcing various industries and government officials to implement drastic measures. Approximately 93% of Texas is in some level of drought, and about 34% of Texas is in "severe" or worse drought conditions. As a result, Texas Governor Rick Perry continues to renew his Emergency Disaster proclamation every month since it was originally issued on July 5, 2011, certifying that drought conditions pose a threat of imminent disaster in specified counties in Texas.





On February 26, 2014, the Texas Commission on Environmental Quality (TCEQ) approved the Lower Colorado River Authority's (LCRA) request for an emergency drought relief, which will cut-off Highland Lakes water to farmers about 1.1 million acre feet. Consequently, rice farmers will not receive irrigation water from the Highland Lakes for the third year. The LCRA will revisit this decision in approximately four months. In an attempt to stay in business, rice farmers are able to plant cotton in some of their rice fields, but only 25% of the soil allows for such alternative.

The beef supply is at a record low since the 1950's and continues to decline. The lack of rainfall forced many Texas ranchers to sell their cattle, which resulted in a loss of 15% of Texas' cattle or about two million animals between 2011 and 2013. As a result, the U.S. Department of Agriculture reported an increase of about $5.04 a pound in the average price of beef due to the drought.

Similarly, the oil and gas industry faces water challenges. Millions of gallons of fresh water are required to frack a single well, and much of the drilling is concentrated in areas where water is in short supply. Oil and gas production through fracking is on track to double in Texas over the next 5 years. Texas is America's oil and natural gas leader supporting nearly two million jobs thus playing a major role in the state's economy, but it will require a significant use of water and cause a dramatic impact to Texas' water capacity. The country as a whole has used about 97 billion gallons of water since 2011 for fracturing, and about half of that water was used to frack wells in Texas.

In an effort to improve the state's water situation, Texas voters passed Proposition 6 on November 5, 2013, which supported amending the constitution to invest $2 billion from the state's rainy day fund into a water bank to finance water-planning projects. There were many supporters for this proposition. The proposition acknowledges the importance of water to the Texas economy and the necessity to implement new strategies that will prevent future devastating drought effects like those seen today.

A new study from Stanford University gives the El Niño weather pattern a 76% chance of returning late this year. Generally, climatologists are limited to predicting El Niño six months prior to its formation, but Stanford researchers believe they have developed a model that allows for projections to be made an entire year in advance. According to the state climatologist, Dr. John Nielson-Gammon, the signs are pointing toward the possibility of an El Niño. If an El Niño does occur, it will be later in the year having no effect on the hotter summer months observed over the last several years.

According to the TCEQ, as of February 26, 2014, approximately 24.5% of the state's community water systems were under voluntary or mandatory water restrictions. In addition, a study conducted by the TCEQ, as of January 8, 2014, reported that 46 of the state's public water systems are at risk of running out of water in 180 days or less.

Financial institutions continue to observe and adjust to the effects of the lingering drought through their distressed customers.

SUPERVISORY CONCERNS

The number of problem institutions has declined since year-end 2010 and is considered manageable for both agencies. However, examination staff continues to monitor institutional exposure to changes in the banking industry. Banking conditions and performance can be affected by a number of factors, including the economy, regulatory burden, and monetary policy.

Maintaining a safe and sound financial services industry is a priority for both Departments. Although not an inclusive list, the following issues are of particular concern to bankers and regulators as they pertain to the stability of the banking industry.

Federal Issues

The Texas Department of Banking and the Texas Department Savings and Mortgage Lending continue to monitor events in Washington relating to the financial services industry. Though the state banking system is considered sound and most Texas banks have recovered from the recession, regulatory compliance issues mandated at the federal level are the subject of much discussion.

Each Department continues to monitor modifications and other releases related to the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank or the Act). For the most part, the provisions of the Dodd-Frank that affect the Departments' regulated entities have been implemented. In the foreseeable future, there is a possibility for general modifications to clarify implemented provisions. There are also various outstanding proposals to reform parts of Dodd-Frank that remain to be implemented; however, there has been little corroboration in Congress to legislate these changes.

Currently, the Department of Banking is reviewing how the stress test rules for $50 billion plus institutions and for $10-$50 billion institutions will affect state-chartered banks. In addition, our examination staff is analyzing the rules relating to the Ability-to-Repay and Qualified Mortgage (QM) Standards. Under those rules, lenders must categorize borrowers into those that receive "qualified mortgages" and those that do not. These mortgages must meet higher underwriting requirements, including a debt-to-income ratio no greater than 43%. Lenders still have the ability to make non-QM loans, but they must properly document the reasons why borrowers have the ability to repay the loan. The rules also ban larger lenders from making balloon loans, revise loan originator compensation limits and expand restrictions on higher-cost mortgages. Reports from state-chartered banks indicate that the strict guidelines have caused some institutions to no longer offer mortgage loans or reduced their involvement in mortgage lending.

Another post-crisis regulation tool being used by federal regulators is litigation resulting from the legal doctrine of disparate impact in relation to lending. In disparate impact cases, a protected class (minorities, women, etc.) does not need to establish evidence of a lender's intent to discriminate. The loan underwriting standards can be completely blind to race, gender, ethnicity, and other protected characteristics. Yet, if a bank does not approve loans in a pattern that mirrors the market population's characteristics, the bank may be found in violation of fair-lending regulations. Industry analysts' fear that disparate impact enforcement is more likely to constrain the availability of consumer credit to borrowers who are well-qualified but lack protected characteristics.

The lagging effects of the nation's monetary policy continue to affect financial institutions as they continue to grapple with net interest margin compression due to the low interest rate environment. Institutions holding longer term fixed rate assets inherit risk exposure. Correspondingly, any adverse shift in the level of rate-sensitive income could impair the underlying value of assets and/or liabilities. As indicated in the recent Department of Banking's Banker Economic and Business Survey, banks have been negatively impacted by the low interest rate environment leaving some to find other ways to generate revenue. The monitoring of bank activity in new markets or products is an interest to both Departments to ensure that institutions are managing the risks associated with these new endeavors.

Information Technology (IT)

A high profile area sparking concern at both the state and federal level is information technology threats, more specifically cyber security and crimes. Unfortunately, cyber-criminal activities are increasing and the end result being a need to increase cyber security. The cost of a cyber-theft can be exponential as many companies have experienced in the recent months. These thefts are both financially taxing, and damaging to the reputation of any business. These cybercrimes highlight the entity's sensitivity and vulnerability. Cyber-attacks, malware, data leakage and other security issues require significant attention from bankers and regulators. Staying aware of these particular IT issues is important to the Texas Department of Banking, who has partnered with the U.S. Secret Service and the Texas Bankers Electronic Crimes Task Force to create awareness and offer risk management guidance. Additionally, the Department of Banking's Director of IT Security Examinations devotes a considerable amount of time to promoting cyber awareness and prevention on both a state and national level.

Other Concerns

An area of growing concern for financial institutions is patent infringement litigation and

Other Items Reviewed at Examinations

- Bank Secrecy Act/Anti-Money Laundering
- Risk Management Practices
- Capital Levels
- Composition of Classified Assets
- Fraud
- Internal Watch Lists
- Overdraft Programs
- Private-label Collateralized Mortgage Obligations
- Tax Liens
- Reputational Risk
    - Fair Lending
    - Deceptive Trade Practices
    - Foreclosure

the increased litigation against banks. “Patent trolls”, also known as patent assertion entities or non-practicing entities, are companies that buy broadly worded patents, sometimes from firms that go bankrupt, with the intent of suing other companies for illegally infringing on these patents. Intellectual property is highly valuable to large companies and defended extensively against the asserted patent rights of others. Patent trolls therefore tend to prey more on small businesses. At this time, states have limited power to address the issue; however, the Texas Legislature and U.S. Congress have both taken notice.

DEPARTMENTAL SUPERVISORY MEASURES BEING TAKEN

In an effort to minimize the impact of an adverse event on financial institutions, each Department concentrates on specific areas of risks by monitoring current events. Prudent efforts are made to mitigate any potential risk as early as possible in order to diminish any negative impact on regulated entities. The Departments have each detailed the areas in which supervisory staff is currently monitoring.

Texas Department of Banking

- Assessing interest rate risk, as banks adjust to improve, net interest margins by extending the duration of the investment portfolio;
- Monitoring reductions in internal and external audit functions, loan review and training programs made by banks in an effort to modify operations to reduce overhead costs;
- Conducting targeted reviews of new product lines as banks seek additional sources of revenue;
- Initiating enforcement actions early in the detection of deteriorating trends;
- Continuing frequent on-site examinations of problem institutions;
- Communicating and coordinating joint enforcement actions and other supervisory activities with other 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.

Texas Department of Savings and Mortgage Lending

- 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);
- 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;
- Offsite reviews of the re-pricing of state savings banks’ portfolio assets and liabilities to identify excess exposure to interest rate risk, based on established benchmarks, with actions or recommendations on a case by case basis;
- Internal monitoring of local, state, national and world political and economic events impacting the industry; 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

Although the number of state-chartered banks has steadily decreased in the last few years, total assets continue to rise. With ten less charters at year-end 2013 than the same period the previous year, total assets nonetheless rose by $10.8 billion to $216.6 billion. Although consolidations are occurring, it is evident that state-chartered banks are continuing to explore opportunities for growth.

Overall, the reported core capital signifies a well-capitalized industry with state banks reporting a 9.7% ratio, an improvement from year-end 2012. Of the 283 state-chartered banks, 94.7% report profitability. Net income of approximately $2.2 billion was reported at December 31, 2013. The improvement in earnings from the previous year can be attributed to the decreased interest expenses, a smaller dividend payout, and lower loan and lease loss provisions. Return on assets (ROA) improved slightly to 1.06%; a 0.7% increase from year-end 2012.

The low interest rate environment continues to keep margins narrow. Net interest margins (NIM) for state banks were virtually unchanged from the previous year, with only a three basis point (BP) increase. With low NIMs, returns on earning asset balances remain low as well, with state banks reporting 3.6% yield on earning assets, a five BP decrease from year-end 2012. In December 2011, the yield was at 4.2%.

Loan demand has significantly increased in the last two years. Since December 2011, net loans and leases have increased from $98.1 billion to $121.3 billion. This equates to a 23.6% increase. The most notable increase has been in commercial and industrial loans, commercial real estate loans and 1-4 single family residential loans.

State banks are reporting a reduction in past due assets, as non-current loans to total loans improved from 1.5% to 1.1% at year-end. State-chartered banks appear to have decreased reserves to absorb potential losses as their allowance for loan and leases loss account decreased slightly to 1.30% and earnings coverage to net loan charge-offs increased to 13.8 from 7.3 a year earlier. In addition, net charge-offs decreased during the year to 0.19% from 0.33% a year ago. It is noted that the allowance for loan and lease losses increased marginally between year-end 2013 and 2012.

FDIC INSURED STATE-CHARTERED THRIFTS

For 2013, state thrifts had $210.2 million in net income. ROA for thrifts remained at 2.1%. The level of unprofitable savings banks has decreased from 6.7% to 3.3%. Most recently chartered, reorganized or converted institutions have reached profitability. Provisions for loan and lease losses to average assets have decreased 36 BP. Non-interest income to assets has increased by 1 BP, while non-interest expense to assets has decreased by 25 BP.

State thrifts experienced an 89 BP increase in their core capital levels during 2013 from 16.7% to 17.6%. The increase in thrift capital ratio is due to the industry raising over $43.9 million in capital, lower cash dividends paid, and more net income as noted above. Texas state thrifts also continue to far exceed the national capital ratios for all savings institutions, which was 10.9% for year-end 2013, and 10.99% for year-end 2012.

NIMs for state thrifts posted an 18 BP decrease from 5.1% to 4.9% at year-end. Year-to-date provisions to the allowance for loan losses decreased for thrifts $3.285 million during the year. The Texas thrift allowances for loan and lease losses to non-current loans and leases, presently at 27.9%, is below the ratio of 56.98% for all 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 4.9% at December 31, 2013. Thrifts also experienced a decrease in noncurrent loans as a percentage of total loans from 6.8% to 5.4%, but does not represent a supervisory concern as previously discussed. Loss reserves have decreased and now represent 1.5% of loans. This is a 16 BP decrease for savings institutions since December 31, 2012.

Number of Institutions and Total Assets

FDIC financial data is reflective of FDIC insured institutions only.

Assets in Billions

	12-31-2013 No. of Institutions	12-31-2013 Assets	12-31-2012 No. of Institutions	12-31-2012 Assets	Difference No. of Institutions	Difference Assets
Texas State-Chartered Banks	283	$216.6	293	$205.8	-10	+$10.8
Texas State-Chartered Thrifts	30	$10.3	30	$10.1	0	+0.2
	313	$226.9	323	$215.9	-10	+$11
Other states' state-chartered:						
Banks operating in Texas*	26	$43.3	27	$38.4	-1	+$4.9
Thrifts operating in Texas*	0	0	0	0	0	0
	26	$43.3	27	$38.4	-1	+$4.9
Total State-Chartered Activity	339	$270.2	350	$254.3	-11	+$15.9
National Banks Chartered in Texas	211	$138.8	227	$156.4	-16	-$17.6
Federal Thrifts Chartered in Texas	9	$68.0	12	$64.4	-3	+$3.6
	220	$206.8	239	$220.8	-19	-$14.0
Other states' federally-chartered:						
Banks operating in Texas*	23	$292.1	23	$265.6	0	+$26.5
Thrifts operating in Texas*	9	$0.9	9	$0.9	0	0
	32	$293	32	$266.5	0	+$26.5
Total Federally-Chartered Activity	252	$499.8	271	$487.3	-19	+$12.5
Total Banking/Thrift Activity	591	$770	621	$741.6	-30	+$28.4

**Indicates estimates based on available FDIC information.*

Ratio Analysis

As of December 31, 2013

FDIC financial data is reflective of FDIC insured institutions only.

	State-Chartered Banks 283	Texas National Banks 211	All Texas Banks 494	State-Chartered Thrifts** 30	Texas Federal Thrifts 9	All Texas Thrifts 39
% of Unprofitable Institutions	5.30%	2.84%	4.25%	3.33%	11.11%	5.13%
% of Institutions with Earnings Gains	58.30%	48.34%	54.05%	46.67%	44.44%	46.15%
Yield on Earning Assets	3.61%	3.56%	3.59%	5.55%	4.37%	4.52%
Net Interest Margin	3.30%	3.30%	3.30%	4.90%	3.89%	4.02%
Return on Assets	1.06%	1.27%	1.14%	2.10%	1.22%	1.34%
Return on Equity	9.61%	11.87%	10.52%	12.19%	13.75%	13.40%
Net Charge-offs to Loans	0.19%	0.19%	0.19%	0.22%	1.23%	1.09%
Earnings Coverage of Net Loan C/Os	13.76	15.07	14.32	15.76	3.16	3.53
Loss Allowance to Loans	1.30%	1.64%	1.44%	1.51%	1.74%	1.71%
Loss Allowance to Noncurrent Loans	114.76%	106.97%	111.03%	27.89%	135.07%	90.58%
Noncurrent Assets+OREO to Assets	0.92%	1.07%	0.98%	4.88%	0.84%	1.37%
Net Loans and Leases to Core Deps	72.61%	75.30%	73.67%	102.33%	80.94%	83.46%
Equity Capital to Assets	10.98%	11.18%	11.06%	17.69%	9.02%	10.15%
Core Capital (Leverage) Ratio	9.65%	10.15%	9.85%	17.56%	9.00%	10.11%

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.
December 31, 2013

	State Banks*		State Thrifts	
	End of Period	***% of Total Assets***	**End of Period**	***% of Total Assets***
Number of Institutions	283		30	
Number of Employees (full-time equivalent)	41,938		2,068	
(In millions)				
Total Assets	$216,554		$10,274	
Net Loans and Leases	$121,265	56.00%	$7,192	70.01%
Loan Loss Allowance	$1,602	0.74%	$111	1.08%
Other Real Estate Owned	$602	0.28%	$105	1.02%
Goodwill and Other Intangibles	$4,132	1.91%	$39	0.38%
Total Deposits	$181,010	83.59%	$7,812	76.04%
Federal Funds Purchased and Repurchase Agreements	$3,397	1.57%	$0	0.00%
Other Borrowed Funds	$4,552	2.10%	$499	4.86%
Equity Capital	$23,785	10.98%	$1,819	17.70%
Memoranda:				
Noncurrent Loans and Leases	$1,396	0.64%	$396	3.86%
Earning Assets	$196,205	90.60%	$9,444	91.92%
Long-term Assets (5+ years)	$66,148	30.55%	$3,646	35.49%
	Year-to Date	***% of Avg. Assets***	**Year-to Date**	***% of Avg. Assets***
Total Interest Income	$6,824	3.27%	$510	5.11%
Total Interest Expense	$586	0.28%	$60	0.60%
Net Interest Income	$6,238	2.99%	$451	4.51%
Provision for Loan and Lease Losses	$234	0.11%	$11	0.11%
Total Noninterest Income	$2,888	1.39%	$132	1.33%
Total Noninterest Expense	$6,066	2.91%	$338	3.38%
Securities Gains	$54	0.03%	-$4	-0.04%
Net Income	$2,205	1.06%	$210	2.10%
Memoranda:				
Net Loan Charge-offs	$222	0.11%	$16	0.16%
Cash Dividends	$1,266	0.61%	$92	0.92%

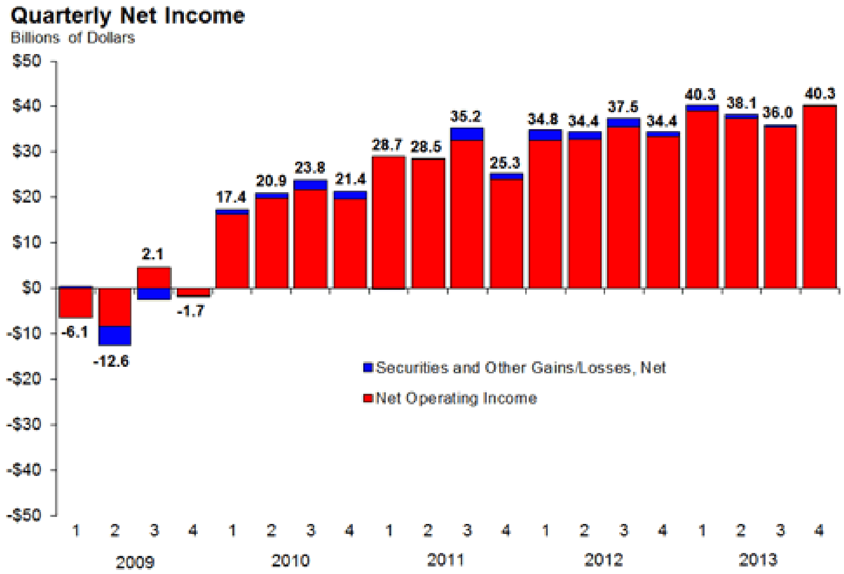
**Excludes branches of state-chartered banks of other states doing business in Texas. As of December 31, 2013, there are an estimated twenty nine out-of-state state-chartered institutions with $43.3 billion in assets.*

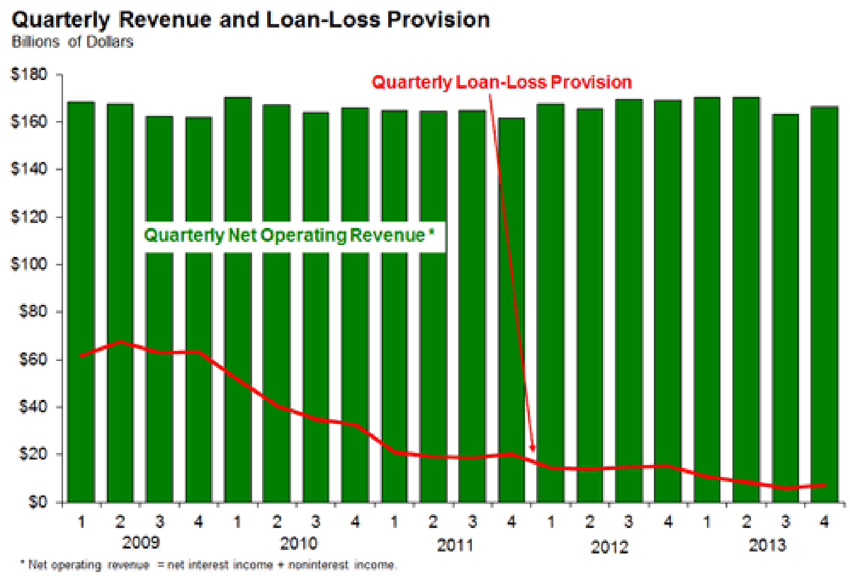
No branches of state-chartered thrifts of other states conducted business in Texas as of December 31, 2013.

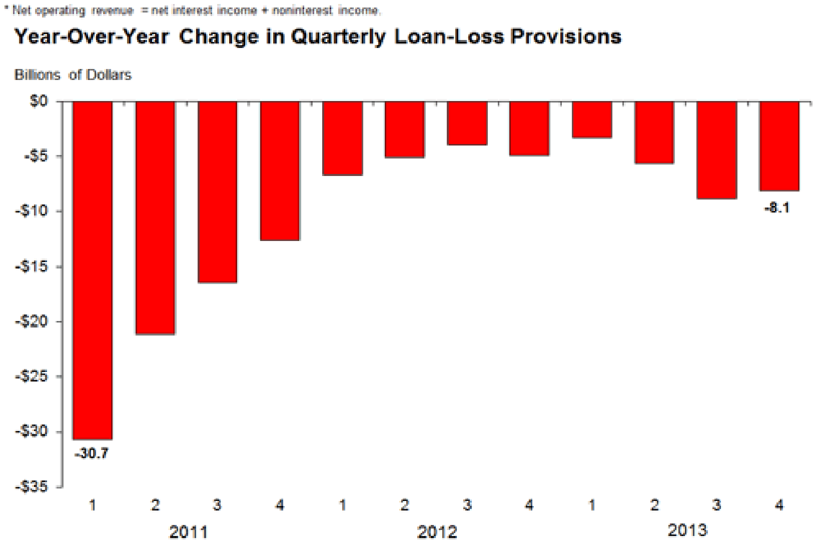
Federal Deposit Insurance Corporation Quarterly Banking Profile
Fourth Quarter 2013 - www.fdic.gov

⇧ **Lower Provision Expenses Exceed Decline in Revenues** – Lower expenses for loan-loss provisions and a reduction in litigation reserves contributed to a $5.8 billion (16.9%) year-over-year increase in quarterly net income at the nation's 6,812 insured commercial banks and savings institutions. Earnings improved despite a second consecutive year-over-year decline in quarterly revenues, caused in large part by reduced mortgage lending activity. A majority of institutions – 53.1% – reported higher quarterly earnings than in fourth quarter 2012, while the percentage of institutions reporting quarterly losses fell to 12.2%, compared with 15% in the same quarter in 2012. The average ROA rose to 1.1%, from 0.96% a year ago.

⇩ **Income from Mortgage Lending Remains Below Year-Ago Level** – Net operating revenue – the sum of net interest income and total noninterest income – was $2.8 billion (1.7%) lower than a year ago. Net interest income posted the first year-over-year increase in five quarters, rising by $1.4 billion (1.3%), but noninterest income was $4.2 billion (6.6%) less than banks reported in fourth quarter 2012. The decline in noninterest income reflected lower income from sale, securitization and servicing of 1-to-4 family residential mortgage loans (down $2.8 billion, or 34.4% compared with a year ago), and reduced income from trading (down $1.4 billion, or 32.2%). In addition to the decline in net operating revenue, realized securities gains were $1 billion (66.6%) lower than a year ago. The year-over-year drop in revenue was offset by an $8.1 billion (53.7%) reduction in loan-loss provisions, and a $5.8 billion (5.3%) decline in noninterest expenses. Much of the reduction in noninterest expenses was attributable to a $3.1 billion decline in

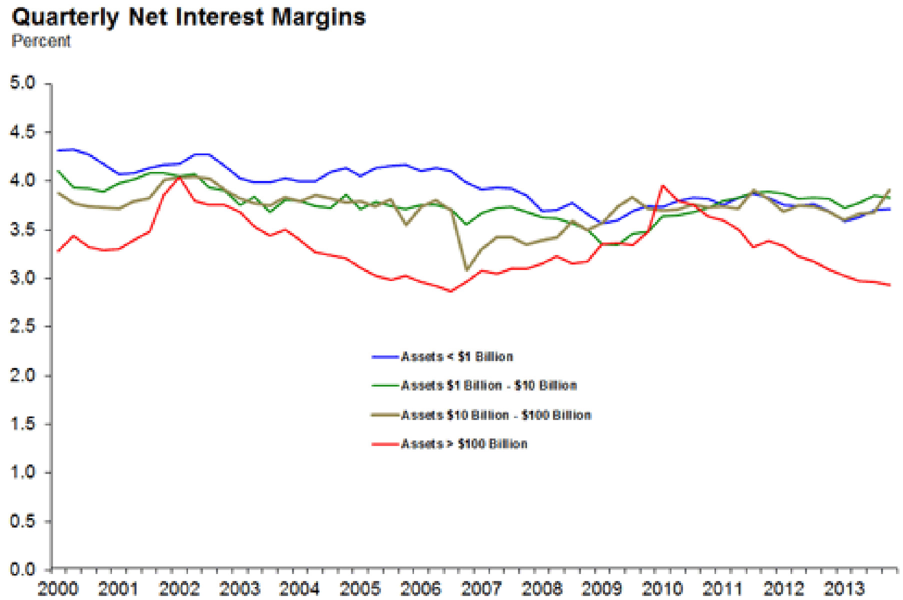


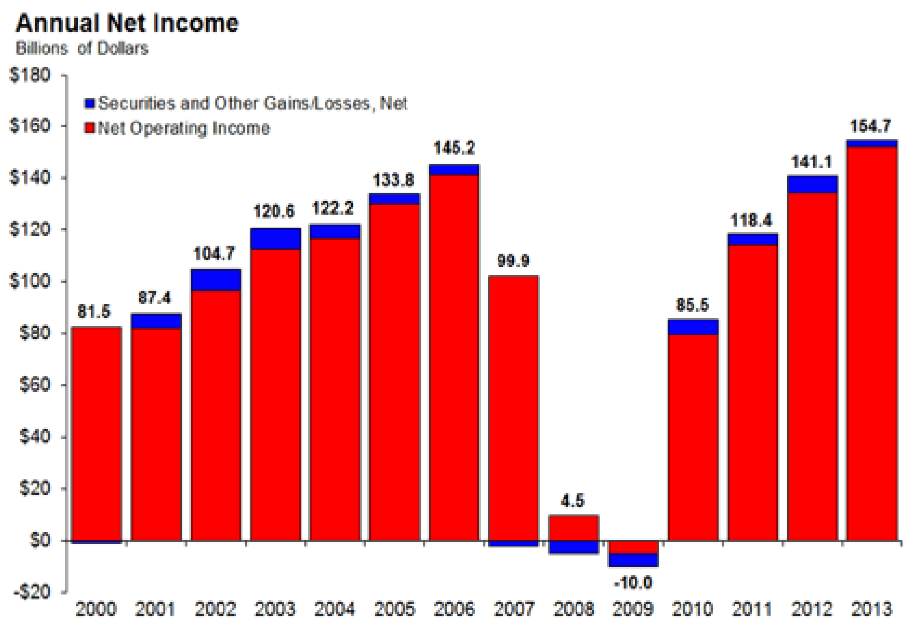




litigation expenses at one large institution, but the industry's expenses for salaries and employee benefits were also $756 million (1.6%) lower, and premises and fixed asset expenses fell by $118 million (1%).

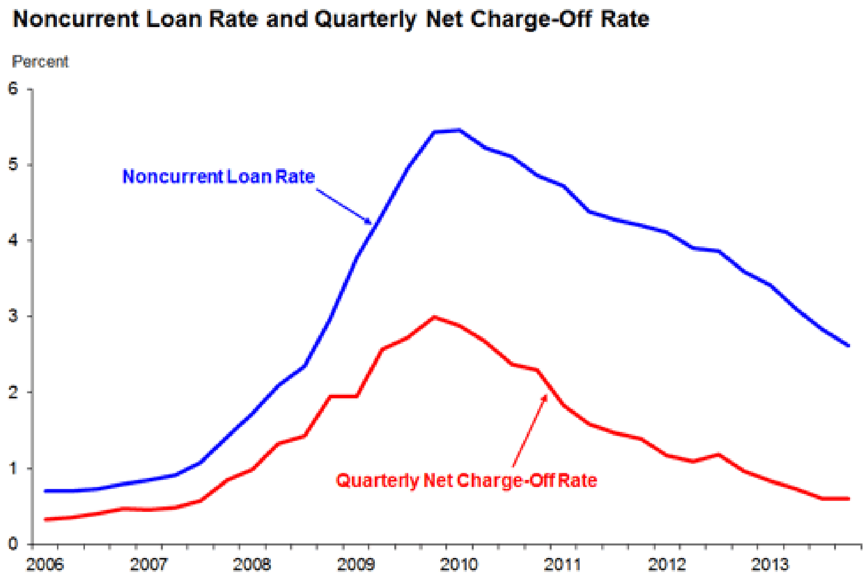
⇧ **Full-Year Earnings Post Fourth Consecutive Increase** – For full year 2013, industry net income totaled $154.7 billion, an increase of $13.6 billion (9.6%) over 2012. This is the fourth year in a row that full-year earnings have risen. More than half of all institutions – 54.2% – reported higher annual net income in 2013, while only 7.8% reported net losses for the full year. This is the lowest annual proportion of unprofitable institutions for the industry since 2005. Full-year loan-loss provisions of $32.1 billion were $25.7 billion (44.4%) less than banks set aside in 2012. This is the fourth year in a row that loan-loss provisions have been lower, and the total for 2013 was the smallest annual total since 2006. Net interest income declined for a third consecutive year, falling by $3.7 billion (0.9%), as interest income fell more rapidly than interest expense. Noninterest income was $3.2 billion (1.3%) above the level of 2012, as trading revenue increased by $4.3 billion (23.7%), and servicing fee income rose by $3.9 billion (27.5%). Realized gains on securities were $5.2 billion (53.7%) lower than a year ago. Total noninterest expense was $4.5 billion (1.1%) less. The average ROA for 2013 was 1.07%, the highest annual average for the industry since 2006.



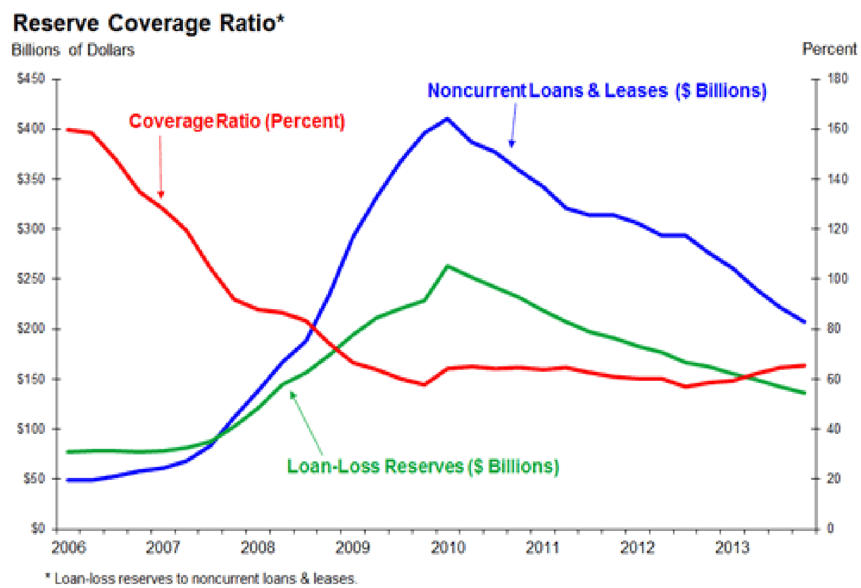


⇧ **Loan Losses Fall to Seven-Year Low** – Asset quality indicators continued to show improvement in the fourth quarter. Net charge-offs of loans and leases totaled $11.7 billion, a $6.8 billion (36.7%) decline from fourth quarter 2012. This is the 14th consecutive quarter that net charge-offs have posted a year-over-year decline, and is the lowest fourth-quarter total since 2006. Charge-offs were lower in all major loan categories, with the largest decline occurring in residential mortgages, where charge-offs were $2.1 billion (57.7%) lower than a year ago.

⇧ **<u>Noncurrent Balances are Down 50% From Their Cyclical Peak</u>** – The amount of loans and leases that were noncurrent (90 days or more past due or in nonaccrual status) declined for a 15th consecutive quarter, falling by $14 billion (6.3%). Noncurrent balances declined in all major loan groups, led by residential mortgages, where noncurrent loans fell by $7.5 billion (5.3%). At the end of 2013, noncurrent loan balances totaled $207.1 billion, which is $202.9 billion (49.5%) below the peak level reached at the end of first quarter 2010. At year-end 2013, 2.62% of all loan and lease balances were noncurrent, the lowest percentage since third quarter 2008.

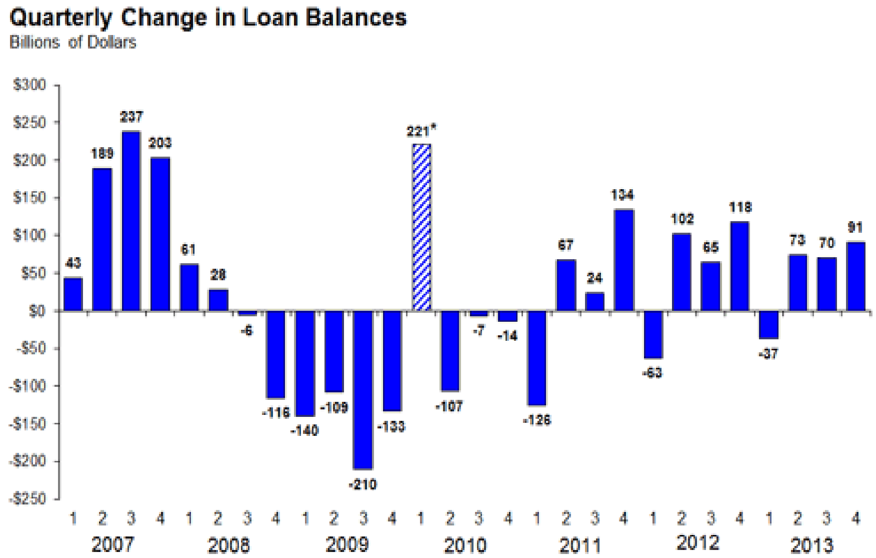


⇧ **<u>Coverage Improves Despite Reductions in Reserves</u>** – Insured institutions reduced their loan-loss reserves by $6.7 billion (4.7%) during the fourth quarter, as the $11.7 billion in net charge-offs taken out of reserves exceeded the $7 billion in provisions that banks added to reserves. This is the 15th consecutive quarter that the industry's loss reserves have declined. At the end of the quarter, reserves represented 1.72% of total loans and leases, the lowest percentage since first quarter 2008. Despite the reduction in reserve balances, the industry's "coverage ratio" of reserves to noncurrent loans and leases rose from 64.5% to 65.6% during the quarter because of the large decline in noncurrent loans. This is the 5th consecutive quarter that the coverage ratio has risen.



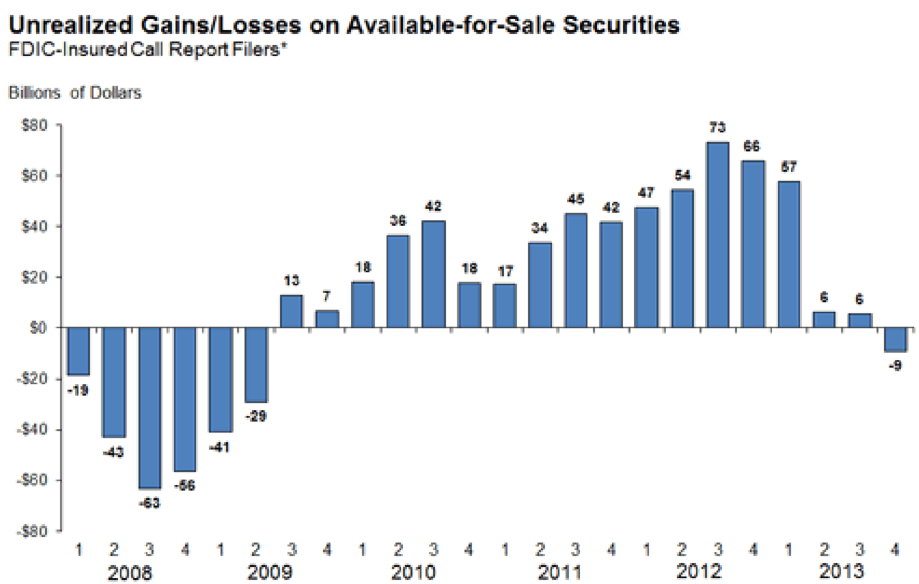
⇧ **<u>Banks Continue to Increase Capital Levels</u>** – Equity capital increased by $21.3 billion (1.3%) during the quarter. Retained earnings contributed $11.2 billion to equity, while capital infusions from parent holding companies added $11.9 billion. A decline in market values of available-for-sale securities reduced equity growth by $9 billion. Tier 1 leverage capital increased by $23 billion (1.7%). The industry's core capital (leverage) ratio edged up from 9.4% to 9.41%, which is the highest level for this regulatory capital ratio in the 23 years that current capital standards have been in effect. At the end of 2013, almost 98% of all insured institutions, representing 99.8% of total industry assets, met or surpassed the highest regulatory capital standards as defined for Prompt Corrective Action purposes.

⇧ **<u>Two-Thirds of Banks Report Growth in Loan Portfolios</u>** – Total assets increased by $126.6 billion (0.9%), as loan portfolios grew for the 9th time in the past 11 quarters. Total loan and lease balances increased by $90.9 billion (1.2%), with commercial and industrial (C&I) loans rising by $27.3 billion (1.7%), real estate loans secured by nonfarm nonresidential properties up by $17.1 billion (1.6%), and credit card balances posting a seasonal $14.3 billion (2.1%) increase. Loans to small businesses and



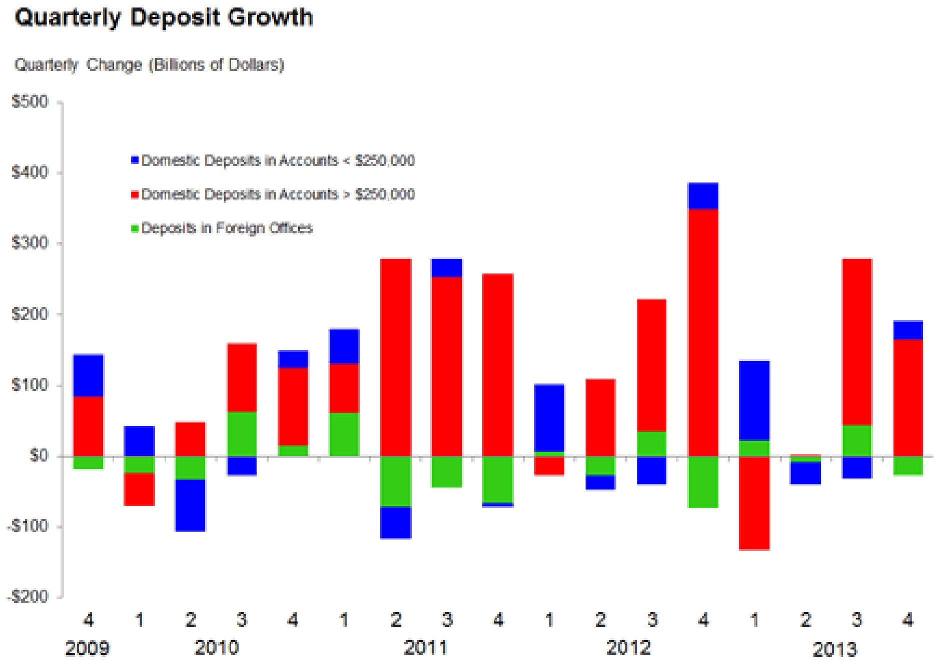
* FASB Statements 166 and 167 resulted in the consolidation of large amounts of securitized loan balances back onto banks' balance sheets in the first quarter of 2010. Although the total amount consolidated cannot be precisely quantified, the industry would have reported a decline in loan balances for the quarter absent this change in accounting standards.

farms rose by $2.9 billion (0.4%), as small C&I loans increased by $3 billion (1%). Home equity loan balances declined for a 19th consecutive quarter, falling by $6.9 billion (1.3%). Balances of other loans secured by 1-to-4 family residential real estate properties fell by $13 billion (0.7%), as the amount of mortgage loans sold during the quarter surpassed the amount originated for sale by $29 billion. Nearly two out of every three banks (65.1%) reported growth in their loan portfolios during the quarter. Securities portfolios increased by $44.3 billion (1.5%), despite a $14.5 billion decline in the fair value of securities in available-for-sale accounts. Much of the growth consisted of increased holdings of U.S. Treasury securities, which rose by $33 billion (20.6%).

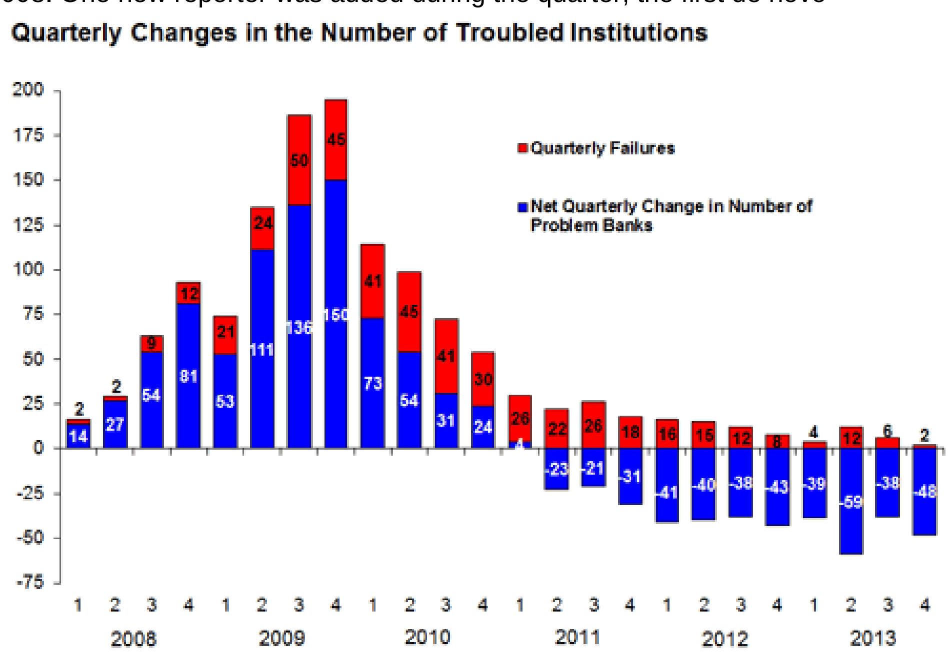


* Prior to 2012, does not include data for insured savings institutions that file Thrift Financial Reports (TFRs). Beginning in 2012, all insured institutions file Call Reports.

⇧ **<u>Deposit Growth Remains Strong</u>** – Increased balances in large-denomination accounts were responsible for much of the growth in deposits in the fourth quarter. Total deposits increased by $163.8 billion (1.5%), as balances in domestic offices rose by $191.3 billion and foreign office balances fell by $27.4 billion. Deposits in domestic accounts with balances greater than $250,000 rose by $166 billion (3.5%). Nondeposit liabilities fell by $55.1 billion (2.9%), largely because of a $42 billion (12.1%) decline in securities sold under repurchase agreements. Banks increased their advances from Federal Home Loan Banks by $33.1 billion (8.9%).



⇧ **<u>Quarterly Failures Fall to Lowest Level in More than Five Years</u>** – The number of insured institutions reporting financial results declined from 6,891 to 6,812 during the fourth quarter. Mergers absorbed 73 institutions, while two insured institutions failed. This is the smallest number of quarterly failures since second quarter 2008. One new reporter was added during the quarter, the first de novo charter since fourth quarter 2010. The number of institutions on the FDIC's "Problem List" declined from 515 to 467 during the quarter. Total assets of "problem" banks fell from $174.2 billion to $152.7 billion. The number of full-time equivalent employees declined by 11,584 (0.6%) during the quarter. For all of 2013, the net reduction in reporting institutions was 271. There were 232 mergers during the year, while 24 insured institutions failed. Two new reporters were added in 2013. For the full year, the number of employees declined by 41,490 (2%).

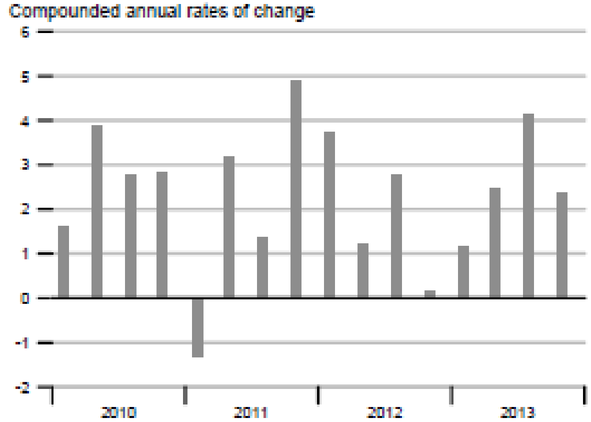


Name	Last Trade		52 Wk Range		PE	EPS	Mkt Cap	Div/Shr	Div Yld
ACNB Corporation	03/14	18.09	16.21	19.66	11.60	1.56	107.89M	0.76	4.20%
BancFirst Corporation	03/14	56.65	40.11	58.02	16.23	3.49	868.61M	1.24	2.20%
Banco Bilbao Vizcaya Argentaria	03/14	12.06	8.13	13.54	28.44	0.42	69.7B	0.43	3.40%
BOK Financial Corporation	03/14	67.19	60.4	69.36	14.63	4.59	4.63B	1.60	2.40%
Cass Information Sys, Inc.	03/14	54.73	39.41	68.81	27.09	2.02	630.11M	0.80	1.40%
CoBiz Incorporated	03/14	11.80	7.5	12.45	17.77	0.66	468.29M	0.14	1.20%
Commerce Bancshares, Inc.	03/14	44.74	36.63	46.49	16.47	2.72	4.29B	0.90	2.00%
Comerica, Inc.	03/14	48.60	33.55	49.95	17.05	2.85	8.85B	0.76	1.50%
Community Shores Bank Corp	03/14	2.75	0.21	4.95	0.73	3.75	4.04M	N/A	N/A
Cullen Frost Bankers, Inc.	03/14	75.19	59.11	76.63	19.79	3.80	4.57B	2.00	2.60%
Enterprise Fin Serv Corp	03/14	19.32	13.06	20.96	11.17	1.73	373.32M	0.21	1.10%
First Community Corp S C	03/14	11.08	8.44	11.37	14.19	0.78	58.69M	0.24	2.20%
First Financial Bankshares, Inc.	03/14	60.09	45.92	67.52	24.33	2.47	1.91B	1.04	1.60%
Great Southern Bancorp, Inc.	03/14	29.26	22.60	31.23	12.09	2.42	400.07M	0.72	2.50%
Guaranty Fed Bancshares, Inc.	03/14	12.66	9.3	14.5	8.01	1.58	34.59M	0.00	0.00%
Heartland Financial USA, Inc.	03/14	26.48	22.40	30.99	12.98	2.04	487.21M	0.40	1.40%
International Bancshares Corp	03/14	24.35	17.95	27.2	12.95	1.88	1.64B	0.46	1.80%
Landmark Bancorp, Inc.	03/14	19.41	17.39	21.43	13.09	1.49	61.26M	0.76	3.90%
Liberty Bancorp, Inc.	03/14	12.67	10.5	12.75	12.07	1.05	38.52M	0.12	0.90%
Mackinac Financial Corp	03/14	12.22	8.25	12.24	12.23	1.00	67.7659M	0.20	1.70%
Metrocorp Bancshares, Inc.	03/14	15.06	9.05	15.63	N/A	0.64	N/A	0.08	0.50%
MidWest One Finl Group, Inc.	03/14	25.20	22.82	29.30	11.56	2.18	213.72M	0.58	2.20%
OmniAmerican Bancorp, Inc.	03/14	21.32	20.46	26.17	34.95	0.61	223.09M	0.20	1.00%
Osage Bancshares, Inc.	03/14	11.32	7.5	11.50	N/A	0.24	N/A	0.34	4.50%
Prosperity Bancshares, Inc.	03/14	64.21	44.33	66.9	17.59	3.65	4.25B	0.96	1.50%
QCR Holdings, Inc.	03/14	17.15	13.18	18.2	8.25	2.08	135.21M	0.08	0.50%
Southwest Bancorp, Inc.	03/14	17.71	11.82	18.77	20.12	0.88	349.45M	0.16	0.90%
Texas Capital Bancshares, Inc.	03/14	63.97	36.75	65.38	23.52	2.72	2.74B	N/A	N/A
UMB Financial Corporation	03/14	63.84	46.34	68.27	19.95	3.20	2.89B	0.90	1.40%
West Bancorp Incorporated	03/14	15.15	10.1	16.64	14.85	1.02	204.04M	0.44	2.80%
Zions Bancorp	03/14	31.35	23.1	32.29	19.84	1.58	5.8B	0.16	0.50%

Source: Yahoo Finance (March 2014)
NA – Indicates information was not available.

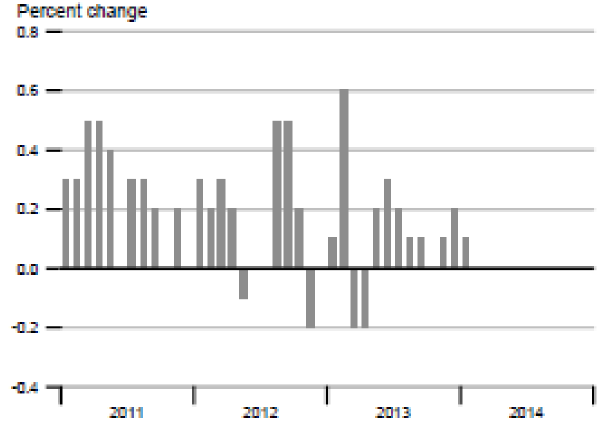
Real GDP Growth

Compounded annual rates of change



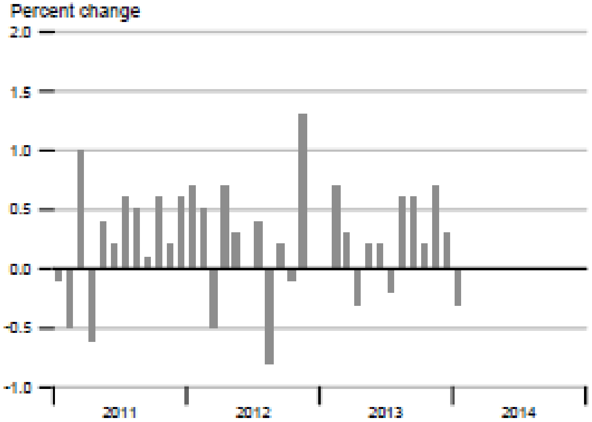
Consumer Price Index

Percent change



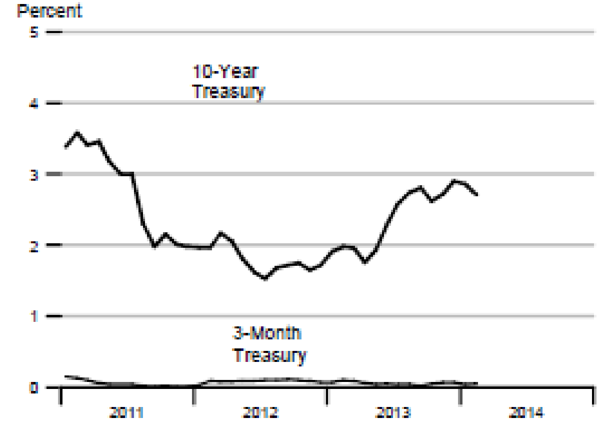
Industrial Production

Percent change



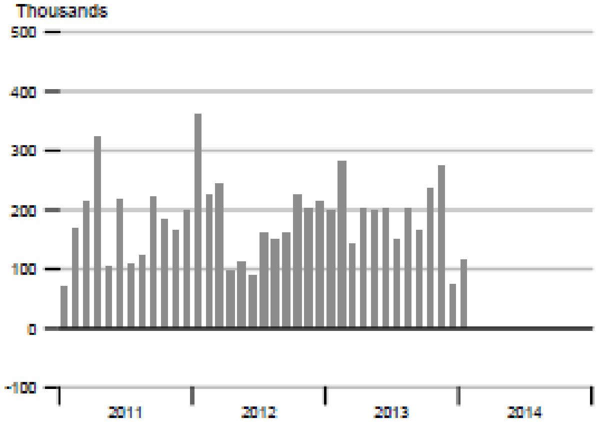
Interest Rates

Percent



Change in Nonfarm Payrolls

Thousands



Unemployment Rate

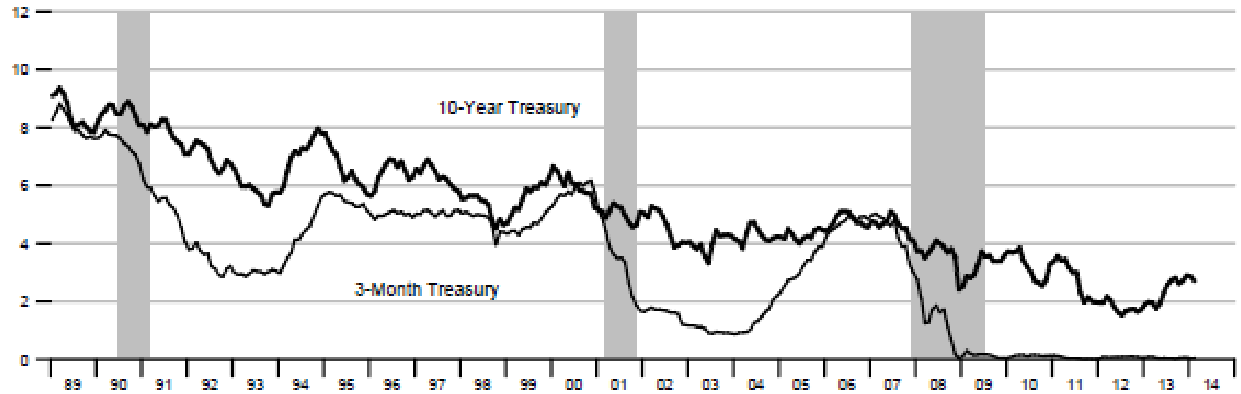
Percent of labor force

Source: Federal Reserve Bank of St. Louis, *National Economic Trends*.

March 5, 2014.

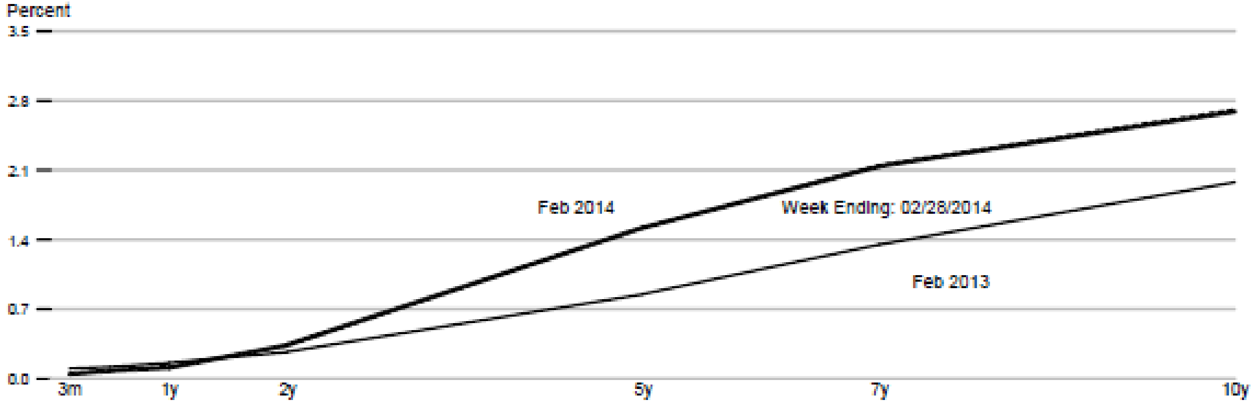
Interest Rates

Percent



Treasury Yield Curve

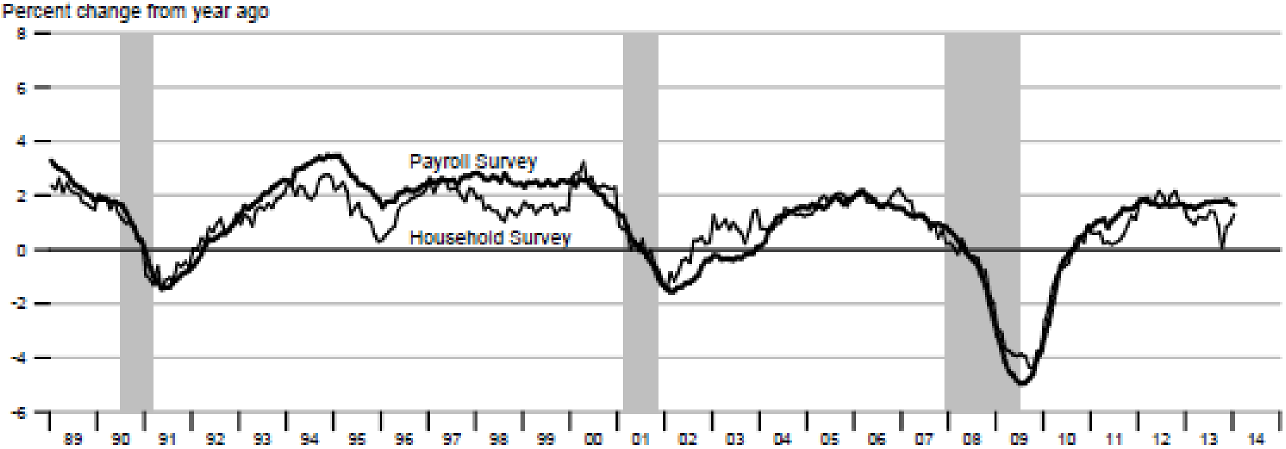
Percent



* Treasury Yield Curve for February 2014 is almost identical to Week Ending 2/28/2014.

Employment

Percent change from year ago

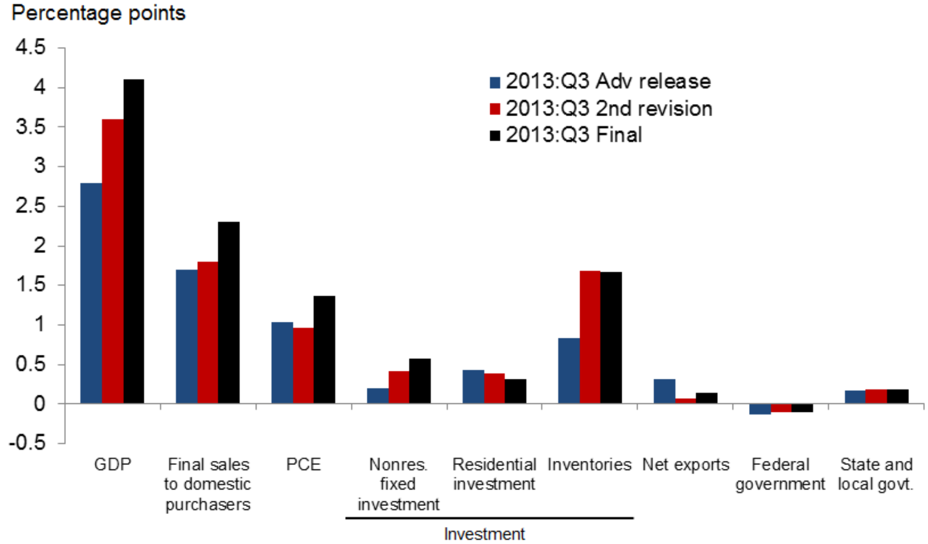


Source: Federal Reserve Bank of St. Louis, *National Economic Trends*. March 5, 2014.

Federal Reserve Bank, Dallas National Update
January 2014 - www.dallasfed.org

⇧ **Economy** – Economic indicators released since the last national update suggest the economy accelerated in the second half of 2013. The final national income and product accounts release for third quarter 2013 revised real gross domestic product (GDP) growth upward for a second time to 4.1% at a seasonally adjusted, annualized rate. This reading improved from November's 3.6% estimate for the third quarter, with gains in real personal consumption expenditures (PCE) growth. Private-sector estimates for fourth quarter 2013 growth were revised upward, reflecting positive signals from consumption, manufacturing and investment. The December employment report from the Bureau of Labor Statistics (BLS) revealed mixed news on the state of the labor market. The discrepancy between the payroll survey's employment figures and the household survey's decline in the unemployment rate may be due to weather. Core inflation continues to run below target, while long-run expectations remain anchored.

Third Quarter 2013 Growth Estimates Kept Growing



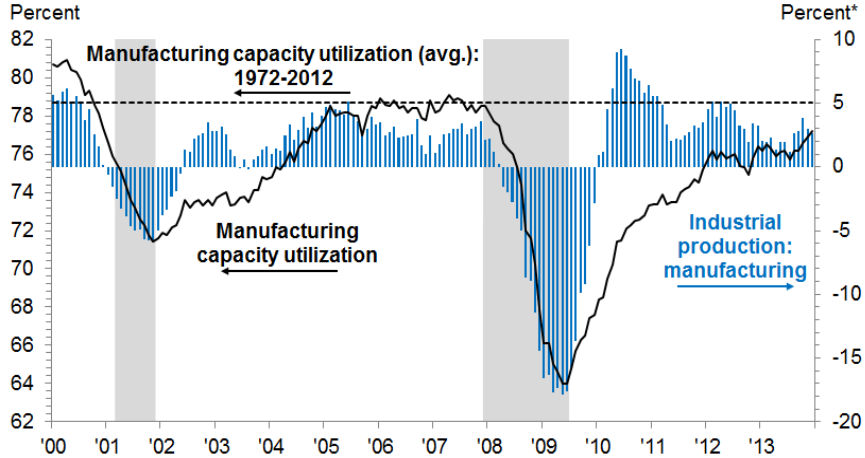
SOURCE: Bureau of Economic Analysis.

⇧ **Consumption Leads Strong Fourth Quarter Growth** – The January Blue Chip consensus estimates have edged up, putting fourth quarter 2013 GDP growth 0.8% points higher than December's forecast of 1.6%. This upward revision is supported by strong real PCE growth at 5.0% and 6.4% annualized rates for October and November, with particularly strong growth contributions from durable goods purchases. This suggests a strong contribution from PCE to growth in the fourth quarter. Despite revisions to third-quarter growth and strong PCE contributions in the fourth quarter, the Blue Chip consensus remains steady for first quarter 2014 at 2.5%. However, momentum from rising house prices and less household debt continues to improve household balance sheets, which will support consumption expenditures, thus strengthening growth in 2014.

⇳ **Capital Investment Steady** – Investment growth remains steady despite a temporary drag from bad weather on residential investment indicators. According to the Census Bureau's advance report, durable goods orders continue to trend upward, despite some slowing in December and downward revisions to November estimates. Business equipment orders grew 2.6% in November, followed by a 1.3% decrease in December. However, with healthy balance sheets, less economic uncertainty from the euro zone and less fiscal drag with a new government spending deal, the downside risks to investment appear moderate. Housing data also showed fewer gains in December. Housing starts ticked down from 1,107,000 to 999,000 and permits from 1,017,000 to 986,000. However, growth continued in most areas not affected by inclement weather. The West added 35,000 starts at an annualized rate, while heavily affected regions of the Midwest and South had 74,000 and 59,000 fewer housing starts, respectively. Housing permits, which are forward-looking, grew in both the West and the Northeast by 15,000 and 12,000 units at an annualized rate, while permits in the South and Midwest declined by 28,000 and 30,000, respectively. The coincident bad weather and weak housing reports are likely one-off events, and conditions should normalize in the coming months

⇧ **Manufacturing Trends Upward** – Manufacturing continued to expand in December, according to the Institute for Supply Management's Manufacturing Index. The December survey was slightly below November's figure at 57.0 points but still above reports from the previous three years. The more current indicator of industrial production from the Federal Reserve Board firmed for the fifth consecutive month. Likewise, manufacturing capacity utilization continues to normalize, registering just 1.5% points below long-run averages. This indicates improvements, but slack still remains.

Manufacturing and Capacity Continue Normalizing



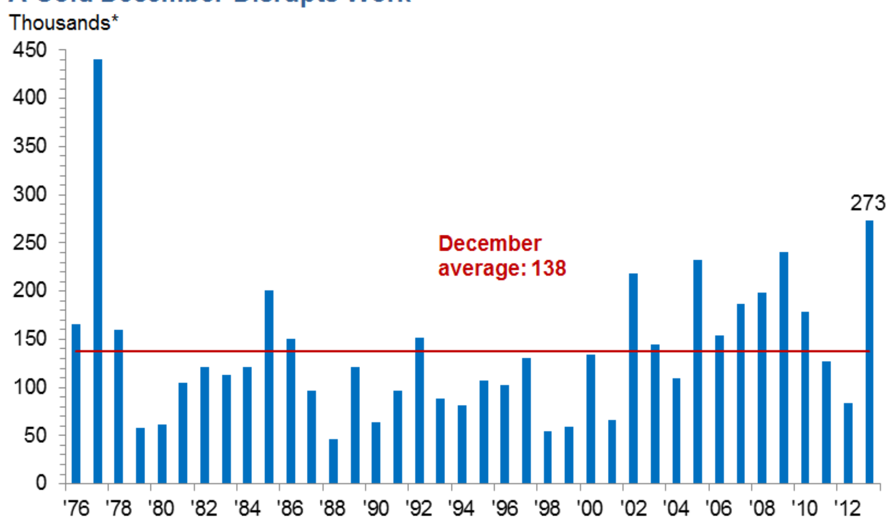
*12-month percent change

NOTE: Shaded areas indicate recessions.

SOURCE: Federal Reserve Board.

⇩ **December Payroll Numbers Chilled with Weather** – The December Current Population Survey from the Bureau of Labor Statistics ticked down headline unemployment from 7.0 to 6.7%. The four-week moving average of initial claims continues to trend downward after some unevenness in fourth-quarter weekly claims. This contrasts with the Current Employment Statistics report that the U.S. economy added 74,000 new jobs in December, disappointing forecasters' expectations of 200,000. This is most likely due to weather-related impediments. The chart shows 273,000 employees not at work due to bad weather, the highest December reading since 1977 and approximately 135,000 above the historical December average. The weakness in payroll numbers is probably a one-time deviation from the trend and is anticipated to normalize in January.

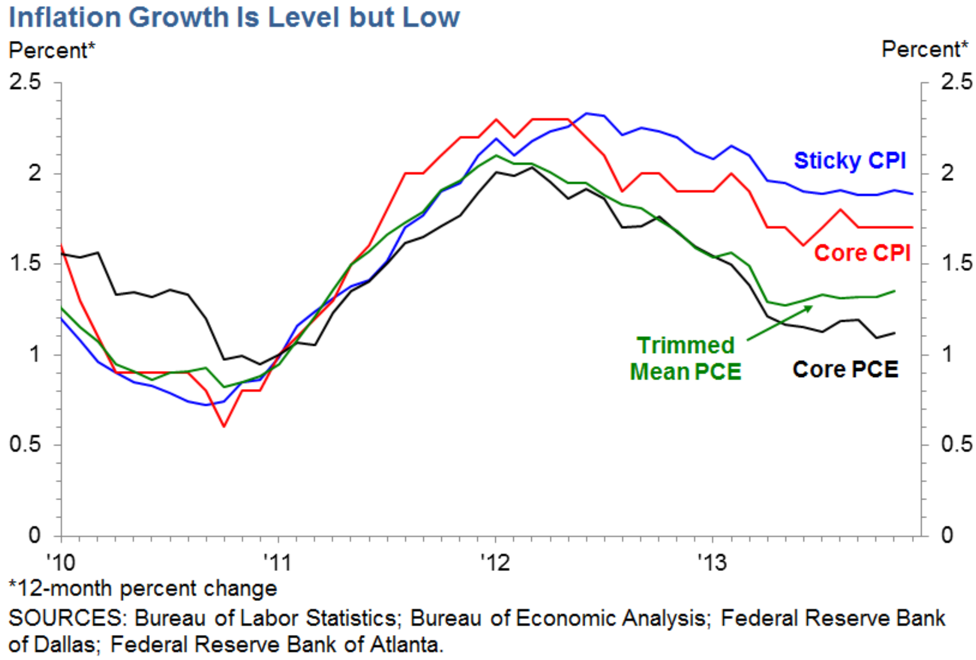
A Cold December Disrupts Work



*Not at work due to bad weather in December

SOURCE: Bureau of Labor Statistics.

⇳ **Core Inflation Bottoms Out** – Core inflation measures ticked up slightly in November and December. The chart on the following page shows that the Federal Reserve's preferred measure of price growth, core PCE, grew 1.1% year over year in November. Comparable core Consumer Price Index (CPI) growth remained flat at 1.7%. These growth rates, along with alternative measures of the Atlanta Fed's sticky-price CPI and the Dallas Fed's Trimmed Mean PCE, are below Federal Reserve targets, but the University of Michigan's long-run inflation expectations for CPI remain anchored at 2.9%, according to its January Survey of Consumer Attitudes and Behavior. The overall economy continues to show signs of improvement, and the increasing frequency of these signs is hopeful. Consumer demand is strengthening in regard to consumption and improved balance sheets, and businesses continue to grow production and utilize more capacity. A slowdown in emerging markets and lower-than-desired inflation pose downside risks, but on the whole, 2014 has a promising start.



Data Series	Sept 2013	Oct 2013	Nov 2013	Dec 2013	Jan 2014	Feb. 2014
Unemployment Rate (1)	7.2	7.2	7.0	6.7	6.6	6.7
Change in Payroll Employment (2)	164	237	274	84	(P) 129	(P) 175
Average Hourly Earnings (3)	24.06	24.09	24.15	24.17	(P) 24.22	(P) 24.31
Consumer Price Index (4)	0.1	0.0	0.1	0.2	0.1	
Producer Price Index (5)	0.1	(P) 0.2	(P) 0.0	(P) 0.1	(P) 0.2	
U.S. Import Price Index (6)	0.3	-0.6	-0.9	(R) 0.2	(R) 0.1	

Footnotes:
(1) In %, 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% change, seasonally adjusted.
(5) Finished goods, 1982=100, 1-month% change, seasonally adjusted.
(6) All imports, 1-month% change, not seasonally adjusted.
(R) Revised.
(P) Preliminary.

Data Series	4th Qtr 2012	1st Qtr 2013	2nd Qtr 2013	3rd Qtr 2013	4th Qtr 2013
Employment Cost Index (1)	0.4	0.5	0.5	0.4	0.5
Productivity (2)	(R) -1.5	(R) -1.8	1.8	(R) 3.5	(R) 1.8

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

Data extracted on: March 8, 2014

⇳ Reports from most of the twelve Federal Reserve Districts indicated that economic conditions continued to expand from January to early February. Eight Districts reported improved levels of activity, but in most cases the increases were characterized as modest to moderate. New York and Philadelphia experienced a slight decline in activity, which was mostly attributed to the unusually severe weather experienced in those regions. Growth slowed in Chicago, and Kansas City reported that conditions remained stable during the reporting period. The outlook among most Districts remained optimistic. Retail sales growth weakened since the previous report for most Districts, as severe winter weather limited activity. However, Richmond, St. Louis, and Minneapolis reported modest sales growth since the beginning of the year. Weather was also cited as a contributing factor to softer auto sales in many Districts, with the exception of Cleveland, which saw strong gains. Tourism increased in a number of Districts but declined in Philadelphia and was reported to have been mixed in New York and Minneapolis.

The demand for nonfinancial services was mixed compared with the last report; however, both Boston and San Francisco reported strong demand for technology related services. Manufacturing sales and production in several Districts were negatively impacted by severe winter weather; however, modest improvements were noted in Boston, Atlanta, Minneapolis, and Dallas.

Residential real estate markets continued to improve in several areas, albeit modestly. Boston and New York gave mixed reports on sales, and Philadelphia, Cleveland, Minneapolis, and Kansas City noted a decrease in sales. Many Districts cited low inventories of housing and continued home price appreciation. Commercial real estate leasing expanded, according to most reports, while reports on construction activity were mixed. Demand for commercial real estate loans was solid in Boston, improved slightly in Dallas, and continued to grow steadily in Chicago and Kansas City.

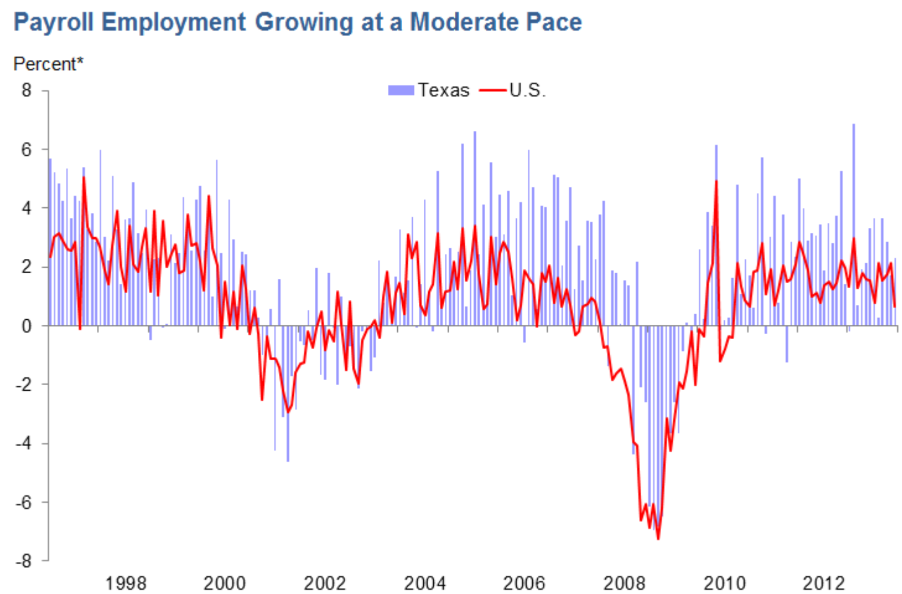
Of the Districts that reported on agriculture, conditions softened in Kansas City and Dallas as dry soil adversely affected wheat crops. Districts reported that energy production and demand continued to increase as a result of increased demand due to the unusually cold winter.

Employment levels improved gradually for most Districts, and shortages of specialized skilled labor continued to be reported. Price pressures remained subdued, with the exception of upward cost pressures for some energy and construction products. Wage pressures remained stable for most Districts.

Federal Reserve Bank, Dallas Regional Economic Update
January 2014 - www.dallasfed.org

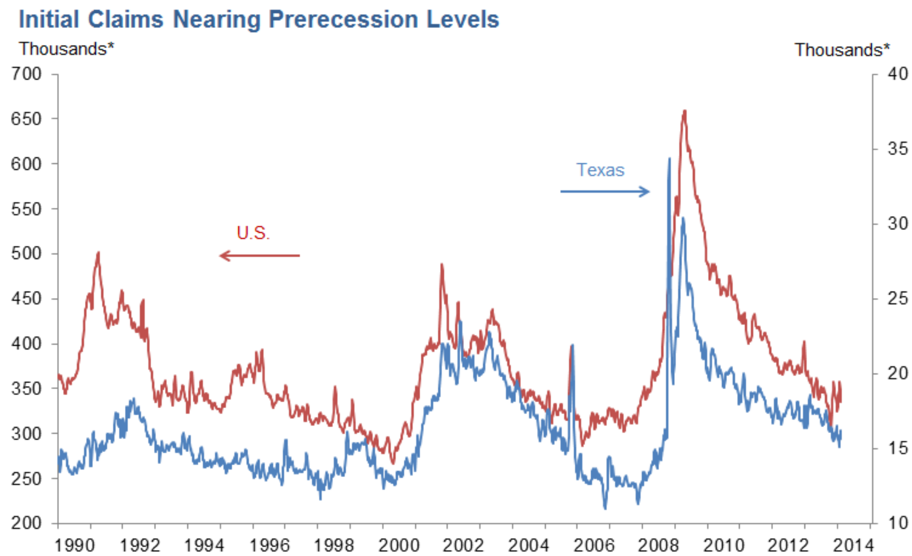
⇧ **Texas Economy** – Over the past six weeks, the regional economy has accelerated slightly and grown at a moderate pace. Payroll employment grew at a 2.3% annual rate in the fourth quarter, and Texas Business Outlook Survey (TBOS) readings remained positive. Energy and real estate are still strong, and Texas exports remain high as petroleum-related trade continues to boost the state economy. A modest rise in wage and price pressures is evident. Employment growth is forecast to accelerate in 2014, with little evidence that recent economic strengthening is likely to fade**.**

⇧ **Employment Indicators Improve at Moderate Pace** – Payroll employment increased at a 2.3% annual rate in December. Employment indexes from the Texas Manufacturing Outlook Survey (TMOS), Texas Service Sector Outlook Survey (TSSOS) and Texas Retail Outlook Survey all advanced in January from December levels, suggesting growth ahead. These favorable labor market data are echoed by the Beige Book, which reports steady-to-increased hiring over the past six weeks. Contacts also noted increased difficulty finding skilled labor, and there were scattered reports of unskilled labor shortages as well. The Texas unemployment rate fell in December to a post-recession low of 6%. Initial claims in Texas have also fallen to a post-recession low and are nearing prerecession levels.



*Month/month; seasonally adjusted, annualized rate.
SOURCE: Bureau of Labor Statistics.

⇳ **Real Estate Strengthens but Construction Lags** – Single-family permits have flattened over the last few months after drifting upward in the first half of 2013, while multifamily permits have risen rapidly after an early-2013 swoon. Overall residential housing starts grew strongly at the end of the year, with the five-month moving average rising 7.5% in December. Turning to the pre-owned market, the seemingly inexorable improvement in existing-home sales came to a sudden halt in November after three years of generally upward movement. The six-month moving average fell by



*Seasonally adjusted; four-week moving average.
SOURCE: U.S. Department of Labor.

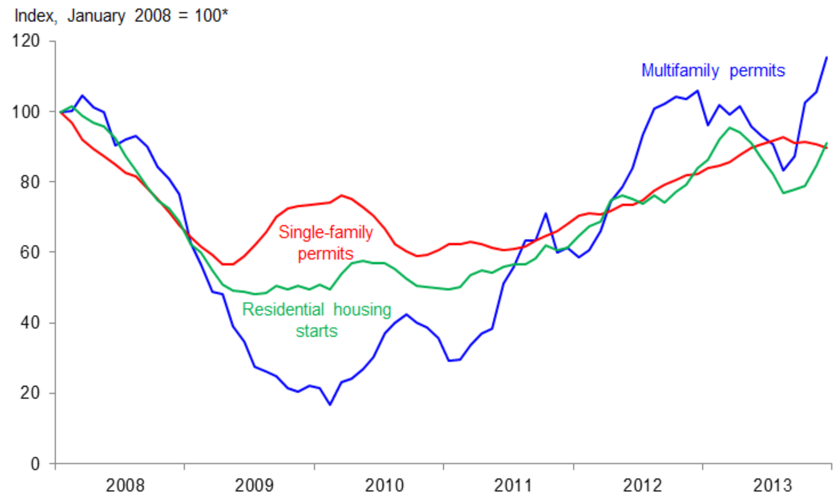
a modest 0.3% in November and flattened in December. The downward movement was especially pronounced in the Dallas metro area. Anecdotal reports suggest existing-home sales have been hampered not by a lack of buyer interest but by below-normal stocks available for sale, which some Beige Book contacts expect to ease in the first half of 2014.

⇧ **<u>Service Providers Grow Strongly</u>** – The headline revenue measure from TSSOS rose to a 23-month high of 18.1 in January amid growing anecdotal reports of strengthening service sector demand. The broader outlook measure also ticked up, reaching its highest level since February 2012. Consistent with this data, service sector payroll employment rose at a 2.3% annual rate in the fourth quarter. The Beige Book reinforces this generally positive outlook, with most service sector contacts reporting stronger demand and positive near-term outlooks.

⇧ **<u>Energy Remains Robust</u>** – The rig count moved toward the upper end of the 810–850 range it has occupied for the last year, though it ticked down to 839 rigs for the week ending Jan. 24. According to the Beige Book, drilling activity has been particularly strong over the last six weeks. Contacts expect the sector to be at least as robust in 2014 as it was in 2013.

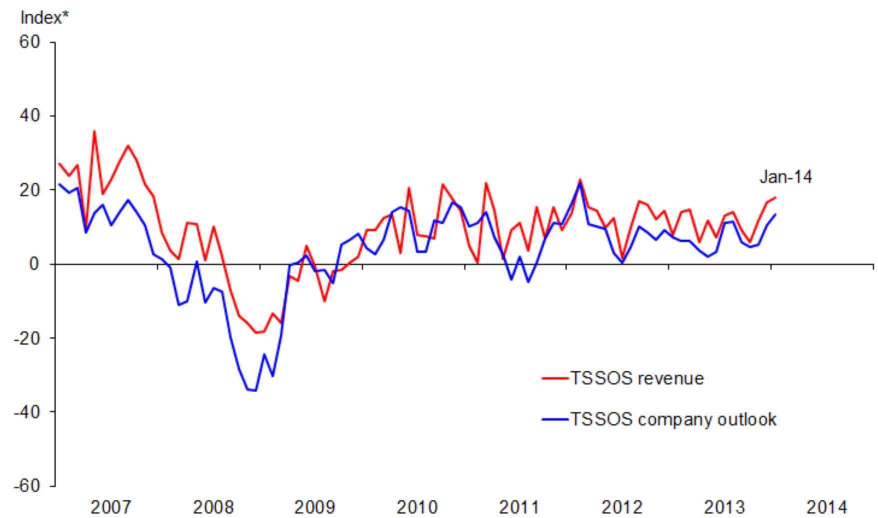
⇧ **<u>Exports Resume Strong Growth</u>** – In the first two months of the fourth quarter, Texas exports rose 5.4%, compared with 3.9% for the nation excluding Texas. A strengthening Mexico may be at least partly responsible—the Mexican economy seems to have regained its footing following a weaker-than-expected first half in 2013.

Housing Market Strengthens as Multifamily Hits Five-Year High



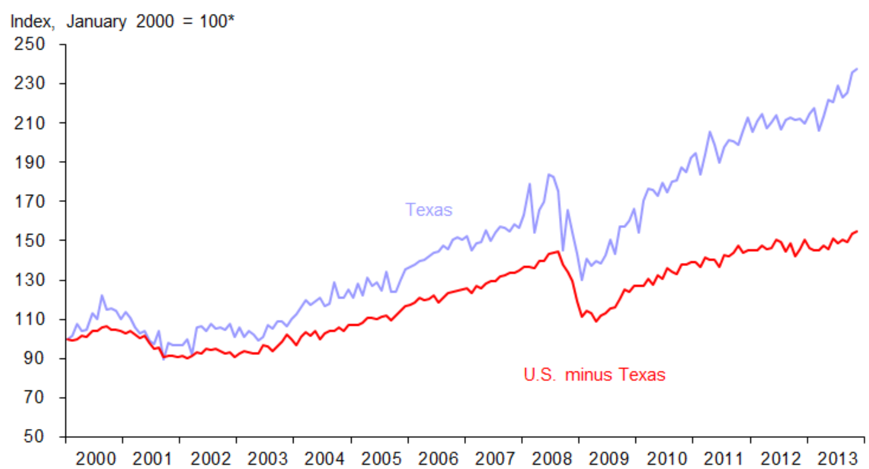
*Seasonally adjusted; five-month moving average.
SOURCES: Census Bureau; Bank of Tokyo-Mitsubishi.

Service Sector Revenue, Outlook Indexes Improve in January



*Seasonally adjusted.
SOURCE: Federal Reserve Bank of Dallas' Texas Service Sector Outlook Survey

Exports Rise Faster in Texas than U.S.

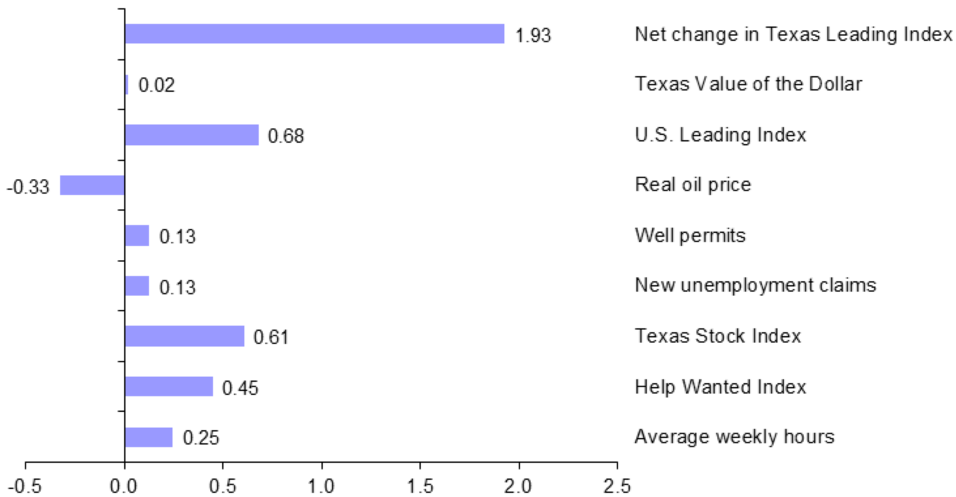


*Seasonally adjusted, real dollars.
SOURCES: Census Bureau; Wisertrade; seasonal and other adjustments by the Federal Reserve Bank of Dallas.

⇧ **<u>Pressures Grow Modestly</u> –** The wage and benefit components of both TSSOS and TMOS essentially reached five-year highs in December, although both retreated slightly in January. This is consistent with the most recent Beige Book, which cites "acute labor shortages" for a broad array of occupations. The TMOS raw materials and TSSOS input price indexes edged down in January, though the TMOS index remained elevated. One might typically expect these wage and input-price pressures to eventually feed through to final-goods prices. Consistent with this modest uptick in reported price pressures, the finished-goods indexes for TMOS and TSSOS both advanced in January, with the service sector measure reaching its highest level since March 2012.

⇧ **<u>Outlook Points to Moderate Growth in 2014</u> –** The Texas Leading Index reached a post-recession high of 128.8 in November, with nearly every component of the index making a positive contribution. Payroll employment is forecast to grow 2.5 to 3.5% in 2014. The most significant downside risk to the state's outlook comes from a possible softening of the U.S. economy, though other indicators do not suggest this is especially likely. Overall, the balance of risks points toward a healthy Texas economy heading into 2014.

Leading Index Components Almost Uniformly Positive
(Three-month change, September–November)



SOURCES: Federal Reserve Bank of Dallas; Conference Board; Haver Analytics; Texas Workforce Commission.

Data Series	July 2013	Aug 2013	Sept 2013	Oct 2013	Nov 2013	Dec 2013
Labor Force Data						
Civilian Labor Force (1)	(5) 12,826.3	(5) 12,830.6	(5)12,835.3	(5) 12,853.1	(5) 12,856.9	(5) 12,869.6
Employment (1)	(5) 12,003.1	(5)12,014.8	(5) 12,032.2	(5) 12,057.4	(5) 12,079.0	(5) 12,102.3
Unemployment (1)	(5) 823.2	(5)815.8	(5)803.2	(5)795.7	(5)777.9	(5) 767.3
Unemployment Rate (2)	(5) 6.4	(5) 6.4	(5) 6.3	(5)6.2	(5)6.1	(5)6.0
Nonfarm Wage and Salary Employment						
Total Nonfarm (3)	11,195.1	11,188.9	11,225.3	11,239.1	11,259.5	(P)11,277.1
12-month% change	2.8	2.5	2.6	2.5	2.4	(P)2.3
Mining and Logging (3)	287.0	288.3	290.4	290.4	288.5	(P) 289.6
12-month% change	5.2	5.3	5.2	5.6	4.8	(P) 4.6
Construction (3)	616.2	609.7	612.0	607.9	607.7	(P) 611.1
12-month% change	5.7	3.8	3.5	2.4	2.2	(P) 2.3
Manufacturing (3)	866.8	869.8	868.0	869.1	871.4	(P) 878.0
12-month% change	0.0	0.3	0.0	0.1	0.9	(P) 1.4
Trade, Transportation, and Utilities (3)	2,232.6	2,232.9	2,246.4	2,250.1	2,265.9	(P) 2,274.0
12-month% change	2.6	2.5	3.0	3.1	3.1	(P) 3.1
Information (3)	202.8	202.7	205.7	205.7	204.2	(P) 205.8
12-month% change	3.1	3.3	4.6	4.0	3.7	(P) 4.8
Financial Activities (3)	679.8	676.4	678.5	672.5	672.0	(P) 672.1
12-month% change	2.8	2.1	2.1	1.4	1.3	(P) 1.5
Professional & Business Services (3)	1,473.3	1,479.9	1,484.0	1,489.9	1,499.8	(P) 1,492.1
12-month% change	4.6	4.4	4.1	5.2	5.6	(P) 4.2
Education & Health Services (3)	1,494.6	1,499.9	1,504.3	1,509.7	1,507.8	(P) 1,512.2
12-month% change	2.7	2.6	2.5	2.2	1.8	(P) 1.7
Leisure & Hospitality (3)	1,133.9	1,133.3	1,142.2	1,149.4	1,143.9	(P) 1,144.9
12-month% change	4.7	4.0	4.2	3.7	2.6	(P) 2.7
Other Services (3)	388.6	388.3	387.5	390.0	387.8	(P) 388.1
12-month% change	2.0	1.5	0.9	1.3	0.4	(P) 0.2
Government (3)	1,819.5	1,807.7	1,806.3	1,804.4	1,810.5	(P) 1,809.2
12-month% change	1.1	0.7	0.7	0.3	0.6	(P) 0.5
Mass layoffs						
Layoff events, all industries (4)						
Initial claimants, all industries (4)						

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.
(5) Reflects revised population controls, model reestimation, and new seasonal adjustment.

The January 2014 Senior Loan Officer Opinion Survey on Bank Lending Practices addressed changes in the standards and terms on, and demand for, bank loans to businesses and households over the past three months. Domestic banks, on balance, reported having eased their lending standards on many types of business and consumer loans and experienced increases in loan demand, on average, over the past three months. The survey contained two sets of special questions. The first set asked about effects of the supervisory guidance on leveraged lending issued on March 21, 2013. The second set of questions asked banks about the outlook for loan performance for different categories of lending over 2014. This summary is based on the responses from 75 domestic banks and 21 U.S. branches and agencies of foreign banks. Regarding loans to businesses, the January survey results generally indicated that, on balance, banks eased their lending policies for commercial and industrial (C&I) loans to firms of all sizes and experienced stronger demand for such loans over the past three months. Almost all domestic banks that eased their C&I lending policies cited increased competition for such loans as an important reason for having done so. A modest fraction of foreign respondents indicated, on net, that they had eased standards on C&I loans, and a moderate net fraction of such banks reported that demand for C&I loans had increased somewhat. In response to the special questions on the supervisory guidance on leveraged lending, a number of large domestic and foreign banks indicated that they had tightened standards on such loans. Those banks also reported that some leveraged loans had been curtailed or significantly altered by the guidance, but a majority of them believed that affected borrowers would be able to turn to other sources of funding.

On net, domestic institutions also reported having eased standards for most types of commercial real estate (CRE) loans and having experienced stronger demand for such loans. A modest net fraction of foreign respondents indicated that they had eased standards on CRE loans in the aggregate, while a large net fraction of such banks indicated that they had experienced stronger demand for such loans. Changes in standards and terms on, and demand for, loans to households were mixed. The survey results indicated that a modest fraction of large banks had eased standards on prime residential real estate loans, but a similar fraction of small banks had tightened standards on such loans. A moderate fraction of banks reported, on balance, weaker demand for prime mortgage loans to purchase homes, and a large net fraction reported weaker demand for nontraditional mortgage loans. Demand for home equity lines of credit (HELOCs) was little changed. Respondents indicated that they had eased standards on credit card loans, auto loans, and other consumer loans. Most banks reported little change in most terms on consumer loans, with the exception of credit card limits and loan rate spreads on auto loans, which modest fractions of banks reported having eased on balance. Modest net fractions of banks reported increases in demand for all types of consumer loans. Survey respondents were asked about their expectations for loan delinquency and charge-off rates in 2014, assuming that economic activity progresses in line with consensus forecasts. Both domestic and foreign respondents generally indicated that they anticipated improvements in the performance of business loans. Domestic banks also reported that they expected improved performance for most types of loans to households, with the exception of auto loans to subprime borrowers, for which they expected increasing delinquency and charge-off rates in 2014.

Business Lending

C&I Loans – A modest fraction of domestic survey respondents, on net, indicated that they had eased their standards for C&I loans to large and middle-market firms over the fourth quarter of 2013. Standards on loans to small firms remained basically unchanged. On balance, banks reported having eased almost all terms on C&I loans, regardless of firm size. In particular, a large net fraction of respondents indicated that they had decreased spreads on C&I loan rates over their bank's cost of funds for all firm sizes. In addition, moderate net fractions of banks reported having reduced the cost of credit lines and decreased the use of interest rate floors for all firm sizes. A moderate fraction of banks also reported, on net, that they had eased loan covenants, though primarily to large and middle-market firms. Among domestic respondents that reported having eased either standards or terms on C&I loans over the past three months, the majority of banks cited more-aggressive competition from other banks or nonbank lenders as an important reason for having done so. In addition, about half of respondents that reported having eased their C&I loan policies cited a more favorable or less uncertain economic outlook as a reason for having done so, a larger fraction than in the October 2013 survey. About one-fourth of domestic respondents that eased C&I standards or terms indicated increased tolerance for risk was an important reason for the easing. Modest net fractions of banks reported having experienced stronger demand for C&I loans from firms of all sizes. Banks reporting stronger loan demand most often cited as reasons increases in customers' need to finance mergers or acquisitions or to fund investment in plant or equipment, inventories, and accounts receivable. About half of banks experiencing stronger demand also cited shifts in customer borrowing to their bank from other bank or nonbank sources because those sources became less attractive. Almost all foreign banks reported that they had kept their C&I lending standards basically unchanged over the past three months, except for two respondents, which reported having eased standards somewhat. However, on balance, foreign banks generally reported that they had eased terms on such loans. A moderate net fraction of the foreign banks indicated that demand for C&I loans had strengthened over the past three months.

Leveraged Lending – The January survey contained a set of special questions about the reaction of banks to supervisory guidance on leveraged lending issued on March 21, 2013. In response to, or in anticipation of, the supervisory guidance, a number of large domestic and foreign survey respondents tightened standards on such loans, and no bank reported having eased standards. On net, a moderate fraction of large domestic banks and a modest fraction of foreign banks increased maximum debt-to-EBITDA (earnings before interest, taxes, depreciation, and amortization) restrictions. Almost all large domestic and foreign banks indicated that the fraction of C&I loans on their books they considered to be leveraged loans was less than 20%. In addition, all but two large domestic banks judged that 20% or less of leveraged loans that typically had been underwritten or participated in by their bank had been or would be curtailed or significantly altered by the supervisory guidance, and all but one foreign bank said that 10% or less of their leveraged loans would be similarly affected. Nevertheless, moderate net fractions of large domestic banks reported that the guidance was resulting in somewhat decreased dollar volumes on all of the broad categories of loans that were queried in the survey, such as by borrowers' use of funds or by firm size. About 40% of foreign institutions reported that the guidance was resulting in somewhat decreased dollar volumes for borrowing for leveraged buyout purposes or capital distributions. A somewhat smaller fraction of foreign banks reported decreased dollar volumes for mergers and acquisition purposes. On net, a moderate fraction of foreign institutions reported that the guidance was resulting in a decrease in the dollar value of leveraged loans to middle-market firms, and only a few such institutions indicated any change in leveraged loans to large firms. A majority of both large domestic and foreign respondents believed that it was at least somewhat likely that affected borrowers would be able to turn to other sources of funding.

Commercial Real Estate Lending – Starting with the October 2013 survey, the questions regarding CRE loans at domestic banks were asked separately for the three major CRE loan categories--construction and land development loans, loans secured by nonfarm nonresidential structures, and loans secured by multifamily residential structures. Small net fractions of domestic banks reported that they had eased standards on each of the three categories of CRE loans. Moderate net fractions of banks also indicated that they had experienced stronger demand for all subcategories of CRE loans. Modest fractions of foreign banks reported having eased their lending standards on their combined portfolio of CRE loans, on balance, and a large net fraction of foreign respondents reported having experienced stronger demand for such loans over the past three months.

Lending to Households

Residential Real Estate Lending – A small net fraction of large banks reported that they had eased standards on prime residential mortgages over the past three months, while a modest net fraction of small banks indicated that they had tightened standards on such loans. On balance, a small number of banks reported having tightened standards on nontraditional residential mortgages. Banks reported having experienced weaker demand for prime and nontraditional mortgages on balance. Few banks reported having changed their standards on HELOCs, and on net, respondents indicated that they had experience little change in demand for such loans.

Consumer Lending – A modest fraction of domestic banks, on balance, indicated that they were more willing to make consumer installment loans as compared with the previous quarter. Very few banks reported having changed their standards for approving applications for credit cards, and a modest net fraction of banks reported having eased their standards for auto loans. Most terms on credit cards were little changed except for credit limits, which a modest net fraction of banks reported having eased. A modest fraction of banks, on balance, reported having reduced the loan rate spreads on auto loans. Most banks reported that they had kept their standards and terms on other consumer loans unchanged. Only modest fractions of banks, on net, reported having experienced an increase in demand for auto loans, credit card loans, and other consumer loans over the past three months.

Banks' Outlook for Loan Performance in 2014

The January survey contained a set of special questions on respondents' expectations for loan performance in 2014, assuming that economic activity progresses in line with consensus forecasts (these questions have been repeated annually, with some changes in loan categories, since 2006). Overall, modest to large fractions of domestic banks, on net, expected improvements in delinquency and charge-off rates during 2014 for most loan categories included in the survey, with the notable exception of subprime auto loans. Regarding the outlook for the performance of business loans, about 20 to 40% of domestic banks, on net, reported that they expect delinquency and charge-off rates on most types of C&I loans to firms of all sizes to decline in 2014, except for syndicated leveraged loans, for which respondents expect little change in performance. These responses indicate that expectations of improvement in the quality of C&I loans are somewhat less widespread than in the 2013 survey, which is largely consistent with the already low delinquency and charge-off rates on such loans by historical standards. About half of domestic banks indicated that they expect delinquency and charge-off rates on construction and land development loans to decline in 2014, with smaller fractions expecting improvements in performance for the other major categories of CRE lending--loans secured by nonfarm nonresidential properties or by multifamily residential properties. Foreign respondents reported anticipating little improvement in the performance of C&I loans to large and middle-market firms this year. Regarding CRE loans, about one-third of foreign respondents forecast improvement in the performance of those secured by nonfarm nonresidential properties, and a similar fraction expected little change in the performance of other types of such loans. About 40% of domestic banks, on net, expect the delinquency and charge-off rates on prime and nontraditional residential real estate loans to improve in 2014, up somewhat from the fractions reported in last year's survey. About one-third of respondents expect improvements in the credit quality of HELOCs. On balance, about 15 to 20% of banks indicated that they expect improvement in loan performance for credit card loans, auto loans to prime borrowers, and other consumer loans. However, the majority of the 12 banks answering the special question on the outlook for the performance of subprime auto loans reported that they anticipate some deterioration in delinquency and charge-off rates on such loans.

Federal Deposit Insurance Corporation, Washington, D.C.
Federal Reserve Bank of Dallas, Dallas, TX
Federal Reserve Bank of St. Louis, St. Louis, MO
Federal Reserve Board, Washington D.C.
Fox News, Lubbock, TX
Institute for Energy Research, Washington, DC
KXAN Austin News, Austin, TX
Lower Colorado River Authority, Austin, TX
Office of the Governor, Rick Perry, Austin, TX
RealtyTrac, Irvine, CA
StateImpact NPR, Austin TX
Texas A&M AgriLife Extension Service, College Station, TX
Texas Commission on Environmental Quality, Austin, TX
Texas Comptroller of Public Accounts, Austin, TX
Texas Department of Agriculture, Austin, TX
Texas Department of Banking, Austin, TX
Texas Parks and Wildlife Department, Austin, TX
Texas Railroad Commission, Austin, TX
Texas Water Development Board, Austin, TX
Texas Department of Savings and Mortgage Lending, Austin, TX
United States Department of Agriculture, Washington, D.C.
U.S. Drought Monitor, Lincoln, NE
U.S. Bureau of Labor Statistics, Washington, D.C.
Wall Street Journal, New York, NY
Yahoo Finance