

# Condition of the Texas State Banking System



Texas Department of Banking  
Department of Savings and Mortgage Lending

Financial Data as of December 31, 2017



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<b><u>Symbols Used Throughout this Report:</u></b>	<b><u>Abbreviations Used Throughout this Report:</u></b>
↑ Improving or strong conditions	FDIC – Federal Deposit Insurance Corporation
↓ Deteriorating or weak conditions	OCC – Office of the Comptroller of the Currency
↕ Mixed conditions	FRB – Federal Reserve Board
❖ Interest item	

2601 North Lamar Blvd.  
Austin, Texas 78705

This publication is also located on the Texas Finance Commission website: [www.fc.texas.gov](http://www.fc.texas.gov)

For more information about this publication, you may contact the Texas Department of Banking.  
(512) 475-1320 | [media@dob.texas.gov](mailto:media@dob.texas.gov)

# ECONOMIC REVIEW AND OUTLOOK

## BANKING SYSTEM OVERVIEW

A positive outlook is foreseen for the Texas banking sector in 2018 considering the recent tax reform, anticipated regulatory relief and a strong local economy. Inflation will be an economic factor to monitor this year, in addition to the Federal Reserve's monetary policy. If the national economy grows faster than expected and inflation begins to rise above the Federal Reserve's threshold, a need to raise rates more quickly may evolve.

For financial institutions and their shareholders, the tax reform changes include lower tax rates and limitations on certain deductions, which may require changes to accounting procedures and internal worksheets used for estimating income tax expenses. Specifically, the enacted tax reform legislation will affect accruals of income tax expenses for call report purposes. Nearly all banks and thrifts are anticipated to be affected in some manner. Further discussion regarding the impact on state banks and thrifts can be found in the Performance Summary and Profile: Texas Banking System section of this report.

Both tax-deferred assets and liabilities will result in adjustments to account for the lower corporate rate of 21%, a 14-point reduction from previous years. Additionally, under the new law, all or a portion of the FDIC premium will no longer be non-deductible for large banks with total consolidated assets of more than \$10 billion. Banks with assets less than \$10 billion will still be able to write off their deposit insurance premiums.

Financial institutions organized as S corporations are not generally subject to corporate level income taxes. However, the tax provisions will affect the calculation of taxable income allocated to shareholders and other income tax related computations. As of March, there were 115 Texas state-chartered banks and nine state-chartered thrifts organized as S corporations.

While Congress continued at year-end to debate alterations to the Dodd-Frank Wall Street Reform and Consumer Protection Act, a topic addressed elsewhere in this report, lawmakers were also debating restructuring government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac. Issues under consideration include moving both GSEs out of conservatorship, creating new private-market guarantors, introducing alternatives to current credit-scoring methodologies, and modifying GSEs' affordable housing provisions. As of 2017, both GSEs either own or insure three out of every five residential mortgages in the U.S. This represents \$4.6 trillion in loans, an amount approximately \$700 billion more than those owned or insured by non-government mortgage lenders.

Despite changes to the tax code, an unknown future for regulatory reform, a new Chair of the Federal Reserve, and initial uncertainties surrounding the leadership of the Consumer Financial Protection Bureau, optimism of Texas bankers at year-end 2017 remained high.

Respondents to the fourth-quarter Banker Economic and Business Survey conducted by the Texas Department of Banking found that 49% of Texas state-chartered banks described general business activity as either increasing or significantly increasing and 69% described loan activity as either increasing or significantly increasing. Thirty percent of the banks responding to the survey reported consumer loans increasing, while 61% described commercial loans as increasing. Additionally, 23% of banks participating in the survey reported past due loans decreasing, compared to only 2% that reported an increase.

One negative note was Hurricane Harvey's destruction and the spike in mortgage delinquencies regionally. Some housing advocates and nonprofit organizations voiced concerns regarding a potential wave of foreclosures. According to *Insurance Journal*, 5.5% of the state's mortgages and 5.7% of Houston area mortgages were delinquent in the month prior to the hurricane; by December 2017, those figures jumped to 7.2% and 10.0%, respectively. A review of the December 31, 2017, Call Report data

does not reflect that Texas state-chartered institution residential mortgage portfolios were affected to the same degree as other mortgage lenders.

Another challenge facing Texas banks continues to be the threat of cybercrime and a growing sophistication among criminals in the methods used to commit these acts through ransomware, malware, and other indirect means. Combining six years' worth of FBI Internet Crime Report data with identity theft and cybercrime statistics from the Insurance Information Institute, the consulting firm Website Builder Expert predicts that more than 33,600 Texans will report being a victim of a cybercrime in 2018. These events are projected to cost the state an estimated \$96 million.

Lastly, Texas banks and thrifts continue the process of evaluating (if not implementing) their choices of methodologies regarding the Financial Accounting Standards Board's (FASB) new Current Expected Credit Loss Standard (CECL), which takes effect in 2020. Texas state-chartered banks, in this respect, have much in common with those in other states. In a national survey jointly conducted by KPMG, Main Street Technologies, Pacific Coast Bankers Bank, and SS&C Technologies, 67% of banks queried stated that they have yet to begin CECL implementation. Conversely, 11% believe they are ready for CECL standards to take effect while 8% have fully implemented the process. Further discussion can be found in the Supervisory Concerns section of this report.

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

There were 240 Texas state-chartered banks at year-end 2017. This number was unchanged from June 30, 2017. Three transactions resulted in a reduction in the number of Texas state-chartered banks but was offset by three transactions increasing the number of state-chartered banks.

The three reductions were the result of banks merging into other Texas state-chartered banks. The three gains in the number of Texas state-chartered banks occurred through a combination of two national banks converting to a Texas state-charter and the opening of The Bank of Austin, the first de novo state bank chartered in Texas since 2009. During the same period, the Department processed 116 applications related to banks, with approximately 50% of the filings involving branch and loan production office activity, 19% involving changes in ownership/control or chartering authority, 16% involving bank identification issues, 13% involving subsidiary formations, and 2% involving foreign bank activity.

Though the number of banks held steady, the overall asset size of Texas state-chartered banks increased from \$253.9 billion as of June 30, 2017, to \$259.4 billion at year-end 2017. Actual organic asset growth was \$5.0 billion, enhanced by an additional approximate \$0.5 billion due to conversions and a de novo banking charter.

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

State-chartered thrift assets under the Department's jurisdiction totaled \$23.1 billion as of December 31, 2017, which represents an increase of 23.5% or \$4.4 billion from this time last year. The total number of state-chartered savings banks declined by three to 25 since December 2016 due to mergers.

Increased profitability occurred in 60% of the thrift institutions since the end of 2016, primarily due to an increase in the volume of loans at most institutions. The median level of nonperforming loans and other real estate foreclosures remains low in state-chartered thrifts at 0.5% of total assets. Past due and nonaccrual loans, and foreclosed real estate continue to be monitored closely by state and federal regulators.

The Department continues to receive and process applications. During the past twelve months, there have been three branch office applications, three merger/reorganization applications, and various other types of applications.

## TEXAS ECONOMIC PROFILE

Buoyed by higher oil prices, increasing exports, and rising optimism resulting from a new federal tax law and the overall health of the U.S. economy, the Texas economy showed notable strength in both revenue and production last year.

Revenue from tax collections were up significantly in 2017. However, the Texas Comptroller of Public Accounts warned in March that much of this revenue has already been committed, meaning that state lawmakers won't necessarily have additional funds in 2019 to address issues such as hurricane recovery, the state's retired employee pension system, and health insurance for retired teachers. The result could be a downgrade of Texas' credit rating, making it more expensive for the state to borrow money.

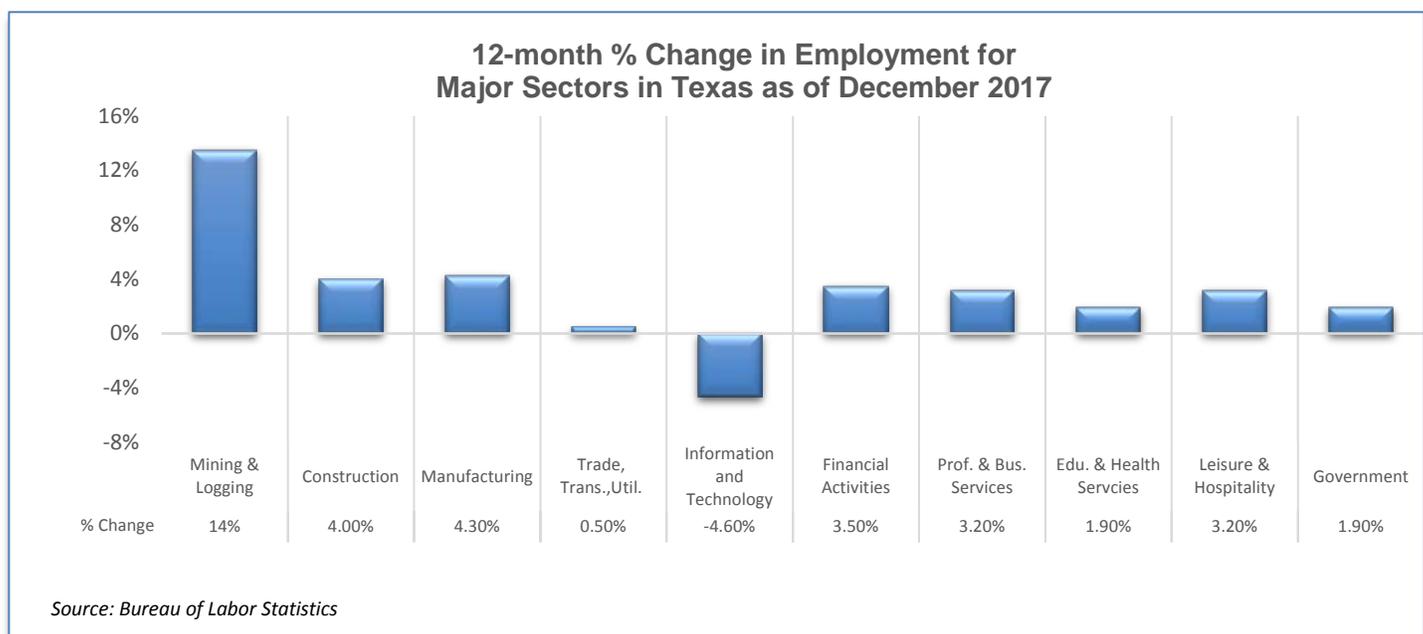
The Federal Reserve Bank (FRB) of Dallas, citing its Texas Business Outlook Surveys, portrayed 2017 as a year of an emphatic rebound, particularly during the second half. The regional reserve bank's Business Cycle Index – a measure of current economic activity in the state – rose 3.7%. Additionally, its Texas Leading Economic Index, a measure of future directional changes in the business cycle, jumped to a 30-month high.

The Texas economy further benefitted from a 6.0% increase in exports to Mexico, its primary foreign trading partner. Specifically, petroleum exports increased rapidly last year according to the FRB of Dallas, as unplanned outages in Mexico resulted in refinery utilization rates under 50.0% for parts of 2017. Gasoline exports from Texas rose to an all-time high in November, with more than half going to the state's southern neighbor.

2017 also saw new manufacturing orders and general business activity indexes surge to 11-year highs in December while the general business activity index further increased to its highest level since late 2005.

### Employment

According to the Texas A&M Real Estate Center, Texas' economy continued to outpace the U.S. economy in job creation. The state gained 306,900 nonagricultural jobs from December 2016 to December 2017, an annual growth rate of 2.7%, a figure higher than the nation's employment growth rate of 1.4%.



Figures from the Texas Workforce Commission (TWC) indicate that employment growth for the fourth quarter totaled 121,300 jobs, making it the strongest fourth quarter gain in the history of TWC’s series of statewide industry employment statistics.

In fact, every industry within the state except the information sector had more jobs as of December 2017 than during the same period in 2016. The mining and logging industry, which includes energy production, ranked first in job creation followed by manufacturing, financial services, professional and business services, construction, leisure and hospitality, and transportation, warehousing, and utilities.

Conversely, Texas’ seasonally adjusted unemployment rate in December 2017 was 3.7%, lower than the 4.5% rate in December 2016, while the nation’s rate decreased to 3.9%. Despite low unemployment levels, however, employee compensation remained stagnant as real Texas private hourly earnings increased only 1.1%

**Population and Migration**

The U.S. Census Bureau estimates the population of Texas in 2017 at 28,304,596. The state experienced an estimated growth rate of 1.4% during the year, the seventh-fastest in the U.S. Nearly half of the state’s population growth resulted from natural increase (i.e., births minus deaths), while the remaining growth resulted from net international and domestic migration.

Texans historically are migratory people, a tendency showing no signs of slowing. The state’s residents continue to migrate toward the geographic triangle formed by Harris, Dallas, Tarrant, Bexar, and Travis counties: Approximately 86% of the state’s population is now concentrated along and east of Interstate 35.

A significant amount of the state’s economic activity is confined within this triangle; the Waco-based economic forecasting firm The Perryman Group notes that at year-end 2017 the state’s largest Metropolitan Statistical Areas accounted for 74.8% of employment in the state and 80.3% of all output.

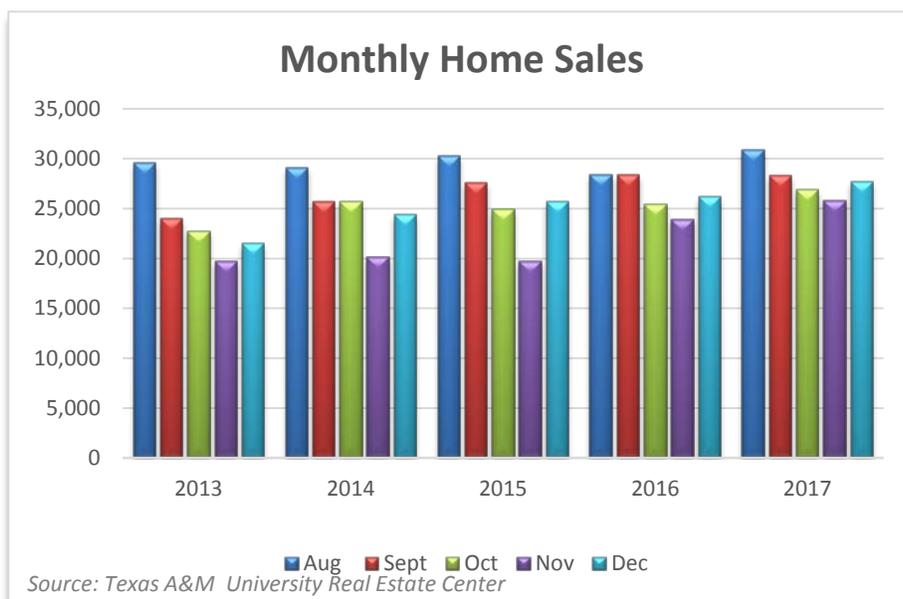
On the other side of the coin, 96 counties – all west of I-35 – continue to experience population declines. Put another way, the population of 38.0% of Texas counties is contracting. Rural areas losing residents face new and threatening challenges, such as access to health care, teacher shortages, and insufficient local government revenues.

Net international migration to Texas in 2017 was roughly 110,000 over the period, essentially unchanged from the prior two years but up 15.0% from the 12 months ended in July 2014.

**Housing**

After dipping in 2016, total Texas housing starts finished 2017 up 3.0%, slightly above the national rate of 2.4%. Market forces helped pull construction activity away from an oversupplied multifamily sector to the undersupplied single-family sector.

The now-vigorous Texas economy, however, combined with limited housing supplies helped to elevate home prices to record levels: The median home sales price increased by more than \$13,000 to an



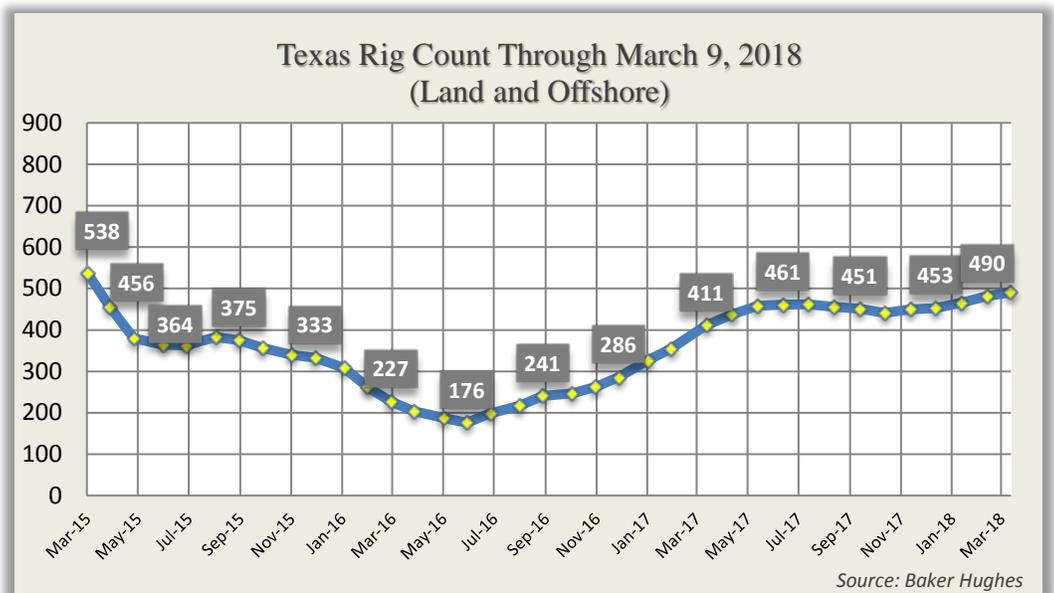
annual average of \$222,106. The market remained steady despite this average increase as sales rose 4.0%, maintaining the current four-year average. Demand remained robust, especially in the resale market where buyers were seeking more affordable options.

More important, these market conditions also helped shift sales away from the lowest price tier – homes priced under \$200,000 – where 2017 sales accounted for 41.0% of all homes sold through a Multiple Listing Service (MLS), according to the Texas A&M Real Estate Center. This represents a significant drop from 2011, when this pricing tier accounted for 68.0% of all sales. Every other pricing tier saw double-digit annual growth.

The result of these rapid home price increases, coupled with stagnant wages, led to an erosion of the housing affordability advantage Texas long enjoyed. Figures from the Texas Association of Realtors point to home sales and home prices reaching record highs in both 2015 and 2016, meaning many households are being priced out of the single-family market. The state's homeownership rate was 62.8% at the end of 2017, eleventh-lowest in the country.

### Oil and Gas

After several months of a downturn in the energy sector, the oil and gas (O&G) industry reversed course in 2017 in impressive fashion. Oil price increases induced a resurgence in activity, leading to job growth and near-record levels of production. A strong global demand and booming crude oil exports provided further support for increased output.



The West Texas Intermediate (WTI) crude oil spot price rose seven straight months to close 2017 at \$57.88 per barrel, more than \$15 higher than in 2016. Reduced crude inventories, political tensions in the Middle East, and a 20-day shutdown of a key North Sea pipeline system helped escalate oil prices to a two-year high.

In response to higher prices, crude oil production jumped 8.0% and was poised to surpass record levels previously attained in 1970. The number of active rigs matched 2015 levels at an annual average of 430, peaking twice during July and August at 466, accounting for nearly half of all working rigs in the nation. The rig count ended 2017 at 453. As of March 9, 2018, the total rig count was at 490.

### Other Manufacturing

Texas produces more than 11.0% of the total manufactured goods in the U.S. In addition, it is also among the top exporting states, with most of these goods going to Mexico and Canada. Despite a strong dollar, which typically reduces demand for exports, the FRB of Dallas' manufacturing production index, a key measure of state manufacturing conditions, soared 18 points in December to 32.8, reaching its highest level in more than 11 years.

Additionally, the new orders index saw a bump of 10 points up to 30.1, another 11-year high, while the growth rate of orders index moved up to 21.4. The capacity utilization index increased nine points to 26.3, and the shipments index rose from 16.7 to 21.5. Survey data from the FRB of Dallas also noted that

wages, employment, and hours worked all increased in 2017, reaching a 12-year high, and manufacturer sentiments surpassed record levels.

Meanwhile, the total value of Texas construction reached an all-time high at \$32.4 billion but experienced a slight slowdown by year's end, as declines in multifamily housing and office construction dragged these figures down statewide. Solid improvements for 2018 are expected, as reconstruction efforts continue in areas hit hard by Hurricane Harvey.

### *Agribusiness*

The agriculture and forestry industry may be one of Texas' smallest in terms of employment, but nonetheless leads the nation in several metrics. Texas produces the most cattle, cotton, hay, sheep, goats, and mohair of any state in the nation. It is also big in terms of economic impact: The estimated value of 2016 (the most recent figures available) agricultural production and related items totaled \$23.58 billion.

Having said that, the market was mixed in 2017. Demand for agricultural loans continued to decrease for a ninth consecutive quarter, according to the FRB of Dallas' fourth quarter agriculture survey. Loan renewals and extensions continued to increase, but loan repayment rates stabilized by year end 2017 after falling in the third quarter.

The most significant event affecting agribusiness in 2017, unfortunately, was Hurricane Harvey. The storm caused more than \$200 million in crop and livestock losses, according to Texas A&M AgriLife Extension Service economists. In terms of dollars, the greatest losses by agricultural commodity as the result of Harvey included cotton (\$100 million), livestock (\$93 million), and rice and soybeans (\$8 million).

Meanwhile, the equivalent of 200,000 bales of cotton on the stalk, valued at \$62.4 million, was lost and another 200,000 harvested bales worth an estimated \$9.6 million were damaged and lost value as the result of rain and floodwaters. Grain commodity losses would have been even higher but most of corn and sorghum crops along the coast were harvested prior to the storm.

### *Other Impacts from Hurricane Harvey*

Beyond the impact Hurricane Harvey had on the construction and agribusiness industries, the ripple effect of the storm will continue to be felt by the Texas economy well into the next fiscal year. Taking all figures into account, the total net impact on Texas is a projected \$3.8 billion loss in gross state product (GSP) in the first year following the storm. The Texas A&M Real Estate Center estimates that 185,000 houses were damaged or destroyed and as many as 55,000 multifamily units flooded.

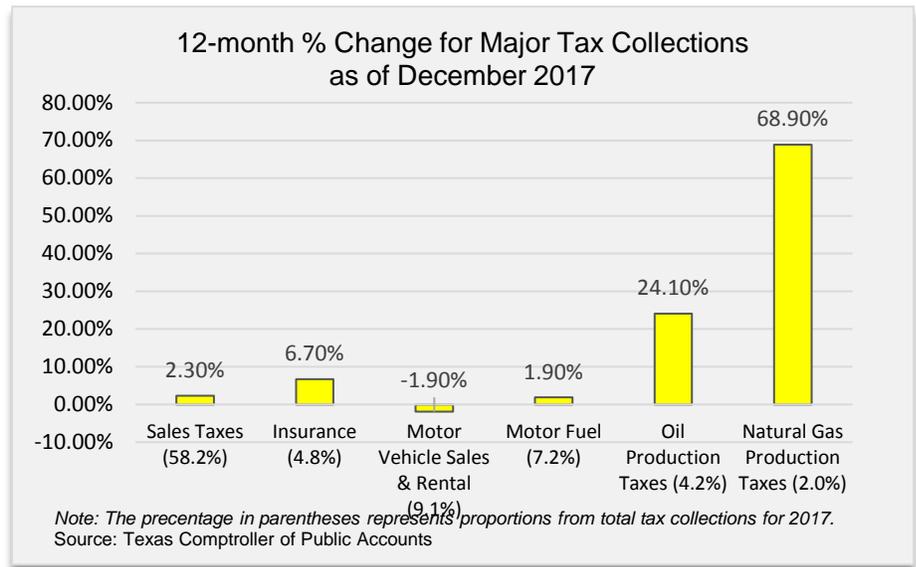
However, on a macro scale, gains from increased construction and associated spending undertaken to repair and rebuild communities is anticipated to offset losses in the months and years to come. Based on available data, federal, state, and local governments, along with private insurers, have spent or committed approximately \$31 billion for Harvey-related disaster relief and rebuilding at year end 2017, a figure likely to rise in the coming months.

Money for reconstruction efforts will come primarily from the Federal Emergency Management Agency, state and local governments, and private insurance. With this influx of financial assistance, the state should recover in the second year after the storm and gain about half as many jobs as it would have lost in the absence of this aid. Without the rebuilding effort, Texas' GSP would otherwise take four to five years to recover to pre-Harvey conditions.

**Tax Revenue**

Bolstered by the rise in tax revenues for O&G prices, Texas saw its total tax revenues increase significantly. Tax revenue for all of 2017 rose by 9.3% to \$49.2 billion, according to the Texas Comptroller of Public Accounts. On a percentage basis, this increase was the largest since February 2015 when sales tax revenues rose 11.7%.

As noted, increased O&G prices played a significant role in this increase, as tax revenue from O&G production during 2017 increased by \$1.8 billion and \$783.2 million, respectively. As a result, collections from these two natural resources increased last year by 23.8% and 54.7%, respectively, as compared to revenue collected during the same period one year before.



Overall, total net state revenue from taxes and other revenue sources – including licenses, fees, fines, rebates, lottery proceeds, land income, and others – increased modestly 3.25% to \$113.9 billion in 2017.

## SUPERVISORY CONCERNS

Jerome Powell was confirmed in January 2018 as the 16<sup>th</sup> chairman of the Federal Reserve and assumed the role after Chairwoman Janet Yellen’s term expired on February 3, 2018. Economists and the financial services industry await Chairman Powell’s role in continuing the economic expansion at a moderate pace and his overall monetary policy. Chairman Powell will also be challenged with unwinding the remaining economic stimulus.

**Federal Reserve Board Monetary Policy**

Date	Increase (In Basis Points)
December 14, 2017	25
June 15, 2017	25
March 16, 2017	25
December 15, 2016	25
December 17, 2015	25

Source: Board of the Federal Reserve System

The Federal Reserve Board has slowly raised interest rates beginning at the end of 2016, as the economy continued to grow. The strong economy and tight labor markets encouraged the FRB to continue raising rates in 2017; increasing rates three times.

Should interest rates continue to rise, intensified pressure will be placed on bank balance sheets. Historic low interest rates between 2008 and 2016 created compressed margins and led some institutions to invest in higher yielding, higher-risk assets with extended

maturities. Rate hikes will also drive the cost of funds higher. Banks and thrifts must manage their interest-rate, liquidity, and credit risk to sustain growth. These challenges will continue to be a focus of supervisory attention.

The Federal Reserve views modest inflation important to the economy, with an inflation target of 2%. The economy has missed this target for the last five and a half years. The recent tax cut measures could change, leading to a healthy wave of inflation. Depending on how consumers and corporations react, this will determine how the Federal Reserve handles future monetary policy actions. Movements in interest rates, weaknesses in the Texas economy, or an industry downturn can place pressure on the state’s banking system. Consequently, supervisory efforts of Texas’ regulatory agencies must remain forward-

looking and identify any cyclical troughs or potentially damaging factors that may weaken institutions, as early as possible.

The Texas Department of Banking and the Department of Savings and Mortgage Lending have been monitoring banks identified as having a significant volume of outstanding loans to O&G related customers or those located in an area highly dependent on O&G production. Following the sharp downturn in O&G commodity prices that began in 2014, banks sought to reduce their exposure to this industry, and have reported reduced lending volumes in quarterly surveys. However, in the second and third quarters of 2017, reporting banks show a modest increase in O&G related credits. These credits primarily reflect the improved commodity price. Problem O&G loans, which often can take years to resolve, peaked in 2016 for a majority of these financial institutions, with several others reporting a peak in the third quarter of 2017.

For banks with significant O&G exposure, the Texas Department of Banking expects continued improvement in asset quality indicators for 2018, as problem borrowers improve their financial circumstances. Department staff will continue to closely monitor the impact of energy commodity prices on Texas institutions and continue analyzing trends in affected banks.

Beginning March 2018, Texas Department of Banking and Department of Savings and Mortgage Lending examiners began discussing the implementation of FASB's Accounting Standards Update (ASU) 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, referred to as CECL.

Examiners will discuss the implementation of CECL at safety and soundness examinations with senior management as well as evaluate the steps management has taken to transition to this new methodology. The CECL method will have a significant impact on the way financial institutions estimate and provide for credit losses. Early preparation is prudent, and institutions should start planning as soon as possible to transition to CECL by the required implementation date. As the implementation deadline draws closer, each department will expect more from institutions relating to the implementation process. At this point in time, financial institutions should have researched the new accounting standards and begun searching for data sources. Regulators encourage banks to inquire seek assistance from their data processors, accounting firms and/or reliable consultants.

Other issues that remain a supervisory concern include business continuity plans, disaster recovery procedures, concentrations, cybersecurity, and management succession. Supervisors will remain alert to recognize significant changes in the areas described above and initiate prompt corrective action for those institutions that are unable to monitor and manage these threatening circumstances.

#### *Washington, D.C. and Regulatory Relief*

Senate Bill 2155, known as the Economic Growth, Regulatory Relief and Consumer Protection Act, was passed by U.S. senators in mid-March. The bill, led by Banking Committee Chairman Mike Crapo, R-Idaho, offers the largest regulatory relief for community and regional banks. The most significant provision of the bill is an increase in the size threshold at which banks are subjected to more stringent oversight by the Federal Reserve. Today, banks with more than \$50 billion in assets face rigorous regulation. The Crapo bill would raise the threshold to \$250 billion. Other provisions include: relief for smaller banks from new mortgage regulations on home loans held in their portfolio; exempting smaller banks from the Volcker Rule; shorter call reports; and relaxed capital rules.

The bill has been presented to U.S. representatives, specifically the House Financial Services Committee chaired by Jeb Hensarling. Reports indicate that committee members will expand the legislation package to add additional regulatory relief provisions. The debate will continue over the course of the next several weeks.

Related to regulatory relief, bankers and regulators alike will monitor Chairman Powell's position on right-size regulation. Reports indicate that Chairman Powell supports reducing regulatory burden, however, there is no indication on the degree of rollback he would support for the Dodd-Frank Wall Street Reform and Consumer Protection Act.

## DEPARTMENTAL SUPERVISORY MEASURES BEING TAKEN

As of March 12, 2018, problem state-chartered financial institutions remain stable at 5.0% or 12 state banks, and one state thrift were classified as a regulatory concern. The Texas Department of Banking and the Department of Savings and Mortgage Lending consider any bank with a Uniform Financial Institutions Composite Rating of 3, 4, or 5 a problem institution.

The supervisory measures of each department are designed to identify potential risks that could impact an institution's financial condition. Changes in economic conditions, technological threats, changes in interest rates, and competitive pressures all influence the supervisory measures listed below.

### *Texas Department of Banking*

- ❖ Monitoring institutions affected by Hurricane Harvey;
- ❖ Monitoring bank preparation for the industry's pending transition to CECL;
- ❖ Monitoring institutions affected by lower crude oil prices and efforts to resolve problem credit relationships;
- ❖ Determining preparedness for cybersecurity attacks and performing follow-up procedures for institutions that are below a baseline level of preparedness;
- ❖ Assessing risks posed by increasing market interest rates on net interest margins, extended durations of investment securities, and economic value of equity;
- ❖ Evaluating efforts to prudently assess and mitigate concentration risks in commercial real estate, O&G, and agriculture lending;
- ❖ 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 onsite examinations or visitations of problem institutions;
- ❖ Communicating and coordinating joint enforcement actions and other supervisory activities with federal regulators;
- ❖ Placing monthly calls to state banks to obtain industry input about prevailing economic conditions;
- ❖ 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; and
- ❖ Increasing internal communication and training to improve examiner awareness of pertinent issues.

### *Department of Savings and Mortgage Lending*

- ❖ Coordinating closely with other state and federal regulators;
- ❖ Continuing to monitor any impacts from Hurricane Harvey on the thrift industry;
- ❖ Engaging in regular correspondence with state savings banks regarding institution-specific and industry issues;
- ❖ Performing targeted examinations of high risk areas of state savings banks;
- ❖ Issuing enforcement actions and placing supervisory agents when deemed necessary;
- ❖ Conducting 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);
- ❖ Developing 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 primary federal regulator;
- ❖ On-going monitoring of any impact from volatility within the energy industries;
- ❖ On-going monitoring of interest rate risk;
- ❖ On-going monitoring of lending, investment, and funding concentrations;
- ❖ Monitoring local, state, national and world political and economic events impacting the industry; and
- ❖ Participating in federal compliance examinations of each institution.

# PERFORMANCE SUMMARY AND PROFILE: TEXAS BANKING SYSTEM

## STATE-CHARTERED BANKS

Since December 2008, the number of Texas state-chartered banks has declined 26.6% to 240; however, total assets have risen by 57.6% during the same timeframe. Of the 240 state banks, 11 operate branches in eight other states. As of December 31, 2017, state-chartered banks held \$259.4 billion in total assets with approximately 41,000 full-time employees.

Depositors and creditors continue to be well protected by industry capital. The leverage ratio for all state-chartered banks of 10.3% in 2017 is an improvement from 9.9% at year-end 2016. State banks with less than \$1 billion in total assets reflect a leverage ratio of 11.1%, while banks between \$1-\$10 billion exhibited a 11.2% leverage ratio. Although the three largest state banks with assets over \$10 billion have a lower leverage ratio of 9.5%, they are all well above regulatory capital requirements.

Earnings performance for state-chartered banks in 2017 was excellent, despite state banks reporting a net income of \$651.7 million in the fourth quarter of 2017, a 6.8% decrease from the 2016 fourth quarter figure of \$689.4 million. This one-time decline is a result of the tax changes passed at the end of 2017, which lowered the value of deferred tax assets. For 2017, higher net interest income and lower provisions for loan and lease losses resulted in an annual net income of \$3.0 billion, an increase of \$408.6 million over December 31, 2016.

The return on assets (ROA) for state-chartered banks is 1.2%, a 12-basis point (BP) increase from the 1.1% posted in 2016. Both interest income and interest expense, as a percent of average assets, were reduced from 2016 levels, even though short-term interest rates moved higher throughout 2017. Bank net interest margins (NIM) increased from 2016 to 2017 by 15 BP, signifying that banks positioned themselves to absorb the incremental interest rate increases.

Asset quality indicators improved by year-end with the noncurrent loan rate at 0.6%, an improvement from 0.7% during the same period in 2016. The noncurrent loan rate is aligned with all Texas banks. The coverage ratio (loan loss reserves relative to noncurrent loans) increased from 133.5% to 140.5% at year-end. Net charge-offs to loans and leases also declined by 7 BP to 0.2%. Likewise, noncurrent assets plus other real estate owned as a percent of total assets improved by 7 BP to 0.6%. Based on this information, it appears Hurricane Harvey did not affect the customer base as extensively as expected.

## STATE-CHARTERED THRIFTS

Through December 31, 2017, state thrifts had \$317.7 million in year-to-date net income, compared to \$288.6 million for 2016. The pretax, quarterly return on average assets for the median thrift remains strong at 1.2%. The quarterly NIM expanded by 23 BP during the last twelve months to 4.0%. Non-interest income to assets increased 1 BP, while overhead expenses increased 4 BP.

Provision expenses for loan and lease losses remain low at 0.2% of average assets. Year-to-date provisions to the allowance for loan and lease losses (ALLL) increased \$10.8 million from the prior year due to loan growth. Asset quality remains sound. The median Texas thrift ratio of nonperforming assets to total assets remains low at 0.5%, which is 15 BP less than the level of the thrift industry across the nation. ALLL coverage of nonperforming loans and leases with a median level of 141.0% is stronger than the median ratio of 106.0% for all savings institutions nationwide.

Capital protection remains sufficient among state thrifts, which experienced a decrease in the median Tier 1 Leverage Capital levels since one year earlier, by 36 BP to 10.2%. This decrease is a result of the growth in lending.

## NUMBER OF INSTITUTIONS AND TOTAL ASSETS

FDIC financial data is reflective of FDIC insured institutions only.  
Assets in Billions

	12-31-2017		12-31-2016		Difference	
	<u>No. of Institutions</u>	<u>Assets</u>	<u>No. of Institutions</u>	<u>Assets</u>	<u>No. of Institutions</u>	<u>Assets</u>
Texas State-Chartered Banks	240	\$259.4	244	\$254.6	-4	+\$4.8
Texas State-Chartered Thrifts	<u>25</u>	<u>\$23.1</u>	<u>28</u>	<u>\$18.7</u>	<u>-3</u>	<u>+4.4</u>
	265	\$282.5	272	\$273.3	-7	+\$9.2
Other states' state-chartered:						
Banks operating in Texas*	38	\$62.5	31	\$62.5	+7	\$0
Thrifts operating in Texas*	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
	38	\$62.5	31	\$62.5	+7	\$0
<b>Total State-Chartered Activity</b>	<b>303</b>	<b>\$345.0</b>	<b>303</b>	<b>\$335.8</b>	<b>0</b>	<b>+\$9.2</b>
National Banks Chartered in Texas	183	\$133.3	186	\$122.4	-3	+\$10.9
Federal Thrifts Chartered in Texas	<u>6</u>	<u>\$83.3</u>	<u>6</u>	<u>\$80.7</u>	<u>0</u>	<u>+2.6</u>
	189	\$216.6	192	\$203.1	-3	+13.5
Other states' federally-chartered:						
Banks operating in Texas*	24	\$405.7	24	\$375.8	0	+\$29.9
Thrifts operating in Texas*	<u>6</u>	<u>\$0.3</u>	<u>6</u>	<u>\$0.3</u>	<u>0</u>	<u>0</u>
	30	\$406.0	30	\$376.1	0	+\$29.9
<b>Total Federally-Chartered Activity</b>	<b>219</b>	<b>\$622.6</b>	<b>222</b>	<b>\$579.2</b>	<b>-3</b>	<b>+43.4</b>
<b>Total Banking/Thrift Activity</b>	<b>522</b>	<b>\$967.6</b>	<b>525</b>	<b>\$915.0</b>	<b>-3</b>	<b>+\$52.6</b>

\*Indicates estimates based on available FDIC information.

## RATIO ANALYSIS

As of December 31, 2017  
FDIC financial data is reflective of FDIC insured institutions only.

	<u>State-Chartered Banks</u> 240	<u>Texas National Banks</u> 183	<u>All Texas Banks</u> 423	<u>State-Chartered Thrifts</u> 25	<u>Texas Federal Thrifts</u> 6	<u>All Texas Thrifts</u> 31
% of Unprofitable Institutions	2.50%	5.46%	3.78%	4.00%	N/A	3.23%
% of Institutions with Earnings Gains	62.50%	62.30%	62.41%	60.00%	66.67%	61.29%
Yield on Earning Assets	3.76%	3.92%	3.82%	4.47%	4.69%	4.65%
Net Interest Margin	3.46%	3.54%	3.49%	3.75%	4.49%	4.35%
Return on Assets	1.17%	1.36%	1.24%	1.56%	0.92%	1.05%
Return on Equity	9.98%	12.67%	10.83%	13.20%	10.29%	11.00%
Net Charge-offs to Loans	0.18%	0.17%	0.18%	0.09%	1.40%	1.11%
Earnings Coverage of Net Loan C/Os	16.44	17.24	16.72	31.90	2.90	3.43
Loss Allowance to Loans	1.16%	1.11%	1.14%	0.85%	1.77%	1.54%
Loss Allowance to Noncurrent Loans	140.46%	141.27%	140.74%	42.59%	168.54%	120.45%
Noncurrent Assets+OREO to Assets	0.59%	0.58%	0.59%	1.55%	0.63%	0.83%
Net Loans and Leases to Core Deps	79.56%	85.54%	81.59%	105.71%	73.52%	79.51%
Equity Capital to Assets	11.98%	10.71%	11.55%	11.01%	9.16%	9.56%
Core Capital (Leverage) Ratio	10.32%	10.37%	10.34%	10.83%	9.27%	9.61%
Common Equity Tier 1 Capital	13.25%	14.05%	13.51%	14.76%	13.69%	13.94%

Data for other state-chartered institutions doing business in Texas is not available and therefore excluded.  
Information derived from the FDIC website.

## RATIO ANALYSIS BY ASSET GROUPS FOR STATE-CHARTERED BANKS

As of December 31, 2017  
FDIC financial data is reflective of FDIC insured institutions only.  
Assets in Billions

	<u>&lt; \$1</u> 213	<u>\$1 - \$10</u> 24	<u>&gt; \$10</u> 3
% of Unprofitable Institutions	2.82%	NA	NA
% of Institutions with Earnings Gains	63.38%	50.00%	100.00%
Yield on Earning Assets	4.27%	4.16%	3.30%
Net Interest Margin	3.85%	3.71%	3.14%
Return on Assets	1.29%	1.13%	1.15%
Return on Equity	11.48%	8.90%	10.02%
Net Charge-offs to Loans	0.17%	0.15%	0.20%
Earnings Coverage of Net Loan C/Os	15.63	18.00	15.93
Loss Allowance to Loans	1.22%	0.92%	1.31%
Loss Allowance to Noncurrent Loans	159.80%	113.04%	151.41%
Noncurrent Assets+OREO to Assets	0.57%	0.72%	0.51%
Net Loans and Leases to Core Deps	75.39%	101.72%	70.09%
Equity Capital to Assets	11.24%	13.32%	11.50%
Core Capital (Leverage) Ratio	11.07%	11.17%	9.45%
Common Equity Tier 1 Capital	16.71%	13.66%	11.70%

## RATIO ANALYSIS BY ASSET GROUPS FOR STATE-CHARTERED THRIFTS

As of December 31, 2017  
FDIC financial data is reflective of FDIC insured institutions only.  
Assets in Billions

	<u>&lt; \$1</u> 19	<u>\$1 - \$10</u> 6	<u>&gt; \$10</u> 0
% of Unprofitable Institutions	NA	16.67%	NA
% of Institutions with Earnings Gains	52.63%	83.33%	NA
Yield on Earning Assets	4.77%	4.36%	NA
Net Interest Margin	4.17%	3.59%	NA
Return on Assets	0.89%	1.84%	NA
Return on Equity	8.62%	14.73%	NA
Net Charge-offs to Loans	0.08%	0.10%	NA
Earnings Coverage of Net Loan C/Os	23.23	35.18	NA
Loss Allowance to Loans	0.98%	0.79%	NA
Loss Allowance to Noncurrent Loans	173.61%	31.05%	NA
Noncurrent Assets+OREO to Assets	0.48%	1.93%	NA
Net Loans and Leases to Core Deps	96.99%	109.61%	NA
Equity Capital to Assets	10.38%	11.23%	NA
Core Capital (Leverage) Ratio	10.36%	11.00%	NA
Common Equity Tier 1 Capital	14.09%	15.01%	NA

## COMPARISON REPORT

Select Balance Sheet and Income/Expense Information  
FDIC financial data is reflective of FDIC insured institutions only.  
December 31, 2017

	State Banks*		State Thrifts	
	<u>End of Period</u>	<u>% of Total Assets</u>	<u>End of Period</u>	<u>% of Total Assets</u>
Number of Institutions	240		25	
Number of Employees (full-time equivalent) (In millions)	41,076		2,849	
Total Assets	\$259,421		\$23,115	
Net Loans and Leases	\$157,459	60.70%	\$15,880	68.70%
Loan Loss Allowance	\$1,851	0.71%	\$136	0.59%
Other Real Estate Owned	\$208	0.08%	\$40	0.17%
Goodwill and Other Intangibles	\$5,813	2.24%	\$145	0.63%
Total Deposits	\$212,733	82.00%	\$17,119	74.06%
Federal Funds Purchased and Repurchase Agreements	\$2,640	1.02%	\$11	0.05%
Other Borrowed Funds	\$10,280	3.96%	\$3,224	13.95%
Equity Capital	\$31,083	11.98%	\$2,545	11.01%
<b>Memoranda:</b>				
Noncurrent Loans and Leases	\$1,318	0.51%	\$318	1.38%
Earning Assets	\$236,483	91.16%	\$21,700	93.88%
Long-term Assets (5+ years)	\$71,159	27.43%	\$8,291	35.87%
	<u>Year-to-Date</u>	<u>% of Avg. Assets<sup>†</sup></u>	<u>Year-to-Date</u>	<u>% of Avg. Assets<sup>†</sup></u>
Total Interest Income	\$8,695	3.44%	\$854	4.20%
Total Interest Expense	\$705	0.28%	\$138	0.68%
Net Interest Income	\$7,990	3.16%	\$716	3.52%
Provision for Loan and Lease Losses	\$316	0.12%	\$33	0.16%
Total Noninterest Income	\$3,180	1.26%	\$182	0.90%
Total Noninterest Expense	\$6,709	2.65%	\$487	2.40%
Securities Gains	-\$3	0.00%	\$11	0.05%
Net Income	\$2,966	1.17%	\$318	1.56%
<b>Memoranda:</b>				
Net Loan Charge-offs	\$271	0.11%	\$13	0.06%
Cash Dividends	\$1,840	0.73%	\$584	2.87%

\*Excludes branches of state-chartered banks of other states doing business in Texas. As of December 31, 2017, there are an estimated thirty-eight out-of-state state-chartered institutions with \$62.5 billion in assets. Assets are based upon the June 30, 2017 FDIC Summary of Deposits.

†Income and Expense items as a percentage of average assets are annualized.

No branches of state-chartered thrifts of other states conducted business in Texas as of December 31, 2017.

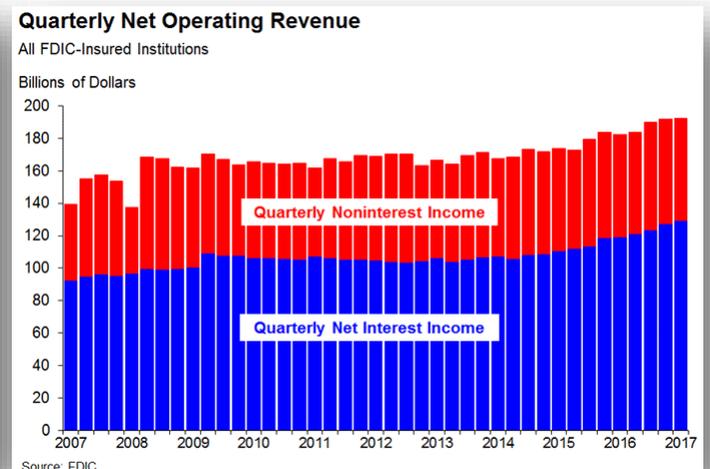
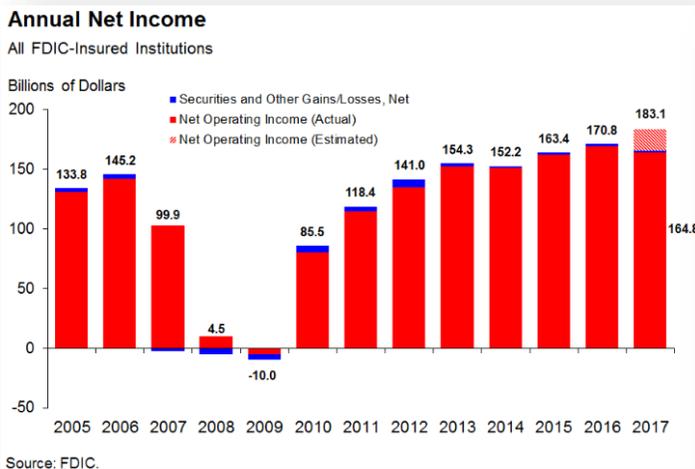
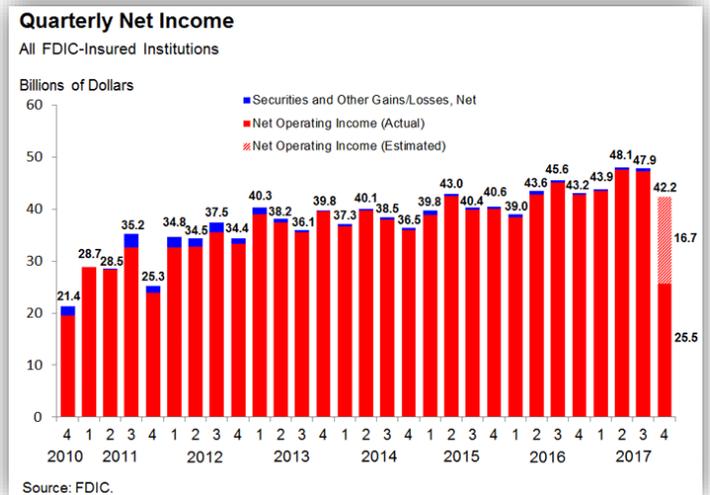
# PERFORMANCE SUMMARY: UNITED STATES BANKING SYSTEM

## FDIC QUARTERLY BANKING PROFILE

Fourth Quarter 2017 - [www.fdic.gov](http://www.fdic.gov)  
All Institutions Performance

↓ Quarterly Net Income Is 40.9% Lower Than a Year Ago Largely Due to One-Time Changes from the New Tax Law

In the fourth quarter, 5,670 insured institutions reported quarterly net income of \$25.5 billion, down \$17.7 billion (40.9%) from a year ago. Higher income taxes, reflecting one-time income tax effects enacted from the new tax law, coupled with higher noninterest expense and loan-loss provisions, lowered quarterly net income. Excluding one-time income tax effects, estimated quarterly net income would have been \$42.2 billion, down 2.3%.



↓ Full-Year 2017 Net Income Declines 3.5% Due to One-Time Tax Changes

Net income for full-year 2017 totaled \$164.8 billion, a decline of \$6 billion (3.5%) compared to

2016. The decline in full-year net income was due to higher income taxes (up \$21.6 billion, or 28.4%), which reflects one-time changes from the new tax law, combined with higher noninterest expense (up \$19.5 billion, or 4.6%) and higher loan-loss provisions (up \$3 billion, or 6.2%). Net operating revenue (the sum of net

interest income and total noninterest income) increased by \$39.5 billion from 2016, as net interest income rose by \$37.7 billion (8.2%) and noninterest income grew by \$1.8 billion (0.7%). The average net interest margin increased to 3.25% from 3.13% in 2016. Without the one-time tax charges in the fourth quarter, estimated full-year 2017 net income would have been \$183.1 billion, an increase of 7.2% from 2016.

### ↑ Net Interest Income Rises 8.5% From Fourth Quarter 2016

Net operating revenue of \$192.2 billion, was \$10 billion (5.5%) higher than fourth quarter 2016. Net interest income grew by \$10.2 billion (8.5%), while noninterest income fell by \$202.4 million (0.3%). More than four out of five banks (86.4%) reported higher net interest income from a year ago, as interest-bearing assets increased (up 4.4%) and the average NIM increased to 3.31% from 3.16% a year ago. This is the highest quarterly NIM for the industry since fourth quarter 2012. More than two out of three banks (70%) reported higher net interest margins than a year earlier.

### ↓ Provisions Increase 8.9% From a Year Ago

Loan-loss provisions totaled \$13.6 billion in the fourth quarter, an increase of \$1.1 billion (8.9%) from a year ago. More than one in three (38.9%) institutions reported higher loan-loss provisions than in fourth quarter 2016. Fourth quarter loan-loss provisions totaled 7.1% of net operating revenue, up from 6.8% a year ago.

### ↓ Noninterest Expense Increases from a Year Ago

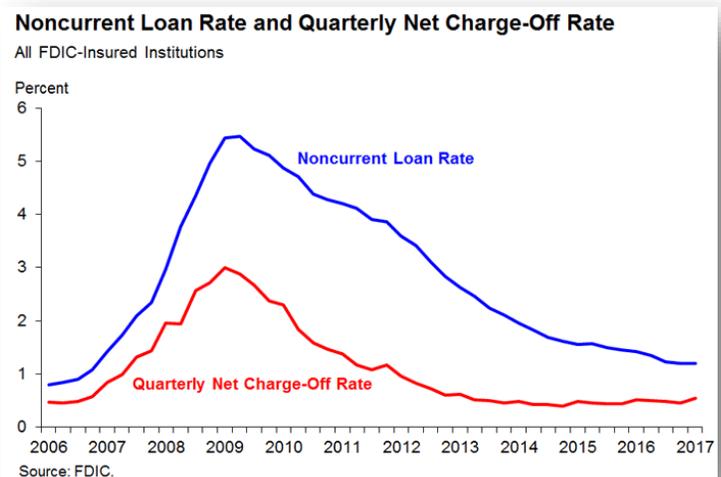
Noninterest expense for the banking industry was \$9.4 billion (8.6%) higher than fourth quarter 2016, led by an increase in "other" noninterest expense (up \$6.3 billion, or 14.1%). Other noninterest expense includes, but is not limited to, information technology costs, legal fees, consulting services, and audit fees. Salary and employee benefits rose by \$3.2 billion (6.3%) from a year ago. Full-time equivalent employees at FDIC-insured institutions rose by 1.1% from a year ago, while industry assets increased by 3.8%. Average assets per employee rose to \$8.4 million from \$8.2 million in fourth quarter 2016.

### ↓ Net Charge-Off Rate Increases Slightly

Banks charged off \$13.2 billion in uncollectable loans during the quarter, an increase of \$1 billion (8.6%) from a year ago. This marks a ninth consecutive quarter that net charge-offs increased. Less than half (45.3%) of all banks reported an annual increase in their quarterly net charge-offs. The increase in net charge-offs was led by credit card balances, which grew by \$1.1 billion (15.7%). Net charge-offs declined for commercial and industrial loans (down \$210.3 million, 8.6%), home equity loans (down \$178.1 million, or 68.6%), and residential mortgage loans (down \$68.3 million, or 36.4%). The average net charge-off rate rose from 0.52% in fourth quarter 2016 to 0.55%.

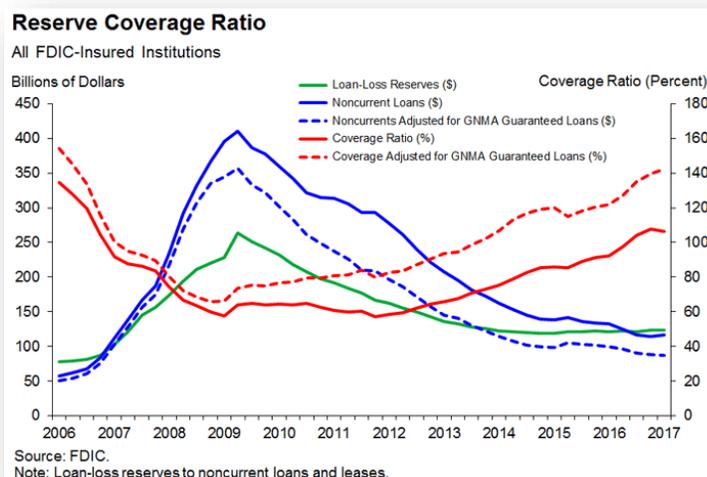
### ↔ Noncurrent Loan Rate Remains Stable

After declining for the past six consecutive quarters, noncurrent balances (90 days or more past due or in nonaccrual status) for total loans and leases increased by \$1.5 billion (1.3%) during the fourth quarter. The increase in noncurrent balances was led by residential mortgages (up \$2.8 billion, or 5.2%) and credit cards (up \$1.2 billion, or 11.5%), and was partially offset by a decline in noncurrent commercial and industrial loans (down \$1.7 billion, or 8.5%). Despite the overall dollar increase, the average noncurrent loan rate remained unchanged at 1.20% from the previous quarter.



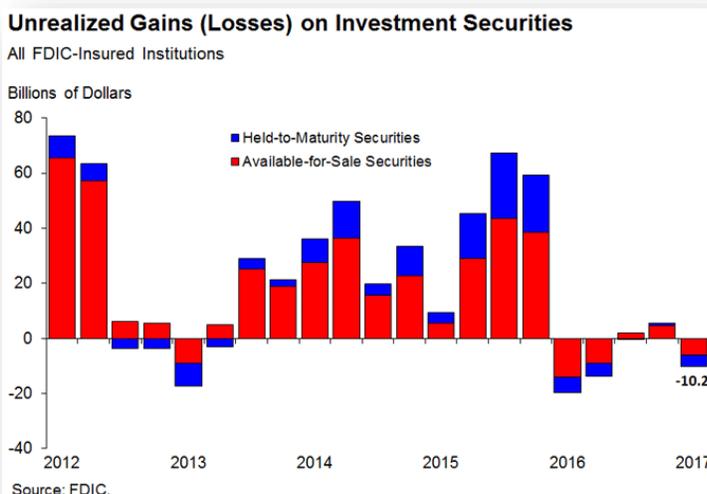
## ↓ Loan-Loss Reserves Increase from The Previous Quarter

Banks continued to increase their loan-loss reserves (up \$236.2 million, or 0.2%) during the quarter, as loan-loss provisions of \$13.6 billion exceeded net charge-offs of \$13.2 billion. Banks that itemize their reserves (banks with assets greater than \$1 billion) reported higher reserves for credit card losses (up \$1.9 billion, or 5.2%) from the previous quarter, and lower reserves for residential real estate losses (down \$827.2 million, or 5.4%) and commercial and industrial loan losses (down \$723.5 million, or 2.2%) during the quarter. The coverage ratio (loan-loss reserves to noncurrent loan balances) declined slightly to 106.3% but has been above 100% for the past three quarters.



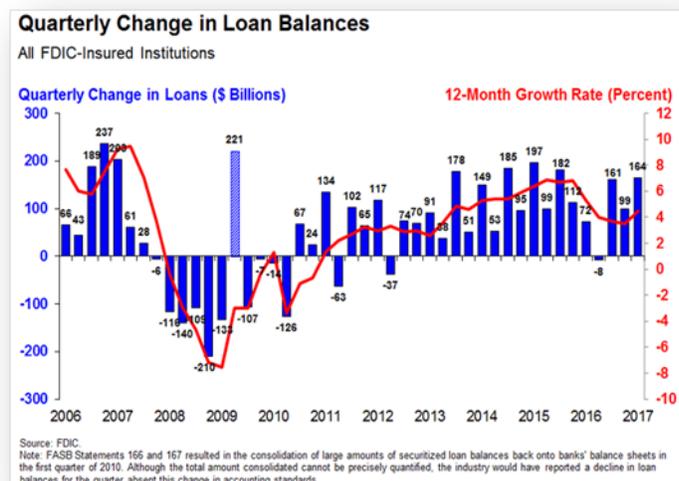
## ↑ Equity Capital Rises Modestly

Total equity capital increased by \$3.6 billion (0.2%) in fourth quarter 2017. Declared dividends of \$30.1 billion exceeded the quarterly net income of \$25.5 billion during the quarter, reducing retained earnings by \$4.6 billion. Accumulated other comprehensive income declined by \$8.5 billion in the quarter, which was led by a decline in the market value of available-for-sale securities. The equity-to-asset ratio declined to 11.22% from 11.31% in third quarter 2017 but remained above the year-ago ratio of 11.10%. At year-end 2017, 99.4% of all insured institutions, which account for 99.97% of total industry assets, met or exceeded the requirements for the highest regulatory capital category, as defined for Prompt Corrective Action purposes.



## ↑ Total Loan and Lease Balances Increase \$164.1 Billion During the Fourth Quarter

Total loan and lease balances increased by \$164.1 billion (1.7%) from third quarter 2017, as balances in all major loan categories increased. Credit card balances increased by \$69.6 billion (8.8%) from the previous quarter, commercial and industrial loans grew by \$24.5 billion (1.2 percent), and residential mortgage loans rose by \$21.7 billion (1.1%). Unused loan commitments were \$108.9 billion (1.5%) higher than the previous quarter, led by higher unused credit card lines (up \$57.7 billion, or 1.6%). Over the past 12 months, loan and lease balances increased



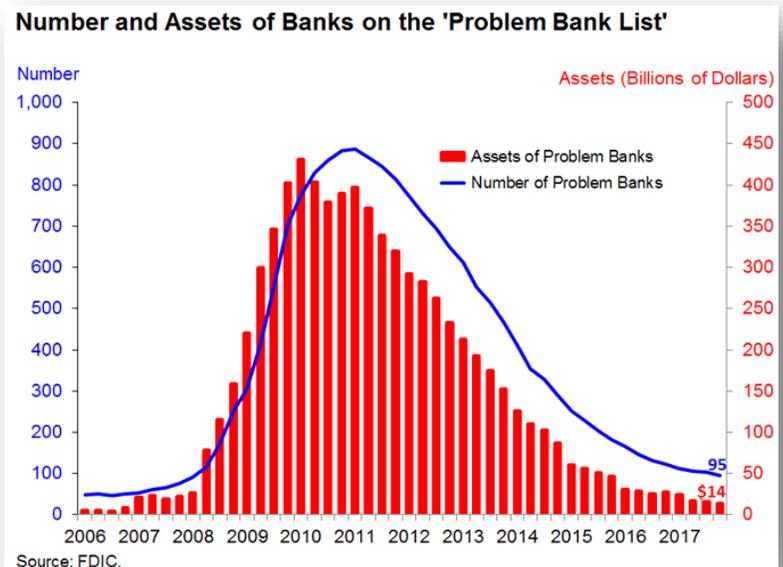
by \$416.1 billion (4.5%), exceeding last quarter's annual growth rate of 3.5%. The 12-month increase in loan and lease balances was led by commercial and industrial loans (up \$78.4 billion, or 4.1%), residential mortgage loans (up \$68.7 million, or 3.4%), nonfarm nonresidential loans (up \$67.1 billion, or 5.1%), and credit card balances (up \$65.2 billion, or 8.2%). Home equity lines of credit continued with the year-over-year decline (down \$23 billion, or 5.3%). Unused loan commitments increased 4.4% from a year ago, the largest annual growth rate since third quarter 2016.

### ↑ Deposits Grew 1.4% from the Previous Quarter

Total deposits increased by \$179.8 billion (1.4%) in the fourth quarter. Balances in domestic interest-bearing accounts rose by \$153.7 billion (1.8%), and balances in noninterest-bearing accounts grew by \$7.8 billion (0.2%). Domestic deposits in accounts larger than \$250,000 increased by \$159.6 billion (2.5%) from third quarter 2017. Nondeposit liabilities declined by \$8.9 billion (0.4%), as other liabilities were down \$29.3 billion (7.3%).

### ↑ Problem Bank List Falls Below 100

The FDIC's Problem Bank List declined from 104 to 95 at year-end 2017, the lowest number of problem banks since first quarter 2008. Total assets of problem banks were down from \$16 billion in the third quarter to \$13.9 billion. During the quarter, merger transactions absorbed 64 institutions, two institutions failed, and one new charter was added. For full-year 2017, five new charters were added, 230 institutions were absorbed by mergers, and eight institutions failed.



## SNAPSHOT STOCK PERFORMANCE SOUTHWEST REGIONAL BANKS (MSECTOR415) MARCH 2018

Name	Last Trade	52 Wk Range		PE	EPS	Mkt Cap	Div/Shr	Div Yld
ACNB Corporation	03/09 <b>28.55</b>	24.45	32.50	18.18	1.57	200.38M	0.20	2.80%
BancFirst Corporation	03/09 <b>56.95</b>	48.20	115.80	21.49	2.65	1.86B	0.21	1.44%
BOK Financial Corporation	03/09 <b>99.72</b>	73.44	99.50	19.49	5.11	6.53B	0.45	1.79%
Cass Information Sys, Inc.	03/09 <b>62.30</b>	54.37	69.86	31.00	2.01	765.46M	0.24	1.44%
CoBiz Incorporated	03/09 <b>20.13</b>	15.39	22.01	25.81	0.78	850.06M	0.06	1.07%
Commerce Bancshares, Inc.	03/09 <b>60.79</b>	51.90	60.82	21.03	2.89	6.49B	0.23	1.46%
Cullen Frost Bankers, Inc.	03/09 <b>109.42</b>	81.09	109.69	19.84	5.51	6.96B	0.57	2.09%
Enterprise Fin Serv Corp	03/09 <b>49.40</b>	36.65	49.67	23.86	2.07	1.14B	0.11	0.89%
First Community Corp S C	03/09 <b>22.50</b>	18.50	24.87	21.63	1.04	150.89M	0.10	1.64%
First Financial Bankshares, Inc.	03/09 <b>48.90</b>	36.85	48.85	27.02	1.81	3.30B	0.19	1.56%
Frist Financial Northwest, Inc.	03/09 <b>16.68</b>	13.13	20.32	19.55	0.85	178.64M	0.07	1.68%
Great Southern Bancorp, Inc.	03/09 <b>51.80</b>	47.25	58.45	14.43	3.59	730.89M	0.24	1.81%
Guaranty Fed Bancshares, Inc.	03/09 <b>22.80</b>	18.21	23.71	16.06	1.42	100.82M	0.12	1.84%
Heartland Financial USA, Inc.	03/09 <b>56.00</b>	42.1	56.40	21.13	2.65	1.74B	0.13	0.82%
International Bancshares Corp	03/09 <b>41.40</b>	32.50	42.45	17.54	2.36	2.74B	0.33	1.59%
Landmark Bancorp, Inc.	03/09 <b>28.76</b>	27.02	32.00	29.60	0.97	117.38M	0.20	2.68%
Liberty Bancorp, Inc.	03/09 <b>23.80</b>	20.05	24.50	39.02	0.61	85.69M	0.07	1.03%
Mackinac Financial Corp	03/09 <b>16.30</b>	13.16	16.80	14.30	1.14	99.58M	0.12	2.94%
MidWest One Finl Group, Inc.	03/09 <b>33.60</b>	30.56	38.00	21.68	1.55	411.10M	0.20	2.08%
North Dallas Bank & Trust Co. TX	03/09 <b>80.25</b>	70.50	80.20	36.16	2.22	206.04M	0.33	0.86%
Prosperity Bancshares, Inc.	03/09 <b>78.24</b>	55.84	79.05	19.99	3.92	5.47B	0.36	1.79%
QCR Holdings, Inc.	03/09 <b>47.55</b>	39.85	50.00	18.57	2.56	661.81M	0.05	0.44%
Solera National Bancorp, Inc.	03/09 <b>8.75</b>	7.40	8.75	NA	NA	23.74M	NA	NA
Texas Capital Bancshares, Inc.	03/09 <b>94.20</b>	69.65	102.90	25.24	3.73	4.67B	NA	NA
UMB Financial Corporation	03/09 <b>77.03</b>	62.37	80.04	20.98	3.67	3.85B	0.28	1.40%
West Bancorp Incorporated	03/09 <b>26.20</b>	20.60	28.00	18.58	1.41	424.85M	0.18	2.75%

Source: Yahoo Finance (March 2018)

NA – Indicates information was not available.

## SNAPSHOT STOCK PERFORMANCE

### SOUTHWEST REGIONAL BANKS (MSECTOR415)

### MARCH 2017

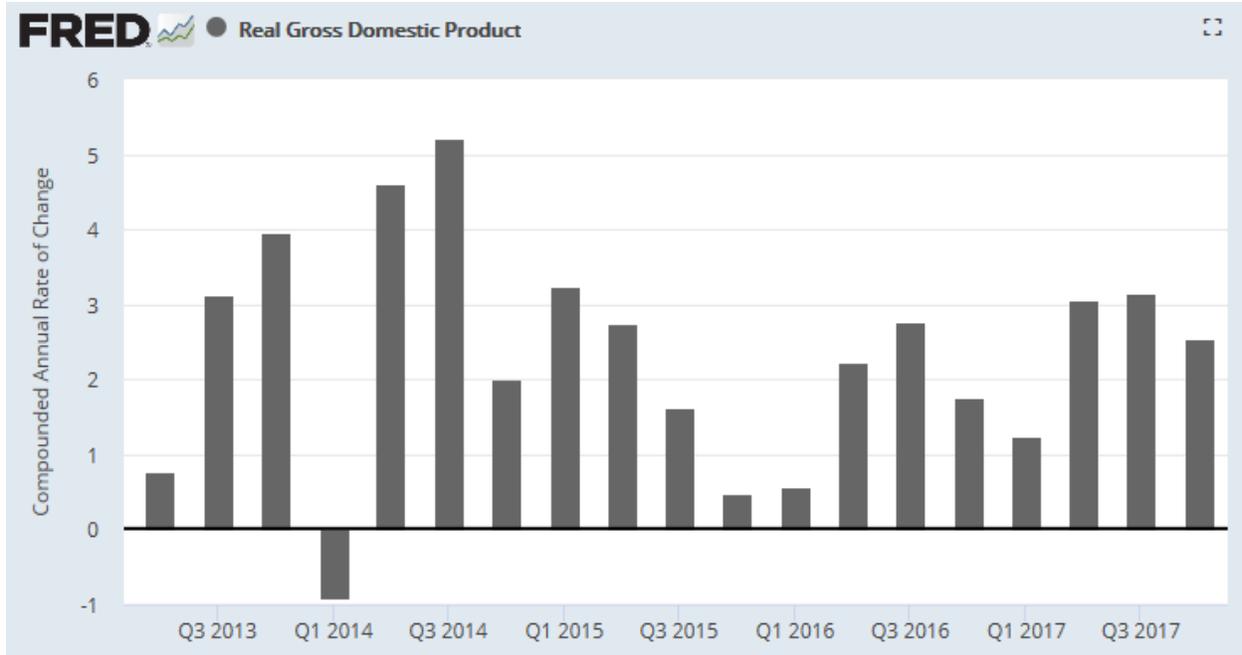
Name	Last Trade	52 Wk Range	PE	EPS	Mkt Cap	Div/Shr	Div Yld
ACNB Corporation	03/06 <b>29.85</b>	21.36 32.85	16.19	1.84	180.92M	0.80	2.71%
BancFirst Corporation	03/06 <b>93.75</b>	53.39 98.35	21.11	4.44	1.48B	1.52	1.61%
BOK Financial Corporation	03/06 <b>82.85</b>	51.38 85.25	23.49	3.53	5.41B	1.76	2.13%
Cass Information Sys, Inc.	03/06 <b>64.51</b>	45.05 74.83	30.00	2.15	720.98M	0.92	1.40%
CoBiz Incorporated	03/06 <b>17.16</b>	10.63 17.99	20.43	0.84	705.07M	0.20	1.16%
Commerce Bancshares, Inc.	03/06 <b>58.92</b>	40.93 60.61	22.54	2.61	5.99B	0.90	1.53%
Cullen Frost Bankers, Inc.	03/06 <b>93.95</b>	51.43 96.62	19.97	4.70	5.99B	2.16	2.31%
Enterprise Fin Serv Corp	03/06 <b>44.15</b>	25.04 46.25	18.32	2.41	1.03B	0.44	1.00%
First Community Corp S C	03/06 <b>20.35</b>	13.01 23.55	20.77	0.98	136.52M	0.36	1.75%
First Financial Bankshares, Inc.	03/06 <b>43.85</b>	27.67 46.7	27.63	1.59	2.9B	0.72	1.64%
First Financial Northwest, Inc.	03/06 <i>NA</i>	<i>NA</i> <i>NA</i>	<i>NA</i>	<i>NA</i>	<i>NA</i>	<i>NA</i>	<i>NA</i>
Great Southern Bancorp, Inc.	03/06 <b>51.00</b>	34.48 56.7	15.89	3.21	712.39M	0.88	1.75%
Guaranty Fed Bancshares, Inc.	03/06 <b>14.9</b>	14.9 21.95	15.76	1.27	87.02M	0.40	1.95%
Heartland Financial USA, Inc.	03/06 <b>50.30</b>	29.58 51.7	15.62	3.22	1.31B	0.41	0.81%
International Bancshares Corp	03/06 <b>37.90</b>	22.96 42.25	18.76	2.02	2.5B	0.62	1.63%
Landmark Bancorp, Inc.	03/06 <b>30.70</b>	24.05 32.4	13.29	2.31	118.75M	0.80	2.64%
Liberty Bancorp, Inc.	03/06 <b>23.94</b>	<i>N/A</i> <i>N/A</i>	15.65	1.53	86.18M	0.22	0.92%
Mackinac Financial Corp	03/06 <b>13.4624</b>	0 14.07	18.96	0.71	84.32M	0.40	2.99%
MidWest One Finl Group, Inc.	03/06 <b>36.98</b>	25.46 39.2	20.78	1.78	423.13M	0.66	1.82%
North Dallas Bank & Trust Co. TX	03/06 <i>NA</i>	<i>NA</i> <i>NA</i>	<i>NA</i>	<i>NA</i>	<i>NA</i>	<i>NA</i>	<i>NA</i>
Prosperity Bancshares, Inc.	03/06 <b>74.85</b>	42.78 77.87	19.00	3.94	5.2B	1.36	1.81%
QCR Holdings, Inc.	03/06 <b>42.80</b>	22.55 45	19.72	2.17	560.97M	0.20	0.46%
Solera National Bancorp, Inc.	03/06 <i>NA</i>	<i>NA</i> <i>NA</i>	<i>NA</i>	<i>NA</i>	<i>NA</i>	<i>NA</i>	<i>NA</i>
Texas Capital Bancshares, Inc.	03/06 <b>90.30</b>	34.54 93.35	29.04	3.11	4.47B	<i>NA</i>	<i>NA</i>
UMB Financial Corporation	03/06 <b>77.53</b>	48.49 81.55	24.08	24.08	3.86B	1.02	1.29%
West Bancorp Incorporated	03/06 <b>22.35</b>	17.33 25.05	15.74	1.42	360.68M	0.68	3.04%

Source: Yahoo Finance (March 2017)

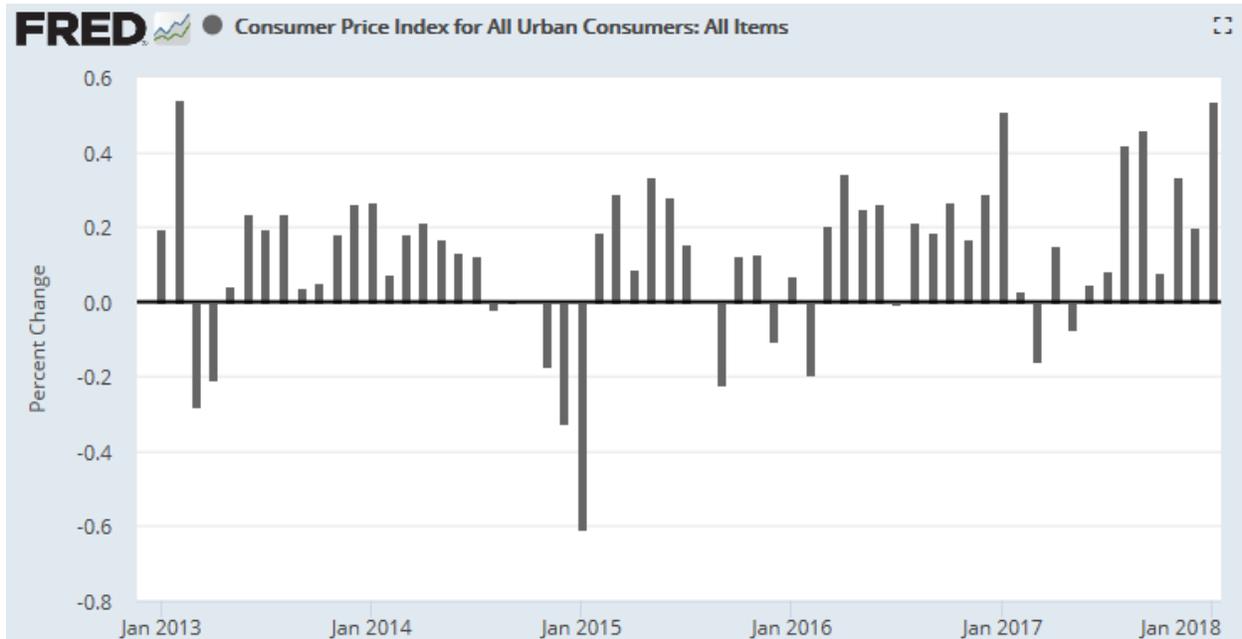
NA – Indicates information was not available.

# NATIONAL ECONOMIC TRENDS

## Real GDP



## Consumer Price Index

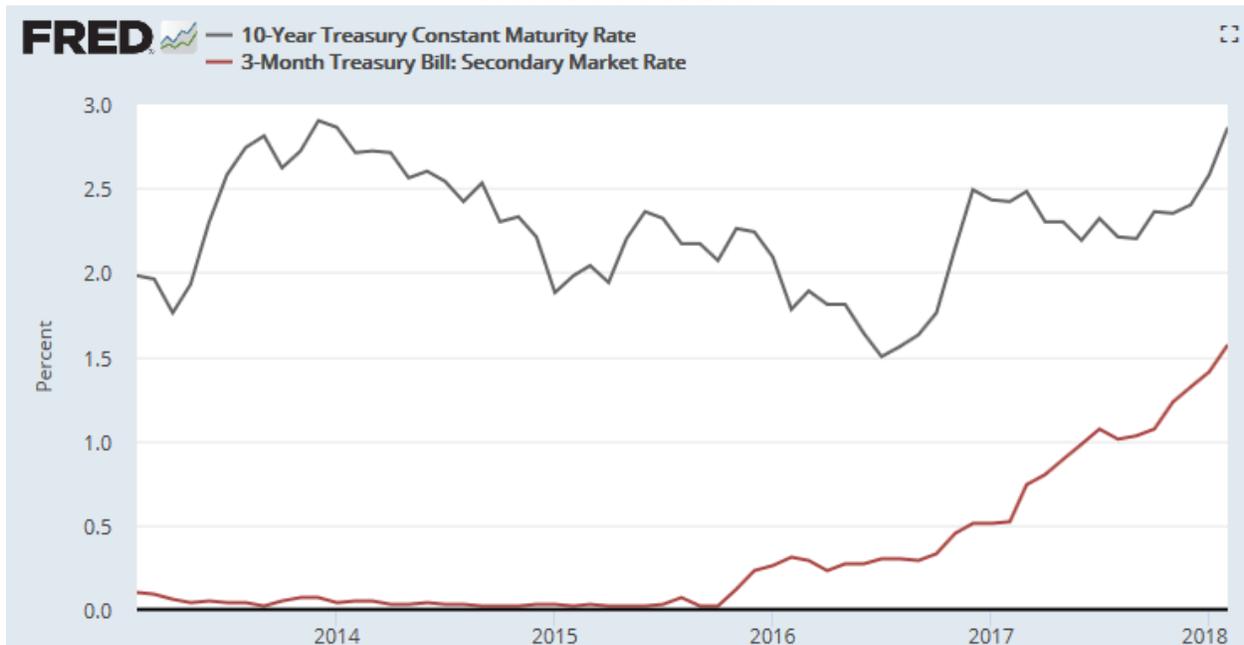


Source: Federal Reserve Bank of St. Louis, National Economic Trends, March 2018.

## Unemployment Rate

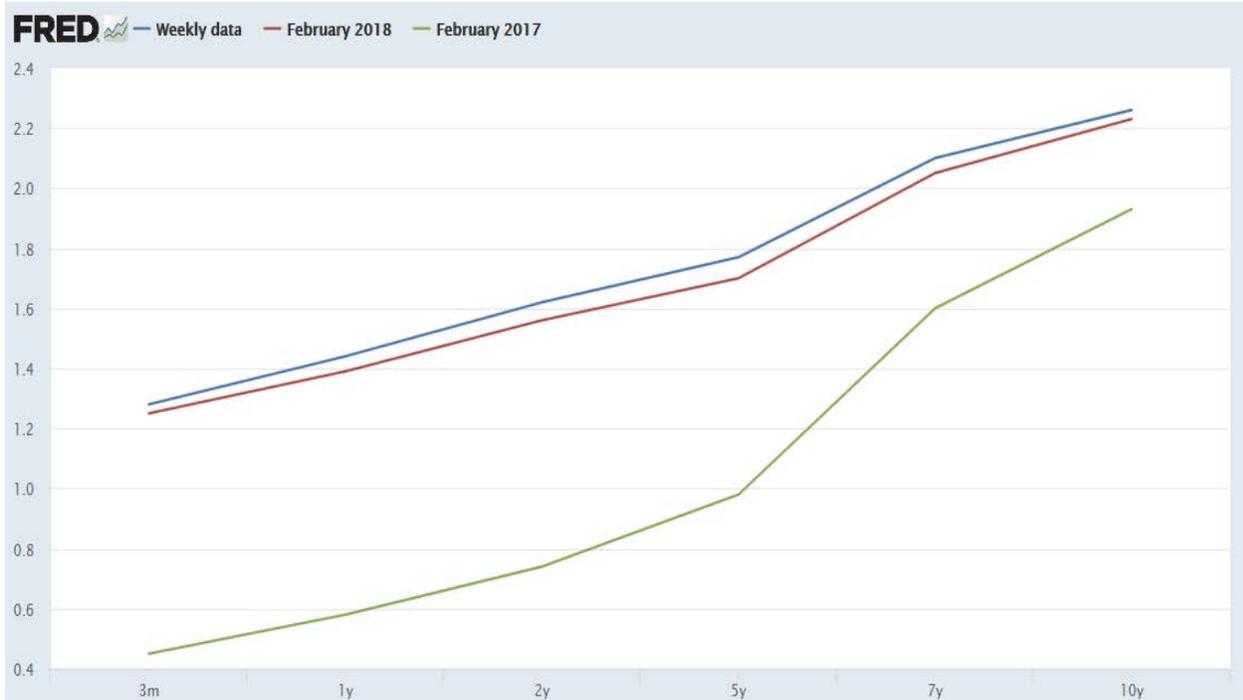


## Interest Rates

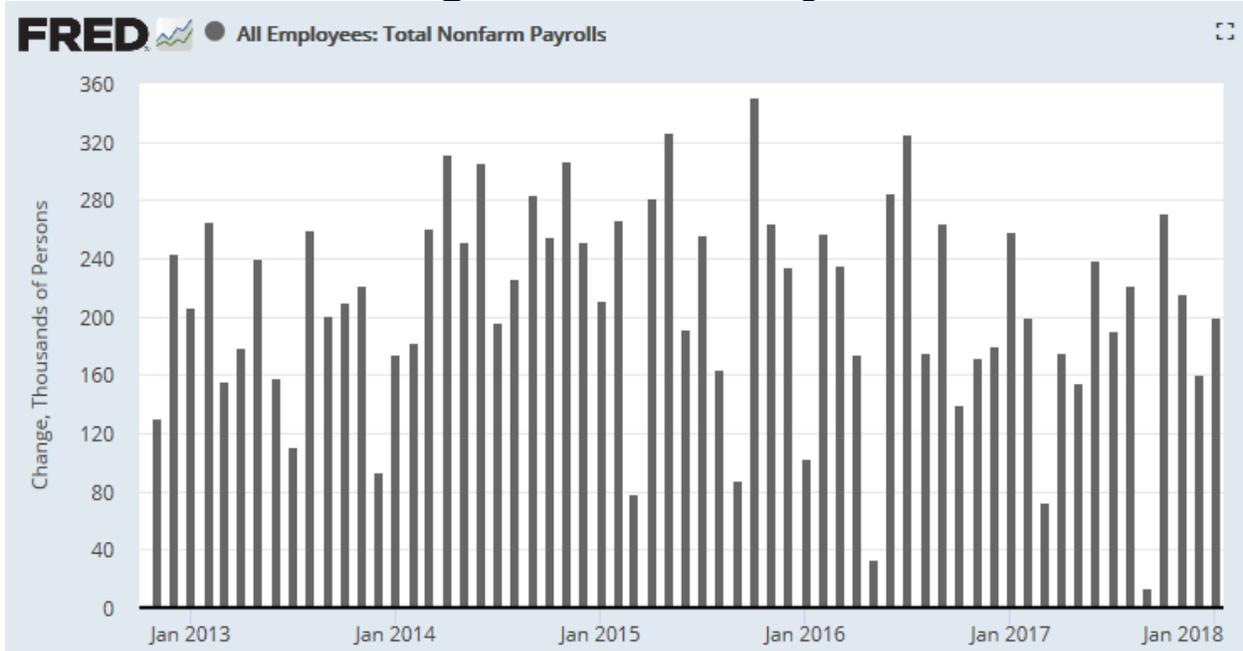


Source: Federal Reserve Bank of St. Louis, National Economic Trends, March 2018.

## Treasury Yield Curve Percent



## Change in Nonfarm Payrolls



Source: Federal Reserve Bank of St. Louis, National Economic Trends, March 2018.

# ECONOMIC REPORTS AND FORECASTS: UNITED STATES

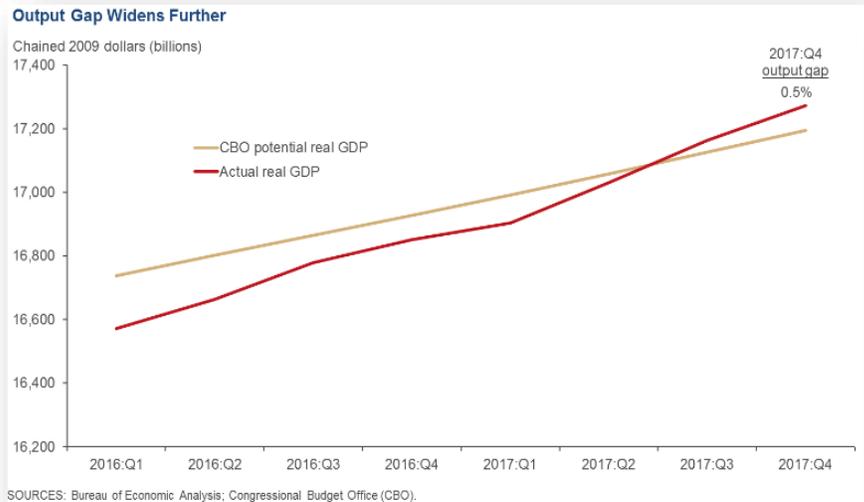
## FEDERAL RESERVE BANK, DALLAS NATIONAL UPDATE

February 2018 - [www.dallasfed.org](http://www.dallasfed.org)

### ⇄ Economy

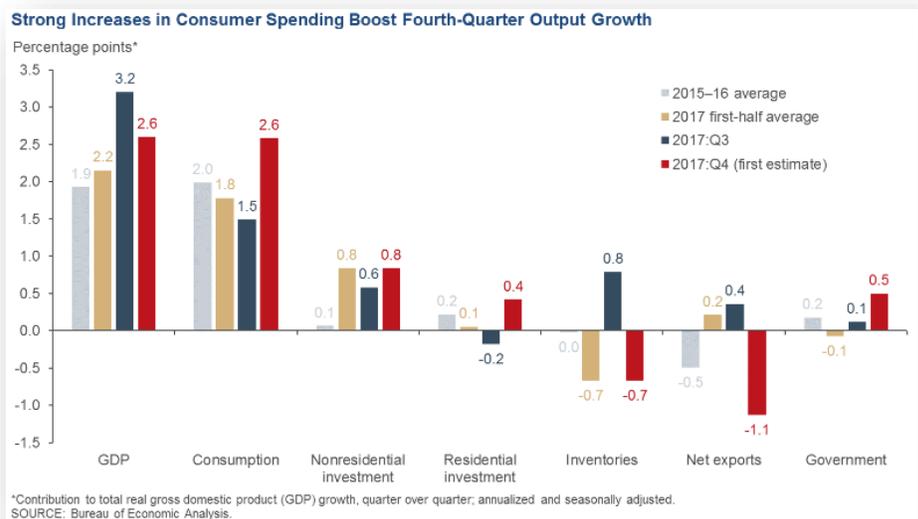
U.S. economic growth slowed in fourth quarter 2017 following two strong quarters. While real gross domestic product (GDP) growth came in below consensus expectations, due in part to drags from inventories and trade, it showed strength in consumption and investment. Overall, the report indicated real GDP has positive momentum entering 2018.

The labor market continues to tighten, and there are recent signs of wage pressure. Inflationary pressures remain modest, with core inflation below the Federal Reserve's 2% target.



### ⇄ Strong Consumer Spending

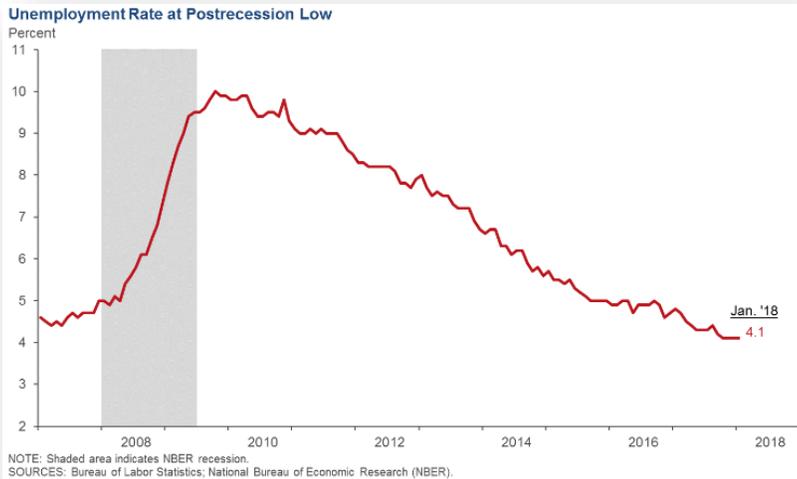
Real (inflation-adjusted) GDP grew at a 2.6% annualized rate during the fourth quarter and 2.5% year over year. The main driver of growth in the quarter was consumer spending, which contributed 2.6 percentage points, followed by nonresidential investment, which contributed 0.8 percentage points. On the downside, inventories and net exports depressed real GDP growth as they subtracted 0.7 and 1.1 percentage points, respectively.



### ⇄ Output Gap Continues to Widen

The latest GDP measure showed that the output gap—the difference in the level of GDP and the

Congressional Budget Office's potential level of real GDP, divided by the level of potential output—is widening. The output gap is now 0.5%, up from



rate will fall to 3.9% by year-end 2018.

The labor force participation rate was unchanged at 62.7%, while the average workweek decreased by 0.2 hours to 34.3. Over the past year, average hourly earnings have advanced 2.9%. During the expansion, earnings have been subdued compared with the strength of the recovery observed in other measures of the labor market.

### ↑ Wage Pressures Seen at Lower End of Wage Distribution

0.2% in the third quarter. This is consistent with an economy operating above potential and with a continuous tightening of the labor market. The U.S. economy is currently estimated to be above full employment.

### ↑ Labor Market Remains Tight

January's employment report shows that the labor market continues to tighten. The U.S. economy added 200,000 jobs in January, bringing the three-month job creation average to 192,000.

Unemployment was little changed from December's employment report. The headline unemployment (U-3) rate remained at 4.1% in January, the lowest level since the Great Recession.

The unemployment rate is presently overshooting its long-run level of 4.7%, estimated by the Congressional Budget Office. Given the recent sustained pace of economic growth and the widening of the output gap, the unemployment rate is expected to decline even further. Economic projections from December's Federal Open Market Committee (FOMC) meeting forecast that the unemployment

Wage growth has begun to pick up the past few years, largely due to persistent improvements in the labor market. A recent development has been the pace of wage growth for low-wage workers, which has been lagging behind growth for medium- and high-wage workers.

The chart shows the annual change in the three-month average (August–October) between 2017 and 2016, along with the same three-month average annualized wage growth over the previous five years. The chart presents evidence of wage pressures across the wage distribution, but in the 12 months ending in October 2017, low-wage workers (those in the 10<sup>th</sup> to 30<sup>th</sup> percentile) have seen a larger increase in wage growth



compared with middle- and high-wage workers. The rationale for this development stems from recent increases in the minimum wage across states and municipalities as well as the higher sensitivity of low-wage workers compared with medium- and high-wage earners to persistent improvements in the labor market.

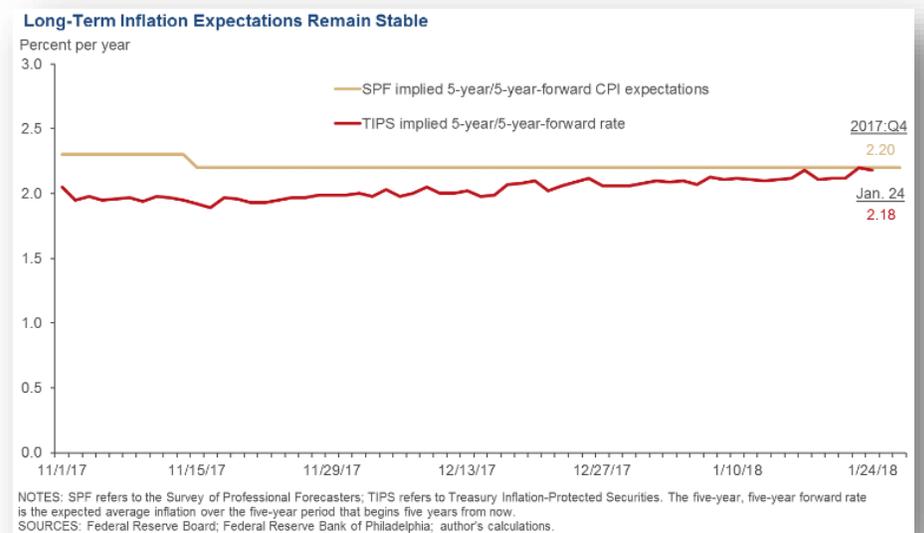
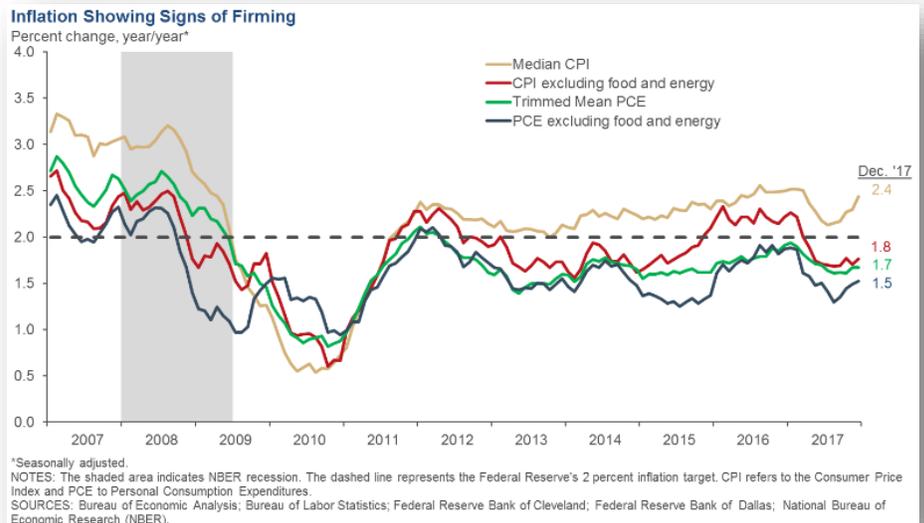
average inflation over the five-year period that begins five years from now) have dipped to 2.2% from 2.3%. They have been hovering around 2.2% -to 2.3% for a long time and seem largely unaffected by recent changes in both fiscal and monetary policies. The five-year/five-year-forward Treasury Inflation-Protected Securities-implied breakeven inflation rate is at 2.2%, little changed since early December.

### ↕ Core Inflation Measures Show Signs of Firming

Recent inflation data show that measures of core inflation remain below the FOMC's 2% target but seem to be slightly advancing. The 12-month core Consumer Price Index (CPI), which measures all items excluding food and energy, rose to 1.8% in December from 1.7% in November. Core personal consumption expenditures (PCE) inflation in December remained the same as it was in November at 1.5% on a year-over-year basis. Likewise, the Dallas Fed's Trimmed Mean PCE inflation measure in December was unchanged from November at 1.7% year over year. But recent measures of core inflation, both CPI and PCE, have begun to tick upward and close in on the 2% target. The Survey of Professional Forecasters projects that core PCE inflation will reach 2% by 2019.

### ↕ Long-Term Inflation Expectations Well-Anchored

Long-term inflation expectations have remained stable. The Survey of Professional Forecasters' implied five-year/five-year-forward CPI inflation expectations (expected



## U.S. ECONOMY AT A GLANCE

### U.S. BUREAU OF LABOR STATISTICS

Data Series	Aug 2017	Sept 2017	Oct 2017	Nov 2017	Dec 2017	Jan 2017
<b>Unemployment Rate</b> <sup>(1)</sup>	4.4	4.2	4.1	4.1	4.1	4.1
<b>Change in Payroll Employment</b> <sup>(2)</sup>	221	14	271	216	(P) 160	(P) 200
<b>Average Hourly Earnings</b> <sup>(3)</sup>	26.39	26.51	26.47	26.54	(P) 26.65	(P) 26.74
<b>Consumer Price Index</b> <sup>(4)</sup>	0.4	0.5	0.1	0.3	0.2	0.5
<b>Producer Price Index</b> <sup>(5)</sup>	0.3	0.3	(P) 0.5	(P) 0.4	(P) 0.0	(P) 0.4
<b>U.S. Import Price Index</b> <sup>(6)</sup>	0.6	0.8	0.2	(R) 1.0	(R) 0.2	(R) 1.0

**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) Final Demand, 1-month percent change, seasonally adjusted.  
(6) All imports, 1-month percent change, not seasonally adjusted.  
(R) Revised.  
(P) Preliminary.

Data Series	4 <sup>th</sup> Qtr 2016	1 <sup>st</sup> Qtr 2017	2 <sup>nd</sup> Qtr 2017	3 <sup>rd</sup> Qtr 2017	4 <sup>th</sup> Qtr 2017
<b>Employment Cost Index</b> <sup>(1)</sup>	0.5	0.8	0.5	0.7	0.6
<b>Productivity</b> <sup>(2)</sup>	1.3	0.1	1.5	(R) 2.7	-0.1

**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: February 27, 2018

## THE FEDERAL RESERVE BOARD THE BEIGE BOOK – MARCH 7, 2018 EXCERPT

### *Overall Economic Activity*

Economic activity expanded at a modest to moderate pace across the 12 Federal Reserve Districts in January and February. Consumer spending was mixed, as non-auto retail sales increased in just over half of the Districts while auto sales declined or were flat in every District. Tourism activity was broadly solid, with Atlanta and Richmond recording robust growth in this sector. On balance, Districts reported modest growth in home sales and construction, with the latter constrained by shortages of labor and materials. Conditions in the nonresidential real estate market improved moderately since the previous report, with robust construction activity noted in three Districts. Commercial rents in and around New York City were up significantly, according to contacts in the area. Increases in production were broad-based across manufacturing sectors, with all but one District noting at least modest growth in activity. Loan volumes were generally flat, with a handful of Districts noting a modest decrease in delinquency rates. Among reporting Districts, agricultural sector activity was mixed but flat overall. Contacts in natural resource sectors saw modestly improving industry conditions, except in the Minneapolis District, where energy and mining activity was robust.

### *Highlight of Dallas Federal Reserve*

Economic activity grew moderately, with sectors like manufacturing and energy continuing their solid expansions, while others cooled somewhat. Growth in nonfinancial services activity slowed slightly, as did loan growth, and retail sales fell modestly. Hiring remained solid despite a tight labor market, and wage and price pressures remained elevated and, in some cases, strengthened.

# ECONOMIC REPORTS AND FORECASTS: STATE OF TEXAS

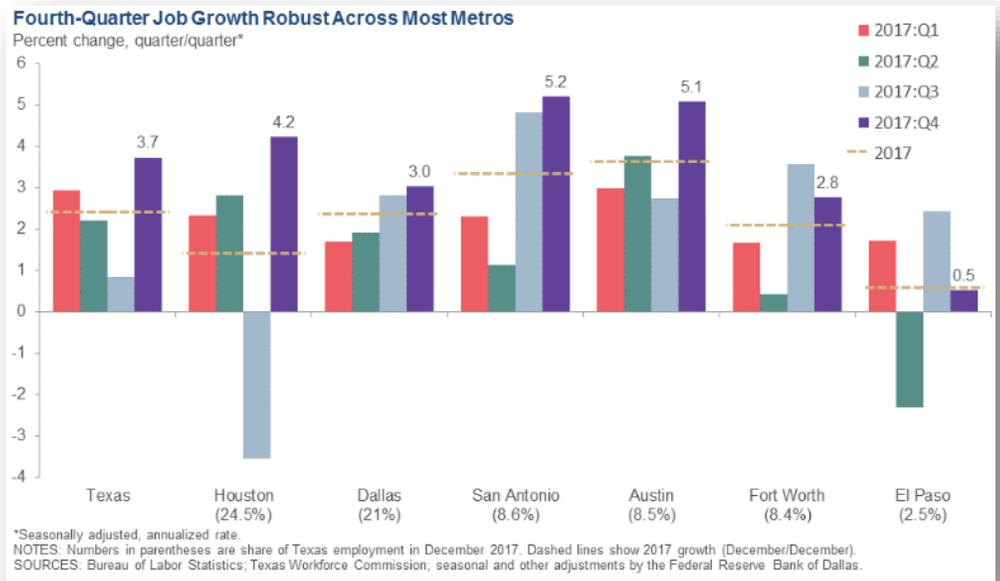
## FEDERAL RESERVE BANK, DALLAS REGIONAL ECONOMIC UPDATE

February 2018 - [www.dallasfed.org](http://www.dallasfed.org)

### ↑ Thriving Texas Economy Expands Broadly

The Texas economy continues its broad expansion. Texas employment growth accelerated in the fourth quarter and was strong across most metros and industries. The Dallas Fed's Texas Business Outlook Surveys (TBOS) showed notable strength in revenue and production in January, with the three-month moving averages of the headline indexes at levels well above their postrecession averages. However, labor markets continue to tighten, and price pressures are mounting.

The Texas economy is benefiting from oil prices above \$60 per barrel, rising exports, business optimism stemming from the new federal tax law and strength in the U.S. economy. Headwinds include uncertainty about North American Free Trade Agreement renegotiations and a tight labor supply dampening the potential for even stronger economic growth going forward.

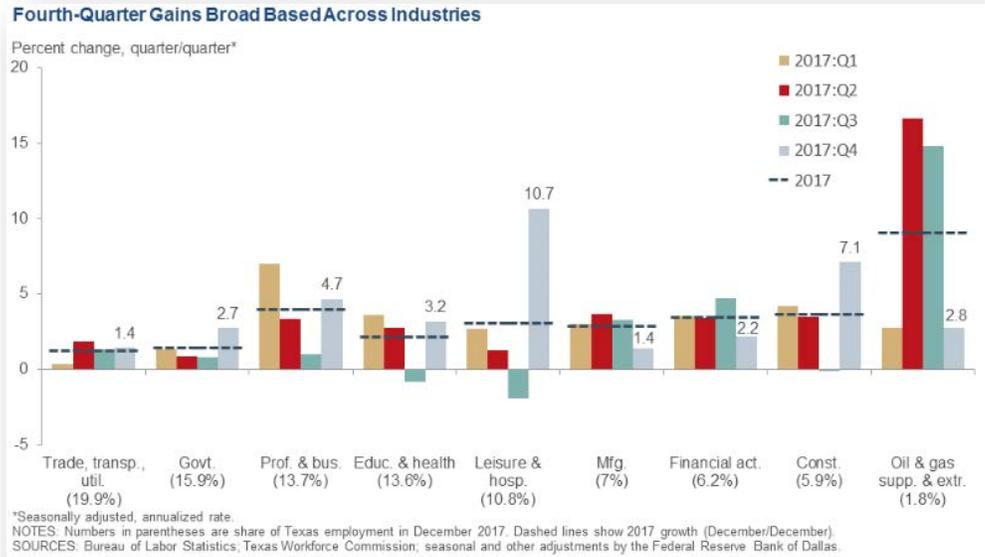


### ↑ Texas Job Growth Robust in Fourth Quarter

Texas added jobs at a 2.4% rate in 2017, ranking No. 4 in the nation after falling below the national average in 2015 and 2016. The Dallas Fed forecasts 2018 Texas job growth of 2.8%.

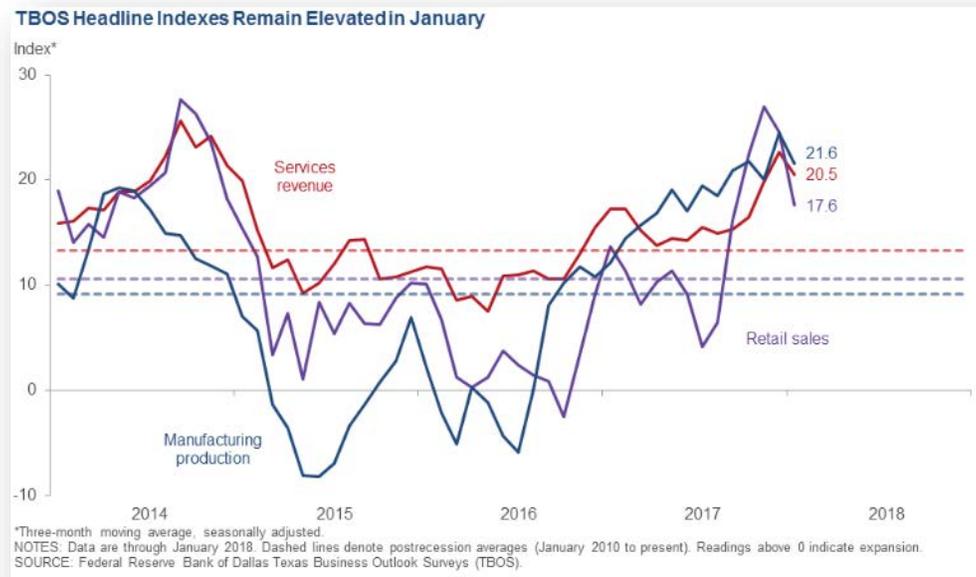
Fourth-quarter job growth in Texas was robust and far reaching—spanning all major metros and industries and indicating economic strength beyond the temporary boost from Hurricane Harvey recovery efforts. The Houston economy rebounded from a hurricane-induced decline in the third quarter—when employment contracted 3.6%—to 4.2% in the fourth quarter. The metropolitan area finished 2017 with 1.4% employment growth after two years of flat employment. San Antonio and Austin posted blistering annual growth rates of 5.2% and 5.1%, respectively, in the fourth quarter. Austin's 3.6% job growth for the year was the highest of the state's major metros.

While fourth-quarter employment growth occurred across major industries, energy sector expansion moderated. Still, the energy sector experienced the greatest 2017 growth (9.0%) among major industries after two years of decline due to the oil bust. Job growth picked up notably in professional and business services in the fourth quarter and surged in leisure and hospitality and in construction—two sectors benefiting from hurricane recovery.



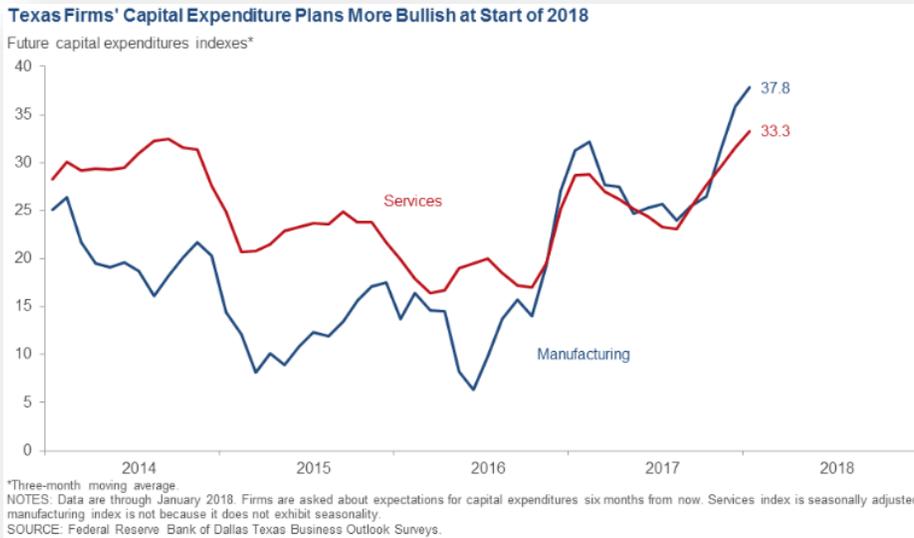
### ↑ Business Activity Ends 2017 on High Note

The Dallas Fed's TBOS paint 2017 as a banner year, with a hearty rebound in manufacturing output and strong retail sales growth, particularly during the second half. While the headline indexes dipped in January 2018, the three-month moving averages remained elevated at levels well above their postrecession averages.



Manufacturing new orders and general business activity indexes surged to 11-year highs in

December. The new orders index edged down in January but remained at its highest point since mid-2006, while the general business activity index strengthened further to its highest level since late 2005. Looking ahead, Texas firms' optimism picked up notably at year end. In January, the service-sector company outlook index advanced for a second month, while the manufacturing sector company outlook index ticked down but remained elevated.

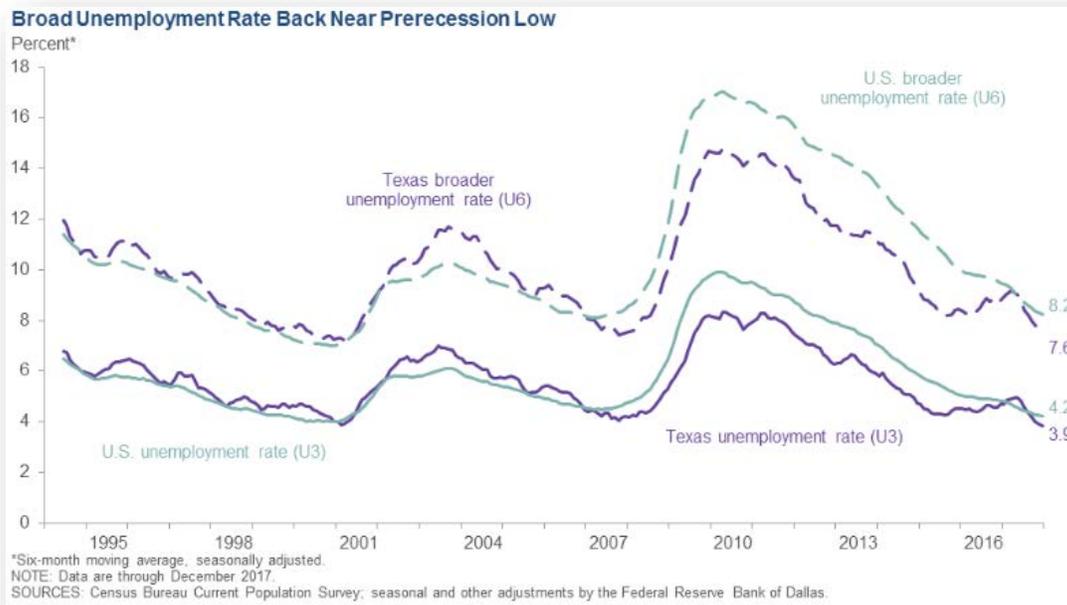


Additionally, a sharp rise in firms' capital spending plans was seen in the December TBOS and was sustained in the January readings. The December survey collection period covered the days that led up to and included the passage of the federal tax code revision, which likely contributed to the jump as the new tax policy includes more favorable deduction rules for capital spending.

### ↑ Tight Labor Market a Headwind for Stronger Growth

A key question facing the Texas economy entering 2018 is the extent to which the state can add jobs when the labor market is very tight. The state unemployment rate is near its all-time low at 3.9%, and firms responding to TBOS report that labor shortages are impairing their growth. Even Texas' U6 unemployment rate—a measure that includes marginally attached workers and those employed part time for economic reasons—has receded to near prerecession lows, suggesting slack in the broader labor market has largely been absorbed.

The wages and benefits indexes across the three TBOSs remain above average, as an increasingly tight labor market continues to translate into wage inflation. Manufacturers are more bullish about future wages—60% of firms expect wages and benefits will be higher six months from now, pushing the future



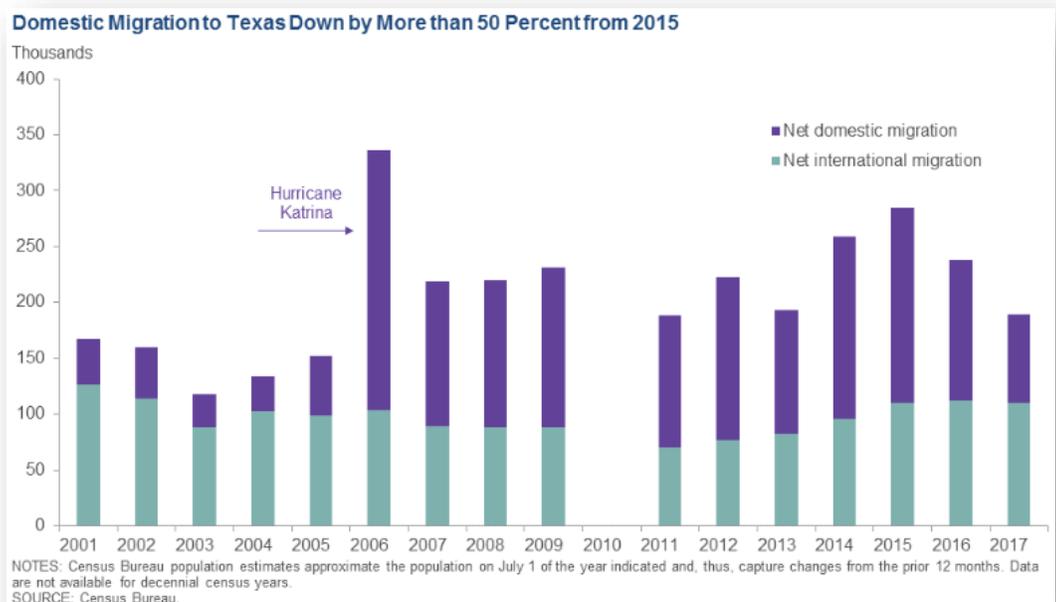
wages and benefits index to 56.9 in January, its second-highest reading since the series began in 2004 and more than 20 points above its postrecession average.

## ↑ Strong Population Growth Continues in 2017

The Texas population gained nearly 400,000 new residents from July 2016 to July 2017, representing the largest population gain among the states. This 1.4% growth rate is the seventh fastest in the U.S. Just over half of the state's population growth was from natural increase (births minus deaths), while the rest was from net international and domestic migration.

Net international migration to Texas was roughly 110,000 over the period, largely unchanged from the prior two years but up 15% from the 12 months ended in July 2014. Texas continues to experience the fourth-largest net inflow of international migrants among the states.

The number of domestic migrants to Texas fell by more than half between the periods of July 2014 to July 2015 and July 2016 to July 2017, as the oil bust damped the Texas economy during a period of relative strength elsewhere in the U.S. Despite the easing in net domestic migration to Texas, the state still recorded the second-largest net inflow of domestic migrants in the most recent period, trailing only Florida. With Texas now once again posting robust job growth relative to the U.S., domestic migration to the state might pick up going forward.



## ↕ Texas Core Inflation Continues to Accelerate

Texas core inflation has picked up slightly in recent months. The 12-month change in Texas core consumer price index (CPI) edged up to 2.2% in October and 2.3% in November. For Texas headline CPI, the 12-month change ticked up to 2.9% in October then edged back to 2.7% in November.

Firms responding to TBOS indicate that upward pressure on input and selling prices remained elevated across the board in January, with increases in the three-month moving averages of the input prices index and selling prices index in the manufacturing and services surveys. The three-month moving average of the selling prices index reached its highest level since mid-2011 among manufacturers and since September 2007 among services firms.

Looking ahead, the TBOS future price measures suggest inflation in Texas will likely continue rising. The manufacturing survey's six-months-ahead future selling prices index remained elevated in January after reaching a 10-year high in December. The service sector survey's future selling prices index rose for the third month in January, also reaching a 10-year high.



## TEXAS ECONOMIC STATISTICS U.S. BUREAU OF LABOR STATISTICS

Data Series	July 2017	Aug 2017	Sept 2017	Oct 2017	Nov 2017	Dec 2017
<b>Labor Force Data</b>						
Civilian Labor Force <sup>(1)</sup>	<sup>(2)</sup> 13,538.2	<sup>(2)</sup> 1,557.4	<sup>(2)</sup> 13,577.7	<sup>(2)</sup> 13,592.1	<sup>(2)</sup> 13,593.5	<sup>(2)</sup> 13,591.0
Employment <sup>(1)</sup>	<sup>(2)</sup> 12,981.5	<sup>(2)</sup> 13,011.8	<sup>(2)</sup> 13,039.3	<sup>(2)</sup> 13,057.4	<sup>(2)</sup> 13,057.3	<sup>(2)</sup> 13,053.3
Unemployment <sup>(1)</sup>	<sup>(2)</sup> 556.7	<sup>(2)</sup> 545.6	<sup>(2)</sup> 538.4	<sup>(2)</sup> 534.7	<sup>(2)</sup> 536.2	<sup>(2)</sup> 537.7
Unemployment Rate <sup>(3)</sup>	<sup>(2)</sup> 4.1	<sup>(2)</sup> 4.0	<sup>(2)</sup> 4.0	<sup>(2)</sup> 3.9	<sup>(2)</sup> 3.9	<sup>(2)</sup> 4.0
<b>Nonfarm Wage and Salary Employment</b>						
Total Nonfarm <sup>(4)</sup>	12,328.4	12,328.4	12,323.4	12,390.7	12,444.3	<sup>(P)</sup> 12,444.7
12-month% change	2.5	2.4	2.1	2.6	2.7	<sup>(P)</sup> 2.5
Mining and Logging <sup>(4)</sup>	242.9	243.5	247.5	247.6	248.6	<sup>(P)</sup> 245.4
12-month% change	12.6	13.6	15.5	15.5	15.0	<sup>(P)</sup> 13.5
Construction <sup>(4)</sup>	712.2	711.3	715.9	721.2	728.5	<sup>(P)</sup> 732.8
12-month% change	1.4	1.7	2.1	2.6	3.3	<sup>(P)</sup> 4.0
Manufacturing <sup>(4)</sup>	875.2	878.0	877.7	876.7	880.6	<sup>(P)</sup> 878.2
12-month% change	3.7	4.3	4.4	4.2	4.7	<sup>(P)</sup> 4.3
Trade, Transportation, and Utilities <sup>(4)</sup>	2,443.4	2,450.8	2,448.2	2,460.2	2,470.5	<sup>(P)</sup> 2,460.0
12-month% change	0.8	1.1	0.9	1.3	1.3	<sup>(P)</sup> 0.5
Information <sup>(4)</sup>	193.3	191.9	191.2	189.9	188.5	<sup>(P)</sup> 192.1
12-month% change	-4.4	-5.0	-5.5	-5.4	-6.4	<sup>(P)</sup> -4.6
Financial Activities <sup>(4)</sup>	758.2	757.3	762.2	765.2	797.3	<sup>(P)</sup> 765.2
12-month% change	3.4	3.2	3.6	3.6	3.8	<sup>(P)</sup> 3.5
Professional & Business Services <sup>(4)</sup>	1,680.3	1,674.9	1,679.6	1,685.9	1,700.1	<sup>(P)</sup> 1,699.8
12-month% change	3.0	2.7	2.5	3.1	3.4	<sup>(P)</sup> 3.2
Education & Health Services <sup>(4)</sup>	1,688.8	1,688.3	1,680.5	1,684.0	1,689.8	<sup>(P)</sup> 1,689.3
12-month% change	3.2	2.9	2.2	2.1	2.3	<sup>(P)</sup> 1.9
Leisure & Hospitality <sup>(4)</sup>	1,327.3	1,330.5	1,310.9	1,340.5	1,348.2	<sup>(P)</sup> 1,355.0
12-month% change	2.9	2.8	1.1	2.8	2.9	<sup>(P)</sup> 3.2
Other Services <sup>(4)</sup>	448.7	442.7	446.1	448.6	448.7	<sup>(P)</sup> 449.1
12-month% change	6.5	5.0	3.8	4.5	4.5	<sup>(P)</sup> 4.7
Government <sup>(4)</sup>	1,958.1	1,959.2	1,963.6	1,971.0	1,973.5	<sup>(P)</sup> 1,977.8
12-month% change	1.4	1.4	1.5	1.9	1.9	<sup>(P)</sup> 1.9
<b>Footnotes</b>			<sup>(3)</sup> Number of jobs, in thousands, seasonally adjusted.			
<sup>(1)</sup> Number of persons, in thousands, seasonally adjusted.			<sup>(P)</sup> Preliminary.			
<sup>(2)</sup> In percent, seasonally adjusted.						

Data extracted on: March 5, 2018

# FEDERAL RESERVE BANK

## SENIOR LOAN OFFICER OPINION SURVEY

The January 2018 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, which generally corresponds to the fourth quarter of 2017. Responses were received from 71 domestic banks and 23 U.S. branches and agencies of foreign banks. Unless otherwise indicated, this summary refers to the responses of domestic banks.

Regarding loans to businesses, respondents to the January survey indicated that, on balance, banks eased their standards and terms on commercial and industrial (C&I) loans to large and middle-market firms while demand for such loans was basically unchanged. Meanwhile, banks' standards on most categories of commercial real estate (CRE) loans tightened, while demand for CRE loans reportedly weakened.

For loans to households, banks reported that, on balance, their lending standards on consumer loans, as well as for most categories of residential real estate loans, remained basically unchanged over the third quarter. Meanwhile, banks reported weaker demand for auto loans and residential mortgages.

Banks also responded to a set of special questions inquiring about their outlook for lending policies and loan performance over 2018. On balance, banks reported expecting to ease standards on residential mortgages and C&I loans to large and middle-market firms, while expecting to tighten standards on CRE loans and credit card loans. Demand for C&I loans is also expected to strengthen on net. Meanwhile, banks anticipate that loan performance will improve, on net, for C&I loans while deteriorating for consumer loans. The performance of most categories of loans backed by real estate is expected to remain basically unchanged on net.

### BUSINESS LENDING

#### C&I Loans

A moderate net percentage of banks reported that they eased standards for C&I loans to large and middle-market firms over the past three months, while lending standards remained basically unchanged, on net, for loans to small firms. Further, terms on such loans followed a similar pattern, on balance, with most terms on loans to large and middle-market firms having been eased, while terms on loans to small firms remained basically unchanged.

Specifically, for C&I loans to large and middle-market firms, moderate net percentages of banks reportedly decreased loan rate spreads, increased the maximum size of credit lines, and eased loan covenants. Other surveyed terms on these loans were reported as having been eased by a modest net share of banks or were basically unchanged. Banks reported all terms on C&I loans to small firms were basically unchanged on net.

Among the domestic respondents that reportedly eased their credit policies on C&I loans over the past three months, more aggressive competition from other banks or nonbank lenders was by far the most emphasized reason for easing. Nearly every bank that reported having eased standards attributed this change, in part, to more aggressive competition, with a majority of respondents indicating that the reason was "very important." No other reason queried was cited as important by a majority of banks, nor was any other reason cited as "very important" by more than a couple of banks. However, significant shares of banks additionally reported that improvements in the favorability or certainty of the economic outlook, improvement in industry-specific problems, increased risk tolerance, and increased secondary market liquidity also contributed to their having eased standards on C&I loans.

Regarding the demand for C&I loans, a modest net share of domestic banks reported that demand for C&I loans from small firms strengthened, while demand for such loans from large and middle-market firms was basically unchanged on net. A majority of banks indicated that increases in customers' needs to finance inventory, accounts receivable, mergers and acquisitions, and investment in plants and equipment contributed to stronger demand, as did a shift in customers' borrowing toward other bank or nonbank sources. Meanwhile, the number of inquiries from potential business borrowers regarding the availability and terms of new credit lines or increases in existing lines reportedly remained basically unchanged over the past three months on net.

All foreign banks surveyed responded that their standards for C&I loans remained basically unchanged over the fourth quarter; however, they reportedly eased several loan terms. In particular, moderate net shares of foreign banks reported looser loan covenants, increased maximum sizes of credit lines, and decreased loan rate spreads and premiums charged on riskier loans. Meanwhile, demand for C&I loans

and inquiries from businesses about credit lines reportedly remained basically unchanged on balance.

### CRE Lending

Moderate net fractions of banks reported tightening their standards for loans secured by multifamily residential properties and loans for construction and land development purposes, while banks reportedly left standards for loans secured by nonfarm nonresidential properties basically unchanged on net.

Meanwhile, modest net fractions of banks reported weaker demand for multifamily and construction and land development loans, while demand for loans secured by nonfarm nonresidential properties was basically unchanged on net.

A modest net share of foreign banks reported tighter standards for CRE loans. In contrast to domestic respondents, a moderate net share of foreign banks indicated that demand for CRE loans strengthened in the fourth quarter.

## LENDING TO HOUSEHOLDS

### Residential Real Estate Lending

On balance, banks reported that standards for residential home purchase mortgage lending remained basically unchanged over the past three months, with the exception of mortgages eligible to be securitized by government sponsored enterprises (GSE-eligible), for which a moderate net share of banks reported easing their underwriting standards. Similarly, banks reported that standards for revolving home equity lines of credit (HELOCs) remained basically unchanged on balance.

Meanwhile, moderate net shares of banks reported weaker demand for all categories of residential mortgages, and a modest net share of banks reported weaker demand for HELOCs.

### Consumer Lending

Banks reported that standards for all categories of consumer loans were basically unchanged, on balance, over the fourth quarter. However,

banks did indicate that some consumer loan terms became tighter. For credit card loans, modest net shares of banks reportedly increased their minimum required credit scores and decreased the extent to which loans are granted to customers that do not meet credit scoring thresholds. For auto loans, modest net shares of banks reportedly widened loan rate spreads and increased minimum required credit scores and monthly repayment rates. Terms and conditions for consumer loans other than credit card and auto loans were mostly unchanged, although a modest net share of banks reported a decreased willingness to grant loans to customers who do not meet credit scoring thresholds.

Meanwhile, a modest net share of banks reported weaker demand for auto loans, while demand for credit card loans and other consumer loans remained basically unchanged in the fourth quarter on balance.

## OUTLOOK FOR LENDING PRACTICES, CONDITIONS, AND LOAN PERFORMANCE OVER 2018

A set of special questions asked banks about their expectations for lending practices and conditions over 2018, assuming that economic activity progresses in line with consensus forecasts. On balance, banks reported expecting to ease standards on residential mortgages and C&I loans to larger firms while tightening standards on CRE loans and credit card loans.

Regarding expectations for the C&I loan market, a moderate net fraction of banks reported that they expect to ease lending standards on loans to large and middle-market firms, while a significant net share of banks expects to narrow loan rate spreads for these firms. In contrast, lending standards and interest rate spreads for small firms are expected to remain basically unchanged on balance. Significant net shares of banks expect demand for C&I loans from small and large firms to strengthen over 2018.

On balance, banks expect to tighten standards across all categories of CRE loans over 2018. A significant net fraction of banks reported that they expect to tighten lending standards on loans secured by multifamily residential properties. Meanwhile, a moderate and modest net fraction of banks reported expecting to tighten lending standards on construction and land development loans and loans secured by nonfarm nonresidential properties, respectively.

The expected changes in lending standards for loans to households over the next year were somewhat mixed. On the one hand, moderate net shares of banks reported expecting to ease standards on GSE-eligible and nonconforming jumbo residential mortgage loans. On the other, a modest net share of banks reported expecting to tighten standards for approving credit card loans over 2018. Standards for approving auto loan applications are expected to remain basically unchanged on balance.

Foreign banks, on net, reported that they expect lending standards for C&I loans to remain basically unchanged over 2018 for both small and large and middle-market firms. In addition, a moderate net fraction of these banks anticipate narrowing loan rate spreads for large firms, while spreads on loans to small firms are expected to remain basically unchanged over this period. A moderate net share of foreign banks expect demand for C&I loans from small firms to strengthen; these banks expect demand from larger firms to remain basically unchanged on net. Regarding CRE loans, a significant net fraction of foreign banks expect to tighten lending standards on construction and land development loans over 2018, with moderate net fractions of these banks expecting to tighten lending standards on loans secured by nonfarm nonresidential properties and multifamily residential properties.

A second set of special questions asked about banks' expectations for asset quality for 2018, as measured by their outlook for loan charge-offs and delinquencies, assuming that economic activity progresses in line with consensus forecasts.

Regarding expectations for the performance of loans to businesses, modest net fractions of banks reported that they expect the quality of syndicated nonleveraged loans and nonsyndicated loans to large and middle-market firms to improve over 2018, while the performance of loans to small firms and syndicated leveraged loans are expected to remain basically unchanged on net. Meanwhile, banks, on balance, reported little change to their outlook for delinquencies and charge-off rates for loans secured by multifamily residential properties or nonfarm nonresidential properties, whereas a modest net fraction of banks reported expecting the performance of construction and land development loans to deteriorate somewhat over 2018. Foreign banks were less optimistic about the quality of C&I loans, with moderate net shares of banks expecting the performance of syndicated leveraged loans and C&I loans to small firms to deteriorate somewhat while expecting other loans to large and middle-market firms to remain unchanged on balance.

Regarding the expected performance of loans to households, banks reported expecting the quality of residential mortgages to remain around current levels, although a modest net share of banks expect the performance on HELOCs to deteriorate over 2018. Banks had a less optimistic outlook regarding the quality of consumer loans, with a significant net share of banks reporting that they expect the asset quality of credit card loans to deteriorate over 2018 and a moderate net share of banks expecting the quality of auto loans to do so.

# ACKNOWLEDGEMENTS AND RESOURCES

*American Banker, New York, New York*  
*Austin American-Statesman, Austin, Texas*  
*Baker Hughes, San Antonio, Texas*  
*BankInnovation.net online*  
*Board of Governors of the Federal Reserve System, Washington, D.C.*  
*Blumberg Capital, San Francisco, California*  
*Dallas Morning News, Dallas, Texas*  
*Department of Savings and Mortgage Lending, Austin, Texas*  
*Eide Bailly LLP, Fargo, North Dakota*  
*Houston Chronicle, Houston, Texas*  
*Federal Deposit Insurance Corporation, Washington, D.C.*  
*Federal Reserve Bank of Dallas, Dallas, Texas*  
*Federal Reserve Bank of St. Louis, St. Louis, Missouri*  
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*State Demographic Center, San Angelo, Texas*  
*Texas A&M AgriLife Extension Service, College Station, Texas*  
*Texas Association of Realtors, Austin, Texas*  
*Texas Comptroller of Public Accounts, Austin, Texas*  
*Texas Department of Banking, Austin, Texas*  
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*Yahoo Finance, online*

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