# Condition of the Texas State Banking System

September 2018

Texas Department of Banking

Texas Department of Savings and Mortgage Lending

Financial Data as of June 30, 2018

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| **Symbols Used Throughout this Report**: | | **Abbreviations Used Throughout this Report**: |
|---|---|---|
| ⇧ | 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 |

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# ECONOMIC REVIEW AND OUTLOOK

Texas banks are well positioned to build on the positive momentum which began in 2018. The state's financial institutions continue to benefit from increased profitability, healthier asset quality, and strong loan growth.

The industry segued into 2018 with momentum after the boost it received in late 2017 from higher oil prices, increased exports, and optimism borne from changes to federal tax laws which led to expanding regional and national economies.

Asset quality and commercial and industrial (C&I) loan portfolios strengthened due to the recovery in the energy sector. This was supported by the responses received on the Texas Department of Banking's second quarter *Banker Economic and Business Survey.*

Banks' overall loan growth increased due to healthier commercial real estate (CRE) portfolios for most financial institutions. Respondents to the survey also supported this point, with thirty-two percent indicating that CRE activity increased or significantly increased and 66% reporting increases or significant increases in commercial lending.

Fifty-two percent of state-chartered banks surveyed reported an increase in total assets and 57% reported an increase in deposits. Fifty-five percent of banks responding to the survey noted an increase in loans, while 43% exhibited an increase in general business activity. The complete *Banker Economic and Business Survey* is available on the Texas Department of Banking's website.

The federal tax cuts enacted at the end of 2017, and a corresponding increase in federal spending approved in February 2018, helped push the U.S. economy by August into its tenth year of expansion. Robust consumer spending, above-trend labor force growth, and rising business and consumer sentiment is expected to support continued growth through the remainder of 2018.

As interest rates continue to rise from historic lows, the Federal Reserve Bank of Dallas (FRB Dallas) notes the impact on funding costs will bear watching, particularly among relatively smaller community banks. In addition, overall financial industry growth and increased competition from nontraditional institutions may compel banks to pay more to maintain or enlarge their deposit base.

Several changes affecting banks and other financial institutions took effect in the second quarter of 2018. Most significant, President Trump signed legislation in May providing regulatory relief from certain provisions of the Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). Further discussion on this legislation may be found in the *Supervisory Concerns* section of this report.

Segments of the banking industry, meanwhile, continue to pursue consolidation as a means of achieving greater economies of scale, expanding business lines or geographic reach, or reducing costs through operational efficiencies. While the industry will always benefit from greater efficiencies, consolidation on a significant scale will become a concern should it reduce access to credit and banking services, especially in rural areas of the state.

Lastly, the financial services industry continues to face the increasing – and more sophisticated – threat of cybercrimes. IT Governance, a provider of technology risk management and compliance solutions, estimates there were 139.7 million personal records worldwide leaked, stolen, other otherwise compromised in July 2018 alone.

Legislative efforts to prevent such leaks or mitigate their impact, however, appear to have lost all momentum since the early weeks after the massive 2017 Equifax data breach, a cybersecurity event affecting an estimated 146 million consumers.

## State-Chartered Banking Profile (Department of Banking)

There were 237 Texas state-chartered banks as of June 30, 2018, three fewer than at year-end 2017. The net reduction in the number of state banks during the first half of 2018 resulted from five reductions and two additions.

The decline was due solely to mergers of which two were into Texas national banks, two were into out-of-state state-chartered banks, and one was into a Texas state bank. The loss of these five banks was partially offset by the conversion of two national banks to Texas state charters.

During the same period, the Department processed 109 filings related to banks, with approximately 53% involving office facilities and loan production office activity, 24% involving changes in ownership/control or chartering authority, 13% involving bank identification and corporate governance issues, 6% involving subsidiary formations, and 4% involving foreign bank activity.

Like the modest decline in the number of Texas state-chartered banks, the overall asset size of Texas state-chartered banks decreased from $259.4 billion at year-end 2017 to $257.8 billion as of June 30, 2018. The asset decline resulted from $4.9 billion in merger-related activity offsetting organic asset growth of $3.1 billion and an additional $0.2 billion in assets from conversion activity.

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

State-chartered thrift assets under the Department's jurisdiction totaled $22.6 billion as of June 30, 2018, an increase of 9.9% or $2 billion from this time last year. The total number of state-chartered savings banks decreased by two.

Through June 30, 2018, state thrifts had $170.3 million in year-to-date net income. Increased profitability occurred in 70.8% of the thrift institutions since the middle of 2017, due to an increase in the volume of loans at most institutions and non-interest income to assets increasing 35 basis points to 1.3%, while overhead expenses remained at 2.5%. No thrift charters were unprofitable as of June 30, 2018, the same as last June.

The level of nonperforming loans and other real estate foreclosed remains low in state-chartered thrifts at 1.9% of total assets. State and federal regulators continue to closely monitor past due and nonaccrual loans, as well as foreclosed real estate.

The Department continues to receive and process applications, administering seven branch office applications, one branch office relocation application, two merger/reorganization applications, one purchase and assumption application, one change of control application, and ten various other applications during the past 12 months.

## Texas Economic Profile

The Texas economy continued to expand through the second quarter of 2018 amidst increased activity in the manufacturing and service industries, yet uncertainty developed in the form of domestic tariffs which have the potential to diminish the rate of future growth.

Economic activity accelerated over first quarter figures, as the FRB Dallas' Business-Cycle Index averaged 5.5% over a quarterly seasonally adjusted annualized rate, reaching levels the state has not experienced since 2014. Elevated oil prices continued to drive the Houston economy, pushing growth up 8.9%, while a mushrooming technology sector boosted Austin's index to 6.1%. North Texas economies

experienced more modest expansion rates of 5.0% and 3.6% in Dallas and Fort Worth, respectively, while the San Antonio index rose 2.1%.

The Texas Leading Economic Index (a measure of future directional changes in the business cycle) trended positive but slowed to 5.7% growth year over year. The minor slowdown led to downward revisions from 3.6% to 3.3% growth in the FRB Dallas' 2018 statewide employment forecast. Gains in the Texas trade-weighted value of the dollar offset higher oil prices, low unemployment, and growth in the national economy.

Looking ahead, growth in the Texas economy is projected to continue to outpace that of the nation over the next five years. The Perryman Group, a Waco-based economic forecasting firm, is projecting the Texas economy will add approximately 1.4 million net new jobs between 2018 and 2022, a 2.05% annual rate of growth over the five-year period.

Service industries will likely drive future job gains, with net new jobs concentrated in healthcare. Wholesale and retail trade businesses are also expected to see significant hiring.

While economic conditions remain chiefly optimistic, uncertainty began to creep upwards by late second quarter. Among the potential concerns:

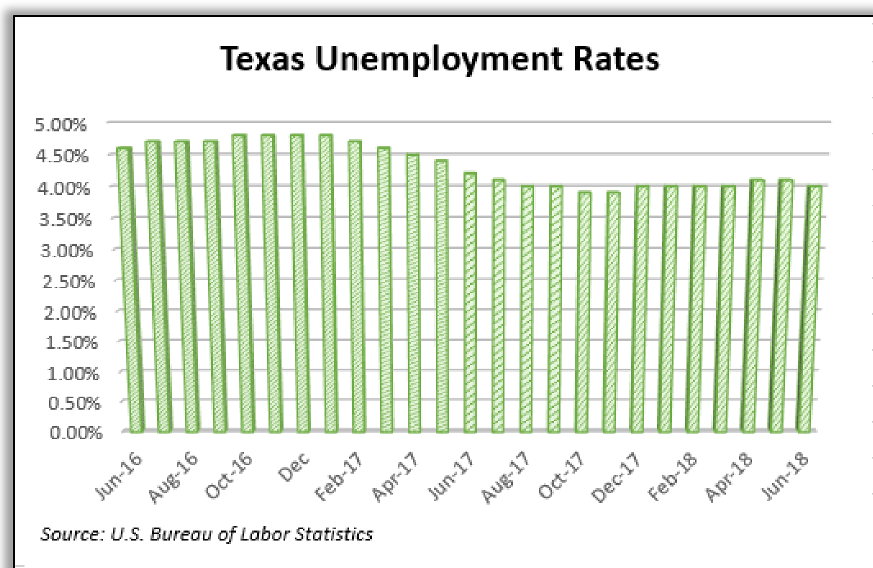
- Trade tariffs on steel and aluminum put in place by the Trump Administration are negatively impacting the Texas economy. Because steel accounts for a significant share of expenses associated with drilling rigs and pipelines, one industry group cited by the *Fort Worth Star-Telegram* estimated the new tariffs could increase the cost of well completions in the Permian Basin by up to 10% while slowing production and exports of crude oil and natural gas.

- While state tax revenue is not as dependent on the oil and gas industry as it once was, it continues to play a substantial role in job creation through its "ripple effect." Should market conditions cause expenses to rise too high or oil prices to drop below $48 per barrel, roughly the average breakeven price for drilling new wells in Texas' most productive oil fields, the effect would be felt throughout the state's economy.

- The state's dependence on international trade makes Texas vulnerable to disruptions. Nearly half of its exports go to Mexico and Canada, and alterations to the North American Free Trade Agreement (NAFTA) will likely negatively impact Texas manufacturers and their suppliers.

***Employment***

Texas continues to be the premier state in the nation in which to do business, despite a slight slowdown in employment at mid-year. The Lone Star State again won *Site Selection Magazine*'s 2017 Governor's Cup, an annual award that recognizes the top-performing states for business and job creation. The 2017 Governor's Cup is a record-breaking sixth in a row for Texas and the 14th overall win.




The state's economy added 23,500 seasonally adjusted nonfarm jobs in July 2018, according to the Texas Workforce Commission. This marked 25 consecutive months of employment growth; however, it was the smallest monthly increase of 2018, indicating that rapid gains at the beginning of the year have cooled.

Year over year, Texas added 359,500 jobs for an annual employment growth rate of 2.9%. Improved job opportunities continue to draw more employees into the workforce, raising the labor force participation rate to 64%, a three-year high. As of June 2018, the Texas nonfarm labor force totaled a seasonally-adjusted 12,596,700.

The Midland metropolitan statistical area (MSA) recorded the lowest unemployment rate among Texas MSAs with a non-seasonally adjusted rate of 2.2% in June, followed by the Amarillo and Odessa MSAs each with a rate of 2.9%. The Austin-Round Rock MSA recorded the fourth-lowest rate of 3.1%.

Job creation statewide, however, outpaced the labor force expansion, bringing the unemployment rate in line with the national average at 4%.

Texas payrolls expanded at a 3.6% annualized rate in the first half of the year, ranking number one in the country, up from ninth place in 2017.

***Population***

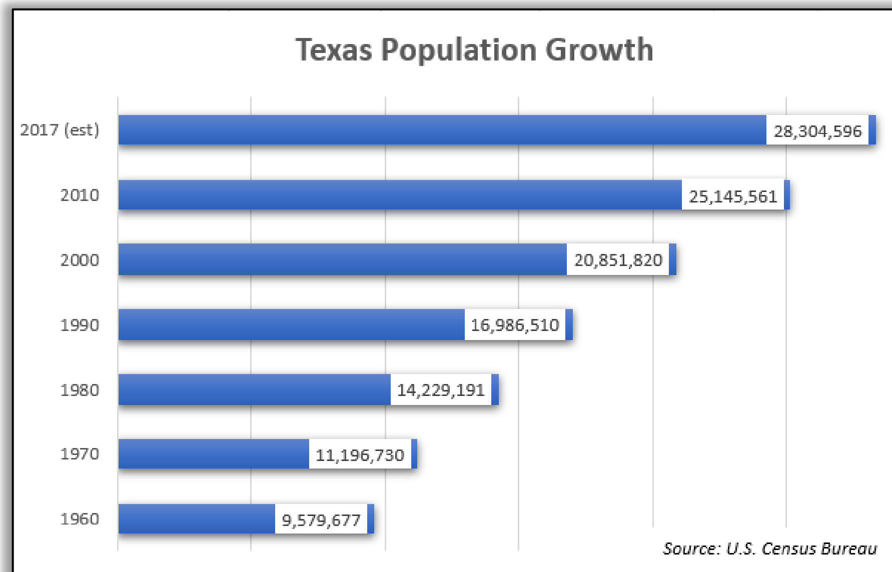
The most recent projections from the U.S. Census Bureau estimate the state's population at 28.3 million, a 12.6% increase since the 2010 census and more than double that of California, the country's most populous state, which experienced a growth rate of 6.1% over the same period.

According to The Perryman Group, the pace of expansion will be even faster in the coming years; the organization predicts Texas' population will grow by about 2.1 million people between 2018 and 2022, reaching 30.5 million.

Of the current 15 fastest-growing cities in the U.S. with populations greater than 50,000, seven are in Texas. Frisco led the nation with a growth rate of 8.2%, some 11 times faster than the national rate of 0.7%.

**Seven of the 15 Fastest Growing U.S. Cities are in Texas**

| #1: Frisco | #2: New Braunfels | #3: Pflugerville |
|---|---|---|
| #6: Georgetown | #9: McKinney | #11: Flower Mound |
| | #13: Cedar Park | |




In terms of raw numbers, San Antonio has welcomed more new residents since 2017 than anywhere in the country; the city's population is now estimated to be above 1.5 million. Austin, Dallas, and Houston also continue to experience strong population growth, and the U.S. Census Bureau estimates Fort Worth surpassed Indianapolis in 2018, joining the other three among the country's 15 most populous cities.

Most of this growth came through domestic migration, and U.S. Census Bureau statistics estimate that 13% of this influx was the result of households relocating from California.

Meanwhile, people migrating from foreign countries continue to immigrate to Texas in large numbers, as international immigrants now account for 17% of the state's total population. Meaning, one in six Texas

residents is an immigrant, while another 15% of its residents are native-born U.S. citizens with at least one immigrant parent.

Most of those immigrating from foreign countries continue to come from Mexico; however, greater numbers of people are immigrating to Texas from El Salvador, Honduras, Guatemala, India and other southeast Asian countries.

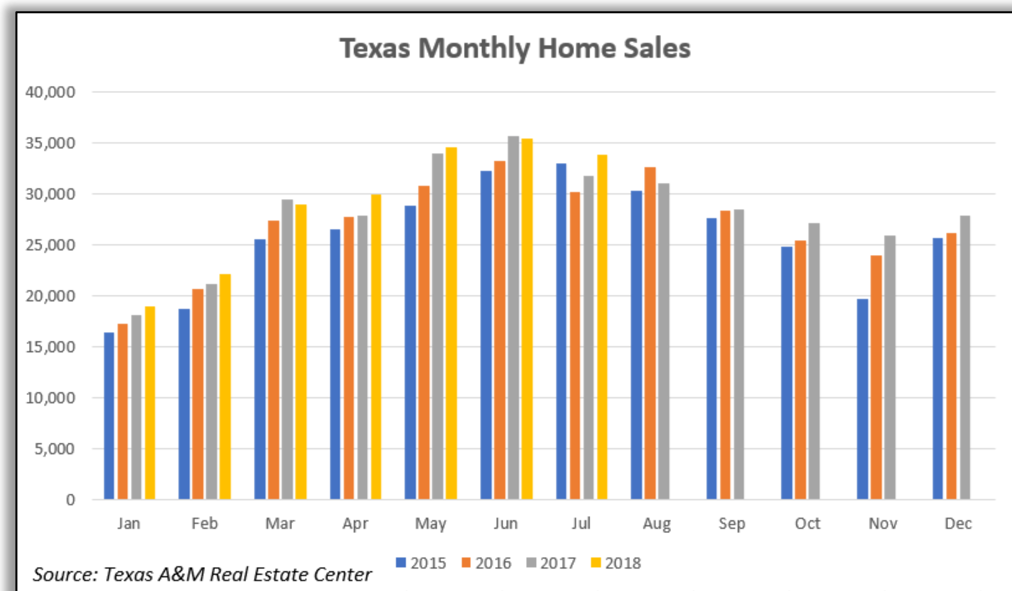
As with those arriving via domestic migration, most new arrivals from other countries are settling in the state's four largest MSAs: Dallas-Fort Worth, Houston, San Antonio, and Austin.

***Housing***

If there is one market segment that could potentially cool a torrid Texas economy, it would be the state's housing sector. Prices continue to climb, albeit at a slightly slower rate than at the beginning of 2018, while inventory levels continue to tighten significantly.

Existing-home sales plateaued during second quarter of 2018, with the number sold in June 4.3% below that of December 2017. This softening is partly a result of slowing in sales of mid-priced homes (priced between $250,000 and $499,000), which made up 33.4% of 2017 sales. The sale of all homes, both new and existing, still increased 27% during this same time.

Thanks to the heated job market resulting from the oil and gas industry's recovery, Midland has become the nation's hottest housing market, according to the National Association of Realtors, beating out the trendier coastal tech centers San Francisco and Boston. The median home price, $370,000, is now more expensive than in the Houston or Dallas-Fort Worth MSAs.




At the same time, a report by the Texas A&M Real Estate Center indicates that the state had a 3.6-month housing inventory at the beginning of the quarter, well below the six months of inventory considered to be a balanced housing market.

Affordable home prices have long played a key role in Texas' economic growth. Affordable housing attracts more people from other states and results in more demand for goods and services, higher economic growth rates, and more jobs attracting more people. However, this advantage is slowly eroding.

Home price indexes published by the Federal Housing Finance Agency show that Texas home prices rose 0.7% in the second quarter of 2018, the slowest rate since 2014. Nevertheless, the index also indicates that Texas prices were 54% higher than a decade ago; nationally, home prices increased just 16% over the same period.

Market forces on both the demand and supply side of the state's housing markets are contributing to these rising prices. On the demand side are higher growth rates for the state's economy and increasing interest rates. On the supply side are increasing land prices, which account for 20% or more of the cost of new-home construction.

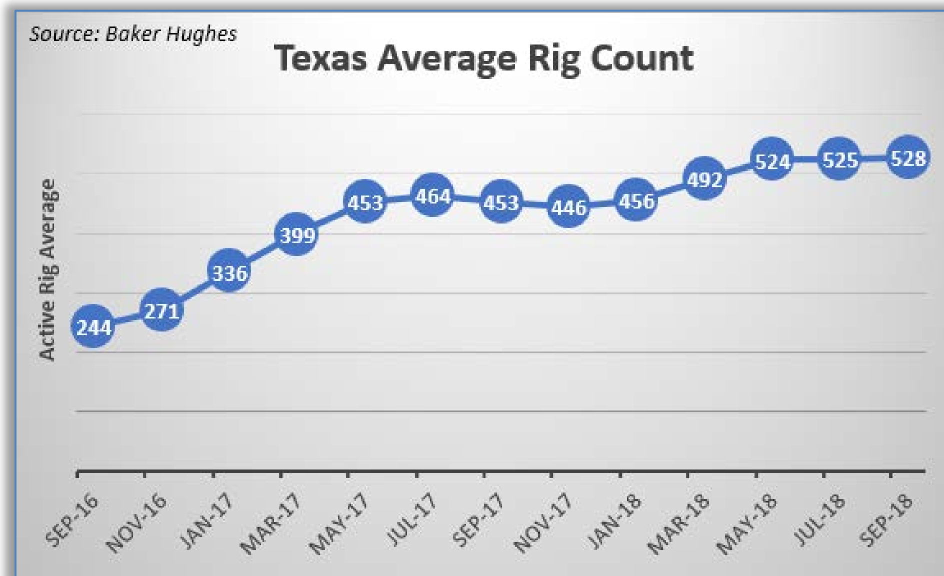
***Oil and Gas***

The oil and gas industry, after spending all of 2016 and early 2017 in the doldrums, came back in 2018.

Advances in research and drilling technology have significantly improved the industry's capacity to find oil and gas, maximize well completion, and recover more product, opening unconventional reserves and revolutionizing the industry.

As a result, the U.S., which is now producing 10.9 million barrels a day, has passed Saudi Arabia and is close to surpassing Russia as the world's leading oil producer. Texas is the largest oil-producing state in the U.S., producing approximately 4.8 million barrels a day.

Texas now produces nearly 44% of the nation's oil. Monthly production, however, has essentially been flat over most of the second quarter; drilling in Texas basins leveled off in June and July, driven in part by the impact of pipeline constraints.




According to industry analysts with Baker Hughes, there were 528 active rigs (both onshore and offshore) at the end of August 2018, down slightly from June's high of 534.

The average West Texas intermediate crude oil price, which began 2018 at $60.37 per barrel, dipped from $73.80 in June to $68.53 per barrel by the end of August amid rising Organization of Petroleum Exporting Countries (OPEC) production targets; however, a drop in U.S. inventories provided upward pressure to end the second quarter.

Texas also continues to be a leading producer of natural gas. The state currently produces 20.3 billion cubic feet per day in natural gas, more than 1.2 times that of Pennsylvania, the state's closest competitor. Natural gas prices at Henry Hub dropped to $3.23 per thousand cubic feet by June, down 0.08% from the previous June. Summer power demand was unlikely to move benchmark pricing, given that gas production is rising as a byproduct of crude oil currently coming out of Texas shale.

Liquefied natural gas (LNG) exports continue to soar. Despite Canadian market factors that resulted in a reduction in exports to that country, causing a dip in Texas' total natural gas pipeline exports, the FRB Dallas expects Texas LNG exports to increase 24% by the end of the year and 136% by the end of 2019.

***Agribusiness***

Extremely dry or full-on drought conditions were affecting approximately 16.2 million Texans as of August, according to the Texas A&M AgriLife Extension, a figure comprising about 65% of the state's population. Conditions were depleting soil moisture, while record high temperatures were taking a toll both on crops and livestock.

The heat and drought combined caused considerable stress and damage to crops and pastures in several parts of the state. In drought-affected areas, pasture and hay struggled and dried up, while cotton fared little better; large quantities of sorghum, cotton, corn, and soybeans fields were lost.

Given the poor pasture and hay growth, many producers were looking to buy hay, which was scarce and expensive due to the widespread need for feeding livestock. Farmers in drought areas were abandoning their grain and other crops, baling them instead for cattle feed.

Adding to the state's agricultural woes, China's 25% tariff on U.S. soybeans will likely slow exports and crimp profits for many Texas farmers, who typically produce $60.9 million worth of product each year. China is the world's largest buyer of U.S. soybeans. Reduced revenue from soybean exports could affect farmers' other financial decisions, potentially delaying large capital expenditures and hurting Texas banks active in this particular agriculture lending.

On a more positive note, Texas rice farmers are experiencing near-record yields of good quality grain and many are considering a second harvest, according to Texas A&M AgriLife research staff. Producers in the rice-growing coastal region were able to take advantage of planting windows before late March avoiding the worst of the heat wave which could have hurt yields.

### *Tax Revenue*

Sales tax receipts for the seven months ending in July 2018 soared to $34.9 billion, or 11.6% higher than the $31.3 billion the state received during the same period a year ago. At $18.7 billion, sales tax revenue was the largest source of funding for the state budget, accounting for more than half of total tax collections (53.5%) through July.

Motor vehicle sales and rental taxes ($2.8 billion), motor fuel taxes ($2.1 billion), and oil and natural gas production taxes ($2.9 billion combined) were other major sources of tax revenue, making up slightly more than 22% of total tax collections.

Taxes derived from oil production in July 2018 were significantly higher than that of July 2017, jumping from $169 million to $292 million, a remarkable 72.7% increase. Natural gas tax revenue increased 40.5% in July 2018 over that of the previous July, rising from $82.4 million to $115.8 million.

In fact, the only source of tax revenue for the state that did not increase from July to July were those tied to the sale of cigarette and tobacco products. Taxes in this category dropped 4.7% to $796.1 million, down from $836.1 million from the previous year.

## Supervisory Concerns

Texas has a strong economy, but economic fluctuations are inevitable. In good times, heightened competition can lead to the easing of underwriting standards and result in asset quality and earnings problems if the economy takes a downward turn.

Most remember the last economic downturn that affected Texas, which occurred ten years ago. The regulatory environment changed dramatically during those years, with more regulations and stricter compliance standards. In this type of environment, bankers had to take appropriate actions to ensure the effectiveness and efficiency of their risk and compliance programs met applicable laws, regulations, and supervisory expectations.

In May 2018, legislative changes were made to reduce the regulatory burden created by Dodd-Frank. The President signed the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA), which includes some revisions to Dodd-Frank. However, since the legislative changes are not a complete repeal of Dodd-Frank, bank management should continue assessing their risk areas and compliance programs.

The EGRRCPA also contained proposed changes to the Volcker Rule, which have since been approved to be issued for comment by the federal regulators.

Regulators note that as banks and thrifts move forward in an era of reduced regulatory burden, there is the possibility of an expansion in financial services and innovation. The processes, quality, and product development are all important areas of risk that must be carefully monitored. It is imperative that any new product line or service be monitored and evaluated to ensure it is viable and safe.

As with any situation, it is essential that bank management identify key trends, challenges, and opportunities that may affect their line of business and influence their risk management strategies. Regulatory expectations continue to focus on the need for improvement within these strategies.

One such risk area is financial crimes risk management. The objective and focus for banks should be the preservation of the integrity of the financial system, domestically and across the globe. Over the past few years, the number of civil and criminal enforcement actions related to anti-money laundering has increased. Technological solutions that effectively detect and prevent fraud can aide and help mitigate these potential crimes.

Regulators expect depository institutions to know their third-party vendors. The idea is for banks to strive to make their efforts effective and efficient to enhance the oversight of third-party risks. Employees should have the expertise to conduct effective due diligence and risk analyses on the bank's vendors to ensure potential risks are properly identified and mitigated. Banks are increasingly relying on third parties, and therefore an institution needs to not only vet their vendors, but the companies who partner with those third-party providers as well.

Banks are also challenged to employ a workforce capable of maintaining the bank's risk platforms and other internal programs. The development of technology, changing demographics, and the fluctuating economic situation have all affected talent and employment. Banks are having to reassess and consider other options to attract, retain, and engage qualified staff. With limited talent in a tight labor market, there are also implicit costs such as turnover, loss of production, and less than satisfactory customer service. An aging staff and a diminishing interest in community banking by the younger generation continues to impact the banking sector.

Finally, the Federal Reserve continues to move forward with its monetary policy to manage the level of short-term interest rates. In August 2018, Federal Reserve Chairman Jerome Powell signaled that interest rates will continue to gradually increase. Furthermore, the central bank will continue supporting the economic momentum but is cautiously managing growth.

There have been two interest rate increases in 2018, and committee members have indicated that two more are possible by year-end. As the pendulum takes a full swing in the opposite direction from prior years, bankers must adapt and manage their interest-rate, liquidity, and credit risk to sustain growth. Consequently, supervisory efforts by Texas' regulatory agencies will remain forward-looking to identify any cyclical troughs or potentially damaging factors that may weaken institutions.

# Departmental Supervisory Measures Being Taken

As of August 31, 2018, problem state-chartered financial institutions remain stable at 5.0%, with 11 state banks and two state thrifts classified as a regulatory concern. The Texas Department of Banking and the Department of Savings and Mortgage Lending consider any institution 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. Actions taken to mitigate or eliminate these risks include the following:

***Texas Department of Banking***

- Assess institutions' preparedness to identify, detect, respond to, protect against, and recover from cyber-attacks and perform follow-up evaluations for those below a base-line level of readiness;
- Provide all examination personnel with additional cyber-security training;
- Evaluate underwriting criteria during on-site examinations to assess the sensitivity of asset quality metrics to changes in economic conditions;
- Monitor efforts to prudently assess and mitigate concentration risks in commercial real estate, oil and gas, and agriculture lending;
- Assess bank liquidity levels, including dependence upon potentially volatile funding sources, funding concentrations, and deposit costs relative to local competition;
- Assess risks posed by increasing market interest rates on net interest margins, extended durations of investment securities, and economic value of equity;
- Monitor bank preparations for the industry's pending transition to CECL;
- Conduct off-site monitoring of institution's key financial performance metrics and analyze exceptions;
- Initiate enforcement actions early in the detection of deteriorating trends;
- Continue frequent on-site examinations or visitations of problem institutions;
- Communicate and coordinate joint enforcement actions and other supervisory activities with federal regulators;
- Place monthly calls to state banks to obtain industry input regarding prevailing economic conditions;
- Monitor state, national, and world political and economic events impacting the industry; and
- Increase internal communication and training to improve examiner awareness of pertinent issues.

***Department of Savings and Mortgage Lending***

- Close coordination with other state and federal regulators;
- Engage in regular correspondence with state savings banks regarding institution-specific and industry issues;
- Perform targeted examinations of high-risk areas of state savings banks;
- Issue enforcement actions and placing supervisory agents when deemed necessary;
- Conduct 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);
- Develop 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;
- Monitor any impact from volatility within the energy industries;
- Assess interest rate risk;
- Monitor lending, investment, and funding concentrations;
- Monitor local, state, national and world political and economic events impacting the industry; and,
- Participate in federal compliance examinations of each institution.

# PERFORMANCE SUMMARY AND PROFILE: TEXAS BANKING SYSTEM

## State-Chartered Banks

The Texas banking industry remains healthy as the state continues to experience positive economic growth and perform better than most of their national peers. Overall, net income rose over 17% for Texas state-chartered banks thanks to lower taxes resulting from last year's legislative overhaul and growth in interest-related revenue. While about half of the increase in net income was due to a lower corporate tax rate, rising net interest margins and higher loan balances are a sign that institutions continue to derive their revenue from their loan portfolio.

As of June 30, 2018, there were 237 Texas state-chartered banks operating in the state. While this number has decreased by three since June 30, 2017, total assets for these institutions increased by $3.9 billion or 1.5% during the 12-month period. The slight reduction in the number of banks is not limited to state banks; federally-chartered Texas institutions diminished by two during the same period.

Texas state-chartered institutions reported an aggregate profit of $1.9 billion in the second quarter of 2018, a $325 million improvement from the same period in 2017. The average return on assets (ROA) rose significantly to 1.47% from 1.2% a year ago. More than three-fourths of state-chartered banks or 79.75% reported year-to-date improvements to their quarterly net income.

Meanwhile, only 2.11% reported net losses for the second quarter, compared to 2.92% in 2017. During the last 12 months, core capital ratios increased nominally from 10.19% to 10.64% and net interest margins (NIM) increased 24 basis points (BP) to 3.63% due to increasing yields on earning assets.

Asset quality continues to show strength with the ratio of noncurrent assets plus other real estate to total assets at 0.48%, a decrease from 0.61% at June 30, 2017. The median ratio for Texas banks is 14 BP below the national average. State-chartered banks appear to have adequate reserves to absorb potential losses as their allowance for loan and lease losses (ALLL) is 1.12%.

In addition, net charge-offs decreased slightly during the last 12 months to 0.16% from 0.18% a year ago. The average nationwide is 0.46%. While nonperforming loans have declined, second quarter financial information shows that commercial real estate (CRE) for commercial banks in Texas continues to rise and now represents approximately 27% of net loans and leases. There is no immediate indication that CRE held by commercial banks in Texas is deteriorating; however, management should consider additional capital support to counter the concentration risk.

## State-Chartered Thrifts

Through June 30, 2018, state thrifts had $170.3 million in year-to-date net income, compared to $165.7 million for the first half of 2017. The pretax return on average assets remains strong at 2.0%. Non-interest income to assets increased 35 basis points, while non-interest expense remained the same.

The Texas thrift ratio of nonperforming loans plus other real estate owned to total assets has increased from 1.3% to 1.9% in the last twelve months but remains closely monitored.

State thrifts experienced a slight increase in the core capital levels since one year earlier, from 11.4% to 11.6%, despite the growth in total assets due to strong earnings, capital injections, and lower dividends paid.

## Number of Institutions and Total Assets

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

| | 6-30-2018 | | 6-30-2017 | | Difference | |
|---|---|---|---|---|---|---|
| | No. of Institutions | Assets | No. of Institutions | Assets | No. of Institutions | Assets |
| Texas State-Chartered Banks | 237 | $257.8 | 240 | $253.9 | -3 | +$3.9 |
| Texas State-Chartered Thrifts | 24 | $22.7 | 26 | $20.6 | -2 | +$2.1 |
| | 261 | $280.5 | 266 | $274.5 | -5 | +$6.0 |
| Other states' state-chartered: | | | | | | |
| Banks operating in Texas* | 39 | $65.4 | 31 | $62.5 | +8 | $2.9 |
| Thrifts operating in Texas* | 0 | 0 | 0 | 0 | 0 | 0 |
| | 39 | $65.4 | 31 | $62.5 | +8 | $2.9 |
| **Total State-Chartered Activity** | **300** | **$345.9** | **297** | **$337.0** | **+3** | **+$8.9** |
| National Banks Chartered in Texas | 182 | $138.4 | 184 | $127.6 | -2 | +$10.8 |
| Federal Thrifts Chartered in Texas | 5 | $84.8 | 6 | $83.4 | -1 | +$1.4 |
| | 187 | $223.2 | 190 | $211.0 | -3 | +12.2 |
| Other states' federally-chartered: | | | | | | |
| Banks operating in Texas* | 24 | $405.7 | 24 | $375.8 | 0 | +$29.9 |
| Thrifts operating in Texas* | 6 | $0.3 | 6 | $0.3 | 0 | 0 |
| | 30 | $406.0 | 30 | $376.1 | 0 | +$29.9 |
| **Total Federally-Chartered Activity** | **217** | **$622.6** | **220** | **$587.1** | **-3** | **+35.5** |
| **Total Banking/Thrift Activity** | **517** | **$968.5** | **517** | **$924.1** | **0** | **+$44.4** |

**Indicates estimates based on available FDIC information.*

## Ratio Analysis

*As of June 30, 2018*
*FDIC financial data is reflective of FDIC insured institutions only.*

| | State-Chartered Banks 237 | Texas National Banks 182 | All Texas Banks 419 | State-Chartered Thrifts 24 | Texas Federal Thrifts 5 | All Texas Thrifts 29 |
|---|---|---|---|---|---|---|
| % of Unprofitable Institutions | 2.11% | 3.30% | 2.63% | N/A | N/A | N/A |
| % of Institutions with Earnings Gains | 79.75% | 78.57% | 79.24% | 70.83% | 80.00% | 72.41% |
| Yield on Earning Assets | 4.06% | 4.20% | 4.11% | 4.32% | 4.85% | 4.74% |
| Net Interest Margin | 3.63% | 3.68% | 3.65% | 3.49% | 4.68% | 4.44% |
| Return on Assets | 1.47% | 1.37% | 1.44% | 1.52% | 1.47% | 1.48% |
| Return on Equity | 12.24% | 12.86% | 12.44% | 13.30% | 16.04% | 15.36% |
| Net Charge-offs to Loans | 0.16% | 0.21% | 0.18% | 0.13% | 1.42% | 1.11% |
| Earnings Coverage of Net Loan C/Os | 18.61 | 13.27 | 16.33 | 23.96 | 3.16 | 3.74 |
| Loss Allowance to Loans | 1.12% | 1.10% | 1.11% | 0.80% | 1.64% | 1.43% |
| Loss Allowance to Noncurrent Loans | 177.37% | 151.07% | 166.84% | 29.67% | 117.92% | 84.36% |
| Noncurrent Assets+OREO to Assets | 0.48% | 0.56% | 0.51% | 1.93% | 0.79% | 1.03% |
| Net Loans and Leases to Core Deps | 81.96% | 89.24% | 84.49% | 109.16% | 70.24% | 76.87% |
| Equity Capital to Assets | 12.07% | 10.67% | 11.58% | 11.88% | 9.41% | 9.93% |
| Core Capital (Leverage) Ratio | 10.64% | 10.75% | 10.68% | 11.64% | 9.48% | 9.93% |
| Common Equity Tier 1 Capital | 13.44% | 14.05% | 13.65% | 16.25% | 14.72% | 15.08% |

*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 June 30, 2018*
*FDIC financial data is reflective of FDIC insured institutions only.*
*Assets in Billions*

| | < $1<br>208 | $1 - $10<br>25 | >$10<br>4 |
|---|---|---|---|
| % of Unprofitable Institutions | 2.40% | NA | NA |
| % of Institutions with Earnings Gains | 78.37% | 88.00% | 100.00% |
| Yield on Earning Assets | 4.41% | 4.41% | 3.75% |
| Net Interest Margin | 3.90% | 3.82% | 3.43% |
| Return on Assets | 1.36% | 1.40% | 1.54% |
| Return on Equity | 12.20% | 10.95% | 12.96% |
| Net Charge-offs to Loans | 0.08% | 0.23% | 0.15% |
| Earnings Coverage of Net Loan C/Os | 34.14 | 11.33 | 22.10 |
| Loss Allowance to Loans | 1.20% | 0.96% | 1.18% |
| Loss Allowance to Noncurrent Loans | 166.34% | 141.21% | 208.46% |
| Noncurrent Assets+OREO to Assets | 0.54% | 0.68% | 0.35% |
| Net Loans and Leases to Core Deps | 76.32% | 100.40% | 76.06% |
| Equity Capital to Assets | 11.14% | 12.93% | 12.01% |
| Core Capital (Leverage) Ratio | 11.30% | 11.61% | 9.88% |
| Common Equity Tier 1 Capital | 16.82% | 14.59% | 11.78% |

## Ratio Analysis by Asset Groups for State-Chartered Thrifts

*As of June 30, 2018*
*FDIC financial data is reflective of FDIC insured institutions only.*
*Assets in Billions*

| | < $1<br>18 | $1 - $10<br>6 | >$10<br>0 |
|---|---|---|---|
| % of Unprofitable Institutions | NA | NA | NA |
| % of Institutions with Earnings Gains | 77.78% | 50.00% | NA |
| Yield on Earning Assets | 4.92% | 4.13% | NA |
| Net Interest Margin | 4.22% | 3.27% | NA |
| Return on Assets | 1.02% | 1.68% | NA |
| Return on Equity | 9.92% | 14.21% | NA |
| Net Charge-offs to Loans | 0.07% | 0.15% | NA |
| Earnings Coverage of Net Loan C/Os | 26.06 | 23.63 | NA |
| Loss Allowance to Loans | 0.94% | 0.75% | NA |
| Loss Allowance to Noncurrent Loans | 178.28% | 21.43% | NA |
| Noncurrent Assets+OREO to Assets | 0.49% | 2.39% | NA |
| Net Loans and Leases to Core Deps | 97.10% | 114.35% | NA |
| Equity Capital to Assets | 10.21% | 12.40% | NA |
| Core Capital (Leverage) Ratio | 10.36% | 12.07% | NA |
| Common Equity Tier 1 Capital | 14.24% | 16.94% | NA |

# Comparison Report

Select Balance Sheet and Income/Expense Information
*FDIC financial data is reflective of FDIC insured institutions only.*
June 30, 2018

| | State Banks* | | State Thrifts | |
|---|---|---|---|---|
| | End of Period | % of Total Assets | End of Period | % of Total Assets |
| Number of Institutions | 237 | | 24 | |
| Number of Employees (full-time equivalent) | 40,781 | | 2,980 | |
| *(In millions)* | | | | |
| Total Assets | $257,764 | | $22,685 | |
| Net Loans and Leases | $159,173 | 61.75% | $15,076 | 66.46% |
| Loan Loss Allowance | $1,801 | 0.70% | $121 | 0.53% |
| Other Real Estate Owned | $219 | 0.08% | $30 | 0.13% |
| Goodwill and Other Intangibles | $5,814 | 2.26% | $204 | 0.90% |
| Total Deposits | $209,549 | 81.29% | $15,897 | 70.08% |
| Federal Funds Purchased and Repurchase Agreements | $2,355 | 0.91% | $11 | 0.05% |
| Other Borrowed Funds | $12,045 | 4.67% | $3,833 | 16.90% |
| Equity Capital | $31,131 | 12.08% | $2,694 | 11.88% |
| Memoranda: | | | | |
| Noncurrent Loans and Leases | $1,015 | 0.39% | $409 | 1.80% |
| Earning Assets | $234,459 | 90.96% | $21,047 | 92.78% |
| Long-term Assets (5+ years) | $71,517 | 27.75% | $7,518 | 33.14% |
| | **Year-to-Date** | ***% of Avg. Assets*†** | **Year-to-Date** | ***% of Avg. Assets*†** |
| Total Interest Income | $4,744 | 3.71% | $453 | 4.02% |
| Total Interest Expense | $503 | 0.39% | $86 | 0.77% |
| Net Interest Income | $4,240 | 3.31% | $366 | 3.26% |
| Provision for Loan and Lease Losses | $105 | 0.08% | $3 | 0.03% |
| Total Noninterest Income | $1,488 | 1.16% | $148 | 1.32% |
| Total Noninterest Expense | $3,394 | 2.65% | $282 | 2.51% |
| Securities Gains | -$2 | -0.00% | $1 | 0.01% |
| Net Income | $1,877 | 1.47% | $171 | 1.52% |
| **Memoranda:** | | | | |
| Net Loan Charge-offs | $125 | 0.10% | $10 | 0.09% |
| Cash Dividends | $965 | 0.75% | $8 | 0.07% |

**Excludes branches of state-chartered banks of other states doing business in Texas. As of June 30, 2018, there are an estimated thirty-nine out-of-state state-chartered institutions with $65.4 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.*

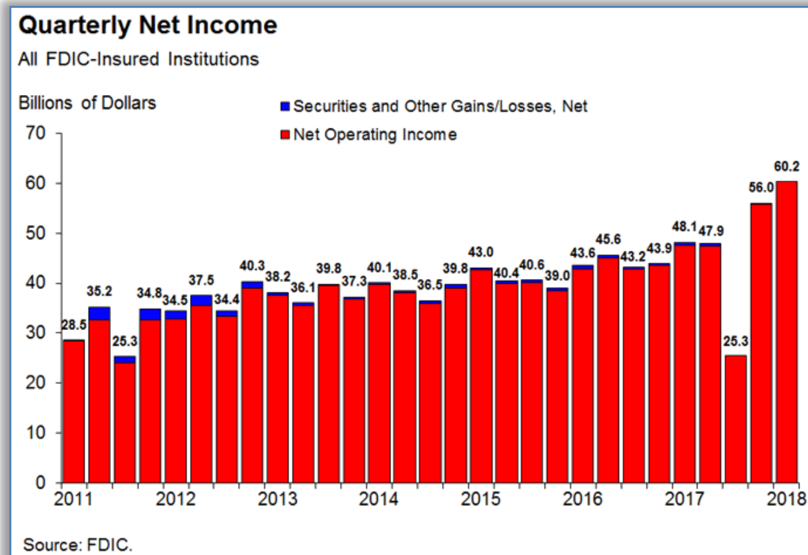
*No branches of state-chartered thrifts of other states conducted business in Texas as of June 30, 2018.*

# PERFORMANCE SUMMARY: UNITED STATES BANKING SYSTEM

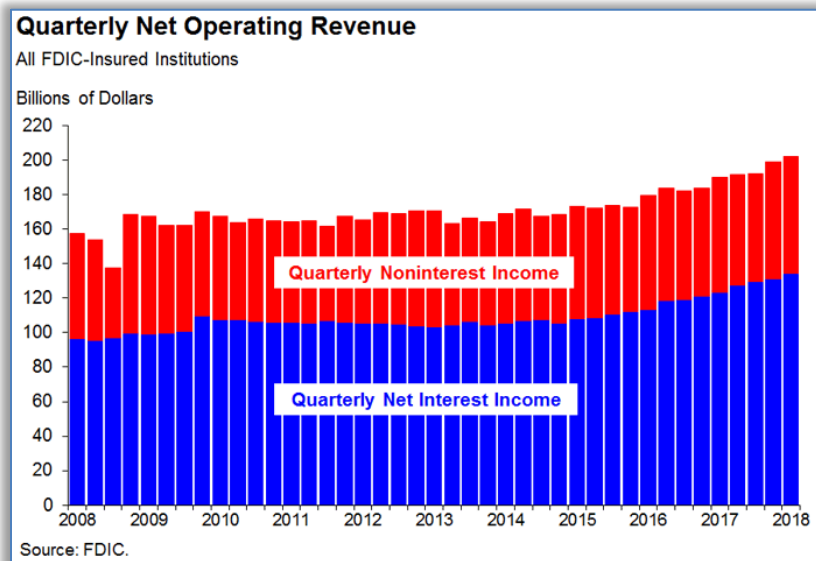
## FDIC QUARTERLY BANKING PROFILE

*Second Quarter 2018 - [www.fdic.gov](http://www.fdic.gov)*
***All Institutions Performance***

### ⇧ Net Income Rises 25.1% Over Second Quarter 2017, Led by Higher Net Operating Revenue and a Lower Effective Tax Rate




The 5,542 FDIC-insured commercial banks and savings institutions reported net income of $60.2 billion during the three months ended June 30, an increase of $12.1 billion (25.1%) from a year earlier. Higher net operating revenue (the sum of net interest income and noninterest income) and a lower effective tax rate contributed to the increase in industry net income. Assuming the effective tax rate before the new tax law, net income would have totaled an estimated $53.8 billion, an increase of $5.6 billion (11.7%) from second quarter 2017. The average return on assets was 1.37%, up from 1.13% a year earlier. Only 3.8% of institutions were unprofitable during the quarter, down from 4.3% in second quarter 2017.




### ⇧ Margins Increase as Average Yields Outpace Growth in Funding Costs

Net interest income totaled $134.1 billion, an increase of $10.7 billion (8.7%) from 12 months earlier and the largest annual dollar increase ever reported by the industry. More than four out of five banks (85.1%) reported year-over-year increases. Net interest margin (NIM) rose to 3.38%, up 16 basis points from a year earlier, as average asset yields grew more rapidly than average funding costs. Institutions with assets of

$10 billion to $250 billion reported the largest annual increase in average funding costs (up 30 basis points). The improvement in NIM was widespread, as more than two out of three banks (70.2%) reported increases from a year earlier.

## ⇧ Provisions Decline Modestly from Second Quarter 2017

Banks set aside $11.7 billion in loan-loss provisions during the second quarter, a decline of $293.5 million (2.4%) from the previous year. Almost one-third of all banks (31.3%) reported lower loan-loss provisions than in second quarter 2017. Loan-loss provisions as a percentage of net operating revenue declined to 5.8% for the current quarter, the lowest level since third quarter 2015.

## ⇧ Noninterest Income Expands 2% From a Year Earlier

Noninterest income totaled $68.1 billion, an increase of $1.3 billion (2%) from the previous year. The 12-month increase in noninterest income was attributable to servicing fees (up $638.2 million, or 29.5%), fiduciary activity (up $558.4 million, or 6.3%), and net gains on sales of other assets (up $388.3 million). Slightly more than half of all institutions (55.6%) reported increases in noninterest income from a year earlier.

## ⇩ Noninterest Expense Grows 4.6% Year-Over-Year

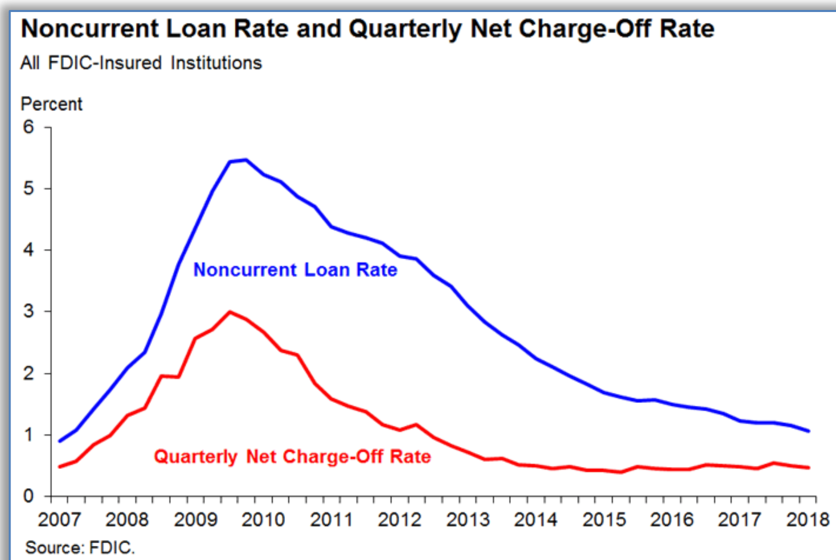
Noninterest expenses rose by $5 billion (4.6%) from a year earlier, as salary and employee benefits grew by $2.7 billion (5.2%) and other noninterest expense increased by $1.8 billion (4.2%). Average assets per employee totaled $8.4 million for the current quarter, up from $8.2 million in second quarter 2017. The efficiency ratio (noninterest expense as a percentage of net operating revenue) improved to 55.5% in the second quarter, the lowest level since first quarter 2010.

## ⇳ Net Charge-Off Rate Remains Stable

For the past eleven quarters in a row, net charge-offs increased compared with a year earlier but at a slower rate. During the second quarter, banks charged-off $11.7 billion in uncollectable loans, an increase of $446.4 billion (4%) over the past 12 months. The annual increase in net charge-offs was led by credit card balances (up $918.9 million, or 12.8%). The average net charge-off rate remained stable from a year earlier at 0.48%.

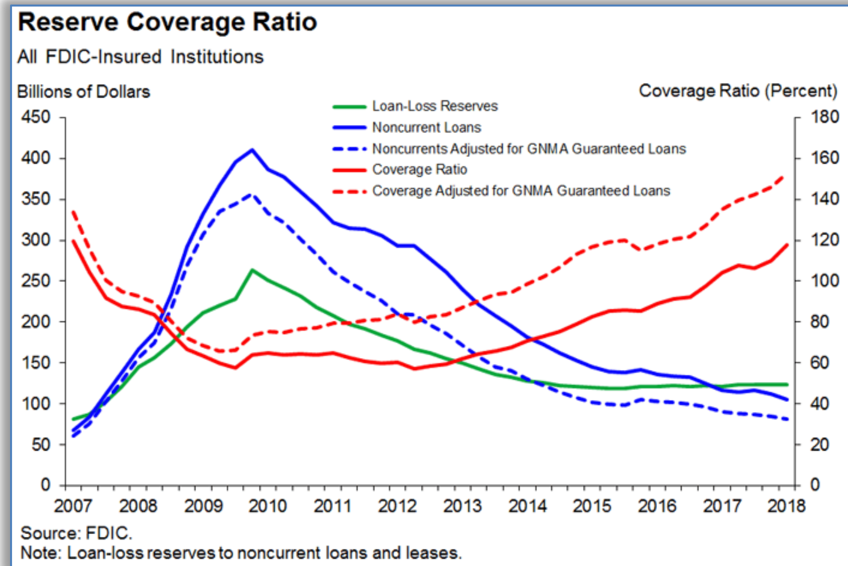
## ⇧ Noncurrent Loan Rate Declines to 1.06%

Noncurrent loan balances (90 days or more past due or in nonaccrual status) declined by $7.7 billion (6.8%) from the first quarter, as more than half (52%) of all institutions reported quarterly declines. The improvement was led by residential mortgages (down $5.2 billion, or 9.7%), commercial and industrial loans (down $1.2 billion, or 6.8%), and credit cards (down $848.6 million, or 7.4%). The average noncurrent rate fell from 1.15% in the first quarter to 1.06%.



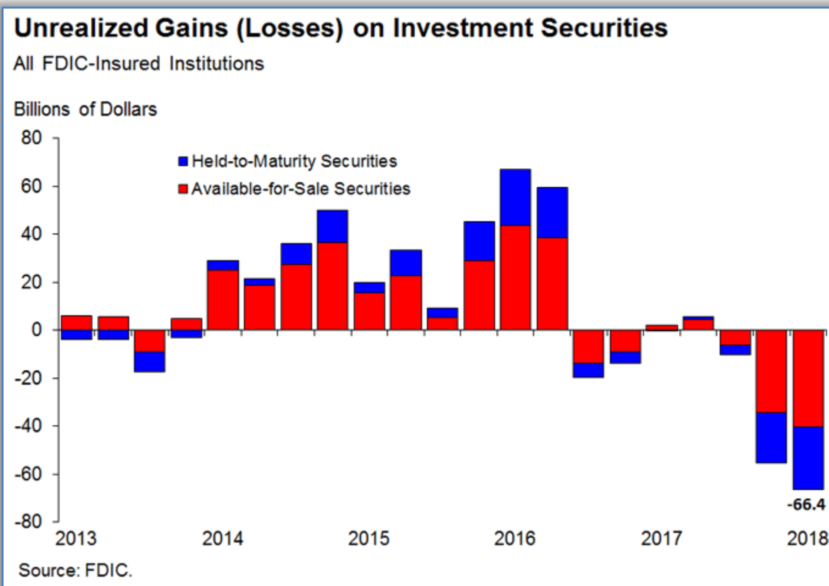
## ⇧ Reserve Coverage of Noncurrent Loans Continues to Grow

Loan-loss reserves declined by $330 million (0.3%) from the first quarter, as less than one-third (25.3%) of all institutions reported a quarterly decline. At banks that itemize their loan-loss reserves, which represent almost 91% of total industry loan-loss reserves, losses on credit cards increased by $284.2 million (0.7%). Itemized reserves for residential real estate losses fell by $522.3 million (3.7%). As noncurrent loan balances declined at a faster quarterly rate than loan-loss reserves, the coverage ratio (loan-loss reserves to noncurrent loan balances) grew from 110% in the first quarter to 117.7%.




## ⇧ Equity Capital Increases from the First Quarter

Equity capital of $2 trillion rose by $15.3 billion (0.8%) from the first quarter. Retained earnings contributed $22.4 billion to equity growth but were partly offset by a $7.8 billion reduction in accumulated other comprehensive income. With a decline in market value of available-for-sale securities, unrealized losses totaled $40.2 billion for the current quarter, an increase of $6 billion (17.4%) from the previous quarter. Declared dividends totaled $37.8 billion, an increase of $9.5 billion (33.4%) from the year before. At the end of the quarter, 99.6% 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.

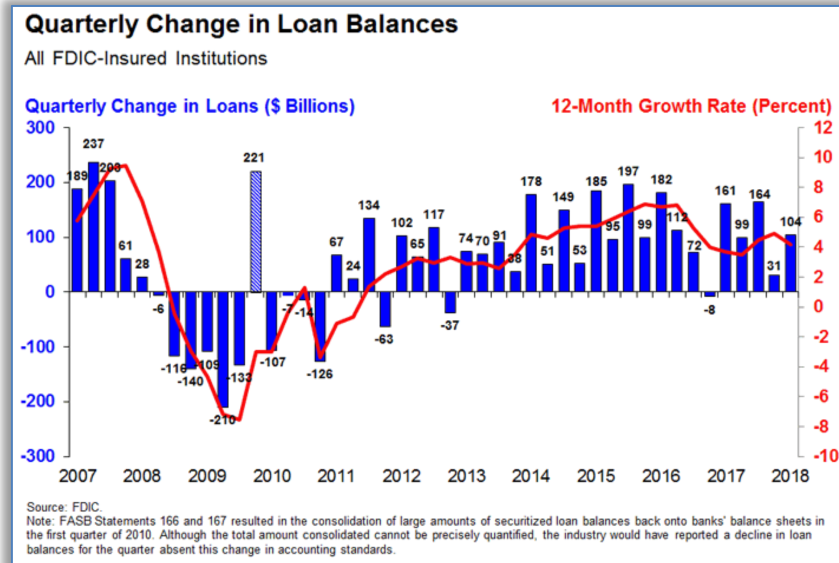



## ⇩ Balances at Federal Reserve Banks Decline Almost 12%

Total assets rose modestly (up $1.3 billion) from the previous quarter, as cash and balances due from depository institutions declined by $126.4 billion (6.5%), the largest quarterly dollar decline since second quarter 2015. Balances at Federal Reserve banks declined by $139.7 billion (11.7%), and mortgage-backed securities rose by $43.5 billion (2.1%)

## ⇧ Loan Balances Expand 4.2% From Second Quarter 2017

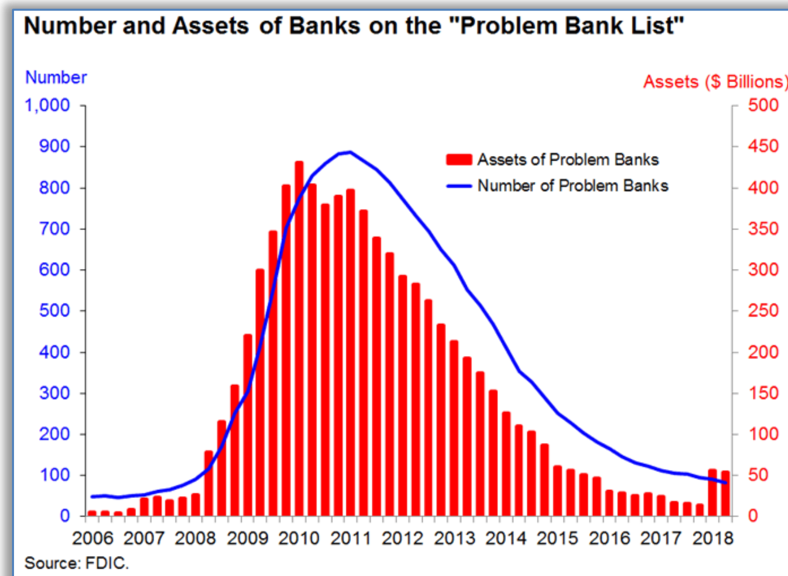
Total loan and lease balances increased by $104.3 billion (1.1%) from the first quarter, as more than three out of four banks (76.2%) reported quarterly increases. All major loan categories registered quarterly increases, led by commercial and industrial loans (up $25.5 billion, or 1.2%); consumer loans, which include credit card balances (up $23.7 billion, or 1.4%); nonfarm nonresidential loans (up $18.9 billion, or 1.3%); and residential mortgage loans (up $17.9 billion, or 0.9%). Over the past year, total loan and lease balances grew by $398.5 billion (4.2%), a slight decline from last quarter's annual growth rate of 4.9%. Commercial and industrial loans rose by $95.2 (4.8%); consumer loans, which include credit card balances, increased by $84.4 billion (5.4%); residential mortgage loans grew by $70.6 billion (3.5%); and nonfarm nonresidential loans expanded by $56.4 billion (4.1%).




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

## ⇩ Deposits Decline from the Previous Quarter

Total deposits fell by $60.2 billion (0.4%) from the previous quarter, as deposits in both foreign offices (down $38.8 billion, or 3%) and domestic offices (down $21.5 billion, or 0.2%) declined. Domestic interest-bearing deposits rose by $13.5 billion (0.1%), while noninterest-bearing deposits declined by $34.9 billion (1.1%). Banks increased their nondeposit liabilities by $46.3 billion (2.3%) from the first quarter, led by Federal Home Loan Banks advances (up $30 billion, or 5.4%) and other liabilities (up $11.7 billion, or 3.1%).




Source: FDIC.

## ⇧ Two New Charters Added in Second Quarter 2018

During the three months ended June 30, the number of FDIC-insured commercial banks and savings institutions declined by 65 to 5,542. Two new charters were added, 64 institutions were absorbed by mergers, and no banks failed. The number of institutions on the FDIC's "Problem Bank List" fell from 92 to 82, the lowest number since fourth quarter 2007. Assets of problem banks declined from $56.4 billion to $54.4 billion.

# Snapshot Stock Performance
# Southwest Regional Banks (MSECTOR415)
# September 2018

| Name | Last Trade | | 52 Wk Range | | PE | EPS | Mkt Cap | Div/Shr | Div Yld |
|---|---|---|---|---|---|---|---|---|---|
| ACNB Corporation | 09/11 | **37.70** | 26.45 | 37.92 | 17.83 | 2.11 | 265.36M | 0.92 | 2.58% |
| BancFirst Corporation | 09/11 | **63.05** | 50.10 | 65.70 | 20.56 | 3.06 | 2.06B | 1.20 | 1.89% |
| BOK Financial Corporation | 09/11 | **104.36** | 80.11 | 107.00 | 18.08 | 5.77 | 5.77B | 2.00 | 1.93% |
| Cass Information Sys, Inc. | 09/11 | **69.50** | 54.37 | 74.49 | 31.17 | 2.23 | 854.46M | 1.04 | 1.47% |
| CoBiz Incorporated | 09/11 | **23.33** | 16.71 | 23.48 | 25.08 | 0.93 | 980.36M | 0.40 | 1.72% |
| Commerce Bancshares, Inc. | 09/11 | **71.47** | 54.13 | 72.55 | 20.64 | 3.46 | 7.62B | 0.94 | 1.32% |
| Cullen Frost Bankers, Inc. | 09/11 | **110.57** | 85.74 | 121.66 | 17.71 | 6.24 | 7.06B | 2.68 | 2.41% |
| Enterprise Fin Serv Corp | 09/11 | **55.70** | 38.40 | 58.15 | 19.49 | 2.86 | 1.28B | 0.48 | 0.86% |
| First Community Corp S C | 09/11 | **25.45** | 19.60 | 26.25 | 23.37 | 1.09 | 193.54M | 0.40 | 1.58% |
| First Financial Bankshares, Inc. | 09/11 | **61.50** | 39.10 | 61.65 | 30.13 | 2.04 | 4.16B | 0.84 | 1.38% |
| First Financial Northwest, Inc. | 09/11 | **17.29** | 13.13 | 21.81 | 12.62 | 1.37 | 188.71M | 0.32 | 1.86% |
| Great Southern Bancorp, Inc. | 09/11 | **59.20** | 48.10 | 61.65 | 16.44 | 3.60 | 837.21M | 1.12 | 1.89% |
| Guaranty Fed Bancshares, Inc. | 09/11 | **24.90** | 20.41 | 25.00 | 35.07 | 0.71 | 110.84M | 0.48 | 1.92% |
| Heartland Financial USA, Inc. | 09/11 | **60.75** | 43.40 | 61.95 | 21.70 | 2.80 | 2.09B | 0.56 | 0.92% |
| International Bancshares Corp | 09/11 | **47.75** | 35.60 | 47.95 | 16.71 | 2.86 | 3.16B | 0.66 | 1.39% |
| Landmark Bancorp, Inc. | 09/11 | **28.95** | 27.01 | 30.40 | 25.39 | 1.14 | 120.51M | 0.80 | 2.76% |
| Liberty Bancorp, Inc. | 09/11 | **26.70** | 21.01 | 27.00 | 16.48 | 1.62 | 96.12M | 0.27 | 1.00% |
| Mackinac Financial Corp | 09/11 | **16.32** | 14.22 | 17.58 | 27.34 | 0.60 | 174.83M | 0.48 | 2.92% |
| MidWest One Finl Group, Inc. | 09/11 | **33.88** | 30.56 | 37.94 | 20.03 | 1.69 | 413.99M | 0.78 | 2.30% |
| North Dallas Bank & Trust Co. TX | 09/11 | **87.00** | *NA* | *NA* | 35.22 | 2.47 | 223.50M | 0.72 | 0.83% |
| Prosperity Bancshares, Inc. | 09/11 | **75.76** | 67.27 | 79.20 | 18.13 | 4.18 | 5.29B | 1.44 | 1.92% |
| QCR Holdings, Inc. | 09/11 | **43.30** | 40.40 | 49.70 | 15.67 | 2.76 | 678.26M | 0.24 | 0.56% |
| Solera National Bancorp, Inc. | 09/11 | **10.00** | *NA* | *NA* | 33.90 | 0.29 | 40.58M | *NA* | *NA* |
| Texas Capital Bancshares, Inc. | 09/11 | **89.35** | 74.05 | 103.05 | 18.93 | 4.72 | 4.48B | *NA* | *NA* |
| Two Rivers Fin Group | 09/11 | **35.15** | *NA* | *NA* | 15.35 | 2.29 | 82.46M | 0.62 | 1.76% |
| UMB Financial Corporation | 09/11 | **75.72** | 65.24 | 82.14 | 13.88 | 5.45 | 3.79B | 1.16 | 1.53% |
| West Bancorp Incorporated | 09/11 | **23.85** | 21.55 | 28.00 | 15.79 | 1.51 | 388.64M | 0.80 | 3.34% |

*Source: Yahoo Finance (September 2018)*
*NA – Indicates information was not available.*

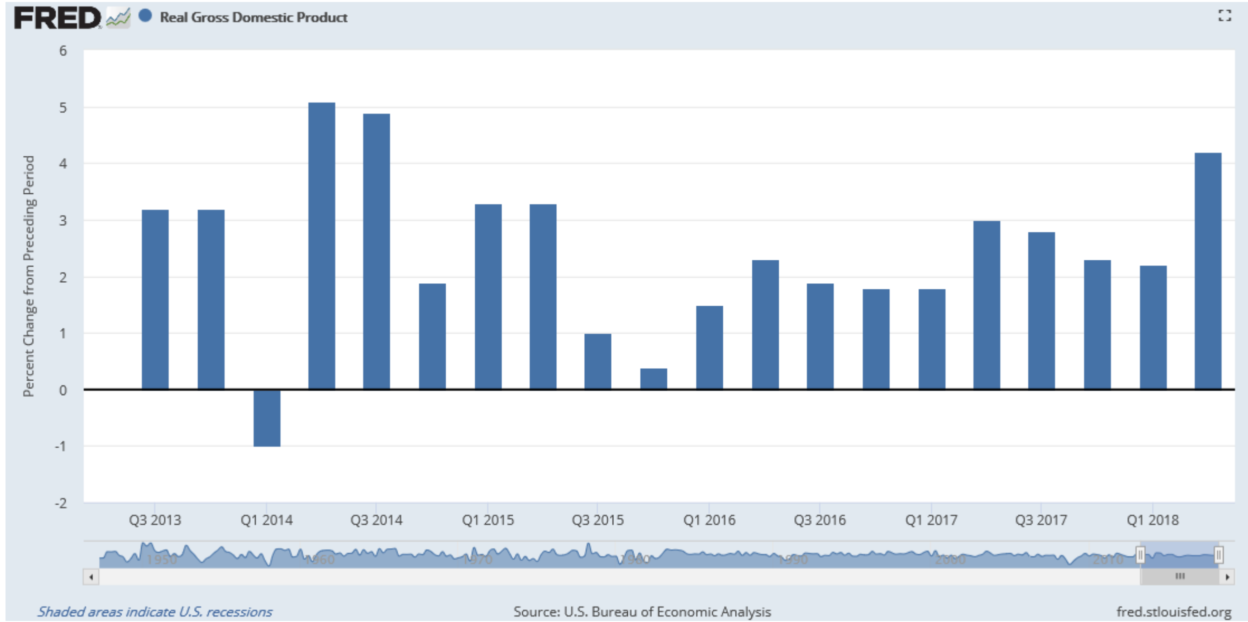
# Snapshot Stock Performance
# Southwest Regional Banks (MSECTOR415)
# September 2017

| Name | Last Trade | | 52 Wk Range | | PE | EPS | Mkt Cap | Div/Shr | Div Yld |
|---|---|---|---|---|---|---|---|---|---|
| ACNB Corporation | 09/13 | **26.85** | 24.45 | 32.85 | 15.21 | NA | 188.36M | 0.80 | 2.99% |
| BancFirst Corporation | 09/13 | **51.60** | 34.06 | 51.80 | 20.34 | 2.79 | 1.64B | 0.76 | 1.48% |
| BOK Financial Corporation | 09/13 | **82.98** | 65.74 | 88.80 | 18.11 | 5.57 | 5.43B | 1.75 | 2.14% |
| Cass Information Sys, Inc. | 09/13 | **61.51** | 52.69 | 74.83 | 27.34 | NA | 689.15M | 0.91 | 1.50% |
| CoBiz Incorporated | 09/13 | **17.10** | 12.40 | 18.85 | 19.21 | 1.09 | 707.28M | 0.20 | 1.29% |
| Commerce Bancshares, Inc. | 09/13 | **55.00** | 47.64 | 60.61 | 19.93 | 3.11 | 5.59B | 0.88 | 1.64% |
| Cullen Frost Bankers, Inc. | 09/13 | **89.15** | 67.86 | 99.20 | 17.56 | 5.69 | 5.73B | 2.19 | 2.56% |
| Enterprise Fin Serv Corp | 09/13 | **39.15** | 30.59 | 46.25 | 17.04 | 3.05 | 918.58M | 0.44 | 1.13% |
| First Community Corp S C | 09/13 | **20.25** | 14.80 | 23.55 | 20.3 | 1.28 | 135.62M | 0.34 | 1.78% |
| First Financial Bankshares, Inc. | 09/13 | **40.50** | 35.05 | 46.70 | 24.97 | 1.85 | 2.68B | 0.73 | 1.90% |
| First Financial Northwest, Inc. | 09/13 | NA | NA | NA | NA | NA | NA | NA | NA |
| Great Southern Bancorp, Inc. | 09/13 | **51.50** | 38.35 | 56.70 | 14.43 | 3.41 | 722.88M | 0.90 | 1.88% |
| Guaranty Fed Bancshares, Inc. | 09/13 | **22.38** | 16.00 | 23.71 | 16.22 | 1.51 | 98.96M | 0.38 | 1.77% |
| Heartland Financial USA, Inc. | 09/13 | **44.45** | 35.02 | 52.65 | 14.58 | 3.44 | 1.33B | 0.42 | 0.99% |
| International Bancshares Corp | 09/13 | **36.70** | 28.47 | 42.25 | 16.99 | NA | 2.42B | 0.64 | 1.75% |
| Landmark Bancorp, Inc. | 09/13 | **28.30** | 25.88 | 32.40 | 12.64 | NA | 109.63M | 0.78 | 2.82% |
| Liberty Bancorp, Inc. | 09/13 | **21.50** | 18.10 | 23.94 | 10.8 | NA | 77.40M | 0.10 | 1.02% |
| Mackinac Financial Corp | 09/13 | **14.94** | 11.00 | 15.16 | 13.61 | NA | 94.05M | 0.44 | 3.20% |
| MidWest One Finl Group, Inc. | 09/13 | **33.88** | 27.93 | 39.20 | 16.49 | 2.66 | 413.96M | 0.65 | 2.00% |
| North Dallas Bank & Trust Co. TX | 09/13 | NA | NA | NA | NA | NA | NA | NA | NA |
| Prosperity Bancshares, Inc. | 09/13 | **61.37** | 52.19 | 77.87 | 15.54 | 4.26 | 4.26B | 1.32 | 2.20% |
| QCR Holdings, Inc. | 09/13 | **43.00** | 28.70 | 50.00 | 17.69 | 3.11 | 566.79M | 0.18 | 0.47% |
| Solera National Bancorp, Inc. | 09/13 | NA | NA | NA | NA | NA | NA | NA | NA |
| Texas Capital Bancshares, Inc. | 09/13 | **78.30** | 50.67 | 93.35 | 21.73 | 4.97 | 3.88B | NA | NA |
| UMB Financial Corporation | 09/13 | **68.40** | 57.31 | 81.55 | 19.76 | 4.02 | 3.42B | 1.01 | 1.51% |
| West Bancorp Incorporated | 09/13 | **21.95** | 18.75 | 25.05 | 14.73 | 1.66 | 355.84M | 0.69 | 3.27% |

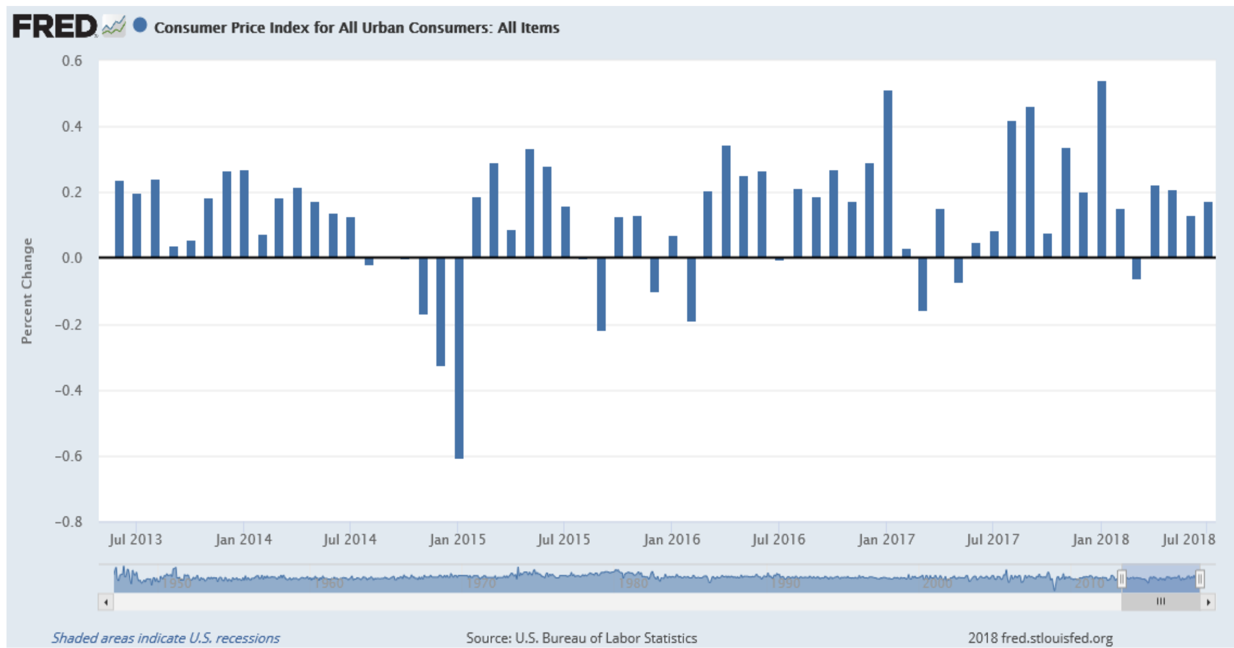
*Source: Yahoo Finance (September 2017)*
*NA – Indicates information was not available.*

# NATIONAL ECONOMIC TRENDS

## Real GDP



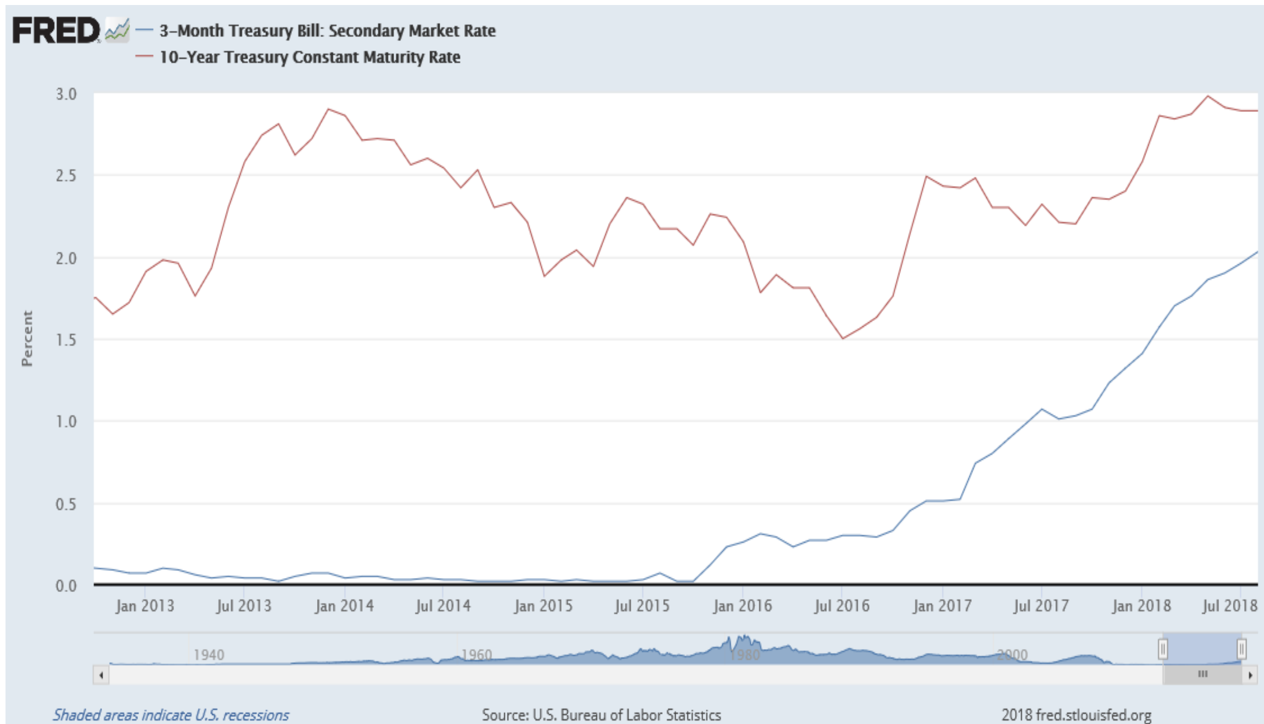

## Consumer Price Index




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

## Unemployment Rate

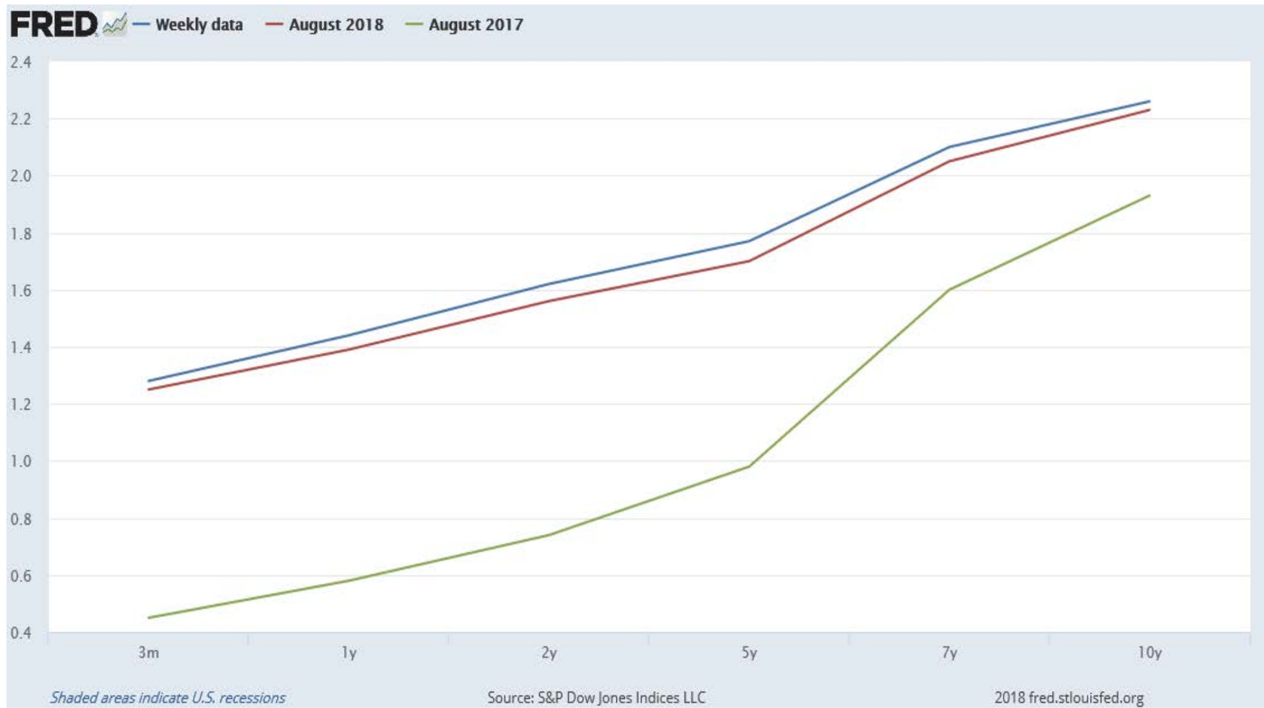
## Interest Rates



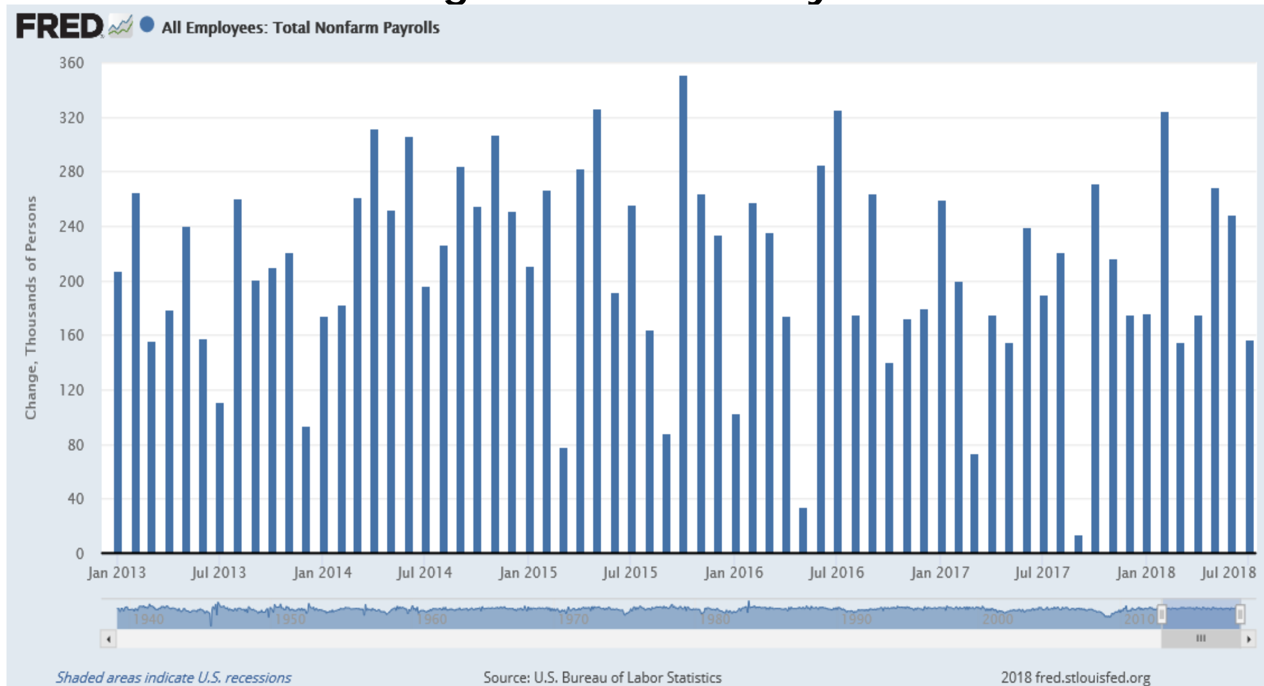

*Source: Federal Reserve Bank of St. Louis, National Economic Trends, August 2018.*

## Treasury Yield Curve

Percent




## Change in Nonfarm Payrolls



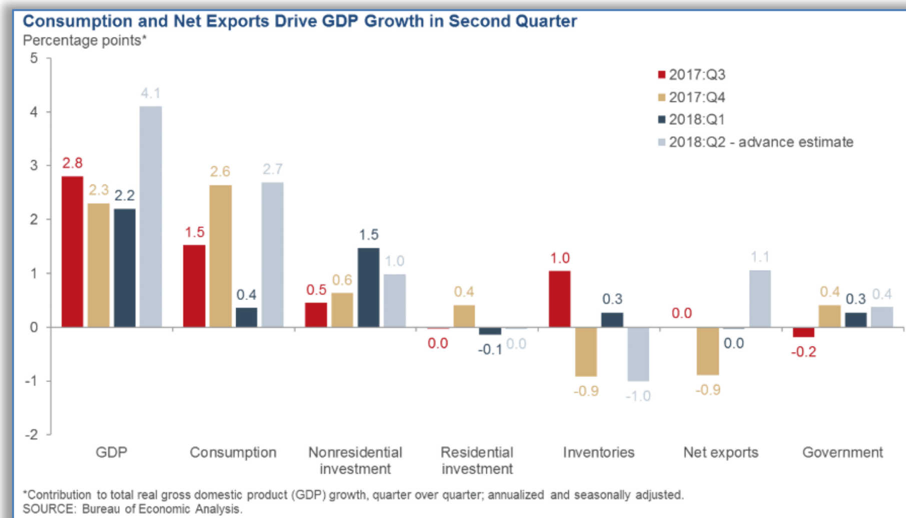

*Source: Federal Reserve Bank of St. Louis, National Economic Trends, August 2018.*

# ECONOMIC REPORTS AND FORECASTS: UNITED STATES

## Federal Reserve Bank, Dallas National Update

*August 2018 - www.dallasfed.org*

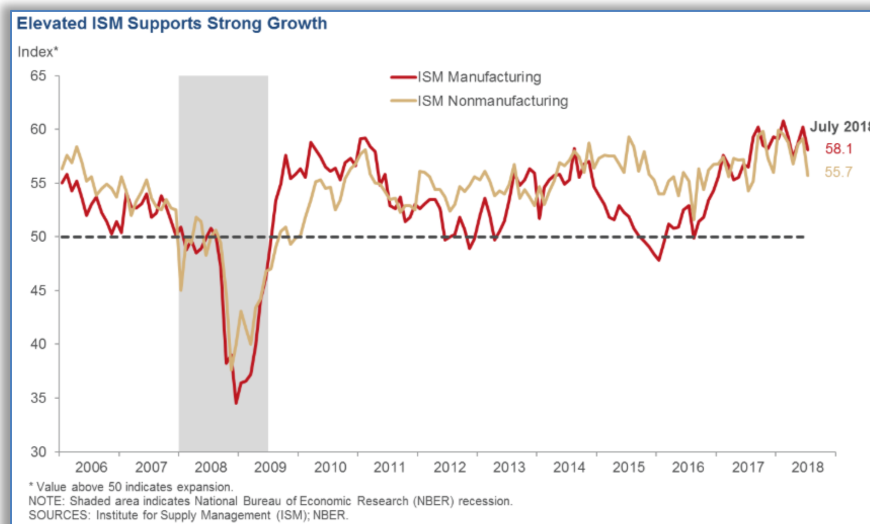
### ⇧ Economy




The U.S. economy entered its 10th year of economic expansion last month, and recent data point to continued economic growth for the second half of the year. Robust consumer spending, above-trend labor force growth, and elevated business and consumer sentiment support above-potential growth through the rest of 2018. Inflation measures remain at or just below the Federal Reserve's 2% target, and long-run inflation expectations are little changed.

### ⇧ Second Quarter Registers Strong GDP Growth

The advance estimate of real (inflation-adjusted) gross domestic product (GDP) for second quarter 2018 indicated the economy grew at a strong pace. GDP growth came in at a seasonally adjusted annual rate of 4.1%, in line with many forecasts. The strong quarter is due to a rebound in consumer spending, which contributed 2.7 percentage points, up from the first-quarter contribution of 0.4 percentage points.




Net exports and nonresidential investments were also drivers of growth in the second quarter, contributing 1.1 and 1.0 percentage points, respectively. On the downside, inventories subtracted 1.0 percentage points from GDP growth.

Although running lower than a month ago, survey-based indicators for real economic activity

remain in expansionary territory. The Institute for Supply Management (ISM) manufacturing index dipped from 60.2 in June to 58.1 in July. Similarly, the nonmanufacturing composite index dropped from 59.1 in June to 55.7 in July. Values above 50 indicate expansion.

Consumer confidence also remains elevated. The Conference Board's Consumer Expectations Index decreased slightly in June to 101.7 from 104.0 in June. Likewise, the University of Michigan's Consumer Sentiment Index was little changed in July at 97.9, compared with 98.2 in June.

## ⇧ Labor Force Growth Above Average for 2018

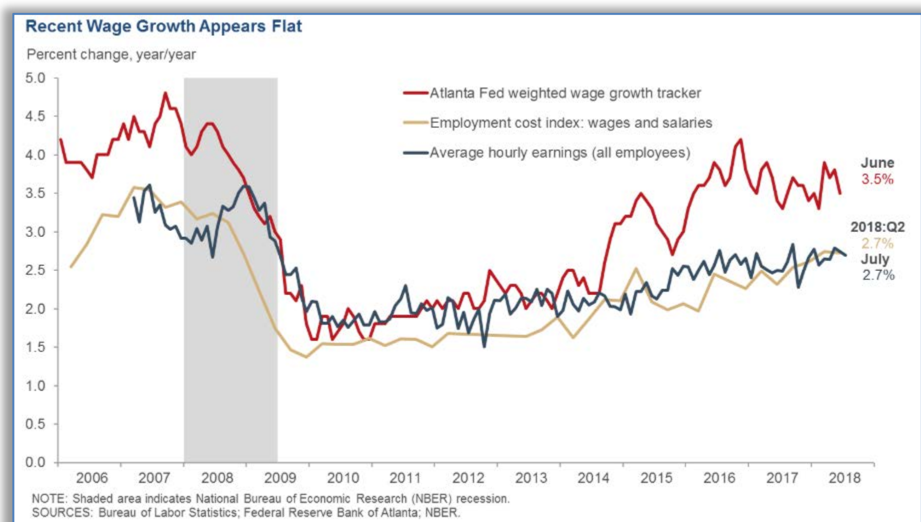
The July employment report shows that the labor market remains tight. Total nonfarm payrolls increased by 157,000 in July, compared with 248,000 in June, bringing 2018 average monthly job gains to 215,000. The 2018 gains exceed the 2016 and 2017 average of 182,000 and 195,000, respectively.

The labor force is also experiencing above-average growth this year and added 105,000 people on net in July, bringing the 2018 monthly average to 235,000. For comparison, the monthly gains in 2017 and 2016 averaged 72,000 and 141,000, respectively. The labor force participation rate was unchanged at 62.9% in July. Despite the aging population, the participation rate has moved sideways since 2014 and has remained within a similar range (62.3% to 63.7%) over the past five years

The labor market remains tight as the headline unemployment rate (U-3) ticked down to 3.9% in July from 4.0% in June. The broader U-6 rate, which includes discouraged workers, other marginally attached workers and those working part time for economic reasons, dropped 0.3 percentage points to 7.5% in July.

## ⇳ Wage Growth Remains Subdued

Despite the strong labor market, recent data suggest there is little upward pressure on wage growth.




The 12-month rise in average hourly earnings for all employees was 2.7% in July, unchanged from June. Likewise,

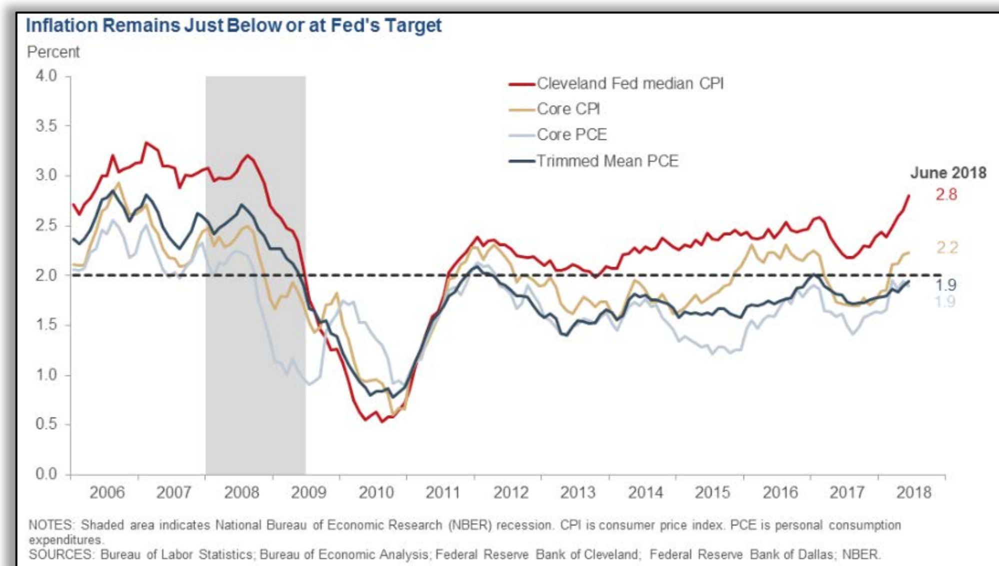
the employment cost index of wages and salaries for civilian workers increased 2.7% year over year in the second quarter, unchanged from the first.

The three-month moving average of the Atlanta Fed weighted median wage growth tracker pulled back slightly in June to 3.5% from 3.8% in May.

## ⇧ June Inflation Measures Change Little

Recent data for June show core inflation measures changed little from May, remaining near the Federal Reserve's 2% target. On a year-over-year basis, core personal consumer expenditures (PCE), which excludes energy and food, increased 1.9% in June, just as it did in May. Similarly, the core Consumer Price Index (CPI) growth rate was unchanged at 2.2% in June. The Federal Reserve Bank of Dallas' Trimmed Mean PCE inflation remained at 1.9% on a year-over-year basis.

The Federal Reserve Bank of Cleveland's median CPI suggests inflation is rising gradually. The 12-month inflation rate ticked up in June to 2.8% from 2.7% in May. This particular measure has seen a fairly pronounced acceleration since the end of 2017.




NOTES: Shaded area indicates National Bureau of Economic Research (NBER) recession. CPI is consumer price index. PCE is personal consumption expenditures.
SOURCES: Bureau of Labor Statistics; Bureau of Economic Analysis; Federal Reserve Bank of Cleveland; Federal Reserve Bank of Dallas; NBER.

Both survey- and market-based inflation expectations have changed little, according to recent data. Market-based inflation expectations, measured by Treasury Inflation-Protected Securities-implied five-year/five-year-forward CPI inflation expectations (expected average inflation over the five-year period that begins five years from now) was 2.2% in July, unchanged from the month before.

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

| Data Series | Mar 2018 | April 2018 | May 2018 | June 2018 | July 2018 | Aug 2018 |
|---|---|---|---|---|---|---|
| Unemployment Rate (1) | 4.1 | 3.9 | 3.8 | 4.0 | 3.9 | 3.9 |
| Change in Payroll Employment (2) | 155 | 175 | 268 | 208 | (P) 147 | (P) 201 |
| Average Hourly Earnings (3) | 26.80 | 26.86 | 26.94 | 26.99 | (P) 27.06 | (P) 27.16 |
| Consumer Price Index (4) | -0.1 | 0.2 | 0.2 | 0.1 | 0.2 | |
| Producer Price Index (5) | 0.2 | (P) 0.2 | (P) 0.5 | (P) 0.3 | (P) 0.0 | |
| U.S. Import Price Index (6) | -0.2 | 0.5 | 0.9 | (R) -.01 | (R) 0.0 | |

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

| Data Series | 2nd Qtr 2017 | 3rd Qtr 2017 | 4th Qtr 2017 | 1st Qtr 2018 | 2nd Qtr 2018 |
|---|---|---|---|---|---|
| Employment Cost Index (1) | 0.5 | 0.7 | 0.6 | 0.8 | 0.6 |
| Productivity (2) | 1.6 | 2.3 | -0.3 | 0.3 | 2.9 |

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

*Data extracted on: September 11, 2018*

# THE FEDERAL RESERVE BOARD
# THE BEIGE BOOK – SEPTEMBER 12, 2018 EXCERPT

### *Overall Economic Activity*

Reports from the Federal Reserve Districts suggested that the economy expanded at a moderate pace through the end of August. Dallas reported relatively brisk growth, while Philadelphia, St. Louis, and Kansas City indicated somewhat below average growth. Consumer spending continued to grow at a modest pace since the last report, and tourism activity expanded, to varying degrees, across the nation. Manufacturing activity grew at a moderate rate in most Districts, though St. Louis described business as little changed and Richmond reported a decline in activity. Transportation activity expanded, with a few Districts characterizing growth as robust. Home construction activity was mixed but up modestly, on balance. However, home sales were somewhat softer, on balance--in some cases due to reduced demand, in others due more to low inventories. Commercial real estate construction was also mixed, while both sales and leasing activity expanded modestly. Lending activity grew throughout the nation. Some Districts noted weakness in agricultural conditions. Businesses generally remained optimistic about the near-term outlook, though most Districts noted concern and uncertainty about trade tensions--particularly though not only among manufacturers. A number of Districts noted that such concerns had prompted some businesses to scale back or postpone capital investment.

### *Highlight of Dallas Federal Reserve*

Economic activity expanded at a solid pace. Manufacturing and service sectors sustained a healthy pace of growth, while activity in the housing and energy sectors was flat to down. Retail spending accelerated, as did loan demand. Wages and other input costs rose, but firms' ability to pass these increases on to customers was limited.

# ECONOMIC REPORTS AND FORECASTS: STATE OF TEXAS

## Federal Reserve Bank, Dallas Regional Economic Update

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

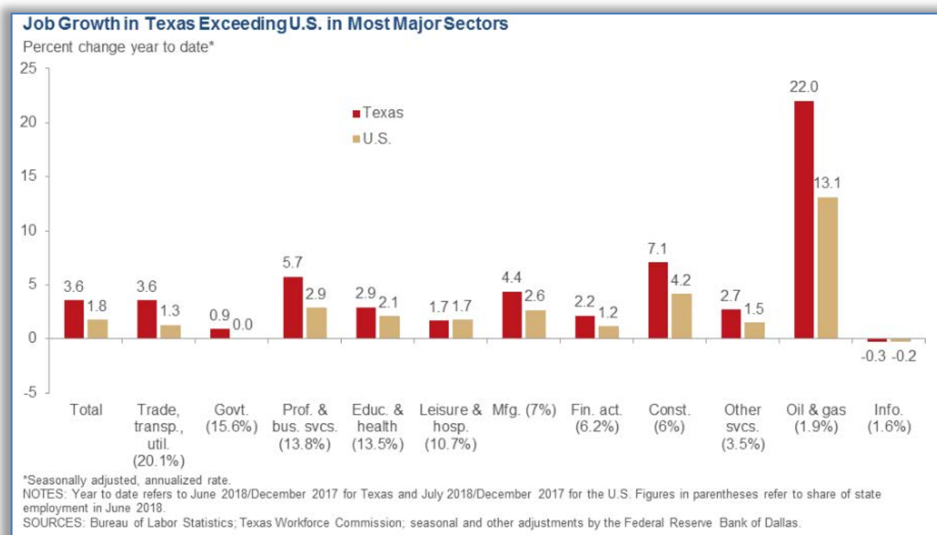
### ⇧ Red-Hot Texas Economic Growth Likely to Cool

The regional economy is about as hot as the Texas summer. Texas job growth was a blistering 3.6% (annualized) in the first half of 2018. The Dallas Fed's Texas Business Outlook Surveys provide further evidence of continued widespread and solid growth. Labor market tightness continues, leading to mounting wage pressures, and trade frictions are increasing price inflation.

However, after red-hot gains the first half of the year, expansion in the regional economy will likely cool in the second half due to a historically tight labor market and a slowing in export growth. Additionally, growth in Houston, which makes up 25% of state employment, will likely moderate as Hurricane Harvey-induced activity dissipates in the second half of the year. Despite the softening, Texas payroll expansion is expected to remain above its long-term average.

### ⇧ Job Growth Remains Strong, Placing Texas in the No. 1 Spot

Texas employment grew an annualized 2.8% in June, down from 3.7% in May. Nevertheless, the pace of job creation was nearly as rapid in the second quarter (3.5%) as the first (3.6%). Texas payrolls have expanded at a 3.6% annualized rate (217,600 jobs) in the first half of the year, ranking No. 1 in the country, up from 9th place in 2017.



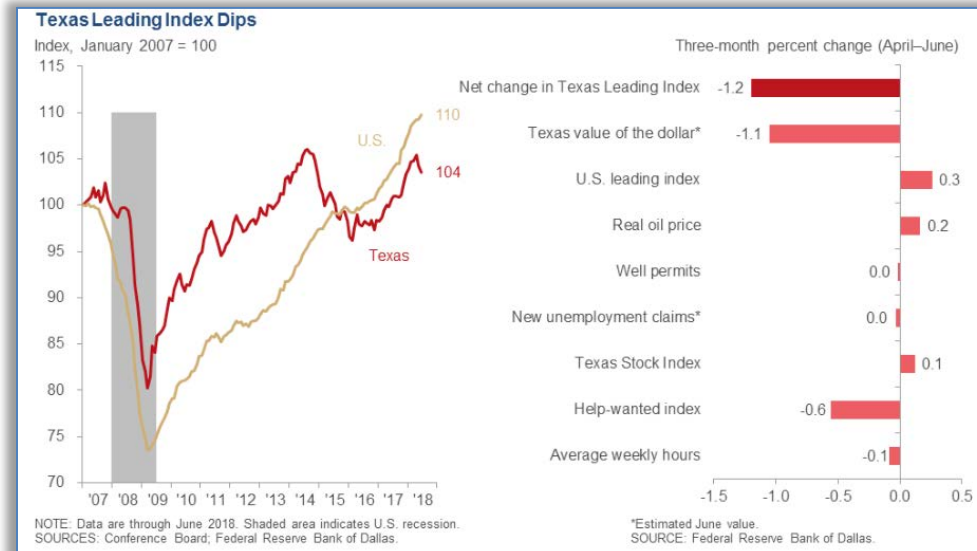

Texas employment is expanding at twice the nation's rate so far this year, with the state's lead over the U.S. in job growth extending to most major sectors. The difference is the largest in the goods sector, where Texas is growing 4.3 percentage points faster than the U.S. Among the private service industries, the state's two largest sectors—trade, transportation and utilities and professional and business services—boast the highest job growth premiums relative to the U.S.

### ⇧ Business Activity Expands Broadly

Beyond employment growth, the Texas Business Outlook Surveys (TBOS) also signal broad-based strength in the state's economy. The three-month moving average of the Texas Manufacturing Outlook Survey (TMOS) headline production index ticked up in July to its highest level since March 2006. The

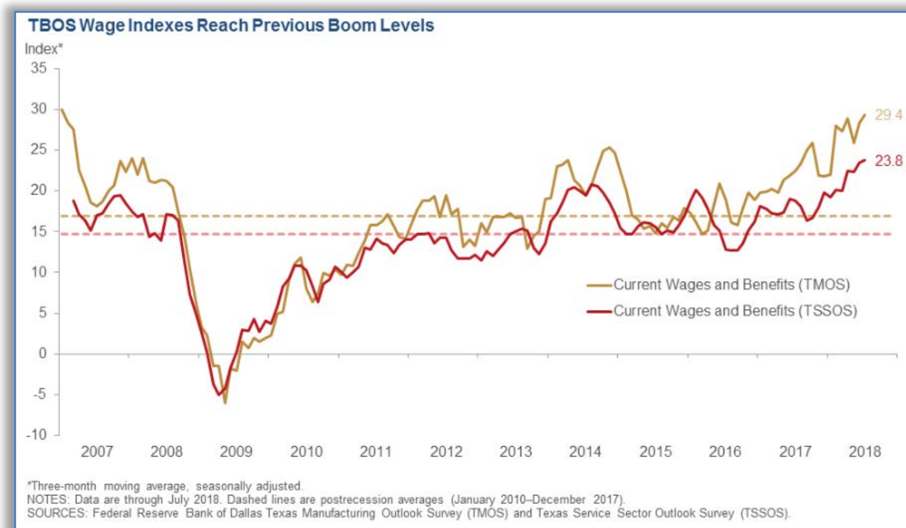
three-month moving averages of the Texas Service Sector Outlook Survey (TSSOS) and the Texas Retail Outlook Survey (TROS) headline indexes also edged up last month and remained above post-recession averages (January 2010–December 2017), indicating solid growth.

## ⇳ Texas Leading Index Dips




Although job growth and business activity remained robust in the second quarter, the Texas leading index slipped 1.2%, resulting in a downward revision to the 2018 job forecast for the state. The surge in the Texas trade-weighted value of the dollar and the decline in help-wanted advertising were the most significant drags on the index in the second quarter. The Dallas Fed's 2018 Texas job growth forecast now stands at 3.0%, down from 3.3% in June, suggesting that growth may cool in the second half of the year.

## ⇳ Tight Labor Market Pressures Wages



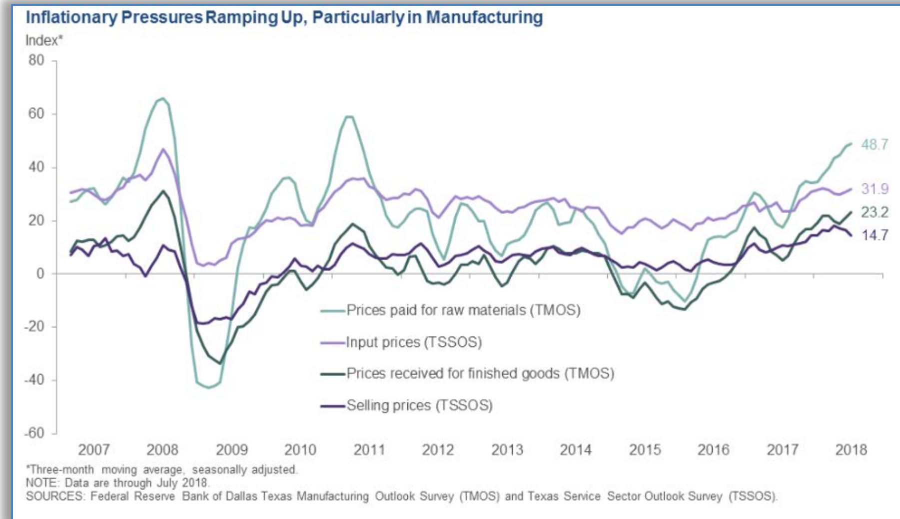

The Texas unemployment rate dipped to 4.0% in June and is only 0.1 percentage points higher than its all-time low of 3.9% in November 2017. Reports of worker shortages are rife across industries and skill sets. Even broader measures of unemployment are below their prerecession averages, indicating that slack in the labor market has been largely absorbed. This suggests that pressure on employers to attract workers may spur further wage increases.

TBOS data provide evidence of elevated and escalating wage pressures across the manufacturing and services sectors. The three-month moving averages of the wages and benefits indexes for both the services and retail surveys hit all-time highs in the 11-year history of the surveys in July; the three-month moving average of the TMOS wages and benefits index reached its highest point since January 2007.

Future expectations of wage growth ratcheted up in July. The three-month moving averages of the TMOS and TSSOS six-months-ahead wages and benefits indexes reached their highest point since 2004 and 2007, respectively, and the TROS equivalent hit a new record high.

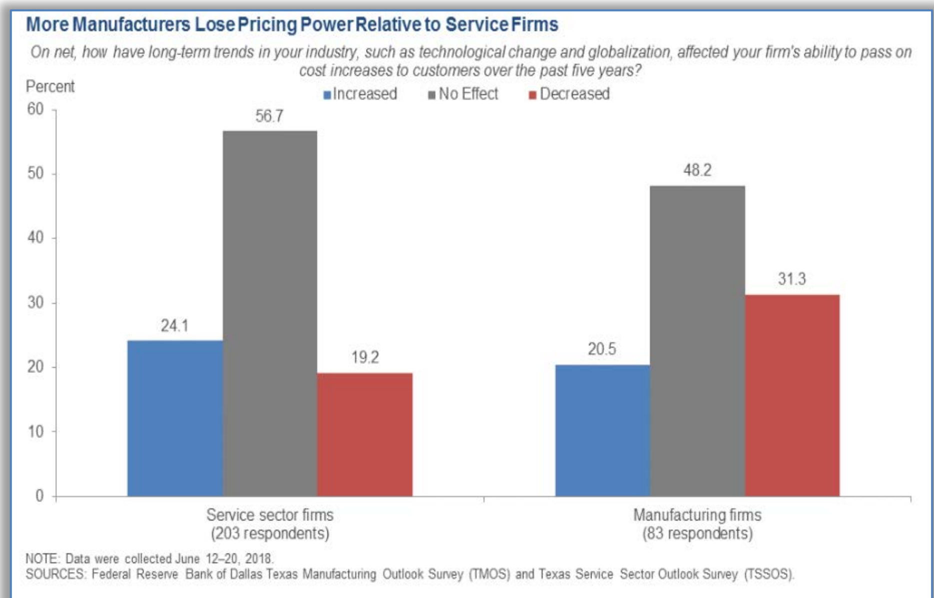
## ⇳ Inflationary Pressures Elevated, Particularly in Manufacturing

Firms responding to TBOS report that like wages pressures, prices are ramping up. The three-month moving average of the TMOS finished goods price index rose to its highest point since 2008, and the TSSOS selling prices index remained well above its post-recession average, suggesting upward pressure on prices.




Manufacturers' input costs have increased at a much faster rate in recent months partly due to the new tariffs, while their ability to pass these higher costs on to customers remains limited, thus widening the gap between the TMOS finished goods and raw materials price indexes shown. The three-month moving average of the TSSOS input price index edged up in July, suggesting inflationary pressures on service firms as well.

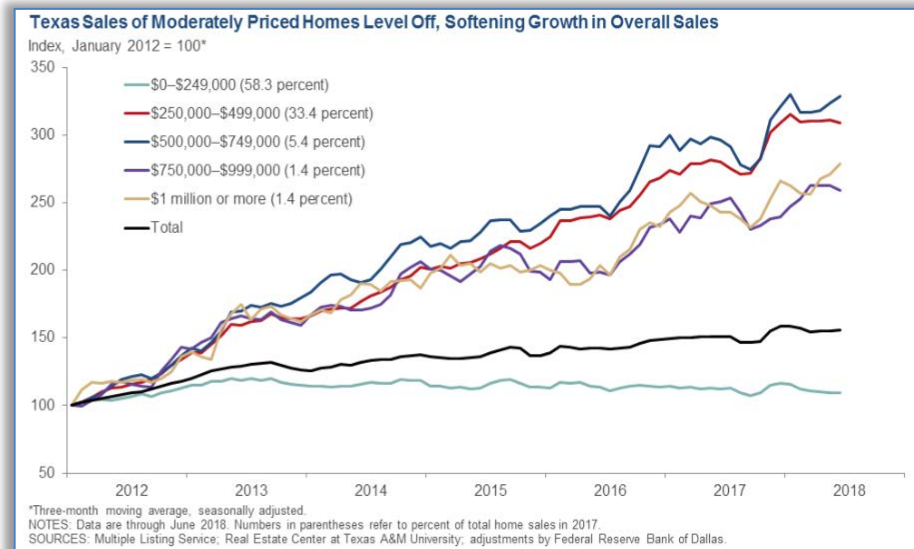
## ⇩ Manufacturers Suffer Greater Loss of Pricing Power




Responses to the June TBOS special questions suggest that manufacturers' pricing power has suffered from long-term trends, such as technological change and globalization, while service firms have seen less of an erosion. A larger share of service firms (24.1%) versus manufacturers (20.5%) reported an increase in pricing power due to these long-term trends over the past five years. Conversely, a higher percentage of manufacturers (31.3%) said their pricing power had been diminished by these trends compared with service firms (19.2%) noting a decline.

## ⇩ Home Sales Nearly Flat Due to Slowing Activity in Moderate Price Points

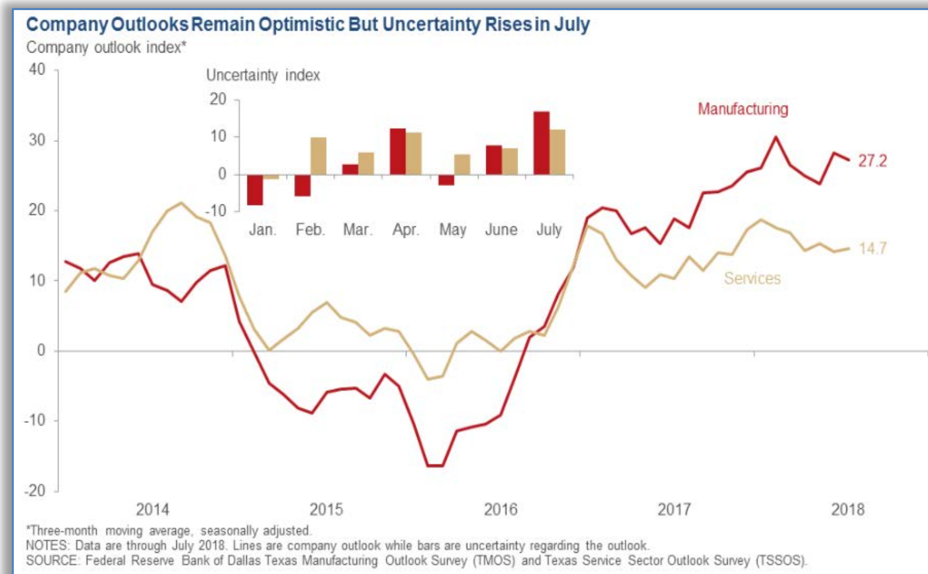
Texas existing-home sales appear to have plateaued at elevated levels in recent months, with the number of homes sold in June 4.3% below the December 2017 record. In the first half of the year, total existing-home sales are up 2.8% compared with the same period last year.




A closer look at the data reveals that the softening is partly a result of slowing in sales of mid-priced homes ($250,000–$499,000), which made up 33.4% of 2017 sales. Tight inventory at the low- to mid-price points and declining affordability (due to higher prices and mortgage rates) are likely impacting sales.

## ⇳ Exports at Record Highs but Trade Frictions Weigh on Sentiment and Outlooks

Texas exports rose for the fifth straight month in June. Total state exports expanded 14.8% in the first half of 2018 compared with the same period a year ago—more than twice the nation's 5.2% increase. An expanding global economy and higher oil prices are boosting exports, although recent trade frictions and uncertainty surrounding North American Free Trade Agreement talks are significant headwinds for future growth.




Numerous business contacts across a wide range of industries are expressing concern about the impact of the ongoing trade disputes on future growth and prices. While future expectations among TBOS respondents remain fairly optimistic, we are seeing uncertainty in outlooks increase as trade tensions escalate.

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

| Data Series | Feb 2018 | Mar 2018 | Apr 2018 | May 2018 | June 2018 | July 2018 |
|---|---|---|---|---|---|---|
| **Labor Force Data** | | | | | | |
| **Civilian Labor Force** (1) | 13,656.9 | 13,702.9 | 13,750.8 | 13,788.9 | 13,813.3 | (P) 13,824.4 |
| **Employment** (1) | 13,112.8 | 13,150.6 | 13,192.2 | 13,229.2 | 13,255.6 | (P) 13,276.7 |
| **Unemployment** (1) | 544.1 | 552.3 | 558.6 | 559.7 | 557.8 | (P) 547.7 |
| **Unemployment Rate** (2) | 4.0 | 4.0 | 4.1 | 4.1 | 4.0 | (P) 4.0 |
| **Nonfarm Wage and Salary Employment** | | | | | | |
| **Total Nonfarm** (3) | 12,431.7 | 12,467.9 | 12,507.6 | 12,548.3 | 12,573.2 | (P) 12,596.7 |
| **12-month% change** | 2.4 | 2.5 | 2.7 | 2.9 | 2.9 | (P) 3.1 |
| **Mining and Logging** (3) | 239.3 | 240.9 | 246.7 | 252.5 | 257.4 | (P) 257.8 |
| **12-month% change** | 12.9 | 11.9 | 12.9 | 13.8 | 15.0 | (P) 14.5 |
| **Construction** (3) | 740.2 | 744.8 | 748.5 | 754.1 | 757.8 | (P) 768.3 |
| **12-month% change** | 4.8 | 4.9 | 5.7 | 6.0 | 6.1 | (P) 8.1 |
| **Manufacturing** (3) | 861.7 | 866.3 | 874.3 | 877.7 | 878.2 | (P) 874.7 |
| **12-month% change** | 2.1 | 2.4 | 3.2 | 3.5 | 3.0 | (P) 2.5 |
| **Trade, Transportation, and Utilities** (3) | 2,489.8 | 2,499.4 | 2,503.7 | 2,509.7 | 2,511.8 | (P) 2,519.3 |
| **12-month% change** | 2.0 | 2.3 | 2.3 | 2.6 | 2.4 | (P) 2.7 |
| **Information** (3) | 200.2 | 199.0 | 199.0 | 200.0 | 197.6 | (P) 196.6 |
| **12-month% change** | -1.3 | -2.3 | -1.8 | -0.9 | -2.0 | (P) -2.5 |
| **Financial Activities** (3) | 769.5 | 770.9 | 769.1 | 771.5 | 773.9 | (P) 775.2 |
| **12-month% change** | 3.0 | 2.9 | 2.4 | 2.5 | 2.4 | (P) 2.3 |
| **Professional & Business Services** (3) | 1,720.7 | 1,728.1 | 1,734.4 | 1,739.3 | 1,751.4 | (P) 1,749.1 |
| **12-month% change** | 4.0 | 4.2 | 4.6 | 4.7 | 5.0 | (P) 4.8 |
| **Education & Health Services** (3) | 1,683.9 | 1,686.7 | 1,693.0 | 1,698.4 | 1,701.0 | (P) 1,707.4 |
| **12-month% change** | 1.5 | 1.4 | 1.7 | 2.0 | 2.0 | (P) 2.5 |
| **Leisure & Hospitality** (3) | 1,352.1 | 1,352.5 | 1,355.9 | 1,361.2 | 1,362.7 | (P) 1,368.4 |
| **12-month% change** | 3.3 | 3.1 | 3.6 | 3.7 | 3.8 | (P) 3.6 |
| **Other Services** (3) | 430.0 | 433.6 | 436.2 | 437.6 | 436.1 | (P) 437.0 |
| **12-month% change** | 0.9 | 1.4 | 2.0 | 2.4 | 2.4 | (P) 3.4 |
| **Government** (3) | 1,944.3 | 1,945.7 | 1,946.8 | 1,946.3 | 1,945.3 | (P) 1,942.9 |
| **12-month% change** | 0.4 | 0.3 | 0.2 | 0.3 | 0.3 | (P) 0.2 |

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

*Data extracted on: September 11, 2018*

# FEDERAL RESERVE BANK SENIOR LOAN OFFICER OPINION SURVEY

The July 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 correspond to the second quarter of 2018. Responses were received from 72 domestic banks and 22 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 July survey indicated that they eased their standards and terms on commercial and industrial (C&I) loans to firms of all sizes and kept commercial real estate (CRE) lending standards about unchanged on balance. Banks reported stronger demand for C&I loans by small firms and weaker demand for CRE loans.

Banks also responded to a set of special questions inquiring about the level of banks' current lending standards relative to the midpoint of the range over which banks' standards have varied between 2005 and the present. Banks, on balance, reported that their levels of lending standards on C&I loans are currently at the easier end of the range from 2005 to the present. For CRE loans, banks reported currently having relatively tight lending standards on net.

For loans to households, banks reported that, on balance, their lending standards on residential real estate (RRE) loans and auto loans remained little changed, while a moderate share of banks tightened standards on credit card loans. In addition, banks reported weaker demand for all categories of RRE loans, while demand for consumer loans reportedly remained about unchanged. From a longer-term perspective, banks, on balance, reported that their current level of RRE and subprime consumer lending standards are at the tighter end of the range from 2005 to now.

## BUSINESS LENDING

### C&I Loans

On net, a moderate fraction of domestic banks reportedly eased standards on loans to large and middle-market firms, and a modest fraction reported having done so on lending to small firms. Over the second quarter of the year, banks reportedly eased most terms on C&I loans to firms of all sizes. Significant net fractions of banks reportedly increased the maximum size of credit lines and narrowed loan rate spreads on loans to large and middle-market firms. In addition, moderate net shares of banks increased the maximum maturity of loans, reduced the cost of credit lines and premiums charged on riskier loans, and eased loan covenants on such loans. Moderate net fractions of banks narrowed loan rate spreads and increased the maximum maturity on loans to small firms.

Notably, almost all domestic banks that reportedly eased standards or terms on C&I loans over the past three months cited increased competition from other lenders as a reason for easing. In addition, significant fractions of banks mentioned a more favorable or less uncertain economic outlook, increased tolerance for risk, and increased liquidity in the secondary market for these loans as important reasons for easing.

Over the second quarter of the year, a modest net share of foreign banks reportedly eased C&I loan standards. Foreign banks also eased several terms on C&I loans; moderate net fractions reportedly narrowed loan rate spreads, increased the maximum size of credit lines, and eased loan covenants.

A modest net percentage of domestic banks reported stronger demand for C&I loans by small firms in the second quarter, while demand for loans by large and middle-market firms was little changed. Foreign banks reported that demand for C&I loans remained about unchanged. The number of inquiries from potential borrowers reportedly rose for a modest net share of domestic banks and was about unchanged at foreign banks.

Major shares of domestic banks that reported stronger C&I loan demand indicated that increases in customers' accounts receivable, inventory, and merger or acquisition financing needs, as well as increased customer investment in plant or equipment were important reasons for stronger demand. Major shares of banks that reported weaker C&I loan demand cited increases in customers' internally generated funds, reduced customer investment in plant or equipment, and customers' borrowing having shifted to other lenders as important reasons.

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

On balance, banks reportedly kept CRE lending standards about unchanged. However, a modest net share of domestic banks reported that they tightened lending standards on loans secured by multifamily residential properties. Meanwhile, a modest net fraction of foreign banks reported easing their standards on CRE loans.

Moderate and modest net shares of domestic banks indicated weaker demand for construction and land development loans and multifamily loans, respectively. Over the same period, foreign banks reported that demand for CRE loans was about unchanged on balance.

## Lending to Households

### Residential Real Estate Lending

Banks reportedly kept residential mortgage lending standards little changed on balance. However, a moderate net share of banks reportedly eased standards on GSE (government-sponsored enterprise)-eligible residential mortgages, and modest net fractions of banks reported easing standards on government and non-qualified (non-QM) jumbo mortgages. A modest net fraction of banks reportedly eased standards on home equity lines of credit (HELOCs).

In the second quarter of 2018, banks reported weaker demand across all surveyed RRE loan categories. Moderate net shares of domestic banks reported decreased demand for subprime, government, non-QM non-jumbo, and QM non-jumbo non-GSE-eligible residential mortgages. In addition, modest net fractions of banks reported weaker demand for non-QM jumbo, QM jumbo, and GSE-eligible mortgage loans. Over the same period, a moderate net fraction of banks reported weaker demand for HELOCs.

### Consumer Lending

A moderate net percentage of banks reported tightening standards on credit card loans over the past three months, while standards on auto and other consumer loans were reportedly little changed on net. In addition to tightening standards on credit card loans, banks also reportedly tightened several terms on such lending. Modest net shares of banks reportedly increased the minimum required credit scores and widened loan rate spreads on credit card loans. While a modest net share of banks reported widening loan rate spreads on auto loans, banks reportedly kept most terms on auto lending and other consumer loans about unchanged.

Demand for auto, credit card, and other consumer loans reportedly was little changed on balance. A modest net share of banks reported increased willingness to make consumer installment loans.

## Special Question on the Level of Banks' Current Lending Standards

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. The July 2018 survey included a set of special questions that asked respondents to describe the current levels of lending standards at their bank. Specifically, for each loan category surveyed, respondents were asked to consider the range over which their lending standards have varied from 2005 to the present, and then to report where the level of standards on such loans currently resides, relative to the midpoint of that range.

Domestic banks reported that, on net, their current lending standards on all categories of C&I loans remained at levels that are at the easier ends of their respective ranges since 2005. In particular, significant net shares of banks reported that their levels of lending standards on non-syndicated loans to large and middle-market firms and on investment-grade syndicated C&I loans are currently at the easier

ends of their respective ranges since 2005. Moderate net fractions of banks reported that their current standards on non-syndicated loans to small and very small firms are at the relatively easier ends of their ranges from 2005 to now, and a modest net share of banks reported so for current standards on syndicated C&I loans to below-investment-grade firms. On net, domestic banks' current levels of lending standards on most C&I loan categories were generally in line with their responses to a similar set of special questions in the July 2017 survey.

Among foreign banks, moderate and modest net fractions reported that their current levels of lending standards on investment-grade syndicated loans and non-syndicated C&I loans to large and middle-market firms are at the easier ends of their ranges from 2005 to the present, respectively. However, a significant net share of foreign banks reported that their level of standards on lending to small firms is at the tighter end of the range since 2005. Foreign banks' current level of standards on syndicated loans to below-investment-grade firms is reportedly around the midpoint of its range on net. On balance, compared to responses to the July 2017 survey, foreign banks' current levels of standards appear to have eased on syndicated investment-grade loans and on non-syndicated loans to large and middle-market firms, and tightened on loans to small firms.

Regarding the levels of standards on CRE loans, domestic banks, on balance, reported that the current levels of their standards on most major categories of these loans are at the relatively tighter ends of the ranges that have prevailed since 2005. Significant and moderate net percentages of domestic banks reported that current levels of standards are tighter than the respective midpoints on loans for construction and land development purposes and on loans secured by multifamily residential properties, respectively. On net, banks' current level of lending standards on loans secured by nonfarm nonresidential properties is reported to be around the midpoint of the range of standards that have prevailed since 2005. Major net shares of foreign banks reported relatively tight current levels of standards on construction and land development loans and loans secured by nonfarm nonresidential properties, and a significant net fraction reported so for multifamily loans. Compared to the July 2017 survey, domestic banks' current levels of CRE lending standards appear generally less tight, while foreign banks' current levels of such standards appear to have tightened on balance.

With respect to RRE loans, on balance, domestic banks reported that lending standards for all categories included in this survey remained at the relatively tighter ends of the ranges of those standards since 2005. Subprime residential mortgages remained the category that was most consistently reported as being tight, with a major net share of banks reporting that standards are currently tighter than the midpoint. Additionally, a significant net share of banks reported relatively tight standards on jumbo residential loans, and moderate net fractions reported so for standards on government and GSE-eligible residential mortgages and HELOCs. The shares of banks that reported that their lending standards are at the relatively tighter ends of the ranges since 2005 have increased across most RRE loan types, compared to the July 2017 survey.

On balance, banks' current levels of standards on consumer loans were reported to be on the tighter end of the range since 2005 for subprime borrowers. In particular, significant net fractions of banks reported that the levels of their standards are currently at the relatively tighter ends of their respective ranges since 2005 on both auto and credit card loans to subprime borrowers. However, on auto loans to prime borrowers, a modest net percentage of banks reported that the current level of standards is easier than the midpoint, while standards are around the midpoint on credit card loans to prime borrowers and on consumer loans other than credit card and auto loans. On net, this year's responses on banks' current levels of standards on credit card and auto lending are generally in line with those reported in the July 2017 survey. However, the net fraction of banks reporting that their subprime credit card lending standards are currently at the relatively tighter end of the range since 2005 has increased, compared to last year.

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*Yahoo Finance, online*

*Visit the Finance Commission of Texas website for previous*

*Condition of the Texas State Banking System Reports.*