FDIC State Profile

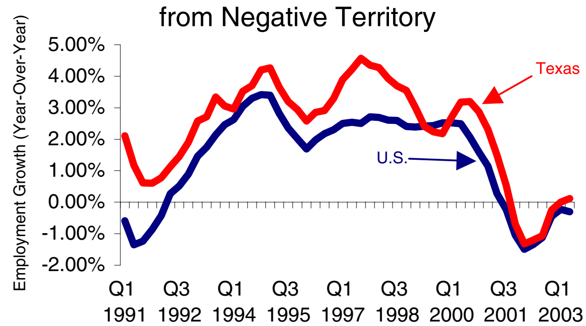
FALL 2003

# Texas

**Despite a long-awaited return to employment growth in second quarter 2003, the Texas economy remains weak, undermined by state budget deficits and continued woes in key industries.**

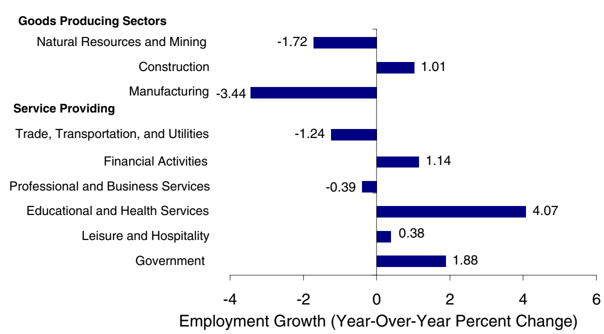
- Texas employment grew on a year-over-year basis in the second quarter of 2003, the first expansion in employment since third quarter 2001 (see Chart 1). The construction sector showed positive employment growth of 1.0 percent, primarily a reflection of the state's healthy housing market. The service-providing sectors have improved in four categories, with modest-to-moderate year-over-year employment gains reported in education and health services, government, construction, and tourism. Improvements in these employment sectors helped Texas gain jobs for the first time in seven quarters.
- Employment growth in Texas has been uneven with the manufacturing and transportation sectors still losing jobs. The Texas manufacturing sector continues to shed jobs on a year-over-year basis with negative employment growth of 3.4 percent in the second quarter of 2003 (see Chart 2). Since the beginning of the tepid recovery, the Texas manufacturing sector has lost an additional 69,000 jobs. Employment declines in transportation may intensify as American and Continental Airlines, major employers in ***Dallas*** and ***Houston,*** continue to struggle. These job losses contribute to Texas' growing unemployment rate that stood at 6.6 percent in the second quarter, its highest level in nine years, and well above the U.S. rate of 6.2 percent. Diversification away from energy and toward high-tech manufacturing benefited the Texas economy greatly during the 1990s expansion. However, the downturn in the high-tech and telecom sectors represents a major contributing factor in the state's sluggish economic performance since 2001.
- U.S. crude oil prices plunged after the U.S.-Iraq war ended in May but have since climbed because of concerns over lean inventory levels. The price of a barrel of West Texas Intermediate crude oil dipped to approximately $25 in late April, but climbed above $30 a barrel in August. Natural gas supplies are running below their five-year historical average, contributing to rising natural gas prices (over 63 percent higher as of June 2003 on a year-ago basis). Higher crude oil and natural gas prices affect the Texas economy in two different ways: 1) boosting industry revenues, profits, and capital spending; and 2) causing oil and gas users, including manufacturers, farmers, and households, to reduce spending, production, or employment.

Chart 1: Employment Trends in Texas Closely Track U.S. Economy, with Texas Emerging from Negative Territory




Source: Bureau of Labor Statistics (Haver Analytics)

Chart 2: The Texas Manufacturing Sector Leads Negative Employment Growth



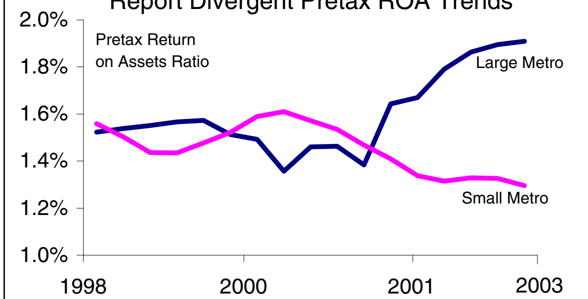

Source: Bureau of Labor Statistics (Haver Analytics)

- Declining tax revenues, coupled with soaring health care costs, have undermined the Texas state budget. The 2003 budget deficit is estimated to be $1.8 billion and is projected to double in 2004. In response, the governor has called for a 7 percent reduction in most government programs. As a result, Texas may see slower growth due to reduced government spending.

## Small metro insured institutions face continued pressure from larger institutions.

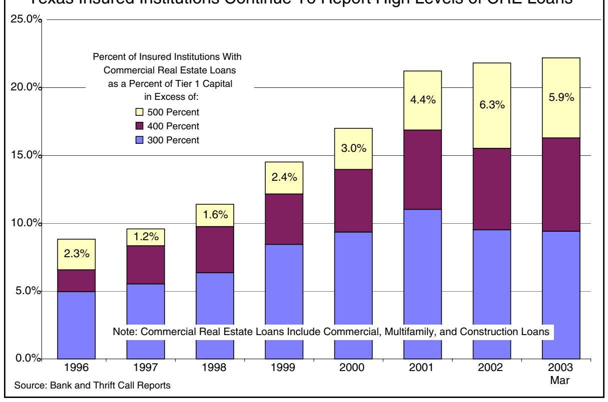
- A sluggish state economy has resulted in mixed results for the 712 insured institutions headquartered in Texas. While the four quarter moving average pretax return on assets ratio[1] was 1.85 percent at March 31, 2003, up 15 basis from a year earlier, a disparity is growing between small banks (less than $250 million in assets) and larger banks (more than $250 million in assets), especially those located in metro areas (see Chart 3). There are several reasons for this change:
  - — Small banks have been more affected by falling interest rates. The average net interest margin for small metro banks fell 32 basis points over the two-year period ending March 31, 2003, whereas large banks increased NIM by 9 basis points over the same period.
  - — Noninterest income for larger banks increased at a greater pace than for small banks and remains about 50 basis points higher. A few large institutions have been especially successful in generating income through loan sales.
  - — Large banks have lowered their provision for loan and lease losses by 23 basis points over the two-year period compared to an 8 basis point increase for small banks. While both large and small banks have improved past-due and nonaccrual loan positions, larger banks have slightly lower ratios.

Chart 3: As Interest Rates Decline, Texas Large and Small Metro Institutions Report Divergent Pretax ROA Trends




Source: Bank and Thrift Call Reports

Chart 4: Despite Continued Commercial Real Estate Weakness Texas Insured Institutions Continue To Report High Levels of CRE Loans




Source: Bank and Thrift Call Reports

- Texas insured institutions reported the highest concentration of commercial real estate (CRE) loans[2] as a percent of Tier 1 capital in a decade (see Chart 4). Despite this heightened exposure, CRE past-due and charge-off rates remained near relatively low five-year averages. The Dallas metro area had the highest office vacancy rate in the nation at 26.5 percent as of June 30, 2003. ***Austin*** ranked second at 25.5 percent. Houston office vacancy rates were slightly above the national average of 17.0 percent, while ***Fort Worth*** office vacancy rates declined 170 basis points to 15.8 percent. Industrial, multifamily, and hotel property types have shown similar signs of weakness. Consequently, rental rates fell in major markets putting downward pressure on cash flow as leases renew. The CRE portfolios of banks and thrifts have been insulated from the effects of deteriorating market fundamentals by: 1) low interest rates; 2) the tremendous growth in public, non-governmental mortgage securitization; and 3) greater regulatory oversight and stringent CRE lending standards.[3] While most banks and thrifts headquartered in Texas were not lenders to the largest CRE projects, rising vacancies and increasing unemployment may have negative implications for community bank loan portfolios.
- Texas per capita bankruptcy rates continue to hover near record levels, albeit below national averages. Moreover, continued slow employment growth does not suggest a quick recovery. While total past-due and charge-off rates have remained stable, median consumer charge-off rates for Texas insured institutions are beginning to rise.

[1] Pretax ROA is used to allow better comparability between regular banking corporations and institutions electing Subchapter S status. Thirty-seven percent of Texas' insured institutions have elected Subchapter S status, which eliminates income tax at the bank level. Income statement comparisons are on an average assets basis.

[2] Commercial real estate is defined as non-residential real estate, multifamily, and construction and development loans.

[3] Murray, Thomas, "How Long Can Bank Portfolios Withstand Problems in Commercial Real Estate?" *FDIC FYI,* June 23, 2003.

# Texas at a Glance

| General Information | Mar-03 | Mar-02 | Mar-01 | Mar-00 | Mar-99 |
|---|---|---|---|---|---|
| Institutions (#) | 712 | 727 | 746 | 799 | 837 |
| Total Assets (in thousands) | 220,193,035 | 200,590,479 | 186,349,325 | 244,304,295 | 230,606,751 |
| New Institutions (# < 3 years) | 17 | 17 | 23 | 35 | 34 |
| New Institutions (# < 9 years) | 53 | 50 | 50 | 48 | 45 |

| Capital | Mar-03 | Mar-02 | Mar-01 | Mar-00 | Mar-99 |
|---|---|---|---|---|---|
| Tier 1 Leverage (median) | 9.14 | 8.93 | 9.10 | 9.13 | 8.83 |

| Asset Quality | Mar-03 | Mar-02 | Mar-01 | Mar-00 | Mar-99 |
|---|---|---|---|---|---|
| Past-Due and Nonaccrual (median %) | 2.33% | 2.17% | 2.16% | 1.91% | 2.31% |
| Past-Due and Nonaccrual >= 5% | 134 | 107 | 119 | 106 | 150 |
| ALLL/Total Loans (median %) | 1.28% | 1.24% | 1.19% | 1.20% | 1.24% |
| ALLL/Noncurrent Loans (median multiple) | 1.68 | 1.84 | 1.96 | 2.17 | 1.87 |
| Net Loan Losses/Loans (aggregate) | 0.38% | 0.42% | 0.33% | 0.34% | 0.44% |

| Earnings | Mar-03 | Mar-02 | Mar-01 | Mar-00 | Mar-99 |
|---|---|---|---|---|---|
| Unprofitable Institutions (#) | 46 | 53 | 33 | 38 | 53 |
| Percent Unprofitable | 6.46% | 7.29% | 4.42% | 4.76% | 6.33% |
| Return on Assets (median %) | 1.08 | 1.14 | 1.19 | 1.26 | 1.10 |
| 25th Percentile | 0.69 | 0.66 | 0.81 | 0.88 | 0.75 |
| Net Interest Margin (median %) | 4.27% | 4.43% | 4.54% | 4.72% | 4.40% |
| Yield on Earning Assets (median) | 5.80% | 6.52% | 8.17% | 8.02% | 7.55% |
| Cost of Funding Earning Assets (median) | 1.53% | 2.12% | 3.64% | 3.27% | 3.14% |
| Provisions to Avg. Assets (median) | 0.13% | 0.14% | 0.12% | 0.11% | 0.09% |
| Noninterest Income to Avg. Assets (median) | 0.90% | 0.85% | 0.88% | 0.87% | 0.86% |
| Overhead to Avg. Assets (median) | 3.33% | 3.33% | 3.36% | 3.41% | 3.26% |

| Liquidity/Sensitivity | Mar-03 | Mar-02 | Mar-01 | Mar-00 | Mar-99 |
|---|---|---|---|---|---|
| Loans to Deposits (median %) | 62.25% | 62.45% | 62.09% | 59.46% | 55.88% |
| Loans to Assets (median %) | 54.05% | 54.38% | 54.57% | 52.37% | 49.07% |
| Brokered Deposits (# of institutions) | 61 | 50 | 48 | 42 | 38 |
| Bro. Deps./Assets (median for above inst.) | 3.65% | 2.01% | 1.73% | 2.53% | 2.19% |
| Noncore Funding to Assets (median) | 16.72% | 16.60% | 16.71% | 15.22% | 14.38% |
| Core Funding to Assets (median) | 72.06% | 72.57% | 72.30% | 74.26% | 74.59% |

| Bank Class | Mar-03 | Mar-02 | Mar-01 | Mar-00 | Mar-99 |
|---|---|---|---|---|---|
| State Nonmember | 293 | 297 | 307 | 329 | 346 |
| National | 329 | 340 | 351 | 374 | 401 |
| State Member | 43 | 41 | 40 | 43 | 39 |
| S&L | 11 | 12 | 10 | 11 | 13 |
| Savings Bank | 12 | 13 | 14 | 15 | 15 |
| Mutually Insured | 24 | 24 | 24 | 27 | 23 |

| MSA Distribution | # of Inst. | Assets | % Inst. | % Assets |
|---|---|---|---|---|
| No MSA | 374 | 34,504,862 | 52.53% | 15.67% |
| Dallas TX PMSA | 79 | 46,119,218 | 11.10% | 20.94% |
| Houston TX PMSA | 50 | 30,156,021 | 7.02% | 13.70% |
| Ft Worth-Arlington TX PMSA | 40 | 7,848,907 | 5.62% | 3.56% |
| Austin-San Marcos TX | 20 | 2,823,932 | 2.81% | 1.28% |
| San Antonio TX | 18 | 49,514,778 | 2.53% | 22.49% |
| Longview-Marshall TX | 12 | 1,589,907 | 1.69% | 0.72% |
| Killeen-Temple TX | 11 | 2,510,815 | 1.54% | 1.14% |
| Waco TX | 11 | 1,598,068 | 1.54% | 0.73% |
| McAllen-Edinburg-Mission TX | 10 | 7,643,749 | 1.40% | 3.47% |
| Lubbock TX | 9 | 6,254,955 | 1.26% | 2.84% |
| Corpus Christi TX | 8 | 1,803,472 | 1.12% | 0.82% |
| Sherman-Denison TX | 7 | 1,109,985 | 0.98% | 0.50% |