

# Houston Business

A Perspective on the Houston Economy

## Houston Banking in The 1990s: Healthy Profits In a Regional Niche

**T**he 1990s turned the page on the failures and forced mergers that marked Texas banking in the 1980s. The cleanup of bad assets from the crisis of the 1980s, a healthy regional economy and favorable interest margins left Texas banks sound, profitable and as willing and aggressive lenders in the 1990s.

The number of banking institutions in Texas continues to shrink, from 1,165 in 1991 to 959 today, partly as a legacy of the state's unit banking laws and partly as scale economies emerge from new technology and interstate bank combinations. Statewide bank assets, however, have grown 15.7 percent since 1991, and lending 34.7 percent.

Houston-based banks shared fully in the state's improved financial results, and this article examines the performance of local banks in the 1990s. For decades, Houston and Dallas competed to be home to the state's largest banking system, as banks in both cities held similar levels of deposits, assets and loans. However, the decline of Houston-based energy lending, combined with the consolidation and merger of many of the state's largest banks into out-of-state holding companies, helped Dallas emerge as the center of statewide banking activity. With a handful of exceptions, Houston's banks now primarily operate to provide credit and services to a Houston metropolitan market.

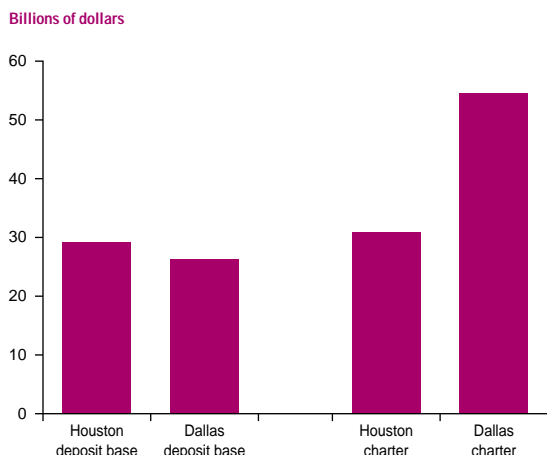
### REGIONAL BANKING COMPARISONS

Available data limit our ability to discuss Houston, Dallas or other local banking markets. The data used here are primarily from the quarterly Report of

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**Figure 1**  
**Bank Deposits Collected**  
**(Houston and Dallas, 1994)**



SOURCE: Report of Condition and Income and FDIC.

Condition and Income (the Call Report) required of all banks, which provides detailed financial data by bank and based on the location of its charter. The Call Report attributes all assets, deposits, loans and other measures of bank activity to the city in which the charter resides. A Houston-based bank with a statewide branching network, for example, has all statewide activity attributed to Houston.

We can illustrate limitations of the data in Figure 1, which compares Houston and Dallas bank deposits in 1994. Call Report figures are compared with Federal Deposit Insurance Corporation (FDIC) data on deposits collected according to the physical location of each branch. The FDIC data provide insight into the relative size of the Houston and Dallas banking markets, with Houston's \$29.3 billion in deposits about 11 percent larger than Dallas'. However, Dallas-chartered banks collect deposits more than twice the size of their home market (\$54.6 billion vs. \$26.3 billion), while Houston-based banks collect only \$31 billion statewide, or \$1.7 billion more than the local market. With very few exceptions, and those found among the city's largest banks, Houston banking fills a metropolitan niche.

As we will see below, Call Report data provide insight into the health of locally chartered banks. They do not, however, provide information on the availability of credit in Houston. First, some Houston-chartered banks lend outside the city, and we cannot esti-

mate how much. Second, banks across the state branch into Houston, and we cannot estimate their local lending. Finally, bank lending continues to shrink as a share of credit extended by the financial system. Across the nation, banking assets have fallen as a share of total financial intermediary assets, from 57 percent in the early 1980s to 35 percent today.

## A HEALTHY BANKING SYSTEM

Earlier issues of this newsletter examined the effects of the Texas banking crisis on Houston and the state (December 1991, February 1992). Of the 10 largest Texas holding companies in the early 1980s, only one survived the decade, and all of the largest Houston banks failed or merged with out-of-state holding companies. Even after the end of the banking crisis, however, the number of Houston-based banks continues to shrink, following state and national trends in merger activity. The number of banks holding a Houston charter has fallen from 135 in 1989 to only 91 in 1995. Among the smallest banks, those holding under \$100 million in assets, the number fell from 104 to 56.

Unlike the 1980s crisis, current consolidation activity is occurring against a backdrop of rapid economic growth and strong bank profits. Texas has been among the strongest state economies in the nation throughout the first half of this decade. Using the same FDIC data displayed in Figure 1, we can determine the growth in the size of the Houston and Dallas deposit base from 1989 to 1994. Both Houston and Dallas enjoyed a rapidly expanding market for banking services, growing 26.5 and 17.8 percent, respectively.

The return to profitability by Houston banks is evident in Figure 2. The chart shows the course of profit margins, expressed as net income relative to operating income, and the share of operating income diverted to reserves (as a precaution or required by regulators) and held as a provision against loan losses. By 1990, Houston banks had turned the corner, and by 1992 they saw excellent financial results. Small, medium and large banks in the Houston market shared in these profits. Dallas and other Texas banks mirrored these results, in timing and the level of performance.

Broad measures of the health of the local banking system, such as return on assets and equity, also reflected this return to profitability. Since early 1992, the quarterly return on assets

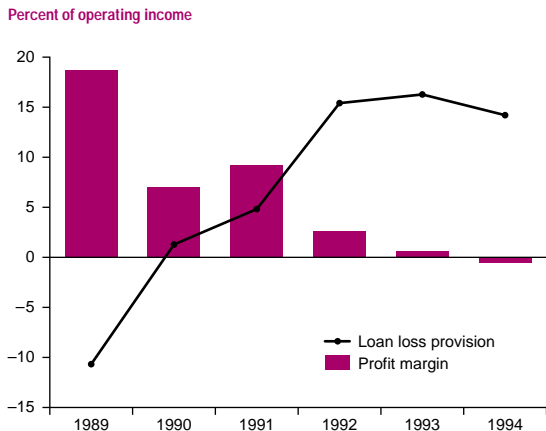
among Houston banks has averaged 1.1 percent, and return on equity 15.5 percent. Comparable figures for Dallas are nearly identical at 1.2 percent and 15.5 percent, respectively.

As Figure 2 shows, stemming the diversion of income to loan loss provisions was a key to better financial performance. Otherwise, the financial factors that affected Houston banks in recent years were largely positive and similar to those affecting banks throughout the nation. Falling interest rates generally marked the 1990–94 period, but a steeply sloped yield curve propped up interest income from lending and securities, while interest expense for deposits fell more rapidly. Holdings of securities grew among large and medium-size Houston banks through 1992, as a difficult economic environment, and perhaps regulatory pressures, held back lending. Fee-based income grew in importance throughout the period. Noninterest expense has steadily grown as the banks have administered a larger deposit base and a rapidly growing loan portfolio.

### RETURN OF BANK LENDING

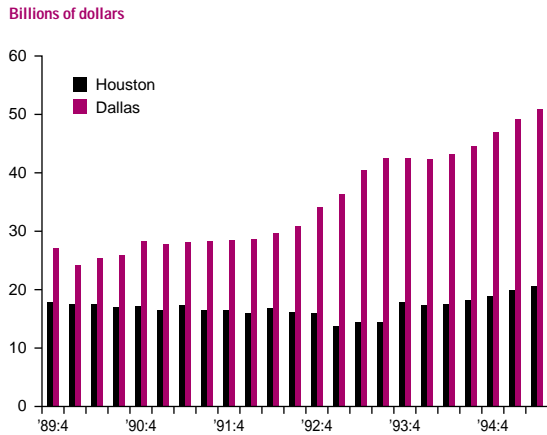
Houston banks have been slow to return as aggressive lenders, even with basic financial improvement in the local banking system. An apparent credit crunch marked the 1990–91 period statewide, and many banks hesitated to lend. The Texas economy slowed along with the 1990–91 national recession, providing a difficult economic environment, and potential

**Figure 2**  
Profits and Loan Loss Provision  
(Houston Banks, 1989–94)



SOURCE: Report of Condition and Income.

**Figure 3**  
Total Loans by Houston- and Dallas-Chartered Banks



SOURCE: Report of Condition and Income.

capital gains from falling interest rates tempted banks into the securities markets. Growing banking problems in New England and California increased regulatory awareness and scrutiny of lending activity throughout the nation.

The past three years, however, have marked the return of bank lending across the state, although less lending growth has occurred in Houston. Figure 3 shows the value of loans on the books of Houston- and Dallas-chartered banks; Dallas banks have been the more aggressive lenders. We know Houston and Dallas banks share strong recent financial results, and they share the same regulators. So, differences in lending growth are probably attributable to differences between the economic performance of Houston and the rest of Texas.

Dallas banks had the advantage of lending into one of the fastest growing metropolitan markets in the United States in 1993–94, plus greater ability to lend into strong economies across the state. Meanwhile, Houston was the slowest growing major city in Texas in 1993–94 and did not rejoin statewide growth trends until 1995. Loan prospects were relatively scarce in Houston, with slow growth at home and few banks operating outside of Houston in strong statewide markets. Stronger lending results for Houston banks should be expected as data become available for the second half of 1995.

— Timothy K. Hopper  
Ambreen Salters

**B**eige Book respondents reported little change in local markets in November, with strong to moderate levels of activity in most sectors. Cold November weather had a positive effect on energy markets, and petrochemical markets seem to be stabilizing at profitable levels. Otherwise, local markets are mostly unchanged.

### RETAIL AND AUTO SALES

Holiday sales got off to a slow start, and high inventories have led stores to use major sales and promotions early in the holiday season. Overall retail levels for the city are difficult to gauge because local problems are based on an over-supply of stores and retail square footage. Collective results may be good, even if each individual store suffers from having too many competitors. The recent closing of several regional chains has underscored the difficult market.

Auto sales in October were up a very strong 28 percent. The comparison is helped by very poor results for October 1994, but the figures are more than 10 percent over trend. Aggressive rebates from manufacturers stimulated a local market that was already very healthy.

### ENERGY PRICES

Crude oil prices moved over \$18 during the second half of November, after spending most of the previous five months between \$17 and \$18 per barrel. Higher crude prices followed the upward course already set by product prices, as a colder than normal November created a seller's market for heating oil, in particular. The strong demand for products and crude oil came against a backdrop of generally low inventories, helping push prices up quickly.

Cold weather also helped natural gas prices, as spot prices at the Henry Hub surpassed \$2 in mid-November. Working inventories of natural gas were pulled down by the weather, and storage was 10 percent below last year's level by the end of the month. Despite strong demand, and some scrambling for supplies, there were no shortages of gas or transportation.

### OIL SERVICES AND MACHINERY

Demand for oil services and machinery

remains strong and is unchanged from earlier this fall. The overall rate of drilling activity is not high, but drilling is occurring in lucrative overseas and offshore markets. The result has been good revenues and profits. Offshore activity in the Gulf of Mexico and the North Sea remains very strong, with day-rates rising sharply for rigs that can drill in deep water. Canadian drilling activity is down sharply compared with last year, although it remains strong in any historical comparison. A shortage of pipeline capacity to move new gas discoveries out of Canada and into U.S. markets accounts for the slowdown.

### DOWNSTREAM REFINING AND PETROCHEMICALS

October and November bring slack seasonal demand for both gasoline and heating oil, putting the price of key refined products under downward pressure. Cold weather in late November and concerns about gasoline inventories and supplies reversed these product price trends and helped boost refiners' profit margins.

Petrochemical inventories seem to be stabilizing after building for much of the past quarter. Manufacturers, including auto producers, are again placing orders. Respondents cited weak packaging demand and a Chinese embargo on chemical products as continuing problems. Profits in the industry peaked last April but continue to be relatively strong.

### REAL ESTATE AND HOUSING

Local commercial real estate markets are little changed. The demand for high-quality industrial space remains high, with occupancy near 95 percent. Retail expansion continues but recently has slowed. The rest of the market is flat, with a few more concessions being made to prospective office or apartment tenants than earlier in the year.

New home sales have defied the normal autumn slowdown, as lower mortgage rates and strong job growth continue to tempt buyers. Sales for the past three months are up 21 percent over 1994 levels. The story is similar for existing homes. Inventories of both new and existing homes are down sharply, and new starts should increase in the months ahead.

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