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Banks still growing, but

... robust FDIC data covers period before subprime meltdown

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Jim Stein and Don Brunson found few believers when they first floated the idea of opening a bank inside Loop 610.

In early 2004, new banks were flocking to suburban areas in pursuit of steady population growth to the north and west.

"Some bankers were skeptical because of all the big banks and heavy competition down there," recalls Stein, president and CEO of Bank of Houston.

Two years after opening in the upscale Tanglewood area in March 2005, Stein and Brunson have grown their upstart bank from de novo status to a thriving enterprise.

Bank of Houston's brisk development reflects an overall upward trend in the Houston banking market during the past two years, according to Federal Deposit Insurance Corp. filings compiled by research firm SNL Financial.

Total branch deposits for banks in the Houston region grew from \$89.9 billion in mid-2006 to \$104 billion in mid-2007, a period when numerous financial institutions — big and small — were gobbled up by competitors and an unprecedented number of de novo banks were launched.

Bank of Houston stood out in the de novo crowd with \$282.4 million in deposits at three branches as of June 30. A fourth office opened in September in the tony Park Laureate building on Memorial Drive.

Stein says setting up shop in a high-income neighborhood contributed to the fast start.

Says Stein: "(Tanglewood) is really somewhat of a recession-proof area, not bothered by \$3 gasoline."

Dan Bass, managing director of Houston investment bank Carson Medlin Co., agrees that a vibrant economy relatively unhurt by rising fuel prices can support banks of all sizes. But not all local banks serve customers in upscale neighborhoods less immune to cost increases.

Bass suggests effects of the credit crunch may show up locally in 12 to 24 months and might run counter to the optimistic FDIC data compiled in midsummer at an early stage of the subprime meltdown.

A couple of ominous signs appear in his just-re-



Craig Hartley/HBJ

Jim Stein of Bank of Houston: 'Any way you slice it, \$100 oil is good for the Houston economy.'

leased analysis of third-quarter numbers for banks headquartered in Houston.

Nonperforming loans in the third quarter were \$288 million — the highest level in the past two years. And deposits actually slipped from \$17.1 billion in the second quarter to \$16.4 billion in the third.

While the short-term outlook might be cloudy, Bass acknowledges that the FDIC numbers point to robust performance by banks, big and small, over the past several years.

"The big consolidations obviously affected the Top 10 in the city, but the organic growth year-over-year has been pretty impressive," he says. "Looking across the numbers, Chase was up 28 percent, Capital One more than 30 percent, and some of the smaller banks made even bigger gains."

For now, major institutions still have local growth plans on the front burner.

Says Bass: "There are some well-positioned players on the list who have stated publicly that they intend to focus on building Houston market share."

NO PAIN, ALL GAIN

Leading the Houston pack, as usual, is JPMorgan Chase & Co. with \$33.8 billion in local deposits —

up from \$26.4 billion a year earlier. The New York banking behemoth has 130 branches representing 32 percent of the local market.

Chase Bank is three times larger than second-place Bank of America Corp., with \$9.2 billion in deposits. Wells Fargo & Co. is No. 3 with \$8.2 billion. Sterling Bancshares Inc. remains the largest locally owned bank in the Top 10, with deposits of \$2.9 billion.

The largest overall gain in market share in the past 12 months was made by one of the big-name national heavyweights.

Wachovia Corp. moved up from 17th to fourth overall, with \$6.3 billion in deposits by midyear following the \$26 billion acquisition in late 2006 of Golden West Financial Corp., parent company of World Savings Bank. Twelve former World Savings branches in Houston were converted to the Wachovia brand, and four were closed.

Lori Vetter, Wachovia's Houston regional president, says she still has local expansion in mind looking ahead to 2008.

"Our strategy has been consistent the past two years, focusing on customers, keeping expenses in check with a good eye on risk management," Vetter says.

HOW THE BANK BUCK STOPS IN HOUSTON

2006

RANK/INSTITUTION	NO. OF BRANCHES	HOUSTON DEPOSITS	MARKET SHARE
1. JPMorgan Chase & Co.	125	\$26.4	29.4%
2. Bank of America Corp.	112	\$9.3	10.3%
3. Wells Fargo & Co.	141	\$7.9	8.8%
4. Zions Bancorp	78	\$5.2	5.8%
5. Washington Mutual Inc.	99	\$4.7	5.2%
6. Compass Bancshares Inc.**	45	\$3.2	3.6%
7. Golden West Financial Corp.*	13	\$3.1	3.4%
8. Sterling Bancshares Inc.	27	\$2.5	2.8%
9. Prosperity Bancshares Inc.	37	\$1.9	2%
10. Cullen/Frost Bankers Inc.	27	\$1.8	1.9%
11. Woodforest Financial Group Inc.	91	\$1.6	1.8%
12. Temple-Inland Inc.	26	\$1.6	1.8%

2007

RANK/INSTITUTION	BRANCHES	HOUSTON DEPOSITS	MARKET SHARE
1. JPMorgan Chase & Co.	129	\$33.8	32.5%
2. Bank of America Corp.	109	\$9.1	8.8%
3. Wells Fargo & Co.	147	\$8.2	7.9%
4. Wachovia Corp.*	80	\$6.3	6.1%
5. Zions Bancorp	81	\$5.4	5.2%
6. Washington Mutual Inc.	105	\$5.1	4.9%
7. Compass Bancshares Inc.**	45	\$3.4	3.3%
8. Sterling Bancshares Inc.	31	\$2.9	2.8%
9. Woodforest Financial Group Inc.	97	\$1.9	1.8%
10. Prosperity Bancshares Inc.	40	\$1.8	1.7%
11. Cullen/Frost Bankers Inc.	26	\$1.8	1.7%
12. Banco Bilbao Vizcaya Argentaria SA**	12	\$1.7	1.7%

* CHARLOTTE, N.C.-BASED WACHOVIA CORP. ACQUIRED OAKLAND, CALIF.-BASED GOLDEN WEST FINANCIAL CORP. FOR \$25 BILLION IN LATE 2006.

** BANCO BILBAO VIZCAYA ARGENTARIA SA OF SPAIN COMPLETED A \$9.1 BILLION ACQUISITION OF BIRMINGHAM, ALA.-BASED COMPASS BANCSHARES INC. IN SEPTEMBER, MERGING ALL COMPASS ASSETS INTO BBVA USA INC., BASED IN THE WOODLANDS.

ALL DOLLAR AMOUNTS IN BILLIONS. SOURCE: SNL FINANCIAL/FEDERAL DEPOSIT INSURANCE CORP.

FDIC: Glowing performance by Houston banks could reflect calm before storm

Wachovia's footprint in the Houston region for the near term will move more inside the Beltway, in contrast to the bank's Texas push in 2005.

Says Veters: "In the past 12 months we've focused on where we need to fill in sites of the branch network. We started on the fringes and are moving more centrally. Coming into the market, sites were harder to find inside the Loop but they're easier to fill in now."

Another big-name player that did well on a smaller scale in the past 12 months was Citi-Group Inc., despite all of the gloom and doom surrounding its subprime losses on a national stage.

CitiBank moved up from 36th in 2006 with \$233.3 million in deposits to \$470.8 million, taking the 25th spot. The bank opened a 13th area branch earlier this month at FM 1960 and N. Eldridge Parkway.

Ray Stanley, CitiBank Houston-area manager, says the bank made an aggressive push in mid-2006 to focus on retail customer pricing.

The bank heavily advertised a 6 percent CD — about 50 to 75 basis points above the competition — to bring in new customers. A year later, that same CD has a 4.75 percent interest rate.

CitiBank intends to focus future growth to the north along U.S. Highway 290 and the Interstate 45 corridor, and to the west on Interstate 10 and U.S. Highway 59.

Says Stanley: "Texas is a dynamic market and the competition here is fierce. Every bank is scratching for every client that they can."



Veters



Stanley

CRUNCHING THE NUMBERS

Effects of the credit squeeze will be reflected in the FDIC numbers for 2008. A decline in deposits could give more impetus to consolidation.

One of the biggest players to change hands in Houston this year was Compass Bank, owned by Birmingham, Ala.-based Compass Bancshares Inc.

Compass was acquired by Spanish financial behemoth Banco Bilbao Vizcaya Argentaria SA for \$9.1 billion in a deal that closed in September. Existing BBVA branches in the Houston area were merged into Compass operation, boosting the number of area offices from 45 to 58.

Bass of Carson Medlin expects to see continued consolidation. He suggests the credit crunch will stimulate market activity when big national banks that have taken huge writedowns this year slow organic expansion plans typically formulated one or two years in advance.

One publicly traded Houston bank is already preparing for a possible writedown.

This week, Franklin Bank Corp. saw shares plummet after the bank said it would increase the allowance for potential credit losses by \$20 million in response to what it describes as "unprecedented" market conditions.

The company cited housing market value deterioration, increased Chapter 11 filings of national home builders, and liquidity issues in the national mortgage markets.

QUALIFIED JOB GROWTH

Other banks see solid gains ahead for established players, aided by the economic gusher provided by rising oil prices.

The employment outlook is favorable in a TrendLines report researched by Transwestern affiliate Delta Associates. The report, released this month, projects an average of 60,000 new jobs created in the Houston area each year in 2008 and 2009.

"There's still a lot of opportunity in this marketplace,"

says Don Ellis, CEO of Patriot Bancshares Inc. "Commercial real estate is being absorbed incredibly rapidly."

Patriot Bank was one of the area's biggest movers in the past 12 months, rising from 34th to 24th overall in regional deposit rankings. A two-office operation with \$248 million in deposits in 2006 more than doubled in size to four local branches with \$507 million in deposits in June of this year.

The bank, which like Bank of Houston focuses on the owner-operated, small-business market, has other branches in Dallas and Mesquite, and is planning to open a second Clear Lake branch in 2008.

Ellis and Bank of Houston's Stein see a different obstacle emerging. While there is no doubt the region will grow, they say, the number of qualified bankers to handle that growth is dwindling.

"People bank with the bankers and not the bank," Ellis says. "I think we'll continue to see consolidation, and recruiting problems will contribute to it. Our biggest limitation to growth in 2008 is human capital."

Stein says bankers with experience in the Houston market can basically write their own ticket when it comes to walking across the street to a competitor — something that has been happening with increasing regularity here in the past 12 months.

"Good people are getting locked up all over the city, and you're seeing more noncompetes, non-solicitation clauses put in when people come over (to a bank) before they get that sign-on bonus," says Stein. "The competition means there's no better time to be a banker."

Operating in a recession-proof area like Tanglewood is an added boon for Bank of Houston.

Says Stein: "Our customers are still bullish on the Houston market. Any way you slice it, \$100 oil is good for the Houston economy."

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