



COMMUNITY REINVESTMENT ACT
PERFORMANCE EVALUATION
PUBLIC DISCLOSURE

Lone Star Bank

RSSD 63957

8117 East Freeway
Houston, Texas 77029

As of
September 18, 2000

This evaluation is not, nor should it be construed as, an assessment of the financial condition of this institution. The rating assigned to this institution does not represent an analysis, conclusion or opinion of the federal financial supervisory agency concerning the safety and soundness of this financial institution.

Federal Reserve Bank Of Dallas

P. O. Box 655906, Dallas, Texas 75265-5906

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION PUBLIC DISCLOSURE

<u>Lone Star Bank</u> Name of Institution	<u>8117 East Freeway</u> Street
<u>Houston</u> City	<u>Harris</u> County
<u>Texas</u> State	<u>77029</u> Zip Code
<u>Joseph S. Buehler</u> Examiner-in-Charge	

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CRA PERFORMANCE ASSESSMENT

GENERAL INFORMATION

The Community Reinvestment Act (CRA) requires each federal financial supervisory agency to use its authority when examining financial institutions subject to its supervision, to assess the institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operation of the institution. Upon conclusion of such examination, the agency must prepare a written evaluation of the institution's record of meeting the credit needs of its community.

This document is an evaluation of the CRA performance of Lone Star Bank, Houston, Texas prepared by the Federal Reserve Bank of Dallas, Dallas, Texas, the institution's supervisory agency, as of September 18, 2000. The agency rates the CRA performance of an institution consistent with the provisions set forth in Appendix A to 12 CFR Part 228.

INSTITUTION'S CRA RATING: This institution is rated Satisfactory.

The bank's satisfactory performance is primarily based on its distribution of motor vehicle loans to the various borrower income levels, and especially to low- and moderate-income borrowers. Further, its performance is highlighted by the distribution of loans inside its assessment area, its significant lending to motor vehicle and small business borrowers located in all geographies within its assessment area, and particularly in low- and moderate-income tracts.

DESCRIPTION OF INSTITUTION

Lone Star Bank, Houston, Texas (LSB) is a bank with assets of \$120.5 million. As of June 30, 2000, the bank’s net loan-to-deposit ratio was 81.85 percent. LSB is an independently owned financial institution. The bank is not a part of a holding company at this time. The main office, located at 8117 East Freeway in Houston, Texas is a full service facility offering typical loan and deposit products.

Real estate lending comprises 52 percent of LSB’s total portfolio. Commercial and Industrial loans account for 34 percent and Consumer loans accounted for 13 percent of the bank’s total lending. The following table details the distribution of the bank’s loan portfolio as of June 30, 2000, Consolidated Reports of Condition and Income (Call Report):

LOAN TYPE	DATA (IN THOUSANDS)	PERCENT OF GROSS LOANS
Real Estate		
Commercial	\$34,634	35.95
Residential	6,362	6.60
Construction/Land		
Development	7,144	7.41
Multifamily	1,795	1.86
Home Equity	98	.10
Agriculture	265	.28
Total Real Estate	50,298	52.20
Consumer		
All Other	12,878	13.37
Open-End Credit	96	.10
Total Consumer	12,974	13.47
Commercial and Industrial	33,040	34.29
Agricultural	5	.01
Other	35	.04
Gross Loans	\$96,352	100.0%

As the chart above illustrates, real estate and commercial lending dominate the bank’s loan portfolio. Within the real estate category, commercial real estate constitutes almost 36 percent of the portfolio.

The bank’s ability to meet various community credit needs is not hampered by its capacity to lend, the capacity of other similarly-situated institutions to lend in the assessment area, demographic and economic factors present in the assessment area, or the lending opportunities available in the institution’s assessment area. Lone Star Bank’s CRA performance was evaluated by the Office of the Comptroller of the Currency on May 14, 1996, and received an overall rating of “satisfactory”.

DESCRIPTION OF HOUSTON, TEXAS PMSA 3360

The bank's head office is located in Houston, Texas. LSB has designated Harris County, a part of the Houston, TX Primary Metropolitan Statistical Area (PMSA) 3360 as its assessment area. Houston, Texas is the largest city in the state and the fourth largest in the nation. PMSA 3360 consists of six counties on the Texas Gulf Coast with Harris County as the largest of the six counties comprising the Houston, TX PMSA. Almost 85 percent of the PMSA's total population reside in Harris County.

The bank's performance was evaluated in terms of the context in which it operates. As of June 30, 1999, 88 FDIC-insured financial institutions operated 705 banking offices in Harris County holding total deposits of \$43.5 billion. Chase Bank of Texas ranked first in deposit market share with 22.4 percent, followed by NationsBank at 12.3 percent, Bank United at 9.3 percent, Wells Fargo with 8.3 percent, and Bank One with 8 percent. As of March 31, 2000, 50 commercial banks were headquartered in Harris County, including the following ranked by asset size: Chase Bank of Texas, N.A. (\$25.4 billion); Southwest Bank of Texas, N.A. (\$3 billion); and Sterling Bank (\$1.9 billion). In addition, non-bank competitors, including mortgage companies, credit unions, brokerage firms, and finance companies, play a major role in providing credit services.

During another recent CRA examination of a Houston institution in June 2000, community contacts indicated there has been a proliferation of Community Development Corporations and Community Housing Development Organizations in recent years, offering numerous opportunities for community development investment by area financial institutions. In addition, a twenty square mile area including Houston's central business district is a federally designated Enhanced Enterprise Community, with access to new economic development financing programs for micro-enterprise and small business loans as well as large scale development projects through the EDI/Section 108 Loan Guarantee Program. Identified community credit needs include affordable housing financing and rehabilitation, as well as loans under \$100,000 for small business start-ups.

Demographic and economic information also impact the bank's performance context and is discussed below. Information was obtained from publicly available sources including the 1990 U.S. Department of Commerce's Bureau of the Census, 1990, the U.S. Department of Labor, the U.S. Department of Housing and Urban Development, the Texas Workforce Commission, the City of Houston Department of Housing and Community Development, and the Houston Association of Realtors.

Demographic Characteristics

According to the 1990 census, the total population of the bank's assessment area is approximately 2.8 million. The census bureau estimates the population increased 15 percent, to 3.2 million as of July 1, 1999. More than 64 percent (1.8 million) of the population resides in the city of Houston.

Income Characteristics

The 1990 median family income for the assessment area portion of PMSA 3360 is \$36,404, compared to \$31,553 for the state. The 2000 HUD-adjusted median family income for the Houston PMSA is \$56,700, a 4.8 percent increase over the 1999 figure of \$54,100. The income ranges are as follows:

Income Level		54,1000 – 1999	56,700- 2000
Low income	0 < 50	\$0 - <\$27,050	\$0 - <\$28,350
Moderate income	50 < 80	\$27,050 - <\$43,280	\$28,350 - <\$45,360
Middle income	80 < 120	\$43,280 - <\$64,920	\$45,360 - <\$68,040
Upper income	>= 120	\$64,920 and up	\$68,040 and up

The assessment area contains 568 populated census tracts, 73 or 13 percent of which are low-income tracts and 179 or 31 percent moderate-income tracts. In addition, there are 14 census tracts categorized as low-income tracts that have zero population and/or housing units. Low- and moderate-income census tracts are concentrated on the northeast, east and south sides of the city of Houston.

The United States Census Bureau divides metropolitan areas into statistical subdivisions called census tracts (CTs). Various information, including population, race, household composition, education, employment and income statistics, are available for each census tract.

Information from the 1990 census indicates there are 708,831 families in the assessment area. The majority of families in the assessment area (40 percent) are classified as upper-income. Twenty-three percent of the families are low-income, 17 percent are moderate-income, and 20 percent are middle-income families. Half of the low-income families or 12.5 percent of total families are living below the poverty level, compared to 14 percent statewide. Only 8 percent of total families reside in low-income census tracts. Moderate-income tracts contain 27 percent of assessment area families, and the remaining 65 percent are equally divided between the middle- and upper-income census tracts in the assessment area. The following table illustrates the distribution of the population by census tract income level:

DISTRIBUTION OF POPULATION BY CENSUS TRACT INCOME LEVEL						
Census Tract Income Level	Total Tracts		Total Families		Total Population	
	#	%	#	%	#	%
Low income*	73	12.8%	57,716	8.1%	255,690	9.1%
Moderate income	179	31.5%	190,331	26.9%	809,142	28.7%
Middle income	169	29.8%	230,890	32.6%	911,859	32.4%
Upper income	147	25.9%	229,894	32.4%	841,508	29.9%
TOTAL	568	100.0%	708,831	100.0%	2,818,199	100.0%

*Number of low income tracts excludes 14 tracts with 0 population and/or housing units.

Housing Characteristics

There are 1,173,808 total housing units in the assessment area. Owner occupancy in Harris County, at 45.5 percent, is the lowest of all eight counties in the Consolidated Metropolitan Statistical Area (CMSA) 3362 (Houston-Galveston-Brazoria, TX). By contrast, within the five counties in the Houston PMSA which are not included in the bank's assessment area, owner-occupancy ranges from 57.6 percent in Waller County to 69.5 percent in Chambers County. The state owner-occupancy percentage is 52.7 percent. Rental units comprise 42 percent of all housing units in Harris County. This figure is substantially higher than the rest of the Houston PMSA, which ranges from 16.4 percent to 26.3 percent.

The 1990 median housing value is \$62,567 and median gross rent is \$405. Data from the Houston Association of Realtors Multiple Listing Service indicates housing prices have soared in the Houston area, especially since 1995. The median home price rose 39 percent between 1995 and 2000, from \$79,000 to \$109,500. The single-family residential market is booming in the Houston area due to strong job growth and low interest rates, exacerbated by shortages of labor and materials for new homes and a low inventory of homes for sale. The housing boom has not increased home ownership percentages, however, since the median sales price of homes in the Houston market is out of reach of most of the low- and moderate-income households in the community. Housing is generally less affordable in the assessment area compared to all other counties in the PMSA except Fort Bend and Montgomery Counties, which have 1990 median values of \$70,725 and \$68,938, respectively. According to the city of Houston's 2000 Consolidated Plan, there is a shortage of affordable housing for the city's low- and moderate-income residents. Families with incomes below 30 percent of median family income have the greatest difficulty obtaining affordable rent. A total of 12,500 families are on the waiting list for Section 8 Tenant-Based Assistance and 4,863 families are on the waiting list for Public Housing.

Fifty-four percent of assessment area housing units are single-family, 34 percent are multi-family units housing five or more families, and nine percent are 2-4 family units. Almost ten percent of assessment area housing units are located in low-income tracts, 29 percent in moderate-income, 33 percent in middle-income, and 32 percent in upper-income tracts. The distribution of the 533,891 owner-occupied units by tract is 6 percent low, 23 percent moderate, 32 percent middle, and 39 percent upper.

The median age of the assessment area housing stock is 22 years, with only 11 percent of units built prior to 1950. The oldest homes are located in moderate-income tracts, where the median age is 35 years, compared to 30, 24 and 25 years in the low-, middle- and upper-income tracts, respectively. Approximately half of the city of Houston's public housing was constructed in the 1930's and 1940's, with the need for constant maintenance and regular renovation.

Labor, Employment and Economic Characteristics

The Houston economy enjoyed economic diversification in the 1990's, growing from a primarily oil-dependent economy to today's highly industrialized corporate management and international business center and a center for energy, space and medical research. The petrochemical industry

continues to employ approximately half of Houston's workforce; however, that industry has achieved a better balance between exploration and drilling and petroleum processing in refineries and chemical companies. Other major area employers include the Texas Medical Center, Johnson Space Center, Compaq Computer, American General Insurance, Continental Airlines, and Sysco. The county boasts the nation's largest concentration of petrochemical plants, the largest U.S. wheat-exporting port, and ranks among the top U.S. ports in the value of foreign trade and total tonnage. The labor force has grown over 19 percent since 1990, totaling 1.8 million (17 percent of the state's 10.4 million workers) as of May 2000. Unemployment continues into its third year of decade lows, averaging 4.3 percent in May.

According to Dun & Bradstreet, Harris County boasts almost 18 percent of the total business establishments in the state with 108,028 businesses as of June 1999. Almost 87 percent of assessment area establishments reported gross annual revenues under \$1 million. The Services industry dominates with 48 percent of total businesses, followed by 21 percent retail trade, 9 percent wholesale trade, and almost 9 percent in finance, insurance and real estate. Only 7 percent of businesses are located in low-income census tracts, while 27.5 percent are in moderate-income tracts, 29.5 percent in middle-income tracts, and almost 36 percent in upper-income census tracts.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

LOAN-TO-DEPOSIT RATIO

The bank's average loan-to-deposit ratio for the fifteen quarters since the previous examination is 65.03%. As of March 31, 2000, the bank's net loans represented 81.85% of total deposits, compared to the unadjusted national peer ratio of 77.19%. Three similarly situated institutions in the Assessment Area (AA) had quarterly average ratios of 54.60%, 58.28%, and 79.51%. In light of the bank's performance context, which includes the bank's capacity to lend, the capacity of other similarly situated banks to lend in the AA, and economic factors present and lending opportunities available in the bank's AA, the loan-to-deposit ratio is considered adequate and meets the standards for a satisfactory rating.

The following chart compares LSB's loan-to-deposit ratios with three similarly situated financial institutions in the Houston area. Two of the banks, Capital Bank, Jacinto City, Texas and Horizon Capital Bank, Webster, Texas, were identified by LSB as among their primary competitors. Woodcreek Bank, Houston, was selected because of its similar asset size and branch operations in the Houston market.

BANK	COUNTY	TOTAL ASSETS (000'S) JUNE 30, 2000	LTD RATIO JUNE 30, 2000	QUARTERLY AVG. LTD RATIO
Lone Star Bank Houston, Texas	Harris	\$124,330	81.85%	65.03%
Woodcreek Bank Houston, Texas	Harris	\$114,280	75.48%	54.60%
Capital Bank Houston, Texas	Harris	\$101,671	61.50%	58.28%
Horizon Capital Bank Houston, Texas	Harris	\$155,247	90.32%	79.51%

LENDING IN ASSESSMENT AREA

A sample of 45 motor vehicle loans originated during the six-month period of September 1, 1999 through March 31, 2000 revealed a majority of the loans extended were located in the bank's AA. Because the bank has chosen Harris County as its AA, it is expected that a majority of the loans will be originated within its AA. In addition to motor vehicle loans, a sample of 72 of the small business loans originated during the same period were included in the review. The percentages for loans made inside the AA were slightly higher for these small business loans. The higher number of small business loans inside the bank's AA is attributable to the bank's location in a high industrial area. Bank management indicated that the customers work for the businesses with which the bank conducts transactions, but live in areas outside Harris County. In addition, some of the branch locations are in close proximity to other counties, so customers residing in counties outside Harris may be using the banking services provided by those branch locations. Overall, the bank's lending inside its AA is considered adequate at almost 90 percent and meets the standards for satisfactory performance. The chart below details the loans, by product, originated inside and outside the AA by number of loans and dollar amount:

ANALYSIS OF LENDING IN THE ASSESSMENT AREA								
LOAN TYPE	INSIDE ASSESSMENT AREAS				OUTSIDE ASSESSMENT AREAS			
	#	%	\$000'S	% OF \$	#	%	\$000'S	% OF \$
Motor Vehicle	45	82	701	74	10	18	245	26
Small Business	72	95	6,172	97	4	5.3	189	3
TOTAL	117	89	6,873	94	14	11	434	6

Of the motor vehicle loans sampled, 82 percent were in the AA and 95% of the small business loans sampled were originated in the AA.

LENDING TO BORROWERS OF DIFFERENT INCOMES AND TO BUSINESSES OF DIFFERENT SIZES

LSB's distribution of loans and record of lending to low- and moderate-income persons for consumer motor vehicle loans in its assessment area, by borrower income, is commendable and reflects an excellent penetration. The distribution of small business loans by gross annual revenue data indicates an attempt to make loans available to small businesses in its community. A majority of the loans, however, were made to those businesses whose annual revenues were higher than \$1 million. Bank management indicated that the proximity of the main office's location to the Houston ship channel was one reason many of the businesses which they provided loans to had higher annual revenues. Many of those businesses with high-grossing annual revenues obtained loans locally to maintain a presence in the community and because the location was convenient to local operations. Most of the businesses LSB makes loans to request relatively small dollar loans and obtain financing for larger amounts through the large financial institutions.

HOUSTON, TEXAS PMSA HUD-ADJUSTED MEDIAN FAMILY INCOME		
INCOME LEVEL	1999	2000
Low income	\$0 < \$27,050	\$0 < \$28,350
Moderate income	\$27,050 < \$43,280	\$28,350 < \$45,360
Middle income	\$43,280 < \$64,920	\$45,360 < \$68,040
Upper income	\$64,920 and up	\$68,040 and up
Median Family Income	\$54,100	\$56,700

As the chart below illustrates, the bank's performance in lending for motor vehicle loans to all income levels in its AA is considerable. When compared with the distribution of families in the community, the bank's lending performance exceeds the percentages of low- and moderate-income borrowers in the AA. Lending to low-income borrowers is 17 percent, compared to 23 percent of the families in the AA, and lending to moderate-income borrowers is 29 percent, compared to 17 percent of families, for the AA. The bank's performance in making motor vehicle loans demonstrates a willingness to lend to all members of its assessment area, especially low- and moderate-income persons.

DISTRIBUTION OF MOTOR VEHICLE LOANS BY MEDIAN FAMILY INCOME LEVEL					
	LOW	MODERATE	MIDDLE	UPPER	INCOME N/A
Number of Loans	7	12	9	14	3
% of Number	17%	29%	21%	33%	7%
Dollar Volume	\$72	\$172	\$120	\$296	\$40
% of Dollar Volume	11%	26%	18%	45%	6%
Percent of Families	23%	17%	20%	40%	N/A

Data from the U.S. Small Business Administration for 1997 indicates there are 77,800 firms in Houston, Texas. In terms of employment size, firms with 20 or fewer employees total 65,308, those with less than 500 employees total 79,881, and those with 500 or more employees total 2,611. Dun & Bradstreet data for 1999 indicates that almost 87 percent of the business establishments in the bank's assessment area have sales volumes less than one million dollars.

The chart below depicts the bank's lending performance by gross annual revenues and loan size for the small business loans sampled.

DISTRIBUTION OF COMMERCIAL LOANS BY GROSS ANNUAL REVENUES AND LOAN SIZE							
GROSS ANNUAL REVENUES (\$000s)	LOAN AMOUNT					TOTAL	
	LESS THAN \$10,000	\$10,000 - <\$50,000	\$50,000 - <\$100,000	\$100,000 AND UP			
Less than \$100	1	3	0	3	7	13%	
\$100 – less than \$250	1	0	0	1	2	4%	
\$250 – less than \$500	1	5	1	0	7	13%	
\$500 – less than \$1,000	0	3	3	0	6	11%	
\$1,000 and up	0	12	8	10	30	54%	
Revenues N/A	0	2	0	1	3	5%	
Total	3	25	12	15	55	100%	
	6%	45%	22%	27%			

As the chart indicates, the bank's record of lending to businesses with revenues of less than one million dollars is not as good as its record of lending to those businesses with revenues of one million dollars and more. Of the small business loans sampled, 22 or 43 percent of the businesses had gross annual revenues less than a million and 30 or 54 percent had gross annual revenues of one million dollars and more. Although the bank makes a significant number of small dollar loans, it does so to businesses which do not meet the definition of small business under the CRA.

GEOGRAPHIC DISTRIBUTION OF LOANS

A review of the distribution of loans within LSB's AA consisted of analyzing the bank's lending among the various census tract income categories in comparison to the distribution of census tracts by income level and the distribution of the population in the AA.

Within the bank's AA, there are 568 populated census tracts, of which 73 or almost 13 percent are low-income and 179 or about 32 percent are moderate-income. In terms of families residing in the various tracts, eight percent of the families reside in low-income tracts and almost 27 percent reside in moderate-income tracts. The percentage of families residing in middle- and upper-income tracts is virtually even at 33 percent and 32 percent, respectively.

The chart below details the bank's performance in lending to borrowers residing in the various income tracts for motor vehicle and small business loans.

DISTRIBUTION OF LENDING BY CENSUS TRACT INCOME LEVEL						
CENSUS TRACT INCOME LEVEL	MOTOR VEHICLE		SMALL BUSINESS		TOTAL	
	#	%	#	%	#	%
Low-income	1	2	6	8	7	6
Moderate-income	13	29	30	42	43	37
Middle-income	12	28	18	24	20	25
Upper-income	19	42	19	26	38	32
TOTAL	45	100	72	100	117	100

As the chart indicates, the bank's lending patterns show an excellent distribution of loans to borrowers residing in low- and moderate-income tracts as two percent and 29 percent of motor vehicles were made to people in those respective tracts. For small business loans, eight percent of loans were made in low-income tracts and 42 percent were made in moderate-income tracts. When the two products are aggregated, six percent and 37 percent of the loans sampled were originated to borrowers in low- and moderate-income geographies, respectively. Taking into account the fact that almost 39 percent of families residing in low-income tracts and 21 percent of families living in moderate-income tracts live below the poverty level, the bank's ability to make loans in these income tracts can be especially difficult.

COMMUNITY DEVELOPMENT SERVICES AND QUALIFIED INVESTMENTS

The regulation provides that, if a bank meets each of the standards for a "satisfactory" rating under the various criteria, and exceeds some or all of those standards, then the bank may warrant consideration for a rating of "outstanding". Examiners will consider the bank's performance in making qualified investments and providing branches and other delivery systems and services that enhance credit availability in its AA.

A listing of services and investments was provided by bank management and reviewed by examiners. However, the bank's performance does not materially exceed the standards in some or all of the categories for consideration for an "outstanding" rating. The bank's participation in investment and service opportunities is noted. However, qualified donations totaled \$1,500. The bank's qualified services include participation by bank officers in a career day at a local high school in a moderate-income tract and continued involvement in H.O.S.T.S. (Help One Student To Succeed) through the adoption of an elementary school located in a moderate-income geography. Because of its participation in the H.O.S.T.S. program, the bank received HOSTS Corporation's Betty Scharff Memorial Award because of its contributions in time and money benefiting the Language Arts, Spanish, and Math programs at its adopted elementary school. The bank was also a recipient of The Texas Banker's Foundation Cornerstone Award in 1999, which recognizes outstanding community efforts by a bank.

RESPONSE TO COMPLAINTS

The bank has not received any CRA-related complaints since the previous evaluation.

COMPLIANCE WITH ANTI-DISCRIMINATION LAWS (ECOA, FHA OR HMDA)

No violations of the substantive provisions of the anti-discrimination laws and regulations were identified during the Consumer Affairs Examination.