



PUBLIC DISCLOSURE

August 14, 2015

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

The Falls City National Bank
Charter Number 8606

Highway 181 & Maverick
Falls City, TX 78113

Office of the Comptroller of the Currency
San Antonio South Field Office
10001 Reunion Place Boulevard, Suite 250
San Antonio, TX 78216

NOTE: This document is an evaluation of this 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. 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.

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

Falls City National Bank's (FCNB) lending performance reflects a satisfactory response to community credit needs in its assessment areas (AAs). This conclusion is based on the following results from our review:

- The loan-to-deposit (LTD) ratio meets the standard for satisfactory performance.
- The bank originated a majority of loans inside its AA.
- Lending activities represent a reasonable penetration among individuals of different income levels and businesses of different sizes.
- Geographic distribution of loans represents a reasonable dispersion.

SCOPE OF EXAMINATION

FCNB was evaluated under the Small Bank examination procedures, which includes a lending test. The lending test evaluates the bank's record of meeting the credit needs of its AAs through its lending activities.

The lending test for FCNB covers its performance from January 1, 2012 through June 30, 2015, as this is representative of its lending strategy since the last Community Reinvestment Act (CRA) examination.

FCNB's primary loan products are residential and commercial loans. The bank reports data under the requirements of the Home Mortgage Disclosure Act (HMDA). HMDA data from 2012, 2013, and 2014 were tested and found to be reliable. Therefore, HMDA data was used to evaluate the bank's residential loan performance. To evaluate the bank's commercial lending performance, we selected a sample of 40 commercial loans made from January 1, 2012 through June 30, 2015.

DESCRIPTION OF INSTITUTION

FCNB is an intrastate bank headquartered in Falls City, Texas. As of June 30, 2015, your assets totaled \$343 million with Tier one capital at \$27 million. The bank was chartered in 1907 and is independently owned. The bank has three offices: the main office located in Falls City, Texas, one branch in Poth, Texas, and another in Floresville, Texas. All three locations have a walk-in teller lobby, a drive-up motor bank, and an automated teller machine (ATM). Since the last CRA examination, no branches have been opened or closed. There have not been any significant changes to FCNB's corporate structure, including merger or acquisition activities, since the last CRA examination.

The bank provides full service deposit and loan products at all of its branches. Loan applications are accepted at all branches. The underwriting process is centralized and all loans are closed at the Falls City branch. Additionally, customers are able to access their depository accounts through the internet, ATMs, and phone bank.

As of June 30, 2015, FCNB reported \$113 million in total loans. A summary of the loan portfolio is as follows:

Loan Portfolio Summary by Loan Product June 30, 2015		
Loan Category	Dollar Volume \$(000)	% of Outstanding Dollars
Residential	50,576	44.93
Commercial	34,039	30.24
Agriculture/Farm	16,235	14.42
Consumer	11,332	10.07
Other Loans	395	0.35
Total	112,577	100.00

There are no legal, financial, or other factors that impede FCNB's ability to help meet the credit needs in its AAs. FCNB was rated "Satisfactory" under the small bank criteria during the previous CRA examination dated December 12, 2011.

DESCRIPTION OF ASSESSMENT AREA(S)

FCNB has two AAs in South Texas, which are described below.

Wilson County Assessment Area

The Wilson County AA is comprised of the complete county. Wilson County is located in South Texas and is in the San Antonio/New Braunfels MSA. This AA meets the requirements of the regulation and does not arbitrarily exclude any low-or moderate-income (LMI) areas.

Demographic Information for the Wilson County AA					
	#	% Low	% Moderate	% Middle	% Upper
Geographies (Census Tracts)	11	0.00	18.18	45.45	36.36
Population by Geography	42,918	0.00	18.18	36.96	44.86
Owner-Occupied Housing by Geography	15,943	0.00	58.02	74.34	87.01
Businesses by Geography	2,455	0.00	24.46	29.82	46.72
Farms by Geography	227	0.00	17.18	55.51	27.31
Family Distribution by Income Level	11,717	0.00	17.47	35.75	46.78
Household Distribution by Income Level	14,455	0.00	18.79	37.03	44.18
Census Median Family Income (MFI)		\$58,222	Median Housing Value		\$124,930
HUD-Adjusted MFI: 2014		\$58,800	Families Below the Poverty Level		8.21%
HUD- Adjusted MFI: 2013		\$61,300	Unemployment Rate		3.60%
HUD – Adjusted MFI: 2012		\$60,800			

Source: 2010 U. S. Census

Current local economic conditions have been robust due to the oil and gas activities associated with the Eagle Ford Shale formation until earlier this year. Economic activity in the area has been relatively diverse with oil field related services, agriculture, services, and retail and wholesale businesses being the primary economic activities. However, since the first quarter of 2015, noticeable changes in the local market are evident with a number of exploration and pipeline companies closing shop. Average unemployment for the area remains low.

Competition from other financial institutions is high. The bank's competitors include one local community bank, two regional bank branches, two branches of large financial institutions, and a number of mortgage/ finance companies.

In assessing the bank's performance, we contacted a member of a local community. This contact indicated the community's current economic condition is mixed. With the decline in oil related activity, many low and moderate-income individuals who received mineral royalties are having trouble managing their money. The contact indicated that many of the individuals that did not save have had to take lower paying jobs and they are struggling to make ends meet.

Karnes County Assessment Area

The Karnes County AA is comprised of the complete county. Karnes County is located in South Texas and is adjacent to the Wilson County AA. This AA meets the requirements of the regulation and does not arbitrarily exclude any LMI areas. The County's two middle-income census tracts are designated as distressed and underserved.

Demographic Information for the Karnes County AA					
	#	% Low	% Moderate	% Middle	% Upper
Geographies (Census Tracts)	4	0.00	25.00	50.00	25.00
Population by Geography	14,824	0.00	9.65	75.42	14.92
Owner-Occupied Housing by Geography	5,533	0.00	42.54	58.99	62.69
Businesses by Geography	901	0.00	6.99	77.91	15.09
Farms by Geography	147	0.00	10.20	42.86	46.94
Family Distribution by Income Level	3,452	0.00	10.31	69.52	20.16
Household Distribution by Income Level	4,657	0.00	10.29	68.76	20.96
Census Median Family Income (MFI)		\$47,817	Median Housing Value		\$74,114
HUD-Adjusted MFI: 2014		\$51,600	Families Below the Poverty Level		20.96%
HUD- Adjusted MFI: 2013		\$50,500	Unemployment Rate		1.26%
HUD – Adjusted MFI: 2012		\$49,300			

Source: 2010 U. S. Census

Current local economic conditions have been robust due to the oil and gas activities associated with the Eagle Ford Shale formation until earlier this year. Economic activity

in the area has been relatively diverse with oil field related services, agriculture, services, and retail and wholesale businesses being the primary economic activities. However, since the first quarter of 2015, noticeable changes in the local market are evident with a number of exploration and pipeline companies closing shop. Average unemployment for the area remains low.

Competition from other financial institutions is high. The bank's competitors include two local community financial institutions, two regional bank branches, and one branch of a large national bank.

In assessing the bank's performance, we contacted a member of a local community. Due to the downturn in oil and gas activity, many low and moderate-income individuals have been laid off and are re-employed at lower wages. Many that received mineral royalties did not manage their funds well and have little left. The contact also stated that hotels have cut rates and decreased occupancy rates and that a few businesses have closed.

Based on the information the contact feels there are many opportunities for financial institutions to aid in community development by providing financial training and money management education specifically geared towards low and moderate-income individuals.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

LENDING TEST

FCNB's performance under the lending test is satisfactory considering the performance context and needs of the bank's AAs. The borrower distribution was given more weight than the geographical distribution because the bank has no low-income census tracts (CTs) and few moderate-income CTs in the AAs.

Loan-to-Deposit Ratio

FCNB's net loan-to-deposit ratio is reasonable given the bank's size, financial condition, and AAs credit needs. The net loan-to-deposit ratio averaged 36.28 percent over the 14 quarters since the last CRA examination, with a quarterly low of 32.46 percent and a quarterly high of 44.13 percent.

The ratio compares favorably with other community banks of similar size, location, and product offerings. FCNB ranks second among three similarly situated banks serving its AAs. The other banks, one nationally chartered and one state chartered had an average net loan-to-deposit ratio of 27.78 and 74.52 percent over the same period, respectively.

Lending in Assessment Area

A majority of the primary loan products originated by FCNB are to consumers within its AAs. FCNB originated 71.74 percent inside their AAs. The following table details the lending within the AAs by number and dollar amount of loans originated during the evaluation period.

Table 1 - Lending in Karnes and Wilson AA										
Loan Type	Number of Loans					Dollars of Loans				
	Inside		Outside		Total	Inside		Outside		Total
	#	%	#	%		\$	%	\$	%	
Home Purchase	123	72.73	56	31.28	179	14,618	60.40	9,583	39.60	24,201
Home Improvement	20	83.33	4	16.67	24	1,569	72.81	586	27.19	2,155
Refinance	24	72.73	9	27.27	33	2,460	52.05	2,266	47.95	4,726
Commercial	31	77.50	9	22.50	40	5,796	93.38	411	6.62	6,207
Totals	198	71.74	78	28.26	276	24,443	65.55	12,846	34.45	37,289

Source: Data reported under HMDA and Loan Sample.

Lending to Borrowers of Different Incomes and to Businesses of Different Sizes

The distribution of loans reflects a reasonable penetration among individuals of different income levels and businesses of different sizes, given the bank's product offerings and local economic conditions.

Performance in the Wilson County AA

The borrower distribution of loans in the Wilson County AA is reasonable. Loans for housing were identified as a credit need in this AA.

Home Loans

The distribution of home loans to borrowers reflects poor penetration among borrowers of different income levels. The bank's level of lending to low and moderate-income borrowers is below the demographic comparator in most areas. The rapid increase in the median housing values outpacing the increase in the median family income contributes to the poor performance. The median housing value increased 71 percent to \$124, 930 while median family income increased only 31 percent over the same period since the last CRA examination. This makes it difficult for families of low to moderate-income levels to afford housing whether it is home purchasing, home improvements, or refinance. The AA's poverty rate of 8.21 percent was taken into consideration. The following table shows the distribution of home loan products among borrowers of different income levels as compared to the percent of families in each income category.

Table 2 - Borrower Distribution of Residential Real Estate Loans in Wilson AA								
Borrower Income Level	Low		Moderate		Middle		Upper	
Loan Type	% of AA Families	% of Number of Loans	% of AA Families	% of Number of Loans	% of AA Families	% of Number of Loans	% of AA Families	% of Number of Loans
Home Purchase	15.21	4.76	14.86	10.71	21.91	16.67	48.02	63.10
Home Improvement	15.21	0.00	14.86	9.09	21.91	18.18	48.02	72.73
Refinance	15.21	5.26	14.86	10.53	21.91	26.32	48.02	52.63

Source: Data reported under HMDA; U.S. Census data

Commercial Loans

The distribution of loans to businesses reflects excellent penetration among businesses of different sizes. Of loans to businesses originated and purchased during the loan-sampling period, 90 percent were made to small businesses. Small businesses are businesses with gross annual revenues of one million dollars or less. This is considered excellent compared to demographic data that show 72.63 percent of the area's businesses are considered small businesses. The following table shows the distribution of commercial loans among different sized businesses in the AA.

Table 2A - Borrower Distribution of Loans to Businesses in Wilson AA				
Business Revenues (or Sales)	≤\$1,000,000	>\$1,000,000	Unavailable/Unknown	Total
% of AA Businesses	72.63	1.91	25.46	100%
% of Bank Loans in AA by #	90.00	10.00	0.00	100%
% of Bank Loans in AA by \$	90.92	9.08	0.00	100%

Source: Loan sample; Dunn and Bradstreet data.

Performance in the Karnes County AA

The borrower distribution of loans in the Karnes County AA is reasonable. Loans for housing were identified as a credit need in this AA.

Home Loans

The distribution of home loans to borrowers reflects poor penetration among borrowers of different income levels. FCNB made 2.56 percent of its home loans to low-income borrowers during the evaluation period. The demographic data indicates that 25.46 percent of families in the AA are low-income. A mitigating factor in the penetration of low-income families is the fact that 20.96 percent of families are below the poverty level

in the AA. Borrowers living below the poverty level might have a difficult time qualifying for home loans since the median housing value has increased 85 percent to \$74,114 since the last CRA examination while the median family income has increased only 31 percent over the same period.

FCNB did have excellent penetration of its refinance loans to moderate-income individuals; however, this was given little weight since refinance loans represent only 9.35 percent of all home loans. The following table shows the distribution of home loan products among borrowers of different income levels compared to the percent of families in each income category.

Table 2 - Borrower Distribution of Residential Real Estate Loans in Karnes AA								
Borrower Income Level	Low		Moderate		Middle		Upper	
Loan Type	% of AA Families	% of Number of Loans	% of AA Families	% of Number of Loans	% of AA Families	% of Number of Loans	% of AA Families	% of Number of Loans
Home Purchase	25.46	2.56	16.51	12.82	16.89	12.82	41.14	71.79
Home Improvement	25.46	0.00	16.51	11.11	16.89	22.22	41.14	55.56
Refinance	25.46	0.00	16.51	20.00	16.89	20.00	41.14	60.00

Source: Data reported under HMDA; U.S. Census data

Commercial Loans

The distribution of loans to businesses reflects excellent penetration among businesses of different sizes. Of loans to businesses originated and purchased during the loan-sampling period, 95 percent were made to small businesses. Also, 91.31 percent of the dollar amount of the loans in our sample were to small businesses, further supporting the overall excellent penetration. The following table shows the distribution of commercial loans among different sized businesses in the AA.

Table 2A - Borrower Distribution of Loans to Businesses in Karnes AA				
Business Revenues (or Sales)	≤\$1,000,000	>\$1,000,000	Unavailable/Unknown	Total
% of AA Businesses	65.15	3.22	31.63	100%
% of Bank Loans in AA by #	95.00	5.00	0.00	100%
% of Bank Loans in AA by \$	91.31	8.69	0.00	100%

Source: Loan sample; Dunn and Bradstreet data.

Geographic Distribution of Loans

The geographic distribution of loans reflects reasonable dispersion throughout the bank's AAs given the identified credit needs. No significant lending gaps were found within the bank's AAs.

Performance in the Wilson County AA

The bank’s geographic distribution of loans in this AA reflects an excellent dispersion throughout census tracts of different income levels.

Home Loans

The bank’s geographic distribution of home loans in this AA reflects an excellent dispersion throughout CTs of different income levels for all products. The following table details the bank’s performance as compared to the percentage of owner-occupied housing units in each CT income level.

Table 3 - Geographic Distribution of Residential Real Estate Loans in Wilson AA								
Census Tract Income Level	Low		Moderate		Middle		Upper	
Loan type	% of AA Owner Occupied Housing	% of Number of Loans	% of AA Owner Occupied Housing	% of Number of Loans	% of AA Owner Occupied Housing	% of Number of Loans	% of AA Owner Occupied Housing	% of Number of Loans
Home Purchase	0.00	0.00	14.42	38.10	37.51	48.81	48.07	13.10
Home Improvement	0.00	0.00	14.42	18.18	37.51	63.64	48.07	18.18
Refinance	0.00	0.00	14.42	15.79	37.51	68.42	48.07	15.79

Source: Data reported under HMDA; U.S. Census data.

Business Loans

The bank’s geographic distribution of business loans reflects an excellent dispersion throughout the CTs of different income levels. In particular, the percentage of business loans originated in the moderate-income CT is excellent. The following table details the bank’s performance as compared to the percentage of businesses in each CT income level.

Table 3A - Geographic Distribution of Loans to Businesses in Wilson AA								
Census Tract Income Level	Low		Moderate		Middle		Upper	
Loan Type	% of AA Businesses	% of Number of Loans	% of AA Businesses	% of Number of Loans	% of AA Businesses	% of Number of Loans	% of AA Businesses	% of Number of Loans
Businesses	0.00	0.00	23.46	50.00	29.82	30.00	46.72	20.00

Source: Loan sample; Dunn and Bradstreet data.

Performance in the Karnes County AA

The bank’s geographic distribution of loans in this AA reflects reasonable dispersion throughout census tracts of different income levels. This is explained by competition in the area. FCNB has only one banking location in Karnes County. The main branch is located in North West Karnes County near the Karnes County/ Wilson County border. Karnes County contains four CTs. The two middle-income CTs are located in the North

West half of the county between Falls City and Karnes City, Texas. The two moderate-income CTs are located in the South East half of the county beginning in Kenedy, Texas. There are five financial institutions located in Kenedy, Texas; Karnes County National Bank, Wells Fargo, Texas Champion Bank, Texas Federal Credit Union, and Capital Farm Credit. These financial institutions service a majority of the borrowers in the moderate-income CTs, making it difficult for FCNB to lend to borrowers in these areas.

Home Loans

The bank’s geographic distribution of home loans in this AA reflects a poor dispersion throughout CTs of different income levels. This performance is explained by competition in the area and the fact that less than 10 percent of the population live in the low and moderate-income tracts. The following table details the bank’s performance as compared to the percentage of owner-occupied housing units in each CT income level.

Table 3 - Geographic Distribution of Residential Real Estate Loans in Karnes AA								
Census Tract Income Level	Low		Moderate		Middle		Upper	
Loan type	% of AA Owner Occupied Housing	% of Number of Loans	% of AA Owner Occupied Housing	% of Number of Loans	% of AA Owner Occupied Housing	% of Number of Loans	% of AA Owner Occupied Housing	% of Number of Loans
Home Purchase	0.00	0.00	8.46	2.56	68.40	51.28	23.13	46.15
Home Improvement	0.00	0.00	8.46	0.00	68.40	44.44	23.13	55.56
Refinance	0.00	0.00	8.46	0.00	68.40	60.00	23.13	40.00

Source: Data reported under HMDA; U.S. Census data.

Business Loans

The bank’s geographic distribution of business loans reflects a reasonable dispersion throughout the CTs of different income levels. The percentage of business loans originated in the moderate-income CTs is excellent at 10 percent, while the percentage of business loans originated in the middle-income CTs is poor at 35 percent. The demographic data indicates that 77.91 percent of businesses in the AA are in the two middle-income CTs. The two middle-income CT’s are designated as underserved and distressed tracts. The following table details the bank’s performance as compared to the percentage of businesses in each CT income level.

Table 3A - Geographic Distribution of Loans to Businesses in Karnes AA								
Census Tract Income Level	Low		Moderate		Middle		Upper	
Loan Type	% of AA Businesses	% of Number of Loans	% of AA Businesses	% of Number of Loans	% of AA Businesses	% of Number of Loans	% of AA Businesses	% of Number of Loans
Businesses	0.00	0.00	6.99	10.00	77.91	35.00	15.09	55.00

Source: Loan sample; Dunn and Bradstreet data.

Responses to Complaints

FNB has not received any CRA complaints during this evaluation period.

Fair Lending or Other Illegal Credit Practices Review

We found no evidence of discriminatory or other illegal credit practices inconsistent with helping to meet community credit needs.