



INTERMEDIATE SMALL BANK

Comptroller of the Currency
Administrator of National Banks
Washington, DC 20219

PUBLIC DISCLOSURE

March 5, 2007

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**Grayson National Bank
Charter Number 10834**

**113 West Main Street
Independence, VA 24348**

**Comptroller of the Currency
3800 Electric Road Suite 204
Roanoke, VA 24018**

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.

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INSTITUTION'S CRA RATING

This institution is rated Outstanding.

The Lending Test is rated: **OUTSTANDING**

The Community Development Test is rated: **SATISFACTORY**

The major facts that support this rating include:

- The loan-to-deposit ratio is more than reasonable given the bank's size, financial condition, and the assessment areas (AA) credit needs.
- The bank made a substantial majority of its loans within its AAs.
- The distribution of borrowers reflects, given the demographics of the AAs, excellent penetration among individuals of different income levels (including low- and moderate-income).
- The bank's community development performance demonstrates adequate responsiveness to community development needs in its AAs.

Scope of Examination

This Performance Evaluation assesses the bank's performance under the Lending and Community Development Tests. The evaluation under the Lending Test covers the bank's performance from January 1, 2003 through December 31, 2006, excluding community development loans. We reviewed residential mortgage loans originated during this period. The evaluation period for community development loans, investments, and services is May 13, 2004 through March 5, 2007.

The analysis is based on the bank's performance in each state where they do business using comparative demographic data from the 2000 U. S. Census. These conclusions were factored into the final ratings and the bank's overall performance.

Description of Institution

Grayson National Bank (GNB) is an interstate bank headquartered in Independence, Virginia (VA) with operations in VA and North Carolina (NC). GNB is wholly-owned by Grayson Bankshares, Inc. Grayson Bankshares, Inc. is a \$333 million bank holding company also headquartered in Independence, VA, and listed on the OTC Bulletin Board under the symbol "GSON".

GNB is a full service community bank serving the counties of Grayson and Carroll and the City of Galax in VA and Alleghany County in NC. GNB operates nine full service offices and eight automated teller machines (ATMs). Three branch offices were opened during the evaluation period; one in Carroll County, VA (2004), one in Hillsville, VA (2005), and one in Whitetop, VA. (2007).

GNB's primary loan product is residential mortgage loans. As of December 31, 2006, residential mortgages represented approximately 45% of total loans outstanding. As of December 31, 2006, Tier 1 Capital was \$26 million, Tier 1 Risk-based Capital to Risk Weighted Assets equaled 11.35%, and Tier 1 Leverage Capital equaled 8.46%.

There are no legal, financial or other factors impeding GNB's ability to help meet the credit needs in its AAs. GNB received an "Outstanding" rating on its May 2004 CRA Performance Evaluation.

Conclusions With Respect to Performance Tests

GNB's overall rating is a blend of the VA and NC State ratings. The VA rating was given the most weight because the majority of GNB's outstanding loans and deposits and those originated during the evaluation period are located there.

GNB has two AAs. Grayson County, Carroll County, and City of Galax make up the VA assessment area. Alleghany County makes up the NC assessment area. Descriptions of each AA are contained in the respective State section of this evaluation.

We took into consideration GNB's business strategy and types of credit offered. The bank offers basic community bank credit products.

Lending Test

Loan-to-Deposit Ratio

GNB's average loan-to-deposit (LTD) ratio is more than reasonable compared to similarly situated institutions. The bank's quarterly average loan-to-deposit ratio since the last CRA examination is 83%. This ratio exceeds those of the two similarly situated banks, Mountain National Bank at 53% and The Bank of Floyd at 71%. These institutions are similar in market area and product offerings.

Lending in Assessment Areas

A substantial majority of loans and other lending related activities were inside the bank's AAs. We used a statistical sample of 52 loans to evaluate the bank's performance in this area. For the evaluation period, 96% of number and 92% of the dollar amount of residential mortgage loans were made inside the bank's AAs.

Table 1 - Lending Bank-wide										
Loan Type	Number of Loans					Dollars of Loans (000s)				
	Inside		Outside		Total	Inside		Outside		Total
	#	%	#	%		\$	%	\$	%	
Residential Mortgages	50	96%	2	4%	52	\$3,289	92%	\$267	8%	\$3,556

Source: 2000 U.S. Census

Lending to Borrowers of Different Incomes

The distribution of borrowers reflects excellent penetration among individuals of different income levels and businesses of different sizes. Refer to the State Rating sections for VA and NC for related facts and data.

Geographic Distribution of Loans

There are no low- or moderate-income geographies in either of the bank's AA. An analysis of the geographic distribution of loans would not be meaningful.

Responses to Complaints

There were no complaints regarding the bank's CRA performance during the evaluation period. This has a neutral impact on the CRA rating.

Community Development Test

The bank's community development performance demonstrates adequate responsiveness to community development needs in its AAs through community development loans, donations to qualified organizations, and community development services, considering the bank's capacity and the need and availability of such opportunities for community development in the AAs.

Number and amount of community development loans

The bank made five community development loans totaling \$2 million during the evaluation period. Proceeds were used to finance affordable housing and business development in economically distressed and underserved areas.

Number and amount of qualified investments

The bank had no investments that qualify under CRA. Management reported that there were minimal to no investments available for purchase that would directly affect the AA. The bank did make 33 donations totaling \$36,000 to qualified organizations.

Extent to which the bank provides community development services

The bank offers loans with no mandatory minimum balance, and branches are located in rural communities. During the evaluation period, officers and employees provided technical services and support to qualified community development organizations. The bank is also partnering with the Economic Crisis Strike Force to assist customers displaced by job losses announced by three major employers in the VA assessment area.

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.

Virginia State Rating

The overall CRA rating for Virginia: OUTSTANDING

The lending test is rated: OUTSTANDING

The community development test is rated: SATISFACTORY

The major factors that support this rating include:

- The distribution of borrowers reflects, given the demographics of the AAs, excellent penetration among individuals of different income levels (including low- and moderate-income).
- The bank's community development performance demonstrates adequate responsiveness to community development needs in its AAs.

Scope of Examination

This Performance Evaluation assesses the bank's performance under the Lending and Community Development Tests. The evaluation under the Lending Test covers the bank's performance from January 1, 2003 through December 31, 2006, excluding community development loans. We reviewed residential mortgage loans originated during this period. The evaluation period for community development loans, investments, and services is May 13, 2004 through March 5, 2007.

The analysis is based on the bank's performance using comparative demographic data from the 2000 U. S. Census.

Description of Bank's Operations in Virginia

GNB operates eight bank branches in VA, all of which are located in the AA that includes the city of Galax, Carroll County, and Grayson County. GNB operates seven ATMs in the AA. As of December 31, 2006, GNB had deposits of \$244 million in VA, which represented less than a 1% deposit market share in the state, and ranked 69th out of 170 financial institutions operating in the state of VA. GNB's primary competitors in its AAs are Mountain National Bank, Branch Banking and Trust Company, and Wachovia.

The AA includes Grayson County, Carroll County and the City of Galax. Carroll County and the City of Galax border Grayson County, which is located in the southwestern part of Virginia in the region known as the New River Valley. Carroll County is located on the crest of the Blue Ridge Mountains of Southwest Virginia. The City of Galax is adjacent to Carroll County and serves as the employment and commercial hub of Grayson and Carroll Counties. The area is approximately two hours south of Roanoke, VA and two hours north of Charlotte, NC. Interstates 81 and 77 are convenient to the area. Manufacturing businesses employ the largest segment of the population, with healthcare being the second largest segment. Over the evaluation period, the AA has experienced an economic downturn due to significant plant

closings and layoffs, primarily in the furniture and textile industries.

Fifteen percent of families in the AA live below poverty. The unemployment rate as of December 31, 2006 in Carroll County was 4.5%, Grayson County was 4.8%, and City of Galax 6.3%. The unemployment rate for the state of Virginia was 2.7%.

GNB is ranked first in market share among FDIC-insured institutions with 32% of total deposits. The AA includes eight institutions. Mountain National Bank continues to be GNB’s primary competitor. GNB’s primary business focus in this AA is residential mortgage lending.

There are few opportunities for making qualified investments in this assessment area.

We conducted one community contact in the AA. Identified credit needs included funding for affordable housing and small business development.

Conclusions With Respect to Performance Tests in Virginia

GNB’s performance in VA is rated **Outstanding**.

In evaluating performance under the Lending Test and determining how each loan type would be weighted, we considered GNB's business strategy, the volume of originations, and community credit needs identified through discussions with the community contact. We also took into consideration the limitations that high rates of unemployment place on the bank’s opportunities to lend. Overall, residential real estate loans were considered GNB's primary product.

In evaluating performance under the Community Development Test, we considered the bank’s capacity to lend and invest in its community, the availability of investment and community development lending opportunities, and the bank’s responsiveness in providing services to the communities in which it does business.

Lending Test

Lending to Borrowers of Different Incomes

The distribution of borrowers reflects, given the demographics of the AA, excellent penetration among individuals of different income levels.

Table 2 - Borrower Distribution of Residential Real Estate Loans in the VA 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
Residential Real Estate	21%	18%	21%	28.5%	25%	28.5%	33%	25%

Source: 2000 U.S. Census

Community Development Test

The bank's community development performance demonstrates adequate responsiveness to community development needs in its AA through community development loans, donations to qualified organizations and community development services, considering the bank's capacity and the need and availability of such opportunities for community development in the bank's AA.

Number and amount of community development loans

The bank made three community development loans totaling \$1.1 million during the evaluation period. Proceeds were used to finance activities that revitalize or stabilize designated underserved non-metropolitan middle-income geographies.

Number and amount of qualified investments

The bank had no qualifying investments. Management reported that there were minimal to no qualified investments available for purchase. The bank made 29 donations totaling \$32,000 to qualified organizations from January 1, 2005 through the end of the evaluation period. Management did not retain documentation for donations in 2004, but stated they were comparable. Contributions went to organizations that provide health and human services for low- and moderate-income individuals, and to organizations that offer technical support and credit programs to small businesses. The number and volume of bank contributions reflects an interest in supporting community development organizations.

Extent to which the bank provides community development services

During the evaluation period and across the bank's AA, five officers and employees provided technical services and support to six qualified community development organizations.

Additionally, the bank is partnering with the Economic Crisis Strike Force to assist customers displaced by job losses announced by three major employers in the assessment area. Under this program, the bank offers qualified customers benefits including: waiving the penalty on certificates of deposit if cashed out early; interest only payments for six months on loans; six payment extensions; and free checks.

Bank's responsiveness through such activities to community development lending, investment, and services needs

The bank is responsive to community credit needs within the context of the products and services offered and opportunities to lend for community development purposes.

North Carolina State Rating

The CRA rating for North Carolina: OUTSTANDING

The lending test is rated: OUTSTANDING

The community development test is rated: SATISFACTORY

The major factors that support this rating include:

- The distribution of borrowers reflects, given the demographics of the assessment area, excellent penetration among individuals of different income levels and businesses of different sizes.
- The bank's community development performance demonstrates adequate responsiveness to community development needs in its AA.

Scope of Examination

This Performance Evaluation assesses the bank's performance under the Lending and Community Development Tests. The evaluation under the Lending Test covers the bank's performance from January 1, 2003 through December 31, 2006, excluding community development loans. We reviewed residential mortgage loans originated during this period. The evaluation period for community development loans, investments, and services is May 13, 2004 through March 5, 2007.

The analysis is based on the bank's performance using comparative demographic data from the 2000 U. S. Census.

Description of Bank's Operations in North Carolina

GNB operates one bank branch and one remote ATM in the town of Sparta, NC. As of December 31, 2006, GNB had deposits of \$22 million in NC, which represented less than a 1% deposit market share in the state, and ranked 120th out of 136 financial institutions operating in the state of NC. GNB's primary competitors in the AA are Branch Banking and Trust, First Charter Bank, First Citizens Bank, and First Community Bank.

Alleghany Co. is bordered by Grayson County, VA., on the north, and by North Carolina counties: Ashe on the west, Wilkes to the south, and Surry to the east. Sparta, its county seat and only municipality, sits at the crossroads of US 21 and NC 18 at the county's center. To this day, Alleghany County has few towns of any size, and nothing that would qualify as a city. The county seat, Sparta, had about 1,800 inhabitants in the year 2000 census.

Nineteen percent of families in the AA live below poverty. The unemployment rate as of December 31, 2006 in Alleghany County was 5.5%. The unemployment rate for the state of North Carolina was 4.9%.

GNB operates one branch in the AA. Approximately 7.5% of GNB’s total deposits are located in this AA. GNB is ranked fifth in market share among FDIC-insured institutions with 11% of total deposits. The AA includes six institutions. GNB’s primary business focuses in this AA is residential mortgage lending.

There are few opportunities for making qualified investments in this assessment area.

Conclusions With Respect to Performance Tests in North Carolina

GNB’s performance in NC is rated **Outstanding**.

In evaluating performance under the Lending Test and determining how each loan type would be weighted, we considered GNB’s business strategy, the volume of originations, and community credit needs identified through discussions with community contacts. We also took into consideration the limitations that high rates of unemployment and poverty place on the bank’s opportunities to lend. Overall, residential real estate loans were considered GNB’s primary products.

In evaluating performance under the Community Development Test, we considered the bank’s capacity to lend and invest in its community, the availability of investment and community development lending opportunities, and the bank’s responsiveness in providing services to the communities in which it does business.

Lending Test

Lending to Borrowers of Different Incomes

The distribution of borrowers reflects, given the demographics of the AA, excellent penetration among individuals of different income levels.

Table 2 - Borrower Distribution of Residential Real Estate Loans in Alleghany Co., NC 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
Residential Real Estate	20%	13%	21%	33%	24%	29%	35%	25%

Source: 2000 U.S. Census

Community Development Test

The bank’s community development performance demonstrates adequate responsiveness to community development needs in its AA through community development loans, donations to qualified organizations and community development services, considering the bank’s capacity

and the need and availability of such opportunities for community development in the bank's AA.

Number and amount of community development loans

The bank made two community development loans totaling \$936,000 during the evaluation period. Proceeds were used to provide Affordable multi-family rental housing for low- or moderate-income individuals.

Number and amount of qualified investments

The bank had no qualifying investments. Management reported that there were minimal to no qualified investments available for purchase. The bank made four donations totaling \$4,000 to qualified organizations from January 1, 2005 through the end of the evaluation period. Management did not retain documentation for donations in 2004, but stated they were comparable. Contributions went to organizations that provide health and human services for low- and moderate-income individuals, and to organizations that offer technical support and credit programs to small businesses. The number and volume of bank contributions reflects an interest in supporting community development organizations.

Extent to which the bank provides community development services

During the evaluation period, one of the bank's officers provided technical services and support to two qualified community development organizations.

Bank's responsiveness through such activities to community development lending, investment, and services needs

The bank is responsive to community credit needs within the context of the products and services offered and opportunities to lend for community development purposes.

Appendix

Scope of Examination Table

The following table identifies the time period covered in this evaluation, affiliate activities that were reviewed, and loan products considered. The table also reflects the areas that received examination review.

Time Period Reviewed	Lending Test: (January 1, 2003 through December 31, 2006) CD Test: (May 13, 2004 through March 5, 2007)	
Financial Institution		Products Reviewed
Grayson National Bank (GNB) Independence, VA		Residential Mortgages
Affiliate(s)	Affiliate Relationship	Products Reviewed
None		
List of Assessment Areas and Type of Examination		
Assessment Area	Type of Exam	Other Information
State of Virginia Grayson Co., Carroll Co., City of Galax Non-MSA	Full-scope	
State of North Carolina Alleghany Co. Non-MSA	Full-scope	