



SMALL BANK

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

PUBLIC DISCLOSURE

February 22, 2005

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**First-Nichols National Bank of Kenedy
Charter Number 12187**

**113 South Sunset Strip
Kenedy, TX 78119**

**Comptroller of the Currency
San Antonio South Field Office
10101 Reunion Place Boulevard, Suite 402
San Antonio, TX 78216-4165**

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.

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 the 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 **First-Nichols National Bank of Kenedy** prepared by the **Office of the Comptroller of the Currency (OCC)**, the institution's supervisory agency, as of **February 22, 2005**. The agency rates the CRA performance of an institution consistent with the provisions set forth in Appendix A to 12 C.F.R. Part 25.*

INSTITUTION'S CRA RATING

This institution is rated Satisfactory.

First-Nichols National Bank (FNNB) is responsive to the community's credit needs, including low- and moderate-income individuals and areas, as well as small business and small agricultural operations. This is evidenced by the following:

- The bank's loan-to-deposit ratio meets the standards for satisfactory performance, averaging 39 percent over the 21 quarters since the prior CRA Performance Evaluation. This compares satisfactorily to the other financial institutions in the bank's assessment area (AA).
- A majority of the bank's loans are made within its AA, which meets the standards for satisfactory performance. Seventy-five (75) percent of the number and 59 percent of the dollar volume of the loan originations sampled during the last five years since the prior CRA Performance Evaluation are within the AA.
- The distribution of loans to borrowers reflects a satisfactory penetration among individuals of different income levels, including low- and moderate-income families, and to businesses and farms of different sizes. The distribution generally reflects the income characteristics of the AA.
- The geographic distribution of our sample of loans reflects excellent dispersion throughout the AA.
- There have been no complaints filed by consumers either at this bank or the OCC concerning the bank's CRA performance.

DESCRIPTION OF INSTITUTION

FNNB is a \$41 million community bank that opened in 1906 in the city of Kenedy, Texas. It is located in Karnes County, approximately 60 miles southeast of San Antonio, Texas. FNNB is an independently owned bank that operates one main office with an attached drive-thru and an Automated Teller Machine. FNNB received a Satisfactory rating during its prior CRA examination, dated November 8, 1999. There are no legal, financial, or other factors that impede the bank's ability to meet the credit needs of its AA. The bank is a subsidiary of Nichols Bancshares, Inc., a one-bank holding company with total assets of \$42 million as of December 31, 2004.

The bank's primary focus is business, agricultural, real estate, and consumer lending. The bank also provides customary deposit products. Competition in the AA comes from two community banks and a branch of a large bank.

Total loans outstanding as of December 31, 2004 were \$17.7 million, or approximately 43 percent of total assets. The composition of the portfolio is as follows:

Loan Category	\$ (000)	%
Commercial and Commercial Real Estate Loans	10,889	62
Consumer Loans	2,709	15
Agriculture and Farm Land Loans	1,594	9
1-4 Family Residential Real Estate Loans	1,615	9
Other Loans	881	5
Total	17,688	100

DESCRIPTION OF THE ASSESSMENT AREA

FNNB designates all of Karnes County as its AA. The AA meets the requirements of the CRA regulation and does not arbitrarily exclude low- and moderate-income geographies. The 2000 census counted 15,445 people living in the AA, a 24 percent increase over the 1990 census population count. In 2000, 21 percent of the households were below the poverty level, an improvement over the 33 percent recorded during the 1990 census. In 2000, the average cost of housing was \$40 thousand, which represented a 37 percent increase over the 1990 estimate.

The county is divided into four tracts, with two each designated as moderate- and middle-income. There are no tracts designated as either low- or upper-income. According to the United States Department of Housing and Urban Development (HUD), the 2000 Non-Metropolitan Statistical Area Median Family Income for Texas is \$42,000, an increase of 24 percent. The percentage of families in the AA, by income level, is as follows: 28 percent low-income, 20 percent moderate-income, 18 percent middle-income, and 34 percent upper-income. This represents a downward shift of seven percent for low-income families since 1990 and an upward shift of three and four percent for moderate- and middle-income families, respectively. The upper-income percentage remained constant from 1990 to 2000.

Kenedy remains the largest city in this predominately rural county. Principal industries for the

AA include: farming, correctional facilities, education, medical, and retail. Major employers include: Texas Department of Criminal Justice, Correctional Facility – 800 employees; Karnes Correctional Facility – 200 employees; Karnes City ISD – 164 employees; Kenedy ISD – 151 employees; and, Red Ewald, Inc., Fiberglass Plant – 100 employees. The general economy is considered weak; however, improvement in personal income is noted in the 2000 census data.

One community contact was made during this Performance Evaluation. The contact spoke highly of all three of the banks headquartered in the AA, including FNNB. The contact, representing a nonprofit development corporation, is focused on attracting businesses to the area. As businesses expand or move into the area, the banks will be able to provide financing and depository products. She sees that this opportunity for the banks will, in the long term, provide for more jobs and higher incomes in the AA.

The table below provides additional demographic information about the AA.

DEMOGRAPHIC AND ECONOMIC CHARACTERISTICS OF AA	
Population	
Number of Families	3,283
Number of Households	4,478
Number of people	15,445
Geographies	
Number of Census Tracts/BNA	4
% Low-Income Census Tracts/BNA	0
% Moderate-Income Census Tracts/BNA	50
% Middle-Income Census Tracts/BNA	50
% Upper-Income Census Tracts/BNA	0
<i>Median Family Income (MFI)</i>	
1990 HUD-Adjusted MFI	33,900
2000 HUD-Adjusted MFI	42,000
Economic Indicators	
Unemployment Rate	2.12%
2000 Median Housing Value	40,020
% of Households Below Poverty Level	21.00%

SAMPLING INFORMATION

Examiners used loan samples to assist in evaluating three of the five performance criteria. The sample consisted of loans that were originated between December 31, 1999 and December 31, 2004. The bank's loan portfolio is diversified among commercial and commercial real estate loans, consumer loans (including 1-4 family residential loans), and agriculture loans. Examiners evaluated these types of loans against the performance criteria. Eighty (80) loans, totaling \$3.4 million, were sampled and consisted of 20 loans from each of the following types: 1-4 family residential, consumer, agricultural, and business.

CONCLUSIONS ABOUT PERFORMANCE CRITERIA

Loan-to-Deposit Ratio

FNNB's loan-to-deposit ratio meets the standards for satisfactory performance, averaging 39 percent over the last 21 quarters since the prior CRA Performance Evaluation. This compares satisfactorily to the other financial institutions in the AA. During this period, extending from December 31, 1999 through December 31, 2004, the loan-to-deposit ratio ranged from a low of 31 percent as of March 31, 2000 to a high of 50 percent as of September 30, 2004. At December 31, 2004, the last quarter calculated, the ratio was 47 percent. The table below shows the average loan-to-deposit ratio for the 21 quarters since the previous CRA examination for each of the three banks headquartered in the AA.

Institution	Assets (as of 12/31/04)	Average LTD Ratio
Falls City National Bank, Falls City	104,250	45
Karnes County National Bank, Karnes City	57,348	49
First-Nichols National Bank, Kenedy	41,569	39

Lending in the Assessment Area

FNNB meets the standards for satisfactory performance for this criterion. A majority of the loans has been extended within the AA. A review of the 80 loans in the sample indicated that a majority of both the number and dollar volume were extended within the AA. The bank has recently successfully solicited the loan business of a large business in adjacent Bee County and has participated in another large loan to a business in Bee County, originated by a bank headquartered in Beeville. Management stated that they were going to recommend to the Board of Directors that they include, in their AA, the tracts that comprise the cities of Beeville and Pettus. Thirteen percent of loan originations come from those two cities. The table below reflects the distribution by product type.

TOTAL LOANS REVIEWED								
LOAN TYPE	IN ASSESSMENT AREA				OUT OF ASSESSMENT AREA			
	#	%	\$ (000s)	%	#	%	\$ (000s)	%
Residential	16	80	685	54	4	20	584	46
Consumer	14	70	225	75	6	30	74	25
Agriculture	17	85	435	83	3	15	88	17
Business	13	65	602	49	7	35	626	51
Total Reviewed	60	75	1,947	59	20	25	1,372	41

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

FNNB meets the standards for satisfactory performance under this criterion by having a reasonable distribution of loans to individuals with different income levels and to businesses and farms of different sizes. The number of loans to the different income levels is commensurate with the number of families of the different income levels. The one area that is out of line is

residential loans to moderate-income families. During the 21 quarters reviewed for this evaluation, the bank originated only 22 1-4 family residential loans. During the assessment period, interest rates have been very low and mortgage lenders, who can obtain long-term, low-rate money to fund long-term residential loans, have dominated the business. Only one very small \$5 thousand residential loan was originated for a moderate-income family. Both the number and dollar amount of consumer loans originated for moderate-income families are in line with the percentage of moderate-income families in the AA. The table below reflects that, in the aggregate, the number of loans to families of different income levels is in line with the percentage of families in each income level residing in the AA.

LENDING TO BORROWERS OF DIFFERENT INCOME LEVELS								
Borrower Income Level	LOW		MODERATE		MIDDLE		UPPER	
% of AA Families	28		20		18		34	
LOAN TYPE	% of Number	% of Amount						
Residential	19	15	6	1	25	24	50	60
Consumer	37	20	29	16	7	12	27	52
Total	27	17	17	4	17	21	39	58

The table below reflects a good distribution of loans to small businesses and farms. Small refers to a business or farm that generates less than or equal to \$1 million in annual revenues. Ninety-three percent of the dollar amount of business loans were granted to businesses with less than \$1 million in annual revenues, which is the same as the percentage of small businesses in the AA. Ninety-eight percent of the farms in the AA generate less than \$1 million. Every loan in our sample of farm loans was made to small farms.

BORROWER DISTRIBUTION OF LOANS TO SMALL BUSINESSES AND FARMS		
Annual Revenues	≤\$1,000,000	>\$1,000,000
Business Loans		
% of AA Businesses	93	7
% of Bank Loans in AA #	85	15
% of Bank Loans in AA \$	93	7
Farm Loans		
% of AA Farms	98	2
% of Bank Loans in AA #	100	0
% of Bank Loans in AA \$	100	0

Geographic Distribution of Loans

FNNB exceeds the standards for satisfactory performance for this criterion. The geographic distribution of loans represents an excellent dispersion throughout the bank's AA. Our sample of loan originations in the AA reflects that the bank's performance in the moderate-income tracts greatly exceeded the demographics. The table below illustrates the distribution of loans by product type.

Geographic Distribution of Loans										
	Low Income Tracts		Moderate-Income Tracts		Middle-Income Tracts		Upper-Income Tracts		Total	
Residential Loans										
Percent Owner-Occupied	0 Percent		50 Percent		50 percent		0 Percent		100 Percent	
	#	%	#	%	#	%	#	%	#	%
Residential Loans	NA	NA	12	75	4	25	NA	NA	16	100
Consumer Loans										
Percent of Households	0 Percent		51 Percent		49 Percent		0 Percent		100 Percent	
	#	%	#	%	#	%	#	%	#	%
Consumer Loans	NA	NA	12	86	2	14	NA	NA	14	100
Business Loans										
Percent of Businesses	0 Percent		54 Percent		46 Percent		0 Percent		100 Percent	
	#	%	#	%	#	%	#	%	#	%
Business Loans	NA	NA	12	92	1	8	NA	NA	13	100
Farm Loans										
Percent of Farms	0 Percent		33 Percent		67 Percent		0 Percent		100 Percent	
	#	%	#	%	#	%	#	%	#	%
Farm Loans	NA	NA	13	76	4	24	NA	NA	17	100

Response to Complaints

No complaints concerning FNNB's CRA performance have been received during this evaluation period.

Record of Compliance with Anti-discrimination Laws

We found no evidence of illegal discrimination or other illegal credit practices. Our sample included 20 consumer loans not secured by cash and 20 1-4 family residential loans.