



**SMALL BANK**

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Comptroller of the Currency  
Administrator of National Banks

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## **PUBLIC DISCLOSURE**

**May 27, 2008**

### **COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION**

The Hondo National Bank  
Charter Number 14351

1112 Eighteenth Street  
Hondo, TX 78861-0000

Office of the Comptroller of the Currency

San Antonio South Field Office  
10001 Reunion Place, 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.**

Hondo National Bank (HNB) reflects satisfactory lending performance in its efforts to meet the credit needs of its community, including low- and moderate-income individuals and geographies. Factors that support the overall rating include:

- The average quarterly loan-to-deposit (LTD) ratio of 63 percent over the prior 20 quarters is reasonable given the asset size and overall financial condition of the bank.
- A substantial majority of loans in our sample, 84 percent of the number and 85 percent of the dollar volume, originated within the AA.
- The distribution of borrowers reflects reasonable penetration among businesses and farms of different sizes and individuals of different income levels.

**SCOPE OF EXAMINATION**

Our examination covered the time period from May 20, 2003, the date of the prior Performance Evaluation, to May 27, 2008, the as of date for the current examination. We identified commercial loans as the primary loan product of the bank. These loans represent a majority of the loans; however, HNB also originates agriculture, consumer, and residential loans.

**DESCRIPTION OF INSTITUTION**

HNB, an intrastate community bank with total assets of \$105 million as of March 31, 2008, is a wholly-owned subsidiary of Texas Heritage Bancshares, a one-bank holding company headquartered in Hondo, Texas. The main office of the bank is also located in Hondo, Texas. The three branches are located in the cities of Bandera, Leakey, and Uvalde. Competition exists from small, local institutions, and from several regional and nationwide bank branches located throughout the assessment areas.

HNB provides lobby and drive-through services during reasonable hours from Monday through Friday at all four locations. Each location has an onsite automated teller machine (ATM) that allows customers to obtain cash, request account balance information, and transfer funds between accounts. A stand-alone ATM is located in a retail-shopping center in Hondo. HNB offers traditional loan and deposit products with a primary focus on commercial lending, which includes commercial real estate.

Based on its financial condition, the local economy, product offerings, competition, and past performance, HNB has the ability to meet credit needs in its community. The bank was rated "Satisfactory" at the last CRA examination. There are no legal impediments or other financial factors that hinder the ability of HNB to provide credit within its assessment areas.

At March 31, 2008, net loans totaled \$71.3 million and represented 67 percent of total assets. The following table details the composition of the loan portfolio:

<b>Loan Portfolio Summary by Loan Product March 31, 2008</b>		
<b>Loan Category</b>	<b>Dollar Volume (000's)</b>	<b>% of Dollar Volume</b>
Commercial Real Estate Loans	35,725	50.13
Commercial Loans	9,853	13.82
Residential Real Estate Loans	9,789	13.74
Agricultural Loans	7,040	9.88
Consumer Loans	4,906	6.88
Municipal Leases	3,952	5.55
<b>Total</b>	<b>71,265</b>	<b>100</b>

*Source: March 31, 2008 Consolidated Report of Condition*

## **DESCRIPTION OF ASSESSMENT AREA (AA)**

HNB has designated Medina, Bandera, Uvalde, and Real counties as its AA. The counties are contiguous, but two of the counties (Medina and Bandera) are part of the San Antonio Metropolitan Statistical Area. For analytical purposes the bank has two separate AAs, each with its own set of demographic data.

The Medina and Bandera Counties AA includes ten census tracts that are designated middle-income geographies. Neither county has any low-, moderate- or upper-income census tracts. Major cities in this AA include Hondo, the county seat of Medina County, and Bandera. HNB has an office in each of these cities. Economic conditions in Hondo are stable with some improvement noted. The city is located thirty miles west of San Antonio and has benefited from the growth along the Medina and Bexar County line.

To gather current information on the nature of the community and potential lending opportunities within the AAs, we contacted an individual from a local community organization during this examination. The contact indicated that affordable housing was a primary need in the community. The contact spoke favorably about local institutions and indicated the institutions were meeting credit needs in the community. We reviewed the community contact database and found a recent contact with another individual at a state agency. This contact identified student loans, affordable housing, and financial literacy programs as community needs.

The Uvalde and Real Counties AA is not included in a metropolitan statistical area and consists of six census tracts. One tract is designated moderate-income and five are designated middle-income. Neither county has any low- or upper-income census tracts. Major cities in this AA include Uvalde and Leakey. HNB has an office in each of these cities.

The AAs meet the requirements of the regulation and do not arbitrarily exclude low- or moderate-income geographies. The following table is a summary of demographic information for these AAs:

<b>Demographics and Economic Characteristics of Assessment Areas</b>		
	Medina & Bandera Counties	Uvalde & Real Counties
<i>Population</i>		
Number of Families	15,417	7,553
Number of Households	19,950	9,777
<i>Geographies</i>		
Number of Census Tracts/BNA	10	6
% Low-Income Census Tracts/BNA	0%	0%
% Moderate-Income Census Tracts/BNA	0%	17%
% Middle-Income Census Tracts/BNA	100%	83%
% Upper-Income Census Tracts/BNA	0%	0%
<i>Median Family Income (MFI)</i>		
2000 Census MFI	\$44,591	\$36,380
2007 HUD-Adjusted MFI	\$53,700	\$41,800
<i>Economic Indicators</i>		
Unemployment Rate	2%	3%
2007 Median Housing Value	\$73,742	\$47,607
% Owner Occupied Housing	66%	59%
% Households Below Poverty Level	14%	23%

*Source: 2007 Business Geodemographic Data; 2000 U.S. Census Data.*

## **CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA**

HNB demonstrated satisfactory performance in meeting the credit needs of its AA. We focused our review on commercial loans, the primary lending product, and also reviewed performance for agriculture, consumer, and residential loans. We selected a sample of loans to determine the extent of lending within the AA, the distribution of loans by borrower income level, and the geographic distribution of loans.

### **Loan-to-Deposit Ratio**

HNB's loan-to-deposit (LTD) ratio meets the standard for satisfactory performance. During the evaluation period, the LTD ratio ranged from a low of 53 percent to a high of 77 percent at December 31, 2007. The average quarterly LTD ratio over the past 20 quarters, 63 percent, compared favorably to the overall average of 57 percent reported for the six other similarly situated financial institutions located in the bank's AA. The LTD ratio has steadily increased during the evaluation period and was 73 percent at March 31, 2008.

<b>Institution</b>	<b>Total Assets at 3/31/2008 (000's)</b>	<b>Average LTD Ratio 6/30/2003-3/31/2008</b>
<i>The Hondo National Bank</i>	105,425	62.90
Bandera Bank	40,636	76.43
Community National Bank	100,911	73.71
Uvalde National Bank	35,904	60.39
First State Bank of Uvalde	465,374	50.90
Castroville State Bank	88,586	45.98
Medina Valley State Bank	77,529	33.09

*Source: Quarterly Call Report Information.*

### **Lending in Assessment Area**

HNB exceeds the standards for satisfactory performance with a substantial majority of loans originating in its AA. We reviewed a sample of commercial (including commercial real estate), agricultural, residential, and consumer loans originated since the prior evaluation. The following table reflects the distribution of loans in our sample, by number and dollar volume, originated in and out of the AA.

<b>Lending in and out of Assessment Area</b>										
Loan Type	Number of Loans					Dollars of Loans				
	Inside		Outside		Total	Inside		Outside		Total
	#	%	#	%		\$	%	\$	%	
Small Business	31	78	9	22	40	3,554	79	971	21	4,525
Small Farm	35	78	5	12	40	2,922	93	236	7	3,157
Residential	36	78	4	12	40	334	89	41	11	375
Consumer	33	83	7	17	40	2,062	86	333	14	2395
<b>Totals</b>	<b>135</b>	<b>84</b>	<b>25</b>	<b>16</b>	<b>160</b>	<b>8,872</b>	<b>85</b>	<b>1581</b>	<b>15</b>	<b>10,452</b>

*Source: Loan Sample; selected at random from bank records.*

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

Overall, HNB meets the standards for satisfactory performance with reasonable distribution of loans to businesses and farms of different sizes. We selected a sample of loans in the AAs to evaluate performance. The following narratives and tables document our findings.

The distribution of loans to small businesses reflects strong penetration among businesses of different sizes. The following tables reflect the percentage of loans to small businesses originated by HNB is comparable to the percentage of businesses with annual revenues less than \$1 million. Thirty-three percent of the businesses in each AA did not report revenue data or it was not available.

Borrower Distribution of Small Loans to Businesses – Medina & Bandera Counties AA			
Business Revenues	≤\$1,000,000	>\$1,000,000	Unavailable or Unknown
% of AA Businesses	65	2	33
% of Bank Loans in AA #	90	10	0
% of Bank Loans in AA \$	89	11	0

Source: Loan Sample; 2007 Business Geodemographic Data.

Borrower Distribution of Small Loans to Businesses – Uvalde & Real Counties AA			
Business Revenues	≤\$1,000,000	>\$1,000,000	Unavailable or Unknown
% of AA Businesses	64	3	33
% of Bank Loans in AA #	80	20	0
% of Bank Loans in AA \$	79	21	0

Source: Loan Sample; 2007 Business Geodemographic Data.

The distribution of loans to small farms reflects strong penetration among farms of different sizes. The following tables reflect the percentages of the number and dollar volume of loans made by the bank are comparable to the percentage of farms in the two AAs.

Borrower Distribution of Small Loans to Farms – Medina & Bandera Counties AA			
Business Revenues	≤\$1,000,000	>\$1,000,000	Unavailable or Unknown
% of AA Businesses	97	2	1
% of Bank Loans in AA #	90	10	0
% of Bank Loans in AA \$	71	29	0

Source: Loan Sample; 2007 Business Geodemographic Data.

Borrower Distribution of Small Loans to Farms – Uvalde & Real Counties AA			
Business Revenues	≤\$1,000,000	>\$1,000,000	Unavailable or Unknown
% of AA Businesses	95	4	1
% of Bank Loans in AA #	95	5	0
% of Bank Loans in AA \$	85	15	0

Source: Loan Sample; 2007 Business Geodemographic Data.

Our analysis of residential lending activity in Medina and Bandera counties reflected percentages lower than those reported in the demographic data for low- and moderate-income families. Households below the poverty level represent 14 percent of the total households in the AA. The level of income based on the 2007 HUD-adjusted median family income for this household segment is \$26,850. This low level could inhibit potential borrowers from qualifying for residential loans, since the 2007 median housing value is \$73,742.

RESIDENTIAL REAL ESTATE – Medina & Bandera Counties AA								
Borrower Income Level	LOW		MODERATE		MIDDLE		UPPER	
% of AA Families	21%		20%		22%		37%	
	% of Number	% of Amount						
Total	15	6	10	5	30	26	45	63

Source: Loan sample; U.S. Census data.

Our analysis of residential lending activity in Uvalde and Real counties reflected percentages lower than those reported in the demographic data for low- income families. Households below the poverty level represent 23 percent of the total households in this AA. The level of income based on the 2007 HUD-adjusted median family income for this household segment is \$20,900. This level could inhibit potential borrowers from qualifying for residential loans. The 2007 median housing value was \$47,607. There is good penetration for loans to moderate-income individuals. The percentage of loans made is comparable to demographic information.

RESIDENTIAL REAL ESTATE – Uvalde & Real Counties AA								
Borrower Income Level	LOW		MODERATE		MIDDLE		UPPER	
% of AA Families	27		20		20		33	
	% of Number	% of Amount						
Total	5	2	20	13	40	42	35	44

Source: Loan sample; U.S. Census data.

Consumer lending activity in Medina and Bandera counties reflected good distribution of loans to borrowers with low- and moderate-income levels. As shown in the following table, 35 percent of the number of loans in our sample originated to borrowers with low- or moderate-income levels. The percentage is higher than the 33 percent reported in demographic data for low- and moderate-income households.

CONSUMER - Medina & Bandera Counties AA								
Borrower Income Level	LOW		MODERATE		MIDDLE		UPPER	
% of AA Households	19		14		50		14	
	% of Number	% of Amount						
Total	25	17	10	5	25	29	40	49

Source: Loan sample; U.S. Census data.

Consumer lending activity in Uvalde and Real counties reflected reasonable distribution of loans to borrowers with low- and moderate-income levels. As shown in the following table, 25 percent of the number of loans in our sample originated to borrowers with low-income. The percentage is near to the 28 percent reported in demographic data for low-income households. The percentage for moderate-income households is lower than reported demographic data.

CONSUMER - Uvalde & Real Counties AA								
Borrower Income Level	LOW		MODERATE		MIDDLE		UPPER	
% of AA Households	28		18		18		36	
	% of Number	% of Amount						
Total	25	17	10	5	25	29	40	49

Source: Loan sample; U.S. Census data.

### Geographic Distribution of Loans

An analysis of the geographic distribution of loans was not conducted for either AA. An analysis would not be meaningful in the Medina and Bandera Counties AA since all ten census tracts are designated middle-income. An analysis for the Uvalde and Real Counties AA would not be meaningful as only one of the six census tracts is designated moderate-income. (There are no low-income census tracts in either of these two counties.) While an analysis was not done, our samples included loans that originated in the moderate-income census tract located in Uvalde County.

### Responses to Complaints

HNB has not received any consumer complaints related to its CRA performance during the 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.