



SMALL BANK

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

PUBLIC DISCLOSURE

October 11, 2011

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

The First National Bank of Mertzton
Charter Number 9810

106 S. Broadway
Mertzton, TX 76941

Office of the Comptroller of the Currency
Southern District
ADC-San Antonio – North 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 the 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."

The First National Bank of Mertzon's (FNB) lending performance reflects a satisfactory response to community credit needs based on the following.

- Though efforts have been made to increase lending during the evaluation period, the loan-to-deposit (LTD) ratio is somewhat less than reasonable given the bank's size, financial condition, and AA credit needs. The performance context bears consideration.
- FNB originated a substantial majority of loans within its assessment area (AA) since the prior evaluation dated April 2, 2007.
- The distribution of loans reflects reasonable penetration among individuals of different income levels including low- and moderate-income (LMI) and businesses of different sizes.
- The geographic distribution of loans reflects excellent dispersion throughout the AA.
- FNB has had no complaints related to its Community Reinvestment Act (CRA) performance during this evaluation period.

SCOPE OF EXAMINATION

We evaluated FNB's CRA performance under the Small Bank examination procedures, which is comprised of a lending test. The lending test evaluates the bank's record of meeting the credit needs of its AA through its lending activities. FNB operates in only one AA, which includes Irion and Tom Green Counties, and is designated as the San Angelo MSA. The full-scope review focused on commercial real estate (CRE) and commercial loans from January 1, 2008 through June 30, 2011. In addition, our review also focused on residential real estate loans reported under the Home Mortgage Disclosure Act (HMDA) for 2008, 2009, 2010, and the first half of 2011. We focused our review on these primary loan products because they represent over 64% of the total loan portfolio as of June 30, 2011. The bank does not have any affiliates that would impact the CRA examination. HMDA data was determined to be reliable based on a review of internal audit records.

DESCRIPTION OF INSTITUTION

FNB is a \$203 million financial institution and currently has its main office in Mertzon and two branches in San Angelo. FNB is a locally-owned community bank and is not part of a holding company. The bank owns three automatic teller machines (ATM) with one located at each location. FNB is a full-service, traditional bank with a focus on providing small business and consumer loans. FNB has a 10.4% market share of deposits in the San Angelo MSA, with three other banks having greater market shares in the AA. FNB is the only bank in Irion County.

As of June 30, 2011, net loans represented 20% of the bank's total assets. The bank focuses on commercial lending, which makes up 46% of its loan portfolio. FNB also has a significant level of residential real estate loans. Please see Table 1 below for a summary of the loan portfolio.

Loan Category	\$ (000)	%
Commercial Real Estate Loans	8,316	20
Commercial Loans	10,879	26
Agricultural Loans	7,973	19
Consumer Loans	5,090	12
Residential Real Estate Loans	7,803	19
Other Loans	1,905	4
Total	41,966	100

Source: Institution Consolidated Reports of Condition as of June 30, 2011

DESCRIPTION OF ASSESSMENT AREA(s)

FNB's AA consists of all contiguous census tracts in Irion and Tom Green Counties. Mertzon is the county seat for Irion County, while San Angelo is the county seat for Tom Green County. The San Angelo Metropolitan Statistical Area (MSA) is all of Tom Green and Irion Counties. The 2011 median family income for the AA is \$51,800.

San Angelo is headquarters for two competing commercial banks and the location of multiple branches of other banks and credit unions. Leading industries are local, state, and federal government positions, as well as the medical related field, with top employers including Goodfellow Air Force Base, Shannon Health System, and Angelo State University. The area has a lower-than-average unemployment rate of 6.8% as of August 2011, compared to Texas at 8.5%, and the United States at 9.1%. Tom Green County is comprised of 23 census tracts; one is designated as low-income, four are moderate-, thirteen are middle- and five are upper-income. Irion County consists of only one middle-income census tract, located approximately 30 miles southwest of San Angelo. The entire AA has a population of approximately 106,000, with about 1,700 of that population centered in Irion County.

In order to gather more current information on the nature of the community and potential lending opportunities in the AA, we contacted the director of a local Small Business Development organization. The contact indicated there is a need for start-up financing for small businesses, debt consolidation, and restructuring loans. With a slight uptick in local unemployment, there has been an increased demand for start-up loans, and many local banks are using SBA loan products because of the guarantee. There are also revolving loan funds and micro lenders operating in the AA, such as ACCION and the People Fund. Local community banks and some national banks have been instrumental in providing debt consolidation loans, though tough economic conditions have resulted in tighter underwriting requirements. With regards to restructuring loans, banks are interested in working only with existing clients. The contact concluded that overall, area banks are meeting the banking needs of the area.

A review of FNB's lending practices revealed no evidence of illegal discrimination. The AA meets the requirements of the regulation and does not arbitrarily exclude any LMI geographies. Based on its financial condition, resources, the local economy, product offerings, and competition, FNB has the ability to meet the various credit needs in its community. No legal impediments or other factors hinder the bank's ability to provide credit in its AA. FNB received a "Satisfactory" rating at its previous CRA examination conducted in March 2007. Since the prior evaluation, there have been no complaints relating to FNB's CRA performance. See Table 2 below for demographic information for the entire AA.

Table 2 Demographic and Economic Characteristics of Assessment Area	
Population	
Number of Families	27,594
Number of Households	40,223
Geographies	
Number of Census Tracts (CTs)	24
Low-Income CTs	1
Moderate-Income CTs	4
Middle-Income CTs	14
Upper-Income CTs	5
Median Family Income (MFI)	
2000 Census MFI	41,614
2011 HUD-Adjusted MFI	51,800
2010 HUD-Adjusted MFI	51,800
2009 HUD-Adjusted MFI	52,400
2008 HUD-Adjusted MFI	49,100
Economic Indicators	
Unemployment Rate	4.5%
Median Housing Value	64,591
% of Households Below Poverty Level	15%
% of Owner Occupied Units	58%

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

Management had demonstrated satisfactory performance in meeting the credit needs of the AA. In forming this conclusion, we evaluated the following factors:

Loan-to-Deposit Ratio

Despite negative economic trends, the bank has focused on generating loan growth in its market area since the last CRA examination. The loan portfolio has grown by 33% during that time. Loan growth as a percentage of total loans, however, has been closely matched with overall deposit growth during that time period. In contrast, recent deposit increases in the past year represent more than 24% of total deposit levels, versus annual loan growth of less than 8%. FNB has historically had a significantly large volume of deposits held by insiders of the bank. The recent influx of additional deposits in the past 12 months is tied primarily to bank director accounts and close family relationships. This provides the bank a stable and low-cost funding base, but effectively lowers the bank's LTD ratio. The LTD ratio increases to about 39% if director deposits are not included in the calculation, which is more in line with comparison banks. On the other hand, excluding the unusual deposit increase of the past year, the effective LTD ratio would be just over 27%. The San Angelo banking market is similar to the overall US market, in that deposit levels at many financial institutions remain elevated in a period of economic uncertainty, historically low investment yields, and investor flight to safety. For this same reason, many consumers are paying down debt, and demand for loan products remains suppressed.

Considering the bank's performance context and comparison with similar institutions in the general market area, the LTD ratio is somewhat less than reasonable given the bank's size, financial condition, and AA credit needs. The LTD ratio has averaged 25% since the prior evaluation. The ratio trended up to exceed 28% in the first several quarters of the evaluation period, but dropped off in the fourth quarter of 2008. Over the past year, it has tapered off further due to an influx of deposits, and is currently near 22%. FNB's ratio ranks last compared to six other local community banks. For these six comparable banks, the LTD ratio averaged 52% between 2007 and 2011. However, the average LTD ratio of comparison banks (from the prior evaluation) has dropped about 4% versus the FNB decline of only 1% during the current evaluation period; this also indicates some improvement in lending compared to other area banks.

Please see Table 3 below for a comparative LTD ratio analysis among banks.

Table 3 Loan to Deposit Ratio		
Institution	Total Assets	Average LTD Ratio (%)
First Financial Bank, NA	22,105	47
The First National Bank of Eldorado	51,374	37
The First National Bank of Sterling City	87,909	36
The First National Bank of Ballinger	121,699	62
Texas State Bank	199,612	51
The First National Bank of Mertzton	203,430	25
The First National Bank of Sonora	293,332	77

Source: Institution Consolidated Reports of Condition March 31, 2007 through June 30, 2011

Lending in Assessment Area

A substantial number of loans and other lending-related activities are in the bank's AA. FNB made 81% of its loans during the evaluation period inside its AA. See Table 4 for the level of lending within the AA.

Table 4 Lending in San Angelo MSA Assessment Area										
Loan Type	Number of Loans					Dollars of Loans				
	Inside		Outside		Total	Inside		Outside		Total
	#	%	#	%		\$	%	\$	%	
Home Purchase	45	71.43	18	28.57	63	\$4,895	71.97	\$1,906	28.03	\$6,801
Home Improvement	98	82.35	21	17.65	119	\$1,075	83.66	\$210	16.34	\$1,285
Refinance	65	85.53	11	14.47	76	\$4,676	74.23	\$1,623	25.77	\$6,299
Commercial Loans (Sample)	30	81.08	7	18.92	37	\$1,812	76.61	\$553	23.39	\$2,365
Totals	238	80.68	57	19.32	295	\$12,458	74.38	\$4,292	25.62	\$16,750

Source: Data reported under HMDA; Loan Sample.

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

FNB's overall loan distribution reflects a reasonable penetration among individuals of different income levels (including LMI) and businesses of different sizes, given AA demographics. Although residential real estate lending to LMI borrowers in the bank's AA is below area demographics, we gave greater consideration to the bank's performance in commercial lending, as this represents a majority of their loan portfolio. In addition, performance context factors help clarify the bank's residential lending efforts.

Business Loans

The bank's record of lending to small businesses reflects reasonable penetration. Small businesses are defined as having annual gross revenues of less than \$1 million. According to 2000 US Census demographics, at least 77% of AA businesses have annual gross revenues of less than \$1 million; 20% of businesses have unknown revenue levels. Of the 30 loans sampled in the AA, 24 were made to small businesses, which represent 80% of the sample population. This compares favorably to the demographic comparative information and reflects an outstanding level of lending to small businesses. The percentage of loans to small businesses as a percent of the total dollar amount is significantly lower as a result of a small number of large dollar loans to large businesses. However, the number of loans generated is a more relevant measure of bank's lending performance to small businesses. Overall penetration is considered satisfactory. Please see Table 5 below for more detail.

Business Revenues (or Sales)	≤\$1,000,000	>\$1,000,000	Unavailable/Unknown	Total
% of AA Businesses	76.50%	3.49%	20.01%	100%
% of Bank Loans in AA by #	80%	20%	0%	100%
% of Bank Loans in AA by \$	31.25%	68.75%	0%	100%

Home Loans

The bank's record of making residential real estate loans to LMI borrowers reflects reasonable dispersion to LMI families. While the bank's penetration to LMI borrowers is lower than the demographic comparison data, the performance context does bear consideration. While the bank's dollar volume of residential lending is material at 19%, the actual number of loans generated during the evaluation period is relatively small at 208. FNB provides standard residential loan products and subscribes to conservative underwriting requirements. FNB retains each originated loan on its balance sheet for the life of the loan. Loans are generally set up on a 3-5 year term with a "balloon payment" due at the end of the term, at which point the remaining loan balance would generally be refinanced. Low- and moderate-income populations and organizations that assist these groups in obtaining financing generally prefer fixed-rate loans over a 30-year term, which is outside the bank's loan policy and risk tolerance. There are other banks in the market area that provide these types of longer-term loans. Therefore, FNB is less competitive in this product and bank management does not engage in significant marketing efforts to promote residential loan products. Please see Table 5A on the following page for more details.

Borrower Income Level	Low		Moderate		Middle		Upper	
Loan Type	% of AA Families	% of # of Loans	% of AA Families	% of # of Loans	% of AA Families	% of # of Loans	% of AA Families	% of # of Loans
Home Purchase	19.37	4.44	18.37	11.11	22.73	24.44	39.53	57.78
Home Improvement	19.37	6.12	18.37	12.24	22.73	23.47	39.53	57.14
Refinance	19.37	4.62	18.37	9.23	22.73	20.00	39.53	63.08

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

Geographic Distribution of Loans

The geographic distribution of loans reflects excellent dispersion throughout the AA. We put more weight on the commercial lending performance since a majority of the loans made by FNB were commercial-related loans. Since there was only one low-income tract in the AA, analysis was less meaningful than for lending to moderate-income tracts. We did not identify any conspicuous gaps in lending throughout the bank's AA.

Business Loans

FNB's dispersion of business lending to moderate-income census tracts is excellent. Our sample indicated that small business loans to borrowers located in LMI tracts were 3% and 33%, respectively. This compares very favorably to census data, which shows that only 2% and 14% of AA businesses are located in LMI tracts, respectively. Please see Table 6 below for more data.

Census Tract Income Level	Low		Moderate		Middle		Upper	
Loan Type	% of AA Businesses	% of # of Loans	% of AA Businesses	% of # of Loans	% of AA Businesses	% of # of Loans	% of AA Businesses	% of # of Loans
Businesses	2.11	3.33	14.20	33.33	53.69	56.67	29.99	6.67

Source: Loan sample; Dunn and Bradstreet data.

Home Loans

Analysis regarding the only low-income tract is not meaningful due to the small percentage that tract represents. Therefore, more weight is given to lending in moderate-income tracts. FNB's level of residential real estate lending in moderate-income census tracts is below area demographics when compared to the percentage of owner-occupied properties in those tracts; census data indicates 16% of owner-occupied units in the AA are located in moderate-income census tracts. Bank data for the evaluation period indicates that FNB originated 11% (home purchase), 4% (home improvement), and 8% (refinance) of their residential loans to moderate-income census tracts. This represents a reasonable dispersion considering performance context factors. These factors were discussed under the Borrower Distribution section for home loans. Please see Table 6A below.

Table 6A Geographic Distribution of Residential Real Estate Loans in San Angelo MSA Assessment Area								
Census Tract Income Level	Low		Moderate		Middle		Upper	
Loan type	% of Owner Occupied Housing	% of # of Loans	% of Owner Occupied Housing	% of # of Loans	% of Owner Occupied Housing	% of # of Loans	% of Owner Occupied Housing	% of # of Loans
Home Purchase	0.93	0.00	15.85	11.11	54.08	62.22	29.15	26.67
Home Improvement	0.93	0.00	15.85	4.08	54.08	71.43	29.15	24.49
Refinance	0.93	0.00	15.85	7.69	54.08	69.23	29.15	23.08

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

Responses to Complaints

The First National Bank of Mertz on has not received any complaints or public comments regarding its CRA performance 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.