



SMALL BANK

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

PUBLIC DISCLOSURE

December 12, 2011

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 Field Office
10001 Reunion Place, Suite 250
San Antonio, TX 78216-4133

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 June 26, 2006 through December 14, 2011, as this is representative of its lending strategy since the last Community Reinvestment Act (CRA) examination.

FCNB's primary loan products are commercial and residential loans. The bank reports data under the requirements of the Home Mortgage Disclosure Act (HMDA). HMDA data from 2008, 2009, and 2010 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, 2008 through December 14, 2011.

DESCRIPTION OF INSTITUTION

FCNB is an intrastate bank headquartered in Falls City, Texas. As of September 30, 2011 FCNB had total assets of \$189 million and Tier one capital of \$18 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). No branches have been opened or closed since the last CRA examination. 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 decentralized and all loans are closed at the branch where the application is originated. Additionally,

customers are able to access their depository accounts through the internet, ATMs, and phone bank.

As of September 30, 2011, FCNB reported net loans of \$79 million and had a net loans and leases to total assets ratio of 42%. A summary of the loan portfolio is as follows:

Loan Portfolio Summary by Loan Product September 30, 2011		
Loan Category	Dollar Volume \$(000)	% of Outstanding Dollars
Commercial	30,059	37.54
Residential	28,847	36.02
Agriculture/Farm	12,509	15.62
Consumer	8,403	10.49
Other Loans	260	0.33
Total	80,078	100.00

There are no legal, financial, or other factors that impede FCNB's ability to help meet the credit needs in its AAs. The previous CRA examination is dated June 26, 2006, and FCNB was rated "Satisfactory" under the small bank criteria.

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)	9	0	11.11	88.89	0
Population by Geography	32,408	0	14.60	85.40	0
Owner-Occupied Housing by Geography	9,377	0	11.91	88.09	0
Businesses by Geography	3,520	0	13.12	86.88	0
Farms by Geography	225	0	5.33	94.67	0
Family Distribution by Income Level	8,870	0	22.92	77.08	0
Household Distribution by Income Level	11,028	0	21.69	78.31	0
Census Median Family Income (MFI)		\$44,591	Median Housing Value		\$72,925
HUD-Adjusted MFI: 2010		\$57,800	Families Below the Poverty Level		9.15%
HUD- Adjusted MFI: 2009		\$57,200	Unemployment Rate		4.84%
HUD – Adjusted MFI: 2008		\$54,700			

Source: 2000 U. S. Census

The current local economy is characterized as good and expanding due primarily to the current oil and gas mining activity associated with the Eagle Ford shale formation. Economic activity in the area is relatively diverse with oil field related services, agriculture, services, and retail and wholesale businesses being the primary economic activities. Average unemployment for the area is 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 conducting the assessment of the bank’s performance, we contacted a member of a local community organization in Wilson County. This contact indicated the community’s current economic condition is good due to the oil field activity in the area. The contact indicated there is a shortfall in hotel rooms and housing due to the abundance of oilfield workers. Based on this information, the contact feels the main opportunity for financial institutions to aid in community development is by providing home loans.

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.

Demographic Information for the Karnes County AA					
	#	% Low	% Moderate	% Middle	% Upper
Geographies (Census Tracts)	4	0	50.00	50.00	0
Population by Geography	15,446	0	57.77	42.23	0
Owner-Occupied Housing by Geography	3,296	0	48.63	51.37	0
Businesses by Geography	1,197	0	54.47	45.53	0
Farms by Geography	123	0	34.15	65.85	0
Family Distribution by Income Level	3,283	0	50.32	49.68	0
Household Distribution by Income Level	4,478	0	50.54	49.46	0
Census Median Family Income (MFI)		\$36,380	Median Housing Value		\$40,020
HUD-Adjusted MFI: 2010		\$46,500	Families Below the Poverty Level		18.46%
HUD- Adjusted MFI: 2009		\$45,600	Unemployment Rate		6.52%
HUD – Adjusted MFI: 2008		\$43,600			

Source: 2000 U. S. Census

The current local economy is characterized as good and expanding due primarily to the current oil and gas mining activity associated with the Eagle Ford shale formation. Economic activity in the area is relatively diverse with oil field related services, agriculture, services, and retail and wholesale businesses being the primary economic activities. Average unemployment for the area is 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 conducting the assessment of the bank's performance, we contacted a member of a local community organization in Karnes County. This contact indicated the community's current economic condition is good due to the oil field activity in the area. The contact indicated there is a shortfall in hotel rooms and both permanent and rental housing due to the abundance of oilfield workers. The contact also stated the area is short on restaurants and retail and office space. Based on this information the contact feels there are many opportunities for financial institutions to aid in community development by providing permanent and rental home construction and permanent financing loans, as well as restaurant, retail, and office building construction and permanent financing loans.

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 bank's net loan-to-deposit ratio averaged 60.79 percent over the 23 quarters since the last CRA examination, with a quarterly low of 46.01 percent and a quarterly high of 74.32 percent.

The ratio compares favorably with other community banks of similar size, location, and product offerings. FCNB ranks second among a total of five similarly situated banks serving its AAs. The other four banks had an average net loan-to-deposit ratio averaging 49.84 percent and ranged from 33.88 percent to 77.14 percent over the 23 quarters since the last CRA examination.

Lending in Assessment Area

A majority (74.55 percent) of the primary loan products originated by FCNB are to consumers within its AAs. The following table details the bank's lending within the AAs by number and dollar amount of loans originated during the evaluation period.

Table 1 - Lending in Karnes and Wilson Counties										
Loan Type	Number of Loans					Dollars of Loans (000s)				
	Inside		Outside		Total	Inside		Outside		Total
	#	%	#	%		\$	%	\$	%	
Home Purchase	68	78.16	19	21.84	87	5,233	62.65	3,120	37.35	8,353
Home Improvement	10	62.50	6	37.50	16	473	57.40	351	42.60	824
Refinance	17	77.27	5	22.73	22	2,004	79.18	527	20.82	2,531
Commercial	28	70.00	12	30.00	40	1,576	85.14	275	14.86	1,851
Totals	123	74.55	42	25.45	165	9,286	68.49	4,273	31.51	13,559

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 excellent penetration among borrowers of different income levels. The bank’s level of lending to LMI borrowers is above the demographic comparator in most areas. The AA’s poverty rate of 12.20 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 County 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	19.34	7.14	18.93	19.05	20.90	16.67	40.83	57.14
Home Improvement	19.34	25.00	18.93	37.50	20.90	12.50	40.83	25.00
Refinance	19.34	20.00	18.93	10.00	20.90	0.00	40.83	70.00

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. Seventy five percent of the bank’s loans to businesses originated and purchased during the loan sampling period 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 70.88 percent of the area’s businesses are considered small businesses. Although only 48.89 percent of the dollar amount of the bank’s loans to businesses was made to small businesses, 95 percent of the loans in our sample were in amounts less than \$200 thousand. 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 County AA				
Business Revenues (or Sales)	≤\$1,000,000	>\$1,000,000	Unavailable/Unknown	Total
% of AA Businesses	70.88	0.99	28.13	100.00
% of Bank Loans in AA by #	75.00	25.00	0.00	100.00
% of Bank Loans in AA by \$	48.89	51.11	0.00	100.00

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 reasonable penetration among borrowers of different income levels although our review of home loans reflects percentages lower than those reported in the demographic data for low-income borrowers. FCNB made 4.55 percent of its home loans to low-income borrowers during the evaluation period. The demographic data indicates that 27.81 percent of families in the AA are low-income. A mitigating factor in the penetration of low-income families is the fact that 18.46 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 for the AA is \$40,020.

Home loans to moderate-income borrowers are reasonable. In particular, the percentage of home purchase and refinanced home loans to moderate- income borrowers is reasonable. The percentage of home improvement loans to moderate-income borrowers is poor, but this was given little weight as only 6.45 percent of the bank’s home loans were home improvement 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 County 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	27.81	4.55	20.16	18.18	17.79	13.64	34.24	63.63
Home Improvement	27.81	0.00	20.16	0.00	17.79	0.00	34.24	100.00
Refinance	27.81	0.00	20.16	14.29	17.79	0.00	34.24	85.71

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. Eighty five percent of the bank’s loans to businesses originated and purchased during the loan sampling period were made to small businesses. Also, 87.13 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 County AA				
Business Revenues (or Sales)	≤\$1,000,000	>\$1,000,000	Unavailable/Unknown	Total
% of AA Businesses	65.33	1.67	33.00	100.00
% of Bank Loans in AA by #	85.00	15.00	0.00	100.00
% of Bank Loans in AA by \$	87.13	12.87	0.00	100.00

Source: Loan sample; Dunn and Bradstreet data.

Geographic Distribution of Loans

The geographic distribution of loans reflects reasonable dispersion throughout the bank’s AA given 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. In particular, the percentage of home purchase and home improvement loans originated in the moderate-income CT is excellent. While the level of refinanced home loans originated in the moderate-income CT is poor, this received little weight as only 16.67 percent of the home loans originated were refinanced home loans. 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 County 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	11.91	21.43	88.09	78.57	0.00	0.00
Home Improvement	0.00	0.00	11.91	25.00	88.09	75.00	0.00	0.00
Refinance	0.00	0.00	11.91	0.00	88.09	100.00	0.00	0.00

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 County 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	13.13	35.00	86.87	65.00	0.00	0.00

Source: Loan sample; Dunn and Bradstreet data.

Performance in the Karnes County AA

The bank’s geographic distribution of loans in this AA reflects a poor dispersion throughout census tracts of different income levels, but 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. In particular, the percentage of home purchase and refinanced home loans originated in the moderate-income CTs is poor. While the level of home improvement loans originated in the moderate-income CT is excellent, this received little weight as only 13.33 percent of the home loans originated were home improvement loans. 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 County 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	48.63	27.27	51.37	72.73	0.00	0.00
Home Improvement	0.00	0.00	48.63	50.00	51.37	50.00	0.00	0.00
Refinance	0.00	0.00	48.63	0.00	51.37	100.00	0.00	0.00

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

Business Loans

The bank’s geographic distribution of business loans reflects a poor dispersion throughout the CTs of different income levels. In particular, the percentage of business loans originated in the moderate-income CTs is poor. 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 County 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	54.47	10.00	45.53	90.00	0.00	0.00

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.