



## **PUBLIC DISCLOSURE**

July 13, 2015

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

The Karnes County National Bank of Karnes City  
Charter Number 5614

301 E. Calvert Street  
Karnes City, TX 78118

Office of the Comptroller of the Currency  
San Antonio South  
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.**

Karnes County National Bank of Karnes City (KCNB) reflects reasonable lending performance in its efforts to meet community credit needs in its assessment area (AA). Factors that support the rating:

- The average loan-to-deposit ratio (LTD) of 27.78% is reasonable given the bank's strategy, competition, economic conditions, lending opportunities, and financial condition. Large deposit growth stems from royalty income from the Eagle Ford Shale for many of the depositors in the AA and lower loan demand.
- The majority of loans originated are within the AA.
- The distribution of loans reflects reasonable penetration among borrowers of different income levels and businesses of different sizes.
- The geographical distribution of loans reflects reasonable dispersion throughout the AA.

**SCOPE OF EXAMINATION**

We evaluated KCNB's lending activities using Small Bank CRA Examination Procedures. The examination scope included lending from January 1, 2012 to December 31, 2014, which we compared to the 2010 Census Data. We identified consumer, 1-4 family residential and business loans as the primary products for the evaluation period. We selected a sample of 20 consumer, 20 1-4 family residential real estate, and 20 business loans. We used the original sample to determine lending inside the AA and then replaced loans that originated outside the AA with loans originating inside the AA to determine the borrower and geographic distribution.

**DESCRIPTION OF INSTITUTION**

KCNB is an independently owned community bank headquartered in Karnes City, Karnes County, Texas. KCNB offers traditional loan and deposit products and services. The bank has its main office in Karnes City and one full service branch located in Kenedy, Texas. Each location has an automated teller machine (ATM) and drive-through facility. The bank is not a subsidiary of any holding company.

KCNB has total assets of \$303 million at year December 31, 2013 and \$376 million at December 31, 2014. Net loans represent 26.59% of total assets at March 31, 2015. KCNB's business strategy is to continue to serve its community through offering traditional banking products in its AA. The following table details KCNB's lending activity.

Loan Portfolio Composition as of December 31, 2014		
Loan Category	\$(000's)	%
Residential Real Estate	22,719	24
Business Loans	40,023	43
Construction and Land Development	9,181	10
Consumer	6,560	7
Agriculture and Farmland	14,919	16
Total Loans	92,135	100

Source: Call Report December 31, 2014

Although the percentage of consumer loans is less in dollars, the number of loans originated were significantly greater. The bank originated 1,011 loans of which 64% were consumer loans from January 12, 2012 to March 31, 2015. As such, we determined this to be a primary lending product despite the lesser dollars. In addition, we assessed business loans and 1 – 4 family residential lending as primary products based on the above data.

There are no legal or financial circumstances that impede the bank's ability to help meet the credit needs in its AA. KCNB's previous CRA rating, dated January 10, 2012, was rated "Satisfactory".

## DESCRIPTION OF ASSESSMENT AREA(S)

The bank's AA is Karnes County, Texas. The AA meets the requirements of the regulation and does not arbitrarily exclude low- or moderate-income tracts. The 2010 Census had one upper-income census tract, two middle-income "distressed" census tracts and one moderate-income census tract. A "distressed" census tract is defined as a nonmetropolitan middle-income geographies located in counties with: (1) an unemployment rate of at least 1.5 times the national average; (2) a poverty rate of 20 percent or more; or (3) a population loss of 5 percent or more in a five-year period preceding the most recent decennial census.

Karnes City, Texas, the county seat of Karnes County, is located in the southern region of Texas. The recent economic boom due to the exploration of the oil and gas in the Eagle Ford Shale play has greatly benefitted Karnes County and surrounding regions. The area has experienced vast economic growth, new retail facilities, and improvements to local infrastructure. This concentration of the oil and gas industry in the region has increased labor and housing demands and costs, business development, traffic and the need for enhanced planning for the future growth of the area. KCNB's competition comes primarily from regional banks making large commercial loans, and a national bank that is also located in the AA.

As per the 2010 U.S. Census, the county population totaled 14,824, with Karnes City representing 21%. Other cities include Kenedy, Panna Maria, Runge, and Falls City. The 2010 Census shows 20.96% of the population below the poverty level and 22.50% of the residents are institutionalized. Please refer to the following table for additional information on the economic and demographic characteristics of the AA.

<b>Demographic and Economic Characteristics of Assessment Area</b>	
	<b>2010 Census</b>
<b>Population</b>	
Number of Families	3,452
Number of Households	4,657
Number of Owner Occupied Household Units as a % of total Household Units	57.89%
<b>Geographies</b>	
Number of Census Tracts	4
% Low Income Census Tracts	0
% Moderate Income Census Tracts	9.65%
% Middle Income Census Tracts	75.42%
% Upper Income Census Tracts	14.94%
<b>Median Family Income (MFI)</b>	
Weighted Average MFI	48,669
2013 HUD updated Statewide MFI	50,500
2014 HUD updated Statewide MFI	51,600
<b>Economic Indicators</b>	
Unemployment Rate	1.26%
Weighted Average Median Housing Value	\$74,114
% of Households Below Poverty Level	20.96%

Source: U.S. Census Data

We conducted one community contact from an organization in the AA. The representative identified a need for additional financial training to low and moderate-income individuals. The contact stated the oil and gas industry picture has changed in second quarter 2015, and that many individuals working in the industry have had to find lower paying jobs elsewhere. The contact also indicated that although many residents of Karnes City are receiving royalty checks, they have not been educated to manage money.

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

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

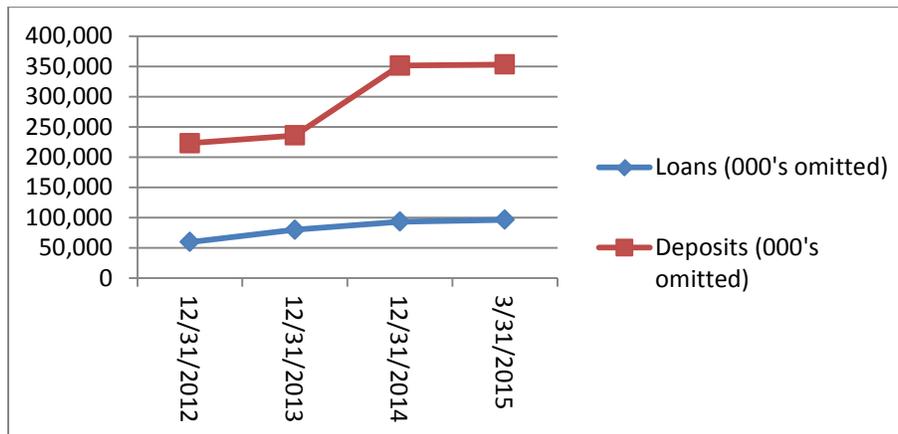
The quarterly average LTD ratio is reasonable given the financial condition and AA credit needs. During our review period, KCNB had a quarterly average ratio of 27.78% for 14 quarters between December 2011 and March 2015. During this period, the ratio ranged from a low of 25.6% to a high of 30.48%. This LTD is marginally reasonable when compared to similarly situated institutions. The factors that have affected the LTD ratio include (1) substantial influx of deposits due to the bank's location in the center of the Eagle Ford Shale and (2) lower loan demand due to the increasing income and royalties from oil and gas production.

Institution	County	Total Assets (000) (as of 03/31/2015)	Average LTD Ratio
<b><i>Karnes County National Bank in Karnes City</i></b>	<b><i>Karnes</i></b>	<b>\$379.759</b>	<b>28%</b>
The Falls City National Bank	Karnes	\$355,269	36%
Dilley State Bank	Frio	\$141,070	15%
Jourdanton State Bank	Atascosa	\$182,820	24%
Atascosa National Bank	Atascosa	\$102,789	14%

The following table shows the total assets in millions and LTD for KCNB since the last CRA exam. The table reflects declining trends in LTD as total assets have increased due to the influx of deposits, primarily from oil and gas royalties.

	12/31/2011	12/31/2012	12/31/2013	12/31/2014
Total Assets	155,244	244,895	303,168	375,535
Total Deposits	142,232	222,913	285,839	351,279
Total Loans	43,953	59,847	79,091	93,403
LTD Ratio	30.90	26.85	27.67	26.59

KCNB and other surrounding area banks have had declining trends with the loan-to-deposit ratios. This is due to the rapid growth in the oil and gas industry and rapidly increasing deposit base from lease and production income. Total loans have increased in dollars; however, at a much slower rate than deposit dollars. See chart below:



### Lending in Assessment Area

KCNB extends a majority of loans to borrowers located in the AA. The following tables reflect the percentages, by number and dollar volume, of loans that originated inside the AA. In this evaluation period, 63 percent of the number and 56 percent of the dollar volume, of loans originated in the AA.

<b>Table 1 - Lending in AA</b>										
Loan Type	Number of Loans					Dollars of Loans (000's omitted)				
	Inside		Outside		Total	Inside		Outside		Total
	#	%	#	%		\$	%	\$	%	
Residential Loans	12	60	8	40	100	1,127	53	994	47	100
Business	12	60	8	40	100	2,742	57	2,101	43	100
Consumer	14	70	6	30	100	168	76	52	24	100
<b>Total</b>	<b>38</b>	<b>63</b>	<b>22</b>	<b>37</b>	<b>100</b>	<b>4,037</b>	<b>56</b>	<b>3,147</b>	<b>44</b>	<b>100</b>

Source: Bank data or sample of loans.

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

The distribution of borrowers reflects reasonable penetration among individuals of different income levels and businesses of different sizes.

Residential lending represents a poor penetration of loans originated to borrowers with low- or moderate-income levels. The loan distribution is less than the percentage of low-and moderate-income levels. This is attributed to a significant increase in housing costs and lack of homes available for sale since the growth in the Eagle Ford Shale, and the significant number of households below the poverty level 20.96 percent per the 2010 Census.

<b>Table 2 - Borrower Distribution of Residential Real Estate Loans in AA</b>								
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 Loans	25.46	0.00	16.51	0.00	16.89	35.00	41.14	65.00

Source: Bank data or sample of loans; U.S. Census data.

KCNB's record of lending to businesses with revenue less than or equal to \$1 million reflects reasonable penetration. The following table summarizes the results of our sample of 20 loans. KCNB made seventy percent of the number of loans sampled to businesses with annual revenues of less than \$1 million.

<b>Table 2A - Borrower Distribution of Loans to Businesses in AA</b>				
Business Revenues (or Sales)	≤\$1,000,000	>\$1,000,000	Unavailable/ Unknown	Total
% of AA Businesses	65.15	3.22	31.63	100%
% of Bank Loans in AA by #	70.00	30.00	0.00	100%
% of Bank Loans in AA by \$	30.00	70.00	0.00	100%

Source: Bank data or sample of loans; Dun and Bradstreet data.

KCNB’s record of consumer lending to low- and moderate-income borrowers is reasonable. Loans made to low-income borrowers comprised 5% representing poor penetration compared to the 26.97 percent of low-income households in the AA. Loans made to moderate-income borrowers demonstrate excellent penetration with 40 percent of the loans to moderate-income borrowers compared to 15.31 percent of the households in the AA.

The following table summarizes the results of our sample of 20 consumer loans.

<b>Table 2B - Borrower Distribution of Consumer Loans in AA</b>								
Borrower Income Level	Low		Moderate		Middle		Upper	
	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans
Consumer Loans	26.97	5.00	15.31	40.00	16.83	35.00	40.88	20.00

*Source: Bank data or sample of loans; U.S. Census data.*

**Geographic Distribution of Loans**

Overall, KCNB meets the standards for adequate performance with reasonable distribution of loans to borrowers in different income levels within the AA. The bank’s AA consists of four census tracts, one moderate-income tract, two middle-income “distressed” census tracts and one upper-income tract.

The geographic distribution of residential real estate loans is reasonable. Performance in moderate-income census tracts represents a reasonable penetration of 5% for moderate-income geographies although somewhat lower than the comparator and excellent distribution for distressed middle-income geographies.

<b>Table 3 - Geographic Distribution of Residential Real Estate Loans in AA</b>								
Census Tract Income Level	Low		Moderate		Middle		Upper	
	% 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 Loans	0.00	0.00	8.46	5.00	68.40	90.00	23.13	5.00

*Source: Bank data or sample of loans; U.S. Census data.*

The geographic distribution of business loans in the AA is reasonable. KCNB has 5 percent of the loans sampled in the moderate-income census tract demonstrating reasonable penetration when compared to the percentage of businesses in the moderate census tracts of 6.99 percent. KCNB demonstrates an excellent penetration in the two middle-income “distressed” census tracts compared to the census data.

Table 3A - Geographic Distribution of Loans to Businesses in 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	6.99	5.00	77.91	90.00	15.09	5.00

Source: Bank data or sample of loans; D & B data.

The geographic distribution of loans to consumers in the AA is reasonable. Lending to consumers in moderate-income census tracts is reasonable when compared to the percentages of households in the assessment area. The distribution of consumer loans in middle-income distressed census tracts is excellent at 90 percent and exceeds the 68.78 percent of middle-income households in the AA.

Table 3B - Geographic Distribution of Consumer Loans in AA								
Census Tract Income Level	Low		Moderate		Middle		Upper	
	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans
Consumer Loans	0.00	0.00	10.29	10.00	68.76	90.00	20.96	0.00

Source: Bank data or sample of loans; U.S. Census data.

### Responses to Complaints

KCNB has not received any consumer complaints during this evaluation period regarding its CRA performance.

### Fair Lending or Other Illegal Credit Practices Review

Pursuant to 12 C.F.R. 25.28(c), or 12 C.F.R. 195.28(c), in determining a national bank's (bank) or Federal savings association's (FSA) CRA rating, respectively, the OCC considers evidence of discriminatory or other illegal credit practices in any geography by the bank or FSA, or in any assessment area by an affiliate whose loans have been considered as part of the bank's or FSA's lending performance.

We found no evidence of discriminatory or other illegal credit practices inconsistent with helping to meet community credit needs.