



**SMALL BANK**

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

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## **PUBLIC DISCLOSURE**

**August 23, 2005**

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

**Bank of The Hills, National Association  
Charter Number 23475**

**1075 Junction Highway  
Kerrville, TX 78028**

**Comptroller of the Currency  
San Antonio North  
10101 Reunion Place Boulevard Suite 402  
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.”**

- Bank of the Hills’ (BOTH) lending performance is satisfactory given its size, financial condition, and known credit needs in its assessment area (AA).
- The bank’s loan-to-deposit (LTD) ratio is satisfactory and averaged 58% during the evaluation period. This performance is reasonable given the available loan demand in the AA.
- A substantial majority of BOTH’s loans are within its AA.
- BOTH has demonstrated a satisfactory willingness to extend loans to individuals of varying incomes and businesses of different sizes.
- There have been no complaints with respect to BOTH’s CRA performance.

## **DESCRIPTION OF INSTITUTION**

BOTH is headquartered in Kerrville, Texas, which is approximately 62 miles northwest of San Antonio. Besides the main bank, a stand-alone drive-through is also located south of town. Since BOTH opened in 1998, the bank has established full service branches in the neighboring towns of Ingram, Hunt, and Comfort. Unlike the previously mentioned locations, the Hunt branch does not offer drive-through services. Saturday drive-through service is available at all full service locations with the exception of Hunt and Comfort. All bank locations have onsite automated teller machines (ATM). An ATM was recently installed in the town of Center Point. Ownership of the bank is comprised of a two-tiered holding company structure. BOTH is 100% owned by BOTH of Delaware, Inc., a one-bank Delaware-based holding company, which is 100% owned by BOTH, Inc. located in Kerrville. Total consolidated assets of both holding companies and BOTH as of June 30, 2005 were \$277 million.

As of June 30, 2005, BOTH had total assets of \$276 million with 51% centered in the loan portfolio. The bank’s primary loan products include residential, commercial, and consumer loans. The table on the following page details a breakdown of BOTH’s loan portfolio as of June 30, 2005.

<b>Loan Type</b>	<b>Dollar Amount (000's)</b>	<b>% of Total Loans (* Less than 1%</b>
Real Estate (RE) Construction	1,648	3
RE Farmland	3,734	7
RE Residential (1-4)	9,434	18
Multifamily	2,378	5
RE Nonfarm Nonresidential	16,374	31
Agricultural Production	1,504	3
Commercial and Industrial	7,117	14
Consumer	1,732	3
Municipal obligations	8,258	16
Other	71	0*
<b>Total</b>	<b>52,250</b>	<b>100</b>

Source: June 30, 2005 Consolidated Report of Condition

BOTH has a 24-hour telephone response system that allows customers to obtain account balance information and transfer funds between accounts. Internet banking services are also available at [www.bankofthehills.com](http://www.bankofthehills.com). BOTH faces strong competition from other financial institutions located in Kerrville. Based on its financial condition, the local economy, product offerings, competition, and prior performance, BOTH has the ability to meet the various credit needs in its community. The bank was rated “Satisfactory” at the last CRA examination on March 27, 2000. No legal impediments or other factors hinder BOTH’s ability to provide credit in its AA.

## **DESCRIPTION OF KERR AND KENDALL COUNTIES**

BOTH has designated all of Kerr and Kendall Counties as its AA. Principal communities located in the AA include Kerrville, Ingram, Hunt, Comfort, and Center Point.

The Comfort branch in Kendall County is the only bank located in a Metropolitan Statistical Area (MSA). Kendall County is part of the San Antonio MSA. The town of Comfort is near the Kerr and Kendall County boundary, and is approximately 47 miles from San Antonio. The Comfort branch primarily serves the town and its surrounding rural communities. A separate analysis for performance in the San Antonio MSA was not warranted, as BOTH has no significant presence in or around San Antonio markets. The majority of BOTH’s loan portfolio is generated within Kerr County. The Comfort branch comprises only 14% of the portfolio.

Specific demographic data for this combined area is listed in the table on the following page.

<b>DEMOGRAPHIC AND ECONOMIC CHARACTERISTICS OF AA</b>	
<i>Population</i>	
Number of Families	18,967
Number of Households	26,387
<i>Geographies</i>	
Number of Census Tracts	12
% Low-Income Census Tracts	0
% Moderate-Income Census Tracts	0
% Middle-Income Census Tracts	8
% Upper-Income Census Tracts	4
<i>Median Family Income (MFI)</i>	
2000 MFI for AA	39,117
2003 HUD-Adjusted MFI	41,200
2004 HUD-Adjusted MFI	45,167
<i>Economic Indicators</i>	
Unemployment Rate	1.80
2004 Median Housing Value	100,710
% of Households Below Poverty Level	12

This area is made up of contiguous census tracts, which surround and include BOTH's respective business locations. This area meets the requirements of the regulation and does not arbitrarily exclude low to moderate-income (LMI) geographies. A further description of the AA is presented below.

Based on the 2000 Census data, the AA has a population of approximately 67 thousand. The 12 census tracts are divided between middle and upper-income areas. There are no low or moderate-income areas in the AA. There are 30 thousand housing units in the AA of which 67% are owner-occupied, 22% renter-occupied, and 11% vacant. Major employers located in and/or adjacent to the AA include medical facilities, school districts, local government, retail, and service-related organizations.

In order to gather more current information on the nature of the community and potential lending opportunities in the AA, we contacted the local Director of Business Programs during this evaluation. This individual stressed the need for affordable housing within the city of Kerrville and the surrounding areas. The contact stated that there were no unmet credit needs in the City of Kerrville. The contact further stated that BOTH is active in the community and responsive to local credit needs.

## CONCLUSIONS ABOUT PERFORMANCE CRITERIA

Management has been successful in meeting the credit needs of its AA, including LMI individuals, consistent with its resources and capabilities.

### Loan-to-Deposit Ratio

BOTH's LTD ratio is considered satisfactory, given its asset size, financial condition, and lending opportunities in the AA. Since the last CRA examination, the LTD ratio has decreased from 61% at December 31, 1999, to 55% at June 30, 2005. This decline was attributed to the substantial deposit growth as BOTH expanded its banking locations. The end result was that deposit growth outpaced loan growth in light of increased banking competition. The average LTD ratio over the past 16 quarters was 58%, which is above an average 53% during the previous evaluation. This increase in the average LTD was due to the bank's level of loan participations. When excluding the bank's loan participations, the LTD falls to 50% and is slightly below the 53% achieved in 1999. During the period from January 2000 through June 2005, the competing banks had LTD ratios ranging from 58% to 82%. It should be noted that Security State Bank & Trust has more branches than BOTH, which provides the bank with access to a larger market with greater lending opportunities. The asset size and LTD ratio for BOTH and its two competing banks during this period are listed below.

Institution	Assets as of 6/30/05 (000s)	Average LTD Ratio %
Union State Bank	40,000	58.37
Security State Bank & Trust	529,000	81.99
<i>Bank of the Hills</i>	<i>276,000</i>	<i>57.54</i>

### Lending in Assessment Area

A substantial majority of the bank's loans are made within its AA. The following table shows the bank's lending pattern in and out of the AA by loan type.

TOTAL LOANS REVIEWED								
LOAN TYPE	IN ASSESSMENT AREA				OUT OF ASSESSMENT AREA			
	#	%	\$ (000s)	%	#	%	\$ (000s)	%
Consumer	23	92	54	95	2	8	3	5
Residential	121	86	10,025	54	20	14	8,411	46
Commercial	29	83	1,130	88	6	17	154	12
Total Reviewed	173	86	11,209	57	28	14	8,568	43

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

BOTH's loan portfolio reflects a satisfactory distribution among individuals of various income levels and commercial businesses of different sizes within the AA. In order to assess the bank's performance within the AA, we used residential real estate loans reported under the Home Mortgage Disclosure Act (HMDA). This loan sample was limited to loans originated in January 2000 through June 2005. Our consumer loan sample was derived using BOTH's internal reports for documenting borrower income. The commercial loan sample was comprised of 27 non-real estate loans originated during the period of January 2003 through June 2005.

Our analysis determined that BOTH lends to all applicants, regardless of their income category. Based on the 2000 Census, 32% of AA households are LMI. Our review determined that 28% of consumer loans were made to LMI households. Though this is slightly below AA demographics, it should be noted that BOTH has a strong commitment towards meeting the everyday credit need of the local communities. However, the bank's residential loan penetration of 22% to LMI families was below AA demographics. Based on the 2000 Census, 32% of AA families are LMI. According to the community contact made during this evaluation, there are very few homes available in the AA at selling prices that LMI families could qualify for. The following chart reflects the results of our selected sample of consumer loans originated in BOTH's AA

CONSUMER								
Borrower Income Level	LOW		MODERATE		MIDDLE		UPPER	
% of AA Households	18		14		17		51	
	% of Number	% of Amount						
Total	12	3	14	5	15	8	59	84

HMDA - RESIDENTIAL REAL ESTATE								
Borrower Income Level	LOW		MODERATE		MIDDLE		UPPER	
% of AA Families	16		16		20		48	
LOANS BY YEAR	% of Number	% of Amount						
Total**	10	1	12	2	25	17	50	77

\*\* *Less than 3% of applicants lacked personal income information*

BOTH originates commercial loans in a manner consistent with area demographics. The bank's distribution of loans to "small businesses with revenues less than \$1 million" is reflective of BOTH's focus on providing loans that will enhance the local economy.

<b>BORROWER DISTRIBUTION OF SMALL LOANS TO BUSINESSES</b>		
Business Revenues	≤\$1,000,000	>\$1,000,000
% of AA Businesses	95	5
% of Bank Loans in AA #	82	18
% of Bank Loans in AA \$	83	17

### **Geographic Distribution of Loans**

As previously mentioned, there are no LMI areas. Therefore, an analysis of loan distribution by geographic area would not be meaningful.

### **Responses to Complaints**

BOTH has received no complaints relating to CRA performance.

### **Fair Lending or Other Illegal Credit Practices Review**

We found no evidence of illegal discrimination or other illegal credit practices. An analysis of January 2000 through August 2005 public comments and consumer complaint information was performed according to the OCC's risk-based fair lending approach. Based on its analysis of the information, the OCC decided that a comprehensive fair lending examination would not need to be conducted in connection with the CRA evaluation this year.