



SMALL BANK

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

PUBLIC DISCLOSURE

June 26, 2006

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**The Falls City National Bank
Charter Number 8606**

**Highway 181 & Maverick
Falls City, TX 78113**

**Comptroller of the Currency
San Antonio South
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.

The Falls City National Bank's (FCNB) 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 reasonable averaging 51.5% since the previous evaluation period.

A substantial majority of FCNB's loans are made with the AA.

The distribution of loans reflects a reasonable penetration to families and households of different income levels and to businesses of different sizes.

The geographic distribution of loans is reasonably dispersed throughout the AA.

There are no unresolved or pending consumer complaints with respect to the bank's CRA performance.

DESCRIPTION OF INSTITUTION

The Falls City National Bank is an independently owned community bank with assets of \$113 million as of March 31, 2006. The main office is located in Falls City, Texas (Karnes County), with branches in Poth and Floresville, Texas (Wilson County). Bank lobby and drive-through services are provided Monday through Friday with extended hours at the Floresville branch only. Drive-through services are provided at all offices on Saturday till noon. The bank operates three 24-hour automated teller machines, one at the main office and one at each branch. FCNB's loan portfolio is comprised of residential, interim construction, commercial, and consumer loan products.

Based on the bank's financial condition, the local economy, product offerings, competition, and prior performance, FCNB has the ability to meet the various credit needs in its community. The bank was rated "Satisfactory" at the previous CRA examination on January 2, 2002. No legal impediments or other factors hinder FCNB's ability to provide credit in its AA.

The following chart details a breakdown of FCNB's loan portfolio as of March 31, 2006.

Loan Type	Dollar Amount (000s)	% of Total Loans
Residential (1-4 Family)	20,303	33
Consumer	9,334	15
Real Estate(RE) Construction	7,120	12
Commercial and Industrial	6,918	11
RE Nonfarm Nonresidential	6,031	10
RE Farmland	5,974	10
Agricultural Production	4,930	8
Other	502	1
Total	61,112	100

DESCRIPTION OF KARNES COUNTY AND WILSON COUNTY

FCNB has designated Karnes County and Wilson County as its AA. The largest communities located in Karnes County include Karnes City, Falls City (main bank location), and Kenedy. The largest communities in Wilson County include Floresville (bank branch location), Poth (bank branch location), La Vernia, and Stockdale. Karnes County is not in a metropolitan statistical area (MSA) while Wilson County is part of the San Antonio MSA. This review combined the two counties for statistical purposes since they are contiguous. The AA consists of 13 census tracts of which three are designated as moderate-income and ten are designated as middle-income. There are no designated low-income or upper-income census tracts in the AA. This AA meets the requirements of the regulation and does not arbitrarily exclude low- and moderate-income (LMI) geographies. Competition in the AA is strong with three community banks, five regional bank branches, and one branch of a large federal credit union.

Overall economic conditions are currently good with a low unemployment rate in the AA. The level of households below the poverty level has declined to 15%. The local economy is based on retail and wholesale business, housing construction, the prison industry, cattle ranching, and oil field related services. Major employers include a private detention center and a large state prison located in Karnes County. Other large employers include the school districts and local government. Many in the agricultural sector also work in other industries to augment income. The AA has experienced significant housing and population growth over the last several years due to its proximity to San Antonio. The AA has many residents who commute to San Antonio for employment. Wilson County is part of the San Antonio MSA which is one of the fastest growing communities in the country.

In order to gather more current information on the nature of the community and potential lending opportunities within the AA, we conducted two community contacts during this review. The contacts included a local government entity and an economic development corporation. One contact identified small farm loans as a specific credit need. Another contact identified home loans for low-income individuals and first-time homebuyers as a credit need. Both contacts

related that banks in the AA were doing a good job providing basic banking services and promoting community development. The following chart reflects the basic demographic and economic characteristics of the AA.

DEMOGRAPHIC AND ECONOMIC CHARACTERISTICS OF AA	
Population	
Number of Families	12,153
Number of Households	15,506
Geographies	
Number of Census Tracts	13
% Low-Income Census Tracts	0%
% Moderate-Income Census Tracts	23%
% Middle-Income Census Tracts	77%
% Upper-Income Census Tracts	0%
Median Family Income (MFI)	
2005 Weighted average of MFI	\$41,728
2005 HUD-Updated MSA MFI	\$48,577
Economic Indicators	
Unemployment Rate	2.18%
2005 Median Housing Value	\$62,675
% of Households Below Poverty Level	15%

CONCLUSIONS ABOUT PERFORMANCE CRITERIA

Management has demonstrated “Satisfactory” performance in meeting the credit needs of the AA consistent with its resources and capabilities.

Loan-to-Deposit Ratio (LTD)

FCNB’s LTD ratio is satisfactory given its asset size, financial condition, and lending opportunities in the AA. Since the previous examination, the quarterly LTD ratio has ranged from a low of 43% to a high of 62%. The average LTD ratio over the past 18 quarters was 51.5% which is substantially higher than the 36.8% average noted in the prior evaluation. The chart on the following page compares FCNB’s LTD ratio to other similarly situated banks.

Institution	Assets as of 3/30/06 (000s)	Average LTD Ratio %*
Karnes County National Bank	60,509	55.0
Falls City National Bank	113,168	51.5
Security State Bank Stockdale	27,143	43.5
Atascosa National Bank	54,264	34.9

*Average from December 2001 through March 2006.

Lending in Assessment Area

A substantial majority of the bank's loans originated within its AA. We reviewed the bank's residential loans reported on the 2004 and 2005 HMDA reports, and loans originated in the first quarter of 2006. We also reviewed a sample of consumer and small farm/business loans that originated in 2004, 2005, and 2006. Our analysis determined that 88% of the number, and 88.6% of the dollar amount, of new loans were made with the AA. The following table reflects the bank's lending in and out of the AA by type of loan.

Lending in the Karnes County and Wilson County Assessment Area										
Loan Type	Number of Loans					Dollar Amount of Loans				
	Inside		Outside		Total	Inside		Outside		Total
	#	%	#	%	#	\$	%	\$	%	\$
Residential *	86	92	8	8	94	5,426	89	690	11	6,116
Consumer **	16	80	4	20	20	79	68	38	32	117
Small Farm/Biz**	16	80	4	20	20	297	93	21	7	318
Totals	118	88	16	12	134	5,802	89	749	11	6,551

Source: * data reported under HMDA, ** data from sample of loans.

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

FCNB meets the standards for satisfactory performance in this category. The distribution of loans reflects a reasonable penetration among families of different income levels including low- and moderate-income families. The following table indicates the income distribution of the loans reported under HMDA for 2004 and 2005, and through March 31, 2006.

Borrower Distribution of Residential Real Estate Loans in the Karnes/Wilson 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
Residential	22	15	19	14	20	23	39	48

Source: data reported under HMDA.

Our sample of consumer loans reflected that FCNB exceeds the standards for lending to households of various income levels. Our sample of twenty loans originated in the AA reflected that 40% were made to low-income households while 25% of the loans were made to moderate-income households. The following table reflects the distribution of consumer loans by household income level.

Borrower Distribution of Consumer Loans in the Karnes/Wilson AA					
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	23	40	17	25	19	20	41	15.0

Source: data from sample of loans.

The banks record of lending to small businesses and farms is very good. Of the 20 business/farm loans sampled, 95% were to businesses and farms with less than \$1 million in revenue. The following table reflects the bank's record of lending to businesses and farms by revenue level.

Borrower Distribution of Loans to Businesses/Farms in the Karnes/Wilson AA				
Business Revenues (or Sales)	≤\$1,000,000	>\$1,000,000	Unavailable/Unknown	Total
% of AA Businesses	64	3	33	100%
% of Bank Loans in AA by #	95	5		100%
% of Bank Loans in AA by \$	86	14		100%

Source: data from sample of loans.

Geographic Distribution of Loans

FCNB's geographic distribution of residential, consumer, and business/farm loans throughout the AA is reasonable and meets the standards for satisfactory performance. Three of the thirteen census tracts in the AA are designated as moderate income, and the other ten census tracts are designated as middle-income. There are no census tracts designated as low-income or upper income. The following tables illustrate the geographic distribution of residential real estate, consumer, and business/farm loans in the AA by census tract income level.

Geographic Distribution of Residential Real Estate Loans in the Karnes/Wilson 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
Residential	-	-	22	12	78	88	-	-

Source: data reported under HMDA.

Geographic Distribution of Consumer Loans in the Karnes/Wilson 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	-	-	34	25	66	75	-	-

Source: data from sample of loans.

Geographic Distribution of Loans to Businesses/Farms in the Karnes/Wilson AA								
Census Tract Income Level	Low		Moderate		Middle		Upper	
Loan Type	% of AA Businesses /Farms	% of Number of Loans	% of AA Businesses/ Farms	% of Number of Loans	% of AA Businesses /Farms	% of Number of Loans	% of AA Businesses /Farms	% of Number of Loans
Small Farm/Biz	-	-	30	30	70	70	-	-

Source: data from sample of loans.

Responses to Complaints

There are no unresolved or pending CRA-related consumer complaints.

Fair Lending or Other Illegal Credit Practices Review

On March 14, 2005, we conducted a Fair Lending Examination. We reviewed and analyzed a sample of declined and approved residential real estate loans from the bank's 2004 Home Mortgage Disclosure Act Loan Application Register report. We found no evidence of discriminatory or other illegal credit practices inconsistent with helping to meet community credit needs.