



SMALL BANK

Comptroller of the Currency
Administrator of National Banks

PUBLIC DISCLOSURE

May 29, 2003

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**The Hondo National Bank
Charter Number 14351**

**1112 18th Street
Hondo, Texas 78861**

**Comptroller of the Currency
San Antonio North Field Office
10101 Reunion Place Boulevard, Suite 402
San Antonio, Texas 78216-4605**

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.

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INSTITUTION'S CRA RATING

This institution is rated Satisfactory.

Hondo National Bank's lending performance reflects a satisfactory response to community credit needs. Factors in our assessment include:

- The bank's loan-to-deposit ratio is reasonable given the bank's size, financial condition, and assessment area credit needs.
- A substantial majority of loans are in the bank's assessment area.
- The distribution of loans reflects, given the demographics of the assessment area, reasonable penetration among individuals of different income levels (including low- and moderate-income) and businesses of different sizes.
- The geographic distribution of loans reflects reasonable dispersion through the assessment area.

DESCRIPTION OF INSTITUTION

Hondo National Bank (HNB) is a \$58 million financial institution. The bank is headquartered in Hondo, Texas, and has branches in Bandera and Uvalde. HNB opened the Bandera branch in June of 1998 and the Uvalde branch in February of 2003. HNB did not close any branches during the evaluation period. Texas Heritage Bancshares owns 100% of HNB's common stock. The one-bank holding company is locally owned. The bank owns four automatic teller machines (ATMs). The bank has one ATM at each of the Hondo and Bandera locations. Another is located in a local fast-food restaurant in Hondo. The other ATM is in Medina. HNB is a full-service bank. It offers traditional loan products with a focus on small business and agricultural lending. At the prior CRA examination dated January 6, 1998, a Satisfactory rating was assigned. There are no legal or financial factors impeding the bank's ability to help meet the credit needs of the assessment area.

As of March 31, 2003, net loans represent 50% of the bank's total assets. A summary of the loan portfolio is shown below.

Loan Category	\$ (000)	%
Commercial Real Estate Loans	9,222	32%
Agricultural Loans	7,604	26%
Commercial Loans	6,187	21%
Residential Real Estate Loans	4,311	15%
Consumer Loans	1,815	6%
Total	29,139	100%

DESCRIPTION OF ASSESSMENT AREA

HNB's assessment area includes Medina, Bandera, and Uvalde Counties. The assessment area consists of 16 block numbering areas (BNAs). Two BNAs are designated moderate-income, 11 are middle-income, and three are upper-income. There are no low-income tracts in the assessment area. The assessment area meets the requirements of the regulation and does not arbitrarily exclude any low- or moderate-income geographies.

Hondo is a small community in Medina County with a population of approximately 8,000. Hondo is located approximately 40 miles west of San Antonio. The economy is reliant on farming, ranching, and mineral production. Two state prisons employ roughly 500 people. One bank headquartered in Hondo, two bank branches, and a branch of a credit union provide competition in Hondo.

Bandera has a population of less than 1,000 and is located approximately 40 miles northwest of San Antonio. The area is dependent on the craft and tourism industry. There is one bank headquartered in Bandera. Competition also comes from branches of Wells Fargo and a savings and loan.

Uvalde is approximately 80 miles west of San Antonio and has a population of about 5,000. The local economy is primarily agricultural. Two local banks headquartered in Uvalde provide competition, as does the branch of a federal credit union and a branch of Bank of America.

In addition, there are six other banks headquartered in small communities in the assessment area.

Of all families living in the assessment area, 24% are low-income, 16% are moderate-income, 19% are middle-income, and 41% are upper-income. The following table provides more information on the assessment area.

DEMOGRAPHIC AND ECONOMIC CHARACTERISTICS OF AA	
<i>Population</i>	
Number of Persons	61,214
Number of Families	16,272
Number of Households	20,811
<i>Geographies</i>	
Number of Census Tracts/BNA	16
% Low-Income Census Tracts/BNA	0%
% Moderate-Income Census Tracts/BNA	12.50%
% Middle-Income Census Tracts/BNA	68.75%
% Upper-Income Census Tracts/BNA	18.75%
<i>Median Family Income (MFI)</i>	
1990 MFI for AA	\$21,295
2002 HUD-Adjusted MFI	\$36,100
<i>Economic Indicators</i>	
Unemployment Rate	3.68%
2002 Median Housing Value	\$48,616
% of Owner-occupied Properties	58%
% of Households Below Poverty Level	22%

Examiners contacted the Hondo Chamber of Commerce and reviewed two contacts from the Uvalde area. These contacts revealed no unmet credit needs.

SAMPLING/COMPARISON INFORMATION

Our review focused on the bank's primary product lines: commercial/small business loans, agricultural loans, and residential real estate loans. For the purpose of our evaluation, we combined commercial and commercial real estate loans into one sample. HNB originated all loans in our samples since the previous CRA examination.

In evaluating the bank's loan-to-deposit ratio, we compared HNB to the ten banks that are headquartered in the bank's assessment area.

CONCLUSIONS ABOUT PERFORMANCE CRITERIA

Management has demonstrated satisfactory performance in meeting the credit needs of the assessment area.

Loan-to-Deposit Ratio

The loan-to-deposit ratio is reasonable given the bank's size, financial condition, and assessment area credit needs. The table that follows shows how HNB's quarterly average loan-to-deposit ratio compares to the ratios of the ten banks headquartered in the assessment area. Since the previous CRA examination in January of 1998, HNB's quarterly average loan-to-deposit ratio is

55%. This ranks HNB the fourth highest out of the eleven area banks.

Institution	Assets as of 3/31/03 (000's)	Average LTD Ratio
Hondo National Bank	57,767	55%
The La Coste National Bank	25,484	25%
Medina Valley State Bank	68,214	37%
The Bank of Texas	46,254	39%
First State Bank of Uvalde	351,302	42%
Castroville State Bank	61,796	43%
National American Bank	73,815	48%
The Lytle State Bank of Lytle, Texas	61,319	49%
D'Hanis State Bank	28,864	59%
Bandera Bank	25,077	59%
Community National Bank	78,512	60%

Lending in Assessment Area

A substantial majority of loans are in the bank's assessment area. HNB made 90% of all 60 loans sampled in the assessment area, including 100% of the sampled agricultural loans. Loans made in the assessment area represent 88% of the dollar volume of all loans sampled. The following table shows HNB's record of lending in the assessment area.

TOTAL LOANS REVIEWED								
	IN ASSESSMENT AREA				OUT OF ASSESSMENT AREA			
LOAN TYPE	#	%	\$ (000s)	%	#	%	\$ (000s)	%
Commercial	18	90	901	82	2	10	200	18
Agricultural	20	100	977	100	0	0	0	0
Residential	17	85	486	81	3	15	111	19
Total Reviewed	55	92	2,364	88	5	8	311	12

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

The distribution of loans reflects, given the demographics of the assessment area, reasonable penetration among individuals of different income levels (including low- and moderate-income) and businesses of different sizes. HNB's record of lending to businesses and farms with gross annual revenues less than \$1 million is reasonable. HNB made all 20 commercial loans sampled to businesses with gross annual revenues of less than \$1 million. Ninety-six percent of all businesses in the assessment area have gross annual revenues less than \$1 million. The following table reflects HNB's record of commercial lending.

BORROWER DISTRIBUTION OF LOANS TO SMALL BUSINESSES		
Business Revenues	≤\$1,000,000	>\$1,000,000
% of AA Businesses	96	4
% of Bank Loans in AA #	100	0
% of Bank Loans in AA \$	100	0

HNB made 95% of the number of agricultural loans that were sampled to farms with gross annual revenues of less than \$1 million. This is comparable to the 93% of farms located in the assessment area having gross annual revenues of less than \$1 million.

BORROWER DISTRIBUTION OF LOANS TO SMALL FARMS		
Business Revenues	≤\$1,000,000	>\$1,000,000
% of AA Businesses	93	7
% of Bank Loans in AA #	95	5
% of Bank Loans in AA \$	99	1

The bank's record of making residential real estate loans to low-income borrowers is low compared to the demographics of the assessment area. HNB made 15% of the number and 12% of the dollar volume of sampled residential real estate loans to low-income borrowers. Twenty-four percent of families in the assessment area are low-income. This is reasonable, as low-income families generally purchase homes less frequently than middle- and upper-income families.

HNB's record of residential real estate lending to moderate-income borrowers is strong. The bank made 25% of the number and 21% of the dollar volume of residential real estate loans sampled to moderate-income borrowers. Only 16% of the families living in the assessment area are moderate-income.

RESIDENTIAL REAL ESTATE LOANS								
Borrower Income Level	LOW		MODERATE		MIDDLE		UPPER	
	% of Number	% of Amount	% of Number	% of Amount	% of Number	% of Amount	% of Number	% of Amount
% of AA Families	24		16		19		41	
LOANS BY YEAR	% of Number	% of Amount	% of Number	% of Amount	% of Number	% of Amount	% of Number	% of Amount
1998 to 2003	15	12	25	21	45	54	15	13

Geographic Distribution of Loans

The geographic distribution of loans reflects reasonable dispersion throughout the assessment area. HNB's level of agricultural lending in moderate-income geographies compares favorably to the demographics of the assessment area, but the bank's level of commercial and residential real estate lending in the moderate-income BNAs is low. The bank made 5% of the number and 1% of the dollar volume of commercial loans sampled in moderate-income areas. This compares to 15% of assessment area businesses located in those areas. HNB made 5% of the number and

2% of the dollar volume of residential real estate loans to borrowers located in the moderate-income tracts. However, the bank's low level of commercial and residential real estate lending to moderate-income BNAs is reasonable because as of the evaluation date, the Uvalde branch has only been open for three months. As noted earlier, HNB opened the Uvalde branch in February of 2003. Both of the moderate-income BNAs in the assessment area are in Uvalde County. There are no low-income BNAs in the assessment area. The following three tables reflect the bank's record of lending by geographic income level for each of the three loan types reviewed.

GEOGRAPHIC DISTRIBUTION OF AGRICULTURAL LOANS								
Census Tract Income Level	LOW		MODERATE		MIDDLE		UPPER	
% of AA Farms	0		15		67		18	
	% of Number	% of Amount	% of Number	% of Amount	% of Number	% of Amount	% of Number	% of Amount
	0	0	20	25	80	75	0	0

GEOGRAPHIC DISTRIBUTION OF COMMERCIAL LOANS								
Census Tract Income Level	LOW		MODERATE		MIDDLE		UPPER	
% of AA Businesses	0		15		66		19	
	% of Number	% of Amount	% of Number	% of Amount	% of Number	% of Amount	% of Number	% of Amount
	0	0	5	1	80	86	15	13

GEOGRAPHICAL DISTRIBUTION OF RESIDENTIAL REAL ESTATE								
Census Tract Income Level	LOW		MODERATE		MIDDLE		UPPER	
% of AA Owner Occupied	0		13		70		17	
	% of Number	% of Amount	% of Number	% of Amount	% of Number	% of Amount	% of Number	% of Amount
	0	0	5	2	85	89	10	9

Responses to Complaints

HNB has not received any complaints or public comments regarding its CRA performance during this evaluation period.

Fair Lending Review

An analysis of 1998 through 2003 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. The latest comprehensive fair lending examination was performed in 1997.