



SMALL BANK

Comptroller of the Currency
Administrator of National Banks

PUBLIC DISCLOSURE

July 23, 2007

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**The Karnes County National Bank of Karnes City
Charter Number 5614**

**301 E. Calvert Street
Karnes City, TX 78118**

**Comptroller of the Currency
San Antonio South Field Office
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 quarterly average loan-to-deposit ratio of 54.57 percent is reasonable given the bank's size, financial condition, market focus, and lending opportunities available in the assessment area (AA).
- A majority of the sample loans, representing 85 percent of the number and 62 percent of the dollar volume, were made to borrowers in the bank's AA.
- The distribution of loans to individuals of different income levels and to businesses of different sizes is reasonable and meets the standards for satisfactory performance.
- The geographic distribution of loans is satisfactory and includes lending in moderate-income census tracts.

SCOPE OF EXAMINATION

The scope of the CRA examination covered the time period since the date of the prior examination of February 10, 2003. Karnes County National Bank's (KCNB) primary loan products include residential, consumer, business/commercial, and farm loans. To conduct the CRA examination, we used a sample of residential, consumer, and business/farm loans originated from January 1, 2004, to March 31, 2007. This sample is representative of the bank's business strategy since the last examination.

DESCRIPTION OF INSTITUTION

KCNB is an independently owned community bank with assets of \$67 million as of June 30, 2007. The main office is located in Karnes City, Texas, with automated teller machines (ATMs) in Karnes City and Kenedy, Texas. The bank recently filed an application with the Comptroller of the Currency for a full-service branch facility in Kenedy, Texas which is located in a moderate-income census tract. KCNB's loan portfolio is composed primarily of commercial real estate, 1-4 family residential, consumer, farmland/agricultural and commercial loans. The bank's business strategy will continue to focus on similar types of loans including home-equity loans. There are no legal or other impediments that limit the bank's ability to meet the credit needs of the AA. The date of the previous CRA examination is February 10, 2003, and the rating was "Satisfactory".

Net loans of \$25 million represent 38 percent of KCNB's total assets. A summary of the loan portfolio as of June 30, 2007 is as follows:

Loan Category	\$ (000)	%
Commercial Real Estate	7,033	27.6%
1-4 Family Residential	5,039	19.8%
Consumer	4,397	17.3%
Real Estate Construction/ Land Development	3,624	14.2%
Farmland	2,168	8.5%
Commercial & Industrial	1,897	7.5%
Agricultural	1,096	4.3%
Other	207	0.8%
Total	25,461	100%

Source: June 30, 2007 Consolidated Report of Condition

DESCRIPTION OF ASSESSMENT AREA

Karnes County Assessment Area (AA)

KCNB has designated Karnes County, Texas as its AA. Karnes County consists of four census tracts (CTs) with a 2000 Census total population of 15,446. The largest communities in the AA are Karnes City, Falls City, Kenedy, and Runge. The AA has two moderate-income CTs and two middle-income CTs. The AA meets the requirements of the regulation and does not arbitrarily exclude any low- or moderate-income geographies. Although the AA has a high percentage of families below the poverty level, 21 percent, economic conditions have improved since the previous census. Of the families living in the AA, 28 percent are low-income, 20 percent are moderate-income, 18 percent are middle-income, and 34 percent are upper-income. The primary industries in the AA include correctional facilities, school districts, oil and gas production, retail, cattle ranching, agriculture, hunting, and manufacturing. The recent

improvement in economic conditions is primarily attributable to an increase in oil and gas production and related services. The recent opening of a new Wal-Mart Super Center in Kenedy should provide an additional economic boost to the AA. Competition in Karnes County is strong with one other national community bank, two branches of a large interstate regional bank, and a branch of a state community bank.

We conducted one community contact during this review. The organization contacted is an economic development corporation. The contact indicated that the local economy is considered distressed, but that it is improving. The contact related that housing is a present and growing need in the AA. The contact related that given the current improving economic climate, there will be an increasing number of lending opportunities for area banks.

DEMOGRAPHIC AND ECONOMIC CHARACTERISTICS OF AA	
Population	
Number of Families	3,283
Number of Households	4,478
Geographies	
Number of Census Tracts	4
% Low-Income Census Tracts	0.00%
% Moderate-Income Census Tracts	50.00%
% Middle-Income Census Tracts	50.00%
% Upper-Income Census Tracts	0.00%
<i>Median Family Income (MFI)</i>	
2000 MFI for AA	\$31,078
2004 HUD-Adjusted MFI	\$42,000
2005 HUD Adjusted MFI	\$42,000
2006 HUD Adjusted MFI	\$43,100
Economic Indicators	
Unemployment Rate-AA	2.12%
2000 Median Housing Value	\$40,020
% Households Below Poverty Level	20.97%
% Owner Occupied Housing	81.29%

Source: U.S. Census Data.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

Loan-to-Deposit Ratio

The bank's loan-to-deposit ratio (LTD) is reasonable and meets the standards for satisfactory performance. Over the previous 18 quarters, the quarterly LTD ratio averaged 54.57 percent. The LTD ratio ranged from 41 percent to 69 percent over this time period. The following table compares KCNB's LTD ratio to that of a comparable community bank in the AA.

Institution	Total Assets (6/30/2007) 000's	Average LTD Ratio
Falls City National Bank, Falls City, Tx	\$115,933	57.77%
<i>Karnes County National Bank</i>	<i>\$66,566</i>	<i>54.57%</i>

Source: June 30, 2007 Consolidated Report of Condition

Lending in Assessment Area

Lending in the AA is reasonable and meets the standard for satisfactory performance. The bank extends a majority of its loans to borrowers in its AA. Of our total sample of loans, 85 percent by number, and 62 percent by dollar amount, were made to borrowers in the AA. The following table summarizes the sample of loans made in and out of the AA.

TOTAL LOANS REVIEWED								
LOAN TYPE	IN ASSESSMENT AREA				OUT OF ASSESSMENT AREA			
	#	%	\$ (000s)	%	#	%	\$ (000s)	%
Residential Real Estate	19	95%	\$599	90%	1	5%	\$70	10%
Consumer	18	90%	\$238	91%	2	10%	\$23	9%
Business/Farm	14	70%	\$262	31%	6	30%	\$576	69%
Total Reviewed	51	85%	\$1,099	62%	9	15%	\$669	38%

Source: Loan sample

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

The overall distribution of loans to borrowers of different income levels is reasonable. The residential and consumer loan distribution to individuals within the AA, by different income levels, is reasonable and meets the standard for satisfactory performance. The distribution of loans to businesses and farms of different sizes in the AA is more than reasonable and exceeds the standard for satisfactory performance.

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

KARNES COUNTY RESIDENTIAL REAL ESTATE								
Borrower Income Level	LOW		MODERATE		MIDDLE		UPPER	
% of AA Families	27.81%		20.16%		17.79%		34.24%	
	% of Number	% of Amount	% of Number	% of Amount	% of Number	% of Amount	% of Number	% of Amount
Total	15%	11%	20%	11%	20%	28%	45%	50%

Source: U.S. Census Data; Loan Sample

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

KARNES COUNTY CONSUMER								
Borrower Income Level	LOW		MODERATE		MIDDLE		UPPER	
% of AA Households	28.65%		17.82%		17.51%		36.02%	
	% of Number	% of Amount	% of Number	% of Amount	% of Number	% of Amount	% of Number	% of Amount
Total	20%	23%	40%	32%	10%	3%	30%	42%

Source: U.S. Census Data; Loan Sample

The following table summarizes the results of our sample of 20 business/farm loans. Ninety-five percent of the number of sample loans was made to businesses and farms with annual revenues of less than \$1 million.

BORROWER DISTRIBUTION OF LOANS TO BUSINESSES & FARMS				
Business Revenues	≤\$1,000,000	>\$1,000,000	Unavailable/ Unknown	Total
% of AA Businesses *	56.74%	3.03% *	40.23%	100%
% of Bank Loans in AA #	95%	5%	NA	100%
% of Bank Loans in AA \$	95%	5%	NA	100%

Source: U.S. Census Business Demographic Data; Loan sample

Geographic Distribution of Loans

The overall geographic distribution of loans made within the AA is reasonable and meets the standards for satisfactory performance. Your record of residential and consumer lending in moderate income CTs is satisfactory. Your record of business/farm lending in moderate-income CTs tracts is more than reasonable and exceeds the standard for satisfactory performance. There are no low-income CTs in the AA.

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

GEOGRAPHIC DISTRIBUTION OF RESIDENTIAL REAL ESTATE LOANS IN KARNES COUNTY								
Census Tract Income Level	LOW		MODERATE		MIDDLE		UPPER	
% of AA Owner Occupied	0%		48.63%		51.37%		0%	
	% of Number	% of Amount	% of Number	% of Amount	% of Number	% of Amount	% of Number	% of Amount
Total	NA%	NA%	35%	29%	65%	71%	NA%	NA%

Source: U.S. Census; Loan sample

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

GEOGRAPHIC DISTRIBUTION OF CONSUMER LOANS IN KARNES COUNTY								
Census Tract Income Level	LOW		MODERATE		MIDDLE		UPPER	
% of AA Households	0		50.54%		49.46%		0	
	% of Number	% of Amount	% of Number	% of Amount	% of Number	% of Amount	% of Number	% of Amount
Total	NA	NA	50%	35%	50%	65%	NA	NA

Source: U.S. Census; Loan sample

The following table summarizes the results of our sample of 20 business and farm loans.

GEOGRAPHIC DISTRIBUTION OF BUSINESSES & FARMS IN KARNES COUNTY								
Census Tract Income Level	LOW		MODERATE		MIDDLE		UPPER	
% of AA Businesses	0%		52.66%		47.34%		0%	
	% of Number	% of Amount	% of Number	% of Amount	% of Number	% of Amount	% of Number	% of Amount
Total	NA%	NA%	70%	80%	30%	20%	NA%	NA%

Source: U.S. Census Business Demographic Data; Sample

Responses to Complaints

There have been no consumer complaints during this evaluation period regarding the bank's CRA performance.

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.