



SMALL BANK

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

PUBLIC DISCLOSURE

August 24, 2006

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**The First National Bank in Falfurrias
Charter Number 14072**

**200 S. St. Mary Street
Falfurrias, TX 78355**

**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.

- First National Bank’s (FNB) lending performance is satisfactory given its size, financial condition, and known credit needs in its assessment area (AA).
- FNB’s loan-to-deposit ratio (LTD) does not meet supervisory standards as it is well below AA peer group ratios. The LTD ratio averaged 19 percent during the evaluation period. Please see the LTD section of this performance evaluation (PE) for full details.
- A substantial majority of FNB’s loans are within its AA.
- FNB has demonstrated an excellent willingness to extend loans to individuals of varying incomes and businesses of different sizes.
- There have been no complaints with respect to FNB’s CRA performance.

DESCRIPTION OF INSTITUTION

The First National Bank in Falfurrias (FNB) is a community bank with one office located in Falfurrias, Texas, the county seat of Brooks County. The bank is locally owned and operated. As of June 30, 2006, FNB had total assets of \$66 million with 15 percent centered in the loan portfolio. The bank’s primary loan products include consumer and small business loans. The following chart details a breakdown of FNB’s loan portfolio as of June 30, 2006.

Loan Type	Dollar Amount (000's)	% of Total Loans
<i>Consumer</i>	4,398	44.6
<i>Commercial and Industrial</i>	2,535	25.7
Agricultural Production	1,181	12.0
RE Nonfarm Nonresidential	917	9.3
RE Farmland	563	5.7
Real Estate (RE) Construction	77	0.9
RE Residential (1-4)	23	0.2
RE Multifamily	20	0.2
Municipal Obligations	43	0.4
Other	99	1.0
Total	9,856	100.0

Bank lobby and drive-through services are provided Monday through Friday, with drive-through services also provided on Saturdays. There is an Automated Teller Machine (ATM) located on the bank parking lot that allows customers to obtain cash, account balance information, and transfer funds between accounts. Based on its financial condition, product offerings, competition, and prior performance, FNB has the ability to meet the various credit needs in its community. The bank was rated “Satisfactory” at the last CRA examination on July 16, 2001. There are no legal impediments that hinder FNB’s ability to provide credit in its AA; however, currently depressed economic conditions and the lack of residential construction have inhibited loan growth in recent years. The local economic conditions in Falfurrias and Brooks County are considered to be depressed according to a community contact performed during this evaluation. There has been no new residential construction in the area as the average construction date for housing is 1967. The town of Falfurrias is also in close proximity to the larger cities of Kingsville and Alice. Please see description of the AA below for further details on demographics.

DESCRIPTION OF BROOKS & JIM WELLS COUNTIES

FNB has designated all of Brooks County, and the southernmost census tract of Jim Wells County as its AA. Falfurrias is the county seat of Brooks County, while the Jim Wells census tract includes the town of Premont. Other communities located within Brooks County include Encino and Rachal. Specific demographic data for this area is listed below.

DEMOGRAPHIC AND ECONOMIC CHARACTERISTICS OF AA	
Population	
Number of Families	3,122
Number of Households	4,044
Geographies	
Number of Census Tracts	3
% Low-Income Census Tracts	0%
% Moderate-Income Census Tracts	100%
% Middle-Income Census Tracts	0%
% Upper-Income Census Tracts	0%
Median Family Income (MFI)	
2000 MFI for AA	\$36,380
2005 HUD-Adjusted MFI	\$42,000
2006 HUD-Adjusted MFI	\$43,100
Economic Indicators	
Unemployment Rate	2.95%
2006 Median Housing Value	\$32,835
% of Households Below Poverty Level	35%

The bank’s AA is comprised of three contiguous census tracts. This area meets the requirements of the regulation and does not arbitrarily exclude low- and moderate-income (LMI) geographies. A further description of the AA follows.

Based on the 2000 Census data, FNB’s AA has a population of approximately 12 thousand. All

three census tracts are classified as moderate income. There are 4.7 thousand housing units in the AA of which 64 percent are owner-occupied, 21 percent renter-occupied and 15 percent vacant. There have been no new residential developments in the area. The local economy is based on farming, ranching, hunting, and small retail businesses. The AA's major employers are the U.S Border Patrol, Falfurrias School District, home health businesses, restaurants, and convenience stores.

In order to gather more current information on the nature of the community and potential lending opportunities within the AA, we contacted a city government official during this evaluation. The community contact stated that economic conditions within the AA are depressed. Other than the convenience stores along highway 281, there has been no new commerce established in Falfurrias. The town continues to benefit economically from the high volume of travel from motorists via highway 281. These travelers contribute a substantial portion of sales tax revenue for the town of Falfurrias. The contact also stated that new Border Patrol agents accepting jobs in Falfurrias usually end up living in nearby Alice and Kingsville. As a whole, the community contact felt that local institutions were meeting the credit needs of the community.

CONCLUSIONS ABOUT PERFORMANCE CRITERIA

Despite AA demographics and a weak economy, management is performing satisfactorily and has been successful in meeting the credit needs of its AA, including LMI individuals.

Loan-to-Deposit Ratio

FNB's LTD ratio does not meet performance standards in comparison to peer group ratios. The following table provides LTD ratios for FNB's peer group.

Institution	Assets as of 06/30/06*	Total Deposits*	Average LTD Ratio %**
Falfurrias State Bank	16,947	14,680	77.51
Greater South Texas Bank - Falfurrias	26,278	22,557	71.36
Bank of South Texas – Hebbronville	56,587	46,654	55.94
FNB Hebbronville	99,641	84,476	21.71
<i>FNB Falfurrias</i>	<i>65,806</i>	<i>58,925</i>	<i>18.90</i>

* *Asset size and deposits of institutions is in thousands (000's)*

***The average LTD ratio is based on the period between June 2001 and June 2006.*

Since the last CRA examination, the LTD ratio has decreased from 24 percent at March 31, 2001, to 16 percent at June 30 2006. The average LTD ratio over the past 18 quarters was 19 percent, which is below an average 23 percent during the previous evaluation. This decrease is primarily attributed to limited loan demand and weak economic conditions within the AA. Management began purchasing commercial loans from other institutions to improve their LTD performance. As of July 31, 2006 the funded portion of these loans amounted to \$2 million, with \$1.4 million being unfunded. FNB's LTD has increased during the months of July (17 percent) and August (18 percent). Upon review of total loans originated for each year beginning in 2002

through September 11, 2006, total consumer loans originated during this period have increased from 194 to 432. This translates to a 62% increase by dollar amount in loan originations between 2002 and 2006. The increase by number of loans translates to a 55% increase. The number and dollar amount of these consumer loans were also compared as percentage of the total loans originated within each year. The following table provides a summary of consumer loans originated within each respective year. Data collected for this table supports the continued concentration of consumer loans within FNB's loan portfolio, and solidify's FNB's role as a consumer lender in the community.

	Gross Loans Originated by Year (000's)	% of total dollar volume	Number of Loans Originated	% of total number volume
2002	720	51	194	89%
2003	793	89	211	89%
2004	1,194	90	339	56%
2005	1,733	43	524	86%
2006 (Jan – Sept. 11)	1,385	85	432	85%

We noted that FNB has 59 percent of the total consumer loan portfolio amongst all three banks located in Falfurrias. FNB's large volume of small consumer loans, while meeting a credit need, does not substantially increase their loan-to-deposit ratio given their small dollar amounts. During a period between 2004 and 2006, 52 percent of the consumer loans originated were under \$2 thousand dollars. Despite incurring substantial delinquencies and losses within the consumer loan portfolio, FNB continues to meet the credit needs of LMI individuals as evidenced by the income distribution test performed during this evaluation. FNB's loan performance towards meeting the needs of LMI individuals exceeded AA demographics, and is commendable as the bank has established itself in the community as a consumer lender. Some of these consumers are also self employed or own their own businesses. Our loan sampling determined that FNB makes a concerted effort in supporting individual borrowing needs, in addition to supporting small business commerce.

FNB also has a substantial dollar volume of public funds (\$19 million or 32 percent) deposited by local governments and school district. A LTD ratio of 25 percent is obtained upon netting these public funds. The depository relationship with these public entities has existed within the bank for over 50 years. The bank's ten largest non-government depositors also comprise \$9 million or 15 percent of total deposits. This particular customer base has little reliance on borrowing, with only one residential loan (\$589 thousand) generated within this group of customers. This particular loan could easily be paid off by the customer as they are one of the bank's largest depositors. Together these deposits total \$28 million or 47 percent of total deposits. The two other banks in Falfurrias have a total of \$98 thousand in public funds combined.

A review of performance evaluations for Greater South Texas Bank (GSTB) and Falfurrias State Bank (FSB), help further explain their much higher LTD ratios. All three banks have total loan portfolios ranging between \$10 and \$16 million, with FNB Falfurrias being the largest bank with total assets of \$66 million. Total assets for GSTB and FSB are \$26 million and \$17 million

respectively. GSTB has a loan production office (LPO) in McAllen, Hidalgo County, Texas and a branch located in Hebbronville, Jim Hogg County, Texas. FSB is part of a dual-bank holding company with sister bank Champions Bank (Alice, Texas) having 6 total branches in South Texas including Corpus Christi, Benavides, Charlotte, George West, Kennedy, and Pleasanton. Both of these banks also have direct/indirect access to large metropolitan statistical areas (MSA) in McAllen and Corpus Christi.

GSTB has improved its LTD performance as it has a large concentration in residential loans (\$10 million or 59 percent) that is primarily attributed to the significant number of loans originated by their McAllen LPO in the Rio Grande Valley. Based on loan sampling, the performance evaluation for GSTB stated that 74 percent of the dollar volume and 65 percent of the number of loans to small business and residential loans were generated outside its AA in Hidalgo County. Given the depressed economic conditions and weak loan demand in Falfurrias, GSTB has ventured beyond its AA for loan growth.

FSB has a large concentration of commercial real estate loans (\$5 million or 42 percent). Loan sampling at FSB did not include an assessment of commercial real estate loans and was limited to consumer, small business, and small farm loans. The community contact stated that economic conditions were depressed and that there has been no new commerce in Falfurrias. Driving through the down of Falfurrias, you see several vacant commercial buildings and for sale signs. Without an assessment of the commercial real estate loans held at FSB, we can not evaluate whether the loans are for properties located outside the bank's AA or if they are participations from its much larger sister bank located in Alice (\$184 million total assets).

The Bank of South Texas in Hebbronville has a branch located in Kingsville, Kleberg County, Texas. This branch is located in an area currently experiencing economic growth, thus providing additional lending opportunities beyond its local Hebbronville market. FNB Falfurrias is more comparable to FNB Hebbronville. These banks are large public fund depositories for their respective communities, they offer the same products and services as other peer banks, and neither have a branch. The consumer loan concentrations for FNB Falfurrias and FNB Hebbronville are substantial at 45 percent and 50 percent respectively. According to community contacts within both of these areas, the economic conditions in Falfurrias and Hebbronville are depressed.

Lending in Assessment Area

A substantial majority of the bank's loans are made within its AA. We reviewed internal bank reports in order to assess performance for this criteria. The loans sampled within these reports were for the time period beginning January 2003 through June 2006. Our analysis determined that 89 percent of the number and 82 percent of the dollar amount of all loans were made within the AA.

TOTAL LOANS REVIEWED								
	IN ASSESSMENT AREA				OUT OF ASSESSMENT AREA			
LOAN TYPE	#	%	\$ (000s)	%	#	%	\$ (000s)	%
Consumer	786	89	2,573	82	102	11	549	18
Commercial	40	89	651	79	5	11	170	21
Total Reviewed	826	89	3,224	82	107	11	719	18

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

FNB's loan portfolio reflects an excellent distribution among individuals of various income levels and businesses of different sizes within the AA. In addition to loan sampling, we reviewed internal bank reports in order to assess performance for these criteria. In order to assess the bank's performance, our consumer and small business loan sample consisted of 30 and 26 loans respectively. Our analysis determined that FNB lends to all applicants, regardless of income category. Based on the 2000 Census, 58 percent of AA households are LMI. Our sample of 30 consumer loans determined that 60 percent of consumer loans were made to LMI households. The penetration to low-income borrowers exceeded AA demographics. The distribution of loans to moderate-income borrowers is relatively in line with AA demographics using the percentage of the dollar amount. The following chart reflects the results of our selected sample of consumer loans originated in FNB's AA.

CONSUMER								
<i>Borrower Income Level</i>	LOW		MODERATE		MIDDLE		UPPER	
<i>% of AA Households</i>	41		17		15		27	
	<i>% of Number</i>	<i>% of Amount</i>	<i>% of Number</i>	<i>% of Amount</i>	<i>% of Number</i>	<i>% of Amount</i>	<i>% of Number</i>	<i>% of Amount</i>
Total	53	43	7	14	30	29	10	14

FNB originates a substantial number of loans to businesses with less than \$1 million in revenues. All, but one loan within our sample were to such businesses. Management continues to support the small business community within the AA. Most of the loans within our sample were to self-employed individuals or locally owned businesses.

BORROWER DISTRIBUTION OF LOANS TO BUSINESSES - AGRICULTURAL		
Business Revenues	≤\$1,000,000	>\$1,000,000
% of AA Businesses	94	6
% of Bank Loans in AA #	96	4
% of Bank Loans in AA \$	96	4

Geographic Distribution of Loans

As previously mentioned, all three census tracts located within the AA are classified as moderate-income areas. Therefore, an analysis of loan distribution by geographic area would not be meaningful.

Responses to Complaints

No complaints relating to CRA performance have been received by FNB.

Fair Lending Review

An analysis of September 2001 through June 2006 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.