



**SMALL BANK**

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Comptroller of the Currency  
Administrator of National Banks

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Washington, DC 20219

## **PUBLIC DISCLOSURE**

**January 10, 2012**

### **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  
10001 Reunion Place Boulevard, Suite 250  
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.**

Karnes County National Bank of Karnes City's (KCNB) lending performance reflects a satisfactory response to community credit needs, including low- and moderate-income individuals and areas.

- The loan-to-deposit (LTD) ratio is reasonable given the bank's size, financial condition, market focus, and lending opportunities available in the assessment area (AA).
- The bank made a majority of the loans in our sample to borrowers within its AA.
- The bank demonstrates a reasonable distribution of loans to borrowers of different income levels and businesses of different sizes.
- The geographical distribution within the bank's AA indicates reasonable dispersion throughout the AA.

## **SCOPE OF EXAMINATION**

We performed a small bank Community Reinvestment Act (CRA) examination of the Karnes County National Bank, using financial data as of September 30, 2011. The evaluation period for lending activity included loans originated between January 1, 2010 and January 18, 2012. The LTD ratio was reviewed using both the current ratio and an 18-quarter average ratio. Analysis of lending performance was based on our samples taken of 20 consumer loans, 20 residential loans, and 20 commercial loans, which originated during the evaluation period. During analysis of the loans, we omitted loans made outside of the AA and supplemented similar loans within the AA to reach our sample of 20 loans.

The following table demonstrates the bank's primary lending products (by number and dollar) during the evaluation period. This differs from prior CRA examinations in that we did not combine the farm loans with the business loans. Primary products include residential real estate, consumer installment, and commercial loans.

<b>Loan Type</b>	<b>% by Dollars of Loans Originated/Purchased during evaluation period</b>	<b>% by Number of Loans Originated/Purchased during evaluation period</b>
<b>Business Loans</b>	<b>54%</b>	<b>8%</b>
<b>Consumer Loans</b>	<b>22%</b>	<b>82%</b>
<b>Home Loans</b>	<b>17%</b>	<b>3%</b>
Farm Loans	7%	7%
Total	100%	100%

## DESCRIPTION OF INSTITUTION

KCNB is an independently-owned community bank with assets of \$139 million as of September 30, 2011. The main office is located in Karnes City, Texas, and there is a full-service branch in Kenedy, Texas, which is a moderate-income census tract. The bank has automated teller machines (ATMs) on its premises, but does not have any ATMs located off-site. KCNB's loan portfolio is composed primarily of 1-4 family residential real-estate, consumer, and commercial loans. The bank's business strategy is to continue originating similar types of loans.

Our previous CRA Performance Evaluation, dated July 23, 2007, reflected a satisfactory rating. There are no legal or other impediments that limit the bank's ability to meet the community's credit needs.

## DESCRIPTION OF ASSESSMENT AREA

KCNB has designated Karnes County, Texas as its assessment area (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 census tracts (CTs) and two middle-income distressed CTs. The AA conforms to regulatory requirements and does not arbitrarily exclude any low- or moderate-income geographies. The 2000 Census indicated that 21 percent of households in the AA had incomes below the poverty level. Additionally, 23 percent of residents in the AA are institutionalized. The unemployment rate for the AA is 8.0 percent as of November 30, 2011 data. This has been on a downward trend and reached its most recent high of 10 percent in June 2011. The Texas State Unemployment rate is at 8.1 percent as of November 30, 2011 and reached its most recent high of 8.5 percent in August 2011.

AA Income Composition by Families and Geographies								
Income Designation	Low-Income		Moderate-Income		Middle-Income		Upper Income	
	#	%	#	%	#	%	#	%
Families	913	27.81%	662	20.16%	584	17.79%	1,124	34.24%
Census Tracts	0	0.00%	2	50.00%	2	50.00%	0	0.00%

Source: 2000 Census Data.

As of the 2000 Census, the population of the AA was 15,446, consisting of 3,283 total families. The AA family total comprised of approximately 28 percent low-income, 20 percent moderate-income, 18 percent middle-income, and 34 percent upper-income families, as displayed in the table above. Of the AA's housing units, approximately 60 percent (5,479) are owner-occupied and have an average median cost of \$40,020, and about 21 percent (1,158) are occupied rental units. The Department of Housing and Urban Development's (HUD) estimate of the AA's median family income was \$48,600 for 2011 and is \$46,500 for 2010. Based on 2011 Dunn and

Bradstreet data, 20 (2 percent) of the AA's non-farm businesses reported revenues greater than \$1 million, and 782 (65 percent) reported revenues less than \$1 million; 395 businesses (33 percent) in the AA did not report revenue for 2011.

The primary industries in the AA include oil and gas production, correctional facilities, school districts, retail, cattle ranching, agriculture, hunting, and manufacturing. There is a new Federal immigration detention center opening this year and this will create about 150 jobs. The recent improvement in economic conditions is primarily attributable to a significant increase in oil and gas production and related services. Competition for lending in Karnes County is strong. Competitors include Falls City National Bank, located in Falls City, and Wells Fargo and Texas Champion Bank, which each have a branch in the AA.

We conducted two recent interviews with community contacts from organizations relating to the AA. One organization indicated that there are guaranty-loan programs available, but banks are generally not using these at the present time. Another organization indicated that opportunities for lending exist with rental and permanent housing in the AA. Because of the increased oil and gas activity, the workers brought in from out-of-town have need for housing, and existing housing is insufficient to meet present demand. The contacts did not provide specific information regarding KCNB.

## **CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA**

### **Loan-to-Deposit (LTD) Ratio**

The LTD ratio of 31.93 percent as of September 30, 2011 is reasonable given the bank's capacity to lend, market competition, local demographic and economic factors, and lending opportunities available in the AA. The average LTD ratio over the last 18 quarters since the prior CRA examination of 37.32 percent is also reasonable. The bank's quarterly LTD ratio ranged from a low of 31.57 percent at June 30, 2011, to a high of 43.13 percent at June 30, 2007. For analysis purposes, we compared KCNB's current and 18-quarter average LTD ratios with a peer group consisting of five FDIC insured financial institutions which are similarly situated. KCNB's average ratio compared well with the peer average of 40.13 percent for the same time period. The peer group LTDs ranged from a low LTD of 17.35 percent and high LTD was 74.32 percent.

**Lending in Assessment Area**

KCNB’s lending in the AA is reasonable and meets the standard for satisfactory performance. The bank extends a majority of its loans to borrowers inside its AA. Of our total sample of loans, KCNB originated 75 percent by number, and 68 percent by dollar amount, within the AA. The following table summarizes the sample of loans made in and out of the AA.

<b>Table 1 - Lending in Karnes County AA</b>										
Loan Type	Number of Loans					Dollars of Loans (000s)				
	Inside		Outside		Total	Inside		Outside		Total
	#	%	#	%		\$	%	\$	%	
Home Loans	15	75%	5	25%	20	\$567	68%	\$263	32%	\$830
Consumer Loans	15	75%	5	25%	20	\$74	82%	\$16	18%	\$90
Commercial Loans	15	75%	5	25%	20	\$319	65%	\$172	35%	\$491
Totals	45	75%	15	25%	60	\$960	68%	\$451	32%	\$1,411

Source: Loan sample.

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

The overall distribution of loans to businesses of different sizes and borrowers of different income levels is reasonable. Some areas reflect excellent penetration, while others are poor, and overall, support a satisfactory lending effort by the bank.

The following table summarizes the results of our sample of 22 residential loans, which includes an increase in the sample size. We expanded the sample to include all AA loans of this type to get a better picture of the actual dispersion of loans. Residential lending penetration to low- and moderate-income families is poor. One important factor to consider is that the number of loans originated within the AA of this type was relatively low. This is because of the lack of housing available in the AA. Additionally, income levels have improved in the AA since the 2000 census, primarily because of the increasing economy resulting from the oil and gas activity.

<b>Table 2 - Borrower Distribution of Residential Real Estate Loans in Karnes County AA</b>								
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
Home Loans	27.81	13.64	20.16	4.55	17.79	27.27	34.24	54.54

Source: Loan sample; U.S. Census data.

The following table summarizes the results of our sample of 20 business loans. KCNB made ninety percent of the number of sample loans to businesses with annual revenues of less than \$1 million. This represents excellent penetration to small businesses within the AA.

<b>Table 2A - Borrower Distribution of Loans to Businesses in Karnes County AA</b>				
Business Revenues (or Sales)	≤\$1,000,000	>\$1,000,000	Unavailable/ Unknown	Total
% of AA Businesses	65.33	1.67	33.00	100.00
% of Bank Loans in AA by #	90.00	10.00	0.00	100.00
% of Bank Loans in AA by \$	73.57	26.43	0.00	100.00

Source: Loan sample; Dunn and Bradstreet data.

The bank’s record of consumer lending to low- and moderate-income borrowers is excellent. Loans made to low-income borrowers comprised of 50 percent of the sample, and moderate-income borrowers were another 35 percent. The following table summarizes the results of our sample of 20 consumer loans.

<b>Table 2B - Borrower Distribution of Consumer Loans in Karnes County AA</b>								
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	28.65	50.00	17.82	35.00	17.51	0.00	36.02	15.00

Source: Loan sample; U.S. Census data.

**Geographic Distribution of Loans**

The overall geographic dispersion of loans made within the AA is reasonable and meets the standards for satisfactory performance. The bank lends in all of the CTs within its AA.

The following table summarizes the results of our sample of 20 residential loans. KCNB’s record of real estate lending in moderate-income CTs is excellent and exceeds the standard for satisfactory performance.

<b>Table 3 - Geographic Distribution of Residential Real Estate Loans in Karnes County AA</b>								
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
Home Loans	0.00	0.00	48.63	54.55	51.37	45.45	0.00	0.00

Source: Loan sample; U.S. Census data.

The following table summarizes the results of our sample of 20 business loans. KCNB’s record of business lending in moderate-income CTs is excellent and exceeds the standard for satisfactory performance.

<b>Table 3A - Geographic Distribution of Loans to Businesses in Karnes County AA</b>								
Census Tract Income Level	Low		Moderate		Middle		Upper	
Loan Type	% of AA Businesses	% of Number of Loans	% of AA Businesses	% of Number of Loans	% of AA Businesses	% of Number of Loans	% of AA Businesses	% of Number of Loans
Businesses	0.00	0.00	54.47	60.00	45.53	40.00	0.00	0.00

Source: Loan sample; Dunn and Bradstreet data.

The following table summarizes the results of our sample of 20 consumer loans. KCNB’s record of consumer lending in moderate-income CTs is lower than the standard, but is reasonable given the current condition of the AA and the distressed nature of the middle-income tracts.

<b>Table 3B - Geographic Distribution of Consumer Loans in Karnes County AA</b>								
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	0.00	0.00	50.54	40.00	49.46	60.00	0.00	0.00

Source: Loan sample; U.S. Census data.

**Responses to Complaints**

KCNB has not received any 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.