SMALL BANK

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

PUBLIC DISCLOSURE

July 19, 2004

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

The Farmers and Merchants National Bank of Nashville
Charter Number 8221

120 West St. Louis Street
Nashville, IL 62263

Comptroller of the Currency
St. Louis Field Office
2350 Market Street, Suite 100
St. Louis, MO 63103

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.

All the lending performance components meet the standards for satisfactory performance. The major factors that support this rating are:

- The bank's lending reflects a good dispersion among borrowers of different income levels and a good dispersion among farms of different sizes given the demographics, economic factors, and legal impediments faced by the bank.

- The level of lending is reasonable. The bank's average loan-to-deposit ratio is 69% and is comparable to similarly situated area banks.

- A majority of the bank's loans extended during this evaluation period were originated within the bank's assessment area (AA).

DESCRIPTION OF INSTITUTION

Farmers and Merchants National Bank of Nashville (F&MNB) is 100% owned by Farmers and Merchants Bancshares, a one-bank holding company located in Nashville, Illinois. As of December 31, 2002, F&MNB had total assets of $123 million, net loans of $57 million, total deposits of $105 million, and total risk-based capital of $14 million. F&MNB has four offices. The main office is located in Nashville, Illinois. The bank also has full-service branches in Hoyleton and Dubois, Illinois, and a drive-in branch in Nashville.

The bank operates depository ATMs at the main bank and at each of the branch locations. Cash-dispensing ATMs are located at four locations throughout Nashville. These sites include a restaurant/truck stop, gas station, grocery store, and local factory. In December 2002, a cash-dispensing ATM was removed from the Gas Mart store at 150 N. Mill Street in Nashville because the owner of the store wished to install his own machine.

F&MNB offers traditional bank services and loan products normally associated with a community bank. As of December 31, 2002, net loans totaled $57 million, representing 50% of total assets. The loan portfolio consisted of 40% residential real estate, 28% farm real estate/agricultural, 23% commercial real estate/business, 8% consumer, and 1% other loans. By dollar value, residential real estate (33%) and agriculture-related loans (32%) account for the majority of loans originated between January 1, 2000 and December 31, 2002. Consumer loans (53%) were the bank's primary product category based on the number of loans originated over that same period.

There are no legal constraints placed on the bank's ability to help meet the community's credit needs. The bank has adequate resources to provide for the credit needs of its AA, although earnings have been lower than the average of similarly sized banks. Bank management feels that the increase in the amount of farm equipment and supplies financed by dealers has resulted in a lower demand for bank loans of this type. The bank entered into a formal agreement with bank regulators in 2003 to strengthen credit administration and control systems. The bank has addressed all of the articles of this document in a satisfactory manner, and the agreement was terminated in March 2004. No branches were opened or closed during the evaluation period. F&MNB's last CRA evaluation was August 20, 1997, and we rated the bank Outstanding.

DESCRIPTION OF ASSESSMENT AREA

Management has designated Washington County, Illinois as its AA. This is a contiguous area, meets the requirements of the regulation, and does not arbitrarily exclude low- or moderate-income geographies.

Washington County is in a non-Metropolitan Statistical Area (non-MSA) and is comprised of four census tracts (CTs). Based on the 1990 State of Illinois non-MSA median family income, all CTs are classified as middle-income. The bank's main office and drive-in branch are located in CT 9503. The Hoyleton branch is located in CT 9501, while the Dubois branch is in CT 9504. CT 9502 rounds out the AA, and includes the town of Okawville.

The 1990 census data shows the total population of Washington County was 14,965, which included 4,161 families. Of these families, 625 or 15% were classified as low-income, 833 or 20% as moderate-income, 1,030 or 25% as middle-income, and 1,673 or 40% as upper-income. The non-MSA statewide median family income as of the 1990 census was $29,693. The 2002-updated figure, adjusted for inflation by the Department of Housing and Urban Development, is $46,700. We used the 2002-updated figure in our analysis to determine borrower income levels.

Based on the 1990 census data for Washington County, 19% of the population is 65 or older, 15% of households are in retirement, and 11% of households live below the poverty level. The median housing value is $44,873 and the median year built is 1958. Owner-occupied units represent 73% of the housing stock, with 86% being 1-4 family units. Vacant housing units in the AA represent 9.63% of total housing units.

The July 2004 seasonally unadjusted unemployment rates for Washington County and the State of Illinois are 8.7% and 6.2%, respectively. The June 2004 seasonally unadjusted unemployment rate in Washington County was 4.1%, compared to the state figure of 6.1%. Scheduled plant shutdowns and temporary manufacturing lay-offs caused the significant spike in Washington County. By comparison, the July 2003 seasonally unadjusted unemployment rate in Washington County was 9.0%. The annual average unemployment rates for Washington County for 2000, 2001 and 2002, seasonally unadjusted, were 4.0%, 4.2%, and 4.7%, respectively. Seasonally adjusted unemployment figures for the United States were 5.6% in June 2004 and 5.5% in July 2004.

Major employers in the AA include Nascote Industries, Inc. (600 employees), Washington County Hospital (190) and Friendship Manor (130). Other major employers include Ligma Corporation, Agri-Pride FS, Inc., Land O'Lakes, and the local school districts. There have been no significant plant closures for several years, and no large employers have recently located to the area.

Competitive pressure in the local community comes from a large regional bank, two national banks, and four state financial institutions. Collectively, these banks have nine branches located in Washington County. This number does not include the array of mortgage companies, investment services, farm services, and insurance company offices that now offer loan products. Management noted that the bank also competes with a number of larger banks in the St. Louis metro area for deposit and loan customers.

To further our understanding of the community's credit needs, we contacted a local government official knowledgeable about the community. Our contact identified residential real estate, agriculture, consumer, and business lines of credit as the primary credit needs in the community. Our contact did not identify any unmet credit needs and felt that local banks were involved in the community and are adequately meeting its credit needs.

CONCLUSIONS ABOUT PERFORMANCE CRITERIA

F&MNB does a satisfactory job of meeting the credit needs of its AA, given the demographics, economic factors, and competitive pressures faced by the bank. Please refer to the "Description of Institution" and "Description of Assessment Area" sections of this evaluation for details on these performance context factors.

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

F&MNB's lending reflects a good dispersion among borrowers of different income levels and a good dispersion among farms of different sizes. Lending levels, as shown by the volume of all loans generated, reflect good responsiveness to the credit needs of the AA. Based on internal reports, between January 1, 2000 and December 31, 2002, F&MNB originated approximately 863 real estate, farm and consumer loans, totaling nearly $49 million.

Using only loans made in the AA, we sampled 40 residential real estate loans, 20 agriculture-related loans, and 20 consumer loans originated from January 1, 2000 through December 31, 2002. Residential real estate loans were not differentiated by type, i.e., home purchase, refinance, and home improvement, because that information was not readily available.

Residential Real Estate Loans

The overall borrower distribution of residential real estate loans in the bank's AA is good. In evaluating the borrower distribution of residential real estate loans, we considered the number of households that live below the poverty level (11%) and the limitations on home ownership that situation creates. Further, a significant number of households are either in retirement (15%) or receiving Social Security payments (35%). The nature of the reduced, fixed incomes faced by these households makes home ownership less feasible. The data used to evaluate F&MNB's residential lending activity is presented in the following table.

Borrower Distribution of Residential Real Estate Loans in Washington County

Borrower Income Level	Low		Moderate		Middle		Upper	
	% 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 Real Estate	15%	10%	20%	25%	25%	27%	40%	38%

Sources: Loan Sample and 1990 US Census Information. The updated 2002 non-MSA median family income is $46,700. The income categories are defined as: less than 50%, 50% to 80%, 80% to 120%, and over 120%, respectively, of $46,700.

Based on the sample of loans selected, the bank's residential lending to low-income borrowers is below the percentage of low-income families in the AA. Of those loans sampled, 10% were made to low-income borrowers, while 15% of the families in the AA are low-income. However, residential lending to moderate-income borrowers is higher than the percentage of moderate-income families in the AA. Twenty-five percent of sampled loans were made to moderate-income borrowers, while 20% of AA families are classified as moderate-income.

Opportunities to make real estate loans to low-income borrowers are limited by the percentage of people living below the poverty level, and by the high percentage of people in retirement or receiving Social Security benefits. The majority of the sampled loans (58%) were refinances, and it is likely that middle- and upper-income borrowers can more easily afford the costs associated with refinancing. Residential lending to middle- and upper-income borrowers closely resembles the AA demographics. During the evaluation period, the bank also made two multi-family purpose loans totaling $399,000.

Consumer Loans

The overall borrower distribution of consumer loans is good in the bank's AA. In evaluating the borrower distribution of consumer loans, we considered the number of households in the AA below the poverty level (11%). The data used to evaluate F&MNB's consumer lending activity is presented in the following table.

Borrower Distribution of Consumer Loans in Washington County								
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	21%	25%	16%	50%	18%	10%	45%	15%

Sources: Loan Sample and 1990 US Census Information.

Based on the sample of loans selected, the bank's consumer lending to low-income borrowers (25%) slightly exceeds the percentage of low-income households (21%) in the AA. Consumer lending to moderate-income borrowers (50%) significantly exceeds the percentage of moderate-income households (16%) in the AA.

Farm Loans

The overall borrower distribution of farm loans is good in the bank's AA. The data used to evaluate F&MNB's farm loan activity is presented in the following table.

Borrower Distribution of Loans to Farms in Washington County		
Farm Revenues	≤$1,000,000	>$1,000,000
% of AA Farms*	97%	3%
% of Bank Loans in AA by #	95%	5%
% of Bank Loans in AA by $	61%	39%

*Source: Loan Sample and Dunn and Bradstreet 2002 data. * 0.25% of AA farms did not report revenue data*

Based on the sample of loans selected, F&MNB's lending to small farms (95%) with revenues of $1 million or less is comparable to the percentage of small farms (97%) in the AA.

Loan-to-Deposit Ratio

F&MNB's loan-to-deposit (LTD) ratio is reasonable. As of December 31, 2002, the bank's LTD ratio was 54%. F&MNB's quarterly average LTD ratio since June 30, 1997 was 69%. This is comparable to six similarly situated banks in the area whose quarterly average LTD ratios ranged from 57% to 77%, with an average ratio of 73%. These banks are considered similarly situated because of their size, lending opportunities, and location. Although slightly below the average LTD ratio for its peer group, F&MNB's LTD ratio is satisfactory based on the contextual factors. Please refer to the "Description of Institution" and "Description of Assessment Area" sections of this evaluation for details on these performance context factors.

Lending in Assessment Area

A majority of the bank's loans extended during this evaluation period were originated within the bank's AA. A sample of 20 residential real estate loans, 20 consumer loans, and 20 farm loans found that 78% by number and 84% by dollar were made within the bank's AA. The data used to evaluate F&MNB's lending in the AA is presented in the following table.

Lending in Washington County										
	Number of Loans					Dollars of Loans				
	Inside		Outside		Total	Inside		Outside		Total
Loan Type	#	%	#	%		$	%	$	%	
Residential Real Estate	14	70%	6	30%	20	1,371M	80%	343M	20%	1,714M
Farm	18	90%	2	10%	20	1,720M	90%	182M	10%	1,902M
Consumer	15	75%	5	25%	20	169M	63%	99M	37%	268M
Totals	**47**	**78%**	**13**	**22%**	**60**	**3,260M**	**84%**	**624M**	**16%**	**3,884M**

Source: Random sample of loans originated between January 1, 2000 and December 31, 2002.

Geographic Distribution of Loans

All CTs in the assessment area are designated middle-income. An analysis of the geographic distribution of loans within the assessment area does not provide meaningful information.

Responses to Complaints

F&MNB has not received any complaints about its performance in helping to meet community credit needs since the previous CRA examination.

Fair Lending or Other Illegal Credit Practices Review

We found no evidence of discrimination or other illegal credit practices.

Other Lending Related Activity

F&MNB is a participant in community development activities, as they become available. Some of the more significant activities that the bank participates in include:

Jefferson Marion Washington Community Development Corporation – This CDC is comprised of eleven area banks. The objective is to provide financing to for-profit existing small businesses in the region. The CDC focuses on firms seeking funds for modernization, physical rehabilitation of their structures, or cash flow to make them more economically viable, with a special emphasis placed on job addition and retention. F&MNB has a total investment of $100,000 in the CDC. During the assessment period, the CDC has provided financing for two projects: a $63,000 loan to a manufacturer of sports equipment to purchase an electric transformer for their facility in Salem, IL, and a $210,000 loan to the Salem Business and Industrial Commission to purchase 24.56 acres of land in the Salem Industrial Park. This land is in a prime industrial growth area and will have the potential to create new employee opportunities.

USDA Guaranteed Rural Housing Loan Program – The bank began participating in this program in 2004. This program allows low- and moderate-income borrowers the opportunity to qualify for a home loan with little or no down payment. Loans may also include closing costs, legal fees, and title service charges, provided the appraised value of the property is sufficient.