



PUBLIC DISCLOSURE

January 11, 2016

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

The First National Bank of Mertzton
Charter Number 9810

106 S. Broadway
Mertzton, TX 76941

Office of the Comptroller of the Currency
San Antonio North Field Office
10001 Reunion Place, Suite 250
San Antonio, TX 78216-4165

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 the 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 Lending Test is rated: Satisfactory.

The Community Development Test is rated: Satisfactory.

Major factors supporting the rating include:

- The quarterly average loan-to-deposit (LTD) ratio is less than reasonable; however, the bank experienced sizeable deposit growth that outpaced loan growth during the evaluation period.
- A substantial majority of loans, by number and dollar volume, originated inside the assessment area (AA).
- The distribution of loans reflects reasonable penetration to borrowers of different income levels and businesses and farms of different sizes.
- The geographic distribution of loans reflects reasonable dispersion.
- Community development (CD) activity reflects adequate responsiveness to CD needs of the AA through CD lending, investments, and services.

Scope of Examination

We evaluated the First National Bank of Mertzon's (Mertzon) Community Reinvestment Act (CRA) performance using interagency Intermediate Small Bank (ISB) procedures that include a Lending Test and a CD Test. The evaluation period ranges from October 11, 2011, the date of the previous Performance Evaluation (PE), through January 11, 2016, the date of the current evaluation. The Lending Test focuses on activity from January 1, 2013 to December 31, 2015. Mertzon's primary loan products, by dollar volume, relate to business, agricultural (farm), and residential lending. The CD Test covers CD activity related to loans, investments, and services, and focuses on activities from the prior PE date of October 11, 2011, to our current evaluation date of January 11, 2016.

To evaluate the distribution of loans, we used the demographics and geographies related to the 2010 Census as it applies to the years from 2013 through 2015. The 2013 Office of Management and Budget (OMB) Metropolitan Area geographic boundary revisions (referred to as the 2014 OMB Changes) became effective for CRA purposes on January 1, 2014. Since the changes did not affect Mertzon's AA delineation, this PE contains a single analysis of loan data for the 2013 through 2015 evaluation period.

We tested Home Mortgage Disclosure Act (HMDA) data for residential mortgages to verify the accuracy of data and found it reliable to use for this evaluation. We also verified information that bank management provided for CD loans, investments, and

services to ensure it met the regulatory definition of CD, and excluded any item that did not meet the definition or purpose of CD from our analysis. To evaluate business and farm loans, we selected a sample of 20 loans from each category. We performed a full scope review of Mertzson's one AA.

Description of Institution

Mertzson, a full-service, intrastate bank headquartered in Mertzson, Texas, is an independently owned institution and has no holding company. Mertzson operates three locations including the main office in Mertzson and two branches in San Angelo. Each location has an onsite automated teller machine (ATM) and a drive-up facility.

At September 30, 2015, Mertzson reported total assets of \$296.7 million. Tier 1 capital totaled \$22.3 million and represented 7.5% of total assets. Net loans represented 22% of total deposits and 20% of total assets. As shown in the following table, business (commercial) loans comprise the majority of the loan portfolio, followed to a lesser degree by agricultural (farm) and residential loans.

Loan Portfolio Composition as of September 30, 2015		
Loan Category	Dollar Volume (000's)	Percentage
Business (Commercial)	28,681	48
Agricultural/Farm	14,405	24
Residential	9,243	16
Consumer	4,294	7
Other	2,785	5
Total:	59,408	100

Source: September 30, 2015 Call Report

Based on its financial condition and size, there are no legal, financial, or other factors that inhibit Mertzson's ability to meet credit needs in its AA. Mertzson's current business strategy is to continue offering commercial loans as its primary loan product. The prior CRA examination, dated October 11, 2011, assigned an overall "Satisfactory" rating to the lending performance of the bank.

Description of Assessment Area(s)

Mertzson has one AA; it is the San Angelo, TX Metropolitan Statistical Area (MSA), which is comprised of Irion and Tom Green Counties. The City of Mertzson is the county seat for Irion County and has total population of 1,599. Irion County is comprised of one upper-income census tract (CT). The City of San Angelo is the county seat for Tom Green County. Tom Green County has 25 CTs - one low-income, seven moderate-income, ten middle-income, six upper-income, and one with no income designation because it is where the San Angelo airport is located. The AA meets regulatory requirements, does not reflect discrimination, and does not arbitrarily exclude any low- or moderate-income (LMI) geographies. The following table reflects pertinent information about the AA.

Demographic Information for the Mertzon Assessment Area						
	#	% Low	% Moderate	% Middle	% Upper	% NA*
Geographies (Census Tracts)	26	4	27	38	27	4
Population by Geography	111,823	2	30	43	25	0
Owner-Occupied Housing Units by Geography	28,650	1	26	44	29	0
Businesses by Geography	8,313	11	16	44	29	<1
Farms by Geography	564	5	6	37	52	0
Family Distribution by Income Level	28,202	22	18	19	41	0
Household Distribution by Income Level	42,084	23	17	17	43	0
Census Median Family Income (MFI)	\$53,682	Median Housing Value			\$97,465	
HUD – Adjusted MFI: 2013	\$55,300	Households Below Poverty Level (%)			15.20	
HUD – Adjusted MFI: 2014	\$56,100	Unemployment Rate (%)			3.89	
HUD – Adjusted MFI: 2015	\$61,200					

*The NA category consists of one geography that has not been assigned an income classification.

Source: 2010 US Census, 2013 – 2015 FFIEC updated MFI, and Bureau of Labor Statistics

The main office, located in the City of Mertzon, is in an upper-income CT. It is the only financial institution in Irion County. Two branches are located in San Angelo; one in a low-income CT and one in an upper-income CT. All three offices are readily accessible to the population of the AA.

The City of San Angelo is a highly competitive banking environment that includes large regional and national banks, and smaller community banks. The FDIC June 30, 2015 Deposit Market Share Report reflects 15 financial institutions operate 32 offices within Tom Green County. Mertzon ranks fourth with a deposit market share of 11.5%. First Financial Bank, NA ranks first with a 25.5% deposit market share.

Irion County has abundant oil and gas reserves from three shale plays - Cline Shale, Wolfberry/Spraberry, and Wolfcamp. As oil prices rose, oil and gas companies found it profitable to begin using fracking technology in these shale plays. This activity peaked in 2014 and began declining in 2015 as oil prices dropped. Tom Green County, especially the City of San Angelo benefitted from the increased oil and gas activity as the unemployment rate improved, personal income growth increased, and housing starts accelerated.

The November 2015 Moody’s Analytics report reflects San Angelo’s expansion has slowed markedly over the last several months as a result of cheap oil. Job growth has declined to slowest pace in four years and contractors have scaled back construction of single-family homes. The report also reflects San Angelo will struggle in the near term as oilfield service providers scale back operations and reduce investment in response to less drilling and exploration. Weakness in the energy industry will spill over to retail and housing in the near term as well. However, an expanding healthcare industry will help support the local economy. The City of San Angelo serves as a regional healthcare hub as there are no other large municipalities within a 90-mile radius. Healthcare providers account for three of the top five employers in San Angelo. The other two employers are Goodfellow Air Force Base and Angelo State University.

We met with two community contacts during this examination. Both contacts noted the unemployment rate is increasing due to recent layoffs in the oil and gas industry. Businesses that provide indirect services to the industry are also feeling the effects. The contacts identified the following credit needs in the community:

- Affordable housing: when the oil and gas activity was strong, existing housing market was at a premium and often resulted in LMI tenants priced out of homes with no place to go, which increased the homeless population in the area.
- Financial literacy: most clients the contacts help are unbanked and living paycheck to paycheck, resulting in poor/delinquent payment history that prevents them from opening accounts or getting loans.

The contacts said area banks are the biggest supporters of helping to meet community needs, the biggest supporters of area nonprofit organizations, and there were numerous community opportunities where banks could be more proactive in helping unbanked individuals.

Conclusions with Respect to Performance Tests

LENDING TEST

Mertzon's performance under the Lending Test is Satisfactory.

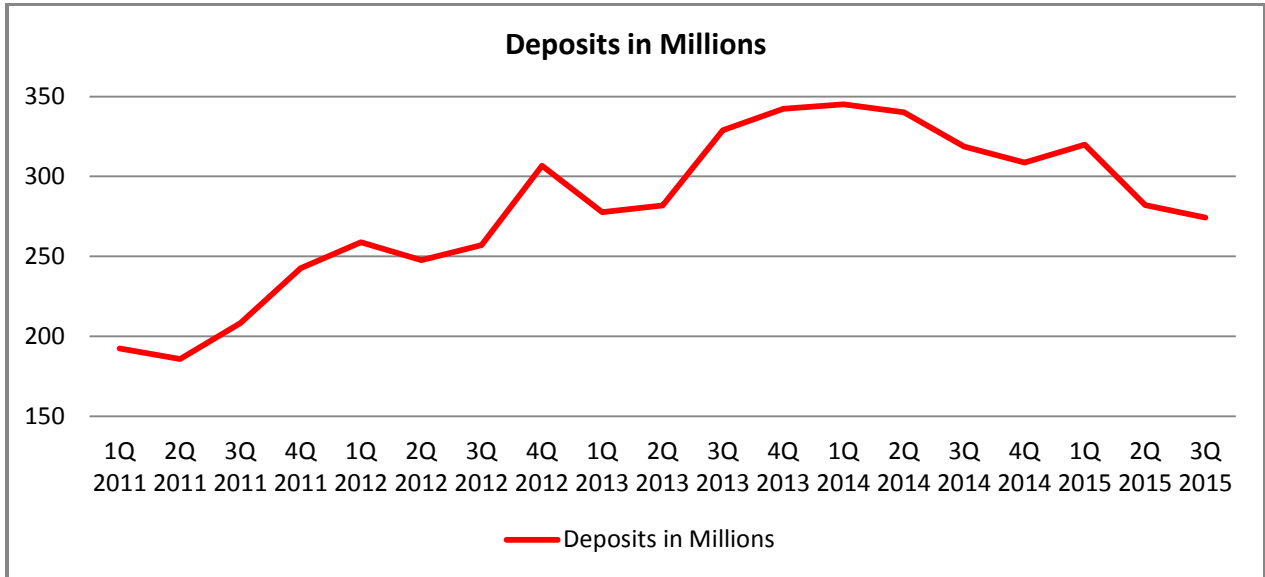
Loan-to-Deposit Ratio

Mertzon's LTD ratio is less than reasonable given the bank size, local competition, and credit needs within the AA. During the evaluation period, the LTD ratio ranged from a low of 14% to a high of 21% with a quarterly average of 17%. To assess Mertzon's performance, we compared its average LTD ratio to five similarly situated institutions. As reflected in the following table, the average LTD ratios for the five institutions ranged from 51% to 102% (no ranking is intended or implied). The overall quarterly average LTD ratio for all five institutions is 74%.

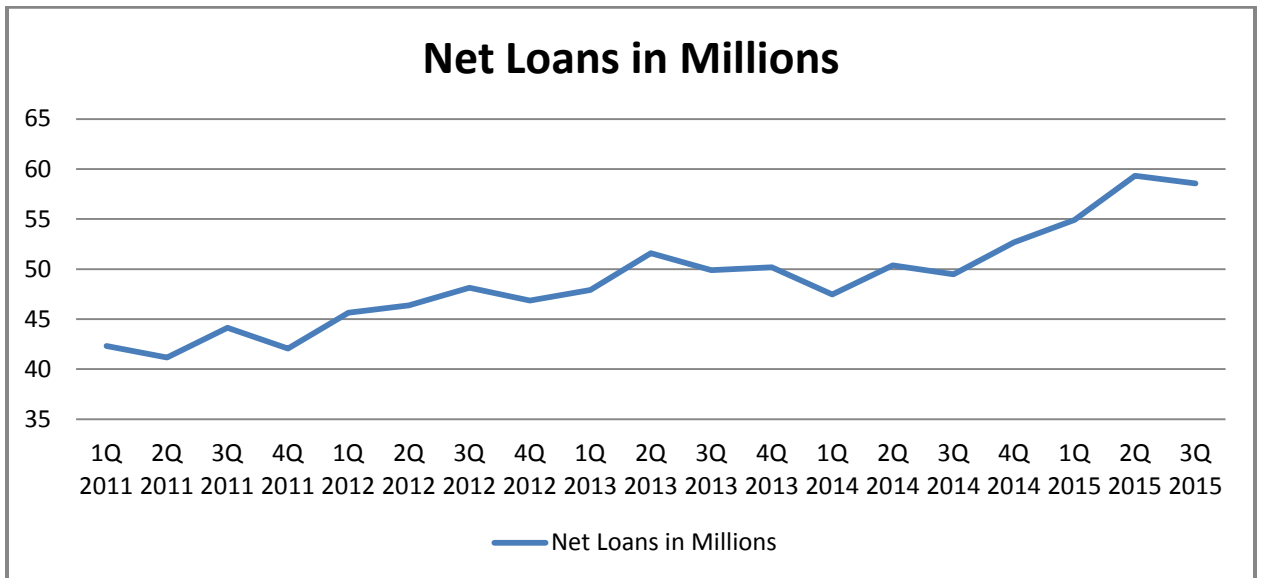
Institution	Total Assets (\$000's) As of 9/30/2015	Average Quarterly LTD Ratio As of 9/30/2015
Crockett National Bank, Crockett County	564,078	102
Citizens State Bank, Runnels County	112,610	89
First National Bank of Sonora, Sutton County	332,970	68
First National Bank of Ballinger, Runnels County	150,470	59
Texas State Bank, Tom Green County	247,526	51
First National Bank of Mertzon, Irion County	296,741	17

The primary factor affecting Mertzon's LTD ratio is the sizeable deposit volume. Historically high, the dollar volume grew significantly, when oil and gas activity related to fracking activities increased during the evaluation period. The activity resulted in sizeable one-time bonus checks for land leases and an increased volume in royalty payments for some Mertzon depositors. The increased activity caused an influx of

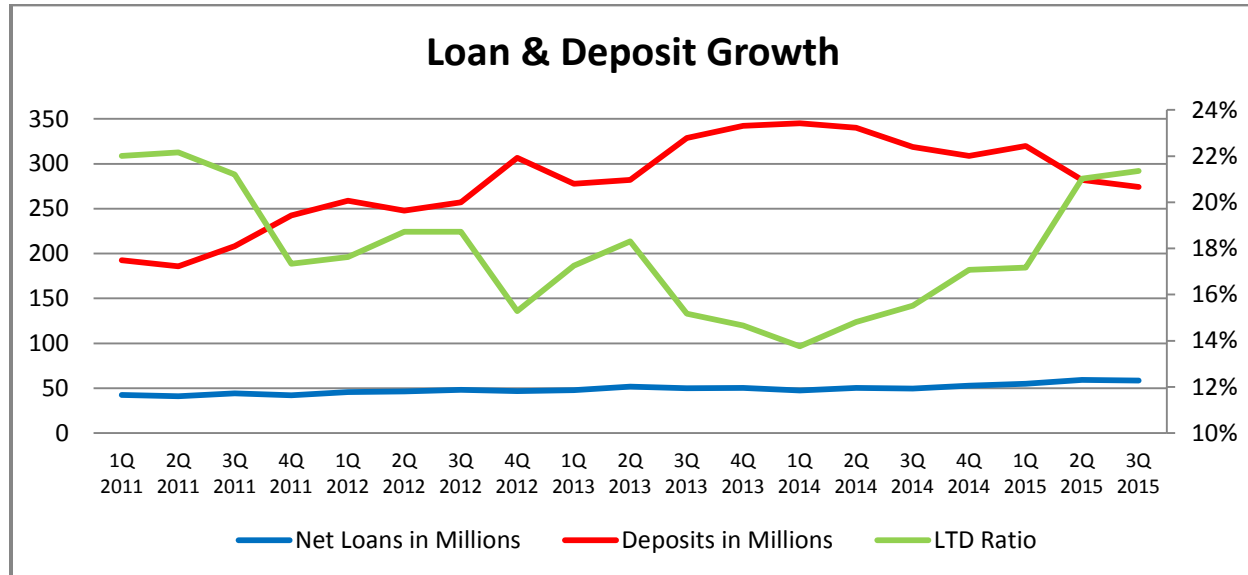
deposits that peaked at \$395 million in August 2014. During the evaluation period, deposits ranged from a low of \$192 million to a high of \$345 million or an increase of 86%. The fracking activity eventually slowed and virtually ended in 2015 resulting in deposits dropping to \$274 million at September 30, 2015. Bank management forecasts deposits to drop further in 2016. The graph below shows deposit activity from January 1, 2011 to September 30, 2015.



As deposits soared, Mertzon continued to make loans resulting in 39% loan growth since the prior CRA evaluation. The following graph shows the loan growth from January 1, 2011 to September 30, 2015.



While both loans and deposits grew during the evaluation period, deposits grew at a faster pace, especially in 2014, resulting in a declining LTD ratio. As the following graph shows, the LTD ratio increased to just over 21% at the end of 2015 and is expected to improve as bank management forecasts that deposits will continue to drop.



Lending in Assessment Area

Lending in the AA is excellent with a substantial majority of loans originated inside the AA, exceeding the standard for satisfactory performance. The following table reflects the percentages, by number and dollar volume, of loans originated inside the AA.

Lending in the Assessment Area										
Loan Type	Number of Loans					Dollars of Loans				
	Inside		Outside		Total	Inside		Outside		Total
	#	%	#	%		\$	%	\$	%	
Residential	113	78	31	22	144	9,066	78	2,620	22	11,686
Business	16	80	4	20	20	2,075	91	199	9	2,274
Farm	16	80	4	20	20	2,347	68	1,092	32	3,439
Total	145	79	39	21	184	13,488	78	3,911	22	17,399

Source: Data reported under HMDA; Sample of loans

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

The distribution of loans represents reasonable penetration to businesses and farms of different sizes, and to individuals of different income levels. Business loans represented the largest percentage of the loan portfolio during the evaluation period. As such, we weighed business loan performance more heavily in our conclusion.

Business Loans

For the distribution of business loans, we compared data from our business loan sample to demographic data from Dun and Bradstreet. As reflected in the following table, by number, 65% of the loans originated to businesses with annual revenues equal to or less than \$1 million. Demographic data reflects about 70% of the businesses in the AA have annual revenues equal to or less than \$1 million. The distribution of business loans reflects reasonable penetration to businesses of different sizes.

Borrower Distribution of Loans to Businesses in the Assessment Area				
Business Revenues (or Sales)	≤\$1,000,000	>\$1,000,000	Unavailable/ Unknown	Total
% of AA Businesses	70	4	26	100%
% of Bank Loans in AA by #	65	35	0	100%
% of Bank Loans in AA by \$	55	45	0	100%

Source: Loan sample; Dun and Bradstreet data

Farm Loans

For the distribution of farm loans, we compared data from our farm loan sample to demographic data. As reflected in the following table, by number, 100% of the loans originated to farms with annual revenues equal to or less than \$1 million. Demographic data reflects 98% of the farms in the AA have annual revenues equal to or less than \$1 million. The distribution of farm loans reflects excellent penetration to farms of different sizes.

Borrower Distribution of Loans to Farms in the Assessment Area				
Business Revenues (or Sales)	≤\$1,000,000	>\$1,000,000	Unavailable/ Unknown	Total
% of AA Farms	98	1	1	100%
% of Bank Loans in AA by #	100	0	0	100%
% of Bank Loans in AA by \$	100	0	0	100%

Source: Loan sample; Dun and Bradstreet data

Residential Loans

For the distribution of residential loans, we compared loans reported under HMDA to demographic data from the 2010 Census. As reflected in the following table, the number of residential loans to LMI borrowers represented poor penetration when compared to the demographic data. However, we noted reasonable penetration to LMI borrowers for home improvement loans. The number of home improvement loans to low-income borrowers represents 12% of the number of home improvement loans. The number of loans to moderate-income borrowers represents 15% of the number of home improvement loans. While both are somewhat lower than the 22% demographic, the ratios do reflect adequate performance.

As reported under HMDA, 33 of the 113 residential loans that Mertz on originated from January 1, 2013 through December 31, 2015 were home improvement loans.

While the dollar volume of residential loans represents 15.5% of the total loan portfolio, Mertz on originated only 113 loans in the AA during the evaluation period. The bank provides residential loan products using conservative underwriting requirements. Most borrowers and organizations that assist LMI borrowers with obtaining financing usually prefer fixed rate loans with a 30-year term. However, the longer term is outside bank loan policy and risk tolerance resulting in Mertz on being less competitive for residential loan products. Other financial institutions in the AA offer the longer-term loans.

Borrower Distribution of Residential Real Estate Loans in the Assessment Area								
Borrower Income Level	Low		Moderate		Middle		Upper	
Loan Type	% of AA Families	% of # of Loans	% of AA Families	% of # of Loans	% of AA Families	% of # of Loans	% of AA Families	% of # of Loans
Residential	22	7	18	8	19	23	41	62

Source: Data reported under HMDA; U.S. Census data

Geographic Distribution of Loans

The geographic distribution of loans reflects reasonable dispersion throughout the AA. Business loans represented the largest percentage of the loan portfolio during the evaluation period. As such, we weighed business loan performance more heavily in our conclusion.

Business Loans

The geographic distribution of loans reflects excellent dispersion. As reflected in the following table, the percentage of loans to businesses in the low-income CT is near to the percentage of businesses located in the low-income CT. The percentage of loans to businesses in moderate-income CTs is lower than the percentage of businesses located in these CTs. Only one CT, or 4% of the CTs in the AA, is low-income. As such, more weight is given to the lending performance in the low-income CT.

Geographic Distribution of Loans to Businesses in the Assessment Area								
Census Tract Income Level	Low		Moderate		Middle		Upper	
Loan Type	% of AA Businesses	% of # of Loans	% of AA Businesses	% of # of Loans	% of AA Businesses	% of # of Loans	% of AA Businesses	% of # of Loans
Businesses	11	10	16	5	44	45	29	40

Source: Loan sample; Dun and Bradstreet data

Farm Loans

The geographic distribution of loans reflects very poor dispersion as Mertzon did not originate any loans in the LMI CTs. However, a significant percentage of farm loans are located in Irion County, which is comprised of one upper-income CT.

Geographic Distribution of Loans to Farms in the Assessment Area								
Census Tract Income Level	Low		Moderate		Middle		Upper	
Loan Type	% of AA Farms	% of # of Loans	% of AA Farms	% of # of Loans	% of AA Farms	% of # of Loans	% of AA Farms	% of # of Loans
Farms	5	0	6	0	37	25	52	75

Source: Loan sample; Dun and Bradstreet data

Residential Loans

The geographic distribution of loans reflects poor dispersion. Mertzon did not originate any loans in the low-income CT. The percentage of loans in moderate-income CTs is lower than the percentage of owner-occupied housing in the moderate-income CTs. As noted in the residential loan section of borrower distribution, Mertzon originates very few residential loans.

Geographic Distribution of Residential Real Estate Loans in the Assessment Area								
Census Tract Income Level	Low		Moderate		Middle		Upper	
Loan type	% of AA Owner-Occupied Housing	% of # of Loans	% of AA Owner-Occupied Housing	% of # of Loans	% of AA Owner-Occupied Housing	% of # of Loans	% of AA Owner-Occupied Housing	% of # of Loans
Residential	1	0	26	11	44	35	29	54

Source: Loan sample; Dun and Bradstreet data

Responses to Complaints

Mertzon has not received any complaints related to its CRA performance during the evaluation period.

COMMUNITY DEVELOPMENT TEST

Mertzon’s CD activity through CD lending, investments, and services reflects adequate responsiveness to CD needs of its AA.

Number and Amount of Community Development Loans

The level of CD lending reflects adequate responsiveness to CD needs of the AA. Mertzon originated fifteen CD loans totaling \$1.7 million during the evaluation period. Three loans totaling \$449 thousand provided affordable housing to LMI individuals and families. One loan totaling \$102 thousand provided funds through the City of San

Angelo Development Corporation to a small business required to retain and create new jobs. Eleven loans totaling \$1.2 million met the definition of community service. The largest loan (\$1 million) provided funds to a local junior college that provides Pell Grants and participates in the HSI Program. (Of the students, 93% qualify for Pell Grants.) Through these loans, Mertzson has made a positive impact on the CD needs in its AA.

Number and Amount of Qualified Investments

The level of qualified investments reflects poor responsiveness to CD needs of the AA. During the evaluation period, Mertzson made no equity or debt investments in the AA. Fewer CD opportunities are available in the AA due to the upper-income borrower and geographic levels of Irion County and the strong financial competition in Tom Green County. Mertzson made 19 separate qualified donations totaling \$27.5 thousand to CD organizations in the AA. Two donations totaling \$15.6 thousand went to organizations providing affordable housing and the remaining donations went to CD organizations benefitting LMI youth and individuals.

Broader Statewide Area

During the evaluation period, Mertzson invested \$24.85 million in general obligation municipal bonds that qualify as CD investments because they serve essential community needs in school districts where more than 50% of the students qualify for free or reduced lunch assistance.

Extent to Which the Bank Provides Community Development Services

The level of CD services reflects adequate responsiveness to CD needs of the AA. Mertzson meets these needs through volunteer activities of directors, officers, and employees, several on a continuing basis to organizations that provide community service and economic development. Bank staff have served as directors and committee members, and have provided loan underwriting, fund raising, financial education, and marketing expertise.

Responsiveness to Community Development Needs

Mertzson demonstrates adequate responsiveness to meeting CD needs in the AA as evidenced by CD lending and CD services. The main office and the two branch offices are readily accessible to all portions of the LMI population. One branch and an ATM is located in the only low-income CT in the AA.

Fair Lending or Other Illegal Credit Practices Review

Pursuant to 12 CFR 25.28(c) or 12 CFR 195.28(c), in determining a national bank's (bank) or Federal Savings Association's (FSA) CRA rating, respectively, the OCC considers evidence of discriminatory or other illegal credit practices in any geography by the bank or FSA, or in any AA by an affiliate whose loans have been considered as part of the bank's or FSA's lending performance.

We found no evidence of discriminatory or other illegal credit practices inconsistent with helping to meet community credit needs.