

PUBLIC DISCLOSURE

February 5, 1999

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**Farmers & Merchants State Bank of Krum
Certificate Number: 16674**

**146 West McCart
P.O. Box 218
Krum, Texas 76249-0218**

Federal Deposit Insurance Corporation

**Division of Compliance and Consumer Affairs
1910 Pacific Avenue, 20th Floor
Dallas, Texas 75201**

NOTE: 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.

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GENERAL INFORMATION

The Community Reinvestment Act (CRA) requires each federal financial supervisory agency to use its authority when examining financial institutions subject to its supervision, to assess the 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. Upon conclusion of such examination, the agency must prepare a written evaluation of the institution's record of meeting the credit needs of its community.

*This document is an evaluation of the Community Reinvestment Act (CRA) performance of **Farmers & Merchants State Bank** prepared by the **Federal Deposit Insurance Corporation**, the institution's supervisory agency, as of **February 8, 1999**. The agency rates the CRA performance of an institution consistent with the provisions set forth in Appendix A to 12 CFR Part 345.*

INSTITUTION RATING

INSTITUTION'S CRA RATING: This institution is rated **Outstanding**.

- The bank's overall lending to borrowers of different incomes exceeds standards for satisfactory performance based on the above average penetration of loans to low- and moderate-income borrowers as indicated by the consumer loan sample reviewed.
- The bank has achieved an excellent dispersion of loans, which indicates above average performance regarding distribution of loans throughout the bank's assessment area including low- and moderate-income geographies.
- The bank's average loan-to-deposit ratio based on twelve quarters since the last evaluation is approximately 75 percent. This ratio exceeds that of banks with similar size, asset structure and loan products. The bank's loan-to-deposit ratio indicates an excellent responsiveness to area credit needs.
- Analysis of consumer loans revealed that 77 percent by number and 70 percent by dollar volume of the loans sampled were advanced to customers inside the assessment area. The bank performed an analysis of the total consumer loan portfolio, which revealed that 75 percent by number and 75 percent by dollar volume of loans were made to consumers inside the bank's assessment area. Based on these analyses, the bank's performance of lending in the assessment area is considered satisfactory.

DESCRIPTION OF INSTITUTION

Farmers and Merchants State Bank is an independent bank located in Krum, Texas. The bank has a branch, established in 1997, in Denton, Texas. Krum is located five miles west of Denton. Both communities are located 40 miles north of Dallas, and are part of the Dallas Metropolitan Statistical Area (MSA). The ownership of the bank has not changed since the previous examination. The bank offers a full line of deposit and loan products. Banking hours are responsive to community needs and extended hours are provided through drive-in facilities on weekdays and Saturdays. Lobbies are open extended hours on Fridays.

The September 30, 1998, Consolidated Reports of Condition and Income show the bank's assets total \$54,495,000, with gross loans of \$38,057,000. The following tables display the bank's asset composition and loan mix as of September 30, 1998.

ASSET COMPOSITION		
Asset Type	Asset Volume (\$000)	Percent of Volume (%)
Net Loans	37,678	69
Securities/Investments	12,509	23
Cash and Due from Banks	2,903	05
Premises and Fixed Assets	547	01
Other Assets	858	02
TOTALS	\$54,495.00	100

LOAN MIX		
Loan Type	Loan Volume (\$000)	Percent of Volume (%)
Real Estate	16,424	43
Consumer	12,882	34
Commercial	7172	19
Agricultural	1,458	04
TOTALS	\$38,057.00	100

No legal, regulatory, or other impediments were noted. Farmers and Merchants State Bank's product offerings, financial condition, and lack of impediments enable the bank to serve the credit needs of the community. As part of their community participation, the bank continues to be involved in and make contributions to organizations that support victims of sexual assault and family violence as well as women's shelters.

DESCRIPTION OF DENTON COUNTY

The bank's assessment area is defined as forty-eight census tracts located in Denton County, which consists of small towns and rural areas. The largest community located in this area is Denton, with an estimated population in 1997 of 70,000. The 1997 estimated population of Krum is 1,700. The total population of the assessment area is 273,525, according to the 1990 Census. Population in this area has grown significantly since 1990.

There are no other lending institution's located in Krum; however, banks are located in communities around Krum, including Sanger, Justin, and Roanoke. Denton, where the branch is located, contains one large bank and numerous branches of other institutions. In 1995, Denton County's three largest industries as a percentage of total industries are service (64 percent), retail trade (21 percent), and manufacturing (14 percent). The unemployment rate for Denton County is significantly lower than three years ago.

Census Bureau data reflect that there are 5,432 private non-farm establishments (i.e. employers) in Denton County and approximately 95 percent of these establishments employ less than 50 people each. According to the 1990 Census, there are 58,574 housing units in the assessment area; 52 percent of these units are owner occupied, 39 percent are rental units, and 9 percent are vacant. The median home value in the assessment area is \$88,758.

The major employer in Krum is the school district, which employs approximately 200 people. According to the community contact, there are not many new businesses locating in Krum due to the shortage of available land in the downtown area. However, two new housing developments are under construction, which will provide 80 houses, priced in the \$95,000 to 105,000 range.

The community contact stated that the bank provided a needed service to the area when they formed the mortgage company, which allows borrowers to obtain mortgage loans locally at comparable rates. The mortgage company participates in loan programs, which offer mortgage loans under government programs that require smaller down payments such as Farmers Home Administration, Fannie Mae, Veterans Administration, and Farmer Mac.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

Sampling Information

By number of credits originated, Farmers and Merchants State Bank focuses on consumer loans, which represent a substantial majority of total loans granted. As noted, consumer credits constitute 34 percent of the dollar volume of total outstanding loans. The bank originated 1,245 consumer loans totaling \$10,290,178 in 1998. From those originated in 1998, a sample of 51 consumer loans totaling \$467,816 was drawn to assess the bank's current lending performance under *Lending in the Assessment Area*, *Lending to Borrowers of Different Incomes*, and *Geographic Distribution* criteria.

LENDING TO BORROWERS OF DIFFERENT INCOMES

The 1998 HUD estimated median family income for the Dallas MSA of \$54,400, was used for the borrower distribution analysis. The following table provides information on how each income level is defined.

INCOME LEVEL	PERCENT OF MEDIAN FAMILY INCOME	INCOME RANGE
Low	Less than 50%	Less than \$27,200
Moderate	50% to 80%	\$27,200 to less than \$43,520
Middle	80% to 120%	\$43,520 to less than \$65,280
Upper	120% and over	\$65,280 and over

The following table reflects the lending distribution of the consumer loan sample reviewed. In addition, the table includes the percentage of families in the assessment area, within each income level according to the 1990 Census data, which states the median family income as \$38,754. The analysis only includes the sampled loans originated within the assessment area.

CONSUMER LOANS					
INCOME LEVEL	PERCENT OF FAMILIES	NUMBER	PERCENT	DOLLAR AMOUNT	PERCENT
Low	12	21	54	154,954	48
Moderate	16	7	18	46,554	14
Middle	25	7	18	42,686	13
Upper	47	4	10	82,223	25
TOTALS	100	39	100	326,417	100

Generally, consumer loan data favors low- and moderate-income borrowers since the other income groups usually have access to a greater number of funding sources for this type of small dollar credit. Despite this tendency, however, the 72 percent of the number and 62 percent of the dollar volume of sampled credits granted to lower income borrowers, which only represent 28 percent of the area's total families, reflect the bank's strong record.

The bank participates in a loan program geared toward low- and moderate-income areas where individuals can finance home loans at 100 percent of the purchase price in specified census tracts identified by HUD as low-to-moderate income housing areas. The program, through the Bank of America, has been responsible for making five loans totaling \$350,000.

GEOGRAPHIC DISTRIBUTION OF LOANS

The consumer loan sample inside the assessment area was further analyzed to determine geographic dispersion by number and dollar volume. This dispersion is presented in the following table, and includes the percent of families living in the geographies according to the 1990 Census. Both the bank's main office and the branch in Denton are located in middle-income census tracts.

CONSUMER LOANS					
INCOME LEVEL	PERCENT OF FAMILIES	NUMBER	PERCENT	DOLLAR AMOUNT	PERCENT
Low	2	4	10	56,489	17
Moderate	6	2	5	10,125	4
Middle	45	28	72	174,149	53
Upper	47	5	13	85,654	26
TOTALS	100	39	100	326,417	100

The bank has achieved an excellent dispersion of loans and indicates above average performance regarding distribution of loans throughout the bank's assessment area including low- and moderate-income geographies.

LOAN-TO-DEPOSIT RATIO

The table on the following page compares the bank's average loan-to-deposit ratio for the last twelve quarters with that of banks of similar size and loan product structure. It also compares the loan-to-deposit ratio for the last quarter with that of similar banks. Comparable banks are located within the bank's assessment area and are listed alphabetically to avoid any appearance of preference.

DESCRIPTION	ASSET SIZE AS OF 09/30/98 (By 000's)	LOAN-TO- DEPOSIT RATIO AS OF 09/30/98	AVERAGE LOAN-TO- DEPOSIT RATIO FROM 03/31/96 THROUGH 09/30/98
Farmer & Merchants State Bank, Krum	54,495	76.16%	74.55%
Northwest Bank Roanoke	49,752	64.42%	62.39%
Sanger Bank Sanger	43,715	55.64%	63.13%
Texas National Bank Southlake	58,855	54.42%	51.89%

The bank's average loan-to-deposit ratio based on twelve quarters since the last evaluation is approximately 75 percent. This ratio exceeds that of banks with similar size, asset structure and loan products. The bank's loan-to-deposit ratio indicates an excellent responsiveness to area credit needs.

LENDING IN THE ASSESSMENT AREA

An analysis of 51 consumer loans revealed that 77 percent by number and 70 percent by dollar volume of the loans sampled were advanced to customers inside the assessment area. The bank performed an analysis of the total consumer loan portfolio as of January 26, 1999. This analysis revealed that there are 2,197 loans totaling \$26,626,92075 in the bank's consumer loan portfolio, and that 75 percent by number and 75 percent by dollar volume of these consumer loans were made to consumers inside the bank's assessment area. Based on these analyses, the bank's performance of lending in the assessment area is considered satisfactory.

INVESTMENT AND SERVICES

The bank's investments and services were reviewed to determine applicability to CRA. The institution cashes any government checks without charge to customers and non-customers. In addition, many consumer loans are made for under \$1,000 for low- and moderate-income individuals to allow them to pay bills and buy groceries until the next payday. These loans are made at rates similar to those rates charged on higher dollar loans.

Other services provided include a \$50,000 grant applied for by the bank from the Federal Home Loan Bank. The funds will be used by borrowers who make less than 80 percent of median family income and have their home located in the Krum, Sanger, or Ponder areas. The program will allow borrowers to obtain up to \$2,000 grant money to pay a portion of their closing costs or down payments.

Qualified investments include donations to organizations that serve low- and moderate-income individuals. Examples of these organizations include the following:

- Habitat for Humanity (which builds homes for low-income individuals) and
- SPAN (an organization that delivers meals to low- and moderate-income elderly).

RESPONSE TO COMPLAINTS

The bank has not received any CRA-related complaints since the last examination.

COMPLIANCE WITH ANTI-DISCRIMINATION LAWS AND REGULATIONS

No violations of the substantive provisions of the anti-discriminatory laws and regulations were identified during the examination.

GLOSSARY

BLOCK GROUP AREA - the smallest area defined by the Census Bureau for which it collects data. A block group is a subgroup of census tracts or block numbering areas.

BLOCK NUMBERING AREA - an area defined by the Census Bureau with State assistance, similar to a census tract. Usually located in rural areas.

CENSUS TRACT - a small locally demarcated area, usually in a metropolitan neighborhood, defined by the decennial census to generally consist of stable boundaries and an average population of 4,000. Boundaries for census tracts do not cross county or state lines.

HMDA - Home Mortgage Disclosure Act (see HMDA-LAR)

HMDA-LAR - Home Mortgage Disclosure Act-Loan Application Register. The Home Mortgage Disclosure Act requires institutions located or operating in MSAs to record certain information for applications received for the purpose of purchasing, improving, or refinancing a dwelling, except for unsecured home improvement loans, which need not be reported.

LOW-INCOME –

- o for a census tract - this refers to income levels less than 50% of the MFI for the MSA in which the tract is located.
- o for a block numbering area - this income range is less than 50% of the MFI for all non-MSA areas in the state in which the block numbering area is located.
- o for individuals - this refers to income levels less than 50% of the most recent year's estimation of the MFI by the Department of Housing and Urban Development (HUD).

MFI - median family income as determined by either the Census Bureau or adjusted by HUD.

MIDDLE-INCOME - determined using the same methodology as for low-income. The percentage used for middle-income designation is 80% - 119%.

MODERATE-INCOME - determined using the same methodology as for low-income. The percentage used for moderate-income designation is 50%-79%.

MSA - metropolitan statistical area as determined by the Census Bureau. Usually consists of contiguous census tracts and block numbering areas comprising one or more counties including a large population nucleus and nearby communities that have a high degree of interaction and which usually have a combined population of greater than 50,000.

UPPER-INCOME - determined using the same methodology as for low-income. The percentage used for upper-income designation is greater than or equal to 120%.