

PUBLIC DISCLOSURE

June 17, 2003

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**First State Bank
Certificate Number: 25340**

**115 Neosho Avenue
P.O. Box 8
Thayer, Kansas 66776-0008**

**Federal Deposit Insurance Corporation
2345 Grand Boulevard, Suite 1500
Kansas City, Missouri 64108**

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 **First State Bank, Thayer, Kansas**, prepared by the **Federal Deposit Insurance Corporation**, the institution's supervisory agency, as of **June 17, 2003**. 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 Satisfactory.

First State Bank has established a satisfactory record of meeting the credit needs of its designated assessment area. A Satisfactory rating is supported by the following:

- ❑ The bank has maintained an average net loan-to-deposit ratio of 49 percent since the previous evaluation (February 1, 1999), which reasonably compares to similarly situated lenders and is reflective of the bank's willingness to make loans.
- ❑ A sample of residential real estate and agricultural loans extended in 2001 and 2002 revealed that the bank is willing to meet the credit needs of local borrowers, as a majority of the bank's loans have been extended within the assessment area.
- ❑ The sample of loans also revealed that the bank has established an adequate record of lending to borrowers of different incomes and farms of different sizes.
- ❑ Finally, the sample revealed that the geographic distribution of the bank's loans is reasonable given the bank's assessment area is comprised solely of middle-income Block Numbering Areas (BNAs).
- ❑ The bank has not received any written CRA-related complaints since the previous evaluation.

DESCRIPTION OF INSTITUTION

First State Bank operates from one location in the small rural community of Thayer, Kansas (population 500). First State Bank is one of six area banks owned by multi-bank holding company Southeast Bancshares, Inc. As reported in the March 31, 2003 Report of Condition, bank assets total \$10,262,000; gross loans total \$4,135,000; and deposits total \$9,492,000.

The bank's primary lending focus is to provide funding for local farmers, including operating credit and real estate loans. The bank also periodically participates in loan funding with its affiliate banks. This activity has, in large part, contributed to the bank's high concentration in residential real estate loans. Residential real estate loans (Table 1 – Row 1) comprise the bank's largest loan category, at 38 percent of total loans. Agricultural purpose loans (Rows 2 and 4) comprise the bank's second largest loan category, at 28 percent of total loans. Refer to Table 1 for the total composition of the bank's loan portfolio as of March 31, 2003

Table 1

DISTRIBUTION OF BANK'S LOANS AS OF MARCH 31, 2003		
Loan Type	Dollar Volume	Percent* of Total Loans
1) Loans Secured by 1-4 Family Residential Properties – Includes Revolving , Open-End Loans; First Lien and Junior Lien Loans	\$1,578,000	38%
2) Loans to Finance Agricultural Production and Other Loans to Farmers	\$701,000	17%
3) Loans to Individuals for Household, Family, and Other Personal Expenditures – Includes Revolving Credit Plans, Single Payment and Installment Loans	\$689,000	17%
4) Loans Secured by Farmland	\$456,000	11%
5) Commercial and Industrial Loans	\$411,000	10%
6) Construction and Land Development, and Other Land Loans	\$179,000	4%
7) Lease Financing Receivables	\$65,000	2%
8) Loans Secured by Nonfarm Nonresidential Properties	\$56,000	1%
GROSS LOANS	\$4,135,000	100%

**Rounded*

Source: March 31, 2003 Report of Condition

No apparent legal, financial, or other impediments were identified that would inhibit the bank's ability to meet the reasonable and customary credit needs of the area it serves.

DESCRIPTION OF ASSESSMENT AREA

The Community Reinvestment Act (CRA) requires financial institutions to identify one or more “assessment areas” within which the appropriate regulatory agency will evaluate CRA performance. Typically, an institution’s assessment area (AA) will include the towns, cities, counties, or other political subdivisions in which the bank’s facilities are located and where a significant portion of the bank’s loans are originated. Assessment areas consist of one or more block numbering areas or census tracts, which are statistical subdivisions of a county. Block Numbering Areas (BNAs) are generally used in rural areas.

First State Bank has designated one BNA in Wilson County (BNA 9971) and four BNAs in Neosho County (BNAs 9517, 9518, 9519, and 9520) as its assessment area. The bank is located in BNA 9520. All of the BNAs are considered middle-income geographies. The income level of BNAs in Kansas is determined by comparing the median family income of a BNA to the 1990 Kansas Non-metropolitan Median Family Income of \$28,067. The following table illustrates how, based on this figure, the income levels are determined.

Table 2

DETERMINATION OF BLOCK NUMBERING AREA INCOME LEVEL	
Income Category	Percent of Kansas Non-Metro Median Family Income
Low	Less than 50% of median family income
Moderate	50% to less than 80% of median family income
Middle	80% to less than 120% of median family income
Upper	Equal to or greater than 120% of median family income

The largest community in the assessment area is Chanute (population 9,411), which encompasses three of the five BNAs in the assessment area. Other communities in the assessment area include Altoona, Benedict, Buffalo, and Galesburg. The economy of the area is largely dependent upon livestock and grain production. According to an area businessperson interviewed during the evaluation, the agricultural economy, which has suffered a great deal in recent years, is improving with gains in cattle and grain prices. Unemployment rates in the area are also down from two-year highs in the first quarter of 2001. According to Bureau of Labor Statistics Reports, the unemployment rate in Neosho County for the first quarter of 2003 was 4.1 percent. The unemployment rate in the first quarter of 2001 was 7.3 percent. In Wilson County, the unemployment rate in the first quarter of 2001 was 5.9 percent and the rate for the first quarter of 2003 was 4 percent. The unemployment rate for the State of Kansas reported for the first quarter of 2003 was 5.1 percent. The largest employers in the assessment area include Chanute Manufacturing (236 employees), NU-WA Industries Inc. (200 employees), and Kustom Signals Inc. (164 employees).

As of the 2000 Census, owner-occupied housing units accounted for 75 percent of total housing units in Neosho County and 78 percent of total housing units in Wilson County. According to the interviewee, there are no specific needs for additional housing in the area. Vacant units account for 10 percent of total housing units in Neosho County and 15 percent of total housing units in Wilson County.

The interviewee stated that the primary credit needs of the area are loans for agricultural purposes, and those needs are met by local banks. In addition to First State Bank, five financial institutions (including banks, savings associations, and credit unions, but excluding mortgage companies) operate within the assessment area.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

Performance Criteria

First State Bank, under CRA, is considered a “small bank.” A small bank is a bank that, as of December 31st of either of the prior two calendar years, had total assets of less than \$250 million and was independent or an affiliate of a holding company that, as of December 31st of either of the prior two calendar years, had total banking and thrift assets of less than \$1 billion. The FDIC evaluates the CRA performance of a small bank pursuant to the following criteria:

- (1) The bank's loan-to-deposit ratio, adjusted for seasonal variation and, as appropriate, other lending-related activities, such as loan originations for sale to the secondary markets, community development loans, or qualified investments;
- (2) The percentage of loans and, as appropriate, other lending-related activities located in the bank's assessment area(s);
- (3) The bank's record of lending to and, as appropriate, engaging in other lending-related activities for borrowers of different income levels and businesses and farms of different sizes;
- (4) The geographic distribution of the bank's loans; and
- (5) The bank's record of taking action, if warranted, in response to written complaints about its performance in helping to meet the credit needs in its assessment area(s).

Loan-to-Deposit Ratio

The bank's average net loan-to-deposit ratio, which is one measure used to determine if the bank is committed to lending, is adequate considering the bank's business focus, the size and financial condition of the bank, area demographics, and the performance of similarly situated lenders¹. Since the previous evaluation, First State Bank has maintained an average net loan-to-deposit ratio of 49 percent, which reasonably compares to the average net loan-to-deposit ratio of similarly situated lenders.

¹Similarly situated lenders are banks located in and near the subject bank's assessment area that are similar in size and loan portfolio composition.

Table 3 depicts total assets and net loan-to-deposit ratios for First State Bank and the similarly situated lenders, listed alphabetically by the community in which they are located. First State Bank’s average net loan-to-deposit ratio is the lowest ratio in comparison to the similarly situated lenders. However, the average ratio is down only two points from the previous evaluation. In addition, First State Bank is located in the smallest community among those listed, which impedes the bank’s ability to attract new customers. According to management, the bank focuses primarily upon the borrowing needs of local farmers and residents, many of whom have banked with First State Bank for many years. Furthermore, the local businessperson contacted during the evaluation, who works with area farmers on a day-to-day basis, stated that the First State Bank and other financial institutions in the assessment area are adequately meeting the credit needs and other banking service needs of the community. In conclusion, while the bank’s average net loan-to-deposit ratio is the lowest among similarly situated lenders, it is considered adequate given the focus of the institution, limitations described, and the interviewee’s comments regarding community credit needs.

Table 3

NET LOAN-TO-DEPOSIT RATIO COMPARISON			
Institution	Assets (000’s) 03/31/03	Current L/D Ratio* 03/31/03	Average L/D Ratio* 03/31/03
Home State Bank Erie, KS	\$20,643	45%	56%
First National Bank in Fredonia Fredonia, KS	\$70,972	48%	58%
The State Bank of Kansas Fredonia, KS	\$85,026	81%	90%
First Neodesha Bank Neodesha, KS	\$48,995	84%	81%
The Exchange State Bank of St. Paul St. Paul, Kansas	\$53,069	63%	68%
First State Bank Thayer, KS	\$10,262	43%	49%
Home State Bank, Erie, Kansas and First Neodesha Bank, Neodesha, Kansas are affiliates of the subject bank, First State Bank. *The average ratio was determined by obtaining net loan-to-deposit ratios from Reports of Condition for the 17 quarters since the previous evaluation.			

Sampling Procedures

The bank’s two largest loan categories (residential real estate and agricultural) were sampled to assess the bank’s CRA performance. The loan samples, selected from loans originated in 2001 and 2002 that remain outstanding, were reviewed to determine: (1) the percentage of the bank’s loans extended within the assessment area, (2) the distribution of loans among farms of different sizes and among residential borrower income levels, and (3) the geographic distribution of loans. The residential real estate loan sample consisted of 19 loans totaling \$514,874 selected from a universe of 28 loans totaling \$767,422. The agricultural loan sample included 16 loans totaling \$272,094 selected from a universe of 22 loans totaling \$332,116. In general, a bank’s CRA performance can best be evaluated by sampling three loan categories.

However, a third loan sample was not selected to analyze First State Bank's performance because it was believed that the two largest loan categories best represented the bank's lending patterns. The bank's third largest loan category is consumer loans (Row 3 in Table 1), and consumer loans are generally not included in the assessment of a bank's CRA performance. Finally, the universe of outstanding commercial loans originated in 2001 and 2002 consisted of only nine loans, which was determined to be too few to produce any meaningful conclusions.

Assessment Area Concentration

A majority of the bank's residential real estate and agricultural loans have been extended within the assessment area, which reflects the bank's willingness to meet the credit needs of local borrowers. Fifteen of the nineteen residential real estate loans sampled (79 percent) were extended within the assessment area. Seventy-three percent of the dollar volume sampled (\$375,598/\$514,874) was extended within the assessment area. The sample of agricultural loans revealed a higher penetration within the assessment area as 81 percent of the number (13/16) and 98 percent of the dollar volume (\$266,410/\$272,094) sampled was extended within the assessment area. Overall, the bank is adequately lending within its designated assessment area.

Lending to Farms of Different Sizes

An analysis of the bank's agricultural loans extended within the assessment area was conducted to determine whether or not the bank is sufficiently lending to farms in different revenue categories. This analysis revealed that the bank has established an adequate record of lending to farms of different sizes. Revenues for the bank's agricultural borrowers were obtained from Tax Returns and Financial Statements in borrower loan files and confirmed by management. The revenues were then compared to data obtained from 1997 Agricultural Census Reports for farms in Neosho and Wilson counties. As illustrated in Table 4 on the following page, 48 percent of the farms in both counties reported less than \$10,000 in gross annual revenue, and only 31 percent of the agricultural loans extended within the assessment area were to farms with less than \$10,000 in gross annual revenue. It is important to note, however, that approximately 71 percent of the farms reporting less than \$10,000 in gross revenues were farms that did not pay interest on loans (i.e., did not borrow). In general, farming is not the principal occupation of these operators. Therefore, while the bank's lending to smaller farms (farms with less than \$10,000 in gross revenue) does not compare well to the data, overall performance under this criterion is considered adequate.

Table 4

GROSS ANNUAL REVENUE DISTRIBUTION – FARM LOANS						
Revenue (000's)	Number of Loans and Percentage* of Total		Dollar Volume And Percentage* of Total		**Number of Farms in Wilson and Neosho Counties and Percentage* of Total	
<\$10	4	31%	\$35,185	13%	603	48%
\$10 to <\$50	3	23%	\$22,820	9%	343	27%
\$50 to <\$100	2	15%	\$21,820	8%	129	10%
\$100 to <\$250	4	31%	\$186,585	70%	125	10%
≥\$250	0	0%	\$0	0%	63	5%
TOTAL	13	100%	\$266,410	100%	1,263	100%

*Rounded

**Source: 1997 Kansas Agricultural Census

Lending to Borrowers of Different Incomes

The residential loans extended to borrowers within the assessment area were reviewed in an effort to assess the bank’s lending penetration among borrowers of different income levels. Particular emphasis in this criterion is given to a bank’s penetration among low- and moderate-income borrowers. To determine the income level of a borrower (low, moderate, middle, or upper), the borrower’s income, obtained from applications in borrower loan files and confirmed by management, was compared to the HUD-estimated median family income for non-metropolitan areas of the state of Kansas. The 2001 and 2002 estimated median family income for Kansas non-metropolitan areas is \$43,200 and \$44,200, respectively. The designation of low-, moderate-, middle-, or upper-income is determined as illustrated in Table 5.

Table 5

DETERMINATION OF BORROWER INCOME LEVEL	
Borrower Income Level	Percentage of Kansas Non-metropolitan Median Family Income
Low	Less than 50% of median family income
Moderate	50% to less than 80% of median family income
Middle	80% to less than 120% of median family income
Upper	Equal to or greater than 120% of median family income

This review revealed that the bank has established a reasonable penetration of loans among both low- and moderate-income borrowers. As shown in Table 6, 13 percent of the number of residential loans extended within the assessment area were to low-income borrowers, which compares reasonably to 1990 Census Data revealing that 20 percent of the families in the assessment area are low-income families. In addition, 27 percent of the bank’s loans, by number, were extended to moderate-income borrowers, which compares favorably to the Census Data. Only 20 percent of the families in the assessment area are moderate-income families. The remaining loans are reasonably dispersed among the middle- and upper-income categories. The bank has, overall, established an adequate record of lending to borrowers of different incomes.

Table 6

BORROWER INCOME LEVEL DISTRIBUTION – RESIDENTIAL REAL ESTATE LOANS						
Income Level	Number of Loans and Percentage* of Total		Dollar Volume of Loans and Percentage* of Total		**Number of Families in the AA and Percentage* of Total	
Low	2	13%	\$28,087	7%	881	20%
Moderate	4	27%	\$55,615	15%	876	20%
Middle	5	33%	\$216,474	58%	1,109	26%
Upper	4	27%	\$75,422	20%	1,444	34%
TOTAL	15	100%	\$375,598	100%	4,310	100%

**Rounded*
***Source: 1990 U.S. Census*

Geographic Distribution of Loans

The geographic distribution of the bank’s loans is adequate given the bank’s business focus, the location of the office, competition provided by area lenders, and assessment area demographics. The bank’s performance under this criterion receives less consideration than other criteria because the bank’s assessment area does not include low- or moderate-income BNAs. In general, particular emphasis under this criterion is given to a bank’s volume of lending in low- or moderate-income areas. All 13 of the agricultural loans extended within the assessment area were to operations in BNA 9520, the BNA in which the bank is located. In addition, 14 of the 15 residential real estate loans extended within the assessment area were to borrowers in this BNA. The remaining loan was extended in BNA 9518. Overall, the geographic distribution of loans is reasonable.

Response to CRA-related Complaints

Since the previous evaluation, the bank has not received any CRA-related complaints.

Compliance with Anti-discrimination Laws and Regulations

No violations of the substantive provisions of the anti-discrimination laws and regulations were identified during the evaluation.