

PUBLIC DISCLOSURE

September 04, 2007

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**First State Bank
FDIC Certificate Number: 58217**

**123 Center Avenue
Holbrook, Nebraska 68948**

**Federal Deposit Insurance Corporation
2345 Grand Boulevard, Suite 1200
Kansas City, MO 64108**

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.

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INSTITUTION'S CRA RATING: This institution is rated Satisfactory.

The bank's CRA performance, as supported by the following findings, depicts a satisfactory record of meeting the credit needs of its designated assessment area.

- The bank's average net loan-to-deposit ratio of 93 percent over the past seven quarters reflects a more than reasonable willingness to extend credit given the assessment area credit needs and competition within the assessment area.
- A majority of the number of loans extended by the bank are in the bank's assessment area.
- An analysis of agricultural loans and commercial loans in the assessment area revealed an adequate distribution of loans among farms and businesses of different sizes.
- The bank has not received any CRA-related complaints since the bank was opened on December 6, 2005.

SCOPE OF EVALUATION

This evaluation includes a review of the bank's CRA performance since the bank was opened on December 6, 2005. Conclusions with respect to the following three performance criteria under the lending test, *Lending inside the Assessment Area*, *Lending to Farms of Different Sizes*, and *Geographic Distribution of Loans*, are based on a review of the institution's small business and small farm loans. Residential real estate loans were not reviewed as they represented only 9 percent of the loan portfolio. The time period reviewed for small business and small farm loans was from December 6, 2005, to August 3, 2007, which is the cutoff date on the data download received from the bank. Information on paid off loans was unavailable. The small farm loan sample included 23 loans totaling \$2,097,423 out of a total universe of 46 loans totaling \$3,617,992. The small business loan universe included 17 loans totaling \$5,558,523. Due to the limited number of commercial loans originated and the small number located in the assessment area, examiners sampled all 17 small business loans. Small business loans are being reviewed at this evaluation since they represent 43 percent of the loan portfolio by dollar volume. However, management and the community contacts stated that agricultural credit is the primary type of credit need in the local area; therefore, more emphasis was placed on the small farm loans at this evaluation. Most of the small business loans held by the bank are participation loans purchased from affiliated banks.

DESCRIPTION OF INSTITUTION

First State Bank, Holbrook, Nebraska, has one full-service location in Holbrook, Nebraska. The bank is owned by Nebraska Bankshares, Inc., Farnam, Nebraska, a two-bank holding company. First State Bank is affiliated with Farnam Bank, Farnam, Nebraska. The bank's financial condition allows it to serve the needs of the local area. No legal impediments exist which would inhibit the bank's willingness and ability to meet community credit needs. This is the first CRA evaluation of this bank that was opened on December 6, 2005.

The bank is located in southwestern Nebraska. As of June 30, 2007, the bank had total assets of \$25,762,000, net loans of \$12,450,000, and total deposits of \$12,214,000. According to management, the bank's primary business focus is agricultural lending. The community contacts also noted that agricultural lending is the primary type of credit needed in the local area. As of June 30, 2007, 43 percent of the loan portfolio was invested in commercial purpose loans and 36 percent were invested in agricultural purposes. The majority of the commercial loans are participations the bank purchased from affiliated banks. Management stated that there is little demand for commercial loans in the Holbrook, Nebraska, area. The table on the next page provides detail on the composition of the bank's loan portfolio.

Loan Portfolio Distribution		
Loan Category	Dollar Amount (000s)	Percent of Total Loans
Construction and Land Development	\$440	3%
Secured by Farmland	\$1,097	9%
1-4 Family Residential	\$1,169	9%
Secured by Non-farm nonresidential properties	\$1,345	11%
Agricultural Production Loans	\$3,453	27%
Commercial and Industrial Loans	\$3,985	32%
Other Consumer Loans	\$1,090	9%
Other Loans	\$6	0%
Total Loans and Leases	\$12,585	100%

DESCRIPTION OF ASSESSMENT AREA

The Community Reinvestment Act (CRA) requires financial institutions to identify one or more “assessment area(s)” within which the appropriate regulatory agency will evaluate the bank’s CRA performance. Typically, an institution’s assessment area will include the towns, cities, counties, or other political subdivisions in which its offices are located and a substantial portion of its loans are made. Assessment areas must consist of one or more census tracts (CTs), which are statistical subdivisions of a county.

The income level of the CT is based on median family income information from the 2000 Census. Therefore, in order to determine the income category for each geography located in the bank’s assessment area, examiners compared the 2000 Census Bureau State of Nebraska non-metropolitan median family income of \$41,596 to the median family income for each CT.

<i>Low-income</i>	<i>Income of less than 50 percent of the area median family income (MFI)</i>
<i>Moderate-income</i>	<i>Income of at least 50 percent and less than 80 percent of the area MFI</i>
<i>Middle-income</i>	<i>Income of at least 80 percent and less than 120 percent of the area MFI</i>
<i>Upper-income</i>	<i>Income of at least 120 percent or more of the area MFI</i>

Assessment Area Discussion:

The bank's assessment area (AA) includes all of Frontier, Furnas, Gosper, and Red Willow Counties in Nebraska. The assessment area consists of 7 middle-income CTs. The two CTs in Furnas County and the one CT that consists of Frontier County are underserved middle-income¹ CTs due to the remote and rural population. All three CTs in Red Willow County are designated as underserved and distressed² middle-income CTs due to the remote rural location and loss of population. The banking office is located in CT 9637 in Furnas County. According to 2000 Census data, the AA has 6,198 families, of which 17 percent are low-income, 21 percent are moderate-income, 29 percent are middle-income, and 33 percent are upper-income. 2000 Census data also showed that 7 percent of families live below the poverty level³.

Population:

According to 2000 census data, the population in the AA was 22,014. Management and the community contacts indicated that the population in the Holbrook, Nebraska, area is steady to slightly declining. The community contacts felt that the population in Holbrook is an elderly population; however, recently younger families have been moving into the community when housing does become available. Holbrook has a limited supply of housing available for sale and no rentals available in the community. The 2000 Census data shows 20 percent of the population in the AA to be above age 65. The Department of Housing and Urban Development's estimated median family income for the non-metropolitan areas of the State of Nebraska for 2007 is \$50,400.

¹ "Underserved nonmetropolitan middle-income geographies" must meet criteria for population size, density, and dispersion that indicate that an area's population is sufficiently small, thin, and distant from a population center such that the geography is likely to have difficulty in financing the fixed costs of essential community needs. The agencies will use as the basis for these designations the "urban influence codes" numbered 7, 10, 11, and 12 that are maintained by the Economic Research Service of the United States Department of Agriculture.

² "Distressed nonmetropolitan middle-income" geographies are those located in counties that meet one or more triggers that generally reflect the "distress criteria" used by the Community Development Financial Institutions (CDFI) Fund. The distress triggers are: (1) an unemployment rate of at least 1.5 times the national average; (2) a poverty rate of 20 percent or more; (3) a population loss of 10 percent or more between the previous and most recent decennial census, or a net migration loss of 5 percent or more over the five-year period preceding the most recent census. The agencies will utilize annual information where possible.

³ Poverty level is an established dollar threshold rather than a percentage based calculation of the median family income. Specifically, for a family of four, the 2007 poverty level threshold was \$20,650; therefore, a family earning less than \$20,650 is considered to be below the poverty level. This figure is determined on a national level and is not adjusted regionally.

Economic Conditions:

Management and the community contacts felt that the AA's overall agricultural economy is good with higher crop prices and stable cattle prices. The above average rainfall this year also helped area farmers reduce the irrigation expense; however, this did have an unfavorable decline in sales for some area businesses that sell fuel to area farmers. One of the biggest economic concerns management noted in the southwestern part of Nebraska is water restrictions for area farmers in the Republican River Valley. Management has concerns over the future and what affect the water restrictions may have on area farmers. However, management and the community contact both felt that the business economy in the local area was doing pretty well with some exceptions. According to the Bureau of Labor Statistics, the unemployment rate for Furnas County was less than 3 percent in 2006; however, this rate spiked in the first quarter of 2007 to almost 4 percent. Major employers in the AA include: Cambridge hospital, Anderson Livestock, Nebraska Pork Partners, local schools, and county governments. The area will also be getting a new ethanol plant in Cambridge, Nebraska, and a soy bio-diesel plant in Arapahoe, Nebraska. In addition, area residents commute to Holdrege, Nebraska, to work at Becton Dickinson.

The 2002 Agricultural Census indicates that 34 percent of the farmers in the AA did not report any interest expense (i.e. non-borrowing farmers). Many of the local operators appear to be "hobby farmers". According to the 2002 Agricultural Census, 20 percent of the farmers in the AA indicated that farming is not their principal occupation. In addition, 24 percent of all farmers in the AA reported gross farm revenues of less than \$10,000 per year. These small farms typically have limited or no borrowing needs.

Housing:

Housing data from the 2000 Census shows that the AA has 10,832 housing units, with 23 percent of the units being rental-occupied and 16 percent vacant. The median age of homes in the AA is 50 years, the median housing value is \$54,379, and the median gross rent is \$372. The housing data indicates that the AA's housing is older and lower priced than the median for the State of Nebraska.

Other Financial Institutions:

There are numerous other financial institutions operating in the AA. Management indicated its major competitors are First National Bank and First Central Bank both in Cambridge, Nebraska, and First State Bank, Beaver City, Nebraska. There are ten different banks headquartered in the AA and five other banks have branches located inside the AA. Communities in the AA which have banks headquartered there include Bartley, Beaver City, Cambridge (2), Curtis, Holbrook, Maywood, and McCook (3). Communities in the AA that have branch banks include: Cambridge, Elwood, Eustis, Indianola, and McCook.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

Loan-To-Deposit Ratio Analysis

Examiners reviewed the bank's average quarterly net loan-to-deposit (LTD) ratio in order to evaluate the bank's performance for this criterion. A bank's net LTD ratio is calculated by dividing the institution's net loans and leases by its total deposits. The bank's net LTD ratio is then averaged for all quarter-ends since the last evaluation. Each institution's ratio is evaluated and analyzed using performance context, including the bank's capacity to lend, demographic and economic factors present in the assessment area, and the lending opportunities available in the bank's assessment area. Detailed below is an analysis of this performance criterion for the bank.

The bank's average net loan-to-deposit ratio reflects a more than reasonable willingness to provide credit given the bank's size, financial condition, community credit needs, and area competition. The bank has maintained a seven quarter average net loan-to-deposit ratio of 93 percent. The bank's ratio is tied for the highest when compared to six similarly situated lenders. Similarly situated lenders were selected based on similar size, product offerings, and proximity to subject bank's AA. The bank's net loan-to-deposit ratio as of June 30, 2007, was 102 percent. The ratio has ranged from a low of 88 percent on March 31, 2007, to a high of 102 percent on June 30, 2007.

Bank	City, State*	Total Assets (000s)	Avg. net LTD Ratio 7 Qtrs.	Net LTD Ratio 6/30/07
The State Bank of Bartley	Bartley, NE	\$29,595	93%	75%
First State Bank	Beaver City, NE	\$41,012	90%	91%
First Central Bank	Cambridge, NE	\$65,795	83%	83%
The First National Bank of Cambridge	Cambridge, NE	\$36,524	69%	70%
Curtis State Bank	Curtis, NE	\$25,982	85%	77%
First State Bank	Holbrook, NE	\$25,762	93%	102%
First Central Bank McCook	McCook, NE	\$50,260	93%	96%

* Banks are listed in alphabetical order by city.

Lending Inside the Assessment Area

Examiners reviewed the bank’s assessment area lending concentration in order to evaluate its performance under this CRA criterion. Examiners typically sample loans and complete a comparative analysis that details loans extended inside and outside of the bank’s assessment area. Detailed below is an analysis of this performance criterion.

A majority of the number of loans sampled were located in the bank’s AA. The agricultural loan sample revealed that all of the loans sampled were in the AA. The small business loan sample had a very small number and dollar volume located in the AA. However, when combining the small business loans and the small farm sample, a majority of the number of loans is located in the AA. More emphasis was placed on the small farm loans since management and the community contacts both stated that farm loans are the primary type of credit needed in the local area. The majority of the small business loans the bank has are participations purchased from affiliated banks located outside of the bank’s AA. The following table includes the bank’s lending in the AA.

Loan Type	Dollar amount (000s)		% of Dollar Amount		Number of Loans		% of Number of Loans	
	In	Out	In	Out	In	Out	In	Out
Small Business Loans	\$500	\$5,058	9%	91%	5	12	29%	71%
Small Farm Loans	\$2,097	\$0	100%	0%	23	0	100%	0%
Total Loans	\$2,597	\$5,058	34%	66%	28	12	70%	30%

Lending To Farms of Different Sizes

For this criterion, examiners determine the distribution of loans that the bank originated inside its assessment area by farm size using gross annual revenues.

The sample of agricultural loans made in the AA shows an adequate distribution among small farms. The agricultural loan sample revealed that 65 percent of the number (15 of 23) of loans the bank originated inside the AA was extended to farms with less than \$250,000 in gross revenue. The 2002 Agricultural Census data revealed that 83 percent of the number of farms in the AA reported gross farm revenues of less than \$250,000, while the D&B data for year 2006 indicated that 86 percent of the farms had revenues under \$250,000. The 2002 Agricultural Census information also revealed that the average sales per farm in the AA were \$216,043.

As previously mentioned, the 2002 Agricultural Census indicates that 34 percent of the farmers in the AA did not report any interest expense (i.e. non-borrowing farmers). Many of the local

operators appear to be “hobby farmers”. According to the 2002 Agricultural Census, 20 percent of the farmers in the AA indicated that farming is not their principal occupation. In addition, 24 percent of all farmers in the AA reported gross farm revenues of less than \$10,000 per year. These small farms typically have limited or no borrowing needs.

The bank’s lending to different size farms in the AA lags the 2002 Agricultural Census and 2006 D&B data for lending to farms under \$250,000. However, when considering the hobby farmers and farms that have no borrowing needs, the bank’s lending to small farms appears reasonable.

Lending to Businesses of Different Sizes

For this criterion, examiners determine the distribution of loans that the bank originated inside its assessment area by business size using gross annual revenues.

Only 5 of the bank’s 17 small business loans were originated to businesses located inside the AA. Examiners analyzed these five small business loans to determine the bank’s lending to businesses of different sizes. Analysis of the five loans identified that the loans were made to four different businesses. The business with two loans had gross revenues of over \$1,000,000 and the other three businesses had gross revenues under \$250,000. 2006 D&B data for the assessment area indicated that 6 percent of the businesses in the AA had gross revenues over \$1,000,000. Overall, lending to businesses of different sizes is reasonable. This evaluation factor was given very little consideration in the overall rating due to the limited number of small business loans originated in the AA.

Geographic Distribution of Loans

Examiners analyze the bank’s performance under this criterion to determine if the bank is lending throughout its assessment area including the low- and moderate-income areas or geographies within the assessment area. The composition of the bank’s assessment area by CT income level is important to this evaluation process because it is compared to where the bank originated its sampled loans by CT. Detailed below is an analysis of this performance criterion for the bank.

The bank’s geographic distribution of loans is reasonable. Examiners did not give this criterion much consideration in the overall rating since the entire AA consists of middle-income CTs. Overall, the bank’s geographic distribution of loans is reasonable.

CRA Complaints

The bank has not received any CRA complaints since the previous evaluation.

FAIR LENDING OR OTHER ILLEGAL CREDIT PRACTICES REVIEW

No evidence of discriminatory or other illegal credit practices inconsistent with helping to meet community credit needs was identified.