



PUBLIC DISCLOSURE

MARCH 27, 2017

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**FIRST NEODESHA BANK
RSSD# 172158**

**524 MAIN STREET
NEODESHA, KANSAS 66757**

**Federal Reserve Bank of Kansas City
1 Memorial Drive
Kansas City, Missouri 64198**

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 COMMUNITY REINVESTMENT ACT RATING: *This institution is rated Satisfactory.*

First Neodesha Bank, Neodesha, Kansas (the bank), has a satisfactory record of meeting the credit needs of its assessment area (AA) pursuant to the Community Reinvestment Act (CRA), in a manner consistent with its resources and operating philosophy.

The bank's average net loan-to-deposit (NLTD) ratio is more than reasonable considering the characteristics of the bank, performance of local competitors, and the economic conditions and credit needs of the communities it serves. A substantial majority of the loans reviewed for this evaluation were originated inside the bank's AA. The bank's lending reflects an overall reasonable dispersion of loans throughout its AA, to borrowers of different income levels, and to farms of different revenue sizes.

SCOPE OF EXAMINATION

The bank's CRA performance was evaluated using the Federal Financial Institutions Examination Council's (FFIEC's) *Interagency Examination Procedures for Small Institutions*. The examination included an evaluation of the bank's lending performance with consideration given to the demographic profile of the area in which the bank operates. Four of the five criteria used to evaluate a small bank's lending performance under the CRA were relevant to this review and are as follows:

- NLTD Ratio
- Lending Inside the AA
- Distribution of Loans Among Geographies of Different Income Level
- Lending to Borrowers of Different Income Levels and to Farms of Different Revenue Sizes

The bank's responsiveness to complaints under the CRA, the fifth criterion, was not evaluated as the bank has not received any CRA-related complaints since the previous evaluation.

Conclusions regarding the four performance criteria were based on data compiled from the bank's major product lines: agricultural and residential real estate loans. The major product lines were determined through discussions with bank management, a review of the bank's September 30, 2016 Reports of Condition and Income, and a review of the number of outstanding loan originations since the bank's prior CRA examination. In addition, conclusions regarding the bank's performance were based on a 16-quarter average of its NLTD ratio. The examination included a statistically derived sample of 79 small farm loans from a universe of 129 loans originated between April 1, 2016 and September 30, 2016, and 51 residential real estate loans from a universe of 69 loans originated between October 1, 2015 and September 30, 2016.

For evaluative purposes, the bank's lending performance was compared with area

demographic data, including the U.S. Census 2006-2010 five-year estimated American Community Survey (2010 ACS) data, 2016 FFIEC's Census data, and 2016 Dun & Bradstreet (D&B) farm data. To augment the evaluation, interviews were conducted with members of the local community involved with city government to help ascertain the specific credit needs, opportunities, and local market conditions of the AA and to evaluate the responsiveness of area banks in helping to meet such needs.

DESCRIPTION OF INSTITUTION

The bank is a \$93.5 million (MM) institution headquartered in Neodesha, Kansas, approximately 100 miles east of Wichita, in southeastern Kansas. The bank is wholly owned by Southeast Bancshares, Inc., Chanute, Kansas, a shell, multibank holding company that also owns Bank of Commerce in Chanute, Kansas, and Chetopa State Bank & Trust Co. in Chetopa, Kansas. The bank operates four full-service branches in Fall River, Howard, Longton, and Parsons, Kansas. The locations in Howard, Neodesha, and Parsons have cash-dispensing automated teller machines on site.

According to the June 30, 2016 Federal Deposit Insurance Corporation (FDIC) Deposit Market Share Report, the bank's market share of FDIC-insured deposits in the AA is 3.8 percent, which ranks 8th among 28 FDIC-insured financial institutions with locations in the bank's AA. The bank is primarily an agricultural and residential real estate lender; however, it offers a variety of products to meet the credit needs of the AA. Table 1 illustrates the distribution of the bank's loan portfolio as of September 30, 2016. The bank reported total assets of \$93.5MM; of which, gross loans represented \$75.6MM.

TABLE 1 FIRST NEODESHA BANK LOAN PORTFOLIO AS OF SEPTEMBER 30, 2016		
Loan Type	Amount \$(000)	Percent of Total
Agricultural	33,102	43.8
Residential Real Estate	22,215	29.4
Commercial	12,896	17.1
Consumer	5,125	6.8
Other	2,260	3.0
Gross Loans	75,598	100.0
(NOTE: Total percentages shown may vary by 0.1 percent due to automated rounding differences.)		

Based on the bank's asset size, product offerings, and financial condition, it has the ability to meet the credit needs of its AA. Furthermore, there are no legal or financial factors that prevent the bank from meeting the credit needs of its AA. The bank received a Satisfactory rating at its previous CRA evaluation conducted by the Federal Reserve Bank of Kansas City on March 11, 2013.

DESCRIPTION OF THE BANK'S ASSESSMENT AREA

The bank's AA includes all of Cherokee, Elk, Labette, Montgomery, Neosho, and Wilson Counties, in their entirety, and the southern half of Greenwood County, Kansas. The AA is comprised of 1 low-, 5 moderate-, 31 middle-, and 1 upper-income census tracts. The AA's delineation has changed since the previous examination. Montgomery County was added to the bank's AA due to the bank's lending in the area and the proximity of branch locations in bordering counties.

Population Trends and Characteristics

The AA's total population, based on 2010 U.S. Census Data, was 109,245. The largest portion of the AA's population (49.9 percent) is between the ages of 25 and 64 years old. The AA contains a slightly older population, with 17.4 percent of the population aged 65 years and older, compared to the state of Kansas average of 13.2 percent and the statewide rural figure of 16.2 percent. Elk County, in particular, has a higher 65 years and older population of 24.3 percent, where two of the bank's branches are located. These demographics may have an impact on the level of credit demand in the area as this population group may be more established and less likely to need residential real estate credit.

The majority of the AA's population is located in Montgomery (32.5 percent), Cherokee (19.8 percent), Labette (19.8 percent), and Neosho (15.1 percent) Counties. One of the bank's five branches is located in Labette County, Kansas, while the other four branches are located in counties with lower populations. Wilson County, Kansas, where the bank's main office is located, comprises 8.6 percent of the AA's population; Elk County, Kansas, where two branches are located, comprises 2.6 percent of the AA's population; and Greenwood County, Kansas, where one branch is located, comprises 2.6 percent of the AA's population.

Income and Housing Characteristics

The AA is less affluent than other statewide rural areas of Kansas. The AA's estimated median family income (MFI), at \$49,118, is lower than the statewide rural MFI figure of \$52,419. Additionally, the percent of AA families considered low- and moderate income (LMI) is 40.7 percent, whereas 37.2 percent of families are considered LMI for other rural statewide areas. The AA has a higher rate of families below poverty, at 10.8 percent, compared to the statewide rural figure, at 9.2 percent.

The median housing value for the AA is \$66,756, compared to \$81,447 for statewide rural areas. With the median housing value in the AA lower than the statewide rural figure, the AA has an affordability ratio¹ of 57.9 percent, which indicates the area contains more affordable housing when compared to housing in other statewide rural areas, which had an affordability ratio of 51.0 percent. In addition, the median age of housing stock within the AA is 55 years, which is significantly higher than the statewide rural figure of 46 years; Elk County, in

¹ Affordability ratios are calculated using median household income divided by median housing value. The higher the rate, the more affordable the housing stock.

particular, had the oldest housing stock at 68 years. The vacancy rates are also considered high in Elk County, at 25.3 percent, and in Greenwood County, at 26.8 percent, compared to the overall average for the entire AA, at 14.6 percent, and the statewide rural average of 13.3 percent. The older housing stock and high vacancy rates may indicate dilapidated housing, which may have an impact on the level of residential real estate lending opportunities in the AA.

Economic and Employment Characteristics

The AA's economy is primarily reliant on agriculture; however, a community member indicated that a push is being made within Neodesha to increase the industrial economy with a new industrial park meant to attract new industry to the area. According to a community member, the largest employer in Neodesha is Cobalt Boats, employing an estimated 600 individuals. Other area employers include Neodesha Plastics, Inc.; Neodesha Quality Machining, Inc.; GBW Railcar Services, LLC; Wilson Medical Center; Wilson County Schools; and city government offices. The unemployment rate in the AA, at 7.6 percent, is higher than the statewide and statewide rural figures of 6.0 percent and 5.0 percent, respectively.

Table 2 summarizes the demographic and economic characteristics of the bank's AA based on the 2010 ACS data and 2016 D&B data.

**TABLE 2
SOUTHEAST KANSAS 2016 ASSESSMENT AREA DEMOGRAPHICS**

Income Categories	Tract Distribution		Families by Tract Income		Families < Poverty Level as % of Families by Tract		Families by Family Income	
	#	%	#	%	#	%	#	%
Low	1	2.6	377	1.3	106	28.1	6,417	21.4
Moderate	5	13.2	3,113	10.4	619	19.9	5,801	19.3
Middle	31	81.6	25,384	84.5	2,427	9.6	7,471	24.9
Upper	1	2.6	1,153	3.8	80	6.9	10,338	34.4
Unknown	0	0.0	0	0.0	0	0.0	0	0.0
Total AA	38	100.0	30,027	100.0	3,232	10.8	30,027	100.0
	Housing Units by Tract	Housing Type by Tract						
		Owner-occupied			Rental		Vacant	
		#	% by tract	% by unit	#	% by unit	#	% by unit
Low	720	353	1.1	49.0	267	37.1	100	13.9
Moderate	6,162	3,387	10.2	55.0	1,799	29.2	976	15.8
Middle	43,522	28,254	84.7	64.9	8,808	20.2	6,460	14.8
Upper	1,864	1,351	4.1	72.5	417	22.4	96	5.2
Unknown	0	0	0.0	0.0	0	0.0	0	0.0
Total AA	52,268	33,345	100.0	63.8	11,291	21.6	7,632	14.6
	Total Businesses by Tract		Businesses by Tract & Revenue Size					
			Less Than or = \$1 Million		Over \$1 Million		Revenue Not Reported	
			#	%	#	%	#	%
Low	63	1.7	48	1.4	13	3.6	2	2.3
Moderate	515	13.6	445	13.3	55	15.2	15	17.2
Middle	3,103	81.9	2,749	82.3	284	78.5	70	80.5
Upper	108	2.9	98	2.9	10	2.8	0	0.0
Unknown	0	0.0	0	0.0	0	0.0	0	0.0
Total AA	3,789	100.0	3,340	100.0	362	100.0	87	100.0
Percentage of Total Businesses:			88.1		9.6		2.3	
	Total Farms by Tract		Farms by Tract & Revenue Size					
			Less Than or = \$1 Million		Over \$1 Million		Revenue Not Reported	
			#	%	#	%	#	%
Low	0	0.0	0	0.0	0	0.0	0	0.0
Moderate	51	10.3	48	9.8	2	40.0	1	100.0
Middle	441	88.7	438	89.2	3	60.0	0	0.0
Upper	5	1.0	5	1.0	0	0.0	0	0.0
Unknown	0	0.0	0	0.0	0	0.0	0	0.0
Total AA	497	100.0	491	100.0	5	100.0	1	100.0
Percentage of Total Farms:			98.8		1.0		0.2	

Based on 2010 ACS five-year estimate data, 2016 FFIEC's census tract designations, and 2016 D&B data.
(NOTE: Total percentages shown may vary by 0.1 percent due to automated rounding differences.)

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

The bank’s overall record of meeting the credit needs of its AA is satisfactory. A review of the bank’s 16-quarter average NLTD ratio, distribution of lending within its AA, distribution of lending by income level of geographies, and distribution of lending to borrowers of different income levels and farms of different revenue sizes was conducted. The data utilized to analyze the bank’s performance included its loan data, area demographic information, and information obtained from members of the community. Based on the analysis, the bank’s NLTD ratio was more than reasonable when compared to the performance of local competitors, and a substantial majority of the bank’s loans were extended within its AA. The bank’s lending reflected reasonable penetration amongst the AA’s geographies of different income levels. Furthermore, the bank’s lending to borrowers of different income levels and farms of different revenue sizes is also considered reasonable.

Net Loan-to-Deposit Ratio:

This performance criterion utilizes the bank’s average NLTD ratio to evaluate the bank’s lending levels, given its capacity to lend, the availability of lending opportunities, and the AA’s demographic and economic profile. The bank’s NLTD ratio reflects a more than reasonable effort to extend credit based on its size, financial condition, credit needs of the AA, and in context of the NLTD ratios of local competitors and similarly situated institutions. The bank’s NLTD ratio was averaged over a 16-quarter period since the previous CRA evaluation and compared with the NLTD ratios of six similarly situated institutions. As of September 30, 2016, the bank’s average NLTD ratio of 89.9 percent was higher than five of the six similarly situated institutions, with NLTD ratios ranging from 20.2 percent to 67.7 percent. The sixth institution’s NLTD ratio appears to be an outlier, at 123.5 percent.

Assessment Area Concentration:

This performance criterion evaluates the bank’s distribution of lending inside and outside of its AA. The evaluation analyzes both the number and dollar volume of originations. As shown in Table 3, a substantial majority of the bank’s residential real estate and small farm loans were originated within the delineated AA at 92.3 percent by number and 85.8 percent by dollar.

TABLE 3 LENDING INSIDE AND OUTSIDE THE BANK’S ASSESSMENT AREAS								
Bank Loans	Inside				Outside			
	#	\$(000)	#%	\$%	#	\$(000)	#%	\$%
Residential Real Estate Loans	45	3,676	88.2	80.8	6	874	11.8	19.2
Small Farm Loans	75	3,654	94.9	91.5	4	340	5.1	8.5
Total Loans	120	7,330	92.3	85.8	10	1,214	7.7	14.2

The remaining conclusions are based solely on the loans originated inside the AA.

Distribution by Income Level of Geographies:

This performance criterion evaluates the bank’s distribution of loans among geographies of different income levels (geographic distribution). Overall, the geographic distribution of lending was reasonable. While the bank’s geographic distribution of residential real estate lending is considered excellent, more weight was placed on the bank’s small farm lending resulting in an overall reasonable rating. In assessing the bank’s performance, its residential real estate lending was compared to the percentage of owner-occupied units in each census tract income level. The bank’s small farm lending activity was compared to the percentage of farms located in each census tract level. The evaluation reviewed both the number of loans originated and dollar volume.

**TABLE 4
DISTRIBUTION BY INCOME LEVELS OF GEOGRAPHIES
SOUTHEAST KANSAS 2016 ASSESSMENT AREA**

Census Tract Income Level	Residential Real Estate Loans				% of Owner-Occupied Units ¹
	#	\$(000)	#%	\$%	
Low	0	0	0.0	0.0	1.1
Moderate	9	713	20.0	19.4	10.2
Middle	36	2,962	80.0	80.6	84.7
Upper	0	0	0.0	0.0	4.1
Unknown ³	0	0	0.0	0.0	0.0
Census Tract Income Level	Small Farm Loans				% of Farms ²
	#	\$(000)	#%	\$%	
Low	0	0	0.0	0.0	0.0
Moderate	12	635	16.0	17.4	10.3
Middle	63	3,020	84.0	82.6	88.7
Upper	0	0	0.0	0.0	1.0
Unknown ³	0	0	0.0	0.0	0.0

¹ Based on 2010 ACS five-year estimate data and 2016 FFIEC’s census tract designations.
² Based on 2016 D&B data.
³ Does not include tracts where the income level is unknown. Only includes tract locations not known.
(NOTE: Total percentages shown may vary by 0.1 percent due to automated rounding differences.)

Residential Real Estate Loans

The bank’s residential real estate lending reflects an excellent distribution among geographies of different income levels, even though the bank did not originate any loans in the AA’s low-income census tract. The bank’s performance in this geography was consistent with demographics as the AA’s low-income tract only contains 1.1 percent of owner-occupied housing. This is further supported by the fact that there are only 720 housing units in this census tract, with 13.9 percent classified as vacant and 37.1 percent as rental units. These figures are reflected in Table 2.

As indicated above in Table 4, the bank originated 20.0 percent by number and 19.4 percent by dollar of its residential real estate loans to borrowers in the moderate-income tracts, which exceeded the 10.2 percent of owner-occupied units in these geographies. The bank’s lending

in the middle-income tracts, at 80.0 percent, was comparable to the demographic figure of 84.7 percent owner-occupied units in the middle-income census tract. The bank had no lending in the upper-income tract, which accounts for 4.1 percent of area owner-occupied units.

For additional performance context, aggregate lending data reported by HMDA reporting financial institutions in the AA was reviewed to assess market demand for loans as well as provide an indicator of lending challenges that other institutions may similarly experience. According to the data, aggregate lenders originated a relatively low volume of loans in the AA's low-income census tract at, 0.4 percent by number and 0.1 percent by dollar, which was also below the AA demographic figure of owner-occupied units at 1.1 percent. In the moderate-income tracts, the volume of loans was low, at 6.6 percent by number and 5.2 percent by dollar. The lower numbers by aggregate lenders indicate that there may be limited opportunities to lend in these census tracts.

Small Farm Loans

The bank's small farm lending reflects a reasonable distribution among geographies of different income levels. The bank originated 16.0 percent of its small farm loans by number and 17.4 percent by dollar to farms within the moderate-income census tracts, which slightly exceeded the 10.3 percent of farms operating in this geography. In the middle-income tracts, the bank originated 84.0 percent of its small farm loans by number, which is comparable to the AA demographic number of 88.7 percent. According to D&B data, there are no farms located in the AA's low- or upper- income census tracts, which supports the bank's lack of lending in these areas.

Distribution by Borrower Income and Revenue Size of Farms:

This performance criterion evaluates the bank's lending to borrowers of different income levels, with emphasis placed on LMI individuals as well as to farms of different revenue sizes, with emphasis placed on farms with gross annual revenues of \$1MM or less. The review evaluates both the number of loan originations and the dollar volume. The bank's residential real estate lending activity was compared to the percentage of families in the AA by income level, while small farm lending activity was compared to the percentage of farms operating in the AA by revenue sizes. Overall, the bank's borrower distribution of lending is reasonable.

**TABLE 5
DISTRIBUTION BY INCOME LEVEL OF BORROWER AND
REVENUE SIZE OF FARMS
SOUTHEAST KANSAS 2016 ASSESSMENT AREA**

Borrower Income Level	Residential Loans				% of Families ¹
	#	\$(000)	#%	\$%	
Low	5	181	11.1	4.9	21.4
Moderate	7	185	15.6	5.0	19.3
Middle	16	820	35.6	22.3	24.9
Upper	17	2,491	37.8	67.7	34.4
Farm Revenue	Small Farm Loans				% of Farms by Revenue ²
	#	\$(000)	#%	\$%	
\$1MM or Less	72	3,303	96.0	90.4	98.8
Over \$1MM	3	352	4.0	9.6	1.0
Income Not Known	0	0	0.0	0.0	0.2

¹ Based on 2010 ACS five-year estimate data.
² Based on 2016 D&B data.
(Note: Total percentages shown may vary by 0.1 percent due to automated rounding differences.)

Residential Real Estate Loans

The bank's residential real estate lending reflects a reasonable distribution among borrowers of different income levels. The bank's distribution of lending to low-income borrowers was 11.1 percent by number and 4.9 percent by dollar, while lending to moderate-income borrowers was 15.6 percent by number and 5.0 percent by dollar. The bank's lending to LMI borrowers was lower than the AA's demographic figures of 21.4 percent for low-income and 19.3 percent for moderate-income. While the majority of residential loans were originated to middle- and upper-income borrowers by both number and dollar, the bank's performance is considered reasonable when compared to aggregate lenders who originated 10.0 percent by number and 4.9 percent by dollar to low-income borrowers; and 19.0 percent by number and 12.2 percent by dollar to moderate-income borrowers. In addition, the opportunity for residential real estate lending may be limited given the area's older housing stock, higher unemployment rate, and higher elderly population.

Small Farm Loans

The bank's lending to farms of different revenue sizes is reasonable. The bank originated 96.0 percent of its small farm loans by number and 90.4 percent by dollar to farms with gross annual revenues of \$1MM or less. This performance is similar to demographic figures, as 98.8 percent of farms within the AA are considered small farms. Lending to farms with gross annual revenues of greater than \$1MM was also comparable to the demographic figure.

FAIR LENDING OR OTHER ILLEGAL CREDIT PRACTICES REVIEW

An evaluation of the bank's fair lending activities was conducted during the examination to determine compliance with the substantive provisions of the antidiscrimination laws and regulations, including the Equal Credit Opportunity Act and the Fair Housing Act. No evidence of discrimination was identified. Furthermore, the bank has not engaged in any illegal credit practices inconsistent with helping to meet the credit needs of the community.