



## **PUBLIC DISCLOSURE**

SEPTEMBER 24, 2012

### **COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION**

**FARMERS STATE BANK  
RSSD# 727156**

**234 SOUTH COMMERCIAL AVENUE  
WALLACE, NEBRASKA 69169**

**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 CRA RATING:** *This institution is rated **Satisfactory***

Farmers State Bank (the bank) has a satisfactory record of meeting the credit needs of its assessment area (AA), including small farms and small businesses, consistent with its resources and operating philosophy. Four of the five criteria used to evaluate a small bank's lending performance under the Community Reinvestment Act (CRA) were relevant to this review and are listed below:

- Net loan-to-deposit (NLTD) ratio
- Lending inside the AA
- Distribution of loans by income level of geography
- Lending to farms and businesses of different revenue sizes

The bank's responsiveness to complaints, the fifth core criterion used to assess a small bank's performance, was not evaluated as the bank has not received any CRA-related complaints since the last evaluation.

**SCOPE OF EXAMINATION**

The bank's CRA performance was evaluated using the Federal Financial Institutions Examination Council Interagency Small Bank Examination Procedures. The examination included an evaluation of the bank's performance, with contextual consideration given to area demographic information. Conclusions regarding the four applicable lending test criteria were based on an analysis of the bank's average NLTD ratio since the prior examination and data compiled from the bank's two major product lines, agricultural and commercial loans. The major product lines were determined through discussions with bank management, a review of the bank's June 30, 2012 Report of Condition and Income (Call Report), and a review of the number of loan originations since the bank's prior CRA examination.

The analysis included a statistical sample of 28 agricultural loans from a universe of 62 loans originated in a six-month time period between December 22, 2011 and June 21, 2012. In addition, the evaluation analyzed a statistical sample of 36 commercial loans from a universe of 125 loans originated from July 9, 2008 to July 8, 2012.

To augment the evaluation, members of the community were interviewed to ascertain local market conditions, determine specific credit needs of the AA, and obtain information about the bank's economic operating environment. The contacts included a local farmer and a small business owner who also serves on the local Chamber of Commerce.

**DESCRIPTION OF INSTITUTION**

The bank is a small financial institution headquartered in Wallace, Nebraska. Wallace is located in the southwestern part of Nebraska in Lincoln County, and is approximately 140 miles west of

Kearney, the state's fifth largest town. The bank operates its main office in Wallace and maintains one cash-dispensing automated teller machine (ATM) at that location. The bank also operates one branch location and a full-service ATM in North Platte, Nebraska, the county seat of Lincoln County.

Table 1 displays the bank's loan portfolio by product as of the June 30, 2012 Call Report. The bank reported total assets of \$45.6 million, of which gross loans represented \$23.6 million, or 51.8 percent. The bank is primarily an agricultural and commercial lender and offers other consumer loan products to meet the credit needs of its AA. According to the June 30, 2012 Federal Deposit Insurance Corporation (FDIC) Market Share Report, the bank had approximately \$41.5 million in deposits and a market share of 3.2 percent, ranking 8th of 19 FDIC-insured depository institutions operating within its AA.

Loan Type	Amount (\$000)	Percent of Total
Agricultural	12,651	53.6
Commercial	5,312	22.5
Residential RE	3,858	16.3
Consumer	1,723	7.3
Other	62	0.3
<b>Total Gross Loans</b>	<b>23,606</b>	<b>100.0</b>

The CRA analysis considered the bank's financial capacity, local economic conditions, AA demographics, and competition. There are no financial or legal impediments that currently impact the bank's ability to lend or prevent it from fulfilling its responsibilities under the CRA. The bank received a satisfactory rating at the previous CRA evaluation conducted by the Federal Reserve Bank of Kansas City (Reserve Bank) on July 7, 2008.

**DESCRIPTION OF THE BANK'S ASSESSMENT AREA**

The bank's AA consists of Lincoln, Keith, Logan, Perkins, and Hayes Counties, located in southwest Nebraska. The AA is predominately rural and includes one moderate-, eleven middle-, and two upper-income census tracts. Table 2 reflects the AA demographics based on 2000 Census data and 2010 Dun & Bradstreet data.

*Population Trends and Characteristics:*

The AA population remained relatively stable and experienced a modest 1.7 percent increase between 2000 and 2010. In 2000, the AA population was 48,549 compared to 2010 Census estimates of 49,356. The increase in AA population is mainly attributed to the 4.8 percent growth in Lincoln County, the most densely populated county in the bank's AA, which encompasses the city of

North Platte. The population of the remaining four counties in the bank's AA has declined and is indicative of the continuing migration of the state's population from rural areas to metropolitan communities and their suburbs. One community contact stated that many of the area's small towns are increasingly comprised of aging populations due to the exodus of younger individuals to metropolitan areas in search of more lucrative employment opportunities.

*Income Characteristics:*

According to 2000 Census data, the median family income (MFI) for the AA was \$42,949, which was 3.3 percent higher than the statewide rural MFI at \$41,596. Low- and moderate-income (LMI) families within the AA reflected slightly lower concentrations when compared to statewide rural families. The AA LMI families totaled 34.9 percent, compared to 36.4 percent throughout rural Nebraska. Additionally, 7.4 percent of AA families were below the poverty level, compared to rural Nebraska at 7.8 percent and the entire state at 6.7 percent.

*Economic and Employment Characteristics:*

The local economy is primarily supported by agriculture and agricultural-related businesses. Due to rising operational costs, agricultural lending continues to be one of the greatest credit needs in the community. However, as one community contact noted, elevated commodity prices have improved financial conditions for local farmers and ranchers over the past several years, which has decreased the demand for additional lines of credit. The contact also noted that current drought conditions may serve to negate many of the recent gains.

The local economy in the surrounding area is also supported by the transportation, education, government, and retail sectors. According to the community contacts, major employers in the area include a major railroad switching and locomotive repair facility; a distribution center for a prominent big-box retail chain; and a regional medical center.

*Housing Characteristics:*

In 2000, AA housing units totaled 22,972, and 60.7 percent of area housing was owner-occupied, compared to 62.2 percent for the entire state and 63.4 percent in statewide rural areas. The AA housing affordability ratio, which considers median household income as a percentage of the median housing value, was 48.4 percent compared to statewide rural areas and the state of Nebraska at 50.0 percent and 45.2 percent, respectively. A higher ratio generally indicates greater affordability.

Table 2 summarizes the demographic and economic characteristics of the bank's AA based on 2000 Census data and 2010 Dun & Bradstreet data.

<b>TABLE 2 FARMERS STATE BANK AA DEMOGRAPHICS</b>								
<b>Income Categories</b>	<b>Tract Distribution</b>		<b>Families by Tract Income</b>		<b>Families &lt; Poverty Level as % of Families by Tract</b>		<b>Families by Family Income</b>	
	<b>#</b>	<b>%</b>	<b>#</b>	<b>%</b>	<b>#</b>	<b>%</b>	<b>#</b>	<b>%</b>
Low-income	0	0.0	0	0.0	0	0.0	2,259	16.8
Moderate-income	1	7.1	316	2.4	46	14.6	2,424	18.1
Middle-income	11	78.6	10,959	81.7	838	7.6	3,246	24.2
Upper-income	2	14.3	2,138	15.9	113	5.3	5,484	40.9
<b>Total Assessment Area</b>	<b>14</b>	<b>100.0</b>	<b>13,413</b>	<b>100.0</b>	<b>997</b>	<b>7.4</b>	<b>13,413</b>	<b>100.0</b>
	<b>Total Farms by Tract</b>		<b>Farms by Tract &amp; Revenue Size</b>					
			<b>Less Than or = \$1 Million</b>		<b>Over \$1 Million</b>		<b>Revenue Not Reported</b>	
	<b>#</b>	<b>%</b>	<b>#</b>	<b>%</b>	<b>#</b>	<b>%</b>	<b>#</b>	<b>%</b>
Moderate-income	46	6.6	46	6.7	0	0.0	0	0.0
Middle-income	512	73.7	505	73.5	6	85.7	1	100.0
Upper-income	137	19.7	136	19.8	1	14.3	0	0.0
<b>Total Assessment Area</b>	<b>695</b>	<b>100.0</b>	<b>687</b>	<b>100.0</b>	<b>7</b>	<b>100.0</b>	<b>1</b>	<b>100.0</b>
	<b>Percentage of Total Farms:</b>			98.8		1.0		0.1
	<b>Total Businesses by Tract</b>		<b>Businesses by Tract &amp; Revenue Size</b>					
			<b>Less Than or = \$1 Million</b>		<b>Over \$1 Million</b>		<b>Revenue Not Reported</b>	
	<b>#</b>	<b>%</b>	<b>#</b>	<b>%</b>	<b>#</b>	<b>%</b>	<b>#</b>	<b>%</b>
Moderate-income	40	1.4	35	1.3	1	0.8	4	3.2
Middle-income	2,249	78.4	2,055	78.4	93	78.2	101	79.5
Upper-income	578	20.2	531	20.3	25	21.0	22	17.3
<b>Total Assessment Area</b>	<b>2,867</b>	<b>100.0</b>	<b>2,621</b>	<b>100.0</b>	<b>119</b>	<b>100.0</b>	<b>127</b>	<b>100.0</b>
	<b>Percentage of Total Businesses:</b>			91.4		4.2		4.4

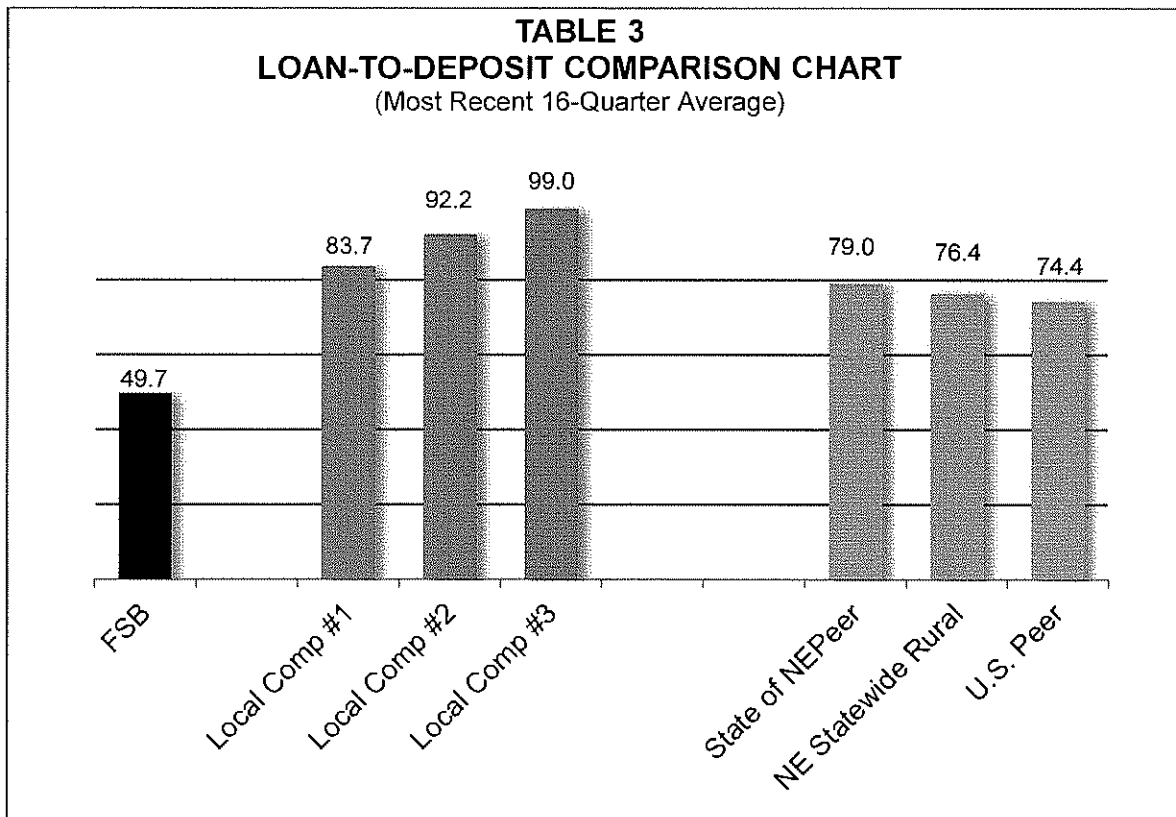
**CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA**

The bank's performance under the CRA is considered satisfactory based on an assessment of its average NLTD ratio, level of lending within its AA to geographies of different income levels, as well as its level of lending within its AA to farms and businesses of different revenue sizes. Data utilized for this analysis included the bank's lending performance data, area demographic information, and input from members of the local community.

**Net Loan-to-Deposit Ratio**

The bank's NLTD ratio is considered less than reasonable. The NLTD ratio was averaged over a 16-quarter period since the previous CRA evaluation and compared with the NLTD ratios of three similarly-situated competitor institutions and those of state, statewide rural, and national peer groups. As illustrated in Table 3, the bank's average NLTD ratio of 49.7 percent was lower than three similarly-situated banks, whose average NLTD ratios ranged from 83.7 percent to 99.0 percent. In addition, the bank's NLTD ratio was lower than the state, statewide rural, and national peer group averages of 79.0 percent, 76.4 percent, and 74.4 percent, respectively.

A review of performance context factors indicated that the NLTD ratio was affected by the presence of a significant number of competitors in the bank's AA. In particular, the North Platte branch operates within a one-half mile radius of nine competitor financial institutions, including several nationally-recognized banking organizations. Furthermore, the bank has traditionally embraced a conservative lending philosophy, as confirmed by discussions with bank management and a review of the bank's most recent Call Report. Although the bank's NLTD ratio has declined since the previous examination, its 2012 year-to-date NLTD ratio notes significant improvement at 56.9 percent. The bank actively monitors its NLTD ratio and plans to increase lending volume through strategic marketing efforts and relationship building.



**Lending in the Bank's Assessment Area**

The bank's efforts to extend credit within its AA are reasonable. As illustrated in Table 4, a majority of the loans sampled, or 75.0 percent, were originated to borrowers within its AA. The bank originated 64.3 percent of agricultural loans and 83.3 percent of commercial loans inside its AA. The remaining conclusions of the bank's lending performance are based exclusively on loans originated inside the AA.

**TABLE 4  
SUMMARY OF LENDING PERFORMANCE**

**Lending within the Assessment Area**

	Inside AA				Outside AA			
	#	%	\$(000)	%	#	%	\$(000)	%
Agricultural	18	64.3	1,751	66.3	10	35.7	890	33.7
Commercial	30	83.3	1,938	86.3	6	16.7	308	13.7
<b>TOTAL</b>	<b>48</b>	<b>75.0</b>	<b>3,689</b>	<b>75.5</b>	<b>16</b>	<b>25.0</b>	<b>1,198</b>	<b>24.5</b>



**Geographic Distribution of Loans**

The bank's distribution of loans by income level of geography is reasonable. This core performance criterion evaluates the bank's distribution of loans among geographies of various income levels. The bank's agricultural and commercial loans were compared to the percentage of all farms and businesses located in each census tract level as well as the activity of aggregate CRA reporters in the bank's AA. The results are illustrated in Table 5.

**TABLE 5  
SUMMARY OF LENDING PERFORMANCE  
Distribution by Income Level of Geographies**

<b>Agricultural</b>							
Census Tract Income Level	AA Small Farms <sup>1</sup>	Bank's Loan Distribution				Aggregate CRA Data <sup>2</sup>	
	%	#	%	\$(000)	%	# %	\$ %
Moderate-income	6.6	0	0.0	0	0.0	2.5	4.8
Middle-income	73.7	8	44.4	377	21.5	83.3	80.2
Upper-income	19.7	10	55.6	1,374	78.5	13.2	14.8
Tract Unknown	0.0	0	0.0	0	0.0	1.0	0.2
<b>TOTAL</b>	<b>100.0</b>	<b>18</b>	<b>100.0</b>	<b>1,751</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
<b>Commercial</b>							
Census Tract Income Level	AA Small Businesses <sup>1</sup>	Bank's Loan Distribution				Aggregate CRA Data <sup>2</sup>	
	%	#	%	\$(000)	%	# %	\$ %
Moderate-income	1.4	0	0.0	0	0.0	0.8	0.5
Middle-income	78.4	20	66.7	567	29.3	69.3	71.1
Upper-income	20.2	10	33.3	1,371	70.7	23.4	27.4
Tract Unknown	0.0	0	0.0	0	0.0	6.5	1.0
<b>TOTAL</b>	<b>100.0</b>	<b>30</b>	<b>100.0</b>	<b>1,938</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

1 Based on 2010 Dun & Bradstreet data. (Note: Total percentages shown may vary by .1 percent due to automated rounding differences.)  
2 Includes the aggregate lending performance of all other financial institutions that collect and report CRA loan data within the bank's AA, hereby referred to as aggregate data.

*Agricultural Loans*

The bank's distribution of lending to agricultural borrowers by income level of census tract is considered reasonable, based on AA demographics. The bank did not originate any loans within Hayes County, which comprises the only moderate-income tract within the bank's delineated AA. According to 2010 Dun & Bradstreet data, 6.6 percent of AA farms are located within this moderate-income tract, and aggregate CRA data indicates that lending in Hayes County was limited to 2.5 percent of all AA originations by CRA-reporting banks. It is important to note that Hayes County is sparsely populated and lending opportunities are limited. Furthermore, Farmers State Bank does

not have a presence in this county. The town of Hayes Center, where a competitor branch is located, is the only sizable community in Hayes County. Therefore, despite the lack of lending by the bank in this moderate-income county, its overall geographic distribution of agricultural loans in the sample is reasonable.

*Commercial Loans*

The bank's level of commercial lending to borrowers by income level of geography is considered reasonable when compared to area demographics and competition in surrounding communities. Similar to the agricultural distribution, the bank did not originate any loans in Hayes County, which accounts for 1.4 percent of the businesses within the AA. Moreover, the volume of lending by aggregate CRA reporters in Hayes County was 0.8 percent by volume and 0.5 percent by dollar amount.

**Distribution of Lending to Farms and Businesses of Different Revenue Sizes**

The bank's distribution of lending to farms and businesses of different revenue sizes is reasonable. This core performance criterion evaluates the bank's lending to farms and businesses of different revenue sizes, particularly to small farms and small businesses which are defined as those with gross annual revenues of \$1 million or less. Results of this analysis are illustrated in Table 6.

<b>TABLE 6 SUMMARY OF LENDING PERFORMANCE</b>					
<b>Distribution by Revenue Size of Farm and Business</b>					
	<b>Bank's Small Farm Loans</b>				<b>AA Small Farms<sup>1</sup></b>
<b>Revenue Size</b>	<b>#</b>	<b>%</b>	<b>\$(000)</b>	<b>%</b>	<b>%</b>
Revenue < \$1 Million	18	100.0	1,751	100.0	98.8
	<b>Bank's Small Business Loans</b>				<b>AA Small Businesses<sup>1</sup></b>
<b>Revenue Size</b>	<b>#</b>	<b>%</b>	<b>\$(000)</b>	<b>%</b>	<b>%</b>
Revenue < \$1 Million	24	80.0	1,340	69.2	91.4

<sup>1</sup> Based on 2010 Dun & Bradstreet data.

*Small Farm Loans*

The bank's level of lending to small farms in its AA is excellent. Table 6 indicates that 100.0 percent of the bank's 18 agricultural loans originated within its AA were to small farms. Furthermore, 94.4 percent of the loans made to small farms were in amounts of \$250,000 or less, which demonstrates the bank's willingness to lend to smaller farming operations within the local area.

*Small Business Loans*

The bank's level of lending to small businesses in its AA is reasonable. Table 6 indicates the bank originated 80.0 percent of its commercial loans to small businesses. Furthermore, 83.3 percent of the loans made to small businesses were for loan amounts of \$100,000 or less, which is typical of the funding needed most by most small business entities. Although demographic data indicates that 91.4 percent of the businesses operating in the AA had gross annual revenues of \$1 million or less, the bank's level of lending is reasonable when considering the highly competitive environment in which the bank operates.

**FAIR LENDING OR OTHER ILLEGAL CREDIT PRACTICES REVIEW**

The bank is in compliance with the substantive provisions of the antidiscrimination laws and regulations. A review of bank policies and procedures, credit applications, loans and denials, and staff interviews revealed no prohibited practices designed to discourage loan applicants. In addition, the bank has not engaged in any illegal credit practices inconsistent with helping to meet the credit needs of its communities.