

PUBLIC DISCLOSURE

November 17, 1997

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**The Farmers and Merchants Bank
RSSD# 731443**

**102 East Buchanan Street
Prairie Grove, Arkansas 72753-2900**

**Federal Reserve Bank of St. Louis
P.O. Box 442
St. Louis, Missouri 63166-0442**

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 Reserve 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 **The Farmers and Merchants Bank** prepared by the **Federal Reserve System**, the institution's supervisory agency, as of November 17, 1997. The agency evaluates performance in assessment area(s), as they are delineated by the institution, rather than individual branches.*

This assessment area evaluation may include visits to some, but not necessarily all of the institution's branches. The agency rates the CRA performance of an institution consistent with the provisions set forth in Appendix A to 12 CFR Part 228.

INSTITUTION'S CRA RATING: The Farmers and Merchants Bank is rated Satisfactory.

The bank's lending activity, qualified investments, and service delivery systems are all considered satisfactory in light of the bank's size and environment. The following paragraphs summarize each performance category.

An analysis of the bank's lending performance reflects the bank's successful efforts to lend to all income levels of individuals, businesses, and farms. Examples of how the bank has successfully met the lending needs of its assessment area include:

- A substantial majority of the bank's loans are located in its assessment area.
- The distribution of borrowers reflects good penetration among retail customers of different income levels.
- The distribution of borrowers reflects adequate penetration among farm and business customers of different income levels.
- The bank has satisfactory loan distribution by geography.
- The bank's lending levels, community development lending, responsiveness to credit needs, and flexible lending practices are also satisfactory.

Investments are adequate considering the bank's size and location. The bank has invested in several local community development purpose organizations and projects.

The bank's retail and community development services are satisfactory. A wide variety of services and products are offered to retail customers. In addition, bank staff provided several community development services to the bank's assessment area.

The following table indicates the performance level of The Farmers and Merchants Bank with respect to the lending, investment, and service tests.

PERFORMANCE LEVELS	<u>The Farmers and Merchants Bank</u>		
	PERFORMANCE TESTS		
	Lending Test*	Investment Test	Service Test
Outstanding			
High Satisfactory	X		X
Low Satisfactory		X	
Needs to Improve			
Substantial Noncompliance			

*Note: The lending test is weighted more heavily than the investment and service tests when arriving at an overall rating.

DESCRIPTION OF INSTITUTION:

The Farmers and Merchants Bank is located in the northwestern portion of Arkansas, and has offices in Prairie Grove, Farmington, and West Fork. The bank had \$95 million in assets and \$62 million in loans as of June 30, 1997. Primary lending products include residential real estate and consumer loans. Commercial and agricultural loans are also available.

The bank is owned by Arvest Bank Group, Inc., a multi-bank holding company located in Bentonville, Arkansas. The holding company reported assets of \$2.7 billion in June 1997.

DESCRIPTION OF ASSESSMENT AREA:

The assessment area consists of a portion of Washington County, which is located in northwestern Arkansas. Washington County is part of the Fayetteville-Springdale-Rogers Metropolitan Statistical Area (MSA). The assessment area consists of eleven census tracts including 105.01, 105.04, 105.05, 105.06, 110.01, 110.02, 110.03, 110.04, 111.01, 111.02, and 111.03. All of the tracts are categorized as middle-income¹ except one, 111.01, which is categorized as moderate-income.

The following table displays population percentages of assessment area families by income level compared to the MSA population.

¹Low-income is defined as individual income, or in the case of a geography, a median family income that is less than 50 percent of the MSA median family income.

Moderate-income is defined as individual income, or in the case of a geography, a median family income that is at least 50 percent and less than 80 percent of the MSA median family income.

Middle-income is defined as individual income, or in the case of a geography, a median family income that is at least 80 percent and less than 120 percent of the MSA median family income.

Upper-income is defined as individual income, or in the case of a geography, a median family income that is 120 percent or more of the MSA median family income.

Assessment Area Income Stratification²

1990 Census Data	Metropolitan Statistical Area (MSA)	Assessment Area
Low-Income Families	17.0%	23.2%
Moderate-Income Families	19.9%	22.6%
Middle-Income Families	25.1%	25.6%
Upper-Income Families	37.9%	28.6%

Assessment area population percentages are somewhat similar to the MSA percentages. However, a larger portion, 45.8 percent, of the area is considered low- and moderate-income as compared to 36.9 percent for the MSA.

According to the Northwest Arkansas Regional Planning Commission (NWARPC), the MSA had a population of 210,908 in 1990. This figure represents a 65 percent increase from 1970 and an 18 percent increase from 1980.

The growth and prosperity experienced by the region's employers and the low unemployment rate have led to low-skilled jobs being filled by workers who are recruited from outside the immediate region. This increase in the labor force has caused an urgent need for affordable housing which cannot be developed and constructed fast enough to accommodate the growing population.

The largest employment sector for the MSA is trade, followed by manufacturing. This is not surprising considering the nation's largest retailer, Wal-Mart, is headquartered in the area along with two of the larger national food processors, Tyson Foods and Hudson Foods.

In September 1997, unemployment for Washington County was 2.9 percent compared to the state unemployment rate of 5.3 percent. However, this number will increase due to three manufacturing plant closings scheduled in the next six months. These closings will result in the loss of over 800 jobs.

CONCLUSIONS WITH RESPECT TO THE PERFORMANCE TESTS:

²Population income levels were determined using the 1990 census median family income.

Lending Test

The Farmers and Merchants Bank meets the standards to receive a high satisfactory rating under the lending test performance criteria. Loan distributions show that the bank originates a significant majority of its loans within the assessment area. Further, the distributions reveal, given the product lines offered, good penetration among borrowers of different income levels and businesses of different sizes, and the geographic distribution of loans reflects reasonable penetration throughout the assessment area. Lending levels reflect a satisfactory responsiveness to assessment area credit needs. Given the size of the bank and available resources, the bank originates an adequate volume of community development lending and demonstrates a moderate level of innovativeness and flexibility in its lending practices.

As required by the CRA, the bank collected and submitted data on small business, small farm, and one-to-four family real estate loans. In addition, the bank opted to have motor vehicle loans included in the analysis.

Lending in the Assessment Area

A review of the bank's motor vehicle, residential, small business, and small farm loans from the previous six months revealed that a substantial majority of the bank's loans are located within the assessment area. The following table identifies, by loan type, the number, dollar volume, and percentage of loans originated inside the assessment area.

Distribution of Loans In/Out of the Assessment Area

Lending Inside Assessment Area					
Loan Type	Total Number/Dollars	Number in Assessment Area		Dollar Amount in Assessment Area	
Motor Vehicle	90 \$826,745	81	90%	\$752,739	91%
Residential	89 \$3,890,100	78	88%	\$3,158,600	81%
Small Farm	50 \$1,153,780	47	94%	\$864,780	75%
Small Business	66 \$2,427,807	61	92%	\$2,361,807	97%
Total	295 \$8,298,432	267	91%	\$7,137,926	86%

As depicted in the table, 267 of the 295 loans reviewed (91 percent) were located within the assessment area. By dollar volume, 86 percent of the loans reviewed were located inside the assessment area.

Consumer Loan Distribution by Borrower Income

The distribution of borrowers reflects good penetration among retail customers of different income levels³ given the product lines offered by the institution. The bank's volume of lending to low- and moderate-income borrowers is adequate. The following table shows the distribution of residential and motor vehicle loans within the assessment area by income level of the borrower.

Distribution of Consumer Loans (Number and Dollar Volume) within Assessment Area by Income Level of Borrower

³ The distribution of loans to individuals by income level is determined using the income definitions in footnote one but is based on the 1997 median family income figures made available by the Department of Housing and Urban Development, rather than of 1990 census data. Comparison population figures are based 1990 census data.

Loan Type	Borrower Income Classification				
	Low-	Moderate-	Middle-	Upper-	Total
Residential	7	13	25	29	74
	9%	18%	34%	39%	100%
	\$129,000	\$515,000	\$819,200	\$1,574,40	\$3,037,600
	4%	17%	27%	52%	100%
Motor Vehicle	12	15	22	26	75
	16%	20%	29%	35%	100%
	\$58,648	\$110,727	\$211,896	\$292,235	\$673,506
	9%	16%	31%	43%	100%
Total Loans Sampled	19	28	47	55	149
	13%	19%	31%	37%	100%
	\$187,648	\$625,727	\$1,031,09	\$1,866,63	\$3,711,106
	5%	17%	28%	50%	100%
Total Loans Sampled	19	28	47	55	149
	13%	19%	31%	37%	100%
	\$187,648	\$625,727	\$1,031,09	\$1,866,63	\$3,711,106
	5%	17%	28%	50%	100%
Assessment Area Family Population	23.2%	22.6%	25.6%	28.6%	100%

The sample revealed 32 percent of the number and 22 percent of the dollar volume of consumer loans were extended to low- and moderate-income applicants. This is adequate compared to the 45.8 percent of assessment area families categorized as low- and moderate-income. The increase in population to the area, especially by low-skilled workers, and the area's inability to develop and construct affordable housing, may somewhat mitigate the low volume of residential lending to low- and moderate-income individuals.

Loan Distribution to Small Businesses and Farms

The distribution of loans to small businesses and small farms is adequate. In addition, a majority of these loans were extended in dollar amounts less than \$100,000. The following table displays the small farm and small business loans within the assessment area originated to low- and moderate-income borrowers.⁴ Loans were grouped by the income level of the borrower using income definitions in footnote one, but based on 1997 median family income figures.

⁴ The CRA requires an assessment of the bank's loan distribution to businesses and farms with gross annual revenues of \$1 million or less. Because the bank did not collect revenue data, the bank's distribution of loans to low- and moderate- income borrowers was analyzed.

Distribution of Small Business/Small Farm Loans (Number and Dollar Volume) within Assessment Area by Income Level of Borrower			
Loan Type	Borrower Income Classification		
	Low-	Moderate-	Total
Small Farm ⁵	4 9%	10 21%	47
	\$30,403 4%	\$103,894 12%	\$864,780
Small Business	12 20%	14 23%	61
	\$123,900 5%	\$163,703 7%	\$2,361,807
Total	16 15%	24 22%	108
	\$154,303 5%	\$267,597 8%	\$3,226,587

The bank's lending to small businesses and farms is generally reflective of population percentages. Of 108 small farm and small business loans reviewed, 37 percent were extended to farmers and business owners whose income is categorized as low- and moderate-income. This figure is adequate considering that 45.8 percent of the assessment areas' families are low- and moderate-income.

Small farm and small business loans within the bank's assessment area were also analyzed by size of loan. For both loan types, a substantial majority was extended in dollar amounts less than \$100,000.

Distribution of Small Business/Small Farm Loans (Number) within Assessment Area by Loan Size

⁵ Although revenue data was lacking, the loans are classified as small farm and small business loans because they meet the regulatory definition. A small business loan is defined as a loan in an original amount of \$1 million or less, regardless of revenue size; a small farm loan is a loan in an original amount of \$500,000 or less, regardless of revenue size.

Loan Type	Distribution by Loan Size			
	≤ \$100,000	> \$100,000 < \$250,000	> \$250,000 < \$1,000,000	Total
Small Farm	45 96%	2 4%	0 0%	47 100%
Small Business	56 92%	3 5%	2 3%	61 100%
Total	101 93%	5 5%	2 2%	108 100%

The preceding table reflects excellent distribution by loan size. As shown in the table, the bank is lending in small dollar amounts to farms and businesses in the assessment area. Of small farm loans reviewed, 96 percent were extended in loan amounts of less than \$100,000. As with small farm lending, the bank's distribution for small business loans is excellent, with 92 percent of the loans sampled extended in dollar amounts of less than \$100,000.

Loan Distribution by Geography

The bank's origination of loans reflects good penetration throughout the bank's assessment area considering the bank's size and office locations. The following table demonstrates the number and dollar amount of loans by the income level of the census tract. As stated earlier, the assessment area consists of 10 middle-income tracts and one moderate-income tract.

Distribution of Loans (Number and Dollar Volume) within Assessment Area by Income Level of Census Tract			
Loan Type	Census Tract Income Level		
	Number of Loans and Dollar Amount		
	Moderate-	Middle-	Total
Motor Vehicle	1 1%	80 99%	81 100%
	\$5,404 1%	\$747,335 99%	\$752,739 100%
Residential	1 1%	77 99%	78 100%
	\$12,000 0% ⁶	\$3,146,600 100%	\$3,158,600 100%
Small Farm	0 0%	47 100%	47 100%
	\$0 0%	\$864,780 100%	\$864,780 100%
Small Business	0 0%	61 100%	61 100%
	\$0 0%	\$2,361,807 100%	\$2,361,807 100%
Total	2 1%	265 99%	267 100%
	\$17,404 0% ⁶	\$7,120,522 100%	\$7,137,926 100%
Population Distribution	11%	89%	100%

Lending in the moderate-income geography is sparse, but this is reasonable given the composition of the census tract. The Fayetteville Municipal Airport comprises most of this census tract. The census is on the outer edge of the bank's assessment area and closer to Fayetteville than the bank's branch in Farmington. Fayetteville has a number of financial institutions competing in the area. Therefore, the opportunity to lend to individuals in this census tract is limited.

⁶ The percentage is rounded to zero because it is less than one percent.

Lending Activity

The bank's average net loan-to-deposit ratio for the previous eleven quarters reported from December 31, 1994, through June 30, 1997, is 66 percent. In comparison, the average loan-to-deposit ratios of the bank's two local competitors were 76 percent and 80 percent, respectively.

Although slightly lower than its competitors, the bank's loan-to-deposit ratio is considered satisfactory in light of the bank's size and branch network. Over the previous 11 quarters, the bank's loan-to-deposit ratio has exhibited an upward trend from 65 percent in December 1994 to 70 percent in June 1997. Further, the competitor with the 86 percent loan-to-deposit ratio is an institution with assets substantially greater than the bank and is situated in the city of Fayetteville, a regional population center.

Community Development Lending

The bank's level of community development lending is adequate given the opportunities for such lending in the assessment area. The bank loaned \$275,000 to an individual to purchase and refurbish an 18 unit multi-family housing structure. The majority of the units are leased to low- and moderate-income, mainly elderly individuals on fixed incomes. In addition, the bank made another loan of \$275,000 for the construction of a 14 unit multi-family housing structure. Although the structure is not specifically targeted to low- and moderate-income individuals, the majority of the occupants are anticipated to be from of these income categories. The units are expected to rent at approximately \$380 and the Department of Housing and Urban Development (HUD) intends to offer a rent subsidy to families who qualify for assistance.

Responsiveness to Credit Needs

The bank has responded to local credit needs of low- and moderate-income individuals, small farms, and small businesses, as discussed in previous sections. In addition, the bank does not require a minimum loan amount, which meets the community's needs by allowing low- and moderate-income customers to borrow small amounts of money.

Innovative or Flexible Lending Practices

The bank offers several innovative loan products designed to increase the accessibility of credit to low- and moderate-income borrowers. These programs include agricultural financing through the Farmers Home Administration and assistance with loan closing costs and preferential interest rates through a program sponsored by the Arkansas Development and Financing Authority (ADFA).

The ADFA Low Income Home Buyers Assistance Program furnishes a grant of \$3,000 to defray closing costs to first time homebuyers. To become eligible for assistance, the consumer must have combined household income of not more than \$46,920 for two members or \$57,740 for three members, attend home ownership counseling, and meet the bank's underwriting standards. Once approved, the bank will finance the loan at a below market interest rate set by the ADFA. Because funds for ADFA grants are limited, only five applications have been funded. The below table shows the five applications by date, interest rate, and loan amount.

ADFA Low Income Home Buyers Assistance Program			
Loan	Date of Loan	Interest Rate	Amount
1	8-96	7.00%	68,700
2	9-96	7.00%	72,250
3	1-97	7.00%	74,500
4	4-97	6.85%	74,800
5	10-97	5.95%	62,000

From August 1996 to October 1997, the bank funded the five loan applications at below-market interest rates ranging from 5.95 percent to 7.00 percent. To date, funds totaling \$352,250 have been allocated to this program.

Investment Test

Although the bank has not made any qualified community investments, it is rated a low satisfactory in this category because opportunities for investment in the assessment area are limited and the institution has an adequate level of qualified community development grants.

Qualified Investments and Grants

Currently, the bank's portfolio does not contain any qualified community development investments. Opportunities to participate in qualified investments are limited because the bank is located in a predominantly rural area. Through its provision of qualified community grants, however, the bank does exhibit an adequate responsiveness to credit and community economic development needs. The bank provided the personnel, equipment and materials used to publish a cookbook. The proceeds benefited the Prairie Grove Senior Citizens Center. The center benefits elderly individuals who are primarily low- and moderate income.

Service Test

Given the bank's branch network, hours of operation, and product and service offerings, the bank's delivery systems are accessible to all portions of the assessment area. Further, the bank's retail services adequately meet the needs of low- and moderate-income families and geographies in the assessment area. The institution also provides a satisfactory number of community development services. As a result, the bank's performance under the service test is considered a high satisfactory.

Retail Services

The bank operates four banking facilities, which include the main office, two full-service branches, and a stand alone drive-up facility located in proximity to the main office. In addition, the bank operates three automatic teller machines (ATMs), one located along U.S. Highway 62 in Prairie Grove and two located at the branch offices. The lobby hours of the main office and branch offices are 9:00 a.m. to 4:00 p.m., Monday through Thursday, and 9:00 a.m. to 6:00 p.m. on Friday. The drive-thru facilities operate from 8:00 a.m. to 5:00 p.m., Monday through Thursday; 8:00 a.m. to 6:00 p.m. on Friday; and 9:00 a.m. to 12:00 a.m. on Saturday. Appointments are available after banking hours.

The bank offers a variety of loan products oriented toward community development. These include agriculture, consumer, commercial, construction, home mortgage, mobile home, and home improvement loans. Government-sponsored loan programs for agriculture and small business loans are also available. Further, loans, underwritten in conjunction with ADFAs grants, allow low- and moderate-income individuals to obtain a below-market interest rate. Finally, the bank does not have a minimum loan amount for consumer credit products and offers credit cards through First Financial Corporation.

The bank also offers deposit products and services oriented toward community development. The bank offers a comprehensive list of deposit products, including a no-cost checking account. Available banking services include bank-by-phone, which permits customers to access an automated system for determining account balances, verifying check clearings and deposit activity, and making transfers and withdrawals. Direct deposit, ATM cards, and check/point sale cards are also offered. Customers may make deposits, withdrawals, and loan payments at any Arvest Bank Group, Inc. bank, and a listing of the bank's products and services are located at the Arvest Internet Web site.

Community Development Services

The institution provides a satisfactory level of community development services to its assessment area. Bank employees serve in various capacities to improve the level of community and financial services available to low- and moderate-income persons residing in the assessment area. Such services include bank personnel serving on the building committee for the Prairie Grove Senior Citizens Center. In addition, the president of the institution has served on the Board of Directors and the Allocations Committee for the Washington County United Way Foundation.

Bank management and personnel also have served as intermediaries to obtain funding for low- and moderate-income organizations and individuals. The bank was instrumental to obtaining a grant from the Walton Family Foundation for the construction of the Prairie Grove Senior Citizens Center parking lot. Further, the bank helped two disabled individuals obtain money under Veteran's Administration Specially Adapted Housing Grant Funds Program. Besides helping to author the grant proposal, the bank conducted periodic inspections and acted as a disbursal agent during the construction/conversion of the handicapped accessible housing. No fees were charged in connection with any of the services rendered.

Additional Information

A fair lending analysis focusing on Regulation B (Equal Credit Opportunity) and the Fair Housing Act was performed during the examination. The analysis revealed that the bank is in compliance with the substantive provisions of antidiscrimination laws and regulations.

SCOPE OF EXAMINATION			
The bank recorded small business, small farm, and residential loans for year-to-date 1997. Of these, the previous six months of loans were reviewed during the examination. In addition, the bank provided information for other loan types. Of these, motor vehicle loans originated in the previous six months were chosen for review because of the high loan volume. The bank has one assessment area, and bank activities in the area were reviewed using the large bank examination procedures.			
TIME PERIOD REVIEWED		May 1, 1997 to November 14, 1997	
FINANCIAL INSTITUTION		PRODUCTS REVIEWED	
The Farmers and Merchants Bank Prairie Grove, Arkansas		Small Farm Small Business Residential Motor Vehicle	
AFFILIATE(S) REVIEWED	AFFILIATE RELATIONSHIP		PRODUCTS REVIEWED
None			
LIST OF ASSESSMENT AREAS AND TYPE OF EXAMINATION			
ASSESSMENT AREA	TYPE OF EXAMINATION	BRANCHES VISITED	OTHER INFORMATION
<u>Northwestern Arkansas</u> Washington County 105.01, 105.04, 105.05, 105.06, 110.01, 110.02, 110.03, 110.04, 111.01, 111.02, 111.03	On-site	Farmington	