



PUBLIC DISCLOSURE

MARCH 22, 2010

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**HOME STATE BANK
RSSD# 797159**

**318 SOUTH MAIN STREET
ERIE, KANSAS 66733**

**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***

Home State Bank (HSB) has a satisfactory record of helping to meet the credit needs of its entire assessment area (AA), including low- and moderate-income (LMI) borrowers and moderate-income geographies, in a manner consistent with its resources, operating philosophy, and the credit needs of the community.

HSB's average net loan-to-deposit (NLTD) ratio reflects a reasonable effort to extend credit consistent with safe and sound banking practices. A majority of the bank's lending activity occurred inside its AA. Also, the bank's distribution of loans among businesses of different revenue sizes and borrowers of different income levels was reasonable.

SCOPE OF EXAMINATION

HSB's Community Reinvestment Act (CRA) performance was evaluated using the Federal Financial Institution Examination Council's interagency examination procedures for small banks.

Three of the five lending test criteria were relevant to this review and are as follows:

- NLTD ratio;
- Lending Inside the AA; and,
- Lending to Borrowers of Different Income Levels and to Businesses of Different Revenue Sizes

Two lending test criteria were not relevant. The distribution of loans by income level of geographies was not analyzed because HSB's AA consisted of only middle-income census tracts so an analysis would not be meaningful. Also, the bank's responsiveness to CRA related complaints was not evaluated because the bank has not received any such complaints.

The evaluation of the bank's CRA record was based on a comparison between the bank's performance and area demographics and included comparisons between the bank's record and the records of local peer institutions. Conclusions about the three performance criteria were based on data compiled from a statistically-derived sample of loan files for each major product line. The major product lines were determined through discussions with bank management, a review of the Report of Condition and Income (Call Report), and a review of the number of loan originations since the bank's last CRA examination as of February 27, 2006. The two loan types selected for review were small business loans and residential real estate loans. To augment the evaluation, an interview was conducted with a member of the local community to ascertain local market conditions, the specific credit needs of the AA, and the banks' responsiveness in helping to meet those needs. The contact indicated that area banks were meeting the credit needs.

DESCRIPTION OF INSTITUTION

HSB is headquartered in Erie, Kansas, in the southeast portion of the state. The bank operates only one office which includes a drive-up window. The bank offers basic deposit and loan products. HSB is a wholly-owned subsidiary of Southeast Bancshares, Inc., a bank holding company headquartered in Chanute, Kansas. Although HSB does not have any branch offices, it is affiliated with five other financial institutions through common ownership by its bank holding company.

The analysis of the bank's CRA performance considers the bank's financial constraints, local economic conditions, and demographics, including the competitive environment in which the bank operates. There are no legal impediments that currently impact the bank's ability to lend. The bank's lending activity is primarily devoted to residential real estate and commercial loans. According to the December 31, 2009 Call Report, the bank's total assets were \$20.9 million, which included loans totaling \$10.3 million and deposits totaling \$19.1 million. Table 1 illustrates the breakdown of the bank's loan portfolio by product type.

Loan Type	Amount (\$000)	Percent of Total
Real Estate	4,068	39.3
Commercial	3,182	30.8
Agricultural	2,056	19.9
Consumer	950	9.2
Other	86	0.8
Total Gross Loans	10,342	100.0

The bank's CRA performance was last evaluated at the February 27, 2006 examination at which time it also was assigned a satisfactory rating.

DESCRIPTION OF THE BANK'S ASSESSMENT AREA

HSB's AA consists of two middle-income census tracts in Neosho County Kansas, which encompasses all of the county except a portion in the northwest corner. That portion of the county was excluded to avoid competition with an affiliated bank that operates in that area. According to Federal Deposit Insurance Corporation (FDIC) information as of June 30, 2009, the bank had 6.0 percent of all FDIC-insured deposits in the AA and was ranked 5th out of the 9 FDIC-insured financial institutions with offices located in the AA. The AA has not changed since the last CRA examination and does not arbitrarily exclude any LMI areas.

Population Trends and Characteristics

The 2008 AA population was estimated by the U.S. Census Bureau to have declined by 4.5 percent from 2000 to 2008 compared with a statewide growth rate of 4.2 percent during the same time period. The AA had a similar labor force to the total statewide nonmetropolitan area at 64.9 percent and 64.5 percent, respectively.

Income Characteristics

Overall, the AA is slightly less affluent than other Kansas nonmetropolitan areas. In 2000, the AA median family income (MFI) was \$40,099 compared to \$41,490 for the statewide nonmetropolitan areas. The 2008 U.S. Department of Housing and Urban Development (HUD) estimated MFI for the statewide Kansas nonmetropolitan areas had increased to \$52,100. Approximately 38.7 percent of AA families were considered to be LMI, whereas LMI families comprised 36.5 percent in statewide nonmetropolitan Kansas as a whole according to the 2000 Census data. The AA also had a slightly higher concentration of families living below the poverty level compared to the statewide nonmetropolitan areas, at 8.6 percent and 8.2 percent, respectively.

Economic Characteristics

The AA employment base relies heavily on the agricultural industry. Major employers in the AA consisted of county government offices and the local school district. According to a community contact, the local economy was depressed but currently stable. In addition, the community contact indicated that the primary credit needs of the community are residential real estate and commercial lending, and that local institutions are meeting these needs.

Housing Characteristics

The composition of AA housing is somewhat higher compared to other areas of nonmetropolitan Kansas. Approximately 73.9 percent of housing units in the AA are owner-occupied, compared to an owner-occupancy rate of 63.6 percent for nonmetropolitan Kansas as a whole. The median age of housing stock was slightly lower in the two areas, at 40 years for the AA and 45 years for nonmetropolitan Kansas. AA housing is relatively more affordable than other areas of nonmetropolitan Kansas. The AA's housing affordability ratio¹ equaled 65 whereas the ratio for the entire nonmetropolitan Kansas area was 58.

Table 2 illustrates the AA's income and business characteristics by family and tract income categories.

¹ The housing affordability rate is calculated by dividing the median household income by the median housing value. A lower ratio reflects less affordable housing.

**TABLE 2
BANK'S ASSESSMENT AREA DEMOGRAPHICS**

Income Categories	Tract Distribution		Families by Tract Income		Families < Poverty Level as % of Families by Tract		Families by Family Income	
	#	%	#	%	#	%	#	%
Low-income							360	17.6
Moderate-income							432	21.1
Middle-income	2	100.0	2,044	100.0	177	8.7	534	26.1
Upper-income							718	35.2
Total AA	2	100.0	2,044	100.0	177	8.7	2,044	100.0
Income Categories	Housing Units by Tract	Housing Types by Tract						
		Owner Occupied			Rental		Vacant	
	#	#	% by Tract	% by Unit	#	%	#	%
Middle-income	2,909	2,150	100.0	73.9	454	15.6	305	26.1
Total AA	2,909	2,150	100.0	73.9	454	15.6	305	26.1
	Total Businesses by Tract		Businesses by Tract & Revenue Size					
			Less Than or = \$1 Million		Over \$1 Million		Revenue Not Reported	
	#	%	#	%	#	%	#	%
Middle-income	254	100.0	224	100.0	15	100.0	15	100.0
Total AA	254	100.0	224	100.0	15	100.0	15	100.0
Percentage of Total Businesses:				88.2		5.9		5.9

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

The bank's record of meeting the credit needs of its AA was considered satisfactory, based on its lending performance in the bank's designated AA. This analysis included the data derived from statistical loan samples, area demographic information, and input obtained from members of the local community.

Net Loan-to-Deposit Ratio

This performance criterion evaluates the reasonableness of the bank's aggregate NLTD ratio in light of performance context information, including the institution's capacity to lend, demographic and economic factors present in the AA, and the availability of lending opportunities.

The bank's average NLTD ratio over the past 16 quarters averaged 54.9 percent. The bank's average NLTD ratio over the most recent 8 quarters was 55.6 percent, which was compared with those of three other financial institutions of similar asset sizes and operations within the southeastern part of Kansas. During the same time period, those three banks had average NLTD ratios ranging from 50.8 percent to 92.4 percent. The bank's state and national peer group average NLTD ratios were 55.0 percent and 65.2 percent for the same period,

respectively. The bank's NLTD ratio was higher than two out of three local peer group competitors and it was between its state and national peer group banks. The bank's performance under this test was considered reasonable.

Lending in the Bank's Assessment Areas

This lending test criterion evaluates the concentration of small business and residential real estate loans originated by the bank within its AA. As shown in Table 3, the bank's overall lending was considered reasonable with 55.1 percent of the bank's sampled loans being made within the AA. In addition, a review was made of all commercial and residential real estate loans originated or renewed since the previous CRA examination. According to the loan trial balance, approximately 82 percent of those loans were made within the bank's AA; however, the bank's loan trial did consist of a large volume of repeat loan customers.

Loan Distribution by Borrower Income Level and Revenue Size of Businesses

This performance criterion focuses on the bank's level of lending to small businesses and LMI families. The bank's distribution of small business and residential real estate loans represents reasonable penetration. Small businesses are defined as businesses with gross annual revenues of less than \$1 million.

Small Business Loans

The bank's lending performance to small businesses is considered to be strong. As shown in Table 3, 100.0 percent of the bank's sampled business loans were made to small businesses compared to 88.2 percent of small businesses in the AA. Of the loans sampled in the AA, 87.5 percent were in amounts less than \$100,000; amounts typically needed by small businesses.

Residential Real Estate Loans

The bank's level of lending to borrowers of different income levels was considered strong relative to AA demographics. Table 3 reflects a total of 54.5 percent of its residential loans were made to LMI borrowers compared to a total of 38.7 percent of LMI families in the AA.

Loan Distribution by Income Level of Geography

This performance criterion focuses on the bank's lending penetration in the AA among geographies of various income levels. Since there were only middle-income geographies within the bank's AA, this analysis would not be meaningful.

Record of Responding to Complaints

The bank has not received any CRA related complaints about its performance, so the bank's performance in responding to complaints would not be meaningful.

**TABLE 3
SUMMARY OF LENDING PERFORMANCE**

Lending within the Assessment Area

Product	Inside AA				Outside AA			
	#	%	\$(000)	%	#	%	\$(000)	%
Small Business Loans	16	57.1	562	36.8	12	42.9	964	63.2
Residential Loans	11	52.4	504	43.3	10	47.6	660	56.7
TOTAL	27	55.1	1,066	39.6	22	44.9	1,624	60.4

Distribution by Revenue Size of Business and Borrower Income Level

Product	% of Bank Loans				% of Small Businesses			
	Low	Moderate	Middle	Upper	Low	Moderate	Middle	Upper
Small Business Loans	100.0				88.2			
Residential Loans	% of Bank Loans				% of Families			
	Low	Moderate	Middle	Upper	Low	Moderate	Middle	Upper
Residential Loans	18.2	36.4	9.1	36.4	17.6	21.1	26.1	35.2

FAIR LENDING OR OTHER ILLEGAL CREDIT PRACTICES REVIEW

HSB was 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 the community

GLOSSARY OF COMMON CRA TERMS

(For additional information, please see the Definitions section of Regulation BB at 12 CFR 228.12.)

Assessment Area – The geographic area(s) delineated by the bank and used in evaluating the bank’s record of helping to meet the credit needs of its community. The assessment area must include the geographies where the main office, branches, and deposit-taking automated tellers machines are located. The assessment area must consist only of whole geographies, may not reflect illegal discrimination, and may not arbitrarily exclude low- or moderate-income geographies.

Census Tracts – Census tracts are small, relatively permanent geographic entities within counties delineated by a committee of local data users. Census tracts are designed to be homogenous with respect to population characteristics, economic status, and living conditions to allow for statistical comparisons and average about 4,000 inhabitants.

Consumer Loans – Loans to individuals for household, family, and other personal expenditures. These loans do not include real estate-secured loans.

Dun & Bradstreet Data – Data collected by Dun & Bradstreet regarding types of businesses and their respective gross annual revenues. The data can be sorted by geographies.

Geography – A census tract delineated by the U.S. Bureau of the Census in the most recent decennial census.

Income Level – Both geographies and individuals can be described in terms of their income levels. In MSAs, the level is based on the MSA median family income (MFI). In nonMSA areas, the level is based on the statewide, nonMSA median family income.

Low-Income – Less than 50 percent of the area median family income

Moderate-Income – At least 50 percent and less than 80 percent of the area median family income

Middle-Income – At least 80 percent and less than 120 percent of the area median family income

Upper-Income – At least 120 percent or more of the area median family income

LMI – Collectively, low- and moderate-income families or tracts.

Metropolitan Statistical Area (MSA) – The general concept of an MSA is that of a core area containing a large population nucleus, together with adjacent communities having a high degree of economic and social integration with that core. Generally, a single city with at least 50,000 inhabitants or an urbanized area with a total population of at least 100,000 would meet the definition of an MSA.

Small Business – A business with gross annual revenues of \$1 million or less.

Small Farm – A farm with gross annual revenues of \$1 million or less.

Small Loan(s) to Business(es) – A loan included in “loans to small businesses” as defined in the Consolidated Report of Condition and Income (“Call Report”). These loans have original amounts of \$1 million or less and typically are either secured by nonfarm or nonresidential real estate or are classified as commercial and industrial loans.

Small Loan(s) to Farm(s) – A loan included in “loans to small farms” as defined in the instructions for preparation of the Call Report. These loans have original amounts of \$500 thousand or less and are either secured by farmland, or are classified as loans to finance agricultural production and other loans to farmers.