



## **PUBLIC DISCLOSURE**

MARCH 21, 2011

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

**BANK OF CHEROKEE COUNTY  
RSSD# 815754**

**110 EAST MAIN STREET  
HULBERT, OKLAHOMA 74441**

**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***

Bank of Cherokee County (the bank) has a satisfactory record of helping to meet the credit needs of its entire assessment area (AA), including low- and moderate-income (LMI) families, in a manner consistent with its resources, operating philosophy, and the credit needs of the community. Three of the five criteria used to evaluate small bank lending performance were relevant to this review and are as follows:

- Net Loan-to-Deposit (NLTD) Ratio
- Lending Inside the AA
- Lending to Businesses of Different Revenue Sizes and Borrowers of Different Income Levels

Two of the criteria used to assess small bank performance under the Community Reinvestment Act (CRA) were not reviewed at this examination. The geographic distribution of loans among tracts of various income levels was not evaluated because the bank's AA is comprised of only middle-income tracts. The bank's responsiveness to complaints under the CRA also was not evaluated because the bank has not received any such complaints.

The bank's NLTD ratio reflected a reasonable effort to extend credit and a majority of the bank's lending activity occurred inside its AA. Finally, the bank's distribution of loans reflected a reasonable penetration among businesses of different revenue sizes and to individuals of different income levels.

## **SCOPE OF EXAMINATION**

The bank's performance under the CRA was evaluated using the Federal Financial Institutions Examination Council Interagency Small Bank Examination Procedures. The examination evaluated the bank's performance in the context of demographic information from the area in which the bank operates. Conclusions about the 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 management, a review of the bank's Report of Condition and Income (Call Report), and a review of the number of loan originations since the last CRA examination in March 2007. The loan sample consisted of 33 commercial loans and 32 residential real estate loans originated between July 1, 2010 and December 31, 2010. To augment the evaluation, interviews with members of the community were conducted during the examination to ascertain the credit needs of the bank's AA and local economic conditions.

## **DESCRIPTION OF INSTITUTION**

The bank is headquartered in Hulbert, Oklahoma, and operates two full-service branch facilities in Tahlequah and Park Hill, Oklahoma, approximately 11 miles east of Hulbert. Each

branch has a full-service automated teller machine (ATM) and a drive-through facility. The Park Hill location, just south of Tahlequah, currently serves as the bank's main office. In addition to the three facilities and ATM locations, the bank's website is transactional, allowing customers to transfer funds between accounts. The bank is a wholly-owned subsidiary of Cherokee County Bancshares, a one-bank holding company.

The bank has a substantial presence in its market, ranking 2<sup>nd</sup> in deposit market share among the seven banks with offices in Cherokee County. According to the June 30, 2010 Federal Deposit Insurance Corporation Market Share Report, the bank holds 21.9 percent of the deposits in Cherokee County. There are no legal restrictions limiting the bank's lending capabilities, and based on its size, financial condition, and resources, it has the ability to meet the credit needs of its AA. According to the December 31, 2010 Call Report, the bank's assets totaled \$96,326M, of which total loans represented \$65,446M or 67.9 percent. The bank is primarily a residential real estate and commercial lender but offers a variety of credit products to meet the needs of its AA, as illustrated in Table 1.

<b>TABLE 1 BANK'S LOAN PORTFOLIO</b>		
<b>Loan Type</b>	<b>Amount (\$000)</b>	<b>Percent of Total</b>
Commercial	30,380	46.4
Real Estate	21,212	32.4
Consumer	8,126	12.4
Agricultural	4,243	6.5
Other	1,485	2.3
<b>Total Gross Loans</b>	<b>65,446</b>	<b>100.0</b>

The bank's performance under the CRA was last evaluated at the March 19, 2007 examination, at which time it also was assigned a satisfactory rating.

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

The bank's AA consists of all eight tracts in Cherokee County, a rural area in northeastern Oklahoma approximately 60 miles east of Tulsa. Tahlequah is the largest city in Cherokee County and is adjoined by Park Hill to the south. As mentioned previously, all of the tracts in Cherokee County are middle-income.

The population of the AA was 46,029 based on 2009 Census estimates, which represents an increase of nearly 8.2 percent since the 2000 Census. Oklahoma averaged growth of 6.9 percent over the same time period.

According to 2000 Census data, the AA is less affluent than other rural areas of Oklahoma. The percentage of AA families living below the poverty level (17.0 percent) is higher than other

rural areas of the state (13.2 percent). Additionally, Cherokee County's population of LMI families (43.0 percent) is higher than other nonmetropolitan areas of Oklahoma (38.4 percent). The AA's median household income of \$26,608 is slightly lower than the \$28,864 median household income for other rural areas of the state. According to 2008 Census estimates, the median household income in Cherokee County has increased more than 21 percent to \$32,296.

The AA's median housing value of \$62,529 is higher than the statewide rural area average of \$54,030. Consequently, the AA's affordability ratio<sup>1</sup> of 42.0 percent is lower than the statewide rural ratio of 53.0 percent, indicating that AA homes are less affordable than other rural areas in the state. Cherokee County also has slightly higher percentages of rental and vacant housing units at 27.6 percent and 17.1 percent compared to other rural areas of Oklahoma at 23.7 percent and 15.3 percent, respectively. Despite the high level of rental properties, a community contact indicated that the affordable housing options in the area need to increase. Mobile homes comprise almost 25 percent of the AA housing and many affordable homes need structural improvements. Finally, the contact stated the community will benefit from new affordable housing developments currently underway and additional credit to renovate older units.

Labor statistics depict a decrease in the AA's unemployment rate over the last decade. Census data from 2000 states that Cherokee County's unemployment rate was 8.5 percent, while more recent 2009 estimates show the unemployment rate for the AA at 5.4 percent. In comparison, the unemployment rate for the state of Oklahoma increased from 5.2 percent to 6.4 percent over the same time period.

The AA's economy is relatively diversified. Major industries include government/education, tourism/service-related jobs, and health care. Northeastern State University is located in Tahlequah and provides significant employment opportunities. In addition, the area benefits from two major healthcare facilities, WW Hastings Indian Hospital and the Tahlequah City facility which serves as a regional hospital. A 258-acre industrial park in Tahlequah provides additional employment opportunities. Finally, the area's close proximity to recreational areas, such as Lake Tenkiller, which attracts approximately 2 million tourists annually, and the Illinois River which attracts approximately 400,000 visitors annually, provides additional jobs. Each of these areas is within 15 minutes of Tahlequah.

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

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<sup>1</sup> The affordability ratio is calculated by dividing the median household income by the median housing value. A higher ratio indicates more 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	0	0.0	0	0.0	0	0.0	2,683	23.9	
Moderate-income	0	0.0	0	0.0	0	0.0	2,141	19.1	
Middle-income	8	100.0	11,231	100.0	1,914	17.0	2,342	20.8	
Upper-income	0	0.0	0	0.0	0	0.0	4,065	36.2	
Total Assessment Area	8	100.0	11,231	100.0	1,914	17.0	11,231	100.0	
	Housing Units by Tract	Housing Type by Tract							
		Owner-occupied			Rental		Vacant		
		#	% by tract	% by unit	#	% by unit	#	% by unit	
Middle-income	19,499	10,801	100.0	55.4	5,374	27.6	3,324	17.0	
Total Assessment Area	19,499	10,801	100.0	55.4	5,374	27.6	3,324	17.0	
	Total Businesses by Tract	Businesses by Tract & Revenue Size							
				Less Than or = \$1 Million		Over \$1 Million		Revenue Not Reported	
		#	%	#	%	#	%	#	%
Middle-income	1,816	100.0	1,687	100.0	68	100.0	61	100.0	
Total Assessment Area	1,816	100.0	1,687	100.0	68	100.0	61	100.0	
		Percentage of Total Businesses:		92.9		3.7		3.4	

**CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA**

**Net Loan-to-Deposit Ratio**

The bank's NLTD ratio is reasonable given its size, financial condition, the credit needs of the AA, and the NLTD ratios of competing institutions and peer groups. The NLTD ratio averaged 75.6 percent over the past 16 quarters ending December 31, 2010. The only similarly situated financial institution in Cherokee County had an average NLTD ratio of 89.6 percent over the same 16-quarter period. The bank's average NLTD ratio was between those of its state and national peer groups, which averaged 74.2 percent and 76.7 percent respectively, over the same time frame.

**TABLE 3  
SUMMARY OF LENDING PERFORMANCE**

<b>Lending within the Assessment Area</b>								
	<b>Inside AA</b>				<b>Outside AA</b>			
	<b>#</b>	<b>%</b>	<b>\$(000)</b>	<b>%</b>	<b>#</b>	<b>%</b>	<b>\$(000)</b>	<b>%</b>
Residential Real Estate	27	84.4	2,002	85.1	5	15.6	352	14.9
Small Business	29	87.9	5,690	94.6	4	12.1	326	5.4
<b>TOTAL</b>	<b>56</b>	<b>86.2</b>	<b>7,692</b>	<b>91.9</b>	<b>9</b>	<b>13.8</b>	<b>677</b>	<b>8.1</b>
<b>Distribution by Borrower Income Level and Revenue Size of Business and Farms</b>								
	<b>% of Bank Loans</b>				<b>% of Families</b>			
	<b>Low</b>	<b>Moderate</b>	<b>Middle</b>	<b>Upper</b>	<b>Low</b>	<b>Moderate</b>	<b>Middle</b>	<b>Upper</b>
Residential Real Estate	14.8	18.5	11.1	40.6	23.9	19.1	20.9	36.1
	<b>% of Bank Loans</b>				<b>% of Small Businesses</b>			
Small Business	89.7				92.9			

**Lending in the Bank's AA**

This performance criterion evaluates the concentration of residential real estate and small business loans originated in the bank's AA. As shown in Table 3, a majority of the bank's small business and residential real estate loans were originated inside its AA. Therefore, the bank's performance is considered reasonable for this criterion.

**Distribution by Borrower Income Level and Revenue Size of Businesses**

This lending test focuses on the bank's level of lending to borrowers of different income levels, particularly LMI individuals, and to businesses of different revenue sizes, primarily those with gross annual revenues of \$1 million or less. This analysis focused on the number of loans originated rather than the dollar volume, as it is a better indicator of the number of individuals and businesses benefiting from those products.

*Residential Real Estate Loans*

The bank's level of lending to borrowers of different income levels is reasonable. As shown in Table 3, the bank's lending to LMI borrowers at 33.3 percent is lower than the percentage of LMI families in the AA at 43.0 percent. While the bank's performance was less than demographics would suggest, borrower income was unknown on approximately 15.0 percent of the loans in the bank's residential real estate sample. Additionally, the bank's performance is considered satisfactory given the AA's lower housing affordability ratio and the poor condition of much of the affordable housing as indicated by the community contacts. Finally, a community contact indicated that demand for rental units by students attending the local

university and lower-income families in Tahlequah has caused the availability of affordable housing for purchase to be reduced.

*Small Business Loans*

The bank's lending to small businesses is considered reasonable. As Table 3 depicts, the bank's lending to small businesses is slightly lower than the percentage of small businesses in the AA. The bank's commitment to small business lending was further demonstrated by its volume of small dollar loans to small businesses. Additional analysis revealed that 88.5 percent of the bank's loans to small businesses were in amounts of \$250,000 or less, which are amounts typically needed by small businesses.

**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, credit applications, loans, and interview procedures revealed no prohibited practices designed to discourage loan applicants. Further, the bank has not engaged in other illegal credit practices inconsistent with helping to meet community credit needs.

## **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.

**Community Development** – Includes affordable housing (including multifamily rental housing) for low- and moderate-income individuals; community services targeted to low- and moderate-income individuals; activities that promote economic development by financing businesses or farms that have gross annual revenues of \$1 million or less; or activities that revitalize or stabilize low- or moderate-income geographies, designated distressed or underserved nonmetropolitan middle-income areas or designated disaster areas.

**Community Development Loan** – A loan that has community development as its primary purpose and (except in the case of a wholesale or limited-purpose bank):

1. Has not been reported or collected by the bank or an affiliate as a home mortgage, small business, small farm, or consumer loan, unless it is a multifamily dwelling loan, and
2. Benefits the bank's assessment area(s) or a broader statewide or regional area that includes the bank's assessment area(s).

**Community Development Service** – A service that has as its primary purpose community development, is related to the provision of financial services, has not been considered in the evaluation of the bank's retail banking services, benefits the banks assessment area(s) or a broader statewide or regional area that includes the bank's assessment area, and has not been claimed by other affiliated institutions.

**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.

**Qualified Investment** – A lawful investment, deposit, membership share, or grant that has as its primary purpose community development.

**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.