

# **PUBLIC DISCLOSURE**

May 3, 2010

## **COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION**

First State Bank  
RSSD# 1003549

300 East Main Street  
Manchester, Iowa 52057

Federal Reserve Bank of Chicago

230 South LaSalle Street  
Chicago, IL 60604-1413

**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.

## TABLE OF CONTENTS

Institution's CRA (Community Reinvestment Act) Rating .....	1
Description of Institution.....	2
Description of Assessment Area.....	3
Conclusions with Respect to Performance Criteria:.....	5
Loan-To-Deposit Ratio.....	6
Lending in the Assessment Area.....	6
Lending To Borrowers of Different Incomes and to Businesses and Farms of Different Sizes .....	7
Geographic Distribution of Loans.....	8
Response to Complaints .....	9
Fair Lending and Other Illegal Credit Practices Review.....	9
Appendix A.....	10

**INSTITUTION'S COMMUNITY REINVESTMENT ACT (CRA) RATING:** This institution is rated **satisfactory**.

First State bank is meeting the needs of its community based upon an analysis of lending activities, economic conditions, and area demographics. This assessment is further supported by information and feedback supplied by community representatives. While reasonable, the loan-to-deposit ratio is low when compared to national peer and local competitors. Not included in the ratio is the dollar volume of residential real estate loans sold to the secondary market. In 2009, the bank sold \$7.1 million in residential real estate loans to secondary market investors. Lending in the assessment area is satisfactory, as a majority of the loans are originated within the assessment area. Lending to borrowers of different income levels is also satisfactory and reflects a reasonable distribution to low- and moderate-income individuals. Similarly, the distribution of loans to small businesses and small farms is satisfactory and loans are in amounts that typically support small business/small farm development. Furthermore, the geographic distribution of loans is satisfactory, as the loans are reasonably dispersed throughout the assessment area. There were no CRA-related complaints received by this institution or this Reserve Bank since the previous evaluation.

The institution was rated **satisfactory** under the CRA at its previous evaluation conducted on May 1, 2006.

### SCOPE OF EXAMINATION

First State Bank's CRA Performance was evaluated in the context of information about the institution and its assessment area, such as asset size, financial condition, competition, and economic and demographic characteristics. The scope of the evaluation was the four-year period following the previous CRA Public Evaluation dated May 1, 2006. The loan sample was taken from loans originated between January 1, 2008 and December 31, 2009. A sample of agricultural, commercial, and 1-4 family residential real estate loans was reviewed to determine performance within the designated assessment area. First State Bank was evaluated using the *Small Bank Examination Procedures* based on the following performance standards:

- *Loan-to-Deposit (LTD) Ratio*- Performed a comparative analysis of the average loan-to-deposit ratios for the 15 quarters from June 30, 2006 to December 31, 2009 for the bank, its national peer group and local competitors identified by the bank.
- *Lending in the Assessment Area* - Analyzed the percentage of commercial, agricultural, and residential real estate loans originated in the assessment area.
- *Lending to Borrowers of Different Incomes and to Businesses and Farms of Different Sizes* – Analyzed a sample of residential real estate, commercial, and agricultural loans to assess the loan distribution among borrowers of different income levels and to businesses and farms with different revenue levels.

- *Geographic Distribution of Lending in the Assessment Area* - Because the assessment area contains only middle-income geographies, only a limited analysis was performed to determine the dispersion of loans within the assessment area.
- *Complaints* – Neither First State Bank or this Reserve Bank received any CRA-related complaints since the previous evaluation.

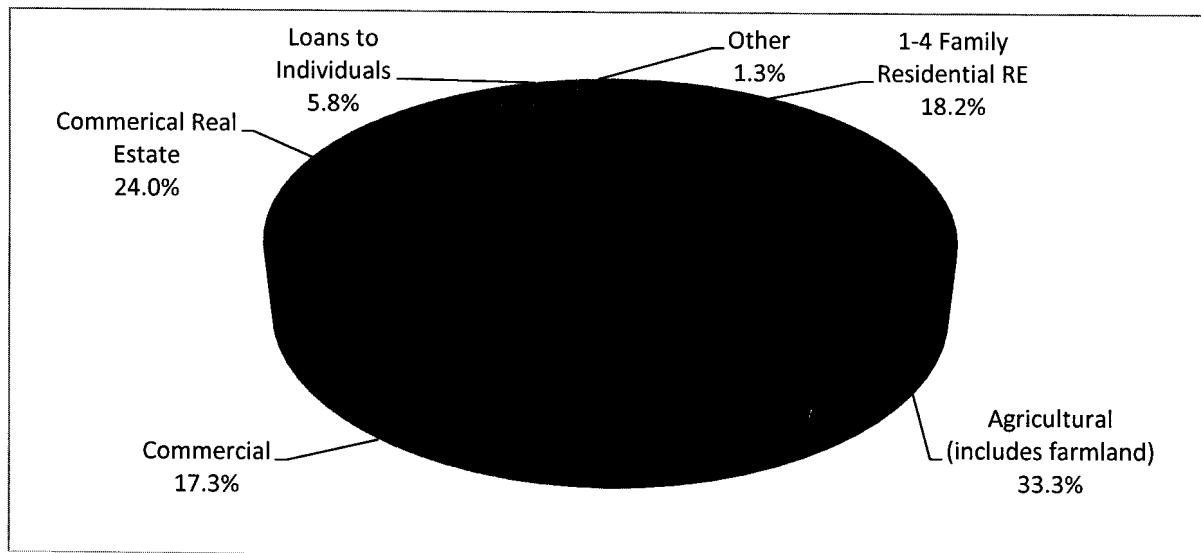
In addition to the above criteria, information obtained through discussions with two community representatives was considered in the overall evaluation.

### DESCRIPTION OF INSTITUTION

First State Bank is owned by a one-bank holding company, Delaware Service Co., located in Manchester, Iowa. The bank's sole office is located in Manchester with a cash-dispensing ATM. Manchester is located in northeast Iowa in Delaware County, approximately 45 miles west of Dubuque, Iowa and 170 miles northeast of Des Moines, Iowa.

According to the March 31, 2010 Uniform Bank Performance Report, the bank had total assets of \$72.7 million. The bank offers standard, non-complex loan and deposit products. As shown in Exhibit #1 below, the loan portfolio consists primarily of agricultural and commercial loans and to a lesser extent, residential real estate.

**Exhibit #1 – First State Bank Loan Portfolio as of March 31, 2010**



The bank's peer group includes all commercial banks with assets between \$50 and \$100 million, with 2 or fewer banking offices, and located in a non-metropolitan area. Local competitors for loans and deposits include Farmers & Merchants Savings Bank, Manchester, Iowa, and Farmers

Savings Bank, Colesburg, Iowa. Other competitors maintain branch facilities in both Manchester and nearby Delhi. These include Heritage Bank, Marion, Iowa, with a branch located in Delhi, as well as Community Savings Bank, Edgewood, Iowa, and Citizens State Bank, Monticello, Iowa, with branches located in Manchester. According to the June 30, 2009 FDIC Deposit Market Share Report, First State Bank holds 23.3% of deposits in the Delaware County market which ranks second out of the six financial institutions located in Delaware County.

There are no apparent factors relating to its financial condition, size, products offered, prior performance, legal impediments, or local economic conditions that would prevent the bank from meeting the needs of the community.

## **DESCRIPTION OF ASSESSMENT AREA**

*An institution's assessment area(s) will include the towns, counties, or other political subdivisions where its branches are located and a substantial portion of its loans are made. Assessment area(s) must consist of one or more geographies defined by census tracts, which are statistical subdivisions of a county. The 2000 U.S. Bureau of Census data is used in this evaluation, unless stated otherwise.*

First State Bank's assessment area, shown in Appendix A, consists of four middle-income geographies, 9501, 9502, 9503, and 9504 in Delaware County in nonmetropolitan Iowa. There have been no changes in the assessment area or branching network since the previous evaluation.

### **Population Changes**

According to the U.S. Census Bureau, the population of Delaware County as of July 1, 2009 was estimated at 17,205. The small decline in population as compared to the July 1, 2005 estimate of 17,619 is attributed to the workforce relocating to smaller outlying communities that offer inexpensive housing closer to larger population centers. The cities of Cedar Rapids, Dubuque, and Waterloo offer more employment opportunities with Manchester located at a greater distance than closer low-cost alternatives. The current population represents 6.5% decline from the 2000 Census total of 18,404.

### **Income Characteristics**

Exhibit #2 compares the income levels for the assessment area to nonmetropolitan State of Iowa based on the 2000 U.S. Census Bureau data. In contrast to the 2000 data, the 2009 Housing and Urban Development adjusted median family income for Delaware County and nonmetropolitan Iowa is \$56,300 and \$56,600, respectively.

Exhibit #2 Distribution of Families by Income Level						
Location	Median Family Income(\$)	Percent of Families				
		Low	Moderate	Middle	Upper	Below Poverty Level
Assessment Area	43,562	17.6	19.3	24.9	38.2	6.3
Non-Metropolitan Iowa	43,887	16.4	19.5	26.3	37.8	6.4

*Low-income is defined as less than 50% of median family income; moderate-income as 50% to less than 80% of median family income; middle-income as 80% to less than 120% of median family income; and upper-income as 120% or more of median family income.*

### Housing Characteristics and Affordability

The assessment area has 7,682 housing units of which 69.4% are owner-occupied, 19.6% are rental units, and 11.0% are vacant. Non-metropolitan Iowa, by comparison, has 68.6% owner-occupied, 22.7% rental units, and 8.7% vacant. The median age of housing stock in the assessment area is 40 years, while the median age of housing stock in non-metropolitan Iowa is 48 years.

*Affordability ratios, developed by dividing the median household income by the median housing value for a given area or groups of geographies, are helpful in comparing costs for different areas. An area with a high ratio generally has more affordable housing than an area with a low ratio.*

The affordability ratios for the assessment area and for non-metropolitan Iowa are .44 and .52, respectively, indicating that housing is generally less affordable in the assessment area. This is influenced considerably by a median housing value in the assessment area of \$83,905, compared to non-metropolitan Iowa of \$69,296.

Affordable housing is accessible but limited in Manchester as development opportunities are restricted by demand and available space. The area struggles to compete with smaller communities surrounding the metropolitan areas of Cedar Rapids, Waterloo, and Dubuque, Iowa, which offer inexpensive housing alternatives with closer proximity to a greater amount of amenities in the larger population centers.

### Labor and Employment

The area unemployment rate increased as area businesses have experienced labor force layoffs to coincide with increasing costs and lower output demand. This has further affected raw material manufacturing suppliers and equipment producers/fabricators as the need for resources and staffing has declined in conjunction with reduced product demand. According to Iowa Workforce Development as depicted in Exhibit #3, the jobless rate in Delaware County has experienced a smaller increase than the State of Iowa. Major employers in the assessment area are listed in Exhibit #4.

Exhibit # 3		
Unemployment Figures		
Location	March 2010	March 2009
Delaware County	8.1	7.5
State of Iowa	6.8	5.5

Exhibit # 4		
Major Employers in the Assessment Area		
Company	Location	Description
Attachment Technologies Inc.	Delaware County	Manufacturing
Delaware County Memorial Hospital	Delaware County	Health Services
Henderson Manufacturing Inc.	Delaware County	Manufacturing
West Delaware County Community School District	Delaware County	Education
X-L Specialized Trailers Inc.	Delaware County	Manufacturing
Maquoketa Valley Community Schools	Delaware County	Education

Source: Hoovers

Two community representatives, contacted during the examination to determine the credit needs of the assessment area, indicated that local financial institutions are actively involved in the community and are adequately meeting the credit needs of the community.

## CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

*Performance standards for small banks consist of the following, as applicable: the bank's loan-to-deposit (LTD) ratio, the percentage of loans and other lending-related activities located in the bank's assessment area, the record of lending to borrowers of different income and farms and businesses of different sizes, the geographic distribution of loans, and the record of taking action in response to written complaints. To determine CRA performance, the above standards are analyzed and evaluated within the assessment area context, which includes, but not limited to, comparative analyses of the assessment area and the state and the non-metropolitan portions of the state demographic data on median income, nature of housing stock, housing costs, and other relevant data pertaining to the bank's assessment area.*

**Loan-to-Deposit Ratio**

*The bank's average loan-to-deposit ratio, calculated from data contained in the Consolidated Reports of Condition, was evaluated giving consideration to the bank's capacity to lend, competitor and peers' loan-to-deposit ratios, as well as demographic factors, economic conditions and lending opportunities present in the assessment area.*

The bank's average LTD ratio for the previous fifteen quarters is below its national peer group and local competitors as shown in Exhibit #5 below. However, the ratio is viewed as reasonable as the bank sells a considerable volume of fixed-rate residential loans through third party investors. In 2009 sales represented 67 loans aggregating \$7.1 million. First State Bank has aggressively targeted deposit generation as its single banking location does not provide the deposit-taking network of many of its competitors. Further, the expanded branch networks of many of the other area competitors enhances their ability to court additional loan prospects both in Manchester and surrounding communities. The assessment area is highly competitive, especially in Manchester which currently houses four banks and a credit union with a population base of 5,257.

<b>Exhibit # 5</b>		
<b>LTD Ratios Comparison to National Peer and Area Competitors</b>		
<b>Bank Name, City, State</b>	<b>Assets as of 12/31/2009 (Thousands)</b>	<b>Avg. LTD Ratio (%)</b>
<b>First State Bank, Manchester, IA</b>	<b>\$135.9</b>	<b>61.3</b>
National Peer	N/A	72.9
Citizens State Bank, Monticello, IA	286.0	84.5
Community Savings Bank, Edgewood, IA	297.9	89.6
Farmers & Merchants Savings Bank, Manchester, IA	261.2	94.3
Farmers Savings Bank, Colesburg, IA	125.1	87.1
Heritage Bank, Marion, IA	32.0	62.4

**Lending in the Assessment Area**

*To assess the extent of lending within the assessment area, the following were reviewed: agricultural, commercial, and residential real estate loans. The sample period for each loan product was January 1, 2008 to December 31, 2009. Information from the performance context, such as economic conditions present within the assessment area, loan demand, bank size, financial condition, branching network, and business strategies, were considered when evaluating the bank's performance.*

Overall, lending within the bank's assessment area meets the standards for satisfactory performance under this criterion. The majority of First State Bank's loans are originated within the assessment area. The distribution of a sample of the bank's primary loan products, originated during the two year period January 1, 2008 through December 31, 2009, is illustrated in Exhibit #6.



Exhibit # 6 Distribution of Loans in/out of Assessment Area (AA)			
Loan Type	Number of Loans		
	# in Sample	# in AA	% in AA
Residential Real Estate	168	148	88.1
Agricultural	229	201	87.8
Commercial	157	130	82.8
Totals	554	479	86.5

**Lending to Borrowers of Different Income Levels and to Businesses and Farms of Different Sizes**

*The distribution of loans among borrowers of different income levels was determined by reviewing: 1-4 family residential real estate loans as well as small farm and small business loans. The sample period for residential real estate, small farm and small business loans was January 1, 2008 to December 31, 2009. Information from the performance context, such as economic conditions present within the assessment area, demographics, loan demand, bank size, financial condition, branching network, and business strategies, was considered when evaluating the bank's performance.*

Given the demographics of the bank's assessment area, the loan distribution across borrowers of different income levels, and farms and businesses of different sizes meets the standards for satisfactory performance under this criterion.

**Residential Real Estate Loans**

Exhibit #7 shows the distribution of the sample of 1-4 family residential real estate loans, originated during the period January 1, 2008 through December 31, 2009, by income level. As shown, the percentage of loans to low- and moderate-income borrowers is reasonable at 30.0%, compared to assessment area demographics of 36.9%. Not included in these numbers is the high volume of secondary market loans that resulted in 67 originations totaling \$7.1 million in 2009. These totals represent active residential real estate lending products with terms not offered directly through First State Bank to meet customer needs/demand.

Exhibit # 7 Loan Distribution of Residential Real Estate Loans by Income Level			
Income Level	Total Number of Loans	Percent of Total Loans	Percent of Families in Assessment Area
Low	5	10.0%	17.6%
Moderate	10	20.0	19.3
Middle	20	40.0	24.9
Upper	15	30.0	38.2
Totals	50	100.0%	100.0%

\* HUD's estimated 2009 median family income was used to determine the income level of the applicants.

## **Agricultural and Commercial Loans**

The distribution of commercial and agricultural loans reflects a reasonable penetration among small businesses and small farms. The distribution is based on a sample of 50 commercial and 50 agricultural loans originated between January 1, 2008 and December 31, 2009. Loans to small businesses with revenue of \$1 million or less represented 86.0% of the commercial and industrial portfolio. By comparison, 89.9% of businesses in the assessment area had \$1 million or less in revenue. Loans to small farms with revenue of \$500,000 or less represented 84.0% of the agricultural and farmland portfolio. By comparison, 99.8% of farms in the assessment area had \$500,000 or less in revenue.

Small business loan originations in the \$100,000 or less category represent 93.0% of the number and 69.6% of the dollar amount of small business loans. Emphasis is placed on this category as these loans encourage economic development in the community and are most beneficial to small businesses. During the sample period, First State Bank also originated four loans under the SBA guarantee program totaling \$642,780 that provided funding to various start-up and locally established small businesses.

Small farm loan originations in the \$100,000 or less category represent 78.6% of the number and 34.1% of the dollar amount of small farm loans. Emphasis is placed on this category as these loans encourage agricultural lending to start-up and small farm operations in the assessment area. Loan programs offered through the Farm Service Agency resulted in origination of nine loans totaling \$1,019,882 during 2009. These loans particularly helped beginning farmers who had limited capital positions.

According to community contacts, area financial institutions are meeting the needs of the farmers and business owners in the area with assistance from state and local governmental programs. Given the economy and most notably the lay-offs and down-sizing experienced in Manchester and the surrounding area there has been limited activity as it relates to attracting new businesses or expanding operations. The agricultural sector is doing well although there are fewer beginning farmers due largely to the high start-up costs. However, local institutions are working through government programs in an attempt to provide borrower's with additional funding support.

## **Geographic Distribution of Loans**

*The distribution of lending activities among geographies of different income levels within the assessment area, was reviewed. Since there are no low- and moderate-income tracts, the dispersal of loans amongst the four middle-income tracts was assessed. To assess the bank's performance, the following were reviewed: real estate, agricultural and commercial loans. The sample period was January 1, 2008 to December 31, 2009. Information from the performance context, such as economic conditions present within the assessment area, demographics, loan demand, bank size, financial condition, branching network, and business strategies were considered when evaluating the bank's performance.*

The geographic distribution of loans meets the standards for satisfactory performance under this criterion. The assessment area is comprised of four middle-income census tracts. As shown in Exhibit #8, the distribution of lending within the assessment area is reasonably dispersed throughout the four geographies given the location of banking offices. The lower distribution of lending in census tract 9501 is attributed to the geographic location of the tract being further from the sole bank location. Tract 9501 includes Dyersville, Iowa, which houses three banks and a credit union, with residents more likely to utilize banking services in closer proximity to their residence than in Manchester. The townships of Colesburg and Edgewood have a strong community banking presence, with competitor branches extending to Earlville, Greely, and Strawberry Point. This is in contrast to tract 9504 which has lesser competition with one competitor occupying the town of Ryan, thus bank lending activity in this tract is more prominent.

Exhibit # 8					
Geographic Distribution of Loans within the Assessment Area					
County	Census Tract	Number of Agricultural Loans	Number of Commercial Loans	Number of Real Estate Loans	Total
Delaware	9501	7	13	8	28
Delaware	9502	93	25	50	168
Delaware	9503	25	54	71	150
Delaware	9504	76	38	19	133
<b>Total Loans within the Assessment Area</b>		<b>201</b>	<b>130</b>	<b>148</b>	<b>479</b>

### Complaints

Neither the bank nor this Reserve Bank has received any CRA-related complaints since the previous evaluation.

### Fair Lending and Other Illegal Credit Practices Review

The bank is in compliance with the substantive provisions of the anti-discrimination laws and regulations, including the Equal Credit Opportunity and Fair Housing Acts. A sample of the bank's lending activity was reviewed to determine whether loan policies and lending standards were in compliance with the fair lending laws and regulations, and that these are being consistently applied to all applicants. No evidence of prohibited discriminatory credit practices was detected.

Appendix A

First State Bank's Assessment Area

