

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 the 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 CRA performance of Security State Bank & Trust Company, Polson, Montana, prepared by the Federal Reserve Bank of Minneapolis, the institution’s supervisory agency, as of March 17, 1997. 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: This institution is rated “Satisfactory.”

Several factors support the bank’s satisfactory rating. First, the bank has maintained a reasonable loan-to-deposit ratio since the last evaluation. This ratio is further enhanced by the number of real estate and commercial loans sold on the secondary market since the previous evaluation. Second, it makes a significant portion of its loans to residents of its assessment area. Third, it has a very notable distribution of loans to low- and moderate-income borrowers as well as to small farms and businesses in its assessment area. Finally, it has a reasonable distribution of loans between geographies of different income levels.

The following table indicates the performance level of Security State Bank & Trust Company, Polson, Montana, with respect to each of the five performance criteria.

SMALL INSTITUTION ASSESSMENT CRITERIA	SECURITY STATE BANK & TRUST COMPANY POLSON, MONTANA PERFORMANCE LEVELS		
	Exceeds Standards for Satisfactory Performance	Meets Standards for Satisfactory Performance	Does Not Meet Standards for Satisfactory Performance
Loan-to-Deposit Ratio		X	
Lending in Assessment Area	X		
Lending to Borrowers of Different Income Levels and to Businesses of Different Sizes	X		
Geographic Distribution of Loans		X	
Response to Complaints	No CRA complaints were received since the previous evaluation.		

DESCRIPTION OF INSTITUTION

Based on its size and financial condition, the bank is able to meet the credit needs of its assessment area effectively. The bank was rated outstanding in helping to meet the credit needs of its community at its previous CRA evaluation. The bank operates a full-service office, a detached drive-through facility, and a detached deposit-accepting automated teller machine (“ATM”) in Polson, Montana. The bank has not opened or closed any branches since the last evaluation.

According to its December 31, 1996, Report of Condition (“ROC”), the bank’s assets totaled approximately \$55 million. The December 31, 1996, ROC indicates the bank’s major loan category is consumer real estate lending, which constituted approximately 31% of its loan portfolio. The balance of the bank’s lending portfolio is comprised of 26% agricultural, 21% commercial, 21% consumer, and 1% other loans. The composition of the bank’s loan portfolio reflects the level of demand for specific types of loans in the assessment area.

The bank offers a variety of products that serve the credit needs of area residents, including agricultural, consumer, small business, community development, and government-guaranteed loans. In addition, the bank provides residential real estate loans for purchasing, refinancing, and improving homes. The bank offers government-guaranteed loan programs sponsored by the Small Business Administration, Department of Veterans Affairs, Federal Housing Administration, Rural Housing Service, Bureau of Indian Affairs, Montana Board of Housing, and Montana Board of Investments. The bank provides applications for government-guaranteed student loans, which are serviced by the Montana Higher Education Student Assistance Corporation. Finally, the bank is active in Lake County’s First-Time Homebuyer Assistance Program, which is designed to help low-income families become homeowners by providing down-payment and closing-cost assistance. The bank’s loan products appear appropriate for its community’s credit needs.

DESCRIPTION OF SECURITY STATE BANK & TRUST COMPANY’S ASSESSMENT AREA

The bank’s assessment area is defined as Lake County, located in northwestern Montana. The county is composed of block numbering areas (“BNAs”) 9950, 9951, 9952, 9953, 9954, 9955, and 9956. BNAs 9955 and 9956 are designated moderate income. The remaining BNAs are classified as middle income. Polson and the bank’s facilities are located in BNA 9953. Approximately 22% of the assessment area’s residents live in the moderate-income BNAs.

Based on the 1990 U.S. Census, the assessment area has a population of 21,041. The city of Polson, which is located at the southern end of Flathead Lake, is the county seat of Lake County. It is the largest community in the assessment area and has a population of 3,283. The Lake County area is referred to as the Mission Valley because it is flanked on the east by the Mission Mountains. Flathead Lake is the largest natural freshwater lake found west of the Mississippi River. The communities within the assessment area include Polson, Ronan, St. Ignatius, Ravalli, Pablo, Charlo, and Arlee.

Lake County is situated within the Flathead Indian Reservation (“Reservation”), which is home to the Confederated Salish and Kootenai Tribes of the Flathead Reservation. The tribal government headquarters are located in Pablo, which is seven miles south of Polson. In addition, Pablo is home to the Salish Kootenai College, with an enrollment of more than 900 full- and part-time students.

CRA divides income levels into four categories: low, moderate, middle, and upper. Because the bank's assessment area is not located in a metropolitan statistical area, the categorization of a borrower or BNA's income is determined relative to the statewide nonmetropolitan median family income. Pursuant to CRA's definitions, low-income individuals have incomes of less than 50% of the statewide nonmetropolitan median family income, while moderate-income individuals have incomes of at least 50% but less than 80% of this amount. The regulation defines middle-income individuals as persons with an income of at least 80% but less than 120% of the statewide nonmetropolitan median family income. Individuals with incomes of 120% or more of the statewide nonmetropolitan median family income are classified as upper-income persons. BNAs are classified using similar categories based on the level of the median family income in the geography. Based on 1990 census data, Montana's nonmetropolitan median family income is \$27,352. According to the 1996 updated census data, the statewide nonmetropolitan median family income in Montana is \$34,700.

According to 1990 census data, the assessment area's median family income is \$23,287, while its median household income is \$19,758. There are 5,766 families and 7,891 households in the assessment area. Approximately 17% of the families and 19% of the households in the assessment area have incomes below the poverty level. In comparison, 16% of the households and 13% of the families statewide have incomes below the poverty level. The following table summarizes the distribution of household and family incomes for the assessment area.

ASSESSMENT AREA POPULATION BY INCOME LEVEL				
Unit of Measure	Low Income	Moderate Income	Middle Income	Upper Income
Households Compared to Median Household Income	29%	17%	19%	35%
Families Compared to Median Family Income	27%	20%	23%	30%

According to community contacts, as well as information obtained from bank management, the county's major industries are timber, agriculture, and tourism. The timber industry, which includes lumber and wood processing, has declined in recent years. One community contact considered the local timber industry to be fairly stable. However, timber harvesting and processing technology has reduced the need for labor. Agriculture, which includes farming and ranching, is considered to range from stable to poor. The cattle market is down, mainly because of low prices for beef. Some farmers have subdivided their land, finding that selling it is more profitable than farming it. Retail and service-oriented businesses are doing well. Major employers in the area include government-, education-, health care-, and service-related organizations.

A community contact stated that affordable housing is difficult to find in the assessment area. He indicated that real estate costs increased greatly between 1990 and 1995.

The local banking environment is strongly competitive. One community contact stated there are 11 banking institutions in Lake County. In addition, there are several nonbank entities such as insurance companies and brokerage firms that compete for loan customers.

Examiners contacted a representative of the tribal government and a federal government employee as part of the bank's CRA evaluation. The tribal contact provided information regarding the credit needs of tribal members. The federal government representative provided information regarding the local economy and housing credit needs. Examiners used information from these contacts as well as information from bank management to help evaluate the bank's CRA performance.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

The bank's performance in meeting the credit needs in its assessment area is satisfactory. Much of the analysis on the following pages is based on a statistical sample of 161 consumer, 99 agricultural and commercial, and 50 residential real estate loans originated by the bank in the 12 months preceding the evaluation. The criteria detailed below were reviewed to determine this rating.

LOAN-TO-DEPOSIT RATIO ANALYSIS

The bank's loan-to-deposit ratio meets the standards for satisfactory performance. Based on quarterly ROC data, the bank's average net loan-to-deposit ratio since the previous evaluation is 68%. The following chart, based on quarterly ROC data since the previous evaluation, shows that the bank's net loan-to-deposit ratio has ranged from 67% to 70%. According to the December 31, 1996, Uniform Bank Performance Report, the bank's net loan-to-deposit ratio was 67%, which places the institution in the 60th percentile of its national peer group.

DATE	NET LOANS (IN THOUSANDS)	DEPOSITS (IN THOUSANDS)	NET LOAN-TO- DEPOSIT RATIO
December 31, 1996	\$31,577	\$46,885	67%
September 30, 1996	\$31,631	\$47,917	66%
June 30, 1996	\$31,414	\$44,991	70%
March 31, 1996	\$30,456	\$44,869	68%
December 31, 1995	\$30,664	\$43,617	70%
September 30, 1995	\$29,685	\$44,083	67%

A substantial number of real estate and commercial loans were sold on the secondary market since the previous evaluation. If the secondary market loans were included in the respective quarterly data mentioned previously, the bank's loan-to-deposit ratio would increase by a few percentage points. The bank's secondary-market lending included several loans to low- and moderate-income individuals under Lake County's First-Time Homebuyer Assistance Program.

According to bank management, the fluctuations in the loan-to-deposit ratios listed are caused by cyclical agricultural loan needs. The increase in loans is attributed partly to the number of agricultural loans that have not paid off as they would have normally. Since September 30, 1995, net loans and deposits have increased approximately \$1.9 million and \$2.8 million, respectively.

The bank does not compete with many similarly sized financial institutions in Lake County. Loan-to-deposit information was available for one similarly sized institution (Competitor B) that shows it compares closely with the subject bank. The bank's average loan-to-deposit ratio compares favorably with the quarterly average ratios of many of its other assessment area competitors. Based on the quarterly ROC

data from September 30, 1995, to December 31, 1996, the following table identifies the asset size and quarterly average loan-to-deposit ratios for the bank and its competitors.

BANK AND LOCATION	TOTAL ASSETS (AS OF DECEMBER 31, 1996) (IN THOUSANDS)	QUARTERLY AVERAGE NET LOAN-TO-DEPOSIT RATIO
Subject Bank Polson, Montana	\$55,289	68%
Competitor A Ronan, Montana	\$80,881	67%
Competitor B Bigfork, Montana	\$49,886	70%
Competitor C Ronan, Montana	\$20,917	85%
Competitor D St. Ignatius, Montana	\$20,621	58%
Competitor E Polson, Montana	\$19,187	74%

The high number of financial institutions operating within or near the bank's assessment area creates a very competitive credit market for the types of loans offered by the bank. As reflected by the competitor data, it appears the demand for credit in the assessment area is strong. It is apparent that local banks are willing to extend credit to fulfill the needs of local residents, farms, and businesses. Based on the bank's reasonable loan-to-deposit ratio and secondary market lending, the bank meets the standards for satisfactory rating.

DISTRIBUTION OF CREDIT WITHIN THE ASSESSMENT AREA

A review of the statistical sample of the loans originated by the bank during the 12 months preceding the evaluation reveals that a substantial majority of its loans were made inside the assessment area. The following table shows the percentage of loans within the assessment area based on total number and dollar amount in each major loan category.

PERCENTAGE OF LOANS IN THE ASSESSMENT AREA		
Loan Product	Total Number of Loans	Total Amount of Loans
Consumer	78%	76%
Residential Real Estate	86%	78%
Commercial & Agriculture	82%	84%

As noted in the table, a substantial percentage of the bank's loans are within the assessment area. Further, many loans outside the bank's assessment area are to borrowers in neighboring communities. Based on this high concentration of loans within the assessment area, the bank's lending performance for this category exceeds the standards for satisfactory performance.

LENDING TO BORROWERS OF DIFFERENT INCOME LEVELS AND TO BUSINESSES OF DIFFERENT SIZES

The bank's level of lending to individuals of different incomes and to businesses and farms of different sizes exceeds the standards for satisfactory performance. As discussed previously, the CRA classifies income levels into four categories: low, moderate, middle, and upper. The median household and family incomes for the bank's assessment area are \$19,758 and \$23,287, respectively.

The following table shows the percentage of consumer loans made to borrowers of different income levels.

DISTRIBUTION OF LOANS BY BORROWER INCOME LEVEL IN THE ASSESSMENT AREA *				
Loan Type	Low Income	Moderate Income	Middle Income	Upper Income
CONSUMER				
Percentage of Total Loans	42%	29%	14%	14%
Percentage of Total Loan Amounts	32%	25%	21%	22%
RESIDENTIAL REAL ESTATE				
Percentage of Total Loans	7%	39%	27%	27%
Percentage of Total Loan Amounts	3%	39%	26%	32%
*Income level is determined based on Montana's 1996 nonmetropolitan median family income of \$34,700.				

The consumer loan data, based on a statistical sampling of loans originated during the 12 months preceding the evaluation, reveal the bank extends a large percentage of consumer loans to low- and moderate-income borrowers. Consumer loans to these borrowers represent 71% of the total number of loans and 57% of the total dollar amount of loans in the sample. Low- and moderate-income households and families comprise 46% and 47% of the assessment area's households and families, respectively. Thus, the bank's consumer lending to low- and moderate-income borrowers appears to exceed their representation in the assessment area. The heavy level of lending to low- and moderate-income borrowers is particularly noteworthy in light of the heavy competition in the area.

The bank's residential real estate lending to low- and moderate-income individuals is particularly noteworthy. As shown in the chart, the bank made 46% of its real estate loans to low- and moderate-income individuals. Given the shortage of affordable housing in the assessment area, the bank's real estate lending to low- and moderate-income individuals is commendable. The bank also participates in several government loan programs that serve primarily low- and moderate-income individuals.

The agricultural and commercial loans reviewed during the evaluation were exclusively to borrowers with gross annual revenues of \$1 million or less. In addition, 96% of the loans to these borrowers had amounts less than or equal to \$100,000. Another 1% of these loans had amounts greater than \$100,000 but less than or equal to \$250,000. The remaining 3% of loans had amounts greater than \$250,000. This distribution of small business and farm loans is consistent with the bank's asset size, legal lending limit, and overall assessment area economic conditions.

The bank's distribution of loans by borrower income level exceeds the standards for satisfactory performance. The level of consumer lending to low- and moderate-income borrowers exceeds the representation of these borrowers in the community. More significantly, the bank's level of real estate lending to moderate-income borrowers is high given the identified need for affordable housing. The bank

actively participates in government loan products tailored to meet the needs of these residents. Community contacts identified the bank as a leading real estate lender in the area. Finally, the distribution of commercial and agricultural loans is reasonable.

GEOGRAPHIC DISTRIBUTION OF LOANS

The distribution of the bank's loans between geographies of different income levels is considered reasonable and meets the standards for satisfactory performance. The table indicates the bank's penetration in the assessment area's moderate- and middle-income BNAs.

DISTRIBUTION OF LOANS IN ASSESSMENT AREA BY BNA INCOME LEVEL*		
Type of Loan	Moderate Income	Middle Income
Consumer		
Total Number of Loans	6%	94%
Total Amount of Loans	3%	97%
Residential Real Estate		
Total Number of Loans	0%	100%
Total Amount of Loans	0%	100%
Commercial/Agricultural		
Total Number of Loans	11%	89%
Total Amount of Loans	27%	73%

*The bank's assessment area does not contain any low- or upper-income BNAs.

As previously discussed, the bank's assessment area includes two moderate-income and five middle-income BNAs. The moderate-income BNAs are found in the southern portion of Lake County and represent 22% of the assessment area's population, according to 1990 U.S. Census data.

The above table shows a low percentage of credit activity in the moderate-income BNAs in the assessment area. It should be noted that the moderate-income BNAs are located in the southern portion of the subject bank's assessment area, which also is actively served by three strong competitors in Ronan and St. Ignatius. These competitors are located between the subject bank and the borrowers in these moderate-income BNAs. Borrowers would have to bypass their local banks to reach the subject bank in Polson. As such, the low penetration of the bank's credit products in the moderate-income BNAs does not seem unreasonable. Based on these factors, the bank meets the standards for satisfactory performance in this category.

GENERAL

The evaluation did not reveal any violations of the substantive provisions of the fair housing and fair lending laws and regulations. The bank has not received any CRA complaints since the previous evaluation.

PUBLIC DISCLOSURE

March 17, 1997

Date of Evaluation

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

Security State Bank & Trust Company

Name of Depository Institution

093008200000

Identification Number of Institution

Polson, Montana

Address of Institution

Federal Reserve Bank of Minneapolis
250 Marquette Avenue
Minneapolis, Minnesota 55401-2171

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 financial supervisory agency concerning the safety and soundness of this financial institution.