

## 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 Farmers State Bank of Montana, Conrad, Montana, prepared by the Federal Reserve Bank of Minneapolis, the institution’s supervisory agency, as of September 15, 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.”

The CRA evaluation revealed several factors that support rating the bank’s CRA performance as satisfactory. First, the bank’s net loan-to-deposit ratio is comparable to ratios of other financial institutions located within the bank’s assessment area. Second, the bank has originated a significant majority of its loans to assessment area residents, businesses, and farms. Third, it actively extends consumer loans to individuals with low and moderate incomes and to small businesses and farms. Finally, it originates loans to borrowers residing throughout its assessment area.

## DESCRIPTION OF INSTITUTION

The bank is able to fulfill area credit needs effectively. The previous CRA evaluation, conducted as of June 10, 1996, revealed the bank's performance in meeting community credit needs was satisfactory. The bank operates full-service offices in Conrad and Cut Bank, Montana. The main office is in block numbering area ("BNA") 9770, a middle-income area. The bank's Cut Bank branch office, which the bank acquired in March 1996, is in BNA 9760, also a middle-income area. The bank operates four cash-dispensing automated teller machines ("ATM"), which are located in BNAs 9770 (2), 9760 (1), and 9761 (1). Since the last evaluation, the bank added its second ATM in Conrad. Its offices are centrally located in the assessment area.

The bank's size does not restrict its ability to fulfill the credit needs of residents, businesses, and farms within the assessment area. According to the June 30, 1997, Report of Condition ("ROC"), the bank had total assets of approximately \$100 million. The bank's loan portfolio has increased since June 30, 1996. The bank's quarterly loan and deposit growth rates are set forth in the following table:

<b>QUARTERLY GROWTH RATES</b>		
<b>Period</b>	<b>Loans</b>	<b>Deposits</b>
July 1, 1996 to September 30, 1996	2.47%	(2.22%)
October 1, 1996 to December 31, 1996	.11%	3.84%
January 1, 1997 to March 31, 1997	1.87%	(1.77%)
April 1, 1997 to June 30, 1997	21.10%	(3.54%)

The June 30, 1997, ROC indicates that the bank is primarily an agriculture lender; approximately 41% of its portfolio is agriculture loans and 14% is agriculture real estate loans. The balance of the bank's loan portfolio is composed of 13% consumer real estate, 10% consumer, and 21% commercial loans. The composition of the loan portfolio remained relatively stable since the last evaluation; however, the bank has increased its commercial real estate loan holdings during that time period. The composition of the bank's loan portfolio reflects the level of demand for specific types of credit by residents, businesses, and farms in the assessment area.

The bank offers a variety of loan products to fulfill the credit needs of residents, businesses, and farms within its assessment area. It extends conventional consumer, residential real estate, mobile home, commercial, and agricultural loans for a variety of purposes. The bank's residential real estate loan products include adjustable rate mortgages, construction loans, fixed-rate loans with 15- and 30-year maturities, and balloon loans with 3- to 5-year maturities. The bank also extends residential real estate loans secured, in part, by private mortgage insurance ("PMI"). Its PMI loan program is a new product the bank began offering in August 1996.

To serve consumer credit needs, the bank participates in holiday loan programs in Conrad and Cut Bank. Through the Conrad loan program, the bank extends short-term, interest-free loans for use at local retail establishments. In Cut Bank, the bank offers interest-free loans with six-month maturities, which have no spending restrictions. Its open-end products include personal ready reserve, commercial, agricultural, and home equity lines of credit. The bank also extends loans to municipalities and issues letters of credit for local businesses. Finally, although it does not extend credit card loans, the bank provides its customers applications for MasterCard and VISA credit cards from another creditor.

In addition to conventional loan products, the bank participates in numerous government-sponsored loan programs. For residential real estate loan borrowers, it offers Department of Veterans Affairs ("VA"), Rural Development ("RD"), U.S. Department of Housing and Urban Development Section 184 Indian Housing Loan Guarantee Program ("HUD Section 184"), Neighborhood Housing Service ("NHS") Affordable Housing and Grant Assistance for Downpayment/Closing Cost, Federal Housing Administration ("FHA") Title I, and Montana Board of Housing ("MBOH") loans. The bank participated in the FHA Title I, MBOH, VA, and RD loan programs prior to the last evaluation, but start participating in the NHS and HUD Section 184 program since the last evaluation. The bank is also in the process of obtaining approval to grant FHA loans. For commercial and agricultural borrowers, the bank offers Small Business Administration ("SBA") and Farm Service Agency ("FSA") loans. Since the last evaluation, the bank has started originating loans through the SBA's 504 program. Finally, it actively extends government-subsidized student loans.

### **DESCRIPTION OF FARMERS STATE BANK OF MONTANA'S ASSESSMENT AREA**

The bank has defined its assessment area as including all or sections of five counties in northwestern Montana. Pondera, Toole, and Liberty counties are entirely in the assessment area while all but the western section of Glacier County and the south-central section of Teton County are in assessment area. More specifically, the assessment area surrounds the following BNAs: 9760, 9761, 9762, 9745, 9746, 9770, 9771, 9714, 9716.98, 9750, and 9751. With one exception, BNA 9762, the BNAs in the assessment area are designated middle-income areas according to the 1990 U.S. Census. BNA 9762 is a low-income area. The bank has not changed the definition of its assessment area since the last evaluation.

The largest communities within the assessment area include Conrad, Shelby, Cut Bank, and Browning, Montana. The respective populations of these communities are 2,891; 2,763; 3,329; and 4,548. According to 1990 census data, the population of the assessment area is 30,286. The four largest towns in the assessment area represent 45% of the assessment area's total population. According to community contacts in Conrad and Cut Bank, the populations of these two cities have declined since 1990.

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's or an area's income is determined relative to the statewide nonmetropolitan median family income. Pursuant to the 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 people with incomes of at least 80% but less than 120% of the statewide nonmetropolitan median family income. Individuals with incomes of 120% or more than the statewide nonmetropolitan median family income are classified as upper-income persons. According to the 1997 updated data, the statewide nonmetropolitan median family income in Montana is \$36,100; this figure is used to classify income levels of borrowers. BNAs are classified using similar categories based on the level of the median family income in the geography compared with the 1990 statewide nonmetropolitan median family income of \$27,352.

According to the 1990 U.S. Census data, the assessment area's median family income is \$26,314, which is approximately 96% of the statewide nonmetropolitan median family income. The median household income for the assessment area is \$21,781. There are approximately 7,490 families and 10,300 households within the assessment area. Approximately 18% of the families and 19% of the households have incomes below the poverty level. The percentages of such families and households in the assessment area are higher

than the nonmetropolitan statewide percentages of 13% and 17%, respectively. The distribution of family and household income for the assessment area is summarized in the following table.

<b>ASSESSMENT AREA POPULATION DISTRIBUTION BY INCOME LEVEL</b>				
Unit of Measure	Low Income	Moderate Income	Middle Income	Upper Income
Families Compared to Median Family Income	25%	17%	22%	36%
Households Compared to Median Household Income	26%	16%	17%	41%

As previously discussed, the bank's assessment area includes 11 BNAs in five counties. The following table describes the assessment area's population and income distribution by BNA.

<b>INCOME DESIGNATION AND POPULATION DISTRIBUTION BY BNA</b>		
BNAs	Income Designation	Percentage of Assessment Area Population
Glacier County		
9760	Middle	14%
9761	Middle	10%
<b>9762</b>	<b>Low</b>	<b>15%</b>
Liberty County		
9745	Middle	2%
9746	Middle	6%
Pondera County		
9770	Middle	14%
9771	Middle	7%
Teton County		
9714	Middle	4%
9716.98	Middle	11%
Toole County		
9750	Middle	5%
9751	Middle	12%

As the table illustrates, the bank's assessment area has only one low-income area, which represents 15% of the assessment area's population. The median family income in BNA 9762 is \$12,065, according to census data, and is only 44% of the statewide median family income for Montana's nonmetropolitan areas. Two of the assessment area's middle-income BNAs have median family incomes slightly above the \$21,879 for classification as moderate-income areas; BNAs 9761 and 9771 have median family incomes of \$22,909 and \$23,077, respectively, which represent 84% of the statewide median family income for Montana's nonmetropolitan areas.

Real property values in the assessment area are increasing. One community contact estimated that Conrad's housing prices have increased 50% since 1990. According to the 1990 U.S. Census, the median value of the assessment area's housing was \$42,802. Comparing the 1990 median housing value to the

assessment area's median family income shows that housing is relatively expensive in one part of the assessment area. The following table sets forth the median value of housing in each of the counties in the bank's assessment area.

<b>1990 MEDIAN HOUSING VALUES</b>			
<b>County</b>	<b>Median Housing Value</b>	<b>Median Family Income</b>	<b>Affordability Ratio</b>
Glacier	\$44,367	\$21,497	42%
Liberty	\$41,970	\$28,125	54%
Pondera	\$41,513	\$25,000	57%
Teton	\$46,000	\$26,322	48%
Toole	\$38,650	\$29,720	65%

The assessment area's housing is most expensive relative to income in Glacier County, as illustrated by the low affordability, which is calculated by dividing the median family income by the median housing value. The affordability ratio for Montana's nonmetropolitan areas is 41%.

According to community contacts, housing construction is limited in both Conrad and Cut Bank. In Conrad, this fact is not a concern for local residents because of the negative population growth. According to bank management, the rental home market remains tight, and manufactured homes are the typical starter dwelling. In Cut Bank, a 1993 study showed that only 2 single-unit dwellings and 19 multiple-unit dwellings were built during the two years preceding the study. At the time of the study, the average monthly rent for a two-bedroom house was \$300 and the average cost of a three-bedroom house was \$50,000.

According to bank management, the assessment area has a large and increasing population of wealthy, retired people, who are full-time residents of the area. The census data show that 14.1% of the assessment area's population is age 65 years and older; the percentage of such persons in the assessment area is only slightly higher than in Montana's nonmetropolitan areas, where people age 65 years and older represent 13.6% of the population. In all but Glacier County, the percentage of people age 65 years and older is much higher than the state's nonmetropolitan areas. Most people move to the area because of its relatively low cost of living and its proximity to the mountains. Approximately five years ago, Conrad acquired housing from a military base, which was converted into a retirement community. Many of the area's elderly residents have limited credit demands.

The census data also show that the bank's assessment area has a high percentage of young people. People age 17 years and younger represent 33% of the bank's assessment area. Compared with Montana's nonmetropolitan area data, which show that people age 17 years and younger represent 28% of the population, the assessment area has a higher number of young people than the state's rural areas in general. At 37%, Glacier County's population has the highest proportion of young people.

One unique characteristic of the assessment area is that it is home to numerous Hutterite colonies. Apparently, as many as 16 Hutterite colonies have farming operations in the assessment area. The average colony population is 100 persons. The colonies and their members have very limited credit needs.

Another unique characteristic of the bank's assessment area is the Blackfeet Indian Reservation ("Reservation"). The Reservation's boundaries surround approximately 1.5 million acres in Glacier and Pondera counties. Estimates show that 40% of the Reservation land is owned by non-Indians. As of March 1995, the Blackfeet Indian Nation ("Tribe") had 14,334 members of which 7,300 live on the Reservation; approximately 51% of the members reside on the Reservation. Community contacts stated that the population of tribal members on the Reservation is increasing as people who left for educational opportunities are returning to the area. The tribal government is centralized in Browning, which is located in BNA 9762. Browning is approximately 45 miles west of Cut Bank and 65 miles from Conrad.

Glacier County has the lowest median family and household incomes of all the counties located in the assessment area. It also has the highest concentration of people with incomes below the poverty level; approximately 31% and 29% of Glacier County's families and households, respectively, had incomes below the poverty level. According to a 1993 report on the socioeconomic status of the Tribe, unemployment on the Reservation was a significant problem; community contacts confirmed that the high unemployment rate continues today. Most of the Tribe's labor force work for the federal or tribal government. Only 27% of the population works in the private sector.

As previously discussed, housing prices compared with median family incomes in Glacier County are high. Rents are similarly high. The median gross rent in the assessment area is \$261. In Glacier County, it is \$257; however, Glacier County's median family income is only 82% of the assessment area's median family income. Glacier County has more rental units, more mobile homes, and fewer owner-occupied dwellings than the assessment area in general.

The assessment area's only low-income BNA surrounds Browning, Montana, on the Reservation. Of the families living in the low-income area, 55% are low income and 18% are moderate-income families. In the low-income area, only 37% of the housing units are owner-occupied dwellings and 53% are renter-occupied units. The data for the assessment area's middle-income BNAs show 58% of the housing units are owner-occupied dwellings and 23% are renter-occupied units. Only 8% of the assessment area's owner-occupied dwellings are located in the low-income BNA.

According to the 1993 socioeconomic analysis of the Tribe, most tribal members own homes; estimates show less than half the population lives in rental dwellings. The median value of specified owner-occupied units was \$39,000 according to the 1990 U.S. Census. The analysis report stated members' low incomes and lending institutions' minimum down payment requirements are the primary obstacles to home ownership, but noted that the relatively few Indians who own land and the lack of information about housing programs also hinder tribal members' ability to purchase homes. The report also concluded that tribal members cannot afford to maintain the physical condition or change structural deficiencies of their residences. With respect to rental units, the median rent for specified renter-occupied units on the Reservation was \$99, according to the 1990 U.S. Census.

The assessment area's private business sector appears to be dominated by small businesses. Since Conrad and Cut Bank are county seats and Browning is the tribal headquarters, many local people are employed in the public sector. In Pondera County, where Conrad is the county seat, agriculture is the primary local industry, employing over 20% of the county's labor force. The primary agriculture commodities are barley, wheat, and cattle. Important secondary industries are oil, tourism, and retirement. Government and governmental enterprises, which employ approximately 18% of the local labor force, also represent a large sector of Pondera County's economy. The hospital is Conrad's largest employer. Because Conrad is located approximately 50 miles from Great Falls, Montana, its retail sector has declined; an increasing

number of people are willing to travel greater distances for goods and services. Conrad's retail and service establishments continue to provide the necessities, including medical, needed by the community's residents and travelers to and from Canada and Glacier National Park. Like the assessment area in general, almost all of Pondera County's business establishments have fewer than 49 employees, according to the 1993 County Business Patterns data.

Glacier County also has an agriculture-based economy. Historically, the oil industry significantly influenced the local economy; this industry's presence remains in the form of some seasonal employment, but it is much reduced from the 1980s. Cut Bank, which is the county seat of Glacier County, has a larger retail sector than Conrad due to Cut Bank's larger population and distance from Great Falls. Its businesses also service the needs of Reservation residents and tourists who drive through the town en route to Glacier National Park. According to a community contact, the tourist trade continues to increase; one goal of city leaders is to increase the number of tourists who spend dollars in Cut Bank. Most of Glacier County's business establishments employ fewer than 49 employees; however, the county has several large employers, including a construction company, grocery store, and power company. On the Reservation, the federal government and the tribe are the largest employers. Other significant employers include the Blackfeet Community College and the Blackfeet Indian Housing Authority.

In 1996, the area's wheat farmers produced average crops due to lack of rainfall. Grain prices declined between May and December. During 1996, cattle ranchers saw prices increase after a two-year weak market, but profits did not rise proportionally because the lack of rainfall resulted in higher feed prices. Bank management expects that the agricultural industry will have average results in 1997. According to bank management, the business economies in Conrad and Cut Bank are stable. Neither area is experiencing significant growth; in fact, Cut Bank's residents have seen several businesses close.

Teton County is located in the southern section of the bank's assessment area. Its primary industry is agriculture, both farming and ranching, which employs over 28% of the county's labor force. The primary commodities are livestock, small grains, and hay. Like other sections of the assessment area, tourism is becoming an important component of the local economy.

The bank has numerous bank and nonbank competitors in the assessment area. In addition to the bank, Conrad residents, farms, and businesses obtain financial services from Norwest Bank Montana, National Association, Billings, Montana (branches in Conrad and Shelby); Heritage Bank, F.S.B., Great Falls, Montana (branch in Chester); and Western Federal Savings Bank of Montana, Missoula, Montana (branch in Conrad). The bank also competes with the Great Falls Teachers Federal Credit Union, Great Falls, Montana. The bank's primary nonbank competitors in Conrad are Norwest Mortgage, Farm Credit Services, and dealerships, both automobile and equipment. In Cut Bank, the bank's branch office competes with First Interstate Bank of Commerce, Billings, Montana (branch in Cut Bank); The First State Bank of Shelby, Shelby; Blackfeet National Bank, Browning; and Glacier Bank, F.S.B., Kalispell, Montana. The Cut Bank branch also competes with First Liberty Federal Credit Union, Great Falls, as well as the Tribe's credit office. According to bank management, Reservation residents who bank at the Cut Bank office are typically from the Browning area while those who bank at the Conrad office are typically from the southern section of the Reservation.

Examiners contacted a city official, an economic development director, and numerous tribal officials to discuss community credit needs and development projects. This evaluation reflects information from these community contacts.

## CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

The bank's performance in meeting the credit needs of its assessment area is satisfactory. Most of the analysis on the following pages is based on a statistical sample of 120 consumer, 71 consumer real estate, 72 small business, and 121 small farm loans originated during the six months prior to the evaluation. The following criteria were analyzed to determine the bank's CRA rating: loan-to-deposit ratio, credit extended inside compared to credit extended outside the assessment area, loans to borrowers of different income levels and to businesses and farms of different sizes, loans to borrowers in different geographies, and general information.

The bank's overall rating primarily reflects its quarterly net loan-to-deposit ratio, which is merely comparable to ratios of other local financial institutions. Notably, since the last evaluation, the bank's lending activity has steadily increased with the largest significant increase occurring during the second quarter of 1997. In addition to the bank's overall lending activity, as evidenced by the quarterly average net loan-to-deposit ratio, significant weight was given to the bank's loan distributions, both by borrower incomes and geographical locations, in determining the bank's overall CRA rating.

### LOAN-TO-DEPOSIT RATIO ANALYSIS

The bank's net loan-to-deposit ratio meets the standards for satisfactory performance. Since the last evaluation, the bank's net loan-to-deposit ratio has increased from 55% to 72%. The bank's general lending level is lower than most of its national peer group, based on June 30, 1997, Uniform Bank Performance Report ("UBPR") data. These data indicate that the bank's June 30, 1997, net loan-to-deposit ratio of 72% ranks the bank in the 49th percentile as compared with its national peers. The quarterly average of the bank's net loan-to-deposit ratios, based on the data for the five calendar quarters since June 30, 1996, is 59%. The following chart summarizes the bank's net loan-to-deposit ratio and its components since June 30, 1996.

<b>DATE</b>	<b>NET LOANS (In thousands)</b>	<b>DEPOSITS (In thousands)</b>	<b>NET LOAN-TO- DEPOSIT RATIO</b>
June 30, 1996	\$45,315	\$83,123	55%
September 30, 1996	\$46,432	\$81,275	57%
December 31, 1996	\$46,483	\$84,392	55%
March 31, 1997	\$47,351	\$82,897	57%
June 30, 1997	\$57,342	\$79,962	72%

The bank's loan data do not reflect loans sold since the last evaluation. The bank sells residential real estate loans to the secondary market; if these loans were included in the data set forth above, the net loan-to-deposit ratio would increase. The bank also sold a portion of a commercial loan, and the data set forth above do not reflect this amount.

Since the last evaluation, the bank has made a concerted effort to increase its lending. As a direct result, during the year between June 30, 1996 and 1997, the bank's loan portfolio increased by 27%. The most significant loan growth occurred between March 31 and June 30, 1997. As noted, the bank's quarterly average net loan-to-deposit ratio is 59% and compares very favorably with the 45% ratio noted during the last evaluation.



As previously discussed, the bank's quarterly average net loan-to-deposit ratio is merely comparable to ratios of other financial institutions operating main offices in the assessment area.

<b>BANK</b>	<b>TOTAL ASSETS (June 30, 1997) (In thousands)</b>	<b>QUARTERLY AVERAGE NET LOAN-TO-DEPOSIT RATIO</b>
Farmers State Bank of Montana Conrad, Montana	\$99,835	59%
The First State Bank of Shelby Shelby, Montana	\$52,041	62%
Blackfeet National Bank Browning, Montana	\$16,404	62%
The Citizens State Bank of Choteau, Montana Choteau, Montana	\$29,057	51%
Dutton State Bank Dutton, Montana	\$15,231	57%
This list does not include banks such as First Interstate Bank of Commerce and Norwest Bank Montana, National Association, Billings, Montana, which operate in the assessment area but have significantly more assets and branches than the bank.		

Although the bank's ranking compared with national peers remains low, the bank has improved its position against the four banks located in its assessment area. At the last evaluation, the bank's quarterly average net loan-to-deposit ratio ranked lowest among the four banks listed above. As the table shows, the bank has significantly increased its lending and its ranking among the local bank competition since the last evaluation.

Bank management stated that the increase in loans is the direct result of a more focused marketing plan. In 1996, the bank dedicated significant resources to the merger that resulted in the acquisition of the Cut Bank branch. Since the merger, bank staff has devoted resources to lending and developing loan products, such as the PMI, FHA, and SBA 504 loan programs.

Community characteristics temper the effectiveness of the bank's efforts to increase its loan portfolio. Perhaps the single most notable factor is the number of local financial services providers operating in the assessment area. The bank's assessment area also has a significant population of retired and young people, who generally have limited need for credit. It also has a large population of Hutterites, who rarely seek loans from financial institutions. Further, according to bank management, it has many farmers and ranchers who have no land debt and no need for operating credit. Additionally, the bank's assessment area has a relatively high number of families and households with incomes below the poverty level; this limits the pool of creditworthy borrowers in the assessment area. Finally, given the lack of growth in Conrad's and Cut Bank's business sectors, the bank's successful efforts to increase its commercial loan portfolio are commended.

According to community contacts on the Reservation, the demand for credit among tribal members is high. This might present the bank with opportunities to increase its lending activity in the future; however, the economy on the Reservation is currently very weak and unemployment is high. Further, the overall income level of Reservation residents remains low. As of the evaluation date, these factors appear to limit the pool of creditworthy applicants from the Reservation.

The bank's quarterly average net loan-to-deposit ratio has increased significantly since the last evaluation, but it is merely comparable to ratios of other banks operating offices in the assessment area. Although bank management has successfully implemented its plans to increase lending activity, the competitiveness of the local financial services market and the demographics of the assessment area present many challenges to banks seeking to increase lending in a safe and sound manner. For these reasons, the bank's lending activity meets this category's standards for a satisfactory rating.

#### DISTRIBUTION OF CREDIT WITHIN THE ASSESSMENT AREA

The bank's lending activity is concentrated in the assessment area. Since the last evaluation, the bank has extended a significant majority of its loans to residents, farms, and businesses in its assessment area. The table below shows the percentage of consumer, residential real estate, small farm, and small business loans by total number and dollar amount originated within the assessment area.

<b>LOANS IN THE ASSESSMENT AREA</b>		
<b>LOAN TYPE</b>	<b>TOTAL NUMBER OF LOANS</b>	<b>TOTAL DOLLAR AMOUNT OF LOANS</b>
Consumer	90%	86%
Residential Real Estate	87%	84%
Small Farm	93%	92%
Small Business	90%	89%

As mentioned previously, the data are based on loans originated during the six months preceding the evaluation. As the data show, the bank extends almost all of its loans to assessment area residents, farms, and businesses. The bank's commitment to extend credit in the assessment area is very strong. Consequently, the bank's lending performance in the assessment area exceeds this category's standard for a satisfactory rating.

#### 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 is satisfactory. As previously discussed, the CRA classifies income levels into four categories: low, moderate, middle, and upper. According to the 1990 U.S. Census data, the median family income for the assessment area is \$26,314. For purposes of classifying the bank's consumer and residential real estate borrowers, the 1997 Montana nonmetropolitan median family income of \$36,100 is compared to borrowers' incomes.

The table, set forth below, shows the percentage of consumer and residential real estate loans made to borrowers of different income levels.

**DISTRIBUTION OF LOANS IN THE ASSESSMENT AREA  
 BY BORROWERS' INCOME LEVELS\***

Loan Type	Low-Income Borrowers		Moderate-Income Borrowers		Middle-Income Borrowers		Upper-Income Borrowers	
	Number of Loans	Amount of Loans	Number of Loans	Amount of Loans	Number of Loans	Amount of Loans	Number of Loans	Amount of Loans
Consumer	28%	14%	23%	23%	27%	32%	21%	31%
Residential Real Estate	7%	2%	18%	14%	23%	18%	52%	67%

\*Income level is determined based on the 1997 Montana nonmetropolitan median family income of \$36,100.

The bank extends 51% of its consumer loans, representing 37% of the total amount of such loans, to low- and moderate-income persons. The residential real estate data show that the bank's lending to low- and moderate-income persons is 25% of the total number and 16% of the total amount of residential real estate loans originated during the six months prior to the evaluation.

Low- and moderate-income families and households represent 41% and 42% of the assessment area's population, respectively. More specifically, the assessment area's population is comprised 25% of low-income families and 26% of low-income households. The bank's consumer lending to low- and moderate-income people appears reasonable in light of the assessment area's demographics. As previously noted, 18% of the families and 19% of the households residing in the assessment area had 1989 incomes below the poverty level. The level of families and households with incomes below the poverty level is higher in the assessment area than in Montana's nonmetropolitan areas; census data do not segregate these families and households by income level. While it is not possible to determine precisely how this factor affects the bank's ability to extend loans to low- and moderate-income families, it appears reasonable to conclude that the number of low- and moderate-income people who qualify for credit is less than represented by the demographic data.

As the data show, the bank extends more residential real estate loans to middle- and upper-income people than other income groups. This performance reflects several characteristics of the assessment area's housing market. First, 31% and 23% of the assessment area's low-income families and households, respectively, and 15% of the assessment area's moderate-income families and households reside in the low-income area on the Reservation. In the low-income area, 74% and 66% of the families and households, respectively, have low or moderate incomes. Second, only 8% of the assessment area's owner-occupied housing is located in the low-income area. More specifically, only 37% of the housing units located in the low-income area are owner-occupied dwellings. Third, for persons residing on the Reservation, housing is somewhat expensive relative to the level of incomes. Fourth, community contacts indicated that many tribal members find renting housing more affordable and preferable to owning homes. Apparently as a result of these factors, the number of households in owner-occupied dwellings located in the low-income area is a low 41% compared with the number of such households in the middle-income areas, which is 72%. In combination, these factors limit the bank's ability to extend residential real estate loans to the low- and moderate-income persons in the assessment area's low-income area.

With respect to the low- and moderate-income people who do not live in the assessment area's low-income area, the number of owner-occupied dwellings in the market increases substantially. In fact, with few exceptions, all of the bank's residential real estate loans were to people who reside in the assessment area's middle-income areas. Although 70% and 77% of low- and moderate-income families and households,

respectively, reside in the assessment area's middle-income areas, these middle-income area households and families represent 31% and 34%, respectively, of the assessment area's population. For these people, the availability of affordable and habitable housing is limited, according to a community contact in Conrad. Also, the housing construction markets in Conrad and Cut Bank are limited, restricting residents' ability to acquire "move-up" housing.

To serve the credit needs of low- and moderate-income people, the bank offers a variety of loan products. For consumers, the bank offers small loans and ready reserve lines of credit. It also offers small, no-interest loans during the holidays. To service the residential real estate credit needs of low- and moderate-income borrowers, the bank participates in specialized MBOH, RD, and NHS home loan programs.

The bank offers MBOH's Low-Interest Mortgage Loan Program for First-Time Homebuyers loans. This program benefits eligible applicants with low and moderate incomes who seek funds to purchase a home. The following table sets forth the program's income restrictions:

<b>GROSS ANNUAL INCOME LIMITS</b>		
<b>Area</b>	<b>Small Household*</b>	<b>Large Household*</b>
Pondera, Glacier (excluding Browning), Teton, and Liberty Counties	\$36,200	\$41,630
Toole County	\$36,400	\$41,860
Town of Browning	\$43,440	\$50,680
*Small household is defined as two persons or less, and large household is defined as three persons or more.		

RD offers two residential real estate loan programs: Guaranteed Rural Housing Loan Program ("GRHLP") and Rural Housing Loan Leveraging Program ("RHLLP"). Although the bank offers loans through each of these programs, it has only originated GRHLP loans. Up to the maximum loan amount, GRHLP provides up to 100% financing for the acquisition of new or existing homes. RD guarantees all losses up to 35% of the original principal; it guarantees 85% of the losses in excess of this amount. Borrowers eligible for GRHLP loans must have moderate incomes, which are defined as incomes that do not exceed 115% of the area's median income level as determined by HUD. The 1997 adjusted income limits are set forth in the following table:

<b>1997 ADJUSTED INCOME LIMITS</b>								
<b>County</b>	<b>Household Size By Number of Persons</b>							
	1	2	3	4	5	6	7	8
Pondera	\$29,950	\$34,200	\$38,500	\$42,750	\$46,200	\$49,600	\$53,050	\$56,450
Glacier	\$29,100	\$33,250	\$37,400	\$41,550	\$44,850	\$48,200	\$51,500	\$54,850
Toole	\$30,750	\$35,150	\$39,500	\$43,900	\$47,450	\$50,950	\$54,450	\$57,950
Liberty	\$30,750	\$35,150	\$39,500	\$43,900	\$47,450	\$50,950	\$54,450	\$57,950
Teton	\$29,100	\$33,250	\$37,400	\$41,550	\$44,850	\$48,200	\$51,500	\$54,850

An additional eligibility requirement, among others, is the applicant's inability to obtain a loan on terms and conditions that can reasonably be fulfilled without the guarantee. The GRHLP has lower up-front cash requirements than conventional and FHA loan programs and no private mortgage insurance requirements. The bank has originated numerous GRHLP loans since the last evaluation.

The RHLLP benefits very low- to low-income people. Under this program, eligible applicants receive a mortgage loan which is 50% funded through FHA and 50% financed through RD. The FHA loan accrues interest at 6% and the RD loan accrues interest between 1% and 6.5%, depending upon the applicant's income compared with the area's median family income. The program benefits people with adjusted incomes of 80% or less of the area's median family income.

Through the NHS program, the bank can extend down-payment assistance loans subject to MBOH program requirements and additional NHS requirements. First, the loan program assists people in Pondera, Glacier, Liberty, Toole and Teton counties, among others. Second, the borrower must have up-front cash for all prepayable closing cost plus \$100. Third, the program benefits people with annual family incomes of 80% or less than the area median family income for the county. The table sets forth the income restrictions for the down-payment assistance program:

<b>ANNUAL FAMILY INCOME LIMITS</b>								
<b>County</b>	<b>Household Size By Number of Persons</b>							
	1	2	3	4	5	6	7	8
Pondera	\$20,850	\$23,800	\$26,800	\$29,750	\$32,150	\$34,500	\$36,900	\$39,300
Glacier	\$20,200	\$23,100	\$26,000	\$28,900	\$31,200	\$33,500	\$35,800	\$38,100
Toole	\$21,400	\$24,450	\$27,500	\$30,550	\$33,000	\$35,450	\$37,900	\$40,350
Liberty	\$21,400	\$24,450	\$27,500	\$30,550	\$33,000	\$35,450	\$37,900	\$40,350
Teton	\$20,200	\$23,100	\$26,000	\$28,900	\$31,200	\$33,500	\$35,800	\$38,100

Fourth, the program does not provide funds to pay relocation costs of displaced renters. Successful applicants receive up to a maximum of \$5,000 for down payment and closing costs. The grant is secured by a promissory note and deed of trust.

Although the bank's residential real estate lending to low- and moderate-income people seems low, the lending activity appears to reflect the characteristics of the assessment area's local housing market as well as the income demographics of the area's residents. To address the unique credit needs of low- and moderate-income people, the bank stands ready to extend residential real estate loan through numerous government-sponsored loan programs, including the HUD Section 184 program that benefits tribal members. For these reasons, the level of residential real estate lending to low- and moderate-income people appears reasonable.

The sample of agricultural and commercial loans reviewed during the evaluation shows that the bank originated all its loans to small businesses, defined as entities that have received a loan of \$1 million or less. The regulation defines small farms as entities that have received a loan of \$500,000 or less, and the bank originated almost all of its agriculture loans to small farms. The bank originated 97% and 86% of its small farm and business loans, respectively, to entities with gross annual revenues of \$1 million or less. The table below sets forth the information reviewed during the evaluation.

<b>DISTRIBUTION OF SMALL FARM AND BUSINESS LOANS BY LOAN SIZE*</b>			
	<b>Loan Amount \$100,000 or less</b>	<b>Loan Amount \$100,000.01 to \$250,000</b>	<b>Loan Amount \$250,000.01 to \$1,000,000</b>
Small Farm Loans	89%	8%	3%
Small Business Loans	98%	2%	-
*This table sets forth data about small farm and small business loans to entities with gross annual revenues of \$1 million or less.			

The high level of loan originations to small businesses and farms is expected because almost all commercial and farm entities in the bank's assessment area are classified as small businesses and farms. Further, of these entities, almost all have gross annual revenues of \$1 million or less. To service the needs of these borrowers, the bank participates in SBA and FSA loan programs.

The bank's lending performance to small businesses and farms is very good, but generally reflects the concentration of such entities in the assessment area. Its performance with respect to residential real estate loans extended to low- and moderate-income people is reasonable given the demographics of the assessment area, characteristics of the local housing market, and types of programs offered by the bank. The bank's consumer loan originations demonstrate a willingness to extend credit to low- and moderate-income individuals. Consequently, the bank's lending to borrowers of different income levels and businesses of various sizes meets this category's standards for satisfactory performance.

### GEOGRAPHIC DISTRIBUTION OF LOANS

The distribution of the bank's loans throughout the assessment area is reasonable. As previously discussed, the bank's assessment area has 1 low-income BNA and 10 middle-income BNAs. The assessment area does not have any areas classified as moderate or upper income. The following table shows the distribution of the bank's consumer, residential real estate, small farm, and small business loans in low- and middle-income areas.

<b>DISTRIBUTION OF LOANS IN THE ASSESSMENT AREA BY BNA INCOME LEVEL*</b>				
Loan Type	Low-Income BNA		Middle-Income BNAs	
	Number of Loans	Amount of Loans	Number of Loans	Amount of Loans
Consumer	26%	20%	74%	80%
Residential Real Estate	5%	2%	95%	98%
Small Business	-	-	100%	100%
Small Farm	9%	3%	91%	97%
*The bank's assessment area does not include any moderate- or upper-income BNAs.				

As the data show, the bank does extend consumer, residential real estate, and farm loans in the assessment area's low-income BNA, which represents 15% of the assessment area's population. The sample shows that the bank does not extend commercial loans in BNA 9762. The low-income BNA, 9762, is approximately 45 miles west of Cut Bank.

BNA 9762 surrounds Browning, which is on the Reservation. To service the residential real estate loan needs of the Reservation, the bank participates in the MBOH program that has declared Browning as a target area and the HUD Section 184 loan program.

According to community contacts, the economy on the Reservation is not improving. According to census data, approximately 50% of the households residing in the low-income BNA have incomes below the poverty level. The unemployment rate remains very high, small businesses have closed, and farm operations have suffered through periods of low commodity prices. Affordable housing is limited and, according to community contacts, many tribal members often find renting housing more affordable than owning a home. (Refer also to the Lending to Borrowers of Different Income Levels and to Businesses of Different Sizes section of this evaluation for further discussion of the housing market on the Reservation.)

These are the factors that affect the ability of financial institutions to lend to people, farms, and businesses on the Reservation.

Another factor affecting the bank's ability to extend credit on the Reservation may be the Blackfeet National Bank ("BNB"), located in Browning. BNB is owned, in part, by the Tribe and had total assets of approximately \$16 million on June 30, 1997. On that same date, its net loan portfolio was approximately \$9 million. Community contacts stated that Reservation residents obtain bank services at BNB as well as at institutions located in Cut Bank, Shelby, Conrad, Great Falls, and Kalispell. Credit for consumer, residential real estate, agriculture, and business purposes is also available through the Tribe's credit office.

As previously discussed, the bank's lending has increased since the last evaluation. The extension of credit to Reservation residents, farms, and businesses has also increased since the last evaluation. At that time, the data showed that the bank extended 12% of its consumer loans, 4% of its agricultural and commercial loans, and none of its residential real estate loans in BNA 9762. The increased activity in BNA 9762 evidenced by the current evaluation's data probably reflects the bank's March 1996 acquisition of the Cut Bank branch.

The distribution of loans in the middle-income BNAs shows that the bank is extending credit throughout the assessment area. Its lending, however, is concentrated in the middle-income BNAs where the bank's offices are located. For the sampled loans, the distribution is described in the table set forth below.

<b>DISTRIBUTION OF LOANS IN MIDDLE-INCOME BNAs</b>				
<b>BNA</b>	<b>Loan Category</b>			
	<b>Consumer</b>	<b>Residential Real Estate</b>	<b>Commercial</b>	<b>Agricultural</b>
9714	-	-	-	4%
9716.98	1%	3%	3%	5%
9746	1%	2%	-	4%
9750	2%	-	-	5%
9751	1%	-	3%	6%
9760	34%	34%	45%	12%
9761	6%	3%	3%	7%
9770	21%	48%	43%	28%
9771	8%	5%	3%	20%

As the data show, the bank's lending is concentrated in BNAs 9760 (Cut Bank) and 9770 (Conrad). The bank did not extend any loans in BNA 9745. BNA 9745 is on the assessment area's eastern boundary; borrowers from this section of the assessment area probably obtain financial services from institutions located nearer to that area.

While the bank does extend loans throughout its assessment area, most of its lending activity is concentrated in the geographies where the bank offices are located. As previously discussed, the bank does extend loans in the only low-income BNA in the assessment area. Although the bank's residential real estate, small business, and small farm lending in the low-income BNA is not high, it does appear to be reasonable in light of the demographic characteristics of the community. Probably partially reflecting the acquisition of the Cut Bank branch, the sampled data show that the bank's lending in the low-income BNA has increased since the last evaluation. This change is nonetheless positive. For these reasons, the

geographic distribution of the bank's loan originations meets this category's standards for satisfactory performance.

GENERAL

The evaluation did not reveal any violations of the substantive provisions of the fair lending and fair housing laws and regulations; however, it did reveal technical violations of the Equal Credit Opportunity Act's Regulation B. During the evaluation, management promised to correct the noted violations.

The bank has not received any CRA complaints since the last evaluation.



## **PUBLIC DISCLOSURE**

September 15, 1997

Date of Evaluation

## **COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION**

Farmers State Bank of Montana

Name of Depository Institution

093002800000

Identification Number of Institution

Conrad, 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.