

PUBLIC DISCLOSURE

September 14, 1998
Date of Evaluation

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

First Security Bank of Laurel
Name of Depository Institution

093006670000
Identification Number of Institution

Laurel, Montana
Address of Institution

Federal Reserve Bank of Minneapolis
90 Hennepin Avenue
Minneapolis, Minnesota 55401-1804

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.

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 First Security Bank of Laurel, Laurel, Montana, prepared by the Federal Reserve Bank of Minneapolis, the institution's supervisory agency, as of September 14, 1998. 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: "Satisfactory."

The bank's satisfactory rating is based on several factors. First, the bank actively lends to borrowers of different income levels and to businesses of different sizes. Second, the bank's net loan-to-deposit ratio reflects a reasonable level of lending. Third, a majority of the bank's loans were made within the assessment area. Finally, the bank's loans are adequately distributed throughout its assessment area.

DESCRIPTION OF INSTITUTION

Based on its size and financial condition, the bank is capable of meeting the credit needs of residents and businesses located within its assessment area effectively. The bank received a satisfactory rating at its last CRA performance evaluation, conducted August 19, 1996. The bank is a significant commercial lender in a competitive banking market. The bank operates two full-service offices in Laurel in census tract ("CT") 19: the main office at 20 Montana Avenue and a branch office located at Jan's IGA, 205 First Avenue South. The bank opened its IGA branch office since the previous evaluation. The bank has two cash-dispensing automated teller machines ("ATM") in Laurel located at the Kwik Way, 815 East Main Street and the branch location. Bank customers have 24-hour access to the bank's ATMs. The bank also offers a 24-hour "Telebank" service for customers' convenience. The bank's main office lobby is open from 9:00 a.m. to 4:00 p.m. Monday through Thursday, and 9:00 a.m. to 5:00 p.m. Friday. The bank's drive-up is open 7:00 a.m. to 6:00 p.m. Monday through Friday and 9:00 a.m. to 1:00 p.m. on Saturday. The branch lobby is open 9:00 a.m. to 7:00 p.m. Monday through Friday, 9:00 a.m. to 6:00 p.m. on Saturday, and 11:00 a.m. to 4:00 p.m. on Sunday.

The bank's continued growth supports its ability to meet the credit needs of the community. According to its June 30, 1998, Report of Condition ("ROC"), the bank's assets totaled approximately \$23.3 million. This is an increase of approximately \$1.7 million since the previous evaluation. The ROC data indicate the bank continues to be primarily a commercial lender. The bank's loan portfolio is composed of approximately 53% commercial, 30% agriculture, 11% residential real estate, 4% consumer loans, and 2% other loans. The loan mix has not changed significantly since the previous examination. Consumer loans have decreased by a slight 2%. Although the commercial loans appear to have increased significantly since the previous examination, the change in the ROC data is the result of reporting changes for construction/development and farmland real estate loans, initiated by bank management during the first quarter of 1998. The information corresponds with the reported decrease in consumer real estate loans.

The bank's market niche is commercial loans for small businesses, but it also originates consumer, residential real estate, and small farm loans in an effort to be a full-service bank for its customers. The composition of the bank's loan portfolio reflects the level of demand for specific types of loans by residents and businesses of the bank's market.

The bank continues to offer a variety of loan products to fulfill the credit needs of individuals, businesses, and farms within its assessment area. It extends closed-end consumer loans and conventional residential real estate credit products including temporary construction, purchase-money, refinance, and home improvement loans as well as open-end and closed-end agricultural and commercial loans. In addition to offering conventional loan products, the bank continues to participate in several federal and state loan programs such as the Small Business Administration ("SBA") Guaranteed, SBA 504, Montana Board of Housing, Federal Housing Administration, and Department of Veteran Affairs loan programs. In addition, the bank refers applicants interested in secondary-market real estate loans to other financial institutions and several mortgage companies.

DESCRIPTION OF FIRST SECURITY BANK OF LAUREL'S ASSESSMENT AREA

The bank has defined its assessment area as portions of Yellowstone, Carbon, and Stillwater counties located in south central Montana. The area is more specifically defined as CTs 14, 16, and 19 in the Billings, Montana, metropolitan statistical area ("MSA") in Yellowstone County. Although the Crow Indian Reservation comprises a portion of CT 16, it has no towns and few residents. Laurel's assessment area is partly comprised of the census tracts surrounding Billings; however, it does not include the city.

Laurel is located in CT 19 in south central Yellowstone County, approximately 15 miles southwest of Billings. The remainder of the assessment area includes block numbering areas (“BNA”) 9662, 9663, and 9664 in Stillwater County and BNAs 9652, 9653, 9654, and 9655 in Carbon County.

CRA divides income levels into four categories: low, moderate, middle, and upper. The categorization of a borrower or geography’s income level is determined relative to the MSA median family income for MSA areas and the statewide nonmetropolitan median family for non-MSA median family areas. Pursuant to CRA’s definitions, low-income individuals have incomes of less than 50% of the MSA or statewide nonmetropolitan median family income, while moderate-income individuals have incomes of at least 50% but less than 80% of the appropriate area’s median family income. The regulation defines middle-income individuals as persons with incomes of at least 80% but less than 120% of the MSA or statewide nonmetropolitan median family income. Individuals with incomes of 120% or more of the MSA or statewide nonmetropolitan median family income are classified as upper-income persons. Within the combined assessment area, the 1990 median family income is \$28,850 and the median household income is \$24,407. For the MSA, the 1990 median family income was \$31,534 and the median household income is \$25,943, while the nonmetropolitan median family income and median household income were \$27,352 and \$22,345, respectively. Both figures for income in the assessment area are higher than the median family and household incomes for the state of Montana but lower than the figures for income in the MSA. BNAs and CTs are classified using similar categories based on the level of the median family income in the geography.

For purposes of classifying borrowers’ incomes, this evaluation used the U.S. Department of Housing and Urban Development (“HUD”)-estimated 1998 median family income for the relevant area. For borrowers in the MSA portion of the assessment area, this figure is \$43,900. For borrowers in the nonmetropolitan portion of the assessment area, this figure is \$36,100.

The bank’s assessment area has a population of 27,716, according to the 1990 U.S. Census data. Laurel has a population of approximately 6,628. The assessment area has approximately 8,011 families, approximately 8.8% of which have incomes below the poverty level. The assessment area has 10,267 households, approximately 12.6% of which have incomes below the poverty level. The distribution of family and household income for the assessment area is summarized in the following table and shows that almost half the assessment area’s households are upper income.

ASSESSMENT AREA POPULATION DISTRIBUTION BY INCOME LEVEL				
Unit of Measure	Low Income	Moderate Income	Middle Income	Upper Income
Households Compared to Median Household Income	21.4%	18.1%	19.4%	41.0%
Families Compared to Median Family Income	18.8%	22.0%	24.6%	34.6%

As stated previously, the bank’s assessment area includes 10 CTs and BNAs. Based on the 1990 U.S. Census data, the assessment area includes no low-income, 1 (10%) moderate-income, 9 (90%) middle-income, and no upper-income CTs and BNAs. The moderate-income BNA (9655) has a population of 817, or 3% of the assessment area’s total population. In addition, this BNA is located on the outer edge of the assessment area.

According to 1990 U.S. Census data, there are 11,703 housing units in the assessment area, 7,815 (66.8%) of which are owner occupied. Approximately 461 housing units, or 3.9% of the housing units in the assessment area, are located in the moderate-income BNA. The data show that 51.6% of these units are

owner occupied, 17.8% are rental units, and 30.6% are vacant. The median family income in this tract is \$17,083 (62.5%) of Montana nonmetropolitan median family income as of the 1990 census.

Approximately 11,242 units, or 96.1% of the housing units in the assessment area, are located in the middle-income CTs or BNAs. The data show that 67.4% of these units are owner occupied, 19.9% are rental units, and 12.7% are vacant. Median family income in these CTs and BNAs ranged from \$25,304 to \$35,502 as of the 1990 census. As a percent of the Billings MSA or Montana nonmetropolitan median family income, the CT and BNA median family incomes ranged from 81.3% to 112.6%.

As discussed above, the number of housing units and the level of owner-occupied and rental housing vary throughout the assessment area. The number of housing units and the level of owner-occupied housing are lowest in the one moderate-income BNA and approximately 16 percentage points higher in the middle-income CTs and BNAs. According to 1990 census data, the average median housing value in the assessment area was \$57,455. The affordability ratio of .425 for the assessment area is higher than the .414 affordability ratio for the statewide nonmetropolitan areas and the .407 affordability ratio for Montana. Rental units account for 2,318, or approximately 19.8%, of the housing units in the assessment area. Of the total number of rental units, 82 are located in the moderate-income BNA. Gross rent for the assessment area as of 1990 was \$302. This figure mirrors the gross rent amount for the statewide nonmetropolitan areas and is \$9 lower than the state of Montana gross rent amount.

The local economy is strong and growing. According to data updated through June 1998 from the Office of Research & Analysis of the Montana Department of Labor & Industry, the unemployment rate for Yellowstone County is 4.5%. The economy around Laurel has remained strong for several reasons. First, Laurel serves as a bedroom community for Billings and the area between Billings and Laurel continues to be developed for both residential housing and commercial purposes. Community contacts indicated that Billings serves as the major trade center for eastern Montana as well as northern Wyoming. Second, Laurel's commercial activity is quite diverse and not entirely dependent on agriculture. Several of the assessment area's larger employers include railroad, manufacturing, and oil refinery operations, which employ many of the local residents. One community contact indicated that although retail businesses have declined in number, the businesses that have remained in Laurel are viable. The local agricultural commodities include sugar beets, wheat, barley, and cattle. According to bank management, the agricultural economy is struggling with low grain and cattle prices.

Numerous bank and nonbank financial institutions serve the credit needs of residents and businesses located in the bank's assessment area. According to bank management, Billings and the surrounding credit markets continue to be competitive. Among the competitors in Laurel are another bank, a federal savings bank, and two credit unions. The credit unions provide a significant amount of competition for local residents' consumer banking business. In addition, Billings has a large number of financial institutions, including several large regional banks. According to bank management, many residents living in Laurel are employed in Billings. The fact that creditors are operating in a competitive marketplace results in better service, interest rates, and loan terms for local borrowers.

Examiners made community contacts with representatives of the community and local government as part of this CRA evaluation. These individuals are familiar with the demographic and economic characteristics and credit needs of the assessment area. Information obtained from these individuals and bank management was used in evaluating the bank's CRA performance.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

The bank's performance in serving the credit needs of its assessment area is satisfactory. Much of the analysis on the following pages is based on a statistical sample of 64 consumer loans, 40 residential loans,

53 small business loans, and 48 small farm loans originated in the twelve months preceding the evaluation. These loan categories represent the bank's major product lines based on number and/or dollar amount of loans originated.

The loan products were chosen because of the relative significance of the product either as a percentage of number of loans or the percentage of the dollar volume of loans in the sample period. The following table illustrates those percentages.

Loan Product	% of Total Number of Loans (Twelve months ending 9/8/98)	% of Total Dollar Amount of Loans (Twelve months ending 9/8/98)
Consumer	34.3%	5.4%
Residential Real Estate	18.2%	33.7%
Small Business	26.3%	36.4%
Small Farm	21.2%	24.9%

The consumer loans were chosen for review because they represent a significant percentage of the total number originated in the sample period. Small business, small farm, and residential real estate loans were chosen because they represent a significant percentage of the total dollar amount during the same period. As discussed in the Description of Institution section, the bank is primarily a commercial lender. According to the June 30, 1998, ROC for the bank, approximately 53% of the bank's loan portfolio was in commercial loans.

The criteria discussed below were reviewed in determining the rating. In assigning an overall rating, the greatest weight was placed on the assessment of lending to borrowers of different income levels and businesses of different sizes and the net loan-to-deposit ratio. These factors most closely measure the bank's efforts to meet the credit needs of its community.

LOAN-TO-DEPOSIT RATIO ANALYSIS

The bank's net loan-to-deposit ratio is reasonable and meets the standards for satisfactory performance. The bank's quarterly net loan-to-deposit ratio has decreased slightly since the last evaluation. Based on the data from the bank's quarterly ROC for the eight calendar quarters since the last evaluation, the quarterly average of the bank's net loan-to-deposit ratio is 57.1%. The following chart summarizes the bank's quarterly loan-to-deposit ratio and its components since the last evaluation dated August 19, 1996.

DATE	NET LOANS (In thousands)	DEPOSITS (In thousands)	NET LOAN-TO- DEPOSIT RATIO
September 30, 1996	\$11,282	\$19,918	56.6%
December 31, 1996	\$10,570	\$19,961	53.0%
March 31, 1997	\$11,815	\$20,763	56.9%
June 30, 1997	\$12,201	\$20,140	60.6%
September 30, 1997	\$12,781	\$20,824	61.4%
December 31, 1997	\$12,717	\$20,952	60.7%
March 31, 1998	\$11,458	\$21,535	53.2%
June 30, 1998	\$11,697	\$21,367	54.7%

As the data indicate, the bank deposits have increased while loans have remained relatively stable. Net loans have increased only 3.7% since the previous evaluation. During the same period, the bank's deposits have grown 7.3%. However, the above chart does not reflect the bank's efforts to refer real estate loans to the secondary market or the bank's agricultural and commercial participation activity. Although the bank does not originate loans for sale on the secondary market, it does assist individuals interested in applying for such loans. The bank helps the applicant complete the application and then sends the information to a secondary-market provider. The bank has only two loan officers, and management indicated that the bank does not have the expertise to originate complicated real estate loans. Bank management indicated that the level of demand is very strong for both commercial and residential housing loans, which reflects the excellent small business economy of the Billings and surrounding areas. In addition, the steady growth of deposits reflects the strong economy. Community contacts identified the bank as a strong lender in the community and commended the bank's commitment to the community.

According to its March 31, 1998, Uniform Bank Performance Report, the bank's 53.2% net loan-to-deposit ratio is lower than its national peer group average of 62.0%. The bank's ratio places it in the 29th percentile compared with its national peers. The following chart shows the asset size and average net loan-to-deposit ratio for the bank and its local competitors since September 1996:

Bank	TOTAL ASSETS (as of June 30, 1998) (In thousands)	QUARTERLY AVERAGE NET LOAN-TO- DEPOSIT RATIO
First Security Bank of Laurel Laurel, Montana	\$23,290	57.1%
Little Horn State Bank Hardin, Montana	\$38,757	52.8%
United Bank, NA Absarokee, Montana	\$29,523	66.6%
The Yellowstone Bank Laurel, Montana	\$184,473	64.0%
Stockman Bank of Montana Miles City, Montana	\$396,264	80.0%
Rocky Mountain Bank Billings, Montana	\$257,332	74.8%

As illustrated in the chart, the bank's net loan-to-deposit ratio compares favorably to one of its competitors of similar asset size. Bank management indicated that competition from the credit unions is increasing and that although the bank's assessment area does not include Billings, the bank competes with Billings' financial institutions. Several of Billings' banks are large regional institutions, which have not

been included in the comparisons because of their size. However, Stockman Bank of Montana is included as they have a branch in Billings. As shown above, of the two competitors of similar asset size, the bank compares favorably to one. Based on the level of competition in the assessment area, the comparison to local peers, and the fact that the community contacts did not identify any unmet credit needs in the assessment area, the bank's net loan-to-deposit ratio is reasonable. As such, it meets the standards for satisfactory performance.

COMPARISON OF CREDIT EXTENDED INSIDE AND OUTSIDE THE ASSESSMENT AREA

The bank's lending activity in the assessment area meets the standards for satisfactory performance. A review of the statistical sample of loans originated by the bank during the past twelve months reveals that the bank extended a majority of its loans inside the assessment area. The following table shows the percentage of loans within the assessment area based on the total number and loan amount in each major loan category.

LOANS ORIGINATED INSIDE THE ASSESSMENT AREA		
Loan Type	Total Number of Loans	Total Dollar Amount of Loans
Consumer	75%	66%
Residential Real Estate	63%	57%
Small Farm	78%	64%
Small Business	72%	70%

The bank's lending activity in the assessment area continues to be comparable to the lending levels observed at the previous evaluation with the exception of consumer lending, which has declined slightly. The last evaluation revealed that the bank extended 79% of its small business and small farm loans, 65% of its residential real estate loans, and 82% of its consumer loans in the assessment area. Management indicated there is strong competition for consumer loans from the credit unions and local financial institutions as well as the financial institutions in Billings.

As mentioned previously, the bank is primarily a commercial lender. Based on the relatively high concentration of loans originated within the assessment area, the bank meets the standards for satisfactory performance in this category.

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

The bank's level of lending to individuals of different income levels and to businesses of different sizes meets the standards for satisfactory performance. As previously mentioned, CRA groups income levels into four categories: low, moderate, middle, and upper. The following table shows the percentage of consumer loans made to borrowers of different income levels.

DISTRIBUTION OF LOANS IN THE ASSESSMENT AREA BY BORROWER INCOME LEVEL*				
Loan Type	Low-Income Borrowers	Moderate-Income Borrowers	Middle-Income Borrowers	Upper-Income Borrowers
<u>Consumer</u>				
Total Number of Loans	56%	29%	9%	7%
Total Amount of Loans	45%	34%	11%	9%
<u>Residential Real Estate</u>				
Total Number of Loans	4%	20%	16%	60%
Total Amount of Loans	1%	21%	24%	54%
*Income level is based on the Montana 1998 MSA median family income of \$43,900 and nonmetropolitan median family income of \$36,100.				

As previously described in the Description of Assessment Area section, low-income households and families represent 21.4% and 18.8% of the assessment area's population, respectively. Moderate-income households and families represent 18.1% and 22% of the assessment area's population, respectively. The data in the table indicate the bank originated a substantial percentage, 85%, of its consumer loans to low- and moderate-income borrowers. This figure is significantly higher than the combined demographic distribution of low- and moderate-income households and families in the assessment area and reflects relatively strong loan demand. Furthermore, bank management indicated that because competition for consumer credit is very intense, every effort is made to extend credit to consumers who otherwise may not be able to obtain credit.

Regarding residential real estate lending, the limited number and amount of loans in the sample to low-income borrowers is primarily due to affordability and availability. Laurel continues to have problems with affordable housing, especially for elderly residents and young families. One community contact indicated that the demand for residential real estate in Laurel and the area between Laurel and Billings is very strong, thereby increasing property values. The community contact also indicated that very few lots are available within the Laurel City limits. The average selling price for homes in Laurel continues to increase with more homes priced over \$100,000. Examiners evaluated the affordability of homes in the assessment area for low- and moderate-income borrowers using Partners software, which is available from the Reserve Bank. Based on the 1998 Montana nonmetropolitan median family income of \$36,100, a low-income resident had a median family income of \$18,050 and a moderate-income resident had a median family income of \$28,880. The assumptions for both evaluations were no down payment, 7% annual percentage rate for 30 years, and 28% front- and 36% back-end ratios for both income levels, and \$480 and \$600 for taxes and insurance and \$250 and \$400 for other monthly payments, respectively. According to the Partners software, the financing potential for the low-income borrower is \$37,803, and \$62,588 for the moderate-income borrower. It appears very unlikely that a low-income borrower could find many properties in the assessment area to purchase at such prices using these favorable terms. Accordingly, the concentration of loans to low-income residents is reasonable, while the level of lending to moderate-income borrowers is good.

The bank has a good record of providing small business loans to businesses with gross annual revenues of \$1 million or less. The bank's CRA loan sample also has a reasonable distribution of small business loans of different sizes. For the purpose of this evaluation, small farm loans are defined as loans with original principal amounts of \$500,000 or less, and small business loans are commercial loans with original principal amounts of \$1 million or less. The bank has an excellent record of providing small business and small farm loans to businesses and farms with gross annual revenues of \$1 million or less. The loan sample reveals that the bank originated 100% of its small farm loans and 97% of its small business loans to entities with gross annual revenues of \$1 million or less. Of the total number of loans to farms with revenues of less than \$1 million, the bank extended 91% for loan amounts of \$100,000 or less

and 9% for amounts between \$100,001 and \$250,000. Of the total number of loans to businesses with revenues of less than \$1,000,000, the bank extended 81% for loan amounts of \$100,000 or less, 16% for amounts between \$100,001 and \$250,000, and 3% for amounts between \$250,001 and \$1,000,000. The bank's lending patterns reflect the characteristics of the small business lending niche market it has developed in Laurel.

Based on the bank's strong level of consumer lending, reasonable level of residential real estate lending to low- and moderate-income individuals, and level of small farm/small business lending, the bank meets this category's standards for satisfactory performance.

GEOGRAPHIC DISTRIBUTION OF LOANS

The distribution of the bank's loans throughout the assessment area generally meets the standards for satisfactory performance. However, the bank's consumer lending performance in the moderate-income BNA is lower than expected given the population data. As previously discussed, the bank's assessment area includes one moderate-income BNA. The remaining nine CTs and BNAs are classified as middle income. The bank's main office and branch office are located in a middle-income CT.

Based on the statistical sample of the bank's loans, the following table shows the distribution of consumer, residential real estate, agriculture, and commercial loans in those moderate- and middle-income CTs and BNAs located within the assessment area.

DISTRIBUTION OF LOANS IN THE ASSESSMENT AREA BY CT or BNA INCOME LEVEL		
Loan Type	Moderate Income	Middle Income
<u>Consumer</u>		
Total Number of Loans	0%	100%
Total Amount of Loans	0%	100%
<u>Residential Real Estate</u>		
Total Number of Loans	0%	100%
Total Amount of Loans	0%	100%
<u>Small Farm</u>		
Total Number of Loans	14%	86%
Total Amount of Loans	26%	74%
<u>Small Business</u>		
Total Number of Loans	0%	100%
Total Amount of Loans	0%	100%

As previously mentioned, 3% of the assessment area's population resides in the moderate-income BNA. The table indicates that the bank did not originate any consumer, real estate, or small business loans in the moderate-income BNA. This is explained by a couple of factors. The moderate-income BNA has only a small percentage of the assessment area's population and contains mostly ranch land. As such it is reasonable that the bank has only small farm loans in this BNA. Second, the BNA is located on the outer edge of the assessment area. Few BNA residents travel to Laurel for banking services when other financial institutions are more accessible.

For these reasons, the bank's level of lending to residents, farms, and businesses located in moderate-income BNA, although low, is adequate under the circumstances. Because of the same reasons, the bank has a reasonable dispersion of its loans among the assessment area's BNAs and CTs. The bank made most of its loans in CT 19, the census tract in which both of its offices are located. The bank made no

loans in BNA 9653, a sparsely populated BNA located south of Laurel. The bank also made few loans in BNA 9662. This BNA is also sparsely populated and located some distance from the bank. In general, the dispersion of the bank's loans is reasonable given its office locations and its size. Because of the reasons discussed, the bank's level of lending to residents, farms, and businesses throughout the assessment area is reasonable and meets the standards for satisfactory performance in this category.

GENERAL

The evaluation did not reveal any violations of the substantive or technical provisions of the fair lending and fair housing laws and regulations. In addition, the bank has not received any CRA-related complaints since the previous evaluation.