

## PUBLIC DISCLOSURE

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# COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

## FARMERS STATE BANK

RSSD Number: 696243

201 Main Street  
Merrill, Iowa 51038

FEDERAL RESERVE BANK  
OF CHICAGO

230 South LaSalle  
Chicago, Illinois 60604

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 safe and sound operations 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, Merrill, Iowa**, prepared by the **Federal Reserve Bank of Chicago** as of **October 26, 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 RATING:** This institution is rated **Satisfactory**.

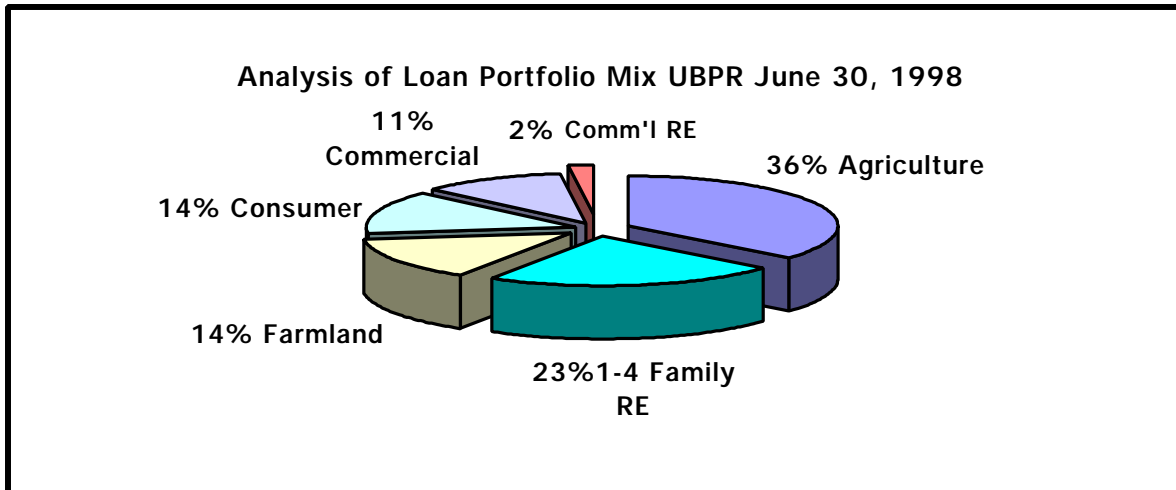
Farmers State Bank has a satisfactory CRA program through which it responds to the identified credit needs within the assessment area. The bank is predominately a real estate and agricultural lender, which is consistent with the identified credit needs of the community. The bank's lending activities include the origination of real estate loans for small business/small farm and residential purposes. The bank's loan-to-deposit ratio is below the peer group average and a sample of local competitors. However, based on an improving trend in the loan-to-deposit ratio, noted low demand for loans, and high level of competition for loans, it meets the standards for satisfactory performance. The high percentage of the bank's loans in number and in dollar volume in the assessment area meets the standards for satisfactory performance. The distribution of residential real estate loans to low- and moderate-income borrowers is low in comparison to the distribution of low- and moderate-income families in the assessment area. However, agricultural loans, based on dollar amount, reasonably meet the credit needs of area small farms. There were no residential real estate loans made to low-income borrowers and only one made to a moderate-income borrower. The bank's overall distribution of lending in the assessment area was evaluated as low satisfactory, but mitigated by strong local competition for loans, high housing costs, and the bank's adequate response to the credit needs of small farms. There were no low- or moderate-income geographies in the assessment area. As such, the geographic distribution was not evaluated. There were no CRA-related complaints received by the institution or this Reserve Bank since the bank became a member of the Federal Reserve System.

**DESCRIPTION OF INSTITUTION**

Farmers State Bank, with total assets of \$25,016,000 as of June 30, 1998, is a subsidiary of Merrill Bancorporation, Incorporated, a one-bank holding company located in Merrill, Iowa. Farmers State Bank became a member of the Federal Reserve System on February 24, 1998. The bank's office network consists of its main office located in Merrill, Iowa, and a limited service office located in Hinton, Iowa. The bank also operates one automatic teller machine located in a gas station in Hinton. Merrill is located approximately 6 miles south of the county seat of Le Mars on Highway 75, which is approximately 24 miles north of Sioux City, Iowa. Hinton is located approximately 8 miles south of Merrill on Highway 75.

The bank provides traditional deposit services, and is predominantly a real estate and agricultural lender. In addition, insurance and limited trust services are available to the local community. Based upon information contained in the June 30, 1998 Uniform Bank Performance Report (UBPR), the distribution of the portfolio is shown in Exhibit 1:

## Exhibit 1



The competition for banking services is highly competitive in Plymouth County. There are seven other banks located within the county who provide competition: American Bank, Le Mars; First National Bank, Le Mars; First State Bank, Brunsville; Iowa State Bank, Craig; Kingsley State Bank, Kingsley; Le Mars Bank and Trust Company, Le Mars; and Western Bank and Trust, St. Pierson. In addition, a savings and loan association, a credit union, Farm Credit Services, and other banks outside of the county soliciting business within the assessment area. Thirteen competing financial institutions are located in nearby Sioux City. A sample of competitors for loan-to-deposit ratio analysis purposes includes American Bank National Bank, Le Mars, Iowa and First National Bank of Akron with a branch located in Merrill.

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

#### DESCRIPTION OF ASSESSMENT AREA

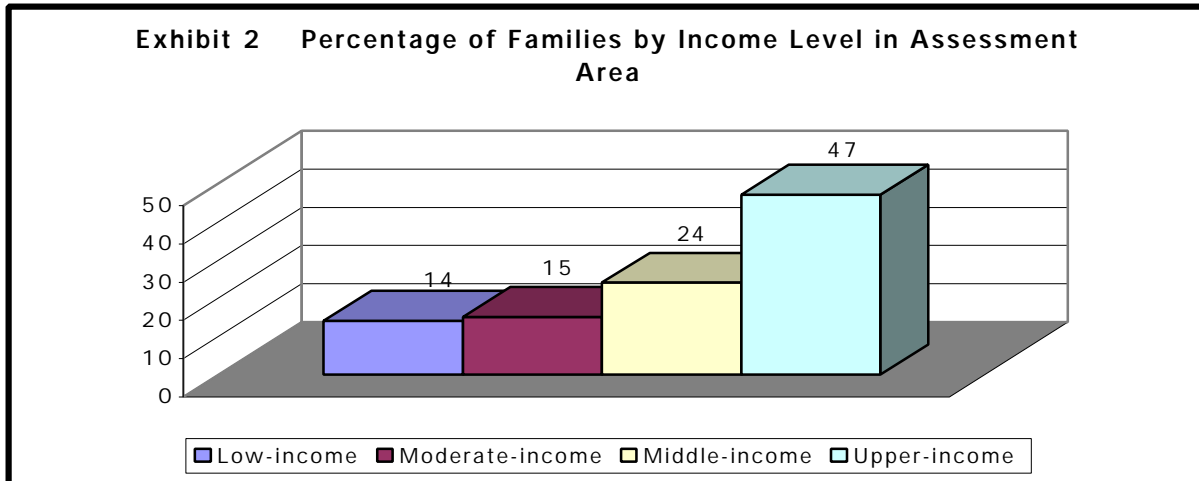
*Definition of Assessment Area: An institution's assessment area will include the towns, counties, or other political subdivisions where its branches are located and a substantial portion of its loans are made. Assessment areas must consist of one or more geographies defined by "block number areas (BNAs)" or "census tracts", which are statistical subdivisions of a county. Census tracts are primarily used in metropolitan areas, while BNAs are used in non-metropolitan areas.*

The bank's assessment area includes the southwest portion of Plymouth County, in Northwestern Iowa. Farmers State Bank has defined its assessment area as one BNA, 9706, which is classified as middle-income.

According to the 1990 U.S. Bureau of Census data, the median family income for the assessment area is \$33,380, which is significantly higher than the \$29,303 median family average income for all of non-metropolitan Iowa.

The total population in the bank's assessment area is 4,669. Whites comprise 99% of the assessment area's population. Approximately 31% of the assessment area's population is 17 years of age or younger and 11% is 65 years of age or older. In comparison to demographics for non-metropolitan areas of the state, the assessment area has more residents that are aged 17 and younger and fewer residents aged 65 or older, as a percentage of the total population.

The distribution of families, by income level in the assessment area, is shown in Exhibit 2:



In comparison to the assessment area, the family distribution for non-metropolitan areas of the state is 18%, 19%, 26%, and 37%, respectively, for low-, moderate-, middle-, and high-income categories. This demographic data indicates that a smaller percentage of families in the assessment area are classified as low-, moderate-, and middle-income in comparison to non-metropolitan areas of the state. The percentage of upper-income families in the assessment area significantly exceeds non-metropolitan areas of the state.

There are 1,675 total housing units in the assessment area. Approximately 77% are owner occupied, 19% are rental units, and 4% are vacant. The percentage of owner-occupied units in the assessment area significantly exceeds the non-metropolitan average of 66%. Further, the assessment area has fewer rental and vacant units than non-metropolitan Iowa. The median housing value in the assessment area is \$51,522 and the median age of the housing stock is 45 years. In comparison, the median housing value for non-metropolitan Iowa is \$38,521, with a median age of 39 years. The median housing value in the assessment area significantly exceeds that of non-metropolitan Iowa, on average by \$13,001. Median gross monthly rent for the assessment area is high, at \$345, compared to \$292 for non-metropolitan Iowa. This difference may suggest an overall shortage of housing units since the assessment area contained 19% rental units compared to 25% for non-metropolitan Iowa. Housing within the assessment area is predominately single-family, and approximately 91% of the housing stock consists of one-to-four family units.

*An affordability ratio can be developed by dividing the median household income by the median household value for a given area or group of geographies. This ratio is useful in comparing housing costs for different areas. An area with a higher ratio generally has more affordable housing than an area with a lower ratio. According to the 1990 U.S. Bureau of Census data, the affordability ratio for the bank's assessment area is .61, which is slightly lower than the non-metropolitan ratio of .63, indicating that housing is less affordable in the assessment area than for all of non-metropolitan Iowa.*

According to area representatives, housing in the assessment area is predominantly single-family, owner-occupied, and more expensive than in non-metropolitan portions of the state, which may further support a conclusion that housing is in short supply.

The assessment area's economy is dependent upon agriculture, with corn and soybeans as the major cash crops, and cattle and swine production as major livestock endeavors. Merrill is primarily considered a bedroom community to Sioux City and Le Mars. Many residents commute to these communities for jobs in agricultural-related industry.

In Exhibit 3, a list of the major employers in the bank's assessment area is shown:

<b>Exhibit 3 MAJOR ASSESSMENT AREA EMPLOYERS</b>			
<b>EMPLOYER</b>	<b>LOCATION</b>	<b>NUMBER OF EMPLOYEES</b>	<b>PRODUCT/SERVICE</b>
Wells Dairy	Le Mars	1,500	Dairy Products
Harkers Distribution	Le Mars	250	Food Processing/Distribution
Le Mars School District	Le Mars	250	Education
Schuster Companies, Inc.	Le Mars	250	Transportation/Trucking
Floyd Valley Hospital	Le Mars	100	Medical Services
Wal-Mart	Le Mars	100	Retail

Unemployment in Plymouth County is low. According to the Iowa Work Force Development, the unemployment rate for Plymouth County was 2.2% as of September 30, 1998, compared to 2.7% as of September 30, 1997. In comparison, the unemployment rate for the State of Iowa was 2.6%, and 3.1%, respectively.

### **CONCLUSION WITH RESPECT TO PERFORMANCE CRITERIA**

#### **FAIR LENDING**

A sample of the bank's loans and denied applications were reviewed to determine whether loan policies and lending standards were in compliance with fair lending laws and regulations. No evidence of prohibited discriminatory credit practices was detected. The bank is in compliance with the substantive provisions of antidiscrimination laws and regulations, including the Equal Credit Opportunity and Fair Housing Acts.

#### **PERFORMANCE STANDARDS**

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

#### **Loan-to-Deposit Ratio**

Farmers State Bank's loan portfolio was reviewed to evaluate its lending, loan mix, and how the bank's performance compares to the peer group and a sample of local competitors. The loan-to-deposit (LTD)

ratios and trends for the subject bank, peer group, and a sample of two competitors are shown in Exhibit 4:

<b>Exhibit 4</b>				
<b>LOAN-TO-DEPOSIT RATIO SUMMARY</b>				
<b>FINANCIAL INSTITUTION</b>	<b>Total Assets As of June 30, 1998 (000's)</b>	<b>LTD Ratio as of June 30, 1996</b>	<b>LTD Ratio as of June 30, 1998</b>	<b>Nine- Quarter Average LTD Ratio</b>
Farmers State Bank	\$25,016	42%	59%	49%
American Bank, NA	\$82,434	69%	92%	83%
First National Bank of Akron	\$38,245	68%	71%	69%
Peer Group	N/A	67%	68%	66%

While below the peer group averages and ratios reported by competitors, further analysis revealed that the bank's LTD ratio had increased significantly in the nine-quarter period ended June 30, 1998. The bank's LTD ratio increased from 42% as of June 30, 1996 to 59% as of June 30, 1998, an increase of 17 percentage points or an overall increase of 40%. Management indicated that the bank's LTD ratio is affected by a significant number of residents who work and seek financial services in Sioux City and Le Mars, low demand for loans, and highly competitive market for loans in the assessment area. According to a community representative, farmland in the bank's assessment area is above average. Crop yields have been more favorable in Plymouth County in comparison to other areas of the State of Iowa. These higher yields have somewhat mitigated the financial impact of an overall drop in grain prices for local farmers. Based on the positive trend noted in the bank's LTD ratio and assessment area demographics, the bank's LTD performance meets the standards for satisfactory performance.

#### Lending in the Assessment Area

A sample of 314 loans for the twelve-month period from September 30, 1997 to September 30, 1998, was reviewed to determine the bank's level of lending in the assessment area. The sample consisted of 21 residential real estate loans totaling \$1,372,100 and 293 agricultural loans totaling \$4,171,463. The distribution of these loans within the bank's assessment area is shown in Exhibit 5:

<b>Exhibit 5</b>			
<b>FARMERS STATE BANK LENDING WITHIN THE ASSESSMENT AREA</b>			
<b>LOAN TYPE</b>	<b>TOTAL SAMPLE</b>	<b>WITHIN THE ASSESSMENT AREA</b>	<b>PERCENT OF TOTAL</b>
Residential Real Estate	21	18	86
Agricultural Loans	293	249	85
Totals	314	267	85

Further review indicates that \$4,776,158 or 86% of the total dollar amount of loans was within the assessment area. The bank's 249 agricultural loans represent the largest number and dollar volume, \$3,579,058, of loans in the assessment area. The dollar volume of residential real estate and agricultural loans in the assessment area was similar at 87% or \$1,197,100, and 86% or \$3,579,058, respectively. The percentage of loans in the assessment area meets the standard for satisfactory performance.

## Lending to Borrowers of Different Incomes and to Businesses and Farms of Different Sizes

### Consumer Loans

A twelve-month sample of residential real estate loans was reviewed to evaluate the bank's distribution of loans to borrowers of different income levels in the assessment area. In the twelve-month period from September 30, 1997 to September 30, 1998, the bank originated 21 residential real estate loans totaling \$1,372,100. Of these totals, 18 loans totaling \$1,197,100 were secured by properties located in the bank's assessment area. Income information was readily available for all 18 loans reviewed. The distribution of these loans among the different income categories as defined by U.S. Census data is shown in Exhibit 6:

<b>Exhibit 6</b>				
<b>FARMERS STATE BANK</b>				
<b>DISTRIBUTION OF RESIDENTIAL REAL ESTATE LOANS BY APPLICANT INCOME CATEGORY</b>				
<b>Borrower Income Category</b>	<b>Number of Families</b>	<b>Percent of Total Families</b>	<b>Number of Loans</b>	<b>Percent of Total Loans</b>
Low – 0 to 49%	174	14%	0	0%
Moderate – 50 to 79%	193	15%	1	6%
Middle – 80 to 119%	313	24%	4	22%
Upper – > 119%	601	47%	13	72%
Totals	1,281	100%	18	100%

As illustrated in the preceding table, the distribution of the bank's loans to borrowers of different income levels compares unfavorably to the family distribution, by income, in the assessment area. There were no loans made to low-income borrowers. Only one loan or 6% of total loans was made to a moderate-income borrower, four loans or 22% of total loans were made to middle-income borrowers, and 13 loans or 72% of total loans were made to upper-income borrowers. Only in the category of loans to upper-income borrowers did the bank significantly exceed the distribution of families in the assessment area. One percent, 16%, and 83% of the dollar amount of loans were made to moderate, middle and upper-income borrowers, respectively. A primary contributing factor to the low number of loans to low- and moderate-income borrowers is that housing in the assessment area is not as affordable as in other non-metropolitan areas of the state. According to management, the low number of loans made to low- and moderate-income borrowers is attributed to a significant number of residents who work and seek financial services in Sioux City and Le Mars, a low demand for loans, and a highly competitive market for loans in the assessment area. The bank's distribution of loans to low- and moderate-income borrowers is low, yet meets the standards for satisfactory performance.

### Small Business and Small Farm Loans

*Small business loans are those loans with an original loan balance of less than \$1 million made to businesses with less than \$1 million in gross annual revenues. Small farm loans are those loans with an original loan balance of less than \$500,000 made to farms with less than \$1 million in gross annual revenues.*

A twelve-month sample of 249 agricultural loans made in the assessment area was reviewed to determine the bank's level of lending to small farms. Since income information was not readily available, the original loan amount was used as a proxy to determine the distribution for these loans. Of the 249 total agricultural loans made in the assessment area, 247 or 99% were in original loan amounts of less than \$100,000, indicating that the bank is making loans in amounts that may most reasonably be expected to serve the credit needs of small farms. According to management, all of the 249 agricultural loans were made to farms with gross annual incomes of less than \$1 million.

According to the June 30, 1998 Consolidated Report of Condition and Income, all of the bank's 62 commercial and 294 agricultural loans in the portfolio had balances below \$100,000. The distribution of the bank's loans to small farms exceeds the standards for satisfactory performance.

There is a high level of local competition for loans and housing costs are high in the assessment area. The bank's response to the credit needs of small farms has been strong; this indicates that the bank's primary business emphasis is consistent with the primary credit needs of the assessment area. Overall, the bank's distribution of loans to borrowers of different incomes and to small businesses/farms meets the standards for satisfactory performance.

#### **GEOGRAPHIC DISTRIBUTION OF LOANS**

There are no low- or moderate-income geographies within the bank's assessment area. Therefore, an analysis of loan distribution within geographies was not conducted.

#### **RESPONSE TO SUBSTANTIATED COMPLAINTS**

No complaints were received by the institution or this Reserve Bank regarding its CRA performance during the scope of this examination.