

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 Citizens State Bank of St. James, St. James, Minnesota, prepared by the Federal Reserve Bank of Minneapolis, the institution’s supervisory agency, as of May 11, 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: This institution is rated “Outstanding.”

The bank’s CRA rating is based on several factors. First, the bank originates a significant portion of its consumer real estate and consumer loans to low- and moderate-income individuals. Second, the bank’s net loan-to-deposit ratio has remained at a high level since the previous evaluation. Third, the bank’s lending is reasonably distributed throughout the assessment area. Fourth, the bank extends a majority of its loans in the assessment area. Finally, the bank made a substantial investment in a qualified community development project since the prior evaluation and continues to hold another substantial qualified community development security in its investment portfolio.

DESCRIPTION OF INSTITUTION

Based on its size and financial condition, the bank is able to meet the credit needs of its assessment area effectively. The bank was rated outstanding in helping to meet the credit needs of its assessment area at its previous CRA evaluation, dated June 30, 1997. The bank's only office is located in St. James, Minnesota. It does not own or operate an automated teller machine ("ATM"), but does offer ATM access and debit cards. The bank has not opened or closed any offices since the last evaluation.

The bank's total assets have grown approximately 5% since the previous evaluation. According to Report of Condition ("ROC") data, the bank had assets of \$47.6 million on June 30, 1997, and \$50.1 million on March 31, 1998. The same data show net loans increased from \$34.5 million to \$36.9 million since the last evaluation. Bank management attributed the growth to ongoing community and credit needs ascertainment activities and the multitude of loan programs offered by the bank. Since the last evaluation, total deposits have also increased. The ROC data show total deposits of \$40.7 million on June 30, 1997, and \$43.5 million on March 31, 1998. The bank attributed the deposit growth to normal operations. The composition of the bank's loan portfolio is 38% agricultural, 34% commercial, 18% consumer real estate, 7% consumer, and 3% other loans.

The bank offers a wide variety of loan programs for consumers, small businesses, and small farms in its assessment area. Its residential real estate programs include conventional, Federal Housing Administration, Department of Veterans Affairs, Minnesota Housing Finance Agency ("MHFA") First-Time Home Buyers, MHFA Fix-up, MHFA Home Energy, and Rural Development loans. As mentioned, the bank also offers a wide variety of commercial and agricultural loans. The commercial loan programs are directed primarily toward small businesses and include Small Business Administration loan programs. Small business customers may obtain equipment, working capital, accounts receivable, and commercial real estate loans through this program or directly from the bank. The bank offers agricultural borrowers Farm Service Agency, Minnesota Agriculture Best Farm ("MABF"), and Long-Term Fixed Rate Farm loans. The bank is the only lender in Watonwan County that participates in the MABF program.

DESCRIPTION OF CITIZENS STATE BANK OF ST. JAMES' ASSESSMENT AREA

The bank's assessment area is defined as Watonwan County, Minnesota. Watonwan County is located in south-central Minnesota and consists of three block numbering areas ("BNA"): 9501, 9502, and 9503. The city of St. James and the bank's office are located in BNA 9502. According to 1990 U.S. Census data, the assessment area has a total population of 11,682. The largest city in the assessment area is St. James; it is also the county seat for Watonwan County.

An individual familiar with residential, small business, and agricultural development issues in the assessment area was interviewed during the CRA evaluation. Information from this contact and bank management was used in the evaluation of the bank's CRA performance. The community contact indicated St. James and Watonwan County's overall population has remained relatively stable. The community contact classified the local economy as strong. Downtown St. James had six vacant retail business sites as recently as one year ago. Currently, only one retail business location is vacant. The employment situation is also strong. The community contact stated that any person seeking employment can find a job in the area. Generally, local employers in Watonwan County are experiencing difficulty in filling open positions.

The community contact indicated the major employers in Watonwan County are St. James Automotive, Dynamic Tool & Engineering, and food processors Tony Downs Foods Company and Swift-Eckrich, Inc. Other significant local employers are the public school system, Watonwan County, and city of St. James. According to the community contact, the strong local employment market in the city of St. James and Watonwan County has created an affordable housing shortage. According to the community contact, the majority of employees in the assessment area earn less than \$10.00 per hour. As a result, these people do not qualify for loans to purchase available housing. The community contact stated the sale price for housing is averaging around \$100,000.

The community contact indicated that while St. James has a large industrial economy, agricultural production is the assessment area's primary industry. According to the contact, the farming economy has been robust. The mild weather in the spring of 1998 allowed farmers to work the fields early and finish planting ahead of schedule. The community contact indicated this year's crop production could be a record. In addition, Watonwan County has a sizable number of turkey and hog farms. Based on current prices, the community contact indicated that 1998 could be a very strong year for these operations.

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 ("MSA"), the categorization of a borrower or geography's income is determined relative to the statewide nonmetropolitan median family income. 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 a middle-income individual as one with an income of at least 80% but less than 120% of the statewide nonmetropolitan median family income. An individual with an income that is 120% or more of the statewide nonmetropolitan median family income is considered upper income. BNAs are classified using similar categories based on the level of the median family income in the geography. Minnesota's 1990 nonmetropolitan median family income of \$28,993 is used to classify the income level of the assessment area's BNAs. The 1997 median family income for Minnesota's nonmetropolitan areas is \$38,400; this figure is used to classify the income level of individual borrowers.

As previously mentioned, the bank's assessment area consists of three BNAs, all of which are classified middle-income areas. As a percentage of the 1990 nonmetropolitan median family income, the median family income of the assessment area's three BNAs ranges from 94.1% to 97.1%. The assessment area does not have any low-, moderate-, or upper-income BNAs. According to 1990 U.S. Census data, 46% of the population was 17 and younger and 65 and older. The relative percentage of assessment area residents in these age brackets is similar to that of Minnesota's nonmetropolitan areas. The bank's main office is located in BNA 9502.

According to 1990 census data, the bank's assessment area has 4,483 households and 3,099 families. The census data show 23% of the households and 18% of the families in the assessment area are classified as low income, 17% of the households and 21% of the families are moderate income, 22% of the households and 28% of the families are middle income, and 38% of the households and 33% of the families are upper income. The assessment area's median household and family incomes are \$20,000 and \$27,633, respectively. Both figures are lower than Minnesota's nonmetropolitan area household and family median incomes of \$23,627 and \$28,933, respectively. Within the assessment area, the relative percentage of households and families with below-poverty level incomes is lower than that of Minnesota's nonmetropolitan areas.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

The bank has done an outstanding job of meeting the credit needs of its assessment area. Much of the analysis on the following pages was based on a statistical sample of 101 small business/small farm, 92 consumer, and 34 consumer real estate loans originated in the six months before the evaluation. The categories were selected based on the total number and dollar amount of loans originated during the sample period. Since commercial and agricultural loans represent 72% of the bank's loan portfolio, the bank's small business/small farm lending performance received the greatest weight when assigning the rating. In assigning weight among the different performance categories, the greatest weight was placed on the bank's lending to borrowers of different income levels, followed by the net loan-to-deposit ratio and the percentage of loans originated in the bank's assessment area.

LOAN-TO-DEPOSIT RATIO ANALYSIS

The bank's net loan-to-deposit ratio exceeds the standards for satisfactory performance. The bank's quarterly average net loan-to-deposit ratio since the previous evaluation is 85%. At the last evaluation, the bank's quarterly average net loan-to-deposit ratio was 81%. The bank's quarterly ratios have been relatively stable since the previous evaluation. The following table, based on quarterly ROC data, reflects this pattern.

DATE	NET LOANS (In thousands)	DEPOSITS (In thousands)	NET LOAN- TO-DEPOSIT RATIO
March 31, 1998	\$36,896	\$43,502	85%
December 31, 1997	\$38,066	\$45,380	84%
September 30, 1997	\$37,926	\$44,186	86%
June 30, 1997	\$34,519	\$40,661	85%

According to the December 31, 1997, Uniform Bank Performance Report, the bank's net loan-to-deposit ratio of 84% places the bank in the 88th percentile of its national peer group. The bank's net loan-to-deposit ratio significantly exceeds the peer group average ratio of 67%. Not included in the bank's net loan-to-deposit ratio data, however, is a sizable number and dollar amount of residential real estate loans that the bank sold to the secondary market.

Three financial institutions operate in St. James. In addition, several other financial institutions are located in the bank's assessment area. The following table shows the total assets and quarterly average net loan-to-deposit ratios for the bank and its assessment area competitors.

Bank and Location	Total Assets as of March 31, 1998 (In thousands)	Quarterly Average Net Loan-to-Deposit Ratio
Citizens State Bank of St. James St. James, Minnesota	\$50,102	85%
The First National Bank at St. James St. James, Minnesota	\$19,717	48%
State Bank of La Salle (Incorporated) La Salle, Minnesota	\$28,580	72%
Merchants State Bank of Lewisville Lewisville, Minnesota	\$10,564	84%
Farmers State Bank of Madelia (Incorporated) Madelia, Minnesota	\$37,463	80%
Odin State Bank Odin, Minnesota	\$25,108	74%

As noted in the table, the bank is larger than the other banks operating in the assessment area and its net loan-to-deposit ratio is higher than the competitor banks in the assessment area. The bank attributes its loan activity to normal operating conditions and the strong local economy. The community contact identified the bank as one of the leading financial institutions in the assessment area.

The bank's net loan-to-deposit ratio is high in comparison to its national peer group and local competitors. Further, the bank's quarterly average net loan-to-deposit ratio has increased since the last evaluation. Also, the bank actively sells residential real estate loans to the secondary market; these loans are not included in the bank's net loan-to-deposit ratio data. For these reasons, the bank's net loan-to-deposit ratio exceeds this category's standards for satisfactory performance.

COMPARISON OF CREDIT EXTENDED INSIDE AND OUTSIDE THE ASSESSMENT AREA

The bank's lending activity within its assessment area meets the standards for satisfactory performance. The bank originates a majority of loans inside the assessment area. The following table shows the percentages of loans by number and dollar amount originated within the assessment area.

LOANS IN THE ASSESSMENT AREA		
Loan Type	Total Number of Loans	Total Amount of Loans
Small Business/Small Farm	57%	44%
Consumer Real Estate	76%	81%
Consumer	76%	53%

As indicated in the table, the bank originated a majority of its loans within its assessment area. The percentage of small business/small farm loans originated in the assessment area has declined since the previous evaluation. The bank attributes this decline to its decision to purchase commercial lease paper. The majority of these commercial leases are to companies located outside the bank's assessment area. The percentage of consumer lending by dollar amount appears low. The bank attributes this fact to its origination of a few large-dollar consumer loans to individuals outside of the assessment area and its purchasing of indirect consumer loans. The indirect loans are generally purchased from small businesses located in the assessment area.

Because the number of small business/small farm loans and the number and amount of consumer and real estate loans in the assessment area exceeds 50%, the concentration of the bank's lending activity in the assessment area meets the standards for satisfactory performance.

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

The bank's level of lending to individuals of different incomes and to businesses and farms of different sizes exceeds the standards for satisfactory performance. As previously mentioned, CRA classifies income levels into four categories: low, moderate, middle, and upper. Because the assessment area is not located in an MSA, a borrower's income level is determined in relation to the 1997 nonmetropolitan median family income for Minnesota. According to 1990 census data, the income distribution of assessment area households is 23% low income, 17% moderate income, 22% middle income, and 38% upper income. The income distribution of assessment area families is 18% low income, 21% moderate income, 28% middle income, and 33% upper income. The table below shows the distribution of the bank's consumer real estate and consumer loans by income level of borrowers.

DISTRIBUTION OF LOANS BY INCOME LEVEL IN THE ASSESSMENT AREA*				
Loan Type	Low Income	Moderate Income	Middle Income	Upper Income
<u>Consumer Real Estate</u>				
Total Number of Loans	4%	35%	17%	44%
Total Amount of Loans	1%	33%	14%	52%
<u>Consumer</u>				
Total Number of Loans	29%	32%	22%	17%
Total Amount of Loans	14%	23%	32%	31%

*Income level is determined based on Minnesota's 1997 median family income of \$38,400.

The bank originated 39% of its consumer real estate and 61% of its consumer loans to low- and moderate-income borrowers. As mentioned, 40% of the households and 39% of the families in the assessment area are classified as low and moderate income. The relative percentage of consumer real estate loans extended to low- and moderate-income borrowers has declined since the last evaluation. At that time, the bank extended 49% of the total number of consumer real estate loans to borrowers classified as low or moderate income. Consumer real estate and consumer loans represent 18% and 7%, respectively, of the bank's loan portfolio. Given the assessment area demographics, the bank's consumer real estate and consumer lending to low- and moderate-income borrowers is excellent. To service the credit needs of these borrowers, the bank offers small-dollar amount loans and overdraft lines of credit. It also participates in numerous government loan programs and purchases indirect consumer loan paper from various small businesses in the assessment area.

The loan data reveal that the percentage of the bank's consumer real estate lending to low- and moderate-income individuals approximates the percentage of these families in the assessment area. The bank indicated that the percentage of its lending to low- and moderate-income individuals would be higher, if not for several reasons. First, the bank follows secondary-market guidelines for consumer real estate loans. The underwriting guidelines set by the secondary market are conservative and have specific underwriting parameters that must be followed. The bank is not required to comply with these parameters

for all consumer real estate loans, but to maintain flexibility and minimize liquidity concerns, the bank follows these guidelines. Given secondary-market underwriting guidelines, low- and moderate-income individuals may not be able to qualify for the financing needed to acquire residential real estate in the assessment area. Second, bank management and a community contact stated that St. James lacks affordable housing. Third, low-income borrowers have incomes below \$19,200. To purchase a home valued at \$60,000 requires principal and interest payments of \$448 per month (assuming a 3% down payment and interest at 7.5%). In contrast, median rent in the assessment area is only \$252 per month. Accordingly, rental housing is substantially more affordable for low-income borrowers than is owner-occupied housing. Finally, the community contact stated that existing homes' sale prices have averaged around \$100,000. Individuals in the assessment area earn an average wage of less than \$10.00 per hour. Individuals in this income bracket do not qualify to finance housing purchases in this price range. All of these factors particularly affect the bank's ability to extend consumer real estate loans to low-income borrowers, who received only 4% of the bank's real estate loans originated during the sample period. To service the consumer real estate credit needs of assessment area residents, the bank participates in a multitude of government-insured or -guaranteed real estate loan programs. Most of these programs are directed toward first-time homebuyers and low- and moderate-income individuals.

The bank has a strong record of lending to small businesses/small farms in its assessment area. For purposes of the evaluation, a small business loan is most commercial loans with original principal amounts of \$1 million or less and small farm loans are most agricultural loans with original principal amounts of \$500,000 or less. The bank originated all of its small business/small farm loans to entities with \$1 million or less in gross annual revenues. Of these loans, 93% had loan amounts of \$100,000 or less, and the remaining 7% had amounts of \$100,001 to \$250,000. Agricultural and commercial loans represent the largest parts of the bank's loan portfolio. The percentage of small business/small farm loans to small entities is consistent with the bank's asset size and legal lending limit as well as the characteristics of and the economic conditions in the assessment area.

Based on its strong level of consumer lending to low- and moderate-income borrowers and consumer real estate lending to moderate-income borrowers compared with the representation of those individuals in the community, its involvement in affordable housing loan programs, and the high percentage of small business/small farm loans extended to entities with gross annual revenues of \$1 million or less, the bank exceeds this category's standards for satisfactory performance.

GEOGRAPHIC DISTRIBUTION OF LOANS

The bank's lending in geographies of different income levels meets the standards for satisfactory performance. As previously mentioned, the BNAs that make up the bank's assessment area are classified middle income; there are no low-, moderate-, or upper-income BNAs in the assessment area. Bank management indicated low- and moderate-income residents are not concentrated in any particular area, but are dispersed throughout the assessment area. Examiners determined that proxies which might enable a meaningful geographic analysis were not available. An analysis of the bank's lending activity shows that the bank extended 95% of its consumer loans, 100% of its consumer real estate loans, and 97% of its small business/small farm loans in BNA 9502. The concentrated lending activity in BNA 9502 is reasonable given the fact that the bank's office is in that BNA. The few loans not in BNA 9502 are distributed almost equally in the assessment area's other two BNAs. Thus, the geographic distribution of the bank's loans meets this category's standards for satisfactory performance.

INVESTMENT AND SERVICES

The bank engages in qualified community development investment and service activity that supports rating the bank's CRA performance as outstanding. In September 1997, the bank purchased a \$500,000 St. James Economic Development Authority ("SJEDA") housing development revenue bond. The proceeds of the sale were used for the construction of an assisted-living care facility for low- and moderate-income individuals. In addition, prior to the last evaluation, the bank purchased a \$250,000 SJEDA revenue bond that was used for affordable housing development. The bank still holds this SJEDA revenue bond in its investment portfolio. As mentioned in the Description of the Assessment Area section, St. James lacks affordable housing. Given the lack of affordable housing in the assessment area, the bank's support of SJEDA housing projects was very critical to fulfilling a community development need. According to the community contact, most individuals living in SJEDA units are senior citizens. The community contact also stated that these units are fully occupied. Given the bank's size, this level of community development investment is excellent and warrants rating the bank's CRA performance as outstanding.

In addition to purchasing and holding qualified community development investment securities, the bank made approximately \$3,000 in qualified community development donations. Its donations supported the following organizations: Spirit of St. James and Region 9 Development Commission. The bank also made a sizable donation to the local hospital, which will use the funds in part to finance the development of an assisted-living facility and liaison department for providing services to the area's Hispanic residents. The community expects that the assisted-living facility will service housing needs of seniors, who will undoubtedly sell their existing homes. This will make more affordable housing available in the assessment area. The liaison department will increase access to medical services by Hispanics, who generally have low and moderate incomes. The bank contributes to many other local organizations; however, these contributions are not qualified community development investments for purposes of this evaluation.

The bank engages in the following community development services:

- One officer conducts home buying seminars through the MHFA Homestretch program, which is directed toward low- and moderate-income individuals. He also served as the treasurer for the Spirit of St. James downtown revitalization project, which upgraded the infrastructure of the downtown area, composed of small businesses.
- Several bank officers serve on the SJEDA board.

The bank offers the retail banking services identified in the list below to benefit low- and moderate-income people. The bank provides its services during the following lobby hours: 9:00 a.m. to 3:00 p.m. Monday through Friday, except Thursday when it is open until 6:00 p.m., and 8:00 a.m. to noon on Saturday. Its drive-through and walk-up facilities are open 8:00 a.m. to 6:00 p.m., Monday through Friday, and 8:00 a.m. to noon on Saturday.

- The bank provides residential application guides in Spanish. Many of the assessment area's low- and moderate-income residents are Hispanic.
- The bank provides Federal Deposit Insurance Corporation and Elan credit card brochures in Spanish.

As previously stated, the bank's community development investment activity is excellent. This activity is further supplemented by community development service activity and retail services. For these reasons, the bank's CRA performance is rated outstanding.

GENERAL

The evaluation did not reveal any procedural practices that are inconsistent with 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 last evaluation.

PUBLIC DISCLOSURE

May 11, 1998
Date of Evaluation

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

Citizens State Bank of St. James
Name of Depository Institution

092753600000
Identification Number of Institution

St. James, Minnesota
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.