

PUBLIC DISCLOSURE

June 25, 2001
Date of Evaluation

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

Victoria State Bank - 773751
Name of Depository Institution
Institution's Identification Number

Victoria, Minnesota
Address of Institution

Federal Reserve Bank of Minneapolis
Name of Supervisory Agency

Minneapolis, Minnesota
Address of Supervisory Agency

NOTE: This document is an evaluation of this institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operation of the institution. 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.

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INSTITUTION'S CRA RATING: This institution is rated "Satisfactory."

Victoria State Bank's satisfactory rating is based on several factors. First, the level of consumer loans to borrowers of different income levels reflects very good penetration among low- and moderate-income borrowers. In addition, the bank's small business lending reflects a reasonable penetration of loans to small business entities. Second, the bank's net loan-to-deposit ratio reflects a satisfactory level of lending. Last, the bank originated a majority of sampled loans within its assessment area.

DESCRIPTION OF INSTITUTION

Offices. The bank operates one full-service main office in Victoria, Minnesota. The bank operates three automated teller machines ("ATMs") in its assessment area. Two ATMs are located at the main office and both accept deposits. The third ATM is located at the Cenex gasoline station and only dispenses cash. The bank's main office and ATMs are located in middle-income census tracts. The bank has not opened a new office or installed a new ATM since the last CRA evaluation and its office hours remain the same. However, since the previous CRA evaluation, the bank introduced Internet banking to customers through Klein Financial, Inc. ("KFI"), the bank's holding company. In addition, it continues to offer 24-hour telephone banking.

The bank purchases and sells small business loan participations to KFI affiliated banks. The bank is subject to the Home Mortgage Disclosure Act ("HMDA") by virtue of its size and because it has an office in the Minneapolis-St. Paul metropolitan statistical area ("MSA").

Loan portfolio. According to the March 31, 2001, Report of Condition ("ROC"), the bank's assets totaled \$48.1 million and increased 36% since the last CRA evaluation. The ROC data indicates the composition of the loan portfolio consisted of 50% residential real estate loans, 41% commercial loans, and 9% consumer loans. The evaluation did not reveal any financial constraints on the bank's ability to lend within its overall assessment area.

Credit products. The bank continues to offer a wide variety of loan products designed to serve the credit needs of residents and small businesses in the assessment area. Its products include open- and closed-end consumer loans, residential real estate loans, and commercial loans to small businesses. The bank participates in federal and state loan programs sponsored by the Farmers Home Administration, Veterans Administration, and Small Business Administration. The bank has not introduced a new credit product or discontinued a credit product since the last CRA evaluation.

Previous CRA rating. The bank received a satisfactory CRA rating at its last evaluation, dated May 27, 1997.

DESCRIPTION OF VICTORIA STATE BANK ASSESSMENT AREA

Assessment area. The bank's assessment area consists of 19 census tracts in the southwestern section of the MSA. The census tracts are as follows: 263.02, 272.03, 274, 275.01, 275.02, 276.01, 276.02, and 277 in Hennepin County and 901, 903 through 910, 911.98, and 912 in Carver County. Carver County is composed of 13 census tracts, and 11 of these census tracts are inside the bank's assessment area. Victoria is located in Carver County, approximately 25 miles southwest of Minneapolis, Minnesota.

Communities in the assessment area include Chanhassen, Chaska, Cologne, Norwood-Young America, St. Bonifacius, Waconia, and Watertown as well as several Lake Minnetonka communities.

Population. According to 1990 U.S. Census data, the population of the bank's assessment area is 80,966. The population for Victoria and the southwestern portion of Hennepin County and Carver County has dramatically increased since the 1990 census. According to population data prepared by the Metropolitan Council ("MC"), the 1999 population of Victoria increased to 3,899 from 2,354 in 1990. In 1999, Carver County population was 66,168, up 38% from 1990. According to the MC, all cities and towns in Carver County experienced population growth during the last decade, and the MC anticipates continued population growth in all towns and cities in Carver County during the next decade.

Income. CRA divides income levels into four categories: low, moderate, middle, and upper. Because the bank's assessment area is located in the MSA, the categorization of a borrower's or census tract's income is determined relative to the MSA median family income. The regulation defines low-income individuals as those with incomes of less than 50% of the MSA median family income, while moderate-income individuals have incomes of at least 50% but less than 80% of this amount. The regulation defines middle-income individuals as persons with incomes at least 80% but less than 120% of the MSA median family income. Individuals with incomes of 120% or more of the MSA median family income are classified as upper income. Table 1 identifies certain characteristics of the assessment area.

<i>Tract Summary</i>	
Total Number of Tracts	19
Number of Low-Income Tracts	0
Number of Moderate-Income Tracts	0
Number of Middle-Income Tracts	12
Number of Upper-Income Tracts	7
<i>Income Summary</i>	
Median Family Income - 1990	\$48,368
Number of Low-Income Families	12%
Number of Moderate-Income Families	17%
Number of Middle-Income Families	27%
Number of Upper-Income Families	44%

According to 1990 census data, the 1990 median family income for the bank's assessment area was \$48,368. According to the U.S. Department of Housing and Urban Development, the 2000 median family income for the MSA increased to \$68,600. The borrower distribution percentages reflected in Table 5 are based on 2000 median family income.

Housing. Based on 1990 census data, the number, type, and age of housing in the assessment area does not restrict the bank's ability to extend consumer real estate loans.

As part of this evaluation, examiners interviewed a community member familiar with economic and demographic issues in the assessment area. The community contact develops affordable housing in Carver County. The contact indicated that the price of existing housing stock in Carver County has significantly increased over the past few years. According to housing data compiled by the contact for 2000, the average sale price of a residential home in Carver County has risen to \$218,115. As such,

Carver County has a continuing need for affordable housing, particularly for senior citizens. The contact indicated the residential housing market in Carver County has changed dramatically since the last census.

Economy. The economy in the bank's assessment area was described as very good, according to the contact. The economy in Victoria is tied to the overall economic conditions in the MSA. According to economic data compiled by the Minnesota Department of Economic Security, Carver County's unemployment rate stood at 1.8%, which represents a 51% decline from 1990 census data. The community contact indicated that Victoria's largest employers are a few small manufacturing companies and landscaping firms. Individuals who reside in the assessment area predominately work in Eden Prairie, Chanhassen, Waconia, or Chaska, Minnesota.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

The bank's performance in meeting the credit needs of its assessment area is satisfactory. The following table shows the combined loan originations by number and dollar volume originated by the bank since January 1, 1999.

<i>Loan Type</i>	<i>Total Number of Loans</i>	<i>Total Amount in Loans (in thousands)</i>
Consumer	538	\$ 6,030
Small Business	324	\$34,870
Consumer Real Estate*	68	\$ 5,814

*Real estate loans originated from May 27, 1997, to December 31, 2000, reported on the bank's HMDA Loan/Application Register.

The analysis on the following pages is based on a six-month statistical sample of consumer loans originated between December 2000 and May 2001, and a 12-month statistical sample of small business loans originated between June 2000 and May 2001. Also, the analysis includes residential real estate loans originated between May 27, 1997, and December 31, 2000 (as reported on the bank's HMDA Loan/Application Register). As such, examiners reviewed 68 consumer loans, 73 small business loans, and 68 residential real estate loans. Examiners assigned greater weight to the bank's consumer and small business lending. This weighting is based on the number of consumer and small business loans originated during the past 12 months in comparison to the number of residential real estate loans reported on the HMDA Loan/Application Register. However, because the bank is located in the MSA, examiners included HMDA loans in the analysis.

As mentioned, the bank is subject to HMDA because of its asset size and geographic location in the MSA. Examiners attempted to compare the bank's HMDA performance to aggregate HMDA lenders in its assessment area. However, comparison of the bank to aggregate HMDA lenders was not meaningful as the bank originated a small percentage of all HMDA loans originated in the assessment area. In assigning the CRA rating, examiners placed greater weight on the bank's lending performance to borrowers of different income levels and small businesses of different sizes.

LOAN-TO-DEPOSIT RATIO ANALYSIS

The bank's net loan-to-deposit ratio is reasonable, given the bank's asset size, financial condition, and the assessment area's credit needs. The bank's average net loan-to-deposit ratio for the past 16 quarters is 74%. The average net loan-to-deposit ratios for the past 16 quarters of similarly situated banks that are located within the bank's assessment area are shown in Table 3.

<i>Bank</i>	<i>Total Assets (March 31, 2001) (In thousands)</i>	<i>Quarterly Average Net Loan-To-Deposit Ratio</i>
Victoria State Bank Victoria, Minnesota	\$ 48,101	74%
Security Bank Waconia, Minnesota	\$ 84,359	69%
First National Bank of Waconia Waconia, Minnesota	\$168,034	76%
State Bank of Chanhassen Chanhassen, Minnesota	\$105,562	69%
Community Bank Chaska Chaska, Minnesota*	\$ 27,283	41%
First National Bank of Chaska Chaska, Minnesota	\$168,520	76%

*Reflects five quarters of ROC data.

According to ROC data, the bank's quarterly net loan-to-deposit ratio has fluctuated from 67% to 80% since the last CRA evaluation. Beginning in March 2000, the bank's net loan-to-deposit ratio was 80% and steadily declined throughout the year. As of December 31, 2000, the bank's loan-to-deposit ratio was 68%. Bank management attributed the decline to a 16% increase in deposits and decreased loan demand in the second half of the year. The bank indicated that loan demand has remained somewhat soft, and loan originations have covered overall loan payments and payoffs. According to bank management, the bank operates in an extremely competitive banking environment.

According to Uniform Bank Performance Report data, the bank's quarterly net loan-to-deposit ratio as of December 31, 2000, was 68%, as compared to peer group ratio of 70%. As shown in Table 3, the bank's net loan-to-deposit ratio reasonably compares with similarly situated banks in the assessment area. The bank sells a limited number of residential real estate loans on the secondary market. In addition, the bank has sold participation interests in a few small business loans to KFI affiliated banks.

The bank's net loan-to-deposit ratio is reasonable and indicates that the bank is an active lender. The bank's lending activity is responsive to the assessment area's credit needs.

COMPARISON OF CREDIT EXTENDED INSIDE AND OUTSIDE THE ASSESSMENT AREA

The bank's lending activity in the assessment area is satisfactory. A review of the statistical sample reveals that the bank extended a majority of its loans inside the assessment area. Table 4 shows the percentage of consumer real estate, small business, and consumer loans that bank originated in its assessment area.

TABLE 4 LOANS ORIGINATED IN THE ASSESSMENT AREA		
<i>Loan Type</i>	<i>Total Number of Loans</i>	<i>Total Amount of Loans</i>
Consumer Real Estate	53%	62%
Small Business	64%	78%
Consumer	82%	77%

The bank originated a slim majority of consumer real estate loans in its assessment area. Bank management attributed the relatively low percentage of consumer real estate loans within the assessment area to the turnover of lending staff in its residential real estate lending function. The turnover caused the bank to rely on referrals from existing customers to generate real estate loan activity. As reflected in the table, many of the resulting loan customers reside outside the assessment area. Another factor contributing to this relatively low percentage of lending in the assessment area is the fierce competition among mortgage lenders in the assessment area. During the first half of 2001, the bank hired a new residential real estate lender to increase its consumer real estate loan production.

Overall, the bank originated a majority of consumer real estate, small business, and consumer loans in its assessment area. The bank's lending activity in the assessment area is satisfactory.

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 small businesses of different sizes is very good. Table 5 shows the percentage of consumer real estate and consumer loans made to borrowers of different income levels.

TABLE 5 DISTRIBUTION OF LOANS IN THE ASSESSMENT AREA BY BORROWER INCOME LEVEL*										
Loan Category	<i>Low Income</i>		<i>Moderate Income</i>		<i>Middle Income</i>		<i>Upper Income</i>		<i>Income Not Available</i>	
	<i>#</i>	<i>\$</i>	<i>#</i>	<i>\$</i>	<i>#</i>	<i>\$</i>	<i>#</i>	<i>\$</i>	<i>#</i>	<i>\$</i>
Consumer Real Estate**	11%	11%	28%	25%	33%	19%	25%	24%	3%	22%
Consumer	30%	21%	21%	13%	20%	13%	16%	22%	13%	31%
Percentage of Families in Assessment Area***	12%		17%		27%		44%		N/A	
*2000 Median Family Income \$68,600.										
**Percentages exceed 100% due to rounding.										
***According to 1990 census data.										

Real estate lending. The bank's level of consumer real estate lending to borrowers of different income levels is satisfactory. Table 5 shows that the percentage of consumer real estate loans to low- and moderate-income borrowers generally meets or exceeds the percentage of low- and moderate-income families in the assessment area. In addition, the bank's consumer real estate lending to middle- and upper-income borrowers is reasonable in comparison to the number of middle- and upper-income families in the assessment area.

As mentioned, the consumer real estate sample is composed of all consumer real estate loans originated from May 27, 1997, through December 31, 2000, and reported on the bank's HMDA Loan/Application Register. As such, the sample consists of 36 loans (all reported loans located within the assessment area) consisting of 4 loans to low-income borrowers and 10 loans to moderate-income borrowers. The bank does not offer specialized loan programs that are specifically directed toward low-income and moderate-income borrowers. Loan products offered by the bank are standard mortgage loan programs.

The community contact indicated that the economy of the assessment area is very good, and as a result, the value of housing in the southwestern portion of the MSA has dramatically increased over the past four years. As previously mentioned, housing data provided by the contact indicates that the 2000 average residential housing sale price was \$218,115.

The bank's consumer real estate lending to low- and moderate-income borrowers is favorable. However, due to the relatively low number of consumer real estate loans, examiners assigned less weight to the bank's real estate lending category. However, based on the competitive banking environment in the assessment area and the staff turnover in the consumer real estate lending area, the bank's level of consumer real estate loans to borrowers of different income levels is satisfactory.

Consumer lending. The bank's level of consumer loans to low- and moderate-income borrowers is very good. The level of consumer lending to low-income borrowers significantly exceeds the percentage of low-income families in the assessment area. The bank's consumer lending to moderate-income borrowers also exceeds the percentage of moderate-income families in the assessment area. As noted in Table 5, the bank originated over 50% of sampled consumer loans to low- and moderate-income borrowers. The bank's level of service to this segment of the market is also apparent by its origination of small-dollar consumer loans. Approximately 28% of the sampled consumer loans were for \$3,500 or less. Of the loans in this subcategory, 58% were originated to low- and moderate-income borrowers.

Bank management and the community contact indicated that the local economy is strong. Bank management indicated that middle- and upper-income borrowers usually finance large consumer purchases through home equity lines of credit, and low- and moderate-income individuals use traditional secured and unsecured consumer loans to finance large-scale consumer purchases. According to bank management, this is because low- and moderate-income individuals in the assessment area usually rent. The community contact confirmed the bank's statement concerning homeownership in the assessment area. The bank does not provide any specialized consumer loan programs specifically directed toward low- and moderate-income individuals.

The level of consumer lending to low- and moderate-income borrowers demonstrates the bank's willingness to originate consumer loans to individuals of all income levels in the assessment area. The bank's level of consumer lending is very good.

Small business lending. The bank has a good distribution of loans to small businesses. Table 6 shows the percentage of loans made to businesses of different sizes.

TABLE 6						
SMALL BUSINESS LENDING						
	<i>Loan Amount Less than \$100,000</i>		<i>Loan Amount More than \$100,000 less than \$250,000</i>		<i>Loan Amount \$250,000 to less than \$1,000,000</i>	
	#	\$	#	\$	#	\$
Small Business	64%	18%	19%	23%	17%	59%

The CRA sample loan data reveals that the bank extended 100% of small business loans to entities with gross annual revenues of \$1 million or less. According to data published by Dun & Bradstreet as of June 1999, 91% of the business establishments in the assessment area had gross annual revenues of \$1 million or less. (Only banks and thrifts with more than \$250 million in assets or that are subsidiaries of bank holding companies with more than \$1 billion in assets report data for CRA purposes as reflected in the Dun & Bradstreet reports.) Table 6 shows that the bank originated a sizable majority of small business loans of less than \$100,000. The percentage of small business loans by loan amount correspondingly increases as the loan amount category increases. The community contact indicated that the city of Victoria lacks a thriving small business district. Based on the small business lending percentages noted in Table 6, the bank has a good distribution of loans to small businesses.

Overall, the bank's lending to individuals of different income levels and to small business entities of different sizes is very good. A significant number of the bank's consumer loans are extended to low- and moderate-income borrowers. In addition, the majority of small business loans were originated for amounts less than \$100,000.

GEOGRAPHIC DISTRIBUTION OF LOANS

The distribution and dispersion of the bank's loans in the assessment area is reasonable and does not reveal any unexplained gaps in lending patterns. As previously stated, the bank's assessment area consists solely of middle- and upper-income census tracts in the assessment area. Discussions with bank management and the community contact did not reveal any significant concentrations of low- and/or moderate-income families in any of the census tracts that comprise the assessment area. Therefore, further analysis of the bank's lending in geographies of different income levels is not meaningful. The loan sample indicates that the bank actively originates loans in the majority of census tracts that comprise the assessment area. As such, the geographic distribution and dispersion of sampled loans is satisfactory.

GENERAL

The bank has not received any CRA-related complaints since the previous evaluation. In addition, the February 5, 2001, Consumer Affairs Report of Examination did not reveal any fair lending issues or concerns.