

## **PUBLIC DISCLOSURE**

May 28, 2002

Date of Evaluation

## **COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION**

CornerStone State Bank

Name of Depository Institution

914853

Institution's Identification Number

Le Sueur, Minnesota

Address of Institution

Federal Reserve Bank of Minneapolis  
90 Hennepin Avenue, P.O. Box 291  
Minneapolis, MN 55480-0291

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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*Definitions for many of the terms used in this performance evaluation can be found in section 228.12 of Regulation BB. For additional convenience, a “Glossary of Common CRA Terms” is attached as Appendix A at the end of this performance evaluation.*

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

Several factors contribute to the institution's satisfactory rating:

- First, the bank has a strong record of lending to borrowers of different income levels. The consumer loan sample selected by examiners showed that the bank extended a majority of its consumer loans to low- and moderate-income individuals.
- Second, the bank's net loan-to-deposit ratio reflects a fully satisfactory level of lending.
- Third, the bank extended a substantial majority of its loans within the assessment area.
- Finally, the geographic distribution of the bank's loans is reasonable.

## DESCRIPTION OF INSTITUTION

Based on its size and financial condition, the bank is able to meet the credit needs of its two assessment areas effectively. The bank was rated satisfactory in helping to meet the credit needs of its community at its previous CRA evaluation dated May 26, 1998.

*Offices.* The bank operates two full-service offices, one in Le Sueur and one in Cloquet, Minnesota. The bank also owns and operates two automated teller machines (“ATM”). One is located at the Holiday convenience store in Le Sueur, and the other is located at a Holiday convenience store in Cloquet. Users of these ATMs can withdraw funds but the ATMs do not accept deposits. The bank has not closed any branches since the last evaluation.

*Loan portfolio.* According to the bank’s March 31, 2002, Report of Condition (“ROC”), the bank’s residential real estate loans are 50% of the bank’s loan portfolio, commercial loans are 37%, consumer loans are 9%, and agricultural loans are 4%.

The bank offers a variety of loan products including home equity, ready reserve, installment, single-payment, construction, real estate, Minnesota Housing Finance Agency (“MHFA”), and mobile home loans. In addition, its loan products include conventional agricultural, commercial, consumer, and residential real estate loans. With respect to the latter loan category, the bank has referral arrangements with two other institutions to provide applicants with residential real estate loan products it is unable to effectively offer on its own.

In addition to offering conventional loan products, the bank participates in federal loan programs sponsored by the Federal Housing Administration, Rural Economic Community Development, Federal Home Loan Mortgage Corporation, Department of Veterans Affairs, and the Small Business Administration. The bank also participates in state programs sponsored by the MHFA and the Minnesota Department of Agriculture Rural Finance Authority.

The bank’s loan products appear appropriate to fulfill the credit needs of residents, businesses, and farms in its assessment areas.

## DESCRIPTION OF CORNERSTONE STATE BANK’S TWO ASSESSMENT AREAS

The bank operates two offices in two widely separated geographic assessment areas. For purposes of this section of the evaluation, these two assessment areas will be described separately. The following assessment area descriptions will include a discussion of the demographic and economic characteristics of individuals and geographies in the assessment areas.

### Le Sueur Assessment Area

The Le Sueur assessment area includes portions of three Minnesota counties: Le Sueur, Sibley, and Nicollet. The area consists of five block numbering areas (“BNA”) in the south-central region of Minnesota located southwest of the Minneapolis metropolitan area. Three BNAs are classified as middle income and two BNAs are classified as upper income. Le Center is the county seat of Le Sueur County. It is approximately 15 miles east of Le Sueur. Other communities in and near the assessment area include Arlington, Henderson, Nicollet, New Prague, Belle Plaine, and St. Peter. The bank’s main office is in Le Sueur, which is located in BNA 9502 and is approximately 30 miles southwest of Minneapolis.

*Population.* According to 1990 census data, 20,470 people reside in the Le Sueur assessment area. Le Sueur has a population of roughly 3,700 residents. Table 1 illustrates some key information about the bank's Le Sueur assessment area. The contact indicated that the population of Le Sueur is homogenous but aging. Roughly one-third of the area population consists of people who receive Social Security benefits.

<b>TABLE 1 LE SUEUR ASSESSMENT AREA CHARACTERISTICS<sup>1</sup></b>	
<b><i>Tract Summary</i></b>	
<b>Total Number of Tracts</b>	5
Number of Low-Income Tracts	0
Number of Moderate-Income Tracts	0
Number of Middle-Income Tracts	3
Number of Upper-Income Tracts	2
<b><i>Income Summary</i></b>	
<b>Statewide 1990 Median Family Income<sup>2</sup></b>	<b>\$36,916</b>
Percentage of Low-Income Families	13%
Percentage of Moderate-Income Families	16%
Percentage of Middle-Income Families	23%
Percentage of Upper-Income Families	48%
<b><i>Miscellaneous Information</i></b>	
<b>Total Population</b>	<b>20,470</b>
Percentage of Families Below Poverty Level	6.2%
<b>Total Housing Units</b>	<b>7,652</b>
Percentage Owner-Occupied to Total Units	77.7%
Percentage Rental to Total Units	17.2%
Percentage Vacant to Total Units	5.1%

*Economy.* According to bank management and a community contact, economic conditions in the bank's assessment area are satisfactory. The economy has three main components--industrial production, retail services, and government services.

The manufacturing segment of the local economy employs approximately one-third of the area work force. Major employer ADC Telecommunications, Inc., Eden Prairie, Minnesota ("ADC"), has a distribution center in Le Sueur, Minnesota. ADC manufactures telecommunications materials such as fiber optics, network components, software, and related services designed to improve the speed of telecommunications. Its distribution center also has a manufacturing plant. Another large Le Sueur area employer is Le Sueur, Incorporated. It makes aluminum die casting, aluminum sand casting, and mold casting products from its Le Sueur location. In addition, Cambria, Incorporated, a leader in the manufactured quartz industry, employs about 100 people at its Le Sueur plant.

The retail services component of the local economy also employs almost one-third of the area work force. Le Sueur, St. Peter, and the surrounding communities have health care providers, insurers, realtors, accountants, and attorneys.

<sup>1</sup>All information based on 1990 census data unless otherwise noted.

<sup>2</sup>See Appendix A for definitions of low, moderate, middle, and upper income.

With respect to government positions, the assessment area includes portions of three counties. Each county has its set of government employees that provide services ranging from tax assessing to veterans' assistance. Likewise, each county has school districts composed of teachers and paraprofessionals who are figured into the employment data referred to above.

According to the community contact who is familiar with economic development issues in the area, the farming community enjoyed a good 2001. Corn and soy beans are the two main crops, but some farms still grow peas. General Mills, the current owner of the Green Giant, still buys green beans and peas grown by area farms.

*Housing.* According to the community contact, affordable housing continues to be a problem. There is not enough affordable housing in Le Sueur to accommodate the number of local employees and their families. Many people who work in Le Sueur must commute from surrounding communities, such as Mankato, St. Peter, and Jordan.

Based on the 1990 census, 83% of the assessment area's homes are one-unit structures. Dwellings consisting of two to four units accounted for 5% of the assessment area's housing units. Likewise, a dwelling consisting of five or more units accounted for 6% of the assessment area's housing units. Finally, mobile homes represented 5% of this assessment area's housing structures.

The following table shows median values for housing and rent in this assessment area and for statewide nonmetropolitan areas based on 1990 census data.

	<i>Median Housing Value</i>	<i>Median Gross Rent</i>
Le Sueur Assessment Area	\$61,357	\$310/month
Statewide Nonmetropolitan	\$73,683	\$422/month

Examiners contacted a representative of a local economic development association familiar with the economic and demographic characteristics of the assessment area as part of the bank's CRA evaluation. The community contact provided information regarding the local business and housing conditions. Examiners used information from this contact as well as information from bank management to evaluate the bank's CRA performance.

### **Cloquet Assessment Area**

The bank has defined this assessment area as portions of Carlton County in east-central Minnesota. Carlton County is composed of middle-income BNAs 9701, 9702, 9704, and 9707 and upper-income BNA 9703. The branch office is located in Cloquet in BNA 9701. Cloquet is approximately 15 miles southwest of Duluth, Minnesota. Other communities in and near the assessment area include Esko, Carlton, Wrenshall, Barnum, and Scanlon, Minnesota.

*Population.* The Cloquet assessment area has a population of 21,444 people. Cloquet has a population of approximately 10,885. Census data show that 80% of the assessment area residents live in middle-income BNAs and 20% live in upper-income BNAs. Of the 8,061 households in the assessment area, 23% are classified as low income, 15% are moderate income, 16% are middle income, and 46% are upper income. Table 2 illustrates some key information about the bank's Cloquet assessment area.

<b>TABLE 2 CLOQUET ASSESSMENT AREA CHARACTERISTICS<sup>3</sup></b>	
<i>Tract Summary</i>	
<b>Total Number of Tracts</b>	5
Number of Low-Income Tracts	0
Number of Moderate-Income Tracts	0
Number of Middle-Income Tracts	4
Number of Upper-Income Tracts	1
<i>Income Summary</i>	
<b>Statewide 1990 Median Family Income<sup>4</sup></b>	<b>\$36,916</b>
Percentage of Low-Income Families	18%
Percentage of Moderate-Income Families	17%
Percentage of Middle-Income Families	20%
Percentage of Upper-Income Families	45%
<i>Miscellaneous Information</i>	
<b>Total Population</b>	<b>21,444</b>
Percentage of Families Below Poverty Level	8.7%
<b>Total Housing Units</b>	<b>8,700</b>
Percentage Owner-Occupied to Total Units	74.7%
Percentage Rental to Total Units	18.0%
Percentage Vacant to Total Units	7.4%

*Economy.* The largest employer in Carlton County is the Fon du Lac Band of the Lake Superior Chippewa Indians (“Tribe”). It owns two large casinos--the Fon du Luth and the Black Bear Casinos. One casino has an attached hotel, and the other casino is located near several hotels and motels. Aside from the Tribe, there are approximately 750 employers in Carlton County, according to the Minnesota Work Force Center. The labor force in Carlton County consists of approximately 16,000 people. Employers have approximately 15,323 employees that work for them.

The Cloquet assessment area’s economy is generally performing well. According to information from the Minnesota Work Force Center, the unemployment rate is around 4.8% as of August 2002 and has remained within a point of this rate since the beginning of 2001. Although the rate inflated in the months following September 11, 2001, it has fallen back to its current level.

Of the roughly 15,000 employees in Cloquet, approximately 80% are wage earning individuals. Another 16% are individuals who run their own businesses, and the final 4% are farmers. The largest sector of private industry is in the retail services area, which has increased roughly 28% since 1990. This increase likely reflects the growth of the casinos and the hotel owned by the Tribe. Retail trade shops employ another 17% of area residents, with government services representing another 17%. An additional 16% of the residents work in manufacturing.

<sup>3</sup>All information based on 1990 census data unless otherwise noted.

<sup>4</sup>See Appendix A for definitions of low, moderate, middle, and upper income.

## CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

The bank's overall performance in meeting the credit needs of its assessment area is satisfactory. Table 3 shows the combined loan originations in both assessment areas by number and dollar volume between October 2001 and March 2002.

<i>Loan Type</i>	<i>Total Number of Loans</i>	<i>%</i>	<i>Total Amount of Loans (in thousands)</i>	<i>%</i>
Consumer	353	81	\$ 9,771	61
Small Business	59	13	\$ 3,781	24
Residential Real Estate	26	6	\$ 2,454	15
<b>TOTAL</b>	438	100	\$16,006	100

Based on the volume and dollar amount of activity for the loan categories, examiners reviewed consumer loans. The statistical sample consisted of 128 consumer loans originated between October 1, 2001, and March 31, 2002.

To determine the bank's CRA rating, examiners analyzed the following criteria:

- Loan-to-deposit ratio
- Lending inside the assessment area
- Lending to borrowers of different income levels and businesses of different sizes
- Geographic distribution of loans
- Record of responding to complaints about the bank's CRA performance

In assigning the overall rating, examiners placed the greatest weight on the bank's level of lending to low- and moderate-income borrowers.

### LOAN-TO-DEPOSIT RATIO ANALYSIS

The CRA urges banks to extend credit in their assessment areas. To gain an understanding of the bank's lending activity, examiners look at the loan-to-deposit ratio of the bank and compare this ratio to the ratios of competitor banks in the assessment area. Loan-to-deposit ratios help the examiners understand the loan demand of the area and the willingness of the bank to meet the area's loan demands.

The bank's net loan-to-deposit ratio is strong given its size and financial condition. Table 4 lists the average quarterly net loan-to-deposit ratios for the past 16 quarters for the bank and its main competitor. Loan-to-deposit ratio information is not available by branch location for the bank's competitors based in other communities.



<i>Bank</i>	<i>Total Assets as of March 31, 2002 (in thousands)</i>	<i>Quarterly Average Net Loan-to-Deposit Ratio</i>
CornerStone State Bank Le Sueur, Minnesota	\$49,948	92%
First Farmers and Merchants National Bank Le Sueur, Minnesota	\$49,163	79%
Community Bank Minnesota Valley Jordan, Minnesota	\$61,729	72%

Bank management indicated that the bank's chief competitors are Community Bank Le Sueur, a branch of Community Bank Minnesota Valley, Jordan, Minnesota, and First Farmers and Merchants National Bank in Le Sueur. Several large credit unions located in Cloquet, Minnesota, also provide significant competition to the bank's Cloquet branch. According to bank management within the Le Sueur area, the bank excels at attracting consumer loan customers who have worked with the bank for a number of years. However, management noted that in the Cloquet area, large credit unions have become challenging competitors because they have more favorable tax and regulatory environments. Accordingly, attracting loans and deposits in the branch assessment area can be difficult.

As Table 4 illustrates, the bank is an active lender. According to the March 31, 2002, Uniform Bank Performance Report, the bank's 107% net loan-to-deposit ratio placed the bank in the 98th percentile of its peer group banks. The bank's peer group consists of all banks with assets between \$50 million and \$100 million with two or fewer offices located in a nonmetropolitan area. Since the last CRA evaluation, the bank's net loan-to-deposit ratio fluctuated between 73% and 107%.

Based on bank's asset size, financial condition, and the assessment area credit needs, the bank's net loan-to-deposit ratio is strong and meets the standards for satisfactory performance.

#### COMPARISON OF CREDIT EXTENDED INSIDE AND OUTSIDE THE ASSESSMENT AREA

The CRA emphasizes the importance of banks serving the credit needs of the individuals and businesses inside their assessment areas. By extending credit inside their assessment areas, banks fulfill a financial need of the community. As part of the CRA evaluation, examiners reviewed consumer loan files to determine the number of loans and dollar amount of loans originated inside the bank's assessment area.

The bank's lending activity in the overall assessment area is adequate. An analysis of the statistical sample demonstrates that the bank extends a majority of its loans inside the assessment area. Table 5 shows the percentage of consumer loans that the bank originated in its assessment area.

<i>Loan Type</i>	<i>Total Number of Loans</i>	<i>Total Dollar Amount of Loans</i>
Consumer	71%	66%

Table 5 suggests that a majority of the bank’s consumer borrowers reside in the bank’s two assessment areas. This shows the bank’s willingness to meet the credit needs of assessment area residents. Management explained that a significant number of borrowers who reside outside of the assessment area are long-time customers who continue to use the bank for credit needs.

Based on the concentrations of loans within the bank’s two assessment areas, its lending performance meets this category’s standards for satisfactory performance.

**LENDING TO BORROWERS OF DIFFERENT INCOME LEVELS**

In establishing the CRA, Congress sought to ensure that banks extended credit to low- and moderate-income geographies and to low- and moderate-income persons, consistent with safe and sound banking operations. Examiners consider the extent to which banks extend credit to low- and moderate-income persons.

The bank’s level of lending to low- and moderate-income borrowers is commendable. Table 6 reflects the percentages of consumer loans made to borrowers of different income levels.

<b>TABLE 6 DISTRIBUTION OF LOANS IN THE LE SUEUR ASSESSMENT AREA BY BORROWER INCOME LEVELS*</b>								
	<i>Low Income</i>		<i>Moderate Income</i>		<i>Middle Income</i>		<i>Upper Income</i>	
	#	\$	#	\$	#	\$	#	\$
Consumer Loans	50%	38%	19%	7%	21%	42%	10%	14%
Percentage of Families by Assessment Area**	13%		16%		23%		48%	
*2001 Median Family Income of \$47,100 for Nonmetropolitan Areas of Minnesota.								
**According to 1990 U.S. Census Data.								

*Consumer lending.* The Le Sueur office has a strong record of lending to low- and moderate-income borrowers. Its record of extending consumer loans to low- and moderate-income borrowers exceeds the relative number of low- and moderate-income families in the assessment area. In fact, the percentage of the bank’s consumer lending to low-income borrowers is over three times the percentage of low-income families in the assessment area. The percentage of consumer loans to moderate-income borrowers slightly exceeds the percentage of moderate-income families in the Le Sueur assessment area. This is significant, as it shows the bank’s ability to target all assessment area residents that are reasonable credit risks.

<b>TABLE 7 DISTRIBUTION OF LOANS IN THE CLOQUET ASSESSMENT AREA BY BORROWER INCOME LEVELS*</b>								
	<i>Low Income</i>		<i>Moderate Income</i>		<i>Middle Income</i>		<i>Upper Income</i>	
	#	\$	#	\$	#	\$	#	\$
Consumer Loans	13%	3%	50%	51%	25%	34%	13%	12%
Percentage of Families by Assessment Area**	18%		17%		20%		45%	
*2001 Median Family Income of \$47,100 for Nonmetropolitan Areas of Minnesota.								
**According to 1990 U.S. Census Data.								

*Consumer lending.* As was the case at the Le Sueur office, the Cloquet office originates a large number and volume of consumer loans to low- and moderate-income borrowers. Its record is particularly impressive with respect to moderate-income borrowers, as it is nearly three times the number of moderate-income families in the assessment area. These figures reflect the commitment of both offices to attract and make loans to low- and moderate-income borrowers, consistent with safe and sound banking operations.

The bank also serves the needs of the community's low- and moderate-income borrowers by extending small-dollar loans, typically requested to fund borrower living expenses. By making these small-dollar loans, the bank ensures it responds to the reasonable credit needs of area borrowers. This high level of consumer lending to low- and moderate-income borrowers demonstrates the bank's ability to meet the credit needs of all residents in its assessment area.

The bank's strong level of consumer lending to low- and moderate-income borrowers is commendable and the bank exceeds the standards for satisfactory performance in this area.

#### GEOGRAPHIC DISTRIBUTION OF LOANS

The geographic distribution of the bank's lending is satisfactory. As noted above, the CRA seeks to ensure that banks lend to all geographic portions within their assessment area. While the CRA urges banks to make loans to low- and moderate-income borrowers, it also encourages banks to lend to those borrowers who reside in low- and moderate-income areas. As part of the evaluation, examiners determined the addresses of borrowers and plotted those addresses in the appropriate BNAs.

Both of the bank's assessment areas consist solely of middle- and upper-income BNAs. Conversations with bank management and the community contact did not indicate that there were any significant concentrations of low- and/or moderate-income families in any of the BNAs. Therefore, further analysis of the bank's lending in geographies of different income levels is not meaningful. The consumer loan sample indicates that the bank actively lends in all of the BNAs that comprise its assessment areas. Consequently, the geographic distribution and dispersion of the bank's loans are satisfactory.

#### GENERAL

The evaluation did not reveal any violations of the substantive provisions of fair housing laws and regulations. The examination did reveal a procedural violation of Regulation B--Equal Credit Opportunity Act. The bank has not received any CRA-related complaints since its last evaluation.

## Appendix A Glossary of Common CRA Terms

(For additional information, please see the Definitions sections of Regulation BB at 12 C.F.R. 228.12.)

**Assessment Area** - The geographic area(s) delineated by the bank and used in evaluating the bank's record of helping to meet the needs of its community. The assessment area must include the geographies where the main office, branches, and deposit-taking automated teller machines are located. The assessment area must consist only of whole geographies, may not reflect illegal discrimination, and may not arbitrarily exclude low- or moderate-income geographies.

**Block Numbering Areas (BNAs)** - BNAs are geographic entities similar to census tracts. Metropolitan areas are most often delineated into census tracts, while rural areas are delineated into BNAs.

**Census Tracts** - Census tracts are small, relatively permanent geographic entities within counties delineated by a committee of local data users. Generally, census tracts have between 2,500 and 8,000 residents and boundaries that follow visible features.

**Community Development** - Includes affordable housing (including multifamily rental housing) for low- and moderate-income individuals, community services targeted to low- and moderate-income individuals, activities that promote economic development by financing businesses or farms that have gross annual revenues of \$1 million or less, or activities that revitalize or stabilize low- or moderate-income geographies.

**Community Development Loan** - A loan that has community development as its primary purpose and (except in the case of a wholesale or limited-purpose bank):

1. has not been reported or collected by the bank or an affiliate as a home mortgage, small business, small farm, or consumer loan, unless it is a multifamily dwelling loan, and
2. benefits the bank's assessment area(s) or a broader statewide or regional area that includes the bank's assessment area(s).

**Community Development Service** - A service that has as its primary purpose community development is related to the provision of financial services, has not been considered in the evaluation of the bank's retail banking services, benefits the bank's assessment area(s) or a broader statewide or regional area that includes the bank's assessment area, and has not been claimed by other affiliated institutions.

**Consumer Loans** - Loans to individuals for household, family, and other personal expenditures. These loans do not include real estate-secured loans.

**Dun & Bradstreet Data** - Data collected by Dun & Bradstreet regarding types of businesses and their respective gross annual revenues. This data can be sorted by geographies.

**Income Level** - Both geographies and individuals can be described in terms of their income levels. In MSAs, the level is based on the MSA median income. In non-MSA areas, the level is based on the statewide, non-MSA median income.

- **Low Income** - Less than 50 percent of the area median income.
- **Moderate Income** - At least 50 percent and less than 80 percent of area median income.

- **Middle Income** - At least 80 percent and less than 120 percent of the area median income.
- **Upper Income** - At least 120 percent or more of the area median income.

**Metropolitan Statistical Area (MSA)** - A federally designated geographical unit consisting of an urbanized area with a central city of at least 50,000 residents and a regional population of 100,000. MSAs may cross state boundaries.

**Qualified Investment** - A lawful investment, deposit, membership share, or grant that has as its primary purpose community development.

**Small Business** - A business with gross annual revenues of \$1 million or less.

**Small Business Loan** - A loan with an original amount of \$1 million or less that has been reported in the Consolidated Report of Condition and Income in the category "Loans secured by nonfarm nonresidential properties" or "Commercial and industrial loans."

**Small Farm** - A farm with gross annual revenues of \$1 million or less.

**Small Farm Loan** - A loan with an original amount of \$500,000 or less that has been reported in the Consolidated Report of Condition and Income in the category "Loans secured by farmland" or "Loans to finance agricultural production and other loans to farmers."