

SECURITY STATE BANK, HARTLEY, IOWA**CRA PERFORMANCE EVALUATION****Examination Date: July 31, 1998****INSTITUTION RATING:** This institution is rated Satisfactory.

Security State Bank has a satisfactory CRA program that is responsive to the identified credit needs in the assessment area. The bank is predominately an agricultural lender which is consistent with the primary credit needs of the community. The bank's lending activities include the origination of residential real estate and small business/agricultural loans, and the use of flexible government sponsored loan programs. The bank's loan-to-deposit ratio meets the standards for satisfactory performance. The high percentage of loans in the assessment area exceeds the standards for satisfactory performance. Lending to borrowers of different incomes is reasonable, although no residential real estate loans were made to low-income borrowers during the scope of the examination. The distribution of instalment and single payment loans was reasonable based on an income proxy including loans to low- and moderate-income borrowers. The distribution of lending to small businesses and small farms was determined to be reasonable based on the use of a proxy derived from the loan size. All geographies located in the assessment area are classified as middle-income; therefore, an evaluation of the geographic distribution of loans based on income levels was not necessary. There were no CRA-related complaints received by the bank since the previous examination.

DESCRIPTION OF INSTITUTION

The bank's CRA performance was last reviewed as of May 13, 1996, when a CRA rating of Outstanding was assigned.

Security State Bank, with total assets of \$33,613,000 as of June 30, 1998, is a subsidiary of First Security Bancshares, Inc., Lake Park, Iowa, a two-bank holding company. The bank operates one full-service office in Hartley, Iowa. A temporary full-service branch in Milford, Iowa, is scheduled to open on August 17, 1998. This temporary facility will be replaced by a new facility currently being built directly across the street from this location. Management indicated several reasons for opening the Milford office: the desire to expand the bank's operations, the high population growth rate in that lake resort area, and the need to keep pace with local competition. The bank also operates two limited service automated teller machines (ATMs) at local gas stations.

The bank is predominantly an agricultural lender. Based upon information contained in the March 31, 1998 Uniform Bank Performance Report (UBPR), approximately 56% of the bank's loan portfolio is concentrated in agriculture, with 23% secured by real estate, 13% in commercial loans and 8% in consumer loans. The bank's product mix consists of agricultural and commercial loans as well as direct consumer installment, credit card, single-payment and residential real estate loans. The bank offers a 10% down payment mortgage product for first-time homebuyers that does not require private mortgage insurance or other subsidies. The bank also offers home equity loans, home

improvement loans, loans guaranteed by the Small Business Administration and the Farm Services Agency (FSA) and government-subsidized student loans.

The bank's primary competitors in Iowa are State Bank, Spencer, (f/k/a Everly State Bank, Everly); Sanborn Savings Bank, Sanborn; First National Bank, Primghar; United Community Bank, Hartley, an office of United Community Bank, Milford; and First Federal Savings and Loan Association, Hartley.

The bank meets the credit needs of its assessment area consistent with its size, financial capacity, location and current economic conditions. There are no legal or regulatory impediments that would prevent the bank from meeting its CRA obligations.

DESCRIPTION OF SECURITY STATE BANK'S ASSESSMENT AREA

The Community Reinvestment Act requires financial institutions to identify one or more "assessment areas" within which the appropriate regulatory agency will evaluate the bank's CRA performance. 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 block numbering 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 nonmetropolitan locations.

Security State Bank has defined its assessment area to include portions of Clay, O'Brien and Osceola Counties. The bank's office is in Hartley, Iowa, population 1,632, in O'Brien County, and is approximately 20 miles west of Spencer, Iowa. A new office in Milford, in Dickinson County, approximately 30 miles northeast of Hartley, is scheduled to open on August 17, 1998.

The bank's assessment area includes three middle-income geographies, or block-numbering areas: 9804, 9901 and 9602. The assessment area includes the following eleven communities: Everly, Fostoria, Royal, Rossie and Peterson, in Clay County; Hartley and Moneta in O'Brien County; and Harris, Ocheyedon, Melvin, and Ashton in Osceola County. All 11 communities have populations below 1,000 based on 1990 U.S. census data. The total population in the bank's assessment area is 10,245. Whites constitute 99% of the assessment area's population.

The median family income for the assessment area is \$27,748. This figure is significantly below the average median family income for all non-metropolitan portions of the State of Iowa of \$29,303. The breakdown of families in the assessment area, by income level, is as follows: low-income, 17%; moderate-income, 21%; middle-income, 29%; and upper-income, 33%. The assessment area population of persons 17 years of age or younger and 65 years of age or older is consistent with the rest of nonmetropolitan Iowa. According to representatives from the community, there has been a steady increase in the population of individuals of Hispanic decent and Somalian ancestry in recent years.

The assessment area's housing market consists of 4,383 total housing units: 69% are owner occupied, 23% are rental units. In comparison, non-metropolitan Iowa has 67% owner-occupied units and 25% rental units, respectively. One-to-four family units and five or more units account for 95% and 2% of total housing units, respectively. In

comparison, non-metropolitan Iowa's one-to-four family and five or more units account for 88% and 6% of the housing stock, respectively. The median housing value in the assessment area is \$26,376, compared to \$38,521 for the non-metropolitan portions of the State of Iowa. The median age of the assessment area's housing stock is approximately 58 years, compared to 39 years for non-metropolitan Iowa. This strongly suggests that a need may exist for home improvement or rehabilitation loans.

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 areas with lower ratios. According to the 1990 U.S. Census data, the affordability ratio for the assessment area was .89, in comparison to .63 for non-metropolitan Iowa, suggesting that housing is significantly more affordable in the assessment area than for all of non-metropolitan Iowa.

According to the Iowa Work Force Development, Clay, O'Brien and Osceola counties had an unemployment rate of 2.7%, 2.5% and 2.5%, respectively, as of June 1997 and 2.8%, 2.3% and 2.3%, respectively, as of June 1998, which is below the state unemployment rate of 3.2% and 2.5% for the corresponding periods. The local economy is stable and largely dependent on agricultural, especially grain farming, and cattle and hog production.

Major employers in the community are as follows:

SECURITY STATE BANK MAJOR EMPLOYERS			
EMPLOYER	LOCATION	# OF EMPLOYEES	PRODUCT/SERVICE
Beef Specialist of Iowa	Hartley	200	Beef Processing
Northwest Iowa Co-Op	Ashton	26	Fertilizer & livestock feed
Rehms-Stewart, Inc.	Ocheyedan	16	Ready-mix concrete
Cargill, Inc.	Royal	12	Feed & Fertilizer

Terra Industries, Inc.	Hartley	10	Poultry & Livestock Feed
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Based on the data above, the assessment area has a significantly lower average income, a significantly lower average unemployment rate, significantly more affordable housing, and a higher percentage of owner-occupied residences than other nonmetropolitan areas across the state. Housing stock is also much older than the average age for nonmetropolitan Iowa.

Community contacts confirm this situation. Although there is a low unemployment rate, many of the jobs are low paying. Most of the new construction in town is for low-income rental units. There is a demand for additional low-income housing to be made available for purchase. One contact stated that area banks are trying to meet the needs of the community; however, a popular choice for residential mortgages is a loan guaranteed by the Farm Services Agency (FSA). With an FSA guaranteed loan, customers typically need to provide only the money required for closing costs without any need for a down payment. The contact stated that there needs to be programs for customers with marginal credit histories. Another contact stated that the city is making progress towards supplying the housing needs of the community. There is also a need for rehabilitation loans for the existing rental units.

Security State Bank is primarily an agricultural lender. The bank does offer a First Time Home Buyers program where the customer is charged a low interest rate (one and a half percent lower than market) for the first five years of the mortgage. Subsequently, it is refinanced at the existing market rate. Another program the bank is involved in is the Homestead Co-op, which provides housing for senior citizens. Both local financial institutions, Security State Bank and United Community Bank, are financing the project. The only requirement to occupy these homes is that the buyer must be over 55 years old; there are no income requirements. In response to identified community credit needs, the bank is encouraged to investigate opportunities for home improvement and rehabilitation loans as well as opportunities to provide credit counseling to assist customers with marginal credit histories.

Loan-to-Deposit Ratio

Security State Bank’s loan portfolio was reviewed to evaluate its lending, loan mix and how the bank’s performance compares to its peer group and a sample of local competitors. The bank’s net loan-to-deposit ratio (LTD) averaged 63.37% for the eight quarters ended March 31, 1998, compared to 63.48%, 81.96%, 77.36% and 37.80%, respectively, for the bank’s peer group and three of its competitors. As of March 31, 1997, the bank’s LTD ratio was 62.12%, compared to 61.34%, 78.15%, 78.12% and 39.70% for the bank’s peer group and three of its competitors. The LTD ratio for the bank, peer group and a sample of three competitors is as follows:

SECURITY STATE BANK Loan-to-Deposit Ratio Summary				
	Total Assets As of June 30, 1998	LTD Ratio as of	LTD Ratio as of	Eight Quarter Average LTD

Institution	(000's)	March 31, 1997	March 31, 1998	Ratio
Security State Bank	\$33,513	62.12	67.26	63.37
United Community Bank	\$92,060	78.15	89.79	81.96
State Bank	\$34,928	78.12	79.86	77.36
First National Bank	\$19,687	39.70	41.14	37.80
Peer Group	-	61.34	64.38	63.48

As indicated in the preceding chart, the bank's LTD ratio is similar to that of the peer group, and is below the LTD ratio for two competitors. A comparison of the bank's current average LTD ratio with information contained in the previous report of examination, data as of March 31, 1996, revealed an overall increase of 2.41%, from 61.88% to 63.37%. The bank's LTD performance meets the standards for satisfactory performance.

Lending in the Assessment Area

A sample of loan originations for a six-month period, from January 1, 1998 to June 30, 1998, was utilized to determine the extent of lending within the assessment area. The sample consisted of 614 loans totaling \$7,058,644: 75 instalment loans (\$309,520), 63 commercial loans (\$1,009,640), 465 agricultural loans (\$5,383,134) and 11 residential real estate loans (\$356,350). The distribution of these loans within the assessment is as follows:

SECURITY STATE BANK Loans in the Assessment Area			
LOAN TYPE	TOTAL # OF LOANS SAMPLED	# OF LOANS WITHIN THE ASSESSMENT AREA	PERCENT OF TOTAL
Direct Installment	75	60	80%
Commercial Loans	63	59	94%
Agricultural Loans	465	441	95%
Residential Real Estate	11	11	100%
Totals	614	571	93%

As illustrated in the preceding chart, 93% of the bank's loans are within the assessment area. Agricultural loans represent the largest number (441) of loans in the assessment area and residential real estate loans represent the highest percentage (100%). While not shown in the above chart, a total of \$6,328,102 or 90% of the total dollar amount of loans was in the assessment area. Agricultural loans had the largest dollar

concentration (\$5,057,234) in the assessment area and residential real estate loans the largest dollar percentage (100%) of loans. Overall, the bank’s lending activity within the assessment area exceeds the standards for satisfactory performance.

Flexible Loan Programs

Security State Bank participates in several government-sponsored loan programs that utilize flexible underwriting criteria, in an effort to make credit more widely available in the assessment area. Since the previous examination, the bank has participated in the following government sponsored loan programs: Farm Services Agency (FSA) and the Small Business Administration (SBA) loan programs. Since the previous examination, the bank originated 10 FSA loans totaling \$2,005,590 and two SBA loans totaling \$348,500. In addition, the bank offers a program for first time homebuyers that requires a 10% down payment and no private mortgage insurance. The bank has granted seven loans for \$117,100 since they started offering this program. While these loan programs are designed to make credit more widely available throughout the assessment area, income information was not readily available to allow a determination to be made regarding their effectiveness.

Community Development Services

A member of the bank’s staff serves as president for the local Industrial Development Corporation (IDC). The IDC’s goal of increasing jobs in the local community is accomplished by assisting local businesses to expand and by attracting new businesses to the community.

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

Consumer Loans

A six-month sample of 11 real estate mortgages and 58 direct instalment loans was relied upon to determine the distribution of the bank’s loans to borrowers of different income levels. Income information was available in the credit files on all of the real estate loans. The distribution of these loans is as follows:

LOAN TYPE	LOW-INCOME \$000's/Number	MODERATE-INCOME \$000's/Number	MIDDLE-INCOME \$000's/Number	UPPER-INCOME \$000's/Number
Residential Real Estate	-0-	\$109/4	\$79/3	168/4

The bank originated a total of 11 residential real estate loans totaling \$356,000. Four loans, or 36%, of the total number of loans were made to moderate-income borrowers. The percent of loans made to moderate-income borrowers exceeds the 21% distribution of moderate-income families in the assessment area. No residential real estate loans were made to low-income borrowers. Management attributed the lack of residential real estate loans to low- and moderate-income borrowers to local competition for mortgage loans, particularly from First Federal Savings and Loan Association, which specializes in mortgage lending.

The bank does not routinely collect income information for its instalment loans. Therefore, based upon discussions with management and a review of instalment loan data, it was determined that a loan amount proxy of \$1,500 is representative of the dollar amount of credit frequently requested by low- or moderate-income individuals. Eighteen or 31% of the bank's total number of instalment loans were in amounts of \$1,500 or less, which indicates the bank's willingness to make loans in amounts typically requested by low- or moderate-income individuals.

Small Farm and Small Business Loans

A six-month sample of 63 commercial loans totaling \$1,009,640 and 465 agricultural loans totaling \$5,383,134 was reviewed to determine the distribution of these loans to small businesses and small farms. 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.

Income information for the bank's commercial and agriculture loans was not readily available. Therefore, to determine their distribution, these loans were stratified similar to the manner in which they are reported on the Consolidated Report of Condition and Income. Of the bank's 528 total commercial and agricultural loans, 523 or 99% were in amounts of \$100,000 or less. According to management, one of the 63 commercial loans was made to a business with gross annual revenues greater than \$1.0 million. None of the 465 farm loans were made to farms with gross annual revenues greater than \$1.0 million. These results indicate that the bank is making the types of loans identified as primary credit needs in the assessment area.

According to the June 30, 1998 Consolidated Report of Condition and Income, virtually all of the bank's commercial and agricultural loans were in amounts equal to or less than \$100,000.

Overall, the bank's distribution of loans to borrowers of different income levels and to small farms and small businesses is evaluated as high satisfactory. The use of a proxy and the lack of residential real estate loans made to low-income borrowers prevented the bank's performance from being evaluated at a higher level.

Geographic Distribution

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 regarding its CRA performance since the previous examination.