

PUBLIC DISCLOSURE

November 8, 1999
Date of Evaluation

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

First State Bank of Emmons
Name of Depository Institution

935054
Identification Number of Institution

Emmons, 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.

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 First State Bank of Emmons, Emmons, Minnesota, prepared by the Federal Reserve Bank of Minneapolis, the institution’s supervisory agency, as of November 8, 1999. 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: “Satisfactory.”

Several factors support the bank’s satisfactory CRA rating. The bank’s lending to low- and moderate-income borrowers, small businesses, and small farms is good. The bank’s quarterly average net loan-to-deposit ratio has remained high since the last evaluation. Last, the bank originates a majority of its loans to assessment area residents, businesses, and farms.

DESCRIPTION OF INSTITUTION

The bank fulfills the credit needs of the residents and businesses in its assessment area in a satisfactory manner. The bank received a satisfactory CRA rating at its last evaluation, dated February 18, 1997.

Offices. The bank's only office and automated teller machine ("ATM") are in Emmons, Minnesota. The main office is a full-service office and is located in middle-income block numbering area ("BNA") 9803. The bank has not opened or closed any branch offices since the previous evaluation. The bank's ATM is at the main office. It is accessible 24 hours a day and does not accept deposits. The bank added the ATM since the last evaluation. The bank's lobby hours are 8:30 a.m. to 4:00 p.m., Monday through Thursday, and 8:30 a.m. to 6:00 p.m., Friday. The bank does not have a drive-up facility.

Bank's size. The bank's size does not restrict its ability to meet the credit needs of residents, businesses, and farms within the assessment area. According to the September 30, 1999, Report of Condition ("ROC"), the bank's total assets were approximately \$8.1 million.

Loan portfolio. The ROC data indicate that the composition of the bank's loan portfolio has remained relatively stable since the previous evaluation. The bank's March 31, 1997, ROC data show the loan portfolio composition as 57% commercial, 16% consumer real estate, 14% consumer, and 13% agricultural loans. As of September 30, 1999, the bank's loan portfolio composition was 52% commercial, 22% consumer real estate, 15% consumer, and 11% agricultural loans. Although the percentages have changed, commercial and consumer real estate loans remain the largest loan categories. The greatest relative increase since the last evaluation was in consumer real estate loans.

Credit products. The bank offers a variety of loan products designed to serve the credit needs of residents, businesses, and farms in its assessment area. Its products include conventional agricultural, commercial, consumer, and consumer real estate loans. The bank originates closed-end consumer loans for a variety of purposes. It also extends consumer home equity and overdraft checking lines of credit. The bank offers a variety of conventional real estate loan products, including home purchase, improvement, and refinance loans. The bank extends both closed- and open-end conventional agricultural and commercial loans.

DESCRIPTION OF FIRST STATE BANK OF EMMON'S ASSESSMENT AREA

Assessment area. The bank has defined its assessment area as the southeastern section of Faribault County, Minnesota; the southwestern corner of Freeborn County, Minnesota; the western half of Worth County, Iowa; and all of Winnebago County, Iowa. The assessment area is made up of Minnesota BNAs 9605 and 9803 and Iowa BNAs 9902, 9801, 9802, and 9803. All of the BNAs are classified as middle income. As previously mentioned, the bank's office and ATM are in Minnesota BNA 9803. The bank has not changed its assessment area since the previous evaluation.

Emmons is located 12 miles southwest of Albert Lea, Minnesota, on the Iowa border. The southern section of Emmons' main street is in Iowa. Other communities in the assessment area include Twin Lakes, Minnesota; Lake Mills, Iowa; Northwood, Iowa; and Forest City, Iowa.

In addition to discussions with bank management, examiners contacted a representative of a local business organization who is familiar with current economic issues. Information received from this contact and bank management was used to evaluate the bank's CRA performance.

Population. The population of the bank’s assessment area is 21,116, according to 1990 U.S. Census data. The community contact indicated that the population of the southwestern portion of Freeborn County has remained relatively stable since the 1990 census. According to the community contact, the cities of Lake Mills and Forest City are the largest employment centers for residents living in southwestern Freeborn and southeastern Faribault counties. The community contact does not expect the 2000 U.S. Census to reflect population decreases in the assessment area.

Income. CRA divides income levels into four categories: low, moderate, middle, and upper. Because the bank’s assessment area is in a nonmetropolitan area, the categorization of a borrower or BNA’s income is determined relative to the statewide nonmetropolitan median family income for the relevant state. The regulation defines low-income individuals as those with 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 middle-income individuals as persons with incomes of at least 80% but less than 120% of the statewide nonmetropolitan median family income. Individuals with incomes of 120% or more of the statewide nonmetropolitan median family income are classified as upper-income persons.

The U.S. Department of Housing and Urban Development (“HUD”) estimated 1999 median family incomes for the nonmetropolitan areas of Minnesota and Iowa. According to HUD data, the median family incomes for Minnesota and Iowa are \$41,600 and \$42,100, respectively. These incomes are used to classify borrowers’ income levels. For the purpose of classifying BNA income levels, this evaluation uses the 1990 statewide nonmetropolitan median family incomes for Minnesota and Iowa of \$28,933 and \$29,303, respectively.

As previously noted, the assessment area is composed of middle-income BNAs. There are no low-, moderate-, or upper-income BNAs in the assessment area. According to 1990 U.S. Census data, the median family income of the assessment area was \$29,177. On average, the nonmetropolitan median family incomes in Minnesota and Iowa have increased by 44% since the 1990 U.S. Census. The 1990 census data provide the median family incomes for each of the BNAs that comprise the bank’s assessment area. The median family incomes for these BNAs range between 89% and 108% of the 1990 nonmetropolitan median family incomes for Minnesota and Iowa.

There are 8,169 households and 5,877 families within the assessment area. The distribution of the assessment area residents by median household and family incomes is summarized in the following table.

ASSESSMENT AREA POPULATION DISTRIBUTION BY INCOME LEVEL								
Unit of Measure	Low Income		Moderate Income		Middle Income		Upper Income	
	#	%	#	%	#	%	#	%
Households compared to Median Household Income	1,736	21	1,338	16	1,870	23	3,225	40
Families compared to Median Family Income	911	15	1,118	19	1,732	30	2,116	36

Approximately 11% of the households and 8% of the families in the assessment area have incomes below the poverty level. These figures are slightly lower than the comparable nonmetropolitan statewide figures for Minnesota and Iowa.

Economy. According to bank management and the community contact, economic conditions in the assessment area are very good. The community contact described the current economic conditions as the strongest in the past six years. Unemployment is at a historical low. In fact, the community contact stated that local community development agencies have hosted seminars attempting to attract employment age individuals to the area. The community development agencies usually visit cities where a large employer has recently reduced its staff. Emmons and nearby small towns are bedroom communities. The majority of individuals who reside in the assessment area commutes to Lake Mills or Forest City to work.

The community contact stated that the largest industries in the assessment area are farming and agricultural-related businesses, which constitute 60% of the assessment area's economy. The assessment area's farming conditions have been very good. A recent study conducted by a community development agency indicated that recent farm failures resulted from poor management rather than low prices. The majority of farms and industries in the assessment area have diversified operations. Recent low pork prices have not hurt farmers in the assessment area, except those who have not diversified their operations.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

The bank's performance in meeting the credit needs of its assessment area is satisfactory. Given the relatively high number of consumer loans and dollar amounts of commercial and agricultural loans originated since the last evaluation, the bank's CRA evaluation is based on consumer, small business, and small farm lending. The following table shows the bank's loan originations since the last evaluation.

Loan Type	Percentage of Loan Originations	
	Number of Loans	Dollar Amounts
Consumer	70%	31%
Residential Real Estate	4%	14%
Commercial	15%	39%
Agricultural	11%	16%

The analysis on the following pages is based on a review of 62 consumer, 43 small business, and, 52 small farm loans. The sample period for small business and small farm loans was the two-year period preceding the evaluation. For consumer loans, the sample period was the six-month period preceding the evaluation. The criteria discussed in the following sections were used to determine the bank's CRA rating. In assigning an overall rating, the greatest weight was placed on the assessment of lending to borrowers of different income levels and businesses of different sizes.

LOAN-TO-DEPOSIT RATIO ANALYSIS

The bank's net loan-to-deposit ratio is reasonable and continues to meet the standards for satisfactory performance. Since the last evaluation, the bank's quarterly net loan-to-deposit ratio has fluctuated between 69% and 81%. According to the September 30, 1999, ROC data, the bank's net loan-to-deposit ratio was 79%. The bank's average net loan-to-deposit ratio for the past eleven quarters is 75%. At the

last evaluation, the bank's quarterly average net loan-to-deposit ratio was 69%. The following table shows the bank's quarterly net loan-to-deposit ratios and components since the last evaluation.

DATE	NET LOANS (in thousands)	DEPOSITS (in thousands)	NET LOAN-TO- DEPOSIT RATIO
March 31, 1997	\$5,297	\$7,774	68%
June 30, 1997	\$5,374	\$7,570	71%
September 30, 1997	\$5,510	\$7,424	74%
December 31, 1997	\$5,204	\$7,354	71%
March 31, 1998	\$5,476	\$7,163	76%
June 30, 1998	\$5,580	\$6,961	80%
September 30, 1998	\$5,591	\$6,879	81%
December 31, 1998	\$5,459	\$7,344	74%
March 31, 1999	\$4,967	\$6,908	72%
June 30, 1999	\$5,168	\$6,888	75%
September 30, 1999	\$5,494	\$6,911	79%

As noted in the table, the bank's net loan-to-deposit ratio has increased since the last evaluation. The most recent Uniform Bank Performance Report ("UBPR") shows that the bank's June 30, 1999, net loan-to-deposit ratio compares favorably to the bank's national peer group. The June 30, 1999, net loan-to-deposit ratio for the national peer group was 58%. The bank's 75% net loan-to-deposit ratio ranks the bank in the 78th percentile of its national peer group.

The bank's net loan-to-deposit ratio is comparable to ratios of other similar-sized financial institutions that operate offices or branches in the assessment area. The table below, based on quarterly UBPR data from March 31, 1997, to June 30, 1999, compares the bank's quarterly average net loan-to-deposit ratio with competitor banks in the bank's assessment area.

BANK AND COMPETITOR DATA*		
BANK AND LOCATION	TOTAL ASSETS (June 30, 1999)	QUARTERLY AVERAGE NET LOAN-TO-DEPOSIT RATIO
First State Bank of Emmons Emmons, Minnesota	\$ 8,041	74%
Frost State Bank Frost, Minnesota	\$ 9,990	67%
The First National Bank of Kiester Kiester, Minnesota	\$17,131	78%
State Bank of Bricelyn Bricelyn, Minnesota	\$21,968	72%
*Financial information is not available for comparing the bank to branches of regional banks operating in the assessment area.		

Based on the bank's asset size, the net loan-to-deposit ratio is reasonable in comparison to competitor banks in the assessment area. The competitor financial institutions differ from the bank in the composition of their loan portfolios; the competitor banks are primarily agricultural lenders. Bank management indicated that the bank's main competitors are larger financial institutions that have branch offices in Twin Lakes and Lake Mills.

The bank's quarterly average net loan-to-deposit ratio is reasonable. The bank's quarterly average net loan-to-deposit ratio compares favorably with ratios of other banks operating offices in the assessment area as well as the bank's national peer group. In addition, the community contact did not identify any unmet credit needs. As such, the bank's net loan-to-deposit ratio meets the standards for satisfactory performance.

COMPARISON OF CREDIT EXTENDED INSIDE AND OUTSIDE THE ASSESSMENT AREA

The bank's lending activity in the assessment area exceeds the standards for satisfactory performance. A review of the statistical sample of loans originated by the bank reveals that the bank extends a significant majority of its loans inside the assessment area. The following table shows the percentages of consumer, small business, and small farm loans that the bank originated within its assessment area.

LOANS ORIGINATED INSIDE THE ASSESSMENT AREA		
Loan Type	Total Number of Loans	Total Dollar Amount of Loans
Consumer	89%	93%
Small Business	88%	86%
Small Farm	83%	89%

The bank originated significantly more than a majority of consumer, small business, and small farm loans within its defined assessment area. The concentration of lending in the bank's assessment area has not changed since the previous evaluation. As previously mentioned, the bank's assessment area has remained the same. The bank originates a number of loans to borrowers outside of its assessment area. According to management, it extended these loans to individuals who have moved away from the assessment area but who continue to borrow from the bank.

Based on the concentration of lending in the bank's assessment area, the bank's performance in this category exceeds 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 borrowers of different income levels and to businesses and farms of different sizes meets the standards for satisfactory performance.

Consumer lending. As previously mentioned, CRA groups income levels into four categories: low, moderate, middle, and upper. According to the 1990 census data, the median family income for the assessment area was \$29,177. For purposes of classifying income levels of the bank's consumer borrowers, this evaluation uses HUD estimated 1999 median family incomes for the nonmetropolitan areas of Minnesota and Iowa, which are \$41,600 and \$42,100, respectively. The following table reflects the percentages of consumer loans made to borrowers of different income levels.

DISTRIBUTION OF CONSUMER LOANS IN THE ASSESSMENT AREA BY BORROWER INCOME LEVEL*					
Loan Type	Low- Income Borrowers	Moderate- Income Borrowers	Middle- Income Borrowers	Upper- Income Borrowers	Income Not Reported
Total Number of Loans	31%	36%	13%	11%	9%
Total Dollar Amount of Loans	35%	34%	11%	14%	6%
*Income level is based on 1999 median family incomes for the nonmetropolitan areas of Minnesota and Iowa.					

As described in the Description of the Assessment Area section, low-income families represent 15% of the assessment area's population. Moderate-income families represent 19% of the assessment area's population. Middle- and upper-income families comprise the remaining 66% of the assessment area's population. The bank's level of consumer lending to low- and moderate-income borrowers exceeds the representation of low- and moderate-income families in the assessment area.

According to the bank, residents in the assessment area commute to larger cities for employment. The majority of these individuals earn wages slightly over the minimum wage. The bank indicated that these individuals usually reside in small cities within the assessment area due to the lower cost of living. The evaluation revealed higher lending percentages to low- and moderate-income borrowers, which was also the case in the previous evaluation. The bank serves the needs of low- and moderate-income people by offering and extending small consumer loans. The level of consumer lending to low- and moderate-income borrowers demonstrates the bank's willingness to meet the credit needs of the assessment area.

Small business and small farm lending. The bank has a good distribution of loans to small businesses and small farms with different revenues. For the purpose of this evaluation, small business loans are most commercial loans with principal amounts of \$1 million or less and small farm loans are most agricultural loans with original principal amounts of \$500,000 or less. During the sample period, the bank did not extend any commercial or agricultural loans with original principal amounts higher than the amount for classification as a small business or small farm loan. The loan sample reveals that the bank originated 82% of small business and 100% of small farm loans to entities with gross annual revenues of \$1 million or less. The sample also showed that all of the small business and small farm loans were in amounts of less than \$100,000. The small business and small farm lending patterns reflect the bank's asset size, legal lending guidelines, and market.

Pursuant to CRA, independent banks with assets of \$250 million or more and banks affiliated with a holding company with total bank and thrift assets of \$1 billion or more must report small business and small farm loan data. The reporting financial institutions extended 60% of small business loans and 95% of small farm loans to entities with gross annual revenues of \$1 million or less. Even though the bank does not report CRA data, its level of lending to small businesses and small farms compares favorably to 1998 small business and small farm aggregate data.

Overall, the bank satisfactorily lends to individuals of different income levels and businesses and farms of different sizes. It extends a significant percentage of consumer loans to low- and moderate-income borrowers. Further, the bank's small business and small farm lending is reasonable. The bank's lending to borrowers of different income levels and to businesses and farms of different sizes meets the standards for satisfactory performance.

GEOGRAPHIC DISTRIBUTION OF LOANS

The bank's level of lending to geographies of different income levels meets the standards for satisfactory performance. As previously discussed, the bank's assessment area is composed of only middle-income BNAs. As such, further analysis of the bank's lending in geographies of different income levels is not meaningful. The loan sample indicates that the bank actively lends in all of the BNAs that comprise its assessment area. Consequently, the geographic distribution and dispersion of the bank's loans meets the standards for satisfactory performance.

GENERAL

The evaluation did not reveal any violations of the substantive provisions of the fair lending and housing laws and regulations. In addition, the bank has not received any CRA-related complaints since the previous evaluation.