



SMALL BANK

Comptroller of the Currency
Administrator of National Banks

PUBLIC DISCLOSURE

March 20, 2006

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**Northern National Bank
Charter Number 23450**

**24110 Smiley Road
Nisswa, Minnesota 56468**

**Comptroller of the Currency
Minneapolis North
920 Second Avenue South, Suite 800
Minneapolis, Minnesota 55402**

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.

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

Northern National Bank (Northern) chartered in Nisswa, Minnesota is satisfactorily meeting the credit needs of its assessment area (AA). This is best demonstrated by:

- High loan volume, particularly in comparison to other local banks of similar size.
- Origination of a substantial majority of loans within the AA.
- Home lending performance that meets the AA's demographics for low- and moderate-income families, considering the AA's unique performance context.
- Adequate distribution of commercial and commercial real estate loans to businesses of all sizes within the AA.
- Reasonable geographic distribution of loans throughout the AA.

DESCRIPTION OF INSTITUTION

Northern is a \$114 million bank located in north-central Minnesota. The bank has four full-service offices; the main office is located in Nisswa with branch offices located in Baxter, Brainerd, and Crosslake. The Brainerd office was opened in December 2001. Drive-up facilities and automated teller machines (ATM) are also located at each office. There are no legal or financial constraints inhibiting Northern's CRA performance or its ability to meet the lending needs of its AA. Northern received a rating of Satisfactory at the last CRA examination dated November 13, 2000.

The bank is primarily a residential real estate and commercial lender. As of December 31, 2005, business loans (commercial & commercial real estate) comprised 45% of total outstanding loans, 1-4 family residential real estate 33%, construction loans 18%, and consumer 4%. Total net loans represent 83% of total assets.

Northern is majority owned by Anderson Financial Group, Inc., a closely held one-bank holding company. Northern does not have any bank or non-bank affiliates engaged in lending activities that impact the bank's CRA performance.

DESCRIPTION OF THE ASSESSMENT AREA

Northern's AA is one contiguous group of census tracts including all 13 census tracts of Crow Wing County plus four census tracts in Cass County. The AA is primarily rural and is not located in a Metropolitan Statistical Area. The adjoining cities of Baxter and Brainerd comprise the center of economic activity and represent approximately one-third of the AA population and a majority of its businesses. Geographically, the majority of the AA consists of small towns and population clusters near or surrounding area lakes. The AA is located approximately 120 miles northwest of the Twin Cities metropolitan area. The proximity to the Twin Cities and number of area lakes has a significant impact on the local economy and residential housing market.

The AA is also unique with regards to its high level of seasonal residents, the out-of-area income brought to the area, and the concentration in second home purchases of high-priced lakeshore properties. The 2000 census data details that 31% of all housing in Crow Wing County is comprised of seasonal units. This is consistent with 2005 records of the Crow Wing County Assessor, which report 30% of residential buildings are assessed as seasonal non-homestead. These seasonal units are comprised of homes along area lakes occupied primarily during the summer months and weekends, predominately by residents of the Twin Cities metropolitan area.

According to 2005 real estate multiple listing data for Crow Wing and southern Cass Counties, the average lakeshore home sales price is \$431,000. This is compared to the non-lakeshore home average of \$155,000. A local resident earning the non-MSA median family income of \$54,100 would have to pay approximately 50% of their gross income on a house payment (principal, interest, taxes, and insurance) to purchase an average-priced lakeshore home. As a result, individuals/families of low- and moderate-income levels are typically unable to afford such a home and these properties are purchased by out-of-area individuals with higher incomes. For these reasons, we have segregated our analyses of primary residence home loans from second home loans when evaluating the bank's home lending performance.

The AA is economically sound, unemployment is low, real estate values climbing, and population base is growing. The local economy is centered in tourism, medical services, and retail sectors. External factors, such as the strength of the Twin Cities economy, impact the strength of the local economy. For example, housing values are being impacted by strong demand for lake homes as previously discussed.

The bank's AA has numerous financial institutions serving the area and competition is high. There are a total of 38 banking offices within Crow Wing County comprised of local banks and branches of large regional banks. In addition, there are several very active credit unions and finance companies that service the area.

Examiners spoke with a representative from a local nonprofit development organization during this evaluation. The contact indicated that the primary credit needs of the area were conventional residential real estate and small business lending. It was the contact's conclusion that the financial institutions in the area are meeting the credit needs of the community. However, the contact would like to see more involvement by financial institutions in rehabilitation of the downtown area of Brainerd.

The 17 census tracts comprising the bank's AA include 13 middle income tracts and four

moderate income tracts (two in Crow Wing County and two in Cass County). The AA meets the requirements of the Community Reinvestment Act and does not arbitrarily exclude low- or moderate-income geographies. According to 2000 U.S. Census Data, the total population for the AA is 70,748 persons. The 2000 Census Data reported a Median Family Income for the AA of \$45,925, while the updated 2002 Median Family Income for the AA is \$54,100. Also according to the 2000 Census Data, the weighted average value of homes in the AA was \$111,546; however, values have increased significantly with 2005 sales data indicating average selling prices of \$155,000 for non-lakeshore homes and \$431,000 for lakeshore homes. The following table summarizes the income levels of census tracts and families located within the bank's combined AA.

| Assessment Area by Income Level | Census Tract % | Total Families % | Total Businesses by Tract Income % |
|----------------------------------------|-----------------------|-------------------------|-------------------------------------------|
| Low Income | N/A | N/A | N/A |
| Moderate Income | 23.53 | 18.34 | 25.28 |
| Middle Income | 76.47 | 81.66 | 74.72 |
| Upper Income | N/A | N/A | N/A |

CONCLUSIONS ABOUT PERFORMANCE CRITERIA

Loan-to-Deposit Ratio

Northern's loan-to-deposit ratio is strong given the bank's size and area's credit needs. The bank's quarterly net loan-to-deposit ratio averaged 106% over the 21 quarters from December 31, 2000 to December 31, 2005.

Northern's quarterly net loan-to-deposit ratio is among the highest when compared to other commercial banks in the bank's AA. Northern ranks a close second among these eight similarly situated banks chartered in the AA. The other seven banks had quarterly average net loan-to-deposit ratios averaging 86% and ranging from 58% to 107% over the same 21 quarters from December 31, 2000 to December 31, 2005.

In addition, Northern originates residential real estate loans and sells loans through the secondary market. The bank sold over \$11 million in residential mortgage loans to the secondary markets in both 2004 and 2005. While these activities assist in Northern's efforts to meet local credit needs, the volume of sold loans is not reflected in the quarterly loan-to-deposit ratio noted above.

Lending in Assessment Area

Northern originates a substantial majority of its loans to borrowers located within its AA. Based upon bank records for the origination of loans from January 1, 2004 through February 28, 2006, the bank originated 90% of home loans by number and 88% by dollar amount within the AA. Business loans of 89% by number and 81% by dollar amount were originated within the AA. The following table summarizes the results.

| Loan Type | In Assessment Area By Number % | In Assessment Area by Dollar % |
|------------------|-------------------------------------------|-------------------------------------------|
| Home Loans | 90.34 | 88.29 |
| Business Loans | 88.93 | 81.09 |

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

Northern's distribution of loans originated within its AA to borrowers of all income levels and businesses of all sizes is reasonable. To make this conclusion, examiners focused upon local originations of principal residence home loans and business loans for a variety of purposes.

Banks in the business of originating second home loans in the AA will have difficulty meeting the demographic because of the volume of lake homes being built or purchased by upper-income individuals residing outside of the AA.

The following table summarizes the reasonable penetration of lending to borrowers, by income levels, for the purchase or refinance of a principal dwelling:

| Home Loans (Principal Dwelling) by Family Income Level in the Assessment Area | | | | |
|--------------------------------------------------------------------------------------|------------------------|-----------------------------|---------------------------|--------------------------|
| Demographic | Low-Inc. Families % | Moderate-Inc. Families % | Middle-Inc. Families % | Upper-Inc. Families % |
| By Number of Loans | 11.69 | 22.73 | 26.62 | 38.96 |
| By Dollar Amount | 4.68 | 13.01 | 25.19 | 57.12 |
| Assessment Area Demographic | 18.27 | 20.35 | 24.93 | 36.44 |

The table below includes lending to purchase and refinance principal dwellings and second homes, again by borrower income levels. Penetration levels for low- and moderate-income families is diluted, but not to a level that raises any concern.

| All Home Loans by Family Income Level in the Assessment Area | | | | |
|---------------------------------------------------------------------|------------------------|-----------------------------|---------------------------|--------------------------|
| Demographic | Low-Inc. Families % | Moderate-Inc. Families % | Middle-Inc. Families % | Upper-Inc. Families % |
| By Number of Loans | 9.62 | 20.32 | 23.00 | 47.06 |
| By Dollar Amount | 3.61 | 10.72 | 20.20 | 65.47 |
| Assessment Area Demographic | 18.27 | 20.35 | 24.93 | 36.44 |

The following table is based upon a random sample of 20 business loans, commercial and commercial real estate, and shows the bank's reasonable distribution of loans to businesses of all sizes. Business size is determined via reported annual revenue levels of businesses within the

AA. Businesses are grouped into revenue levels of less than \$1 million or more than \$1MM. Unfortunately, 29.54% of the area businesses have chosen not to report their revenue data.

| Business Loans by Revenue Size | | | |
|---------------------------------------|------------------------------|------------------------------|------------------------|
| Loan Sample/Demographic | Revenue (<) \$1 Million % | Revenue (>) \$1 Million % | Revenue Not Reported % |
| By Number of Loans | 65.00 | 35.00 | NA |
| By Dollar Amount | 80.36 | 19.64 | NA |
| Assessment Area Demographic | 66.41 | 4.04 | 29.54 |

Geographic Distribution of Loans

The geographic distribution of Northern’s loan originations is reasonable. And in particular, performance related to lending in the AA’s few designated moderate-income areas is reasonable. (The AA has no designated low-income areas.) The distribution of loan originations reasonably concentrates around the bank’s offices, and lessens as the distance increases from these locations. Origination data for home loan originations follows this path. Penetration into the two moderate-income areas closest to bank offices approach the proportion of owner-occupied housing units these areas hold in relation to the entire AA. Including the remaining two more distant moderate-income geographies results in an aggregate understandably diluted penetration level. The distribution of business loan originations follows a similar pattern. The two distant moderate-income geographies are serviced by much closer banks, credit unions, and mortgage brokers who compete assertively to build and retain their local market share.

The following table, based upon bank records, shows the distribution of home loan originations for the purchase or refinance of residential real estate, by the two geographic income levels.

| Income Level of Geography | Home Loans by Number % | Home Loans by Dollar % | Assessment Area Owner Occupied Units % |
|----------------------------------|-------------------------------|-------------------------------|-----------------------------------------------|
| Low Income | N/A | N/A | N/A |
| Moderate Income | 6.42 | 3.29 | 17.93 |
| Middle Income | 93.58 | 96.71 | 82.07 |
| Upper Income | N/A | N/A | N/A |

The following table, based again upon bank records, shows the bank’s distribution of business loans, commercial and commercial real estate, by the two geographic income levels.

| Income Level of Geography | Business Loans by | Business Loans by | Assessment Area |
|----------------------------------|--------------------------|--------------------------|------------------------|
|----------------------------------|--------------------------|--------------------------|------------------------|

| | Number % | Dollar % | Distribution of Businesses % |
|-----------------|-----------------|-----------------|-----------------------------------------|
| Low Income | N/A | N/A | N/A |
| Moderate Income | 6.67 | 6.73 | 25.28 |
| Middle Income | 93.33 | 93.27 | 74.72 |
| Upper Income | N/A | N/A | N/A |

Responses to Complaints

There have been no CRA related complaints against the bank.

Fair Lending or Other Illegal Credit Practices Review

We found no evidence of illegal discrimination or other illegal credit practices.