



SMALL BANK

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

PUBLIC DISCLOSURE

June 30, 2008

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

The First National Bank of Northfield
Charter Number 2073

329 Division Street
Northfield, MN 55057-0000

Office of the Comptroller of the Currency

MINNEAPOLIS SOUTH
222 South Ninth Street Suite 800
Minneapolis, MN 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.

The major factors that support this rating include:

- The bank's loan-to-deposit ratio is reasonable given the bank's size, financial condition, and assessment area credit needs.
- A majority of loan originations are made within the bank's assessment area.
- The distribution of loans reflects reasonable penetration among businesses of different sizes and individuals of different income levels.

SCOPE OF EXAMINATION

We evaluated the First National Bank of Northfield's (FNB) Community Reinvestment Act performance covering the period from March 25, 2003 through June 30, 2008. In evaluating the bank's lending performance, we reviewed lending data for commercial and residential real estate loans, the bank's primary loan products. Based on originations from January 1, 2006 through March 31, 2008, commercial loans totaled 23.21% of loan originations by number of loans and 46.23% by dollar volume. During this time, residential real estate loans totaled 9.97% of loan originations by number and 31.22% by dollar volume. We selected a random sample of 20 loans from each of these product types in order to evaluate the bank's lending within the assessment area and borrower income distribution. We used 2000 census information for demographic comparison purposes.

DESCRIPTION OF INSTITUTION

FNB is a \$112 million bank located in Northfield, Minnesota. Northfield is a city of approximately 19,000 people and is located 40 miles south of Minneapolis, MN. The bank operates two full service locations, a stand-alone drive-up facility, and 6 ATM's. The main branch is located in downtown Northfield. The bank recently opened the second full-service branch on the South side of the city in December 2007. Bank ATM's are located at each branch, the drive-up facility, a local grocery store, Carleton College, and St. Olaf College. The only deposit-taking ATM is located at the drive-up facility. FNB is 100% owned by Heywood Bancshares, a one-bank holding company located in Northfield. The bank does not have any affiliate relationships that impact their CRA performance.

FNB offers a wide range of loan and deposit products which are designed to meet the community's needs. The bank's primary lending focus is commercial and residential real estate loans. As of March 31, 2008, the bank's \$79 million loan portfolio consisted of 53% commercial loans, 35% residential real estate loans, 7% agricultural loans, and 5% consumer loans. In 2006 and 2007 residential real estate loans sold to the secondary market totaled \$3.4million and \$6.9 million, respectively. As of March 31, 2008, net loans made up 69.90% of total assets.

There are no financial, legal, or other factors that impede FNB's ability to meet its CRA obligations. The bank's last CRA rating was "Satisfactory" dated March 24, 2003.

DESCRIPTION OF ASSESSMENT AREA

FNB's assessment area (AA) includes four census tracts (CT's) in northern Rice County and encompasses the cities of Northfield and Dundas. One of the CT's in the AA is middle income, while the three other CT's are upper income. The bank's AA complies with regulatory requirements and does not arbitrarily exclude low- or moderate-income geographies.

Based on 2000 census information, 8.14% of families within the bank's AA are low-income, 11.91% are moderate-income, 20.79% are middle-income, and 59.16% are upper-income. The 2000 census median family income for the AA was \$61,982. Based on the Department of Housing and Urban Development's 2008 estimate, the updated median family income is \$56,700 for non-metropolitan areas in the State of Minnesota. The 2000 census data indicated 522 households (6.47%) in the AA are living below the poverty line. This compares to 7.91% of households in the State of Minnesota that are living below the poverty level.

According to 2007 estimates by the U.S. Census Bureau, the population of the state of Minnesota has increased by an estimated 5.65% since 2000. Comparatively, the population of Rice County has increased by 9.34% since 2000. The growth in Rice County can be attributed to its close proximity to the Minneapolis-St Paul metro area.

Unemployment levels in the AA are comparable to both state and national averages. According to the MN Department of Employment and Economic Development, as of May 2008, 5.5% of the total workforce in Rice County was unemployed. This compares to unemployment levels in the State of Minnesota of 5.4%, and 5.5% for the United States. Northfield is home to two private colleges which bring approximately 5,000 students to the area. The Northfield Chamber of Commerce lists the top five employers in the city as Malt-O-Meal, St. Olaf College, Carleton College, Northfield Hospital, and the Northfield School District. Each of these entities employs at least 500 people.

The median value of owner-occupied housing in the AA per 2000 census data was \$149,235. This compares to a median housing value for the State of Minnesota of \$122,400. Census data indicated that 73.5% of the housing units in the AA are owner-occupied. This compares to 74.6% owner occupied-housing in the state of MN, and 66.2% nationwide per the 2000 census data.

There are 6 financial institutions with a presence in FNB Northfield's AA, some of which are branches of large banks. FNB Northfield is ranked 3rd in deposit market share, with 22.84% of the market share, based on June 2007 deposit information obtained from the Federal Deposit Insurance Corporation.

Our community contact indicated that local banks are active in the community. Most local banks offer a wide range of products and services. However, the contact stated that there is a need for working capital loans for start-up businesses and financing for affordable housing. The contact stated that FNB and its employees have been very active in local community projects.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

Loan-to-Deposit Ratio

The loan-to-deposit ratio is reasonable given the bank's size, financial condition, and local credit needs. The bank's quarterly average loan-to-deposit ratio for the 21 quarters since the previous CRA examination is 74.71%. Similarly-situated banks have quarterly average loan-to-deposit ratios ranging from 81.40% to 89.60% over the same time frame. These banks have a presence in FNB's assessment area with total assets between \$188 million and \$266 million.

| Institution | Asset Size as of 3/31/2008 | Average Loan-to-Deposit Ratio 1Q03 to 1Q08 |
|--|----------------------------|--|
| First National Bank of Northfield | \$112 million | 74.71% |
| Frandsen Bank & Trust | \$266 million | 81.40% |
| Premier Bank Minnesota | \$188 million | 86.65% |
| Community Resource Bank | \$231 million | 89.60% |

Lending in Assessment Area

A majority of loan originations are made within the bank's AA. We reviewed a random sample of 20 commercial loans and 20 residential real estate loans that had originated between January 1, 2006 and March 31, 2008. The majority of those loans, 87.50% by number and 89.59% by dollar volume, were originated within the bank's AA. The following table shows loans originated inside their AA by number and dollar volume:

| Loan Type | Lending in Assessment Area | | | |
|----------------|----------------------------|-------------------|--------------------|-------------------|
| | Loans Inside AA | | | |
| | Number | Percent by Number | Dollar Amount | Percent by Dollar |
| Commercial | 19 | 95.00% | \$1,437,201 | 95.51% |
| Residential RE | 16 | 80.00% | \$2,733,750 | 86.77% |
| Total | 35 | 87.50% | \$4,170,951 | 89.59% |

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

FNB has a reasonable distribution of credit to businesses of different sizes. Our random sample of 20 commercial loans indicated that 65.00% of loans by number and 65.99% of loans by dollar amount went to businesses with gross annual revenues less than or equal to \$1 million.

Assessment area demographics indicate that 67.68% of businesses in the assessment area have sales under \$1 million, 3.37% have sales over \$1 million, and 28.95% did not report revenue data. Our community contact indicated that there are several larger employers in the area and the amount of large businesses reported was not representative of the community. Given this information, FNB has a reasonable distribution of credit to businesses of different sizes.

| Borrower Distribution of Loans to Businesses | | | | |
|---|---------------------|------------------------|---------------------------------|--------------|
| Business Revenues (or Sales) | ≤\$1,000,000 | >\$1,000,000 | Unavailable/ Unknown | Total |
| % of AA Businesses | 67.68% | 3.37% | 28.95% | 100% |
| % of Bank Loans in AA by # | 65.00% | 35.00% | - | 100% |
| % of Bank Loans in AA by \$ | 65.99% | 34.01% | - | 100% |

*Source: 2007 Business Geo-Demographic Data

FNB has a reasonable distribution of credit among individuals of different income levels. From our sample of 20 residential real estate loans, the percentage of loans to low- and moderate-income level borrowers is comparable to the percentage of low- and moderate-income level families in the AA. According to 2000 U.S. Census data, the population includes the 2.75% of families in the AA living below the poverty line, which would have difficulty purchasing a home.

| Borrower Distribution of Residential Real Estate Loans | | | | | | | | |
|---|------------------|----------------------|------------------|----------------------|------------------|----------------------|------------------|----------------------|
| Borrower Income Level | Low | | Moderate | | Middle | | Upper | |
| Loan Type | % of AA Families | % of Number of Loans | % of AA Families | % of Number of Loans | % of AA Families | % of Number of Loans | % of AA Families | % of Number of Loans |
| Residential RE | 8.14% | 5.00% | 11.91% | 10.00% | 20.79% | 20.00% | 59.16% | 65.00% |

*Sources: Borrower income levels are from 2006-2008 HUD Estimated Median Family Income for non-metro area of MN. Percentage of families within the AA in each income category is per 2000 census data

Geographic Distribution of Loans

The geographic distribution of loans does not provide a meaningful analysis as the bank's AA has no low- or moderate-income CT's.

Responses to Complaints

The bank has not received any complaints regarding its CRA performance since the last evaluation.

Fair Lending or Other Illegal Credit Practices Review

We found no evidence of discriminatory or other illegal credit practices inconsistent with helping to meet community credit needs.