



SMALL BANK

Comptroller of the Currency
Administrator of National Banks

PUBLIC DISCLOSURE

August 11, 2003

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**Neighborhood National Bank
Charter Number 24223**

**803 North Nokomis NE
Alexandria, MN 56308**

**Comptroller of the Currency
Alexandria Field Office
P.O. Box 849
Alexandria, MN 55308**

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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Institution's CRA Rating

Neighborhood National Bank is rated Satisfactory. An institution in this group has a satisfactory record of helping to meet the credit needs of the assessment area it serves, consistent with its resources and capabilities. Factors contributing to this rating include the following:

- Neighborhood National Bank's loan-to-deposit ratio exceeds the standard for satisfactory performance.
- The bank's record of lending to businesses of different sizes and individuals of different income levels meets the standard for satisfactory performance.
- Neighborhood National Bank's lending performance in the assessment area (AA) shows a willingness to meet the credit needs in this area.

Description of Institution

Neighborhood National Bank (NNB) is a \$28 million bank located in Alexandria, MN in Douglas County. Douglas County Bancshares, a one-bank holding company, owns 100% of the bank and is also located in Alexandria, MN. Holding company assets consist primarily of the bank. The bank does not have any branches.

The bank is a De Novo bank. It obtained its national charter and opened to the public on September 4, 2001. This is the first CRA examination conducted for the bank.

The bank's loan portfolio is diverse. As of June 30, 2003, the composition of the portfolio was as follows:

| Loan Portfolio Composition | \$ (000) | % |
|--------------------------------------|-----------------|-------------|
| Commercial (including real estate) | 7,878 | 38% |
| Residential Real Estate | 7,839 | 37% |
| Consumer Loans | 2,215 | 11% |
| Home equity lines of credit | 1,656 | 8% |
| Leases | 895 | 4% |
| Agricultural (including real estate) | 393 | 2% |
| Total | 20,876 | 100% |

Neighborhood National Bank offers traditional banking products and services. In the near future, the bank will be adding Internet Banking services. Its lending practices are focused on business, residential real estate, and consumer loans. As of June 30, 2003, net loans represent 73% of total assets and the bank's Tier One Leverage Capital is 12.10%, or \$3.3 million. There are no legal or financial impediments that restrict the bank's ability to meet the credit needs of the community.

Description of Neighborhood National Bank's Assessment Area

Neighborhood National Bank's assessment area (AA) includes eight contiguous census tracts (CTs). This represents all of Douglas County. The AA has all middle-income CTs. There are no low- moderate- or upper-income CTs in the AA.

The AA meets the requirements of the regulation. The AA does not exclude low- or moderate-income geographies. Cities included in the AA include, but are not limited to Alexandria, Evansville, Osakis, Carlos, Nelson, Garfield, and Kensington. Alexandria is the largest city with a 2000 census population of 9,855 and is the Douglas County seat.

The economy of the AA is diversified with agriculture, manufacturing, retail trade, and tourism. Major employers in the area include a regional hospital, public and technical school systems, and manufacturing companies such as Douglas Machine, Tastefully Simple, Alexandria Extrusion, and 3M Corporation. Many residents located in the outskirts of the Alexandria city limits, commute for employment opportunities.

Information from the Minnesota Workforce Center lists the 2002 annual average unemployment rate for Douglas County at 3.5%. This compares favorably to the state average of 4.4% and the nationwide average of 5.8% for the same time period.

The institution's primary competition is other Alexandria area banks. The strongest competition for commercial loans comes from the larger regional bank of Wells Fargo and Bremer Bank. First State Bank of Alexandria and Vikings Savings Bank also compete for smaller commercial, real estate, and consumer loans.

During our evaluation, we contacted a community redevelopment organization to better understand the credit needs of the AA. The contact identified the ongoing need for affordable housing and stated the area financial institutions are cooperative in helping to meet the related credit needs.

The demographics of the AA are illustrated on the next page. The information is based on 2000 census data unless otherwise noted. Census 2000 data was available and deemed relevant to the bank's CRA performance given its recent opening.

| DEMOGRAPHIC AND ECONOMIC CHARACTERISTICS OF AA | |
|---|-----------|
| <i>Population</i> | |
| Number of Families | 9,045 |
| Number of Households | 13,241 |
| Number of Low-Income Families | 1,637 |
| % of Low-Income Families | 18% |
| Number of Moderate-Income Families | 1,706 |
| % of Moderate-Income Families | 19% |
| Number of Middle-Income Families | 2,205 |
| % of Middle-Income Families | 24% |
| Number of Upper-Income Families | 3,497 |
| % of Upper-Income Families | 39% |
| <i>Geographies</i> | |
| Number of Census Tracts | 8 |
| % Low-Income Census Tracts | 0% |
| % Moderate-Income Census Tracts | 0% |
| % Middle-Income Census Tracts | 100% |
| % Upper-Income Census Tracts | 0% |
| <i>Median Family Income (MFI)</i> | |
| 2000 MFI for AA | \$46,163 |
| 2003 HUD-Adjusted MFI | \$51,700 |
| <i>Economic Indicators</i> | |
| Unemployment Rate | 2% |
| Median Housing Value | \$105,360 |
| % of Households Below Poverty Level | 10% |

Loan Sampling

The bank's primary loan types were determined by reviewing all loans originated from September 4, 2001 through June 30, 2003.

The primary loan types identified are business loans, residential real estate loans, and consumer loans. Business loans account for 41% of the dollar volume and 22% of the number of loans originated. Residential real estate loans account for 35% of the dollar volume and 20% of the number of loans originated. Consumer loans represent 42% of the number of loans originated.

| Loan Products | # | % | \$ (000) | % |
|--------------------------------------|------------|-------------|-----------------|-------------|
| Commercial (including real estate) | 129 | 22% | 9,537 | 41% |
| Residential Real Estate | 122 | 20% | 8,144 | 35% |
| Consumer Loans | 251 | 42% | 2,178 | 10% |
| Home equity lines of credit | 58 | 10% | 1,576 | 7% |
| Leases | 33 | 5% | 895 | 4% |
| Agricultural (including real estate) | 6 | 1% | 723 | 3% |
| Total | 599 | 100% | 23,053 | 100% |

To conduct our analysis, we performed statistically valid sampling techniques selecting a sample of twenty business loans, twenty residential real estate, and twenty consumer loans. After initial sampling to determine the bank's lending within the AA, additional files were selected as needed so all loans in the sample were made in the AA.

Conclusions about Performance Criteria

Loan-to-Deposit Ratio

Neighborhood National Bank's loan-to-deposit (LTD) ratio exceeds the standard for satisfactory performance given the size and financial condition of the bank, assessment area needs, and local economic conditions. Since the bank opened in third quarter of 2001, the bank's average quarterly LTD ratio is 88%.

When compared to five similarly situated institutions in or around the AA, Neighborhood National Bank is ranked first out of six banks. These banks have asset sizes ranging from \$22 to \$57 million. The average LTD ratio of all six banks for the evaluation period is 75%.

| Institution | Assets (as of 06/30/03) | Average LTD Ratio |
|-----------------------------------|--------------------------------|--------------------------|
| <i>Neighborhood National Bank</i> | <i>\$28 million</i> | <i>88%</i> |
| Stearns Bank Evansville NA | \$33 million | 86% |
| First National Bank of Osakis | \$54 million | 80% |
| Farmers State Bank of Hoffman | \$22 million | 70% |
| First National Bank of Starbuck | \$27 million | 66% |
| First State Bank of Kensington | \$57 million | 62% |

Lending in Assessment Area

Neighborhood National Bank meets the standard for satisfactory performance for lending within the AA. A majority of the loans are originated within the AA. The following table illustrates lending activity with the AA since the bank opened.

| TOTAL LOANS REVIEWED | | | | | | | | |
|----------------------|--------------------|-----|-----------|-----|------------------------|-----|-----------|-----|
| | IN ASSESSMENT AREA | | | | OUT OF ASSESSMENT AREA | | | |
| LOAN TYPE | # | % | \$ (000s) | % | # | % | \$ (000s) | % |
| Business | 17 | 85% | 1,102 | 71% | 3 | 15% | 444 | 29% |
| Residential RE | 18 | 90% | 965 | 82% | 2 | 10% | 212 | 18% |
| Consumer | 14 | 70% | 149 | 85% | 6 | 30% | 27 | 15% |
| Total Reviewed | 49 | 82% | 2,216 | 76% | 11 | 18% | 683 | 24% |

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

Lending to borrowers of different incomes and businesses of different sizes meets the standard for satisfactory performance. Business and residential real estate loans meet and consumer loans exceed the demographics of the AA.

Business Loans

Neighborhood National Bank's lending to small businesses meets the demographics of the AA. Ninety percent of the number and 96% of the dollar volume of loans are to businesses with revenues of less than \$1 million. The demographic information indicates 94% of small businesses in the AA have annual gross revenues of less than \$1 million.

| BORROWER DISTRIBUTION OF SMALL LOANS TO BUSINESSES | | |
|--|--------------|--------------|
| Business Revenues | ≤\$1,000,000 | >\$1,000,000 |
| % of AA Businesses | 94% | 6% |
| % of Bank Loans in AA # | 90% | 10% |
| % of Bank Loans in AA \$ | 96% | 4% |

Residential Real Estate Loans

Residential real estate loans to low- and moderate-income families meets the demographics of the AA. The following chart illustrates that 45% of the number and 53% of the dollar volume of loans are made to moderate-income families. The demographic information indicates 19% of the families are in the moderate-income category.

| RESIDENTIAL REAL ESTATE | | | | | | | | |
|-------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Borrower Income Level | LOW | | MODERATE | | MIDDLE | | UPPER | |
| % of AA Families | 18% | | 19% | | 24% | | 39% | |
| | % of Number | % of Amount |
| Loans | 0% | 0% | 45% | 53% | 35% | 24% | 20% | 23% |

Although the sampled loans did not have any loans made to low-income families, this is reasonable when considering the median housing cost of \$105,360 for the AA. The bank demonstrates a willingness to lend to families other than middle- and upper-income families exclusively based on the lending performance to moderate-income families.

Consumer Loans

Neighborhood National Bank's lending to households exceeds the demographics of the AA. Low- and moderate-income households represent 24% and 17%, respectively, of the demographic households. The sample indicates the bank is lending to 40% of the number and 31% of the dollar volume to low-income households and 20% of the number and 25% of the dollar volume to moderate-income households.

| CONSUMER | | | | | | | | |
|-----------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Borrower Income Level | LOW | | MODERATE | | MIDDLE | | UPPER | |
| % of AA Households | 24% | | 17% | | 19% | | 40% | |
| | % of Number | % of Amount |
| Total | 40% | 31% | 20% | 25% | 30% | 34% | 10% | 10% |

Geographic Distribution of Loans

The bank's assessment area is made up of all middle income CTs. Therefore, an analysis of the geographic distribution of loans in different income geographies is not meaningful.

Responses to Complaints

Neighborhood National Bank has not received any complaints about performance in helping to meet the credit needs of the assessment area since the bank opened.

Fair Lending and the PE

An analysis of public comments and consumer compliant information was performed according to the OCC's risk based, fair lending approach. Based on the analysis of the information, the OCC decided that a comprehensive fair lending examination would not need to be conducted in connection with this CRA evaluation.

