



Office of the
Comptroller of the Currency
Washington, DC 20219

SMALL BANK

PUBLIC DISCLOSURE

November 21, 2016

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

The First National Bank of Frederick
Charter Number 8624

314 Main Street
Frederick, SD 57441

Office of the Comptroller of the Currency

4900 S Minnesota Avenue, Suite 300
Sioux Falls, SD 57108-2865

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 Lending Test is rated: Satisfactory

- The First National Bank's (FNB's) quarterly average loan-to-deposit (LTD) ratio is reasonable.
- A majority of the bank's loans by number (78 percent) and by dollar amount (95 percent) are located within the bank's assessment area (AA).
- FNB's borrower distribution to farms of different sizes reflects reasonable penetration.
- FNB's geographic distribution to farms located in low-and-moderate income census tracts (CTs) reflects reasonable dispersion.

SCOPE OF EXAMINATION

FNB was evaluated using the Small Bank examination procedures, which includes a lending test. The lending test evaluates the bank's record of meeting the credit needs of its AA through its lending activities. The lending test for FNB covers performance from January 1, 2014 through September 30, 2016.

Overall, FNB's primary loan product is farm loans. To evaluate the bank's lending performance, examiners reviewed the bank's average quarterly loan-to-deposit ratio since the prior CRA examination and assessed the volume of loans originated within the bank's AA. In addition, examiners selected a sample of farm loans originated and purchased during the performance period within the bank's AA to assess the bank's borrower distribution and geographic distribution.

DESCRIPTION OF INSTITUTION

FNB is a single branch bank located in Frederick, South Dakota in Brown County. The bank is owned by 13 individuals. The highest percent of bank ownership is held by the Campbell family. As of September 30, 2016, FNB had total assets of \$21.7 million. Net loans represented 42 percent of total bank assets. FNB's tier one capital was \$2.7 million and the tier one leverage ratio totaled 13.3 percent of average assets as of September 30, 2016. There have been no acquisitions or mergers since the previous CRA evaluation. The bank received a Satisfactory rating at the previous CRA examination dated June 20, 2011.

The bank remains conservative in its business strategy and lending philosophy. FNB offers basic banking products to agricultural, business, and individual customers. Management's primary focus continues to be farm loans. The following table illustrates the loan portfolio composition as of September 30, 2016.

FNB Loan Portfolio Composition	\$ (000)	%
Agricultural Loans	7,753	83
Business Loans	1,418	15
Consumer Loans	143	2
Total	\$9,314	100%

Source: September 30, 2016 Call Report

The bank's primary loan product was determined by taking all loans originated during the evaluation period with an outstanding balance as of September 30, 2016. The following table depicts the number and volume of loans outstanding at FNB.

For the purpose of this evaluation, the primary loan product is farm loans. As illustrated in the table below, farm loans account for 74 percent by number and 75 percent by volume of total loans. Community contacts concurred that farm loans are the primary credit need of the community. To conduct our analysis, we reviewed a sample of 40 farm loans totaling \$7.3 million.

FNB in Frederick, SD Loan Products	#	%	\$ (000)	%
Farm Loans	152	73.8	25,081	75
Business Loans	30	14.6	2,852	23
Consumer Loans	24	11.6	733	2
Total	206	100	28,666	100

Source: Loans originated during the evaluation period with outstanding balances as of September 30, 2016.

There are no legal impediments that would restrict the bank's ability to meet the credit needs of the AA.

DESCRIPTION OF ASSESSMENT AREA

FNB's AA includes the northern half of Brown County, South Dakota (SD) and the western portion of Dickey County, North Dakota (ND). The AA consists of one CT in Brown County (middle-income) and two CTs in Dickey County (one middle-income and one moderate-income CT). Both Dickey County tracts are designated distressed, underserved, and remote rural tracts. The AA meets the requirements of the regulation and does not arbitrarily exclude any low- or moderate- income areas.

Economic conditions in the AA are generally good with low unemployment at one percent. This is lower than the national unemployment rate of 5 percent and the North Dakota unemployment rate of 3.1 percent, as of September 30, 2016. The economy is influenced by changes in agricultural conditions. The AA has 1,016 businesses. The largest sector is agriculture with 396 businesses and farms (39 percent) followed by 300 service businesses (30 percent). Businesses in the AA are small with 84 percent of the businesses showing revenue of under \$500 thousand. FNB is located in a rural AA with a total population of 7,383. The population of Frederick, where the bank is located, is 199 as of the 2010 Census. Competition in the surrounding areas is high and consists primarily of branches of larger institutions. Nearby Aberdeen, SD has twelve banks and Ellendale, ND, located in the bank's only moderate-income CT with a population of

1,471, has three banks. FNB has one percent of the deposit market share in the AA and no market share outside of the AA.

We did not identify any unmet credit needs in FNB's AA. We contacted two local businesses to better understand the AA demographics and to determine the primary credit needs of the AA. Both contacts stated that local financial institutions satisfactorily meet financing needs in the AA. They identified the primary credit need in the area as agricultural lending.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

Loan-to-Deposit Ratio

FNB's LTD ratio is considered reasonable given the bank's capacity to lend in comparison to similarly situated financial institutions in the AA, demographic and economic factors present in the AA, and lending opportunities in the AA. The bank's LTD ratio has remained stable since the last CRA examination when the quarterly average was 42 percent. During the past twenty-six quarters since the prior CRA examination the average quarterly LTD ratio was 40.55 percent with a high of 53.16% and a low of 34.33%. As of September 30, 2016, FNB's LTD ratio was 48.65.

Performance Context

FNB's legal lending limit (LLL) restricts the bank's ability to hold all loans on their books without selling participations. The bank has a LLL of \$416 thousand. An additional 10 percent of capital, or \$277 thousand, could be utilized if the loan is secured by livestock or similar readily marketable collateral. The bank regularly sells participations to stay within the regulatory guidance. The addition of the participated loans due to the bank's LLL would increase the September 2016 LTD ratio from 48.65 percent to 54.19 percent.

Farmers and ranchers continue to be the bank's primary customer base. As of September 30, 2016, 83 percent of the bank's loan portfolio consists of farm loans. This represents a concentration of 280 percent of total capital. Total agriculture loans have increased from \$4.52 million to \$7.75 million or by 71 percent since September 30, 2011. This date is used because it represents the same point in the agriculture cycle as the current examination.

FNB's LTD ratio is reasonable when compared with similarly situated financial institutions. We chose five similarly situated banks in the same geographical region. These banks ranged in size from \$18 million to \$61.9 million and had an average LTD ratio of 55.06% over the same 26 quarters with an average high of 77.46% and an average low of 20.15%. The low average LTD ratio for these similarly situated banks further supports the lack of lending opportunities in the area. FNB ranks fifth in asset size and fourth in average LTD ratio compared to the similarly situated banks.

The demographic factors present a limited source of lending for CRA purposes for FNB. The AA consists of two non-metropolitan middle-income CTs in Brown County, SD and

Dickey County, ND. There is one moderate-income tract in the Dickey County seat of Ellendale, ND. The two CTs located in Dickey County, ND are considered distressed, underserved, and remote rural CTs.

Lending in Assessment Area

FNB makes a substantial majority of its loans to farm operations inside the AA. Based on a sample of 40 farm loans, 78 percent by number and 95 percent by volume were within the AA as demonstrated in the following table.

Lending in FNB in Frederick, SD AA										
Loan Type	Number of Loans				Dollars of Loans				Total	
	Inside		Outside		Total	Inside		Outside		
	#	%	#	%		\$ (000)	%	\$ (000)	%	
AA Farms	31	78	9	22	40	\$6,924	95%	\$334	5%	\$7,258

Source: sample of FNB farm loans

Lending to Farms of Different Sizes

The distribution of borrowers given the demographics of the AA reflects reasonable penetration among farms of different sizes. The bank's record of lending to farms of different sizes is reasonable. Out of the 31 farm loans sampled in the bank's AA, 25 were to farms with revenues under \$1 million (81 percent) and 6 farm loans were made to borrowers with incomes greater than \$1 million. The following table illustrates FNB's lending to farm operations in the AA.

Borrower Distribution of Loans to Farms in FNB in Frederick, SD AA				
Farm Revenues (or Sales)	$\leq \$1,000,000$	$> \$1,000,000$	Unavailable/ Unknown	Total
% of AA Farms	99%	1%	0	100%
% of Bank Loans in AA by #	81%	19%	0	100%
% of Bank Loans in AA by \$	58%	42%	0	100%

Source: 2010 U.S. Census data; Sample of loans inside FNB's CTs.

The USDA 2012 Census of Agriculture County Data shows 684 of the 1,599 farms, or 43 percent, of all farms in Dickey and Brown Counties have annual sales of less than \$10,000. These would be considered hobby farms with typically no lending needs. The data shows an additional 251 farms or 16 percent have annual sales revenue between \$10,000 and \$99,000. These small farms would have limited borrowing needs.

Geographic Distribution of Loans

The geographic distribution of loans reflects reasonable dispersion throughout CTs of different income levels. We used data from loans in the AA and determined there are no significant geographic gaps in the bank's lending patterns.

Geographic Distribution of Loans to Farms in AA								
Census Tract Income Level	Low		Moderate		Middle		Upper	
Loan Type	% of AA Farms	% of Number of Loans	% of AA Farms	% of Number of Loans	% of AA Farms	% of Number of Loans	% of AA Farms	% of Number of Loans
Farm Loans	0	0	3.7%	0	96.3%	100%	0	0

Source: 2010 U.S. Census data; sample of loans in FNB's AA

The table above shows the bank did not originate any loans to farms in the moderate-income tract located in Ellendale. However, there are only 15 farms located in the moderate-income CT or 3.7 percent of the total farms in the bank's AA. To further put into context, the moderate-income CT consists entirely of the county seat of Ellendale (1.52 square miles) and these farms would be small in size. In addition, Ellendale has three financial institutions to serve the needs of this small community (172 families).

The bank shows the willingness and ability to lend to small farms located in the distressed, underserved, and remote rural middle-income tract in Dickey County. While the bank did not lend in the distressed and underserved moderate-income tract, our sample shows 58 percent of the loans originated in the AA were to farms in the distressed and underserved middle-income tract. Additionally, all loans were to farms with revenue less than \$1 million.

Responses to Complaints

FNB has not received any CRA related complaints during the evaluation period.

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.