



SMALL BANK

Comptroller of the Currency
Administrator of National Banks
Washington, DC 20219

PUBLIC DISCLOSURE

October 25, 2004

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**Merchants Bank, National Association
Charter Number 24377**

**316 Main Street
La Crescent, MN 55947**

**Comptroller of the Currency
Minneapolis South
1310 West Clairemont Avenue Suite 100
Eau Claire, WI 54702**

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 bank's average loan-to-deposit ratio is reasonable.
- The bank originates a majority of its loans within its assessment area.
- The bank has an excellent distribution of credit among businesses of different sizes and a reasonable distribution of credit among residential real estate borrowers of different income levels.
- The geographic distribution of commercial and residential real estate loans reflect a reasonable dispersion throughout the assessment area.

DESCRIPTION OF INSTITUTION

Merchants Bank, N.A. (Merchants) was a \$47 million institution as of June 30, 2004. Merchants has only one bank location and one cash-out only ATM located in La Crescent, Minnesota. La Crescent is located in Houston County, MN just across the Mississippi River from La Crosse, Wisconsin. La Crescent is known for its beautiful apple orchards and spectacular scenery. It's known as the "Apple Capital of Minnesota" and is home to more than 5,000 residents.

The bank offers telephone and Internet banking to its customers. These services provide customers with 24-hour access to deposit and loan account information. It also allows customers to make transfers between accounts, including making loan and bill payments.

Merchants offers a wide range of loan and deposit products which are designed to meet the community's needs. As of June 30, 2004, the bank's \$36 million loan portfolio consisted of 46% commercial loans, 26% residential real estate loans, 13% consumer loans, 11% construction and development loans, and 4% other loans. As of June 30, 2004, net loans made up 76.53% of total assets. Based on the number and dollar of loans originated from January 1, 2002 through June 30, 2004, commercial and consumer lending were the bank's primary lending activities. However, the bank requested that we review commercial and residential real estate in our lending analysis. Bank management stated that loan originations for residential real estate lending are understated due to the correspondent bank program with its affiliate Merchants-Winona. Mortgage loan applications are forwarded to Merchants-Winona, where Winona will underwrite the loans and report the loan with its HMDA data. These HMDA loans are given back to the bank for consideration in its CRA evaluation. Using the bank's HMDA data, residential real estate lending activity consisted primarily of home mortgage refinance loans. Therefore, the lending analysis will cover commercial and home mortgage refinance lending.

Merchants Financial Group, Inc. is a five-bank holding company that had total assets of \$672 million as of June 30, 2004. The other Merchants Banks are located in Winona, Caledonia and Hampton, Minnesota, and Onalaska, Wisconsin. Merchants Financial Group, Inc. purchased LaCrescent State Bank, now Merchants Bank, in November 1990. The original charter was transferred to the new Merchants Bank located in Onalaska, Wisconsin on October 1, 2003. The current Merchants Bank La Crescent, MN charter was established October 1, 2003. As the business of Merchants Bank, La Crescent, has not changed with the change in charter, this CRA

examination will cover the period from the last CRA Examination, completed by the Federal Reserve Bank of Minneapolis, for La Crescent State Bank, now Merchants Bank, without consideration to the change in charter number. La Crescent State Bank changed its name to Merchants Bank on February 1, 2002.

There are no financial, legal, or other factors that impede Merchants ability to meet its CRA obligations. The bank's last CRA rating was an "Outstanding Record of Meeting Community Credit Needs" dated April 27, 1998.

DESCRIPTION OF ASSESSMENT AREA

Merchants assessment area (AA) includes all of Houston County, Minnesota and La Crosse County, Wisconsin. These two counties combine as a Metropolitan Statistical Area (MSA). The total MSA/AA, using 1990 census information, included 32 Census Tracts (CTs). Based on the 1990 census data, 2 CTs are low-income (6.3%), 6 CTs are moderate-income (18.8%), 18 CTs are middle-income (56.3%), 5 CTs are upper income (15.6%), and 1 CT does not have any income data available (3.1%). Using 2000 census information, the MSA/AA includes 30 CTs. There are no low-income CTs, 4 CTs are moderate-income (13.3%), 23 CTs are middle-income (76.7%) and 3 CTs are upper-income (10%). Boundary changes made by the Office of Management and Budget (OMB) in 2004 did not impact the bank's assessment area. The AA complies with regulatory requirements and does not arbitrarily exclude any low- or moderate-income geographies. The Census Bureau indicates the population of the AA has increased almost 9% from 1990 to 2000 to 126,838 persons.

Based on 1990 census information, 17% of the families within this AA are low income, 19% moderate income, 26% middle income and 37% upper income. The 1990 census median family income for the AA was \$33,505. Using 2000 census information, 16% of the families within this AA are low income, 20% moderate income, 27% middle income and 37% upper income. The 2000 census median family income for the AA was \$50,889. Based on the Department of Housing and Urban Development's 2002 estimate, the updated median family income for the MSA is \$54,000; the median family income for the MSA based on HUD's 2003 estimate is \$54,900.

The 1990 census data indicates that 5,398 households (12.35%) are below the poverty level. The 2000 census indicates that amount has decreased to 4,915 households (9.98%).

The average median housing value per 1990 census data was \$58,066. The 2000 census data indicates the median housing value is \$97,093. Census information shows home ownership at 62.6% in 1990 and 64.4% for 2000 in the AA. We made one community contact with a local realtor during our examination. The realtor's geographic area includes La Crescent and its surrounding communities. The contact stated that the city of La Crescent encourages housing development, but still wants to remain a small bedroom community for La Crosse. Single family homes average \$120,000 in La Crescent and can go as high as \$369,000. Homes under \$100,000 are hard to find. According to the contact, no low-income housing is available in La Crescent and there are no plans to provide any. However, the contact believes low-income housing is

needed in the area.

Unemployment levels in the AA are lower than the national average and lower than both the State of Wisconsin and State of Minnesota levels. Pursuant to the U.S. Department of Labor, Bureau of Labor Statistics, the unemployment rate for the State of Wisconsin as of June 30, 2004 was 5.1% and the La Crosse County unemployment for the same date was 3.8%. Minnesota unemployment rate as of June 30, 2004 was 4.7%, compared to the Houston County unemployment rate of 4.0%. As of June 30, 2004, the national unemployment rate was 5.8%.

The local economy is good. Major employers in La Crescent include Apple Growers, La Crescent School District, Winona Knits, La Crescent Health Care Center, and Truss Specialists, Inc. Large employers in La Crosse include Gundersen Lutheran and Franciscan Skemp/Mayo Health Systems which employ more than 8,000 persons. Other employers with more than 1,000 employees are Trane Company, the La Crosse Area School District and University of Wisconsin-La Crosse. La Crosse is home to two public colleges and one private college.

Bank competition in the AA is strong. There are 22 financial institutions based on the FDIC Deposit Market Share Report as of June 30, 2004. Merchants is ranked 11th of the 22 financial institutions appearing on that FDIC report. Almost 40% of the deposit share in the AA is maintained by two large financial institutions with branches in the AA. The AA also has a large credit union presence, which institutions are not included in the FDIC reports.

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 24 quarters since the previous CRA exam is 68.89%. Similarly situated banks are those with total assets between \$40 and \$75 million with all of their branch locations located within the AA. Quarterly average loan-to-deposit ratios for similarly situated banks range from 65.84% to 101.38% over the same time frame. The loan-to-deposit ratio does not take into account loans sold by banks on the secondary market.

Institution	Total Assets (As of 6/30/2004)	Average Loan-to-Deposit Ratio 2Q98 – 2Q04
UNION STATE BANK, West Salem, WI	\$ 46 million	65.84
MERCHANTS BANK, La Crescent, MN	\$ 47 million	68.89
PARK BANK, Holmen, WI	\$ 43 million	70.10
FARMERS STATE BANK, Bangor, WI	\$ 75 million	71.06
MERCHANTS BANK, Caledonia, MN	\$ 40 million	79.44
EITZEN STATE BANK, Eitzen, MN	\$ 40 million	101.38

Lending in Assessment Area

Merchants originates a majority of its commercial and home mortgage refinance loans in the assessment area. Based on a sample of 20 commercial loans each from years 2002 and January 1, 2003 through June 30, 2004, 80% by number and 79% by dollar volume were made to businesses located within the bank's AA. Home refinance HMDA data from January 1, 2002 through June 30, 2004, shows 80% of total loans and 81% of total dollar amount of loans were originated within the bank's assessment area. The following table shows loans originated inside and outside their AA by number and dollar volume.

Loan Type	Number of Loans					Dollar of Loans				
	Inside		Outside		Total	Inside		Outside		Total (000's)
	#	%	#	%		\$ (000's)	%	\$ (000's)	%	
Commercial Loans	32	80%	8	20%	40	\$3,121	79%	\$834	21%	\$3,955
Home Refinance	588	80%	146	20%	734	\$59,527	81%	\$14,161	19%	\$73,688
Totals	620	80%	154	20%	774	\$62,648	81%	\$14,995	19%	\$77,643

Lending to Businesses of Different Revenue Sizes and Residential Real Estate Borrowers of Different Income Levels

Merchants has an excellent distribution of credit among businesses of different sizes and a reasonable distribution of credit among home mortgage refinance borrowers of different income levels.

Commercial borrowers have a wide diversity of gross revenue levels ranging from a few thousand to more than a million dollars. A random sample of 20 commercial loans each from years 2002 and from January 1, 2003 through June 30, 2004, indicates the following breakdown of annual revenues. There were no substantial changes in the business demographics between 2002 and 2003, therefore we used the 2003 business demographic data for comparison.

Borrower Distribution of Loans to Business		
Business Revenues	< \$1,000,000	> \$1,000,000
% of AA Businesses*	65%	7%
% of Bank Loans in AA by #	65%	35%
% of Bank Loans in AA by \$	51%	50%

*28% of businesses did not report revenues

Merchants has a good distribution of credit among home mortgage refinance borrowers of different income levels based on 1990 census information. The following table compares the percentage of families based on income level located within the AA to 2002 home refinance HMDA data.

Borrower Distribution of Residential Real Estate Loans

Borrower Income Level*	Low (0 - \$27,000)		Moderate (\$27,001 - \$43,200)		Middle (\$43,201 - \$64,800)		Upper (\$64,801 and over)	
	% 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
Home Refinance	17.38%	6.53%	19.29%	18.78%	26.32%	27.35%	37.02%	46.94%

*per 2002 HUD Estimated Median Family Income for La Crosse/Houston County MSA

Merchants has a good distribution of credit among residential real estate borrowers of different income levels based on 2000 census information. The following table compares the percentage of families based on income level located within the AA to the HMDA information for home mortgage refinance loans originated or purchased from January 1, 2003 through June 30, 2004.

Borrower Distribution of Residential Real Estate Loans								
Borrower Income Level*	Low (0 - \$27,450)		Moderate (\$27,451 - \$43,920)		Middle (\$43,921 - \$65,880)		Upper (\$65,881 and over)	
	% 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
Home Mortgage Refinance Loans*	16.30%	9.91%	19.92%	22.45%	26.76%	27.99%	37.02%	37.90%

*per 2003 HUD Estimated Median Family Income for La Crosse/Houston County MSA; 1.75% of HMDA loans did not report income information.

The demographics of the assessment area show that 17% of families were in the low-income category and 19% in the moderate-income category based on 1990 census information. Based on 2000 census information, 16% were low-income and 20% were moderate-income. Our analysis of HMDA information for loans originated and purchased by Merchants during 2002 indicates that only 7% of home refinance loans were made to low-income families and 19% to moderate-income families. The analysis of HMDA data from January 1, 2003 through June 30, 2004, indicates that 10% of home refinance loans were made to low-income families and 22% were made to moderate-income families. Our community contact mentioned that it is difficult to find houses for sale that are under \$100,000. This makes it difficult for low-income families to be able to purchase a house. Some low-income families participate in first-time homebuyer programs, making it undesirable to refinance their homes. In addition, the percentage of families below poverty level according to 1990 and 2000 census information was 12% and 10%, respectively. These families would have difficulty purchasing homes. Taking these factors into consideration, the bank's penetration of lending to low-income families more closely approximates area demographics.

Geographic Distribution of Loans

The geographic distribution of commercial and home mortgage refinance loans reflects a reasonable dispersion throughout the AA. We did not identify any conspicuous gaps in lending to low and moderate income CTs. Merchants bank is located in a middle-income CT using both 1990 and 2000 census information. The majority of Merchants loans are made to borrowers located within middle-income CTs.

The geographic distribution of commercial loans is good for 2002 and excellent for those loans made in 2003 through June 30, 2004. The bank originated 30% of its commercial loans to borrowers in moderate-income CTs in both 2002 and 2003 through June 30, 2004. This exceeds the demographic of 22.40% and 19.18%, respectively. The 2002 loan data shows the bank did not originate any commercial loans in the low-income CTs in the AA. This is neither unreasonable nor unexpected given the location of the bank. The two low-income CTs are located across the state line into Wisconsin, approximately 6 miles from Merchants main bank. There are approximately 21 financial institutions located within the La Crosse city limits, where the low- to moderate-income tracts are located. There were no low-income CTs per the 2000 census data.

Geographic Distribution of Loans to Businesses in Assessment Area								
1990 Census Tract Income Level*	Low 6.3%		Moderate 18.8%		Middle 56.3%		Upper 15.6%	
Loan Type	% of AA Businesses	% of Number of Loans	% of AA Businesses	% of Number of Loans	% of AA Businesses	% of Number of Loans	% of AA Businesses	% of Number of Loans
Commercial	13.74%	0%	22.40%	30%	52.43%	70%	11.40%	0%

*3.1% of the Census Tracts in this AA are N/A; % of AA Businesses in these CTs is .03%.

Geographic Distribution of Loans to Businesses in Assessment Area								
2000 Census Tract Income Level	Low 0%		Moderate 13.3%		Middle 76.7%		Upper 10%	
Loan Type	% of AA Businesses	% of Number of Loans	% of AA Businesses	% of Number of Loans	% of AA Businesses	% of Number of Loans	% of AA Businesses	% of Number of Loans
Commercial	0	0%	19.18%	30%	72.17%	70%	8.65%	0%

The bank's geographic distribution of its home refinance loans is adequate for both 2002 and loans made from January 1, 2003 through June 30, 2004. For 2002, the bank originated .41% of its home refinance loans to borrowers residing in low-income CTs and 5.71% in moderate-income CTs. Between January 1, 2003 and June 30, 2004, Merchants originated 1.75% of loans to borrowers in moderate-income CTs. It is reasonable that the bank originated only a limited number of refinance loans to borrowers in the low-income tracts given the demographic data. Although the bank's lending to moderate-income CTs is lower than demographics, this is not unreasonable due to the bank's location and lending activity by local Wisconsin lenders. A 2002 peer mortgage data report indicates several LaCrosse-based lenders have a significant market share of the refinance loans.

Geographic Distribution of Residential Real Estate Loans in Assessment Area								
1990 Census Tract Income Level*	Low 6.3%		Moderate 18.8%		Middle 56.3%		Upper 15.6%	
Loan Type	% of AA Owner Occupied Housing Units	% of Number of Loans	% of AA Owner Occupied Housing Units	% of Number of Loans	% of AA Owner Occupied Housing Units	% of Number of Loans	% of AA Owner Occupied Housing Units	% of Number of Loans
Home Refinance	1.14%	.41%	16.96%	5.71%	64.57%	86.53%	17.33%	7.35%

*3.1% of the Census Tracts in this AA are N/A

Geographic Distribution of Residential Real Estate Loans in Assessment Area								
2000 Census Tract Income Level	Low 0%		Moderate 13.3%		Middle 76.7%		Upper 10%	
Loan Type	% of AA Owner Occupied Housing Units	% of Number of Loans	% of AA Owner Occupied Housing Units	% of Number of Loans	% of AA Owner Occupied Housing Units	% of Number of Loans	% of AA Owner Occupied Housing Units	% of Number of Loans
Home Refinance	0%	0%	9.03%	1.75%	79.70%	93.29%	11.27%	4.96%

Responses to Complaints

Merchants has not received any complaints about its performance in helping meet assessment area credit needs during this evaluation period.

Fair Lending Review

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