



SMALL BANK

Comptroller of the Currency
Administrator of National Banks

PUBLIC DISCLOSURE

September 8, 2003

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**Merchants Bank, National Association
Charter Number 24302**

**23280 Main Street
Hampton, MN 55031**

**Comptroller of the Currency
ADC-Minneapolis South
920 Second Avenue South, 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.

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

- Merchants Bank, National Association originates a majority of its loans inside the bank's assessment area.
- The bank meets the credit needs of the community as indicated by the bank's quarterly average loan-to-deposit ratio of 73 percent since the last CRA examination.
- The bank's performance is strong given the level of lending to low- and moderate-income borrowers and small businesses.
- Geographic distribution of loans in the assessment area is reasonable.

DESCRIPTION OF INSTITUTION

Merchants Bank, National Association (Merchants Bank) is a \$94 million commercial bank located approximately 30 miles southeast of the Twin Cities area. The bank's main office is located in Hampton with branches in Hastings, Cottage Grove, and Apple Valley, Minnesota. While the bank is legally headquartered in Hampton, it conducts a majority of its operations out of its downtown Hastings office. The bank has 3 ATMs but none accept deposits.

The bank's primary focus is residential real estate and commercial lending. According to the December 31, 2002 Report of Condition and Income, the bank's loan mix consists of commercial (61 percent), residential real estate (30 percent), consumer (8 percent), and agricultural (1 percent). The bank also has a considerable number of residential real estate loans sold to correspondent banks, which are not shown in the above loan mix. Because of the number of residential loans sold, we put more emphasis on residential loans for our conclusions. Net loans to total assets total 57 percent.

Merchants Bank is 100 percent owned by Merchants Financial Group, Inc., a four-bank holding company headquartered in Winona, Minnesota with \$602 million in total assets. Affiliate banks are located in Winona (MN), Caledonia (MN), La Crescent (MN), and Onalaska (WI). Merchants Financial Group, Inc. acquired Merchants Bank in April 2000. Merchants Bank converted from a state charter to a national charter in February 2002.

Merchants Bank received a “satisfactory” rating at its April 14, 1998 CRA examination. There are no financial, legal, or other factors impeding the bank's ability to meet its CRA obligations.

SCOPE OF EVALUATION

Examiners sampled data from August 1, 2001 through December 31, 2002. The bank converted software systems in July 2001 and due to the conversion, purpose codes were not transferred correctly in some cases before August 2001. Loan reports prior to this date are not reliable.

For our CRA review, we sampled 20 commercial loans, and since the bank is a HMDA reporter, we used the bank's HMDA LARs instead of selecting a sample for residential real estate.

DESCRIPTION OF ASSESSMENT AREA

The bank's assessment area includes 22 census tracts in Dakota County and 9 census tracts in Washington County. The assessment area is part of the Minneapolis-Saint Paul Metropolitan Area (MA). The Hampton, Hastings, and Apple Valley branches are located in Dakota County, while the Cottage Grove branch is located in Washington County. According to the 1990 U.S. Census Data, the total population of the assessment area is 165,514 people. The bank's assessment area complies with regulatory requirements and does not arbitrarily exclude low- or moderate-income geographies.

The U.S. Department of Housing and Urban Development's updated median family income (MFI) for the MA in 2002 is \$76,700. The following table summarizes the income levels of individual Census Tracts (CTs) and families located within the bank's assessment area:

INCOME DISTRIBUTION OF GEOGRAPHIES AND FAMILIES								
Percentage of CT's					Percentage of Families			
Low	Moderate	Middle	Upper	N/A	Low	Moderate	Middle	Upper
0%	7%	61%	29%	3%	10%	15%	31%	44%

Source: U.S. Census Data (1990)

Major employers in the area are the services, retail trade, government, and manufacturing. They include local school districts, Dakota County, Target, Wal-Mart, Smead Manufacturing, Menards, and Home Depot. Unemployment rates of 3.9 percent in Dakota County and 3.7 percent in Washington County percent are slightly lower than the unemployment rate in the state of Minnesota of 4.4 percent at July 31, 2003.

Competition from other financial institutions in Dakota and Washington Counties is strong. Including Merchants Bank, there are 50 banks located in the two Counties. Merchants bank has 2 percent of the deposits within the area, and ranks 11th in deposit market share out of the 50 banks. Major competitors in the area include Wells Fargo, US Bank, TCF, Associated Bank, and Bremer Bank with 20 percent, 13 percent, 9 percent, 7 percent, and 5 percent of the deposits, respectively.

We did not identify any unmet credit needs in Merchant Bank's Assessment Area.

CONCLUSIONS ABOUT PERFORMANCE CRITERIA

Loan-to-Deposit Ratio

Merchants Bank's net loan-to-deposit ratio is reasonable given the bank's size, financial condition, and assessment area credit needs. The bank's quarterly net loan-to-deposit ratio averaged 73 percent over the 20 quarters from March 31, 1998 through December 31, 2002.

Merchants Bank's net loan-to-deposit ratio has ranged between 57 percent and 83 percent and

totaled 70 percent at December 31, 2002.

Merchants Bank’s net loan-to-deposit ratio is comparable with other community banks of similar size (total assets between \$60 and \$120 million) in the assessment area. The average net loan-to-deposit ratio for the five similarly situated banks in the assessment area is 74 percent with a range from 55 percent to 90 percent over the last 20 quarters from March 31, 1998 through December 31, 2002.

Lending in Assessment Area

Merchants bank originates a majority of its loans to borrowers inside its assessment area. Of residential loans originated from August 1, 2001 through December 31, 2002, about 64 percent by number and 60 percent by dollar volume were made to borrowers located within the bank’s assessment area. Of commercial loans originated from August 1, 2001 through December 31, 2002, about 65 percent by number and 45 percent by dollar volume were made to commercial borrowers located within the bank assessment area. The following table shows loans originated inside the assessment area by number and dollar volume:

LENDING IN ASSESSMENT AREA BY NUMBER AND DOLLAR AMOUNT (000s)				
Type of Loan	Number	Percent of Number	Dollars	Percent of Dollars
Residential	170	64%	\$19,222	60%
Commercial	13	65%	\$729	45%

Source: Bank records (verified by examiners)

The bank’s commercial loans by dollar volume area are significantly lower than residential loans by dollar volume inside the assessment area. Of the seven commercial loans outside the bank’s assessment area, two of these loans were originated at \$200 thousand or more, causing the commercial loan percentage of dollars to be significantly reduced.

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

Overall, the bank’s performance is strong given the level of lending to low- and moderate-income borrowers and to small businesses. Residential loans were given more consideration than commercial loans because the residential loans are the most significant portion of the loan portfolio. Lending to low- and moderate-income families exceeds community demographics and lending to businesses meets community demographics.

Residential lending activity in the assessment area exceeds community demographics. As presented in the table, lending to low- and moderate-income borrowers was 18 and 28 percent, respectively, by number of loans and 13 and 25 percent, respectively, by dollar volume. These numbers compare favorable to the 10 percent of low-income families and 15 percent moderate-income families living in the assessment area. Merchants Bank originated 265 residential loans totaling \$32 million from August 1, 2001 through December 31, 2002. Examiners included all 170 residential loans originated in the assessment area from August 1, 2001 through

December 31, 2002. The following table compares the bank's residential lending activity by different income levels to community demographics:

BORROWER DISTRIBUTION OF RESIDENTIAL LOANS BY INCOME LEVEL					
Borrower Income Level	Originations Dated August 1, 2001 through December 31, 2002				Percent of Families in Assessment Area
	Number	Percent of Number	Amount (\$000)	Percent of Amount	
Low – Income	30	18%	\$2,500	13%	10%
Moderate – Income	47	28%	\$4,797	25%	15%
Middle – Income	55	32%	\$6,354	33%	31%
Upper - Income	38	22%	\$5,571	29%	44%
Totals	170	100%	\$19,222	100%	100%

Source: Bank records (verified by examiners) and U.S Census Data (1990)

Commercial lending activity in the assessment area meets the community demographics. However, 40 percent of the businesses did not report annual revenue, which has a potential impact on the business demographics for the area. Merchants Bank originated 189 commercial loans totaling \$22 million between August 1, 2001 and December 31, 2002. The largest number of loans in the assessment area was originated to small businesses with annual revenues of less than \$250 million. Examiners sampled 20 commercial and commercial real estate loans originated in the assessment area from August 1, 2001 through December 31, 2002. The following table compares the bank's commercial lending activity by revenue size to community demographics.

BORROWER DISTRIBUTION OF COMMERCIAL LOANS BY REVENUE SIZE			
Annual Gross Revenue	Originations Dated August 1, 2001 through December 31, 2002		Business Demographic Data
	Number	Percent of Number	
<\$1,000,000	13	65%	56%
>\$1,000,000	6	30%	4%
Not Reported	1	5%	40%
Totals	20	100%	100%

Source: Bank records (verified by examiners) and U.S Census Business Demographic Data (1990)

Geographic Distribution of Loans

Overall, geographic distribution of loans in the assessment area is reasonable. Residential loan

distribution in moderate-income census tracts meets the assessment area demographics, and commercial loan distribution in moderate-income census tracts exceeds the demographics, as shown in the following tables.

GEOGRAPHIC DISTRIBUTION OF RESIDENTIAL LOANS BY INCOME LEVEL					
Tract Income Level	Originations Dated August 1, 2001 through December 31, 2002				Percent of Owner- Occupied By Tract Category
	Number	Percent of Number	Amount (\$000)	Percent of Amount	
Low – Income	0	0%	\$0	0%	0%
Moderate – Income	2	1%	\$96	1%	2%
Middle – Income	142	84%	\$15,034	78%	65%
Upper – Income	26	15%	\$4,092	21%	21%
Totals	170	100%	\$19,222	100%	100%

Source: Bank records (verified by examiners) and U.S Census Data (1990)

GEOGRAPHIC DISTRIBUTION OF COMMERCIAL LOANS BY INCOME LEVEL					
Tract Income Level	Originations Dated August 1, 2001 through December 31, 2002				Percent of Businesses By Tract Category
	Number	Percent of Number	Amount (\$000)	Percent of Amount	
Low – Income	0	0%	\$0	0%	0%
Moderate – Income	1	5%	\$225	16%	1%
Middle – Income	16	80%	\$980	69%	66%
Upper – Income	3	15%	\$210	15%	33%
Totals	20	100%	\$1,415	100%	100%

Source: Bank records (verified by examiners) and U.S Census Data (1990)

We did not identify any specific gaps in the bank's lending patterns for residential real estate or commercial loans.

Responses to Complaints

The bank has not received any CRA-related complaints since the last CRA examination.

OTHER INFORMATION**Fair Lending Review**

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