



Comptroller of the Currency
Administrator of National Banks

SMALL BANK*

Public Disclosure

May 6, 2003

Community Reinvestment Act Performance Evaluation

**First National Bank of Herman
Charter Number: 8049**

**103 Fifth Street East
Herman, MN 56248**

**Office of the Comptroller of the Currency
Alexandria Field Office
P. O. Box 849
Alexandria, MN 56308**

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

The First National Bank of Herman 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:

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

Description of Institution

First National Bank (FNB) of Herman is an \$18 million bank located in Herman, MN in Grant County. The First National Agency of Herman, Inc., a one-bank holding company, owns 100% of the bank and is also located in Herman, MN. Holding company assets consist primarily of the bank. The bank does not have any branches.

The bank's loan portfolio is diverse. As of December 31, 2002, the composition of the portfolio was as follows:

Loan Portfolio Composition	\$ (000)	%
Agricultural (including real estate)	4,288	59.6
Commercial (including real estate)	1,172	16.3
Residential Real Estate Loans	1,042	14.5
Consumer Loans	687	9.6
Total	7,189	100.0

FNB of Herman offers traditional banking products and services. Its lending practices are focused on agricultural and consumer loans. As of December 31, 2002, net loans represent 38% of total assets and the Bank's Tier One Leverage Capital is 11.32%, or \$1.9 million. There are no legal or financial impediments that restrict the bank's ability to meet the credit needs of the community. The bank's structure has not changed since the previous examination.

FNB of Herman was rated "Satisfactory" at the last CRA examination dated July 6, 1998.

Description of First National Bank of Herman's Assessment Area

FNB of Herman's assessment area (AA) includes four contiguous Block Numbering Areas (BNAs). The AA includes parts of Grant, Traverse, and Stevens Counties. The AA includes three middle-income BNAs and one moderate-income BNA. There are no low-income or upper-income BNAs 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 Herman, Hoffman, Browns Valley, Wheaton and Chokio. These communities are small in size with the largest being Wheaton with a population of 1,590 people. All other cities have a population under 700 people.

The bank's AA is dependent on agriculture. Outside this industry, employment opportunities include the public school system, a regional grain elevator, and a local seed company. Employment is also available in the surrounding communities of Alexandria, Fergus Falls, and Morris. These are located outside the bank's AA.

Information from the Bureau of Labor Statistics lists 2002 unemployment rates for Grant County at 7.4%, Traverse County at 4.5%, and Stevens County at 3.0%. The average unemployment rate is 4.4% for Minnesota and 5.8% nationwide.

During our evaluation we contacted a community organization to better understand the credit needs of the AA. Based on this information we determined that agriculture loans help support the local economy. The contact stated that the FNB of Herman effectively meets community credit needs.

The demographics of the AA are illustrated on the next page. The information is based on 1990 census data unless otherwise noted. This is the most recent information available during our evaluation.

DEMOGRAPHIC AND ECONOMIC CHARACTERISTICS OF AA	
<i>Population</i>	
Number of Families	2,983
Number of Households	4,075
Number of Low-Income Families	645
% of Low-Income Families	21.6%
Number of Moderate-Income Families	677
% of Moderate-Income Families	22.7%
Number of Middle-Income Families	778
% of Middle-Income Families	26.1%
Number of Upper-Income Families	883
% of Upper-Income Families	29.6%
<i>Geographies</i>	
Number of Census Tracts/BNA	4
% Low-Income Census Tracts/BNA	0%
% Moderate-Income Census Tracts/BNA	25%
% Middle-Income Census Tracts/BNA	75%
% Upper-Income Census Tracts/BNA	0%
<i>Median Family Income (MFI)</i>	
1990 MFI for AA	\$28,933
2002 HUD-Adjusted MFI	\$48,500
<i>Economic Indicators</i>	
Unemployment Rate	2.4%
Median Housing Value	\$24,186
% of Households Below Poverty Level	16.91%

Loan Sampling

The bank's primary loan types were determined by reviewing all loans originated from July 6, 1998 through December 31, 2002.

For purposes of this evaluation, the primary loan types are farm loans and consumer loans. Farm loans account for 55% of the dollar volume and 32% of the number of loans originated. Consumer loans represent 44% of the number of loans originated.

The table below shows a breakdown of all originations in our evaluation period.

Loan Products	#	%	\$ (000)	%
Farm Loans	82	32%	2,502	55%
Commercial Loans	29	11%	675	15%
Consumer Loans	115	44%	548	12%
Residential Real Estate Loans	33	13%	800	18%
Total	259	100%	4,525	100%

To conduct our analysis, we performed statistically valid sampling techniques selecting a sample

of twenty agriculture loans 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

FNB of Herman's loan-to-deposit (LTD) ratio meets the standards for satisfactory performance given the size and financial condition of the bank, assessment area needs, and local economic conditions. Since the last CRA evaluation, the bank's average quarterly LTD ratio is 54%.

When compared to five similarly situated institutions in or around the AA, FNB of Herman is ranked fifth out of six banks. These banks have asset sizes ranging from \$18 to \$27 million and are rural in nature. The average LTD ratio of all six banks for the evaluation period is 63%.

Institution	Assets (as of 12/31/02)	Average LTD Ratio
1 st American State Bank of Minnesota	\$19 million	75%
Farmers State Bank of Hoffman	\$22 million	67%
First State Bank of Ashby	\$23 million	66%
United Farmers & Merchants State Bank	\$27 million	65%
First National Bank of Herman	<i>\$18 million</i>	<i>54%</i>
Union State Bank of Browns Valley	\$18 million	51%

Lending in Assessment Area

The FNB of Herman exceeds the standard for satisfactory performance for lending with the AA. A substantial majority of the loans are originated within the AA. The following table illustrates lending activity within the AA during the evaluation period.

TOTAL LOANS REVIEWED								
LOAN TYPE	IN ASSESSMENT AREA				OUT OF ASSESSMENT AREA			
	#	%	\$ (000s)	%	#	%	\$ (000s)	%
Farm Loan sample	20	100%	344	100%	0	0%	0	0
Consumer Loan sample	18	90%	75	87%	2	10%	11	13%
Total Reviewed	38	95%	419	97%	2	5%	11	3%

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

Lending to borrowers of different incomes and farms of different sizes exceeds the standard for satisfactory performance. Farms loans meet the demographics of the AA and consumer loans sampled exceed the AA demographics.

Farm Loans

FNB of Herman’s lending to small farms exceeds the demographics of the AA. One hundred percent of the loans are to farms with revenues of less than \$1 million and the demographic information indicates 99% of farms in the AA have annual gross revenues of less than \$1 million.

BORROWER DISTRIBUTION OF SMALL LOANS TO FARMS		
Farm Revenues	≤\$1,000,000	>\$1,000,000
% of AA Farms	99%	1%
% of Bank Loans in AA #	100%	0%
% of Bank Loans in AA \$	100%	0%

Consumer Loans

Consumer loans to low- and moderate-income households exceed the demographics of the AA. The following chart illustrates that 40% of the number and dollar volume of loans sampled are to low-income households and 40% of the number and 42% of the dollar volume of loans are to moderate-income households. The demographic information indicates 25% of the households in the AA are low-income and 19% are moderate-income.

CONSUMER LOANS								
Borrower Income Level	LOW		MODERATE		MIDDLE		UPPER	
% of AA Households	25%		19%		21%		35%	
	% of Number	% of Amount						
Loans	40%	40%	40%	42%	10%	8%	10%	10%

Geographic Distribution of Loans

FNB of Herman’s geographic distribution of loans throughout the AA does not meet the standard for satisfactory performance.

FNB of Herman has a low level of lending to the one moderate-income area based on our sample of 40 total loans. A majority of the bank’s loans are made in the middle-income BNA in which the bank is located. Lending patterns decrease as the distance grows further from the bank location and closer to other financial institutions.

Farm Loans

FNB of Herman has one farm loan made to a borrower in the moderate-income tract. The following table illustrates the distribution of the sampled loans in the bank’s AA.

FARM LOANS								
Census Tract Income Level	LOW		MODERATE		MIDDLE		UPPER	
% of AA Farms	0%		15%		85%		0%	
	% of Number	% of Amount						
Loans	N/A	N/A	5%	5%	95%	95%	N/A	N/A

Consumer Loans

The bank does not have any consumer loans made to households located in the moderate-income tract. As detailed in the table below, 18% of the households are located in the moderate-income tract.

CONSUMER LOANS								
Census Tract Income Level	LOW		MODERATE		MIDDLE		UPPER	
% of AA Households	0%		18%		82%		0%	
	% of Number	% of Amount						
Loans	N/A	N/A	0	0	100%	100%	N/A	N/A

Although the bank does not meet the standard for satisfactory performance based on the data detailed above, mitigating factors exist. The moderate-income tract’s largest community, which has nearly 50% of the tract’s population, is located at the far southwest corner of the tract. This is geographically the furthest point from the FNB of Herman. The portion of the moderate-income tract that is closer to the bank is less populated and is primarily farmland.

Responses to Complaints

The FNB of Herman has not received any complaints about performance in helping to meet the credit needs of the assessment area during this evaluation period.

Fair Lending Review

An analysis of public comments and consumer complaint 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.