



SMALL BANK

Comptroller of the Currency
Administrator of National Banks

PUBLIC DISCLOSURE

December 9, 2002

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**The First National Bank of Milaca
Charter Number 9050**

**192 Second Avenue S.W.
Milaca, MN 56353**

**Comptroller of the Currency
Minneapolis North Field Office
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.

- The distribution of loans by borrower income level and business revenue size meets the demographics of the assessment area.
- Loan penetration in moderate-income geographies exceeds the percentage of owner-occupied housing and businesses located in such geographies in the assessment area.
- The bank originates a substantial majority of its loans within the assessment area.
- Loan to deposit performance is reasonable despite being lower than other similarly situated banks.

DESCRIPTION OF INSTITUTION

The First National Bank of Milaca (FNB) is a \$115 million institution located in Milaca, Minnesota. FNB has a branch office in Isle, Minnesota. FNB also operates six automated teller machines. The bank's primary lending products are business and residential real estate loans. As of September 30, 2002, FNB's net loans and leases totaled \$62 million or 54% of the bank's total assets. The loan portfolio is comprised of business (45%), residential real estate (24%), consumer (14%), agricultural (13%), and construction and all other (4%) loans.

There are no legal, financial, or other factors that impede FNB's ability to help meet the credit needs in its assessment area. FNB has an insurance company affiliate. The activities of the affiliate do not impact the bank's CRA performance.

The bank's most recent CRA performance evaluation was dated April 13, 1998 and a rating of "Satisfactory" was assigned.

DESCRIPTION OF ASSESSMENT AREA

FNB's assessment area consists of five adjacent block numbering areas (BNAs) covering most of Mille Lacs County and southeast Aitkin County. Three (60%) of the BNAs are middle-income and two (40%) are moderate-income. The three middle-income BNAs are contiguous and include the City of Milaca where the bank's main office is located. The two moderate-income BNAs encompass the City of Isle in northeast Mille Lacs County and southeast Aitkin County. The assessment area meets the requirements of the regulation.

The economy of the assessment area is stable. Most jobs are service or trade oriented. Many individuals are self-employed. Tourism is an important economic factor in the assessment area. Unemployment rates in Mille Lacs and Aitkin Counties (5.5% and 4.6%, respectively) are slightly higher than the state-wide average for Minnesota. The 2002 updated median family income figure for non-metropolitan Minnesota is \$48,500. Based on data from the 1990 Census,

approximately 22% of families in the assessment are considered low-income, 21% moderate-income, 23% middle-income, and 34% upper-income. Population growth has been moderate. In 2000, the population of the assessment area was approximately 14 thousand, an increase of 23% from 1990. The assessment area includes a significant number of housing units used as vacation/lake homes (26% per 2000 Census) because of its recreational value and proximity to the Twin Cities. Because much property is not used as primary residences, the percentage of owner-occupied real estate in the assessment area appears artificially low at 60%. Median home values increased 92% from 1990 to \$92 thousand in 2000.

FNB competes with several other community banks and a credit union for loans and deposits. The level of banking competition in the area is considered moderate. In addition to FNB, another bank and a credit union are located in Milaca. FNB’s branch and a credit union are the only financial institutions located in Isle

We considered information from two community contacts in completing this evaluation. The contacts represented individuals from an affordable housing organization and tribal government. Needs mentioned by the contacts included affordable housing and financial education and jobs for Native Americans. Opportunities for borrowers to obtain credit were considered sufficient.

CONCLUSIONS ABOUT PERFORMANCE CRITERIA

Lending in Assessment Area

FNB originates a substantial majority of its loans within the assessment area. Based on a sample of 20 residential real estate and 20 commercial loans, 85% of the loans by number and 93% by dollar are within the bank’s assessment area.

Geographic Distribution of Loans

The bank’s geographic distribution of loans throughout the assessment area is excellent.

Both residential real estate and business loans originated in moderate-income geographies exceed the percentage of owner-occupied real estate and businesses located in such geographies. This level of performance is not unexpected given the location of the bank’s offices. FNB’s Isle office is located in a moderate-income geography and is the only commercial bank in Isle. The following table shows the overall geographic distribution of residential real estate loans sampled.

Income Level of Geography	Originations by Number	Originations by Dollar	% of AA Owner Occupied RE
Low	NA	NA	NA
Moderate	30%	43%	29%
Middle	70%	57%	71%
Upper	NA	NA	NA

The following table shows the overall geographic distribution of business loans sampled.

Income Level of Geography	Originations by Number	Originations by Dollar	% of AA Businesses
Low	NA	NA	NA
Moderate	40%	44%	27%
Middle	60%	56%	73%
Upper	NA	NA	NA

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

The bank's distribution of loans to borrowers of different incomes and businesses of different revenue sizes is reasonable.

FNB's residential real estate loan volume originated to borrowers with low-incomes is similar to the percentage of low-income families in the assessment area. FNB's residential real estate loan volume originated to borrowers with moderate-incomes exceeds the percentage of moderate-income families in the assessment area. The following table shows the overall borrower income distribution of residential real estate loans sampled. Examiners sampled 20 residential real estate loans at random originated in the assessment area since January 1, 2000.

Income Level of Borrowers	Loan Originations by Number	Loan Originations by Dollar	Families in Assessment Area
Low (< \$24,250)	20%	11%	22%
Moderate (\$24,250-38,799)	30%	32%	21%
Middle (\$38,800-58,199)	10%	6%	23%
Upper (>\$58,200)	40%	51%	34%

FNB's loans originated to small businesses, those with annual revenue of \$1 million or less, is similar to the percentage of small business in the assessment area. The vast majority of businesses in the assessment area with known revenue size are considered small businesses. However, the revenue size of 22% of assessment area businesses is unknown. The following table shows the overall distribution of business loans sampled. Examiners sampled 20 business loans at random originated in the assessment area since January 1, 2000.

Business with Known Annual Revenue Size	Loan Originations by Number	Loan Originations by Dollar	% of AA Businesses
\$1 Million or Less	80%	45%	94%
> \$1 Million	20%	55%	6%

Loan-to-Deposit Ratio

FNB's loan to deposit ratio is reasonable but below peer average. The bank's quarterly average loan to deposit ratio over the last 19 quarters ending September 30, 2002 is 58%. This ratio is the lowest among five similarly situated community banks by asset size and location of headquarters. The quarterly average loan to deposit ratio over the last 19 quarters for the four

other banks in the peer group is 79%. The bank does not have minimum loan size requirements and does not offer an open-end home equity product. These factors impact average loan size and loan demand and along with other management philosophies may contribute to a lower loan to deposit ratio.

Qualified Investments and Community Development Services

FNB participated in a community development activity by purchasing a qualified investment issued by the City of Isle in the amount of \$175 thousand in July 2000. The proceeds of the bond issuance were used by the city to finance the costs of a project consisting of 16 single-family homes designed for low-and moderate-income families.

Responses to Complaints

FNB has not received any CRA related complaints since its April 13, 1998 CRA evaluation.

Fair Lending Review

An analysis of 1998 to 2002 public comments and consumer complaint information was performed according to the OCC's risk based fair lending approach. Based on our analysis of the information, the OCC decided that a comprehensive fair lending examination would not need to be conducted in connection with the CRA evaluation this year. The latest comprehensive fair lending examination was performed in 1998.