



SMALL BANK

Comptroller of the Currency
Administrator of National Banks

PUBLIC DISCLOSURE

February 18, 2003

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**The First National Bank of Waconia
Charter Number 11410**

**53 West Main Street
Waconia, MN 55387**

**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 Outstanding.

- The First National Bank of Waconia's (FNB) distribution of home purchase loans, home improvement loans, and refinancings to borrowers of different income levels reflects excellent penetration to low- and moderate-income borrowers.
- FNB originated a substantial majority of residential real estate, commercial, and agriculture loans to borrowers located in its assessment area.
- FNB's involvement in qualified investments and community development services assists in enhancing credit availability to or addressing the identified needs of low- and moderate-income families within the assessment area.

DESCRIPTION OF INSTITUTION

FNB is a \$186 million bank headquartered in Waconia, Minnesota. The bank operates three facilities. The main office and a deposit taking ATM are located in Waconia with branches located in Cologne and St. Bonifacius, Minnesota. The branch in St. Bonifacius is located in an upper-income geography. The other two facilities are in middle-income geographies. All offices have drive-up access. All facilities have identical hours for lobby access on Monday through Saturday and extended hours for drive-up access on Monday through Saturday. The bank also has three cash dispensing machines located in Cologne (at Cenex convenience store), St. Bonifacius (at the branch), and Waconia (at the hospital). There have been no changes to the bank's branch network since the prior CRA evaluation period.

The bank is owned by Klein Financial Inc., a nine-bank holding company with consolidated assets of \$1.2 billion headquartered in Chaska, Minnesota. In 2000, Klein Financial Inc. purchased Hometown Mortgage, a mortgage company. Mortgage loans originated by Hometown Mortgage did not impact the bank's CRA performance during the evaluation period. The holding company also operates a data center that provides data processing services to the bank.

FNB's \$119 million loan portfolio is comprised of: \$46 million in commercial and commercial real estate loans (39%); \$41 million in residential real estate loans (35%); \$17 million in consumer loans (15%); \$7 million in construction loans (6%); and \$6 million in agricultural loans (5%). For purposes of this evaluation, we considered residential real estate lending to be the primary product line with commercial and agricultural lending constituting a second primary product.

FNB offers a full range of loan products including residential real estate, commercial, agricultural, and consumer. The bank participates in government guaranteed or sponsored loan programs including the FHA, VA, Rural Development, FSA, Farmer Mac II, Minnesota

Department of Agriculture Rural Finance Authority, and Small Business Administration. In addition, FNB offers home loan products with minimal downpayment requirements. Conventional and government-guaranteed residential real estate loans are also sold on the secondary market.

FNB offers a basic non-interest bearing checking account with no minimum balance requirement, no monthly service fee, free ATM card, free 24-hour telephone banking, and free online banking to access account. Customers can use the bank or its affiliate banks' offices in a total of sixteen locations to obtain the following services: checking and savings deposits and withdrawals; loan payments; and check cashing for checks drawn on the bank or its affiliate banks.

There are no legal, financial, or regulatory impediments limiting the bank's ability to meet the credit needs of its assessment area. FNB was rated "Outstanding" as of the prior CRA evaluation dated January 10, 1997.

DESCRIPTION OF ASSESSMENT AREA

The bank's assessment area (AA) is located in the southwestern portion of the Minneapolis/St. Paul Metropolitan Statistical Area #5120 (MSA). There are 78 census tracts in the assessment area, including all tracts in Carver and Scott Counties and the southwestern portion of Hennepin County, which includes 51 census tracts. In the AA, 1 census tract is designated as moderate-income, 42 are middle-income, and 35 are upper-income. No low-income census tracts are located in the AA. The AA meets the requirements of the regulation and does not arbitrarily exclude low- or moderate-income geographies.

Based on 1990 Census data, the population of the assessment area is 325,496. The Department of Housing and Urban Development's (HUD) 2002 Median Family Income for the MSA is \$76,700. The assessment area has less than 3% of families reporting income below the poverty level (less than 30% of the Median Family Income). The following table summarizes the income levels and geographic distribution of families located in the AA.

| Income Distribution of Geographies and Families | | | | | | | | |
|---|-------------------------|----------|--------|-------|------------------------|----------|--------|-------|
| Waconia Assessment Area | Number of Census Tracts | | | | Percentage of Families | | | |
| | Low | Moderate | Middle | Upper | Low | Moderate | Middle | Upper |
| | 0 | 1 | 42 | 35 | 10% | 15% | 26% | 49% |

Major employers in the city of Waconia include: Ridgeview Medical Center, Medallion Kitchens, Waconia School District, Milltronics, and Waconia Good Samaritan Center. For Carver and Scott Counties, employment is predominately in the industries of manufacturing, educational/health/social services, and retail. Unemployment rates for Carver, Hennepin, and Scott Counties of 3.3%, 3.2%, and 3.9%, respectively, are equal or less than the state and national unemployment rates of 3.9% and 6.0%, respectively.

Including FNB, there are three financial institutions in Waconia. Security State Bank and First Federal Savings Bank of Waconia are located within a few miles of FNB's main office. Also, Wells Fargo operates a Home Mortgage office in Waconia.

We did not identify any unmet credit needs in the assessment area through our contacts with a trade association and housing authority agency. Through these contacts, the construction of affordable housing units was perceived to be a need in the community. Our contacts also indicated that area banks are willing to provide financing to the communities. Also, bank employees have been involved in many local organizations and are visible members of the community.

CONCLUSIONS ABOUT PERFORMANCE CRITERIA

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

FNB's distribution of home purchase loans, home improvement loans, and refinancings to borrowers of different income levels reflects excellent penetration to low- and moderate-income borrowers. Originations of home purchase loans to low- and moderate-income borrowers are particularly impressive at 13% and 32% by number of loans, respectively. In the aggregate, FNB originated 14% of its HMDA loans to low-income borrowers and 26% of its HMDA loans to moderate-income borrowers during the prior three years. Assessment demographics reveal that 10% and 15% of the families are categorized as low- and moderate-income, respectively.

Between January 1, 2000 and December 31, 2002, the bank reported 333 originated or purchased loans totaling \$40.6 million on its Home Mortgage Disclosure Act – Loan Application Register (HMDA-LAR) within its assessment area. National bank examiners verified the accuracy of the HMDA-LAR prior to its use in the bank's CRA evaluation.

| Distribution of Home Purchase Loans | | | | | |
|--|-----------------|------------------------|----------------------------|----------------------------|-----------------------------------|
| Originated in 2000, 2001, and 2002 from HMDA-LAR data | | | | | |
| Income Category of Borrower | Number of Loans | Dollar of Loans (000s) | Percent by Number of Loans | Percent by Dollar of Loans | Percent of Families within the AA |
| Low-Income | 13 | 966 | 13.3% | 7.1% | 10.4% |
| Moderate-Income | 31 | 3,448 | 31.6% | 25.5% | 15.3% |
| Middle-Income | 24 | 3,173 | 24.3% | 23.5% | 25.7% |
| Upper-Income | 29 | 5,712 | 29.6% | 42.7% | 48.6% |
| Not Available | 1 | 172 | 1.0% | 1.3% | |

| Distribution of Home Improvement Loans | | | | | |
|--|-----------------|------------------------|----------------------------|----------------------------|-----------------------------------|
| Originated in 2000, 2001, and 2002 from HMDA-LAR data | | | | | |
| Income Category of Borrower | Number of Loans | Dollar of Loans (000s) | Percent by Number of Loans | Percent by Dollar of Loans | Percent of Families within the AA |
| Low-Income | 10 | 505 | 13.0% | 9.7% | 10.4% |
| Moderate-Income | 20 | 1,049 | 25.9% | 20.1% | 15.3% |
| Middle-Income | 33 | 2,439 | 42.9% | 46.6% | 25.7% |
| Upper-Income | 14 | 1,234 | 18.2% | 23.6% | 48.6% |

| Distribution of Refinanced Loans | | | | | |
|--|-----------------|------------------------|----------------------------|----------------------------|-----------------------------------|
| Originated in 2000, 2001, and 2002 from HMDA-LAR data | | | | | |
| Income Category of Borrower | Number of Loans | Dollar of Loans (000s) | Percent by Number of Loans | Percent by Dollar of Loans | Percent of Families within the AA |
| Low-Income | 23 | 1,968 | 14.6% | 9.1% | 10.4% |
| Moderate-Income | 37 | 4,443 | 23.6% | 20.5% | 15.3% |
| Middle-Income | 54 | 7,257 | 34.4% | 33.5% | 25.7% |
| Upper-Income | 36 | 7,329 | 22.9% | 33.8% | 48.6% |
| Not Available | 7 | 662 | 4.5% | 3.1% | |

The distribution of loans to businesses and farms of different revenue sizes is reasonable in comparison to 2002 demographics from Dun & Bradstreet given the bank's large lending capacity and nature of business requiring financing within the assessment area.

| Distribution of Commercial and Agricultural Loans | | | | | |
|---|-----------------|------------------------|----------------------------|----------------------------|--|
| From a sample of loans originated August 1, 2001 through December 31, 2002 | | | | | |
| Annual Revenues of Business/Farm | Number of Loans | Dollar of Loans (000s) | Percent by Number of Loans | Percent by Dollar of Loans | Percent of Businesses or Farms within the AA |
| Businesses: | | | | | |
| Revenues < \$1 million | 18 | 6,448 | 72.0% | 58.9% | 89.5% |
| Revenues > \$1 million | 7 | 4,501 | 28.0% | 41.1% | 10.5% |
| Farms: | | | | | |
| Revenues < \$1 million | 19 | 443 | 95.0% | 88.4% | 96.3% |
| Revenues > \$1 million | 1 | 58 | 5.0% | 12.6% | 3.7% |

| Distribution of Commercial and Agricultural Loans | | | | | |
|---|-----------------|------------------------|----------------------------|----------------------------|--|
| From a sample of loans originated August 1, 2001 through December 31, 2002 | | | | | |
| Annual Revenues of Business/Farm | Number of Loans | Dollar of Loans (000s) | Percent by Number of Loans | Percent by Dollar of Loans | Percent of Businesses or Farms within the AA |
| Revenues < \$.5 million | 33 | 6,133 | 73.3% | 53.6% | 83.3% |
| Revenues \$.5 to \$.99 million | 4 | 758 | 8.9% | 6.6% | 6.0% |
| Revenues > \$1 million | 8 | 4,559 | 17.8% | 39.8% | 10.7% |

Community Development Lending

Since the prior CRA evaluation, the bank originated two community development loans totaling \$440 thousand. Proceeds of one \$290 thousand loan originated in 2002 were used to purchase a 12-unit apartment building that is HUD Section 8 qualified. In 2000, FNB renewed a \$150 thousand loan that was used to convert a building into Section 8 housing for the elderly. Financing for this project involved a combination of public and private loans and grants.

Loan-to-Deposit Ratio

The bank's quarterly net loan-to-deposit ratio is reasonable considering its size and the

assessment area credit needs. The bank's average quarterly net loan-to-deposit ratio is 74%. The quarterly net loan-to-deposit ratio has remained relatively stable and has ranged from 67% to 81% during the September 30, 1996 to September 30, 2002.

The bank's quarterly net loan-to-deposit ratio is commensurate with other banks headquartered in the assessment areas and of similar size (with total assets between \$111 million and \$329 million). The average quarterly net-loan-to-deposit ratio for comparison banks is 77% and ranged from 59% to 104% during the 25 quarters from September 30, 1996, through September 30, 2002.

Lending in the Assessment Area

FNB originated a substantial majority of residential real estate, commercial, and agriculture loans to borrowers located in its assessment area. According to HMDA-LAR data from January 1, 2000, through December 31, 2002, 86% by number and 85% by dollar of residential real estate loans were originated to borrowers located in the assessment area. By analyzing samples of commercial and agricultural loans, we determined that a substantial majority of the loans originated were to borrowers located within the assessment area. Of the commercial and commercial real estate loans originated from August 1, 2001 to December 31, 2002, 84% by number and 95% by dollar were originated to borrowers located in the assessment area. Of the agricultural loans originated from August 1, 2001 to December 31, 2002, 92% by number and 94% by dollar were made to borrowers located in the assessment area. The following table shows loans originated within the assessment area by number and dollar volume.

| Lending Within the Assessment Area by Number and Dollar of Loans | | | | |
|---|------------------------|--------------------------|-------------------------------|---------------------------|
| Type of Loan | Number of Loans | Percent by Number | Dollar of Loans (000s) | Percent by Dollars |
| Residential Real Estate | | | | |
| Home Purchases | 98 | 76% | 13,531 | 77% |
| Home Improvements | 77 | 95% | 5,227 | 94% |
| Refinancing | 157 | 89% | 21,659 | 89% |
| Multi-Family | 1 | 100% | 140 | 100% |
| Residential Real Estate Subtotal | 333 | 86% | 40,557 | 85% |
| Agricultural | 22 | 92% | 510 | 94% |
| Commercial and Commercial Real Estate | 26 | 84% | 11,103 | 94% |
| Total | 381 | 86% | 52,170 | 87% |

Geographic Distribution of Loans

The bank's geographic distribution of loans throughout the assessment area is reasonable. Residential real estate, commercial, and agricultural loans are primarily originated in middle-income geographies. This level of performance is reasonable given that more than one half of geographies of the assessment area are middle-income.

Eighty eight percent by number and 89% by dollar of residential real estate loans were originated to borrowers located in middle-income geographies. The following table represents the overall geographic distribution of all residential real estate loans reported in the bank's 2000, 2001, and 2002 HMDA-LARs.

| Geographic Distribution of Residential Real Estate Loans (based on all HMDA loans originated between January 1, 2000 and December 31, 2002) | | | | | |
|---|-----------------|-------------------|---------------|-------------------|--|
| Income Level of Geography | Number of Loans | Percent by Number | Dollar (000s) | Percent by Dollar | Percent of Owner-Occupied Housing Units in Geography |
| Low-Income | 0 | 0% | 0 | 0% | 0% |
| Moderate-Income | 0 | 0% | 0 | 0% | 1% |
| Middle-Income | 294 | 88% | 36,094 | 89% | 53% |
| Upper-Income | 39 | 12% | 4,463 | 11% | 46% |

Of the commercial loans sampled, 84% by number and 80% by dollar were originated to businesses and farms located in middle-income geographies. The following table shows the overall geographic distribution of commercial loans sampled.

| Geographic Distribution of Commercial Loans (based on a sample of loans originated between August 1, 2001 and December 31, 2002) | | | | | |
|--|-----------------|-------------------|---------------|-------------------|------------------------------------|
| Income Level of Geography | Number of Loans | Percent by Number | Dollar (000s) | Percent by Dollar | Percent of Businesses in Geography |
| Low Income | 0 | 0% | 0 | 0% | 0% |
| Moderate Income | 0 | 0% | 0 | 0% | 1% |
| Middle Income | 22 | 84% | 8,887 | 80% | 53% |
| Upper Income | 4 | 16% | 2,216 | 20% | 46% |

Of the agriculture loans sampled, farms were located in middle-income geographies. The following table shows the overall geographic distribution of agriculture loans sampled.

| Geographic Distribution of Agricultural Loans (based on a sample of loans originated between August 1, 2001 and December 31, 2002) | | | | | |
|--|-----------------|-------------------|---------------|-------------------|-------------------------------|
| Income Level of Geography | Number of Loans | Percent by Number | Dollar (000s) | Percent by Dollar | Percent of Farms in Geography |
| Low-Income | 0 | 0% | 0 | 0% | 0% |
| Moderate-Income | 0 | 0% | 0 | 0% | 1% |
| Middle-Income | 22 | 100% | 510 | 100% | 79% |
| Upper-Income | 0 | 0% | 0 | 0% | 20% |

FNB originated loans to borrowers, businesses, and farms within the majority of census tracts in Carver County. Census tracts in Hennepin and Scott Counties with no lending activity for all products reviewed were not in close proximity to banking offices.

Qualified Investments and Community Development Services

FNB's involvement in qualified investments and community development services assists in enhancing credit availability to or addressing the identified needs of low- and moderate-income families within the assessment area.

Since November 2002, FNB has held a \$150 thousand bond issued by Carver County Minnesota Housing and Redevelopment Authority. Proceeds were used to acquire and rehabilitate an 18-unit rental housing facility located within the bank's assessment area. This qualified investment targets affordable housing for low- to moderate-income individuals as eligible tenants must consist of persons and families with incomes not greater than 80% of the median income of the MSA. The volume of qualified investment equates to .8% of the bank's Tier 1 Capital.

In 2000, bank officers taught two seminars that informed prospective home loan applicants about the basics of getting credit. This seminar was sponsored by the Minnesota Housing Finance Agency and the Carver County Housing and Redevelopment Agency. It consisted of a series of workshops over three evenings. Completion of the class is required for certain financing programs in order to qualify for affordable mortgage loans.

FNB is registered with the State of Minnesota to provide welfare recipients with free check cashing services.

Responses to Complaints

Neither FNB nor its regulatory agency has received complaints regarding the bank's CRA performance.

Fair Lending Review

An analysis of public comments, consumer complaint information since April 1998, HMDA, data since the prior CRA evaluation was performed according to the OCC's risk based fair lending approach. Based on its 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 exam was performed in 1996.