



SMALL BANK

Comptroller of the Currency
Administrator of National Banks

PUBLIC DISCLOSURE

July 08, 2002

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**First National Bank
Charter Number 6813**

**27 Main Avenue Northwest
Bagley, Minnesota 56621**

**Comptroller of the Currency
North Dakota & Northwest Minnesota
3211 Fiechtner Drive Southwest
Fargo, North Dakota 58103**

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 First National Bank's rating is based on the following factors:

- ◆ The geographic distribution of the loans sampled exceeds standards for satisfactory performance. A majority of the bank's loans are made to borrowers in moderate-income tracts.
- ◆ The bank's lending within its assessment area meets the standards for satisfactory performance. A majority of the bank's loan originations are made in their assessment area.
- ◆ The bank's lending to borrowers of different income and businesses of different sizes meets the standards for satisfactory performance.

Description of Institution

First National Bank (FNB) is located in Clearwater County in Bagley, Minnesota. It is an intrastate bank with one branch located in Fosston, Minnesota, approximately 20 miles west of Bagley. The bank does not have any deposit taking ATMs. FNB's assets total \$59 million as of March 31, 2002. The First National Agency of Bagley, a one-bank holding company, owns 100% of the bank. The holding company is located in Bagley, Minnesota and has \$7 million in total assets. There have been no acquisitions or mergers since the previous CRA evaluation.

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

| Loan Portfolio Composition | \$(000) | % |
|---|----------------|-------------|
| Commercial (including Real Estate) | 13,818 | 35% |
| Residential Real Estate | 9,787 | 25% |
| Consumer Loans | 7,947 | 20% |
| Agriculture (including Real Estate) | 6,239 | 16% |
| Construction | 851 | 2% |
| Obligations of State & Political Subdivisions | 403 | 1% |
| All Other Loans | 133 | 1% |
| Total | 39,178 | 100% |

The bank is conservative in its business strategy and lending philosophy. FNB offers traditional banking products and focuses its lending on commercial, residential real estate, consumer, and

agriculture loans. Total loans represent 66% of total bank assets. Tier One Leverage Capital for the bank is 9.69% of average assets, or \$5.8 million.

There are no legal impediments that would 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 was rated "Satisfactory" at the last CRA evaluation dated September 16, 1997.

Description of First National Bank's Assessment Area

FNB's assessment area (AA) is comprised of Clearwater and Mahnomen Counties as well as a portion of Polk County in northwestern Minnesota. The AA includes block-numbering areas (BNAs) 9601, 9602, and 9603 in Clearwater County, BNAs 9601 and 9603 in Mahnomen County, and census tracts (CT) 209 and 210 in Polk County. Census tracts 209 and 210 are located in the Grand Forks/East Grand Forks Metropolitan Statistical Area (MSA). The western edge of BNA 9602 in Clearwater County and both BNAs in Mahnomen County make up a portion of the White Earth Indian Reservation. The northern half of BNA 9603 in Clearwater County is a portion of the Red Lake Indian Reservation. BNAs 9601 and 9602 in Clearwater County, BNA 9603 in Mahnomen County, and CTs 209 and 210 in Polk County are designated moderate-income areas. BNA 9603 in Clearwater County and BNA 9601 in Mahnomen County are designated middle-income areas. The bank's AA contains no low-income or upper-income tracts.

The AA includes only whole BNAs or CTs that are contiguous. The AA meets the requirements of the regulation. The AA does not arbitrarily exclude low- or moderate-income geographies. Cities included in the AA are Bagley, Fosston, McIntosh, Mahnomen, Clearbrook, and Gonvick.

The bank's AA is dependent on the logging industry, agricultural operations, and small businesses. The primary agriculture products are wheat, barley, and cattle. Employment opportunities outside of these industries include the local school district, the hospital, and a product research development business. Unemployment for the area is low at 3.8%. The economic conditions in the area remain poor. Clearwater County, where the bank is located, is one of the poorest counties in the state.

The bank's competitors include financial institutions located in Fosston, Mahnomen, Clearbrook, and Gonvick. These banks range in size from \$19 million to \$59 million in assets. The Northern State Bank of Gonvick and First State Bank of Clearbrook are primary competition for the bank's main office in Bagley. Ultima Bank Minnesota is the primary competition for the bank's branch office in Fosston.

During our evaluation we contacted an economic development organization and a housing authority organization. One of the contacts stated there are needs in the area for low-income rental units, existing home ownership rehabilitation, and home ownership opportunities for low-income people.

The demographics of the AA are illustrated in the table below. 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> | |
| Population | 20,598 |
| Number of Families | 5,567 |
| Number of Households | 7,702 |
| Number of Low-Income Families | 1,670 |
| % of Low-Income Families | 30.00% |
| Number of Moderate-Income Families | 1,374 |
| % of Moderate-Income Families | 24.68% |
| Number of Middle-Income Families | 1,184 |
| % of Middle-Income Families | 21.27% |
| Number of Upper-Income Families | 1,339 |
| % of Upper-Income Families | 24.05% |
| % Minority Population | 9.73% |
| <i>Geographies</i> | |
| Number of Census Tracts/BNA | 7 |
| % Low-Income Census Tracts/BNA | None |
| % Moderate-Income Census Tracts/BNA | 71.43% |
| % Middle-Income Census Tracts/BNA | 28.57% |
| % Upper-Income Census Tracts/BNA | None |
| <i>Median Family Income (MFI)</i> | |
| 1990 MFI for AA | \$29,179 |
| 2001 HUD-Adjusted MFI | \$47,500 |
| <i>Economic Indicators</i> | |
| Unemployment Rate | 4.21% |
| Owner-Occupied Housing | 59.53% |
| Median Housing Value | \$31,982 |
| % of Households Below Poverty Level | 22.99% |

Conclusions about Performance Criteria

The bank's CRA performance is based on the assessment of five criteria. We selected a sample from the bank's primary loan products originated since July 1997 to assess the bank's performance. The loan sample was selected by dollar volume of loans, the number of loans originated was not available. The primary loan products for FNB are residential real estate and commercial, including real estate.

We also conducted interviews with people in the community and reviewed the bank's CRA public file as part of our evaluation process.

FNB's strength is its willingness to lend to low- and moderate-income borrowers and extend loans to borrowers within the assessment area.

Geographic Distribution of Loans

The distribution of the bank’s loans exceeds the standards for satisfactory performance. The bank’s AA includes five moderate-income tracts and two middle-income tracts. Upon review of FNB’s primary loan products, we determined the bank lends in all income tracts in their AA and does a good job of lending to moderate-income borrowers. The table below illustrates the demographic data for the AA and the findings from our review.

| GEOGRAPHIC DISTRIBUTION OF LOANS | | |
|---|--|--------------------------------------|
| Loan Type | MODERATE -INCOME TRACTS | MIDDLE- INCOME TRACTS |
| Residential Real Estate | | |
| % Owner-Occupied Housing | 57% | 67% |
| FNB Performance by # | 90% | 10% |
| FNB Performance by \$ | 91% | 9% |
| Commercial | | |
| % Small Businesses | 70% | 30% |
| FNB Performance by # | 100% | 0% |
| FNB Performance by \$ | 100% | 0% |

Lending in Assessment Area

The bank meets the standards for satisfactory performance of lending within its assessment area. FNB’s lending patterns indicate a majority of loans are originated within their AA. Internal bank reports calculate the lending inside and outside of the AA using all loans originated in a specific year. The reports indicate that 82% of the loans originated in 2001 were extended to borrowers within the AA. We verified the reports by sampling the following loans originated since July 1, 1997, 20 residential real estate loans and 20 commercial loans totaling \$1.6 million. Eighty-seven percent of the number of loans sampled and 64% of the volume were originated within the bank’s AA.

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

The bank’s lending to borrowers of different incomes and businesses of different sizes is reasonable and meets the standard for satisfactory performance. FNB’s primary loan products were determined by examining the percentage of loans originated by dollar amount and by number of originations. Residential real estate and commercial loans (including real estate) were chosen based on the dollar volume and number of originations.

Residential Real Estate

The bank’s lending practices for residential real estate loans are consistent with the AA demographic data information. The data indicates that 30% of families in the AA were considered low-income and 25% moderate-income. Our residential real estate sample reveals that 5% of loan originations by number are extended to low-income families and 40% by number are extended to moderate-income families. The table below summarizes income levels of the sample of 20 residential real estate loans originated since July 1, 1997.

| RESIDENTIAL REAL ESTATE | | | | |
|--------------------------------|---|---|--|--|
| Borrower Income Level | LOW <50% of median family income* | MODERATE At least 50% and <80% of median family income* | MIDDLE At least 80% and <120% of median family income* | UPPER >120% of median family income* |
| % of Families | 30% | 25% | 21% | 24% |
| Number of Loans | 1 | 8 | 7 | 4 |
| Percentage Number | 5% | 40% | 35% | 20% |
| Dollar Amount of Loans | \$17,000 | \$269,372 | \$309,312 | \$195,674 |
| Percentage Number | 2% | 34% | 39% | 25% |

*Median family income for 2001 is \$47,500

Residential real estate lending to low-income borrowers appears low. However, the demographic information regarding FNB’s AA indicates that 23% of the population lives below the poverty level. Low-income borrowers may not qualify for a residential real estate loan.

Commercial Loans (including real estate)

The bank’s lending practices for commercial loans are consistent with the AA demographic data. The data reflects that 88% of businesses have revenues less than \$1 million. Of the loans sampled, 90% by number and 53% by dollar amount have revenues well below this level. The table below summarizes income levels of the sample of 20 commercial loans originated since July 1, 1997 in the bank’s AA.

| BORROWER DISTRIBUTION OF LOANS TO SMALL BUSINESSES | | |
|---|---------------------|---------------------|
| Business Revenue | ≤\$1,000,000 | ≥\$1,000,000 |
| % of Businesses in AA | 88% | 7% |
| % of Bank Loans in AA by # | 90% | 10% |
| % of Bank Loans in AA by \$ | 53% | 47% |

Loan-to-Deposit Ratio

FNB's loan-to-deposit ratio meets the standards for satisfactory performance given the size, financial condition, assessment area needs, and local economic conditions. Since the last CRA evaluation, the bank's average quarterly loan-to-deposit ratio is 66%. The bank's loan-to-deposit ratio as of March 31, 2002 is 75%. FNB's trend in lending is increasing. The loan demand in the AA is not high as evidenced by the other bank's loan-to-deposit ratios. Twenty-three percent of households in the AA are below the poverty level, which could lead to difficulty in originating loans.

When compared to six other similarly situated banks in the AA, FNB is ranked third out of the seven banks. All of these financial institutions are of a similar size, located in close proximity to one another, and offer similar loan products. The quarterly ratios range from 37% to 74%. The following table depicts the comparison of these banks.

| Institution | Assets 12/31/01 | Average Quarterly LTD Ratio |
|--------------------------------------|------------------------|------------------------------------|
| First State Bank of Clearbrook | \$24 Million | 74% |
| American State Bank of Erskine | \$19 Million | 73% |
| First National Bank of Bagley | \$59 Million | 66% |
| The First National Bank in Mahnomen | \$47 Million | 58% |
| The Northern State Bank of Gonvick | \$33 Million | 50% |
| First National Bank of McIntosh | \$24 Million | 38% |
| Ultima Bank Minnesota | \$44 Million | 38% |

Responses to Complaints

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

Fair Lending Review

An analysis of three years public comments, consumer complaint information, and HMDA data 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 1997.