



PUBLIC DISCLOSURE

June 22, 1998

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**Heritage Bank, National Association
Charter Number: 15401**

**310 1st Street Southwest
Willmar, Minnesota**

**Office of the Comptroller of the Currency
Omaha Field Office
11606 Nicholas Street #201
Omaha, Nebraska 68154**

NOTE: 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.

GENERAL INFORMATION

The Community Reinvestment Act (CRA) requires each federal financial supervisory agency to use its authority when examining financial institutions subject to its supervision, to assess the 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. Upon conclusion of such examination, the agency must prepare a written evaluation of the institution's record of meeting the credit needs of its community.

*This document is an evaluation of the Community Reinvestment Act (CRA) performance of **Heritage Bank, National Association, Willmar, Minnesota** prepared by **The Office of the Comptroller of the Currency**, the institution's supervisory agency, as of **June 22, 1998**. The agency rates the CRA performance of an institution consistent with the provisions set forth in Appendix A to 12 CFR Part 25.*

INSTITUTION'S CRA RATING: This institution is rated **Outstanding**.

Heritage Bank, National Association's rating is based on the following factors:

- The record of extending credit to businesses, farms of different sizes, and individuals of different income levels is outstanding.
- Heritage is a leader in credit programs which benefit both individuals and small businesses.
- The bank has a strong commitment to lending. This is evidenced by strong loan growth and a high loan-to-deposit ratio.

DESCRIPTION OF INSTITUTION

Heritage Bank, National Association (Heritage) is an \$80 million bank located in Kandiyohi County in west central Minnesota. It is a full service bank offering a variety of loan and deposit products. The bank has a branch in Pennock, Minnesota, 5 miles from Willmar, and an automated teller machine.

The primary lending focus is residential real estate, agricultural, and commercial loans. As of March 31, 1998, gross loans represent 70% of total assets. The loan portfolio distribution includes 32% one-to-four family real estate, 36% commercial and commercial real estate, 24% agricultural, and the balance in consumer and miscellaneous loans.

The bank is owned by Heritage Bancshares, Inc, a one bank holding company. Through common ownership, the bank is affiliated with Heritage Bank, N.A. in Holstein, IA.

Heritage was rated "Outstanding Record of Meeting Community Credit Needs" at the last CRA examination dated January 27, 1995. There are no legal or financial impediments limiting Heritage's ability to help meet the credit needs of the area it serves.

During the examination process, we contacted the Kandiyohi County Economic Development Partnership, Inc. and with a local Realtor. A review of past Kandiyohi County community contacts was also completed. All contacts stated that local banks were active participants in existing programs and were also innovators in establishing new credit programs. One contact specifically mentioned Heritage as an excellent resource for the Small Business Administration (SBA) 7a loan program.

DESCRIPTION OF HERITAGE NATIONAL BANK'S ASSESSMENT AREA

The bank's assessment area (AA) includes all of Kandiyohi County and is not in a Metropolitan Statistical Area. The AA meets the requirements of the regulation and does not arbitrarily exclude low- or moderate-income geographies. Based on 1990 census data information, 14,327 families reside in the AA with a median family income of \$30,269. The AA contains twelve block numbering areas (BNAs). Ten of these are considered middle income and two are considered upper income.

The local economy in Kandiyohi County is reliant on agriculture and smaller

manufacturing industries. The community of Willmar, with a population of approximately 18,000, is the largest city in the county and is a growing regional center for industry, health care, education, government, and retail/wholesale trade.

Primary employers are two large poultry companies and the local hospital and school district. Competition within the AA includes First American Bank of Willmar, US Bank of Willmar, Norwest Bank of Willmar, and several smaller institutions.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA:

Loan-to-Deposit Ratio

The bank has a strong commitment to lending. The bank’s December 31, 1997 Loan-to-Deposit (LTD) ratio is 80% and the quarterly LTD ratio has averaged 74% since the last CRA examination. Loan growth in 1997 was 22% following growth of 40% in 1996. Areas of greatest growth were in 1-4 family residential real estate and loans to small businesses. The bank also sold \$34.2 million in 1-4 family and \$15.7 million in SBA loans in 1997 and year-to-date 1998.

Heritage is one of the leading originators of residential mortgages and SBA loans in its assessment area. Heritage participates with several programs to sell real estate loans. The following table identifies the secondary market outlet and the dollar volume of loans sold from January 1, 1997 to May 31, 1998.

Secondary Market Outlet Residential Real Estate Loans	\$ Volume - 1/1/97 thru 5/31/98 (000s)
Federal Home Loan Mortgage Corporation	\$24,850
Norwest Mortgage	\$6,697
Minnesota Housing Finance Agency (MHFA)	\$1,739
U.S. Department of Agriculture - Rural Development (USDA)	\$874
Total	\$34,160

Heritage is very active in SBA lending, consistently being one of the top SBA lenders

in the state. Heritage is the number six originator of SBA loans in the state of Minnesota. All of the financial institutions ranking higher than Heritage are significantly larger. Through May 31, 1998, the active balance on SBA loans was slightly more than \$21 million. Heritage sells the guaranteed portion of these loans which is generally 75% of the loan balance. Approximately \$15.7 million of the \$21 million have been sold.

Adjusting the LTD ratio to include the real estate and SBA sold loans would increase the LTD ratio significantly.

Lending to Borrowers of Different Incomes and to Businesses of Different Sizes in the Assessment Area

Heritage has an excellent record of lending to individuals of different income levels and businesses of all sizes. The bank participates in several programs that target low- and moderate-income borrowers and small businesses. These programs include Minnesota Housing Finance Agency, United States Department of Agriculture Rural Development, Kandiyohi County Rural Development Finance Authority, and the Small Business Administration.

Business and Small Farm Loans

Heritage is a state leader in SBA lending. SBA loans total \$21 million. In SBA's most recent reporting period from October 1996 to September 1997, Heritage is the sixth leading originator of SBA loans among financial institutions in the state of Minnesota. During this period Heritage originated 30 loans for a total of \$8,547,900. This is a substantial amount of activity for an \$80 million community bank.

The next table illustrates loans to various businesses and farmers within the bank's AA. Our sample included 40 loans totaling \$2,761,652 originated during 1997 through May 31, 1998. This represents 12% of the total number and 24% of the total dollar volume of loans extended during this time frame. Eighty percent of the number of loans sampled were to businesses and farms with gross sales less than \$1 million.

Annual Gross Sales (000's)	% Number of Loans Sampled	% Dollar Volume Sampled
\$100 or less	12.5%	1.5%
\$101 - \$250	25%	7.7%
\$251 - \$1,000	42.5%	59.5%
> \$1,000	20%	31.5%

Heritage is also active in the Kandiyohi County Rural Development Finance Authority's Industrial Initiatives Loan Program. All banks in the county participate in this program in which individuals, businesses, government entities, and financial institutions deposit funds in local banks. These funds are then used for new or existing industrial and manufacturing businesses at a preferred interest rate. Since December 31, 1995, this program has originated 19 loans totaling nearly \$1.7 million. Heritage has been the direct lender in 26% of these loans.

Consumer and Residential Real Estate Loans

The following table illustrates a strong commitment to low- and moderate-income consumer instalment lending. We sampled 40 loans within the AA totaling \$276,951. This represents 6.5% of the total number and 7.5% of the dollar volume of consumer instalment loans originated during 1997 through May 31, 1998. The table below reflects the distribution of these loans by income levels in comparison to 1990 census data information:

Income Level	% Families in the AA (1990 Census Data)	% Number of Loans Sampled	% Dollar Volume Loans Sampled
Low-Income < 50% Median Family income*	16%	37.5%	28%
Moderate-Income at least 50% < 80% Median Family Income*	17%	30%	29%
Middle-Income at least 80% < 120% Median Family Income*	25.5%	10%	16.5%
Upper-Income 120% and > Median Family Income*	41.5%	22.5%	26.5%

* 1998 Outstate Median Family Income \$40,500

The following table illustrates substantial penetration in low- and moderate income residential real estate lending activities. Our sample included loans made within the bank's AA. We sampled 40 loans within the AA totaling \$2,966,865. This represents 9% of the total number and 8% of the dollar volume of residential real estate loans originated during 1997 through May 31, 1998. The table below reflects the distribution of these loans by income levels in comparison to 1990 census data information.

Our assessment of the bank's performance in this category placed a high level of significance on the bank's notable volume of residential real estate lending. For the sample period the bank originated 425 loans for the secondary market totaling \$34.2 million.

Income Level	% Families in the AA (1990 Census Data)	% Number of Loans Sampled	% Dollar Volume Loans Sampled
Low-Income < 50% Median Family income*	16%	7.5%	4.5%
Moderate-Income at least 50% < 80% Median Family Income*	17%	20%	23.5%
Middle-Income at least 80% < 120% Median Family Income*	25.5%	25%	30%
Upper-Income 120% and > Median Family Income*	41.5%	47.5%	42%

* 1998 Outstate Median Family Income \$40,500

The bank is a leader in programs making real estate loans available to low- to moderate-income borrowers. Demographics of the bank's assessment area show that 9% of the families have income that is below the poverty level. As a way to increase lending residential real estate lending to low- and moderate-income borrowers, Heritage participates in the following two housing programs that directly benefit *only* low- and moderate-income individuals:

The MHFA loan program allows borrowers to purchase homes only if their income is below maximum thresholds. These thresholds equal approximately 80% of the median income. Heritage made 37 loans at an average of \$47 thousand each from January 1, 1997 to May 31, 1998. This volume represented 59% of the total number of these loans made in Kandiyohi County.

Participants in the USDA Rural Development loan program must also have income below a maximum threshold amount. Heritage is very active in this program and originated 23 loans at an average of \$38 thousand each from January 1, 1997 to May 31, 1998.

Lending in the Assessment Area

A majority of the loans the bank originates are in the AA. This was determined by using a bank generated report which lists all new loans originated during 1997 through May 31, 1998. These loans were reviewed by address to determine which ones were made within the AA. The table below illustrates the bank’s lending activities within its AA.

	Loans Originated
Total number of Loans Originated	1,926
Number of Loan Originations in AA	1,563
Percentage in AA	81%
Total Dollar of Total Loans Originated	\$69,235,000
Dollar of Loans Originated in AA	\$49,828,000
Percentage in AA	72%

Geographic Distribution of Loans

An analysis of the geographic distribution of loans among different income geographies is not meaningful. Of the bank’s 12 BNA’s, 10 are middle income and 2 are upper income.

Record of Response to Complaints

Heritage received no complaints concerning its performance in meeting the credit needs of its AA.

Record of Compliance with Anti-discriminatory laws

Based on our review, the bank is complying with anti-discriminatory laws. We found no substantive violations of the fair lending laws.

