



## **PUBLIC DISCLOSURE**

June 23, 2015

### **COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION**

The Farmers and Merchants National Bank of Hatton  
Charter Number 7905

415 7th Street  
Hatton, ND 58240

Office of the Comptroller of the Currency

222 South Ninth Street  
Suite 800  
Minneapolis, MN 55402-3393

**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.

**INSTITUTION'S CRA RATING: This institution is rated Satisfactory**

The major factors that support this rating include:

- The bank's average loan-to-deposit (LTD) ratio is reasonable given the bank's size, financial condition, and the credit needs of its assessment area (AA).
- The bank originates a substantial majority of loans inside its AA.
- The bank has excellent dispersion among farms of different sizes and reasonable dispersion among consumers of different income levels in the Hatton AA.
- The bank has excellent geographic dispersion throughout the Fargo AA.

**SCOPE OF EXAMINATION**

We evaluated The Farmers & Merchants National Bank of Hatton's (FMNB) Community Reinvestment Act (CRA) performance using small bank procedures. The bank's CRA performance was assessed under the lending test and focused on the bank's primary loan products based on loans originated and purchased from January 1, 2013 to December 31, 2014. We determined the bank's primary products to be agriculture and consumer loans in the Hatton AA and commercial loans in the Fargo MSA AA. We reviewed all agriculture and consumer loans in the Hatton AA and selected a random sample of 20 commercial loans from the Fargo MSA AA to determine the bank's lending activity within its AAs. The following table shows loan originations by number and dollar volume:

| <b>Loan Originations and Purchases in 2013 and 2014 in Hatton AA</b> |                    |                     |
|--|--------------------|---------------------|
| <i>Loan Type</i>   | <i>Volume by #</i> | <i>Volume by \$</i> |
| <b>Farm</b>  | <b>17%</b>         | <b>75%</b>          |
| Commercial   | 23%                | 19%                 |
| <b>Consumer</b>  | <b>60%</b>         | <b>6%</b>           |
| Home Mortgage  | 0%                 | 0%                  |

*Source: Bank loan origination report for 2013 and 2014*

| <b>Loan Originations and Purchases in 2013 and 2014 in Fargo MSA</b> |                    |                     |
|--|--------------------|---------------------|
| <i>Loan Type</i>   | <i>Volume by #</i> | <i>Volume by \$</i> |
| Farm   | 12%                | 18%                 |
| <b>Commercial</b>  | <b>58%</b>         | <b>73%</b>          |
| Consumer   | 30%                | 9%                  |
| Home Mortgage  | 0%                 | 0%                  |

*Source: Bank loan origination report for 2013 and 2014*

We used call report data to determine the bank's quarterly LTD ratio and annual deposit information reported to the Federal Deposit Insurance Corporation to find similarly situated banks. The most recent deposit information is as of June 30, 2014.

## **DESCRIPTION OF INSTITUTION**

FMNB is a \$24 million bank chartered in Hatton, ND. The bank is wholly owned by Hatton Bancshares, Inc., a one-bank holding company headquartered in Fargo, ND. FMNB has two full service locations. The bank operates its main office in Hatton, ND and one branch in Fargo, ND. There have been no branch openings or closing since the previous CRA examination. The bank does not have any automated teller machines.

FMNB offers a variety of loan and deposit products. As of March 31, 2015, the loan portfolio totaled \$18 million and consisted of 62 percent commercial, 22 percent agricultural, 11 percent residential real estate, and 5 percent consumer loans. FMNB's total loans and leases account for 75 percent of total assets.

There are no legal or financial factors that impede FMNB's ability to meet the credit needs of its AA. FMNB was rated Satisfactory at the last CRA examination dated October 28, 2009.

## **DESCRIPTION OF ASSESSMENT AREA(S)**

FMNB has two designated AAs, consisting of the Fargo MSA AA and the Hatton Non-MSA AA. Both AAs meet the requirements of the regulation and do not arbitrarily exclude any low- or moderate-income areas.

### **Hatton, ND AA**

FMNB's Hatton AA consists of three census tracts (CTs), including all of Steele County and a portion of Traill County in eastern North Dakota. All three CTs are designated as middle-income. The table of the following page shows demographic information for the Hatton AA.

| <b>DEMOGRAPHIC AND ECONOMIC CHARACTERISTICS OF THE HATTON AA</b> |          |
|--|----------|
| Population   |          |
| Number of Families   | 1,943    |
| Number of Households   | 2,945    |
| % of Low-Income Families   | 13.79%   |
| % of Moderate-Income Families                                    | 22.85%   |
| % of Middle-Income Families                                      | 21.36%   |
| % of Upper-Income Families                                       | 42.00%   |
| Geographies  |          |
| Number of Census Tracts  | 3        |
| % Low-Income Census Tracts                                       | 0%       |
| % Moderate-Income Census Tracts                                  | 0%       |
| % Middle-Income Census Tracts                                    | 100%     |
| % Upper-Income Census Tracts                                     | 0%       |
| <i>Median Family Income (MFI)</i>                                |          |
| 2010 MFI for AA  | \$58,592 |
| 2014 HUD-Adjusted MFI  | \$64,200 |
| Economic Indicators  |          |
| 2010 Median Housing Value  | \$80,201 |
| % of Households Below Poverty Level                              | 9.17%    |

*Source: 2010 U.S. Census data with updated information when available*

Economic conditions in the AA are favorable. The economy is primarily supported by services and agricultural businesses. According to the US Bureau of Labor Statistics, the unemployment rate is 3.4 percent and 4.1 percent in Steele and Traill Counties, respectively. This is comparable to the state of North Dakota's unemployment rate of 3.8 percent.

Competition among financial institutions within the AA is moderate. According to the June 30, 2014 FDIC Deposit Market Share report, there are nine deposit taking financial institutions located in the AA. FMNB ranks seven in deposit market share among the nine institutions. The bank's market share was 4.19 percent or \$14 million.

We contacted a local community organization in the AA to gain a better understanding of the local economy, assess area credit needs, and the involvement of local financial institutions. According to the contact, the primary credit need in the AA is competitive rates for agricultural lending. The contact indicated that the local financial institutions are adequately meeting the credit needs of the community.

**Fargo MSA AA**

The Fargo ND-MN MSA consists of 46 CTs encompassing all of Cass County in North Dakota and all of Clay County in Minnesota. The Fargo MSA includes 2 low-, 7 moderate-, 28 middle-, and 9 upper-income CTs.

The following table shows demographic information for the Fargo MSA AA:

| <b>DEMOGRAPHIC AND ECONOMIC CHARACTERISTICS OF THE FARGO MSA AA</b> |           |
|---|-----------|
| Population  |           |
| Number of Families  | 48,919    |
| Number of Households  | 84,600    |
| % of Low-Income Families  | 18.15%    |
| % of Moderate-Income Families                                       | 17.92%    |
| % of Middle-Income Families   | 24.84%    |
| % of Upper-Income Families  | 39.09%    |
| Geographies   |           |
| Number of Census Tracts   | 46        |
| % Low-Income Census Tracts  | 4.35%     |
| % Moderate-Income Census Tracts                                     | 15.22%    |
| % Middle-Income Census Tracts                                       | 60.87%    |
| % Upper-Income Census Tracts  | 19.57%    |
| <i>Median Family Income (MFI)</i>                                   |           |
| 2010 MFI for AA   | \$67,695  |
| 2014 HUD-Adjusted MFI   | \$72,100  |
| Economic Indicators   |           |
| 2010 Median Housing Value   | \$146,683 |
| % of Households Below Poverty Level                                 | 13.94%    |

*Source: 2010 U.S. Census data with updated information when available*

Economic conditions in the AA are favorable. The population of the area increased by 43 percent since the last CRA evaluation. According to the US Bureau of Labor Statistics, the unemployment rate is 3.3 percent in the Fargo ND-MN MSA. This is lower than the state of Minnesota's unemployment rate of 4.5 percent and the state of North Dakota's unemployment rate of 3.8 percent. Major industries in the area include agricultural, services, and retail trade.

Competition among financial institutions within the AA is strong. According to the June 30, 2014 FDIC Deposit Market Share report, there are 27 deposit taking financial institutions located in the AA. FMNB ranks 26 in deposit market share among the 27 institutions. The bank's market share was 0.10 percent or \$6 million.

We contacted a local community organization in the AA to gain a better understanding of the local economy, assess area credit needs, and the involvement of local financial

institutions. According to the contact, the primary credit need in the AA is competitive rates for agricultural lending. The contact indicated that the local financial institutions are adequately meeting the credit needs of the community.

## CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

### Loan-to-Deposit Ratio

FMNB's LTD ratio is reasonable given the bank's size and the credit needs of the AAs. The bank's quarterly average LTD ratio is 76 percent for the 22 quarters since the previous CRA evaluation. The ratio ranged from a high of 88 percent during the third quarter of 2014 to a low of 58 percent during the first quarter of 2013. The bank's average LTD ratio is comparable to similarly situated banks. The following table shows FMNB's average LTD ratio compared to four other similarly situated financial institutions:

| <b>Loan-to-deposit Ratio<br/>Institution (Headquarters)</b> | <b>Assets as of<br/>3/31/15</b> | <b>Average LTD Ratio<br/>4Q2009 – 1Q2015</b> |
|---|---------------------------------|--|
| Union State Bank of Fargo                                   | \$87 Million                    | 102%   |
| <b>Farmers and Merchants National Bank of<br/>Hatton</b>    | <b>\$24 Million</b>             | <b>76%</b>                                   |
| The First and Farmers Bank                                  | \$55 Million                    | 73%  |
| Harwood State Bank  | \$36 Million                    | 68%  |
| Kindred State Bank  | \$33 Million                    | 42%  |

*Source: Call Report data as of March 31, 2015.*

### Lending in Assessment Area

The bank originates a substantial majority of its loans inside their AAs. Based on our review of agricultural, consumer, and commercial products, FMNB originated 84 percent of loans by number and 97 percent by dollar amount within their AAs. The following table shows loans originated inside and outside FMNB's AAs by number and dollar volume:

| <b>Lending in AAs</b> |                 |     |         |     |       |                         |     |         |     |         |
|-----------------------|-----------------|-----|---------|-----|-------|-------------------------|-----|---------|-----|---------|
|                       | Number of Loans |     |         |     |       | Dollars of Loans (000s) |     |         |     |         |
| Loan Type             | Inside          |     | Outside |     | Total | Inside                  |     | Outside |     | Total   |
|                       | #               | %   | #       | %   |       | \$                      | %   | \$      | %   |         |
| Agricultural          | 7               | 78% | 2       | 22% | 9     | \$2,015                 | 99% | \$29    | 1%  | \$2,044 |
| Consumer              | 16              | 80% | 4       | 20% | 20    | \$68                    | 54% | \$58    | 46% | \$126   |
| Commercial            | 18              | 90% | 2       | 10% | 20    | \$4,746                 | 98% | \$108   | 2%  | \$4,854 |
| Totals                | 41              | 84% | 8       | 16% | 49    | \$6,829                 | 97% | \$195   | 3%  | \$7,024 |

Source: Agricultural loan review, Consumer loan review, and Commercial loan sample

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

#### Hatton AA

The distribution of loans reflects excellent penetration among farms of different sizes. FMNB originated 100 percent of loans to farms with revenues of less than \$1 million. This exceeds the demographic comparative of 98 percent. The following table shows FMNB's lending performance to farms of different sizes:

| <b>Borrower Distribution of Loans to Farms in the Hatton AA</b> |              |              |                         |       |
|---|--------------|--------------|-------------------------|-------|
| Farm Revenues (or Sales)  | ≤\$1,000,000 | >\$1,000,000 | Unavailable/<br>Unknown | Total |
| % of AA Businesses  | 98%          | 1%           | 1%                      | 100%  |
| % of Bank Loans in AA by #                                      | 100%         | 0%           | 0%                      | 100%  |
| % of Bank Loans in AA by \$                                     | 100%         | 0%           | 0%                      | 100%  |

Source: Agricultural loan review and 2014 Business Geodemographic Data

The distribution of loans reflects reasonable penetration among borrowers of different incomes. While lending to moderate-income borrowers is below the demographic comparative, lending to low-income borrowers greatly exceeds the demographic comparative. The following table shows the distribution of consumer loans among borrowers of different income levels:

| <b>Borrower Distribution of Consumer Loans in the Hatton AA</b> |                     |                      |                     |                      |                     |                      |                     |                      |
|---|---------------------|----------------------|---------------------|----------------------|---------------------|----------------------|---------------------|----------------------|
| Borrower Income Level   | Low                 |                      | Moderate            |                      | Middle              |                      | Upper               |                      |
| Loan Type   | % of AA House holds | % of Number of Loans | % of AA House holds | % of Number of Loans | % of AA House holds | % of Number of Loans | % of AA House holds | % of Number of Loans |
| Consumer  | 14%                 | 65%                  | 23%                 | 16%                  | 21%                 | 13%                  | 42%                 | 6%                   |

Source: Consumer loan review and 2014 Business Geodemographic Data

**Lending to Businesses of Difference Sizes**

**Fargo AA**

The distribution of loans reflects poor penetration among businesses of different sizes. Lending to small businesses is considerably less than the demographic comparative. Strong competition with other lending institutions and increased economic growth in the area has made it difficult for FMNB to lend to businesses of different sizes. The following table shows the distribution of business loans:

| <b>Borrower Distribution of Loans to Businesses in the Fargo MSA</b> |              |              |                     |       |
|--|--------------|--------------|---------------------|-------|
| Business Revenues (or Sales)   | ≤\$1,000,000 | >\$1,000,000 | Unavailable/Unknown | Total |
| % of AA Businesses   | 71%          | 7%           | 23%                 | 100%  |
| % of Bank Loans in AA by #   | 48%          | 52%          | 0%                  | 100%  |
| % of Bank Loans in AA by \$  | 46%          | 54%          | 0%                  | 100%  |

*Source: Commercial loan sample and 2014 Business Geodemographic Data*

**Geographic Distribution of Loans**

**Hatton AA**

Geographic distribution analysis is not meaningful as only middle-income CTs are located within the AA.

**Fargo AA**

The geographic distribution of commercial loans reflects excellent dispersion throughout the AA. FMNB’s lending in moderate-income CTs exceeds the demographic comparative. While FMNB’s lending in low-income CTs is below the demographic comparative, only 3 percent of businesses are located in low-income CTs, making it difficult to lend in these CTs. The following table shows the bank’s performance as compared to the percentage of businesses in each income level:

| <b>Geographic Distribution of Loans to Businesses in Fargo MSA</b> |                    |                 |                    |                 |                    |                 |               |                 |
|--|--------------------|-----------------|--------------------|-----------------|--------------------|-----------------|---------------|-----------------|
| Census Tract Income Level  | Low                |                 | Moderate           |                 | Middle             |                 | Upper         |                 |
| Loan Type  | % of AA Businesses | % of # of Loans | % of AA Businesses | % of # of Loans | % of AA Businesses | % of # of Loans | % of AA Farms | % of # of Loans |
| Commercial   | 3%                 | 0%              | 20%                | 35%             | 53%                | 18%             | 23%           | 47%             |

*Source: Commercial Loan Sample and 2014 Business Geodemographic Data*

**Responses to Complaints**

The bank has not received any complaints regarding its CRA performance since the last CRA evaluation dated October 28, 2009.

## **Fair Lending or Other Illegal Credit Practices Review**

Pursuant to 12 C.F.R. 25.28(c), or 12 C.F.R. 195.28(c), in determining a national bank's CRA rating the OCC considers evidence of discriminatory or other illegal credit practices in any geography by the bank, or in any assessment area by an affiliate whose loans have been considered as part of the bank's or FSA's lending performance.

We found no evidence of discriminatory or other illegal credit practices inconsistent with helping to meet community credit needs.