

**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 the 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 CRA performance of Farmers State Bank of Montana, Conrad, Montana, prepared by the Federal Reserve Bank of Minneapolis, the institution's supervisory agency, as of June 10, 1996. The agency rates the CRA performance of an institution consistent with the provisions set forth in Appendix A to 12 CFR Part 228.*

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

The CRA evaluation revealed several factors that support rating the bank's CRA performance satisfactory. First, the bank's loan-to-deposit ratio is reasonable given the credit demands and demographics of its assessment area. Second, the bank has originated a majority of its loans to assessment area residents. Third, the bank actively extends loans to low- and moderate-income individuals and to small farms and businesses. Finally, the bank has a reasonable distribution of loans within its assessment area.

The following table indicates the performance level of Farmers State Bank of Montana, Conrad, Montana, with respect to each of the five performance criteria.

SMALL INSTITUTION ASSESSMENT CRITERIA	FARMERS STATE BANK OF MONTANA CONRAD, MONTANA PERFORMANCE LEVELS		
	Exceeds Standards for Satisfactory Performance	Meets Standards for Satisfactory Performance	Does Not Meet Standards for Satisfactory Performance
Loan-to-Deposit Ratio		X	
Lending in Assessment Area	X		
Lending to Borrowers of Different Incomes and to Businesses of Different Sizes	X		
Geographic Distribution of Loans		X	
Response to Complaints	The bank has not received any CRA complaints since the last evaluation.		

#### **DESCRIPTION OF INSTITUTION**

Based on its size and financial condition, the bank is able to meet the credit needs of its assessment area effectively. The bank was rated satisfactory in helping to meet the credit needs of its community at its previous CRA evaluation. The bank operates a full-service office in Conrad and a full-service branch in the town of Cut Bank, Montana, approximately 45 miles northwest of Conrad. The bank also operates three cash-dispensing automated teller machines in its assessment area. The branch in Cut Bank was acquired through a merger that was finalized in March 1996.

According to its March 31, 1996, Report of Condition ("ROC"), the bank's assets totaled approximately \$92.9 million. The March 31, 1996, ROC indicates that the bank is primarily an agricultural lender; approximately 50% of its loan portfolio is composed of agricultural loans. The balance of the bank's loan portfolio is composed of 21% commercial, 11% consumer, 17% consumer real estate, and 1% other loans. The composition of the bank's loan portfolio reflects the level of demand for specific types of loans by members of the assessment area.

The bank offers a variety of loan products to fulfill the credit needs of residents and businesses within its assessment area. It extends consumer open- and closed-end, residential real estate, mobile home, agricultural, and commercial loans. In addition to these conventional loan products, the bank offers Small Business Administration, consumer real estate loans guaranteed through the Montana Board of Housing ("MBH") and Rural Economic Community Development ("RECD"), and government-guaranteed student loans.

#### **DESCRIPTION OF FARMERS STATE BANK OF MONTANA'S ASSESSMENT AREA**

The bank has defined its assessment area as Pondera, Toole, and Liberty counties and portions of Glacier and Teton counties in northwestern Montana. The assessment area contains block numbering areas ("BNA") 9760, 9761, 9762, 9745, 9746, 9770, 9771, 9714, 9716.98, 9750, and 9751. BNA 9762 is designated as low income. The remaining BNAs within the assessment area are classified as middle income.

The bank's assessment area is known as the Golden Triangle because of the excellent soil and weather conditions, which result in productive farming conditions. The communities within the assessment area include Conrad, Shelby, Cut Bank, and Browning, Montana. According to 1990 census data, the population of the assessment area is 30,286. The bank's assessment area also includes the Blackfeet Indian Reservation ("Reservation"). The Blackfeet Indian Nation has approximately 14,630 members, 8,208 of whom reside on the Reservation.

CRA divides income levels into four categories: low, moderate, middle, and upper income. Because the bank's assessment area is not located in a metropolitan statistical area, the categorization of a borrower or BNA's income is determined relative to the statewide nonmetropolitan median family income. Pursuant to CRA's definitions, low-income individuals have incomes of less than 50% of the statewide nonmetropolitan median family income, while moderate-income individuals have incomes of at least 50% but less than 80% of this amount. The regulation defines middle-income individuals as persons with an income of at least 80% but less than 120% of the statewide nonmetropolitan median family income. Individuals with incomes of 120% or more of the statewide nonmetropolitan median family income are classified as upper-income persons. BNAs are classified using similar categories based on the level of the median family income in the geography. According to the 1995 updated census data, the statewide nonmetropolitan median family income in Montana is \$32,200.

According to 1990 census data, the assessment area's median family income is

\$26,314, while its median household income is \$21,781. There are 7,490 families and 10,300 households in the assessment area. Approximately 18% of the families and 19% of the households in the assessment area have incomes below the poverty level. The distribution of family and household incomes for the assessment area is summarized in the following table.

<b>ASSESSMENT AREA POPULATION DISTRIBUTION BY INCOME LEVEL</b>				
<b>Unit of Measure</b>	<b>Low Income</b>	<b>Moderate Income</b>	<b>Middle Income</b>	<b>Upper Income</b>
Households Compared to Median Family Income	26%	16%	17%	41%
Families Compared to Median Family Income	25%	17%	22%	36%

Examiners contacted local and tribal government representatives familiar with the assessment area as part of the bank's CRA evaluation. Information obtained from these contacts was used to evaluate the bank's CRA performance.

According to bank management and community contacts, the economy in the bank's assessment area is agriculture-based and is generally strong and stable. The main industries in the western and eastern areas are cattle ranching and farming, respectively. The good soil and weather conditions have resulted in high yields for area farmers in past years. As a result, the community is generally considered to be quite prosperous. The main crops are wheat and barley, but canola, alfalfa, and malt barley are also grown. It is anticipated that low cattle prices this year will adversely affect ranchers. High grain prices, however, will benefit farmers, somewhat mitigating the negative effect on the local economy.

The Reservation occupies a sizable portion of the bank's assessment area, encompassing most of Glacier County and a small portion of western Pondera County. The Reservation has approximately 8,208 residents. Browning, the Reservation's main town and the seat of the tribal government, is approximately 45 miles west of the town of Cut Bank, where the bank's branch is located. Between 50% and 70% of the residents of the Reservation are considered low or moderate income. The tribe is the major employer of tribal members. Farming and ranching are also major sources of employment. There are approximately 724 Indian ranchers and farmers on the Reservation. An additional 375 tribal members are employed in farming or ranching. According to a tribal contract, as of May 1996, approximately 41% of the Reservation's eligible work force was unemployed. Contacts on the Reservation also stated that the development of a retail and service sector on the Reservation is a pressing need.

According to another contact, affordable housing is in short supply in the assessment area because of an influx of people migrating to the area from the West, mainly California. Adequate housing is in particularly short supply on the Reservation. Most residents of the Reservation, however, rent housing from the tribe. Unemployment outside the Reservation tends to be low. The area farms, ranches, and small businesses seem to provide sufficient employment opportunities for the majority of the residents of the assessment area.

#### **CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA**

The bank's performance in meeting the credit needs in its assessment area is considered satisfactory. The following criteria were analyzed to determine this rating.

Loan-to-Deposit Ratio Analysis

The bank's loan-to-deposit ratio meets the standards for satisfactory performance. The bank's quarterly loan-to-deposit ratio is relatively low and has fluctuated between 40% and 51% since the previous evaluation. Based on the March 31, 1996, Uniform Bank Performance data, the bank's loan-to-deposit ratio is lower than many of its peers. Based on the data for the seven calendar quarters since the previous evaluation, the quarterly average of the bank's net loan-to-deposit ratio is 45%. The following chart summarizes the bank's loan-to-deposit ratio and its components.

<b>DATE</b>	<b>NET LOANS (In thousands)</b>	<b>DEPOSITS (In thousands)</b>	<b>NET LOAN-TO- DEPOSIT RATIO</b>
March 31, 1996*	\$37,847	\$83,773	45%
December 31, 1995	\$24,227	\$54,877	44%
September 30, 1995	\$27,044	\$52,790	51%
June 30, 1995	\$26,188	\$51,938	50%
March 31, 1995	\$21,989	\$53,640	41%
December 31, 1994	\$21,989	\$54,884	40%
September 30, 1994	\$23,256	\$52,697	44%

\*The bank's branch merger was finalized in March 1996.

The bank's average loan-to-deposit ratio is below the quarterly average ratios of four of its local competitors. Based on quarterly ROC data, the following table identifies asset size and quarterly average loan-to-deposit ratios for the bank and its competitors.

<b>BANK</b>	<b>TOTAL ASSETS March 31, 1996 (In thousands)</b>	<b>QUARTERLY AVERAGE LOAN-TO-DEPOSIT RATIO</b>
Subject Bank	\$92,952	45%
Competitor A	\$17,533	61%
Competitor B	\$27,322	47%
Competitor C	\$14,546	63%
Competitor D	\$51,818	60%

Bank management attributes its low quarterly loan-to-deposit ratio to several factors. Conrad is a fairly affluent area with many retired residents, resulting in larger deposit accounts and low demand for real estate and consumer loans. Because the majority of the bank's portfolio is agricultural loans, the loan-to-deposit ratio fluctuates with the agriculture market. Typically, loans increase between March and September and deposits decrease during the same period. The inverse occurs between September and December, when agricultural loan lines are paid down and deposits increase. The bank's seasonal lending low usually occurs in January. The Loan-to-Deposit Ratio chart on page 5 shows that the bank's loan-to-deposit ratio increased by ten percentage points between March and September 1995. Management attributes this increase to a combination of factors including seasonal loan demand and an aggressive agricultural loan department which resulted in several new agricultural loan lines. Additionally, the bank faces strong competition from a number of area lenders.

Despite being low, the bank's loan-to-deposit ratio appears reasonable and meets the standards for satisfactory performance given the demographic characteristics of its assessment area. It appears that the bank's lending activities are restricted by community demographic factors and market competition, and its loan-to-deposit ratio is not indicative of a lack of willingness to extend credit to local residents and businesses or any unmet credit needs.

#### Lending in the Assessment Area

A review of a statistical sample of the loans originated by the bank in the past year reveals that a substantial majority of its loans were made inside its assessment area. The following table shows the percentages for number and dollar volume of major loan product lines that were inside the assessment area.

PERCENTAGE OF LOANS IN THE ASSESSMENT AREA		
Major Loan Product Lines	Total Number of Loans	Total Dollar Amount of Loans
Consumer Real Estate	100	100
Consumer Loans	91	91
Agricultural and Commercial	92	95

This level of concentration in the assessment area exceeds standards for satisfactory performance. As noted in the table, the vast majority of all the bank's loans are within the assessment area. Because agricultural and commercial loans comprise the bank's stated focus, the high percentage of loans and loan amounts in this category is especially significant.

Lending to Borrowers of Different Income Levels and to Businesses of Different Sizes

The bank's level of lending to individuals of different incomes and to businesses of different sizes exceeds the standards for satisfactory performance. As discussed, the CRA classifies income levels into four categories: low, moderate, middle, and upper income. The median household and family incomes for the bank's assessment area are \$21,781 and \$26,314, respectively. Both figures are below the statewide nonmetropolitan household and family incomes for the state of Montana. These low figures are due to the presence of the Reservation in the bank's assessment area, where approximately 41% of the residents are unemployed. The following table shows the percentage of consumer loans made to borrowers of different income levels.

DISTRIBUTION OF LOANS IN THE ASSESSMENT AREA BY BORROWER INCOME LEVELS*				
Loan Type	Low-Income Borrowers	Moderate-Income Borrowers	Middle-Income Borrowers	Upper-Income Borrowers
<u>Consumer</u>				
Total Number of Loans	40%	26%	16%	18%
Total Amount of Loans	30%	21%	22%	28%
<u>Consumer Real Estate</u>				
Total Number of Loans	11%	27%	30%	32%
Total Amount of Loans	5%	18%	19%	53%
*Income level is determined based on Montana's 1995 nonmetropolitan median family income of \$32,200.				

The data reveals that the bank extends a large percentage of its consumer loans to low- and moderate-income borrowers. Low- and moderate-income households comprise 41.8% of the bank's assessment area. More specifically, low- and moderate-income households represent 25.6% and 16.2% of the local population, respectively. Approximately 43% of the low- and moderate-income households in the assessment area are in Glacier County, which is composed largely of the Reservation. Approximately 90% of the low-income households in Glacier County have incomes below the poverty line. Consumer loans to low- and moderate-income borrowers represented 66% of the number and 51% of the total amount of loans in the sample. Likewise, consumer real estate loans to low- and moderate-income borrowers comprised 38% of the total number and 23% of the total amount of the loans sampled. This is noteworthy because both bank management and contacts stated that there is a shortage of affordable housing in the area. Given the demographic data of the area, the bank's

record of lending to low- and moderate-income borrowers is commendable.

The bank also has an excellent record of lending to small businesses and small farms. Approximately 96% of the number and 88% of the total dollar amount of the loans sampled were made to small farms or businesses. Of these loans, 86% were made in amounts under \$100,000. Given the bank's significant level of lending to low- and moderate-income consumers and to small businesses and farms, its distribution of loans by income level exceeds the standards for satisfactory performance.

Geographic Distribution of Loans

The distribution of the bank's loans throughout its assessment area meets the standards for satisfactory performance. As previously discussed, the bank's assessment area includes one low-income BNA, which is located approximately 45 miles west of the bank's branch office in Cut Bank. The remaining BNAs are all designated as middle income. The following table shows the distribution of the bank's consumer and agricultural loans in low- and middle-income BNAs.

DISTRIBUTION OF LOANS IN THE ASSESSMENT AREA BY BNA INCOME LEVEL*		
Loan Type	Low-Income BNA	Middle-Income BNA
<u>Consumer</u>		
Total Number of Loans	12%	88%
Total Amount of Loans	2%	98%
<u>Consumer Real Estate</u>		
Total Number of Loans	0%	100%
Total Amount of Loans	0%	100%
<u>Agricultural and Commercial</u>		
Total Number of Loans	4%	96%
Total Amount of Loans	1%	99%
*The bank's assessment area does not include any moderate- or upper-income BNAs.		

The bank's consumer and agricultural and commercial lending performance in the low-income BNA is reasonable considering the representation of residents in this BNA within the assessment area population. The total population of the low-income BNA is 4,613 persons, which is 15% of the total assessment area population. The low-income BNA is composed largely of Browning, which is on the Reservation. Contacts made on the Reservation stated that residents bank in a variety of towns surrounding the reservation, including Valier and Kalispell, Montana. Additionally, the Blackfeet National Bank, which is owned by the tribe and located in Browning, gives residents in that BNA a more convenient banking locale than the bank's closest branch 45 miles to the east.

The fact that no consumer real estate loans were made in the low-income BNA is explained by contacts on the Reservation who stated that the majority of the residents there rent housing. The small percentage who purchase homes have a number of purchasing options through the tribe and other local banks that offer HUD Section 184 housing loans. It should also be noted that 50% of the households in the low-income BNA had incomes below the poverty level and may not qualify for consumer and consumer real estate loans. Given these demographic factors and the population distribution, the total dollar amount of the loan originations to residents of the low-income BNA is reasonable and meets the standards for satisfactory performance.

General Comments

The evaluation did not reveal any substantive violations of fair lending laws and regulations and only one isolated violation of the Fair Credit Reporting Act. The bank has not received any CRA complaints since the previous

evaluation.

## **PUBLIC DISCLOSURE**

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June 10, 1996  
Date of Evaluation

## **COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION**

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Farmers State Bank of Montana  
Name of Depository Institution

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093002800000  
Identification Number of Institution

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Conrad, Montana  
Address of Institution

Federal Reserve Bank of Minneapolis  
250 Marquette Avenue  
Minneapolis, Minnesota 55401-2171

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.