

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 North Shore Bank of Commerce, Duluth, Minnesota, prepared by the Federal Reserve Bank of Minneapolis, the institution’s supervisory agency, as of October 6, 1997. 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 bank’s CRA rating is based on several factors. First, the bank’s lending to borrowers of different income levels is very good. Second, the bank actively lends in the majority of census tracts and block numbering areas (“BNA”), including low- and moderate-income areas, located in its assessment area. The bank offers two mortgage loan products specifically targeted to low- and moderate-income tracts. Third, the bank’s net loan-to-deposit ratio is high and has steadily increased since the last evaluation. Finally, the bank originated a significant majority of its loans inside the assessment area.

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 outstanding in helping to meet the credit needs of its assessment area at its previous CRA evaluation. The bank operates five full-service offices and six automated teller machines ("ATM") in its assessment area. All of the branches and ATMs operated by the bank are located in Duluth or Hermantown, Minnesota. The bank maintains a mortgage loan production office in Cloquet, Minnesota, and at its Hermantown branch office.

The bank's main office is located in Duluth's downtown business district; there is a full-service ATM at this location. The bank operates full-service branches and cash-dispensing ATMs at 1600 Miller Trunk Highway (Miller Hill Mall), 4810 Miller Trunk Highway (Hermantown office), and 4801 East Superior Street (Lakeside office). It also operates a full-service branch at 17 Calvary Road (Woodland office). The other two ATMs only dispense cash and are located at Jubilee Foods, 15 South 13th Avenue East, Duluth, and Pike Lake Holiday Gas Station, 5699 Miller Trunk Highway, Hermantown.

Between June 30, 1996 and 1997, the bank's total assets increased approximately 11% from \$111 million to \$123 million. During the same period, the bank's net loan portfolio grew faster than total assets at a rate of approximately 19%. The June 30, 1996 and 1997, Reports of Condition ("ROC") show that net loans were \$75 and \$89 million, respectively. Bank management attributes the loan growth primarily to increases in the residential real estate loan portfolio. It stated that loan demand in the Duluth/Superior Metropolitan Statistical Area ("MSA") has been very strong. Based on June 30, 1997, ROC data, the composition of the bank's loan portfolio is 57% residential real estate, 39% commercial, and 4% consumer loans. Total deposits have remained relatively stable since the previous evaluation. Bank management indicated that attracting new deposits has become very competitive.

The bank offers a wide variety of loan products to meet the credit needs of residents and businesses in its assessment area. Its consumer credit products include both open- and closed-end loans. The bank offers installment, single-payment, overdraft protection, personal lines of credit, and home equity consumer loans. The bank also offers conventional home improvement loans where the borrower can obtain funds up to 110% of the value of the home. The commercial loan programs are directed primarily toward small businesses and include Small Business Administration ("SBA") loans. Small business customers may obtain equipment, working capital, accounts receivable, and commercial real estate loans.

The bank continues to emphasize its real estate loan department. It offers a wide variety of conventional and government-guaranteed residential real estate mortgages. Its conventional residential real estate loan products include purchase money, refinance, construction, and home improvement loans. In addition to these products, the bank extends Minnesota Housing Finance Agency ("MHFA") First-Time Homebuyer, Federal Housing Administration ("FHA"), FHA Title I home improvement, and Department of Veterans Affairs loans. It also extends MHFA home improvement and home energy mortgage loans. In addition, the bank participates in residential real estate mortgage programs that are directed toward first-time homebuyers and low- and moderate-income borrowers and geographies. For first-time homebuyers, it offers residential mortgage loans through the Minnesota Mortgage and Minnesota Cities loan programs. Mortgage programs directed toward low- and moderate-income census tracts include the Target Census Tract and the Neighborhood Housing Services ("NHS") programs. NHS is the primary mortgage program used by the bank to enhance its lending in the low- and moderate-income census tracts. NHS mortgage loans have low down payment requirements, and qualifying individuals with incomes below 115% of the median income for Duluth can obtain a 7.5% interest rate loan. The bank offers 203(k) mortgage loans through FHA. The 203(k) program is designed for borrowers who are interested in one loan for both purchasing and rehabilitating a home.

Finally, the bank continues to participate in a special loan program offered by a nonprofit organization. The nonprofit group purchases and rehabilitates homes, which are then sold to qualifying families. The organization sells only the house, not the real property, which is held in trust. When the house is sold, the purchaser pays only for the value of the home, making the purchase price more affordable.

DESCRIPTION OF NORTH SHORE BANK OF COMMERCE'S ASSESSMENT AREA

The bank's assessment area includes Carlton County, Minnesota; the southern section of St. Louis County, Minnesota; and the northern section of Douglas County, Wisconsin. The southern section of St. Louis County and the northern section of Douglas County are in the Duluth/Superior MSA. The assessment area does not include all of the MSA's census tracts. Carlton County lies outside of the MSA and consists of seven BNAs. Since the previous evaluation, the bank conducted its own internal geographic analysis and expanded its assessment area. Previously, the bank's assessment area consisted only of the southern section of St. Louis County, which includes the cities of Duluth, Hermantown, and Proctor, Minnesota. Based on its geographic analysis, the bank added the northern section of Douglas County, which includes the city of Superior, Wisconsin, and Carlton County, which includes the city of Cloquet and the Fond du Lac Indian Reservation ("Reservation"). The Reservation is home to the Fond du Lac Band of Chippewa Indians ("Band").

The assessment area consists of 61 census tracts and seven BNAs. The southern section of St. Louis County includes 47 census tracts, while the northern section of Douglas County includes 14 census tracts. All seven BNAs lie within Carlton County, which is adjacent to the MSA. The largest cities in the assessment area are Duluth, Hermantown, Proctor, Cloquet, and Superior. According to 1990 U.S. Census data, the assessment area has a total population of 189,067. Because of the bank's size and location in an MSA, it is subject to the requirements of Regulation C--Home Mortgage Disclosure Act ("HMDA").

Local residents of the assessment area and Reservation who are familiar with housing, small business, and economic development issues and activities in the assessment area were interviewed as part of the CRA evaluation. A community contact with the Band stated the Reservation has approximately 1,100 residents. Residents generally obtain bank services from financial institutions located in Cloquet because of its proximity to the Reservation. Based on the success of its two gambling casinos, the Band is financially strong. The Band offers mortgage programs designed for the purchase, refinance, or rehabilitation of residential real estate. It usually charges below-market interest rates for these loans. The financial institutions in the assessment area cannot compete effectively with the Band's low-interest-rate mortgage loans. According to the Reservation contact, the Band members have no unfulfilled credit needs.

A contact from an affordable housing agency in Duluth stated the city does not have an affordable housing shortage. The contact attributed the reduced need for affordable housing programs to Duluth's strong, stable economic conditions. The contact stated the unemployment rate in Duluth is less than 5%. The affordable housing agency conducted its own internal analysis of Duluth's affordable housing situation and discovered that a number of individuals who previously participated in its rental program have purchased their own housing. These individuals have generally acquired homes on the outskirts of Duluth. The community contact stated the cities of Hermantown and Proctor have experienced strong residential real estate development over the past year.

Another community contact stated Duluth's central downtown business district has been changing to a professional business district consisting of attorneys, doctors, dentists, and service-related businesses. Duluth's primary retail business area is the Miller Hill Mall. The contact stated Duluth lacks high-paying

jobs. However, the number of jobs in Duluth has continually increased as new businesses start operations in the city. The community contact indicated that most of the jobs being created in Duluth are telemarketing or operational support positions. The contact stated Duluth has a very competitive banking environment with a large number of financial institutions including two regional banks. In fact, the commercial loan market is very price sensitive as a result of the number of both bank and nonbank lenders in the assessment area. According to economic data prepared by the Duluth Chamber of Commerce, the largest employers in the assessment area are a utilities company, two manufacturers, a paper manufacturer, and companies involved in the medical industry. According to the data, four of the largest employers are medical facilities and hospitals.

Four colleges operate in the assessment area: The University of Minnesota Duluth, College of St. Scholastica, and Lake Superior College in Duluth and the University of Wisconsin Superior in Superior. The four schools have a combined student population of approximately 14,091, and the enrollment at each institution has increased over the last five years. Community contacts stated the universities in the assessment area constitute their own separate industry. They are major employers, contributors to the overall economy, and sources of labor in the assessment area. Bank management indicated college students do not demand consumer and consumer real estate loan products.

An affordable housing agency contact in Superior stated the city has an abundance of affordable rental units. The main streets in Superior are Belknap Avenue and Tower Avenue. At the intersection of these two streets is Superior's downtown business district. The area north of Belknap Avenue near Tower Avenue consists primarily of small retail businesses and light industrial-based companies. There are a number of vacant commercial building lots in the northern section of Superior. The northern section of Superior does not have a large number of owner-occupied housing. The assessment area's Douglas County low- and moderate-income census tracts primarily surround the downtown business district. During the last few years, the city has purchased existing retail establishments and vacant buildings in an attempt to change the area from retail to light industrial-based businesses.

The contact stated a problem in Superior has been the condition of many older homes in the area. Approximately 50% of the housing in Superior is more than 50 years old. The contact said that senior citizens are moving out of family homes that need major home improvement repairs. A number of these residences have lead paint, plumbing, electrical, and structural problems.

The outlying areas of Superior have been experiencing most of the city's new residential housing development. Consequently, residential real estate lot prices have been steadily increasing in these areas. The increase in lot prices makes it extremely difficult for the community service agency to purchase land for future development. Residential housing acquired by this nonprofit agency is rented primarily to low- and moderate-income individuals; however, the contact indicated that demand for affordable housing has been weak.

CRA divides income levels into four categories: low, moderate, middle, and upper. The categorization of a borrower or geography's income level is determined relative to either the MSA median family income or the statewide nonmetropolitan median family income. Pursuant to CRA's definitions, low-income individuals have incomes of less than 50% of the MSA or 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 people with incomes of at least 80% but less than 120% of the MSA or statewide nonmetropolitan median family income. Individuals with incomes of 120% or more than the MSA or statewide nonmetropolitan median family income are classified as upper-income persons. Census tracts and BNAs are classified using similar categories based on the level of the median family income in the geography compared with the 1990 MSA and statewide nonmetropolitan family incomes, respectively. Based on 1990 U.S. Census data, the MSA and statewide

nonmetropolitan median family incomes were \$30,561 and \$28,933, respectively. According to the 1997 updated census data, the MSA and the statewide nonmetropolitan median family incomes increased to \$40,600 and \$38,400, respectively. These figures are used to classify income levels of borrowers.

As discussed, the bank's assessment area includes 61 census tracts and seven BNAs. The bank's assessment area includes 11 census tracts that are classified as low income: 16, 17, 19, 22.99, 25, 25.99, 28, 32, 201, 201.99, and 210.99. The last three census tracts are located in Douglas County, Wisconsin. The total population in the low-income census tracts is 9,474, which is 5% of the assessment area population. Census tracts 22.99, 25.99, 201.99, and 210.99 are classified as crews-of-vessels tracts and have a combined population of 12 individuals. These tracts are located on the waterfront where individuals maintain residences on watercraft. The bank's main office and ATM are located in low-income census tract 19. Another ATM is located at Jubilee Foods in census tract 17.

Thirteen assessment area census tracts are classified as moderate-income areas. These census tracts are 12, 13, 14, 18, 20, 24, 26, 27, 33, 37, 202, 203, and 206. Once again, the last three census tracts are located in Douglas County. These moderate-income census tracts have a total population of 27,205, which represents 14% of the assessment area population.

Middle-income geographies constitute the largest segment of the assessment area and include 28 census tracts and six BNAs. Census tracts 2, 3, 4, 9, 22, 29, 30, 31, 34, 36, 38, 101, 102, 104, 105, 106, 111, 112, 113, 114, 204, 205, 207, 208, 209, 210, 301, and 302 and BNAs 9701, 9702, 9704, 9705, 9706, and 9707 are classified as middle income. Census tracts 204 through 302 are in Douglas County. The BNAs are in Carlton County and outside the MSA. The middle-income census tracts and BNAs have a total population of 114,944, which is 61% of the assessment area population. The bank's Miller Hill Mall branch and ATM are located in census tract 3. The mortgage loan production office in Carlton County is located in BNA 9704.

The remaining assessment area census tracts and BNA are upper income. Census tracts 1, 5, 6, 7, 8, 10, 11, 23, and 103, and BNA 9703 are classified as upper income. The bank's Lakeside, Woodland, and Hermantown branch offices are located in census tracts 6, 1, and 103, respectively. The bank operates ATMs at the Lakeside and Hermantown branch offices. In addition, the bank operates an ATM at the Pike Lake Holiday gasoline station, which is located in census tract 103. Representing 20% of the assessment area's population, the upper-income census tracts and BNAs have a total population of 37,444. The assessment area's four colleges are located in middle- and upper-income census tracts.

The 1990 census data indicate there are 82,677 housing units in the assessment area. Approximately 5,539 housing units in the assessment area are located in low-income census tracts. There are 1,071 owner-occupied, 4,094 rental, and 374 vacant units in these low-income census tracts. As a percentage of housing units in low-income census tracts, 74% are rental and 19% are owner-occupied units. Only 2% of the assessment area's owner-occupied dwellings are in low-income census tracts. The data indicate the number of owner-occupied homes in low-income census tracts is very low. The moderate-income census tracts have 12,686 housing units. Of these units, 5,630 are owner-occupied, 6,261 are rental, and 795 are vacant. As a percentage of housing units in the moderate-income census tracts, 49% are rental and 44% are owner-occupied units. Only 11% of the assessment area's owner-occupied dwellings are in moderate-income census tracts. The majority of housing units in the low- and moderate-income census tracts are rental units. This situation limits the number of loans financial institutions can make to borrowers in the assessment area's low- and moderate-income census tracts. Community contacts confirmed the census data by stating the downtown business districts in Duluth and Superior are low- and moderate-income census tracts.

According to the census data, 25% of the assessment area's population is 17 years old or younger, 59% of the population is between 18 and 64 years old, and 16% of the population is age 65 and over. In addition, economic data provided by the Duluth Chamber of Commerce indicate that a significant percentage of the population in the assessment area is students. Students, young people, and individuals over the age of 65 usually do not need mortgage loans to purchase real estate. In fact, students do not usually borrow funds for noneducational purposes.

The census data provide a breakdown of the percentage of low-, moderate-, middle-, and upper-income households and families who reside in the assessment area. Approximately 15% of the households and 9% of the families in the assessment area have incomes below the poverty level. The representation of such households and families in the assessment area is less than in the MSA and Minnesota's nonmetropolitan areas. The distribution of assessment area households and families by income level is summarized in the following table.

ASSESSMENT AREA POPULATION DISTRIBUTION BY INCOME LEVEL				
Unit of Measure	Low Income	Moderate Income	Middle Income	Upper Income
Households Compared to Median Household Income	24%	15%	17%	43%
Families Compared to Median Household Income	19%	18%	23%	40%

The median household and family incomes for the assessment area are \$24,485 and \$30,945, respectively.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

The bank's performance in meeting the credit needs of its assessment area is highly satisfactory. Much of the analysis on the following pages was based on a statistical sample of 101 consumer and 77 small business loans originated in the six months preceding the evaluation. The 994 sampled consumer real estate loans consisted of all HMDA loans reported on the bank's Loan/Application Register since the previous evaluation. In assigning the overall rating, the greatest weight was placed on the assessment of the bank's lending to borrowers of different income levels and to businesses of different sizes as well as to geographies of various income levels. These factors most closely measure the bank's success in meeting the credit needs of all segments of its assessment area.

LOAN-TO-DEPOSIT RATIO ANALYSIS

The bank's net loan-to-deposit ratio exceeds the standards for satisfactory performance. Since the previous evaluation, the bank's loan portfolio has steadily increased. As noted in the following table, the bank's net loan-to-deposit ratio has also increased each quarter since the last evaluation.

DATE	NET LOANS (In thousands)	DEPOSITS (In thousands)	NET LOAN-TO- DEPOSIT RATIO
June 30, 1997	\$89,008	\$114,349	78%
March 31, 1997	\$80,762	\$109,898	73%
December 31, 1996	\$80,610	\$113,948	71%
September 30, 1996	\$78,313	\$112,074	70%

According to June 30, 1996, ROC data, net loans totaled \$75 million. As the table shows, the bank's net loans have increased 19% to \$89 million. The bank attributes the increased ratio to strong loan demand, specifically in the consumer real estate area loan market. The bank's quarterly average net loan-to-deposit ratio since the previous evaluation is 73%. At the last evaluation, this ratio was 66%. According to the June 30, 1997, Uniform Bank Performance Report ("UBPR"), the bank's net loan-to-deposit ratio of 78% exceeded the national peer group ratio of 72% and ranked the bank in the 66th percentile as compared to its national peers. The June 30, 1997, UBPR shows that the bank's net loan-to-assets ratio was 72.23% and is higher than the average net loan-to-assets ratio of 65.45% for Minnesota banks with assets of \$100 million or more. This data show that the bank commits relatively more of its assets to loans than comparably sized banks operating in the state.

The bank's net loan-to-deposit ratio compares favorably with those of competitor financial institutions located in the assessment area. The first six banks mentioned in the following table are in Duluth, and the remaining financial institutions are located throughout the assessment area.

BANK AND LOCATION	TOTAL ASSETS (June 30, 1997) (In thousands)	QUARTERLY AVERAGE NET LOAN-TO-DEPOSIT RATIO
North Shore Bank of Commerce Duluth, Minnesota	\$123,232	73%
Norwest Bank Minnesota North, N.A. ("Norwest Bank") Duluth, Minnesota	\$833,972	47%
Republic Bank, Incorporated Duluth, Minnesota	\$ 81,049	78%
Western National Bank Duluth, Minnesota	\$ 79,753	87%
The Pioneer National Bank of Duluth Duluth, Minnesota	\$ 64,789	70%
Park State Bank Duluth, Minnesota	\$ 18,691	68%
The First National Bank of Proctor, Proctor, Minnesota	\$ 15,055	47%
National Bank of Commerce in Superior, Superior, Wisconsin	\$176,497	79%
M&I Bank Superior, Wisconsin	\$109,441	85%
Community Bank Superior, Wisconsin	\$ 42,785	81%
Superior Savings Bank Superior, Wisconsin	\$ 39,729	89%
F&M Bank-Superior Superior, Wisconsin	\$ 33,630	88%
Superior National Bank Superior, Wisconsin	\$ 26,357	47%

The bank's average ratio as compared with the five competitor banks located in Duluth is the third highest and significantly higher than Norwest Bank's net loan-to-deposit ratio. The bank's average quarterly net loan-to-deposit ratio is in the middle of the range when compared with other competitor banks located in

the assessment area. Except for Norwest Bank, the competitor banks located in Duluth are smaller than the bank, and only two of the four have higher net loan-to-deposit ratios. Financial information is not available on branch operations of the large regional banks operating in the assessment area. Community contacts and bank management indicated the lending market in Duluth is very price-competitive. Recently, nonbank financial institutions have been aggressively seeking new business by offering reduced interest rate loans.

As discussed under the Description of Institution section, the bank offers a wide variety of mortgage loan products that benefit the community. Community contacts identified the bank as one of the leading financial institutions in Duluth. Although the bank has a high net loan-to-deposit ratio, not reflected in the ratio is the large number of consumer real estate loans originated by the bank and sold on the secondary market or to government agencies.

The bank has made the following community development loans since the last evaluation:

- two loans for the construction and rehabilitation of low-income, multifamily housing units and
- a loan for the purchase of household appliances for low-income housing units.

According to community contacts, affordable housing is available in the assessment area. Consequently, there is limited need for new affordable housing units. This situation affects the bank's ability to extend housing-related community development loans. The fact that the bank financed one affordable housing construction and two rehabilitation projects is commendable.

The bank's quarterly average net loan-to-deposit ratio is high and has increased since the last evaluation. Not reflected in the net loan data are the loans sold to the secondary market; the bank actively sells residential real estate loans in order to make funds available for reinvesting in new loans. Given these factors and the bank's community development loan originations since the last evaluation, the bank's loan-to-deposit ratio exceeds the standards for satisfactory performance.

COMPARISON OF CREDIT EXTENDED INSIDE AND OUTSIDE THE ASSESSMENT AREA

The bank's lending activity within its assessment area exceeds the standards for satisfactory performance. Based on the sampled loans, the bank originated a high percentage of its loans to residents and businesses within its assessment area. The following table reflects the percentages of consumer real estate, small business, and consumer loans originated to borrowers within the assessment area.

PERCENTAGE OF LOANS IN THE ASSESSMENT AREA		
Product Lines	Total Number of Loans	Total Amount of Loans
Consumer Real Estate	91	87
Small Business	97	91
Consumer	95	97

As previously mentioned, the data in the table is based on a sample of small business and consumer loans originated during the six months preceding the evaluation and consumer real estate loans originated since the last evaluation.

Since the previous evaluation, the bank enlarged its assessment area by including 14 census tracts in Douglas County and seven BNAs in Carlton County, which is adjacent to the MSA. Probably reflecting the larger assessment area, the percentage of consumer and small business lending within the assessment

area increased since the previous evaluation. The percentage of consumer real estate loans originated in the assessment area remained very high, but declined slightly from the last evaluation. The bank attributes this decline to underwriting all consumer real estate loan requests aggressively, regardless of a borrower's location.

According to 1996 HMDA data, the bank originated 84% of its 839 reportable loans in the MSA section of the assessment area. The bank originated 702 HMDA-reportable loans in the assessment area census tracts in the MSA. All lenders reported 6,017 loan originations in these census tracts. The bank's market share of 1996 HMDA-reportable loans is 12%, making it the second most active lender in the assessment area's MSA census tracts. The most active lenders of HMDA-reportable loans in these areas are Norwest Bank as well as its affiliated banks and mortgage company.

As the loan data show, the bank concentrates its lending activity in the assessment area. The high concentration of loans in the assessment area reflects the bank's commitment to serving the credit needs of people and businesses in the local community. For this reason, the bank's lending performance exceeds this category's standards for satisfactory performance.

LENDING TO BORROWERS OF DIFFERENT INCOME LEVELS AND TO BUSINESSES OF DIFFERENT SIZES

The bank's lending to borrowers of different income levels and to businesses of different sizes is very good and meets the standards for satisfactory performance. As previously mentioned, CRA classifies borrower income levels into four categories: low, moderate, middle, and upper. The distribution of families by income level is 19% low income, 18% moderate income, 23% middle income, and 40% upper income. The 1990 census data indicate that low-income households comprise 25%, moderate-income households comprise 15%, middle-income households comprise 17%, and upper-income households comprise 43% of the assessment area's population. The 1990 census data show the median household and family incomes for the assessment area were \$24,485 and \$30,945, respectively. The updated 1997 median family income figures are used to classify borrower incomes. For borrowers in the MSA, the relevant median family income is \$40,600. The relevant figure for classifying borrowers in the assessment area's BNAs is \$38,400. Both the MSA and the non-MSA median family incomes have increased significantly since the 1990 census.

As discussed in the Description of Institution section, consumer real estate loans constitute 57% of the loan portfolio. Greater weight was assigned to this loan product category when analyzing the bank's distribution of loans to borrowers of different income levels. The following table shows the percentage of sampled 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 Real Estate:</u>				
Total Number of Loans	8%	21%	28%	43%
Total Amount of Loans	6%	16%	27%	51%
<u>Consumer:</u>				
Total Number of Loans	12%	23%	30%	35%
Total Amount of Loans	12%	22%	32%	35%

*Income level is determined based on the 1997 median family income of \$40,600 and \$38,400 for the Duluth/Superior MSA and state of Minnesota nonmetropolitan areas, respectively.

The data in the table reflect that 29% of the consumer real estate and 35% of the consumer loans were to low- and moderate-income individuals. The bank's consumer and consumer real estate loans to low- and moderate-income borrowers are slightly lower than the representation of such people in the assessment area. This situation may be attributable to several factors. First, community contacts indicated the supply of affordable housing units exceeds demand. The community contacts attributed this to good economic conditions, low-income individuals purchasing their own homes outside of Duluth, and the competitive environment of mortgage loan underwriting. Second, as previously mentioned, 1990 census data on the age demographics of the assessment area indicate 25% of the population is younger than 18 and 16% is older than 65. Individuals in these two age brackets usually have limited credit needs, particularly for residential real estate loans to purchase homes. Third, according to 1990 census data, 15% of the households and 9% of the families in the assessment area have incomes below the poverty level. Individuals in this category often will not be able to obtain consumer real estate loans. Fourth, as previously mentioned, the assessment area has four colleges with approximately 14,000 students. Students generally do not need residential real estate or consumer loans. Fifth, in January 1997, the bank opened a mortgage loan production office at its Hermantown branch facility. The production office is located on the border of the assessment area and has been very successful in attracting middle- and upper-income borrowers from the surrounding area. Finally, according to economic data provided by the Duluth Area Association of Realtors, the 1995 average price for a four-bedroom home in Duluth is \$110,878. Individuals in the low- and moderate-income categories will not be able to qualify for loans for homes in this price range.

The bank offers a wide variety of loan products directed specifically toward low- and moderate-income individuals in the assessment area. As mentioned in the Description of the Institution section, the bank offers MHFA, NHS, and FHA loans for these individuals. It also participates in the land trust program, which benefits mostly low- and moderate-income people. Finally, the bank serves the credit needs of low- and moderate-income borrowers by offering small personal lines of credit.

The HMDA data show that the bank's performance with respect to reportable loans is comparable with that of the aggregate lenders. According to 1996 HMDA data, the bank originated 702 consumer real estate loans in the MSA section of the assessment area; 182 of these loans, or 26%, were to low- and moderate-income individuals. Similar to the bank, aggregate lenders originated 26% of their loans to low- and moderate-income individuals in the MSA section of the assessment area. According to HMDA data, the bank's approval rate for such loans was 78%. The bank's HMDA loan approval rate for low- and moderate-income applicants was much higher than the 63% approval rate for all lenders. In 1995, the bank originated 32% of its HMDA-reportable loans to low- and moderate-income borrowers, compared with 27% for the aggregate lenders. The bank did not have a specific reason for the relative decrease in its lending to low- and moderate-income borrowers.

The bank originates a large percentage of its small businesses loans to entities with gross annual revenues of \$1 million or less. CRA defines small business loans as commercial loans of \$1 million or less. The statistical sampling of small business loans indicates that 87% of the small business loans were to entities with gross annual revenues of \$1 million or less. Of loans to these entities, 91% had amounts of \$100,000 or less; 8% ranged from \$100,001 to \$250,000; and the remaining 1% ranged from \$250,001 to \$1 million. The distribution of small business loans is consistent with the bank's asset size, legal lending limit, and the size of businesses in the assessment area.

The bank's lending to individuals of different income levels and to businesses of different sizes is very good. Although the level of consumer real estate and consumer loan originations to low- and moderate-income borrowers is less than expected given the assessment area's demographics, the bank's lending is very good given the characteristics of the assessment area, current economic conditions, excess supply of

affordable housing units, and the bank's loan programs directed toward low- and moderate-income individuals. As such, the bank's lending to borrowers of different income levels and to businesses of different sizes meets the standards for satisfactory performance.

GEOGRAPHIC DISTRIBUTION OF LOANS

The distribution of the bank's loans throughout the assessment area exceeds the standards for satisfactory performance. As previously mentioned, the bank's assessment area includes 61 census tracts in the Duluth/Superior MSA and seven BNAs in Carlton County. Eleven of the census tracts are classified as low income, 13 census tracts are classified as moderate income, 28 census tracts and six BNAs are classified as middle income, and nine census tracts and one BNA are classified as upper income.

The 1990 census data show that 5% of the assessment area's population resides in the low-income census tracts, 14% resides in the moderate-income census tracts, 61% resides in the middle-income geographies, and 20% resides in the upper-income geographies. The following table reflects the bank's lending pattern within its assessment area based on the income level of the census tracts and BNAs.

DISTRIBUTION OF LOANS IN THE ASSESSMENT AREA BY CENSUS TRACT AND BNA INCOME LEVEL				
Loan Type	Low-Income Census Tracts	Moderate- Income Census Tracts	Middle-Income Census Tracts or BNAs	Upper-Income Census Tracts or BNAs
Consumer Real Estate:				
Total Number of Loans	2%	8%	57%	33%
Total Amount of Loans	1%	6%	59%	34%
Small Business:				
Total Number of Loans	37%	12%	31%	20%
Total Amount of Loans	64%	13%	15%	9%
Consumer:				
Total Number of Loans	2%	7%	57%	33%
Total Amount of Loans	1%	14%	54%	31%

As previously discussed, the consumer real estate loan portfolio represents the largest percentage of the bank's loan portfolio, followed by commercial and consumer loans. As such, the analysis gives the greatest weight to the consumer real estate loan category. The 1990 census data indicate there are 82,677 housing units in the assessment area. Within the assessment area, 2% of the owner-occupied housing units are located in the low-income census tracts, 10.7% are located in the moderate-income census tracts, 65.8% are located in the middle-income geographies, and 21.5% are in the upper-income geographies. According to census data, 74% of the housing units in the low-income census tract, and 49% of the units in the moderate-income census tracts are rental units. As the data show, the majority of housing units in the low- and moderate-income census tracts are rental units.

The data in the table indicate the bank originated 10% of its consumer real estate loans in the low- and moderate-income census tracts. The bank's lending percentage in the low- and moderate-income census tracts is slightly less than expected given the demographic characteristics of the assessment area. In addition, the data show that the percentage of consumer real estate loans in the moderate-income census

tracts is less than the percentage of owner-occupied housing in those areas. The bank's performance in low-income census tracts is comparable to the percentage of owner-occupied housing in those areas. Several factors may explain the bank's lending pattern. First, community contacts and bank management indicated the low- and moderate-census tracts predominantly include the downtown Duluth and Superior central business districts. This factor accounts for the bank's high level of small business loans in the assessment area's low- and moderate-income census tracts. Second, as mentioned previously, there is limited owner-occupied housing available in these tracts. Community contacts confirmed that these census tracts are mature areas, with little or no residential real estate development. Finally, in addition to the mortgage loan production office in Cloquet (Carlton County), the bank opened a mortgage loan production office at its Hermantown branch. These two loan production offices are located in middle- and upper-income geographies. The outlying areas of Duluth, specifically Hermantown and Proctor, have been experiencing strong residential real estate development. Based on the real estate sample data, it appears these mortgage loan production offices have been successful in attracting individuals from the middle- and upper-income geographies.

According to 1996 HMDA data, the bank originated 702 HMDA-reportable real estate loans in the MSA section of the assessment area, of which 83, or 12%, were originated in the low- and moderate-income census tracts. The bank's 86% HMDA loan origination rate in the low- and moderate-income census tracts is much higher than the 65% loan origination rate for all lenders in the assessment area's MSA census tracts. The aggregate lenders originated 14% of their 1996 HMDA loans in the low- and moderate-income census tracts. According to 1995 HMDA data, the bank originated 16% of its HMDA-reportable mortgage loans in the low- and moderate-income census tracts, compared with 15% for the aggregate lenders. The bank did not have a specific reason for the decline of its HMDA-reportable loan activity in the low- and moderate-income census tracts.

As discussed in the Description of the Institution section, the bank offers a specific mortgage loan program directed toward low- and moderate-income geographic areas. The NHS mortgage loan program was instituted by the bank in early 1997. It primarily focuses on lending in identified low- and moderate-income census tracts within Duluth. More specifically, the NHS loan program benefits borrowers in Duluth's Lincoln Park, Central Hillside, and East Hillside areas, which are in census tracts 12, 13, 14, 16, 17, 18, 19, 20, 24, 25, 27, and 28. The bank does not generate any revenue from this program and offers it as a service to the community. The bank is the only financial institution that offers this loan program. In addition to the NHS program, the bank offers loans through the Target Census Tract Program.

As noted in the table on the previous page, the bank originated 49% of the number and 77% of the amount of small business loans to entities located in low- and moderate-income census tracts. According to 1996 aggregate loan information for the MSA, reporting financial institutions (banks with total assets exceeding \$250 million or financial institutions affiliated with a holding company that has total banking and thrift assets of more than \$1 billion) disclosed that 40% of the number and 39% of the amount of small business loans were originated in assessment area's low- and moderate-income census tracts. Relatively, the bank's small business lending activity significantly exceeds the activity of the aggregate lenders in the low- and moderate-income census tracts.

The bank lends in almost all of the census tracts and BNAs in its assessment area. The percentages of consumer real estate and consumer loans in the low- and moderate-income census tracts are less than expected given the demographics of these tracts. However, given the bank's unique loan programs, assessment area's housing characteristics, and community contacts' statements, the bank's overall lending distribution pattern is very good. Moreover, the bank's small business lending in low- and moderate-income areas substantially exceeds the concentration of lending by large institutions in these geographies. Therefore, based on the bank's distribution of consumer real estate, small business, and consumer loans

in the low-, moderate-, middle-, and upper-income census tracts and BNAs, the geographic distribution of the bank's loans exceeds the standards for satisfactory performance.

GENERAL

The evaluation did not reveal any credit practices that are inconsistent with the substantive provisions of the fair housing and lending laws and regulations. It did reveal technical violations of HMDA's reporting requirements. Bank management promised prompt corrective action. In addition, the bank has not received any CRA-related complaints since the last evaluation.

PUBLIC DISCLOSURE

October 6, 1997
Date of Evaluation

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

North Shore Bank of Commerce
Name of Depository Institution

092716750000
Identification Number of Institution

Duluth, Minnesota
Address of Institution

Federal Reserve Bank of Minneapolis
90 Hennepin Avenue
Minneapolis, Minnesota 55480-0291

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.