

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 Valley Bank of Ronan, Ronan, Montana, prepared by the Federal Reserve Bank of Minneapolis, the institution’s supervisory agency, as of August 4, 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 “Outstanding.”

Several factors support rating the bank’s CRA performance outstanding. First, based on a statistical sample of loans, the bank actively extends loans to individuals of different income levels and to businesses of different sizes. Second, the bank demonstrates its commitment to serving the moderate-income areas in its assessment area not only by extending loans to individuals and businesses located in these areas, but also by continuing to operate branches in the moderate-income areas, thereby enhancing credit availability. Third, the bank’s loan-to-deposit ratio is consistently high and is an indication of an active lending program. Fourth, the bank extends a substantial majority of its loans to residents and businesses located within its assessment area. In addition, the bank’s active level of involvement in providing qualified investments and services within the assessment area enhances the bank’s overall CRA performance.

DESCRIPTION OF INSTITUTION

Considering its size and financial condition, the bank is able to meet the credit needs of the communities in its assessment area effectively. The bank operates two full-service branches in Hot Springs and Arlee, Montana, in addition to the main office in Ronan, Montana. All three office lobbies are open from 9:00 a.m. to 4:00 p.m., Monday through Friday, with drive-up teller service from 8:00 a.m. to 5:00 p.m., Monday through Friday. The bank also operates a cash-dispensing automated teller machine (“ATM”) at a grocery store in Ronan. Each of the bank’s offices serves the Confederated Salish and Kootenai Tribes of the Flathead Indian Reservation (“Tribe”). The bank has not opened or closed any offices since the last examination. The bank’s CRA performance was rated outstanding at the previous evaluation.

According to the June 30, 1997, Report of Condition (“ROC”), the bank had total assets of approximately \$21.5 million. The bank’s asset size has increased by approximately \$1.2 million since June 30, 1996. During that same period, the bank’s net loans increased by approximately \$3.0 million. This growth indicates the demand for credit in the area and the bank’s willingness and ability to assist in meeting the credit needs of the communities in its assessment area. The bank’s quarterly average net loan-to-deposit ratio since the last examination is 87%. The June 30, 1997, loan-to-deposit ratio is 94%. The bank’s loan portfolio is composed of approximately 40% commercial, 40% consumer and consumer real estate, 19% agricultural, and 1% other loans. The composition of the loan portfolio has shifted slightly since the last evaluation with consumer and consumer real estate loans increasing by five percentage points, commercial loans decreasing by two percentage points, and agriculture loans decreasing by four percentage points. The bank’s loan mix and these changes reflect the demand for specific types of loans requested by residents 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 the following types of loans: consumer, residential real estate, mobile home, commercial, and agricultural. In addition to these conventional loan products, the bank originates loans guaranteed by the Federal Housing Administration, Department of Veterans Affairs (“VA”), Small Business Administration (“SBA”), Department of Housing and Urban Development (“HUD”), and Farm Service Agency. The bank sells qualifying residential real estate and SBA loans on the secondary market to permit it to continue to originate long-term, residential real estate, and commercial loans.

DESCRIPTION OF VALLEY BANK OF RONAN’S ASSESSMENT AREA

The bank’s assessment area is defined to include sections of Lake and Sanders counties in northwestern Montana. This area is further defined as block numbering areas (“BNA”) 9952, 9953, 9954, 9955, and 9956 in Lake County and 9966 and 9967 in Sanders County. Four BNAs in the assessment area are designated as moderate income: 9955 and 9956 in Lake County and 9966 and 9967 in Sanders County. The remaining three BNAs, 9952, 9953, and 9954, in Lake County are designated middle income. There are no low- or upper-income BNAs in the assessment area. The bank’s main office in Ronan is located in BNA 9954, a middle-income BNA. The Hot Springs and Arlee offices are located in BNAs 9966 and 9956, respectively, which are both moderate-income BNAs.

The bank’s assessment area is located north of Missoula, Montana, in the Mission Valley area. Based on 1990 census data, it has a population of 22,999. Ronan is located on the Flathead Indian Reservation in Lake County, about 15 miles south of Flathead Lake. The population of Ronan is approximately 1,600, and Lake County has a population of approximately 21,000. Approximately 20% of Ronan residents and

21% of Lake County residents are American Indians. Local economic conditions are stable. Real estate prices in Ronan are increasing. Banking competition in the assessment area is intense; offices of six banks are located in or near the assessment area.

Hot Springs, Montana, is located about 40 miles west of Ronan near the western edge of the Flathead Indian Reservation. The population of Hot Springs is approximately 450, and about 50% of the residents are American Indians. The local economy is stable. The primary industry is cattle production. Hot Springs is experiencing steady population growth.

Arlee, Montana, is located in the southernmost section of the assessment area, approximately 30 miles south of Ronan. The local economy is stable; however, bank management believes new businesses such as light manufacturing will be necessary to promote noticeable growth in the Arlee area.

CRA divides income into four categories: low, moderate, middle, and upper. Because the bank's assessment area is not in a metropolitan statistical area, the categorization of a borrower or BNA's income is determined relative to the statewide nonmetropolitan median family income. 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 a middle-income person as one with an income of at least 80% but less than 120% of the statewide nonmetropolitan median family income. An individual with an income that is 120% or more of the statewide nonmetropolitan median family income is considered an upper-income person. BNAs are classified using similar categories based on the level of the median family income in the geography. The 1997 Montana statewide nonmetropolitan median family income is \$36,100.

As mentioned previously, the bank's assessment area includes four moderate-income and three middle-income BNAs. As a percentage of statewide nonmetropolitan median family income, the moderate-income BNAs range from 62.6% to 79.0% and the middle-income BNAs range from 81.0% to 106.2%. According to 1990 census data, the median family income of the assessment area is \$22,389; the income range for the moderate-income BNAs is \$17,115 to \$21,607, and the income range for the middle-income BNAs is \$22,157 to \$29,054. As a comparison, the nonmetropolitan median family income for Montana is \$27,352, as of the 1990 census. The assessment area's median household income is \$18,488, which is below the Montana statewide nonmetropolitan median household income of \$22,345. Of the 8,708 households in the assessment area, 30.3% are low-income, 18.3% are moderate-income, 18.6% are middle-income, and 32.9% are upper-income households. In the assessment area, 20.3% of the households and 17.2% of the families have incomes below the poverty level.

Examiners contacted a government official and a member of a community-based development corporation familiar with the economic characteristics and credit needs of the assessment area. Information obtained from these individuals and bank management was used in evaluating the bank's CRA performance.

The economy of the assessment area has remained strong and stable due to the diversity of local industries and employers. The primary industries are agriculture, government, health and human services, and tourism. Due to the need for more jobs, one of the community contacts stated that light manufacturing businesses are one of the primary focuses in an attempt to bring new companies to the area. The population concentration in the assessment area is the greatest in the north and east sides of the assessment area. This concentration is consistent with the location of the majority of the commercial businesses. Two of the bank's branches, Hot Springs and Arlee, are respectively located on the west and south sides of the

assessment area. There are few economic development projects in these communities, which makes growth challenging for the bank.

A portion of the Flathead Indian Reservation is included in the bank's assessment area. Both of the community contacts indicated the Tribe and local community groups work closely to resolve both employment and housing issues in the local area.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

The bank has done an excellent job of meeting the credit needs of its assessment area. Much of the analysis on the following pages was based on a statistical sample of 136 consumer loans and 81 small business and small farm loans originated in the six months preceding the evaluation. In assigning the overall rating, greatest emphasis was placed on the fact that the bank lends to borrowers of many different income levels and to small businesses. Secondly, the bank demonstrates its commitment to serving moderate-income areas not only by extending loans to individuals and businesses located in these areas, but also by continuing to operate its two branches in moderate-income BNAs, thereby enhancing credit availability. Third, the bank maintains a high loan-to-deposit ratio. Finally, the bank has a significant number of its loans within its assessment area. The criteria discussed below were reviewed in determining the rating.

LOAN-TO-DEPOSIT RATIO ANALYSIS

The bank's net loan-to-deposit ratio exceeds the standards for satisfactory performance. The bank's deposits have grown approximately 5% since the last evaluation; however, loan demand has remained strong and the bank has managed to increase net loans by approximately 16% to \$18.2 million from \$15.2 million. According to the most recent Uniform Bank Performance Report data available, March 31, 1997, the bank's net loan-to-deposit ratio is 88%, which places it in the 97th percentile of its peer group, significantly above its national peer group ratio of 65%. The quarterly average net loan-to-deposit ratio since the last evaluation is 87%, which exceeds all the current peer averages.

The following chart, based on quarterly ROC data, shows how the bank's net loan-to-deposit ratio has grown since the previous examination.

DATE	NET LOANS (In thousands)	DEPOSITS (In thousands)	NET LOAN-TO- DEPOSIT RATIO
June 30, 1997	\$18,250	\$19,455	94%
March 31, 1997	\$17,188	\$19,481	88%
December 31, 1996	\$16,116	\$19,013	85%
September 30, 1996	\$16,208	\$18,853	86%
June 30, 1996	\$15,244	\$18,543	82%

The following chart shows the average net loan-to-deposit ratio over four previous quarters ending March 1997 for the bank and its main local competitors.

BANK	TOTAL ASSETS (In thousands)	QUARTERLY AVERAGE DEPOSIT RATIO
Valley Bank of Ronan Ronan, Montana	\$21,518	85%
Security State Bank & Trust Company Polson, Montana	\$53,323	68%
Ronan State Bank Ronan, Montana	\$84,935	65%
Lake County Bank St. Ignatius, Montana	\$21,010	59%
The First State Bank of Montana Thompson Falls, Montana	\$51,901	78%
First Citizens Bank of Polson Polson, Montana	\$20,109	75%

As shown above, the bank's quarterly average net loan-to-deposit ratio is greater than all of its main local competitors. Bank management indicated that loan demand continues to be high and by taking an aggressive approach to providing for these credit needs, they have been able to increase their loan portfolio with good quality credits even with significant competition from the other financial institutions.

Based on the bank's consistently high quarterly net loan-to-deposit ratio, comparison with competitors, and its peer group rank, the bank's loan-to-deposit ratio exceeds standards for satisfactory performance.

COMPARISON OF CREDIT EXTENDED INSIDE AND OUTSIDE THE ASSESSMENT AREA

A review of a statistical sample of all consumer and small business and small farm loans originated by the bank in the six months preceding this evaluation reveals that a significant majority of the loans were made inside the assessment area. The following table shows the percentages of loans in and out of the assessment area, including the number of loans and the dollar amount of each of the two categories sampled.

DISTRIBUTION OF LOANS IN/OUT OF ASSESSMENT AREA								
LOAN TYPE	IN				OUT			
	# of Loans	%	Amt of Loans (000s)	%	# of Loans	%	Amt of Loans (000s)	%
Consumer loans (136)	125	92%	\$525	92%	11	8%	\$44	8%
Small business/farm (81)	71	88%	\$1.727	88%	10	12%	\$226	12%
Totals (217)	196	90%	\$2.252	89%	21	10%	\$270	11%

As the table above shows, a significant majority of the bank's loans in the statistical sample were made within the bank's assessment area. Based on the high concentration of lending within the assessment area, the bank exceeds the standards for satisfactory performance in this category.

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

The bank's level of lending to individuals of different income levels and to small businesses of different sizes exceeds the standards for satisfactory performance. As previously mentioned, CRA groups income levels into four categories: low, moderate, middle, and upper.

The following table illustrates the distribution of the consumer loans in the CRA sample by borrower income level.

DISTRIBUTION OF CONSUMER LOANS IN THE ASSESSMENT AREA BY BORROWER INCOME LEVEL*					
	Low Income	Moderate Income	Middle Income	Upper Income	Total
Total number of loans	52 42%	43 34%	20 16%	10 8%	125 100%
Total amount of loans	\$157,686 30%	\$167,237 32%	\$121,127 23%	\$78,960 15%	\$525,010 100%
*Income level is based on Montana 1997 median family income of \$36,100.					

The data in the table indicate that the bank originated 76% of its total number of consumer loans in the sample to low- and moderate-income borrowers. In addition, the table shows 62% of the total amount of the bank's consumer loans were made to low- and moderate-income borrowers. This distribution compares favorably with the population of low- and moderate-income borrowers in the assessment area. As previously mentioned in the Description of Assessment Area section, approximately 49% of the population in the bank's assessment area is classified as low- and moderate-income families, based on the 1990 census figures. To define this percentage further, only 39% of the assessment area's population live in the moderate-income BNAs, yet the bank originated 76% of its total number of consumer loans to these borrowers. As previously indicated, the bank offers a variety of conventional credit services. The bank participates in several loan programs targeted to first-time and low- and moderate-income real estate borrowers, including FHA, VA, and HUD Section 184 loans. The Section 184 Loan Program provides homeownership to American Indians on tribal trust land. Based on the foregoing reasons, it is evident the bank aggressively pursues and provides for the credit needs of the low- and moderate-income borrowers.

In the small business-small farm loan sample, 99% of the number of loans were to borrowers with gross annual revenues of \$1 million or less. Within this group, 96% were made in amounts under \$100,000. The remaining loans consisted of two loans in the \$100,000 to \$250,000 range and one loan in the \$250,000 to \$1 million range. The loans were reasonably distributed throughout the assessment area. Based on the bank's emphasis on lending to small businesses and small farms, its very active consumer lending to low- and moderate-income borrowers, and the lack of any unmet credit needs, the bank demonstrates a strong commitment to meeting the credit needs of all segments of the assessment area and exceeds the standards for satisfactory performance in this category.

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 four moderate-income and three middle-income BNAs. The bank's main office is located in a middle-income BNA, and the Hot Springs and Arlee offices are located in separate moderate-income BNAs, one in Sanders County and the other in Lake County.

The following table shows the distribution of the bank's consumer and small business and small farm loans in moderate- and middle-income BNAs.

DISTRIBUTION OF LOANS IN THE ASSESSMENT AREA BY BNA INCOME LEVEL*		
Loan Type	Moderate-Income BNAs	Middle-Income BNAs
<u>Consumer</u>		
Total Number of Loans	79 (63%)	46 (37%)
Total Amount of Loans	\$330,532 (63%)	\$194,478 (37%)
<u>Small Business-Small Farm</u>		
Total Number of Loans	44 (62%)	27 (38%)
Total Amount of Loans	\$918,191 (53%)	\$808,719 (47%)
*The bank's assessment area includes no low-income or upper-income BNAs.		

As previously stated, only 39% of the assessment area's population lives in the moderate-income BNAs. The bank's consumer lending performance in the moderate-income BNAs exceeds the representation of residents in such areas as compared with the total assessment area population. Given this population distribution and concentration in the assessment area, the bank's consumer loan originations to residents of the moderate-income BNAs exceed expectations despite the fact that the bank has two offices located in moderate-income BNAs.

As the above table indicates, the bank's small business and small farm lending performance in the moderate-income BNAs is quite high and exceeds expectations. Bank management indicated the bank continues to support commercial activities in the Hot Springs and Arlee communities by originating loans to the existing retail establishments and looks for ways to accommodate new business ventures. The commercial development of both areas is limited by poor infrastructure. Recent developments through the Lake County Community Development Corporation ("LCCDC") indicate progress has been made by the organization working with the communities of Ronan, Pablo, Arlee, St. Ignatius, and Hot Springs to create and/or renovate public sewer and water systems, complete funding packages, and administer the resulting construction projects. The bank has been working very closely with the LCCDC and has been instrumental in providing financial expertise and direction in getting the financing for the water system project finalized.

Based on the distribution of the bank's consumer and small business loans in the moderate-income BNAs of the assessment area, the continued operation of two branch offices in the moderate-income geographies, the lack of unmet credit needs, and the fact there is a limited number of existing small businesses in the moderate-income BNAs, the bank has demonstrated strong lending performance in this area and exceeds satisfactory performance standards.

INVESTMENTS AND SERVICES

The locations of the bank's main office and branches significantly enhance the availability of credit and other bank services for residents of the assessment area. The main office is centrally located in the assessment area, while the Hot Springs branch is on the western border of the Reservation and the assessment area and the Arlee branch office is located at the southern end of the assessment area. It is notable that both the Hot Springs and Arlee offices are located in BNAs classified as moderate-income and there are no other financial institutions serving these areas. The bank also allows unaffiliated professionals, such as accountants and attorneys, to use office space at the Hot Springs and Arlee locations, which provides an additional service and convenience to the local residents of these communities.

Bank management actively solicits and extends credit to all segments of its assessment area, including low- and moderate-income residents and minorities. Bank management routinely assists and counsels applicants, particularly those who might have difficulty qualifying for credit. The bank is a strong supporter of community development in its assessment area. Bank management assesses community and economic development needs in the bank's assessment area through active involvement in several of the local community development and housing development agencies in the area. For example, the bank's president serves on the board of the LCCDC and the bank's vice president serves on the board of the Lake County Community Housing Development Organization. In addition, the bank's cashier is on the board of the Ronan Housing Authority. Also, a branch officer is on the Sanders County Economic Development Association.

Since the last evaluation, the bank has assisted in obtaining several community block grants and has provided follow-up funding of many of the programs to construct and remodel low-income housing units, expand businesses to provide for new jobs in the community primarily for low- and moderate-income individuals, and help start new businesses for low-income individuals. In addition, the bank bids on local bond issues and purchases municipal bonds from communities within the bank's assessment area when offered. The bank currently holds several municipal bonds that helped finance a group home for low- and moderate-income people with developmental disabilities. These bonds are classified as qualified investments. The bank also regularly donates funds to a wide variety of diverse tribal causes that serve the needs of low- and moderate-income individuals, including educational and employment-assistance programs operated by the Tribe. The bank also provides direct funding for projects throughout its assessment area to stimulate local development and is very active in the SBA-guaranteed business start-up loan program.

The bank maintains regular contact with the Tribal Housing Authority and the Tribal Credit Offices to keep abreast of housing and credit needs and programs available to members of the Tribe. One of the community contacts stated that local financial institutions have always been receptive to Tribal Housing Authority credit needs by providing short-term financing, federal assistance, and letters of credit to local American Indian contractors. Bank management indicated the bank is working with the tribal offices on a program that teaches individuals the basics of personal finance.

The bank's active level of involvement in providing qualified investments and services within the assessment area significantly enhances the bank's overall CRA performance.

GENERAL

The evaluation did not reveal any substantive violations of fair lending laws and regulations. However, it did reveal a procedural violation of monitoring information collection provisions of Regulation B. Bank management promised prompt corrective action. In addition, the bank has not received any CRA complaints since the previous evaluation.

PUBLIC DISCLOSURE

August 4, 1997
Date of Evaluation

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

Valley Bank of Ronan
Name of Depository Institution

093008770000
Identification Number of Institution

Ronan, Montana
Address of Institution

Federal Reserve Bank of Minneapolis
90 Hennepin 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.