

## 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 Victoria State Bank, Victoria, Minnesota, prepared by the Federal Reserve Bank of Minneapolis, the institution’s supervisory agency, as of May 27, 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.”

There are several factors that support the bank’s satisfactory rating. First, the bank’s loan-to-deposit ratio indicates that the bank is an active lender. Second, based on an analysis of its loans, the bank lends to borrowers of many different income levels and to businesses of different sizes. Third, the bank’s distribution of loans throughout its assessment area is reasonable. Finally, the bank has a reasonable number of loans within its assessment area.

## **DESCRIPTION OF INSTITUTION**

The bank is able to meet the credit needs of its assessment area effectively. At its last evaluation for CRA, the bank received a satisfactory rating. Its only office is located in Victoria, Minnesota, an outer-ring suburb of the Minneapolis-St. Paul metropolitan area. The bank operates two automated teller machines ("ATM"). The first ATM is located in the bank's outer lobby and is available to customers 24 hours a day. The second ATM is located at a local gas station and available to customers from 7 a.m. to 11 p.m. In addition to Victoria State Bank, the parent company, Klein Bancorporation, Inc., Chaska, Minnesota, owns four other banks located in the bank's assessment area.

According to the March 31, 1997, Report of Condition ("ROC"), the bank had total assets of approximately \$33.9 million, an increase of 13.7% from the bank's March 31, 1996, ROC, which showed total assets of approximately \$29.8 million. Loans and deposits during that time period increased 17.2% and 13.8%, respectively. The bank attributes this growth to strong loan demand generated by the housing boom that is occurring in Victoria and the surrounding area. This is also reflected in the composition of the bank's loan portfolio. According to March 31, 1997, ROC data, the loan portfolio includes 38% consumer real estate, 43% commercial, 18% consumer, and 1% agricultural loans. The loan portfolio also shows that 16% of the consumer real estate loans are construction loans.

The bank offers a variety of loan products that serve the credit needs of the residents and businesses within its assessment area. It extends consumer open- and closed-end, residential real estate, and commercial loans. The bank also provides loans guaranteed by federal and state agencies.

## **DESCRIPTION OF VICTORIA STATE BANK'S ASSESSMENT AREA**

The bank's assessment area includes 19 census tracts in the southwestern section of the Minneapolis-St. Paul metropolitan statistical area ("MSA"). The tracts are as follows: 263.02, 272.03, 274, 275.01, 275.02, 276.01, 276.02, 277 in Hennepin County and 901, 903 through 910, 911.98, and 912 in Carver County. Victoria is located in Carver County, approximately 25 miles southwest of Minneapolis, Minnesota. Communities included in the assessment area are Chanhassen, Chaska, Cologne, Norwood-Young America, St. Bonifacius, Waconia, and Watertown as well as several Lake Minnetonka communities. The population for Victoria and Carver County has been rising dramatically. Using 1994 estimated data from the State of Minnesota, Victoria's population is 2,926, a 24% increase since the 1990 U.S. Census. The population for Carver County has increased to 55,025 from 47,915, a 15% increase, while the entire MSA population increased by 12% in that time period. 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").

Examiners made contacts with local and county government officials as part of the CRA evaluation process. Information obtained from these individuals and from bank management was used in evaluating the bank's CRA performance.

While Victoria could technically be described as a suburban community, it is probably best described as a growing bedroom community. There are no grocery stores, major shopping areas, or medical and dental clinics in Victoria. The school district that includes Victoria is very large and no schools are actually located in the city. Bank management and a community contact indicated that the lack of a school, particularly an elementary school, is an important issue for the residents. City officials are hopeful that a

school will be built in Victoria within the next few years and have even set aside land for development. Most of the residents in Victoria commute to work in the Minneapolis-St. Paul metropolitan area.

Victoria's business district is very small. The city has designated downtown Victoria as a Tax Increment Finance ("TIF") district. According to bank management, the city would like to purchase homes that are located in the business district to develop a more pleasing downtown area. The TIF designation should attract new business development in the downtown area as well. Downtown Victoria is located next to the Carver County Regional Park. Ideally, the city would like to establish a shopping area that would blend in with the park system and attract more visitors. The city has a few small manufacturing companies and a group home for developmentally disabled young adults as its major employers. Housing construction and related services such as nurseries and landscaping companies are also contributing to the local economy.

CRA divides income levels into four categories: low, moderate, middle, and upper. The categorization of a borrower or geography's income is determined relative to the MSA's median family income. Low-income individuals have incomes of less than 50% of the MSA's 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 MSA's median family income. An individual with an income that is 120% or more of the MSA's median family income is considered an upper-income person. According to the 1997 updated census data, the median family income for the MSA is \$57,300.

According to 1990 census data, 12 of the 19 census tracts in the assessment area are classified as middle income. The remaining seven tracts are classified as upper income. There are no low- or moderate-income census tracts in the assessment area. Using the 1990 census data, the assessment area's median family income is \$47,272, while the median household income is \$42,352. This is significantly above the median family and household incomes for the MSA, which are \$43,063 and \$36,468, respectively. Of the 29,308 households in the assessment area, approximately 15% are low income, 15% are moderate income, 22% are middle income, and 48% are upper income. Approximately 5% of the households and 3% of the families have incomes below the poverty level.

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

The bank has done a satisfactory 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 77 residential real estate loans and 79 commercial loans originated in the 12 months preceding the evaluation. The criteria discussed below were reviewed in determining this rating. In assigning the overall rating, greatest weight was placed on the assessment of lending to borrowers of different income levels and businesses of different sizes and the geographic distribution of loans. These two factors most closely measure the bank's efforts to meet the credit needs of all segments of its community.

### **LOAN-TO-DEPOSIT RATIO ANALYSIS**

The bank's loan-to-deposit ratio exceeds the standards for satisfactory performance based on the ratio's consistently strong level and its comparison to local competitors, loan demand, and the lack of any unmet credit needs. Since the previous evaluation, the quarterly average of the bank's net loan-to-deposit ratio is 76.4%. According to the March 31, 1997, ROC, the bank's loan-to-deposit ratio was 78.0%. The following chart, based on quarterly ROC data, shows the steady growth of the bank's loans and deposits

since the previous evaluation. The lower than usual loan volume as of March 1997 reflects the long winter and a slowing in construction due to more severe weather conditions than in prior years. The growth in deposits from March to June in 1996 and again from September to December 1996 was the result of special certificate of deposit promotions by the bank to fund the increased loan demand. The decrease in deposits in March 1997 reflects the payout of some of the maturing certificates.

<b>DATE</b>	<b>DEPOSITS (In thousands)</b>	<b>NET LOANS (In thousands)</b>	<b>NET LOAN-TO- DEPOSIT RATIO</b>
March 31, 1997	\$30,348	\$23,668	78.0%
December 31, 1996	\$31,407	\$23,596	75.1%
September 30, 1996	\$29,181	\$23,202	79.5%
June 30, 1996	\$29,438	\$21,621	73.4%
March 31, 1996	\$26,672	\$20,234	75.9%

According to its March 31, 1997, Uniform Bank Performance Report ("UBPR"), the bank's 78.0% loan-to-deposit ratio is above its peer group average of 65.8%. The bank's ratio places it in the 78th percentile compared with its peers. The following chart shows the asset size and average net loan-to-deposit ratio for the bank's local competitors.

<b>BANK</b>	<b>TOTAL ASSETS (As of March 31, 1997) (In thousands)</b>	<b>QUARTERLY AVERAGE NET LOAN- TO-DEPOSIT RATIO</b>
Victoria State Bank	\$33,949	76%
State Bank of Chanhassen Chanhassen, Minnesota	\$73,441	62%
First National Bank of Chaska Chaska, Minnesota	\$100,280	70%
First National Bank of Waconia Waconia, Minnesota	\$131,283	75%
Security Bank of Waconia Waconia, Minnesota	\$62,566	67%

As shown above, while the bank's asset size is considerably smaller than that of its competitors, its loan-to-deposit ratio is higher than the competition. Bank management stated that loan demand in the area has been very strong. The bank has a good reputation with the small home builders in the area and gets many referrals from them for temporary construction loans as well as permanent mortgage financing. Community contacts did not state that there were any unmet credit needs in the area. It should be noted that some of the competitors listed are affiliates of the subject bank.

Based on the bank's consistently strong loan-to-deposit ratio, comparison to competitors, its UBPR peer ranking, and the lack of any identified unmet credit needs, the bank's loan-to-deposit ratio exceeds the standards for satisfactory performance.

### COMPARISON OF CREDIT EXTENDED INSIDE AND OUTSIDE THE ASSESSMENT AREA

Overall, the bank's lending in its assessment area meets the standards for satisfactory performance. The following chart based on the CRA loan sample shows the percentage of loans within the assessment area based on total number and loan amount in each loan category in the sample.

<b>PERCENTAGE OF LOANS IN THE ASSESSMENT AREA</b>		
<b>Loan Type</b>	<b>Total Number of Loans</b>	<b>Total Amount of Loans</b>
Residential Real Estate	44	38
Commercial	78	70

While the number and dollar amounts of residential real estate loans appear to be low, there is an explanation. The loan sample includes 17 contractor construction loans totaling \$2,340 million, representing 22% of the loans in the sample. All but one of the loans is located outside the assessment area. The dollar amount for these loans is also typically greater than the other real estate loans in the sample. The average loan size for these contractor loans was \$137,671, while the average loan size for the remaining loans in the sample was \$95,090. If the contractor loans were excluded from the sample, the percentage of loans in the assessment area would increase to 55%. As previously mentioned, residential real estate construction loans make up 16% of the bank's residential real estate loan portfolio. Thirty-eight percent of the bank's loan portfolio is residential real estate loans. Real estate construction loans generally are not reported for HMDA purposes.

The 1995 and 1996 HMDA data indicate that the bank is lending in its assessment area. In 1995, the bank originated 78% of its HMDA-reportable loans within the assessment area. In 1996, 74% of the HMDA loans the bank originated were within the assessment area. Comparison of the bank to the aggregate in 1995 is not meaningful as the bank originated less than 1% of all loans in the assessment area. The 1996 preliminary HMDA data does not have an aggregate component as of this evaluation.

The table also indicates that the bank makes a substantial majority of its commercial loans in the assessment area. Commercial loans represent 43% of the bank's loan portfolio.

Based on the percentage of commercial loans originated inside the assessment area, the bank's lending activity is reasonable and therefore meets the standards for satisfactory performance. The concentration of nonconstruction consumer real estate loans in the assessment area as demonstrated by the bank's HMDA data also supports the conclusion that lending in the assessment area is reasonable.

### 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 businesses of different sizes is reasonable and meets 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 residential real estate loans in the CRA sample by borrower income level.

<b>DISTRIBUTION OF LOANS IN THE ASSESSMENT AREA BY BORROWER INCOME LEVEL*</b>				
<b>Loan Type</b>	<b>Low-Income Borrowers</b>	<b>Moderate-Income Borrowers</b>	<b>Middle-Income Borrowers</b>	<b>Upper-Income Borrowers</b>
<b>Residential Real Estate:</b>				
Total Number of Loans	15%	15%	45%	24%
Total Amount of Loans	9%	8%	44%	39%
*Income level is based on 1997 median family income of \$57,300 for the Minneapolis-St. Paul MSA.				

The data in the table indicate that the bank originated 30% of its residential real estate loans in the sample to low- and moderate-income borrowers. As previously mentioned in the Description of Assessment Area section, approximately 30% of the households in the bank's assessment area are classified as low- and moderate-income according to the 1990 census figures. It appears that the bank's level of residential real estate lending matches the percentage of low- and moderate-income borrowers in the assessment area. The number of loans originated for middle-income borrowers exceeds the percentage of households in that category.

Information from community contacts indicated that there is a lack of affordable housing in the assessment area. In a study conducted for Carver County, the median home value for the county for 1996 was \$105,900. Many of the new housing developments in the assessment area are designed for middle- and upper-income individuals.

Based on 1995 HMDA data, 18% of the loans originated by the bank were to low- and moderate-income borrowers. The aggregate lenders made 20% of the loans in the assessment area to low- and moderate-income borrowers. In 1996, the bank's level of lending to low- and moderate-income borrowers increased to 42%. As previously mentioned, aggregate information for 1996 was not available at the time of the evaluation.

A significant number of the commercial loans in the sample were made to small businesses, defined as those businesses having gross annual revenues of \$1 million or less. Seventy-four percent of the loans in the sample were to small businesses. Approximately 82% of the loans in the sample had loan amounts of less than \$100,000. This distribution of commercial loans is consistent with the bank's asset size and the bank's overall assessment area economic conditions.

Based on the level of consumer real estate lending to low- and moderate-income borrowers as compared with the representation of those individuals in the community and the number of small business loans originated, the bank meets the standards for satisfactory performance.

**GEOGRAPHIC DISTRIBUTION OF LOANS**

The distribution of the bank's loans throughout its assessment area is reasonable. As previously discussed, the bank's assessment area includes 12 middle-income census tracts and 7 upper-income census tracts. There are no low- or moderate-income census tracts in the assessment area. Approximately 66% of the population resides in the middle-income census tracts. The following table illustrates the distribution of loans in the CRA sample by census tract income level.

<b>DISTRIBUTION OF LOANS IN THE ASSESSMENT AREA BY CENSUS TRACT INCOME LEVEL</b>		
<b>Loan Type</b>	<b>Middle-Income Census Tracts</b>	<b>Upper-Income Census Tracts</b>
<u>Residential Real Estate</u>		
Total Number of Loans	91%	9%
Total Amount of Loans	83%	17%
<u>Commercial Loans</u>		
Total Number of Loans	69%	31%
Total Amount of Loans	74%	26%

While the number of loans in the middle-income tracts exceeds the population, there is an explanation for the concentration of loans in these tracts. Most of the development and construction in the area is occurring in the middle-income tracts. The upper-income tracts are more developed, and there is less real estate activity in these areas. The commercial loans appear to be reasonably distributed throughout the bank's assessment area. Based on the analysis of the loans in the sample, the bank's level of lending to geographies of different income levels appears reasonable and meets the standards for satisfactory performance.

#### GENERAL

The evaluation did not reveal any substantive violations of fair lending laws and regulations. The evaluation revealed violations of technical aspects of HMDA's Regulation C. Bank management promised to correct the violations promptly. In addition, the bank has not received any CRA-related complaints since the previous evaluation.

## **PUBLIC DISCLOSURE**

May 27, 1997

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Date of Evaluation

## **COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION**

Victoria State Bank

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Name of Depository Institution

092761800000

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Identification Number of Institution

Victoria, Minnesota

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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.