

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 First State Bank of Rushmore, Rushmore, Minnesota, prepared by the Federal Reserve Bank of Minneapolis, the institution’s supervisory agency, as of September 2, 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.”

There are several factors that support the bank’s outstanding rating. First, based on an analysis of its loans, the bank actively lends to borrowers of many different income levels and to businesses of different sizes. Second, the bank’s distribution of loans throughout its assessment area is reasonable. Third, the bank’s loan-to-deposit ratio indicates that it is an active lender. Fourth, the bank has a significant majority of its loans within its assessment area. Finally, the bank’s level of investments and services provided to the community is commendable. This high level of investments and service enhances the bank’s overall CRA performance.

DESCRIPTION OF INSTITUTION

The bank is able to meet the credit needs of the communities in its assessment area effectively. The bank received an outstanding rating at its last evaluation. The bank's designated main office is located in Rushmore, Minnesota. It operates a full-service office in Worthington, Minnesota, as well as three automated teller machines ("ATM"). The ATMs are available 24 hours a day. The ATM located at the Worthington branch office accepts deposits, the remaining two ATMs are cash-dispensing only. While the Rushmore office is the designated main office, the office in Worthington is generally considered to be the bank's principal office. All of the bank's operations and most of the loan processing are handled out of this office. Since the previous evaluation, the bank has added a 24-hour telephone banking service. This service allows bank customers to make account inquiries, transfer funds between accounts, and make loan payments from accounts with the bank using a toll-free number.

According to the June 30, 1997, Report of Condition ("ROC"), the bank had total assets of approximately \$57.8 million. Since June 30, 1996, the bank's assets increased approximately \$3.2 million, or 5.8%. Net loans have increased by approximately \$3.7 million, or 11.5%. Deposits grew less dramatically, with an increase of \$2.6 million, or 5.2%. The bank's loan portfolio is composed of approximately 39% agricultural, 30% commercial, 20% consumer real estate, 10% consumer, and 1% other loans. The composition of the loan portfolio reflects the level of demand for specific credit products by residents of the assessment area.

The bank offers a variety of loan products to meet the credit needs of the residents of its assessment area. It extends open- and closed-end consumer, residential real estate, commercial, and agricultural loans. In addition to offering conventional loan products, the bank participates in several federal and state loan programs including those sponsored by Farm Service Agency, Small Business Administration, and Minnesota Housing Finance Agency ("MHFA"). The bank does not originate purchase money real estate transactions for MHFA, but it refers those applications to another financial institution in Worthington. The bank does, however, take the initial application and will provide the initial disclosures to the applicant. Loan officers will also provide assistance to applicants in qualifying for the loan program. The MHFA program is directed toward first-time homebuyers with low and moderate incomes.

DESCRIPTION OF FIRST STATE BANK OF RUSHMORE'S ASSESSMENT AREA

The bank defines its assessment area as Nobles County, Minnesota, located in the southwestern corner of Minnesota. The county's southern border is the Minnesota-Iowa state line. There are six block numbering areas ("BNA") in the county: 9901 through 9906. BNA 9906 is designated upper income while the remaining five BNAs are classified as middle income. According to 1990 U.S. Census data, the population of the assessment area is 20,098. Worthington, the county seat, has a population of 9,977; it is the largest community in the assessment area. Rushmore's population is 381. Other communities in the assessment area include Adrian, Brewster, and Round Lake.

CRA divides income levels into four categories: low, moderate, middle, and upper. Because the bank's assessment area is not in a metropolitan statistical area ("MSA"), 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 income. An individual with an income that is 120% or more of this

figure is considered an upper-income person. BNAs are classified using similar categories based on the level of the median family income in the geography.

According to 1990 census data, the assessment area's median family income is \$28,427, while the median household income is \$22,942. The median family and household incomes for nonmetropolitan areas in Minnesota are \$28,933 and \$23,627, respectively. Of the 7,758 households in the assessment area, approximately 23% are low income, 17% are moderate income, 20% are middle income, and 40% are upper income. Approximately 12% of the households and 9% of the families have incomes below the poverty level.

Examiners contacted a government official familiar with housing-related credit needs within the assessment area. Information obtained from this individual along with information received from bank management was used in evaluating the bank's CRA performance.

Agriculture and its related industries are the dominant economic force in Nobles County. The county is one of the state's largest hog producers. While pork prices have remained strong, the area has suffered over the past 12 months. Winter was especially difficult with many blizzards, and the county was declared a disaster area by the federal government. The area was fortunate to escape the spring's severe flooding that occurred in the Red River Valley. On August 1, 1997, after many months of uncertainty, Worthington's second largest employer closed its poultry-processing plant. The plant employed 435 workers and had been in the area for more than 40 years. Worthington's civic leaders have been working with state officials to find a buyer for the property and hope to attract a business that will employ as many of the displaced workers as possible. The bank president is serving on this committee.

According to 1990 census data, the assessment area has 8,094 total housing units. Of these, 72% are owner-occupied units, 23% are rental units, and the remaining 5% are vacant or boarded up. There are 7,758 households in the assessment area. Of these households, 5,791, or 75%, are owner occupied. Seventy-nine percent of the owner-occupied households are located in the assessment area's five middle-income BNAs. Housing demand in the area is high, particularly for quality single-family rental homes. The area has had a substantial population increase due to the resettlement of refugees from Ethiopia and Somalia. While vacancy rates for rental properties are low at 2%, the quality of the housing is less than desirable. The community contact stated that this creates a difficult situation for renters. Because rents at the existing housing units are low, individuals are sometimes reluctant to move into better housing with higher monthly rents. One of the local housing offices is trying to educate renters on the hidden costs of lower quality housing. The contact also stated that while housing demand is high for all price ranges, prices for existing real estate appear to be high and possibly inflated. There has been new housing development but the number of units targeted to low- and moderate-income individuals has been limited.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

The bank has done an outstanding 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 120 agricultural loans, 98 commercial loans, and 127 consumer loans. The criteria discussed below were reviewed in determining this rating. In assigning the overall rating, the greatest weight was placed on the assessment of lending to borrowers of different income levels and businesses and farms of different sizes. This factor along with the bank's level

of community development lending, qualified investments and services most closely measure the bank's success in meeting the credit needs of all segments of its community.

LOAN-TO-DEPOSIT RATIO ANALYSIS

The bank's loan-to-deposit ratio meets the standards for satisfactory performance based on the ratio's consistent level, loan demand, the lack of any unmet credit needs, and its comparison to local competitors. Since the previous evaluation, the quarterly average of the bank's net loan-to-deposit ratio is 68.7%. According to the June 30, 1997, ROC, the bank's net loan-to-deposit ratio was 69.2%. The following chart, based on quarterly ROC data, shows the steady growth of the bank's loans and deposits. The fluctuations in loan volume are typical of an agricultural-based loan portfolio. Deposits tend to fluctuate with the level of public funds that are available for deposit at any given time.

DATE	DEPOSITS (In thousands)	NET LOANS (In thousands)	NET LOAN-TO- DEPOSIT RATIO
June 30, 1997	\$51,400	\$35,573	69.2%
March 31, 1997	\$51,800	\$35,426	68.4%
December 31, 1996	\$51,645	\$36,921	71.5%
September 30, 1996	\$50,232	\$34,619	68.9%
June 30, 1996	\$48,845	\$31,897	65.3%

According to the June 30, 1997, Uniform Bank Performance Report ("UBPR"), the bank's 69.2% loan-to-deposit ratio is slightly above its peer group average of 66.2%. The bank's ratio places it in the 55th 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.

BANK	TOTAL ASSETS (As of June 30, 1997) (In thousands)	QUARTERLY AVERAGE NET LOAN-TO- DEPOSIT RATIO
First State Bank of Rushmore Rushmore, Minnesota	\$57,760	68.7%
United Prairie Bank Mountain Lake, Minnesota	\$81,812	79.2%
Adrian State Bank Adrian, Minnesota	\$22,406	63.9%
First National Bank of Brewster Brewster, Minnesota	\$24,982	46.9%
Ellsworth State Bank Ellsworth, Minnesota	\$27,345	28.0%

The banking competition in the Worthington area is intense. In addition to the financial institutions listed above, there are branch offices of two large regional banks, a savings and loan, and a credit union. Nonbank financial institutions such as Farm Credit Services also are very active in the community. Bank management stated that Farm Credit Services has been particularly aggressive by offering loan rates that the banks have been unable to match. Information received from the community contact and bank management did not indicate that there were any unmet credit needs.

The bank made a significant community development loan during this evaluation period. Funds were loaned as interim construction financing on a tax-credit project to build a 24-unit apartment complex. The units are each three to four bedroom and are targeted to low- and moderate-income families.

Based on the strong competition for loans, the bank's consistent loan-to-deposit ratio, its willingness to participate in community development lending, and the lack of any identified unmet credit needs, the bank's loan-to-deposit ratio meets the standards for satisfactory performance.

COMPARISON OF CREDIT EXTENDED INSIDE AND OUTSIDE THE ASSESSMENT AREA

A review of the statistical sample of the loans originated by the bank in the six months preceding the evaluation reveals that a significant majority of the loans were made inside the assessment area. The following table shows the percentage of loans within the assessment area based on total number and loan amount in each major loan category.

PERCENTAGE OF LOANS IN THE ASSESSMENT AREA		
Loan Type	Total Number of Loans	Total Amount of Loans
Consumer	83%	80%
Agricultural	88%	95%
Commercial	83%	90%

As previously mentioned, 70% of the bank's loan portfolio is composed of agricultural and commercial loans. It is reasonable that the number of consumer loans is not as high. In addition, there are several borrowers in the consumer loan sample who reside just outside the assessment area.

Based on the very high concentration of the bank's major loan categories 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 borrowers of different income levels and to businesses and farms of different sizes significantly exceeds the standards for satisfactory performance. 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 LEVEL*				
Loan Type	Low-Income Borrowers	Moderate-Income Borrowers	Middle-Income Borrowers	Upper-Income Borrowers
<u>Consumer</u>				
Total Number of Loans	43%	33%	12%	11%
Total Amount of Loans	31%	27%	13%	29%

*Income level based on Minnesota's 1997 non-MSA median family income of \$38,400.

The data in the table indicate that the bank originated a significant majority, or 76%, of its consumer loans to low- and moderate-income borrowers. As previously mentioned in the Description of Assessment Area section, approximately 40% of the households in the assessment area are classified as low and moderate income according to the 1990 census figures. The bank's level of lending to low- and moderate-income borrowers significantly exceeds the demographic distribution. There are several reasons for this. First, according to bank management, the bank has historically been considered the primary financial institution that caters to "blue collar" workers. Second, the segment of the population that is growing the fastest is low- and moderate-income individuals. As mentioned earlier, the area has had a significant number of resettled refugees from Ethiopia and Somalia. This immigrant population typically holds low-wage jobs while developing job skills. Finally, 46% of the city of Rushmore's population is classified as low to moderate income according to 1990 census data. The bank is commended for being an active lender to the low- and moderate-income residents of its assessment area.

All of the commercial and agricultural loans in the sample were made to small businesses and small farms. The definition for a small business or small farm is a business or farm with gross annual revenues of \$1 million or less. Approximately 93% of the commercial loans and 96% of the agricultural loans in the sample were for loan amounts of \$100,000 or less. This distribution is consistent with the bank's asset size and the bank's overall assessment area economic conditions.

The bank's high percentages of loans to small businesses and small farms and particularly consumer loans to low- and moderate-income borrowers demonstrates its strong commitment to meeting the credit needs of all residents of its community. The bank's performance in this category significantly exceeds 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 one upper-income BNA and five middle-income BNAs. There are no low- or moderate-income BNAs in the assessment area. Approximately 80% of the population resides in the middle-income BNAs. The following table illustrates the distribution of loans in the CRA sample by BNA income level.

DISTRIBUTION OF LOANS IN THE ASSESSMENT AREA BY BNA INCOME LEVEL		
Loan Type	Middle-Income BNAs	Upper-Income BNA
<u>Consumer</u>		
Total Number of Loans	75%	25%
Total Amount of Loans	64%	36%
<u>Commercial</u>		
Total Number of Loans	89%	11%
Total Amount of Loans	87%	13%
<u>Agricultural</u>		
Total Number of Loans	96%	4%
Total Amount of Loans	97%	3%

A tract-by-tract analysis reveals that the bank's loans are reasonably distributed throughout the middle-income BNAs. The low level of agricultural and commercial lending in the upper-income BNA is reasonable because this BNA is located within the city limits of Worthington and is largely residential. Based on these factors, the bank's level of lending to geographies of different income levels appears reasonable and meets the standard for satisfactory performance.

INVESTMENTS AND SERVICES

The bank has an excellent record of helping to meet the credit needs of its assessment area through its qualified investments and the banking services it provides to benefit low- and moderate-income individuals.

Investments

The bank is an active participant in all available investments that have community development as their primary purpose. The bank has made substantial contributions to a local residential school and sheltered workshop for low- and moderate-income physically disabled persons. In addition, the bank has invested in a bond for the construction of an expanded facility for the workshop. With the expansion, the school will be able to provide more jobs for its residents. The bank also continues to hold in its investment portfolio a security that provided funding for the construction of an apartment building for low- and moderate-income households. Total investments were \$400M, half of which represent new investments since the last evaluation. Given the bank's size and the rural nature of the community, this level of investments is noteworthy.

Services

The bank is very effective in delivering retail banking services to low- and moderate-income individuals. In January, the bank added a toll-free, 24-telehour phone banking service. Customers can access their checking and savings accounts for inquiries and transfers between accounts. In addition, they can make loan payments from these accounts. As mentioned earlier, the bank also helps customers apply for loans under the MHFA First-Time Homebuyer and Federal Housing Administration loan programs. The bank has a relationship with a regional mortgage bank to process these applications. Several loans have been originated under this program. In providing this service, the bank offers low- and moderate-income loan applicants access to programs that are not within the bank's area of expertise.

Bank management has been very active in helping the employees of the recently closed poultry-processing plant. As stated earlier, this plant was Worthington's second largest employer. A bank officer was on the Worthington Area Chamber of Commerce committee that organized a job fair for these employees. The goal of the job fair was to attract potential employers that could provide jobs at similar wages and skill levels for the displaced workers. It is too soon to know how many people were able to find jobs from this event. Another bank officer is the president of a local group of business owners that promotes economic development in the Worthington area. This group has been working tirelessly to find a buyer for the closed plant. The goal is to find a buyer that will be able to use the facility and hire at least as many workers as were employed at the plant. This group was also instrumental in helping another local business remain open. The company was about to close its facility and open a new plant in another state. The company decided not to relocate and is in fact adding additional jobs. This company employs approximately 250 people, the majority being low- and moderate-income individuals. This level of service to the community is commendable and is a factor in assigning the bank an outstanding rating.

GENERAL

The evaluation revealed one violation of a technical aspect of Regulation B--Equal Credit Opportunity Act. Bank management promised prompt corrective action. The bank has not received any CRA-related complaints since the last evaluation.

PUBLIC DISCLOSURE

September 2, 1997

Date of Evaluation

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

First State Bank of Rushmore

Name of Depository Institution

092752600000

Identification Number of Institution

Rushmore, Minnesota

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.