

## 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 safe and sound operation of the institution. Upon conclusion of each 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 Community Reinvestment Act (CRA) performance of First State Bank of Hotchkiss, Hotchkiss, Colorado, prepared by the Federal Reserve Bank of Kansas City – Denver Branch, the institution's supervisory agency, as of March 16, 1998. 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 rating was assessed using the following five core performance criteria developed for evaluating small banks:

- Loan-to-Deposit Ratio
- Lending Inside the Assessment Area
- Lending to Borrowers of Different Income Levels and Businesses of Different Sizes
- Geographic Distribution of Loans
- Record of Responding to Complaints about the Bank's CRA Performance

Additionally, the bank's record of investments and services was evaluated to determine if it enhanced credit availability in the bank's assessment area.

The bank's overall performance under the CRA is considered Satisfactory. The distribution of lending activity indicates that the bank is satisfactorily lending to consumers of different income levels and to businesses of different revenue sizes. The bank's geographic lending activity is also considered satisfactory. The bank demonstrates an outstanding level of lending activity, which is reflected in a high loan-to-deposit ratio. However, a majority of the bank's lending activity is located outside the assessment area. Therefore, the bank's level of lending in its assessment area is considered "needs to improve." The bank has not received any complaints regarding its CRA performance; therefore, this performance criterion was not rated. The bank's investment and service activities have enhanced credit availability in the bank's assessment area.

The bank's performance under the CRA was last evaluated as of August 19, 1996 at which time it was assessed as Outstanding.

## DESCRIPTION OF INSTITUTION

First State Bank of Hotchkiss is located in Hotchkiss, Colorado, in the west central portion of the state. The bank operates from one full-service facility located at 102 East Bridge Street. The bank also has a separate drive-up facility located near the institution and an automated teller machine located at the local grocery store.

Based on its December 31, 1997 Report of Condition (Call Report), the bank has total assets of \$29.7 million, net loans of \$18 million, and total deposits of \$27 million. According to the bank's loan portfolio and level of lending activity, the bank's main products include commercial and consumer loans. The following table shows the distribution of loans in the institution's portfolio.

<b>DISTRIBUTION OF LOANS IN THE LOAN PORTFOLIO AS OF DECEMBER 31, 1997</b>		
<b>Type of Loan</b>	<b>Percentage of Loans by Dollar Amount</b>	<b>Percentage of Loan Originations Since the Last Examination</b>
Commercial	<b>43.0</b>	<b>62.0</b>
Loans Secured by Real Estate:		
Construction and land development	<b>44.0</b>	
Multi-Family	1.0	
Secured by nonfarm, nonresidential properties	2.0	
Farmland	1.0	
Agriculture Production	3.0	
Consumer	3.0	<b>34.0</b>
Consumer loans secured by 1- to 4-family properties	3.0	4.0
<b>TOTAL</b>	<b>100.0</b>	<b>100.0</b>

According to management, the bank's primary business focus is commercial lending with an emphasis in government-insured loans. Lending personnel have originated over \$4 million in Small Business Administration (SBA) loans since the previous examination. Additionally, lending personnel have originated \$3.5 million in loans through the Rural Economic Development Corporation's Business and Industry Lending Program since the previous examination. The First State Bank of Hotchkiss is one of only a few banks in western Colorado that are preferred SBA lenders. The preferred status allows lending personnel at First State Bank of Hotchkiss to make credit decisions on SBA loans, which greatly reduces the loan's processing time. Additionally, bank management is active in a commercial and commercial real estate loan participation program with an affiliate bank located in Englewood, Colorado. More than half of the bank's total loan portfolio consisted of these participation loans.

## DESCRIPTION OF THE BANK'S ASSESSMENT AREA

The bank's assessment area consists of all of Delta County and parts of Montrose and Gunnison Counties. The assessment area includes the towns of Hotchkiss, Delta, Cedaredge, Paonia, Crawford, Olathe, Mahar, and Somerset. The assessment area includes the Grand Mesa National Forest and a portion of the Gunnison National Forest. In addition, the assessment area includes agricultural properties.

The assessment area, which is the geographic area bank management has designated as its primary service area, consists of seven block numbering areas (BNA). Based upon 1990 Census Bureau information, the BNAs are designated as follows: two moderate-income BNAs

and five middle-income BNAs. Please refer to Attachment A for a map of the bank's assessment area.

Based on 1990 Census Bureau information, the assessment area is comprised of 26,222 individuals. Since 1990, there has been an increasing trend in population figures for the three counties represented in the bank's assessment area. Revised 1996 figures from the state of Colorado show that Delta County's population increased by 22 percent; Gunnison County's population increased by 17 percent; and Montrose County's population increased by 23 percent. The median housing price for single-family homes in Delta County for 1997 was \$86,729.

The following table shows the distribution of families in the bank's assessment area by income category. Low-income is defined as less than 50 percent, moderate-income is at least 50 percent and less than 80 percent, middle-income is at least 80 percent and less than 120 percent, and upper-income is 120 percent or more of the median family income of the nonmetropolitan areas in Colorado. The United States Census Bureau and the Department of Housing and Urban Development estimate the 1997 median family income for the nonmetropolitan areas of Colorado to be \$38,700.

<b>DISTRIBUTION OF FAMILY INCOME IN THE BANK'S ASSESSMENT AREA BY INCOME LEVEL OF FAMILIES</b>					
	<b>Low-income</b>	<b>Moderate-income</b>	<b>Middle-income</b>	<b>Upper-income</b>	<b>Total</b>
Number of Families	2,066	1,815	1,787	2,080	7,748
Percentage of Total Families	27%	23%	23%	27%	100%

According to community contacts interviewed (one member of a local trade association and one member of an economic development organization), the local economy is improving. The economy's improvement is attributed to an increase in diversified employment opportunities, as there is currently less dependence on the area's mining industry. Gross retail sales figures for Delta County indicate a fluctuating economy over a recent 4-year period. The service industry is the largest employment sector in the community, followed by retail trade and area government agencies. The major employers in the assessment area include the school districts, local coal mines, the agricultural industry, tourism, and area government agencies.

## CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

The analysis was based on data compiled from a statistically-derived sample of loans. Discussions with bank management, a review of the bank's Call Report, and a review of the volume of loan originations were used to determine the bank's major product lines. The sample of loans was then selected from the bank's major product lines. As a result, two loan types were sampled, including commercial loans and consumer loans. The sample consisted of 70 commercial and 60 consumer loans.

### Lending to Borrowers of Different Incomes and to Businesses of Different Sizes

The bank's overall level of lending to borrowers of different incomes and to businesses of different sizes is considered satisfactory. As previously presented, the following table shows the distribution of families located in the bank's assessment area by income category:

INCOME CLASSIFICATION OF FAMILIES WITHIN THE BANK'S ASSESSMENT AREA				
	Low	Moderate	Middle	Upper
Percentage of Families	27%	23%	23%	27%

The bank's distribution of lending to consumer borrowers of different income levels within the assessment area is reflected in the following table:

INCOME CLASSIFICATION OF BORROWERS IN BANK'S LOAN SAMPLE				
Percentage of Loans	Low	Moderate	Middle	Upper
By Number	30	24	18	28
By Dollar Volume	20	26	17	37

Given the demographics of the assessment area, the bank's loan sample indicates a well-distributed lending activity among individuals of all income levels. The sample indicates slightly higher lending activity to low- and moderate-income individuals. As reflected in the table, 54 percent of loan originations were to low- and moderate-income borrowers. By comparison, Census Bureau information indicates that 50 percent of the families in the assessment area are low- and moderate-income families.

The bank's lending to businesses of different sizes is considered outstanding. Ninety percent of the commercial loans originated in the assessment area were extended to businesses with gross annual revenues of \$1 million or less. The loans comprised 94 percent of the dollar volume of commercial loans sampled in the assessment area. The table on the following page shows the distribution of commercial loans to businesses of various revenue levels. Additionally, the following table shows an excellent distribution of loans to businesses with gross annual revenues less than \$100,000 and to businesses with gross annual revenues of \$500,000 or less.

<b>LENDING TO BUSINESSES OF DIFFERENT SIZES IN THE ASSESSMENT AREA</b>				
<b>Gross Annual Revenue</b>	<b>Number of Loans</b>	<b>%</b>	<b>Dollar Amount of Loans</b>	<b>%</b>
Less than \$100,000	11	36%	\$99,859	6%
Greater than or equal to \$100,000 but less than \$250,000	10	32%	\$709,715	44%
Greater than or equal to \$250,000 but less than \$500,000	5	16%	\$365,200	22%
Greater than or equal to \$500,000 but less than \$750,000	1	3%	\$335,000	21%
Greater than \$750,000 but less than \$1,000,000	1	3%	\$20,000	1%
Greater than or equal to \$1,000,000	3	10%	\$95,000	6%

### **Geographic Distribution of Loans**

The following table classifies the bank's seven BNAs into income categories and displays the percentage of families living in each, based on 1990 Census data.

<b>INCOME CLASSIFICATION OF BLOCK NUMBERING AREAS IN THE BANK'S ASSESSMENT AREA</b>				
	<b>Low</b>	<b>Moderate</b>	<b>Middle</b>	<b>Upper</b>
<b>Percentage of Total BNAs</b>	0	29	71	0
<b>Percentage of Families Residing in Designated BNAs</b>	N/A	<b>35</b>	<b>65</b>	N/A

The bank's loan sample revealed the following distribution by income classification of BNAs within the bank's assessment area.

<b>DISTRIBUTION OF LOANS ACROSS THE ASSESSMENT AREA BY INCOME LEVEL OF BNA</b>									
<b>Loan Type</b>	<b>Low</b>		<b>Moderate</b>		<b>Middle</b>		<b>Upper</b>		
	<b>#</b>	<b>\$</b>	<b>#</b>	<b>\$</b>	<b>#</b>	<b>\$</b>	<b>#</b>	<b>\$</b>	
Consumer	N/A	N/A	5	\$8,192	49	\$226,446	N/A	N/A	
<b>Percent of Total</b>	N/A	N/A	<b>9%</b>	<b>3%</b>	<b>91%</b>	<b>97%</b>	N/A	N/A	
Commercial	N/A	N/A	2	\$356,000	29	\$1,268,774	N/A	N/A	
<b>Percent of Total</b>	N/A	N/A	<b>6%</b>	<b>22%</b>	<b>94%</b>	<b>78%</b>	N/A	N/A	

The bank's geographic distribution of lending activity throughout the assessment area reflects a reasonable distribution and is therefore considered satisfactory. The consumer and commercial loan samples show that the bank's lending activity is concentrated in the middle-income BNAs with fewer loans made in the moderate-income BNAs. Demographically, 35 percent of the families in the assessment area live in the moderate-income BNAs. The sample showed that only 9 percent of consumer loans and 6 percent of commercial loans were located in the moderate-income BNAs. The distribution is considered reasonable as the bank is located in a middle-income BNA where the bank conducts almost 60 percent of its lending activity. Additionally, the moderate-income BNAs encompass Delta and Cedaredge located 20 to 30 miles from the bank. These communities are served by several other financial institutions. For example, Delta has approximately five times the population of Hotchkiss and is served by four financial institutions. Additionally, Cedaredge is almost twice the size of Hotchkiss and is served by two financial institutions. Considering these factors, the bank's geographic distribution of lending activity is considered reasonable.

## Lending in the Assessment Area

The following table reflects the bank's lending activity in its assessment area.

DISTRIBUTION OF LOANS IN AND OUT OF THE ASSESSMENT AREA								
	Inside the Assessment Area				Outside the Assessment Area			
	Number of Loans	%	\$ Amount of Loans	%	Number of Loans	%	\$ Amount of Loans	%
Consumer	54	90%	\$234,638	81%	6	10%	\$54,320	19%
Commercial	31	44%	\$1,624,774	25%	39	56%	\$4,824,773	75%
Total	85	65%	\$1,859,412	28%	45	35%	\$4,879,093	72%

The distribution of loans sampled revealed that a substantial majority of the consumer sample was located in the bank's assessment area. However, a majority of the bank's commercial sample was located outside the assessment area. Therefore, the overall performance does not meet the standards for a satisfactory rating and is considered "needs to improve."

Seventy five percent of the dollar volume of the commercial loan sample was located outside the assessment area. The large percentage is due to the bank's commercial and commercial real estate loan participations purchased through the bank's affiliate in Englewood, Colorado. As previously stated, more than half of the bank's loan portfolio consists of these loan participations; therefore, a large number of commercial loans sampled were located in the Denver metropolitan area.

As First State Bank of Hotchkiss is one of the only preferred SBA lenders in western Colorado, a large number of applicants from the Western Slope submit SBA loan requests to the bank. Therefore, as bank management is actively involved in SBA lending, a large portion of this product is also located outside the bank's assessment area. Finally, the bank's activity in the Rural Economic Development Corporation's Business and Industry Lending Program typically generates loans to businesses located outside the bank's assessment area.

The bank's substantial activity in commercial loan participations and government insured loans has not impaired its ability to meet the credit needs of its assessment area. The bank has generated approximately \$1.4 million in SBA loans to businesses within the assessment area since the last examination. Furthermore, the bank's affiliate has agreed to repurchase any loan participation if necessary, in the event First State Bank of Hotchkiss has liquidity issues to meet changing credit needs of its assessment area. Finally, community contacts stated that the First State Bank of Hotchkiss is meeting the credit needs of its assessment area. Bank management recently conducted a survey of its customers and the customers were satisfied with the bank's products and did not request any additional credit products. Bank management stated that they are committed to meeting the credit needs of their community.

## Loan-to-Deposit Ratio

The bank's loan-to-deposit ratio, which is a quick measure of the bank's overall lending activity, is considered outstanding given the bank's size, financial condition, and assessment area credit needs. The bank's average loan-to-deposit ratio for six quarters ending December 31, 1997, was 79 percent. For a local comparison, three other banks with main offices in the assessment area averaged a six-quarter loan-to-deposit ratio of 74 percent. For a more regional comparison, seven other banks located in the central western part of the state

averaged a six-quarter loan-to-deposit ratio of 74 percent. The bank's active involvement in government insured lending further supplements the bank's lending performance, which is reflected in the loan-to-deposit ratio.

### **Response to Complaints**

The final core performance criteria, which evaluates the bank's performance in responding to substantiated complaints about its performance in meeting assessment area credit needs, is not rated. The bank has not received any complaints about its performance in meeting assessment area credit needs; therefore, no assessment of the bank's performance in responding to complaints was made.

### **Qualified Investments**

This performance criterion focuses on the bank's investment record in enhancing credit availability in its assessment area. A qualified investment is defined as a lawful investment, deposit, membership or grant that has as its primary purpose community development. Community development encompasses affordable housing for low- and moderate-income individuals; community services targeted to low- and moderate-income individuals; activities that promote economic development; or activities that revitalize or stabilize low- and moderate-income geographies.

The bank's investment record enhances credit availability in its assessment area. The bank provides a \$27,000 annual grant and provides additional financing as needed to the Colorado Housing Partnership. The Colorado Housing Partnership was formed by the bank's affiliate. The partnership's main focus is refurbishing residential areas by providing affordable housing for low- and moderate-income individuals. In conjunction with this organization, First State Bank of Hotchkiss financed the construction of three affordable homes in the bank's assessment area.

Additionally, bank management recently contributed \$5,000 to the Revolving Loan Fund of the Region 10 League for Economic Assistance and Planning. The organization serves a six-county area, including Delta County. The revolving loan fund's primary purpose is to finance start-ups or expansion of manufacturers and agricultural processors. As a condition of granting credit, at least 51 percent of the new businesses' employees must be low- or moderate-income individuals. The bank also provided a substantial majority of financing to three businesses in participation with the Region 10 Revolving Loan Fund since the last examination.

### **Qualified Services**

This performance criterion focuses on the bank's record of providing branches, ATMs, loan production offices, and/or other delivery systems that enhance credit availability in its assessment area.

#### *Accessibility of Delivery Systems*

Delivery systems are accessible to essentially all portions of the institution's assessment area. The bank offers a 24-hour, automated banking phone line that allows consumers and businesses to access their accounts. In addition, the bank owns and operates a cash dispensing automated teller machine in Hotchkiss.

### *Community Development Services*

The institution provides a relatively high level of community development services. Management's financial expertise is provided to the loan committee of the Region 10 Revolving Loan Fund. As previously mentioned, this organization serves a six-county area, including Delta County. As a large percentage of the revolving loan fund is to finance business start-ups or expansions, the bank's president, as the committee chairman, conducts credit quality review for each application submitted to the organization. As a condition of granting credit, at least 51 percent of the businesses' new employees must be low- or moderate-income individuals.

As previously mentioned, the Colorado Housing Partnership was formed by the bank's affiliate and the partnership's main focus is refurbishing dilapidated areas. In conjunction with this organization, the bank's president coordinated the construction of three affordable homes in the bank's assessment area.

The senior vice president has provided her financial expertise to two organizations that enhance credit availability in the bank's assessment area. The senior vice president works with a local small business development organization as an instructor. She assists small businesses in creating business plans to obtain long-term financing. The senior vice president also served on the formation board of Delta Area Development, Inc. The organization was formed to work with grants of matching funds from US West that will be used towards businesses that will offer higher paying jobs in Delta County.

### **Compliance with Antidiscrimination Laws and Regulations**

Although the examination revealed violations of the antidiscrimination laws and regulations, they were considered inadvertent and not indicative of a pattern or practice.

