

## 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 Farmers State Bank, Victor, Montana, prepared by the Federal Reserve Bank of Minneapolis, the institution’s supervisory agency, as of January 5, 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.”

There are several factors that support the bank’s satisfactory rating. First, based on 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. Finally, a significant majority of the bank’s loans are within the assessment area.

## **DESCRIPTION OF INSTITUTION**

Based on its size and financial condition, the bank is able to meet the credit needs of the communities in its assessment area effectively. At its last evaluation, the bank received an outstanding rating. The bank's main office is located in Victor, Montana; two full-service branch offices are in Florence and Darby, Montana. The lobby hours at all locations are Monday through Thursday from 8:15 a.m. to 5:00 p.m. and Friday from 9:00 a.m. to 6:00 p.m. The bank's drive-up facility hours at Victor and Darby are Monday through Thursday from 8:15 a.m. to 5:00 p.m. and Friday from 9:00 a.m. to 6:00 p.m. The drive-up hours at the Florence office are Monday through Friday from 7:00 a.m. to 6:00 p.m. and Saturday from 9:00 a.m. to 12:00 p.m. The bank has automated teller machines ("ATM") in five locations. Three of these ATMs are cash dispensing only and are located in Victor, Florence, and Darby. The ATM in Victor is available 24 hours a day, the Florence location is available daily from 7:00 a.m. to 11:00 p.m., and the ATM at Darby is available from 7:00 a.m. to 10:00 p.m. daily. The remaining two ATMs are cash-dispensing and deposit-taking machines located in Stevensville and Corvallis, Montana. The Stevensville location is available 24 hours a day, and the Corvallis location is available from 6:30 a.m. to 11:00 p.m. daily. The ATMs located in Victor and Corvallis are new since the last examination. The addition of these two ATMs allows the bank to improve and expand its services to more consumers within the bank's assessment area.

According to the September 30, 1997, Report of Condition ("ROC"), the bank had total assets of approximately \$112.7 million, an increase of nearly 10% from the bank's March 31, 1996, ROC, which reported total assets of approximately \$102.6 million. During this time, gross loans increased approximately 18% and deposits increased approximately 12%. Bank management attributed the loan growth to increased demand for consumer and commercial real estate loans. According to the September 30, 1997, ROC, the bank's loan portfolio consists of approximately 13.3% consumer, 29.6% consumer real estate, 44.2% commercial, 11.5% agricultural, and 1.4% other loans. The composition of the loan portfolio reflects the level of demand for specific credit products by the residents of the assessment area.

The bank offers a variety of loan products to serve the credit needs of the individuals, businesses, and farms within its assessment area. It extends open- and closed-end consumer, residential real estate, and commercial loans. In addition to offering conventional loan products, the bank participates in federal and state loan programs such as Small Business Administration and Montana Board of Investment loans. Bank management indicated the bank is one of the few financial institutions in the area to process start-up business loans and originate mobile home loans that others will not process.

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

The bank defines its assessment area as Ravalli County, which is located in the Bitterroot Valley in western Montana near the Idaho border. This area is further defined as block numbering areas ("BNA") 9926 through 9933. One BNA in the assessment area, 9932, is designated moderate income, and the remaining seven BNAs are designated middle income. There are no low- or upper-income BNAs in the assessment area. The main office in Victor and the Florence office are located in BNAs 9928 and 9926, respectively, and are both designated middle-income BNAs. The Darby office is located in moderate-income BNA 9932. The bank's main office in Victor is about 40 miles south of Missoula. The branch offices in Florence and Darby are 20 miles and 65 miles, respectively, south of Missoula.

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, 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 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 compared with the statewide median family income of \$27,352. The updated 1997 statewide nonmetropolitan median family income is \$36,100. This figure is used to classify borrowers' incomes.

As mentioned previously, one of the BNAs in the bank's assessment area is classified as a moderate-income area and seven of the BNAs are classified as middle-income areas. The population of the moderate-income BNA is 1,657, or 6.6% of the assessment area's total population, based on 1990 U.S. census data. The remaining 93.4% of the total assessment area population is distributed throughout the seven middle-income BNAs. As a percentage of statewide nonmetropolitan median family income, the moderate-income BNAs' median family income is 77.7%, and the middle-income BNAs' median family incomes range from 82.1% to 114.1%. According to 1990 census data, the assessment area's median family income is \$24,522 and the median household income is \$21,113. According to the 1990 census data, the median family and household incomes for nonmetropolitan areas in Montana were \$27,352 and \$22,345, respectively. Of the 6,932 families in the assessment area, 22% are low income, 22% are moderate income, 22% are middle income, and 34% are upper income. Of the 9,608 households in the assessment area, approximately 24% are low income, 19% are moderate income, 19% are middle income, and 38% are upper income. The assessment area has relatively more low- and moderate-income families and households than Montana's nonmetropolitan areas. Approximately 11% of the families and 15% of the households in the assessment area have incomes below the poverty level.

Examiners contacted members of two business and labor groups familiar with community development and housing needs in the assessment area. Information obtained from the community contacts, along with information received from bank management, was used in evaluating the bank's CRA performance.

The bank's assessment area, Ravalli County, has a diverse economy that includes agriculture, light manufacturing, tourism, retail, and service sectors. Since 1990, there has been a shift in agricultural land use as some ranches have been subdivided into smaller parcels for residential properties. Existing ranchers who are considering expansion have not been able to do so because nonresident individuals have purchased large parcels of land for investment purposes. According to a community contact, current economic conditions are fair and stable. However, real estate values are inflated and future growth is limited due to the lack of good-paying jobs to attract new residents. According to 1990 census data, the assessment area has 11,099 total housing units. Of these units, 66% are owner-occupied, 22% are rental units, and the remaining 13% are vacant or boarded up. In the assessment area's moderate-income BNA, 777 total housing units are available, 477 (61%) of these are owner-occupied. In the assessment area's middle-income BNAs, there are 10,322 total housing units available and 6,804 (66%) are owner-occupied. Approximately 12% of the middle-income BNA housing units are vacant.

## 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 57 residential real estate loans, 152 consumer loans, and 106 small business and small farm loans originated in the six months preceding the evaluation. 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 farms 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 its community.

### LOAN-TO-DEPOSIT RATIO ANALYSIS

The bank's net loan-to-deposit ratio meets the standards for satisfactory performance based on loan demand, the lack of any identified unmet credit needs, and a comparison to national peers and local competitors. Since the previous evaluation, the quarterly average of the bank's net loan-to-deposit ratio is 64.7%. According to the September 30, 1997, ROC, the bank's net loan-to-deposit ratio is 63.2%. The following chart, based on quarterly ROC data, shows an upward trend, subject to quarterly fluctuations, in the net loan-to-deposit ratio. The fluctuations evidence both the local demand for credit and the bank's willingness and ability to assist in meeting the credit needs in its assessment area. Since the last evaluation, deposits have increased approximately 12%, which is attributed partly to the highly competitive banking environment.

DATE	DEPOSITS (In Thousands)	NET LOANS (In Thousands)	NET LOAN-TO- DEPOSIT RATIO
September 30, 1997	\$101,533	\$64,210	63.2%
June 30, 1997	\$97,756	\$64,664	66.2%
March 31, 1997	\$94,916	\$62,944	66.3%
December 31, 1996	\$94,413	\$61,556	65.2%
September 30, 1996	\$93,286	\$62,564	67.1%
June 30, 1996	\$92,264	\$59,900	64.9%
March 31, 1996	\$90,463	\$54,452	60.2%

According to the most recent Uniform Bank Performance Report ("UBPR") data available (September 30, 1997), the bank's 63.2% net loan-to-deposit ratio is below its national peer group average of 74.5% and places it in the 21st percentile of its peer group. The September 30, 1997, UBPR also shows that the bank's net loan-to-assets ratio of 57.0% is below its national peer group. Banks with assets between \$100 million and \$300 million with three or more banking offices had an average net loan-to-assets ratio of 62.2%. The data show the bank commits relatively fewer assets to loans than similarly sized banks. Bank management indicated competition in the local area is very intense and loan growth is a long, slow process. Management also stated that the desired loan-to-deposit ratio is 75%. The following chart shows the total asset size and quarterly average net loan-to-deposit ratio for the bank and some of its local competitors. The bank's average loan-to-deposit ratio exceeds that of one competitor and is below that of two others.

<b>BANK</b>	<b>TOTAL ASSETS (As of September 30, 1997) (In Thousands)</b>	<b>QUARTERLY AVERAGE NET LOAN-TO-DEPOSIT RATIO</b>
Farmers State Bank Victor, Montana	\$112,673	64.7%
Ravalli County Bank Hamilton, Montana	\$86,329	84.4%
Citizens State Bank Hamilton, Montana	\$62,768	63.9%
Bitterroot Valley Bank Lolo, Montana	\$64,331	101.9%

As stated previously, the competition among financial institutions in the assessment area is intense. Despite this competition, the bank's quarterly net loan-to-deposit ratio has been increasing. Information received from community contacts did not indicate any unmet credit needs in the assessment area. Based on the strong competition for loans, limited loan demand in the assessment area, the lack of any identified unmet credit needs, and competitors' quarterly average net loan-to-deposit ratios, the bank's net loan-to-deposit ratio meets the standards for satisfactory performance in this category.

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

A review of the statistical sample of consumer, small farm and business loans, and residential real estate loans originated by the bank in the six months preceding the evaluation reveals that the bank made a significant majority of its loans inside the assessment area. The following table illustrates the percentage of loans within the assessment area based on total number and loan amount in each major loan category.

<b>LOANS IN THE ASSESSMENT AREA</b>		
<b>Loan Type</b>	<b>Total Number of Loans</b>	<b>Total Amount of Loans</b>
Consumer	86%	82%
Residential Real Estate	89%	82%
Small Farm and Business	97%	93%

As the table shows, a significant majority of the bank's loans 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 borrowers of different income levels and to businesses of different sizes exceeds the standards for satisfactory performance. The following table shows the percentage of consumer and residential real estate loans to borrowers of different income levels.

<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>
<u>Consumer</u>				
Total Number of Loans	40%	28%	24%	8%
Total Amount of Loans	22%	26%	36%	15%
<u>Residential Real Estate</u>				
Total Number of Loans	10%	35%	24%	31%
Total Amount of Loans	5%	27%	26%	41%
*Income level based on the 1997 Montana nonmetropolitan median family income of \$36,100.				

The data in the table indicate the bank originated a significant majority, or 68%, of its consumer loans to low- and moderate-income borrowers. In addition, 45% of the residential real estate loans were made to low- and moderate-income borrowers. As previously mentioned in the Description of the Assessment Area section, approximately 43% of the households in the assessment area are classified as low- and moderate-income according to the 1990 census figures. In addition, the table shows that 48% of the total amount of consumer loans was to low- and moderate-income borrowers. This figure indicates the bank is willing to originate small dollar amount loans to creditworthy consumers. According to the table, 67% of the total amount of residential real estate loans was originated to middle- and upper-income borrowers. This reflects the high cost of real estate in the county. Present conditions affecting real estate, as previously discussed, limit the possibility for borrowers with low or moderate incomes to afford either constructing a house or purchasing an existing or manufactured home.

A review of the bank's small farm and small business loan sample shows that the bank makes a substantial majority of its loans to small farms and businesses. The loan sample reveals that 100% of the loans in the sample were made to small farms and businesses. When analyzing loan sizes, a significant majority of loans in the sample (94%) were for less than \$100,000. The concentrated distribution of small farm and business loans to entities with gross annual revenues of \$1 million or less appears to reflect the business and farm market in which the bank operates.

Based on the bank's high level of consumer and residential real estate lending to low- and moderate-income borrowers and the high level of small farm and small business loans in the loan sample, the bank exceeds the standards for satisfactory performance in this category.

#### GEOGRAPHIC DISTRIBUTION OF LOANS

The distribution of the bank's loans throughout its assessment area is reasonable. As previously mentioned, the bank's assessment area includes one moderate- and seven middle-income BNAs. The following table illustrates the distribution of loans in the CRA sample by BNA income level.

<b>DISTRIBUTION OF LOANS IN THE ASSESSMENT AREA BY BNA INCOME LEVEL *</b>		
<b>Loan Type</b>	<b>Moderate-Income BNAs</b>	<b>Middle-Income BNAs</b>
<u>Consumer</u>		
Total Number of Loans	20%	80%
Total Amount of Loans	12%	88%
<u>Residential Real Estate</u>		
Total Number of Loans	6%	94%
Total Amount of Loans	4%	96%
<u>Small Farm and Business</u>		
Total Number of Loans	18%	82%
Total Amount of Loans	9%	91%
*The assessment area has no low- or upper-income BNAs.		

A tract-by-tract analysis reveals that the bank's loans are reasonably distributed throughout the assessment area's moderate- and middle-income BNAs. As the table shows, a significant majority of the bank's consumer, residential real estate, and small farm and small business loans are made to borrowers in the middle-income BNAs. A review of the population concentration in the seven middle-income BNAs shows that 93.4% of the population resides in these BNAs. The remaining 1,657 individuals, or 6.6% of the assessment area population, reside in the moderate-income BNA. Based on the small number of individuals residing in the moderate-income BNA, it is reasonable that the concentration of loans is in the middle-income BNAs.

Based on the distribution of the bank's loans throughout the assessment area, the lack of unmet credit needs, the concentration of the residents, and competition from other financial institutions, the bank meets the standards for satisfactory performance in this category.

#### GENERAL

The evaluation did not reveal any substantive violations of fair lending laws and regulations. The evaluation did reveal a procedural violation of the technical provisions of the Equal Credit Opportunity Act's Regulation B. Bank management promised prompt corrective action. The bank has not received any CRA-related complaints since the last evaluation.

## **PUBLIC DISCLOSURE**

January 5, 1998  
Date of Evaluation

## **COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION**

Farmers State Bank  
Name of Depository Institution

093010400000  
Identification Number of Institution

Victor, Montana  
Address of Institution

Federal Reserve Bank of Minneapolis  
90 Hennepin Avenue  
Minneapolis, Minnesota 55401-1804

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.