

PUBLIC DISCLOSURE

August 31, 1998
Date of Evaluation

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

American Bank of Montana
Name of Depository Institution

093001160000
Identification Number of Institution

Bozeman, 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.

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 American Bank of Montana, Bozeman, Montana, prepared by the Federal Reserve Bank of Minneapolis, the institution’s supervisory agency, as of August 31, 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: “Outstanding.”

Several factors support the bank’s outstanding CRA rating. First, its lending to borrowers of different income levels and to businesses of different sizes is excellent. Since the previous evaluation, the bank has made several community development affordable housing loans to help serve the needs of low- and moderate-income assessment area residents. Second, the bank has a high level of community development services. Third, the bank has several qualified community development investments. Fourth, the bank has a reasonable distribution of loans among block numbering areas (“BNA”) in its assessment area, particularly in the assessment area’s moderate-income BNAs. Finally, the bank has a relatively high loan-to-deposit ratio and it provides most of its loans within its assessment areas.

DESCRIPTION OF INSTITUTION

The bank is capable of meeting the credit needs of assessment area residents and businesses effectively. The bank received an outstanding rating at its previous CRA evaluation conducted as of September 9, 1996. An affiliated institution, American Bank Whitefish, Whitefish, Montana ("American Bank Whitefish"), merged with the bank on April 27, 1998. American Bank Whitefish received a satisfactory rating at its March 10, 1997, CRA evaluation. In addition to its April merger, the bank sold its Billings, Montana, office in December 1997. After the sale of its Billings office, the bank's Bozeman office became its main office.

The bank now operates 4 full-service offices, a detached facility, and 11 automated teller machines ("ATM") in its assessment areas. None of the bank's ATMs accepts deposits. The bank has identified four assessment areas based on the location of its offices and ATMs. Three contiguous assessment areas will be combined into one assessment area for purposes of this evaluation. This assessment area ("Assessment Area 1") includes Gallatin, Park, and Sweet Grass counties in Montana. The bank has offices in Big Timber, Bozeman, and Livingston, Montana. All these offices, as well as the bank's Bozeman detached facility, are located in middle-income BNAs in Assessment Area 1. In this assessment area, the bank also has an ATM in each of the following communities: Belgrade, Big Timber, Gardiner, and Livingston, Montana. The bank has five additional ATMs in Bozeman, two of which are located in moderate-income BNAs 9861 and 9866. The bank's other assessment area ("Assessment Area 2") contains its office and two ATMs in Whitefish. Assessment Area 2 consists of all 14 census tracts that make up Flathead County, Montana.

The evaluation did not reveal any constraints on the bank's ability to lend in its assessment areas. According to its June 30, 1998, Report of Condition ("ROC"), the bank's assets totaled approximately \$179.8 million. Major fluctuations in the bank's assets since the previous evaluation relate mostly to its office changes. Despite these changes, however, the bank's assets have grown steadily since the previous evaluation.

The bank is primarily a commercial lender. Based on its June 30, 1998, ROC, about 62% of the bank's loan portfolio consisted of commercial loans. Another 19% of the portfolio consisted of residential real estate loans. Commercial and residential construction loans make up about 8% of the portfolio. The remainder of the portfolio contains 8% agricultural and 3% consumer loans.

The bank offers a wide variety of loan products that help meet community credit needs. Generally, the bank offers commercial, consumer, residential real estate, commercial real estate, and agricultural loans. It will provide commercial loans for a wide range of purposes. Its conventional real estate products include adjustable rate mortgages, construction loans, fixed-rate loans of varying maturities, and mobile home loans. The bank also offers closed- and open-end consumer loans for many types of consumer purposes. Its open-end products include home equity, overdraft checking, and personal lines of credit.

In addition to its conventional products, the bank offers a wide range of government-guaranteed and -sponsored loan products, including government-guaranteed student loans. It offers Small Business Administration ("SBA") commercial loans. It has also participated in the U.S. Department of Agriculture ("USDA") Rural Business and Cooperative Development Service Business and Industry loan program and the Montana Economic Development Board's 504 program. The bank provides residential real estate loans guaranteed by the following agencies: Federal Housing Administration ("FHA"), Department of Veterans Affairs ("VA"), Montana Board of Housing ("MBOH"), and USDA Rural Development. The bank sells residential real estate loans to the Montana Board of Investments and other secondary market outlets.

DESCRIPTION OF AMERICAN BANK OF MONTANA'S ASSESSMENT AREAS

Overall Assessment Areas

For CRA evaluation purposes, American Bank has two assessment areas. As discussed previously, Assessment Area 1 contains Gallatin, Park, and Sweet Grass counties. This assessment area contains the bank's Livingston, Bozeman, and Big Timber offices. The bank defines Assessment Area 2 as Flathead County; this assessment area contains the bank's Whitefish office. According to U.S. Census data, the assessment areas have a combined population of 127,397. The combined assessment areas have 5 moderate-income, 23 middle-income, and 5 upper-income BNAs and census tracts. Based on the total population in the assessment areas, moderate-income BNAs and tracts contain 12%, middle-income BNAs and tracts contain 72%, and upper-income BNAs and tracts contain 16% of the population. The median household and family incomes for the combined assessment areas are \$23,492 and \$28,539, respectively.

As will be discussed subsequently, the bank originates the vast majority of its loans through its Bozeman and Livingston offices. As such, this evaluation will not review individual lending activity in Assessment Area 2. The following assessment area description and most of the subsequent analysis pertain only to Assessment Area 1. The loan-to-deposit ratio analysis and the evaluation of the bank's lending inside and outside its assessment areas relate to both assessment areas.

Examiners contacted local government officials and other community representatives familiar with the housing, development, and business characteristics of Assessment Area 1 in an attempt to identify community credit needs. Information obtained from these community contacts was used in evaluating the bank's CRA performance.

Description of Assessment Area 1

Assessment Area 1 is located in southwestern Montana, north of Yellowstone National Park. It encompasses 4 moderate-income, 12 middle-income, and 3 upper-income BNAs in the three Montana counties that make up this assessment area. Two moderate-income BNAs (9861 and 9866) are located in Bozeman. Moderate-income BNA 9843 encompasses the entire portion of Park County north of Livingston; moderate-income BNA 9845 is located in Livingston.

Assessment Area 1 has a population of 68,179, as of the 1990 U.S. Census. Most of these residents (50,463) live in Gallatin County; only 3,154 of these residents live in Sweet Grass County. In general, the assessment area's population has grown since 1990 as more individuals move to the area for its natural beauty and other amenities. As will be discussed, such growth has strained the availability of affordable housing in the assessment area.

CRA divides income levels into four categories: low, moderate, middle, and upper. Because Assessment Area 1 is located in a nonmetropolitan area, the categorization of a borrower or BNA's income is determined relative to the statewide nonmetropolitan median family income. Pursuant to CRA's definitions, 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 middle-income individuals as persons with incomes of at least 80% but less than 120% of the statewide nonmetropolitan median family income. Individuals with incomes of 120% or more of the statewide nonmetropolitan median family income are classified as upper-income persons.

For purposes of classifying borrowers' incomes, this evaluation used the U.S. Department of Housing and Urban Development ("HUD") estimated 1998 median family income for the nonmetropolitan areas of Montana of \$36,100. For purposes of classifying BNA income levels, this evaluation used the statewide nonmetropolitan median family income for Montana from the 1990 U.S. Census, which was \$27,352.

According to 1990 U.S. Census data, the assessment area's median family income is \$28,512; its median household income is \$22,968. The assessment area has approximately 17,138 families, of which 10.2% have incomes below the poverty level. Approximately 16.3% of the assessment area's 26,001 households have incomes below the poverty level. The following table identifies the distribution of assessment area families and households by income level.

| ASSESSMENT AREA 1 POPULATION DISTRIBUTION BY INCOME LEVEL | | | | |
|--|------------|-----------------|---------------|--------------|
| Unit of Measure | Low Income | Moderate Income | Middle Income | Upper Income |
| Households Compared to Median Household Income | 22.5% | 16.4% | 19.1% | 42.0% |
| Families Compared to Median Family Income | 17.0% | 17.4% | 24.6% | 41.0% |

As previously discussed, Assessment Area 1 encompasses 4 moderate-income, 12 middle-income, and 3 upper-income BNAs. Based on 1990 U.S. Census data, the moderate-income BNAs contain about 19% of the assessment area's population but only 16% of its total households. The 1,927 owner-occupied housing units located in these BNAs constitute about 12% of the assessment area's total owner-occupied housing units. About half (2,399) the housing units in these BNAs are rental units and about 40% are owner occupied. Another 9% are vacant.

The vast majority of the assessment area's residents live in middle-income BNAs. Specifically, according to 1990 U.S. Census data, the middle-income BNAs have a combined population of 41,454, or about 61% of the assessment area's total population. These BNAs also contain about 64% of the assessment area's total households. The number of owner-occupied housing units located in the middle-income BNAs (10,204) constitutes about 65% of the assessment area's total housing units. These owner-occupied housing units make up about 52% of the middle-income BNAs' total housing units. Of the remaining units, about 33% are rental units and 15% are vacant.

The remaining assessment area residents live in upper-income BNAs. Based on 1990 U.S. Census data, the upper-income BNAs have a combined population of 13,947, or about 21% of the assessment area's total population. Approximately 19% of the assessment area's total households are located in these BNAs. The upper-income BNAs contain about 23%, or 3,642 units, of the assessment area's total owner-occupied housing units. These owner-occupied housing units constitute about 65% of the total housing units located in the upper-income BNAs. Only 25% of the housing units located in these tracts are rental units. The remaining 10% of units are vacant.

GALLATIN COUNTY

As discussed previously, Gallatin County has the largest population of the three counties in Assessment Area 1. Population estimates contained in the United Way of Gallatin County's April 1998 Community Indicators Report ("Gallatin County Report") show that Gallatin County's population has increased about 21% since 1990. Gallatin County's 1997 population is approximately 61,111. The county's largest city,

Bozeman, has about 28,522 residents. The next largest city in the county, Belgrade, has about 4,846 residents. Other cities in the county include Manhattan, Big Sky, Three Forks, and West Yellowstone.

One community contact described Bozeman's economy as steady. Annual growth in the area has been about 3%. The diversity of the local economy contributes to its economic strength. Tourism is a major factor in the area's local economy. Several nationally recognized ski resorts bring in tourists during winter months. Summer tourism is also strong with people coming to the area to fish, hike, or visit Yellowstone National Park. Another major factor in the local economy is Montana State University-Bozeman ("University"), a university with about 11,500 students. In 1997, Gallatin County had an estimated unemployment rate of 2.8%, down from 4.7% in 1990.

Housing in the Bozeman area is expensive by Montana standards. Based on Gallatin County Report estimates, the average sale price of a home in Bozeman increased from \$63,505 in 1990 to \$133,089 in early 1998. Homes in nearby Belgrade sold for an average of \$55,550 in 1990 and \$102,100 in 1997. The Gallatin County Report also estimates that an average wage earner in Gallatin County earned \$19,839 in 1996. City planning statistics state that average rental costs in Bozeman are the following: one bedroom \$300 to \$425; two bedrooms \$500 to \$750; and three bedrooms \$750 to \$1,000. A two-bedroom house rents for about \$600 and a three-bedroom house rents for about \$900 in Bozeman. Community contacts indicated that affordable housing, including affordable rental housing, is greatly needed in the Bozeman area.

One of Bozeman's moderate-income BNAs (9866) includes the University. Although this BNA has 1,590 households, only about 24% of these households are owner occupied. Bozeman's other moderate-income BNA (9861) covers the northern part of the city; it is relatively sparsely populated with only 1,827 residents.

PARK COUNTY

Park County has significantly fewer residents than Gallatin County. Based on 1990 U.S. Census data, Park County has 14,562 residents. The county's largest community, Livingston, has a population of about 7,500. The other communities in the county, such as Gardiner, Emigrant, and Clyde Park, are much smaller. One of the moderate-income BNAs in Park County (9843) has only 1,600 residents and 577 households. Although this BNA encompasses the entire northern half of the county, it contains only two small towns. The other moderate-income BNA in the county (9845) has almost twice as many residents; it encompasses the northern part of Livingston.

Bank management described Livingston's economy as good. Similar to Bozeman, Livingston's economy relies heavily on tourism. The city's close proximity to Yellowstone National Park contributes to its strong tourism industry. The community also has several strong employers, including Livingston Rebuild Center and RY Timber. Other major employers in the community include the school district and hospital.

Affordable housing is also an issue in Livingston. According to one community contact, most affordable homes for sale in Livingston require significant improvements. A 1994 housing study conducted by the City of Livingston noted that the average sale price for homes in Livingston increased from \$43,000 in 1989 to \$102,000 in 1994. According to the study, about 66% of Park County residents could not afford the average home sale price.

SWEET GRASS COUNTY

Unlike the other two counties in Assessment Area 1, Sweet Grass County has more of an agriculture-based economy. According to one community contact, the local agricultural economy is suffering. Tourism in the county has also increased in recent years. Big Timber is its largest community; it has about 1,557 residents based on 1990 figures. According to 1990 U.S. Census data, the county has a relatively small population of 3,154. Population estimates from 1996 show that the county's population has increased to about 3,437. Unemployment is about 3.7% in the county. Major local employers include a hospital, a foundry, and the U.S. government. Big Timber has two banks and one savings and loan. A new platinum and palladium mine in the county will create about 600 new jobs in the area in the next few years. Estimates show that new residents to the area will take between 17% and 30% of these jobs.

The availability of affordable housing in Sweet Grass County is also limited. The availability of housing may become a bigger problem in the future depending on how many individuals and families move to the area to take jobs at the mine. According to one community contact, the county has investigated whether to expand some town sites for mobile homes.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

The bank's performance in serving the credit needs of Assessment Area 1 is outstanding. Much of the analysis on the following pages is based on a statistical sample of 83 consumer, 56 residential real estate, and 89 small business loans originated in the six months preceding the evaluation. These loan categories represent the bank's major product lines based on number of loans originated and the relative significance of the product in the bank's overall loan portfolio.

One factor evaluated in the decision to choose the products reviewed was the relative significance of the product as a percentage of the number of loans originated during the six-month sample period. The following table illustrates those percentages.

| Loan Product | % of Total Number of Loans (Six months ending 8/14/98) |
|-------------------------|---|
| Consumer | 33% |
| Commercial | 42% |
| Residential Real Estate | 20% |
| Agricultural | 5% |

As discussed under the Description of the Institution section, the bank's loan portfolio consists of 62% commercial, 19% residential real estate, 8% agricultural, and 3% consumer loans. The loan portfolio also contains 8% commercial and residential construction loans. During the six-month sample period, commercial loans represented the largest percentage of the total number of loans originated during this period. Commercial loans also constitute more than half the bank's loan portfolio. Based on these figures, examiners chose to review commercial loans during this evaluation. Although consumer loans represent a small portion of the bank's loan portfolio, they constituted 33% of the total number of loans originated during the sample period. As such, examiners chose to evaluate consumer loans because of the percentage of such loans originated during the sample period. Finally, examiners evaluated residential real estate loans because they constituted about one-fifth of the loans originated during the sample period. Such loans also represent a similar percentage of the bank's overall loan portfolio. Examiners did not

evaluate agricultural loans because they represent a small percentage of the loan portfolio and of the total number of loans originated during the sample period.

The analysis to follow supports the bank's outstanding CRA rating. In assigning an overall rating, the greatest weight was placed on the bank's lending to borrowers of different income levels and businesses of different sizes, the geographic distribution of its loans among BNAs of different income levels, and the bank's level of community development loans, investments, and services. These factors most closely measure the bank's efforts to meet the credit needs of its community. The analysis in the loan-to-deposit ratio and assessment area lending sections includes data for the entire bank. For the most part, the remaining sections pertain only to lending, investment, and service activities in Assessment Area 1. There is no indication that performance in Assessment Area 2 is inconsistent with that of Assessment Area 1.

LOAN-TO-DEPOSIT RATIO ANALYSIS

The bank's net loan-to-deposit ratio is good and exceeds the standards for satisfactory performance. The quarterly average of the bank's net loan-to-deposit ratio since September 1996 is 78%. Based on June 30, 1998, Uniform Bank Performance Report data, the bank's loan-to-deposit ratio of 85% exceeds the peer average ratio of 73%. The following chart summarizes the bank's quarterly net loan-to-deposit ratio and its components since the last evaluation, dated September 9, 1996.

| DATE | NET LOANS (In thousands) | DEPOSITS (In thousands) | NET LOAN-TO- DEPOSIT RATIO |
|--------------------|-------------------------------------|------------------------------------|---------------------------------------|
| September 30, 1996 | \$110,572 | \$147,222 | 75% |
| December 31, 1996 | \$116,361 | \$148,585 | 78% |
| March 31, 1997 | \$112,322 | \$147,655 | 76% |
| June 30, 1997 | \$112,961 | \$152,325 | 74% |
| September 30, 1997 | \$112,809 | \$160,122 | 70% |
| December 31, 1997 | \$100,972 | \$122,861 | 82% |
| March 31, 1998 | \$111,322 | \$131,278 | 85% |
| June 30, 1998 | \$119,010 | \$139,562 | 85% |

The bank's net loan-to-deposit ratio increased significantly from 70% to 82% after the sale of its Billings office in December 1997. As shown, the bank's deposits decreased much more than its loans after this sale. The ratio has increased slightly in June 1998 after the bank's merger with American Bank Whitefish. An increase in both loans and deposits after this merger did not change the bank's net loan-to-deposit ratio.

The bank operates in a competitive banking environment. The following chart shows quarterly average net loan-to-deposit ratio and total assets information for banks operating in Assessment Area 1.

| Bank | Total Assets as of June 30, 1998) (in thousands) | Quarterly Average Net Loan-to-Deposit Ratio |
|--|---|--|
| American Bank of Montana, Bozeman, Montana | \$179,824 | 78% |
| First Security Bank of Bozeman, Bozeman, Montana | \$202,237 | 62% |
| Manhattan State Bank, Manhattan, Montana | \$41,668 | 83% |
| Citizens Bank & Trust Company, Big Timber, Montana | \$38,465 | 66% |
| Valley Bank of Belgrade, Belgrade, Montana | \$33,928 | 73% |
| Big Sky Western Bank, Big Sky, Montana | \$33,394 | 76% |
| First Security Bank of West Yellowstone West Yellowstone, Montana | \$22,009 | 80% |
| Security Bank of Three Forks, Three Forks, Montana | \$13,630 | 55% |

As shown by the preceding chart, the bank's quarterly average net loan-to-deposit ratio significantly exceeds that of its main competitor, First Security Bank of Bozeman, Bozeman, Montana ("First Security"). The bank's net loan-to-deposit ratio compares favorably to the ratios of smaller bank competitors that operate in Assessment Area 1. As discussed, Assessment Area 1 also has several branch offices of larger banks with statewide operations. Local loan-to-deposit ratio information is not available for these banks. The assessment area also has several credit unions and savings and loans for which loan-to-deposit information is not available.

The bank sells residential real estate loans actively on the secondary market. The bank's loan-to-deposit ratio data do not reflect the loans originated and subsequently sold. Since September 1996, the bank has sold approximately \$10.5 million real estate loans on the secondary market.

As will be discussed subsequently, the bank has originated several community development loans since the previous evaluation. Most of these loans financed construction of affordable multifamily dwellings in and near Assessment Area 1.

The bank's net loan-to-deposit ratio exceeds the standards for satisfactory performance. As discussed, the bank's ratio has increased significantly in recent years and exceeds the ratio of its main competitor. In addition, the bank sells real estate loans actively on the secondary market and originates community development loans regularly.

COMPARISON OF CREDIT EXTENDED INSIDE AND OUTSIDE THE ASSESSMENT AREAS

The bank's lending activity in its assessment areas meets the standards for satisfactory performance. Based on a review of a statistical sample of loans originated by the bank during the past six months, the bank extended a substantial majority of its loans inside the assessment areas. The following table shows the percentage of loans originated in the assessment areas by total number and total dollar amount of loans for each loan category.

| LOANS ORIGINATED INSIDE THE ASSESSMENT AREA | | |
|--|------------------------------|-------------------------------------|
| Loan Type | Total Number of Loans | Total Dollar Amount of Loans |
| Consumer | 90% | 78% |
| Residential Real Estate | 84% | 80% |
| Small Business | 91% | 69% |

The above chart shows that the bank made several large commercial loans outside its assessment areas during the sample period. The bank also made several relatively large consumer loans outside its assessment areas during this same time period. In general, however, the bank makes most of its loans inside the assessment areas.

As mentioned previously, the bank is primarily a commercial lender. Based on the high concentration of small business loans originated within the assessment area, the bank meets 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 businesses of different sizes exceeds the standards for satisfactory performance. The bank has a good distribution of loans to borrowers of different income levels and businesses of different sizes. The bank also originated several significant community development affordable housing loans since the previous evaluation. In addition, the bank offers a wide array of loan products designed to accommodate the needs of low- and moderate-income real estate borrowers.

As discussed previously, CRA classifies income levels into four categories: low, moderate, middle, and upper. To determine a borrower's income level, the income is compared with the 1998 Montana nonmetropolitan median family income of \$36,100. The table below shows the percentage of residential real estate and consumer loans made to borrowers of different income levels in Assessment Area 1.

| DISTRIBUTION OF LOANS IN ASSESSMENT AREA 1 BY BORROWER INCOME LEVEL* | | | | |
|---|-----------------------------|----------------------------------|--------------------------------|-------------------------------|
| Loan Type | Low-Income Borrowers | Moderate-Income Borrowers | Middle-Income Borrowers | Upper-Income Borrowers |
| <u>Residential Real Estate</u> | | | | |
| Total Number of Loans | 14% | 17% | 26% | 43% |
| Total Amount of Loans | 5% | 9% | 15% | 71% |
| <u>Consumer</u> | | | | |
| Total Number of Loans | 6% | 21% | 21% | 51% |
| Total Amount of Loans | 4% | 12% | 19% | 65% |

*Income level is based on the Montana 1998 nonmetropolitan median family income of \$36,100.

RESIDENTIAL REAL ESTATE LENDING

The table above shows that the bank made 14% of its residential real estate loans to low-income borrowers and 17% of such loans to moderate-income borrowers. The remaining 26% and 43% of such loans were made to middle- and upper-income borrowers, respectively. As discussed in the Description of Assessment Area 1, about 22% of the assessment area's households and 17% of its families have low incomes as of the 1990 U.S. Census. About 16% of the assessment area's households and 17% of its families have moderate incomes.

Despite the serious affordable housing issues existing in the assessment area, the bank made more than 30% of its residential real estate loans to low- and moderate-income borrowers. Because of these affordability issues, the bank's level of residential real estate lending to low- and moderate-income borrowers is exceptional. As discussed previously, the most populated portions of the assessment area (Bozeman and Livingston) have a serious lack of affordable housing. The average sale price of a Bozeman home in early 1998 was \$133,089, almost double the sale price of a Bozeman home in 1990. Livingston's average home price in 1990 was \$102,100, more than double the average sale price in 1989.

Examiners further evaluated the affordability of homes in the assessment area using the Partners software program, available from the Reserve Bank. Based on Montana's 1998 nonmetropolitan median family income of \$36,100, a low-income resident has a median family income no higher than \$18,050. A moderate-income resident has a median family income no higher than \$28,880. In using the program, the following assumptions were made for both income levels: no down payment, 7% interest rate, 30-year term, 28% front-end ratio, and 36% back-end ratio. For low-income borrowers, it was assumed they would have annual tax and insurance costs of \$450 and other monthly payments of \$250. For moderate-income borrowers, it was assumed that they would have annual tax and insurance costs of \$600 and other monthly payments of \$400. Given these assumptions, the Partners software states that a low-income borrower could finance no more than \$37,051 for a house and a moderate-income borrower could finance no more than \$61,085 for a house. Based on these figures, the relatively high cost of housing in Assessment Area 1 limits the opportunity for low- and moderate-income individuals to find affordable homes.

This distribution of residential real estate loans compares favorably to the distribution of households and families in the assessment area. More importantly, however, the bank's level of real estate lending to low- and moderate-income borrowers reflects the bank's willingness to serve the real estate credit needs of low- and moderate-income borrowers. As discussed, the bank offers a wide array of real estate loan products, several of which are designed to serve the needs of low- and moderate-income individuals. The bank participates in MBOH and Rural Development programs designed to help low- and moderate-income individuals purchase homes. In addition, the bank made several government-guaranteed residential real estate loans since the previous evaluation. Specifically, the bank made 17 FHA loans totaling \$1,114,530 and 1 VA loan totaling \$73,000 since the previous evaluation. One of the bank's FHA-guaranteed loans was made to an individual under the MBOH's Disabled Accessible Affordable Homeownership and Rental Housing Program. Under this program, the very low-income, disabled borrower received a 2.75%, 30-year mortgage loan from the bank to purchase a home. The individual also received a down payment assistance loan from MBOH that does not require repayment until the home is sold.

In addition, the bank has participated in the Human Resource Development Council, Inc.'s ("HRDC") Livingston Affordable Housing Land Trust program. Specifically, the bank provided a loan to a low-income family to purchase one of several affordable townhouses constructed, in part, by a local community development agency. These homes are on land donated by the City of Livingston and put into trust to ensure that the homes remain affordable. Because the homeowners own the home but not the land, they sell the home back to the trust for the current market value at the time of the sale. The bank also committed to provide a \$150,000 loan pool for borrowers interested in purchasing these properties. As will be discussed subsequently, the bank developed a Homebuyer's Club to provide potential homeowners with information, education, and assistance on purchasing a home. In conjunction with the Homebuyer's Club, the bank applied to the Federal Home Loan Bank ("FHLB") of Seattle for a grant to provide down payment assistance funds to individuals or families who successfully complete the Homebuyer's Club. The bank also provides reduced fees for individuals who complete the Homebuyer's Club. In order to become eligible to purchase a home through the land trust, individuals must receive some type of homeownership counseling, such as that provided by the Homebuyer's Club.

CONSUMER LENDING

The Distribution of Loans by Borrower Income Level table shows that the bank made 6% of its consumer loans to low-income borrowers and 21% of such loans to moderate-income borrowers. The remaining 21% and 51% of such loans were made to middle-income and upper-income borrowers, respectively.

The bank's level of consumer lending to low- and moderate-income borrowers is reasonable for several reasons. First, consumer loans represent a relatively small percentage of the bank's overall lending activity. As discussed, the bank is predominantly a commercial and residential real estate lender. Second, bank management indicated during the evaluation that the bank has had extreme difficulty competing with nonbank consumer lenders in Assessment Area 1. The bank cannot compete with some of the terms offered by these other financial institutions, such as five-year, unsecured loans. As such, these other lenders may be making more consumer loans to the assessment area's low- and moderate-income borrowers. Finally, examiners were not able to obtain income information for approximately 30% of the consumer loans sampled. About half of these borrowers had loan amounts of \$5,000 or less. Specifically, these borrowers had an average loan amount of \$2,244. Because low- and moderate-income consumer borrowers tend to borrow smaller amounts than middle- and upper-income borrowers, it is possible that several of the borrowers for which income information was not available may be low- or moderate-income borrowers.

The bank processes a significant volume of student loan applications for the Montana Higher Education Student Assistance Corporation. Since the previous evaluation, the bank processed 1,004 student loan applications totaling \$1,277,230 in loans. In general, the distribution of the bank's consumer loans among borrowers of different income levels is reasonable.

SMALL BUSINESS LENDING

The bank has a reasonable distribution of its small business loans to businesses of different sizes. Specifically, the bank makes the majority of its small business loans to businesses with \$1 million or less in gross annual revenues.

Based on the small business loans sampled during the evaluation, the bank made 71% of such loans to businesses with \$1 million or less in gross annual revenues. Aggregate CRA small business loan data for loans reported in Assessment Area 1 provide an indication of the demand for small business credit in the assessment area. Banks with at least \$250 million in assets or banks belonging to bank holding companies with \$1 billion or more in assets must report small business loan data for CRA. Such banks reported 1,354 small business loans in Assessment Area 1 in 1997. These lenders made approximately 67% of these loans to businesses with \$1 million or less in gross annual revenues. Based on 1994 U.S. Census data, about 97% of the business establishments in the three counties that comprise Assessment Area 1 have between 1 and 49 employees. This data indicates that most of the businesses in Assessment Area 1 are relatively small.

The bank's level of lending to small businesses compares favorably to the level of such lending made by large bank CRA reporters in 1997. In addition, the bank made several of the sampled small business loans to one local business whose gross annual revenues exceeded \$1 million. This business sells high-ticket-item consumer goods.

The bank also has a reasonable distribution of its sampled small business loans among loan size categories. The following chart shows the distribution of loans in Assessment Area 1 to businesses with \$1 million or less in gross annual revenues.

| DISTRIBUTION OF SMALL BUSINESS LOANS BY LOAN SIZE | | | |
|--|--|--|--|
| Loan Type | Loan Amount \$100,000 or less | Loan Amount \$100,000.01 to \$250,000 | Loan Amount \$250,000.01 to \$1 million |
| Small Business Loans | 78% | 16% | 6% |

As the above chart shows, most of the bank's small business loans had loan amounts of \$100,000 or less. In general, the bank's lending to small businesses is reasonable given the types of businesses in the community and amount of small business lending done by other area lenders.

COMMUNITY DEVELOPMENT LENDING

The bank made several significant community development loans since the previous evaluation. All these loans related to some type of multifamily housing for low- and moderate-income individuals. One project involved construction and permanent financing for two phases of development of affordable rental housing. This property is located just across the county line between Gallatin and Madison counties. Although the property is located just outside Assessment Area 1, it will serve the needs of residents living in and around Big Sky, Montana, a community located in Assessment Area 1.

The project involved the construction of 24 housing units in an area in great need of affordable housing. The project qualified for tax credits under the Internal Revenue Service's Low Income Housing Tax Credit Program. To live in the properties, individuals must have incomes no greater than 65% of Madison County's median household income. The bank made loans for \$410,000 and \$36,000 for the project's first phase of development in 1997. Both these loans were for construction and permanent financing. The bank made construction loans for \$375,000 and \$18,000 for the project's second phase of development in early 1998.

The bank made another loan in 1998 for the construction of a Bozeman group home for very low-income developmentally disabled individuals. This loan totaled \$140,248.

Finally, the bank made another loan in the same area of Madison County near Big Sky, Montana. Again, the bank provided funds for the construction of affordable multifamily housing. In this case, the project involved construction of condominiums for purchase. Approximately 22% of the 72 units being constructed would be affordable to moderate-income individuals, according to an appraisal conducted on the property. The bank made the \$2 million construction loan in late 1997.

The bank's lending to borrowers of different incomes and businesses of different sizes exceeds the standards for satisfactory performance because of several reasons. First, considering the lack of affordable housing in Assessment Area 1, the bank made an exceptional percentage of its sampled residential real estate loans to low- and moderate-income borrowers. Second, the bank has been a strong supporter of government-guaranteed and other programs designed to address the housing needs of low- and moderate-income individuals. Third, the bank made several significant community development affordable housing loans since the previous evaluation. Finally, distribution of small business and consumer loans in Assessment Area 1 during the sample period is reasonable.

GEOGRAPHIC DISTRIBUTION OF LOANS

The bank has a reasonable distribution of its loans among geographies of different income levels in Assessment Area 1. As such, the distribution of bank loans in Assessment Area 1 meets the standards for satisfactory performance. As previously discussed, Assessment Area 1 includes 4 moderate-income, 12 middle-income, and 3 upper-income BNAs. The table below shows the distribution of the bank's sampled loans among the assessment area's moderate-, middle-, and upper-income BNAs.

| DISTRIBUTION OF LOANS IN ASSESSMENT AREA 1 BY BNA INCOME LEVEL | | | |
|---|----------------------------|--------------------------|-------------------------|
| Loan Type | Moderate Income | Middle Income | Upper Income |
| <u>Consumer</u> | | | |
| Total Number of Loans | 10% | 69% | 21% |
| Total Amount of Loans | 4% | 82% | 14% |
| <u>Residential Real Estate</u> | | | |
| Total Number of Loans | 18% | 64% | 18% |
| Total Amount of Loans | 7% | 56% | 37% |
| <u>Small Business</u> | | | |
| Total Number of Loans | 25% | 61% | 14% |
| Total Amount of Loans | 22% | 51% | 27% |

As shown above, the bank made 18% of its residential real estate and 10% of its consumer loans in moderate-income BNAs. The bank made the majority of its residential real estate (64%) and consumer (69%) loans in middle-income BNAs. The remainder of its residential real estate (18%) and consumer (21%) loans were made in upper-income BNAs.

The distribution of the bank's residential real estate and consumer loans is reasonable for several reasons.

First, the distribution of both loan types among BNAs of different income levels compares favorably to the population distribution in the assessment area. Specifically, the assessment area's moderate-income BNAs contain only 19% of its population, whereas the middle-income BNAs contain a much larger percentage of the population (61%). Although the bank made fewer consumer loans in the moderate-income BNAs, again, such loans account for a relatively small percentage of the bank's overall lending activity.

Second, the bank's distribution of residential real estate loans exceeds the distribution of owner-occupied housing in Assessment Area 1. As discussed in the Description of Assessment Area 1 section, the moderate-income BNAs in the assessment area contain only 12% of the assessment area's owner-occupied housing units. The vast majority (65%) of these housing units are located in the assessment area's middle-income BNAs. In addition, about half the housing units in these BNAs are rental units. No more than 33% of the housing units in the middle- and upper-income BNAs are rental units. As such, the relatively limited amount of owner-occupied housing in the moderate-income BNAs helps support the reasonableness of the bank's level of real estate lending in these BNAs.

As shown above, the bank also has a reasonable distribution of its small business loans among geographies of different income levels. Specifically, the bank made 25% of its sampled small business loans to businesses located in moderate-income BNAs. The bank made 61% and 14% of its sampled small business loans in middle- and upper-income BNAs, respectively.

The bank's level of small business lending in the moderate-income BNAs is more than reasonable for several reasons. First, most of the business district areas in the assessment area are located in middle-income BNAs. Although small portions of the Bozeman and Livingston business districts are located in moderate-income BNAs, the primary business areas are in middle-income BNAs. The entire community of Big Timber is located in a middle-income BNA. In addition, moderate-income BNA 9843 has very few residents and very few businesses. Given this information, the bank's level of small business lending in the moderate-income BNAs is reasonable.

Second, the bank's level of small business lending in the moderate-income BNAs exceeds the level of such lending done by large bank CRA lenders in these BNAs. As discussed previously, large bank CRA lenders must report small business loan data annually. In 1997, such lenders reported originating 1,354 small business loans in Assessment Area 1. The lenders originated 12% of these loans in the assessment area's moderate-income BNAs. As such, the bank originated a greater percentage of its small business loans in the assessment area's moderate-income BNAs than did its large bank CRA competitors.

The dispersion of the bank's residential real estate, consumer, and small business loans is also reasonable. Based on the sampled loans, the bank made loans in almost all the BNAs located in the assessment area. The only BNAs with no loans (9858, 9859) are located in the northwestern section of Gallatin County and are middle-income BNAs. Several competitor banks operate in this section of the county. The bank made no residential real estate loans in moderate-income BNA 9861. Because this BNA has only 364 owner-occupied households, the bank's lack of real estate loans in this BNA appears to be reasonable. Also, the bank made no consumer and small business loans in moderate-income BNA 9843. As discussed, this is a very sparsely populated BNA located north of Livingston. It contains few residents and few businesses. As such, the lack of lending in this BNA is also reasonable.

Since the previous evaluation, the bank made one community development loan in one of the assessment area's moderate-income BNAs. In mid-1997, the bank provided approximately \$1.75 million for a borrower to construct a 34-unit rental property located in moderate-income BNA 9866 in Bozeman. In early 1998, the bank made the permanent loan on this property. The property is located near the University campus and is intended to serve the housing needs of University students.

The distribution and dispersion of loans in geographies of different income levels is reasonable and, as such, meets the standards for satisfactory performance. The bank made a reasonable level of its loans in the assessment area's moderate-income BNAs. The bank also made a community development loan in one of the assessment area's moderate-income BNAs.

INVESTMENTS AND SERVICES

The bank's strong level of community development investments and services helps support its outstanding rating. The bank's bond portfolio contains \$130,000 in bonds purchased in 1995 that were used to assist construction of a group home for developmentally disabled individuals. All the individuals living in the group home have very low incomes. Also, the bank made several donations since the previous evaluation that qualify as community development donations. The bank provided the following amount of qualified donations by year since the previous evaluation.

| Qualified Donations Since September 1996 | | |
|---|-------------|-------------|
| 1996 | 1997 | 1998 |
| \$263 | \$4,286 | \$3,082 |

The bank also donated advertising space to assist the HRDC sell homes through the Livingston Affordable Housing Land Trust.

The bank has provided many community development services since the previous evaluation. One of its most significant services involves its Home Buyer's Club. In mid-1996, the bank established a sophisticated homeownership counseling program designed to provide a wide array of information to low- and moderate-income first-time homebuyers. The bank hired a consultant to develop the program. Topics covered by the program included how to budget, save for a home, price a home, apply for a mortgage, and maintain a home. The course also covered credit counseling issues and mortgage-related costs such as closing fees and property taxes. As part of this program, participants learned how to start a dedicated savings plan to cover down payment and closing costs on a home purchase. As discussed previously, the bank received a grant from the FHLB of Seattle to provide matching funds (up to \$3,000) to individuals who finish the program. The bank worked with the HRDC and the Park County Economic Development Corporation ("PCEDC"), Livingston, on this project.

The bank has other community development services. For instance, a bank loan officer serves on a loan review committee for PCEDC. The committee reviews loans for a PCEDC small business revolving loan fund. The bank also assisted a local organization with an affordable housing grant application in early 1997. This organization serves the needs of low- and moderate-income developmentally disabled individuals. In mid-1998, a bank employee assisted Habitat for Humanity of Park County with a fund-raising drive. Another employee participated in a Small Business Development Workshop sponsored by

the Livingston Job Service Employer Committee in November 1996. This employee discussed loan application procedures, including how to complete an application and what supporting documentation to provide. She also discussed credit report issues.

In addition to its provision of financial services to individuals and organizations, the bank provides deposit-related services to its customers. Specifically, the bank has two ATMs located in moderate-income BNAs 9861 and 9866. In October 1996, the bank added a Student Advantage Checking account, which has limited account fees. The bank also initiated a 24-hour voice response telephone banking service in October 1997. In general, the bank's significant level of community development investments and services contributes to its overall outstanding rating.

GENERAL

The evaluation did not reveal any violations of the substantive provisions of the fair lending and fair housing laws and regulations. The evaluation did reveal isolated violations of the technical provisions of Regulation C--Home Mortgage Disclosure Act. In addition, the bank has not received any CRA-related complaints since the previous evaluation.