

Public Disclosure

November 13, 2000

Community Reinvestment Act Performance Evaluation

**Northern National Bank
Charter Number: 23602**

**25 Smiley Road North
Nisswa, Minnesota 56468**

**Office of the Comptroller of the Currency
920 Second Avenue South, Suite 800
Minneapolis, Minnesota 55402**

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 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 **Northern National Bank, Nisswa, Minnesota**, prepared by the **Office of the Comptroller of the Currency**, the institution's supervisory agency, as of **November 13, 2000**. The agency rates the CRA performance of an institution consistent with the provisions set forth in Appendix A to 12 CFR Part 25.

Institution's CRA Rating: This institution is rated satisfactory.

The bank's loan-to-deposit ratio and in/out ratio indicate that the bank is doing a good job of lending within its assessment area. The bank's distribution of home loans, purchase or refinance of residential real estate, is adequate in relation to the portion of low- and moderate-income families and moderate-income geographies in the assessment area. The impact of second homes, such as lake homes, was a significant contextual factor considered in evaluating the bank's lending performance. The bank's distribution of business loans, commercial and commercial real estate, is adequate in relation to the range of businesses by revenue size and business location in the assessment area.

- By number, 85 percent of the bank's primary loan product originations, home and business loans, were made in the assessment area.
- The bank's quarterly average loan-to-deposit ratio of 106 percent ranked it second highest among 12 banks with charters in the same region of the state.
- Seasonal non-homestead real estate, primarily lake homes, represent over 12 thousand properties or 36 percent of total properties in Crow Wing County.
- Excluding second home loans (lake homes), the bank's home lending performance was near the assessment area demographics for low- and moderate-income families.
- The bank's business lending performance was near the assessment area demographics for businesses by annual revenue size and business location.

Description of Institution

Northern National Bank (Northern) is a \$56 million bank located in Nisswa, Minnesota. Northern also maintains offices in Crosslake, 20 miles to the northeast of Nisswa, and in Baxter, 15 miles to the south of Nisswa. Products, services, and hours are substantially identical at each office. The bank owns an ATM at each of its offices. The Baxter office was just opened in October 2000. A second office located in Nisswa was closed at about the same time.

The bank is primarily a home and business lender. As of September 30, 2000, business loans (commercial & commercial real estate) comprised 49 percent of total outstanding loans, 1-4 family residential real estate (1st lien, jr. lien, & equity) 41 percent, construction loans 5 percent, and consumer 5 percent. Total loans equaled \$49 million or 87 percent of total assets as of September 30, 2000.

Northern is majority owned by Anderson Financial Group, Inc., a closely held one bank holding company. Northern does not have any bank or non-bank affiliates engaged in lending activities that impact the bank's CRA performance.

There are currently no legal impediments or other factors, including the financial condition of the bank, which limit its ability to meet the credit needs of its assessment area. However, the bank was subject to a non-compete agreement during the first three years of its existence which prohibited it from establishing an office in the most densely populated portion of its assessment area.

The bank's last CRA evaluation was March 29, 1999. The bank was rated needs to improve at that time.

Description of Assessment Area

Northern's assessment area is one contiguous group of census tracts including all of Crow Wing County plus five tracts in Cass County. The bank's assessment area is located approximately 120 miles to the northwest of the Twin Cities. The economic center of the assessment area is the adjoining cities of Brainerd and Baxter. These two cities contain 38 percent of assessment area population and 45 percent of its businesses. Land wise, the majority of the assessment area consists of small towns located on or near lakes. The proximity of the assessment area to the Twin Cities coupled with its primary natural resource (lakes) has a significant impact on the local economy and residential housing market.

There is a major disconnect in the assessment area between its median family income and the average selling price of a residential home. For example, a resident of Crow Wing County making the stated non-MSA median family income of \$44,300 and buying an average priced residential home in Crow Wing County (\$162,000 year-to-date 2000) would spend 34 percent of their income on a house payment consisting of principal, interest, taxes, and insurance. Compare this to the 28 percent underwriting standard common to the residential mortgage industry or the 21 percent incurred by a Twin City resident under a comparable scenario. Median family income for the Twin Cities (Metropolitan Statistical Area 5120) is \$68,600 and the average residential home price is \$145,000 as of June 2000.

Two considerations in evaluating the bank's lending performance were the significant number of second homes (lake homes) located in the assessment area and the lack of any adjustment to the median family income due to seasonal residents. According to records of the Crow Wing County Assessor, 36 percent of improved real estate in Crow Wing County is classified as seasonal non-homestead (mainly lake homes and cabins). This large number of second homes in conjunction with the assessment areas proximity to a higher income population center, such as the Twin Cities, provides an explanation for the local disconnect between income and housing costs. For these reasons, we separated primary residence home loans from second home loans when evaluating the bank's residential lending performance. In the latter case, the individual's income was likely derived from employment in the Twin Cities and not from within the bank's assessment area.

The assessment area is economically sound. Unemployment is low, real estate values are climbing, and the population base is growing. The local economy is centered in tourism and service industries. Thus, external factors such as the weather and the strength of the economy in the Twin Cities play an important role in determining the strength of the local economy. Housing values are being impacted by strong demand for lake homes as previously discussed.

A total of 12 community banks are headquartered in either Crow Wing or Cass County. These two counties are also served by credit unions, finance companies, and in recent

years, branches of multi-billion dollar regional banks.

One new community contact and eight existing contacts were considered in evaluating the credit needs of the assessment area. Affordable housing was the primary credit need consistently mentioned. However, no community contacts indicated a lack of financing opportunities for qualified applicants. The root causes stem from population growth, an abundance of lower paying jobs, and the level of planning and partnering necessary to make large scale affordable housing projects attractive to builders, developers, and other participants.

The assessment area meets the requirements of the regulation and does not arbitrarily exclude any low- or moderate-income geographies. Assessment area composition by census tract income level is detailed in the following table for: geographies (census tracts), families, and businesses.

Assessment Area by Income Level	Census Tract %	Total Families %	Total Businesses by Tract Income %
Low Income	N/A	N/A	N/A
Moderate Income	23.81	17.46	20.30
Middle Income	71.43	71.62	67.24
Upper Income	4.76	10.92	12.46

Conclusions with Respect to Performance Criteria

Loan-to-Deposit Ratio

Northern's loan-to-deposit ratio is good. The bank's quarterly loan-to-deposit ratio has ranged from 97 percent to 117 percent during this assessment period. Northern's quarterly average loan-to-deposit ratio was 106 percent and on an individual quarter-end basis reached a high of 117 percent on September 30, 2000. Northern's loan-to-deposit ratio performance ranks second among banks chartered in Crow Wing or Cass County.

Lending in Assessment Area

Northern's record of lending in its assessment area is good. The bank originated 85 percent by number of loans and 78 percent by dollar amount within its assessment area. The bank's in/out ratio was calculated by taking a random sample of 20 home loans and 20 business loans. The tables below show the results of this sample. Additional loans were later selected at random to regain a population of 20 home loans and 20 business loans all made to individuals and businesses in the bank's assessment area.

Loan Type	In Assessment Area By Number %	In Assessment Area by Dollar %
Home Loans	85.00	90.40
Business Loans	85.00	64.20

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

Northern's distribution of loans in its assessment area by income level of the borrower and revenue size of the business is adequate. Northern's distribution of home loans is less than the demographic for low- and moderate-income families. However, banks in the business of originating second home loans in this assessment area will have a difficulty meeting the demographic because of the volume of lake homes being built or purchased by upper-income individuals residing outside of the assessment area. Northern's distribution of loans to businesses with annual revenues of less than \$1 million is near the demographic for the same.

The following table shows the bank's distribution of home loans, for the purchase or refinance of a residential real estate, to borrowers of different incomes.

Home Loans by Family Income Level in the Assessment Area				
Loan Sample/Demographic	Low-Inc. Families %	Moderate-Inc. Families %	Middle-Inc. Families %	Upper-Inc. Families %
By Number of Loans	10.00	10.00	5.00	75.00
By Dollar Amount	1.76	4.78	2.75	90.71
Assessment Area Demographic	22.95	20.18	22.59	34.81

The following table shows the same analysis as in the above table but excludes loans to purchase or refinance a second home.

Home Loans by Family Income Level in the Assessment Area - Second Homes Excluded				
Loan Sample/Demographic	Low-Inc. Families %	Moderate-Inc. Families %	Middle-Inc. Families %	Upper-Inc. Families %
By Number of Loans	16.67	16.67	8.33	58.33
By Dollar Amount	3.66	9.94	5.72	80.68
Assessment Area Demographic	22.95	20.18	22.59	34.81

The following table shows the bank's distribution of business loans, commercial and commercial real estate, to businesses with annual revenues of less than \$1 million versus the demographic for the same. Note, approximately 15 percent of businesses surveyed did not report revenues.

Business Loans by Revenue Size			
Loan Sample/Demographic	Revenue (< \$1 Million %	Revenue (> \$1 Million %	Revenue Not Reported %
By Number of Loans	85.00	15.00	NA
By Dollar Amount	61.71	38.29	NA
Assessment Area Demographic	79.61	5.62	14.77

Geographic Distribution of Loans

Northern's geographic distribution of home loans and business loans within the assessment area is adequate. Northern's distribution of home loans, per the loan sample, is less than the portion of owner occupied housing units located in moderate-income geographies. However, bank management provided information on additional loans which showed that the bank's distribution of home loans exceeded the demographic for owner occupied units in two of the five moderate-income geographies in the assessment area. The three remaining moderate-income geographies not meeting this demographic are the geographies that are the furthest from any office of Northern. The bank's distribution of business loans is near the proportion of assessment area businesses located in moderate-income geographies. There are no low-income geographies in the assessment area.

The following table shows the bank's distribution of home loans, for the purchase or refinance of residential real estate, by the income level of geographies.

Income Level of Geography	Home Loans by Number %	Home Loans by Dollar %	Assessment Area Owner Occupied Units %
Low Income	N/A	N/A	N/A
Moderate Income	5.00	1.51	17.09
Middle Income	95.00	98.49	71.59
Upper Income	0.00	0.00	11.32

The following table shows the bank's distribution of business loans, commercial and commercial real estate, by the income level of geographies.

Income Level of Geography	Business Loans by Number %	Business Loans by Dollar %	Assessment Area Distribution of Businesses %
Low Income	N/A	N/A	N/A
Moderate Income	15.00	6.09	20.30
Middle Income	80.00	59.92	67.24
Upper Income	5.00	34.02	12.46

Response to Complaints

There have been no CRA related complaints against the bank.

Record of Compliance with Antidiscrimination Laws

An analysis of 1998 HMDA, Small Business, and Small Farm lending data, public comments, and consumer complaint information was performed according to the OCC's risk based fair lending approach. The analysis of these data revealed no basis for the OCC to conduct a comprehensive fair lending examination in connection with the CRA evaluation. The latest comprehensive fair lending examination performed by the OCC was in connection with the March 29, 1999 CRA evaluation. At that examination, examiners compared the underwriting standards applied to five denied female consumer loan applicants versus 24 approved male applicants. Examiners did not identify any evidence of discrimination.