



**SMALL BANK**

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Comptroller of the Currency  
Administrator of National Banks

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Washington, DC 20219

## **PUBLIC DISCLOSURE**

**September 05, 2008**

### **COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION**

The First National Bank of Deerwood  
Charter Number 9703

21236 Archibald Road  
Deerwood, MN 56444

Office of the Comptroller of the Currency

Minneapolis North Field Office  
302 West Superior Street, The Lonsdale Building, Suite 307  
Duluth, MN 55802

**NOTE:** This document is an evaluation of this 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. 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.

**INSTITUTION'S CRA RATING: This institution is rated Satisfactory.**

First National Bank of Deerwood is responsive to its community's needs including low- and moderate-income neighborhoods.

- The majority of bank's loans were originated to customers within their assessment area.
- The distribution of loans to borrowers reflects a reasonable penetration among families and individuals of different income levels.
- First National Bank of Deerwood's performance for lending to borrowers in low- and moderate-income areas is reasonable.
- The bank's loan-to-deposit ratio is reasonable.

**SCOPE OF EXAMINATION**

We assessed First National Bank of Deerwood's (FNB) record of meeting the credit needs of the entire community, including low- and moderate-income neighborhoods consistent with the provisions set forth in the Community Reinvestment Act (CRA) for the period beginning March 18, 2003 and ending August 30, 2008. In order to determine the bank's lending performance, we selected primary products based on the dollar amount and number of loan originations for the period beginning January 1, 2006 and ending August 30, 2008. We determined residential real estate and consumer loans are the bank's primary loan products. We selected a random sample from each of the primary products in order to evaluate lending within the assessment area, borrower distribution, and geographic distribution. We used 2000 census information for demographic comparison purposes.

**DESCRIPTION OF INSTITUTION**

FNB is a \$232 million bank located in north-central Minnesota. FNB is owned by Deerwood Bankshares, a one-bank holding company headquartered in Deerwood, Minnesota. The bank has 8 branch locations and 13 automated teller machines (ATM). The branch locations are located in the Minnesota cities of Garrison, Brainerd, Bemidji, Northome, Blackduck, Littlefork, Grand Rapids and Baxter. None of the ATMs accept deposits.

FNB had multiple branch openings and closures since the last CRA examination. All branches opened and closed were located in middle-income tracts. Seven branch locations were opened in Minnesota. New branches were opened in Bemidji, Red Lake, Northome, Blackduck, Littlefork, Grand Rapids and Baxter. Three branch locations were closed in Minnesota. Branches closed were Bemidji, Red Lake and Cross Lake.

Additionally, the bank relocated their existing Bemidji branch approximately one mile from the previous location.

FNB's lending focus is residential real estate loans and consumer loans. As of June 30, 2008, FNB's net loans and leases totaled \$190M or 82% of the bank's total assets. The loan portfolio was comprised of commercial and commercial real estate loans (25%), residential real estate loans (73%), loans to individuals (3%), agricultural loans (1%) and all other loans and leases (1%). Tier one capital totaled \$21.1 million as of June 30, 2008.

There are no legal or financial constraints inhibiting FNB's CRA performance or its ability to meet the lending needs of its assessment area.

FNB received a rating of Satisfactory at the last CRA examination dated March 17, 2003

## **DESCRIPTION OF ASSESSMENT AREAS**

FNB has identified one assessment areas (AA) in North Central Minnesota, which consists of 39 census tracts. Upon review of the bank's assessment area, we determined the bank has two geographically separate assessment areas, which are described below. While the AAs are geographically separate, for analysis purposes we will be considering them as one combined AA due to the similar demographics of the AAs as well as their rural locations. The bank's AA meets the requirements of 12 CFR 25.41 and does not arbitrarily exclude any low- or moderate- income areas.

### **Crow Wing/Aitkin/Mille Lacs Assessment Area**

The Crow Wing/Aitkin/Mille Lacs assessment area consists of three complete counties and sixteen census tracts. The assessment area is located in rural Minnesota and is not located in a Metropolitan Statistical Area (MSA). The AA consists of three moderate income census tracts and thirteen middle income census tracts. This AA contains 42% of the combined AA households.

### **Beltrami/Hubbard/Cass/Koochiching/Itasca Assessment Area**

The Beltrami/Hubbard/Cass/Koochiching/Itasca assessment area consists of five counties and twenty-three census tracts. The assessment area is located in rural Minnesota and is not part of a MSA. The AA consists of one low-income census tract, six moderate-income census tracts, and sixteen middle income census tracts. This AA contains 58% of the combined AA households.

In conclusion, we determined the banks AA is comprised of 8 counties and 39 census tracts. The table below summarizes information on the combined assessment areas for analysis purposes, as indicated above.

<b>Demographic Information for the AA</b>
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	#	% Low	% Moderate	% Middle	% Upper
Geographies (Census Tracts)	39	2.56%	23.08%	74.36%	0%
Population by Geography	160,113	3.18%	17.46%	79.36%	0%
Owner-Occupied Housing by Geography	90,463	1.70%	14.73%	83.56%	0%
Family Distribution by Income Level	44,318	21.07%	19.88%	23.99%	35.06%
Household Distribution by Income Level	64,062	24.97%	17.33%	20.19%	37.51%
Census Median Family Income (MFI)		\$56,874	Median Housing Value		\$90,079
Families Below the Poverty Level					8.78%
Unemployment Rate					6.55%

Data Source: 2000 US Census

Lending competition from other financial institutions is strong as several banks, credit unions, savings institutions, and mortgage companies maintain main or branch offices within the AA. FNB currently maintains a 4.74% market share of deposits in the eight counties that it serves, and a 7.02% market share of deposits in the four counties where the bank serves the majority of the county.

The current local economy for the AA is characterized as stable. According to the 2000 U.S. Census Data, the total population of the AA by geography is 160,113. The 2000 U.S. Census Data reported a Median Family Income (MFI) of \$56,874 and the AA reports a MFI of \$43,012. The report also identified the Median Housing Value in the AA as \$90,279. The AA has a significant concentration of middle-income tracts with 74.36% of total tracts designated middle-income, containing 81% of total households. Nine tracts or 23% of total tracts are designated as moderate-income, containing 17% of total households, and one or 2.56% of total tracts are designated as low-income, containing 2% of total households.

Employment conditions in the AA are considered stable. The unemployment rate in the AA is slightly higher than the state average at 6.55% compared to 4.6%. The state of Minnesota unemployment rate is in line with the national average as both are 4.6%, as of 2007. The local economy is primarily dependent on the hospitality industry related to vacation and tourism. Deerwood is located about 20 miles east of Brainerd, which is well known for the attraction it draws from local lakes. Water sports such as fishing and boating are prevalent in the area. The local economy also provides additional employment opportunities through various nearby resorts, a retail shopping mall, multiple restaurants, a community college, high schools and elementary schools, and a hospital.

Examiners utilized several contacts with representatives from regional development

entities to assess the credit needs of the area. The contacts indicated that the primary credit needs of the area are affordable residential real estate, consumer, and small business lending. It was the opinion of the contacts that the financial institutions in the area are adequately meeting the credit needs of the community.

## CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

### Loan-to-Deposit Ratio

FNB's net loan-to-deposit ratio is reasonable given the bank's size, financial condition, and the area's credit needs. The bank's quarterly net loan-to-deposit ratio averaged 85.6% over the 22 quarters from March 31, 2003 to June 30, 2008.

FNB's net loan-to-deposit ratio is comparable to other community banks of similar size (total assets between \$117 million and \$282 million) serving the counties included in the assessment area. FNB ranks third among a total of six similarly situated banks in the assessment area. The other six banks had quarterly average net loan-to-deposit ratios averaging 84.62% and ranging from 54.4% to 107.3% over the same 22 quarters from March 31, 2003 to June 30, 2008. Due to the size of the assessment area, we also looked at banks primarily serving the counties where the bank does the majority of their business. Three of the comparable banks were included in this list as well as the previous list. FNB ranked in the middle of these four banks in regards to market share, and had a comparable loan-to-deposit ratio.

FNB brokers and sells residential loans on the secondary market. While these activities assist in FNB's efforts to meet local credit needs, the volume of brokered and sold loans are not reflected in the quarterly loan-to-deposit ratio.

### Lending in Assessment Area (AA)

The majority of the bank's loans are originated in the AA. We selected a random sample of 20 residential real estate loans and 20 consumer loans originated between January 2006 and August 30, 2008. The bank originated 90% of those loans by number and 88% of loans by dollar, within the AA.

<b>Table 1 - Lending in Deerwood AA</b>										
Loan Type	Number of Loans					Dollars of Loans				
	Inside		Outside		Total	Inside		Outside		Total
	#	%	#	%		\$ (000)	%	\$ (000)	%	
Residential Real Estate	19	95%	1	5%	20	1,890	94%	113	6%	2,003
Consumer	17	85%	3	15%	20	205	52%	186	48%	391
Totals	36	90%	4	10%	40	2,095	88%	299	12%	2,394

### Lending to Borrowers of Different Incomes

FNB's distribution of loans to borrowers of different incomes is satisfactory. Specifically, the performance in its primary line of residential real estate lending generally meets the AA demographic of low- and moderate- income families. The performance in its primary line of consumer lending significantly exceeds the AA demographic of low and moderate income households.

Residential real estate lending generally meets the demographics of the AA for low- and moderate- income borrowers. Examiners originally sampled twenty-two loans from the 1,177 loans made to borrowers in the assessment area that were originated between January 1, 2006 and August 31, 2008. Eighteen percent of loans were made to low income borrowers and twenty-three to moderate income borrowers using the original sample. Due to the lower level of loans to low income borrowers, examiners expanded the sample for a total of 58 loans. The following table compares the bank's residential real estate lending activity by borrower income level to community demographics for the combined samples.

Borrower Distribution of Residential RE Loans in Deerwood AA								
Borrower Income Level	Low		Moderate		Middle		High	
	% of AA Families	% of Number of Loans	% of AA Families	% of Number of Loans	% of AA Families	% of Number of Loans	% of AA Families	% of Number of Loans
Residential RE	21.07	15.52	19.88	18.97	23.99	18.97	35.06	46.55

Data Source: 2000 US Census

Consumer lending significantly exceeds the demographics of the AA for low- and moderate- income borrowers. Examiners originally selected a sample of twenty-one loans from the 2,738 loans made to borrowers in the assessment area that were originated between January 1, 2006 and August 31, 2008. Forty-seven percent of loans were made to low-income borrowers and nineteen percent to moderate-income borrowers using the original sample. We verified these results with an additional 39 loans sampled for a total of 60 loans. The following table compares the bank's consumer lending activity by borrower income level to community demographics for the combined samples.

Borrower Distribution of Consumer Loans in Deerwood AA								
Borrower Income Level	Low		Moderate		Middle		High	
	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans
Consumer	24.97	50	17.33	21.67	20.19	11.67	37.51	16.67

Data Source: 2000 US Census

### Geographic Distribution of Loans

FNB's performance for lending to borrowers in low- and moderate-income areas is reasonable. The geographic distribution of loans reflects a reasonable dispersion of loan originations in the bank's AA. The bank's lending practices show penetration of all census tracts when combining consumer with residential real estate loans.

To review the bank's performance in this area, we sampled 22 Residential Real Estate Loans and 21 Consumer Loans originated in the bank's AA since the last CRA examination. The original sample results did not meet the demographic distribution. We expanded the sample to 58 Residential Real Estate Loans and 60 Consumer Loans.

Consumer lending exceeds the demographic distribution. Consumer lending in low-income tracts was 8.33% by number and .80% by dollar amount compared to the demographic of 2.13% of households located in low-income tracts. Consumer lending in moderate-income tracts was 18.33% by number and 4.65% by dollar amount compared to a demographic of 16.78%.

Geographic Distribution of Consumer Loans in Deerwood AA								
Census Tract Income Level	Low		Moderate		Middle		High	
	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans
Consumer	2.13	8.33	16.78	18.33	81.09	73.33	0	0

Data Source: 2000 US Census

Residential Real Estate lending is significantly lower than the demographic distribution. Residential Real Estate Lending in low-income tracts was 0% by number and 0% by dollar compared to the demographic of 2.55% of families located in low-income tracts. Residential lending in moderate-income tracts was 3.45% by number and 2.31% by dollar compared to the demographic of 15.28% of families located in moderate-income tracts. The lower penetration of Residential Real Estate Loans is attributable to the location of the tracts. The majority of moderate-income tracts are located at the farthest edges of the assessment area, and have the highest poverty rates. In addition, the families in these tracts accounts for 17.83% of the AA population, and 26.58% of the AA families below the poverty level. Owner occupied units in the low-income tract are only 1.7% of the AA owner occupied units, and the moderate-income tracts account for just under 15% of total AA owner occupied units.

Geographic Distribution of Residential RE Loans in Deerwood AA				
Census Tract Income Level	Low	Moderate	Middle	High

	% of AA Owner Occupied Housing	% of Number of Loans	% of AA Owner Occupied Housing	% of Number of Loans	% of AA Owner Occupied Housing	% of Number of Loans	% of AA Owner Occupied Housing	% of Number of Loans
Residential RE	1.7	0	14.73	3.45	83.56	96.55	0	0

Data Source: 2000 US Census (STF3)

**Responses to Complaints**

FNB has not received any CRA related complaints since its March 17, 2003 CRA evaluation.

**Fair Lending or Other Illegal Credit Practices Review**

We found no evidence of discriminatory or other illegal credit practices inconsistent with helping to meet community credit needs.