



**SMALL BANK**

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Comptroller of the Currency  
Administrator of National Banks

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## **PUBLIC DISCLOSURE**

**October 10, 2006**

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

**Heritage Bank, National Association  
Charter Number 18269**

**101 North Main Street  
Holstein, IA 51025**

**Comptroller of the Currency  
Minneapolis West  
4900 South Minnesota Avenue Suite 300  
Sioux Falls, SD 57108**

**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 Outstanding.**

- The bank's average loan-to-deposit ratio is excellent.
- The bank originates a substantial majority of its loans by number and dollar volume within its assessment areas.
- The bank has a more than reasonable distribution of credit among agricultural and commercial borrowers of different sizes.
- The geographic distribution of agricultural and commercial loans reflects excellent dispersions throughout the assessment area.

## **DESCRIPTION OF INSTITUTION**

Heritage Bank, N.A. (HBNA) is a \$116 million institution headquartered in Holstein, Iowa, in northwest Iowa. Their main office is located in Holstein, Iowa, a city of 1,470 persons located 46 miles east of Sioux City. HBNA has seven full-service branches located in Holstein, Aurelia, Lytton, Alta, Anthon, Sioux City, and Storm Lake, Iowa. Their Cushing, Iowa branch does not originate loans since there is no loan officer employed there. The Storm Lake branch opened in March 2006, subsequent to our previous Community Reinvestment Act (CRA) exam.

The Sioux City, Cushing, and Anthon locations are in the Sioux City, IA-NE Metropolitan Statistical Area (MSA). The Holstein, Aurelia, Lytton, Alta, and Storm Lake branch locations are located in Ida, Cherokee, Sac, and Buena Vista counties in a non-MSA area (rural assessment area). HBNA offers telephone and internet banking to its customers. These services provide customers with 24-hour access to deposit and loan account information and allow customers to make transfers between accounts. HBNA owns five automated teller machines (ATMs), one located at their Holstein and Storm Lake branches and three others in local convenience stores in Correctionville, Alta, and Aurelia. Only the Holstein ATM accepts deposits from HBNA customers. The Holstein location also accepts deposits from non-HBNA customers.

HBNA offers a wide range of loan and deposit products which are designed to meet the community's needs. The Sioux City and Anthon branch location's primary product is agricultural loans and the other branch's primary products are agricultural and commercial loans. The majority, 72 percent, of loans are originated in the non-MSA branches. As of June 30, 2006, net loans made up 85.5 percent of total assets. The bank's primary credit products are agriculture, commercial, residential real estate, and consumer loans. The table below breaks down the portfolio by originated dollars and number of loans.

	<b>% of originated dollars</b>	<b>% of originated # of loans</b>
Agricultural/RE Loans	63%	52%
Commercial/RE Loans	24%	16%
Consumer Loans	7%	28%
Residential RE Loans	5%	4%

*Source: FDIC Call Report Data*

HBNA is owned by Heritage Bancshares Group, Inc. a two-bank holding company with an

affiliate bank located in Willmar, Minnesota. As of June 30, 2006, Heritage Bancshares Group had total assets of \$278 million.

There are no financial, legal or other factors that impede HBNA's ability to meet its CRA obligations. The bank's last CRA rating dated February 13, 2002 was "Satisfactory."

## **DESCRIPTION OF RURAL ASSESSMENT AREA (AA)**

HBNA's rural AA consists of 18 CTs in Buena Vista, Sac, Ida, Calhoun, and Cherokee Counties in Iowa. The bank's branches are in the cities of Holstein, Aurelia, Lytton, Alta, and Storm Lake. All of the 18 CTs in the AA are considered middle-income. HBNA's AA complies with regulatory requirements and does not arbitrarily exclude any low- or moderate-income geographies.

The 2000 median family income for the AA was \$42,385. The Department of Housing and Urban Development estimates the updated 2006 median family income for the AA is \$52,800. The 2000 census data indicates that 2,191 households (ten percent) within the rural AA are below the poverty level. According to the FDIC's Report for County Overview, the unemployment levels in the rural AA counties averaged 3.4 percent, compared to 4.7 percent nationwide, and 4.3 percent for the state of Iowa.

There is a fair amount of competition in the rural AA with 31 institutions in the area. HBNA ranks eighth and has 4.82 percent of the market share based on June 2005 deposit information obtained from the Federal Deposit Insurance Corporation.

## **DESCRIPTION OF SIOUX CITY ASSESSMENT AREA**

HBNA's Sioux City assessment area (AA) includes 30 census tracts (CTs) in Woodbury County, Iowa, and Dakota County, Nebraska. The Missouri River, coupled with the Nebraska and Iowa state line, is a major barrier between the two states. Of the 30 CTs in the AA, one is low income, seven are moderate-income, sixteen are middle-income, and six are upper-income. HBNA's AA complies with regulatory requirements and does not arbitrarily exclude any low- or moderate-income geographies.

Based on 2000 census information, 0.04 percent of the AA's population live in low-income CTs, 21.0 percent in moderate-income CTs, 55.52 percent middle-income CTs, and 23.44 percent upper-income CTs. The 2000 median family income for the AA was \$46,955. Based on the Department of Housing and Urban Development's 2006 estimate, the updated median family income for the AA is \$55,700. The 2000 census data shows that 4,578 households (ten percent) within the Sioux City AA are below the poverty level.

According to the U.S. Bureau of Labor Statistics, unemployment levels in the State of Iowa as of December 31, 2005 were 4.5 percent, compared to 2.14 percent in the Sioux City, IA-NE MSA and 5.1 percent nationwide. The largest employers in the area are Tyson Foods, Beef Processing Inc. (BPI), Morrell Meat Packing, and the local colleges.

Bank competition in HBNA's Sioux City AA is strong. There are 34 financial institutions with a presence in HBNA's AA, some of which are branches of mid-size and large banks situated in the metro area. HBNA is ranked twenty fourth in deposit market share with 0.91 percent of the market share based on June 2005 deposit information obtained from the Federal Deposit Insurance Corporation.

## CONCLUSIONS ABOUT PERFORMANCE CRITERIA

### Loan-to-Deposit Ratio

The loan-to-deposit ratio is more than reasonable given the bank's size, financial condition and local credit needs. The bank's quarterly average loan-to-deposit ratio for the 18 quarters since the previous CRA exam is 100.67 percent. Similarly situated banks with a presence in the AA are those with total assets between \$101 and \$165 million. Quarterly average loan-to-deposit ratios for similarly situated banks range from 44.38 percent to 100.67 percent over the same time frame.

Institution	Assets (as of 6/30/06)	Average Loan-to-Deposit Ratio 1Q02-2Q06
The Citizens First National Bank of Storm Lake	\$165 million	56.73
Cherokee State Bank	\$154 million	68.72
First National Bank	\$137 million	86.97
<b>Heritage Bank, National Association</b>	<b>\$116 million</b>	<b>100.67</b>
Pioneer Bank	\$103 million	80.29
Security Trust & Savings Bank	\$101 million	44.38

Source: FDIC Call Report Data

### Lending in Assessment Areas

HBNA originates a substantial majority of its loans in their AAs. Based on a sample of 40 agriculture loans and 20 commercial loans, HBNA originates a substantial majority of its loans by number and dollar to borrowers located within its defined AAs. The sample determined that of loans originated from January 1, 2004 through September 30, 2006, 93.33 percent by number and 87.74 percent by dollar were made to agricultural and commercial customers located within the bank's AAs. The following table shows loans originated inside and outside their AAs by number and dollar volume:

Loan Type	Number of Loans				Dollar of Loans			
	Inside		Outside		Inside		Outside	
	#	%	#	%	\$	%	#	%
<b>Agriculture</b>	<b>38</b>	<b>95.00</b>	<b>2</b>	<b>5.00</b>	<b>2,052,155</b>	<b>94.48</b>	<b>120,000</b>	<b>5.52</b>
<b>Commercial</b>	<b>18</b>	<b>90.00</b>	<b>2</b>	<b>10.00</b>	<b>520,906</b>	<b>68.51</b>	<b>239,460</b>	<b>31.49</b>
<b>TOTALS:</b>	<b>56</b>	<b>93.33</b>	<b>4</b>	<b>6.67</b>	<b>2,573,061</b>	<b>87.74</b>	<b>359,450</b>	<b>12.26</b>

Source: Loan Sample

## Lending to Businesses and Farms of Different Sizes

Borrower distribution of loans is excellent. HBNA has a more than reasonable distribution of credit among agricultural and commercial borrowers of different sizes in the AAs.

### RURAL ASSESSMENT AREA

Borrower distribution of loans originated to farms and businesses with revenues of \$1 million or less is more than reasonable within the Rural AA. While the number of businesses not reporting revenues is high, the bank's distribution would still be more than reasonable even if a significant portion of the non-reporting businesses reported revenues less than \$1 million. Agricultural and commercial borrowers have a wide diversity of gross revenue levels ranging from a few thousand to more than a million dollars. A random sample of 18 agricultural and 18 commercial files showed the following breakdown of annual revenues.

<b>Borrower Distribution of Loans to Farms</b>		
<b>Business Revenues</b>	<b>&lt; \$1,000,000</b>	<b>&gt; \$1,000,000</b>
% of AA Businesses*	96.21%	2.24%
% of Bank Loans in AA by #	94.44%	5.56%
% of Bank Loans in AA by \$	97.92%	2.08%

\* Per 2005 Business Geodemographic Data; 1.55% of farms did not report revenues  
Source: Loan Sample

<b>Borrower Distribution of Loans to Businesses</b>		
<b>Business Revenues</b>	<b>&lt; \$1,000,000</b>	<b>&gt; \$1,000,000</b>
% of AA Businesses**	59.02%	4.82%
% of Bank Loans in AA by #	77.78%	22.22%
% of Bank Loans in AA by \$	48.87%	51.13%

\*\* Per 2005 Business Geodemographic Data; 36.16% of businesses did not report revenues  
Source: Loan Sample

### SIOUX CITY ASSESSMENT AREA

Borrower distribution of loans originated to farms with revenues of \$1 million or less is more than reasonable within the Sioux City AA. Agricultural borrowers have a wide diversity of gross revenue levels ranging from a few thousand to more than a million dollars. A random sample of 20 agricultural loan files showed the following breakdown of annual revenues.

<b>Borrower Distribution of Loans to Farms</b>		
<b>Business Revenues</b>	<b>&lt; \$1,000,000</b>	<b>&gt; \$1,000,000</b>
% of AA Farms*	94.65%	3.10%
% of Bank Loans in AA by #	80.00%	20.00%
% of Bank Loans in AA by \$	32.17%	67.83%

\* Per 2005 Business Geodemographic Data; 2.25% of farms did not report revenues  
Source: Loan Sample

## Geographic Distribution of Loans

Overall, lending throughout the AAs is more than reasonable.

### SIoux CITY ASSESSMENT AREA

The geographic distribution of agricultural loans reflects reasonable dispersions throughout the Sioux City AA. HBNA's Sioux City location is in an upper-income CT, and their Anthon location is in a middle-income CT. HBNA does a reasonable job of lending in their moderate-income CTs. The random sample of loans showed that the number of loans made were in line with the number of farms in the moderate-income tract area. While none of the loans in our sample were to businesses located in the low-income CTs, only 0.42 percent of farms are located in these areas. We did not identify any conspicuous gaps in lending to low- or moderate-income CTs. The following table compares the demographics of the area to the bank's actual lending, based on a random sample of 20 agricultural loans:

Geographic Distribution of Loans to Farms in Assessment Area								
Census Tract	Low		Moderate		Middle		Upper	
Loan Type	% of AA Farms	% of Number of Loans	% of AA Farms	% of Number of Loans	% of AA Farms	% of Number of Loans	% of AA Farms	% of Number of Loans
Agricultural	0.42%	0%	5.21%	5%	81.41%	95%	12.96%	0%

### RURAL ASSESSMENT AREA

The geographic distribution for the rural AA is not meaningful as all of HBNA's branches in the AA are located in middle-income CTs.

### Responses to Complaints

HBNA has not received any complaints about its performance in helping meet assessment area credit needs during this evaluation period.

### Fair Lending or Other Illegal Credit Practices Review

We found no evidence of illegal discrimination or other illegal credit practices.