



SMALL BANK

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

PUBLIC DISCLOSURE

July 21, 2008

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

First National Bank
Charter Number 6813

31 Central Street East
Bagley, MN 56621-0000

Office of the Comptroller of the Currency

NORTH DAKOTA & NW MINNESOTA
1309 Highway 29 North Suite 102
Alexandria, MN 56308-0849

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.

The major factors supporting this rating for First National Bank (FNB) of Bagley are:

- The bank’s lending in its assessment area meets the standard for satisfactory performance. A substantial majority of the bank’s loans are made within the assessment area.
- FNB's loan-to-deposit ratio is reasonable given the institution’s size, financial condition, and assessment area credit needs.
- Lending to borrowers of different incomes and businesses of different sizes is reasonable and meets the standard for satisfactory performance.

SCOPE OF EXAMINATION

First National Bank (FNB) was evaluated under the Small Bank examination procedures, which included a lending test. The lending test evaluates the bank’s record of meeting the credit needs of its assessment areas (AA’s) through its lending activities.

The lending test for FNB covers its performance from January 1, 2006 through July 21, 2008, as this is representative of its lending strategy since the last CRA examination. FNB’s primary loan products are residential real estate, consumer, and commercial loans.

DESCRIPTION OF INSTITUTION

FNB is located in Clearwater County in Bagley, Minnesota. It is an intrastate bank with branches located in Fosston and Wilton, Minnesota. Fosston is approximately 20 miles west of Bagley in Polk County. Wilton is approximately 20 miles east of Bagley in Beltrami County. FNB does not have any deposit taking ATMs. As of March 31, 2008, total assets were \$62 million. The First National Agency of Bagley, a one-bank holding company, owns 100% of the bank.

FNB is conservative in its business strategy and lending philosophy. They offer traditional banking products and focus its lending on commercial, residential real estate, consumer, and agriculture loans. Net loans represent 62% of total assets. Tier 1 Leverage Capital was 9.44% of average assets, or \$5.8 million, as of March 31, 2008.

Table 1 – Loan Portfolio Composition	\$ (000)	%
Commercial Loans	\$15,475	39.5%
Agricultural Loans	\$7,047	18.0%
Residential Real Estate Loans	\$10,254	26.2%
Consumer Loans	\$6,408	16.3%

*Source: March 31, 2008 call report

There are no legal impediments which restrict the bank's ability to meet the credit needs of the community. The most recent CRA rating, dated July 8, 2002, was "Satisfactory."

DESCRIPTION OF ASSESSMENT AREA(S) (AA)

FNB has two assessment areas in northwest Minnesota, which are described below.

Clearwater/Mahnomen/Beltrami AA

The Clearwater/Mahnomen/Beltrami AA is comprised of the complete counties of Clearwater and Mahnomen, which include census tracts (CTs) 1, 2, 3, 9601, and 9603. In addition, CT 9501 in Beltrami County is included due to the location of the Wilton branch. CTs 9601 and 9603 are designated as moderate-income tracts, while all other CTs in the AA are designated as middle-income tracts. There are no low- or upper- income tracts in the AA. The AA meets the requirements of the regulation.

The AA is dependent on the logging industry and small businesses. Employment opportunities include the local school district, hospital, product research development business, and manufacturing. Unemployment is at 7.97% and 14.83% of households are living below the poverty level. The median family income is \$40,315, based on 2000 census data.

Main competitors include financial institutions located in Mahnomen, Clearbrook, Gonvick, and Bemidji. These banks range in size from \$31 million to \$73 million in assets, with the exception of FNB of Bemidji with \$442 million in assets.

During our evaluation, we contacted a local community organization to better understand the AA demographics and determine the primary credit needs of the AA. The contact stated the primary credit needs are affordable housing and small business lending.

The demographics of the Clearwater/Mahnomen/Beltrami AA are illustrated in the following table. The information is based on 2000 census data unless otherwise noted. This is the most recent information available during our evaluation.

Table 2A- Demographic and Economic Characteristics of Clearwater/Mahnomen/Beltrami AA	
<i>Population</i>	
Number of Families	5,058
Number of Households	7,143
Number of Low-Income Families	1226
% of Low-Income Families	24.24%
Number of Moderate-Income Families	1062
% of Moderate-Income Families	21.00%
Number of Middle-Income Families	1205
% of Middle-Income Families	23.82%
Number of Upper-Income Families	1565
% of Upper-Income Families	30.94%
% Minority Population	17.88%
<i>Geographies</i>	
Number of Census Tracts	6
% Low-Income Census Tracts	0%
% Moderate-Income Census Tracts	33%
% Middle-Income Census Tracts	67%
% Upper-Income Census Tracts	0%
<i>Median Family Income (MFI)</i>	
2000 MFI for AA	40,315
2008 HUD-Adjusted MFI	56,700
<i>Economic Indicators</i>	
Unemployment Rate	7.97%
2008 Median Housing Value	66,301
% of Households Below Poverty Level	14.83%

Grand Forks MSA AA

The other AA of the bank includes part of the Grand Forks MSA AA comprised of two complete CTs in Polk County. Polk County is located in northwestern Minnesota. The AA consists of CTs 209 and 210. The Fosston branch is located in CT 210. Both tracts are designated as middle-income tracts. There are no low-, moderate-, or upper-income tracts. The AA meets the requirements of the regulation and does not arbitrarily exclude any low- or moderate-income tracts.

The AA is dependent on small businesses and consumer lending. Employment opportunities include the local school district and hospital. Unemployment is at 7.22% and 12.87% of households are living below the poverty level. The 2008 HUD-adjusted median family income is \$60,100.

Main competitors include financial institutions located in Erskine, McIntosh, Fertile, Crookston, and Winger. These banks range in size from \$19 million to \$79 million in assets.

During our evaluation, we contacted a local community organization to better understand the AA demographics and determine the primary credit needs of the AA. The contact stated the primary credit needs are affordable housing and small business lending.

The demographics of the AA are illustrated in the following table. The information is based on 2000 census data unless otherwise noted. This is the most recent information available during our evaluation.

Table 2B - Demographic and Economic Characteristics of Grand Forks MSA AA	
<i>Population</i>	
Number of Families	2,006
Number of Households	3,039
Number of Low-Income Families	459
% of Low-Income Families	22.88%
Number of Moderate-Income Families	471
% of Moderate-Income Families	23.48%
Number of Middle-Income Families	474
% of Middle-Income Families	23.63%
Number of Upper-Income Families	602
% of Upper-Income Families	30.01%
% Minority Population	3.40%
<i>Geographies</i>	
Number of Census Tracts	2
% Low-Income Census Tracts	0%
% Moderate-Income Census Tracts	0%
% Middle-Income Census Tracts	100%
% Upper-Income Census Tracts	0%
<i>Median Family Income (MFI)</i>	
2000 MFI for AA	38,451
2008 HUD-Adjusted MFI	60,100
<i>Economic Indicators</i>	
Unemployment Rate	7.22%
2008 Median Housing Value	55,707
% of Households Below Poverty Level	12.87%

LOAN SAMPLING

The primary loan types were determined by taking all loans originated and purchased between January 1, 2006 and July 21, 2008. The following table depicts the number and volume of loans originated. We used this information along with 3/31/08 Call Report data to determine the primary loan types.

Table 3 - Loan Products	#	%	\$ (000)	%
Agricultural Loans	469	14%	\$11,741	18%
Commercial Loans	855	25%	\$29,349	45%
Consumer Loans	1,915	57%	\$12,935	20%
Residential Real Estate Loans	146	4%	\$11,521	18%
Total:	3,385	100%	\$65,546	100%

For this evaluation the primary loan types are commercial, consumer, and residential real estate loans. FNB does a lot of consumer lending as the table indicates and the call report indicated commercial loans made up the largest percentage of loans based on total dollar amount. We included the residential real estate loans in the sample because the community contacts indicated that affordable housing was one of the primary credit needs for the AA.

To conduct our analysis, we selected a sample of twenty commercial, consumer, and residential real estate loans originated or purchased between January 1, 2006 and July 21, 2008 for each AA. Our sample included both the Clearwater/Mahnomen/Beltrami AA and the Grand Forks MSA AA.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

Loan-to-Deposit Ratio

FNB's loan-to-deposit ratio is reasonable given the bank's size, financial condition, assessment area's credit needs, and local economic conditions. Since the previous CRA examination, the bank's average quarterly loan-to-deposit ratio is 71.47%, with a quarterly low of 64.88%, and a quarterly high of 77.19%. The loan-to-deposit ratio is comparable with FNB's main competition. Among competition in the Grand Forks MSA AA, FNB ranks third out of six. Among competition in the Clearwater/Mahnomen/Beltrami AA, FNB ranks second out of six. The other ten competitors had an average loan-to-deposit ratio of 64.7%.

The following table depicts the loan-to-deposit ratios of similar sized banks that are located in FNB's assessment area or have overlapping assessment areas:

Table 4A - Clearwater/Mahnomen/Beltrami AA Loans to Deposit Ratio		
Institution	Assets 3/31/08	Average Ratio
Northern State Bank of Gonvick	\$34 Million	29%
FNB of Bemidji	\$442 Million	67%
FNB of Mahnomen	\$73 Million	68%
First State Bank of Clearbrook	\$31 Million	68%
FNB	\$63 Million	71%
Security Bank USA	\$94 Million	95%

Table 4B - Grand Forks MSA AA Loans to Deposit Ratio		
Institution	Assets 3/31/08	Average Ratio
First State Bank of Fertile	\$31 Million	44%
FNB of McIntosh	\$24 Million	46%
Crookston National Bank	\$46 Million	56%
FNB	\$63 Million	71%
American State Bank of Erskine	\$19 Million	75%
Ultima Bank Minnesota, Winger	\$79 Million	99%

Lending in Assessment Area

FNB has a substantial majority of its residential, commercial, and consumer loans within its AA. Based on a sample of 120 loans, including 40 commercial, 40 residential, and 40 consumer loans for each AA, the bank originated 93% by number and 85% by dollar volume of loans within its AA as demonstrated in the following table:

Table 5 – Lending in the Clearwater/Mahnomen/Beltrami AA & Grand Forks MSA AA										
LOAN TYPE	Number of loans					Dollars of Loans				
	Inside AA		Outside AA		Total #	Inside AA		Outside AA		Total \$ (000s)
	#	%	#	%		\$ (000s)	%	\$ (000s)	%	
Residential	36	90%	4	10%	40	\$2,880,725	87%	\$419,108	13%	\$3,299,833
Commercial	36	90%	4	10%	40	\$2,746,530	81%	\$648,258	19%	\$3,394,788
Consumer	40	100%	0	0%	40	\$437,309	100%	\$0	0%	\$437,309
Total reviewed	112	93%	8	7%	120	\$6,064,564	85%	\$1,067,366	15%	\$7,131,930

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

Lending to borrowers of different incomes and businesses of different sizes is reasonable and meets the standard for satisfactory performance. FNB’s primary loan products were determined by examining the percentage of loans originated by dollar amount and by number of originations. Commercial loans (including real estate), residential real estate and consumer loans were chosen based on the dollar volume, number of originations and the needs of the community.

Performance in the Clearwater/Mahnomen/Beltrami AA

The borrower distribution of loans in Clearwater/Mahnomen/Beltrami AA is satisfactory and reflects reasonable penetration.

Commercial Loans

The distribution of loans to businesses meets the standard for satisfactory performance for loans to businesses of different sizes. Ninety-five percent of the loans to businesses originated and purchased during the loan sampling period were made to small businesses. Small businesses are businesses with gross annual revenues of one million dollars or less. This is considered reasonable compared to demographic data which show 97% of the area’s businesses are considered small businesses.

The following table shows the distribution of commercial loans among different sized businesses in the AA:

Table 6A - Borrower Distribution of Loans to Businesses in Clearwater/Mahnomen/Beltrami AA			
Business/Farm Revenues	≤1,000,000	>1,000,000	Total
% of AA Businesses	97%	3%	100%
% of Bank Loans in AA by #	95%	5%	100%
% of Bank Loans in AA by \$	94%	6%	100%

Residential Real Estate Loans

The distribution of home loans to borrowers reflects reasonable penetration among borrowers of low-income levels but does not meet the standard for moderate-income. Twenty percent of home loans originated and purchased during the loan sampling period were made to low-income borrowers. Ten percent were to moderate-income. Demographic information indicates the unemployment rate is 7.97% and the households below the poverty level is 14.83%. Lending to moderate-income borrowers is mitigated due to the higher level difficulty for these borrowers to qualify for home loans. Refer to the demographic table below:

Table 6B - Residential Real Estate Loans in the Clearwater/Mahnommen/Beltrami AA				
Borrower Income Level	LOW <50% of median family income*	MODERATE At least 50% and < 80% of median family income*	MIDDLE At least 80% and < 120% of median family income*	UPPER >120% of median family income*
% of Families	24%	21%	24%	31%
Number of Loans	4	2	6	8
Percentage Number	20%	10%	30%	40%
Dollar Amount of Loans	\$239,953	\$155,782	\$378,789	\$928,258
Percentage Number	14%	9%	22%	55%

Consumer Loans

The distribution of consumer loans meets the needs of borrowers of different income levels. Twenty percent of consumer loans originated and purchased during the loan sampling period were made to low-income borrowers. Twenty-five percent were to moderate-income. Based on the demographic information this reflects reasonable penetration. Refer to the demographic table below:

Table 6C - Consumer Loans in the Clearwater/Mahnommen/Beltrami AA				
Borrower Income Level	LOW <50% of median family income*	MODERATE At least 50% and < 80% of median family income*	MIDDLE At least 80% and < 120% of median family income*	UPPER >120% of median family income*
% of Families	24%	21%	24%	31%
Number of Loans	4	5	5	6
Percentage Number	20%	25%	25%	30%
Dollar Amount of Loans	\$40,212	\$64,360	\$69,071	\$52,921
Percentage Number	37%	59%	63%	48%

*Median family income for 2008 is \$40,315

Performance in Grand Forks MSA AA

The borrower distribution of loans in Grand Forks MSA AA is satisfactory, and reflects reasonable penetration.

Commercial Loans

The distribution of loans to businesses exceeds the standard for satisfactory performance for businesses of different sizes. 100% percent of the loans to businesses originated and purchased during the loan sampling period were made to small businesses. Small businesses are businesses with gross annual revenues of one million dollars or less. This is considered excellent penetration compared to demographic data which show 97% of the area’s businesses are considered small businesses.

The following table shows the distribution of commercial loans among different sized businesses in the AA:

Table 7A - Borrower Distribution of Loans to Businesses in the Grand Forks MSA AA			
Business Revenues	≤1,000,000	>1,000,000	Total
% of AA Businesses	97%	3%	100%
% of Bank Loans in AA by #	100%	0%	100%
% of Bank Loans in AA by \$	100%	0%	100%

Residential Real Estate Loans

The distribution of home loans to low-income borrowers does not meet the satisfactory standards but the loans to moderate income have good penetration. The primary reason for the low penetration to low-income borrowers is the unemployment rate of 7.22% and the number of borrowers from households below the poverty level is 12.87%. In addition, lending to low-income borrowers is mitigated due to the higher level of difficulty for these borrowers to qualify for home loans. Refer to the demographic table below:

Table 7B - Residential Loans in the Grand Forks MSA AA				
Borrower Income Level	LOW <50% of median family income*	MODERATE At least 50% and < 80% of median family income*	MIDDLE At least 80% and < 120% of median family income*	UPPER >120% of median family income*
% of Families	23%	23%	24%	30%
Number of Loans	2	6	9	3
Percentage Number	10%	30%	45%	15%
Dollar Amount of Loans	\$101,471	\$449,631	\$529,841	\$227,646
Percentage Number	8%	34%	40%	17%

*Median family income for 2008 is \$60,100

Consumer Loans

The distribution of consumer loans reflects excellent penetration among borrowers of different income levels. Fifty percent of consumer loans originated and purchased during the loan sampling period were made to low-income borrowers. Twenty-five percent were to moderate-income. Refer to the demographic table below:

Table 7C - Consumer Loans in the Grand Forks MSA AA				
Borrower Income Level	LOW <50% of median family income*	MODERATE At least 50% and < 80% of median family income*	MIDDLE At least 80% and < 120% of median family income*	UPPER >120% of median family income*
% of Families	23%	23%	24%	30%
Number of Loans	10	5	3	2
Percentage Number	50%	25%	15%	10%
Dollar Amount of Loans	\$90,612	\$49,193	\$52,243	\$18,697
Percentage Number	43%	23%	25%	9%

*Median family income for 2008 is \$60,100

Geographic Distribution of Loans

The distribution of the bank’s loans exceeds the standards for reasonable performance. Upon review of FNB’s primary loan products, we determined the bank lends in all income tracts in their AA and does a reasonable job of lending to moderate-income borrowers. The Clearwater/Mahnommen/Beltrami Non-MSA AA consists of 2 moderate-income tracts and 4 middle-income tracts. The tables below illustrate the demographic data for the AA and the findings from our review.

Table 8A - Geographic Distribution of Loans to Businesses in the Clearwater/Mahnommen/Beltrami AA								
Census Tract Income Level	Low		Moderate		Middle		Upper	
Loan Type	% of AA Businesses	% of Number of Loans	% of AA Businesses	% of Number of Loans	% of AA Businesses	% of Number of Loans	% of AA Businesses	% of Number of Loans
Business	0.0%	0.0%	13.88%	40.0%	86.12%	60.0%	0.0%	0.0%

Table 8B - Geographic Distribution of Residential Real Estate Loans in the Clearwater/Mahnommen/Beltrami AA								
Census Tract Income Level	Low		Moderate		Middle		Upper	
Loan type	% 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
Home Mortgage	0.0%	0.0%	27.15%	30.0%	72.85%	70.0%	0.0%	0.0%

Table 8C - Geographic Distribution of Loans to Consumers the Clearwater/Mahnommen/Beltrami AA								
Census Tract Income Level	Low		Moderate		Middle		Upper	
Loan Type	% of AA Consumers	% of Number of Loans	% of AA Consumers	% of Number of Loans	% of AA Consumers	% of Number of Loans	% of AA Consumers	% of Number of Loans
Consumer	0.0%	0.0%	27.15%	65.0%	72.85%	35.0%	0.0%	0.0%

A review of the geographic distribution in the Polk AA was not performed as there are no low- or moderate-income tracts.

Responses to Complaints

FNB has not received any complaints, during this evaluation period, regarding its performance in helping to meet assessment area credit needs.

Fair Lending or Other Illegal Credit Practices Review

We found no evidence of discrimination or illegal credit practices inconsistent with helping meet the community credit needs.