



SMALL BANK

Comptroller of the Currency
Administrator of National Banks

PUBLIC DISCLOSURE

April 02, 2002

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**Merchants Bank, National Association
Charter Number 15718**

**115 W. Washington Square
Caledonia, MN 55921**

**Comptroller of the Currency
Minneapolis South Field Office
1310 West Clairemont Avenue Suite 100
Eau Claire, WI 54702**

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.

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INSTITUTION'S CRA RATING

This institution is rated Outstanding.

The Outstanding rating for this bank is based on the following overall conclusions.

- The distribution of loans reflects, given the demographics of the assessment area, excellent penetration among individuals of different income levels and businesses and farms of different sizes.
- The geographic distribution of loans reflects excellent dispersion throughout the assessment area.
- A substantial majority of loans and other related lending activities are in the bank's assessment area.
- The bank's loan-to-deposit (LTD) ratio is reasonable given the bank's size, financial condition and assessment area credit needs.

DESCRIPTION OF INSTITUTION

Merchants Bank, National Association (Merchants) is a \$38 million bank with one office located in Caledonia, Minnesota. The bank office is located in a moderate-income geography. Merchants has one deposit taking automated teller machine (ATM) located at the drive-up facility of the bank. The bank offers traditional business, agriculture and consumer lending products that include real estate loans, operating lines of credit, home mortgages, and consumer installment loans. The bank's primary lending products are business loans, agriculture loans and consumer installment loans. Primary products were based on total dollar volume and number of loans originated during the evaluation period.

On December 31, 2001 the bank's loan portfolio mix (outstandings) was as follows: business and business real estate loans \$12.03 million (44%), home mortgages \$5.08 million (18%), agriculture and agriculture real estate loans \$7.6 million (28%) and consumer loans \$2.8 million (10%). Total outstanding loans equal \$27.5 million or 72% of assets.

Merchants has been instrumental in the development and construction of a new community center in Caledonia, Minnesota. The bank is the third largest pledge donor to the building fund with a commitment to give \$100 thousand to the construction of the community center. President Todd Roesler has been actively involved on the Board of Directors for the community center serving as the treasurer. One of the functions of the Board has been to raise construction money and to create an endowment fund to pay the operating expenses of the center. The community center will be for the general use of the community and will provide a setting for local human service groups to carry out activities that benefit low- and moderate-income individuals and families.

Merchants is owned by a multi-bank holding company Merchants Financial Group, Inc. The holding company is located in Winona, Minnesota. Total assets of the holding company as of December 31, 2001 were \$581 million. There is no financial or legal impediment limiting the ability of the bank to meet the community credit needs. The bank's last CRA evaluation was May 21, 1997. The bank was rated Satisfactory at that time. There have been no other changes in corporate structure since the last CRA examination.

DESCRIPTION OF HOUSTON COUNTY

The bank's assessment area is Houston County, Minnesota and is located in southeastern Minnesota. Houston County is in the La Crosse WI-MN Metropolitan Statistical Area (MSA). The city of Caledonia is the county seat. The city of La Crosse, Wisconsin is the economic, retail and employment center of the MSA. La Crosse, Wisconsin is located approximately 22 miles from the bank. The assessment area contains 3 moderate-income and 3 middle-income census tracts.

Based on 2000 estimated census data, the population of Houston County is 119,718. The city of Caledonia has a population of 2,965. The 1990 weighted average median family income for the La Crosse MSA was \$30,963. The 2000 updated weighted median family income for the La Crosse MSA is \$50,900. Houston County covers 558 square miles. Houston County has been experiencing slow growth over the past decade. In 2000, there were 73 permits for new housing. Home ownership rate totaled 81%. The 2000 median sale price for a home in Caledonia was \$76,000. A total of 3 permits for new commercial construction in Caledonia were issued.

Able, Incorporated, Houston County, and Caledonia Schools are the three largest employers. These organizations each employ between 100 and 200 workers. As of February 2002, the unemployment rate in the La Crosse MSA was 5.2%. This is an increase from the February 2001 unemployment rate of 4.5% and can be attributed to the downturn in the economy-experienced nation wide. As a comparison, the average unemployment rate for the State of Minnesota was 4.2% in February 2001 and 3.5% in February 2001. The lower State of Minnesota unemployment rates can be attributed to job stability in the larger metropolitan areas.

The banking environment is competitive in Houston County. For example, Merchants competes with 8 financial institutions with headquarters or branch locations in Houston County. Merchants is the third largest bank and has a deposit market share of 18%. Community First National Bank and La Crescent State Bank each have a 21% share of the market.

One new community contact and two existing contacts were used as part of the evaluation. Community contacts were made with two economic development agencies and a mayor from a community within the assessment area. The new contact stated all banks within the county are actively meeting the assessment areas credit needs. Local banks are working with revolving loan funds within the communities to support business growth and development. All local financial institutions within the county are perceived to be actively lending to farmers, businesses, and consumers. There were no known credit needs not being met by local banks in the county.

The assessment area meets the requirements of the regulation and does not arbitrarily exclude any low- or moderate-income geographies. Table 1 below shows the assessment area composition by census tract income level based on the 1990 census data.

Table 1. Assessment Area Income Level	Number of Census Tracts	Percent of Census Tract
Low	0	0.00%
Moderate	3	50.00%
Middle	3	50.00%
Upper	0	0.00%

Table 2 shows family income level based on the 2001 updated MSA median family income of \$50,900.

Table 2. Family Income Level	Percent of Families
Low	17.67%
Moderate	23.08%
Middle	26.59%
Upper	32.66%

CONCLUSIONS ABOUT PERFORMANCE CRITERIA

Loan-to-Deposit Ratio

Merchants has a loan-to-deposit ratio that is reasonable given the bank's size, financial condition, and assessment area credit needs. The bank's quarterly average loan-to-deposit ratio since its last CRA examination is 77%. Similarly situated banks had a quarterly average loan-to-deposit ratio ranging from 65% to 93% with an overall average ratio of 78%. Similarly situated banks are those operating primarily in Houston County with total assets less than \$50 million. The loan-to-deposit ratio for Merchants ranked third out of the four banks in the comparison.

Lending in Assessment Area

The bank's record for lending in the assessment area is excellent. A substantial majority of loans and other lending-related activities are in the bank's assessment area. The bank's ratio of lending within the assessment area was calculated from the bank's three primary loan products, business loans, agriculture loans and consumer installment loans. Primary loan products were identified using loan originations from April 1997 through March 2002. A random sample of 20 business loans, 20 agriculture loans and 20 consumer installment loans were evaluated. Table 3 below shows the bank's lending within the assessment area based on the three primary product types.

Table 3. In/Out Lending Analysis	In Assessment Area by Number %	In Assessment Area by Dollar %
Business Loans	80.00%	74.81%
Agriculture Loans	85.00%	91.98%
Consumer Installment Loans	95.00%	99.73%

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

The distribution of loans reflects, given the demographics of the assessment area, excellent penetration among individuals of different income levels (including low- and moderate-income) and businesses of different sizes.

Lending to small business is reasonable compared to the demographic information. We reviewed a sample of 20 loans originated within the assessment area. The bank originated 79% by number and 73% by dollar of loans in our sample to businesses with revenues less than or equal to \$1 million per year. This compares with a small business demographic of 93%. Table 4 below shows loan distribution to businesses based on annual revenues.

Table 4. Business Loans Income Distribution	By Number %	By Dollar %	% of Businesses in Assessment Area
Revenues ≤ \$1,000,000	78.57%	72.96%	93.32%
Revenues > \$1,000,000	21.43%	27.04%	6.68%

Lending to small farms is excellent compared to the demographic information. We reviewed a sample of 20 loans originated within the assessment area. The bank originated 95% by number and 99% by dollar of loans in our sample to small farms with revenues less than or equal to \$1 million per year. This compares with a small farm demographic of 99%. Table 5 below shows loan distribution to small farms based on annual revenues.

Table 5. Agriculture Loans Income Distribution	By Number %	By Dollar %	% of Farms in Assessment Area
Revenues ≤ \$1,000,000	94.74%	98.56%	98.94%
Revenues > \$1,000,000	1.44%	5.26%	1.06%

The distribution of loans to low- and moderate-income households is excellent given the demographics of the assessment area. We reviewed a sample of consumer installment loans and found that the bank originated 53% by number and 47% by dollar to low-income households. For moderate-income households the bank originated consumer installment loans that total 24% by number and 37% by dollar. The bank's performance exceeds the demographic for the assessment area. Table 6 below shows the loan distribution by income category.

Table 6. Consumer Loans Income Distribution	By Number %	By Dollar %	% Households Assessment Area
Low	52.94%	47.05%	23.18%
Moderate	23.53%	36.95%	17.14%
Middle	17.65%	9.97%	21.65%
Upper	5.88%	6.04%	38.05%

The bank's performance for meeting the credit needs in the community is good. This is based on the comments from community contacts that state that there are no perceived unmet credit needs in the community. The lending performance of the bank provides support that the bank is meeting the credit needs of the community.

Geographic Distribution of Loans

The geographic distribution of loans reflects excellent dispersion through all areas of the assessment area. An analysis of the bank's lending within all geographies of the assessment area was performed. There were no conspicuous gaps or areas of low penetration identified. The banking environment in the assessment area is competitive. A total of 8 banks and savings associations have offices in the assessment area. Merchants is located within a moderate-income geography.

Geographic distribution of loans to businesses reflects excellent dispersion through all areas of the assessment area. From a sample of 20 loans made within the assessment area we determined that 70% by number and 75% by dollar, were made in moderate-income geographies. Demographic information indicates that 37% of businesses in the assessment area are located within moderate-income geographies. Table 7 below shows the geographic distribution of business loans within the assessment area.

Table 7. Business Loans Geographic Distribution	By Number %	By Dollar %	% of Businesses in Assessment Area
Low	0.00%	0.00%	0.00%
Moderate	70.00%	74.88%	37.00%
Middle	30.00%	25.12%	63.00%
Upper	0.00%	0.00%	0.00%

Geographic distribution of loans to small farms reflects excellent dispersion through all areas of the assessment area. From a sample of 20 loans made within the assessment area we determined that 85% by number and 89% by dollar, were made in moderate-income geographies. Demographic information indicates that 52% of small farms in the assessment area are located within moderate-income geographies. Table 8 below shows the geographic distribution of small

farm loans within the assessment area.

Table 8. Agriculture Loans Geographic Distribution	By Number %	By Dollar %	% of Farms in Assessment Area
Low	0.00%	0.00%	0.00%
Moderate	85.00%	88.86%	52.21%
Middle	15.00%	11.14%	47.79%
Upper	0.00%	0.00%	0.00%

Geographic distribution of consumer installment loans reflects excellent dispersion throughout the assessment area. The percentage of loans the bank made to households in the moderate-income areas exceeds area demographics. From a sample of 20 loans made within the assessment area we determined that 70% by number and 75% by dollar were made to borrowers located in moderate-income geographies of the assessment area. 40% of the households in the assessment area are located in moderate-income geographies. Table 9 below shows the geographic distribution of consumer installment loans within the assessment area.

Table 9. Consumer Loans Geographic Distribution	By Number %	By Dollar %	% Households in Assessment Area
Low	0.00%	0.00%	0.00%
Moderate	70.00%	75.26%	39.53%
Middle	30.00%	24.74%	60.47%
Upper	0.00%	0.00%	0.00%

Responses to Complaints

There have been no CRA related complaints.

Fair Lending Review

An analysis of 2000 HMDA data, public comments, and consumer complaint information was performed according to the OCC's risk based fair lending approach. Based on its analysis of the information, the OCC decided that a comprehensive fair lending examination would not need to be conducted in connection with the CRA evaluation this year.