



SMALL BANK

Comptroller of the Currency
Administrator of National Banks

PUBLIC DISCLOSURE

August 4, 2003

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**First National Bank
Charter Number 8280**

**414 Main Street, P.O. Box 129
Milnor, ND 58060**

**Office of the Comptroller of the Currency
North Dakota & NW Minnesota
3211 Fiechtner Drive, SW
Fargo, ND 58103**

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 Satisfactory.

The satisfactory rating is supported by the following factors:

- The bank's loan-to-deposit ratio meets the standard for satisfactory performance.
- The bank's record of lending to farm, business, and consumer borrowers in the Assessment Area (AA) exceeds the standard for satisfactory performance.
- The bank's record of lending to farm, business, and individual borrowers of different sizes and income levels meets the standard for satisfactory performance.

DESCRIPTION OF INSTITUTION

First National Bank (FNB) is located in the city of Milnor, North Dakota in Sargent County in southeastern North Dakota. FNB has one branch located in Lisbon, North Dakota in Ransom County. It has 3 nondeposit-taking automated teller machines located within both cities. FNB's assets total \$46 million as of December 31, 2002. FNB Bankshares, a one-bank holding company, owns 100 percent of the bank. The holding company is located in Milnor, North Dakota and has total assets equal to the equity in the bank. There have been no acquisitions or mergers since the previous CRA evaluation. The bank has no affiliates.

The bank is conservative in its business strategy and lending philosophy. FNB offers traditional banking products and focuses its lending primarily on farm and commercial/industrial borrowers and, to a slightly lesser extent, consumer and residential real estate. In addition to those loans held on the bank's books, management assisted 47 borrowers, representing \$3.3 million, during 2001 and 2002 by helping them obtain financing through the secondary market. Net loans represent 63 percent of total bank assets. Tier One Leverage Capital for the bank is 12 percent of average assets, or \$5.6 million.

| Loan Portfolio Composition 12/02 | \$ (000) | % |
|---------------------------------------------|-----------------|-------------|
| Agriculture & Agriculture Real Estate Loans | \$15,908 | 55% |
| Commercial & Commercial Real Estate Loans | \$5,981 | 21% |
| Consumer Loans | \$4,469 | 15% |
| Residential Real Estate Loans | \$2,706 | 9% |
| Total | \$29,064 | 100% |

Table data from December 31, 2002 Call Report

There are no legal impediments that would restrict the bank's ability to meet the credit needs of the community. The evaluation period for the Performance Evaluation is from January 27, 1998 to August 4, 2003. The most recent CRA rating was Satisfactory, dated January 26, 1998.

DESCRIPTION OF FNB'S ASSESSMENT AREA

FNB's assessment area (AA) is comprised of both Sargent and Ransom counties in southeastern North Dakota. The AA is not located within a metropolitan statistical area (MSA). The AA includes six block-numbering areas (BNAs), five are middle-income and one is upper-income. The AA contains no low-income or moderate-income BNAs.

The bank's AA includes only whole BNAs that are contiguous. The AA meets the requirements of the regulation. The AA does not arbitrarily exclude low- or moderate-income geographies. Larger cities included in the AA are Lisbon and Milnor.

The bank's AA is dependent on agricultural operations. Employment opportunities outside of the agricultural industry include various manufacturing companies, two school districts, a hospital and various nursing homes. The number of households living below the poverty level is 12 percent of total households. The statewide median income for 2002 is \$41,700.

The bank's competitors include a credit union in Milnor and Bremer Bank, US Bank and another credit union in Lisbon.

During our evaluation, we contacted a local community organization to better understand the AA demographics and to determine the primary credit needs of the AA. We also relied on previous community contacts made by this agency and other governmental agencies. The top credit need within the Milnor and Lisbon communities continues to be agricultural related.

The demographics of the AA are illustrated in the table on the next page. The information is based on 1990 census data unless otherwise noted. This is the most recent information available during our evaluation.

| DEMOGRAPHIC AND ECONOMIC CHARACTERISTICS OF AA | |
|-------------------------------------------------------|----------|
| <i>Population</i> | |
| Number of Families | 2,879 |
| Number of Households | 4,052 |
| Number of Low-Income Families | 494 |
| % of Low-Income Families | 17.1% |
| Number of Moderate-Income Families | 490 |
| % of Moderate-Income Families | 17.0% |
| Number of Middle-Income Families | 635 |
| % of Middle-Income Families | 22.1% |
| Number of Upper-Income Families | 1,260 |
| % of Upper-Income Families | 43.8% |
| <i>Geographies</i> | |
| Number of Census Tracts/BNA | 6 |
| % Low-Income Census Tracts/BNA | 0.0% |
| % Moderate-Income Census Tracts/BNA | 0.0% |
| % Middle-Income Census Tracts/BNA | 83.3% |
| % Upper-Income Census Tracts/BNA | 16.7% |
| <i>Median Family Income (MFI)</i> | |
| 1990 MFI for AA | \$29,325 |
| 2002 HUD-Adjusted MFI | \$41,700 |
| <i>Economic Indicators</i> | |
| Unemployment Rate | 3.7% |
| 2002 Median Housing Value | \$28,638 |
| % of Households Below Poverty Level | 12% |

LOAN SAMPLING

The bank's primary loan types were determined by taking all loans outstanding as of December 31, 2002. For the purposes of this evaluation, the primary loan types are agricultural, commercial, and consumer. Agricultural loans account for 28 percent of the number of loans outstanding and 55 percent of the volume of loans. Commercial loans total 11 percent of the number of loans and 21 percent of the volume of loans. Consumer loans represent 55 percent of the number of loans and 15 percent of the volume of loans. Residential real estate loans were not selected as a primary loan type due to the limited number of loans made. Agricultural, commercial and consumer loans closely mirror the community credit needs as identified by the community contact.

To conduct our analysis, we selected a sample of twenty agricultural, commercial and consumer loans made in the AA and outstanding on December 31, 2002.

CONCLUSIONS ABOUT PERFORMANCE CRITERIA

Loan-to-Deposit Ratio

The bank's LTD ratio meets the standard for satisfactory performance given the size, financial condition, and lending opportunities within the bank's AA. The quarterly LTD ratio averaged 67.03 percent in the 21 calendar quarters from March 31, 1998 to March 31, 2003. During this period, the LTD ratio increased from 59.07 percent on March 31, 1998 to 72.73 percent on March 31, 2003.

Comparisons to four similar sized rural community banks located in southeastern North Dakota with no more than two branch office indicate that the LTD ratio is satisfactory. The comparison banks have similar assets, ranging from \$14 to \$64 million. These four banks had average LTD ratios ranging from 57 percent to 93 percent as depicted by the table below.

| Institution | Assets (as of 3-31-03) | Average Quarterly LTD Ratio |
|----------------------------|------------------------|-----------------------------|
| Citizens State Bank | \$61,378 | 93% |
| Peoples State Bank | \$14,402 | 72% |
| <i>First National Bank</i> | <i>\$46,856</i> | <i>67%</i> |
| Sargent County Bank | \$64,424 | 58% |
| Lincoln State Bank | \$32,277 | 57% |

Lending in Assessment Area

Lending within the AA exceeds the standard for satisfactory performance. A substantial majority of loans are originated within the AA. We used our sample of 60 loans, including agricultural, commercial and consumer loans, to assess the bank's lending in the AA. The following table illustrates lending activity within the AA during the evaluation period.

| TOTAL LOANS REVIEWED | | | | | | | | |
|----------------------|--------------------|------|-----------|------|------------------------|-----|-----------|-----|
| LOAN TYPE | IN ASSESSMENT AREA | | | | OUT OF ASSESSMENT AREA | | | |
| | # | % | \$ (000s) | % | # | % | \$ (000s) | % |
| Agricultural Loans | 20 | 100% | 499,266 | 100% | 0 | 0% | 0 | 0% |
| Commercial Loans | 18 | 90% | 697,326 | 98% | 2 | 10% | 15,005 | 2% |
| Consumer Loans | 16 | 80% | 200,990 | 89% | 4 | 20% | 24,640 | 11% |
| Total Reviewed | 54 | 90% | 1,397,582 | 97% | 6 | 10% | 39,645 | 3% |

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

Lending to borrowers of different incomes and to farms of different sizes meets the standard for

satisfactory performance.

Agricultural Loans

FNB’s lending to farms of different sizes is good. Lending to farms with revenues under \$1 million exceeds the demographics of the AA. All of the farm loans sampled were to farms with revenues under \$1 million. The following table illustrates FNB’s lending to farms.

| BORROWER DISTRIBUTION OF SMALL LOANS TO FARMS | | |
|-----------------------------------------------|--------------|--------------|
| Annual Farm Revenues | ≤\$1,000,000 | >\$1,000,000 |
| % of AA Farms | 97.61% | 2.39% |
| % of Bank Loans in AA # | 100% | 0% |
| % of Bank Loans in AA \$ | 100% | 0% |

Commercial Loans

Lending to businesses with revenues under \$1 million meets the standard for satisfactory performance. The distribution of numbers of loans to businesses closely reflects the percentage of businesses with revenues under \$1 million. The distribution of loans by dollar volume is impacted as the loan sample captured only one business with revenues over \$1 million. This loan originated for \$12,500 while the average loan size for businesses under \$1 million was \$41,872.

| BORROWER DISTRIBUTION OF SMALL LOANS TO BUSINESSES | | | |
|----------------------------------------------------|--------------|--------------|--------------|
| Business Revenues | ≤\$1,000,000 | >\$1,000,000 | Not Reported |
| % of AA Businesses | 75.25% | 4.69% | 20.06% |
| % of Bank Loans in AA # | 75% | 5% | 20% |
| % of Bank Loans in AA \$ | 92% | 2% | 6% |

Consumer Loans

Lending to consumers of different income levels meets the standard for satisfactory performance. Our sample included a total of 20 loans, although only 14 of these had income information. Borrower distribution of these 14 consumer loans is detailed in the following table. While lending in the low- and moderate-income levels appears low, additional file documentation indicates that most, if not all, of the six loans without income information would fall within the low- or moderate-income level. By including these borrowers within the low- and moderate-income categories, levels meet the standard for satisfactory performance.

| CONSUMER LOAN BORROWER DISTRIBUTION | | | | | | | | |
|-------------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Borrower Income Level | LOW | | MODERATE | | MIDDLE | | UPPER | |
| % of AA Households | 17.16% | | 17.02% | | 22.06% | | 43.77% | |
| Sample Loans | % of Number | % of Amount | % of Number | % of Amount | % of Number | % of Amount | % of Number | % of Amount |
| 14 | 7% | 2% | 0% | 0% | 36% | 30% | 57% | 68% |

Geographic Distribution of Loans

Geographic distribution analysis is not meaningful due to the lack of low- or moderate-income level tracts within the assessment area.

RESPONSES TO COMPLAINTS

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

FAIR LENDING REVIEW

An analysis of public comments and consumer compliant information over the evaluation period 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.