

PUBLIC DISCLOSURE

July 6, 1999

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**The First National Bank of Bemidji
Charter Number 5582**

**502 Minnesota Avenue
Bemidji, Minnesota 56619**

**Office of the Comptroller of the Currency
Alexandria Field Office
1309 Highway 29 North, P. O. Box 849
Alexandria, Minnesota 56308**

NOTE: 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.

GENERAL INFORMATION

The Community Reinvestment Act (CRA) requires each federal financial supervisory agency to use its authority when examining financial institutions subject to its supervision, to assess the 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. Upon conclusion of such examination, the agency must prepare a written evaluation of the institution's record of meeting the credit needs of its community.

*This document is an evaluation of the Community Reinvestment Act (CRA) performance of **The First National Bank of Bemidji, Bemidji, Minnesota** prepared by **The Office of the Comptroller of the Currency**, the institution's supervisory agency, as of **July 6, 1999**. The agency rates the CRA performance of an institution consistent with the provisions set forth in Appendix A to 12 CFR Part 25.*

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

This bank has an exceptional record of meeting the credit needs of the community:

- C Virtually all of the bank's lending activities are conducted with persons residing within the assessment area.
- C The bank has an exceptional record of lending to low- and moderate-income persons. The bank is very active in programs targeted to low- and moderate-income family credit needs. The bank is a community leader in providing low-interest, low down-payment housing loans. Also, the bank makes nearly all of its commercial loans to small businesses.
- C The bank's commitment to providing for housing needs is manifested in a high level of residential real estate lending. The bank's residential one-to-four family mortgages represent 41% of all the bank's loans. In addition, the bank sells a significant amount of residential mortgages on the secondary market.
- C The bank is very active in improving consumer education on credit matters.
- C Bemidji area leaders indicate that this bank is the community leader in providing services that enhance credit availability in the assessment area.

DESCRIPTION OF INSTITUTION

The First National Bank of Bemidji (FNBB) is owned by First Bemidji Holding Company, a one-bank holding company located in Bemidji, Minnesota. The Holding Company's assets consist primarily of FNBB. This \$271 million institution is located in Beltrami County in north central Minnesota with a current net loan-to-total asset ratio of 51.35%. We evaluated FNBB as a small bank because the bank's total assets have not exceeded \$250 million for each of the past two years. FNBB has its main office and one branch located in downtown Bemidji and a branch in north Bemidji. The bank also owns four ATMs located in the main office, the north branch, a convenience store, and the local hospital.

The bank's loan portfolio is dominated by real estate loan products, but it offers a diversified variety of products and services. As of March 31, 1999, the loan portfolio consists of:

Loan Type	Amount	Percent
Real Estate	\$84,538,000	60%
Commercial	\$23,029,000	16%
Consumer	\$27,491,000	20%
Agricultural	\$5,277,000	4%
Other	\$193,000	-
Gross Loans	\$140,528,000	100%

Source: Report of Condition 3/31/99

The bulk of the real estate loan portfolio is in one-to-four family residence loans. Those loans represent 68% of all real estate loans, with the balance primarily commercial real estate loans.

The prior CRA examination was conducted on July 18, 1996 in which the bank received an *Outstanding* rating. This rating reflected the bank's strong performance in lending to individuals of different income levels and businesses of different sizes, extending credit primarily within the bank's assessment area, and the bank's activity in community development programs to reach the low- and moderate-income persons.

DESCRIPTION OF FNBB'S ASSESSMENT AREA

The bank’s assessment area (AA) includes all of Beltrami County and portions of northern Cass County and northern Hubbard County. This includes the cities of Bemidji, Cass Lake, Red Lake, and Blackduck. This area consists of ten contiguous Block Numbering Areas (BNAs). The bank’s AA includes six middle-income BNAs, three moderate-income BNAs, and one low-income BNA. FNBB’s assessment area meets the requirements of the regulation and does not arbitrarily exclude any low- or moderate-income geographies.

The AA includes a large number of low- and moderate-income persons. The total population of the AA is 38,631 persons and 13,269 households. Twenty-four percent of the households are under the poverty level. The median housing value is \$49,741 and the median year built is 1970. Owner-occupied units are low at 59% of total housing units. Rentals units total 21% of total housing units. The remaining 20% are vacant units. The statewide updated median family income is \$40,500. Based on this amount, FNBB’s assessment area demographics include:

Income Level	Percent of AA (Population)
Low-Income	27%
Moderate-Income	19%
Middle-Income	23%
Upper-Income	31%

Unemployment is relatively high at 4%. Major employers include Bemidji Public Schools, Bemidji State University, North Country Health Services, the County Government, and a variety of manufacturing and retail businesses.

Two community contacts were made. One was with the Headwaters Regional Development Commission and the other was with the City of Bemidji, Planning and Zoning. These contacts stated that the local economy is improving. The local needs include housing and more commercial enterprises to improve the quantity and quality of the job market. The City of Bemidji has recently condemned and destroyed 100 housing units that were not considered fit for occupancy. The contacts indicated that FNBB has been a leader in meeting the credit needs to help fund housing credit needs. The area has a shortage of higher paying jobs, but a decreasing unemployment rate. The contacts stated that an influx of several businesses should improve the job market.

FNBB’s competition consists of five banks, two credit unions, and a savings bank. All

institutions are considerably smaller in asset size than FNBB and are located in the AA.

A portion of the bank's AA is located in the Red Lake Indian Reservation (RLIR). This portion comprises one entire BNA and is classified as low-income. Because of tribal law, lenders are unable to obtain a mortgage on real estate located in the closed reservation. The Red Lake Tribal Council provides low-interest home improvement loan rates and home improvement grant funds. While this limits the bank's ability to provide residential loans in that BNA, the bank has been successful in meeting the other credit needs.

DESCRIPTION OF LOANS SAMPLED

In order to determine the bank's performance, we selected a sample of loans made since the last CRA examination. FNBB's major products are real estate loans, consumer loans and commercial loans. We selected a random sample of 20 loans from each of these major loan products for a total sample size of 60 loans. This was based on the originations from 5-1-96 through 5-31-99 as shown in the following table.

Product Class	Origination Amt	% of Dollar Volume	Number of Originations	% of Number Volume
Consumer Loans	\$66,689,000	20%	12372	72%
Commercial Loans	\$129,151,000	39%	1673	10%
Real Estate Loans	\$113,568,000	35%	2300	13%
Home Equity Loans	\$2,795,000	1%	91	1%
Logging Loans	\$7,627,000	2%	399	2%
Agricultural Loans	\$9,753,000	3%	460	2%
Totals	\$329,583,000	100%	17295	100%

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA:

Lending in the Assessment Area

The First National Bank of Bemidji does an excellent job of lending within its designated AA. A substantial majority of the bank's loans were originated in the AA. The following table illustrates the results of our random sample.

Penetration of Lending Inside the AA - Loans originated from May 1, 196 to May 31, 1999	
Total number of Loans Sampled	60
Number of Sampled Loans in AA	55
Percentage In AA	92%
Total Dollar of Total Loans Sampled	\$1,494,000
Dollar of Sampled Loans In AA	\$1,370,000
Percentage In AA	92%

The above data is consistent with bank-generated data showing similar percentages of loans in the AA based on zip code analysis of all outstanding loans.

Lending to Borrowers of Different Incomes and to Businesses of Different Sizes in the Assessment Area

FNBB does an excellent job of lending to borrowers of different income levels, and businesses of different sizes. In particular, the bank has a good record of lending to low-income persons. As described later, the bank participates in a large number of programs designed to assist low- and moderate-income borrowers.

The following tables demonstrate the bank's success in exceeding the demographics of the lending area and meeting credit needs for all sectors of the community. These results were from the sample of loans selected as previously discussed.

Consumer Loans

The following table illustrates the level of consumer instalment lending activities.

Income Level	% Families in the AA (1990 Census Data)	% Number of Loans Sampled	% Dollar Volume Loans Sampled
Low-Income < 50% Median Family income*	27%	55%	54%
Moderate-Income at least 50% < 80% Median Family Income*	19%	10%	6%
Subtotal Low- and Moderate-Income	46%	65%	60%
Middle-Income at least 80% < 120% Median Family Income*	23%	20%	23%
Upper-Income 120% and > Median Family Income*	31%	15%	17%

* 1998 Outstate Median Family Income \$40,500

These numbers are especially impressive given the demographics of the AA show 24% of the low-income households are below the poverty level, allowing for fewer qualified borrowers. Furthermore, FNBB has done an exceptional job of making other credit products and services available to help meet the credit needs of all borrowers. We describe these products and services later in this evaluation.

Residential Real Estate Loans

The following table illustrates the bank's residential real estate lending activities.

Income Level	% Families in the AA (1990 Census Data)	% Number of Loans Sampled	% Dollar Volume Loans Sampled
Low-Income < 50% Median Family income*	27%	20%	12%
Moderate-Income at least 50% < 80% Median Family Income*	19%	15%	9%
Middle-Income at least 80% < 120% Median Family Income*	23%	25%	19%
Upper-Income 120% and > Median Family Income*	31%	40%	60%

* 1998 Outstate Median Family Income \$40,500

The bank has done a good job of meeting the housing needs of the community. Furthermore, the bank has done an excellent job of reaching the low- and moderate-income market in all BNAs and through products that specifically target those families. Some of those products are described below.

The above numbers show good penetration among all income levels. Because the bank cannot make real estate loans in the low-income BNA tract, we expect the penetration to be lower than the demographics for the low-income level. We note that 69% of the families in the low-income BNA tract are low- or moderate-income. Also, a large amount (21%) of the housing in the AA is rental units. Therefore, we expect a lower level of penetration in real estate lending for low- and moderate-income families who are more typically renters.

A small portion of the low-income BNA, not owned by the RLIR, has been grandfathered in to allow real estate mortgages. On these parcels, the bank has extended credit for two residential real estate loans and five small businesses.

FNBB Participation in Real Estate Programs for Low- and Moderate-Income Persons

As the community contacts indicated, FNBB is a leader in several loan programs intended to assist low- and moderate-income applicants:

-Minnesota Mortgage Program - Administered through the Minnesota Housing Finance Agency (MHFA).

This program includes several separate home loan programs. FNBB has been the lead bank in Bemidji for this program for the past 18 years. In a July 1999 MHFA memo, an agency representative states that FNBB has been the leader in Beltrami County in originations of all MHFA loans. The bank had 64% of all MHFA originations for the area. During the past three years FNBB has originated 59 mortgages totaling about \$3 million. The programs vary but most carry low-interest rates and are targeted to the lowest income tier possible. The current rate for a MHFA first-time home buyer loan is 5.89% fixed for 30 years. The bank's real estate manager has served on the MHFA's Lender Advisory Committee for the past three years.

-Rural Development Program

Applicants finance greater than 100% of the value of the home they are purchasing including closing costs. The maximum income level is \$30M and qualified applicants are required to attend three 3-hour training sessions on home mortgages. Because these sessions are only available through HUD twice a year, FNBB developed and coordinates area training sessions for those purchases in the interim. This training was HUD approved and has allowed for additional applicants to get into a home. Over the past three years, FNBB has originated 24 loans under this program.

-Minnesota Cities Participation Program (MCPP)

These funds are set aside annually by MHFA specifically for the Bemidji area to be used by the Bemidji area banks. This program is designed for first-time home buyers with a maximum income of \$30M. This program offers a lower interest rate for qualified applicants. The bank originated 20 loans under this program during the evaluation period.

-VA and FHA Programs

These programs provide low to zero down payment long term loans at market or lower interest rates. During 1998, the bank granted and sold 26 loans (\$2.1 million) under these programs.

-Community Assistance Set Aside Program (CASA)

This is a cooperative first-time home buyers program. The parties involved are the Headwaters Regional Development Commission (HRDC), vocational and high school

classes, and the local banks. The HRDC finances the interim construction, students provide volunteer labor, and banks pre-qualify applicants. The homes are sold to applicants for \$10M under the market value. The maximum income for applicants is \$30M. Over the past 3 years, FNBB has originated 4 loans under this program, or about one-half of all loans under this cooperative project.

Commercial Loans

The next table illustrates loans to various businesses within the bank’s AA.

Annual Gross Sales (000's)	% Number of Loans Sampled	% Dollar Volume Sampled
\$100 or less	35%	37%
\$101 - \$250	10%	12%
\$251 - \$500	20%	10%
\$501 - \$1,000	25%	30%
> \$1,000	10%	11%

The bank has done an outstanding job of lending to small businesses and has lent a vast majority of the dollars and loan number to businesses with gross revenues less than \$1,000,000. This sample indicates approximately 90% of total number and dollar volume are to small businesses and 10% to larger businesses.

Specific Community Development Loans Targeted to Assist Low- and Moderate-Income Individuals or Businesses

The bank regularly extends no-fee Letters of Credit and a revolving line of credit to a company located in the low-income BNA. These facilities, totaling over \$1 million, enable this company to construct homes and roads on the Red Lake Indian Reservation. The bank has provided these loans for over 20 years.

The bank currently has a \$49M loan that is participated with the Indian Economic Development Fund and State Indian Business Loan Fund. This is a business located in a moderate BNA, with funds used to revitalize a small business.

Geographic Distribution of Loans

The geographic distribution of loans represents a good dispersion throughout the assessment area. The table below is based on the distribution of real estate, consumer, and commercial loans in the loan sample previously described.

Geographic Distribution of Loans by BNA Type				
BNA Type	% of BNA's in AA	% of Population in AA	% Total Number	% Total Dollars
Low	10%	10%	7%	3%
Moderate	30%	18%	15%	10%
Middle	60%	72%	78%	87%

The low-income tract is located on a closed Indian reservation which prevents the bank from making real estate loans in that tract. Using just consumer and commercial loans, the penetration in the low-income BNA would be 11% of the total number and 7% of the total dollars. Those ratios indicate that FNBB lends in a reasonable proportion to the demographics of the AA. We also note that 49% of the families in the low-income BNA are below the poverty level, limiting the amounts that a typical family qualify for.

The moderate-income BNAs are sparsely populated and include large bodies of water. The moderate-income BNAs also are served by other financial institutions located closer to the population base of the BNAs.

Loan-to-Deposit Ratio

The bank's loan-to-deposit (LTD) ratio is acceptable. The quarterly LTD ratio has averaged 67% since the last CRA examination. The bank ranks third out of five in comparing average LTD ratios of all financial institutions located in the AA. The ratios of these five institutions range from a high of 82% and low of 26%.

FNBB's LTD would be higher if the bank retained residential mortgages in-house. FNBB has been active in secondary market residential real estate loans since the last examination. The bank originates a large volume of these loans and sells them to the secondary market. During 1998, a total of \$22,771,000 in loans were sold. That amount represents about 15% of outstanding loans as of March 1999.

The LTD is also skewed by the bank's funding practices. FNBB has been active in the

bidding of public funds. Although the bank does not need the deposits, its strategy is to provide a service to public entities by offering interest rates that are typically higher than other local competitors. In December 1998, the bank accepted an \$8.8 million deposit from a governmental entity. This caused the LTD ratio to drop from 68% in September 1998 to 62.5% in December 1998.

Record of Response to Complaints

The bank has not received any CRA complaints since the prior CRA examination.

Record of Compliance with Anti-discriminatory laws

Based on our review, the bank is complying with anti-discriminatory laws. We found no substantive violations of the fair lending laws.

Qualified Investments, Services, and Delivery Systems

Community Development Investments

- C Bemidji Tax Increment Refunding Bond (\$150,000):
This bond was purchased by the bank 5-1-98. The purpose of the investment was to provide funding for the City of Bemidji to revitalize a blighted downtown area into a shopping community consisting of small businesses. The area had previously contained a junk yard and other dilapidated properties. This was completed in conjunction with federal grant monies.

Community Services

The culture and focus of FNBB's service activities are centered on attending to the needs of the local communities. The following services are representative of these activities.

- C Consumer Education:
In 1998, The First National Bank of Bemidji was one of six banks nation-wide to receive an *Award for Outstanding Contributions to Consumer Education* from the American Bankers Association. Examples of the bank's efforts to improve consumers knowledge about credit and community service endeavors are more fully described below.
- C Bemidji High School (District #31) Student Bank:
Since the last CRA examination, FNBB established a high school bank in the Bemidji school district. The bank has a special charter and is not technically an

affiliate of FNBB. However, FNBB trains the student workers and acts as an ongoing consultant for the bank. Students learn about various banking functions, including responsible use of credit. FNBB has received local and national accolades for this project. The student bank provides small, short-term loans for students, many of whom are low-income.

C Financial Services to the low-income BNA:

FNBB provides ongoing support and financial services to the one low-income BNA in the AA, ranging from low fee and low rate loan programs to financial and deposit services. This is demonstrated in a March 1999 letter to FNBB from a leader in the low-income BNA, who stated, “ *The financial programs and business services we have received have certainly been a financial management tool that we have used to enhance our business management efforts. You and your staff have always responded to our needs in a commendable fashion.* ”

C Home Mortgage Consumer Training:

The bank developed and coordinates an area training program to educate first-time home buyers. This training is HUD approved and is targeted to low- and moderate-income persons with incomes less than \$30M.

C First National Bank Foundation (Foundation):

This charitable foundation was established in 1993 to assist with the needs of the community, with emphasis placed on education needs. The Foundation’s only source of contributions is from FNBB. Board members of the foundation are bank employees. Contributions made by the Foundation to organizations that specifically aid the low- and moderate-income people totaled \$2,500 in 1996, \$6,000 in 1997, \$9,500 in 1998, and \$7,000 for year-to-date 1999. Examples include donations to Habitat for Humanity, scholarships for students from low-income families, and for youth programs in the low-income BNA. These funds represent a large portion of the Foundation’s annual income.

Delivery Systems:

C Bank Branches and ATMs:

The bank has three locations. The main office and express bank are located in the downtown Bemidji area and the north branch is located on the north side of Bemidji. The bank has recently applied to establish another branch in South

Bemidji, which will provide convenient banking services in an area where no other banking office is presently located.

The bank also has four ATMs. Two are located at the bank facilities, one is located at a Bemidji convenience store, and one is located in the local hospital.