

# **PUBLIC DISCLOSURE**

**June 3, 2002**

## **COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION**

**Argyle State Bank  
Certificate Number: 15392**

**103 West 3<sup>rd</sup> Street  
P.O. Box 275  
Argyle, Minnesota 56713-0275**

**Federal Deposit Insurance Corporation**

**2345 Grand Boulevard, Suite 1500  
Kansas City, Missouri 64108**

**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.**

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## 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 Argyle State Bank (ASB) prepared by the Federal Deposit Insurance Corporation, the institution's supervisory agency, as of June 3, 2002. The agency rates the CRA performance of an institution consistent with the provisions set forth in Appendix A to 12 CFR Part 345.*

## INSTITUTION RATING

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

An institution in this group has a satisfactory record of helping to meet the credit needs of its assessment area, including low- and moderate-income neighborhoods, in a manner consistent with its resources and capabilities. Support for this rating is summarized below.

- ASB's average net loan-to-deposit ratio of 68.7 percent demonstrates a reasonable willingness to lend given the bank's size and financial condition, external economic factors, and comparisons with similarly situated lenders.
- Using statistically valid sampling procedures, it was determined that the bank has originated a majority of its agricultural and commercial loans to entities located within the bank's designated assessment area. This performance demonstrates a reasonable record of lending within the assessment area.
- Analysis of the aforementioned sampled loans revealed that ASB is originating loans to farm and business operators of varying revenue size. Lending performance data evidences that the bank has extended a reasonable number and dollar volume of loans to small farm and small business operators.
- Based on an analysis of the sample of agricultural and commercial loans, it was determined that the bank is reasonably lending to geographic areas of different income levels.

## DESCRIPTION OF INSTITUTION

ASB is owned by Argyle Financial Services, Inc., a one-bank holding company. ASB's sole office is located in Argyle, Minnesota, and the bank also operates a cash-dispensing automated teller machine in Argyle. The bank's December 31, 2001, Report of Condition reflects total assets of \$17,606,000, total loans of \$8,458,000, and total deposits of \$16,184,000.

The bank offers standard loan products that appear to be well suited to the banking needs of the local area. In addition, they participate in government guaranteed loan programs sponsored by the Farm Service Agency (FSA) and the Small Business Administration (SBA). ASB also offers an agricultural loan program sponsored by Minnesota Rural Finance Authority (MRFA), and participates in the Argyle Rural Development Loan Pool, which is a commercial loan program funded by the bank, the city of Argyle, and a corporate sponsor. Furthermore, ASB refers certain commercial entities to the Northwest Minnesota Foundation, which provides loans for start-up businesses or existing business expansions that will create new jobs. Secondary market residential real estate housing products are also available through a special referral arrangement with another lender.

As shown in Table 1 on the following page, ASB's primary focus by dollar volume is agricultural and commercial credit. According to a member of the community contacted in conjunction with this evaluation, the lending emphasis of the bank is consistent with the credit needs of the communities being served.

Several years of poor crop quality and quantity have adversely affected the agricultural economy and resulted in farmers purchasing fewer products. This has had an adverse impact on the commercial economy and limited the commercial credit needs within the local area. As a result, the bank has engaged in purchasing commercial loans from other lending institutions outside of the area in an effort to diversify their loan portfolio. Without these commercial loans, the loan portfolio would be heavily concentrated in agriculture.

Aside from statutory lending limits, ASB does not appear to have any legal impediments that restrict its ability to meet the credit needs of the area.

<i>Table 1 – Loan Distribution as of December 31, 2001</i>		
<i>Loan Type</i>	<i>Dollar Amount</i>	<i>Percent of Total Loans (%)</i>
<i>Secured by Farmland</i>	\$1,059,000	12.5%
<i>Secured by First Liens: 1 -4 Family Residential</i>	\$451,000	5.3%
<i>Secured by Junior Liens: 1-4 Family Residential</i>	\$4,000	Nominal
<i>Secured by Nonfarm Nonresidential</i>	\$1,052,000	12.4%
<b><i>Total Real Estate Loans</i></b>	<b><i>\$2,566,000</i></b>	<b><i>30.3%</i></b>
<i>Loans to Depository Institutions and Acceptances of Other Banks</i>	\$313,000	3.7%
<i>Agricultural</i>	\$2,821,000	33.4%
<i>Commercial and Industrial</i>	\$2,009,000	23.8%
<i>Other Consumer Revolving Credit Plans</i>	\$4,000	Nominal
<i>Consumer (single pay, installment, student)</i>	\$674,000	8.0%
<i>Obligations of State and Political Subdivisions in the U.S.</i>	\$7,000	Nominal
<i>Other Loans</i>	\$64,000	0.8%
<b><i>Total Loans</i></b>	<b><i>\$8,458,000</i></b>	<b><i>100%</i></b>

*Source: Report of Condition*

## DESCRIPTION OF ARGYLE STATE BANK'S ASSESSMENT AREA

*The Community Reinvestment Act (CRA) of 1977 (12 U.S.C. 2901) as amended requires banks to identify one or more "assessment areas" within which its regulatory agency will evaluate the bank's performance. In most cases, an institution's assessment area will be the towns, counties, or some other political sub-divisions in which its branches are located and a substantial portion of its loans are made. Assessment areas always consist of one or more whole block numbering areas (BNAs) or census tracts (CTs), which are statistical subdivisions of a county. BNAs are generally used in non-metropolitan areas, while CTs are generally used in metropolitan areas.*

ASB has designated its assessment area as BNAs 9802, 9803, and 9804 in Marshall County, which is located in northwestern Minnesota. BNAs 9803 and 9804 are middle-income geographies<sup>1</sup>, and BNA 9802 is a moderate-income geography. The assessment area consists of the western two-thirds of Marshall County and encompasses an area approximately 40 miles east to west and 25 miles north to south. The city of Argyle is located in the eastern half of the assessment area in BNA 9803.

According to the 1990 Census, the population of the assessment area is 8,262. The assessment area includes the small cities of Argyle (population 636), Newfolden (population 345), Oslo (population 362), Stephen (population 707), Warren (population 1,813), and Alvarado (population 356). The majority of the remaining population lives in rural areas. Preliminary 2000 Census data indicates that the population of Marshall County has decreased by 7.6 percent since the 1990 Census. Management attributed this decrease to the declining number of farmers and an outward migration of residents. However, management indicated that the preliminary 2000 Census reflects a 6.9 percent increase in population from the 1990 Census for the city of Argyle. Management attributed the increase in population to a city-sponsored advertising campaign designed to attract new residents.

The assessment area is rural in nature, and agriculture is the core economic activity. According to management and a member of the community contacted in conjunction with this evaluation, area crops include barley, corn, soybeans, sugar beets, sunflowers, wheat, potatoes, and edible beans. Management stated that area farms are generally well diversified among a variety of crops, and the two major crops are sugar beets and wheat. Management indicated that area crop yields and quality have been down in the past several years. In addition, Marshall County has received a Federal Disaster Declaration for the past four years due to excessive moisture. Disaster payments and crop insurance have offset some of the effects of poor crops.

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<sup>1</sup> A BNA's income level is determined by comparing the 1990 median family income (MFI) for each individual BNA with the 1990 non-metropolitan MFI for the State of Minnesota, which was \$28,933. The breakdown is as follows: low income – less than 50 percent of the MFI; moderate income – 50 to less than 80 percent of the MFI; middle income – 80 to less than 120 percent of the MFI; upper income – 120 percent or more of the MFI.

Management indicated that land productivity changes substantially approximately 10 miles east of Argyle. Land to the west of this area is very fertile, while land to the east is less fertile and productive. Management stated that a majority of the small farm operations with annual gross revenues under \$50,000 reside in the eastern half of Marshall County, which includes BNA 9802.

Management stated that the commercial economy over the last couple of years has experienced a moderate slow down. Area farmers throughout Marshall County have been putting more land into the Conservation Reserve Program in recent years. This has resulted in farmers purchasing fewer products, such as fuel. However, management indicated that the economy appears to be improving this year. According to Dun & Bradstreet data as of July 18, 2001, large employers in the assessment area include Warren Tire Service Incorporated, PKM Electric Co-operative, and Evergreen Implements Company, which are all located in Warren, as well as Farmers Union Oil Company, which is located in Oslo.

Management and a member of the community contacted in conjunction with this evaluation stated that a number of residents in the southern portion of the assessment area commute to Grand Forks, North Dakota; East Grand Forks, Minnesota; or Thief River Falls, Minnesota, for employment. Management further indicated that these residents generally obtain banking services where they work.

Unemployment information from the Bureau of Labor Statistics for the fourth quarter of 2001 lists the unemployment rate for Marshall County as 6.3 percent. The comparable figure for Minnesota is 3.6 percent.

Management indicated the housing market in Argyle and the surrounding area is adequate, with approximately 15 to 25 homes currently available for sale. Houses available for sale range in price from \$10,000 to \$175,000.

Local competition for potential loan customers is strong, as there are two individually chartered financial institutions and six branch offices of regional financial institutions located in the assessment area. Three of the branches are located in Warren, Minnesota. According to the 1990 Census, Warren is the largest city in the assessment area and accounts for 21.9 percent of the assessment area's population. Management identified the bank's primary competitor as Farm Credit Services.

## CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

*Five criteria are utilized in evaluating a small bank's effectiveness in meeting the financing needs of consumers, agricultural borrowers, and commercial entities within the assessment area. Four of the criteria relate to lending performance, and one addresses responsiveness to consumer complaints. The findings for each criterion are evaluated and result in an overall rating for Community Reinvestment Act performance. Furthermore, a bank's compliance with anti-discrimination laws and regulations is considered when evaluating a bank's performance. Comments supporting the conclusions for each criterion are detailed on the following pages.*

### I. Loan-to-Deposit Ratio

The institution's average net loan-to-deposit ratio demonstrates a reasonable willingness to lend given the bank's financial condition and size, external economic factors, and comparisons with similarly situated lenders.<sup>2</sup>

According to Report of Condition data, the institution's 17-quarter average net loan-to-deposit ratio from December 31, 1997, to December 31, 2001, is 68.7 percent. Since the prior evaluation, the bank's quarterly net loan-to-deposit ratio has fluctuated between 51.5 and 80.5 percent. Net loans have fluctuated from a high of \$10,325,000 to a low of \$8,341,000. Total assets and deposits have fluctuated in a similar manner. Management attributed these fluctuations to the variables inherent to the agricultural economy. These fluctuations are generally consistent with those of an agriculturally based financial institution.

Table 2 below displays that ASB's average net loan-to-deposit ratio from December 31, 1997, to December 31, 2001, is comparable to institutions that are similarly situated.

<i>Table 2 – Net Loan-to-Deposit Ratios for the Subject Bank and Similarly Situated Institutions</i>		
<i>Bank City, State</i>	<i>Total Assets (12/31/01)</i>	<i>Average Net Loan-to-Deposit Ratio (12/31/97 – 12/31/01)</i>
<i>Argyle State Bank Argyle, Minnesota</i>	<i>\$17,606,000</i>	<i>68.7%</i>
American State Bank of Grygla Grygla, Minnesota	\$14,874,000	68.8%
Marshall County State Bank Newfolden, Minnesota	\$21,387,000	74.0%

*Institutions are listed alphabetically by city*

<sup>2</sup> Similarly situated lenders were chosen based on similarities in the market served, loan portfolio composition, product offering, asset size, and/or number of offices.

## **II. Lending Inside the Assessment Area**

Based on an evaluation of statistically valid samples of agricultural and commercial loans, it was determined that the bank has originated a majority of sampled loans to farms and businesses operating within the bank's designated assessment area. This performance demonstrates a reasonable record of lending within the assessment area.

To determine the bank's record of lending within the assessment area, statistically valid samples of agricultural and commercial loans were selected for analysis. These products were chosen because they comprise the largest percentages of the bank's loan portfolio by dollar volume. A sample of 27 agricultural loans was taken from a universe of 66 agricultural loans that were originated between January 1, 2001, and May 14, 2002, and are still outstanding.

A sample of 14 commercial loans was taken from a universe of 35 commercial loans that were originated in the same timeframe and are still outstanding. This timeframe was chosen in order to encompass a normal business cycle, recent trends, and a statistically valid sample size.

The sample data provided in Table 3 on the following page evidences a reasonable commitment to lending within the assessment area, with 92.7 percent by number and 84.7 percent by dollar volume of the combined agricultural and commercial loans being granted to entities operating within the assessment area. The one sampled agricultural loan originated outside of the assessment area was originated to a farm operator in a bordering county.

The two sampled commercial loans originated outside of the assessment area were loans purchased from other financial institutions. These loans comprise 51.5 percent by dollar volume of sampled commercial loans. The institution's location in a small community provides a limited lending base, particularly for commercial lending. As previously mentioned, the institution is putting forth an effort to assist businesses in their assessment area by being involved with the Argyle Rural Development Loan Pool, offering SBA loans, and providing referrals to the Northwest Minnesota Foundation. However, with limited business credit needs in the area, the bank has engaged in purchasing commercial loans from outside of their assessment area in order to diversify their loan portfolio. Based on the above factors, the dollar volume of commercial lending within the assessment area appears reasonable.

<i>Table 3 – Distribution of Loans Inside and Outside of the Assessment Area</i>										
<i>Loan Category or Type</i>	<i>Number of Loans</i>					<i>Dollars in Loans</i>				
	<i>Inside</i>		<i>Outside</i>		<i>Total</i>	<i>Inside</i>		<i>Outside</i>		<i>Total</i>
	<i>#</i>	<i>%</i>	<i>#</i>	<i>%</i>		<i>\$</i>	<i>%</i>	<i>\$</i>	<i>%</i>	
<i>Agricultural</i>	26	96.3%	1	3.7%	27	\$1,643,700	99.5%	\$7,500	0.5%	\$1,651,200
<i>Commercial</i>	12	85.7%	2	14.3%	14	\$328,944	48.5%	\$349,480	51.5%	\$678,424
<b><i>Total</i></b>	<b>38</b>	<b>92.7%</b>	<b>3</b>	<b>7.3%</b>	<b>41</b>	<b>\$1,972,644</b>	<b>84.7%</b>	<b>\$356,980</b>	<b>15.3%</b>	<b>\$2,329,624</b>

### **III. Lending to Farms and Businesses of Different Sizes**

Loans in the aforementioned analysis that were originated to farm and business operations within the assessment area were further analyzed to determine ASB's record of lending to farm and business operations of varied size. Gross annual revenues were used as a determinant of size. Revenue data was obtained from loan files or from discussions with bank management.

The analysis reveals that ASB is originating loans to farm and business operators of different revenue sizes, with a reasonable number and dollar volume of loans originated to small farm and small business operators. In addition, as mentioned previously, the bank offers guaranteed loan programs sponsored by FSA and SBA, as well as an agricultural loan program sponsored by MRFA. Specifically, the bank has originated four FSA loans since the prior evaluation, totaling approximately \$395,000. In addition, the bank has originated two MRFA loans since the prior evaluation, totaling approximately \$233,000. The institution's involvement in these programs reflects their effort to meet the credit needs of smaller farm and business operators.

#### Agricultural Loans

The analysis of agricultural loans, detailed in Table 4 on the following page, indicates that the bank is making a reasonable effort to lend to farm operations of different revenue sizes, with an adequate number and dollar volume of loans originated to smaller farm operations.

The findings reveal that 11.5 percent by number and 5.0 percent by dollar volume of the sampled agricultural loans originated in the assessment area were extended to farm operators with gross annual revenues below \$50,000. The 1997 Census of Agriculture indicates that 53.2 percent of the farm operators in Marshall County had gross annual revenues below \$50,000. However, as stated previously, management indicated that a majority of farm operations with annual gross revenues below \$50,000 reside in the eastern half of Marshall County where the agricultural land

is less productive. Only a portion of this area is included in the bank's assessment area. The 1997 Census of Agriculture reports that 40.0 percent of farm operators in Marshall County did not list farming as their primary occupation. In addition, management specifically stated that a significant volume of tillable farmland in BNA 9802 is in the Conservation Reserve Program. This would reduce the need to borrow for operating expenses since no crops are raised when the land is enrolled in this program. These factors would appear to limit the number of farm operators with gross annual revenues under \$50,000 that would apply for credit.

The evaluation findings also revealed that 19.2 percent by number and 9.9 percent by dollar volume of the sampled agricultural loans that were originated within the bank's assessment area were extended to farm operators with gross annual revenues between \$50,000 and \$100,000. These findings reasonably compare to the 1997 Census of Agriculture, which indicates that 15.2 percent of the farm operators in the assessment area had gross annual revenues between \$50,000 and \$100,000.

<b>Table 4 – Distribution of Agricultural Loans by Gross Annual Revenues of the Farm</b>					
<b>Gross Annual Revenues</b>	<b>Percentage of Farms* (% of #)</b>	<b>Number</b>		<b>Dollar</b>	
		<b>#</b>	<b>%</b>	<b>\$</b>	<b>%</b>
<b>&lt; \$50,000</b>	53.2%	3	11.5%	\$82,500	5.0%
<b>\$50,000 - &lt; \$100,000</b>	15.2%	5	19.2%	\$163,200	9.9%
<b>\$100,000 - &lt; \$250,000</b>	19.1%	8	30.8%	\$749,000	45.6%
<b>\$250,000 - &lt; \$500,000</b>	8.4%	10	38.5%	\$649,000	39.5%
<b>≥ \$500,000</b>	4.1%	0	0%	0	0%
<b>Total</b>	<b>100</b>	<b>26</b>	<b>100%</b>	<b>\$1,643,700</b>	<b>100%</b>

\*Source: 1997 Census of Agriculture

### Commercial Loans

The analysis of commercial loans, detailed in Table 5 on the following page, reveals that the bank is making a reasonable effort to lend to business operations of different revenues, including small business operators. The findings revealed that 33.3 percent by number and 7.2 percent by dollar volume of the sampled commercial loans that were originated within the bank's assessment area were extended to business operators with gross annual revenues under \$50,000. These findings compare favorably to 1999 Dun & Bradstreet data, which indicates that 21.2 percent of the business operators in the assessment area had gross annual revenues under \$50,000.

The percentage of loans by dollar volume originated to businesses with gross annual revenues below \$50,000 is adequate, as business operations of this size typically do not need, request, or qualify for loans at the same dollar volume as businesses with larger gross annual revenues. The evaluation findings also revealed that 41.7 percent by number and 41.1 percent by dollar volume of the sampled commercial loans that were originated within the bank’s assessment area were extended to business operators with gross annual revenues between \$50,000 and \$100,000. These findings reasonably compare to the 1999 Dun & Bradstreet data, which indicates that 29.5 percent of the business operators in the assessment area had gross annual revenues between \$50,000 and \$100,000.

<b>Table 5 – Distribution of Commercial Loans by Gross Annual Revenues of the Business</b>					
<b>Gross Annual Revenues</b>	<b>Percentage of Businesses* (% of #)</b>	<b>Number</b>		<b>Dollar</b>	
		<b>#</b>	<b>%</b>	<b>\$</b>	<b>%</b>
<b>&lt; \$50,000</b>	21.2%	4	33.3%	\$23,831	7.2%
<b>\$50,000 - &lt; \$100,000</b>	29.5%	5	41.7%	\$135,113	41.1%
<b>\$100,000 - &lt; \$250,000</b>	28.4%	2	16.7%	\$70,000	21.3%
<b>≥ \$250,000</b>	20.9%	1	8.3%	\$100,000	30.4%
<b>Total</b>	<b>100%</b>	<b>12</b>	<b>100%</b>	<b>\$328,944</b>	<b>100%</b>

\*Source: June 1999 Dun & Bradstreet data

#### **IV. Geographic Distribution of Loans**

The sampled agricultural and commercial loans that were originated to borrowers within the assessment area were further analyzed to determine whether the institution’s lending activity is reasonably dispersed throughout the assessment area, including the moderate-income geography. As evidenced by the following analysis, ASB’s geographic distribution of loans throughout the assessment area, including the moderate-income geography, is adequate when considering demographic information, the location of the bank’s office, competition with other lenders, and the topography of the area.

##### Agricultural Loans

As detailed in Table 6 on the following page, a majority of the sampled agricultural loans have been originated in middle-income geographies. This is reasonable given that the bank’s office is located in one of the two middle-income geographies. As stated previously, management also indicated that land east of Argyle, which primarily consists of moderate-income BNA 9802, is less fertile than land in the rest of the assessment area, and a significant volume of tillable

farmland in this BNA is in the Conservation Reserve Program. These factors would appear to minimize the agricultural lending opportunities in the moderate-income geography. There are no low- or upper-income BNAs within the assessment area.

<b>Table 6 – Distribution of Agricultural Loans by Income Category of the Geography</b>				
<b>Geography Income Level</b>	<b>Number</b>		<b>Dollar</b>	
	<b>#</b>	<b>%</b>	<b>\$</b>	<b>%</b>
<b>Low</b>	NA	NA	NA	NA
<b>Moderate</b>	8	30.8%	\$444,000	27.0%
<b>Middle</b>	18	69.2%	\$1,199,700	73.0%
<b>Upper</b>	NA	NA	NA	NA
<b>Total</b>	<b>26</b>	<b>100%</b>	<b>\$1,643,700</b>	<b>100%</b>

#### Commercial Loans

As detailed in Table 7 below, all of the sampled commercial loans originated in the assessment area have been originated in middle-income geographies. This appears acceptable given that the bank’s office is located in one of the two middle-income geographies. In addition, the moderate-income geography is sparsely populated with no cities of significant size, and business activity is limited. Management indicated that banks in nearby Thief River Falls, Minnesota, also compete for commercial loans in the moderate-income BNA 9802.

<b>Table 7 – Distribution of Commercial Loans by Income Category of the Geography</b>					
<b>Geography Income Level</b>	<b>Percentage of Businesses* (% of #)</b>	<b>Number</b>		<b>Dollar</b>	
		<b>#</b>	<b>%</b>	<b>%</b>	<b>%</b>
<b>Low</b>	NA	NA	NA	NA	NA
<b>Moderate</b>	24.5%	0	0%	\$0	0%
<b>Middle</b>	75.5%	12	100%	\$328,944	100%
<b>Upper</b>	NA	NA	NA	NA	NA
<b>Total</b>	<b>100%</b>	<b>12</b>	<b>100%</b>	<b>\$328,944</b>	<b>100%</b>

\*Source: June 1999 Dun & Bradstreet data

V. **Response to Complaints**

The bank has not received any CRA-related complaints since the previous evaluation.

**Compliance with Anti-Discrimination Laws and Regulations**

Examiners did not identify any substantive violations of anti-discrimination laws and regulations during the evaluation.