

# **PUBLIC DISCLOSURE**

**September 3, 2004**

## **COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION**

**Pine City State Bank  
Certificate Number 9744**

**600 Hillside Avenue Southwest  
Pine City, Minnesota 55063**

**Federal Deposit Insurance Corporation  
2345 Grand Boulevard, Suite 1200  
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.

**TABLE OF CONTENTS**

I. General Information.....1

II. Institution Rating .....1

III. Description of Institution.....2

IV. Description of Assessment Area .....3

V. Conclusions .....5

## 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 **Pine City State Bank, Pine City, Minnesota**, prepared by the **Federal Deposit Insurance Corporation**, the institution's supervisory agency, as of **September 3, 2004**. 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.

Pine City State Bank demonstrates a satisfactory record of helping to meet the credit needs of its assessment area<sup>1</sup>, in a manner consistent with its resources and capabilities. The bank's rating is primarily based on its lending performance. Specifically, the analysis of lending performance concentrated on residential and commercial-related loans, which represent the primary business focus and most significant product lines of the institution. The evaluation revealed the following:

- ❑ Pine City State Bank originates a majority of its loans within its assessment area both by number and dollar volume.
- ❑ The bank's residential lending among borrowers of different incomes is reasonable in relation to assessment area demographics, and is especially good to moderate-income persons.
- ❑ The bank's commercial lending is reasonably distributed among businesses of different sizes and demonstrates responsiveness to smaller businesses.
- ❑ The bank demonstrates a strong willingness to extend credit as shown by its net loan-to-deposit ratio, which is currently 111 percent (as of June 30, 2004) and averaged 96 percent since the previous evaluation.
- ❑ The bank has not received any written complaints concerning its CRA performance.

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<sup>1</sup> An *Assessment Area* is delineated by the financial institution and includes the geographies in which the bank has its main office, its branches, and other deposit-taking remote service facilities, as well as the surrounding geographies in which the bank has originated or purchased a substantial portion of its loans. The assessment area always consists of one or more whole census tracts, which are statistical subdivisions of counties.

## DESCRIPTION OF INSTITUTION

Pine City State Bank is a commercial bank that was established in 1915 and received deposit insurance in 1934. The institution is owned by Pine City Bancorporation, Inc., Pine City, Minnesota, a one-bank holding company. The bank operates one full-service facility in Pine City, Minnesota. The prior CRA evaluation of the bank was performed by the FDIC as of August 2, 1999, and resulted in a "Satisfactory" rating.

The bank offers a wide array of deposit products to meet consumer and business banking needs including checking, savings, and certificate of deposit accounts. In addition to traditional banking services, customers have access to telephone banking, automated teller machines, and Internet banking 24-hours a day.

The institution offers a variety of loan products for commercial, residential real estate, agricultural, and consumer purposes. Commercial loans offered include working capital lines of credit, commercial real estate loans, and term loans. Residential real estate loans include mortgages for purchase, refinance, construction, or improvement of one-to-four family homes. Long-term mortgages are offered through a referral relationship with secondary market investors. Home equity lines of credit and other miscellaneous mortgage loans are also offered. Agricultural loans include operating lines and other miscellaneous farming-related loans. Loans for consumer purposes include automobile, recreational vehicle, and other personal loans, and overdraft protection lines of credit.

The June 30, 2004, Report of Condition listed total assets of \$62,667,000, gross loans of \$55,045,000, and total deposits of \$49,091,000. The bank has grown significantly since the previous evaluation with total assets increasing approximately 69 percent, from \$37,012,000 as of June 30, 1999. The bank's primary business focus is residential real estate and commercial-related lending, which together comprise approximately 59 percent of the institution's gross loans.

There are no legal impediments apparent which would limit the bank's ability to meet the credit needs of its assessment area.

## DESCRIPTION OF PINE CITY STATE BANK'S ASSESSMENT AREA

Pine City State Bank's assessment area is comprised of five census tracts located in the southern portion of Pine County. The assessment area is rural in nature and is not part of a Metropolitan Statistical Area (MSA). The assessment area's census tracts are all middle-income<sup>2</sup> areas according to year 2000 United States Census Bureau data. The assessment area does not arbitrarily exclude any low- or moderate-income areas.

The bank operates in a competitive banking environment. Competing institutions are varied and include local community banks, regional banks, and multi-billion dollar national banking chains. Specifically, there were 7 different institutions with 11 total banking offices in Pine County as of June 2003. Furthermore, in adjacent counties where other direct competing institutions are located, including Kanabec, Chisago, and Isanti Counties, there were 17 institutions with 27 banking offices as of June 2003. These figures do not include several credit union offices that are also located in the counties and provide notable competition. Measuring by deposit market share, there are not any dominant institutions in the four counties. The leading institution holds approximately 9 percent of deposits<sup>3</sup> in the four counties. By comparison, Pine City State Bank ranks twelfth in deposit market share and holds almost 4.5 percent of deposits in the counties.

In conjunction with Community Reinvestment Act evaluations, regulatory agencies may interview members of a bank's community to gather perceptions on credit needs and the performance of local banks in meeting these needs. Examiners also review pertinent local information available from previous interviews conducted by the FDIC or other regulatory agencies. In addition to identifying credit needs, community members provide general economic and demographic information, as well as any other information impacting the banking environment in the area. Based on information from community member interviews, overall demand for credit in the assessment area appears strong. Furthermore, there is a notable amount of vacation property financing occurring in the assessment area and surrounding area. Additional information from community interviews is provided where appropriate throughout this evaluation.

The assessment area has experienced significant growth over the last decade as indicated by the population increase between 1990 and 2000. Specifically, the population of the assessment area increased 25 percent, from 15,250 to 19,032. The assessment area grew at approximately twice the rate than was typical for the State of Minnesota as a whole, which saw a slightly greater than 12 percent population growth between 1990 and 2000. Of the 4,832 families in the assessment

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<sup>2</sup> Census tracts are grouped into four income categories based on the median family income for the larger area where the geography is located. Geographies located within an MSA are categorized based on the MSA median family income, whereas geographies not located within an MSA are categorized based on the non-metropolitan area median family income for the entire state. Low-income geographies have an income of less than 50 percent of the area median family income. Moderate-income geographies have incomes of 50 to less than 80 percent of the area median family income. Middle-income geographies have incomes of 80 to less than 120 percent of the area median family income. Upper-income geographies have incomes of 120 percent or more of the area median family income. The estimated 2004 median family income for the State of Minnesota was \$53,000.

<sup>3</sup> Deposit market share information is from the FDIC/OTS Summary of Deposits. This information is compiled annually, as of June 30 each year. The information can be accessed through the Internet by going to <http://www2.fdic.gov/sod/index.asp>

area, 19 percent are low income, 19 percent are moderate income, 25 percent are middle income, and 37 percent are upper income. Table 1 below provides a specific breakdown of the median family income levels applicable to lending analysis in this evaluation.

<b>Table 1 – Median Family Income (MFI) Ranges</b>		
<b>Income Category</b>	<b>2003 Statewide Minnesota Non-Metropolitan MFI (\$51,700)</b>	<b>2004 Statewide Minnesota Non-Metropolitan MFI (\$53,000)</b>
Low (< 50%)	< \$25,850	< \$26,500
Moderate (50 - < 80%)	\$25,850 - < \$41,360	\$26,500 - < \$42,400
Middle (80 - < 120%)	\$41,360 - < \$62,040	\$42,400 - < \$63,600
Upper (≥ 120%)	≥ \$62,040	≥ \$63,600

*Source: Department of Housing and Urban Development*

The percentage of families living below the poverty level in the assessment area decreased from 11 percent to 7.7 percent, between 1990 and 2000. However, the percent of families below the poverty level in the assessment area remains higher than the statewide level of 5.1 percent. The poverty level threshold is updated annually by the Census Bureau and varies based on the size of the family unit. For example, a family of four earning less than \$18,810 in 2003 was considered to be below the poverty level. The poverty level threshold is a national figure and is not adjusted by state or region.

The assessment area contains diverse industries, but there is a concentration in education and manufacturing among the largest employers in Pine County. According to the Minnesota Department of Employment and Economic Development, some of the largest employers in Pine County include School District 578 (205 employees), Imation (200 employees), Pine Technical College (150 employees), Lakeside Medical Center, Inc. (135 employees), Pine County Government (135 employees), Product Fabrication (115 employees), and Atscott Manufacturing (100 employees).

Unemployment rates in the assessment area on average are generally slightly above statewide and national rates according to information from the Bureau of Labor Statistics. As of August 2004, the unemployment rate for Pine County was 5.9, compared to 4.3 percent for the State of Minnesota and 5.4 percent nationally. Pine County typically experiences dramatic increases in the unemployment rates for December through April each year due to the seasonal nature of some industries in the area. For example, the unemployment rates for January through March of 2004 were 11.5, 11.7, and 11.5 percent, respectively.

## CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

The evaluation focused on sampling loans to determine the institution's performance in meeting the credit needs of the assessment area. Specifically, loan samples were used to determine the amount of lending within the assessment area, the distribution of lending among borrowers of different incomes and businesses of different sizes, and the distribution of lending among different income geographies. The sampling concentrated on the bank's primary business focus of residential and commercial/commercial real estate lending. The examiner did not sample agricultural loans because these did not represent a primary business line of the institution. As part of the lending analysis, the bank's net loan-to-deposit ratio was also evaluated to determine the institution's willingness to extend credit.

The residential and commercial sampling considered all applicable loans originated or purchased by the bank in 2003 and 2004. Specifically, the residential sample consisted of 46 loans totaling \$3,853,720, which came from a potential universe of 110 loans totaling approximately \$5,478,376. The commercial sample consisted of 50 loans totaling \$2,719,413, which came from a potential universe of 109 loans totaling approximately \$8,550,151. The dollar figures for the commercial sample include the maximum credit amount available for lines of credit and the total loan amount for participations sold.

### *Lending Within the Assessment Areas*

The bank's level of lending within the assessment area is reasonable considering the size of the area, lending opportunities, and competition from other financial institutions. The sampling of residential and commercial loans revealed that the bank originates a majority of its loans, both by number and dollar volume, within the assessment area. However, the commercial dollar amount of lending was slightly more concentrated outside of the assessment area. The specific findings are provided in Table 2 below.

Table 2 – Distribution of Loans Inside and Outside of the Assessment Areas										
Loan Sample	Number of Loans					Dollars in Loans				
	Inside		Outside		Total	Inside		Outside		Total
	#	%	#	%		\$	%	\$	%	
<b>Residential</b>	32	70%	14	30%	46	\$2,589,582	67%	\$1,264,138	33%	\$3,853,720
<b>Commercial</b>	27	54%	23	46%	50	\$1,267,644	47%	\$1,451,769	53%	\$2,719,413
<b>Total</b>	59	61%	37	39%	96	\$3,857,226	59%	\$2,715,907	41%	\$6,573,133

*Source – Bank Records*

Overall, the bank's performance demonstrates that it is helping to meet the credit needs of the assessment area.

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

The bank's distribution of lending among borrowers of different incomes and businesses of different sizes is reasonable. Specifically, the bank's residential lending is limited in the amount to low-income borrowers, but good to moderate-income borrowers in comparison to assessment area demographics. The bank's commercial lending is concentrated in smaller businesses and reasonably consistent with assessment area demographics.

#### ***Residential Loans***

Table 3 shows the distribution of lending among borrowers of different incomes within the assessment area for the residential analysis.

<b>Table 3 – Distribution of Residential Loans by Borrower Income</b>					
<b>Borrower(s) Income Level</b>	<b>Number of Loans</b>		<b>Dollar Volume of Loans</b>		<b>Percent of Assessment Area Families</b>
	<b>#</b>	<b>%</b>	<b>\$</b>	<b>%</b>	
Low	2	6%	\$133,449	5%	19%
Moderate	10	31%	\$653,594	25%	19%
Middle	7	22%	\$529,887	21%	25%
Upper	13	41%	\$1,272,652	49%	37%
Totals	32	100%	\$2,589,582	100%	100%

*Source – Bank Records and U.S. Census Data (2000)*

The bank's level of residential lending to borrowers of all incomes is reasonable, but especially good to moderate-income persons. The bank's level of lending to moderate-income borrowers exceeds the percentage of families within the assessment area that are considered moderate income according to census demographics. The bank's lending to low-income persons, although lower than comparable demographics, is reasonable considering that generally fewer low-income families own homes and require residential loans than moderate-, middle-, and upper-income families. Furthermore, almost eight percent of assessment area families have incomes below the poverty level and are less likely to qualify for housing loans. The bank's performance in relation to these facts demonstrates an adequate responsiveness to low- and moderate-income borrowers.

The bank's lending to middle- and upper-income borrowers is reasonable in relation to assessment area demographics. These borrowers have sufficient access to credit and are adequately represented in the institution's residential loan originations. Overall, the bank addresses the needs of residential borrowers of all incomes.

## Commercial Loans

Table 4 provides the breakdown of the bank's commercial lending within the assessment area by the gross annual revenues of the business.

<b>Table 4 – Distribution of Business Loans by Gross Annual Revenues of Business</b>					
<b>Gross Annual Revenues</b>	<b>Number of Loans</b>		<b>Dollar Volume of Loans</b>		<b>Percent of Assessment Area Businesses</b>
	<b>#</b>	<b>%</b>	<b>\$</b>	<b>%</b>	
<\$100,000	6	22%	\$146,427	12%	55%
\$100,000 - <\$250,000	8	30%	\$463,468	37%	21%
\$250,000 - <\$500,000	7	26%	\$399,017	31%	11%
\$500,000 - ≤\$1,000,000	4	15%	\$188,732	15%	6%
>\$1,000,000	2	7%	\$70,000	5%	7%
Totals	27	100%	\$1,267,644	100%	100%

Source – Bank Records and 2003 D&B Corporation Business Survey Data

The previous table shows that the vast majority of the bank's lending by number and dollar volume of loans is to businesses with gross annual revenues of less than \$1,000,000 (smaller businesses). For comparison, based on business survey information provided by D&B Corporation, 93 percent of businesses within the assessment area have gross annual revenues of less than \$1,000,000, and the majority (55 percent) of businesses have revenues of less than \$100,000. The D&B data is only used as an indicator of business demographics in the assessment area and is not considered an absolute distribution.

The bank's level of lending to the smallest businesses (<\$100,000) is reasonable even though it is lower than expected based on business demographics. There are several factors that limit a bank's opportunity to lend to these businesses. First is the fact that generally, many of the smallest businesses do not require financing due to the small size of the business operations. Second, many small business persons obtain loans through the consumer-lending department of a bank. Loans originated through the consumer loan department are not considered when conducting a commercial loan analysis. Overall, the bank's level of lending to businesses of various sizes reflects a good responsiveness to the credit needs of assessment area entities.

## Geographic Distribution of Loans

The bank's assessment area includes only middle-income census tracts; therefore, a formal analysis of the geographic distribution of loans would not provide any meaningful conclusions and was not performed. A cursory review of the loan samples revealed that the bank appears to be originating loans throughout its assessment area.

### ***Net Loan-to-Deposit Ratio***

The bank's average net loan-to-deposit (LTD) ratio<sup>4</sup> demonstrates its willingness to extend credit in relation to its financial capacity and lending opportunities. The bank's net LTD ratio, averaged over the 20 quarters since the previous evaluation (through June 30, 2004), is very strong at 96 percent. During this time, the net LTD ratio has ranged from a low of 79 percent to a high of 111 percent (as of June 30, 2004) and has generally trended upwards. The bank's net LTD ratio has been above 100 percent for the last seven quarters. Overall, the bank's willingness to lend, as demonstrated by its net loan-to-deposit ratio performance, is strong considering lending opportunities and apparent demand within the community.

### ***Response to Complaints***

The bank has not received any written complaints concerning its CRA performance.

### ***Compliance with Anti-discrimination Laws and Regulations***

No violations of the substantive provisions of anti-discriminatory laws and regulations were identified during the evaluation.

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<sup>4</sup> The *Net Loan-to-Deposit Ratio* is calculated by dividing total loans and leases minus the allowance for loan and lease losses, by total deposits.