

PUBLIC DISCLOSURE

September 7, 2004

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**The First State Bank
14771**

**120 West Center Street
Conrad, Iowa 50621**

**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.

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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 **The First State Bank, Conrad, Iowa**, prepared by the **Federal Deposit Insurance Corporation**, the institution's supervisory agency, as of **September 7, 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.

An institution in this group has a satisfactory record of helping to meet the needs of its assessment area, including low- and moderate-income neighborhoods, in a manner consistent with its resources and capabilities. Detailed below is a summary of the bank's performance.

- The bank's average quarterly net loan-to-deposit ratio (LTD) is reasonable given the bank's size and financial resources. The bank's net LTD ratio averaged 79 percent for the quarters from December 31, 1998, through June 30, 2004, and demonstrates a willingness to extend credit.
- A majority of the agricultural and commercial loans sampled by number are located in the bank's assessment area, reflecting management's willingness to lend locally.
- The bank's level of lending to agricultural and commercial operations of different sizes reflects a reasonable performance of meeting the credit needs within its assessment area.
- The geographic distribution of agricultural and commercial loans reflects a reasonable dispersion throughout the assessment area, illustrating the bank's commitment to extend loans in communities that surround each bank office location.
- The bank has not received any CRA complaints since the previous CRA evaluation. Therefore, this area was not evaluated and not considered in the bank's CRA rating.
- No violations of the substantive provisions of the anti-discrimination laws and regulations were identified during the evaluation.

DESCRIPTION OF INSTITUTION

The First State Bank operates from its main office and two other branch offices. The main office is located in Conrad, Iowa, and the branch offices are located in Parkersburg and Melbourne, Iowa. All office locations include a 24-hour Automated Teller Machine (ATM). The bank opened its newly constructed Parkersburg office with expanded facilities in March 2004. Control of the institution is with ISB Financial Corporation, Iowa City, Iowa, a two-bank holding company. Iowa State Bank & Trust Company, Iowa City, Iowa, is affiliated with subject bank through ownership of the holding company. There are no legal or financial impediments that prevent The First State Bank from helping to meet the credit needs of its assessment area. The bank's competitors include national, regional, and community institutions that have main offices or branch offices located within and adjacent to the assessment area. Specifically, the FDIC database showed that there are 16 financial institutions operating home offices or branch offices within the three counties where the bank has its office locations.

The bank's June 30, 2004, Consolidated Reports of Income and Condition reported total assets of \$113 million, total loans of \$61 million, and total deposits of \$81 million. The bank was rated Outstanding at the previous evaluation conducted October 27, 1998.

The bank's lending focus has historically been primarily agricultural loans; however, during this evaluation period the bank's loan portfolio has diversified to represent a higher percentage of commercial business loans. Part of this increase in the commercial loan portfolio is attributed to the bank's investment in loans originated by the bank's affiliate financial institution. Investing in purchased loans to maintain earning assets do not detract from the bank's lending within the assessment area. Purchased commercial loans as of June 30, 2004, represented 13 percent of the loan portfolio. As of June 30, 2004, agricultural loans represent 40 percent of the loan mix by dollar volume, while commercial loans represent 31 percent of the bank's total loans. For this evaluation, sampled loans from the two categories of agricultural loans and commercial loans were selected for analysis. Residential real estate loans represent 17 percent of the bank's loan portfolio and was not included due to its smaller proportion of the loan portfolio.

DESCRIPTION OF THE FIRST STATE BANK'S ASSESSMENT AREA

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

Each geography (CT) is designated as low, moderate, middle, or upper income by comparing the 2000 U.S. Census Bureau median family income (MFI) of the geography to the MFI for the applicable area. The income levels for CTs are derived from U.S. Census Bureau information and are updated every ten years. For loans originated in 2004, the applicable figure used to determine the income categories for this institution's assessment area is the 2000 U.S. Census Bureau MFI of \$44,001 for the State of Iowa non-Metropolitan Statistical Area (non-MSA)

(after the MSA realignment effective January 1, 2004) and \$47,833 for the Waterloo/Cedar Falls Metropolitan Statistical Area (MSA). For loans originated in 2003, the applicable figure used to determine the income categories for this institution's assessment area is the 2000 U.S. Census Bureau MFI of \$44,603 for the State of Iowa non-MSA and \$47,398 for the Waterloo/Cedar Falls MSA (prior to the MSA realignment). For loans originated prior to 2003, the applicable figure used to determine the income categories for this institution's assessment area is the 1990 U.S. Census Bureau MFI of \$29,303 for the State of Iowa non-MSA and \$32,438 for the Waterloo/Cedar Falls MSA. Table 1 provides the income category definitions used in this evaluation.

Table 1 – Definitions of Income Categories	
Income Category	Definition
Low Income	Income of less than 50 percent of the area MFI
Moderate Income	Income of at least 50 percent and less than 80 percent of the area MFI
Middle Income	Income of at least 80 percent and less than 120 percent of the area MFI
Upper Income	Income of 120 percent or more of the area MFI

The institution's assessment area in central Iowa includes the three whole counties of Grundy (4 CTs, 9901 through 9904), Butler (5 CTs, 9701 through 9705), and Marshall (10 CTs, 9501 through 9510). Also individual geographies of CT 9805 in Hardin County, west of Conrad, and CT 402 in Jasper County, south of Melbourne, are included as part of the bank's assessment area. The assessment area consists of 21 adjoining CTs. According to the 2000 U.S. Census Bureau data, all of the assessment area CTs are middle-income with exceptions of CT 9505, located on the north side of Marshalltown being moderate-income and adjoining CTs 9508 and 9510 on the south side of Marshalltown being upper-income. The entire assessment area is comprised of 73,865 residents. Marshall County is the largest populated county of the assessment area with 39,311 residents. Marshalltown is the largest city in Marshall County with a population of 26,009 residents. Other cities in the assessment area have less than 3,000 residents, and the assessment area is primarily rural and largely dependent upon the agricultural economy.

Demographic and Economic Data

To better understand the credit needs and current demographic information of local neighborhoods, cities, or counties, general demographic and economic data is gathered and confidential community contacts are conducted by all financial institution regulatory agencies. Information obtained from community contacts is used to gauge the public's impression of an institution's lending performance locally and to identify potential community development needs.

According to the 2000 U.S. Census Bureau data, the assessment area has 29,161 households. Of these households, 20,555 are families. In 2000, 15.4 percent of these families were low-income families and of those, 6.1 percent were below the poverty level. Families and persons are classified as "below poverty" if their total family income or unrelated individual income is less

than the poverty threshold specified for the applicable family size, age of householder, and number of related children under 18 present. Specifically, for a family of four, the 2000 poverty level threshold is \$17,029; therefore, a family earning less than \$17,029 would be below the poverty level. This indicates that in 2000, approximately 40 percent of the low-income families are below the poverty level. The poverty level threshold is determined on a national basis and is not adjusted regionally.

The 2000 U.S. Census Bureau information also shows that the assessment area housing stock totaled 31,127 housing units. In addition, the 2000 data revealed that 72 percent of the housing units were owner-occupied, 22 percent were rental units, and 6 percent were vacant. The median value of a home was \$71,515, and the median age of the housing stock was 49 years.

According to 2003 D&B Corporation data, the institution's assessment area has a reported 1,558 farms. The 2002 Census of Agriculture further reports a decline in the number of farms since 1997 in all three counties that primarily comprise the assessment area. Grundy County's farms declined 8 percent from 1997 to 2002, with the average size of its farms increasing from 418 acres to 448 acres. Butler County's number of farms declined 7 percent, with the average size of farms increasing from 289 acres to 305 acres. Marshall County's farm numbers declined 13 percent, with the average farm size increasing from 340 acres to 395 acres. According to community contact information, farm land sold is being merged with nearby larger farm operations. Farmers in central Iowa raise primarily grain crops of corn and soybeans. There are several large hog and cattle operations. The smaller average farm size in Butler County is attributed to having more cattle and hog operations with less individually owned farm acres.

Iowa Workforce Development reported the State's seasonally adjusted unemployment rate at 4.4 percent as of July 2004, a slight increase from 4.3 reported as of June 2004. The unemployment rate is not reported by census tract but by county. Grundy County reported 2.2 percent for the month of July 2004, while Butler County reported 3.8 percent, and Marshall County reported 4.1 percent. The nationwide unemployment rate dropped slightly to 5.5 percent in July from 5.6 percent in June 2004.

The 2003 D&B Corporation data indicates there are 4,539 non-farm business operations in the assessment area. According to D&B Corporation 2003 data, the largest industries in the assessment area, as a percentage of total industries, are services (26.4 percent); agriculture, forestry & fishing (25.6 percent); and retail trade (12.3 percent). Community contact information indicates that many residents in the assessment area commute for employment to Marshalltown (population 26,009) or to Waterloo/Cedar Falls (population 104,892), located within 8 miles east of the northern Grundy County border.

Reports of Condition filed by financial institutions in the area also support the fact that agricultural lending remains a primary credit need for the central portion of Iowa. Commercial and residential real estate lending are also identified credit needs of the assessment area. Recent community contact information reveals that competition for these credit types is strong within the assessment area and that these needs are being met.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

Loan-to-Deposit Ratio

Examiners reviewed the institution's average quarterly net loan-to-deposit (LTD) ratio in order to evaluate the institution's performance for this criterion. A small institution's net LTD ratio is calculated by dividing the institution's net loans and leases by its total deposits. The institution's net LTD ratio is then averaged for all quarter-ends since the last evaluation. Each small institution's ratio is evaluated and analyzed using performance context, including the institution's capacity to lend, demographic, and economic factors present in the assessment area, and the lending opportunities available in the institution's assessment area. Detailed below is an analysis of this performance criterion for this institution.

The institution's average quarterly net LTD ratio, which is one measure of the institution's overall level of lending, is reasonable given the institution's size, financial condition, and assessment area demographics. The institution's net LTD ratio averaged 79 percent for the 23 quarters beginning December 31, 1998, and ending June 30, 2004. The institution's net LTD ratio went through a period of increase to a high of 92.4 percent on December 31, 2000, followed by a decline to a low of 64.1 percent on March 31, 2003. The LTD ratio has been increasing and is currently 72.8 percent for quarter ending June 30, 2004.

Commercial loans purchased as earning assets for the bank have added to the LTD ratio in more recent years to compensate in part for the bank's decline in loans. As of June 30, 2004, the bank's loan portfolio included about \$8 million in purchased commercial loans originated to businesses operating outside the assessment area. Comparatively, the balance outstanding for commercial loans sold as of June 30, 2004, that are not reflected in the bank's LTD ratio totaled slightly over \$4 million. Also not included within the bank's loan portfolio or as part of the LTD ratio is the residential real estate loans the bank assists borrowers with that are sold on the secondary market. These residential real estate loan products have a longer maturity with a fixed rate compared to shorter term loans offered by the bank and retained in the loan portfolio. Since the last CRA evaluation, the bank has assisted 63 borrowers with residential real estate loans sold on the secondary market for total origination amounts of over \$5 million.

To further evaluate the reasonableness of this ratio, examiners compared the institution's average net LTD ratio to other similarly situated institutions located within the institution's assessment area. Comparable institutions are chosen based on size, credit products offered, and/or markets served. The average net LTD ratios for similarly situated institutions range between 69 and 83 percent, with assets sizes between \$98 and \$137 million.

As previously mentioned, recent community contact information indicates that primary credit needs in the area are being met. Overall, the institution's performance in origination of loans through use of available deposited funds and other sources is reasonable.

Selection of Loan Product Samples

The sample sizes for loan categories chosen for review were based on a 90 percent confidence interval, with a plus or minus 15 percent level of precision. In other words, there is a 90 percent chance that the results from the sample will be within 15 percent of the true population.

Agricultural and commercial loans comprise 71 percent of the bank's loan portfolio, and examiners reviewed both loan types. Examiners reviewed 40 agricultural loans totaling \$2.7 million that were originated between July 31, 2003, and July 30, 2004, from a total universe of 277 agricultural loans totaling \$17.1 million. Examiners also reviewed 40 commercial loans totaling \$4.0 million that were originated between July 31, 2003, and July 30, 2004, from a total universe of 139 commercial loans totaling \$18.5 million.

Assessment Area Concentration

Examiners reviewed the institution's assessment area lending concentration in order to evaluate its performance with CRA small bank criteria. Examiners typically sample loans and complete a comparative analysis that details loans extended inside and outside of the institution's assessment area. Detailed below is an analysis of this performance criterion for this institution.

As indicated by Table 2, a substantial majority of the combined agricultural and commercial loans by number were located within the bank's assessment area, illustrating a reasonable record of making loans within the assessment area. While the dollar volume of sampled agricultural loans is being primarily extended to borrowers inside the assessment area, the dollar volume of commercial loans to borrowers outside the assessment area is significant according to the sample. Specifically, the sampled commercial loans had 73 percent of the dollar volume extended to borrowers outside the assessment area. The largest portion of the commercial dollar volume outside the assessment area is attributed to two of the sample of 40 being purchased commercial loans of a higher dollar volume. Further analysis of the purchased commercial loans reveals that they represent 41 percent of the commercial loan volume based on the bank's June 30, 2004, Consolidated Reports of Income and Condition. In comparison, sold commercial loans that are originated to borrowers within the assessment area represented 22 percent of the June 30, 2004, commercial loan dollar volume. Management stated that the credit needs of commercial operations located within the assessment area are being met, and investments in purchased commercial loans do not detract from lending within the assessment area. The bank's level of lending inside the assessment area illustrates the bank's commitment to making credit available within the local communities surrounding office locations. Overall, the bank's performance with this criterion is considered reasonable.

Table 2 – Distribution of Loans Inside and Outside of the Assessment Area										
Loan Category	Number of Loans					Dollars Volume of Loans				
	Inside		Outside		Total #	Inside		Outside		Total \$ (000s)
	#	%	#	%		\$ (000s)	%	\$ (000s)	%	
Agricultural	31	78	9	22	40	2,137	78	599	22	2,736
Commercial	34	85	6	15	40	1,056	27	2,908	73	3,964
Total	65	81	15	19	80	3,193	48	3,507	52	6,700

Source: Examiner sampling.

The majority of the remaining analysis will focus on number of loans originated, rather than on the dollar volume, since loans extended to small farm operations and small commercial business operations are generally for smaller dollar amounts than loans to large agricultural or commercial business operations. An analysis using dollar volume of loans would not provide a representative picture of the institution's lending.

Borrower Profile

For this criterion, examiners determine the distribution of loans that the institution originated inside its assessment area by business gross annual revenues (agricultural and commercial) or by borrower income (residential real estate), as applicable. Gross Income or Revenue information for all loans sampled was obtained from credit files and discussions with loan officers.

Overall, the bank's level of lending to agricultural and commercial operations of different sizes reflects a reasonable performance of meeting the credit needs within its assessment area.

Agricultural Loans

To aid in evaluating the institution's performance in lending to agricultural operations of different sizes, examiners used D&B Corporation 2003 data. D&B Corporation provides a breakdown of the number of farms in the assessment area that reported gross revenues, as well as those that did not report earnings, and assigns each farm operation into a specific revenue category.

The review of sampled agricultural loans and further information within the bank's records showed the bank's lending to farm operations of different sizes is reasonable. Table 3 displays the number, dollar volume, and related percentages of sampled loans made to farm operations of different sizes. This table also compares those percentages to the percentages of farm operations within the assessment area according to 2003 D&B Corporation business demographic data. Only those farm operations that reported gross revenues to D&B Corporation are included in the percentage categories as represented in Table 3.

The bank's record of lending to small farm operations with revenues less than \$1 million is considered reasonable given further analysis of the lending administration for agricultural loans. Community contact information indicates that lenders for agricultural credit within central Iowa have been increasing, and competition is particularly strong for farms that have been in operation for several years. Very few new farm operations with outside lending needs are common within the assessment area.

Management attributed its lower level of lending to farm businesses with revenues of less than \$250,000, in comparison to the percentage of small farms with revenues below this level, to the fact that many of these small farms are operated by farmers who have off-farm employment which reduces the need to borrow funds. Moreover, Agricultural Census Bureau data for 2002 shows that approximately 51 percent of all farm operations do not borrow, so no more than 49 percent of operators in the area are seeking credit. Further, the census data shows that 70 percent of farmers within the three whole counties that comprise the assessment area are classified as full-time farmers, indicating that many of the farms with less than \$250,000 in gross revenues may have minimal need for loans. Additionally, census data shows that 30 percent of farmers within the three counties are classified as "hobby farmers," indicating that these types of farmers have other sources of revenue and, most likely, minimal need for loans. Management agreed and further stated that part-time farmers typically do not have the same agricultural financing needs as other types of farmers and may either work off-farm to supplement their farming operations or use other types of loans to indirectly finance their farming operations. Therefore, limited opportunities exist for the bank to lend to small operations in the loan category below \$250,000 in annual revenues.

To further support the bank's reasonable efforts in this area, the bank assisted small farm operations in partnership with the Iowa Agricultural Development Authority (IADA) Beginning Farmer Loan Program. This program allows qualifying new farm operations to purchase agricultural land, breeding livestock, buildings, machinery, or equipment. The loans may also be used to improve existing buildings or farmland. As of June 30, 2004, the bank's loan portfolio included loans in this program that totaled \$289,000.

The bank has also assisted small farm operations with the Farm Service Agency (FSA) guaranteed loan program. As of June 30, 2004, the bank's loan portfolio included loans in this program that totaled \$916,000. According to community contact information these federal assisted guaranty programs have declined in recent years. Farmers in the assessment area have not been affected by drought conditions compared to other Midwest states, and crop prices have been favorable.

Overall, the institution's level of lending to agricultural operations is reasonable.

Table 3 – Distribution of Agricultural Loans by Gross Annual Revenues					
Gross Annual Revenues	Farms in the Assessment Area	Distribution of Agricultural Loans Sampled			
	%	#	%	\$ (000s)	%
< \$100,000	56	13	42	597	28
\$100,000 to < \$250,000	37	8	26	370	17
\$250,000 to < \$500,000	5	7	23	600	28
\$500,000 to < \$1,000,000	1	2	6	450	21
≥ \$1,000,000	1	1	3	120	6
Total	100	31	100	2,137	100

Source: Examiner Loan Sampling and 2003 D&B Corporation Data. (Note: 28 farm operations (2 percent) in the assessment area that did not report incomes to D&B Corporation are excluded from this analysis).

Commercial Loans

To aid in evaluating the institution's performance in lending to commercial businesses of different sizes, examiners used D&B Corporation 2003 data. D&B Corporation provides a breakdown of the number of businesses in the assessment area that reported gross revenues, as well as those that did not report earnings, and assigns each business into a specific revenue category.

As indicated in Table 4, the review of sampled commercial loans showed that the bank's lending to operations of different sizes is reasonable, and is favorable in lending to businesses with revenues of less than \$250,000. Table 4 displays the number, dollar volume, and related percentages of sampled loans made to business operations of different sizes. This table also compares those percentages to the percentages of business operations within the assessment area according to D&B Corporation 2003 business demographic data. Only those businesses that reported gross revenues to D&B Corporation are included in the percentage categories as represented in Table 4.

Bank management attributed the level of lending to businesses with revenues of less than \$250,000 to the fact that it concentrates its lending efforts to the communities surrounding its small town bank locations, which tend to be businesses with annual revenues below \$250,000. The D&B Corporation statistical data includes many business operations in Marshalltown, Iowa, and although this is included as part of the bank's assessment area it is not a community that the bank has an active lending presence. A larger proportion of businesses in the assessment area with annual revenues over \$250,000 are located in the larger populated Marshalltown area. Management further indicated that many of the small business operations in the three communities surrounding its office locations may use either non-commercial loan products as a means of financing (such as personal Home Equity Lines of Credit or zero-interest credit cards). Bank management also reported a trend where more small businesses are borrowing from wholesale dealers offering very low- to zero percent interest rate financing.

To further support the bank's efforts in this area, the bank assisted borrowers in obtaining Small Business Administration (SBA) guaranteed loans. As of June 30, 2004, the bank's loan portfolio included lending under the Small Business Administration guaranteed loan program.

Overall, the institution's performance in lending to commercial businesses is considered reasonable.

Table 4 – Distribution of Commercial Loans by Gross Annual Revenues					
Gross Annual Revenues	Businesses in the Assessment Area	Distribution of Commercial Loans Sampled			
	%	#	%	\$ (000s)	%
< \$100,000	53	21	62	788	74
\$100,000 to < \$250,000	24	10	29	177	17
\$250,000 to < \$500,000	11	2	6	61	6
\$500,000 to < \$1,000,000	5	1	3	30	3
≥ \$1,000,000	7	0	0	0	0
Total	100	34	100	1,056	100

Source: Examiner Loan Sampling and 2003 D&B Corporation Data. (Note: 1,460 non-farm businesses (32 percent) in the assessment area that did not report incomes to D&B Corporation are excluded from this analysis).

Geographic Distribution of Lending

Examiners analyze the institution's performance under this criterion to determine if the institution is lending throughout its assessment area including any low- and moderate-income areas or geographies within the assessment area. The composition of the institution's assessment area by CT income level is important to this evaluation process because it is compared to where the institution originated its sampled loans by CT. Detailed below is an analysis of this performance criterion for the institution.

According to recent available U.S. Census data, the bank's assessment area includes only one census tract that is considered moderate-income, while the others are middle- and upper-income. The one moderate-income census tract had been identified as being also middle-income until realignment of the geographies in late 2003. The one moderate-income census tract is located on the north side of the City of Marshalltown, Iowa. According to bank management it is difficult to extend loans in Marshalltown, due to the distance of this city from any of the bank's office locations and the presence of a number of other financial institutions within Marshalltown. The sample of loans reviewed did not include any loans within the one moderate-income census tract. The distribution of both agricultural loans and commercial loans are concentrated closer to the bank's office locations and reflects a reasonable distribution within the communities surrounding bank offices.

Response to CRA-Related Complaints

Examiners are required to review the institution's response to any substantiated complaints. If the institution receives any written comments from the public relating to its CRA performance, they will be found in its CRA public file along with the institution's response. Comments and responses for the preceding two calendar years will be maintained in the institution's CRA public file, except for those comments that reflect adversely on the good name or reputation of any persons other than the institution.

A review of the bank's CRA public file and discussions with management revealed that the institution has not received any CRA-related complaints since the previous CRA evaluation.

Compliance With Anti-discrimination Laws and Regulations

Examiners are required to take into consideration the institution's compliance with fair lending laws when assigning a CRA rating.

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