

PUBLIC DISCLOSURE

May 14, 2018

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

Farmers Security Bank
Certificate Number: 09122

710 Main Street
Washburn, North Dakota 58577

Federal Deposit Insurance Corporation
Division of Depositor and Consumer Protection
Kansas City Regional Office

1100 Walnut Street, Suite 2100
Kansas City, Missouri 64106

This document is an evaluation of this institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operation of the institution. This evaluation is not, nor should it be construed as, an assessment of the financial condition of this institution. The rating assigned to this institution does not represent an analysis, conclusion, or opinion of the federal financial supervisory agency concerning the safety and soundness of this financial institution.

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INSTITUTION RATING

INSTITUTION'S 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.

- The loan-to-deposit ratio is reasonable given the institution's size, financial condition, and assessment area credit needs.
- The bank made a substantial majority of its small farm and small business loans in the assessment area.
- A geographic distribution analysis was not conducted since the bank's assessment area is comprised entirely of middle-income geographies.
- The distribution of borrowers reflects reasonable penetration of loans among farms and businesses of different sizes.
- The institution did not receive any CRA-related complaints since the previous evaluation; therefore, this factor did not affect the rating.

SCOPE OF EVALUATION

General Information

This evaluation covers the period from the prior evaluation dated August 20, 2012, to the current evaluation dated May 14, 2018. Examiners used the Interagency Small Institution Examination Procedures to evaluate Farmers Security Bank’s CRA performance. These procedures considered the institution’s performance according to the following criteria:

- Loan-to-deposit ratio
- Assessment area concentration
- Geographic distribution
- Borrower profile
- Response to CRA-related complaints

An interview with bank management and information obtained through a community contact were used to assess current economic and demographic conditions and credit needs in the assessment area. In addition, examiners reviewed pertinent information from the 2015 American Community Survey (ACS) to provide context for the overall evaluation.

Loan Products Reviewed

The bank’s primary lending focus is agricultural lending, followed by commercial lending. This conclusion considered the bank’s business strategy, the number and dollar volume of loans originated, renewed, or extended during the evaluation period, and the composition of the loan portfolio. Bank records indicate that the institution’s lending focus and product mix did not significantly change during the evaluation period. Agricultural loans continue to comprise the largest portion of the loan portfolio, by dollar volume, at 66 percent as of December 31, 2017. This loan product type increased 10 percent since the previous evaluation. Commercial loans comprise the second largest percentage of the loan portfolio, by dollar volume, at 24 percent. This loan product type made up 27 percent of the loan portfolio at the previous evaluation.

To help assess the bank’s lending performance, examiners reviewed a sample of small farm and small business loans taken from a universe of loans originated, renewed, or extended between January 1, 2017, and December 31, 2017. The analysis did not include small farm or small business loans originated, renewed, or extended and paid off during this same time period as that information was not readily available. D&B data for 2017 was used for comparison purposes in evaluating the bank’s small farm and small business lending performance.

The following table reflects the number and dollar volume of the universe and samples sizes considered in this evaluation.

Loan Products Reviewed				
Loan Category	Universe		Reviewed	
	#	\$(000s)	#	\$(000s)
Small Farm	49	5,171	33	3,208
Small Business	42	3,442	29	2,380

Source: Bank Data from 1/1/2017 through 12/31/2017.

The bank's record of small farm lending received greater weight than small business lending when reaching overall conclusions since agricultural lending is the bank's primary lending focus, and these loans comprise the largest portion of the loan portfolio. No other loan types, such as home mortgage or consumer loans, represent major product lines; therefore, no other loan products were analyzed. In drawing conclusions, lending activity based on the number of loans rather than on the dollar volume is emphasized. This is because the number of loans more clearly represents the bank's lending efforts. Historically, loans to smaller farms and businesses are for smaller dollar amounts than those loans made to larger farms and businesses. As a result, an analysis using only the dollar volume of loans would not provide a representative assessment of the bank's lending efforts. The bank is affiliated with other financial institutions that offer credit products and services; however, examiners did not consider affiliate lending activities in the analysis of the bank's performance.

Farmers Security Bank does not offer a formal small-dollar loan program and does not officially track small-dollar lending activities. However, the institution originates consumer loans that would qualify as small-dollar loans under the FDIC Affordable Small-Dollar Loan Guidelines. Although these loans did not affect the overall CRA rating, such activity shows responsiveness to the credit needs of the community.

DESCRIPTION OF INSTITUTION

Background

Farmers Security Bank continues to operate from its sole office in Washburn, North Dakota. The institution is wholly owned by McLean Bank Holding Company, a three-bank holding company located in Garrison, North Dakota. At the previous evaluation, dated August 20, 2012, the FDIC evaluated the institution under the Interagency Small Institution Examination Procedures, and the institution received a "Satisfactory" rating.

Operations

Farmers Security Bank operates as a community bank offering a traditional array of products and services. The bank offers agricultural, commercial, consumer, and home mortgage loan products with a primary emphasis on agricultural lending activities. The products are consistent with the institution's size, financial capacity, and geographic location. The bank also offers loans with guarantees from the Farm Service Agency and the Small Business Administration. These programs are generally designed to assist small farms and businesses that may not qualify for loans through conventional financing methods. In addition, the institution utilizes various programs, such as Beginning Farmer, Farm Financial Stability, and Flex PACE programs, through the Bank of North Dakota. The bank is also involved in the Red River Corridor Fund, a collaboration of 36 North Dakota communities with the goal of supporting small businesses by increasing access to capital and enhancing credit programs across North Dakota. Finally, the institution provides access to secondary market residential real estate loans. This arrangement provides options for different types and terms of home mortgage loans that the bank does not offer.

In addition to the various loan programs offered by the institution, the bank makes available a variety of deposit-related products including checking, savings, money market deposit accounts, and certificates of deposit. Alternative banking services include internet and mobile banking, online bill pay, online credit applications, mobile deposits, person-to-person payments, prepaid cards, access to surcharge-free automated teller machines, and Saturday business hours. The bank did not open or close any branches, and no merger or acquisition activities occurred since the previous evaluation.

Ability and Capacity

As of December 31, 2017, the institution reported total assets of \$56,314,000, net loans of \$35,137,000, and total deposits of \$50,233,000. Since September 30, 2012, total assets, net loans, and total deposits have increased by approximately 23, 53, and 24 percent, respectively. The bank's loan portfolio is illustrated in the following table. The loan portfolio does not reflect home mortgage loans sold on the secondary market.

Loan Portfolio Distribution as of 12/31/2017		
Loan Category	\$(000s)	%
Construction and Land Development	194	0.5
Secured by Farmland	9,682	27.2
1-4 Family Residential	1,066	3.0
Multi-family (5 or more) Residential	0	0.0
Commercial Real Estate	5,475	15.4
Total Real Estate Loans	16,417	46.1
Commercial and Industrial	3,248	9.1
Agricultural	13,882	39.0
Consumer	1,700	4.8
Other	394	1.0
Less: Unearned Income	0	0.0
Total Loans	35,641	100.0
<i>Source: Reports of Condition and Income</i>		

Examiners did not identify any financial, legal, or other impediments that affect the bank's ability to meet assessment area credit needs.

DESCRIPTION OF ASSESSMENT AREA

The CRA requires each financial institution to define one or more assessment area within which its CRA performance will be evaluated. Farmers Security Bank continues to designate a single assessment area in west central North Dakota. The following sections discuss demographic and economic information for the bank's assessment area.

Economic and Demographic Data

The institution's assessment area includes the entire counties of McLean and Oliver in North Dakota. Based on 2015 ACS data, McLean County consists of two middle-income census tracts (9608 and 9610) located in a nonmetropolitan area in west central North Dakota. Oliver County, which is part of the Bismarck, ND Metropolitan Statistical Area (MSA), consists of one middle-

income geography located directly to the south of McLean County. The assessment area does not contain any low-, moderate-, or upper-income geographies. The bank's sole office is located in census tract 9608 in McLean County.

The assessment area has changed since the previous evaluation. Specifically, the assessment area previously consisted of two of three census tracts in McLean County, and the one census tract that comprised all of Oliver County. The bank excluded the third census tract in McLean County that included the city of Garrison, North Dakota since one of its affiliated banks was located there. The assessment area was located entirely in a nonmetropolitan area; however, in conjunction with the revised MSA delineations in 2014, the makeup of McLean County changed from three census tracts to two census tracts. In addition, Oliver County became part of the Bismarck, ND MSA. These changes have no impact on the CRA rating of the institution.

As reflected in 2015 ACS data, the population of the assessment area is 11,270. This includes 5,026 households, of which 3,409 are families. Of these families, 21.9 percent are considered low income, 19.1 percent are moderate income, 23.9 percent are middle income, and 35.1 percent are upper income. Furthermore, 6.9 percent of the families in the assessment area live below the poverty level. The percentage of families with incomes below the poverty level can be an indicator of a reduced capacity to borrow, which can effectively limit a financial institution's ability to lend to lower-income borrowers.

According to 2017 D&B data, there were 274 farms operating in the assessment area. Gross annual revenues for these operations are as follows:

- 98.9 percent reported gross annual revenues of \$1 million or less
- 0.4 percent reported gross annual revenues greater than \$1 million
- 0.7 percent did not report revenues

In regards to business operations, 2017 D&B data reflects 824 businesses operating in the assessment area. Reported gross annual revenues for these operations are as follows:

- 77.5 percent reported gross annual revenues of \$1 million or less
- 5.1 percent reported gross annual revenues greater than \$1 million
- 17.4 did not report revenues

Industries representing the largest portion of operations in the assessment area include service industries at 27.6 percent, followed by agriculture, forestry & fishing (25.0 percent); retail trade (9.7 percent); and construction (7.9 percent). In addition, 77.1 percent of area businesses employ four or fewer employees, and 88.7 percent operate from a single location. According to bank management, major employers in the area include Great River Energy, Falkirk Mining Company, RDO Equipment Co., area school systems, and government entities.

Bank management stated that the overall economy in the assessment area is fairly strong. The community contact and bank management agreed that agriculture plays a significant role in the assessment area followed by small business industries. Primary crops are wheat, soybeans, and corn.

The U.S. Bureau of Labor Statistics reports that the preliminary unemployment rates for February 2018 were 4.7 percent for McLean County and 5.4 percent for Oliver County. Comparable figures for the State of North Dakota and the U.S. were 3.4 percent and 4.4 percent, respectively. The unemployment rates for the two counties, the State of North Dakota, and the U.S. have decreased when compared to those reflected in the previous evaluation.

Competition

Competition includes community banks, agricultural finance companies, regional and national bank offices, and credit unions. According to June 30, 2017, FDIC Deposit Market Share data, seven FDIC-insured financial institutions operated an office in McLean and Oliver Counties. Of these institutions, Farmers Security Bank ranked second with 15.1 percent of the deposit market share. Bank management indicated that the bank's primary competitors for loans are Dakota West Credit Union, Farm Credit Services, and equipment financing through RDO Equipment Co. in Washburn.

Community Contact

As indicated earlier, part of the evaluation process includes a discussion with third parties active in the assessment area to assist in identifying the credit needs of the area. This information helps determine whether local financial institutions are responsive to these needs and credit opportunities available in the area. For this evaluation, examiners conducted an interview with a representative from an agricultural-related organization.

The contact confirmed that the area is dependent on agriculture and agricultural-related businesses and noted that the area is dry due to the 2017 drought that affected the farm economy. The individual further noted that most individuals are employed in their local communities; however, some individuals commute to Bismarck-Mandan for better employment opportunities. Overall, the contact could not identify any unmet credit needs by area financial institutions, but noted that it would be nice to see more banks involved in government loan programs.

CONCLUSIONS ON PERFORMANCE CRITERIA

Loan-to-Deposit Ratio

The loan-to-deposit ratio is reasonable given the institution's size, financial condition, and assessment area credit needs. The institution's loan-to-deposit ratio, calculated from Reports of Condition and Income data, averaged 70.9 percent over the past 22 calendar quarters from September 30, 2012, to December 31, 2017. The bank's average loan-to-deposit ratio has increased from 64 percent at the previous evaluation.

In addition, examiners assessed the bank's performance against similarly-situated institutions. Examiners selected the comparable institutions based on asset size, branching structure, geographic location, and lending focus.

Loan-to-Deposit Ratio		
Bank	Total Assets as of 12/31/2017 \$(000s)	Average Net LTD Ratio (%)
Garrison State Bank and Trust * Garrison, North Dakota	135,274	88.7
First State Bank of Harvey Harvey, North Dakota	83,754	37.8
Bank of Turtle Lake * Turtle Lake, North Dakota	49,264	80.2
Farmers Security Bank Washburn, North Dakota	56,314	70.9
<i>Source: Reports of Condition and Income 9/30/2012 through 12/31/2017. Institutions are listed alphabetically by office location. *Affiliated institution.</i>		

Assessment Area Concentration

The bank originated a substantial majority of the sampled small farm and small business loans, by number and dollar volume, within its assessment area, as demonstrated in the following table.

Lending Inside and Outside of the Assessment Area										
Loan Category	Number of Loans				Total #	Dollar Amount of Loans \$(000s)				Total \$(000s)
	Inside		Outside			Inside		Outside		
	#	%	#	%		\$	%	\$	%	
Small Farm	31	93.9	2	6.1	33	3,066	95.6	142	4.4	3,208
Small Business	24	82.8	5	17.2	29	2,160	90.8	220	9.2	2,380
<i>Source: Bank Data - Evaluation Period 1/1/2017 - 12/31/2017.</i>										

Geographic Distribution

The purpose of performing an analysis of the geographic distribution of loans is to review the bank's lending performance in low- and moderate-income census tracts; however, since there are no low- or moderate-income tracts in the bank's assessment area, a traditional geographic distribution analysis was not conducted.

Borrower Profile

The distribution of borrowers reflects reasonable penetration among farms and businesses of different sizes in the assessment area. The bank's reasonable performance of small farm and excellent small business lending supports this conclusion. Examiners focused on the percentage by number of loans to farms and businesses with gross annual revenues of \$1 million or less.

Small Farm Loans

The distribution of small farm loans reflects reasonable penetration of loans to farms with gross annual revenues of \$1 million or less. The following table shows that 93.5 percent of the sampled small farm loans, by number, were to farms with gross annual revenues of \$1 million or less in 2017. In comparison, D&B data indicates that 98.9 percent of farms in the assessment area reported gross annual revenues of \$1 million or less. As noted in the following table, all but two of the small farm loans analyzed were to farm operators with reported gross annual revenues of \$1 million or less. Given this information, the bank's performance is reasonable.

Distribution of Small Farm Loans by Gross Annual Revenue Category					
Gross Revenue Level	% of Farms	#	%	\$(000s)	%
<=\$1,000,000	98.9	29	93.5	2,166	70.6
>1,000,000	0.4	2	6.5	900	29.4
Revenue Not Available	0.7	0	0.0	0	0.0
Total	100.0	31	100.0	3,066	100.0

Source: 2017 D&B Data, 1/1/2017 - 12/31/2017 Bank Data.

Small Business Loans

The distribution of small business loans reflects excellent penetration of loans to businesses with gross annual revenues of \$1 million or less. All of the bank's small business loans analyzed were to businesses with gross annual revenues of \$1 million or less. In comparison, D&B data indicates that 77.5 percent of business operations in the assessment area reported gross annual revenues of \$1 million or less. This level of lending displays excellent performance.

Response to Complaints

The bank did not receive any CRA-related complaints since the previous evaluation; therefore, this criterion did not affect the rating.

DISCRIMINATORY OR OTHER ILLEGAL CREDIT PRACTICES REVIEW

Examiners did not identify any evidence of discriminatory or other illegal credit practices; therefore, this consideration did not affect the institution's CRA rating.

GLOSSARY

Aggregate Lending: The number of loans originated and purchased by all reporting lenders in specified income categories as a percentage of the aggregate number of loans originated and purchased by all reporting lenders in the metropolitan area/assessment area.

Area Median Income: The median family income for the MSA, if a person or geography is located in an MSA; or the statewide nonmetropolitan median family income, if a person or geography is located outside an MSA.

Assessment Area: A geographic area delineated by the bank under the requirements of the Community Reinvestment Act.

Census Tract: A small, relatively permanent statistical subdivision of a county or equivalent entity. The primary purpose of census tracts is to provide a stable set of geographic units for the presentation of statistical data. Census tracts generally have a population size between 1,200 and 8,000 people, with an optimum size of 4,000 people. Census tract boundaries generally follow visible and identifiable features, but they may follow nonvisible legal boundaries in some instances. State and county boundaries always are census tract boundaries.

Combined Statistical Area (CSA): A combination of several adjacent metropolitan statistical areas or micropolitan statistical areas or a mix of the two, which are linked by economic ties.

Consumer Loan(s): A loan(s) to one or more individuals for household, family, or other personal expenditures. A consumer loan does not include a home mortgage, small business, or small farm loan. This definition includes the following categories: motor vehicle loans, credit card loans, home equity loans, other secured consumer loans, and other unsecured consumer loans.

Core Based Statistical Area (CBSA): The county or counties or equivalent entities associated with at least one core (urbanized area or urban cluster) of at least 10,000 population, plus adjacent counties having a high degree of social and economic integration with the core as measured through commuting ties with the counties associated with the core. Metropolitan and Micropolitan Statistical Areas are the two categories of CBSAs.

Family: Includes a householder and one or more other persons living in the same household who are related to the householder by birth, marriage, or adoption. The number of family households always equals the number of families; however, a family household may also include non-relatives living with the family. Families are classified by type as either a married-couple family or other family. Other family is further classified into “male householder” (a family with a male householder and no wife present) or “female householder” (a family with a female householder and no husband present).

Family Income: Includes the income of all members of a family that are age 15 and older.

FFIEC-Estimated Income Data: The Federal Financial Institutions Examination Council (FFIEC) issues annual estimates which update median family income from the metropolitan and nonmetropolitan areas. The FFIEC uses American Community Survey data and factors in

information from other sources to arrive at an annual estimate that more closely reflects current economic conditions.

Full-Scope Review: A full-scope review is accomplished when examiners complete all applicable interagency examination procedures for an assessment area. Performance under applicable tests is analyzed considering performance context, quantitative factors (for example, geographic distribution, borrower profile, and total number and dollar amount of investments), and qualitative factors (for example, innovativeness, complexity, and responsiveness).

Geography: A census tract delineated by the United States Bureau of the Census in the most recent decennial census.

Home Mortgage Disclosure Act (HMDA): The statute that requires certain mortgage lenders that do business or have banking offices in a metropolitan statistical area to file annual summary reports of their mortgage lending activity. The reports include such data as the race, gender, and the income of applicants; the amount of loan requested; and the disposition of the application (approved, denied, and withdrawn).

Home Mortgage Disclosure Loan Application Register (HMDA LAR): The HMDA LARs record all applications received for residential purchase, refinance, home improvement, and temporary-to-permanent construction loans.

Home Mortgage Loans: Includes home purchase and home improvement loans as defined in the HMDA regulation. This definition also includes multi-family (five or more families) dwelling loans, loans to purchase manufactured homes, and refinancings of home improvement and home purchase loans.

Household: Includes all persons occupying a housing unit. Persons not living in households are classified as living in group quarters. In 100 percent tabulations, the count of households always equals the count of occupied housing units.

Household Income: Includes the income of the householder and all other persons that are age 15 and older in the household, whether related to the householder or not. Because many households are only one person, median household income is usually less than median family income.

Housing Unit: Includes a house, an apartment, a mobile home, a group of rooms, or a single room that is occupied as separate living quarters.

Limited-Scope Review: A limited scope review is accomplished when examiners do not complete all applicable interagency examination procedures for an assessment area. Performance under applicable tests is often analyzed using only quantitative factors (for example, geographic distribution, borrower profile, total number and dollar amount of investments, and branch distribution).

Low-Income: Individual income that is less than 50 percent of the area median income, or a median family income that is less than 50 percent in the case of a geography.

Market Share: The number of loans originated and purchased by the institution as a percentage of the aggregate number of loans originated and purchased by all reporting lenders in the metropolitan area/assessment area.

Median Income: The median income divides the income distribution into two equal parts, one having incomes above the median and other having incomes below the median.

Metropolitan Division (MD): A county or group of counties within a CBSA that contain(s) an urbanized area with a population of at least 2.5 million. A MD is one or more main/secondary counties representing an employment center or centers, plus adjacent counties associated with the main/secondary county or counties through commuting ties.

Metropolitan Statistical Area (MSA): CBSA associated with at least one urbanized area having a population of at least 50,000. The MSA comprises the central county or counties or equivalent entities containing the core, plus adjacent outlying counties having a high degree of social and economic integration with the central county or counties as measured through commuting.

Micropolitan Statistical Area: CBSA associated with at least one urbanized area having a population of at least 10,000, but less than 50,000.

Middle-Income: Individual income that is at least 80 percent and less than 120 percent of the area median income, or a median family income that is at least 80 and less than 120 percent in the case of a geography.

Moderate-Income: Individual income that is at least 50 percent and less than 80 percent of the area median income, or a median family income that is at least 50 and less than 80 percent in the case of a geography.

Multi-family: Refers to a residential structure that contains five or more units.

Nonmetropolitan Area: All areas outside of metropolitan areas. The definition of nonmetropolitan area is not consistent with the definition of rural areas. Urban and rural classifications cut across the other hierarchies. For example, there is generally urban and rural territory within metropolitan and nonmetropolitan areas.

Owner-Occupied Units: Includes units occupied by the owner or co-owner, even if the unit has not been fully paid for or is mortgaged.

Rated Area: A rated area is a state or multistate metropolitan area. For an institution with domestic branches in only one state, the institution's CRA rating would be the state rating. If an institution maintains domestic branches in more than one state, the institution will receive a rating for each state in which those branches are located. If an institution maintains domestic branches in two or more states within a multistate metropolitan area, the institution will receive a rating for the multistate metropolitan area.

Rural Area: Territories, populations, and housing units that are not classified as urban.

Small Business Loan: A loan included in “loans to small businesses” as defined in the Consolidated Report of Condition and Income (Call Report). These loans have original amounts of \$1 million or less and are either secured by nonfarm nonresidential properties or are classified as commercial and industrial loans.

Small Farm Loan: A loan included in “loans to small farms” as defined in the instructions for preparation of the Consolidated Report of Condition and Income (Call Report). These loans have original amounts of \$500,000 or less and are either secured by farmland, including farm residential and other improvements, or are classified as loans to finance agricultural production and other loans to farmers.

Upper-Income: Individual income that is 120 percent or more of the area median income, or a median family income that is 120 percent or more in the case of a geography.

Urban Area: All territories, populations, and housing units in urbanized areas and in places of 2,500 or more persons outside urbanized areas. More specifically, “urban” consists of territory, persons, and housing units in places of 2,500 or more persons incorporated as cities, villages, boroughs (except in Alaska and New York), and towns (except in the New England states, New York, and Wisconsin).

“Urban” excludes the rural portions of “extended cities”; census designated place of 2,500 or more persons; and other territory, incorporated or unincorporated, including in urbanized areas.