

PUBLIC DISCLOSURE

May 4, 2020

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

Farmers and Merchants State Bank of Appleton
Certificate Number: 8845

239 North Miles Street
Appleton, Minnesota 56208

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 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.

- 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 loans within its assessment area.
- The geographic distribution of small farm loans reflects excellent dispersion throughout the assessment area.
- The distribution of borrowers reflects reasonable penetration among farms of different sizes.
- The institution has not received any Community Reinvestment Act (CRA)-related complaints since the previous evaluation; therefore, this criterion did not affect the rating.

DESCRIPTION OF INSTITUTION

Farmers and Merchants State Bank of Appleton is wholly owned by MPS Investment Company, a one-bank holding company located in Appleton, Minnesota. The institution does not have any affiliates or subsidiaries that offer credit products or services. Farmers and Merchants State Bank of Appleton received a Satisfactory rating at its previous FDIC Performance Evaluation, dated May 27, 2014, based on Interagency Small Institution Examination Procedures.

Farmers and Merchants State Bank of Appleton operates from its sole office in Appleton. The bank did not open or close any branches, and no merger or acquisition activities occurred since the previous evaluation. The bank offers a variety of loan products, including agricultural, commercial, home mortgage, and consumer loans. Per bank management, the bank's primary lending focus continues to be agricultural lending. In addition to conventional lending, Farmers and Merchants State Bank of Appleton participates in loan programs through the Farm Service Agency, Small Business Administration, and Minnesota Department of Agriculture. The institution also provides a variety of traditional deposit services, including checking, savings, and certificates of deposit accounts. Finally, alternative banking services include internet banking, mobile banking, and electronic statements.

As of December 31, 2019, Farmers and Merchants State Bank of Appleton reported total assets of \$45,826,000, total loans of \$35,306,000, and total deposits of \$39,094,000; the following table illustrates the loan portfolio. Finally, examiners did not identify any financial, legal, or other impediments that affect the bank's ability to meet assessment area credit needs.

Loan Portfolio Distribution as of 12/31/2019		
Loan Category	\$(000s)	%
Construction, Land Development, and Other Land Loans	0	0.0
Secured by Farmland	14,114	40.0
Secured by 1-4 Family Residential Properties	1,465	4.1
Secured by Multifamily (5 or more) Residential Properties	0	0.0
Secured by Nonfarm Nonresidential Properties	619	1.8
Total Real Estate Loans	16,198	45.9
Commercial and Industrial Loans	2,450	6.9
Agricultural Production and Other Loans to Farmers	15,455	43.8
Consumer Loans	1,047	3.0
Obligations of State and Political Subdivisions in the U.S.	0	0.0
Other Loans	156	0.4
Lease Financing Receivable (net of unearned income)	0	0.0
Less: Unearned Income	0	0.0
Total Loans	35,306	100.0
<i>Source: Reports of Condition and Income</i>		

DESCRIPTION OF ASSESSMENT AREA

The bank has designated a single assessment area in nonmetropolitan Minnesota. The assessment area is comprised of one census tract in eastern Big Stone County, one census tract in northern Chippewa County, two census tracts in western Lac qui Parle County, and two census tracts in western Swift County. The assessment area has not changed since the previous evaluation. According to 2015 American Community Survey (ACS) data, the assessment area is comprised of one moderate-income census tract, 4 middle-income census tracts, and one upper-income census tract.

Economic and Demographic Data

The assessment area is rural and primarily dependent on agriculture and related industries. Management stated that the local economy was doing fine until 2019, but it has since weakened due to the depressed agricultural sector as a result of low commodity prices and yields. The following table illustrates select demographic characteristics of the assessment area.

Demographic Information of the Assessment Area						
Demographic Characteristics	#	Low	Moderate	Middle	Upper	NA*
Geographies (Census Tracts)	6	0.0	16.7	66.7	16.7	0.0
Population by Geography	11,698	0.0	19.6	66.4	14.1	0.0
Housing Units by Geography	5,948	0.0	21.1	66.4	12.6	0.0
Owner-Occupied Units by Geography	3,995	0.0	17.9	67.2	14.9	0.0
Occupied Rental Units by Geography	1,007	0.0	33.6	58.4	8.0	0.0
Vacant Units by Geography	946	0.0	21.0	71.5	7.5	0.0
Businesses by Geography	873	0.0	21.4	65.2	13.4	0.0
Farms by Geography	444	0.0	13.5	73.2	13.3	0.0
Family Distribution by Income Level	3,376	19.0	17.7	23.9	39.3	0.0
Household Distribution by Income Level	5,002	22.7	16.1	18.8	42.3	0.0
Median Family Income Non-MSAs - MN		\$63,045	Median Housing Value			\$93,680
			Median Gross Rent			\$614
			Families Below Poverty Level			6.4%
<small>Source: 2015 ACS Census and 2019 D&B Data; Due to rounding, totals may not equal 100.0 (*) The NA category consists of geographies that have not been assigned an income classification.</small>						

Competition

Farmers and Merchants State Bank of Appleton operates in a relatively competitive banking market, especially given the rural nature of the assessment area. Based on 2019 FDIC Deposit Market Share data, six financial institutions operate eight offices within the assessment area. Of these institutions, Farmers and Merchants State Bank of Appleton ranked third with 16.3 percent of the deposit market.

Community Contacts

As part of the evaluation process, examiners contact third parties active in the assessment area to assist in identifying credit needs. This information helps to determine what credit opportunities are available and whether local financial institutions are responsive to those needs.

Examiners reviewed two community contact interviews previously conducted with representatives of agriculture-related organizations within the assessment area. According to the contacts, the area is heavily dependent on the agricultural industry, which has been affected by low commodity prices. One contact noted that the average age of farmers continues to increase as young people move away to further their education and do not return for various reasons, such as limited employment opportunities. Both contacts stated that agricultural-related fields are the major source of employment and that agricultural loans are the primary credit need of the area. Finally, the contacts stated that financial institutions are meeting the credit needs of the area.

Credit Needs

Considering information from the community contacts, bank management, and demographic and economic data, examiners determined that agricultural lending represents the primary credit need in the assessment area.

SCOPE OF EVALUATION

General Information

This evaluation covers the period from the prior evaluation dated May 27, 2014, to the current evaluation dated May 4, 2020. Examiners used the Interagency Small Institution Examination Procedures to evaluate Farmers and Merchants State Bank of Appleton's CRA performance.

Activities Reviewed

Bank records indicated that the lending focus and product mix remained consistent throughout the evaluation period. As noted earlier, the bank's primary lending focus is agricultural lending. Therefore, examiners analyzed all small farm loans originated, extended, or purchased in 2019 for the Assessment Area Concentration and Geographic Distribution analyses. During this timeframe, Farmers and Merchants State Bank of Appleton originated, extended, or purchased 289 small farm loans totaling \$22,113,000. For the Borrower Profile analysis, examiners sampled 55 small farm loans totaling \$4,604,000 that were originated, extended, or purchased in 2019 within the assessment area. The sample selected was considered representative of the bank's performance during the entire evaluation period, and 2019 D&B data provided a standard of comparison for the small farm loans. While both the number and dollar volume of loans are presented, examiners emphasized performance by number of loans because the number of loans is a better indicator of the number of farms served. Finally, examiners did not review small business or home mortgage loans as neither are a lending focus of the bank and they comprise only 8.7 percent and 4.1 percent of the overall loan portfolio, respectively.

CONCLUSIONS ON PERFORMANCE CRITERIA

LENDING TEST

Farmers and Merchants State Bank of Appleton demonstrated satisfactory performance under the Lending Test. The reasonable Loan-to-Deposit Ratio and Borrower Profile performance received the most weight when arriving at this overall conclusion.

Loan-to-Deposit Ratio

The loan-to-deposit ratio is reasonable given the institution's size, financial condition, and assessment area credit needs. As shown in the following table, Farmers and Merchants State Bank of Appleton's net loan-to-deposit ratio averaged 78.4 percent over the past 23 calendar quarters, which is similar to comparable institutions. Examiners selected comparable institutions based on their asset size, branching structure, geographic location, and lending focus.

Loan-to-Deposit (LTD) Ratio Comparison		
Bank	Total Assets as of 12/31/2019 (\$000s)	Average Net LTD Ratio (%)
Farmers and Merchants State Bank of Appleton, Appleton, Minnesota	45,826	78.4
Prairie Sun Bank, Milan, Minnesota	50,272	73.1
State Bank of Bellingham, Bellingham, Minnesota	47,823	121.1
State Bank of Danvers, Benson, Minnesota	50,395	51.2

Source: Reports of Condition and Income 6/30/2014 – 12/31/2019

Assessment Area Concentration

As detailed in the table below, the bank made a substantial majority of its small farm loans within the assessment area.

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	266	92.0	23	8.0	289	20,496	92.7	1,617	7.3	22,113

Source: Evaluation Period: 1/1/2019 - 12/31/2019 Bank Data

Geographic Distribution

As depicted in the table below, the geographic distribution of small farm loans reflects excellent dispersion throughout the assessment area when compared to D&B data. Examiners focused on the percentage of small farm loans in the moderate-income census tract.

Geographic Distribution of Small Farm Loans					
Tract Income Level	% of Farms	#	%	\$(000s)	%
Moderate	13.5	170	63.9	12,849	62.7
Middle	73.2	83	31.2	6,305	30.8
Upper	13.3	13	4.9	1,342	6.5
Totals	100.0	266	100.0	20,496	100.0

Source: 2019 D&B Data; 1/1/2019 - 12/31/2019 Bank Data

Borrower Profile

The distribution of borrowers reflects reasonable penetration among farms of different revenue sizes. Examiners focused on the percentage of small farm loans to farms with gross annual revenues of \$1 million or less. All of the 55 sampled small farm loans were extended to operations with gross annual revenues of \$1 million or less. This performance is in line with demographic data, which indicates that 99.3 percent of farms in the assessment area have revenues in this income category.

Response to Complaints

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

DISCRIMINATORY OR OTHER ILLEGAL CREDIT PRACTICES REVIEW

No evidence of discriminatory or other illegal credit practices inconsistent with helping meet community credit needs was identified.

APPENDICES

SMALL BANK PERFORMANCE CRITERIA

Lending Test

The Lending Test evaluates the bank's record of helping to meet the credit needs of its assessment area(s) by considering the following criteria:

- 1) The bank's loan-to-deposit ratio, adjusted for seasonal variation, and, as appropriate, other lending-related activities, such as loan originations for sale to the secondary markets, community development loans, or qualified investments;
- 2) The percentage of loans, and as appropriate, other lending-related activities located in the bank's assessment area(s);
- 3) The bank's record of lending to and, as appropriate, engaging in other lending-related activities for borrowers of different income levels and businesses and farms of different sizes;
- 4) The geographic distribution of the bank's loans; and
- 5) The bank's record of taking action, if warranted, in response to written complaints about its performance in helping to meet credit needs in its assessment area(s).

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).

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 (e.g., geographic distribution, borrower profile, and total number and dollar amount of investments), and qualitative factors (e.g., 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 Loans: Includes closed-end mortgage loans or open-end line of credits as defined in the HMDA regulation that are not an excluded transaction per the HMDA regulation.

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 (e.g., 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.

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 (also known as **non-MSA**): 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.