

PUBLIC DISCLOSURE

August 3, 2020

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

Security State Bank of Warroad
Certificate Number: 9773

502 Lake Street NE
Warroad, Minnesota 56763

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 majority of its small business and small farm loans within its assessment area.
- The assessment area does not contain any low- or moderate-income census tracts. Therefore, examiners did not evaluate the geographic distribution of loans.
- The distribution of borrowers reflects excellent penetration among businesses and 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

Security State Bank of Warroad is a community-based financial institution operating from its main office and a limited-service facility in Warroad, Minnesota. Warroad Bancshares, Inc. a one-bank holding company owns the institution. It does not have any affiliates or subsidiaries that offer credit products or services, has not opened or closed any branches, and has not had any merger or acquisition activities since the previous evaluation. Security State Bank of Warroad received a Satisfactory rating at its previous FDIC Performance Evaluation, dated July 28, 2014, based on Interagency Small Institution Examination Procedures.

The bank offers a variety of loan products, including commercial, consumer, agricultural, and home mortgage loans. According to bank management, the institution's primary lending focus continues to be commercial lending. In addition to conventional lending, the institution participates in loan programs through the Small Business Administration and Farm Service Agency. In addition to the loan products that help meet the credit needs in the area, the bank provides a variety of traditional deposit services as well. These products include, but are not limited to, checking, savings, certificates of deposit, and health savings accounts. Finally, alternative banking services include internet, telephone, and mobile banking, along with electronic statements.

As of March 31, 2020, Security State Bank of Warroad reported total assets of \$105,387,000, net loans of \$49,570,000, and total deposits of \$87,631,000. The following table illustrates the loan portfolio distribution.

Loan Portfolio Distribution as of March 31, 2020		
Loan Category	\$(000s)	%
Construction, Land Development, and Other Land Loans	0	0.0
Secured by Farmland	5,500	10.6
Secured by 1-4 Family Residential Properties	2,653	5.1
Secured by Multifamily (5 or more) Residential Properties	0	0.0
Secured by Nonfarm Nonresidential Properties	9,850	19.1
Total Real Estate Loans	18,003	34.8
Commercial and Industrial Loans	15,966	30.9
Agricultural Production and Other Loans to Farmers	4,811	9.3
Consumer Loans	12,836	24.9
Obligations of State and Political Subdivisions in the U.S.	0	0.0
Other Loans	33	0.1
Lease Financing Receivable (net of unearned income)	0	0.0
Less: Unearned Income	0	0.0
Total Loans	51,649	100.0
<i>Source: Reports of Condition and Income</i>		

Aside from statutory lending limits, examiners did not identify any financial, legal, or other impediments affecting the bank's ability to meet the assessment area's credit needs.

DESCRIPTION OF ASSESSMENT AREA

The CRA requires each financial institution to define one or more assessment areas within which its CRA performance is evaluated. The bank has designated a single assessment area that includes the eastern half of Roseau County and the western part of Lake of the Woods County in the north central portion of Minnesota. The bank’s main office and limited-service facility are both located in census tract 9701 in Roseau County.

Economic and Demographic Data

The delineation of the assessment area has not changed since the previous evaluation; however, the demographics within it have changed. At the last evaluation, the assessment area contained two moderate- and one middle-income census tracts whereas all of the census tracts are now designated middle income based on data from the 2015 American Community Survey (ACS). The following table provides additional demographic information on the assessment area.

Demographic Information of the Assessment Area						
Demographic Characteristics	#	Low % of #	Moderate % of #	Middle % of #	Upper % of #	NA* % of #
Geographies (Census Tracts)	3	0.0	0.0	100.0	0.0	0.0
Population by Geography	10,059	0.0	0.0	100.0	0.0	0.0
Housing Units by Geography	6,518	0.0	0.0	100.0	0.0	0.0
Owner-Occupied Units by Geography	3,364	0.0	0.0	100.0	0.0	0.0
Occupied Rental Units by Geography	719	0.0	0.0	100.0	0.0	0.0
Vacant Units by Geography	2,435	0.0	0.0	100.0	0.0	0.0
Businesses by Geography	644	0.0	0.0	100.0	0.0	0.0
Farms by Geography	107	0.0	0.0	100.0	0.0	0.0
Family Distribution by Income Level	2,821	18.2	20.7	21.8	39.3	0.0
Household Distribution by Income Level	4,083	20.8	18.5	19.6	41.1	0.0
Median Family Income Nonmetropolitan Minnesota	\$63,045		Median Housing Value			\$114,811
			Median Gross Rent			\$650
			Families Below Poverty Level			6.9%
<small>Source: 2015 ACS 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

Security State Bank of Warroad operates in a relatively competitive banking market. Based on June 30, 2019 FDIC Deposit Market Share data (the most recently available), five financial institutions operate nine offices within the assessment area. Of these institutions, Security State Bank of Warroad ranked third with 13.9 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 previously conducted community contact interviews in conjunction with this evaluation. It should be noted that these contacts were both conducted before the Covid-19 pandemic began.

According to one of the contacts, the area's overall economy is doing well. The individual added that there was an upswing in small businesses throughout Roseau County and stated that all businesses were hiring at the time of the interview. The one contact stated that primary credit needs in the area include agricultural, commercial, home mortgage and consumer loans and added that there is a fair amount of competition between the institutions. 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 commercial lending represents the primary credit need in the assessment area, followed by agricultural lending.

SCOPE OF EVALUATION

General Information

This evaluation covers the period from the prior evaluation dated July 28, 2014, to the current evaluation dated August 3, 2020. Examiners used the Interagency Small Institution Examination Procedures to evaluate Security State Bank of Warroad's CRA performance.

Activities Reviewed

Based on the bank's business strategy and assessment area credit needs, examiners determined that commercial lending remains the primary focus of the institution, followed by agricultural lending. Bank records indicated that the lending focus and product mix remained consistent throughout the evaluation period. Therefore, examiners analyzed the entire universe of small business and small farm loans originated, renewed, extended, or purchased in 2019 (the most recent calendar year) for the Assessment Area Concentration criterion. During this timeframe, the bank originated, renewed, extended, or purchased 139 small business loans totaling approximately \$10.1 million and 45 small farm loans totaling approximately \$2.4 million. Examiners did not consider loans that were originated and subsequently paid off during this timeframe as this information was not readily available. For the Borrower Profile criterion analysis, examiners reviewed a sample of 41 small business loans totaling \$2.8 million and all small farm loans originated, renewed, extended, or purchased within the assessment area during 2019. Examiners did not consider home mortgage loans since they are not a lending focus of the institution.

The bank's small business loan performance contributed greater weight to overall conclusions as commercial lending is the bank's primary lending focus. The bank's small business and small farm lending performance was compared to 2019 D&B demographic data. 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 businesses and farms served.

CONCLUSIONS ON PERFORMANCE CRITERIA

LENDING TEST

Security State Bank of Warroad demonstrated satisfactory performance under the Lending Test. Reasonable performance for Loan-to-Deposit Ratio and Assessment Area Concentration and excellent performance for Borrower Profile support this 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 reflected in the following table, Security State Bank of Warroad’s net loan-to-deposit ratio averaged 58.0 percent over the past 23 calendar quarters, which is generally in line with 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 3/31/2020 (\$000s)	Average Net LTD Ratio (%)
The First National Bank of Bagley, Bagley, Minnesota	86,296	70.8
Citizens State Bank of Roseau, Roseau, Minnesota	224,027	59.8
Security State Bank of Warroad, Warroad, Minnesota	105,387	58.0
<i>Source: Reports of Condition and Income 9/30/2014 – 3/31/2020. Alphabetical by city.</i>		

Assessment Area Concentration

As detailed in the table below, the bank originated a majority of its small business and small farm loans in its 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 Business	95	68.3	44	31.7	139	6,152	60.9	3,943	39.1	10,095
Small Farm	33	73.3	12	26.7	45	1,487	61.2	943	38.8	2,430
<i>Source: 2019 Bank Data. Due to rounding, totals may not equal 100.0.</i>										

Geographic Distribution

The assessment area does not include any low- or moderate-income census tracts, and a review of the Geographic Distribution criterion would not result in meaningful conclusions. Therefore, examiners did not evaluate this criterion.

Borrower Profile

The distribution of borrowers reflects excellent penetration among businesses and farms of different sizes. Examiners focused on the bank’s performance, by number of loans, to businesses and farms with gross annual revenues of \$1 million or less.

Small Business Loans

The distribution of borrowers reflects excellent penetration among businesses of different sizes. As reflected in the following table, the bank’s performance exceeds demographic data.

Distribution of Small Business Loans by Gross Annual Revenue Category					
Gross Revenue Level	% of Businesses	#	%	\$(000s)	%
<=\$1,000,000	87.4	40	97.6	2,511	90.9
>1,000,000	3.9	1	2.4	250	9.1
Revenue Not Available	8.7	0	0.0	0	0.0
Total	100.0	41	100.0	2,761	100.0
<i>Source: 2019 D&B Data, Bank Data. Due to rounding, totals may not equal 100.0.</i>					

Small Farm Loans

The distribution of borrowers reflects excellent penetration among farms of different revenue sizes. The bank originated all of the 33 small farm loans reviewed to operations with gross annual revenues of \$1 million or less. This performance is in line with demographic data, which indicates that 98.1 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

Examiners did not identify any evidence of discriminatory or other illegal credit practices inconsistent with helping meet community credit needs.

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.