

# **PUBLIC DISCLOSURE**

February 3, 2020

## **COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION**

Farmers State Bank of Underwood  
Certificate Number: 10174

110 Main Street  
Underwood, Minnesota 56586

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 following points summarize the bank's Community Reinvestment Act (CRA) performance:

- The loan-to-deposit ratio is reasonable given the institution's size, financial condition, and assessment area credit needs.
- The institution made a majority of its small business, small farm, and home mortgage loans in its assessment area.
- The assessment area does not include any low- or moderate-income geographies, and a review of the Geographic Distribution criterion would not result in meaningful conclusions. Therefore, this criterion was not evaluated.
- The distribution of borrowers reflects reasonable penetration among businesses and farms of different sizes and individuals of different income levels.
- The institution has not received any CRA-related complaints since the previous evaluation; therefore, this criterion did not affect the rating.

## DESCRIPTION OF INSTITUTION

Farmers State Bank of Underwood continues to operate from its main office in Underwood, Minnesota, and maintains branches in Dalton and Rothsay, Minnesota. The institution is controlled by Underwood Bancshares, Inc., a one-bank holding company located in Underwood, Minnesota. Farmers State Bank of Underwood received a Satisfactory rating at its previous FDIC Performance Evaluation, dated February 24, 2014, based on Interagency Small Institution Examination Procedures.

The bank's business focus is divided between commercial, agricultural, home mortgage, and consumer lending. Farmers State Bank of Underwood offers additional credit avenues via its participation in government sponsored loan programs through the Farm Service Agency. The bank also maintains several referral arrangements for assisting customers in obtaining home mortgage loans on the secondary market. Farmers State Bank of Underwood also offers basic deposit services including checking and savings accounts and certificates of deposit. Alternative banking services include telebanking, internet and mobile banking, mobile check deposit, and electronic bill pay.

Assets totaled approximately \$73,006,000 as of December 31, 2019, and included total loans of \$53,872,000. Total deposits were \$63,773,000. Examiners did not identify any financial, legal, or other impediments that affect the bank's ability to meet the assessment area's credit needs. The loan portfolio is illustrated in the following table.

<b>Loan Portfolio Distribution as of December 31, 2019</b>		
<b>Loan Category</b>	<b>\$(000s)</b>	<b>%</b>
Construction and Land Development	3,952	7.3
Secured by Farmland	6,636	12.3
Secured by 1-4 Family Residential Properties	12,630	23.4
Secured by Multifamily (5 or more) Residential Properties	343	0.6
Secured by Nonfarm Nonresidential Properties	6,710	12.5
<b>Total Real Estate Loans</b>	<b>30,271</b>	<b>56.2</b>
Agricultural Loans	9,684	18.0
Commercial and Industrial Loans	10,747	20.0
Consumer Loans	3,124	5.8
Other Loans	46	0.1
Less: Unearned Income	0	0.0
<b>Total Loans</b>	<b>53,872</b>	<b>100.0</b>
<i>Source: Reports of Condition and Income</i>		

## **DESCRIPTION OF ASSESSMENT AREA**

Farmers State Bank of Underwood has designated one assessment area in west central Minnesota, which is comprised of Census Tract 4501 in Douglas County; Census Tract 701 in Grant County; Census Tracts 9603, 9607, 9608, 9609, 9610, 9611, 9612, 9616, 9617 in Otter Tail County; and Census Tract 9501 in Wilkin County.

### **Economic and Demographic Data**

The assessment area is rural in nature and primarily dependent on agriculture and related industries. Bank management stated that the farm economy has remained stable since the previous evaluation. The primary crops grown in the assessment are include soybeans, corn, wheat, alfalfa, and edible beans. Crop yields were average in 2019; however, commodity prices were lower. Agricultural land values and rental rates have remained stable and are relatively strong. Management also stated that off-farm income plays an important role in many farming operations.

Demographic information shows that the population remains similar to prior evaluation data. Large employers in the area include Otter Tail Corporation, county government, and healthcare- and agriculture-related businesses. Main street businesses are primarily unchanged. There is minimal new business growth in the small towns where the bank operates due to a lack of demand.

For December 2019, the U. S. Bureau of Labor and Statistics reported unemployment rates (not seasonally adjusted) for Douglas, Grant, Otter Tail, and Wilkin counties of 3.9 percent, 5.4

percent, 5.4 percent, and 3.5 percent, respectively. Comparably, the December 2019 unemployment rate for the State of Minnesota was 3.5 percent and the national average rate was 3.4 percent. Unemployment rates were generally consistent throughout the evaluation period.

Demographic characteristics of the assessment area and the 2019 median family income ranges for nonmetropolitan Minnesota are illustrated in the tables below.

<b>Demographic Information of the Assessment Area</b>					
<b>Demographic Characteristics</b>	<b>#</b>	<b>Low % of #</b>	<b>Moderate % of #</b>	<b>Middle % of #</b>	<b>Upper % of #</b>
Geographies (Census Tracts)	12	0.0	0.0	83.3	16.7
Population by Geography	41,094	0.0	0.0	84.5	15.5
Housing Units by Geography	22,904	0.0	0.0	85.0	15.0
Owner-Occupied Units by Geography	13,268	0.0	0.0	82.9	17.1
Occupied Rental Units by Geography	3,910	0.0	0.0	94.8	5.2
Vacant Units by Geography	5,726	0.0	0.0	83.3	16.7
Businesses by Geography	3,514	0.0	0.0	87.8	12.2
Farms by Geography	503	0.0	0.0	81.9	18.1
Family Distribution by Income Level	11,678	16.7	17.7	22.8	42.8
Household Distribution by Income Level	17,178	22.4	15.7	17.8	44.1
Median Family Income – Nonmetropolitan Minnesota		\$63,045	Median Housing Value		\$156,593
Families Below Poverty Level		6.1%	Median Gross Rent		\$626

*Source: 2015 ACS Data and 2019 D&B Data*

<b>Median Family Income Ranges Nonmetropolitan Minnesota</b>				
<b>Median Family Incomes</b>	<b>Low &lt;50%</b>	<b>Moderate 50% to &lt;80%</b>	<b>Middle 80% to &lt;120%</b>	<b>Upper ≥120%</b>
2019 (\$68,800)	<\$34,400	\$34,400 to <\$55,040	\$55,040 to <\$82,560	≥\$82,560

*Source: FFIEC*

**Competition**

Farmers State Bank of Underwood operates in a moderately competitive market for financial services. According to Reports of Condition filed by financial institutions, 19 other banks with deposits ranging between \$10.1 million and \$136.2 million operate either a main office or a branch office within the assessment area. Of these institutions, Farmers State Bank of Underwood ranked 6<sup>th</sup> with a 6.2 percent deposit market share. AgCounty Farm Credit Services located in Fergus Falls, Minnesota is also a major competitor for agricultural loans.

## **Community Contacts**

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

Examiners reviewed two recent interviews conducted with representatives of community-based organizations within the assessment area. The contacts did not have concerns with area economic conditions. Both contacts indicated that retirees are not leaving the area, while people of all ages continue to purchase or build lake homes resulting in a shortage of affordable housing stock. The lack of affordable housing and childcare options are significant barriers to growing the work force. The contacts indicated that the population is diverse with affluent, working, and middle class individuals, as well as those that would be classified as living in poverty and even homeless. The credit needs in the area vary. There is a need for down payment assistance for home mortgages. Funding is needed for seasonal properties, as well as home mortgages in general. People also finance land for recreational purposes, such as hunting cabins. Individuals living near the lakes purchase many items used for recreation. Therefore, in addition to cars and pickups, financing is requested for boats, ice houses, snowmobiles, jet skis, all-terrain vehicles, and similar items. There is also a need for small business lending; however, in general, local main street businesses do very well, some staying within families for generations. Big box stores are closing in many parts of the nation. Locally, this has affected several big box stores; however, jobs for affected individuals are available as many other businesses are looking for both skilled and unskilled laborers. Tourism dollars that come in during the summer help support the economy of the area. In addition to tourism-related businesses, manufacturing, agriculture, and healthcare also contribute to the local economy.

The contacts stated that the area's financial institutions have good reputations. Neither contact has heard of any concerns with regard to lending and stated that local financial institutions are meeting the area's credit needs.

## **Credit Needs**

Both the community contacts and bank management agree that commercial, agricultural, home mortgage, and consumer financing are needed within the assessment area.

## SCOPE OF EVALUATION

### **General Information**

Examiners used Interagency Small Institution Examination Procedures to evaluate Farmers State Bank of Underwood's CRA performance. This evaluation covers the period from the prior CRA evaluation dated February 24, 2014, to the current evaluation dated February 3, 2020. These procedures evaluate an institution's performance according to the Lending Test criteria as detailed in the appendices.

### **Activities Reviewed**

Farmers State Bank of Underwood has a varied lending focus. This conclusion is based on discussions with bank management; information obtained from community contacts; a review of the loan categories reported in the December 31, 2019 Reports of Condition; and the number and dollar volume of loans originated, renewed, and extended during the evaluation period. The Reports of Condition revealed that commercial and agricultural lending continue to comprise the largest portions of the portfolio. The bank also originates a relatively significant amount of home mortgage loans; therefore, examiners reviewed all three primary products during the evaluation. Bank records indicated that the lending focus and product mix generally remained consistent throughout the evaluation period. Given this information, examiners selected 2019, the most recent calendar year, as the review period. This timeframe was considered representative of the bank's performance during the entire evaluation period.

For the Assessment Area Concentration analysis, examiners reviewed all small business, small farm, and home mortgage loans that were originated, extended, or renewed in 2019. During this timeframe, Farmers State Bank of Underwood originated, extended, or renewed 140 small business loans totaling \$10,235,000, 167 small farm loans totaling \$11,360,000, and 34 home mortgage loans totaling \$4,046,000.

To evaluate the Borrower Profile criterion, examiners reviewed statistical random samples of small business and small farm loans that were originated within the bank's assessment area. This analysis included a review of 47 small business loans totaling \$4,574,000 and 51 small farm loans totaling \$3,301,000. Finally, all 26 home mortgage loans in the assessment area were reviewed, totaling \$2,787,000.

D&B data for 2019 provided a standard of comparison for the small business and small farm loans. D&B is a business that maintains a database of information on businesses and farms using a variety of resources including public records, trade references, and surveys. D&B data is used as a general indicator of the local economy and includes information from only those entities that voluntarily report. American Community Survey (ACS) data from 2015 and FFIEC information from 2019 were used as a standard of comparison for home mortgage lending.

The bank's record of originating small business and small farm loans contributed more weight to overall conclusions due to the larger loan volumes when compared to home mortgage lending during the most recent calendar year. In addition, while both 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 and businesses served.

## CONCLUSIONS ON PERFORMANCE CRITERIA

### LENDING TEST

Farmers State Bank of Underwood demonstrated satisfactory performance under the Lending Test. Loan-to-Deposit Ratio, Assessment Area Concentration, and Borrower Profile performance 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. This ratio, calculated from Reports of Condition data, averaged 82.2 percent over the past 24 calendar quarters from March 31, 2014 to December 31, 2019. The ratio ranged from a high of 87.5 percent as of September 30, 2015, to a low of 76.7 percent as of December 31, 2016. Fluctuations during the review period are primarily due to the seasonal pattern of agricultural lending, which comprises approximately one third of the loan portfolio. The following table shows the institution's performance when compared with similar institutions, selected based on asset size, geographic location, and lending focus.

<b>Loan-to-Deposit Ratio Comparison</b>		
<b>Bank</b>	<b>Total Assets as of 12/31/2019 (\$000s)</b>	<b>Average Net Loan-to-Deposit Ratio (%)</b>
<b>Farmers State Bank of Underwood Underwood, Minnesota</b>	<b>73,006</b>	<b>82.2</b>
Farmers & Merchants State Bank of New York Mills, Incorporated New York Mills, Minnesota	62,490	56.6
Vergas State Bank Vergas, Minnesota	50,951	43.5
<i>Source: Reports of Condition and Income 3/31/2014 through 12/31/2019</i>		

#### Assessment Area Concentration

The following table shows that Farmers State Bank of Underwood originated a majority of its small business, small farm, and home mortgage loans within the assessment area.

<b>Lending Inside and Outside of the Assessment Area</b>										
<b>Loan Category</b>	<b>Number of Loans</b>				<b>Total #</b>	<b>Dollar Amount of Loans \$(000s)</b>				<b>Total \$(000s)</b>
	<b>Inside</b>		<b>Outside</b>			<b>Inside</b>		<b>Outside</b>		
	#	%	#	%		\$	%	\$	%	
Small Business	109	77.9	31	22.1	140	8,391	82.0	1,844	18.0	10,235
Small Farm	164	98.2	3	1.8	167	10,946	96.4	414	3.6	11,360
Home Mortgage	26	76.5	8	23.5	34	2,787	68.9	1,259	31.1	4,046
<i>Source: 1/1/2019 - 12/31/2019 Bank Data</i>										

### **Geographic Distribution**

The assessment area does not include any low- or moderate-income geographies, and a review of the Geographic Distribution criterion would not result in meaningful conclusions. Therefore, this criterion was not evaluated.

### **Borrower Profile**

The distribution of borrowers reflects reasonable penetration among businesses and farms of different sizes and individuals of different income levels. The bank's reasonable performance of small business, small farm, and home mortgage lending supports this conclusion. Examiners focused on the percentage by number of loans to businesses and farms with gross annual revenues of \$1 million or less. They also focused on the percentage by number of home mortgage loans to low- and moderate-income borrowers.

#### ***Small Business Loans***

The distribution of small business loans reflects reasonable penetration of loans to businesses with gross annual revenues of \$1 million or less. Examiners determined that 89.4 percent of the small business loans within the assessment area were made to businesses with gross annual revenues of \$1 million or less, which compares reasonably with the 82.9 percent of businesses in this revenue category reported by D&B.

#### ***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 institution originated 98.0 percent of small farm loans within the assessment area to farms with gross annual revenues of \$1 million or less. This number mirrors the 98.0 percent of farms in this revenue category reported by D&B.

#### ***Home Mortgage Loans***

The distribution of home mortgage loans to individuals of different income levels, including low- and moderate-income borrowers, is reasonable. The table below shows that Farmers State Bank of Underwood originated only one home mortgage loan to a low-income borrower in 2019. However, a low-income family in the assessment area, with an income of \$34,400 or less, would likely not qualify for a mortgage under conventional underwriting standards, especially considering the median housing value of \$156,593. Therefore, the demand and opportunity for lending to low-income families are relatively limited. The bank's performance of lending to moderate-income borrowers, at 15.4 percent, is generally in line with 2015 ACS data. In addition, as described earlier, there is a significant amount of competition in the area for home mortgage loans. As such, the bank's level of lending reflects reasonable performance.

<b>Distribution of Home Mortgage Loans by Borrower Income Level</b>					
<b>Borrower Income Level</b>	<b>% of Families</b>	<b>#</b>	<b>%</b>	<b>\$(000s)</b>	<b>%</b>
Low	16.7	1	3.8	104	3.7
Moderate	17.7	4	15.4	346	12.4
Middle	22.8	6	23.1	620	22.3
Upper	42.8	15	57.7	1,717	61.6
<b>Total</b>	<b>100.0</b>	<b>26</b>	<b>100.0</b>	<b>2,787</b>	<b>100.0</b>
<i>Source: 2015 ACS Data; 1/1/2019 - 12/31/2019 Bank Data</i>					

### **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.

**Multifamily:** 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.