

PUBLIC DISCLOSURE

December 7, 2020

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

Frost State Bank
Certificate Number: 26519

205 Main Street
Frost, Minnesota 56033

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.

Frost State Bank's satisfactory Community Reinvestment Act (CRA) performance under the applicable performance criteria supports the overall rating. The following points summarize the bank's performance.

- The loan-to-deposit ratio is more than reasonable given the institution's size, financial condition, and assessment area credit needs.
- A majority of the small farm and small business loans reviewed were located inside the assessment area.
- The assessment area does not include any low- or moderate-income geographies, and a review of Geographic Distribution criterion would not result in a meaningful conclusion. Therefore, this criterion was not evaluated.
- The distribution by borrowers reflects reasonable penetration among farms and businesses of different revenue sizes.
- The institution did not receive any CRA-related complaints since the previous evaluation; therefore, this factor did not affect the rating.

DESCRIPTION OF INSTITUTION

Frost State Bank received a “Satisfactory” rating at its January 20, 2015, FDIC Performance Evaluation based on Interagency Small Institution Examination Procedures. The bank’s sole office is headquartered in Frost, Minnesota, and is wholly owned by President Mark Hooper.

The bank offers various loan products including agriculture, commercial, and consumer loans. Agriculture loans continue to represent the bank’s primary business line followed by commercial lending. The bank also offers Paycheck Protection Program loans offered through a temporary loan program administered by the Small Business Administration. In addition, Frost State Bank provides a variety of deposit account services including checking, savings, and certificates of deposit. The bank also offers Internet banking and electronic bank statements.

As of September 30, 2020, assets totaled approximately \$51.9 million, loans totaled approximately \$40.8 million, and deposits totaled approximately \$44.7 million. The loan portfolio is illustrated in the following table.

| Loan Portfolio Distribution as of 9/30/2020 | | |
|---|-----------------|--------------|
| Loan Category | \$(000s) | % |
| Construction, Land Development, and Other Land Loans | 0 | 0.0 |
| Secured by Farmland | 9,844 | 24.1 |
| Secured by 1-4 Family Residential Properties | 661 | 1.6 |
| Secured by Multifamily (5 or more) Residential Properties | 0 | 0.0 |
| Secured by Nonfarm Nonresidential Properties | 1,757 | 4.3 |
| Total Real Estate Loans | 12,262 | 30.1 |
| Commercial and Industrial Loans | 6,249 | 15.3 |
| Agricultural Production and Other Loans to Farmers | 20,493 | 50.2 |
| Consumer Loans | 1,684 | 4.1 |
| Other Loans | 109 | 0.3 |
| Total Loans | 40,797 | 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 its 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 will be evaluated. Frost State Bank maintains a single assessment area that includes all of Faribault County, which is located in the southern portion of the nonmetropolitan area of Minnesota. The assessment area is unchanged from the prior evaluation.

Economic and Demographic Data

According to 2015 American Community Survey (ACS) data, the assessment area is comprised of six middle-income census tracts. The assessment area does not contain any low-, moderate-, or upper-income census tracts. The following table illustrates select demographic characteristics of the assessment area.

| Demographic Information of the Assessment Area | | | | | | |
|--|----------|-----------------------|------------------------------|--------------------------|-------------------------|-----------------------|
| Demographic Characteristics | # | Low % of # | Moderate % of # | Middle % of # | Upper % of # | NA* % of # |
| Geographies (Census Tracts) | 6 | 0.0 | 0.0 | 100.0 | 0.0 | 0.0 |
| Population by Geography | 14,230 | 0.0 | 0.0 | 100.0 | 0.0 | 0.0 |
| Housing Units by Geography | 7,055 | 0.0 | 0.0 | 100.0 | 0.0 | 0.0 |
| Owner-Occupied Units by Geography | 4,897 | 0.0 | 0.0 | 100.0 | 0.0 | 0.0 |
| Occupied Rental Units by Geography | 1,477 | 0.0 | 0.0 | 100.0 | 0.0 | 0.0 |
| Vacant Units by Geography | 681 | 0.0 | 0.0 | 100.0 | 0.0 | 0.0 |
| Businesses by Geography | 1,186 | 0.0 | 0.0 | 100.0 | 0.0 | 0.0 |
| Farms by Geography | 308 | 0.0 | 0.0 | 100.0 | 0.0 | 0.0 |
| Family Distribution by Income Level | 4,164 | 21.5 | 20.3 | 23.2 | 35.1 | 0.0 |
| Household Distribution by Income Level | 6,374 | 25.3 | 17.6 | 19.2 | 37.9 | 0.0 |
| Median Family Income Non-MSAs - MN | | \$63,045 | Median Housing Value | | | \$84,731 |
| | | | Median Gross Rent | | | \$543 |
| | | | Families Below Poverty Level | | | 9.4% |
| <i>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.</i> | | | | | | |

D&B data for 2019 indicates that service industries represent the largest portion of businesses in the assessment area at 31.1 percent; followed by agriculture, forestry & fishing (20.6 percent); retail trade (10.0 percent), and construction (7.8 percent). In addition, 74.3 percent of area businesses have 4 or fewer employees, and 87.8 percent operate from a single location.

Competition

Frost State Bank operates in a competitive banking environment. According to FDIC Deposit Market Share data as of June 30, 2019, there were 9 financial institutions operating 11 locations within the assessment area. These institutions range from small community banks to larger national

financial institutions. Frost State Bank ranks 4th and holds approximately 8.9 percent of the deposit market share.

Frost State Bank is not required to collect or report small business CRA loan data and has elected not to do so. Therefore, examiners did not compare the bank's small business lending performance to aggregate CRA data within this evaluation. However, the aggregate CRA data provides an indication of the level of demand for small business loans and the level of competition within the assessment area. According to 2018 aggregate CRA data (most recent available), 23 CRA data reporters collectively reported 258 small business loans originated within the assessment area. These figures do not include the number of loans originated by smaller institutions that are not required to report small business lending data but operate within assessment area. The overall volume of small business lending in the assessment area reflects a competitive market.

Community Contact(s)

As part of the evaluation process, examiners contact third parties active in the assessment area to assist in identifying the credit and community development needs. This information helps determine whether financial institutions are responsive to these needs. It also helps reveal what credit and community development opportunities are available. For this evaluation, examiners reviewed a previously conducted interview with an economic development agency representative familiar with the assessment area. The contact stated that while banks are lending and are less stringent on loan qualifications for small business loans, there is not a specific need for small business lending. The contact also stated that farmers are affected by the high cost for broadband in rural areas, which is required for operating farming equipment. Finally, the contact noted that dairy farmers are struggling with low prices and profits.

Credit Needs

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

SCOPE OF EVALUATION

General Information

This evaluation covers the period from the previous evaluation dated January 20, 2015, to the current evaluation dated December 7, 2020. Examiners used Interagency Small Institution Examination Procedures to evaluate Frost State Bank's CRA performance. These procedures focus on the bank's performance under the Lending Test as outlined in the Small Bank Performance Criteria appendix.

Activities Reviewed

Examiners determined that the bank's major product lines are agricultural loans, followed by commercial loans. This conclusion considered discussions with management regarding the bank's business strategy, review of bank records of the number and dollar volume of loans originated during the evaluation period, and a review of the Consolidated Reports of Condition and Income (Reports of Condition). Lending activity throughout the evaluation period indicates a strong emphasis on agricultural lending by both number and dollar volume, followed to a lesser extent by

commercial lending. Therefore, when arriving at overall conclusions, examiners weighted agricultural lending performance more heavily. Examiners did not evaluate home mortgage or consumer installment lending activities because they represent a small portion of the loan portfolio, are not a business focus of the institution, and provide no material support for conclusions.

Bank records indicate that the lending focus and product mix remained generally consistent throughout the evaluation period. Therefore, examiners reviewed all small farm and small business loans originated or renewed in 2019, as this period was considered representative of the bank’s performance during the entire evaluation period. D&B data for 2019 provided a standard of comparison for the bank’s small farm and small business lending performance.

Examiners reviewed the entire universe of loans to evaluate the Assessment Area Concentration criterion. Examiners reviewed a sample of small farm and small business loans originated inside the assessment area to evaluate the Borrower Profile criterion. The table below provides information on the number and dollar volume of loans reviewed.

| Loan Products Reviewed | | | | |
|----------------------------------|-----------------|-----------------|-----------------|-----------------|
| Loan Category | Universe | | Reviewed | |
| | # | \$(000s) | # | \$(000s) |
| Small Farm | 315 | 43,595 | 58 | 6,747 |
| Small Business | 71 | 4,278 | 36 | 2,013 |
| <i>Source: 2019 Bank Records</i> | | | | |

While the number and dollar volume of loans are presented, examiners emphasized performance by number of loans because it is a better indicator of the number of farms and businesses served.

CONCLUSIONS ON PERFORMANCE CRITERIA

LENDING TEST

Frost State Bank demonstrated satisfactory performance under the Lending Test. The bank’s Loan-to-Deposit Ratio, Assessment Area Concentration, and Borrower Profile performance supports this conclusion.

Loan-to-Deposit Ratio

The average net loan-to-deposit ratio is more than reasonable given the institution’s size, financial condition, and assessment area credit needs. The bank’s net loan-to-deposit ratio, calculated from Reports of Condition data, averaged 97.3 percent over the past 23 calendar quarters from March 31, 2015, to September 30, 2020. The ratio ranged from a high of 105.7 as of September 30, 2015, to a low of 86.8 percent as of December 31, 2018. The net loan-to-deposit ratio is higher than similarly situated institutions, as illustrated in the table below. Examiners selected comparable institutions based on their asset size, geographic location, and lending focus.

| Loan-to-Deposit (LTD) Ratio Comparison | | |
|--|---|---------------------------------|
| Bank | Total Assets as of 9/30/2020 (\$000s) | Average Net LTD Ratio (%) |
| First Financial Bank in Winnebago Winnebago, Minnesota | 50,508 | 83.0 |
| Frost State Bank Frost, Minnesota | 51,936 | 97.3 |
| Global Innovations Bank Kiestler, Minnesota | 26,227 | 69.6 |
| Peoples State Bank of Wells Wells, Minnesota | 57,421 | 90.8 |
| <i>Source: Reports of Condition and Income 3/31/2015 – 9/30/2020</i> | | |

Assessment Area Concentration

Frost State Bank originated a majority of its small farm and small business loans within its assessment area, as shown in the following table.

| Lending Inside and Outside of the Assessment Area | | | | | | | | | | |
|---|-----------------|------|---------|------|------------|----------------------------------|------|---------|------|-------------------|
| Loan Category | Number of Loans | | | | Total # | Dollars Amount of Loans \$(000s) | | | | Total \$(000s) |
| | Inside | | Outside | | | Inside | | Outside | | |
| | # | % | # | % | | \$ | % | \$ | % | |
| Small Farm | 168 | 53.3 | 147 | 46.7 | 315 | 17,926 | 41.1 | 25,669 | 58.9 | 43,595 |
| Small Business | 39 | 54.9 | 32 | 45.1 | 71 | 2,253 | 52.7 | 2,025 | 47.3 | 4,278 |
| <i>Source: Bank Data</i> | | | | | | | | | | |

Geographic Distribution

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

Borrower Profile

The bank's lending performance demonstrates reasonable performance for this criterion. The bank's reasonable small farm lending performance is the primary driver for this conclusion; although, the bank's small business performance is excellent. Examiners focused on the bank's record of lending to farms and businesses with gross annual revenues of \$1 million or less.

Small Farm Loans

The distribution of sampled small farm loans reflects reasonable penetration to farms of different sizes. The following table shows that Frost State Bank's lending performance to farms with gross annual revenues of \$1 million or less lags demographic data. However, management stated that the bank faces strong competition for agricultural loans in the assessment area. Additionally, according to 2017 Agricultural Census data, the most recent available, 40 percent of farms in Faribault County did not report interest expenses, indicating that they do not borrow funds for their operations. Given these factors, 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 | 98.7 | 46 | 79.3 | 4,424 | 65.6 |
| >1,000,000 | 1.0 | 12 | 20.7 | 2,323 | 34.4 |
| Revenue Not Available | .03 | 0 | 0.0 | 0 | 0.0 |
| Total | 100.0 | 58 | 100.0 | 6,747 | 100.0 |
| <i>Source: 2019 D&B Data; 2019 Bank Data.</i> | | | | | |

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. As shown in the following table, the bank’s performance exceeds demographic data in this revenue category.

| Distribution of Small Business Loans by Gross Annual Revenue Category | | | | | |
|--|------------------------|-----------|--------------|-----------------|--------------|
| Gross Revenue Level | % of Businesses | # | % | \$(000s) | % |
| <=\$1,000,000 | 81.0 | 36 | 100.0 | 2,013 | 100.0 |
| >1,000,000 | 4.0 | 0 | 0.0 | 0 | 0.0 |
| Revenue Not Available | 15.0 | 0 | 0.0 | 0 | 0.0 |
| Total | 100.0 | 36 | 100.0 | 2,013 | 100.0 |
| <i>Source: 2019 D&B Data; 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 to 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 geographic distribution of the bank's loans;
- 4) 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; 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.

American Community Survey (ACS): A nationwide United States Census survey that produces demographic, social, housing, and economic estimates in the form of five-year estimates based on population thresholds.

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.