



PUBLIC DISCLOSURE

April 28, 2014

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

The First National Bank of Elk River
Charter Number: 8757

812 Main Street NW
Elk River, MN 55330

Office of the Comptroller of the Currency

222 South Ninth Street Suite 800
Minneapolis, MN 55402

NOTE: 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.

INSTITUTION'S CRA RATING: This institution is rated Satisfactory.

The Lending Test is rated: Satisfactory

The Community Development Test is rated: Satisfactory

The primary factors supporting this rating include:

- The bank’s net loan-to-deposit (LTD) ratio is reasonable given the bank’s size, financial condition, and credit needs of the assessment area.
- The bank originated a majority of its loans within its assessment area.
- Distribution of loans reflects reasonable penetration among borrowers of different income levels and businesses of different sizes.
- Geographic distribution of loans reflects a reasonable dispersion throughout the bank’s assessment area.
- The bank’s community development activities demonstrate adequate responsiveness to the community development needs of the assessment.

Scope of Examination

This Community Reinvestment Act (CRA) examination assessed The First National Bank of Elk River’s (FNB) performance in meeting the credit needs of its community for the time period January 6, 2009, through December 31, 2013 (evaluation period). FNB was evaluated under the standards tests for Intermediate Small Banks (ISB), which includes the lending test and the community development test.

The lending test focused on the bank’s primary loan products based on loan originations by number and dollar volume from January 1, 2012, through December 31, 2013. Commercial business loans and consumer loans were determined to be the primary loan products during this evaluation period. Commercial loans represent the largest product by aggregate dollar amount of loans originated, while consumer loans represented the largest product by aggregate number of loans originated. The table below illustrates the number and dollar volume of loans originated/purchased during this period.

Loan Originations and Purchases in 2012 and 2013		
<i>Loan Type</i>	<i>Volume by #</i>	<i>Volume by \$</i>
Commercial	33.19%	62.15%
Consumer	46.01%	5.48%
Residential Real Estate	17.86%	29.47%
Agricultural	2.94%	2.90%

Source: Bank loan origination reports for 2012 and 2013

A random sample of 20 loans from each primary product was used to evaluate lending performance within the assessment area. Additional loans were sampled for analysis purposes as necessary.

The community development (CD) test included a review of community development loans, qualified investments, and community development services originated or performed during the evaluation period.

Description of Institution

FNB is a \$306 million intrastate bank headquartered in Elk River, Minnesota. FNB is wholly owned by First National Financial Services Inc., a one-bank holding company headquartered in Elk River, Minnesota. First National Financial Services is not engaged in any activities that materially affect the bank's CRA performance.

FNB operates four branches all located in the Minneapolis-St. Paul Metropolitan Statistical Area (MSA). Two offices, including the main branch, are located within the city of Elk River. The other offices are located in the cities or townships of Anoka and Rogers, Minnesota.

FNB is a full-service financial institution, offering a wide variety of commercial and retail banking products and services. As of March 31, 2014, FNB's net loans and leases totaled \$125 million representing 41 percent of total assets. The loan portfolio is comprised of commercial (81 percent), residential mortgage (15 percent), and other loans (4 percent). The investment portfolio totals \$155 million or 51 percent of total assets. Investment holdings include U.S. Treasury and Agency securities (\$139 million), municipal securities (\$105 thousand), and interest-bearing bank balances (\$16 million).

There are no legal, financial, or other factors impeding FNB's ability to help meet the credit needs in its assessment area. FNB received a "Satisfactory" CRA rating at its prior CRA examination on January 5, 2009.

Description of Assessment Area

FNB has one assessment area (AA), which consists of fifty-nine census tracts located in the northwest section of the Minneapolis-St. Paul MSA. The AA consists of the northeastern section of Wright County, the eastern two-thirds of Sherburne County, the western half of Anoka County, and the northernmost section of Hennepin County. FNB's four office locations are dispersed throughout the AA where three branches are located in middle-income census tracts and one branch is in an upper-income census tract. The AA is not designated as distressed or underserved by the Federal Financial Institutions Examination Council (FFIEC). Most census tracts in the assessment area are middle-income. There are no low-income census tracts and only seven moderate-

income census tracts located in the AA. The AA meets the requirements of the regulation and does not arbitrarily exclude any low- or moderate-income geographies. The following table shows demographic information for FNB's AA.

DEMOGRAPHIC AND ECONOMIC CHARACTERISTICS OF THE AA	
Population	
Number of Families	84,439
Number of Households	111,505
% of Low-Income Families	15.20
% of Moderate-Income Families	19.44
% of Middle-Income Families	28.87
% of Upper-Income Families	36.49
Geographies	
Number of Census Tracts	59
% Low-Income Census Tracts	0.00
% Moderate-Income Census Tracts	11.86
% Middle-Income Census Tracts	81.36
% Upper-Income Census Tracts	6.78
<i>Median Family Income (MFI)</i>	
2010 MFI for AA	\$80,925
2012 FFIEC Estimated MFI	\$83,900
2013 FFIEC Estimated MFI	\$82,300
Economic Indicators	
2012 Average Unemployment Rate	5.88%
2013 Average Unemployment Rate	5.88%
2010 Median Housing Value	\$230,576
% of Households Below Poverty Level	5.08

Source: 2010 U.S. Census data with updated information when available

Major employers in the AA are manufacturing, health care, retail, government, and education. The average unemployment rate in the AA slightly exceeds the state unemployment rates of 5.6 percent in 2012 and 5.1 percent in 2013.

Economic activity in the AA is centered in the services industry followed by construction. Based upon 2013 Business Geodemographic Data, services comprise 42 percent of the AA's activity, followed by construction at 15 percent.

Competition from other financial institutions is strong. Based upon the June 30, 2013, FDIC market share data, there are 100 different financial institutions with offices and deposits in the AA. FNB ranks twenty-fifth in deposit market share, which equates to 0.15 percent or \$178 million. FNB's primary banking competitors are Wells Fargo National Association and U.S. Bank National Association along with a host of smaller banks.

In order to gather current information on the community and potential lending opportunities in the area, we contacted a community leader. We discussed with the community contact whether financial institutions in the area were meeting the credit needs of the community. The contact indicated that financial institutions are meeting the credit needs of the community. The main credit need noted is for senior and affordable housing where financial institutions could participate through lending or investments. The community contact did not identify any specific needs for community development services in which financial institutions could participate.

Conclusions with Respect to Performance Tests

LENDING TEST

The bank's performance under the lending is satisfactory. The loan-to-deposit ratio is reasonable, and the majority of loans originated were inside the bank's AA. Geographic distribution of consumer and commercial loans reflect reasonable dispersion throughout the bank's geographies. Distribution of loans reflects excellent penetration among borrowers of different income levels and reasonable penetration among businesses of different sizes.

Loan-to-Deposit Ratio

FNB's net loan-to-deposit (LTD) ratio is reasonable given the bank's size, financial condition, and AA credit needs. FNB's quarterly LTD ratio averaged 67 percent over the 22 quarters from October 1, 2008, to March 31, 2014. This ratio ranged from a quarterly low of 53 percent in 1Q14 to a quarterly high of 75 percent in 4Q10. FNB's ratio began to decline in 3Q13 due to the purchasing of deposits, which decreased the overall LTD ratio during the evaluation period.

FNB's average LTD ratio ranks fourth among five similarly situated banks. The following table depicts the average LTD ratios of similarly situated banks defined as banks located in the AA with total assets between \$150 million to \$425 million.

Peer Group for Loan-to-Deposit Analysis		
Financial Institution	Assets (As of 3/31/14)	Average LTD Ratio (4Q08 - 1Q14)
Northeast Bank	\$350 million	102.53%
21 st Century Bank	\$367 million	93.31%
Village Bank	\$169 million	82.44%
The Bank of Elk River	\$355 million	78.61%
<i>The First National Bank of Elk River</i>	\$306 million	67.31%
First Minnesota Bank	\$409 million	44.29%

Source: Call Report data, October 1, 2008 through March 31, 2014.

Lending in Assessment Area

FNB originates the majority of its loans inside the AA. Loans originated to businesses and consumers within the bank’s AA total 77.50 percent by number and 69 percent by dollar volume. The following table shows lending in the AA during the evaluation period.

Lending in AA										
	Number of Loans					Dollars of Loans (000s)				
Loan Type	Inside		Outside		Total	Inside		Outside		Total
	#	%	#	%		\$	%	\$	%	
Business	14	70.00	6	30.00	20	6,305	69.15	2,813	30.85	9,118
Consumer	17	85.00	3	15.00	20	139	75.96	44	24.04	183
Totals	31	77.50	9	22.50	40	6,444	69.28	2,857	30.72	9,301

Source: Commercial and consumer loan samples from 2012-2013.

Lending to Borrowers of Different Incomes and to Businesses of Different Sizes

Overall, the FNB’s lending to borrowers of different incomes and to businesses of different sizes reflects reasonable penetration in the AA.

Consumer Loans

FNB had excellent penetration among borrowers of different income levels. FNB’s consumer lending to low- and moderate-income borrowers significantly exceeds the demographic comparators in the AA. The following table compares the bank’s consumer lending activities by the borrower income level to the local demographics.

Borrower Distribution of Consumer Loans								
Borrower Income Level	Low		Moderate		Middle		Upper	
Loan Type	% of AA House holds	% of Number of Loans	% of AA House holds	% of Number of Loans	% of AA House holds	% of Number of Loans	% of AA House holds	% of Number of Loans
Consumer Loans	16.14	30.00	15.45	30.00	22.88	25.00	45.53	15.00

Source: Loan Sample and 2010 U.S. Census data.

Business Loans

FNB’s borrower distribution of loans reflects reasonable penetration among businesses of different sizes. Fifty-five percent of the bank’s business loans, by number, were originated to businesses with gross annual revenues of \$1 million or less (small businesses). This is considered reasonable but low given demographic data shows 79 percent of the AA businesses are small businesses. Demographic data contains a high

level of businesses of unknown size, as they chose not to report the information. Although this eighteen percent could potentially be additional small businesses, we have no reason to believe that the non-reporters are a disproportionate amount of small businesses. The following table shows the distribution of business loans among businesses of different sizes in the AA.

Borrower Distribution of Loans to Businesses				
Business Revenues (or Sales)	≤\$1,000,000	>\$1,000,000	Unavailable/ Unknown	Total
% of AA Businesses	78.85	3.50	17.65	100
% of Bank Loans in AA by #	55.00	45.00	0.00	100
% of Bank Loans in AA by \$	24.47	75.53	0.00	100

Source: Loan Sample and Dunn and Bradstreet Data

Geographic Distribution of Loans

FNB’s geographic distribution of loans in the AA reflects reasonable dispersion throughout census tracts of different income levels. There are no low-income census tracts in the AA. There were no conspicuous gaps in the bank’s geographic distribution of loans.

Business Loans

The geographic distribution of business loans reflects reasonable dispersion throughout census tracts of different income levels. FNB’s distribution of business loans in moderate-income census tracts is reasonable, but below the demographic comparator. The following table shows the bank’s performance as compared to the percentage of businesses in each census tract income level.

Geographic Distribution of Loans to Businesses								
Census Tract Income Level	Low		Moderate		Middle		Upper	
Loan Type	% of AA Businesses	% of Number of Loans	% of AA Businesses	% of Number of Loans	% of AA Businesses	% of Number of Loans	% of AA Businesses	% of Number of Loans
Business	0.00	0.00	4.72	1.67	84.28	76.66	11.00	21.67

Source: Loan Sample; 2010 U.S. Census Data

Consumer Loans

Geographic penetration of consumer loans reflects reasonable dispersion throughout the census tracts of different income levels. Consumer lending within the moderate-income census tracts is comparable to the percentage of households within the census tract. The following table shows the distribution of consumer loans among census tracts of different income levels.

Geographic Distribution of Consumer Loans in the AA								
Census Tract Income Level	Low		Moderate		Middle		Upper	
Loan Type	% of AA House holds	% of Number of Loans	% of AA House holds	% of Number of Loans	% of AA House holds	% of Number of Loans	% of AA House holds	% of Number of Loans
Consumer	0.00	0.00	7.71	5.00	84.54	90.00	7.75	5.00

Source: Loan Sample; 2010 U.S. Census Data

Responses to Complaints

FNB has not received any CRA related complaints during this evaluation period.

COMMUNITY DEVELOPMENT TEST

FNB’s performance under the community development test is satisfactory. The bank’s community development performance demonstrates adequate responsiveness to the community development needs of the AA through qualified investments and community development services. The bank’s AA has a moderate level of opportunities for community development loans, qualified investments, and community development services.

Number and Amount of Community Development Loans

FNB has reported no community development loans during this evaluation period.

Number and Amount of Qualified Investments

FNB’s number and amount of qualified investments demonstrates adequate responsiveness to the community development needs of the AA. FNB purchased one investment for \$1.97 million to investment in mortgage-backed securities to borrowers meeting the definition of low- or moderate-income individuals (LMI). FNB has also made an additional 117 charitable donations totaling \$53 thousand to a variety of organizations who largely used these funds to promote social services for LMI individuals and economic development for the area.

Extent to Which the Bank Provides Community Development Services

FNB staff provides adequate responsiveness to community development services to local organizations, including occasional services in a leadership role. Seven staff members regularly participate in a variety of organizations focused upon providing services and meeting the needs of individuals with low and moderate incomes, promoting local economic development, and affordable housing. Throughout the evaluation period, bank staff volunteered their expertise to eleven organizations focused

upon these issues. Involvement included board membership, president, and volunteer staff positions.

Responsiveness to Community Development Needs

FNB has shown adequate responsiveness to the community development needs throughout the evaluation period. FNB addressed these needs primarily through its offering of bank products, services, delivery systems, and locations.

Fair Lending or Other Illegal Credit Practices Review

Pursuant to 12 C.F.R. 25.28(c), in determining a national bank's CRA rating, the OCC considers evidence of discriminatory or other illegal credit practices in any geography by the bank, or in any AA by an affiliate whose loans have been considered as part of the bank's lending performance.

We found no evidence of discriminatory or other illegal credit practices inconsistent with helping to meet community credit needs.