



**SMALL BANK**

---

Comptroller of the Currency  
Administrator of National Banks

---

Washington, DC 20219

## **PUBLIC DISCLOSURE**

September 15, 2008

### **COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION**

Merchants Bank, National Association  
Charter Number 15718

115 West Washington Square  
Caledonia, MN 55921

Office of the Comptroller of the Currency

Minneapolis South Field Office  
222 Ninth Street South 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 major factors supporting the institution's rating are:

- The bank's loan-to-deposit ratio is reasonable given the bank's size, financial condition, and credit needs of the assessment area.
- A majority of the bank's loans are originated to customers inside the assessment area.
- The bank has a reasonable distribution of lending to businesses of different sizes and excellent distribution of lending to borrowers of different incomes.

## **SCOPE OF EXAMINATION**

We evaluated Merchants Bank National Association's (Merchants) Community Reinvestment Act (CRA) performance from April 3, 2002 through June 30, 2008. We focused our review on commercial and home loans, as these were identified as the bank's primary products based on number and dollar volume of loans originated.

In order to assess the bank's lending activity, we sampled 20 commercial and 20 home loans originated between January 1, 2006 through June 30, 2008. During this period, the bank originated 41.0% commercial loans and 27.1% home loans by dollar volume.

## **DESCRIPTION OF INSTITUTION**

Merchants is a \$48 million bank with one full-service facility located in Caledonia, MN. The bank has one deposit-taking ATM located in the main office. Merchants offers telephone and Internet banking services to both consumer and business customers.

The bank has two affiliates, with locations in La Crescent, MN and Winona, MN. These affiliates do not impact the bank's CRA performance.

Merchants offers traditional loan and deposit products. As of June 30, 2008, the bank's net loans totaled 52.1% of total assets. The bank's \$25 million loan portfolio consisted of 40.8% commercial loans, 26.8% agricultural loans, 21.6% home loans, and 10.8% consumer loans. A significant portion of the bank's home loans are sold on the secondary market, as this represented 21.0% by dollar volume of all loans originated from January 1, 2006 through June 30, 2008.

Merchants is owned by the multi-bank holding company, Merchants Financial Group, Inc. The holding company is located in Winona, MN. Total assets of the holding company as of June 30, 2008 were \$940 million. Merchants received an "Outstanding" rating at the April 2, 2002 CRA examination. There are no financial, legal, or other factors affecting the bank's ability to meet its CRA lending obligations.

## DESCRIPTION OF ASSESSMENT AREA

The bank's assessment area (AA) is all of Houston County, MN, which is located in southeastern Minnesota. Houston County is part of the La Crosse WI-MN Metropolitan Statistical Area (MSA). The AA contains five middle-income census tracts (CT). The AA meets regulatory requirements and does not arbitrarily exclude low- or moderate-income geographies.

Demographic Information for the AA					
	#	% Low	% Moderate	% Middle	% Upper
Geographies (Census Tracts)	5	0%	0%	100%	0%
Population by Geography	19,718	n/a	n/a	100%	n/a
Owner-Occupied Housing by Geography	6,187	n/a	n/a	100%	n/a
Businesses by Geography	1,689	n/a	n/a	100%	n/a
Farms by Geography	357	n/a	n/a	100%	n/a
Family Distribution by Income Level	5,376	16.6%	20.4%	28.0%	35.0%
Household Distribution by Income Level	7,594	20.9%	17.9%	21.8%	39.4%
Census Median Family Income (MFI)		\$50,140	Median Housing Value		\$91,913
HUD-Adjusted MFI: 2008		\$63,400	Families Below the Poverty Level		4.2%
HUD- Adjusted MFI: 2007		\$60,400	Unemployment Rate		3.9%
HUD- Adjusted MFI: 2006		\$59,200			

Source: 2000 U.S. Census Data

The local economy is stable. The City of La Crosse, WI is the economic, retail, and employment center of the MSA and is located approximately 22 miles from the bank. The City of Caledonia is the Houston County seat. Economic activities in the area are relatively diverse with services, retail, and agriculture as leading industries. Top employers in Caledonia include the Caledonia School District and Houston County. According to Minnesota Workforce Center, the unemployment rate for Houston County as of August 2008 was 5.3%, compared to the state average of 5.8%.

The banking environment is competitive in Houston County. Merchants competes with eight other financial institutions with a presence in the AA. The bank's competitors include several local community banks and branches of large regional and national institutions. According to the June 30, 2007 FDIC Market Share Report, Merchants is fourth in market share with 14.2% of deposits in the AA.

We made one community contact during our examination. The community contact was a community development director. The contact stated that all local financial institutions are active in meeting the credit needs of the community. The community contact was unaware of any situations in which credit needs were not being met.

## CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

### Loan-to-Deposit Ratio

Merchant's net loan-to-deposit ratio is reasonable given the bank's size, financial condition, and credit needs of the AA. The bank's quarterly net loan-to-deposit ratio averaged 75.2% for the 26 quarters from March 31, 2002, through June 30, 2008. Based on this ratio, the bank ranked fifth compared to five similarly-situated banks in the AA. These five similarly-situated banks had total assets ranging from \$47 to \$83 million.

Institution Name	Total Assets \$(000)s (as of 6/30/2008)	Average Loan to Deposit Ratio 1Q02-2Q08
Eitzen State Bank	52,584	95.0%
Jennings State Bank	47,875	90.2%
Merchants Bank – La Crescent	78,794	86.0%
Security State Bank of Lewiston	83,363	81.9%
<b>Merchants Bank - Caledonia</b>	<b>48,128</b>	<b>75.2%</b>

Source: Call Report Data

### Lending in Assessment Area

Merchants originates a majority of its loans to borrowers inside the AA. In order to determine the bank's lending activity in the AA, we pulled a random sample of 20 commercial loans and 20 home loans originated from January 1, 2006 through June 30, 2008. Loans originated within the AA totaled 85.0% by number and 84.1% by dollar volume. The following table details the bank's lending within the AA.

Lending in AA										
Loan Type	Number of Loans					Dollars of Loans				
	Inside		Outside		Total	Inside		Outside		Total
	#	%	#	%		\$	%	\$	%	
Commercial	17	85.0%	3	15.0%	20	\$861,489	82.4%	\$184,016	17.6%	\$1,045,505
Home Loans	17	85.0%	3	15.0%	20	\$1,662,164	85.0%	\$293,367	15.0%	\$1,955,531
Totals	34	85.0%	6	15.0%	40	\$2,523,653	84.1%	\$477,383	15.9%	\$3,001,036

Source: OCC Loan Sample

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

The bank has a reasonable distribution of lending to businesses of different sizes and an excellent distribution of lending to borrowers of different incomes.

Merchants has a reasonable distribution of loans to businesses of different sizes. Based on our sample of 20 commercial loans in the AA, the bank originated 80.0% of its loans to small businesses. Small businesses are businesses with gross annual revenues below \$1 million.

The amount of business with unreported revenues is high at 39.4%. Discussions with bank management indicate that a majority of the businesses in this category would be borrowers with revenues less than \$1 million, as there are many sole proprietorships in the AA that would not formally report business revenues. Given this information and comparing the bank's lending to the demographics in the AA, we feel that the bank's lending to small businesses is reasonable. The following table summarizes commercial lending activity by revenue size:

<b>Borrower Distribution of Loans to Businesses in AA</b>				
Business Revenues (or Sales)	≤\$1,000,000	>\$1,000,000	Unavailable/ Unknown	Total
% of AA Businesses	57.0%	3.6%	39.4%	100%
% of Bank Loans in AA by #	80.0%	20.0%	-	100%
% of Bank Loans in AA by \$	51.8%	48.2%	-	100%

Source: OCC Loan Sample & 2007 Business Geodemographic Data

Merchant's home loan lending activity represents excellent penetration among borrowers of different income levels. Home loans are for the purchase, refinance, or improvement of residential real estate. The bank exceeded demographics for home loans made to both low- and moderate- income families. The following table shows the distribution of home loan products among borrowers of different income levels for the period of January 1, 2006 through June 30, 2008, as compared to the percent of families in each income category:

<b>Borrower Distribution of Home Loans in AA</b>								
Borrower Income Level	Low		Moderate		Middle		Upper	
	% of AA Families	% of Number of Loans	% of AA Families	% of Number of Loans	% of AA Families	% of Number of Loans	% of AA Families	% of Number of Loans
Home Loans	16.6	30.0	20.4	35.0	28.0	15.0	35.0	20.0

Source: OCC Loan Sample & 2000 U.S. Census Data

### **Geographic Distribution of Loans**

A review of lending by geographic distribution is not meaningful. We did not perform an analysis as the AA contains only middle-income geographies.

### **Responses to Complaints**

Merchants has not received any CRA related complaints since our last exam.

### **Fair Lending or Other Illegal Credit Practices Review**

We found no evidence of discriminatory or other illegal credit practices that would inhibit the bank's ability to meet community credit needs.