



PUBLIC DISCLOSURE

May 11, 2015

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

Heritage Bank, National Association
Charter Number 15401

120 South Street West, Spicer, MN 56288

Office of the Comptroller of the Currency
Sioux City Field Office
700 4th Street Suite 320, Sioux City, IA 51101

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.

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

The Lending Test is rated: Satisfactory.

The Community Development Test is rated: Satisfactory.

- The bank's loan-to-deposit ratio is more than reasonable given the bank's size, financial condition, and the needs of the assessment areas (AAs).¹
- A majority of the bank's loans are originated inside the bank's designated AAs.¹
- The borrower distribution of loans reflects reasonable penetration among businesses and farms of different sizes and individuals of different income levels.
- The geographic distribution of loans reflects excellent dispersion throughout census tracts (CTs) of different income levels.
- Community development (CD) activities represent adequate responsiveness to AA needs and opportunities. CD activities primarily benefited low- and moderate-income (LMI) individuals in the Minnesota AA. The bank provided limited CD activities in the Iowa AAs relative to the opportunities in these AAs.
- Three of the bank's 12 branches are located in a moderate-income CT or a distressed or underserved middle-income nonmetropolitan CT during the evaluation period, which generally increases access to financial services for low- and moderate-income individuals.² Another branch serves and is located adjacent to a moderate-income CT.
- Examiners did not identify any evidence of discriminatory or other illegal credit practices inconsistent with helping to meet community credit needs.

Scope of Examination

Heritage Bank, National Association (Heritage or Bank) was evaluated under the Intermediate Small Bank examination procedures, which includes a Lending Test and a Community Development test for the Bank overall, the State of Minnesota, and the State of Iowa.

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1. The net loan-to-deposit ratio and percentage of loans and other lending-related activity in the assessment area only apply to the institution overall. No discussion of these performance criteria applies to sections of the performance evaluation relating to states.
 2. The Federal Financial Institutions Examination Council publishes a list of distressed and underserved middle-income geographies each year. The designations reflect local economic conditions, including triggers such as unemployment poverty, and population changes.

The Lending Test evaluates the bank's record of meeting the credit needs of its AAs through its lending activities. The Lending Test covers Heritage's performance from January 1, 2013 through March 31, 2015 for the Minnesota Non-Metropolitan Statistical Area (Non-MSA) AA and the Iowa Non-MSA AA as this is representative of its lending strategy since the last CRA examination. The Lending Test evaluation for the Sioux City Metropolitan Statistical Area (MSA) only covered performance from January 1, 2014 through March 31, 2014 (not 2013 because the Woodbury County census tract boundaries were adjusted effective January 1, 2014).

The Lending Test evaluated agriculture, commercial, consumer, and residential real estate loans originated by the bank during the evaluation period. To evaluate the bank's agriculture, commercial, and consumer lending performance, examiners selected a random sample of 20 loans originated and purchased during the evaluation for each primary loan product in the Minnesota. Examiners selected additional loans as needed to have sufficient information to analyze borrower and geographic distributions within each AA. To evaluate residential real estate loans, we relied on data submitted under the requirements of the Home Mortgage Disclosure Act (HMDA). The HMDA data was tested and found to be reliable prior to the start of the examination. We based market comparisons on 2014 peer data. Refer to Appendix A for a list of primary products in each AA or the "Scope of Evaluation" section of each State Rating section for details on which primary products were reviewed in each state.

The CD Test evaluates the bank's record of responding to CD needs in its AAs through CD lending, qualified investments, donations, and services. The evaluation period for the CD Test is from October 16, 2012 through May 11, 2015.

Description of Institution

Heritage is a multi-state financial institution headquartered in Spicer, Minnesota. As of March 31, 2015, Heritage has \$393 million in total assets. Heritage is a wholly owned subsidiary of Heritage Bancshares Group, Incorporated, a one-bank holding company located in Spicer, Minnesota. Including the location in Spicer, Minnesota, Heritage operates 12 branches in two states: Minnesota (four branches) and Iowa (eight branches). The bank has three distinct AAs across these two states. The AAs meet the requirements of the regulations and do not arbitrarily exclude low- or moderate-income CTs.

Heritage has three cash dispensing automated teller machines (ATMs) located at branches and 24 additional ATMs located in cities where they have branches and surrounding communities. Heritage does not operate any deposit-taking ATMs.

Heritage closed one branch since the last CRA review. The branch was located in Storm Lake, Iowa in a middle-income CT and was closed on August 16, 2013. The branch was closed because of the branch was not profitable. The bank continues to meet the banking needs of Storm Lake customers through the neighboring Alta, Iowa branch (six miles away) and through online banking services. Additionally, seven other financial institutions serve the banking needs of the small community. Examiners did not identify any concerns with the branch closure.

The bank offers traditional loan and deposit products and services to its customers. As of the March 31, 2015 call report, the bank has the following outstanding loans by dollar volume: commercial (42 percent), residential real estate (13 percent), agricultural (42 percent), and consumer (3 percent). Heritage's tier one leverage capital is plus the allowance for loan and lease losses was \$42 million or 11 percent of average total assets as of March 31, 2015.

Heritage's strategy is focused on meeting the needs of each of the areas it serves. The Minnesota market has a primary focus on residential real estate, commercial, and consumer lending. The Iowa market has a primary focus on agricultural and commercial loans.

There are no legal, financial, or other factors impeding Heritage's ability to meet the credit needs of its AAs. Heritage was rated "Satisfactory" rating at its last CRA examination dated October 15, 2012 CRA examination.

Selection of Areas for Full-Scope Review

In each state where the bank has a branch, at least one AA within that state was selected for full-scope reviews. If the bank had more than one AA in a state, examiners considered the volume of lending during the evaluation period at branches within each AA, the amount of deposits as of June 30, 2014, the number of branches in the AA, and other performance context factors when determining which AAs would receive full-scope reviews and which would receive limited-scope reviews.

Examiners completed full-scope reviews of all three AAs.

Ratings

The bank's overall rating is a blend of the state ratings. Refer to Appendix B for a summary of state ratings. Examiners gave more weight to the Minnesota state ratings in the overall rating because the lending in Minnesota makes up the majority of the bank's overall lending (66 percent by number and 63 percent by dollar volume), the majority of the bank's deposits come from this state (58 percent), and the bank operates four branches in this state. Examiners gave the Iowa state ratings less weight than the Minnesota state ratings; however, the Iowa state ratings were significant as the majority of the bank's branches are located in this state (eight branches), a significant amount of

the bank's deposits come from this state (42 percent), and the lending in Iowa was significant in relation to the bank's overall lending (34 percent by number and 37 percent by dollar volume).

The state ratings are based primarily on those areas that received a full-scope review. We completed a full-scope review of all three of the bank's AAs. Refer to the "Scope of Evaluation" section under each state rating section for details regarding how the areas were weighted in arriving at the respective ratings.

The following tables show the volume of lending by the branches located within each AA and state during the evaluation period, including number and dollar volume and which branch within each AA the bank's deposits come from.

Lending by AA During Evaluation Period for January 1, 2013 through March 31, 2015 (all AAs)					
State	AA	#	%	\$(000s)	%
Minnesota (total)	Rural AA	2,681	66%	338,568	63%
Iowa	Rural AA	784	19%	127,812	24%
Iowa	Sioux City MSA	620	15%	69,496	13%
Iowa (total)		1,404	34%	197,308	37%
Total		4,085	100%	535,876	100%

Source: Bank loan data

Summary of Deposits and Deposit Market Share as of June 30, 2014					
State	AA	Deposits \$(000s)	% of Deposits	Market Share (%)	Market Share (Rank)
Minnesota (total)	Rural AA	187,424	58%	13%	3 rd
Iowa	Rural AA	98,140	30%	4%	7 th
Iowa	Sioux City MSA	37,328	12%	2%	17 th
Iowa (total)		135,468	42%		
Total		322,892			

Source: FDIC Reports (www.fdic.gov)

Conclusions with Respect to Performance Criteria

Loan-to-Deposit Ratio

Heritage's net loan-to-deposit ratio is more than reasonable given the bank's size, financial condition, and AA credit needs. The bank's quarterly net loan-to-deposit ratio averaged 84 percent over 10 quarters, from September 30, 2012 through March 31, 2015. The ratio ranged from a quarterly low of 73 percent to a quarterly high of 94 percent during the time period. The loan-to deposit ratio does not reflect the volume of mortgage loans sold on the secondary market.

The bank's net loan-to-deposit ratio is comparable to 13 other community banks of similar size (total assets of \$190 million to \$700 million) in the AAs. Heritages' average net loan-to-deposit ratio ranked fourth among a total of 13 similarly situated institutions. The other 13 institutions had a net loan-to-deposit ratios averaging 70 percent and ranging from a low of 36 percent to a high of 99 percent over the same ten quarters.

Lending in Assessment Area

Heritage originated a majority of its loans to borrowers located inside its designated AAs. Examiners sampled loans from each primary product analyzed in each AA including all home loans originated during the evaluation period, 40 business loans, 50 farm loans, and 20 consumer loans. Heritage originated 80 percent of its loans by number and 74 percent of its loans by dollar volume within its AAs.

Table 1 details the bank’s lending within its AAs by number and dollar volume of loans sampled.

Table 1 - Lending in Minnesota Non-MSA AA, Iowa Non-MSA AA, and Sioux City MSA										
Loan Type	Number of Loans					Dollars of Loans (\$000s)				
	Inside		Outside		Total	Inside		Outside		Total
	#	%	#	%		\$	%	\$	%	
Home Purchase	244	74%	84	26%	328	33,249	69%	14,927	31%	48,176
Home Refinance	219	80%	55	20%	274	30,941	72%	11,776	28%	42,717
Home Improvement	112	85%	19	15%	131	8,145	83%	1,723	17%	9,868
Business Loans	33	82%	7	18%	40	8,892	89%	1,111	11%	10,003
Farm Loans	38	95%	2	5%	40	7,238	80%	1,861	20%	9,099
Consumer Loans	18	90%	2	10%	20	247	96%	9	4%	256
Total	664	80%	169	20%	833	88,712	74%	31,407	26%	120,119

Source: 2013-2014 HMDA; Loan Sample

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.

State Rating

State of Minnesota

CRA Rating for Minnesota: Satisfactory.

The Lending test is rated: Satisfactory.

The Community Development test is rated: Satisfactory.

- The bank's distribution of loan in the Minnesota AA reflects reasonable penetration among individuals of different income levels and businesses of different sizes.
- The bank's geographic distribution of loans in the Minnesota AA reflects excellent dispersion throughout CTs of different income levels.
- The bank provided an adequate level of CD loans and services in the AA.
- One of the bank's four branches in the AA is adjacent to and serves the moderate-income level CT.

DESCRIPTION OF INSTITUTION'S OPERATIONS IN MINNESOTA

The Minnesota Non-MSA AA consists of two whole counties: Kandiyohi and Chippewa. Both counties are located in central Minnesota. The bank's assessment complies with the CRA and does not arbitrarily exclude low- or moderate-income CTs from the AA.

The AA area consists of 16 CTs. There is one moderate-income, 13 middle-income, and one upper-income CT. There are no low-income CTs or underserved and or distressed nonmetropolitan middle-income CTs.

The bank operates four branches in Kandiyohi County and no branches in Chippewa County. However, it is reasonable for the bank to include Chippewa County in their AA as the Raymond branch is located less than a mile from the Chippewa County line.

The four branches in this AA represent 58 percent of the bank's total deposits as of June 30, 2014.

The combined population of the CTs in this AA is 54,680 with 25,198 housing units, according to the updated 2010 U.S. Census data. According 2014 Department of Housing and Urban Development (HUD) data, median family income is \$61,700. The median housing value for owner-occupied housing is \$101,100, according to 2013 U.S. Census data. 72 percent of all housing units are owner-occupied.

Economic conditions in the area are good. The major employment sectors in the area are services and agriculture. A majority of the businesses are considered small with 77 percent of businesses reporting less than \$1 million in revenue. Minnesota Department

of Employment and Economic Development reports the unemployment rate for April 2015 in Chippewa and Kandiyohi Counties are 3.9 percent and 3.6 percent, respectively. This is below the national unemployment rate of 5.5 percent, according to March 2015 U.S. Bureau of Labor Statistics.

Competition in the area is healthy. The FDIC market share report shows 16 banks operating in this market. Bremer Bank, Farm Credit Services, Citizens Alliance Bank, and some of the smaller community banks in the area provide the most competition.

We reviewed a recent community contact with a local economic development organization. The contact stated credit needs in the community are being met. The contact stated local institutions are meeting the demands of the community by participating in a small business loan fund and providing financing for some large community development projects related to an industrial park and the regional hospital.

SCOPE OF EVALUATION IN MINNESOTA

Examiners completed a full-scope review of the Non-Metropolitan (Non-MSA) MN AA. Examiners conducted a full-scope review of the Non-MSA MN AA because it is the only AA in the state of Minnesota and the majority of loans and deposits originate from branches in this AA.

The primary loan products in the Non-MSA AA were home, business, and consumer loans:

- o Home loans represented 31 percent by number and 36 percent by dollar volume of lending in the AA during the sampling period.
- o Business loans represented 36 percent by dollar volume of lending in the AA during the sampling period.
- o Consumer loans represented 36 percent by number volume of lending in the AA during the sampling period.

Examiners analyzed all home loans, 60 business loans, and 20 consumer loans in the MN Non-MSA AA during the evaluation period.

Loan Originations/Purchased Summary by Loan Product for Minnesota Non-MSA AA				
	Number of Loans		Dollars of Loans (\$000s)	
	#	%	\$(000s)	%
Home Loans	847	31%	121,819	36%
Consumer Loans	953	36%	12,486	4%
Business Loans	423	16%	122,670	36%
Farm Loans	458	17%	81,593	24%
Total	2,681	100%	338,568	100%

Source: Bank loan data

CONCLUSIONS WITH RESPECT TO PERFORMANCE TESTS IN MINNESOTA

Heritage's CRA performance in Minnesota is satisfactory. The bank's performance is satisfactory under both the lending test and the Community Development (CD) test. The Minnesota rating is based on the performance of the MN Non-MSA AA, which received a full-scope review as the only AA in Minnesota.

LENDING TEST

The bank's performance under the lending test in Minnesota is rated "Satisfactory". Heritage has reasonable penetration among borrowers of different income levels and businesses of different sizes. Heritage has excellent dispersion throughout CTs of different income levels. We placed more weight was placed on the distribution of borrowers of different income levels and businesses of different sizes because there is less geographic diversity in the Minnesota AAs with a relatively small amount of borrowers and businesses located in moderate-income CTs. In addition, there are no low-income CTs or underserved and/or distressed middle-income CTs in the Minnesota AA.

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

The bank's distribution of loans in the Minnesota AA reflects reasonable penetration among borrowers of different income levels and businesses of different sizes.

Home loans:

The bank's distribution of home loans reflects reasonable penetration among borrowers of different income levels. The bank's level of lending to low- and moderate-income borrowers in the AA is near the demographic comparator. We placed the most weight on home purchase loans as the bank originated or purchased more home purchase loans than home refinance or home improvement loans.

- *Home purchase loans:* The bank originated or purchased 10 percent of home purchase loans to low-income borrowers, which is near the demographic data that shows 17 percent of families in the AA are low-income. The bank originated or purchased 24 percent of home purchase loans to moderate-income borrowers which exceeds the demographic data that shows 18 percent of families in the AA are moderate-income.
- *Home improvement loans:* The bank originated or purchased 8 percent of home improvement loans to low-income borrowers, which is near the demographic data that shows 17 percent of families in the AA are low-income. The bank originated or purchased 20 percent of home improvement loans to moderate-income borrowers, which exceeds the demographic data that shows 18 percent of families in the AA are moderate-income.
- *Home refinance loans:* The bank originated or purchased 3 percent of home refinance loans to low-income borrowers, which is significantly lower than the demographic data that shows 17 percent of families in the AA are low-income.

The bank originated or purchased 14 percent of home purchase loans to moderate-income borrowers, which is near the demographic data that shows 18 percent of families in the AA are moderate-income.

Table 2A shows the distribution of home purchase, home improvement, and home refinance loans among borrowers of different income levels.

Table 2A - Borrower Distribution of Residential Real Estate Loans in Minnesota Non-MSA AA									
Borrower Income Level	Low		Moderate		Middle		Upper		NA
Loan Type	% 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	% of Number of Loans
Home Purchase	17%	10%	18%	24%	24%	20%	41%	44%	2%
Home Improvement	17%	8%	18%	20%	24%	24%	41%	43%	5%
Home Refinance	17%	3%	18%	14%	24%	23%	41%	59%	1%

Source: 2010 U.S. Census data; 2013-2014 HMDA

Business loans:

The bank’s distribution of loans to businesses reflects reasonable penetration among businesses of different sizes. The bank originated or purchased 65 percent by number and 59 percent by dollar volume of business loans sampled in this AA to small businesses. This is considered reasonable as it is near the demographic data that shows 73 percent of businesses in the AA are considered small businesses.

Table 2B shows the distribution of business loans among businesses of different sizes in the AA.

Table 2B - Borrower Distribution of Loans to Businesses in Minnesota Non-MSA AA				
Business Revenues (or Sales)	≤\$1,000,000	>\$1,000,000	Unavailable/Unknown	Total
% of AA Business	73%	6%	21%	100%
% of Bank Loans in AA by #	65%	35%	0%	100%
% of Bank Loans in AA by \$	59%	41%	0%	100%

Source: 2010 U.S. Census data, Loan Sample (expanded to 60 loans)

Consumer loans:

The bank’s distribution of consumer loans reflects excellent penetration among borrowers of different income levels. The bank’s level of lending to low- and moderate-income borrowers significantly exceeds the demographic comparator. The bank originated or purchased 25 percent of consumer loans sampled in this AA to low-income borrowers, which exceeds the demographic data that shows 22 percent of households in the AA are low-income. The bank originated or purchased 30 percent of consumer loans to moderate-income borrowers, which significantly exceeds the demographic data that shows 16 percent of households are moderate-income.

Table 2C shows the distribution of borrowers among borrowers with different income levels in the AA.

Table 2C - Borrower Distribution of Consumer Loans in Minnesota Non-MSA AA								
Borrower Income Level	Low		Moderate		Middle		Upper	
	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans
Consumer Loans	22%	25%	16%	30%	19%	25%	43%	20%

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

Geographic Distribution of Loans

The bank’s geographic distribution of loans in the Minnesota AA reflects excellent dispersion throughout CTs of different income levels. The AA has one moderate-income CT and no low-income CTs.

Home loans:

The bank’s geographic distribution of home loans reflects excellent dispersion throughout CTs of different income levels. The bank’s performance is excellent in the moderate-income CT in the AA. We placed the most weight on home purchase loans as the bank originated or purchased more home purchase loans than home refinance or home improvement loans. The bank originated or purchased 13 percent of home purchase loans, 10 percent of home improvement, and 6 percent of home refinance loans in this AA to borrowers located in the moderate-income CT. This exceeds or is near the 7 percent of owner occupied housing in the AA located in the moderate-income CT for home purchase and home improvement loans.

Table 3A shows the bank’s performance compared to the percentage of owner occupied housing in each CT income level.

Table 3A - Geographic Distribution of Residential Real Estate Loans in Minnesota Non-MSA AA								
Census Tract Income Level	Low		Moderate		Middle		Upper	
	% of AA Owner Occupied Housing	% of Number of Loans	% of AA Owner Occupied Housing	% of Number of Loans	% of AA Owner Occupied Housing	% of Number of Loans	% of AA Owner Occupied Housing	% of Number of Loans
Home Purchase	0%	0%	7%	13%	78%	65%	15%	22%
Home Improvement	0%	0%	7%	10%	78%	66%	15%	24%
Home Refinance	0%	0%	7%	6%	78%	67%	15%	27%

Source: 2010 U.S. Census data; 2013-2014 HMDA

Business loans:

The bank’s geographic distribution of business loans reflects excellent dispersion throughout CTs of different income levels. The bank’s performance is excellent in the moderate-income CT. The bank originated or purchased 13 percent of business loans

sampled in this AA to businesses located in the moderate-income CT. This exceeds the nine percent of businesses in the moderate-income CT.

Table 3B shows the bank’s performance compared to the percentage of businesses in each CT income level.

Table 3B - Geographic Distribution of Loans to Businesses in Minnesota Non-MSA AA								
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 Loans	0%	0.00%	9%	13%	78%	65%	13%	22%

Source: 2010 U.S. Census data, Loan Sample (expanded to 60 loans)

Consumer loans:

The bank’s geographic distribution of consumer loans reflects reasonable dispersion throughout CTs of different income levels. The bank’s performance is reasonable in the moderate-income CT. The bank originated or purchased ten percent of consumer loans sampled in this AA to borrowers located in moderate-income CTs. This is comparable to the nine percent of households in the AA located in moderate-income CTs.

Table 3C shows the bank’s performance compared to the percentage of households in each CT income level.

Table 3C - Geographic Distribution of Consumer Loans in Minnesota Non-MSA AA								
Census Tract Income Level	Low		Moderate		Middle		Upper	
Loan type	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans
Consumer Loans	0%	0%	9%	10%	78%	75%	13%	15%

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

Responses to Complaints

Heritage did not receive any CRA complaints during the evaluation period.

COMMUNITY DEVELOPMENT TEST

The bank’s performance under the community development (CD) test in Minnesota is rated “Satisfactory”.

Heritage demonstrated adequate responsiveness to the CD needs of the Minnesota AA through lending, investments, and services. The bank provided one CD loan totaling \$2.4 million and four qualifying investments (donations) totaling \$10,500 to four non-profit organizations within the Minnesota AA. Three employees provided services to four separate qualifying organizations in the Minnesota AA. Heritage also provides

products and services that are accessible to individuals of different income levels. One of the four branches in Minnesota is located adjacent to the AA's only moderate-income level CT. The AA does not have any low-income CTs.

Number and Amount of Community Development Loans

Heritage provided an adequate level of CD loans in the Minnesota AA during the evaluation period.

Heritage originated one CD loan in this AA for \$2,400,000. This loan was to a nursing home which provides services primarily to low or moderate income individuals. The nursing home has one location in the moderate-income CT and another location in a CT bordering the moderate-income CT. The organization meets the needs of Kandiyohi County, specifically the city of Willmar.

Number and Amount of Qualified Investments

Heritage provided an adequate level of qualified investments in the Minnesota AA during the evaluation period.

Heritage made four qualifying investments to four different organizations totaling \$10,500. The qualifying investments were all donations.

Extent to Which the Bank Provides Community Development Services

Heritage provided an adequate level of CD services in the Minnesota AA during the evaluation period.

One of the four branches in the AA was located in a middle-income CT adjacent to the moderate-income CT. The Willmar branch is located a couple of blocks from the moderate-income CT, which may increase access to financial services to low- and moderate-income individuals.

Responsiveness to Community Development Needs

Heritage's CD activities demonstrated adequate responsiveness to CD needs in the Minnesota AA. The CD loans and services provided included a variety of purposes including community services, economic development, and job creation. The level of CD activities provided in Minnesota is consistent with the level of staff in the four branches in the AA and with the branch's deposit and lending activity in relation to the whole bank.

State Rating

State of Iowa

CRA Rating for Iowa: Needs to Improve.

The Lending test is rated: Satisfactory.

The Community development test is rated: Needs to Improve.

The major factors that support the overall rating for Iowa include:

- The bank had poor responsiveness to the CD needs of the AA with a low level of CD lending, investments, and services.
- The distribution of loan in the Iowa AA reflects reasonable penetration among individuals of different income levels and businesses of different sizes.
- The geographic distribution of loans in the Minnesota AA reflects excellent dispersion throughout CTs of different income levels. We put more weight on the bank's borrower distribution factor because the Minnesota AA only has one moderate-income census tract.
- Three of the bank's eight branches in Iowa were located in a moderate-income CT, or in a distressed or underserved middle-income nonmetropolitan CT.

DESCRIPTION OF INSTITUTION'S OPERATIONS IN IOWA

The bank has two AAs in Iowa:

- Iowa Non-MSA AA
- Sioux City MSA

Iowa Non-MSA

Heritage Bank's Iowa Non-MSA assessment area consists of three whole counties and two partial counties in northwest Iowa. The whole counties include Sac, Ida, and Cherokee counties. The partial counties include Buena Vista and Calhoun counties. The bank has only one branch in southwestern Buena Vista County in the city of Alta. Thus, the bank excludes the northeast CT. The CT is a middle-income CT. The bank has a branch in Sac County in the city of Lytton, near the eastern border of Calhoun County. Thus, the bank excludes the two western CTs of Calhoun County. On CT is a moderate-income CT and the other a distressed and underserved middle-income CT. All of these exclusions are reasonable given the location of the bank's branches. The bank does not arbitrarily exclude low- or moderate-income CTs from the AA.

This AA consists of 18 CTs. According to 2014 data, nine of the tracts are considered underserved and/or distressed middle-income, seven tracts are middle-income (not distressed/underserved), and two tracts are upper-income.

Heritage operates four branches in this AA in the following counties and cities:

<u>County:</u>	<u>City:</u>
Ida	Holstein
Sac	Lytton
Cherokee	Aurelia
Buena Vista	Alta

The four branches in this AA represent 30 percent of the bank's total deposits and 72 percent of the bank's Iowa state deposits as of June 30, 2014.

The counties have a combined population of 53,706 with 24,896 housing units according to the updated 2010 U.S. Census data. U.S. Census data reports the median housing value to be \$78,788 and 67 percent of all housing units are owner-occupied. The updated 2014 HUD median family income is \$60,700.

The economic conditions in the area are good. The rural economies were relatively strong during a part of the evaluation period, as land, corn, and soybean prices were high through 2013. Corn and soybean prices declined in 2014, which affected the crop production year. The major employment sectors in the area are agriculture and services establishments. A majority of the businesses are considered small with 79 percent of businesses reporting less than \$1 million in revenue per updated 2014 U.S. Census data. According to March 2015 U.S. Bureau of Labor Statistics, the assessment area unemployment rate is 4.0 percent. This is below the national unemployment rate of 5.5 percent.

There are 27 institutions competing in the rural assessment area. United Bank of Iowa, Central Bank, and Bank Midwest are the larger community banks that provide competition. Farm Credit Services also competes for agricultural lending.

We reviewed a recent community contact with a local federal farm agency. The contact stated credit needs in the community are related to agriculture and housing related needs. The contact stated local institutions are meeting the demands of the community and the local banks in the area have a good reputation for community involvement.

Sioux City MSA

The Sioux City MSA AA consists of a portion of the Sioux City, IA-NE-SD multi-state MSA (#4358029). Heritage includes all of Woodbury County in Iowa and all of Dakota County in Nebraska in its AA. The bank does not include Dixon County in Nebraska, Plymouth County in Iowa, or Union County in South Dakota. The bank's AA is reasonable given the bank only operates branches in the Iowa portion of the MSA.

The bank operates four branches in this AA: two in Sioux City, one in Cushing, and one in Anthon. All of these branches are in Woodbury County, Iowa. Since the bank does not operate any branches in Nebraska or South Dakota, we integrated the Sioux City MSA conclusions with the Iowa state conclusions.

Of the 29 census tracts in the Sioux City MSA AA, one is low income, seven are moderate-income, seventeen are middle-income, and four are upper-income.

The four branches in this AA represent 12 percent of the bank's total deposits and 28 percent of the bank's Iowa state deposits as of June 30, 2014.

Woodbury and Dakota Counties have a population of 123,178 with 49,269 housing units, respectively, according to the 2010 U.S. Census data. The median housing value is \$101,271 and 64 percent of all housing units are owner-occupied. The updated 2014 HUD median family income is \$62,500.

The economic conditions in the area are stable. The major employment sectors in the area are service and retail. According to the March 2015 U.S. Bureau of Labor Statistics, the AA unemployment rate is 4.2 percent. This is below the national unemployment rate of 5.5 percent. A majority of the businesses are considered small with 73 percent of businesses reporting less than \$1 million in revenue.

Bank competition in the Sioux City assessment area is strong. There are 26 financial institutions with a presence in the bank's assessment area, some of which are branches of regional and national banks situated in the metro area.

We reviewed a recent community contact with a local economic development organization. The contact indicated the competitive banking environment resulted in area banks meeting the needs of the AA. The contact stated all banks in the area are involved with community projects and charitable organizations with no specific bank performing better than the other banks.

SCOPE OF EVALUATION IN IOWA

Examiners completed a full-scope review of both the IA Nonmetropolitan (Non-MSA) AA and the Sioux City MSA. The Iowa state ratings are more heavily weighted on the results of the Non-MSA AA because the majority of the lending and deposit activity originates from the Non-MSA AA. During the lending evaluation period 56 percent by number and 65 percent by dollar volume of lending was originated in the Non-MSA AA. As of June 30, 2014, 72 percent of the bank's Iowa deposits came from the Non-MSA AA. Four of the bank's eight branches are located in the Non-MSA AA. The Sioux City MSA results were still significant to the Iowa state rating, although weighted less than the Non-MSA AA results.

The primary loan products in the Non-MSA AA were farm loans. Farm loans represented 55 percent number and 80 percent by dollar volume of loans originated in the AA during the evaluation period. Examiners analyzed the distribution of 60 farm loans in the IA Non-MSA AA.

Loan Originations/Purchased Summary by Loan Product for Iowa Non-MSA AA				
	Number of Loans		Dollars of Loans (\$000s)	
	#	%	\$(000s)	%
Home Loans	3	0%	233	0%
Consumer Loans	214	28%	2,060	2%
Business Loans	135	17%	22,767	18%
Farm Loans	432	55%	102,752	80%
Total	784	100%	127,812	100%

Source: Bank loan data

The primary loan products in the Sioux City MSA were farm loans and business loans. Farm loans represented 37 percent by number and 49 percent by dollar volume of lending in the AA during the evaluation period. Business loans represented 38 percent by dollar volume of lending in the AA during the evaluation period. The evaluation period for the Sioux City MSA lending sample only includes loans originated from January 1, 2014 through March 31, 2015 because the census tract boundaries in Woodbury County in the MSA were changed effective January 1, 2014. Examiners analyzed 20 farm and 20 business loans in the Sioux City MSA for the lending test.

Loan Originations/Purchased Summary by Loan Product for Sioux City MSA*				
	Number of Loans		Dollars of Loans (\$000s)	
	#	%	\$(000s)	%
Home Loans	57	17%	4,283	11%
Consumer Loans	78	24%	973	2%
Business Loans	70	22%	15,255	38%
Farm Loans	119	37%	19,340	49%
Total	324	100%	39,851	100%

Source: Bank loan data

CONCLUSIONS WITH RESPECT TO PERFORMANCE TESTS IN IOWA

Heritage's CRA performance in Iowa needs to improve. The bank's performance is needs to improve under the CD test and satisfactory under the lending test. The Iowa rating is weighted heavier on performance in the Non-MSA AA as discussed in the above "Scoping" section. Performance in the Sioux City MSA was still significant. Both AAs received a full-scope review.

LENDING TEST

The bank's performance under the lending test in Iowa is rated "Satisfactory". Heritage has reasonable penetration among farms and businesses of different sizes. Heritage has reasonable geographic dispersion throughout CTs of different income levels. More weight was placed on the distribution of farms and businesses of different sizes as there is less diversity in the Iowa AAs with relatively small amount of farms and businesses located in low- or moderate-income CTs.

Iowa Non-MSA AA:

The bank’s performance under the lending test in this AA is rated needs to improve. Heritage has poor penetration of loans among farms of different sizes in this AA. The geographic distribution of loans in the IA Non-MSA AA was not meaningful as this AA has no low- or moderate-income CTs. However, we considered 52 percent of the farm loans sampled were originated in distressed and/or underserved nonmetropolitan middle-income CTs based on 2014 CT income levels.

Sioux City MSA

The bank’s performance under the lending test in this AA is rated satisfactory. Heritage has excellent penetration of loans among farms and businesses of different sizes and reasonable geographic dispersion of farm and business loans throughout CTs of different income levels in this AA. We considered the AA’s overall lending performance satisfactory because of the lack of lending to any businesses in the low-income CT and to any farms in the moderate-income CT. While the opportunity to lend to farms and businesses in these CTs is reasonable given the low volume of farms and businesses in these AAs, the bank’s performance is not reflective of an outstanding rating.

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

The distribution of loans in Iowa AAs reflects reasonable penetration among farms and businesses of different sizes.

IA Non-MSA AA:

The distribution of farm loans reflects poor penetration among farms of different sizes. The bank originated or purchased 77 percent by number and 47 percent of farm loans sampled by dollar volume of loans sampled in this AA to small farms. This is considered poor as it is significantly lower than the demographic data which shows 99 percent of farms in the AA are considered small farms. Small farms are farms with gross annual revenues of one million dollars or less.

Table 4A shows the distribution of farm loans among farms of different sizes in the AA.

Table 4A - Borrower Distribution of Loans to Farms in Iowa Non-MSA AA				
Farm Revenues (or Sales)	≤\$1,000,000	>\$1,000,000	Unavailable/ Unknown	Total
% of AA Farms	99%	1%	0%	100%
% of Bank Loans in AA by #	77%	20%	3%	100%
% of Bank Loans in AA by \$	47%	52%	1%	100%

Source: 2010 U.S. Census data, Loan Sample (expanded to 60 loans)

Sioux City MSA:

The distribution of farm and business loans reflects excellent penetration among farms and businesses of different sizes.

Farm loans:

The bank’s distribution of loans to farms reflects excellent penetration among farms of different sizes. The bank originated or purchased 100 percent by number and dollar volume of farm loans sampled in this AA to small farms. This is considered excellent as it exceeds the demographic data which shows 98 percent of farms in the AA are considered small. Small farms are farms with gross annual revenues of one million dollars or less.

Table 4B shows the distribution of farm loans among farms of different sizes in the AA.

4B - Borrower Distribution of Loans to Farms in Sioux City MSA				
Farm Revenues (or Sales)	≤\$1,000,000	>\$1,000,000	Unavailable/Unknown	Total
% of AA Farms	98%	1%	1%	100%
% of Bank Loans in AA by #	100%	0%	0%	100%
% of Bank Loans in AA by \$	100%	0%	0%	100%

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

Business loans:

The bank’s distribution of loans to businesses reflects excellent penetration among businesses of different sizes. The bank originated or purchased 85 percent by number and 98 percent by dollar volume of business loans sampled in this AA to small businesses. This is considered excellent as it exceeds the demographic data, which shows 70 percent of businesses in the AA are considered small. Small businesses are businesses with gross annual revenues of one million dollars or less.

Table 4C shows the distribution of business loans among businesses of different sizes in the AA.

4C - Borrower Distribution of Loans to Businesses in Sioux City MSA				
Business Revenues (or Sales)	≤\$1,000,000	>\$1,000,000	Unavailable/Unknown	Total
% of AA Business	70%	6%	24%	100%
% of Bank Loans in AA by #	85%	5%	10%	100%
% of Bank Loans in AA by \$	98%	1%	1%	100%

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

Geographic Distribution of Loans

The geographic distribution of loans in Iowa AAs reflects reasonable dispersion throughout CTs of different income levels.

IA Non-MSA AA:

The geographic distribution of loans in the Iowa Non-MSA AA is not meaningful because there are no low- or moderate-income CTs in this AA in 2014. However, the bank originated or purchased 52 percent of farm loans sampled to borrowers located in underserved and/or distressed nonmetropolitan middle-income CTs. Nine of the bank’s

18 CTs in this AA are considered underserved and/or distressed nonmetropolitan middle-income CTs in 2014. One of these CTs was a moderate-income CT in 2013 and is now an underserved and distress nonmetropolitan middle income CT in 2014. Four loans in our sample were originated to borrowers located in the previously moderate-income CT in 2013.

Sioux City MSA:

The geographic distribution of loans in the Sioux City MSA reflects reasonable dispersion throughout CTs of different income levels.

Farm loans:

The bank’s geographic distribution of farm loans reflects reasonable dispersion throughout CTs of different income levels. The bank’s performance is reasonable in moderate-income CTs. Although the bank did not originate any of the farm loans sampled in this AA to farms located in a moderate-income CT, only 5 percent of farms in the AA are located in a moderate-income CT. No farms in the Sioux City MSA are located in the low-income CT.

Table 5A shows the bank’s performance compared to the percentage of farms in each CT income level.

5A - Geographic Distribution of Loans to Farms in Sioux City MSA								
Census Tract Income Level	Low		Moderate		Middle		Upper	
Loan Type	% of AA Farms	% of Number of Loans	% of AA Farms	% of Number of Loans	% of AA Farms	% of Number of Loans	% of AA Farms	% of Number of Loans
Farm Loans	0%	0%	5%	0%	81%	100%	14%	0%

Source: 2010 U.S. Census data

Business loans:

The bank’s geographic distribution of business loans reflects reasonable dispersion throughout CTs of different income levels. The bank’s performance is reasonable in moderate-income CTs. The bank originated or purchased 20 percent of business loans sampled in this AA to businesses located in moderate-income CTs. This is near the 29 percent of businesses located in moderate-income CTs. The bank’s performance is reasonable in the low-income CT. Although the bank did not originate any of the business loans in the sampled in this AA to businesses located in the moderate-income CT, only 2 percent of businesses in the AA are located in the low-income CT.

Table 5B shows the bank’s performance compared to the percentage of businesses in each CT income level.

5B - Geographic Distribution of Loans to Businesses in Sioux City MSA								
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 Loans	2%	0%	29%	20%	49%	60%	20%	20%

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

Responses to Complaints

Heritage did not receive any CRA complaints during the evaluation period.

COMMUNITY DEVELOPMENT TEST

The bank’s performance under the community development test in Iowa is rated “Needs to Improve”.

Heritage demonstrated poor responsiveness to the CD needs of the Iowa AAs. The bank did not provide any CD loans and provided a low volume of CD investments and services in the AAs. The bank provided four qualifying investments to four organizations totaling \$13,000. Two employees provided CD services to three separate qualifying organizations in the Iowa AAs. Employees also provided technical assistance to eight individuals applying for down payment assistance through the FHLB grant program. Heritage also provides bank products and services that are accessible to individuals of different income levels. Three of the bank’s eight branches in Iowa is located in a moderate-income CT or in a distressed and/or underserved nonmetropolitan middle-income CTs.

Number and Amount of Community Development Loans

Heritage provided a poor level of CD loans in the Iowa AAs during the evaluation period. Heritage did not provide any loans in the Non-MSA AA or the Sioux City AA during the evaluation period.

Number and Amount of Qualified Investments

Heritage provided a poor level of qualified investments in the Iowa AAs during the evaluation period.

IA Non-MSA AA

Heritage provided a poor level of qualified investments in the Non-MSA AA during the evaluation period. Heritage made two qualifying investments to separate qualifying organizations totaling \$2,500. Both investments were donations.

Sioux City MSA

Heritage provided a poor level of qualified investments in the Non-MSA AA during the evaluation period. Heritage made two qualifying investments to separate qualifying organizations totaling \$10,500. Both qualifying investments were donations.

Extent to Which the Bank Provides Community Development Services

Heritage provided a poor level of CD services in the Iowa AAs during the evaluation period. Management needs to increase the bank's CD activities in the Iowa state AAs.

Iowa Non-MSA AA

Heritage provided a poor level of CD services in the Non-MSA AA during the evaluation period.

One employee provided one CD service to one qualifying organization in this AA, related to economic development. Additionally, employees provided technical assistance to four low- or moderate-income individuals applying for home loan down payment assistance through the rural FHLB grant program.

Two of the four branches in the AA were located in a distressed and/or underserved middle-income nonmetropolitan CT. The Holstein and Lytton branches were located in a distressed and/or underserved nonmetropolitan middle-income CT during the entire evaluation period.

Sioux City MSA

Heritage provided a poor level of CD services in the Sioux City MSA during the evaluation period.

One employee supported two separate qualifying organizations targeted to serve low- and moderate-income individuals. Additionally, employees provided technical assistance to four low- or moderate-income individuals applying for home loan down payment assistance through the urban FHLB grant program.

One of the four branches in the AA is located in a moderate-income CT. This increases access to financial services to low- and moderate-income individuals. The downtown Sioux City branch is in a moderate-income CT.

Responsiveness to Community Development Needs

Heritage's CD activities demonstrated poor responsiveness to CD needs in the Iowa AAs. Management need to increase the bank's CD activities in the Iowa state AAs. There are CD opportunities within the Iowa AAs in lending, investments or services. The Non-MSA AA has three counties with distressed and/or underserved middle-income CTs and the Sioux City MSA has moderate-income CTs and numerous organizations targeted to serve low- and moderate-income individuals and/or geographies. The bank made no loans, a low volume of investments and a relatively small number of employees are involved in CD activities.

Appendix A: Scope of Examination

The following table identifies the time period covered in this evaluation, affiliate activities that were reviewed, and loan products considered. The table also reflects the metropolitan and nonmetropolitan areas that received comprehensive examination review (designated by the term “full-scope”) and those that received a less comprehensive review (designated by the term “limited-scope”).

Time Period Reviewed	Lending Test: 01/01/13 to 03/31/15 Community Development Test: (10/16/12 to 05/11/15)	
Financial Institution	Products Reviewed	
Heritage Bank, National Association (Heritage) Spicer, MN	See list below for each AA	
Affiliate(s)	Affiliate Relationship	Products Reviewed
None		
List of Assessment Areas and Type of Examination		
Assessment Area	Type of Exam	Other Information
Minnesota Nonmetropolitan MN	Full-scope	Home loans, Business loans, Consumer loans
Iowa Nonmetropolitan MN Sioux City MSA #43580 (Partial)	Full scope Full Scope	Farm loans Farm loans, Business loans

Appendix B: Summary of State Area Ratings

Overall Bank:	Lending Test Rating	Community Development Test Rating	Overall Bank/State/Multistate Rating
Heritage Bank, NA	Satisfactory	Satisfactory	Satisfactory
Minnesota	Satisfactory	Satisfactory	Satisfactory
Iowa	Satisfactory	Needs to Improve	Needs to Improve