



SMALL BANK

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

PUBLIC DISCLOSURE

October 29, 2007

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

North Cascades National Bank
Charter Number: 21107

220 Johnson Avenue
Chelan, WA 98816

Office of the Comptroller of the Currency
Western District
San Francisco Field Office
One Front Street, Suite 1000
San Francisco, CA 94111

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 COMMUNITY REINVESTMENT ACT (CRA) RATING: This institution is rated Satisfactory.

- The average loan-to-deposit ratio of 64.65% is reasonable given the bank's size, financial condition, credit needs and the competitive banking market of the assessment area.
- A majority of loans originated are in the bank's assessment area.
- The distribution of loans reflects reasonable penetration among businesses of different sizes.
- The geographic distribution of loans reflects reasonable dispersion throughout the assessment area.

SCOPE OF EXAMINATION

The scope of this examination includes a review of lending activity for the time period of January 1, 2005 through June 30, 2007. The lending products reviewed were commercial loans, real estate commercial loans, and real estate non-conforming loans.

The bank recently acquired Mid-State Bank in July 2007. However, we did not include lending activity of Mid-State Bank in our review since the acquisition occurred after the review period.

DESCRIPTION OF INSTITUTION

North Cascades National Bank (NCNB) is a community bank headquartered in Chelan, Washington with 11 branches (including three new branches through the acquisition of Mid-State Bank in July 2007) in surrounding towns. North Cascades Bancshares, Inc. is the holding company for the bank and is the sole owner of the bank. The bank received a Satisfactory rating at the last CRA examination performed October 29, 2001.

NCNB serves Chelan, Douglas, Okanogan, and Grant Counties. As of June 30, 2007, the bank has total assets of \$233 million. Net loans represent approximately 68% of the bank's average assets. NCNB added three branches and has not closed any branches since the previous CRA examination. NCNB operates 11 automated teller machines (ATMs) in the community. The ATMs are located at the bank's Chelan, Pateros, Twisp, Wenatchee, Omak, Bridgeport, Grand Coulee, and Waterville branches. They also have ATM locations in Coulee City, Mansfield, and Orondo. The 24-hour ATMs allow customers to transfer funds, deposit money, inquire about balances, and withdraw money. The bank also offers telephone and Internet banking.

NCNB's primary focus is commercial real estate lending, which accounts for over 71% of the bank's loan portfolio. NCNB also offers commercial, agricultural, home mortgage,

home improvement, credit card and consumer loans. The following table shows the composition of the loan portfolio as of June 30, 2007.

| LOAN PORTFOLIO COMPOSITION June 30, 2007 | | |
|---|------------------------|-----------------------|
| Loan Type | \$ Volume (000) | % of Portfolio |
| Commercial Real Estate | 122,759 | 71.73 |
| Commercial | 24,970 | 14.59 |
| 1-4 Family Residential | 13,891 | 8.12 |
| Agriculture | 5,287 | 3.09 |
| Consumer | 2,577 | 1.51 |
| Obligations of State and Political | 1,666 | 0.97 |
| Total: | 171,150 | 100.00 |

Source: 06/30/07 Call Report

There are no legal or financial factors that impede the bank’s ability to help meet the credit needs in its assessment area. The only factor that may impact the bank’s ability to make loans in its primary product line and to penetrate its entire assessment area is the strong competition from other financial institutions.

DESCRIPTION OF ASSESSMENT AREA(S)

NCNB's assessment area is located in the north central part of the state of Washington. The current assessment area consists of all of Chelan, Douglas, Okanogan, and Grant Counties. Two counties, Chelan and Douglas, are located in a Metropolitan Statistical Area (MSA); and Okanogan and Grant counties are located in a non-MSA. The bank expanded their assessment area to include all of Grant County from one Block Numbering Area (BNA) in the county at the previous examination. Based on 2000 U.S. Census data, the bank's assessment area has a population of 213,481, which is an increase of 50% since the bank expanded the assessment area. The assessment area meets the requirements of the regulation and does not arbitrarily exclude low- and moderate-income geographies. The following table details the number and percentage of census tracts by income level within the bank's assessment area.

| ASSESSMENT AREA COMPOSITION INCOME DISTRIBUTION OF CENSUS TRACTS & FAMILIES | | | | |
|--|--------------------------------------|---------------------------------|---------------------------------|----------------------------------|
| Income of Census Tracts | Number of Total Census Tracts | Percent of Census Tracts | Number of Total Families | Percent of Total Families |
| Low Income | 0 | 0.00 | 0 | 0.00 |
| Moderate Income | 13 | 29.54 | 17,174 | 30.86 |
| Middle Income | 25 | 56.82 | 29,855 | 53.64 |
| Upper Income | 6 | 13.64 | 8,629 | 15.50 |
| Total: | 44 | 100.00 | 55,658 | 100.00 |

Sources: 2000 U.S. Census

The 2006 updated Department of Housing and Urban Development (HUD) MSA median family income is \$49,873. Based on 2000 U.S. Census data, there are 55,658 families residing in the assessment area, of which none live in low-income tracts, 30.86% in moderate-income tracts, 53.64% in middle-income tracts, and 15.50% in upper-income tracts. Fifty-six percent of housing is owner-occupied and 14% of the households are below the poverty level.

The local economy is tied to summer tourism and agricultural products. Most area employers are recreation or tourist businesses, government employment or businesses which serve and support the local population. The average unemployment rate for the four counties, from 2003 to first quarter 2007, ranges from a low of 5.98% to a high of 8.95%, with a four-year average of 7.36%.

The Wenatchee MSA includes Chelan and Douglas Counties. Chelan County covers 2,921 square miles and Douglas County covers 1,821 square miles. Chelan and Douglas Counties contain the majority of the tree fruit growing in the bank's assessment area. The geographic setting is primarily agriculture and the predominant products are fruit trees and wheat crops. Also, wineries are becoming more prevalent in the area. The unemployment rate decreased slightly to 4.6%, as of the second quarter of 2007³. Four of the thirteen moderate-income tracts in the assessment area are located in this MSA.

Okanogan County covers 5,265 square miles; however, only 30% of the land within the county is in private ownership due to the amount of state and federal land¹. The Colville Indian Reservation, located in the southeast corner of the county, occupies approximately 700,000 acres of Okanogan County. Employment growth remained stable at 1.8%, as of the first quarter of 2007³. Five of the thirteen moderate-income tracts in the assessment area are located in this county.

Grant County covers 2,681 square miles and approximately 1,678 square miles, or 63%, are farm lands². The non-farm employment rate is increasing rapidly, and the

1 Source: June 2001 Okanogan County Assessor's Office

2 Source: 2002 Census of Agriculture

county's total employment growth rate was 3.4% as of the first quarter of 2007³. Four of the thirteen moderate-income tracts in the assessment area are located in this county.

Competition from other financial institutions is strong. There are 17 financial institutions in the bank's assessment areas with 77 branches. NCNB is ranked sixth with 6.88% deposit market share.

In conjunction with this CRA examination, we conducted a community contact in the bank's assessment area to learn about the credit opportunities within the community, and how well financial institutions are addressing the community's credit and service needs. We spoke with a business group, and this contact revealed that the local apple industry experienced difficulties in the early part of the evaluation period. However, within the last two years, an upswing in the economy has occurred with the growth of the wine and tourism industries. This contact did not identify any credit needs in the assessment area.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

Loan-to-Deposit Ratio

NCNB's level of lending is reasonable given the bank's size, its capacity to lend, credit needs of the assessment area, and the competitive banking market in north central Washington.

We analyzed NCNB's loan-to-deposit (LTD) ratio over the last 24 quarters, September 2001 through June 2007. During these 24 quarters, the LTD ratio ranged from a low of 50.65% in September 2003 to a high of 85.6% in June 2007, with an average of 64.65%.

We compared NCNB's performance under this criterion to three banks with total assets between \$19 million and \$878 million in north central Washington. These banks had an average LTD ratio, over the same period, of 64.98%.

Lending in Assessment Area

The bank's level of lending within its assessment area meets the standard for satisfactory performance.

Our analysis of lending in the assessment area was determined from a review of the bank's three primary loan products; commercial, commercial real estate, and real estate non-conforming loans. We reviewed a random sample of 40 loans from the commercial product, 60 loans from the commercial real estate product, and 20 loans from the real estate non-conforming product originated since the previous CRA examination. The following tables demonstrate the distribution of commercial, commercial real estate, and

3 Source: FDIC regional Economic Conditions (RECON)

real estate non-conforming loans originated inside and outside NCNB's assessment area.

| COMMERCIAL, COMMERCIAL REAL ESTATE AND REAL ESTATE NON-CONFORMING LOANS YEARS 1/1/2005- 6/30/2007 | | | | | | | | |
|--|------------------------|------------|---------------------|--------------|-------------------------|------------|---------------------|--------------|
| | Inside Assessment Area | | | | Outside Assessment Area | | | |
| | # of Loans | % of Loans | \$ (000's) of Loans | % of \$(000) | # of Loans | % of Loans | \$ (000's) of Loans | % of \$(000) |
| Commercial Loan Sample | 36 | 90.00 | 5,638 | 64.93 | 4 | 10.00 | 3,045 | 35.07 |
| Commercial Real Estate Loan Sample | 45 | 75.00 | 16,730 | 50.38 | 15 | 25.00 | 16,480 | 49.62 |
| R.E. Non-Conforming Loan Sample | 20 | 100.00 | 2,050 | 100.00 | 0 | 0.00 | 0 | 0.00 |
| Total Loans Reviewed | 101 | 84.17 | 24,428 | 55.57 | 19 | 15.83 | 19,525 | 44.43 |

As demonstrated above, NCNB originated a majority of its commercial, commercial real estate, and real estate non-conforming loans within its assessment area. Moreover, the bank disbursed a majority of lending dollars within the assessment area. Consequently, NCNB's lending within the assessment area meets the standard for satisfactory performance.

Lending to Businesses of Different Sizes

The bank's level of lending to businesses of different sizes meets the standard for satisfactory performance.

Our sample included 36 commercial loans, 45 commercial real estate loans, and 20 real estate non-conforming loans, totaling \$5.6 million, \$16.7 million and \$2.1 million, respectively. These loans were originated between January 1, 2005 and June 30, 2007, and were within the bank's assessment area.

We compared the bank's commercial and commercial real estate lending in the assessment area to the demographics of small businesses of the assessment area. Small businesses are those with gross revenues of \$1 million or less. Updated business demographics reflect that approximately 68% of the businesses in the assessment area are designated small businesses. The following table reflects the distribution of commercial and commercial real estate loans by business revenue size.

| DISTRIBUTION OF COMMERCIAL LOANS BY ANNUAL REVENUE YEARS 1/1/2005-6/30/2007 | | | | | |
|--|-------------------|-------------------|----------------------------|---------------------|-------------------------------------|
| Revenue Size | # of Loans | % of Loans | \$ (000's) of Loans | % of \$(000) | % of Small Businesses in AA* |
| Under \$1,000,000 | 28 | 77.78 | 3,741 | 66.34 | 67.79 |
| Over \$1,000,000 | 8 | 22.22 | 1,897 | 33.66 | 3.58 |
| Unavailable/Unknown | - | - | - | - | 28.63 |
| Total Loan Sample: | 36 | 100.00 | 5,638 | 100.00 | 100.00 |

*Source: 2006 Business Geo-demographic Data

| DISTRIBUTION OF COMMERCIAL REAL ESTATE LOANS BY ANNUAL REVENUE YEARS 1/1/2005-6/30/2007 | | | | | |
|--|-------------------|-------------------|----------------------------|---------------------|-------------------------------------|
| Revenue Size | # of Loans | % of Loans | \$ (000's) of Loans | % of \$(000) | % of Small Businesses in AA* |
| Under \$1,000,000 | 35 | 77.78 | 12,839 | 76.74 | 67.79 |
| Over \$1,000,000 | 10 | 22.22 | 3,891 | 23.26 | 3.58 |
| Unavailable/Unknown | - | - | - | - | 28.63 |
| Total Loan Sample: | 45 | 100.00 | 16,730 | 100.00 | 100.00 |

*Source: 2006 Business Geo-demographic Data

These tables reflect a distribution of loans to small businesses that are comparable to the demographics of the assessment area. The majority of business loans are made to businesses with revenues under \$1 million. Of the commercial loans, 77.78% of the loans reviewed had gross annual revenues under \$1 million, of which 67.86% were under \$500,000. Of the commercial real estate loans of the assessment area reviewed, 77.78% had gross annual revenue under \$1 million, of which 64.44% were to businesses with annual revenues under \$500,000. This demonstrates the bank's commitment to make loans available to small businesses, an identified community credit need. The bank's lending to small businesses reasonably compares with the demographics in the assessment area and meets the standard for satisfactory performance.

Geographic Distribution of Loans

The bank's geographic distribution of loans within the assessment area meets the standard for satisfactory performance.

We analyzed the sample loans used in the previous performance criteria section to determine if the distribution among census tracts of various income levels tracts meets the demographics of the assessment area. The following table illustrates the commercial loans' geographic distribution of the bank's lending within the assessment area.

| COMMERCIAL LOANS' GEOGRAPHIC DISTRIBUTION YEARS 1/1/2005 – 6/30/2007 | | | | | |
|---|-------------------|-------------------|----------------------------|---------------------|-------------------------------------|
| Income of Tract | # of Loans | % of Loans | \$ (000's) of Loans | % of \$(000) | % of Small Businesses in AA* |
| Low Income | 0 | 0.00 | 0 | 0.00 | 0.00 |
| Moderate Income | 8 | 22.22 | 1,379 | 24.46 | 28.68 |
| Middle Income | 28 | 77.78 | 4,259 | 75.54 | 58.47 |
| Upper Income | 0 | 0.00 | 0 | 0.00 | 12.85 |
| Total Loan Sample: | 36 | 100.00 | 5,638 | 100.00 | 100.00 |

*Source: 2006 Business Geo-demographic Data

As shown above, loan penetration in the moderate-income tract is slightly below in number of loans and dollar volume. Overall, the distribution of commercial loans generally corresponds to the income distribution of the census tracts and reflects reasonable dispersion among moderate-income geographies. Consequently, the bank's geographic distribution of commercial loans meets the standard for satisfactory performance.

The following table illustrates the commercial real estate loans' geographic distribution of the bank's lending within the assessment area.

| COMMERCIAL REAL ESTATE LOANS' GEOGRAPHIC DISTRIBUTION YEARS 1/1/2005 – 6/30/2007 | | | | | |
|---|-------------------|-------------------|----------------------------|---------------------|-------------------------------------|
| Income of Tract | # of Loans | % of Loans | \$ (000's) of Loans | % of \$(000) | % of Small Businesses in AA* |
| Low Income | 0 | 0.00 | 0 | 0.00 | 0.00 |
| Moderate Income | 9 | 20.00 | 5,655 | 33.80 | 28.68 |
| Middle Income | 35 | 77.78 | 10,439 | 62.40 | 58.47 |
| Upper Income | 1 | 2.22 | 636 | 3.80 | 12.85 |
| Total Loan Sample: | 45 | 100.00 | 16,730 | 100.00 | 100.00 |

*Source: 2006 Business Geo-demographic Data

As shown above, commercial real estate loan penetration in the moderate-income tract is slightly below demographics in number of loans, but above in dollar amount of loans. Overall, the distribution of commercial real estate loans generally corresponds to the income distribution of the MSA and census tracts and reflects reasonable dispersion among moderate-income geographies. Therefore, the bank's geographic distribution of commercial real estate loans meets the standard for satisfactory performance.

The following table compares the geographic distribution of real estate non-conforming loans located in each type of census tract.

| REAL ESTATE NON-CONFORMING LOANS' GEOGRAPHIC DISTRIBUTION | | | | | |
|--|-------------------|-------------------|----------------------------|---------------------|-----------------------------|
| YEARS 1/1/2005 – 6/30/2007 | | | | | |
| Income of Tract | # of Loans | % of Loans | \$ (000's) of Loans | % of \$(000) | % of Families in AA* |
| Low Income | 0 | 0.00 | 0 | 0.00 | 0.00 |
| Moderate Income | 5 | 25.00 | 287 | 13.99 | 29.55 |
| Middle Income | 15 | 75.00 | 1,764 | 86.01 | 56.82 |
| Upper Income | 0 | 0.00 | 0 | 0.00 | 13.64 |
| Total Loan Sample: | 20 | 100.00 | \$2,051 | 100.00 | 100.00 |

*Source: 2006 Business Geo-demographic Data

For the real estate non-conforming loans sampled, NCNB's performance in lending to moderate-income families, by number and dollar volume is below demographics. However a large area of Okanogan County (70%) is designated state and federal land. Also, competition for affordable housing is strong in Chelan and Douglas counties as there are only two moderate-income tracts in each of these counties.

Responses to Complaints

NCNB received one written complaint related to CRA performance since the last examination. The letter was in regards to the pending relocation of the bank's Pateros Office to Brewster, WA. The bank acknowledged the letter and a response was issued.

Fair Lending or Other Illegal Credit Practices Review

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