



Comptroller of the Currency
Administrator of National Banks

Small Bank

Northeastern District
1114 Avenue of the Americas, Suite 300
New York, New York 10036

PUBLIC DISCLOSURE

August 9, 1999

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

Merchants National Bank of Kittanning

Charter Number 5073

**222 Market Street
Kittanning, Pennsylvania 16201**

**Office of the Comptroller of the Currency
4075 Monroeville Boulevard, Suite 300
Monroeville, Pennsylvania 15146-2529**

NOTE: 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.

GENERAL INFORMATION

The Community Reinvestment Act (CRA) requires each federal supervisory agency to use its authority when examining financial institutions subject to its supervision, to assess the 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. Upon conclusion of such examination, the agency must prepare a written evaluation of the institution's record of meeting the credit needs of its community.

This document is an evaluation of the Community Reinvestment Act (CRA) performance of **Merchants National Bank of Kittanning** prepared by the **Office of the Comptroller of the Currency**, the institution's supervisory agency, as of August 9, 1999. The agency rates the CRA performance of an institution consistent with the provisions set forth in Appendix A to 12 CFR Part 25.

INSTITUTIONS'S CRA RATING: This institution is rated **SATISFACTORY**

Major factors supporting the overall rating for Merchants National Bank of Kittanning include the following:

- ◆ The distribution of residential mortgage loans among various geographies is strong.
- ◆ The loan distribution among borrowers of different incomes and businesses of different sizes is reasonable.
- ◆ The majority of loans are originated within the assessment area.

DESCRIPTION OF INSTITUTION

Merchants National Bank of Kittanning (MNB) is a \$125 million community bank located in central Armstrong County. The bank is headquartered approximately 50 miles northeast of Pittsburgh, Pennsylvania in the town of Kittanning, the seat of Armstrong County. The bank is wholly owned by Merchants Bancorp of Pennsylvania, Inc., a one-bank holding company. MNB is a full service bank offering a wide range of deposit and loan products. Loan products include residential and commercial mortgages, consumer and commercial loans. MNB received a satisfactory CRA rating as a result of the previous CRA evaluation, which was conducted as of August 1, 1996.

Net loans represent 51% of MNB's total assets. MNB's loan portfolio is broken down by dollar volume as follows: 44% residential real estate loans, 27% consumer loans, 21% commercial real estate loans and 8% commercial loans. There are no financial or legal impediments that would preclude MNB from lending.

The bank has four branch locations. The main office and two additional branch offices are located in Kittanning, Pennsylvania. One additional branch office is located in neighboring Worthington, Pennsylvania. The bank also has six Automatic Teller Machines (ATM) located throughout the Kittanning and Worthington areas.

DESCRIPTION OF ASSESSMENT AREA

MNB has identified eight whole geographies as its assessment area (AA). Seven of the geographies are located in Armstrong County while the remaining geography is located in Butler County. The assessment area is comprised primarily of middle-income geographies. However, the assessment area also contains one moderate-income geography situated in Armstrong County. The assessment area contains no low- or upper-income geographies. The bank does not operate any branches or ATMs within a Metropolitan Statistical Area (MSA.) According to 1998 demographic data, the Pennsylvania non-MSA median family income is \$35,200. The assessment area complies with all regulatory requirements and does not arbitrarily exclude low- or moderate-income areas.

The bank's assessment area consists of predominantly small town and rural communities. The population of MNB's assessment area as of the 1990 census was 41,255. Demographic data collected during the 1990 census reports the median family income to be \$35,833 for the assessment area of the bank. The same data also reports that within the bank's assessment area, owner occupied housing represents 70% of housing units, and the median housing value equals \$47,975. The majority (70%) of households are

supported by wage or salaried jobs. However, 12% of households are considered to be at or below poverty level.

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Industry within the assessment area is diverse. Major employers are manufacturers of plumbing ware and rubber. Other significant employers include county government, a local hospital, four school districts and a small branch campus of a state university. The remainder of local industry consists of small retail and service establishments as well as several smaller machine shops. Technology and industry consolidation have resulted in the loss of some jobs. A significant portion of the population now commutes to jobs in Butler and Allegheny Counties. However, a nearby industrial park is being developed to attract new industries such as optical manufacturing. Overall, economic conditions in the assessment area remain stagnant.

Competition is strong. Kittanning is heavily banked, housing a total of seven banks including MNB. Bank management considers the primary competition for its customer base to be four of the smaller, local banks. A fifth bank is primarily a deposit taking institution. The remaining bank is the branch of a large regional institution located in Pittsburgh. Local branches of two other large regional banks have closed in recent years.

Discussions with management indicated that within the assessment area, credit needs continue to be concentrated primarily in residential mortgage, consumer (automobile and home improvement) and small business lending. Examiners contacted the program coordinator of Armstrong County Industrial Development Authority. The credit needs identified by the contact were consistent with management's assessment. The contact indicated that the local community banks are responsive to community credit needs. According to the contact, local community banks actively participate in community development related projects and have utilized available community outreach programs. The contact mentioned a revolving loan fund established by local banks for the purpose of revitalizing downtown Kittanning. The contact also specifically identified Merchants National Bank as a local financial institution that "does a lot" to meet community credit needs.

SAMPLING

Business, residential mortgage and consumer loan data was collected from the bank through a random sample of residential mortgage loans and consumer loans originated to borrowers located inside and outside of the bank's assessment area. Since the bank experienced no significant changes in lending patterns during the years since the previous CRA evaluation, data derived from 1/1/98 through 6/30/99 was used to represent lending throughout the entire period.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

Loan to Deposit Analysis

- ◆ The loan to deposit ratio is reasonable compared to local peer banks and meets the performance standard.

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The loan to deposit ratio over the past 12 quarters averages 59.2%. This compares reasonably to the level of lending achieved by the bank's local peer group, which averaged 62.7% over the same 12 quarters. Peer banks included twenty-four local Pennsylvania banks with an asset size of \$250 million or less, operating within a seven county area. Overall, the loan to deposit ratio has trended upward from 51.8%, as of 6/30/96.

Lending in Assessment Area

- ◆ The majority of sampled residential mortgage, consumer loans and business loans are originated within the bank's assessment area, which meets the performance standard.

To assess MNB's level of lending in its assessment area, we sampled a total of 75 loans originated between 1/1/98 and 6/30/99. Our sample revealed that 67% of the total loan volume and 79% of the total loan dollars were originated within the assessment area. Conversely, residential mortgage, consumer and business loan originations to borrowers located outside of the assessment area were 33% of the total loan volume and 21% of the total loan dollars.

The following table details the percentage of loans originated by MNB inside the assessment area broken down by loan type.

ASSESSMENT AREA	LENDING IN			
	Volume		Dollar	
	Total	Percentage in Assessment Area	Total (000's)	Percentage in Assessment Area
Residential Real Estate	25	84%	1,499	70%
Consumer Loans	25	36%	185	65%

Business Loans	25	80%	3,730	84%
Total Loans	75	67%	5,414	79%

Lending to Borrowers of Different Incomes and Businesses of Different Sizes

- ◆ MNB's lending to borrowers of different income levels and businesses of different sizes meets the performance standard.

Residential Mortgage and Consumer Lending

MNB's primary product lines include residential mortgage loans and consumer loans. A sample of 50 loans originated by MNB was reviewed to determine the level of lending to low-income and moderate-income borrowers. The sample revealed that between 1/1/98 and 6/30/99, combined residential mortgage and consumer lending to LMI borrowers (low- and moderate- income borrowers collectively) represented 32% of the combined loan volume and 24% of the combined loan dollars, respectively. Demographic information taken from 1990 U.S. Census data indicates that LMI families represent 39% of the assessment area population. Overall, MNB's record of lending to LMI borrowers is considered to be reasonable.

The following table illustrates MNB's lending to borrowers of different income levels for the same sample of 50 loans.

LENDING TO BORROWERS OF DIFFERENT INCOME LEVELS					
	ASSESSMENT AREA POPULATION	LOAN SAMPLE			
		Residential Mortgage Loans		Consumer Loans	
		#	\$000's	#	\$000's
LOW INCOME FAMILIES	19%	1	36	1	1
		4%	2%	4%	1%
MODERATE INCOME FAMILIES	20%	8	337	6	37
		32%	23%	24%	20%
MIDDLE INCOME FAMILIES	24%	6	246	11	62
		24%	16%	44%	34%
UPPER INCOME FAMILIES	37%	10	880	7	85
		40%	59%	28%	46%
TOTAL FAMILIES	100%	25	1,499	25	185

		100%	100%	100%	100%
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MNB's record of lending to moderate-income borrowers compares favorably to assessment area demographics. As indicated above, of residential mortgage originations, 32% of loan volume and 23% of loan dollars were originated to moderate-income borrowers compared to total AA families of which 20% are moderate income. As the table also indicates, of consumer loan originations 24% of loan volume and 20% of loans dollars were originated to moderate-income borrowers, while of total AA families 20% are moderate-income.

MNB's level of residential mortgage and consumer lending to low-income borrowers compared to assessment area (AA) demographics is reasonable. Of sampled loans, residential mortgages originated to low-income borrowers represented 4% of mortgage volume and 2% of mortgage dollars. MNB's opportunity to originate mortgage loans to low-income borrowers is impacted by the environment in which the bank operates. For example, of households in the bank's assessment area, 12% are considered to be at or below poverty level. This makes it difficult for many low-income borrowers to qualify for available owner-occupied housing. According to bank management, much of the area's low-income, affordable housing is comprised of rental rather than owner-occupied units.

In addition, qualifying mortgage applicants are generally directed by local realtors to county programs, which provide credit to low-income borrowers on more favorable terms than the bank is able to offer. Nevertheless, MNB is responsive to the needs of low-income mortgage borrowers by offering loan terms and programs which require minimum funds to close. For example, MNB offers residential mortgages with no points, PMI (Private Mortgage Insurance) and PHFA (Pennsylvania Housing and Finance Agency) Programs. The PHFA program increases borrower access to residential mortgages by facilitating financing requiring minimal down payments. MNB directs qualifying borrowers requiring down payment assistance towards the PHFA programs.

Of sampled loans, consumer loans originated to low-income borrowers represented 4% of consumer loan volume and 1% of consumer loan dollars. MNB's opportunity to originate consumer loans to low-income borrowers is impacted by the bank's operating environment. For example, MNB's ability to originate home improvement loans is limited by the availability of a program offered by a local non-profit housing organization. This program

provides low interest and no interest \$5,000 and \$10,000 loans to low-income individuals for specific home improvement purposes.

Business Lending

MNB has demonstrated a commitment to small businesses. Sampled business loans originated to local small businesses exceed the volume of reporting small businesses in the assessment area. Small business loans are defined as those loans made to enterprises whose annual gross revenues are \$1,000,000 or less. The volume of businesses in the bank's AA reporting to Dunn and Bradstreet with gross revenues less than \$1 million represents 60% of total businesses. Of all sampled loans originated by MNB to businesses during 1998, 92% of the total number of business loans and 90% of total business loan dollars were originated to small businesses.

Geographic Distribution of Loans

- ◆ MNB's distribution of sampled residential mortgage and consumer loans among various geographies meets the performance standard.

Overall, the bank's geographic distribution of residential mortgage loans demonstrates a strong dispersion throughout the AA. Of all owner-occupied housing available within the AA, only 8% is located within the AA's only moderate-income geography. Nevertheless, of sampled residential mortgage loans, 14% were originated within this moderate-income geography.

The following table details residential mortgages originated by MNB to borrowers located within low-, moderate-, middle-, and upper-income geographies as compared to the representation of owner occupied housing within low-, moderate-, middle-, and upper-income geographies in the bank's assessment area.

LOANS		GEOGRAPHIC DISTRIBUTION OF									
		LOW INCOME GEOGRAPHIES		MODERATE INCOME GEOGRAPHIES		MIDDLE INCOME GEOGRAPHIES		UPPER INCOME GEOGRAPHIES		TOTAL GEOGRAPHIES	
OWNER OCCUPIED HOUSING	0%		8%		92%		0%		100%		
	####	\$000s	####	\$000s	####	\$000s	####	\$000s	####	\$000s	
RESIDENTIAL MORTGAGE LOANS	0	0	3	\$91	18	\$966	0	\$0	21	\$1,057	
	0%	0%	14%	9%	86%	91%	0%	0%	100%	100%	

Overall, MNB's geographic distribution of consumer loans demonstrates a favorable dispersion throughout the AA. Of the total population in the AA, 12% is located within the AA's only moderate-income geography and of sampled consumer loans, 12% were originated within this same geography.

The following table details the consumer loans originated by MNB to borrowers located within low-, moderate-, middle-, and upper-income geographies as compared to the representation of the population within low-, moderate-, middle-, and upper-income geographies within the bank's assessment area. The ability of the bank to originate consumer loans within the moderate income geography where 23% of households are below poverty level, is limited by the housing program discussed in the Loans to Borrowers of Different Incomes and Businesses of Different Sizes section of this evaluation.

LOANS		GEOGRAPHIC DISTRIBUTION OF								
		LOW INCOME GEOGRAPHIES		MODERATE INCOME GEOGRAPHIES		MIDDLE INCOME GEOGRAPHIES		UPPER INCOME GEOGRAPHIES		TOTAL GEOGRAPHIES
ASSESSMENT AREA POPULATION	0%	12%		88%		0%		100%		
	####	\$000	####	\$000	####	\$000	####	\$000	####	\$000
CONSUMER LOANS	0	\$0	2	\$12	14	\$109	0	\$0	16	\$121
	0%	0%	12%	10%	88%	90%	0%	0%	100%	100%

Response to Complaints

No complaints have been received since the last examination.

Record of Compliance with Anti-Discrimination Laws

A fair lending examination was performed concurrently with this examination. Examiners found no violations of antidiscrimination laws and regulations. The bank has appropriate policies, procedures, and training programs in place to prevent discriminatory or other illegal credit practices.

