

PUBLIC DISCLOSURE

February 1, 1999

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**The First National Bank
of
Mercersburg
Charter Number 9330**

**12 South Main Street
Mercersburg, Pennsylvania 17236**

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

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 financial 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 **The First National Bank of Mercersburg** prepared by **The Office of the Comptroller of the Currency**, the institution's supervisory agency, as of February 1, 1999. The agency rates the CRA performance of an institution consistent with the provisions set forth in Appendix A to 12 CFR Part 25.*

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

Lending volumes are strong as demonstrated by a loan to deposit ratio of 88%. In addition, the bank demonstrates a commitment to both small farm lending and consumer instalment lending as follows:

- total dollar volume to small farms represents 15% of total loans; and
- consumer loan originations to low-and moderate-income borrowers well exceed area demographics.

The following table indicates the performance level of The First National Bank of Mercersburg with respect to each of the five performance criteria.

SMALL INSTITUTION ASSESSMENT CRITERIA	<u>The First National Bank of Mercersburg</u> PERFORMANCE LEVELS		
	Exceeds	Meets	Does not

	Standards for Satisfactory Performance	Standards for Satisfactory Performance	meet Standards for Satisfactory Performance
Loan to Deposit Ratio	X		
Lending in Assessment Area		X	
Lending to Borrowers of Different Incomes and to businesses of Different sizes		X	
Geographic Distribution of Loans	Analysis Not Meaningful		
Response to Complaints	No Complaints Received		

DESCRIPTION OF INSTITUTION

First National Bank of Mercersburg (FNBM) is a \$78 million community bank located in Franklin County. The bank is a wholly owned subsidiary of Mercersburg Financial Corporation, a one bank holding company. The bank has three locations. The main office and the North End branch are located in Mercersburg, Pennsylvania. A third branch is located in Fort Loudon, Pennsylvania. FNBM provides full service banking through its three locations and automated teller machines (ATMs) at the North End and Fort Loudon locations. Products offered include farm, commercial, consumer and

residential mortgage loans. The bank also offers a full range of deposit services. Competition consists of larger financial institutions based in nearby Chambersburg, Pennsylvania, and other small local institutions, two of which have branches in Mercersburg.

The bank's loan portfolio is broken down by dollar as follows: 58% residential real estate, 15% farm loans, 11% commercial loans, and 13% consumer loans. There are no financial or legal impediments that would preclude the FNBM from lending.

DESCRIPTION OF BANK'S ASSESSMENT AREA

FNBM has identified seven political subdivisions located in southwestern Franklin County as its assessment area (AA). These political subdivisions include Montgomery, Warren, Peters, St. Thomas, Metal and Atrim Townships, as well as the Borough of Mercersburg. The assessment area is comprised entirely of seven middle income Block Numbering Areas (BNAs). Franklin County is not included in a Metropolitan Statistical Area (MSA). The Pennsylvania non-MSA median family income is \$35,200. The bank's assessment area complies with all regulatory requirements and does not arbitrarily exclude low- or moderate-income areas.

Franklin County is a predominantly rural county. According to 1990 census data, the assessment area population is 28,178. Bank management confirmed that self-employed farmers continue to represent the largest employment category in their area. Demographic data collected during the 1990 census, reports that within the bank's assessment area, owner occupied housing represents 71% of housing units and the median housing value equals \$68,000.

Assessment area economic conditions are stable and local employment levels are good. According to bank management, reductions in the workforces of some employers have been mitigated by new job opportunities. As a result of the community's ability to replace lost jobs, the bank's assessment area has not experienced an adverse economic

impact. Discussions with management confirmed that within their assessment area, credit needs continue to be concentrated primarily in mortgage, consumer instalment and farm lending.

Examiners contacted the president of a local area intra-church organization that participates in social programs and provides assistance to low- and moderate-income individuals. This contact indicated a community credit need for consumer instalment lending within the school district in which FNBM is located. The contact stated that community needs for credit are generally being met. However, opportunities for banks to participate in development of low- and moderate-income housing have been limited.

The contact identified FNBM as “visible” in and “oriented” towards the local community offering a variety of affordable loan and deposit products and customer convenient services, such as extended hours.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

Loan to Deposit Analysis

FNBM’s loan to deposit ratio clearly demonstrates its strong commitment to lending to its community. The bank’s loan to deposit ratio is high. The loan to deposit ratio over the past 12 quarters averages 85%. The loan to deposit ratio is also trending upward and as of 12/31/98 reached 88%. This level of lending significantly exceeds the national peer bank ratio of 73% and a local peer bank ratio of 72%. The local peer bank ratio included four local Pennsylvania banks with an asset size of less than \$140 million.

The graph below indicates FNBM’s December 31, 1998 and 12 month average loan to deposit as compared to peer banks.

Borrowers of Different Incomes and Businesses of Different Sizes

FNBM has demonstrated a strong degree of lending to small farms and businesses; and low- and moderate-income borrowers. Of total loans originated during 1997, loans to low- and moderate-income borrowers equaled 20% of the bank’s total loan volume. Similarly, of total loans originated during 1998, loans to low- and moderate-income also equaled 20% of total loan volume. This lending penetration to borrowers of low- and moderate-income levels compares favorably to demographic data. Demographically low- and moderate-income families comprise 12% and 17%, respectively, of the assessment area population.

The table below details FNBM’s lending to low-and moderate-income borrowers as compared to the representation of low- and moderate-income borrowers in the bank’s assessment area.

	LOW		MODERATE		MIDDLE		UPPER	
Families	12%		17%		27%		44%	
	#	\$	#	\$	#	\$	#	\$
FNBM	20%	5%	20%	8%	19%	10%	41%	78%

Originations								
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Farm and Business Lending

- FNBM demonstrates an excellent degree of lending to small farms which is identified as a community credit need.
- FNBM’s small business lending reflects area demographics and a commitment to local small business and non-profit enterprises.

Small farm and small business lending data was collected by the bank for 1998 and verified for integrity. Since the bank experienced no significant changes in its level of lending to small businesses and farms during the years since the last CRA evaluation, 1998 data was used to represent lending throughout the entire period.

The bank has shown a strong commitment to small business and small farm lending. Small business loans and small farm loans are defined as those loans made to enterprises whose annual, gross revenues are \$1,000,000 or less and \$500,000 or less, respectively.

FNBM demonstrates an excellent degree of lending to small farms which is identified as a community credit need. All farm mortgages and agricultural loans originated by FNBM within its assessment area between January 1996 and December of 1998 were to farms with gross revenues of less than \$500,000. Farm mortgages and agricultural loans originated during 1998 constituted 13 loans totaling \$2.7 million and 27 loans totaling \$717 thousand, respectively. The bank’s lending to farms represents 15% of the bank’s total loans and places FNBM among the top 25 farm lenders in Pennsylvania.

The volume of reporting businesses in the bank’s assessment area, with gross annual revenues less than \$1 million represent 92% of total businesses. Of all loans originated by FNBM to businesses during 1998, 89% of the total number of business loans and 87% of total business loan dollars were originated to small businesses. From year end 1996 through year end 1998, FNBM demonstrated its commitment to provide lending to area small businesses, community development, non-profit organizations, and rental housing. The bank originated 31 loans totaling \$2.1 million for amounts less than \$250,000 to small area businesses and 13 loans totaling \$2.4 million to local non-profit

organizations. FNBM financed local business development through loan extensions to two organizations totaling \$320 thousand. The bank also provided lending to seven borrowers to purchase, or finance, construction of rental housing units.

Mortgage and Instalment Lending

- FNBM's level of instalment lending to low- and moderate-income borrowers, which was identified as a community credit need, significantly exceeds the demographic representation of low- and moderate-income families.
- FNBM's level of mortgage lending to low- and moderate-income families, represents less than the demographic representation of low- and moderate-income families within the assessment area.

Mortgage, instalment and total loans were reviewed and verified from bank compiled information for 1997 and 1998. According to management, 1996 activity was similar to 1997 and 1998 activity. Accordingly, this review used 1997 and 1998 information to represent the examination period since the last CRA examination.

FNBM's record of lending is excellent with respect to the volume of instalment loans extended to low- and moderate-income individuals. For 1997 and 1998, the bank's lending to low- and moderate-income borrowers represented 26% and 24% of instalment loan volume and 16% and 19% of instalment loan dollars. The bank's instalment lending to low- and moderate-income borrowers is particularly strong given 1990 census data which indicates low- and moderate-income families represent 12% and 17% of the assessment area population. Instalment lending was identified as an area credit need by the community contact initiated in conjunction with this examination.

However, FNBM's level of mortgage lending to borrowers of low- and moderate-income levels is less than the demographic representation of low- and moderate-income families for the assessment area of the bank. For example, during 1997 and 1998, the

bank's lending to low- and moderate-income borrowers represented 5% and 8% of mortgage loan volume and 1% and 4% of mortgage loan dollars. The bank does not participate in federal, state, or local residential mortgage lending programs or originate proprietary lending strategies which may target low- and moderate-income borrowers. Overall, the pattern of residential lending demonstrated by the bank reflects conservative residential lending practices.

The following table details the mortgage, instalment and total loans originated by the

bank to low- and moderate-income borrowers as compared to the percentage of low- and moderate-income families in the population.

	LOW		MODERATE		MIDDLE		UPPER	
Families	12%		17%		27%		44%	
	#	(000)	#	(000)	#	(000)	#	(000)
Mortgages	11	\$281	20	\$1066	24	\$1,248	186	\$22,003
	5%	1%	8%	4%	10%	5%	77%	89%
Instalment	215	\$1,206	204	\$1,476	196	\$2,058	222	\$2,970
	26%	16%	24%	19%	23%	27%	27%	39%
Total Originations	248	\$1,683	252	\$2,917	242	\$3,625	514	\$29,016
	20%	5%	20%	8%	19%	10%	41%	78%

Lending in Assessment Area

A majority of the bank's loan originations are to borrowers within its AA. Since January 1996, FNBM has originated 71% by volume and 61% by dollar of total loans within the AA.

Geographic Distribution of Loans

An analysis of the geographic distribution of loans within the AA is not meaningful as the AA contains only middle income Block Numbering Area.

Response to Complaints

No complaints have been received since the last examination.

Record of Compliance with Antidiscrimination Laws

Examiners found no violations of the antidiscrimination laws and regulations. The bank has appropriate policies, procedures and training programs in place to prevent

discriminatory or other illegal credit practices.