



SMALL BANK

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

PUBLIC DISCLOSURE

September 24, 2012

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

Kennebec FS&LA of Waterville
Charter Number 703844

70 Main St
Waterville, ME 04901-6602

Office of the Comptroller of the Currency

99 Summer St, Suite 1400
Boston, MA 02110

NOTE: This document is an evaluation of this institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods consistent with safe and sound operation of the institution. This evaluation is not, nor should it be construed as, an assessment of the financial condition of this institution. The rating assigned to this institution does not represent an analysis, conclusion, or opinion of the federal financial supervisory agency concerning the safety and soundness of this financial institution.

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

The major factors supporting the institution's rating are:

- The bank's level of lending, as reflected by the loan-to-deposit ratio, is more than reasonable.
- The majority of originated and purchased loans are within the bank's assessment area.
- The borrower distribution of loans reflects a reasonable distribution among individuals of different income levels.
- The geographic distribution of loans reflects excellent distribution in the moderate-income census tract.

SCOPE OF EXAMINATION

Kennebec Federal Savings (KFS) was evaluated using Small Bank Community Reinvestment (CRA) examination procedures, which primarily includes a lending test. Our review covered the bank's lending performance from January 1, 2009 through December 31, 2011, as this was representative of the bank's lending strategy since its last CRA examination.

KFS is primarily a mortgage lender and the primary loan product, based on originations during the evaluation period, is residential mortgages. This review analyzed the institution's residential loans. For purposes of this evaluation, residential loans are home purchase, home refinance, and home improvement loans reported pursuant to the Home Mortgage Disclosure Act (HMDA). As indicated by the June 30, 2012 Uniform Bank Performance Report (UBPR), 1-4 family residential loans, represents approximately 97% of the bank's overall loan portfolio.

KFS does not have a home or branch office located in a Metropolitan Statistical Area (MSA) and is therefore exempt from data reporting requirements of the HMDA, the institution does however maintain HMDA information on its residential loans. We conducted data integrity exam of the bank's HMDA data for residential real estate loans originated/purchased, and found that the data was reliable. All residential real estate loans originated and purchased during the assessment period were included in our evaluation of the bank's lending.

A full scope review was performed on the bank's only Assessment (AA), a non-MSA AA, which includes the northern portion of Kennebec County and Southern portions of Somerset County, Maine. The majority of the bank's deposits, lending activity, and physical presence is in this market.

DESCRIPTION OF INSTITUTION

Kennebec Federal Savings is a \$76 million mutual thrift headquartered in Waterville, Maine. The bank does not have any operating subsidiaries and affiliate activities were not considered in this evaluation. The bank's main office and its one full service branch are located in Waterville, Maine. The main office is located in a moderate-income geography; and the Washington Street office is located in an upper-income geography. Branch hours are typically 8:30AM to 4:30PM from Monday through Friday with extended drive-up hours at the Washington Street branch from 7:30AM to 5:30pm. The Washington Street branch is also open on Saturdays from 9:00AM to 1:00PM. No branches were closed during the evaluation period. There have not been any significant changes to KFS's corporate structure since the last CRA examination.

KFS is a full service, intrastate institution offering a standard array of traditional loan and deposit products for both personal and business customers. The bank's website, www.kfsavings.com, provides a listing and description of its deposit and loan services. The bank offers a variety of different account access alternatives including online banking with bill pay options. The bank operates automated teller machines (ATMs) at both of its branches and is a member of the SUM ATM network which allows member customers to access their accounts from participating SUM network ATMs without charge.

As of June 30, 2012, total deposits totaled \$52.7 million, and net tier one capital was \$6.7 million. The loan portfolio totaled \$64.4 million, or 85% of total assets, as of the same date. The following table provides a summary of the loan mix.

| Loan Portfolio Summary by Loan Product June 30, 2012 | |
|---|------------------------------------|
| Loan Category | % of Gross Loans and Leases |
| 1-4 Family Residential Mortgage – Closed End | 73% |
| Home Equity | 24% |
| Commercial & Industrial | 0% |
| Commercial Real Estate | 1% |
| Construction and Development | 2% |
| Consumer | < 1% |

Source: FDIC Call Report

The bank has no financial or legal impediments to meeting the credit needs of the community. The bank was rated "Satisfactory" using small bank procedures at the last CRA examination dated August 24, 2007.

DESCRIPTION OF ASSESSMENT AREA(S)

The CRA requires a bank to define an AA in which it will be evaluated. KFS's one AA meets the requirements of the regulation and does not arbitrarily exclude any low- or moderate-income tracts.

The bank's AA consists of 13 towns in the northern portion of Kennebec County and 8 towns in the southern portion of Somerset County, Maine. The AA is comprised of 21 census tracts. There are no low-income tracts within the bank's AA. The assessment area includes one moderate-income tract (5%), 19 middle-income tracts (90%) and 1 upper-income tract (5%). The 2000 U.S. Census Data indicates that 37% of families in the AA are considered low- or moderate-income and approximately 13% of the households are below the poverty line.

| Demographic Information for KFS AA – Kennebec and Somerset Counties | | | | | |
|---|---------|----------|------------------------------|-----------|---------|
| Income Level | Total # | % Low | % Moderate | % Middle | % Upper |
| Geographies (Census Tracts) | 21 | 0% | 5% | 90% | 5% |
| Population by Geography | 83,451 | 0% | 5% | 90% | 5% |
| Owner Occupied Housing by Geography | 24,334 | 0% | 3% | 91% | 6% |
| Family Distribution by Income Level | 22,512 | 18% | 19% | 23% | 40% |
| 2000 Census Median Family Income | | \$40,084 | 2011 Median Housing Value* | \$135,000 | |
| | | | Median Age of Housing** | 39 Years | |
| HUD Updated MFI: 2011 | | \$54,200 | Families Below Poverty Level | 13% | |
| | | | Unemployment Rate *** | 8.8% | |

Source: 2000 U.S. Census data

*Data from Zillow.com

**Data from bestplaces.net

***Data from US Bureau of Labor Statistics as of 7/31/2012. Rate is an average of Kennebec and Somerset Counties.

KFS operates in a highly competitive market with competition from local commercial banks and savings banks. The Federal Deposit Insurance Corporation's Institutions Deposit Market Share Report, as of June 30, 2012, indicates 11 institutions operate branches within KFS's AA. KFS ranks 7th with deposit market share of approximately 3%. Area competitors include: Kennebec Savings Bank, The Bank of Maine, and Bangor Savings Bank. Large nationwide banks that provide further competition and are deposit share leaders include: TD Bank, National Association, KeyBank National Association; Bank of America, National Association; and People's United Bank.

Several nationwide entities provide additional competition for mortgage and business loans within Kennebec and Somerset counties including: Bank of America, N.A; TD Bank, N.A; JPMorgan Chase Bank, NA; and Wells Fargo Bank, NA. Peer Mortgage 2010 Market Share data indicates that KFS competes with 106 lenders within Kennebec County and 56 lenders within Somerset County. The top ten lenders dominate the market with an overall market share of approximately 50%.

Per Moody's Analytics, the economic recovery in Maine remains slow with an increase in the state's unemployment rate over the past six months. The Moody's report indicates that the economic recovery in the state has remained sluggish and has underperformed when compared to the National and New England economic recovery. The national rate of unemployment in 2012 exhibits a decreasing trend, while the state rate of unemployment has gone up when compared to 2011 year-end. Data from the U.S. Bureau of Labor Statistics indicates that the unemployment rate for the state of

Maine as of July 2012 was 7.6% compared to the year-end unemployment rate of 7%, and the national rate of 8.3% as of July 2012 has improved compared to 8.5% at 2011 year-end. The unemployment rate as of July 2012 for the two counties in the AA averaged 8.5%. Rates were 7.2% and 9.7% for Kennebec and Somerset counties, respectively. The local economy in the AA is driven by education and healthcare. Major employers within AA include Colby College; Maine General Hospital, Waterville; Maine General Medicine Center, Waterville; and New Balance Athletic Shoe, Skowhegan. As per the Moody's Analytics some of the other major employers in the state include: Hannaford Brothers Company, Wal-Mart Stores Inc., Bath Iron Works Corporation, and L.L. Bean Inc.

Despite the effects of a national recession on the state housing market, median housing prices in the AA remain high compared to median family income. The expensive housing market limits the availability of affordable housing for low- and moderate-income families in the AA. Based on data from Zillow.com, as of July 2012, the average median cost of housing for the towns that are part of the AA is \$135 thousand. While the average is below the median housing cost in the state of Maine of \$176 thousand, it remains high compared to median family income in the AA.

In assessing the bank's performance, we contacted a local organization whose purpose is to provide affordable housing to the low- and moderate-income people in the state of Maine. The contact indicated that affordable housing is a key issue due to the high cost of housing in the area and stressed that long-term affordable housing is a need. The need for affordable housing in the area is significant given the high cost of housing compared to median family income in these areas. The contact also indicated that a large population in the state is self-employed which makes it difficult to obtain financing for home purchase. The community contact mentioned that the local financial institutions are supportive of the credit needs of the community and do a very good job of meeting the needs of the community.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

KFS's performance under the lending test is satisfactory. KFS's loan-to-deposit ratio is more than reasonable and majority of the loans are originated inside the bank's AA. Overall, the distribution of loans reflects a reasonable distribution among individuals of different income levels. Overall, the geographic distribution of loans reflects excellent distribution in the moderate-income census tracts.

Loan-to-Deposit Ratio

The bank's loan-to-deposit ratio is more than reasonable given the bank's size, AA credit needs, and the loans sold in the secondary market. The bank sold approximately \$33 million, \$18 million, and \$20 million in mortgage loans to the secondary market in the years 2009, 2010 and 2011, respectively. The bank's net loan-to-deposit ratio averaged 133% over the last 20 quarters, since the previous CRA examination. During

this period the loan-to-deposit ratio ranged from a quarterly low of 116% to a high of 152%. KFS's loan-to-deposit ratio is higher than the national peer bank median quarterly average of 87% over the same period.

Lending in Assessment Area

A majority of KFS's primary loan products were made within the bank's assessment area and the bank meets the standard for satisfactory performance. KFS originated 78% by number and 79% by dollar amount of loans in the AA. The following table details the bank's lending within the AA by number and dollar amount of loans.

| Table 1 – Lending in AA – Kennebec & Somerset Counties | | | | | | | | | | |
|---|------------------------|----------|----------------|----------|--------------|-------------------------|----------|----------------|----------|--------------|
| Loan Type | Number of Loans | | | | | Dollars of Loans | | | | |
| | Inside | | Outside | | Total | Inside | | Outside | | Total |
| | # | % | # | % | | \$ | % | \$ | % | |
| Home Loans | 660 | 78 | 182 | 22 | 842 | 78,145 | 79 | 20,831 | 21 | 98,976 |
| Totals | 660 | 78 | 182 | 22 | 842 | 78,145 | 79 | 20,831 | 21 | 98,976 |

Source: Home loan data reported by the bank from 1/1/2009 to 12/31/2011.

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

The distribution of loans originated in the bank's AA reflects reasonable distribution among individuals of different income levels.

The percent of home loans made to low-income borrowers is significantly lower than percent of low-income families in the AA. The percent of home loans is also lower when compared to the aggregate lending data for HMDA reporters to low-income families.

The percent of home loans made to moderate-income borrowers equals the percent of moderate-income families in the AA; however, it is slightly lower when compared to the aggregate lending data for HMDA reporters within the bank's AA.

The bank's performance is considered satisfactory given the lack of affordable housing and competition in the AA. As noted in our community contact interview, the property prices in the area remain high relative to the median family income in the AA. Lack of affordable housing limits lending opportunities. As of July, 2012, the average median home price in the AA was \$135,000. The HUD updated median family income is \$54,000, which means the maximum income that is considered low-income is \$27,000 therefore; low-income borrowers would have difficulty qualifying for home purchase loans. Additionally, moderate-income families also could encounter difficulty qualifying for home purchase loans with an income range of \$27,000 to a maximum income of \$43,000.

Market competition for home mortgage loans is also evident within the bank's AA. According to 2010 Peer Mortgage Market Share data, mortgage lending is dominated by larger institutions with the top ten institutions holding over 50% of the market share.

The following table shows the distribution of home loan products among borrowers of different income levels compared to the percent of families in each income category as well as the aggregate lending data for HMDA reporters within the bank's AA.

| Table 2 – Distribution of Home Loans by Borrower Income Level | | | |
|--|-------------------|------------------------------|----------------------------------|
| Borrower Income Category | % of Loans | % Family Distribution | % of Aggregate (or Peers) |
| Low | 6 | 18 | 7 |
| Moderate | 19 | 19 | 22 |
| Middle | 25 | 23 | 27 |
| Upper | 50 | 40 | 44 |
| TOTAL | 100 | 100 | 100 |

Source: Data reported from 1/1/2009-12/31/2011; 2010 HMDA Data; 2000 U.S. Census data.

Geographic Distribution of Loans

The geographic distribution of home loans reflects excellent distribution in the moderate-income tract within the bank's AA. The AA includes 1 moderate-income tract and no low-income tracts. We found no conspicuous gaps or areas of low penetration in the bank's lending patterns.

The percent of KFS's lending for home loans exceeds the percent of owner-occupied housing in the moderate-income tract. The percent of KFS's lending for all loans in the moderate-income tract also substantially exceeds the performance of aggregate HMDA reporters within the AA.

The following table details the bank's performance compared to the percentage of owner-occupied housing units in each census tract income level as well as the aggregate lending data for all HMDA reporters within the bank's AA.

| Table 3 – Distribution of Home Loans by Census Tract Income Level | | | |
|--|-------------------|-------------------------|----------------------------------|
| Census Tract Income Category | % of Loans | % Owner Occupied | % of Aggregate (or Peers) |
| Low | 0 | 0 | 0 |
| Moderate | 4 | 3 | 2 |
| Middle | 89 | 91 | 93 |
| Upper | 7 | 6 | 5 |
| TOTAL | 100 | 100 | 100 |

Source: Data reported from 1/1/2009-12/31/2011; 2010 HMDA Data; 2000 U.S. Census data.

Responses to Complaints

The bank did not receive any CRA related complaints during this evaluation period.

Fair Lending or Other Illegal Credit Practices Review

Pursuant to C.F.R. 195.28(c), in determining a Federal savings association's (FSA) CRA rating, the OCC considers evidence of discriminatory or other illegal credit practices in any geography by the FSA, or in any assessment area by an affiliate whose loans have been considered as part of the FSA's lending performance. We found no evidence of discriminatory or other illegal credit practices inconsistent with helping to meet community credit needs.