



# INTERMEDIATE SMALL BANK

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Comptroller of the Currency  
Administrator of National Banks

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Washington, DC 20219

## PUBLIC DISCLOSURE

February 2, 2008

### COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

The Merchants National Bank of Bangor  
Charter Number: 4513

25 Broadway  
Bangor, PA 18013

Office of the Comptroller of the Currency

NEW YORK METRO-EAST  
343 Thornall Street Suite 610  
Edison, NJ 08837

**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 Lending Test is rated: Satisfactory**

**The Community Development Test is rated: Satisfactory**

The major factors that support this rating include:

- Merchants National Bank of Bangor's (hereafter "Merchants" or "the bank") distribution of loans represents a reasonable penetration among individuals and geographies of different income levels and businesses of different sizes.
- Merchants' loan-to-deposit ratio is reasonable.
- A substantial majority of Merchants' primary loan products were originated within the bank's assessment area.
- Merchants' responsiveness to community development needs and opportunities in its assessment area is adequate.

## **Scope of Examination**

Merchants National Bank of Bangor was evaluated under the Intermediate Small Bank examination procedures, which include a lending test and a community development (CD) test. The lending test evaluates the bank's record of meeting the credit needs of its assessment area (AA) through its lending activities. Home Mortgage Disclosure Act (hereafter "HMDA") mortgage loans were given more weight than the small business loans during the exam due to volume. The CD test evaluates the bank's responsiveness to CD needs in its AA through CD lending, qualified investments, and community development services.

The lending test for HMDA loans covers the bank's performance from January 1, 2005 through December 31, 2007, as this is representative of its lending strategy since the last CRA examination. The lending test for small business loans covers performance from January 1, 2005 through September 30, 2007. The evaluation period for the CD test covers the period from January 20, 2005 through February 2, 2008.

Merchants' primary loan products are home mortgage and small business loans. The bank reports data under the requirements of HMDA. To evaluate the bank's small business lending performance, we selected a sample of twenty Community Reinvestment Act (CRA) small business loans made during the evaluation period for these loans.

Merchants' publicly filed information for HMDA reportable loans and small loans to businesses were tested for accuracy. Results of this testing evidenced the data is sufficiently accurate for purposes of this CRA evaluation.

## **Description of Institution**

Merchants National Bank is an independent, intrastate community bank founded in 1891, with its main office located in Bangor, Pennsylvania. The bank is located in eastern Pennsylvania in Northampton County, which is part of the Allentown-Bethlehem-Easton Metropolitan Statistical Area (MSA). Merchants is a wholly owned subsidiary of the parent holding company, MNB Corporation. Merchants and MNB Corporation have similar total assets of \$260 million as of December 31, 2007.

Merchants is community oriented, full service bank. The bank has a website which offers information on branch hours, bank products and rates, and on-line loan applications. The bank operates ten full service branches and one limited small business loan center, all located in Northampton County. Each branch includes a deposit taking ATM. A full range of loan and deposit services, including residential mortgages and commercial loans, is offered.

At December 31, 2007, Merchants reported \$151 million in net loans and \$211 million in total deposits. Net loans represent 52% of total assets. Major loan products include residential mortgages and commercial loans, with residential mortgages the primary lending product at 60% of the loan portfolio. Commercial loans total only 9% of total loans. Tier I Capital is \$24.7 million as of the same date.

There are no legal or financial impediments to Merchants' ability to meet the credit and CD needs of its AA. The bank was rated Satisfactory at its last CRA examination dated January 19, 2005.

## **Description of Assessment Area**

Merchants' assessment area (AA) includes all of Northampton County's sixty-two census tracts (CTs), which are part of the Allentown-Bethlehem-Easton MSA (MSA 0240). The AA meets regulatory requirements and does not arbitrarily exclude low- or moderate-income geographies.

Based on 2000 census data, Merchants' AA included three low-income CTs (5%), eleven moderate-income CTs (18%), thirty-seven middle-income CTs (60%), and eleven upper-income CTs (18%). The total population in the AA was 267,066 and the median cost of housing in the AA was \$117,274. The percentage of households below the poverty level was 8%. The AA's population was comprised of 71,507 families with the following family income distributions: 18% low-income, 19% moderate-income, 24% middle-income and 39% upper-income. The updated median family income for 2007 was \$53,852.

Northampton County remains a very industrial oriented region, despite the continued loss of manufacturing jobs led by the departure of Bethlehem Steel in 2003. Today the major industrial employers in the area include CF Martin & Company, Binney & Smith, Majestic Athletic Wear, and Just Born. Many of the largest employers, however, are in the health care, educational and service industries.

In conducting the assessment of the bank's performance, we contacted a local government organization and a local non-profit organization. The mission of the local government entity is to encourage business growth, employment opportunities, and community development in the bank's AA. The mission of the non-profit is to address poverty in the Lehigh Valley area, including a variety of issues that affect low-income individuals such as housing and employment opportunities.

Both entities report a continuing need in the area for affordable housing. Rising real estate costs, development costs, and energy costs, combined with limited affordable and developable land has made the development of affordable housing difficult. Most affordable housing is located in older areas or in the larger cities; giving low-income persons limited housing choices. Further, there is a gap between income and cost of housing. Subprime lending and foreclosure activity remain a concern, as does the development and preservation of affordable rental housing.

The banking environment in Northampton County remains competitive. Based on the most recent HMDA Peer Mortgage Data, over 300 lenders originated HMDA loans in the Allenton-Bethlehem-Easton MSA in 2006. The market leader for home purchase loans was Countrywide, with a 26% market share; Merchants ranked 69th in the MSA with a market share of 0.2%. There are approximately thirty-seven banks competing for deposits, with the largest market share held by Wachovia at 24%. Merchants' deposit market share is 1.6%, the seventeenth largest in the MSA.

## Conclusions with Respect to Performance Tests

### LENDING TEST

Merchants' performance under the lending test is satisfactory. Merchants' loan-to-deposit ratio is reasonable and a majority of Merchants' loans are within the bank's AA. The bank was found to have reasonable penetration among borrowers of different income levels and businesses of different sizes. Merchants' geographical distribution of loans was also reasonable.

All of the criteria of the lending test are documented below.

#### Loan-to-Deposit Ratio

Merchants' net loan-to-deposit ratio is reasonable given the bank's size, financial condition, and the AA's credit needs. The bank's net loan-to-deposit ratio averaged 66% over the thirteen quarters ending December 31, 2007. This ratio ranged from a quarterly low of 63% to a quarterly high of 71% during this time period.

The bank's net loan-to-deposit ratio compares favorably to other financial institutions of similar size, location, and product offerings. The average loan-to-deposit of Pennsylvania banks with total assets between \$200 and \$300 million was 77% as of September 30, 2007.

#### Lending in Assessment Area

A substantial majority of Merchants' primary loan products were made within the bank's AA. A total of 89% of these loans by number and 84% of these loans by dollars were granted within the AA. The following table details the bank's lending within the AA by number and dollar amount of loans.

Loan Type	Number of Loans					Dollars of Loans				
	Inside		Outside		Total	Inside		Outside		Total
	#	%	#	%		\$	%	\$	%	
Home Purchase	149	82.32	32	17.68	181	23,795	84.25	4,447	15.75	28,242
Home Refinance	285	88.51	37	11.49	322	29,302	82.74	6,114	17.26	35,416
Home Improvement	237	94.05	15	5.95	252	10,227	87.43	1,470	12.57	11,697
Business	18	90.00	2	10.00	20	1,964	82.11	428	17.89	2,392
Totals	689	88.90	86	11.10	775	65,288	83.97	12,459	16.03	77,747

Source: HMDA data 1/1/2005-12/31/2007 and sampled business loan data 1/1/2005-9/30/2007

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

The distribution of loans within the bank's AA reflects excellent penetration among individuals of different income levels and businesses of different sizes.

### Home Loans

The percent of home loans originated to low-income borrowers is significantly below the percent of low-income families in the AA. However, Merchants' market share for all three types of home loans to low-income borrowers exceeds the bank's overall market share. Lending opportunities to this group are limited given the median home price in the AA of \$117,274. Low-income borrowers would have difficulty qualifying for a home purchase loan with the median family income being \$53,852.

The percent of all home loans to moderate-income borrowers significantly exceeds the percent of moderate-income families in the AA. In addition, the market share for home refinance and home improvement loans to moderate-income borrowers exceeds the bank's overall market share. The market share for home purchase loans to moderate-income borrowers is near the overall market share.

The following table shows the distribution of home loan products among borrowers of different income levels for the period of January 1, 2005 through December 31, 2007 as compared to the percent of families in each income category.

Borrower Income Level	Low		Moderate		Middle		Upper	
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
Home Purchase	17.81	7.69	19.44	21.68	24.23	33.57	38.52	37.06
Home Improvement	17.81	9.91	19.44	25.00	24.23	27.16	38.52	37.93
Home Refinance	17.81	9.12	19.44	27.01	24.23	22.99	38.52	40.88

Source: HMDA data for 1/1/2005-12/31/2007 and HUD-updated 2000 U.S. Census data

### Business Loans

The distribution of loans to businesses reflects excellent penetration among businesses of different sizes. All of the loans sampled were made to businesses with revenue less than \$1 million, which exceeds the 70% of businesses in the AA that have revenue less than \$1 million.

The following table shows the distribution of commercial loans among different sized businesses in the AA.

<b>Table 2A - Borrower Distribution of Loans to Businesses in Northampton AA</b>				
Business Revenues (or Sales)	≤\$1,000,000	>\$1,000,000	Unavailable/Unknown	Total
% of AA Businesses	69.87	5.92	24.21	100%
% of Bank Loans in AA by #	100.00	0.00	0.00	100%
% of Bank Loans in AA by \$	100.00	0.00	0.00	100%

Source: small business loans sampled from 1/1/2005 - 9/30/07

## Geographic Distribution of Loans

The distribution of loans reflects poor dispersion throughout the bank's AA. There were no conspicuous gaps identified within Merchants' AA.

### Home Loans

The geographic distribution of home loans in Merchants' AA reflects a reasonable dispersion throughout the census tracts. The percent of lending for all home loans in the three low-income geographies is below the percent of owner-occupied housing in these geographies. However, the opportunities to lend are limited and the competition from larger community, national, and mortgage financial institutions is high.

There are only 1,142 owner-occupied units within the low-income geographies. Of the 2,420 families within the low-income geographies, 79% are either low- or moderate-income families. Based upon a weighted average of median housing price of \$70,108, these families would have difficulty qualifying for a mortgage with a weighted average of median family income of \$20,411. In addition, 37% of the households are below the poverty level.

The volume of home loans originated within the low-income geographies is low and dominated by larger financial institutions. Based upon the 2006 market share data for Eastern U.S., there were only 371 home purchase, 164 home refinance and 32 home improvement loans made within the low-income geographies. The top five financial institutions originated 38% of the home purchase loans, the top three lenders originated 26% of the home refinance loans and two lenders originated 34% of the home improvement loans.

The percent of lending for home purchase and refinance loans in the moderate-income geographies is near the percent of owner-occupied housing in these geographies. The percent of lending for home improvement in the moderate-income geographies is significantly lower than the percent of owner-occupied. The volume of home improvement loans is low, 276, and dominated by the five lenders who originated 50% of all home improvement loans.

Lending in these moderate-income geographies is limited given that 60% of the population is low- or moderate-income families. It may be difficult for these families to qualify for a home loan with an average median family income of \$36,593; given the weighted average median housing price is \$73,689 in these geographies. Another

factor is 16% of households in the moderate-income census tracts are below the poverty level.

Following is a table that details the bank's performance as compared to the percentage of owner-occupied housing units in each census tract income level.

Census Tract Income Level	Low		Moderate		Middle		Upper	
Loan type	% 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	1.53	0.00	10.83	8.11	58.92	72.97	28.71	18.92
Home Improvement	1.53	0.00	10.83	2.95	58.92	88.19	28.71	8.86
Home Refinance	1.53	0.35	10.83	7.02	58.92	81.40	28.71	11.23

Source: HMDA data for 1/1/2005-12/31/2007 and 2000 U.S. Census data

### *Business Loans*

None of the twenty small business loans sampled were made to borrowers in low- or moderate-income CTs, reflecting poor dispersion throughout the AA. Information from community contacts indicates that small business lending remains an identified need.

Following is a table that details the bank's performance as compared to the percentage of businesses in each census tract income level.

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	3.86	0.00	13.47	0.00	52.69	85.00	26.38	15.00

Source: small business loans sampled from 1/1/2005-9/30/2007

### **Responses to Complaints**

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

## COMMUNITY DEVELOPMENT TEST

The community development test is rated satisfactory. The bank's level of CD activities is considered adequate given its size and capacity, and considering the CD needs and opportunities within its AA. During the evaluation period, Merchants' CD loans totaled 18% of tier one capital, demonstrating outstanding responsiveness to the community development needs of its AA. In addition, the bank provided \$12,875 in grants to local community development groups serving low- and moderate-income individuals and families. Finally, the bank has demonstrated adequate responsiveness to community development needs through the volunteer services of nine bank personnel. These individuals provide financial expertise to eleven community development organizations serving the AA.

### Number and Amount of Community Development Loans

Merchants originated nine loans totaling \$4.5 million that had a CD purpose. Seven of these loans, totaling \$2.9 million, were to finance the development or renovation of multi-family dwellings in low- or moderate-income CTs within the bank's AA. The bank made two loans, totaling \$1.6 million, directly to entities that serve low- and moderate-income individuals within the bank's AA. Both of these entities assist with the housing needs of low- and moderate-income individuals within their communities.

During the assessment period the bank also made a \$225 thousand loan for the purpose of renovating a multi-family dwelling in a low-income CT in Allentown, PA, which is adjacent to, but not part of, the bank's AA.

### Number and Amount of Qualified Investments

During the evaluation period, the bank provided \$12,875 in grants to local CD organizations, directly benefiting low- and moderate-income families and individuals. These entities provide educational and housing services, as well as promote economic development within the bank's AA.

### Extent to Which the Bank Provides Community Development Services

During the evaluation period, nine employees provided financial expertise and leadership services to eleven different qualifying community development organizations serving the AA. The following are the CD services provided by Merchants' employees.

**Bangor Area School District Project Success** (benefits low- and moderate-income children by providing grant money and projects for education)

- Board Member

**Bangor Business Revitalization Program** (strives to revitalize Bangor, which includes moderate-income CTs, through economic development)

- Chairman of the Board
- Board Member

**Easton/Phillipsburg YMCA** (provides scholarships to low- and moderate-income children)

- Board Member and Finance Committee Member

**Easton Area Industrial Land Development Company, Inc.** (strives to increase employment opportunities by attracting industry to the community)

- Member

**Easton Kiwanis** (provides scholarships to low- and moderate-income children)

- Chair of Scholarship Committee

**Third Street Alliance for Women and Children** (strives to improve the quality of life for women and children, particularly low- and moderate-income individuals)

- Board Member and Finance Committee Member

**Two River Area Chamber of Commerce** (strives to promote women in business, serving low- and moderate-income individuals)

- Board Member

**Quota International of Northampton** (benefits disadvantaged women and children)

- Treasurer

**Salvation Army of Easton** (strives to meet humanitarian needs of low- to moderate-income individuals)

- Finance Committee Member

**Valley Housing Development Corporation** (promotes safe and sanitary housing for low-income individuals)

- Board Member

**Forks Township Area Kiwanis** (provides scholarships for low- and moderate-income children)

- Members/fundraising

### **Responsiveness to Community Development Needs**

Merchants' CD activities, as a whole, demonstrate adequate responsiveness to the needs and opportunities in the AA. Identified needs include additional affordable housing and social services for low- and moderate-income individuals and families. In total the bank has lent \$4.5 million in CD loans (18% of Tier I capital) that benefit low- and moderate-income individuals and families, either by providing affordable housing or social services. Officers and employees provide financial technical assistance to eleven different qualified organizations that provide needed community services to the low- and moderate-income population in the AA.

## **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.