



SMALL BANK

Comptroller of the Currency
Administrator of National Banks
Washington, DC 20219

PUBLIC DISCLOSURE

January 10, 2006

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**The National Bank of Middlebury
Charter Number 1195**

**30-32 Main Street
Middlebury, VT 05753**

**Comptroller of the Currency
New England Field Office
20 Winthrop Square, Suite 200
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 SMALL BANK CRA RATING

This institution is rated Outstanding.

The primary factors supporting this rating are:

- An excellent average loan-to-deposit (LTD) ratio of 83%, considering the 531 mortgage loans totaling \$66 million that were sold in the secondary market.
- The bank originated 97% of all loans within its assessment area (AA) of Addison County.
- An excellent record of lending to low- and moderate-income borrowers for 1-4 family residential mortgages and home equity lines of credit.
- An excellent record of lending to businesses of different sizes.
- A strong level of community development (CD) activities through loans, investments, and services.

DESCRIPTION OF INSTITUTION

The National Bank of Middlebury (NBM or “the bank”) is a locally operated community bank in Middlebury, Vermont (VT) founded in 1831 and federally chartered since 1865. At September 30, 2005, assets totaled \$204 million. Total assets have grown significantly from \$126 million at the June 1999 CRA evaluation when the bank received an Outstanding rating.

The bank is headquartered in northwestern VT, approximately 35 miles south of Burlington and 34 miles north of Rutland. The bank operates two full-service branches in Bristol and on Route 7 South Middlebury, as well as its main office in downtown Middlebury. A separate drive-up facility is also located in Middlebury on North Seymour Street as the main office lacks space for one. The branch located on Route 7 South was relocated from its leased location in a retail center to a newly constructed office with a drive-up. The bank also operates a branch in the Middlebury Union High School called the Hannaford Career Center. The high school branch provides skills and training programs for jobs in the banking industry.

Automated teller machines are located at each branch and at four remote locations: two at Middlebury College, one at the Hannaford Career Center, and one at the Blue Hen Kitchen & Market in Middlebury, VT. All the branches have similar hours with Saturday hours offered at the Bristol and Route 7 South Middlebury locations. These two branches have easier access for bank customers conducting weekend banking transactions. No branches were opened or closed during the CRA evaluation period of June 30, 1999 to September 30, 2005.

Middlebury National Corporation, a one-bank holding company, wholly owns the bank. NBM has one affiliate relationship with Community Financial Services Group. The company is a trust

and investment management affiliate that is jointly owned by NBM and two financial institutions. The affiliate serves clients in Barre, Middlebury, and Newport, VT, as well as Littleton, NH.

NBM faces no legal or other impediments that hinder its ability to help meet the credit needs of its AA. At September 30, 2005, the bank held \$134 million in loans and \$167 million in deposits representing 66% and 82% of total assets, respectively. NBM offers standard commercial and consumer credit products. The bank is primarily a residential mortgage lender providing first lien mortgages for home purchases and refinancing, home equity lines of credit, and second-lien home improvement loans. See **Table 1** below for detailed information on the composition of the bank's loan portfolio.

Table 1.

National Bank Middlebury: Loan Portfolio Mix at 9/30/2005		
Loan Category:	\$ Outstanding	% of Loan Portfolio
	(000s)	
Residential Mortgages	74,836	55%
Commercial RE Loans	24,238	18%
Home Equity Lines	9,836	7%
Construction & Development	7,744	6%
Commercial Loans	7,734	6%
Multi-family Residential Properties	6,416	5%
State/Political Subdivisions	2,886	2%
Consumer Loans	1,518	1%
Other Loans	136	< 1%
Gross Loans	135,344	100%

Source: September 30, 2005 Report of Condition

NBM offers a wide variety of deposit products to meet consumer and commercial banking needs. The bank's Internet website www.nationalbankmiddlebury.com provides detailed information on products and services. Banking services are standard and include on-line banking for consumer and business customers including free bill payment options, telephone banking, and ACH services. The bank also offers investment, asset management and financial planning services to individuals and businesses through its affiliate discussed above.

DESCRIPTION OF ASSESSMENT AREA (ADDISON COUNTY)

The bank designated the entire county of Addison, VT as the primary AA for a number of years. The AA includes all towns and geographies in the county that is surrounded by the Green Mountains to the east, Burlington, VT Metropolitan Statistical Area (MSA) to the north, New York State to the west, and Brandon and Rutland, VT to the south. The AA includes nine middle-income geographies and one upper-income geography. There are no low- and moderate-income geographies. Although the Burlington, VT MSA has expanded south into Vergennes, it has not extended into areas where NBM currently has branches. The AA meets the requirements

of the regulation, and does not arbitrarily exclude low- or moderate-income geographies.

Competition

NBM remains one of only two locally owned banks in Addison County. The other locally owned bank is significantly smaller than NBM and is not considered a direct competitor. A number of other banks and non-bank competitors operate branches in Addison County and surrounding communities. NBM's primary competitors in Addison County are Chittenden Bank and numerous other state, regional, and national institutions. NBM is a leader in deposit market share and in residential mortgage loan volume based on a regional credit bureau report for eight months of 2005. The bank attributes its success to hiring seasoned lenders and staff for loan growth and increased capacity.

Economy

Since the June 1999 CRA evaluation, the economy in Addison County has expanded. Economic conditions in the AA are stable with improvements noted in the commercial sector. Existing businesses have experienced revenue growth and added labor. These factors have contributed to a 3% unemployment rate in Addison County that is consistently lower than state and national levels.

Major employers in the AA include Middlebury College, Porter Medical Center, and Goodrich. Middlebury College is a stabilizing factor for the local economy as it employs one out of eleven Addison County residents. The college provides over 270 jobs in the county. In addition, tourism, technology, and agriculture are significant sectors of the economy and represent a smaller number of employers. Although the Addison County unemployment rate is lower than the state and national averages, many new jobs are in the lower-paid service sector making it harder to find and qualify for a limited supply of low- and moderate-income housing.

Affordable Housing

In the past five years, rapid inflation of housing prices has contributed to a decreasing volume of affordable housing as it significantly outpaces increases in median income levels. The most acute housing need is for the elderly and low-income individuals. In addition, the tax burden in VT is heavy with high property taxes contributing to the displacement of fixed-income elderly residents and the poor, and discourages new housing construction and economic development. Not only are houses less affordable, there are fewer of them being built.

The volume of vacation or second homes in the AA is high at 15%. Vermont, New Hampshire, and Maine have the highest ratio of second homes of all the states in the nation, reducing the housing inventory for AA residents. The median age of the housing stock is 40 years, which can further limit home ownership opportunities due to necessary rehabilitation and maintenance costs. Rising heating oil cost in 2004 and 2005 has been an additional burden on home ownership. Mobile home parks present more affordable options for low- and moderate-income borrowers. The AA volume of mobile home units has increased to 10% of available housing units. The housing shortage is being recognized by businesses as a significant impediment to economic growth.

Community Contacts

We contacted a city planner from Addison County. He confirmed that affordable residential

properties for sale and rent were a significant need in the AA. He referred to the town's Plan for 2005 that described housing for low-income families and the elderly as critically limited. The contact stated he was familiar with the extensive involvement of NBM through the participation in loans and investments in community development projects. He specifically mentioned the Chief Executive Officer (CEO) at NBM for his involvement in organizations that work towards increasing the inventory of affordable housing

A second community contact from an area economic development organization stated housing needs were a primary concern in Addison County. He stated banks in general participated in programs to increase affordable housing through loans, grants, donations, and investments. NBM was identified as a strong contributor towards meeting the housing needs of the community. Demographic information of NBM is broken out in **Table 2** below:

Table 2

Demographic/Economic Characteristics: Addison County AA	2000 U.S. Census
Population:	
Total Persons	35,974
Total Families	9,163
Total Households	12,066
Geographies:	
Total number of census tracts (CT)	10
Percentage of Low/Moderate-Income CTs	0
Percentage of Middle-income CTs	90%
Percentage of Upper-income CTs	10%
Percentage of families in AA by Income Level:	
Low	14%
Moderate	17%
Middle	27%
Upper	42%
Economic Indicators:	
Median Family Income (MFI)* 2003 > \$52,800; 2004 > \$55,500; 2005 > \$55,800	
Median Housing Value	\$117,384
Number of Housing Units	15,315
Vacant Housing Units (Second or vacation homes)	15%
Mobile Homes or Trailers	10%
% of Households below Poverty-level	8%
Average monthly gross rent	\$568
Number of Businesses (non-farm)	1,587
Unemployment Information: **	
Addison County	3.0%
State of Vermont	3.1%
National Average	5.0%

Source: 2000 U.S. Census Data; * Updated HUD adjusted figures; ** Bureau of Labor Statistics

CONCLUSIONS ABOUT PERFORMANCE CRITERIA

The bank's lending performance meets the standards for an Outstanding rating. NBM's lending rating is based on five performance criteria that are described in this section. The loan sample was based on the primary products offered during the evaluation period of June 30, 1999 to September 30, 2005. As NBM offered the same loan products for the entire evaluation period, we limited our sample to the last three years (2003, 2004, and 2005) as being representative of the entire evaluation period. Refer to **Table 3** below for number and dollar volume of loans originated for the three years sampled.

Table 3.

NBM Loan Category:	% of Loans By \$ From: 1/01/2003 - 12/31/2005*	% of Loans by # From: 1/01/2003 - 12/31/2005*
Home Mortgages	64%	53%
Home Equity Lines (HELOC)	21%	19%
Business Loans	12%	15%
Consumer Loans	3%	13%
Farm Loans	<0.5%	<0.5%
Total	100%	100%

*Rounding effects are insignificant. Data derived from internally generated reports.

We focused our lending sample on residential mortgages, HELOC, and business loans and randomly selected 24 loans for each primary product from internally generated loans (8 loans per year for each product). It is evident from **Table 3** above that the bank is primarily a residential mortgage lender. The volume of residential lending increased during 2002 and continued into 2003 due to low interest rates. As rates began to increase, home purchase volume slowed in 2004 and HELOC activity increased into 2005. Commercial lending activity increased modestly with a modest economic expansion in Addison County. Many of the bank's existing commercial customers experienced higher revenue levels in 2004 and 2005.

We calculated the percentage of the sample that was originated inside and outside of the bank's assessment area (AA) in **Table 4** on the following page. We took the loans originated inside the AA and used the same sample to determine the distribution of loans by borrowers income level in **Tables 5 & 6**. In each lending test we compared the results with AA population from the 2000 U.S. Census as well as business demographics.

Loan-to-Deposit Ratio

NBM's LTD ratio of 80% as of September 30, 2005 is good when compared to nine similar banks in Vermont, but excellent when we consider the 531 mortgage loans totaling \$66 million that were sold in the secondary market. This includes 34 loans for \$2.4 million to the Vermont Housing Finance Authority (VHFA) for programs that assist first time homebuyers. By selling mortgage loans in the secondary market, the bank is able to obtain additional funding for mortgage loan originations. NBM's LTD ratio since the last CRA evaluation in June 1999 reflects a 26-quarter average of 83.05% which falls in the middle to high range of peer bank's average LTD ratios of 67% to 88% for the same period. The bank's LTD ratio has been steadily increasing since the prior CRA examination, despite selling a significant volume of mortgage loans in the secondary market.

Lending in Assessment Area

NBM's lending within its AA is excellent. Our random sample of 72 loans reflected that 97% of the number and 91% of the dollar volume were originated in the AA. A breakout by loan type reflects the same majority-lending outcome and supports the bank's strong commitment to lending in its AA.

Table 4.

National Bank Middlebury Number and Dollar Volume of Loans Originated inside the Addison County AA (1/01/2003 to 12/31/2005)										
Loan Type	Number of Loans					Dollars of Loans				
	Inside		Outside		Total #	Inside		Outside		Total \$(000)
	#	%	#	%		\$(000)	%	\$(000)	%	
Home Mortgages	24	100	0	0	24	1,897	100	0	0	1,897
Home Equity Lines	23	96	1	4	24	1,026	98	20	2	1,046
Commercial Loans	23	96	1	4	24	2,569	84	495	16	3,064
Totals	70	97	2	3	72	5,492	91	515	9	6,007

Source: Loan Sample compared to Demographics from 2000 U.S. Census.

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

Overall, NBM's loan originations to borrowers of different income levels exceed standards for a satisfactory rating.

Residential Mortgages

Table 5.

National Bank of Middlebury Borrower Income Distribution of Residential Real Estate Loans in Addison County (1/01/2003 to 12/31/2005)								
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 Mortgage	14	17	17	33	27	25	42	25
Home Equity Lines	14	4	17	38	27	25	42	43

Source: Loan sample compared to 2000 U.S. Census data.

Lending to borrowers of different income levels is more than reasonable. The volume of home mortgage loans originated to low-income borrowers exceeds demographics. The volume of HELOC loans is less than area demographics for low-income families. The bank participates in flexible programs to assist with first-time homebuyers and other state programs that assist borrowers qualify for home loans. Home equity lines of credit are more difficult to obtain as low-income borrowers may lack sufficient equity in their home to obtain this loan product. The bank has added a home equity product that does not revolve. It has a fixed borrowed amount that can be used for home improvement and be structured to meet the borrowers

repayment ability.

Loans to moderate-income borrowers are excellent in both home mortgage and HELOC. The home mortgage product includes purchase and refinancing activity. The sample reflected that moderate-income borrowers had more refinance than home purchases for the three-year period of the sample.

Businesses of Different Sizes

NBM does a good job of lending to businesses of different sizes. Small businesses are defined as having total annual revenue of \$1 million or less. For our review we sampled 23 businesses located inside the bank’s AA. As illustrated in **Table 6**, 74% of the number and 79% of the dollar volume of loans were originated to small businesses. This performance exceeds the percentage of businesses in the AA with revenues less than \$1 million. Note that 30% of all AA businesses do not report revenue data. Many of the non-reporting businesses could be self-employed, working from the home, or a part-time operation. Of the businesses in the AA, 64% are to companies with 4 or less employees and the majority or 89% are to a single location. NBM’s participation with the FHLB Community Development Program allows the bank to obtain funding for small business lending with below market rate programs, thus increasing the bank’s volume of small business loans.

Table 6.

National Bank of Middlebury Borrower Distribution of Loans to Businesses in Addison County (1/01/2003 – 12/31/2005)		
Business Revenues (or Sales)	≤\$1,000,000	>\$1,000,000
% of AA Businesses*	65%	5%
% of Bank Loans in AA by #	74%	26%
% of Bank Loans in AA by \$	79%	21%

Source: Loan sample compared to Dunn and Bradstreet data.

**30% of AA businesses did not report revenue data*

Geographic Distribution of Loans

The bank’s assessment area contains no low- or moderate-income geographies. A test of the geographic distribution of loans was not conducted, as it would not be meaningful.

Community Development Activities

NBM continues to demonstrate a strong commitment to its assessment area through CD activities that assist low- and moderate-income families. The following CD loans, qualified investments, and CD services reflect NBM’s overall strategic mission and leadership efforts to improve, develop, and sustain affordable housing opportunities in the bank’s assessment area and surrounding communities.

Community Development Lending

NBM supplements its direct residential lending to low- and moderate-income families with CD

loans made to several non-profit community groups in the area. The groups use the loans to purchase, develop, or renovate affordable housing for low- and moderate-income families. The bank originated 19 CD loans for a total of \$5 million over the entire evaluation period of June 15, 1999 to December 31, 2005 to promote affordable housing and for economic development to retain businesses and support job growth. The following provides more details of the composition of CD loans:

- ❑ \$203 thousand in two loans to an area economic development organization for rehabilitation of two buildings in Middlebury and Vergennes that will be leased to small businesses.
- ❑ \$197 thousand to a Bristol economic development group to refinance and improve a mixed-use commercial and residential facility with 5 affordable housing units.
- ❑ A \$3 million loan with \$2 million participated with another financial institution to construct affordable housing apartments in Middlebury, VT. Of the total 26 units, 80% are targeted towards residents earning less than 60% of the area median income. The development is intended to make use of Low-Income Housing Tax Credits (LIHTC) and addresses the critical shortage of affordable rental units.
- ❑ \$3.2 million to an affordable housing organization to purchase or refinance and improve three mobile home parks in Bristol, Starksboro and Vergennes, VT. This non-profit group manages the parks and ensures perpetual affordability via its ownership of the land.
- ❑ \$250 thousand loan to an affordable housing organization to purchase land, sub-divide, and to construct affordable housing in Hancock, VT.
- ❑ \$460 thousand to a non-profit affordable housing organization to construct five single-family dwellings in Hancock, VT on land donated by an affordable housing organization. The buyers of the homes have been pre-qualified by Rural Development for financing and received grants to provide equity in the homes.

Qualified Investments

NBM actively purchases qualified investments to promote affordable housing in its assessment area and surrounding communities. The bank has taken an equity position in several affordable rental properties through the Federal LIHTC Program.

NBM invested a total of \$1.2 million in 4 different investments. These investments contributed to the creation or renovation of 83 low- and moderate-income housing units, including many that are designed to provide perpetual low-income housing. The majority of the investments are in apartments targeted for low- and moderate-income individuals or families. Affordable rental

properties are also a need in Addison County as lower-paying service jobs make home ownership more difficult to achieve.

NBM has received regulatory approval to make equity investments up to 10% of its capital.

Product Innovation and Flexibility

The bank offers a variety of special credit programs to meet the needs of borrowers in its community. It seeks participation and funding from several local, state and national programs to assist borrowers obtain financing and/or qualify for home ownership. Some examples are as follows:

- ❑ VHFA programs such as home purchase and home improvement loans available as fixed rate mortgages at preferential rates for certain borrowers and no down payment. Over the entire evaluation period, NBM has sold 34 loans for over \$2.4 million to VHFA.
- ❑ Federal Home Loan Bank (FHLB) Equity Builder Program is a grant-type program that assists customers with down payments when buying homes. NBM received a \$53 thousand grant in 2005 to assist first-time homebuyers with down payments. Two \$15 thousand equity grants have been provided to qualified borrowers. The grant does not require repayment if the borrower remains in the home for at least five years. NBM has \$23 thousand remaining in the program.
- ❑ FHLB Community Development Advance Program that provides below-market-rate financing to small businesses. The bank received two advances in March 2005 for a total of \$10 million to fund loans in the Small Business Lending Program.
- ❑ No Nonsense Mortgages provide an affordable alternative to borrowers that can't qualify under secondary underwriting criteria. This program includes an adjustable-rate mortgage program that allows down payments as low as ten percent with no private mortgage insurance to drive up the monthly payments.

Community Development Services

NBM personnel provide support for several groups in the area that promote affordable housing or provide other assistance to low- and moderate-income families. Participation reflects a top down approach by senior management to reinforce the commitment to serving the community.

- ❑ The bank's CEO served on the Board of a nonprofit syndication and development company that creates permanently affordable rental housing through partnerships with local organizations, public agencies, and the private sector.
- ❑ The CEO serves on the investment committee of one of the equity funds that the bank is a participant. Responsibilities include reviewing operating budgets, tax credit compliance, and conducting oversight of the management of the property.
- ❑ The CEO serves as director of a conservation Board that promotes affordable housing.
- ❑ The CEO serves on the Board of a local general partner of a housing project in

Middlebury. The 30 unit transitional housing has section 8 vouchers attached to them.

- ❑ The bank's Chief Financial Officer is a treasurer of a non-profit group that provides emergency food, clothing, and housing for low-income families.
- ❑ A loan officer is on the Board of an area non-profit entity that provides affordable housing to low- and moderate-income individuals. The entity is a property manager of seven mobile home parks in Addison County.
- ❑ A senior officer is on the Board of an international non-profit organization that partners with people in need to build and renovate decent, affordable housing. The structures are subsequently sold to those in need at no profit and with no interest charged.
- ❑ The bank and its employees participate in financial education sessions and training with students of various grade levels.

Responses to Complaints

No consumer complaints have been received since the last performance evaluation.

Fair Lending or Other Illegal Credit Practices Review

We found no evidence of illegal discrimination or other illegal credit practices.