



SMALL BANK

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

PUBLIC DISCLOSURE

July 16, 2012

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

The National Bank of Middlebury
Charter Number 1195

30-32 Main Street
Middlebury, VT 05753

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 Outstanding

The major factors supporting the institution's rating are:

- The National Bank of Middlebury (NBM or Bank) level of lending, as reflected by the loan-to-deposit ratio, is more than reasonable
- A substantial majority of originated and purchased loans are within the Bank's assessment area.
- The borrower distribution of loans reflects excellent penetration among individuals of different income levels.
- A strong level of community development (CD) activities as evidenced by qualified CD investments and services.

SCOPE OF EXAMINATION

National Bank of Middlebury (NBM) 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, 2010 through December 31, 2011. The Bank also provided us with Community Development (CD) information to evaluate the Bank's responsiveness to CD needs in its assessment area (AA) through qualified CD investments and services. The evaluation period for the CD test is from January 10, 2006, the date of the prior Performance Evaluation (PE) through July 16, 2012. CD investments and services submitted by management were verified to ensure they met the regulatory definition for community development.

NBM's primary loan products, based on originations during the evaluation period, are residential mortgages. Since residential mortgages were determined to be the Bank's primary loan product, we did not review business loans as part of this examination. As indicated by the March 31, 2012 Uniform Bank Performance Report (UBPR), residential loans, which includes home equity loans, represents approximately 73% of the overall loan portfolio at the Bank.

The Bank reports data under the requirements of Home Mortgage Disclosure Act (HMDA). We reviewed the testing results of the Bank's HMDA data for residential real estate loans originated and 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 AA 1 – Non Metropolitan Statistical Area (MSA) assessment area that includes the entire Addison County and portions of Rutland County. The majority of the Bank's deposits, lending activity, and physical presence are

in this market. There was not a meaningful volume of HMDA data and business loan activity during the evaluation period in AA 2 – Chittenden County to perform an analysis.

DESCRIPTION OF INSTITUTION

National Bank of Middlebury is a \$279 million financial institution headquartered in Middlebury, Vermont. The Bank is fully owned by Middlebury National Corporation, a one bank holding company. NBM has one operating subsidiary, Community Financial Services, LLC which was created in partnership with two other financial institutions. The subsidiary was created to offer trust and investment services to Bank customers and NBM has one-third ownership interest in the operating subsidiary. Affiliate activities were not considered in this evaluation. In addition to the Bank's main office located in Middlebury, VT, the institution has five full service branches located in Middlebury, VT; Bristol, VT; Hinesburg, VT; Vergennes, VT; and Brandon, VT. The Bank also operates four stand alone ATMs which are located at the Middlebury drive-up location, Middlebury Market and Café, and two ATMS located on Middlebury College campus. All of NBM's branches and ATMs are located in middle-income geographies. Branch hours are typically 8:30AM to 4:00PM from Monday through Wednesday with extended hours on Thursday's and Friday's and 8:30AM to 12:00PM on Saturday. No branches were closed during the evaluation period; however, the Bank has opened three new branches since the last CRA exam. The branches in Hinesburg, VT; Vergennes, VT; and Brandon, VT were opened after the last CRA exam dated January 10, 2006.

NBM 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.nbmv.com, provides a listing and description of its deposit and loan services. The Bank offers a variety of different account access alternatives including telephone banking, online banking with bill pay options, mobile banking, e-statements, and Finance Works. In addition to the above services for personal account customers, the Bank also offers a wide variety of account access alternatives for their business customers, which include eCorp (online banking for business customers), eDeposit (Remote Deposit Capture), merchant credit card processing, automated clearinghouse origination, and bill pay service.

NBM's balance sheet has grown since the last CRA examination as the Bank has expanded their operations and opened new branches. Total assets as of March 31, 2012, were \$279.3 million compared to \$212.7 million as of March 31, 2006. Total loans of \$183.2 million and deposits of \$239.2 million represent 66% and 86% of total assets respectively. The following table provides a summary of the loan mix:

Loan Portfolio Summary by Loan Product March 31, 2012	
Loan Category	% of Gross Loans and Leases
1-4 Family Residential Mortgage – Closed End	52%
Home Equity	11%
Commercial & Industrial	7%
Commercial Real Estate	24%
Construction and Development	3%
Municipal Loans	2%
Consumer Loans	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 Outstanding using small bank procedures at the last CRA examination dated January 10, 2006.

DESCRIPTION OF ASSESSMENT AREA(S)

The CRA requires a Bank to define an AA in which it will be evaluated. NBM has two AAs that meet the requirements of the regulation and do not arbitrarily exclude any low- or moderate-income tracts.

AA 1 is a non MSA AA and consists of all of the cities and towns in Addison County as well as portions of Rutland County, which are contiguous to the Bank's branches. The AA is comprised of 14 census tracts. There are no low- or moderate-income tracts within the Bank's AA. The AA is comprised of 13 middle-income tracts (93%) and 1 upper-income tract (7%). The 2000 U.S. Census Data indicates that 33% of families in the AA are considered low- or moderate-income and approximately 9% of the households are below the poverty line.

AA 2 contains portions of Chittenden County, which are contiguous to the Bank's branches and is part of the Burlington-South Burlington MSA 15540. The AA is comprised of six census tracts and does not include any low or moderate-income tracts. The AA includes two middle-income (33%) tracts and 4 upper-income tracts (67%).

Our analysis was based on AA1 when arriving at the overall conclusion as the majority of the Bank's deposits are located within this AA and the Bank's physical presence is in this market. We performed a limited-scope review of the Bank's activity in AA 2 – Burlington-South Burlington MSA because there was not a meaningful volume of lending or deposit activity in this AA.

Demographic Information for NBM AA 1 – Addison and Rutland County					
Income Level	Total #	% Low	% Moderate	% Middle	% Upper
Geographies (Census Tracts)	14	0%	0%	93%	7%
Population by Geography	47,292	0%	0%	94%	6%
Owner Occupied Housing by Geography	13,300	0%	0%	94%	6%
Family Distribution by Income Level	12,320	15%	19%	26%	40%
2000 Census Median Family Income (MFI)		\$46,084	2011 Median Housing Value*		\$266,544
HUD Updated MFI: 2011		\$62,900	Median Age of Housing		46 Years
			Families Below the Poverty Level		8.6%
			Unemployment Rate **		5.2%

Source: 2000 U.S. Census data

*Data from Zillow.com

**Data from US Bureau of Labor Statistics as of 4/30/2012. Rate is an average of Addison and Rutland County.

NBM operates in a competitive market with competition from local commercial banks and savings banks. The Bank commands a good market share within Addison County, which is part of AA1. The Federal Deposit Insurance Corporation's Institutions Deposit Market Share Report, as of June 30, 2011, indicates six institutions operate branches within Addison County and eight institutions operate branches within Rutland County, which are both part of NBM's AA 1. NBM ranks first with a deposit market share of approximately 43% and a total deposit balance of \$209 million in Addison County. The Bank ranks last at the eighth position with a deposit market share of less than 1% in Rutland County. NBM commands a greater market share within Addison County as majority of the Bank's branches are located in Addison County. Competitors within the AA include: TD Bank, National Association; RBS Citizens, National Association; People's United Bank; The Merchants Bank; and Key Bank, National Association.

Several local and nationwide entities provide further competition for mortgage and business loans; however, the Bank commands a higher market share for mortgage loans when compared to other competitors in the area. NBM competes with 71 other lenders in Addison County and leads with a market share of 19.72%. In Rutland County, the Bank competes with 57 lenders and ranks 4th with a market share of 6.61%. Lending competitors within the Bank's AA include: Bank of America, N.A.; Vermont Federal Credit Union; New England Federal Credit Union, People's United Bank, PHH Mortgage Corporation; and Lake Sunapee Bank.

Per Moody's Analytics and vteconomy.com, the economy in Vermont remains stable with improving trends in the state's unemployment rate. The national and state rate of unemployment in 2012 decreased as compared to the prior year. Data from the U.S. Bureau of Labor Statistics indicates that the unemployment rate for the state of Vermont as of June 2012 was 4.7% compared to the national rate of 8.2%. The unemployment rate as of April 2012 for the two counties in AA1 averaged 5.2%. Rates were 4.4% and

6.0% for Addison and Rutland counties, respectively. The local economy in AA 1 is driven by education and healthcare. Major employers within AA 1 include Middlebury College, Porter Medical Center, and Goodrich. Per Moody's Analytics, some of the other major employers in the state include: IBM, Fletcher Allen Health Care, and University of Vermont.

Despite the effects of a national recession on the state housing market, median housing prices in AA 1 – Addison and Rutland Counties remain high. The expensive housing market limits the availability of affordable housing for low- and moderate-income families in AA 1. Based on data from Zillow.com, as of June 18, 2012, the average median cost of housing for the cities that are part of AA 1 is \$267 thousand. This is well above the median housing cost in the state of Vermont of \$239 thousand.

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 of Addison County, including working families, seniors, and individuals. 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. He also mentioned that building affordable housing in the area has become difficult due to cutbacks in federal funding. He indicated that tax credits are still available; however, the lack of federal funding has had an impact on the planning and implementation of their projects. The community contact mentioned that the local financial institutions are supportive of the credit and community development activities and do an excellent job at meeting the needs of the community. The contact also mentioned NBM's extensive involvement in community development activities through the Bank's participation in loans and investments in community development projects.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

The Bank's lending performance meets the standards for an outstanding rating. NBM'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 originated a substantial majority of its primary loan products within its assessment area. The distribution of loans originated in AA 1 reflects excellent penetration among individuals of different income levels.

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 \$30 million and \$34 million in mortgage loans to the secondary market in the years 2010 and 2011, respectively. The Bank's net loan-to-deposit ratio averaged 84% over the last 25 quarters, since the previous CRA examination. During this period the loan-to-deposit ratio ranged from a quarterly low of 74% to a high of 90%. NBM's loan-to-

deposit ratio is higher than the national peer bank median quarterly average of 78% over the same period.

Lending in Assessment Area

A substantial majority of NBM’s primary loan products were originated within the Bank’s assessment area and the Bank meets the standard for outstanding performance. NBM originated 97% by number and 98% by dollar amount of loans in the AAs. The following table details the Bank’s lending within the AA by number and dollar amount of loans.

Table 1 - Lending in Non MSA AA – Addison and Rutland County										
Loan Type	Number of Loans					Dollars of Loans				
	Inside		Outside		Total	Inside		Outside		Total \$
	#	%	#	%		\$	%	\$	%	
Home Loans	613	97	17	3	630	97,337	98	2,418	2	99,755
Totals	613	97	27	3	630	97,337	98	2,428	2	99,755

Source: HMDA reported data and a sample of commercial loans from 1/1/2010 to 12/31/2011.

Lending to Borrowers of Different Incomes

The distribution of loans originated in AA 1 reflects excellent penetration among individuals of different income. HMDA data and business loans were not analyzed in AA 2 – Burlington-South Burlington MSA as there was not a meaningful volume of activity in the AA to perform an analysis.

Conclusion for full-scope AA 1 – Addison and Rutland Counties

Home Loans

The distribution of home loans reflects excellent penetration among borrowers of different income levels. The percent of home purchase loans exceeds the percent of moderate income families within the Bank’s AA. The percent of home refinance and home improvement loans are slightly lower than the percent of moderate income families in the AA.

Home purchase, home refinance, and home improvement loans are all lower than the percent of low-income families in the AA. The Bank’s performance of lending to low-income families meets the standards for a satisfactory performance given the lack of affordable housing in the AA. According to the 2010 peer mortgage market share data, the Bank ranks first with an overall market share of 26% for home refinance loans made to low-income borrowers in Addison County. Home refinance loans represent the majority of the originated/purchased loans during the evaluation period. While the national downturn in the economy and real estate market are evident in the area, median housing prices remain high relative to median incomes. The lack of affordable housing limits lending opportunities. As of June 2012, the average median home price in the AA was \$267 thousand. The HUD updated median family income is \$62,900, which means the maximum income that is considered low-income is \$31,450 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 \$31,450 to a maximum income of \$50,320.

The Bank’s performance of lending to moderate-income families exceeds the standard for satisfactory performance. Market competition for home mortgage loans is significant; however, NBM does an excellent job of making loans to moderate-income borrowers in AA 1. According to 2010 peer mortgage market share data, NBM ranks 1st in Addison County for home purchase, home refinance, and home improvement loans with market shares of 26%, 16%, and 30%, respectively. The Bank’s performance in Rutland County is considered satisfactory given the low volume of loans made to moderate-income borrowers with the evaluation period.

The following tables show the distribution of home loan products among borrowers of different income levels compared to the percent of families in each income category.

Table 2 - Borrower Distribution of Residential Real Estate Loans in AA 1								
Loan Type	Borrower Income Level							
	Low		Moderate		Middle		Upper	
	% 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	15	3	19	20	26	19	40	54
Home Improvement	15	7	19	13	26	31	40	47
Home Refinance	15	5	19	14	26	26	40	55

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

Geographic Distribution of Loans

We did not perform an analysis on the geographic distribution of loans as there are no low or moderate income tracts within the Bank’s AA.

Conclusion for limited-scope AA 2

Based on a limited-scope review, the Bank's performance under the lending test in AA 2 is consistent with the Bank's overall lending test rating under the lending test in the full scope AA 1.

Qualified Investments and CD Services

NBM continues to demonstrate strong commitment to its assessment area through CD activities that assist low-and moderate-income families. The following CD activities reflects the Bank’s overall strategic mission and leadership efforts to improve, develop,

and sustain affordable housing opportunities in the Bank's assessment area and surrounding communities.

Number and Amount of Community Development Loans

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 six CD loans for a total of \$859 thousand over the entire evaluation period of January 10, 2006 to July 16, 2012 to promote affordable housing and for economic development to retain businesses and support job growth.

Number and Amount of Qualified Investments

NBM actively purchases qualified investments to promote affordable housing in its assessment area and surrounding communities. The Bank made two community development investments totaling \$700 thousand or 2.94% of Tier 1 Capital during the evaluation period of January 10, 2006 to July 16, 2012. The Bank also had three prior period investments with \$332 thousand in outstanding balances as of June 30, 2012. The Bank invested \$500 thousand in an equity fund during the assessment period and the proceeds from the offering were used to acquire, rehabilitate, construct, lease, and sell low- and moderate-income housing projects and related commercial facilities in Vermont. The Bank also made a \$200 thousand investment in a different equity fund and the proceeds from this offering were used to purchase and renovate an affordable housing project for the elderly in Brandon, Vermont. Total qualified CD investments, including prior period investments, amount to \$1.03 million or 4.33% of Tier 1 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:

- Federal Home Loan Bank (FHLB) Equity Builder Program is a grant-type program that assists customers with down payments when buying homes. NBM has received \$100 thousand in grants for the years 2010, 2011, and 2012 to assist first-time homebuyers with down payments. In 2010 the Bank utilized \$10 thousand in grants, in 2011 the Bank utilized \$10 thousand in grants, and year-to-date in 2012 the Bank has utilized \$30 thousand of the grant money. The grant does not require repayment if the borrower remains in the home for at least five years.
- NBM also participated in a loan participation program offered by NeighborWorks of Western Vermont. The Bank provided \$250 thousand in funding for two

different rounds bringing the total funding to \$500 thousand. The loan participation pool is comprised of second mortgages up to 100% loan-to-value made to low- and moderate-income borrowers. The Bank's overall share in the loan participation for the two rounds of funding is approximately 19% and the Bank services the loans that were funded by the Bank.

Community Development Services

Accessibility to the Bank's delivery systems in the AA is good. NBM's delivery systems are accessible to geographies and individuals of different income levels throughout the AA. The Bank has five full-service branches locations in AA 1. All of the five branches in AA 1 are located in middle-income tracts. The branches are easily accessible to all residents. No branches were closed during the evaluation period; however, since the last CRA examination, the Bank opened three new branches located in Hinesburg, VT; Vergennes, VT; and Brandon, VT were opened since the last CRA examination.

NBM does a good job of providing CD services and the Bank personnel provide support for several groups in the area that promote affordable housing, economic development or to provide other assistance to low- and moderate-income families.

CD service activities in the AA during the evaluation period include:

- ❑ One Bank employee is a Board member and Treasurer at a local non-profit organization whose mission is to reduce the effects of poverty in Addison County by providing residents with emergency, basic, and enrichment programs. The organization has created nearly 200 affordable housing units in Addison County since 1985.
- ❑ One of the Bank employees conducts classroom sessions on mortgage process and financing programs available to first time home buyers for a local organization that provides Vermonters in three counties with education, counseling, and access to affordable loans to needed to purchase, improve, and help keeping their home.
- ❑ One of the employees serves as the Board member, Treasurer, and Finance Committee Chair for the organization mentioned above, which also promotes safe and affordable housing, focusing on sustainable home ownership.
- ❑ One of the employees serves as a Board member for a local organization that provides affordable housing for low-and moderate-income people of Addison County, including working families, seniors, and individuals. The same employee is also a Loan Committee member at a local organization mentioned above that promotes safe and affordable housing, focusing on sustainable home ownership.

Responses to Complaints

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

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.