



PUBLIC DISCLOSURE

October 14, 2014

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

Heritage Bank
Charter Number 702078

95 E Tabernacle St
St. George, UT 84770-2307

Office of the Comptroller of the Currency

1225 17th Street
Suite 450
Denver, CO 80202-5534

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 Heritage Bank's rating are:

- The loan-to-deposit (LTD) ratio reflects reasonable performance based on the institution's business model.
- A substantial majority of the bank's lending activity is within its assessment area (AA).
- Lending to borrowers with different income levels is reasonable.
- The geographic distribution of loans reflects an excellent dispersion of loans.
- Other lending-related activities support the bank's overall CRA performance.
- The bank has received no consumer complaints concerning its performance in meeting the community's credit needs.

SCOPE OF EXAMINATION

Our objective was to assess Heritage Bank's performance in meeting community credit needs within its AA. The evaluation period for this examination is from the start date of the bank's prior CRA examination, May 13, 2009, to the start date of this examination, October 14, 2014. Our review period, the time period for sampling loans, is from January 1, 2012 to June 30, 2014, and is representative of the bank's lending activity since the 2009 examination. Heritage Bank is a "small bank" under CRA regulation criterion. Accordingly, we evaluated Heritage Bank under small bank examination procedures, which include a lending test as described in the regulation. Based on loans originated during the review period, Heritage Bank's primary product is one-to-four family residential real estate loans both by dollar and by number. The bank reports mortgage loan activity under the requirements of the Home Mortgage Disclosure Act (HMDA). We used the bank's HMDA data to conduct our analyses and make conclusions regarding the bank's lending performance. We performed an on-site data integrity review in July 2014 and found the bank's HMDA data accurate and reliable.

DESCRIPTION OF INSTITUTION

Heritage Bank (Heritage) is an \$87 million financial institution headquartered in St. George, Utah, with one banking office. Heritage has one primary shareholder and no bank holding company or related organizations.

Heritage does not operate as a traditional financial institution. In the years prior to the recession, Heritage Bank was an active real estate lender. In the early stages of the 2007 nationwide economic recession and the related sharp decline in real estate activity, Heritage's board determined the bank would be subject to substantial credit risk

should they not make significant changes to their business strategy. The board then withdrew from the market as a retail real estate lender and employed a wholesale business strategy. Heritage Bank now invests in low credit risk securities and, to a lesser extent, originates residential real estate and construction loans. The bank generally underwrites its loans to secondary market guidelines and sells most of these loans on the secondary market as part of the bank's interest rate risk strategy. This results in a loan portfolio that is disproportionately small compared to the institution's asset size and lending activity. Additionally, the bank does not accept deposits from the general public; the only retail deposits are those of employees and affiliated parties.

The bank's balance sheet reflects this strategy. As of September 30, 2014, Heritage Bank reported total assets of \$87 million, total liabilities of \$74 million, and capital of \$13 million. The primary components of total assets were U.S. Treasuries and Agency securities (\$45 million), municipal securities (\$19 million), FHLB equity securities (\$19 million), other assets (\$2 million), and loans (\$1.4 million). Net loans represented only 1.6 percent of total assets, and the loan portfolio composition was as follows: 1-4 family residential real estate (67 percent of the portfolio), real estate construction and development (23 percent), multi-family real estate (8 percent), and commercial real estate (2 percent).

The bank has no legal, financial, or other constraints that impede its ability to help meet the credit needs in its AA. The bank received a "Satisfactory" rating at its last CRA evaluation dated May 13, 2009.

DESCRIPTION OF ASSESSMENT AREA

Heritage Bank's AA is the St. George, Utah metropolitan statistical area (MSA). The St. George, UT MSA consists of Washington County in the state of Utah. St. George is the largest city in the county and the largest city in the state of Utah outside the Wasatch Front (Salt Lake City, Ogden, Provo-Orem). A large part of the local economy comes from tourism, due to its proximity to Zion National Park, Bryce Canyon National Park, and Grand Canyon National Park, as well as several other state parks and recreational areas. Year-round golf and other world-recognized events are also large contributors to the city's economy. St. George is warmer than the rest of the state as its climate is hot in summer months but moderate during the winter and attracts a significant retirement segment to the area. From the early 1990s through 2005, Washington County, Utah, was the fastest growing metropolitan area in the United States. This exponential growth dramatically altered the composition of the balance sheets of many of the banking institutions in the lending area, including Heritage Bank's. When the real estate market experienced a significant downturn followed by economic recession in 2007, the economy in St. George was stagnant and the real estate lending market was virtually at a standstill. According to Moody's, the unemployment rate was greater than 10 percent in the early years of the slowdown. Mortgage originations in the MSA were at their high point at 1,750 in 2007 compared to 465 originations in 2013. While economic recovery has lagged in St. George, there are positive indicators. Permits for single-family residence construction grew 50 percent in 2012 over the previous year, and then grew

another 40 percent in 2013 over 2012 totals. Personal bankruptcies peaked in 2010 at 1,123, but decreased in succeeding years and were 760 in 2013.

Data from the 2010 United States (US) Census reports the population of the St. George, Utah MSA at 138,115. The MSA has 21 geographies (Census Tracts) as follows: one moderate-income tract (five percent of all geographies), 17 middle-income tracts (81 percent), and three upper-income tracts (14 percent). There are no low-income tracts in the AA. The AA meets the requirements of the regulation and does not arbitrarily exclude low- or moderate-income geographies.

According to 2010 US Census data, the weighted average of the median family income in the MSA was \$54,315. The HUD updated median family income in 2013 was \$56,800. Approximately 10 percent of MSA households were below poverty level. The distribution of families by income level was approximately 16 percent low-income, 19 percent moderate-income, 26 percent middle-income, and 39 percent upper-income. The weighted average median housing cost for the St. George, Utah MSA was \$244,006. The 2010 US Census listed the MSA unemployment rate as 2.91 percent.

We made one community contact in Washington County during this examination. The community contact was generally supportive of the local banks' performance but also stated they could be more involved in affordable housing lending.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

Loan-to-Deposit (LTD) Ratio

Heritage Bank's LTD ratio is reasonable considering its unique business strategy, lending record, and lack of deposits from the general public.

Heritage Bank's average quarterly LTD ratio for the 22 quarters from the date of the last CRA examination through September 30, 2014, is 425 percent. While this compares favorably to the 76 percent average LTD ratio for other financial institutions headquartered in southern Utah for the same period, the comparison is not meaningful because of the unique business strategy Heritage Bank employs. Further, Heritage Bank does not have comparable size, locations, or product offerings of the other institutions.

In response to market conditions, Heritage Bank implemented a significant change to its business strategy during this evaluation period. As a result, its LTD ratios vary widely. The average LTD ratio for second quarter 2009 through first quarter 2010 was an astounding 1,935 percent. Heritage Bank's LTD ratio reduced each quarter through 2010, until the end of the first quarter 2011 when the LTD ratio was 25 percent. From then to September 30, 2014, the average quarterly LTD ratio is just less than 7 percent.

Under its present business strategy, Heritage Bank remains a small residential real estate lender. Through 2012, 2013, and the first half of 2014, Heritage provided home

purchase loans to two borrowers and home refinance loans to 48 borrowers for a total of \$9.1 million. Heritage Bank does not accept retail deposits from the general public. The only retail deposits in the bank are from employees and affiliated parties.

Lending in Assessment Area

A substantial majority of Heritage Bank’s lending for residential real estate loans is to customers within its AA. The following table details the bank’s lending activity within the AA by number and dollar amount of loans originated during the review period.

Table 1 - Lending in St. George, UT MSA										
Loan Type	Number of Loans					Dollars of Loans				
	Inside		Outside		Total	Inside		Outside		Total
	#	%	#	%		\$(000s)	%	\$	%	
Home Purchase	2	100.0	0	0.0	2	247	100.0	0	0.0	247
Home Refinance	48	100.0	0	0.0	48	8,887	100.0	0	0.0	8,887
Home Improvement	0	0.0	0	0.0	0	0	0.0	0	0.0	0
Total	50	100.0	0	0.0	50	9,134	100.0	0	0.0	9,134

Source: 2010 U.S. Census data; 2012-2013 HMDA data, HMDA LAR

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

The overall borrower distribution of loans to borrowers of different incomes reflects a reasonable penetration.

The borrower distribution of home purchase loans does not meet the standard for satisfactory performance. The bank’s lending to both low- and moderate-income families was less than area demographics. However, the bank made only two home purchase loans during the review period, and the lack of significant activity discounts the usefulness of the comparison. The bank’s home refinance loan performance for area low-income families was significantly lower than demographic comparators and was somewhat lower than moderate-income comparator demographics for the area. The following table shows the borrower distribution of home purchase loans and home refinance loans based on income level of the borrower.

Table 2 - Borrower Distribution of Residential Real Estate Loans in St. George, UT MSA								
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	15.6	0.0	19.3	0.0	26.0	0.0	39.1	0.0
Home Refinance	15.6	1.7	19.3	8.5	26.0	37.3	39.1	52.5

Source: 2010 U.S. Census data; 2012-2013 HMDA data; 2014 HMDA LAR

Geographic Distribution of Loans

Heritage Bank’s distribution of loans among the various census tracts (CT) in its AAs is excellent.

The bank’s performance in the St. George, UT MSA exceeds the demographics in moderate-income tracts for both home purchase lending and home refinance lending. There are no low-income CTs in the St. George, UT MSA. Again, the bank made only two home purchase loans during the review period, and the lack of significant activity discounts the usefulness of the comparison. However, the number of loans for home refinance was reasonable.

Table 3 - Geographic Distribution of Residential Real Estate Loans in St. George, Utah MSA								
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	0.0	0.0	1.8	50.0	83.6	50.0	14.6	0.0
Home Refinance	0.0	0.0	1.8	3.4	83.6	79.7	14.6	16.9

Source: 2010 U.S. Census data; 2012-2013 HMDA data; 2014 HMDA LAR

Other Lending-Related Activities

Heritage Bank makes substantial contributions to a charitable foundation, the Brent and Bonnie Jean Beesley Foundation, which is administered by principals of the bank. Considering the needs and opportunities in the St. George, UT MSA, and Heritage Bank’s performance context and capacity, the bank’s performance in providing lending-related qualified investments supports the bank’s overall Satisfactory CRA performance rating.

During the review period for community development activities, May 13, 2009 to October 14, 2014, the Foundation provided grants totaling \$66,500 to two lending-related community development organizations based in the St. George, UT MSA.

Responses to Complaints

Heritage Bank has not received any complaints during this evaluation period regarding its CRA performance.

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.