



**SMALL BANK**

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Comptroller of the Currency  
Administrator of National Banks

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## **PUBLIC DISCLOSURE**

**June 2, 2003**

### **COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION**

**The First National Bank Of Mercersburg  
Charter Number 9330**

**12 South Main Street  
Mercersburg, PA 17236**

**Comptroller of the Currency  
Western Pennsylvania Field Office  
4075 Monroeville Boulevard Building 2, Suite 300  
Monroeville, PA 15146**

**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.**

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**INSTITUTION'S CRA RATING:** This institution is rated **SATISFACTORY.**

The primary factors supporting the bank's overall rating include:

The distribution of sampled residential mortgage, business and farm purpose loan originations among AA borrowers of different income levels meets the standard for satisfactory performance.

The distribution of sampled business purpose loan originations among AA geographies of different income levels meets the standard for satisfactory performance.

The average loan to deposit ratio exceeds the standard for satisfactory performance since it surpasses peer group loan to deposit averages.

The level of lending inside the assessment area (AA) meets the standard for satisfactory performance, since a majority of sampled loans were originated within the AA.

## **DESCRIPTION OF INSTITUTION**

The First National Bank of Mercersburg (FNB) is a \$113 million, intrastate community bank, located in Franklin County, Pennsylvania. FNB is a wholly owned subsidiary of Mercersburg Financial Corporation, a one-bank holding company. FNB is headquartered in the town of Mercersburg, in Franklin County, Pennsylvania. Franklin County is situated in south central Pennsylvania on the edge of the greater Washington D.C./Baltimore, MD metropolitan area. Mercersburg itself is located approximately 175 miles west of Philadelphia and 150 miles east of Pittsburgh, Pennsylvania. FNB is a full service community bank offering a range of deposit and loan products. Loan products include residential real estate mortgages, and commercial and farm loans. FNB received a satisfactory rating as a result of the previous CRA evaluation, which was conducted as of February 1, 1999.

Net loans represent 68% of FNB's assets. FNB's loan portfolio by dollar volume consists of: 38% residential real estate, 23% commercial real estate and commercial loans, 19% farmland secured and agricultural loans, 12% consumer loans and the remainder in other loan types including multifamily real estate secured, construction, and home equity loans. There are no financial or legal impediments that would preclude FNB from lending.

## **DESCRIPTION OF ASSESSMENT AREA**

FNB has identified Franklin County as its AA. Franklin County consists of twenty five whole, contiguous geographies. Franklin County is situated within the south central portion of Pennsylvania. The AA is not located within a Metropolitan Statistical Area (MSA). FNB's AA is composed primarily of middle-income geographies, which total twenty. The remaining AA geographies, which are upper-and moderate-income, total four and one respectively. The

bank's AA contains no low-income geographies. The AA's only moderate-income geography is situated in Chambersburg Borough. FNB's AA meets regulatory requirements and does not arbitrarily exclude any low- or moderate-income geographies.

FNB operates five full service branch offices in Franklin County. FNB's headquarters and one of the five branches, are housed together on Main Street in Mercersburg, PA. Branch locations include two in Mercersburg (Main Street and North End), and one each in Fort Loudon, Greencastle and Chambersburg, PA. The Greencastle and Chambersburg branches were opened in December 1999 and November 2001 respectively. FNB did not close any branch offices during the evaluation period. FNB operates automatic teller machines (ATM's) at its branch locations in Mercersburg (North End), Fort Loudon, Greencastle and Chambersburg. Additionally, each branch location is equipped with a drive-through window.

FNB's branch locations are currently situated in the southern portion of the Franklin County AA. Historically, FNB's branch locations have been concentrated in the southwest portion of Franklin County. However, over the evaluation period, FNB established branch offices in Greencastle and Chambersburg. Expansion extended FNB's branch network further east into Franklin County, closer to Interstate 81 and most recently into the more urban, more competitive Chambersburg market.

Demographic information derived from annually updated HUD data was used to analyze the bank's lending distribution among borrowers of different income levels. HUD data updated for 2002 reports the median family income for the bank's AA to be \$41,100. AA demographic information, derived from annually updated HUD data, reports that of AA families 12%, 17%, 25% and 46% are of low-, moderate-, middle- and upper-income respectively.

Demographic data collected during the 1990 census is used to analyze the bank's lending distribution among AA geographies. The 1990 census reports the population of FNB's AA to be 121,000. The majority (77%) of AA households are supported by wage or salaried jobs, 33% derive income from social security and 20% report retired residents. 1990 census data also reports that within the bank's AA, owner occupied housing represents 68% of housing, the median housing value equals \$69,785 and for AA housing, the median year built is 1959. Census data for 2000 reports that the median housing value has increased to \$97,800. Additionally, over 53% of AA owner occupied housing is valued at more than \$100,000. These AA demographic factors restrict loan demand for residential mortgage loans. Particularly restricted is residential mortgage demand from low-income borrowers impacted by issues of housing availability and affordability.

Franklin County remains predominantly rural. Franklin County has benefited from its proximity to the expanding greater Washington/Baltimore area. Benefits include population growth and below statewide unemployment levels. Specifically, the average unemployment rate for Franklin County from May 2002 through April 2003 was under 5%, which compares favorably to a seasonally adjusted statewide average for the same period of nearly 6%. The community's demonstrated ability to replace jobs lost to workforce reductions by some area employers mitigates the extent of adverse impact to the area economy. In recent years, the area's proximity to Interstates 81, 70, and the Pennsylvania Turnpike have attracted major retail distribution

centers. Area employment is derived primarily from the service industry, retail, wholesale trade and manufacturing. Construction, farming, government, insurance and finance, as well as the local hospital and school district, support area employment.

Banking competition within FNB's trade area is strong. The southern portion of Franklin County is heavily banked as it borders on Washington County, Maryland, where Hagerstown is located. Competition consists of financial institutions, including banks and credit unions. Competitors are substantially larger in asset size and have more elaborate branch networks and a more established presence in the urban Chambersburg area than does FNB. The larger, more sophisticated profile of the competing financial institutions allows them to offer a greater variety of products and services. Competition includes regional banks, which have established a strong area presence, as well as more locally based commercial banks. According to bank management within the AA, credit needs continue to be concentrated in residential mortgage, business and farm purpose lending.

Examiners contacted a local community development corporation. The contact indicated that area economic conditions mirror statewide conditions. The contact identified housing as a community need citing the area's network of interstate roads has fostered growth throughout the community. The contact described the performance of local financial institutions as favorable in responsiveness to community credit needs. Additionally, the contact specifically referenced willingness on the part of local financial institutions to originate housing loans to qualified applicants.

#### *SAMPLING*

FNB loan data was collected through a random sample consisting of a total of 90 loans. Examiners sampled 30 each of residential mortgage, business purpose and farm purpose loans originated to borrowers located inside and outside of the bank's AA over the evaluation period. Residential mortgage loans, business purpose and farm purpose loans, were selected for sampling since these loans represent 38%, 23% and 19% respectively of the bank's loan portfolio and are considered to be FNB's primary loan products for the period. The loan sample was used to analyze the bank's record of originating loans inside its AA as well as its record of distributing loans among AA borrowers of different income levels and AA geographies.

#### ***CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA***

## **LOAN TO DEPOSIT ANALYSIS**

FNB's loan to deposit ratio exceeds the standard for satisfactory performance, and surpasses the average loan to deposit ratio exhibited by peer banks over the same period.

To assess FNB's lending activity we collected and analyzed loan to deposit data for the evaluation period for FNB and its local peer group. The peer group to which FNB's level of lending activity was compared included banks with assets up to \$200 million, operating within Franklin and surrounding Pennsylvania counties, which totaled nine.

Levels of lending activity were measured by comparing the seventeen-quarter average loan to deposit ratios achieved by FNB and its local peer group. The seventeen-quarter average loan to deposit ratio was calculated using quarter-end financial data from 3/31/99 through 3/31/03. FNB's level of lending over the period compares favorably to lending by its local peer group of banks. Specifically, FNB achieved an average loan to deposit ratio of 84.8% over the seventeen-quarter period. In comparison, the local peer group achieved a seventeen-quarter average loan to deposit ratio of 79.2%.

## **LENDING IN ASSESSMENT AREA**

Lending in the assessment area (AA) meets the standard for satisfactory performance.

FNB originated a majority of its mortgage and business loans within its AA.

An analysis of mortgage and business purpose loans originated by FNB over the evaluation period (2/1/99 to 3/31/03) revealed that of sampled, combined, residential mortgage, business and farm purpose loan volume and dollars, 82% and 79% respectively, were originated within FNB's AA.

The following table details the FNB's record of originating residential mortgage, business and farm purpose loan volume and dollars inside and outside of its AA over the evaluation period.

## LENDING INSIDE VS OUTSIDE THE ASSESSMENT AREA

	Inside AA		Outside AA		TOTALS	
	#####	\$000	#####	\$000	#####	\$000
<b>Residential Mortgage Loans</b>	28	\$2,339	2	\$106	30	\$2,445
	93%	96%	7%	4%	100%	100%
<b>Business Loans</b>	23	\$3,174	7	\$1,043	30	\$4,217
	77%	75%	23%	25%	100%	100%
<b>Farm Loans</b>	23	\$2,101	7	\$862	30	\$2,963
	77%	71%	23%	29%	100%	100%
<b>Combined Loans</b>	74	\$7,614	16	\$2,011	90	\$9,625
	82%	79%	18%	21%	100%	100%

## LENDING TO BORROWERS OF DIFFERENT INCOME LEVELS

### *Income Distribution of Residential Mortgage Lending*

FNB's record of lending to borrowers of different income levels meets the standard for satisfactory performance.

Demographic data compiled during the 1990 census for the bank's AA categorizes income levels of AA families as follows:

- 12% of AA families are low-income families
- 17% of AA families are moderate-income families
- 25% of AA families are middle-income families
- 46% of AA families are upper-income families

FNB's record of residential mortgage lending among AA borrowers of different income levels is reasonable considering AA demographics. A sample of AA residential mortgage loans, originated by FNB over the evaluation period, was reviewed to assess the bank's record of lending to low-and moderate-income AA borrowers. The analysis was performed to assess the distribution among AA borrowers of different income levels compared to the income levels of AA families.

AA demographic information derived from annually updated HUD data reports that of AA families 12% and 17% are of low- and moderate-income respectively. Low-income AA families

by definition are families with annual incomes below \$20,550. Moderate-income AA families by definition are families with annual incomes between \$20,550 and \$32,880.

As indicated below, data derived from the sample of AA residential mortgage loans, originated by FNB over the evaluation period, revealed that loans originated to low- and moderate-income AA borrowers represented 10% and 10% of loan volume and 4% and 7% of loan dollars, respectively. This level of residential mortgage lending to borrowers of different income levels is reasonable considering the demographic context in which FNB operates.

FNB's ability to extend residential purchase mortgage loans to low-income borrowers is hampered by AA demographics. Specifically, of households in the bank's AA, 14.5% of the AA population is age 65 or older and 20% of the AA households are comprised of retired residents. In addition, 33% of area households derive income from social security and 8.5% are considered to be at or below poverty level. The percentages of retired, senior AA residents and limited income AA households restrict residential mortgage demand particularly from low-income AA families.

Limited residential mortgage loan demand from low -income families may be attributed to many low-income families consisting of more senior, long time residents who have already owned and occupied residences in the area for many years. For this segment of the population, often housing needs tend to shift from owner occupied housing to apartment living. Therefore, the bank's opportunity to originate residential mortgage loans to low -income borrowers is limited by area demographics.

Additionally, 1990 census data also reports that within the bank's AA, owner occupied housing represents 68% of housing, the median housing value equals \$69,785 and the median year built is 1959. Census data for 2000 reports that the median housing value has increased to \$97,800. And over 53% of AA owner occupied housing is valued at more than \$100,000. These AA demographic factors restrict loan demand for residential mortgages. Particularly restricted is demand from low-income home mortgage borrowers impacted by issues of housing availability and affordability.

FNB is, however, responsive to the needs of AA residential mortgage borrowers for whom down payment amounts represent a barrier to obtaining home purchase financing. FNB offers a First Time Homebuyers Program. The Program offers residential mortgages with loan to value (LTV) ratio criteria as high as 89%. FNB also offers Third Party Originator (TPO) residential mortgages with loan to value (LTV) ratio criteria as high as 95%.

The following table details residential mortgages originated by FNB in its AA over the evaluation period, distributed among AA borrowers of different income levels.

## INCOME DISTRIBUTION OF AA RESIDENTIAL MORTGAGE LOANS

AA Families	Low Income Families		Moderate-Income Families		Middle Income Families		Upper Income Families		TOTALS	
	12%		17%		25%		46%		100%	
	####	\$000	####	\$000	####	\$000	####	\$000	####	\$000
Residential Mortgages	3	\$86	3	\$169	6	\$408	17	\$1,770	29	\$2,433
	10%	4%	10%	7%	21%	17%	59%	73%	100%	100%

### *Income Distribution of Business Purpose Lending*

FNB's record of lending to AA businesses of different sizes meets the standard for satisfactory performance.

Demographic data compiled during the 1990 census for the AA indicates that of AA businesses (5,523) that reported annual revenues, revenue was recorded as follows:

- 5,150 or 93% of AA business report annual revenues < or = \$1 million
- 373 or 7% of AA business report annual revenues > than \$1 million

FNB's record of business lending among AA businesses of different sizes is reasonable considering AA demographics. A sample of AA business purpose loans, originated by FNB over the evaluation period, was reviewed to assess the bank's record of lending to AA small businesses. Small business loans are defined as those loans made to business enterprises whose annual, gross revenues are \$1 million or less. AA small businesses, according to Dunn and Bradstreet, represent 93% of total AA businesses. Of business purpose loans originated by FNB to businesses between 2/01/99 and 3/31/03, 82% of business loan volume was originated to small businesses. This level of business purpose lending to businesses of different sizes is reasonable considering the demographic context in which FNB operates.

FNB is also responsive to the needs of AA small businesses offering more competitive interest rates than are offered with Small Business Administration (SBA) loans. Additionally, the majority of business purpose loans originated by FNB to AA businesses represent the smaller dollar amounts needed by AA businesses. For example, of sampled AA business purpose loans 89%, 84% and 79% were originated for dollar amounts less than or equal to \$250,000, \$100,000 and \$50,000 respectively. Additionally, 63% of sampled business purpose loans were originated for dollar amounts less than or equal to \$25,000.

The following table details the distribution of sampled AA business purpose loans originated by FNB in its AA over the evaluation period, among AA borrowers of different income levels.

## INCOME DISTRIBUTION OF AA BUSINESS LOANS

	Annual Revenues < or \$1MM		Annual Revenues > \$1MM		TOTALS	
	93%		4%		100%	
AA Businesses	#####	\$000	#####	\$000	#####	\$000
Business Loans	19	\$1,927	4	\$1,247	23	\$2,101
	82%	61%	17%	39%	100%	100%

### *Income Distribution of Farm Purpose Lending*

FNB's record of lending to AA farms of different sizes meets the standard for satisfactory performance.

Demographic data compiled during the 1990 census for the AA indicates that of AA farms (705), which reported annual revenues, revenue was recorded as follows:

- 675 or 96% of AA farms report annual revenues < or = \$1 million
- 30 or 4% of AA farms report annual revenues > than \$1 million

FNB's record of farm lending among AA farms of different sizes is reasonable considering AA demographics. A sample of AA farm purpose loans, originated by FNB over the evaluation period, was reviewed to assess the bank's record of lending to AA small farms. Small farm loans are defined as those loans made to farm enterprises whose annual, gross revenues are \$1 million or less. AA small farms, according to Dunn and Bradstreet, represent 96% of total AA farms. Of farm purpose loans originated by FNB to AA farms between 2/01/99 and 3/31/03, 96% of farm loan volume was originated to small farms. This level of farm lending to farms of different sizes is reasonable considering the demographic context in which FNB operates.

FNB is also responsive to the needs of AA small farms, offering interest rates on farm loans, which are more competitive than commercial loan rates. FNB also finances the purchase of farm equipment with dealers at interest rates equal to those offered for automobile financing. Additionally, the majority of farm purpose loans originated by FNB to AA farms represent the smaller dollar amounts needed by AA farms. For example, of sampled AA farm purpose loans 86%, 81% and 68% were originated for dollar amounts less than or equal to \$250,000, \$100,000 and \$50,000 respectively.

The following table details the distribution of sampled AA farm purpose loans originated by FNB in its AA over the evaluation period, among AA farms of different sizes.

## INCOME DISTRIBUTION OF AA FARM LOANS

	Annual Revenues < or \$1MM		Annual Revenues > \$1MM		TOTALS	
AA Farms	96%		4%		100%	
	#####	\$000	#####	\$000	#####	\$000
Farm Loans	22	\$1,901	1	\$200	23	\$2,101
	96%	80%	4%	20%	100%	100%

## GEOGRAPHIC DISTRIBUTION OF LOANS

### *Geographic Distribution of Residential Mortgage Lending*

Demographic data compiled during the 1990 U.S. census for the FNB's AA indicates that available owner occupied housing is dispersed throughout the AA as follows:

- 1% of AA owner occupied housing is in moderate-income geographies
- 76% of AA owner occupied housing is in middle-income geographies
- 23% of AA owner occupied housing is in upper-income geographies

Opportunities for residential mortgage lending in the AA's only moderate-income geography are hampered by the fact that just 1% of AA owner occupied housing is located within that moderate-income geography. Therefore, an analysis of the geographic distribution of AA residential mortgage loans is not considered to be meaningful and consequently was not performed.

### *Geographic Distribution of Business Purpose Loans*

FNB's distribution of sampled AA business purpose loans among AA geographies meets the standard for satisfactory performance since it is reasonable considering AA demographics.

Demographic data compiled during the 1990 census for the bank's AA indicates that 7,768 businesses are distributed throughout AA geographies as follows:

- 474 or 6% businesses are located in moderate-income geographies
- 5,571 or 71% businesses are located in middle-income geographies
- 1,823 or 23% businesses are located in upper-income geographies

A sample of 23 AA business purpose loans totaling \$4,159 million, originated by FNB over the evaluation period, to AA businesses was reviewed. As indicated below, of sampled AA business

loans originated during the evaluation period, 4% of business loan volume and 8% of business loan dollars were originated in the AA's only moderate-income geography. FNB's geographic distribution of business purpose loans demonstrates a reasonable dispersion among AA geographies.

FNB's geographic distribution of business purpose loans is reasonable since opportunities for lending in the AA's only moderate-income geography are hampered because the moderate-income geography is located in Chambersburg, PA. The City of Chambersburg is situated in the eastern half of Franklin County, removed from FNB's established branch network, which is concentrated in the southwestern portion of Franklin County. Therefore, the AA's moderate-income geography is geographically removed from where historically FNB has had an established presence. In addition, Chambersburg residents are also likely to patronize established, local banks and credit unions associated with major area employers. No unexplained or conspicuous gaps in geographic lending distribution were noted.

The following table details the distribution of sampled AA business purpose loans, originated by FNB in its AA over the evaluation period, among AA geographies of different income levels.

**GEOGRAPHIC DISTRIBUTION OF AA BUSINESS LOANS**

	Low Income Geographies		Moderate Income Geographies		Middle Income Geographies		Upper Income Geographies		Totals	
# Businesses in Geography	0%		6%		71%		23%		100%	
Business Loans	#####	\$000	#####	\$000	#####	\$000	#####	\$000	#####	\$000
	0	\$0	1	\$323	21	\$2,236	1	\$250	23	\$4,159
	0%	0%	4%	8%	91%	86%	4%	6%	100%	100%

*Geographic Distribution of Farm Purpose Lending*

Demographic data compiled during the 1990 U.S. census for the FNB's AA indicates that reporting farms are dispersed throughout the AA as follows:

- 0% of AA farms are in moderate-income geographies
- 86% of AA farms are in middle-income geographies
- 14% of AA farms are in upper-income geographies

Opportunities for farm lending in the AA's only moderate-income geography are hampered by the fact that less than less than .5% of reporting AA farms are located within the AA's only moderate-income geography. Therefore, an analysis of the geographic distribution of AA farm purpose loans is not considered to be meaningful and, consequently, was not performed.

#### **RESPONSE TO COMPLAINTS**

No complaints have been received since the last examination.

#### **RECORD OF COMPLIANCE WITH ANTI-DICRIMINATION LAWS**

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

