



**SMALL BANK**

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Comptroller of the Currency  
Administrator of National Banks

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Washington, DC 20219

## **PUBLIC DISCLOSURE**

**November 09, 2009**

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

Farmers & Merchants Bank of Western Pennsylvania  
Charter Number 5073

222 Market Street  
Kittanning, PA 16201

Office of the Comptroller of the Currency

WESTERN PENNSYLVANIA (PITTSBURGH) Field Office  
4075 Monroeville Boulevard, Building 2, Suite 300  
Monroeville, PA. 15146-2529

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

- The bank's quarterly average, net loan-to-deposit ratio is considered to be reasonable;
- The bank originated a majority of its loans within its assessment area;
- The bank's record of originating loans reflects reasonable distribution among assessment area borrowers of different income levels and businesses of different sizes;
- The bank's record of originating loans reflects excellent distribution among assessment area geographies of different income levels;
- The bank has received no consumer complaints regarding its community reinvestment performance.

**SCOPE OF EXAMINATION**

Farmers and Merchants Bank of Western Pennsylvania, NA (F&M) was evaluated under the Small Bank Community Reinvestment Act (CRA) examination procedures. Our review encompassed the bank's performance from January 1, 2007 to November 2, 2009, as this is representative of its lending strategy since the last CRA examination. Residential mortgages and business loans were determined to be the bank's primary loan products and were reviewed as part of this examination. In order to assess the bank's lending activity, we reviewed the bank's 2007, 2008, and year-to-date 2009 Home Mortgage Disclosure Act-Loan Application Register (HMDA-LAR). We also reviewed a random sample of thirty-three (33) business loans originated between January 1, 2007 and September 30, 2009.

**DESCRIPTION OF INSTITUTION**

F&M is a \$369 million intrastate, community bank, chartered in 1897 and headquartered in Kittanning, PA. The bank grew from the merger between Merchants National Bank of Kittanning ("MNBK") and The Farmers National Bank of Kittanning ("FNBK") on April 1, 2008. MNBK's charter was retained. Subsequent to the merger, FNBK's assessment area (AA) became F&M's AA. The merger increased the bank's lending capacity, which supports the bank in meeting the lending needs of the community. As of 2008, F&M ranked second within Armstrong County for residential mortgage originations, with 7.39% of the market share. Through October 2009, F&M ranked first within Armstrong County for total number of mortgages originated, with 10.5% of the market share. The merger also facilitates the bank in offering a broader range of products and services, such as a free checking account. F&M also maintains the largest deposit market share within Armstrong County.

The bank is wholly owned by Farmers and Merchants Bancorp of Western Pennsylvania, a one-bank holding company located in Kittanning, PA. F&M does not operate any subsidiaries. In May 2008, F&M opened a new branch office in Leechburg, PA. The bank did not close any branch offices during the evaluation period.

F&M operates seven full-service branch offices and one limited-service branch. One of the branch offices is located at F&M's main office in Kittanning, PA. The limited-service branch office and four of the full-service branch offices are also located in Kittanning. One full-service branch is located in Worthington PA, and another one is located in Leechburg, PA. All eight branch office locations are situated within Armstrong County PA. F&M operates eight automated teller machines (ATMs.) Seven of the ATMs are located in conjunction with branch office sites. The other ATM is situated at an off-site location. The branches operate during regular business hours. Five of the branches also offer expanded hours on Saturdays.

F&M offers a full range of loan and deposit services. F&M's retail products include checking accounts, savings programs, and individual retirement accounts. F&M's commercial products include commercial, agricultural, and small business loans. The bank also offers services including telephone and internet banking, as well as business payroll services. Internet banking is limited to standard services such as account transfers and bill pay. Additional information regarding the bank's products and services is offered via its website: [www.fmbwpa.com](http://www.fmbwpa.com).

As of September 30, 2009, F&M reported net loans of \$243 million, total deposits of \$302 million, and tier one capital of \$37 million. Net loans represented 68% of total assets. F&M's loan portfolio consists of residential real estate loans (45%), commercial loans (43%), consumer loans (8%), and construction and development loans (4%).

There are no financial or legal circumstances impeding the bank's ability to help meet the credit needs in its AA. F&M was rated "Satisfactory" at its last CRA examination, dated May 3, 2004.

## **DESCRIPTION OF ASSESSMENT AREA**

F&M has designated one assessment area (AA) with twenty-seven (27) census tracts (CTs) all contained within the Pittsburgh Metropolitan Statistical Area (38300). The AA consists of Armstrong County in its entirety and eight (8) additional, contiguous CTs, three (3) and five (5) of which are situated in Butler and Westmoreland Counties respectively. Of the twenty-seven (27) CTs, seventeen (17) are classified as middle-income and the remaining ten (10) CTs are classified as moderate-income. The bank's AA does not include any low- or upper-income CTs. F&M's AA meets CRA regulatory requirements and does not arbitrarily exclude low- or moderate-income geographies. The following information describes the AA:

Demographic Characteristics	#	Low % of #	Moderate % of #	Middle % of #	Upper % of #	NA* % of #
Geographies (Census Tracts/BNAs)	27	0.00	37.04	62.96	0.00	0.00
Population by Geography	104,254	0.00	34.06	65.94	0.00	0.00
Owner-Occupied Housing by Geography	32,635	0.00	31.34	68.66	0.00	0.00
Business by Geography	5,663	0.00	36.38	63.62	0.00	0.00
Farms by Geography	265	0.00	32.83	67.17	0.00	0.00
Family Distribution by Income Level	29,628	23.92	22.36	24.59	29.14	0.00
Distribution of Low and Moderate Income Families throughout AA Geographies	13,710	0.00	40.15	59.85	0.00	0.00
Median Family Income HUD Adjusted Median Family Income for 2009 Households Below Poverty Level		47,195 62,500 11%	Median Housing Value Unemployment Rate (June 2009 BLS)	71,265 9.4%		

(\*) The NA category consists of geographies that have not been assigned an income classification.

Source: 2000 US Census and 2009 HUD updated MFI

As determined by the federal banking agencies, there are no geographies within the bank's AA that are designated as "underserved" or "distressed."

According to 2000 U.S. Census Data, the AA population totaled 104,254, AA families totaled 29,268 and AA households totaled 41,287. Of AA households, 11.34% subsist below the poverty level. Of the 29,628 AA families, 7,086 and 6,624 were classified as low- and moderate-income respectively. The 2000 U.S. census reports the AA median income to be \$47,195 and HUD, updated for 2009, reports AA median family income to be \$62,500. Of AA families, 24%, 22%, 25% and 29% are classified as low-, moderate-, middle-, and upper-income respectively.

The economy in the Pittsburgh MSA is stabilizing as the housing market improves and job losses moderate. Payroll declines have slowed measurably since the beginning of the year, supported by the public sector and leisure/hospitality industry. Hiring in leisure/hospitality is attributed to the opening of a casino and the hosting of the G-20 conference during the latter half of 2009. Payroll declines in manufacturing are moderating, and estimated industrial production in July increased for the first time since October 2008. The housing market is showing signs of recovery, with sales, prices, and permits all rising since the beginning of 2009. At 7.7%, the unemployment rate is 2% below the national rate and 1% below the state rate in Pennsylvania. Supporting the Pittsburgh MSA are top-tier educational and research institutions, a significant amount of skilled, healthcare labor and low cost-of-living relative to metro areas. Pittsburgh MSA challenges include a declining population, a significant number of heavily leveraged households, an aging infrastructure and reliance on old-line manufacturing.

Armstrong County's economy continues to experience some economic decline. The Bureau of Labor Statistics, as of June 2009, reported the unemployment rate in

Armstrong County to be 9.4%. This level of unemployment represents a slightly higher level than the state rate in Pennsylvania, which was reported to be 8%. The unemployment rate for Armstrong County also reflects a significant increase from a rate of 5.1% reported for June 2008. As of October 2009, top county employers include Armstrong County Memorial Hospital (ACMH), Allegheny Ludlum Corporation, Creekside Mushrooms LTD, Wal-Mart Associates, Inc., and Barker Bros, Inc. Eljer, Inc., a local manufacturing company, no longer represents a predominant source of employment as a result of recent significant downsizing. Healthcare continues to be a prevailing source of area employment with ACMH employing over 3,000 people. Other major area industries include education, social services, manufacturing, and retail trade.

Competition in the AA is strong. According to the June 30, 2008 FDIC Deposit Market Share Report, within Armstrong County, F&M is ranked first in market share with 27.42% of county deposits. All F&M branches are located within Armstrong County. Area competitors include Elderton State Bank (three branches, 13.48% deposit market share), Citizens Bank of PA (three branches, 11.26% deposit market share), S&T Bank (three branches, 7.70% deposit market share), and First Commonwealth Bank (two branches, 6.41% deposit market share).

During the examination, two economic development organizations serving Armstrong County were contacted. The focus of both organizations is housing development, as well as business retention and expansion. Both contacts indicated several local employers have been affected by the economy, resulting in significant downsizing. The contacts characterized business growth as stagnant and unemployment as increasing. The contacts cited other factors contributing to economic decline including an aging population and matriculation of younger residents to other areas in search of employment. According to both contacts, an opportunity exists for local financial institutions to meet the credit needs of low-and moderate-income area residents. Both contacts stated that there is a lot of goodwill, interest, and support from local financial institutions and the institutions are all very visible in the local community. According to one contact, the fact that its headquarters is located in the heart of Kittanning better equips F&M to be more involved in the community.

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

F&M's performance under the lending test is "Satisfactory." F&M's loan-to-deposit ratio is considered to be reasonable. F&M originated a majority of residential mortgage loans and sampled business loans within its AA. F&M demonstrated a reasonable record of originating residential mortgage loans among AA borrowers of different income levels and business loans among AA businesses of different sizes. F&M demonstrates a reasonable record of originating residential mortgage loans and business loans among AA geographies of different income levels.

### **Loan-to-Deposit Ratio**

F&M's lending activity, measured by its loan-to-deposit (LTD) ratio, is considered to be reasonable and meets the standard for satisfactory performance, considering the bank's

size, financial condition, lending opportunity, and competitive market.

Lending activity over the evaluation period was measured by comparing the twenty (20) quarter-average LTD ratios reported by F&M and a peer group. The peer group consisted of financial institutions with assets between \$100 million and \$400 million operating within F&M's local market. The twenty (20) quarter- average LTD ratio was calculated using financial data reported for each quarter-end over the period since the previous evaluation. F&M's net LTD ratio over the evaluation period averaged 62%, ranged between 54% and 79%, and trended upward.

F&M's quarterly-average net LTD ratio is slightly below the quarterly-average net LTD ratio reported over the same period for the similarly sized banks. The average LTD ratio over the period reported by the peer group was 68% and ranged between 40% and 109%. However, following the merger between MNBK and FNBK in April 2008, F&M's loan to deposit ratio grew considerably. Since the merge, F&M's LTD ratio increased from 66% to 78%. For the quarter ending September 30, 2009, F&M's LTD ratio of 78% exceeded the average peer LTD ratio of 70%.

### **Lending in Assessment Area**

F&M's record of originating loans within its AA meets the standard for satisfactory performance. F&M's record of originating loans within its AA over the evaluation period was evaluated through measuring and analyzing data collected from residential mortgage loan originations and a sample of thirty-three (33) small business loan originations.

The analysis of F&M's residential mortgage lending demonstrates that F&M originated a majority (70%) of the number of its home mortgage loans within its AA during the period. The analysis of F&M's business lending demonstrates that F&M originated a majority (54%) of the number of its business loans within its AA during the period.

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

The bank's record of originating loans reflects reasonable distribution among assessment area borrowers of different income levels and businesses of different sizes.

#### *Residential Mortgage Loans*

F&M's record of originating residential real estate loans reflects a reasonable distribution among AA borrowers of different income levels and meets the standard for satisfactory performance.

Data reported by F&M in accordance with the Home Mortgage Disclosure Act (HMDA) was analyzed. The analysis was performed to assess F&M's record of distributing its residential mortgage loan originations among AA borrowers of different income levels. Specifically, we analyzed home purchase loans, home improvement loans and home

mortgage refinance loans that F&M originated to AA borrowers between January 1, 2007 and September 30, 2009.

The percentage of residential mortgage loans F&M originated to moderate-income AA borrowers exceeds the percentage of AA families classified as moderate-income. The percentage of residential mortgage loans originated by F&M to low-income borrowers is less than the percentage of low-income AA families.

When considering the affordability of housing in the AA, F&M's performance is considered to be reasonable. Based on 2000 U.S. Census data, the median cost of housing in the Armstrong County Area AA is \$71,265. The 2009 HUD updated median family income was \$62,500, which indicates that low-income borrowers earned less than \$31,250. Affordability impacts demand for residential mortgage loans from low-income AA borrowers.

The following table details the distribution of residential real estate loans originated by F&M during the evaluation period among AA borrowers of different income levels.

<b>Table 2 - Borrower Distribution of AA Residential Mortgage Loans</b>								
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	23.92	12.50	22.36	25.57	24.59	25.00	29.13	36.93
Home Improvement	23.92	7.25	22.36	24.64	24.59	28.99	29.13	39.13
Home Refinance	23.92	9.16	22.36	27.89	24.59	31.47	29.13	31.47

Source: 2000 US Census Data; 2007 – 2009 HMDA-LAR Data

*Business Loans*

F&M's record of originating business loans reflects a reasonable distribution among AA businesses of different sizes and meets the standard for satisfactory performance.

Data collected from a sample of business loans originated by F&M within its AA was analyzed. The analysis was performed to assess F&M's record of distributing its business loan originations among AA businesses of different sizes. Specifically, we collected and analyzed data from twenty (20) business loans that F&M originated to its AA businesses between January 1, 2007 and September 30, 2009.

The percentage of business loans F&M originated to small AA businesses is less than the percentage of AA businesses classified as small. Within the AA, approximately 78% of businesses are classified as small businesses. Small businesses are defined as businesses reporting annual gross revenues of \$1 million or less. Comparatively, based on the business loan sample, 65% of F&M's business loans were originated to small AA businesses.

When considering responsiveness to the needs of small AA businesses, F&M's performance is considered to be reasonable. The vast majority of business loans originated by F&M to AA businesses represent the smaller dollar amounts needed by small AA businesses. Specifically, of analyzed AA business loans, 80% originated were for \$100,000 or less.

The following table details the distribution of business loans originated by F&M during the evaluation period to AA businesses of different sizes.

Business Revenues (or Sales)	≤\$1,000,000	>\$1,000,000	Unavailable/Unknown	Total
% of AA Businesses	78.28	4.29	17.43	100%
% of Bank Loans in AA by #	65.00	25.00	10.00	100%

Source: 2000 US Census Data; F&M Loan Sample from January 1, 2007 – September 30, 2009

### **Geographic Distribution of Loans**

The bank's record of originating loans reflects excellent distribution among assessment area geographies of different income levels;

#### *Residential Mortgage Loans*

F&M's record of originating residential real estate loans reflects an excellent distribution among AA CTs of different income levels and meets the standard for satisfactory performance. No conspicuous gaps or areas of low penetration were identified.

F&M's record of originating residential mortgage loans within moderate-income AA CTs exceeds the percentage of owner-occupied housing located within moderate-income AA CTs. The AA does not contain any low-income CTs.

The following table details the distribution of residential mortgage loans originated by F&M during the evaluation period among AA geographies.

Census Tract Income Level	Low		Moderate		Middle		Upper	
	% 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	0.00	0.00	31.34	36.36	68.66	63.64	0.00	0.00
Home Improvement	0.00	0.00	31.34	47.83	68.66	52.17	0.00	0.00
Home Refinance	0.00	0.00	31.34	39.92	68.66	60.08	0.00	0.00

Source: 2000 US Census Data; 2007 – 2009 HMDA-LAR Data  
*Business Loans*

F&M’s record of originating business loans reflects an excellent distribution among AA CTs of different income levels and meets the standard for satisfactory performance. No conspicuous gaps or areas of low penetration were identified.

F&M’s record of originating business loans within moderate-income AA exceeds the percentage of businesses located within moderate-income AA CTs. The AA does not contain any low-income CTs.

The following table details the distribution of business loans originated by F&M during the evaluation period among AA businesses.

<b>Table 3A - Geographic Distribution of AA Businesses Loans</b>								
Census Tract Income Level	Low		Moderate		Middle		Upper	
	% 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 Loans	0.00	0.00	36.38	50.00	63.62	50.00	0.00	0.00

Source: 2000 US Census Data; F&M Loan Sample from January 1, 2007 – September 30, 2009

**Responses to Complaints**

F&M did not receive any complaints about its performance in helping to meet credit needs in the AA during the 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...