

Comptroller of the Currency
Administrator of National Banks

Small Institution Evaluation

PUBLIC DISCLOSURE

May 15, 2000

**COMMUNITY REINVESTMENT ACT
PERFORMANCE EVALUATION**

**Merchants National Bank, N.A.
Charter Number 11875**

**1015 7th Street
Sacramento, CA 95804**

**Comptroller of the Currency
Western District
50 Fremont Street, Suite 3900
San Francisco, CA 94105**

Note: 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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GENERAL INFORMATION

The Community Reinvestment Act (CRA) requires each federal financial supervisory agency to use its authority when examining financial institutions subject to its supervision, to assess the 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. Upon conclusion of such examination, the agency must prepare a written evaluation of the institution's record of meeting the credit needs of its community.

*This document is an evaluation of the CRA performance of the **Merchants National Bank** prepared by the **Office of the Comptroller of the Currency (OCC)**, the institution's supervisory agency, **as of May 15, 2000**. The agency rates the CRA performance of an institution consistent with the provisions set forth in Appendix A to 12 CFR Part 25.*

INSTITUTION'S CRA RATING: This institution is rated “**Satisfactory.**” The factors supporting the bank's overall rating include the following:

- ♀ The distribution of loans to businesses with different revenues is reasonable.
- ♀ The geographic distribution of loans is good.
- ♀ The bank's loan to deposit ratio does not meet the standard for satisfactory performance. However, this factor is mitigated by the bank's efforts to meet identified credit needs in low and moderate income areas, through loans to local non-profit community organizations, and efforts to help revitalize economically depressed areas of its community.
- ♀ A reasonable number of loans were funded within the bank's assessment area.

DEFINITIONS OF TERMS APPLIED IN THIS PUBLIC DISCLOSURE

Low - Income Geography:

For a census tract: The median *family* income is less than 50% of the median *family* income for the MSA in which it is located.

Moderate - Income Geography:

For a census tract: The median *family* income is equal to or greater than 50% and less than 80% of the median *family* income for the MSA in which it is located.

Middle - Income Geography:

For a census tract: The median *family* income is equal to or greater than 80% and less than 120% of the median *family* income for the MSA in which it is located.

Upper - Income Geography:

For a census tract: The median *family* income is equal to or greater than 120% of the median *family* income for the MSA in which it is located.

HMDA:

Abbreviation for Home Mortgage Disclosure Act.

LMI:

Abbreviation for low- or moderate - income. Characterizes geographies and families.

Median Family Income:

As determined by U.S. Census Bureau data in 1990.

1999 HUD Median Family Income:

Updated U.S. Census Bureau data, determined by the Department of Housing and Urban Development for 1999.

MSA:

Metropolitan Statistical Area.

DESCRIPTION OF INSTITUTION

The Merchants National Bank of Sacramento (MNB) is a community bank founded in 1921. It is a wholly owned subsidiary of The Merchants National Bank Holding Company, a unit bank holding company located in Sacramento, California. The bank is located in the city of Sacramento, California. The main office is located in downtown Sacramento and has a branch located in the city of Carmichael. The bank does not have any ATM's. All offices are in the bank's defined assessment area. The bank extends a wide range of credits to businesses, individuals and provides residential real estate financing.

As of 3/31/2000, the bank had total assets of \$ 90 million, loans of \$32 million, and deposits of \$80 million. The bank does not have any legal or financial circumstances impeding its ability to help meet the credit needs in its assessment area.

The following table shows loans outstanding as of 4/30/2000:

| Loan Type as of | \$ Million | Percent |
|-------------------------|------------|---------|
| Real Estate | \$20.5 | 63% |
| Commercial | \$11.7 | 35% |
| Agricultural | \$.1 | .1% |
| Consumer Loans | \$.1 | .1% |
| Total Loans Outstanding | \$32.4 | 100% |

Source: Bank Generated Reports (Statement of Condition as of 4/30/2000)

MNB received a Satisfactory rating in its prior CRA evaluation in April 1996.

DESCRIPTION OF ASSESSMENT AREA

Geographic Description

MNB defines its assessment area as Sacramento County, which was incorporated in 1850 as one of the original 27 counties of the State of California. The County's largest city, the City of Sacramento is the seat of government for the State of California and also serves as the county seat. The County is the major component of the Sacramento Metropolitan Statistical Area ("SMSA") which includes Sacramento, El Dorado, and Placer Counties. Sacramento County encompasses approximately 994 square miles in the middle of the 400-mile long Central Valley, which is California's prime agricultural region. The County is bordered by Contra Costa and San Joaquin Counties on the south, Amador and El Dorado Counties on the east, Placer and Sutter Counties on the north, and Yolo and Solano Counties on the west. Sacramento County extends from the low delta lands between the Sacramento and San Joaquin rivers north to about

ten miles beyond the State Capitol and east to the foothills of the Sierra Nevada Mountains. The southernmost portion of Sacramento County has direct access to the San Francisco Bay.

Sacramento County is a long-established center of commerce for the surrounding area. Trade and services, federal, state and local government, and food processing are important economic sectors. The County's location at the intersection of four major highways brings additional visitors destined for the San Francisco Bay Area, the Gold Country, the Central Valley and the Sierra Nevada Mountains.

Recent data reflects population growth in Sacramento County. According to 1990 Census Data, the county population of Sacramento was 1,041,219. The State Department of Finance estimated county population at 1,177,800 as of January 1, 1999. Sacramento County has five incorporated cities: Citrus Heights, Folsom, Galt, Isleton and Sacramento. Approximately 33.9% of the county's population live in the City of Sacramento. Population growth in the County has increased at a faster rate than in the City of Sacramento. Approximately 53.2% of the county's population lives in unincorporated areas, giving Sacramento County one of the largest unincorporated populations among all counties in the State.

Major employers in the Sacramento area include those in government, medical services, electronics, retail sales, communications services, and financial services. The State employs 64,726 personnel in the county in various branches of government, making the State the largest employer in the area. County employees account for 12,694 additional jobs.

As of October 1999, based on unadjusted data, unemployment in the Sacramento MSA was 3.6% compared to 4.6% for the State.

MNB's assessment area meets the requirements of the regulation and does not arbitrarily exclude low- or moderate-income geographies. The assessment area consists of 207 census tracts of which 17 (8%) are low income, 48 (23%) are moderate income, 92 (44%) are middle income, and 50 (24%) are upper income census tracts.

There are 65 different financial institutions represented in the Sacramento market.

Demographics and Credit Needs

| Census Tracts & Population within Assessment Area | | | | |
|---|--------------------|------------------------|-----------------|--|
| Income category of Census Tract | # of Census Tracts | % of all Census Tracts | 1990 Population | % of Population within Tract Income Category |
| | 17 | 8.21% | 68,828 | 6.61% |

| Income category of Census Tract | # of Census Tracts | % of all Census Tracts | 1990 Population | % of Population within Tract Income Category |
|---------------------------------|--------------------|------------------------|------------------|--|
| Low | 48 | 23.19% | 200,162 | 19.22% |
| Moderate | 92 | 44.44% | 520,077 | 49.95% |
| Middle | 50 | 24.15% | 252,152 | 24.22% |
| Upper | 0 | 0.0% | 0 | 0.00% |
| NA | | | | |
| Total | 207 | 100 % | 1,041,219 | 100 % |

Source: 1990 Census Data

According to 1990 Census data, the median family income was \$38,850. The Census median housing value for the assessment area was \$131,007. The HUD median family income was updated in 1999 to \$51,900.

The following table illustrates the distribution of families by family income, based on 1990 Census data:

| Families within Current Assessment Area (Distributed by Family Income) | | |
|---|-----------------|---------------------|
| Family Income Category * | Assessment Area | |
| | # of Families | Percent of Families |
| Low | 56,374 | 21.25% |
| Moderate | 48,623 | 18.33% |
| Middle | 60,710 | 22.88% |
| Upper | 99,591 | 37.54% |
| Total Families | 265,298 | 100% |
| Total Population | 1,041,219 | |

Source: 1990 Census Data

*Income category is for the families, regardless of the income category of the census tract in which they reside.

Low- and moderate-income families live throughout the assessment area.

Dun & Bradstreet economic reports show that 40,879 businesses (945 farms and 39,934 non-farm businesses) operate within the bank's assessment area. Of those farms and businesses with

reported revenues, 73% have reported annual revenues of \$1 million or less. Approximately 78% employ fewer than ten employees.

We conducted two community contacts for this examination. The first community contact was a nonprofit organization that raises funds to help meet the needs of the community. The primary need identified by the organization was short term lending to charitable organizations for funding of low-income housing. The second community contact was a nonprofit developer of housing and services for the homeless population of Sacramento. There was no community need identified by the organization.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA:

Scope of Review

The review period for this evaluation is the period of May 1996 - April 2000. We used bank-generated information, which we tested for accuracy. MNB makes a wide range of credit products available within its delineated service area. Based on the information provided by the bank, we determined that business loans were the primary lending product over the four years reviewed. Business loans surpassed both residential real estate and consumer loans by dollar and volume. For the purpose of our review, business lending includes commercial real estate loans, business loans and agricultural loans.

Lending to Businesses of Different Sizes:

♀ **MNB's lending to businesses of different sizes meets the standards for Satisfactory Performance. This conclusion is based on the context of the bank's size, resources, and competition.**

Lending opportunities are strong, based on Dun & Bradstreet data for the assessment area. There are 40,879 businesses within the area, including 945 farms and 39,934 non-farm businesses. Of these farms and businesses with reported revenues, 73% have reported annual revenues of \$1 million or less.

To determine lending to businesses of different sizes, we used bank-generated data, which we tested for accuracy. The information included 100% (137) of the new business loan originations in the assessment area during the rating period. The following tables show the distribution of business lending opportunities and the bank's lending performance in these sectors:

**Businesses of Different Sizes:
Lending Opportunities and the Bank's Lending Performance within Assessment Area
Commercial Loans**

| Businesses with Reported Income: | Opportunities Per Dun & Bradstreet | | Commercial Loans Originated (By Revenue of Borrower) | | | |
|---|---|-------------|---|---------------------|----------------------|----------------------|
| | # | % | # of Loans | % of Total # | Loans (\$000) | % of Total \$ |
| < \$1,000,000 | 29,834 | 73% | 84 | 61% | \$7,321 | 46% |
| >\$1,000,000 | 3,111 | 8% | 53 | 39% | \$8,435 | 54% |
| Rev Not Reported | 7,934 | 19% | N/A | N/A | N/A | N/A |
| Total with Reported Income | 40,879 | 100% | 137 | 100% | \$15,756 | 100% |

Source: Dun & Bradstreet Business Demo Data and Bank Data

Of the commercial loans within the bank's assessment area, we found that 61% by number and 46% by dollar volume were to small businesses (with revenues of \$1 million or less). The number of loans made to small business within the assessment area meets the standard of satisfactory performance.

Geographic Distribution of Loans

♀ **The geographic distribution of loans originated during the evaluation is good.** The following table shows the distribution of census tracts within the assessment area by income category; distribution of businesses within the assessment area by census tract income; and the distribution of loans originated by census tract income.

| Demographics | | | Loan Originations | | | |
|-----------------|------|--------------------------------|-------------------|------------|-------------------|------------|
| Census Tracts | | % of total Businesses in tract | # of Loans | % of Total | \$ Loaned (000's) | % of Total |
| Low Income | 8% | 7% | 29 | 22% | \$2,598 | 16% |
| Moderate Income | 23% | 26% | 39 | 28% | \$4,027 | 26% |
| Middle Income | 45% | 43% | 51 | 37% | \$7,483 | 47% |
| Upper Income | 24% | 24% | 18 | 13% | \$1,649 | 11% |
| N/A | 0% | 0% | N/A | N/A | N/A | N/A |
| Total | 100% | 100% | 137 | 100% | \$15,756 | 100% |

Source: 1990 Census, 1999 D & B Business Demographic Data and Bank Generated Reports

The bank's loans are well distributed in the low- and moderate-income census tracts of the assessment area. Thirty-three percent of businesses in the assessment area are located in low and moderate census tracts. The bank originated loans, 50% in number and 42% in dollars, to businesses in low and moderate census tracts.

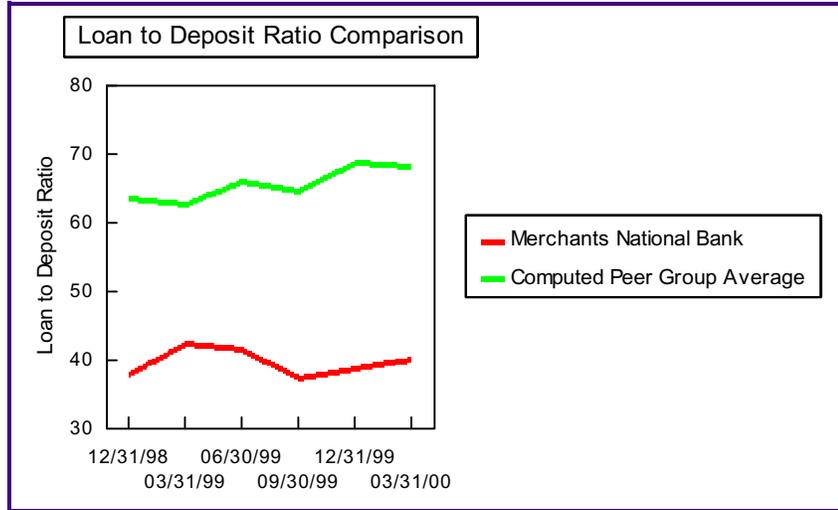
Loan to Deposit Ratio

♀ **MNB's Loan-to-Deposit Ratio does not meet the standard for Satisfactory Performance, given the bank's size, financial condition, and assessment area credit needs. However, management continues to work with community organizations to meet identified community credit needs.**

We evaluated the bank's loan-to-deposit ratio for six quarters ending 3/31/2000. The average

loan to-deposit ratio for the last six quarters was 40%. This ratio is low when compared to the average loan to deposit ratio of 68% of the six peer banks located within the bank's assessment area. The following chart compares MNB's quarterly loan-to-deposit ratio to the computed peer group average and to the high and low ratios of the six peer institutions. The peer banks include

six community banks with assets of \$500 million or less in Sacramento County.



Historically, MNB has maintained very high credit standards, which has resulted in

lower than average loan production. However, the bank has increased marketing efforts and increased its average loan-to-deposit ratio from 32% (the last CRA exam in 1996) to 40% as of March 2000.

Source: Call Report data

Through community organization outreach efforts, the bank is helping to meet identified credit needs. For example, during this assessment period, the bank extended over \$604 thousand in

loans to a local community non-profit community organization to enlarge facilities for providing shelter, food, and job training for the homeless and disadvantaged. The bank also extended a \$25 thousand line of credit to a non-profit community organization, to provide funds for creating transitional housing units for the homeless. In addition, the bank extended over \$20 thousand in loans to a California state funded nonprofit organization that finds employment and transportation for the disadvantage and handicapped. To facilitate these extensions of credit the bank used relaxed lending standards.

In another area of community development, MNB is helping to revitalize economically depressed areas of its community through its business credit extensions in Redevelopment Areas and Enterprise Zones located in the bank’s assessment area. These areas are designated by federal and state agencies as either deteriorated or economically depressed. Both local and federal government designates these areas with tax and other incentives to induce business and development in these areas. According to bank data, during 1997, 1998 and 1999, the bank extended over \$4.6 million of credit to businesses located within these areas.

Lending within the Assessment Area

♀ **The proportion of MNB’s lending within its assessment area meets the standard for Satisfactory Performance.**

We reviewed and validated the bank’s data on all loan originations for the review period. We found 81% of the number and 78% of the dollar volume of loans to be within the assessment area. This is demonstrated in the following table:

| Lending Inside and Outside the Assessment Area | | | | |
|---|--------------------------------------|---|--|--|
| Commercial | | | | |
| | # of Loans in Assess Area | % of # of Loans in Assess Area | \$000 of Loans in Assess Area | % of \$ of Loans in Assess Area |
| Inside Assessment Area | 137 | 81% | \$15,756 | 78% |
| Outside Assessment Area | 33 | 19% | \$4,533 | 22% |
| Total | 170 | 100 | \$20,289 | 100% |

Source: Bank Data

OTHER ITEMS

Services that benefit Low-Income individuals:

Through its community organization outreach efforts, MNB has offered its services to Sacramento Cottage Housing, a non-profit developer for housing for the homeless. They have demonstrated this by providing its residents free checking accounts, forgiving the first five overdrafts, and teaching the residents how to balance their checkbooks. MNB officers and employees have provided personal financial management training to these formerly homeless individuals enrolled in the program.

Response to Complaints:

Neither the bank's management nor the Office of the Comptroller of the Currency has received any complaints about the bank's CRA performance.

Fair Lending Examination:

A concurrent fair lending review did not identify any violations of the various anti-discrimination laws and regulations.

Investments:

In February 2000, MNB purchased two bonds totaling \$225 thousand of a \$5 million North Sacramento School District Bond issue. According to the prospectus, the bond proceeds were used to renovate and rehabilitate ten elementary school buildings located in low- and moderate-income census tracts in the North Sacramento area. Additionally during the assessment period, MNB made \$9 thousand in donations to nonprofit and charitable organizations that benefited low- and -moderate income individuals.