



SMALL BANK

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

PUBLIC DISCLOSURE

January 07, 2008

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

The Herndon National Bank
Charter Number 13982

Main Street
Herndon, PA 17830

Office of the Comptroller of the Currency
NORTHERN PENNSYLVANIA FIELD OFFICE
60 Public Square Suite 602
Wilkes-Barre, PA 18701

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.

INSTITUTION'S CRA RATING

This institution is rated Satisfactory.

- A substantial majority of the bank's loans are originated in its assessment area.
- The bank's record of lending to borrowers of different incomes is excellent.
- The loan-to-deposit ratio is satisfactory.
- The bank has had no consumer complaints regarding its community reinvestment performance.

SCOPE OF EXAMINATION

The Small Bank examination assesses the bank's performance under the lending tests. The lending test evaluates the bank's record of meeting the credit needs of its assessment area through its lending activities. CRA activities at Herndon National Bank (HNB) were completed using full-scope review procedures. The time period covered by review was from January 1, 2005 through December 31, 2007. Refinanced residential mortgage loans were determined to be the bank's primary loan product and were reviewed as part of this examination. Since HNB is not a HMDA reporter, a sample of refinanced mortgage loans originated by the bank during the evaluation period were selected using current OCC sample selection guidance.

DESCRIPTION OF INSTITUTION

HNB is a \$28 million intrastate community bank. The bank's main and only office is located in Herndon, PA, which is in Northumberland County, PA. The bank's business plan is to remain an independent community bank offering a full range of banking services to its community. HNB received a "Satisfactory" rating at their last CRA examination dated April 22, 2002. Since September 2001, HNB has operated one ATM located at the main office in Herndon, PA. HNB does not have any legal or financial conditions that would impede its ability to help meet the credit need of the community. HNB is not part of a holding company structure. HNB does not have any legal or financial condition restrictions that would impeded their ability to meet the credit needs of the community.

At September 30, 2007, HNB reported \$8.1 million in net loans and \$20.4 million in total deposits. Net loans represent 28% of average assets. The bank's loan portfolio consists of 61% residential mortgages, 26% commercial loans, 7% consumer loans, and 6% farmland loans. The primary product reviewed at this examination was refinanced residential mortgage loans. During the evaluation period January 1, 2005 through December 31, 2007 the bank originated 59 mortgage loans, 153 consumer loans, and 33 commercial loans. Of the mortgage loans

originated during the past three years (2005, 2006, and 2007), 52% were refinanced mortgages. HNB does not purchase loans or make loans for resale into the secondary markets, and does not participate in credits with any other institutions. HNB also does not offer mortgage loans with less than an 80% loan to value and does not offer private mortgage insurance.

According to June 30, 2007 Summary of Deposit Data from the Federal Deposit Insurance Corporation and Office of Thrift Supervision, HNB's market share of deposits in Northumberland County is 1.70% and the bank is ranked 15th out of 18 institutions operating in the county. Major competitors are:

- Manufacturers and Traders Trust Company
- SunBank
- Northumberland National Bank
- FNB Bank, N.A.
- Union National Bank of Mount Carmel
- Turbotville National Bank
- Sovereign Bank
- Community Banks

Overall competition for loans and deposits is strong in Northumberland County. There are 115 different lenders located within HNB's Assessment area. Major competitors include:

- Beneficial Company LLC.
- Community Banks
- Omega Bank
- FNB Bank, N.A.
- Nationstar Mortgage LLC.
- GMAC Mortgage Company
- The Gratz National Bank

DESCRIPTION OF ASSESSMENT AREA(S)

HNB's AA consists of three Census Tracts (CT's) in Northumberland County. The population of the AA is approximately 14,400. All three Census Tracts are middle-income areas. The 2007 HUD Adjusted Median Family Income for the AA is \$50,600, which was used in our analysis of lending by borrower income. The breakdown of families within the AA is 13.66% low-income, 18.38% moderate-income, 27.34% middle-income, and 40.63% upper-income.

The AA is primarily rural; a large portion of it is farmland. Most of the farmland is controlled by family-owned agricultural businesses. Other primary employers include Meckley's Limestone Products, a firm that mines, sells, and transports limestone products, and Line Mountain School District, which provides education from elementary through high school levels. Most residents travel outside the AA for employment opportunities. The unemployment rate in Northumberland County, at 5.4%, exceeds the state's unemployment rate of 4.79% as of

December 2006.

Total occupied housing units in the AA are 4,961. Eighty-seven percent of these units are owner-occupied, and the rest are rental units. Households below the poverty level represent 8% of the population.

A community contact was made with a representative of local government during our examination, representing the Borough of Herndon. According to this contact, the area is economically weak as a result of a lack of employment opportunities which force residents to commute out of the AA to Harrisburg or Sunbury for employment. In addition, limited growth in housing and new business occurred in Herndon as no new building permits were issued while a new sewage system installation took place. This project began during 2002 and was finally completed in 2007.

Further conversations with this contact indicated that it is his belief that the HNB meets the credit needs of the community for home purchase, low cost refinancing, and for consumer loans, especially for used autos and unsecured loans.

Given the circumstances of the rural nature of the assessment area, along with the lack of new building allowed in the community during this evaluation period, community development opportunities are very limited.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

The evaluation period covered lending activity for refinanced home mortgages reported from January 1, 2005 through December 31, 2007. These loans were the only products reviewed due to the business focus of the bank and the percentage of the loan portfolio which is comprised of refinanced home mortgage loans.

LENDING TEST

Loan-to-Deposit Ratio

The loan-to-deposit ratio, although below average, is reasonable given the bank's size and credit needs of this community and meets the standards for satisfactory performance. HNB's average loan-to-deposit (LTD) ratio calculated on quarter-end financial data from September 30, 2002 to September 30, 2007 is 38%. The LTD ratio for other one-office banks operating in Pennsylvania for the same time period is 60%. There are however several factors that contribute to HNB's below average LTD ratio.

- HNB operates in an isolated and very rural area, primarily consisting of farmland. The bank does little or no farm lending given the competition from the Department of Agriculture programs.
- HNB's largest credit product is consumer loans, given the number of loans (153) approved during the evaluation period. However, these are very small dollar loans, in

amounts as little as \$250.00 per loan. The entire consumer credit portfolio amounts to only 7% of the bank's loan portfolio as of September 30, 2007.

- With a large percentage of home ownership, high unemployment, and virtually no new construction in the Borough of Herndon, small business and new home lending is a challenge for the bank. Further, the bank requires a 20% down payment on home purchase loans, (and offers no private mortgage insurance programs) making competition for first time homebuyers extremely difficult.
- HNB rejects only a limited number of loans, preferring to work with each of its customers. There were only 4 total rejected mortgage loans during the year 2007.

Lending in Assessment Area

A substantial majority of refinanced home mortgage loans originated during the evaluation period were within the AA. HNB substantially exceeds the standards for satisfactory performance for lending in the AA. An analysis of our random sample of twenty refinanced mortgages disclosed that 80% of the loans were originated within the AA.

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

HNB's record of lending to borrowers of different incomes exceeds the standard for satisfactory performance. The level of refinanced home mortgage loans originated to low-income borrowers is higher than the percentage of low-income families in the AA. Considering the affordability of housing in the AA, this performance exceeds the standard for satisfactory performance. The median cost of housing in the AA is \$82,300, based on the 2000 census data. The HUD adjusted median family income for 2007 is \$50,600. This means that a low-income person earns less than \$25,300 or 50% of the HUD adjusted median family income. Based upon these statistics, it would be difficult for a low-income individual to purchase housing in the AA.

The percentage of loans made to moderate-income borrowers also exceeds the percentage of moderate-income families in the AA. Considering the affordability of housing in the AA, this performance is excellent. The median cost of housing in the AA is \$82,300, based on the 2000 census data. The HUD adjusted median family income for 2007 is \$50,600. This means that a moderate-income person earns less than \$40,480 or 50% of the HUD adjusted family income. Based on these statistics, it would also be difficult for a moderate-income individual to purchase housing in the AA.

Also, in 2007, of the 115 lenders in the AA, HNB would have been ranked approximately 6th, with an approximate market share of 2.61%. Other home mortgage lenders included Beneficial Company LLC, (ranked first with a 16.37% market share), Community Banks, (ranked second with a 6.05% market share), and Omega Bank, (ranked third with a 3.44% market share).

Please refer to the following table for borrower distribution of refinanced home mortgage loans in the AA.

| Borrower Distribution of Loans | | |
|---------------------------------------|---------------------------------------|---------------------------------------|
| Income Level | % of Refinanced Mortgages by # | Income Level of Families in AA |
| Low | 18.8% | 13.66% |
| Moderate | 25% | 18.38% |
| Middle | 25% | 27.34% |
| Upper | 31.2% | 40.63% |
| Total | 100% | 100% |

Note: Sample size of refinanced mortgages includes 20 loans.

Geographic Distribution of Loans

The geographic distribution of loans is not meaningful, as all three Census Tracts which make up the bank's AA are middle-income. Therefore no analysis will be presented.

Responses to Complaints

During the review period, the bank did not receive any CRA related consumer complaints with respect to lending performance within its AA.

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.