



SMALL BANK

Comptroller of the Currency
Administrator of National Banks
Washington, DC 20219

PUBLIC DISCLOSURE

May 3, 2004

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**Merchants National Bank of Kittanning
Charter Number 5073**

**222 Market Street
Kittanning, PA 16201**

**Assistant Deputy Comptroller James Calhoun
Comptroller of the Currency
Western Pennsylvania
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.

MERCHANTS NATIONAL BANK OF KITTANNING'S CRA RATING

This institution is rated Satisfactory.

The major factors that support this rating include:

- A majority of sampled loans are made within the assessment area (AA).
- Lending to borrowers of different incomes and to businesses of different sizes meets the standard for satisfactory performance.
- The distribution of sampled residential mortgage and business purpose loans among AA geographies of different income levels meets the standard for satisfactory performance.
- The loan-to-deposit ratio meets the standard for satisfactory performance.
- The bank is adequately meeting the lending needs of the AA.
- The bank has not received any consumer complaints regarding Community Reinvestment Act (CRA) performance.

The Merchants National Bank of Kittanning, Pennsylvania is committed to serving the community. This is demonstrated by satisfactory lending performance as described in this Public Disclosure.

DESCRIPTION OF MERCHANTS NATIONAL BANK OF KITTANNING

Merchants National Bank of Kittanning (MNB) is headquartered in Kittanning, Pennsylvania. The bank is entirely owned by Merchants Bancorp of Pennsylvania, Inc., a one-bank holding company. At December 31, 2003, the holding company had total assets of \$153 million. MNB operates a full service bank in Kittanning at 222 Market Street. Branches are located in Kittanning at 316 First Avenue, Suite 101 and R D 1, Burton Drive. An additional branch is located Route 422 West & Claypoole Road in Worthington. No branch locations have been opened or closed since the previous CRA examination. MNB's primary focus is to provide a full range of traditional banking services to the community in and around Kittanning. MNB meets the loan and deposit needs of the local community by providing various loan and deposit products, including Internet Banking, and other financial services. MNB also has seven Automatic Teller Machines (ATMs) located throughout the Kittanning and Worthington areas.

As of December 31, 2003, MNB reported \$149 million in total assets, with over half of the assets in various types of loans to individuals and small businesses. At year-end December 2003, MNB reported the loan totals listed in the table below.

Loan Category	\$ (000)	%
Residential Real Estate Loans	34,710	43%
Commercial Real Estate/Commercial Loans	28,166	34%
Consumer Loans	16,391	20%
Other Loans	2,191	3%
Total	\$81,458	100%

MNB received an overall rating of "Satisfactory" at the previous Community Reinvestment Act Examination dated August 9, 1999. There are no legal or financial impediments to prevent MNB from meeting the credit needs of the designated AA. As reflected in the table, MNB continues to have significant residential real estate lending activity.

DESCRIPTION OF THE MNB OF KITTANNING ASSESSMENT AREA

MNB's AA meets the requirements of the regulation and does not arbitrarily exclude low or moderate-income areas. The AA includes nine Census Tracts in Southwest Pennsylvania. Eight of the Census Tracts are located in Armstrong County and one is in Butler County. The Census Tracts include 9804, 9805, 9806, 9808, 9809, 9810, 9811, and 9812 in Armstrong County and 9113 in Butler County. MNB is located in Census Tract 9811.

The total population of the AA is 41,255 according to the 1990 census. Although there are no low- and only one moderate-income census tract in the AA, there are low- and moderate-income families located throughout the AA. Of the 15,666 households, 12 percent are below the poverty level. The median housing value is \$47,975 with the median age of housing stock at 41 years. The unemployment rate for Armstrong County is 6.1% and Butler County is 6.7%.

The local economic conditions remain stagnant with area job losses mounting. The economy has been and remains to a certain extent reliant on local aggregate businesses. However, the largest employers in the area are the Armstrong County Memorial Hospital, the Armstrong School District, Eljer Plumbingware, Inc. (which has recently announced a significant reduction in local jobs), Creekside Mushrooms, Ltd., and the Armstrong County Government. MNB's major competitors include several similar sized community banks located in or near the AA.

DEMOGRAPHIC AND ECONOMIC CHARACTERISTICS OF AA	
Population	
Number of Families	11,676
Number of Households	15,666
Geographies	
Number of Census Tracts/BNA	9
% Low-Income Census Tracts/BNA	0
% Moderate-Income Census Tracts/BNA	11%
% Middle-Income Census Tracts/BNA	89%
% Upper-Income Census Tracts/BNA	0
Median Family Income (MFI)	
HUD-Updated Median Family Income	\$41,967
Economic Indicators	
Unemployment Rate	3%
Median Housing Value	\$47,975
% of Households Below Poverty Level	12%

Source: Data from 1990 US Census.

Two community contacts were conducted in the bank's AA to help ascertain the credit needs of the community. According to the first contact, the General Manager of the Leader Times, the immediate credit needs of the community are being met. The contact indicated that the most immediate economic concern is to attract new businesses to generate additional jobs. The job market is tightening and the area population base is aging as younger workers are moving or will need to move out of the area to find work. The contact further stated that this bank and the other financial institutions in the area are actively involved in the community. The second contact, the Executive Director of the Armstrong County Department of Planning and Development, also stated this bank and the other locally owned banks have been very involved in community activities including providing financing to attract new businesses. The contact stated the local economy is challenging. New job creation is declining and additional companies are needed to diversify area employment opportunities.

CONCLUSIONS ABOUT PERFORMANCE CRITERIA

This Performance Evaluation (PE) assesses MNB's performance focusing primarily on five performance criteria: the loan-to-deposit ratio; lending in the AA; lending to borrowers of different incomes and to businesses of different sizes; geographic distribution of loans; and, responses to complaints.

To evaluate the MNB's lending performance, a random sample of 60 loans was reviewed. Major loan products offered by the bank were sampled and consisted of 20 residential real estate loans, 20 consumer loans, and 20 business loans, originated between December 31, 1999 and December 31, 2002. This timeframe was selected due to the change in demographics from the 1990 census to the 2000 census. The 2000 census primarily relates data to loans made after 2003. MNB originated many more loans in the three years prior to 2003, than in the shorter time since.

Based on the analysis and consistent with available resources and capabilities, MNB is meeting the credit needs of the AA in a satisfactory manner.

Loan-to-Deposit Ratio

MNB's loan-to-deposit ratio meets the standard for satisfactory performance. This determination is based on MNB's quarterly average loan to deposit ratio of 64 percent. The actual ratio at December 31, 2003 is 60 percent. MNB's loan-to-deposit ratio has declined recently. MNB's loan-to-deposit ratio has been trending down after reaching a high of 71 percent on December 31, 2000. This decline was primarily caused by an increase in deposits due to the fluctuations in rates of return in alternative products, i.e. the stock market.

The average loan-to-deposit ratio for the 16 banks headquartered in the AA and contiguous counties at December 31, 2003 is 75 percent, with average ratios ranging from 50 percent to 102 percent. The average loan-to-deposit ratio for the banks considered to be the primary competitors in the trade area (listed below) is approximately 75 percent.

Institution	Assets as of (12/31/03) (000's)	Average LTD Ratio
<i>Merchants National Bank of Kittanning</i>	<i>\$149,301</i>	<i>64%</i>
Apollo Trust Company	\$125,986	65%
The Marion Center National Bank	\$187,402	70%
The Farmers National Bank of Kittanning	\$146,654	74%
Elderton State Bank	\$132,598	90%

Lending in Assessment Area

MNB's lending in the AA meets the standard for satisfactory performance. A majority of credit is extended within the AA. The number of credits extended and the accompanying percentage meets the standard for satisfactory performance as illustrated in the table below.

TOTAL LOANS REVIEWED										
Loan Type	Number of Loans					Dollars of Loans (000's)				
	Inside		Outside		Total	Inside		Outside		Total
	#	%	#	%		\$	%	\$	%	
Residential	12	60%	8	40%	20	\$651	56%	\$508	44%	\$1,159
Commercial	11	55%	9	45%	20	\$1,404	53%	\$1,234	47%	\$2,638
Consumer	9	45%	11	55%	20	\$189	56%	\$145	44%	\$334
Totals	32	53%	28	47%	60	\$2,244	55%	\$1,887	45%	\$4,131

Source: Data from sample of loans.

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

MNB’s overall distribution of loans by income level of borrowers meets the standard for satisfactory performance. The following tables represent the distribution of lending based on the sample of residential real estate, consumer, and business loans located in the AA.

MNB’s record of lending to borrowers of different incomes is reasonable. Based on our sample, the percentage of residential real estate loans to low-income families is poor. Housing costs in the AA inhibit low-income families from purchasing homes. The median housing value in the AA is \$47,975. The percentage of households below the poverty level is 12 percent and 35 percent of the households in the AA receive social security. In addition, low- and moderate-income borrowers typically have fewer resources for down payments. The level of residential real estate loans originated to moderate-income families is near to the percentage of moderate-income families in the AA. Consumer loan distribution closely approximates area demographics.

Borrower Distribution of Residential Real Estate Loans								
Borrower Income Level	Low		Moderate		Middle		Upper	
	% 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
Residential Loans	19%	0%	20%	17%	24%	33%	37%	50%

Source: Loan sample.

Borrower Distribution of Consumer Loans								
Borrower Income Level	Low		Moderate		Middle		Upper	
	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans
Consumer Loans	24%	22%	17%	22%	19%	34%	40%	22%

Source: Loan sample.

MNB’s lending to businesses of different sizes exceeds the standard for satisfactory performance. The percentage of bank loans to businesses with revenues less than \$1 million is higher than the percentage of businesses with revenues less than \$1 million located in the AA.

BORROWER DISTRIBUTION OF SMALL LOANS TO BUSINESSES				
Business Revenues (or Sales)	≤\$1,000,000	>\$1,000,000	Unavailable/ Unknown	Total
% of AA Businesses	67%	5%	28%	100%
% of Bank Loans in AA by #	73%	18%	9%	100%
% of Bank Loans in AA by \$	76%	20%	4%	100%

Source: Loan sample.

Geographic Distribution of Loans

MNB's overall geographic distribution of loans meets the standard for satisfactory performance.

The following tables represent the geographic distribution of lending based on the sample of residential real estate, consumer, and business loans located in the AA.

MNB's distribution of residential real estate loans among AA geographies exceeds the standard for satisfactory performance. Geographic distribution of real estate mortgage loans in moderate-income census tract exceeds the percentage of owner occupied units.

Geographic Distribution of Residential Real Estate Loans								
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
Residential Loans	N/A	N/A	8%	17%	92%	83%	N/A	N/A

Source: Loan sample.

MNB's distribution of consumer loans among AA geographies exceeds the standard for satisfactory performance. Geographic distribution of consumer loans in the moderate-income census tract exceeds the percentage of moderate-income households.

Geographic Distribution of Consumer Loans								
Census Tract Income Level	Low		Moderate		Middle		Upper	
	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans
Consumer Loans	N/A	N/A	14%	22%	86%	78%	N/A	N/A

Source: Indicate source, i.e., loan sample or data collected by bank; U.S. Census data.

MNB's distribution of business loans among AA geographies does not meet the standard for satisfactory performance. Geographic distribution of business loans in the moderate-income census tract is much lower than the percentage of businesses located in the census tract. Several factors mitigate the lack of business loans in the moderate-income census tract. The AA includes only one moderate-income census tract located in downtown Kittanning. The need for business loans in this well established area of retail stores and financial institutions is low.

Geographic Distribution of Loans to Businesses								
Census Tract Income Level	Low		Moderate		Middle		Upper	
Loan Type	% 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	N/A	N/A	43%	0%	57%	100%	N/A	N/A

Source: Indicate source, i.e., loan sample or data collected by bank; U.S. Census data.

Additionally, MNB has in the past made investment in and continues support the efforts to provide affordable housing to low-income elderly in Armstrong County. MNB made an equity investment of \$520 thousand in the Valley View II Limited Partnership. This project consisted of building 11 units to be used for low income housing for the elderly. The most recent investment of \$520 thousand and \$456 thousand were made in 1999 and 1998 respectively, which is prior to this evaluation period.

Responses to Complaints

MNB has not received any complaints regarding their performance in helping to meet AA credit needs during this evaluation period.

FAIR LENDING OR OTHER ILLEGAL CREDIT PRACTICES REVIEW

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