



SMALL BANK

Comptroller of the Currency
Administrator of National Banks

PUBLIC DISCLOSURE

July 29, 2002

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**Mercantile National Bank
Charter Number 17220**

**1840 Century Park East
Los Angeles, CA 90067**

**Comptroller of the Currency
Los Angeles North Field Office
550 North Brand Boulevard, Suite 500
Glendale, CA 91203**

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 bank’s performance in the Los Angeles MSA is “Satisfactory”.

- The bank’s loan-to-deposit ratio is satisfactory. The bank is making loans at a volume consistent with its resources and capabilities.
- The bank's concentration of lending within its assessment area is good.
- The bank engages in a significant level of community development activities that offset weaknesses in the borrower distribution and geographic distribution of its lending activities.

DESCRIPTION OF INSTITUTION

Mercantile National Bank (MNB) is a community bank headquartered in the Century City area of Los Angeles, California. MNB is owned by a two-bank holding company, National Mercantile Bancorp, which is also located in Century City. The holding company reported consolidated total assets of \$374 million as of December 31, 2001. MNB operates two full-service branches, one at the Century City headquarters and one in Encino. Both branches are located in affluent areas. The branch in Encino was opened during this CRA evaluation period. Both branches have attached full service 24-hour automated teller machines.

MNB is a business-oriented bank. It reported \$173 million of total assets, \$111 million of net loans, and \$13 million of net Tier 1 capital as of March 31, 2002. Net loans equal 64 percent of total assets. Gross loans and leases were \$113 million, divided into the following categories: commercial and industrial loans 51 percent; commercial real estate loans 33 percent; 1-4 family residential loans 5 percent; construction and development loans 4 percent; multifamily loans 3 percent; loans to individuals 3 percent; and home equity and credit card loans 1 percent. This loan mix reflects MNB’s strategy of focusing on providing specialized banking services to the commercial, professional, and entertainment markets. MNB participates in SBA loan programs. The bank offers a full menu of personal and business deposit products that can be accessed by telephone and the Internet, as well as through traditional means. MNB also offers investment services through its contractual relationship with SWS Financial Services, Inc. Though it has a business focus, MNB does offer a full range of retail banking products, but these products are used to accommodate the personal needs of business customers.

During part of this CRA evaluation period, MNB attained large bank status due to its holding company affiliation with Texas Financial Bancorporation, an entity that held total assets in excess of \$1 billion. A later transfer of ownership restored MNB to community bank status under the CRA. Nevertheless, for a portion of the evaluation period MNB did conform to the enhanced record keeping requirements for large banks, and it submitted that information for consideration in this examination.

The bank faces strong competition. It competes with Los Angeles area community banks, credit

unions, brokerage houses, federal branches, mortgage companies, and thrifts, as well as local branches of much larger financial institutions that serve regional, national, and/or international markets. Many of these large competitors have the advantages of broader name recognition and greater marketing power over smaller local banks.

We are not aware of any legal or other impediments restricting the bank’s ability to meet the credit needs of its assessment area. MNB’s CRA performance was last evaluated as of March 2, 1998, when it received a “Satisfactory” rating.

DESCRIPTION OF LOS ANGELES ASSESSMENT AREA

MNB significantly expanded its assessment area since the last CRA examination. Its assessment area now consists of 1,083 census tracts that comprise approximately the western two-thirds of the Los Angeles MSA. The following table contains key demographic and economic information about the assessment area.

Los Angeles Assessment Area

DEMOGRAPHIC INFORMATION FOR MERCANTILE NB ASSESSMENT AREA						
Demographic Characteristics	#	Low % of #	Moderate % of #	Middle % of #	Upper % of #	NA % of #
Geographies (Census Tracts/BNAs)	1,083	12.0	28.0	27.0	32.0	1.0
Population by Geography	5,579,693	12.0	33.0	27.0	28.0	0.0*
Owner-Occupied Housing by Geography	811,395	4.0	19.0	28.0	49.0	0.0
Businesses by Geography	266,443	12.0	21.0	28.0	39.0	0.0*
Family Distribution by Income Level	1,250,270	26.0	17.0	18.0	39.0	0.0
Distribution of Low- and Moderate-Income families throughout AA Geographies	543,223	15.0	38.0	32.0	15.0	0.0
Median Family Income = \$39,035 Updated Median Family Income 2001 = \$54,500 Households Below the Poverty Level = 13.41%		Median Housing Value = \$260,256 Unemployment Rate (2Q2001) = 5.3%				

Source: 1990 U.S. Census, 2001 HUD updated MFI, 2001 Dun & Bradstreet small business data, and 2002 BLS employment data.

*Values equal less than 1%.

Los Angeles is a complex, highly diverse urban area that includes 80 cities and a number of unincorporated areas. Los Angeles is the largest and most rapidly growing metropolitan region in the fastest growing state in the country. Contained within this MSA is the city of Los Angeles, which is the largest city in Southern California with an estimated population of 3.6 million as of January 1994.

Competition is strong, with 145 institutions in Los Angeles competing for FDIC insured customer deposits. MNB has only a 0.10 percent market share of the FDIC insured deposits available as of June 30, 2001. Major banking institutions that compete for deposits include Bank of America, California Federal Bank, City National Bank, Union Bank of California, Washington Mutual Bank, and Wells Fargo Bank.

In the late 1980s, structural changes in the economy and other events combined to undermine the general prosperity. Defense spending cuts and other federal decisions caused huge reductions in aerospace and defense manufacturing jobs. Other states lured away business with tax concessions and more favorable business environments. The civil disturbances in 1992 further aggravated the business and community problems. Despite federal and state assistance, many of the businesses destroyed during the disturbances have not reopened. As a result, jobs were lost. This created further economic dislocations. Los Angeles MSA's economy has now rebounded, and the unemployment rate has continued to decline. The Bureau of Labor Statistics reported a 5.3 percent unemployment rate for the second quarter of 2001.

The assessment area's largest industries in order of importance are services, retail trade, wholesale trade, finance and real estate, manufacturing and construction. In response to concessions from other states, the motion picture industry has moved a great deal of its production activity out of Los Angeles. However, there are still many business opportunities within the assessment area. According to 2000 Dun & Bradstreet statistics, 83 percent of businesses located within the area have annual revenues of less than or equal to \$1 million.

The assessment area meets the legal requirements of the CRA and does not arbitrarily exclude any low- or moderate-income areas.

Community contacts on file show that individuals in the community knowledgeable about community credit needs identified the area's major credit needs as affordable housing, redevelopment, and small business lending.

CONCLUSIONS ABOUT PERFORMANCE CRITERIA

Mercantile National Bank's focus on business lending dictated our selection of commercial loan originations for our testing sample. We evaluated a sample of 45 commercial loans randomly selected from the bank's list of loans originated since March 1998. We also reviewed community development activities during the evaluation period that were submitted by the bank for consideration.

We discuss the bank's performance in detail under the following headings:

Loan-to-Deposit Ratio

MNB's loan-to-deposit (LTD) ratio is satisfactory. The bank is making loans at a volume consistent with its resources and capabilities. The bank's LTD ratio compares favorably with its peers, both now and historically.

MNB's LTD ratio was 76 percent as of March 31, 2002. Over the previous 13 quarters, the bank's LTD ratio has averaged 63 percent. During that period, MNB reached its highest quarterly average ratio of 79 percent in the fourth quarter of 2000. The bank's lowest quarterly average ratio was in the second quarter of 1999, at 46 percent.

The median 13-quarter average LTD ratio for a group of nine similarly situated banks located in Los Angeles was 73 percent as of December 31, 2001. The highest 13-quarter ratio in the group was 89 percent and the lowest was 52 percent. MNB's ratio places it near the middle of the group of similarly situated banks. Similarly situated banks are those banks with comparable asset size that are operating in the same assessment area.

Lending in Assessment Area

MNB's level of lending in its assessment area is good. Forty-one (41) of the 45 loans sampled from the bank's commercial loan activity during the evaluation period were made to borrowers within its assessment area. This represents a 91 percent concentration of lending activity within the assessment area, as would be expected of a relatively small bank operating in a large assessment area.

Lending to Businesses of Different Sizes

As noted above, we sampled lending products that targeted businesses. Hence, gross annual revenue is the criteria used for the evaluation of borrower distribution. In this part of the analysis we use only loans in the sample made to borrowers within the assessment area.

MNB's record of lending to businesses in the assessment area with revenues equal to or less than \$1 million is poor. As shown in Table 1 below, the percentage of bank loans made to businesses with revenues equal to or less than \$1 million is substantially below the percentage of businesses in the assessment area that earn revenues equal to or less than \$1 million. This demonstrates that the bank places a less than satisfactory amount of emphasis on making loans to small businesses in its commercial lending activities. To some extent, the bank's market niche is a mitigating factor, as it tends to focus on higher income borrowers. Also, a significant level of community development lending offsets the weakness in borrower distribution, as discussed later.

Table 1: Business Lending Compared to Business Distribution by Gross Revenue						
Gross Revenue	# Bank Loans	% Bank Loans	\$ Bank Loans (000's)	% Bank Loans	# of Businesses*	% of Businesses*
<=\$1mm	11	27	3,730	31	222,119	83
>\$1mm	27	66	7,848	66	27,674	10
Unknown	3	7	320	3	16,650	7

* 2001 Dun & Bradstreet geodemographic data.

Geographic Distribution of Loans

MNB's pattern of lending reflects poor geographic distribution. As shown in Table 2, the percentage of bank loans made to borrowers in both low-income and moderate-income geographies is substantially below the percentage of businesses located in those geographies. Here again, the bank's market niche, as well as the location of its branches in affluent areas, are mitigating factors. A significant level of community development lending offsets the weakness in geographic distribution, as discussed below.

Table 2: Business Lending Across Assessment Area by Income Level						
Tract Type	# Bank Loans	% Bank Loans	\$ Bank Loans (000's)	% Bank Loans	# of Businesses*	% of Businesses*
Low Income	3	7	760	7	31,397	12
Moderate Income	2	5	1,050	9	54,818	21
Middle Income	11	27	2,792	23	73,463	28
Upper Income	25	61	7,296	61	106,102	39
NA	0	0	0	0	663	0

* 2001 Dun & Bradstreet geodemographic data.

Qualified Community Development Activities

Investments

MNB made two qualifying investments that total \$67,150 and which together equal about 1 percent of net Tier 1 capital. MNB made contributions to the Federal Home Loan Bank's affordable housing program (AHP). This program provides subsidies that help create affordable housing for very-low-income and low-income households. The bank also invested in the Southern California Business Development Corporation during the evaluation period. This community development corporation is well known and has previously been qualified as a CRA investment at other banks.

Loans

The bank made a \$345,000 loan to fund the purchase and rehabilitation of a distressed 9-unit apartment building located in a moderate-income census tract. The borrower's primary business is to acquire such properties, make capital improvements to them, and offer the units at lower than market rates to enhance occupancy. He provides rental housing under HUD Section 8 programs that provide subsidies, vouchers, or certificates to low-income families to enable them to afford decent housing.

MNB also has a \$2 million loan participation in a large credit facility at another bank, which finances the purchase of distressed single-family residences out of foreclosure. The borrower is a corporation that refurbishes the homes and markets them for sale at 10 percent below market value to help ensure quick turnover. Data supplied by the borrower shows that the average sales price was \$213 thousand for homes sold in 1999; \$221 thousand for homes sold in 2000; and \$235 thousand for homes sold in the first two quarters of 2001. Further, the corporation showed an inventory of 14 units valued under \$100 thousand, 46 units valued between \$100 and \$150 thousand, 21 units valued between \$150 and \$200 thousand, and 7 units valued over \$200 thousand. This information shows that the borrower rehabilitates and sells a substantial number of residences that are well below the HUD updated median housing value in the assessment area, which is \$260 thousand. Based on the average sales prices, the inventory values, and the HUD updated median family income noted above, most of the homes would be affordable for moderate-income families. And many of the homes would be affordable for low-income families.

The above loans help provide housing that is affordable for low- and moderate-income families, and as such they qualify as community development loans. The total for the two loans equals 18 percent of the bank's net Tier 1 capital, which represents a substantial commitment of resources to the provision of affordable housing in the assessment area.

MNB participates in a special loan program that finances affordable housing in the assessment area. The bank is presently carrying on its books \$244,828 of loans made through its participation in programs offered by the California Community Reinvestment Corporation (CCRC). CCRC's mission is to provide products and services that facilitate the development of safe and affordable housing. This includes using tax-exempt bond programs and AHP sponsorships through the Federal Home Loan Bank to fund or financially support qualifying loans.

Services

Officers and employees of the bank provided community development services to seven different nonprofit organizations during the evaluation period. These organizations provide educational, medical, social, and financial services primarily targeted at low- and moderate-income persons.

Responses to Complaints

Mercantile National Bank has received no CRA-related complaints since its last evaluation.

Fair Lending Review

The OCC performed an analysis of consumer complaint information supplied by the bank and 1999 and 2000 HMDA lending data using the OCC's risk-based fair lending approach. Based on its analysis of the information, the OCC decided that a comprehensive fair lending examination would not need to be conducted in connection with the CRA evaluation this year. The OCC performed the last comprehensive fair lending examination of the bank in 1998 and found no evidence of illegal disparate treatment of protected groups.