

PUBLIC DISCLOSURE

April 29, 1996

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**Farmers and Merchants Bank of Rockford
12-53-0665-0000**

**North 25 Mullan Road
Spokane, Washington 99214**

**FEDERAL RESERVE BANK OF SAN FRANCISCO
101 MARKET STREET
SAN FRANCISCO, CALIFORNIA 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.

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 Community Reinvestment Act (CRA) performance of **Farmers and Merchants Bank of Rockford** prepared by the **Federal Reserve Bank of San Francisco**, the institution's supervisory agency, as of April 29, 1996. The agency rates the CRA performance of an institution consistent with the provisions set forth in Appendix A to 12 CFR Part 228.*

INSTITUTION'S CRA RATING:

Farmers and Merchants Bank of Rockford's overall CRA (Community Reinvestment Act) performance is rated **outstanding**. This rating is based upon a review and evaluation of the following factors: a more than reasonable average loan-to-deposit ratio, a substantial majority of the bank's loans made in its assessment area, an excellent penetration among individuals of different income levels and businesses with revenues of less than \$1 million, a geographic distribution of loans that reflect reasonable dispersion throughout the assessment area, and services and investments that compliment its performance under CRA. In addition, evidence was found during the examination that management had taken an affirmative role in identifying and meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, in a manner consistent with its resources and capabilities.

The following table indicates the performance level of Farmers and Merchants Bank of Rockford with respect to each of the five performance criteria.

SMALL INSTITUTION ASSESSMENT CRITERIA	Farmers and Merchants Bank of Rockford PERFORMANCE LEVELS		
	Exceeds Standards for Satisfactory Performance	Meets Standards for Satisfactory Performance	Does not meet Standards for Satisfactory Performance
Loan-to-Deposit Ratio	X		
Lending in Assessment Area	X		
Lending to Borrowers of Different Incomes and to Businesses of Different Sizes	X		
Geographic Distribution of Loans		X	
Response to Complaints	No complaints were received since the prior examination.		

DESCRIPTION OF INSTITUTION:

Farmers and Merchants Bank of Rockford, a wholly-owned institution, has the ability to meet the various credit needs of its assessment area based on its financial size, product offerings, prior performance, lack of legal impediments and other factors. The bank had total assets of \$155.6 million as of December 31, 1995, and serviced its assessment area with six branches and two loan production offices (a real estate production office and a business loan production office). All of its facilities are located in Spokane county. The bank's product offerings, which reflect management's effective ascertainment efforts, include commercial loans and lines of credit, Small Business Administration loans, agricultural loans, real estate loans (includes Federal Housing Authority loans and Veterans Administration loans), consumer loans, credit cards, and lines of credit. Its primary business focus is lending to consumers and to small businesses in the community. At its previous compliance examination, the bank's CRA performance was outstanding

A review of the bank's portfolio as of year-end 1995 reveals the following loan distribution:

Loans secured by real estate	51%	
Agricultural production loans		2%
Commercial and Industrial Loans	23%	
Consumer-Purpose Loans	23%	
Other Loans		1%

The other factors that were considered in the bank's ability to meet credit needs were its asset mix and high average loan-to-deposit ratio. A majority of the bank's asset holdings are loans (73.56%), and its quarterly average loan-to-deposit ratio indicates that deposited funds are reinvested in the community.

DESCRIPTION OF Spokane County:

Farmers and Merchants Bank of Rockford has identified Spokane County as its assessment area. The county consists of 99 census tracts (7% low-income, 23% moderate-income, 52% middle-income, and 18% upper-income). Spokane County's population, median-income, and employment levels reflect increasing trends. As of 1993, the county's population was 390,900, a 5% increase over the 1990 population of 372,300. The county's 1993 median income of \$31,015 increased 12.4% from the 1990 median income of \$27,573. Additionally, the county's 1993 employment estimate of 213,585 individuals has increased 4.3% over 1990 employment estimate of 204,646. Spokane county's labor force is primarily employed in three areas: in service industries (35%), retail trade (23%), and manufacturing (14%). The major employers in the county are: Fairchild Air Force Base, Spokane School District #81, Sacred Heart Medical Center, Kaiser Aluminum Corporation, State of Washington, U. S. Federal Government, City of Spokane, Empire Health Service, Spokane county, and the U. S. Postal Service.

During the examination, an interview with a member of the community affiliated with a

community development corporation, was conducted. According to the community contact, home loans and small business loans are the types of credits needed in the community. The contact indicated that Farmers and Merchants Bank of Rockford was known in the community for making these types of loans. In addition, the contact's organization's employees have referred potential users of credit to Farmers and Merchants Bank of Rockford.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA:

LOAN TO DEPOSIT RATIO:

In analyzing the bank's average loan-to-deposit ratio, a quarterly average since the previous examination was calculated, producing a ratio of 81.67%. This ratio was compared to similarly situated banks within and outside the bank's assessment area. In this analysis, a similarly situated bank, with a loan-to-deposit ratio of 83.41%, located in the same assessment area was given more emphasis because this bank has experienced the economic factors and lending opportunities that would apply most closely to Farmers and Merchants Bank of Rockford. A comparison of the bank's loan-to-deposit ratio for the period since the last examination to those of similarly situated nationwide banks which averaged only 67.31%, disclosed that Farmers and Merchants Bank ranks in the 82nd percentile. Farmer and Merchants Bank of Rockford's average loan-to-deposit ratio of 81.16% was deemed to be more than reasonable given the bank's size, financial condition, and assessment area credit needs.

LENDING IN ASSESSMENT AREA:

Farmers and Merchants Bank of Rockford's lending level within its assessment area was determined by the analysis of two loan products: its motor vehicle loans and small business loans. These loan products were selected because, by dollar amount, they represented the largest types of credit extended by the bank. The analysis used samples of the bank's motor vehicle and small business loans to identify the percentage of loans made inside and outside its assessment area. As evidenced by the following chart, the analysis of the bank's motor vehicle loans indicate a large volume and percentage of these loans were made to borrowers inside the bank's assessment area.

Motor Vehicle Loans

	Inside Assessment	Outside Assessment
Total Number of Loans	135	10
Percentage by Numbers	93%	7%
Total Dollar Amount	\$897,126	\$99,266
Percentage by \$ Amount	90%	10%

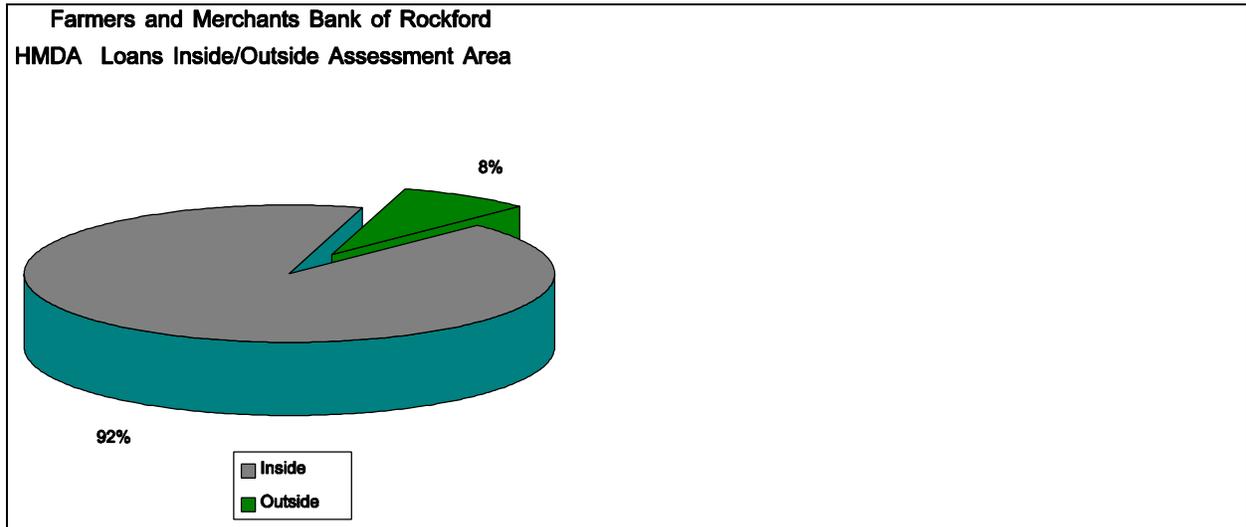
The sample of the bank's small business loans also reflected a large percentage and volume of its loans were made to borrowers inside its assessment area.

Small Business Loans

	Inside Assessment	Outside Assessment
Total Number of Loans	96	4
Percentage by Number	96%	4%
		<p align="center">Loans</p>
Total Amount of Loans	\$5,845,335	\$265,151
Percentage by \$ Amount	96%	4%

In addition, the 1995 Home Mortgage Disclosure Act's Loan Application Register (HMDA-LAR) indicated that of the 286 loans reported, 262 or 92% of the loans were made in the bank's assessment area, and 24 or 8% of HMDA loans were made out of the bank's assessment area.

Based upon the sample of motor vehicle loans, small business loans, as well as the bank's 1995 HMDA-LAR, it is concluded that a substantial majority of loans are in the bank's assessment area.



LENDING BY BORROWER INCOME AND BY BUSINESS REVENUE:

The following information was used to determine the geographic distribution of motor vehicle loans among borrowers with different income levels.

Distribution of Households by Income Level

% Low Income Households	% Moderate Income Households	% Middle Income Households	% Upper Income Households
12.5%	34.8%	46.3%	6.5%

The review of motor vehicle loans indicate reasonable penetration among individuals of different income levels, which for low- and moderate-income levels compare to actual households of the bank's assessment area.

Dist. of Motor vehicle loans by income level	HOUSEHOLDS BY INCOME LEVELS				
	Low	Moderate	Middle	Upper	Total
Total # of Loans	19	41	32	39	131
% of Total #	15%	31%	24%	30%	100%
Total \$ Amount	105,568	254,533	171,559	340,075	871,735
% of Total \$	12%	29%	20%	39%	100%

A review of the loan sizes that were extended to small businesses revealed that 100% of the loans are for loans that were equal to or less than \$1 million, and a majority of the small business loans were made to businesses with less than \$1 million in revenue.

Therefore, it is concluded that the bank proactively extends credit to borrowers of different income levels and to small businesses. The distribution of borrowers reflects, given the demographics of the assessment area, an excellent penetration among individuals of different income levels (including low- and moderate-income) and businesses of different sizes.

**Distribution of Small Business Loans by
Business Revenue and Loan Amount
By Number of Loans**

Loan Amounts	Small Businesses	Large Businesses	Total
Loan Amount of <\$100,000	60 (85%)	11 (15%)	71
Loan Amount of <\$250,000	1 (20%)	4 (80%)	5
Loan Amount of <\$1,000,000	2 (40%)	3 (60%)	5
Total	63 (78%)	18 (22%)	81

**Distribution of Small Business Loans by
Business Revenue and Loan Amount
By Dollar Amount**

Loan Amounts	Small Businesses	Large Businesses	Total
Loan Amount of <\$100,000	\$1,963,649 (86%)	\$ 329,536 (14%)	\$2,293,185
Loan Amount of <\$250,000	\$ 833,653 (58%)	\$ 610,017 (42%)	\$1,443,670
Loan Amount of <\$1,000,000	\$2,622,029 (66%)	\$1,378,000 (34%)	\$4,000,029
Total	\$5,419,331 (70%)	\$2,317,553 (30%)	\$7,736,884

GEOGRAPHIC DISTRIBUTION OF LOANS:

To analyze the geographic distribution of the bank's lending activity within geographies of all income levels within the bank's assessment area, examiners utilized information supplied by the bank as well as information obtained from the U. S. Census Bureau. According to the U. S. Census Bureau, Spokane county has 99 census tracts. Of these tracts, 7 represented low-income areas, 23 moderate-income areas, 51 middle-income areas and 18 upper-income areas. The information supplied by the bank consisted of the borrowers' names, addresses, loan dates, and loan amounts. Using this information, the examiner identified each of the geographic areas from which the loans originated and assessed the bank's overall lending pattern within the various income categories.

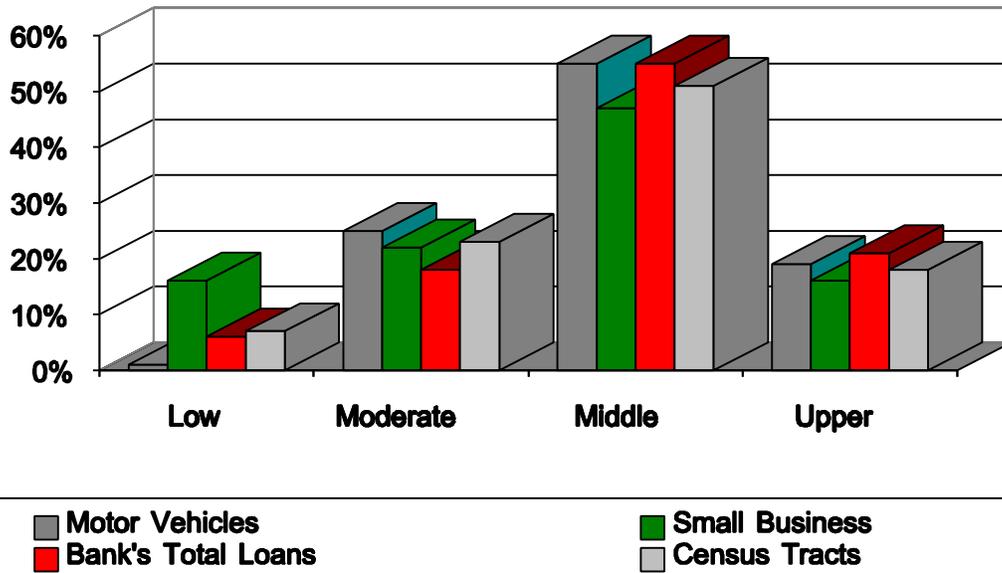
Motor Vehicle Loans	Low Income Tract	Moderate Income Tract	Middle Income Tract	Upper Income Tract	TOTAL
Total Number of Loans	1	34	74	26	135
Percentage of Total Loans	1%	25%	55%	19%	100%
Total Amount of Loans	\$5,067	\$190,918	\$500,366	\$200,776	\$897,127
Percentage of Total Amount of Loans	1%	21%	56%	22%	100%
Percentage of census tracts in assessment area	7%	23%	52%	18%	100%

The geographic distribution of sampled motor vehicle loans generally reflects a reasonable dispersion throughout most of its assessment area. Although Farmers and Merchants Bank of Rockford's performance in moderate, middle, and upper income tracts reflects its assessment area, the bank's performance in low-income tracts appears low when compared to the percentage of low-income census tracts(1% versus

7%). However, the bank supplied information of its total motor vehicle loans made since the previous examination, which revealed that 22 of 840 (2.6% of total) loans were made to individuals that lived in low-income census tracts. While 2.6% is more than double the 1% noted in the examiner's loan sample, it is still far less than the 7% which represents the percentage of low-income tracts in the assessment area. Nonetheless, the bank's performance in moderate-income tracts regarding motor vehicle loans, compensates for the low amount of lending in low-income tracts.

Small Business Loans	Low Income Tract	Moderate Income Tract	Middle Income Tract	Upper Income Tract	TOTAL
Total Number of Loans	15	21	45	15	96
Percentage of Total Loans	16%	22%	46%	16%	100%
Total Amount of Loans	\$1,475,976	\$1,080,393	\$1,983,586	\$1,305,380	\$5,845,335
Percentage of Total Loans	25%	19%	34%	22%	100%
Percentage of census tracts in assessment area	7%	23%	52%	18%	100%

Farmers and Merchants Bank of Rockford Geographic Distribution of Loans



The geographic distribution of the bank's small business loans reflects a reasonable dispersion throughout the assessment area. Farmers and Merchants Bank of Rockford's performance in moderate, middle, and upper-income tracts reflect the composition of its assessment area, and the bank's performance for low income tracts compares favorably to the percentage of low census tracts (16% versus 7%) in its assessment area.

The bank performed its own geographical analysis in which the bank's total loans since the previous examination were reviewed. The bank's performance is reflected in the following table.

Total Loans	Low Income Tract	Moderate Income Tract	Middle Income Tract	Upper Income Tract	TOTAL
Total # of Loans	112	330	1,024	400	1,866
% of Total Loans	6%	18%	55%	21%	100.00%
Assessment area	7%	23%	52%	18%	100.00%

Although the bank's performance regarding motor vehicle loans in low-income census tracts shows room for improvement, the bank's strong performance in low-income census tracts for small business loans was taken into consideration. Overall, a review of the Farmers and Merchants Bank of Rockford's performance with its motor vehicle loans and small business loans, as well as the bank's internal assessment of its total loans since the previous examination, indicates a reasonable dispersion of credit throughout its assessment area by income level.

RESPONSE TO COMPLAINTS:

Because the bank has not received any complaints concerning its performance in meeting local credit needs, this factor was not evaluated in the bank's CRA assessment.

QUALIFIED INVESTMENTS:

Farmers and Merchants Bank of Rockford has made and continues to make various investments in its assessment area. These investments include a school grant, extension of credit to women owned businesses and a business engaged in affordable housing (rehabilitation and construction), on-going support to a community neighborhood group in a low-income area, and home ownership counseling. The bank's school grant of \$500 is given annually to a graduating high school student who is chosen based on scholarship, leadership, self-expression, self-motivation, and financial need. Since the previous examination, the bank extended 24 loans totalling over \$1,659 million to 15 women-owned businesses. The bank supported businesses engaged in affordable housing by extending credit totalling over \$1,590 million to finance five different projects. The five loans provided funding for the following projects: 1) 55 units of affordable, single-room occupancy for homeless individuals; 2) a five-room addition on property that housed 20 students; 3) an apartment which will

provide housing for up to 22 "at risk youths;" 4) two housing units for disabled people; and 5) an 81-unit apartment complex to be rented to individuals at or below 80% of the median income. The bank supported a community neighborhood group by donating computers and providing training to members of the group. The counseling program consisted of 15 homebuyer education classes which generated 74 loans totalling \$4,437,466 in home loans. The previously mentioned investments of Farmers and Merchants Bank of Rockford have enhanced credit availability in its assessment area.

PROVISION OF SERVICES:

Farmers and Merchants Bank of Rockford's record of providing branches, Automated Teller Machines (ATMs), loan production offices, and other services and delivery systems enhance credit availability in its assessment area. The bank has six branches located in its assessment area, one of which is located in a low-income area, representing 17% of the bank's branching network. The bank has 132 ATMs located in its assessment area, one located at a bank site and 131 through Exchange System network; 21 ATMs or 8.08% are located in low-income areas and 33 (or 24.24%) ATMs are located in moderate-income areas. The bank has two loan production offices, a real estate loan production office and a business loan production office, both located in middle-income areas, but accessible to individuals located in low- and moderate-income areas. The bank's other services include a Customer Service Hotline available Monday through Friday from 7:00 a.m. to 8:00 p.m., bank-by-mail and courier services.

The availability and nature of the previously mentioned services indicate that the bank provides such needed services to its entire assessment area.

Farmers and Merchants Bank of Rockford has also provided technical expertise to a community center, located in a low-income census tract, by furnishing computers and training.

COMPLIANCE WITH FAIR LENDING LAWS AND REGULATIONS:

Farmers and Merchants Bank of Rockford is in compliance with the provisions of the Fair Housing Act, Equal Credit Opportunity Act, and the Home Mortgage Disclosure Act. Although there were violations of technical provisions of the Home Mortgage Disclosure Act, these violations did not result in any disparate treatment or discrimination on a prohibited basis. Consequently, those violations did not have a negative affect on the assessment of the bank's overall CRA performance. To help prevent illegal discrimination or discouragement, management has committed to provide periodic fair lending training sessions to its employees and implement a second review procedure of its approved and declined loans.