

## GENERAL INFORMATION

The Community Reinvestment Act (ACRA®) 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 operations 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 **Michigan Heritage Bank, Novi, Michigan**, prepared by the **Federal Reserve Bank of Chicago**, the institution's supervisory agency, as of **April 27, 1998**. 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 RATING:** This institution is rated satisfactory.

Michigan Heritage Bank is a denovo institution which commenced operations on March 10, 1997. Our examination represented the first review of this organization's compliance with CRA. Based on our findings, the bank's overall performance under CRA is considered satisfactory. In a short period of time, management has made significant strides in promoting economic revitalization and growth, consistent with the bank's size, financial capacity, location, and local economic conditions. Of particular note is the bank's average loan-to-deposit ratio of 78.6%, a significant achievement in light of the fact that the bank has been in operation for only slightly more than one year. Our review of the geographic distribution of loans also revealed that the majority of loans originated within the bank's defined assessment area, indicating satisfactory performance. However, the absence of a substantial banking presence in the assessment area has resulted in weak loan penetration at this time. Currently, the bank has only its main office serving an assessment area which includes Oakland and Wayne counties, an area that covers approximately 1,400 square miles. As the bank continues to grow and expand, management's plans to open six to eight branches in the Detroit metropolitan area will result in increased loan penetration in the assessment area. Expansion and growth will also assist management in diversifying its loan portfolio, thereby increasing its lending to borrowers of different income levels and businesses of different sizes. Currently, commercial leases represent approximately 90.2% of the total loan portfolio. Management's strategic plan calls for the diversification of the loan portfolio to include commercial real estate and residential mortgage loans in addition to commercial leases. This portfolio mix will better position the bank to lend to borrowers of different income levels and different-sized businesses. Our review disclosed no evidence of illegal lending and credit activities, and no arbitrary exclusion of low- or moderate-income geographies was noted. The bank received no complaints regarding its CRA performance since operations commenced.

## PERFORMANCE CONTEXT

## DESCRIPTION OF INSTITUTION

Michigan Heritage Bank, a subsidiary of Michigan Heritage Bancorp, Inc., is a denovo bank which opened for business in March 1997. Unlike most denovo banking organizations, the bank experienced substantial growth in its first year of operation due to prior customer relationships that senior management had previously developed in the leasing industry. Many of these accounts transferred over to the bank when it opened for business. In slightly over one year, the bank reported total assets of \$55.5 million (as of March 31, 1998).

In accordance with the bank's significant growth and growth potential, management's strategic plan calls for the opening of six to eight branches in the Detroit metropolitan area. Currently, the bank operates from one full service facility located in Novi, Michigan. The first branch will be a storefront in a strip shopping mall and is expected to open by September 1998. Management also plans to move its main office to Farmington Hills in 1999 and retain its office in Novi as a branch. Other branches will be opened in the Detroit metropolitan area as the bank continues to grow and build its customer base. The bank is also reviewing the potential benefits of automated teller machines to enhance services, but no definitive decisions have been made in that regard.

Although the bank provides a full range of credit products, commercial leasing dominates the bank's lending activities, comprising 90.2% of the total loan portfolio as of December 31, 1997. Leases are made to corporations and small businesses through third parties. Lease amounts range from a low of \$5,000 to a division of General Motors to lease a copy machine, to a high of \$500,000 to a medical association to lease an X-Ray machine. Real estate mortgages and other credit products are offered; however, originations to-date have been accommodation transactions to bank employees, lease clients, and their employees. The credit products offered by the bank are consistent with its mission statement and the credit needs in the assessment area. The bank also offers a full range of deposit products and services to meet the needs of the community.

The bank's strategic plan addresses the need to diversify its loan portfolio into other areas in addition to commercial leasing. Although leasing will continue to be a profitable niche for the bank, management's efforts are focused towards building a balanced loan portfolio of commercial real estate loans, residential mortgage loans, and commercial leasing, each representing approximately one-third of the total loan portfolio. To this end, management has been aggressively searching for an experienced mortgage lender to lead the efforts in building a residential mortgage portfolio. Other activities being considered include land contract financing which is often the only viable option for home borrowers who are unable to qualify for traditional mortgage instruments. The diversification of lending activities as the bank continues to grow will provide greater credit opportunities for customers in the assessment area.

The bank is located in a highly competitive market with many different types of financial

institutions offering credit and depository services. The bank's primary competitors include branches of: Comerica Bank, Detroit, Michigan; First of America Bank, Kalamazoo, Michigan; Michigan National Bank, Farmington Hills, Michigan; Old Kent Bank, Grand Rapids, Michigan; and Standard Federal Bank, Troy, Michigan.

**DESCRIPTION OF ASSESSMENT AREA**

When the bank opened for business in March 1997, management defined its assessment area as the cities of Novi and Northville in the Detroit metropolitan area. After receiving technical assistance from this Reserve Bank and completing an internal analysis to determine the location of the bank's loans and deposits, management expanded its assessment area to include the whole geographies of Oakland and Wayne counties. Based on the internal analysis, this assessment area enabled the bank to capture 65.0% of its loans and 80.0% of its deposits when geocoded.

The bank's current assessment area of Oakland and Wayne counties is located within the Detroit metropolitan statistical area (AMSA). The assessment area contains a total of 894 census tracts, including 209 low-income census tracts, 154 moderate-income census tracts, 309 middle-income census tracts, and 222 upper-income census tracts. As a percentage, low- and moderate-income census tracts comprise 40.6% of the total census tracts in the assessment area.

According to the 1990 U.S. census data, the population of the bank's assessment area is 3.2 million, and consists of 1.2 million households with a median household income of \$33,141. Of the total households in the assessment area, 27.5% are low-income, 14.6% are moderate-income, 18.2% are middle-income, and 39.7% are upper-income. Housing units in the assessment area total 1.3 million, of which 61.7% are owner-occupied, and 30.8% represent rental units. Of the total number of owner-occupied units, 10.2% are in low-income areas, and 10.5% are in moderate-income areas. The median age and value of housing stock in the assessment area is 44 years and \$63,293, respectively.

As noted previously, the bank is located in the city of Novi which has experienced tremendous growth in the 1990s. Between 1990 and 1996, Novi's population rose 32.2%. Novi and other cities surrounding I-275 in Oakland county are supplanting the traditional suburbs as home to the affluent residents of the Detroit metropolitan area. Median household incomes in Novi are among the highest in this area. Community representatives described the area as **A wealthy, A new, and Agrowing.**

The Detroit metropolitan area is host to a wide variety of manufacturing and service organizations. Major area employers include:

<u>Employer</u>	<u>Product/Service</u>	<u>Number of Employees</u>
Addison Inc.	Management Services	260
American Staffing	Temp. Contract Employment	350

Digital Equipment	Commercial Equipment	300
Guardian Industries	Photo Finishing	260
Hewlett-Packard Co.	Commercial Equipment	unknown
Hudson's	Department Store	720
Michigan Tractor & Machinery	Equipment	600
Sears Roebuck & Company	Department Store	340

The Department of Labor reported the following unemployment rates as of March 31, 1998:

United States	4.3%
State of Michigan	3.5%
Detroit MSA	3.7%
Oakland County	2.8%
Wayne County	4.3%

**PERFORMANCE CRITERIA****I. LOAN-TO-DEPOSIT RATIO**

An analysis of the bank's Consolidated Reports of Condition since operations commenced revealed the following loan-to-deposit ratios:

Quarter Ending	Loan-to-Deposit Ratio
June 30, 1997	76.9%
September 30, 1997	68.1%
December 31, 1997	79.8%
March 31, 1998	84.7%
Average	78.6%

The above table indicates an average loan-to-deposit ratio of 78.6%. For a denovo institution in operation for slightly more than one year, this ratio is considered strong, particularly when compared to the bank's peer group ratio of 68.1% as of December 31, 1997. Considering the short time in operation, its competition, asset size, and capacity to lend within its assessment area, the bank's loan-to-deposit ratio **exceeds** the standards for satisfactory performance under this criterion.

## II. LENDING IN ASSESSMENT AREA

As previously noted in the **A**Description of Assessment Area,<sup>@</sup>management performed an internal analysis to determine the origin of its deposits and loans in establishing its current assessment area of Oakland and Wayne counties in the Detroit MSA. Similar data as of March 31, 1998, revealed the following distribution of loans and deposits:

	Oakland County	Wayne County	Outside of the Assessment Area	Total
		(in thousands)		
<b>Loans</b>	\$23,445	\$ 7,162	\$16,417	\$47,024
<b>Deposits</b>	\$28,491	\$17,678	\$12,544	\$58,714

This analysis indicates that as of March 31, 1998, 65.1% of all loans originated in Oakland and Wayne counties, and 78.6% of the bank's deposits were drawn from the assessment area as well. Management stated that the majority of deposits outside of its assessment area was obtained by posting the bank's deposit rates through a listing service, Express Data Corporation. These out-of-area deposits constitute nonbrokered deposits in amounts less than \$100,000. The bank uses the listing service sparingly, and management has committed that no more than one-third of deposits will originate through this source.

The examination loan sample of approved consumer loans was also reviewed to determine lending activity within the bank's assessment area. The sample revealed that 60.0% (15 of 25) of approved consumer loans originated within Oakland and Wayne counties.

Although both of the above analyses of the bank's lending within its assessment area indicated that 35.0% to 40.0% of its loans were made to borrowers outside of Oakland and Wayne counties, a majority of loan originations did occur within the bank's assessment area. Based on this slight majority, the bank **meets** the standards for satisfactory performance under this criterion.

### III. LENDING TO BORROWERS OF DIFFERENT INCOME LEVELS AND TO BUSINESSES OF DIFFERENT SIZES

#### Lending to borrowers of different income levels:

In 1997, the bank was not a reporter of information pursuant to the Home Mortgage Disclosure Act (AHMDA@), and was therefore not required to collect monitoring data that would be used in the analysis of its lending to borrowers of different income levels. As of December 31, 1997, the bank met all requirements and became a HMDA reporter for the 1998 calendar year. This information will be used on future examinations to assess the bank's lending to borrowers of different incomes.

Although the bank's mortgage lending activities to-date are minimal, management is committed to meet local community housing needs, particularly for low- and moderate- income borrowers. Accordingly, the bank extended a \$1 million line of credit to Detroit Revitalization, Inc., a corporation whose purpose is to rehabilitate homes in the city of Detroit. The homes are currently in the process of being renovated to meet city code requirements. When all renovations are complete, the homes will be sold exclusively to low- and moderate- income families. Currently, the line of credit to Detroit Revitalization, Inc. is fully extended. Management's efforts to compensate for its limited mortgage lending activities and service the credit needs of low- and moderate- income borrowers through the loan to Detroit Revitalization, Inc., is positively regarded.

#### Lending to businesses of different sizes:

As noted previously, commercial leases dominate the bank's current lending activities. No agricultural loans were originated, consistent with the assessment area which is located in a large metropolitan area. Internal bank records as of March 31, 1998, indicated the following outstanding loans/leases to commercial businesses:

Type of Loans/Leases	Number of Loans / Leases	Amount Currently Outstanding (in 000s)
Commercial Loans and Leases:		
With original amounts of \$100,000 or less	349	\$12,706
With original amounts of more than \$100,000 through \$250,000	98	\$14,768
With original amounts of more than \$250,000 through \$1,000,000	29	\$12,325

As of March 31, 1998, the bank reported 558 business loans with a total outstanding balance of \$42.7 million. As the preceding chart indicates, 62.5% (349 of 558) of commercial loans/leases had total outstanding balances of \$100,000 or less. Although this would appear to indicate that the bank is lending primarily to small businesses, further analysis indicated otherwise. Of the 558 business loans booked at quarter-end, only 5.2% (29 loans totaling \$1.5 million) were made to businesses with less than \$1 million in annual revenues. Overall, this analysis indicated a weak lending penetration by the bank to businesses of different sizes, particularly given the highly commercial nature of the assessment area. Based on these results, the bank **does not meet** the standards for satisfactory performance under this criterion.

#### IV. GEOGRAPHIC DISTRIBUTION OF LOANS

A random sample of 100 commercial loans/leases was geocoded and analyzed to assess the bank's lending in different income geographies. The sample revealed the following distribution:

	<u>Number of loans</u>
Low-income census tracts	5
Moderate-income census tracts	5
Middle-income census tracts	28
Upper-income census tracts	<u>62</u>
	100

As the preceding table indicates, the majority of loans, 62.0%, was made to borrowers in upper-income census tracts. In contrast, only 10.0% of the sampled loans originated in low- and moderate-income census tracts. This level of lending is weak in relation to the total number of low- and moderate-income geographies in the bank's assessment area. As previously noted in the **A**Description of Assessment Area, 40.6% of census tracts in Oakland and Wayne counties are low- and moderate-income geographies. Based on this analysis, the geographic distribution of loans throughout the bank's assessment area **does not meet** the standards for satisfactory performance under this criterion.

#### V. RESPONSE TO COMPLAINTS

No complaints were received by the institution regarding its CRA performance.

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## CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

Management has developed adequate policies and procedures to support nondiscrimination in lending activities. Our review indicated that the institution is generally in compliance with the substantive provisions of anti-discrimination laws and regulations, including the Equal Credit Opportunity Act and the Fair Housing Act. No discriminatory lending patterns or practices intended to discourage loan applications were detected during the examination. The bank's denovo status has impacted its ability to meet the CRA standards for satisfactory performance under two of the performance criterion at this time. However, as the bank continues to grow and diversify its activities, improvement is anticipated. The overall **Satisfactory** CRA rating took into account the denovo status of the bank, its lending performance to-date, and efforts currently underway to enhance its lending activities in the assessment area.