

## 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 CRA performance of Highlands Union Bank in Abingdon, Virginia, prepared by The Federal Reserve Bank of Richmond, the institution's supervisory agency, as of February 9, 1998. The agency rates the CRA performance of an institution consistent with the provisions set forth in Appendix A of 12 CFR Part 228.

**INSTITUTION'S CRA RATING:** This institution is rated Satisfactory.

The bank's loan-to-deposit ratio is considered more than reasonable given its financial capacity and demand for credit in the area. A majority of loans sampled during the examination were provided to residents of the assessment area. The institution's lending to low- and moderate-income borrowers meets standards for satisfactory performance. The distribution of lending by income level of geographies is considered reasonable given the bank's resources, branch locations, and demographics of the local community.

**DESCRIPTION OF INSTITUTION:**

Highlands Union Bank operates five full-service branches and one express facility throughout Washington and Smyth Counties and the City of Bristol, Virginia. The institution is headquartered in the Town of Abingdon, Virginia, and is a subsidiary of Highlands Bankshares, Inc., a one-bank holding company. As of December 31, 1997, the bank had total assets of \$256 million, of which 74% were loans. The institution has experienced exceptional asset growth in recent years primarily due to strong loan demand. From December 1996 to December 1997, total assets and total loans increased by 24%, while total deposits grew 23%. Various credit products are available through the institution including residential mortgage, home improvement, consumer, business, and agricultural loans. The loan portfolio as of December 31, 1997, was comprised of 55% real estate secured (consumer and business), 14% commercial/agricultural, and 31% consumer. Based on the number and dollar amount of loans extended during the previous six months, motor vehicle and mortgage loans were identified as the principal credit products offered by the bank. The institution's previous CRA rating was satisfactory.

**DESCRIPTION OF METROPOLITAN ASSESSMENT AREA**

The bank serves two assessment areas. The first assessment area contains five branches and encompasses Washington County, the City of Bristol, Virginia, and census tracts 425.00 through 430.00 in Sullivan County, Tennessee. Although primarily rural, this market area is included within the Johnson City-Kingsport-Bristol Metropolitan Statistical Area (MSA). This assessment area contains 23 census tracts of which 22 are populated. Of the populated geographies, five are moderate-income, twelve are middle-income, and five are upper-income. There are no populated low-income census tracts within the bank's market. According to 1990 census data, the assessment area has a population of 94,532 and a median housing value of \$51,368. The owner-occupancy rate for the market is 66% which is comparable to that for the MSA (68%). The 1997 median family income for the MSA is \$34,000. The following table provides demographics for the metropolitan assessment area by the income level of families and the percentage of population living in census tracts of varying income levels.

	Low- Income	Moderate- Income	Middle- Income	Upper- Income	Total
<b>Percentage of Area Families by Income Level</b>	22%	18%	21%	39%	100%
<b>Percentage of Population Residing in Census Tracts by Income Level</b>	0%	25%	55%	20%	100%

**DESCRIPTION OF NONMETROPOLITAN ASSESSMENT AREA**

The bank's second assessment area includes Smyth County. This nonmetropolitan assessment area contains seven block numbering areas (BNAs), of which two are moderate-income and five are middle-income. There are no low- or upper-income geographies within this market. The bank's one branch office was opened on December 6, 1997, and is located within a middle-income census tract in the Town of Marion. According to 1990 census data, this assessment area has a population of 32,370 and a median housing value of \$43,195. The owner-occupancy rate for the market is 69% which is slightly higher than that for the Commonwealth of Virginia (61%). The

1997 median family income for nonmetropolitan areas within Virginia is \$34,800. The following table provides demographics for the nonmetropolitan assessment area by the income level of families and the percentage of population living in census tracts of varying income levels.

	Low- Income	Moderate- Income	Middle- Income	Upper- Income	Total
<b>Percentage of Area Families by Income Level</b>	24%	21%	25%	30%	100%
<b>Percentage of Population Residing in Census Tracts by Income Level</b>	0%	27%	73%	0%	100%

The bank's assessment areas are contiguous and located in the western portion of Virginia. The local economy is primarily dependent on various manufacturing companies and agriculture. The major employers in the area include Johnson Memorial Hospital, Bristol Compressors, CAMAC (producer of various fibers), Mid-Mountain Foods (grocery distribution center), and Exide Battery Corporation. Agricultural activities primarily involve tobacco, poultry, and egg production. As of December 1997, the unemployment rates for the City of Bristol and Washington and Smyth Counties, Virginia were 4.7%, 5.3%, and 6.3%, respectively. These rates are slightly high in comparison to the jobless rate for the Commonwealth of Virginia of 3.1%. The unemployment rate for Sullivan County, Tennessee is 3.0%.

A representative from a local community service organization was recently contacted to further assist in evaluating the bank's CRA performance. The contact indicated that affordable housing is a primary need for local residents. The contact further revealed that area banks are sufficiently meeting the credit needs of the community.

**CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA**

**LOAN-TO-DEPOSIT RATIO**

The institution is responsive to area loan demand. During the six-quarter period ending September 1997, the quarterly average loan-to-deposit ratio for all banks headquartered in metropolitan areas of Virginia and of similar asset size to Highlands Union Bank ranged from 72% to 76%. The bank's average loan-to-deposit ratio for the previous seven quarters is 82% and exceeds standards for satisfactory performance given the institutions financial capacity, size, and current local economic conditions.

**LENDING IN ASSESSMENT AREA**

To determine the institution's volume of lending within the assessment area, 304 mortgage loans and a sample of 172 consumer motor vehicle loans were reviewed. The sample was chosen from the approximately 1,168 consumer motor vehicle loans extended during the previous six months. All originated mortgage loans reported on the bank's 1997 Home Mortgage Disclosure Act (HMDA) Loan Application Register were analyzed. The lending distribution is represented in the following table.

Comparison of Credit Extended Inside and Outside of Assessment Areas

	<b>Inside Assessment Areas</b>	<b>Outside Assessment Areas</b>	<b>Total</b>
<b>Total Number of Loans</b>	338	138	476
<b>Percentage of Total Loans</b>	71%	29%	100%
<b>Total Amount of Loans (000's)</b>	\$10,857	\$2,027	\$12,884
<b>Percentage of Total Amount</b>	84%	16%	100%

As illustrated above, a majority of the number and dollar amounts of the sampled loans were provided to residents of the assessment areas.

**LENDING TO BORROWERS OF DIFFERENT INCOMES**

The following charts illustrate the distribution of the mortgage loans and the sample of consumer motor vehicle loans originated within the metropolitan assessment area by income level of the borrower. One of the 100 motor vehicle loan files extended within this assessment area did not include the applicants income and, therefore, was not included in this analysis.

Distribution of Loans by Income Level of Borrower - MSA

Consumer Motor Vehicle Loans

	<b>Low-Income</b>	<b>Moderate- Income</b>	<b>Middle- Income</b>	<b>Upper- Income</b>	<b>Total</b>
<b>Total Number of Loans</b>	20	29	20	30	99
<b>Percentage of Total Loans</b>	20%	30%	20%	30%	100%
<b>Total Amount of Loans (000's)</b>	\$144	\$214	\$191	\$392	\$941
<b>Percentage of Total Loans</b>	15%	23%	20%	42%	100%

HMDA Mortgage Loans

	<b>Low-Income</b>	<b>Moderate- Income</b>	<b>Middle- Income</b>	<b>Upper- Income</b>	<b>Total</b>
<b>Total Number of Loans</b>	16	48	60	99	223
<b>Percentage of Total Loans</b>	7%	22%	27%	44%	100%
<b>Total Amount of Loans (000's)</b>	\$208	\$1,251	\$1,835	\$6,208	\$9,502
<b>Percentage of Total Loans</b>	2%	13%	19%	66%	100%

When compared to the distribution of area families by income, the percentage of consumer motor vehicle loans extended to low- and moderate-income borrowers (50%) exceeds the proportion (40%) of such families in the community. The percentage of mortgage loans extended to low- and moderate-income borrowers (29%), however, is somewhat lower than the area demographics. This penetration is a result of the banks limited lending to low-income families (7%). However, approximately 13% of the families within the assessment area are below the poverty level, and home-ownership is generally unaffordable for these families. Collectively, the distribution to borrowers of different income levels is considered reasonable relative to the estimated demand for these types of loans, using area demographics as a proxy.

As mentioned previously, the banks only branch office in the nonmetropolitan assessment area recently opened in December 1997. Consequently, only ten of the sampled motor vehicle loans and five of the mortgage loans were originated within this market area. As a result of this limited lending activity, no meaningful analysis could be performed for this assessment area.

**GEOGRAPHIC DISTRIBUTION OF LOANS**

A review of the loan files also included an analysis of lending among the various census tracts within the banks metropolitan assessment area. As mentioned previously, there are no populated low-income census tracts located within the market. The following tables illustrate the geographic distribution of the mortgage and sampled consumer motor vehicle loans according to income level of the census tract. Due to the limited lending activity, no meaningful analysis could be performed for the nonmetropolitan assessment area.

Distribution of Loans in Assessment Area by Income Level of Census Tract - MSA

Consumer Motor Vehicle Loans

	Moderate- Income	Middle- Income	Upper- Income	Total
<b>Total Number of Loans</b>	17	66	17	100
<b>Percentage of Total Loans</b>	17%	66%	17%	100%
<b>Total Amount of Loans (000s)</b>	\$122	\$702	\$140	\$964
<b>Percentage of Total Loans</b>	13%	73%	14%	100%

HMDA Mortgage Loans

	Moderate- Income	Middle- Income	Upper- Income	Total
<b>Total Number of Loans</b>	37	164	22	223
<b>Percentage of Total Loans</b>	17%	73%	10%	100%
<b>Total Amount of Loans (000s)</b>	\$1,423	\$7,340	\$739	\$9502
<b>Percentage of Total Loans</b>	15%	77%	8%	100%

Overall, 17% (54/323) of the sampled loans were extended in moderate-income census tracts. This level of lending is somewhat lower than the percentage of the population residing in such areas (25%), as well as the percentage of owner-occupied units in such tracts (22%). Eighteen percent of the families residing in moderate-income census tracts, however, are below the poverty level. In addition, a large portion of one of the moderate-income census tracts which contains 6% of the assessment area population is surrounded by a national forest. The mountainous terrain may therefore be a barrier to potential borrowers in this area. Given the demographics of the assessment area and branch locations, the geographic distribution of lending is considered reasonable.

**COMPLIANCE WITH ANTIDISCRIMINATION LAWS AND REGULATIONS**

No credit practices inconsistent with the substantive provisions of fair housing and fair lending laws and regulations were identified. Adequate policies, procedures, and training programs have been developed to support nondiscrimination in lending activities.