

PUBLIC DISCLOSURE

September 22, 1997

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

HERITAGE BANK

10-20-4217

16650 West 135th STREET
OLATHE, KANSAS 66062

Federal Reserve Bank of Kansas City

925 Grand Blvd.
Kansas City, Missouri 64198

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 CRA performance of Heritage Bank prepared by the Federal Reserve Bank of Kansas City, the institution's supervisory agency, as of September 22, 1997. 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: Satisfactory record of meeting community credit needs.

The bank has a satisfactory record of helping to meet the credit needs of its assessment area. Its average loan-to-deposit ratio was relatively high and reflected the bank's willingness to meet assessment area credit demand. A majority of the loans sampled were within the assessment area. The geographic distribution of loans was not a performance consideration, as the assessment area contains no low- or moderate-income census tracts. The distribution of bank loans among borrowers of different income levels and businesses of different sizes was reasonable.

DESCRIPTION OF INSTITUTION

Heritage Bank is an affiliate of Fidelity Bankshares, Inc. in Garden City, Kansas. As of June 30, 1997, its total asset size was \$41,307M, making it one of the smallest institutions in the assessment area.

The bank consists of two full-service offices, both of which are in Olathe, Kansas. The bank's facilities are easily accessible to most points within the assessment area.

According to management, the bank's primary lending focus continues to be small business loans. The bank's June 30, 1997 Reports of Condition and Income ("Call Report") confirm the bank's overall lending focus by showing the following mix in its loan portfolio: business real estate-secured loans, 31.2 percent; commercial loans, 26.8 percent; residential loans, 13.7 percent; consumer purpose loans, 10 percent; construction/land development loans, 10 percent; agricultural loans, .8 percent; and all other loan types, 7.5 percent.

Business loans comprised the largest dollar volume of the bank's lending since the last examination, but a large number of the bank's loans were consumer automobile-secured loans. Table 1 shows the number and dollar volume of loans by loan type that were made by the bank since the last examination. As a result, these two loan products were selected for review as major product types.

TABLE 1 BANK LOANS ORIGINATED FROM 1-22-97 TO 8-14-97 BY NUMBER AND DOLLAR VOLUME				
LOAN TYPE:	BY NUMBER		BY DOLLAR VOLUME	
	#	% of Total	\$(000)	% of Total
Real Estate Secured Loans:				
Owner-Occupied 1- 4-Family	13	2.8	1,212	3.8
Non-Owner Occupied 1- 4-Family	15	3.2	957	3.0
Junior Lien 1- 4-Family	21	4.5	813	2.5
1- 4-Family Construction	42	8.9	6,212	19.2
Construction/Development	5	1.1	1,753	5.4
Secured by Farmland	3	0.6	260	0.8
Secured by Business Property	25	5.3	8,067	25.0
Agriculture Loans	4	0.9	2,200	6.8
Commercial Loans	111	23.5	8,338	25.8
Consumer Unsecured	15	3.2	122	0.4
Consumer Secured by Deposits/Stocks, etc.	40	8.5	568	1.8

Automobile Secured	178	37.5	1,825	5.5
TOTALS	472	100.0	32,327	100.0
Shaded loans were considered major product types and were used for the CRA performance analysis.				

The bank's CRA performance was last reviewed on January 22, 1996, and resulted in a satisfactory rating.

DESCRIPTION OF HERITAGE BANK'S ASSESSMENT AREA

Performance Context Methodology

Regional Economic Information System (REIS) data, information from community contacts, 1990 census data, Bureau of Labor Statistics employment and economic information, and data from the Call Reports of assessment area institutions were used to determine a performance context on which to base this analysis. The performance context serves as the basis for determining the reasonableness of the bank's lending levels and loan distribution. In addition, a local government official, a business trade association representative, and a small business owner were contacted to discuss assessment area credit needs, housing, labor, and economic trends. Discussions were held with bank management to ascertain its lending goals and philosophies.

Assessment Area Overview

Johnson County, Kansas, is the bank's assessment area. The county consists of 75 census tracts in the southwest corner of the Kansas City, Missouri-Kansas Metropolitan Statistical Area (MSA). According to the 1990 U.S. Census, approximately 23 percent of the MSA families live in the assessment area.

Population Trends

Over the past decade, the assessment area population has steadily increased. Information from the Johnson County Economic Research Institute (CERI) showed that from 1982 to 1992 the assessment area population grew by 34 percent and accounted for 62 percent of MSA-wide growth during that decade. REIS data indicates that the area's population grew by 10 percent from 1990 to 1994, compared to a 3.8 percent growth rate for the MSA.

Income Characteristics

The assessment area is prosperous compared to the MSA as a whole. There are no low- or moderate-income census tracts in the assessment area, whereas 36 percent of the MSA

consists of low- and moderate-income tracts.¹ Of the 75 tracts in the assessment area, 29 (38.7 percent) are middle-income tracts and 46 (61.3 percent) are upper-income tracts.

The income characteristics of the assessment area indicate that the bank may have less opportunity to lend to low- and moderate-income individuals than do financial institutions with offices in other parts of the MSA. (Table 2) The 1997 median family income for the assessment area is \$50,393, which is significantly higher than the \$37,652 figure for the MSA. A smaller percentage of low- and moderate-income families live in the assessment area than MSA-wide. In addition, 57.7 percent of assessment area families in 1990 had incomes that were more than 120 percent of the MSA median family income. This was far greater than the 38.7 percent representation of upper-income families MSA-wide (i.e. upper-income families).

	Percent of Total Households or Families	
	Assessment Area	MSA
Households Income Summary:		
Low-Income	10.3	21.0
Below Poverty Rate	4.0	9.9
Moderate-Income	13.1	17.5
Middle-Income	19.3	21.1
Upper-Income	57.4	40.4
Family Income Summary:		
Low-Income	7.0	16.5
Below Poverty Rate	2.5	7.3
Moderate-Income	13.4	19.8
Middle-Income	21.9	25.1
Upper-Income	57.7	38.7
The families category is a subset of households. A family consists of a household where there are at least two individuals related by birth, marriage or adoption.		

Although community contacts indicated that the city of Olathe contains a growing low- and moderate-income population, census data shows that it is a middle-income area compared to the MSA as a whole. Annually estimated income data indicated that the city's median family income was \$44,572 in 1996, or 118 percent of the MSA median family income.

¹ By definition, a low-income census tract has a median family income less than 50 percent of the median family income of the MSA. The other income categories are defined as follows: moderate-income, 50-79

percent of the MSA median family income; middle-income, 80-119 percent of the MSA median family income; and upper-income, equal to or greater than 120 percent of the MSA median family income. These same categories are applied to the annual estimated MSA median family income figure to classify low-moderate-, and upper-income borrowers later in this analysis.

Community contacts indicated a need to educate the area's growing low- and moderate-income population on the services and products offered by financial institutions. However, the contacts did not indicate that credit was unavailable to low- and moderate-income individuals.

Housing Trends and Characteristics

Assessment area housing characteristics indicate a prosperous economy and an expanding housing base. In 1990, median housing values and gross rent were 38 percent and 21 percent higher, respectively, in the assessment area than in the MSA as a whole. The median housing age in the assessment area was 17 years, compared to 29 years in the MSA.

Increasing construction industry employment levels indicate continuing housing development, and contacts confirmed that housing construction is occurring at a rapid pace. However, contacts also stated a need for middle-income housing, rather than the upper-income and lower-income housing built in the recent past.

In the 1990's, new assessment area housing construction and rehabilitation focused on single-family units rather than multiple-family units. Figures supplied by CERA and the Olathe Chamber of Commerce showed that single-family building permits decreased by 18 percent from 1994 to 1995, while multiple-family building permits increased by 30 percent. Community contacts indicated that this may be due in part to several federally-subsidized housing projects being built in the city of Olathe. Thus, the low- and moderate-income population in the city of Olathe may be increasing beyond the level suggested by the 1990 census data.

Labor and Economic Trends

In October 1995 the unemployment rate of the assessment area was 2.4 percent, compared to 3.2 percent in the MSA and 5.2 percent nationwide. REIS data shows a 14 percent job base growth from 1990 to 1994.

Job expansion was widespread and affected most of the area's major industries. Jobs in the service industries increased by 27,828 from 1990 to 1994, the largest increase reported in any sector. REIS data shows that service industries comprised 77.1 percent

of the assessment area job base in 1994.

Although the assessment area contains businesses of all sizes, community contacts commented on the large volume of small businesses in the assessment area. Many of the businesses are service industries. One contact commented favorably on the bank's reputed willingness to extend credit and work cooperatively with small businesses.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

Several factors were considered in evaluating the bank's CRA performance, including its level of lending in relation to its deposits and in comparison with peer financial institutions, the concentration of bank lending within and outside of the assessment area, and the bank's record of lending to borrowers of different income levels and to businesses of various sizes. The bank has not received any complaints about its CRA activities or performance since the last examination. As previously noted, three community representatives were contacted regarding the assessment area demographics, credit needs, and economic trends. A detailed description of the bank's performance follows.

Loan-to-Deposit Ratio

The bank's loan-to-deposit ratio is significantly higher than its national peer average and is in the upper ranges of the ratios of other banks in the assessment area.² The bank's quarterly loan-to-deposit ratio has increased steadily over the past two years, and its average ratio (calculated using quarterly Call Reports from March 1996 to June 1997) was 81.2 percent.

Because the bank had no assessment area peers in its size range, the bank's average loan-to-deposit ratio was compared to the averages of six other area banks with assets ranging from approximately \$20MM to \$337MM. These six assessment area banks had average ratios ranging from 38.8 percent to 82.9 percent, and the bank's national peer group had an average ratio of 67 percent.

The bank's relatively high loan-to-deposit ratio is considered to be reflective of the area's significant loan demand and the bank's willingness to meet that demand.

Lending in Assessment Area

The bank's concentration of lending within the assessment area is considered satisfactory.

As noted in Table 3, a majority of the number and dollar amount of bank loans sampled were made to borrowers from within the assessment area. Of the loans extended to borrowers outside of the assessment area, many were attributed to MSA commuting patterns. For example, some business owners lived in the assessment area, although their businesses were located in, and the loans were attributed to, other parts of the MSA.

² The bank's peer group consists of all insured commercial banks with assets between \$25 million and \$50 million, with two or more banking offices, and located in a metropolitan area.

TABLE 3 LOANS WITHIN THE ASSESSMENT AREA				
	Number of Loans	Percent in Assessment Area	Dollar Amount of Loans (000's)	Percent in Assessment Area
Consumer Automobile	55	87	583	89
Business real estate secured	15	60	4,284	53
TOTALS:	70	80	4,867	56

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

The distribution of consumer automobile loans among individuals of different income levels is reasonable in comparison to the median family income characteristics of the assessment area. As noted in Table 4, 41 percent of the consumer automobile loans were to borrowers with low or moderate incomes, which significantly exceeds the 20.4 percent representation of low- and moderate-income families in the assessment area. This reflects the bank's willingness and efforts to lend to borrowers with limited incomes.

TABLE 4 PERCENTAGE OF LOANS REVIEWED BY DIFFERENT INCOME LEVELS IN THE ASSESSMENT AREA
Area Median Family Income

Income Level of Borrower	Percent of Consumer Automobile Loans Reviewed	Percent of Families in Assessment Area
Low (<50 percent of median)	22	7.0
Moderate (50 to 80 percent of median)	19	13.4
Middle (80 to 120 percent of median)	31	21.9
Upper (>120 percent of median)	28	57.7
Total	100	100.0

Based on the revenue sizes of the commercial loans that were made within the assessment area, the bank's record of lending to small businesses was also considered reasonable. A small business is defined as one with gross annual revenues of less than \$1MM. Of the real estate-secured commercial loans within the assessment area, the bank relied on business revenue in making its credit decision in 13 cases, and in two cases it relied on the income of the individual borrower. Of these 15 loans, 1 was in a loan amount less than \$100M, 9 were between \$100M and \$250M, and 5 were between \$250,000 and \$1MM. In addition, 73 percent of the number and 75 percent of the dollar amount of the loans were extended to small businesses or individual business owners with low incomes. The high percentage of loans to small businesses reflects the bank's commitment to lend to businesses of all sizes. In addition, it reflects a reasonable distribution, since most of the assessment area businesses are comprised of small retail and service enterprises.

Although the bank has not complied with all provisions of the antidiscrimination regulations, a review of bank policies, credit applications, and loans revealed no prohibited practices designed to discourage or discriminate against applicants. In addition, management has provided training to staff members in order to prevent violations of the antidiscrimination laws and regulations.