

PUBLIC DISCLOSURE

January 19, 1999

COMMUNITY REINVESTMENT ACT

PERFORMANCE EVALUATION

**Capital Bank of North County
964362**

**2602 El Camino Real
Carlsbad, California 92008**

**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.

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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 for **Capital Bank of North County** prepared by the Federal Reserve Bank of San Francisco, the institution's supervisory agency, as of **January 19, 1999**. The agency rates the CRA performance of an institution consistent with the provisions set forth in Appendix A to CFR Part 228.*

Institution's CRA Rating: Capital Bank of North County is rated outstanding.

Basis for rating

The bank's outstanding performance is based on its record of addressing the credit needs of small businesses within its community. Its overall lending record demonstrates a substantial majority of activity within the defined assessment area, while the geographic distribution of lending shows a reasonable penetration in all types of census tracts. In addition, the lending dispersion among businesses of different sizes is excellent in comparison to assessment area demographics. Considering that the bank's target market is small- to medium-sized businesses, its record of lending to small businesses was very responsive to the need for business loans in small dollar amounts, a credit need identified by a local community organization. The bank's satisfactory lending record is further complemented through its active provision of community development services as well as the adequate level of qualified investments. All of these factors contributed to the bank's overall outstanding rating.

DESCRIPTION OF INSTITUTION

Capital Bank of North County (CBNC) is located in Carlsbad, California, 35 miles north of downtown San Diego in the area commonly known as North County. Since the bank's previous CRA examination in March 1996, total assets have grown 45 percent to \$87 million as of September 30, 1998. A review of the bank's loan portfolio as of this date reveals the following distribution:

Loan type	Percent of total loans
Commercial/Industrial, and Non-Farm Non-Residential Real Estate	69%
Construction Loans	19%
Loans Secured by 1-4 Family Residential Property	9%
Consumer Loans	3%

As reflected, Capital Bank of North County is primarily a business lender. Specifically, the bank's target market is small- and medium-sized businesses. Aside from business loans, the bank also offers a full array of consumer-purpose loans, primarily on an accommodation basis to its business clients. These loan products include residential mortgage loans, residential construction loans, home equity loans, auto loans, and overdraft lines of credit.

In addition to the main office, which offers a drive-up banking facility and a 24-hour automated teller machine (ATM), the bank has two other full-service branches located in the cities of Carlsbad and Vista. These branches also offer either a drive-up facility or an ATM. In keeping with its business lending focus, the bank recently established business loan production offices (LPO) in the cities of Oceanside and Encinitas.

The bank faces strong competition from local branches of statewide financial institutions as well as community banks located throughout its assessment area, particularly with regard to mortgage loans. Nevertheless, there are no legal or financial impediments that would prevent the bank from meeting the community's credit needs consistent with its size, resources, financial capacity, and local economic conditions. Capital Bank of North County's CRA performance was rated outstanding at the previous examination conducted as of March 25, 1996.

DESCRIPTION OF ASSESSMENT AREA

The bank's assessment area consists of the northern portion of San Diego County, comprising the cities of Bonsall, Carlsbad, Del Dios, Encinitas, Escondido, Fallbrook, Oceanside, Rancho Santa Fe, San Marcos, Solana Beach, and Vista. These cities are commonly referred to as North County, as they comprise the northern section of San Diego County. Of the 87 census tracts in the assessment area, 1 (1 percent) is low-income, 18 (21 percent) are moderate-income, 41 (47 percent) are middle-income, and 27 (31 percent) are upper-income area census tracts. Residing in these areas are 145,684 families, of which 1 percent are low-income, 21 percent moderate-income, 50 percent middle-income, and 28 percent upper-income. The median family income for the area is \$41,397 slightly above the state's \$40,559.

San Diego County's economy is strong and has been improving over the last two years. The unemployment rate remains low, declining from 4.0 percent in October 1997 to 3.6 percent in October 1998, significantly below the state rate of 5.6 percent. Also, information from the Bureau of Labor Statistics for the San Diego MSA suggests a strong economy due to an increase in the establishment of new businesses. In 1996, San Diego County's largest employment category by industry is services, comprising 32 percent of the employed population. Other significant employment industries are retail and wholesale trade, government, and manufacturing. The services industry also had the largest employment growth (12.6 percent) between 1992 and 1996.¹

Data provided by Dunn and Bradstreet (a firm that provides business and credit data) show that the vast majority of businesses operating within the bank's defined assessment area, 18,120 or 88.5 percent, have gross annual sales of \$1 million or less.² Moreover, 26 percent of these businesses are situated in moderate-income areas, with the highest percentage (43 percent) located within the middle-income geographies. The data also suggests that business-lending opportunities are very limited in the one low-income tract. Except for this one low-income area, there are a significant number of businesses located throughout the entire assessment area, providing local financial institutions opportunities for small business lending. According to a contact within the community, needs exist for small business financing in amounts less than \$25,000.

¹ Regional Economic Information System (REIS)

² These are considered "small businesses" for purposes of the CRA regulation.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

Capital Bank of North County's performance was evaluated using the small bank CRA examination procedures. The bank's performance was evaluated based on its loan volume in comparison to its deposits (Loan-to-Deposit), its level of lending inside and outside its defined assessment area (Lending in Assessment Area), the distribution of lending to businesses of different sizes (Lending by Business Revenue), and lending dispersion in the geographies within the assessment area (Geographic Distribution of Loans). A fifth criteria, the bank's responsiveness to consumer complaints, was not evaluated because the bank received no CRA-related complaints since the previous examination. Additionally, at the request of bank management, qualified investments and services were evaluated for consideration of an outstanding rating.

Because the bank is primarily a business lender, small business loans were utilized to assess the bank's CRA performance. A total of 218 small business loans extended from January 1, 1997 through September 30, 1998, were reviewed to ascertain the volume of lending within the bank's assessment area. Thereafter, the 191 loans made inside the assessment area were analyzed to evaluate the distribution among the four income-level geographies. To further assess the bank's lending by business revenue, revenue data was collected for a sample of 112 loans from the 191 loans made in the assessment area. By utilizing only those loans extended inside of the bank's assessment area, examiners evaluated the bank's record of meeting the credit needs of its designated community.

LOAN-TO-DEPOSIT RATIO

Capital Bank of North County's loan-to-deposit ratio meets standards for satisfactory performance. The loan-to-deposit ratio is a quick test to determine the bank's level of lending activity in comparison to its deposits. This review is achieved by measuring the bank's net loans against its total deposits over time with the result being analyzed within the bank's performance context. For the 11 quarters since the previous CRA examination, the bank's average loan-to-deposit ratio is 64 percent. During the same time period, its local peer banks had an average of 72 percent.

In light of the bank's resources and capabilities, coupled with the strong competition from local branches of statewide financial institutions as well as community banks located throughout the assessment area, its loan-to-deposit ratio is reasonable.

LENDING IN ASSESSMENT AREA

The bank's credit extensions inside and outside its defined assessment area exceeds standards for satisfactory performance. Table 1-1 confirms that a substantial majority of loans were extended inside the assessment area both in number and dollar volume.

Table 1-1

Loan Type	Number of Loans		Dollar Amount of Loans	
	% Inside	% Outside	% Inside	% Outside
Small Business	88	12	83	17

LENDING BY BUSINESS REVENUE

Capital Bank of North County's distribution of loans to businesses of different sizes exceeds standards for satisfactory performance. In comparing its lending performance to the assessment area and its needs, the bank has made a more than reasonable amount of loans to small businesses. Of the 112 small business loans sampled, 54 percent were extended to small businesses (those with gross annual revenues of \$1 million or less). Additionally, 84 percent of the loans extended to small businesses were in amounts of \$100,000 or less. Addressing the stated credit need for loans in amounts less than \$25,000, 41 percent of the loans to small businesses were in amounts under \$25,000. The high number of loans extended to small businesses, coupled with the fact that a substantial majority of the loan amounts were for smaller dollar amounts, confirms the bank's responsiveness to the needs of small businesses and is addressing the more critical small business needs in the community.

GEOGRAPHIC DISTRIBUTION OF LOANS

The bank's overall geographic distribution of lending exhibits an adequate penetration among assessment area geographies. Its assessment area is comprised mainly of middle-income areas, followed by a smaller number of moderate- and upper-income geographies. The area contains only one low-income census tract, which houses the Oceanside Small Business LPO. Table 2-1 portrays the bank's dispersion of small business loans within the various income geographies. As shown in the table, the percentage of loans made in the low- and moderate-income areas is consistent with the distribution of businesses and tracts in the assessment area, as well as the distribution of loans originated by all lenders required to collect and report data for CRA purposes.

Table 2-1

	Low- Income	Moderate- Income	Middle- Income	Upper- Income
Loan Distribution	1%	20%	60%	19%
Distribution of Businesses	1%	26%	43%	30%
Distribution of Aggregate³ Small Business Lending	1%	20%	43%	36%
Census Tract Distribution	1%	21%	47%	31%

Additionally, the bank’s lending dispersion shows that the highest concentrations of loans are in the areas surrounding its branch and LPO offices, with similar penetrations in moderate-, middle-, and upper-income areas. All of these factors demonstrate that the bank is actively lending in all types of census tracts, and that lending activities are responsive to the credit needs of small businesses located in low- and moderate-income areas.

RESPONSE TO COMPLAINTS

The bank’s responsiveness to consumer complaints was not evaluated because no CRA-related complaints have been received since the previous examination.

QUALIFIED INVESTMENTS AND PROVISION OF SERVICES

Given the bank’s size, financial resources, and capabilities, its level of both qualified investments and services is reasonable. The bank donated \$7,440 to various community development organizations offering services specifically targeted to low- and moderate-income individuals. While these donations do address community development needs in the assessment area, the bank’s active provision of community development services was the primary factor in raising the bank’s overall CRA performance to an outstanding level.

Officers of the bank routinely participate in numerous community-based organizations primarily by serving on loan committees for community development corporations and providing credit counseling and financial planning services to low- and moderate-income individuals. All of these services are provided on an ongoing basis.

COMPLIANCE WITH FAIR LENDING LAWS AND REGULATIONS

Capital Bank of North County is in compliance with the substantive provisions of the anti-discrimination laws and regulations. The bank has detailed policies and procedures designed to ensure compliance with fair lending laws and regulations. Additionally, no violations were noted during the examination that suggests that the bank engage in any type of discrimination or discouragement in its lending activities.

³ Aggregate small business lending is the total number of small business loans extended during 1997 in the area by large financial institutions required to collect and report loan data for CRA purposes.