

PUBLIC DISCLOSURE

January 18, 2000

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**Pacific State Bank
10577
1975 Winchester Avenue
Reedsport, Oregon 97467**

**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 CRA performance for **Pacific State Bank, Reedsport, Oregon**, by the **Federal Reserve Bank of San Francisco**, the institution's supervisory agency, as of **January 18, 2000**. 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: This institution is rated outstanding.

Pacific State Bank's outstanding performance under the Community Reinvestment Act is based on its record of addressing the credit needs of small businesses and low- and moderate-income borrowers 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 throughout the assessment area. In addition, the lending dispersion among businesses of different sizes and borrowers of different incomes, especially low- and moderate-income is excellent in comparison to assessment area demographics. Its record of lending to small businesses was very responsive to the identified need of small dollar loans. The bank's lending record is further complemented by its proactive provision of community development services, demonstrating the bank's willingness to support activities that promote community development. All these factors contributed to the bank's overall outstanding rating.

PERFORMANCE CONTEXT

Description of Institution

Pacific State Bank, a wholly owned subsidiary of Security Bank Holding Company headquartered in Coos Bay, Oregon, operates a full-service unit bank in Reedsport, Oregon. The bank also offers ATM services at its sole facility. Commencing operations in 1963, Pacific State Bank was acquired by Security Bank Holding Company in November 1997 and converted to Federal Reserve System membership on July 1, 1998.

Since the previous examination conducted as of April 24, 1995, by the Federal Deposit Insurance Corporation, the bank has maintained a stable asset base. As of September 30, 1999, total assets stood at \$52.1 million, increasing slightly by 1.9 percent from \$51.1 million as of September 30, 1995. During the period, deposits have grown by 5.6 percent, while loan growth has declined. The assessment area's economic profile and a stagnant, older population base have impacted loan demand. The chart below illustrates the distribution of loans outstanding as of September 30, 1999:

Loan Type	Dollar Amount (000's)	Percentage of Total
COMMERCIAL / INDUSTRIAL & NON-FARM NON-RESIDENTIAL REAL ESTATE	14,952	58.6
SECURED BY 1-4 FAMILY RESIDENTIAL - OTHER	6,240	24.4
CONSUMER LOANS	2,505	9.8
MULTIFAMILY HOUSING	1,104	4.3
FARMLAND & AGRICULTURAL	443	1.7
CONSTRUCTION & LAND DEVELOPMENT	125	0.5
SECURED BY 1-4 FAMILY RESIDENTIAL REVOLVING	102	0.4
STATES & POLITICAL SUBDIVISIONS	36	0.1
ALL OTHER	17	-
Total Loans (gross)	25,524	100.0

As reflected, Pacific State Bank is primarily a commercial lender, targeting small- to medium-sized businesses. Aside from business loans, the bank also offers a full array of consumer-purpose loans, including variable-rate residential mortgage loans, residential construction loans, home equity loans, and installment and single-payment loans. Pacific State also brokers loan applications for 30-year fixed residential mortgages through its affiliate, Security Mortgage Company.

Pacific State Bank's local competitor for loans and deposits is a branch of a large statewide commercial bank that operates in Reedsport. The Federal Deposit Insurance Corporation Market Share Report as of June 30, 1999 indicates that Pacific State Bank holds a majority of the deposits at 63.23 percent compared to its competitor in the city of Reedsport. 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. Pacific State Bank's CRA performance was rated satisfactory at the previous examination conducted as of April 25, 1995.

Description of Assessment Area

Pacific State Bank identifies its assessment area as "that general area in Western Douglas County and Northern Coos County, Oregon, and includes the City of Reedsport, and the unincorporated communities of Lakeside and Winchester Bay to the south, Gardiner to the North and Scottsburg and Wells Creek to the East."

The assessment area consists of three census tracts and each of the three census tracts is designated as middle-income. Based on the 1998 HUD adjusted income figures, the median family income for the assessment area is \$28,850, which is somewhat lower than the state's \$32,336. Within the assessment area reside 3,697 families: 21 percent of these families are low-income, with 11.1 percent of this group falling below the poverty level; 15.6 percent are moderate-income, 24.2 are middle-income, and 39.2 percent are upper-income. There are no low- or moderate-income tracts in the assessment area, nor are there any in the immediate vicinity surrounding the assessment area. There is no evidence of conspicuous gaps or illegal discrimination in the bank's selection of its assessment area.

DOUGLAS COUNTY

Located in the southern half of western Oregon, Douglas County is largely a mountainous area bisected by Interstate 5. The county is bound on the east by the Cascade mountain range and to the west by a small stretch of the Pacific coastline. The county is heavily forested with 2.8 million acres in commercial forestlands, making timber and the related wood products industries a major economic force. These heavily forested, largely wild areas also make Douglas County a prime location for recreational activities.

DEMOGRAPHICS

With an estimated 1998 population of 4,860, Reedsport is the second largest city in the county.¹ In addition to the City of Reedsport, several unincorporated communities are located in close proximity – Gardiner, Winchester Bay/Salmon Harbor, and Scottsburg. The combined area of these communities is referred to as the Lower Umpqua Area. The area boasts around 10,000 residents² but also draws a larger labor force from Coos Bay, 27 miles to the south in Coos County, and Florence, 18 miles to the north in Lane County. Since January 1996, the Lower Umpqua Area has been designated by the state as a "nonurban" enterprise zone to foster employment opportunities, business development, and competitiveness. Located in economically lagging areas, these zones offer substantial property tax relief to new private capital. Qualifying businesses in the zone receive 100 percent abatement from local property taxes for three to five years. This exemption applies to the construction or expansion of facilities totaling at least \$25,000 and investment in new equipment totaling at least \$1000 of used in production or \$50,000 for other personal property. Companies making a sizeable investment and creating at least 100 jobs may be

¹ 2000 Regional Economic Profile, Region 6, Douglas County, Oregon Employment Department, p. 6

² Reedsport Renaissance, Lower Umpqua Economic Development Forum, Draft Report, p. 6

eligible for a property tax exemption of 15 years.³ The Lower Umpqua Area is also in a foreign trade zone (FTZ), which benefits companies that import any part of their product.⁴

Douglas County's estimated 1998 population totaled 100,300 residents. Although it is the ninth largest county in the state, Douglas County is the slowest-growing county out of the 36 counties that comprise Oregon. Since 1994, population growth has been almost entirely due to in-migration.⁵ Recent years have seen a large portion of in-migration in the 65-plus age group. In-migration, plus aging of the baby boom generation make citizens of Douglas County, on average, older than the rest of the country.⁶ These population shifts have resulted in significant increases in government transfer payments (in the form of Social Security and Medicare payments) for the county. This category of income has increased 39 percent in real terms between 1990 and 1997.⁷

AREA INDUSTRIES

The southwest region of Oregon, which is comprised of the counties Douglas, Coos, and Curry, Jackson, and Josephine has been coping with a huge shift in its industrial base. In general, the region's traditional high-paying, resource-based processing industries - once the mainstay of the region's economy - are giving way to rapidly growing (but mostly lower-paying) service and trade industries. The most dominant and pervasive employment trend in southwestern Oregon has been the rapid decline in the number of lumber and wood products manufacturing jobs after 1990. These counties were particularly hard-hit due to their greater-than-average reliance on this industry -- over two-thirds (68%) of the region's manufacturing base in 1990 was in the lumber and wood products industry. From 1990 to 1998, the manufacturing sector declined by 1,410 jobs, mainly due to losses in lumber and wood products. Forestry has played an important part in Douglas County's economy. Lumber and wood products accounted for 82 percent of all manufacturing jobs in the county, and comprise about 17 percent of the county's total private sector employment, compared to 3 percent statewide.⁸ Timber harvests in 1998 fell to one-third of the peak harvest of 1988 due mainly to a dramatic reduction in harvests of national forests and BLM-managed lands. In late 1998 and early 1999 International Paper closed its plant in Reedsport, terminating 300 higher paying jobs.

The major employers located in Reedsport include: Lower Umpqua Hospital (135); Reedsport School District (103); Custom Business Systems, Inc. (90) and, Umpqua River Navigation (80).

ECONOMIC INDICATORS

From 1995 through 1998, the annual average jobless rate for Douglas County ranged from a low of 8.0 percent in 1995, to a high of 9.3 percent in 1998. These unemployment rates were substantially higher than the state that ranged from a low of 4.8 percent in 1995 to a high of 5.9 percent in 1996. As of June 1999, the rate for the county declined to 8.3 percent. Although at its lowest since 1995, the county unemployment rate is still 50 percent higher than that of the state at 5.5 percent for the same period.⁹ Douglas County's rural setting, its reliance on agriculture, wood products, and

³ *Enterprise Zones in Oregon* (2nd Edition; January 1998), Oregon Economic Development Department, p. 11

⁴ Reedsport Renaissance, Lower Umpqua Economic Development Forum, Draft Report, p. 9

⁵ 2000 Regional Economic Profile, Region 6 Douglas County, Oregon Employment Department, p.7

⁶ Oregon Employment Department Regional Economic Profile: 9/99

⁷ 2000 Regional Economic Profile, Region 6 Douglas County, Oregon Employment Department, p. 7

⁸ 1999 State of Oregon Employment Department

⁹ Reedsport Renaissance, Lower Umpqua Economic Development Forum Draft Report, p. 15

tourism and the related seasonality of these industries, as well as job losses in the timber industry have clearly impacted the local economy. As a result, the Oregon Economic and Community Development Department has designated Douglas County as a “distressed area”. This designation was originally based on economic distress resulting from reductions in timber harvest. However, in mid-1997, the measures for designating a distress area were expanded to include indicators of economic distress or dislocation, including, but not limited to unemployment, poverty, and job loss. The department was directed by the state to maintain this list and to “give priority” to these areas. Douglas County has been designated as a “distressed area” under this new methodology since December 1997.

COOS COUNTY

A small portion of northern Coos County is included in the bank's assessment area and encompasses the community of Lakeside. Coos County is located on Oregon's southern coast. Much of its 1,629 square miles is mountainous. The beaches, dunes, and estuaries of the Pacific Ocean provide wildlife habitat and recreation. The Coos Bay area is the site of Southwestern Oregon Community College, the Oregon Institute of Marine Biology, and has the largest deepwater port on the Oregon coast.

DEMOGRAPHICS

Coos County had 61,400 residents in 1998, remaining unchanged from the year before, but 1,400 less than in 1994. The population loss has occurred in spite of growth among persons of retirement age. The Coos Bay-North Bend area, with a population of about 30,000, is the largest urban center on the Oregon coast. Since 1990, net migration has accounted for all of the county's population increase. Deaths have actually exceeded births. Many of the persons who move to the area are retired. The median age is nearly 40 years, one of the highest in the state. These population shifts have resulted in significant increases in government transfer payments (in the form of Social Security and Medicare payments) for the county. This category of income has increased 17 percent in real terms between 1967 and 1997.¹⁰

For this same time period, Lakeside's population grew to 1,675, an increase of about 17 percent, despite the closure of a lumber mill in the town and the loss of timber-related jobs in nearby Reedsport.

AREA INDUSTRIES

Over the last twenty years, Coos County's economy has experienced a sharp decline in employment and income from such natural resource industries as timber and fishing. Recreation and retirement have increased in importance. For the same period, Coos County's labor force increased by just over one percent, while total employment fell slightly. A decrease in the area's natural resource industries and a decline in the wage-earner portion of the population account for this decline in total employment.¹¹ Manufacturing jobs in Coos County have also fallen substantially. The closure of obsolete mills and a reduction in timber supplies have led to about 1,800 fewer wood products jobs since the late-1980s and 3,400 fewer since the late-1970s. Early in

¹⁰ 2000 Regional Economic Profile Region 7 Coos County, Oregon Employment Department, p. 40

¹¹ 2000 Regional Economic Profile, Region 7 Coos and Curry County, Oregon Employment Department, p. 9

1998, due to falling demand from Japan, Weyerhaeuser Corporation closed its export lumber mill in Coos Bay and reduced its logging operations. Employment in the rest of manufacturing has also fallen in the past ten years. Food products employment, mostly seafood processing, though up slightly in 1999, has fallen by nearly 200 in the last decade. Employment in paper products has also decreased.

ECONOMIC INDICATORS

Recent unemployment rates for the county are much higher than the statewide average. Between 1988 and 1998, the unemployment rate in Coos County averaged 9.3 percent, while Oregon's rate has averaged just under 6.0 percent, approximately the same as the national rate. In 1998, at 10.1 percent, Coos County had the fourth highest annual average rate of all labor market areas in Oregon in 1998, comparing very unfavorably to the state at 5.6 percent for the same period. Since December 1997 Coos County has also been designated as a "distressed area" by the Oregon Economic & Community Development Department.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

Scope of Examination

To evaluate the bank's performance under the Community Reinvestment Act, examiners reviewed the bank based upon four of the five performance criteria. These include the following:

- The bank's loan volume in comparison to its deposits (Loan-to-Deposit Ratio)
- The bank's lending inside and outside its assessment area (Lending in Assessment Area)
- The distribution of lending to businesses of different sizes and borrowers with different income levels (Lending by Borrower Income and Business Revenue), and
- The dispersion of lending throughout the census tracts or geographic areas within the assessment area (Geographic Distribution of Loans)

The bank's responsiveness to consumer complaints was not evaluated because the institution has not received any CRA-related complaints since its previous examination. Additionally, at the request of bank management, qualified investments and services were evaluated for consideration of an outstanding rating.

Although the bank is primarily a commercial lender, in terms of number of loans, retail credit activity is also significant. Therefore, consumer as well as small business loans were used as the basis for this evaluation. The review included a total of 126 loans extended during the period beginning January 1998 through September 1999, consisting of 53 business and 73 consumer loans. The entire loan sample was used to determine the bank's volume of lending inside its assessment area. However, only those loans extended inside the assessment area were included in the evaluation of the geographic distribution and borrower distribution profiles. With respect to these two categories, examiners focused on the bank's record of meeting the credit needs within its designated community.

Loan-to-Deposit Ratio

Pacific State Bank's loan-to-deposit ratio is considered reasonable and meets the standards for satisfactory performance. This conclusion is based upon an analysis of the bank's level of lending activity in comparison to its deposit base. The bank's net loans are measured against its total deposits over time with the result being evaluated within the bank's performance context.

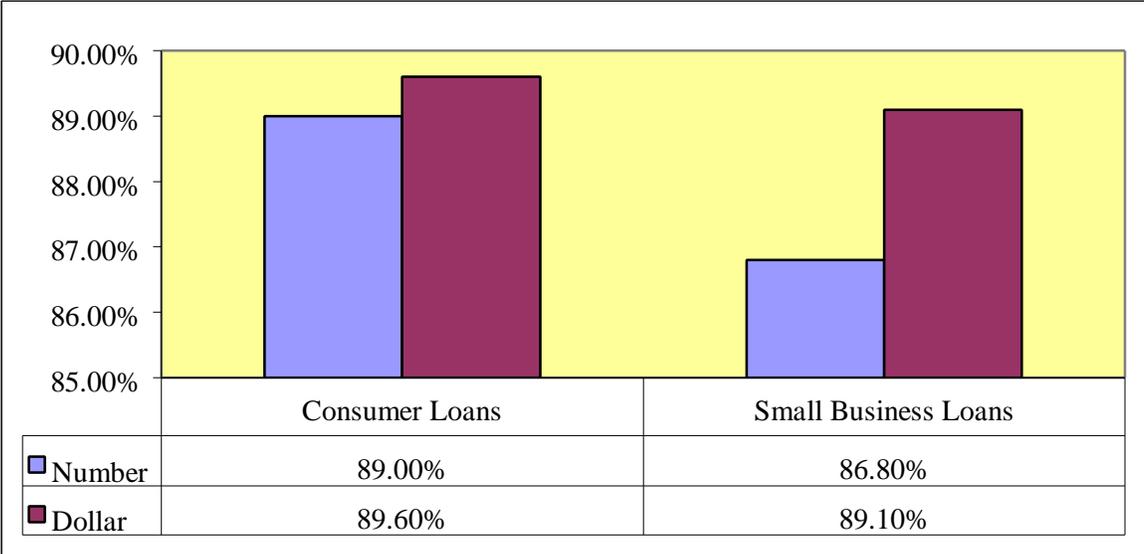
	PACIFIC STATE BANK	PEER 1	PEER 2
AVERAGE L-T-D RATIO – 8 QUARTERS	59.16%	74.32%	74.39%
FDIC MARKET SHARE REPORT DEPOSITS	63.23%	5.19%	34.36%

Two peer banks were selected for this institution based on comparable asset size, number of banking facilities, business strategy, and geographic location. A comparison of the average loan-to-deposit ratios for these institutions shows that the average loan-to-deposit ratio over the preceding eight quarters for each peer bank was 74.32 percent and 74.39 percent, respectively. Pacific State Bank’s average ratio was 59.16 percent for the same period. Although the bank’s average falls below these peers, the bank’s loan-to-deposit ratio is considered reasonable. As an established institution in the market, Pacific State Bank has a significantly higher market share of deposits in comparison to these peers. While the bank continues to lend, substantive loan growth thwarted by a growing elderly population predisposed to savings.

Lending in Assessment Area

Pacific State Bank’s distribution of loans inside and outside of the assessment area exceeds the standard for satisfactory performance.

An analysis of loans extended shows a substantial majority of the bank’s loans were originated inside the assessment area. Of the total number of loans sampled, 88.1 percent were originated inside the market. When broken down by loan type, this concentration is still apparent as illustrated in the chart below.



The bank’s volume of small business and consumer lending in the assessment area reflect an excellent match between the bank’s primary products and identified credit needs.

Geographic Distribution of Loans

Pacific State Bank's overall geographic distribution of lending exhibits a reasonable penetration among the assessment area geographies. The bank's assessment area is comprised entirely of three middle-income census tracts. In reviewing the bank's lending dispersion, examiners noted a good dispersion throughout the assessment area in that activity was in each tract. As such, there are no conspicuous gaps in the bank's lending distribution.

Lending by Borrower Income and by Business Revenue

Pacific State Bank's distribution of loans to business of different sizes and to borrowers of different income levels exceeds the standards for satisfactory performance.

The following table shows the percentages of consumer loans to borrowers of different income levels for Pacific State Bank compared to distribution of families by income category.

DISTRIBUTION OF CONSUMER LOANS BY BORROWER INCOME			
BORROWER INCOME LEVEL	PERCENTAGE OF TOTAL FAMILIES	PERCENTAGE OF LOANS (BY NUMBER)	PERCENTAGE OF LOANS (BY DOLLAR)
LOW-INCOME	21.0	33.3	26.7
MODERATE-INCOME	15.6	19.3	19.3
MIDDLE-INCOME	24.2	24.6	23.0
UPPER-INCOME	39.2	22.8	31.0
<i>TOTAL</i>	<i>100%</i>	<i>100%</i>	<i>100%</i>

The bank's consumer loan distribution by borrower income demonstrates an excellent penetration when considered in light of assessment area characteristics relating to family poverty levels and identified credit needs as previously discussed. Despite the absence of low- and moderate-income tracts within the bank's assessment area, low- and moderate-income families represent 21 and 15.6 percent, respectively. As illustrated in the table above, a combined 52.6 percent in number and 46 percent in dollar amount of consumer loans were extended to low- and moderate-income borrowers. These amounts exceed those groups' populations in the assessment area both in number and dollar percentage of loans extended to low- and moderate-income borrowers.

Data provided by Dun & Bradstreet indicates that 94.2 percent of the businesses in the assessment area are small business, that is, businesses with gross annual revenues less than \$1 million. Of the commercial loans sampled, 80.4 percent of the number and 83.7 percent of the dollar amount went to small businesses. Moreover, of those loans to small businesses, 83.8 percent were in amounts less than \$100,000 and 8.1 percent for amounts over \$100,000 to \$250,000 as well as amounts over \$250,000. A substantial majority of the bank's commercial

loans are in small dollar amounts, exhibiting an excellent responsiveness to identified credit needs of small businesses.

Based on the percentage of commercial loans originated to small businesses coupled with the bank's strong performance in originating loans to low- and moderate-income consumers, the bank's performance for this category exceeds the standards for satisfactory performance.

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 \$5750 to various community development organizations that include activities to revitalize the assessment area and to provide services to low- and moderate-income individuals. These include:

- \$5,000 grant to Lower Umpqua Development Forum for use by Reedsport Business Recruitment Committee.
- \$750 stipend to Douglas County Senior Companion Program for low-income seniors to offset mileage expense.

While these donations do address community development needs in the assessment area, the bank's proactive provision of community development services was a primary factor in raising the bank's overall CRA performance to an outstanding level.

Through their participation on various boards and committees, officers of Pacific State Bank take an active role in improving the economic well being of the assessment area. Current participation includes:

- Coos, Curry, Douglas Regional Strategies Board – Evaluating applications for grants to local city, county, ports, schools and other public entities.
- Lower Umpqua Economic Development Forum – Directing recruitment of potential businesses. Works with County, State, and Federal agencies to recruit and retain industry in the area.
- Regional Strategies Loan Committee - Providing funding for new start-up businesses that have been denied by lenders.
- Reedsport Business Assistance and Recruitment Team – Providing financial, marketing, and hands-on management support to struggling local businesses.
- Senior Services Companion Program Board – Overseeing the budget of Douglas County Senior Services Volunteer Service Program of senior companions in service to low-income seniors.

The bank also provides credit counseling and financial planning services to low- and moderate-income individuals and offers no-fee government check cashing services to noncustomers.

Response to Complaints

Since the previous examination, the bank has not received any complaints relating to its CRA performance. Therefore, the bank's performance under this criterion could not be evaluated.

Compliance with Fair Lending Laws and Regulations

Pacific State Bank is in compliance with the substantive provisions of the antidiscrimination laws and regulations. Additionally, there was no evidence that Pacific State Bank engages in any type of discriminatory practices or discouragement in its lending activities.