



Comptroller of the Currency
Administrator of National Banks
Washington, DC 20219

Small Bank

PUBLIC DISCLOSURE

March 1, 2004

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**The Upstate National Bank
Charter Number 12018**

**65 Main St
Lisbon, NY 13658**

**Comptroller of the Currency
Upstate New York (Syracuse)
231 Salina Meadows Parkway 105
Syracuse, NY 13212**

NOTE: This document is an evaluation of this 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. 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.

INSTITUTION'S CRA RATING

This institution is rated “Needs to Improve.”

The following are the primary factors supporting this rating.

- Upstate National Bank’s (UNB) lending inside its assessment areas does not meet the standard for satisfactory performance. Residential lending inside the assessment areas was very poor.
- UNB’s distribution of loans by borrower income does not meet the standard for satisfactory performance.
- UNB’s distribution of loans by geographic income meets the standards for satisfactory performance. However, since only commercial loans originated in the Rochester/Monroe assessment could be evaluated, this factor had limited positive impact on the overall rating.
- The new management team’s ability to improve the bank’s CRA performance was seriously limited by safety and soundness issues.

DESCRIPTION OF INSTITUTION

Upstate National Bank (UNB) is a community bank with \$94.6 million in assets as of December 31, 2003. The bank is majority owned by K&Z Company LLC. The bank has four full service offices, three long time offices in the Northern Region of New York State, and one in downtown Rochester, NY. The bank’s headquarters are officially in Lisbon, NY, but all executive staff is located at the facility in Rochester, NY. There are two defined assessment areas for CRA that are discussed later in this report.

The bank has very limited loan products at this time. The only product currently offered is commercial loans, and that is essentially limited to the Rochester, NY, area. There is very little lending done in the Northern NY Region. UNB began offering a credit card product through a third party vendor in February 2004. The bank recently began referring customers interested in a residential mortgage to a local mortgage broker who operates in both assessment areas.

UNB, formerly the National Bank of Lisbon, operated exclusively in the Northern Region of New York State until the mid 1990s. At that time, the bank set out in a direction that was contrary to the requirements and spirit of the CRA. In addition, the bank became involved in unsafe and unsound lending practices that eventually resulted in a Consent Order with this Agency dated March 22, 2002. During this period the bank opened loan production offices in Rochester and Syracuse, NY, and began to lend almost exclusively outside of its Northern NY assessment area where it had obtained the majority of its deposits.

A new management team was not in place until October 2002. Since that time the new management team and the Board have focused their attention and resources on complying with the Consent Order. The imposition of the Consent Order placed significant restraint on the bank's lending ability, and thus new management's ability to improve on the poor CRA performance within this examination period.

UNB's gross loans of \$63.3 million represented 64% of total assets as of December 31, 2003. Real estate secured loans represented the largest portion of loans at 85%, followed by commercial loans at 14% and individual loans 1%. UNB had total deposits of \$82.6 million as of June 30, 2003. Of this total, 46% of the deposits were obtained through brokers, 43% were from the Northern New York assessment area branches, and 11% were from the Rochester branch.

The bank received a Satisfactory CRA rating at its last examination dated August 17, 1998.

DESCRIPTION OF NORTHERN NEW YORK ASSESSMENT AREA(AA)

UNB's Northern NY AA consists of St. Lawrence and Jefferson Counties, which are not part of a Metropolitan Statistical Area (MSA). The bank has three offices located in this area, which is part of the North Country of New York State. Two of the bank's offices are located in the small townships of Philadelphia and Lisbon. The other office is located on the outskirts of the City of Ogdensburg. The population of the AA is 77,236 based on the 2000 Census. The 2000 Census classified 75% of the AA census tracts as middle-income. The other 25% are classified as moderate-income. There are no low or upper income-census tracts in the AA. The 2003 Median Family Income of the AA is \$47,300. The distribution of the families by income level is 23% low-income, 22% moderate-income, 24% middle-income, and 31% upper-income. There are 3,092 businesses in the AA per 2003 demographic data, of which 65% are classified as small size businesses (gross annual revenues less than or equal to \$1 million). Only 5% are classified as large size businesses (gross annual revenues greater than \$1 million). Thirty percent of the businesses are not classified for business size.

The community credit needs of the area include residential loans, consumer loans, business loans and farm loans. This was verified by a community contact with an organization involved in affordable housing in St. Lawrence County, OCC resources, bank management and published materials. The marketplace is competitive with two large regional banks, two large sized community banks, and several small community banks and credit unions operating in the area. UNB lost footing in this area over the last several years by essentially not offering loans and by not staying up with current trends for deposit services. The new management team is taking steps to improve the situation, such as introducing a debit card product in December 2003.

January 2004 statistics indicate the AA unemployment rate is significantly higher than the State average of 7.2%. In St. Lawrence County, the unemployment rate was 10.6%, 1.2% higher than a year earlier. The Jefferson County unemployment rate was 11.1%, up 1.3% from a year earlier.

DESCRIPTION OF ROCHESTER/MONROE NEW YORK ASSESSMENT AREA (AA)

UNB's Rochester/Monroe AA consists of Monroe County, which is one of the six counties comprising the Rochester, NY, MSA (6840). The City of Rochester, the third largest city in New York State, is part of Monroe County. The bank has one office located in the main commercial district of downtown Rochester. UNB began operations in the area in the mid 1990s with a Loan Production Office (LPO). The LPO converted to a branch office in March 2002 in order to offer certificates of deposit. On March 6, 2003, the bank moved from the previous LPO office location to its present location, which includes a full service banking facility. The population of the AA is 735,343 based on the 2000 Census. The 2000 Census classified 20% of the AA census tracts as low-income, 17% as moderate-income, 35% as middle-income, and 28% as upper-income. The 2003 Median Family Income of the AA is \$56,900. The distribution of the families by income level is 19% low-income, 17% moderate-income, 22% middle-income, and 42% upper-income. There are 43,255 businesses in the AA per 2003 demographic data, of which 64% are classified as small size businesses. Only 7% are classified as large size businesses. Twenty-nine percent of the businesses are not classified for business size.

The community credit needs of the area include residential loans, business loans, and consumer loans. This was verified by a community contact with an organization that monitors local bank performance under the CRA, OCC resources, bank management, and published materials. The marketplace is competitive with several large global and regional banks, large and small size credit unions, and several community banks.

The January 2004 unemployment rate for the County was 6.2%, well below the State average of 7.2%. The rate was up .5% from one year earlier.

CONCLUSIONS ABOUT PERFORMANCE CRITERIA

This evaluation covers the time period from the last examination dated August 17, 1998, through December 31, 2003. The two products reviewed, residential loans and commercial loans, were essentially the only loan products offered by the bank during this period. Loan performance results are based on a sample of commercial loans made from January 1, 2001, through December 31, 2003. Residential loan performance is based on the loan originations reported by UNB under the Home Mortgage Disclosure Act (HMDA) for the years 2001-2003. Loans reported under HMDA are home purchase, home improvement, home purchase refinance and multi-family home loans. We believe the bank's performance within this three-year period is representative of its performance for the entire examination period.

Loan-to-Deposit Ratio

UNB's loan to deposit ratio meets the standards for satisfactory performance. The bank's average loan to deposit ratio for the 22 quarters (July 1, 1998 through December 31, 2003) was 92.11%. This compared favorably to the loan to deposit ratio of two other community banks

operating in similar markets in Upstate NY. One bank had an average loan to deposit ratio of 62.43% and the other 48.77%.

Lending in Assessment Areas

UNB's bank's lending in its AAs areas does not meet the standard for satisfactory performance. As Table 1 below shows, the percentage of loans made in the AAs is very poor, both number and dollar of loans. The percentage of residential home loans made in the AA area is especially poor, with only 3% of the number of loans and 2% of the loan dollars being made inside one of the bank's AAs. UNB's participation in a loan program with a mortgage broker resulted in the bank originating and selling several hundred residential mortgage loans over the examination period. The loans were made in several states, with no loans under this program made in the bank's AAs. There were no residential mortgage loans made in the bank's Northern NY AA, the source of 43% of the bank's deposits as of June 30, 2003. The percentage of commercial loans made in the AA is much better than the residential loans, but is still somewhat below the standard for satisfactory performance. There were only six commercial loans for \$82 thousand made in the Northern NY AA during the three-year period from January 1, 2001 through December 31, 2003. Of that, three loans for \$30 thousand represented the annual renewal of a \$10 thousand line of credit to one entity.

New management has made some visible strides in improving the bank's lending inside its AAs. Seven of the 11 residential loans made in the Rochester AA were made in 2003 under the new management. Fifty four percent of the residential loans and 86% of the commercial loans originated in 2003 were made in the bank's AAs, a ratio that would meet the standards for satisfactory performance. Since only 3% of the residential loans were originated in 2003, the overall in/out ratio was very poor despite this positive trend.

Table 1 - Lending in Assessment Areas

| Loan Type | Number of Loans | | | | | Dollars of Loans | | | | |
|-------------------|-----------------|----|---------|----|-------|------------------|----|---------|----|-------|
| | Inside | | Outside | | Total | Inside | | Outside | | Total |
| | # | % | # | % | | \$ | % | \$ | % | |
| | | | | | | 000's | | 000's | | |
| Residential Loans | 11 | 3 | 416 | 97 | 100 | 2,857 | 2 | 124,861 | 98 | 100 |
| Commercial Loans | 66 | 50 | 66 | 50 | 100 | 13,845 | 24 | 43,842 | 76 | 100 |
| Totals | 77 | 14 | 482 | 86 | 100 | 16,701 | 9 | 168,703 | 91 | 100 |

Source: Residential loans are from Home Mortgage Disclosure Act data. Commercial loans data is based on a sample of commercial loans originated during the examination period.

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

UNB's lending to borrowers of different incomes and different sizes does not meet the standard for satisfactory performance. An analysis of the borrower distribution of residential loans was not performed since so few of these loans were made in the AAs, and none were made in the Northern NY AA.

The table below shows that the bank made 35% of its commercial loans to small sized businesses during the examination period compared to 64% small sized businesses located in the Rochester/Monroe AA. Management provided an analysis of all loans booked in 2003 showing 48% of those loans made to small sized businesses, an improvement over results for the examination period.

| Business Revenues (or Sales) | ≤\$1,000,000 | >\$1,000,000 |
|------------------------------|--------------|--------------|
| % of AA Businesses* | 64 | 7 |
| % of Bank Loans in AA by # | 35 | 65 |
| % of Bank Loans in AA by \$ | 34 | 66 |

Sources: Loan sample and Dunn and Bradstreet data. * 29% of AA businesses did not report revenue data.

The commercial lending in the Northern Region AA was minimal and so is not presented in a tabular format. As mentioned earlier only commercial six loans for \$82 thousand were made in this AA. On the positive note, four of the six loans for \$62 thousand were made in 2003 under the new management.

Geographic Distribution of Loans

UNB's distribution of loans by geographic income meets the standards for satisfactory performance. However, since only commercial loans originated in the Rochester/Monroe assessment could be evaluated, this factor had limited positive impact on the overall rating.

Residential loans were not analyzed for geographic distribution due to the small percentage of these loans made in the AAs. The geographic distribution of commercial loans made in the Northern Region AA was also not analyzed due to the very small number of these loans made. UNB's geographic distribution of commercial loans in the Rochester/Monroe AA meets the standards for satisfactory performance. The following two tables show the distribution of the bank's commercial loans compared to the distribution of businesses by geographic income in the AA. Table 3 shows the geographic distribution of commercial loans originated in 2003 compared to the census tract income levels based on the 2000 Census. Table 3A shows the distribution of commercial loans originated in 2001 and 2002 compared to the census tract income level based on the 1990 Census. In 2003, UNB's percentage of loans made in low-income census tracts significantly exceeded the percentage of businesses located in these census tracts. At the same time the bank made no loans in moderate-income census tracts. In 2001/2002 the results were just the opposite, with no loans made in low-income census tracts but a good distribution of loans in moderate-income census tracts. The improvement in lending to low-income census tracts in 2003 is attributed to the reclassification of some downtown census tracts located near the bank to low-income. This business district area was not classified for income under the 1990 Census.

| Table 3 - Geographic Distribution of Loans to Businesses in Rochester/Monroe AA in 2003 | | | | | | | | |
|--|-----------------------|-------------------------------|-----------------------|-------------------------------|-----------------------|-------------------------------|-----------------------|-------------------------------|
| Census Tract Income Level 2000 Census | Low | | Moderate | | Middle | | Upper | |
| Loan Type | % of AA Businesses | % of Number of Loans |
| Commercial | 14 | 36 | 13 | 0 | 37 | 18 | 36 | 45 |

Source: Based on sample of loans originated in 2003.

| Table 3A - Geographic Distribution of Loans to Businesses in Rochester/Monroe AA in 2001&2002 | | | | | | | | |
|--|-----------------------|-------------------------------|-----------------------|-------------------------------|-----------------------|-------------------------------|-----------------------|-------------------------------|
| Census Tract Income Level 1990Census* | Low | | Moderate | | Middle | | Upper | |
| Loan Type | % of AA Businesses | % of Number of Loans |
| Commercial | 6 | 0 | 11 | 11 | 45 | 67 | 34 | 22 |
| | | | | | | | | |

*Source: Based on sample of loans originated in 2001 and 2002. * 4% of businesses were located in census tracts which were not classified for income.*

Responses to Complaints

No written complaints relating to UNB's performance in helping meet the credit needs of its two AAs were received by the bank or the OCC during the examination period.

Fair Lending or Other Illegal Credit Practices Review

We found no evidence of illegal discrimination or other illegal credit practices.