



SMALL BANK

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

PUBLIC DISCLOSURE

May 2, 2005

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**First National Bank of North County
Charter Number 17248**

**1145 San Marino Drive
San Marcos, CA 92069**

**Comptroller of the Currency
Southern California South Field Office
1925 Palomar Oaks Way Suite 202
Carlsbad, CA 92008**

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 Satisfactory.

The major factors that support this rating include the following:

- First National Bank of North County's level of lending is reasonable given its size, the credit needs of the assessment area, and its comparison to peer bank averages.
- The bank originated a majority of its loans both by number and by dollar volume within its assessment area.
- Lending to businesses of different sizes compares similarly to area demographics, and compares well based on the number of loans the bank granted to small businesses.
- The geographic loan distribution does not compare favorably to demographics of businesses in moderate-income census tracts. Management plans a more concerted effort to identify and address credit needs in those geographies.

DESCRIPTION OF INSTITUTION

First National Bank of North County (FNBNC) is a full-service commercial bank headquartered in San Marcos, California. Established in 1982, the bank provides community access to credit at all three of its branch offices: the main office in San Marcos, and in each of the branch offices in the nearby cities of Carlsbad and Vista. The San Marcos and Carlsbad offices are located in upper-income census tracts. The Vista office is located in a moderate-income census tract, and it provides 24-hour access to account services through an onsite automatic teller machine.

FNBNC is a wholly-owned subsidiary of Duke Financial Group, Incorporated, a multi-bank holding company based in Minneapolis, Minnesota. Affiliate banks include Inland Empire National Bank, State Bank of New Prague, and Peoples Bank of Commerce. As of December 31, 2004, the holding company reported total assets of \$579 million.

The bank provides a variety of loan and deposit products. Loan products include Small Business Administration (SBA) guaranteed loans, commercial real estate and construction loans, and personal and business loans and lines of credit. Deposit products include personal and business checking, money market and savings accounts, as well as individual retirements accounts and certificates of deposit.

There are no financial or legal impediments that hinder the bank's ability to meet the credit needs of its community. As of December 31, 2004, total bank assets were \$103.7 million, 64 percent of which consisted of net loans. The primary business focus is commercial lending. Commercial real estate, construction, and business loans comprised 94% of the total loan portfolio.

Table 1 shows the composition of the bank's loan portfolio by major product type as of December 31, 2004.

Table 1

LOAN PORTFOLIO COMPOSITION December 31, 2004	
Loan Type*	% of Portfolio
Commercial (including Commercial RE)	94%
Residential Real Estate-Secured	5%
Consumer Loans	1%
Total:	100%

*Source: Consolidated Report of Condition and Income

FNBNC'S last CRA examination in October 1999 rated the bank's performance as "Satisfactory."

DESCRIPTION OF ASSESSMENT AREA

FNBNC's assessment area meets the requirements of the regulation and it does not arbitrarily exclude low- or moderate-income geographies. The area consists of 76 contiguous census tracts that surround the bank's three branches in northern San Diego County. These tracts comprise the cities of San Marcos, Carlsbad, Vista, and Oceanside with an area population of 387,567. According to the 2000 U.S. Census, there are 19 moderate-income census tracts in the assessment area, 37 middle-income tracts, and 20 upper-income tracts. There are no low-income census tracts in the delineated area.

San Diego County comprises the San Diego-Carlsbad-San Marcos Metropolitan Statistical Area (MSA) 41740, which is the southern-most metropolitan area in California. San Diego County includes 4,261 square miles of urban and rural land. Orange County borders it to the north, the Pacific Ocean to the west, Imperial County to the east, and by Mexico to the south. The 2000 U.S. Census indicates a population of 2.8 million for San Diego County, a 13% increase over the 1990 numbers. The San Diego Regional Planning Agency projects another 17% in population growth over the next 15 years. The 2000 Census median housing value was \$229,602. The Department of Housing and Urban Development Housing reported 2004 median family income of \$62,400.

Banking competition in the area is strong with numerous large, regional, and community banks and other financial service providers. The largest banks offering commercial and consumer financial products throughout the area include Bank of America, Washington Mutual Bank, Wells Fargo Bank, Union Bank of California, California Bank and Trust, and Citibank. Often such large institutions have the advantages of brand recognition and stronger marketing resources over smaller local institutions.

According to the Bureau of Labor Statistics, San Diego County's unemployment rate was 3.5% at year-end 2004, comparing favorably to 5.6% for the State of California and 5.1% for the nation. The Los Angeles Economic Development Corporation (LAEDC) projects a positive trend for San Diego County, with average unemployment improving from 3.9% in 2004 to 3.6% in 2005. The LAEDC projects continued growth in the aerospace industry, and the recent stem-cell research initiative should benefit the bio-medical industry.

The region's housing sales are projected to increase by nearly 10% over the next year, but the supply of housing is not expected to keep pace with local population growth. As a result, prices are projected to increase by approximately 12%. As local housing prices continue to escalate, fewer residents can afford to own a home. Currently, there is a housing shortage for all income groups, but the shortage has acutely affected low- and moderate-income residents. Approximately 16% of the region's population can afford a median priced home, compared to 25% throughout California, and 57% nationwide.

Economic conditions and demographic trends are reflective of San Diego County according to information from the Chamber of Commerce of the four cities that comprise the bank's assessment area.

- Carlsbad is a high-growth and prosperous city located along a scenic coastline approximately 35 miles north of downtown San Diego. Carlsbad's growth management plan calls for residential, business, and industrial development and to provide a variety of community services. Current industries include tourism, light manufacturing, research and development, communications, and biotechnology. Major employers include Cobra Golf, Callaway, Taylor Made, Isis Pharmaceuticals, and Beckman Coulter. Carlsbad has a population of 78,247 according to the 2000 Census.
- San Marcos, originally agricultural and dairy land, became the third fastest growing city in California in the 1980s. The population doubled during the 1990s to now more than 53,000 residents. Retail, resorts, and service industries dominate the economy.
- Oceanside is a beach community with more than 3 miles of coastline and it is the northernmost coastal city in San Diego County. The federal government purchased much of the original land grant in 1942 to establish Camp Pendleton Marine Base. Oceanside has continued to grow with the influx of military, tourism, retail, and light industry in numerous and sprawling industrial parks. Coca-Cola, Ashworth, and Biogen Idec are the largest employers.
- The City of Vista, incorporated in 1963, was once a sprawling area of citrus groves. It is a growing and largely moderate-income area, with plans to redevelop and revitalize the "Santa Fe/Mercantile Corridor" (shops and restaurants).

In conjunction with this CRA examination, we contacted representatives from a community services organization to learn about credit opportunities within the community and how well financial institutions address identified credit and service needs. The contact identified affordable housing as a critical and ongoing need for ownership and for renters. The contact also identified the need for job training and employment opportunities for low- and moderate-income persons, particularly at-risk youth. We concluded that there is also a need for small loans to small businesses in the area based on our knowledge and other contacts with community members knowledgeable about the MSA.

Please refer to the bank's CRA public file for more information about the assessment area.

CONCLUSIONS ABOUT PERFORMANCE CRITERIA

LOAN-TO-DEPOSIT RATIO

FNBNC's level of lending is reasonable given its size, the credit needs of the assessment area, and its comparison to peer bank averages. The bank's loan-to-deposit ratio meets the standard for satisfactory performance.

We analyzed the average quarterly loan-to-deposit ratio from the bank's last CRA examination through December 2004 covering 22 quarters. During this period, the bank's ratio averaged 79%.

We compared the bank's ratio with that of peer banks in the San Diego area with similar demographics, asset size, and lending products. The average quarterly loan-to-deposit ratio for the peer group was 78 % compared to FNBNC's ratio of 79%. The peer group consisted of five financial institutions, ranging in total asset size from \$39 million to \$168 million.

LENDING IN ASSESSMENT AREA

The bank originated a majority of its loans within the assessment area and it meets the standard for satisfactory performance.

For this analysis, we focused our sample on the bank's major loan product, which is business lending. We randomly sampled 40 commercial loans the bank originated during the evaluation period from January 2003 through December 2004. In order to meet the standard of performance for this criterion, a bank needs to originate at least 50% of the number of loans and 50% of the dollar volume within its defined assessment area. We found that FNBNC originated 60% of the number of loans and 53% of the dollar volume within its assessment area. Therefore, the bank's lending within the assessment area meets the standard for satisfactory performance.

LENDING TO BORROWERS OF DIFFERENT INCOMES AND TO BUSINESSES OF DIFFERENT SIZES

FNBNC's lending to businesses of different sizes within the assessment area compares similarly with area demographics and meets the standard for satisfactory performance.

We focused our sample on the bank's major loan product, which is business lending. From our original random sample of 40 loans, we analyzed 24 commercial loans the bank originated within the assessment area during the evaluation period from January 2003 through December 2004. We combined the data for both years to evaluate the bank's lending to businesses with revenues of different sizes as our analysis of demographic data showed no measurable differences between the comparison years of 2003 and 2004.

We found that the bank's pattern of lending to businesses of different sizes compares similarly to area demographics and compares especially well based on the number of loans the bank granted to small businesses. Small businesses are defined as those with gross revenues of \$1 million or less. The dollar volume of loans granted to small businesses is somewhat less by percentage compared

to the demographic. We gave greater consideration to the number of loans, which indicated the bank is serving the credit needs of small businesses. This was an identified need in the assessment area. Table 2 reflects the bank's lending to businesses of different sizes based on our sample.

Table 2

Income Distribution of Business Loans San Diego Assessment Area (AA) Years 2003 and 2004		
Business Revenues	≤\$1,000,000	>\$1,000,000
% of Businesses in AA*	66%	7%
% of Bank Loans in AA by #	71%	29%
% of Bank Loans in AA by \$	62%	38%

* Demographic Data Source: 2004 Dun & Bradstreet (27% of AA businesses did not report revenue data)

GEOGRAPHIC DISTRIBUTION OF LOANS

FNBNC's pattern of lending in moderate-income census tracts does not compare favorably with area demographics. The bank's geographic distribution of loans does not meet the standard for satisfactory performance.

For this analysis, we used the same sample of 24 business loans described above. The demographics showed that 29% of businesses in the assessment area are located in moderate-income census tracts, and the bank originated only 4% of the sampled loans to businesses in those areas.

Bank management explained that the demand for business loans from moderate-income areas has been weak. Management plans to assess lending opportunities in the moderate-income census tracts and reasonably address identified credit needs. Table 3 compares the percentage of the bank's number of business loans to the percentage of businesses in the area by census tract type.

Table 3

Geographic Distribution of Loans to Businesses San Diego Assessment Area (AA) Years 2003 and 2004								
Census Tract Income Level	Low		Moderate		Middle		Upper	
	% of Number of Business Loans	% of AA Businesses	% of Number of Business Loans	% of AA Businesses	% of Number of Business Loans	% of AA Businesses	% of Number of Business Loans	% of AA Businesses
	0%	0%	4%	29%	58%	37%	38%	34%

Demographic Data Source: 2004 Dun & Bradstreet Business Data, 2000 U.S. Census Tract Data

RESPONSES TO COMPLAINTS

The bank has not received any public complaints associated with its performance under the provisions of the Community Reinvestment Act during the evaluation period.

FAIR LENDING OR OTHER ILLEGAL CREDIT PRACTICES REVIEW

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