

STATE OF NEW JERSEY



DEPARTMENT OF BANKING AND INSURANCE DIVISION OF BANKING

COMMISSIONER'S DECISION AND ORDER

**IN THE MATTER OF THE APPLICATION OF PENN BANCSHARES, INC.,
PENNSVILLE, SALEM COUNTY, NEW JERSEY, TO ACQUIRE UP TO
24.89 PERCENT OF THE OUTSTANDING COMMON STOCK OF HARVEST
COMMUNITY BANK, PENNSVILLE, SALEM COUNTY, NEW JERSEY.
(CC-38)**

I have reviewed the proposed application for acquisition of stock submitted by Penn Bancshares, Inc. (the "Applicant" or "Penn Bancshares"), Pennsville, Salem County, New Jersey. The Applicant seeks permission to obtain up to 24.89 percent of the voting shares of Harvest Community Bank ("Harvest"), Pennsville, Salem County, New Jersey.

The Department of Banking and Insurance (the "Department") accepted this application on January 9, 2006. Notice of this application appeared on the Department's website on January 16, 2006, as required by *N.J.A.C. 3:13-1.2(b)*. The New Jersey Bankers Association and the New Jersey League of Community Bankers were advised in writing. Additionally, the Office of Thrift Supervision and the Northeastern District Office of the Comptroller of the Currency were informed. Notice was also published in *Today's Sunbeam* on January 11, 2006, as prescribed by *N.J.S.A. 17:9A-412c(1)*. The Department has received written objections from Harvest, two members of the public, and an employee of Harvest in connection with this application within the established comment period. Another financial institution commented and "urged the Department to thoroughly study both banks' operations and their long-term objectives" and "be

guided by what would be in the best interests of the consumers and businesses that we all attempt to serve in our communities.” Objections to this and similar applications must be filed with the Department within 10 days after the last publication. In this instance, comments were due no later than January 26, 2006. The Department received additional correspondence after the close of the comment period that were not considered in the decision process.

Materials Considered

In my review of the proposed acquisition of shares of Harvest Community Bank, I considered the information supplied pursuant to *N.J.S.A. 17:9A-409 et seq.* which is as follows:

- The application filed by Penn Bancshares, Inc. that was accepted by the Department on January 9, 2006 including all documents filed in accordance with the provisions of *N.J.A.C. 3:13-1.2 et seq.*;
- The application from Penn Bancshares to the Federal Reserve Board of Governors dated September 19, 2005, and related attachments;
- A packet of 73 comments from Harvest Community Bank, local politicians, and the general public to the FRB commenting on the application to that agency;
- An objection filed by Harvest Community Bank dated January 20, 2006, received by the Department on January 23, 2006, with Exhibits;
- An objection filed on behalf of Harvest Community Bank dated January 20, 2006, received by the Department on January 23, 2006, by Gary Green, Esq. of the law firm of Archer & Greiner;
- Four comments/objections filed by others prior to the deadline of January 26, 2006;
- Correspondence from the Applicant dated February 24, 2006, responding to the objections received;
- Examination reports for Harvest Community Bank and Pennsville National Bank performed under the Community Reinvestment Act (“CRA”); and

- Quarterly Call Report filings by Harvest Community Bank and Pennsville National Bank to the Federal Financial Institutions Examination Council (“FFIEC”).

Harvest has requested that a hearing be held on this matter. N.J.S.A. 17:9A-414b allows the commissioner discretion as to holding a hearing. However, after a review of the application and other materials available to this Department, I find that a hearing is not necessary. The record is full and provides an ample basis for reaching a decision. I considered the 73 objections received by the FRB as part of Penn Bancshares’ application to it, and considered the four objections/comments received timely by the Department. These have given me a full sense of the objectors’ points of view and eliminate the need for a public hearing to supplement the record.

Among the items considered in my review are the September 19, 2005 application by Penn Bancshares to the Board of Governors of the Federal Reserve System (“FRB”) to acquire up to 24.89% of the outstanding shares of Harvest, and the FRB’s approval of said application via an Order Approving Acquisition of Shares of a Bank Holding Company (“Order”) dated December 19, 2005. While approving the proposal, the FRB Order contained an Appendix that cited eleven (11) conditions designed to ensure that Penn Bancshares would honor its commitment to remain as a passive investor. The FRB Order cited financial, managerial, and supervisory considerations; competitive considerations; and convenience and needs considerations as the areas that were reviewed.

The FRB Order notes the 73 comments it received on the proposal, and that many of the commenters objected to the proposal on the ground that it could hurt the future prospects of Harvest. Other comments expressed concern that competition and the convenience and needs of the communities Harvest serves might be adversely impacted.

Regarding financial, managerial, and supervisory considerations, the FRB noted that Penn Bancshares, and its subsidiary bank, Pennsville National Bank ("Pennsville National") were well capitalized, and would remain so on consummation of the proposal. Managerial strength was noted at Penn Bancshares, Pennsville National, and Harvest. Neither of the banking institutions involved had existing supervisory issues.

As to the issue of competitive considerations, the FRB reviewed the proposal based on its potential impact on the Philadelphia banking market ("Philadelphia Market"), which is defined as Burlington, Camden, Cumberland, Gloucester, and Salem Counties in New Jersey and Bucks, Chester, Delaware, Montgomery, and Philadelphia Counties in Pennsylvania. The Order notes that in 2004, 25 percent of the total number of small business loans made in Salem County were made by banks with no branches in Salem County, but with branches within the Philadelphia Market. On that basis, the FRB concluded that Salem County was part of the Philadelphia Market, and that the Philadelphia Market was the appropriate geographical area to consider in analyzing the competitive effects of the proposal.

Finally, in analyzing the effect of the proposal on the convenience and needs of the communities, the FRB considered the performance of both Harvest and Pennsville National under the CRA, the pledge of passive investment by Pennsville National regarding this proposal, data reported under the Home Mortgage Disclosure Act ("HMDA"), other supervisory information, and the public comments received on the proposal. Relying heavily on the CRA performance of Pennsville National, which was satisfactory, the FRB found the record to be consistent with approval.

The FRB applied federal law and federal standards. Although the analysis is helpful, the findings are in no way binding on my decision.

Analysis under New Jersey Law

N.J.S.A. 17:9A-413a provides that in deciding whether to approve an application for a proposed acquisition, I shall consider whether the proposed acquisition may:

- (1) be detrimental to the safety and soundness of the New Jersey bank or New Jersey bank holding company to be acquired;**
- (2) result in an undue concentration of resources or a substantial reduction of competition within this State; or**
- (3) have a significant adverse impact on the convenience and needs of the community or communities served by the New Jersey bank or New Jersey bank holding company.**

I will first consider whether the proposed transaction may have a significant adverse impact on the convenience and needs of the community served by Harvest. For purposes of this analysis under N.J.S.A. 17:9A-413a(3), I consider the appropriate community to be all of Salem County, New Jersey. All branches of both Harvest and Pennsville National are located within Salem County, and both banks are headquartered in the same municipality. Their branch networks are comparable, and they are of similar size. There are great overlaps in their respective trade areas. Both institutions use all of Salem County in their CRA assessment area, while Pennsville National also includes the southern portion of Gloucester County.

I noted that the FRB made its determination based upon the effect the proposed transaction will have on the Philadelphia market. This determination was based on federal law and supported in the FRB decision. During the Department's review of this matter under state law, it was determined that for purposes of the Department's analysis the market area to be considered as served by these institutions was much narrower than the Philadelphia market. This change in the analysis of the appropriate applicable market area for purposes of New Jersey law is critical. While the effect of the application on the Philadelphia area as a whole is *de minimus*, the proposed combination would seriously impact services to the Salem County community. Salem County has historically lagged behind most of the other counties in New Jersey in

economic growth. The need for the continuance of small business lending in the Salem County community is critically important to the viability and continued development of this area.

Harvest is a relatively new institution, having opened for business in January 2000. I note that Harvest's loans-to-deposits ratio has been strong and loan volume has steadily increased over the last five years. Pennsville National has been in business since 1969. During the same five-year period Pennsville National's loans-to-deposits ratio and loan volume have been at a low level and have remained relatively flat. As of December 31, 2005, Harvest reported a loans-to-deposits ratio of 76.2% while Pennsville National reported a ratio of only 39.8%. Harvest's lending practices have been active and progressive while maintaining low delinquencies and minimal loan charge-offs.

The following table was generated from the respective banks' financial reports filed with the FFIEC:

Year Ended	Harvest		Pennsville National	
	Total Loans (000s omitted)	Ratio of Loans-to- deposits	Total Loans (000s omitted)	Ratio of Loans-to- deposits
12-31-01	\$25,948	82.6%	\$63,132	40.0%
12-31-02	\$49,116	84.9%	\$68,844	45.9%
12-31-03	\$55,903	78.7%	\$59,756	39.8%
12-31-04	\$75,484	75.5%	\$59,953	38.0%
12-31-05	\$99,849	76.2%	\$62,388	39.8%

The table presented indicates a pronounced difference in lending patterns. My review of the most recent CRA examinations of both Harvest and Pennsville National finds that the institutions define similar assessment areas but differ in their primary business focus. Harvest has focused much of its lending in commercial loans, primarily small business loans. Pennsville National's

primary business focus is residential mortgage lending. A recurrent theme that runs through the objection letters is a concern that the needs of the community for small business loans continues to be met by Harvest.

A review of the data submitted to the FFIEC at the most recent filing date, December 31, 2005, shows substantial differences in the volume of lending between Harvest and Pennsville National, both in total and by loan type. Harvest had loans outstanding of \$99.8 million, or 70.2% of total assets and 76.2% of deposits. Pennsville National had loans outstanding of \$62.4 million, or 38.0% of total assets and 39.8% of deposits.

The following table shows the balances by loan type, and illustrates the differences between the two institutions:

As of 12-31-05 Loan Type	Harvest		Pennsville National	
	Amount (000s omitted)	% of Total Assets	Amount (000s omitted)	% of Total Assets
Loans secured by real estate:				
Construction and land loans	\$ 2,815	2.0%	\$ 340	0.2%
Secured by farmland	2,461	1.7%	0	N/A
Secured by 1-4 family residential properties	28,139	20.0%	45,705	27.8%
Secured by multi-family properties	3,040	2.2%	0	N/A
Secured by commercial real estate	36,838	26.1%	9,225	5.6%
Loans to finance agricultural loans and other farm loans:	171	0.1%	0	N/A
Commercial and industrial loans:	24,288	17.2%	1,453	0.9%
Loans to individuals for household purposes:	2,093	1.5%	1,401	0.9%
Obligations of states and political subdivisions:	0	N/A	4,264	2.6%

As of December 31, 2005, Harvest had loans outstanding either secured by commercial real estate or made for commercial or industrial purposes of \$61.1 million, or 43.3% of total assets. At the same date, Pennsville National had only \$10.7 million, or 6.5% of total assets invested in loans made for commercial real estate or commercial and industrial loans.

Harvest, since its inception, has been making increasing levels of credit available, particularly credit for commercial loans and small business loans, and even some agricultural loans. Pennsville National concentrates its lending activities in making real estate loans secured by 1-4 family residential properties. As I previously noted, Pennsville National's lending has been relatively flat over the last five years. The community of Salem County has demonstrated a need for commercial and small business loans as evidenced by Harvest's finding and servicing a demand for such loans.

As a result of my review I find that Pennsville National is not providing all of the types of loans nor the amount of loans that consumers in the community of Salem County need. Those consumers will be better served if Harvest's current philosophy of actively providing credit for commercial and small business growth is continued and not stifled. Harvest needs to be allowed to continue to grow so it can continue to service its community.

When the FRB considered the issue of whether approval of this application may be detrimental to the safety and soundness of Harvest, it relied upon submissions made by the Applicant that this investment will be passive in nature and that no steps will be taken to assert influence over the operation of Harvest. From the Applicant's submissions, the FRB set forth eleven specific conditions in its Order designed to ensure that the assertions by the Applicant are adhered to and that no influence will be asserted on the operation of Harvest.

Despite the conditions set forth in the FRB Order and the Applicant's statements that this investment would be passive in nature, there are still opportunities for Penn Bancshares to exert influence over the operation of Harvest, merely by taking no action. For example, N.J.S.A.

17:9A-116 *et seq.* requires that two-thirds, or a "super majority" of stockholders approve any amendments to a bank's Certificate of Incorporation. Such a change in the Certificate of Incorporation will be necessary if Harvest needs to increase the amount of authorized stock in the future. Given the nature of its lending patterns and growth rates, Harvest may well need to issue stock in the future to raise additional capital so it can grow and service the community. Penn Bancshares could, by merely doing nothing, deprive Harvest its ability to raise capital by issuing additional shares of stock and thus deprive Harvest of its ability to continue to service the community. Penn Bancshares by doing nothing could stifle Harvest's growth.

I also note that N.J.S.A. 17:9A-27.50 *et seq.* requires that two thirds of all stockholders approve any stock option plan for the benefit of a bank's employees. Such stock option plans are common practice in New Jersey, and failure to be able to provide such incentive could restrict Harvest's ability to recruit and retain qualified managers and employees. Harvest is a growing institution and will need to recruit additional management personnel. By not participating in votes for stock option plans, Bancshares could deny Harvest the ability to offer incentives in the form of stock options. This could stymie Harvest's ability to recruit and retain qualified personnel, and, ultimately, its ability to continue to grow.

As Harvest is a direct competitor of the Bancshares' subsidiary bank, it is reasonable to conclude that Bancshares might benefit from placing limitations on the growth and success of Harvest, and could influence the placement of those limitations without directly violating any of the FRB's conditions.

Based on my review of the application, subsequent submissions made to the Department by the Applicant and Harvest, the public comments submitted to the Department within the designated comment period, the information supplied to the Department by the FRB, and a review of all other pertinent public records, I find that the approval of this application may have a significant adverse impact on the convenience and needs of the community, namely, Salem

County. As a result of this finding, I have not considered whether approval of this application would be detrimental to the safety and soundness of Harvest except as it affects the ability of Penn Bancshares to influence Harvest, nor have I considered the reduction of competition. Therefore, in accordance with N.J.S.A. 17:9A-413a(3), I hereby deny the application by Penn Bancshares, Inc. for approval to acquire more than 5% of the outstanding stock of Harvest Community Bank.



Steven M. Goldman
Commissioner

Dated: 3/21/06