

PUBLIC DISCLOSURE

February 1, 1999

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**Hawthorn Bank
33566**

**208 Oak Creek Plaza
Mundelein, Illinois 60060**

**Federal Deposit Insurance Corporation
Division of Compliance and Consumer Affairs
Chicago Regional Office**

**500 W. Monroe, Suite 3300
Chicago, Illinois 60661**

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 of **Hawthorn Bank** prepared by the Federal Deposit Insurance Corporation, the institution's supervisory agency, as of **February 1, 1999**. The agency rates the CRA performance of an institution consistent with the provisions set forth in Appendix A to 12 CFR Part 345.*

INSTITUTION RATING

INSTITUTION'S CRA RATING: This institution is rated Satisfactory.

Hawthorn Bank's lending performance is reasonable. To make this determination, a sample of commercial real estate and commercial/industrial loans were analyzed. The distribution of loans to borrowers of different income levels (based on annual business revenue) is acceptable. A majority of loans are originated within the assessment area and a reasonable loan-to-deposit ratio is maintained.

No evidence of discrimination or other illegal credit practices were noted. Management is in compliance with the substantive provisions of the anti-discrimination laws.

DESCRIPTION OF INSTITUTION

Hawthorn Bank is a one-office commercial bank located in Mundelein, Illinois. The bank opened in February 1992, and is a subsidiary of Hawthorn Corporation, a one-bank holding company. The holding company was formed on August 31, 1998. Mundelein is located in central Lake County, approximately 35 miles northwest of downtown Chicago and approximately 20 miles north of Chicago's O'Hare International Airport. As of December 31, 1998, total assets were \$54,484,000, with total liabilities of \$50,665,000, and total deposits of \$47,899,000. Since the last Community Reinvestment Act (CRA) Performance Evaluation, total assets have increased 76 percent and net loans have increased 125 percent. Earnings are positive with an annualized return-on-assets of .50 percent.

The one office has a drive-up teller and an automated teller machine. A variety of deposit and loan products are offered. Deposit accounts include checking, savings, and money market accounts. Credit products range from personal to commercial loans. Products are generally targeted toward small and medium sized, closely held, commercial/industrial enterprises. Loans via the Small Business Administration are offered. The following chart provides the loan portfolio's composition as of December 31, 1998. At 73 percent, commercial real estate and commercial/industrial loans represent the largest portion of the loan portfolio.

Table 1

Loans	Dollar Amount (000)	Percentage
Construction	\$1,524	4%
Commercial Real Estate	\$15,350	40%
Multifamily	\$326	1%
1 to 4 Family Residential	\$4,122	11%
Home Equity	\$2,489	6%
Commercial/Industrial	\$12,602	33%
Other Loans to Individuals	\$544	1%
Other Loans and Leases	\$1,457	4%
<i>GROSS LOANS</i>	<i>\$38,414</i>	<i>100%</i>

DESCRIPTION OF THE ASSESSMENT AREA

A Glossary for terms used in this evaluation is included at the end of this report.

CRA requires that financial institutions define an assessment area within which lending efforts will be concentrated. This provides a context for the Federal Deposit Insurance Corporation to evaluate performance under CRA. A broad range of demographic, economic, and community specific information about the assessment area is considered during the evaluation. CRA requires that the assessment area (1) consist of whole geographies, (2) not arbitrarily exclude low- or moderate-income census tracts, and (3) not exceed metropolitan statistical area (MSA) boundaries. The assessment area meets these requirements.

The assessment area includes 363 census tracts in Cook, Lake, McHenry, and Kane Counties. The assessment area general extends from Devon Avenue (in the City of Chicago) to the south, Lake Michigan to the east, the Wisconsin border to the North, and Route 47 to the west. The assessment area includes 9 low-income, 25 moderate-income, 145 middle-income, and 184 upper-income census tracts. The assessment area does not arbitrarily exclude any low- or moderate-income areas. Table 2 provides demographic and economic characteristics of the assessment area. The chart compares the assessment area to the Chicago Metropolitan Statistical Area (1600).

Table 2

Demographic & Economic Characteristics of the Assessment Area and Chicago MSA		
	<i>Assessment Area</i>	<i>Chicago MSA 1600</i>
Total Population	1,885,152	7,410,858
1998 Estimated Median Family Income		\$59,500
<i>Percentage of Families by Income Level:</i>		
Low-Income	11%	20%
Moderate-Income	14%	17%
Middle-Income	24%	24%
Upper-Income	51%	39%
Families Below the Poverty Level	3%	9%
Median Housing Value	\$140,866	\$108,960
Median Housing Age	34 years	45 years
<i>Percentage of Total Housing Units:</i>		
1-4 Family Residential Units	73%	70%
Multi-Family Units	25%	29%
Mobile Homes and Other	2%	1%
Gross Rent Median	\$601	\$492
Owner-Occupied Housing Units	68%	57%
Rental Housing Units	28%	37%
Vacant Housing Units	4%	6%

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

Sampling:

To assess lending performance, a sample of originated loans are reviewed. The sample is selected from the largest number of loan originations (by number and dollar volume). Commercial and commercial real estate loans represent the largest number of originations by both number and dollar volume. Sixty seven loans originated in 1998 were selected via random statistical sampling. Random statistical sampling is a procedure where each loan has a known, non-zero probability of being selected.

Lending In the Assessment Area:

The aforementioned sample of loans is used to estimate the percentage (by number and dollar amount) of loans originated within the assessment area. The loans within the assessment area are then used for additional analysis. By both number and dollar amount, 66 percent of originated loans are within the assessment area. This majority is acceptable for CRA.

Lending to Businesses of Different Sizes:

For commercial loans, annual revenue is used to assess lending to borrowers of different income levels. Table 3 illustrates that loans are originated to businesses of all sizes. Performance is in line with the general business strategy of serving small to medium sized businesses. Several loans are to new businesses or businesses opened less than three years. Additionally, the number of loans to businesses with annual revenue over \$1,000,000 include equipment loans to manufacturers, working capital lines to local partnerships and sole proprietorships, as well commercial loans to real estate developers.

Table 3

Distribution of Commercial loans by Business Annual Revenues				
Gross Annual Revenue (000)	Number of Loans	Percent	Dollar Volume of Loans (000)	Percent
<i>Less than \$100</i>	9	20%	\$1,358	13%
<i>\$101 to \$250</i>	13	30%	\$3,197	31%
<i>\$251 to \$500</i>	6	14%	\$2,162	21%
<i>\$501 to \$1,000</i>	5	11%	\$1,637	16%
<i>Greater than \$1,000</i>	11	25%	\$2,002	19%
<i>Totals</i>	44	100%	\$10,356	100%

In addition to analyzing credits based on revenue, commercial loan originations are also reviewed based on the origination amount. According to federal regulations, a loans with an original balance of less than \$1,000,000 is a small business loan. Using this definition, 95 percent of the loans within the assessment area are small business loans. This also reflects a willingness to serve customers with small credit needs. Table 4 illustrates that a substantial majority loans have origination amounts less that \$500,000.

Table 4

Commercial Loans by Origination Amount		
Original Balance (000)	Number	Percentage
Less than \$100	14	32%
\$101 to \$250	18	40%
\$251 to \$500	8	18%
\$500 to \$1,000	2	5%
Over \$1,000	2	5%
<i>Total</i>	<i>44</i>	<i>100%</i>

Geographic Distribution of Loans:

Dispersion of loans within the assessment area is reasonable. This dispersion is presented in Table 5. This table includes the number of census tracts in the assessment area for each income category (based on 1990 U.S. Census data).

Of the nine low-income census tracts, six have little (e.g. less than 20 individuals) or no population. Two of the nine low-income tracts are located in Lake County several miles from the bank and have a combined population of 5,000. The last low-income census tract is located on the far northeast side of Chicago over 25 miles from the main office. The 25 moderate income tracts are scattered randomly throughout the assessment area and are not within the immediate vicinity of the bank. The moderate tracts are located in Waukegan, Zion, Round Lake, Chicago's Rogers Park Neighborhood, and the City of Evanston.

Since 91 percent of the tracts within the assessment area are middle- and upper-income geographies, a significant majority of loans within these two categories is reasonable. Approximately 20 percent of the loans are in the same upper-income census tract as the bank or the adjacent upper-income tracts. Most of the other loans have been originated in the middle- and upper-income tracts to the south and east of the bank.

Considering the composition of the assessment area and the geographic distribution of the low- and moderate-income tracts, the geographic loan dispersion is reasonable.

Table 5

Distribution of Loans by Income Category of Census Tract				
<i>Census Tract Income Category</i>	<i>Census Tracts</i>		<i>Commercial Loans</i>	
	Number	Percentage	Number	Percentage
<i>Low</i>	9	2%	0	0%
<i>Moderate</i>	25	7%	1	2%
<i>Middle</i>	145	40%	9	21%
<i>Upper</i>	184	51%	34	77%
<i>Total</i>	363	%	44	100%

Loan-to-Deposit Ratio:

The loan-to-deposit ratio is reviewed to assess the level of lending. This ratio is reviewed quarterly since the last CRA Performance Evaluation. Since the last evaluation, the loan-to-deposit ratio has ranged from 68 percent to 81 percent and averaged 73 percent. Since the last CRA Performance Evaluation, loan growth (at 125 percent) has out paced deposit growth (at 69 percent). The level of lending is restricted by deposit growth.

Competition within the assessment area is also strong. Competition includes several large regional as well as locally owned and managed institutions. No one institution is considered similarly situated based on products, business focus, charter, and asset size.

Response to Complaints:

No CRA complaints have been received since the last CRA Performance Evaluation.

Compliance with Anti-discrimination Laws and Regulations:

No violations of the substantive provisions of the anti-discrimination laws and regulations were identified during the evaluation.

GLOSSARY

Census tracts are small subdivisions of metropolitan or other relatively densely populated counties. They usually have between 2,500 and 8,000 persons and their physical size varies depending on population density. Census tracts are designed to be homogeneous with respect to population characteristics, economic status, and living conditions to allow for statistical comparisons.

Family includes a householder and one or more other persons living in the same household who are related to the householder by birth, marriage, or adoption.

Householder includes in most cases the person or one of the persons in whose name the home is owned, being bought, or rented.

Median divides a set of values into two equal parts, one-half above and one-half below the median.

Median Family Income divides the income distribution of families into two equal parts, one having incomes above the median and the other having incomes below the median. Median family income is then used to derive four income categories (low-, moderate-, middle-, and upper income). These income categories are defined as:

Low-income: Individuals and geographies having a median family income less than 50 percent of the area median income.

Moderate-income: Individuals and geographies having a median family income of at least 50 percent and less than 80 percent of the area median income.

Middle-income: Individuals and geographies with a median family income of at least 80 percent and less than 120 percent of the area median.

Upper-income: Individuals and geographies with a median family income of 120 percent or more of the area median income.

Metropolitan Statistical Area (MSA) is a metropolitan area with economic and social ties.

U.S. Small Business Administration (SBA) was created by Congress in 1953 to help America's entrepreneurs form successful small enterprises. Today, SBA's program offices in every state offer financing, training, and advocacy for small firms.