

PUBLIC DISCLOSURE

April 19, 2004

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

First State Bank of Round Lake
RSSD# 944841

1777 North Cedar Lake Road
Round Lake Beach, Illinois 60073

Federal Reserve Bank of Chicago

230 South LaSalle Street
Chicago, Illinois 60604-1413

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.

TABLE OF CONTENTS

Institution’s CRA (Community Reinvestment Act) Rating..... 1

Description of Institution..... 1

Description of Assessment Area 2

Conclusions with Respect to Performance Criteria: 5

 Loan-To-Deposit Ratio..... 5

 Lending in the Assessment Area 6

 Lending To Borrowers of Different Incomes and to Businesses of
 Different Sizes..... 6

 Geographic Distribution of Loans 8

 Response to Complaints 9

Fair Lending..... 9

Appendix A..... 10

INSTITUTION'S COMMUNITY REINVESTMENT ACT (CRA) RATING: This institution's performance is rated **satisfactory**.

First State Bank of Round Lake has provided credit consistent with its size, financial capacity, location, economic conditions, and competitive factors within its assessment area. The bank has accomplished these efforts through the origination of commercial and small business loans, real estate loans and consumer loans. First State Bank of Round Lake's loan-to-deposit ratio is slightly below peer, yet meets the standards for satisfactory performance. The bank's level of lending within its assessment area also meets the standards for satisfactory performance. Of loans made within the assessment area, the bank has shown a reasonable level of lending to borrowers with different incomes and to businesses of different revenue levels. In addition, the geographic distribution of the bank's loans demonstrates the bank's willingness to extend credit throughout its assessment area. The examination revealed no patterns or practices intended to discriminate or discourage loan applications from any member of a protected class. No CRA-related complaints have been received by the bank or this Reserve Bank during the scope of the examination.

The institution was rated **outstanding** under the CRA at its previous evaluation conducted by the Federal Deposit Insurance Corporation on April 15, 1999.

DESCRIPTION OF INSTITUTION

The First State Bank of Round Lake is a wholly owned subsidiary of Northern States Financial Corporation, as of January 1, 2004. The lending function is centralized at the main bank, located at 1777 North Cedar Lake Road, Round Lake Beach. A full service branch is located at 301 Goodnow Boulevard, Round Lake, IL. Drive-up and automated teller machine (ATM) services are available at both offices. The bank has four ATMs (two full service and two cash-dispensing). One of the cash-dispensing machines is an office-premise ATM located at 701 West Railroad Avenue, Round Lake.

According to the Uniform Bank Performance Report, the bank had \$108,054,000 in total assets as of December 31, 2003. The bank's primary focus is retail banking, offering products and services designed to meet the unique credit needs of its growing community. The bank currently offers three types of checking accounts, statement and passbook savings, money market deposit accounts, certificates of deposit and IRA investment products. Products offered are competitively priced with reasonable term options.

Credit products offered by the bank include commercial and industrial, real estate, agricultural, and consumer loans. Consumer loan products include personal, automobile and single-payment loans, residential real estate loans, overdraft, and home equity lines of credit. The bank recently consolidated its deposit product offering in an effort to streamline the deposit function and provide customers with easy-to-understand deposit product options. Additionally, the bank introduced the First Reserve PRA product (overdraft line of credit) since the previous examination, to accommodate consumers growing credit needs.

According to the Uniform Bank Performance Report as of December 31, 2003, the bank's largest loan

products by dollar amount, as a percentage of gross loans and leases were real estate loans (79.12%), with the majority concentrated in commercial real estate loans; commercial and industrial loans (12.6%) and consumer loans (6.05%).

The bank's peer group includes all commercial banks with assets between \$100 and \$300 million, with two or fewer banking offices, and located in a metropolitan area. The bank's local competitors for loans and deposits include National City Bank (Illinois), Harris Bank (Chicago, IL), TCF Bank (Minnesota) and Guaranty Bank (Wisconsin). All four competitors are larger, non-local institutions with branches located within the Round Lake area, whereas First State Bank of Round Lake is a community bank.

No apparent factors were identified relating to the bank's financial condition, size, products offered, prior performance, or local economic conditions that would prevent the bank from meeting the credit needs of the community.

DESCRIPTION OF ASSESSMENT AREA

An institution's assessment area will include the towns, counties, or other political subdivisions where its branches are located and a substantial portion of its loans are made. Assessment area must consist of one or more geographies defined by block numbering areas (BNAs) or census tracts, which are statistical subdivisions of a county. Census tracts are primarily used in metropolitan areas, while BNAs are used in non-metropolitan areas. 1990 U.S. Bureau of Census data is used in this evaluation, unless stated otherwise.

First State Bank of Round Lake's assessment area, shown on the map in Appendix A, comprises portions of Lake County, including the villages of Round Lake, Round Lake Beach, Round Lake Heights, Round Lake Park, and the surrounding communities of Ingleside, Fox Lake, Lake Villa, Grayslake, and Antioch. The assessment area consists of thirty-one census tracts (one moderate-income, twenty-three middle-income and seven upper-income). The main bank is located in Round Lake Beach, Illinois, and the branch is located in Round Lake, Illinois. The main bank and the branch, as well as the off-premise cash-dispensing ATM are located in middle-income census tracts. The bank's overall assessment area has not changed since the previous examination. However, based on the 2000 U.S. census data, the number of tracts within the assessment area increased from 18 to 31.

Population Changes

The total population within the assessment area, according to 2000 U.S. Census data is 131,651 individuals. The assessment area has experienced steady population growth in the past ten years, which is evidenced by an approximate 44% increase in population. According to 1990 U.S. Census data, the assessment area population was 91,116 individuals.

Income Characteristics

Exhibit 1 compares the income levels for the assessment area to that of Lake County, the Chicago

Metropolitan Statistical Area (Chicago MSA) and the State of Illinois based on 2000 U.S. Census data. The 2000 U.S. Census data and the 2003 HUD adjusted median family income for the Chicago MSA and State of Illinois are \$65,600 and \$62,200, respectively.

Exhibit #1						
Distribution of Families by Income Level						
Location	Median Family Income(\$)	Percent of Families				
		Low	Moderate	Middle	Upper	Below Poverty Level
Assessment Area	\$66,761	12.6	16.7	27.0	43.7	3.2
Lake County	\$76,424	13.1	14.0	20.4	52.5	4.0
Chicago MSA	\$61,182	20.6	17.6	22.2	39.6	7.9
State of Illinois	\$55,545	20.0	18.1	22.9	39.0	7.8

Low-income is defined as less than 50% of median family income; moderate-income as 50% to less than 80% of median family income; middle-income as 80% to less than 120% of median family income; and upper-income as 120% or more of median family income.

Housing Characteristics and Affordability

According to 2000 U.S. Census data, 131,651 individuals reside in First State Bank of Round Lake’s assessment area. The assessment area includes a total of 48,669 housing units, of which 77.2% are owner-occupied, 16.6% are occupied rental units and 6.2% are vacant units. There are 897 housing units in the only moderate-income geography within the assessment area. Approximately 77.5% of these units are owner-occupied, 19.7% are renter-occupied, and 2.8% are vacant. In comparison, of the 35,456 housing units in middle-income geographies, 72.7% are owner-occupied, 20% are renter-occupied, and 7.3% are vacant. Additionally, of the 12,316 housing units in upper-income geographies within the assessment area, 90.2% are owner-occupied, 6.7% are renter-occupied, and 3.1% are vacant. The median age of housing stock in the assessment area is 23 years, compared to 26 years for Lake County, and the median housing value is \$154,484, compared to \$191,600 for Lake County.

Affordability ratios, developed by dividing the median household income by the median household value for a given area or groups of geographies, are helpful in comparing costs for different areas. An area with a high ratio generally has more affordable housing than an area with a low ratio. According to the 2000 U.S. Census data, the median household income for the assessment area and Lake County are \$61,461 and \$66,973, respectively. The affordability ratios for the assessment area and Lake County are 39% and 34%, respectively, indicating that housing is generally more affordable in the assessment area than in Lake County.

Labor and Employment

According to 2002 data provided by the U.S. Bureau of Labor Statistics, and the Illinois Department of Employment and Security, the most recent average unemployment rate as of February 2004 for

Lake County was 6.8%, which represents a .02% drop in unemployment during the past year. A community representative indicated that there has been a rise in the number of small business development opportunities in the assessment area over the past year. This may have contributed to the decrease in unemployment figures within the assessment area, as small business development usually provides job opportunities. The major employers in the bank's assessment area are listed in Exhibit 2.

Exhibit #2			
Major Employers in the Assessment Area			
Company	Location	Employees	Description
Baxter Laboratories	Round Lake	3,500	Hospital Equipment
Grieve Corporation	Round Lake	137	Industrial Ovens
Round Lake Area Schools	Round Lake	370	Education
Wal-Mart	Round Lake Beach	240	Retail
Super Kmart	Round Lake Beach	300	Retail

Source: Illinois Department of Commerce and Economic Opportunity

Community representatives indicated that local financial institutions are actively involved in the community and are adequately meeting the credit needs of the community. According to representatives, as the population continues to grow, so does the opportunities for bank involvement within the community. One representative identified a wide array of credit-related opportunities for bank involvement, including construction projects for business development, financing programs including affordable housing and low cost rehab loans, and economic development projects. Increasing marketing efforts and accessibility to credit for all segments of population were also mentioned as ways banking institutions could improve their overall effectiveness.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

Performance standards for small banks consist of the following, as applicable: the bank's loan-to-deposit (LTD) ratio, the percentage of loans and other lending-related activities located in the bank's assessment area, the record of lending to borrowers of different income levels and farms and businesses of different sizes, the geographic distribution of loans, and the record of taking action in response to written complaints. To determine CRA performance, the preceding standards are analyzed and evaluated within the assessment area context, which includes, but is not limited to, comparative analyses of the assessment area and the state and the non-metropolitan portions of the state demographic data on median income, nature of housing stock, housing costs, and other relevant data pertaining to the bank's assessment area.

Loan-to-Deposit Ratio

The bank's average loan-to-deposit ratio, calculated from data contained in the Consolidated Reports of Condition, was evaluated giving consideration to the bank's capacity to lend, competitor and peers' loan-to-deposit ratios, as well as demographic factors, economic conditions and lending opportunities present in the assessment area.

Review of the bank's LTD ratios, and those of its peer group and a sample of competitors, indicate that the bank meets the standards for satisfactory performance under this criterion. Exhibit 3 shows the comparison for the eight-quarters ending December 31, 2003.

Exhibit #3 – LTD Ratios

Exhibit #3									
LTD Ratios									
Bank Name, City, 12/03 Assets \$(Millions)	3/02 (%)	6/02 (%)	9/02 (%)	12/02 (%)	3/03 (%)	6/03 (%)	9/03 (%)	12/03 (%)	Avg.
First State Bank of Round Lake, \$108.1	74.5	74.0	72.8	73.3	72.0	69.3	67.5	71.6	71.9
Peer Group	75.1	78.3	79.5	78.9	78.6	78.2	79.3	81.2	78.6
National City (branch), Bannockburn, IL, \$20,336.3	85.9	89.7	102.4	107.0	94.1	61.2	60.2	58.1	82.3
Lakeland Community Bank Round Lake Heights, IL, \$166.0 (now branch of Harris Bank)	73.7	71.7	75.6	82.6	81.7	83.4	85.4	92.8	80.9
TCF Bank (branch) Wayzata, MN, \$11,422.8	114.7	109.7	109.9	109.0	104.6	106.4	108.6	111.6	109.3

Lending in the Assessment Area

To assess the extent of lending within the assessment area, the following were reviewed: Home Mortgage Disclosure Act (HMDA) data and commercial loans. The sample period for each loan product was January 1, 2003 to December 31, 2003. Information from the performance context, such as economic conditions present within the assessment area, loan demand, bank size, financial condition, branching network, and business strategies, were considered when evaluating the bank's performance.

Overall, mortgage and commercial lending within the bank's assessment area meets the standards for satisfactory performance under this criterion.

The majority of First State Bank of Round Lake's loans originated within the assessment area. The distribution of a sample of the bank's primary loan products, originated during the year ended December 31, 2003, is illustrated in Exhibit 4.

Exhibit #4			
Distribution of Loans in/out of Assessment Area (AA)			
Loan Type	Number of Loans		
	# in Sample	# in AA	% in AA
HMDA Reportable Loans	63	46	73%
Commercial Loans	50	33	66%
Totals	113	79	70%

Lending to Borrowers of Different Income Levels and to Businesses of Different Sizes

The distribution of loans among borrowers of different income levels was determined by reviewing Home Mortgage Disclosure Act (HMDA) data and commercial loans. The sample period for each loan product was January 1, 2003 to December 31, 2003. Small business loan data from June 30, 2003 Consolidated Report of Condition was also reviewed. Information from the performance context, such as economic conditions present within the assessment area, demographics, loan demand, bank size, financial condition, branching network, and business strategies, were considered when evaluating the bank's performance.

Given the demographics of the bank's assessment area, the loan distribution across borrowers of different income levels and businesses of different sizes meets the standards for satisfactory performance under this criterion.

The distribution of First State Bank of Round Lake's loans reflects reasonable penetration among borrowers of different income and revenue levels, as supported by a review of HMDA-reportable and commercial loans.

HMDA-Reportable Loans

Exhibit 5 shows the distribution of the sample of HMDA reportable loans originated between January 1, 2003 and December 31, 2003, by income level. As shown, the percent of loans to low- and moderate-income borrowers is 37%, which exceeds the percentage of low- and moderate-income families residing within the assessment area, at 29.3%. Overall lending to low- and moderate-income borrowers is considered strong based on economic and demographic conditions within the assessment area.

Exhibit #5		
Loan Distribution of HMDA-Reportable Loans by Income Level		
Income Level	Total Number of Loans	Percent of Total Loans*
Low	9	19.6%
Moderate	8	17.4%
Middle	11	23.9%
Upper	13	28.2%
Income data not known	5	10.9%
Totals	46	100.0%

* HUD's estimated 2002 median family income was used to determine the income level of the applicants.

Commercial Loans

The distribution of commercial loans reflects a reasonable penetration among business of different revenue sizes. The distribution of small business loans based on June 30, 2003 Consolidated Report of Condition, is shown in Exhibit 6. Additionally, a sample of commercial loans from the period January 1, 2003 through December 31, 2003, is shown in Exhibit 7.

Exhibit #6		
Distribution of Small Business Loans		
Original Dollar Amount	Outstanding Number	Outstanding Dollar Amount (000's)
Loans Secured by Non-Farm Nonresidential Properties		
Less than or equal to \$100,000	23	\$1,291
Greater than \$100,000 through \$250,000	35	\$4,210
Greater than \$250,000 through \$1 million	34	\$13,596
Total	92	\$19,097
Commercial and Industrial Loans		
Less than or equal to \$100,000	85	\$2,237
Greater than \$100,000 through \$250,000	30	\$1,737
Greater than \$250,000 through \$1 million	5	\$1,915
Total	120	\$5,889
Loans Secured by Non-Farm Nonresidential Properties and Commercial and Industrial Loans		
Grand totals	212	\$24,986

As Exhibit 6 shows, small business loan originations in the \$100,000 or less category represent 51% of the number and 14% of the dollar amount of small business loans. Small business loans represent 70% of the bank's commercial loan portfolio.

Exhibit #7		
Distribution of Commercial Loans - 2003 Sample		
Original Dollar Amount	Outstanding Number	Outstanding Dollar Amount (000's)
Less than or equal to \$100,000	13	\$501
Greater than \$100,000 through \$250,000	8	\$1,339
Greater than \$250,000 through \$1 million	11	\$5,051
Total	32	\$6,891

As Exhibit 7 shows, commercial loan in the \$100,000 or less category represent 40% of the number and 6% of the dollar amount of small business loans. Of these commercial loans, 97% were to businesses with annual revenues of \$1 million or less.

According to community representatives, area financial institutions are meeting the needs of local business owners.

Other Lending Related Activities

It should be noted that the bank has made considerable efforts to ensure that its marketing addresses all segments of the population within the assessment area. All signage within the bank is in both English and Spanish, to better meet the needs of the Spanish speaking population within the assessment area. In addition, the bank has many bi-lingual employees.

First State Bank of Round Lake provided \$500,000 in financing to assist the Village of Round Lake in a property rehab project. The goal of the project is to purchase single-family residential properties that have gone through foreclosure, rehab the properties, and resell them to generate community revenue and increase property value. To date, there are 300 such properties within the village, for which it incurs considerable costs in upkeep. The majority of lenders for these foreclosed properties are out of the area and they do not provide proper maintenance for these properties. This project provides the Village the financing necessary to buy, rehab, and resell the properties, thus diminishing the potential for blight on the community that could result if these properties remain vacant for a prolonged period of time.

Geographic Distribution of Loans

The distribution of lending among geographies of different income levels within the assessment area, particularly those defined as low- and moderate-income, was reviewed. To assess the bank's performance, the following were reviewed: Home Mortgage Disclosure Act (HMDA) data and commercial loan data. The sample period for each loan product was January 1, 2003 to December 31, 2003. Loans for which census tracts were unknown were not included in the analysis. Demographic characteristics of census tracts, such as housing types and income level, were considered in the evaluation.

The geographic distribution of the bank's lending is considered reasonable and meets the standards for satisfactory performance under this criterion. The bank's lending in differing geographies is reflective of the bank's thirty-one census tract assessment area, which is comprised of one moderate-income tract, twenty-three middle-income and seven upper-income tracts. The assessment area does not include any low-income tracts, nor does the bank appear to have arbitrarily excluded low- or moderate-income tracts from the assessment area.

Approximately 96.0%, or 44 of the 46 HMDA-reportable loans originated in middle-income census tracts; and 4.3%, or 2 of the 46 loans originated were in upper-income census tracts. No HMDA-reportable loans were made in moderate-income census tracts; however, this is not a concern at this time. The percentage of families in the assessment area that reside in the moderate-income census tract is 2%. Consequently, it could be viewed that there are limited opportunities for lending within this tract. In addition, the bank originated 8% of its 2002 HMDA-reportable loans within the moderate-income census tract.

Of the sampled commercial loans within the assessment area, 3% originated in a moderate-income census tract, 91% in middle-income census tracts and 6% in upper-income census tracts. By comparison, 3% of businesses with revenues less than 1 million are located in the moderate-income census tract. Lending to business in moderate-income geographies is consistent with the number of businesses located in moderate-income geographies.

Complaints

Neither the bank nor this Reserve Bank has received any CRA-related complaints since the previous evaluation.

Fair Lending

The bank is in compliance with the substantive provisions of the anti-discrimination laws and regulations, including the Equal Credit Opportunity and Fair Housing Acts. A sample of the bank's lending activity was reviewed to determine whether loan policies and lending standards were in compliance with the fair lending laws and regulations, and that these are being consistently applied to all applicants. No evidence of prohibited discriminatory or other illegal credit practices was detected.