



PUBLIC DISCLOSURE

July 05, 2016

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

The First National Bank of McHenry
Charter Number 15765

3814 West Elm
McHenry, IL 60050

Office of the Comptroller of the Currency

1700 East Golf Road
Suite 800
Schaumburg, IL 60173

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 supporting the rating of First National Bank of McHenry (FNBM) include:

- A majority of lending is originated inside the bank's assessment area (AA).
- The loan-to-deposit (LTD) ratio is reasonable given the bank's size, financial condition, and the credit needs of the AA.
- The borrower distribution of loans reflects excellent penetration among individuals of different income levels within the AA.

SCOPE OF EXAMINATION

Evaluation Period/Products Evaluated

This Community Reinvestment Act (CRA) examination assesses the performance of FNBM in meeting the credit needs of its community using Small Bank CRA examination procedures. The evaluation period for this assessment is November 29, 2010 through July 5, 2016.

The primary evaluation is performed under the lending test, which evaluates the bank's record of meeting the credit needs of its AA through lending activities. The review period for the lending analysis is January 1, 2014 through December 31, 2015.

The lending analysis includes a sample from the bank's primary lending products. Based on the loan portfolio composition and loan originations, we determined the bank's primary product to be residential real estate loans. We included a sample of consumer lending into our analysis per the bank's request. The consumer lending sample contained 64 loan originations during 2014 and 2015. We included all HMDA reportable loans from 2014 and 2015 in our lending analysis.

We used quarterly financial data since the last CRA evaluation to assess the loan-to-deposit (LTD) ratio. The average spanned 22 quarters dating from December 2010 through March 2016.

This examination included a determination of the accuracy of the bank's 2014 and 2015 Home Mortgage Disclosure Act (HMDA) Loan Application Registers. We accomplished this by reviewing a representative sample of HMDA loans reported during this time period. We identified no material errors in the sampled HMDA data. Based on that review, we determined the HMDA data to be reliable for use in assessing the bank's CRA performance.

We used the deposit information reported to the Federal Deposit Insurance Corporation as of June 30, 2015, to determine the bank's deposit market share and market presence within its AA.

DESCRIPTION OF INSTITUTION

FNBM is a \$159 million intrastate financial institution as of March 31, 2016, and a wholly owned subsidiary of First McHenry Corporation. The bank has no subsidiaries or affiliates. First McHenry Corporation is a one-bank holding company headquartered in McHenry, Illinois.

FNBM operates four full-service office locations. The main office and one branch are located in the county and city of McHenry. One branch is located in McHenry County in the Village of Richmond. The fourth branch is located in the Village of Island Lake, IL which is located in Lake County. There is an automated teller machine (ATM) located at each office location. FNBM offers traditional loan, deposit, and other bank services at each location.

The bank's lending activity consists primarily of residential real estate and consumer lending. As of March 31, 2016, gross loans and leases totaled approximately \$46 million or 29 percent of total assets. The loan portfolio was comprised of the following.

Table 1 – Loans By Category	\$ (000s)	Percent
Residential Mortgages	\$26,617	58%
Agriculture (including farmland loans)	\$688	2%
Commercial (including CRE, multifamily residential and non-residential construction loans)	\$17,158	37%
Consumer Loans	\$959	2%
Other Loans	\$259	1%
Total Gross Loans	\$45,681	100%

FNBM's primary focus is community banking, offering a variety of products and services to commercial and retail customers. Although residential lending continues to be the bank's primary loan source, consumer lending volume has increased.

FNBM's last performance evaluation under the Community Reinvestment Act was dated November 29, 2010. The bank's overall level of performance was rated "Satisfactory" under the Small Bank performance standards. The current performance evaluation is also being conducted using the Small Bank performance standards.

There are no legal, financial, or other factors that would hinder the bank's ability to help meet the credit needs in its AA.

During this assessment, we conducted two community contacts to help determine the credit needs and economic conditions within the area. The contacts indicated that the major credit needs in the local market are small business start-up lending, affordable housing developments, and general commercial and industrial credit. The contacts indicated although there is a large need for affordable housing development in McHenry County, there are other economic factors contributing to the lack of affordable housing development besides financing. The demand for affordable housing stems primarily from individuals in need of affordable rents. There is low demand from affordable housing developers for financing of affordable housing developments.

DESCRIPTION OF ASSESSMENT AREA(S)

FNBM's AA is comprised of portions of Lake and McHenry Counties in Illinois. Lake County is part of the Lake County-Kenosha County IL-WI Metropolitan Division (MD) and McHenry County is part of the Chicago-Naperville-Arlington Heights, IL Metropolitan Division (MD). McHenry and Lake Counties are adjacent to each other. The bank's AA meets the requirements of the CRA regulation and does not arbitrarily exclude any low- or moderate-income geographies.

The portion of the AA located in McHenry County consists of 17 census tracts (CT). The total population of the 17 CTs totaled 99,940 per the 2010 U.S. Census. There are no low- or moderate-income CTs in this AA. Nine middle-income CTs represent 53 percent of the McHenry County portion of the AA, with eight upper-income CTs comprising the remaining 47 percent. There were 26,667 families living in this AA of which 12 percent were low-income, 15 percent were moderate-income, and five percent live below the poverty level. The 2015 FFIEC adjusted median family income for the McHenry AA was \$77,700. The median housing value was \$250,156.

The portion of the AA located in Lake County Illinois consists of four CTs. The total population of the four CTs totaled 21,370 per the 2010 U.S. Census. Of the four CTs in this portion of the AA, three (75 percent) are middle-income and one (25 percent) is a moderate-income CT. There were 5,618 families in this AA of which 21 percent were low-income, 19 percent were moderate-income, and five percent lived below the poverty level per the 2010 U.S. Census. The 2015 FFIEC adjusted median family income for this AA was \$87,500. The median housing value in the Lake County AA was \$237,327.

More weight was given to the portion of the AA located in McHenry County than over the portion of the AA Lake County, as three of the four bank branches are located in McHenry County. Of the 49 loan originations in the AA reported on the HMDA LAR during the review period, 48 were originated in McHenry County compared to only one origination in Lake County. In addition, of the 51 consumer loans originated inside the assessment area during our review period only five consumer loans were originated in Lake County and the remaining 46 were originated in McHenry County.

As with other surrounding counties, the local economy has suffered due to the recession. The unemployment rates in McHenry and Lake Counties were 5.7 and 5.5 percent as of April 30, 2016, respectively, which was lower than the unemployment rate for Illinois of 6.2 percent, and is just slightly higher than the national unemployment rate. This area has shown several marked signs of recovery from the recession as development has increased but has not returned to pre-recession levels. There are several large industrial employers, in addition to the Centegra Northern Illinois Medical Center, located in the area. Despite the recent economic and residential market improvements since the 2010 census, McHenry County has seen a 1 percent loss in population based on 2015 population estimates. Additionally, many new businesses are entering the area and retrofitting existing buildings. The area is experiencing little single family residential construction.

Competition among financial institutions in the AA is strong. FNBM competes with several large national and regional banks that are well established in their AA. According to the Federal Deposit Insurance Corporation's June 30, 2015 deposit market share report, FNBM ranks 32nd among 53 financial institutions in the combined AA, with a 0.56% deposit market share.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

The bank's performance under the lending test is Satisfactory.

The bank's LTD ratio is reasonable. FNBM originates a majority of its loans inside the AA. The borrower distribution reflects excellent penetration. We found no evidence of discriminatory lending practices.

Loan-to-Deposit Ratio

FNBM's quarterly average LTD ratio is reasonable based on the bank's resources, capacity to lend, demographic and economic factors, the lending opportunities available in the AA, and the LTD's consistency with peer since the prior CRA review. FNBM's quarterly average LTD ratio for the period from December 31, 2010 through March 31, 2016 was 38.49 percent. During the period, the LTD ratio had a quarterly high of 52.55 percent and a quarterly low of 30.55 percent. The peer LTD ratio during the review period of nine similarly situated banks ranged from 34.95 percent to 85.85 percent. FNBM was ranked ninth out of ten in LTD when compared peer banks. The nine peer institutions are all independent community banks with total assets ranging from \$107 million to \$253 million and are located in the same vicinity as FNBM.

Lending in Assessment Area

FNBM originates the majority of its loans inside its AA. We included all HMDA loans and a sample of 64 consumer loans originated in 2014 and 2015. Based on the loans reviewed, 74.07 percent of the number of loans and 58.67 percent based on dollar amount of the bank’s lending was inside the AA, as illustrated by the table below.

Table 1 - Lending in the AA										
Type of Loan	Number of Loans					Dollars of Loans (000's)				
	Inside		Outside		Total	Inside		Outside		Total
	#	%	#	%		\$	%	\$	%	
Home Purchase	10	47.62%	11	52.38%	21	\$1,477	38.29%	\$2,380	61.71%	\$3,857
Home Improvement	12	70.59%	5	29.41%	17	\$478	71.56%	\$190	28.44%	\$688
Home Refinance	27	81.82%	6	18.18%	33	\$3,556	70.67%	\$1,476	29.33%	\$5,032
Consumer Loans	51	79.36%	13	20.64%	64	\$428	75.75%	\$137	24.25%	\$565
Total	100	74.07%	35	25.93%	135	\$5,939	58.67%	\$4,183	41.33%	\$10,122

Source: Data reported under HMDA and Loan Sample.

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

The bank’s distribution of lending among borrowers of different income levels reflects excellent penetration.

The bank’s lending activity within its designated AA reflects an excellent level of lending to low- and moderate-income borrowers. The substantial majority of the bank’s lending occurred in McHenry County, therefore more weight was given to the bank’s lending performance in the McHenry County portion of the AA. We did not analyze the bank’s performance in home purchase and home improvement lending as the volume of loans originated in these categories did not produce a large enough sample for a meaningful analysis. The bank extended 9 home purchase and 12 home improvement loans during the evaluation period. Please refer to table 2 for details.

Residential Lending

McHenry Chicago IL MD

FNBM’s distribution of residential home loan products demonstrates excellent penetration among borrowers of different income levels. The bank’s refinance lending to low-income borrowers is reasonable as the percentage of loans made to low-income borrowers is near the percentage of low-income families. The bank’s refinance lending

to moderate-income borrowers is excellent as the percentage of loans made to moderate-income borrowers exceeds the percentage of moderate-income families.

Table 2 – Borrower Distribution to Residential Real Estate Loans in the AA								
Borrower Income Level	Low		Moderate		Middle		Upper	
	% of AA Families	% of Number of Loans	% of AA Families	% of Number of Loans	% of AA Families	% of Number of Loans	% of AA Families	% of Number of Loans
Home Refinance	12.46%	7.69%	15.31%	42.31%	22.99%	19.23%	49.25%	30.77%

Source: HMDA Data (2014&2015)

Consumer Lending:

FNBM’s distribution of consumer loan products demonstrates excellent penetration among borrowers of different income levels. The bank’s consumer lending penetration to both low- and moderate-income borrowers is excellent as the bank’s consumer lending to low- and moderate-income borrowers exceeds the percentage of both low- and moderate-income households. Please refer to the following table for details.

Table 2B – Borrower Distribution of Consumer Loans in the AA								
Borrower Income Level	Low		Moderate		Middle		Upper	
	% of AA House holds	% of Number of Loans	% of AA House holds	% of Number of Loans	% of AA House holds	% of Number of Loans	% of AA House holds	% of Number of Loans
Consumer Loans	15.77%	36.96%	13.96%	23.91%	18.64%	21.74%	51.62%	17.39%

Source: Sample of 64 consumer loans originated in 2014 and 2015 and CRA Wiz Reports.

Lake-Kenosha County IL-WI MD

We did not perform an analysis of the bank’s lending to borrowers of different income levels in the Lake County portion of the AA. The volume of bank loans originated did not produce a large enough sample to perform a meaningful analysis. The bank extended one home purchase loan and five consumer loans to borrowers in Lake County during our review period.

Geographic Distribution of Loans

A geographic distribution was not performed on the McHenry Chicago MD as it contains no low- or moderate-income census tracts. Based on our limited-scope review, the bank's performance under the lending test for geographic distribution of the primary loan categories in the Lake County portion of the AA of the Lake IL – Kenosha WI MD is not inconsistent with the bank's overall lending test performance.

Responses to Complaints

FNBM has not received any written complaints about its performance in helping to meet the credit needs within its AA during this evaluation period. The OCC has not received any written comments, complaints, or inquiries concerning FNBM and its efforts to comply with the spirit and intent of the CRA.

Fair Lending or Other Illegal Credit Practices Review

Pursuant to 12 C.F.R. 25.28(c), or 12 C.F.R. 195.28(c), in determining a national bank's (bank) or Federal savings association's (FSA) CRA rating, respectively, the OCC considers evidence of discriminatory or other illegal credit practices in any geography by the bank or FSA, or in any assessment area by an affiliate whose loans have been considered as part of the bank's or FSA's lending performance.

We found no evidence of discriminatory or other illegal credit practices inconsistent with helping to meet community credit needs.