OLD SECOND BANCORP INC
Form 10-K
March 15, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

x	**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2006

OR

o	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission file number 0-10537

OLD SECOND BANCORP, INC.

(Exact name of registrant as specified in its charter)

Delaware	**36-3143493**
(State of Incorporation)	(IRS Employer Identification Number)

37 South River Street, Aurora, Illinois 60506
(Address of principal executive offices, including Zip Code)

(630) 892-0202
(Registrant s telephone number, including Area Code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Class	**Name of each exchange on which registered**
Common Stock, $1.00 par value	The Nasdaq Stock Market
Preferred Securities of Old Second Capital Trust I	The Nasdaq Stock Market

Securities registered pursuant to Section 12(g) of the Act:
None
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.

Yes o No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained to the best of registrant s knowledge, in definitive proxy or information statements incorporated by Reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer o Accelerated filer x Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2).

Yes o No x

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant, on June 30, 2006, the last business day of the registrant s most recently completed second fiscal quarter, was approximately $383 million*. The number of shares outstanding of the registrant s common stock, par value $1.00 per share, was 13,110,423 at March 12, 2007.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company s 2006 Annual Report are incorporated by reference into Parts I, II and IV.

Portions of the Company s Proxy Statement for the 2006 Annual Meeting of Stockholders are incorporated by reference into Part III.

Based on the last reported price of an actual transaction in registrant s common stock on June 30, 2006 and reports of beneficial ownership filed by directors and executive officers of registrant and by beneficial owners of more than 5% of the outstanding shares of common stock of registrant; however, such determination of shares owned by affiliates does not constitute an admission of affiliate status or beneficial interest in shares of registrant s common stock.

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PART I

Item 1. Business

General

Old Second Bancorp, Inc. (the Company or the Registrant) was organized under the laws of Delaware on September 8, 1981. It is a registered bank holding company under the Bank Holding Company Act of 1956 (the BHCA). The Company s office is located at 37 South River Street, Aurora, Illinois 60506.

The Company conducts a full service community banking and trust business through its wholly owned subsidiaries, which are together referred to as the Company :

- The Old Second National Bank of Aurora (Old Second Bank).
- Old Second Bank-Yorkville.
- Old Second Bank-Kane County.
- Old Second Financial, Inc., which provides insurance agency services.
- Old Second Mortgage Company, which is a wholly owned subsidiary of Old Second Bank. As of January 1, 2007, Old Second Mortgage Company was dissolved as a separate entity and became part of Old Second Bank.
- Old Second Capital Trust I, a Delaware business trust, which was formed for the exclusive purpose of issuing trust-preferred securities in a transaction completed in July 2003.
- Old Second Affordable Housing Fund, L.L.C. for the purpose of providing down payment assistance for home ownership to qualified individuals.
- Old Second Management, LLC (OSM), which was formed for the purpose of providing a possible future source of capital as well as providing certain tax advantages. OSM is a wholly owned subsidiary of Old Second Bank. Old Second Realty, LLC (OSR) is a Delaware real estate investment trust and the common stock is 100% owned by OSM. As of January 2, 2007, there were various minority holders of preferred stock in OSR.

The banking subsidiaries are referred to herein as the Banks. Inter-company transactions and balances are eliminated in consolidation. The Company provides financial services through its thirty-one banking locations, one commercial loan production office, and three mortgage banking offices located in Kane, Kendall, DeKalb, DuPage, LaSalle and Will counties in Illinois.

Business of the Company and its Subsidiaries

The Banks full service banking businesses include the customary consumer and commercial products and services which banks provide. The following services are included: demand, NOW, money market, savings, time deposit, individual retirement and Keogh deposit accounts; commercial, industrial, consumer and real estate lending, including installment loans, student loans, farm loans, lines of credit and overdraft checking; safe deposit operations; trust services; and an extensive variety of additional services tailored to the needs of individual customers, such as the acquisition of U.S. Treasury notes and bonds, the sale of traveler s checks, money orders, cashier s checks and foreign currency, direct deposit, discount brokerage, debit cards, credit cards, and other special services. The Banks also offer a full complement of electronic banking services such as internet banking and corporate cash management including remote deposit capture. Commercial and consumer loans are made to corporations, partnerships and individuals, primarily on a secured basis. Commercial lending focuses on business, capital, construction, inventory and real estate lending. Installment lending includes direct and indirect loans to consumers and commercial customers.

The Banks originate residential mortgages, offering a wide range of products including conventional, government, jumbo and sub prime loans. Secondary marketing of those mortgages is handled at Old Second Bank. In addition to operating through the Banks locations, mortgage origination offices are located in Sycamore, Wheaton and St. Charles, Illinois.

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Market Area

Old Second Bank is the lead banking subsidiary of Old Second Bancorp, Inc. Old Second Bank s primary market area is Aurora, Illinois, and its surrounding communities. The city of Aurora is located in northeastern Illinois, approximately 40 miles west of Chicago. Aurora is strategically situated on U.S. Interstate 88 and is centrally located near our banking subsidiaries in Kane, Kendall, DeKalb, DuPage, LaSalle and Will counties in Illinois. Based upon 2003 estimates, these counties together represent a market of more than 2.2 million people. The city of Aurora has a current reported population of approximately 175,000 residents.

Lending Activities

General. The Banks provide a broad range of commercial and retail lending services to corporations, partnerships, individuals and government agencies. The Banks actively market their services to qualified borrowers. Lending officers actively solicit the business of new borrowers entering our market areas as well as long-standing members of the local business community. The Banks have established lending policies that include a number of underwriting factors to be considered in making a loan, including location, amortization, loan to value ratio, cash flow, pricing, documentation and the credit history of the borrower. The Banks loan portfolios are comprised primarily of loans in the areas of commercial real estate, residential real estate, construction, general commercial and consumer lending. As of December 31, 2006, residential mortgages made up approximately 33% of its loan portfolio, commercial real estate loans comprised approximately 34%, construction lending comprised approximately 21%, general commercial loans comprised approximately 10% and consumer and other lending comprised 2%. It is the Bank s policy to comply at all times with the various consumer protection laws and regulations including, but not limited to, the Equal Credit Opportunity Act, the Fair Housing Act, the Community Reinvestment Act, the Truth in Lending Act, and the Home Mortgage Disclosure Act. The Banks do not discriminate in application procedures, loan availability, pricing, structure, or terms on the basis of race, color, religion, national origin, sex, marital status, familial status, handicap, age (providing the applicant has the legal capacity to enter into a binding contract), whether income is derived from public assistance, whether a borrower resides or his property is located in a low- or moderate-income area, or whether a right was exercised under the Consumer Credit Protection Act. The Banks strive to offer all of their credit services throughout their primary market area, including low- and moderate-income areas.

Commercial Loans. As noted above, the Banks are active commercial lenders. The areas of emphasis include: loans to wholesalers, manufacturers, building contractors, developers, business services companies and retailers. The Banks provide a wide range of business loans, including lines of credit for working capital and operational purposes and term loans for the acquisition of equipment and other purposes. Collateral for these loans generally includes accounts receivable, inventory, equipment and real estate. In addition, the Banks may take personal guarantees to help assure repayment. Loans may be made on an unsecured basis if warranted by the overall financial condition of the borrower. Commercial lines of credit are generally for 1 year and have floating rates. Commercial term loans range from 1 to 7 years with the majority falling in the 3 to 5 year range with rates fixed for the duration of the loan. A recent trend has seen a decrease in the percentage of the portfolio attributed to commercial loans. This trend reflects decreased demand for working capital and equipment financing over the course of the last few years. Repayment of commercial loans is largely dependent upon the cash flows generated by the operations of the commercial enterprise. The Banks underwriting procedures identify the sources of those cash flows and seek to match the repayment terms of the commercial loans to the sources. Secondary repayment sources are typically found in collateralization and guarantor support.

Commercial Real Estate Loans. A large portion of the loan portfolio is comprised of commercial real estate loans. The primary repayment risk for a commercial real estate loan is interruption or discontinuance of cash flows, usually derived from rent, and caused by economic events, which may or may not be under the control of the borrower, or changes in governmental regulations that negatively impact the future cash flow and market values of the affected properties. Repayment risk can also arise from systemic downward shifts in the valuations of classes of properties over a given geographic area, and caused by changes in demand and other economic factors. The Banks mitigate these risks through staying apprised of market conditions and by maintaining underwriting practices that provide for adequate cash flow margins and multiple repayment sources. In most cases, the Banks have collateralized these loans and/or taken personal guarantees to help assure repayment. The commercial real estate loans are primarily made based on the identified cash flow of the borrower and secondarily on the underlying real estate acting as collateral. Credit support provided by the borrower for most of these loans and the probability of repayment is based on the liquidation of the real estate and enforcement of a personal guarantee, if any exists.

Construction Loans. The Banks originate loans to finance the construction of residential and commercial properties located in the Company s market area. The Banks use underwriting and construction loan guidelines for financing where reputable contractors are involved. Construction loans are structured most often to be converted to permanent loans at the end of the construction phase or, infrequently, to be paid off upon receiving financing from another financial institution. Construction loans are based on the appraised value of the property, as determined by an independent appraiser, and an analysis of the potential marketability and profitability of the project, and identification of a cash flow source to service the permanent loan, or verification of a refinancing source. Construction loans generally have terms of up to 12 months, with extensions as needed. The Banks disburse loan proceeds in increments as construction progresses and as inspections warrant.

Construction loans afford the Banks the opportunity to increase the interest rate sensitivity of their loan portfolio and to receive yields higher than those obtainable on ARM loans secured by existing residential properties. These higher yields correspond to the higher risks associated with construction lending.

Construction development loans involve additional risks. Development lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project rather than the ability of the borrower or guarantor to repay principal and interest. This involves more risk than other lending because it is based on future estimates of value and economic circumstances. While appraisals are required prior to funding, and advances are limited to the value determined by the appraisal, there is the possibility of an unseen event affecting the value of the project. Development loans are primarily used for single-family developments, where the sale of lots and houses are tied to the customer preferences and interest rates. If the borrower defaults prior to completion of the project, the Bank may be required to fund additional amounts so that another developer can complete the project. The Banks are located in an area where a large amount of development activity is taking place, as rural and semi-rural areas are being suburbanized. This growth is both unprecedented and not likely to occur again once the area has been fully developed, and therefore extends a one-time opportunity as well as some economic risks should a sudden shift occur in the local demand for housing. The Banks have attempted to address these risks by closely monitoring local real estate activity, strong underwriting procedures, construction monitoring, and by limiting the amount of construction development lending. The Banks did observe a slower rate of real estate building and development activity in the market area in 2006, and it is likely that the slower growth trend will continue into 2007.

Residential Real Estate Loans. Residential first mortgage loans, second mortgages, and home equity line of credit mortgages are included in this category. First mortgage loans may include fixed rate loans that are generally sold to investors. Old Second Bank, through the merged operations of Old Second Mortgage Company, is a direct seller to FNMA, and retains servicing rights for those sold mortgages. Management believes that the retention of mortgage servicing provides the Company, on a consolidated basis, with a relatively steady source of fee income as compared to fees generated solely from mortgage origination operations. Moreover, the retention of such servicing rights allows the Banks to continue to have regular contact with mortgage customers and solidifies our involvement with the community. Other loans that are not sold to FNMA primarily include adjustable rate mortgages, lot loans, and constructions loans that are held in portfolio by the Banks.

Consumer Loans. The Banks also provide many types of consumer loans including motor vehicle, home improvement, home equity, signature loans and small personal credit lines. Consumer loans typically have shorter terms and lower balances with higher yields as compared to our other loans, but generally carry higher risks of default. Consumer loan collections are dependent on the borrower s continuing financial stability, and thus are more likely to be affected by adverse personal circumstances. Home equity lending is a rapidly growing segment of the Banks business and the largest share of consumer loans, having replaced indirect automobile financing over the course of the last few years.

Competition

The Company s market area is highly competitive. Many financial institutions based in Aurora s surrounding communities and in Chicago, Illinois, operate banking offices in the greater Aurora area or actively compete for customers within the Company s market area. The Company also faces competition from finance companies, insurance companies, mortgage companies, securities brokerage firms, money market funds, loan production offices and other providers of financial services.

The Company competes for loans principally through the range and quality of the services it provides, interest rates and loan fees. Management believes that its long-standing presence in the community and personal service philosophy enhances its ability to compete favorably in attracting and retaining individual and business customers. The Company actively solicits deposit-related clients and competes for deposits by offering personal attention, professional service and competitive interest rates.

The Banks are subject to vigorous competition from other banks and savings and loan associations, as well as credit unions and other financial institutions in the area. Within the Aurora banking market, which geographically covers the southern two-thirds of Kane County and the northern one-third of Kendall County, there are in excess of 20 other financial institutions. Within the Old Second Bank-Yorkville market, which includes portions of Kane and LaSalle counties and all of Kendall County, there are approximately 10 other banks or banking facilities and several savings and loan associations. Competition for residential mortgage lending also includes a number of mortgage brokerage operations. The financial services industry is also likely to become more competitive as further technological advances enable more companies to provide financial services. These technological advances may diminish the importance of depository institutions and other financial intermediaries in the transfer of funds between parties.

Employees

At December 31, 2006, the Company employed 582 full-time equivalent employees. The Company places a high priority on staff development, which involves extensive training, including customer service training. New employees are selected on the basis of both technical skills and customer service capabilities. None of the Company s employees are covered by a collective bargaining agreement with the Company. The Company offers a variety of employee benefits and management considers its employee relations to be excellent.

Internet

The Company maintains a corporate web site at http://www.o2bancorp.com. The Company makes available free of charge on or through its web site the annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after the Company electronically files such material with, or furnish it to, the Securities and Exchange Commission. Many of the Company s policies, committee charters and other investor information including our Code of Conduct, are available on the web site. The Company will also provide copies of its filings free of charge upon written request to: J. Douglas Cheatham, Senior Vice President and Chief Financial Officer, Old Second Bancorp, Inc., 37 South River Street, Aurora, Illinois 60506-4172.

SUPERVISION AND REGULATION

General

Financial institutions, their holding companies and their affiliates are extensively regulated under federal and state law. As a result, the growth and earnings performance of the Company may be affected not only by management decisions and general economic conditions, but also by the requirements of federal and state statutes and by the regulations and policies of various bank regulatory authorities, including the Illinois Department of Financial and Professional Regulation (the DFPR), the Office of the Comptroller of the Currency (the OCC), the Board of Governors of the Federal Reserve System (the Federal Reserve) and the Federal Deposit Insurance Corporation (the FDIC). Furthermore, taxation laws administered by the Internal Revenue Service and state taxing authorities and securities laws administered by the Securities and Exchange Commission (the SEC) and state securities authorities have an impact on the business of the Company. The effect of these statutes, regulations and regulatory policies may be significant, and cannot be predicted with a high degree of certainty.

Federal and state laws and regulations generally applicable to financial institutions regulate, among other things, the scope of business, the kinds and amounts of investments, reserve requirements, capital levels relative to operations, the nature and amount of collateral for loans, the establishment of branches, mergers and consolidations and the payment of dividends. This system of supervision and regulation establishes a comprehensive framework for the respective operations of the Company and its subsidiaries and is intended primarily for the protection of the FDIC-insured deposits and depositors of the Bank Subsidiaries, rather than shareholders.

The following is a summary of the material elements of the regulatory framework that applies to the Company and its subsidiaries. It does not describe all of the statutes, regulations and regulatory policies that apply, nor does it restate all of the requirements of those that are described. As such, the following is qualified in its entirety by reference to applicable law. Any change in statutes, regulations or regulatory policies may have a material effect on the business of the Company and its subsidiaries.

The Company

General. The Company, as the sole shareholder of the Bank Subsidiaries, is a bank holding company. As a bank holding company, the Company is registered with, and is subject to regulation by, the Federal Reserve under the Bank Holding Company Act of 1956, as amended (the BHCA). In accordance with Federal Reserve policy, the Company is expected to act as a source of financial strength to the Bank Subsidiaries and to commit resources to support the Bank Subsidiaries in circumstances where the Company might not otherwise do so. Under the BHCA, the Company is subject to periodic examination by the Federal Reserve. The Company is also required to file with the Federal Reserve periodic reports of the Company s operations and such additional information regarding the Company and its subsidiaries as the Federal Reserve may require.

Acquisitions, Activities and Change in Control. The primary purpose of a bank holding company is to control and manage banks. The BHCA generally requires the prior approval of the Federal Reserve for any merger involving a bank holding company or any acquisition by a bank holding company of another bank or bank holding company. Subject to certain conditions (including deposit concentration limits established by the BHCA), the Federal Reserve may allow a bank holding company to acquire banks located in any state of the United States. In approving interstate acquisitions, the Federal Reserve is required to give effect to applicable state law limitations on the aggregate amount of deposits that may be held by the acquiring bank holding company and its insured depository institution affiliates in the state in which the target bank is located (provided that those limits do not discriminate against out-of-state depository institutions or their holding companies) and state laws that require that the target bank have been in existence for a minimum period of time (not to exceed five years) before being acquired by an out-of-state bank holding company.

The BHCA generally prohibits a bank holding company from acquiring direct or indirect ownership or control of more than 5% of the voting shares of any company that is not a bank and from engaging in any business other than that of banking, managing and controlling banks or furnishing services to banks and their subsidiaries. This general prohibition is subject to a number of exceptions. The principal exception allows bank holding companies to engage in, and to own shares of companies engaged in, certain businesses found by the Federal Reserve to be so closely related to banking ... as to be a proper incident thereto. This authority would permit the Company to engage in a variety of banking-related businesses, including the operation of a thrift, consumer finance, equipment leasing, the operation of a computer service bureau (including software development), and mortgage banking and brokerage. The BHCA generally does not place territorial restrictions on the domestic activities of non-bank subsidiaries of bank holding companies.

Additionally, bank holding companies that meet certain eligibility requirements prescribed by the BHCA and elect to operate as financial holding companies may engage in, or own shares in companies engaged in, a wider range of nonbanking activities, including securities and insurance underwriting and sales, merchant banking and any other activity that the Federal Reserve, in consultation with the Secretary of the Treasury, determines by regulation or order is financial in nature, incidental to any such financial activity or complementary to any such financial activity and does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally. The Company has elected (and the Federal Reserve has accepted the Company s election) to operate as a financial holding company.

Federal law also prohibits any person or company from acquiring control of an FDIC-insured depository institution or its holding company without prior notice to the appropriate federal bank regulator. Control is conclusively presumed to exist upon the acquisition of 25% or more of the outstanding voting securities of a bank or bank holding company, but may arise under certain circumstances at 10% ownership.

Capital Requirements. Bank holding companies are required to maintain minimum levels of capital in accordance with Federal Reserve capital adequacy guidelines. If capital levels fall below the minimum required levels, a bank holding company, among other things, may be denied approval to acquire or establish additional banks or non-bank businesses. The Federal Reserve s capital guidelines establish the following minimum regulatory capital requirements for bank holding companies: (i) a risk-based requirement expressed as a percentage of total assets weighted according to risk; and (ii) a leverage requirement expressed as a percentage of total assets. The risk-based requirement consists of a minimum ratio of total capital to total risk-weighted assets of 8% and a minimum ratio of Tier 1 capital to total risk-weighted assets of 4%. The leverage requirement consists of a minimum ratio of Tier 1 capital to total assets of 3% for the most highly rated companies, with a minimum requirement of 4% for all others. For purposes of these capital standards, Tier 1 capital consists primarily of permanent stockholders equity less intangible assets (other than certain loan servicing rights and purchased credit card relationships). Total capital consists primarily of Tier 1 capital plus certain other debt and equity instruments that do not qualify as Tier 1 capital and a portion of the company s allowance for loan and lease losses.

The risk-based and leverage standards described above are minimum requirements. Higher capital levels will be required if warranted by the particular circumstances or risk profiles of individual banking organizations. For example, the Federal Reserve s capital guidelines contemplate that additional capital may be required to take adequate account of, among other things, interest rate risk, or the risks posed by concentrations of credit, nontraditional activities or securities trading activities. Further, any banking organization experiencing or anticipating significant growth would be expected to maintain capital ratios, including tangible capital positions (*i.e.*, Tier 1 capital less all intangible assets), well above the minimum levels. As of December 31, 2006, the Company had regulatory capital in excess of the Federal Reserve s minimum requirements.

Dividend Payments. The Company s ability to pay dividends to its shareholders may be affected by both general corporate law considerations and policies of the Federal Reserve applicable to bank holding companies. As a Delaware corporation, the Company is subject to the limitations of the Delaware General Corporation Law (the DGCL). The DGCL allows the Company to pay dividends only out of its surplus (as defined and computed in accordance with the provisions of the DGCL) or if the Company has no such surplus, out of its net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year. Additionally, policies of the Federal Reserve caution that a bank holding company should not pay cash dividends unless its net income available to common shareholders over the past year has been sufficient to fully fund the dividends and the prospective rate of earnings retention appears consistent with its capital needs, asset quality, and overall financial condition. The Federal Reserve also possesses enforcement powers over bank holding companies and their non-bank subsidiaries to prevent or remedy actions that represent unsafe or unsound practices or violations of applicable statutes and regulations. Among these powers is the ability to proscribe the payment of dividends by banks and bank holding companies.

Federal Securities Regulation. The Company s common stock is registered with the SEC under the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended (the Exchange Act). Consequently, the

Company is subject to the information, proxy solicitation, insider trading and other restrictions and requirements of the SEC under the Exchange Act.

The Bank Subsidiaries

General. Old Second Bank-Yorkville and Old Second Bank-Kane County (the State Banks) are Illinois-chartered banks, the deposit accounts of which are insured by the FDIC s Deposit Insurance Fund (DIF). The State Banks are also members of the Federal Reserve System (member banks). As Illinois-chartered, FDIC-insured member banks, the State Banks are subject to the examination, supervision, reporting and enforcement requirements of the DFPR, as the chartering authority for Illinois banks, the Federal Reserve, as the primary federal regulator of member banks, and the FDIC, as administrator of the DIF.

The Old Second National Bank of Aurora (the National Bank) is a national bank chartered by the OCC under the National Bank Act. The deposit accounts of the National Bank are insured by the DIF, and the National Bank is a member of the Federal Reserve System. The National Bank is subject to the examination, supervision, reporting and enforcement requirements of the OCC, the chartering authority for national banks. The FDIC, as administrator of the DIF, also has regulatory authority over the National Bank.

Deposit Insurance. As FDIC-insured institutions, the Banks are required to pay deposit insurance premium assessments to the FDIC. The FDIC has adopted a risk-based assessment system under which insured depository institutions are assigned to one of four risk assessment categories based upon their respective levels of capital, supervisory evaluations and other financial factors. Institutions that are well-capitalized and exhibit minimal or no supervisory weaknesses pay the lowest premium while institutions that are less than adequately capitalized and considered of substantial supervisory concern pay the highest premium. An institution s risk-classification is determined by the FDIC.

For the past several years, FDIC insurance assessments ranged from 0% to 0.27% of total deposits. Pursuant to regulatory amendments adopted by the FDIC, effective January 1, 2007, insurance assessments will range from 0.05% to 0.43% of total deposits (unless subsequently adjusted by the FDIC). FDIC-insured institutions that were in existence as of December 31, 1996, and paid an FDIC-insurance assessment prior to that date (eligible institutions), as well as successors to eligible institutions, will be entitled to a credit that may be applied to offset insurance premium assessments due for assessment periods beginning on and after January 1, 2007. The amount of an eligible institution s assessment credit will be equal to the institution s pro rata share (based on its assessment base as of December 31, 1996, as compared to the aggregate assessment base of all eligible institutions as of December 31, 1996) of the aggregate amount the FDIC would have collected if it had imposed an assessment of 10.5 basis points on the combined assessment base of all institutions insured by the FDIC as of December 31, 2001. Subject to certain statutory limitations, an institution s assessment credit may be applied to offset the full amount of premiums assessed in 2007, but may not be applied to more than 90% of the premiums assessed in 2008, 2009 or 2010. The FDIC will track the amount of an institution s assessment credit and automatically apply it to the institution s premium assessment to the maximum extent permitted by federal law.

FICO Assessments. The Financing Corporation (FICO) is a mixed-ownership governmental corporation chartered by the former Federal Home Loan Bank Board pursuant to the Federal Savings and Loan Insurance Corporation Recapitalization Act of 1987 to function as a financing vehicle for the recapitalization of the former Federal Savings and Loan Insurance Corporation. FICO issued 30-year non-callable bonds of approximately $8.2 billion that mature by 2019. Since 1996, federal legislation has required that all FDIC-insured depository institutions pay assessments to cover interest payments on FICO s outstanding obligations. These FICO assessments are in addition to amounts assessed by the FDIC for deposit insurance. During the year ended December 31, 2006, the FICO assessment rate was approximately 0.01% of deposits.

Supervisory Assessments. All Illinois banks and national banks are required to pay supervisory assessments to the DFPR and the OCC, respectively, to fund the operations of those agencies. The amount of the assessment paid by an Illinois bank to the DFPR is calculated on the basis of the institution s total assets, including consolidated subsidiaries, as reported to the DFPR. In the case of a national bank, the amount of the assessment paid to the OCC is calculated using a formula that takes into account the bank s size and its supervisory condition (as determined by the composite rating assigned to the bank as a result of its most recent OCC examination). During the year ended December 31, 2006, the State Banks paid supervisory assessments to the DFPR totaling $96,842 and the National Bank paid supervisory assessments to the OCC totaling $327,514.

Capital Requirements. Banks are generally required to maintain capital levels in excess of other businesses. The federal bank regulatory agencies have established the following minimum capital standards for insured state and national banks, such as the Bank Subsidiaries: (i) a leverage requirement consisting of a minimum ratio of Tier 1 capital to total assets of 3% for the most highly-rated banks with a minimum requirement of at least 4% for all others; and (ii) a risk-based capital requirement consisting of a minimum ratio of total capital to total risk-weighted assets of 8% and a minimum ratio of Tier 1 capital to total risk-weighted assets of 4%. In general, the components of Tier 1 capital and total capital are the same as those for bank holding companies discussed above.

The capital requirements described above are minimum requirements. Higher capital levels will be required if warranted by the particular circumstances or risk profiles of individual institutions. For example, federal regulations provide that additional capital may be required to take adequate account of, among other things, interest rate risk or the risks posed by concentrations of credit, nontraditional activities or securities trading activities.

Further, federal law and regulations provide various incentives for financial institutions to maintain regulatory capital at levels in excess of minimum regulatory requirements. For example, a financial institution that is well-capitalized may qualify for exemptions from prior notice or application requirements otherwise applicable to certain types of activities and may qualify for expedited processing of other required notices or applications. Additionally, one of the criteria that determines a bank holding company s eligibility to operate as a financial holding company is a requirement that all of its financial institution subsidiaries be well-capitalized. Under the regulations of the Federal Reserve and the OCC, in order to be well-capitalized a financial institution must maintain a ratio of total capital to total risk-weighted assets of 10% or greater, a ratio of Tier 1 capital to total risk-weighted assets of 6% or greater and a ratio of Tier 1 capital to total assets of 5% or greater.

Federal law also provides the federal banking regulators with broad power to take prompt corrective action to resolve the problems of undercapitalized institutions. The extent of the regulators powers depends on whether the institution in question is adequately capitalized, undercapitalized, significantly undercapitalized or critically undercapitalized, in each case as defined by regulation. Depending upon the capital category to which an institution is assigned, the regulators corrective powers include: (i) requiring the institution to submit a capital restoration plan; (ii) limiting the institution s asset growth and restricting its activities; (iii) requiring the institution to issue additional capital stock (including additional voting stock) or to be acquired; (iv) restricting transactions between the institution and its affiliates; (v) restricting the interest rate the institution may pay on deposits; (vi) ordering a new election of directors of the institution; (vii) requiring that senior executive officers or directors be dismissed; (viii) prohibiting the institution from accepting deposits from correspondent banks; (ix) requiring the institution to divest certain subsidiaries; (x) prohibiting the payment of principal or interest on subordinated debt; and (xi) ultimately, appointing a receiver for the institution.

As of December 31, 2006: (i) none of the Bank Subsidiaries was subject to a directive from its primary federal regulator to increase its capital to an amount in excess of the minimum regulatory capital requirements; (ii) each of the Bank Subsidiaries exceeded its minimum regulatory capital requirements under applicable capital adequacy guidelines; and (iii) each of the Bank Subsidiaries was well-capitalized, as defined by applicable regulations.

Liability of Commonly Controlled Institutions. Under federal law, institutions insured by the FDIC may be liable for any loss incurred by, or reasonably expected to be incurred by, the FDIC in connection with the default of commonly controlled FDIC-insured depository institutions or any assistance provided by the FDIC to commonly controlled FDIC-insured depository institutions in danger of default. Because the Company controls each of the Bank Subsidiaries, the Bank Subsidiaries are commonly controlled for purposes of these provisions of federal law.

Dividend Payments. The primary source of funds for the Company is dividends from the Bank Subsidiaries. Under the Illinois Banking Act, the State Banks generally may not pay dividends in excess of their net profits. The Federal Reserve Act also imposes limitations on the amount of dividends that may be paid by state member banks, such as the State Banks. Generally, member banks may pay dividends out of their undivided profits, in such amounts and at such times as each bank s board of directors deems prudent. Without prior Federal Reserve approval, however, state member banks may not pay dividends in any calendar year that, in the aggregate, exceed their calendar year-to-date net income plus their retained net income for the two preceding calendar years.

Under the National Bank Act, the National Bank may pay dividends out of its undivided profits in such amounts and at such times as its board of directors deems prudent. Without prior OCC approval, however, the National Bank may not pay dividends in any calendar year that, in the aggregate, exceed its year-to-date net income plus its retained net income for the two preceding years.

The payment of dividends by any financial institution is affected by the requirement to maintain adequate capital pursuant to applicable capital adequacy guidelines and regulations, and a financial institution generally is prohibited from paying any dividends if, following payment thereof, the institution would be undercapitalized. As described above, each of the Bank Subsidiaries exceeded its minimum capital requirements under applicable guidelines as of December 31, 2006. As of December 31, 2006, approximately $50 million was available to be paid as dividends by the Bank Subsidiaries. Notwithstanding the availability of funds for dividends, however, the Federal Reserve (in the case of the State Banks) and the OCC (in the case of the National Bank) may prohibit the payment of any dividends if the agency determines such payment would constitute an unsafe or unsound practice.

Insider Transactions. The Bank Subsidiaries are subject to certain restrictions imposed by federal law on extensions of credit to the Company and its subsidiaries, on investments in the stock or other securities of the Company and its subsidiaries and the acceptance of the stock or other securities of the Company or it subsidiaries as collateral for loans made by the Bank Subsidiaries. Certain limitations and reporting requirements are also placed on extensions of credit by the Bank Subsidiaries to their directors and officers, to directors and officers of the Company and its subsidiaries, to principal shareholders of the Company and to related interests of such directors, officers and principal shareholders. In addition, federal law and regulations may affect the terms upon which any person who is a director or officer of the Company or one of its subsidiaries or a principal shareholder of the Company may obtain credit from banks with which the Bank Subsidiaries maintain correspondent relationships.

Safety and Soundness Standards. The federal banking agencies have adopted guidelines that establish operational and managerial standards to promote the safety and soundness of federally insured depository institutions. The guidelines set forth standards for internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, asset quality and earnings. In general, the safety and soundness guidelines prescribe the goals to be achieved in each area, and each institution is responsible for establishing its own procedures to achieve those goals. If an institution fails to comply with any of the standards set forth in the guidelines, the institution s primary federal regulator may require the institution to submit a plan for achieving and maintaining compliance. If an institution fails to submit an acceptable compliance plan, or fails in any material respect to implement a compliance plan that has been accepted by its primary federal regulator, the regulator is required to issue an order directing the institution to cure the deficiency. Until the deficiency cited in the regulator s order is cured, the regulator may restrict the institution s rate of growth, require the institution to increase its capital, restrict the rates the institution pays on deposits or require the institution to take any action the regulator deems appropriate under the circumstances. Noncompliance with the standards established by the safety and soundness guidelines may also constitute grounds for other enforcement action by the federal banking regulators, including cease and desist orders and civil money penalty assessments.

Branching Authority. Illinois banks, such as the State Banks, have the authority under Illinois law to establish branches anywhere in the State of Illinois, subject to receipt of all required regulatory approvals. National banks headquartered in Illinois, such as the National Bank, have the same branching rights in Illinois as banks chartered under Illinois law, subject to OCC approval.

Federal law permits state and national banks to merge with banks in other states subject to: (i) regulatory approval; (ii) federal and state deposit concentration limits; and (iii) state law limitations requiring the merging bank to have been in existence for a minimum period of time (not to exceed five years) prior to the merger. The establishment of new interstate branches or the acquisition of individual branches of a bank in another state (rather than the acquisition of an out-of-state bank in its entirety) is permitted only in those states the laws of which expressly authorize such expansion.

State Bank Investments and Activities. The State Banks generally are permitted to make investments and engage in activities directly or through subsidiaries as authorized by Illinois law. However, under federal law and FDIC regulations, FDIC-insured state banks are prohibited, subject to certain exceptions, from making or retaining equity investments of a type, or in an amount, that are not permissible for a national bank. Federal law and FDIC regulations also prohibit FDIC-insured state banks and their subsidiaries, subject to certain exceptions, from engaging as principal in any activity that is not permitted for a national bank unless the bank meets, and continues to meet, its minimum regulatory capital requirements and the FDIC determines the activity would not pose a significant risk to the deposit insurance fund of which the bank is a member. These restrictions have not had, and are not currently expected to have, a material impact on the operations of the State Banks.

Financial Subsidiaries. Under Federal law and OCC regulations, national banks are authorized to engage, through financial subsidiaries, in any activity that is permissible for a financial holding company and any activity that the Secretary of the Treasury, in consultation with the Federal Reserve, determines is financial in nature or incidental to any such financial activity, except (i) insurance underwriting, (ii) real estate development or real estate investment activities (unless otherwise permitted by law), (iii) insurance company portfolio investments and (iv) merchant banking. The authority of a national bank to invest in a financial subsidiary is subject to a number of conditions, including, among other things, requirements that the bank must be well-managed and well-capitalized (after deducting from capital the bank s outstanding investments in financial subsidiaries). Federal law also provides that state banks may invest in financial subsidiaries (assuming they have the requisite investment authority under applicable state law), subject to substantially the same conditions that apply to national bank investments in financial subsidiaries. None of the Bank Subsidiaries has applied for approval to establish any financial subsidiaries.

Federal Reserve System. Federal Reserve regulations, as presently in effect, require depository institutions to maintain non-interest earning reserves against their transaction accounts (primarily NOW and regular checking accounts), as follows: for transaction accounts aggregating $45.8 million or less, the reserve requirement is 3% of total transaction accounts; and for transaction accounts aggregating in excess of $45.8 million, the reserve requirement is $1.119 million plus 10% of the aggregate amount of total transaction accounts in excess of $45.8 million. The first $8.5 million of otherwise reservable balances are exempted from the reserve requirements. These reserve requirements are subject to annual adjustment by the Federal Reserve. The Bank Subsidiaries are in compliance with the foregoing requirements.

The statistical data required by Guide 3 of the Guides for Preparation and Filing of Reports and Registration Statements under the Securities Exchange Act of 1934 is set forth in the following pages. This data should be read in conjunction with the consolidated financial statements, related notes and Management s Discussion and Analysis of Financial Condition and Results of Operations as set forth in the 2006 Annual Report incorporated herein by reference (attached hereto as Exhibit 13). All dollars in the tables are expressed in thousands.

The following table sets forth certain information relating to the Company s average consolidated balance sheets and reflects the yield on average earning assets and cost of average liabilities for the years indicated. Dividing the related interest by the average balance of assets or liabilities derives rates. Average balances are derived from daily balances.

ANALYSIS OF AVERAGE BALANCES,

TAX EQUIVALENT INTEREST AND RATES

Years ended December 31, 2006 ,2005 and 2004

	2006 Average Balance	**Interest**	**Rate**	**2005 Average Balance**	**Interest**	**Rate**	**2004 Average Balance**	**Interest**	**Rate**
ASSETS									
Interest bearing deposits	$ 968	$ 38	3.93 %	$ 361	$ 3	0.83 %	$ 307	$ 4	1.14 %
Federal funds sold	809	42	5.19	216	7	3.24	3,967	58	1.47
Securities:									
Taxable	319,992	12,837	4.01	338,167	12,064	3.57	320,185	10,624	3.32
Non-taxable (tax equivalent)	140,864	7,709	5.47	139,137	7,400	5.32	97,221	5,023	5.17
Total securities	460,856	20,546	4.46	477,304	19,464	4.08	417,406	15,647	3.75
Loans and loans held for sale (1)	1,756,360	124,327	7.08	1,629,615	103,551	6.35	1,437,030	83,653	5.82
Total interest earning assets	2,218,993	144,953	6.53	2,107,496	123,025	5.84	1,858,710	99,362	5.35
Cash and due from banks	53,114			55,063			52,228		
Allowance for loan losses	(16,085)			(15,522)			(18,295)		
Other noninterest-bearing assets	121,749			92,297			73,372		
Total assets	$ 2,377,771			$ 2,239,334			$ 1,966,015		
LIABILITIES AND STOCKHOLDERS EQUITY									
Now accounts	$ 259,666	3,944	1.52	$ 243,908	1,824	0.75	$ 244,806	1,018	0.42
Money market accounts	415,610	13,980	3.36	442,837	9,633	2.18	393,407	5,104	1.30
Savings accounts	114,787	647	0.56	123,616	531	0.43	122,239	299	0.24
Time deposits	947,577	40,965	4.32	819,341	26,052	3.18	696,013	18,602	2.67
Interest bearing deposits	1,737,640	59,536	3.43	1,629,702	38,040	2.33	1,456,465	25,023	1.72
Securities sold under agreement to repurchase	46,461	2,030	4.37	45,993	1,303	2.83	37,006	450	1.22
Federal funds purchased and other borrowed funds	128,861	6,308	4.90	114,560	4,308	3.76	71,515	1,037	1.45
Junior subordinated debentures	31,625	2,467	7.80	31,625	2,448	7.74	31,625	2,486	7.86
Note payable	7,905	489	6.19	2,910	125	4.30	1,638	43	2.63
Total interest bearing liabilities	1,952,492	70,830	3.63	1,824,790	46,224	2.53	1,598,249	29,039	1.82
Noninterest bearing deposits	254,609			253,649			227,912		
Accrued interest and other liabilities	15,980			16,052			13,856		
Stockholders equity	154,690			144,843			125,998		
Total liabilities and stockholders equity	$ 2,377,771			$ 2,239,334			$ 1,966,015		
Net interest income (tax equivalent)		$ 74,123			$ 76,801			$ 70,323	
Net interest income (tax equivalent) to total earning assets			3.34 %			3.64 %			3.78 %
Interest bearing liabilities to earnings assets	87.99 %			86.59 %			85.99 %		

(1). Interest income from loans is shown tax equivalent as discussed below and includes fees of $3,764,000, $3,127,000 and $4,116,000 for 2006, 2005 and 2004 respectively. Nonaccrual loans are included in the above stated average balances.

Notes: For purposes of discussion, net interest income and net interest income to earning assets have been adjusted to a non-GAAP tax equivalent (TE) basis using a marginal rate of 35% to more appropriately compare returns on tax-exempt loans and securities to other interest earning assets. The table below provides a reconciliation of each non-GAAP TE measure to the GAAP equivalent:

	Effect of Tax Equivalent Adjustment		
	2006	**2005**	**2004**
Interest income (GAAP)	$ 142,029	$ 120,223	$ 97,398
Taxable equivalent adjustment - loans	226	212	206
Taxable equivalent adjustment - securities	2,698	2,590	1,758
Interest income (TE)	144,953	123,025	99,362
Less: interest expense (GAAP)	70,830	46,224	29,039
Net interest income (TE)	$ 74,123	$ 76,801	$ 70,323
Net interest and income (GAAP)	$ 71,199	$ 73,999	$ 68,359
Net interest income to total interest earning assets	3.21 %	3.51 %	3.68 %
Net interest income to total interest earning assets (TE)	3.34 %	3.64 %	3.78 %

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The following table allocates the changes in net interest income to changes in either average balances or average rates for earnings assets and interest bearing liabilities. The changes in interest due to both volume and rate have been allocated proportionately to the change due to balance and due to rate. Interest income is measured on a tax equivalent basis using a 35% rate as per the note to the analysis of average balance table on page 14.

ANALYSIS OF YEAR-TO-YEAR CHANGES IN NET INTEREST INCOME

	2006 Compared to 2005 Change Due to			**2005 Compared to 2004 Change Due to**		
	Average Balance	**Average Rate**	**Total Change**	**Average Balance**	**Average Rate**	**Total Change**
EARNING ASSETS/INTEREST INCOME						
Interest bearing deposits	$ 11	$ 24	$ 35	$ 1	$ (2)	$ (1)
Federal funds sold	29	6	35	(84)	33	(51)
Securities:						
Taxable	(587)	1,360	773	616	824	1,440
Tax-exempt	93	216	309	2,226	151	2,377
Loans and loans held for sale	8,426	12,350	20,776	11,821	8,077	19,898
TOTAL EARNING ASSETS	7,972	13,956	21,928	14,580	9,083	23,663
INTEREST BEARING LIABILITIES/ INTEREST EXPENSE						
Interest bearing transaction accounts	125	1,995	2,120	(4)	810	806
Money market accounts	(551)	4,898	4,347	709	3,820	4,529
Savings accounts	(34)	150	116	3	229	232
Time deposits	4,522	10,391	14,913	3,598	3,852	7,450
Repurchase agreements	13	714	727	131	722	853
Federal funds purchased and other borrowed funds	585	1,415	2,000	897	2,374	3,271
Junior subordinated debentures		19	19		(38)	(38)
Note payable	290	74	364	45	37	82
INTEREST BEARING LIABILITIES	4,950	19,656	24,606	5,379	11,806	17,185
NET INTEREST INCOME	$ 3,022	$ (5,700)	$ (2,678)	$ 9,201	$ (2,723)	$ 6,478

The following table presents the composition of the securities portfolio by major category as of December 31, of each year indicated:

SECURITIES PORTFOLIO COMPOSITION

	2006		**2005**		**2004**	
	Amount	**% of Portfolio**	**Amount**	**% of Portfolio**	**Amount**	**% of Portfolio**
SECURITIES AVAILABLE FOR SALE						
U.S. Treasury securities	$ 9,630	2.04 %	$ 10,737	2.28 %	$ 992	0.22 %
U.S. government agencies	267,167	56.49 %	302,149	64.23 %	303,875	68.14 %
U.S. government agency mortgage-backed	19,604	4.15 %	11,522	2.45 %	9,294	2.08 %
States and political subdivisions	149,642	31.64 %	145,971	31.03 %	131,590	29.51 %
Collateralized mortgage obligations	26,724	5.65 %		0.00 %	185	0.04 %
Other securities	130	0.03 %	52	0.01 %	52	0.01 %
	$ 472,897	100.00 %	$ 470,431	100.00 %	$ 445,988	100.00 %

The Company s holdings of U.S. government agency and U.S. government agency mortgage-backed securities are comprised of government-sponsored enterprises, such as Fannie Mae, Freddie Mac and the Federal Home Loan Banks, which are not backed by the full faith and credit of the United States government.

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SECURITIES AVAILABLE FOR SALE-MATURITY AND YIELDS

The following table presents the expected maturities or call dates and weighted average yield (non tax equivalent) of securities by major category as of December 31, 2006:

	Within One Year		After One But Within Five Years		After Five But Within Ten Years		After Ten Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
U.S. Treasury securities	$	0.00 %	$ 4,830	3.79 %	$ 4,800	4.01 %	$	0.00 %	$ 9,630	3.90 %
U.S. government agencies	65,556	3.66 %	126,692	4.21 %	62,803	5.54 %	12,116	5.70 %	267,167	4.45 %
States and political subdivisions	5,466	3.00 %	21,513	3.68 %	64,593	3.57 %	58,070	3.49 %	149,642	3.53 %
	71,022	3.61 %	153,035	4.12 %	132,196	4.52 %	70,186	3.88 %	426,439	4.12 %
Mortgage-backed securities and collateralized mortgage obligations									46,328	5.42 %
Other securities									130	0.12 %
	$ 71,022	3.61 %	$ 153,035	4.12 %	$ 132,196	4.52 %	$ 70,186	3.88 %	$ 472,897	4.25 %

As of December 31, 2006, net unrealized losses of $4,208,000, offset by a deferred tax benefit of $1,663,000, resulted in a decrease in equity capital of $2,545,000. As of December 31, 2005, net unrealized gains of $7,562,000, offset by deferred income taxes of $3,000,000, resulted in a decrease in equity capital of $4,562,000. At year-end 2006 and 2005, there were no holdings of securities of any one issuer, other than the U.S. government and its agencies, in an amount greater than 10% of shareholders equity.

LOAN PORTFOLIO

The following table presents the composition of the loan portfolio at December 31, for the years indicated:

	2006	2005	2004	2003	2002
Commercial and industrial	$ 174,964	$ 168,052	$ 170,535	$ 191,390	$ 208,535
Real estate - commercial	605,098	590,328	512,661	456,391	411,122
Real estate - construction	374,654	361,859	269,537	218,519	120,899
Real estate - residential	585,448	548,651	514,020	408,789	262,304
Installment / others	23,748	35,492	42,323	44,449	59,007
Gross loans	1,763,912	1,704,382	1,509,076	1,319,538	1,061,867
Allowance for loan losses	(16,193)	(15,329)	(15,495)	(18,301)	(15,769)
Loans, net	$ 1,747,719	$ 1,689,053	$ 1,493,581	$ 1,301,237	$ 1,046,098

The above loan totals include net unearned and deferred loan fees and costs.

MATURITY AND RATE SENSITIVITY OF LOANS

The following table sets forth the remaining contractual maturities for certain loan categories at December 31, 2006:

		Over 1 Year Through 5 Years		Over 5 Years		
	One Year or Less	Fixed Rate	Floating Rate	Fixed Rate	Floating Rate	Total
Commercial and industrial	$ 100,881	$ 53,151	$ 13,641	$ 6,660	$ 631	$ 174,964
Real estate - commercial	107,599	383,723	17,137	61,649	34,990	605,098
Real estate - construction	216,821	74,810	46,599	20,469	15,955	374,654
Real estate - residential	34,452	114,121	18,871	36,729	381,275	585,448
Installment / others	7,043	11,760	4,875	70		23,748
Total	$ 466,796	$ 637,565	$ 101,123	$ 125,577	$ 432,851	$ 1,763,912

The above loan totals include net unearned and deferred loan fees and costs; column one includes demand notes.

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The Company had no concentration of loans exceeding 10% of total loans at December 31, 2006.

NONPERFORMING ASSETS

The following table sets forth the amounts of nonperforming assets at December 31, of the years indicated:

	2006	2005	2004	2003	2002
Nonaccrual loans	$ 1,632	$ 3,845	$ 5,129	$ 2,265	$ 4,803
Loans past due 90 days or more and still accruing interest	583	2,752	116	381	641
Total nonperforming loans	2,215	6,597	5,245	2,646	5,444
Other real estate owned	48	251		663	131
Total nonperforming assets	$ 2,263	$ 6,848	$ 5,245	$ 3,309	$ 5,575

Accrual of interest is discontinued on a loan when principal or interest is ninety days or more past due, unless the loan is well secured and in the process of collection. When a loan is placed on nonaccrual status, interest previously accrued but not collected in the current period is reversed against current period interest income. Interest accrued in prior years but not collected is charged against the allowance for loan losses. Interest income of approximately $199,000, $334,000 and $229,000 was recorded during 2006, 2005, and 2004, respectively on loans in nonaccrual status at year-end. Interest income, which would have been recognized during 2006, 2005, and 2004, had these loans been on an accrual basis throughout the year, was approximately $325,000, $636,000, and $409,000, respectively. There were no troubled debt restructurings for any of the five years presented in the table above.

ANALYSIS OF ALLOWANCE FOR LOAN LOSSES

The following table summarizes, for the years indicated, activity in the allowance for loan losses, including amounts charged off, amounts of recoveries, additions to the allowance charged to operating expense, and the ratio of net charge-offs to average loans outstanding:

	2006	2005	2004	2003	2002
Average total loans (exclusive of loans held for sale)	1,748,328	1,617,557	1,421,483	1,183,290	969,982
Allowance at beginning of year	15,329	15,495	18,301	15,769	12,313
Charge-offs:					
Commercial and industrial	243	674	402	971	752
Real estate - commercial					
Real estate - construction					
Real estate - residential	73	70	18	42	25
Installment and other loans	572	305	337	463	383
Total charge-offs	888	1,049	757	1,476	1,160
Recoveries:					
Commercial and industrial	151	468	688	489	462
Real estate - commercial					
Real estate - construction					
Real estate - residential	80		11	25	128
Installment and other loans	277	62	152	243	221
Total recoveries	508	530	851	757	811
Net charge-offs	380	519	(94)	719	349
Provision for loan losses	1,244	353	(2,900)	3,251	3,805
Allowance at end of period	16,193	15,329	15,495	18,301	15,769
Net charge-offs to average loans	0.02 %	0.03 %	-0.01 %	0.06 %	0.04 %
Allowance at year end to average loans	0.93 %	0.95 %	1.09 %	1.55 %	1.63 %

The provision for loan losses is based upon management s estimate of losses inherent in the portfolio and its evaluation of the adequacy of the allowance for loan losses. Factors which influence management s judgement in

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estimating loan losses are the composition of the portfolio, past loss experience, loan delinquencies, nonperforming loans, and other factors that, in management s judgment, deserve evaluation in estimating loan losses.

ALLOCATION OF THE ALLOWANCE FOR LOAN LOSSES

The following table shows the Company s allocation of the allowance for loan losses by types of loans and the amount of unallocated allowance, at December 31, of the years indicated:

	2006		2005		2004		2003		2002	
	Amount	Loan Type to Total Loans	Amount	Loan Type to Total Loans	Amount	Loan Type to Total Loans	Amount	Loan Type to Total Loans	Amount	Loan Type to Total Loans
Commercial and industrial	$ 2,252	9.9 %	$ 3,332	9.9 %	$ 5,221	11.3 %	$ 3,728	14.5 %	$ 6,016	19.5 %
Real estate - commercial	7,403	34.3 %	1,379	34.6 %	1,349	34.1 %	5,766	34.7 %	4,500	38.8 %
Real estate - construction	3,816	21.2 %	8,059	21.2 %	6,144	17.8 %	6,080	16.5 %	1,166	11.5 %
Real estate - residential	751	33.2 %	332	32.3 %	700	34.0 %	277	30.9 %	500	24.7 %
Installment and other loans	506	1.4 %	738	2.1 %	400	2.8 %	1,410	3.4 %	945	5.5 %
Unallocated	1,465		1,489		1,681		1,040		2,642	
Total	$ 16,193	100.0 %	$ 15,329	100.0 %	$ 15,495	100.0 %	$ 18,301	100.0 %	$ 15,769	100.0 %

CONTRACTUAL OBLIGATIONS, COMMITMENTS, CONTINGENT LIABILITIES, AND OFF-BALANCE SHEET ARRANGEMENTS

The Company has various financial obligations that may require future cash payments. The following table presents, as of December 31, 2006, significant fixed and determinable contractual obligations to third parties by payment date:

	Within One Year Amount	One to Three Years Amount	Three to Five Years Amount	Over Five Years Amount	Total Amount
Deposits without a stated maturity	$ 1,088,579	$	$	$	$ 1,088,579
Certificates of deposit	729,828	209,511	34,775		974,114
Securities sold under repurchase agreements	38,218				38,218
Other short-term borrowings	127,090				127,090
Junior subordinated debentures				31,625	31,625
Note payable	16,425				16,425
Purchase obligations	2,230	1,516	375	839	4,960
Operating leases	714	754	310	385	2,163
Total	$ 2,003,084	$ 211,781	$ 35,460	$ 32,849	$ 2,283,174

Purchase obligations represent obligations under agreements to purchase goods or services that are enforceable and legally binding on the Company and that specify all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. The purchase obligation amounts presented above primarily relate to certain contractual payments for services provided for information technology, capital expenditures, and the outsourcing of certain operational activities.

The following table details the amounts and expected maturities of significant commitments to extend credit as of December 31, 2006:

	Within One Year	One to Three Years	Three to Five Years	Over Five Years	Total
Commitment to extend credit:					
Commercial secured by real estate	$ 58,297	$ 24,637	$ 4,339	$ 5,156	$ 92,429
Revolving open end residential	6,145	454	1,609	124,005	132,213
Other	125,619	3,762	535	491	130,407
Financial standby letters of credit	4,744	1,638			6,382
Performance standby letters of credit	32,943	4,575	25		37,543
Commercial letters of credit	3,165		12,000		15,165
Total	$ 230,913	$ 35,066	$ 18,508	$ 129,652	$ 414,139

Commitments to extend credit do not necessarily represent future cash requirements, in that these commitments often expire without being drawn upon.

DEPOSITS

The following table sets forth the amount and maturities of deposits of $100,000 or more at December 31, 2006:

3 months or less	$ 108,629
Over 3 months through 6 months	61,323
Over 6 months through 12 months	122,098
Over 12 months	90,123
	$ 382,173

SELECTED RATIOS

The following table presents selected financial ratios as of December 31, for the years indicated:

	2006	2005	2004
Return on average total assets	0.99 %	1.24 %	1.34 %
Return on average equity	15.29 %	19.11 %	20.86 %
Average equity to average assets	6.51 %	6.47 %	6.41 %
Dividend payout ratio	31.07 %	24.88 %	23.47 %

SHORT-TERM BORROWINGS

The following table presents categories of short-term borrowings having average balances during the year greater than 30% of stockholders equity of the Company at the end of the year. The information presented is as of or for the year ended December 31, for the years indicated:

	2006	2005	2004
Federal Funds Purchased			
Average daily balance during the year	$ 74,583	$ 109,362	$ 102,084
Average interest rate during the year	5.09 %	3.56 %	1.13 %
Maximum month-end balance during the year	$ 155,000	$ 178,000	$ 113,499
Balance at year-end	$ 54,000	$ 170,000	$ 95,899
Weighted average interest rate at year-end	5.45 %	3.72 %	1.28 %
FHLB Advances			
Average daily balance during the year	$ 53,808	N/A	N/A
Average interest rate during the year	5.25 %	N/A	N/A
Maximum month-end balance during the year	$ 90,000	N/A	N/A
Balance at year-end	$ 70,000	N/A	N/A
Weighted average interest rate at year-end	5.38 %	N/A	N/A
Repurchase Agreements			
Average daily balance during the year	N/A	$ 45,993	$ 40,763
Average interest rate during the year	N/A	2.83 %	1.00 %
Maximum month-end balance during the year	N/A	$ 57,625	$ 39,312
Balance at year-end	N/A	$ 57,625	$ 35,161
Weighted average interest rate at year-end	N/A	3.24 %	0.91 %

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Item 1.A. Risk Factors

In addition to the other information in this Annual Report on Form 10-K, stockholders or prospective investors should carefully consider the following risk factors:

Our business is concentrated in and dependent upon the continued growth and welfare of several counties in Illinois.

Old Second Bank s primary market area is Aurora, Illinois, and its surrounding communities. The city of Aurora is located in northeastern Illinois, approximately 40 miles west of Chicago. Our banking subsidiaries operate primarily in Kane, Kendall, DeKalb, DuPage, LaSalle and Will Counties in Illinois, and as a result, our financial condition, results of operations and cash flows are subject to changes in the economic conditions in those areas. We have developed a strong presence in the counties we serve, with particular concentration in Aurora, Illinois and surrounding communities. Based upon 2003 estimates, these counties together represent a market of more than 2.2 million people. The city of Aurora has a current reported population of approximately 175,000 residents. The Banks offer banking services for retail, commercial, industrial, and public entity customers in the Aurora, North Aurora, Batavia, Geneva, St. Charles, Burlington, Elburn, Elgin, Maple Park, Kaneville, Sugar Grove, Naperville, Lisle, Joliet, Yorkville, Plano, Sandwich, Wasco, DeKalb and Ottawa communities and surrounding areas. Old Second Bank also offers complete trust investment management and other fiduciary services and through a registered broker/dealer and member of NASD and SIPC, provide stocks, bonds, securities, annuities, and non-FDIC insured mutual funds.

Although the communities that we serve have been growing rapidly in recent years and we anticipate continuing to concentrate our business efforts in the communities we currently serve and the immediately surrounding communities, our continued success is largely dependent upon the continued growth of these communities. Because of our geographic concentration, we are less able than other regional or national financial institutions to diversify our credit risks across multiple markets. A decline in the growth of these communities could negatively impact our net income and profitability. Additionally, declines in the economies of these communities could affect our ability to generate new loans or to receive repayments of existing loans, adversely affecting our financial condition.

We may experience difficulties in managing our growth and our growth strategy involves risks that may negatively impact our net income.

As part of our general growth strategy, we may expand into additional communities or attempt to strengthen our position in our current markets by opening new branches and acquiring existing branches of other financial institutions. To the extent that we undertake additional branch openings and acquisitions, we are likely to continue to experience the effects of higher operating expenses relative to operating income from the new operations, which may have an adverse effect on our levels of reported net income, return on average equity and return on average assets. Other effects of engaging in such growth strategies may include potential diversion of our management s time and attention and general disruption to our business.

Although we do not have any current plans to do so, we may also acquire banks and related businesses that we believe provide a strategic fit with our business or engage in de novo bank formations. To the extent that we grow through acquisitions and de novo bank formations, we cannot assure you that we will be able to adequately and profitably manage this growth. Acquiring other banks and businesses will involve similar risks to those commonly associated with branching, but may also involve additional risks, including:

- potential exposure to unknown or contingent liabilities of banks and businesses we acquire;
- exposure to potential asset quality issues of the acquired bank or related business;
- difficulty and expense of integrating the operations and personnel of banks and businesses we acquire; and
- the possible loss of key employees and customers of the banks and businesses we acquire.

We face intense competition in all phases of our business from other banks and financial institutions.

Our right size strategy is to provide a broad range of services and the convenience of a large bank as well as the personal relationships and community focus of a smaller bank. Many of the entities that we compete with are substantially larger in size and may have greater resources available to them, offer the consumers the most competitive interest rates, have more locations and may provide a greater range of products than we do. We also compete with smaller financial institutions that may be perceived to offer a higher degree of customer service. Additionally, many non-bank financial intermediaries are not subject to the regulatory restrictions applicable to our bank subsidiaries. We have experienced an increase in the level of competition as well as the number of competitors in recent years and this increase may affect our future profitability.

With respect to specific products, we compete for deposits with a large number of depository institutions including commercial banks, savings and loan associations, credit unions, money market funds and other financial institutions and financial intermediaries serving our market area. We also compete for loans with other banks headquartered in northern Illinois, with loan production offices of large money center banks headquartered in other states, as well as with savings and loan associations, credit unions, finance companies, mortgage bankers, leasing companies and other institutions. This competition may lead to a reduction in our net interest income and increases in our costs of doing business.

Interest rates and other conditions impact our results of operations.

Our profitability is in part a function of the spread between the interest rates earned on investments and loans and the interest rates paid on deposits and other interest-bearing liabilities. Like most banking institutions, our net interest spread and margin will be affected by general economic conditions and other factors, including fiscal and monetary policies of the federal government, that influence market interest rates and our ability to respond to changes