HMN FINANCIAL INC
Form 10-K
March 04, 2011

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-K

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

For the fiscal year ended December 31, 2010

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: 0-24100.
HMN FINANCIAL, INC.
(Exact Name of Registrant as Specified in its Charter)

Delaware	**41-1777397**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
1016 Civic Center Drive Northwest, PO Box 6057 Rochester, Minnesota	**55901**
(Address of Principal Executive Offices)	(Zip Code)

(507) 535-1200
Registrant s Telephone Number, Including Area Code

Securities Registered Pursuant to Section 12(b) of the Act: Common Stock, par value $.01 per share(Title of each class)

Securities Registered Pursuant to Section 12(g) of the Act: None

Name of each exchange on which registered: Nasdaq Global Market

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 þ

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 þ

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 requirements for the past 90 days. YES þ NO o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).YES o NOo

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, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company þ

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES o NO þ

As of June 30, 2010, the aggregate market value of the registrant s common stock held by non-affiliates of the registrant was $12.9 million based on the closing stock price of $4.58 on such date as reported on the Nasdaq Global Market.

As of February 18, 2011, the number of outstanding shares of common stock of the registrant was 4,388,399.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s annual report to stockholders for the year ended December 31, 2010, are incorporated by reference in Parts I, II and IV of this Form 10-K. Portions of the registrant s definitive proxy statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days after the close of the registrant s fiscal year ended December 31, 2010 are incorporated by reference in Part III of this Form 10-K.

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Forward-Looking Statements

The information presented or incorporated by reference in this Annual Report on Form 10-K under the headings Item 1. Business and Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934. These statements are often identified by such forward-looking terminology as expect, intent, look, believe, anticip estimate, project, seek, may, will, would, could, should, trend, target, and goal or similar stater such terms and include, but are not limited to those relating to the adequacy and amount of available liquidity and capital resources to the Bank, the Company s liquidity and capital requirements, changes in the size of the Bank s loan portfolio, the recovery of the valuation allowance on deferred tax assets, the amount and mix of the Bank s non-performing assets and the adequacy of the allowance there for, future losses on non-performing assets, the amount of interest-earning assets, the amount and mix of brokered and other deposits (including the Company s ability to renew brokered deposits), the availability of alternate funding sources, the payment of dividends, the future outlook for the Company, and the Company s and the Bank s compliance with regulatory standards generally (including the Bank s status as well-capitalized), and supervisory agreements, individual capital requirements or other supervisory directives or requirements to which the Company or the Bank are expressly subject, specifically. A number of factors could cause actual results to differ materially from the Company s assumptions and expectations. These include but are not limited to the adequacy and marketability of real estate securing loans to borrowers, possible legislative and regulatory changes, including changes in the degree and manner of regulatory supervision, the ability of the Company and the Bank to establish and adhere to plans and policies relating to, among other things, capital, business, non-performing assets, loan modifications, documentation of loan loss allowance and concentrations of credit that are satisfactory to the OTS in accordance with the terms of the Company and Bank supervisory agreements and to otherwise manage the operations of the Company and the Bank to ensure compliance with other requirements set forth in the supervisory agreements; the ability of the Company and the Bank to obtain required consents from the OTS under the supervisory agreements or other directives; adverse economic, business and competitive developments such as shrinking interest margins, reduced collateral values, deposit outflows and reduced demand for financial services and loan products; changes in accounting policies and guidelines, or monetary and fiscal policies of the federal government or tax laws; international economic developments; changes in credit or other risks posed by the Company s loan and investment portfolios; technological, computer-related or operational difficulties; adverse changes in securities markets; results of litigation; collateral advance rates and policies of the FHLB; costs associated with alternate funding sources; or other significant uncertainties. Additional factors that may cause actual results to differ from the Company s assumptions and expectations include those set forth in this Form 10-K. All forward-looking statements are qualified by, and should be considered in conjunction with, such cautionary statements. For additional discussion of the risks and uncertainties applicable to the Company, see the Risk Factors section of this Form 10-K.

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PART I

ITEM 1. BUSINESS

General

HMN Financial, Inc. (HMN or the Company) is a stock savings bank holding company that owns 100% of Home Federal Savings Bank (the Bank). The Bank has a community banking philosophy and operates retail banking and loan production facilities in Minnesota and Iowa. The Bank has one wholly owned subsidiary, Osterud Insurance Agency, Inc. (OIA) which offers financial planning products and services. HMN has another wholly owned subsidiary, Security Finance Corporation (SFC) which acts as an intermediary for the Bank in completing certain real estate transactions. The Company was incorporated in Delaware in 1994.

As a community-oriented financial institution, the Company seeks to serve the financial needs of communities in its market area. The Company s business involves attracting deposits from the general public and businesses and using such deposits to originate or purchase one-to-four family residential, commercial real estate, and multi-family mortgage loans as well as consumer, construction, and commercial business loans. The Company also invests in mortgage-backed and related securities, U.S. government agency obligations and other permissible investments. The executive offices of the Company are located at 1016 Civic Center Drive Northwest, Rochester, Minnesota 55901. Its telephone number at that address is (507) 535-1200. The Company s website is located at www.hmnf.com. Information contained on the Company s website is expressly not incorporated by reference into this Form 10-K.

Market Area

The Company serves the southern Minnesota counties of Fillmore, Freeborn, Houston, Mower, Olmsted and Winona and portions of Steele, Dodge, Goodhue and Wabasha through its corporate office located in Rochester, Minnesota and its ten branch offices located in Albert Lea, Austin, La Crescent, Rochester, Spring Valley and Winona, Minnesota. The portion of the Company s southern Minnesota market area consisting of Rochester and the contiguous communities is composed of primarily urban and suburban communities, while the balance of the Company s southern Minnesota market area consists primarily of rural areas and small towns. Primary industries in the Company s southern Minnesota market area include manufacturing, agriculture, health care, wholesale and retail trade, service industries and education. Major employers include the Mayo Clinic, Hormel Foods (a food processing company), and IBM. The Company s market area is also the home of Winona State University, Rochester Community and Technical College, University of Minnesota Rochester, Winona State University Rochester Center and Austin s Riverland Community College.

The Company serves Dakota County, in the southern portion of the Minneapolis and St. Paul metropolitan area, from its office located in Eagan, Minnesota. Major employers in this market area include Delta Airlines, Cenex Harvest States (cooperative), Flint Hills Resources LP (oil refinery), Unisys Corp (computer software) and West Group, a Thomson Reuters business (legal research).

The Company serves the Iowa counties of Marshall and Tama through its branch offices located in Marshalltown and Toledo, Iowa. Major employers in the area are Swift & Company (pork processors), Fisher Controls International (valve and regulator manufacturing), Lennox Industries (furnace and air conditioner manufacturing), Iowa Veterans Home (hospital care), Marshall Community School District (education), Marshall Medical & Surgical Center (hospital care) and Meskwaki Casino (gaming operations).

Based upon information obtained from the U.S. Census Bureau for 2009 (the last year for which information is available), the population of the six primary counties in the Bank s southern Minnesota market area was estimated as follows: Fillmore 20,838; Freeborn 31,002; Houston 19,244; Mower 38,215; Olmsted 143,962; and Winona 49,436. For these same six counties, the median household income from the U.S. Census Bureau for 2008 (the last year for which information is available) ranged from $45,155 to $66,993. The population of Dakota County was 396,500 and the median household income was $71,988. With respect to Iowa, the population of Marshall County was 39,259 and the population of Tama County was 17,377. The median household income of these two counties ranged from $44,615 to $47,298.

The Company also serves a diverse high net worth customer base primarily in the seven county metropolitan area of Minneapolis and St. Paul from its private banking office, located in Edina, Minnesota. The Company serves a

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similar group of individuals and businesses in Olmsted County from its private banking office located in Rochester, Minnesota.

Lending Activities

General. Historically, the Company has originated 15 and 30 year fixed rate mortgage loans secured by one-to-four family residences for its loan portfolio. Over the past 10 years, the Company has focused on managing interest rate risk and increasing interest income by increasing its investment in shorter term and generally higher yielding commercial real estate, commercial business and construction loans, while reducing its investment in longer term one-to-four family real estate loans. The Company continues to originate 15 and 30 year fixed rate mortgage loans and some shorter term fixed rate loans. The shorter term fixed and adjustable rate loans are placed into portfolio, while the majority of the 15 and 30 year fixed rate mortgage loans are sold in the secondary mortgage market. Mortgage interest rates were at historical lows in 2010 and very few 15 and 30 year loans were placed into portfolio as most were sold into the secondary market in order to manage the Company s interest rate risk position. The Company also offers an array of consumer loan products that include both open and closed end home equity loans. Home equity lines of credit have adjustable interest rates based upon the prime rate, as published in the Wall Street Journal, plus a margin. Refer to Notes 4 and 5 of the Notes to Consolidated Financial Statements in the Annual Report for more information on the loan portfolio (incorporated by reference in Item 8 of Part II of this Form 10-K).

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The following table shows the composition of the Company s loan portfolio by fixed and adjustable rate loans as of December 31:

	2010		2009		2008		2007		2006	
(Dollars in thousands)	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Fixed rate Loans										
Real estate:										
One-to-four family:										
GEM	$ 4,221	0.60%	$ 7,590	0.92%	$ 8,962	0.97%	$ 11,854	1.34%	$ 13,335	1.70%
Other	65,203	9.20	70,104	8.50	79,728	8.62	80,663	9.14	62,184	7.92
Total one-to-four family	69,424	9.80	77,694	9.42	88,690	9.59	92,517	10.48	75,519	9.62
Multi-family	23,079	3.26	11,455	1.39	4,703	0.50	5,952	0.68	6,238	0.80
Commercial	110,267	15.56	103,036	12.49	91,835	9.93	69,276	7.84	100,562	12.80
Construction or development	5,743	0.81	11,148	1.35	29,344	3.17	16,519	1.87	6,640	0.84
Total real estate loans	208,513	29.43	203,333	24.65	214,572	23.19	184,264	20.87	188,959	24.06
Consumer loans:										
Savings	534	0.07	324	0.04	277	0.03	358	0.04	814	0.10
Automobile	604	0.09	902	0.11	1,333	0.15	1,730	0.20	3,093	0.39
Home equity	18,127	2.56	21,396	2.59	22,961	2.48	20,249	2.29	21,181	2.70
Mobile home	764	0.11	977	0.12	1,316	0.14	1,699	0.19	2,052	0.26
Land/Lot loans	2,139	0.30	2,554	0.31	1,956	0.21	2,616	0.30	1,426	0.18
Other	2,790	0.39	4,777	0.58	3,087	0.33	2,007	0.23	2,192	0.28
Total consumer loans	24,958	3.52	30,930	3.75	30,930	3.34	28,659	3.25	30,758	3.91
Commercial business loans	68,962	9.73	76,936	9.33	90,458	9.78	90,688	10.27	65,347	8.32
Total non-real estate loans	93,920	13.25	107,866	13.08	121,388	13.12	119,347	13.52	96,105	12.23
Total fixed rate loans	302,433	42.68	311,199	37.73	335,960	36.31	303,611	34.39	285,064	36.29
Adjustable rate Loans										
Real estate:										
One-to-four family	59,111	8.34	66,937	8.12	73,299	7.92	60,456	6.85	58,751	7.48
Multi-family	25,187	3.56	47,811	5.80	24,589	2.66	23,120	2.62	23,624	3.01
Commercial	182,607	25.77	209,678	25.42	233,469	25.23	212,547	24.08	193,928	24.69
Construction or development	9,508	1.34	29,264	3.54	78,939	8.53	94,516	10.70	53,538	6.82
Total real estate loans	276,413	39.01	353,690	42.88	410,296	44.34	390,639	44.25	329,841	42.00
Consumer:										

Home equity	44,647	6.30	50,061	6.07	52,194	5.64	51,322	5.81	54,328	6.91
Land/Lot loans	371	0.05	636	0.08	1,013	0.11	1,535	0.17	4,076	0.52
Other	627	0.09	588	0.07	2,464	0.27	3,393	0.39	686	0.09
Total consumer loans	45,645	6.44	51,285	6.22	55,671	6.02	56,250	6.37	59,090	7.52
Commercial business loans	84,077	11.87	108,589	13.17	123,317	13.33	132,271	14.99	111,423	14.19
Total non-real estate loans	129,722	18.31	159,874	19.39	178,988	19.35	188,521	21.36	170,513	21.71
Total adjustable rate loans	406,135	57.32	513,564	62.27	589,284	63.69	579,160	65.61	500,354	63.71
Total loans	708,568	100.00%	824,763	100.00%	925,244	100.00%	882,771	100.00%	785,418	100.00%
Less										
Loans in process *	0		0		0		3,011		5,252	
Unamortized (premiums) discounts	413		177		569		(11)		40	
Net deferred loan fees	1,086		1,518		2,529		2,245		2,021	
Allowance for losses on loans	42,828		23,812		21,257		12,438		9,873	
Total loans receivable, net	$ 664,241		$ 799,256		$ 900,889		$ 865,088		$ 768,232	

* *- Core data processing systems converted in 2008, loans in process amounts are reflected in loan amounts in table.*

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The following table illustrates the interest rate maturities of the Company s loan portfolio at December 31, 2010. Loans which have adjustable or renegotiable interest rates are shown as maturing in the period during which the contract is due. Scheduled repayments of principal are reflected in the year in which they are scheduled to be paid. The schedule does not reflect the effects of possible prepayments or enforcement of due-on-sale clauses.

	One-to-four family		Real Estate Multi-family and Commercial		Construction or Development		Consumer		Commercial Business		Total	
During Years Ending mber 31,	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Wei Ave Ra
(1)	$ 22,446	5.54%	$ 86,887	4.53%	$ 8,308	3.12%	$ 4,046	9.03%	$ 61,539	4.29%	$ 183,226	4.
	6,840	6.11	39,971	5.22	1,665	4.93	2,784	7.56	48,829	5.84	100,089	5.
	7,169	5.35	69,533	5.28	2,333	0.00	5,000	6.32	17,665	4.24	101,700	5.
through 2015	2,578	6.63	31,894	5.86	566	4.26	9,981	6.51	8,472	6.76	53,491	6.
through 2020	13,942	5.74	68,829	6.37	0	0.00	4,208	7.58	15,517	6.77	102,496	6.
through 2035	24,434	4.49	43,723	6.26	650	6.00	44,576	5.67	1,017	6.17	114,400	5.
and thereafter	51,126	5.54	303	5.25	1,729	4.88	8	0.00	0	0.00	53,166	5.
	$ 128,535		$ 341,140		$ 15,251		$ 70,603		$ 153,039		$ 708,568	

(1) Includes demand loans, loans having no stated maturity and overdraft loans.

The total amount of loans due after December 31, 2011 that have predetermined interest rates is $219.9 million, while the total amount of loans due after such date that have floating or adjustable interest rates is $305.4 million. At December 31, 2010, construction or development loans were $10.7 million for one-to-four family dwellings, $3.9 million for multi-family and $0.7 million for nonresidential.

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The aggregate amount of loans and extensions of credit that the Bank is permitted to make to any one borrower is generally limited to 15% of unimpaired capital and surplus. In addition to the 15% limit, the Bank is permitted to lend an additional amount equal to 10% of unimpaired capital and surplus if the additional amount is fully secured by readily marketable collateral having a current market value of at least 100% of the loan or extension of credit. Similarly, the Bank is permitted to lend additional amounts equal to the lesser of 30% of unimpaired capital and surplus or $30 million for certain residential development loans. Applicable law establishes a number of rules for combining loans to separate borrowers. Loans or extensions of credit to one person may be attributed to other persons if: (i) the proceed of a loan or extension of credit are used for the direct benefit of the other person; or (ii) a common enterprise is deemed to exist between persons. At December 31, 2010, based upon the 15% limitation, the Bank s regulatory limit for loans to one borrower was approximately $13.7 million. At December 31, 2010, excluding loans subject to an exception to the 15% lending limit, loans to two borrowers exceeded the current 15% limitation, by $216,000 and $434,000, respectively. These loans are not considered to be a violation of the regulatory lending limit requirements as they were within the Bank s lending limit when originated and the Bank is making efforts to bring these loans into compliance with the current lending limit. As of December 31, 2010, other loans also exceeded the 15% limit but were subject to additional limits referenced above. At December 31, 2010, the Bank s largest aggregate amount of loans to one borrower totaled $24.4 million. All of the loans for the largest borrower were performing in accordance with their terms and the borrower had no affiliation with the Bank other than its relationship as a borrower.

All of the Bank s lending is subject to its written underwriting standards and to loan origination procedures. Decisions on loan applications are made on the basis of detailed applications and property valuations determined by an independent appraiser. The loan applications are designed primarily to determine the borrower s ability to repay. The more significant items on the application are verified through the use of credit reports, financial statements, tax returns or confirmations.

One-to-four family loans that are equal to or less than the conforming/saleable loan dollar limits as established by FHLMC/FNMA may be approved by a Market President or designated underwriter. This limit was $417,000 for both 2010 and 2009. Loans up to and including $500,000, need the approval of one of the above personnel and a Loan Committee Member. Loans over $500,000 need approval from the Board of Directors or its Executive Committee.

The Bank s individual commercial loan officers have the authority to approve loans that meet the guidelines established by the Bank s commercial loan policy for loans up to $250,000 based on their individual delegated aggregate relationship authority. Individual delegated aggregate relationship authority varies by loan officer, with the highest individual authorities being $250,000. The aggregate relationship amount is determined by the total customer credit commitments outstanding plus the new loan request amount. The Business Banking Department Managers can approve loans up to a $500,000 aggregate relationship. The Chief Commercial Credit Officer and Limited Committee (consisting of the lender and the Business Banking Department Manager) or the Chief Credit Officer and Limited Committee have approval authorities for $1.0 million aggregate and $2.0 million aggregate, respectively. New relationship loan requests greater than $2.0 million to our internal loan limit to one borrower of $4.5 million, or existing loan relationship requests greater than $2.0 million to $7.5 million, are approved by the Senior Loan Committee. Any loan requests greater than these limits must be approved by the Bank s Board of Directors or its Executive Loan Committee.

The Bank generally requires title insurance on its mortgage loans, as well as fire and extended coverage casualty insurance in amounts at least equal to the principal amount of the loan or the value of improvements on the property. The Bank also requires flood insurance to protect the property securing its interest when the property is located in a flood plain.

One-to-Four Family Residential Real Estate Lending. At December 31, 2010, the Company s one-to-four family real estate loans, consisting of both fixed rate and adjustable rate loans, totaled $128.5 million, a decrease of $16.1 million, from $144.6 million at December 31, 2009. The decrease in the one-to-four family loans in 2010 is the result of selling more of the loans that were originated into the secondary market, instead of placing them into the portfolio, in order to reduce the Company s interest rate risk position. The Company s short term

strategy is to continue to sell the majority of the loans originated into the secondary market at least until market interest rates increase from their current levels.

The Company offers conventional fixed rate one-to-four family loans that have maximum terms of 30 years. In order to manage interest rate risk, the Company typically sells the majority of fixed rate loan originations with terms to maturity of 15 years or greater that are eligible for sale in the secondary market. The interest rates charged on the fixed rate loan products are based on the secondary market delivery rates, as well as other competitive factors. The Company also originates fixed rate loans with terms up to 30 years that are insured by the Federal Housing Authority (FHA), Veterans Administration, Minnesota Housing Finance Agency or Iowa Finance Authority.

The Company also offers one-year adjustable rate mortgages (ARMs) at a margin (generally 275 to 375 basis points) over the yield on the Average Monthly One Year U.S. Treasury Constant Maturity Index for terms of up to 30 years. The ARM loans offered by the Company allow the borrower to select (subject to pricing) an initial period of one year, three years, or five years between the loan origination and the date the first interest rate change occurs. The ARMs generally have a 200 basis point annual interest rate change cap and a lifetime cap of 600 basis points over or under the initial rate. The Company s originated ARMs do not permit negative amortization of principal, generally do not contain prepayment penalties and are not convertible into fixed rate loans. Because of the low interest rate environment that has existed over the last couple of years, a limited number of ARM loans have been originated as consumers have opted for the longer term fixed rate loans.

In underwriting one-to-four family residential real estate loans, the Company evaluates the borrower s credit history; ability to make principal, interest and escrow payments; the value of the property that will secure the loan; and debt to income ratios. Properties securing one-to-four family residential real estate loans made by the Company are appraised by independent appraisers. The Company originates residential mortgage loans with loan-to-value ratios up to 95% for owner-occupied homes and up to 90% for non-owner occupied homes; however, private mortgage insurance is generally required to reduce the Company s exposure to 80% of value or less on most loans. In addition, all non-owner occupied properties must be self supporting using the debt service ratio requirements, which usually requires approximately a 50% down payment on one-to-four family dwellings. The Company generally seeks to underwrite its loans in accordance with secondary market or FHA standards.

The Company s residential mortgage loans customarily include due-on-sale clauses giving it the right to declare the loan immediately due and payable in the event that, among other things, the borrower sells or otherwise disposes of the property subject to the mortgage.

Fixed rate loans in the Company s portfolio include both growing equity mortgages (GEM) loans and conventional fixed rate loans. The GEM loans require payments that increase after the first year. Under the GEM loans, the monthly payments required for the first year are established based on a 30-year amortization schedule. Depending upon the program selected, the payments may increase in the succeeding years by amounts ranging from 0% to 6.2%. Most of the GEM loans originated by the Company provide for at least four annual payment increases over the first five years of the loan. The increased payments required under GEM loans are applied to principal and have the effect of shortening the term to maturity; the GEM loans do not permit negative amortization. The Company currently offers one GEM product with a contractual maturity of approximately 15 years. The GEM loans are generally priced based upon loans with similar contractual maturities. The GEMs were targeted to consumers who anticipated future increases in income and who wanted an amortization schedule of less than 30 years. Low mortgage interest rates over the past several years have eliminated the demand for GEM loans as consumers have opted for shorter term fixed rate loans and none of these loans have been originated in the past three years. The decreased originations of GEM loans over the past several years has mitigated the risks associated with increasing loan payment amounts in a weakening economy with lower home values as those borrowers that have taken out these loans in the past have had time to build equity in their homes to offset a portion of the decline in value.

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Commercial Real Estate and Multi-Family Lending. The Company originates permanent commercial real estate and multi-family loans secured by properties located primarily in its market area. It also purchases a limited amount of participations in commercial real estate and multi-family loans originated by third parties on properties outside of its market area. The commercial real estate and multi-family loan portfolio includes loans secured by motels, hotels, apartment buildings, churches, ethanol plants, manufacturing plants, office buildings, business facilities, shopping malls, nursing homes, golf courses, restaurants, warehouses and other non-residential building properties primarily located in the upper Midwestern portion of the United States.

Permanent commercial real estate and multi-family loans are generally originated for a maximum term of 10 years and may have longer amortization periods with balloon maturity features. The interest rates may be fixed for the term of the loan or have adjustable features that are tied to the prime rate or another published index. Commercial real estate and multi-family loans are generally written in amounts up to 80% of the lesser of the appraised value of the property or the purchase price and generally have a debt service coverage ratio of at least 120%. The debt service coverage ratio is the ratio of net cash from operations to debt service payments. The Company may originate construction loans secured by commercial or multi-family real estate, or may purchase participation interests in third party originated construction loans secured by commercial or multi-family real estate.

Appraisals on commercial real estate and multi-family real estate properties are performed by independent appraisers prior to the time the loan is made. For transactions less than $250,000, the Company may use an internal valuation. All appraisals on commercial and multi-family real estate are reviewed and approved by a commercial loan officer, credit manager, commercial department manager or a qualified third party. The Bank s underwriting procedures require verification of the borrower s credit history, income and financial statements, banking relationships and income projections for the property. The commercial loan policy generally requires personal guarantees from the proposed borrowers. An initial on-site inspection is generally required for all collateral properties for loans with balances in excess of $250,000. Independent annual reviews are performed for aggregate commercial lending relationships that exceed $500,000. The reviews cover financial performance, documentation completeness and accuracy of loan risk ratings.

Multi-family and commercial real estate loans generally present a higher level of risk than loans secured by one-to-four family residences. This greater risk is due to several factors, including the concentration of principal in a limited number of loans and borrowers, the effects of general economic conditions on income producing properties and the increased difficulty of evaluating and monitoring these types of loans. Furthermore, the repayment of loans secured by multi-family and commercial real estate is typically dependent upon the successful operation of the related real estate project. If the cash flow from the project is reduced (for example, if leases are not obtained or renewed), the borrower s ability to repay the loan may be impaired. At December 31, 2010, $36.7 million of loans in the commercial real estate portfolio were nonperforming, with the largest two relationships being an $5.9 million loan secured by a residential development in Minnesota and a $5.0 million loan secured by an alternative fuel plant in Nebraska.

Construction Lending. The Company makes construction loans to individuals for the construction of their residences and to builders for the construction of one-to-four family residences. It also makes a very limited number of loans to builders for houses built on speculation. Construction loans also include commercial real estate loans.

Almost all loans to individuals for the construction of their residences are structured as permanent loans. These loans are made on the same terms as residential loans, except that during the construction phase, which typically lasts up to twelve months, the borrower pays interest only. Generally, the borrower also pays a construction fee at the time of origination equal to the origination fee plus other costs associated with processing the loan. Residential construction loans are underwritten pursuant to the same guidelines used for originating residential loans on existing properties.

Construction loans to builders or developers of one-to-four family residences generally carry terms of one year or less and may permit the payment of interest from loan proceeds.

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Construction loans to owner occupants are generally made in amounts up to 95% of the lesser of cost or appraised value, but no more than 90% of the loan proceeds can be disbursed until the building is completed. The Company generally limits the loan-to-value ratios on loans to builders to 80%. Prior to making a commitment to fund a construction loan, the Company requires a valuation of the property, financial data, and verification of the borrower s income. The Company obtains personal guarantees for substantially all of its construction loans to builders. Personal financial statements of guarantors are also obtained as part of the loan underwriting process. Construction loans are generally located in the Company s market area.

Construction loans are obtained principally through continued business from builders and developers who have previously borrowed from the Bank, as well as referrals from existing customers and walk-in customers. The application process includes a submission to the Bank of accurate plans, specifications and costs of the project to be constructed. These items are used as a basis to determine the appraised value of the subject property to be built.

At December 31, 2010, construction loans totaled $15.3 million, of which one-to-four family residential totaled $10.7 million, multi-family residential totaled $3.9 million and commercial real estate totaled $0.7 million.

The nature of construction loans makes them more difficult to evaluate and monitor, especially in a market where home prices have been declining. The risk of loss on a construction loan is dependent largely upon the accuracy of the initial estimate of the property s value upon completion of the project, experience of the builder, and the estimated cost (including interest) of the project. If the estimate of value proves to be inaccurate, the Company may be confronted, at or prior to the maturity of the loan, with a project having a value that is insufficient to assure full repayment and/or the possibility of having to make substantial investments to complete and sell the project. Because defaults in repayment may not occur during the construction period, it may be difficult to identify problem loans at an early stage. In these cases, the Company may be required to modify the terms of the loan.

Consumer Lending. The Company originates a variety of consumer loans, including home equity loans (open-end and closed-end), automobile, mobile home, lot loans, loans secured by deposit accounts and other loans for household and personal purposes.

Consumer loan terms vary according to the type and value of collateral, length of contract and creditworthiness of the borrower. The Company s consumer loans are made at fixed or adjustable interest rates, with terms up to 20 years for secured loans and up to five years for unsecured loans.

The Company s home equity loans are written so that the total commitment amount, when combined with the balance of any other outstanding mortgage liens, may not exceed 95% of the appraised value of the property or an internally established market value. Internal market values are established using current market data, including tax assessment values and recent sales data, and are typically lower than third party appraised values. The closed-end home equity loans are written with fixed or adjustable rates with terms up to 15 years. The open-end home equity lines are written with an adjustable rate with a 10-year draw period that requires interest only payments followed by a 10-year repayment period that fully amortizes the outstanding balance. The consumer may access the open-end home equity line either by making a withdrawal at the Bank or writing a check on the home equity line of credit account. Open and closed-end equity loans, which are generally secured by second mortgages on the borrower s principal residence, represented 88.9% of the Company s consumer loan portfolio at December 31, 2010.

The underwriting standards employed by the Company for consumer loans include a determination of the applicant s payment history on other debts and ability to meet existing obligations and payments on the proposed loan. Although creditworthiness of the applicant is of primary consideration, the underwriting process also includes a comparison of the value of the security, if any, in relation to the proposed loan amount. Consumer loans may entail greater credit risk than do residential mortgage loans, particularly in the case of consumer loans that are unsecured or are secured by rapidly depreciable assets, such as automobiles or mobile homes. In these cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. In addition, consumer loan collections are dependent on the borrower s continuing financial stability, and thus are more likely to be affected by adverse personal circumstances. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount that can be recovered on such loans. At December 31, 2010, $0.2 million of the consumer loan portfolio was non-performing compared to $4.1 million at December 31, 2009.

Commercial Business Lending. The Company maintains a portfolio of commercial business loans to borrowers associated with the real estate industry as well as to retail, manufacturing operations and professional firms. The Company s commercial business loans generally have terms ranging from six months to five years and may have either fixed or variable interest rates. The Company s commercial business loans generally include personal guarantees and are usually, but not always, secured by business assets such as inventory, equipment, leasehold interests in equipment, fixtures, real estate and accounts receivable. The underwriting process for commercial business loans includes consideration of the borrower s financial statements, tax returns, projections of future business operations and inspection of the subject collateral, if any. The Company also purchases participation interests in commercial business loans originated outside of the Company s market area from third party originators. These loans generally have underlying collateral of inventory or equipment and repayment periods of less than ten years.

Unlike residential mortgage loans, which generally are made on the basis of the borrower s ability to make repayment from his or her income, and which are secured by real property with more easily ascertainable value, commercial business loans are of higher risk and typically are made on the basis of the borrower s ability to make repayment from the cash flow of the borrower s business. As a result, the availability of funds for the repayment of commercial business loans may be substantially dependent on the success of the business itself. Furthermore, the collateral securing the loans may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business. At December 31, 2010, $26.3 million of loans in the commercial business loan portfolio were non-performing compared to $17.8 million at December 31, 2009.

Originations, Purchases and Sales of Loans and Mortgage-Backed and Related Securities

Real estate loans are generally originated by the Company s salaried and commissioned loan officers. Loan applications are taken in all branch and loan production offices.

The Company originates both fixed and adjustable rate loans, however, its ability to originate loans is dependent upon the relative customer demand for loans in its markets. Demand for adjustable rate loans is affected by the interest rate environment and the number of adjustable rate loans remained low in 2010 due to the low long term fixed mortgage rates that existed during the year. The Company originated for its portfolio $5.5 million of one-to-four family adjustable rate loans during 2010, a decrease of $5.8 million, from $11.3 million in 2009. The Company also originated for its portfolio $7.6 million of fixed rate one-to-four family loans during 2010, a decrease of $3.5 million, from $11.1 million for 2009.

During the past several years, the Company has focused its portfolio loan origination efforts on commercial real estate, commercial business and consumer loans because these loans have terms to maturity and adjustable interest rate characteristics that are generally more beneficial to the Company in managing interest rate risk than single family fixed rate conventional loans. The Company originated $72.5 million of multi-family and commercial real estate, commercial business and consumer loans (which excludes commercial real estate loans in construction or development) during 2010, a decrease of $20.5 million, from originations of $93.0 million for 2009. The decrease in originations reflects the reduced demand for credit as a result of the difficult economic environment that existed in 2010.

In order to supplement loan demand in the Company s market area and geographically diversify its loan portfolio, the Company purchases participations in real estate loans from selected sellers, with yields based upon then-current market rates. The Company reviews and underwrites all loans purchased to ensure that they meet the

Company s underwriting standards and the seller generally continues to service the loans. The Company purchased $10.2 million of loans during 2010, an increase of $3.6 million, from $6.6 million during 2009. Purchases were increased in 2010 as a result of the reduced local commercial loan demand. The purchased commercial real estate and commercial business loans have terms and interest rates that are similar in nature to the Company s originated commercial and business portfolio. Refer to Notes 4 and 5 of the Notes to Consolidated Financial Statements in the Annual Report to Security Holders for the year ended December 31, 2010 for more information on purchased loans (incorporated by reference in Item 8 of Part II of this Form 10-K).

The Company has some mortgage-backed and related securities that are held, based on investment intent, in the available for sale portfolio. The Company did not purchase any mortgage-backed securities in 2010 or 2009. No mortgage-backed securities were purchased in 2010 as debt instruments issued by federal agencies such as Fannie Mae and Freddie Mac became more appealing to purchase due to their shorter duration given the low interest rate environment that existed in 2010. The Company did not sell any mortgage backed securities in 2010 and sold $98,000 in mortgage backed securities in 2009. See Investment Activities.

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The following table shows the loan and mortgage-backed and related securities origination, purchase, acquisition, sale and repayment activities of the Company for the periods indicated.

LOANS HELD FOR INVESTMENT

	Year Ended December 31,		
(Dollars in thousands)	2010	2009	2008
Originations by type:			
Adjustable rate:			
Real estate -			
- one-to-four family	$ 5,539	11,300	24,986
- multi-family	0	1,357	4,418
- commercial	12,504	3,966	38,700
- construction or development	3,042	4,596	49,093
Non-real estate -			
- consumer	9,413	20,295	19,560
- commercial business	11,539	18,881	44,968
Total adjustable rate	42,037	60,395	181,725
Fixed rate:			
Real estate -			
- one-to-four family	7,606	11,141	21,023
- multi-family	450	803	206
- commercial	15,165	8,142	14,936
- construction or development	6,492	1,917	26,650
Non-real estate -			
- consumer	14,745	15,184	18,251
- commercial business	8,732	24,403	38,926
Total fixed rate	53,190	61,590	119,992
Total loans originated	95,227	121,985	301,717
Purchases:			
Real estate -			
- commercial	5,683	904	4,505
- construction or development	625	388	1,596
Non-real estate -			
- commercial business	3,930	5,264	4,275
Total loans purchased	10,238	6,556	10,376
Sales, participations and repayments:			
Real estate -			
- one-to-four family	390	0	4,248
- multi-family	0	649	0
- commercial	3,921	3,579	21,827

- construction or development	0	0	7,712
Non-real estate -			
- consumer	1,813	423	440
- commercial business	6,230	975	38,559
Total sales	12,354	5,626	72,786
Transfers to loans held for sale	4,478	5,228	7,292
Principal repayments	181,716	191,870	172,350
Total reductions	198,548	202,724	252,428
Decrease in other items, net	(23,112)	(26,298)	(17,192)
Net increase (decrease)	$ (116,195)	(100,481)	42,473

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LOANS HELD FOR SALE

(Dollars in thousands)	Year Ended December 31, 2010	2009	2008
Originations by type:			
Adjustable rate:			
Real estate -			
- one-to-four family	$ 0	399	1,009
Total adjustable rate	0	399	1,009
Fixed rate:			
Real estate -			
- one-to-four family	81,659	113,025	48,308
Total fixed rate	81,659	113,025	48,308
Total loans originated	81,659	113,424	49,317
Sales and repayments:			
Real estate -			
- one-to-four family	86,367	118,202	57,359
Total sales	86,367	118,202	57,359
Transfers from loans held for investment	(4,478)	(5,228)	(7,292)
Changes in deferred fees and market value	7	33	(37)
Total reductions	81,896	113,007	50,030
Net increase (decrease)	$ (237)	417	(713)

MORTGAGE-BACKED AND RELATED SECURITIES

(Dollars in thousands)	Year Ended December 31, 2010	2009	2008
Purchases:			
Mortgage-backed securities:			
FNMA MBSs	$ 0	0	59,556
Total purchases	0	0	59,556
Sales:			
Mortgage-backed securities:			
Fixed rate MBSs	0	(98)	0
CMOs and REMICs	0	(2,039)	0

Total sales	0	(2,137)	0
Principal repayments	(20,053)	(25,905)	(697)
Net increase (decrease)	$ (20,053)	(23,768)	58,859

Classified Assets and Delinquencies

***Classification of Assets*.** Federal regulations require that each savings institution evaluate and classify its assets on a regular basis. In addition, in connection with examinations of savings institutions, the Office of Thrift Supervision (OTS) and the Federal Deposit Insurance Corporation (FDIC) examiners may identify problem assets and, if appropriate, require them to be classified with an adverse rating. There are three adverse classifications: substandard, doubtful and loss. Assets classified as substandard have one or more defined weaknesses and are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have the weaknesses of those classified as substandard, with additional characteristics that make collection in full on the basis of currently existing facts, conditions and values questionable, and there is a high possibility of loss. An asset classified as loss is considered uncollectible and of such little value that continuance as an asset on the balance sheet of the institution is not warranted. Assets classified as substandard or doubtful require the institution to establish prudent specific allowances for loan losses. If an asset, or portion thereof, is classified as loss, the institution must either establish specific allowances for loan losses in the amount of 100% of the portion of the asset classified as loss, or charge off such amount. If an institution does not agree with an OTS or FDIC examiner s classification of an asset, it may appeal the determination to the OTS District Director or the appropriate FDIC personnel, depending on the regulator. On the basis of management s review of its assets, at December 31, 2010, the Bank classified a total of $134.5 million of its loans and other assets as follows:

(Dollars in thousands)	One-to-Four Family	Real Estate Construction or Development	Commercial and Multi-family	Consumer	Commercial Business	Other Assets	Total
Substandard	$ 14,209	6,003	38,883	197	17,439	11,301	88,032
Doubtful	1,081	2,397	9,089	51	6,675	3,636	22,929
Loss	333	32	10,435	58	11,260	1,458	23,576
Total	$ 15,623	8,432	58,407	306	35,374	16,395	134,537

The Bank s classified assets consist of non-performing loans and loans and other assets of concern discussed in Management s Discussion and Analysis of Financial Condition and Results of Operations (incorporated by reference in Item 7 of Part II of this Form 10-K). At December 31, 2010, these asset classifications were materially consistent with those of the OTS and FDIC.

Delinquency Procedures. Generally, the following procedures apply to delinquent one-to-four family real estate loans. When a borrower fails to make a required payment on a loan, the Company attempts to cure the delinquency by contacting the borrower. A late notice is sent on all loans over 16 days delinquent. Additional written and verbal contacts are made with the borrower between 30 and 60 days after the due date. If the loan is contractually delinquent 90 days, the Company sends a 30-day demand letter to the borrower and after the loan is contractually delinquent 120 days, institutes appropriate action to foreclose on the property. If foreclosed, the property is sold at a sheriff s sale and may be purchased by the Company. Delinquent commercial real estate and commercial business loans are generally handled in a similar manner. The Company s procedures for repossession and sale of consumer collateral are subject to various requirements under state consumer protection laws.

Real estate acquired by the Company as a result of foreclosure is typically classified as real estate in judgment for six to twelve months and thereafter as real estate owned until it is sold. When property is acquired by foreclosure or deed in lieu of foreclosure, it is recorded at the lower of cost or estimated fair value, less the estimated cost of disposition as real estate owned. After acquisition, all costs incurred in maintaining the property are expensed. Costs relating to the development and improvement of the property, however, are capitalized to the extent of fair value less disposition cost.

The following table sets forth the Company s loan delinquencies by loan type, amount and percentage of type at December 31, 2010 for loans past due 60 days or more.

	Loans Delinquent For:						Total Delinquent Loans		
	60-89 Days			90 Days and Over					
(Dollars in thousands)	Number	Amount	Percent of Loan Category	Number	Amount	Percent of Loan Category	Number	Amount	Percent of Loan Category
One-to-four family real estate	10	$ 695	0.54%	26	$ 3,500	2.72%	36	$ 4,195	3.26%
Commercial real estate	2	4,163	1.42	12	19,298	6.59	14	23,461	8.01
Real estate construction or	0	0	0.00	4	5,133	33.66	4	5,133	33.66

development									
Consumer	9	163	0.23	11	207	0.29	20	370	0.52
Commercial business	1	45	0.03	19	20,908	13.66	20	20,953	13.69
Total	22	$ 5,066	0.71%	72	$ 49,046	6.92%	94	$ 54,112	7.64%

Loans delinquent for 90 days and over are non-accruing and are included in the Company s non-performing asset total at December 31, 2010.

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Investment Activities

The Company and the Bank utilize the available for sale securities portfolio in virtually all aspects of asset/liability management. In making investment decisions, the Investment-Asset/Liability Committee considers, among other things, the yield and interest rate objectives, the credit risk position, and the Bank s liquidity and projected cash flow requirements.

Securities. Federally chartered savings institutions have the authority to invest in various types of liquid assets, including United States Treasury obligations, securities of various federal agencies, certain certificates of deposit of insured banks and savings institutions, certain bankers acceptances, repurchase agreements and federal funds. Subject to various restrictions, the holding company of a federally chartered savings institution may also invest its assets in commercial paper, investment grade corporate debt securities and mutual funds whose assets conform to the investments that a federally chartered savings institution is otherwise authorized to make directly.

The investment strategy of the Company and the Bank has been directed toward a mix of high-quality assets (primarily government agency obligations) with short and intermediate terms to maturity. At December 31, 2010, the Company did not own any investment securities of a single issuer that exceeded 10% of the Company s stockholder s equity other than U.S. government agency obligations.

The Bank invests a portion of its liquid assets in interest-earning overnight deposits of the Federal Home Loan Bank of Des Moines (FHLB). Other investments include high grade medium-term (up to four years) federal agency notes, and a variety of other types of mutual funds that invest in adjustable rate mortgage-backed securities, asset-backed securities, repurchase agreements and U.S. Treasury and agency obligations. The Company invests in the same type of investment securities as the Bank and may also invest in taxable and tax exempt municipal obligations and corporate equities such as preferred and common stock. Refer to Note 3 of the Notes to Consolidated Financial Statements in the Annual Report to Security Holders for the year ended December 31, 2010 for additional information regarding the Company s securities portfolio (incorporated by reference in Item 8 of Part II of this Form 10-K).

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The following table sets forth the composition of the Company s securities portfolio, excluding mortgage-backed and related securities, at the dates indicated.

	December 31, 2010				December 31, 2009				December 31, 2008			
llars in thousands)	Amort Cost	Adjusted To	Market Value	% of Total	Amort Cost	Adjusted To	Market Value	% of Total	Amort Cost	Adjusted To	Market Value	% o Tota
urities available for												
Government ncy obligations	$ 117,931	(48)	117,883	82.70%	$ 105,023	845	105,868	85.00%	$ 94,745	2,723	97,468	84.
porate preferred k (1)	700	(525)	175	0.10	700	(525)	175	0.10	700	(350)	350	0.
total	118,631		118,058	82.80	105,723		106,043	85.10	95,445		97,818	84.
eral Home Loan k stock	6,743		6,743	4.70	7,286		7,286	5.80	7,286		7,286	6.
l investment urities and Federal ne Loan Bank k	125,374		124,801	87.50	113,009		113,329	90.90	102,731		105,104	91.