

HMN FINANCIAL INC
Form 10-K
March 11, 2016
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

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

For the fiscal year ended December 31, 2015

OR

**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

(State or other jurisdiction of incorporation or organization)

41-1777397

(I.R.S. Employer Identification No.)

1016 Civic Center Drive Northwest

Rochester, Minnesota

(Address of principal executive offices)

55901

(Zip Code)

(507) 535-1200

Registrant's telephone number, including area code

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

Title of each class

Name of each exchange on which registered

Common Stock, par value \$.01 per share NASDAQ Global 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 [] 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 [] 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 requirements for the past 90 days.

YES [X] NO []

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 (§229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES [X] NO []

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§232.405 of this chapter) 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. [X]

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

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

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

YES [] NO [X]

As of June 30, 2015, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was \$36.0 million based on the closing stock price of \$11.79 on such date as reported on the NASDAQ Global Market.

As of February 22, 2016, the number of outstanding shares of common stock of the registrant was 4,486,299.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's annual report to stockholders for the year ended December 31, 2015 (Annual Report), are incorporated by reference in Parts I and II 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, 2015 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 Form 10-K 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,” “intend,” “look,” “believe,” “anticipate,” “estimate,” “project,” “seek,” “may,” “will,” “could,” “should,” “trend,” “target,” and “goal” or similar statements or variations of such terms and include, but are not limited to, those relating to increasing our core deposit relationships, improving credit quality, reducing non-performing assets, growing earning assets, generating improved financial results (including profitability); the adequacy and amount of available liquidity and capital resources to the Bank; the Company’s liquidity and capital requirements; our expectations for core capital and our strategies and potential strategies for improvement thereof; improvements in loan production; changes in the size of the Bank’s loan portfolio; the amount of the Bank’s non-performing assets and the appropriateness of the allowance therefor; our ability to complete the acquisition of certain assets from Deerwood Bank and integrate its operations; anticipated future levels of the provision for loan losses; future losses on non-performing assets; the amount and mix of interest-earning assets; the amount and mix of interest-bearing liabilities; the availability of alternate funding sources; the payment of dividends by HMN; the future outlook for the Company; the amount of dividends paid by the Federal Home Loan Bank (FHLB) on its stock; the amount of deposits that will be withdrawn from checking and money market accounts and how the withdrawn deposits will be replaced; the projected changes in net interest income based on rate shocks; the range that interest rates may fluctuate over the next twelve months; the net market risk of interest rate shocks; the future outlook for the issuer trust preferred securities held by the Bank; the ability of the Bank to pay dividends to HMN; the ability of HMN to pay the principal and interest payments on its third party note payable; the ability to remain well capitalized; and compliance by the Bank with regulatory standards generally (including the Bank’s status as “well-capitalized”) and other supervisory directives or requirements to which the Company or the Bank are or may become expressly subject, specifically, and possible responses of the Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (FRB), the Bank, and the Company to any failure to comply with any such regulatory standard, directive or requirement.

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 and other collateral securing loans to borrowers; federal and state regulation and enforcement; possible legislative and regulatory changes, including additional changes to regulatory capital rules; the ability of the Bank to comply with other applicable regulatory capital requirements; enforcement activity of the OCC and FRB in the event of our non-compliance with any applicable regulatory standard or requirement; adverse economic, business and competitive developments such as shrinking interest margins, reduced collateral values, deposit outflows, changes in credit or other risks posed by the Company’s loan and investment portfolios; changes in costs associated with alternate funding sources, including changes in collateral advance rates and policies of the FHLB; technological, computer-related or operational difficulties; results of litigation; 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; the Company’s access to and adverse changes in securities markets; the market for credit related assets; the future operating results, financial condition, cash flow requirements and capital spending priorities of the Company; the availability of internal and, as required, external sources of funding; acquisition integration costs; our ability to attract and retain employees; or other significant uncertainties. For additional discussion of these and certain other risks and uncertainties applicable to the Company, see the “Risk Factors” sections of this Form 10-K. All forward-looking statements are qualified by, and should be considered in conjunction with, such cautionary

statements.

Any forward-looking statement speaks only as of the date hereof and we undertake no duty to update any of the forward-looking statements after the date of this Form 10-K.

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PART I

ITEM 1. BUSINESS

General

HMN Financial, Inc. (HMN and, together with its subsidiaries, the Company) is a stock savings bank holding company that owns 100 percent of Home Federal Savings Bank (the Bank). The Bank has a community banking philosophy and operates retail banking and loan production facilities in Minnesota, Iowa, and Wisconsin. The Bank has two wholly owned subsidiaries, Osterud Insurance Agency, Inc. (OIA), which offers financial planning products and services, and HFSB Property Holdings, LLC (HPH), which was inactive in 2015, but has acted as an intermediary for the Bank in holding and operating certain foreclosed properties. HMN 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 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 Dodge, Fillmore, Freeborn, Houston, Mower, Olmsted and Winona and portions of Steele, Goodhue and Wabasha through its corporate office located in Rochester, Minnesota and its eleven branch offices located in Albert Lea, Austin, Kasson (2), La Crescent, Rochester (4), 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.

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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, CHS Cooperative, Flint Hills Resources LP (oil refinery), Unisys Corp (computer software), Blue Cross Blue Shield of Minnesota, and West Group, a Thomson Reuters business (legal research).

The Company serves the Iowa county of Marshall through its branch office located in Marshalltown, 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), and Marshall Medical & Surgical Center (hospital care).

Based upon information obtained from the U.S. Census Bureau for 2014 (the last year for which information is available), the population of the seven primary counties in the Company's southern Minnesota market area was estimated as follows: Dodge – 20,353; Fillmore – 20,776; Freeborn – 30,840; Houston – 18,738; Mower – 39,323; Olmsted – 150,287; and Winona – 51,097. For these same seven counties, the median household income from the U.S. Census Bureau for 2010-2014 ranged from \$45,569 to \$68,587. The population of Dakota County was 412,529 and the median household income was \$74,995. With respect to Iowa, the population of Marshall County was 40,866 and the median household income was \$52,354.

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 15 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 rate loans and adjustable rate loans are generally 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 continued to be at relatively low levels in 2015 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 "Note 5 Loans Receivable, Net" and "Note 6 Allowance for Loan Losses and Credit Quality Information" in 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:

	2015		2014		2013		2012		2011	
<i>(Dollars in thousands)</i>	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
<u>Fixed rate</u>										
<u>Loans</u>										
Real estate:										
One-to-four family	\$55,226	11.68%	\$46,288	12.39%	\$47,377	11.96%	\$57,463	12.08%	\$69,426	11.96%
Multi-family	8,045	1.70	10,919	2.92	7,687	1.94	9,608	2.02	26,132	4.50
Commercial	117,790	24.91	104,178	27.89	109,387	27.62	115,519	24.28	94,535	16.29
Construction	27,381	5.79	7,361	1.97	2,645	0.67	8,430	1.77	5,145	0.89
Total real estate loans	208,442	44.08	168,746	45.17	167,096	42.19	191,020	40.15	195,238	33.64
Consumer loans:										
Automobile	2,885	0.61	1,124	0.30	971	0.25	623	0.13	404	0.07
Home equity	10,231	2.16	10,711	2.87	11,629	2.94	11,390	2.39	13,426	2.31
Recreational vehicle	2,650	0.56	0	0.00	0	0.00	0	0.00	0	0.00
Other	4,635	0.99	4,091	1.09	4,174	1.05	4,827	1.02	6,156	1.06
Total consumer loans	20,401	4.32	15,926	4.26	16,774	4.24	16,840	3.54	19,986	3.44
Commercial loans										
Total non-real estate loans	59,598	12.61	48,073	12.87	56,896	14.37	49,609	10.43	74,590	12.85
Total fixed rate loans	268,040	56.69	216,819	58.04	223,992	56.56	240,629	50.58	269,828	46.49
<u>Adjustable rate Loans</u>										
Real estate:										
One-to-four family	35,719	7.55	23,553	6.31	29,090	7.34	39,574	8.32	49,640	8.55
Multi-family	4,279	0.90	4,781	1.28	426	0.11	2,148	0.45	9,385	1.62
Commercial	79,136	16.74	59,187	15.84	69,099	17.45	105,202	22.11	148,940	25.66
Construction	10,722	2.27	5,242	1.40						