



# SR003\_7: Failed Bank Report

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## Sherman County Bank

734 'o' Street  
Loup City, NE 68853

(1/1/1932 – 2/13/2009)

# Report Objective

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This report has **two** objectives, using the bank's **data**\*

1. To examine the bank finances in the quarters prior to its failure.
2. To analyze the bank finances using our Key Performance Indicator (KPI) scoring approach to determine if the bank's failure is something we could have predicted.

\*Data source: FDIC and company filings.

# Bank Background

|                               |  |
|-------------------------------|--|
| <b>FDIC Certificate #</b>     | <b>5431</b>  |
| <b>Parent Holding Company</b> | SHERMAN COUNTY MANAGEMENT, INC.  |
| <b>Bank Charter Class</b>     | Federal Reserve Non-member   |
| <b>Asset Concentration</b>    | Agricultural Specialization  |
| <b>Product Specialty</b>      | Personal and Business Banking Services, Deposit Products, Home Loans, Financial Services |
| <b>Number of Branches</b>     | 4 (as of December 31, 2008)  |
| <b>Number of Employees</b>    | 30 (as of December 31, 2008)   |

## Executives

|                      |                   |
|----------------------|-------------------|
| <b>CEO/President</b> | Gerald E. Wortman |
|----------------------|-------------------|

# What took place?

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**S**herman County Bank, Loup City, Nebraska (with three branches doing business as Howard County Bank) was closed by the Nebraska Department of Banking & Finance on February 13<sup>th</sup>, 2009. The Federal Deposit Insurance Corporation (FDIC) was named Receiver. The estimated cost to the FDIC Deposit Insurance Fund is \$28,000,000, compared to the average cost of \$389,206,944. Heritage Bank of Nebraska acquired all deposits and some assets.

# Bank Financial Snapshot

| Financial Data Overlay (thousands) |           |            |                   |
|------------------------------------|-----------|------------|-------------------|
|                                    | 2007 Q4   | 2008 Q4    | Percentage Change |
| <b>Assets</b>                      | \$ 96,435 | \$ 135,431 | ↑ 40.4%           |
| <b>Liabilities</b>                 | \$ 87,600 | \$ 124,516 | ↑ 42.1%           |
| <b>Net Income</b>                  | \$ 1,018  | \$ 297     | ↓ 70.8%           |

- The average net income change for all FDIC banks was -83.49% in the same period; for total assets was +9.49%; for total liabilities was +10.66%.
- The average net income change for all the agricultural specialization banks was -6.5% in the same period.
- Compared with the whole industry and other agricultural specialization banks, Sherman County Bank's decline from Net Income is relatively large (-70.8%) during 2008, and its increase from both assets and liabilities is abnormally large as well.

# Key Performance Indicators

| KPI Summary for 2008 Q4     |                    |
|-----------------------------|--------------------|
| Normalized Income Rating    | Moderate           |
| Delinquent Asset Rating     | Good               |
| Asset: Liability Rating     | Poor               |
| Real Estate Asset Rating*   | Good               |
| Bankability Composite Score | 48.54** (Moderate) |

Possible ratings: *Excellent, Good, Moderate, Poor, Very Poor.*

\*This rating is relevant to the current “financial crisis” fueled by mortgage security backed loans.

\*\*This is out of 100.


# Normalized Income Analysis

|                    | 2007Q3   | 2007Q4   | 2008Q1   | 2008Q2   | 2008Q3 | 2008Q4   |
|--------------------|----------|----------|----------|----------|--------|----------|
| Normalized Income  | 0.20%    | 0.32%    | 0.32%    | 0.27%    | -0.63% | 0.28%    |
| SD's from Average* | -0.337   | 0.327    | 0.106    | 0.00582  | -1.74  | 0.350    |
| Ranking            | Moderate | Moderate | Moderate | Moderate | Poor   | Moderate |


- Sherman County Bank had a normalized income of 0.28% in the fourth quarter of 2008, the quarter before it failed.
- Banks of the same asset concentration hierarchy (agricultural specialization) had an average normalized income of 0.14%. The standard deviation of the normalized incomes was 0.40%, which means that Sherman County Bank was 0.350 SD's above the average.

\*Average of banks of the same asset concentration hierarchy

# Delinquent Asset Analysis

|                    | 2007Q3  | 2007Q4    | 2008Q1    | 2008Q2  | 2008Q3   | 2008Q4  |
|--------------------|--|-----------|-----------|---------|----------|---------|
| Delinquent Asset   | 5.1633%  | 7.7974%   | 9.4650%   | 1.1487% | 1.8045%  | 0.5432% |
| SD's from Average* | 2.43   | 4.27      | 4.25      | -0.15   | 0.37     | -0.52   |
| Ranking            | Very Poor  | Very Poor | Very Poor | Good    | Moderate | Good    |

- Sherman County Bank had a delinquent assets out of total assets ratio 0.54% in the fourth quarter of 2008, the quarter before it failed.
- Banks of the same asset concentration hierarchy (agricultural specialization) had an average delinquent asset of 1.3080%. The standard deviation of the delinquent assets was 1.49%, which means that Sherman County Bank was about 0.5 SD's below the average.
- Since the third quarter of 2007, Sherman County Bank's delinquent assets ratio has been higher than the average. However, after 2008 Q2, the ratio has improved back to a good condition; therefore, from a perspective of delinquent assets ratio, there was no signs of its failure during 2008 Q4.

 \*Average of banks of the same asset concentration hierarchy  
 Indicates sign of bank in financial distress

# Real Estate Loan Asset Analysis

|                              | 2007Q3   | 2007Q4   | 2008Q1   | 2008Q2   | 2008Q3   | 2008Q4 |
|------------------------------|----------|----------|----------|----------|----------|--------|
| Real Estate Loan Asset Ratio | 23.72%   | 24.10%   | 23.69%   | 23.67%   | 23.29%   | 18.12% |
| SD from Average*             | -0.60    | -0.54    | -0.55    | -0.58    | -0.64    | -1.00  |
| Ranking                      | Moderate | Moderate | Moderate | Moderate | Moderate | Good   |

- Sherman County Bank had a 18.12% of R/A ratio in 08 Q4, the quarter before it failed.
- In 08 Q4, banks of the same asset concentration hierarchy (agricultural lending specialization) had an average R/A ratio of 32.14%. The standard deviation of the R/A ratio was 14.01%, which means that 1<sup>st</sup> Sherman County Bank was 1.00 SD's below the average.

\*Average of banks of the same asset concentration hierarchy

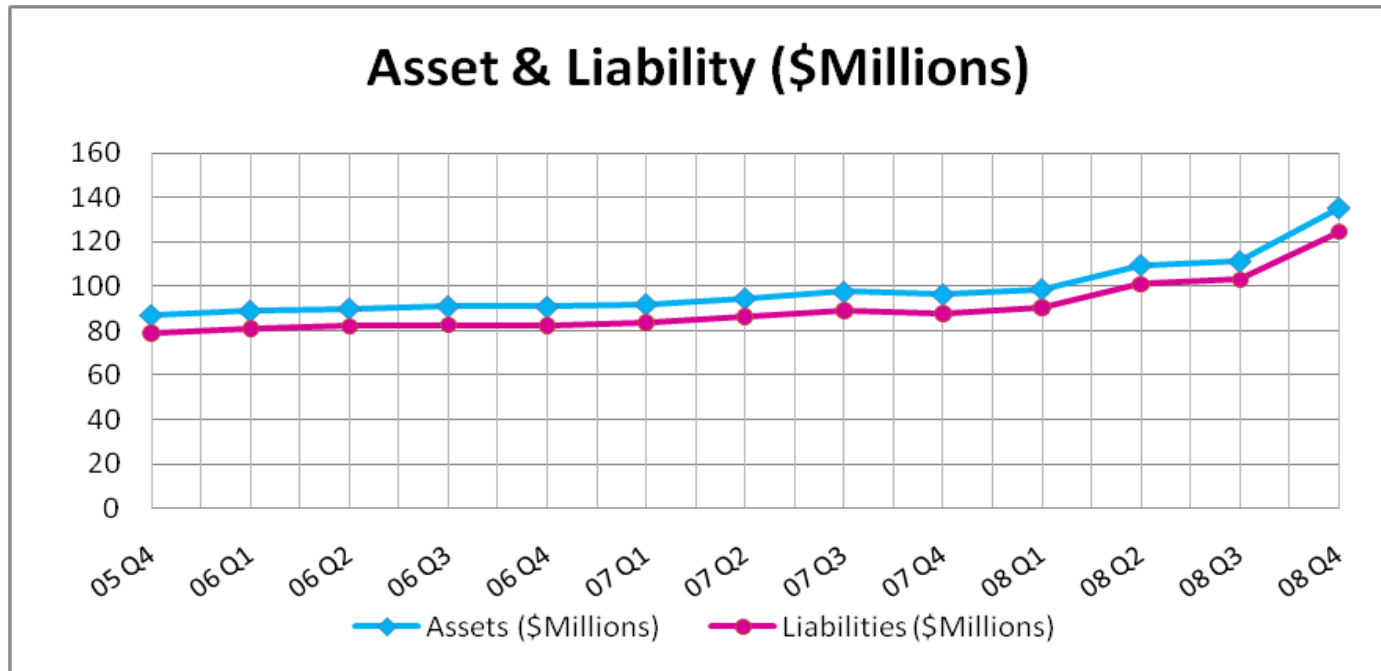
# Asset: Liability Analysis

|                              | 2007Q3   | 2007Q4   | 2008Q1  | 2008Q2  | 2008Q3  | 2008Q4  |
|------------------------------|----------|----------|---------|---------|---------|---------|
| Asset:<br>Liability<br>Ratio | 109.57%  | 110.09%  | 109.40% | 108.56% | 108.12% | 108.77% |
| Median A/L<br>Ratio*         | 111.87%  | 111.69%  | 111.74% | 111.45% | 111.67% | 111.67% |
| Ranking                      | Moderate | Moderate | Poor    | Poor    | Poor    | Poor    |

- Sherman County Bank experienced decreasing A/L ratio from 07 Q4 to 08 Q3.

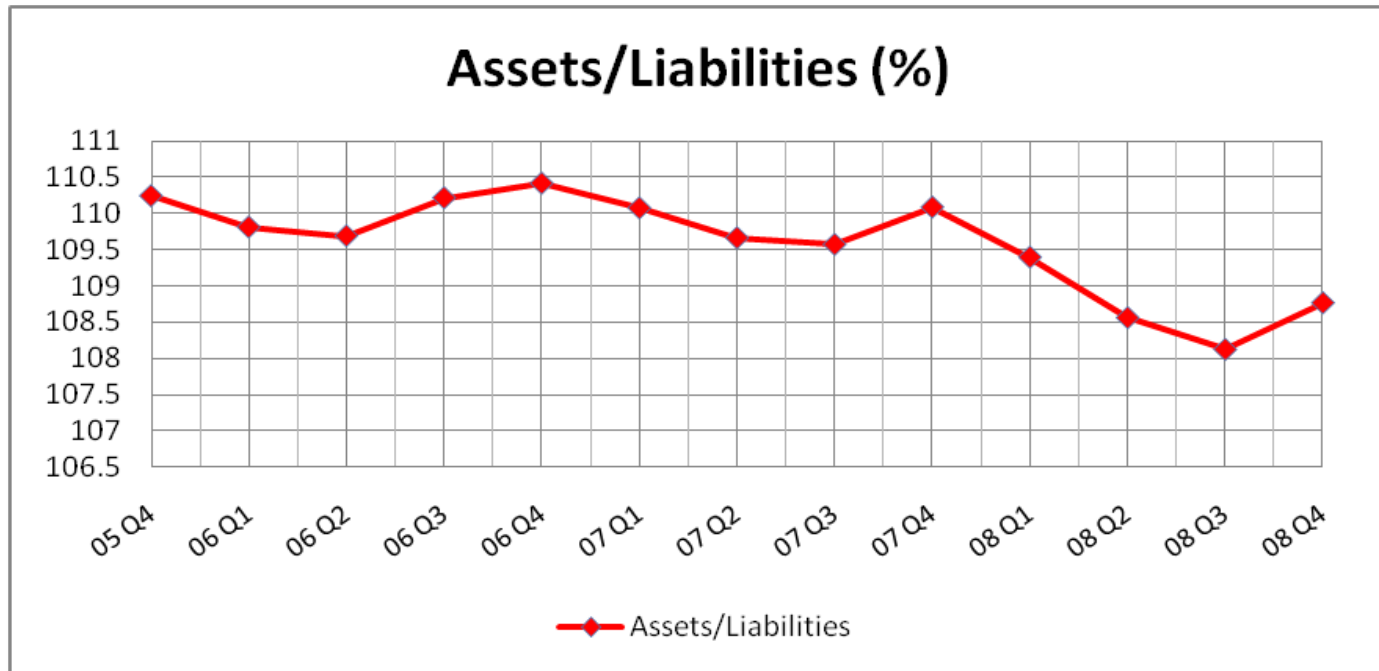
\*Median of banks of the same asset concentration hierarchy

# Asset & Liability History



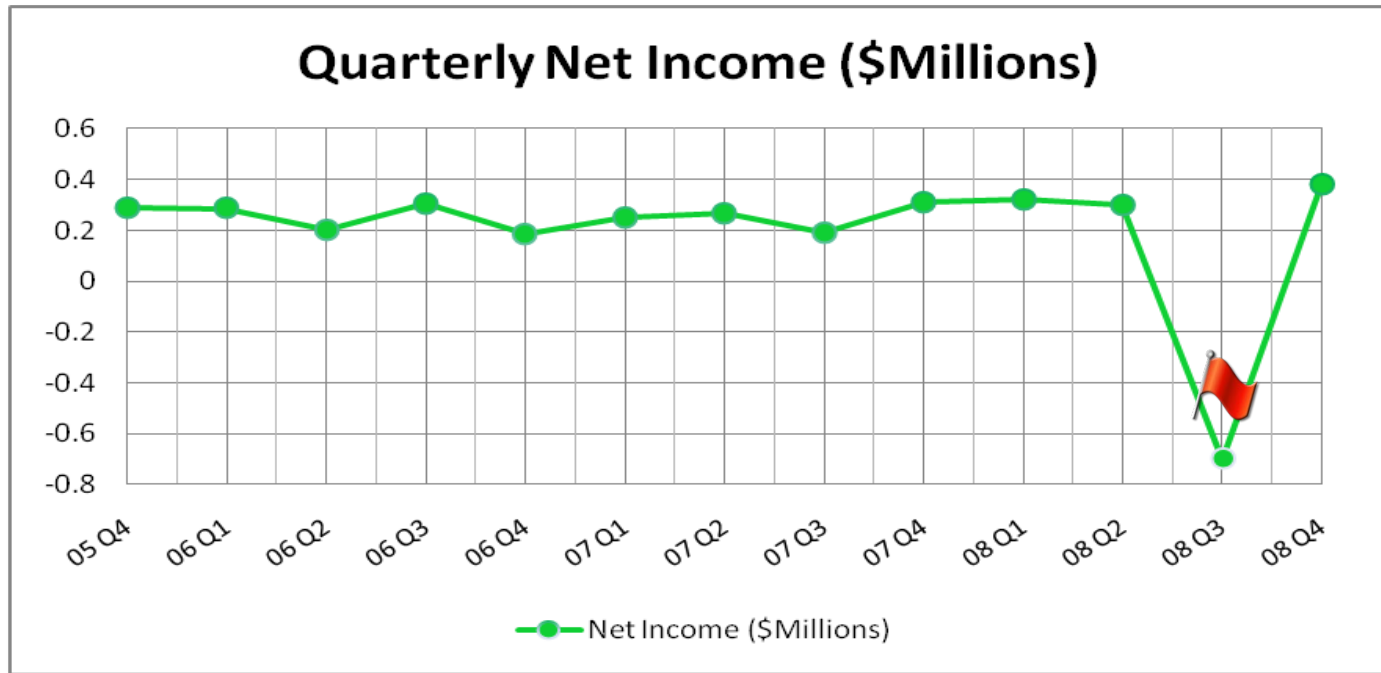
- Both asset and liability reached the highest points in 08 Q4.

# Asset/Liability History



- The A/L ratio was decreasing from 07 Q4 to 08 Q3.

# Net Income History

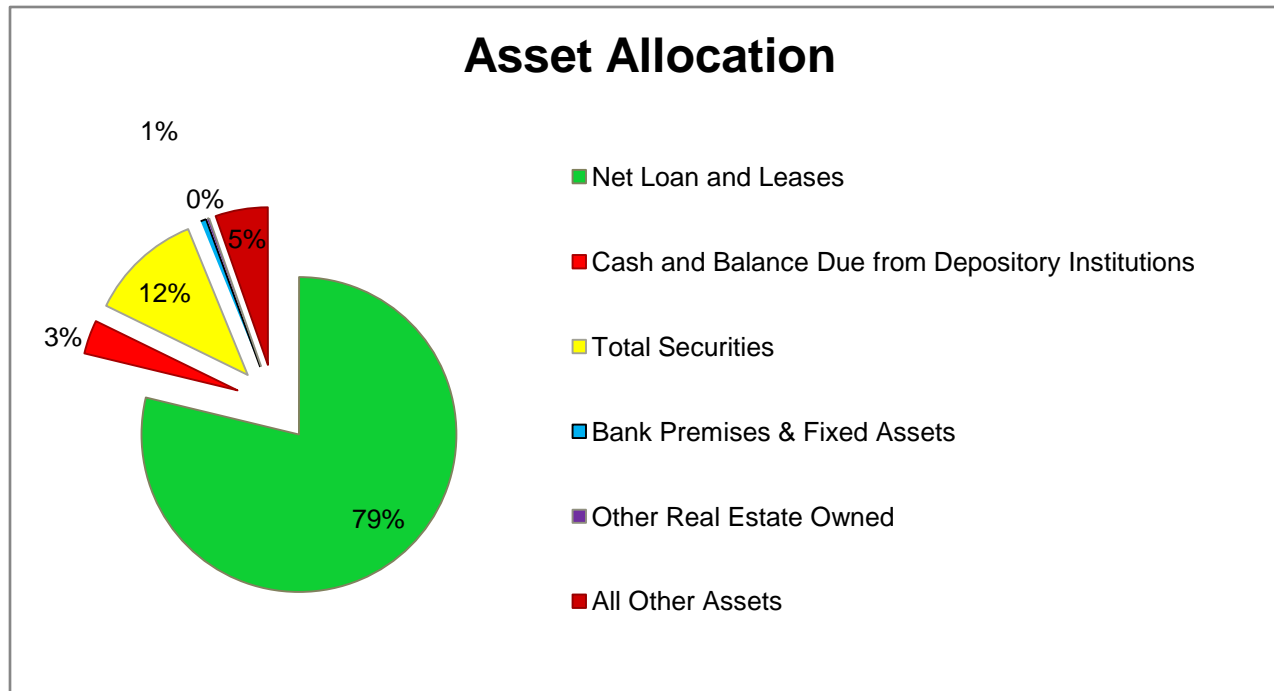


- The bank recorded a big loss in 08 Q3.



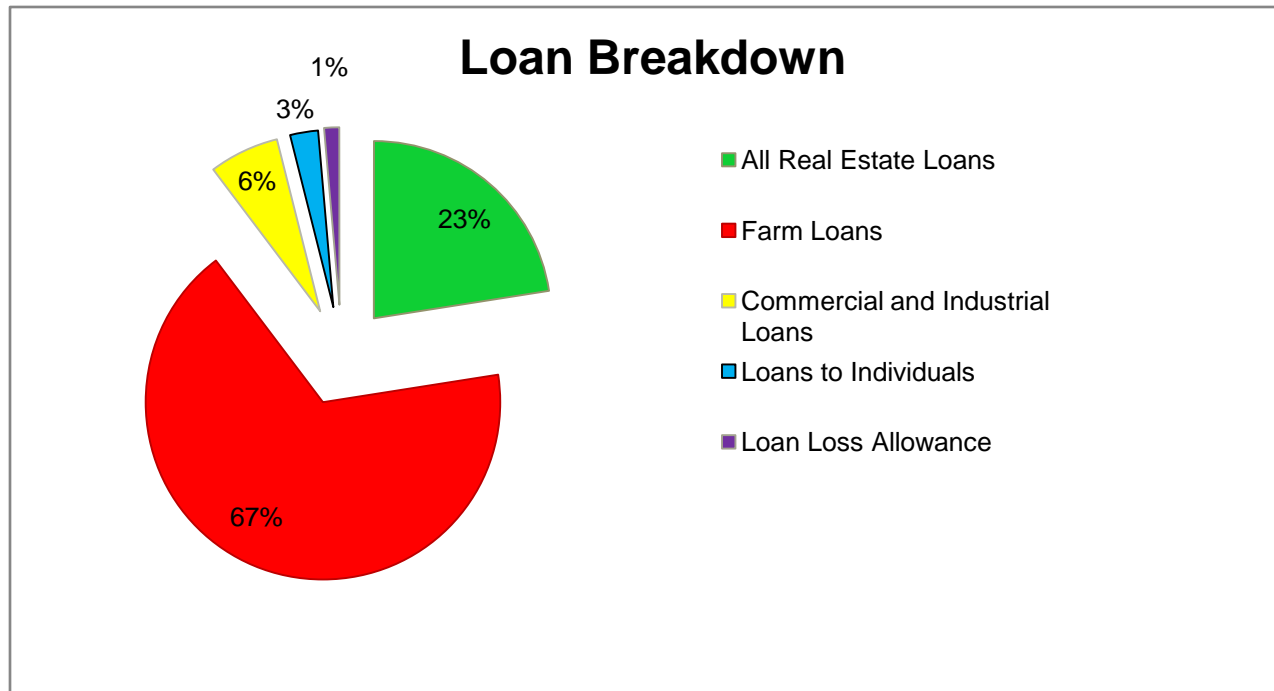
Indicates sign of bank in financial distress

# Asset Allocation



- The average percentage of Net Loans for banks of the same Asset Concentration Hierarchy in the fourth quarter of 2008 was 61.07%.
- The average Net Loan percentage of all banks in the fourth quarter of 2008 was 66.14%.

# Loan Breakdown



- The average percentage of Real Estate Loans for banks of the same Asset Concentration Hierarchy in the fourth quarter of 2008 was 50.94%.
- The average percentage for all banks in the fourth quarter of 2008 was 71.23%.

# Events Timeline

- Mar. 4, 08** - SEC voted to disclose information for the secondary market ETF investors in Form N-1A.
- Mar. 7, 08** - The Fed will initiate a series of term repurchase transactions that are expected to cumulate to \$100 billion.
- Mar. 19, 08** - Fannie Mae and Freddie Mac is expected to provide support to the U.S. mortgage market, up to \$200 billion immediate liquidity.
- May 29, 08** - U.S.-Canada mutual recognition arrangement: U.S. Securities markets and certain U.S. financial service firms could gain greater freedom to operate in Canada under SEC.
- June 10, 08** - FDIC releases a supervisory letter to all banks on interest reserves that examines the risks that this underwriting practice presents.
- June 11, 08** - SEC voted on a comprehensive series of credit rating agency reforms to bring increased transparency to credit rating process.
- June 17, 08** - New HOPE NOW guidelines to deal with issues surrounding second mortgages and short sales.
- June 26, 08** - FDIC adopts Basel II-Based Standardized Approach as an alternative risk-based capital framework available to all banks except the largest and most complex banks
- June 26, 08** - FRS, FDIC, and OCC issued the host state loan-to-deposit ratios, which help indicate branches outside of the home state that were established or acquired for the purpose of deposit production.

# Events Timeline

- Jul. 13, 08** - Paulson Announces a three-part plan for GSEs: a temporary increase in the line of credit, a temporary authority for Treasury to purchase equity, and an advisory role is given to the Fed.
- Aug. 20, 08** - FDIC's implementation in Loan Modification Program will help to modify troubled IndyMac mortgages loans.
- Sept. 17, 08** - SEC clarified that bank support of money market mutual funds generally are not required to present the fund on-balance sheet, but disclosure of the nature of the support provided is expected.
- Sept. 18, 08** - SEC requires that certain institutional money managers report their new short sales of certain publicly traded securities.
- Sept. 19, 08** - SEC prohibited short selling in 779 financial institutions.
- Sept. 20, 08** - Treasury Secretary Hank Paulson releases \$700 billion proposal to purchase troubled mortgage-related assets.
- Oct. 7, 08** - Emergency Economic Stabilization Act of 2008 Temporarily Increases Basic FDIC Insurance Coverage from \$100,000 to \$250,000 per Depositor.
- Oct. 14, 08** - FDIC creates new program to guarantee bank debts and fully insure non-interest bearing deposit transaction accounts.
- Oct. 14, 08** - The Treasury Department will invest up to \$250 billion in the nation's banks via the Capital Purchase Program.
- Nov. 20, 08** - FDIC announces the availability of IndyMac Loan Modification Model.
- Nov. 25, 08** - Created the Term Asset-Backed Securities Loan Facility to support the issuance of asset-backed securities collateralized by loans.

# Events Timeline

- Dec. 3, 08** - SEC approved measures to strengthen oversight of credit rating agencies.
- Dec. 16, 08** - Troubled banks have to provide certain position level and counterparty level data and QFC counterparty and portfolio identifiers to FDIC in a timely manner.
- Dec. 23, 08** - Treasury provides TARP funds to focal Banks by purchasing \$2.8 billion investment from 49 banks.
- Dec. 30, 08** - The Fed announced that it will purchase mortgage-backed securities.
- Jan. 15, 09** - The Senate voted to allow access to the remaining bailout funds of \$350 billion.
- Jan. 27, 09** - As part of the Capital Purchase Program, Treasury announced investments of \$386 million in 23 healthy banks.
- Feb. 10, 09** - Geithner rolls out the Financial Stability Plan, promises to perform “stress tests” on big banks, and commit \$100 billion to boost the TALF.
- Feb. 10, 09** - A Capital Assistance Program to help ensure banks hold sufficient capital, produce a more consistent and forward-looking assessment of risks on banks' balance and their potential capital needs.
- Feb. 10, 09** - A Public-Private Investment Fund will combine public and private capital with government financing to help free up capital to support new lending.
- Feb. 10, 09** - Treasury and Fed expended the Term Asset-Backed Securities Lending facility up to \$1 trillion.
- Feb. 13, 09** - Sherman County Bank was closed by the Nebraska Department of Banking and Finance. Heritage Bank assumed all the deposits of Sherman County Bank.

# Events Timeline

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- Feb. 18, 09** - President Obama signs the American Recovery and Reinvestment Act of 2009, which limits bonuses of the highest earning executives.
- Mar. 4, 09** - Treasury announced loan modification guidelines under the Administration's Homeowner Affordability and Stability Plan.
- Mar. 23, 09** - Using TARP capital and capital from private investors, the Public-Private Investment Program will generate \$500 billion in purchasing power to buy legacy assets.
- May 29, 09** - FDIC tightens the deposit interest rates paid by banks that are less than well capitalized. Generally, such banks will be permitted to offer to "national rate" plus 75 basis points.
- June 9, 09** - 10 Of the largest U.S financial institutions are expected to make CPP repayments to Treasury.
- Jul. 2, 09** - FDIC proposed guidelines require private equity firms to hold bank purchases for 3yrs and maintain capital levels.

# Report Summary – *Surprise?*

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Based on the methods with which we analyzed, Sherman County Bank, its failure was **a surprise**.

Here are the reasons why Sherman County Bank should not fail:

- 1) **The normalized income was positive in 5 out of 6 quarters.**
- 2) **Delinquent loan: asset ratio was significantly improved in the last 3 quarters.**
- 3) **The bank's real estate loan was below average in all 6 quarters.**
- 4) **Its Bankability Composite Score was 48.54 before its failure, which was considered to be moderate.**

The combination of all these four reasons shows that the failure of Sherman County Bank was not in our prediction.

# References

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