



# SR003\_7: Failed Bank Report

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## Heritage Community Bank

18301 South Halsted Street  
Glenwood, IL 60425

(11/28/1969 – 2/27/2009)

# 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>	20078
<b>Parent Holding Company</b>	Heritage Community Bancorporation, Inc.
<b>Bank Charter Class</b>	Federal Reserve Non-member
<b>Asset Concentration</b>	Commercial Lending Specialization
<b>Product Specialty</b>	Personal and Business Banking Services, Consumer Lending Services, Home Loans
<b>Number of Branches</b>	4 (as of December 31, 2008)
<b>Number of Employees</b>	61 (as of December 31, 2008)

<b>Executives</b>	
<b>CEO</b>	John M. Saphir
<b>CFO</b>	Stephen Faydash

# What took place?

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**H**eritage Community Bank, Glenwood, IL was closed by the Illinois Department of Financial and Professional Regulation, Division of Banking on February 27<sup>th</sup>, 2009. The Federal Deposit Insurance Corporation (FDIC) was named Receiver. The estimated cost to the FDIC Deposit Insurance Fund is \$41,600,000, compared to the average cost of \$389,206,944. MB Financial Bank acquired all deposits of Heritage Community Bank and \$181 million in assets.

# Bank Financial Snapshot

Financial Data Overlay (thousands)			
	2007 Q4	2008 Q4	Percentage Change
<b>Assets</b>	\$ 298,418	\$ 235,154	↓ 21.2%
<b>Liabilities</b>	\$ 271,729	\$ 230,278	↓ 15.3%
<b>Net Income</b>	\$ 4,622	-\$ 21,182	↓ 558%

- The average net income change for all FDIC banks was -83.49% in the same period.
- The average net income change for all the commercial lending specialization banks was -99.60% in the same period.
- Compared with the whole industry and other commercial lending specialization banks, Heritage Community Bank's decline from Net Income is relatively large (-558%) during 2008.

# Key Performance Indicators


KPI Summary for 2008 Q4	
Normalized Income Rating	Poor
Delinquent Asset Rating	Very Poor
Asset: Liability Rating	Very Poor
Real Estate Asset Rating*	Poor
Bankability Composite Score	-29.31** (Very Poor)

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	0.59%	-0.49%	-0.17%	-4.16%	-2.08%	-2.12%
SD's from Average*	1.00	-0.816	-0.568	-6.45	-2.46	-1.84
Ranking	Good	Moderate	Moderate	Very Poor	Very Poor	Poor

- Heritage Community Bank had a normalized income of -2.12% in the fourth quarter of 2008, the quarter before it failed.
- Banks of the same asset concentration hierarchy (commercial lending specialization) had an average normalized income of -0.24%. The standard deviation of the normalized incomes was 1.02%, which means that Heritage Community Bank was 1.84 SD's below the average.

\*Average of banks of the same asset concentration hierarchy


 Indicates sign of bank in financial distress

# Delinquent Asset Analysis

	2007Q3	2007Q4	2008Q1	2008Q2 	2008Q3	2008Q4
Delinquent Asset	2.9251%	3.8114%	2.4324%	6.4057%	5.2407%	11.4100%
SD's from Average*	1.09	1.44	0.48	2.70	1.96	4.50
Ranking	Poor	Poor	Moderate	Very Poor	Poor	Very Poor

- Heritage Community Bank had a delinquent assets out of total assets ratio 11.4% in the fourth quarter of 2008, the quarter before it failed.
- Banks of the same asset concentration hierarchy (commercial lending specialization) had an average delinquent asset of 1.7356%. The standard deviation of the delinquent assets was 2.15%, which means that Heritage Community Bank was about 4.5 SD's above the average.
- Except 2008 Q1, Heritage Community Bank's delinquent asset ratio has been in a poor condition relatively to other banks. Its ratio was at the peak right before the bank's failure.

\*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	76.71%	74.72%	73.87%	78.82%	78.87%	70.97%
SD from Average*	1.41	1.25	1.20	1.49	1.49	0.97
Ranking	Very Poor	Very Poor	Very Poor	Very Poor	Very Poor	Poor

- Heritage Community Bank had a 70.97% of R/A ratio in 08 Q4, the quarter before it failed.
- In 08 Q4, banks of the same asset concentration hierarchy (commercial lending specialization) had an average R/A ratio of 56.72%. The standard deviation of the R/A ratio was 14.63%, which means that Heritage Community Bank was 0.97 SD's above the average.


\* Average of banks of the same asset concentration hierarchy

# Asset: Liability Analysis

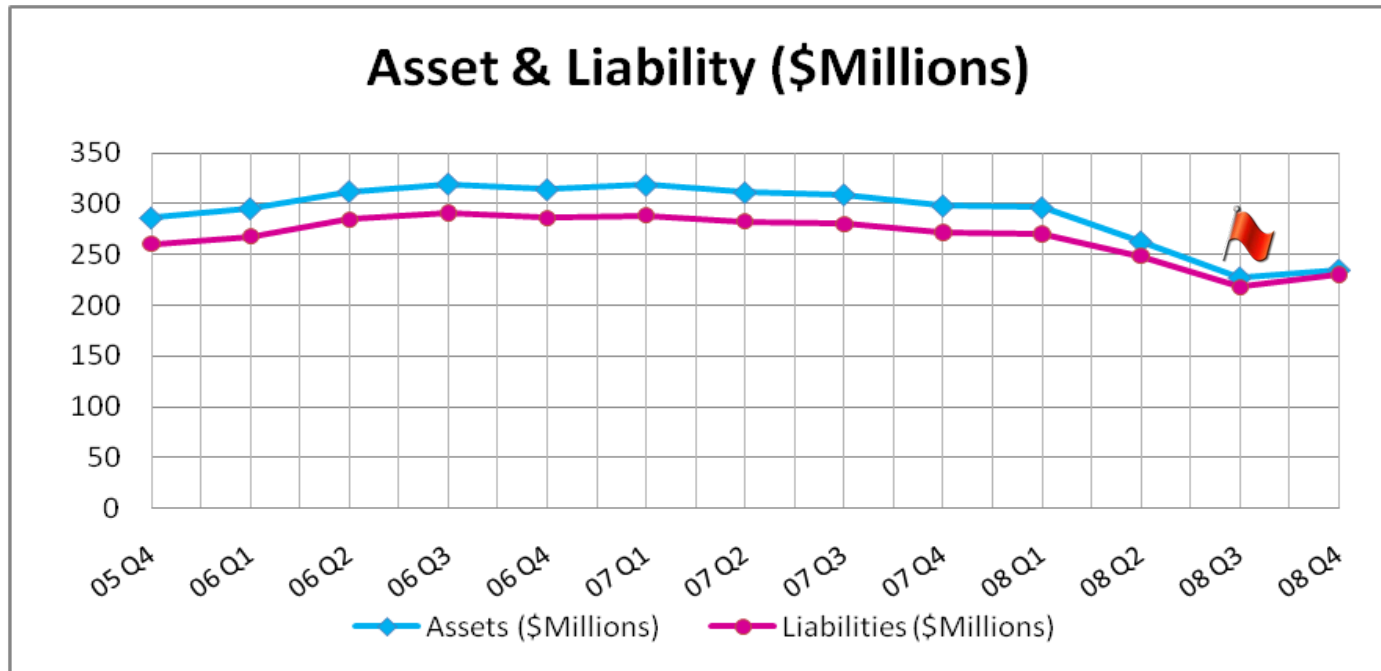
	2007Q3	2007Q4	2008Q1	2008Q2	2008Q3 	2008Q4
Asset: Liability Ratio	110.37%	109.82%	109.73%	108.71%	104.38%	102.12%
Median A/L Ratio*	110.97%	110.95%	110.93%	110.69%	110.65%	110.52%
Ranking	Moderate	Moderate	Moderate	Poor	Very Poor	Very Poor

- Heritage Community Bank experienced decreasing A/L ratio in all 6 quarters.
- The bank fell into the worst ranking in 08 Q3.
- Of the banks failed in 09 Q1, 90.48% of them had an A/L ratio under 107%.
- Of the bank with an A/L ratio under 106% in 08 Q4, 12% failed in the subsequent quarter.

\*Average of banks of the same asset concentration hierarchy

 Indicates sign of bank in financial distress

# Asset & Liability History

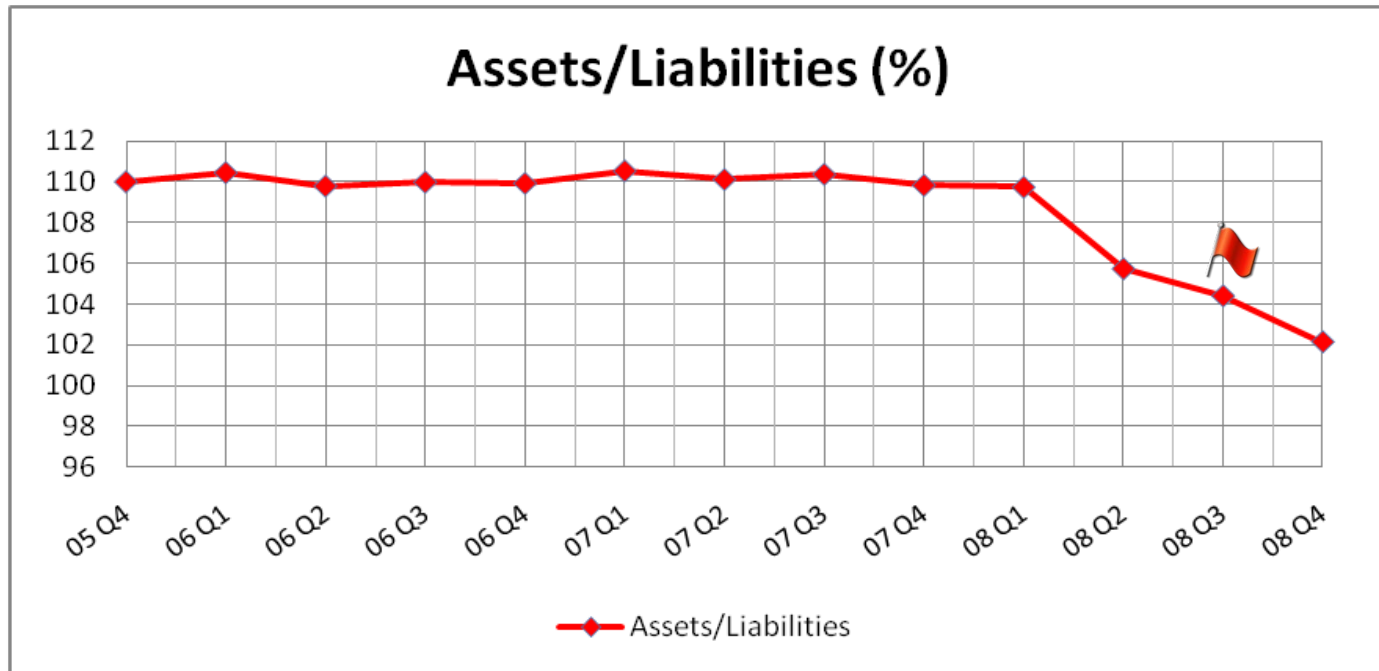


- The difference between asset and liability was getting closer in 08 Q2.



Indicates sign of bank in financial distress

# Asset/Liability History

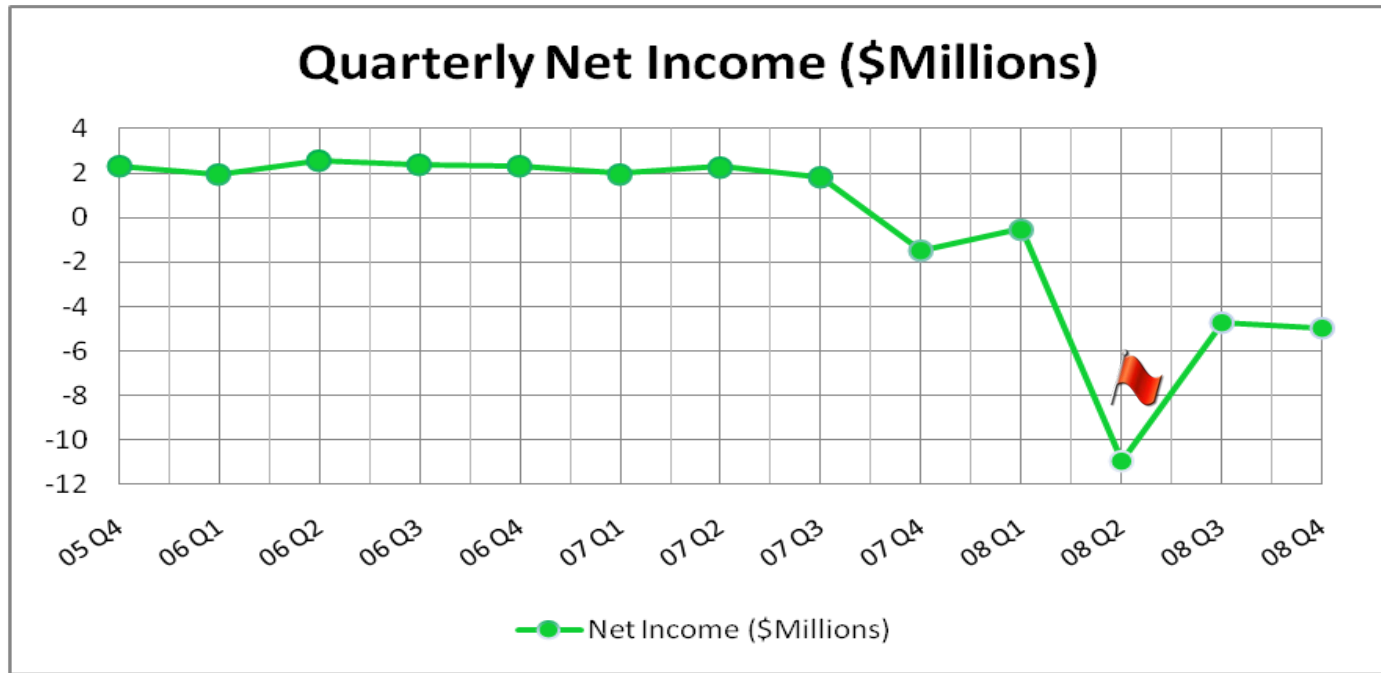


- The A/L ratio was decreasing since 08 Q1.




Indicates sign of bank in financial distress

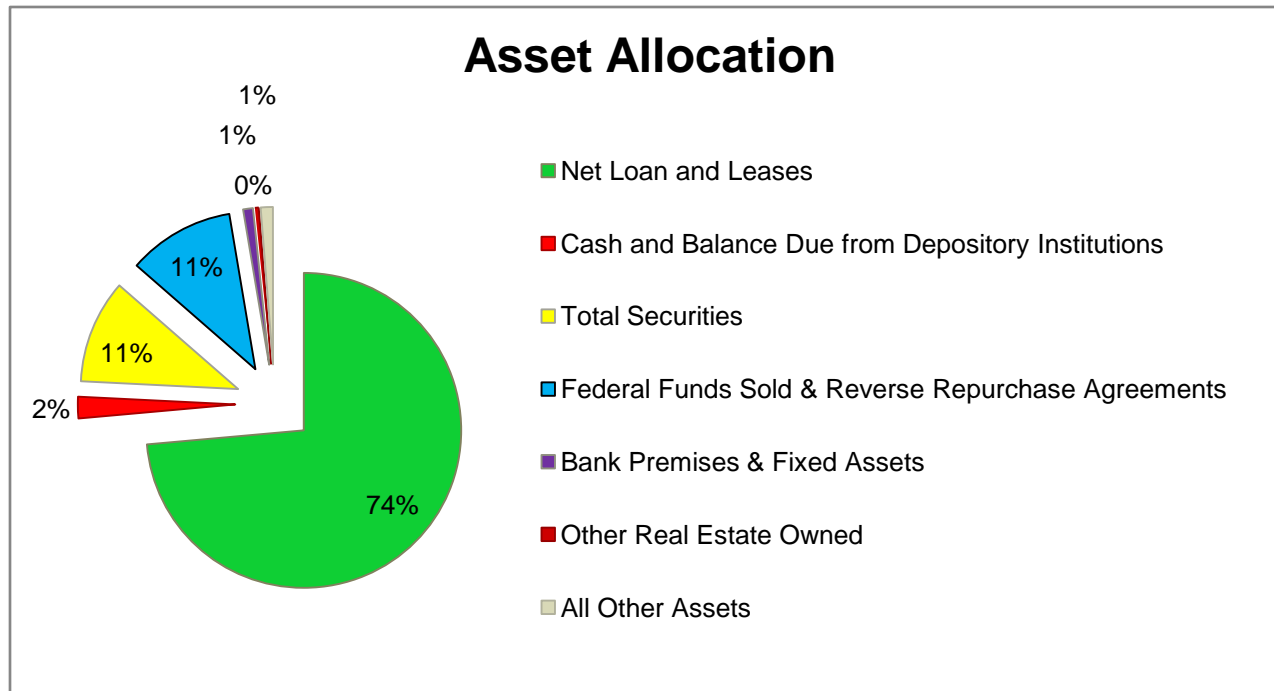
# Net Income History



- The bank recorded a big loss in 08 Q2.
- The bank reported losses since 07 Q4.

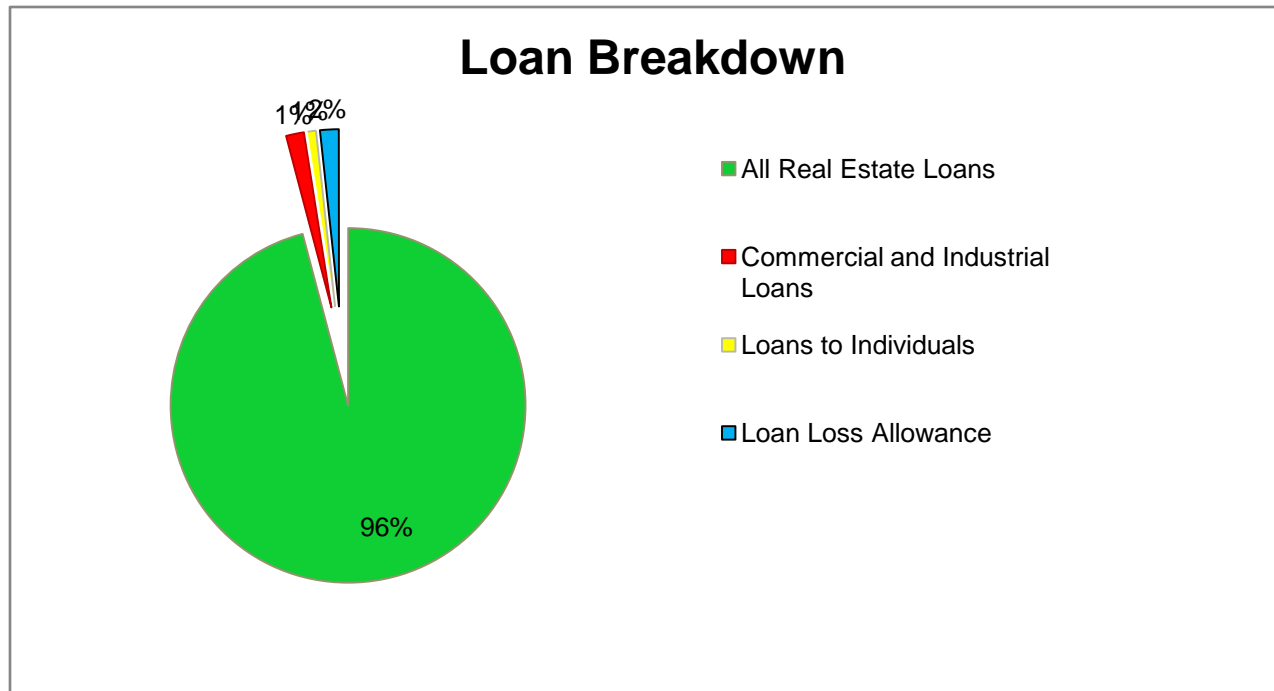
 Indicates sign of bank in financial distress

# Asset Allocation



- The average percentage of Net Loans for banks of the same Asset Concentration Hierarchy in the fourth quarter of 2008 was 72.53%.
- 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 76.45%.
- 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. 10, 08** - [Heritage Community Bank of Glenwood has been hit with a cease-and-desist order from state and federal regulators.](#)
- 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.

# Events Timeline

- 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.
- 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.
- Dec. 31, 08** - Heritage Community Bank was significantly undercapitalized per regulatory guidelines, with a tier 1 leverage rate of 2.04% and a total risk-based capital ratio of 3.29%.
- Dec. 31, 08** - Heritage Community reported net losses of \$21 million during 2008.
- 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.

# Events Timeline

- 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 expanded the Term Asset-Backed Securities Lending facility up to \$1 trillion.
- Feb. 18, 09** - President Obama signs the American Recovery and Reinvestment Act of 2009, which limits bonuses of the highest earning executives.
- Feb. 27, 09** - Heritage Community Bank was closed by the Illinois Department of Financial Professional Regulation. MB Financial Bank assumed all of the deposits of Heritage Community Bank.
- 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?*

Based on the methods with which we analyzed Heritage Community Bank, its failure was ***not a surprise***.

Here are the indications that Heritage Community Bank should fail:

- 1) **Heritage Community Bank reported losses since the second quarter of 2007. It dropped more than 4 SD's below average in the second quarter of 2008.**
- 2) **More than 11% of Heritage Community Bank's assets were delinquent the quarter before it failed.**
- 3) **Heritage Community Bank's asset to liability ratio dropped below 107% two quarter before it failed and had a 102% ratio the quarter before it failed.**
- 4) **Heritage Community Bank had a bankability composite score of - 29.31 the quarter before it failed and 0.187 the quarter before. These scores indicate the bank's very poor overall financial health and likelihood to fail.**

# References

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# Contact Information

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For additional information regarding this report series, you can contact us at:

**By E-mail:**

[info@moneyeconomics.com](mailto:info@moneyeconomics.com)

**By Mail:**

Money Economics  
P.O. Box 587  
Alameda, CA 94501

**By Phone:\***

510.550.1694

*\*For media inquiry only please.*