



SR003_7: Failed Bank Report

Michigan Heritage Bank

28300 Orchard Lake Road
Farmington Hills, MI 48334

(3/10/1997 – 4/27/2009)

Report Objective

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

FDIC Certificate #	34369
Parent Holding Company	MICHIGAN HERITAGE BANCORP, INC.
Bank Charter Class	Federal Reserve Member
Asset Concentration	Commercial Lending Specialization
Product Specialty	Personal and Business Banking Services, Customer Lending Services, Financial Services
Number of Branches	4 (as of March 31, 2009)
Number of Employees	29 (as of March 31, 2009)

Executives	
CEO/President	Raymond A. Biggs
Chairman	Perry Driggs, Jr.

What took place?

Michigan Heritage Bank, Farmington Hills, MI was closed by the State of Michigan's Office of Financial and Insurance Regulation on April 24th, 2009. The Federal Deposit Insurance Corporation (FDIC) was named Receiver. The estimated cost to the FDIC Deposit Insurance Fund is \$71,300,000, compared to the average cost of \$389,206,944. Level One Bank of Farmington Hills acquired all non-brokered deposits and some assets.

Bank Financial Snapshot

Financial Data Overlay (thousands)			
	2008 Q1	2009 Q1	Percentage Change
Assets	\$ 188,406	\$ 167,710	↓ 11.0%
Liabilities	\$ 173,419	\$ 161,348	↓ 7.0%
Net Income	-\$ 160	-\$ 320	↓ 100%

- The average net income change for all FDIC banks was -59.6% in the same period.
- The average net income change for all the commercial lending specialization banks was -107.5% in the same period.
- Compared with the whole industry and other commercial lending specialization banks, Michigan Heritage Bank's decline from Net Income is close to average (-100%) during 2009.

Key Performance Indicators

KPI Summary for 2009 Q1	
Normalized Income Rating	Moderate
Delinquent Asset Rating	Very Poor
Asset: Liability Rating	Very Poor
Real Estate Asset Rating*	Excellent
Bankability Composite Score	-1.08** (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

	2007Q4	2008Q1	2008Q2 	2008Q3	2008Q4	2009Q1
Normalized Income	-1.04%	-0.08%	-2.21%	-0.25%	-2.17%	-0.19%
SD's from Average*	-1.61	-0.390	-3.44	-0.238	-1.89	-0.312
Ranking	Poor	Moderate	Very Poor	Moderate	Poor	Moderate


- Michigan Heritage Bank had a normalized income of -0.19% in the first quarter of 2009, the quarter before it failed.
- Banks of the same asset concentration hierarchy (commercial lending specialization) had an average normalized income of -0.01%. The standard deviation of the normalized incomes was 0.58%, which means that Michigan Heritage Bank was 0.312 SD's below the average.
- Since the fourth quarter of 2007, Michigan Heritage Bank's normalized income in relation to banks of the same asset concentration hierarchy has been sporadic, ranging from Poor to Moderate each quarter.

*Average of banks of the same asset concentration hierarchy



Indicates sign of bank in financial distress

Delinquent Asset Analysis

	2007Q4 	2008Q1	2008Q2	2008Q3	2008Q4	2009Q1
Delinquent Asset	7.5172 %	3.4590%	4.3562%	2.6453%	4.3396%	8.4173%
SD's from Average*	3.63	1.02	1.59	0.60	1.21	2.74
Ranking	Very Poor	Poor	Poor	Moderate	Poor	Very Poor

- Michigan Heritage Bank had a delinquent assets out of total assets ratio 8.4% in the first quarter of 2009, the quarter before it failed.
- Banks of the same asset concentration hierarchy (commercial lending specialization) had an average delinquent asset of 1.9142%. The standard deviation of the delinquent assets was 2.37%, which means that Michigan Heritage Bank was about 2.7 SD's above the average.
- Except the third quarter of 2008, Michigan Heritage Bank's delinquent assets ratio has been poor and stayed above than the average. Especially right before the bank's failure, Michigan Heritage Bank's delinquent assets ratio suddenly increased to more than 8%.

*Average of banks of the same asset concentration hierarchy



Indicates sign of bank in financial distress

Real Estate Loan Asset Analysis

	2007Q4	2008Q1	2008Q2	2008Q3	2008Q4	2009Q1
Real Estate Loan Asset Ratio	39.02%	36.27%	32.77%	33.06%	31.78%	32.64%
SD from Average*	-1.08	-1.28	-1.57	-1.59	-1.70	-1.64
Ranking	Good	Excellent	Excellent	Excellent	Excellent	Excellent

- Michigan Heritage Bank had a 32.64% of R/A ratio in 09 Q1, the quarter before it failed.
- In 09 Q1, banks of the same asset concentration hierarchy (commercial lending specialization) had an average R/A ratio of 56.23%. The standard deviation of the R/A ratio was 14.37%, which means that Michigan Heritage Bank was 1.647 SD's below the average.

* Average of banks of the same asset concentration hierarchy

Asset: Liability Analysis

	2007Q4	2008Q1	2008Q2 	2008Q3	2008Q4	2009Q1
Asset: Liability Ratio	108.75%	108.64%	106.29%	105.91%	103.69%	103.94%
Median A/L Ratio*	110.95%	110.93%	110.69%	110.65%	110.52%	110.57%
Ranking	Poor	Poor	Very Poor	Very Poor	Very Poor	Very Poor

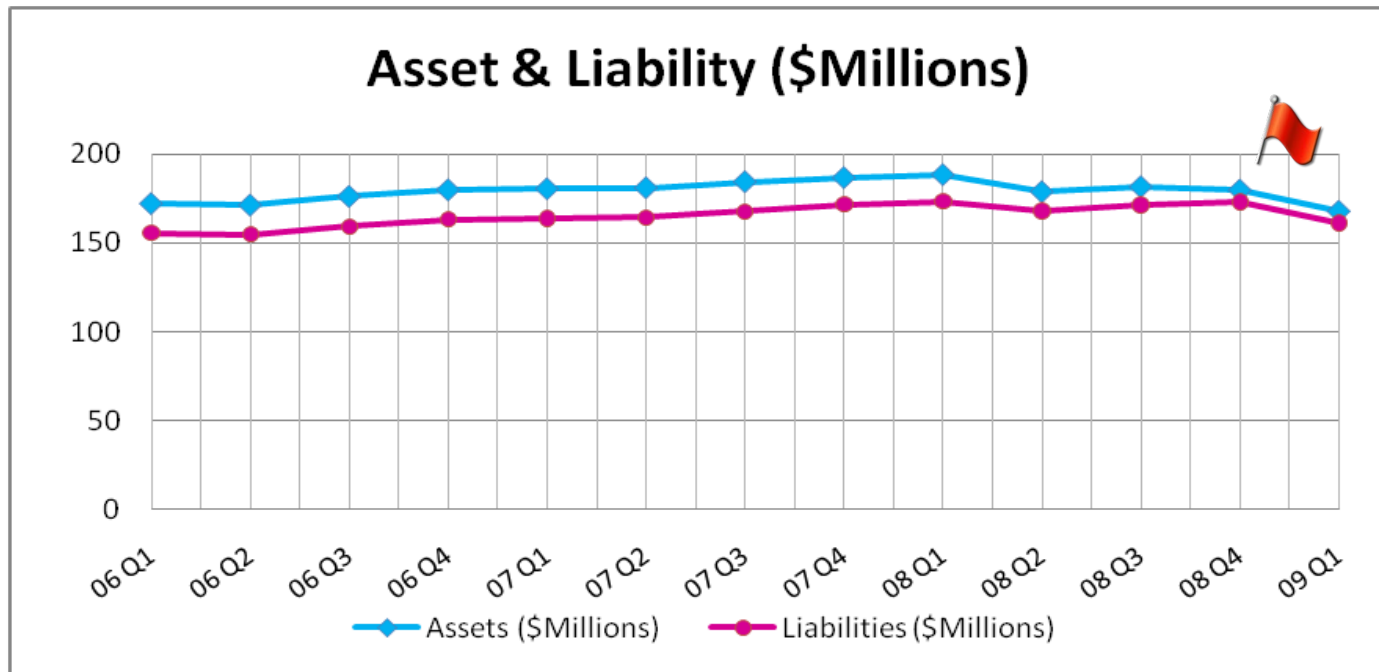
- Michigan Heritage Bank experienced decreasing A/L ratio from 07 Q4 to 08 Q4.
- The bank fell into the worst ranking in 08 Q2.
- Of the banks failed in Q2 09, 87.50% of them had an A/L ratio under 107%.
- Of the bank with an A/L ratio under 106% in Q1 09, 10.75% failed in the subsequent quarter.

* Median of banks of the same asset concentration hierarchy



Indicates sign of bank in financial distress

Asset & Liability History

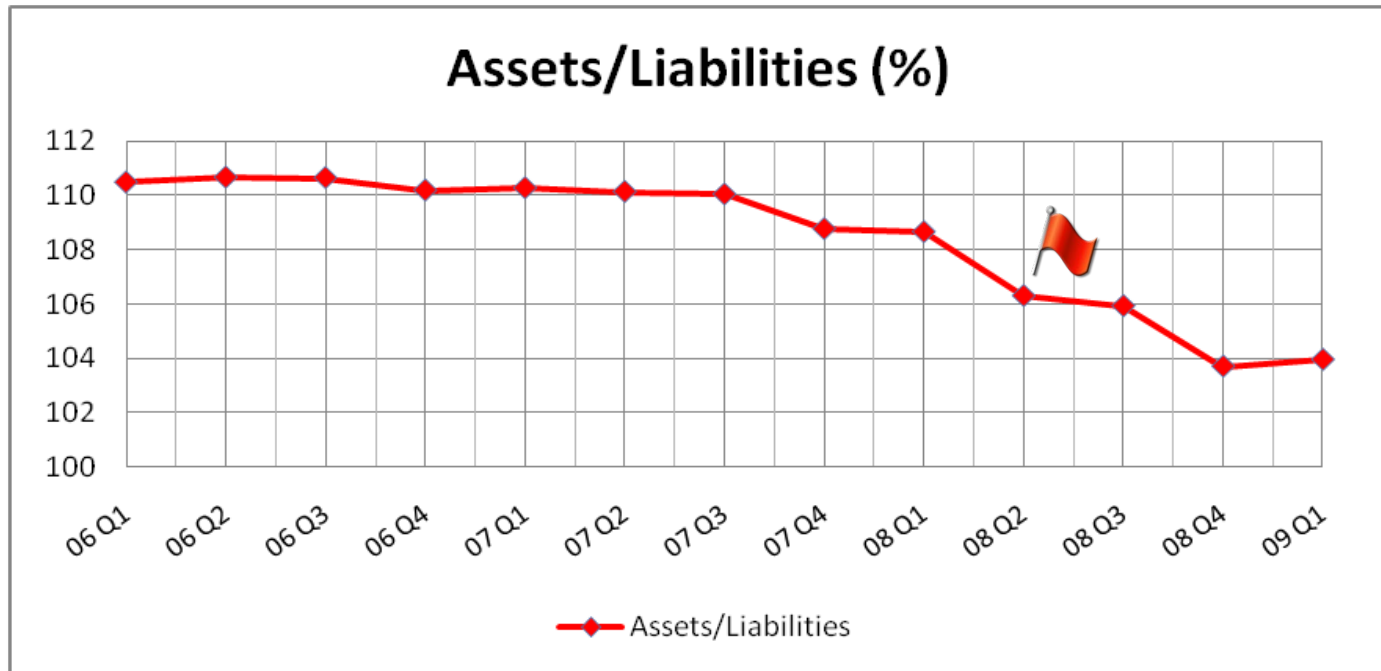


- The difference between asset and liability was getting closer in 08 Q2.



Indicates sign of bank in financial distress

Asset/Liability History

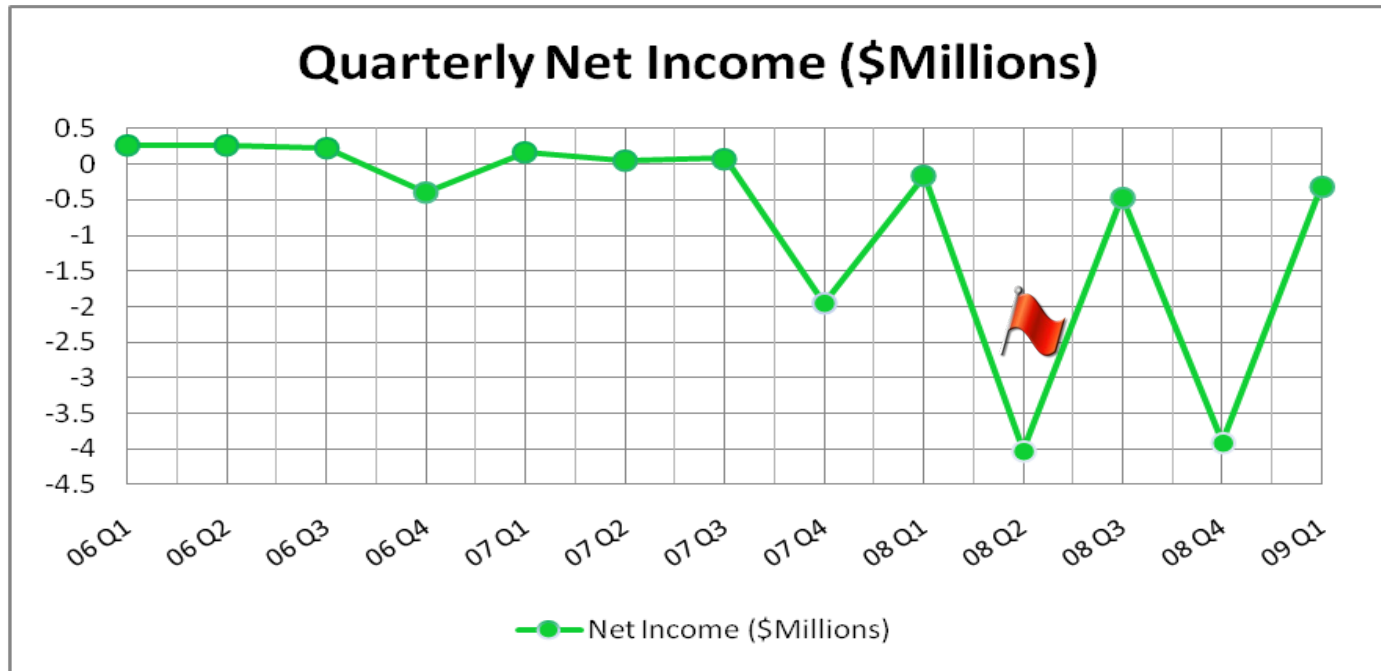


- The A/L ratio was decreasing from 07 Q3 to 08 Q4.



Indicates sign of bank in financial distress

Net Income History

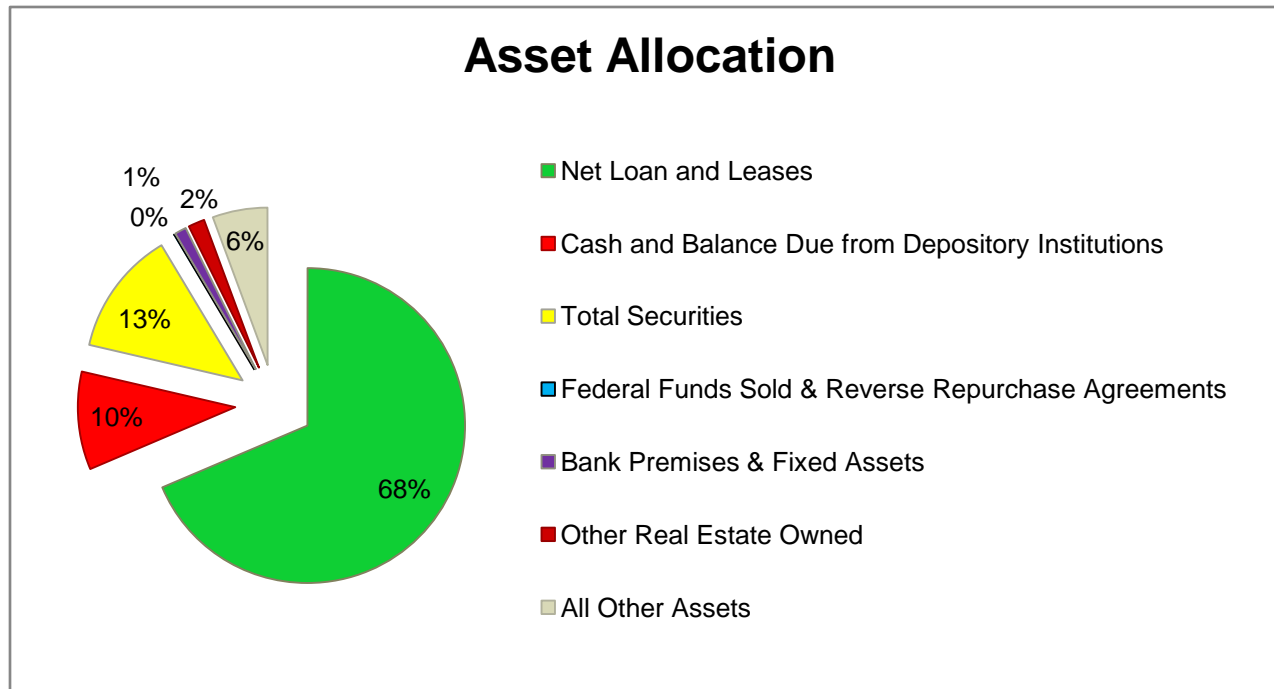


- The bank recorded big losses in 08 Q2 and Q4.
- The bank started reporting losses since 07 Q4.



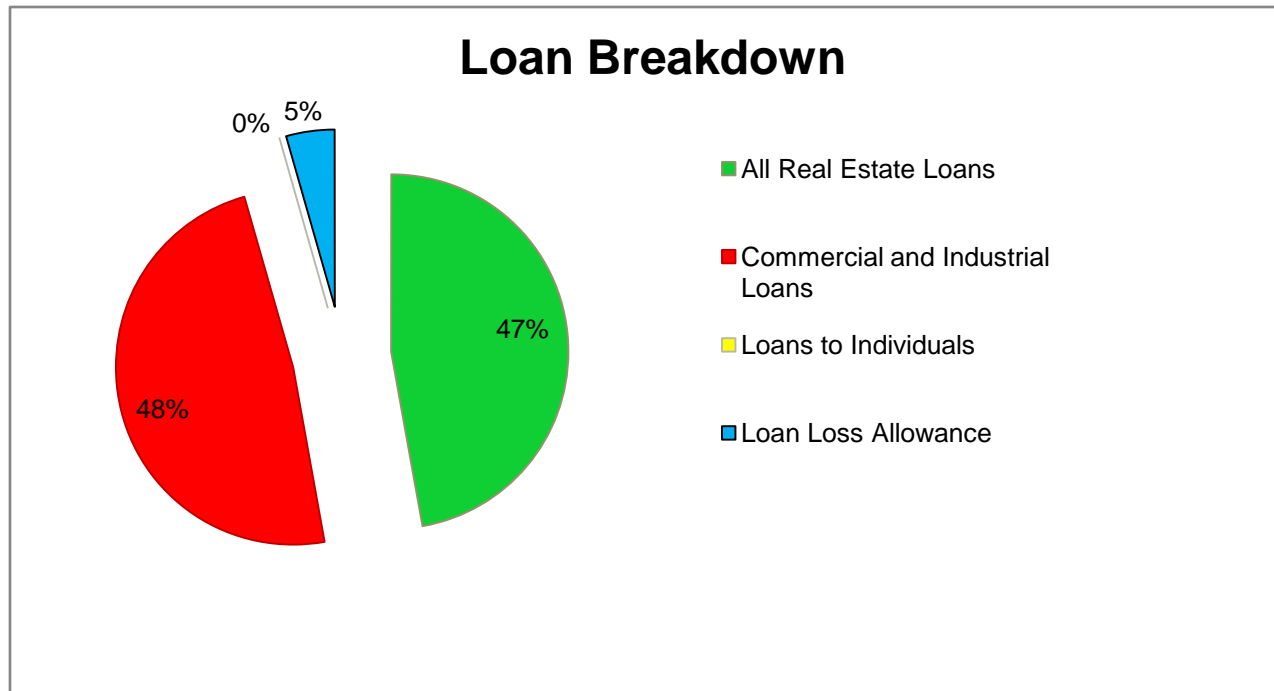
Indicates sign of bank in financial distress

Asset Allocation



- The average percentage of Net Loans for banks of the same Asset Concentration Hierarchy in the first quarter of 2009 was 71.42%.
- The average Net Loan percentage of all banks in the first quarter of 2009 was 64.89%.

Loan Breakdown



- The average percentage of Real Estate Loans for banks of the same Asset Concentration Hierarchy in the first quarter of 2009 was 76.90%.
- The average percentage for all banks in the first quarter of 2009 was 71.75%.

Events Timeline

- Mar. 16, 07** - Net income was \$313,000, or \$0.20 per diluted share, for the year ended Dec. 31, 2006, 70% decrease in net come.
- Mar. 17, 07** - Michigan Heritage Bank directors and management exercised 52,350 stock options in 2006.
- May 14, 07** - The parent company of Michigan Heritage Bank posted net income of \$156,000, or \$0.10 per diluted share, for 1Q of 2007.
- 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.
- Apr. 21, 08** - Michigan Heritage will consolidate the accounts and business activities from its Livonia branch office with branch offices of Farmington Hills, and Novi.
- 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.

Events Timeline

- 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.
- 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. 7, 08** – Michigan Heritage announced the launch of their iEarn Checking Account that will pay 5.5% annual percentage yield to customers.
- 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.

Events Timeline

- 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.
- 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. 16, 08** - Michigan Heritage entered into a written agreement with regulators.
- Dec. 19, 08** - A quarterly loss of \$3.18 million and an annual loss of \$4.645 million for the year ending Sept. 30.
- 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.

Events Timeline

- 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 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.
- 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.
- Apr. 24, 09** – Michigan Heritage Bank was closed by the Michigan Office of Financial and Insurance Regulation. Level One Bank assumed all of the deposits of Michigan Heritage Bank.
- 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, Michigan Heritage Bank, its failure was **not a surprise**.

Although Michigan Heritage Bank's normalized income and real estate loan asset analysis was relatively typical of banks with the same asset concentration hierarchy, there are other indications that Michigan Heritage Bank should fail:

- 1) **Except 2008 Q2, Michigan Heritage Bank has always had too much delinquent asset from 2007 Q4 to 2009 Q1, the quarter before the bank failed.**
- 2) **Michigan Heritage Bank's asset: liability ratio rapidly decreased to 103% two quarters before the bank's failure.**
- 3) **Its Bankability Composite Score was -1.08 before its failure, which was considered to be very poor.**

The combination of these three measures being very poor shows that the bank could fail anytime.

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