



SR003_7: Failed Bank Report

First Heritage Bank, N.A.

4675 Macarthur Court, Suite 1480
Newport Beach, CA 92660

(2/15/2005 – 7/25/2008)

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 # | 57961 |
| Parent Holding Company | FIRST NATIONAL BANK HOLDING COMPANY |
| Bank Charter Class | National Bank |
| Asset Concentration | Commercial Lending Specialization |
| Product Specialty | Commercial Banking Services, Personal Loans and Small Business Lending Services |
| Number of Branches | 3 (as of June 30, 2008) |
| Number of Employees | 25 (as of June 30, 2008) |

Executives

| | |
|----------------------|-------------------|
| CEO/President | James R. Claffee |
| Chairman | Raymond A. Lamb |
| CFO | Stephen J. Austin |

What took place?

First Heritage Bank N.A., Newport Beach, CA was closed by the Office of the Comptroller of the Currency (OCC) on July 25th, 2008, and the Federal Deposit Insurance Corporation (FDIC) was named Receiver. The estimated cost to the FDIC Deposit Insurance Fund is \$862,000,000, compared to the average cost of \$389,206,944. Mutual of Omaha Bank acquired all deposits and some assets.

Bank Financial Snapshot

| Financial Data Overlay (thousands) | | | |
|------------------------------------|------------|------------|-------------------|
| | 2007 Q2 | 2008 Q2 | Percentage Change |
| Assets | \$ 245,452 | \$ 255,376 | ↑ 4.0% |
| Liabilities | \$ 226,177 | \$ 239,471 | ↑ 5.9% |
| Net Income | \$1,010 | -\$4,856 | ↓ 581% |

- The average net income change for all the FDIC banks was -65.89% in the same period.
- The average net income change for all the commercial lending specialization banks was -50.5% in the same period.
- Compared with the whole industry and other commercial lending specialization banks, First Heritage Bank's decline from Net Income is extremely large (-581%) during 2008.

Key Performance Indicators


| KPI Summary for 2008 Q2 | |
|-----------------------------|----------------|
| Normalized Income Rating | Poor |
| Delinquent Asset Rating | Moderate |
| Asset: Liability Rating | Very Poor |
| Real Estate Asset Rating* | Excellent |
| Bankability Composite Score | 27.10** (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

| | 2007Q1 | 2007Q2 | 2007Q3 | 2007Q4 | 2008Q1  | 2008Q2 |
|--------------------|----------|----------|----------|----------|--|--------|
| Normalized Income | 0.27% | 0.17% | 0.35% | 0.48% | -1.19% | -1.16% |
| SD's from Average* | 0.171 | 0.0666 | 0.408 | 0.599 | -2.60 | -1.84 |
| Ranking | Moderate | Moderate | Moderate | Moderate | Very Poor | Poor |

- First Heritage Bank had a normalized income of -1.16% in the second quarter of 2008, the quarter before it failed.
- Banks of the same asset concentration hierarchy (commercial lending specialization) had an average normalized income of 0.03%. The standard deviation of the normalized incomes was 0.65%, which means that First Heritage Bank was almost 2 SD's below the average.

*Average of banks of the same asset concentration hierarchy



Indicates sign of bank in financial distress

Delinquent Asset Analysis

| | 2007Q1 | 2007Q2 | 2007Q3 | 2007Q4 | 2008Q1 | 2008Q2 |
|--------------------|-----------|-----------|-----------|-----------|----------|----------|
| Delinquent Asset | 0.0000% | 0.0000% | 0.0000% | 0.0000% | 2.3894% | 1.5005% |
| SD's from Average* | -0.61 | -0.63 | -0.80 | -0.82 | 0.45 | 0.06 |
| Ranking | Excellent | Excellent | Excellent | Excellent | Moderate | Moderate |

- First Heritage Bank had a delinquent assets out of total assets ratio 1.5% in the second quarter of 2008, the quarter before it failed.
- Banks of the same asset concentration hierarchy (commercial lending specialization) had an average delinquent asset of 1.5282%. The standard deviation of the delinquent assets was 1.89%, which means that First Heritage Bank was about 0.06 SD's above the average.
- Since the first quarter of 2007, First Heritage Bank's delinquent assets ratio has been below the average in relation to banks of the same asset concentration hierarchy. None of the bank's delinquent assets was past due over 3 months.

*Average of banks of the same asset concentration hierarchy

Real Estate Loan Asset Analysis

| | 2007Q1  | 2007Q2 | 2007Q3 | 2007Q4 | 2008Q1 | 2008Q2 |
|------------------------------|--|--------|-----------|-----------|--------|-----------|
| Real Estate Loan Asset Ratio | 88.36% | 82.77% | 80.24% | 27.51% | 42.92% | 23.71% |
| SD's from Average* | 1.35 | 1.06 | 1.64 | -1.83 | -0.84 | -2.17 |
| Ranking | Very Poor | Poor | Very Poor | Excellent | Good | Excellent |

- First Heritage Bank had a 23.71% of R/A ratio in 2008 Q2, the quarter before it failed.
- In 08 Q2, banks of the same asset concentration hierarchy (commercial lending specialization) had an average R/A ratio of 56.36%. The standard deviation of the R/A ratio was 15.04%, which means that First National Bank of Nevada Bank was 2.17 SD's below the average.

*Average of banks of the same asset concentration hierarchy



Indicates sign of bank in financial distress

Asset: Liability Analysis

| | 2007Q1 | 2007Q2 | 2007Q3 | 2007Q4 | 2008Q1 | 2008Q2  |
|------------------------------|---------|---------|---------|---------|---------|--|
| Asset: Liability Ratio | 109.49% | 108.52% | 109.47% | 117.75% | 113.50% | 106.41% |
| Median A/L Ratio* | 111.98% | 112.03% | 110.97% | 110.95% | 110.93% | 110.69% |
| Ranking | Poor | Poor | Poor | Good | Good | Very Poor |

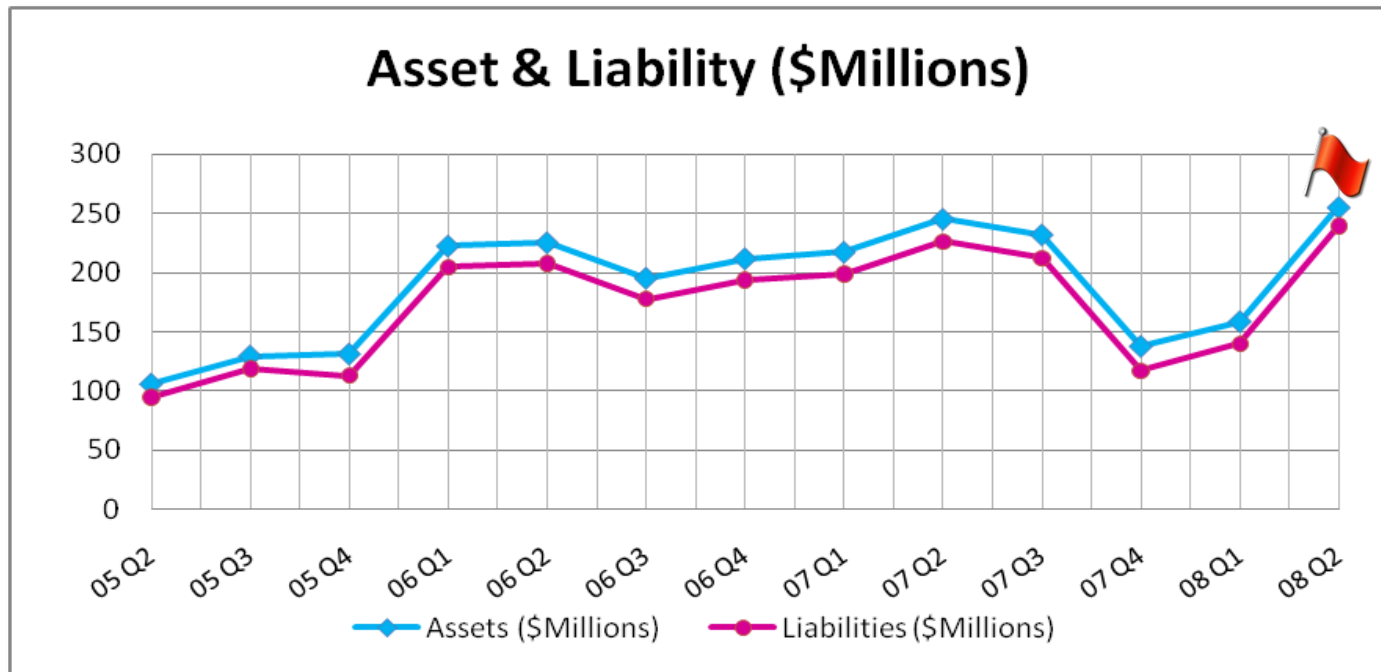
- First Heritage Bank's A/L ratio decreased in the last 2 quarters before it failed.
- The bank fell into the worst ranking in 08 Q2.
- Of the banks failed in 08 Q2, 77.78% of them had an A/L ratio under 107%.

*Median of banks of the same asset concentration hierarchy



Indicates sign of bank in financial distress

Asset & Liability History

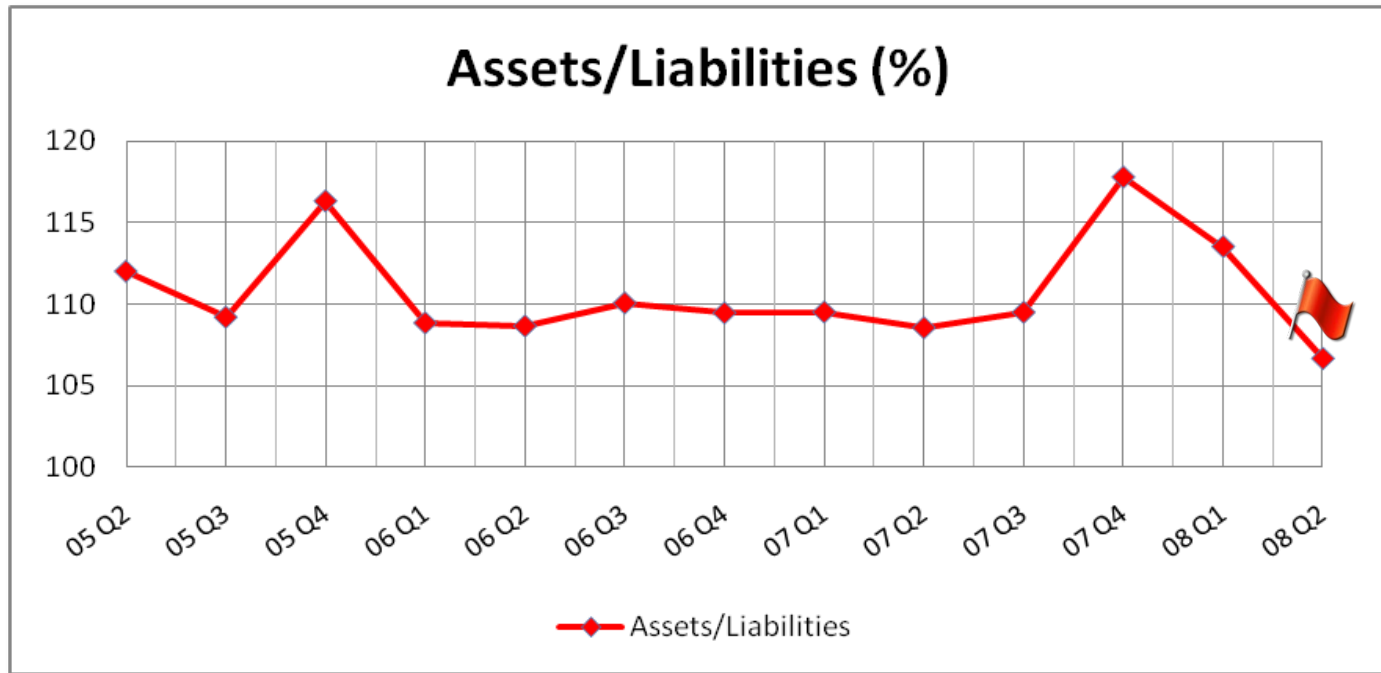


- The difference between asset and liability was getting close in 08 Q2.



Indicates sign of bank in financial distress

Asset/Liability History

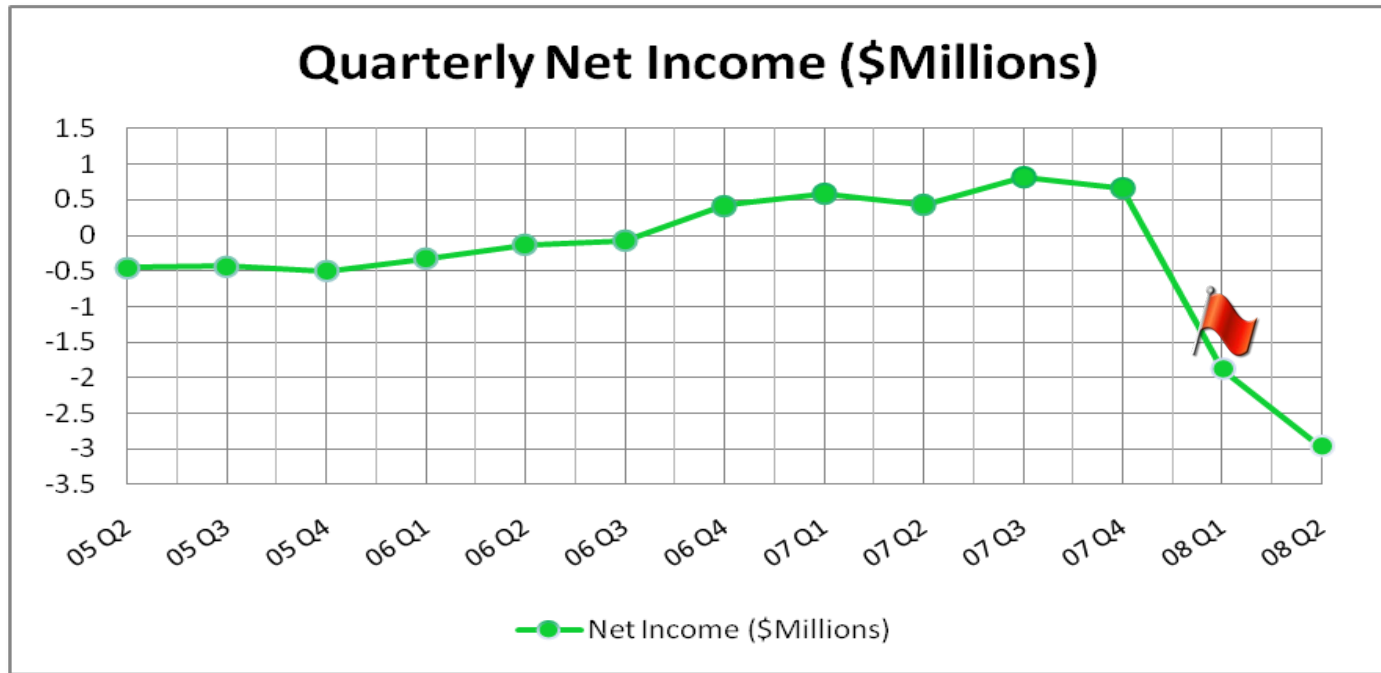


- The A/L ratio was decreasing since 07 Q4.



Indicates sign of bank in financial distress

Net Income History



- The bank recorded big losses in the last two quarters prior to failure.



Indicates sign of bank in financial distress

Events Timeline

Dec. 11, 07 - Belvedere ends buyout talks with First Heritage Bank.

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.

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.

Events Timeline

- Jul. 25, 08** – First Heritage Bank was closed by FDIC and its deposit was transferred to Omaha Bank.
- 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. 18, 09** - President Obama signs the American Recovery and Reinvestment Act of 2009, which limits bonuses of the highest earning executives.

Events Timeline

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, First Heritage Bank, its failure was **not a surprise**.

Here are the indications that First Heritage Bank should fail:

- 1) **First Heritage Bank's normalized income was ranked poor and very poor in the last 2 quarters, in which it lost over 1% of its asset each quarter.**
- 2) **The bank's A/L ratio was ranked poor in the last quarter. In fact, it decreases 7%.**
- 3) **Its Bankability Composite Score was 27.10 before its failure, which was considered to be poor.**

The combination of all these three measures shows that the failure of First Heritage Bank was in our prediction.

References

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