



SR003_7: Failed Bank Report

Horizon Bank

600 Hillside Avenue SW
Pine City, MN 55063

(6/1/1915 – 6/26/2009)

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 #	9744
Parent Holding Company	PINE CITY BANCORPORATION, INC.
Bank Charter Class	Federal Reserve Non-member
Asset Concentration	Commercial Lending Specialization
Product Specialty	Real Estate Loans, Retail Banking, Commercial Banking Services, Construction and Home Equity Loans
Number of Branches	2 (as of March 31, 2009)
Number of Employees	20 (as of March 31, 2009)

Executives	
CEO/President	Steven Schmidt

What took place?

Horizon Bank, Pine City, MN was closed by the Minnesota Department of Commerce on June 26th, 2009. The Federal Deposit Insurance Corporation (FDIC) was named Receiver. The estimated cost to the FDIC Deposit Insurance Fund is \$33,500,000, compared to the average cost of \$389,206,944. Stearns Bank of St. Cloud, Minn., bought Horizon Bank's deposits and about \$84.4 million of assets.

Bank Financial Snapshot

Financial Data Overlay (thousands)			
	2008 Q1	2009 Q1	Percentage Change
Assets	\$ 89,723	\$ 84,763	↓ 5.5%
Liabilities	\$ 81,864	\$ 83,681	↑ 2.2%
Net Income	\$ 23	-\$ 3,757	↓ 16,435%

- 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, Horizon Bank's decline from Net Income is abnormally large (-16435%) during 2009.

Key Performance Indicators

KPI Summary for 2009 Q1	
Normalized Income Rating	Very Poor
Delinquent Asset Rating	Moderate
Asset: Liability Rating	Very Poor
Real Estate Asset Rating*	Moderate
Bankability Composite Score	12.96** (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	-0.29%	0.03%	-0.69%	-1.17%	-1.41%	-4.43%
SD's from Average*	-0.528	-0.169	-1.10	-1.36	-1.15	-7.62
Ranking	Moderate	Moderate	Poor	Poor	Poor	Very Poor


- Horizon Bank had a normalized income of -4.43% 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 Horizon Bank was 7.62 SD's below the average.
- Since the first quarter of 2008, Horizon Bank's normalized income has declined 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	3.0618%	5.3676%	6.9792%	2.5995%	3.6299%	3.3692%
SD's from Average*	0.99	2.03	3.01	0.58	0.88	0.61
Ranking	Poor	Very Poor	Very Poor	Moderate	Moderate	Moderate

- Horizon Bank had a delinquent assets out of total assets ratio 3.36% 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 Horizon Bank was about 0.6 SD's above the average.
- Since the fourth quarter of 2007, Horizon Bank's delinquent assets ratio has been poor and higher than the average. However, after the third quarter of 2008, its delinquent assets ratio suddenly improved and went into a good condition.

*Average of banks of the same asset concentration hierarchy



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Real Estate Loan Asset Analysis

	2007Q4	2008Q1	2008Q2	2008Q3	2008Q4	2009Q1
Real Estate Loan Asset Ratio	60.20%	63.12%	58.29%	61.04%	60.70%	62.15%
SD from Average*	0.30	0.49	0.13	0.29	0.27	0.41
Ranking	Moderate	Moderate	Moderate	Moderate	Moderate	Moderate

- Horizon Bank had a 62.15% 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 Horizon Bank was 0.41 SD's above the average.

* Average of banks of the same asset concentration hierarchy

Asset: Liability Analysis

	2007Q4	2008Q1	2008Q2	2008Q3 	2008Q4	2009Q1
Asset: Liability Ratio	109.08%	109.60%	107.97%	106.97%	105.52%	101.29%
Median A/L Ratio*	110.95%	110.93%	110.69%	110.65%	110.52%	110.57%
Ranking	Poor	Moderate	Poor	Very Poor	Very Poor	Very Poor

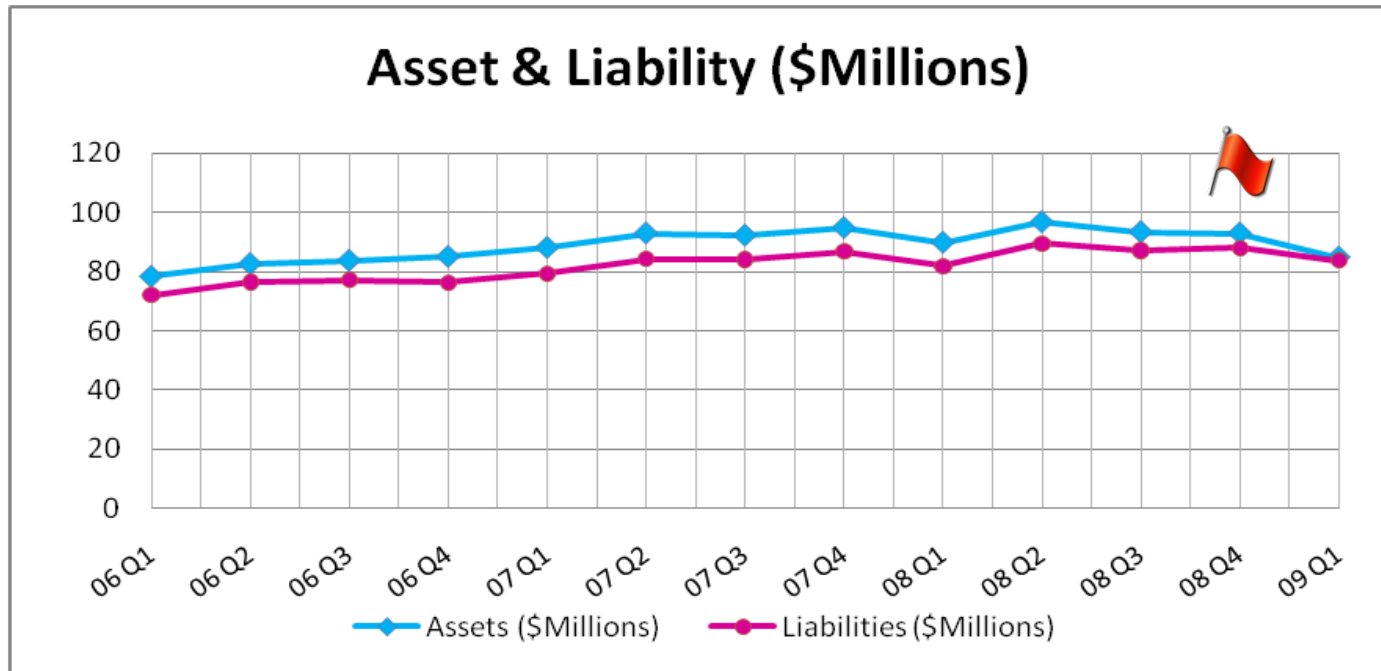
- Horizon Bank experienced decreasing A/L ratio since 08 Q1.
- The bank fell into the worst ranking in 08 Q3.
- Of the banks failed in Q2 09, 87.50% of them had an A/L ratio under 107%.
- Of the bank with an A/L ratio under 106% in Q1 09, 10.75% failed in the subsequent quarter.

* Average of banks of the same asset concentration hierarchy



Indicates sign of bank in financial distress

Asset & Liability History

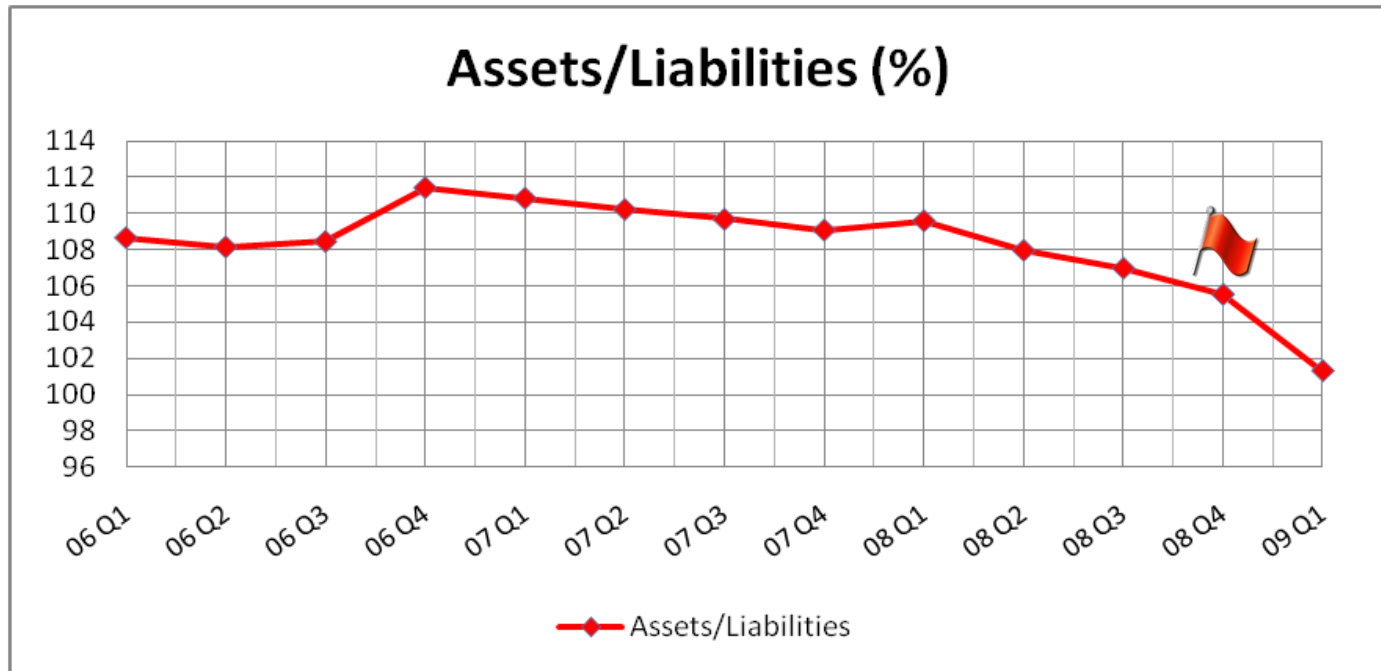


- The difference between asset and liability was getting closer in 08 Q3.



Indicates sign of bank in financial distress

Asset/Liability History

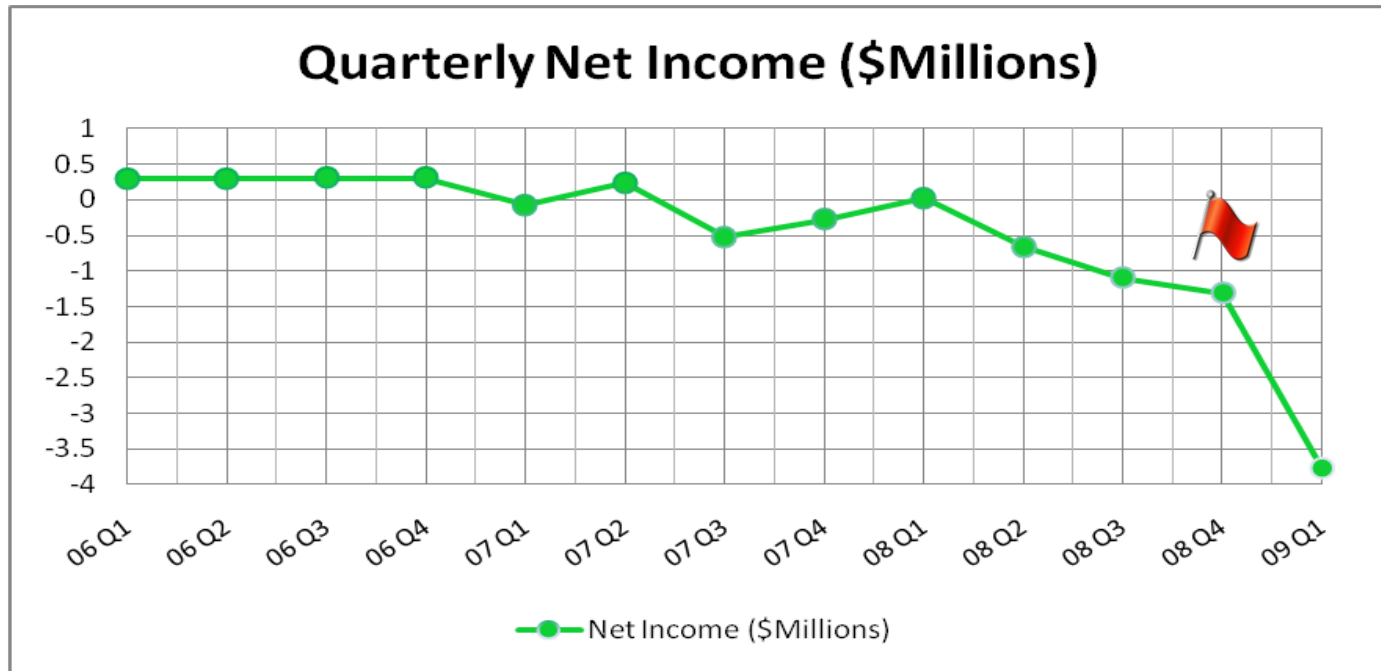


- The A/L ratio was decreasing since 08 Q1.



Indicates sign of bank in financial distress

Net Income History

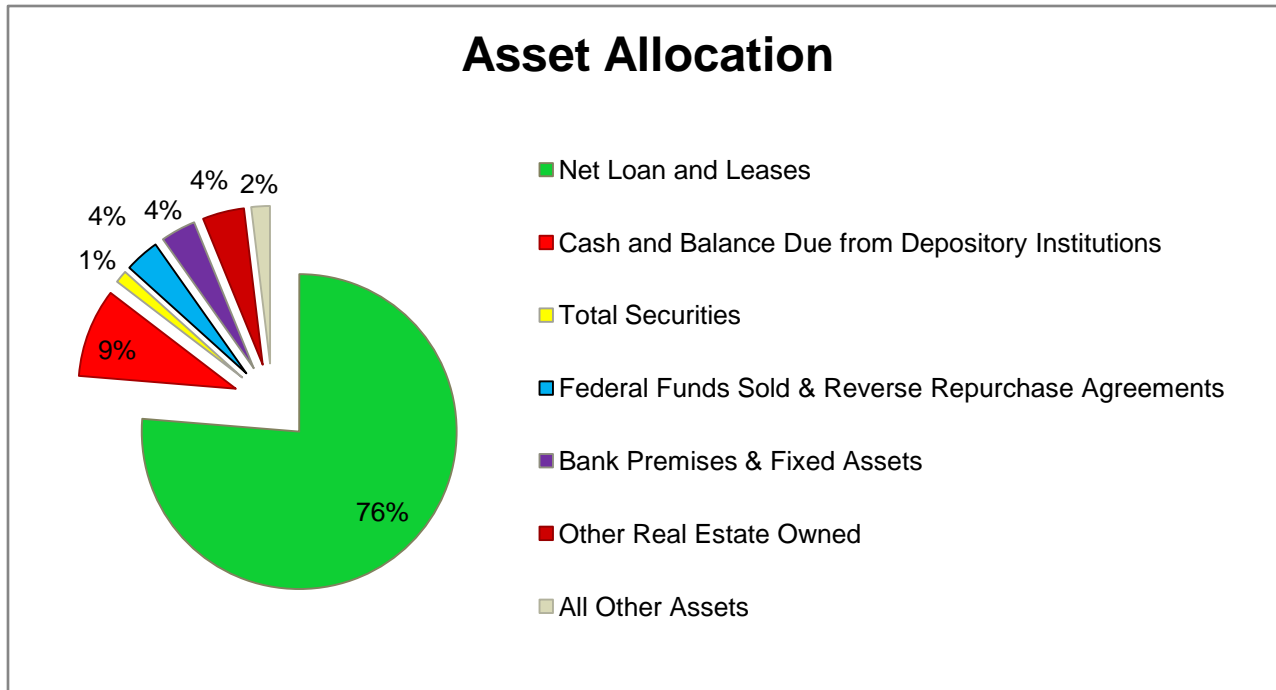


- The bank recorded a big loss in the last quarter prior to failure.
- The bank started reporting losses since 08 Q2.



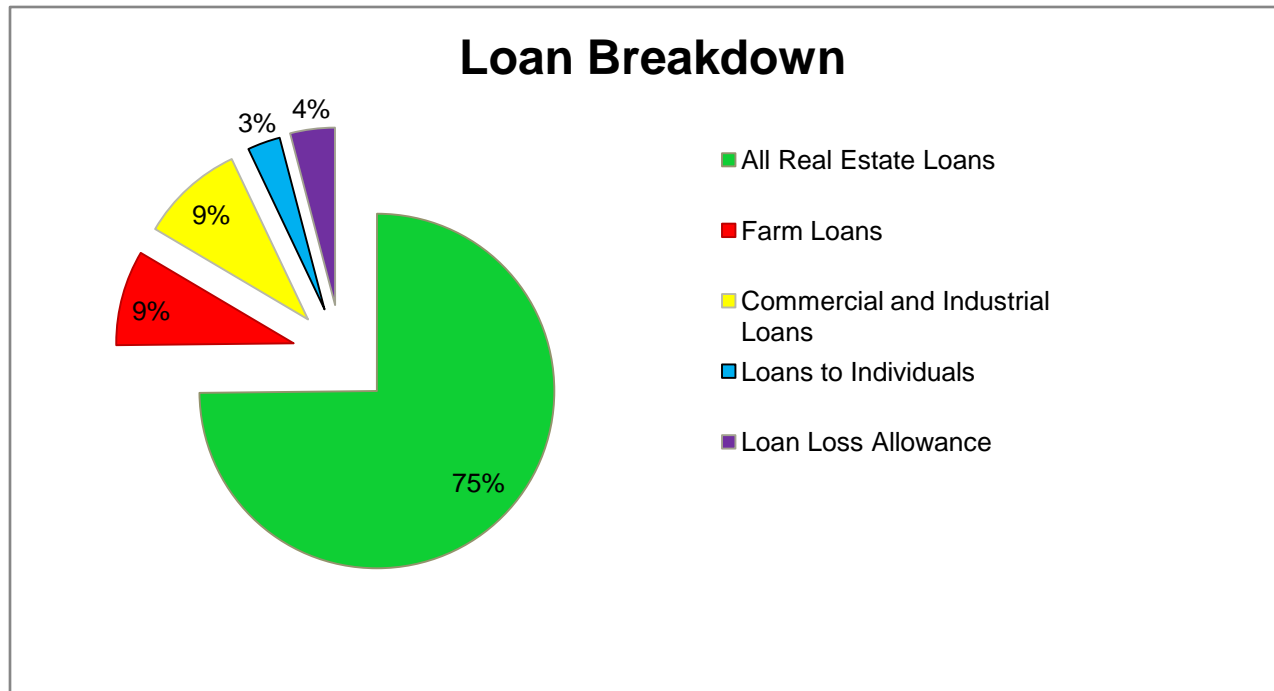
Indicates sign of bank in financial distress

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

- Dec. 31, 07** - Horizon Bank had \$155 million in loans and \$147 million in deposits. It reported a drop in nonperforming assets and total delinquent loans during the fourth quarter.
- Feb. 5, 08** - SEC created Office of Collections and Distributions to expedite the distribution of more than \$5 billion to injured investors.
- 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.
- Mar. 31, 08** - Tangible book value was \$10.72, equity to assets was 9.22% and risk-based capital was 11.02%.
- May 26, 08** - FDIC reported that Horizon Bank of Oskaloosa has the highest rate of bad loans , 15% of its loans classified as non-accruing as of Dec. 31, among Iowa banks.
- 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.

Events Timeline

- 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.
- Jul. 17, 08** - 2nd quarter 2008 earnings were \$238,000, compared to earnings of \$411,000 in 2nd quarter of 2007.
- Jul. 30, 08** - SEC proposed guidance that would help fund boards of directors in oversighting of an adviser's trading activities and use of soft dollar arrangements.
- 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.

Events Timeline

- 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.
- 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.

Events Timeline

- 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 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. 2, 09** - The banking regulators demanded that the Bellingham parent of Horizon Bank take corrective measures in various areas of its lending practices.
- Mar. 4, 09** - Treasury announced loan modification guidelines under the Administration's Homeowner Affordability and Stability Plan.
- Mar. 20, 09** - Horizon Bank has mailed new MasterCard debit cards to nearly 25% of its customers b/c of potential security problems.
- Mar. 27, 09** - Horizon Bank operate under tighter regulatory scrutiny: they must obtain Fed's approval before they pay dividends, incur more debt or redeem any shares of their sock.
- 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.

Events Timeline

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.

June 26, 09 - Stearns Bank, N.A. paid a premium of 0.75% to acquire all of the deposits of Horizon Bank.

Jul. 2, 09 - FDIC proposed guidelines require private equity firms to hold bank purchases for 3yrs and maintain capital levels.

* All internal news are written in [blue color](#).

Report Summary – *Surprise?*

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

Here are the indications that Horizon Bank should fail:

- 1) **The bank was ranked between poor and very poor in the last 4 quarters. It lost around 7% of its total asset in the three quarters combined.**
- 2) **Horizon Bank's asset: liability ratio was ranked between poor and very poor in 5 out of 6 quarters prior to failure. The A/L ratio was 101.29% in the last quarter, which is much lower than the dangerous line 107%.**
- 3) **Its Bankability Composite Score was 12.96 before its failure, which was considered to be very poor.**

The combination of all these three indications shows that the failure of Horizon Bank is within our prediction.

References

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