

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

**Form 10-K**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the fiscal year ended December 31, 2021

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission file number: 0-24100.

**HMN FINANCIAL, INC.**  
(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**41-1777397**

(I.R.S. Employer Identification No.)

**1016 Civic Center Drive Northwest**  
**Rochester, Minnesota**  
(Address of principal executive offices)

**55901**  
(Zip Code)

**(507) 535-1200**

Registrant's telephone number, including area code

Securities registered pursuant to Section 12(b) of the Act:

Title of each class  
Common Stock, par value \$.01 per share

Trading Symbol(s)  
HMNF

Name of each exchange on which registered  
The Nasdaq Stock Market, LLC

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.  
Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  
Yes  No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).  
Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input checked="" type="checkbox"/>	Smaller reporting company	<input checked="" type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

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If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes  No

As of June 30, 2021, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was \$78.6 million based on the closing stock price of \$21.30 on such date as reported on the Nasdaq Global Market.

As of February 25, 2022, the number of outstanding shares of common stock of the registrant was 4,569,950.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's annual report to stockholders for the year ended December 31, 2021 (Annual Report), are incorporated by reference in Parts I and II of this Form 10-K. Portions of the registrant's definitive proxy statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days after the close of the registrant's fiscal year ended December 31, 2021 are incorporated by reference in Part III of this Form 10-K.

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### **Forward-Looking Statements**

The information presented or incorporated by reference in this Form 10-K contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). These statements are often identified by such forward-looking terminology as "expect," "estimate," "intend," "look," "believe," "anticipate," "project," "continue," "may," "will," "would," "could," "target," "goal," "should," and "trend," or similar statements or variations of such terms and include, but are not limited to, those relating to maintaining credit quality; maintaining net interest margins; the adequacy and amount of available liquidity and capital resources to Home Federal Savings Bank (the Bank); the liquidity and capital requirements of HMN Financial, Inc. (HMN or the Company); the anticipated impacts of the COVID-19 pandemic and efforts to mitigate the same on the general economy, our clients, and the allowance for loan losses; the amount of the Bank's non-performing assets in future periods and the appropriateness of the allowances therefor; anticipated future levels of the provision for loan losses; future losses on non-performing assets; the amount and composition of interest earning assets; the amount and compositions of non-interest and interest-bearing liabilities; the availability of alternate funding sources; the payment of dividends or repurchases of stock by HMN; the amount of deposits that will be withdrawn from checking and money market accounts and how the withdrawn deposits will be replaced; the projected changes in net interest income based on rate shocks; the range that interest rates may fluctuate over the next twelve months; the net market risk of interest rate shocks; the future outlook for the issuer of the trust preferred securities held by the Bank; the anticipated results of litigation and our assessment of the impact on our financial statements; the ability of the Bank to pay dividends to HMN; the ability to remain well capitalized; the impact of new accounting pronouncements; and compliance by the Bank with regulatory standards generally (including the Bank's status as "well-capitalized") and other supervisory directives or requirements to which the Company or the Bank are or may become expressly subject.

A number of factors, many of which may be amplified by the COVID-19 pandemic and efforts to mitigate the same, could cause actual results to differ materially from the Company's assumptions and expectations. These include but are not limited to the adequacy and marketability of real estate and other collateral securing loans to borrowers; federal and state regulation and enforcement; possible legislative and regulatory changes, including changes to regulatory capital rules; the ability of the Bank to comply with other applicable regulatory capital requirements; enforcement activity of the Office of the Comptroller of the Currency (OCC) and the Federal Reserve Bank of Minneapolis in the event of our non-compliance with any applicable regulatory standard or requirement; adverse economic, business and competitive developments such as continued shrinking interest margins, reduced collateral values, deposit outflows, changes in credit or other risks posed by the Company's loan and investment portfolios; changes in costs associated with traditional and alternate funding sources, including changes in collateral advance rates and policies of the Federal Home Loan Bank (FHLB) and the Federal Reserve Bank; technological, computer-related or operational difficulties including those from any third party cyberattack; results of litigation; reduced demand for financial services and loan products; changes in accounting policies and guidelines, or monetary and fiscal policies of the federal government or tax laws; domestic and international economic developments; the Company's access to and adverse changes in securities markets; the market for credit related assets; the future operating results, financial condition, cash flow requirements and capital spending priorities of the Company and the Bank; the availability of internal and, as required, external sources of funding; our ability to attract and retain employees; or other significant uncertainties. Additional factors that may cause actual results to differ from the Company's assumptions and expectations include those set forth in the "Risk Factors" section of the Company's Annual Report on Form 10-K for the year ended December 31, 2021. All forward-looking statements are qualified by, and should be considered in conjunction with, such cautionary statements.

All statements in this Form 10-K, including forward-looking statements, speak only as of the date they are made, and we undertake no duty to update any of the forward-looking statements after the date of this Form 10-K.

**PART I**

**ITEM 1. BUSINESS**

**General**

HMN was incorporated in Delaware in 1994 as a stock savings bank holding company. HMN owns 100 percent of Home Federal Savings Bank. The Bank has a community banking philosophy and operates retail banking and loan production facilities in Minnesota, Iowa and Wisconsin. The Bank has two wholly owned subsidiaries, Osterud Insurance Agency, Inc. (OIA), which does business as Home Federal Investment Services and offers financial planning products and services, and HFSB Property Holdings, LLC (HPH), which is currently inactive, but has acted in the past as an intermediary for the Bank in holding and operating certain foreclosed properties.

As a community-oriented financial institution, the Company seeks to serve the financial needs of communities in its market area. The Company's business involves attracting deposits from the general public and businesses and using such deposits to originate or purchase single family residential, commercial real estate and multi-family mortgage loans as well as consumer, construction and commercial business loans. The Company also invests in mortgage-backed and related securities, U.S. government agency obligations and other permissible investments. The executive offices of the Company are located at 1016 Civic Center Drive Northwest, Rochester, Minnesota 55901. Its telephone number at that address is (507) 535-1200. The Company's website is [www.hmnf.com](http://www.hmnf.com). Information contained on the Company's website is expressly not incorporated by reference into this Form 10-K.

**Market Area**

The Company serves the southern Minnesota counties of Dodge, Fillmore, Freeborn, Houston, Mower, Olmsted, Steele and Winona, and portions of Goodhue and Wabasha through its corporate office located in Rochester, Minnesota and its eleven branch offices located in Albert Lea, Austin, Kasson, La Crescent, Owatonna, Rochester (4), Spring Valley and Winona, Minnesota. The portion of the Company's southern Minnesota market area consisting of Rochester and the contiguous communities is composed of primarily urban and suburban communities, while the balance of the Company's southern Minnesota market area consists primarily of rural areas and small towns. Primary industries in the Company's southern Minnesota market area include manufacturing, agriculture, health care, wholesale and retail trade, service industries and education. Major employers include the Mayo Clinic, Hormel Foods (a food processing company), Federated Insurance and IBM (a computer technology company). The Company's market area is also the home of Winona State University, Rochester Community and Technical College, University of Minnesota - Rochester, Winona State University - Rochester Center and Austin's Riverland Community College.

The Company serves Dakota County, in the southern portion of the Minneapolis and St. Paul metropolitan area, from its office located in Eagan, Minnesota. Major employers in this market area include Delta Airlines, Patterson Companies (dental and animal health), UTC (aerospace systems), CHS Cooperative, Flint Hills Resources LP (oil refinery), Unisys Corp (computer software), Blue Cross Blue Shield of Minnesota and West Group, a Thomson Reuters business (legal research).

The Company serves the Iowa county of Marshall through its branch office located in Marshalltown, Iowa. Major employers in the area include Swift & Company (pork processors), Emerson (automation solutions, and commercial and residential solutions), Lennox Industries (furnace and air conditioner manufacturing), Iowa Veterans Home (hospital care), Marshalltown Community School District (education) and UnityPoint Health (hospital care).

The Company serves the Wisconsin county of Waukesha through its branch office located in Pewaukee, Wisconsin. Major employers in the area include Kohl's Department Stores, ProHealth Care, Quad Graphics, Inc. (media services), Froedtert (academic medical center), General Electric Healthcare (medical technologies), Roundy's (supermarkets), Aurora Health Care, the School District of Waukesha, Waukesha County Technical College, WE Energies, and Cooper Power.

**Lending Activities**

**General.** The Company originates 15 and 30 year fixed rate mortgage loans secured by single family residences and sells the majority of these loans into the secondary market in order to manage its interest rate risk. However, the Company may place some 10 and 15 year fixed rate mortgage loans that are eligible for sale in the secondary market into the loan portfolio from time to time in order to increase the yield earned on the Bank's interest earning assets. The Company also originates shorter term and generally higher yielding commercial real estate, commercial business and construction loans that it places into its loan portfolio. Some shorter term single family fixed rate mortgage loans and single family adjustable rate mortgage loans are also placed into the loan portfolio. The Company also offers an array of consumer loan products that include both open and closed end home equity loans. Home equity lines of credit have adjustable interest rates based upon the prime rate, as published in the Wall Street Journal, plus a margin. Refer to "Note 5 Loans Receivable, Net" and "Note 6 Allowance for Loan Losses and Credit Quality Information" in the Notes to Consolidated Financial Statements in the Annual Report for more information on the loan portfolio (incorporated by reference in Item 8 of Part II of this Form 10-K).

The following table shows the composition of the Company's loan portfolio by fixed and adjustable rate loans as of December 31:

<i>(Dollars in thousands)</i>	2021		2020	
	Amount	Percent	Amount	Percent
<b>Fixed rate Loans</b>				
Real estate:				
Single family	\$ 103,766	15.67%	\$ 72,580	11.10%
Multi-family	26,437	3.99	23,470	3.59
Commercial	186,796	28.22	183,857	28.12
Construction	27,176	4.11	19,043	2.92
Total real estate loans	344,175	51.99	298,950	45.73
Other loans:				
Consumer loans:				
Home equity	4,748	0.72	7,779	1.18
Recreational vehicle	10,985	1.66	15,645	2.39
Other	3,938	0.59	5,524	0.85
Total consumer loans	19,671	2.97	28,948	4.42
Commercial business loans	31,630	4.78	67,876	10.39
Total non-real estate loans	51,301	7.75	96,824	14.81
Total fixed rate loans	395,476	59.74	395,774	60.54
<b>Adjustable rate Loans</b>				
Real estate:				
Single family	59,556	9.00	62,443	9.55
Multi-family	16,703	2.52	17,986	2.75
Commercial	119,694	18.08	123,898	18.95
Construction	20,062	3.03	12,450	1.90
Total real estate loans	216,015	32.63	216,777	33.15
Consumer:				
Home equity line	17,467	2.64	21,308	3.26
Home equity	2,809	0.42	3,770	0.58
Other	1,698	0.26	1,365	0.21
Total consumer loans	21,974	3.32	26,443	4.05
Commercial business loans	28,535	4.31	14,797	2.26
Total non-real estate loans	50,509	7.63	41,240	6.31
Total adjustable rate loans	266,524	40.26	258,017	39.46
Total loans	662,000	100.00%	653,791	100.00%
<b>Less:</b>				
Unamortized discounts	10		12	
Net deferred loan fees	209		450	
Allowance for losses on loans	9,279		10,699	
Total loans receivable, net	\$ 652,502		\$ 642,630	

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The following table illustrates the interest rate and maturities of the Company's loan portfolio by loan category and interest rate type at December 31, 2021. Loans which have adjustable or renegotiable interest rates are shown as maturing in the period during which the contract is due. Scheduled repayments of principal are reflected in the year in which they are scheduled to be paid. The schedule does not reflect the effects of possible prepayments or enforcement of due-on-sale clauses.

<i>(Dollars in thousands)</i>	Real Estate						Consumer	Commercial Business		Total		
	Single family	Multi-family and Commercial		Construction and Development		Commercial Business		Total				
Due during years ending December 31,	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate		
<b>Fixed-rate loans:</b>												
2022 <sup>(1)</sup>	\$ 6,760	3.73%	\$ 39,065	4.01%	\$ 4,038	4.20%	\$ 3,595	5.77%	\$ 15,548	4.37%	\$ 69,006	4.17%
2023 through 2026	31,172	3.54	120,675	4.08	15,715	3.78	9,137	5.25	15,162	3.81	191,861	4.00
2027 through 2036	46,873	3.13	51,883	3.75	7,423	3.45	6,845	5.77	920	4.44	113,944	3.60
2037 and thereafter	18,961	3.13	1,610	4.49	0	0.00	94	5.10	0	0.00	20,665	3.24
<b>Total fixed-rate loans</b>	<b>\$ 103,766</b>		<b>\$ 213,233</b>		<b>\$ 27,176</b>		<b>\$ 19,671</b>		<b>\$ 31,630</b>		<b>\$ 395,476</b>	
<b>Adjustable-rate loans:</b>												
Due during years ending December 31,	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate
2022 <sup>(1)</sup>	\$ 2,811	3.11%	\$ 7,179	4.64%	\$ 16,836	3.39%	\$ 909	4.80%	\$ 9,011	4.51%	\$ 36,746	3.92%
2023 through 2026	7,709	3.54	42,695	4.56	2,515	3.61	2,169	5.16	13,802	4.00	68,890	4.32
2027 through 2036	22,318	3.49	78,479	4.23	711	3.96	16,320	4.42	5,722	4.80	123,550	4.15
2037 and thereafter	26,718	3.35	8,044	4.46	0	0.00	2,576	4.80	0	0.00	37,338	3.69
<b>Total adjustable-rate loans</b>	<b>\$ 59,556</b>		<b>\$ 136,397</b>		<b>\$ 20,062</b>		<b>\$ 21,974</b>		<b>\$ 28,535</b>		<b>\$ 266,524</b>	
<b>Total</b>	<b>\$ 163,322</b>		<b>\$ 349,630</b>		<b>\$ 47,238</b>		<b>\$ 41,645</b>		<b>\$ 60,165</b>		<b>\$ 662,000</b>	

(1) Includes demand loans, loans having no stated maturity, and overdraft loans.

The total amount of loans due after December 31, 2022 which have predetermined interest rates is \$326.5 million, while the total amount of loans due after such date that have floating or adjustable interest rates is \$229.8 million. Construction and development loans at December 31, 2021 were \$23.3 million for single family dwellings, \$10.0 million for multi-family and \$13.9 million for nonresidential.

The aggregate amount of loans and extensions of credit that the Bank is permitted to make to any one borrower is generally limited to 15% of unimpaired capital and surplus. In addition to the 15% limit, the Bank is permitted to lend an additional amount equal to 10% of unimpaired capital and surplus if the additional amount is fully secured by "readily marketable collateral" having a current market value of at least 100% of the loan or extension of credit. Similarly, the Bank is permitted to lend additional amounts equal to the lesser of 30% of unimpaired capital and surplus, or \$30 million, for certain residential development loans. Applicable law establishes a number of rules for combining loans to separate borrowers. Loans or extensions of credit to one person may be attributed to other persons if: (i) the proceeds of a loan or extension of credit are used for the direct benefit of the other person; or (ii) a common enterprise is deemed to exist between persons. At December 31, 2021, based upon the 15% limitation, the Bank's regulatory limit for loans to one borrower was approximately \$15.7 million and no loans to any one borrower exceeded this amount. At December 31, 2021, the Bank's largest aggregate amount of loans to one borrower totaled \$15.0 million. All of the loans for the largest borrower were performing in accordance with their terms as of December 31, 2021 and the borrower had no affiliation with the Bank other than their relationship as a customer.

All of the Bank's lending is subject to its written underwriting standards and to loan origination procedures. Decisions on loan requests are made on the basis of detailed applications and property valuations determined by an independent appraiser. The loan applications are designed primarily to determine the borrower's ability to repay. The more significant items on the application are verified through the use of credit reports, financial statements, tax returns or confirmations.

Single family loans are originated either for inclusion in the loan portfolio under the Bank's Portfolio First loan program or for sale in the secondary market to the Federal National Mortgage Association (FNMA) on a servicing retained basis or to other third party investors on a servicing released basis. The limit for a retail mortgage originated for sale on the secondary market was \$548,250 and \$510,400 for 2021 and 2020, respectively, and these loans require the approval of a designated secondary market underwriter.

Two levels of approval authority have been established for loans originated under the Portfolio First loan program. The two levels of authority include Approved Portfolio First Lenders and Credit Administration positions with Portfolio First approval authority. Approved Portfolio First Lenders are select mortgage loan officers recommended for the Portfolio First program approval authority by their Market President and are approved by the Chief Credit Officer or Chief Operating Officer. The Credit Administration positions with Portfolio First approval authority include the Director of Retail Lending and Loan Servicing, the Chief Credit Officer and the Chief Operating Officer.

Loans less than \$750,000 require the approval of one Credit Administration individual with Portfolio First approval authority. Loans over \$750,000 require the approval of two individuals with Portfolio First approval authority. Loans where the total aggregate amount of all loan obligations owed or guaranteed to the Bank plus the new obligation is greater than \$2.5 million require the approval of a majority of the Senior Loan Committee, which is comprised of the Bank's most experienced lending staff.

Loans that meet the underwriting guidelines of secondary market investors are approved by designated Credit Administration positions. The Credit Administration positions with secondary market approval authority include Retail Loan Underwriters, the Director of Retail Lending and Servicing, the Chief Credit Officer and the Chief Operating Officer. Resident and Physician loan products that fall under the Portfolio First Policy are underwritten by a Retail Loan Underwriter who has the authority to approve these loans. Resident and Physician loans with exceptions require a second approval from an individual with Portfolio First approval authority. Approval level authorities are granted by the Chief Credit Officer or Chief Operating Officer and confirmed by the Executive Loan Committee on an annual basis. Loans are originated based on the specific guidelines established by the secondary market investor.



The Bank generally requires title insurance on its mortgage loans, as well as fire and extended coverage casualty insurance in amounts at least equal to the principal amount of the loan or the value of improvements on the property. The Bank also requires flood insurance to protect the property securing its interest when the property is located in a flood plain.

**Single Family Residential Real Estate Lending.** At December 31, 2021, the Company's single family real estate loans, consisting of both fixed rate and adjustable rate loans, totaled \$163.3 million, an increase of \$28.3 million from \$135.0 million at December 31, 2020. The increase in the single family loans in 2021 is the result of an increase in loan originations due to the low interest rate environment that existed during the year and an increased emphasis on placing shorter term fixed (10 year and certain 15 year loans) and adjustable rate mortgage loans into the portfolio. The majority of the longer term loans that were originated during the year continued to be sold into the secondary market in order to manage the Company's interest rate risk position.

The Company offers conventional fixed rate single family loans that have maximum terms of 30 years. In order to manage interest rate risk, the Company typically sells the majority of fixed rate loan originations with terms to maturity of 15 years or greater that are eligible for sale in the secondary market. The interest rates charged on the fixed rate loan products are based on the secondary market delivery rates, as well as other competitive factors. The Company also originates fixed rate loans with terms up to 30 years that are insured by the Federal Housing Administration (FHA), Veteran's Administration (VA), Minnesota Housing Finance Agency, Iowa Finance Authority, or the United States Department of Agriculture-Guaranteed Housing (RD).

The Company also offers one year adjustable rate mortgages (ARMs) at a margin (generally 250 to 300 basis points) over the yield on the Average Weekly One Year U.S. Treasury Constant Maturity Index for terms of up to 30 years. The ARMs offered by the Company allow the borrower to select (subject to pricing) an initial period of one to fifteen years between the loan origination and the date the first interest rate change occurs. The ARMs generally have a 200 basis point annual interest rate change cap and a lifetime cap of 600 basis points over or under the initial rate. The Company's originated ARMs do not permit negative amortization of principal, generally do not contain prepayment penalties and are not convertible into fixed rate loans. Because of the low interest rate environment that has existed over the last few years, a limited number of ARM loans have been originated as consumers have generally opted for longer term fixed rate loans.

In underwriting single family residential real estate loans the Company evaluates the borrower's credit history and ability to make principal, interest and escrow payments; the value of the property that will secure the loan; and debt-to-income ratios. Properties securing single family residential real estate loans made by the Company are appraised by independent appraisers. The Company originates residential mortgage loans with loan-to-value ratios up to 100% for owner-occupied homes and up to 85% for nonowner-occupied homes; however, private mortgage insurance is generally required to reduce the Company's exposure to 80% or less of the value on most loans. The Company generally seeks to underwrite its loans in accordance with secondary market, FHA, VA or RD standards. However, the Company does originate some shorter term fixed rate and adjustable rate single family loans for its portfolio that do not meet certain secondary market guidelines.

The Company's single family mortgage loans customarily include due-on-sale clauses giving it the right to declare the loan immediately due and payable in the event that, among other things, the borrower sells or otherwise disposes of the property subject to the mortgage.

At December 31, 2021, \$0.3 million of the single family residential loan portfolio was non-performing, compared to \$0.5 million at December 31, 2020.

**Commercial Real Estate and Multi-Family Lending.** The Company originates permanent commercial real estate and multi-family loans secured by properties located primarily in its market area. It also purchases a limited amount of participations in commercial real estate and multi-family loans originated by third parties. The commercial real estate and multi-family loan portfolio includes loans secured by motels, hotels, apartment buildings, churches, manufacturing plants, land developments, office buildings, movie theaters, shopping malls, nursing homes, restaurants, warehouses and other non-residential building properties primarily located in the upper Midwestern portion of the United States. At December 31, 2021, the Company's commercial and multi-family real estate loans totaled \$349.6 million, an increase of \$0.4 million from \$349.2 million at December 31, 2020.

Permanent commercial real estate and multi-family loans are generally originated for a maximum term of 10 years and may have longer amortization periods with balloon maturity features. The interest rates may be fixed for the term of the loan or have adjustable features that are tied to the prime rate or another published index. Commercial real estate and multi-family loans are generally written in amounts up to 80% of the lesser of the appraised value of the property or the purchase price and generally have a debt service coverage ratio of at least 110%. The debt service coverage ratio is the ratio of net cash from operations to debt service payments. The Company may originate construction loans secured by commercial or multi-family real estate, or may purchase participation interests in third party originated construction loans secured by commercial or multi-family real estate.

Appraisals on commercial real estate and multi-family real estate properties are performed by independent appraisers prior to the time the loan is made. For transactions less than \$500,000, the Company may use an internal valuation. All appraisals on commercial and multi-family real estate are reviewed and approved by a qualified Bank employee or independent third party. The Bank's underwriting procedures require verification of the borrower's credit history, income, financial statements, banking relationships and income projections for the property. The commercial loan policy generally requires personal guarantees from the proposed borrowers. An initial on-site inspection is generally required for all collateral properties for loans with balances in excess of \$250,000. Independent annual reviews are performed for aggregate commercial lending relationships that exceed \$500,000. The reviews cover financial performance, documentation completeness and accuracy of loan risk ratings.

Multi-family and commercial real estate loans generally present a higher level of risk than loans secured by single family residences. This greater risk is due to several factors, including the concentration of principal in a limited number of loans and borrowers, the effects of general economic conditions on income producing properties and the increased difficulty of evaluating and monitoring these types of loans. Furthermore, the repayment of loans secured by multi-family and commercial real estate is typically dependent upon the successful operation of the related real estate project. If the cash flow from the project is reduced (for example, if leases are not obtained or renewed), the borrower's ability to repay the loan may be impaired. At December 31, 2021, \$3.8 million of loans in the commercial real estate portfolio were non-performing compared to \$1.5 million at December 31, 2020. The largest non-performing loan in this category as of December 31, 2021 was a \$3.4 million loan relationship in the hospitality industry located in the Bank's primary market area.

**Construction Lending.** The Company makes construction loans to individuals for the construction of their residences and to builders for the construction of single family residences. It also makes a limited number of loans to builders for houses built on speculation. Construction loans also include commercial real estate loans.

Almost all loans to individuals for the construction of their residences are structured as permanent loans. These loans are made on the same terms as residential loans, except that during the construction phase, which typically lasts up to twelve months, the borrower pays interest only. Generally, the borrower also pays a construction fee at the time of origination plus other costs associated with processing the loan. Residential construction loans are underwritten pursuant to the same guidelines used for originating residential loans on existing properties.

Construction loans to builders or developers of single family residences generally carry terms of one year or less.

Construction loans to owner occupants are generally made in amounts up to 95% of the lesser of cost or appraised value, but no more than 90% of the loan proceeds can be disbursed until the building is completed. The Company generally limits the loan-to-value ratios on loans to builders to 80%. Prior to making a commitment to fund a construction loan, the Company requires a valuation of the property, financial data and verification of the borrower's income. The Company obtains personal guarantees for substantially all of its construction loans to builders. Personal financial statements of guarantors are also obtained as part of the loan underwriting process. Construction loans are generally located in the Company's market area.

Construction loans are obtained principally through continued business from builders and developers who have previously borrowed from the Bank, as well as referrals from existing and walk-in clients. The application process includes a submission to the Bank of accurate plans, specifications and costs of the project to be constructed. These items are some of the factors utilized in the determination of the appraised value of the subject property to be built.

At December 31, 2021, construction loans totaled \$47.2 million, an increase of \$15.7 million from \$31.5 million at December 31, 2020. Total construction loans included \$23.3 million and \$19.8 million of single family residential, \$10.0 million and \$2.3 million of multi-family residential and \$13.9 million and \$9.4 million of commercial real estate loans at December 31, 2021 and 2020, respectively. The nature of construction loans makes them more difficult to evaluate and monitor than loans on existing buildings. The risk of loss on a construction loan is dependent largely upon the accuracy of the initial estimate of the property's value upon completion of the project, experience of the builder and the estimated cost (including interest) of the project. If the estimate of value proves to be inaccurate, the Company may be confronted, at or prior to the maturity of the loan, with a project having a value that is insufficient to assure full repayment or the possibility of having to make substantial investments to complete and sell the project. Because defaults in repayment may not occur during the construction period, it may be difficult to identify problem loans at an early stage. In these cases, the Company may be required to modify the terms of the loan. There were no construction loans in the commercial real estate portfolio that were non-performing at December 31, 2021 or December 31, 2020.

**Consumer Lending.** The Company originates a variety of consumer loans, including home equity loans (open-end and closed-end), automobile, recreational vehicles, mobile home, lot loans, loans secured by deposit accounts and other loans for household and personal purposes. At December 31, 2021, the Company's consumer loans totaled \$41.6 million, a decrease of \$13.8 million from \$55.4 million at December 31, 2020.

Consumer loan terms vary according to the type and value of collateral, length of contract and creditworthiness of the borrower. The Company's consumer loans are made at fixed or adjustable interest rates, with terms up to 20 years for secured loans and up to five years for unsecured loans.

The Company's home equity loans are generally written so that the total commitment amount, when combined with the balance of any other outstanding mortgage liens, does not exceed 85% of the appraised value of the property or an internally established market value. Internal market values are established using current market data, including recent sales data, and are typically lower than third party appraised values. The closed-end home equity loans are written with fixed or adjustable rates with terms up to 20 years. The open-end home equity lines are written with an adjustable rate and a 2, 5 or 10 year draw period that requires interest only payments followed by a 10 year repayment period that fully amortizes the outstanding balance. The consumer may access the open-end home equity line by making a withdrawal at the Bank, transferring funds through our online or mobile banking products or writing a check on the home equity line of credit account. Open and closed-end equity loans, which are generally secured by second mortgages on the borrower's principal residence, represented 60.1% and 59.3% of the Company's consumer loan portfolio at December 31, 2021 and December 31, 2020, respectively.

The underwriting standards employed by the Company for consumer loans include a determination of the applicant's payment history on other debts and their ability to meet existing obligations and payments on the proposed loan. Although creditworthiness of the applicant is of primary consideration, the underwriting process also includes a comparison of the value of the security, if any, in relation to the proposed loan amount. Consumer loans may entail greater credit risk than do residential mortgage loans, particularly in the case of consumer loans that are unsecured or are secured by rapidly depreciable assets, such as automobiles, recreational vehicles or mobile homes. In these cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and thus are more likely to be affected by adverse personal circumstances. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount that can be recovered on such loans. At December 31, 2021, \$0.5 million of the consumer loan portfolio was non-performing, compared to \$0.7 million at December 31, 2020.

**Commercial Business Lending.** The Company maintains a portfolio of commercial business loans to borrowers associated with the real estate industry as well as to retail, manufacturing operations and professional firms. The Company's commercial business loans generally have terms ranging from six months to five years and may have either fixed or variable interest rates. The Company's commercial business loans generally include personal guarantees and are usually, but not always, secured by business assets such as inventory, equipment, leasehold interests in equipment, fixtures, real estate and accounts receivable. The underwriting process for commercial business loans includes consideration of the borrower's financial statements, tax returns, projections of future business operations and inspection of the subject collateral, if any. The Company may also purchase a limited amount of participation interests in commercial business loans originated outside of the Company's market area from third party originators. These loans generally have underlying collateral of inventory or equipment and repayment periods of less than ten years. At December 31, 2021, the Company's commercial business loans totaled \$60.2 million, a decrease of \$22.5 million from \$82.7 million at December 31, 2020. The decrease was primarily due to a \$31.0 million decrease in outstanding Paycheck Protection Program loans between the periods that was partially offset by an increase in other types of commercial business loans.

Unlike residential mortgage loans, which generally are made on the basis of the borrower's ability to make repayment from his or her income, and which are secured by real property with more easily ascertainable value, commercial business loans are of higher risk and typically are made on the basis of the borrower's ability to make repayment from the cash flow of the borrower's business. As a result, the availability of funds for the repayment of commercial business loans may be substantially dependent on the success of the business itself. Furthermore, the collateral securing the loans may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business. At December 31, 2021 and 2020, the amount of non-performing loans in the commercial business portfolio was not material.

## **Originations, Purchases and Sales of Loans and Mortgage-Backed and Related Securities**

Real estate loans are generally originated by the Company's salaried loan officers. Mortgage and consumer loan officers may also receive a commission in addition to their base salary for meeting production and other branch goals. Loan applications are taken in all branch and loan production offices.

The Company originates both fixed and adjustable rate loans, however, its ability to originate loans is dependent upon the relative client demand for loans in its markets. Demand for adjustable rate loans is affected by the interest rate environment. The amount of adjustable rate loans increased in 2021 due to a change in the mix of the loans originated as more commercial business lines of credit, which typically have an adjustable rate, were originated in 2021 compared to 2020. The Company originated \$18.8 million of single family adjustable rate loans for its portfolio during 2021, an increase of \$0.4 million from \$18.4 million in 2020. The Company also originated \$72.1 million of fixed rate single family loans for its portfolio during 2021, an increase of \$13.7 million from \$58.4 million for 2020. The increase in the amount of fixed rate single family loans that were placed into the loan portfolio during 2021 is primarily the result of placing more 10 and 15 year fixed rate mortgage loans that were eligible for sale in the secondary market into the loan portfolio in order to increase the yield on the Bank's interest earning assets.

The Company typically focuses its portfolio loan origination efforts on commercial real estate, commercial business and consumer loans because these loans have terms to maturity and adjustable interest rate characteristics that are generally more beneficial to the Company in managing interest rate risk than traditional single family fixed rate conventional loans. The Company originated \$239.2 million of multi-family and commercial real estate, commercial business and consumer loans (which excludes commercial real estate loans for construction and development) during 2021, an increase of \$47.3 million from originations of \$191.9 million for 2020. The increase in originations primarily reflects the \$47.9 million increase in originations of commercial business loans, in 2021 compared to 2020. The increase in commercial business loans was primarily related to the increase in commercial business lines of credit that were originated between the periods.

In order to supplement loan demand in the Company's market area and geographically diversify its loan portfolio, the Company purchases participations in real estate loans from selected sellers, from time to time, with yields based upon then-current market rates. The Company reviews and underwrites all loans purchased to ensure that they meet the Company's underwriting standards, and the seller generally continues to service the loans. The Company has generally not experienced higher losses or credit quality issues with purchased participations than other loans originated by the Company. The Company purchased \$4.8 million of loans during 2021, a decrease of \$3.0 million from the \$7.8 million purchased during 2020. All of the loans purchased have terms and interest rates that are similar in nature to the Company's originated single family, commercial real estate, construction and development and commercial business portfolios.

The Company has mortgage-backed and related securities that are held, based on investment intent, in the available for sale portfolio. The Company acquired mortgage-backed securities of \$188.8 million and \$62.2 million, respectively, in 2021 and 2020. The increase in the amount of mortgage-backed securities purchased is because there was an increase in deposit balances between the periods and the Bank had excess liquidity that was used to purchase additional investments in 2021 compared to 2020. The Company did not sell any mortgage-backed securities in 2021 or 2020. See "Investment Activities" section of this Form 10-K for further discussion of the Company's investment activity.

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The following table shows the loan and mortgage-backed and related securities origination, purchase, acquisition, sale and repayment activities of the Company for the periods indicated.

**LOANS HELD FOR INVESTMENT**

<i>(Dollars in thousands)</i>	Year Ended December 31,	
	2021	2020
<b>Adjustable rate:</b>		
Real estate:		
Single family	\$ 18,817	18,401
Multi-family	1,950	3,602
Commercial	20,949	23,581
Construction and development	34,333	24,419
Non-real estate:		
Consumer	9,984	9,127
Commercial business	87,782	13,050
Total adjustable rate	173,815	92,180
<b>Fixed rate:</b>		
Real estate:		
Single family	72,082	58,371
Multi-family	10,385	6,399
Commercial	50,990	48,816
Construction and development	36,536	9,084
Non-real estate:		
Consumer	8,683	12,035
Commercial business	48,469	75,279
Total fixed rate	227,145	209,984
Total loans originated	400,960	302,164
<b>Purchases</b>		
Real estate:		
Single family	1,767	1,534
Commercial	1,050	246
Construction and development	0	6,000
Non-real estate:		
Commercial business	1,950	0
Total loans purchased	4,767	7,780
<b>Sales, participations and repayments</b>		
Real estate:		
Commercial	2,421	201
Non-real estate:		
Consumer	2,787	2,023
Commercial business	49,000	1,303
Total sales	54,208	3,527
Transfers to loans held for sale	12,971	6,815
Principal repayments	329,971	249,201
Total reductions	397,150	259,543
Decrease in other items, net	(368)	(1,045)
Net increase	\$ 8,209	49,356

**LOANS HELD FOR SALE**

<i>(Dollars in thousands)</i>	Year Ended December 31,	
	2021	2020
<b>Originations by type</b>		
Fixed rate:		
Real estate:		
Single family	\$ 172,779	254,484
Total fixed rate	172,779	254,484
Total loans originated	172,779	254,484
<b>Sales and repayments</b>		
Real estate:		
Single family	181,113	255,181
Total sales	181,113	255,181
Transfers from loans held for investment	(7,764)	(3,288)
Change in market value/deferred fees	12	0
Principal repayments	29	11
Total reductions	173,390	251,904
Net (decrease) increase	\$ (611)	2,580

**MORTGAGE-BACKED AND RELATED SECURITIES**

<i>(Dollars in thousands)</i>	Year Ended December 31,	
	2021	2020
<b>Purchases</b>		
Fixed rate mortgage-backed securities	\$ 188,807	62,191
Total purchases	188,807	62,191
Decrease in other items, net	(44,874)	(15,578)
Net increase	\$ 143,933	46,613

**Classified Assets and Delinquencies**

**Classification of Assets.** Federal regulations require that each savings institution evaluate and classify its assets on a regular basis. In addition, in connection with examinations of savings institutions, the OCC or the Federal Deposit Insurance Corporation (FDIC) examiners may identify problem assets and, if appropriate, require them to be classified with an adverse rating. There are three adverse classifications: substandard, doubtful, and loss. Assets classified as substandard have one or more defined weaknesses and are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have the weaknesses of those classified as substandard, with additional characteristics that make collection in full on the basis of currently existing facts, conditions and values questionable, and there is a high possibility of loss. An asset classified as loss is considered uncollectible and of such little value that continuance as an asset on the balance sheet of the institution is not warranted. Assets classified as substandard or doubtful require the institution to establish prudent specific allowances for loan losses. If an asset, or portion thereof, is classified as a loss, the institution generally charges off such amount. On the basis of management's review of its assets, at December 31, 2021, the Bank classified a total of \$17.8 million of its loans and real estate as follows:

<i>(Dollars in thousands)</i>	Single Family	Commercial and Multi-family	Consumer	Commercial Business	Other Real Estate	Total
Substandard	\$ 791	14,324	475	1,813	290	17,693
Doubtful	56	0	21	0	0	77
Loss	0	0	50	0	0	50
Total	\$ 847	14,324	546	1,813	290	17,820

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The Bank's classified assets consist of non-performing loans and other assets and loans of concern discussed in Management's Discussion and Analysis of Financial Condition and Results of Operations (incorporated by reference in Item 7 of Part II of this Form 10-K). See "Note 6 Allowance for Loan Losses and Credit Quality Information" in the Notes to Consolidated Financial Statements in the Annual Report (incorporated by reference in Item 8 of Part II of this Form 10-K) for more information on classified assets.

**Delinquency Procedures.** Generally, the following procedures apply to delinquent single family real estate loans. When a borrower fails to make a required payment on a loan, the Company attempts to cure the delinquency by contacting the borrower. A late notice is sent on all loans over 16 days delinquent. Additional written and verbal contacts are made with the borrower between 30 and 60 days after the due date. If the loan is contractually delinquent 90 days, the Company sends a 30-day demand letter to the borrower and after the loan is contractually delinquent 120 days, institutes appropriate action to foreclose on the property. If foreclosed, the property is sold at a sheriff's sale and may be purchased by the Company. Delinquent commercial real estate and commercial business loans are generally handled in a similar manner. The Company's procedures for repossession and sale of consumer collateral are subject to various requirements under state consumer protection laws.

Real estate acquired by the Company as a result of foreclosure is typically classified as real estate in judgment for six to twelve months and thereafter as real estate owned until it is sold. When property is acquired by foreclosure or deed in lieu of foreclosure, it is recorded as real estate owned at the estimated fair value less the estimated cost of disposition. After acquisition, all costs incurred in maintaining the property are expensed. Costs relating to the development and improvement of the property, however, are capitalized to the extent of fair value less disposition cost.

The following table sets forth the Company's loan delinquencies by loan type, amount and percentage of loan category at December 31, 2021 for loans past due 60 days or more.

<i>(Dollars in thousands)</i>	Loans Delinquent For:						Total		
	60-89 Days			90 Days and Over			Number	Amount	Percent of Loan Category
	Number	Amount	Percent of Loan Category	Number	Amount	Percent of Loan Category			
Single family	2	\$ 65	0.04%	5	\$ 153	0.09%	7	\$ 218	0.13%
Commercial real estate	1	3,402	1.11	0	0	0.00	1	3,402	1.11
Consumer	4	89	0.21	6	122	0.29	10	211	0.51
Total	7	\$ 3,556	0.54%	11	\$ 275	0.04%	18	\$ 3,831	0.58%

Loans delinquent for 90 days and over are generally non-accruing and are included in the Company's non-performing asset total at December 31, 2021.

**Investment Activities**

The Company utilizes the available for sale securities portfolio in virtually all aspects of asset/liability management. In making investment decisions, the Investment-Asset/Liability Committee considers, among other things, the yield and interest rate objectives, the credit risk position and the Bank's liquidity and projected cash flow requirements.

**Securities.** Federally-chartered savings institutions have the authority to invest in various types of liquid assets, including United States Treasury obligations, securities of various federal agencies, certain certificates of deposit of insured banks and savings institutions, certain bankers' acceptances, repurchase agreements and federal funds. Subject to various restrictions, the holding company of a federally-chartered savings institution may also invest its assets in commercial paper, investment grade corporate debt securities and mutual funds whose assets conform to the investments that a federally-chartered savings institution is otherwise authorized to make directly.



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The investment strategy of the Company has been directed toward a mix of high-quality government agency obligations with short terms to maturity. At December 31, 2021, the Company did not own any investment securities of a single issuer that exceeded 10% of the Company's stockholders' equity other than U.S. government agency obligations.

The Bank invests a portion of its liquid assets in interest-earning overnight deposits of the FHLB of Des Moines and the Federal Reserve Bank of Minneapolis. Other investments may include high grade municipal bonds, corporate preferred stock, corporate equity securities and medium-term (up to five years) federal agency notes. HMN may invest in the same type of investment securities as the Bank. See "Note 4 Securities Available For Sale" in the Notes to Consolidated Financial Statements in the Annual Report for additional information regarding the Company's securities portfolio (incorporated by reference in Item 8 of Part II of this Form 10-K).

The following table sets forth the composition of the Company's securities portfolio, excluding mortgage-backed and related securities, at the dates indicated.

	December 31, 2021				December 31, 2020			
	Amortized Cost	Adjusted To	Fair Value	% of Total	Amortized Cost	Adjusted To	Fair Value	% of Total
<i>(Dollars in thousands)</i>								
Securities available for sale:								
U.S. Government agency obligations	\$ 39,991	(281)	39,710	31.5%	\$ 45,029	204	45,233	36.8%
Municipal obligations	0	0	0	0.0	725	1	726	0.6
Corporate obligations	0	0	0	0.0	37	0	37	0.0
Corporate preferred stock	700	(42)	658	0.5	700	(70)	630	0.5
Subtotal	\$ 40,691		40,368	32.0	\$ 46,491		46,626	37.9
Average remaining life of other marketable securities (in years)								
	1.98				0.81			
Other interest-earning assets:								
Cash equivalents	\$ 85,804		85,804	68.0	\$ 76,450		76,450	62.1
Total	\$ 126,495		126,172	100.0%	\$ 122,941		123,076	100.0%
Average remaining life or term to repricing of other marketable securities and cash equivalents (in years)								
	0.64				0.31			

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The composition and maturities of the investment securities portfolio, excluding FHLB stock, equity securities, mortgage-backed and related securities, are indicated in the following table.

	December 31, 2021					
	1 Year or Less	After 1 through 5 Years	Over 10 Years	Total Securities		
	Amortized Cost	Amortized Cost	Amortized Cost	Amortized Cost	Adjusted To	Fair Value
<i>(Dollars in thousands)</i>						
Securities available for sale:						
U.S. government agency securities (1)	\$ 29,992	9,999	0	39,991	(281)	39,710
Corporate preferred stock	0	0	700	700	(42)	658
Total	\$ 29,992	9,999	700	40,691	(323)	40,368
Weighted average yield	0.54%	0.26%	4.56%	0.54%		

(1) Callable U.S. government agency securities maturity date based on first available call date that the security is anticipated to be called.

**Mortgage-Backed and Related Securities.** In order to supplement loan production and achieve its asset/liability management goals, the Company invests in mortgage-backed and related securities. All of the mortgage-backed and related securities owned by the Company are issued, insured or guaranteed either directly or indirectly by a U.S. government agency and are considered to be investment grade securities. The Company had \$245.4 million of mortgage-backed and related securities that were all classified as available for sale at December 31, 2021, compared to \$101.5 million at December 31, 2020. The Company purchased \$188.8 million in mortgage-backed securities in 2021 and \$62.2 million were purchased in 2020.

The contractual maturities of the mortgage-backed and related securities portfolio without any prepayment assumptions at December 31, 2021 are as follows:

	December 31, 2021		
	5 to 10 Years	10 to 20 Years	Balance
<i>(Dollars in thousands)</i>			
Securities available for sale:			
Federal National Mortgage Association	\$ 124,907	12,904	137,811
Federal Home Loan Mortgage Corporation	97,414	10,122	107,536
Collateralized Mortgage Obligations	0	50	50
Total	\$ 222,321	23,076	245,397
Weighted average yield	0.86%	1.38%	0.91%

At December 31, 2021, the Company did not have any non-agency mortgage-backed or related securities in excess of 10% of its stockholders' equity.

Mortgage-backed and related securities can serve as collateral for borrowings and, through sales and repayments, as a source of liquidity. In addition, mortgage-backed and related securities available for sale can be sold to respond to changes in economic conditions.

**Sources of Funds**

**General.** The Bank's primary sources of funds are retail, commercial, Internet and brokered deposits, payments of loan principal, interest earned on loans and securities, repayments and maturities of securities, borrowings and other funds provided from operations.

**Deposits.** The Bank offers a variety of deposit accounts to retail and commercial clients having a wide range of interest rates and terms. The Bank's deposits consist of savings, interest bearing checking, non-interest bearing checking, money market and certificate accounts (including individual retirement accounts). The Bank relies primarily on competitive pricing policies and client service to attract and retain these deposits.

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The variety of deposit accounts offered by the Bank has allowed it to be competitive in obtaining funds and to respond with flexibility to changes in consumer demand. As clients become more interest rate conscious, the Bank may become more susceptible to short-term fluctuations in deposit flows. The Bank manages the pricing of its deposits in keeping with its asset/liability management, profitability and growth objectives. Based on its experience, the Bank believes that its savings and checking accounts are relatively stable sources of deposits. However, the ability of the Bank to attract and maintain certificates of deposit and money market accounts, and the rates paid on these deposits, has been and will continue to be significantly affected by market conditions. The increase in deposits in 2021 related to the \$117.6 million increase in retail and commercial checking accounts, the \$54.1 million increase in savings and money market accounts and the decrease in certificates of deposit of \$16.2 million between the periods.

The following table sets forth the deposit flows at the Bank during the periods indicated.

<i>(Dollars in thousands)</i>	Year Ended December 31,	
	2021	2020
Opening balance	\$ 795,204	673,870
Deposits	6,910,888	5,461,051
Withdrawals	(6,756,981)	(5,341,738)
Interest credited	1,555	2,021
Ending balance	950,666	795,204
Net increase	\$ 155,462	121,334
Percent change	19.55%	18.01%

The following table sets forth the dollar amount of deposits in the various types of deposit products offered by the Bank as of December 31:

<i>(Dollars in thousands)</i>	2021		2020	
	Amount	Percent of Total	Amount	Percent of Total
Transaction and Savings Deposits(1):				
Non-interest checking	\$ 344,404	36.2%	\$ 239,587	30.1%
Interest checking – 0.12%(2)	151,476	15.9	138,709	17.4
Savings– 0.06%(3)	119,517	12.6	100,209	12.6
Money market – 0.21%(4)	249,089	26.2	214,300	27.0
Total non-certificates	\$ 864,486	90.9%	\$ 692,805	87.1%
Certificates:				
0.00 - 0.99%	\$ 74,481	7.8%	\$ 56,001	7.0%
1.00 - 1.99%	4,357	0.5	20,613	2.6
2.00 - 2.99%	6,316	0.7	21,973	2.8
3.00 - 3.99%	1,026	0.1	3,812	0.5
Total Certificates	86,180	9.1%	102,399	12.9%
Total Deposits	\$ 950,666	100.0%	\$ 795,204	100.0%

- (1) Reflects weighted average rates paid on transaction and savings deposits at December 31, 2021.
- (2) The weighted average rate on interest checking accounts for 2020 was 0.12%.
- (3) The weighted average rate on savings accounts for 2020 was 0.06%.
- (4) The weighted average rate on money market accounts for 2020 was 0.25%.

The following table shows rate and maturity information for the Bank's certificates of deposit as of December 31, 2021.

<i>(Dollars in thousands)</i>	0.00- 0.99%	1.00- 1.99%	2.00- 2.99%	3.00- 3.99%	Total	Percent of Total
<b>Certificate accounts maturing in quarter ending:</b>						
March 31, 2022	\$ 15,063	795	1,543	463	17,864	20.72%
June 30, 2022	13,589	479	2,840	235	17,143	19.89
September 30, 2022	12,375	164	550	328	13,417	15.57
December 31, 2022	12,176	1,007	680	0	13,863	16.09
March 31, 2023	4,429	229	44	0	4,702	5.46
June 30, 2023	3,392	218	36	0	3,646	4.23
September 30, 2023	5,136	299	0	0	5,435	6.31
December 31, 2023	2,384	147	187	0	2,718	3.15
March 31, 2024	414	118	0	0	532	0.62
June 30, 2024	1,397	62	365	0	1,824	2.12
September 30, 2024	1,995	224	71	0	2,290	2.66
December 31, 2024	366	256	0	0	622	0.72
Thereafter	1,765	359	0	0	2,124	2.46
<b>Total</b>	<b>\$ 74,481</b>	<b>4,357</b>	<b>6,316</b>	<b>1,026</b>	<b>86,180</b>	<b>100.0%</b>
<b>Percent of total</b>	<b>86.42%</b>	<b>5.06%</b>	<b>7.33%</b>	<b>1.19%</b>	<b>100.00%</b>	

The following table indicates the amount of the Bank's certificates of deposit and other deposits by time remaining until maturity as of December 31, 2021.

<i>(Dollars in thousands)</i>	Maturity				Total
	3 Months or Less	Over 3 to 6 Months	Over 6 to 12 Months	Over 12 Months	
Certificates of deposit less than \$250,000	\$ 15,825	13,912	22,755	22,111	74,603
Certificates of deposit of \$250,000 or more	797	1,728	3,906	1,769	8,200
Public funds less than \$250,000(1)	1,242	1,239	619	13	3,113
Public funds of \$250,000 or more(1)	0	264	0	0	264
<b>Total certificates of deposit</b>	<b>\$ 17,864</b>	<b>17,143</b>	<b>27,280</b>	<b>23,893</b>	<b>86,180</b>
Other deposit accounts of \$250,000 or more	\$ 385,239	0	0	0	385,239
Accounts of \$250,000 or more	\$ 386,036	1,992	3,906	1,769	393,703
Uninsured deposits (2)	\$ 323,858	4,474	8,197	7,254	343,783

(1) Deposits from governmental and other public entities.

(2) Estimated amount of uninsured deposits based on customer relationships.

For additional information regarding the composition of the Bank's deposits, see "Note 11 Deposits" in the Notes to Consolidated Financial Statements in the Annual Report (incorporated by reference in Item 8 of Part II of this Form 10-K). For additional information on certificate maturities and the impact on the Company's liquidity see "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources" of the Annual Report (incorporated by reference in Item 7 of Part II of this Form 10-K).

**Borrowings.** The Bank's other available sources of funds include advances from the FHLB and borrowings from the Federal Reserve Bank of Minneapolis. As a member of the FHLB of Des Moines, the Bank is required to own capital stock in the FHLB and is authorized to apply for advances. Each FHLB credit program has its own interest rate, which may be fixed or variable, and range of maturities. The FHLB may prescribe the acceptable uses for these advances, as well as limitations on the size of the advances and repayment provisions. Consistent with its asset/liability management strategy, the Bank has utilized FHLB advances from time to time to fund loan growth and extend the term to maturity of its liabilities. The Bank may also use short-term FHLB and Federal Reserve Bank borrowings to offset short term cash needs due to deposit outflows or loan fundings. At December 31, 2021, the Bank had no FHLB advances or Federal Reserve Bank borrowings outstanding. On such date, the Bank had a collateral pledge arrangement with the FHLB pursuant to which the Bank could borrow up to \$178.0 million for liquidity purposes, subject to approval from the FHLB. The Bank also had the ability to borrow \$50.3 million from the Federal Reserve Bank of Minneapolis based upon the loans that were pledged to it as collateral at December 31, 2021.

Refer to the information on pages 17 through 19 under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources" in the Annual Report and "Note 12 Federal Home Loan Bank (FHLB) Advances and Other Borrowings" in the Notes to Consolidated Financial Statements in the Annual Report for more information on FHLB advances and other borrowings (incorporated by reference in Items 7 and 8 of Part II of this Form 10-K).

#### **Service Corporations of the Bank**

As a federally-chartered savings bank, the Bank is permitted by OCC regulations to invest up to 2% of its assets in the stock of, or loans to, service corporation subsidiaries, and may invest an additional 1% of its assets in service corporations where these additional funds are used for inner-city or community development purposes. In addition to investments in service corporations, federal institutions are permitted to invest an unlimited amount in operating subsidiaries engaged solely in activities in which a federal savings bank may engage directly.

OIA is one of two subsidiaries of the Bank. OIA is a Minnesota corporation that was organized in 1983 and operated as an insurance agency until 1986 when its assets were sold. OIA remained inactive until 1993 when it began offering credit life insurance, annuity and mutual fund products to the Bank's clients and others. OIA currently offers a variety of financial planning products and services. HPH is the Bank's other subsidiary and was organized as a limited liability company in Minnesota in 2013. It was inactive in 2021 but has operated as an intermediary for the Bank in holding and operating certain foreclosed properties.

#### **Competition**

The Bank faces strong competition both in originating real estate, commercial and consumer loans and in attracting deposits. Competition in originating loans comes primarily from mortgage bankers, commercial banks, credit unions and other savings institutions which have offices in the Bank's market area and those that operate through Internet banking operations throughout the United States. The Bank competes for loans principally on the basis of the interest rates and loan fees it charges, the types of loans it originates and the quality of services it provides to borrowers.

Competition for deposits is principally from mutual funds, securities firms, commercial banks, credit unions and other savings institutions located in the same communities and those that operate through Internet banking operations throughout the United States. The ability of the Bank to attract and retain deposits depends on its ability to provide an investment opportunity that satisfies the requirements of investors as to rate of return, liquidity, risk, convenience and other factors. The Bank competes for these deposits by offering a variety of deposit accounts at competitive rates, convenient business hours and a client-oriented staff.

#### **Other Corporations Owned by the Company**

The Bank was HMN's sole direct subsidiary at December 31, 2021.

## **Employees**

At December 31, 2021, the Company had 163 full time employees. None of the employees of the Company are represented by any collective bargaining unit. Management considers its employee relations to be good.

## **Regulation and Supervision**

The banking industry is highly regulated. As a savings and loan holding company (SLHC), HMN is subject to regulation, supervision and examination by the Board of Governors of the Federal Reserve Bank (FRB). The Bank, a federally-chartered savings association, is also subject to regulation, supervision and examination by the OCC, which is the Bank's primary federal regulator. The FDIC also has authority to regulate the Bank. Subsidiaries of HMN and the Bank may also be subject to state regulation and/or licensing in connection with certain insurance and investment activities. The Company is subject to numerous laws and regulations. These laws and regulations impose restrictions on activities, set minimum capital requirements, impose lending and deposit restrictions and establish other restrictions. References in this section to applicable statutes and regulations are brief and incomplete summaries only. The Company recommends consulting the statutes, regulations and related policies and interpretive guidance for a full understanding of the details of their operation. Changes in statutes, regulations or regulatory policies applicable to the Company, including interpretation or implementation thereof, could have a material effect on the Company's business.

### ***Holding Company Regulation***

As a savings and loan holding company, HMN is subject to regulation and supervision by the FRB. FRB regulations require holding companies to act as a source of strength to their subsidiary depository institutions by providing capital, liquidity and other support in times of financial stress.

Acquisitions by Savings and Loan Holding Companies. Acquisition of a savings association or a savings and loan holding company is generally subject to FRB approval and the public must have an opportunity to comment on the proposed acquisition. Without prior approval from the FRB, HMN may not acquire, directly or indirectly, control of another savings association.

Examination and Reporting. Under the Home Owners' Loan Act and FRB regulations, HMN, as a SLHC, must file periodic reports with the FRB. In addition, HMN must comply with FRB record keeping requirements and is subject to holding company supervision and examination by the FRB. The FRB may take enforcement action if the activities of a SLHC constitute a risk to the financial safety, soundness or stability of a subsidiary savings association.

Affiliate Transactions. The Bank, as a holding company subsidiary that is a depository institution, is subject to both qualitative and quantitative limitations on transactions with the Company. See section "Bank Regulation - Transactions with Affiliates and Insiders".

Capital Adequacy. The Bank is subject to various regulatory capital requirements, however, the Company meets certain exemption requirements pursuant the FRB's Small Bank Holding Company Policy Statement, and therefore, is exempt from the consolidated capital requirements.

Dividends. Federal law limits the ability of a savings and loan holding company, such as HMN, to pay dividends or make other capital distributions. FRB guidance applicable to holding companies sets out factors that should be taken into account when considering dividends or distributions, including, among other things, current and prospective earnings and liquidity, and the holding company's ability to serve as an ongoing source of financial and managerial strength to insured depository institution subsidiaries such as the Bank.

## **Bank Regulation**

As a federally-chartered savings association, the Bank is subject to regulation and supervision by the OCC. Federal law authorizes the Bank, as a federal savings association, to conduct, subject to various conditions and limitations, business activities that include: accepting deposits and paying interest on them; making and buying loans secured by residential and other real estate; making consumer loans; making commercial loans; investing in corporate obligations, government debt securities, and other securities; and offering various banking, trust, securities and insurance agency services to its clients.

Savings associations are expected to conduct lending activities in a prudent, safe and sound manner. The OCC regulates the safety and soundness of the Bank by enforcing statutory limits on the Bank's lending and investment powers. OCC regulations set aggregate limits on certain types of loans including commercial business, commercial real estate and consumer loans. OCC regulations also establish limits on loans to a single borrower. As of December 31, 2021, the Bank's lending limit to one borrower was approximately \$15.7 million.

A federal savings association generally may not invest in noninvestment-grade debt securities. A federal savings association may establish subsidiaries to conduct any activity the association is authorized to conduct and may establish service corporation subsidiaries for limited preapproved activities.

Qualified Thrift Lender Test. Savings associations, including the Bank, must be qualified thrift lenders (QTLs). A savings association generally satisfies the QTL requirement if at least 65% of a specified asset base consists of assets such as loans to small businesses and loans to purchase or improve domestic residential real estate. Savings associations may qualify as QTLs in other ways. Savings associations that do not qualify as QTLs are subject to significant restrictions on their operations. If the Bank fails to meet QTL requirements, the Company would face certain limitations, including potential enforcement action by the OCC and, a statutory bar to the payment by the Bank of dividends except under prescribed conditions including approval by the OCC. As of December 31, 2021, the Bank met the QTL test.

OCC Assessments. The OCC is authorized by statute to charge assessments to cover the costs of examining the financial institutions it regulates and to fund its operations. The Bank's OCC assessments for the year ended December 31, 2021 were approximately \$0.2 million. The FRB does not currently assess HMN for examination fees.

Transactions with Affiliates and Insiders. Savings associations, like banks, are subject to affiliate and insider transaction restrictions. The restrictions prohibit or limit a savings association from extending credit to, or entering into certain covered transactions with, affiliates, principal stockholders, directors and executive officers of the savings association and its affiliates. The term "affiliate" generally includes a holding company, such as HMN, and any company under common control with the savings association. Federal law limits covered transactions between the Bank and any one affiliate to 10% of the Bank's capital and surplus and with all affiliates in the aggregate to 20%. In addition, the federal law governing unitary savings and loan holding companies prohibits the Bank from making any loan to any affiliate whose activity is not permitted for a subsidiary of a bank holding company. This law also prohibits the Bank from making any equity investment in any affiliate that is not its subsidiary. The Bank is currently in compliance with these requirements. Covered transactions also include derivatives and the borrowing and lending of securities, and repurchase agreements with affiliates are subject to collateralization requirements.

Dividend Restrictions. Federal law limits the ability of a depository institution, such as the Bank, to pay dividends or make other capital distributions. The Bank, as a subsidiary of a savings and loan holding company, must file a notice with the FRB before payment of a dividend or approval of a proposed capital distribution by its board of directors and must obtain prior approval from the FRB if it fails to meet certain regulatory conditions.

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During 2021, the Bank paid dividends to HMN of \$6.0 million, which were used to fund the ongoing operating expenses of the Company, purchase treasury stock and improve its cash position. The improved cash position will potentially allow the Company to make a capital contribution into the Bank should the Bank need additional capital to support its operations. HMN did not declare or distribute any dividends to its common shareholders in 2021. In January 2022 the Company's Board of Directors declared a quarterly dividend of \$0.06 per share of common stock. See pages 18 and 19 in the "Management's Discussion and Analysis of Financial Condition and Results of Operations – Dividends" section of the Annual Report incorporated by reference in Part II, Item 7 of this Form

10-K for more information on the dividend that was declared in the first quarter of 2022.

**Deposit Insurance.** The FDIC insures the deposits of the Bank through the Deposit Insurance Fund (DIF). The DIF is funded by assessments of FDIC members such as the Bank. The FDIC applies a risk-based system for setting deposit insurance assessments. Under the risk-based assessment system, an institution's insurance assessments vary according to the level of capital the institution holds and the degree to which it is the subject of supervisory concern. During 2021, the Bank was assessed approximately \$0.3 million for the DIF.

**Capital Requirements and Prompt Corrective Action Requirements.** The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. Quantitative measures established by regulations to ensure capital adequacy required the Bank to maintain minimum amounts and ratios of Common Tier 1 risk-based capital, Total Tier 1 capital (Tier 1 leverage ratio), Tier 1 capital to risk-based assets, and risk-based capital to total assets (in each case as defined in the regulations). The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) established five capital categories: 1) well-capitalized; 2) adequately capitalized; 3) undercapitalized; 4) significantly undercapitalized; and 5) critically undercapitalized. The activities in which a depository institution may engage and regulatory responsibilities of federal bank regulatory agencies vary depending upon whether an institution is well-capitalized, adequately capitalized or undercapitalized. Undercapitalized institutions are subject to various restrictions such as limitations on dividends and growth. A depository institution's prompt corrective action capital category depends upon where its capital levels are in relation to relevant capital measures, which include risk-based capital measures and certain other factors.

In addition to the capital categories, federal regulators have established a "capital conservation buffer" of 2.50% above the minimum capital ratios otherwise required by the prompt corrective action framework. If an institution's capital levels fall below the buffer amount, the institution will be subject to limitations on the payment of dividends, share repurchases and the payment of discretionary bonuses.

At December 31, 2021, the Bank's capital amounts and ratios are presented for actual capital and required capital and ratios under the prompt corrective actions regulations to which the Bank is currently subject:

	Prompt Corrective Action Regulations					
	Actual		Required to be Adequately Capitalized		Required to be Well-Capitalized	
	Amount	Percent of Assets(1)	Amount	Percent of Assets(1)	Amount	Percent of Assets(1)
<i>(Dollars in thousands)</i>						
<b>December 31, 2021</b>						
Common equity Tier 1 capital	\$ 97,710	13.18%	\$ 33,368	4.50%	\$ 48,199	6.50%
Tier 1 leverage	97,710	9.47	41,283	4.00	51,603	5.00
Tier 1 risk-based capital	97,710	13.18	44,491	6.00	59,322	8.00
Total risk-based capital	106,979	14.43	59,322	8.00	74,152	10.00

(1) Based upon the Bank's adjusted total assets for the purpose of the Tier 1 or core capital ratios and risk-weighted assets for the purpose of the risk-based capital ratios.



Management believes that, as of December 31, 2021, the Bank's capital ratios were in excess of those quantitative capital ratio standards set forth under the prompt corrective action regulations described above, including the capital conservation buffer, and was "well-capitalized" within the meaning of those prompt corrective action regulations. However, there can be no assurance that the Bank will continue to maintain such status in the future. In addition, the OCC has extensive discretion in its supervisory and enforcement activities, including the ability to downgrade the Bank's prompt corrective action capital category by one level under certain conditions.

Under applicable banking regulations, the failure to comply with capital rules or other applicable requirements as they arise, could subject HMN, the Bank and their directors and officers to such restrictions, legal actions or sanctions as the FRB or the OCC considers appropriate. Possible sanctions include, among others, (i) the imposition of one or more cease and desist orders requiring corrective action, which are enforceable directives that may address any aspect of the Company's management, operations or capital, including requirements to change management, raise equity capital, dispose of assets or effect a change of control; (ii) civil money penalties; and (iii) downgrades in the capital adequacy status of the Bank. These regulatory actions may significantly restrict the ability of the Company to take operating and strategic actions that may be in the best interests of stockholders or compel the Company to take operating and strategic actions that are not potentially in the best interests of stockholders.

Other Regulations and Examination Authority. The FDIC has adopted regulations to protect the DIF and depositors, including regulations governing the deposit insurance of various forms of accounts. Federal regulation of depository institutions is intended for the protection of depositors, and not for the protection of stockholders or other creditors. In addition, federal law requires that in any liquidation or other resolution of any FDIC-insured depository institution, claims for administrative expenses of the receiver and for deposits in U.S. branches (including claims of the FDIC as subrogee of the insured institution) shall have priority over the claims of general unsecured creditors.

The OCC may sanction any OCC-regulated bank that does not operate in accordance with OCC regulations, policies and directives. The FDIC has additional authority to terminate insurance of accounts, after a notice and hearing, upon a finding that the insured institution is or has engaged in any unsafe or unsound practice that has not been corrected, is operating in an unsafe or unsound condition, or has violated any applicable law, regulation, rule, or order of or condition imposed by the FDIC.

FHLB System. The Bank is a member of the FHLB of Des Moines, which is one of the 11 regional Federal Home Loan Banks (FHBs). The primary purpose of the FHBs is to provide funding to their financial institution members in support of the home financing credit function of the members. Each FHB serves as a reserve or central bank for its members within its assigned region. FHBs are funded primarily from proceeds derived from the sale of consolidated obligations of the FHLB System. FHBs make loans or advances to members in accordance with policies and procedures established by the board of directors of the FHB. These policies and procedures are subject to the regulation and oversight of the Federal Housing Financing Board. All advances from a FHB are required to be fully secured by sufficient collateral as determined by the FHB. Long-term advances are required to be used for residential home financing and small business and agricultural loans.

As a member, the Bank is required to purchase and maintain stock in the FHLB of Des Moines. As of December 31, 2021, the Bank had \$1.1 million in FHLB stock, which was in compliance with this requirement. The Bank receives dividends on its FHLB stock. The FHLB's dividend philosophy is to differentiate dividend rates between membership and activity-based capital stock. Based on the FHLB's most recent quarterly filing on Form 10-Q for the nine months ended September 30, 2021, the effective dividend rates paid on these subclasses of its capital stock at September 30, 2021 were 3.00% and 6.00%, respectively.

**Other Regulation.** Numerous other regulations promulgated by the FRB, the OCC, the Consumer Financial Protection Bureau (CFPB) and other agencies and other governmental authorities affect the business operations of the Bank. These include but are not limited to regulations relating to privacy, equal credit access, mortgage lending and foreclosure practices, electronic fund transfers, collection of checks, lending and savings disclosures and availability of funds. The CFPB has broad authority to develop new rules and interpretations with respect to consumer financial products and services, even though its examination and enforcement authority currently do not extend to the Bank.

**Community Reinvestment Act.** The Community Reinvestment Act (CRA) requires financial institutions regulated by the federal financial supervisory agencies to ascertain and help meet the credit needs of their delineated communities, including low to moderate income neighborhoods within those communities, while maintaining safe and sound banking practices. The regulatory agency assigns one of four possible ratings to an institution's CRA performance and is required to make public an institution's rating and written evaluation. The four possible ratings of meeting community credit needs are outstanding, satisfactory, needs improvement and substantial non-compliance. Under regulations that apply to all current CRA performance evaluations, many factors play a role in assessing a financial institution's CRA performance. The institution's regulator must consider its financial capacity and size, legal impediments, local economic conditions and demographics, including the competitive environment in which it operates. The evaluation does not rely on absolute standards, and the institutions are not required to perform specific activities or to provide specific amounts or types of credit. The Bank maintains a CRA statement for public viewing, as well as an annual CRA highlights document. These documents describe the Bank's credit programs and services, community outreach activities, public comments and other efforts to meet community credit needs. The Bank's last CRA exam was January 27, 2020 and the Bank received an "outstanding" rating under the Intermediate Small Savings Association criteria.

**Bank Secrecy Act.** The Bank Secrecy Act (BSA) requires financial institutions to verify the identity of clients, keep records and file reports that are determined to have a high degree of usefulness in criminal, tax and regulatory matters, and to implement anti-money laundering programs and compliance procedures. The impact on Bank operations from the BSA depends on the types of clients served by the Bank.

#### **Available Information**

The Company's website is [www.hmnf.com](http://www.hmnf.com). The Company makes available, free of charge, through its website its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) of the Exchange Act. These reports are available as soon as reasonably practicable after it electronically files these materials with, or furnishes them to, the Securities and Exchange Commission (the SEC). Information contained on the Company's website is expressly not incorporated by reference into this Form 10-K.

#### **ITEM 1A. RISK FACTORS**

Like all financial companies, the Company's business and results of operations are subject to a number of risks, many of which are outside of the Company's control. In addition to the other information in this report, readers should carefully consider that the following important factors, among others, could materially impact the Company's business and future results of operations.

## Risks Related to our Business

*Our capital may not be adequate to meet all our needs and requirements in the future and we may need to take steps to meet our capital needs. These actions may reduce our base of earning assets and core deposits and may dilute our shareholders or result in a change of control of the Company. There can be no assurance that we will satisfactorily meet our required future capital needs.*

We are required by federal regulatory authorities to maintain adequate levels of capital to support our operations and protect depositors of the Bank. Depending upon the operating performance of the Bank and our other liquidity and capital needs, we may find it prudent, subject to prevailing market conditions and other factors, to raise additional capital through the issuance of additional shares of our common stock or other equity securities. Additional capital would potentially allow the Bank to grow its assets more aggressively. Depending on circumstances, if we were to raise capital, we may deploy it to the Bank for general banking purposes, or may retain some or all of such capital for use by the Company.

If the Company were to raise capital through the issuance of additional shares of common stock or other equity securities, it would dilute the ownership interests of existing stockholders, dilute the Company's earnings per share and could result in a change in control of the Company and the Bank. New investors may also have rights, preferences and privileges senior to our current stockholders which may adversely impact our current stockholders. Our ability to raise additional capital through the issuance of equity securities, if deemed prudent, would depend on conditions in the capital markets at that time, which are outside of our control, and on our financial performance. A significant investment by a person or group may also necessitate an amendment to our Certificate of Incorporation, which would require stockholder approval. Accordingly, we may not be able to raise additional capital, if needed, on favorable economic terms or other terms acceptable to us.

*The Bank may not be able to meet its cash flow needs on a timely basis at a reasonable cost, and its cost of funds for banking operations may significantly increase as a result of general economic conditions, interest rates and competitive pressures. HMN, on an unconsolidated basis, has limited capital resources and liquidity to assist the Bank with its liquidity and capital requirements.*

Liquidity is the ability to meet cash flow needs on a timely basis and at a reasonable cost. The liquidity of the Bank is used to pay expenses, make loans and to repay deposit and borrowing liabilities as they become due or are demanded by clients and creditors. Many factors affect the Bank's ability to meet liquidity needs, including variations in the markets served by its network of offices, its composition of assets and liabilities, reputation and standing in the marketplace and general economic conditions.

The Bank's primary source of funding is retail and commercial deposits gathered through its network of fourteen banking offices. Wholesale funding sources principally consist of borrowing lines from the FHLB of Des Moines and the Federal Reserve Bank of Minneapolis and brokered and internet certificates of deposit obtained from the national market. Borrowings from the FHLB are subject to the FHLB's credit policies and procedures relating to the valuation of the loans securing advances as well as the amount of funds the FHLB will loan to the Bank. The current collateral pledged to secure advances may become unacceptable, the formulas for determining the excess pledged collateral may change or the Bank's credit rating with the FHLB could decrease. In these cases, the Bank may not have sufficient collateral to pledge or have the borrowing capacity to meet its funding needs and may be required to rely upon alternate funding sources, such as the Federal Reserve Bank, which bear higher borrowing costs. The Bank's securities and loan portfolios also provide a source of contingent liquidity that could be accessed in a reasonable time period through sales.

Significant changes in general economic conditions, market interest rates, competitive pressures or otherwise, could cause the Bank's deposits to decrease relative to overall banking operations, and it would have to rely more heavily on brokered and Internet deposits or borrowings in the future, which are typically more expensive than retail deposits.

The Bank actively manages its liquidity position and monitors it using cash flow forecasts. Changes in economic conditions, including consumer savings habits and availability or access to borrowed funds and the brokered and Internet deposit markets could potentially have a significant impact on the Company's liquidity position, which in turn could materially impact its financial condition, results of operations and cash flows.

HMN's primary source of cash is dividends from the Bank, and the Bank is restricted from paying dividends to HMN unless certain conditions are met under bank regulatory requirements. At December 31, 2021, HMN had \$12.5 million in cash balances. Primarily, HMN requires cash for the payment of holding company level expenses, including director and management fees, legal expenses and regulatory costs. HMN may also use cash for the repurchase of outstanding HMN stock or the payment of dividends. HMN does not anticipate that it will have, on an ongoing long term stand-alone basis, adequate liquid resources to make all of the required cash payments for these items in the future. To meet these payment requirements or other potential HMN liquidity or capital needs would require dividends from the Bank or external capital. Failure to meet regulatory requirements for any future dividends from the Bank to HMN, or to receive dividends in amounts deemed satisfactory by HMN, could cause HMN to require other sources of liquidity for its needs in 2022 and beyond. Further information about HMN's liquidity position is available on page 17 in the "Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources" section of the Annual Report incorporated by reference in Part II, Item 7 of this Form 10-K.

***Our allowance for loan losses may prove to be insufficient to absorb losses or appropriately reflect, at any given time, the inherent risk of loss in our loan portfolio.***

Our non-performing assets were at \$4.9 million, or 0.46% of total assets, at December 31, 2021. Classified loans at December 31, 2021 were \$42.7 million, or 6.5% of total loans. Classified loans represent special mention, performing substandard and non-performing loans. The low level of our classified loans is primarily due to the current economic environment. If the favorable economic environment does not continue these assets may not perform according to their terms and the value of the collateral may be insufficient to pay any remaining loan balance. If this occurs, we may experience losses or an increased risk of loss in our loan portfolio, which could have a negative effect on our results of operations. Like all financial institutions, we maintain an allowance for loan losses to provide for loans in our portfolio that may not be repaid in their entirety. Our allowance for loan losses may not be sufficient to cover actual loan losses or the inherent risk of loss in our loan portfolio, and future provision for loan losses could materially adversely affect our operating results.

In evaluating the appropriateness of our allowance for loan losses, we consider numerous factors, including but not limited to, specific occurrences of loan impairment, our historical charge-off experience, actual and anticipated changes in the size of the portfolios, national, regional and local economic conditions such as unemployment data, loan delinquencies, demand for single family homes, demand for commercial real estate and building lots, loan portfolio composition and observations made by the Company's ongoing internal audit and regulatory exam processes. In addition, we use information about specific borrower situations, including their financial position and estimated collateral values, to estimate the risk and amount of loss for those borrowers. Our estimates of the risk of loss and amount of loss on any loan are complicated by the significant uncertainties surrounding our borrowers' abilities to successfully execute their business models through changing economic environments, competitive challenges and other factors. Because of the degree of uncertainty and susceptibility of these factors to change, our actual losses and estimates of risk of loss inherent in our loan portfolio have varied and are likely to continue to vary from our current estimates. Such variances may materially and adversely affect our financial condition and results of operations.

Federal regulators, as an integral part of their examination process, periodically review our allowance for loan losses and may require us to increase our allowance for loan losses by recognizing additional provisions for loan losses charged to expense, or to decrease our allowance for loan losses by recognizing loan charge-offs. Any such additional provisions for loan losses or charge-offs, as required by these regulatory agencies, could have a material adverse effect on our financial condition and results of operations.

***The Company has concentrations in commercial business and commercial real estate loans, increasing the risk in its loan portfolio.***

In order to enhance the yield and shorten the term-to-maturity of its loan portfolio, the Company continues to maintain the balances of its commercial business and commercial real estate portfolios. These categories of loans represented approximately 69% of the total loans receivable at December 31, 2021. Some of the Company's commercial real estate portfolio is in land development loans, while many of the Company's commercial business loans are made to borrowers associated with the real estate industry. Commercial business and commercial real estate loans generally, and land development loans in particular, present a higher level of risk than loans secured by single family residences. This greater risk is due to several factors, including the concentration of principal in a limited number of loans and borrowers, the effects of general economic conditions on income producing properties and the increased difficulty of evaluating and monitoring these types of loans.

Furthermore, the repayment of loans secured by commercial real estate is typically dependent upon the successful operation of the related real estate project. If the cash flow from the project is reduced (for example, if leases are not obtained or renewed or properties intended for resale are not developed and sold), the borrower's ability to repay the loan and the underlying collateral may be impaired. Commercial business loans to businesses that are dependent on the cash flow generated by the sale or leasing of real estate are similarly impacted. At December 31, 2021, the Company had \$4.6 million of non-performing loans, of which \$3.8 million related to commercial business and commercial real estate loans. At December 31, 2021, total classified loans included \$40.9 million of commercial business and commercial real estate loans. The Company may experience actual losses in respect of these classified loans and further increases in the level of classified loans in our loan portfolio that may require further increases in our provision for loan losses.

***Regional economic changes in the Company's markets have in the past adversely impacted, and may in the future adversely impact, results from operations.***

Like all financial institutions, the Company is subject to the effects of any economic downturn, and in particular a significant decline in home values and reduced commercial development in the Company's markets has had a negative effect on results of operations in the past. The Company's success depends primarily on the general economic conditions in the counties in which the Company conducts business, and in the southern Minnesota, northern Iowa and eastern Wisconsin areas in general. Unlike larger financial institutions that are more geographically diversified, the Company provides banking and financial services to clients primarily in the Minnesota counties of Dakota, Dodge, Fillmore, Freeborn, Houston, Mower, Olmsted, Steele, and Winona and portions of Goodhue and Wabasha counties, as well as Marshall county in Iowa. The Bank also offers banking services to the Milwaukee, Wisconsin area through a branch location in Waukesha County in Wisconsin. The local economic conditions in these market areas have a significant impact on the Company's ability to originate loans, the ability of the borrowers to repay these loans and the value of the collateral securing these loans. A significant decline in the general economic conditions caused by inflation, recession, unemployment or other factors beyond the Company's control can affect and has in the past affected these local economic conditions and can adversely affect and has in the past adversely affected the Company's financial condition and results of operations. The Company has a significant amount of commercial business and commercial real estate loans and decreases in tenant occupancy and development home sales can have, and in the past have had, a negative effect on the ability of many of the Company's borrowers to make timely repayments of their loans and the value of the collateral held as security for these loans, which can have, and in the past has had, an adverse impact on the Company's earnings.

During 2021, the U.S. economy continued to perform reasonably well despite the negative impact of the COVID-19 pandemic. However, there are continuing concerns related to, among other things, the long term effectiveness of the vaccines to mutations in the COVID-19 virus and changes in customer behaviors as a result of the pandemic, the level of U.S. government debt and fiscal actions that may be taken to address such debt, the potential effects of COVID-19 on international trade (including supply chains and export levels), travel, employee productivity and other economic activities, depressed oil prices and the U.S. international relations and their effects on the financial markets and economic activity. There can be no assurance that current economic conditions will continue or improve, and economic conditions could worsen. Economic pressure on consumers and uncertainty regarding continuing economic improvement may result in changes in consumer and business spending, borrowing and saving habits. A return of recessionary conditions and/or other negative developments in the domestic or international credit markets may significantly affect the markets in which we do business, the value of our loans and investments, and our ongoing operations, costs and profitability. Declines in real estate value and sales volumes and high unemployment may also result in higher than expected loan delinquencies and a decline in demand for our products and services. These negative events may cause us to incur losses and may adversely affect our capital, liquidity and financial condition.

***Because of the asset size of the Company, adverse performance affecting a few large loans or lending relationships can cause significant volatility in earnings.***

Due to the Company's asset size, the provision for loan losses or charge offs associated with individual loans can be large relative to the Company's earnings for a particular period. If one or a few relatively large loans become non-performing in a period and the Company is required to increase its loss reserves, or to write off principal or interest relative to such loans, the operating results for that period could be significantly adversely affected. The effect on results of operations for any given period from a change in the performance of a small number of loans may be disproportionately larger than the impact of such loans on the quality of the Company's overall loan portfolio. The Company generally limits its internal loan originations to loans less than \$7.5 million with loans over that amount approved by its Executive Loan Committee. The Company's regulatory lending limit was \$15.7 million at December 31, 2021. The Bank's largest borrowing relationship had outstanding loans totaling \$15.0 million and was performing at December 31, 2021.

***Changes in interest rates could negatively impact the Company's results of operations.***

The earnings of the Company are primarily dependent on net interest income, which is the difference between interest earned on loans and investments and interest paid on interest-bearing liabilities such as deposits and borrowings. Interest rates are highly sensitive to many factors, including government monetary and fiscal policies and domestic and international economic and political conditions. Conditions such as inflation, recession, unemployment, money supply, government borrowing and other factors beyond management's control may also affect interest rates. If the Company's interest-earning assets mature, reprice or prepay more quickly than interest-bearing liabilities in a given period, a decrease in market interest rates could adversely affect net interest income. Likewise, if interest-bearing liabilities mature or reprice, or, in the case of deposits, are withdrawn by the account holder, more quickly than interest-earning assets in a given period, an increase in market interest rates could adversely affect net interest income. Given the Company's assets and liability composition as of December 31, 2021, a falling interest rate environment would negatively impact the Company's results of operations. The effect on our deposits of decreases in interest rates generally lags the effect on our assets. The lagging effect of deposit rate changes is primarily due to the Bank's deposits that are in the form of certificates of deposit, which do not re-price immediately when the federal funds rate changes.

Fixed rate loans increase the Company's exposure to interest rate risk in a rising rate environment because interest-bearing liabilities would be subject to repricing before assets become subject to repricing. Adjustable rate loans decrease the risks to a lender associated with changes in interest rates but involve other risks. As interest rates rise, the payment by the borrower rises to the extent permitted by the terms of the loan, and the increased payment increases the potential for default. At the same time, for secured loans, the marketability of the underlying collateral may be adversely affected by higher interest rates. In a declining interest rate environment, there is likely to be an increase in prepayment activity on loans as the borrowers refinance their loans at lower interest rates. Under these circumstances, the Company's results of operations could be negatively impacted.

Changes in interest rates also can affect the value of loans, investments and other interest-rate sensitive assets including mortgage servicing rights, and the Company's ability to realize gains on the sale or resolution of assets. This type of income can vary significantly from quarter-to-quarter and year-to-year based on a number of different factors, including the interest rate environment. An increase in interest rates that adversely affects the ability of borrowers to pay the principal or interest on loans may lead to an increase in non-performing assets and increased loan loss reserve requirements that could have a material adverse effect on the Company's results of operations.

***Changes in interest rates or prepayment speeds could negatively impact the value of capitalized mortgage servicing rights.***

The capitalization, amortization and impairment of mortgage servicing rights are subject to significant estimates. These estimates are based upon loan types, note rates and prepayment speed assumptions. Changes in interest rates or prepayment speeds may have a material effect on the net carrying value of mortgage servicing rights. In a declining interest rate environment, prepayment speed assumptions will increase and result in an acceleration in the amortization of the mortgage servicing rights as the assumed underlying portfolio declines and also may result in impairment as the value of the mortgage servicing rights declines.

***Strong competition within the Company's market area may limit profitability or generate losses.***

The Company faces significant competition both in attracting deposits and in the origination of loans. Mortgage bankers, commercial banks, credit unions and other savings institutions, which have offices in the Bank's market area have historically provided most of the Company's competition for deposits and loans; however, the Company also competes with financial institutions that operate through Internet banking operations throughout the United States. In addition, the Company faces additional and significant competition for funds from money market and mutual funds, and securities firms located in the same communities and those that operate through Internet banking operations throughout the United States. Many competitors have substantially greater financial and other resources than the Company. Finally, credit unions do not pay federal or state income taxes and are subject to fewer regulatory constraints than savings banks and as a result, they may enjoy a competitive advantage over the Company. The Bank competes for loans principally on the basis of the interest rates and loan fees it charges, the types of loans it originates and the quality of services it provides to borrowers. This competitive strategy places significant competitive pressure on the prices of loans and deposits.

***Loss of large checking and money market deposit clients could increase cost of funds and have a negative effect on results of operations.***

The Company has a number of large deposit clients that maintain balances in checking and money market accounts at the Bank. At December 31, 2021, there was \$161.5 million in checking and money market accounts of clients in the alternative energy and other industries that have individual relationship balances greater than \$5 million. The ability to attract and retain these types of deposits has a positive effect on the Company's net interest margin as they provide a relatively low cost of funds to the Company compared to certificates of deposits or advances. If these depositors were to withdraw these funds and the Bank was not able to replace them with similar types of deposits, the Bank's cost of funds would increase and the Company's results of operation would be negatively impacted.

***We may decide to grow our business through acquisitions, which may disrupt or harm our business and dilute stockholder value.***

The Company continues to regularly monitor acquisition opportunities and from time to time conducts due diligence activities related to possible transactions with banks and other financial institutions. Negotiations may take place and future acquisitions may occur at any time. Our ability to grow through acquisitions will depend, in part, on the availability of suitable acquisition targets at acceptable prices, terms and conditions; our ability to compete effectively for these acquisition candidates; and the availability of capital and personnel to complete such acquisitions and run the acquired business effectively. These risks could be heightened if we complete a large acquisition or multiple acquisitions within a relatively short period of time.

The benefits of an acquisition may take more time than expected to develop or integrate into our operations and we cannot guarantee that any acquisition will ultimately produce any benefits. Acquiring other banks, businesses, or branches involves various risks, such as potential disruption of the Company's business, including diversion of management's attention; difficulty in valuing the target company; potential exposure to undisclosed, contingent, or other liabilities or problems, unanticipated costs associated with an acquisition, and an inability to recover or manage such liabilities and costs; exposure to potential asset quality issues of the target company; volatility in reported income as goodwill and other impairment losses could occur irregularly and in varying amounts; difficulty and expense of integrating the operations and personnel of the target company or in realizing projected efficiencies, revenue increases, cost savings, increased market presence, or other projected benefits; potential loss of key employees or clients of the Company or the target company; dilution to existing stockholders if securities are issued as part of transaction consideration or to fund transaction consideration; and potential changes in banking or tax laws or regulations that may affect the target company. Any of the foregoing factors could have a material adverse effect on the Company's financial condition and results of operations.

**Risks related to the Regulation of Our Industry**

***The Company operates in a highly regulated environment and may be adversely affected by changes in federal and state laws and regulations.***

The Company is and will continue to be subject to extensive examination, supervision and comprehensive regulation by federal bank regulatory agencies. Banking regulations are primarily intended to protect depositors' funds, federal deposit insurance funds, and the banking system and the financial system as a whole, and not holders of our common stock. These regulations affect our lending practices, capital structure, investment practices, dividend policy, and growth, among other things. See Item 1 "Business – Regulation and Supervision" of this Form 10-K for information regarding regulation affecting the Company.

Changes in the regulatory landscape may significantly impact the profitability of business activities, require material changes to certain business practices, impose more stringent capital, liquidity and leverage requirements or otherwise adversely affect our business.

The FRB assesses the condition, performance and activities of savings and loan holding companies in a manner that is consistent with its established risk-based approach regarding bank holding company supervision to ensure that savings and loan holding companies are effectively supervised and can serve as a source of strength for, and do not threaten the soundness of, subsidiary depository institutions such as the Bank.

The CFPB has broad authority to develop new rules and interpretations with respect to consumer financial products and services even though its examination and enforcement authority do not currently extend to the Bank.



Congress and federal regulatory agencies continually review banking laws, regulations and policies for possible changes. Changes to statutes, regulations, or regulatory policies, including changes in interpretation or implementation of statutes, regulations, or policies, could affect us in substantial and unpredictable ways. Such changes could subject us to additional costs, limit the types of financial services and products we may offer, restrict mergers and acquisitions, investments, access to capital, the location of banking offices, or increase the ability of non-banks to offer competing financial services and products, among other things. Failure, or alleged failure, to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil or criminal penalties or money damages in connection with actions or proceedings on behalf of regulators or consumers, and/or reputational damage, any of which could have a material adverse effect on our business, financial condition and results of operations. While we have policies and procedures designed to prevent any such violations and to reduce the likelihood of such actions or proceedings, there can be no assurance that such violations will not occur or that such actions or proceedings will not be brought.

Changes to laws and regulations, including changes in interpretation or implementation, may also limit the Bank's flexibility on financial products and fees which could result in additional operational costs and a reduction in our non-interest income.

Further, our regulators have significant discretion and authority to prevent or remedy unsafe or unsound practices or violations of laws by financial institutions and holding companies in the performance of their supervisory and enforcement duties. Examples include limits on payment of dividends by banks and regulations governing compensation. Regulation of dividends may limit the liquidity of the Company and restrictions on compensation may adversely affect our ability to attract and retain employees.

***We are subject to the CRA and fair lending laws, and failure to comply with these laws could lead to material penalties.***

The CRA and fair lending laws and regulations impose nondiscriminatory lending requirements on financial institutions. The Department of Justice, the CFPB and other federal agencies are responsible for enforcing these laws and regulations. A successful challenge to an institution's performance under the CRA or fair lending laws and regulations could result in a wide variety of sanctions, including the required payment of damages and civil money penalties, injunctive relief, imposition of restrictions on mergers and acquisitions activity, and restrictions on expansion activity. Private parties may also have the ability to challenge an institution's performance under fair lending laws in private class action litigation. The Bank has implemented policies and procedures designed to ensure compliance with such laws and regulations, but any non-compliance could lead to regulatory actions that could result in material penalties or sanctions.

***The USA PATRIOT Act and Bank Secrecy Act may subject us to large fines for non-compliance.***

The USA PATRIOT Act and the Bank Secrecy Act require financial institutions to develop programs to prevent financial institutions from being used for money laundering and terrorist activities. If these activities are detected, financial institutions are obligated to file suspicious activity reports with the U.S. Treasury Department's Office of Financial Crimes Enforcement Network. These rules require financial institutions to establish procedures for identifying and verifying the identity of clients seeking to open new financial accounts. Failure to comply with these regulations could result in fines or sanctions. In recent years, several banking institutions have received large fines for non-compliance with these laws and regulations. Although the Bank has developed policies and procedures designed to ensure compliance, regulators may take enforcement action against the Bank in the event of non-compliance.

## Technology and Cybersecurity Risks

*The extended disruption or compromise of vital infrastructure, including the Company's technology systems, could negatively impact the Company's results of operations and financial condition.*

The Company's business depends on its ability to process, record and monitor a large number of transactions. The Company's technological and physical infrastructures, which include its financial, accounting and other data processing systems, are vital to its operation. Extended disruption or compromise of its vital infrastructure by fire, power loss, natural disaster, telecommunications failure, computer hacking and viruses, terrorist activity or the domestic and foreign response to such activity, or other events outside of the Company's control, could cause the Company to suffer regulatory consequences, reputational damage and financial losses, any of which could have a material adverse effect either on the financial services industry as a whole, or on the Company's business, financial condition and results of operations.

*The Company faces cybersecurity and other external data security risks that could adversely affect the reputation of the Company and that could have a material adverse effect on the Company's financial condition and results of operations.*

The Company's business is dependent upon the transmission and storage of confidential information in digital technologies, computer and email systems, software and networks. The Company has security systems in place and regularly monitors its computer systems and network infrastructure. The Company does not believe that it has experienced a material cybersecurity breach, but it has experienced immaterial threats to its data and systems, including computer virus and malware attacks and other attempted unauthorized access to our systems. Cyber threats are rapidly evolving and the Company may not be able to anticipate or prevent all future attacks. Other financial institutions have been, and continue to be, the target of various evolving and adaptive cyber attacks, including malware and denial of service, as part of an effort to disrupt the operations of financial institutions, potentially test their cybersecurity capabilities, or obtain confidential, proprietary, or other information. As cybersecurity threats continue to evolve, the Company may incur increasing costs in an effort to minimize these risks. In addition, the Company could be held liable for, and could suffer reputational damage as a result of, any security breach or loss, which could have a material adverse effect on the Company's financial condition and results of operations.

Third parties with which the Company does business or that facilitate its business activities, including vendors and retailers, could also be sources of operational and information security risk to the Company. There have been increasingly sophisticated and large-scale efforts on the part of third parties to breach data security with respect to financial transactions, including intercepting account information at locations where clients make purchases, as well as the use of social engineering schemes such as "phishing." For example, large retailers have reported data breaches resulting in the loss of client information. In the event that third parties are able to misappropriate financial information of the Bank's clients, even if such breaches take place due to weaknesses in other parties' internal data security procedures, the Company could suffer reputational or financial losses which could have a material adverse effect on its financial condition and results of operations.

## Risks related to our Common Stock

*The price of our common stock has been volatile and could continue to fluctuate in the future.*

During the year ended December 31, 2021, the price of our common stock on The Nasdaq Global Market ranged from \$17.20 to \$25.61 per share, and over the period from January 1, 2020 to December 31, 2021 it ranged from \$13.06 to \$25.61. Our closing sale price on December 31, 2021 was \$24.67 per share and on February 14, 2022 it was \$25.02 per share. Our stock generally trades in relatively low volumes and its price may fluctuate in response to a number of events and factors, including, but not limited to, variations in operating results, litigation or governmental and regulatory proceedings, market perceptions of our financial reporting, changes in financial estimates and recommendations by securities analysts, the operating and stock price performance of other companies that investors may deem comparable to us, and news reports relating to trends in our markets or general economic conditions.

***We may issue additional stock, or reissue shares of treasury stock, without shareholder consent.***

We have authorized 16,000,000 shares of common stock. As of December 31, 2021, 9,128,662 shares were issued and outstanding (including 4,564,087 shares that were held as treasury stock) and 6,871,338 shares were unissued. The Company has also granted options to purchase 34,229 shares of common stock that are currently outstanding and has 345,907 shares that are available to be awarded pursuant to our current equity incentive plans. The board of directors has authority, without action or vote of the stockholders, to issue all or part of the authorized but unissued shares and to reissue all of the treasury shares. Additional shares may be issued, or treasury shares reissued, in connection with future financing, acquisitions, employee stock plans or otherwise. Any such issuance, or reissuance, will dilute the percentage ownership of existing stockholders. We are also currently authorized to issue up to 500,000 shares of preferred stock, however, as of December 31, 2021, there were no preferred stock shares issued and outstanding. Under our certificate of incorporation, our board of directors can issue additional preferred stock in one or more series and fix the terms of such stock without shareholder approval. Preferred stock may include the right to vote as a series on particular matters, preferences as to dividends and liquidation, conversion and redemption rights and sinking fund provisions. The issuance of preferred stock could adversely affect the rights of the holders of common stock and reduce the value of the common stock. In addition, specific rights granted to holders of preferred stock could be used to restrict our ability to merge with or sell our assets to a third party.

***Our ability to pay dividends on or repurchase our common stock is restricted.***

We are a stock savings bank holding company and our operations are conducted primarily by the Bank. Since we receive substantially all of our revenue from dividends from the Bank, our ability to pay dividends on our common stock or repurchase common stock depends on our receipt of dividends from the Bank. Dividend payments from the Bank are subject to legal and regulatory limitations. The ability of the Bank to pay dividends to us is also subject to its profitability, financial condition, capital needs and other cash flow requirements. There is no assurance that the Bank will be able to pay dividends to us in the future or that we will be able to generate adequate cash flow to continue to pay dividends or repurchase our common stock in the future. The inability to receive dividends from the Bank could have an adverse effect on our business and financial condition.

***Provisions of our certificate of incorporation and bylaws, as well as Delaware and federal law, may discourage, delay or prevent an acquisition of control of us, even in situations that may be viewed as desirable by our stockholders.***

Provisions included in our certificate of incorporation and bylaws, as well as provisions of the Delaware General Corporation Law and federal law (including banking regulations), may discourage, delay or prevent potential acquisitions of control of us, particularly when attempted in a transaction that is not negotiated directly with and approved by our board of directors, despite perceived short-term benefits to our stockholders (such as an increase in the trading price of our common stock).

Specifically, our certificate of incorporation and bylaws include provisions that:

- limit the voting power of shares held by a stockholder beneficially owning in excess of 10% of the outstanding shares of our common stock;

- require that, with limited exceptions, business combinations between us and a stockholder beneficially owning in excess of 10% of the voting power of the outstanding shares of our stock entitled to vote in the election of directors, be approved by at least 80% of the total number of our outstanding voting shares;
- require that prior to acquiring publicly traded equity securities from a stockholder that owns 5% or more of our publicly traded voting stock, with limited exception, holders of 80% or more of our voting stock outstanding, other than shares held by the selling stockholder, must approve the transaction;
- divide our board of directors, other than directors who may be elected by a class or series of preferred stock, into three classes serving staggered three-year terms and provide that a director may only be removed prior to the expiration of a term for cause by the affirmative vote of the holders of at least 80% of the voting power of all of the outstanding shares of capital stock entitled to vote in an election of directors;
- require that a special meeting of stockholders be called pursuant to a resolution adopted by a majority of our board of directors;
- require advance notice of nominations of directors to be made, or business to be brought, by stockholders at our annual meetings;
- authorize the issuance of preferred stock with such designations, rights and preferences as may be determined from time to time by our board of directors; and
- require that amendments to (i) our certificate of incorporation be approved by a two-thirds vote of our board of directors and by a majority of the outstanding shares of our voting stock or, with respect to the amendment of certain provisions (regarding, among other things, provisions relating to number, classification, election and removal of directors, amendment of the bylaws, call of special stockholder meetings, acquisitions of control, director liability, and certain business combinations), by 80% of the outstanding shares of our voting stock, and (ii) our bylaws be approved by a majority vote of our board of directors or the affirmative vote of at least 80% of the total votes eligible to be voted at a duly constituted meeting of stockholders.

We are subject to the provisions of Section 203 of the Delaware General Corporation Law, which prohibits a publicly-held Delaware corporation from engaging in a "business combination" with an "interested stockholder" for a period of three years after the date of the transaction in which the person became an interested stockholder, unless the business combination is approved in a prescribed manner. For purposes of Section 203, a "business combination" includes a merger, asset sale or other transaction resulting in a financial benefit to the interested stockholder, and an "interested stockholder" is a person who, either alone or together with affiliates and associates, owns (or within the past three years, did own) 15% or more of the corporation's voting stock. For purposes of Section 203, "voting stock" means stock of any class or series entitled to vote generally in the election of directors. Furthermore, federal law requires FRB or OCC approval prior to any direct or indirect acquisition of control (as defined in regulations) of HMN or the Bank, respectively, including, with respect to the Bank, any indirect acquisition of control through an acquisition of control of HMN.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2. PROPERTIES**

The Company owns its corporate office in Rochester, Minnesota and the buildings and land for eleven of its fourteen full service branches. The remaining three full service branches and two loan production offices are leased. These leased branches are located at; 100 1st Ave Bldg., Suite 200, Rochester, Minnesota; 2805 Dodd Road, Suite 160, Eagan, Minnesota; and 1015 West Frontage Road, Suite 100, Owatonna, Minnesota. The leased loan production offices are located at; 50 14th Avenue East, Suite 100, Sartell, Minnesota and 700 3rd St. North, Suite 2104, La Crosse, Wisconsin. The Bank uses all properties and they are all located in Minnesota, except for one full service branch located in Iowa and the one full service branch and one loan production office that are located in Wisconsin.

**ITEM 3. LEGAL PROCEEDINGS**

From time to time, the Company is party to legal proceedings arising out of its lending and deposit operations. See "Note 18 Commitments and Contingencies" of the Notes to the Consolidated Financial Statements for more information.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

The information on pages 18 and 19 under the caption "Dividends", on page 44 under "Note 16 Stockholders' Equity" of the Notes to Consolidated Financial Statements, on page 58 under the caption "Common Stock Information" and on the inside back cover page of the Annual Report is incorporated herein by reference.

The following table provides information with respect to purchases made by the Company of its own stock during the fourth quarter of 2021:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (a)	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased under the Plans or Programs (a)
October 1, 2021 to October 31, 2021	0	\$ N/A	0	\$ 4,870,500
November 1, 2021 to November 30, 2021	30,000	24.10	30,000	\$ 4,147,650
December 1, 2021 to December 31, 2021	0	N/A	0	\$ 4,147,650
Total	30,000	\$ 24.10	30,000	\$ 4,147,650

(a) On July 27, 2021 the Company's Board of Directors announced an increase of \$4.2 million in the amount of shares authorized to be repurchased from time to time, which increased the aggregate purchase price of shares eligible to be repurchased to \$6.0 million. Share repurchases may be executed through various means, including through open market transactions, privately negotiated transactions or otherwise. The repurchase program does not obligate the Company to purchase any shares and has no set expiration date.

**ITEM 6. RESERVED**

**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The table on page 7 and the tables regarding investment maturities on page 18 of Part 1 Item 1 of this Form 10-K, as well as the information on pages 6 through 20 under the caption "Management Discussion and Analysis" of the [Annual Report](#) is incorporated herein by reference.

**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Not applicable.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

The financial statements (including the Notes to Consolidated Financial Statements) on pages 21 through 51 of the [Annual Report](#), are incorporated herein by reference.

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

**ITEM 9A. CONTROLS AND PROCEDURES**

***Evaluation of disclosure controls and procedures.*** An evaluation was carried out under the supervision and with the participation of the Company's management, including the Bank's President (our Principal Executive Officer) and our Chief Financial Officer (our Principal Financial Officer) of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) as of the end of the period covered by this report. Based on that evaluation, the Principal Executive Officer and Principal Financial Officer have concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms.

***Changes in internal controls.*** No change in the Company's internal control over financial reporting was identified in connection with the evaluation required by Rule 13a-15(d) of the Exchange Act that occurred during the fourth quarter of the fiscal year ended December 31, 2021 and that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

***Management's Annual Report on Internal Control over Financial Reporting.*** The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Internal control over financial reporting includes those policies and procedures that pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company; provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are only being made in accordance with authorizations of management and directors of the Company; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Any control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. The design of a control system inherently has limitations, and the benefits of controls must be weighed against their costs. Additionally, controls can be circumvented by the individual acts of some persons by collusion of two or more people, or by management override of the control. Therefore, no assessment of a cost-effective system of internal controls can provide absolute assurance that all control issues and instances of fraud, if any, will be detected.

Under the supervision and with the participation of management, including the Principal Executive Officer and Principal Financial Officer, the Company conducted an evaluation of the effectiveness of its internal control over financial reporting based on the framework in the *Internal Control-Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on the Company's evaluation under this framework, the Company's management concluded that the Company's internal control over financial reporting was effective as of December 31, 2021.

#### **ITEM 9B. OTHER INFORMATION**

None.

#### **ITEM 9C. DISCLOSURE REGARDING FOREIGN JURISDICTIONS THAT PREVENT INSPECTIONS**

Not applicable.

### **PART III**

#### **ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

The information required by this Item is incorporated by reference from the information under the captions "Proposal 1 – Election of Directors - Board of Directors," "Corporate Governance - Committees of the Board of Directors" and, if applicable, "Delinquent Section 16(a) Reports" in the Company's definitive proxy statement to be filed with the SEC pursuant to Regulation 14A not later than 120 days after the close of the Company's fiscal year ended December 31, 2021 (the 2022 Proxy Statement).

##### **Information About Our Executive Officers**

Executive officers are chosen by and serve at the discretion of the Board of Directors of HMN and the Bank. There are no family relationships among any of the directors or officers of HMN and the Bank. The business experience of each executive officer of both HMN and the Bank is set forth below.

**Bradley C. Krehbiel**, age 63. Mr. Krehbiel has been a director of HMN and President of the Bank since 2009, President of HMN since 2010, and Chief Executive Officer of HMN and the Bank since 2012. Prior to that, he had been the Executive Vice President of the Bank since 2004. Mr. Krehbiel joined the Bank as Vice President of Business Banking in 1998. Prior to his employment at the Bank, Mr. Krehbiel held several positions in the financial services industry.

**Jon J. Eberle**, age 56. Mr. Eberle is Chief Financial Officer, Senior Vice President and Treasurer of HMN and the Chief Financial Officer, Executive Vice President and Treasurer of the Bank. Mr. Eberle has held the Chief Financial Officer and Treasurer positions since 2003 and the Executive Vice President position since 2012. Prior to that he served as a Vice President since 2000 and as the Controller since 1998. From 1994 to 1998, he served as the Director of Internal Audit for HMN and the Bank. Prior to his employment at the Bank, Mr. Eberle worked as a certified public accountant for a national accounting firm.

**Lawrence D. McGraw**, age 58. Mr. McGraw has served as the Chief Operating Officer and Executive Vice President of the Bank since 2012. Prior to that he served as Chief Credit Officer and Senior Vice President since 2010. Prior to his employment at the Bank, Mr. McGraw served as Regional President and Chief Banking Officer of a Minnesota community bank from 2005 until 2010. From 2001 to 2005 he served as the President and Chief Executive Officer of a branch location of the same community bank. Prior to his tenure at the Minnesota community bank, Mr. McGraw held various positions at two other community banks and the FDIC.

The Company has adopted a Code of Ethics that applies to its principal executive officer, principal financial and accounting officer, controller and other persons performing similar functions. The Company has posted the Code of Ethics on its website located at [www.hmmf.com](http://www.hmmf.com). The Company intends to post on its website any amendment to, or a waiver from, a provision of the Code of Ethics that applies to its principal executive officer, principal financial and accounting officer, controller or other persons performing similar functions within four business days following the date of such amendment or waiver.

#### **ITEM 11. EXECUTIVE COMPENSATION**

The information required by this Item is incorporated by reference from the information under the captions "Executive Compensation" and "Director Compensation" in the 2022 Proxy Statement.

#### **ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information required by this Item is incorporated by reference from the information under the captions "Security Ownership of Management and Certain Beneficial Owners" and "Other Equity Compensation Plan Information" in the 2022 Proxy Statement.

#### **ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

The information required by this Item is incorporated by reference from the information under the captions "Corporate Governance - Director Independence; - Related Person Transaction Approval Policy; and - Certain Transactions" in the 2022 Proxy Statement.

#### **ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES**

The information required by this Item is incorporated by reference from the information under the captions "Corporate Governance - Independent Registered Public Accounting Firm" and "Approval of Independent Registered Public Accounting Firm Services and Fees" in the 2022 Proxy Statement.



## PART IV

## ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

## 1. Financial Statements

The following financial statements appearing in the Company's [Annual Report](#), are incorporated herein by reference.

<u>Annual Report Section</u>	<u>Starting Page in Annual Report</u>
Consolidated Balance Sheets -- December 31, 2021 and 2020	20
Consolidated Statements of Comprehensive Income -- Each of the Years in the Two-Year Period Ended December 31, 2021	21
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## 2. Financial Statement Schedules

All financial statement schedules have been omitted as this information is not required under the related instructions, is not applicable or has been included in the Notes to Consolidated Financial Statements.

## 3. Exhibits

<u>Exhibit Number</u>	<u>Exhibit</u>	<u>Filing Status</u>
3.1	<a href="#">Certificate of Incorporation (Amended and Restated through July 28, 2015)</a>	Incorporated by Reference (1)
3.2	<a href="#">Amended and Restated By-laws</a>	Incorporated by Reference (2)
4.1	Form of Common Stock Certificate	Incorporated by Reference (3)
4.2	<a href="#">Description of Capital Stock</a>	Incorporated by Reference (4)
10.1†	<a href="#">Form of Change in Control Agreement with executive officers</a>	Incorporated by Reference (5)
10.2†	Directors Deferred Compensation Plan	Incorporated by Reference (6)
10.3†	<a href="#">Non-Employee Director Stock Purchase Plan</a>	Incorporated by Reference (7)
10.4†	<a href="#">Description of annual awards to non-employee directors under the 2009 Equity Incentive Plan and form of Restricted Stock Agreement (approved April 28, 2015)</a>	Incorporated by Reference (8)

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<b>Exhibit Number</b>	<b>Exhibit</b>	<b>Filing Status</b>
10.5†	<a href="#">HMN Financial, Inc. Employee Stock Ownership Plan (Amended and Restated January 1, 2016)</a>	Incorporated by Reference (9)
10.6†	<a href="#">HMN Financial, Inc. 2009 Equity Incentive Plan</a>	Incorporated by Reference (10)
10.7†	<a href="#">Form of Incentive Stock Option Agreement under HMN Financial, Inc. 2009 Equity Incentive Plan (Approved January 26, 2016)</a>	Incorporated by Reference (11)
10.8†	<a href="#">Executive Management Incentive Plan (Amended and Restated January 31, 2017)</a>	Incorporated by Reference (12)
10.9†	<a href="#">HMN Financial, Inc. 2017 Equity Incentive Plan</a>	Incorporated by Reference (13)
10.10†	<a href="#">Form of Directors' Restricted Stock Agreement for awards granted to directors under the HMN Financial, Inc. 2017 Equity Incentive Plan</a>	Incorporated by Reference (14)
10.11†	<a href="#">Form of Executives' Restricted Stock Agreement for awards granted to executives under the HMN Financial, Inc. 2017 Equity Incentive Plan</a>	Incorporated by Reference (15)
10.12†	<a href="#">Executive Severance Agreement, dated May 23, 2017, among the Company, the Bank and Bradley C. Krehbiel</a>	Incorporated by Reference (16)
13	<a href="#">Portions of Annual Report to Security Holders for the fiscal year ended December 31, 2021 incorporated by reference</a>	Filed Electronically
21	<a href="#">Subsidiaries of Registrant</a>	Incorporated by Reference (17)
23.1	<a href="#">Consent of CliftonLarsonAllen LLP</a>	Filed Electronically
24	<a href="#">Powers of Attorney</a>	Included with Signatures
31.1	<a href="#">Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer</a>	Filed Electronically
31.2	<a href="#">Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer</a>	Filed Electronically
32	<a href="#">Section 1350 Certifications</a>	Filed Electronically
101	Financial Statements of the Company from the annual report on Form 10-K for the year ended December 31, 2021, formatted in inline Extensible Business Reporting Language (iXBRL): (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Comprehensive Income, (iii) the Consolidated Statements of Stockholders' Equity, (iv) the Consolidated Statements of Cash Flows and (v) Notes to Consolidated Financial Statements.	Filed Electronically
104	Cover Page Interactive Data File (formatted as inline XBRL and contained in Exhibit 101)	Filed Electronically

<b>Exhibit Number</b>	<b>Exhibit</b>	<b>Filing Status</b>
	† Management contract or compensatory arrangement.	
1	Incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the period ended September 30, 2015.	
2	Incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K, dated March 5, 2012.	
3	Incorporated by reference to the same numbered exhibit to the Company's Registration Statement on Form S-1 dated April 1, 1994.	
4	Incorporated by reference to Exhibit 4.2 to the Company's annual report on Form 10-K for the period ended December 31, 2019.	
5	Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K dated May 27, 2014, filed on June 2, 2014.	
6	Incorporated by reference to the same numbered exhibit to the Company's annual report on Form 10-K for the period ended December 31, 1994.	
7	Incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the period ended March 31, 2015.	
8	Incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the period ended March 31, 2015.	
9	Incorporated by reference to Exhibit 10.5 to the Company's annual report on Form 10-K for the period ended December 31, 2015.	
10	Incorporated by reference to Exhibit A to the Company's Proxy Statement for its Annual Meeting of Stockholders held on April 28, 2009.	
11	Incorporated by reference to Exhibit 10.9 to the Company's annual report on Form 10-K for the period ended December 31, 2015.	
12	Incorporated by reference to Exhibit 10.11 to the Company's annual report on Form 10-K for the period ended December 31, 2016.	
13	Incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the period ended March 31, 2017.	
14	Incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the period ended March 31, 2017.	
15	Incorporated by reference to Exhibit 10.5 to the Company's annual report on Form 10-K for the period ended December 31, 2017.	
16	Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K dated May 23, 2017, filed on May 30, 2017.	
17	Incorporated by reference to Exhibit 21 to the Company's annual report on Form 10-K for the period ended December 31, 2019.	

**ITEM 16. FORM 10-K SUMMARY**

None.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: March 4, 2022

HMN FINANCIAL, INC.

By: /s/Bradley Krehbiel

Bradley Krehbiel,  
President and CEO

Each of the undersigned hereby appoints Wendy Shannon and Jon Eberle, and each of them (with full power to act alone), as attorneys and agents for the undersigned, with full power of substitution, for and in the name, place and stead of the undersigned, to sign and file with the Securities and Exchange Commission under the Securities Act of 1934, as amended, any and all amendments and exhibits to this Form 10-K and any and all applications, instruments, and other documents to be filed with the Securities and Exchange Commission pertaining to this Form 10-K or any amendments thereto, with full power and authority to do and perform any and all acts and things whatsoever requisite and necessary or desirable. Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the registrant and in the capacities indicated on March 4, 2022.

<u>Name</u>	<u>Title</u>
<u>/s/ Bradley Krehbiel</u> Bradley Krehbiel	President and Chief Executive Officer (Principal Executive Officer)
<u>/s/ Jon Eberle</u> Jon Eberle	Senior Vice President, Chief Financial Officer and Treasurer (Principal Financial and Accounting Officer)
<u>/s/ Wendy Shannon</u> Wendy Shannon	Chair of the Board
<u>/s/ Allen Berning</u> Allen Berning	Director
<u>/s/ Sequoya Borgman</u> Sequoya Borgman	Director
<u>/s/ Bernard Nigon</u> Bernard Nigon	Director
<u>/s/ Mark Utz</u> Mark Utz	Director
<u>/s/ Barbara Butts Williams</u> Barbara Butts Williams	Director
<u>/s/ Hans Zietlow</u> Hans Zietlow	Director

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HMN Financial, Inc. and Home Federal Savings Bank are headquartered in Rochester, Minnesota. Home Federal Savings Bank operates twelve full service offices in Minnesota located in Albert Lea, Austin, Egan, Kasson, La Crescent, Owatonna, Rochester (4), Spring Valley and Winona, one full service office in Marshalltown, Iowa, and one full service office in Pewaukee, Wisconsin. The Bank also operates two loan origination offices in Sartell, Minnesota and La Crosse, Wisconsin.

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## Financial Highlights

	At or For the Year Ended		Percentage Change
	December 31,		
	2021	2020	
<b>Operating Results:</b>			
<i>(Dollars in thousands, except per share data)</i>			
Total interest income	\$ 31,761	31,959	(0.6)%
Total interest expense	1,553	2,851	(45.5)
Net interest income	30,208	29,108	3.8
Provision for loan losses	(2,119)	2,699	(178.5)
Net interest income after provision for loan losses	32,327	26,409	22.4
Fees and service charges	3,125	2,877	8.6
Loan servicing fees	1,555	1,356	14.7
Gain on sales of loans	6,566	9,531	(31.1)
Other non-interest income	3,017	1,319	128.7
Total non-interest income	14,263	15,083	(5.4)
Total non-interest expense	27,661	27,122	2.0
Income before income tax expense	18,929	14,370	31.7
Income tax expense	5,365	4,068	31.9
Net income	\$ 13,564	10,302	31.7

### Per Common Share Information:

#### Earnings per common share and common share equivalents:

Basic	\$ 3.03	2.23	
Diluted	3.01	2.22	
Stock price (for the year):			
High	25.61	21.76	
Low	17.20	13.06	
Close	24.67	17.20	
Book value per common share	24.11	21.65	
Closing price to book value	102.32%	79.45%	

### Financial Ratios:

Return on average assets	1.38%	1.21%	14.0%
Return on average stockholders' equity	12.62	10.56	19.5
Net interest margin	3.18	3.55	(10.4)
Operating expenses to average assets	2.81	3.16	(11.1)
Average stockholders' equity to average assets	10.92	11.43	(4.5)
Stockholders' equity to total assets at year end	10.29	11.35	(9.3)
Non-performing assets to total assets	0.46	0.37	24.3
Efficiency ratio	62.20	61.26	1.5

### Balance Sheet Data:

	December 31,		Percentage Change
	2021	2020	
<i>(Dollars in thousands)</i>			
Total assets	\$ 1,069,538	909,580	17.6%
Securities available for sale	285,765	148,090	93.0
Loans held for sale	5,575	6,186	(9.9)
Loans receivable, net	652,502	642,630	1.5
Deposits	950,666	795,204	19.5
Stockholders' equity	110,031	103,252	6.6
Home Federal Savings Bank regulatory capital ratios:			
Common equity Tier 1 capital	13.18%	13.62%	(3.2)%
Tier 1 leverage	9.47	9.85	(3.9)
Tier 1 risk-based capital	13.18	13.62	(3.2)
Total risk-based capital	14.43	14.87	(3.0)

I am proud to present you with our 2021 Annual Report.

The year represented our second fiscal year of operation under the COVID-19 Pandemic and we were able to bring forward much of what we learned in dealing with the Pandemic from the previous year. This experience enabled us to reopen our branches to foot traffic and to call many of our employees back to work in their offices, albeit in most cases on a hybrid work from home, work from office basis. Our primary goal was to deliver our products and services in an effective manner that would also protect the health of both our clients and employees. I am proud of how flexible our employees have been over the past two years and pleased to report that we experienced no major workplace-based outbreaks of the virus.

Bolstered by strong mortgage lending revenue, income earned from the Paycheck Protection Program and a continuing improvement in asset quality, the Company posted its highest net income since 2013.

Our mortgage lending area originated over \$247 million of loans during the year. While most of these loans were sold into the secondary market, we retained over \$90 million for our mortgage loan portfolio, providing valuable earning assets for future years.

Our Business Banking department faced significant interest rate competition across all of our markets as market loan rates declined during the year. Our strategy to compete for the best clients on price, but not compromising on credit quality, has made it challenging to grow our commercial loan portfolio as some competition has eased underwriting standards to attract new business. The \$2.1 million credit provision for loan losses we recorded during the year reflects the continued performance of our loan portfolios during the year despite the headwinds many businesses encountered because of the Pandemic.

Our Business Banking and Small Business Administration (SBA) departments worked very diligently during the year to administer the Paycheck Protection Program for the SBA. This included working with clients to process the forgiveness of loans originated in 2020 under the first round of the program and to originate and process loan forgiveness for loans originated in 2021 under the second round of the program. I am proud to report that as of year-end, close to 100% of loans originated under both funding rounds have been forgiven as agreed. We estimate that our clients were able to protect the jobs of approximately 5,000 individuals in the markets that we serve.

During the year, we focused an increased amount of resources to expand our agricultural loan portfolio. Several of our branches are in cities surrounded by prime agricultural land. Our strategy is to grow this portfolio in a sustainable manner by identifying and attracting the strongest producer in each market with the best production staff and state of the art digital banking products and services. By year-end, our agricultural loan portfolio had grown to over \$22 million in outstanding balances.

Our balance sheet experienced strong asset growth during the year, driven primarily by a substantial growth in deposits. While admittedly some of these deposits represent the proceeds of government support payments designed to stimulate the economy, consumer spending habits have also changed, resulting in a higher savings rate. I am proud to point out that, as of year-end, our deposit base did not include non-core sources of funds such as brokered deposits or Federal Home Loan Bank advances.

Our capital ratios continued to be strong throughout the year, with the Bank reporting a Tier I leverage ratio of 9.5% at the year-end, which was \$10 million over our 8.5% internal benchmark for core capital.

Dividends from the Bank to HMN during the year totaled \$6 million, raising our holding company capital ratio to 10.3%. Most importantly, by year-end, HMN held \$12.5 million in cash and had no debt, making the Company a significant source of strength for the Bank.

I am pleased that our strong trends in earnings and capital accretion placed us in a position to commence quarterly dividends with the declaration of a dividend to our common shareholders that was paid in the first quarter of 2022. This dividend was our first common shareholder dividend paid since 2008.

Finally, I would be remiss if I didn't mention that in January of 2022 we suffered the sudden and unexpected loss of our valued friend, colleague, and fellow member of our Board of Directors, Mike Bue. Mike had served on our board since 2016. He was a member of several committees but mentioned to a number of us that his favorite was that of the Executive Loan Committee, for which he served as Chairman. Mike was a consummate career banker who earned the respect of everyone he interacted with. He will be greatly missed by everyone who had the good fortune to know and work with him.

I want to thank you for your continued support of HMN Financial, Inc. and Home Federal Savings Bank. Together with our talented staff, I look forward to continuing to work diligently to grow our organization one relationship at a time.

Best Regards,



Bradley Krehbiel

President and Chief Executive Officer



Board of Directors



Dr. Wendy Shannon  
Board Chair



Bradley Krehbiel  
President and CEO



Allen Berning



Sequoya Borgman



Bernard Nigon



Dr. Barbara Butts Williams



Mark Utz



Hans Zietlow



## Five-Year Consolidated Financial Highlights

### Selected Operations Data:

(Dollars in thousands, except per share data)

	Year Ended December 31,				
	2021	2020	2019	2018	2017
Total interest income	\$ 31,761	31,959	31,890	30,381	27,680
Total interest expense	1,553	2,851	3,339	2,233	1,797
Net interest income	30,208	29,108	28,551	28,148	25,883
Provision for loan losses	(2,119)	2,699	(1,216)	(649)	(523)
Net interest income after provision for loan losses	32,327	26,409	29,767	28,797	26,406
Fees and service charges	3,125	2,877	3,100	3,330	3,354
Loan servicing fees	1,555	1,356	1,278	1,255	1,202
Gain on sales of loans	6,566	9,531	2,941	2,095	2,138
Other non-interest income	3,017	1,319	1,136	1,114	1,032
Total non-interest income	14,263	15,083	8,455	7,794	7,726
Total non-interest expense	27,661	27,122	27,105	25,467	25,326
Income before income tax expense	18,929	14,370	11,117	11,124	8,806
Income tax expense	5,365	4,068	3,324	2,888	4,402(1)
Net income	\$ 13,564	10,302	7,793	8,236	4,404
Basic earnings per common share	\$ 3.03	2.23	1.69	1.89	1.04
Diluted earnings per common share	3.01	2.22	1.68	1.71	0.90

(1) Relates to the decrease in the Company's net deferred tax asset as a result of the reduction in the corporate federal tax rate from 34% to 21% in the fourth quarter of 2017.

### Selected Financial Condition Data:

(Dollars in thousands, except per share data)

	At December 31,				
	2021	2020	2019	2018	2017
Total assets	\$ 1,069,538	909,580	777,639	712,315	722,685
Securities available for sale	285,765	148,090	107,592	79,859	77,472
Loans held for sale	5,575	6,186	3,606	3,444	1,837
Loans receivable, net	652,502	642,630	596,392	586,688	585,931
Deposits	950,666	795,204	673,870	623,352	635,601
Stockholders' equity	110,031	103,252	92,648	83,147	80,818
Book value per common share	24.11	21.65	19.13	17.19	17.97
Number of full service offices	14	14	14	14	13
Number of loan origination offices	2	1	1	2	3
Key Ratios: (2)					
Stockholders' equity to total assets at year end	10.29%	11.35%	11.91%	11.67%	11.18%
Average stockholders' equity to average assets	10.92	11.43	12.06	11.52	11.43
Return on stockholders' equity (ratio of net income to average equity)	12.62	10.56	8.74	9.88	5.52
Return on assets (ratio of net income to average assets)	1.38	1.21	1.05	1.14	0.63

(2) Average balances were calculated based upon amortized cost without the market value impact of ASC 320.

## Management Discussion and Analysis

*This Annual Report, other reports filed by HMN Financial, Inc. (HMN or the Company) with the Securities and Exchange Commission (SEC), and the Company's proxy statement may contain forward-looking statements within the meaning of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements are often identified by such forward-looking terminology as "expect," "estimate," "intend," "look," "believe," "anticipate," "project," "continue," "may," "will," "would," "could," "target," "goal," "should," and "trend," or similar statements or variations of such terms and include, but are not limited to, those relating to maintaining credit quality; maintaining net interest margins; the adequacy and amount of available liquidity and capital resources to Home Federal Savings Bank (the Bank); the Company's liquidity and capital requirements; the anticipated impacts of the COVID-19 Pandemic and efforts to mitigate the same on the general economy, our clients, and the allowance for loan losses; the amount of the Bank's non-performing assets in future periods and the appropriateness of the allowances therefor; anticipated future levels of the provision for loan losses; future losses on non-performing assets; the amount and composition of interest earning assets; the amount and compositions of non-interest and interest-bearing liabilities; the availability of alternate funding sources; the payment of dividends or repurchases of stock by HMN; the amount of deposits that will be withdrawn from checking and money market accounts and how the withdrawn deposits will be replaced; the projected changes in net interest income based on rate shocks; the range that interest rates may fluctuate over the next twelve months; the net market risk of interest rate shocks; the future outlook for the issuer of the trust preferred securities held by the Bank; the anticipated results of litigation and our assessment of the impact on our financial statements; the ability of the Bank to pay dividends to HMN; the ability to remain well capitalized; the impact of new accounting pronouncements; and compliance by the Bank with regulatory standards generally (including the Bank's status as "well-capitalized") and other supervisory directives or requirements to which the Company or the Bank are or may become expressly subject.*

*A number of factors, many of which may be amplified by the COVID-19 pandemic and efforts to mitigate the same, could cause actual results to differ materially from the Company's assumptions and expectations. These include but are not limited to the adequacy and marketability of real estate and other collateral securing loans to borrowers; federal and state regulation and enforcement; possible legislative and regulatory changes, including changes to regulatory capital rules; the ability of the Bank to comply with other applicable regulatory capital requirements; enforcement activity of the Office of the Comptroller of the Currency (OCC) and the Federal Reserve Bank of Minneapolis in the event of our non-compliance with any applicable regulatory standard or requirement; adverse economic, business and competitive developments such as continued shrinking interest margins, reduced collateral values, deposit outflows, changes in credit or other risks posed by the Company's loan and investment portfolios; changes in costs associated with traditional and alternate funding sources, including changes in collateral advance rates and policies of the Federal Home Loan Bank (FHLB) and the Federal Reserve Bank; technological, computer-related or operational difficulties including those from any third party cyberattack; results of litigation; reduced demand for financial services and loan products; changes in accounting policies and guidelines, or monetary and fiscal policies of the federal government or tax laws; domestic and international economic developments; the Company's access to and adverse changes in securities markets; the market for credit related assets; the future operating results, financial condition, cash flow requirements and capital spending priorities of the Company and the Bank; the availability of internal and, as required, external sources of funding; our ability to attract and retain employees; or other significant uncertainties. Additional factors that may cause actual results to differ from the Company's assumptions and expectations include those set forth in the "Risk Factors" section of the Company's Annual Report on Form 10-K for the year ended December 31, 2021. All forward-looking statements are qualified by, and should be considered in conjunction with, such cautionary statements.*

*All statements in this Annual Report, including forward-looking statements, speak only as of the date hereof, and we undertake no duty to update any of the forward-looking statements after the date of this Annual Report.*

### Overview

HMN is the stock savings bank holding company for the Bank, which operates community banking and loan production offices in Minnesota, Iowa and Wisconsin. The earnings of the Company are primarily dependent on the Bank's net interest income, which is the difference between interest earned on loans and investments, and the interest paid on interest-bearing liabilities such as deposits and other borrowings. The difference between the average rate of interest earned on assets and the average rate paid on liabilities is the interest rate spread. Net interest income is produced when interest-earning assets equal or exceed interest-bearing liabilities and there is a positive interest rate spread. Net interest income and net interest rate spread are affected by changes in interest rates, the volume and composition of interest-earning assets and interest-bearing liabilities, and the level of non-performing assets. The Company's net earnings are also affected by the generation of non-interest income, which consists primarily of gains from the sale of loans, fees for servicing loans, commissions on the sale of uninsured investment products, and service charges on deposit accounts. The Bank incurs expenses in addition to interest expense in the form of compensation and benefits, occupancy and equipment expenses, provisions for loan losses, data processing costs, professional services, deposit insurance, amortization expense on mortgage servicing assets, advertising expenses, and income taxes. The earnings of financial institutions, such as the Bank, are also significantly affected by prevailing economic and competitive conditions, particularly changes in interest rates, government monetary and fiscal policies, and regulations of various regulatory authorities. Lending activities are influenced by the demand for and supply of business credit, single family and commercial properties, competition among lenders, the level of interest rates and the availability of funds. Deposit flows and costs of deposits are influenced by prevailing market rates of interest on competing investments, account maturities and the levels of personal income and savings.

### Critical Accounting Estimates

While our significant accounting policies are described in the notes to our consolidated financial statements, we believe the following discussion addresses our most critical accounting estimates, which are those estimates made in accordance with U.S. generally accepted accounting principles (GAAP) that involve a significant level of estimation uncertainty and have had or are reasonably likely to have a material impact on our financial condition or results of operations. The Company has identified the following critical accounting estimates that management believes involve the most difficult, subjective, and/or complex judgments that are inherently uncertain. Therefore, actual financial results could differ significantly depending upon the estimates, assumptions and other factors used.

#### *Allowance for Loan Losses and Related Provision*

The allowance for loan losses is based on periodic analysis of the loan portfolio and is maintained at an amount considered to be appropriate by management to provide for probable losses inherent in the loan portfolio as of the balance sheet dates. In this analysis, management considers factors including, but not limited to, specific occurrences of loan impairment, actual and anticipated changes in the size of the portfolios, national, regional and local economic conditions such as unemployment data, loan delinquencies, demand for single family homes, demand for commercial real estate and building lots, loan portfolio composition, historical loss experience and observations made by the Company's ongoing internal audit and regulatory exam processes. Loans are charged off to the extent they are deemed to be uncollectible. The Company has established separate processes to determine the appropriateness of the loan loss allowance for its homogeneous and non-homogeneous loan portfolios. The determination of the allowance on the homogeneous single family and consumer loan portfolios is calculated on a pooled basis with individual determination of the allowance for all non-performing loans. The determination of the allowance for the non-homogeneous commercial, commercial real estate and multi-family loan portfolios involves assigning standardized risk ratings and loss factors that are periodically reviewed. The loss factors are estimated based on the Company's own loss experience and other qualitative factors and are assigned to all loans without identified credit weaknesses. For each non-performing loan, the Company also performs an individual analysis of impairment that is based on the expected cash flows or the value of the assets collateralizing the loans and establishes any necessary reserves or charges off all loans, or portions thereof, that are deemed uncollectible.

The appropriateness of the allowance for loan losses is dependent upon management's estimates of variables affecting valuation, appraisals of collateral, evaluations of performance and status and the amounts and timing of future cash flows expected to be received on impaired loans. Such estimates, appraisals, evaluations and cash flows may be subject to adjustments due to changing economic prospects of borrowers or properties. The fair market value of collateral dependent loans is typically based on the appraised value of the property less estimated selling costs. The estimates are reviewed periodically and any adjustments are recorded in the provision for loan losses in the periods in which the adjustments become known. Because of the size of some loans, changes in estimates can have a significant impact on the loan loss provision. The allowance is allocated to individual loan categories based upon the relative risk characteristics of the loan portfolios, the actual loss experience and other qualitative factors. The Company increases its allowance for loan losses by charging the provision for loan losses against income and by receiving recoveries of previously charged off loans. The Company decreases its allowance by crediting the provision for loan losses and recording loan charge-offs. The current year activity resulted in a decrease in the allowance and a credit to the loan loss provision. The methodology for establishing the allowance for loan losses takes into consideration probable losses that have been identified in connection with specific loans as well as losses in the loan portfolio that have not been specifically identified. Although management believes that based on current conditions the allowance for loan losses is maintained at an appropriate amount to provide for probable loan losses inherent in the portfolio as of the balance sheet dates, future conditions may differ substantially from those anticipated in determining the allowance for loan losses and adjustments may be required in the future. In addition, the Company will be required to adopt Accounting Standards Update (ASU) 2016-13, *Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* in the first quarter of 2023. See "Note 1 - New Accounting Pronouncements" in the Notes to Consolidated Financial Statements for further information on the potential impact of adopting ASU 2016-13.

### *Income Taxes*

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. These calculations are based on many complex factors including estimates of the timing of reversals of temporary differences, the interpretation of federal and state income tax laws, and a determination of the differences between the tax and the financial reporting basis of assets and liabilities. Actual results could differ significantly from the estimates and interpretations used in determining the current and deferred income tax assets and liabilities.

The Company maintains significant net deferred tax assets for deductible temporary differences, the largest of which relates to the allowance for loan losses. For tax purposes only the net charge-offs are deductible while the entire provision for loan losses is used to determine book income. A deferred tax asset is created because of the timing difference of when the expense is recognized for book and tax purposes. Under GAAP, a valuation allowance is required to be recognized if it is "more likely than not" that the deferred tax asset will not be realized. The determination of the realizability of the deferred tax assets is highly subjective and dependent upon management's judgment and evaluation of both positive and negative evidence, including the forecasts of future income, tax planning strategies, and assessments of the current and future economic and business conditions. The positive evidence considered includes the Company's cumulative net income in the prior three-year period, the ability to implement tax planning strategies to accelerate taxable income recognition, and the probability that taxable income will be generated in future periods. The Company could not currently identify any negative evidence. It is possible that future conditions may differ substantially from those anticipated in determining that no valuation allowance was required on deferred tax assets and adjustments may be required in the future.

Determining the ultimate settlement of any tax position requires significant estimates and judgments in arriving at the amount of tax benefits to be recognized in the financial statements. It is possible that the tax benefits realized upon the ultimate resolution of a tax position may result in tax benefits that are significantly different from those estimated.

### *Litigation*

Estimates related to litigation are inherently subjective and the ultimate resolution of any litigation may be different than current management estimates. See "Note 18 Commitments and Contingencies" in the Notes to Consolidated Financial Statements for further information on outstanding litigation matters.

### **COVID-19 Pandemic**

In 2020, the spread of COVID-19 slowed economic activity in many countries, including the United States. Millions of Americans were at some point ordered to stay home, including those residing in the states of Minnesota and Wisconsin, and many businesses were ordered to be closed for a period of time or to operate at reduced capacities in order to reduce the spread of COVID-19. These orders severely reduced the flow of commerce which reduced, or entirely eliminated, the revenue streams for many small businesses. This reduction in income forced many small businesses to close temporarily, furlough employees, or terminate operations entirely.

In 2021 several COVID-19 vaccines were approved for distribution and became available to the general public. Since that time, the majority of the population in the United States received an initial vaccination, with some also obtaining a recommended booster vaccination when it became available in the fall of 2021. Despite these vaccinations, the original virus has mutated multiple times and continues to infect both vaccinated and unvaccinated individuals. Due to the variations in both the seriousness of symptoms and degree of transmissibility with these variants, surges of positive cases began to occur in the fourth quarter of 2021 and continue as we begin 2022. Because of the increase in COVID-19 infections, some mask mandate orders were put back in place in certain areas of the country and some schools implemented distance learning for short periods of time in order to reduce the spread of COVID-19. The impact of these measures on the economy, however, has been much less than previously experienced due to having fewer government mitigation measures requiring people to stay at home or to close down certain businesses than when the pandemic first began.

The Bank has, and continues to be, impacted by the disruption in economic activity due to the pandemic. During 2020, it temporarily closed the lobbies in all of its locations and for a period of time conducted business entirely through the drive-ups at the branches that have that capability. Branches without drive-up facilities were closed for a period of time in order to meet the social distancing guidelines recommended by health officials. Beginning in January 2021, the Bank re-opened all of its lobbies to walk-in services during limited hours while continuing to offer drive-up service during normal business hours. The Bank continues to encourage its customers to conduct business through its on-line loan and deposit account services, as well as through ATM and night drop facilities available at its branches.

The *Coronavirus Aid, Relief, and Economic Security (CARES) Act* was signed into law on March 27, 2020 and the Bank's regulators issued the *Interagency Statement on Loan Modification and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus* on April 7, 2020. In accordance with regulatory guidance, the Bank offered loan payment accommodations to certain customers by deferring the loan payments on their outstanding loans with the Bank for up to six months. After the initial deferral period was over, the Bank granted additional accommodations on certain loans to borrowers in accordance with Section 4013 of the CARES Act on a case-by-case basis. See "Note 6 Allowance for Loan Losses and Credit Quality Information" in the Notes to Consolidated Financial Statements for further information.

The extent of any future impact on the Company related to the pandemic is difficult to determine as it is not clear how many times the virus will mutate, how effective the vaccines will be on future mutations of the virus, the impact that any future mutations will have on economic activity, or what the long-term implications will be on customer behavior as a result of the pandemic, among other factors. The impact on the Bank's loan portfolio is also unclear for many of the same reasons. At this time, the Company has not seen a negative impact on its deposit relationships as many of its clients have been able to conduct their business with the Bank through the drive-ups, ATMs, night drop, on-line banking website, or by using its mobile banking application.

#### Paycheck Protection Program (PPP)

The Bank actively participated in helping businesses that applied for forgivable loans under the PPP as part of the CARES Act. The Bank had the following activity related to the first round of the PPP through December 31, 2021:

<i>(Dollars in thousands)</i>	Number of Loans	Amount	Net Deferred Fees
Originated	413	\$ 53,153	1,837
Repaid	(130)	(19,484)	0
Net deferred fees recognized	0	0	(1,097)
Balance, December 31, 2020	283	\$ 33,669	740
<b>Repaid</b>	<b>(283)</b>	<b>(33,669)</b>	<b>0</b>
<b>Net deferred fees recognized</b>	<b>0</b>	<b>0</b>	<b>(740)</b>
<b>Balance, December 31, 2021</b>	<b>0</b>	<b>\$ 0</b>	<b>0</b>

The *Consolidated Appropriations Act of 2021* was signed into law on December 27, 2020 and allocated \$284 billion to the Small Business Administration (SBA) to fund a second round of the PPP. The Bank actively participated in the second round of the PPP and had the following activity through December 31, 2021:

<i>(Dollars in thousands)</i>	Number of Loans	Amount	Net Deferred Fees
Originated	466	\$ 28,965	1,625
Repaid	(459)	(26,306)	0
Net deferred fees recognized	0	0	(1,551)
Balance, December 31, 2021	7	\$ 2,659	74

It is anticipated that the outstanding loans at December 31, 2021 will be forgiven by the SBA and the remaining net deferred fees will be recognized into income when the loans are repaid.

#### Results of Operations

##### Comparison of 2021 with 2020

Net income was \$13.6 million for 2021, an increase of \$3.3 million, or 31.7%, compared to net income of \$10.3 million for 2020. Diluted earnings per share for the year ended December 31, 2021 was \$3.01, an increase of \$0.79 per share, compared to diluted earnings per share of \$2.22 for the year ended December 31, 2020. The increase in net income between the periods was primarily because of a \$4.8 million decrease in the provision for loan losses. The provision for loan losses decreased primarily because of the reduction in the required reserves due to the reduced economic impact of the COVID-19 pandemic and the results of an internal analysis of the loan portfolio. Other non-interest income increased \$1.7 million due primarily to an increase in the gains that were realized on the sale of real estate owned. Net interest income increased \$1.1 million primarily due to an increase in the yield enhancements that were realized on PPP loans that were repaid during the period and also because of a decrease in the interest rates paid on deposits. These increases in net income were partially offset by a \$3.0 million decrease in the gain on sales of mortgage loans due to a decrease in mortgage loan activity between the periods. Compensation expense increased \$0.5 million due primarily to an increase in incentives earned between the periods. Income tax expense also increased \$1.3 million as a result of the increased pre-tax income between the periods.

### Net Interest Income

Net interest income was \$30.2 million for 2021, an increase of \$1.1 million, or 3.8%, from \$29.1 million for 2020. Interest income was \$31.8 million for 2021, a decrease of \$0.2 million, or 0.6%, from \$32.0 million for 2020. Interest income decreased despite the \$2.3 million in yield enhancements that were recognized on PPP loans during the period and the \$130.8 million increase in the average interest-earning assets between the periods. These increases in interest income were entirely offset by a decrease in the average yield earned on interest-earning assets which was 3.34% for 2021, a decrease of 56 basis points from 3.90% for 2020. The decrease in the average yield is primarily related to the decrease in the prime rate that occurred in the first quarter of 2020, which lowered the rate on adjustable rate loans in the portfolio as well as any new or renewing fixed rate loans that were originated since that time.

Interest expense was \$1.6 million for 2021, a decrease of \$1.3 million, or 45.5%, from \$2.9 million for 2020. Interest expense decreased despite the \$123.1 million increase in the average interest-bearing liabilities and non-interest bearing deposits between the periods primarily because of the decrease in the average interest rate paid on deposits. The average interest rate paid on interest-bearing liabilities and non-interest bearing deposits was 0.18% for 2021, a decrease of 20 basis points from 0.38% for 2020. The decrease in the interest paid on interest-bearing liabilities was primarily because of the decrease in deposit rates as a result of the decrease in the federal funds rate in the first quarter of 2020.

The following table presents the total dollar amount of interest income from average interest-earning assets and the resultant yields, as well as the interest expense on average interest-bearing liabilities, expressed both in dollars and rates. Non-accruing loans have been included in the average outstanding loan balance in the table as loans carrying a zero yield.

	Year Ended December 31,					
	2021			2020		
(Dollars in thousands)	Average Outstanding Balance	Interest Earned/Paid	Average Yield/Rate	Average Outstanding Balance	Interest Earned/Paid	Average Yield/Rate
<b>Interest-earning assets:</b>						
Securities available for sale(1):						
Mortgage-backed and related securities	\$ 167,759	1,864	1.11%	\$ 61,364	1,155	1.88%
Other marketable securities	42,878	282	0.66	46,407	702	1.51
Loans held for sale	5,335	159	2.98	7,292	215	2.95
Loans receivable, net(1) (2)	631,969	29,290	4.63	644,912	29,709	4.61
FHLB stock and other earning assets including cash equivalents	102,146	166	0.16	59,321	178	0.30
<b>Total interest-earning assets</b>	<b>\$ 950,087</b>	<b>31,761</b>	<b>3.34</b>	<b>\$ 819,296</b>	<b>31,959</b>	<b>3.90</b>
<b>Interest-bearing liabilities:</b>						
Checking accounts	\$ 157,857	182	0.12%	\$ 122,781	151	0.12%
Savings accounts	113,314	69	0.06	90,064	65	0.07
Money market accounts	245,409	557	0.23	209,522	840	0.40
Certificate accounts	93,650	745	0.80	115,079	1,795	1.56
FHLB advances and other borrowings	0	0	0.00	0	0	0.00
<b>Total interest-bearing liabilities</b>	<b>\$ 610,230</b>			<b>\$ 537,446</b>		
Noninterest checking	257,549			207,456		
Other noninterest-bearing liabilities	2,490			2,251		
<b>Total interest-bearing liabilities and noninterest-bearing deposits</b>	<b>\$ 870,269</b>	<b>1,553</b>	<b>0.18%</b>	<b>\$ 747,153</b>	<b>2,851</b>	<b>0.38%</b>
<b>Net interest income</b>		<b>30,208</b>			<b>\$ 29,108</b>	
<b>Net interest rate spread</b>			<b>3.16%</b>			<b>3.52%</b>
<b>Net earning assets</b>	<b>\$ 79,818</b>			<b>\$ 72,143</b>		
<b>Net interest margin</b>			<b>3.18%</b>			<b>3.55%</b>
Average interest-earning assets to average interest-bearing liabilities		<b>109.17%</b>			<b>109.66%</b>	

(1) Tax exempt income was not material; therefore, the yield was not presented on a tax equivalent basis for any of the years presented.

(2) Calculated net of deferred loan costs, loan discounts, loans in process and loss reserves.

Net interest margin (net interest income divided by average interest-earning assets) for 2021 was 3.18%, a decrease of 37 basis points, compared to 3.55% for 2020. The decrease in the net interest margin is primarily related to the decrease in the average yield earned on interest-earning assets as a result of the decrease in the prime rate that occurred in the first quarter of 2020.

Average net earning assets increased to \$79.8 million in 2021 compared to \$72.1 million in 2020. The \$7.7 million increase in the average net earning assets in 2021 is due primarily to the net income earned in 2021 that was partially offset by the purchase of premises and equipment and treasury stock.

The following table presents the dollar amount of changes in interest income and interest expense for major components of interest-earning assets and interest-bearing liabilities. It quantifies the changes in interest income and interest expense related to changes in the average outstanding balances (volume) and those changes caused by fluctuating interest rates. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (i) changes in volume (i.e. changes in volume multiplied by old rate) and (ii) changes in rate (i.e. changes in rate multiplied by current volume).

	Year Ended December 31,		
	2021 vs. 2020		
	Increase (Decrease) Due to		Total Increase (Decrease)
Volume (1)	Rate(1)		
<i>(Dollars in thousands)</i>			
<b>Interest-earning assets:</b>			
Securities available for sale:			
Mortgage-backed and related securities	\$ 2,003	(1,294)	709
Other marketable securities	(53)	(367)	(420)
Loans held for sale	(58)	2	(56)
Loans receivable, net	(711)	292	(419)
Other	114	(126)	(12)
Total interest-earning assets	\$ 1,295	(1,493)	(198)
<b>Interest-bearing liabilities:</b>			
Checking accounts	\$ 57	(26)	31
Savings accounts	17	(13)	4
Money market accounts	166	(449)	(283)
Certificate accounts	(335)	(715)	(1,050)
Total interest-bearing liabilities	\$ (95)	(1,203)	(1,298)
<b>Increase (decrease) in net interest income</b>	<b>\$ 1,390</b>	<b>(290)</b>	<b>1,100</b>

(1) For purposes of this table, changes attributable to both rate and volume which cannot be segregated have been allocated proportionately to the change due to volume and the change due to rate.

The following table sets forth the weighted average yields on the Company's interest-earning assets, the weighted average interest rates on interest-bearing liabilities and the interest rate spread between the weighted average yields and rates as of the date indicated. Non-accruing loans have been included in the average outstanding loan balances in the table as loans carrying a zero yield.

At December 31, 2021			
Weighted average yield on:		Weighted average rate on:	
Securities available for sale:		Checking accounts	0.12%
Mortgage-backed and related securities	1.06%	Savings accounts	0.06
Other marketable securities	0.54	Money market accounts	0.21
Loans held for sale	3.42	Certificate accounts	0.53
Loans receivable, net	4.14	Combined weighted average rate on interest-bearing liabilities	0.13
FHLB stock and other interest-earning assets	0.19	Interest rate spread	2.80
Combined weighted average yield on interest-earning assets	2.93		

#### **Provision for Loan Losses**

The provision for loan losses was (\$2.1) million for 2021, a decrease of \$4.8 million from the \$2.7 million provision for loan losses for 2020. The provision for loan losses decreased primarily because of the reduction in the required reserves due to the reduced economic impact of the COVID-19 pandemic and the results of an internal analysis of the loan portfolio. The provision also decreased between the periods due to an increase in the current year in the recoveries received on previously charged off loans. During 2020, the Company increased its allowance for loan losses due to the changes in the economic environment related to the disruption in business activity as a result of the COVID-19 pandemic. The amount of the increase in the allowance for loan losses related to the economic environment was based, in part, on the amount of loans to borrowers in the hospitality, restaurant and entertainment industries that were negatively impacted by the COVID-19 pandemic. The underlying operations supporting many of the loans that were initially negatively impacted by the pandemic have improved and the amount of loans requiring accommodations decreased in 2021. At December 31, 2021, the Company had no loans with outstanding loan accommodations in accordance with Section 4013 of the CARES Act, compared to \$34.6 million of outstanding loans that had been granted accommodations at December 31, 2020. See "Note 6 Allowance for Loan Losses and Credit Quality Information" in the Notes to Consolidated Financial Statements for additional information related to deferrals and loan modifications to borrowers impacted by the COVID-19 pandemic.

**Non-Interest Income**

Non-interest income was \$14.3 million for 2021, a decrease of \$0.8 million, or 5.4%, from \$15.1 million for 2020. The following table presents the components of non-interest income:

<i>(Dollars in thousands)</i>	Year Ended December 31,		Percentage Change
	2021	2020	
Fees and service charges	\$ 3,125	2,877	8.6%
Loan servicing fees	1,555	1,356	14.7
Gain on sales of loans	6,566	9,531	(31.1)
Other non-interest income	3,017	1,319	128.7
Total non-interest income	\$ 14,263	15,083	(5.4)

Gain on sales of loans decreased \$3.0 million between the periods primarily because of a decrease in single family loan originations and sales. This decrease in non-interest income was partially offset by an increase in other non-interest income of \$1.7 million due primarily to a \$1.4 million increase in the gain realized on the sale of commercial real estate owned and an increase in the income earned on the sale of uninsured investment products between the periods. Fees and service charges increased \$0.2 million between the periods because of an increase in debit card income due to an increase in the volume of transactions. Loan servicing fees increased \$0.2 million between the periods due to an increase in the aggregate balances of single family mortgage loans that were being serviced for others.

**Non-Interest Expense**

Non-interest expense was \$27.7 million for 2021, an increase of \$0.6 million, or 2.0%, from \$27.1 million for 2020. The following table presents the components of non-interest expense:

<i>(Dollars in thousands)</i>	Year Ended December 31,		Percentage Change
	2021	2020	
Compensation and benefits	\$ 16,114	15,646	3.0%
Occupancy and equipment	4,372	4,429	(1.3)
Data processing	1,445	1,314	10.0
Professional services	1,438	1,405	2.3
Other	4,292	4,328	(0.8)
Total non-interest expense	\$ 27,661	27,122	2.0

Compensation and benefits expense increased \$0.5 million because of an increase in the incentives earned between the periods. Data processing expense increased \$0.1 million due primarily to increased debit card processing costs. Professional services expense increased slightly between the periods primarily because of an increase in employee recruitment fees. These increases in non-interest expense were partially offset by a \$0.1 million decrease in occupancy and equipment expense due primarily to a decrease in building rent expense between the periods. Other non-interest expense decreased slightly between the periods due primarily to a decrease in mortgage servicing expense due to a decrease in prepayments on loans being serviced for third parties.

**Income Taxes**

The Company considers the calculation of current and deferred income taxes to be a critical accounting policy that is subject to significant estimates. Income tax expense was \$5.4 million for 2021, an increase of \$1.3 million from \$4.1 million for 2020. The increase in income tax expense between the periods is primarily the result of an increase in pre-tax income.



**Financial Condition***Loans Receivable, Net*

The following table sets forth the information on the Company's loan portfolio in dollar amounts and percentages before deductions for deferred costs/fees and discounts and the allowance for losses as of the dates indicated:

<i>(Dollars in thousands)</i>	December 31,			
	2021		2020	
	Amount	Percent	Amount	Percent
<b>Real Estate Loans:</b>				
Single family	\$ 163,322	24.67%	\$ 135,023	20.65%
Multi-family	43,140	6.51	41,456	6.34
Commercial	306,490	46.30	307,755	47.07
Construction and development	47,238	7.14	31,493	4.82
Total real estate loans	560,190	84.62	515,727	78.88
<b>Other Loans:</b>				
<b>Consumer Loans:</b>				
Home equity line	17,467	2.64	21,308	3.26
Home equity	7,557	1.14	11,549	1.76
Recreational vehicles	10,985	1.66	15,645	2.39
Other	5,636	0.85	6,889	1.06
Total consumer loans	41,645	6.29	55,391	8.47
Commercial business loans	60,165	9.09	82,673	12.65
Total other loans	101,810	15.38	138,064	21.12
Total loans	\$ 662,000	100.00%	\$ 653,791	100.00%
<b>Less:</b>				
Unamortized discounts	10		12	
Net deferred loan fees	209		450	
Allowance for losses	9,279		10,699	
Total loans receivable, net	\$ 652,502		\$ 642,630	

The growth in the loan portfolio in 2021 was primarily because of the growth experienced in single family real estate, construction and development loans, and multi-family loans that was partially offset by a decrease in commercial business and consumer loans. Based on current economic conditions and the projected loan origination and prepayment amounts, it is anticipated that the overall growth in the loan portfolio will be limited in 2022.

Single family real estate loans were \$163.3 million at December 31, 2021, an increase of \$28.3 million, compared to \$135.0 million at December 31, 2020. The single family loan portfolio increased in 2021 primarily because of an increase in the amount of originated loans that were placed in the portfolio during 2021 compared to 2020. The single family loan portfolio increased due to a \$20.5 million increase in the amount of saleable 10 and 15 year single family loans that were placed into the loan portfolio rather than being sold in the secondary market. These loans were placed into the portfolio in order to increase the overall loan portfolio balance and improve the overall yield earned on interest earning assets during 2021.

Multi-family real estate loans were \$43.1 million at December 31, 2021, an increase of \$1.6 million, compared to \$41.5 million at December 31, 2020. The increase in multi-family real estate loans in 2021 is primarily the result of new loan originations and transfers in of completed multi-family construction loans exceeding the loans that were repaid during the year.

Commercial real estate loans were \$306.5 million at December 31, 2021, a decrease of \$1.3 million, compared to \$307.8 million at December 31, 2020. The outstanding commercial real estate loans decreased despite the \$41.1 million increase in originations between the periods as there were also more loans that were paid off during 2021 compared to 2020.

Construction and development loans were \$47.2 million at December 31, 2021, an increase of \$15.7 million, compared to \$31.5 million at December 31, 2020. The increase in construction loans is primarily related to the \$21.5 million increase in the amount of originations and advances on existing loans between the periods. This increase in outstanding construction and development loans was partially offset by an increase in the amount of loans that were either paid off or moved to another loan category after the construction projects were completed.

Home equity lines of credit were \$17.5 million at December 31, 2021, a decrease of \$3.8 million, compared to \$21.3 million at December 31, 2020. The open-end home equity lines are generally written with an adjustable rate and a two to ten year draw period which requires interest only payments followed by a ten year repayment period which fully amortizes the outstanding balance. Home equity loans were \$7.5 million at December 31, 2021, a decrease of \$4.0 million, compared to \$11.5 million at December 31, 2020. Closed-end home equity loans are written with fixed or adjustable rates with terms up to fifteen years. The overall decrease in the open-end equity lines and closed-end equity loans is related primarily to an increase in loan payoffs and other principal reductions as borrowers refinanced their homes and rolled outstanding equity loan balances into their first mortgage.

Recreational vehicle loans were \$11.0 million at December 31, 2021, a decrease of \$4.6 million, compared to \$15.6 million at December 31, 2020. These loans have been made primarily to finance the recreational vehicle sales of a single dealer within the Bank's market area and the decrease in the balance between the periods is primarily due to a decrease in originations as a result of discontinuing the recreational vehicle loan program in 2021.

Commercial business loans were \$60.2 million at December 31, 2021, a decrease of \$22.5 million, compared to \$82.7 million at December 31, 2020. The decrease in commercial business loans in 2021 is primarily because of the \$31.0 million decrease in outstanding PPP loans between the periods due to the repayments that occurred during the year. The \$8.5 million increase in non-PPP commercial business loans is because of an increase in originations between the periods.

#### Allowance for Loan Losses

The determination of the allowance for loan losses and the related provision is a critical accounting policy of the Company that is subject to significant estimates. The allowance for loan losses is made up of general reserves on the entire loan portfolio and specific reserves on impaired loans. The general reserve amount includes quantitative reserves based on our past loan loss history and qualitative reserves for other items determined to have a potential impact on future loan losses. The current level of the allowance for loan losses is a result of management's assessment of the risks within the portfolio based on the information obtained through the credit evaluation process. The Company utilizes a risk-rating system on non-homogeneous commercial real estate and commercial business loans that includes regular credit reviews to identify and quantify the risk in the commercial portfolio. Management conducts quarterly reviews of the entire loan portfolio and evaluates the need to adjust the allowance balance on the basis of these reviews.

Management actively monitors asset quality and, when appropriate, charges off loans against the allowance for loan losses. Although management believes it uses the best information available to make determinations with respect to the allowance for loan losses, future adjustments may be necessary if economic conditions differ substantially from the economic conditions in the assumptions used to determine the size of the allowance for loan losses.

The allowance for loan losses was \$9.3 million, or 1.40% of gross loans at December 31, 2021, compared to \$10.7 million, or 1.64% of gross loans at December 31, 2020. The allowance for loan losses decreased in 2021 primarily because of a decrease in qualitative reserves related to the COVID-19 pandemic. The decrease in qualitative reserves for COVID-19 was due to an improvement in the underlying operations supporting many of the loans that were initially negatively impacted by the COVID-19 pandemic.

The following table reflects the activity in the allowance for loan losses and selected statistics:

<i>(Dollars in thousands)</i>	December 31,	
	2021	2020
Balance at beginning of year	\$ 10,699	8,564
Provision for losses	(2,119)	2,699
Charge-offs:		
Commercial real estate	(36)	(730)
Consumer	(42)	(84)
Commercial business	0	(8)
Recoveries	777	258
Net recoveries (charge-offs)	699	(564)
Balance at end of year	\$ 9,279	10,699
Year end allowance for loan losses as a percent of year end gross loan balance	1.40%	1.64%
Ratio of net loan recoveries (charge-offs) to average loans outstanding	0.11	(0.09)
Allowance as a percent of total assets at year end	0.87	1.18

The following table presents information related to net recoveries (charge-offs) by loan category:

	2021		2020	
	Net Recoveries	Ratio of Net Recoveries to Average Loans Outstanding	Net (Charge-offs) Recoveries	Ratio of Net (Charge-offs) Recoveries to Average Loans Outstanding
<i>(Dollars in thousands)</i>				
Commercial real estate	\$ 617	0.16%	\$ (703)	(0.19)%
Consumer	16	0.30	(55)	(0.09)
Commercial business	66	0.09	194	0.26
	<u>\$ 699</u>	<u>0.11</u>	<u>\$ (564)</u>	<u>(0.09)</u>

The following table reflects the allocation of the allowance for loan losses by loan category:

	December 31,			
	2021		2020	
	Allocated Allowance as a % of Loan Category	Percent of Loans in Each Category to Total Loans	Allocated Allowance as a % of Loan Category	Percent of Loans in Each Category to Total Loans
<i>(Dollars in thousands)</i>				
Single family	0.60%	24.67%	0.76%	20.65%
Commercial real estate	1.61	59.95	1.92	58.23
Consumer	2.35	6.29	2.51	8.47
Commercial business	1.56	9.09	1.19	12.65
Total	<u>1.40</u>	<u>100.00%</u>	<u>1.64</u>	<u>100.00%</u>

The allocated allowance percentages for all loan categories, except commercial business loans, decreased in 2021 primarily because of the reduction in the required reserves due to the reduced economic impact of the COVID-19 pandemic. The increase in the allowance percentage for commercial business loans between the periods is due to the \$31.0 million decrease in PPP loans that are included in this category that are guaranteed by the SBA and have no allocated allowance amount.

#### *Allowance for Real Estate Losses*

Real estate properties acquired or expected to be acquired through loan foreclosures are initially recorded at fair value less estimated selling costs. Management periodically performs valuations and an allowance for losses is established if the carrying value of a property exceeds its fair value less estimated selling costs. There was no allowance for real estate losses at December 31, 2021 or 2020.

#### *Non-performing Assets*

Loans are reviewed at least quarterly and if the collectability of any loan is doubtful, it is placed on non-accrual status. Loans are placed on non-accrual status when either principal or interest is 90 days or more past due, unless, in the judgment of management, the loan is well collateralized and in the process of collection. Interest accrued and unpaid at the time a loan is placed on non-accrual status is charged against interest income. Subsequent payments are either applied to the outstanding principal balance or recorded as interest income, depending on the assessment of the ultimate collectability of the loan. Restructured loans include the Bank's troubled debt restructurings (TDRs) that involved forgiving a portion of interest or principal or making a loan with terms that the Bank would not normally grant to borrowers whose financial condition had deteriorated. Foreclosed and repossessed assets include assets acquired in settlement of loans. Total non-performing assets were \$4.9 million at December 31, 2021, an increase of \$1.6 million, or 47.9%, from \$3.3 million at December 31, 2020. Non-performing loans increased \$1.9 million and foreclosed and repossessed assets decreased \$0.3 million during 2021. The increase in non-performing loans is primarily related to a \$3.4 million hotel loan that was classified as non-performing during the year that was partially offset by a \$1.0 million commercial real estate loan that was classified as non-performing at December 31, 2020 that became performing during 2021. The decrease in the foreclosed and repossessed assets is related to changes in foreclosed commercial properties between the periods.

The following table sets forth the amounts and categories of non-performing assets in the Company's portfolio:

<i>(Dollars in thousands)</i>	December 31,	
	2021	2020
Non-performing loans:		
Single family	\$ 340	502
Commercial real estate	3,757	1,484
Consumer	517	689
Commercial business	7	9
Total	4,621	2,684
Foreclosed and repossessed assets:		
Commercial real estate	290	636
Total	290	636
Total non-performing assets	\$ 4,911	3,320
Total as a percentage of total assets	0.46%	0.37%
Total non-performing loans	\$ 4,621	\$ 2,684
Total as a percentage of total loans receivable	0.70%	0.41%
Allowance for loan losses to non-performing loans	200.81%	398.72%

Gross interest income which would have been recorded had the non-acruing loans been current in accordance with their original terms amounted to \$0.3 million for the year ended December 31, 2021 and \$0.2 million for the year ended December 31, 2020. The amounts that were included in interest income on a cash basis for these loans were \$0.2 million for the year ended December 31, 2021 and \$0.1 million for the year ended December 31, 2020.

At December 31, 2021 and 2020, there were loans included in loans receivable, net, with terms that had been modified in a TDR totaling \$1.1 million and \$1.5 million, respectively. Had these loans been performing in accordance with their original terms throughout 2021 and 2020, the Company would have recorded gross interest income of \$0.1 million in both years. During 2021 and 2020, the amount of interest income received on these loans was not material.

For the loans that were modified in 2021, none were classified and performing, and \$0.3 million were non-performing at December 31, 2021. The decrease in TDRs in 2021 related primarily to a single family first mortgage loan that paid off during the year. Of the loans that were modified in 2021 and outstanding at December 31, 2021, \$0.2 million related to a loan secured by commercial real estate and \$0.1 million consisted of two unrelated loans secured by first mortgages on single family properties.

For the loans that were modified in a TDR in 2020, none were classified and performing and \$0.3 million were non-performing at December 31, 2020. The decrease in TDRs in 2020 was primarily due to two related commercial loans that had performed according to their restructured terms and met the criteria to be upgraded to non-TDR status during the year. Of the loans that were modified in 2020 and outstanding at December 31, 2020, \$0.2 million related to a loan secured by commercial real estate and \$0.1 million related to a loan secured by a first mortgage on a single family property.

The following table sets forth the amount of TDRs in the Company's portfolio:

<i>(Dollars in thousands)</i>	December 31,	
	2021	2020
Single family	\$ 254	612
Commercial real estate	355	211
Consumer	442	630
Commercial business	0	25
Total TDRs	\$ 1,051	1,478
TDRs on accrual status	\$ 29	442
TDRs on non-accrual status	1,022	1,036
Total	\$ 1,051	1,478

This TDR table does not include loan accommodations that were granted during 2021 and 2020 to borrowers in accordance with the *Interagency Statement on Loan Modification and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus* or Section 4013 of the CARES Act. See "Note 6 Allowance for Loan Losses and Credit Quality Information" in the Notes to Consolidated Financial Statements for further information on accommodations that were granted to borrowers in 2021 and 2020.

## Liquidity and Capital Resources

The Company manages its liquidity position so that the funding needs of borrowers and depositors are met in a timely and cost-effective manner. Asset liquidity is the ability to convert assets to cash through the maturity or sale of the asset. Liability liquidity is the ability of the Bank to obtain retail, internet, or brokered deposits or to borrow funds from third parties such as the FHLB or the Federal Reserve Bank of Minneapolis.

The primary investing activities are the origination of loans and the purchase of securities. Principal and interest payments on loans and securities, along with the proceeds from the sale of loans held for sale, are the primary sources of cash for the Bank. Additional cash can be obtained by selling securities from the available for sale portfolio or by selling loans or mortgage servicing rights.

The primary financing activity is the attraction of retail, commercial and internet deposits. The Bank also has the ability to borrow funds from the FHLB or Federal Reserve Bank of Minneapolis based on the collateral value of the loans pledged, subject to applicable borrowing base and collateral requirements. See "Note 12 Federal Home Loan Bank (FHLB) Advances and Other Borrowings" in the Notes to Consolidated Financial Statements for more information on the advances that could be drawn based upon existing collateral levels with the FHLB and the Federal Reserve Bank of Minneapolis. Unpledged securities could also be pledged and used as collateral for additional borrowings with the FHLB or Federal Reserve Bank of Minneapolis.

The Bank's most liquid assets are cash and cash equivalents, which consist of short-term highly liquid investments with original maturities of less than three months that are readily convertible to known amounts of cash, and interest-bearing deposits. The level of these assets is dependent on the operating, financing and investing activities during any given period.

Cash and cash equivalents for the Company at December 31, 2021 were \$94.1 million, an increase of \$7.8 million, compared to \$86.3 million at December 31, 2020. Net cash provided by operating activities during 2021 was \$24.3 million. The Company conducted the following major investing activities during 2021: purchases of securities available for sale and FHLB stock were \$214.0 million; principal payments and maturity proceeds received on securities available for sale were \$71.1 million; and the proceeds from the sale of premises and other real estate were \$2.1 million. Net loans receivable increased \$18.4 million and the Company purchased premises and equipment of \$8.3 million. Net cash used by investing activities during 2021 was \$167.4 million. The Company conducted the following major financing activities during 2021: deposits increased \$155.5 million; purchased treasury stock of \$4.6 million; and customer escrows increased \$0.1 million. Net cash provided by financing activities was \$151.0 million for 2021.

The Bank has certificates of deposits from customers with outstanding balances of \$62.3 million that mature during 2022. Based upon past experience, management anticipates that the majority of the deposits will renew for another term. The Company believes that deposits that do not renew will be replaced with deposits from other customers or FHLB advances. Proceeds from the sale of securities could also be used to fund unanticipated outflows of deposits.

The Bank has deposits of \$161.5 million in checking and money market accounts of eleven customers that have individual relationship balances greater than \$5.0 million. These funds may be withdrawn at any time, however, management anticipates that the majority of these deposits will remain on deposit with the Bank over the next twelve months. If these deposits are withdrawn, it is anticipated that they would be funded with available cash, replaced with deposits from other customers or with advances from the FHLB. Proceeds from the sale of securities could also be used to fund unanticipated outflows of deposits.

Dividends from the Bank have been the Company's primary source of cash. The Bank is restricted under applicable federal banking law from paying dividends to the Company without prior notice to and non-objection of the applicable regulator. During 2021, the Bank paid dividends to the Company of \$6.0 million and at December 31, 2021, the Company had an available cash balance of \$12.5 million.

The Company's primary use of cash is the payment of holding company level expenses including the payment of director and management fees, legal expenses and regulatory costs. The Company may also use cash to repurchase stock or pay any declared dividends. The Company plans to continue to fund its liquidity needs through dividends from the Bank, or if deemed prudent, by obtaining external capital.

### ***Contractual Obligations and Commercial Commitments***

The Company has no off-balance sheet arrangements other than commitments to originate and sell loans in the ordinary course of business. The Company does have certain obligations and commitments to make future payments under existing contracts. See “*Note 18 Commitments and Contingencies*” in the Notes to Consolidated Financial Statements for further information on the outstanding contractual obligations and commercial commitments at December 31, 2021.

### ***Regulatory Capital Requirements***

The Bank is subject to the Basel III regulatory capital requirements. The Basel III requirements, among other things, (i) apply a set of capital requirements to the Bank, including requirements relating to common equity as a component of core capital, (ii) implement a “capital conservation buffer” against risk and a minimum Tier 1 capital requirement, and (iii) set forth rules for calculating risk-weighted assets for purposes of such requirements. The rules made corresponding revisions to the prompt corrective action framework and include capital ratios and buffer requirements. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of its assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

The Board of Governors of the Federal Reserve Bank (FRB) amended its Policy Statement, to exempt small bank and savings and loan holding companies with assets less than \$3 billion from the above capital requirements. The Company currently meets the qualitative exemption requirements, and therefore, is exempt from the above capital requirements.

Quantitative measures established by regulations to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of common equity Tier 1 capital to risk-weighted assets, Tier 1 capital to adjusted total assets, Tier 1 capital to risk-weighted assets and total capital to risk-weighted assets.

The Bank must maintain a capital conservation buffer of at least 2.50% composed of common equity Tier 1 capital above its minimum risk-based capital requirements in order to avoid limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers. Management believes that, as of December 31, 2021, the Bank's capital ratios were in excess of those quantitative capital ratio standards set forth under the current prompt corrective action regulations, including the capital conservation buffer described above. However, there can be no assurance that the Bank will continue to maintain such status in the future. The OCC has extensive discretion in its supervisory and enforcement activities, and can adjust the requirement to be well-capitalized in the future. See “*Note 17 Regulatory Capital*” in the Notes to Consolidated Financial Statements for a table that reflects the Bank's capital compared to these capital requirements.

The Company also serves as a source of capital, liquidity and financial support to the Bank. Depending upon the operating performance of the Bank and the Company's other liquidity and capital needs, the Company may find it prudent, subject to prevailing capital market conditions and other factors, to raise additional capital through issuance of its common stock or other equity securities. Additional capital would potentially permit the Company to implement a strategy of growing Bank assets. Depending on the circumstances, if it were to raise capital, the Company may deploy it to the Bank for general banking purposes, or may retain some or all of it for use by the Company.

If the Company raises capital through the issuance of additional shares of common stock or other equity securities, it would dilute the ownership interests of existing stockholders and could result in a change in control of the Company and the Bank. New investors may also have rights, preferences and privileges senior to the Company's current stockholders which may adversely impact the Company's current stockholders. The Company's ability to raise additional capital through the issuance of equity securities, if deemed prudent, will depend on, among other factors, conditions in the capital markets at that time, which are outside of the Company's control. Accordingly, the Company may not be able to raise additional capital, if deemed prudent, on favorable economic terms, or other terms acceptable to it.

### ***Dividends***

The declaration of dividends is subject to, among other things, the Company's financial condition and results of operations, the Bank's compliance with regulatory capital requirements and other regulatory restrictions, tax considerations, industry standards, economic conditions, anticipated asset growth, general business practices and other factors. The Company did not make any dividend payments to common stockholders during the two-year period ending December 31, 2021 but will continue to evaluate the best use of the Company's capital based on the factors identified above.

Under applicable federal banking laws and regulations, no dividends can be declared or paid by the Bank to the Company without notice to and non-objection from the applicable banking regulator. There is no assurance that the Bank and the Company would satisfy the applicable regulatory requirements necessary to effect any such dividends. The payment of dividends by the Company is dependent upon the Company having adequate cash or other assets that can be converted to cash to pay dividends to its stockholders and is subject to the discretion of the Board of Directors of both the Bank and the Company and would depend on numerous factors including the results of operations, financial conditions, asset growth plans, planned stock repurchases, and the cash flow requirements of the Company and the Bank.

In January 2022, the Company's Board of Directors declared a quarterly dividend of 6 cents per share of common stock payable on March 9, 2022 to stockholders of record at the close of business on February 16, 2022. The declaration and amount of any future cash dividends remains subject to the sole discretion of the Board of Directors and will depend upon many factors, including the Company's results of operations, financial condition, capital requirements, regulatory and contractual restrictions, business strategy and other factors deemed relevant by the Board of Directors.

#### New Accounting Pronouncements

"Note 1 Description of the Business and Summary of Significant Accounting Policies" in the Notes to Consolidated Financial Statements discusses recently issued accounting pronouncements that the Company will be required to adopt. Also discussed is management's expectation of the impact these new accounting pronouncements will have on the Company's consolidated financial statements.

#### Market Risk

Market risk is the risk of loss from adverse changes in market prices and rates. The Company's market risk arises primarily from interest rate risk inherent in its investing, lending and deposit taking activities. Management actively monitors and manages its interest rate risk exposure.

The Company's profitability is affected by fluctuations in interest rates. A sudden and substantial change in interest rates may adversely impact the Company's earnings to the extent that the interest rates borne by assets and liabilities do not change at the same speed, to the same extent, or on the same basis. The Company monitors the projected changes in net interest income that occur if interest rates were to suddenly change up or down. The *Rate Shock Table* located in the following Asset/Liability Management section of this Management's Discussion and Analysis discloses the Company's projected changes in net interest income based upon immediate interest rate changes called rate shocks.

The Company utilizes a model that uses the discounted cash flows from its interest-earning assets and its interest-bearing liabilities to calculate the current market value of those assets and liabilities. The model also calculates the changes in market value of the interest-earning assets and interest-bearing liabilities under different interest rate changes.

The following table discloses the projected changes in market value to the Company's interest-earning assets and interest-bearing liabilities based upon incremental 100 basis point changes in interest rates from interest rates in effect on December 31, 2021.

<i>(Dollars in thousands)</i>	Market Value			
	-100	0	+100	+200
Basis point change in interest rates				
Total market-risk sensitive assets	\$ 1,075,897	1,059,780	1,037,029	1,013,668
Total market-risk sensitive liabilities	980,648	920,067	870,045	826,865
Off-balance sheet financial instruments	(66)	0	409	780
Net market risk	\$ 95,315	139,713	166,575	186,023
Percentage change from current market value	(31.78)%	0.00%	19.23%	33.15%

The preceding table was prepared utilizing the following assumptions (the Model Assumptions) regarding prepayment and decay ratios that were determined by management based upon its review of historical prepayment speeds and decay rates. Fixed rate loans were assumed to prepay at annual rates of between 4% and 59%, depending on the note rate and the period to maturity. Adjustable rate mortgages (ARMs) were assumed to prepay at annual rates of between 6% and 49%, depending on the note rate and the period to maturity. Mortgage-backed securities were projected to have prepayments based upon the underlying collateral securing the instrument. All loan prepayments vary based on the note rate and period to maturity of the individual loans. Certificate accounts were assumed not to be withdrawn until maturity. Retail money market demand accounts (MMDAs) and passbook accounts were assumed to decay at an annual rate of 17%. Retail non-interest and interest-bearing checking accounts were assumed to decay at annual rates of 19% and 24%, respectively. Commercial non-interest and interest-bearing checking accounts were assumed to decay at annual rates of 16% and 23%, respectively. Commercial MMDAs were assumed to decay at annual rates of between 13% and 26%.

Certain shortcomings are inherent in the method of analysis presented in the foregoing table. The interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types of assets and liabilities may lag behind changes in market interest rates. The model assumes that the difference between the current interest rate being earned or paid compared to a treasury instrument or other interest index with a similar term to maturity (the interest spread) will remain constant over the interest changes disclosed in the table. Changes in interest spread could impact projected market value changes. Certain assets, such as ARMs, have features that restrict changes in interest rates on a short-term basis and over the life of the assets. The market value of the interest-bearing assets that are approaching their lifetime interest rate caps or floors could be different from the values calculated in the table. Certain liabilities, such as certificates of deposit, have fixed rates that restrict interest rate changes until maturity. In the event of a change in interest rates, prepayment and early withdrawal levels may deviate significantly from those assumed in calculating the foregoing table. The ability of many borrowers to service their debt may also decrease in the event of a substantial increase in interest rates.

*Asset/Liability Management*

The Company's management reviews the impact that changing interest rates will have on the net interest income projected for the twelve months following December 31, 2021 to determine if its current level of interest rate risk is acceptable. The following table projects the estimated impact on net interest income during the twelve month period ending December 31, 2022 of immediate interest rate changes called rate shocks:

<i>(Dollars in thousands)</i>				
Rate Shock in Basis Points		Net Interest Change		Percent Change
+200	\$	1,474		5.48%
+100		725		2.70
0		0		0.00
-100		(1,436)		(5.34)

The preceding table was prepared utilizing the Model Assumptions. Certain shortcomings are inherent in the method of analysis presented in the preceding table. In the event of a change in interest rates, prepayment and early withdrawal levels would likely deviate significantly from those assumed in calculating the preceding table. The ability of many borrowers to service their debt may decrease in the event of a substantial increase in interest rates and could impact net interest income. The increase in interest income in a rising rate environment is because there are more loans that are anticipated to reprice to higher interest rates in that environment in the next twelve months than there are deposits that would reprice.

In managing the Company's exposure to changes in interest rates, management closely monitors interest rate risk. The Company has an Asset/Liability Committee that meets frequently to discuss changes in the interest rate risk position and projected profitability. The Committee makes adjustments to the asset/liability position of the Bank that are reviewed by the Board of Directors of the Bank. This Committee also reviews the Bank's portfolio, formulates investment strategies and oversees the timing and implementation of transactions as intended to assure attainment of the Bank's objectives in an effective manner. In addition, each quarter the Board reviews the Bank's asset/liability position, including simulations of the effect on the Bank's capital of various interest rate scenarios.

In managing its asset/liability composition, the Bank may, at times, depending on the relationship between long-term and short-term interest rates, market conditions and consumer preference, place more emphasis on managing net interest margin than on better matching the interest rate sensitivity of its assets and liabilities in an effort to enhance net interest income. Management believes that the increased net interest income resulting from a mismatch in the maturity of its asset and liability portfolios can, in certain situations, provide high enough returns to justify the increased exposure to sudden and unexpected changes in interest rates.

To the extent consistent with its interest rate spread objectives, the Bank attempts to manage its interest rate risk and has taken a number of steps to structure its balance sheet to better match the maturities of its assets and liabilities. The Bank sells almost all of its originated 30-year fixed rate single family residential loans that are saleable to third parties and generally places only adjustable rate or shorter-term fixed rate loans that meet certain risk characteristics into its loan portfolio. In addition, a significant portion of the Bank's commercial loans that are placed into the portfolio are adjustable rate loans or fixed rate loans that reprice in less than five years.



**Consolidated Balance Sheets**

<i>(Dollars in thousands, except par value)</i>	December 31, 2021	December 31, 2020
<b>ASSETS</b>		
Cash and cash equivalents	\$ 94,143	86,269
Securities available for sale:		
Mortgage-backed and related securities (amortized cost \$247,275 and \$99,821)	245,397	101,464
Other marketable securities (amortized cost \$40,691 and \$46,491)	40,368	46,626
Total securities available for sale	<u>285,765</u>	<u>148,090</u>
Loans held for sale	5,575	6,186
Loans receivable, net	652,502	642,630
Accrued interest receivable	2,132	3,102
Mortgage servicing rights, net	3,280	3,043
Premises and equipment, net	17,373	10,133
Goodwill	802	802
Core deposit intangible	10	57
Prepaid expenses and other assets	5,427	7,241
Deferred tax asset, net	2,529	2,027
Total assets	<u>\$ 1,069,538</u>	<u>909,580</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Deposits	\$ 950,666	795,204
Accrued interest payable	63	140
Customer escrows	2,143	1,998
Accrued expenses and other liabilities	6,635	8,986
Total liabilities	<u>959,507</u>	<u>806,328</u>
Commitments and contingencies		
Stockholders' equity:		
Serial-preferred stock (\$.01 par value):		
authorized 500,000 shares; issued 0	0	0
Common stock (\$.01 per value):		
authorized 16,000,000 shares; issued 9,128,662	91	91
Additional paid-in capital	40,740	40,480
Retained earnings, subject to certain restrictions	131,413	117,849
Accumulated other comprehensive (loss) income	(1,583)	1,282
Unearned employee stock ownership plan shares	(1,256)	(1,450)
Treasury stock, at cost 4,564,087 and 4,359,552 shares	(59,374)	(55,000)
Total stockholders' equity	<u>110,031</u>	<u>103,252</u>
Total liabilities and stockholders' equity	<u>\$ 1,069,538</u>	<u>909,580</u>

See accompanying notes to consolidated financial statements.

## Consolidated Statements of Comprehensive Income

Years ended December 31

(Dollars in thousands, except per share amounts)

	2021	2020
<b>Interest income:</b>		
Loans receivable	\$ 29,449	29,924
Securities available for sale:		
Mortgage-backed and related	1,864	1,155
Other marketable	282	702
Other	166	178
<b>Total interest income</b>	<b>31,761</b>	<b>31,959</b>
<b>Interest expense:</b>		
Deposits	1,553	2,851
<b>Total interest expense</b>	<b>1,553</b>	<b>2,851</b>
<b>Net interest income</b>	<b>30,208</b>	<b>29,108</b>
<b>Provision for loan losses</b>	<b>(2,119)</b>	<b>2,699</b>
<b>Net interest income after provision for loan losses</b>	<b>32,327</b>	<b>26,409</b>
<b>Non-interest income:</b>		
Fees and service charges	3,125	2,877
Loan servicing fees	1,555	1,356
Gain on sales of loans	6,566	9,531
Other	3,017	1,319
<b>Total non-interest income</b>	<b>14,263</b>	<b>15,083</b>
<b>Non-interest expense:</b>		
Compensation and benefits	16,114	15,646
Occupancy and equipment	4,372	4,429
Data processing	1,445	1,314
Professional services	1,438	1,405
Other	4,292	4,328
<b>Total non-interest expense</b>	<b>27,661</b>	<b>27,122</b>
<b>Income before income tax expense</b>	<b>18,929</b>	<b>14,370</b>
<b>Income tax expense</b>	<b>5,365</b>	<b>4,068</b>
<b>Net income</b>	<b>13,564</b>	<b>10,302</b>
<b>Other comprehensive (loss) income, net of tax</b>	<b>(2,865)</b>	<b>1,236</b>
<b>Comprehensive income available to common shareholders</b>	<b>\$ 10,699</b>	<b>11,538</b>
<b>Basic earnings per common share</b>	<b>\$ 3.03</b>	<b>2.23</b>
<b>Diluted earnings per common share</b>	<b>\$ 3.01</b>	<b>2.22</b>

See accompanying notes to consolidated financial statements.

**Consolidated Statements of Stockholders' Equity**

<i>(Dollars in thousands)</i>	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Unearned Employee Stock Ownership Plan	Treasury Stock	Total Stockholders' Equity
Balance, December 31, 2019	\$ 91	40,365	107,547	46	(1,643)	(53,758)	92,648
Net income			10,302				10,302
Other comprehensive income				1,236			1,236
Stock repurchases						(1,450)	(1,450)
Restricted stock awards		(268)				268	0
Stock awards withheld for tax withholding						(60)	(60)
Amortization of restricted stock awards		238					238
Earned employee stock ownership plan shares		145			193		338
Balance, December 31, 2020	\$ 91	40,480	117,849	1,282	(1,450)	(55,000)	103,252
Net income			13,564				13,564
Other comprehensive loss				(2,865)			(2,865)
Stock repurchases						(4,589)	(4,589)
Restricted stock awards		(222)				222	0
Stock awards withheld for tax withholding						(7)	(7)
Amortization of restricted stock awards		243					243
Earned employee stock ownership plan shares		239			194		433
Balance, December 31, 2021	\$ 91	40,740	131,413	(1,583)	(1,256)	(59,374)	110,031

See accompanying notes to consolidated financial statements.

**Consolidated Statements of Cash Flows**
*Years ended December 31 (Dollars in thousands)*

	2021	2020
<b>Cash flows from operating activities:</b>		
Net income	\$ 13,564	10,302
Adjustments to reconcile net income to cash provided by operating activities:		
Provision for loan losses	(2,119)	2,699
Depreciation	1,068	1,108
Amortization of premiums, net	1,035	221
Amortization of deferred loan fees	(2,564)	(977)
Amortization of core deposit intangible	47	99
Amortization of purchased asset fair value adjustments	(23)	(29)
Amortization of mortgage servicing rights	1,168	1,318
Capitalized mortgage servicing rights	(1,405)	(2,189)
Deferred income tax expense (credit)	612	(802)
(Gains) losses recognized on equity securities, net	(99)	19
Gains on sale of premises	(15)	(5)
Gains on sale of real estate owned, net	(1,492)	(129)
Gain on sales of loans	(6,566)	(9,531)
Proceeds from sales of loans held for sale	193,078	268,019
Disbursements on loans held for sale	(172,779)	(254,484)
Amortization of restricted stock awards	243	238
Amortization of unearned ESOP shares	194	193
Earned ESOP shares priced above original cost	239	145
Decrease (increase) in accrued interest receivable	970	(851)
Decrease in accrued interest payable	(77)	(280)
Decrease in other assets	1,503	1,175
(Decrease) increase in other liabilities	(2,307)	670
Other, net	28	13
Net cash provided by operating activities	<u>24,303</u>	<u>16,942</u>
<b>Cash flows from investing activities:</b>		
Principal collected on securities available for sale	40,353	17,046
Proceeds collected on maturity of securities available for sale	30,762	41,240
Purchases of securities available for sale	(213,803)	(97,294)
Purchase of Federal Home Loan Bank stock	(159)	(79)
Proceeds from sales of real estate	2,128	434
Net increase in loans receivable	(18,429)	(55,106)
Proceeds from sale of premises	17	12
Purchases of premises and equipment	(8,309)	(734)
Net cash used by investing activities	<u>(167,440)</u>	<u>(94,481)</u>
<b>Cash flows from financing activities:</b>		
Increase in deposits	155,462	121,334
Treasury stock purchased	(4,589)	(1,450)
Stock awards withheld for tax withholding	(7)	(60)
Proceeds from borrowings	1	2
Repayment of borrowings	(1)	(2)
Increase (decrease) in customer escrows	145	(415)
Net cash provided by financing activities	<u>151,011</u>	<u>119,409</u>
Increase in cash and cash equivalents	7,874	41,870
Cash and cash equivalents, beginning of year	86,269	44,399
Cash and cash equivalents, end of year	<u>\$ 94,143</u>	<u>86,269</u>
<b>Supplemental cash flow disclosures:</b>		
Cash paid for interest	\$ 1,630	3,131
Cash paid for income taxes	6,628	3,617
<b>Supplemental noncash flow disclosures:</b>		
Loans transferred to loans held for sale	12,971	6,815
Transfer of loans to real estate owned, net	290	362
Right to use assets obtained in exchange for lease obligations	99	0
Termination of lease right of use assets and lease obligations	2,273	0

*See accompanying notes to consolidated financial statements.*

**NOTE 1 Description of the Business and Summary of Significant Accounting Policies**

HMN Financial, Inc. (HMN or the Company) is a stock savings bank holding company that owns 100 percent of Home Federal Savings Bank (the Bank). The Bank has a community banking philosophy and operates retail banking and loan production facilities in Minnesota, Iowa and Wisconsin. The Bank has two wholly owned subsidiaries, Osterud Insurance Agency, Inc. (OIA), which does business as Home Federal Investment Services and offers financial planning products and services, and HFSB Property Holdings, LLC (HPH), which is currently inactive, but has acted in the past as an intermediary for the Bank in holding and operating certain foreclosed properties.

The consolidated financial statements included herein are for HMN, the Bank, OIA and HPH. All significant intercompany accounts and transactions have been eliminated in consolidation.

The Company evaluated subsequent events through the filing date of our annual 10-K with the Securities and Exchange Commission (SEC) on March 4, 2022.

**Use of Estimates**

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ from those estimates.

An estimate that is particularly susceptible to change relates to the determination of the allowance for loan losses. Management believes that the allowance for loan losses is appropriate to cover probable losses inherent in the portfolio at the date of the balance sheet. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions and other factors. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the allowance for loan losses. Such agencies may require changes to the allowance based on their judgment about information available to them at the time of their examination.

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. These calculations are based on many complex factors including estimates of the timing of reversals of temporary differences, the interpretation of federal and state income tax laws, and a determination of the differences between the tax and the financial reporting basis of assets and liabilities. Actual results could differ significantly from the estimates and interpretations used in determining the current and deferred income tax assets and liabilities.

Estimates related to litigation are inherently subjective and the ultimate resolution of any litigation may be different than current management estimates. See "Note 18 Commitments and Contingencies" for further information on outstanding litigation matters.

**Cash and Cash Equivalents**

The Company considers highly liquid investments with original maturities of three months or less to be cash equivalents.

**Securities**

Securities are accounted for according to their purpose and holding period. The Company classifies its debt securities in one of three categories:

*Trading Securities*

Securities held principally for resale in the near term are classified as trading securities and are recorded at their fair values. Unrealized gains and losses on trading securities are included in other income.

*Securities Held to Maturity*

Securities that the Company has the positive intent and ability to hold to maturity are reported at cost and adjusted for premiums and discounts that are recognized in interest income using the interest method with discounts amortized over the period to maturity and premiums amortized to the earliest call date. Unrealized losses on securities held to maturity reflecting a decline in value judged to be other than temporary are charged to income and a new cost basis is established.

*Securities Available for Sale*

Securities available for sale consist of securities not classified as trading securities or as securities held to maturity. They include securities that management intends to use as part of its asset/liability strategy or that may be sold in response to changes in interest rates, changes in prepayment risk, or similar factors. Unrealized gains and losses, net of income taxes, are reported as a separate component of stockholders' equity until realized. Gains and losses on the sale of securities available for sale are determined using the specific identification method and recognized on the trade date. Premiums and discounts are recognized in interest income using the interest method with discounts amortized over the period to maturity and premiums amortized to the earliest call date. Unrealized losses on securities available for sale reflecting a decline in value judged to be other than temporary are charged to income and a new cost basis is established.

Management monitors the investment security portfolio for impairment on an individual security basis and has a process in place to identify securities that could potentially have a credit impairment that is other than temporary. This process involves analyzing the length of time and extent to which the fair value has been less than the amortized cost basis, the market liquidity for the security, the financial condition and near-term prospects of the issuer, expected cash flows, and the Company's intent and ability to hold the investment for a period of time sufficient to recover the temporary loss, including determining whether it is more-likely-than-not that the Company will be required to sell the security prior to recovery. To the extent it is determined that a security is deemed to be other-than-temporarily impaired, an impairment loss is recognized.

#### ***Equity Securities***

Equity securities are carried at their fair market value with any changes during the period recognized in other income on the consolidated statements of comprehensive income.

#### ***Loans Held for Sale***

Mortgage loans originated which are intended for sale in the secondary market are carried at the lower of cost or estimated market value in the aggregate. Net fees and costs associated with originating loans held for sale are deferred and included in the basis of the loan in determining the gain or loss on the sale of the loans. Gains on the sale of loans are recognized on the settlement date. Net unrealized losses are recognized through a valuation allowance by charges to income.

#### ***Loans Receivable, net***

Loans receivable, net, are carried at amortized cost. Loan origination fees received, net of certain loan origination costs, are deferred as an adjustment to the carrying value of the related loan and are amortized into income using the interest method over the estimated life of the loans.

Premiums and discounts on purchased loans are amortized into interest income using the interest method over the period to contractual maturity, adjusted for estimated prepayments.

The allowance for loan losses is based on a periodic analysis of the loan portfolio and is maintained at an amount considered to be appropriate by management to provide for probable losses inherent in the loan portfolio as of the balance sheet dates. In this analysis, management considers factors including, but not limited to, specific occurrences of loan impairment, actual and anticipated changes in the size of the portfolios, national, regional and local economic conditions (such as unemployment data, loan delinquencies, demand for single family homes, demand for commercial real estate and building lots), loan portfolio composition, historical loss experience, and observations made by the Company's ongoing internal audit and regulatory exam processes. In connection with the determination of the allowance for loan losses, management obtains independent appraisals for significant properties or other collateral securing classified loans. Appraisals on collateral dependent commercial real estate and commercial business loans are obtained when it is determined that the borrower's risk profile has deteriorated and the loan is classified as impaired. Subsequent new third party appraisals of properties securing impaired commercial real estate and commercial business loans are prepared at least every two years. For all land development loan types, a new third party appraisal is prepared on an annual basis where current activity is not materially consistent with the assumptions made in the most recent third party appraisal. Non-performing residential and consumer home equity loans and home equity lines may have a third party appraisal or an internal evaluation completed depending on the size of the loan and location of the property. These appraisals, or internal valuations, are generally completed when a residential or consumer home equity loan or home equity line of credit becomes 120 days past due and are typically updated after possession of the property is obtained. Valuations are reviewed on a quarterly basis and adjustments are made to the allowance for loan losses for temporary impairments and charge-offs are taken when the impairment is determined to be permanent. The fair market value of the properties for all loan types are adjusted for estimated selling costs in order to determine the net realizable value of the properties. Loans are charged off to the extent they are deemed to be uncollectible. The appropriateness of the allowance for loan losses is dependent upon management's estimates of variables affecting valuation, appraisals of collateral, evaluations of performance and status, and the amounts and timing of future cash flows expected to be received on impaired loans. Such estimates, appraisals, evaluations and cash flows may be subject to adjustments due to changing economic prospects of borrowers or properties. The fair market value of collateral dependent loans is typically based on the appraised value of the property less estimated selling costs. The estimates are reviewed periodically and adjustments, if any, are recorded in the provision for loan losses in the periods in which the adjustments become known. The allowance is allocated to individual loan categories based upon the relative risk characteristics of the loan portfolios and the actual loss experience. The Company increases its allowance for loan losses by charging the provision for loan losses against income and decreases its allowance by crediting the provision for loan losses. The methodology for establishing the allowance for loan losses takes into consideration probable losses that have been identified in connection with specific loans as well as losses in the loan portfolio that have not been specifically identified.

Interest income is recognized on an accrual basis except when collectability is in doubt. When loans are placed on a non-accrual basis, generally when the loan is 90 days past due, previously accrued but unpaid interest is reversed from income. If the ultimate collectability of a loan is in doubt and the loan is placed in nonaccrual status, the cost recovery method is used and cash collected is applied to first reduce the principal outstanding. Generally, the Company returns a loan to accrual status when all delinquent interest and principal becomes current under the terms of the loan agreement, the borrower has consistently made the required payments for a period of six months, and the collectability of remaining principal and interest is no longer doubtful. Previously collected interest payments that were applied to principal when the loan was classified as non-accrual are recorded as interest income using the effective yield method over the estimated life of the loan, including expected renewal terms.

All impaired loans are valued at the present value of expected future cash flows discounted at the loan's initial effective interest rate. The fair value of the collateral of an impaired collateral-dependent loan or an observable market price, if one exists, may be used as an alternative to discounting. If the value of the impaired loan is less than the recorded investment in the loan, the impaired amount is charged off. A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impaired loans include all loans which are on non-accrual, delinquent as to principal and interest for 90 days or more, or restructured in a troubled debt restructuring (TDR) involving a modification of terms. All non-accruing loans are reviewed for impairment on an individual basis.

Included in loans receivable, net, are certain loans that have been modified in order to maximize collection of the loan balances. The Company evaluates all loan modifications and if the Company, for legal or economic reasons related to the borrower's financial difficulties, grants a concession compared to the original terms and conditions of the loan that the Company would not otherwise consider, the modified loan is considered a TDR and is classified as an impaired loan. If the TDR loan was performing (accruing) prior to the modification, it typically will remain accruing after the modification as long as it continues to perform according to the modified terms. If the TDR loan was non-performing (non-accruing) prior to the modification, it will remain non-accruing after the modification for a minimum of six months. If the loan performs according to the modified terms for a minimum of six months, it typically will be returned to accruing status. In general, there are two conditions in which a TDR loan is no longer considered to be a TDR and potentially not classified as impaired. The first condition is when the loan is refinanced with terms that reflect normal market terms for the type of credit involved and performs according to the modified terms for a period of at least one year. The second condition is when the loan is repaid or charged off.

The *Interagency Statement on Loan Modification and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus* and section 4013 of the CARES Act allows financial institutions to grant modifications of loans to borrowers that were impacted by the pandemic without classifying the modifications as TDR's. See "*Note 6 Allowance for Loan Losses and Credit Quality Information*" for additional information on accommodations that were granted to borrowers in 2021 and 2020.

#### ***Transfers of Financial Assets and Participating Interests***

Transfers of an entire financial asset or a participating interest in an entire financial asset are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

The transfer of a participating interest in an entire financial asset must also meet the definition of a participating interest. A participating interest in a financial asset has all of the following characteristics: (1) from the date of transfer, it must represent a proportionate (pro rata) ownership interest in the financial asset, (2) from the date of transfer, all cash flows received, except any cash flows allocated as any compensation for servicing or other services performed, must be divided proportionately among participating interest holders in the amount equal to their share of ownership, (3) the rights of each participating interest holder must have the same priority, and (4) no party has the right to pledge or exchange the entire financial asset unless all participating interest holders agree to do so.

#### ***Real Estate, net***

Real estate acquired through loan foreclosure or deed in lieu of foreclosure is initially recorded at its fair value less estimated selling costs. Third party appraisals are obtained as soon as practical after obtaining possession of the property. Valuations are reviewed quarterly by management and an allowance for losses is established if the carrying value of a property exceeds its fair value less estimated selling costs.

***Mortgage Servicing Rights, net***

Mortgage servicing rights are capitalized at their fair value and amortized in proportion to, and over the period of, estimated net servicing income. The Company evaluates its capitalized mortgage servicing rights for impairment each quarter. Loan type and note rate are the predominant risk characteristics of the underlying loans used to stratify capitalized mortgage servicing rights for purposes of measuring impairment. Any impairment is recognized through a valuation allowance.

***Premises and Equipment, net***

Land is carried at cost. Office buildings, improvements, and furniture and equipment are carried at cost less accumulated depreciation. Depreciation is computed on a straight-line basis over their estimated useful lives of 5 to 40 years for office buildings and improvements and 3 to 10 years for furniture and equipment.

***Goodwill***

The Company records goodwill for acquisition amounts paid in excess of the net assets purchased. Goodwill is not amortized but is tested for impairment at least annually or more frequently if there are indications of impairment.

***Core Deposit Intangible, net***

The Company records the estimated fair value of the deposit base acquired in an acquisition as a core deposit intangible asset. The recorded amount is amortized on a straight line basis over the estimated life of the deposits acquired.

***Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of***

The Company reviews long-lived assets and certain identifiable intangibles for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

***Stock Based Compensation***

The Company recognizes the grant-date fair value of stock options and restricted stock awards issued as compensation expense, amortized over the vesting period.

***Employee Stock Ownership Plan (ESOP)***

The Company has an ESOP that borrowed funds from the Company and purchased shares of HMN common stock. The Company makes quarterly principal and interest payments on the ESOP loan. As the debt is repaid, ESOP shares that were pledged as collateral for the debt are released from collateral based on the proportion of debt service paid in the year and then allocated to eligible employees. The Company accounts for its ESOP in accordance with ASC 718, *Employers' Accounting for Employee Stock Ownership Plans*. Accordingly, the shares pledged as collateral are reported as unearned ESOP shares in stockholders' equity. As shares are determined to be ratably released from collateral, the Company reports compensation expense equal to the current market price of the shares, and the shares become outstanding for earnings per share computations.

***Income Taxes***

Deferred tax assets and liabilities are recognized for future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date. A valuation allowance is required to be recognized if it is more-likely-than-not that the deferred tax asset will not be realized. The determination of the realizability of the deferred tax asset is subjective and dependent upon judgment concerning management's evaluation of both positive and negative evidence regarding the ultimate realizability of deferred tax assets. The Company is no longer subject to federal or state income tax examinations by tax authorities for years before 2018.

***Earnings per Common Share***

Basic earnings per common share excludes dilution and is computed by dividing the income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted earnings per common share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that shared in the earnings of the entity.

***Comprehensive Income***

Comprehensive income is defined as the change in equity during a period from transactions and other events from non-owner sources. Comprehensive income is the total of net income and other comprehensive (loss) income, which for the Company is comprised of unrealized losses and gains on securities available for sale.

***Segment Information***

The amount of each segment item reported is the measure reported to the chief operating decision maker for purposes of making decisions about allocating resources to the segment and assessing its performance. Adjustments and eliminations made in preparing an enterprise's general-purpose financial statements and allocations of revenues, expenses, and gains or losses are included in determining reported segment profit or loss if they are included in the measure of the segment's profit or loss that is used by the chief operating decision maker. Similarly, only those assets that are included in the measure of the segment's assets that are used by the chief operating decision maker are reported for that segment.



### ***New Accounting Pronouncements***

In June 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-13, *Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The amendments in this ASU affect all entities that measure credit losses on financial instruments including loans, debt securities, trade receivables, net investments in leases, off-balance sheet credit exposures, reinsurance receivables, and any other financial asset that has a contractual right to receive cash that is not specifically excluded. The main objective of this ASU is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. To achieve this objective, the amendments in this ASU replace the incurred loss impairment methodology required in current GAAP with a methodology that reflects expected credit losses that requires consideration of a broader range of reasonable and supportable information to estimate credit losses. The amendments in this ASU will affect entities to varying degrees depending on the credit quality of the assets held by the entity, the duration of the assets held, and how the entity applies the current incurred loss methodology. The amendments in this ASU, for public business entities that are filers with the Securities and Exchange Commission (SEC), were originally effective for fiscal years beginning after December 15, 2019, including interim periods within those annual periods. On November 26, 2019, the FASB issued ASU 2019-11, *Codification Improvements to Topic 326, Financial Instruments – Credit Losses* which delayed the implementation date of ASU 2016-13 for SEC smaller reporting companies, such as HMN, from the first quarter of 2020 to the first quarter of 2023. All entities may adopt the amendments in the ASU early as of the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Amendments should be applied using a modified retrospective transition method by means of a cumulative-effect adjustment to equity as of the beginning of the period in which the guidance is adopted. The Company has not early adopted this ASU. Management has accumulated the charge off information necessary to calculate the appropriate life of loan loss percentages for the various loan categories, has identified several key metrics to help identify and project anticipated changes in the credit quality of the Bank's loan portfolio upon enactment, has identified some qualitative reserve metrics and amounts, and has prepared preliminary calculations using the new methodology as outlined in the ASU. Based on the preliminary calculations it is not anticipated that the adoption of this ASU will have a material impact on the Company's consolidated financial statements when it is adopted in the first quarter of 2023.

On February 6, 2020, the FASB issued ASU 2020-02, *Financial Instruments-Credit Losses (Topic 326) and Leases (Topic 842)-Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 119 and Update to SEC Section on Effective Date Related to Accounting Standards Update No. 2016-02, Leases (Topic 842)*. The amendments in this ASU related to *Leases (Topic 842)* did not have any impact on the Company. The amendments in this ASU related to Topic 326 adds additional guidance related to the SEC's expectations for the documentation of the measurement, review process, and the systematic methodology used by entities to determine the current credit losses under FASB ASC Topic 326. It is anticipated that this additional guidance will require periodic third party reviews of the Company's calculation of the allowance for credit losses in subsequent periods after ASC Topic 326 is adopted in the first quarter of 2023.

### ***Derivative Financial Instruments***

The Company uses derivative financial instruments in order to manage the interest rate risk on residential loans held for sale and its commitments to extend credit for residential loans. The Company may also from time to time use interest rate swaps to manage interest rate risk. Derivative financial instruments include commitments to extend credit and forward mortgage loan sales commitments.

### ***Reclassifications***

Certain amounts in the consolidated financial statements for the prior year have been reclassified to conform to the current year presentation.

### **NOTE 2 Revenue Recognition**

The Company recognizes revenue in accordance with ASU 2014-09 (*Topic 606*) and all subsequent amendments to the ASU (collectively, "ASC 606"). The Company's services that fall within the scope of ASC 606 are presented on the income statement within non-interest income and are recognized as revenue as the Company satisfies its performance obligation to the customer. Services within the scope of ASC 606 include fees and service charges on deposit accounts, ATM and debit card interchange income, safe deposit box rental fees, check printing charges, income earned on the sale of uninsured investment products, and gains or losses recognized on the sale of real estate owned.

The following table presents the Company's sources of non-interest income for the years ended December 31, 2021 and 2020. Sources of revenue outside the scope of ASC 606 are noted as such.

<i>(Dollars in thousands)</i>	Year Ended December 31,	
	2021	2020
<b>Non-interest income:</b>		
Fees and service charges on deposit accounts	\$ 979	986
Other fees and service charges	392	369
Debit card interchange fees	1,754	1,522
Gain on sale of loans (1)	6,566	9,531
Loan servicing fees (1)	1,555	1,356
Uninsured investment product sales	1,208	991
Other	1,809	328
<b>Total non-interest income</b>	<b>\$ 14,263</b>	<b>15,083</b>

(1) Not within the scope of ASC 606.

A description of the Company's revenue categories that are accounted for under ASC 606 is as follows:

***Fees and Service Charges on Deposit Accounts***

The Company earns fees from deposit customers for transaction-based, account maintenance, and overdraft services. Transaction-based fees, which include services such as ATM use fees, wire transfer fees, check cashing fees, stop payment charges, statement rendering charges, ACH fees, and other deposit related fees, are recognized at the time the transaction is executed or when the Company fulfills the customer's request. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period over which the Company satisfies the performance obligation. Overdraft fees are recognized at the point in time that the overdraft occurs. Service charges on deposit accounts are recognized when they are withdrawn from the customer's account balance.

***Other Fees and Service Charges***

Other fees and service charges consist of revenues that are both within the scope of and outside the scope of ASC 606. Other fees and service charges within the scope of ASC 606 consist of fees for the rental of safe deposit boxes and check printing charges. Revenues for these fees are recognized over the period the service is provided or the fee is incurred by the customer. Other fees and service charges outside the scope of ASC 606 consist of loan commitment fees and late charges on loans.

***Debit Card Interchange Fees***

The Company earns interchange fees from debit card holder transactions conducted through various payment networks. Interchange fees from cardholder transactions are recognized daily, concurrently with the transaction processing services provided by an outsourced technology solution and are presented on a net basis.

***Uninsured Investment Product Sales***

Commission revenues on the sale of uninsured investment products may be recognized up front on the sale date of the investment or monthly over a period of years depending on the product being sold. The commissions on investment sales are recognized when the product sale is completed or monthly for trailer fees in accordance with the customer agreement. Any subsequent commission adjustments are recognized upon our receipt of notification from the investment companies concerning matters necessitating such adjustments. Profit-sharing contingent commissions are recognized when determinable, which is generally when such commissions are received from the investment companies.

***Other***

Other non-interest income consists of revenues that are both within the scope of and outside the scope of ASC 606. Other income within the scope of ASC 606 consists of gains and losses on asset sales and gains and losses on the sale of real estate owned which are recognized when the asset or real estate is sold. Other income outside the scope of ASC 606 consists of gains and losses on equity securities and rental income on buildings.

**NOTE 3 Other Comprehensive (Loss) Income**

The components of other comprehensive (loss) income and the related tax effects were as follows:

	For the Years Ended December 31,					
	2021			2020		
<i>(Dollars in thousands)</i>	Before Tax	Tax Effect	Net of Tax	Before Tax	Tax Effect	Net of Tax
Securities available for sale:						
Unrealized (losses) gains arising during the period	\$ (3,979)	(1,114)	(2,865)	1,714	478	1,236
Other comprehensive (loss) income	\$ (3,979)	(1,114)	(2,865)	1,714	478	1,236

**NOTE 4 Securities Available for Sale**

A summary of securities available for sale at December 31, 2021 and 2020 is as follows:

<i>(Dollars in thousands)</i>	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>December 31, 2021</b>				
<b>Mortgage-backed securities:</b>				
Federal National Mortgage Association (FNMA)	\$ 138,628	550	(1,367)	137,811
Federal Home Loan Mortgage Corporation (FHLMC)	108,599	126	(1,189)	107,536
<b>Collateralized mortgage obligations:</b>				
FNMA	48	2	0	50
	247,275	678	(2,556)	245,397
<b>Other marketable securities:</b>				
U.S. Government agency obligations	39,991	56	(337)	39,710
Corporate preferred stock	700	0	(42)	658
	40,691	56	(379)	40,368
	\$ 287,966	734	(2,935)	285,765
<b>December 31, 2020</b>				
<b>Mortgage-backed securities:</b>				
FNMA	\$ 68,699	1,313	(3)	70,009
FHLMC	31,025	327	0	31,352
<b>Collateralized mortgage obligations:</b>				
FNMA	97	6	0	103
	99,821	1,646	(3)	101,464
<b>Other marketable securities:</b>				
U.S. Government agency obligations	45,029	204	0	45,233
Municipal obligations	725	1	0	726
Corporate obligations	37	0	0	37
Corporate preferred stock	700	0	(70)	630
	46,491	205	(70)	46,626
	\$ 146,312	1,851	(73)	148,090

The Company did not sell any available for sale securities and did not recognize any gains or losses on securities available for sale in 2021 or 2020.

The following table presents the amortized cost and estimated fair value of securities available for sale at December 31, 2021, based upon contractual maturity adjusted for scheduled repayments of principal and projected prepayments of principal based upon current economic conditions and interest rates. Actual maturities may differ from the maturities in the following table because obligors may have the right to call or prepay obligations with or without call or prepayment penalties:

<i>(Dollars in thousands)</i>	Amortized Cost	Fair Value
Due one year or less	\$ 71,861	71,318
Due after one year through five years	170,404	169,129
Due after five years through fifteen years	45,700	45,317
Due after fifteen years	1	1
<b>Total</b>	<b>\$ 287,966</b>	<b>285,765</b>

The allocation of mortgage-backed securities in the table above is based upon the anticipated future cash flow of the securities using estimated mortgage prepayment speeds.

The following table shows the gross unrealized losses and fair values for the securities available for sale portfolio aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2021 and 2020:

<i>(Dollars in thousands)</i>	Less Than Twelve Months			Twelve Months or More			Total	
	# of Investments	Fair Value	Unrealized Losses	# of Investments	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<b>December 31, 2021</b>								
<b>Mortgage backed securities:</b>								
FNMA	19	\$ 98,423	(1,234)	2	\$ 6,810	(133)	\$ 105,233	(1,367)
FHLMC	17	85,624	(1,038)	2	7,664	(151)	93,288	(1,189)
<b>Other marketable securities:</b>								
U.S. government agency obligations	7	34,659	(337)	0	0	0	34,659	(337)
Corporate preferred stock	0	0	0	1	658	(42)	658	(42)
<b>Total temporarily impaired securities</b>	<b>43</b>	<b>\$ 218,706</b>	<b>(2,609)</b>	<b>5</b>	<b>\$ 15,132</b>	<b>(326)</b>	<b>\$ 233,838</b>	<b>(2,935)</b>
<b>December 31, 2020</b>								
<b>Mortgage backed securities:</b>								
FNMA	1	\$ 4,956	(3)	0	\$ 0	0	\$ 4,956	(3)
<b>Other marketable securities:</b>								
Corporate preferred stock	0	0	0	1	630	(70)	630	(70)
<b>Total temporarily impaired securities</b>	<b>1</b>	<b>\$ 4,956</b>	<b>(3)</b>	<b>1</b>	<b>\$ 630</b>	<b>(70)</b>	<b>\$ 5,586</b>	<b>(73)</b>

We review our investment portfolio on a quarterly basis for indications of impairment. This review includes analyzing the length of time and the extent to which the fair value has been lower than the cost, the market liquidity for the investment, the financial condition and near-term prospects of the issuer, including any specific events which may influence the operations of the issuer, and our intent and ability to hold the investment for a period of time sufficient to recover the temporary loss. The unrealized losses on impaired securities other than the corporate preferred stock are the result of changes in interest rates. The unrealized losses reported for the corporate preferred stock at December 31, 2021 relates to a single trust preferred security that was issued by the holding company of a small community bank. As of December 31, 2021 all payments were current on the trust preferred security and the issuer's subsidiary bank was considered to be "well-capitalized" based on its most recent regulatory filing. Based on a review of the issuer, it was determined that the trust preferred security was not other-than-temporarily impaired at December 31, 2021. The Company does not intend to sell the preferred stock and has the intent and ability to hold it for a period of time sufficient to recover the temporary loss. Management believes that the Company will receive all principal and interest payments contractually due on the security and that the decrease in the market value is primarily due to a lack of liquidity in the market for trust preferred securities. Management will continue to monitor the credit risk of the issuer and may be required to recognize other-than-temporary impairment charges on this security in future periods.

**NOTE 5 Loans Receivable, Net**

A summary of loans receivable at December 31, 2021 and 2020, is as follows:

<i>(Dollars in thousands)</i>	2021	2020
Single family real estate	\$ 163,322	135,023
Commercial real estate:		
Construction:		
Single family	23,293	19,832
Multi-family	9,986	2,316
Commercial real estate	13,959	9,345
Childcare services	2,796	3,933
Churches/community service	11,332	8,427
Land developments	12,041	13,237
Lodging	57,220	61,823
Manufacturing	23,913	20,833
Movie theaters	9,334	9,619
Multi-family	43,140	41,456
Nursing home/healthcare	19,870	14,488
Restaurant/bar/cafe	8,473	6,383
Retail/office	87,244	93,472
Warehouse	31,501	32,568
Other (1)	42,766	42,972
	<u>396,868</u>	<u>380,704</u>
Consumer:		
Home equity line	17,467	21,308
Home equity	7,557	11,549
Land/lots	2,154	3,357
Recreational vehicles	10,985	15,645
Other(1)	3,482	3,532
	<u>41,645</u>	<u>55,391</u>
Commercial business	60,165	82,673
Total loans	<u>662,000</u>	<u>653,791</u>
Less:		
Unamortized discounts	10	12
Net deferred loan fees	209	450
Allowance for loan losses	9,279	10,699
Total loans receivable, net	<u>\$ 652,502</u>	<u>642,630</u>
Commitments to originate or purchase loans	\$ 14,501	23,596
Commitments to deliver loans to secondary market	\$ 12,340	24,746
Weighted average contractual rate of loans in portfolio	4.01%	4.21%

(1) Amounts under two million dollars in both years are included in "Other".

Included in total commitments to originate or purchase loans are fixed rate loans aggregating \$13.5 million and \$19.5 million as of December 31, 2021 and 2020, respectively. The interest rates on these loan commitments ranged from 2.50% to 4.75% at December 31, 2021 and from 2.25% to 4.75% at December 31, 2020.

The aggregate amount of loans to executive officers and directors of the Company was \$0.1 million and \$0.2 million at December 31, 2021 and 2020, respectively. During 2021, there were no new loans to executive officers and directors. Loans paid off or closed totaled \$0.1 million in 2021. The remaining balance of \$0.1 million for both years represents a Home Equity Line of Credit for one executive officer and there has been no activity on the line of credit during 2021 or 2020. All loans to executive officers and directors are made in the ordinary course of business on normal credit terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated parties.

At December 31, 2021 and 2020, the Company was servicing loans for others with aggregate unpaid principal balances of \$586.4 million and \$580.0 million, respectively.

The Company originates residential, commercial real estate and other loans primarily in Minnesota and Wisconsin. At December 31, 2021 and 2020, the Company had in its portfolio single family residential loans located in the following states:

<i>(Dollars in thousands)</i>	2021		2020	
	Amount	Percent of Total	Amount	Percent of Total
Minnesota	\$ 142,252	87.1%	\$ 114,575	84.9%
Wisconsin	15,048	9.2	15,910	11.8
Other states (1)	6,022	3.7	4,538	3.3
Total	<u>\$ 163,322</u>	<u>100.0%</u>	<u>\$ 135,023</u>	<u>100.0%</u>

(1) Amounts under two million dollars in both years are included in "Other states".

At December 31, 2021 and 2020, the Company had in its portfolio commercial real estate loans located in the following states:

<i>(Dollars in thousands)</i>	2021		2020	
	Amount	Percent of Total	Amount	Percent of Total
Colorado	\$ 6,150	1.6%	\$ 0	0.0%
Florida	4,293	1.1	4,350	1.1
Iowa	7,955	2.0	6,281	1.7
Minnesota	264,376	66.6	261,598	68.7
North Carolina	4,436	1.1	4,571	1.2
Wisconsin	93,999	23.7	90,112	23.7
Other states (1)	<u>15,659</u>	<u>3.9</u>	<u>13,792</u>	<u>3.6</u>

Total

\$ 396,868 100.0% \$ 380,704 100.0%

(1) Amounts under four million dollars in both years are included in "Other states".

**NOTE 6 Allowance for Loan Losses and Credit Quality Information**

The allowance for loan losses is summarized as follows:

<i>(Dollars in thousands)</i>	Single Family	Commercial Real Estate	Consumer	Commercial Business	Total
Balance, December 31, 2019	\$ 857	5,060	1,507	1,140	8,564
Provision for losses	\$ 173	2,938	(63)	(349)	2,699
Charge-offs	0	(730)	(84)	(8)	(822)
Recoveries	0	27	29	202	258
Balance, December 31, 2020	\$ 1,030	7,295	1,389	985	10,699
Provision for losses	\$ (56)	(1,524)	(424)	(115)	(2,119)
Charge-offs	0	(36)	(42)	0	(78)
Recoveries	0	653	58	66	777
<b>Balance, December 31, 2021</b>	<b>\$ 974</b>	<b>6,388</b>	<b>981</b>	<b>936</b>	<b>9,279</b>
Allocated to:					
Specific reserves	\$ 29	95	100	14	238
General reserves	1,001	7,200	1,289	971	10,461
Balance, December 31, 2020	\$ 1,030	7,295	1,389	985	10,699
Allocated to:					
Specific reserves	\$ 36	280	83	7	406
General reserves	938	6,108	898	929	8,873
<b>Balance, December 31, 2021</b>	<b>\$ 974</b>	<b>6,388</b>	<b>981</b>	<b>936</b>	<b>9,279</b>
Loans receivable at December 31, 2020:					
Individually reviewed for impairment	\$ 857	1,484	750	35	3,126
Collectively reviewed for impairment	134,166	379,220	54,641	82,638	650,665
Ending balance	\$ 135,023	380,704	55,391	82,673	653,791
Loans receivable at December 31, 2021:					
Individually reviewed for impairment	\$ 340	3,757	546	7	4,650
Collectively reviewed for impairment	162,982	393,111	41,099	60,158	657,350
Ending balance	\$ 163,322	396,868	41,645	60,165	662,000

The following table summarizes the amount of classified and unclassified loans at December 31, 2021 and 2020:

<i>(Dollars in thousands)</i>	December 31, 2021						Total Loans
	Classified				Unclassified		
	Special Mention	Substandard	Doubtful	Loss	Total	Total	
Single family	\$ 410	791	56	0	1,257	162,065	163,322
Commercial real estate:							
Real estate rental and leasing	16,012	4,753	0	0	20,765	188,901	209,666
Other	6,824	9,571	0	0	16,395	170,807	187,202
Consumer	0	475	21	50	546	41,099	41,645
Commercial business	1,933	1,813	0	0	3,746	56,419	60,165
	<b>\$ 25,179</b>	<b>17,403</b>	<b>77</b>	<b>50</b>	<b>42,709</b>	<b>619,291</b>	<b>662,000</b>

<i>(Dollars in thousands)</i>	December 31, 2020							
	Special Mention	Substandard	Classified			Total	Unclassified Total	Total Loans
			Doubtful	Loss				
Single family	\$ 1,219	2,845	29	0	4,093	130,930	135,023	
Commercial real estate:								
Real estate rental and leasing	8,065	3,483	0	0	11,548	190,852	202,400	
Other	8,774	9,750	0	0	18,524	159,780	178,304	
Consumer	0	600	132	18	750	54,641	55,391	
Commercial business	1,968	2,482	0	0	4,450	78,223	82,673	
	<u>\$ 20,026</u>	<u>19,160</u>	<u>161</u>	<u>18</u>	<u>39,365</u>	<u>614,426</u>	<u>653,791</u>	

Classified loans represent special mention, substandard (performing and non-performing), and non-performing loans categorized as doubtful and loss. Loans classified as special mention are loans that have potential weaknesses that, if left uncorrected, may result in deterioration of the repayment prospects for the asset or in the Bank's credit position at some future date. Loans classified as substandard are loans that are generally inadequately protected by the current net worth and paying capacity of the obligor, or by the collateral pledged, if any. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Substandard loans are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Loans classified as doubtful have the weaknesses of those classified as substandard, with additional characteristics that make collection in full on the basis of currently existing facts, conditions and values questionable, and there is a high possibility of loss. A loan classified as loss is essentially uncollateralized and/or considered uncollectible and of such little value that continuance as an asset on the balance sheet may not be warranted. Loans classified as substandard or doubtful require the Bank to perform an analysis of the individual loan and charge off any loans, or portion thereof, that are deemed uncollectible.

The aging of past due loans at December 31, 2021 and 2020 is summarized as follows:

<i>(Dollars in thousands)</i>	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current Loans	Total Loans	Loans 90 Days or More Past Due and Still Accruing
<b>December 31, 2021</b>							
Single family	\$ 864	65	153	1,082	162,240	163,322	0
Commercial real estate:							
Real estate rental and leasing	198	0	0	198	209,468	209,666	0
Other	226	3,402	0	3,628	183,574	187,202	0
Consumer	174	89	122	385	41,260	41,645	0
Commercial business	0	0	0	0	60,165	60,165	0
	<u>\$ 1,462</u>	<u>3,556</u>	<u>275</u>	<u>5,293</u>	<u>656,707</u>	<u>662,000</u>	<u>0</u>
<b>December 31, 2020</b>							
Single family	\$ 626	38	298	962	134,061	135,023	0
Commercial real estate:							
Real estate rental and leasing	0	0	0	0	202,400	202,400	0
Other	0	0	0	0	178,304	178,304	0
Consumer	458	66	279	803	54,588	55,391	0
Commercial business	0	0	0	0	82,673	82,673	0
	<u>\$ 1,084</u>	<u>104</u>	<u>577</u>	<u>1,765</u>	<u>652,026</u>	<u>653,791</u>	<u>0</u>

Impaired loans include loans that are non-performing (non-accruing) and loans that have been modified in a troubled debt restructuring (TDR).



The following table summarizes impaired loans and related allowances for the years ended December 31, 2021 and 2020:

<i>(Dollars in thousands)</i>	December 31, 2021				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
<b>Loans with no related allowance recorded:</b>					
Single family	\$ 253	272	0	502	2
<b>Commercial real estate:</b>					
Real estate rental and leasing	0	0	0	432	0
Other	189	189	0	197	0
Consumer	419	419	0	545	9
<b>Loans with an allowance recorded:</b>					
Single family	87	87	36	113	0
<b>Commercial real estate:</b>					
Real estate rental and leasing	0	0	0	98	0
Other	3,568	3,568	280	844	142
Consumer	127	127	83	136	2
Commercial business	7	7	7	25	0
<b>Total:</b>					
Single family	340	359	36	615	2
<b>Commercial real estate:</b>					
Real estate rental and leasing	0	0	0	530	0
Other	3,757	3,757	280	1,041	142
Consumer	546	546	83	681	11
Commercial business	7	7	7	25	0
	<u>\$ 4,650</u>	<u>4,669</u>	<u>406</u>	<u>2,892</u>	<u>155</u>

<i>(Dollars in thousands)</i>	December 31, 2020				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
<b>Loans with no related allowance recorded:</b>					
Single family	\$ 740	759	0	616	34
<b>Commercial real estate:</b>					
Real estate rental and leasing	932	1,582	0	580	33
Other	211	211	0	314	2
Consumer	574	574	0	626	10
Commercial business	0	0	0	2	0
<b>Loans with an allowance recorded:</b>					
Single family	117	117	29	242	0
<b>Commercial real estate:</b>					
Real estate rental and leasing	166	166	5	175	0
Other	175	175	90	425	10
Consumer	176	176	100	170	6
Commercial business	35	586	14	200	2
<b>Total:</b>					
Single family	857	876	29	858	34
<b>Commercial real estate:</b>					
Real estate rental and leasing	1,098	1,748	5	755	33
Other	386	386	90	739	12
Consumer	750	750	100	796	16
Commercial business	35	586	14	202	2
	<u>\$ 3,126</u>	<u>4,346</u>	<u>238</u>	<u>3,350</u>	<u>97</u>

At December 31, 2021 and 2020, non-accruing loans totaled \$4.6 million and \$2.7 million, respectively, for which the related allowance for loan losses was \$0.4 million and \$0.2 million, respectively. Non-accruing loans for which no specific allowance has been recorded because management determined that the value of the collateral was sufficient to repay the loan totaled \$0.9 million and \$2.1 million at December 31, 2021 and 2020, respectively. Had the non-accruing loans performed in accordance with their original terms, the Company would have recorded gross interest income on the loans of \$0.3 million and \$0.2 million in 2021 and 2020, respectively. For the years ended December 31, 2021 and 2020, the Company recognized interest income on these loans of \$0.2 million and \$0.1 million, respectively. All of the interest income that was recognized for non-accruing loans was recognized using the cash basis method of income recognition. Non-accrual loans also include some of the loans that have had terms modified in a TDR.

The following table summarizes non-accrual loans at December 31, 2021 and 2020:

<i>(Dollars in thousands)</i>	2021	2020
Single family	\$ 340	502
Commercial real estate:		
Real estate rental and leasing	0	1,098
Other	3,757	386
Consumer	517	689
Commercial business	7	9
	<u>\$ 4,621</u>	<u>2,684</u>

Included in loans receivable, net, are certain loans that have been modified in order to maximize collection of loan balances. If the Company, for legal or economic reasons related to the borrower's financial difficulties, grants a concession compared to the original terms and conditions of the loan, the modified loan is considered a TDR.

At December 31, 2021 and 2020, there were loans included in loans receivable, net, with terms that had been modified in a TDR totaling \$1.1 million and \$1.5 million, respectively. Had these loans been performing in accordance with their original terms throughout 2021 and 2020, the Company would have recorded gross interest income of \$0.1 million in both years. During 2021 and 2020 the amount of interest income received on these loans was not material. For the loans that were modified in 2021, none were classified as performing and \$0.3 million were non-performing at December 31, 2021.

The following table summarizes TDRs at December 31, 2021 and 2020:

<i>(Dollars in thousands)</i>	2021	2020
Single family	\$ 254	612
Commercial real estate:		
Other	355	211
Consumer	442	630
Commercial business	0	25
	<u>\$ 1,051</u>	<u>1,478</u>

TDR concessions can include reduction of interest rates, extension of maturity dates, forgiveness of principal and/or interest due, or acceptance of real estate or other assets in full or partial satisfaction of the debt. Loan modifications are not reported as TDRs after 12 months if the loan was modified at a market rate of interest for comparable risk loans, and the loan is performing in accordance with the terms of the restructured agreement. All loans classified as TDRs are considered to be impaired.

When a loan is modified as a TDR, there may be a direct, material impact on the loans within the Consolidated Balance Sheets, as principal balances may be partially forgiven. The financial effects of TDRs are presented in the following table and represent the difference between the outstanding recorded balance pre-modification and post-modification, for the periods ended December 31, 2021 and 2020:

<i>(Dollars in thousands)</i>	Year ended December 31, 2021			Year ended December 31, 2020		
	Number of Contracts	Pre-modification Outstanding Recorded Investment	Post-modification Outstanding Recorded Investment	Number of Contracts	Pre-modification Outstanding Recorded Investment	Post-modification Outstanding Recorded Investment
Troubled debt restructurings:						
Single family	1	\$ 38	40	1	\$ 94	101
Commercial real estate:						
Other	1	139	139	2	293	293
Consumer	1	93	94	0	0	0
Commercial business	1	14	14	0	0	0
Total	<u>4</u>	<u>\$ 284</u>	<u>287</u>	<u>3</u>	<u>\$ 387</u>	<u>394</u>

There were no loans that were restructured during the years ended December 31, 2021 and 2020 that subsequently defaulted during 2021 and 2020, respectively.

The Company considers a loan to have defaulted when it becomes 90 or more days past due under the modified terms, when it is placed in non-accrual status, when it becomes other real estate owned, or when it becomes non-compliant with some other material requirement of the modification agreement.

Loans that were non-accrual prior to modification remain non-accrual for at least six months following modification. Non-accrual TDR loans that have performed according to the modified terms for six months may be returned to accruing status. Loans that were accruing prior to modification may remain on accrual status after the modification as long as the loan continues to perform under the new terms.

TDRs are reviewed for impairment following the same methodology as other impaired loans. For loans that are collateral dependent, the value of the collateral is reviewed and additional reserves may be added as needed. Loans that are not collateral dependent may have additional reserves established if deemed necessary. The allocated reserves for TDRs were \$0.2 million, or 2.6%, of the total \$9.3 million in allowance for loan losses at December 31, 2021, and \$0.1 million, or 0.9%, of the total \$10.7 million in allowance for loan losses at December 31, 2020.

Section 4013 of the CARES Act temporarily allowed the Bank to grant modifications of loans to borrowers that were impacted by the pandemic without classifying the modifications as TDRs if the accommodation was granted before December 31, 2021. In accordance with the regulatory guidance, the Bank granted accommodations on certain loans to borrowers who were negatively impacted by the pandemic. At December 31, 2021, the Company had no loans with outstanding loan accommodations in accordance with Section 4013 of the CARES Act and at December 31, 2020 had \$34.6 million of outstanding loans that had been granted accommodations. These accommodations were in addition to the TDRs that are disclosed above.

#### NOTE 7 Accrued Interest Receivable

Accrued interest receivable at December 31, 2021 and 2020 is summarized as follows:

<i>(Dollars in thousands)</i>	2021	2020
Securities available for sale	\$ 395	392
Loans receivable	1,737	2,710
	<u>\$ 2,132</u>	<u>3,102</u>

#### NOTE 8 Intangible Assets

The Company's intangible assets consist of core deposit intangibles, goodwill and mortgage servicing rights. A summary of mortgage servicing rights activity for 2021 and 2020 is as follows:

<i>(Dollars in thousands)</i>	2021	2020
Mortgage servicing rights, net:		
Balance, beginning of year	\$ 3,043	2,172
Originations	1,405	2,189
Amortization	(1,168)	(1,318)
Balance, end of year	<u>\$ 3,280</u>	<u>3,043</u>
Fair value of mortgage servicing rights	<u>\$ 4,813</u>	<u>3,378</u>

All of the single family loans sold where the Company continues to service the loans are serviced for FNMA under the individual loan sale program. The following is a summary of the risk characteristics of the loans being serviced for FNMA at December 31, 2021:

<i>(Dollars in thousands)</i>	Loan Principal Balance	Weighted Average Interest Rate	Weighted Average Remaining Term (months)	Number of Loans
Original term:				
15 year fixed rate	\$ 117,439	2.85%	142	1,066
30 year fixed rate	424,109	3.42	313	2,663

The gross carrying amount of intangible assets and the associated accumulated amortization at December 31, 2021 and 2020 are presented in the following table. Amortization expense for intangible assets was \$1.2 million and \$1.4 million for the years ended December 31, 2021 and 2020, respectively.

<i>(Dollars in thousands)</i>	Gross Carrying Amount	Accumulated Amortization	Unamortized Intangible Assets
<b>December 31, 2021</b>			
Mortgage servicing rights	\$ 5,854	(2,574)	3,280
Core deposit intangible	574	(564)	10
Goodwill	802	0	802
<b>Total</b>	<u>\$ 7,230</u>	<u>(3,138)</u>	<u>4,092</u>
<b>December 31, 2020</b>			
Mortgage servicing rights	\$ 5,691	(2,648)	3,043
Core deposit intangible	574	(517)	57
Goodwill	802	0	802
<b>Total</b>	<u>\$ 7,067</u>	<u>(3,165)</u>	<u>3,902</u>

The following table indicates the estimated future amortization expense for amortizing intangible assets:

<i>(Dollars in thousands)</i>	Mortgage Servicing Rights	Core Deposit Intangible	Total Amortizing Intangible Assets
Year ended December 31,			
2022	\$ 695	10	705
2023	648	0	648
2024	613	0	613
2025	543	0	543
2026	441	0	441
Thereafter	340	0	340
	<u>\$ 3,280</u>	<u>10</u>	<u>3,290</u>

No amortization expense relating to goodwill is recorded as GAAP does not allow goodwill to be amortized but requires that it be tested for impairment at least annually, or sooner, if there are indications that an impairment may exist. Goodwill was tested for impairment at December 31, 2021 and the Company determined that it was not permanently impaired and no write down was required.

Projections of amortization are based on asset balances and the interest rate environment that existed at December 31, 2021. The Company's actual experience may be significantly different depending upon changes in mortgage interest rates and other market conditions.

#### NOTE 9 Premises and Equipment

A summary of premises and equipment at December 31, 2021 and 2020 is as follows:

<i>(Dollars in thousands)</i>	2021	2020
Land	\$ 5,156	2,615
Office buildings and improvements	17,445	12,074
Furniture and equipment	12,841	12,497
	<u>35,442</u>	<u>27,186</u>
Accumulated depreciation	(18,069)	(17,053)
	<u>\$ 17,373</u>	<u>10,133</u>

The increase in land and office buildings and improvements is related to the purchase of the combined corporate office and branch facility in Rochester during 2021. This facility had previously been leased by the Company.

#### NOTE 10 Leases

The Company accounts for its leases in accordance with ASU 2016-02, *Leases (Topic 842)* and as of December 31, 2021 a \$0.4 million operating lease right-of-use asset and an offsetting lease payment obligation liability were recorded on the consolidated balance sheet in other assets and other liabilities, respectively.

Operating lease right-of-use assets represent our right to use an underlying asset during the lease term and operating lease liabilities represent our obligation to make lease payments arising from the lease. Right-of-use assets and operating lease liabilities are recognized at lease commencement based on the present value of the remaining lease payments using a discount rate that represents the Company's incremental borrowing rate at the lease commencement date. Because the Company only has operating leases and the right-of-use asset is offset by a lease payment obligation liability, the lease payments are the only amount that is recorded in occupancy expense in the consolidated statements of comprehensive income.

The Company's leases relate to office space and Bank branches with remaining lease terms between 8 and 40 months. Certain leases contain extension options which typically range from 3 to 10 years. Because these extension options are not considered reasonably certain of exercise, they are not included in the lease term.

The table below summarizes our net lease cost for the years ended December 31, 2021 and 2020.

<i>(Dollars in thousands)</i>	2021	2020
Operating lease cost	\$ 739	892

The table below summarizes other information related to our operating leases for the years ended December 31, 2021 and 2020.

<i>(Dollars in thousands)</i>	2021	2020
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows from operating leases	\$ 739	892
Weighted-average remaining lease term – operating leases, in years	2.3	3.8
Weighted-average discount rate – operating leases	1.85%	2.19%

The table below summarizes the maturity of remaining lease liabilities:

<i>(Dollars in thousands)</i>	December 31, 2021
2022	\$ 217
2023	92
2024	77
2025	14
2026 and thereafter	0
Total lease payments	<u>400</u>
Less: Interest	(8)
Present value of lease liabilities	<u>\$ 392</u>



**NOTE 11 Deposits**

Deposits and their weighted average interest rates at December 31, 2021 and 2020 are summarized as follows:

<i>(Dollars in thousands)</i>	2021			2020		
	Weighted Average Rate	Amount	Percent of Total	Weighted Average Rate	Amount	Percent of Total
Noninterest checking	0.00%	\$ 344,404	36.2%	0.00%	\$ 239,587	30.1%
Interest checking	0.12	151,476	15.9	0.12	138,709	17.4
Savings accounts	0.06	119,517	12.6	0.06	100,209	12.6
Money market accounts	0.21	249,089	26.2	0.25	214,300	27.0
		<u>864,486</u>	<u>90.9</u>		<u>692,805</u>	<u>87.1</u>
Certificates by rate:						
0-0.99%		74,481	7.8		56,001	7.0
1-1.99%		4,357	0.5		20,613	2.6
2-2.99%		6,316	0.7		21,973	2.8
3-3.99%		1,026	0.1		3,812	0.5
Total certificates	0.53	<u>86,180</u>	<u>9.1</u>	1.14	<u>102,399</u>	<u>12.9</u>
Total deposits	0.13	<u>\$ 950,666</u>	<u>100.0%</u>	0.25	<u>\$ 795,204</u>	<u>100.0%</u>

At December 31, 2021 and 2020, the Company had \$393.7 million and \$269.3 million, respectively, of deposit accounts with balances of \$250,000 or more and had no certificate accounts acquired through a broker.

Certificates had the following maturities at December 31, 2021 and 2020:

<i>(Dollars in thousands)</i>	2021		2020	
	Amount	Weighted Average Rate	Amount	Weighted Average Rate
<i>Remaining term to maturity</i>				
1-6 months	\$ 35,007	0.68%	\$ 37,165	1.24%
7-12 months	27,280	0.40	39,063	0.97
13-36 months	21,769	0.46	23,604	1.25
Over 36 months	2,124	0.66	2,567	1.21
	<u>\$ 86,180</u>	<u>0.53</u>	<u>\$ 102,399</u>	<u>1.14</u>

At December 31, 2021 and 2020, the Company had pledged mortgage loans and mortgage-backed and related securities with an amortized cost of approximately \$33.2 million and \$29.8 million, respectively, as collateral for certain deposits.

Interest expense on deposits is summarized as follows for the years ended December 31, 2021 and 2020:

<i>(Dollars in thousands)</i>	2021	2020
Checking accounts	\$ 182	151
Savings accounts	69	65
Money market accounts	557	840
Certificate accounts	745	1,795
	<u>\$ 1,553</u>	<u>2,851</u>

**NOTE 12 Federal Home Loan Bank (FHLB) Advances and Other Borrowings**

The Bank had no outstanding advances from the FHLB or other borrowings as of December 31, 2021 or 2020. At December 31, 2021 the Bank had collateral pledged to the FHLB consisting of FHLB stock, mortgage loans and investments with a borrowing capacity of approximately \$178.0 million, subject to a requirement to purchase FHLB stock. The Bank also had the ability to borrow \$50.3 million from the Federal Reserve Bank of Minneapolis based upon the loans that were pledged to them as of December 31, 2021, subject to approval from the FRB.

At December 31, 2020 the Bank had collateral pledged to the FHLB consisting of FHLB stock, mortgage loans and investments with a borrowing capacity of approximately \$168.3 million, subject to a requirement to purchase FHLB stock. The Bank also had the ability to borrow \$60.4 million from the Federal Reserve Bank of Minneapolis based upon the loans that were pledged to them as of December 31, 2020, subject to approval from the FRB.

**NOTE 13 Income Taxes**

Income tax expense for the years ended December 31, 2021 and 2020 is as follows:

<i>(Dollars in thousands)</i>	2021	2020
<b>Current:</b>		
Federal	\$ 3,234	3,418
State	1,519	1,452
Total current	4,753	4,870
<b>Deferred:</b>		
Federal	410	(589)
State	202	(213)
Total deferred	612	(802)
<b>Income tax expense</b>	<b>\$ 5,365</b>	<b>4,068</b>

The reasons for the difference between the expected income tax expense utilizing the federal corporate tax rate of 21% and the actual income tax expense are as follows:

<i>(Dollars in thousands)</i>	2021	2020
Expected federal income tax expense	\$ 3,975	3,019
Items affecting federal income tax:		
State income taxes, net of federal income tax deduction	1,350	1,025
Other, net	40	24
<b>Income tax expense</b>	<b>\$ 5,365</b>	<b>4,068</b>

The tax effects of temporary differences that give rise to the deferred tax assets and deferred tax liabilities are as follows at December 31:

<i>(Dollars in thousands)</i>	2021	2020
<b>Deferred tax assets:</b>		
Allowances for loan losses	\$ 2,610	3,010
Deferred compensation costs	143	141
Deferred ESOP loan asset	399	430
Non-accruing loan interest	96	134
Net unrealized loss on securities available for sale	618	0
Other	679	499
Total gross deferred tax assets	4,545	4,214
<b>Deferred tax liabilities:</b>		
Deferred loan costs	272	119
Premises and equipment basis difference	669	549
Originated mortgage servicing rights	923	856
Net unrealized gain on securities available for sale	0	496
Other	152	167
Total gross deferred tax liabilities	2,016	2,187
<b>Net deferred tax assets</b>	<b>\$ 2,529</b>	<b>2,027</b>

The Company has no federal and \$0.4 million of state net operating loss carryforwards at December 31, 2021.

Retained earnings at December 31, 2021 included approximately \$8.8 million for which no provision for income taxes was made. This amount represents allocations of income to bad debt deductions for tax purposes. Reduction of amounts so allocated for purposes other than absorbing losses will create income for tax purposes, which will be subject to the then-current corporate income tax rate.

The Company considers the determination of the deferred tax asset amount and the need for any valuation reserve to be a critical accounting policy that requires significant judgment. The Company has, in its judgment, made reasonable assumptions and considered both positive and negative evidence relating to the ultimate realization of deferred tax assets. Positive evidence includes the cumulative net income generated over the prior three-year period and the probability that taxable income will be generated in future periods. The Company could not currently identify any negative evidence. Based upon this evaluation, the Company determined that no valuation allowance was required with respect to the net deferred tax assets at December 31, 2021 and 2020.

**NOTE 14 Employee Benefits**

The Company participates in the Pentegra Defined Benefit Plan for Financial Institutions (Pentegra DB Plan), a noncontributory multi-employer defined benefit pension plan covering Bank employees who were hired prior to 2002 that met minimum service requirements. Effective September 1, 2002, this plan was frozen and closed to new participants but employees that were already in the plan at the time it was frozen continue to accrue benefits. The Pentegra DB Plan's Employer Identification Number is 13-5645888 and the Plan number is 333. There are no collective bargaining agreements that require contributions to the Pentegra DB Plan, and there is no funding improvement or rehabilitation plan as part of the Pentegra DB Plan. The Company's policy is to fund accrued pension costs and the employer contributions paid and expensed for each of the years ended December 31, 2021 and 2020 were \$0.3 million. The Company's contributions to the Pentegra DB Plan were not more than 5% of total contributions to the Plan in either of those years. Funded status (market value of plan assets divided by the funding target) as of July 1 for the 2021 and 2020 plan years were 90.9% and 85.3%, respectively.

The Company has a qualified, tax-exempt savings plan with a deferred feature qualifying under Section 401(k) of the Internal Revenue Code (the 401(k) Plan). All employees who have attained 18 years of age are eligible to participate in the 401(k) Plan. Participants are permitted to make contributions to the 401(k) Plan equal to the lesser of 50% of their annual salary or the maximum allowed by law, which was \$19,500 for 2021 and 2020, with additional catch-up contributions allowed for employees over 50 years of age. The Company matches 25% of each participant's contributions up to a maximum of 8% of their annual salary. Participant contributions and earnings are fully and immediately vested. The Company's contributions are vested on a three year cliff basis, are expensed annually, and were \$0.2 million in 2021 and 2020.

The Company has adopted an Employee Stock Ownership Plan (the ESOP) that meets the requirements of Section 4975(e)(7) of the Internal Revenue Code and Section 407(d)(6) of ERISA and, as such, the ESOP is empowered to borrow in order to finance purchases of the common stock of HMN. The ESOP borrowed \$6.1 million from the Company to purchase 912,866 shares of common stock in the initial public offering of HMN in 1994. As a result of a merger with Marshalltown Financial Corporation, the ESOP borrowed \$1.5 million in 1998 to purchase an additional 76,933 shares of HMN common stock to account for the additional employees and to avoid dilution of the benefit provided by the ESOP. The ESOP debt requires quarterly payments of principal plus interest at 7.52%. The Company has committed to make quarterly contributions to the ESOP necessary to repay the loans including interest. The Company contributed \$0.5 million in 2021 and 2020.

As the debt is repaid, ESOP shares that were pledged as collateral for the debt are released from collateral based on the proportion of debt service paid in the year and then allocated to eligible employees. The Company accounts for its ESOP in accordance with ASU 718, *Employers' Accounting for Employee Stock Ownership Plans*. Accordingly, the shares pledged as collateral are reported as unearned ESOP shares in stockholders' equity. As shares are determined to be ratably released from collateral, the Company reports compensation expense equal to the current market price of the shares and the shares become outstanding for earnings per common share computations. ESOP compensation expense was \$0.5 million for 2021 and \$0.4 million for 2020.

All employees of the Bank are eligible to participate in the ESOP after they attain age 18 and complete one year of service during which they worked at least 1,000 hours. A summary of the ESOP share allocation is as follows for the years ended December 31:

	2021	2020
Shares held by participants beginning of the year	359,843	346,097
Shares allocated to participants	24,318	24,377
Shares distributed to participants	(30,484)	(10,631)
Shares held by participants end of year	353,677	359,843
Unreleased shares beginning of the year	182,418	206,795
Shares released during year	(24,318)	(24,377)
Unreleased shares end of year	158,100	182,418
Total ESOP shares end of year	511,777	542,261
Fair value of unreleased shares at December 31	\$ 3,900,327	3,137,590

The Company maintains two equity incentive plans, the HMN Financial, Inc. 2009 Equity and Incentive Plan (2009 Plan) and the HMN Financial, Inc. 2017 Equity Incentive Plan (2017 Plan). The purposes of the Company's equity incentive plans are to attract and retain the best available personnel for positions of responsibility with the Company, to provide additional incentives to them and align their interests with those of the Company's stockholders, and to thereby promote the company's long-term business success.

The 2009 Plan was superseded in April 2017 by the 2017 Plan and options or restricted shares were no longer awarded from the 2009 Plan. As of December 31, 2021 there were 34,229 shares reserved for issuance pursuant to options outstanding under the 2009 Plan. These options expire 10 years from the date of grant, have an average exercise price of \$11.21 and had a grant date fair value of \$4.04.



Initially there were 375,000 shares of HMN common stock available for issuance pursuant to awards under the 2017 Plan subject to adjustment for future stock splits, stock dividends and similar changes to the capitalization of the Company. Additionally, shares of restricted stock that are awarded are counted as 1.5 shares for purposes of determining the total shares available for issuance under the 2017 Plan. As of December 31, 2021, there were no options outstanding under the 2017 Plan. There were 22,841 shares of restricted stock previously granted to employees and directors under the 2017 Plan that remained unvested at December 31, 2021.

A summary of activities under all plans for the past two years is as follows:

	Shares Available For Grant	Unvested Restricted Shares Outstanding	Options Outstanding	Award Value/ Weighted Average Exercise Price	Vesting Period (in years)
<b>2009 Plan</b>					
December 31, 2019	0	3,102	34,229	\$ 11.21	
Vested	0	(3,102)	0		
December 31, 2020	0	0	34,229	\$ 11.21	
<b>December 31, 2021</b>	<b>0</b>	<b>0</b>	<b>34,229</b>	<b>\$ 11.21</b>	
<b>2017 Plan</b>					
December 31, 2019	388,971	14,787	0	N/A	
Granted January 28, 2020	(10,650)	7,100	0		3
Granted April 23, 2020	(9,000)	6,000	0		2
Granted April 28, 2020	(3,579)	2,386	0		1
Vested	0	(8,789)	0		
December 31, 2020	365,742	21,484	0	N/A	
Granted January 26, 2021	(16,685)	11,123	0		3
Granted April 27, 2021	(3,150)	2,100	0		1
Vested	0	(11,866)	0		
<b>December 31, 2021</b>	<b>345,907</b>	<b>22,841</b>	<b>0</b>	<b>N/A</b>	
<b>Total all plans</b>	<b>345,907</b>	<b>22,841</b>	<b>34,229</b>	<b>\$ 11.21</b>	

The following table summarizes information about stock options outstanding at December 31, 2021:

Date of Grant	Exercise Price	Number Outstanding	Weighted Average Remaining Contractual Life in Years	Number Exercisable	Number Unexercisable
January 26, 2016	\$ 11.21	34,229	4.1	34,229	0
		<u>34,229</u>		<u>34,229</u>	<u>0</u>

The Company will issue shares from treasury stock upon the exercise of the outstanding options.

In accordance with ASC 718, the Company recognizes compensation expense relating to stock options over the vesting period. The amount of the expense was determined under the fair value method. The fair value for each option grant is estimated on the date of the grant using the Black Scholes option valuation method. There were no options granted in 2021 or 2020.

**NOTE 15 Earnings per Common Share**

The following table reconciles the weighted average shares outstanding and net income for basic and diluted earnings per common share:

<i>(Dollars in thousands, except per share data)</i>	Year ended December 31,	
	2021	2020
Weighted average number of common shares outstanding used in basic earnings per common share calculation	4,471,363	4,623,237
Net dilutive effect of:		
Options	16,361	10,148
Restricted stock awards	16,214	14,263
Weighted average number of common shares outstanding adjusted for effect of dilutive securities	4,503,938	4,647,648
Net income available to common shareholders	\$ 13,564	10,302
Basic earnings per common share	3.03	2.23
Diluted earnings per common share	3.01	2.22

**NOTE 16 Stockholders' Equity**

On July 27, 2021 the Company's Board of Directors announced an increase of \$4.2 million in the amount of shares authorized to be repurchased, which increased the aggregate purchase price of shares eligible to be repurchased to \$6.0 million. The share repurchase program does not obligate the Company to purchase any shares and has no set expiration date. The Company repurchased 217,400 shares in the open market for \$4.6 million in 2021 and 87,249 shares in the open market for \$1.5 million in 2020. At December 31, 2021 there was \$4.1 million authorized for repurchase in the share repurchase program. The Company did not pay any dividends on its common stock during 2021 or 2020.

In order to grant a priority to eligible accountholders in the event of future liquidation, the Bank, at the time of conversion to a stock savings bank, established a liquidation account equal to its regulatory capital as of September 30, 1993. In the event of future liquidation of the Bank, an eligible accountholder who continues to maintain their deposit account shall be entitled to receive a distribution from the liquidation account. The total amount of the liquidation account will decrease as the balance of eligible accountholders is reduced subsequent to the conversion, based on an annual determination of such balance.

**NOTE 17 Regulatory Capital**

The Bank is subject to the Basel III regulatory capital requirements. The Basel III requirements, among other things, (i) apply a set of capital requirements to the Bank, including requirements relating to common equity as a component of core capital, (ii) implement a "capital conservation buffer" against risk and a higher minimum Tier 1 capital requirement, and (iii) set forth rules for calculating risk-weighted assets for purposes of such requirements. The rules also made corresponding revisions to the prompt corrective action framework and include capital ratios and buffer requirements. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of its assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

The FRB amended its Small Bank Holding Company Policy Statement (Policy Statement), to exempt small bank holding companies with assets less than \$3 billion from the above capital requirements. The Policy Statement was also expanded to include savings and loan holding companies that meet the Policy Statement's qualitative requirements for exemption. The Company currently meets the qualitative exemption requirements, and therefore, is exempt from the above capital requirements.

Quantitative measures established by regulations to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table and defined in the regulation) of common equity Tier 1 capital to risk-weighted assets, Tier 1 capital to adjusted total assets, Tier 1 capital to risk-weighted assets and total capital to risk-weighted assets.

At December 31, 2021 and 2020, the Bank's capital amounts and ratios are presented for actual capital, required capital and excess capital including amounts and ratios in order to qualify as being well capitalized under the prompt corrective action regulations:

	Actual		Required to be Adequately Capitalized		Capital in Excess of Minimum Requirements		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Percent of Assets(1)	Amount	Percent of Assets(1)	Amount	Percent of Assets(1)	Amount	Percent of Assets(1)
<i>(Dollars in thousands)</i>								
<b>December 31, 2021</b>								
Common equity Tier 1 capital	\$ 97,710	13.18%	\$ 33,368	4.50%	\$ 64,342	8.68%	\$ 48,199	6.50%
Tier 1 leverage	97,710	9.47	41,283	4.00	56,427	5.47	51,603	5.00
Tier 1 risk-based capital	97,710	13.18	44,491	6.00	53,219	7.18	59,322	8.00
Total risk-based capital	106,979	14.43	59,322	8.00	47,657	6.43	74,152	10.00
<b>December 31, 2020</b>								
Common equity Tier 1 capital	\$ 89,473	13.62%	\$ 29,571	4.50%	\$ 59,902	9.12%	\$ 42,714	6.50%
Tier 1 leverage	89,473	9.85	36,330	4.00	53,143	5.85	45,412	5.00
Tier 1 risk-based capital	89,473	13.62	39,428	6.00	50,045	7.62	52,571	8.00
Total risk-based capital	97,717	14.87	52,571	8.00	45,146	6.87	65,714	10.00

(1) Based upon the Bank's adjusted total assets for the purpose of the Tier 1 leverage capital ratio and risk-weighted assets for the purpose of the risk-based capital ratios.

The Bank must maintain a capital conservation buffer of 2.50% composed of common equity Tier 1 capital above its minimum risk-based capital requirements in order to avoid limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers. Management believes that, as of December 31, 2021, the Bank's capital ratios were in excess of those quantitative capital ratio standards set forth under the current prompt corrective action regulations, including the capital conservation buffer described above. However, there can be no assurance that the Bank will continue to maintain such status in the future. The OCC has extensive discretion in its supervisory and enforcement activities and can adjust the requirement to be well-capitalized in the future. In addition, the Company must adhere to various U.S. Department of Housing and Urban Development (HUD) regulatory guidelines including required minimum capital and liquidity amounts to maintain their Federal Housing Administration approved status. Failure to comply with the HUD guidelines could result in withdrawal of this certification. As of December 31, 2021, the Company was in compliance with HUD guidelines.

#### NOTE 18 Commitments and Contingencies

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include all commitments to extend credit. These commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the balance sheet. The contract amounts of these instruments reflect the extent of involvement by the Company.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contract amount of these commitments. The Company uses the same credit policies in making commitments as it does for on-balance sheet instruments.

<i>(Dollars in thousands)</i>	Contract Amount	
	2021	2020
December 31,		
Financial instruments whose contract amount represents credit risk:		
Commitments to originate, fund or purchase loans:		
Single family	\$ 7,770	20,283
Multi-family	3,791	1,150
Commercial real estate	2,939	821
Commercial business	0	1,342
Undisbursed balance of loans closed	66,504	38,990
Unused lines of credit	106,125	113,435
Letters of credit	8,012	4,309
Total commitments to extend credit	\$ 195,141	180,330
Forward commitments	\$ 12,340	24,746

Commitments to extend credit are agreements to lend to a customer, at the customer's request, as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require the payment of a fee. Since a portion of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on the loan type and on management's credit evaluation of the borrower. Collateral consists primarily of residential and commercial real estate and personal property. Forward commitments represent commitments to sell loans to a third party following the closing of the loan and are entered into in the normal course of business by the Bank.

The Bank issued standby letters of credit which guarantee the performance of customers to third parties. The standby letters of credit outstanding expire over the next 22 months and totaled \$7.6 million at December 31, 2021 and \$4.1 million at December 31, 2020. The letters of credit are collateralized primarily with commercial real estate mortgages. Draws on standby letters of credit would be initiated by the secured party under the terms of the underlying obligation. Since the conditions under which the Bank is required to fund the standby letters of credit may not materialize, the cash requirements are expected to be less than the total outstanding commitments.

The Company has certain obligations and commitments to make future payments under existing contracts. At December 31, 2021, the aggregate contractual obligations (excluding bank deposits) and commercial commitments were as follows:

<i>(Dollars in thousands)</i>	Payments Due by Period				
	Total	Less Than 1 Year	1-3 Years	4-5 Years	More Than 5 Years
<b>Contractual Obligations:</b>					
Annual rental commitments under non-cancellable operating leases	\$ 400	217	169	14	0
<b>Total contractual obligations</b>	<b>\$ 400</b>	<b>217</b>	<b>169</b>	<b>14</b>	<b>0</b>
<b>Other Commercial Commitments:</b>					
Commercial lines of credit	\$ 68,501	20,494	25,427	22,580	0
Commitments to lend	57,078	9,645	18,803	8,936	19,694
Standby letters of credit	8,012	3,694	4,318	0	0
<b>Total other commercial commitments</b>	<b>\$ 133,591</b>	<b>33,833</b>	<b>48,548</b>	<b>31,516</b>	<b>19,694</b>

From time to time, the Company is party to legal proceedings arising out of its lending and deposit operations. The Company is, and expects to become, engaged in foreclosure proceedings, collection actions, and other litigation as part of its normal banking activities. Among the various current litigation matters, the Company is involved in a bankruptcy litigation claim where the bankruptcy trustee is attempting to recover \$2.5 million related to the principal and interest payments made to the Bank prior to the bankruptcy filing of a former customer of the Bank.

The Company examines each legal matter, and, in those situations where it determines that a particular legal matter presents loss contingencies that are both probable and reasonably estimable, establishes an appropriate accrual. In many situations, the Company is not able to estimate reasonably possible losses due to the preliminary nature of the legal matter, as well as a variety of other factors and uncertainties. For those legal matters where the Company is able to estimate a range of reasonably possible losses, management currently estimates that the aggregate range of losses from all of our outstanding litigation is from \$0 to \$0.6 million in excess of the amounts accrued, if any. This estimated aggregate range is based on an assessment of the information currently available to the Company and the actual aggregate losses could be higher. However, the Company does not believe these losses are probable to occur at this time. The Company reassesses all of its potential loss positions based on the available information each quarter and the estimated range of reasonably possible losses may change in the future. The Company typically vigorously pursues all available defenses related to litigation but may consider other alternatives, including settlement, in situations where there is an opportunity to resolve a legal matter on terms that are considered to be favorable to the Company when considering the continued expense and distraction of defending against any particular legal action.

Based on the Company's current understanding of all of the outstanding legal matters, management does not believe that judgments or settlements arising from any pending or threatened litigation, individually or in the aggregate, would have a material adverse effect on the consolidated financial condition or results of operations. However, litigation is unpredictable and the actual results of litigation cannot be determined with any certainty. Therefore, the ultimate aggregate resolution of any, or all, of the current outstanding legal matters could have a material adverse effect on the Company's results of operations in the future.

**NOTE 19 Derivative Instruments and Hedging Activities**

The Company originates single family residential loans for sale into the secondary market and enters into commitments to sell those loans in order to mitigate the interest rate risk associated with holding the loans until they are sold. The Company accounts for its commitments in accordance with ASC 815, *Accounting for Derivative Instruments and Hedging Activities*.

The Company had commitments outstanding to extend credit to future borrowers that had not closed prior to the end of the year, which is referred to as its mortgage pipeline. As commitments to originate loans enter the mortgage pipeline, the Company generally enters into commitments to sell the loans into the secondary market. The commitments to originate and sell loans are derivatives that are recorded at fair value. The marking of these derivatives to fair value for the periods ended December 31, 2021 and 2020 did not have a material impact on the Company's consolidated financial statements.

As of December 31, 2021 and 2020, the current commitments to sell loans held for sale are derivatives that do not qualify for hedge accounting. The loans held for sale that are not hedged are recorded at the lower of cost or market. The marking of these loans for the periods ended December 31, 2021 and 2020 did not have a material impact on the Company's consolidated financial statements.

**NOTE 20 Fair Value Measurement**

ASC 820, *Fair Value Measurements*, establishes a framework for measuring the fair value of assets and liabilities using a hierarchy system consisting of three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

*Level 1* - Valuation is based upon quoted prices for identical instruments traded in active markets that the Company has the ability to access.

*Level 2* - Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which significant assumptions are observable in the market.

*Level 3* - Valuation is generated from model-based techniques that use significant assumptions not observable in the market and are used only to the extent that observable inputs are not available. These unobservable assumptions reflect our own estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

The following table summarizes the assets of the Company for which fair values are determined on a recurring basis as of December 31, 2021 and 2020.

<i>(Dollars in thousands)</i>	Carrying Value at December 31, 2021			
	Total	Level 1	Level 2	Level 3
Securities available for sale	\$ 285,765	0	285,765	0
Equity securities	248	0	248	0
Mortgage loan commitments	26	0	26	0
<b>Total</b>	<b>\$ 286,039</b>	<b>0</b>	<b>286,039</b>	<b>0</b>

<i>(Dollars in thousands)</i>	Carrying Value at December 31, 2020			
	Total	Level 1	Level 2	Level 3
Securities available for sale	\$ 148,090	0	148,090	0
Equity securities	149	0	149	0
Mortgage loan commitments	261	0	261	0
<b>Total</b>	<b>\$ 148,500</b>	<b>0</b>	<b>148,500</b>	<b>0</b>

The Company may also be required, from time to time, to measure certain other financial assets at fair value on a nonrecurring basis in accordance with GAAP. These adjustments to fair value usually result from the application of the lower-of-cost-or-market accounting or write downs of individual assets. For assets measured at fair value on a nonrecurring basis in 2021 and 2020 that were still held at December 31, the following table provides the level of valuation assumptions used to determine each adjustment and the carrying value of the related individual assets or portfolios at December 31, 2021 and 2020.

Carrying Value at December 31, 2021						Year Ended December 31, 2021
<i>(Dollars in thousands)</i>	Total	Level 1	Level 2	Level 3	Total Losses	
Loans held for sale	\$ 5,575	0	5,575	0	(56)	
Mortgage servicing rights, net	3,280	0	3,280	0	0	
Impaired loans	4,244	0	4,244	0	(218)	
Real estate, net	290	0	290	0	0	
<b>Total</b>	<b>\$ 13,389</b>	<b>0</b>	<b>13,389</b>	<b>0</b>	<b>(274)</b>	

Carrying Value at December 31, 2020						Year Ended December 31, 2020
<i>(Dollars in thousands)</i>	Total	Level 1	Level 2	Level 3	Total Gains (Losses)	
Loans held for sale	\$ 6,186	0	6,186	0	28	
Mortgage servicing rights, net	3,043	0	3,043	0	0	
Impaired loans	2,888	0	2,888	0	(76)	
Real estate, net	636	0	636	0	0	
<b>Total</b>	<b>\$ 12,753</b>	<b>0</b>	<b>12,753</b>	<b>0</b>	<b>(48)</b>	

#### NOTE 21 Fair Value of Financial Instruments

ASC 825, *Disclosures about Fair Values of Financial Instruments*, requires disclosure of the estimated fair values of the Company's financial instruments, including assets, liabilities and off-balance sheet items for which it is practicable to estimate fair value. The fair value estimates are made as of December 31, 2021 and 2020 based upon relevant market information, if available, and upon the characteristics of the financial instruments themselves. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based upon judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments and other factors. The estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based only on existing financial instruments without attempting to estimate the value of anticipated future business or the value of assets and liabilities that are not considered financial instruments. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on the fair value estimates and have not been considered in any of the estimates.

The estimated fair value of the Company's financial instruments is shown below. Following the table, there is an explanation of the methods and assumptions used to estimate the fair value of each class of financial instruments.

<i>(Dollars in thousands)</i>	December 31, 2021						December 31, 2020		
	Carrying Amount	Estimated Fair Value	Fair Value Hierarchy			Contract Amount	Carrying Amount	Estimated Fair Value	Contract Amount
			Level 1	Level 2	Level 3				
<b>Financial assets:</b>									
Cash and cash equivalents	\$ 94,143	94,143	94,143				86,269	86,269	
Securities available for sale	285,765	285,765		285,765			148,090	148,090	
Equity securities	248	248		248			149	149	
Loans held for sale	5,575	5,575		5,575			6,186	6,186	
Loans receivable, net	652,502	661,298		661,298			642,630	648,275	
FHLB stock	1,092	1,092		1,092			932	932	
Accrued interest receivable	2,132	2,132		2,132			3,102	3,102	
<b>Financial liabilities:</b>									
Deposits	950,666	950,558		950,558			795,204	795,927	
Accrued interest payable	63	63		63			140	140	
<b>Off-balance sheet financial instruments:</b>									
Commitments to extend credit	26	26				195,141	261	261	180,330
Commitments to sell loans	12	12				12,340	(44)	(44)	24,746

#### ***Cash and Cash Equivalents***

The carrying amount of cash and cash equivalents approximates their fair value.

#### ***Securities Available for Sale***

The fair values of securities were based upon quoted market prices for similar securities.

#### ***Equity Securities***

The fair values of equity securities were based upon quoted market prices for similar securities.

#### ***Loans Held for Sale***

The fair values of loans held for sale were based upon quoted market prices for loans with similar interest rates and terms to maturity.

#### ***Loans Receivable***

The fair value of the loan portfolio, with the exception of the adjustable rate portfolio, was calculated by discounting the scheduled cash flows through the estimated maturity using anticipated prepayment speeds and using discount rates that reflect the credit and interest rate risk inherent in each loan portfolio. The fair value of the adjustable loan portfolio was estimated by grouping the loans with similar characteristics and comparing the characteristics of each group to the prices quoted for similar types of loans in the secondary market. The fair value disclosures for both the fixed and adjustable rate portfolios were adjusted to reflect the exit price amount anticipated to be received from the sale of the portfolio in an open market transaction.

#### ***FHLB Stock***

The carrying amount of FHLB stock approximates its fair value.

#### ***Accrued Interest Receivable***

The carrying amount of accrued interest receivable approximates its fair value since it is short-term in nature and does not present unanticipated credit concerns.

#### ***Deposits***

The fair value of demand deposits, savings accounts and certain money market account deposits is the amount payable on demand at the reporting date. The fair value of fixed maturity certificates of deposit is estimated using the rates currently offered for deposits of similar remaining maturities. The fair value disclosures for all of the deposits were adjusted to reflect the exit price amount anticipated to be received from the sale of the deposits in an open market transaction.

#### ***Accrued Interest Payable***

The carrying amount of accrued interest payable approximates its fair value since it is short-term in nature.

#### ***Commitments to Extend Credit***

The fair values of commitments to extend credit are estimated using the fees normally charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counter parties.

#### ***Commitments to Sell Loans***

The fair values of commitments to sell loans are estimated using the quoted market prices for loans with similar interest rates and terms to maturity.

**NOTE 22 HMN Financial, Inc. Financial Information (Parent Company Only)**

The following are the condensed financial statements for the parent company only as of and for the years ended December 31, 2021 and 2020.

<i>(Dollars in thousands)</i>	2021	2020
<b>Condensed Balance Sheets</b>		
Assets:		
Cash and cash equivalents	\$ 12,538	10,970
Investment in subsidiaries	96,867	91,558
Prepaid expenses and other assets	785	891
Deferred tax asset, net	4	14
Total assets	<u>\$ 110,194</u>	<u>103,433</u>
Liabilities and Stockholders' Equity:		
Accrued expenses and other liabilities	\$ 163	181
Total liabilities	<u>163</u>	<u>181</u>
Common stock	91	91
Additional paid-in capital	40,740	40,480
Retained earnings	131,413	117,849
Net unrealized (loss) gains on securities available for sale	(1,583)	1,282
Unearned employee stock ownership plan shares	(1,256)	(1,450)
Treasury stock, at cost, 4,564,087 and 4,359,552 shares	(59,374)	(55,000)
Total stockholders' equity	<u>110,031</u>	<u>103,252</u>
Total liabilities and stockholders' equity	<u>\$ 110,194</u>	<u>103,433</u>
<b>Condensed Statements of Income</b>		
Interest income	\$ 31	43
Equity income of subsidiaries	14,174	10,815
Compensation and benefits	(282)	(243)
Occupancy and equipment	(30)	(30)
Data processing	(6)	(6)
Professional services	(111)	(93)
Other	(405)	(383)
Income before income tax benefit	<u>13,371</u>	<u>10,103</u>
Income tax benefit	193	199
Net income	<u>\$ 13,564</u>	<u>10,302</u>
<b>Condensed Statements of Cash Flows</b>		
Cash flows from operating activities:		
Net income	\$ 13,564	10,302
Adjustments to reconcile net income to cash used by operating activities:		
Equity income of subsidiaries	(14,174)	(10,815)
Deferred income tax benefit	10	10
Earned employee stock ownership shares priced above original cost	239	145
Amortization of restricted stock awards	243	238
Decrease in unearned ESOP shares	194	193
Decrease (increase) in other assets	106	(281)
Decrease in other liabilities	(18)	(34)
Net cash provided (used) by operating activities	<u>164</u>	<u>(242)</u>
Cash flows from financing activities:		
Treasury stock purchased	(4,589)	(1,450)
Stock awards withheld for tax withholding	(7)	(60)
Dividends received from Bank	6,000	5,000
Net cash provided by financing activities	<u>1,404</u>	<u>3,490</u>
Increase in cash and cash equivalents	<u>1,568</u>	<u>3,248</u>
Cash and cash equivalents, beginning of year	<u>10,970</u>	<u>7,722</u>
Cash and cash equivalents, end of year	<u>\$ 12,538</u>	<u>10,970</u>



**NOTE 23 Business Segments**

The Bank has been identified as a reportable operating segment in accordance with the provisions of ASC 280. HMN, the holding company, did not meet the quantitative thresholds for a reportable segment and therefore is included in the "Other" category. The Company evaluates performance and allocates resources based on the segment's net income, return on average assets and return on average equity. Each corporation is managed separately with its own officers and board of directors.

The following table sets forth certain information about the reconciliations of reported net income and assets for each of the Company's reportable segments.

<i>(Dollars in thousands)</i>	Home Federal Savings Bank	Other	Eliminations	Consolidated Total
<b>At or for the year ended December 31, 2021:</b>				
Interest income – external customers	\$ 31,761	0	0	31,761
Non-interest income – external customers	14,262	1	0	14,263
Intersegment interest income	0	31	(31)	0
Intersegment non-interest income	234	14,174	(14,408)	0
Interest expense	1,584	0	(31)	1,553
Provision for loan losses	(2,119)	0	0	(2,119)
Non-interest expense	27,060	835	(234)	27,661
Income tax expense (benefit)	5,558	(193)	0	5,365
Net income	14,174	13,564	(14,174)	13,564
Total assets	1,068,834	110,194	(109,490)	1,069,538
<b>At or for the year ended December 31, 2020:</b>				
Interest income – external customers	\$ 31,959	0	0	31,959
Non-interest income – external customers	15,083	0	0	15,083
Intersegment interest income	0	43	(43)	0
Intersegment non-interest income	234	10,815	(11,049)	0
Interest expense	2,894	0	(43)	2,851
Provision for loan losses	2,699	0	0	2,699
Non-interest expense	26,601	755	(234)	27,122
Income tax expense (benefit)	4,267	(199)	0	4,068
Net income	10,815	10,302	(10,815)	10,302
Total assets	909,605	103,433	(103,458)	909,580



## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and the Board of Directors of HMN Financial, Inc.

### **Opinion on the Financial Statements**

We have audited the accompanying consolidated balance sheets of HMN Financial, Inc. and Subsidiaries (the Company) as of December 31, 2021 and 2020, the related consolidated statements of comprehensive income, stockholders' equity, and cash flows for the years then ended, and the related notes (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2021 and 2020, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

### ***Basis for Opinion***

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audit we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

### Critical Audit Matters

The critical audit matter communicated below is a matter arising from the current period audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of the critical audit matter does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing a separate opinion on the critical audit matter or on the accounts or disclosures to which it relates.

#### *Allowance for loan losses*

As described in Notes 1 and 6 to the financial statements, the Company's allowance for loan losses is a valuation account that reflects the Company's estimate of incurred losses in its loan portfolio to the extent they are both probable and reasonable to estimate. The allowance for loan losses was \$9.3 million at December 31, 2021, which consists of two components (i) specific reserves based on probable losses on specific loans (specific reserves), representing \$0.4 million, and (ii) a general allowance based on historical loan loss experience, general economic conditions and other qualitative risk factors, both internal and external to the Company (general reserves), representing \$8.9 million. The general component of the allowance for loan losses is based on a variety of risk considerations, both quantitative and qualitative. Quantitative factors include the Company's historical loss experience, delinquency and charge-off trends, risk ratings, collateral values, known information about individual loans and other factors. Qualitative factors include various considerations regarding the general economic environment in the Company's market area and national economic factors. The qualitative adjustment for the general reserve includes management's consideration of industry concentrations; specific credit risks; credit loss experience; current loan portfolio quality; present economic, political and regulatory conditions; and unidentified losses inherent in the current loan portfolio.

The qualitative adjustment contributes significantly to the general reserve component of the allowance for loan losses. Management's identification and analysis of these considerations and related adjustments requires significant judgment and could have a significant effect on the allowance for loan losses. We identified the estimate of the qualitative adjustment of the general reserve for the allowance for loan losses as a critical audit matter as they represent a significant portion of the total general reserve and because management's estimate relies on a qualitative analysis to determine a quantitative adjustment which required especially subjective auditor judgment.

The primary procedures we performed to address this critical audit matter included:

- Performing substantive testing, including evaluating management's judgments and assumptions for developing the general reserve qualitative adjustments for the allowance for loan losses, including:
  - o Evaluating the completeness and accuracy of data inputs used as a basis for the adjustments relating to qualitative general reserve factors and considering whether the sources of data and factors that management used in forming the assumptions are relevant, reliable, and sufficient for the purpose based on the information gathered.

To the Stockholders and the Board of Directors of HMN Financial, Inc.

- o Assessing the accuracy of management's risk ratings for commercial real estate and commercial business loans. Our evaluation considered evidence from management's credit presentations and annual reviews, including review of borrower financial information, collateral values, payment history, and other credit specific information.
- o Evaluating the reasonableness of management's judgments related to the qualitative and quantitative assessment of the data used in the determination of the general reserve qualitative adjustments for consistency with each other, the supporting data, relevant historical data, and industry data.
- o Assessing whether historical data is comparable and consistent with data of the current year and considering whether the data is sufficiently reliable. Among other procedures, our evaluation considered evidence from internal and external sources, loan portfolio performance and whether such assumptions were applied consistently period to period.
- o Analytically evaluating the qualitative adjustment in the current year compared to prior year for directional consistency and reasonableness.
- o Testing the calculations used by management to translate the assumptions and key factors into the calculation.

/s/ CliftonLarsonAllen LLP

**CliftonLarsonAllen LLP**

We have served as the Company's auditor since 2014.

Minneapolis, Minnesota

March 4, 2022

**Other Financial Data**

The following tables set forth certain information as to the Bank's FHLB advances and other borrowings.

<i>(Dollars in thousands)</i>	Year Ended December 31,	
	2021	2020
Maximum Balance:		
FHLB advances and other borrowings	\$ 1	2
FHLB short-term advances and other borrowings	1	2
Average Balance:		
FHLB advances and other borrowings	0	0
FHLB short-term advances and other borrowings	0	0

See "Note 12 Federal Home Loan Bank (FHLB) Advances and Other Borrowings" in the Notes to Consolidated Financial Statements for more information on the Bank's FHLB advances and other borrowings.

**Selected Quarterly Financial Data (unaudited)***(Dollars in thousands, except per share data)*

	December 31, 2021	September 30, 2021	June 30, 2021
<b>Selected Operations Data (3 months ended):</b>			
Interest income	\$ 7,377	8,401	8,094
Interest expense	330	360	410
Net interest income	7,047	8,041	7,684
Provision for loan losses	234	(886)	(891)
Net interest income after provision for loan losses	6,813	8,927	8,575
<b>Non-interest income:</b>			
Fees and service charges	793	810	783
Loan servicing fees	387	389	384
Gain on sales of loans	1,657	1,471	1,665
Other	378	381	1,910
Total non-interest income	3,215	3,051	4,742
<b>Non-interest expense:</b>			
Compensation and benefits	4,249	3,948	4,096
Occupancy and equipment	1,071	1,090	1,104
Data processing	346	384	368
Professional services	543	409	283
Other	1,087	1,075	1,129
Total non-interest expense	7,296	6,906	6,980
Income before income tax expense	2,732	5,072	6,337
Income tax expense	733	1,453	1,809
Net income	\$ 1,999	3,619	4,528
Basic earnings per common share	\$ 0.45	0.82	1.01
Diluted earnings per common share	\$ 0.45	0.81	1.00
<b>Financial Ratios:</b>			
Return on average assets(1)	0.77%	1.45%	1.86%
Return on average common equity(1)	7.11	13.18	17.18
Average equity to average assets	10.92	10.96	10.96
Net interest margin(1)(2)	2.80	3.32	3.27

*(Dollars in thousands)***Selected Financial Condition Data (end of period):**

Total assets	\$ 1,069,538	1,036,615	981,026
<b>Securities available for sale:</b>			
Mortgage-backed and related securities	245,397	194,307	165,886
Other marketable securities	40,368	40,632	45,648
Loans held for sale	5,575	5,754	7,380
Loans receivable, net	652,502	622,264	637,219
Deposits	950,666	915,302	862,282
Stockholders' equity	110,031	109,934	107,958

(1) Annualized

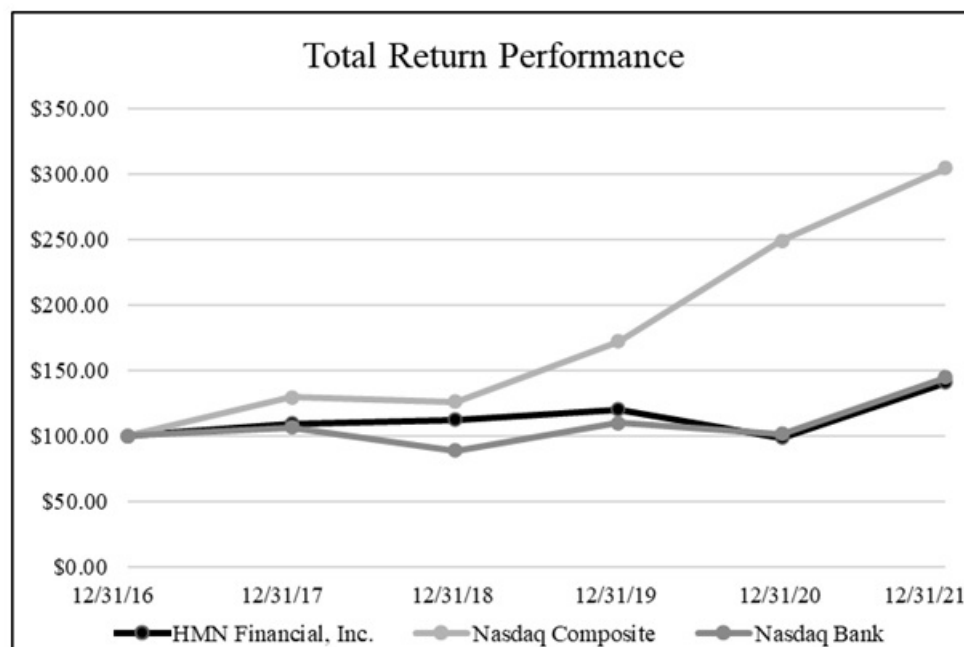
(2) Net interest income divided by average interest-earning assets

<b>March 31, 2021</b>	December 31, 2020	September 30, 2020	June 30, 2020	March 31, 2020
7,889	8,283	7,949	7,883	7,844
453	558	656	745	892
7,436	7,725	7,293	7,138	6,952
(576)	1,151	770	318	460
8,012	6,574	6,523	6,820	6,492
739	741	753	669	714
395	380	347	297	332
1,773	3,028	3,005	2,364	1,134
348	344	422	262	291
3,255	4,493	4,527	3,592	2,471
3,821	3,884	3,916	3,799	4,047
1,107	1,094	1,101	1,111	1,123
347	351	334	321	308
203	230	241	447	487
1,001	1,184	1,135	973	1,036
6,479	6,743	6,727	6,651	7,001
4,788	4,324	4,323	3,761	1,962
1,370	1,199	1,222	1,070	577
3,418	3,125	3,101	2,691	1,385
0.75	0.68	0.67	0.58	0.30
0.74	0.67	0.67	0.58	0.30
1.49 %	1.37%	1.39%	1.29%	0.72%
13.38	12.18	12.50	11.31	5.93
11.11	11.43	11.50	11.72	12.07
3.36	3.51	3.40	3.57	3.76
971,305	909,580	898,452	862,783	784,200
133,505	101,464	71,458	50,593	53,687
45,773	46,626	47,106	47,200	47,252
7,256	6,186	7,225	5,167	4,884
641,787	642,630	670,297	668,432	617,645
855,478	795,204	787,023	752,759	677,519
105,064	103,252	101,143	98,115	95,035

## Common Stock Information

The common stock of the Company is listed on the Nasdaq Stock Market (Nasdaq) under the symbol HMNF. As of December 31, 2021, there were 426 stockholders of record and 1,039 estimated beneficial stockholders. The Company has not paid a dividend on its common stock during the two-year period ending December 31, 2021. See “*Liquidity and Capital Resources – Dividends*” in the “*Management Discussion and Analysis*” section of this annual report for other information relating to dividends including a description of restrictions on the ability of the Company and the Bank to pay dividends.

The following graph and table compare the total cumulative stockholders’ return on the Company’s common stock to the Nasdaq U.S. Stock Index (“Nasdaq Composite”), which includes all Nasdaq traded stocks of U.S. companies, and the Nasdaq Bank Index. The graph and table assume that \$100 was invested on December 31, 2016 and that any dividends were reinvested.



Index	12/31/16	12/31/17	12/31/18	12/31/19	12/31/20	12/31/21
HMN Financial, Inc.	\$ 100.00	\$ 109.14	\$ 112.11	\$ 120.06	\$ 98.29	\$ 140.97
Nasdaq Composite	\$ 100.00	\$ 129.64	\$ 125.96	\$ 172.17	\$ 249.51	\$ 304.85
Nasdaq Bank	\$ 100.00	\$ 106.14	\$ 88.44	\$ 109.61	\$ 101.31	\$ 144.54



**HMN Financial, Inc.**  
1016 Civic Center Drive NW  
Rochester, MN 55901  
(507) 535-1200

**Annual Meeting**

The annual meeting of stockholders will be held virtually on Tuesday, April 26, 2022 at 10:00 a.m. (Central Time).

**Legal Counsel**

Faegre Drinker Biddle & Reath LLP  
2200 Wells Fargo Center  
90 South Seventh Street  
Minneapolis, MN 55402-3901

**Independent Registered Public Accounting Firm**

CliftonLarsonAllen LLP  
220 South Sixth Street, Suite 300  
Minneapolis, MN 55402-1436

**Investor Information and Form 10-K**

**HMN's Form 10-K, filed with the Securities and Exchange Commission, is available without charge upon written request from:**

HMN Financial, Inc.  
Attn: Cindy Hamlin, Investor Relations  
1016 Civic Center Drive NW  
Rochester, MN 55901  
or at [www.hmnf.com](http://www.hmnf.com)

**Transfer Agent and Registrar**

Inquiries regarding change of address, transfer requirements, and lost certificates should be directed to HMN's transfer agent:  
Equiniti Trust Company  
EQ Shareowner Services  
1110 Centre Pointe Curve, Suite 101  
Mendota Heights, MN 55120  
[www.shareowneronline.com](http://www.shareowneronline.com)  
(800) 468-9716

**Directors**

**Dr. Wendy S. Shannon**  
*Chair of the Board*  
*HMN and Home Federal Savings Bank*  
*Former Educational consultant, PTECH in Minnesota,*  
*Former Assistant Professor, Winona State University*

**Allen J. Berning**  
*Chief Executive Officer*  
*Ambient Clinical Analytics, a provider of clinical decision support products*

**Sequoia S. Borgman**  
*Borgman Capital LLC, Founder and*  
*Managing Director*

**Barbara Butts Williams**  
*Executive Dean, Social Responsibility and Community*  
*Engagement, Dean Emerita of Business, Capella*  
*University*

**Bradley C. Krehbiel**  
*President and Chief Executive Officer*  
*HMN and Home Federal Savings Bank*

**Bernard R. Nigon**  
*Retired Audit Partner with RSM US LLP (formerly*  
*McGladrey & Pullen, LLP)*

**Mark E. Utz**  
*Attorney at law, Wendland Utz, Ltd.*

**Hans K. Zietlow**  
*Former Director of Real Estate for Kwik Trip, Inc.*

**Executive Officers Who Are Not Directors**

**Jon J. Eberle**  
*Senior Vice President, Chief Financial Officer*  
*and Treasurer of HMN and Executive Vice*  
*President, Chief Financial Officer and Treasurer of Home*  
*Federal Savings Bank*

**Lawrence D. McGraw**  
*Executive Vice President and*  
*Chief Operating Officer*  
*Home Federal Savings Bank*

**Branch Offices of the Bank**

**Albert Lea**  
143 West Clark Street  
Albert Lea, MN 56007  
(507) 379-2551

**Austin**  
201 Oakland Avenue West  
Austin, MN 55912  
(507) 434-2500

**Egan**  
2805 Dodd Road, Suite 160  
Egan, MN 55121  
(651) 405-2000

**Kasson**

502 South Mantorville Avenue  
Kasson, MN 55944  
(507) 634-7022

**La Crescent**

208 South Walnut  
La Crescent, MN 55947  
(507) 895-9200

**Marshalltown**

303 West Main Street  
Marshalltown, IA 50158  
(641) 754-6198

**Owatonna**

1015 West Frontage Road, Suite 100  
Owatonna, MN 55060  
(507) 413-6420

**Pewaukee**

1870 Meadow Lane  
Pewaukee, WI 53072  
(262) 337-9511

**Rochester**

1201 South Broadway  
Rochester, MN 55904  
(507) 536-2416

1016 Civic Center Drive NW  
Rochester, MN 55901  
(507) 535-1309

100 1st Avenue Bldg., Suite 200  
Rochester, MN 55902  
(507) 280-7250

2048 Superior Drive NW, Suite 400  
Rochester, MN 55901  
(507) 226-0800

**Spring Valley**

715 North Broadway  
Spring Valley, MN 55975  
(507) 346-9709

**Winona**

175 Center Street  
Winona, MN 55987  
(507) 453-6460

**Loan Production Offices**

**Sartell**  
50 14th Ave E, Suite 100  
Sartell, MN 56377  
(320) 654-4020

**La Crosse**

700 3rd St. North, Suite 2104  
La Crosse, WI 54601  
(608) 982-0118



CliftonLarsonAllen LLP  
CLAconnect.com

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference of our report dated March 4, 2022, with respect to the consolidated balance sheets of HMN Financial, Inc. and Subsidiaries as of December 31, 2021 and 2020, and the related consolidated statements of comprehensive income, stockholders' equity, and cash flows for the years then ended, which appears in the December 31, 2021 annual report on Form 10-K of HMN Financial, Inc. and Subsidiaries and in the Registration Statements of HMN Financial, Inc. and Subsidiaries Nos. 33-94388, 33-94386, 333-64232, 333-158893, 333-217714 on Form S-8, and No. 333-156883 on Form S-3.

/s/ CliftonLarsonAllen LLP

**CliftonLarsonAllen LLP**

Minneapolis, Minnesota  
March 4, 2022



## CERTIFICATIONS

I, Bradley Krehbiel, certify that:

1. I have reviewed this annual report on Form 10-K of HMN Financial, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 4, 2022

By: /s/ Bradley Krehbiel  
Bradley Krehbiel  
President and Chief Executive Officer  
(Principal Executive Officer)

## CERTIFICATIONS

I, Jon J. Eberle, certify that:

1. I have reviewed this annual report on Form 10-K of HMN Financial, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 4, 2022

By: /s/ Jon J. Eberle

Jon J. Eberle  
Senior Vice President, Chief Financial Officer and Treasurer  
(Principal Financial Officer)

**HMN FINANCIAL, INC.****CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of HMN Financial, Inc. (the "Company") on Form 10-K for the period ended December 31, 2021 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), we, Bradley Krehbiel, President and Chief Executive Officer of HMN Financial, Inc. (the "Company") (Principal Executive Officer of the Company), and Jon Eberle, Senior Vice President, Chief Financial Officer and Treasurer of the Company (Principal Financial Officer of the Company), certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 4, 2022

*/s/ Bradley Krehbiel*

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Bradley Krehbiel  
President and Chief Executive Officer  
(Principal Executive Officer)

*/s/ Jon Eberle*

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Jon Eberle  
Senior Vice President/Chief Financial Officer  
and Treasurer  
(Principal Financial Officer)