



1016 Civic Center Drive NW PO Box 6057 Rochester, MN 55903-6057 Phone (507) 535-1200 FAX (507) 535-1301

NEWS RELEASE

**CONTACT: Bradley Krehbiel,
Principal Executive Officer
HMN Financial, Inc. (507) 252-7169
FOR IMMEDIATE RELEASE**

HMN FINANCIAL, INC. ANNOUNCES FIRST QUARTER RESULTS

First Quarter Highlights

- Net loss of \$1.8 million, an improvement of \$775,000, compared to net loss of \$2.6 million in the first quarter of 2009
- Diluted loss per common share of \$0.61 compared to diluted loss per common share of \$0.83 in the first quarter of 2009
- Net gain of \$761,000 on the sale of real estate owned compared to net loss of \$1.1 million on real estate owned sales in the first quarter of 2009
- Net interest income down \$821,000 from first quarter of 2009
- Non-performing assets up \$13.3 million to \$90.7 million during first quarter of 2010

LOSS SUMMARY

| | Three Months Ended | |
|---|--------------------|----------|
| | March 31, | |
| | 2010 | 2009 |
| <i>(dollars in thousands, except per share amounts)</i> | | |
| Net loss | \$ (1,847) | (2,622) |
| Diluted loss per common share | (0.61) | (0.83) |
| Return on average assets | (0.73) % | (0.94) % |
| Return on average equity | (7.50) % | (9.57) % |
| Book value per common share | \$ 17.10 | 20.64 |

ROCHESTER, MINNESOTA, April 21, 2010. . . HMN Financial, Inc. (HMN) (NASDAQ:HMNF), the \$1.0 billion holding company for Home Federal Savings Bank (the Bank), today reported a net loss of \$1.8 million for the first quarter of 2010, an improvement of \$775,000 compared to a net loss of \$2.6 million for the first quarter of 2009. Net loss available to common shareholders was \$2.3 million for the first quarter of 2010, an improvement of \$764,000, or 25.0%, from the net loss available to common shareholders of \$3.1 million for the first quarter of 2009. Diluted loss per common share for the first quarter of 2010 was \$0.61, an improvement of \$0.22 from diluted loss per common share of \$0.83 for the first quarter of 2009. The decrease in the net loss between the periods was due primarily to a \$1.9 million improvement in the gains/losses recognized on the sale of real estate owned which was partially offset by an \$821,000 decrease in net interest income. The decrease in net interest income was primarily the result of a decrease in interest-earning assets between the periods.

President's Statement

"Our financial results in the first quarter reflect the challenging economic environment that continues to have a negative effect on real estate values, our loan loss provision, and the amount of non-performing assets in our portfolio," said Home Federal Savings Bank President, Bradley Krehbiel. "We will continue to focus our efforts on reducing non-performing assets, reducing industry loan concentrations, increasing our core deposit relationships and reducing expenses. We believe that, over time, our focus on these areas will be effective in generating improved financial results. In the meantime, Home Federal Savings Bank continues to have adequate available liquidity and its capital position remains above the levels required for it to be considered a well capitalized financial institution by regulatory standards."

First Quarter Results

Net Interest Income

Net interest income was \$8.0 million for the first quarter of 2010, a decrease of \$0.8 million, or 9.3%, compared to \$8.8 million for the first quarter of 2009. Interest income was \$12.9 million for the first quarter of 2010, a decrease of \$2.5 million, or 16.0%, from \$15.4 million for the first quarter of 2009. Interest income decreased between the periods primarily because of a \$104 million decrease in average interest-earning assets between the periods. Average interest earning assets decreased between the periods primarily because of a decrease in the commercial loan portfolio, which occurred because of declining loan demand and the Company's focus on improving credit quality, managing interest rate risk and improving capital ratios. Interest income was also adversely affected by the increase in non-performing assets between the periods. The average yield earned on interest-earning assets was 5.36% for the first quarter of 2010, a decrease of 40 basis points from the 5.76% average yield for the first quarter of 2009.

Interest expense was \$4.9 million for the first quarter of 2010, a decrease of \$1.7 million, or 24.8%, compared to \$6.6 million for the first quarter of 2009. Interest expense decreased primarily because of the lower interest rates paid on money market accounts and certificates of deposits. The decreased rates were the result of the 400 basis point decrease in the federal funds rate that occurred in 2008. Decreases in the federal funds rate, which is the rate that banks charge other banks for short term loans, generally have a lagging effect and decrease the rates banks pay for deposits. The lagging effect of deposit rate changes is primarily due to the Bank's deposits that are in the form of certificates of deposits, which do not re-price immediately when the federal funds rate changes. Interest expense also decreased because of an \$89 million decrease in the average interest-bearing liabilities between the periods. The decrease in average interest-bearing liabilities is primarily the result of a decrease in the outstanding borrowings and brokered certificates of deposits between the periods. The decrease in borrowings and brokered deposits between the periods was the result of using the proceeds from loan principal payments to fund maturing borrowings and brokered deposits. The average interest rate paid on interest-bearing liabilities was 2.17% for the first quarter of 2010, a decrease of 46 basis points from the 2.63% average interest rate paid in the first quarter of 2009. Net interest margin (net interest income divided by average interest earning assets) for the first quarter of 2010 was 3.31%, an increase of 1 basis point, compared to 3.30% for the first quarter of 2009.

Provision for Loan Losses

The provision for loan losses was \$6.5 million for the first quarter of 2010, a decrease of \$0.1 million, or 0.5%, compared to \$6.6 million for the first quarter of 2009. The provision for loan losses remained elevated in the first quarter of 2010 primarily because of \$2.5 million in additional reserves established on two commercial real estate loans as a result of decreases in the estimated value of the underlying collateral supporting the loans, \$1.4 million in additional reserves established on other loans due to risk rating downgrades, \$1.6 million in additional reserves established on a commercial loan due to the borrower filing bankruptcy, and a \$1.1 million increase in the reserves required for other risk rated loans as a result of a loan portfolio analysis. Total non-performing assets were \$90.7 million at March 31, 2010, an increase of \$13.3 million, or 17.2%, from \$77.4 million at December 31, 2009. Non-performing loans increased \$16.9 million and foreclosed and repossessed assets decreased \$3.6 million during the first quarter of 2010. The increase in non-performing loans is primarily due to a \$6.4 million office building loan, a \$5.0 million loan to another financial institution, \$1.7 million in loans to a leasing operation, a \$1.5 million loan to a real estate developer and a \$0.9 million residential development loan that became non-

performing during the quarter. The non-performing loan and foreclosed and repossessed asset activity for the first quarter of 2010 was as follows:

(Dollars in thousands)

| Non-performing loans | | Foreclosed and repossessed assets | |
|----------------------------------|-----------------|--|-----------------|
| January 1, 2010 | \$61,127 | January 1, 2010 | \$16,262 |
| Classified as non-performing | 19,907 | Transferred from non-performing loans | 770 |
| Charge offs | (1,079) | Other foreclosures/repossessions | 389 |
| Principal payments received | (958) | Real estate sold | (5,442) |
| Classified as accruing | (229) | Net gain on sale of assets | 767 |
| Transferred to real estate owned | (770) | Write downs | (18) |
| March 31, 2010 | <u>\$77,998</u> | March 31, 2010 | <u>\$12,728</u> |

A rollforward of the Company's allowance for loan losses for the quarters ended March 31, 2010 and 2009 is summarized as follows:

| <i>(Dollars in thousands)</i> | 2010 | 2009 |
|-------------------------------|-----------------|-----------------|
| Balance at January 1, | \$23,811 | \$21,257 |
| Provision | 6,533 | 6,569 |
| Charge offs: | | |
| One-to-four family | (51) | 0 |
| Consumer | (306) | (694) |
| Commercial business | (61) | (184) |
| Commercial real estate | (660) | (9,461) |
| Recoveries | 18 | 7 |
| Balance at March 31, | <u>\$29,284</u> | <u>\$17,494</u> |
| General allowance | 12,080 | 10,002 |
| Specific allowance | <u>17,204</u> | <u>7,492</u> |
| | <u>\$29,284</u> | <u>\$17,494</u> |

The following table summarizes the amounts and categories of non-performing assets in the Bank's portfolio and loan delinquency information as of March 31, 2010 and December 31, 2009.

| <i>(Dollars in thousands)</i> | March 31, 2010 | December 31, 2009 |
|--|-------------------|----------------------|
| Non-Accruing Loans: | | |
| One-to-four family real estate | \$ 2,194 | \$ 2,132 |
| Commercial real estate | 43,596 | 37,122 |
| Consumer | 3,499 | 4,086 |
| Commercial business | 28,709 | 17,787 |
| Total | <u>77,998</u> | <u>61,127</u> |
| Foreclosed and Repossessed Assets: | | |
| One-to-four family real estate | 1,396 | 1,011 |
| Consumer | 4 | 5 |
| Commercial real estate | 11,328 | 15,246 |
| Total non-performing assets | <u>\$ 90,726</u> | <u>\$ 77,389</u> |
| Total as a percentage of total assets | <u>8.83</u> % | <u>7.47</u> % |
| Total non-performing loans | <u>\$ 77,998</u> | <u>\$ 61,127</u> |
| Total as a percentage of total loans receivable, net | <u>10.07</u> % | <u>7.65</u> % |
| Allowance for loan loss to non-performing loans | <u>37.54</u> % | <u>38.95</u> % |
| Delinquency Data: | | |
| Delinquencies ⁽¹⁾ | | |
| 30+ days | \$ 7,083 | \$ 11,140 |
| 90+ days | | 0 |
| Delinquencies as a percentage of Loan and lease portfolio ⁽¹⁾ | | |
| 30+ days | 0.90 % | 1.37 % |
| 90+ days | 0.00 % | 0.00 % |

(1) Excludes non-accrual loans.

The following table summarizes the number and types of commercial real estate loans (the largest category of non-performing loans) that were non-performing at March 31, 2010 and December 31, 2009.

(Dollars in thousands)

| Property Type | # of relationships | Principal Amount of Loans at March 31, | | # of relationships | Principal Amount of Loans at December 31, | |
|--------------------------|--------------------|--|--------|--------------------|---|--------|
| | | | 2010 | | | 2009 |
| Residential developments | 8 | \$ | 12,914 | 7 | \$ | 12,030 |
| Single family homes | 2 | | 3,088 | 2 | | 3,088 |
| Hotel | 1 | | 4,999 | 1 | | 4,999 |
| Alternative fuel plants | 2 | | 12,889 | 2 | | 12,834 |
| Shopping centers/retail | 2 | | 1,121 | 2 | | 1,136 |
| Restaurants/bar | 3 | | 2,258 | 4 | | 2,436 |
| Office building | 1 | | 6,327 | 1 | | 599 |
| | 19 | \$ | 43,596 | 19 | \$ | 37,122 |

Non-Interest Income and Expense

Non-interest income was \$1.6 million for the first quarter of 2010, a decrease of \$259,000, or 14.1%, from \$1.8 million for the first quarter of 2009. Fees and service charges decreased \$185,000 between the periods primarily because of a decrease in late fees and overdraft charges. Gain on sales of loans decreased \$109,000 between the periods due to a decrease in the gains recognized on the sale of single family loans because of a decrease in loan originations and sales. Other non-interest income increased \$19,000 between the periods primarily because of increased rental income on other real estate owned. Loan servicing fees increased \$16,000 between the periods primarily because of an increase in the number of single family loans that are being serviced for others.

Non-interest expense was \$6.0 million for the first quarter of 2010, a decrease of \$2.4 million, or 28.6%, from \$8.4 million for the first quarter of 2009. The gain/loss on real estate owned increased \$1.9 million between the periods due primarily to a \$1.0 million gain realized on the sale of an elderly care facility in the first quarter of 2010. Compensation expense decreased \$400,000 primarily because of costs associated with the employment agreement of a former executive officer that were expensed in the first quarter of 2009. Occupancy expense decreased \$61,000 due primarily to decreased depreciation expense on furniture and equipment. Amortization of mortgage servicing rights decreased \$46,000 between the periods as a result of fewer mortgage loan payoffs. Advertising expense decreased \$32,000 between the periods due to a decrease in printed advertising material and fewer promotional event sponsorships.

Income tax benefit decreased \$592,000 between the periods due to a decrease in the taxable loss and an effective tax rate that decreased from 40.2% for the first quarter of 2009 to 38.7% for the first quarter of 2010. The decrease in the effective tax rate is primarily due to the impact of tax exempt income.

Return on Assets and Equity

Return on average assets for the first quarter of 2010 was (0.73%), compared to (0.94%) for the first quarter of 2009. Return on average equity was (7.50%) for the first quarter of 2010, compared to (9.57%) for the first quarter of 2009. Book value per common share at March 31, 2010 was \$17.10, compared to \$20.64 at March 31, 2009.

General Information

HMN Financial, Inc. and Home Federal are headquartered in Rochester, Minnesota. Home Federal operates ten full service offices in Minnesota located in Albert Lea, Austin, Eagan, LaCrescent, Rochester, Spring Valley and Winona, Minnesota and two full service offices located in Marshalltown and Toledo, Iowa. Home Federal Private Banking operates branches in Edina and Rochester, Minnesota. Home Federal also operates loan origination offices in Sartell and Rochester, Minnesota.

Safe Harbor Statement

This press release may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including statements regarding reducing non-performing assets, reducing industry loan concentrations, increasing core retail and commercial deposit relationships, reducing expenses, and generating improved

financial results. These statements are often identified by such forward-looking terminology as “expect,” “intent,” “look,” “believe,” “anticipate,” “estimate,” “project,” “seek,” “may,” “will,” “would,” “could,” “should,” “trend,” “target,” and “goal” or similar statements or variations of such terms. A number of factors 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 securing loans to borrowers, possible legislative and regulatory changes and adverse economic, business and competitive developments such as shrinking interest margins; reduced collateral values; deposit outflows; 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; international economic developments, changes in credit or other risks posed by the Company’s loan and investment portfolios; technological, computer-related or operational difficulties; adverse changes in securities markets; results of litigation; 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 Company’s most recent filings on Form 10-K and Form 10-Q with the Securities and Exchange Commission. All forward-looking statements are qualified by, and should be considered in conjunction with, such cautionary statements.

(Three pages of selected consolidated financial information are included with this release.)

END

HMN FINANCIAL, INC. AND SUBSIDIARIES
Consolidated Balance Sheets

| <i>(Dollars in thousands)</i> | March 31, 2010 (unaudited) | December 31, 2009 |
|---|----------------------------------|----------------------|
| Assets | | |
| Cash and cash equivalents | \$ 34,301 | 16,418 |
| Securities available for sale: | | |
| Mortgage-backed and related securities (amortized cost \$46,676 and \$51,840)..... | 48,368 | 53,559 |
| Other marketable securities (amortized cost \$113,744 and \$105,723)..... | 113,714 | 106,043 |
| | <u>162,082</u> | <u>159,602</u> |
| Loans held for sale | 2,386 | 2,965 |
| Loans receivable, net | 774,336 | 799,256 |
| Accrued interest receivable | 3,786 | 4,024 |
| Real estate, net | 12,725 | 16,257 |
| Federal Home Loan Bank stock, at cost..... | 7,286 | 7,286 |
| Mortgage servicing rights, net | 1,356 | 1,315 |
| Premises and equipment, net..... | 10,403 | 10,766 |
| Prepaid expenses and other assets..... | 6,284 | 6,762 |
| Deferred tax asset, net..... | 13,531 | 11,590 |
| Total assets..... | <u>\$ 1,028,476</u> | <u>1,036,241</u> |
| Liabilities and Stockholders' Equity | | |
| Deposits | \$ 789,792 | 796,011 |
| Federal Home Loan Bank advances and Federal Reserve borrowings.... | 132,500 | 132,500 |
| Accrued interest payable..... | 1,747 | 2,108 |
| Customer escrows | 2,112 | 1,427 |
| Accrued expenses and other liabilities | 4,635 | 4,257 |
| Total liabilities | <u>930,786</u> | <u>936,303</u> |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Serial preferred stock (\$.01 par value): | | |
| Authorized 500,000 shares; issued shares 26,000..... | 23,901 | 23,785 |
| Common stock (\$.01 par value): | | |
| Authorized 11,000,000; issued shares 9,128,662..... | 91 | 91 |
| Additional paid-in capital | 56,326 | 58,576 |
| Retained earnings, subject to certain restrictions | 83,943 | 86,115 |
| Accumulated other comprehensive income, net of tax | 1,003 | 1,230 |
| Unearned employee stock ownership plan shares..... | (3,529) | (3,577) |
| Treasury stock, at cost 4,812,303 and 4,965,766 shares | (64,045) | (66,282) |
| Total stockholders' equity..... | <u>97,690</u> | <u>99,938</u> |
| Total liabilities and stockholders' equity | <u>\$ 1,028,476</u> | <u>1,036,241</u> |

HMN FINANCIAL, INC. AND SUBSIDIARIES
Consolidated Statements of Income (Loss)
(unaudited)

| <i>(Dollars in thousands)</i> | Three Months Ended March 31, | |
|--|---------------------------------|---------|
| | 2010 | 2009 |
| Interest income: | | |
| Loans receivable | \$ 11,759 | 13,628 |
| Securities available for sale: | | |
| Mortgage-backed and related | 535 | 802 |
| Other marketable | 572 | 946 |
| Cash equivalents | 1 | 0 |
| Other | 37 | (23) |
| Total interest income | 12,904 | 15,353 |
| Interest expense: | | |
| Deposits | 3,421 | 4,975 |
| Federal Home Loan Bank advances and Federal Reserve borrowings ... | 1,522 | 1,596 |
| Total interest expense | 4,943 | 6,571 |
| Net interest income | 7,961 | 8,782 |
| Provision for loan losses | 6,533 | 6,569 |
| Net interest income after provision for loan losses | 1,428 | 2,213 |
| Non-interest income: | | |
| Fees and service charges | 842 | 1,027 |
| Loan servicing fees | 268 | 252 |
| Gain on sales of loans | 314 | 423 |
| Other | 150 | 131 |
| Total non-interest income | 1,574 | 1,833 |
| Non-interest expense: | | |
| Compensation and benefits | 3,449 | 3,849 |
| (Gain) loss on real estate owned | (761) | 1,103 |
| Occupancy | 1,031 | 1,092 |
| Advertising | 103 | 135 |
| Data processing | 276 | 279 |
| Amortization of mortgage servicing rights, net | 109 | 155 |
| Other | 1,810 | 1,815 |
| Total non-interest expense | 6,017 | 8,428 |
| Loss before income tax benefit | (3,015) | (4,382) |
| Income tax benefit | (1,168) | (1,760) |
| Net loss | (1,847) | (2,622) |
| Preferred stock dividends and discount | (440) | (429) |
| Net loss available to common shareholders | (2,287) | (3,051) |
| Basic loss per common share | \$ (0.61) | (0.83) |
| Diluted loss per common share | \$ (0.61) | (0.83) |

HMN FINANCIAL, INC. AND SUBSIDIARIES
Selected Consolidated Financial Information
(unaudited)

| SELECTED FINANCIAL DATA: (Dollars in thousands, except per share data) | Three Months Ended | | |
|---|---------------------------------------|----------------------------|---------------------------------------|
| | March 31, | | |
| | 2010 | 2009 | |
| I. OPERATING DATA: | | | |
| Interest income | \$ 12,904 | 15,353 | |
| Interest expense | 4,943 | 6,571 | |
| Net interest income | 7,961 | 8,782 | |
| II. AVERAGE BALANCES: | | | |
| Assets ⁽¹⁾ | 1,029,745 | 1,133,058 | |
| Loans receivable, net | 788,981 | 894,379 | |
| Securities available for sale ⁽¹⁾ | 159,759 | 165,387 | |
| Interest-earning assets ⁽¹⁾ | 976,402 | 1,080,825 | |
| Interest-bearing liabilities | 923,614 | 1,012,552 | |
| Equity ⁽¹⁾ | 99,925 | 111,144 | |
| III. PERFORMANCE RATIOS: ⁽¹⁾ | | | |
| Return on average assets (annualized) | (0.73) % | (0.94) % | |
| Interest rate spread information: | | | |
| Average during period | 3.19 | 3.13 | |
| End of period | 3.20 | 3.27 | |
| Net interest margin | 3.31 | 3.30 | |
| Ratio of operating expense to average | | | |
| total assets (annualized) | 2.37 | 2.99 | |
| Return on average equity (annualized) | (7.50) | (9.57) | |
| Efficiency | 63.11 | 79.23 | |
| | March 31, 2010 | December 31, 2009 | March 31, 2009 |
| IV. ASSET QUALITY: | | | |
| Total non-performing assets | \$ 90,726 | 77,389 | 69,881 |
| Non-performing assets to total assets | 8.82 % | 7.47 % | 6.28 % |
| Non-performing loans to total loans | | | |
| receivable, net | 10.07 | 7.65 | 5.71 |
| Allowance for loan losses | \$ 29,284 | 23,811 | 17,494 |
| Allowance for loan losses to total assets | 2.85 % | 2.30 % | 1.57 % |
| Allowance for loan losses to total loans | | | |
| receivable, net | 3.78 | 2.98 | 1.99 |
| Allowance for loan losses to | | | |
| non-performing loans | 37.54 | 38.95 | 34.92 |
| V. BOOK VALUE PER COMMON SHARE: | | | |
| Book value per common share | \$ 17.10 | 17.94 | 20.64 |
| | Three Months Ended Mar 31, 2010 | Year Ended Dec 31, 2009 | Three Months Ended Mar 31, 2009 |
| VI. CAPITAL RATIOS: | | | |
| Stockholders' equity to total assets, | | | |
| at end of period | 9.50 % | 9.64 % | 9.82 % |
| Average stockholders' equity to | | | |
| average assets ⁽¹⁾ | 9.70 | 9.73 | 9.81 |
| Ratio of average interest-earning assets to | | | |
| average interest-bearing liabilities ⁽¹⁾ | 105.72 | 106.50 | 106.74 |
| | March 31, 2010 | December 31, 2009 | March 31, 2009 |
| VII. EMPLOYEE DATA: | | | |
| Number of full time equivalent employees | 212 | 212 | 206 |

(1) Average balances were calculated based upon amortized cost without the market value impact of SFAS 115.