

HMN FINANCIAL INC  
Form 11-K  
June 28, 2006

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**  
**FORM 11-K**

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

**For the fiscal year ended December 31, 2005.**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

**For the transition period from \_\_\_ to \_\_\_**

**Commission file number 0-24100**

A. Full title of the plan and the address of the plan, if different from that of the issuer named below:

**Home Federal Savings Bank Employees Savings and Profit Sharing Plan**

B. Name of issuer of the securities held pursuant to the plan and the address of its principal executive office:

**HMN Financial, Inc.**

**1016 Civic Center Drive**

**Rochester, MN 55901**

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Consent of Independent Registered Public Accounting Firm

**REQUIRED INFORMATION**

The financial statements filed as a part of the annual report of the plan include:

1. Audited statements of net assets available for benefits as filed under the Employee Retirement Income Security Act of 1974, as amended ( ERISA );
2. Audited statements of changes in net assets available for benefits as filed under ERISA.

**HOME FEDERAL SAVINGS BANK**  
**EMPLOYEES SAVINGS & PROFIT SHARING PLAN**  
Financial Statements and Supplemental Schedule  
(With Report of Independent Registered Public Accounting Firm Thereon)  
December 31, 2005 and 2004

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[logo]  
KPMG  
KPMG LLP  
4200 Wells Fargo Center  
90 South Seventh Street  
Minneapolis, MN 55402

**Report of Independent Registered Public Accounting Firm**

To Participants and Administrator of the  
Home Federal Savings Bank Employees  
Savings & Profit Sharing Plan:

We have audited the accompanying statements of net assets available for benefits of the Home Federal Savings Bank Employees Savings & Profit Sharing Plan (the Plan) as of December 31, 2005 and 2004, and the related statements of changes in net assets available for benefits for the years then ended. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets available for benefits of the Plan as of December 31, 2005 and 2004, and the changes in net assets available for benefits for the years then ended in conformity with U.S. generally accepted accounting principles.

Our audits were performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental schedule of assets (held at end of year) as of December 31, 2005 is presented for the purpose of additional analysis and is not a required part of the basic financial statements but is supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. This supplemental schedule is the responsibility of the Plan's management. The supplemental schedule has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

/s/ KPMG LLP  
Minneapolis, Minnesota  
June 27, 2006

**HOME FEDERAL SAVINGS BANK  
EMPLOYEES SAVINGS & PROFIT SHARING PLAN**

Statements of Net Assets Available for Benefits

December 31, 2005 and 2004

	December 31,	
	2005	2004
Investments:		
Cash and cash equivalents	\$ 79,607	85,763
Collective trust fund	452,231	427,245
Common stock at fair market value	1,091,706	1,162,644
Mutual funds at fair market value	4,129,581	3,358,662
	5,753,125	5,034,314
Participant loans	56,612	52,756
Net assets available for benefits	\$ 5,809,737	5,087,070

See accompanying notes to financial statements.

**HOME FEDERAL SAVINGS BANK**  
**EMPLOYEES SAVINGS & PROFIT SHARING PLAN**  
 Statements of Changes in Net Assets Available for Benefits  
 Years ended December 31, 2005 and 2004

	2005	2004
Contributions:		
Employer	\$ 123,189	129,464
Employee	696,327	639,455
Rollover	146,746	131,143
Total contributions	966,262	900,062
Withdrawals	(543,976)	(215,777)
Investment income:		
Net appreciation (depreciation) on fair market value of investments:		
Collective Trust fund	16,894	13,388
Mutual funds	256,599	331,316
Common stock	(132,908)	273,827
Total net appreciation	140,585	618,531
Interest	3,303	2,831
Dividends	166,169	107,828
Less asset management fees	(9,676)	(8,805)
Net investment income	300,381	720,385
Increase in net assets available for benefits	722,667	1,404,670
Beginning of year	5,087,070	3,682,400
End of year	\$ 5,809,737	5,087,070

See accompanying notes to financial statements.

**HOME FEDERAL SAVINGS BANK  
EMPLOYEES SAVINGS & PROFIT SHARING PLAN**

Notes to Financial Statements

December 31, 2005 and 2004

**(1) Summary of Significant Accounting Policies**

**Basis of Presentation**

The accompanying financial statements have been prepared on the accrual basis of accounting.

**Custodian of Investments**

First Trust Corporation is the trustee and custodian of all Plan assets.

**Plan Administration**

Home Federal Savings Bank (the Company) is the administrator of the Plan. Alliance Benefit Group performs the participant accounting.

**Valuation of Investments**

Investments are stated at their fair market value. The collective trust funds are valued based on the market prices of the underlying investments in the funds. Investments in mutual funds are valued using daily net asset value calculations performed by the funds and published by the National Association of Securities Dealers. Investments in common stock are valued at the quoted market price. Participant notes are valued at cost, which approximates fair value. Dividends are recorded on the ex-dividend date and are reinvested in the respective funds.

Purchases and sales of securities are recorded on a trade date basis. Net realized gains or losses are recognized by the Plan upon the sale of its investments or portions thereof based on average cost.

**Use of Estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of net assets available for benefits and changes therein, and disclosure of contingent assets and liabilities at the date of the financial statements and the reported changes in net assets available for benefits during the reporting period. Actual results could differ from those estimates.

**Costs and Expenses**

Asset management fees ranging between 38 and 85 basis points are assessed annually on average net asset values and are deducted from the individual funds. In addition, the Company paid accounting fees totaling \$12,525 and \$8,375 in 2005 and 2004, respectively.

**(2) Description of the Plan**

The following description of the Plan provides only general information. Participants should refer to the Summary Plan Description for more complete information.



**General**

The Plan is a defined contribution plan, qualified under section 401(a) of the Internal Revenue Code. The Plan includes 401(k) provisions, which allow participants to direct the Company to contribute a portion of their compensation to the Plan on a pretax basis through payroll deductions. The Plan is subject to the Employee Retirement Income Security Act of 1974 (ERISA).

**HOME FEDERAL SAVINGS BANK  
EMPLOYEES SAVINGS & PROFIT SHARING PLAN**

Notes to Financial Statements

December 31, 2005 and 2004

**(2) Description of the Plan (Continued)**

All Company employees who have attained the age of 18 are eligible to participate in the Plan, subject to entry dates.

**Funding Policy**

Participants have the ability to contribute up to 50% of their monthly compensation on a pretax basis to the Plan. Participant contributions are subject to the Internal Revenue Service maximum annual limits of \$14,000 during 2005 and \$13,000 during 2004. The Company matches 25% of each participant's contribution not in excess of 8% of the participant's annual salary. Participants over the age of 50 were allowed to contribute an additional \$4,000 and \$3,000 as a catch-up contribution during 2005 and 2004, respectively, as allowed by the tax law changes of 2001.

The Company may, in its sole discretion, contribute to the Plan an amount to be determined from year to year (the Non-Elective Contribution). Such contributions would be allocated to the accounts of participants in the ratio that each participant's compensation for the plan year bears to the total compensation of all participants for the plan year. There were no such contributions during 2005 or 2004.

**Participant Accounts**

Each participant's account is credited with the participant's contribution and allocations of the Company's contribution and Plan earnings. Allocations are based on participant contributions or account balances, as defined.

**Vesting**

Participants are immediately vested in their contributions and the actual earnings thereon.

Employees hired prior to January 1, 1997 are immediately vested in the employer contributions received during the plan year. Employees hired January 1, 1997 and thereafter are subject to 5-year cliff vesting for the employer matching contribution. Effective January 1, 2002, the vesting period was reduced to 3-year cliff vesting for employer matching amounts received during 2002 and thereafter. Employer matching contributions received prior to 2002 remain subject to the 5-year vesting service requirement, as applicable.

Forfeited amounts totaled \$7,460 and \$14,362 for 2005 and 2004, respectively, and are used to reduce future employer match obligations.

**Participant Loans**

Participants may borrow from their fund accounts a minimum of \$1,000 up to a maximum equal to the lesser of \$50,000 or 50 percent of their vested account balance. Loan terms range from 1 to 5 years, except loans used to purchase a primary residence which may have a term up to 15 years. All loans are secured by the balance in the participant's account and bear interest at a rate equal to the prime rate plus 1%. Principal and interest payments must be made monthly.



**HOME FEDERAL SAVINGS BANK  
EMPLOYEES SAVINGS & PROFIT SHARING PLAN**

Notes to Financial Statements

December 31, 2005 and 2004

**(2) Description of the Plan (Continued)**

**Concentration of Market Risk**

At December 31, 2005 and 2004, approximately 19% and 23%, respectively, of the Plan's net assets were invested in the common stock of HMN Financial, Inc. The underlying value of the HMN Financial, Inc. Common Stock is entirely dependent upon the performance of HMN Financial, Inc. and the market's evaluation of such performance. It is at least reasonably possible that changes in the fair value of HMN Financial, Inc. Common Stock in the near term could materially affect participants' account balances and the amounts reported in the statements of net assets available for benefits and the statements of changes in net assets available for benefits.

**Distributions**

Upon termination of employment for any reason, the vested portion of the participant's account balance becomes fully payable.

**Participating Employers**

The Company is a member of a controlled group of corporations as defined in Section 414(b) of the Internal Revenue Code. No members of the group other than the Company participated in the Plan prior to 1996.

**(3) Plan Termination**

The Company, by action of its board of directors, may terminate the Plan. All participants at the time of such termination shall be 100% vested in their account balances and shall be entitled to a benefit equal to the value of their accounts as determined as of the valuation date following termination.

**(4) Description of Investment Options**

Participant contributions are invested by the Plan Trustee in accordance with participant elections, in one or more of the investment options the Plan offers in increments of 1%.

American Funds Europacific A

This fund invests in growing companies based chiefly in Europe and the Pacific Basin, ranging from small firms to large corporations. It invests primarily in common and preferred stocks, convertibles, American Depositary Receipts, European Depositary Receipts, bonds and cash. Normally, at least 80% of assets must be invested in securities of issuers domiciled in Europe or the Pacific Basin.

American Funds Growth Fund A

This fund seeks to provide long-term growth of capital through a diversified portfolio of common stocks. The fund may invest in cyclical companies, turnarounds and value situations. It invests primarily in common stocks, convertibles, preferred stocks, U.S. government securities, bonds and cash.

American Funds AMCAP Fund A

This fund seeks to provide long-term growth of capital. It invests in established growth companies of any size with records of steady, above-average earnings and a growth rate faster than that of the general market. The fund primarily invests in U.S. common stocks, as well as convertible preferred stocks and cash and equivalents.

**HOME FEDERAL SAVINGS BANK  
EMPLOYEES SAVINGS & PROFIT SHARING PLAN**

Notes to Financial Statements

December 31, 2005 and 2004

**(4) Description of Investment Options (Continued)**

Dodge & Cox Stock Fund

The objective of this fund is long-term growth of principal and income. The Fund invests primarily in a diversified portfolio of common stocks.

Galliard Stable Return Fund

This fund invests in investment instruments issued by highly rated financial institutions. These instruments include guaranteed investment contracts, bank investment contracts and security-backed contracts. Safety of principal, consistency of returns with minimal volatility and liquidity for participant-initiated withdrawals are key objectives of the Fund.

T. Rowe Price Mid Cap Growth Advisors

This fund seeks capital appreciation by investing primarily in equity securities of companies with earnings that are expected to grow at an above-average rate. Current income, if considered at all, is a secondary objective.

Royce Premier

This fund seeks capital appreciation by investing primarily in stocks of small companies, as determined by either market capitalization or assets.

Strong Government Securities Fund

This fund invests primarily in high-quality bonds issued by the U.S. government or its agencies. The fund seeks total return by investing for a high level of current income with a moderate degree of share-price fluctuation.

Vanguard 500 Index

This fund seeks to provide investment results that correspond to the total return performance of common stocks of companies publicly traded in the United States. The fund attempts to duplicate the composition and total return of the S&P 500 Index while keeping transaction costs low.

Vanguard Mid Cap Index

This fund seeks to provide investment results that correspond to the total return performance of common stocks of companies publicly traded in the United States. The fund attempts to duplicate that composition and total return of the S&P 400 Mid Cap Index while keeping transaction costs low.

Vanguard Wellesley

This fund seeks total return by investing in a relatively fixed combination of both stocks and bonds. In general, these funds will hold a minimum of 25% in stocks and 25% in bonds at any time.

HMN Financial, Inc. Stock The fund invests in the common stock of HMN Financial, Inc., the Holding Company of Home Federal Savings Bank. Three to six percent of the fund is maintained in a Short Term Investment Fund for liquidity purposes.

**HOME FEDERAL SAVINGS BANK  
EMPLOYEES SAVINGS & PROFIT SHARING PLAN**

Notes to Financial Statements

December 31, 2005 and 2004

**(5) Investments**

The following investments equal or exceed 5% of net assets available for plan benefits at December 31, 2005 and 2004:

Description	Fair market value December 31,	
	2005	2004
American Funds Europacific A	437,714	291,189
Dodge & Cox Stock Fund	548,556	420,302
Galliard Stable Return Fund	452,231	427,245
Royce Premier	479,811	362,780
Strong Government Securities Fund	350,131	300,892
Vanguard 500 Index	567,257	530,896
Vanguard Mid Cap Index	729,970	646,770
Vanguard Wellesley	308,589	283,316
HMN Financial, Inc. Stock	1,091,706	1,162,644

**(6) Income Tax Status**

The Internal Revenue Service (the IRS) determined and informed the Company by a letter dated May 11, 1994 that the Plan and related trust, as then designed, were in compliance with the provisions of 401(a) of the Internal Revenue Code (the IRC) and were thereby exempt from federal income taxes under Section 501(a) of the code. The Plan has been amended in its entirety since receiving this determination letter. During 1999, the Plan, as amended, was again submitted to the IRS for determination of its tax-exempt status. A favorable determination was received on March 15, 2000. The Plan was also amended during 2003 and a favorable determination letter was received on November 17, 2003; therefore, no provision for income taxes has been included in the Plan's financial statements. The Company believes the Plan continues to qualify and operate as designed.

**(7) Party-in-Interest Transactions**

The Plan engages in investment transactions involving the acquisition or disposition of HMN Financial, Inc. common stock. HMN Financial, Inc. is the holding company of Home Federal Savings Bank and is a party-in-interest. Also, certain Plan investments are shares of mutual funds managed by Alliance Benefit Group (ABG). ABG is appointed as the third-party administrator of the Plan as defined by the Basic Plan Document and is a party-in-interest. These transactions are covered by an exemption from the prohibited transactions provisions of ERISA and the IRC.



**HOME FEDERAL SAVINGS BANK**  
**EMPLOYEES SAVINGS & PROFIT SHARING PLAN**  
Schedule of Assets (Held at End of Year)  
December 31, 2005

Description	Number Of Units	Fair Market Value
American Funds AMCAP Fund A	14,423.837	\$ 275,784
American Funds Europacific A	10,649.965	437,714
American Funds Growth Fund A	9,075.421	280,067
Dodge & Cox Stock Fund	3,997.637	548,556
Galliard Stable Return Fund	11,850.918	452,231
Royce Premier	28,458.520	479,811
Strong Government Securities Fund	33,473.317	350,131
T. Rowe Price Mid Cap Growth Advisors	2,827.089	151,702
Vanguard 500 Index	4,936.102	567,257
Vanguard Mid Cap Index	41,405.020	729,970
Vanguard Wellesley	14,645.886	308,589
Fidelity Advisor Daily Prime Money	7,610.030	7,610
First Trust Institutional Money Market	612.790	613
First Trust Money Market Account	71,384.520	71,384
*HMN Financial, Inc. Stock	37,007.000	1,091,706
Participant Loans (5.00% to 10.00%)	12	56,612
Total investments		\$5,809,737

\*Party-in-interest

See accompanying report of independent registered public accounting firm.

**SIGNATURES**

*The Plan.* Pursuant to the requirements of the Securities Exchange Act of 1934, the trustees (or other persons who administer the employee benefit plan) have duly caused this annual report to be signed on its behalf by the undersigned hereunto duly authorized.

**HOME FEDERAL SAVINGS BANK EMPLOYEES  
SAVINGS AND PROFIT SHARING PLAN**

Date: June 27,  
2006

By: /s/ Michael McNeil

Michael McNeil  
Title: President,  
Home Federal Savings Bank

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**EXHIBIT INDEX**

Exhibit  
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Consent of Independent Registered Public Accounting Firm

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