HMN
FINANCIAL INC.
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March 5, 2009

Neil M. Barofsky
Special Inspector General – TARP
1500 Pennsylvania Avenue, NW, Suite 1064
Washington, D.C. 20220

Dear Inspector Barofsky:

The following information is provided in response to your letter dated February 6, 2009.

(1) A narrative response specifically outlining (a) your anticipated use of TARP funds; (b) whether the TARP funds were segregated from other institutional funds; (c) your actual use of TARP funds to date; and (d) your expected use of unspent TARP funds. In your response, please take into consideration your anticipated use of TARP funds at the time that you applied for such funds, or any actions that you have taken that you would not have been able to take absent the infusion of TARP funds.

HMN Financial, Inc. (HMN) received $26.0 million in TARP funds from the Treasury on December 23, 2008 and these funds were not segregated from other institutional funds. The TARP funds were used to immediately pay off overnight advances from the Federal Reserve that were taken out in the fourth quarter of 2008 to fund loan growth. During the fourth quarter of 2008, our loan portfolio increased $27.7 million from $873.2 million at September 30, 2008 to $900.9 million at December 31, 2008. See financial information in the third quarter and fourth quarter of 2008 earnings releases (Exhibits #1 & #2).

The TARP funds were originally anticipated to be used to (1) increase liquidity by replacing wholesale funding sources, (2) ensure adequate capital to absorb potential losses on loans and nonperforming assets as a result of the economic downturn, and (3) position HMN to be able to take advantage of future opportunities to increase its core deposit base. With a stronger capital base, stable funding sources, and a reduced level of non-performing loans HMN would be positioned to prudently promote lending activities. The anticipated uses are more fully documented in the internal memo to our Board of

Directors (Exhibit #3) and the press release issued relating to the TARP funds (Exhibit #4).

The TARP funds improved HMN's capital position and allowed us to continue to lend and maintain our loan portfolio balances despite the elevated level of nonperforming loans and the reduced earnings experienced due to the current economic downturn. Without the TARP funds we would have had to decrease the size of our existing loan portfolio in order to reduce the risk of our capital falling below acceptable levels. See capital calculations attached to internal memo to our Board of Directors (Exhibit #3).

(2) Your specific plans, and the status of implementation of those plans, for addressing executive compensation requirements associated with the funding. Information provided regarding executive compensation should also include any assessments made of loans risks and their relationship to executive compensation; how limitations on executive compensation will be implemented in line with Department of Treasury guidelines; and whether any such limitations may be offset by other changes to other, longer-term or deferred forms of executive compensation.

The original compensation requirements related to TARP recipients would not have had a material impact on our compensation structure based on the nature and amounts of compensation of our senior executive officers. In response to existing Treasury regulations and guidance, we have (1) caused our compensation committee to review our senior executive officer incentive compensation with our senior risk officer to assess whether those arrangements encourage unnecessary or excessive risks that threaten the value of HMN, to discuss and review with our senior risk officer the relationship between our risk management policies and practices and our senior executive officer incentive compensation arrangements, and to certify to the foregoing in our annual proxy statement to stockholders; (2) amended existing arrangements with our senior executive officers to permit recovery by HMN of any bonus or incentive compensation paid to senior executive officers if such payments were based on materially inaccurate financial statements or any other materially inaccurate performance metric; (3) amended existing arrangements with our senior executive officers to assure that no compensation payment on account of an involuntary severance from employment or in the event of our receivership exceeds amounts permissible under new IRC Section 280G(e); (4) instituted controls and procedures to assure that we do not claim a deduction in an applicable tax year for federal income tax purposes from remuneration to a senior executive officer in excess of $500,000, as calculated in accordance with IRC Section 162(m)(5); and (5) taken steps in anticipation of timely execution and submission by our principal executive officer of forms of certification regarding compliance by HMN with the CPP executive compensation requirements.

The American Recovery and Reinvestment Act of 2009(ARRA) included modified and additional standards and requirements that we anticipate will in certain ways significantly affect our executive pay philosophy and practices. Implementation of many of these standards depends on adoption of new Treasury regulations and guidelines that are not yet available. Based on recent guidance from the Securities and Exchange Commission,

HMN has included in its annual proxy statement to stockholders for its upcoming April 2009 stockholder meeting the ARRA requirement for a non-binding proposal for stockholder approval of executive compensation as disclosed in the proxy statement. As required by ARRA, HMN has had in place for many years, consistent with applicable listing standards, a compensation committee comprised entirely of independent directors. As to other ARRA standards and requirements, we believe we must await further Treasury regulation and guidance in order to evaluate fully the impact of the ARRA changes and the revisions to our compensation policies, practices and arrangements necessary to assure full compliance.

Our implementation of the executive compensation requirements under the CPP is discussed in our proxy statement relating to our annual meeting of stockholders to be held in April 2009 (Exhibit #5).

Furthermore, I certify the accuracy of all statements, representations, and supporting information provided, subject to the requirements and penalties set forth in Title 18, United States Code, Section 1001.

Jon Eberle
Chief Financial Officer
Senior Vice President & Treasurer

Please feel free to contact me at (b) (6) if you would like to discuss or if you need additional information.

EXHIBIT #1

HMN FINANCIAL, INC. AND SUBSIDIARIES
Consolidated Balance Sheets

(dollars in thousands, except per share data)		September 30, 2008 (unaudited)	December 31, 2007
Assets			
Cash and cash equivalents	$	17,220	23,718
Securities available for sale:			
Mortgage-backed and related securities (amortized cost $75,496 and $18,786)		74,595	18,468
Other marketable securities (amortized cost $110,439 and $165,430)		111,463	167,720
		186,058	186,188
Loans held for sale		4,222	3,261
Loans receivable, net		873,156	865,088
Accrued interest receivable		5,211	6,893
Real estate, net		8,798	2,214
Federal Home Loan Bank stock, at cost		7,461	6,198
Mortgage servicing rights, net		824	1,270
Premises and equipment, net		13,442	12,024
Goodwill		0	3,801
Prepaid expenses and other assets		7,033	1,680
Deferred tax asset		5,475	4,719
Total assets	$	1,128,900	1,117,054
Liabilities and Stockholders' Equity			
Deposits	$	888,848	888,118
Federal Home Loan Bank advances		141,500	112,500
Accrued interest payable		5,984	9,515
Customer escrows		1,098	866
Accrued expenses and other liabilities		4,894	7,927
Total liabilities		1,042,324	1,018,926
Commitments and contingencies			
Stockholders' equity:			
Serial preferred stock: ($.01 par value) authorized 500,000 shares; issued and outstanding none		0	0
Common stock ($.01 par value): authorized 11,000,000; issued shares 9,128,662		91	91
Additional paid-in capital		57,962	58,049
Retained earnings, subject to certain restrictions		100,605	110,943
Accumulated other comprehensive income		73	1,167
Unearned employee stock ownership plan shares		(3,819)	(3,965)
Treasury stock, at cost 4,961,032 and 4,953,045 shares		(68,336)	(68,157)
Total stockholders' equity		86,576	98,128
Total liabilities and stockholders' equity	$	1,128,900	1,117,054

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

(dollars in thousands)		Three Months Ended September 30, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Interest income:					
Loans receivable	$	14,634	17,258	44,573	49,632
Securities available for sale:					
Mortgage-backed and related		360	212	797	495
Other marketable		1,224	2,498	4,641	6,810
Cash equivalents		78	250	196	972
Other		78	60	211	276
Total interest income		16,374	20,278	50,418	58,185
Interest expense:					
Deposits		6,235	9,283	20,944	24,506
Federal Home Loan Bank advances		1,571	1,182	4,047	4,227
Total interest expense		7,806	10,465	24,991	28,733
Net interest income		8,568	9,813	25,427	29,452
Provision for loan losses		15,790	921	18,480	2,404
Net interest income (loss) after provision for loan losses		(7,222)	8,892	6,947	27,048
Non-interest income:					
Fees and service charges		1,077	828	2,868	2,306
Mortgage servicing fees		240	254	722	789
Securities gains, net		479	0	479	0
Gain on sales of loans		58	205	442	1,189
Other		99	362	716	724
Total non-interest income		1,953	1,649	5,227	5,008
Non-interest expense:					
Compensation and benefits		3,010	3,147	9,406	9,770
Occupancy		1,131	1,127	3,424	3,323
Advertising		95	123	311	424
Data processing		399	325	1,077	941
Amortization of mortgage servicing rights, net		142	169	456	540
Goodwill impairment charge		0	0	3,801	0
Other		1,784	1,062	4,139	3,054
Total non-interest expense		6,561	5,953	22,614	18,052
Income (loss) before income tax expense (benefit)		(11,830)	4,588	(10,440)	14,004
Income tax expense (benefit)		(4,779)	1,806	(2,851)	5,505
Net income (loss)	$	(7,051)	2,782	(7,589)	8,499
Basic earnings (loss) per share	$	(1.93)	0.74	(2.08)	2.26
Diluted earnings (loss) per share	$	(1.93)	0.71	(2.08)	2.16

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

SELECTED FINANCIAL DATA: *(dollars in thousands, except per share data)*		Three Months Ended September 30, 2008		Three Months Ended September 30, 2007		Nine Months Ended September 30, 2008		Nine Months Ended September 30, 2007	
I. OPERATING DATA:									
Interest income	$	16,374		20,278		50,418		58,185	
Interest expense		7,806		10,465		24,991		28,733	
Net interest income		8,568		9,813		25,427		29,452	
II. AVERAGE BALANCES:									
Assets [1]		1,103,824		1,135,219		1,099,419		1,091,421	
Loans receivable, net		897,311		850,557		884,239		819,362	
Securities available for sale [1]		131,053		209,147		145,713		190,231	
Interest-earning assets [1]		1,061,578		1,088,823		1,057,124		1,044,417	
Interest-bearing liabilities		996,011		1,025,409		987,458		985,016	
Equity [1]		96,255		98,629		97,851		97,384	
III. PERFORMANCE RATIOS: [1]									
Return on average assets (annualized)		(2.54)	%	0.97	%	(0.92)	%	1.04	%
Interest rate spread information:									
Average during period		3.02		3.34		2.99		3.55	
End of period		2.83		3.23		2.83		3.23	
Net interest margin		3.21		3.58		3.21		3.77	
Ratio of operating expense to average total assets (annualized)		2.36		2.08		2.75		2.21	
Return on average equity (annualized)		(29.14)		11.19		(10.36)		11.67	
Efficiency		62.36		51.94		73.77		52.39	

		September 30, 2008		December 31, 2007		September 30, 2007	
IV. ASSET QUALITY:							
Total non-performing assets	$	45,248		21,935		20,279	
Non-performing assets to total assets		4.01	%	1.96	%	1.77	%
Non-performing loans to total loans receivable, net		4.17	%	2.27	%	2.10	%
Allowance for loan losses	$	15,571		12,438		11,552	
Allowance for loan losses to total assets		1.38		1.11		1.01	
Allowance for loan losses to total loans receivable, net		1.78	%	1.44	%	1.37	%
Allowance for loan losses to non-performing loans		42.75		63.28		65.12	
V. BOOK VALUE PER SHARE:							
Book value per share	$	20.77		23.50		22.86	

	Nine Months Ended Sept 30, 2008		Year Ended Dec 31, 2007		Nine Months Ended Sept 30, 2007	
VI. CAPITAL RATIOS:						
Stockholders' equity to total assets, at end of period	7.67	%	8.78	%	8.48	%
Average stockholders' equity to average assets [1]	8.90		8.89		8.92	
Ratio of average interest-earning assets to average interest-bearing liabilities [1]	107.06		106.33		106.03	

	September 30, 2008	December 31, 2007	September 30, 2007
VII. EMPLOYEE DATA:			
Number of full time equivalent employees	202	203	203

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

EXHIBIT #2

HMN FINANCIAL, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(unaudited)

(dollars in thousands, except per share data)		December 31, 2008	December 31, 2007
Assets			
Cash and cash equivalents	$	15,729	23,718
Securities available for sale:			
Mortgage-backed and related securities (amortized cost $76,166 and $18,786)		77,327	18,468
Other marketable securities (amortized cost $95,445 and $165,430)		97,818	167,720
		175,145	186,188
Loans held for sale		2,548	3,261
Loans receivable, net		900,889	865,088
Accrued interest receivable		5,568	6,893
Real estate, net		10,558	2,214
Federal Home Loan Bank stock, at cost		7,286	6,198
Mortgage servicing rights, net		728	1,270
Premises and equipment, net		13,972	12,024
Goodwill		0	3,801
Prepaid expenses and other assets		4,408	1,680
Deferred tax asset, net		8,649	4,719
Total assets	$	1,145,480	1,117,054
Liabilities and Stockholders' Equity			
Deposits	$	880,505	888,118
Federal Home Loan Bank Advances and Federal Reserve Borrowings		142,500	112,500
Accrued interest payable		6,307	9,515
Customer escrows		639	866
Accrued expenses and other liabilities		3,316	7,927
Total liabilities		1,033,267	1,018,926
Commitments and contingencies			
Stockholders' equity:			
Serial-preferred stock: ($.01 par value/$1,000 liquidation preference) Authorized 500,000 shares; issued shares 26,000		23,384	0
Common stock ($.01 par value): Authorized 11,000,000; issued shares 9,128,662		91	91
Additional paid-in capital		60,687	58,049
Retained earnings, subject to certain restrictions		98,067	110,943
Accumulated other comprehensive income		2,091	1,167
Unearned employee stock ownership plan shares		(3,771)	(3,965)
Treasury stock, at cost 4,961,032 and 4,953,045		(68,336)	(68,157)
Total stockholders' equity		112,213	98,128
Total liabilities and stockholders' equity	$	1,145,480	1,117,054

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

(dollars in thousands, except per share data)	Three Months Ended December 31, 2008	Three Months Ended December 31, 2007	Year Ended December 31, 2008	Year Ended December 31, 2007
Interest income:				
Loans receivable	$ 14,098	16,483	58,671	66,115
Securities available for sale:				
Mortgage-backed and related	818	232	1,615	727
Other marketable	1,134	2,343	5,775	9,153
Cash equivalents	2	215	198	1,187
Other	42	65	253	341
Total interest income	16,094	19,338	66,512	77,523
Interest expense:				
Deposits	6,212	8,896	27,157	33,403
Federal Home Loan Bank advances and Federal Reserve borrowings	1,593	1,193	5,639	5,420
Total interest expense	7,805	10,089	32,796	38,823
Net interest income	8,289	9,249	33,716	38,700
Provision for loan losses	8,216	1,494	26,696	3,898
Net interest income after provision for loan losses	73	7,755	7,020	34,802
Non-interest income:				
Fees and service charges	1,065	833	3,933	3,139
Mortgage servicing fees	233	265	955	1,054
Securities gains, net	0	0	479	0
Gain on sales of loans	208	325	651	1,514
Other	220	1,163	936	1,887
Total non-interest income	1,726	2,586	6,954	7,594
Non-interest expense:				
Compensation and benefits	3,057	2,721	12,464	12,491
Occupancy	1,097	1,144	4,521	4,467
Advertising	112	118	422	542
Data processing	318	326	1,395	1,267
Amortization of mortgage servicing rights, net	114	166	570	706
Goodwill impairment charge	0	0	3,801	0
Other	1,773	1,295	5,912	4,349
Total non-interest expense	6,471	5,770	29,085	23,822
Income (loss) before income tax expense	(4,672)	4,571	(15,111)	18,574
Income tax expense (benefit)	(2,134)	1,796	(4,984)	7,300
Net income (loss)	(2,538)	2,775	(10,127)	11,274
Preferred stock dividends and discounts	(37)	0	(37)	0
Net income (loss) available to common shareholders	$ (2,575)	2,775	(10,164)	11,274
Basic earnings (loss) per share	$ (0.70)	0.75	(2.78)	3.02
Diluted earnings (loss) per share	$ (0.70)	0.73	(2.78)	2.89

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

SELECTED FINANCIAL DATA: *(dollars in thousand, except per share data)*	Three Months Ended December 31, 2008	Three Months Ended December 31, 2007	Year Ended December 31, 2008	Year Ended December 31, 2007
I. OPERATING DATA:				
Interest income $	16,094	19,338	66,512	77,523
Interest expense	7,805	10,089	32,796	38,823
Net interest income	8,289	9,249	33,716	38,700
II. AVERAGE BALANCES:				
Assets [1]	1,150,853	1,124,661	1,112,348	1,099,800
Loans receivable, net	898,549	852,035	887,836	827,597
Mortgage-backed and related securities [1]	180,906	200,258	154,559	192,758
Interest-earning assets [1]	1,101,622	1,082,818	1,068,309	1,054,193
Interest-bearing liabilities	1,049,854	1,010,301	1,003,142	991,389
Equity [1]	88,340	99,105	95,460	97,818
III. PERFORMANCE RATIOS: [1]				
Return (loss) on average assets (annualized)	(0.88)%	0.98%	(0.91)%	1.03%
Interest rate spread information:				
Average during period	2.85	3.12	2.96	3.44
End of period	3.11	3.20	3.11	3.20
Net interest margin	2.99	3.39	3.16	3.67
Ratio of operating expense to average total assets (annualized)	2.44	2.04	2.61	2.17
Return (loss) on average equity (annualized)	(11.43)	11.11	(10.61)	11.53
Efficiency	64.61	48.75	71.52	51.46

	December 31, 2008	December 31, 2007
IV. ASSET QUALITY		
Total non-performing assets $	74,756	21,935
Non-performing assets to total assets	6.53%	1.96%
Non-performing loans to total loans receivable, net	7.12%	2.27%
Allowance for loan losses $	21,257	12,438
Allowance for loan losses to total assets	1.86%	1.11%
Allowance for loan losses to total loans receivable, net	2.36	1.44
Allowance for loan losses to non-performing loans	33.12	63.28
V. BOOK VALUE PER COMMON SHARE:		
Book value per common share	20.69	23.50

	Year Ended Dec 31, 2008	Year Ended Dec 31, 2007
VI. CAPITAL RATIOS :		
Stockholders' equity to total assets, at end of period	9.80%	8.78%
Average stockholders' equity to average assets [1]	8.58	8.89
Ratio of average interest-earning assets to average interest-bearing liabilities [1]	106.50	106.33

	December 31, 2008	December 31, 2007
VII. EMPLOYEE DATA:		
Number of full time equivalent employees	204	203

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

EXHIBIT # 3

SPECIFIC PLAN ON USE OF PROCEEDS FROM THE TARP CAPITAL PURCHASE PROGRAM

The purpose of this memo is to document the intended uses of the cash and additional capital from the TARP Capital Purchase Program (CPP) if HMN's application to participate in the program is approved.

1. The cash obtained would improve liquidity by replacing some of the brokered deposits that are maturing. Without the proceeds from the CPP, these funds would have to be repaid with commercial loan sale proceeds or replaced using the available liquidity at the Federal Home Loan Bank or the Federal Reserve

2. Given the current economic environment, it is reasonable to assume that some additional losses may materialize in the loan portfolio over the next several months. In addition, if the current economic environment persists for an extended period of time we may be required to write down or liquidate certain non-performing loans at prices below their current estimated fair market value. The increase in capital from the CPP would provide adequate capital to absorb these potential losses while maintaining the Bank in a "well capitalized" position.

(b) (4)

Actual Capital Position at 9-30-08

SCHEDULE B

HOME FEDERAL SAVINGS BANK
SUMMARY CAPITAL CALCULATION
September 30 2008

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		E1	E2	E5	E6	E3	E3	E4
	HOME FEDERAL SAVINGS BANK	Pre dividend	Dividend	REIT Tax	Metro Gem	Cash Received	Sale of Assets	Post Dividend
ccr25	Tangible assets	1 128 228	0	0	0	0	0	1 128 228
ccr25	Adjusted total assets	1,128,228	0	0	0	0	0	1 128 228
ccr78	Risk weighted assets	867 812	0		0	0	0	867 812

	(in thousands)	Actual Amount	Actual Percent	Required to be Adequately Capitalized Amount	Required to be Adequately Capitalized Percent	Excess Capital Amount	Excess Capital Percent	To Be Well Capitalized Under Prompt Corrective Actions Provisions Amount	To Be Well Capitalized Under Prompt Corrective Actions Provisions Percent
ccr100	Bank stockholder's equity	$ 82,925							
	Dividend paid to HMN in 3rd Quarter	0							
	Less : Estimated Loss on Sale of Non-performings	0							
	Less : Estimated Impact if unfavorable outcome on REIT	0							
	Less: Metro Gem Write Off	0							
	Add: Capital Contribution from HMN	0							
	Plus:								
ccr180	Net unrealized loss (gain) on certain securities available for sale and cash flow hedges	(278)							
	Less:								
ccr115	Goodwill and other intangibles	0							
ccr133	Disallowed servicing and tax assets	0							
ccr030	Tier 1 or core capital	82,647					Excess	26 236	
	Tier 1 capital to adjusted total assets		7.33% $	45 129	4.00% $	37.518	3.33% $	56,411	5.00%
	Tier I capital to risk- weighted assets		9.52% $	34,712	4.00% $	47 935	5.52% $	52 069	6.00%
	Less Estimated Loss on Sale								
	Plus;								
ccr350	Allowable allowance for loan losses	8,849							
	Risk-based capital	91,496					Excess	4,715	
	Risk-based capital to risk-weighted assets		10.54%	69 425	8.00%	22 071	2 54%	86,781	10.00%

Estimated CAPITAL POSITION at 12-31-08 AFTER Capital Contribution by HMN and assuming TARP CPP equity capital

SCHEDULE B

HOME FEDERAL SAVINGS BANK
SUMMARY CAPITAL CALCULATION
September 30 2008

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			E1	E2	E3	E3	E4		E5
		Pre dividend	Dividend	REIT Tax	Cash Received	Sale of Assets	Shrink Bank	TARP - CPP	Post Dividend
	HOME FEDERAL SAVINGS BANK								
ccr25	Tangible assets	1 128.228	2,000	0	0	0	0	26,000	1 156 228
ccr25	Adjusted total assets	1 128.228	2,000	0	0	0	0	26 000	1 156 228
ccr78	Risk weighted assets	867,812	0		0	0	0		867,812

		Actual		Required to be Adequately Capitalized		Excess Capital		To Be Well Capitalized Under Prompt Correctiv Actions Provisions	
	(in thousands)	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
ccr100	Bank stockholder's equity	$ 82,925							
	Dividend paid to HMN in 3rd Quarter	0							
	Less : Estimated Loss on Sale of Non-performings	0							
	Less : Estimated Impact if unfavorable outcome on REIT	0							
	Add: Capital Contribution from HMN	2 000							
	TARP CPP	26,000							
	Plus:								
ccr180	Net unrealized loss (gain) on certain securities available for sale and cash flow hedges	(278)							
	Less:								
ccr115	Goodwill and other intangibles	0							
ccr133	Disallowed servicing and tax assets	0							
ccr030	Tier 1 or core capital	110,647					Excess	52,836	
	Tier 1 capital to adjusted total assets		9.57% $	46 249	4.00% $	64,398	5.57% $	57,811	5.00%
	Tier l capital to risk- weighted assets		12 75% $	34 712	4.00% $	75 935	8.75% $	52 069	6.00%
	Less Estimated Loss on Sale								
	Plus:								
ccr350	Allowable allowance for loan losses	8,849							
	Risk-based capital	119,496		69,425		50.071	Excess	32,715	
	Risk-based capital to risk-weighted assets		13.77%		8.00%		5.77%	86,781	10.00%

EXHIBIT # 4

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

NEWS RELEASE

CONTACT: Michael McNeil, President
HMN Financial, Inc. (507) 535-1202
FOR IMMEDIATE RELEASE

HMN FINANCIAL PARTICIPATES IN U.S. TREASURY'S CAPITAL PURCHASE PROGRAM

ROCHESTER, MINNESOTA, December 23, 2008 - HMN Financial, Inc. (HMN or the Company) (NASDAQ:HMNF), the holding company for Home Federal Savings Bank (the Bank), announced today it has successfully completed the sale of $26.0 million in preferred stock and related warrant to the United States Treasury Department. This transaction is part of Treasury's capital purchase program under the Emergency Economic Stabilization Act of 2008. Under the terms of the transaction, the Company issued 26,000 shares of cumulative perpetual preferred stock and a warrant to purchase 833,333 shares of HMN common stock at an exercise price of $4.68 per share.

The preferred shares are entitled to a 5% annual cumulative dividend for each of the first five years of the investment, increasing to 9% thereafter, unless HMN redeems the shares. The preferred stock can't be redeemed for a period of three years from the date of the Treasury investment, except with the proceeds of certain qualifying offerings of Tier 1 capital. After three years, the preferred stock may be redeemed in whole or in part, at par plus accrued and unpaid dividends. The preferred stock is non-voting, other than certain class voting rights. The warrant may be exercised at any time over its ten-year term. Treasury has agreed not to vote any shares of common stock acquired upon exercise of the warrant. Without the consent of Treasury, for three years following issuance of the preferred stock, HMN cannot (i) increase the rate at which it pays dividends on its common stock in excess of the rate at which it last declared a quarterly common stock dividend, or $0.25 per share, or (ii) subject to certain exceptions, repurchase any shares of HMN common stock outstanding.

Both the preferred securities and the warrant will be accounted for as Tier 1 capital. The Bank's risk-based capital ratio (the ratio of risk-based capital to risk-weighted assets) was 10.54% at September 30, 2008, which is above the regulatory capital requirements of 10.0% for a "well capitalized" bank. If this additional capital had been included in the Bank's capital calculation at September 30, 2008, the Bank's risk based capital ratio would have increased to 13.5% as risk-based capital would have increased by $26.0 million from $91.5 million to $117.5 million and risk-weighted assets would have remained at $867.8 million.

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"This investment will further enhance our already well-capitalized position," said Michael McNeil, President and CEO. "Our ability to meet the needs of our customers and the communities we serve will be further strengthened by these funds. Additional capital should also benefit shareholders by providing funding that should enable us to expand our market share and build shareholder value."

General Information

HMN Financial, Inc. and Home Federal Savings Bank are headquartered in Rochester, Minnesota. The Bank operates eleven full service offices in southern Minnesota located in Albert Lea, Austin, Eagan, LaCrescent, Rochester, Spring Valley and Winona and two full service offices in Iowa located in Marshalltown and Toledo. Home Federal Savings Bank also operates loan origination offices in Rochester and Sartell, Minnesota. Home Federal Private Banking operates branches in Edina 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. Forward-looking statements deal with matters that do not relate strictly to historical facts. Words such as "anticipate", "believe", "expect", "intend", "would", "could", "should", "estimate", "project" and similar expressions, as they relate to the Company, are intended to identify such forward-looking statements. These statements include, but are not limited to those relating to the continuation of the Bank's well-capitalized position, the Company's ability to serve the needs of its customers, expand its market share and build shareholder value with the proceeds of the preferred stock investment by the United States Treasury, the adequacy of available liquidity to the Bank, the future outlook for the Company, the result of actions being taken by national and world leaders stabilizing the global economy and assuring consumer and business access to credit, any future dividends, and the Company's financial expectations for earnings and interest income. 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.

END

EXHIBIT # 5

COMPENSATION DISCUSSION AND ANALYSIS

Overview

We have not paid any compensation to our executive officers since our formation. We do not anticipate paying any compensation to these officers until we become actively involved in the operation or acquisition of businesses other than our banking subsidiary. The following discusses the compensation paid or accrued by our banking subsidiary for services rendered by our principal executive officer, principal financial officer and our three most highly compensated other executive officers for 2008. We sometimes refer to the executive officers as the named executive officers.

The compensation committee of our board of directors establishes and administers the compensation and benefits program for executive officers and directors. The compensation committee has designed our executive compensation program to achieve the following primary goals:

- to attract and retain a highly qualified and coordinated workforce of executives who have the skills, experience and work ethic required to effectively achieve our goals and objectives; and
- to align executives' interests with the creation and maintenance of long-term stockholder value.

Two recent developments have impacted our compensation programs and procedures. First, on December 23, 2008, we issued securities to the United States Treasury under the CPP. Under the CPP, we and our senior executive officers must comply with certain limitations on executive compensation pay and practices throughout the time the Treasury holds our securities that it purchased under the CPP. The compensation provisions of the legislation under which the CPP is authorized were amended significantly effective February 17, 2009, and implementing regulations have not yet been issued. See "Impact of the Capital Purchase Program on Compensation Matters" on the following pages. Second, on January 28, 2009, Michael McNeil, our former President and Chief Executive Officer resigned from all positions with our company and the bank, and Bradley C. Krehbiel was appointed President of the bank. Through that appointment, Mr. Krehbiel became our principal executive officer. The following discussion and analysis generally applies to our compensation programs and procedures as they were in effect for 2008, and to the extent permitted by the limitations under the CPP, as they currently would remain. However, based on the recent developments discussed above, we anticipate that modifications to our compensation programs and procedures will be required in 2009. The regulatory environment related to the CPP continues to evolve, and extent of the modifications that we will be required to make to our compensation programs and procedures remains pending.

The committee seeks to achieve the goals of our executive compensation program by providing for a competitive base salary, short-term cash incentives and intermediate and long-term equity awards. Base salaries generally represent one-half to two-thirds of our executives' total annual potential compensation (which consists of base salary, cash bonus potential and the grant date value of equity compensation awards granted in a particular year). The committee's philosophy is that base salaries are a significant retention element of compensation, and that our base salaries should be competitive with those of similar sized financial institutions that have operating results similar to ours. The remainder of our executives' annual potential compensation is divided between cash incentives and equity awards. Cash incentives are a discretionary element of compensation that the committee uses to reward executives for performance, including contributions to company performance, that is consistent with the creation and maintenance of intermediate and long-term stockholder value. Equity awards are designed to promote the retention of executives and to align their interests with the creation and maintenance of intermediate and long-term stockholder value. The compensation committee seeks to blend the elements of the compensation program so that base salaries provide competitive compensation for short-term retention purposes, incentive elements of compensation (incentive bonuses and the appreciation potential of equity awards) provide sufficient incentives to motivate executives to achieve business objectives that will lead to the creation and maintenance of intermediate and long-term stockholder value and time-based elements of compensation (time-based vesting of equity awards) provide sufficient incentives for long-term executive retention and encourage executives to have a long-term perspective in creating and maintaining stockholder value.

In designing our compensation programs, we consider, as ancillary matters, the accounting treatment in our financial statements and the tax impact on us of various potential elements of compensation. We also consider, as ancillary matters, the tax impact, including the timing of taxation, on our executives of various potential elements of

compensation. In the past, we have modified the mix of our compensation elements based on changes in financial accounting treatment (such as changing the nature of equity compensation awards partially in response to changes in accounting for equity compensation) and included compensation elements with favorable tax treatment for our employees (such as employer 401(k) contributions), and we may do so again in the future. However, we do not consider accounting and tax matters as primary factors in managing our compensation program. Our chief financial officer and his staff, together with outside professionals, assist the compensation committee in evaluating the financial accounting and tax treatment of existing and potential elements of our executive compensation program.

The compensation committee consists exclusively of independent non-employee directors. The committee has the authority to retain compensation consultants to assist in the evaluation of executive officer compensation. In 2008, the committee did not engage an independent compensation consultant.

The committee directs our chief financial officer and his staff to perform an annual survey of executive compensation at similar sized financial institutions with similar operating results based on public filings to assist it in determining executive compensation. The survey includes base salaries, bonuses, restricted stock awards, option awards, other compensation and total compensation, all as reported in public filings. The committee reviews executive compensation information from financial institutions that are similar to ours as the information helps the committee members assess whether elements of our executive compensation program are competitive and understand the elements, mix of elements and range in compensation amounts attributable to various elements of compensation paid by similar financial institutions. In determining the 2008 compensation amounts, the committee considered publicly available compensation data for banks and thrifts with assets between $750 million and $1.5 billion with return on asset ratios of .75%-1.25% and return on equity ratios of 7.5%-12.5%. In 2007, the year for which financial results were available when we identified comparable companies, we had assets of $1.0 billion, a return on assets ratio of 1.0% and a return on equity ratio of 10.93% based on an average of the three most recent years. In an attempt to focus the survey on the midrange of the competitive market and reduce wide variances, we eliminated from each executive officer's survey the five financial institutions with the highest total compensation amounts and the five financial institutions with the lowest compensation amounts. The financial institutions included in the annual survey were Atlantic Southern Financial Group, Inc., Bar Harbor Bankshares, Centrue Financial Corporation, Citizens & Northern Corporation, Community Capital Corporation, Crescent Banking Company, Eagle Bancorp, Inc., Eastern Virginia Bankshares, Inc., Enterprise Bancorp, Inc., First National Lincoln Corporation, First Security Group, Inc., German American Bancorp, Inc., MetroCorp Bancshares, Inc., Northrim BanCorp, Inc., PAB Bankshares, Inc., Peapack-Gladstone Financial Corporation, Peoples Financial Corporation, Porter Bancorp, Inc., Pulaski Financial Corp., Severn Bancorp, Inc., Wilber Corporation and WGNB Corporation. The survey included data from these companies on base salaries, bonuses, restricted stock awards, option grants and other compensation.

For 2008, the committee established the annual compensation program for the chief executive officer after evaluating his performance prior to the beginning of the year. The chairman of our compensation committee developed a preliminary compensation package for the chief executive officer prior to the beginning of 2008. The chairman reviewed the preliminary compensation package with the other committee members before presenting it to the chief executive officer. After incorporating input from the committee, the chairman reviewed the proposed compensation package with the chief executive officer, and they engaged in a dialogue regarding the elements and magnitude of the plan. This dialogue took place over the period of several weeks. Throughout the dialogue, the chairman consulted with other members of the committee as he deemed necessary. Once the chairman had considered the input of the chief executive officer, and made any revisions to the proposed compensation package that he considered appropriate, the chairman presented the proposed compensation package to the full compensation committee for approval. The chief executive officer proposed the 2008 annual compensation programs for each of our other executive officers, and the committee evaluated and approved or modified those compensation programs.

Our annual financial performance against our budget is one of the factors the compensation committee considers when evaluating executive compensation. Our budget generally is historically based and is driven extensively by our interest rate model. Our annual budget is prepared by our chief financial officer and his staff. Versions of the budget are reviewed with, and adjustments are proposed by, our senior management, including our principal executive officer, in an iterative process. Management attempts to develop a budget that is appropriate and attainable. After our senior management approves the annual budget, it is presented to, and approved by, the full board of directors.

In acting on the compensation programs for executive officers, the committee considers many factors, including the results of the annual survey of executive compensation, our overall performance compared to expected results and the contributions of the executive to achieving our strategic goals. Although we do not have formal stock ownership guidelines, the committee does consider the value and vesting timetable of outstanding equity awards held by executive officers in determining the timing and amount of new equity awards. While the committee may from time to time establish specific objectives for the receipt of incentive compensation, our compensation program is essentially a discretionary system in which the committee uses annual compensation survey data and draws upon the business experience, business judgment and general knowledge of its members to evaluate compensation matters collaboratively and subjectively.

Elements of Compensation

Executive compensation includes the following elements:

Base Salary. The base salary amount is the fixed portion of each executive's annual compensation and typically represents 50%-70% of an executive's total annual potential compensation. Salary levels are based primarily on the executive's responsibilities and experience and the market compensation paid by similar sized financial institutions for similar positions, as indicated in the annual compensation survey prepared for the committee. Base salaries are reviewed annually, and adjusted from time to time to realign salaries with market levels after taking into account individual responsibilities, performance and experience. While we intend for our overall compensation packages, including the base salary element, to be competitive, our base salaries generally are below the mid-point of the range of base salaries for comparable positions reflected in the annual compensation survey prepared for the committee. Lower base salaries allow us to weight compensation more to discretionary elements of compensation so that we can vary compensation based on performance, including company performance.

Chief Executive Officer 2008 Non-Equity Incentive Plan. The committee established a non-equity incentive plan as a short-term incentive for our chief executive officer for 2008. The plan was based on the achievement of annual financial and non-financial objectives, which were established by the committee, after consultations with our chief executive officer, at the beginning of 2008. The allocation of incentives between financial and non-financial objectives for the 2008 plan was split 25% for attainment of budgeted net income (which would have represented an increase of net income in 2008 of 5.1% from 2007 net income adjusted by approximately $3.6 million for items considered nonrecurring and expected changes in net interest income) and 75% for attainment of strategic objectives.

Under the 2008 plan, our chief executive officer was eligible to receive a bonus of $50,000 for attaining budgeted net income. Our chief executive was also eligible to receive a bonus up to $150,000 for attaining certain strategic objectives. Our chief executive officer received no payments under the non-equity incentive plan for 2008.

Chief Executive Officer Discretionary Annual Bonus. Our chief executive officer was eligible to receive a discretionary bonus. In evaluating whether to award our chief executive officer a discretionary bonus, and the amount of that bonus, the committee considered payment, if any, under his non-equity incentive plan, trends in our financial performance over multi-year time horizons, the importance of continuity and stability in the chief executive officer position to developing and implementing sound long-term strategic plans, and the chief executive officer's contributions to non-financial aspects of our business such as enhancing our reputation and maintaining a favorable corporate culture. Any bonus amount was to be paid in cash in an amount reviewed and approved by the committee in a single installment during the first quarter of the year after the bonus was earned. Our chief executive officer received no discretionary bonus for 2008

Non-Chief Executive Officer Discretionary Annual Bonus. The committee has the authority to award discretionary annual bonuses to our non-chief executive officers. These bonuses are intended to compensate executive officers based on our financial and operating performance, and are determined after considering the individual performance of the executive officers for the prior year. No discretionary bonuses were awarded to our non-chief executive officers for 2008.

Any non-chief executive bonus amounts are paid in cash in an amount reviewed and approved by the committee in a single installment during the first quarter of the year after the bonus is earned. The amount of the executive officer's bonus potential is generally based on a percentage of the executive's base salary. The amount of each executive officer's bonus potential is communicated to him or her at the beginning of each year, but no firm

bonus criteria are established. Also, the committee retains the authority to have bonuses paid in excess of the pre-established percentage of the executive's base salary. The bonus amounts are fully discretionary, but the committee generally exercises that discretion based on our financial performance relative to budgeted net income, general market and economic conditions, as well as an evaluation of the executive's personal performance.

Restricted Stock Grants. The issuance of restricted stock is designed to provide an intermediate-term retention incentive for executives, align executives' interests with the creation and maintenance of long-term stockholder value and reward executives for managing our performance to increase stockholder value. Restricted stock grants are intermediate-term retention incentives because they generally vest over a three-year period and require continued employment by the executive during the vesting period. Restricted stock provides a stronger retention incentive than stock options, which also vest over time, because executives are assured of realizing value as restricted stock vests over time, although that value will vary based on the trading price of the stock at the time of vesting. With stock options, executives only realize value over time if the price of the stock increases from the option exercise price. The committee's philosophy is that restricted stock grants also may encourage executives to balance the risks of losses in stockholder value against the potential for gains in stockholder values when evaluating business decisions. If executives receive only stock options as equity incentive awards, they may adopt higher-risk business strategies in an attempt to increase their company's stock price because the only loss they suffer if the strategies fail and their company's stock price declines is the loss of the potential for value from the option. When executives hold restricted stock, they share in the loss of value realized if the stock price declines. As a result, the executives may adopt strategies that strike a better balance between the potential for stock price appreciation and the risk that a failed strategy will lead to a stock price decline. The committee recommended adoption of the HMN Financial, Inc. 2009 Equity Incentive Plan to the board of directors in part to permit the continued use of restricted stock grants as an element of compensation.

The committee began using restricted stock grants as an element of fulfilling the equity ownership objective of the overall compensation program in 2004, when the accounting requirements for expensing stock options changed and the difference in the financial statement impact between granting awards of restricted stock and granting option awards was reduced. The committee also determined that the long-term vesting requirements of outstanding stock options adequately fulfilled the long-term incentive portion of the compensation plan and that intermediate-term incentives were needed to complement the other types of compensation issued to executive officers.

Stock Options. The committee's philosophy is that part of the financial rewards and incentives for executive officers should come from increases in the value of our common stock. The issuance of stock options is designed to reward executives for favorable long-term performance of our stock. Stock options are a long-term incentive as they generally vest over a three to ten-year period and are exercisable up to ten years from the grant date. Because they are a long-term incentive, stock options encourage the long-term employment of executives which is important to ensure the continuity of our business operations. Beginning in 2004, the committee began issuing restricted stock grants as an equity incentive instead of stock options due, in part, to the relatively long remaining vesting and exercise periods of the then outstanding stock options. No stock options have been issued to executive officers in the past four years. In 2008, the value of the ESOP contributions decreased significantly due to the decline in our share price. It is anticipated that, subject to CPP limitations, we will continue to use stock options as a long-term incentive for executives and that the committee in its discretion will grant new stock options as the remaining vesting and exercise periods for outstanding options decreases. The committee historically made stock option grants in the first quarter of the year, after our fiscal results were released, but prior to our first quarter results being known. The committee may make option grants at other times based on individual circumstances, but will not time option grants based on favorable or unfavorable information about our operations or prospects. The committee recommended adoption of the HMN Financial, Inc. 2009 Equity Incentive Plan to the board of directors in part to permit the continued use of stock options as an element of compensation.

Employee Stock Ownership Plan (ESOP). Our executive officers participate on a nondiscriminatory basis in our ESOP. All of our employees are eligible to participate in the ESOP after they complete one year of service as defined by the plan. The ESOP holds shares that secure a loan for the funds that were used to acquire the ESOP shares. Each year the security interest is released from a fixed number of shares as a fixed amount of the loan is amortized. The shares that are released from the security interest are allocated to eligible participant accounts based on the percentage of the participant's compensation (subject to limits) to the entire compensation of all plan participants. The value of the ESOP contributions generally represent between 6%-12% of each executive's base salary amount. The committee considers the value of the ESOP contributions when it establishes annual

compensation amounts and when it considers the mix between cash and equity compensation. The committee also considers the value of the ESOP contributions when evaluating the total compensation of our executives relative to the compensation of other executives at similar companies.

Other In-Service Compensation. Executive officers participate on an equal, nondiscriminatory basis with all other employees in our medical insurance plan, medical reimbursement plan, childcare plan, long-term disability plan and group life insurance plan. Historically, we have award nominal cash bonuses annually to all employees, including our executives, based upon years of service. We also provide Mr. Krehbiel and Ms. Kolling with use of a company car as their jobs require extensive travel. The committee considers all of the benefits granted to executives when determining executive compensation amounts and comparing compensation amounts to other executives at similar companies.

Post-Service Compensation. The committee's philosophy is that post-service compensation contributes to executive retention. We therefore allow all employees and executives to participate, on a nondiscriminatory basis, in a 401(k) plan with a 25% match on employee contributions up to 8% of the employee's salary. Upon retirement from our company, all employees, including executive officers, are eligible to withdraw their balance from the 401(k) plan and ESOP in accordance with the plans, and to receive any benefit payments to which they are eligible from our defined benefit pension plan. If an executive retires after 15 years of service, we will continue to pay the employer portion of his or her health insurance coverage until he or she reaches the age of 65. The committee considers post-service compensation when determining executive compensation amounts, but our compensation programs are designed primarily on in-service compensation.

We also have entered into change-in-control agreements with our executive officers that, subject to CPP requirement, may provide post-service compensation to executive officers if their employment is terminated following a change in control of our company. The committee's philosophy is that change-in-control agreements are appropriate to induce executives to remain with our company in the event of a proposed or anticipated change in control or through a change in control to facilitate an orderly transition to new ownership. The change-in-control agreements also assist us in recruiting and retaining executives by providing executives with appropriate economic security, given the relatively limited number of alternative employers in our industry and geographic area, against loss of employment following a change in control.

Recovery of Performance-Based Compensation

The Sarbanes-Oxley Act requires recovery of certain incentive and equity compensation from our principal executive officer and principal financial officer in the event of restatement of financial results due to misconduct. The audit committee is responsible for determining if bonus or stock compensation paid to the principal executive officer or principal financial officer should be recovered in the event of a restatement.

Impact of the Capital Purchase Program on Compensation Matters

Restrictions on Compensation. On December 23, 2008, we issued securities to the United States Treasury under the CPP. Under the CPP, we and our senior executive officers must comply with certain limitations on executive compensation pay and practices throughout the time the Treasury holds our securities. These include the following requirements:

- our compensation committee must review within 90 days of the Treasury's purchase of our securities incentive compensation arrangements for our named executive officers with our senior risk officers to assess and limit arrangements which encourage "unnecessary or excessive risks" that could threaten the value of our company; the compensation committee also must meet annually with the senior risk officer to discuss and review the relationship between our company's risk management policies and practices and the named executive officers' incentive compensation arrangements; and the compensation committee must certify to the foregoing in our proxy statement;

- any named executive officer bonus or incentive compensation paid must be subject to recovery by the company if the payments were based on materially inaccurate financial statements or any other materially inaccurate performance metric;

- we may not make any compensation payment to a named executive officer on account of an involuntary severance from employment or in the event of our receivership to the extent the aggregate present value

of such payments equals or exceeds three times that person's annual compensation computed in accordance with Section 280G(e) of the Internal Revenue Code; and

- we may not claim a deduction in an applicable tax year for federal income tax purposes from remuneration in excess of $500,000, as calculated in accordance with Section 162(m)(5) of the Internal Revenue Code.

In addition, on February 17, 2009, the American Recovery and Reinvestment Act of 2009, or ARRA, was signed into law. The ARRA provides that the Secretary of Treasury will require each CPP participant to meet appropriate standards for executive compensation and corporate governance. Those appropriate standards must include:

- limits on compensation that exclude incentives for senior executive officers of CPP participants to take "unnecessary or excessive risks" that could threaten the value of the CPP participant;
- a provision for the recovery by CPP participants of any bonus, retention award, or incentive compensation paid to a senior executive officer and any of the next 20 most highly compensated employees of the CPP participant based on statements of earnings, revenues, gains or other criteria that are later found to be materially inaccurate;
- a prohibition on CPP participants making any payment (except payments for services performed or benefits accrued) to a senior executive officer or any of the five most highly compensated employees of the CPP participant for departure from the CPP participant for any reason;
- a prohibition against a CPP participant paying or accruing any bonus, retention award, or incentive compensation, except for long-term restricted stock with a value not greater than one-third of annual compensation that does not fully vest during the period in which any obligation arising from the financial assistance provided to the CPP participant remains outstanding, for (at our level of participation in the CPP) the five most highly compensated employees of the CPP participant; and
- a prohibition on any compensation plan that would encourage manipulation of the reported earnings of the CPP participant to enhance the compensation of any of its employees.

Each of the requirements listed above will impact the design of our compensation programs and arrangements for our executive officers so long as the Treasury holds our securities and potentially beyond that period. However, the Treasury has not issued implementing regulations governing these new required standards, which vary in certain material respects from previously existing requirements. The extent and nature of the impact of these new requirements on our compensation programs and arrangements remains under consideration as the regulatory environment related to the CPP continues to evolve. Our compensation programs and procedures for 2009 will be determined following publication of additional regulatory guidance.

Recovery of Incentive Compensation. Pursuant to existing Treasury regulations, all bonuses and other incentive compensation arrangements with our senior executive officers have been amended to provide that during the time the Treasury holds a position in our shares, we may recover any payments that were based on materially inaccurate financial statements or any other materially inaccurate performance metrics used to award bonuses or incentive compensation. The right to recover these payments is not dependant upon the occurrence of a restatement of our financial results or of any misconduct.

Restriction on Payment of Golden Parachutes. Also pursuant to existing Treasury regulations, arrangements with our senior executive officers have been amended to prohibit, while the Treasury maintains its investment in our securities, any compensation payment to a named executive officer on account of an involuntary severance from employment or in the event of our receivership to the extent that the aggregate present value of such payments equals or exceeds three times that person's annual compensation computed in accordance with Section 280G(e) of the Internal Revenue Code.

Safeguards Against Unnecessary or Excessive Risk. As noted above, under requirements related to the CPP, the compensation committee must review senior executive officer incentive compensation with our senior risk officer to assess whether those arrangements encourage "unnecessary or excessive risks" to our company. The risk assessment must be done no later than 90 days after the Treasury's purchase of our shares. Additionally, the compensation committee also must meet annually with the senior risk officer to discuss and review the relationship

between our company's risk management policies and practices and the named executive officers' incentive compensation arrangements. The term "senior executive officer" is defined as the chief executive officer, chief financial officer, and the three other most highly compensated executive officers. These senior executive officers are our named executive officers, as defined above.

Our compensation committee has met with our senior risk officer to undertake the foregoing discussions and reviews relating to incentive compensation for our named executive officers. Based on, among other factors, its assessment of the principal risks to which our company is subject, its evaluation of the existing compensation arrangements for our named executive officers, the relatively significant portion of total compensation represented by base salary as opposed to variable forms of compensation, the discretion to award incentive compensation exercisable by the company, the customary use of non-financial objectives in determining a significant portion of any bonus compensation, the use of restricted stock as a significant component of equity incentive compensation and the sole component in recent years, the required vesting periods included in equity awards and the clawback requirements to which incentive compensation is now subject, the compensation committee concluded that our incentive compensation for our named executive officers does not encourage unnecessary or excessive risk that would threaten the value of our company.

COMPENSATION COMMITTEE REPORT

The compensation committee certifies that it has reviewed with senior risk officers the named executive officer incentive compensation arrangements and has made reasonable efforts to ensure that such arrangements do not encourage named executive officers to take unnecessary and excessive risks that threaten the value of our company; and met to discuss and review the relationship between our risk management policies and practices and the incentive compensation arrangements for our named executive officers.

The compensation committee has discussed and reviewed the compensation discussion and analysis with management. Based upon this review and discussion, the compensation committee recommended to the board of directors that the compensation discussion and analysis be included in this proxy statement.

Members of The Compensation Committee

Duane D. Benson
Allan R. DeBoer
Michael J. Fogarty
Karen L. Himle

2008 EXECUTIVE COMPENSATION

Summary Compensation Table

Name and Principal Position	Year	Salary ($)	Bonus ($) [3]	Non-Equity Incentive Plan($)	Stock Awards ($) [4]	Option Awards ($) [4]	All Other Compensation ($) [5]	Total ($)
Michael McNeil[1]	2008	338,000	150	0	105,829	4,592	22,733	471,304
President and Chief Executive	2007	325,000	45,150	120,000	88,433	5,297	34,089	617,969
Officer	2006	310,000	50,150	0	51,452	5,574	36,141	453,317
Jon J. Eberle	2008	142,000	150	0	44,310	1,713	7,713	195,886
Senior Vice President, Chief	2007	136,500	33,593	0	35,452	1,872	17,489	224,906
Financial Officer and Treasurer	2006	130,000	24,525	0	18,473	2,960	20,893	196,851
Dwain C. Jorgensen	2008	112,300	150	0	35,548	2,170	6,505	156,673
Senior Vice President,	2007	109,000	26,855	0	29,997	2,314	14,194	182,360
Technology, Facilities and Compliance Services	2006	105,825	19,992	0	16,389	3,298	17,840	163,344
Susan K. Kolling	2008	119,300	150	0	37,441	1,599	12,469	170,959
Senior Vice President,	2007	114,738	28,261	0	31,398	1,770	19,391	195,558
Business Development	2006	110,325	20,863	0	16,789	2,929	18,838	169,717
Bradley C. Krehbiel[2]	2008	160,700	150	0	50,502	2,059	15,291	228,702
Executive Vice President,	2007	154,500	38,003	0	41,693	2,260	24,464	260,920
Business Banking	2006	150,000	20,150	0	22,415	3,629	28,397	224,591

(1) Mr. McNeil resigned from all positions with our company on January 28, 2009.

(2) Mr. Krehbiel was appointed President of our banking subsidiary on January 28, 2009. He served as Executive Vice President, Business Banking of our banking subsidiary for the periods presented.

(3) We generally pay bonuses for a fiscal year in the first quarter of the following fiscal year.

(4) The amount reported is the compensation expense recognized in our financial statements pursuant to SFAS No. 123(R). In accordance with SFAS No. 123(R), we determine the fair value of options awards or restricted stock awards at the date of grant and recognize the expense for financial reporting purposes over the vesting period. For restricted stock awards we use the average grant date stock price.

(5) All other compensation consists of the following:

Name	Employer 401(k) Contribution ($)	Value of Common Stock Allocated to ESOP ($)	Employer Paid Life Insurance Premiums ($)	Dividends Received on Vested Restricted Stock ($)	Perquisites and Other Personal Benefits ($) [a]	Total ($)
Michael McNeil						
2008	4,600	2,755	664	5,069	9,645	22,733
2007	4,500	18,756	619	2,293	7,921	34,089
2006	4,500	23,745	562	702	6,632	36,141
Jon J. Eberle						
2008	3,543	2,122	74	1,974	0	7,713
2007	3,262	13,262	104	861	0	17,489
2006	2,983	17,492	173	245	0	20,893
Dwain C. Jorgensen						
2008	2,779	1,664	335	1,727	0	6,505
2007	2,581	10,525	304	784	0	14,194
2006	3,269	14,210	121	240	0	17,840
Susan K. Kolling						
2008	2,975	1,782	241	1,803	5,668	12,469
2007	2,738	11,113	335	819	4,386	19,391
2006	2,752	14,814	130	250	892	18,838
Bradley C. Krehbiel						
2008	3,875	2,396	134	2,369	6,517	15,291
2007	3,629	14,375	189	1,061	5,210	24,464
2006	2,517	20,178	216	316	5,170	28,397

(a) Perquisites and other personal benefits include cash payments for country club dues and the use of company cars.

Employment Agreement

We entered into an employment agreement with Mr. McNeil on May 27, 2008. The agreement provided for an initial base salary of $338,000 but is subject to a potential annual upward adjustment based on a review of Mr. McNeil's performance by the compensation committee of our board. Mr. McNeil's annual base salary prior to his resignation was $338,000. The agreement had an initial term of three years. On April 30 of each year, the term automatically extended for a period of twelve months in addition to the then-remaining term of employment, unless any party to the agreement gives contrary written notice or under.certain other circumstances. At the time of Mr. McNeil's resignation, the term of the agreement extended through December 31, 2010. Under the circumstances of his resignation, but subject to any current or future applicable limitations under the CPP, Mr. McNeil will continue to receive his salary and a reimbursement for the cost of premiums to maintain the same level of health insurance coverage as he was receiving before the date of termination through the remaining term of the agreement.

Change-In-Control Agreements

Our banking subsidiary entered into a change-in-control agreement with Mr. McNeil as of May 27, 2008, which remained effective until his resignation. The circumstances of Mr. McNeil's resignation did not entitle him to any payment under his change-in-control agreement. Each of Messrs. Eberle, Krehbiel and Jorgensen and Ms. Kolling entered into a change-in-control agreement with our banking subsidiary as of May 7, 2004. These original agreements expire on May 30, 2010, but they provide for an automatic extension for one year and from year to year thereafter unless either applicable party gives contrary written notice 180 days prior to the expiration date each year. The current term of the agreements extends through May 30, 2010. These agreements are designed to assist us in maintaining a stable and competent management team. The agreements provide for a cash payment equal to a percentage of the employee's prior year base salary and bonus prior to termination in the event that their employment is terminated in connection with a change of control. A change of control has occurred under the agreements if any person other than the executive, us, or one of our benefit plans acquires or becomes beneficial owner of 35% or more of our outstanding stock entitled to vote in a general election of directors; a majority of the members of our board are replaced as a result of an actual or threatened election contest, a reorganization, merger or consolidation of us is consummated that changes our ownership by 35% or more; our stockholders approve a complete liquidation or dissolution of us or disposition of substantially all of our assets. The employee will also be eligible for the cash payment if they voluntarily terminate employment within one year after a change in control has occurred if their duties, responsibilities, base salary, or benefits are reduced or if their principal place of employment is relocated more than 35 miles from its current location. Messrs. Eberle, Jorgensen and Krehbiel and Ms. Kolling are entitled to receive a cash payment equal to 200% of their respective annual average base salaries. These agreements also provide that the employees may participate in the health, disability and life insurance plans and programs that the employees were entitled to immediately prior to termination for one year after termination. The amounts payable pursuant to these agreements will be reduced by the amount of any severance pay that the employees receive from the bank, its subsidiaries or its successors. Based on their prior year base salary and bonus amounts, if their employment had been terminated as of December 31, 2008 under circumstances giving rise to the salary payment described above, Mr. Eberle would have been entitled to receive approximately $340,186, Mr. Jorgensen would have been entitled to receive approximately $271,710, Mr. Krehbiel would have been entitled to receive approximately $385,006 and Ms. Kolling would have been entitled to receive approximately $285,998. The agreements provide that if the cash payments under the agreements together with any other compensation payments triggered by the change in control would constitute a "parachute payment" under Section 280G of the internal revenue code, the cash payments under the agreements would be reduced to the largest amount as would result in no portion of the payment being subject to an excise tax under the code. The continued effectiveness of the change-in-control agreements is subject to any current or future applicable limitations under the CPP.

In addition to the change in control agreements, our restricted stock agreements provide that if there is a merger, dissolution, liquidation of us or sale of substantially all of our assets, the restrictions on the restricted shares shall lapse. Based on the closing price of our common stock on December 31, 2008, the last trading day before year end, and the number of shares of stock subject to restrictions held by them, shares with a value of approximately $14,989 held by Mr. Eberle, shares with a value of approximately $11,921 held by Mr. Jorgensen, shares with a value of approximately $17,001 held by Mr. Krehbiel and shares with a value of approximately $12,611 held by Ms. Kolling, would have been freed from restrictions if the restrictions on the shares would have lapsed on December 31, 2008.

Grants of Plan-Based Awards in 2008

Name	Grant Date	Restricted Stock Awards: Number of Shares of Stock or Units (#)	Fair Market Value of Restricted Stock Awards ($)
Michael McNeil	January 25, 2008	5,377	126,790
Jon J. Eberle	January 25, 2008	2,259	53,267
Dwain C. Jorgensen	January 25, 2008	1,787	42,137
Susan K. Kolling	January 25, 2008	1,898	44,755
Bradley C. Krehbiel	January 25, 2008	2,557	60,294

Based on a market value of $23.59 on January 25, 2008

Outstanding Equity Awards

The following tables summarize the outstanding option grants and stock awards at December 31, 2008 of the named executive officers and the value of the restricted stock that vested in 2008.

Outstanding Equity Awards at December 31, 2008

	Option Awards				Stock Awards	
Name	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Options (#) Unexercisable [(1)]	Option Exercise Price ($)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)[(2)]	Market Value of Shares or Units of Stock That Have Not Vested ($)[(3)]
Michael McNeil	50,000	0	11.50	04/28/2009	8,536	35,680
	1,520	24,796	16.13	04/28/2009		
	5,000	0	27.64	04/28/2009		
Jon J. Eberle	0	9,853	16.13	04/15/2012	3,586	14,989
	3,640	0	27.66	03/02/2014		
Dwain C. Jorgensen	0	12,500	16.13	04/15/2012	2,852	11,921
	3,580	0	27.66	03/02/2014		
Susan K. Kolling	0	9,189	16.13	04/15/2012	3,017	12,611
	3,780	0	27.66	03/02/2014		
Bradley C. Krehbiel	0	11,842	16.13	04/15/2012	4,067	17,001
	4,540	0	27.66	03/02/2014		

(1) Mr. McNeil received a grant of options on February 13, 2004, of which 1,250 vested on February 13, 2008. Mr. McNeil also received a grant of options on April 16, 2002, of which 1,520 options vested on April 16, 2008, and 6,199 options will vest on the anniversary date in each of 2009, 2010, 2011 and 2012. Mr. Eberle received a grant of options on April 16, 2002, of which 3,654 options will vest on April 16, 2011, and 6,199 options will vest on January 1, 2012. Mr. Jorgensen received a grant of options on April 16, 2002, of which 102 options will vest on April 16, 2010, and 6,199 options will vest on each of April 16, 2011 and January 1, 2012. Ms. Kolling received a grant of options on April 16, 2002, of which 2,990 options will vest on April 16, 2011, and 6,199 options will vest on January 1, 2012. Mr. Krehbiel received a grant of options on April 16, 2002, of which 5,643 options will vest on April 16, 2011 and 6,199 options will vest on January 1, 2012.

(2) All of Mr. McNeil's unvested stock awards were forfeited on January 28, 2009 upon his resignation. Of Mr. Eberle's unvested stock awards, 361 shares vested January 24, 2009, 483 shares vested on January 25, 2009 and 483 shares will vest on January 25, 2010 and 753 shares vested on January 25, 2009 and 753 shares will vest on each January 25, 2010 and 2011. Of Mr. Jorgensen's unvested stock awards, 294 shares vested on January 24, 2009, 385 shares vested on January 25, 2009 and 385 shares will vest on January 25, 2010, and 595 shares vested on January 25, 2009 and 596 shares will vest on each January 25, 2010 and 2011. Of Ms. Kolling's unvested stock awards, 307 shares vested on January 24, 2009, and 385 shares vested on January 25, 2009 and 386 shares will vest on January 25, 2010, and 632 shares vested on January 25, 2009 and 633 shares will vest on each January 25, 2010 and 2011. Of Mr. Krehbiel's unvested stock awards, 417 shares vested on January 24, 2009, 546 shares vested on January 25, 2009, and 547 shares will vest on January 25, 2010, and 753 shares vested on January 25, 2009, 852 shares will vest on January 25, 2010, and 853 shares will vest on January 25, 2011.

(3) Represents market value of underlying securities at year end of $4.18, which is the closing price of the common stock on the last trading day of 2008.

2008 Restricted Stock Vesting

Name	Stock Awards	
	Number of Shares Acquired on Vesting (#)	Value Realized on Vesting ($)[1]
Michael McNeil	2,774	65,411
Jon J. Eberle	1,111	26,692
Dwain C. Jorgensen	941	22,592
Susan K. Kolling	984	23,622
Bradley C. Krehbiel	1,307	31,390

[1] Based on market value of $24.95 on January 24, 2008 and $23.59 on 25 and 26, 2008.

Our employees are included in the Financial Institutions Retirement Fund (FIRF), a multi-employer comprehensive pension plan. This non-contributory defined benefit retirement plan covers all employees who have met minimum service requirements. Employees become 100% vested in the pension plan after five years of eligible service. Our policy is to fund the minimum amounts required by the plan, and in 2008, we made a contribution of $94,165 to the plan. On September 1, 2002, benefits for all of our existing participants under the plan were frozen, and as a result, no additional benefits have been earned and no new employees have been enrolled in the plan after that date. At age 65, Mr. McNeil will be entitled to annual payments of $5,667, Mr. Eberle will be entitled to annual payments of $4,141, Mr. Jorgensen will be entitled to annual payments of $28,247, Mr. Krehbiel will be entitled to annual payments of $2,567 and Ms. Kolling will be entitled to annual payments of $23,779. The annual benefit amount is calculated based on the employees' base salary for the five years prior to the plan being frozen.

2008 Pension Benefits

Name	Plan Name	Number of Years Credited Service (#)	Present Value of Accumulated Benefit ($)	Payments During Last Fiscal Year ($)
Michael McNeil	FIRF	3 years, 5 months	46,696	0
Jon J. Eberle	FIRF	6 years, 11 months	11,388	0
Dwain C. Jorgensen	FIRF	27 years, 1 month	221,456	0
Susan K. Kolling	FIRF	28 years, 9 months	164,788	0
Bradley C. Krehbiel	FIRF	3 years, 2 months	10,781	0

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Exchange Act requires our directors and executive officers to file initial reports of ownership and reports of changes in ownership with the Securities and Exchange Commission. Directors and executive officers are required by Securities and Exchange Commission regulations to furnish us with copies of all Section 16(a) forms they file. Based solely on a review of the copies of the forms furnished to us and written representations from our directors and executive officers, all Section 16(a) filing requirements were met for 2008.

ADDITIONAL INFORMATION

We are furnishing our annual report, including financial statements, for the year ended December 31, 2008 to each stockholder with this proxy statement. **Stockholders who wish to obtain an additional copy of our annual report, or a copy of our Current Report on Form 10-K filed with the Securities and Exchange Commission, for the year ended December 31, 2008 may do so without charge by writing to Chief Financial Officer, 1016 Civic Center Drive N.W., Rochester, Minnesota 55901-6057. The annual report is also available online at www.hmnf.com or www.proxydocs.com/hmnf.**

HMN FINANCIAL, INC.
By Order of the Board of Directors

Cindy K. Hamlin
Secretary

Dated: March 20, 2009

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