WEST BANCORPORATION INC
Form 10-Q
October 28, 2011
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x	QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the quarterly period ended September 30, 2011
	or
o	TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the transition period from __________ to __________

Commission File Number: 0-49677

WEST BANCORPORATION, INC.
(Exact Name of Registrant as Specified in its Charter)

IOWA	42-1230603
(State of Incorporation)	(I.R.S. Employer Identification No.)

1601 22nd Street, West Des Moines, Iowa 50266

Telephone Number: (515) 222-2300

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x No o

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

Large accelerated filer	o	Accelerated filer	x

Non-accelerated filer o Smaller reporting company o

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

Yes o No x

As of October 27, 2011, there were 17,403,882 shares of common stock, no par value, outstanding.

WEST BANCORPORATION, INC.

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PART I - FINANCIAL INFORMATION
Item 1. Financial Statements

West Bancorporation, Inc. and Subsidiary
Consolidated Balance Sheets
(unaudited)

(in thousands)	September 30, 2011	December 31, 2010
ASSETS		
Cash and due from banks	$44,851	$20,069
Federal funds sold and other short-term investments	7,922	67,885
Cash and cash equivalents	52,773	87,954
Securities available for sale	247,005	256,326
Federal Home Loan Bank stock, at cost	11,423	11,211
Loans held for sale	3,416	4,452
Loans	866,615	888,649
Allowance for loan losses	(17,476)	(19,087)
Loans, net	849,139	869,562
Premises and equipment, net	5,170	5,068
Accrued interest receivable	4,368	4,959
Bank-owned life insurance	25,506	25,395
Other real estate owned	12,402	19,193
Deferred tax assets	8,249	11,164
Other assets	7,148	10,179
Total assets	$1,226,599	$1,305,463
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits:		
Noninterest-bearing demand	$258,024	$230,277
Interest-bearing demand	149,910	142,031
Savings	290,109	313,850
Time of $100,000 or more	126,733	178,388
Other time	93,763	107,526
Total deposits	918,539	972,072
Federal funds purchased and securities sold under agreements to repurchase	53,203	52,095
Other short-term borrowings	1,445	2,914
Subordinated notes	20,619	20,619
Federal Home Loan Bank advances	105,000	105,000
Accrued expenses and other liabilities	6,657	7,327
Total liabilities	1,105,463	1,160,027
STOCKHOLDERS' EQUITY		
Preferred stock, $0.01 par value, with a liquidation preference of $1,000 per share; authorized 50,000,000 shares; no shares outstanding at September 30, 2011, and 36,000 shares issued and outstanding at December 31, 2010	—	34,508
Common stock, no par value; authorized 50,000,000 shares; 17,403,882	3,000	3,000

shares issued and outstanding at September 30, 2011, and December 31, 2010		
Additional paid-in capital	33,687	34,387
Retained earnings	83,597	76,188
Accumulated other comprehensive income (loss)	852	(2,647)
Total stockholders' equity	121,136	145,436
Total liabilities and stockholders' equity	$1,226,599	$1,305,463

See accompanying Notes to Consolidated Financial Statements.

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West Bancorporation, Inc. and Subsidiary
Consolidated Statements of Operations
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands, except per share data)	2011	2010	2011	2010
Interest income:				
Loans, including fees	$11,674	$13,285	$35,101	$40,516
Securities:				
Taxable securities	1,043	1,057	3,283	3,307
Tax-exempt securities	549	726	1,723	2,428
Federal funds sold and other short-term investments	43	116	170	446
Total interest income	13,309	15,184	40,277	46,697
Interest expense:				
Demand deposits	480	513	1,309	1,737
Savings deposits	275	683	863	3,657
Time deposits	980	1,838	3,171	5,653
Federal funds purchased and securities sold under agreements to repurchase	42	52	131	170
Subordinated notes	177	371	531	1,101
Long-term borrowings	1,030	1,030	3,057	3,285
Total interest expense	2,984	4,487	9,062	15,603
Net interest income	10,325	10,697	31,215	31,094
Provision for loan losses	—	2,000	950	5,400
Net interest income after provision for loan losses	10,325	8,697	30,265	25,694
Noninterest income:				
Service charges on deposit accounts	864	867	2,419	2,525
Debit card usage fees	368	338	1,093	994
Service fee from SmartyPig, LLC	—	253	—	1,314
Trust services	175	210	601	616
Gains and fees on sales of residential mortgages	358	571	814	1,044
Increase in cash value of bank-owned life insurance	223	220	667	664
Gain from bank-owned life insurance	—	420	637	420
Other income	245	228	789	721
Total noninterest income	2,233	3,107	7,020	8,298
Investment securities gains (losses), net:				
Total other than temporary impairment losses	(22)	(117)	(22)	(305)
Portion of loss recognized in other comprehensive income before taxes	—	—	—	—
Net impairment losses recognized in earnings	(22)	(117)	(22)	(305)
Realized securities gains (losses), net	—	16	—	53
Investment securities gains (losses), net	(22)	(101)	(22)	(252)
Noninterest expense:				
Salaries and employee benefits	3,373	2,813	9,598	8,180
Occupancy	841	806	2,478	2,403
Data processing	500	464	1,430	1,366
FDIC insurance expense	216	835	1,111	2,280

Other real estate owned expense	1,650	(3)	1,930	657
Professional fees	297	230	756	704
Miscellaneous losses	102	220	153	1,208
Other expenses	1,339	1,216	3,714	3,545
Total noninterest expense	8,318	6,581	21,170	20,343
Income before income taxes	4,218	5,122	16,093	13,397
Income taxes	1,135	1,181	4,557	3,514
Net income	3,083	3,941	11,536	9,883
Preferred stock dividends and accretion of discount	—	(572)	(2,387)	(1,713)
Net income available to common stockholders	$3,083	$3,369	$9,149	$8,170
Basic and diluted earnings per common share	$0.18	$0.19	$0.53	$0.47
Cash dividends per common share	$0.05	$—	$0.10	$—

See accompanying Notes to Consolidated Financial Statements.

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West Bancorporation, Inc. and Subsidiary
Consolidated Statements of Comprehensive Income
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	2011	2010	2011	2010
Net income	$3,083	$3,941	$11,536	$9,883
Other comprehensive income, before tax:				
Securities for which a portion of an other than temporary impairment has been recorded in earnings:				
Unrealized holding gains (losses) arising during the period	(225)	(8)	18	78
Less: reclassification adjustment for losses realized in net income	22	117	22	117
Net unrealized gains (losses) on securities with other than temporary impairment before tax expense	(203)	109	40	195
Unrealized gains on securities without other than temporary impairment before tax:				
Unrealized holding gains arising during the period	902	2,594	5,604	5,459
Less: reclassification adjustment for net gains realized in net income	—	(16)	—	(53)
Less: reclassification adjustment for impairment losses realized in net income	—	—	—	188
Net unrealized gains on other securities before tax expense	902	2,578	5,604	5,594
Other comprehensive income before tax	699	2,687	5,644	5,789
Tax expense related to other comprehensive income	(266)	(1,021)	(2,145)	(2,200)
Other comprehensive income, net of tax:	433	1,666	3,499	3,589
Comprehensive income	$3,516	$5,607	$15,035	$13,472

See accompanying Notes to Consolidated Financial Statements.

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West Bancorporation, Inc. and Subsidiary
Consolidated Statements of Stockholders' Equity
(unaudited)

(in thousands)	Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2009	$34,024	$3,000	$34,387	$65,959	$ (4,311)	$133,059
Net income	—	—	—	9,883	—	9,883
Other comprehensive income	—	—	—	—	3,589	3,589
Preferred stock discount accretion	363	—	—	(363)	—	—
Preferred stock dividends declared	—	—	—	(1,350)	—	(1,350)
Balance, September 30, 2010	$34,387	$3,000	$34,387	$74,129	$ (722)	$145,181
Balance, December 31, 2010	$34,508	$3,000	$34,387	$76,188	$ (2,647)	$145,436
Net income	—	—	—	11,536	—	11,536
Other comprehensive income	—	—	—	—	3,499	3,499
Preferred stock discount accretion	1,492	—	—	(1,492)	—	—
Redemption of preferred stock	(36,000)	—	—	—	—	(36,000)
Repurchase of common stock warrant	—	—	(700)	—	—	(700)
Cash dividends declared, $0.10 per common share	—	—	—	(1,740)	—	(1,740)
Preferred stock dividends declared	—	—	—	(895)	—	(895)
Balance, September 30, 2011	$—	$3,000	$33,687	$83,597	$ 852	$121,136

See accompanying Notes to Consolidated Financial Statements.

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West Bancorporation, Inc. and Subsidiary
Consolidated Statements of Cash Flows
(unaudited)

	Nine Months Ended September 30,	
(in thousands)	2011	2010
Cash Flows from Operating Activities:		
Net income	$11,536	$9,883
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	950	5,400
Net amortization and accretion	2,216	1,095
Gain on disposition of premises and equipment	(10)	(2)
Securities gains, net	—	(53)
Investment securities impairment losses	22	305
Proceeds from sales of loans held for sale	39,017	47,470
Originations of loans held for sale	(37,937)	(50,305)
Gain on sale of other real estate owned	(361)	(355)
Write-down of other real estate owned	2,211	662
Gain from bank-owned life insurance	(637)	(420)
Increase in value of bank-owned life insurance	(667)	(664)
Depreciation	448	443
Deferred income taxes	769	615
Change in assets and liabilities:		
(Increase) decrease in accrued interest receivable	591	(140)
Decrease in other assets	2,912	2,752
Increase (decrease) in accrued expenses and other liabilities	(445)	107
Net cash provided by operating activities	20,615	16,793
Cash Flows from Investing Activities:		
Proceeds from sales, calls, and maturities of securities available for sale	68,004	232,825
Purchases of securities available for sale	(55,156)	(146,566)
Purchases of Federal Home Loan Bank stock	(681)	(1,120)
Proceeds from redemption of Federal Home Loan Bank stock	469	856
Net decrease in loans	18,070	88,928
Net proceeds from sales of other real estate owned	6,300	5,180
Proceeds from sales of premises and equipment	51	9
Purchases of premises and equipment	(591)	(331)
Proceeds of principal and earnings from bank-owned life insurance	1,192	—
Net cash provided by investing activities	37,658	179,781
Cash Flows from Financing Activities:		
Net increase (decrease) in deposits	(53,533)	(212,415)
Net increase (decrease) in federal funds purchased and securities sold under agreements to repurchase	1,108	(4,949)
Net decrease in other short-term borrowings	(1,469)	(768)
Principal payments on long-term borrowings	—	(20,000)
Common stock dividends paid	(1,740)	—
Preferred stock dividends paid	(1,120)	(1,350)
Redemption of preferred stock	(36,000)	—
Repurchase of common stock warrant	(700)	—
Net cash used in financing activities	(93,454)	(239,482)

Net decrease in cash and cash equivalents	(35,181)	(42,908)
Cash and Cash Equivalents:		
Beginning	87,954	131,495
Ending	$52,773	$88,587

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West Bancorporation, Inc. and Subsidiary
Consolidated Statements of Cash Flows (continued)
(unaudited)

	Nine Months Ended September 30,	
(in thousands)	2011	2010
Supplemental Disclosures of Cash Flow Information:		
Cash payments for:		
Interest	$9,639	$15,834
Income taxes	3,244	1,742
Supplemental Disclosure of Noncash Investing and Financing Activities:		
Transfer of loans to other real estate owned	$1,583	$6,531
Transfer of other real estate owned to loans	620	6,655
Bank-owned life insurance death benefit receivable	—	1,294

See accompanying Notes to Consolidated Financial Statements.

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West Bancorporation, Inc. and Subsidiary
Notes to Consolidated Financial Statements
(unaudited)
(in thousands, except per share information)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared by West Bancorporation, Inc. (the Company) pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements have been condensed or omitted pursuant to such rules and regulations. Although management believes that the disclosures are adequate to make the information presented understandable, it is suggested that these interim consolidated financial statements be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2010. In the opinion of management, the accompanying consolidated financial statements contain all adjustments necessary to present fairly the financial position as of September 30, 2011, and December 31, 2010, the results of operations and comprehensive income for the three and nine months ended September 30, 2011 and 2010, and cash flows for the nine months ended September 30, 2011 and 2010. The results for these interim periods may not be indicative of results for the entire year or for any other period.

The consolidated financial statements have been prepared in conformity with generally accepted accounting principles (GAAP) established by the Financial Accounting Standards Board (FASB). References to GAAP issued by the FASB in these footnotes are to the FASB Accounting Standards Codification™, sometimes referred to as the Codification or ASC. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses for the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term are the fair value of financial instruments and other than temporary impairment (OTTI), the valuation of other real estate owned, and the allowance for loan losses.

The accompanying consolidated financial statements include the accounts of the Company, West Bank, West Bank's wholly-owned subsidiary WB Funding Corporation (which owns an interest in a partnership), and West Bank's 99.99 percent owned subsidiary ICD IV, LLC (a community development entity). All significant intercompany transactions and balances have been eliminated in consolidation. In accordance with GAAP, West Bancorporation Capital Trust I is recorded on the books of the Company using the equity method of accounting and is not consolidated.

Certain items in the financial statements as of September 30, 2010 were reclassified to be consistent with the classifications used in the September 30, 2011, financial statements. The reclassification has no effect on net income or stockholders' equity.

Current accounting developments: In January 2010, the FASB issued guidance for improving disclosures about fair value measurements. This guidance is included in the Codification as part of ASC 820. The portion of the guidance that was effective for annual periods beginning after December 15, 2010, requires additional disclosure in the reconciliation of fair value measurements using significant unobservable inputs (Level 3). A reporting entity should separately present information about purchases, sales, issuances, and settlements. The adoption of this guidance did not have a material impact on the Company's consolidated financial position or statement of operations.

In July 2010, the FASB issued guidance for improving disclosures about an entity's credit quality and risk exposures of its loans and the allowance for loan losses. For public companies, increased disclosures as of the end of a reporting period were effective for periods ending on or after December 15, 2010. Increased disclosures about activity that occurs during a reporting period were effective for interim and annual reporting periods beginning on or after December 31, 2010. In January 2011, the FASB temporarily delayed the effective date of the disclosures required for troubled debt restructured loans (TDR) for public companies. Amended guidance issued by the FASB is discussed in the following paragraph. The amendment to the original pronouncement did not delay any of the other required disclosures. Since the provisions of this accounting guidance were disclosure-related, the adoption of this guidance did not have an impact on the Company's consolidated financial position or statement of operations.

In April 2011, the FASB issued amended guidance clarifying for creditors which restructured loans are considered TDR. To qualify as a TDR, a creditor must separately conclude that the restructuring constitutes a concession and that the debtor is experiencing financial difficulty. The amended guidance was effective for public companies for the first interim or annual period beginning on or after June 15, 2011, and was applied retrospectively to the beginning of the annual period of adoption. The adoption of this guidance did not have an impact on the Company's consolidated financial position or statement of operations.

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In May 2011, the FASB issued amended guidance to improve the comparability of fair value measurements presented and disclosed in financial statements made in accordance with GAAP and International Financial Reporting Standards. The guidance does not extend the use of fair value accounting, but provides guidance on how it should be applied in situations where it is already required or permitted. The guidance is included in the Codification as part of ASC 820. The guidance is effective for public companies during interim and annual periods beginning after December 15, 2011. The Company does not expect that the adoption of this guidance will have a material impact on the consolidated financial statements.

In June 2011, the FASB issued amended guidance for improving the comparability of financial reporting and to increase the prominence of items reported in other comprehensive income. The guidance eliminated the option to present components of other comprehensive income as part of the changes in stockholders' equity and requires all nonowner changes in stockholders' equity to be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The guidance also requires entities to present all reclassification adjustments from other comprehensive income to net income on the face of the financial statements. The guidance did not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. This guidance is included in the Codification as ASC 220. Early adoption is permitted and the Company adopted this guidance effective June 30, 2011. The adoption did not have a material impact on the Company's consolidated financial statements.

2. Critical Accounting Policies

Management has identified its most critical accounting policies to be those related to asset impairment judgments, including fair value and OTTI of available for sale investment securities, the valuation of other real estate owned, and the allowance for loan losses.

Securities available for sale are reported at fair value, with unrealized gains and losses reported as a separate component of accumulated other comprehensive income (loss), net of deferred income taxes. The Company evaluates each of its investment securities whose value has declined below amortized cost to determine whether the decline in fair value is OTTI. The investment portfolio is evaluated for OTTI by segregating the portfolio into two segments and applying the appropriate OTTI model. Investment securities classified as available for sale are generally evaluated for OTTI under FASB ASC 320, Investments - Debt and Equity Securities. However, certain purchased beneficial interests in securitized financial assets, including asset-backed securities and collateralized debt obligations that had credit ratings below AA at the time of purchase, are evaluated using the model outlined in FASB ASC 325, Beneficial Interests in Securitized Financial Assets.

In determining OTTI under the FASB ASC 320 model, the review takes into consideration the severity and duration of the decline in fair value, the length of time expected for recovery, the financial condition of the issuer, and other qualitative factors, as well as whether the Company intends to sell the security or whether it is more likely than not the Company will be required to sell the debt security before its anticipated recovery.

Under the FASB ASC 325 model for the second segment of the portfolio, the Company compares the present value of the remaining cash flows as estimated at the preceding evaluation date to the current expected remaining cash flows. An OTTI is deemed to have occurred if there has been an adverse change in the remaining expected future cash flows.

When OTTI occurs under either model, the amount of the OTTI recognized in earnings depends on whether the Company intends to sell the security or whether it is more likely than not it will be required to sell the security before recovery of its amortized cost basis. If the Company intends to sell or it is more likely than not it will be required to sell the security before recovery of its amortized cost basis, the OTTI is recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. If the Company does not intend to sell the security and it is not more likely than not that the entity will be required to sell before recovery of its amortized cost basis, the OTTI is separated into the amount representing the credit loss and the amount related to all other factors. The amount of the total OTTI related to the credit loss is determined based on the present value of cash flows expected to be collected, using the original yield as the discount rate, and is recognized in earnings. The amount of the total OTTI related to other factors is recognized in other comprehensive income, net of applicable taxes. The previous amortized cost basis less the OTTI recognized in earnings becomes the new amortized cost basis of the investment. The assessment of whether an OTTI exists involves a high degree of subjectivity and judgment and is based on the information available to management at the time.

Other real estate owned includes real estate properties acquired through or in lieu of foreclosure. They are initially recorded at fair value less estimated selling costs. After foreclosure, valuations are performed by management at least annually by obtaining updated appraisals or other market information. Any subsequent write-downs are recorded as a charge to operations.

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The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes that collectibility of the principal is unlikely. The Company has policies and procedures for evaluating the overall credit quality of its loan portfolio, including timely identification of potential problem loans. On a quarterly basis, management reviews the appropriate level for the allowance for loan losses, incorporating a variety of risk considerations, both quantitative and qualitative. Quantitative factors include the Company's historical loss experience, delinquency and charge-off trends, collateral values, known information about individual loans, and other factors. Qualitative factors include the general economic environment in the Company's market areas and the expected trend of those economic conditions. While management uses the best information available to make its evaluations, future adjustments to the allowance may be necessary if there are significant changes in economic conditions or the other factors relied upon. To the extent actual results differ from forecasts and management's judgment, the allowance for loan losses may be greater or less than future charge-offs.

3. Securities Available for Sale

For securities available for sale, the following tables show the amortized cost, unrealized gains and losses (pre-tax) included in accumulated other comprehensive income, and estimated fair value by security type as of September 30, 2011, and December 31, 2010.

	September 30, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
U.S. government agencies and corporations	$12,649	$413	$—	$13,062
State and political subdivisions	52,588	2,063	(66)	54,585
Mortgage-backed securities [1]	167,830	3,225	—	171,055
Trust preferred securities	6,180	—	(4,083)	2,097
Corporate notes and other investments	6,384	5	(183)	6,206
	$245,631	$5,706	$(4,332)	$247,005

	December 31, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
U.S. government agencies and corporations	$47,685	$274	$(161)	$47,798
State and political subdivisions	59,512	464	(839)	59,137
Mortgage-backed securities [1]	140,699	905	(384)	141,220
Trust preferred securities	6,194	—	(4,218)	1,976
Corporate notes and other investments	6,507	16	(328)	6,195
	$260,597	$1,659	$(5,930)	$256,326

(1) All mortgage-backed securities consist of residential mortgage pass-through securities guaranteed by GNMA or issued by FNMA, and real estate mortgage investment conduits guaranteed by FHLMC or GNMA.

Securities with an amortized cost of $142,863 and $168,066 as of September 30, 2011, and December 31, 2010, respectively, were pledged as collateral on the Treasury, Tax, and Loan Option Notes, securities sold under agreements to repurchase, and for other purposes as required or permitted by law or regulation. Securities sold under agreements to repurchase are held in safekeeping at a correspondent bank on behalf of the Company.

The amortized cost and fair value of securities available for sale as of September 30, 2011, by contractual maturity are shown in the following table. Certain securities have call features that allow the issuer to call the securities prior to maturity. Expected maturities may differ from contractual maturities in mortgage-backed securities, because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Therefore, mortgage-backed securities are not included in the maturity categories within the summary.

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	September 30, 2011	
	Amortized Cost	Fair Value
Due in one year or less	$2,806	$2,815
Due after one year through five years	22,187	22,164
Due after five years through ten years	19,773	20,802
Due after ten years	33,035	30,169
	77,801	75,950
Mortgage-backed securities	167,830	171,055
	$245,631	$247,005

The details of the sales of securities for the three and nine months ended September 30, 2011 and 2010, are summarized in the following table.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Proceeds from sales	$—	$10,096	$—	$77,717
Gross gains on sales	—	326	—	412
Gross losses on sales	—	(310)	—	(359)

The following tables show the fair value and gross unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous loss position, as of September 30, 2011, and December 31, 2010. The tables include one trust preferred security (TPS) for which a portion of an OTTI has been recognized in other comprehensive income.

	September 30, 2011					
	Less than 12 months		12 months or longer		Total	
	Fair Value	Gross Unrealized (Losses)	Fair Value	Gross Unrealized (Losses)	Fair Value	Gross Unrealized (Losses)
U.S. government agencies and corporations	$—	$—	$—	$—	$—	$—
State and political subdivisions	—	—	3,078	(66)	3,078	(66)
Mortgage-backed securities	—	—	—	—	—	—
Trust preferred securities	—	—	2,097	(4,083)	2,097	(4,083)
Corporate notes and other investments	—	—	3,809	(183)	3,809	(183)
	$—	$—	$8,984	$(4,332)	$8,984	$(4,332)

	December 31, 2010					
	Less than 12 months		12 months or longer		Total	
	Fair Value	Gross Unrealized (Losses)	Fair Value	Gross Unrealized (Losses)	Fair Value	Gross Unrealized (Losses)
U.S. government agencies and corporations	$19,853	$(161)	$—	$—	$19,853	$(161)
State and political subdivisions	25,374	(700)	2,003	(139)	27,377	(839)
Mortgage-backed securities	47,289	(384)	—	—	47,289	(384)
Trust preferred securities	—	—	1,976	(4,218)	1,976	(4,218)
Corporate notes and other investments	—	—	3,661	(328)	3,661	(328)

$92,516	$(1,245)	$7,640	$(4,685)	$100,156	$(5,930)

See Note 2 for a discussion of financial reporting for securities with unrealized losses. As of September 30, 2011, the available for sale investment portfolio included two municipal securities, two TPSs, and one corporate note with unrealized losses that have existed for longer than one year.

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The Company believes the unrealized losses on investments in municipal obligations and corporate notes are due to market conditions, not reduced estimated cash flows. The Company does not have the intent to sell these securities, does not anticipate that these securities will be required to be sold before anticipated recovery, and expects full principal and interest to be collected. Therefore, the Company does not consider these investments to be OTTI at September 30, 2011.

The Company believes the unrealized loss of $989 on an investment in one single-issuer TPS issued by Heartland Financial, USA, Inc. is due to market conditions, not reduced estimated cash flows. The Company does not have the intent to sell this security, does not anticipate that this security will be required to be sold before anticipated recovery, and expects full principal and interest will be collected. Therefore, the Company does not consider this investment to be OTTI at September 30, 2011.

As of September 30, 2011, the Company had one pooled TPS, ALESCO Preferred Funding X, Ltd., it considered to be OTTI. The Company engaged an independent consulting firm to assist in the valuation of this security. Based on that valuation, management determined the security had an estimated fair value of $1,357 at September 30, 2011. The methodology for determining the appropriate discount rate for a TPS for purposes of determining fair value combines an evaluation of current market yields for comparable corporate and structured credit products with an evaluation of the risks associated with the TPS cash flows in question. More specifically, the market-based yield indicators are used as a baseline for determining appropriate discount rates, and then the resulting discount rates are adjusted on the basis of credit and structural analysis of specific TPS instruments. The primary focus is on the returns a fixed income investor would require in order to allocate capital on a risk-adjusted basis. However, due to the fact that there is currently no active market for this pooled TPS, the focus is on market yields for stand-alone TPSs issued by banks, thrifts, and insurance companies, and for which there are active and liquid markets. A series of adjustments are made to reflect the differences that nevertheless exist between these products (both credit and structural) and, more importantly, to reflect idiosyncratic credit performance differences (both actual and projected) between these products and the underlying collateral in the specific TPSs being valued. Importantly, as part of the analysis described above, consideration is given to the fact that structured instruments frequently exhibit leverage not present in stand-alone instruments, and adjustments are made as necessary to reflect this additional risk. As a result of this analysis and due to the fixed rate nature of the instrument's contractual interest cash flows, a discount rate of LIBOR + 14% (a lifetime average all-in discount rate of approximately 18%) was used for determination of fair value. For purposes of determining any credit loss, projected cash flows were discounted using a rate of LIBOR plus 1.25%.

The consulting firm first evaluates the credit quality of each underlying issuer within the TPS by reviewing a comprehensive database of financial information and/or publicly-filed financial statements. On the basis of this information and a review of historical industry default data and current and near-term operating conditions, default and recovery probabilities for each underlying issuer within the asset were estimated. For issuers who had already defaulted, no recovery was assumed. For deferring issuers, an assumption was made that the majority of deferring issuers will continue to defer and will eventually default. Each deferring issuer is reviewed on a case-by-case basis and, in some instances, a probability is assigned that the deferral will ultimately be cured. The issuer-specific assumptions are then aggregated into cumulative weighted-average default, recovery, and prepayment probabilities. The collateral prepayment assumptions were affected by the view that the terms and pricing of TPSs and subordinated debt issued by banks and insurance companies were so aggressive that it is unlikely that such financing will become available in the foreseeable future. Therefore, the assumption was made that no collateral will prepay over the life of the TPS. In light of generally weak collateral credit performance and a challenging U.S. credit and real estate environment, the assumptions generally imply more issuer defaults during the next two to three years than those that had been experienced historically, and a gradual leveling off of defaults thereafter.

Based on the valuation work performed, an additional credit loss of $22 was recognized in third quarter 2011 earnings. The remaining unrealized loss of $3,094 is reflected in accumulated other comprehensive income, net of taxes of $1,176. The Company will continue to periodically estimate the present value of cash flows expected to be collected over the life of the security.

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The following tables detail information for the individual and pooled TPSs owned as of September 30, 2011, and December 31, 2010.
As of September 30, 2011:

	Single-issuer or pooled	Class	Book value	Fair value	Unrealized gain/(loss)	Credit rating (1)	Number of entities currently performing (2)	Actual deferrals and defaults (3) (4)	Expected deferrals and defaults (5)	Excess subordination (5)
ALESCO Preferred Funding X, Ltd.	Pooled	C-2	$4,451	$1,357	$(3,094)	Ca	50	8.3%	16.1%	0.0%
Heartland Financial Statutory Trust VII 144A	Single	n/a	1,729	740	(989)	NR	n/a	n/a	n/a	n/a

As of December 31, 2010:

	Single-issuer or pooled	Class	Book value	Fair value	Unrealized gain/(loss)	Credit rating (1)	Number of entities currently performing (2)	Actual deferrals and defaults (3)	Expected deferrals and defaults (5)	Excess subordination (5)
ALESCO Preferred Funding X, Ltd.	Pooled	C-2	$4,473	$1,339	$(3,134)	Ca	51	20.6%	19.3%	0.0%
Heartland Financial Statutory Trust VII 144A	Single	n/a	1,721	637	(1,084)	NR	n/a	n/a	n/a	n/a

NR - Not rated
(1) Lowest rating assigned
(2) Pooled issue originally included 58 banks and 19 insurance companies
(3) As a percentage of the original collateral
(4) Approximately $100 million of defaulted collateral was sold to another party during the three months ended June 30, 2011, with a portion of any collateral recovered to be returned to the Fund. This sale is the reason for the reduction in this deferral and default percent compared to prior period disclosures.
(5) As a percentage of the remaining performing collateral

Excess subordination represents the additional defaults in excess of both current and projected defaults that the pool can absorb before the bond experiences any credit impairment. There is no excess collateral to absorb any future defaults. With the excess subordination at zero percent, this means any additional deferrals or defaults will have a negative impact on the value of the pooled TPS.

The following table provides a roll forward of the amount of credit-related losses recognized in earnings for the pooled TPS for which a portion of an OTTI has been recognized in other comprehensive income for the three and nine months ended September 30, 2011 and 2010.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Balance at beginning of period	$427	$310	$427	$310
Current period credit loss recognized in earnings	22	117	22	117
Reductions for securities sold during the period	—	—	—	—
Reductions for securities where there is an intent to sell or requirement to sell	—	—	—	—
Reductions for increases in cash flows expected to be collected	—	—	—	—
Balance at end of period	$449	$427	$449	$427

4. Loans and Allowance for Loan Losses

Loans consist of the following segments as of September 30, 2011, and December 31, 2010.

	September 30, 2011	December 31, 2010
Commercial	$264,988	$310,376
Real estate:		
Construction, land, and land development	113,337	116,601
1-4 family residential first mortgages	52,821	51,760
Home equity	28,899	26,111
Commercial	400,289	372,404
Consumer and other loans	6,540	11,514
	866,874	888,766
Net unamortized fees and costs	259	117
	$866,615	$888,649

Loans are stated at the principal amounts outstanding, net of unamortized loan fees and costs, with interest income recognized on the interest method based upon those outstanding loan balances. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method. Loans are reported by the segments identified above and are analyzed by management on this basis and are not further broken down by class. All loan policies identified below apply to all segments of the loan portfolio.

Delinquencies are determined based on the payment terms of the individual loan agreements. The accrual of interest on past due and other impaired loans is generally discontinued at 90 days or when, in the opinion of management, the borrower may be unable to make all contractual payments as they become due. Unless considered collectible, all interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed against interest income, if accrued in the current year, or charged to the allowance for loan losses, if accrued in the prior year. Interest income is subsequently recognized only to the extent cash payments are received. Generally, all payments received while a loan is on nonaccrual status are applied to the principal balance of the loan. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured.

A loan is classified as a TDR when for economic or legal reasons related to the borrower's financial difficulties a concession is granted to the borrower that would not otherwise be considered. Concessions may include a restructuring of the terms of a loan to alleviate the burden on the borrower's cash requirements, such as an extension of the payment terms beyond the original maturity date or a change in the interest rate charged. TDR loans with extended payment terms are accounted for as impaired until performance is established. A change to the interest rate would change the classification of a loan to a TDR if the restructured loan yields a rate which is below a market rate for that of a new loan with comparable risk. TDR loans with below market rates are considered impaired until fully collected. TDR loans may be reported as nonaccrual, rather than as a TDR, if they are not performing per the restructured terms.

Based upon its ongoing assessment of credit quality within the loan portfolio, the Company maintains a Watch List, which includes Classified loans. These loans involve anticipated potential payment defaults or collateral inadequacies. A loan on the Watch List is considered impaired when management believes it is probable the Company will be unable to collect all contractual principal and interest payments due in accordance with the terms of the loan agreement. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical expedient, at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. The amount of impairment, if any, and any subsequent changes are included in the allowance for loan losses.

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The following table sets forth the recorded investment in nonperforming loans, disaggregated by segment, held by the Company as of September 30, 2011, and December 31, 2010. The recorded investment represents principal balances net of any partial charge-offs. Related accrued interest and net unamortized fees and costs are immaterial and are excluded from the table.

	September 30, 2011	December 31, 2010	Change
Nonaccrual loans:			
Commercial	$2,053	$4,011	$(1,958)
Real estate:			
Construction, land, and land development	60	60	—
1-4 family residential first mortgages	910	1,001	(91)
Home equity	—	59	(59)
Commercial	2,956	2,814	142
Consumer and other loans	—	—	—
Total nonaccrual loans	5,979	7,945	(1,966)
Loans past due 90 days and still accruing interest:			
Commercial	—	—	—
Real estate:			
Construction, land, and land development	70	—	70
1-4 family residential first mortgages	—	198	(198)
Home equity	—	—	—
Commercial	—	—	—
Consumer and other loans	—	—	—
Total loans past due 90 days and still accruing interest	70	198	(128)
Troubled debt restructured loans(1):			
Commercial	—	—	—
Real estate:			
Construction, land, and land development	1,176	1,195	(19)
1-4 family residential first mortgages	173	—	173
Home equity	164	—	164
Commercial	116	3,578	(3,462)
Consumer and other loans	11	14	(3)
Total troubled debt restructured loans	1,640	4,787	(3,147)
Total nonperforming loans	$7,689	$12,930	$(5,241)

(1) While troubled debt restructured loans are commonly reported by the industry as nonperforming, those not classified in the nonaccrual category are accruing interest due to payment performance.

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The following table shows the pre- and post-modification recorded investment in TDR loans by type of modification and loan segment that have occurred during the three and nine months ended September 30, 2011.

	Three months ended September 30, 2011			Nine months ended September 30, 2011		
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Lengthened amortization:						
Commercial	—	$—	$—	—	$—	$—
Real estate:						
Construction, land, and land development	—	—	—	—	—	—
1-4 family residential first mortgages	—	—	—	—	—	—
Home equity	1	164	164	1	164	164
Commercial	—	—	—	1	116	116
Consumer and other loans	—	—	—	—	—	—
	1	164	164	2	280	280
Reduced interest rate:						
Commercial	—	—	—	—	—	—
Real estate:						
Construction, land, and land development	—	—	—	—	—	—
1-4 family residential first mortgages	—	—	—	1	175	175
Home equity	—	—	—	—	—	—
Commercial	—	—	—	—	—	—
Consumer and other loans	—	—	—	—	—	—
	—	—	—	1	175	175
	1	$164	$164	3	$455	$455

There was no financial impact for specific reserves or from charge-offs for the modified loans included in the previous table.

The following table shows the recorded investment in troubled debt restructured loans by segment that have been modified within the previous twelve months and have subsequently had a payment default during the three and nine months ended September 30, 2011.

	Three months ended September 30, 2011		Nine months ended September 30, 2011	
	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment
Commercial	—	$—	—	$—
Real estate:				

Construction, land and land development	—	—	—	—
1-4 family residential first mortgages	1	175	1	175
Home equity	—	—	—	—
Commercial	—	—	1	116
Consumer and other loans	—	—	—	—
Total	1	$175	2	$291

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As a result of adopting the amendments in ASU No. 2011-02, the Company reassessed all loan modifications that occurred on or after the beginning of the current year for identification as TDRs. The Company identified no additional loans for which the allowance for loan losses had previously been measured under a general allowance for credit losses methodology. The amendments in this ASU require prospective application of the impairment measurement guidance for those loans newly identified as impaired. As of September 30, 2011, there was no recorded loan investment for which the allowance for credit losses was previously measured under a general allowance for loan losses methodology that was presently impaired.

The following tables summarize the recorded investment in impaired loans by segment, broken down by loans with no related allowance and loans with a related allowance and the amount of that allowance as of September 30, 2011, and December 31, 2010, and the average recorded investment and interest income recognized on these loans for the three and nine months ended September 30, 2011.

	September 30, 2011			Three months ended September 30, 2011		Nine months ended September 30, 2011	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:							
Commercial	$2,053	$2,207	N/A	$1,498	$—	$1,799	$—
Real Estate:							
Construction, land, and land development	136	136	N/A	137	2	137	5
1-4 family residential	1,083	1,185	N/A	947	1	1,013	2
Home equity	164	164	N/A	85	1	45	1
Commercial	3,072	4,041	N/A	3,288	2	4,319	53
Consumer and other	11	11	N/A	11	—	12	1
	6,519	7,744	N/A	5,966	6	7,325	62
With an allowance recorded:							
Commercial	4,620	4,620	$600	4,657	59	5,670	198
Real Estate:							
Construction, land, and land development	13,228	13,228	1,826	13,344	156	13,682	507
1-4 family residential	282	282	84	282	5	163	10
Home equity	—	—	—	—	—	—	—
Commercial	—	—	—	—	—	—	—
Consumer and other	42	42	12	42	1	43	2
	18,172	18,172	2,522	18,325	221	19,558	717
Total:							
Commercial	6,673	6,827	600	6,155	59	7,469	198
Real Estate:							
Construction, land, and land development	13,364	13,364	1,826	13,481	158	13,819	512
1-4 family residential	1,365	1,467	84	1,229	6	1,176	12
Home equity	164	164	—	85	1	45	1
Commercial	3,072	4,041	—	3,288	2	4,319	53
Consumer and other	53	53	12	53	1	55	3
	$24,691	$25,916	$2,522	$24,291	$227	$26,883	$779

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	December 31, 2010		
	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:			
Commercial	$2,086	$6,270	N/A
Real Estate:			
Construction, land, and land development	139	143	N/A
1-4 family residential	836	884	N/A
Home equity	59	59	N/A
Commercial	6,392	6,392	N/A
Consumer and other	14	14	N/A
	9,526	13,762	N/A
With an allowance recorded:			
Commercial	7,026	7,026	$1,742
Real Estate:			
Construction, land, and land development	14,250	14,250	1,900
1-4 family residential	166	166	25
Home equity	—	—	—
Commercial	—	—	—
Consumer and other	45	45	21
	21,487	21,487	3,688
Total:			
Commercial	9,112	13,296	1,742
Real Estate:			
Construction, land, and land development	14,389	14,393	1,900
1-4 family residential	1,002	1,050	25
Home equity	59	59	—
Commercial	6,392	6,392	—
Consumer and other	59	59	21
	$31,013	$35,249	$3,688

N/A - Not applicable.

The following table reconciles the balance of nonaccrual loans with impaired loans as of September 30, 2011, and December 31, 2010.

	September 30, 2011	December 31, 2010
Nonaccrual loans	$5,979	$7,945
Troubled debt restructured loans	1,640	4,787
Other impaired loans still accruing interest	17,072	18,281
Total impaired loans	$24,691	$31,013

The balance of impaired loans at September 30, 2011, was comprised of 20 different borrowers, and the balance of impaired loans at December 31, 2010, was comprised of 23 different borrowers. The Company has no commitments to advance additional funds on any of the impaired loans.

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The following tables provide an analysis of the payment status of the recorded investment in loans as of September 30, 2011, and December 31, 2010.

	September 30, 2011						
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans	90 Days and Still Accruing
Commercial	$—	$—	$1,253	$1,253	$263,735	$264,988	$—
Real estate:							
Construction, land, and land development	60	5,000	70	5,130	108,207	113,337	70
1-4 family residential first mortgages	123	—	753	876	51,945	52,821	—
Home equity	10	1	—	11	28,888	28,899	—
Commercial	10	1,892	1,724	3,626	396,663	400,289	—
Consumer and other	179	6	—	185	6,355	6,540	—