WEST BANCORPORATION INC
Form 10-Q
July 26, 2013

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 June 30, 2013

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 July 25, 2013, there were 15,969,464 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)

(dollars in thousands)	June 30, 2013	December 31, 2012
ASSETS		
Cash and due from banks	$36,024	$60,417
Federal funds sold and other short-term investments	5,238	111,057
Cash and cash equivalents	41,262	171,474
Securities available for sale	376,328	292,314
Federal Home Loan Bank stock, at cost	12,345	11,789
Loans held for sale	6,753	3,363
Loans	969,109	927,401
Allowance for loan losses	(15,959)	(15,529)
Loans, net	953,150	911,872
Premises and equipment, net	6,813	5,609
Accrued interest receivable	4,402	3,652
Bank-owned life insurance	26,060	25,730
Other real estate owned	7,980	8,304
Deferred tax assets	8,023	6,991
Other assets	8,530	7,077
Total assets	$1,451,646	$1,448,175
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits:		
Noninterest-bearing demand	$308,189	$367,281
Interest-bearing demand	155,025	160,745
Savings	496,513	428,710
Time of $100,000 or more	92,528	100,627
Other time	72,284	77,213
Total deposits	1,124,539	1,134,576
Federal funds purchased and securities sold under agreements to repurchase	65,671	55,596
Subordinated notes	20,619	20,619
Federal Home Loan Bank advances, net of discount	94,638	93,890
Long-term debt	16,765	—
Accrued expenses and other liabilities	7,814	8,907
Total liabilities	1,330,046	1,313,588
STOCKHOLDERS' EQUITY		
Preferred stock, $0.01 par value; authorized 50,000,000 shares; no shares issued and outstanding at June 30, 2013 and December 31, 2012	—	—
Common stock, no par value; authorized 50,000,000 shares; 15,969,464 and		

17,403,882 shares issued and outstanding at June 30, 2013 and December 31, 2012, respectively	3,000	3,000
Additional paid-in capital	18,199	33,805
Retained earnings	100,621	95,856
Accumulated other comprehensive income (loss)	(220)	1,926
Total stockholders' equity	121,600	134,587
Total liabilities and stockholders' equity	$1,451,646	$1,448,175

See accompanying Notes to Consolidated Financial Statements.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
(dollars in thousands, except per share information)	2013	2012	2013	2012
Interest income:				
Loans, including fees	$11,327	$11,206	$22,235	$22,396
Securities:				
Taxable securities	1,319	1,128	2,418	2,099
Tax-exempt securities	599	511	1,101	1,014
Federal funds sold and other short-term investments	16	51	79	93
Total interest income	13,261	12,896	25,833	25,602
Interest expense:				
Deposits	858	1,271	1,737	2,550
Federal funds purchased and securities sold under				
agreements to repurchase	26	29	53	66
Subordinated notes	177	186	354	379
Federal Home Loan Bank advances	662	1,019	1,327	2,038
Long-term debt	5	—	5	—
Total interest expense	1,728	2,505	3,476	5,033
Net interest income	11,533	10,391	22,357	20,569
Provision for loan losses	—	—	150	—
Net interest income after provision for loan losses	11,533	10,391	22,207	20,569
Noninterest income:				
Service charges on deposit accounts	735	738	1,443	1,468
Debit card usage fees	431	412	824	790
Trust services	238	190	477	394
Gains and fees on sales of residential mortgages	226	581	737	1,328
Increase in cash value of bank-owned life insurance	170	191	330	390
Gain from bank-owned life insurance	—	841	—	841
Investment securities impairment losses	—	(127)	—	(173)
Realized investment securities gains, net	—	279	—	246
Other income	217	241	427	463
Total noninterest income	2,017	3,346	4,238	5,747
Noninterest expense:				
Salaries and employee benefits	3,986	3,571	7,955	7,207
Occupancy	1,000	875	1,933	1,732
Data processing	500	505	983	1,006
FDIC insurance expense	176	167	365	333
Other real estate owned expense (income)	(15)	906	1	988
Professional fees	333	287	636	579
Consulting fees	112	121	169	307

Other expenses	1,323	1,381	2,619	2,526
Total noninterest expense	7,415	7,813	14,661	14,678
Income before income taxes	6,135	5,924	11,784	11,638
Income taxes	1,837	1,541	3,538	3,278
Net income	$4,298	$4,383	$8,246	$8,360
Basic earnings per common share	$0.25	$0.25	$0.48	$0.48
Diluted earnings per common share	$0.25	$0.25	$0.48	$0.48
Cash dividends declared per common share	$0.10	$0.08	$0.20	$0.16

See accompanying Notes to Consolidated Financial Statements.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
(dollars in thousands)	2013	2012	2013	2012
Net income	$4,298	$4,383	$8,246	$8,360
Other comprehensive income (loss), before tax:				
Unrealized gains (losses) on securities for which a portion of an other than temporary impairment has been recorded in earnings before tax:				
Unrealized holding gains (losses) arising during the period	185	(52)	282	(108)
Less: reclassification adjustment for impairment losses realized in net income	—	127	—	173
Net unrealized gains on securities with other than temporary impairment before tax expense	185	75	282	65
Unrealized gains (losses) on securities without other than temporary impairment before tax:				
Unrealized holding gains (losses) arising during the period	(6,422)	1,426	(7,516)	1,778
Less: reclassification adjustment for net gains realized in net income	—	(279)	—	(246)
Net unrealized gains (losses) on other securities before tax expense	(6,422)	1,147	(7,516)	1,532
Unrealized gains on derivatives arising during the period before tax	3,365	—	3,773	—
Other comprehensive income (loss) before tax	(2,872)	1,222	(3,461)	1,597
Tax (expense) benefit related to other comprehensive income (loss)	1,092	(464)	1,315	(607)
Other comprehensive income (loss), net of tax:	(1,780)	758	(2,146)	990
Comprehensive income	$2,518	$5,141	$6,100	$9,350

See accompanying Notes to Consolidated Financial Statements.

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

	Preferred	Common Stock		Additional Paid-In	Retained	Accumulated Other Comprehensive	
(in thousands, except per share data)	Stock	Shares	Amount	Capital	Earnings	Income	Total
Balance, December 31, 2011	$—	17,404	$3,000	$33,687	$86,110	$ 654	$123,451
Net income	—	—	—	—	8,360	—	8,360
Other comprehensive income	—	—	—	—	—	990	990
Cash dividends declared, $0.16 per common share	—	—	—	—	(2,784)	—	(2,784)
Stock-based compensation costs	—	—	—	15	—	—	15
Balance, June 30, 2012	$—	17,404	$3,000	$33,702	$91,686	$ 1,644	$130,032
Balance, December 31, 2012	$—	17,404	$3,000	$33,805	$95,856	$ 1,926	$134,587
Net income	—	—	—	—	8,246	—	8,246
Other comprehensive loss	—	—	—	—	—	(2,146)	(2,146)
Cash dividends declared, $0.20 per common share	—	—	—	—	(3,481)	—	(3,481)
Repurchase and cancellation of common stock	—	(1,441)	—	(15,774)	—	—	(15,774)
Stock-based compensation costs	—	—	—	165	—	—	165
Issuance of common stock upon conversion of restricted stock units	—	6	—	3	—	—	3
Balance, June 30, 2013	$—	15,969	$3,000	$18,199	$100,621	$ (220)	$121,600

See accompanying Notes to Consolidated Financial Statements.

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

	Six Months Ended June 30,	
(dollars in thousands)	2013	2012
Cash Flows from Operating Activities:		
Net income	$8,246	$8,360
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	150	—
Net amortization and accretion	2,670	2,238
Loss on disposition of premises and equipment	6	123
Investment securities gains, net	—	(246)
Investment securities impairment losses	—	173
Stock-based compensation	165	15
Gain on sale of loans	(646)	(1,084)
Proceeds from sales of loans held for sale	53,212	53,755
Originations of loans held for sale	(56,092)	(52,359)
Gain on sale of other real estate owned	(60)	(105)
Write-down of other real estate owned	—	1,008
Gain from bank-owned life insurance	—	(841)
Increase in value of bank-owned life insurance	(330)	(390)
Depreciation	379	339
Deferred income taxes	282	927
Change in assets and liabilities:		
Increase in accrued interest receivable	(750)	(383)
(Increase) decrease in other assets	1,570	(499)
Decrease in accrued expenses and other liabilities	(299)	(717)
Net cash provided by operating activities	8,503	10,314
Cash Flows from Investing Activities:		
Proceeds from sales, calls and maturities of securities available for sale	44,944	49,103
Purchases of securities available for sale	(138,106)	(84,477)
Purchases of Federal Home Loan Bank stock	(1,458)	(1,226)
Proceeds from redemption of Federal Home Loan Bank stock	903	939
Net increase in loans	(41,291)	(20,512)
Net proceeds from sales of other real estate owned	334	475
Purchases of premises and equipment	(1,589)	(709)
Net cash used in investing activities	(136,263)	(56,407)
Cash Flows from Financing Activities:		
Net increase (decrease) in deposits	(10,037)	69,761
Net increase in federal funds purchased and securities sold under agreements to repurchase	10,075	4,870
Proceeds from long-term borrowings	16,765	—
Common stock dividends paid	(3,481)	(2,784)
Repurchase and cancellation of common stock	(15,774)	—
Net cash provided by (used in) financing activities	(2,452)	71,847
Net increase (decrease) in cash and cash equivalents	(130,212)	25,754
Cash and Cash Equivalents:		

Beginning	171,474	87,104
Ending	$41,262	$112,858

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

	Six Months Ended June 30,	
(dollars in thousands)	2013	2012
Supplemental Disclosures of Cash Flow Information:		
Cash payments for:		
Interest	$3,461	$5,214
Income taxes	3,075	2,236
Supplemental Disclosure of Noncash Investing and Financing Activities:		
Transfer of loans to other real estate owned	$—	$477
Sale of other real estate owned financed by issuance of a loan	—	800
Purchases of premises financed by issuance of long-term borrowings	765	—
Bank-owned life insurance death benefit receivable	—	1,573

See accompanying Notes to Consolidated Financial Statements.

West Bancorporation, Inc. and Subsidiary
Notes to Consolidated Financial Statements
(unaudited)
(dollars 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, 2012. In the opinion of management, the accompanying consolidated financial statements contain all adjustments necessary to present fairly the financial position as of June 30, 2013 and December 31, 2012, the net income and comprehensive income for the three and six months ended June 30, 2013 and 2012, and cash flows for the six months ended June 30, 2013 and 2012. 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 unaudited 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.

Recent accounting developments: In February 2013, the FASB issued Accounting Standards Update No. 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income, to improve the transparency of reporting reclassifications out of accumulated other comprehensive income. The amendments in the Update do not change the current requirements for reporting net income or other comprehensive income in the financial statements. The new amendments require an organization to present (either on the face of the statement where net income is presented or in the notes) the effects on the line items of net income of significant amounts reclassified out of accumulated other comprehensive income if the item reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. Additionally, for other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under U.S. GAAP to provide additional detail about those amounts. For public companies, the amendments were effective for reporting periods beginning after December 15, 2012. The adoption of this guidance 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, 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 that 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 that 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. Properties are initially recorded at fair value less estimated selling costs at the date of foreclosure, thus establishing a new cost basis. Fair value is determined by management by obtaining appraisals or other market value information at least annually. Any write-downs in value at the date of acquisition are charged to the allowance for loan losses. After foreclosure, valuations are periodically performed by management by obtaining updated appraisals or other market information. Any subsequent write-downs are recorded as a charge to operations, if necessary, to reduce the carrying value of a property to the updated fair value less estimated selling cost. Net costs related to the holding of properties are included in noninterest expense.

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 collectability 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.

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

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 June 30, 2013 and December 31, 2012.

	June 30, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
U.S. government agencies and corporations	$12,603	$302	$(39)	$12,866
State and political subdivisions	86,252	1,981	(2,606)	85,627
Collateralized mortgage obligations [1]	195,413	2,593	(1,670)	196,336
Mortgage-backed securities [1]	64,402	807	(958)	64,251
Trust preferred securities	5,918	—	(3,413)	2,505
Corporate notes and other investments	15,124	1	(382)	14,743
	$379,712	$5,684	$(9,068)	$376,328

	December 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
U.S. government agencies and corporations	$12,614	$420	$—	$13,034
State and political subdivisions	54,075	2,754	(68)	56,761
Collateralized mortgage obligations [1]	170,557	3,140	(103)	173,594
Mortgage-backed securities [1]	36,965	1,459	—	38,424
Trust preferred securities	5,913	—	(3,818)	2,095
Corporate notes and other investments	8,341	69	(4)	8,406
	$288,465	$7,842	$(3,993)	$292,314

[1] All collateralized mortgage obligations and 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 $73,147 and $72,367 as of June 30, 2013 and December 31, 2012, respectively, were pledged as collateral on securities sold under agreements to repurchase, interest rate swaps 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 June 30, 2013, 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 collateralized mortgage obligations and mortgage-backed securities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Therefore, collateralized mortgage obligations and mortgage-backed securities are not included in the maturity categories within the summary.

	June 30, 2013	
	Amortized Cost	Fair Value
Due in one year or less	$636	$644
Due after one year through five years	31,764	32,062
Due after five years through ten years	18,518	19,088
Due after ten years	67,495	62,569
	118,413	114,363
Collateralized mortgage obligations and mortgage-backed securities	259,815	260,587
Equity securities	1,484	1,378
	$379,712	$376,328

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

The details of the sales of securities for the three and six months ended June 30, 2013 and 2012 are summarized in the following table.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Proceeds from sales	$—	$12,161	$—	$16,121
Gross gains on sales	—	288	—	288
Gross losses on sales	—	9	—	42

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 June 30, 2013 and December 31, 2012.

	June 30, 2013					
	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	$4,950	$(39)	$—	$—	$4,950	$(39)
State and political subdivisions	48,831	(2,606)	—	—	48,831	(2,606)
Collateralized mortgage obligations	88,801	(1,659)	3,118	(11)	91,919	(1,670)
Mortgage-backed securities	37,871	(958)	—	—	37,871	(958)
Trust preferred securities	—	—	2,505	(3,413)	2,505	(3,413)
Corporate notes and other investments	13,911	(382)	—	—	13,911	(382)
	$194,364	$(5,644)	$5,623	$(3,424)	$199,987	$(9,068)

	December 31, 2012					
	Less than 12 months		12 months or longer		Total	
	Fair Value	Gross Unrealized (Losses)	Fair Value	Gross Unrealized (Losses)	Fair Value	Gross Unrealized (Losses)
State and political subdivisions	$5,617	$(62)	$305	$(6)	$5,922	$(68)
Collateralized mortgage obligations	19,477	(103)	—	—	19,477	(103)
Trust preferred securities	—	—	2,095	(3,818)	2,095	(3,818)
Corporate notes and other investments	1,032	(4)	—	—	1,032	(4)
	$26,126	$(169)	$2,400	$(3,824)	$28,526	$(3,993)

See Note 2 for a discussion of accounting policies related to securities with unrealized losses. As of June 30, 2013, the available for sale investment portfolio included two collateralized mortgage obligation securities and two trust preferred securities (TPS) with unrealized losses that have existed for longer than one year.

The Company believes the unrealized losses on investments in government agency securities, municipal obligations, all other collateralized mortgage obligations, mortgage-backed securities and corporate notes as of June 30, 2013, were due to market conditions, not reduced estimated cash flows. There was a significant increase in market interest rates in June 2013, particularly in the longer part of the interest rate curve. This caused a measurable decline in the fair market value of the bond portfolio. The Company does not intend 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 did not consider these investments to have OTTI at June 30, 2013.

The Company believes the unrealized loss of $858 on an investment in one single-issuer TPS issued by Heartland Financial, USA, Inc. as of June 30, 2013, was due to market conditions, not reduced estimated cash flows. The Company does not intend 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 did not consider this investment to have OTTI at June 30, 2013.

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As of June 30, 2013, the Company had one pooled TPS, ALESCO Preferred Funding X, Ltd., it has considered to have OTTI since 2009. The Company engaged an independent consulting firm to assist in the valuation of this security. In accordance with ASC 325, a discounted cash flow model was used to determine the estimated fair value of this security. Based on that valuation, management determined the security had an estimated fair value of $1,616 at June 30, 2013. Based on the valuation work performed, no additional credit loss was recognized in the six months ended June 30, 2013. A credit loss of $127 was recognized in the second quarter of 2012 and $173 was recognized during the first six months of 2012. The remaining unrealized loss of $2,555 is reflected in accumulated other comprehensive income, net of taxes of $971. The Company will continue to periodically estimate the present value of cash flows expected to be collected over the life of the security.

The following table provides a roll forward of the cumulative amount of credit-related losses recognized in earnings for the three and six months ended June 30, 2013 and 2012.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Balance at beginning of period	$729	$572	$729	$526
Current period credit loss recognized in earnings	—	127	—	173
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	$729	$699	$729	$699

4. Loans and Allowance for Loan Losses

Loans consist of the following segments as of June 30, 2013 and December 31, 2012.

	June 30, 2013	December 31, 2012
Commercial	$248,640	$282,124
Real estate:		
Construction, land and land development	124,208	121,911
1-4 family residential first mortgages	47,967	49,280
Home equity	24,194	25,536
Commercial	516,131	441,857
Consumer and other loans	8,419	7,099
	969,559	927,807
Net unamortized fees and costs	450	406
	$969,109	$927,401

Real estate loans of approximately $466,000 and $397,000 were pledged as security for Federal Home Loan Bank (FHLB) advances as of June 30, 2013 and December 31, 2012, respectively.

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 portfolio segments identified above and are analyzed by management on this basis. All loan policies identified below apply to all segments of the loan portfolio.

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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 payments pursuant to contractual terms. 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. 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 troubled debt restructured (TDR) when the Company concludes that a borrower is experiencing financial difficulties and a concession was granted that would not otherwise be considered. Concessions may include a restructuring of the loan terms 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 loan if the restructured loan yields a rate that 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 or past due 90 days, 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 June 30, 2013 and December 31, 2012. 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.

	June 30, 2013	December 31, 2012
Nonaccrual loans:		
Commercial	$618	$655
Real estate:		
Construction, land and land development	—	3,356
1-4 family residential first mortgages	686	406
Home equity	—	—
Commercial	2,212	1,983
Consumer and other loans	—	—
Total nonaccrual loans	3,516	6,400
Loans past due 90 days and still accruing interest:		
Commercial	—	—
Real estate:		
Construction, land and land development	—	—
1-4 family residential first mortgages	—	—
Home equity	—	—
Commercial	—	—
Consumer and other loans	—	—
Total loans past due 90 days and still accruing interest	—	—
Troubled debt restructured loans[1]:		
Commercial	—	20
Real estate:		
Construction, land and land development	446	470
1-4 family residential first mortgages	104	273
Home equity	—	—
Commercial	94	93
Consumer and other loans	—	—
Total troubled debt restructured loans	644	856
Total nonperforming loans	$4,160	$7,256

[1] While TDR loans are commonly reported by the industry as nonperforming, those not classified in the nonaccrual category are accruing interest due to payment performance. TDR loans on nonaccrual status, if any, are included in the nonaccrual category. As of June 30, 2013 and December 31, 2012, there was one TDR loan with a balance of $716 and $810, respectively, included in the nonaccrual category.

There were no loan modifications considered to be TDR during the three or six months ended June 30, 2013. There was one loan in the 1-4 family residential first mortgages segment with a pre- and post-modification recorded investment of $74 that was modified using lengthened amortization during the three months ended June 30, 2012. Additionally, there was one loan in the commercial segment with a pre- and post-modification recorded investment of

$28, that was modified using lengthened amortization during the three months ended March 31, 2012. There was no financial impact for specific reserves or charge-offs for the TDR loans that were modified during the three and six months ended June 30, 2012.

There were no TDR loans that were modified within the twelve months preceding June 30, 2013 or June 30, 2012 that subsequently had a payment default during the six months ended June 30, 2013 or 2012, respectively. A TDR loan is considered to have a payment default when it is past due 30 days or more.

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 June 30, 2013 and December 31, 2012, and the average recorded investment and interest income recognized on these loans for the three and six months ended June 30, 2013 and 2012.

	June 30, 2013			December 31, 2012		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:						
Commercial	$—	$—	N/A	$282	$292	N/A
Real Estate:						
Construction, land and land development	446	1,048	N/A	3,825	5,292	N/A
1-4 family residential first mortgages	686	716	N/A	679	679	N/A
Home equity	—	—	N/A	—	—	N/A
Commercial	1,983	2,953	N/A	2,077	3,046	N/A
Consumer and other	—	—	N/A	—	—	N/A
	3,115	4,717	N/A	6,863	9,309	N/A
With an allowance recorded:						
Commercial	3,731	3,731	$1,387	3,615	3,615	$1,297
Real Estate:						
Construction, land and land development	2,770	2,770	2,100	4,441	4,441	3,000
1-4 family residential first mortgages	298	298	34	—	—	—
Home equity	—	—	—	458	458	86
Commercial	323	323	323	1,574	1,574	523
Consumer and other	—	—	—	—	—	—
	7,122	7,122	3,844	10,088	10,088	4,906
Total:						
Commercial	3,731	3,731	1,387	3,897	3,907	1,297
Real Estate:						
Construction, land and land development	3,216	3,818	2,100	8,266	9,733	3,000
1-4 family residential first mortgages	984	1,014	34	679	679	—
Home equity	—	—	—	458	458	86
Commercial	2,306	3,276	323	3,651	4,620	523
Consumer and other	—	—	—	—	—	—
	$10,237	$11,839	$3,844	$16,951	$19,397	$4,906

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	Three Months Ended June 30,				Six Months Ended June 30,			
	2013		2012		2013		2012	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:								
Commercial	$—	$ —	$478	$ 79	$146	$ 9	$616	$ 79
Real Estate:								
Construction, land and land development	1,288	5	959	—	2,372	9	1,754	—
1-4 family residential first mortgages	608	—	1,123	2	655	1	1,110	3
Home equity	—	—	—	—	—	—	—	—
Commercial	1,997	1	3,472	15	2,027	3	3,493	35
Consumer and other		—	—	—		—	—	—
	3,893	6	6,032	96	5,200	22	6,973	117
With an allowance recorded:								
Commercial	3,767	41	3	—	3,694	82	1,309	24
Real Estate:								
Construction, land and land development	3,907	49	15,067	141	4,131	104	14,842	302
1-4 family residential first mortgages	78	3	649	8	45	5	488	15
Home equity	436	4	—	—	444	11	45	—
Commercial	1,254	20	1,269	22	1,390	44	1,271	46
Consumer and other	—	—	8	—	—	—	21	1
	9,442	117	16,996	171	9,704	246	17,976	388
Total:								
Commercial	3,767	41	481	79	3,840	91	1,925	103
Real Estate:								
Construction, land and development	5,195	54	16,026	141	6,503	113	16,596	302
1-4 family residential first mortgages	686	3	1,772	10	700	6	1,598	18
Home equity	436	4	—	—	444	11	45	—
Commercial	3,251	21	4,741	37	3,417	47	4,764	81
Consumer and other	—	—	8	—	—	—	21	1
	$13,335	$ 123	$23,028	$ 267	$14,904	$ 268	$24,949	$ 505

The following table reconciles the balance of nonaccrual loans with impaired loans as of June 30, 2013 and December 31, 2012.

	June 30, 2013	December 31, 2012
Nonaccrual loans	$3,516	$6,400
Troubled debt restructured loans	644	856
Other impaired loans still accruing interest	6,077	9,695
Total impaired loans	$10,237	$16,951

The balance of impaired loans at June 30, 2013 and December 31, 2012 was comprised of 19 and 22 different borrowers, respectively. 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 June 30, 2013 and December 31, 2012.

	June 30, 2013						
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans	90 Days Past Due and Still Accruing
Commercial	$—	$—	$313	$313	$248,327	$248,640	$—
Real estate:							
Construction, land and land development	67	—	—	67	124,141	124,208	—
1-4 family residential first mortgages	331	—	446	777	47,190	47,967	—
Home equity	—	—	—	—	24,194	24,194	—
Commercial	445	—	1,170	1,615	514,516	516,131	—
Consumer and other	6	8	—	14	8,405	8,419	—
Total	$849	$8	$1,929	$2,786	$966,773	$969,559	$—
Nonaccrual loans included above	$563	$—	$1,929	$2,492	$1,024	$3,516	

	December 31, 2012						
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans	90 Days Past Due and Still Accruing
Commercial	$146	$—	$331	$477	$281,647	$282,124	$—
Real estate:							
Construction, land and land development	—	—	3,356	3,356	118,555	121,911	—
1-4 family residential first mortgages	89	143	152	384	48,896	49,280	—
Home equity	279	27	—	306	25,230	25,536	—
Commercial	38	236	1,744	2,018	439,839	441,857	—
Consumer and other	195	—	—	195	6,904	7,099	—
Total	$747	$406	$5,583	$6,736	$921,071	$927,807	$—
Nonaccrual loans included above	$74	$236	$5,583	$5,893	$507	$6,400	

The following tables show the recorded investment in loans by credit quality indicator and portfolio segment as of June 30, 2013 and December 31, 2012.

	June 30, 2013				
	Pass	Watch	Substandard	Doubtful	Total
Commercial	$232,441	$9,548	$6,651	$—	$248,640
Real estate:					
Construction, land and land development	103,489	13,744	6,975	—	124,208
1-4 family residential first mortgages	46,111	530	1,326	—	47,967
Home equity	23,544	100	550	—	24,194
Commercial	499,605	7,453	9,073	—	516,131
Consumer and other	8,358	61	—	—	8,419
Total	$913,548	$31,436	$24,575	$—	$969,559

	December 31, 2012				
	Pass	Watch	Substandard	Doubtful	Total
Commercial	$258,677	$17,234	$6,213	$—	$282,124
Real estate:					
Construction, land and land development	94,855	15,030	12,026	—	121,911
1-4 family residential first mortgages	47,392	861	1,027	—	49,280
Home equity	24,659	105	772	—	25,536
Commercial	420,888	8,101	12,868	—	441,857
Consumer and other	7,063	36	—	—	7,099
Total	$853,534	$41,367	$32,906	$—	$927,807

All loans are subject to the assessment of a credit quality indicator. Risk ratings are assigned for each loan at the time of approval, and they change as circumstances dictate during the term of the loan. The Company utilizes a 9-point risk rating scale as shown below, with ratings 1 - 5 included in the Pass column, rating 6 included in the Watch column, ratings 7 - 8 included in the Substandard column and rating 9 included in the Doubtful column. The Substandard column includes all loans classified as impaired, which are included in the specific evaluation of the allowance for loan losses.

Risk rating 1: The loan is secured by cash equivalent collateral.

Risk rating 2: The loan is secured by properly margined marketable securities, bonds or cash surrender value of life insurance.

Risk rating 3: The borrower is in strong financial condition and has strong debt service capacity. The loan is performing as agreed, and the financial characteristics and trends of the borrower exceed industry statistics.

Risk rating 4: The borrower is in satisfactory financial condition and has satisfactory debt service capacity. The loan is performing as agreed, and the financial characteristics and trends of the borrower fall in line with industry statistics.

Risk rating 5: The borrower's financial condition is less than satisfactory. The loan is still generally paying as agreed, but strained cash flow may cause some slowness in payments. The collateral values adequately preclude loss on the loan. Financial characteristics and trends lag industry statistics. There may be noncompliance with loan covenants.

Risk rating 6: The borrower's financial condition is deficient. Payment delinquencies may be more common. Collateral values still protect from loss, but margins are narrow. The loan may be reliant on secondary sources of repayment, including liquidation of collateral and guarantor support.

Risk rating 7: The loan is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Well-defined weaknesses exist that jeopardize the liquidation of the debt. The Company is inadequately protected by the valuation or paying capacity of the collateral pledged. If deficiencies are not corrected, there is a distinct possibility that a loss will be sustained.

Risk rating 8: All the characteristics of rating 7 exist with the added condition that the loan is past due more than 90 days or there is reason to believe the Company will not receive its principal and interest according to the terms of the loan agreement.

Risk rating 9: All the weaknesses inherent in risk ratings 7 and 8 exist with the added condition that collection or liquidation, on the basis of currently known facts, conditions and values, is highly questionable and improbable. A loan reaching this category would most likely be charged off.

Credit quality indicators for all loans and the Company's risk rating process are dynamic and updated on a continuous basis. Risk ratings are updated as circumstances that could affect the repayment of an individual loan are brought to management's attention through an established monitoring process. Individual lenders initiate changes as appropriate for ratings 1 through 5, and changes for ratings 6 through 9 are initiated via communications with management. The likelihood of loss increases as the risk rating increases and is generally preceded by a loan appearing on the Watch List, which consists of all loans with a risk rating of 6 or worse. Written action plans with firm target dates for resolution of identified problems are maintained and reviewed on a quarterly basis for all segments of criticized loans.

In addition to the Company's internal credit monitoring practices and procedures, an outsourced independent credit review function is in place to further assess assigned internal risk classifications and monitor compliance with internal lending policies and procedures.

In all portfolio segments, the primary risks are that a borrower's income stream diminishes to the point that it is not able to make scheduled principal and interest payments and any collateral securing the loan has declined in value. The risk of declining collateral values is present for most types of loans.

Commercial loans consist primarily of loans to businesses for various purposes, including revolving lines to finance current operations, inventory and accounts receivable, and capital expenditure loans to finance equipment and other fixed assets. These loans generally have short maturities, have either adjustable or fixed interest rates, and are either unsecured or secured by inventory, accounts receivable and/or fixed assets. For commercial loans the primary source of repayment is from the operation of the business.

Real estate loans include various types of loans for which the Company holds real property as collateral and consist of loans on commercial properties and single and multifamily residences. Real estate loans are typically structured to mature or reprice every 5 years with payments based on amortization periods up to 30 years. The majority of construction loans are to contractors and developers for construction of commercial buildings or residential real estate. These loans typically have maturities up to 24 months. The Company's loan policy includes minimum appraisal and other credit guidelines.

Consumer loans include loans extended to individuals for household, family and other personal expenditures not secured by real estate. The majority of the Company's consumer lending is for vehicles, consolidation of personal debts and household improvements. For consumer loans, including 1-4 family residential and home equity loans, the source of repayment typically consists of wages.

The allowance for loan losses is established through a provision for loan losses charged to expense. Loans in each of the Company's segments are charged against the allowance for loan losses when management believes that collectability of the principal is unlikely. The allowance is an amount that management believes will be adequate to absorb probable losses on existing loans, based on an evaluation of the collectability of loans and prior loss experience. This evaluation also takes into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, the review of specific problem loans, and current economic conditions that may affect the borrower's ability to pay. While management uses the best information available to make its evaluation, future adjustments to the allowance may be necessary if there are significant changes in economic conditions or the other factors relied upon.

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The allowance for loan losses consists of specific and general components. The specific component relates to loans that meet the definition of impaired. The general component covers the remaining loans and is based on historical loss experience adjusted for qualitative factors such as delinquency trends, loan growth, economic elements and local market conditions. These same policies are applied to all segments of loans. In addition, regulatory agencies, as an integral part of their examination processes, periodically review the Company's allowance for loan losses, and may require the Company to make additions to the allowance based on their judgment about information available to them at the time of their examinations.

The following tables detail changes in the allowance for loan losses by segment for the three and six months ended June 30, 2013 and 2012.

	Three Months Ended June 30, 2013						
	Real Estate						
	Commercial	Construction and Land	1-4 Family Residential	Home Equity	Commercial	Consumer and Other	Total
Beginning balance	$3,977	$4,428	$ 603	$538	$ 6,070	$ 16	$15,632
Charge-offs	—	—	(30)	—	—	(1)	(31)
Recoveries	197	42	24	90	—	5	358
Provision [1]	(66)	(537)	66	(187)	710	14	—
Ending balance	$4,108	$3,933	$ 663	$441	$ 6,780	$ 34	$15,959

	Three Months Ended June 30, 2012						
	Real Estate						
	Commercial	Construction and Land	1-4 Family Residential	Home Equity	Commercial	Consumer and Other	Total
Beginning balance	$3,916	$4,134	$ 1,234	$601	$ 6,697	$ 69	$16,651
Charge-offs	—	(1,466)	(25)	—	(1)	—	(1,492)
Recoveries	188	—	8	3	—	15	214
Provision [1]	(108)	398	(127)	(8)	(135)	(20)	—
Ending balance	$3,996	$3,066	$ 1,090	$596	$ 6,561	$ 64	$15,373

	Six Months Ended June 30, 2013						
	Real Estate						
	Commercial	Construction and Land	1-4 Family Residential	Home Equity	Commercial	Consumer and Other	Total
Beginning balance	$4,116	$4,616	$ 637	$568	$ 5,564	$ 28	$15,529
Charge-offs	(199)	—	(30)	(5)	—	(1)	(235)
Recoveries	220	42	118	113	2	20	515
Provision [1]	(29)	(725)	(62)	(235)	1,214	(13)	150
Ending balance	$4,108	$3,933	$ 663	$441	$ 6,780	$ 34	$15,959

	Six Months Ended June 30, 2012						
	Real Estate						
	Commercial				Commercial		Total

		Construction and Land	1-4 Family Residential	Home Equity		Consumer and Other	
Beginning balance	$4,409	$3,572	$ 1,215	$832	$ 6,667	$83	$16,778
Charge-offs	—	(1,508)	(64)	(95)	(1)	(12)	(1,680)
Recoveries	235	—	15	8	—	17	275
Provision [(1)]	(648)	1,002	(76)	(149)	(105)	(24)	—
Ending balance	$3,996	$3,066	$ 1,090	$596	$ 6,561	$64	$15,373

(1) The negative provisions for the various segments are primarily related to the decline in each of those portfolio segments during the time periods disclosed or improvement in the credit quality factors related to those portfolio segments.

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The following tables show a breakdown of the allowance for loan losses disaggregated on the basis of impairment analysis method by segment as of June 30, 2013 and December 31, 2012.

	June 30, 2013						
		Real Estate					
	Commercial	Construction and Land	1-4 Family Residential	Home Equity	Commercial	Consumer and Other	Total
Ending balance:							
Individually evaluated for impairment	$1,387	$2,100	$ 34	$—	$ 323	$—	$3,844
Collectively evaluated for impairment	2,721	1,833	629	441	6,457	34	12,115
Total	$4,108	$3,933	$ 663	$441	$ 6,780	$34	$15,959

	December 31, 2012						
		Real Estate					
	Commercial	Construction and Land	1-4 Family Residential	Home Equity	Commercial	Consumer and Other	Total
Ending balance:							
Individually evaluated for impairment	$1,297	$3,000	$ —	$86	$ 523	$—	$4,906
Collectively evaluated for impairment	2,819	1,616	637	482	5,041	28	10,623
Total	$4,116	$4,616	$ 637	$568	$ 5,564	$28	$15,529

The following tables show the recorded investment in loans, exclusive of unamortized fees and costs, disaggregated on the basis of impairment analysis method by segment as of June 30, 2013 and December 31, 2012.

	June 30, 2013						
		Real Estate					
	Commercial	Construction and Land	1-4 Family Residential	Home Equity	Commercial	Consumer and Other	Total
Ending balance:							
Individually evaluated for impairment	$3,732	$3,216	$ 983	$—	$ 2,306	$—	$10,237
Collectively evaluated for impairment	244,908	120,992	46,984	24,194	513,825	8,419	959,322
Total	$248,640	$124,208	$ 47,967	$24,194	$ 516,131	$8,419	$969,559

	December 31, 2012						
		Real Estate					
	Commercial	Construction and Land	1-4 Family Residential	Home Equity	Commercial	Consumer and Other	Total

Ending balance:							
Individually evaluated for impairment	$3,897	$8,266	$ 679	$458	$ 3,651	$—	$16,951
Collectively evaluated for impairment	278,227	113,645	48,601	25,078	438,206	7,099	910,856
Total	$282,124	$121,911	$ 49,280	$25,536	$ 441,857	$7,099	$927,807

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5. Derivatives

The Company uses interest rate swap agreements to assist in its interest rate risk management. The notional amounts of the interest rate swaps do not represent amounts exchanged by the counterparties. The notional amount of a derivative is used to determine, along with other terms of the derivative, the amounts to be exchanged between the counterparties.

The Company has variable rate funding, which creates exposure to variability in interest payments due to changes in interest rates. In December 2012, to manage the interest rate risk related to the variability of interest payments, the Company entered into three forward-starting interest rate swap transactions, with a total notional amount of $80,000, to effectively convert $80,000 of its variable rate FHLB advances to fixed interest rate debt as of the forward-starting date of the swap transactions. The effective dates on the interest rate swaps executed in December 2012 ranged from December 2014 to December 2015. The three swap transactions were designated as cash flow hedges of the changes in cash flows attributable to changes in LIBOR, the benchmark interest rate being hedged, associated with the interest payments made on the previously mentioned FHLB advances with quarterly interest rate reset dates.

In June 2013, to manage the interest rate risk related to the variability of interest payments, the Company entered into a forward-starting interest rate swap transaction, with a total notional amount of $20,000 to effectively convert its $20,000 variable rate junior subordinated notes to fixed rate debt as of the forward-starting date of the swap transaction. The effective date of this swap is June 30, 2014. This swap transaction was designated as a cash flow hedge of the change in cash flows attributable to the change in LIBOR, the benchmark interest rate being hedged, associated with the interest payments made on $20,000 of the Company's junior subordinated debt with a quarterly interest reset date.

At inception of each hedge transaction, the Company asserted that the underlying principal balance would remain outstanding throughout the hedge transaction, making it probable that sufficient LIBOR-based interest payments would exist through the maturity date of the swaps. The cash flow hedges were determined to be fully effective during the remaining terms of the swaps. Therefore, the aggregate fair value of the swaps is recorded in other assets or other liabilities with changes in market value recorded in other comprehensive income, net of deferred taxes. See Note 6 for additional fair value information and disclosures. The amounts included in accumulated other comprehensive income will be reclassified to interest expense should the hedge no longer be considered effective. No amount of ineffectiveness was included in net income for the six months ended June 30, 2013, and the Company expects there will be no reclassification from accumulated other comprehensive income to interest expense for the next twelve months through June 30, 2014. The Company will continue to assess the effectiveness of the hedges on a quarterly basis.

The Company is exposed to credit risk in the event of nonperformance by the interest rate swap counterparty. The Company minimizes this risk by entering into derivative contracts with only large, stable financial institutions, and the Company has not experienced, and does not expect, any losses from counterparty nonperformance on the interest rate swaps. The Company monitors counterparty risk in accordance with the provisions of ASC 815. In addition, the interest rate swap agreements contain language outlining collateral-pledging requirements for each counterparty. Collateral must be posted when the market value exceeds certain threshold limits. The Company was not required to pledge any collateral to the counterparty as of June 30, 2013. The counterparty was required to pledge $3,597 of collateral to the Company as of June 30, 2013. There is the possibility that the Company may need to pledge collateral in the future.

The tables below identify the balance sheet category and fair values of the Company's derivative instruments designated as cash flow hedges as of June 30, 2013 and December 31, 2012.

June 30, 2013		Notional Amount	Fair Value	Balance Sheet Category	Receive Rate		Pay Rate		Maturity
Interest rate swap	(1)	$25,000	$773	Other Assets	0.56	%	2.10	%	12/23/2019
Interest rate swap	(2)	25,000	879	Other Assets	0.58	%	2.34	%	6/22/2020
Interest rate swap	(3)	30,000	1,060	Other Assets	0.58	%	2.52	%	9/21/2020
Interest rate swap	(4)	20,000	317	Other Assets	3.32	%	4.88	%	6/30/2019

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December 31, 2012		Notional Amount	Fair Value	Balance Sheet Category	Receive Rate	Pay Rate	Maturity
Interest rate swap	(1)	$25,000	$(239)	Other Liabilities	0.60 %	2.10 %	12/23/2019
Interest rate swap	(2)	25,000	(238)	Other Liabilities	0.62 %	2.34 %	6/22/2020
Interest rate swap	(3)	30,000	(267)	Other Liabilities	0.62 %	2.52 %	9/21/2020

The table below identifies the pre-tax gains recognized on the Company's derivative instruments designated as cash flow hedges for the six months ended June 30, 2013.

		Effective Portion			Ineffective Portion	
		Amount of Pre-tax Gain Recognized in OCI	Reclassified from AOCI into Income		Recognized in Income on Derivatives	
			Category	Amount of Gain (Loss)	Category	Amount of Gain (Loss)
Interest rate swap	(1)	$1,012	Interest Expense	$—	Other Income	$—
Interest rate swap	(2)	1,117	Interest Expense	—	Other Income	—
Interest rate swap	(3)	1,327	Interest Expense	—	Other Income	—
Interest rate swap	(4)	317	Interest Expense	—	Other Income	—

6. Long-Term Debt

On June 27, 2013, the Company borrowed $16,000 from a commercial bank in the form of a five-year amortizing secured term loan with a variable rate of 1.95 percent plus 30-day LIBOR. The proceeds were used to finance the repurchase and cancellation of 1,440,592 shares of common stock discussed in Note 8. In the event that the Company defaults under the note, the interest rate would increase by an additional five percent. The Company also entered into a $5,000 secured line of credit which expires on June 27, 2014. Both the note and the secured line of credit are secured by a pledge of certain of the Company's assets, including the stock of West Bank.

Also occurring during June 2013 was the purchase of a commercial lot in Coralville for a new eastern Iowa main office. The purchase was financed with an eight-and-one-half-year variable payment contract for $765 with a fixed interest rate of 1.25 percent. The financing was requested by the seller to accommodate their cash flow planning.

7. Fair Value Measurements

Accounting guidance on fair value measurements and disclosures defines fair value, establishes a framework for measuring the fair value of assets and liabilities using a hierarchy system, and defines required disclosures. It clarifies that fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts business.

The Company's balance sheet contains securities available for sale that are recorded at fair value on a recurring basis. The three-level valuation hierarchy for disclosure of fair value is as follows:

Level 1 uses quoted market prices in active markets for identical assets or liabilities.

Level 2 uses observable market-based inputs or unobservable inputs that are corroborated by market data.

Level 3 uses unobservable inputs that are not corroborated by market data.

The Company's policy is to recognize transfers between Levels at the end of each reporting period, if applicable. There were no transfers between Levels of the fair value hierarchy during the six months ended June 30, 2013.

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Securities available for sale: When available, quoted market prices are used to determine the fair value of investment securities, and such items so valued are classified within Level 1 of the fair value hierarchy. Examples include U.S. Treasury securities, certain corporate bonds and preferred stocks. For other securities, the Company determines fair value based on various sources and may apply matrix pricing with observable prices for similar bonds where a price for the identical bond is not observable. Securities measured at fair value by such methods are classified as Level 2. The fair values of Level 2 securities are determined by pricing models that consider observable market data such as interest rate volatilities, LIBOR yield curve, credit spreads, prices from market makers and live trading systems. Certain securities are not valued based on observable inputs and are, therefore, classified as Level 3. The fair value of these securities is based on management's best estimates.

Generally, management obtains the fair value of investment securities at the end of each reporting period via a third party pricing service. Management, with the assistance of an independent investment advisory firm, reviewed the valuation process used by the third party and believes that process is valid. On a quarterly basis management corroborates the fair values of investment securities by obtaining pricing from an independent investment advisory firm and compares the two sets of fair values. Any significant variances are reviewed and investigated. In addition, the Company has instituted a practice of further testing the fair values of a sample of securities. For that sample, the prices are further validated by management, with assistance from an independent investment advisory firm, by obtaining details of the inputs used by the pricing service. Those inputs were independently tested, and management concluded the fair values were consistent with GAAP requirements and securities were properly classified in the fair value hierarchy.

Derivative instruments: The Company's derivative instruments consist of interest rate swaps, which are accounted for as cash flow hedges. The Company's derivative position is classified within Level 2 of the fair value hierarchy and is valued using models generally accepted in the financial services industry that use actively quoted or observable market input values from external market data providers and/or non-binding broker-dealer quotations. The fair value of the derivative is determined using discounted cash flow models. These models’ key assumptions include the contractual terms of the respective contract, along with significant observable inputs, including interest rates, yield curves, nonperformance risk and volatility. Derivative contracts are executed with a Credit Support Annex, which is a bilateral ratings-sensitive agreement that requires collateral postings at established credit threshold levels. These agreements protect the interests of the Company and its counterparties, should either party suffer a credit rating deterioration.

The following tables present the balances of assets and liabilities measured at fair value on a recurring basis by level as of June 30, 2013 and December 31, 2012.

	June 30, 2013			
Description	Total	Level 1	Level 2	Level 3
Securities available for sale:				
U.S. government agencies and corporations	$12,866	$—	$12,866	$—
State and political subdivisions	85,627	—	85,627	—
Collateralized mortgage obligations	196,336	—	196,336	—
Mortgage-backed securities	64,251	—	64,251	—
Trust preferred securities	2,505	—	889	1,616
Corporate notes and other investments	14,743	14,443	300	—

Total securities available for sale	376,328	14,443	360,269	1,616
Derivative instruments:				
Interest rate swaps	3,029	—	3,029	—
Total assets measured at fair value on a recurring basis	$379,357	$14,443	$363,298	$1,616
Derivative instruments:				
Interest rate swaps	$—	$—	$—	$—
Total liabilities measured at fair value on a recurring basis	$—	$—	$—	$—

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	December 31, 2012			
Description	Total	Level 1	Level 2	Level 3
Securities available for sale:				
U.S. government agencies and corporations	$13,034	$—	$13,034	$—
State and political subdivisions	56,761	—	56,761	—
Collateralized mortgage obligations	173,594	—	173,594	—
Mortgage-backed securities	38,424	—	38,424	—
Trust preferred securities	2,095	—	761	1,334
Corporate notes and other investments	8,406	7,780	626	—
Total securities available for sale	292,314	7,780	283,200	1,334
Derivative instruments:				
Interest rate swaps	—	—	—	—
Total assets measured at fair value on a recurring basis	$292,314	$7,780	$283,200	$1,334
Derivative instruments:				
Interest rate swaps	$744	$—	$744	$—
Total liabilities measured at fair value on a recurring basis	$744	$—	$744	$—

The following table presents changes in securities available for sale with significant unobservable inputs (Level 3) for the three and six months ended June 30, 2013 and 2012. The activity in the table consists of one pooled TPS (ALESCO Preferred Funding X, Ltd.).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Beginning balance	$1,431	$1,189	$1,334	$1,245
Transfer into level 3	—	—	—	—
Total gains or (losses):				
Included in earnings	—	(127)	—	(173)
Included in other comprehensive income	185	75	282	65
Sale of security	—	—	—	—
Principal payments	—	—	—	—
Ending balance	$1,616	$1,137	$1,616	$1,137

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Certain assets are measured at fair value on a nonrecurring basis. That is, they are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following tables present those assets carried on the balance sheet by caption and by level within the valuation hierarchy as of June 30, 2013 and December 31, 2012.

	June 30, 2013			
Description	Total	Level 1	Level 2	Level 3
Assets:				
Impaired loans	$3,278	$—	$—	$3,278
Other real estate owned	7,980	—	—	7,980
Total	$11,258	$—	$—	$11,258

	December 31, 2012			
Description	Total	Level 1	Level 2	Level 3
Assets:				
Impaired loans	$5,182	$—	$—	$5,182
Other real estate owned	8,304	—	—	8,304
Total	$13,486	$—	$—	$13,486

Loans in the previous tables consist of impaired loans for which a fair value adjustment was recorded. Impaired loans are evaluated and valued at the lower of cost or fair value when the loan is identified as impaired. Fair value is measured based on the value of the collateral securing these loans and is classified as Level 3 in the fair value hierarchy. Collateral may be real estate or business assets such as equipment, inventory or accounts receivable. Fair value is determined by appraisals. Appraised or reported values may be discounted based on management's opinions concerning market developments or the client's business. Other real estate owned in the tables above consists of property acquired through foreclosures and settlements of loans. Property acquired is carried at fair value of the property less estimated disposal costs, and is classified as Level 3 in the fair value hierarchy.

GAAP requires disclosure of the fair value of financial assets and financial liabilities, including those that are not measured and reported at fair value on a recurring basis or nonrecurring basis. The methodologies for estimating the fair value of financial assets and financial liabilities that are measured at fair value on a recurring or nonrecurring basis are discussed above. The methodologies for other financial assets and financial liabilities are discussed below.

Cash and due from banks: The carrying amount approximates fair value.

Federal funds sold and other short-term investments: The carrying amount approximates fair value.

FHLB stock: The fair value of this restricted stock is estimated at its carrying value and redemption price of $100 per share.

Loans held for sale: The fair values of loans held for sale are based on estimated selling prices.

Loans: The fair values of loans are estimated using discounted cash flow analysis based on observable market interest rates currently being offered for loans with similar terms to borrowers with similar credit quality.

Deposits: The carrying amounts for demand and savings deposits, which represent the amounts payable on demand, approximate their fair values. The fair values for fixed-rate and variable-rate certificates of deposit are estimated using discounted cash flow analysis, based on observable market interest rates currently being offered on certificates with similar terms.

Accrued interest receivable and payable: The fair values of both accrued interest receivable and payable approximate their carrying amounts.

Borrowings: The carrying amounts of federal funds purchased and securities sold under agreements to repurchase approximates their fair values. Fair values of FHLB advances, subordinated notes and other long-term borrowings are estimated using discounted cash flow analysis, based on observable market interest rates currently being offered with similar terms.

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Commitments to extend credit and standby letters of credit: The approximate fair values of commitments and standby letters of credit are based on the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and creditworthiness of the counterparties.

The following table includes the carrying amounts and approximate fair values of financial assets and liabilities as of June 30, 2013 and December 31, 2012.

		June 30, 2013		December 31, 2012	
	Fair Value Hierarchy Level	Carrying Amount	Approximate Fair Value	Carrying Amount	Approximate Fair Value
Financial assets:					
Cash and due from banks	Level 1	$36,024	$36,024	$60,417	$60,417
Federal funds sold and other short-term investments	Level 1	5,238	5,238	111,057	111,057
Securities available for sale	See previous table	376,328	376,328	292,314	292,314
Federal Home Loan Bank stock	Level 1	12,345	12,345	11,789	11,789
Loans held for sale	Level 2	6,753	6,753	3,363	3,409
Loans, net	Level 2	953,150	971,763	911,872	928,048
Accrued interest receivable	Level 1	4,402	4,402	3,652	3,652
Interest rate swaps	See previous table	3,029	3,029	—	—
Financial liabilities:					
Deposits	Level 2	1,124,539	1,125,622	1,134,576	1,136,378
Federal funds purchased and securities sold under agreements to repurchase	Level 1	65,671	65,671	55,596	55,596
Accrued interest payable	Level 1	487	487	472	472
Subordinated notes	Level 2	20,619	11,944	20,619	12,010
Federal Home Loan Bank advances, net	Level 2	94,638	95,076	93,890	95,741
Long-term debt	Level 2	16,765	16,765	—	—
Interest rate swaps	See previous table	—	—	744	744
Off-balance-sheet financial instruments:					
Commitments to extend credit	Level 3	—	—	—	—
Standby letters of credit	Level 3	—	—	—	—

8. Common Stock Repurchase

On June 4, 2013, the Company entered into an agreement to repurchase 1,440,592 shares of its common stock from American Equity Investment Life Holding Company and American Equity Life Insurance Company. The shares represented 8.27 percent of the total common shares of the Company as of that date. The purchase price was $10.95 per share. The purchase took place on June 5, 2013. The repurchased shares were canceled, thus reducing the Company's total issued and outstanding common shares to 15,969,464. This transaction was the result of the seller indicating a desire to sell the shares. The purchase was financed as described in Note 6.

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9. Earnings per Common Share

Basic earnings per common share are computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted earnings per common share for the three and six months ended June 30, 2013 and 2012 reflects the potential dilution that could occur if the Company's outstanding restricted stock units were vested. The dilutive effect was computed using the treasury stock method, which assumes all stock-based awards were exercised during the time period they were outstanding and the hypothetical proceeds from exercise were used by the Company to purchase common stock at the average market price during the period. The incremental shares, to the extent they would have been dilutive, were included in the denominator of the diluted earnings per common share calculation. The calculation of earnings per common share and diluted earnings per common share for the three and six months ended June 30, 2013 and 2012 is presented in the following table.

	Three Months Ended June 30,		Six Months Ended June 30,	
(in thousands, except per share information)	2013	2012	2013	2012
Net income	$4,298	$4,383	$8,246	$8,360
Weighted average common shares outstanding	16,997	17,404	17,199	17,404
Average restricted stock units outstanding	33	11	64	16
Diluted weighted average common shares outstanding	17,030	17,415	17,263	17,420
Basic earnings per common share	$0.25	$0.25	$0.48	$0.48
Diluted earnings per common share	$0.25	$0.25	$0.48	$0.48

10. Comprehensive Income

Comprehensive income consists of net income and other comprehensive income. Other comprehensive income consists of the net change in unrealized gains and losses on the Company's securities available for sale, including the noncredit-related portion of unrealized gains and losses of any OTTI securities, and the effective portion of the change in value of derivative instruments.

The following tables summarize the changes in the balances of each component of accumulated other comprehensive income (loss), net of tax, for the six months ended June 30, 2013 and 2012.

	Noncredit-related Unrealized Gains (Losses) on Securities with OTTI	Unrealized Gains (Losses) on Securities without OTTI	Unrealized Gains (Losses) on Derivatives	Accumulated Other Comprehensive Income (Loss)
Balance, December 31, 2012	$(1,759)	$4,146	$(461)	$1,926
Other comprehensive income (loss) before reclassifications	175	(4,660)	2,339	(2,146)
Amounts reclassified from accumulated other comprehensive income	—	—	—	—
Net current period other comprehensive income				

(loss)	175	(4,660)	2,339	(2,146)
Balance, June 30, 2013	$(1,584)	$(514)	$1,878	$(220)
Balance, December 31, 2011	$(1,940)	$2,594	$—	$654
Net current period other comprehensive income	40	950	—	990
Balance, June 30, 2012	$(1,900)	$3,544	$—	$1,644

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The following tables show the tax effects allocated to each component of other comprehensive income (loss) for the three and six months ended June 30, 2013 and 2012.

	Three Months Ended June 30, 2013			Six Months Ended June 30, 2013		
	Before Tax Amount	Tax (Expense) Benefit	Net of Tax Amount	Before Tax Amount	Tax (Expense) Benefit	Net of Tax Amount
Unrealized noncredit-related gains on securities with OTTI:						
Unrealized holding gains arising during period	$185	$(70)	$115	$282	$(107)	$175
Less: reclassification adjustment for net losses realized in net income	—	—	—	—	—	—
Net unrealized holding gains for securities with OTTI	185	(70)	115	282	(107)	175
Unrealized losses on securities without OTTI:						
Unrealized holding losses arising during the period	(6,422)	2,441	(3,981)	(7,516)	2,856	(4,660)
Less: reclassification adjustment for net gains realized in net income	—	—	—	—	—	—
Net unrealized losses on securities without OTTI	(6,422)	2,441	(3,981)	(7,516)	2,856	(4,660)
Unrealized gains on derivatives	3,365	(1,279)	2,086	3,773	(1,434)	2,339
Other comprehensive (loss)	$(2,872)	$1,092	$(1,780)	$(3,461)	$1,315	$(2,146)

	Three Months Ended June 30, 2012			Six Months Ended June 30, 2012		
	Before Tax Amount	Tax (Expense) Benefit	Net of Tax Amount	Before Tax Amount	Tax (Expense) Benefit	Net of Tax Amount
Unrealized noncredit-related losses on securities with OTTI:						
Unrealized holding losses arising during period	$(52)	$20	$(32)	$(108)	$41	$(67)
Less: reclassification adjustment for net losses realized in net income	127	(49)	78	173	(66)	107
Net unrealized holding gains for securities with OTTI	75	(29)	46	65	(25)	40
Unrealized gains on securities without						

OTTI:						
Unrealized holding gains arising during period	1,426	(542)	884	1,778	(676)	1,102
Less: reclassification adjustment for net gains realized in net income	(279)	107	(172)	(246)	94	(152)
Net unrealized gains on securities without OTTI	1,147	(435)	712	1,532	(582)	950
Other comprehensive income	$1,222	$(464)	$758	$1,597	$(607)	$990

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11. Deferred Income Taxes

Net deferred tax assets consisted of the following as of June 30, 2013 and December 31, 2012.

	June 30, 2013	December 31, 2012
Allowance for loan losses	$6,064	$5,901
Investment security impairment	106	106
Net unrealized losses on securities available for sale	1,286	—
Net unrealized losses on interest rate swaps	—	283
Intangibles	1,541	1,695
Other real estate owned	1,478	1,475
Accrued expenses	677	766
Other deferred tax assets	258	288
State net operating loss carryforward	574	529
Capital loss carryforward	4,065	4,065
Net deferred loan fees and costs	(266)	(272)
Net unrealized gains on securities available for sale	—	(1,463)
Net unrealized gains on interest rate swaps	(1,151)	—
Premises and equipment	(616)	(513)
Loans	(958)	(878)
Other deferred tax liabilities	(290)	(291)
Net deferred tax assets before valuation allowance	12,768	11,691
Valuation allowance	(4,745)	(4,700)
Net deferred tax assets	$8,023	$6,991

The Company has recorded a valuation allowance against the tax effect of the state net operating loss carryforwards, federal and state capital loss carryforwards and investment security impairment as management believes it is more likely than not that such carryforwards will expire without being utilized.

12. Commitments and Contingencies

The Company is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated balance sheets. The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations that it uses for on-balance-sheet instruments. The Company's commitments as of June 30, 2013 and December 31, 2012 consisted of the following approximate amounts.

	June 30, 2013	December 31, 2012
Commitments to extend credit	$424,290	$360,879
Standby letters of credit	3,063	10,488
	$427,353	$371,367

West Bank has executed Mortgage Partnership Finance (MPF) Master Commitments (the Commitments) with the FHLB of Des Moines to deliver mortgage loans and to guarantee the payment of any realized losses that exceed the FHLB's first loss account for mortgages delivered under the Commitments. West Bank receives credit enhancement fees from the FHLB for providing this guarantee and continuing to assist with managing the credit risk of the MPF Program mortgage loans. The term of the current Commitment is through January 16, 2014. At June 30, 2013, the liability represented by the present value of the credit enhancement fees less any expected losses in the mortgages delivered under the Commitments was approximately $445.

On September 29, 2010, West Bank was sued in a purported class action lawsuit that, as amended, asserts that nonsufficient funds fees charged by West Bank to Iowa resident noncommercial customers on bank debit card transactions, but not checks or Automated Clearing House items, are usurious under Iowa law, rather than allowable fees, and that the sequence in which West Bank formerly posted items for payment in consumer demand accounts violated various alleged duties of good faith. As West Bank understands the current claims, plaintiffs are seeking alternative remedies that include injunctive relief, damages (including treble damages), punitive damages, refund of fees, and attorney fees. West Bank believes the lawsuit allegations are factually and legally incorrect in multiple material ways and is vigorously defending the action. The amount of potential loss, if any, cannot be reasonably estimated now because the multiple alternative claims involve different time periods and present different defenses related to potential liability, class certification, and damages.

In the normal course of business, the Company and West Bank are involved in various other legal proceedings. In the opinion of management, any liability resulting from such proceedings would not have a material adverse effect on the consolidated financial statements.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

"SAFE HARBOR" STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT

Certain statements in this report, other than purely historical information, including estimates, projections, statements relating to our business plans, objectives and expected operating results and the assumptions upon which those statements are based, are “forward-looking statements” within the meanings of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements may appear throughout this report. These forward-looking statements are generally identified by the words “believes,” “expects,” “intends,” “should,” “anticipates,” “projects,” “future,” “may,” “will,” “strategy, “opportunity,” “will be,” “will likely result,” “will continue” or similar references, or references to estimates, predictions or future events. Such forward-looking statements are based upon certain underlying assumptions, risks and uncertainties. Because of the possibility that the underlying assumptions are incorrect or do not materialize as expected in the future, actual results could differ materially from these forward-looking statements. Risks and uncertainties that may affect future results include: interest rate risk; competitive pressures; pricing pressures on loans and deposits; changes in credit and other risks posed by the Company's loan and investment portfolios, including declines in commercial or residential real estate values, or changes in the allowance for loan losses dictated by new market conditions or regulatory requirements; actions of bank and non-bank competitors; changes in local and national economic conditions; changes in regulatory requirements, limitations and costs; changes in customers' acceptance of the Company's products and services; and any other risks described in the “Risk Factors” sections of this and other reports filed by the Company with the Securities and Exchange Commission. The Company undertakes no obligation to revise or update such forward-looking statements to reflect current or future events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

(dollars in thousands, except share and per share information)

THREE AND SIX MONTHS ENDED JUNE 30, 2013

OVERVIEW

The following discussion describes the consolidated operations and financial condition of the Company, which includes West Bank, West Bank's wholly-owned subsidiary WB Funding Corporation (which owns an interest in SmartyPig, LLC), and West Bank's 99.99 percent owned subsidiary ICD IV, LLC (a community development entity). Results of operations for the three and six months ended June 30, 2013 are compared to the results for the same periods in 2012, and the consolidated financial condition of the Company as of June 30, 2013 is compared to balances as of December 31, 2012.

Net income for the three months ended June 30, 2013 was $4,298 compared to $4,383 for the three months ended June 30, 2012. The decrease of $85 was due to several significant fluctuations compared to the prior year. Net interest income for the second quarter of 2013 increased $1,142 due to lower market interest rates on deposits and the December 2012 modification of $80,000 of FHLB advances, in conjunction with a higher level of earning assets. Meanwhile, gains and fees on sales of residential mortgages declined $355 due to rising interest rates, and noninterest expense declined primarily because of reduced costs to hold other real estate owned. Finally, the second quarter of 2012 included a tax-exempt gain on bank-owned life insurance of $841 and net gains on the sale of investment securities of $279.

Basic and diluted earnings per common share were $0.25 for the three months ended June 30, 2013 and 2012. The Company's annualized return on average equity and return on average assets for the three months ended June 30, 2013 were 12.93 and 1.19 percent, respectively, compared to 13.69 and 1.32 percent, respectively, for the three months ended June 30, 2012.

Net income for the six months ended June 30, 2013 was $8,246 compared to $8,360 for the six months ended June 30, 2012. Total basic and diluted earnings per common share were $0.48 for both time periods. The Company's annualized return on average equity and return on average assets for the six months ended June 30, 2013 were 12.39 and 1.16 percent, respectively, compared to 13.26 and 1.28 percent, respectively, for the six months ended June 30, 2012.

For the six months ended June 30, 2013 net interest income increased $1,788 compared to the same period in 2012 for the same reasons mentioned above for the three month periods. On a year-to-date basis, the provision for loan losses was $150 in 2013 while no provision was recorded in the six months ended June 30, 2012. Other significant changes between the first six months of 2013 and 2012 were a $987 reduction in other real estate owned expense, which was offset by the previously mentioned gain from bank-owned life insurance in 2012; a $591 reduction in gains and fees on sales of residential mortgages; and a $748 increase in salaries and benefits.

During the first six months of 2013, total loans outstanding increased $41,708, and they grew $110,695 compared to a year earlier. Management believes the loan portfolio will continue to grow during 2013 as the pipeline for new loans remains strong. It is expected that the new branch office, located in Rochester Minnesota, will contribute to the expected growth. After one full quarter of operations, this location had approximately $2,700 of loans outstanding. The Rochester branch office originally opened as a loan production office in March 2013. The Company subsequently requested regulatory approval to operate the Rochester location as a branch office, and the Company received approval in June 2013. The Rochester location began operating as a branch office effective July 1, 2013. As of June 30, 2013, the allowance for loan losses was 1.65 percent of loans outstanding and was deemed by management to be adequate to absorb any losses inherent in the loan portfolio.

Investment securities purchases of approximately $138,100 during the first six months of 2013 caused the investment portfolio to grow by $84,014 compared to December 31, 2012. The purchases were made in a planned effort to reduce the level of federal funds sold, in an effort to improve the net interest margin during a continuing period of downward pressure on the margin.

The Board of Directors declared a quarterly dividend and increased it 10 percent to $0.11 per common share at its meeting on July 24, 2013. The dividend is payable on August 27, 2013, to shareholders of record as of August 7, 2013. The Board of Directors also authorized management to repurchase up to $2,000 of the Company's common stock between July 2013 and April 2014. The authorization does not require such purchases and is subject to certain restrictions. Shares of Company common stock may be repurchased on the open market or in privately negotiated transactions. The extent to which the shares are repurchased, if any, and the timing of such repurchase will depend on market conditions and other corporate considerations.

In early June 2013, the Company repurchased and canceled 1,440,592 shares of its common stock at a price of $10.95 per share. The Company financed the purchase with a five-year, $16,000, secured term note from a commercial bank. Management believes that the favorable terms of the purchase and financing of the transaction should enhance earnings per share going forward.

(dollars in thousands, except share and per share information)

RESULTS OF OPERATIONS

The following table shows selected financial results and measures for the three and six months ended June 30, 2013 compared with the same period in 2012.

	Three Months Ended June 30,				Six Months Ended June 30,			
	2013	2012	Change	Change %	2013	2012	Change	Change %
Net income	$4,298	$4,383	$(85)	(1.9)%	$8,246	$8,360	$(114)	(1.4)%
Average assets	1,443,061	1,339,703	103,358	7.7 %	1,433,642	1,318,207	115,435	8.8 %
Average stockholders' equity	133,290	128,757	4,533	3.5 %	134,256	126,779	7,477	5.9 %
Return on average assets	1.19 %	1.32 %	(0.13)%		1.16 %	1.28 %	(0.12)%	
Return on average equity	12.93 %	13.69 %	(0.76)%		12.39 %	13.26 %	(0.87)%	
Efficiency ratio	53.15 %	49.31 %	3.84 %		53.50 %	50.52 %	2.98 %	
Dividend payout ratio	40.51 %	31.78 %	8.73 %		42.21 %	33.30 %	8.91 %	
Average equity to average assets ratio	9.24 %	9.61 %	(0.37)%		9.36 %	9.62 %	(0.26)%	

	As of June 30,		
	2013	2012	Change
Texas ratio	10.00 %	13.00 %	(3.00)%
Equity to assets ratio	8.38 %	9.63 %	(1.25)%
Tangible common equity ratio	8.38 %	9.63 %	(1.25)%

Definitions of ratios:

- Return on average assets - annualized net income divided by average assets.
- Return on average equity - annualized net income divided by average stockholders' equity.
- Efficiency ratio - noninterest expense (excluding other real estate owned expense) divided by noninterest income (excluding net securities gains and net impairment losses) plus tax-equivalent net interest income.
- Dividend payout ratio - dividends paid to common stockholders divided by net income.
- Texas ratio - total nonperforming assets divided by tangible common equity plus the allowance for loan losses.
- Equity to assets ratio - equity divided by assets.
- Tangible common equity ratio - common equity less intangible assets divided by tangible assets.

(dollars in thousands, except share and per share information)

Net Interest Income

The following tables show average balances and related interest income or interest expense, with the resulting average yield or rate by category of interest-earning assets or interest-bearing liabilities. Interest income and the resulting net interest income are shown on a fully taxable basis.
Data for the three months ended June 30:

	Average Balance				Interest Income/Expense				Yield/Rate		
	2013	2012	Change	Change-%	2013	2012	Change	Change-%	2013	2012	Change
Interest-earning assets:											
Loans:											
Commercial	$255,382	$262,394	$(7,012)	(2.67)%	$2,892	$3,308	$(416)	(12.58)%	4.54%	5.07%	(0.53)%
Real estate	686,522	590,606	95,916	16.24 %	8,485	7,999	486	6.08 %	4.96%	5.45%	(0.49)%
Consumer and other	6,981	5,854	1,127	19.25 %	81	65	16	24.62 %	4.65%	4.47%	0.18 %
Total loans	948,885	858,854	90,031	10.48 %	11,458	11,372	86	0.76 %	4.84%	5.33%	(0.49)%
Investment securities:											
Taxable	315,189	271,721	43,468	16.00 %	1,319	1,129	190	16.83 %	1.67%	1.66%	0.01 %
Tax-exempt	79,430	54,382	25,048	46.06 %	896	765	131	17.12 %	4.51%	5.63%	(1.12)%
Total investment securities	394,619	326,103	68,516	21.01 %	2,215	1,894	321	16.95 %	2.25%	2.32%	(0.07)%
Federal funds sold and short-term investments	23,848	79,555	(55,707)	(70.02)%	16	51	(35)	(68.63)%	0.27%	0.26%	0.01 %
Total interest-earning assets	$1,367,352	$1,264,512	$102,840	8.13 %	13,689	13,317	372	2.79 %	4.02%	4.24%	(0.22)%
Interest-bearing liabilities:											