MidWestOne Financial Group, Inc.
Form 10-K
March 07, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2012

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 000-24630

MIDWESTONE FINANCIAL GROUP, INC.
(Exact name of Registrant as specified in its charter)

Iowa	42-1206172
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)

102 South Clinton Street, Iowa City, IA 52240
(Address of principal executive offices, including zip code)
(319) 356-5800
(Registrant’s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Class	Name of each exchange on which registered
Common Stock, $1.00 par value	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act:
None
(Title of class)

Indicate by check mark if registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. o Yes x No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. o Yes x No

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. x Yes o No

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). x Yes o No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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 the definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	o	Accelerated filer	x
Non-accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company	o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). o Yes x No

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant, based on the last sales price quoted on the NASDAQ Global Select Market on the last business day of the registrant's most recently completed second fiscal quarter, was approximately $146.7 million.

The number of shares outstanding of the registrant's common stock, par value $1.00 per share, as of March 5, 2013, was 8,498,484.

Documents Incorporated by Reference

Portions of the registrant's Proxy Statement for the 2013 Annual Meeting of Shareholders of MidWestOne Financial Group, Inc., to be held on April 18, 2013, are incorporated by reference into Part III of this Annual Report on Form 10-K.

MIDWESTONE FINANCIAL GROUP, INC.
Annual Report on Form 10-K
Table of Contents

Table of Contents

PART I
ITEM 1. BUSINESS.
General
MidWestOne Financial Group, Inc. (“MidWestOne” or the “Company,” which is also referred to herein as “we,” “our” or “us”) is an Iowa corporation incorporated in 1983, a bank holding company under the Bank Holding Company Act of 1956 and a financial holding company under the Gramm-Leach-Bliley Act of 1999. Our principal executive offices are located at 102 South Clinton Street, Iowa City, Iowa 52240.
On March 14, 2008, we consummated a merger-of-equals transaction with the former MidWestOne Financial Group, Inc., in Oskaloosa, Iowa (“Former MidWestOne”). Prior to the merger, we operated under the name “ISB Financial Corp.” We were the surviving entity in the merger and, upon completion of the merger, changed our name from ISB Financial Corp. to MidWestOne Financial Group, Inc. and our common stock began trading on the NASDAQ Global Select Market under the symbol “MOFG.” All references herein to the “Company” and “MidWestOne” refer to the surviving organization in the merger. Following the merger, we consolidated our three bank subsidiaries, Iowa State Bank & Trust Company, First State Bank and MidWestOne Bank, into a single bank charter and renamed the surviving bank MidWestOne Bank.
We operate primarily through our bank subsidiary, MidWestOne Bank, an Iowa state non-member bank chartered in 1934 with its main office in Iowa City, Iowa, and MidWestOne Insurance Services, Inc., our wholly-owned subsidiary that operates through three agencies located in central and east-central Iowa.
As of December 31, 2012, we had total consolidated assets of $1.8 billion, total deposits of $1.4 billion and total shareholders’ equity of $173.9 million, all of which is common shareholders’ equity. For the year ended December 31, 2012, we generated net income available to common shareholders of $16.8 million, which was an increase from the net income available to common shareholders of $12.7 million and $9.3 million for the years ended December 31, 2011 and 2010, respectively. For our complete financial information as of December 31, 2012 and 2011 and for each of the years in the three-year period ended December 31, 2012, see Item 8. Financial Statements and Supplementary Data.
MidWestOne Bank operates a total of 25 branch locations, plus its specialized Home Mortgage Center, in 15 counties throughout central and east-central Iowa. MidWestOne Bank provides full service retail banking in the communities in which its branch offices are located. Deposit products offered include checking and other demand deposit accounts, NOW accounts, savings accounts, money market accounts, certificates of deposit, individual retirement accounts and other time deposits. MidWestOne Bank offers commercial and industrial, agricultural, real estate mortgage and consumer loans. Other products and services include debit cards, automated teller machines, on-line banking, mobile banking, and safe deposit boxes. The principal service consists of making loans to and accepting deposits from individuals, businesses, governmental units and institutional customers. MidWestOne Bank also has a trust and investment department through which it offers a variety of trust and investment services, including administering estates, personal trusts, conservatorships, pension and profit-sharing funds and providing property management, farm management, custodial, financial planning, investment management and retail brokerage services (the latter of which is provided through an agreement with a third-party registered broker-dealer).
Operating Strategy
Our operating strategy is based upon a sophisticated community banking model delivering a complete line of financial products and services while following five guiding principles: (1) hire and retain excellent employees; (2) take care of our customers; (3) conduct business with the utmost integrity; (4) work as one team; and (5) learn constantly so we can continually improve.
Management believes the personal and professional service offered to customers provides an appealing alternative to the “megabanks” that have resulted from large out-of-state national banks acquiring Iowa-based community banks. While we employ a community banking philosophy, we believe that our size, combined with our complete line of financial products and services, is sufficient to effectively compete in our relevant market areas. To remain price competitive, management also believes that we must grow organically, manage expenses, and remain disciplined in our asset/liability management practices.
Market Areas

Our principal offices are located in Iowa City, Iowa. The city of Iowa City is located in east-central Iowa, approximately 220 miles west of Chicago, Illinois, and approximately 115 miles east of Des Moines, Iowa. It is strategically situated approximately 60 miles west of the Mississippi River on Interstate 80 and is the home of the University of Iowa, a public university with approximately 22,000 undergraduate students and 9,500 graduate and professional students. Iowa City is the home of the University

Table of Contents

of Iowa Hospitals and Clinics, a 711-bed comprehensive academic medical center and regional referral center with 1,548 staff physicians, residents, and fellows and 1,845 professional nurses. The city of Iowa City has a total population of approximately 69,000 and the Iowa City MSA has a total population of approximately 155,000. Iowa City is the fifth largest city in the state of Iowa. Based on deposit information collected by the FDIC as of June 30, 2012, the most recent date for which data is available, MidWestOne Bank had the second highest deposit market share in the Iowa City MSA at approximately 19.0%.

MidWestOne Bank operates branch offices and a loan production office in 15 counties in central and east-central Iowa. Based on deposit information collected by the FDIC as of June 30, 2012, in eight of those 15 counties, MidWestOne Bank held between 8% and 26% of the deposit market share. In another county, MidWestOne Bank held 38% of the deposit market share.

Lending Activities

General

We provide a range of commercial and retail lending services to businesses, individuals and government agencies. These credit activities include commercial, industrial and agricultural loans; real estate construction loans; commercial and residential real estate loans; and consumer loans.

We market our services to qualified lending customers. Lending officers actively solicit the business of new companies entering their market areas as well as long-standing members of the business communities in which we operate. Through professional service, competitive pricing and innovative structure, we have been successful in attracting new lending customers. We also actively pursue consumer lending opportunities. With convenient locations, advertising and customer communications, we believe that we have been successful in capitalizing on the credit needs of our market areas.

Our management emphasizes credit quality and seeks to avoid undue concentrations of loans to a single industry or based on a single class of collateral. We have established lending policies that include a number of underwriting factors to be considered in making a loan, including location, loan-to-value ratio, cash flow, interest rate and credit history of the borrower.

Real Estate Loans

Construction Loans. We offer loans both to individuals who are constructing personal residences and to real estate developers and building contractors for the acquisition of land for development and the construction of homes and commercial properties. These loans are generally in-market to known and established borrowers. Construction loans generally have a short term, such as one to two years. As of December 31, 2012, construction loans constituted approximately 8.4% of our total loan portfolio.

Mortgage Loans. We offer residential, commercial and agricultural mortgage loans. As of December 31, 2012, we had $692.9 million in combined residential, commercial and agricultural mortgage loans outstanding, which represented approximately 66.9% of our total loan portfolio.

Residential mortgage lending is a focal point for us, as residential real estate loans constituted approximately 24.4% of our total loan portfolio at December 31, 2012. Included in this category are home equity loans made to individuals. As long-term interest rates have remained at relatively low levels since 2008, many customers opted for mortgage loans that have a fixed rate with 15- or 30-year maturities. We generally retain short-term residential mortgage loans that we originate for our own portfolio, but sell most long-term loans to other parties while retaining servicing rights on the majority of such loans. We also perform loan servicing activity for third parties on participations sold. At December 31, 2012, we serviced approximately $358.4 million in mortgage loans for others. We do not offer subprime mortgage loans and do not operate a wholesale mortgage business.

We also offer mortgage loans to our commercial and agricultural customers for the acquisition of real estate used in their business, such as offices, farmland, warehouses and production facilities, and to real estate investors for the acquisition of apartment buildings, retail centers, office buildings and other commercial buildings. As of December 31, 2012, commercial and agricultural real estate mortgage loans constituted approximately 42.5% of our total loan portfolio.

Commercial and Industrial Loans

We have a strong commercial loan base. We focus on, and tailor our commercial loan programs to, small- to mid-sized businesses in our market areas. Our loan portfolio includes loans to wholesalers, manufacturers, contractors, business services companies and retailers. We provide a wide range of business loans, including lines of credit for working capital and operational purposes and term loans for the acquisition of equipment. Although most loans are made on a secured basis, loans may be made on an unsecured basis where warranted by the overall financial condition of the borrower. Terms of commercial business loans generally range from one to five years.

Our commercial and industrial loans are primarily made based on the reported cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. The collateral support provided by the borrower for most of these loans and the probability of repayment is based on the liquidation of the pledged collateral and enforcement of a personal guarantee, if any exists. The primary repayment risks of commercial loans are that the cash flows of the borrower may be unpredictable, and the collateral securing these loans may fluctuate in value. As of December 31, 2012, commercial and industrial loans comprised approximately 23.0% of our total loan portfolio.

Agricultural Loans

Due to the rural market areas in and around which we operate, agricultural loans are an important part of our business. Agricultural loans include loans made to finance agricultural production and other loans to farmers and farming operations. Agricultural loans comprised approximately 8.2% of our total loan portfolio at December 31, 2012.

Agricultural loans, most of which are secured by crops, livestock and machinery, are generally provided to finance capital improvements and farm operations as well as acquisitions of livestock and machinery. The ability of the borrower to repay may be affected by many factors outside of the borrower's control, including adverse weather conditions, loss of livestock due to disease or other factors, declines in market prices for agricultural products and the impact of government regulations. The ultimate repayment of agricultural loans is dependent upon the profitable operation or management of the agricultural entity.

Our agricultural lenders work closely with our customers, including companies and individual farmers, and review the preparation of budgets and cash flow projections for the ensuing crop year. These budgets and cash flow projections are monitored closely during the year and reviewed with the customers at least once annually. We also work closely with governmental agencies to help agricultural customers obtain credit enhancement products such as loan guarantees or interest rate assistance.

Consumer Lending

Our consumer lending department provides all types of consumer loans, including personal loans (secured or unsecured) and automobile loans. Consumer loans typically have shorter terms, lower balances, higher yields and higher risks of default than one- to four-family residential real estate mortgage loans. Consumer loan collections are dependent on the borrower's continuing financial stability, and are therefore more likely to be affected by adverse personal circumstances. As of December 31, 2012, consumer loans comprised only 1.8% of our total loan portfolio.

Loan Pool Participations

We hold in our portfolio participation interests in pools of loans that are owned and serviced by States Resources Corporation, a third-party loan servicing organization located in Omaha, Nebraska (the "Servicer"). We do not have any ownership interest in or control over the Servicer. The loans in those pools were purchased at varying discounts to their outstanding principal amount. Former MidWestOne began the program of acquiring participation interests from the Servicer in 1988 and we continued with this program following the Merger (although these loan participations have constituted a smaller percentage of our total loan portfolio than they did of Former MidWestOne's total loan portfolio). In 2010, after extensive discussion and analysis of our current loan pool portfolio, we decided to exit this line of business as current balances pay down. This decision was based primarily on our desire to focus on our core business of providing community banking products and services. Additionally, recent loan pool yields have not provided a return reflective of the inherent risk of this investment, a situation we do not expect to change in the near future, making further investment in this class of assets unattractive.

The following discussion summarizes the accounting treatment of our loan pool participations.

A cost "basis" was assigned to each individual loan acquired on a cents per dollar basis (discounted price), which was based on the Servicer's assessment of the recovery potential of each such loan in relation to the total discounted price paid to acquire the pool. This methodology assigned a higher basis to performing loans with greater potential collectibility and a lower basis to those loans identified as having little or no potential for collection.

Loan pool participations are shown on our balance sheet as a separate asset category; they are not included within the loan balance on our balance sheet. The original carrying value of loan pool participation interests represents the discounted price paid by us to acquire our participation interests in various loan pools purchased by the Servicer. Our investment balance with

3

respect to the participation interest is reduced as the Servicer collects principal payments on the loans and remits the proportionate share of such payments to us.

Loan pools are accounted for in accordance with the provisions of ASC Topic 310 (guidance formerly contained in Statement of Position 03-3, “Accounting for Certain Loans or Debt Securities Acquired in a Transfer”) issued by the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants. According to ASC Topic 310, in order to apply the interest method of recognition to these types of loans, there must be sufficient information to reasonably estimate the amount and timing of the cash flows expected to be collected. When that is not the case, the loan is accounted for on nonaccrual status applying cash basis income recognition to the loan.

In each case, where circumstances change or new information leads the Servicer to believe that collection of the loan or recovery of the basis through collateral would be less than originally determined, the cost basis assigned to the loan is written down or written off through a charge against discount income. The Servicer and MidWestOne representatives evaluate at least quarterly the collectibility of the loans and the recovery of the underlying basis. On a quarterly basis, those loans that are determined to have a possible recovery of less than the assigned basis amount are placed on a “watch list.” The amount of basis exceeding the estimated recovery amount on the “watch list” loans is written off by a charge against discount income.

Interest income and discount on loan pool participations that we record is net of collection expenses incurred by the Servicer and net of the servicing fee and share of recovery profit paid to the Servicer. Collection expenses include salary and benefits paid by the Servicer to its employees, legal fees, costs to maintain and insure real estate owned, and other operating expenses. Under the terms of our agreement with the Servicer, the Servicer receives a servicing fee based on one percent of the gross monthly collections of principal and interest, net of collection costs. Additionally, the Servicer receives a tiered percentage share of the recovery profit in excess of our required return on investment on each individual loan pool. The Servicer’s percentage share of recovery profit is linked to a ten-tier index and ranges from zero to 27 percent depending upon the return on investment achieved. MidWestOne’s minimum required return on investment is based on the two-year treasury rate at the time a loan pool was purchased plus four percent. For every one percent increase obtained over our minimum required return, the Servicer percentage moves up one tier level. In the event that the return on a particular pool does not exceed the required return on investment, the Servicer does not receive a percentage share of the recovery profit. Discount income is added to interest income and reflected as one amount on our consolidated statements of operations.

The Servicer provides us with monthly reports detailing collections of principal and interest, face value of loans collected and those written off, actual operating expenses incurred, remaining asset balances (both in terms of cost basis and principal amount of loans), a comparison of actual collections and expenses with target collections and budgeted expenses, and summaries of remaining collection targets. The Servicer also provides aging reports and “watch lists” for the loan pool participations. Monthly meetings are held between our representatives and representatives of the Servicer to review collection efforts and results and to discuss future plans of action. Additionally, our personnel and the Servicer’s personnel communicate on almost a daily basis to discuss various issues regarding the loan pool participations. Our representatives visit the Servicer’s operation on a regular basis, and our loan review officers perform asset reviews on a regular basis.

Our overall cost basis in the loan pool participations represents a discount from the aggregate outstanding principal amount of the loans underlying the pools. For example, as of December 31, 2012, such cost basis was $37.8 million, while the contractual outstanding principal amount of the underlying loans as of such date was approximately $105.3 million. The discounted cost basis inherently reflects the assessed collectibility of the underlying loans. We do not include any amounts related to the loan pool participations in our totals of nonperforming loans.

As part of the ongoing collection process, the Servicer may, from time to time, foreclose on real estate mortgages and acquire title to property in satisfaction of such debts. This real estate may be held by the Servicer as “real estate owned” for a period of time until it can be sold. Because our investments in loan pool participations are classified separately from our loan portfolio, we do not include the real estate owned that is held by the Servicer with the amount of any other real estate that we may hold directly as a result of our own foreclosure activities.

The underlying loans in the loan pool participations include both fixed-rate and variable-rate instruments. No amounts for interest due are reflected in the carrying value of the loan pool participations. Based on historical experience, the average period of collectibility for loans underlying our loan pool participations, many of which have exceeded contractual maturity dates, is approximately three to five years. Our management has reviewed the recoverability of the underlying loans and believes that the carrying value does not exceed the fair value of its investment in loan pool participations.

Table of Contents

Other Products and Services

Deposit Products

We believe that we offer competitive deposit products and programs that address the needs of customers in each of the local markets that we serve. The deposit products are offered to individuals, nonprofit organizations, partnerships, small businesses, corporations and public entities. These products include noninterest bearing and interest bearing demand deposits, savings accounts, money market accounts and certificates of deposit.

Trust and Investment Services

We offer trust and investment services in our market areas to help our business and individual clients in meeting their financial goals and preserving wealth. Our services include administering estates, personal trusts, conservatorships, pension and profit-sharing funds and providing property management, farm management, investment advisory, retail securities brokerage, financial planning and custodial services. Licensed brokers (who are registered representatives of a third-party registered broker-dealer) serve selected branches and provide investment-related services including securities trading, financial planning, mutual funds sales, fixed and variable annuities and tax-exempt and conventional unit trusts.

Insurance Services

Through our insurance subsidiary, MidWestOne Insurance Services, Inc., we offer property and casualty insurance products to individuals and small businesses in the markets that we service.

Liquidity and Funding

A discussion of our liquidity and funding programs has been included in Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations under “Liquidity,” and Item 7A. Quantitative and Qualitative Disclosures About Market Risk under “Liquidity Risk.”

Competition

We encounter competition in all areas of our business pursuits. To compete effectively, grow our market share, maintain flexibility and keep pace with changing economic and social conditions, we continuously refine and develop our products and services. The principal methods of competing in the financial services industry are through service, convenience and price.

The banking industry is highly competitive, and we face strong direct competition for deposits, loans, and other financial-related services. Our offices in central and east-central Iowa compete with other commercial banks, thrifts, credit unions, stockbrokers, finance divisions of auto and farm equipment companies, agricultural suppliers, and other agricultural-related lenders. Some of these competitors are local, while others are statewide, regional or nationwide. We compete for deposits principally by offering depositors a wide variety of deposit programs, convenient office locations, hours and other services, and for loan originations primarily through the interest rates and loan fees we charge, the variety of our loan products and the efficiency and quality of services we provide to borrowers, with an emphasis on building long-lasting relationships. Some of the financial institutions and financial service organizations with which we compete are not subject to the same degree of regulation as that imposed on federally insured Iowa-chartered banks. As a result, such competitors have advantages over us in providing certain services. As of June 30, 2012, there were approximately 94 other banks having 303 offices or branches operating within the 15 counties in which we have locations. Based on deposit information collected by the FDIC, as of June 30, 2012, we maintained approximately 9.1% of the bank deposits within the 15 counties in which we operate. New competitors may develop that are substantially larger and have significantly greater resources than us. Currently, major competitors in some of our markets include Wells Fargo Bank, U.S. Bank, Hills Bank & Trust, Two Rivers Bank & Trust, Marion County State Bank, and Farm Credit Services.

Employees

As of December 31, 2012, we had 390 full-time equivalent employees. We provide our employees with a comprehensive program of benefits, some of which are on a contributory basis, including comprehensive medical and dental plans, life insurance, long-term and short-term disability coverage, a 401(k) plan, and an employee stock ownership plan. None of our employees are represented by unions. Our management considers its relationship with our employees to be good.

5

Company Website

We maintain an internet website for MidWestOne Bank at www.midwestone.com. We make available, free of charge, on this website our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and other reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. Information on, or accessible through, our website is not part of, or incorporated by reference in, this Annual Report on Form 10-K.

Supervision and Regulation

General

Financial institutions, their holding companies and their affiliates are extensively regulated under federal and state law. As a result, our growth and earnings performance may be affected not only by management decisions and general economic conditions, but also by the requirements of federal and state statutes and by the regulations and policies of various bank regulatory authorities, including the Iowa Superintendent of Banking (the “Iowa Superintendent”), the Board of Governors of the Federal Reserve System (the “Federal Reserve”), the Federal Deposit Insurance Corporation (the “FDIC”) and the newly-created Bureau of Consumer Financial Protection (the “CFPB”). Furthermore, taxation laws administered by the Internal Revenue Service and state taxing authorities, accounting rules developed by the Financial Accounting Standards Board (the “FASB”) and securities laws administered by the Securities and Exchange Commission (the “SEC”) and state securities authorities have an impact on our business. The effect of these statutes, regulations, regulatory policies and accounting rules are significant to our operations and results, and the nature and extent of future legislative, regulatory or other changes affecting financial institutions are impossible to predict with any certainty.

Federal and state banking laws impose a comprehensive system of supervision, regulation and enforcement on the operations of financial institutions, their holding companies and affiliates that is intended primarily for the protection of the FDIC-insured deposits and depositors of banks, rather than shareholders. These federal and state laws, and the regulations of the bank regulatory authorities issued under them, affect, among other things, the scope of business, the kinds and amounts of investments banks may make, reserve requirements, capital levels relative to operations, the nature and amount of collateral for loans, the establishment of branches, the ability to merge, consolidate and acquire, dealings with insiders and affiliates and the payment of dividends. In addition, turmoil in the credit markets in recent years prompted the enactment of unprecedented legislation that allowed the U.S. Department of the Treasury (the “Treasury”) to make equity capital available to qualifying financial institutions to help restore confidence and stability in the U.S. financial markets, which imposes additional requirements on institutions in which the Treasury invests.

In addition, we are subject to regular examination by regulatory authorities, which results in examination reports and ratings that are not publicly available and that can impact the conduct and growth of business. These examinations consider not only compliance with applicable laws and regulations, but also capital levels, asset quality and risk, management ability and performance, earnings, liquidity, and various other factors. The regulatory agencies generally have broad discretion to impose restrictions and limitations on the operations of a regulated entity where the agencies determine, among other things, that such operations are unsafe or unsound, fail to comply with applicable law or are otherwise inconsistent with laws and regulations or with the supervisory policies of these agencies.

The following is a summary of the material elements of the supervisory and regulatory framework applicable to the Company and our subsidiaries. It does not describe all of the statutes, regulations and regulatory policies that apply, nor does it restate all of the requirements of those that are described. The descriptions are qualified in their entirety by reference to the particular statutory or regulatory provision.

Financial Regulatory Reform

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) into law. The Dodd-Frank Act represents a sweeping reform of the supervisory and regulatory framework applicable to financial institutions and capital markets in the United States, certain aspects of which are described below in more detail. The Dodd-Frank Act creates new federal governmental entities responsible for overseeing different aspects of the U.S. financial services industry, including identifying emerging systemic risks. It also shifts certain authorities and responsibilities among federal financial institution regulators, including the supervision of holding company affiliates and the regulation of consumer financial services and products. In particular, and among other things, the Dodd-Frank Act: creates the CFPB, which is authorized to regulate providers of consumer credit, savings, payment and other consumer financial products and services; narrows the scope of federal preemption of state consumer laws enjoyed by national banks and federal savings associations and expands the authority of state attorneys

6

Table of Contents

general to bring actions to enforce federal consumer protection legislation; imposes more stringent capital requirements on bank holding companies and subjects certain activities, including interstate mergers and acquisitions, to heightened capital conditions; significantly expands underwriting requirements applicable to loans secured by 1-4 family residential real property; restricts the interchange fees payable on debit card transactions for issuers with $10 billion in assets or greater; requires the originator of a securitized loan, or the sponsor of a securitization, to retain at least 5% of the credit risk of securitized exposures unless the underlying exposures are qualified residential mortgages or meet certain underwriting standards to be determined by regulation; creates a Financial Stability Oversight Council as part of a regulatory structure for identifying emerging systemic risks and improving interagency cooperation; provides for enhanced regulation of advisers to private funds and of the derivatives markets; enhances oversight of credit rating agencies; and prohibits banking agency requirements tied to credit ratings.

Numerous provisions of the Dodd-Frank Act are required to be implemented through rulemaking by the appropriate federal regulatory agencies. Many of the required regulations have been issued and others have been released for public comment, but there remain a number that have yet to be released in any form. Furthermore, while the reforms primarily target systemically important financial service providers, their influence is expected to filter down in varying degrees to smaller institutions over time. Management of the Company and the Bank will continue to evaluate the effect of the changes; however, in many respects, the ultimate impact of the Dodd-Frank Act will not be fully known for years, and no current assurance may be given that the Dodd-Frank Act, or any other new legislative changes, will not have a negative impact on the results of operations and financial condition of the Company and our subsidiaries.

The Increasing Regulatory Emphasis on Capital

The Company is subject to various regulatory capital requirements administered by the federal and state banking regulators noted above. Failure to meet regulatory capital requirements may result in certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on our financial statements. Under capital adequacy guidelines and the regulatory framework for “prompt corrective action” (described below), the Company must meet specific capital guidelines that involve quantitative measures of our assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting policies. Our capital amounts and classifications are also subject to judgments by the regulators regarding qualitative components, risk weightings and other factors.

While capital has historically been one of the key measures of the financial health of both bank holding companies and depository institutions, its role is becoming fundamentally more important in the wake of the financial crisis, as the regulators have recognized that the amount and quality of capital held by banking organizations was insufficient to absorb losses during periods of severe stress. Certain provisions of the Dodd-Frank Act and Basel III, discussed below, will ultimately establish strengthened capital standards for banks and bank holding companies, will require more capital to be held in the form of common stock and will disallow certain funds from being included in capital determinations. Once fully implemented, these provisions will represent regulatory capital requirements that are meaningfully more stringent than those in place currently.

Company and Bank Required Capital Levels. Bank holding companies have historically had to comply with less stringent capital standards than their bank subsidiaries and were able to raise capital with hybrid instruments such as trust preferred securities. The Dodd-Frank Act mandated the Federal Reserve to establish minimum capital levels for bank holding companies on a consolidated basis that are as stringent as those required for insured depository institutions. As a consequence, over a phase-in period of three years, the components of holding company permanent capital known as “Tier 1 capital” are being restricted to capital instruments that are considered to be Tier 1 capital for insured depository institutions. A result of this change is that the proceeds of trust preferred securities are being excluded from Tier 1 capital unless such securities were issued prior to May 19, 2010 by bank holding companies with less than $15 billion of assets. Because the Company has assets of less than $15 billion, it is able to maintain its trust preferred proceeds as Tier 1 capital but will have to comply with new capital mandates in other respects, and will not be able to raise Tier 1 capital in the future through the issuance of trust preferred securities. In addition, the Basel III proposal, discussed below, includes a phase-out of trust preferred securities for all bank holding companies, including the Company.

Under current federal regulations, the Bank is subject to, and, after a phase-in period, the Company will be subject to, the following minimum capital standards:

- a leverage requirement, consisting of a minimum ratio of Tier 1 capital to total assets of 3% for the most highly-rated banks with a minimum requirement of at least 4% for all others; and
- a risk-based capital requirement, consisting of a minimum ratio of total capital to total risk-weighted assets of 8% and a minimum ratio of Tier 1 capital to total risk-weighted assets of 4%. For this purpose, "Tier 1 capital" consists primarily of common stock, noncumulative perpetual preferred stock and related surplus less intangible assets (other than certain loan servicing rights and purchased credit card relationships). Total capital consists primarily of Tier 1

Table of Contents

capital plus “Tier 2 capital,” which includes other non-permanent capital items, such as certain other debt and equity instruments that do not qualify as Tier 1 capital, and a portion of the Bank's allowance for loan and lease losses.

The capital standards described above are minimum requirements. Federal law and regulations provide various incentives for banking organizations to maintain regulatory capital at levels in excess of minimum regulatory requirements. For example, a banking organization that is “well-capitalized” may: (i) qualify for exemptions from prior notice or application requirements otherwise applicable to certain types of activities; (ii) qualify for expedited processing of other required notices or applications; and (iii) accept brokered deposits. Under the capital regulations of the Federal Reserve, in order to be “well-capitalized,” a banking organization must maintain a ratio of total capital to total risk-weighted assets of 10% or greater, a ratio of Tier 1 capital to total risk-weighted assets of 6% or greater and a ratio of Tier 1 capital to total assets of 5% or greater. The Federal Reserve's guidelines also provide that bank holding companies experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels without significant reliance on intangible assets. Furthermore, the guidelines indicate that the Federal Reserve will continue to consider a “tangible Tier 1 leverage ratio” (deducting all intangibles) in evaluating proposals for expansion or to engage in new activity.

Higher capital levels may also be required if warranted by the particular circumstances or risk profiles of individual banking organizations. For example, the Federal Reserve's capital guidelines contemplate that additional capital may be required to take adequate account of, among other things, interest rate risk, or the risks posed by concentrations of credit, nontraditional activities or securities trading activities. Further, any banking organization experiencing or anticipating significant growth would be expected to maintain capital ratios, including tangible capital positions (i.e., Tier 1 capital less all intangible assets), well above the minimum levels.

Prompt Corrective Action. A banking organization's capital plays an important role in connection with regulatory enforcement as well. Federal law provides the federal banking regulators with broad power to take prompt corrective action to resolve the problems of undercapitalized institutions. The extent of the regulators' powers depends on whether the institution in question is “adequately capitalized,” “undercapitalized,” “significantly undercapitalized” or “critically undercapitalized,” in each case as defined by regulation. Depending upon the capital category to which an institution is assigned, the regulators' corrective powers include: (i) requiring the institution to submit a capital restoration plan; (ii) limiting the institution's asset growth and restricting its activities; (iii) requiring the institution to issue additional capital stock (including additional voting stock) or to be acquired; (iv) restricting transactions between the institution and its affiliates; (v) restricting the interest rate the institution may pay on deposits; (vi) ordering a new election of directors of the institution; (vii) requiring that senior executive officers or directors be dismissed; (viii) prohibiting the institution from accepting deposits from correspondent banks; (ix) requiring the institution to divest certain subsidiaries; (x) prohibiting the payment of principal or interest on subordinated debt; and (xi) ultimately, appointing a receiver for the institution.

As of December 31, 2012: (i) the Bank was not subject to a directive from the FDIC to increase capital to an amount in excess of the minimum regulatory capital requirements; (ii) the Bank exceeded its minimum regulatory capital requirements under FDIC capital adequacy guidelines; and (iii) the Bank was “well-capitalized,” as defined by FDIC regulations. As of December 31, 2012, the Company had regulatory capital in excess of the Federal Reserve’s requirements and met the Dodd-Frank Act capital requirements.

Basel III. The current risk-based capital guidelines described above, which apply to the Bank and are being phased in for the Company, are based upon the 1988 capital accord known as “Basel I” adopted by the international Basel Committee on Banking Supervision, a committee of central banks and bank supervisors, as implemented by the U.S. federal banking regulators on an interagency basis. In 2008, the banking agencies collaboratively began to phase-in capital standards based on a second capital accord, referred to as “Basel II,” for large or “core” international banks (generally defined for U.S. purposes as having total assets of $250 billion or more, or consolidated foreign exposures of $10 billion or more). Basel II emphasized internal assessment of credit, market and operational risk, as well as supervisory assessment and market discipline in determining minimum capital requirements.

On September 12, 2010, the Group of Governors and Heads of Supervision, the oversight body of the Basel Committee on Banking Supervision, announced agreement on a strengthened set of capital requirements for banking organizations around the world, known as Basel III, to address deficiencies recognized in connection with the global financial crisis. Basel III requires, among other things:

- a new required ratio of minimum common equity equal to 4.5% of risk-weighted assets;
- an increase in the minimum required amount of Tier 1 capital from the current level of 4% of total assets to 6% of risk-weighted assets; and
- a continuation of the current minimum required amount of total capital at 8% of risk-weighted assets.

Table of Contents

In addition, institutions that seek the freedom to make capital distributions (including for dividends and repurchases of stock) and pay discretionary bonuses to executive officers without restriction must also maintain 2.5% in common equity attributable to a capital conservation buffer to be phased in over three years. The purpose of the conservation buffer is to ensure that banks maintain a buffer of capital that can be used to absorb losses during periods of financial and economic stress. Factoring in the conservation buffer increases the ratios depicted above to 7% for common equity, 8.5% for Tier 1 capital and 10.5% for total capital.

On June 12, 2012, the federal banking regulators (the Office of the Comptroller of the Currency, the Federal Reserve and the FDIC) (the “Agencies”) formally proposed for comment, in three separate but related proposals, rules to implement Basel III in the United States. The proposals are: (i) the “Basel III Proposal,” which applies the Basel III capital framework to almost all U.S. banking organizations; (ii) the “Standardized Approach Proposal,” which applies certain elements of the Basel II standardized approach for credit risk weightings to almost all U.S. banking organizations; and (iii) the “Advanced Approaches Proposal,” which applies changes made to Basel II and Basel III in the past few years to large U.S. banking organizations subject to the advanced Basel II capital framework. The comment period for these notices of proposed rulemaking ended October 22, 2012.

The Basel III Proposal and the Standardized Approach Proposal are expected to have a direct impact on the Company and the Bank. The Basel III Proposal is applicable to all U.S. banks that are subject to minimum capital requirements, including federal and state banks, as well as to bank and savings and loan holding companies other than “small bank holding companies” (generally bank holding companies with consolidated assets of less than $500 million). There will be separate phase-in/phase-out periods for: (i) minimum capital ratios; (ii) regulatory capital adjustments and deductions; (iii) nonqualifying capital instruments; (iv) capital conservation and countercyclical capital buffers; (v) a supplemental leverage ratio for advanced approaches banks; and (vi) changes to the FDIC's prompt corrective action rules.

The criteria in the U.S. proposal for common equity and additional Tier 1 capital instruments, as well as Tier 2 capital instruments, are broadly consistent with the Basel III criteria. A number of instruments that now qualify as Tier 1 capital will not qualify, or their qualification will change, if the Basel III Proposal becomes final. For example, cumulative preferred stock and certain hybrid capital instruments, including trust preferred securities, which the Company may retain under the Dodd-Frank Act, will no longer qualify as Tier 1 capital of any kind. Noncumulative perpetual preferred stock, which now qualifies as simple Tier 1 capital, would not qualify as common equity Tier 1 capital, but would qualify as additional Tier 1 capital.

In addition to the changes in capital requirements included within the Basel III Proposal, the Standardized Approach Proposal revises a large number of the risk weightings (or their methodologies) for bank assets that are used to determine the capital ratios. For nearly every class of assets, the proposal requires a more complex, detailed and calibrated assessment of credit risk and calculation of risk weightings. For example, under the current risk-weighting rules, residential mortgages have a risk weighting of 50%. Under the proposed new rules, two categories of residential mortgage lending would be created: (i) traditional lending would be category 1, where the risk weightings range from 35 to 100%; and (ii) nontraditional loans would fall within category 2, where the risk weightings would range from 50 to 150%. There is concern in the U.S. that the proposed methodology for risk weighting residential mortgage exposures and the higher risk weightings for certain types of mortgage products will increase costs to consumers and reduce their access to mortgage credit.

In addition, there is significant concern noted by the financial industry in connection with the Basel III rulemaking as to the proposed treatment of accumulated other comprehensive income (“AOCI”). The proposed treatment of AOCI would require unrealized gains and losses on available-for-sale securities to flow through to regulatory capital as opposed to the current treatment, which neutralizes such effects. There is concern that this treatment would introduce capital volatility, due not only to credit risk but also to interest rate risk, and affect the composition of firms' securities holdings.

While the Basel III accord called for national jurisdictions to implement the new requirements beginning January 1, 2013, in light of the volume of comments received by the Agencies and the concerns expressed above, the Agencies have indicated that the commencement date for the proposed Basel III rules has been delayed and it is unclear when the Basel III regime, as it may be implemented by final rules, will become effective in the United States.

The Company

General. As the sole shareholder of the Bank, we are a bank holding company. As a bank holding company, we are registered with, and are subject to regulation by, the Federal Reserve under the Bank Holding Company Act of 1956, as amended (the “BHCA”). In accordance with Federal Reserve policy, and as now codified by the Dodd-Frank Act, we are legally obligated to act as a source of financial strength to the Bank and to commit resources to support the Bank in circumstances where we might not otherwise do so. Under the BHCA, we are subject to periodic examination by the Federal Reserve. We are also required to

Table of Contents

file with the Federal Reserve periodic reports of our operations and such additional information regarding the Company and our subsidiaries as the Federal Reserve may require.

Acquisitions, Activities and Change in Control. The primary purpose of a bank holding company is to control and manage banks. The BHCA generally requires the prior approval of the Federal Reserve for any merger involving a bank holding company or any acquisition by a bank holding company of another bank or bank holding company. Subject to certain conditions (including deposit concentration limits established by the BHCA and the Dodd-Frank Act), the Federal Reserve may allow a bank holding company to acquire banks located in any state of the United States. In approving interstate acquisitions, the Federal Reserve is required to give effect to applicable state law limitations on the aggregate amount of deposits that may be held by the acquiring bank holding company and its insured depository institution affiliates in the state in which the target bank is located (provided that those limits do not discriminate against out-of-state depository institutions or their holding companies) and state laws that require that the target bank have been in existence for a minimum period of time (not to exceed five years) before being acquired by an out-of-state bank holding company. Furthermore, in accordance with the Dodd-Frank Act, bank holding companies must be well-capitalized and well-managed in order to effect interstate mergers or acquisitions. For a discussion of the capital requirements, see “-The Increasing Regulatory Emphasis on Capital” above.

The BHCA generally prohibits us from acquiring direct or indirect ownership or control of more than 5% of the voting shares of any company that is not a bank and from engaging in any business other than that of banking, managing and controlling banks or furnishing services to banks and their subsidiaries. This general prohibition is subject to a number of exceptions. The principal exception allows bank holding companies to engage in, and to own shares of companies engaged in, certain businesses found by the Federal Reserve prior to November 11, 1999 to be “so closely related to banking . . . as to be a proper incident thereto.” This authority would permit us to engage in a variety of banking-related businesses, including the ownership and operation of a thrift, or any entity engaged in consumer finance, equipment leasing, the operation of a computer service bureau (including software development) and mortgage banking and brokerage. The BHCA generally does not place territorial restrictions on the domestic activities of nonbank subsidiaries of bank holding companies.

Federal law also prohibits any person or company from acquiring “control” of an FDIC-insured depository institution or its holding company without prior notice to the appropriate federal bank regulator. “Control” is conclusively presumed to exist upon the acquisition of 25% or more of the outstanding voting securities of a bank or bank holding company, but may arise under certain circumstances between 10% and 24.99% ownership.

Financial Holding Company Regulation. Additionally, bank holding companies that meet certain eligibility requirements prescribed by the BHCA and elect to operate as financial holding companies may engage in, or own shares in companies engaged in, a wider range of nonbanking activities, including securities and insurance underwriting and sales, merchant banking and any other activity that the Federal Reserve, in consultation with the Secretary of the Treasury, determines by regulation or order is financial in nature, incidental to any such financial activity or complementary to any such financial activity and does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally. We have elected (and the Federal Reserve has accepted our election) to operate as a financial holding company.

In order to become and maintain our status as a financial holding company, the Company and the Bank must be well-capitalized, well-managed, and have a least a satisfactory Community Reinvestment Act (“CRA”) rating. If the Federal Reserve determines that a financial holding company is not well-capitalized or well-managed, the company has a period of time in which to achieve compliance, but during the period of noncompliance, the Federal Reserve may place any limitations on the company it believes to be appropriate. Furthermore, if the Federal Reserve determines that a financial holding company's subsidiary bank has not received a satisfactory CRA rating, the company will not be able to commence any new financial activities or acquire a company that engages in such activities.

Capital Requirements. Bank holding companies are required to maintain minimum levels of capital in accordance with Federal Reserve capital adequacy guidelines, as affected by the Dodd-Frank Act and Basel III. For a discussion of capital requirements, see “-The Increasing Regulatory Emphasis on Capital” above. If capital levels fall below the minimum required levels, a bank holding company, among other things, may be denied approval to acquire or

establish additional banks or nonbank businesses.
U.S. Government Investment in Bank Holding Companies. Events in the U.S. and global financial markets in 2008 and 2009, including the deterioration of the worldwide credit markets, created significant challenges for financial institutions throughout the country. In response to this crisis affecting the U.S. banking system and financial markets, on October 3, 2008, the U.S. Congress passed, and the President signed into law, the Emergency Economic Stabilization Act of 2008 (the "EESA"). The EESA authorized the Secretary of the Treasury to implement various temporary emergency programs designed to strengthen the capital positions

of financial institutions and stimulate the availability of credit within the U.S. financial system. Financial institutions participating in certain of the programs established under the EESA are required to adopt the Treasury's standards for executive compensation and corporate governance.

On October 14, 2008, the Treasury announced that it would provide Tier 1 capital (in the form of perpetual preferred stock) to eligible financial institutions. This program, known as the TARP Capital Purchase Program (the “CPP”), allocated $250 billion from the $700 billion authorized by the EESA to the Treasury for the purchase of senior preferred shares from qualifying financial institutions (the “CPP Preferred Stock”). Under the program, eligible institutions were able to sell equity interests to the Treasury in amounts equal to between 1% and 3% of the institution's risk-weighted assets. The CPP Preferred Stock is non-voting and pays dividends at the rate of 5% per annum for the first five years and thereafter at a rate of 9% per annum. In conjunction with the purchase of the CPP Preferred Stock, the Treasury received warrants to purchase common stock from the participating public institutions with an aggregate market price equal to 15% of the preferred stock investment. Participating financial institutions were required to adopt the Treasury's standards for executive compensation and corporate governance for the period during which the Treasury holds equity issued under the CPP.

Pursuant to the CPP, on February 6, 2009, we entered into a Letter Agreement with the Treasury, pursuant to which we issued: (i) 16,000 shares of CPP Preferred Stock (designated as “Fixed Rate Cumulative Perpetual Preferred Stock, Series A”); and (ii) a warrant to purchase 198,675 shares of our common stock, par value $1.00 per share, for an aggregate purchase price of $16.0 million in cash.

CPP Repurchase. As approved by the Federal Reserve Board, the Treasury and our other banking regulators, on July 6, 2011, we redeemed from the Treasury all 16,000 outstanding shares of our CPP Preferred Stock, for a redemption price of approximately $16.1 million, including accrued but unpaid dividends to the date of redemption. On July 27, 2011, we also repurchased the warrant issued to the Treasury for an aggregate purchase price of $1.0 million. As a result of our redemption of the CPP Preferred Stock, we are no longer subject to the limits on executive compensation and other restrictions stipulated under the CPP.

Dividend Payments. Our ability to pay dividends to our shareholders may be affected by both general corporate law considerations and policies of the Federal Reserve applicable to bank holding companies. As an Iowa corporation, we are subject to the limitations of Iowa law, which allows us to pay dividends unless, after such dividend, (i) we would not be able to pay our debts as they become due in the usual course of business or (ii) our total assets would be less than the sum of our total liabilities plus any amount that would be needed if we were to be dissolved at the time of the dividend payment, to satisfy the preferential rights upon dissolution of shareholders whose rights are superior to the rights of the shareholders receiving the distribution.

As a general matter, the Federal Reserve indicates that the board of directors of a bank holding company should eliminate, defer or significantly reduce the dividends if: (i) the company's net income available to shareholders for the past four quarters, net of dividends previously paid during that period, is not sufficient to fully fund the dividends; (ii) the prospective rate of earnings retention is inconsistent with the company's capital needs and overall current and prospective financial condition; or (iii) the company will not meet, or is in danger of not meeting, its minimum regulatory capital adequacy ratios. The Federal Reserve also possesses enforcement powers over bank holding companies and their nonbank subsidiaries to prevent or remedy actions that represent unsafe or unsound practices or violations of applicable statutes and regulations. Among these powers is the ability to proscribe the payment of dividends by banks and bank holding companies.

Federal Securities Regulation. Our common stock is registered with the SEC under the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Consequently, we are subject to the information, proxy solicitation, insider trading and other restrictions and requirements of the SEC under the Exchange Act.

Corporate Governance. The Dodd-Frank Act addresses many investor protection, corporate governance and executive compensation matters that will affect most U.S. publicly traded companies. The Dodd-Frank Act will increase stockholder influence over boards of directors by requiring companies to give stockholders a non-binding vote on executive compensation and so-called “golden parachute” payments, and authorizing the SEC to promulgate rules that would allow stockholders to nominate and solicit voters for their own candidates using a company's proxy materials.

The legislation also directs the Federal Reserve to promulgate rules prohibiting excessive compensation paid to bank holding company executives, regardless of whether the company is publicly traded.

Table of Contents

The Bank

General. The Bank is an Iowa-chartered bank, the deposit accounts of which are insured by the FDIC's Deposit Insurance Fund (the “DIF”) to the maximum extent provided under federal law and FDIC regulations. As an Iowa-chartered bank, the Bank is subject to the examination, supervision, reporting and enforcement requirements of the Iowa Superintendent, the chartering authority for Iowa banks, and the FDIC, designated by federal law as the primary federal regulator of state-chartered, FDIC-insured banks that, like the Bank, are not members of the Federal Reserve System (“non-member banks”).

Deposit Insurance. As an FDIC-insured institution, the Bank is required to pay deposit insurance premium assessments to the FDIC. The FDIC has adopted a risk-based assessment system whereby FDIC-insured depository institutions pay insurance premiums at rates based on their risk classification. An institution's risk classification is assigned based on its capital levels and the level of supervisory concern the institution poses to the regulators.

On November 12, 2009, the FDIC adopted a final rule that required insured depository institutions to prepay on December 30, 2009, their estimated quarterly risk-based assessments for the fourth quarter of 2009 and for all of 2010, 2011, and 2012. As such, on December 31, 2009, the Bank prepaid the FDIC its assessments based on its: (i) actual September 30, 2009 assessment base, increased quarterly by a 5% annual growth rate through the fourth quarter of 2012; and (ii) total base assessment rate in effect on September 30, 2009, increased by an annualized three basis points beginning in 2011. The FDIC began to offset prepaid assessments on March 30, 2010, representing payment of the regular quarterly risk-based deposit insurance assessment for the fourth quarter of 2009. Any prepaid assessment not exhausted after collection of the amount due on June 30, 2013, will be returned to the institution.

Amendments to the Federal Deposit Insurance Act also revise the assessment base against which an insured depository institution's deposit insurance premiums paid to the DIF will be calculated. Under the amendments, the assessment base will no longer be the institution's deposit base, but rather its average consolidated total assets less its average tangible equity. This may shift the burden of deposit insurance premiums toward those large depository institutions that rely on funding sources other than U.S. deposits. Additionally, the Dodd-Frank Act makes changes to the minimum designated reserve ratio of the DIF, increasing the minimum from 1.15% to 1.35% of the estimated amount of total insured deposits, and eliminating the requirement that the FDIC pay dividends to depository institutions when the reserve ratio exceeds certain thresholds. The FDIC is given until September 3, 2020 to meet the 1.35% reserve ratio target. Several of these provisions could increase the Bank's FDIC deposit insurance premiums.

The Dodd-Frank Act permanently increases the maximum amount of deposit insurance for banks, savings institutions and credit unions to $250,000 per insured depositor, retroactive to January 1, 2009. Although the legislation provided that non-interest-bearing transaction accounts had unlimited deposit insurance coverage through December 31, 2012.

FICO Assessments.The Financing Corporation (“FICO”) is a mixed-ownership governmental corporation chartered by the former Federal Home Loan Bank Board pursuant to the Competitive Equality Banking Act of 1987 to function as a financing vehicle for the recapitalization of the former Federal Savings and Loan Insurance Corporation. FICO issued 30-year non-callable bonds of approximately $8.1 billion that mature in 2017 through 2019. FICO's authority to issue bonds ended on December 12, 1991. Since 1996, federal legislation has required that all FDIC-insured depository institutions pay assessments to cover interest payments on FICO's outstanding obligations. These FICO assessments are in addition to amounts assessed by the FDIC for deposit insurance. During the year ended December 31, 2012, the FICO assessment rate was approximately 0.0066%, which reflects the change from an assessment base computed on deposits to an assessment base computed on assets as required by the Dodd-Frank Act.

Supervisory Assessments. All Iowa banks are required to pay supervisory assessments to the Iowa Superintendent to fund the operations of that agency. The amount of the assessment is calculated on the basis of the Bank's total assets. During the year ended December 31, 2012, the Bank paid supervisory assessments to the Iowa Superintendent totaling $144,000.

Capital Requirements. Banks are generally required to maintain capital levels in excess of other businesses. For a discussion of capital requirements, see “The Increasing Regulatory Emphasis on Capital” above.

Dividend Payments. The primary source of funds for the Company is dividends from the Bank. Under the Iowa Banking Act, Iowa-chartered banks generally may pay dividends only out of undivided profits. In addition, the Iowa Superintendent may restrict the declaration or payment of a dividend by an Iowa-chartered bank, such as the Bank.

The payment of dividends by any financial institution is affected by the requirement to maintain adequate capital pursuant to applicable capital adequacy guidelines and regulations, and a financial institution generally is prohibited from paying any

12

dividends if, following payment thereof, the institution would be undercapitalized. As described above, the Bank exceeded its minimum capital requirements under applicable guidelines as of December 31, 2012. As of December 31, 2012, approximately $15.7 million was available to be paid as dividends by the Bank. Notwithstanding the availability of funds for dividends, however, the FDIC may prohibit the payment of any dividends by the Bank if the FDIC determines such payment would constitute an unsafe or unsound practice.

Insider Transactions. The Bank is subject to certain restrictions imposed by federal law on “covered transactions” between the Bank and its affiliates. The Company is an affiliate of the Bank for purposes of these restrictions, and covered transactions subject to the restrictions include extensions of credit to the Company, investments in our stock or other securities and the acceptance of our stock or other securities as collateral for loans made by the Bank. The Dodd-Frank Act enhances the requirements for certain transactions with affiliates as of July 21, 2011, including an expansion of the definition of “covered transactions” and an increase in the amount of time for which collateral requirements regarding covered transactions must be maintained.

Certain limitations and reporting requirements are also placed on extensions of credit by the Bank to its directors and officers, to directors and officers of the Company, to principal shareholders of the Company and to “related interests” of such directors, officers and principal shareholders. In addition, federal law and regulations may affect the terms upon which any person who is a director or officer of the Company or the Bank, or a principal shareholder of the Company, may obtain credit from banks with which the Bank maintains correspondent relationships.

Safety and Soundness Standards. The federal banking agencies have adopted guidelines that establish operational and managerial standards to promote the safety and soundness of federally insured depository institutions. The guidelines set forth standards for internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, asset quality and earnings.

In general, the safety and soundness guidelines prescribe the goals to be achieved in each area, and each institution is responsible for establishing its own procedures to achieve those goals. If an institution fails to comply with any of the standards set forth in the guidelines, the institution's primary federal regulator may require the institution to submit a plan for achieving and maintaining compliance. If an institution fails to submit an acceptable compliance plan, or fails in any material respect to implement a compliance plan that has been accepted by its primary federal regulator, the regulator is required to issue an order directing the institution to cure the deficiency. Until the deficiency cited in the regulator's order is cured, the regulator may restrict the institution's rate of growth, require the institution to increase its capital, restrict the rates the institution pays on deposits or require the institution to take any action the regulator deems appropriate under the circumstances. Noncompliance with the standards established by the safety and soundness guidelines may also constitute grounds for other enforcement action by the federal banking regulators, including cease and desist orders and civil money penalty assessments.

Branching Authority. The Bank has the authority under Iowa law to establish branches anywhere in the State of Iowa, subject to receipt of all required regulatory approvals.

Federal law permits state and national banks to merge with banks in other states subject to: (i) regulatory approval; (ii) federal and state deposit concentration limits; and (iii) state law limitations requiring the merging bank to have been in existence for a minimum period of time (not to exceed five years) prior to the merger. The establishment of new interstate branches or the acquisition of individual branches of a bank in another state (rather than the acquisition of an out-of-state bank in its entirety) has historically been permitted only in those states the laws of which expressly authorize such expansion. However, the Dodd-Frank Act permits well-capitalized and well-managed banks to establish new branches across state lines without these impediments.

State Bank Investments and Activities. The Bank is permitted to make investments and engage in activities directly or through subsidiaries as authorized by Iowa law. However, under federal law and FDIC regulations, FDIC-insured state banks are prohibited, subject to certain exceptions, from making or retaining equity investments of a type, or in an amount, that are not permissible for a national bank. Federal law and FDIC regulations also prohibit FDIC-insured state banks and their subsidiaries, subject to certain exceptions, from engaging as principal in any activity that is not permitted for a national bank unless the bank meets, and continues to meet, its minimum regulatory capital requirements and the FDIC determines that the activity would not pose a significant risk to the DIF. These restrictions have not had, and are not currently expected to have, a material impact on the operations of the Bank.

Transaction Account Reserves. Federal Reserve regulations require depository institutions to maintain reserves against their transaction accounts (primarily NOW and regular checking accounts). For 2013: the first $12.4 million of otherwise reservable balances are exempt from the reserve requirements; for transaction accounts aggregating more than $12.4 million to $79.5 million, the reserve requirement is 3% of total transaction accounts; and for net transaction accounts in excess of $79.5 million, the reserve requirement is $2,013,000 plus 10% of the aggregate amount of total transaction accounts in excess of $79.5 million. These reserve requirements are subject to annual adjustment by the Federal Reserve. The Bank is in compliance with the foregoing requirements.

Consumer Financial Services. There are numerous developments in federal and state laws regarding consumer financial products and services that impact the Bank's business. Importantly, the current structure of federal consumer protection regulation applicable to all providers of consumer financial products and services changed significantly on July 21, 2011, when the CFPB commenced operations to supervise and enforce consumer protection laws. The CFPB has broad rulemaking authority for a wide range of consumer protection laws that apply to all providers of consumer products and services, including the Bank, as well as the authority to prohibit “unfair, deceptive or abusive” acts and practices. The CFPB has examination and enforcement authority over providers with more than $10 billion in assets. Banks and savings institutions with $10 billion or less in assets, like the Bank, will continue to be examined by their applicable bank regulators.

Ability-to-Repay Requirement and Qualified Mortgage Rule. The Dodd-Frank Act contains additional provisions that affect consumer mortgage lending. First, it significantly expands underwriting requirements applicable to loans secured by 1-4 family residential real property and augments federal law combating predatory lending practices. In addition to numerous new disclosure requirements, the Dodd-Frank Act imposes new standards for mortgage loan originations on all lenders, including banks and savings associations, in an effort to strongly encourage lenders to verify a borrower's ability to repay, while also establishing a presumption of compliance for certain “qualified mortgages.” Most significantly, the new standards limit the total points and fees that the Bank and/or a broker may charge on conforming and jumbo loans to 3% of the total loan amount. In addition, the Dodd-Frank Act generally requires lenders or securitizers to retain an economic interest in the credit risk relating to loans that the lender sells and other asset backed securities that the securitizer issues if the loans have not complied with the ability-to-repay standards. The risk retention requirement generally will be 5%, but could be increased or decreased by regulation.

On January 10, 2013, the CFPB issued a final rule, effective January 10, 2014, which implements the Dodd-Frank Act's ability-to-repay requirements and clarifies the presumption of compliance for “qualified mortgages.” In assessing a borrower's ability to repay a mortgage-related obligation, lenders generally must consider eight underwriting factors: (i) current or reasonably expected income or assets; (ii) current employment status; (iii) monthly payment on the subject transaction; (iv) monthly payment on any simultaneous loan; (v) monthly payment for all mortgage-related obligations; (vi) current debt obligations, alimony, and child support; (vii) monthly debt-to-income ratio or residual income; and (viii) credit history. The final rule also includes guidance regarding the application of, and methodology for evaluating, these factors.

Further, the final rule also clarifies that qualified mortgages do not include “no-doc” loans and loans with negative amortization, interest-only payments, balloon payments, terms in excess of 30 years, or points and fees paid by the borrower that exceed 3% of the loan amount, subject to certain exceptions. In addition, for qualified mortgages, the monthly payment must be calculated on the highest payment that will occur in the first five years of the loan, and the borrower's total debt-to-income ratio generally may not be more than 43%. The final rule also provides that certain mortgages that satisfy the general product feature requirements for qualified mortgages and that also satisfy the underwriting requirements of Fannie Mae and Freddie Mac (while they operate under federal conservatorship or receivership) or the U.S. Department of Housing and Urban Development, Department of Veterans Affairs, or Department of Agriculture or Rural Housing Service are also considered to be qualified mortgages. This second category of qualified mortgages will phase out as the aforementioned federal agencies issue their own rules regarding qualified mortgages, the conservatorship of Fannie Mae and Freddie Mac ends, and, in any event, after seven years.

As set forth in the Dodd-Frank Act, subprime (or higher-priced) mortgage loans are subject to the ability-to-repay requirement, and the final rule provides for a rebuttable presumption of lender compliance for those loans. The final rule also applies the ability-to-repay requirement to prime loans, while also providing a conclusive presumption of compliance (i.e., a safe harbor) for prime loans that are also qualified mortgages. Additionally, the final rule generally prohibits prepayment penalties (subject to certain exceptions) and sets forth a 3-year record retention period with respect to documenting and demonstrating the ability-to-repay requirement and other provisions.

Changes to Mortgage Loan Originator Compensation. Effective April 2, 2011, previously existing regulations concerning the compensation of mortgage loan originators were amended. As a result of these amendments, mortgage loan originators may not receive compensation based on a mortgage transaction's terms or conditions other than the amount of credit extended under the mortgage loan. Further, the new standards limit the total points and fees that a bank and/or a broker may charge on conforming and jumbo loans to 3% of the total loan amount. Mortgage loan originators may receive compensation from a consumer or from a lender, but not both. These rules contain requirements designed to prohibit mortgage loan originators from “steering” consumers to loans that provide mortgage loan originators with greater compensation. In addition, the rules contain other requirements concerning recordkeeping.

Table of Contents

Foreclosure and Loan Modifications. Federal and state laws further impact foreclosures and loan modifications, with many of such laws having the effect of delaying or impeding the foreclosure process on real estate secured loans in default. Mortgages on commercial property can be modified, such as by reducing the principal amount of the loan or the interest rate, or by extending the term of the loan, through plans confirmed under Chapter 11 of the U.S. Bankruptcy Code. In recent years, legislation has been introduced in the U.S. Congress that would amend the Bankruptcy Code to permit the modification of mortgages secured by residences, although at this time the enactment of such legislation is not presently proposed. The scope, duration and terms of potential future legislation with similar effect continue to be discussed. We cannot predict whether any such legislation will be passed or the impact, if any, it would have on our business.

Special Cautionary Note Regarding Forward-Looking Statements

This report contains certain “forward-looking statements” within the meaning of such term in the Private Securities Litigation Reform Act of 1995. We and our representatives may, from time to time, make written or oral statements that are “forward-looking” and provide information other than historical information. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results to be materially different from any results, levels of activity, performance or achievements expressed or implied by any forward-looking statement. These factors include, among other things, the factors listed below.

Forward-looking statements, which may be based upon beliefs, expectations and assumptions of our management and on information currently available to management, are generally identifiable by the use of words such as “believe”, “expect”, “anticipate”, “should”, “could”, “would”, “plans”, “intend”, “project”, “estimate”, “forecast”, “may” or similar expre forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those expressed in, or implied by, these statements. Readers are cautioned not to place undue reliance on any such forward-looking statements, which speak only as of the date made. Additionally, we undertake no obligation to update any statement in light of new information or future events, except as required under federal securities law.

Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors that could have an impact on our ability to achieve operating results, growth plan goals and future prospects include, but are not limited to, the following:

- credit quality deterioration or pronounced and sustained reduction in real estate market values could cause an increase in the allowance for credit losses and a reduction in net earnings;
- our management’s ability to reduce and effectively manage interest rate risk and the impact of interest rates in general on the volatility of our net interest income;
- changes in the economic environment, competition, or other factors that may affect our ability to acquire loans or influence the anticipated growth rate of loans and deposits and the quality of the loan portfolio and loan and deposit pricing;
- fluctuations in the value of our investment securities;
- governmental monetary and fiscal policies;
- legislative and regulatory changes, including changes in banking, securities and tax laws and regulations and their application by our regulators (particularly with respect to the Dodd-Frank Act and the extensive regulations promulgated and to be promulgated thereunder, as well as rules proposed by the federal bank regulatory agencies to implement the Basel III capital accord), and changes in the scope and cost of FDIC insurance and other coverages;
- the ability to attract and retain key executives and employees experienced in banking and financial services;
- the sufficiency of the allowance for loan losses to absorb the amount of actual losses inherent in our existing loan portfolio;
- our ability to adapt successfully to technological changes to compete effectively in the marketplace;
- credit risks and risks from concentrations (by geographic area and by industry) within our loan portfolio;
- the effects of competition from other commercial banks, thrifts, mortgage banking firms, consumer finance companies, credit unions, securities brokerage firms, insurance companies, money market and other mutual funds, and other financial institutions operating in our markets or elsewhere or providing similar services;
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- the failure of assumptions underlying the establishment of allowances for loan losses and estimation of values of collateral and various financial assets and liabilities;
- volatility of rate-sensitive deposits;
- operational risks, including data processing system failures or fraud;
- asset/liability matching risks and liquidity risks;
- the risks of mergers, acquisitions and divestitures, including, without limitation, the related time and costs of implementing such transactions, integrating operations as part of these transactions and possible failures to achieve expected gains, revenue growth and/or expense savings from such transactions;

Table of Contents

- the costs, effects and outcomes of existing or future litigation;
- changes in general economic or industry conditions, nationally or in the communities in which we conduct business;
- changes in accounting policies and practices, as may be adopted by state and federal regulatory agencies and the Financial Accounting Standards Board; and
- other factors and risks described under "Risk Factors" herein.

We qualify all of our forward-looking statements by the foregoing cautionary statements. Because of these risks and other uncertainties, our actual future results, performance or achievement, or industry results, may be materially different from the results indicated by these forward-looking statements. In addition, our past results of operations are not necessarily indicative of our future results.

ITEM 1A. RISK FACTORS.

An investment in our securities is subject to risks inherent in our business. Before making an investment decision, you should carefully consider the risks and uncertainties described below together with all of the other information included in this report. In addition to the risks and uncertainties described below, other risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially and adversely affect our business, financial condition and results of operations. The value or market price of our securities could decline due to any of these identified or other risks, and you could lose all or part of your investment.

Our business has been and may continue to be adversely affected by conditions in the financial markets and economic conditions generally.

Although it has recently shown signs of improvement, since late 2007, the U.S. economy has generally experienced challenging economic conditions. Business activity across a range of industries and regions remains reduced from historical levels under more favorable economic conditions. Likewise, many local governments have been experiencing certain difficulties, including lower tax revenues, which have impacted their ability to cover costs. Unemployment also generally remains at elevated levels. For the past few years, the financial services industry has generally been affected by declines in the values of many significant asset classes, reduced levels of liquidity and the lack of opportunities to originate new loans. While these challenges are generally less severe than in recent years, their impact continues to be felt.

As a result of these economic conditions, many lending institutions, including the Bank, have experienced declines in the performance of their loans, including commercial loans, commercial and residential real estate loans and consumer loans, from historical norms. Moreover, competition among depository institutions for deposits and quality loans has increased significantly. In addition, the values of real estate collateral supporting many commercial loans and home mortgages remains distressed and may decline further in the future. Bank and bank holding company stock prices have generally been negatively affected over this time period, and the ability of banks and bank holding companies to raise capital or borrow in the debt markets has generally been more difficult than it had been prior to 2007. There have been significant new laws and regulations regarding lending and funding practices and liquidity standards, with a potential for further regulation in the future, and bank regulatory agencies in general have been very aggressive in responding to concerns and trends identified in examinations, including through formal or informal enforcement actions or orders. The impact of new legislation in response to these developments may negatively impact our operations by restricting our business operations, including our ability to originate or sell loans, and adversely impact our financial performance or our stock price.

In addition, if the overall economic climate in the United States, generally, or our market areas, specifically, fails to improve significantly, this may affect consumer confidence levels and may cause adverse changes in payment patterns, causing increases in delinquencies and default rates, which may impact our charge-offs and provisions for credit losses. A worsening of these conditions likely would exacerbate the adverse effects of the recent market conditions on us and others in the financial services industry. Since 2007, the general business environment has had an overall adverse effect on our business, and there can be no assurance that the environment will improve meaningfully in the near term. Until conditions materially improve, we expect our business, financial condition and results of operations to show measured improvement but to remain muted relative to their potential in more favorable economic

conditions.
Interest rates and other conditions impact our results of operations.
Our profitability is in large part a function of the spread between the interest rates earned on investments and loans and the interest rates paid on deposits and other interest-bearing liabilities. Like most banking institutions, our net interest spread and margin is affected by general economic conditions and other factors, including fiscal and monetary policies of the federal government, that influence market interest rates and our ability to respond to changes in such rates. At any given time, our assets

and liabilities will be such that they are affected differently by a given change in interest rates. As a result, an increase or decrease in rates, the length of loan terms or the mix of adjustable and fixed rate loans in our portfolio could have a positive or negative effect on our net income, capital and liquidity. The competition for loans in the marketplace and the overall interest rate environment has kept interest rates on loans low. Interest rates paid on deposit products have declined steadily in recent years, but further significant decline is unlikely as interest rates on deposits have approached zero. We expect to continue battling net interest margin compression in 2013, with interest rates at generational lows.

We measure interest rate risk under various rate scenarios and using specific criteria and assumptions. A summary of this process, along with the results of our net interest income simulations, is presented at "Quantitative and Qualitative Disclosures about Market Risk" included under Item 7A of Part II of this Annual Report on Form 10-K. Although we believe our current level of interest rate sensitivity is reasonable and effectively managed, significant fluctuations in interest rates may have an adverse effect on our business, financial condition and results of operations.

Changes in interest rates also can affect the value of loans, securities and other assets. An increase in interest rates that adversely affects the ability of borrowers to pay the principal or interest on loans may lead to an increase in nonperforming assets and a reduction of income recognized, which could have a material adverse effect on our results of operations and cash flows. Further, when we place a loan on nonaccrual status, we reverse any accrued but unpaid interest receivable, which decreases interest income. Subsequently, we continue to have a cost to fund the loan, which is reflected as interest expense, without any interest income to offset the associated funding expense. Thus, an increase in the amount of nonperforming assets would have an adverse impact on net interest income.

Rising interest rates will likely result in a decline in value of our fixed-rate debt securities. The unrealized losses resulting from holding these securities would be recognized in other comprehensive income (or net income, if the decline is other-than-temporary), and reduce total shareholders' equity. Unrealized losses do not negatively impact our regulatory capital ratios; however, tangible common equity and the associated ratios used by many investors would be reduced. If debt securities in an unrealized loss position are sold, such losses become realized and will reduce our regulatory capital ratios.

Our business is concentrated in and largely dependent upon the continued growth and welfare of the Iowa City and Oskaloosa markets and other markets in eastern and central Iowa.

We operate primarily in the Iowa City and Oskaloosa, Iowa, markets and their surrounding communities in eastern and central Iowa and, as a result, our financial condition, results of operations and cash flows are significantly impacted by changes in the economic conditions in those areas. Our success depends to a significant extent upon the business activity, population, income levels, deposits and real estate activity in these markets. Although our customers' business and financial interests may extend well beyond these market areas, adverse economic conditions that affect these market areas could reduce our growth rate, affect the ability of our customers to repay their loans to us, affect the value of collateral underlying loans and generally affect our financial condition and results of operations. Because of our geographic concentration, we are less able than other regional or national financial institutions to diversify our credit risks across multiple markets. Although, in general, the Iowa economy and real estate market were not affected as severely as other areas of the United States in recent years, they are not immune to challenging economic conditions that affect the United States and world economies.

We must manage our credit risk effectively.

There are risks inherent in making any loan, including risks inherent in dealing with individual borrowers, risks of nonpayment, risks resulting from uncertainties as to the future value of collateral and risks resulting from changes in economic and industry conditions. We attempt to minimize our credit risk through prudent loan application approval procedures, careful monitoring of the concentration of our loans within specific industries and periodic independent reviews of outstanding loans by our credit review department. However, we cannot assure you that such approval and monitoring procedures will reduce these credit risks.

If the overall economic climate in the United States, generally, or our market areas, specifically, fails to meaningfully improve, or even if it does, our borrowers may experience difficulties in repaying their loans, and the level of nonperforming loans, charge-offs and delinquencies could rise and require increases in the provision for loan losses, which would cause our net income and return on equity to decrease.

A significant portion of the Bank’s loan portfolio consists of commercial loans, and we focus on lending to small to medium-sized businesses. The size of the loans we can offer to commercial customers is less than the size of the loans that our competitors with larger lending limits can offer. This may limit our ability to establish relationships with the area’s largest businesses. As a result, we may assume greater lending risks than financial institutions that have a lesser concentration of such loans and tend

Table of Contents

to make loans to larger businesses. Collateral for these loans generally includes accounts receivable, inventory, equipment and real estate. However, depending on the overall financial condition of the borrower, some loans are made on an unsecured basis. In addition to commercial loans and commercial real estate loans, MidWestOne Bank is also active in residential mortgage and consumer lending. Should the economic climate worsen, our borrowers may experience financial difficulties, and the level of nonperforming loans, charge-offs and delinquencies could rise, which could negatively impact our business.

Commercial, industrial and agricultural loans make up a significant portion of our loan portfolio.

Commercial, industrial and agricultural loans (including credit cards and commercially related overdrafts), were $323.3 million, or approximately 31.1% of our total loan portfolio, as of December 31, 2012. Our commercial loans are primarily made based on the identified cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. Most often, this collateral is accounts receivable, inventory and equipment. Credit support provided by the borrower for most of these loans and the probability of repayment is based on the liquidation value of the pledged collateral and enforcement of a personal guarantee, if any exists. As a result, in the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers. The collateral securing these loans may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business. In addition, if the United States economy fails to improve meaningfully, this could harm the businesses of our commercial and industrial customers and reduce the value of the collateral securing these loans.

Payments on agricultural loans are dependent on the successful operation or management of the farm property. The success of the farm may be affected by many factors outside the control of the borrower, including adverse weather conditions that prevent the planting of a crop or limit crop yields (such as hail, drought and floods), loss of livestock due to disease or other factors, declines in market prices for agricultural products (both domestically and internationally) and the impact of government regulations (including changes in price supports, subsidies and environmental regulations). In addition, many farms are dependent on a limited number of key individuals whose injury or death may significantly affect the successful operation of the farm. If the cash flow from a farming operation is diminished, the borrower’s ability to repay the loan may be impaired. The primary crops in our market areas are corn and soybeans. Accordingly, adverse circumstances affecting these crops could have an adverse effect on our agricultural real estate loan portfolio. Likewise, agricultural operating loans involve a greater degree of risk than lending on residential properties, particularly in the case of loans that are unsecured or secured by rapidly depreciating assets such as farm equipment or assets such as livestock or crops. In these cases, any repossessed collateral for a defaulted loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation.

Our loan portfolio has a significant concentration of commercial real estate loans, which involve risks specific to real estate value.

Commercial real estate lending comprises a significant portion of our lending business. Specifically, commercial real estate loans were $440.0 million, or approximately 42.5% of our total loan portfolio, as of December 31, 2012. Of this amount, $118.1 million, or approximately 11.4%, of our total loan portfolio are loans secured by owner-occupied property. The market value of real estate securing our commercial real estate loans can fluctuate significantly in a short period of time as a result of market conditions in the geographic area in which the real estate is located. Although a significant portion of such loans is secured by real estate as a secondary form of repayment, adverse developments affecting real estate values in one or more of our markets could increase the credit risk associated with our loan portfolio. Additionally, real estate lending typically involves higher loan principal amounts and the repayment of the loans generally is dependent, in large part, on sufficient income from the properties securing the loans to cover operating expenses and debt service. Economic events or governmental regulations outside of the control of the borrower or lender could negatively impact the future cash flow and market values of the affected properties.

If problems develop in the commercial real estate market, particularly within one or more of our markets, the value of collateral securing our commercial real estate loans could decline. In such case, we may not be able to realize the amount of security that we anticipated at the time of originating the loan, which could cause us to increase our

provision for loan losses and adversely affect our operating results, financial condition and/or capital. We generally have not experienced a downturn in credit performance by our commercial real estate loan customers, but in light of the general uncertainty that exists in the economy and credit markets nationally, there can be no guarantee that we will not experience any deterioration in such performance.
Our allowance for loan losses may prove to be insufficient to absorb losses in our loan portfolio.
We established our allowance for loan losses in consultation with the credit officers of MidWestOne Bank and maintain it at a level considered adequate by management to absorb probable loan losses that are inherent in the portfolio. The amount of future loan losses is susceptible to changes in economic, operating and other conditions, including changes in interest rates and the value of the underlying collateral, which are beyond our control, and such losses may exceed current estimates. At December 31,

Table of Contents

2012, our allowance for loan losses as a percentage of total gross loans was 1.54% and as a percentage of total nonperforming loans was approximately 149.8%. Although management believes that the allowance for loan losses is adequate to absorb losses on any existing loans that may become uncollectible, we cannot predict loan losses with certainty, and we cannot assure you that our allowance for loan losses will prove sufficient to cover actual loan losses in the future. Loan losses in excess of our reserves may adversely affect our business, financial condition and results of operations.

Nonperforming assets take significant time to resolve and adversely affect our results of operations and financial condition, and could result in further losses in the future.

As of December 31, 2012, our nonperforming loans (which consist of nonaccrual loans, loans past due 90 days or more and still accruing interest and loans modified under troubled debt restructurings) totaled $10.7 million, or 1.03% of our loan portfolio, and our nonperforming assets (which include nonperforming loans plus other real estate owned) totaled $13.9 million, or 1.35% of loans. In addition, we had $6.1 million in accruing loans that were 31-89 days delinquent as of December 31, 2012.

Our nonperforming assets adversely affect our net income in various ways. We do not record interest income on nonaccrual loans or other real estate owned, thereby adversely affecting our net income and returns on assets and equity, increasing our loan administration costs and adversely affecting our efficiency ratio. When we take collateral in foreclosure and similar proceedings, we are required to mark the collateral to its then-fair market value, which may result in a loss. These nonperforming loans and other real estate owned also increase our risk profile and the capital our regulators believe is appropriate in light of such risks. The resolution of nonperforming assets requires significant time commitments from management and can be detrimental to the performance of their other responsibilities. If we experience increases in nonperforming loans and nonperforming assets, our net interest income may be negatively impacted and our loan administration costs could increase, each of which could have an adverse effect on our net income and related ratios, such as return on assets and equity.

The repeal of federal prohibitions on payment of interest on business demand deposits could increase our interest expense.

All federal prohibitions on the ability of financial institutions to pay interest on business demand deposit accounts were repealed as part of the Dodd-Frank Act. As a result, some financial institutions have commenced offering interest on these demand deposits to compete for customers. If competitive pressures require us to pay interest on these demand deposits to attract and retain business customers, our interest expense would increase and our net interest margin would decrease. This could have a material adverse effect on our business, financial condition and results of operations. Further, the effect of the repeal of the prohibition could be more significant in a higher interest rate environment as business customers would have a greater incentive to seek interest on demand deposits.

We could recognize losses on securities held in our securities portfolio, particularly if interest rates increase or economic and market conditions deteriorate.

As of December 31, 2012, the fair value of our securities portfolio was approximately $590.2 million. Factors beyond our control can significantly influence the fair value of securities in our portfolio and can cause potential adverse changes to the fair value of these securities. For example, fixed-rate securities acquired by us are generally subject to decreases in market value when interest rates rise. Additional factors include, but are not limited to, rating agency downgrades of the securities, defaults by the issuer or individual mortgagors with respect to the underlying securities, and instability in the credit markets. Any of the foregoing factors could cause an other-than-temporary impairment in future periods and result in realized losses. The process for determining whether impairment is other-than-temporary usually requires difficult, subjective judgments about the future financial performance of the issuer and any collateral underlying the security in order to assess the probability of receiving all contractual principal and interest payments on the security. Because of changing economic and market conditions affecting interest rates, the financial condition of issuers of the securities and the performance of the underlying collateral, we may recognize realized and/or unrealized losses in future periods, which could have an adverse effect on our financial condition and results of operations.

We have investments in pools of performing and nonperforming loans that generate a material amount of interest income with yields that may fluctuate considerably resulting in inconsistent profitability from period to period.

Although we decided to exit our loan pool participation line of business in 2010, we continue to hold investments in certain loan pools until their balances pay down. As of December 31, 2012, approximately 2% of our earning assets were invested in loan pool participations, and approximately 3% of our gross total revenue for the year ended December 31, 2012 was derived from the loan pool participations. These loan pool participations represent a mixture of performing, subperforming and nonperforming loans. As of December 31, 2012, our loan pool investment of $37.8 million consisted of loans secured by commercial real estate (64.4%), commercial operating (6.3%), single-family residential real estate (12.7%), and other loans (16.6%). The loan pool investment is a “nontraditional” activity that has, until recent years, provided us and our predecessor entities with a higher return than typical loans and investment securities. The return on investment in loan pool participations and the effect on profitability can be unpredictable due to fluctuations in the balance of loan pool participations and collections from borrowers by the loan pool servicer. Loan pool balances can be affected by the payment and refinancing activities of the borrowers resulting in pay-offs of the underlying loans and reduction in the balances. Collections from the individual borrowers are managed by the loan pool servicer and are affected by the borrower's financial ability and willingness to pay, foreclosure and legal action, collateral value, and the economy in general. Any of these identified factors, and others not identified, could affect our return on loan pool investments.

Although we did not seek to purchase consumer or consumer real estate loans characterized as subprime or Alt-A credits, because the purchases of these assets was on a pool basis, we have acquired some subprime loans as characterized by borrowers or guarantors having FICO scores below 640. Consumer-based paper makes up approximately 9.9% of our loan pool investment and, as of December 31, 2012, approximately 0.8% of the basis amount of our loan pool investment represented subprime credit. Because we do not originate the consumer-based loans that may be characterized as Alt-A, and because of the nature of the information provided to us with respect to any Alt-A loans in the loan pool participations, we are not able to verify the basis amount of our loan pool investment that represents Alt-A credit. Loans that are characterized as subprime and, to a lesser extent, Alt-A carry a higher risk of default by the underlying borrowers than other types of loans, which could affect the value of the overall loan pool investment.

Downgrades in the credit rating of one or more insurers that provide credit enhancement for our state and municipal securities portfolio may have an adverse impact on the market for and valuation of these types of securities.

We invest in tax-exempt state and local municipal securities, some of which are insured by monoline insurers. As of December 31, 2012, we had $237.3 million of municipal securities, which represented 39.1% of our total securities portfolio. Since the economic crisis unfolded in 2008, several of these insurers have come under scrutiny by rating agencies. Even though management generally purchases municipal securities on the overall credit strength of the issuer, the reduction in the credit rating of an insurer may negatively impact the market for and valuation of our investment securities. Such a downgrade could adversely affect our liquidity, financial condition and results of operations.

We may desire or be required to raise additional capital in the future, but that capital may not be available.

We are required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations. We intend to grow our business organically and to explore opportunities to grow our business by taking advantage of attractive acquisition opportunities, including through FDIC-assisted transactions, and such growth plans may require us to raise additional capital to ensure that we have adequate levels of capital to support such growth on top of our current operations. We may at some point need to raise additional capital to support our growth plans and in this regard, in early 2013, we renewed our universal shelf-registration statement registering for future sale up to $25 million of securities that places us in a position to raise capital if the need were to arise or if an attractive opportunity were presented. Our ability to raise additional capital will depend on conditions in the capital markets, economic conditions and a number of other factors, including investor perceptions regarding the banking industry, market conditions and governmental activities, and on our financial condition and performance. Accordingly, we cannot assure you of our ability to raise additional capital, if needed or desired, on terms acceptable to us. If we cannot raise additional capital when needed or desired, our ability to further expand our operations through internal growth or acquisitions could be materially impaired.

We may experience difficulties in managing our growth, and our growth strategy involves risks that may negatively impact our net income.

Although we do not have any current definitive plans to do so, we may expand into additional communities or attempt to strengthen our position in our current markets through opportunistic acquisitions of all or part of other financial institutions, including through FDIC-assisted transactions, or by opening new branches. To the extent that we undertake acquisitions or new branch openings, we are likely to experience the effects of higher operating expenses relative to operating income from the new operations, which may have an adverse effect on our levels of reported net income, return on average equity and return on average assets. Other effects of engaging in such growth strategies may include potential diversion of our management's time and attention and general disruption to our business.

To the extent that we grow through acquisitions or branch openings, we cannot assure you that we will be able to adequately and profitably manage this growth. Acquiring other banks and businesses will involve similar risks to those commonly associated with branching, but may also involve additional risks, including:

- potential exposure to unknown or contingent liabilities of banks and businesses we acquire;
- exposure to potential asset quality issues of the acquired bank or related business;

20

Table of Contents

- difficulty and expense of integrating the operations and personnel of banks and businesses we acquire; and
- the possible loss of key employees and customers of the banks and businesses we acquire.

Liquidity risks could affect operations and jeopardize our business, financial condition and results of operations.

Liquidity is essential to our business. An inability to raise funds through deposits, borrowings, the sale of loans and other sources could have a substantial negative effect on our liquidity. Our primary sources of funds consist of cash from operations, investment maturities and sales, deposits and funds from sales of capital securities. Additional liquidity is provided by brokered deposits, bank lines of credit, repurchase agreements and the ability to borrow from the Federal Reserve Bank and the Federal Home Loan Bank. Our access to funding sources in amounts adequate to finance or capitalize our activities or on terms that are acceptable to us could be impaired by factors that affect us directly or the financial services industry or economy in general, such as disruptions in the financial markets or negative views and expectations about the prospects for the financial services industry.

In recent years, the financial services industry and the credit markets generally have been materially and adversely affected by significant declines in asset values and by historically depressed levels of liquidity. The liquidity issues have been particularly acute for regional and community banks, as many of the larger financial institutions have curtailed their lending to regional and community banks to reduce their exposure to the risks of other banks. In addition, many of the larger correspondent lenders have reduced or even eliminated federal funds lines for their correspondent customers. Furthermore, regional and community banks generally have less access to the capital markets than do the national and super-regional banks because of their smaller size and limited analyst coverage.

As a result, we rely more on our ability to generate deposits and effectively manage the repayment and maturity schedules of our loans and investment securities, respectively, to ensure that we have adequate liquidity to fund our operations. Any decline in available funding could adversely impact our ability to originate loans, invest in securities, meet our expenses, pay dividends to our stockholders, or to fulfill obligations such as repaying our borrowings or meeting deposit withdrawal demands, any of which could have a material adverse impact on our liquidity, business, financial condition and results of operations.

The December 31, 2012 expiration of the FDIC's Transaction Account Guarantee Program could negatively impact the Bank's liquidity and cost of funds.

Under the FDIC's Transaction Account Guarantee Program, certain non-interest-bearing transaction accounts, including those of consumers and businesses, were insured by the FDIC over and above the customary $250,000 limit through December 31, 2012, the date on which this program expired. The expiration of this program could cause depositors of the Bank to withdraw deposits in excess of FDIC-insured levels. The withdrawal of these deposits could negatively impact the Bank's liquidity. Furthermore, the withdrawal of these deposits could negatively impact the Bank's cost of funds by potentially reducing its level of core deposits and increasing its need to rely on wholesale funding sources, which typically represent higher cost funds.

Legislative and regulatory actions taken now or in the future may increase our costs and impact our business, governance structure, financial condition or results of operations.

The Company and the Bank are subject to extensive regulation by multiple regulatory bodies. These regulations may affect the manner and terms of delivery of our services. If we do not comply with governmental regulations, we may be subject to fines, penalties, lawsuits or material restrictions on our businesses in the jurisdiction where the violation occurred, which may adversely affect our business operations. Changes in these regulations can significantly affect the services that we provide, as well as our costs of compliance with such regulations. In addition, adverse publicity and damage to our reputation arising from the failure or perceived failure to comply with legal, regulatory or contractual requirements could affect our ability to attract and retain customers.

Economic conditions in recent years, particularly in the financial markets, have resulted in government regulatory agencies and political bodies placing increased focus and scrutiny on the financial services industry. In recent years the U.S. government has intervened on an unprecedented scale by temporarily enhancing the liquidity support available to financial institutions. This environment has subjected financial institutions to additional restrictions, oversight and costs. In addition, new legislative and regulatory proposals continue to be introduced that could further substantially increase the oversight of the financial services industry, impose restrictions on the operations and general ability of firms within the industry to conduct business consistent with historical practices, including in the areas of compensation, interest rates, financial product offerings and disclosures, and have an effect on bankruptcy proceedings with respect to consumer residential real estate mortgages, among other things. If these regulatory trends continue, they could adversely affect our business and, in turn, our consolidated results of operations.

Table of Contents

Monetary policies and regulations of the Federal Reserve could adversely affect our business, financial condition and results of operations.

In addition to being affected by general economic conditions, our earnings and growth are affected by the policies of the Federal Reserve. An important function of the Federal Reserve is to regulate the money supply and credit conditions. Among the instruments used by the Federal Reserve to implement these objectives are open market operations in U.S. government securities, adjustments of the discount rate and changes in reserve requirements against bank deposits. These instruments are used in varying combinations to influence overall economic growth and the distribution of credit, bank loans, investments and deposits. Their use also affects interest rates charged on loans or paid on deposits.

The monetary policies and regulations of the Federal Reserve have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future. The effects of such policies upon our business, financial condition and results of operations cannot be predicted.

Legislative and regulatory reforms applicable to the financial services industry may, if enacted or adopted, have a significant impact on our business, financial condition and results of operations.

On July 21, 2010, the Dodd-Frank Act was signed into law, which requires significant changes to the regulation of financial institutions and the financial services industry. The Dodd-Frank Act, together with the regulations developed and to be developed thereunder, includes provisions affecting large and small financial institutions alike, including several provisions that will affect how community banks, thrifts and small bank and thrift holding companies will be regulated in the future.

Ultimately, the Dodd-Frank Act will, among other things: impose new capital requirements on bank holding companies; change the base for FDIC insurance assessments to a bank's average consolidated total assets minus average tangible equity, rather than upon its deposit base; permanently raise the standard deposit insurance limit to $250,000; and expand the FDIC's authority to raise insurance premiums. The legislation also called for the FDIC to raise the ratio of reserves to deposits from 1.15% to 1.35% for deposit insurance purposes by September 30, 2020 and to "offset the effect" of increased assessments on insured depository institutions with assets of less than $10 billion. The Dodd-Frank Act also authorized the Federal Reserve to limit interchange fees payable on debit card transactions, allowed financial institutions to pay interest on business checking accounts, established the Bureau of Consumer Financial Protection as an independent entity within the Federal Reserve, with broad rulemaking, supervisory and enforcement authority over consumer financial products and services, including deposit products, residential mortgages, home-equity loans and credit cards, and contains provisions on mortgage-related matters, such as steering incentives, determinations as to a borrower's ability to repay and prepayment penalties. The Dodd-Frank Act also includes provisions that have affected, and will further affect in the future, corporate governance and executive compensation at all publicly-traded companies.

The Group of Governors and Heads of Supervision, the oversight body of the Basel Committee on Banking Supervision, adopted Basel III in September 2010, which constitutes a strengthened set of capital requirements for banking organizations in the United States and around the world. Basel III is currently the subject of notices of proposed rulemakings released in June of 2012 by the respective U.S. federal banking agencies. The comment period for these notices of proposed rulemakings ended on October 22, 2012, but final regulations have not yet been released. Basel III was intended to be implemented beginning January 1, 2013 and to be fully-phased in on a global basis on January 1, 2019. However, on November 9, 2012, the U.S. federal bank regulatory agencies announced that the implementation of the proposed rules to effect Basel III in the United States was indefinitely delayed. Basel III would require capital to be held in the form of tangible common equity, generally increase the required capital ratios, phase out certain kinds of intangibles treated as capital and certain types of instruments, like trust preferred securities, and change the risk weightings of assets used to determine required capital ratios.

These provisions, or any other aspects of current or proposed regulatory or legislative changes to laws applicable to the financial industry, if enacted or adopted, may impact the profitability of our business activities or change certain of our business practices, including the ability to offer new products, obtain financing, attract deposits, make loans, and achieve satisfactory interest spreads, and could expose us to additional costs, including increased compliance costs. These changes also may require us to invest significant management attention and resources to make any necessary changes to operations in order to comply, and could therefore also materially and adversely affect our business, financial condition and results of operations. Our management continues to stay abreast of developments with respect to the Dodd-Frank Act, many provisions of which will continue to be phased-in over the next several months and years, and Basel III, the implementation of which has been delayed, and continues to assess their impact on our operations. The ultimate effect of these regulations on the financial services industry in general, and us in particular, cannot be quantified at this time.

Table of Contents

Our ability to pay dividends is subject to certain limitations and restrictions, and there is no guarantee that we will be able to continue paying the same level of dividends in the future that we paid in 2012 or that we will be able to pay future dividends at all.

Our ability to pay dividends is limited by regulatory restrictions and the need to maintain sufficient consolidated capital. The ability of MidWestOne Bank to pay dividends to us is limited by its obligations to maintain sufficient capital and liquidity and by other general restrictions on dividends that are applicable to MidWestOne Bank, including the requirement under the Iowa Banking Act that it may not pay dividends in excess of its accumulated net profits. If these regulatory requirements are not met, MidWestOne Bank will not be able to pay dividends to us, and we may be unable to pay dividends on our common stock.

In addition, as a bank holding company, our ability to declare and pay dividends is subject to the guidelines of the Federal Reserve regarding capital adequacy and dividends. The Federal Reserve guidelines generally require us to review the effects of the cash payment of dividends on common stock and other Tier 1 capital instruments (i.e., perpetual preferred stock and trust preferred debt) in light of our earnings, capital adequacy and financial condition. As a general matter, the Federal Reserve indicates that the board of directors of a bank holding company (including a financial holding company) should eliminate, defer or significantly reduce the Company's dividends if:

- the company's net income available to shareholders for the past four quarters, net of dividends previously paid during that period, is not sufficient to fully fund the dividends;
- the prospective rate of earnings retention is inconsistent with the company's capital needs and overall current and prospective financial condition; or
- the company will not meet, or is in danger of not meeting, its minimum regulatory capital adequacy ratios.

As of December 31, 2012, we had $15.5 million of junior subordinated debentures held by a statutory business trust that we control. Interest payments on the debentures, which totaled $0.7 million for the year ended December 31, 2012, must be paid before we pay dividends on our capital stock, including our common stock. We have the right to defer interest payments on the debentures for up to 20 consecutive quarters. However, if we elect to defer interest payments, all deferred interest must be paid before we may pay dividends on our capital stock.

Our ability to attract and retain management and key personnel may affect future growth and earnings.

Much of our success and growth has been influenced by our ability to attract and retain management experienced in banking and financial services and familiar with the communities in our market areas. Our ability to retain our executive officers, current management teams, branch managers and loan officers will continue to be important to the successful implementation of our strategy. It is also critical, as we grow, to be able to attract and retain qualified additional management and loan officers with the appropriate level of experience and knowledge about our market areas to implement our community based operating strategy. The Dodd-Frank Act also directs the Federal Reserve to promulgate rules prohibiting excessive compensation paid to bank holding company executives. These rules, when adopted, may make it more difficult to attract and retain the people we need to operate our businesses and limit our ability to promote our objectives through our compensation and incentive programs. The unexpected loss of services of any key management personnel, or the inability to recruit and retain qualified personnel in the future, could have an adverse effect on our business, results of operations and financial condition.

We face intense competition in all phases of our business from banks and other financial institutions.

The banking and financial services businesses in our markets are highly competitive. Our competitors include large regional banks, local community banks, savings and loan associations, securities and brokerage companies, mortgage companies, insurance companies, finance companies, money market mutual funds, small local credit unions as well as large aggressive and expansion-minded credit unions, and other nonbank financial services providers. Many of these competitors are not subject to the same regulatory restrictions as we are. Many of our unregulated competitors compete across geographic boundaries and are able to provide customers with a competitive alternative to traditional banking services.

Increased competition in our markets may result in a decrease in the amounts of our loans and deposits, reduced spreads between loan rates and deposit rates or loan terms that are more favorable to the borrower. Any of these results could have a material adverse effect on our ability to grow and remain profitable. If increased competition causes us to significantly discount the interest rates we offer on loans or increase the amount we pay on deposits, our net interest income could be adversely impacted. If increased competition causes us to modify our underwriting standards, we could be exposed to higher losses from lending activities. Additionally, many of our competitors are much larger in total assets and capitalization, have greater access to capital markets, have larger lending limits and offer a broader range of financial services than we can offer.

Table of Contents

We have a continuing need for technological change, and we may not have the resources to effectively implement new technology.

The financial services industry continues to undergo rapid technological changes with frequent introductions of new technology-driven products and services. In addition to enabling us to better serve our customers, the effective use of technology increases efficiency and the potential for cost reduction. Our future success will depend in part upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands for convenience as well as to create additional efficiencies in our operations as we continue to grow our market share. Many of our larger competitors have substantially greater resources to invest in technological improvements. As a result, they may be able to offer additional or superior products to those that we will be able to offer, which could put us at a competitive disadvantage. Accordingly, we cannot provide you with assurance that we will be able to effectively implement new technology-driven products and services or be successful in marketing such products and services to our customers.

System failure or breaches of our network security could subject us to increased operating costs as well as litigation and other liabilities.

The computer systems and network infrastructure we use could be vulnerable to unforeseen problems. Our operations are dependent upon our ability to protect our computer equipment against damage from physical theft, fire, power loss, telecommunications failure or a similar catastrophic event, as well as from security breaches, denial of service attacks, viruses, worms and other disruptive problems caused by hackers. Any damage or failure that causes an interruption in our operations could have a material adverse effect on our financial condition and results of operations. Computer break-ins, phishing and other disruptions could also jeopardize the security of information stored in and transmitted through our computer systems and network infrastructure, as well as that of our customers engaging in Internet banking activities, which may result in significant liability to us and may cause existing and potential customers to refrain from doing business with us. Although we, with the help of third-party service providers, intend to continue to implement security technology and establish operational procedures to prevent such damage, there can be no assurance that these security measures will be successful. In addition, advances in computer capabilities, new discoveries in the field of cryptography or other developments could result in a compromise or breach of the algorithms we and our third-party service providers use to encrypt and protect customer transaction data. Any interruption in, or breach in security of, our computer systems and network infrastructure, or that of our Internet banking customers, could damage our reputation, result in a loss of customer business, subject us to additional regulatory scrutiny, or expose us to civil litigation and possible financial liability, any of which could have a material adverse effect on our financial condition and results of operations.

We are subject to certain operational risks, including, but not limited to, customer or employee fraud and data processing system failures and errors.

Employee errors and employee and customer misconduct could subject us to financial losses or regulatory sanctions and seriously harm our reputation. Misconduct by our employees could include hiding unauthorized activities from us, improper or unauthorized activities on behalf of our customers or improper use of confidential information. It is not always possible to prevent employee errors and misconduct, and the precautions we take to prevent and detect this activity may not be effective in all cases. Employee errors could also subject us to financial claims for negligence. We maintain a system of internal controls and insurance coverage to mitigate against operational risks, including data processing system failures and errors and customer or employee fraud. Should our internal controls fail to prevent or detect an occurrence, and if any resulting loss is not insured or exceeds applicable insurance limits, such failure could have a material adverse effect on our business, financial condition and results of operations.

Adverse weather affecting the markets we serve could hurt our business and prospects for growth.

Substantially all of our business is conducted in the State of Iowa, and a significant portion is conducted in rural communities. The Iowa economy, in general, is heavily dependent on agriculture and therefore the overall Iowa economy, and particularly the economies of the rural communities that we serve, can be greatly affected by severe weather conditions, including droughts, storms, tornadoes and flooding. Unfavorable weather conditions may decrease agricultural productivity or could result in damage to our branch locations or the property of our customers, all of which could adversely affect the local economy. An adverse affect on the economy of Iowa would negatively affect our profitability.

Our reputation could be damaged by negative publicity.

Reputational risk, or the risk to our business, financial condition or results of operations from negative publicity, is inherent in our business. Negative publicity can result from actual or alleged conduct in a number of areas, including legal and regulatory

Table of Contents

compliance, lending practices, corporate governance, litigation, inadequate protection of customer data, ethical behavior of our employees, and from actions taken by regulators, ratings agencies and others as a result of that conduct. Damage to our reputation could impact our ability to attract new or maintain existing loan and deposit customers, employees and business relationships.

We have counterparty risk and therefore we may be adversely affected by the soundness of other financial institutions.

Our ability to engage in routine funding and other transactions could be negatively affected by the actions and the soundness of other financial institutions. Financial services institutions are generally interrelated as a result of trading, clearing, counterparty, credit or other relationships. We have exposure to many different industries and counterparties and regularly engage in transactions with counterparties in the financial services industry, including commercial banks, brokers and dealers, investment banks and other institutional customers. Many of these transactions may expose us to credit or other risks if another financial institution experiences adverse circumstances. In certain circumstances, the collateral that we hold may be insufficient to fully cover the risk that a counterparty defaults on its obligations, which may cause us to experience losses that could have a material adverse effect on our business, financial condition and results of operations.

There is a limited trading market for our common shares, and you may not be able to resell your shares at or above the price you paid for them.

Although our common shares are listed for quotation on The NASDAQ Global Select Market, the trading in our common shares has substantially less liquidity than many other companies listed on NASDAQ. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the market of willing buyers and sellers of our common shares at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which we have no control. We cannot assure you that the volume of trading in our common shares will increase in the future.

Certain MidWestOne shareholders own a significant interest in the company and may exercise their control in a manner detrimental to your interests.

Certain MidWestOne shareholders who are descendants of our founder collectively control approximately 33.2% of our outstanding common stock and may have the opportunity to exert influence on the outcome of matters required to be submitted to shareholders for approval. In addition, this significant level of ownership by members of the founding family may contribute to the rather limited liquidity of our common stock on the NASDAQ Global Select Market.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

None.

Table of Contents

ITEM 2. PROPERTIES.

Our headquarters and MidWestOne Bank's main office are located at 102 South Clinton Street, Iowa City, Iowa, and consist of approximately 63,800 square feet. We currently operate 24 additional branches throughout central and east-central Iowa totaling approximately 120,000 square feet. The table below sets forth the locations of the Bank's branch offices:

802 13th St. Belle Plaine, Iowa	3225 Division St. Burlington, Iowa
4510 Prairie Pkwy. Cedar Falls, Iowa	120 W. Center St. Conrad, Iowa
110 1st Ave. Coralville, Iowa	101 W. Second St., Suite 100 † Davenport, Iowa
2408 W. Burlington Fairfield, Iowa	58 East Burlington Fairfield, Iowa
926 Ave. G Ft. Madison, Iowa	509 S. Dubuque St. *† Iowa City, Iowa
1906 Keokuk St. Iowa City, Iowa	2233 Rochester Ave. Iowa City, Iowa
202 Main St. Melbourne, Iowa	10030 Hwy. 149 North English, Iowa
465 Hwy. 965 NE, Suite A † North Liberty, Iowa	124 South First St. Oskaloosa, Iowa
222 First Ave. East * Oskaloosa, Iowa	116 W. Main St. Ottumwa, Iowa
1001 Hwy. 57 Parkersburg, Iowa	700 Main St. Pella, Iowa
500 Oskaloosa St.* Pella, Iowa	112 North Main St. Sigourney, Iowa
3110 Kimball Ave. Waterloo, Iowa	305 W. Rainbow Dr. West Liberty, Iowa

* Drive up location only.
† Leased office.

In addition to the Bank's branch offices, the insurance subsidiary leases one property totaling approximately 4,800 square feet at 309 High Avenue East, Oskaloosa, Iowa. The Bank owns 40 ATMs that are located within the communities served by branch offices. We believe each of our facilities is suitable and adequate to meet our current operational needs.

In February 2012 we relocated our Belle Plaine office to a new full service branch facility with attached drive up, at which time we closed our former Belle Plaine office. The new office not only increased the efficiency of our operations in Belle Plaine, but was necessitated by continued market growth in the community. In the second quarter of 2012 we completed the sale of our former Home Mortgage Center (”HMC”) office to the University of Iowa for their future building plans. Our HMC operation then relocated to leased space at 509 South Dubuque Street in Iowa City, approximately one block away from our former building, where it will remain pending the eventual construction of a new building next to the current leased space.

Table of Contents

ITEM 3. LEGAL PROCEEDINGS.

We and our subsidiaries are from time to time parties to various legal actions arising in the normal course of business. We believe that there is no threatened or pending proceeding against us or our subsidiaries, which, if determined adversely, would have a material adverse effect on our consolidated business or financial condition.

ITEM 4. MINE SAFETY DISCLOSURES.

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

Our common stock is listed on the NASDAQ Global Select Market under the symbol “MOFG.” The following table presents for the periods indicated the high and low sale price for our common stock as reported on the NASDAQ Global Select Market:

	High	Low	Cash Dividend Declared
2011			
First Quarter	$15.45	$13.62	$0.05
Second Quarter	14.89	12.20	0.05
Third Quarter	15.00	13.75	0.06
Fourth Quarter	15.15	13.66	0.06
2012			
First Quarter	$19.36	$14.41	$0.085
Second Quarter	22.20	18.76	0.085
Third Quarter	23.25	20.58	0.095
Fourth Quarter	22.50	19.31	0.095

As of March 5, 2013, there were 8,498,484 shares of common stock outstanding held by approximately 509 holders of record. Additionally, there are an estimated 1,872 beneficial holders whose stock was held in street name by brokerage houses and other nominees as of that date.

Dividends

We may pay dividends on our common stock as and when declared by our Board of Directors out of any funds legally available for the payment of such dividends, subject to any and all preferences and rights of any preferred stock or a series thereof. The amount of dividend payable will depend upon our earnings and financial condition and other factors, including applicable governmental regulations and policies. See “Supervision and Regulation - The Company - Dividend Payments”

Repurchases of Company Equity Securities

On July 26, 2011, our Board of Directors authorized the implementation of a share repurchase program to repurchase up to $1.0 million of the Company’s outstanding shares of common stock through December 31, 2011. Pursuant to the program, we repurchased 45,039 shares of common stock during the third quarter of 2011 for an aggregate cost of $658,000. On October 18, 2011, our Board of Directors amended the Company’s share repurchase program by increasing the remaining amount of authorized repurchases to $5.0 million, and extending the expiration of the program to December 31, 2012. For the year of 2012 we repurchased a total of 104,518 shares of common stock at a cost of $1.8 million, with $2.4 million remaining in the share repurchase program at December 31, 2012, the expiration date of this program.

On January 15, 2013, our Board of Directors announced the renewal of the Company's share repurchase program, extending the expiration of the program to December 31, 2014 and increasing the remaining amount of authorized repurchases under the program to $5.0 million from the approximately $2.4 million of authorized repurchases that had previously remained. Pursuant to the program, we may continue to repurchase shares from time to time in the open market, and the method, timing and amounts of repurchase will be solely in the discretion of the Company's management. The repurchase program does not require us to acquire

Table of Contents

a specific number of shares. Therefore, the amount of shares repurchased pursuant to the program will depend on several factors, including market conditions, capital and liquidity requirements, and alternative uses for cash available.
The following table sets forth information about the Company's purchases of its common stock in the 4th quarter of 2012:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Programs	Approximate Dollar Value of Shares That May Yet Be Purchased Under the Program
October 1 - 31, 2012	—	$—	—	$2,715,851
November 1 - 30, 2012	18,435	19.82	365,310.94	2,350,540
December 1 - 31, 2012	—	—	—	2,350,540
Total	18,435	$—	365,310.94	$2,350,540

Performance Graph
The following table compares MidWestOne's performance, as measured by the change in price of its common stock plus reinvested dividends, with the NASDAQ Composite Index and the SNL-Midwestern Banks Index for the five years ended December 31, 2012.
MidWestOne Financial Group, Inc.

Table of Contents

Index	At 12/31/2007	12/31/2008	12/31/2009	12/31/2010	12/31/2011	12/31/2012
MidWestOne Financial Group, Inc.	100.00	55.24	50.81	89.15	87.58	125.14
NASDAQ Composite	100.00	60.02	87.24	103.08	102.26	120.42
SNL-Midwestern Banks Index	100.00	65.79	55.75	69.23	65.39	78.71

For the year ended December 31, 2007, our common stock was not traded on the NASDAQ Stock Market or any other stock exchange, but it was quoted on The Pink Sheets LLC. Accordingly, the price in the graph above for such period reflects the most recent price quoted on The Pink Sheets LLC as of such date.

The banks in the custom peer group - SNL-Midwestern Banks Index - represent all publicly traded banks, thrifts or financial service companies located in Iowa, Illinois, Indiana, Kansas, Kentucky, Michigan, Minnesota, Missouri, North Dakota, Nebraska, Ohio, South Dakota and Wisconsin.

Table of Contents

ITEM 6. SELECTED FINANCIAL DATA.

The following selected financial data for each of the five years in the period ended December 31, 2012, have been derived from our audited consolidated financial statements and the results of operations for each of the five years in the period ended December 31, 2012. This financial data should be read in conjunction with the financial statements and the related notes thereto.

	December 31,				
Year Ended (In thousands, except per share data)	2012	2011	2010	2009	2008
Summary of Income Data:					
Total interest income excluding loan pool participations	$67,324	$67,473	$68,350	$71,549	$65,747
Total interest and discount on loan pool participations	1,978	1,108	2,631	1,809	4,459
Total interest income including loan pool participations	69,302	68,581	70,981	73,358	70,206
Total interest expense	15,952	19,783	23,116	28,243	30,395
Net interest income	53,350	48,798	47,865	45,115	39,811
Provision for loan losses	2,379	3,350	5,950	7,725	4,366
Noninterest income	20,082	14,716	14,907	12,519	5,542
Noninterest expense	48,960	42,235	43,289	45,579	65,999
Income (loss) before income tax	22,093	17,929	13,533	4,330	(25,012)
Income tax expense (benefit)	5,342	4,612	3,403	(79)	(450)
Net income (loss)	$16,751	$13,317	$10,130	$4,409	$(24,562)
Less: Preferred stock dividends and discount accretion	—	645	868	779	—
Net income (loss) available to common shareholders	$16,751	$12,672	$9,262	$3,630	$(24,562)
Per share data:					
Net income (loss) - basic	$1.97	$1.47	$1.08	$0.42	$(3.09)
Net income (loss) - diluted	1.96	1.47	1.07	0.42	(3.09)
Net income (loss), exclusive of loss on termination of pension and gain on sale of Home Mortgage Center - diluted	2.12	1.47	1.07	0.42	(3.09)
Cash dividends declared	0.36	0.22	0.20	0.30	0.46
Book value	20.51	18.35	18.39	17.69	15.15
Net tangible book value	19.39	17.15	15.27	14.42	13.58
Selected financial ratios:					
Return on average assets	0.97%	0.82%	0.65%	0.29%	(1.61)%
Return on average assets, exclusive of loss on termination of pension and gain on sale of Home Mortgage Center	1.05%	0.82%	0.65%	0.29%	(1.61)%
Return on average shareholders' total equity	10.13	8.42	6.44	2.99	(15.96)
Return on average shareholders' total equity, exclusive of loss on termination of pension and gain on sale of Home Mortgage Center	10.90	8.42	6.44	2.99	(15.96)
Return on average common equity	10.13	8.87	7.16	3.31	(15.96)

Return on average tangible common equity	11.09	9.51	7.66	3.64	(6.16)
Return on average tangible common equity, exclusive of loss on termination of pension and gain on sale of Home Mortgage Center	11.92	9.51	7.66	3.64	(6.16)
Dividend payout ratio	18.27	14.97	18.52	71.43	NM
Total shareholders' equity to total assets	9.70	9.23	10.02	9.92	8.66
Tangible common equity to tangible assets	9.22	8.68	8.37	8.16	7.81
Tier 1 capital to average assets	9.82	9.60	10.45	10.01	8.75
Tier 1 capital to risk-weighted assets	12.78	12.40	13.37	12.66	10.28
Net interest margin	3.46	3.34	3.43	3.27	3.29
Efficiency ratio	67.32	62.94	64.44	71.92	70.71
Efficiency ratio, exclusive of loss on termination of pension	58.82	62.94	64.44	71.92	70.71
Gross revenue of loan pools to total gross revenue	2.69	1.74	4.19	3.14	9.83
Allowance for bank loan losses to total bank loans	1.54	1.59	1.62	1.44	1.08
Allowance for loan pool losses to total loan pools	5.65	4.09	3.14	2.51	2.29
Non-performing loans to total loans	1.03	1.84	2.11	1.44	1.50
Net loans charged off to average loans	0.21	0.30	0.50	0.48	0.48

Table of Contents

Year Ended (In thousands)	December 31, 2012	2011	2010	2009	2008
Selected balance sheet data:					
Total assets	$1,792,819	$1,695,244	$1,581,259	$1,534,783	$1,508,962
Total loans net of unearned discount	1,035,284	986,173	938,035	966,998	1,014,814
Allowance for loan losses	15,957	15,676	15,167	13,957	10,977
Loan pool participations, net	35,650	50,052	65,871	83,052	92,932
Total deposits	1,399,733	1,306,642	1,219,328	1,179,868	1,128,189
Federal funds purchased and repurchase agreements	68,823	57,207	50,194	44,973	57,299
Federal Home Loan Bank advances	120,120	140,014	127,200	130,200	158,782
Long-term debt	15,464	15,464	15,464	15,588	15,640
Total shareholders' equity	173,932	156,494	158,466	152,208	130,342

NM - Percentage calculation not considered meaningful.

Non-GAAP Presentations:

Certain non-GAAP ratios are provided to evaluate and measure the Company's operating performance and financial condition, including return on average tangible common equity, tangible common equity to tangible assets, Tier 1 capital to average assets, Tier 1 capital to risk-weighted assets, and efficiency ratio, as well as certain of these and other financial metrics excluding the effects of a loss on termination of pension and gain on sale of Home Mortgage Center, as further discussed under Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations. Management believes these ratios provide investors with information regarding the Company's balance sheet, profitability, financial condition and capital adequacy and how management evaluates such metrics internally. The following tables provide a reconciliation of each non-GAAP measure to the most comparable GAAP equivalent.

(dollars in thousands)	As of or for the Year Ended December 31, 2012	2011	2010	2009	2008
Average tangible common equity					
Average total shareholders' equity	$165,429	$158,146	$157,190	$147,544	$138,603
Less: Average preferred stock	—	(8,032)	(15,734)	(14,172)	—
Average goodwill and intangibles	(9,785)	(10,613)	(11,760)	(12,833)	(32,242)
Average tangible common equity	$155,644	$139,501	$129,696	$120,539	$106,361
Income					
Net income available to common shareholders	$16,751	$12,672	$9,262	$3,630	$(24,562)
Plus: Intangible amortization, net of tax(1)	513	591	679	753	18,015
Adjusted net income available to common shareholders	$17,264	$13,263	$9,941	$4,383	$(6,547)
Plus: Loss on termination of pension	6,088	—	—	—	—
Less: Gain on sale of Home Mortgage Center	(4,047)	—	—	—	—
Net tax effect of above items(2)	(755)	—	—	—	—
Adjusted net income available to common shareholders, exclusive of loss on termination of pension and gain on sale of Home Mortgage Center	$18,550	$13,263	$9,941	$4,383	$(6,547)
	11.09%	9.51%	7.66%	3.64%	(6.16)%

Return on average tangible common equity					
Return on average tangible common equity, exclusive of loss on termination of pension and gain on sale of Home Mortgage Center	11.92 %	9.51 %	7.66 %	3.64 %	(6.16)%
Tangible Common Equity					
Total shareholders' equity	$173,932	$156,494	$158,466	$152,208	$130,342
Less: Preferred stock	—	—	(15,767)	(15,699)	—
Goodwill and intangibles	(9,469)	(10,247)	(11,243)	(12,272)	(13,524)
Tangible common equity	$164,463	$146,247	$131,456	$124,237	$116,818
Tangible Assets					
Total assets	$1,792,819	$1,695,244	$1,581,259	$1,534,783	$1,508,962
Less: Goodwill and intangibles	(9,469)	(10,247)	(11,243)	(12,272)	(13,524)
Tangible Assets	$1,783,350	$1,684,997	$1,570,016	$1,522,511	$1,495,438
Tangible common equity to tangible assets	9.22 %	8.68 %	8.37 %	8.16 %	7.81 %

31

Table of Contents

	As of or for the Year Ended December 31,				
(dollars in thousands)	2012	2011	2010	2009	2008
Tier 1 capital					
Total shareholders' equity	$173,932	$156,494	$158,466	$152,208	$130,342
Plus: Long term debt (qualifying restricted core capital)	15,464	15,464	15,464	15,464	15,464
Less: Net unrealized (gains) loss on securities available for sale	(8,180)	(3,328)	1,826	(1,505)	(1,007)
Disallowed goodwill and intangibles	(9,617)	(10,374)	(11,327)	(12,286)	(13,439)
Tier 1 capital	$171,599	$158,256	$164,429	$153,881	$131,360
Average Assets					
Quarterly average assets	$1,757,910	$1,658,738	$1,584,616	$1,549,049	$1,514,043
Less: Disallowed goodwill and intangibles	(9,617)	(10,374)	(11,327)	(12,286)	(13,439)
Average assets	$1,748,293	$1,648,364	$1,573,289	$1,536,763	$1,500,604
Tier 1 capital to average assets	9.82%	9.60%	10.45%	10.01%	8.75%
Risk-weighted assets	$1,343,194	$1,276,512	$1,230,264	$1,215,240	$1,278,121
Tier 1 capital to risk-weighted assets	12.78%	12.40%	13.37%	12.66%	10.28%
Operating expense					
Total noninterest expense	$48,960	$42,235	$43,289	$45,579	$65,599
Less: Amortization of intangibles and goodwill impairment	(778)	(896)	(1,029)	(1,141)	(27,295)
Operating expense	$48,182	$41,339	$42,260	$44,438	$38,304
Less: Loss on termination of pension	(6,088)	—	—	—	—
Operating expense, exclusive of loss on termination of pension	$42,094	$41,339	$42,260	$44,438	$38,304
Operating Revenue					
Tax-equivalent net interest income[1]	$56,481	$51,261	$50,227	$47,682	$41,569
Plus: Noninterest income	20,082	14,716	14,907	12,519	5,542
Impairment losses on investment securities	—	—	189	2,404	6,194
Less: Gain (loss) on sale or call of available for sale securities	805	490	453	813	(346)
Gain (loss) on sale of premises and equipment	4,188	(195)	(709)	8	(516)
Operating Revenue	$71,570	$65,682	$65,579	$61,784	$54,167
Efficiency ratio	67.32%	62.94%	64.44%	71.92%	70.71%
Efficiency ratio, exclusive of loss on termination of pension	58.82%	62.94%	64.44%	71.92%	70.71%
Net income	$16,751	$13,317	$10,130	$4,409	$(24,562)
Net income available to common shareholders	$16,751	$12,672	$9,262	$3,630	$(24,562)
Plus: Loss on termination of pension	6,088	—	—	—	—

Less:	Gain on sale of Home Mortgage Center	(4,047)	—	—	—	—
	Net tax effect of above items(2)	(755)	—	—	—	—
Net income, exclusive of loss on termination of pension and gain on sale of Home Mortgage Center		$18,037	$13,317	$10,130	$4,409	$(24,562)
Net income available to common shareholders, exclusive of loss on termination of pension and gain on sale of Home Mortgage Center		$18,037	$12,672	$9,262	$3,630	$(24,562)
Average Assets		1,721,792	1,628,253	1,559,035	1,543,307	1,523,223
Average Equity		165,429	158,146	157,190	147,544	153,906
Diluted average number of shares		8,527,544	8,632,856	8,637,713	8,604,754	7,945,870
Return on average assets		0.97%	0.82%	0.65%	0.29%	(1.61)%
Return on average assets, exclusive of loss on termination of pension and gain on sale of Home Mortgage Center		1.05%	0.82%	0.65%	0.29%	(1.61)%

Table of Contents

	As of or for the Year Ended December 31,				
	2012	2011	2010	2009	2008
Return on average equity	10.13 %	8.42 %	6.44 %	2.99 %	(15.96)%
Return on average equity, exclusive of loss on termination of pension and gain on sale of Home Mortgage Center	10.90 %	8.42 %	6.44 %	2.99 %	(15.96)%
Earnings per common share-diluted	$1.96	$1.47	$1.07	$0.42	$(3.09)
Earnings per common share-diluted, exclusive of loss on termination of pension and gain on sale of Home Mortgage Center	$2.12	$1.47	$1.07	$0.42	$(3.09)

(1) Computed on a tax-equivalent basis, assuming a federal income tax rate of 34%

(2) Computed assuming a combined state and federal tax rate of 37%

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Overview

We are the holding company for MidWestOne Bank, an Iowa state non-member bank with its main office in Iowa City, Iowa. We are headquartered in Iowa City, Iowa, and are a bank holding company under the Bank Holding Company Act of 1956 that has elected to be a financial holding company. We also are the holding company for MidWestOne Insurance Services, Inc., which operates an insurance business through three agencies located in central and east-central Iowa.

MidWestOne Bank operates a total of 25 branch locations, plus its specialized Home Mortgage Center, in 15 counties throughout central and east-central Iowa. It provides full service retail banking in the communities in which its branch offices are and also offers trust and investment management services.

On March 14, 2008, we consummated our merger with the Former MidWestOne. Prior to such merger, we were named ISB Financial Corp. The results of operations for the year ended December 31, 2008, include our operations for the entire year as well as the operations of Former MidWestOne for the period beginning March 15, 2008, through December 31, 2008. That is, the results of operations include approximately two and one-half months of our stand-alone operations and nine and one-half months of the operations of the Company and Former MidWestOne on a consolidated basis. The results of operations for the years ended December 31, 2009, 2010, 2011, and 2012 include the operations of the combined Company for the entire period.

We reported record earnings in 2012. Company net income available to common shareholders was $16.8 million in 2012 which was a 32.2% increase over 2011's net income available to common shareholders of $12.7 million. Diluted earnings per share for 2012 were $1.96 per share, 33.3% higher than 2011's $1.47. For the second consecutive year we set an all-time record in net income and earnings per share. Return on assets ("ROA") and return on tangible common equity ("ROTCE") for the full year of 2012 of 0.97% and 11.09%, respectively, are well ahead of the 0.82% and 9.51%, respectively, for 2011. In the second quarter of 2012 we realized a $4.0 million gain on the sale of our Home Mortgage Center and a $6.1 million loss on the termination of our defined benefit pension plan. Excluding the effect of these two large non-recurring items that produced an after-tax net loss of $1.3 million, the ROA improves to 1.05% and the ROTCE improves to 11.92%.

The Company continues to grow and ended 2012 with assets of $1.8 billion which was $97.6 million higher than 2011 year ending assets of $1.7 billion. Total deposits increased during the year by more than $93.0 million to end 2012 at $1.4 billion. Bank loans also continued to increase, and ended the year at $1.0 billion, an increase of $49.1 million from December 31, 2011. This growth in assets continued to fuel growth in net interest income. Net interest income grew by 9.3% or $4.6 million for 2012 relative to the year ended December 31, 2011. Of concern is the Federal

Reserve's low interest rate policy and the pressure it places on both MidWestOne and the banking industry generally in efforts to grow or maintain net interest margins.

Most components of our noninterest income performed very well during 2012. Trust, investment and insurance fees were 10.1% higher than in 2011. Mortgage origination and loan servicing fees were $887,000 or 33.0% higher for 2012 than for 2011, due primarily to the current interest rate environment. Despite these general increases, continued restrictive federal regulations have resulted in across the board reductions in service charges and fees on deposit accounts; not only at MidWestOne but at many financial institutions. Service charges declined 12.3% in 2012 compared to 2011. The efficiency ratio showed improvement during 2012. When the aforementioned large one-time items are excluded, the efficiency ratio for the Company declined to 58.82% in 2012 from 62.94% in 2011. It is important that we continue to keep efficiency at these or better levels in order to meet our long term financial goals.

Table of Contents

By any measure, asset quality continues to be strong. The net bank loan charge-off rate as a percentage of average bank loans outstanding was 0.21% for 2012 compared to 0.30% in 2011. At year-end, non-performing loans were 1.03% of total bank loans outstanding, compared to 1.84% a year earlier. We continue to maintain what we believe is an appropriate loan loss reserve that was 1.54% of bank loans outstanding at year-end 2012, with our allowance for loan losses at 149.77% of nonperforming bank loans. Now, as always, we remain committed to outstanding asset quality.

We have been in the loan pool participations business since 1988. Loan pool participations are participation interests in performing, sub-performing and non-performing loans that were purchased from various non-affiliated banking organizations and are serviced by a third party. The “all-in” yield on these loan pool participations for 2012 improved to 4.44% from 1.85% in 2011. While 4.44% is not up to the historical yields in this line of business, it does represent the best full year yield since our merger in 2008. We remain committed to exiting this business and the year-end 2012 net balance of $35.7 million now represents only 1.99% of total assets.

Balance sheet metrics remain very strong and we believe that this strength provides us with great flexibility going forward. Year-end tangible common equity was 9.22% of tangible assets at December 31, 2012, up from 8.68% a year earlier. Tier 1 capital was also strong at 9.82% at December 31, 2012. The balance sheet continues to exhibit modest leverage with the bank loans and loan pool participations to deposit ratio at December 31, 2012 standing at 76.7%. This is down from 79.5% at December 31, 2011 and represents continued modest loan demand in our footprint. As we have stated in prior years, our goal is for this metric to be “in the 80's”. With our capital position strong, the Board of Directors increased the quarterly common dividend at its January 15, 2013 meeting, with the first quarter dividend being payable March 15, 2013 to shareholders of record as of March 1, 2013. The new quarterly dividend is $0.125 per share and represents an increase of 47.1% over the rate of our first quarter 2012 dividend.

Critical Accounting Estimates

We have identified the following critical accounting policies and practices relative to the reporting of our results of operations and financial condition. These accounting policies relate to the allowance for loan losses, participation interests in loan pools, intangible assets, and fair value of available for sale investment securities.

Allowance for Loan Losses

The allowance for loan losses is based on our estimate of probable incurred credit losses in our loan portfolio. In evaluating our loan portfolio, we take into consideration numerous factors, including current economic conditions, prior loan loss experience, the composition of the loan portfolio, and management’s estimate of probable credit losses. The allowance for loan losses is established through a provision for loss based on our evaluation of the risk inherent in the loan portfolio, the composition of the portfolio, specific impaired loans, and current economic conditions. Such evaluation, which includes a review of all loans on which full collectability may not be reasonably assured, considers, among other matters, the estimated net realizable value or the fair value of the underlying collateral, economic conditions, historical loss experience, and other factors that warrant recognition in providing for an appropriate allowance for loan losses. In the event that our evaluation of the level of the allowance for loan losses indicates that it is inadequate, we would need to increase our provision for loan losses. We believe the allowance for loan losses as of December 31, 2012, was adequate to absorb probable losses in the existing portfolio.

Participation Interests in Loan Pools

The loan pool accounting practice relates to our estimate that the investment amount reflected on our financial statements does not exceed the estimated net realizable value or the fair value of the underlying collateral securing the purchased loans. In evaluating the purchased loan pool, we take into consideration many factors, including the borrowers’ current financial situation, the underlying collateral, current economic conditions, historical collection experience, and other factors relative to the collection process. If the estimated net realizable value of the loan pool participations were to decline below their carrying amount, our yield on the loan pools would be reduced.

Intangible Assets

Intangible assets arise from purchase business combinations. As a general matter, intangible assets generated from purchase business combinations and deemed to have indefinite lives are not subject to amortization and are instead tested for impairment at least annually. The intangible assets reflected on our financial statements are deposit premium, insurance agency, trade name, and customer list intangibles. The establishment and subsequent amortization, when required by the accounting standards, of these intangible assets involves the use of significant estimates and assumptions. These estimates and assumptions include, among other things, the estimated cost to service deposits acquired, discount rates, estimated attrition rates and useful lives, future economic and market conditions, comparison of our market value to book value and determination of appropriate market comparables. Actual future results may differ from those estimates. We assess these intangible assets for impairment annually or more often if conditions indicate a possible impairment. Each quarter we evaluate the estimated useful lives of intangible assets and whether events or changes in circumstances warrant a revision to the remaining periods of amortization. Recoverability of these assets is measured by comparison of the carrying amount of the asset to the future undiscounted cash flows the asset is expected to generate. If the asset is considered to be impaired, the amount of any impairment is measured as the difference between the carrying value and the fair value of the impaired asset.

Fair Value of Available for Sale Securities

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. Declines in fair value of individual securities, below their amortized cost, are evaluated by management to determine whether the decline is temporary or "other-than-temporary.'' Declines in the fair value of available for sale securities below their cost that are deemed "other-than-temporary" are reflected in earnings as impairment losses. In determining whether other-than-temporary impairment exists, management considers whether: (1) we have the intent to sell the security, (2) it is more likely than not that we will be required to sell the security before recovery of the amortized cost basis, and (3) we do not expect to recover the entire amortized cost basis of the security. When we determine that other-than-temporary-impairment ("OTTI") has occurred, the amount of the OTTI recognized in earnings depends on whether we intend to sell the security or whether it is more likely than not we will be required to sell the security before recovery of its amortized cost basis. If we intend to sell, or it is more likely than not we will be required to sell, the security before recovery of its amortized cost basis, the OTTI recognized in earnings is equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. If we do not intend to sell the security, and it is not more likely than not that we 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 accumulated other comprehensive income (loss), 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.

Results of Operations - Three-Year Period Ended December 31, 2012

Summary

Our consolidated net income and net income available to common shareholders for the year ended December 31, 2012 was $16.8 million, or $1.96 per fully-diluted share, compared to net income of $13.3 million and net income available to common shareholders of $12.7 million, or $1.47 per fully-diluted share, for the year ended December 31, 2011. The increase in consolidated net income was due primarily to an increase in net interest income, after provision for loan losses, of $5.5 million. We also experienced an increase in noninterest income of $5.4 million, mainly due to the $4.0 million gain on the sale of the Home Mortgage Center location realized during the second quarter of 2012. Absent this gain, the increase in noninterest income for the period was $1.3 million, which was primarily due to a $0.9 million increase in mortgage origination and loan servicing fees to $3.6 million, compared with $2.7 million in 2011. Finally, noninterest expense increased to $49.0 million for the year ended December 31, 2012 from $42.2 million for 2011, mainly due to the $6.1 million loss related to the termination and liquidation of the Company's defined benefit pension plan in the second quarter of 2012, recorded in salaries and employee benefits expense. Absent that event, noninterest expense for the period increased $0.6 million, or 1.5%.

The consolidated net income for the year ended December 31, 2011 was $13.3 million. After subtracting preferred stock dividends and discount accretion of $0.6 million, net income available to common shareholders was $12.7 million, or $1.47 per fully-diluted share, compared to net income of $10.1 million and net income available to common shareholders of $9.3 million, or $1.07 per fully-diluted share, for the year ended December 31, 2010. The increase in consolidated net income was due primarily to an increase in net interest income, after provision for loan losses, of $3.5 million. We also experienced a decrease in noninterest income of $0.2 million, mainly due to a decrease in mortgage origination and loan servicing fees of $0.8 million, as such amount declined to $2.7 million in 2011 from $3.5 million in 2010. Finally, decreased noninterest expense provided a $1.1 million positive impact to earnings in 2011 as compared to 2010, primarily due to a $1.2 million decline in FDIC insurance expense.

We ended the year 2012 with an allowance for loan losses of $16.0 million, which represented 149.8% coverage of our nonperforming bank loans (excluding loan pool participations) at December 31, 2012 as compared to 86.6% coverage of our nonperforming bank loans at December 31, 2011 and 76.7% at December 31, 2010. Nonperforming loans totaled $10.7 million as of December 31, 2012 compared with $18.1 million and $19.8 million at December 31, 2011 and December 31, 2010, respectively. For the year ended December 31, 2012, the provision for loan losses decreased to $2.4 million from $3.4 million for 2011, which had decreased from $6.0 million for 2010.

Various operating and equity ratios for the Company are presented in the table below for the years indicated. The dividend payout ratio represents the percentage of our prior year’s net income that is paid to shareholders in the form of cash dividends. Average equity to average assets is a measure of capital adequacy that presents the percentage of average total shareholders’ equity compared to our average assets. The equity to assets ratio is expressed using the period-end amounts instead of an average amount. As of December 31, 2012, under regulatory standards, MidWestOne Bank had capital levels in excess of the minimums necessary to be considered “well capitalized,” which is the highest regulatory designation.

	12/31/2012		12/31/2011		12/31/2010	
Return on average assets	0.97	%	0.82	%	0.65	%
Return on average assets, exclusive of loss on termination of pension and gain on sale of Home Mortgage Center	1.05		0.82	%	0.65	%
Return on average shareholders' total equity	10.13		8.42		6.44	
Return on average shareholders’ total equity, exclusive of loss on termination of pension and gain on sale of Home Mortgage Center	10.90		8.42		6.44	
Return on average common equity	10.13		8.87		7.16	
Return on average tangible common equity	11.09		9.51		7.66	
Return on average tangible common equity, exclusive of loss on termination of pension and gain on sale of Home Mortgage Center	11.92		9.51		7.66	
Dividend payout ratio	18.27		14.97		18.52	
Average equity to average assets	9.75		9.71		10.08	
Equity to assets ratio (at period end)	9.70		9.23		10.02	

For information on the calculation of certain non-GAAP measures please see pages 31 to 33.

Net Interest Income

Net interest income is the difference between interest income and fees earned on earning assets, less interest expense incurred on interest-bearing liabilities. Interest rate levels and volume fluctuations within earning assets and interest-bearing liabilities impact net interest income. Net interest margin is tax-equivalent net interest income as a percent of average earning assets.

Certain assets with tax favorable treatment are evaluated on a tax-equivalent basis. Tax-equivalent basis assumes a federal income tax rate of 34%. Tax favorable assets generally have lower contractual pre-tax yields than fully taxable assets. A tax-equivalent analysis is performed by adding the tax savings to the earnings on tax favorable assets. After factoring in the tax favorable effects of these assets, the yields may be more appropriately evaluated against alternative earning assets. In addition to yield, various other risks are factored into the evaluation process.

Table of Contents

The following table shows the consolidated average balance sheets, detailing the major categories of assets and liabilities, the interest income earned on interest-earning assets, the interest expense paid for the interest-bearing liabilities, and the related interest rates/yields for the periods, or as of the dates, shown. Average information is provided on a daily average basis.

	Year ended December 31,								
	2012			2011			2010		
(dollars in thousands)	Average Balance	Interest Income/ Expense	Average Rate/Yield	Average Balance	Interest Income/ Expense	Average Rate/Yield	Average Balance	Interest Income/ Expense	Average Rate/Yield
Average earning assets:									
Loans [1][2][3]	$1,001,259	$52,182	5.21 %	$953,392	$52,636	5.52 %	$955,562	$55,055	5.76 %
Loan pool participations [4]	44,507	1,978	4.44	59,972	1,108	1.85	78,150	2,631	3.37
Investment securities:									
Taxable investments	408,600	10,836	2.65	382,064	10,934	2.86	302,435	9,667	3.20
Tax exempt investments [2]	154,289	7,382	4.78	125,402	6,329	5.05	113,136	5,950	5.26
Total investment securities	562,889	18,218	3.24	507,466	17,263	3.40	415,571	15,617	3.76
Federal funds sold and interest-bearing balances	22,180	55	0.25	15,766	37	0.23	16,982	40	0.24
Total earning assets	$1,630,835	$72,433	4.44 %	$1,536,596	$71,044	4.62 %	$1,466,265	$73,343	5.00 %
Noninterest-earning assets:									
Cash and due from banks	21,854			19,413			19,464		
Premises and equipment	25,544			25,886			27,995		
Allowance for loan losses	(18,078)			(17,878)			(16,958)		
Other assets	61,637			64,236			62,269		
Total assets	$1,721,792			$1,628,253			$1,559,035		
Average interest-bearing liabilities:									
Savings and interest-bearing demand deposits	$604,788	$3,150	0.52 %	$544,605	$4,091	0.75 %	$487,873	$4,443	0.91 %
Certificates of deposit	559,847	8,814	1.57	569,067	11,231	1.97	566,196	13,137	2.32
Total deposits	1,164,635	11,964	1.03	1,113,672	15,322	1.38	1,054,069	17,580	1.67
Federal funds purchased and repurchase agreements	56,716	204	0.36	48,410	272	0.56	43,545	303	0.70
Federal Home Loan Bank borrowings	132,786	3,094	2.33	131,306	3,494	2.66	132,656	4,650	3.51
	16,095	690	4.29	16,200	695	4.29	16,385	583	3.56

Long-term debt and other									
Total borrowed funds	205,597	3,988	1.94	195,916	4,461	2.28	192,586	5,536	2.87
Total interest-bearing liabilities	$1,370,232	$15,952	1.16 %	$1,309,588	$19,783	1.51 %	$1,246,655	$23,116	1.85 %
Net interest spread (2)			3.28 %			3.11 %			3.15 %
Noninterest-bearing liabilities									
Demand deposits	170,841			149,033			138,682		
Other liabilities	15,290			11,486			16,508		
Shareholders' equity	165,429			158,146			157,190		
Total liabilities and shareholders' equity	$1,721,792			$1,628,253			$1,559,035		
Interest income/earning assets (2)	$1,630,835	$72,433	4.44 %	$1,536,596	$71,044	4.62 %	$1,466,265	$73,343	5.00 %
Interest expense/earning assets	$1,630,835	$15,952	0.98 %	$1,536,596	$19,783	1.29 %	$1,466,265	$23,116	1.58 %
Net interest income/margin (2)(5)		$56,481	3.46 %		$51,261	3.34 %		$50,227	3.43 %
Non-GAAP to GAAP Reconciliation:									
Tax Equivalent Adjustment:									
Loans		827			473			324	
Securities		2,304			1,990			2,038	
Total tax equivalent adjustment		3,131			2,463			2,362	
Net Interest Income		$53,350			$48,798			$47,865	

(1) Loan fees included in interest income are not material.
(2) Computed on a tax-equivalent basis, assuming a federal income tax rate of 34%.
(3) Non-accrual loans have been included in average loans, net of unearned discount.
(4) Includes interest income and discount realized on loan pool participations.
(5) Net interest margin is tax-equivalent net interest income as a percentage of average earning assets.

Table of Contents

The following schedule presents the dollar amount of changes in interest income and interest expense for major components of interest-earning assets and interest-bearing liabilities. It distinguishes between the difference related to changes in average outstanding balances and the increase or decrease due to the levels and volatility of interest rates. For each category of interest-earning assets and interest-bearing liabilities information is provided on changes attributable to (i) changes in volume (i.e. changes in volume multiplied by old rate) and (ii) changes in rate (i.e. changes in rate multiplied by old volume). For purposes of this table, changes attributable to both rate and volume that cannot be segregated have been allocated proportionately to the change due to volume and the change due to rate.

	Years Ended December 31, 2012, 2011, and 2010					
	Year 2012 to 2011 Change due to			Year 2011 to 2010 Change due to		
(dollars in thousands)	Volume	Rate/Yield	Net	Volume	Rate/Yield	Net
Increase (decrease) in interest income						
Loans (tax equivalent)	$2,573	$ (3,027)	$(454)	$(125)	$ (2,294)	$(2,419)
Loan pool participations	(348)	1,218	870	(518)	(1,005)	(1,523)
Investment securities:						
Taxable investments	732	(830)	(98)	2,103	(836)	1,267
Tax exempt investments (tax equivalent)	1,396	(343)	1,053	604	(225)	379
Total investment securities	2,128	(1,173)	955	2,707	(1,061)	1,646
Federal funds sold and interest-bearing balances	16	2	18	(3)	—	(3)
Change in interest income	4,369	(2,980)	1,389	2,061	(4,360)	(2,299)
Increase (decrease) in interest expense						
Savings and interest-bearing demand deposits	415	(1,356)	(941)	695	(1,047)	(352)
Certificates of deposit	(179)	(2,238)	(2,417)	67	(1,973)	(1,906)
Total deposits	236	(3,594)	(3,358)	762	(3,020)	(2,258)
Federal funds purchased and repurchase agreements	41	(109)	(68)	43	(74)	(31)
Federal Home Loan Bank borrowings	39	(439)	(400)	(47)	(1,109)	(1,156)
Other long-term debt	(5)	—	(5)	(7)	119	112
Total borrowed funds	75	(548)	(473)	(11)	(1,064)	(1,075)
Change in interest expense	311	(4,142)	(3,831)	751	(4,084)	(3,333)
Increase (decrease) in net interest income	$4,058	$ 1,162	$5,220	$1,310	$ (276)	$1,034
Percentage increase in net interest income over prior period			10.2 %			2.1 %

Earning Assets, Sources of Funds, and Net Interest Margin

Average earning assets increased $94.2 million, or 6.1%, to $1.6 billion in 2012 as compared to $1.5 billion in 2011. Average earning assets in 2011 increased by $70.3 million, or 4.8%, from 2010. The growth in the average balance of earning assets in 2012 was due primarily to an increase in our portfolio of investment securities of $55.4 million, or 10.9%, and an increase in average loans outstanding of $47.9 million, or 5.0%, somewhat offset by decreases in loan pool participation balances. Growth in the average balance of earning assets in 2011 was due primarily to an increase in our portfolio of investment securities of $91.9 million, or 22.1%, somewhat offset by decreases in loan pool participation balances. Interest-bearing liabilities averaged $1.4 billion for the year ended December 31, 2012, an increase of $60.6 million, or 4.6%, from the average balance for the year ended December 31, 2011. An increase in deposits of $51.0 million plus an increase in borrowed funds of $9.7 million during 2012 accounted for the increase in average interest-bearing liabilities. Interest-bearing liabilities averaged $1.3 billion for the year ended December 31, 2011, an increase of $62.9 million, or 5.0%, from the average balance for the year ended December 31, 2010. An increase in deposits of $59.6 million plus an increase in borrowed funds of $3.3 million during 2011 accounted for the increase in average interest-bearing liabilities from December 31, 2010.

Interest income, on a tax-equivalent basis, increased $1.4 million, or 2.0%, to $72.4 million in 2012 from $71.0 million in 2011. Tax equivalent interest income in 2011 decreased $2.3 million, or 3.1%, to $71.0 million in 2011 from $73.3 million in 2010. Interest income rose in 2012 due primarily to higher volumes in loans and also investment securities, and despite lower yields. In 2011, interest income declined due primarily to lower yields on loan balances and new securities purchased. Our yield on average earning assets was 4.44% in 2012 compared to 4.62% in 2011 and 5.00% in 2010. These declines were due to the historically lower rate environment resulting from the interest rate policy being pursued by the Federal Reserve in response to current economic conditions.

Table of Contents

Interest expense decreased during 2012 by $3.8 million, or 19.4%, to $16.0 million from $19.8 million in 2011. Interest expense in 2011 decreased by $3.3 million, or 14.4%, from 2010. The decrease in interest expense during 2012 compared to 2011, like that of 2011 compared to 2010, was due to the continued low interest rate environment, and its effect on new liabilities and those repricing during the year. The average rate paid on interest-bearing liabilities was 1.16% in 2012 compared to 1.51% in 2011 and 1.85% in 2010.

Net interest income, on a tax-equivalent basis, increased 10.2% in 2012 to $56.5 million from $51.3 million in 2011. The increased volume of loans and investments during 2012 combined with the lower rates paid on all categories of interest-bearing liabilities, more than offset the lower yields on earning assets and higher volume of interest-bearing liabilities. Tax-equivalent net interest income in 2011 increased by $1.0 million, or 2.1%, from 2010. Net interest margin, which is our net interest income expressed as a percentage of average earning assets stated on a tax-equivalent basis, rose to 3.46% during 2012 compared to 3.34% in 2011 and 3.43% in 2010. The net interest spread, also on a tax-equivalent basis, was 3.28% in 2012 compared to 3.11% in 2011 and 3.15% in 2010.

Net interest income increased in 2012 as compared to 2011 due primarily to the decrease in interest paid on interest-bearing liabilities combined with the increase in interest received on interest-earning assets. This is partially due to the presence of interest rate floors in portions of our loan portfolio, and the higher volume of loans and investment securities. The increased net interest income for 2011 as compared to 2010 was due primarily to the decrease in interest paid on interest-bearing liabilities exceeding the decrease in interest received on interest-earning assets. This was also partially due to the presence of interest rate floors in portions of our loan portfolio, as well as the higher volume of investment securities relative to 2010. The average balance sheets reflect a competitive marketplace on both the interest-earning assets and interest-bearing deposits. The competition for loans in the marketplace and the overall interest rate environment has kept interest rates on loans low. Interest rates paid on deposit products have declined steadily since 2008, but further significant decline is unlikely as interest rates on deposits have approached zero. We expect to continue battling net interest margin compression in 2013, with interest rates at generational lows.

Provision for Loan Losses

The provision for loan losses is a current charge against income and represents an amount which management believes is sufficient to maintain an adequate allowance for known and probable losses. In assessing the adequacy of the allowance for loan losses, management considers the size, composition, and quality of the loan portfolio measured against prevailing economic conditions, regulatory guidelines, historical loan loss experience and credit quality of the portfolio. When a determination is made by management to write-off a loan balance, such write-off is charged against the allowance for loan losses.

Our provision for loan losses was $2.4 million during 2012 compared to $3.4 million in 2011 and $6.0 million in 2010. The decrease in provision expense during 2012 was reflective of management’s belief that the allowance for loan losses was adequate based on the inherent risk in the portfolio as of December 31, 2012. During 2012, we added to the allowance for loan losses by maintaining a provision for loan losses that was somewhat greater than our net charge-off activity. The higher level of provision expense during 2011 was reflective of management’s assessment of the then-current risk in the loan portfolio as compared to the allowance for loan losses. During 2010, we added to the allowance for loan losses due primarily to higher charge-offs and increased volatility in our commercial real estate portfolio. The reduction since 2010 in the level of provision expense is indicative of our belief that weak credits have been identified and adequately provided for. See further discussion of the nonperforming loans, under the Nonperforming Assets section.

Table of Contents

Noninterest Income

	For the Year Ended December 31,							
	2012	2011	$ Change	% Change	2011	2010	$ Change	% Change
(dollars in thousands)								
Trust, investment, and insurance fees	$4,995	$4,537	$458	10.1 %	$4,537	$4,556	$(19)	(0.4)%
Service charges and fees on deposit accounts	3,247	3,702	(455)	(12.3)	3,702	4,042	(340)	(8.4)
Mortgage origination and loan servicing fees	3,578	2,691	887	33.0	2,691	3,506	(815)	(23.2)
Other service charges, commissions and fees	2,316	2,540	(224)	(8.8)	2,540	2,563	(23)	(0.9)
Bank-owned life insurance income	953	951	2	0.2	951	685	266	38.8
Impairment losses on investment securities	—	—	—	NM	—	(189)	189	NM
Gain on sale of available for sale securities	805	490	315	64.3	490	453	37	8.2
Gain (loss) on sale of premises and equipment	4,188	(195)	4,383	NM	(195)	(709)	514	NM
Total noninterest income	$20,082	$14,716	$5,366	36.5 %	$14,716	$14,907	$(191)	(1.3)%
Noninterest income as a % of total revenue*	22.0 %	22.8 %			22.8 %	24.1 %		

NM - Percentage change not considered meaningful.
* - Total revenue includes net interest income plus noninterest income minus gain/loss on sales of securities and premises and equipment.

Total noninterest income rose to $20.1 million, an increase of $5.4 million, or 36.5%, from $14.7 million in 2011. The primary reason for this increase was the $4.0 million gain on the sale of the Home Mortgage Center location realized during the second quarter of 2012. Absent this gain, the increase in noninterest income for the period was $1.3 million, or 9.0%. Mortgage origination and loan servicing fees increased by $0.9 million, or 33.0%, to $3.6 million for 2012, compared to $2.7 million for 2011, due primarily to an increased gains realized on a higher volume of loans originated and sold on the secondary market during 2012 compared to 2011. Trust, investment, and insurance fees increased $0.5 million, or 10.1%, to $5.0 million for 2012, compared with $4.5 million for 2011, due to management concentration of income growth in these areas.

These increases were partially offset by decreased service charges and fees on deposit accounts of $3.2 million for the year ended December 31, 2012, a decline of $0.5 million, or 12.3%, from $3.7 million for 2011. This decline was primarily attributable to lower NSF fees being received between the comparable periods. We expect this decline to stabilize in the coming year, as the regulatory changes resulting in the change will be reflected in both comparable periods. We also experienced a decline in other service charges, commissions and fees to $2.3 million in 2012, down $0.2 million from $2.5 million in 2011. Management's strategic goal is for noninterest income to constitute 30% of total revenues (net interest income plus noninterest income before gains or losses on sales of securities available for sale and premises and equipment) over time. In 2012, noninterest income comprised 22.0% of total revenues, compared with 22.8% for 2011 and 24.1% for 2010. We expect that increased management focus on growing our insurance agency revenues and increasing the rate of growth in our Trust and Investment Services revenues will reverse this decline going forward.

The decrease in noninterest income for 2011 compared to 2010 was primarily due to the decrease in mortgage origination and servicing fees of $0.8 million, as such amount declined to $2.7 million in 2011 compared to $3.5 million in 2010, and the $0.3 million decrease in service charges and fees on deposit accounts to $3.7 million in 2011 compared to $4.0 million in 2010. These declines were partially offset by increased income from bank-owned life insurance income primarily due to the investment of an additional $8.0 million in insurance policies purchased late in 2010, and decreased losses on the sale of premises and equipment. We also experienced lower losses on the sale of premises and equipment in 2011 compared to 2010.

Table of Contents

Noninterest Expense

	For the Year Ended December 31,							
	2012	2011	$ Change	% Change	2011	2010	$ Change	% Change
(dollars in thousands)								
Salaries and employee benefits	$30,684	$23,194	7,490	32.3 %	$23,194	$23,170	24	0.1 %
Net occupancy and equipment expense	6,246	6,537	(291)	(4.5)	6,537	6,566	(29)	(0.4)
Professional fees	2,758	2,825	(67)	(2.4)	2,825	2,734	91	3.3
Data processing expense	1,679	1,670	9	0.5	1,670	1,702	(32)	(1.9)
FDIC insurance expense	1,224	1,612	(388)	(24.1)	1,612	2,850	(1,238)	(43.4)
Amortization of intangible assets	778	896	(118)	(13.2)	896	1,029	(133)	(12.9)
Other operating expense	5,591	5,501	90	1.6	5,501	5,238	263	5.0
Total noninterest expense	$48,960	$42,235	$6,725	15.9 %	$42,235	$43,289	$(1,054)	(2.4)%

In 2012 noninterest expense increased $6.7 million, or 15.9%, primarily due to the $6.1 million loss related to the termination and liquidation of the Company's defined benefit pension plan in the second quarter of 2012, recorded in salaries and employee benefits expense. Absent that event, noninterest expense for the year increased $0.6 million, or 1.5%. Excluding the pension loss, salaries and employee benefits increased $1.4 million, or 6.0%, primarily due to annual salary and benefit rate increases for employees that were effective at the beginning of 2012. Full-time equivalent employee levels were 390, 383 and 383 at December 31, 2012, 2011 and 2010, respectively.

This increase was partially offset by a decrease in FDIC insurance expense of $0.4 million, or 24.1%, to $1.2 million for the year of 2012, compared with $1.6 million for 2011. Net occupancy and equipment also experienced a decline of $0.3 million, or 4.5%, to $6.2 million for 2012, compared with $6.5 million for 2011, due to management’s continued efficiency efforts. Professional fees were virtually unchanged for 2012 compared to 2011, as were data processing expenses, and other operating expenses.

Noninterest expense decreased $1.1 million, or 2.4%, for 2011 compared with 2010, primarily due to a decrease in FDIC insurance expense of $1.2 million. The decrease was due primarily to lower assessment rates by the FDIC. This decrease was partially offset by a $0.3 million increase in other operating expenses. Salary and employee benefit expense was virtually unchanged for 2011 from 2010, as was net occupancy and equipment expense. Professional fees increased $0.1 million for 2011 due to generally higher costs associated with outside professional services we utilize.

Income Tax Expense

Our effective tax rate, or income taxes divided by income before taxes, was 24.2% for 2012 compared with 25.7% for 2011. The lower effective rate in 2012 was primarily due to changes in the levels of taxable income, increased investment in tax-free municipal securities, and realization of a $0.2 million tax benefit from the partial release of a valuation allowance on capital losses during the second quarter of 2012. Income tax expense increased by $0.7 million to $5.3 million in 2012 compared to tax expense of $4.6 million for 2011 due to increased taxable income.

Income taxes increased by $1.2 million for 2011 compared with 2010 due to increased taxable income and the relative amount of income from our investments in tax-favored securities and bank-owned life insurance. Our consolidated income tax rate varies from the statutory rate mainly due to the amount of tax-exempt income. The effective income tax rate as a percentage of income before tax was 25.7% for 2011, compared with 25.1% for 2010.

Financial Condition - December 31, 2012 and 2011

Summary

Our total assets increased $97.6 million, or 5.8%, to $1.8 billion as of December 31, 2012 from $1.7 billion as of December 31, 2011. This growth resulted primarily from increased investment in securities of $54.1 million, and an increase in bank portfolio loans of $49.1 million. Increased funding from deposits and securities sold under agreement to repurchase combined with the reduction of loan pool participations provided additional liquidity. Loan pool participations, net, were $35.7 million at December 31, 2012 compared to $50.1 million at December 31, 2011, a decrease of $14.4 million, or 28.8%, due to loan charge-offs and normal loan repayments. As previously discussed, we intend to exit this line of business as current balances pay down and concentrate on our our core community banking business. Our loan-to-deposit ratio, including loan pool participations,

Table of Contents

decreased to 76.7% at year-end 2012 compared to 79.5% at year-end 2011, with our target range being between 80% and 90%. The decline in this ratio is reflective of the ready availability of deposits in our footprint, and the modest demand for loans. While we continue to focus on quality loan growth, the continuing influx of deposits will make reaching our target range difficult in the near future.

Total liabilities increased by $80.1 million from December 31, 2011 to December 31, 2012. Our deposits increased $93.1 million, or 7.1%, to $1.4 billion as of December 31, 2012 from $1.3 billion at December 31, 2011. The increase in deposits was primarily due to organic growth in business and individual, partnership and non-profit deposits, primarily in both interest-bearing and non-interest-bearing checking products. Brokered CDs obtained through participation in the Certificate of Deposit Account Registry Service ("CDARS") program decreased by $6.4 million in 2012 to $22.4 million, while brokered business money market accounts obtained through participation in the Insured Cash Sweeps ("ICS") program increased by $0.8 million to $20.8 million. We have an internal policy limit on brokered deposits of not more than 10% of our total assets. At December 31, 2012 brokered deposits were 2.7% of our total liabilities. FHLB borrowings were $120.1 million at December 31, 2012 compared to $140.0 million at December 31, 2011, a decrease of $19.9 million, or 14.2%. Other liabilities decreased $4.5 million or 31.8%, due primarily to $3.0 million less in unsettled purchases of investment securities.

Shareholders' equity increased by $17.4 million, primarily due to 2012 net income of $16.8 million.

	December 31, 2012	December 31, 2011	$ Change	% Change
(dollars in thousands)				
Assets				
Investment securities available for sale	$557,541	$534,080	$23,461	4.4 %
Investment securities held to maturity	32,669	2,036	30,633	1,504.6
Net loans	1,019,327	970,497	48,830	5.0
Loan pool participations, net	35,650	50,052	(14,402)	(28.8)
Total Assets	$1,792,819	$1,695,244	$97,575	5.8 %
Liabilities				
Deposits:				
Noninterest bearing	$190,491	$161,287	$29,204	18.1 %
Interest bearing	1,209,242	1,145,355	63,887	5.6
Total deposits	1,399,733	1,306,642	93,091	7.1
Federal Home Loan Bank borrowings	120,120	140,014	(19,894)	(14.2)
Total liabilities	$1,618,887	$1,538,750	$80,137	5.2 %
Shareholders' equity	$173,932	$156,494	$17,438	11.1 %

Investment Securities

Our investment securities portfolio is managed to provide both a source of liquidity and earnings. Our portfolio totaled $590.2 million at December 31, 2012 compared to $536.1 million at December 31, 2011. The increase was due primarily to the investment of increased liquidity generated by deposit and repurchase agreement growth and reduced loan pool participation balances during 2012. Our loan activity is discussed more fully in the Loans section and loan pool participation activity is discussed in the Loan Pool Participations section, while our deposit growth is discussed more fully in the Deposits section.

Securities available for sale are carried at fair value. As of December 31, 2012, the fair value of our securities available for sale was $557.5 million and the amortized cost was $539.3 million. There were $19.8 million of gross unrealized gains and $1.5 million of gross unrealized losses in our investment securities available for sale portfolio for a net unrealized gain of $18.3 million. The after-tax effect of this unrealized gain has been included in shareholders' equity. The ratio of the fair value as a percentage of amortized cost was virtually unchanged from December 31, 2011, due to the continued stability in overall interest rates during 2012, resulting in almost no change in the relative value of our debt-related securities.

U.S. government and agency securities as a percentage of total securities increased to 12.5% at December 31, 2012, from 10.6% at December 31, 2011, while obligations of state and political subdivisions (primarily tax-exempt obligations) as a percentage of total securities decreased to 39.1% at December 31, 2012, from 41.1% at December 31, 2011. Investments in mortgage-backed securities decreased to 43.6% of total securities at December 31, 2012, as compared to 45.7% of total securities at December 31, 2011. The receipt of principal, at par, and interest on mortgage-backed securities is guaranteed by the respective government-sponsored agency guarantor, such that the Company believes that its mortgage-backed securities do not expose the Company to credit-related losses. The Company's mortgage-backed securities portfolio consisted of securities predominantly underwritten to

Table of Contents

the standards of and guaranteed by the government-sponsored agencies of FHLMC, FNMA and GNMA. We consider many factors in determining the composition of our investment portfolio including tax-equivalent yield, credit quality, duration, expected cash flows and prepayment risk, as well as the liquidity position and the interest rate risk profile of the Bank.

Our investment portfolio includes an investment in collateralized debt obligations that are backed by trust preferred securities issued by banks, thrifts and insurance companies. These six securities had an original cost of $9.8 million, but due to several impairment charges recognized during 2010, 2009 and 2008, the book value of these securities at December 31, 2012, had been reduced to $1.8 million. Two of the securities have been written down to a value of zero, with the remaining four having an average book value of 18.2% of their original face value. The market for these securities at December 31, 2012 was not active and markets for similar securities are also not active. The valuation of these securities involves an assessment of the financial strength of the individual institutions that comprise the collateral for the bonds. Future default probabilities are assigned based on these measurements of financial strength. Other factors in the valuation include contractual terms of the cash flow waterfall (for both interest and principal), collateralization testing and events of default/liquidation. Based on our cash flow analysis, we have determined that not all contractual cash flows will be received; however, no additional other-than-temporary impairment charges were recorded during 2012 or 2011. Any future decline in the collateral performance of our pooled trust preferred debt obligations could result in additional other-than-temporary impairment charges.

The composition of securities available for sale was as follows:

	December 31,					
	2012		2011		2010	
(dollars in thousands)						
Securities available for sale						
U.S. Government agency securities and corporations	69,783		56,981		80,334	
States and political subdivisions	218,019		219,261		190,088	
Mortgage-backed securities and collateralized mortgage obligations	243,118		244,802		179,784	
Other securities	26,621		13,036		11,748	
Fair value of securities available for sale	$557,541		$534,080		$461,954	
Amortized cost	$539,288		$517,358		$456,560	
Fair value as a percentage of amortized cost	103.38	%	103.23	%	101.18	%

Securities held to maturity are carried at amortized cost. As of December 31, 2012, the amortized cost of these securities was $32.7 million and the fair value was $32.9 million.

The composition of securities held to maturity was as follows:

	December 31,					
	2012		2011		2010	
(dollars in thousands)						
Securities held to maturity						
States and political subdivisions	19,277		1,119		3,115	
Mortgage-backed securities and collateralized mortgage obligations	10,133		46		50	
Other securities	3,258		871		867	
Amortized cost	$32,668		$2,036		$4,032	
Fair value of securities held to maturity	$32,920		$2,042		$4,086	
Fair value as a percentage of amortized cost	100.77	%	100.29	%	101.34	%

See Note 2. “Investment Securities,’’ and Note 18. “Estimated Fair Value of Financial Instruments and Fair Value Measurements” for additional information related to the investment portfolio.

Table of Contents

The maturities, carrying values and weighted average yields of debt securities as of December 31, 2012 were:

	Maturity											
	Within One Year			After One but Within Five Years			After Five but Within Ten Years			After Ten Years		
	Amount	Yield		Amount	Yield		Amount	Yield		Amount	Yield	
(dollars in thousands)												
Securities available for sale: (1)												
U.S. Government agency securities and corporations	$5,152	2.02	%	$26,754	1.97	%	$37,877	1.59	%	$—	—	%
Obligations of states and political subdivisions (2)	12,738	4.96		51,751	5.24		90,393	4.98		63,137	4.96	
Mortgage-backed securities and collateralized mortgage obligations	7	5.99		4	6.99		47,987	2.72		195,120	2.42	
Other securities	2,059	4.63		17,807	1.86		4,319	2.14		755	1.58	
Total debt securities available for sale	$19,956	4.17	%	$96,316	3.71	%	$180,576	3.60	%	$259,012	3.04	%
Securities held to maturity: (1)												
U.S. Government agency securities and corporations	$—	—	%	$—	—	%	$—	—	%	$—	—	%
Obligations of states and political subdivisions (2)	526	5.45		375	4.18		7,338	5.23		11,181	5.54	
Mortgage-backed securities and collateralized mortgage obligations	—	—		—	—		—	—		10,254	1.88	
Other securities	—	—		2,372	1.26		—	—		874	2.57	
Total debt securities held to maturity	$526	5.45	%	$2,747	1.66	%	$7,338	5.23	%	$22,309	3.74	%
Total debt investment securities	$20,482	4.20	%	$99,063	3.65	%	$187,914	3.66	%	$281,321	3.10	%

(1) Excludes equity securities.

(2) Yield is on a tax-equivalent basis, assuming a federal income tax rate of 34% (the effective federal income tax rate as of December 31, 2012)

As of December 31, 2012, no non-agency issuer's securities exceeded 10% of the Company's total shareholders' equity.

Table of Contents

Loans (Excluding Loan Pool Participations)

The composition of loans (before deducting the allowance for loan losses), was as follows:

	As of December 31,									
	2012		2011		2010		2009		2008	
	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total
(dollars in thousands)										
Agricultural	$84,726	8.2 %	$89,298	9.1 %	$84,590	9.0 %	$92,727	9.6 %	$87,682	8.6 %
Commercial and industrial	237,193	22.9	239,990	24.3	211,334	22.5	218,344	22.6	214,715	21.2
Credit cards	1,001	0.1	934	0.1	655	0.1	628	—	533	—
Overdrafts	759	0.1	885	0.1	491	0.1	643	—	1,002	0.1
Commercial real estate:										
Construction & development	86,794	8.4	73,258	7.4	73,315	7.8	79,437	8.2	99,617	9.8
Farmland	81,063	7.8	74,454	7.6	76,345	8.1	88,747	9.2	94,012	9.3
Multifamily	47,758	4.6	34,719	3.5	33,451	3.6	32,455	3.4	32,122	3.2
Commercial real estate-other	224,369	21.7	213,608	21.7	210,131	22.4	196,025	20.3	195,393	19.3
Total commercial real estate	439,984	42.5	396,039	40.2	393,242	41.9	396,664	41.1	421,144	41.6
Residential real estate:										
One- to four-family first liens	197,742	19.1	175,429	17.8	156,882	16.7	161,065	16.7	186,688	18.4
One- to four-family junior liens	55,134	5.3	63,419	6.4	69,112	7.4	73,665	7.6	77,377	7.6
Total residential real estate	252,876	24.4	238,848	24.2	225,994	24.1	234,730	24.3	264,065	26.0
Consumer	18,745	1.8	20,179	2.0	21,729	2.3	23,262	2.4	25,673	2.5
Total loans	$1,035,284	100.0%	$986,173	100.0%	$938,035	100.0%	$966,998	100.0%	$1,014,814	100.0%
Total assets	$1,792,819		$1,695,244		$1,581,259		$1,534,783		$1,508,962	
Loans to total assets		57.7 %		58.2 %		59.3 %		63.0 %		67.3 %

Our loan portfolio, before allowance for loan losses, increased 5.0% to $1.0 billion as of December 31, 2012 from $986.2 million at December 31, 2011. A significant portion of the overall loan increase occurred in one- to four-family first liens, which increased $22.3 million, or 12.7%, to $197.7 million as of December 31, 2012, from $175.4 million at December 31, 2011. This growth was primarily due to our strategic decision to retain up to $20.0 million of fixed rate loans originated with a maturity of 15 years or less in our own portfolio. Construction and development loans increased $13.5 million, or 18.5%, to $86.8 million as of December 31, 2012, compared to $73.3 million at December 31, 2011. This increase was primarily the result of the funding of two healthcare industry construction

projects in our market. We expect this trend to continue once construction begins on two new assisted living projects in 2013. Multifamily real estate loans also increased to $47.8 million as of December 31, 2012, from $34.7 million at December 31, 2011, a change of $13.0 million, or 37.6%. The refinance from outside the Company of a property in our Iowa City market was the primary reason for this increase. Commitments under standby letters of credit, unused lines of credit and other conditionally approved credit lines, totaled approximately $293.0 million and $206.6 million as of December 31, 2012 and 2011, respectively.
Even with the blend of significant agricultural, manufacturing, academia and healthcare industries prevalent in our markets, we experienced sporadic demand for new non-real-estate debt in recent years. This trend, which we understand to be widespread in the United States, appears to be driven by depressed consumer confidence leading to a generally lower demand for debt financed purchases. Although we maintained prudent underwriting standards in 2012, when presented with opportunities to fund quality loans, we readily acted to assist our customers and communities. Nonetheless, our loan to deposit ratio decreased to 76.7% at year end 2012 from 79.5% at the end of 2011. The decline in this ratio is reflective of the ready availability of deposits in our footprint, and the modest demand for loans. While we continue to focus on quality loan growth, the continuing influx of deposits will make reaching our target range of “in the 80’s” difficult in the near future.
The loan portfolio includes a concentration of loans for commercial real estate, which are included in the table above, amounting to approximately $440.0 million and $396.0 million as of December 31, 2012 and 2011, respectively. Of this amount, $81.1 million, or 7.8%, was secured by farmland at December 31, 2012, compared to $74.5 million, or 7.6%, at December 31, 2011. Generally, these loans are collateralized by assets of the borrowers and are expected to be repaid from cash flows or from proceeds from the sale of selected assets of the borrowers.

Table of Contents

The following table sets forth remaining maturities and rate types of selected loans at December 31, 2012:

	Due Within One Year	Due in One to Five Years	Due After Five Years	Total	Total for Loans Due Within One Year Having Fixed Rates	Total for Loans Due Within One Year Having Variable Rates	Total for Loans Due After One Year Having Fixed Rates	Total for Loans Due After One Year Having Variable Rates
(in thousands)								
Agricultural	$63,180	$15,667	$5,879	$84,726	$8,605	$54,575	$15,876	$5,670
Commercial and industrial	83,247	94,679	59,267	237,193	32,277	50,970	114,368	39,578
Credit cards	1,001	—	—	1,001	—	1,001	—	—
Overdrafts	759	—	—	759	759	—	—	—
Commercial real estate:								
Construction & development	75,128	10,831	835	86,794	40,256	34,872	3,707	7,959
Farmland	10,792	40,783	29,488	81,063	10,622	170	40,618	29,653
Multifamily	4,909	36,162	6,687	47,758	4,909	—	39,192	3,657
Commercial real estate-other	37,761	154,632	31,976	224,369	35,848	1,913	161,992	24,616
Total commercial real estate	128,590	242,408	68,986	439,984	91,635	36,955	245,509	65,885
Residential real estate:								
One- to four- family first liens	14,392	52,833	130,517	197,742	13,690	702	97,043	86,307
One- to four- family junior liens	2,610	13,764	38,760	55,134	1,801	809	22,185	30,339
Total residential real estate	17,002	66,597	169,277	252,876	15,491	1,511	119,228	116,646
Consumer	6,942	10,552	1,251	18,745	6,347	595	11,722	81
Total loans	$300,721	$429,903	$304,660	$1,035,284	$155,114	$145,607	$506,703	$227,860

Of the $373.5 million of variable rate loans, approximately $226.4 million, or 60.6%, are subject to interest rate floors, with a weighted average floor rate of 4.70%.

Nonperforming Assets

It is management’s policy to place loans on nonaccrual status when interest or principal is 90 days or more past due. Such loans may continue on accrual status only if they are both well-secured and in the process of collection. The following table sets forth information concerning nonperforming assets at December 31 for each of the years indicated:

	December 31, 2012	2011	2010	2009	2008
(dollars in thousands)					
90 days or more past due and still accruing interest	$572	$1,054	$1,579	$1,439	$3,024
Troubled debt restructure	7,144	6,135	5,797	2,555	424
Nonaccrual	2,938	10,917	12,405	9,885	11,785
Total nonperforming loans	10,654	18,106	19,781	13,879	15,233
Other real estate owned	3,278	4,033	3,850	3,635	996
	$13,932	$22,139	$23,631	$17,514	$16,229

Total nonperforming loans and nonperforming other assets					
Nonperforming loans to loans, before allowance for loan losses	1.03 %	1.84 %	2.11 %	1.44 %	1.50 %
Nonperforming loans and nonperforming other assets to loans, before allowance for loan losses	1.35 %	2.24 %	2.52 %	1.81 %	1.60 %

We experienced a decrease in total nonperforming assets during 2012 as compared to 2011. Total nonperforming assets were $13.9 million at December 31, 2012, compared to $22.1 million at December 31, 2011, a $8.2 million, or 37.1%, decrease. Nonperforming loans decreased $7.5 million during 2012, with a $0.7 million decrease in nonperforming other assets (other real estate owned). The largest category of nonperforming loans was commercial real estate loans, with a balance of $3.8 million at December 31, 2012. The remaining nonperforming loans consisted of $3.4 million in agricultural, $1.8 million in commercial and industrial, and $1.6 million in residential real estate loans. The decrease in other real estate owned ("OREO") was primarily attributable to decreases in commercial real estate properties to $3.2 million at December 31, 2012 compared to $3.6 million at December 31, 2011, while single family residential OREO decreased to $0.1 million from $0.4 million for the same respective periods.

Table of Contents

The following table sets forth information concerning nonperforming loans by portfolio class at December 31, 2012 and December 31, 2011:

(in thousands)	90 Days or More Past Due and Still Accruing Interest	Troubled Debt Restructure	Nonaccrual	Total
2012				
Agricultural	$—	$3,323	$64	$3,387
Commercial and industrial	85	953	757	1,795
Credit cards	30	—	—	30
Overdrafts	—	—	—	—
Commercial real estate:				
Construction & development	—	78	149	227
Farmland	—	2,316	33	2,349
Multifamily	—	—	—	—
Commercial real estate-other	67	—	1,128	1,195
Total commercial real estate	67	2,394	1,310	3,771
Residential real estate:				
One- to four- family first liens	311	313	550	1,174
One- to four- family junior liens	75	138	223	436
Total residential real estate	386	451	773	1,610
Consumer	4	23	34	61
Total	$572	$7,144	$2,938	$10,654
2011				
Agricultural	$—	$3,323	$1,453	$4,776
Commercial and industrial	537	48	1,494	2,079
Credit cards	—	—	—	—
Overdrafts	—	—	—	—
Commercial real estate:				
Construction & development	—	79	1,159	1,238
Farmland	—	—	2,927	2,927
Multifamily	—	—	259	259
Commercial real estate-other	49	2,081	1,507	3,637
Total commercial real estate	49	2,160	5,852	8,061
Residential real estate:				
One- to four- family first liens	262	579	1,959	2,800
One- to four- family junior liens	206	—	125	331
Total residential real estate	468	579	2,084	3,131
Consumer	—	25	34	59
Total	$1,054	$6,135	$10,917	$18,106

Nonperforming loans decreased from $18.1 million, or 1.84% of total bank loans at December 31, 2011, to $10.7 million, or 1.03% of total bank loans at December 31, 2012. At December 31, 2012, nonperforming loans consisted of $2.9 million in nonaccrual loans, $7.1 million in troubled debt restructures and $0.6 million in loans past due 90 days or more and still accruing. This compares to nonaccrual loans of $10.9 million, troubled debt restructures of $6.1 million, and loans past due 90 days or more and still accruing of $1.1 million at December 31, 2011. The decrease in nonperforming loans is primarily due to the payoff of two agricultural credits totaling $1.8 million, the pay-down of a development loan of $1.1 million, and the reduction of 15 residential real estate loans totaling $1.5 million, all of which had been on nonaccrual. The change in troubled debt restructure is primarily attributable to the movement of a $1.0 million commercial real estate credit out of troubled debt restructure due to continued positive performance, combined with a $2.5 million nonaccrual farmland credit being reclassified as a troubled debt restructure due to a court ordered interest rate reduction in connection with a Chapter 12 bankruptcy. Bank loans past due 30 to 89 days and still accruing interest (not included in the nonperforming loan totals) were $6.1 million at December 31, 2012, compared with $7.0 million at December 31, 2011. At December 31, 2012, other real estate owned (not included in nonperforming loans) was $3.3 million, down from $4.0 million at December 31, 2011. The allowance for loan losses represented 149.77% of nonperforming loans at December 31, 2012, compared with 86.58% of nonperforming loans at December 31, 2011.

Table of Contents

A loan is considered to be impaired when, based on current information and events, it is probable that we will not be able to collect all amounts due. The accrual of interest income on impaired loans is discontinued when there is reasonable doubt as to the borrower's ability to meet contractual payments of interest or principal. Interest income on these loans is recognized to the extent interest payments are received and the principal is considered fully collectible. The gross interest income that would have been recorded in the years ended December 31, 2012, 2011 and 2010 if the nonaccrual and troubled debt restructure loans had been current in accordance with their original terms was $2.2 million, $1.6 million, and $1.9 million, respectively. The amount of interest collected on those loans that was included in interest income was $0.8 million, $0.4 million, and $0.5 million for the years ended December 31, 2012, 2011 and 2010, respectively.

In addition to the non-performing and past due loans mentioned above, the Company also has identified loans for which management has concerns about the ability of the borrowers to meet existing repayment terms. The loans are generally secured by either real estate or other borrower assets, reducing the potential for loss should they become non-performing. Although these loans are generally identified as potential problem loans, it is possible that they never become non-performing. Such loans totaled $2.2 million at December 31, 2012.

Loan Review and Classification Process for Agricultural Loans, Commercial and Industrial Loans, and Commercial Real Estate Loans

The Company maintains a loan review and classification process which involves multiple officers of the Company and is designed to assess the general quality of credit underwriting and to promote early identification of potential problem loans. All commercial and agricultural loan officers are charged with the responsibility of risk rating all loans in their portfolios and updating the ratings, positively or negatively, on an ongoing basis as conditions warrant. A monthly loan officer validation worksheet documents this process. Risk ratings are selected from an 8-point scale with ratings as follows: ratings 1- 4 Satisfactory (pass), rating 5 Watch (potential weakness), rating 6 Substandard (well-defined weakness), rating 7 Doubtful, and rating 8 Loss.

When a loan officer originates a new loan, based upon proper loan authorization, he or she documents the credit file with an offering sheet summary, supplemental underwriting analysis, relevant financial information and collateral evaluations. All of this information is used in the determination of the initial loan risk rating. The Company's loan review department undertakes independent credit reviews of relationships based on either criteria established by loan policy, risk-focused sampling, or random sampling. Loan policy requires the top 50 lending relationships by total exposure as well as all classified and Watch rated credits over $250,000 be reviewed no less than annually. The individual loan reviews consider such items as: loan type; nature, type and estimated value of collateral; borrower and/or guarantor estimated financial strength; most recently available financial information; related loans and total borrower exposure; and current/anticipated performance of the loan. The results of such reviews are presented to executive management.

Through the review of delinquency reports, updated financial statements or other relevant information, the lending officer and/or loan review personnel may determine that a loan relationship has weakened to the point that a criticized (loan grade 5) or classified (loan grade 6 through 8) status is warranted. When a loan relationship with total related exposure of $1.0 million or greater is adversely graded (5 or above), or is classified as a troubled debt restructure (regardless of size), the lending officer is then charged with preparing a loan strategy summary worksheet that outlines the background of the credit problem, current repayment status of the loans, current collateral evaluation and a workout plan of action. This plan may include goals to improve the credit rating, assisting the borrower in moving the loans to another institution and/or collateral liquidation. All such reports are first presented to regional management and then to the board of directors by the Executive Vice President, Chief Credit Officer (or a designee).

Depending upon the individual facts and circumstances and the result of the Classified/Watch review process, loan officers and/or loan review personnel may categorize the loan relationship as impaired. Once that determination has occurred, the loan officer, in conjunction with regional management, will complete an evaluation of the collateral (for collateral-dependent loans) based upon appraisals on file adjusting for current market conditions and other local factors that may affect collateral value. Loan review personnel may also complete an independent impairment analysis when deemed necessary. These judgmental evaluations may produce an initial specific allowance for placement in the Company's allowance for loan & lease losses calculation. As soon as practical, updated appraisals on the collateral backing that impaired loan relationship are ordered. When the updated appraisals are received, regional management, with assistance from the loan review department, reviews the appraisal and updates the specific allowance analysis for each loan relationship accordingly. The board of directors on a quarterly basis reviews the Classified/Watch reports including changes in credit grades of 5 or higher as well as all impaired loans, the related allowances and OREO.

In general, once the specific allowance has been finalized, regional and executive management will consider a charge-off prior to the calendar quarter-end in which that reserve calculation is finalized.

Table of Contents

The review process also provides for the upgrade of loans that show improvement since the last review.

Restructured Loans

We restructure loans for our customers who appear to be able to meet the terms of their loan over the long term, but who may be unable to meet the terms of the loan in the near term due to individual circumstances. We consider the customer's past performance, previous and current credit history, the individual circumstances surrounding the current difficulties and their plan to meet the terms of the loan in the future prior to restructuring the terms of the loan. All of the following factors are indicators that the Bank has granted a concession (one or multiple items may be present):

- The borrower receives a reduction of the stated interest rate for the remaining original life of the debt.
- The borrower receives an extension of the maturity date or dates at a stated interest rate lower than the current market interest rate for new debt with similar risk characteristics.
- The borrower receives a reduction of the face amount or maturity amount of the debt as stated in the instrument or other agreement.
- The borrower receives a deferral of required payments (principal and/or interest).
- The borrower receives a reduction of the accrued interest.

Generally, loans are restructured through short-term interest rate relief, short-term principal payment relief or short-term principal and interest payment relief. Once a restructured loan has gone 90 days or more past due or is placed on nonaccrual status, it is included in the 90+ day past due or nonaccrual totals in the previous table.

During the year ended December 31, 2012 four loans were classified as new troubled debt restructures (“TDR”). One commercial and industrial loan was added to the TDR loan classification due to being extended and re-amortized to a longer period. This credit also experienced a payment default during 2012. Two farmland loans, both to the same borrower, were classified as new TDRs during 2012 due to a court ordered interest rate reduction in connection with a Chapter 12 bankruptcy. One one- to four- family junior lien was granted a rate concession due to borrower financial difficulties during 2012.

During the year ended December 31, 2011 nine loans were classified as new TDRs. One commercial and industrial loan was added to the TDR loan classification due to a partial charge-off of its outstanding principal and an adjustment to its terms granting a below market interest rate. Likewise, a construction and development loan was also added due to a partial balance charge-off and interest rate concession. Four commercial real estate loans, all to the same borrower, were classified as new TDRs during 2011 due to the extension of a forbearance agreement and the granting of a below market interest rate. These four credits also experienced a payment default during 2011. One commercial real estate loan that was a new TDR during 2011 due to a below market interest rate was on non-accrual at year-end. One- to four- family first lien restructures increased by one loan due to an interest rate concession. A commercial real estate loan TDR that was on non-accrual at December 31, 2010, was rewritten with a rate concession and had additional funds advanced in 2011, and was reported as a new TDR. During 2011, one restructured consumer loan that had been on non-accrual at year-end 2010 returned to accrual status. In addition, a commercial and industrial loan moved from being a performing TDR at December 31, 2010 to non-accruing at year-end 2011.

We consider all TDRs, regardless of whether they are performing in accordance with the modified terms, to be impaired loans when determining our allowance for loan losses. A summary of restructured loans as of December 31, 2012 and December 31, 2011 is as follows:

	December 31,	
	2012	2011
(in thousands)		
Restructured Loans (TDRs):		
In compliance with modified terms	$7,144	$6,135
Not in compliance with modified terms - on nonaccrual status	551	1,035
Total restructured loans	$7,695	$7,170

Table of Contents

Allowance for Loan Losses

The following table shows activity affecting the allowance for loan losses:

	Year ended December 31,				
	2012	2011	2010	2009	2008
(dollars in thousands)					
Amount of loans outstanding at end of period (net of unearned interest) [(1)]	$1,035,284	$986,173	$938,035	$966,998	$1,014,814
Average amount of loans outstanding for the period (net of unearned interest)	$1,001,259	$953,392	$955,562	$990,540	$893,451
Allowance for loan losses at beginning of period [(1)]	$15,676	$15,167	$13,957	$10,977	$5,466
Charge-offs:					
Agricultural	$—	$425	$1,347	$227	$416
Commercial and industrial	2,323	1,434	1,483	2,276	1,176
Credit cards	22	6	17	10	24
Overdrafts	41	78	59	105	150
Commercial real estate:					