INTERMOUNTAIN COMMUNITY BANCORP
Form 424B3
May 14, 2012
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PROSPECTUS SUPPLEMENT NO. 3
(TO PROSPECTUS DATED April 23, 2012)

FILED PURSUANT TO RULE 424(B)(3)
REGISTRATION NO. 333-180071

INTERMOUNTAIN COMMUNITY BANCORP
8,700,000 SHARES OF COMMON STOCK

This prospectus supplement No. 3 supplements information contained in that certain prospectus dated April 23, 2012, (as subsequently amended or supplemented, the "Prospectus") relating to the offer to shareholders of record on January 20, 2012 subscription rights to purchase up to 8,700,000 shares of common stock of Intermountain Community Bancorp.

This prospectus supplement includes our Quarterly Report on Form 10-Q for the quarter ended March 31, 2012, which was filed with the Securities and Exchange Commission on May 14, 2012.

The information contained in the Rights Offering Presentation included in this prospectus supplement is dated as of the date of the report. This prospectus supplement should be read in conjunction with the Prospectus that was previously delivered, except to the extent that the information in this prospectus supplement updates and supersedes the information contained in the Prospectus.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this Prospectus Supplement is May 14, 2012

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q
(Mark One)

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

For the quarterly period ended March 31, 2012
OR

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

For the transition period from to
COMMISSION FILE NUMBER 000-50667
INTERMOUNTAIN COMMUNITY BANCORP
(Exact name of registrant as specified in its charter)

Idaho	82-0499463
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

414 Church Street, Sandpoint, ID 83864
(Address of principal executive offices) (Zip code)
Registrant's telephone number, including area code:
(208) 263-0505

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions 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 o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company þ

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o No þ
The number of shares outstanding of the registrant's Common Stock, no par value per share, as of May 7, 2012 was 20,775,493.

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Intermountain Community Bancorp
FORM 10-Q
For the Quarter Ended March 31, 2012
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PART I — Financial Information
Item - 1 Financial Statements
Intermountain Community Bancorp
Consolidated Balance Sheets
(Unaudited)

	March 31, 2012	December 31, 2011
	(Dollars in thousands)	
ASSETS		
Cash and cash equivalents:		
Interest-bearing	$76,316	$82,242
Non-interest bearing and vault	13,908	24,958
Restricted cash	12,561	2,668
Available-for-sale securities, at fair value	264,313	219,039
Held-to-maturity securities, at amortized cost	15,024	16,143
Federal Home Loan Bank (“FHLB”) of Seattle stock, at cost	2,310	2,310
Loans held for sale	4,172	5,561
Loans receivable, net	492,983	502,252
Accrued interest receivable	4,108	4,100
Office properties and equipment, net	37,155	37,687
Bank-owned life insurance ("BOLI")	9,214	9,127
Other intangibles	159	189
Other real estate owned (“OREO”)	6,852	6,650
Prepaid expenses and other assets	19,556	21,292
Total assets	$958,631	$934,218
LIABILITIES		
Deposits	$731,458	$729,373
Securities sold subject to repurchase agreements	63,635	85,104
Advances from Federal Home Loan Bank	29,000	29,000
Cashier checks issued and payable	355	481
Unexercised stock warrant liability	1,007	—
Accrued interest payable	1,821	1,676
Other borrowings	16,527	16,527
Accrued expenses and other liabilities	11,879	10,441
Total liabilities	855,682	872,602
STOCKHOLDERS’ EQUITY		
Common stock 300,000,000 shares authorized; 20,776,220 and 8,427,212 shares issued and 20,770,214 and 8,409,840 shares outstanding as of March 31, 2012 and December 31, 2011, respectively	91,511	78,916
Preferred stock, Series A, 27,000 shares issued and outstanding as of March 31, 2012 and December 31, 2011; liquidation preference of $1,000 per share	26,241	26,149
Mandatorily Convertible Cumulative Participating Preferred Stock, Series B, 698,993 and 0 shares issued and outstanding as of March 31, 2012 and December 31, 2011, respectively; liquidation preference of $0.01 per share	28,735	—
Accumulated other comprehensive income, net of tax	2,064	2,370
Accumulated deficit	(45,602)	(45,819)
Total stockholders’ equity	102,949	61,616
Total liabilities and stockholders’ equity	$958,631	$934,218

The accompanying notes are an integral part of the consolidated financial statements.

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Intermountain Community Bancorp
Consolidated Statements of Operations
(Unaudited)

	Three Months Ended March 31,	
	2012	2011
	(Dollars in thousands, except per share data)	
Interest income:		
Loans	$7,071	$8,335
Investments	2,049	2,153
Total interest income	9,120	10,488
Interest expense:		
Deposits	822	1,248
Other borrowings	676	529
Total interest expense	1,498	1,777
Net interest income	7,622	8,711
Provision for losses on loans	(959)	(1,633)
Net interest income after provision for losses on loans	6,663	7,078
Other income:		
Fees and service charges	1,625	1,670
Loan related fee income	582	575
Net gain on sale of securities	585	—
Other-than-temporary impairment ("OTTI") losses on investments (1)	(271)	—
Bank-owned life insurance	87	89
Fair value adjustment on cash flow hedge	(384)	—
Other	212	329
Total other income	2,436	2,663
Operating expenses		
Salaries and employee benefits	4,136	4,947
Occupancy expense	1,684	1,787
Advertising	112	130
Fees an service charges	622	651
Printing, postage and supplies	300	337
Legal and accounting	350	235
FDIC assessment	313	445
OREO operations	104	476
Other expenses	677	732
Total operating expenses	8,298	9,740
Net income before income taxes	801	1
Income tax (provision) benefit	—	—
Net income	801	1
Preferred stock dividend	466	443
Net income (loss) applicable to common stockholders	$335	$(442)
Earnings (loss) per share — basic	$0.01	$(0.05)
Earnings (loss) per share — diluted	$0.01	$(0.05)
Weighted average common shares outstanding — basic (2)	44,278,310	8,396,495
Weighted average common shares outstanding — diluted (3)	44,426,732	8,396,495

(1)

Consisting of $7 and 0 of total other-than-temporary impairment net losses, net of $(264) and $0, recognized in other comprehensive income, for the three months ended March 31, 2012, and March 31, 2011, respectively.

(2) Includes the weighted average number of non-voting common shares that would be outstanding if the Series B preferred

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shares issued in the January 2012 private offering are converted to non-voting common shares.
(3) Includes the weighted average number of non-voting common shares that would be outstanding if the warrants issued in the January 2012 private offering are exercised directly for 1,700,000 non-voting common shares or exercised for Series B preferred shares and then converted, utilizing the Treasury stock method.
The accompanying notes are an integral part of the consolidated financial statements.

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Intermountain Community Bancorp
Consolidated Statements of Comprehensive Income (Loss)
(Unaudited)

	Three Months Ended March 31,	
	2012	2011
	(Dollars in thousands)	
Net income	$801	$1
Other comprehensive income:		
Change in unrealized gains on investments, and mortgage backed securities (“MBS”) available for sale, excluding non-credit loss on impairment of securities	(731)	394
Realized net gains reclassified from other comprehensive income	(585)	—
Non-credit loss on impairment on available-for-sale debt securities	263	(168)
Less deferred income tax benefit (provision) on securities	417	(89)
Change in fair value of qualifying cash flow hedge, net of tax	330	13
Net other comprehensive income (loss)	(306)	150
Comprehensive income	$495	$151

The accompanying notes are an integral part of the consolidated financial statements.

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Intermountain Community Bancorp
Consolidated Statements of Cash Flows
(Unaudited)

	Three Months Ended March 31,	
	2012	2011
	(Dollars in thousands)	
Cash flows from operating activities:		
Net income	$801	$1
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	676	768
Stock-based compensation expense	30	72
Net amortization of premiums on securities	1,075	604
Provisions for losses on loans	959	1,633
Goodwill impairment		
Amortization of core deposit intangibles	29	31
(Gain) on sale of loans, investments, property and equipment	(973)	(147)
Impact of hedge dedesignation and current fair value adjustment	458	—
OTTI credit loss on available-for-sale investments	271	—
OREO valuation adjustments	(20)	361
Accretion of deferred gain on sale of branch property	(4)	(3)
Net accretion of loan and deposit discounts and premiums	(3)	(3)
Increase in cash surrender value of bank-owned life insurance	(87)	(89)
Change in:		
Accrued interest receivable	(8)	339
Prepaid expenses and other assets	1,869	606
Accrued interest payable	1,301	(66)
Accrued expenses and other liabilities	(125)	(197)
Proceeds from sale of loans originated for sale	18,242	10,466
Loans originated for sale	(16,465)	(8,717)
Net cash provided by operating activities	8,026	5,659
Cash flows from investing activities:		
Purchases of available-for-sale securities	(62,360)	(4,038)
Proceeds from calls or maturities of available-for-sale securities	1,233	132
Principal payments on mortgage-backed securities	12,190	13,132
Proceeds from calls or maturities of held-to-maturity securities	2,967	22
Origination of loans, net principal payments	7,694	20,094
Purchase of office properties and equipment	(144)	(83)
Proceeds from sale of other real estate owned	439	1,270
Net change in restricted cash	(9,893)	67
Net cash used in investing activities	(47,874)	30,596
Cash flows from financing activities:		
Proceeds from issuance of series B preferred stock, gross	32,460	—
Proceeds from issuance of common stock, gross	13,832	—
Proceeds from issuance of warrant, gross	1,007	—
Capital issuance costs	(5,042)	—
Net change in demand, money market and savings deposits	17,931	5,969
Net change in certificates of deposit	(15,846)	(17,161)

Net change in repurchase agreements	(21,469)	(12,877)
Retirement of treasury stock	—	(4)
Net cash provided by financing activities	22,873	(24,073)
Net change in cash and cash equivalents	(16,975)	12,182
Cash and cash equivalents, beginning of period	107,199	144,666
Cash and cash equivalents, end of period	$90,224	$156,848
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$1,655	$1,843
Income taxes, net of tax refunds received	8	—
Noncash investing and financing activities:		
Loans converted to other real estate owned	620	888
Accrual of preferred stock dividend	374	356

The accompanying notes are an integral part of the consolidated financial statements.

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Intermountain Community Bancorp
Notes to Consolidated Financial Statements (Unaudited)

1. Basis of Presentation:

The foregoing unaudited interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X as promulgated by the Securities and Exchange Commission. Accordingly, these financial statements do not include all of the disclosures required by accounting principles generally accepted in the United States of America for complete financial statements. These unaudited interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2011. In the opinion of management, the unaudited interim consolidated financial statements furnished herein include adjustments, all of which are of a normal recurring nature, necessary for a fair statement of the results for the interim periods presented.

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities known to exist as of the date the financial statements are published, and the reported amounts of revenues and expenses during the reporting period. Uncertainties with respect to such estimates and assumptions are inherent in the preparation of Intermountain Community Bancorp's ("Intermountain's" or "the Company's") consolidated financial statements; accordingly, it is possible that the actual results could differ from these estimates and assumptions, which could have a material effect on the reported amounts of Intermountain's consolidated financial position and results of operations.

2. Investments:

The amortized cost and fair values of investments are as follows (in thousands):

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	Available-for-Sale				
	Amortized Cost	Cumulative Non-Credit OTTI (Losses) Recognized in OCI	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value/ Carrying Value
March 31, 2012					
State and municipal securities	$39,661	$—	$1,751	$(3)	$41,409
Mortgage-backed securities - Agency Pass Throughs	75,163	—	2,007	(303)	76,867
Mortgage-backed securities - Agency CMO's	111,895	—	1,908	(333)	113,470
SBA Pools	18,595	—	—	(147)	18,448
Mortgage-backed securities - Non Agency CMO's (investment grade)	5,590	—	368	—	5,958
Mortgage-backed securities - Non Agency CMO's (below investment grade)	10,003	(1,747)	444	(539)	8,161
	$260,907	$(1,747)	$6,478	$(1,325)	$264,313
December 31, 2011					
U.S. treasury securities and obligations of U.S. government agencies	$21	$—	$—	$—	$21
State and municipal securities	35,352	—	1,791	(8)	37,135
Mortgage-backed securities - Agency Pass Throughs	59,436	—	2,252	(126)	61,562
Mortgage-backed securities - Agency CMO's	103,349	—	2,526	(328)	105,547
Mortgage-backed securities - Non Agency CMO's (investment grade)	5,934	—	389	—	6,323
Mortgage-backed securities - Non Agency CMO's (below investment grade)	10,489	(2,011)	435	(462)	8,451
	$214,581	$(2,011)	$7,393	$(924)	$219,039

	Held-to-Maturity				
	Carrying Value / Amortized Cost	Cumulative Non-Credit OTTI (Losses) Recognized in OCI	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
March 31, 2012					
State and municipal securities	$15,024	$—	$1,374	$—	$16,398
December 31, 2011					
State and municipal securities	$16,143	$—	$1,328	$—	$17,471

The following table summarizes the duration of Intermountain’s unrealized losses on available-for-sale and held-to-maturity securities as of the dates indicated (in thousands).

	Less Than 12 Months		12 Months or Longer		Total	
March 31, 2012	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Residential mortgage-back securities	$72,633	$(623)	$3,772	$(552)	$76,405	$(1,175)

SBA Pools	18,336	(147)	—	—	18,336	(147)
State and municipal securities	3,496	(3)	—	—	3,496	(3)
Total	$94,465	$(773)	$3,772	$(552)	$98,237	$(1,325)

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December 31, 2011	Less Than 12 Months Fair Value	Less Than 12 Months Unrealized Losses	12 Months or Longer Fair Value	12 Months or Longer Unrealized Losses	Total Fair Value	Total Unrealized Losses
State and municipal securities	$1,659	$(8)	$—	$—	$1,659	$(8)
Mortgage-backed securities & CMO's	39,905	(433)	3,993	(483)	43,898	(916)
Total	$41,564	$(441)	$3,993	$(483)	$45,557	$(924)

At March 31, 2012, the amortized cost and fair value of available-for-sale and held-to-maturity debt securities, by contractual maturity, are as follows (in thousands):

	Available-for-Sale Amortized Cost	Available-for-Sale Fair Value	Held-to-Maturity Amortized Cost	Held-to-Maturity Fair Value
One year or less	$—	$—	$130	$130
After one year through five years	2,009	2,124	2,367	2,531
After five years through ten years	—	—	7,779	8,457
After ten years	37,652	39,285	4,748	5,280
Subtotal	39,661	41,409	15,024	16,398
Mortgage-backed securities	202,651	204,456	—	—
SBA Pools	18,595	18,448	—	—
Total Securities	$260,907	$264,313	$15,024	$16,398

Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

Intermountain's investment portfolios are managed to provide and maintain liquidity; to maintain a balance of high quality, diversified investments to minimize risk; to offset other asset portfolio elements in managing interest rate risk; to provide collateral for pledging; and to maximize returns. At March 31, 2012, the Company does not intend to sell any of its available-for-sale securities that have a loss position and it is not likely that it will be required to sell the available-for-sale securities before the anticipated recovery of their remaining amortized cost or maturity date. The unrealized losses on residential mortgage-backed securities without other-than-temporary impairment ("OTTI") were considered by management to be temporary in nature.

The following table presents the OTTI losses for the three months ended March 31, 2012 and March 31, 2011:

	2012 Held To Maturity	2012 Available For Sale	2011 Held To Maturity	2011 Available For Sale
Total other-than-temporary impairment losses	$—	$7	$—	$—
Portion of other-than-temporary impairment losses transferred from (recognized in) other comprehensive income (1)	—	264	—	—
Net impairment losses recognized in earnings (2)	$—	$271	$—	$—

(1) Represents other-than-temporary impairment losses related to all other factors.
(2) Represents other-than-temporary impairment losses related to credit losses.

The OTTI recognized on investment securities available for sale relates to two non-agency collateralized mortgage obligations. Each of these securities holds various levels of credit subordination. These securities were valued by third-party pricing services using matrix or model pricing methodologies and were corroborated by broker indicative bids. We estimated the cash flows of the underlying collateral for each security considering credit, interest and prepayment risk models that incorporate management's estimate of projected key assumptions including prepayment rates, collateral default rates and loss severity. Assumptions utilized vary from security to security, and are influenced

by factors such as underlying loan interest rates, geographic location, borrower characteristics, vintage, and historical experience. We then used a third party to obtain information about the structure of each security, including subordination and other credit enhancements, in order to determine how the underlying collateral cash flows will be distributed to each security issued in the structure. These cash flows were then discounted at the interest rate equal to the yield anticipated at the time the security was purchased. We review the actual collateral performance of these securities on a

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quarterly basis and update the inputs as appropriate to determine the projected cash flows.
See Note 11 “Fair Value of Financial Instruments” for more information on the calculation of fair or carrying value for the investment securities.

3. Loans and Allowance for Loan Losses:
The components of loans receivable are as follows (in thousands):

	March 31, 2012			
	Loans Receivable	%	Individually Evaluated for Impairment	Collectively Evaluated for Impairment
Commercial	$114,460	22.7 %	$9,367	$105,093
Commercial real estate	172,508	34.2	7,861	164,647
Commercial construction	6,405	1.3	747	5,658
Land and land development loans	34,258	6.8	4,549	29,709
Agriculture	75,749	14.9	2,368	73,381
Multifamily	16,949	3.4	—	16,949
Residential real estate	57,879	11.5	3,868	54,011
Residential construction	2,554	0.5	—	2,554
Consumer	9,866	2.0	293	9,573
Municipal	13,369	2.7	—	13,369
Total loans receivable	503,997	100.0 %	$29,053	$474,944
Allowance for loan losses	(11,372)			
Deferred loan fees, net of direct origination costs	358			
Loans receivable, net	$492,983			
Weighted average interest rate	5.59 %			

	December 31, 2011			
	Loans Receivable	%	Individually Evaluated for Impairment	Collectively Evaluated for Impairment
Commercial	$110,395	21.4 %	$8,585	$101,810
Commercial real estate	167,586	32.6	10,918	156,668
Commercial construction	6,335	1.2	747	5,588
Land and land development loans	38,499	7.5	5,173	33,326
Agriculture	81,316	15.8	2,423	78,893
Multifamily	26,038	5.1	—	26,038
Residential real estate	58,861	11.4	4,013	54,848
Residential construction	2,742	0.5	—	2,742
Consumer	11,847	2.3	276	11,571
Municipal	11,063	2.2	—	11,063
Total loans receivable	514,682	100.0 %	$32,135	$482,547
Allowance for loan losses	(12,690)			
Deferred loan fees, net of direct origination costs	260			
Loans receivable, net	$502,252			
Weighted average interest rate	5.69 %			

The components of allowance for loan loss by types are as follows (in thousands):

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	March 31, 2012		
	Total Allowance	Individually Evaluated Allowance	Collectively Evaluated Allowance
Commercial	$2,577	$1,009	$1,568
Commercial real estate	3,953	1,675	2,278
Commercial construction	474	262	212
Land and land development loans	2,210	746	1,464
Agriculture	138	—	138
Multifamily	77	—	77
Residential real estate	1,575	976	599
Residential construction	62	—	62
Consumer	258	175	83
Municipal	48	—	48
Total	$11,372	$4,843	$6,529

	December 31, 2011		
	Total Allowance	Individually Evaluated Allowance	Collectively Evaluated Allowance
Commercial	$2,817	$1,300	$1,517
Commercial real estate	4,880	2,804	2,076
Commercial construction	500	252	248
Land and land development loans	2,273	728	1,545
Agriculture	172	32	140
Multifamily	91	—	91
Residential real estate	1,566	939	627
Residential construction	59	—	59
Consumer	295	195	100
Municipal	37	—	37
Total	$12,690	$6,250	$6,440

A summary of current, past due and nonaccrual loans as of March 31, 2012 is as follows, (in thousands):

	Current	30-89 Days Past Due	90 Days or More Past Due and Accruing	Nonaccrual	Total
Commercial	$110,269	$151	$—	$4,040	$114,460
Commercial real estate	171,290	290	—	928	172,508
Commercial construction	6,360	—	—	45	6,405
Land and land development loans	32,080	96	—	2,082	34,258
Agriculture	75,626	—	—	123	75,749
Multifamily	16,949	—	—	—	16,949
Residential real estate	56,788	333	—	758	57,879
Residential construction	2,554	—	—	—	2,554
Consumer	9,758	84	—	24	9,866
Municipal	13,369	—	—	—	13,369
Total	$495,043	$954	$—	$8,000	$503,997

A summary of current, past due and nonaccrual loans as of December 31, 2011 is as follows, (in thousands):

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	Current	30-89 Days Past Due	90 Days or More Past Due and Accruing	Nonaccrual	Total
Commercial	$106,509	$200	$—	$3,686	$110,395
Commercial real estate	164,578	705	—	2,303	167,586
Commercial construction	6,289	—	—	46	6,335
Land and land development loans	35,835	12	—	2,652	38,499
Agriculture	81,129	—	—	187	81,316
Multifamily	26,038	—	—	—	26,038
Residential real estate	58,037	423	—	401	58,861
Residential construction	2,742	—	—	—	2,742
Consumer	11,739	91	—	17	11,847
Municipal	11,063	—	—	—	11,063
Total	$503,959	$1,431	$—	$9,292	$514,682

The following table provides a summary of Troubled Debt Restructuring ("TDR") by performing status, (in thousands).

	March 31, 2012			December 31, 2011		
Troubled Debt Restructurings	Nonaccrual	Accrual	Total	Nonaccrual	Accrual	Total
Commercial	$369	$609	$978	$571	$371	$942
Commercial real estate	—	2,048	2,048	382	1,889	2,271
Commercial construction	45	295	340	295	46	341
Land and land development loans	73	1,845	1,918	794	782	1,576
Agriculture	—	110	110	—	22	.22
Residential real estate	—	993	993	1,377	—	1,377
Consumer	—	75	75	64	27	91
Total	$487	$5,975	$6,462	$3,483	$3,137	$6,620

A modified loan is considered a TDR when two conditions are met: 1) the borrower is experiencing financial difficulty and 2) concessions are made by the Company that would not otherwise be considered for a borrower with similar credit characteristics. Modified terms are dependent upon the financial position and needs of the individual borrower, as the Company does not employ modification programs for temporary or trial periods. The most common types of modifications include interest rate adjustments, covenant modifications, forbearance and/or other concessions. If the modification agreement is violated, the loan is handled by the Company's Special Assets group for resolution, which may result in foreclosure or other asset disposition.

Generally, TDRs are classified as impaired loans and are TDRs for the remaining life of the loan. Impaired and TDR classification may be removed if the borrower demonstrates compliance with the modified terms and the restructuring agreement specifies an interest rate equal to that which would be provided to a borrower with similar credit at the time of restructuring.

The Company's loans that were modified in the three month period ended March 31, 2012 and considered a TDR are as follows (dollars in thousands):

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	Three months ended March 31, 2012		
	Number	Pre-Modification Recorded Investment	Post-Modification Recorded Investment
Commercial	1	$ 75	$ 75
Commercial real estate	1	100	100
Agriculture	1	110	110
	3	$ 285	$ 285

The balances below provide information as to how the loans were modified as TDRs during the three months ended March 31, 2012, (in thousands).

	Three months ended March 31, 2012	
	Adjusted Interest Rate Only	Other*
Commercial	$ 75	$ —
Commercial real estate	—	100
Agriculture	110	—
	$ 185	$ 100

(*) Other includes term or principal concessions or a combination of concessions, including interest rates.

As of March 31, 2012, the Company had specific reserves of $1.8 million on TDRs, and there were 2 TDRs in default totaling $178,000.

The allowance for loan losses and reserve for unfunded commitments are maintained at levels considered adequate by management to provide for probable loan losses as of the reporting dates. The allowance for loan losses and reserve for unfunded commitments are based on management's assessment of various factors affecting the loan portfolio, including problem loans, business conditions and loss experience, and an overall evaluation of the quality of the underlying collateral. Changes in the allowance for loan losses and the reserve for unfunded commitments during the three month periods ending March 31, 2012 and 2011 are as follows:

	Allowance for Loan Losses March 31, 2012				
	Balance, Beginning of Year	Charge-Offs Jan 1 through Mar 31, 2012	Recoveries Jan 1 through Mar 31 2012	Provision	Balance, End of Period
	(Dollars in thousands)				
Commercial	$ 2,817	$ (679)	$ 37	$ 402	$ 2,577
Commercial real estate	4,880	(1,137)	85	125	3,953
Commercial construction	500	—	2	(28)	474
Land and land development loans	2,273	(473)	38	372	2,210
Agriculture	172	(31)	51	(54)	138
Multifamily	91	—	—	(14)	77
Residential real estate	1,566	(163)	54	118	1,575
Residential construction	59	—	7	(4)	62
Consumer	295	(127)	59	31	258
Municipal	37	—	—	11	48
Allowance for loan losses	$ 12,690	$ (2,610)	$ 333	$ 959	$ 11,372

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Allowance for Loan Losses
March 31, 2011

	Balance, Beginning of Year	Charge-Offs Jan 1 through Mar 31, 2011	Recoveries Jan 1 through Mar 31, 2011	Provision	Balance, End of Period
	(Dollars in thousands)				
Commercial	$2,925	$—	$—	$(514)	$2,411
Commercial real estate	3,655	(477)	1	913	4,092
Commercial construction	540	(382)	58	352	568
Land and land development loans	2,408	(476)	154	392	2,478
Agriculture	779	(294)	40	320	845
Multifamily	83	—	—	(10)	73
Residential real estate	1,252	(213)	40	180	1,259
Residential construction	65	—	—	53	118
Consumer	613	(99)	42	21	577
Municipal	135	—	—	(74)	61
Allowances for loan losses	$12,455	$(1,941)	$335	$1,633	$12,482

Allowance for Unfunded Commitments

	March 31, 2012	2011
	(Dollars in thousands)	
Balance Beginning January 1	$13	$17
Adjustment	1	1
Transfers	—	—
Allowance — Unfunded Commitments at end of period	$14	$18

Management's policy is to charge off loans or portions of loans as soon as an identifiable loss amount can be determined from evidence obtained, such as current cash flow information, updated appraisals or similar real estate evaluations, equipment, inventory or similar collateral evaluations, accepted offers on loan sales or negotiated discounts, and/or guarantor asset valuations. In situations where problem loans are dependent on collateral liquidation for repayment, management obtains updated independent valuations, such as appraisals or broker opinions, generally no less frequently than once every six months and more frequently for larger or more troubled loans. In the time period between these independent valuations, the Company monitors market conditions for any significant event or events that would materially change the valuations, and updates them as appropriate. If the valuations suggest an increase in collateral values, the Company does not recover prior amounts charged off until the assets are actually sold and the increase realized. However, if the updated valuations suggest additional loss, the Company charges off the additional amount.

The following tables summarize impaired loans:

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	Impaired Loans					
	March 31, 2012			December 31, 2011		
	Recorded Investment	Principal Balance	Related Allowance	Recorded Investment	Principal Balance	Related Allowance
	(Dollars in thousands)					
With an allowance recorded:						
Commercial	$2,976	$3,304	$1,009	$2,942	$3,323	$1,300
Commercial real estate	5,094	5,485	1,675	7,439	8,732	2,804
Commercial construction	452	588	262	747	902	252
Land and land development loans	2,166	3,693	746	1,745	3,237	728
Agriculture	—	—	—	32	405	32
Multifamily	—	—	—	—	—	—
Residential real estate	1,827	2,026	976	1,928	2,165	939
Residential construction	—	—	—	—	—	—
Consumer	251	252	175	247	264	195
Municipal	—	—	—	—	—	—
Total	$12,766	$15,348	$4,843	$15,080	$19,028	$6,250
Without an allowance recorded:						
Commercial	$6,391	$10,457	$—	$5,643	$9,099	$—
Commercial real estate	2,767	4,545	—	3,479	5,038	—
Commercial construction	295	295	—	—	198	—
Land and land development loans	2,383	4,614	—	3,428	6,165	—
Agriculture	2,368	2,423	—	2,391	2,512	—
Multifamily	—	—	—	—	—	—
Residential real estate	2,041	2,350	—	2,085	2,296	—
Residential construction	—	—	—	—	—	—
Consumer	42	67	—	29	56	—
Municipal	—	—	—	—	—	—
Total	$16,287	$24,751	$—	$17,055	$25,364	$—
Total:						
Commercial	$9,367	$13,761	$1,009	$8,585	$12,422	$1,300
Commercial real estate	7,861	10,030	1,675	10,918	13,770	2,804
Commercial construction	747	883	262	747	1,100	252
Land and land development loans	4,549	8,307	746	5,173	9,402	728
Agriculture	2,368	2,423	—	2,423	2,917	32
Multifamily	—	—	—	—	—	—
Residential real estate	3,868	4,376	976	4,013	4,461	939
Residential construction	—	—	—	—	—	—
Consumer	293	319	175	276	320	195
Municipal	—	—	—	—	—	—
Total	$29,053	$40,099	$4,843	$32,135	$44,392	$6,250

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	Impaired Loans			
	Three Months Ended March 31, 2012		Three Months Ended March 31, 2011	
	Average Recorded Investment	Interest Income Recognized (*)	Average Recorded Investment	Interest Income Recognized (*)
	(Dollars in thousands)			
With an allowance recorded:				
Commercial	$2,959	$81	$2,137	$42
Commercial real estate	6,267	113	5,403	261
Commercial construction	600	24	406	6
Land and land development loans	1,956	177	3,401	34
Agriculture	16	—	274	11
Multifamily	—	—	—	—
Residential real estate	1,878	42	1,318	41
Residential construction	—	—	55	23
Consumer	249	7	507	12
Municipal	—	—	—	—
Total	$13,925	$444	$13,501	$430
Without an allowance recorded:				
Commercial	$6,017	$959	$8,820	$542
Commercial real estate	3,123	211	6,894	369
Commercial construction	148	5	167	11
Land and land development loans	2,906	224	5,888	316
Agriculture	2,380	125	942	77
Multifamily	—	—	—	—
Residential real estate	2,063	73	1,839	69
Residential construction	—	—	223	3
Consumer	36	4	341	5
Municipal	—	—	—	—
Total	$16,673	$1,601	$25,114	$1,392
Total:				
Commercial	$8,976	$1,040	$10,957	$584
Commercial real estate	9,390	324	12,297	630
Commercial construction	748	29	573	17
Land and land development loans	4,862	401	9,289	350
Agriculture	2,396	125	1,216	88
Multifamily	—	—	—	—
Residential real estate	3,941	115	3,157	110
Residential construction	—	—	278	26
Consumer	285	11	848	17
Municipal	—	—	—	—
Total	$30,598	$2,045	$38,615	$1,822

(*) Interest Income on individually impaired loans is calculated using the cash-basis method.

Loan Risk Factors

The following is a recap of the risk characteristics associated with each of the Company's major loan portfolio segments.

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Commercial Loans: Although the impacts of the long economic downturn have increased losses and continue to heighten risk in the commercial portfolio, management does not consider the portfolio to present “concentration risk” at this time. Management believes there is adequate diversification by type, industry, and geography to mitigate excessive risk. The commercial portfolio includes a mix of term loan facilities and operating loans and lines made to a variety of different business types in the markets it serves. The Company utilizes SBA, USDA and other government-assisted or guaranteed financing programs whenever advantageous to further mitigate risk in this area. With the exception of the agricultural portfolio discussed in more detail below, there is no other significant concentration of industry types in its loan portfolio, and no dominant employer or industry across all the markets it serves. Underwriting focuses on the evaluation of potential future cash flows to cover debt requirements, sufficient collateral margins to buffer against devaluations, credit history of the business and its principals, and additional support from willing and capable guarantors.

Commercial Real Estate Loans: Difficult economic conditions and depressed real estate values continue to increase risk in the non-residential component of the commercial real estate portfolio. However, in comparison to its national peer group and the risk that existed in its construction and development portfolio, the Company has less overall exposure to commercial real estate and a stronger mix of owner-occupied (where the borrower occupies and operates in at least part of the building) versus non-owner occupied loans. The loans represented in this category are spread across the Company's footprint, and there are no significant concentrations by industry type or borrower. The most significant property types represented in the portfolio are office 18.0%, industrial 14.1%, health care 12.8% and retail 9.9%. The other 45.2% is a mix of property types with smaller concentrations, including religious facilities, auto-related properties, restaurants, convenience stores, storage units, motels and commercial investment land. Finished condominiums comprise only 2.2% of the commercial real estate portfolio.

While 66.2% of the Company's commercial real estate portfolio is in its Northern Idaho/Eastern Washington region, this region is a large and diverse region with differing local economies and real estate markets. Given this diversity, and the diversity of property types and industries represented, management does not believe that this concentration represents a significant concentration risk.

Non-owner occupied commercial real estate loans are made only to borrowers with established track records and the ability to fund potential project cash flow shortfalls from other income sources or liquid assets. Project due diligence is conducted by the Bank, to help provide for adequate contingencies, collateral and/or government guaranties. The Company has largely avoided speculative financing of investment properties, particularly of the types most vulnerable in the current downturn, including investment office buildings and retail strip developments. Management believes geographic, borrower and property-type diversification, and prudent underwriting and monitoring standards applied by seasoned commercial lenders mitigate concentration risk in this segment, although general economic weakness continues to negatively impact results.

Construction and Development Loans: After the aggressive reduction efforts of the last three years, the land development and construction loan components pose much lower concentration risk for the total loan portfolio. However, the weakness of the overall construction sector still poses risk to the remaining construction and development portfolio. Residential real estate values tend to fluctuate with economic conditions, and have been falling rapidly in many of the Company's markets for the last three years, although the rate of decline is generally slowing. Management is maintaining its aggressive resolution efforts to further reduce its risk.

Agricultural Loans: The agricultural portfolio represents a larger percentage of the loans in the Bank's southern Idaho region. At the end of the period, agricultural loans and agricultural real estate loans totaled $75.7 million or 15.0% of the total loan portfolio. The agricultural portfolio consists of loans secured by livestock, crops and real estate. Agriculture has typically been a cyclical industry with periods of both strong and weak performance. Current conditions are very strong and are projected to remain solid for the next couple years. To mitigate credit risk, specific

underwriting is applied to retain only borrowers that have proven track records in the agricultural industry. Many of Intermountain's agricultural borrowers are third or fourth generation farmers and ranchers with limited real estate debt, which reduces overall debt coverage requirements and provides extra flexibility and collateral for equipment and operating borrowing needs. In addition, the Bank has hired senior lenders with significant experience in agricultural lending to administer these loans. Further mitigation is provided through frequent collateral inspections, adherence to farm operating budgets, and annual or more frequent review of financial performance. The Company has minimal exposure to the dairy industry, the significant agricultural segment that has been under extreme pressure for the past few years.

Multifamily: The multifamily segment comprises $16.9 million or 3.4% of the total loan portfolio at the end of the period. This portfolio represents relatively low risk for the Company, as a result of the strong current market for multifamily properties and low vacancy rates across the Company's footprint.

Residential Real Estate, Residential Construction and Consumer: Residential real estate, residential construction and consumer loans total $70.3 million or 13.9% of the total loan portfolio. Management does not believe they represent significant concentration

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risk. However, continuing high unemployment and loss of equity is putting pressure on segments of this portfolio, particularly home equity lines and second mortgages.

Municipal loans: Municipal loans comprise $13.4 million or 2.7% of the total loan portfolio. The small size of the portfolio and careful underwriting of the loans within it limit overall concentration risk in this segment.

Credit quality indicators

The risk grade analyses included as part of the Company's credit quality indicators for loans and leases are developed through review of individual borrowers on an ongoing basis. Each loan is evaluated at the time of origination and each subsequent renewal. Loans with principal balances exceeding $500,000 are evaluated on a more frequent basis. Trigger events (such as loan delinquencies, customer contact, and significant collateral devaluation) also require an updated credit quality review. Loans with risk grades four through eight are evaluated at least annually with more frequent evaluations often done as borrower, collateral or market conditions change. In situations where problem loans are dependent on collateral liquidation for repayment, management obtains updated independent valuations, generally no less frequently than once every six months and more frequently for larger or more troubled loans.

Other measurements used to assess credit quality, including delinquency statistics, non accrual and OREO levels, net chargeoff activity, and classified asset trends, are updated and evaluated monthly.

These risk grades are defined as follows:

Satisfactory — A satisfactory rated loan is not adversely classified because it does not display any of the characteristics for adverse classification.

Watch — A watch loan has a solid but vulnerable repayment source. There is loss exposure only if the primary repayment source and collateral experience prolonged deterioration. Loans in this risk grade category are subject to frequent review and change due to the increased vulnerability of repayment sources and collateral valuations.

Special mention — A special mention loan has potential weaknesses that deserve management’s close attention. If left uncorrected, such potential weaknesses may result in deterioration of the repayment prospects or collateral position at some future date. Special mention loans are not adversely classified and do not warrant adverse classification.

Substandard — A substandard loan is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified as substandard generally have a well-defined weakness, or weaknesses, that jeopardize the liquidation of the debt. These loans are characterized by the distinct possibility of loss if the deficiencies are not corrected.

Doubtful — A loan classified doubtful has all the weaknesses inherent in a loan classified substandard with the added characteristic that the weaknesses make collection or liquidation in full highly questionable and improbable, on the basis of currently existing facts, conditions, and values.

Loss — Loans classified loss are considered uncollectible and of such little value that their continuing to be carried as an asset is not warranted. This classification does not necessarily mean that there is to no potential for recovery or salvage value, but rather that it is not appropriate to defer a full write-off even though partial recovery may be realized in the future.

Credit quality indicators by loan segment are summarized as follows:

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Loan Portfolio Credit Grades by Type
March 31, 2012

	Satisfactory Grade 1-3	Internal Watch Grade 4	Special Mention Grade 5	Substandard Grade 6	Doubtful Grade 7	Total
	(Dollars in thousands)					
Commercial	$69,499	$31,674	$192	$13,095	$—	$114,460
Commercial real estate	113,273	45,523	—	13,712	—	172,508
Commercial construction	593	5,065	—	747	—	6,405
Land and land development loans	8,788	18,057	—	7,413	—	34,258
Agriculture	60,593	12,524	—	2,632	—	75,749
Multifamily	899	9,577	—	6,473	—	16,949
Residential real estate	43,270	9,640	—	4,969	—	57,879
Residential construction	2,554	—	—	—	—	2,554
Consumer	8,782	614	—	470	—	9,866
Municipal	13,195	174	—	—	—	13,369
Loans receivable, net	$321,446	$132,848	$192	$49,511	$—	$503,997

Loan Portfolio Credit Grades by Type
December 31, 2011

	Satisfactory Grade 1-3	Internal Watch Grade 4	Special Mention Grade 5	Substandard Grade 6	Doubtful Grade 7	Total
	(Dollars in thousands)					
Commercial	$65,844	$32,293	$—	$12,259	$—	$110,396
Commercial real estate	107,984	43,305	—	16,297	—	167,586
Commercial construction	412	5,175	—	747	—	6,334
Land and land development loans	8,658	20,031	1,392	8,418	—	38,499
Agriculture	65,563	12,827	—	2,926	—	81,316
Multifamily	9,721	9,708	—	6,609	—	26,038
Residential real estate	43,419	10,066	—	5,376	—	58,861
Residential construction	2,742	—	—	—	—	2,742
Consumer	10,476	797	—	574	—	11,847
Municipal	11,063		—		—	11,063
Loans receivable, net	$325,882	$134,202	$1,392	$53,206	$—	$514,682

A summary of non-performing assets and classified loans at the dates indicated is as follows:

	March 31, 2012	December 31, 2011
	(Dollars in thousands)	
Loans past due in excess of 90 days and still accruing	$—	$—
Non-accrual loans	8,000	9,292
Total non-performing loans	8,000	9,292
Other real estate owned (“OREO”)	6,852	6,650
Total non-performing assets (“NPAs”)	$14,852	$15,942
Classified loans (1)	$49,511	$53,206

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1)

Classified loan totals are inclusive of non-performing loans and may also include troubled debt restructured loans, depending on the grading of these restructured loans.

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Classified loans include non-performing loans and performing substandard loans where management believes that the loans may not return principal and interest per their original contractual terms. A loan that is classified may not necessarily result in a loss.

4. Other Real Estate Owned:

At the applicable foreclosure date, OREO is recorded at the fair value of the real estate, less the estimated costs to sell the real estate. The carrying value of OREO is regularly evaluated and, if necessary, the carrying value is reduced to net realizable value. The following table presents OREO for the periods presented:

	Three Months Ended	
	March 31, 2012	March 31, 2011
	(Dollars in thousands)	
Balance, beginning of period	$6,650	$4,429
Additions to OREO	620	888
Proceeds from sale of OREO	(438)	(1,270)
Valuation Adjustments in the period (1)	20	(361)
Balance, end of period, March 31	$6,852	$3,686

(1) Amount includes chargedowns and gains/losses on sale of OREO

The balance of OREO increased by $202,000 during the first quarter, 2012, primarily as a result of additions to OREO. For the periods indicated, OREO assets consisted of the following (in thousands):

	March 31, 2012		December 31, 2011	
Single family residence	$349	5.1%	$166	2.5%
Developed residential lots	2,339	34.1%	2,048	30.8%
Commercial buildings	324	4.7%	483	7.3%
Raw land	3,840	56.1%	3,953	59.4%
Total OREO	$6,852	100.0%	$6,650	100.0%

The Company's Special Assets Group continues to dispose of OREO properties through a combination of individual sales to investors and bulk sales to investors.

5. Advances from the Federal Home Loan Bank of Seattle:

Panhandle State Bank, the banking subsidiary of Intermountain, has a credit line with FHLB of Seattle that allows it to borrow funds up to a percentage of its total assets, subject to collateralization requirements. Certain loans are used as collateral for these borrowings. At March 31, 2012 and December 31, 2011, this credit line represented a total borrowing capacity of $127.7 million and $100.3 million, of which $96.6 million and $69.3 million was available, respectively. The advances from FHLB at March 31, 2012 and December 31, 2011 are repayable as follows (in thousands):

	March 31, 2012		December 31, 2011	
	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate
Due within 1 year	$25,000	2.06%	$25,000	2.06%
Due in 1 to 2 years	—	—		—
Due in 2 to 3 years	4,000	3.11	4,000	3.11
Due in 3 to 4 years	—	—	—	—
Due in 4 to 5 years	—	—	—	—

	$29,000	2.20	%	$29,000	2.20	%

Only member institutions have access to funds from the Federal Home Loan Banks. As a condition of membership, Panhandle is

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required to hold FHLB stock. As of March 31, 2012 and December 31, 2011, Panhandle held $2.3 million of FHLB stock. The FHLB of Seattle announced that they would no longer pay dividends or redeem or repurchase capital stock until further notice. Each FHLB continues to monitor its capital and other relevant financial measures as a basis for determining a resumption of dividends and capital stock repurchases at some later date.

6. Other Borrowings:
The components of other borrowings are as follows (in thousands):

	March 31, 2012	December 31, 2011
Term note payable (1)	$8,279	$8,279
Term note payable (2)	8,248	8,248
Total other borrowings	$16,527	$16,527

(1) In January 2003, the Company issued $8.0 million of Trust Preferred securities through its subsidiary, Intermountain Statutory Trust I. The debt associated with these securities bears interest on a variable basis tied to the 90-day LIBOR (London Inter-Bank Offering Rate) index plus 3.25%, with interest only paid quarterly. The rate on this borrowing was 3.72% at March 31, 2012. The debt is callable by the Company quarterly and matures in March 2033. See Note A and B below.

(2) In March 2004, the Company issued $8.0 million of Trust Preferred securities through its subsidiary, Intermountain Statutory Trust II. The debt associated with these securities bears interest on a variable basis tied to the 90-day LIBOR index plus 2.8%, with interest only paid quarterly. The rate on this borrowing was 3.37% at March 31, 2012. The debt is callable by the Company quarterly and matures in April 2034. During the third quarter of 2008, the Company entered into an interest rate swap contract with Pacific Coast Bankers Bank. The purpose of the $8.2 million notional value swap is to convert the variable rate payments made on our Trust Preferred I obligation to a series of fixed rate payments at 7.38% for five years, as a hedging strategy to help manage the Company's interest-rate risk. See Note A and B below:

A) Intermountain's obligations under the debentures issued to the trusts referred to above constitute a full and unconditional guarantee by Intermountain of the Statutory Trusts' obligations under the Trust Preferred Securities. In accordance with ASC 810, Consolidation, the trusts are not consolidated and the debentures and related amounts are treated as debt of Intermountain.

B) To conserve the liquid assets of the parent Company, the Company's Board of Directors decided to defer regularly scheduled interest payments on its outstanding Junior Subordinated Debentures related to its Trust Preferred Securities ("TRUPS Debentures") beginning in December 2009. The Company is permitted to defer payments of interest on the TRUPS Debentures for up to 20 consecutive quarterly periods without default. During the deferral period, the Company may not pay any dividends or distributions on, or redeem, purchase or acquire, or make a liquidation payment with respect to the Company's capital stock, or make any payment of principal or interest on, or repay, repurchase or redeem any debt securities of the Company that rank equally or junior to the TRUPS Debentures.

7. Earnings Per Share:
The following table presents the basic and diluted earnings per share computations (numbers in thousands):

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	Three Months Ended March 31, 2012	2011
Numerator:		
Net income - basic and diluted	$801	$1
Preferred stock dividend	466	443
Net income (loss) applicable to common stockholders	$335	$(442)
Denominator:		
Weighted average shares outstanding	17,778,027	8,396,495
Effect of participating preferred shares on an as converted basis	26,500,283	—
Weighted average shares outstanding — basic	44,278,310	8,396,495
Dilutive effect of common stock options, warrants, restricted stock awards	148,422	—
Weighted average shares outstanding — diluted	44,426,732	8,396,495
Earnings (loss) per share — basic and diluted:		
Earnings (loss) per share — basic	$0.01	$(0.05)
Effect of dilutive common stock options, warrants, restricted stock awards	—	—
Earnings (loss) per share — diluted	$0.01	$(0.05)
Anti-dilutive securities not included in diluted earnings per share:		
Common stock options	153,095	196,057
Common stock warrant - Series A	653,226	653,226
Restricted shares	—	29,649
Total anti-dilutive shares	806,321	878,932

Common stock equivalents were calculated using the treasury stock method. Series B preferred shares issued as part of the Company's January 2012 capital raise (see Note 8 Stockholders' Equity) have been included on an "as converted" basis in the calculation of basic earnings per share. These preferred shares are automatically convertible into non-voting common stock upon the approval of the issuance of non-voting common by the Company's shareholders, which is expected in the second quarter of 2012. The preferred shares and the non-voting common shares into which they would convert maintain the same dividend rights as the voting common shares of the Company.

As part of the same capital raise, warrants were issued for 1,700,000 shares of non-voting common stock (or the economically equivalent number of Series B preferred shares if non-voting common stock is not available). The impacts of these warrants were included in diluted earnings per share, and were calculated using the treasury stock method.

8. Stockholders' Equity:

On December 19, 2008, the Company issued 27,000 shares of Fixed Rate Cumulative Perpetual Preferred Stock, no par value with a liquidation preference of $1,000 per share (“Preferred Stock”) and a ten-year warrant to purchase up to 653,226 shares of Common Stock, no par value, as part of the Troubled Asset Relief Program Capital Purchase Program of the U.S. Department of Treasury (“U.S. Treasury”). The $27.0 million cash proceeds were allocated between the Preferred Stock and the warrant to purchase common stock based on the relative estimated fair values at the date of issuance, and the estimated value of the warrants was included in equity. The fair value of the warrants was determined under the Black-Scholes model. The model includes assumptions regarding the Company’s common stock prices, dividend yield, and stock price volatility as well as assumptions regarding the risk-free interest rate. The strike price for the warrant is $6.20 per share.

Dividends on the Series A Preferred Stock will accrue and be paid quarterly at a rate of 5% per year for the first five years and thereafter at a rate of 9% per year. During the third quarter of 2009, the Board of Directors of the Company approved the deferral of regularly scheduled quarterly dividends on the Series A Preferred Stock, beginning in December 2009. The shares of Series A Preferred Stock have no stated maturity, do not have voting rights except in

certain limited circumstances and are not subject to mandatory redemption or a sinking fund.

The Series A Preferred Stock has priority over the Company's common stock with regard to the payment of dividends and liquidation distributions. The Series A Preferred Stock qualifies as Tier 1 capital. The agreement with the U.S. Treasury contains limitations on certain actions of the Company, including the payment of quarterly cash dividends on the Company's common stock in excess of current cash dividends paid in the previous quarter and the repurchase of its common stock during the first three years

of the agreement. In addition, the Company agreed that, while the U.S. Treasury owns the Series A Preferred Stock, the Company's employee benefit plans and other executive compensation arrangements for its senior executive officers must comply with Section 111(b) of the Emergency Economic Stabilization Act of 2008.

As part of the Company's capital raise in January, 2012, the Company authorized up to 864,600 shares of Mandatorily Convertible Cumulative Participating Preferred Stock, Series B, no par value with a liquidation preference of $0.01 per share ("Series B Preferred Stock"), 698,993 of which were outstanding as of March 31, 2012, and of which each share of Series B Preferred Stock will automatically convert into 50 shares of a new series of non-voting common stock at a conversion price of $1.00 per share (the "Non-Voting Common Stock") upon shareholder approval of such Non-Voting Common Stock. The Series B Preferred Stock will, with respect to dividend rights and rights on liquidation, winding-up and dissolution, rank (i) on a parity with Series A Preferred Stock and (ii) senior to the Company's Common Stock and the Non-Voting Common Stock. Under the terms of the Series B Preferred Stock, until the authorization of the Non-Voting Common Stock is approved, and prior to June 30, 2012, if the Company pays a dividend or other distribution in respect of our Common Stock, the then holders of the Series B Preferred Stock will be entitled to receive a dividend equal to the product of (x) the per share dividend or other distribution paid in respect to each share of Common Stock and (y) the number of shares of Non-Voting Common Stock into which the Series B Preferred Stock is convertible. Additionally, if the authorization of the Non-Voting Common Stock is not approved by June 30, 2012, then, until such approval is subsequently attained, holders of the Series B Preferred Stock will be entitled to receive dividends at an annual rate equal to 15%, where such rate is calculated with respect to the original issue price of $50.00 per share of Series B Preferred stock. The shares of Series B Preferred Stock have no stated maturity, do not have voting rights except in certain limited circumstances and are not subject to mandatory redemption or a sinking fund.

In addition, as part of the Company's January 2012 capital raise, warrants to purchase 1,700,000 shares of the Company's Voting Common or Non-Voting Common (or an economically equivalent number of Series B Preferred shares if Non-Voting Common is not available) to two of the shareholders participating in the raise. The cash proceeds of the January offering were allocated between the warrants, the Common Stock and the Series B Preferred Stock based on the relative estimated fair values at the date of issuance. The fair value of the warrants was determined under the Black-Scholes model. The model includes assumptions regarding the Company's common stock prices, dividend yield, and stock price volatility as well as assumptions regarding the risk-free interest rate. The strike price for the warrant is $1.00 per share, but is adjusted down if the Company recorded or otherwise issues shares at a price lower than the strike price. As such, the warrants are accounted for as a liability and listed at fair value on the Company's financial statements. Adjustments to the fair value are measured quarterly and any changes are recorded through non-interest income.

Reflecting the Company's ongoing strategy to prudently manage through the current economic cycle, the decision to maximize equity and liquidity at the Bank level had correspondingly reduced cash available at the parent Company. Consequently, to conserve the liquid assets of the parent Company, the Company's Board of Directors decided to defer regularly scheduled interest payments on its outstanding Junior Subordinated Debentures related to its Trust Preferred Securities ("TRUPS Debentures"), and also defer regular quarterly cash dividend payments on its preferred stock held by the U.S. Treasury, beginning in December 2009. The Company is permitted to defer payments of interest on the TRUPS Debentures for up to 20 consecutive quarterly periods without default. During the deferral period, the Company may not pay any dividends or distributions on, or redeem, purchase or acquire, or make a liquidation payment with respect to the Company's capital stock, or make any payment of principal or interest on, or repay, repurchase or redeem any debt securities of the Company that rank equally or junior to the TRUPS Debentures. Under the terms of the preferred stock, if the Company does not pay dividends for six quarterly dividend periods (whether or not consecutive), Treasury would be entitled to appoint two members to the Company's board of directors. Deferred payments compound for both the TRUPS Debentures and preferred stock. Although these expenses will be accrued on the consolidated income statements for the Company, deferring these interest and dividend payments will preserve approximately $477,000 per quarter in cash for the Company.

Notwithstanding the pending deferral of interest and dividend payments, the Company fully intends to meet all of its obligations to the Treasury and holders of the TRUPS Debentures as quickly as it is prudent to do so. The Company is

currently evaluating its position and future plans regarding these dividends.

9. Income Taxes:

For both periods ended March 31, 2012 and March 31, 2011, the Company recorded no income tax provision due to net losses incurred. Intermountain maintained a net deferred tax asset of $13.3 million and $13.2 million as of March 31, 2012 and December 31, 2011, net of a valuation allowance of $8.8 million for each period end.
Intermountain uses an estimate of future earnings, future reversal of taxable temporary difference, and tax planning strategies to determine whether it is more likely than not that the benefit of the deferred tax asset will be realized. At March 31, 2012, Intermountain assessed whether it was more likely than not that it would realize the benefits of its deferred tax asset. Intermountain

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determined that the negative evidence associated with a three-year cumulative loss for the period ended December 31, 2011, and challenging economic conditions continued to outweigh the positive evidence. Therefore, Intermountain maintained the valuation allowance of $8.8 million against its deferred tax asset that was established in 2010. The Company analyzes the deferred tax asset on a quarterly basis and may increase the allowance or release a portion or all of this allowance depending on actual results and estimates of future profitability.

In conducting its valuation allowance analysis, the Company developed an estimate of future earnings to determine both the need for a valuation allowance and the size of the allowance. In conducting this analysis, management has assumed economic conditions will continue to be very challenging in 2012, followed by gradual improvement in the ensuing years. These assumptions are in line with both national and regional economic forecasts. As such, its estimates include elevated credit losses in 2012, but at lower levels than those experienced in 2009 through 2011, followed by improvement in ensuing years as the Company's loan portfolio continues to turn over. It also assumes: (1) a compressed net interest margin in 2012, with gradual improvement in future years, as the Company is able to convert some of its cash position to higher yielding instruments; and (2) reductions in operating expenses as credit costs abate and its other cost reduction strategies continue.

The completion of the $47.3 million capital raise in January, 2012 will trigger Internal Revenue Code Section 382 limitations on the amount of tax benefit from net operating loss carryforwards that the Company can utilize annually, because of the level of investment by several of the larger investors. This could impact the amount and timing of the release of the valuation allowance, largely depending on the level of market interest rates and the fair value of the Company's balance sheet at the time the offering was completed. The evaluation of this impact is still being completed and will likely not be known until the end of 2012.

Intermountain has performed an analysis of its uncertain tax positions and has not recorded any potential penalties, interest or additional tax in its financial statements as of March 31, 2012. Intermountain's tax positions for the years 2008 through 2011 remain subject to review by the Internal Revenue Service. Intermountain does not expect unrecognized tax benefits to significantly change within the next twelve months.

10. Derivative Financial Instruments:

Management uses derivative financial instruments to protect against the risk of interest rate movements on the value of certain assets and liabilities and on future cash flows. The instruments that have been used by the Company include interest rate swaps and cash flow hedges with indices that relate to the pricing of specific assets and liabilities. Derivative instruments have inherent risks, primarily market risk and credit risk. Market risk is associated with changes in interest rates and credit risk relates to the risk that the counterparty will fail to perform according to the terms of the agreement. The amounts potentially subject to market and credit risks are the streams of interest payments under the contracts and the market value of the derivative instrument which is determined based on the interaction of the notional amount of the contract with the underlying instrument, and not the notional principal amounts used to express the volume of the transactions.

Management monitors the market risk and credit risk associated with derivative financial instruments as part of its overall Asset/Liability management process.

In accordance with ASC 815, Derivatives and Hedging, the Company recognizes all derivative financial instruments in the consolidated financial statements at fair value regardless of the purpose or intent for holding the instrument. Derivative financial instruments are included in other assets or other liabilities, as appropriate, on the Consolidated Balance Sheet. Changes in the fair value of derivative financial instruments are either recognized periodically in income or in stockholders' equity as a component of other comprehensive income depending on whether the derivative financial instrument qualifies for hedge accounting, and if so, whether it qualifies as a fair value hedge or cash flow hedge. Generally, changes in fair values of derivatives accounted for as fair value hedges are recorded in income in the same period and in the same income statement line as changes in the fair values of the hedged items that relate to the hedged risk(s). Changes in fair values of derivative financial instruments accounted for as cash flow hedges, to the extent they are effective hedges, are recorded as a component of other comprehensive income, net of deferred taxes. Changes in fair values of derivative financial instruments not qualifying as hedges pursuant to ASC 815 are reported in non-interest income. Derivative contracts are valued by the counter party and are periodically validated by management.

Interest Rate Swaps — Previously designated as Cash Flow Hedges

The tables below identify the Company's interest rate swap which was entered into to hedge certain LIBOR-based trust preferred debentures and designated as a cash flow hedges pursuant to ASC 815, which no longer qualifies for hedge accounting as of March 31, 2012 (dollars in thousands):

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			March 31, 2012	
Maturity Date	Notional Amount	Fair Value (Loss)	Receive Rate (LIBOR)	Pay Rate (Fixed)
Pay Fixed, Receive Variable:				
October 2013	$8,248	$(547)	0.25%	4.58%

			December 31, 2011	
Maturity Date	Notional Amount	Fair Value (Loss)	Receive Rate (LIBOR)	Pay Rate (Fixed)
Pay Fixed, Receive Variable:				
October 2013	$8,248	$(635)	0.2495%	4.58%

The fair value loss of $547,000 at March 31, 2012 and $635,000 at December 31, 2011 are included in other liabilities. The Company has deferred the interest payments on the related Trust Preferred borrowing beginning with the January 2010 scheduled remittance. As a result of the deferred interest payments, a calculation of the effectiveness of the hedge has been prepared each quarter. In March, 2012, it was concluded that the hedge no longer qualified for hedge accounting treatment, based on the mismatch between the deferred payments on the underlying Trust Preferred instrument and the required and expected payments on the derivative. As a result, the Company recorded $163,033 in interest expense and $384,000 in a fair value adjustment on its cash flow hedge in the Company's Statement of Operations. Net cash flows from these interest rate swaps are included in interest expense on trust preferred debentures. At March 31, 2012, Intermountain had $600,000 in restricted cash pledged as collateral for the cash flow hedge. The following table provides a reconciliation of cash flow hedges measured at fair value during the periods indicated (in thousands):

	Three Months Ended	
	March 31, 2012	December 31, 2011
Unrealized loss at beginning of period	$(635)	$(892)
Amount of gross gain (loss) recognized in earnings gain (loss)	(458)	86
Amount of gross gain (loss) recognized in other comprehensive income gain (loss)	546	171
Unrealized loss at end of period	$(547)	$(635)

Interest Rate Swaps — Not Designated as Hedging Instruments Under ASC 815

The Company has purchased certain derivative products to allow the Company to effectively convert a fixed rate loan to a variable rate payment stream. The Company economically hedges derivative transactions by entering into offsetting derivatives executed with third parties upon the origination of a fixed rate loan with a customer. Derivative transactions executed as part of this program are not designated as ASC 815 hedge relationships and are, therefore, marked to market through earnings each period. In most cases the derivatives have mirror-image terms to the underlying transaction being hedged, which result in the positions' changes in fair value offsetting completely through earnings each period. However, to the extent that the derivatives are not a mirror-image, changes in fair value will not completely offset, resulting in some earnings impact each period. Changes in the fair value of these interest rate swaps are included in other non-interest income. The following table summarizes these interest rate swaps as of March 31, 2012 and December 31, 2011 (in thousands):

	March 31, 2012		December 31, 2011	
	Notional Amount	Fair Value Loss	Notional Amount	Fair Value Loss

Interest rate swaps with third party financial institutions	$2,559	$(205)	$2,559	$(215)

At March 31, 2012, loans receivable included ($205,000) of derivative assets and other liabilities included $0 of derivative assets related to these interest rate swap transactions. At March 31, 2012, the interest rate swaps had a maturity date of March 2019 and April 2024 and Intermountain had $72,000 in restricted cash as collateral for the interest rate swaps.

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11. Fair Value of Financial Instruments:

Fair value is defined under ASC 820-10 as the price that would be received for an asset or paid to transfer a liability (an exit price) in the principal market for the asset or liability in an orderly transaction between market participants on the measurement date. Fair value estimates are based on quoted market prices, if available. If quoted market prices are not available fair value estimates are based on quoted market prices of similar assets or liabilities, or the present value of expected future cash flows and other valuation techniques. These valuations are significantly affected by discount rates, cash flow assumptions, and risk and other assumptions used. Therefore, fair value estimates may not be substantiated by comparison to independent markets and are not intended to reflect the proceeds that may be realizable in an immediate settlement of the instruments.

Fair value is determined at one point in time and is not representative of future value. These amounts do not reflect the total value of a going concern organization. Management does not have the intention to dispose of a significant portion of its assets and liabilities and therefore, the unrealized gains or losses should not be interpreted as a forecast of future earnings and cash flows.

In support of these representations, ASC 820-10 establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy is as follows:

Level 1 inputs — Unadjusted quoted prices in active markets for identical assets or liabilities that the entity has the ability to access at the measurement date.

Level 2 inputs — Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 inputs — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair values requires significant management judgment or estimation.

The following tables present information about the Company's assets measured at fair value on a recurring basis as of March 31, 2012, and December 31, 2011, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value (in thousands).

	Fair Value Measurements At March 31, 2012, Using			
	Fair Value	Quoted Prices In Active Markets for Identical Assets	Other Observable Inputs	Significant Unobservable Inputs
Description	March 31, 2012	(Level 1)	(Level 2)	(Level 3)
Available-for-Sale Securities:				
State and municipal securities	41,409		41,409	
Residential mortgage backed securities ("MBS")	222,904	—	208,786	14,118
Other Assets — Derivative	(205)	—	—	(205)
Total Assets Measured at Fair Value	$264,108	$—	$250,195	$13,913
Other Liabilities — Derivatives	$547	$—	$—	$547
Unexercised Warrants	1,007	—	—	1,007
Total Liabilities Measured at Fair Value	1,554	—	—	1,554

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Description	Fair Value Measurements At December 31, 2011 Using			
	Fair Value	Quoted Prices In Active Markets for Identical Assets	Other Observable Inputs	Significant Unobservable Inputs
	December 31, 2011	(Level 1)	(Level 2)	(Level 3)
Available-for-Sale Securities:				
U.S. treasury securities and obligations of U.S. government agencies	$—	$—	$—	$—
State and municipal securities	37,135		37,135	
Residential mortgage backed securities (“MBS”)	181,904	—	167,130	14,774
Other Assets — Derivative	(215)	—	—	(215)
Total Assets Measured at Fair Value	$218,824	$—	$204,265	$14,559
Other Liabilities — Derivatives	$635	$—	$—	$635

The changes in Level 3 assets and liabilities measured at fair value on a recurring basis as of March 31, 2012 and December 31, 2011 are summarized as follows (in thousands):

Description	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)		
	Residential MBS	Derivatives	Total
January 1, 2012 Balance	$14,774	$(215)	$14,559
Total gains or losses (realized/unrealized):			
Included in earnings	(271)	10	(261)
Included in other comprehensive income	244	—	244
Principal Payments	(629)	—	(629)
Sales of Securities	—	—	—
Transfers in and /or out of Level 3	—	—	—
March 31, 2012 Balance	$14,118	$(205)	$13,913

Description	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)		
	Unexercised Warrants	Derivatives	Total
January 1, 2012 Balance	$—	$635	$635
Total gains or losses (realized/unrealized):			
Included in earnings	—	458	458
Included in other comprehensive income	—	(546)	(546)
Unexercised warrants issued in capital raise	1,007	—	1,007
Transfers in and /or out of Level 3	—	—	—
March 31, 2012 Balance	$1,007	$547	$1,554

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Description	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Residential MBS	Derivatives	Total
January 1, 2011 Balance	$29,514	$(38)	$29,476
Total gains or losses (realized/unrealized):			
Included in earnings	(1,273)	(177)	(1,450)
Included in other comprehensive income	2,338	—	2,338
Principal Payments	(3,874)	—	(3,874)
Sales of Securities	(11,931)	—	(11,931)
Transfers in and /or out of Level 3	—	—	—
December 31, 2011 Balance	$14,774	$(215)	$14,559

Description	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Derivatives
January 1, 2011 Balance	$892
Total gains or losses:	
Included in earnings	(86)
Included in other comprehensive income	(171)
December 31, 2011 Balance	$635

The following tables present additional quantitative information about assets and liabilities measured at fair value on a recurring basis and for which the company has utilized Level 3 inputs to determine fair value, as of March 31, 2012:

	Quantitative Information about Level 3 Fair Value Measurements - Assets			
March 31, 2012	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range of Inputs
Residential mortgage-backed securities	$14,118	Discounted cash flow and consensus pricing	Prepayment	4.03 to 43.03 CPR (1)
			Default rates	0 to 11.63 CDR (2)
			Loss severities	0% to 227.5%
Interest Rate Derivatives	$(205)	Discounted cash flow modeling and market indications	Cash flows of underlying instruments	Various payment mismatches based on characteristics of underlying loans
			Swap rates	0.50% to 1.00%
			LIBOR rates	0.25% to 0.75%

(1) CPR: Constant prepayment rate
(2) CDR: Constant default rate

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	Quantitative Information about Level 3 Fair Value Measurements - Liabilities			
March 31, 2012	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range of Inputs
Unexercised Warrants	$ 1,007	Black Scholes model	Estimated underlying stock price volatility	90% to 100%
			Duration	2.5 to 3.0 years
			Risk-free rate	0.40% to 1.00%
Interest Rate Derivatives	$ 547	Discounted cash flow modeling and market indications	Cash flows of underlying instruments	Various payment mismatches based on characteristics of underlying loans
			Swap rates	0.50% to 1.00%
			LIBOR rates	0.25% to 0.75%

Intermountain may be required, from time to time, to measure certain other financial assets at fair value on a non-recurring basis. The following table presents the carrying value for these financial assets as of March 31, 2012 and December 31, 2011 (in thousands):

	Fair Value Measurements At March 31, 2012, Using			
	Fair Value	Quoted Prices In Active Markets for Identical Assets	Other Observable Inputs	Significant Unobservable Inputs
Description	March 31, 2012	(Level 1)	(Level 2)	(Level 3)
Loans(1)	$24,210	$—	$—	$24,210
OREO	6,852	—	—	6,852
Total Assets Measured at Fair Value	$31,062	$—	$—	$31,062

(1) Represents impaired loans, net of allowance for loan loss, which are included in loans.

	Fair Value Measurements At December 31, 2011, Using			
	Fair Value	Quoted Prices In Active Markets for Identical Assets	Other Observable Inputs	Significant Unobservable Inputs
Description	December 31, 2011	(Level 1)	(Level 2)	(Level 3)
Loans(1)	$ 25,885	$ —	$ —	$ 25,885
OREO	6,650	—	—	6,650
Total Assets Measured at Fair Value	$ 32,535	$ —	$ —	$ 32,535

(1) Represents impaired loans, net of allowance for loan loss, which are included in loans.

The following table presents additional quantitative information about assets measured at fair value on a nonrecurring basis and for which the company has utilized Level 3 inputs to determine fair value:

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March 31, 2012	Quantitative Information about Level 3 Fair Value Measurements - Liabilities Fair Value Estimate	Valuation Techniques	Unobservable Input	Range of Inputs
Impaired Loans	$24,210	Discounted cash flows and appraisal of collateral	Amount and timing of cash flows	No payment deferral to indefinite payment deferral
			Discount Rate	4% to 9%
			Appraisal adjustments	10% to 15%
			Liquidations Expenses	10% to 15%
OREO	$6,852	Appraisal of collateral	Appraisal adjustments	10% to 35%
			Liquidation Expenses	10% to 15%

The loans above represent impaired loans that have been adjusted to fair value. When a loan is identified as impaired, the impairment is measured using either the present value of the estimated future cash flows of the loan or for loans that are collateral dependent, the current fair value of the collateral, less selling costs. Depending on the characteristics of a loan, the fair value of collateral is generally estimated by obtaining external appraisals or other market-based valuation methods. If the value of the impaired loan is determined to be less than the recorded investment in the loan, the impairment is recognized and the carrying value of the loan is adjusted to fair value through the allowance for loan and lease losses. The carrying value of loans fully charged-off is zero.

OREO represents real estate which the Company has taken control of in partial or full satisfaction of loans. At the time of foreclosure, OREO is recorded at the lower of the carrying amount of the loan or fair value less estimated costs to sell, which becomes the property’s new basis. Any write-downs based on the asset’s fair value at the date of acquisition are charged to the allowance for loan and lease losses. After foreclosure, management periodically performs valuations such that the real estate is carried at the lower of its new cost basis or fair value, net of estimated costs to sell. Fair value adjustments on other real estate owned are recognized within net loss on real estate owned as a component of non-interest expense.

The following is a further description of the principal valuation methods used by the Company to estimate the fair values of its financial instruments.

Securities. The fair values of securities, other than those categorized as level 3 described above, are based principally on market prices and dealer quotes. Certain fair values are estimated using pricing models or are based on comparisons to market prices of similar securities. The fair value of stock in the FHLB equals its carrying amount since such stock is only redeemable at its par value.

Available for Sale Securities. Securities totaling $250.2 million classified as available for sale are reported at fair value utilizing Level 2 inputs. For these securities, the Company obtained fair value measurements from an independent pricing service and internally validated these measurements. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus, prepayment speeds, credit information and the bond’s terms and conditions, among other things.

The available for sale portfolio also includes $14.1 million in super senior or senior tranche collateralized mortgage obligations not backed by a government or other agency guarantee. These securities are collateralized by fixed rate prime or Alt A mortgages, are structured to provide credit support to the senior tranches, and are carefully analyzed and monitored by management. Because of disruptions in the current market for mortgage-backed securities and

collateralized mortgage obligations, an active market did not exist for these securities at March 31, 2012. This is evidenced by a significant widening in the bid-ask spread for these types of securities and the limited volume of actual trades made. As a result, less reliance can be placed on easily observable market data, such as pricing on transactions involving similar types of securities, in determining their current fair value. As such, significant adjustments were required to determine the fair value at the March 31, 2012 measurement date. These securities are valued using Level 3 inputs.

In valuing these securities, the Company utilized the same independent pricing service as for its other available-for-sale securities and internally validated these measurements. In addition, it utilized FHLB indications, which are backed by significant experience in whole-loan collateralized mortgage obligation valuation and another market source to derive independent valuations and used this data to evaluate and adjust the original values derived. In addition to the observable

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market-based input including dealer quotes, market spreads, live trading levels and execution data, both the pricing service and the FHLB pricing also employed a present-value income model that considered the nature and timing of the cash flows and the relative risk of receiving the anticipated cash flows as agreed. The discount rates used were based on a risk-free rate, adjusted by a risk premium for each security. In accordance with the requirements of ASC 820-10, the Company has determined that the risk-adjusted discount rates utilized appropriately reflect the Company’s best estimate of the assumptions that market participants would use in pricing the assets in a current transaction to sell the asset at the measurement date. Risks include nonperformance risk (that is, default risk and collateral value risk) and liquidity risk (that is, the compensation that a market participant receives for buying an asset that is difficult to sell under current market conditions). To the extent possible, the pricing services and the Company validated the results from these models with independently observable data.

Loans. Periodically, the Company records nonrecurring adjustments to the carrying value of loans based on fair value measurements for partial charge-offs of the uncollectible portions of those loans. Nonrecurring adjustments also include certain impairment amounts for impaired loans when establishing the allowance for credit losses. Such amounts are generally based on either the estimated fair value of the cash flows to be received or the fair value of the underlying collateral supporting the loan less selling costs. Real estate collateral on these loans and the Company’s OREO is typically valued using appraisals or other indications of value based on recent comparable sales of similar properties or assumptions generally observable in the marketplace. Management reviews these valuations and makes additional valuation adjustments, as necessary, including subtracting estimated costs of liquidating the collateral or selling the OREO. The related nonrecurring fair value measurement adjustments have generally been classified as Level 3 because of the significant assumptions required estimating future cash flows on these loans, and the rapidly changing and uncertain collateral values underlying the loans. Volatility and the lack of relevant and current sales data in the Company’s market areas for various types of collateral create additional uncertainties and require the use of multiple sources and management judgment to make adjustments. Loans subject to nonrecurring fair value measurement were $24.2 million at December 31, 2011 all of which were classified as Level 3.

Other Real Estate Owned. At the applicable foreclosure date, OREO is recorded at fair value of the real estate, less the estimated costs to sell the real estate. Subsequently, OREO is carried at the lower of cost or net realizable value (fair value less estimated selling costs), and is periodically assessed for impairment based on fair value at the reporting date. Fair value is determined from external appraisals and other valuations using judgments and estimates of external professionals. Many of these inputs are not observable and, accordingly, these measurements are classified as Level 3. The Company’s OREO at March 31, 2012 totaled $6.9 million, all of which was classified as Level 3.

Interest Rate Swaps. During the third quarter of 2008, the Company entered into an interest rate swap contract with Pacific Coast Bankers Bank. The purpose of the $8.2 million notional value swap is to convert the variable rate payments made on the Trust Preferred I obligation (see Note 6 — Other Borrowings) to a series of fixed rate payments for five years, as a hedging strategy to help manage the Company’s interest-rate risk.

This contract is carried as an asset or liability at fair value, and as of March 31, 2012, it was a liability with a fair value of $547,000.

During the first quarter of 2009, the Company entered into an interest rate swap contract with Pacific Coast Bankers Bank. The purpose of the $1.6 million notional value swap is to convert the fixed rate payments earned on a loan receivable to a series of variable rate payments for ten years, as a hedging strategy to help manage the Company’s interest-rate risk. This contract is carried as an asset or liability at fair value, and as of March 31, 2012, it was an asset with a fair value of ($128,000). During the second quarter of 2009, the Company entered into an interest rate swap contract with Pacific Coast Bankers Bank. The purpose of the $1.0 million notional value swap is to convert the fixed rate payments earned on a loan receivable to a series of variable rate payments for ten years, as a hedging strategy to help manage the Company’s interest-rate risk. This contract is carried as an asset or liability at fair value, and as of December 31, 2011, it was an asset with a fair value of ($77,000).

Unexercised Warrant Liability. A liability for unexercised warrants was created as part of the Company's capital raise in January, 2012 (see Note 8--Stockholders' Equity). The liability is carried at fair value and adjustments are made periodically through non-interest income to record changes in the fair value. The fair value is measured using the Black Scholes, we seeks to estimate the market price that the unexercised options would bring if sold. Assumptions

used in calculating the value include the volatility of the underlying stock, the risk-free interest rate, the expected term of the warrants, the market price of the underlying stock and the dividend yield on the stock. The fair value at March 31, 2012 was a liability of $1.0 million.

Intermountain is required to disclose the estimated fair value of financial instruments, both assets and liabilities on and off the balance sheet, for which it is practicable to estimate fair value. These fair value estimates are made at March 31, 2012 based on relevant market information and information about the financial instruments. Fair value estimates are intended to represent the price an asset could be sold at or the price a liability could be settled for. However, given there is no active market or observable market transactions for many of the Company’s financial instruments, the Company has made estimates of many of these fair values which are subjective in nature, involve uncertainties and matters of significant judgment and therefore cannot be determined

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with precision. Changes in assumptions could significantly affect the estimated values.
The estimated fair value of the financial instruments as of March 31, 2012 and December 31, 2011, are as follows (in thousands):

	March 31, 2012				
	Carrying Amount	Fair Value	Quoted Priced in Active Markets for identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial assets:					
Cash, cash equivalents, restricted cash and federal funds sold	$102,785	$102,785	$102,785	$—	$—
Available-for-sale securities	264,313	264,313	—	250,195	14,118
Held-to-maturity securities	15,024	16,399	—	16,399	—
Loans held for sale	4,172	4,172	—	4,172	—
Loans receivable, net	492,983	505,452	—	—	505,452
Accrued interest receivable	4,108	4,108	—	4,108	—
BOLI	9,214	9,214	—	9,214	—
Financial liabilities:				—	—
Deposit liabilities	731,458	712,526	—	—	712,526
Borrowings	109,162	108,885	—	—	108,885
Accrued interest payable	1,821	1,821	—	1,821	—
Unexercised warrants	1,007	1,007	—	—	1,007

	December 31, 2011	
	Carrying Amount	Fair Value
Financial assets:		
Cash, cash equivalents, restricted cash and federal funds sold	$109,868	$109,868
Interest bearing certificates of deposit	—	—
Available-for-sale securities	219,039	219,039
Held-to-maturity securities	16,143	17,471
Loans held for sale	5,561	5,561
Loans receivable, net	502,252	515,737
Accrued interest receivable	4,100	4,100
BOLI	9,127	9,127
Financial liabilities:		
Deposit liabilities	729,373	709,534
Borrowings	130,631	131,202
Accrued interest payable	1,676	1,676

The methods and assumptions used to estimate the fair values of each class of financial instruments are as follows:
Cash, Cash Equivalents, Federal Funds and Certificates of Deposit
The carrying value of cash, cash equivalents, federal funds sold and certificates of deposit approximates fair value due to the relatively short-term nature of these instruments.
Investments and BOLI

See the discussion above regarding the fair values of investment securities. The fair value of BOLI is equal to the cash surrender value of the life insurance policies.

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Loans Receivable and Loans Held For Sale
The fair value of performing mortgage loans, commercial real estate, construction, consumer and commercial loans is estimated by discounting the cash flows using interest rates that consider the interest rate risk inherent in the loans and current economic and lending conditions. See the above discussion for fair valuation of impaired loans. Non-accrual loans are assumed to be carried at their current fair value and therefore are not adjusted.
Deposits
The fair values for deposits subject to immediate withdrawal such as interest and non-interest bearing checking, savings and money market deposit accounts are discounted using market rates for replacement dollars and using Company and industry statistics for decay/maturity dates. The carrying amounts for variable-rate certificates of deposit and other time deposits approximate their fair value at the reporting date. Fair values for fixed-rate certificates of deposit are estimated by discounting future cash flows using interest rates currently offered on time deposits with similar remaining maturities.
Borrowings
The carrying amounts of short-term borrowings under repurchase agreements approximate their fair values due to the relatively short period of time between the origination of the instruments and their expected payment. The fair value of long-term FHLB Seattle advances and other long-term borrowings is estimated using discounted cash flow analyses based on the Company’s current incremental borrowing rates for similar types of borrowing arrangements with similar remaining terms.
Accrued Interest
The carrying amounts of accrued interest payable and receivable approximate their fair value.

12. Subsequent Events:

On April 23, 2012, the Company commenced a rights offering for up to $8.7 million that will allow existing shareholders to purchase common shares at $1.00 per share, the same purchase price per share as the private placement investors paid in the $47.3 million capital raise that the Company completed in January 2012. Certain investors from the January private placement have agreed, subject to applicable regulatory limitations, to purchase shares that any existing shareholders do not purchase in the rights offering.
The Company expects to use the proceeds from the planned rights offering to strengthen its balance sheet, reinvest in its communities and for other general corporate purposes, including using all or a portion of such proceeds to redeem its Series A Preferred Stock held by the U.S. Treasury as part of the TARP Capital Purchase Program.

13. New Accounting Pronouncements:

In April 2011, the FASB issued ASU No. 2011-03, “Reconsideration of Effective Control for Repurchase Agreements.” ASU No. 2011-03 modifies the criteria for determining when repurchase agreements would be accounted for as a secured borrowing rather than as a sale. Currently, an entity that maintains effective control over transferred financial assets must account for the transfer as a secured borrowing rather than as a sale. The provisions of ASU No. 2011-03 removes from the assessment of effective control the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee. The FASB believes that contractual rights and obligations determine effective control and that there does not need to be a requirement to assess the ability to exercise those rights. ASU No. 2011-03 does not change the other existing criteria used in the assessment of effective control. The provisions of ASU No. 2011-03 are effective prospectively for transactions, or modifications of existing transactions, that occur on or after January 1, 2012. As the Company accounts for all of its repurchase agreements as collateralized financing arrangements, the adoption of this ASU did not have a material impact on the Company's statements of operation and financial condition.

In May 2011, the FASB issued ASU No. 2011-04, "Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs." ASU No. 2011-04 results in a consistent definition of fair value and common requirements for measurement of and disclosure about fair value between U.S. GAAP and International Financial Reporting Standards ("IFRS"). The changes to U.S. GAAP as a result of ASU No. 2011-04 are as follows: (1) The concepts of highest and best use and valuation premise are only relevant when measuring the fair value of nonfinancial assets (that is, it does not apply to financial assets or any liabilities); (2) U.S. GAAP currently prohibits application of a blockage factor in valuing financial instruments with quoted prices

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in active markets. ASU No. 2011-04 extends that prohibition to all fair value measurements; (3) An exception is provided to the basic fair value measurement principles for an entity that holds a group of financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk that are managed on the basis of the entity's net exposure to either of those risks. This exception allows the entity, if certain criteria are met, to measure the fair value of the net asset or liability position in a manner consistent with how market participants would price the net risk position; (4) Aligns the fair value measurement of instruments classified within an entity's shareholders' equity with the guidance for liabilities; and (5) Disclosure requirements have been enhanced for recurring Level 3 fair value measurements to disclose quantitative information about unobservable inputs and assumptions used, to describe the valuation processes used by the entity, and to describe the sensitivity of fair value measurements to changes in unobservable inputs and interrelationships between those inputs. In addition, entities must report the level in the fair value hierarchy of items that are not measured at fair value in the statement of condition but whose fair value must be disclosed. The provisions of ASU No. 2011-04 are effective for the Company's interim reporting period beginning on or after December 15, 2011. The adoption of ASU No. 2011-04 did not have a material impact on the Company's statements of operation and financial condition.

In June 2011, the FASB issued ASU No. 2011-05, “Presentation of Comprehensive Income.” The provisions of ASU No. 2011-05 allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. The statement(s) are required to be presented with equal prominence as the other primary financial statements. ASU No. 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders' equity but does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The provisions of ASU No. 2011-05 are effective for the Company's interim reporting period beginning on or after December 15, 2011, with retrospective application required. The adoption of ASU No. 2011-05 is expected to result in presentation changes to the Company's statements of operations and the addition of a statement of comprehensive income. The adoption of ASU No. 2011-05 did not have an impact on the Company's statements of condition.

In September 2011, the FASB issued ASU No. 2011-08, “Testing Goodwill for Impairment.” The provisions of ASU No. 2011-08 permits an entity an option to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If an entity believes, as a result of its qualitative assessment, that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further impairment testing is required. ASU No. 2011-08 includes examples of events and circumstances that may indicate that a reporting unit's fair value is less than its carrying amount. The provisions of ASU No. 2011-08 are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted provided that the entity has not yet performed its annual impairment test for goodwill. The Company performs its annual impairment test for goodwill in the fourth quarter of each year. The adoption of ASU No. 2011-08 did not have a material impact on the Company's statements of operation and financial condition.

Item 2 — Management’s Discussion and Analysis of Financial Condition and Results of Operations

This report contains forward-looking statements. For a discussion about such statements, including the risks and uncertainties inherent therein, see “Forward-Looking Statements.” Management’s Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the Consolidated Financial Statements and Notes presented elsewhere in this report and in Intermountain’s Form 10-K for the year ended December 31, 2011.

General (Overview & History)

Intermountain Community Bancorp ("Intermountain" or the "Company") is a bank holding company registered under the Bank Holding Company Act of 1956, as amended. The Company was formed as Panhandle Bancorp in October 1997 under the laws of the State of Idaho in connection with a holding company reorganization of Panhandle State Bank (the "Bank") that was approved by the stockholders on November 19, 1997 and became effective on January 27, 1998. In September 2000, Panhandle Bancorp changed its name to Intermountain Community Bancorp.

Panhandle State Bank, a wholly owned subsidiary of the Company, was first opened in 1981 to serve the local banking needs of Bonner County, Idaho. Panhandle State Bank is regulated by the Idaho Department of Finance, the State of Washington Department of Financial Institutions, the Oregon Division of Finance and Corporate Securities and by the Federal Deposit Insurance Corporation ("FDIC"), its primary federal regulator and the insurer of its deposits. Since opening in 1981, the Bank has continued to grow by opening additional branch offices throughout Idaho and has also expanded into the states of Oregon and Washington. Intermountain also operates a Trust & Investment Services division, which

provides investment, insurance, wealth management and trust services to its clients.
The national economic recession and continuing soft local markets have slowed the Company’s growth over the past several years. In response, Company management shifted its priorities to improving asset quality, raising additional capital, maintaining a conservative balance sheet and improving the efficiency of its operations. Significant progress has been made in these areas, and management is now implementing plans to pursue prudent growth opportunities.
Intermountain offers banking and financial services that fit the needs of the communities it serves. Lending activities include consumer, commercial, commercial real estate, residential construction, mortgage and agricultural loans. A full range of deposit services are available including checking, savings and money market accounts as well as various types of certificates of deposit. Trust and wealth management services, investment and insurance services, and business cash management solutions round out the Company’s product offerings.

Business Strategy & Opportunities

Intermountain seeks to differentiate itself by attracting, retaining and motivating highly experienced employees who are local market leaders, and supporting them with advanced technology, training and compensation systems. This approach allows the Bank to provide local marketing and decision-making to respond quickly to customer opportunities and build leadership in its communities. Simultaneously, the Bank has focused on standardizing and centralizing administrative and operational functions to improve risk management, efficiency and the ability of the branches to serve customers effectively.
The Company’s strengths include a strong, committed team of experienced banking officers, a loyal and low-cost deposit base, a strong net interest margin, a sophisticated and increasingly effective risk management system, and a strong operational and compliance infrastructure. In the current slow-growth environment, the Company is leveraging these strengths to seek prudent growth opportunities, further reduce risk on its balance sheet, and lower interest and non-interest expense. In particular, Company management is focused on the following:

- Increasing and diversifying its loan origination activity by pursuing attractive small and mid-market commercial credits in its markets, originating commercial real estate loans to strong borrowers at lower real estate prices, originating and seasoning mortgage loans to strong borrowers at conservative loan-to-values in rural and smaller suburban areas not well-served by current secondary market appraisal standards, expanding and diversifying its agricultural portfolio, and expanding its already strong government-guaranteed loan marketing efforts.
- Maintaining a conservative balance sheet and effectively managing Company risk amidst a still uncertain economic and regulatory environment.
- Increasing the efficiency of its operations by continuing to restructure processes, re-negotiate contracts and rationalize various business functions.
- Increasing local, transactional deposit balances while continuing to minimize interest expense by increasing referral activity and targeting specific business and non-profit groups.
- Offsetting anticipated regulatory pressures on current non-interest income streams by expanding its trust, investment and insurance sales, restructuring current product pricing plans, and pursuing opportunities to diversify into new fee-based programs serving both its existing clientele and new potential markets.

In further pursuit of these goals, the Company continues to pursue additional capital. The Company successfully closed on a private offering that netted $42.3 million in new capital for the Company in January, 2012, ("Rights Offering"). It has now commenced an $8.7 million rights offering to existing shareholders of record as of January 20, 2012, which will allow them to buy shares at the same $1.00 share price that the private placement investors received. The Company expects to use the proceeds from the capital raise and the rights offering to make capital contributions to further strengthen its balance sheet, reinvest in its communities and for other general corporate purposes, including, subject to regulatory approval, using all or a portion of such proceeds to redeem its Series A Preferred Stock held by the U.S. Treasury as part of the TARP Capital Purchase Program.
Once completed the two capital offerings will allow the Company additional flexibility to pursue the above goals. In addition, management believes that disruption and consolidation in the market may lead to other opportunities as well, either through direct acquisition of other banks or by capitalizing on opportunities created by market disruption to

attract strong new employees and customers.

Critical Accounting Policies

The accounting and reporting policies of Intermountain conform to Generally Accepted Accounting Principles ("GAAP") and to general practices within the banking industry. The preparation of the financial statements in conformity with GAAP requires

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management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Intermountain's management has identified the accounting policies described below as those that, due to the judgments, estimates and assumptions inherent in those policies, are critical to an understanding of Intermountain's Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations.

Investments. Assets in the investment portfolio are initially recorded at cost, which includes any premiums and discounts. Intermountain amortizes premiums and discounts as an adjustment to interest income using the interest yield method over the life of the security. The cost of investment securities sold, and any resulting gain or loss, is based on the specific identification method.

Management determines the appropriate classification of investment securities at the time of purchase.

Held-to-maturity securities are those securities that Intermountain has the intent and ability to hold to maturity, and are recorded at amortized cost. Available-for-sale securities are those securities that would be available to be sold in the future in response to liquidity needs, changes in market interest rates, and asset-liability management strategies, among others. Available-for-sale securities are reported at fair value, with unrealized holding gains and losses reported in stockholders' equity as a separate component of other comprehensive income, net of applicable deferred income taxes.

Management evaluates investment securities for other-than-temporary declines in fair value on a periodic basis. If the fair value of an investment security falls below its amortized cost and the decline is deemed to be other-than-temporary, the security's fair value will be analyzed based on market conditions and expected cash flows on the investment security. The unrealized loss is considered an other-than-temporary impairment. The Company then calculates a credit loss charge against earnings by subtracting the estimated present value of estimated future cash flows on the security from its amortized cost. The other-than-temporary impairment less the credit loss charge against earnings is a component of other comprehensive income.

Allowance For Loan Losses. In general, determining the amount of the allowance for loan losses requires significant judgment and the use of estimates by management. This analysis is designed to determine an appropriate level and allocation of the allowance for losses among loan types and loan classifications by considering factors affecting loan losses, including: specific losses; levels and trends in impaired and nonperforming loans; historical bank and industry loan loss experience; current national and local economic conditions; volume, growth and composition of the portfolio; regulatory guidance; and other relevant factors. Management monitors the loan portfolio to evaluate the adequacy of the allowance. The allowance can increase or decrease based upon the results of management's analysis.

The amount of the allowance for the various loan types represents management's estimate of probable incurred losses inherent in the existing loan portfolio based upon historical bank and industry loan loss experience for each loan type. The allowance for loan losses related to impaired loans is based on the fair value of the collateral for collateral dependent loans, and on the present value of expected cash flows for non-collateral dependent loans. For collateral dependent loans, this evaluation requires management to make estimates of the value of the collateral and any associated holding and selling costs, and for non-collateral dependent loans, estimates on the timing and risk associated with the receipt of contractual cash flows.

Management believes the allowance for loan losses was adequate at March 31, 2012. While management uses available information to provide for loan losses, the ultimate collectability of a substantial portion of the loan portfolio and the need for future additions to the allowance will be based on changes in economic conditions and other relevant factors. A further slowdown in economic activity could adversely affect cash flows for both commercial and individual borrowers, as a result of which the Company could experience increases in nonperforming assets, delinquencies and losses on loans. The allowance requires considerable judgment on the part of management, and material changes in the allowance can have a significant impact on the Company's financial position and results of operations.

Fair Value Measurements. ASC 820 "Fair Value Measurements" establishes a standard framework for measuring fair value in GAAP, clarifies the definition of "fair value" within that framework, and expands disclosures about the use of fair value measurements. A number of valuation techniques are used to determine the fair value of assets and liabilities in Intermountain's financial statements. These include quoted market prices for securities, interest rate swap

valuations based upon the modeling of termination values adjusted for credit spreads with counterparties, and appraisals of real estate from independent licensed appraisers, among other valuation techniques. Fair value measurements for assets and liabilities where there exists limited or no observable market data are based primarily upon estimates, and are often calculated based on the economic and competitive environment, the characteristics of the asset or liability and other factors. Therefore, the results cannot be determined with precision and may not be realized in an actual sale or immediate settlement of the asset or liability. Additionally, there are inherent weaknesses in any calculation technique, and changes in the underlying assumptions used, including discount rates and estimates of future cash flows, could significantly affect the results of current or future values. Significant changes in the aggregate fair value of assets and liabilities required to be measured at fair value or for impairment will be recognized in the income statement under the framework established by GAAP. If impairment is determined, it could limit the ability of Intermountain's banking subsidiaries to pay dividends or make other payments to the Holding Company. See Note 11 to the Consolidated Financial Statements for more information on fair value measurements.

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Derivative Financial Instruments and Hedging Activities. In various aspects of its business, the Company uses derivative financial instruments to modify its exposure to changes in interest rates and market prices for other financial instruments. Many of these derivative financial instruments are designated as hedges for financial accounting purposes. Intermountain's hedge accounting policy requires the assessment of hedge effectiveness, identification of similar hedged item groupings, and measurement of changes in the fair value of hedged items. If the derivative financial instruments identified as hedges no longer qualify for hedge accounting treatment, changes in the fair value of these hedged items are recognized in current period earnings, and the impact on the consolidated results of operations and reported earnings could be significant. During March, 2012, the Company identified one derivative that no longer qualified for hedge accounting, resulting in a reduction in earnings for the quarter. See Note 10 to the Consolidated Financial Statements for more information on this derivative.

Income Taxes. Income taxes are accounted for using the asset and liability method. Under this method a deferred tax asset or liability is determined based on the enacted tax rates which will be in effect when the differences between the financial statement carrying amounts and tax basis of existing assets and liabilities are expected to be reported in the Company's income tax returns. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation allowances are established to reduce the net carrying amount of deferred tax assets if it is determined to be more likely than not, that all or some portion of the potential deferred tax asset will not be realized. The Company uses an estimate of future earnings, an evaluation of its loss carryback ability and tax planning strategies to determine whether or not the benefit of its net deferred tax asset may be realized. The analysis used to determine whether a valuation allowance is required and if so, the amount of the allowance, is based on estimates of future taxable income and the effectiveness of future tax planning strategies. These estimates require significant management judgment about future economic conditions and Company performance.

At March 31, 2012, Intermountain assessed whether it was more likely than not that it would realize the benefits of its deferred tax asset. Intermountain determined that the negative evidence associated with a three-year cumulative loss for the period ended December 31, 2011, and challenging economic conditions continued to outweigh the positive evidence. Therefore, Intermountain maintained a valuation allowance of $8.8 million against its deferred tax asset. The company analyzes the deferred tax asset on a quarterly basis and may recapture a portion or all of this allowance depending on future profitability. Including the valuation allowance, Intermountain had a net deferred tax asset of $13.3 million as of March 31, 2012, compared to a net deferred tax asset of $13.2 million as of December 31, 2011. The completion of the capital raise noted in the "Business Strategy & Opportunities" section above will trigger Internal Revenue Code Section 382 limitations on the amount of tax benefit from net operating loss carryforwards that the Company can claim annually. The effect of this limitation is currently being evaluated and is influenced by the level of market interest rates and the fair value of the Company's balance sheet at the time the planned offering was completed. This could impact the amount and timing of the release of the valuation allowance. The evaluation of this impact is currently in process and will likely not be known until the end of 2012.

Note 13, "New Accounting Pronouncements" in the Notes to the Consolidated Financial Statements, discusses new accounting pronouncements adopted by Intermountain and the expected impact of accounting pronouncements recently issued or proposed, but not yet required to be adopted.

Results of Operations

Overview. Intermountain recorded net income applicable to common stockholders of $335,000, or $0.01 per diluted share for the three months ended March 31, 2012, compared with net income applicable to common stockholders of $907,000 or $0.11 per diluted share for the fourth quarter of 2012 (the "sequential quarter") and a net loss applicable to common stockholders of $442,000 or $0.05 per diluted share, for the three months ended March 31, 2011.

The annualized return on average assets ("ROAA") was 0.34%, 0.58%, and 0.0% for the three months ended March 31, 2012, December 31, 2011, and March 31, 2011, respectively. The annualized return on average common equity ("ROAE") was 3.23%, 10.28% and -5.37% for the three months ended March 31, 2012, December 31, 2011 and March 31, 2011, respectively.

Net Interest Income. The most significant component of earnings for the Company is net interest income, which is the difference between interest income from the Company’s loan and investment portfolios, and interest expense on deposits, repurchase agreements and other borrowings. During the three months ended March 31, 2012, December 31, 2011 and March 31, 2011, net interest income was $7.6 million, $8.3 million, and $8.7 million, respectively. The decrease in net interest income from the sequential quarter and the prior period last year reflects lower interest income on loans resulting from declines in both volume and rate. Very low market rates and intense competition for strong borrowers are pressuring both the Company's and its competitors' loan yields. Decreasing rates are also impacting the Company's investment portfolio, but the impact in the first quarter was offset by increasing volumes. Interest expense on deposits continued to decrease as deposit rates declined in response to lower market rates, and CD volumes continued to contract. The increase in interest expense on short-term borrowings from the sequential quarter reflected higher interest expense on an ineffective cash flow hedge.

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Average interest-earning assets decreased by 5.2% to $861.1 million for the three months ended March 31, 2011, compared to $908.6 million for the three months ended March 31, 2011. The decrease was driven by a reduction of $49.8 million or 8.9% in average loans. Average investments and cash increased by $2.2 million or 0.6% over the three month period in 2011. Lower loan volumes continued to reflect paydowns and liquidation of existing loan balances, and lower loan demand caused by the slow economy and tighter underwriting standards.

Average interest-bearing liabilities decreased by 8.9% or $82.3 million for the three month period ended March 31, 2012 compared to March 31, 2011. Average deposit balances decreased $42.6 million, or 5.5%, while borrowings decreased $39.7 million, or 25.6%. The decreases reflected management's focus on lowering interest expense and reducing higher rate or non-relationship funding. Part of this money transitioned into non-FDIC insured investments offered through the Company's trust and investments division.

The net interest margin was 3.55% for the three months ended March 31, 2012 as compared to 3.94% in the fourth quarter of 2011 and 3.89% in the first quarter of last year. Decreases in the average yields on both loans and investments more than offset lower borrowing costs.

The Company continues to focus on lowering its overall cost of funds, while maintaining transaction deposit balances from core relationship customers. The cost on interest-bearing liabilities dropped from 0.78% for the first three months of 2011 to 0.71% for the same period in 2012, even with the impact of the ineffective hedge noted above. Management believes that some opportunities still remain to further lower funding costs. However, given the already low level of market rates and the Company's cost of funds, any future gains are likely to be less than those already experienced. Asset yields are likely to remain compressed in the short-term, although management is working to boost yields through the conversion of cash into either the investment or loan portfolio, and the conversion of investment funds into the loan portfolio.

Provision for Losses on Loans & Credit Quality. Management's policy is to establish valuation allowances for estimated losses by charging corresponding provisions against income. This evaluation is based upon management's assessment of various factors including, but not limited to, current and anticipated future economic trends, historical loan losses, delinquencies, underlying collateral values, and current and potential risks identified in the portfolio.

The provision for losses on loans totaled 959,000 for the three months ended March 31, 2012, compared to a provision of $706,000 for the sequential quarter and $1.6 million for the three months ended March 31, 2011. Lower provision costs over the past two quarters reflect continued improvements in the quality of the Company's loan portfolio. The following table summarizes provision and loan loss allowance activity for the periods indicated.

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	March 31,	
	2012	2011
	(Dollars in thousands)	
Balance Beginning January 1	$(12,690)	$(12,455)
Charge-Offs		
Commercial loans	679	—
Commercial real estate loans	1,137	477
Commercial construction loans	—	382
Land and land development loans	473	476
Agriculture loans		