HEARTLAND FINANCIAL USA INC
Form 10-K
March 14, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K

R ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2013

Commission File Number: 001-15393

HEARTLAND FINANCIAL USA, INC.
(Exact name of Registrant as specified in its charter)

Delaware	42-1405748
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer identification number)
1398 Central Avenue, Dubuque, Iowa 52001	(563) 589-2100
(Address of principal executive offices) (Zip Code)	(Registrant's telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:	
Title of Class	Name of Each Exchange on Which Registered
Common Stock $1.00 par value	The NASDAQ Global Select Market
Preferred Share Purchase Rights	

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

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

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.
Yes ¨ No þ

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 ¨

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 ¨

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

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 Act.

Large accelerated filer ¨ Accelerated filer þ Non-accelerated filer ¨ Smaller reporting company ¨

(Do not check if a smaller reporting company)

Indicate by check mark whether the Registrant is a shell company (as defined in Exchange Act Rule 12b-2). Yes ¨ No þ

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant, based on the last sales price quoted on the NASDAQ Global Select Market on June 30, 2013, the last business day of the registrant's most recently completed second fiscal quarter, was approximately $380,609,222.

As of March 13, 2014, the Registrant had issued and outstanding 18,454,048 shares of common stock, $1.00 par value per share.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the 2014 Annual Meeting of Stockholders are incorporated by reference into Part III.

HEARTLAND FINANCIAL USA, INC.
Form 10-K Annual Report
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PART I

SAFE HARBOR STATEMENT

This document (including information incorporated by reference) contains, and future oral and written statements of Heartland and its management may contain, forward-looking statements, within the meaning of such term in the Private Securities Litigation Reform Act of 1995, with respect to the financial condition, results of operations, plans, objectives, future performance and business of Heartland. Forward-looking statements, which may be based upon beliefs, expectations and assumptions of Heartland's management and on information currently available to management, are generally identifiable by the use of words such as "believe", "expect", "anticipate", "plan", "intend", "estimate", "may", "will", "would", "could", "should" or other similar expressions. Additionally, all statements in this document, including forward-looking statements, speak only as of the date they are made, and Heartland undertakes no obligation to update any statement in light of new information or future events.

Heartland's ability to predict results or the actual effect of future plans or strategies is inherently uncertain. The factors which could have a material adverse effect on the operations and future prospects of Heartland and its subsidiaries are detailed in the "Risk Factors" section included under Item 1A. of Part I of this Form 10-K. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements.

ITEM 1. BUSINESS

A. GENERAL DESCRIPTION

Heartland Financial USA, Inc. (individually referred to herein as "Parent Company" and together with all of its subsidiaries and affiliates, collectively referred to herein as "Heartland," "we," "us," or "our") is a multi-bank holding company registered under the Bank Holding Company Act of 1956, as amended (the "BHCA") that was originally formed in the state of Iowa in 1981 and reincorporated in the State of Delaware in 1993. Heartland's headquarters are located at 1398 Central Avenue, Dubuque, Iowa. Our website address is www.htlf.com. You can access, free of charge, our filings with the Securities and Exchange Commission, including our Annual Report on Form 10-K, our quarterly reports on Form 10-Q, current reports on Form 8-K and any other amendments to those reports, at our website under the Investor Relations tab, or at the Commission's website at www.sec.gov. Proxy materials for our upcoming 2014 Annual Shareholders Meeting to be held on May 21, 2014, will be available electronically via a link on our website at www.htlf.com.

At December 31, 2013, Heartland had total assets of $5.92 billion, total loans of $3.50 billion and total deposits of $4.67 billion. Heartland's total capital as of December 31, 2013, was $439.5 million. Net income available to common stockholders for 2013 was $35.7 million.

Heartland conducts its community banking business through ten bank subsidiaries in the states of Iowa, Illinois, Wisconsin, New Mexico, Arizona, Montana, Colorado, Minnesota, Missouri and Kansas (collectively, the "Bank Subsidiaries"). All Bank Subsidiaries are members of the Federal Deposit Insurance Corporation (the "FDIC"). Listed below are our Bank Subsidiaries, which operate a total of 80 banking locations:

- Dubuque Bank and Trust Company, Dubuque, Iowa, is chartered under the laws of the state of Iowa.
- Galena State Bank & Trust Co., Galena, Illinois, is chartered under the laws of the state of Illinois.
- Riverside Community Bank, Rockford, Illinois, is chartered under the laws of the state of Illinois.
- Wisconsin Bank & Trust (formerly known as Wisconsin Community Bank), Madison, Wisconsin, is chartered under the laws of the state of Wisconsin.

- New Mexico Bank & Trust, Albuquerque, New Mexico, is chartered under the laws of the state of New Mexico.
- Rocky Mountain Bank, Billings, Montana, is chartered under the laws of the state of Montana.
- Arizona Bank & Trust, Phoenix, Arizona, is chartered under the laws of the state of Arizona.
- Summit Bank & Trust, Broomfield, Colorado, is chartered under the laws of the state of Colorado.
- Minnesota Bank & Trust, Edina, Minnesota, is chartered under the laws of the state of Minnesota.
- Morrill & Janes Bank and Trust Company, Merriam, Kansas, is chartered under the laws of the state of Kansas.

Dubuque Bank and Trust Company also has two wholly-owned non-bank subsidiaries:

- DB&T Insurance, Inc., a multi-line insurance agency.
- DB&T Community Development Corp., a community development company with a primary purpose of partnering in low-income housing and historic rehabilitation projects.

Heartland has two active non-bank subsidiaries as listed below:

- Citizens Finance Parent Co. is a consumer finance company with two wholly-owned subsidiaries:
  Citizens Finance Co., a consumer finance company with offices in Iowa and Wisconsin.
  Citizens Finance of Illinois Co., a consumer finance company with offices in Illinois.
- Heartland Community Development Inc., a property management company with a primary purpose of holding and managing certain nonperforming assets acquired from the Bank Subsidiaries.

In addition, Heartland has issued trust preferred securities through seven special purpose trust subsidiaries formed for the purpose of offering the cumulative capital securities, including Heartland Financial Statutory Trust III, Heartland Financial Statutory Trust IV, Heartland Financial Statutory Trust V, Heartland Financial Statutory Trust VI, Heartland Financial Statutory Trust VII, Morrill & Janes Statutory Trust I, and Morrill & Janes Statutory Trust II.

All of Heartland's subsidiaries are wholly owned as of December 31, 2013. Heartland repurchased all minority shares of Minnesota Bank & Trust on April 15, 2013. Prior to April 15, 2013, Heartland owned 80% of the capital stock.

The principal business of our Bank Subsidiaries consists of making loans to and accepting deposits from businesses and individuals. Our Bank Subsidiaries provide full service commercial and retail banking in their communities. Both our loans and our deposits are generated primarily through strong banking and community relationships, and through management that is locally active. Our lending and investment activities are funded primarily by core deposits. This stable source of funding is achieved by developing strong banking relationships with customers through value-added product offerings, market pricing, convenience and high-touch service. Deposit products, which are insured by the FDIC to the full extent permitted by law, include checking and other demand deposit accounts, NOW accounts, savings accounts, money market accounts, certificates of deposit, individual retirement accounts, health savings accounts and other time deposits. Loans include commercial and industrial, small business, agricultural, real estate mortgage, consumer, home equity, and lines of credit.

We supplement the local services of our Bank Subsidiaries with a full complement of ancillary services, including trust and wealth management services, investment services and insurance services. We provide convenient electronic banking services and client access to account information through business and personal online banking, mobile banking, bill payment, remote deposit capture, treasury management services, VISA debit cards and automated teller machines.

Operating Strategy

Heartland's operating strategy is to maximize the benefits of a commercial banking model by:

1. Creating strong community ties through local bank delivery.

- Deeply rooted local leadership and boards
- Local community knowledge and relationships
- Local decision-making
- Independent charters
- Locally recognized brands
- Commitment to an exceptional customer experience

2. Providing extensive resources to increase revenue.

- Full range of commercial products, including government guaranteed lending and treasury management services
- Convenient and competitive retail products and services
- Residential mortgage origination
- Extensive menu of wealth management, investment services, insurance, leasing and consumer finance
- Unique approach to consultative relationship building
- Assistance with management of funding costs

3. Centralizing back-office operations for efficiency.

- Leverage expertise across all Bank Subsidiaries
- Leading edge technology for account processing and delivery systems
- Efficient back-office support for loan processing and deposit operations

- Centralized loan underwriting and collections
- Centralized loss management and risk analysis

We believe the personal and professional service offered to customers provides an appealing alternative to the "megabanks" resulting from mergers and acquisitions in the financial services industry. While we employ a community banking philosophy, we believe our size, combined with our complete line of financial products and services, is sufficient to effectively compete in our respective market areas. To remain price competitive, we also believe that we must manage expenses and gain economies of scale by centralizing back office support functions. Although each of our Bank Subsidiaries operates under the direction of its own board of directors, we have standard operating policies regarding asset/liability management, liquidity management, investment management, lending and deposit structure management.

Another component of our operating strategy is to encourage all directors, officers and employees to maintain a strong ownership interest in Heartland. We have established ownership guidelines for our directors and executive management and have made an employee stock purchase plan available to employees since 1996.

We maintain a strong community commitment by supporting the active participation of our employees, officers and board members in local charitable, civic, school, religious and community development activities.

Acquisition and Expansion Strategy

Our primary strategies are to increase profitability and diversify our market area and asset base by expanding existing subsidiaries through acquisitions and to grow organically by increasing our customer base in the markets we serve. In the current environment, we are seeking opportunities for growth through acquisitions. Although we are focused on opportunities in our existing and adjacent markets, we would consider an acquisition in a new market if it fit our business model and would be accretive to earnings within the first year. We typically consider acquisitions of established financial services organizations, primarily commercial banks or thrifts. We have also formed de novo banking institutions in locations determined to have market potential and management with banking expertise and a philosophy similar to our own.

In recent years, we have focused on markets with growth potential in the Midwestern and Western regions of the United States with a strategic goal to expand our presence in Western markets to 50% of total assets, thereby balancing the growth in our Western markets with the stability of our Midwestern markets. As of December 31, 2013, Heartland had approximately 35% of its assets in Western markets.

In August 2003, Heartland and a group of investors opened Arizona Bank & Trust, a de novo banking operation. In 2006, Arizona Bank & Trust expanded by acquiring Bank of the Southwest, a financial institution providing retail and commercial banking services in Phoenix and Tempe, Arizona. In December 2012, Heartland acquired Heritage Bank, N.A., a Phoenix-based commercial bank and subsidiary of Ameri-National Corporation of Overland Park, Kansas, which was merged into Arizona Bank & Trust in March 2013.

In June 2004, we acquired Rocky Mountain Bancorporation, Inc., the one-bank holding company of Rocky Mountain Bank. Headquartered in Billings, Montana, Rocky Mountain Bank has banking locations throughout the state.

In November 2006, we opened Summit Bank & Trust, a de novo banking operation in Broomfield, Colorado. In 2007, Summit Bank & Trust opened two additional branch locations.

In April 2008, we opened Minnesota Bank & Trust in Edina, Minnesota. The capital structure of Minnesota Bank & Trust was very similar to that used with our other de novo banks. Heartland provided 80% of the $16.5 million initial capital and the remaining 20% was provided by a group of local investors. In April 2013, Heartland acquired the 20% minority interest.

In July 2009, Galena State Bank & Trust Co. acquired the deposits of The Elizabeth State Bank in Elizabeth, Illinois in a whole bank with loss sharing transaction facilitated by the FDIC. In addition to assuming all of the deposits of the failed bank, Galena State Bank & Trust Co. purchased $53.6 million of assets.

In July 2012, Dubuque Bank and Trust Company purchased three retail banking offices from Liberty Bank, FSB in its Dubuque, Iowa market. The transaction included deposits of $53.8 million, loans of $9.4 million and certain other assets.

In November 2012, Heartland acquired First Shares Inc., parent company of First National Bank of Platteville in Platteville, Wisconsin. The transaction included assets of $128.0 million, loans of $84.9 million and deposits of $114.2 million. Simultaneous with closing of the transaction, First National Bank was merged into Heartland's Wisconsin Bank & Trust subsidiary. The merger added three communities in southwestern Wisconsin to the bank's service area.

In October 2013, Heartland acquired Morrill Bancshares, Inc., parent company of Morrill & Janes Bank and Trust Company, in Merriam, Kansas. The transaction included assets at fair value of approximately $810.8 million, loans of approximately $377.7 million, and deposits of approximately $665.3 million. The merger added two states to our footprint.

In November 2013, Dubuque Bank & Trust Company acquired Freedom Bank from River Valley Bancorp, Inc., in its Sterling, Illinois market. Freedom Bank, with assets of $67.1 million has three retail branch locations in Whiteside and Mercer Counties in Illinois. Freedom Bank operated independently as a subsidiary of Dubuque Bank and Trust Company until March 2014 when it was merged into Riverside Community Bank.

Primary Business Segments

General
The Bank Subsidiaries provide a wide range of commercial and consumer banking services to businesses and individuals. These activities include credit and deposit products along with investment management, trust, retirement plan services, and brokerage and investment services.

Our bankers actively solicit the business of new companies entering their market areas as well as established members of the Bank Subsidiaries' respective business communities. We believe that our Bank Subsidiaries are successful in attracting new customers in their markets through professional service, competitive pricing, innovative structures, convenient locations and proactive communications.

Commercial Banking
The Bank Subsidiaries have a strong commercial loan base generated primarily through contacts and relationships in the communities they serve. The current portfolios of the Bank Subsidiaries reflect the businesses in those communities and include a wide range of business loans, including lines of credit for working capital and operational purposes and term loans for the acquisition of equipment and real estate. Although most loans are made on a secured basis, loans may be made on an unsecured basis where warranted by the overall financial condition of the borrower. Terms of commercial business loans generally range from one to five years.

Closely integrated with our credit programs is a significant emphasis on treasury management services that expedite our business clients’ ability to monitor, accumulate and disburse funds efficiently. A major feature of our electronic banking services is fraud detection and protection.

Many of the businesses in the communities we serve are small to mid-sized businesses, and commercial lending to small businesses has been, and continues to be, an emphasis for our Bank Subsidiaries. Wisconsin Bank & Trust, Rocky Mountain Bank and New Mexico Bank & Trust are each designated as a Preferred Lender by the U.S. Small Business Administration (SBA). Wisconsin Bank & Trust is designated as an SBA Certified Lender, and five of our banks are designated as SBA Express Lenders. These banks are Dubuque Bank and Trust Company, Riverside Community Bank, Wisconsin Bank & Trust, Minnesota Bank & Trust and Morrill & Janes Bank and Trust Company. Additionally, Wisconsin Bank & Trust has been granted USDA Certified Lender status for the USDA Rural Development Business and Industry loan program. We believe that these guaranteed loans help the communities in which we operate and provide us with a source of income and solid future lending relationships with local businesses as they grow and prosper.

Our commercial loans and leases are primarily made based on the identified cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. We value the collateral for most of these loans and leases based upon its liquidation value and require personal guarantees in most instances. The primary repayment risks of commercial loans and leases are that the cash flow of the borrowers may be unpredictable, and the collateral securing these loans may fluctuate in value.

In 2012, Heartland announced that we had teamed with BluePath Finance LLC to provide upfront financing for the installation of energy-efficient building products used by commercial and industrial companies, as well as the non-profit and public sectors. We believe our relationship with BluePath can help our customers become more energy efficient. BluePath can provide the financial model to accomplish this and help companies realize a bottom-line benefit by reducing costs and increasing profits.

In order to limit underwriting risk, we attempt to ensure that all loan personnel are well trained. We use the RMA Diagnostic Assessment in assessing the credit skills and training needs for our credit personnel and have developed specific individualized training. All new lending personnel are expected to complete a similar diagnostic training program. We assist all of the commercial and agricultural lenders of our Bank Subsidiaries in the analysis and underwriting of credit through centralized staff in the credit administration department.

Although the lending personnel of our Bank Subsidiaries report to their respective board of directors each month, we use an internal loan review function to analyze credits of our Bank Subsidiaries and provide periodic reports to those boards of directors. We have attempted to identify problem loans at an early date and to aggressively seek resolution of these situations.

The downturn in the overall economy that negatively impacted our overall asset quality between 2008 and 2011 resulted in the formation of an internal Special Assets group to focus on resolving problem assets. All commercial or agricultural loans in a default or workout status are assigned to the Special Assets group. Special Assets personnel are also responsible for marketing repossessed properties and meet with representatives from each bank on a monthly basis.

Small Business Banking
In 2013, Heartland established a Small Business Lending Center dedicated to serving the credit needs of small businesses with annual sales generally under $5 million. The Center is designed to provide quick turnaround on customer credit requests on a wide variety of credit products. We are of the belief that this is an underserved market segment and see additional opportunity in serving this market with deposit and electronic banking services as well as wealth management and brokerage services. Most of the Bank Subsidiaries have added business bankers to serve the distinct banking needs of this customer segment.

Agricultural Loans
Agricultural loans are emphasized by those Bank Subsidiaries with operations in and around rural markets, including Dubuque Bank and Trust Company, Rocky Mountain Bank, Wisconsin Bank & Trust’s Monroe and Platteville banking centers, New Mexico Bank & Trust’s Clovis banking offices and the Morrill & Janes Bank & Trust Company's northeast Kansas banking offices. Dubuque Bank and Trust Company is one of the largest agricultural lenders in the State of Iowa. Agricultural loans constituted approximately 11% of our total loan portfolio at December 31, 2013. Dubuque Bank and Trust Company, Wisconsin Bank & Trust and Morrill & Janes Bank and Trust Company are designated Preferred Lenders by the USDA Farm Service Agency (FSA). In making agricultural loans, we have policies designating a primary lending area for each Bank Subsidiary, in which a majority of its agricultural operating and real estate loans are made. Under this policy, loans in a secondary market area must be secured by real estate.

Agricultural loans, many of which are secured by crops, machinery and real estate, are provided to finance capital improvements and farm operations as well as acquisitions of livestock and machinery. Agricultural loans present unique credit risks relating to adverse weather conditions, loss of livestock due to disease or other factors, declines in market prices for agricultural products and the impact of government regulations. The ultimate repayment of agricultural loans is dependent upon the profitable operation or management of the agricultural entity.

In underwriting agricultural loans, the lending personnel of our Bank Subsidiaries work closely with their customers to review budgets and cash flow projections for the ensuing crop year. These budgets and cash flow projections are monitored closely during the year and reviewed with the customers at least annually. The Bank Subsidiaries also work closely with governmental agencies, including the Farm Services Agency, to help agricultural customers obtain credit enhancement products such as loan guarantees or interest assistance.

Residential Real Estate Mortgage Lending
Mortgage lending remains a focal point for Heartland as we continue to build our residential real estate lending business. As long-term interest rates have remained at relatively low levels during the past several years, many

customers elected mortgage loans that are fixed rate with fifteen- or thirty-year maturities. We usually sell these loans into the secondary market and retain servicing. We believe that mortgage servicing on sold loans provides a relatively steady source of fee income compared to fees generated solely from mortgage origination operations. Moreover, the retention of servicing provides an opportunity to maintain ongoing contact with borrowers and cross-sell a wide variety of additional services like checking, savings, consumer loans, wealth management and investment products. At December 31, 2013, total residential real estate mortgage loans serviced for others totaled $3.05 billion.

As with agricultural and commercial loans, we encourage participation in lending programs sponsored by U.S. government agencies when justified by market conditions. Loans insured or guaranteed under programs through the Veterans Administration (the "VA") and the Federal Home Administration (the "FHA") are offered at all of the Bank Subsidiaries.

Late in 2010, we announced a significant enhancement to our residential mortgage lending capabilities with the creation of a mortgage lending unit in the Phoenix, Arizona market. Our mortgage unit now provides residential mortgage lending services at all Bank Subsidiaries and operating under the brand, National Residential Mortgage, serves the non-Heartland markets of metro San Diego, California; Reno, Nevada; Buffalo, Wyoming; Meridian, Idaho; Minot, North Dakota; Portland, Oregon; Seattle, Washington; and Omaha, Nebraska. Administrative and back office support for these operations is performed by "Heartland Mortgage," a division of our lead bank, Dubuque Bank and Trust Company.

Dubuque Bank and Trust Company received approval in 2012 to be a Ginnie Mae (GNMA) issuer for the GNMA I and II single-family mortgage-backed securities program. The approval allows Dubuque Bank and Trust Company to pool and securitize Federal Housing Administration (FHA) loans, Department of Veterans Affairs loans, and Department of Agriculture's Rural Development loans, and provides an avenue for increasing growth by adding these loans to the servicing portfolio.

Retail Banking

A wide variety of retail banking services are delivered through our 80 banking centers. Services include transaction, savings, money market accounts, certificates of deposit, IRAs and HSAs. Brokerage services, including fixed rate annuity products are also provided in many locations. Consumer lending services of our Bank Subsidiaries include a broad array of consumer loans, including motor vehicle, home improvement, home equity line of credit (HELOC), fixed rate home equity and personal lines of credit. Consumer loans typically have shorter terms, lower balances, higher yields and higher risks of default than one- to four-family residential mortgage loans. Consumer loan collections are dependent on the borrower’s continuing financial stability, and are therefore more likely to be affected by adverse personal circumstances.

Our consumer finance subsidiary, Citizens Finance Parent Co., specializes in consumer lending and currently serves the consumer credit needs of over 11,000 customers from twelve locations in Iowa, Illinois and Wisconsin. Citizens Finance Parent Co. typically lends to borrowers with past credit problems or limited credit histories. Heartland expects to incur a higher level of credit losses on Citizens Finance Parent Co. loans compared to consumer loans originated by the Bank Subsidiaries. Correspondingly, returns on these loans are anticipated to be higher than those at the Bank Subsidiaries.

Wealth Management and Retirement Plan Services

Dubuque Bank and Trust Company, Galena State Bank & Trust Co., Riverside Community Bank, Wisconsin Bank & Trust, New Mexico Bank & Trust, Arizona Bank & Trust, Minnesota Bank & Trust, and Morrill & Janes Bank and Trust Company offer trust and investment services in their respective communities. In those markets that do not yet warrant a full trust department, the sales and administration is performed by Dubuque Bank and Trust Company personnel. As of December 31, 2013, total Heartland trust assets were $1.8 billion, $1.6 billion of which were assets under management. Collectively, the Bank Subsidiaries provide a full complement of trust and investment services for individuals and corporations. Heartland also specializes in Retirement Plan Services, offering business clients customized 401(k), 403(b), and Profit Sharing plans.

Heartland has formed a strategic alliance with LPL Financial Institution Services, a division of LPL Financial, to operate independent securities offices at all of the Bank Subsidiaries. Through LPL Financial, Heartland offers a full array of investment services including mutual funds, annuities, retirement products, education savings products, brokerage services, employer sponsored plans and insurance products. A complete line of vehicle, property and casualty, life and disability insurance is also offered by Heartland through DB&T Insurance.

B. MARKET AREAS

Dubuque Bank and Trust Company

Dubuque Bank and Trust Company is primarily located in Dubuque County, Iowa, which encompasses the city of Dubuque and a number of surrounding rural communities. The city of Dubuque is located in northeastern Iowa, on the

Mississippi River, approximately 175 miles west of Chicago, Illinois, and approximately 200 miles northeast of Des Moines, Iowa. It is strategically situated at the intersection of the state borders of Iowa, Illinois and Wisconsin. Based upon the results of the 2010 census, the city of Dubuque had a total population of 57,637 and Dubuque County had a total population of 93,653.

The principal office of Heartland and Dubuque Bank and Trust Company's main office currently occupy the same building. Heartland's operations center is located directly across the street from Dubuque Bank and Trust Company's main office. A second leased location in downtown Dubuque is occupied by Heartland's credit administration function and Dubuque Bank and Trust Company's mortgage servicing operations. In addition to its main banking office, Dubuque Bank and Trust Company operates eight branch offices in Dubuque County, two branch offices in Keokuk, Iowa, one branch office in Carthage, Illinois and one branch office in East Dubuque, Illinois. In June 2011, Heartland combined its First Community Bank charter with its Dubuque Bank and Trust Company charter. The consolidation of charters was designed to realize efficiencies in operating costs, audits, regulatory examinations and insurance premiums. The First Community Bank offices located in Keokuk and Carthage serve customers in the tri-county region of Lee County, Iowa; Hancock County, Illinois; and Clark County, Missouri. According to the 2010 census, the population of Keokuk, primarily an industrial community, is 10,780 and the population of

Lee County is 35,862. In November 2013, Dubuque Bank and Trust Company acquired Freedom Bank of Sterling, Illinois. In March 2014, Dubuque Bank and Trust Company transferred the shares of Freedom Bank to Heartland by dividend and Freedom Bank was simultaneously merged into Riverside Community Bank.

As a subsidiary of Dubuque Bank and Trust Company, DB&T Insurance has substantially the same market area as its parent organization.

The administrative and back office support for National Residential Mortgage, the brand name used for residential mortgage lending services at our non-footprint locations, operates as a division of Dubuque Bank and Trust Company from an office facility in Scottsdale, Arizona. In 2013, additional satellite offices were opened in Greenwood Village, Colorado and Edina, Minnesota.

Dubuque Bank and Trust Company also operates residential mortgage loan production offices, under the National Residential Mortgage brand name, in metro San Diego, California; Reno and Carson City, Nevada; Portland, Oregon; Seattle, Washington; and Omaha, Nebraska.

Galena State Bank & Trust Co.
Galena State Bank & Trust Co.'s main office is in Galena, Illinois, approximately 20 miles east of Dubuque and 155 miles west of Chicago. Galena State Bank & Trust Co. also operates a second office in Galena, Illinois, an office in Stockton, Illinois, and an office in Elizabeth, Illinois. The four banking offices are located in Jo Daviess County, which has a population of 22,678, according to the 2010 census.

Riverside Community Bank
Riverside Community Bank is located on the northeast edge of Rockford, Illinois, which is approximately 75 miles west of Chicago in Winnebago County. In addition to its main banking office, Riverside Community Bank has three branch offices, all of which are located in the Winnebago County area. Based on the 2010 census, the county had a population of 295,266, and the city of Rockford had a population of 152,871. Effective on March 7, 2014, Freedom Bank was merged into Riverside Community Bank, and its three offices in Sterling, Rock Falls and Seaton, Illinois, became branches of Riverside Community Bank.

Wisconsin Bank & Trust
Wisconsin Bank & Trust’s main office is located in Madison, Wisconsin, in Dane County. The bank operates three branch offices in the Madison suburbs, one branch office in Monroe, Wisconsin, and three branch offices in southwestern Wisconsin in Platteville, Lancaster and Hazel Green. Based on the 2010 census, the Madison Metropolitan Statistical Area has a population of 568,593, and the population of the City of Madison is 233,209. The city of Monroe is approximately 50 miles southwest of Madison in Green County. Wisconsin Bank & Trust has two additional banking offices in the cities of Sheboygan and De Pere, which are located in the northeastern Wisconsin counties of Sheboygan and Brown, respectively. The bank operates three residential mortgage loan production offices in the Wisconsin cities of Green Bay, Madison and Milwaukee.

New Mexico Bank & Trust
New Mexico Bank & Trust operates nine banking offices in or around Albuquerque, New Mexico, three offices in and around Clovis, New Mexico, and two offices in Santa Fe, New Mexico. Located in Bernalillo County, the Albuquerque Metropolitan Statistical Area has a 2010 population of 907,775 and the City of Albuquerque has a 2010 population of 545,852. Clovis, the county seat for Curry County, is located approximately 220 miles east of Albuquerque, 100 miles northwest of Lubbock, Texas, and 105 miles southwest of Amarillo, Texas, and has a population of 37,775. Santa Fe, located in Santa Fe County, has a population of 67,947. New Mexico Bank & Trust operates residential mortgage loan production offices in Albuquerque and Clovis.

Arizona Bank & Trust

Arizona Bank & Trust currently operates seven offices, including one in Phoenix, one in Mesa, one in Tempe, two in Chandler, one in Gilbert and one in Scottsdale. These cities are all located in the Phoenix metropolitan area within Maricopa County. Based on the 2010 Census, the Phoenix metro area is the 14th largest metro area by population in the United States with approximately 4.2 million people. Arizona Bank & Trust operates one residential mortgage loan production office in Scottsdale.

Rocky Mountain Bank

Rocky Mountain Bank operates from ten banking locations throughout the State of Montana. Rocky Mountain Bank's main office and two additional branch offices operate in Billings, which is the state's largest city and an agricultural, retail and business center. Billings is also the county seat of Yellowstone County, which has a 2010 Census population of 147,972 and the city has a population of 104,170. The bank has one banking office in northeastern Montana in the city of Plentywood. Its remaining six banking offices are spread throughout the western corridor of Montana in the cities of Bozeman, Bigfork, Kalispell, Plains, Stevensville and Whitehall. Rocky Mountain Bank operates residential mortgage loan production offices in Buffalo, Wyoming; Meridian, Idaho; and the Montana cities of Missoula, Whitefish, Great Falls and Libby.

Summit Bank & Trust
The main facility for Summit Bank & Trust is located in Broomfield, Colorado. The city and county of Broomfield are located in the northwestern tier of the Denver-Aurora Metropolitan Area. The population of Broomfield, according to the 2010 Census, is 55,889. Broomfield is the sixteenth most populous city in the State of Colorado. A second banking location was opened in June of 2007 in Thornton, just west of the Denver International Airport and a third banking location was added in October of 2007 in Erie, Colorado, which is approximately 25 miles north of Denver. Summit Bank & Trust operates residential mortgage loan production offices in Denver and Greenwood Village, Colorado.

Minnesota Bank & Trust
Minnesota Bank & Trust currently operates from a leased facility in Edina, Minnesota, a first-tier suburb of Minneapolis. The population of Edina was 47,941 in 2010 according to the U.S. Census Bureau. Minnesota Bank & Trust operates a residential mortgage loan production office in Minot, North Dakota and two additional offices in metro Minneapolis.

Morrill & Janes Bank and Trust Company
Morrill & Janes Bank and Trust Company operates 11 banking locations in the greater Kansas City and northeast Kansas markets. Morrill & Janes Bank and Trust Company is headquartered in Merriam, Kansas in the southwestern tier of the Kansas City Metropolitan Area. According to the 2010 Census, the population of Merriam is 11,003 and the population of the Kansas City metro area is approximately 2.0 million people.

Citizens Finance Parent Co.
Citizens Finance Parent Co. is headquartered in Dubuque, Iowa. Its two subsidiary companies have offices in Dubuque, Davenport and Cedar Rapids, Iowa; Madison, Appleton, and Milwaukee, Wisconsin; and the Illinois cities of Loves Park, Tinley Park, Crystal Lake, Elgin, Aurora and Peoria.

The following table sets forth certain information concerning the Bank Subsidiaries as of December 31, 2013, dollars in thousands:

Bank Subsidiaries	Charter Location	Year Acquired or Opened	Number Of Bank Offices	Total Portfolio Loans	Total Deposits
Dubuque Bank and Trust Company(1)	Dubuque, IA	1935	16	$915,377	$1,116,154
Galena State Bank & Trust Co.	Galena, IL	1992	4	$183,639	$244,505
Riverside Community Bank	Rockford, IL	1995	4	$186,739	$353,046
Wisconsin Bank & Trust	Madison, WI	1997	10	$459,594	$531,371
New Mexico Bank & Trust	Albuquerque, NM	1998	14	$529,808	$765,572
Arizona Bank & Trust	Phoenix, AZ	2003	7	$329,211	$368,059
Rocky Mountain Bank	Billings, MT	2004	10	$316,702	$380,011
Summit Bank & Trust	Broomfield, CO	2006	3	$73,150	$101,447
Minnesota Bank & Trust	Edina, MN	2008	1	$101,491	$154,812
Morrill & Janes Bank and Trust Company	Merriam, KS	2013	11	$384,685	$692,038

(1) Includes the three branch offices, $37,616 portfolio loans and $52,089 deposits of Freedom Bank, which was subsequently merged into Riverside Community Bank in March 2014.

C. COMPETITION

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

The market areas of our Bank Subsidiaries are highly competitive. Many financial institutions based in the communities surrounding the Bank Subsidiaries actively compete for customers within our market area. We also face competition from finance companies, insurance companies, mortgage companies, securities brokerage firms, money market funds, loan production offices and other providers of financial services. Under the Gramm-Leach-Bliley Act, effective in 2000, securities firms and insurance companies that elect to become financial holding companies may acquire banks and other financial institutions. The Gramm-Leach-Bliley Act significantly changed, and we anticipate the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") will further change, when fully implemented, the competitive environment in which we operate. The financial services industry is also likely to become more competitive as technological advances enable more companies to provide financial services. These technological advances may diminish the importance of depository institutions and other financial intermediaries in the transfer of funds between parties.

We compete for loans principally through the range and quality of the services we provide, with an emphasis on building long-lasting relationships. Our strategy is to serve our customers above and beyond their expectations through excellence in customer service and needs-based selling. We believe that our long-standing presence in the communities we serve and the personal service we emphasize enhance our ability to compete favorably in attracting and retaining individual and business customers. We actively solicit deposit-oriented clients and compete for deposits by offering personal attention, combined with electronic banking convenience, professional service and competitive interest rates.

D. EMPLOYEES

At December 31, 2013, Heartland employed 1,676 full-time equivalent employees. We place a high priority on staff development, which involves extensive training in a variety of areas, including customer service training. New employees are selected based upon their technical skills and customer service capabilities. None of our employees are covered by a collective bargaining agreement. The Predictive Index® system is utilized to assist with placing potential employees in new positions and with evaluating current positions. We offer a variety of employee benefits, and we consider our employee relations to be excellent.

E. INTERNET ACCESS

Heartland maintains an Investor Relations website at www.htlf.com. We offer our Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and other reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") free of charge from our website.

F. SUPERVISION AND REGULATION

General

Financial institutions, their holding companies, and their affiliates are extensively regulated under federal and state law. As a result, the growth and earnings performance of Heartland may be affected not only by management decisions and general economic conditions, but also by the requirements of federal and state statutes and by the regulations and policies of various bank regulatory authorities.

As a bank holding company with subsidiary banks chartered under the laws of nine different states, Heartland is regulated by the Board of Governors of the Federal Reserve System (the "Federal Reserve"). Each of the Bank Subsidiaries is regulated by the FDIC as its principal federal regulator and one of the following as its state regulator: the Arizona State Banking Department (the "Arizona Department"), the Colorado Department of Regulatory Agencies, Division of Banking (the "Colorado Division"), the Illinois Department of Financial and Professional Regulation (the "Illinois DFPR"), the Iowa Superintendent of Banking (the "Iowa Superintendent"), the State Bank

Commissioner of Kansas Division of Banking (the "Kansas Division"), the Minnesota Department of Commerce: Division of Financial Institutions (the "Minnesota Division"), the Montana Division of Banking and Financial Institutions (the "Montana Division"), the New Mexico Financial Institutions Division (the "New Mexico FID"), the Division of Banking of the Wisconsin Department of Financial Institutions (the "Wisconsin DFI").

Heartland also operates a consumer finance company, Citizens Finance Parent Co., with state licenses in Iowa, Illinois and Wisconsin and as such is subject to regulation by the state banking authorities for those states. Further, the Dodd-Frank Act created the Bureau of Consumer Financial Protection (the "CFPB"), which has supervisory authority over banks with assets of more than $10 billion and over nonbank entities that provide consumer financial services and products. The CFPB has supervisory authority over Heartland's consumer finance subsidiary, and rulemaking authority for federal laws covering the consumer financial services and products offered by all Heartland subsidiaries.

As a recipient of Capital Purchase Program (the "CPP") funds under the Troubled Asset Relief Program (the "TARP") established by the Emergency Economic Stabilization Act of 2008 (the "EESA") until September 15, 2011, and a participant in the Small Business Lending Fund (the "SBLF") established by the Small Business Jobs Act of 2010, Heartland is also subject to direct supervision by the United States Department of the Treasury (the "U.S. Treasury").

Federal and state laws and regulations generally applicable to financial institutions regulate, among other things, the scope of business, the kinds and amounts of investments, reserve requirements, capital levels, the establishment of branches, mergers and consolidations and the payment of dividends. This system of supervision and regulation establishes a comprehensive framework for the respective operations of Heartland and its subsidiaries and is intended primarily for the protection of the FDIC-insured deposits and depositors of the Bank Subsidiaries, rather than stockholders.

The following is a summary of material elements of the regulatory framework that applies to Heartland and its subsidiaries. It does not describe all of the statutes, regulations and regulatory policies that apply, nor does it restate all of the requirements of those that are described. As such, the following is qualified in its entirety by reference to applicable law. Significant changes in the regulation of banks and bank holding companies have occurred since the adoption of the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010 (the “Dodd-Frank Act”). Among other things, the Dodd-Frank Act created the CFPB and provided the CFPB with broad authority to regulate consumer financial products and services; reduced interchange fees on debit card transactions, revised the deposit insurance limits and assessment base for assessing deposits, and directed the banking agencies to adopt rules regulating proprietary trading, risk retention on mortgage originations, and compensation practices with mortgage originators. The CFPB has examination and enforcement authority over all banks with more than $10 billion in assets. Banks with $10 billion or less in assets will continue to be examined for compliance with the consumer laws and regulations of the CFPB by their primary bank regulators. Heartland does not currently have assets in excess of $10 billion, but it may at some point in the future. Although many of these regulations are described below, the federal agencies that regulate Heartland and its Bank Subsidiaries are required to adopt other regulations under the Dodd-Frank Act. Any change in regulations or regulatory policies, or further change in applicable law, may have a material effect on the business of Heartland and its subsidiaries.

Heartland

General

Heartland, as the sole shareholder of Dubuque Bank and Trust Company, New Mexico Bank & Trust, Rocky Mountain Bank, Wisconsin Bank & Trust, Galena State Bank & Trust Co., Riverside Community Bank, Arizona Bank & Trust, Summit Bank & Trust, Minnesota Bank & Trust, and Morrill & Janes Bank and Trust Company, is a bank holding company. As a bank holding company, Heartland is registered with, and is subject to regulation by, the Federal Reserve under the Bank Holding Company Act ("BHCA"). In accordance with Federal Reserve policy, Heartland is expected to act as a source of financial and managerial strength to the Bank Subsidiaries and to commit resources to support the Bank Subsidiaries in circumstances where Heartland might not otherwise do so. In addition, under the Dodd-Frank Act, the FDIC has backup enforcement authority over a depository institution holding company, such as Heartland, if the conduct or threatened conduct of the holding company poses a risk to the Deposit Insurance Fund, although such authority may not be used if the holding company is in sound condition and does not pose a foreseeable and material risk to the insurance fund.

Under the BHCA, Heartland is subject to periodic examination by the Federal Reserve. Heartland is also required to file with the Federal Reserve periodic reports of Heartland's operations and such additional information regarding Heartland and its subsidiaries as the Federal Reserve may require.

Acquisitions, Activities and Change in Control

The primary purpose of a bank holding company is to control and manage banks. The BHCA generally requires the prior approval of the Federal Reserve for any merger involving a bank holding company or any acquisition by a bank holding company. Subject to certain conditions (including certain deposit concentration limits established by the BHCA), the Federal Reserve may allow a bank holding company to acquire banks located in any State of the United States. In approving interstate acquisitions, the Federal Reserve is required to give effect to applicable state law limitations on the aggregate amount of deposits that may be held by the acquiring bank holding company and its insured depository institution affiliates in the state in which the target bank is located (provided that those limits do not discriminate against out-of-state depository institutions or their holding companies).

The BHCA generally prohibits Heartland from acquiring direct or indirect ownership or control of more than 5% of the voting shares of any company that is not a bank and from engaging in any business other than that of banking, managing and controlling banks, or furnishing services to banks and their subsidiaries. This general prohibition is subject to a number of exceptions. The principal exception allows bank holding companies to engage in, and to own shares of companies engaged in, certain businesses found by the Federal Reserve to be “so closely related to banking ... as to be a proper incident thereto.” This authority would permit Heartland to engage in a variety of banking-related businesses, including consumer finance, equipment leasing, mortgage banking, brokerage, and the operation of a computer service bureau (including software development). Under the Dodd-Frank Act, however, any such non-bank subsidiary would be subject to regulation no less stringent than that applicable to the lead bank of the bank holding company. The BHCA generally does not place territorial restrictions on the domestic activities of non-bank subsidiaries of bank holding companies.

Additionally, bank holding companies that meet certain eligibility requirements prescribed by the BHCA and elect to operate as financial holding companies may engage in, or own shares in companies engaged in, a wider range of nonbanking activities. As of the date of this filing, Heartland has not applied for approval to operate as a financial holding company.

Federal law also prohibits any person or persons acting in concert from acquiring “control” of an FDIC-insured depository institution or its holding company without prior notice to the appropriate federal bank regulator or any other company acquiring “control” without Federal Reserve approval to become a bank holding company. “Control” is conclusively presumed to exist upon the acquisition of 25% or more of the outstanding voting securities of a bank or bank holding company, but may arise at 10% ownership for companies with registered securities, such as Heartland, and under certain other circumstances. Each of the Bank Subsidiaries is generally subject to similar restrictions on changes in control under the law of the state granting its charter.

Capital Requirements
Bank holding companies are required to maintain minimum levels of capital in accordance with Federal Reserve capital adequacy guidelines, separate from and in addition to the capital requirements applicable to subsidiary financial institutions. If a bank holding company is not well-capitalized, it will have difficulty engaging in acquisition transactions and if its capital levels fall below the minimum required levels, a bank holding company, among other things, may be denied approval to acquire or establish additional banks or non-bank businesses.

The Federal Reserve's capital guidelines applicable to bank holding companies, like the regulations applicable to subsidiary banks, require holding companies to comply with both (i) a risk-based requirement expressed as a percentage of total assets weighted according to risk; and (ii) a leverage requirement expressed as a percentage of total assets. Although the amount of capital required for holding companies is generally the same as required for subsidiary banks as described under “The Bank Subsidiaries-Capital Requirements” below, historically the form of capital has differed for holding companies and allowed the inclusion of certain hybrid instruments, such as trust preferred, in Tier 1 capital. Under the Dodd-Frank Act, these distinctions were eliminated for instruments issued after May 19, 2010. Although the distinctions are also phased out for trust preferred issued by larger institutions prior to that date, the trust preferred issued by Heartland, as a holding company with less than $15 billion in assets, are grandfathered as Tier 1 capital by the Dodd-Frank Act.

As described below under the caption “The Bank Subsidiaries-Regulatory Capital,” on July 2, 2013, the Federal Reserve approved revised regulatory capital rules applicable to both banks and bank holding companies that implement revisions recommended by The Basel Committee on Banking Supervision to the Basel capital framework (the “Basel III Rules”). The Basel III rules become effective for Heartland commencing on January 1, 2015, but are phased in through January 1, 2019.

As of December 31, 2013, Heartland had regulatory capital in excess of the Federal Reserve's minimum requirements.

Treasury Regulation
Bank holding companies that received funding under the TARP CPP or the SBLF are subject to direct regulation by the U.S. Treasury. The TARP CPP, created by the U.S. Treasury in 2008, allowed qualifying financial institutions to sell senior preferred stock and common stock warrants to the U.S. Treasury and include the senior preferred stock as Tier 1 capital under the Federal Reserve's capital guidelines. Under this program, in December 2008 Heartland issued

and sold to the U.S. Treasury $81.7 million of its senior preferred stock together with a 10-year warrant to purchase 609,687 shares of Heartland's common stock at $20.10 per share. Although the capital raised through TARP CPP provided Heartland with considerable regulatory flexibility during 2009 and 2010, the regulations that governed institutions that received TARP CPP contained a number of troubling restrictions relating to dividends and on compensation paid to executive officers.

Under the SBLF, and starting in 2011, the U.S. Treasury made available up to $30.0 billion of capital to qualifying banks and allowed certain participants in the TARP CPP to refinance the senior preferred stock issued under the TARP CPP with SBLF funds. Under the SBLF, the U.S. Treasury purchased senior perpetual non-cumulative preferred stock with a liquidation preference of $1,000 per share. Like the preferred stock issued under TARP, the preferred stock issued under the SBLF is non-voting (except in limited circumstances) and qualifies as Tier 1 capital under the Federal Reserve's guidelines.

Heartland applied for and received SBLF Funding on September 15, 2011, issuing 81,698 shares of its Senior Non-Cumulative Perpetual Preferred Stock, Series C (the “Series C Preferred Stock”), to the U.S. Treasury. Heartland simultaneously used the $81.7 million received under the SBLF to redeem the 81,698 shares of senior preferred stock it had issued under the TARP CPP program. As part of this transaction, Heartland recorded a charge of $2.6 million representing the unamortized discount on the TARP senior preferred stock that was redeemed. Further, on September 28, 2011, Heartland repurchased the warrant to purchase 609,687 shares of its common stock that it issued to the U.S. Treasury under the TARP CPP program for $1.8 million.

The Series C Preferred Stock issued under the SBLF requires quarterly dividends payable to the U.S. Treasury initially equal to 5.00% of the liquidation value of the Preferred Stock. The dividend rate payable under the Series C Preferred Stock is subject to reduction during the second to tenth quarters after issuance (through December 31, 2013, for Heartland) based upon increases in Heartland's qualified small business lending ("QSBL") over a baseline amount. Based upon increases in its QSBL through September 30, 2013, the dividend rate payable by Heartland will be fixed at 1.00% through March 15, 2016, but will increase to 9.00% if the SBLF funding has not been repaid by March 16, 2016.

The terms of the Series C Preferred Stock also prohibit Heartland from paying dividends on its common stock, or repurchasing shares, to the extent that, after payment of such dividends or repurchases, Heartland's Tier 1 Capital would be less than $247.7 million. If Heartland fails to declare and pay dividends on the Series C Preferred Stock in a given quarter, then Heartland may not pay dividends on or repurchase any common stock for the next three quarters, except in very limited circumstances. If any Series C Preferred Stock remains outstanding on the tenth anniversary of issuance, Heartland may not pay any further dividends on its common stock or any other junior stock until the Series C Preferred Stock is redeemed in full.

Dividend Payments

In addition to the restrictions imposed under the SBLF, Heartland's ability to pay dividends to its stockholders may be affected by both general corporate law considerations, and policies of the Federal Reserve applicable to bank holding companies. As a Delaware corporation, Heartland is subject to the limitations of the Delaware General Corporation Law (the “DGCL”), which allows Heartland to pay dividends only out of its surplus (as defined and computed in accordance with the provisions of the DGCL) or if Heartland has no such surplus, out of its net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year. In addition, policies of the Federal Reserve caution that a bank holding company should not pay cash dividends unless its net income available to common stockholders over the past year has been sufficient to fully fund the dividends and the prospective rate of earnings retention appears consistent with its capital needs, asset quality, and overall financial condition. The Federal Reserve also possesses enforcement powers over bank holding companies and their non-bank subsidiaries to prevent or remedy actions that represent unsafe or unsound practices or violations of applicable statutes and regulations. Among these powers is the ability to proscribe the payment of dividends by banks and bank holding companies.

The Bank Subsidiaries

General

All of the Bank Subsidiaries are state chartered, non-member banks, which means that they are all formed under state law and are not members of the Federal Reserve System. As such, each bank is subject to direct regulation by the banking authorities in the State in which it was chartered, as well as by the FDIC as its primary federal regulator.

Dubuque Bank and Trust Company is an Iowa-chartered bank. As an Iowa-chartered bank, Dubuque Bank and Trust Company is subject to the examination, supervision, reporting and enforcement requirements of the Iowa Superintendent, the chartering authority for Iowa banks.

Galena State Bank & Trust Co. and Riverside Community Bank are Illinois-chartered banks. As Illinois-chartered banks, Galena State Bank & Trust Co. and Riverside Community Bank are subject to the examination, supervision, reporting and enforcement requirements of the Illinois DFPR, the chartering authority for Illinois banks.

New Mexico Bank & Trust is a New Mexico-chartered bank. As a New Mexico-chartered bank, New Mexico Bank & Trust is subject to the examination, supervision, reporting and enforcement requirements of the New Mexico FID, the chartering authority for New Mexico banks.

Rocky Mountain Bank is a Montana-chartered bank. As a Montana-chartered bank, Rocky Mountain Bank is subject to the examination, supervision, reporting and enforcement requirements of the Montana Division, the chartering authority for Montana banks.

Wisconsin Bank & Trust is a Wisconsin-chartered bank. As a Wisconsin-chartered bank, Wisconsin Bank & Trust is subject to the examination, supervision, reporting and enforcement requirements of the Wisconsin DFI, the chartering authority for Wisconsin banks.

Summit Bank & Trust is a Colorado-chartered bank. As a Colorado-chartered bank, Summit Bank & Trust is subject to the examination, supervision, reporting and enforcement requirements of the Colorado Division, the chartering authority for Colorado banks.

Arizona Bank & Trust is an Arizona-chartered bank. As an Arizona-chartered bank, Arizona Bank & Trust is subject to the examination, supervision, reporting and enforcement requirements of the Arizona Department, the chartering authority for Arizona banks.

Minnesota Bank & Trust is a Minnesota-chartered bank. As a Minnesota-chartered bank, Minnesota Bank & Trust is subject to the examination, supervision, reporting and enforcement requirements of the Minnesota Division, the chartering authority for Minnesota banks.

Morrill & Janes Bank and Trust Company is a Kansas-chartered bank. As a Kansas-chartered bank, Morrill & Janes Bank and Trust Company is subject to the examination, supervision, reporting and enforcement requirements of the Kansas Division, the chartering authority for Kansas banks.

Deposit Insurance
The FDIC is an independent federal agency that insures the deposits, up to $250,000 per depositor, of federally insured banks and savings institutions and safeguards the safety and soundness of the commercial banking and thrift industries.

As FDIC-insured institutions, the Bank Subsidiaries are required to pay deposit insurance premium assessments to the FDIC based upon a risk-based assessment system. Under this system, each institution is assigned a risk classification based upon its capital levels and the level of supervisory concern it poses. The rate of insurance premium the institution pays was based on this risk classification and the amount of its deposits until April 1, 2011. Currently, FDIC insurance assessments are based upon average total consolidated assets minus tangible equity of the insured bank.

The Dodd-Frank Act directed that the minimum deposit insurance fund reserve ratio would increase from 1.15% to 1.35% by September 30, 2020, and the cost of the increase will be borne by depository institutions with assets of $10 billion or more. The Dodd-Frank Act also provides the FDIC with discretion to determine whether to pay rebates to insured depository institutions when its deposit insurance reserves exceed certain thresholds. Previously, the FDIC was required to give rebates to depository institutions equal to the excess once the reserve ratio exceeded 1.50%, and was required to rebate 50% of the excess over 1.35% but not more than 1.50% of insured deposits.

The FDIC established a Temporary Liquidity Guarantee Program on October 23, 2008, under which the FDIC fully guaranteed all non-interest-bearing transaction accounts and all senior unsecured debt of insured depository institutions or their qualified holding companies issued between October 14, 2008, and October 31, 2009. Heartland did not opt out of the program and as such, was assessed ten basis points during the first quarter of 2010 and fifteen basis points for the remainder of 2010 for transaction account balances in excess of $250,000 and, since it did not issue any senior unsecured debt during the designated time period, was not assessed the applicable rate of 75 basis points on the amount of debt issued. The guarantee of non-interest-bearing transaction accounts was twice extended by the FDIC, and under the Dodd-Frank Act was extended to December 31, 2012, and made applicable to all institutions, without further assessment.

In addition, all institutions with deposits insured by the FDIC are required to pay assessments to fund interest payments on bonds issued by the Financing Corporation, an agency of the Federal government established to recapitalize the predecessor to the Savings Association Insurance Fund. During 2012, the assessment rate was 0.0165% of total deposits and during 2013 was .00160 % of total deposits. These assessments will continue until the

Financing Corporation bonds mature in 2019.

Supervisory Assessments

Each of the Bank Subsidiaries is required to pay supervisory assessments to its respective state banking regulator to fund the operations of that agency. In general, the amount of the assessment is calculated on the basis of each institution's total assets. During 2013, the Bank Subsidiaries paid supervisory assessments totaling $659,000.

Capital Requirements

Under current federal regulations, the Bank Subsidiaries are subject to the following minimum capital standards: (i) a leverage requirement consisting of a minimum ratio of Tier 1 capital to total assets (the "Leverage Ratio") of 3.0% for the most highly-rated banks with a minimum requirement of at least 4.0% for all others; and (ii) a risk-based capital requirement consisting of a minimum ratio of Tier 1 capital to total risk-weighted assets (the "Tier1 Risk-Based Capital Ratio") of 4.0% and (iii) a risk-based capital requirement consisting of a minimum ratio of total capital to total risk-weighted assets (the "Total Risk-Based Capital Ratio") of 8.0%. For purposes of these capital standards, Tier 1 capital consists primarily of permanent stockholders' equity less intangible assets (other than certain loan servicing rights and purchased credit card relationships). Total capital consists primarily of Tier 1 capital plus certain other debt and equity instruments that do not qualify as Tier 1 capital and, for Heartland, a portion of its allowance for loan and lease losses.

The Basel III Rules, which will be effective for Heartland and the Bank Subsidiaries on January 1, 2015, will (1) increase the minimum Leverage Ratio to 4.0% for all banks, (2) increase the Tier 1 Risk-Based Capital Ratio to 6.0% on January 1, 2015 and to 8.5% on January 1, 2019, and (3) create a new requirement to maintain a ratio of common equity Tier 1 Capital (“Common Tier1 Capital”) to risk-weighted assets of 4.5% on January 1, 2015, gradually increasing to 7.0% on January 1, 2019. The Basel III Rules require inclusion in Common Tier 1 Capital of the effects of other comprehensive income adjustments, such as gains and losses on securities held to maturity, that are currently excluded from the definition of Tier1 capital, but allow institutions, such as Heartland, to make a one-time election not to include those effects. Further, under the Basel III rules, if an institution grows beyond $15 billion in assets and makes an acquisition, its ability to include trust preferred securities in Tier 1 capital is phased out. Heartland and its subsidiary banks intend to elect not to include the effects of other comprehensive income in Common Tier 1 Capital.

The capital requirements described above are minimum requirements. Higher capital levels will be required if warranted by the particular circumstances or risk profiles of individual institutions. For example, federal regulations provide that additional capital may be required to take adequate account of, among other things, interest rate risk or the risks posed by concentrations of credit, nontraditional activities or securities trading activities. As a de novo bank, Minnesota Bank & Trust is required to maintain higher Tier 1 capital to assets ratios for the first seven years of its operations (through April 2016).

Further, federal law and regulations provide various incentives for financial institutions to maintain regulatory capital at levels in excess of minimum regulatory requirements. For example, a financial institution generally must be “well-capitalized” to engage in acquisitions, and well-capitalized institutions may qualify for exemptions from prior notice or application requirements otherwise applicable to certain types of activities and may qualify for expedited processing of other required notices or applications. Additionally, one of the criteria that determines a bank holding company's eligibility to operate as a financial holding company is a requirement that both the holding company and all of its financial institution subsidiaries be “well-capitalized.” Under current federal regulations, in order to be “well-capitalized” a financial institution must maintain a Total Risk-Based Capital Ratio of 10.0% or greater, a Tier 1 Risk-Based Capital Ratio of 6.0% or greater and a Leverage Ratio of 5.0% or greater. In order to be "well-capitalized" under the new Basel III Rules, a bank or bank holding company will be required to have a Total Risk-Based Capital Ratio of 10.0% or greater, a Tier 1 Risk-Based Capital Ratio of 8.0% or greater, a Leverage Ratio of 5.0% or greater, and a Common Tier 1 Capital Ratio of 6.5% or greater.

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

As of December 31, 2013: (i) none of the Bank Subsidiaries was subject to a directive from its primary federal regulator to increase its capital; (ii) each of the Bank Subsidiaries exceeded its minimum regulatory capital requirements under applicable capital adequacy guidelines; (iii) each of the Bank Subsidiaries was “well-capitalized,” as defined by applicable regulations; and (iv) each of the Bank Subsidiaries subject to a directive to maintain capital higher than the regulatory capital requirements, as discussed below under “Safety and Soundness Standards,” complied with the directive.

Liability of Commonly Controlled Institutions

Under federal law, institutions insured by the FDIC may be liable for any loss incurred by, or reasonably expected to be incurred by, the FDIC in connection with the default of commonly controlled FDIC-insured depository institutions or any assistance provided by the FDIC to commonly controlled FDIC-insured depository institutions in danger of default. Because Heartland controls each of the Bank Subsidiaries, the Bank Subsidiaries are commonly controlled for purposes of these provisions of federal law.

Anti-Money Laundering

The Bank Secrecy Act, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the “PATRIOT Act”) and other related federal laws and regulations require financial institutions, including the Bank Subsidiaries, to implement policies and procedures relating to anti-money laundering, customer identification and due diligence requirements and the reporting of certain types of transactions and suspicious activity.

Dividend Payments

The primary source of funds for Heartland is dividends from the Bank Subsidiaries. In general, the Bank Subsidiaries may only pay dividends either out of their historical net income after any required transfers to surplus or reserves have been made or out of their retained earnings.

The payment of dividends by any financial institution is affected by the requirement to maintain adequate capital pursuant to applicable capital adequacy guidelines and regulations, and a financial institution generally is prohibited from paying any dividends if, following payment thereof, the institution would be undercapitalized. As described above, each of the Bank Subsidiaries exceeded its minimum capital requirements under applicable guidelines as of December 31, 2013. Minnesota Bank & Trust is subject to the FDIC's further prohibition on the payment of dividends during the first seven years of a bank's operations, allowing cash dividends to be paid only from net operating income, and prohibiting the payment of dividends until an appropriate allowance for loan and lease losses has been established and overall capital is adequate.

As of December 31, 2013, approximately $137.0 million was available to be paid as dividends by the Bank Subsidiaries. Notwithstanding the availability of funds for dividends, however, the FDIC may prohibit the payment of any dividends by the Bank Subsidiaries.

Transactions with Affiliates

The Federal Reserve regulates transactions between Heartland and its subsidiaries. Generally, the Federal Reserve Act and Regulation W, as amended by the Dodd-Frank Act, limit Heartland's banking subsidiaries to lending and other “covered transactions” with affiliates. The aggregate amount of covered transactions a banking subsidiary may enter into with an affiliate may not exceed 10% of the capital stock and surplus of the banking subsidiary. The aggregate amount of covered transactions with all affiliates may not exceed 20% of the capital stock and surplus of the banking subsidiary.

Covered transactions with affiliates are also subject to collateralization requirements and must be conducted on arm’s length terms. Covered transactions include (a) a loan or extension of credit by the banking subsidiary, including derivative contracts, (b) a purchase of securities issued to a banking subsidiary, (c) a purchase of assets by the banking subsidiary unless otherwise exempted by the Federal Reserve, (d) acceptance of securities issued by an affiliate to the banking subsidiary as collateral for a loan, and (e) the issuance of a guarantee, acceptance or letter of credit by the banking subsidiary on behalf of an affiliate.

Insider Transactions

The Bank Subsidiaries are subject to certain restrictions imposed by federal law on extensions of credit to Heartland and its subsidiaries, on investments in the stock or other securities of Heartland and its subsidiaries and the acceptance of the stock or other securities of Heartland or its subsidiaries as collateral for loans made by the Bank Subsidiaries. Certain limitations and reporting requirements are also placed on extensions of credit by each of the Bank Subsidiaries to its directors and officers, to directors and officers of Heartland and its subsidiaries, to principal stockholders of Heartland and to “related interests” of such directors, officers and principal stockholders. In addition, federal law and regulations may affect the terms upon which any person who is a director or officer of Heartland or any of its subsidiaries or a principal stockholder of Heartland may obtain credit from banks with which the Bank Subsidiaries maintain correspondent relationships.

Safety and Soundness Standards

The federal banking agencies have adopted guidelines that establish operational and managerial standards to promote the safety and soundness of federally insured depository institutions. The guidelines set forth standards for internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, asset quality and earnings. In general, the safety and soundness guidelines prescribe the goals to be achieved in each area, and each institution is responsible for establishing its own procedures to achieve those goals. If an institution fails to comply with any of the standards set forth in the guidelines, the institution's primary federal regulator may require the institution to submit a plan for achieving and maintaining compliance. If an institution fails to submit an acceptable compliance plan, or fails in any material respect to implement a compliance plan that has been accepted by its primary federal regulator, the regulator is required to issue an order directing the institution to cure the deficiency. Until the deficiency cited in the regulator's order is cured, the regulator may restrict the institution's rate of growth, require the institution to increase its capital, restrict the rates the institution pays on deposits or require the institution to take any action the regulator deems appropriate under the circumstances. Noncompliance with the standards established by the safety and soundness guidelines may also constitute grounds for other enforcement action by the federal banking regulators, including cease and desist orders and civil money penalty assessments.

Branching Authority

Each of the Bank Subsidiaries has the authority, pursuant to the laws under which it is chartered, to establish branches anywhere in the state in which its main office is located, subject to the receipt of all required regulatory approvals.

Federal law permits state and national banks to merge with banks in other states subject to: (i) regulatory approval; (ii) federal and state deposit concentration limits; and (iii) state law limitations requiring the merging bank to have been in existence for a minimum period of time (not to exceed five years) prior to the merger. Under the Dodd-Frank Act, banks are permitted to establish new branches in another state to the same extent as banks chartered in the other state.

State Bank Investments and Activities

Each of the Bank Subsidiaries generally is permitted to make investments and engage in activities directly or through subsidiaries as authorized by the laws of the state under which it is chartered. However, under federal law and FDIC regulations, FDIC-insured state banks are prohibited, subject to certain exceptions, from making or retaining equity investments of a type, or in an amount, that are not permissible for a national bank. Federal law and FDIC regulations also prohibit FDIC-insured state banks and their subsidiaries, subject to certain exceptions, from engaging as principal in any activity that is not permitted for a national bank unless the bank meets, and continues to meet, its minimum regulatory capital requirements and the FDIC determines the activity would not pose a significant risk to the deposit insurance fund of which the bank is a member.

Incentive Compensation Policies and Restrictions

In July 2010, the federal banking agencies issued guidance that applies to all banking organizations supervised by the agencies. Pursuant to the guidance, to be consistent with safety and soundness principles, Heartland’s incentive compensation arrangements should: (1) provide employees with incentives that appropriately balance risk and reward; (2) be compatible with effective controls and risk management; and (3) be supported by strong corporate governance including active and effective oversight by Heartland's board of directors.

In addition, in March 2011, the federal banking agencies, along with the Federal Housing Finance Agency, and the Securities and Exchange Commission, released a proposed rule intended to ensure that regulated financial institutions design their incentive compensation arrangements to account for risk. Specifically, the proposed rule would require compensation practices for Heartland to be consistent with the following principles: (1) compensation arrangements appropriately balance risk and financial reward; (2) such arrangements are compatible with effective controls and risk management; and (3) such arrangements are supported by strong corporate governance. In addition, financial institutions with $1 billion or more in assets would be required to have policies and procedures to ensure compliance with the rule and would be required to submit annual reports to their primary federal regulator. The comment period has closed and a final rule has not yet been published; however, Heartland believes it is in compliance with the rule as currently proposed.

The Volcker Rule and Proprietary Trading

In December 2013, federal banking regulators jointly issued a final rule to implement the “Volcker Rule” under the Dodd-Frank Act, which prohibits banking entities (including Heartland and the Bank Subsidiaries) from engaging in proprietary trading of securities, derivatives and certain other financial instruments for the entity’s own account, and prohibits certain interests in, or relationships with, a hedge fund or private equity fund. It also imposes rules regarding compliance programs. The final rule will become effective April 1, 2014. Heartland does not believe that it engages in any significant amount of proprietary trading as defined in the Volcker Rule and that any impact would be minimal. Heartland has reviewed its investment portfolio to determine if any investments meet the Volcker Rule's definition of covered funds. Based on the review, Heartland believes that any impact related to investments considered to be covered funds would not have a significant effect on its financial condition or results of operations. However, Heartland may be required to divest certain investments subject to the Volcker Rule by mid-2015.

Federal Reserve Liquidity Regulations

Federal Reserve regulations, as presently in effect, require depository institutions to maintain non-interest earning reserves against their transaction accounts (primarily NOW and regular checking accounts), as follows: (i) for transaction accounts aggregating $10.7 million or less, there is no reserve requirement; (ii) for transaction accounts over $10.7 million and up to $55.2 million, the reserve requirement is 3% of total transaction accounts; and (iii) for transaction accounts aggregating in excess of $55.2 million, the reserve requirement is $1.335 million plus 10% of the aggregate amount of total transaction accounts in excess of $55.2 million. These reserve requirements are subject to annual adjustment by the Federal Reserve. The Bank Subsidiaries are in compliance with the foregoing requirements.

Community Reinvestment Act Requirements
The Community Reinvestment Act requires the Bank Subsidiaries to have a continuing and affirmative obligation in a safe and sound manner to help meet the credit needs of its entire community, including low- and moderate-income neighborhoods. The FDIC and the respective state regulators regularly assess the Bank Subsidiaries' record of meeting the credit needs of its communities. Applications for additional acquisitions would be affected by the evaluation of the Bank Subsidiaries' effectiveness in meeting their Community Reinvestment Act requirements.

Consumer Protection
Each of the Bank Subsidiaries is subject to a number of statutes and regulations designed to protect consumers. These include statutes and regulations applicable to loan operations which govern disclosures of credit terms (the Truth-in-Lending Act and Regulation Z), prohibit discrimination in the extension of credit (the Equal Credit Opportunity Act and Regulation B), govern the use and provision of information to consumer reporting agencies (the Fair Credit Reporting Act) and govern debt collection practices (the Fair Debt Collection Practices Act) and statutes and regulations applicable to deposit operations, which govern disclosure of deposit terms (the Truth in Savings Act and Regulation DD) and the availability of deposit funds (Regulation CC). Other such laws and regulations impose duties to maintain the confidentiality of consumer information and provide privacy policy disclosures (the Gramm-Leach-Bliley Act and the Right to Financial Privacy Act) and those governing electronic fund transfers (the Electronic Funds Transfer Act and Regulation E). The CFPB and other federal agencies have and will continue to propose and finalize rules relating to these statutes and regulations.

Mortgage Operations
Each of the Banking Subsidiaries is subject to a number of rules affecting residential mortgages, including the Home Mortgage Disclosure Act and Regulation C and the Real Estate Settlement Procedures Act ("RESPA") and Regulation X. Over the last year, the CFPB and other federal agencies have proposed and finalized a number of rules affecting residential mortgages. These rules implement the Dodd-Frank Act amendments to the Equal Credit Opportunity Act, the Truth in Lending Act and RESPA. The final rules, among other things, impose requirements regarding procedures to ensure compliance with "ability to repay" requirements, new or revised disclosure requirements, policies and procedures for servicing mortgages, and additional rules and restrictions regarding mortgage loan originator compensation and qualification and registration requirements for individual loan originator employees.

Ability-to-Repay and Qualified Mortgage Rule
Pursuant to the Dodd Frank Act, the CFPB issued a final rule on January 10, 2013 (effective on January 10, 2014), amending Regulation Z as implemented by the Truth in Lending Act, requiring mortgage lenders to make a reasonable and good faith determination based on verified and documented information that a consumer applying for a mortgage loan has a reasonable ability to repay the loan according to its terms. Mortgage lenders are required to determine consumers' ability to repay in one of two ways. The first alternative requires the mortgage lender to consider the following eight underwriting factors when making the credit decision: (1) current or reasonably expected income or assets; (2) current employment status; (3) the monthly payment on the covered transaction; (4) the monthly payment on any simultaneous loan; (5) the monthly payment for mortgage-related obligations; (6) current debt obligations, alimony, and child support; (7) the monthly debt-to-income ratio or residual income; and (8) credit history. Alternatively, the mortgage lender can originate "qualified mortgages," which are entitled to a presumption that the creditor making the loan satisfied the ability-to-repay requirements. In general, a "qualified mortgage" is a mortgage loan without negative amortization, interest-only payments, balloon payments, or terms exceeding 30 years. In addition, to be a qualified mortgage the points and fees paid by a consumer cannot exceed 3% of the total loan amount. Qualified mortgages that are "higher-priced" (e.g. subprime loans) garner a rebuttable presumption of compliance with the ability-to-repay rules, while qualified mortgages that are not "higher-priced" (e.g. prime loans) are

given a safe harbor of compliance. Heartland primarily originates compliant qualified mortgages.

Interchange Fees

The Durbin Amendment (a provision of the Dodd-Frank Act) required the Federal Reserve to establish a cap on the interchange fees that merchants pay banks for electronic clearing of debit transactions. The Federal Reserve issued final rules implementing the Durbin Amendment which were effective October 1, 2011, and, among other things, established standards for assessing whether debit card interchange fees received by debit card issuers were reasonable and proportional costs incurred by issuers and established maximum permissible interchange fees. In July 2013, a Washington, D.C. District Court judge invalidated the interchange fee rule. If upheld, the decision would keep in place current interchange fee transaction standards until new regulations or interim standards are drafted. The decision has been appealed and a stay is in effect. The final impact of this decision on the Banking Subsidiaries will depend on factors such as the outcome of the appeal and the substance of any new or revised regulations that are promulgated. The Durbin Amendment currently applies to banks with greater than $10 billion in assets. Heartland does not currently have assets in excess of $10 billion, but it may at some point in the future.

ITEM 1A. RISK FACTORS

In addition to the other information in this Annual Report on Form 10-K, stockholders or prospective investors should carefully consider the following risk factors that may adversely affect our business, financial results or stock price. Additional risks that we currently do not know about or currently view as immaterial may also impair our business or adversely impact our financial results or stock price.

Credit Risks

Our business and financial results are significantly affected by general business and economic conditions.
Our business activities and earnings are affected by general business conditions in the United States and particularly in the states in which our Bank Subsidiaries operate. Factors such as the volatility of interest rates, home prices and real estate values, unemployment, credit defaults, increased bankruptcies, decreased consumer spending and household income, volatility in the securities markets, and the cost and availability of capital negatively impacted our business during the recession. Although financial markets have stabilized and we are currently benefiting from a modest economic recovery, certain segments of the economy continue to be depressed. Further economic deterioration that affects household and/or corporate incomes could result in renewed credit deterioration and reduced demand for credit or fee-based products and services, negatively impacting our performance. In addition, changes in securities market conditions and monetary fluctuations could adversely affect the availability and terms of funding necessary to meet our liquidity needs.

We could suffer material credit losses if we do not appropriately manage our credit risk.
There are risks inherent in making any loan, including risks inherent in dealing with individual borrowers, risks of nonpayment, risks resulting from uncertainties as to the future value of collateral and risks resulting from changes in economic and industry conditions. We attempt to minimize our credit risk through prudent loan application approval procedures, careful monitoring of the concentration of our loans within specific industries and periodic independent reviews of outstanding loans by our loan review department. However, changes in the economy can cause the assumptions that we made at origination to change and can cause borrowers to be unable to make payments on their loans, and significant changes in collateral values such as those that occurred in 2009 and 2010 can cause us to be unable to collect the full value of loans we make. We cannot assure you that such approval and monitoring procedures will reduce these credit risks.

Commercial loans, which present risks related to the value of the assets that serve as collateral, make up a significant portion of our loan portfolio.
Commercial loans were $2.48 billion (including $1.53 billion of commercial real estate loans), or approximately 71% of our total loan portfolio as of December 31, 2013. Our commercial loans are primarily made based on the identified cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. Most often, this collateral consists of accounts receivable, inventory, machinery or real estate. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers. The other types of collateral securing these loans may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business.

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

Commercial real estate lending is a large portion of our commercial loan portfolio. These loans were $1.53 billion, or approximately 62%, of our total commercial loan portfolio as of December 31, 2013. The market value of real estate can fluctuate significantly in a short period of time as a result of market conditions in the geographic area in which the real estate is located. Adverse developments affecting real estate values could negatively affect some of our commercial real estate loans, and further developments could increase the credit risk associated with our loan portfolio. Non-owner occupied commercial real estate loans typically are dependent, in large part, on sufficient income from the properties securing the loans to cover operating expenses and debt service. A weaker economy has an impact on the absorption period associated with lot and land development loans. When the source of repayment is reliant on the successful and timely sale of lots or land held for resale, a default on these loans becomes a greater risk. Economic events or governmental regulations outside of the control of the borrower or lender could negatively impact the future cash flow and market values of the affected properties.

The construction, land acquisition and development loans that are part of our commercial real estate loans present project completion risks, as well as, the risks applicable to other commercial real estate loans.
Our commercial real estate loans also include commercial construction loans, including land acquisition and development, which involve additional risks because funds are advanced based upon estimates of costs and the estimated value of the completed project. Because of the uncertainties inherent in estimating construction costs, as well as the market value of the completed project and the effects of governmental regulation on real property, it is relatively difficult to evaluate accurately the total funds required to complete a project and the related loan-to-value ratio. As a result, commercial construction loans often involve the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project and the ability of the borrower to sell or lease the property, rather than the ability of the borrower or guarantor to repay principal and interest. If our appraisal of the value of the completed project proves to be overstated, we may have inadequate security for the repayment of the loan upon completion of construction of the project.

We may encounter issues with environmental law compliance if we take possession, through foreclosure or otherwise, of the real property that secures a commercial real estate loan.
A significant portion of our loan portfolio is secured by real property. During the ordinary course of business, we may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, we may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require us to incur substantial expenses which may materially reduce the affected property’s value or limit our ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. Although we have policies and procedures to perform an environmental review before initiating any foreclosure action on real property, these reviews may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on our financial condition and results of operations.

Our agricultural loans are often dependent upon the health of the agricultural industry in the location of the borrower, and the ability of the borrower to repay may be affected by many factors outside of the borrower’s control.
At December 31, 2013, agricultural real estate loans totaled $207.0 million or 6% of our total loan and lease portfolio. Payments on agricultural real estate loans are dependent on the profitable operation or management of the farm property securing the loan. The success of the farm may be affected by many factors outside the control of the borrower, including adverse weather conditions that prevent the planting of a crop or limit crop yields (such as hail, drought and floods), loss of livestock due to disease or other factors, declines in market prices for agricultural products (both domestically and internationally) and the impact of government regulations (including changes in price supports, subsidies and environmental regulations). In addition, many farms are dependent on a limited number of key individuals whose injury or death may significantly affect the successful operation of the farm. If the cash flow from a farming operation is diminished, the borrower’s ability to repay the loan may be impaired. The primary crops in our market areas are corn, soybeans, peanuts and wheat. Accordingly, adverse circumstances affecting these crops could have an adverse effect on our agricultural real estate loan portfolio.

We also originate agricultural operating loans. At December 31, 2013, these loans totaled $169.7 million or 5% of our total loan and lease portfolio. As with agricultural real estate loans, the repayment of operating loans is dependent on the successful operation or management of the farm property. Likewise, agricultural operating loans involve a greater degree of risk than lending on residential properties, particularly in the case of loans that are unsecured or secured by rapidly depreciating assets such as farm equipment or assets such as livestock or crops. The primary livestock in our market areas include dairy cows, hogs and feeder cattle. In these cases, any repossessed collateral for a defaulted loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation.

Our one- to four-family residential mortgage loans may result in lower yields and profitability.
One- to four-family residential mortgage loans comprised $349.3 million or approximately 10% of our loan and lease portfolio at December 31, 2013, with approximately 64% secured by properties located in the Midwest. These loans generally result in lower yields and lower profitability for us than other loans in Heartland’s portfolio and are generally made on the basis of the borrower’s ability to make repayments from his or her employment and the value of the property securing the loan.

Our consumer loans generally have a higher degree of risk of default than our other loans.
At December 31, 2013, consumer loans totaled $294.1 million or approximately 8% of our total loan and lease portfolio. Consumer loans typically have shorter terms and lower balances with higher yields as compared to one- to four-family residential mortgage loans, but generally carry higher risks of default. Consumer loan collections are dependent on the borrower’s continuing financial stability, and thus are more likely to be affected by adverse personal circumstances.

Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount that can be recovered on these loans.

Our allowance for loan losses may prove to be insufficient to absorb losses in our loan portfolio.
We establish our allowance for loan losses in consultation with management of the Bank Subsidiaries and maintain it at a level considered appropriate by management to absorb probable loan losses that are inherent in the portfolio. The amount of future loan losses is susceptible to changes in economic, operating and other conditions, including changes in interest rates, which may be beyond our control, and such losses may exceed current estimates. In each year from 2008 through 2011, we were required to record provisions for loan losses in excess of our pre-2008 historical experience because of the impact of the economy and real estate values on some of our borrowers, resulting in charge-offs and an increased level of nonperforming assets. At December 31, 2013, our allowance for loan losses as a percentage of total loans, exclusive of loans covered by loss share agreements, was 1.19% and as a percentage of total nonperforming loans was approximately 98%. Although we believe that the allowance for loan losses is appropriate to absorb losses on any existing loans that may become uncollectible, we cannot predict loan losses with certainty, and we cannot assure you that our allowance for loan losses will prove sufficient to cover actual loan losses in the future. Further significant provisions, or charge-offs against our allowance that result in provisions, could have a significant negative impact on our profitability. Loan losses in excess of our reserves may adversely affect our business, financial condition and results of operations.

Our business is concentrated in and dependent upon the continued growth and welfare of the various markets that we serve.
We operate over a wide area, including markets in Iowa, Illinois, Wisconsin, Arizona, New Mexico, Montana, Colorado, Minnesota, and Kansas, and our financial condition, results of operations and cash flows are subject to changes in the economic conditions in those areas. Our success depends upon the business activity, population, income levels, deposits and real estate activity in those areas. Although our customers’ business and financial interests may extend well beyond our market areas, adverse economic conditions that affect our specific market area could reduce our growth rate, affect the ability of our customers to repay their loans to us and generally affect our financial condition and results of operations.

Our expansion into new markets through National Residential Mortgage could subject us to economic risks in markets with which we are less familiar.
We have expanded our residential real estate mortgage production capability by adding personnel and capacity in our Heartland Mortgage and National Residential Mortgage unit, and have added residential loan production offices with new personnel in several new geographies. Although we have generally sold the mortgages we originate through National Residential Mortgage into the secondary market, we may elect to retain mortgages in our portfolio in the future, and regardless of such retention have some liability as the originator and servicer of the mortgages. If we inaccurately monitor credit risk in these markets, or retain personnel for National Residential Mortgage who do not accurately report and monitor credit risk, our operations could be negatively affected. Further, new rules promulgated by the CFPB in 2013 may impact our origination and servicing of mortgage loans by eliminating incentives for mortgage personnel and requiring other changes in origination practices.

Liquidity and Interest Rate Risks

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

interest rates. As a result, an increase or decrease in rates, the length of loan terms or the mix of adjustable and fixed rate loans in our portfolio could have a positive or negative effect on our net income, capital and liquidity. We measure interest rate risk under various rate scenarios and using specific criteria and assumptions. A summary of this process, along with the results of our net interest income simulations, is presented under the heading "Quantitative and Qualitative Disclosures About Market Risk" included under Item 7A of Part II of this Form 10-K. Although we believe our current level of interest rate sensitivity is reasonable and effectively managed, significant fluctuations in interest rates may have an adverse effect on our business, financial condition and results of operations.

Revenue from our mortgage banking operations is sensitive to changes in economic conditions, decreased economic activity, a slowdown in the housing market, higher interest rates or new legislation and may adversely impact our profits.
Our mortgage banking division, conducted through our Heartland Mortgage and National Residential Mortgage unit, provided a significant portion of our consolidated revenue during 2012. Our overall mortgage banking revenue is highly dependent upon the volume of loans we originate and sell in the secondary market. Mortgage loan production levels are sensitive to changes in economic conditions and suffer from decreased economic activity, a slowdown in the housing market and higher interest rates.

The mild increase in mortgage interest rates nationwide during 2013 significantly impacted mortgage volumes of most mortgage banking operations, including our own, negatively impacting our mortgage banking revenue in 2013 relative to 2012. Generally, any additional sustained period of decreased economic activity or higher interest rates could adversely affect mortgage originations and, consequently, reduce our income from mortgage lending activities.

The value of our mortgage servicing rights can decline during periods of falling interest rates and we may be required to take a charge against earnings for the decreased value.
A mortgage servicing right ("MSR") is the right to service a mortgage loan for a fee. We acquire MSRs when we originate mortgage loans and keep the servicing rights after we sell the loans. We carry MSRs at the lower of amortized cost or estimated fair value. Fair value is the present value of estimated future net servicing income, calculated based on a number of variables, including assumptions about the likelihood of prepayment by borrowers. Changes in interest rates can affect prepayment assumptions. When interest rates fall, borrowers are more likely to prepay their mortgage loans by refinancing them at a lower rate. As the likelihood of prepayment increases, the fair value of our MSRs can decrease. Each quarter we evaluate our MSRs for impairment based on the difference between the carrying amount and fair value. If temporary impairment exists, we establish a valuation allowance through a charge to earnings for the amount by which the carrying amount exceeds fair value.

The derivative instruments that we use to hedge interest rate risk associated with the loans held for sale and rate locks on our mortgage banking business are complex and can result in significant losses.
We typically use derivatives and other instruments to hedge changes in the value of loans held for sale and interest rate lock commitments. We generally do not hedge all of our risk, and we may not be successful in hedging any of the risk. Hedging is a complex process, requiring sophisticated models and constant monitoring, and is not a perfect science. We may use hedging instruments that may not perfectly correlate with the value or income being hedged. We could incur significant losses from our hedging activities. There may be periods where we elect not to use derivatives and other instruments to hedge mortgage banking interest rate risk.

The market for loans held for sale with secondary purchasers, including government-sponsored entities ("GSEs"), has changed during recent years and further changes could impair the gains we recognize on sale of mortgage loans.
We sell most of the mortgage loans we originate in order to reduce our credit risk and provide funding for additional loans. We rely on GSEs to purchase loans that meet their conforming loan requirements and on other capital markets investors to purchase loans that do not meet those requirements, referred to as “nonconforming” loans. During the past few years investor demand for nonconforming loans has fallen sharply, increasing credit spreads and reducing the liquidity for those loans. In response to the reduced liquidity in the capital markets, we may retain more nonconforming loans. When we retain a loan, not only do we keep the credit risk of the loan, but we also do not receive any sale proceeds that could be used to generate new loans. Continued lack of liquidity could limit our ability to fund, and thus originate, new mortgage loans, reducing the fees we earn from originating and servicing loans. In addition, we cannot assure that GSEs will not materially limit their purchases of conforming loans because of capital constraints or changes in their criteria for conforming loans (e.g., maximum loan amount or borrower eligibility). Each of the GSEs is currently in conservatorship, with its primary regulator, the Federal Housing Finance Agency acting as conservator. We cannot predict if, when or how the conservatorship will end, or any associated changes to the business structure and operations of the GSEs that could result. As noted above, there are various proposals to reform the housing finance market in the U.S., including the role of the GSEs in the housing finance market. The extent and timing of any such regulatory reform regarding the housing finance market and the GSEs, including whether the GSEs will continue to exist in their current form, as well as any effect on Heartland's business and financial results, are uncertain.

Our growth may require us to raise additional capital in the future, but that capital may not be available when it is needed.

We are required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations. We anticipate that our existing capital resources will satisfy our capital requirements for the foreseeable future. However, we may at some point need to raise additional capital to support continued growth, both internally and through acquisitions. Our ability to raise additional capital, if needed, will depend on conditions in the capital markets at that time, which are outside of our control, and on our financial performance. Accordingly, we cannot assure you of our ability to raise additional capital if needed on terms acceptable to us. If we cannot raise additional capital when needed, our ability to further expand our operations through internal growth and acquisitions could be materially impaired.

We rely on dividends from our subsidiaries for most of our revenue.

The primary source of funds for Heartland is dividends from the Bank Subsidiaries. In general, the Bank Subsidiaries may only pay dividends either out of their historical net income after any required transfers to surplus or reserves have been made or out of their retained earnings. The payment of dividends by any financial institution is affected by the requirement to maintain adequate capital pursuant to applicable capital adequacy guidelines and regulations, and a financial institution generally is prohibited from paying any dividends if, following payment thereof, the institution would be undercapitalized. These dividends are the principal source of funds to pay dividends on Heartland's common stock and preferred stock, and to pay interest and principal on the debt.

Operational Risks

We have a continuing need for technological change and we may not have the resources to effectively implement new technology.
The financial services industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. In addition to being able to better serve customers, the effective use of technology increases efficiency and enables financial institutions to reduce costs. Our future success will depend, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands for convenience, as well as, to create additional efficiencies in our operations as we continue to grow and expand our market areas. Many of our larger competitors have substantially greater resources to invest in technological improvements. As a result, they may be able to offer additional or superior products to those that we will be able to offer, which would put us at a competitive disadvantage.

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

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

Our market and growth strategy relies heavily on our management team, and the unexpected loss of key managers may adversely affect our operations.
Much of our success to date has been influenced strongly by our ability to attract and to retain senior management experienced in banking and financial services and familiar with the communities in our different market areas.

Because our service areas are spread over such a wide geographical area, our management headquartered in Dubuque, Iowa, is dependent on the effective leadership and capabilities of the management in our local markets for the continued success of Heartland. Our ability to retain executive officers, the current management teams and loan officers of our operating subsidiaries will continue to be important to the successful implementation of our strategy. It is also critical, as we grow, to be able to attract and retain qualified additional management and loan officers with the appropriate level of experience and knowledge about our market area to implement our community-based operating strategy. The unexpected loss of services of any key management personnel, or the inability to recruit and retain qualified personnel in the future, could have an adverse effect on our business, financial condition and results of operations.

Reduction in the value, or impairment of our investment securities, can impact our earnings and common stockholders' equity.
We maintained a balance of $1.90 billion, or 32% of our assets, in investment securities at December 31, 2013. Changes in market interest rates can affect the value of these investment securities, with increasing interest rates generally resulting in a

reduction of value. Although the reduction in value from temporary increases in market rates does not affect our income until the security is sold, it does result in an unrealized loss recorded in other comprehensive income that can reduce our common stockholders' equity. Further, we must periodically test our investment securities for other-than-temporary impairment in value. In assessing whether the impairment of investment securities is other-than-temporary, we consider the length of time and extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and the intent and ability to retain our investment in the security for a period of time sufficient to allow for any anticipated recovery in fair value in the near term.

We have recorded goodwill as a result of acquisitions that can significantly affect our earnings if it becomes impaired. Under current accounting standards, goodwill is not amortized but, instead, is subject to impairment tests on at least an annual basis or more frequently if an event occurs or circumstances change that reduce the fair value of a reporting unit below its carrying amount. Although we do not anticipate impairment charges, if we conclude that some portion of our goodwill may be impaired, a non-cash charge for the amount of such impairment would be recorded against earnings. Such a charge would have no impact on tangible capital. A decline in our stock price or occurrence of a triggering event following any of our quarterly earnings releases and prior to the filing of the periodic report for that period could, under certain circumstances, cause us to perform a goodwill impairment test and result in an impairment charge being recorded for that period which was not reflected in such earnings release. At December 31, 2013, we had goodwill of $35.6 million, representing approximately 8% of stockholders' equity.

We have substantial deferred tax assets that could require a valuation allowance and a charge against earnings if we conclude that the tax benefits represented by the assets are unlikely to be realized.
Our balance sheet reflected approximately $39.7 million of deferred tax assets at December 31, 2013, that represents differences in the timing of the benefit of deductions, credits and other items for accounting purposes and the benefit for tax purposes. To the extent we conclude that the value of this asset is not more likely than not to be realized, we would be obligated to record a valuation allowance against the asset, impacting our earnings during the period in which the valuation allowance is recorded. Assessing the need for, or the sufficiency of, a valuation allowance requires management to evaluate all available evidence, both negative and positive. Positive evidence necessary to overcome the negative evidence includes whether future taxable income in sufficient amounts and character within the carryback and carryforward periods is available under the tax law. When negative evidence (e.g., cumulative losses in recent years, history of operating losses or tax credit carryforwards expiring unused) exists, more positive evidence than negative evidence will be necessary. If the positive evidence is not sufficient to exceed the negative evidence, a valuation allowance for deferred tax assets is established. The impact of each of these impairment matters could have a material adverse effect on our business, results of operations, and financial condition.

Strategic and External Risks

Government regulation can result in limitations on our operations.
We operate in a highly regulated environment and are subject to supervision and regulation by a number of governmental regulatory agencies, including the Federal Reserve, the FDIC, the CFPB, and the various state agencies where we have a bank presence. Regulations adopted by these agencies, which are generally intended to provide protection for depositors and customers rather than for the benefit of stockholders, govern a comprehensive range of matters relating to ownership and control of our shares, our acquisition of other companies and businesses, permissible activities for us to engage in, maintenance of adequate capital levels and other aspects of our operations. These bank regulators possess broad authority to prevent or remedy unsafe or unsound practices or violations of law deemed to be unfair, abusive and deceptive acts and practices. The laws and regulations applicable to the banking industry could change at any time and we cannot predict the effects of these changes on our business and profitability. Increased regulation could increase our cost of compliance and adversely affect profitability. For example, new legislation or regulation may limit the manner in which we may conduct our business, including our ability to offer new products, obtain financing, attract deposits, make loans and achieve satisfactory interest spreads. The CFPB's

extensive rulemaking in particular may impact our residential mortgage origination and servicing business.

The soundness of other financial institutions could adversely affect our liquidity and operations.
Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services institutions are interrelated as a result of trading, clearing, counterparty or other relationships. We have exposure to many different counterparties, and we routinely execute transactions with counterparties in the financial industry, including brokers and dealers, commercial banks, investment banks, and other institutional clients. As a result, defaults by, or even rumors or questions about, one or more financial services institutions, or the financial services industry generally, have led to market-wide liquidity problems and could lead to losses or defaults by Heartland or the Bank Subsidiaries or by other institutions. Many of these transactions expose us to credit risk in the event of default of our counterparty or client. In addition, our credit risk may be exacerbated when the collateral held by us cannot be realized upon or

is liquidated at prices not sufficient to recover the full amount of the financial instrument exposure due us. There is no assurance that any such losses would not materially and adversely affect our results of operations.

Further downgrades in the U.S. government's sovereign credit rating could present risks to Heartland.
In 2012, ratings agencies have downgraded the sovereign credit rating they publish for, or otherwise negatively revised their outlook for, the U.S. government, and have indicated that they will continue to assess fiscal projections, as well as the medium-term economic outlook for the United States. This development, combined with uncertainty caused by political gridlock, creates a risk of an additional downgrade to the sovereign credit rating of the U.S. government, including the ratings of U.S. Treasury securities. If such a downgrade were to occur, the value and liquidity of instruments issued, insured or guaranteed by institutions, agencies or instrumentalities directly linked to the U.S. government could be adversely affected. Instruments of this nature are often held by financial institutions, including Heartland, for investment, liquidity planning and collateral purposes. A downgrade of the sovereign credit ratings of the U.S. government and perceived creditworthiness of U.S. government-related obligations could impact Heartland's liquidity.

We may experience difficulties in managing our growth and our growth strategy involves risks that may negatively impact our net income.
As part of our general growth strategy, we recently acquired several banks and may acquire additional banks that we believe provide a strategic and geographic fit with our business. We cannot predict the number, size or timing of acquisitions. To the extent that we grow through acquisitions, we cannot assure you that we will be able to adequately and profitably manage this growth. Acquiring other banks and businesses will involve risks commonly associated with acquisitions, including:

- potential exposure to unknown or contingent liabilities of banks and businesses we acquire;
- exposure to potential asset quality issues of the acquired bank or related business;
- difficulty and expense of integrating the operations and personnel of banks and businesses we acquire;
- potential disruption to our business;
- potential restrictions on our business resulting from the regulatory approval process;
- potential diversion of our management’s time and attention; and
- the possible loss of key employees and customers of the banks and businesses we acquire.

In addition to acquisitions, we may expand into additional communities or attempt to strengthen our position in our current markets by undertaking additional de novo bank formations or branch openings. Based on our experience, we believe that it generally takes three years or more for new banking facilities to first achieve operational profitability, due to the impact of organization and overhead expenses and the start-up phase of generating loans and deposits. To the extent that we undertake additional branching and de novo bank and business formations, we are likely to continue to experience the effects of higher operating expenses relative to operating income from the new operations, which may have an adverse effect on our levels of reported net income, return on average equity and return on average assets.

We face intense competition in all phases of our business and competitive factors could adversely affect our business.
The banking and financial services business in our markets is highly competitive and is currently undergoing significant change. Our competitors include large regional banks, local community banks, online banks, thrifts, securities and brokerage companies, mortgage companies, insurance companies, finance companies, money market mutual funds, credit unions and other non-bank financial service providers, and increasingly these competitors provide integrated financial services over a broad geographic area. Some of our competitors may also have access to governmental programs that impact their position in the marketplace favorably. Increased competition in our markets may result in a decrease in the amounts of our loans and deposits, reduced spreads between loan rates and deposit

rates or loan terms that are more favorable to the borrower. Any of these results could have a material adverse effect on our ability to grow and remain profitable.

Legal, Compliance and Reputational Risks

Recent legislation has impacted our operations, and additional legislation and rulemaking could impact us adversely. New laws passed during the past five years, together with regulations adopted or to be adopted by the banking agencies under those laws, significantly impact financial institutions. The Dodd-Frank Act is particularly far reaching, establishing the CFPB with broad authority to administer and enforce a new federal regulatory framework of consumer financial regulation, changing the base for deposit insurance assessments, introducing regulatory rate-setting for interchange fees charged to merchants for debit card transactions, enhancing the regulation of consumer mortgage banking, changing the methods and standards for resolution of troubled institutions, and changing the Tier 1 regulatory capital ratio calculations for bank holding companies. In particular, the new Basel III Rules that establish new and increasing capital requirements may limit or otherwise restrict how Heartland uses its capital, including application for dividends and stock repurchases, and may require Heartland to increase its capital. Many of the provisions of the Dodd-Frank Act have extended implementation periods and delayed effective dates and will require additional rulemaking by various regulatory agencies, and many could have far reaching implications on our operations. Accordingly, Heartland cannot currently quantify the ultimate impact of this legislation and the related future rulemaking, but expects that the legislation may have a detrimental impact on revenues and expenses, require Heartland to change certain of its business practices, increase Heartland's capital requirements and otherwise adversely affect its business.

Other changes in the laws, regulations and policies governing financial services companies could alter our business environment and adversely affect operations.
The Board of Governors of the Federal Reserve System regulates the supply of money and credit in the United States. Its fiscal and monetary policies determine, in a large part, our cost of funds for lending and investing and the return that can be earned on those loans and investments, both of which affect our net interest margin. Federal Reserve Board policies can also materially affect the value of financial instruments that we hold, such as debt securities and mortgage servicing rights. Recent changes in the laws and regulations that apply to us have been significant. Further dramatic changes in statutes, regulations or policies could affect us in substantial and unpredictable ways, including limiting the types of financial services and products that we offer and/or increasing the ability of non-banks to offer competing financial services and products. We cannot predict whether any of this potential legislation will be enacted, and if enacted, the effect that it or any regulations would have on our financial condition or results of operations.

We may be required to repurchase mortgage loans or reimburse investors and others as a result of breaches in contractual representations and warranties.
We sell residential mortgage loans to various parties, including GSEs and other financial institutions that purchase mortgage loans for investment or private label securitization. The agreements under which we sell mortgage loans and the insurance or guaranty agreements with the FHA and VA contain various representations and warranties regarding the origination and characteristics of the mortgage loans, including ownership of the loan, compliance with loan criteria set forth in the applicable agreement, validity of the lien securing the loan, absence of delinquent taxes or liens against the property securing the loan, and compliance with applicable origination laws. We may be required to repurchase mortgage loans, indemnify the investor or insurer, or reimburse the investor or insurer for credit losses incurred on loans in the event of a breach of contractual representations or warranties that is not remedied within a period (usually 90 days or less) after we receive notice of the breach. Contracts for mortgage loan sales to the GSEs include various types of specific remedies and penalties that could be applied to inadequate responses to repurchase requests. Similarly, the agreements under which we sell mortgage loans require us to deliver various documents to the investor, and we may be obligated to repurchase any mortgage loan as to which the required documents are not delivered or are defective. We establish a mortgage repurchase liability related to the various representations and warranties that reflect management's estimate of losses for loans which we have a repurchase obligation. Our mortgage repurchase liability represents management's best estimate of the probable loss that we may expect to incur for the representations and warranties in the contractual provisions of our sales of mortgage loans. Because the level of mortgage loan repurchase losses depends upon economic factors, investor demand strategies and other external conditions that may change over the life of the underlying loans, the level of the liability for mortgage loan repurchase losses is difficult to estimate and requires considerable management judgment. If economic conditions and the housing market deteriorate or future investor repurchase demand and our success at appealing repurchase requests differ from past experience, we could experience increased repurchase obligations and increased loss severity on repurchases, requiring additions to the repurchase liability.

Our participation in the SBLF subjects us to certain reporting obligations and imposes restrictions on the payment of dividends on our common stock and the repurchase of shares of our common stock.
Under the SBLF, we have quarterly reporting obligations to the U. S. Treasury that were used to determine the dividend rate to be paid on the Series C Preferred Stock issued to the U.S. Treasury. The interest rate on the $81.7 million of SBLF funds will remain at 1.00% through March 15, 2016, but will increase to 9.00% if we do not redeem the Series C Preferred Stock by that time.

The terms of the SBLF securities purchase agreement between us and the U.S. Treasury also prohibits us from paying dividends on our common stock, or repurchasing shares, to the extent that, after payment of such dividends or repurchases, our Tier 1 Capital would generally fall below $247.7 million. Additionally, if we fail to pay an SBLF dividend in a given quarter, we may not pay dividends on or repurchase any common stock for the next three quarters, except in very limited circumstances. If any of the Series C Preferred Stock issued to the U.S. Treasury has not been redeemed by September 15, 2021, the tenth anniversary of issuance, we may not pay any further dividends on our common stock until the Series C Preferred Stock is redeemed in full.

Negative publicity could adversely impact our business and financial results.
Reputation risk, or the risk to our earnings and capital from negative publicity, is inherent to our business. Current public uneasiness with the United States banking system heightens this risk, as banking customers often transfer news regarding financial difficulties or even failure of some institutions, to fear of financial difficulty or failure of even the most secure

institutions. In this climate, any negative news may become cause for curtailment of business relationships, withdrawal of funds or other actions that can have a compounding effect, and could adversely affect our operations.

Our ability to obtain reimbursement from the FDIC under loss share agreements depends on our compliance with the terms of those loss share agreements.
Under loss share agreements we have with the FDIC relating to assets of The Elizabeth State Bank that we purchased, we are obligated to certify to the FDIC on a quarterly basis our compliance with the terms of the loss share agreements as a prerequisite to obtaining reimbursement from the FDIC for realized losses on the covered assets. These agreements have specific, detailed and cumbersome compliance, servicing, notification and reporting requirements. Our failure to comply with the terms of the agreements or to properly service the loans and other real estate owned under the requirements of the agreements may cause a specific asset or group of assets to lose eligibility for loss share payments from the FDIC. Additionally, management may decide to forgo loss share coverage on certain assets to allow greater flexibility over the management of those assets. As of December 31, 2013, Heartland had $5.7 million of loans and $58,000 of other real estate owned, or a total of $5.8 million (0.1% percent of total assets), covered by loss share agreements with the FDIC.

Market Risks

Our stock price can be volatile.
Our stock price can fluctuate widely in response to a variety of factors, including: actual or anticipated variations in our quarterly operating results; recommendations by securities analysts; acquisitions or business combinations; capital commitments by or involving Heartland or our Bank Subsidiaries; operating and stock price performance of other companies that investors deem comparable to us; new technology used or services offered by our competitors; new reports relating to trends, concerns and other issues in the financial services industry; and changes in government regulations. General market fluctuations, industry factors and general economic and political conditions and events have caused a decline in our stock price in the past, and these factors, as well as, interest rate changes, continued unfavorable credit loss trends, or unforeseen events such as terrorist attacks could cause our stock price to be volatile regardless of our operating results.

Certain banking laws and the Heartland Stockholder Rights Plan may have an anti-takeover effect.
Certain federal banking laws, including regulatory approval requirements, could make it more difficult for a third party to acquire Heartland, even if doing so would be perceived to be beneficial to Heartland’s shareholders. In addition, Heartland's Amended and Restated Rights Agreement (the “Rights Plan”) is intended to discourage any person from acquiring 15% or more of Heartland's outstanding stock (with certain limited exceptions). The combination of these provisions may inhibit a non-negotiated merger or other business combination, which, in turn, could adversely affect the market price of Heartland's common stock.

ITEM 1B. UNRESOLVED STAFF COMMENTS

As of December 31, 2013, Heartland had no unresolved staff comments.

ITEM 2. PROPERTIES

The following table is a listing of Heartland's principal operating facilities as of December 31, 2013:

Name and Main Facility Address	Main Facility Square Footage	Main Facility Owned or Leased	Number of Locations[1]
Heartland Financial USA, Inc. 1398 Central Avenue Dubuque, IA 52001	65,000	Owned	3
Dubuque Bank and Trust Company 1398 Central Avenue Dubuque, IA 52001	65,500	Owned	29
Galena State Bank & Trust Co. 971 Gear Street Galena, IL 61036	18,000	Owned	4
Riverside Community Bank 6855 E. Riverside Blvd. Rockford, IL 60114	8,000	Owned	4
Wisconsin Bank & Trust 8240 Mineral Point Rd. Madison, WI 53719	19,000	Owned	13
New Mexico Bank & Trust 320 Gold NW Albuquerque, NM 87102	11,400	Lease term through 2016	16
Arizona Bank & Trust 2036 E. Camelback Rd. Phoenix, AZ 85016	14,000	Owned	8
Rocky Mountain Bank 2615 King Avenue West Billings, MT 59102	16,600	Owned	16
Summit Bank & Trust 2002 E. Coalton Road Broomfield, CO 80027	14,000	Owned	5
Minnesota Bank & Trust 7701 France Avenue South, Suite 110 Edina, MN 55435	6,100	Lease term through 2018	4
Morrill & Janes Bank and Trust Company 6740 Antioch Road Merriam, KS 66204	7,500	Lease term through 2022	11
Citizens Finance Parent Co. 1275 Main Street Dubuque, IA 52001	5,600	Owned	12

(1) Includes loan production offices.

The corporate office of Heartland is located in Dubuque Bank and Trust Company's main office. A majority of the support functions provided to the Bank Subsidiaries by Heartland are performed in two leased facilities: one located at 1301 Central Avenue in Dubuque, Iowa, which is leased from Dubuque Bank and Trust Company, and the other located at 700 Locust Street, Suite 300 in Dubuque, Iowa.

ITEM 3. LEGAL PROCEEDINGS

There are no material pending legal proceedings to which Heartland or its subsidiaries are a party at December 31, 2013, other than ordinary routine litigation incidental to their respective businesses. While the ultimate outcome of current legal proceedings cannot be predicted with certainty, it is the opinion of management that the resolution of these legal actions should not have a material effect on Heartland's consolidated financial position or results of operations.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable

EXECUTIVE OFFICERS

The names and ages of the executive officers of Heartland as of December 31, 2013, position held by these officers on that date and other positions held with Heartland and its subsidiaries are set forth below:

Name	Age	Position with Heartland and Subsidiaries and Principal Occupation
Lynn B. Fuller	64	Chairman, President and Chief Executive Officer of Heartland; Vice Chairman of Dubuque Bank and Trust Company, Wisconsin Bank & Trust, New Mexico Bank & Trust, Arizona Bank & Trust, Rocky Mountain Bank, Summit Bank & Trust and Minnesota Bank & Trust; Chairman of Citizens Finance Parent Co.
Bryan R. McKeag	53	Executive Vice President and Chief Financial Officer of Heartland; Treasurer of Citizens Finance Parent Co.
Kenneth J. Erickson	62	Executive Vice President, Chief Credit Officer of Heartland; Executive Vice President, Lending, of Dubuque Bank and Trust Company; Vice Chairman of Citizens Finance Parent Co.
Douglas J. Horstmann	60	Executive Vice President, Lending, of Heartland; Director, President and Chief Executive Officer of Dubuque Bank and Trust Company; Vice Chairman of Galena State Bank & Trust Co. and Riverside Community Bank
John J. Berg	62	Executive Vice President, Marketing and Sales of Heartland
Brian J. Fox	65	Executive Vice President, Operations of Heartland
David L. Horstmann	64	Executive Vice President, Finance/Corporate Strategy of Heartland

Lynn B. Fuller has been a Director of Heartland and of Dubuque Bank and Trust Company since 1984 and has been President of Heartland since 1987. Until 2004, Mr. Fuller had been a Director of Galena State Bank & Trust Co. since 1992 and Riverside Community Bank since 1995. He has been a Director of Wisconsin Bank & Trust since 1997, New Mexico Bank & Trust since 1998, Arizona Bank & Trust since 2003, Summit Bank & Trust since 2006, Minnesota Bank & Trust since 2008 and Heritage Bank, N.A. from 2012 until its merger with Arizona Bank & Trust in 2013. Mr. Fuller became a director of Morrill & Janes Bank and Trust Company in January 2014. Mr. Fuller joined Dubuque Bank and Trust Company in 1971 as a consumer loan officer and was named Dubuque Bank and Trust Company's Executive Vice President and Chief Executive Officer in 1985. Mr. Fuller was President of Dubuque Bank and Trust Company from 1987 until 1999 at which time he was named Chief Executive Officer of Heartland. Mr. Fuller is the brother-in-law of Mr. James F. Conlan, who is a director of Heartland.

Bryan R. McKeag joined Heartland in 2013 as Chief Financial Officer. Prior to joining Heartland, Mr. McKeag served as Executive Vice President, Corporate Controller and Principal Accounting Officer with Associated Banc-Corp in Green Bay, Wisconsin. He is an inactive holder of the certified public accountant certification.

Kenneth J. Erickson was named Executive Vice President, Chief Credit Officer, of Heartland in 1999. Mr. Erickson has been employed by Dubuque Bank and Trust Company since 1975, and was appointed Vice President, Commercial Loans in 1985, Senior Vice President, Lending in 1989 and Executive Vice President in 2000. He was named Vice Chairman of Citizens Finance Co. in 2004. Prior to 2004, Mr. Erickson was Senior Vice President at Citizens Finance Co. Mr Erickson was named Vice Chairman of Citizens Finance Parent Co. when it was formed in 2013.

Douglas J. Horstmann was named Executive Vice President, Lending, of Heartland in 2012. Mr. Horstmann previously served as Senior Vice President, Lending, of Heartland since 1999. He has been employed by Dubuque Bank and Trust Company since 1980, was appointed Vice President, Commercial Loans in 1985, Senior Vice President, Lending in 1989, Executive Vice President, Lending in 2000 and Director, President and Chief Executive Officer in 2004. Mr. Horstmann also served as Vice Chairman of First Community Bank from 2007 until its merger with Dubuque Bank and Trust Company in 2011. In 2013, Mr. Horstmann was elected a Director of Galena State Bank & Trust Co. and Riverside Community Bank. Prior to joining Dubuque Bank and Trust Company, Mr.

Horstmann was an examiner for the Iowa Division of Banking. Mr. Horstmann is the brother of David L. Horstmann, Heartland's Executive Vice President, Finance/Corporate Strategy.

John J. Berg joined Heartland in 2005 as Senior Vice President, Marketing and Sales. In 2008, he was promoted to Executive Vice President, Marketing and Sales. Mr. Berg’s background includes over 30 years of retail marketing and banking experience. Previous to joining Heartland, Mr. Berg served as Vice President and Marketing Director of First Federal Capital Bank in LaCrosse, Wisconsin. His prior experience includes marketing management positions with commercial banks and savings banks in West Des Moines, Iowa; St. Louis, Missouri; Waterloo, Iowa; and Lansing, Michigan.

Brian J. Fox joined Heartland in 2010 as Executive Vice President, Operations. From 2008 until joining Heartland, Mr. Fox served as Chief Information Officer of First Olathe Bancshares in Overland Park, Kansas. One year after joining First Olathe Bancshares, he was asked to help its principal subsidiary, First National Bank of Olathe, comply with a formal agreement it had entered with the Office of the Comptroller of the Currency (the "OCC") and served as its Chief Risk Officer. In October 2011, First National Bank of Olathe was placed in receivership by the OCC. For the eight years prior to joining First Olathe Bancshares, Mr. Fox drew on his 30 years experience at various banking organizations to provide consulting services to over 100 community banks as Senior Consultant at Vitex, Inc. His areas of responsibility have included strategic planning, credit administration, loan workouts, information technology, project management, mortgage banking, deposit operations and loan operations.

David L. Horstmann joined Heartland in 2004 as Vice President, Finance. In 2009, he was promoted to Senior Vice President, Finance. In 2013, he was named Executive Vice President, Finance/Corporate Strategy and served as Interim Chief Financial Officer from July 2013 through September 2013. Prior to joining Heartland, Mr. Horstmann was vice president of finance and operations at Wartburg Theological Seminary in Dubuque, Iowa from 2001 to 2004. He was a founding director and the executive vice president and chief financial officer of Premier Bank in Dubuque, Iowa from 1998 to 2001. His experience includes various executive and financial positions between 1978 and 1998 with Mercantile Bank of Eastern Iowa, Mercantile Bank, FSB of Davenport, Iowa, Harvest Savings Bank of Dubuque, Iowa and Dubuque Savings and Loan Association. Mr. Horstmann is an inactive holder of the certified public accountant certification. Mr. Horstmann is the brother of Douglas J. Horstmann, Heartland's Executive Vice President, Lending.

PART II

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

Heartland's common stock was held by approximately 2,300 stockholders of record as of March 14, 2014, and approximately 2,100 additional stockholders held shares in street name. The common stock of Heartland has been quoted on the NASDAQ Stock Market since May 2003 under the symbol “HTLF” and is a NASDAQ Global Select Market security.

For the periods indicated, the following table shows the range of reported prices per share of Heartland's common stock in the NASDAQ Global Select Market. These quotations represent inter-dealer prices without retail markups, markdowns, or commissions and do not necessarily represent actual transactions.

Calendar Quarter	High	Low
2013:		
First	$27.58	$23.13
Second	28.00	22.29
Third	30.00	26.50
Fourth	29.81	26.18
2012:		
First	$17.70	$14.82
Second	24.00	15.10
Third	28.26	22.67
Fourth	28.70	24.98

Cash dividends have been declared by Heartland quarterly during the two years ending December 31, 2013. A special dividend of $0.10 per common share was declared and paid in December 2012. The following table sets forth the cash dividends per share paid on Heartland's common stock for the past two years:

Calendar Quarter	2013	2012
First	$0.10	$0.10
Second	0.10	0.10
Third	0.10	0.10
Fourth	0.10	0.20

Heartland's ability to pay dividends to stockholders is largely dependent upon the dividends it receives from the Bank Subsidiaries, and the Bank Subsidiaries are subject to regulatory limitations on the amount of cash dividends they may pay. Heartland is also subject to direct regulatory limitations on the amount of dividends it may pay under the terms of its Series C Preferred Stock issued under the SBLF. See "Business – Supervision and Regulation – Heartland – Dividend Payments" and "Business – Supervision and Regulation - The Bank Subsidiaries – Dividend Payments" and "Note 18 Capital Issuance and Redemption to Consolidated Financial Statements" for a more detailed description of these limitations.

Heartland has issued junior subordinated debentures in several private placements. Under the terms of the debentures, Heartland may be prohibited, under certain circumstances, from paying dividends on shares of its common stock. None of these circumstances currently exist.

Effective January 24, 2008, Heartland's board of directors authorized management to acquire and hold up to 500,000 shares of common stock as treasury shares at any one time. During participation in the Treasury's Capital Purchase Program, which was terminated on September 15, 2011, Heartland was prohibited from any repurchase, redemption, or acquisition of its common stock, except for certain repurchases to the extent of increases in shares outstanding because of issuances under existing benefit plans. Heartland and its affiliated purchasers made no purchases of its common stock during the quarter ended December 31, 2013.

Effective October 18, 2013, Heartland issued 1,402,431 shares of its common stock as partial consideration for the purchase of Morrill Bancshares, Inc., the holding company of Morrill & Janes Bank and Trust Company with an aggregate value of $38.8 million. Effective December 31, 2013, Heartland issued 3,894 shares of its common stock to directors of Dubuque Bank and

Trust Company and Wisconsin Bank & Trust, at their election, as compensation for their service on the Board during 2013. These shares of Heartland common stock were issued without registration under the Securities Act of 1933 in reliance upon the exemption set forth in Section 4(a)(2) and Rule 506 promulgated thereunder.

The following table and graph show a five-year comparison of cumulative total returns for Heartland, the NASDAQ Composite Index, the NASDAQ Bank Stock Index and the SNL Bank and Thrift Index. Figures for our common stock represent inter-dealer quotations, without retail markups, markdowns or commissions and do not necessarily represent actual transactions. The table and graph were prepared at our request by SNL Financial, LC.

Cumulative Total Return Performance

	12/31/2008	12/31/2009	12/31/2010	12/31/2011	12/31/2012	12/31/2013
Heartland Financial USA, Inc.	$100.00	$71.73	$89.55	$80.84	$141.00	$157.63
NASDAQ Composite	$100.00	$145.36	$171.74	$170.38	$200.63	$281.22
NASDAQ Bank	$100.00	$83.70	$95.55	$85.52	$101.50	$143.84
SNL Bank and Thrift	$100.00	$98.66	$110.14	$85.64	$115.00	$157.46

COMPARISON OF FIVE YEAR CUMULATIVE TOTAL RETURN*
ASSUMES $100 INVESTED ON DECEMBER 31, 2008
*Total return assumes reinvestment of dividends

ITEM 6. SELECTED FINANCIAL DATA

The following tables contain selected historical financial data for Heartland for the years ended December 31, 2013, 2012, 2011, 2010, and 2009. The selected historical consolidated financial information set forth below is qualified in its entirety by reference to, and should be read in conjunction with, Heartland's consolidated financial statements and notes thereto, included elsewhere in this report and Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations."

SELECTED FINANCIAL DATA
(Dollars in thousands, except per share data)

	For the Years Ended December 31,				
	2013	2012	2011	2010	2009
STATEMENT OF INCOME DATA					
Interest income	$199,511	$189,338	$191,737	$198,932	$203,293
Interest expense	35,683	39,182	46,343	55,880	70,530
Net interest income	163,828	150,156	145,394	143,052	132,763
Provision for loan and lease losses	9,697	8,202	29,365	32,508	39,377
Net interest income after provision for loan and lease losses	154,131	141,954	116,029	110,544	93,386
Noninterest income	89,618	108,662	59,577	52,329	52,704
Noninterest expenses	196,561	183,381	137,296	129,239	132,520
Income taxes	10,335	17,384	10,302	9,846	7,196
Net income	36,853	49,851	28,008	23,788	6,374
Net (income) loss available to noncontrolling interest, net of tax	(64)	(59)	36	115	188
Net income attributable to Heartland	36,789	49,792	28,044	23,903	6,562
Preferred dividends and discount	(1,093)	(3,400)	(7,640)	(5,344)	(5,344)
Net income available to common stockholders	$35,696	$46,392	$20,404	$18,559	$1,218
PER COMMON SHARE DATA					
Net income – diluted	$2.04	$2.77	$1.23	$1.13	$0.07
Cash dividends	0.40	0.50	0.40	0.40	0.40
Dividend payout ratio	19.61%	18.05%	32.52%	35.14%	53.24%
Book value	$19.44	$19.02	$16.29	$15.26	$14.38
Tangible book value per share [(1)]	16.90	17.03	14.62	13.54	12.52
Weighted average shares outstanding-diluted	17,460,066	16,768,602	16,575,506	16,461,679	16,325,320

(1) Tangible common equity is common equity excluding goodwill and other intangible assets. Tangible assets is assets excluding goodwill and other intangible assets.
(2) Tax equivalent using a 35% tax rate.

SELECTED FINANCIAL DATA (Continued)
(Dollars in thousands, except per share data)

	For the Years Ended December 31,				
	2013	2012	2011	2010	2009
BALANCE SHEET DATA					
Investments and federal funds sold	$1,895,044	$1,561,957	$1,326,794	$1,264,564	$1,175,217
Loans held for sale	46,665	96,165	53,528	23,904	17,310
Total loans and leases receivable	3,502,701	2,828,802	2,494,631	2,364,787	2,363,002
Allowance for loan and lease losses	41,685	38,715	36,808	42,693	41,848
Total assets	5,923,716	4,990,553	4,305,058	3,999,455	4,012,991
Total deposits	4,666,499	3,845,660	3,210,113	3,034,048	3,050,389
Long-term obligations	350,109	389,025	372,820	362,527	451,429
Preferred equity	81,698	81,698	81,698	78,483	77,224
Common stockholders’ equity	357,762	320,107	268,520	250,608	235,057
EARNINGS PERFORMANCE DATA					
Return on average total assets	0.70 %	1.04 %	0.50 %	0.46 %	0.03 %
Return on average stockholders’ equity	10.87	15.78	7.77	7.51	0.51
Net interest margin ratio(2)	3.78	3.98	4.16	4.12	3.99
Earnings to fixed charges:					
Excluding interest on deposits	3.02x	3.34x	2.51x	2.43x	1.58x
Including interest on deposits	1.96	2.15	1.70	1.55	1.18
ASSET QUALITY RATIOS					
Nonperforming assets to total assets	1.23 %	1.59 %	2.39 %	3.07 %	2.71 %
Nonperforming loans and leases to total loans and leases	1.21	1.53	2.31	3.87	3.35
Net loan and lease charge-offs to average loans and leases	0.22	0.23	1.46	1.31	1.38
Allowance for loan and lease losses to total loans and leases	1.19	1.37	1.48	1.82	1.80
Allowance for loan and lease losses to nonperforming loans and leases	98.27	89.71	64.09	47.12	53.56
CONSOLIDATED CAPITAL RATIOS					
Average equity to average assets	8.09 %	8.47 %	8.47 %	8.13 %	8.40 %
Average common equity to average assets	6.46	6.58	6.45	6.13	6.32
Total capital to risk-adjusted assets	14.69	15.35	15.87	16.23	15.20
Tier 1 leverage	13.19	13.36	14.08	14.06	13.53

(1) Tangible common equity is common equity excluding goodwill and other intangible assets. Tangible assets is assets excluding goodwill and other intangible assets.
(2) Tax equivalent using a 35% tax rate.

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

The following presents management’s discussion and analysis of the consolidated financial condition and results of operations of Heartland as of the dates and for the periods indicated. This discussion should be read in conjunction with the Selected Financial Data, Heartland’s Consolidated Financial Statements and the Notes thereto and other financial data appearing elsewhere in this report. The Consolidated Financial Statements include the accounts of Heartland and its subsidiaries. All of Heartland’s subsidiaries are wholly-owned.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, income and expenses. These estimates are based upon historical experience and on various other assumptions that management believes are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. The estimates and judgments that management believes have the most effect on Heartland’s reported financial position and results of operations are as follows:

Allowance For Loan And Lease Losses

The process utilized by Heartland to estimate the allowance for loan and lease losses is considered a critical accounting policy for Heartland. The allowance for loan and lease losses represents management’s estimate of identified and unidentified probable losses in the existing loan portfolio. Therefore, the accuracy of this estimate could have a material impact on Heartland’s earnings. The allowance for loan and lease losses is determined using factors that include the overall composition of the loan portfolio, general economic conditions, types of loans, loan collateral values, past loss experience, loan delinquencies, and potential losses from identified substandard and doubtful credits.

For loans individually evaluated and determined to be impaired, the allowance is allocated on a loan-by-loan basis as deemed necessary. These estimates reflect consideration of one of three impairment measurement methods as of the evaluation date:

- the present value of expected future cash flows discounted at the loan's effective interest rate;
- the loan's observable market price; or
- the fair value of the collateral if the loan is collateral dependent.

All other loans, including individually evaluated loans determined not to be impaired, are segmented into groups of loans with similar risk characteristics for evaluation and analysis. Loss rates for various collateral types of commercial and agricultural loans are established through assigned discount factors based upon the realizable value historically received on the various types of collateral. For smaller commercial and agricultural loans, residential real estate loans and consumer loans, a historic loss rate is established for each group of loans based upon a twelve-quarter weighted moving average loss rate. The appropriateness of the allowance for loan and lease losses is monitored on an ongoing basis by the loan review staff, senior management and the boards of directors of each Bank Subsidiary.

There can be no assurances that the allowance for loan and lease losses will be adequate to cover all loan losses, but management believes that the allowance for loan and lease losses was appropriate at December 31, 2013. While management uses available information to provide for loan and lease losses, the ultimate collectibility 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. Should the economic climate deteriorate, borrowers may experience difficulty, and the level of nonperforming loans, charge-offs, and delinquencies could rise and require further increases in the provision for loan and lease losses. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the allowance for loan and lease losses carried by the Heartland subsidiaries. Such agencies may require us to make additional provisions to the allowance based upon their judgment about information available to them at the time of their examinations.

Our allowance for loan and lease losses methodology includes the establishment of a dual risk rating system, which allows the utilization of a probability of default and loss given default for commercial and agricultural loans in the calculation of the allowance for loan lease losses. In addition to the allowance methodology, our software also has the ability to perform stress testing and migration analysis on various portfolio segments.

Goodwill And Other Intangibles

We record all assets and liabilities acquired in purchase acquisitions, including intangibles, at fair value. Goodwill and indefinite-lived assets are not amortized but are subject, at a minimum, to annual tests for impairment. In certain situations, interim impairment tests may be required if events occur or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Other intangible assets are amortized over their estimated useful lives using straight-line and accelerated methods and are subject to impairment if events or circumstances indicate a possible inability to realize the carrying amount.

The initial recognition of goodwill and other intangible assets and subsequent impairment analysis require us to make subjective judgments concerning estimates of how the acquired assets will perform in the future using valuation methods including discounted cash flow analysis. Additionally, estimated cash flows may extend beyond five years and, by their nature, are difficult to determine over an extended timeframe. Events and factors that may significantly affect the estimates include, among others, competitive forces, customer behaviors, changes in revenue growth trends, cost structures, technology, changes in discount rates and market conditions. In determining the reasonableness of cash flow estimates, Heartland reviews historical performance of the underlying assets or similar assets in an effort to assess and validate assumptions utilized in its estimates.

In assessing the fair value of reporting units, we may consider the stage of the current business cycle and potential changes in market conditions in estimating the timing and extent of future cash flows. Also, we often utilize other information to validate the reasonableness of our valuations including public market comparables, and multiples of recent mergers and acquisitions of similar businesses. Valuation multiples may be based on revenue, price-to-earnings and tangible capital ratios of comparable companies and business segments. These multiples may be adjusted to consider competitive differences, including size, operating leverage and other factors. The carrying amount of a reporting unit is determined based on the capital required to support the reporting unit’s activities, including its tangible and intangible assets. The determination of a reporting unit’s capital allocation requires judgment and considers many factors, including the regulatory capital regulations and capital characteristics of comparable companies in relevant industry sectors. In certain circumstances, we will engage a third-party to independently validate its assessment of the fair value of its reporting units.

We assess the impairment of identifiable intangible assets, long lived assets and related goodwill whenever events or changes in circumstances indicate the carrying value may not be recoverable. Factors considered important, which could trigger an impairment review include the following:

- Significant under-performance relative to expected historical or projected future operating results.
- Significant changes in the manner of use of the acquired assets or the strategy for the overall business.
- Significant negative industry or economic trends.
- Significant decline in the market price for our common stock over a sustained period; and market capitalization relative to net book value.
- For intangible assets and long-lived assets, if the carrying value of the asset exceeds the undiscounted cash flows from such asset.

Heartland conducted an internal assessment of the goodwill both collectively and at its subsidiaries in both 2012 and 2013 and determined no further goodwill impairment charges were required.

OVERVIEW

Heartland is a diversified financial services company providing banking, mortgage, wealth management, investments, insurance and consumer finance services to individuals and businesses. Heartland currently has ten banking subsidiaries with 80 locations in 59 communities in Iowa, Illinois, Wisconsin, New Mexico, Arizona, Montana, Colorado, Minnesota, Kansas and Missouri and loan production offices in California, Nevada, Wyoming, Idaho, North Dakota, Oregon, Washington and Nebraska. In addition, Heartland has separate subsidiaries in the consumer finance, insurance and property management businesses. Our primary strategy is to balance our focus on increasing profitability with asset growth and diversification through acquisitions, de novo bank formations and branch openings within existing market areas.

Our results of operations depend primarily on net interest income, which is the difference between interest income from interest earning assets and interest expense on interest bearing liabilities. Noninterest income, which includes service charges and fees, loan servicing income, trust income, brokerage and insurance commissions, securities gains and gains on sale of loans, also affects our results of operations. Our principal operating expenses, aside from interest expense, consist of the provision for loan and lease losses, salaries and employee benefits, occupancy and equipment costs, professional fees and FDIC insurance premiums. During the most recent years, our operating expenses have also been significantly impacted by net losses on repossessed assets.

Net income recorded for 2013 was $36.8 million, compared to $49.8 million recorded during 2012, a decrease of $13.0 million or 26%. Net income available to common stockholders was $35.7 million, or $2.04 per diluted common share, for the year ended December 31, 2013, compared to $46.4 million, or $2.77 per diluted common share, earned during the prior year. Return on average common equity was 10.87% and return on average assets was 0.70% for 2013, compared to 15.78% and 1.04%, respectively, for 2012.

The reduction in earnings for 2013 was due to a decline in income from our mortgage lending operations, offset in part by increased earnings from our community banking. Earnings for 2013, in comparison to 2012, were most positively affected by increases in net interest income, loan servicing income and service charges and fees, combined with decreases in net loss on repossessed assets and other noninterest expenses. These improvements were more than offset by a decline in gains on sale of loans, reduced securities gains and increases in salaries and employee benefits, occupancy and professional fees expenses. Net interest income was $163.8 million during 2013 compared to $150.2 million during 2012, an increase of $13.6 million. Loan servicing income increased $3.1 million and service charges and fees increased $2.4 million, while net loss on repossessed assets decreased $2.7 million and other noninterest expenses decreased $4.1 million. The most significant contributing factors to the reduced earnings in 2013 as compared to 2012 were gains on sale of loans, which decreased $21.8 million, and salaries and employee benefits, which increased $12.5 million.

Net income recorded for 2012 was a record $49.8 million, compared to $28.0 million recorded during 2011, an increase of $21.8 million or 78%. Net income available to common stockholders was $46.4 million, or $2.77 per diluted common share, for 2012, compared to $20.4 million, or $1.23 per diluted common share, earned during 2011. Return on average common equity was 15.78% and return on average assets was 1.04% for 2012, compared to 7.77% and 0.50%, respectively, for 2011.

The factors contributing most significantly to the increased earnings in 2012 compared to 2011 were the continued expansion of mortgage operations, coupled with a reduced provision for loan and lease losses and increased net interest income. Gains on sale of loans were $49.2 million during 2012 compared to $11.4 million during 2011, a $37.8 million increase, and loan servicing income was $11.3 million during 2012 compared to $5.9 million during 2011, a $5.4 million increase. The provision for loan and lease losses during 2012 was $8.2 million compared to $29.4 million during 2011, a decrease of $21.2 million. Net interest income was $150.2 million during 2012 compared to $145.4 million during 2011, an increase of $4.8 million. The effect of these positive factors was offset somewhat by an increase in salaries and employee benefits, which totaled $105.7 million during 2012 compared to $75.5 million during 2011, a $30.2 million increase and other noninterest expenses, which totaled $26.2 million during 2012 compared to $15.7 million during 2011, a $10.5 million increase.

On October 18, 2013, Heartland completed a merger transaction with Morrill Bancshares, Inc., the holding company for Morrill & Janes Bank and Trust Company, based in Merriam, Kansas. On the date of merger, Morrill & Janes Bank and Trust Company had total loans valued at $377.7 million and total deposits valued at $665.3 million. After the merger, Morrill & Janes Bank and Trust Company became Heartland's tenth independent, state-chartered, bank subsidiary and continues to operate under its current name and management team. The aggregate purchase price, which was based on the tangible book value of Morrill Bancshares, Inc., was approximately $55.4 million, $16.6 million or 30% of which was paid in cash, and $38.8 million or 70% of which was paid by delivery of 1,402,431 shares of Heartland common stock.

On November 22, 2013, Heartland acquired Freedom Bank in Sterling, Illinois, from its parent company, River Valley Bancorp, Inc., a Davenport, Iowa-based bank holding company. The acquisition of Freedom Bank was arranged through a negotiated transfer of ownership with Heartland’s flagship bank, Dubuque Bank and Trust Company. On the date of acquisition, Freedom Bank had total loans valued at $39.3 million and total deposits valued at $54.1 million. Freedom Bank operated independently as a subsidiary of Dubuque Bank and Trust Company until March 2014 when it was merged into Riverside Community Bank, Heartland’s Rockford, Illinois-based bank.

During 2012, Heartland completed three acquisitions. On July 13, 2012, the purchase of three retail banking offices from Liberty Bank, FSB in the Dubuque, Iowa market was completed through Dubuque Bank and Trust Company. It included loans of $9.4 million and deposits of $53.8 million. On November 16, 2012, Heartland completed the purchase of First Shares, Inc. headquartered in Platteville, Wisconsin. Simultaneous with closing of this transaction, First National Bank of Platteville was merged into Heartland's Wisconsin Bank & Trust subsidiary. The merger expanded the number of Wisconsin Bank & Trust locations from seven to ten and added three communities in southwestern Wisconsin to the bank's service area. The transaction included, at fair value, assets of $128.0 million, loans of $84.9 million and deposits of $114.2 million. Finally, on December 7, 2012, Heartland completed the purchase of Heritage Bank, N.A. located in Phoenix, Arizona. Heritage Bank, N.A. operated as a separate charter until late in the first quarter of 2013 when it merged into Heartland's Arizona Bank & Trust subsidiary. The transaction included, at fair value, assets of $109.1 million, loans of $63.4 million and deposits of $83.3 million.

Total assets were $5.92 billion at December 31, 2013, an increase of $933.2 million or 19% since December 31, 2012. On the date acquired, Morrill & Janes Bank and Trust Company had $810.8 million in assets and Freedom Bank had $67.1 million in assets. Securities represented 32% of Heartland's total assets at December 31, 2013, compared to 31% at year-end 2012. Total loans and leases held to maturity were $3.50 billion at December 31, 2013, compared to $2.82 billion at year-end 2012, an increase of $675.4 million or 24%, with $595.2 million of the increase occurring during the fourth quarter. Included in the loan growth for the fourth quarter of 2013 were $377.7 million of loans acquired in the Morrill & Janes merger and $39.3 million acquired in the Freedom acquisition. Excluding these acquisitions, loan growth totaled $258.4 million or 9% for 2013. Commercial and commercial real estate loans, which totaled $2.48 billion at December 31, 2013, increased $478.6 million or 24% since year-end 2012, with $295.6 million attributable to the acquisitions. Residential mortgage loans, which totaled $349.3 million at December 31, 2013, increased $99.7 million or 40% since year-end 2012, with $56.9 million attributable to the acquisitions. Agricultural and agricultural real estate loans, which totaled $376.7 million at December 31, 2013, increased $48.4 million or 15% since year-end 2012, with $49.4 million attributable to the acquisitions. Consumer loans, which totaled $294.1 million at December 31, 2013, increased $48.5 million or 20% since year-end 2012, with $15.0 million attributable to the acquisitions.

Total deposits were $4.67 billion at December 31, 2013, compared to $3.85 billion at year-end 2012, an increase of $820.8 million or 21%, with $665.3 million attributable to the Morrill & Janes merger and $54.1 million attributable to the Freedom acquisition. Demand deposits totaled $1.24 billion at December 31, 2013, an increase of $264.3 million or 27% since year-end 2012, with $91.6 million attributable to the acquisitions. Exclusive of $543.6 million acquired, savings deposits decreased $12.8 million or 1% since year-end 2012. Certificates of deposit decreased $58.5 million or 7% when excluding $84.2 million in acquired certificates of deposit. The composition of Heartland's deposits continued its positive trend as no-cost demand deposits as a percentage of total deposits were 27% at December 31, 2013, compared to 25% at December 31, 2012, while higher-cost certificates of deposit as a percentage of total deposits were 19% at December 31, 2013, compared to 23% at December 31, 2012.

Total assets were $4.99 billion at December 31, 2012, an increase of $685.5 million or 16% since December 31, 2011. Included in this asset growth were $290.6 million in assets acquired in acquisitions during the year. Securities represented 31% of total assets at both December 31, 2012 and 2011.Total loans and leases held to maturity were $2.82 billion at December 31, 2012, compared to $2.48 billion at year-end 2011, an increase of $340.3 million or 14%. Exclusive of $157.7 million in loans attributable to the acquisitions, loan growth during 2012 was $182.6 million or 7%. Commercial and commercial real estate loans, which totaled $2.00 billion at December 31, 2012, increased $191.9 million or 11% since year-end 2011, with $83.7 million attributable to the acquisitions. Residential mortgage loans, which totaled $249.7 million at December 31, 2012, increased $55.3 million or 28% since year-end 2011, with $26.3 million attributable to acquisitions. Agricultural and agricultural real estate loans, which totaled $328.3 million at December 31, 2012, increased $65.3 million or 25% since year-end 2011, with $37.7 million of this growth attributable to the acquisitions. Consumer loans, which totaled $245.7 million at December 31, 2012, increased $25.6 million or 12% since year-end 2011, with $10.1 million of the growth attributable to acquisitions.

Total deposits were $3.85 billion at December 31, 2012, compared to $3.21 billion at year-end 2011, an increase of $635.5 million or 20%. Exclusive of the $251.3 million in deposits attributable to the acquisitions, deposit growth during 2012 was $384.2 million or 12%.

RESULTS OF OPERATIONS

Net Interest Income

Net interest income is the difference between interest income earned on earning assets and interest expense paid on interest bearing liabilities. As such, net interest income is affected by changes in the volume and yields on earning assets and the volume and rates paid on interest bearing liabilities. Net interest margin is the ratio of tax equivalent net interest income to average earning assets.

Net interest margin, expressed as a percentage of average earning assets, was 3.78% during 2013 compared to 3.98% during 2012 and 4.16% during 2011. These declines are a result of the sustained low interest rate environment where yields on the securities and loan portfolios declined at a greater pace than rates paid on deposits and other borrowings. With deposit rates at close to the bottom of their manageable range and reinvestment rates on maturing securities at dramatically lower levels, the sustainability of net interest margin as a percentage at current levels will be contingent on management's ability to shift dollars from the securities portfolio into the loan portfolio. Management believes net interest margin in dollars will continue to increase as the amount of earning assets grows.

On a tax-equivalent basis, interest income increased $12.3 million or 6% to $209.0 million from $196.7 million during 2012 and decreased $939,000 or less than 1% from $197.7 million in 2011. Average earning assets increased $620.0 million or 16% during 2013 compared to 2012, with approximately $171.4 million of the growth attributable to the acquisitions completed during the fourth quarter. Average earning assets increased $322.3 million or 9% during 2012 compared to 2011, with approximately $45.0 million attributable to acquisitions completed during the last half of 2012. The average interest rate earned on total average earning assets was 4.56% during 2013 compared to 4.97% during 2012 and 5.43% during 2011. The overall yield earned on the securities portfolio was 2.63% in 2013 compared to 2.97% in 2012 and 3.69% in 2011, a decrease of 34 basis points in 2013 and 72 basis points during 2012. The overall yield earned on the loan portfolio was 5.61% in 2013 compared to 5.95% in 2012 and 6.36% in 2011, a decrease of 34 basis points in 2013 and 41 basis points during 2012. The composition of average earning assets changed as the percentage of average loans, which are typically the highest yielding asset, to total average earning assets was 65% during 2013 compared to 67% during 2012 and 65% during 2011.

Interest expense decreased $3.5 million or 9% during 2013 to $35.7 million compared to $39.2 million during 2012 and decreased $7.2 million or 15% during 2012 from $46.3 million during 2011. Even though average interest bearing liabilities increased $348.5 million or 11% for 2013 and $175.8 million or 6% for 2012, the average interest rate paid on Heartland's deposits and borrowings declined during both years. The average interest rate paid on Heartland's interest bearing deposits and borrowings was 1.01% in 2013 compared to 1.23% in 2012 and 1.53% in 2011. Contributing to these improvements in interest expense was a continued change in the mix of deposits as balances shifted from higher cost certificates of deposit to lower cost interest-bearing deposits. Average savings balances, as a percentage of total average interest bearing deposits, was 71% during 2013 compared to 69% during 2012 and 65% for 2011. Additionally, the average interest rate paid on savings deposits was 0.32% during 2013 compared to 0.38% during 2012 and 0.57% during 2011. Management continues to look for opportunities to reduce Heartland's funding costs. Certificates of deposit maturing within the next six months total $281.2 million at an average weighted interest rate of 1.19%, and an additional $215.9 million matures in the second half of the year at an average interest rate of 1.50%. For the past several months, the average renewal interest rate on maturing certificates of deposit has been ranging between 0.30% and 0.50%. The rates currently paid on our non-maturity deposits are effectively approaching a floor and we believe there is less flexibility to pay lower rates on these deposits in the future.

Net interest income on a tax-equivalent basis totaled $173.3 million during 2013, an increase of $15.7 million or 10% from the $157.6 million recorded during 2012. Net interest income on a tax-equivalent basis increased $6.2 million or 4% during 2012 from the $151.3 million recorded during 2011.

We attempt to manage our balance sheet to minimize the effect that a change in interest rates has on our net interest margin. We plan to continue to work toward improving both our earning asset and funding mix through targeted organic growth strategies, which we believe will result in additional net interest income. We believe our net interest income simulations reflect a well-balanced and manageable interest rate posture. Approximately 40% of our commercial and agricultural loan portfolios consist of floating rate loans that reprice based upon changes in the national prime or LIBOR interest rate. Since nearly 70% of these floating rate loans have interest rate floors that are currently in effect, an upward movement in the national prime interest rate or LIBOR would not have an immediate positive effect on our interest income. Item 7A of this Form 10-K contains additional information about the results of our most recent net interest income simulations. Note 12 to the consolidated financial statements contains a detailed discussion of the derivative instruments we have utilized to manage interest rate risk.

The following table provides certain information relating to our average consolidated balance sheets and reflects the yield on average earning assets and the cost of average interest bearing liabilities for the years indicated, in thousands.

Dividing income or expense by the average balance of assets or liabilities derives such yields and costs. Average balances are derived from daily balances, and nonaccrual loans and loans held for sale are included in each respective loan category. Assets with tax favorable treatment are evaluated on a tax-equivalent basis assuming a federal income tax rate of 35%. Tax favorable assets generally have lower contractual pre-tax yields than fully taxable assets. A tax-equivalent yield is calculated by adding the tax savings to the interest earned on tax favorable assets and dividing by the average balance of the tax favorable assets.

ANALYSIS OF AVERAGE BALANCES, TAX EQUIVALENT YIELDS AND RATES[1]

	For the Year Ended December 31,								
	2013			2012			2011		
	Average Balance	Interest	Rate	Average Balance	Interest	Rate	Average Balance	Interest	Rate
EARNING ASSETS									
Securities:									
Taxable	$1,198,777	$21,501	1.79%	$1,015,624	$22,129	2.18%	$1,069,747	$34,095	3.19%
Nontaxable[1]	395,578	20,452	5.17	283,735	16,459	5.80	190,399	12,362	6.49
Total securities	1,594,355	41,953	2.63	1,299,359	38,588	2.97	1,260,146	46,457	3.69
Interest bearing deposits	9,242	12	0.13	5,658	8	0.14	3,179	3	0.09
Federal funds sold	1,417	1	0.07	556	4	0.72	430	1	0.23
Loans and Leases:[2]									
Commercial and commercial real estate[1]	2,078,594	105,239	5.06	1,889,891	100,644	5.33	1,748,669	100,024	5.72
Residential mortgage	344,606	14,511	4.21	293,850	13,142	4.47	198,312	10,172	5.13
Agricultural and agricultural real estate[1]	331,622	17,494	5.28	282,519	15,896	5.63	255,615	15,553	6.08
Consumer	261,611	24,210	9.25	230,192	22,874	9.94	216,268	20,526	9.49
Fees on loans	—	5,556	—	—	5,580	—	—	4,939	—
Less: allowance for loan and lease losses	(39,151)	—	—	(39,757)	—	—	(42,693)	—	—
Net loans and leases	2,977,282	167,010	5.61	2,656,695	158,136	5.95	2,376,171	151,214	6.36
Total earning assets	4,582,296	208,976	4.56	3,962,268	196,736	4.97	3,639,926	197,675	5.43
NONEARNING ASSETS									
Total nonearning assets	500,835			501,397			431,885		
TOTAL ASSETS	$5,083,131			$4,463,665			$4,071,811		
INTEREST BEARING LIABILITIES									
Savings	$2,101,295	$6,674	0.32%	$1,763,233	$6,736	0.38%	$1,589,697	$9,090	0.57%
Time, $100,000 and over	315,623	4,403	1.40	272,338	4,776	1.75	265,664	5,928	2.23
Other time deposits	532,157	8,891	1.67	531,351	10,718	2.02	590,767	14,206	2.40
Short-term borrowings	257,084	808	0.31	252,849	818	0.32	202,183	893	0.44
Other borrowings	339,578	14,907	4.39	377,478	16,134	4.27	373,119	16,226	4.35
Total interest bearing liabilities	3,545,737	35,683	1.01	3,197,249	39,182	1.23	3,021,430	46,343	1.53
NONINTEREST BEARING LIABILITIES									

Noninterest bearing deposits	1,064,177	829,566	667,952
Accrued interest and other liabilities	62,161	58,572	37,551
Total noninterest bearing liabilities	1,126,338	888,138	705,503
STOCKHOLDERS' EQUITY	411,056	378,278	344,878
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$5,083,131	$4,463,665	$4,071,811
Net interest income(1)	$173,293	$157,554	$151,332
Net interest spread(1)	3.55%	3.74%	3.90%
Net interest income to total earning assets(1)	3.78%	3.98%	4.16%
Interest bearing liabilities to earning assets	77.38%	80.69%	83.01%

(1) Tax equivalent basis is calculated using a tax rate of 35%.
(2) Nonaccrual loans are included in average loans outstanding.

The following table presents the dollar amount of changes in interest income and interest expense for the major components of interest earning assets and interest bearing liabilities, in thousands. It quantifies the changes in interest income and interest expense related to changes in the average outstanding balances (volume) and those changes caused by fluctuating interest rates. For each category of interest earning assets and interest bearing liabilities, information is provided on changes attributable to (i) changes in volume, calculated by multiplying the difference between the average balance for the current period and the average balance for the prior period by the rate for the prior period, and (ii) changes in rate, calculated by multiplying the difference between the rate for the current period and the rate for the prior period by the average balance for the prior period. The unallocated change has been allocated pro rata to volume and rate variances.

ANALYSIS OF CHANGES IN NET INTEREST INCOME(1)

	For the Years Ended December 31,					
	2013 Compared to 2012			2012 Compared to 2011		
	Change Due to			Change Due to		
	Volume	Rate	Net	Volume	Rate	Net
EARNING ASSETS / INTEREST INCOME						
Investment securities:						
Taxable	$3,634	$(4,262)	$(628)	$(1,650)	$(10,316)	$(11,966)
Municipals(1)	5,935	(1,942)	3,993	5,530	(1,433)	4,097
Interest bearing deposits	5	(1)	4	3	2	5
Federal funds sold	3	(6)	(3)	—	3	3
Loans and leases(1)(2)	18,338	(9,464)	8,874	17,106	(10,184)	6,922
TOTAL EARNING ASSETS	27,915	(15,675)	12,240	20,989	(21,928)	(939)
LIABILITIES / INTEREST EXPENSE						
Interest bearing deposits:						
Savings	1,176	(1,238)	(62)	911	(3,265)	(2,354)
Time, $100,000 and over	691	(1,064)	(373)	146	(1,298)	(1,152)
Other time deposits	16	(1,843)	(1,827)	(1,340)	(2,148)	(3,488)
Short-term borrowings	14	(24)	(10)	195	(270)	(75)
Other borrowings	(1,654)	427	(1,227)	188	(280)	(92)
TOTAL INTEREST BEARING LIABILITIES	243	(3,742)	(3,499)	100	(7,261)	(7,161)
NET INTEREST INCOME	$27,672	$(11,933)	$15,739	$20,889	$(14,667)	$6,222

(1) Tax equivalent basis is calculated using a tax rate of 35%.
(2) Nonaccrual loans are included in average loans outstanding.

In both years, the decrease in rates on deposits and borrowings had a significant positive impact on net interest income, with the increase in the volume of these interest bearing liabilities having only a very slight negative impact. In 2013, the increase in the volume of earning assets more than offset the decrease in rate earned on these assets resulting in $12.2 million of the $15.7 million net increase in interest income, while the increased interest income resulting from the higher volume of these assets in 2012 did not quite offset the decrease in interest income resulting from the decreased rate on assets in 2012. In both years the decreasing rates had a significant negative impact on net interest income as asset yields declined more significantly than the rates paid on liabilities, but these decreases in rate were more than offset by the increase in interest income resulting from increased volume of earning assets.

Provision For Loan And Lease Losses

The allowance for loan and lease losses is established through a provision charged to expense to provide, in Heartland management’s opinion, an appropriate allowance for loan and lease losses. In determining that the allowance for loan and lease losses is appropriate, management uses factors that include the overall composition of the loan portfolio, general economic conditions, types of loans, loan collateral values, past loss experience, loan delinquencies, substandard credits, and doubtful credits. For additional details on the specific factors considered, refer to the discussion under the captions "Critical Accounting Policies" and "Allowance For Loan and Lease Losses" in this report. Heartland believes the allowance for loan and lease losses as of December 31, 2013, was at a level commensurate with the overall risk exposure of the loan portfolio. However, if economic conditions should become more unfavorable, certain borrowers may experience difficulty and the level of nonperforming loans, charge-offs and delinquencies could rise and require further increases in the provision for loan and lease losses.

Exclusive of loans covered under loss sharing agreements, the allowance for loan and lease losses at December 31, 2013, was 1.19% of loans and leases and 98.27% of nonperforming loans compared to 1.37% of loans and leases and 89.71% of nonperforming loans at December 31, 2012, and 1.48% of loans and leases and 64.09% of nonperforming loans at December 31, 2011. Exclusive of acquired loans, for which a valuation reserve is recorded, the allowance for loan and lease losses at December 31, 2013, was 1.42% of loans and leases and 105.70% of nonperforming loans. The provision for loan losses was $9.7 million during 2013 compared to $8.2 million during 2012 and $29.4 million during 2011. The increased provision in 2013 was primarily a result of a provision to create a specific allowance for a single impaired loan, resulting in an aggregate allowance for loan and lease losses on impaired loans of $6.7 million at December 31, 2013, and an allowance on non-impaired loans, exclusive of acquisitions, of $35.0 million. A reduction in the level of the allowance for loan and lease losses maintained for impaired loans was the primary contributor to the lower provision during 2012. The portion of the allowance for loan and lease losses maintained for impaired loans was $4.6 million at December 31, 2012, leaving the allowance on non-impaired loans, exclusive of acquisitions, relatively stable at 1.32% of loans and leases at December 31, 2012, compared to 1.31% at December 31, 2011. The provision for loan and lease losses began increasing with the recession in 2008, as depressed economic conditions resulted in increased delinquencies. Particularly affected were our Western markets in Arizona and Montana. The increased, although moderated, provisions continued during 2011 as some individual credits continued to be impacted and updated appraised values of collateral reflected a decline in property values due primarily to a lack of recent comparable sales and an extension of absorption periods. During 2013 and 2012, the provision returned to a pre-recession level, as property values stabilized and, in some areas, increased.

Noninterest Income

The table below summarizes Heartland's noninterest income for the years indicated, in thousands.

NONINTEREST INCOME

	For the Years Ended December 31,			% Change	
	2013	2012	2011	2013/2012	2012/2011
Service charges and fees	$17,660	$15,242	$14,303	16 %	7 %
Loan servicing income	14,413	11,300	5,932	28	90
Trust fees	11,708	10,478	9,856	12	6
Brokerage and insurance commissions	4,561	3,702	3,511	23	5
Securities gains, net	7,121	13,998	13,104	(49)	7
Gain on trading account securities, net	1,421	47	89	2,923	(47)
Impairment loss on securities	—	(981)	—	100	—
Gains on sale of loans held for sale	27,430	49,198	11,366	(44)	333
Valuation adjustment on mortgage servicing rights	496	(477)	(19)	204	(2,411)
Income on bank owned life insurance	1,555	1,442	1,349	8	7

Other noninterest income	3,253	4,713	86	(31	)	5,380	
Total Noninterest Income	$89,618	$108,662	$59,577	(18	)%	82	%

Noninterest income was $89.6 million in 2013 compared to $108.7 million in 2012, a decrease of $19.1 million or 18%, driven primarily by decreases in gains on sale of loans held for sale from our mortgage banking operations, and from decreased gains on sale of securities. These decreases were partially offset by increases in other fee income categories. During 2012, noninterest income was $108.7 million compared to $59.6 million in 2011, an increase of $49.1 million or 82% driven almost exclusively from significantly increased gains on sale of loans held for sale and servicing income from our mortgage banking operations.

Service charges and fees increased $2.4 million or 16% from 2012 to 2013 and increased $939,000 or 7% from 2011 to 2012.
Service charges on checking and savings accounts totaled $4.8 million during 2013 compared to $3.9 million during 2012, an increase of $927,000 or 24%. For 2012, service charges on checking and savings accounts increased $590,000 or 18% from $3.3 million recorded in 2011. Overdraft fees totaled $5.8 million during 2013, $5.5 million during 2012 and $5.4 million during 2011. Interchange revenue from activity on bank debit cards, along with surcharges on ATM activity, resulted in service charges and fees of $6.1 million during 2013, $5.1 million during 2012 and $5.0 million during 2011. These increases are primarily attributable to a larger demand deposit customer base in 2013, a portion of which is due to the acquisitions completed during the last half of 2012.

Loan servicing income increased $3.1 million or 28% for 2013 and $5.4 million or 90% for 2012. Included in loan servicing income are the fees collected for the servicing of mortgage loans for others, which are dependent upon the aggregate outstanding balance of these loans, rather than quarterly production and sale of mortgage loans. Fees collected for the servicing of mortgage loans for others were $6.9 million during 2013 compared to $4.4 million during 2012 and $3.6 million during 2011. The portfolio of mortgage loans serviced for others by Heartland totaled $3.05 billion at December 31, 2013, compared to $2.20 billion at December 31, 2012, and $1.54 billion at December 31, 2011. Two additional components of loan servicing income related to the mortgage loans serviced for others portfolio, mortgage servicing rights and amortization of mortgage servicing rights, are dependent upon the level of loans Heartland originates and sells into the secondary market, which in turn is highly influenced by market interest rates for home mortgage loans. Mortgage servicing rights income was $12.8 million during 2013 compared to $11.5 million during 2012 and $3.7 million during 2011. The amortization of mortgage servicing rights was $7.3 million during 2013 compared to $6.6 million during 2012 and $3.6 million during 2011. Note 8 to the consolidated financial statements contains a discussion about our mortgage servicing rights. Significant expansion of our National Residential Mortgage unit, together with historically low interest rates, combined to generate significantly higher residential mortgage loan origination activity during 2012. Slightly increasing and more stable interest rates in 2013 resulted in less refinancing activity and less loan origination activity in 2013.

The following table summarizes Heartland's residential mortgage loan activity for the years indicated, in thousands:

	As of and For the Years Ended December 31,		
	2013	2012	2011
Mortgage Servicing Fees	$6,897	$4,431	$3,605
Mortgage Servicing Rights Income	12,769	11,451	3,723
Mortgage Servicing Rights Amortization	(7,314)	(6,597)	(3,637)
Total Residential Mortgage Loan Servicing Income	$12,352	$9,285	$3,691
Valuation Adjustment on Mortgage Servicing Rights	$496	$(477)	$(19)
Gains On Sale of Loans Held For Sale	$26,959	$48,907	$11,134
Residential Mortgage Loans Originated	$1,484,949	$1,647,650	$608,236
Residential Mortgage Loans Sold	$1,421,497	$1,531,563	$452,930
Residential Mortgage Loan Servicing Portfolio	$3,045,893	$2,199,486	$1,541,517

Gains on sale of loans held for sale totaled $27.4 million during 2013 compared to $49.2 million during 2012 and $11.4 million during 2011, which result primarily from the gain or loss on sales of mortgage loans into the secondary market, related fees and fair value marks on the associated derivatives. As reflected in the table above, the volume of residential mortgage loans sold totaled $1.42 billion during 2013 compared to $1.53 billion during 2012 and $452.9 million during 2011. Refinancing activity increased during the last half of 2011 as long-term mortgage loan rates fell

to all-time lows and continued throughout 2012 and then tapered off during 2013 as residential mortgage loan interest rates increased. For the fourth quarter of 2013, refinancing activity represented 35% of Heartland's total mortgage loan originations compared to 71% during the fourth quarter of 2012.
In 2011, we began the expansion of our residential mortgage loan operations with the opening of loan production offices in both existing states, as well the new states of California and Nevada during 2011; Wyoming, Nevada, Idaho and North Dakota during 2012; and Oregon, Washington and Nebraska during 2013.

Trust fees increased $1.2 million or 12% during 2013 and $622,000 or 6% during 2012. A large portion of trust fees are based upon the market value of the trust assets under management, which was $1.62 billion at December 31, 2013, compared to $1.38 billion at December 31, 2012, and $1.36 billion at December 31, 2011. Those values fluctuate throughout the year as market conditions improve or decline. The total number of trust accounts was 1,944 at December 31, 2013, compared to 1,950 at December 31, 2012, and 1,987 at December 31, 2011.

Brokerage and insurance commissions increased $859,000 or 23% during 2013 and $191,000 or 5% during 2012. These fees benefited from a more active securities market in 2013.

Securities gains totaled $7.1 million during 2013 compared to $14.0 million during 2012 and $13.1 million during 2011. As market interest rates began to increase in the last three quarters of 2013, the value of Heartland's securities portfolio was impacted, making the realization of securities gains more difficult. During both years 2012 and 2011, volatility in the bond market provided opportunities to swap securities from one sector of the portfolio to another without significantly changing the duration of the portfolio. During 2012, we implemented a strategy of selling short duration (less than 1.5 years) mortgage-backed securities and replacing with well-structured, non-callable bonds, which are expected to protect us under a wider range of possible interest rate scenarios and decrease susceptibility to the mortgage prepayment risk associated with mortgage-backed securities. Strategies implemented during 2011 included the sale of taxable municipal bonds and reinvestment into tax-exempt municipal bonds and the shift of a portion of the securities portfolio from agencies to treasuries and shorter-term mortgage-backed securities. Additionally, during 2013, two private label Z tranche securities with a book value of $31,000 were sold at a gain of $1.6 million. During 2011, one of these private label Z tranche securities with a book value of $10,000 was sold at a gain of $1.4 million. Five of these Z tranche securities remain in Heartland's securities available for sale portfolio at a book value of $89,000 and a market value of $3.3 million at December 31, 2013. Management has not determined when any future sales of these Z tranche securities will occur.

Offsetting, in part, the securities gains during 2012 was an impairment loss on three private-label mortgage-backed securities totaling $981,000 recorded during the first quarter of 2012. This impairment charge related to a decline in the credit quality of these securities. Management does not anticipate further declines on these or any other securities within the portfolio due to credit quality, but will continue to monitor the portfolio for any further declines. Based on its analysis, management believes it is prudent to continue to hold these securities as their economic value exceeds their market value.

Trading securities experienced net gains of $1.4 million during 2013 compared to $47,000 during 2012 and $89,000 during 2011. The net gains in 2013 were primarily attributable to shares of Fannie Mae preferred stock Heartland has held in its trading securities portfolio since 2008. Subsequent to December 31, 2013, this stock was sold.

Other noninterest income was $3.3 million during 2013 compared to $4.7 million during 2012 and $86,000 during 2011. Affecting other noninterest income were payments due to or from the FDIC under loss share agreements associated with The Elizabeth State Bank acquisition completed in 2009. Payments due to the FDIC totaled $913,000 during 2011, whereas payments due from the FDIC totaled $463,000 during 2013 and $203,000 during 2012. Included in other noninterest income during 2013 was $438,000 in gains on two real estate properties obtained through collection efforts on nonperforming loans. Included in other noninterest income during 2012 was $2.0 million in equity earnings which resulted from the sale of two low-income housing projects within partnerships in which Dubuque Bank and Trust Company was a member and a $682,000 write up on the appraised value of real property obtained through collection efforts on nonperforming loans.

Noninterest Expenses

The following table summarizes Heartland's noninterest expenses for the years indicated, in thousands.
NONINTEREST EXPENSES

	For the Years Ended December 31,			% Change	
	2013	2012	2011	2013/2012	2012/2011
Salaries and employee benefits	$118,224	$105,727	$75,537	12 %	40 %
Occupancy	13,459	10,629	9,363	27	14
Furniture and equipment	8,040	6,326	5,636	27	12
Professional fees	17,532	15,338	12,567	14	22
FDIC insurance assessments	3,544	3,292	3,777	8	(13)
Advertising	5,294	5,294	4,292	—	23
Intangible assets amortization	1,063	562	572	89	(2)
Net loss on repossessed assets	7,244	9,969	9,807	(27)	2
Other noninterest expenses	22,161	26,244	15,745	(16)	67
Total Noninterest Expenses	$196,561	$183,381	$137,296	7 %	34 %
Efficiency ratio, fully taxable equivalent (1)	76.84 %	72.71 %	69.41 %		

(1) Efficiency ratio, fully taxable equivalent, is noninterest expense, divided by the sum of taxable equivalent net interest income plus noninterest income, excluding securities gains (losses), net. This efficiency ratio is presented on a taxable equivalent basis, which adjusts net interest income for the tax-favored status of certain loans and investment securities. Management believes this measure to be the preferred industry measurement of net interest income as it enhances the comparability of net interest income arising from taxable and tax-exempt sources, and it excludes certain specific revenue items (such as investment securities gains (losses), net). This is a non-GAAP measure.

Noninterest expenses totaled $196.6 million in 2013 compared to $183.4 million in 2012, a $13.2 million or 7% increase. During 2013, significant increases in salaries and employee benefits, occupancy, furniture and equipment and professional fees were partially offset by decreases in net losses on repossessed assets and other noninterest expenses Noninterest expenses totaled $183.4 million in 2012 compared to $137.3 million in 2011, a $46.1 million or 34% increase. Categories contributing most significantly to the increase during 2012 were salaries and employee benefits, occupancy, professional fees, advertising and other noninterest expenses.

The largest component of noninterest expense, salaries and employee benefits, increased $12.5 million or 12% in 2013 and $30.2 million or 40% in 2012. A large portion of these increases resulted from the expansion of Heartland's residential loan origination operations, with a smaller portion attributable to the additional employees joining Heartland through the acquisitions completed during the last two quarters of 2012. On a sequential quarterly basis, salaries and employee benefits expense decreased during the third quarter of 2013 and were relatively flat during the first half of 2013 as expansion of Heartland's mortgage banking operations slowed. A large portion of the increase during 2012 resulted from the expansion of residential loan origination and the addition of personnel in the Heartland Mortgage and National Residential Mortgage unit. Commission expense, a large portion of which is associated with mortgage loan origination activity, was $19.3 million during 2013, $19.8 million during 2012 and $6.8 million during 2011. Additionally, the accrual for incentive plan compensation payouts was significantly higher in 2012, in direct correlation with the higher earnings and the reinstatement of incentive compensation for Heartland's executive officers after the repayment of TARP (Troubled Asset Relief Program) funds. Full-time equivalent employees totaled 1,676 on December 31, 2013, compared to 1,498 on December 31, 2012. The acquisitions completed in the fourth quarter of 2013 added 133 full-time equivalent employees representing 75% of this increase. Total average full-time equivalent employees were 1,339 during 2012 compared to 1,098 during 2011.

Occupancy expense increased $2.8 million or 27% in 2013 and $1.3 million or 14% in 2012. Furniture and equipment expense increased $1.7 million or 27% during 2013 and $690,000 or 12% during 2012. These increases primarily resulted from the residential loan origination operations expansion and the acquisitions completed during the last two quarters of 2012.

Professional fees increased $2.2 million or 14% during 2013 and $2.8 million or 22% during 2012. These increases were primarily attributable to Heartland's expansion of its mortgage loan origination operations and the services provided to Heartland by third-party consultants, including those performed in relation to acquisitions.

Advertising expense remained consistent at $5.3 million during 2013 and 2012 compared to $4.3 million during 2011. Promotional expenses increased during 2012 commensurate with our residential mortgage expansion, increased media advertising for retail checking accounts and television and radio production expenses for branding campaigns, which continued to be utilized in 2013.

Net losses on repossessed assets totaled $7.2 million during 2013 compared to $10.0 million during 2012 and $9.8 million during 2011. The majority of the losses during 2012 and 2011 resulted from valuation adjustments due to reductions in real estate values.

Other noninterest expenses were $22.2 million during 2013 compared to $26.2 million during 2012 and $15.7 million during 2011. Included in other noninterest expenses during the fourth quarter of both years were writedowns on investments in commercial and residential real estate projects which qualified for historic rehabilitation tax credits totaling $623,000 during 2013 and $5.8 million during 2012. These writedowns were $596,000 in 2013 and $5.3 million in 2012. Also included in the 2012 noninterest expenses were $442,000 in costs incurred for early termination fees on service contracts, severance payouts and retention bonuses paid as a result of the acquisitions. Provisions to fund a repurchase reserve for the potential buyback of residential mortgage loans were recorded in the amount of $530,000 during 2013, $2.6 million during 2012 and $613,000 during 2011, the first year we began such a provision. Also included in the 2012 other noninterest expenses was a $302,000 charge for an early payment fee and remaining unamortized issuance costs due to the early redemption of $5.0 million of trust preferred securities. The 2011 noninterest expenses included a $403,000 writedown on land in Phoenix, Arizona, which had originally been purchased for branch expansion but has now been listed for sale. Additionally, a large portion of the increases in other noninterest expenses in both years was attributable to the expansion of our mortgage origination operations.

Income Taxes

Heartland's effective tax rate was 21.9% for 2013 compared to 25.9% for 2012 and 26.9% for 2011. Heartland's income taxes included the net effect of federal historic rehabilitation tax credits totaling $898,000 for 2013 and $5.8 million in 2012. During 2011, Heartland's income taxes included a $404,000 refund for state taxes attributable to the 2007 and 2008 tax years. Federal low-income housing tax credits included in Heartland's effective tax rate totaled $798,000 during all three years of 2013, 2012 and 2011. Heartland's effective tax rate is also affected by the level of tax-exempt interest income which, as a percentage of pre-tax income, was 37.3% during 2013, 20.4% during 2012 and 28.8% during 2011. The tax-equivalent adjustment for this tax-exempt interest income was $9.5 million during 2013, $7.4 million during 2012 and $5.9 million during 2011.

Segment Reporting

Heartland has two reportable segments: community and other banking and retail mortgage banking. Revenues from community and other banking operations consist primarily of interest earned on loans and investment securities and fees from deposit services. Retail mortgage banking operating revenues consist of interest earned on mortgage loans held for sale, gains on sales of loans into the secondary market, the servicing of mortgage loans for various investors and loan origination fee income. See Note 21 to our consolidated financial statements for further information regarding our segment reporting.

Income before taxes for the community and other banking segment for 2013 was $50.8 million compared to $48.0 million for 2012 and $36.8 million for 2011. The increases in both periods were primarily a result of increased net interest income and a lower provision for loan and lease losses; increases in the other noninterest income categories of services charges and fees, trust fees and brokerage and insurance commissions; offset in part by increased noninterest expenses, particularly in the categories of salaries and employee benefits, occupancy, furniture and equipment and professional fees, primarily as a result of the acquisitions completed in the third and fourth quarters of 2012. The community and other banking segment also benefited from significantly higher gains on sale of securities during 2012. Net interest income in this segment was $161.5 million for 2013 compared to $147.9 million for 2012 and

$145.1 million for 2011. Provision for loan and lease losses was $9.7 million for 2013 compared to $8.2 million for 2012 and $29.4 million for 2011. Noninterest income totaled $49.8 million for 2013 compared to $50.9 million for 2012 and $44.8 million for 2011. Noninterest expense was $150.8 million for 2013 compared to $142.6 million for 2012 and $123.7 million for 2011.

The retail mortgage banking segment recorded a loss before taxes of $3.6 million for 2013 compared to income before taxes of $19.2 million for 2012 and $1.5 million for 2011. The decrease in 2013 is reflective of the change in long-term interest rates during the second and third quarters of 2013, resulting in lower loan originations, and the effect higher interest rates have on the gains on sale of loans into the secondary market. Also contributing to the decreases in income before taxes for the retail mortgage banking segment were additional expenses incurred during 2013 due to expansion efforts. Net interest income for this segment was $2.4 million for 2013 compared to $2.3 million for 2012 and $296,000 for 2011. Noninterest income totaled $39.8 million during 2013 compared to $57.7 million during 2012 and $14.8 million during 2011 reflecting primarily gains on sale of loans held for sale. Noninterest expense was $45.8 million during 2013 compared to $40.7 million during 2012 and $13.6 million during 2011.

FINANCIAL CONDITION

Total assets were $5.92 billion at December 31, 2013, an increase of $933.2 million or 19% since December 31, 2012. Included in the asset growth for 2013 were $810.8 million of assets acquired in the Morrill & Janes merger and $67.1 million in assets acquired in the Freedom acquisition. Total assets were $4.99 billion at December 31, 2012, an increase of $685.5 million or 16% since December 31, 2011. Included in the asset growth for 2012 were the $53.5 million in assets acquired from Liberty Bank, FSB, $128.0 million in assets acquired in the First Shares, Inc. transaction and $109.1 million acquired in the Heritage Bank acquisition.

Lending Activities

Heartland's major source of income is interest on loans and leases. The table below presents the composition of Heartland's loan and lease portfolio at the end of the years indicated, in thousands:

LOAN AND LEASE PORTFOLIO

	As of December 31,									
	2013		2012		2011		2010		2009	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Loans and leases receivable held to maturity:										
Commercial	$950,197	27.16 %	$712,308	25.22 %	$646,116	25.97 %	$559,012	23.79 %	$422,347	18.08
Commercial real estate	1,529,683	43.70	1,289,184	45.62	1,163,784	46.79	1,160,962	49.43	1,250,087	53.52
Agricultural and agricultural real estate	376,735	10.76	328,311	11.62	262,975	10.57	250,943	10.68	256,780	10.99
Residential mortgage	349,349	9.98	249,689	8.84	194,436	7.82	163,726	6.97	175,059	7.49
Consumer	294,145	8.40	245,678	8.70	220,099	8.85	214,515	9.13	231,709	9.92
Gross loans and leases receivable held to maturity	3,500,109	100.00%	2,825,170	100.00%	2,487,410	100.00%	2,349,158	100.00%	2,335,982	100.0
Unearned discount	(168)		(676)		(2,463)		(2,581)		(2,491)	
Deferred loan fees	(2,989)		(2,945)		(3,663)		(2,590)		(2,349)	
Total net loans and leases receivable held to maturity	$3,496,952		$2,821,549		$2,481,284		$2,343,987		$2,331,142	

Loans covered under loss share agreements:										
Commercial and commercial real estate	$2,314	40.24 %	$3,074	42.38 %	$6,380	47.80 %	$10,056	48.34 %	$15,068	47.29
Agricultural and agricultural real estate	543	9.45	748	10.31	1,659	12.43	2,723	13.09	8,984	28.20
Residential mortgage	2,280	39.66	2,645	36.47	4,158	31.15	5,792	27.85	3,626	11.38
Consumer	612	10.65	786	10.84	1,150	8.62	2,229	10.72	4,182	13.13
Total loans covered under loss share agreements	5,749	100.00 %	7,253	100.00 %	13,347	100.00 %	20,800	100.00 %	31,860	100.0
Allowance for loan and lease losses	(41,685)		(38,715)		(36,808)		(42,693)		(41,848)	
Loans and leases receivable, net	$3,461,016		$2,790,087		$2,457,823		$2,322,094		$2,321,154	

Loans held for sale totaled $46.7 million at December 31, 2013, a decrease of $49.5 million or 52% since year-end 2012. These balances decreased as mortgage loan origination activity slowed during 2013. Loans held for sale at December 31, 2012, were significantly higher than the year-end 2011 total of $53.6 million as management began the pooling of certain newly originated mortgage loans into mortgage-backed securities prior to delivery into the secondary market beginning in the fourth quarter of 2012.

The table below sets forth the remaining maturities of loans and leases by category, including loans held for sale and loans covered by loss share agreements, and excluding unearned discount and deferred loan fees, as of December 31, 2013, in thousands:
MATURITY AND RATE SENSITIVITY OF LOANS AND LEASES(1)

		Over 1 Year Through 5 Years		Over 5 Years		
	One Year or Less	Fixed Rate	Floating Rate	Fixed Rate	Floating Rate	Total
Commercial	$420,851	$169,806	$139,507	$95,426	$124,689	$950,279
Commercial real estate	314,903	541,918	284,874	140,859	249,361	1,531,915
Residential real estate	120,325	35,919	16,794	95,912	129,090	398,040
Agricultural and agricultural real estate	176,922	110,887	21,884	24,249	43,590	377,532
Consumer	68,558	75,959	17,142	22,487	110,611	294,757
Lease financing, net	—	—	—	—	—	—
Total	$1,101,559	$934,489	$480,201	$378,933	$657,341	$3,552,523

(1) Maturities based upon contractual dates

Total loans and leases held to maturity were $3.50 billion at December 31, 2013, compared to $2.82 billion at year-end 2012, an increase of $675.4 million or 24%, with $595.2 million of the increase occurring during the fourth quarter. Included in the loan growth for the fourth quarter of 2013 were $377.7 million acquired in the Morrill & Janes merger and $39.3 million acquired in the Freedom acquisition. Excluding these acquisitions, loan growth totaled $178.3 million or 6% for the fourth quarter of 2013 and $258.4 million or 9% for the full year of 2013. Total loans and leases held to maturity at December 31, 2012, increased $340.3 million or 14% from $2.35 billion at December 31, 2011, with $173.6 million occurring during the fourth quarter, $18.4 million during the third quarter, $97.2 million during the second quarter and $51.1 million during the first quarter. Included in the loan growth for the fourth quarter of 2012 were $84.9 million in loans acquired in the First Shares, Inc. acquisition and $63.4 million acquired in the Heritage Bank acquisition. Loan growth for the third quarter of 2012 included $9.4 million in loans acquired from Liberty Bank, FSB. Excluding acquisitions, loan growth for 2012 totaled $182.6 million or 7%. The loan category experiencing the majority of the growth during both 2013 and 2012 was commercial and commercial real estate loans.

The commercial and commercial real estate loan category continues to be the primary focus for all the Bank Subsidiaries. These loans comprised 71% of the loan portfolio at both year-end 2013 and 2012 compared to 73% at year-end 2011. Commercial and commercial real estate loans, which totaled $2.48 billion at December 31, 2013, increased $478.6 million or 24% since year-end 2012, with $295.6 million attributable to the acquisitions. Commercial and commercial real estate loans increased $191.9 million or 11% during 2012. Exclusive of $83.7 million attributable to the acquisitions, this growth was $108.2 million or 6%. Exclusive of the acquisitions, approximately 62% of the 2013 growth and 73% of the 2012 growth occurred at our banks in the Midwest. During the first quarter of 2013, we launched our small business loan center, designed to provide easy access to credit and fast turnaround time for the small business customer, and add efficiencies in the handling of these customers by our business bankers. Most of our bank subsidiaries have selected dedicated staff to serve this market niche.

The initial 5.00% dividend rate payable on the preferred stock issued to the U.S. Treasury under the SBLF was subject to reduction during the second through ninth quarter after issuance (through September 30, 2013, for Heartland) based upon increases in qualified small business lending ("QSBL") over a baseline amount, and could be reduced to as low as 1.00% if QSBL increased by ten percent or more over that period. After adjustments for acquisitions, Heartland's baseline amount was determined to be $1.01 billion, which required growth in QSBL of $101.0 million to have the dividend rate reduced to 1.00%. Through December 31, 2012, Heartland's QSBL had grown by $123.0 million or 12.1%, regressed to $103.2 million or 10.2% at March 31, 2013, $104.7 million or 10.4% at June 30, 2013, and $117.6 million at September 30, 2013. As a result of its QSBL, the dividend rate on Heartland's $81.7 million preferred stock issued to the U.S. Treasury was 2.00% for the first quarter of 2013, 1.00% for the remaining quarters of 2013 and will be 1.00% for each quarter through March 2016.

Residential mortgage loans, which totaled $349.3 million at December 31, 2013, increased $99.7 million or 40% since year-end 2012. Exclusive of $56.9 million attributable to the acquisitions, residential mortgage loans grew $42.8 million or 17% from year-end 2012. During 2012, residential mortgage loans increased $55.3 million or 28% since year-end 2011. Exclusive of $26.3 million attributable to acquisitions, this growth was $29.0 million or 15%. Growth in both years was primarily attributable to the expansion in this line of business.

Agricultural and agricultural real estate loans, which totaled $376.7 million at December 31, 2013, increased $48.4 million or 15% since year-end 2012. Exclusive of $49.4 million attributable to the acquisitions, agricultural and agricultural real estate loans decreased $1.0 million or less than 1% since year-end 2012. During 2012, agricultural and agricultural real estate loans increased $65.3 million or 25% since year-end 2011. Exclusive of $37.7 million attributable to the acquisitions, this growth was $27.6 million or 10%. Approximately 81% of Heartland's agricultural loans at year-end 2013 were borrowers located in the Midwest. The agricultural loan portfolio is well diversified between grains, dairy, hogs and cattle.

Consumer loans, which totaled $294.1 million at December 31, 2013, increased $48.5 million or 20% since year-end 2012. Exclusive of $15.0 million attributable to the acquisitions, consumer loans increased $33.5 million or 14% since year-end 2012. During 2012, consumer loans increased $25.6 million or 12% since year-end 2011. Exclusive of $10.1 million attributable to acquisitions, this growth was $15.5 million or 7% during 2012. Consumer loans at Heartland's consumer finance subsidiary, Citizens Finance Parent Co., comprised 23% of the total consumer loan portfolio at December 31, 2013, compared to 27% at both December 31, 2012 and 2011. We continue to look for opportunities to expand this line of business. A tenth office was opened in Peoria, Illinois in 2011 and an eleventh office was opened in Elgin, Illinois in 2012.

Although repayment risk exists on all loans, different factors influence repayment risk for each type of loan. The primary risks associated with commercial and agricultural loans are the quality of the borrower’s management and the health of national and regional economies. Additionally, repayment of commercial and agricultural real estate loans may be influenced by fluctuating property values and concentrations of loans in a specific type of real estate. Repayment on loans to individuals, including those on residential real estate, are dependent on the borrower’s continuing financial stability as well as the value of the collateral underlying these credits, and thus are more likely to be affected by adverse personal circumstances and deteriorating economic conditions. These risks are described in more detail in Item 1A. “Risk Factors” of this Form 10-K. We monitor loan concentrations and do not believe we have excessive concentrations in any specific industry.

Our strategy with respect to the management of these types of risks, whether loan demand is weak or strong, is to encourage the Bank Subsidiaries to follow tested and prudent loan policies and underwriting practices which include: (i) granting loans on a sound and collectible basis; (ii) ensuring that primary and secondary sources of repayment are adequate in relation to the amount of the loan; (iii) administering loan policies through a board of directors; (iv) developing and maintaining adequate diversification of the loan portfolio as a whole and of the loans within each loan category; and (v) ensuring that each loan is properly documented and, if appropriate, guaranteed by government agencies and that insurance coverage is adequate.

Loans and leases secured by real estate, either fully or partially, totaled $2.21 billion or 63% of total loans and leases at December 31, 2013, and $1.91 billion or 68% of total loans and leases at December 31, 2012. Approximately 55% of the non-farm, nonresidential loans are owner occupied. The largest categories within our real estate secured loans are listed below, in thousands:

LOANS SECURED BY REAL ESTATE	As of December 31,	
	2013	2012
Residential real estate, excluding residential construction and residential lot loans	$566,397	$523,071
Industrial, manufacturing, business and commercial	240,502	241,369
Agriculture	199,998	211,823
Retail	154,786	171,974
Office	160,343	154,681
Land development and lots	98,157	104,716
Hotel, resort and hospitality	97,514	96,928

Multi-family	98,214	76,606
Food and beverage	73,588	79,222
Warehousing	65,724	74,634
Health services	49,070	45,469
Residential construction	36,865	31,351
All other	99,396	101,866
Loans acquired in 4th quarter 2013	272,157	—
Total loans secured by real estate	$2,212,711	$1,913,710

We regularly monitor and continue to develop systems to oversee the quality of our loan portfolio. Under our internal loan review program, loan review officers are responsible for reviewing existing loans and leases, testing loan ratings assigned by loan officers, identifying potential problem loans and leases and monitoring the adequacy of the allowance for loan and lease losses at the Bank Subsidiaries. An integral part of our loan review program is a loan rating system, under which a rating is assigned to each loan and lease within the portfolio based on the borrower's financial position, repayment ability, collateral position and repayment history.

The table below presents the amounts of nonperforming loans and leases and other nonperforming assets on the dates indicated, in thousands:

NONPERFORMING ASSETS

	As of December 31,				
	2013	2012	2011	2010	2009
Not covered under loss share agreements:					
Nonaccrual loans and leases	$42,394	$43,156	$57,435	$90,512	$78,118
Loans and leases contractually past due 90 days or more	24	—	—	85	17
Total nonperforming loans and leases	42,418	43,156	57,435	90,597	78,135
Other real estate	29,794	35,470	43,506	31,731	30,205
Other repossessed assets	397	542	648	302	501
Total nonperforming assets not covered under loss share agreements	$72,609	$79,168	$101,589	$122,630	$108,841
Covered under loss share agreements:					
Nonaccrual loans and leases	$783	$1,259	$3,345	$4,901	$4,170
Loans and leases contractually past due 90 days or more	—	—	—	—	—
Total nonperforming loans and leases	783	1,259	3,345	4,901	4,170
Other real estate	58	352	881	271	363
Other repossessed assets	—	—	—	—	—
Total nonperforming assets covered under loss share agreements	$841	$1,611	$4,226	$5,172	$4,533
Restructured loans[(1)]	$19,353	$21,121	$25,704	$23,719	$46,656
Nonperforming loans and leases not covered under loss share agreements to total loans and leases receivable	1.21 %	1.53 %	2.31 %	3.87 %	3.35 %
Nonperforming assets not covered under loss share agreements to total loans and leases receivable plus repossessed property	2.06 %	2.77 %	4.02 %	5.16 %	4.61 %
Nonperforming assets not covered under loss share agreements to total assets	1.23 %	1.59 %	2.39 %	3.07 %	2.71 %

(1) Represents accruing restructured loans performing according to their restructured terms.

The tables below summarize the changes in Heartland's nonperforming assets, including those covered by loss share agreements, during 2013 and 2012, in thousands:

	Nonperforming Loans	Other Real Estate Owned	Other Repossessed Assets	Total Nonperforming Assets
December 31, 2012	$44,415	$35,822	$542	$80,779
Loan foreclosures	(18,956)	18,343	613	—
Net loan recoveries	(6,727)	—	—	(6,727)
New nonperforming loans	44,884	—	—	44,884
Reduction of nonperforming loans[1]	(20,415)	—	—	(20,415)
OREO/Repossessed sales proceeds	—	(19,081)	(546)	(19,627)
OREO/Repossessed assets writedowns, net	—	(5,232)	(179)	(5,411)
Net activity at Citizens Finance Parent Co.	—	—	(33)	(33)
December 31, 2013	$43,201	$29,852	$397	$73,450

(1) Includes principal reductions and transfers to performing status.

	Nonperforming Loans	Other Real Estate Owned	Other Repossessed Assets	Total Nonperforming Assets
December 31, 2011	$60,780	$44,387	$648	$105,815
Loan foreclosures	(28,942)	28,751	191	—
Net loan recoveries	(6,295)	—	—	(6,295)
New nonperforming loans	33,439	—	—	33,439
Reduction of nonperforming loans[1]	(14,567)	—	—	(14,567)
OREO/Repossessed sales proceeds	—	(30,009)	(364)	(30,373)
OREO/Repossessed assets writedowns, net	—	(7,307)	(156)	(7,463)
Net activity at Citizens Finance Parent Co.	—	—	223	223
December 31, 2012	$44,415	$35,822	$542	$80,779

(1) Includes principal reductions and transfers to performing status.

Nonperforming loans, exclusive of those covered under loss sharing agreements, were $42.4 million or 1.21% of total loans and leases at December 31, 2013, compared to $43.2 million or 1.53% of total loans and leases at December 31, 2012, and $57.4 million or 2.31% of total loans and leases at December 31, 2011. Approximately 63%, or $27.3 million, of Heartland's nonperforming loans at December 31, 2013, had individual loan balances exceeding $1.0 million, the largest of which was $6.8 million. These nonperforming loans, to an aggregate of 8 borrowers, were primarily located in the Midwestern states and were spread over six different industry classifications. At December 31, 2012, approximately 53%, or $22.9 million, of our nonperforming loans had individual loan balances exceeding $1.0 million. These nonperforming loans, to an aggregate of 12 borrowers, were primarily located in the Western states and were spread over eight different industry classifications. The portion of Heartland's nonperforming loans covered by government guarantees was $236,000 at December 31, 2013, compared to $1.7 million at December 31, 2012, and $2.7 million at December 31, 2011.

Delinquencies in each of the loan portfolios continue to be well-managed. Loans delinquent 30 to 89 days as a percent of total loans were 0.30% at December 31, 2013, compared to 0.32% at December 31, 2012, and 0.23% at December 31, 2011.

Other real estate owned was $29.9 million at December 31, 2013, compared to $35.8 million at December 31, 2012, and $44.4 million at December 31, 2011. Liquidation strategies have been identified for all the assets held in other real estate owned. Management continues to market these properties through an orderly liquidation process instead of a quick liquidation process in order to avoid discounts greater than the projected carrying costs. During 2013, $6.0 million of other real estate owned was sold during the fourth quarter, $2.7 million during the third quarter, $5.3 million during the second quarter and $3.3 million during the first quarter. During 2012, $7.0 million of other real estate owned was sold during the fourth quarter, $4.2 million during the third quarter, $5.9 million during the second quarter and $12.4 million during the first quarter. During 2011, $21.8

million of other real estate owned was sold, $5.4 million during the fourth quarter, $6.2 million during the third quarter, $4.9 million during the second quarter and $5.3 million during the first quarter.

In certain circumstances, we may modify the terms of a loan to maximize the collection of amounts due. In most cases, the modification is either a reduction in interest rate, conversion to interest only payments, extension of the maturity date or a reduction in the principal balance. Generally, the borrower is experiencing financial difficulties or is expected to experience difficulties in the near-term, so a concessionary modification is granted to the borrower that would otherwise not be considered. Restructured loans accrue interest as long as the borrower complies with the revised terms and conditions and has demonstrated repayment performance at a level commensurate with the modified terms over several payment cycles. Although many of our loan restructurings occur on a case-by-case basis in connection with ongoing loan collection processes, we have also participated in certain restructuring programs for residential real estate borrowers. In general, certain residential real estate borrowers facing an interest rate reset that are current in their repayment status, are allowed to retain the lower of their existing interest rate or the market interest rate as of their interest reset date. Our Bank Subsidiaries participate in the U.S. Department of the Treasury Home Affordable Modification Program (“HAMP”) for loans in its servicing portfolio. HAMP gives qualifying homeowners an opportunity to refinance into more affordable monthly payments, with the U.S. Department of the Treasury compensating us for a portion of the reduction in monthly amounts due from borrowers participating in this program. We also utilize a similar mortgage loan restructuring program for certain borrowers within our portfolio loans.

We had an aggregate balance of $32.4 million in restructured loans at December 31, 2013, of which $13.1 million was classified as nonaccrual and $19.3 million were accruing according to the restructured terms. At December 31, 2012, we had $26.0 million in restructured loans, of which $4.5 million was classified as nonaccrual and $21.1 million was accruing interest according to the restructured terms.

At December 31, 2013, $115.7 million or 51% of the consumer loans originated by the Bank Subsidiaries were in home equity lines of credit ("HELOCs") compared to $95.0 million or 53% at December 31, 2012, and $90.6 million or 56% at December 31, 2011. Under our policy guidelines for the underwriting of these lines of credit, the customer may receive advances of up to 90% of the value of the property securing the line, provided the customer qualifies for Tier I classification, our internal ranking for customers considered to possess a high credit quality profile. Additionally, to qualify for advances up to 90% of the value of the property securing the line, the first mortgage must be held by Heartland and the customer must escrow for both taxes and insurance. Otherwise, HELOCs are established at an 80% loan to value.

The Bank Subsidiaries have not been active in the origination of subprime loans. Consistent with our community banking model, which includes meeting the legitimate credit needs within the communities served, the Bank Subsidiaries may make loans to borrowers possessing subprime characteristics if there are mitigating factors present that reduce the potential default risk of the loan.

Allowance For Loan And Lease Losses

The process we use to determine the appropriateness of the allowance for loan and lease losses is considered a critical accounting practice for Heartland. The allowance for loan and lease losses represents management’s estimate of identified and unidentified probable losses in the existing loan portfolio. For additional details on the specific factors considered, refer to the critical accounting policies section of this report.

Exclusive of loans covered under loss sharing agreements, the allowance for loan and lease losses at December 31, 2013, was 1.19% of loans and leases and 98.27% of nonperforming loans compared to 1.37% of loans and leases and 89.71% of nonperforming loans at December 31, 2012, and 1.48% of loans and leases and 64.09% of nonperforming loans at December 31, 2011. Exclusive of acquired loans, for which a valuation reserve is recorded, the allowance for loan and lease losses at December 31, 2013, was 1.42% of loans and leases and 105.70% of nonperforming loans in comparison with 1.45% of loans and leases and 90.54% of nonperforming loans at December 31, 2012. The allowance for loan and lease losses as a percentage of loans and leases declined in both years as several credit relationships considered impaired, for which specific reserves had been provided, were charged-off or transitioned to other real estate owned. The provision for loan losses was $9.7 million during 2013 compared to $8.2 million during 2012 and $29.4 million during 2011. The increased provision in 2013 was primarily a result of a provision to create a specific allowance for a single impaired loan, resulting in an aggregate allowance for loan and lease losses on impaired loans of $6.7 million at December 31, 2013, and an allowance on non-impaired loans, exclusive of acquisitions, of $35.0 million. A reduction in the level of the allowance for loan and lease losses maintained for impaired loans was the primary contributor to the lower provision during 2012. The portion of the allowance for loan and lease losses maintained for impaired loans was $4.6 million at December 31, 2012, leaving the allowance on non-impaired loans, exclusive of acquisitions, relatively stable at 1.32% of loans and leases at December 31, 2012, compared to 1.31% at December 31, 2011. The allowance for loan and lease losses related to total impaired loans was $5.5 million at December 31, 2011.

Although the aggregate annual provision for loan losses moderated in 2012, additions to the allowance for loan and lease losses continued during 2011 as the sluggish economic recovery and the long-term affect of adverse economic conditions impacted individual credits and continued to impact the value of collateral when appraisals were obtained.

The amount of net charge-offs not covered by loss share agreements recorded by us was $6.6 million during 2013 compared to $5.9 million during 2012 and $36.3 million during 2011. As a percentage of average loans and leases, net charge-offs were 0.22% during 2013 compared to 0.23% during 2012 and 1.46% during 2011. A large portion of the net charge-offs during both years was related to nonfarm nonresidential real estate and construction, land development and other land loans, including residential lot loans. We recognize charge-offs on certain collateral dependent loans by writing down the loan balance to an estimated net realizable value based on the anticipated disposition value. Citizens Finance Parent Co., our consumer finance subsidiary, experienced net charge-offs of $3.3 million during 2013 compared to $2.5 million during 2012 and $1.6 million during 2011. Net losses as a percentage of average loans, net of unearned, at Citizens were 4.91% for 2013 compared to 3.88% for 2012 and 2.99% for 2011. Loans with payments past due for more than thirty days at Citizens were 2.46% of gross loans at year-end 2013 compared to 2.15% of gross loans at year-end 2012 and 3.79% at year-end 2011. Although we may periodically experience a charge-off of more significance on an individual credit, we feel our credit culture remains solid.

The table below summarizes activity in the allowance for loan and lease losses for the years indicated, including amounts of loans and leases charged off, amounts of recoveries, additions to the allowance charged to income, additions related to acquisitions and the ratio of net charge-offs to average loans and leases outstanding, in thousands:
ANALYSIS OF ALLOWANCE FOR LOAN AND LEASE LOSSES

	As of December 31,				
	2013	2012	2011	2010	2009
Allowance at beginning of year	$38,715	$36,808	$42,693	$41,848	$35,651
Charge-offs:					
Commercial and commercial real estate	5,711	8,697	32,474	27,191	27,888
Residential real estate	1,036	988	1,878	1,641	1,869
Agricultural and agricultural real estate	23	1	167	301	496
Consumer	4,777	4,818	5,461	4,917	4,712
Total charge-offs	11,547	14,504	39,980	34,050	34,965
Recoveries:					
Commercial and commercial real estate	3,397	7,160	3,919	1,585	1,073
Residential real estate	158	164	46	19	79
Agricultural and agricultural real estate	110	81	33	152	32
Consumer	1,155	804	732	631	601
Total recoveries	4,820	8,209	4,730	2,387	1,785
Net charge-offs(1)(2)	6,727	6,295	35,250	31,663	33,180
Provision for loan and lease losses	9,697	8,202	29,365	32,508	39,377
Allowance at end of year	$41,685	$38,715	$36,808	$42,693	$41,848
Net charge-offs to average loans and leases	0.22 %	0.23 %	1.46 %	1.31 %	1.38 %

(1) Includes net charge-offs at Citizens Finance Parent Co. of $3,274 for 2013, $2,468 for 2012, $1,608 for 2011, $1,605 for 2010, and $1,942 for 2009.
(2) Includes net charge-offs on loans covered under loss share agreements of $114 for 2013, $409 for 2012, ($1,065) for 2011, $798 for 2010 and $1,344 for 2009.

The table below shows our allocation of the allowance for loan and lease losses by types of loans and leases and the amount of unallocated reserves, in thousands:
ALLOCATION OF ALLOWANCE FOR LOAN AND LEASE LOSSES

	As of December 31, 2013		2012		2011		2010		2009	
	Amount	Loan Category to Gross Loans & Leases Receivable	Amount	Loan Category to Gross Loans & Leases Receivable	Amount	Loan Category to Gross Loans & Leases Receivable	Amount	Loan Category to Gross Loans & Leases Receivable	Amount	Loan Category to Gross Loans & Leases Receivable
Commercial and commercial real estate(1)	$27,251	70.86 %	$25,861	70.84 %	$25,170	72.76 %	$30,850	73.22 %	$33,602	71.60 %
Residential real estate	3,720	9.98	3,543	8.84	3,001	7.82	2,381	6.97	1,691	7.49
Agricultural and agricultural real estate	2,992	10.76	2,138	11.62	1,763	10.57	2,147	10.68	2,852	10.99
Consumer	7,722	8.40	7,173	8.70	6,874	8.85	6,315	9.13	3,566	9.92
Unallocated	—		—		—		1,000		137	
Total allowance for loan and lease losses	$41,685		$38,715		$36,808		$42,693		$41,848	

(1) For 2013, the amount allocated to commercial was $13,099 and the amount allocated to commercial real estate was $14,152. For 2012, the amount allocated to commercial was $11,388 and the amount allocated to commercial real estate was $14,473.

Management allocates the allowance for loan and lease losses by pools of risk within each loan portfolio. The allocation of the allowance for loan and lease losses by loan portfolio is made for analytical purposes and is not necessarily indicative of the trend of future loan and lease losses in any particular category. The total allowance for loan and lease losses is available to absorb losses from any segment of the loan portfolio.

Securities

The composition of Heartland's securities portfolio is managed to maximize the return on the portfolio while considering the impact it has on Heartland's asset/liability position and liquidity needs. Securities represented 32% of Heartland's total assets at December 31, 2013, compared to 31% at year-end 2012. Total available for sale securities as of December 31, 2013, were $1.63 billion, an increase of $143.6 million or 10% since December 31, 2012. The 2013 acquisitions included $355.7 million of available for sale securities. Total available for sale securities as of December 31, 2012, were $1.49 billion, an increase of $240.3 million or 19% since December 31, 2011. The 2012 acquisitions included available for sale securities of $24.5 million.

The table below presents the composition of the securities portfolio, including trading, available for sale and held to maturity, by major category, in thousands:

SECURITIES PORTFOLIO COMPOSITION

	As of December 31,								
	2013			2012			2011		
	Amount	% of Portfolio		Amount	% of Portfolio		Amount	% of Portfolio	
U.S. government corporations and agencies	$218,303	11.52	%	$21,444	1.37	%	$107,147	8.08	%
Mortgage-backed securities	1,149,920	60.68		1,043,241	66.79		834,185	62.88	
Obligation of states and political subdivisions	498,149	26.29		474,907	30.41		335,799	25.31	
Other securities	28,672	1.51		22,365	1.43		49,461	3.73	
Total securities	$1,895,044	100.00	%	$1,561,957	100.00	%	$1,326,592	100.00	%

The percentage of Heartland's securities portfolio comprised of U.S. government corporation and agencies was 12% at December 31, 2013, compared to 1% at December 31, 2012. Mortgage-backed securities comprised 61% of Heartland's securities portfolio at December 31, 2013, compared to 67% at December 31, 2012, and 63% at December 31, 2011. The change in the composition of the securities portfolio during 2013 was partially a result of the Morrill & Janes merger, as approximately 46% of its securities were held in U.S. government corporations and agency securities, 49% in mortgage-backed securities and the remainder in municipal securities. Additionally, a portion of the proceeds from maturities, paydowns and sales were used to fund loan growth during 2013. During 2012, the composition of the securities portfolio was shifted from lower-yielding U.S. government corporate and agency securities into mortgage-backed securities and obligations of states and political subdivisions.

Approximately 87% of Heartland's mortgage-backed securities were issuances of government-sponsored enterprises at December 31, 2013, compared to 80% at December 31, 2012. Heartland's securities portfolio had an expected duration of 4.50 years as of December 31, 2013, compared to 4.30 years at year-end 2012.
The Volcker Rule prohibits insured depository institutions and their holding companies from engaging in proprietary trading except in limited circumstances, and prohibits them from owning equity interests in excess of 3% of Tier 1 Capital in private equity and hedge funds. The Volcker Rule will not have a material impact on Heartland’s investment securities portfolio. For additional information on the Volcker Rule, see the discussion under the “Business - F. Supervision and Regulation - The Bank Subsidiaries - The Volcker Rule and Proprietary Trading” heading of Part I, Item 1 of this report.

At December 31, 2013, we had $21.8 million of other securities, including capital stock in the various Federal Home Loan Banks of which the Bank Subsidiaries are members and all of which were classified as other securities held at cost.

The tables below present the contractual maturities for the debt securities in the securities portfolio at December 31, 2013, by major category and classification as available for sale or held to maturity, in thousands. Expected maturities will differ from contractual maturities, as borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.
SECURITIES AVAILABLE FOR SALE PORTFOLIO MATURITIES

	Within One Year		After One But Within Five Years		After Five But Within Ten Years		After Ten Years		Mortgage-backed and equity securities		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yiel
U.S. government corporations and agencies	$7,995	0.92%	$134,672	0.96%	$75,636	3.73%	$—	— %	$—	— %	$218,303	1.35
Obligations of states and political subdivisions[1]	4,905	4.17	16,773	3.50	24,192	0.02	220,754	3.37	—	—	266,624	3.51
Mortgage backed securities	—	—	—	—	—	—	—	—	1,143,947	2.66	1,143,947	1.88
Equity securities	—	—	—	—	—	—	—	—	5,028	—	5,028	—
Total	$12,900	2.16%	$151,445	1.25%	$99,828	2.54%	$220,754	337.40%	$1,148,975	2.66%	$1,633,902	2.31

(1) Rates on obligations of states and political subdivisions have been adjusted to tax equivalent yields using a 34% tax rate.
SECURITIES HELD TO MATURITY PORTFOLIO MATURITIES

	Within One Year		After One But Within Five Years		After Five But Within Ten Years		After Ten Years		Mortgage-backed and equity securities		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield

Obligations of states and political subdivisions[1]	$—	—%	$—	—%	$53,121	4.27%	$178,404	4.04 %	$—	— %	$231,525	5.84%
Mortgage backed and equity securities	—	—	—	—	—	—		—	5,973	9.95	5,973	9.95
Total	$—	—%	$—	—%	$53,121	5.87%	$178,404	4.04 %	$5,973	9.95%	$237,498	6.36%

(1) Rates on obligations of states and political subdivisions have been adjusted to tax equivalent yields using a 34% tax rate.

Some of the debt securities held in our available for sale portfolio had market values below their amortized cost basis at December 31, 2013. Because the majority of the decline in market value is attributable to changes in interest rates and not credit quality, and because we have the ability and intent to hold those investments until a recovery of fair value, which may be maturity, we did not consider those investments to be other-than-temporarily impaired at December 31, 2013. See Note 4 to our consolidated financial statements for further discussion regarding unrealized losses on our securities portfolio.

Deposits

The table below sets forth the distribution of our average deposit account balances and the average interest rates paid on each category of deposits for the years indicated, in thousands:

AVERAGE DEPOSITS

	For the Years Ended December 31,								
	2013			2012			2011		
	Average Deposits	Percent of Deposits	Average Interest Rate	Average Deposits	Percent of Deposits	Average Interest Rate	Average Deposits	Percent of Deposits	Average Interest Rate
Demand deposits	$1,064,177	26.52 %	— %	$829,566	24.43 %	— %	$667,952	21.45 %	— %
Savings	2,101,295	52.36	0.32	1,763,233	51.91	0.38	1,589,697	51.05	0.57
Time deposits less than $100,000	532,157	13.26	1.67	531,351	15.64	2.02	590,767	18.97	2.40
Time deposits of $100,000 or more	315,623	7.86	1.40	272,338	8.02	1.75	265,664	8.53	2.23
Total deposits	$4,013,252	100.00 %		$3,396,488	100.00 %		$3,114,080	100.00 %	

Total average deposits increased $616.8 million or 18% during 2013. Exclusive of $145.6 million attributable to the acquisitions completed in the fourth quarter of 2013, total average deposits increased $471.2 million or 14%. During 2012, total average deposits increased $282.4 million or 9%. Exclusive of $45.9 million attributable to acquisitions, this growth was $236.5 million or 8%. During both years, this growth was weighted more heavily in our Midwestern markets, which were responsible for 62% of the growth during 2013 and 71% of the growth during 2012. The percentage of our total average deposit balances attributable to branch banking offices in our Western markets was 38% during 2013, 39% during 2012 and 41% during 2011.

The composition of Heartland's deposits continued to shift from higher cost certificates of deposit to no cost demand deposits during 2013, as average demand deposits increased $234.6 million or 28%. Exclusive of acquisitions, average demand deposits increased $216.5 million or 26% during 2013. For 2012, average demand deposits increased $161.6 million or 24%. Exclusive of acquisitions, average demand deposits increased $153.7 million or 23% during 2012. The result is an improving mix of total deposits, with demand deposits representing 27%, savings representing 54% and time deposits representing 19% at December 31, 2013. At year-end 2012, demand deposits represented 25% of total deposits, savings represented 52% and time deposits represented 23%. At year-end 2011, demand deposits represented 22% of total deposits, savings represented 52% and time deposits represented 26%. The percentage of our total average demand deposit balances attributable to branch banking offices in our Western markets was 44% during 2013, 55% during 2012 and 47% during 2011.

Average savings deposit balances increased by $338.1 million or 19% during 2013. Exclusive of acquisitions, average savings deposit balances increased $226.2 million or 13% during 2013. For 2012, average savings deposit balances increased $173.5 million or 11%. Exclusive of acquisitions, average savings deposit balances increased $159.2 million or 10% during 2012. The percentage of our total average savings deposit balances attributable to branch banking offices in our Western markets was 35% in 2013, 37% in 2012 and 38% in 2011.

Average time deposits increased $44.1 million or 5% during 2013 and, exclusive of those balances acquired through acquisitions, $28.4 million or 4%. For 2012, average time deposits decreased $52.7 million or 6% and, without acquisitions, $76.3 million or 9%. The decrease in time deposits during 2012 was attributable to an increased emphasis on growing our customer base in non-maturity deposit products instead of higher-cost certificates of deposit. The Bank Subsidiaries priced time deposit products competitively to retain existing relationship-based deposit customers, but not to retain certificate of deposit only customers or to attract new customers. Additionally, due to the low interest rates, many certificate of deposit customers elected to place their maturing balances in checking or savings accounts while waiting for interest rates to improve. The percentage of our total average time deposit balances attributable to branch banking offices in our Western markets was 39% during 2013, 40% during 2012 and 41% during 2011.

Average brokered time deposits as a percentage of total average deposits were 1% during both 2013 and 2012. The reliance on brokered time deposits has decreased during more recent years as the Bank Subsidiaries were able to grow deposits in their own markets at comparable or lower interest rates.

The following table sets forth the amount and maturities of time deposits of $100,000 or more at December 31, 2013, in thousands:

TIME DEPOSITS $100,000 AND OVER

	December 31, 2013
3 months or less	$56,420
Over 3 months through 6 months	79,114
Over 6 months through 12 months	75,073
Over 12 months	143,577
	$354,184

Borrowings

Short-term borrowings generally include federal funds purchased, securities sold under agreements to repurchase, short-term FHLB advances and discount window borrowings from the Federal Reserve Bank. These funding alternatives are utilized in varying degrees depending on their pricing and availability. All of Heartland's bank subsidiaries own FHLB stock in either the Chicago, Dallas, Des Moines, Seattle, San Francisco or Topeka FHLB, enabling them to borrow funds from their respective FHLB for short- or long-term purposes under a variety of programs. As of December 31, 2013, the amount of short-term borrowings was $408.8 million compared to $224.6 million at year-end 2012, an increase of $184.2 million or 82%, primarily due to increases in short-term FHLB advances and federal funds purchased. Short-term FHLB advances totaled $105.0 million at December 31, 2013, in comparison with $10.0 million at December 31, 2012.

All of the bank subsidiaries provide retail repurchase agreements to their customers as a cash management tool, sweeping excess funds from demand deposit accounts into these agreements. This source of funding does not increase the bank's reserve requirements. Although the aggregate balance of these retail repurchase agreements is subject to variation, the account relationships represented by these balances are principally local. The balances of retail repurchase agreements were $234.7 million at December 31, 2013, compared to $203.4 million at December 31, 2012, an increase of $31.3 million or 15%.

Also included in short-term borrowings are the revolving credit lines Heartland has with unaffiliated banks, primarily to provide liquidity to Heartland. On June 14, 2013, Heartland replaced its $5.0 million unsecured revolving credit line with a $20.0 million unsecured revolving credit line with the same unaffiliated bank. On November 12, 2013, Heartland chose not to renew one of its two revolving credit lines in the amount of $5.0 million with an unaffiliated bank. There was no balance outstanding on Heartland's revolving credit lines on either December 31, 2013, or December 31, 2012.

The following table reflects information regarding our short-term borrowings as of December 31, 2013, 2012, and 2011, in thousands:

SHORT-TERM BORROWINGS	As of and For the Years Ended December 31,		
	2013	2012	2011
Balance at end of period	$408,756	$224,626	$270,081
Maximum month-end amount outstanding	408,756	298,662	270,081
Average month-end amount outstanding	274,352	248,048	197,527
Weighted average interest rate at year-end	0.19 %	0.31 %	0.35 %
Weighted average interest rate for the year	0.31 %	0.32 %	0.44 %

Other borrowings include all debt arrangements Heartland and its subsidiaries have entered into with original maturities that extend beyond one year. As of December 31, 2013, the amount of other borrowings was $350.1

million, a decrease of $38.9 million or 10% since year-end 2012.

At December 31, 2013, long-term FHLB borrowings totaled $113.5 million compared to $143.2 million at December 31, 2012, a decrease of $29.7 million or 21%. Total FHLB borrowings at December 31, 2013, had an average interest rate of 3.06% and an average maturity of 1.50 years. The interest rate on $74.5 million of these advances changes quarterly at a spread over 3-month LIBOR. When considering the earliest possible call date on these advances, the average maturity is shortened to 10 months.

Structured wholesale repurchase agreements totaled $60.0 million at December 31, 2013 and $85.0 million at December 31, 2012, a decrease of $25.0 million or 29% due to the maturity of one contract.

The outstanding balance on Heartland's amortizing term loan with an unaffiliated bank was $11.7 million at December 31, 2013, compared to $13.0 million at December 31, 2012.

Heartland also had senior notes totaling $37.5 million outstanding at both December 31, 2013, and December 31, 2012. These senior notes mature with respect to $17.5 million on December 1, 2015, $7.0 million on each of February 1, 2017, and February 1, 2018, and $6.0 million on February 1, 2019. The senior notes are unsecured and bear interest at 5.00% per annum payable quarterly.

The balances outstanding on trust preferred capital securities issued by Heartland are also included in other borrowings. On March 7, 2012, Heartland exercised its call option on $5.0 million of its trust preferred capital securities that were at a fixed rate of 10.60%. The prepayment fee of $238,000 and the remaining unamortized issuance costs of $64,000 were expensed upon redemption. A schedule of Heartland's trust preferred offerings outstanding as of December 31, 2013, is as follows, in thousands:

TRUST PREFERRED OFFERINGS

	Amount Issued	Issuance Date	Interest Rate	Interest Rate as of 12/31/13(1)		Maturity Date	Callable Date
Heartland Financial Statutory Trust III	$20,619	10/10/2003	8.25%	8.25	%	10/10/2033	03/31/2014
Heartland Financial Statutory Trust IV	25,774	03/17/2004	2.75% over LIBOR	2.99	%(2)	03/17/2034	03/17/2014
Heartland Financial Statutory Trust V	20,619	01/31/2006	1.33% over LIBOR	1.57	%(3)	04/07/2036	04/07/2014
Heartland Financial Statutory Trust VI	20,619	06/21/2007	6.75%	6.75	%(4)	09/15/2037	03/15/2014
Heartland Financial Statutory Trust VII	20,619	06/26/2007	1.48% over LIBOR	1.72	%(5)	09/01/2037	06/01/2014
Morrill Statutory Trust I	8,524	12/26/2002	3.25% over LIBOR	3.50	%	12/26/2032	03/26/2014
Morrill Statutory Trust II	8,086	12/17/2003	2.85% over LIBOR	3.09	%	12/17/2033	12/17/2014
	$124,860						

(1) Effective weighted average interest rate as of December 31, 2013, was 5.85% due to interest rate swap transactions on the variable rate securities as discussed in Note 12 to Heartland's consolidated financial statements.
(2) Effective interest rate as of December 31, 2013, was 5.33% due to an interest rate swap transaction as discussed in Note 12 to Heartland's consolidated financial statements.
(3) Effective interest rate as of December 31, 2013, was 4.69% due to an interest rate swap transaction as discussed in Note 12 to Heartland's consolidated financial statements.
(4) Interest rate is fixed at 6.75% through June 15, 2017 then resets to 1.48% over LIBOR for the remainder of the term.
(5) Effective interest rate as of December 31, 2013, was 4.70% due to an interest rate swap transaction as discussed in Note 12 to Heartland's consolidated financial statements.

Subsequent to year end, Heartland entered into two interest rate swap transactions to fix the interest rates on the trust preferred debt assumed by Heartland with the Morrill & Janes Bank and Trust Company transaction. The swaps fix the effective interest rate on Morrill Statutory Trust I debt to 4.92% and the effective interest rate on Morrill Statutory Trust II to 4.51% for five years. In addition, subsequent to year end, Heartland entered into a forward starting interest rate swap transaction to replace the interest rate swap on Heartland's Statutory Trust IV debt, which expires on March

17, 2014. The new effective interest rate is 5.00% compared to 5.33% and is fixed for seven years.

CAPITAL RESOURCES

Heartland's risk-based capital ratios, which take into account the different credit risks among banks' assets, met all capital adequacy requirements over the past three years. Tier 1 and total risk-based capital ratios were 13.19% and 14.69%, respectively on December 31, 2013 compared to 13.36% and 15.35%, respectively, on December 31, 2012, and compared to 14.08% and 15.87%, respectively, on December 31, 2011. At December 31, 2013, our leverage ratio, the ratio of Tier 1 capital to total average assets, was 9.67% compared to 9.84% at December 31, 2012, and 10.24% at December 31, 2011. Heartland and our Bank Subsidiaries have been, and will continue to be, managed to meet the well-capitalized requirements under the regulatory framework for prompt corrective action. To be categorized as well capitalized under the regulatory framework, bank holding companies and banks must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios of 10%, 6% and 5%, respectively. The most recent notification from the FDIC categorized Heartland and each of the Bank Subsidiaries as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed each institution's category.

Heartland's capital ratios are detailed in the tables below, in thousands:

RISK-BASED CAPITAL RATIOS[1]

	As of and For the Years Ended December 31,					
	2013		2012		2011	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Capital Ratios:						
Tier 1 capital	$537,964	13.19 %	$463,371	13.36 %	$427,145	14.08 %
Tier 1 capital minimum requirement	163,126	4.00 %	138,743	4.00 %	121,357	4.00 %
Excess	$374,838	9.19 %	$324,628	9.36 %	$305,788	10.08 %
Total capital	$599,038	14.69 %	$532,502	15.35 %	$481,513	15.87 %
Total capital minimum requirement	326,252	8.00 %	277,485	8.00 %	242,715	8.00 %
Excess	$272,786	6.69 %	$255,017	7.35 %	$238,798	7.87 %
Total risk-adjusted assets	$4,078,154		$3,468,565		$3,033,935	

(1) Based on the risk-based capital guidelines of the Federal Reserve, a bank holding company is required to maintain a Tier 1 capital to risk-adjusted assets ratio of 4.00% and total capital to risk-adjusted assets ratio of 8.00%.

LEVERAGE RATIOS[1]

	As of and For the Years Ended December 31,					
	2013		2012		2011	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Capital Ratios:						
Tier 1 capital	$537,964	9.67 %	$463,371	9.84 %	$427,145	10.24 %
Tier 1 capital minimum requirement[2]	222,432	4.00 %	188,284	4.00 %	166,865	4.00 %
Excess	$315,532	5.67 %	$275,087	5.84 %	$260,280	6.24 %
Average adjusted assets	$5,560,796		$4,707,110		$4,171,625	

(1) The leverage ratio is defined as the ratio of Tier 1 capital to average total assets.
(2) We have established a minimum target leverage ratio of 4.00%. Based on Federal Reserve guidelines, a bank holding company generally is required to maintain a leverage ratio of 3.00% plus an additional cushion of at least 100 basis points.

Under the Basel III Rules, which are effective for Heartland on January 1, 2015, the minimum capital ratios will be increased and a new Common Tier 1 Capital Ratio will be added. For more information about these new requirements, see the discussion under the "Business - F. Supervision and Regulation - The Bank Subsidiaries - Capital Requirements" headings under Part I, Item 1 of this report. Management believes that as of December 31, 2013, Heartland would meet all of the capital adequacy requirements under the Basel III Rules on a fully phased-in basis if such requirements were currently effective.

Heartland filed a universal shelf registration statement with the SEC on August 28, 2013, which became effective on September 9, 2013, to register up to $75.0 million in securities. The shelf registration statement provides Heartland with the ability to raise capital, subject to SEC rules and limitations, if Heartland’s board of directors decides to do so.

Minnesota Bank & Trust, Heartland's tenth bank, began operations on April 15, 2008, in Edina, Minnesota. Heartland's initial investment in this de novo bank was $13.2 million, or 80%, of the $16.5 million initial capital. All minority stockholders entered into a stock transfer agreement that imposed certain restrictions on the sale, transfer or other disposition of their shares in Minnesota Bank & Trust and allowed, but did not require, Heartland to repurchase the shares from investors after five years of operations. On April 15, 2013, Heartland completed the repurchase of all minority shares of Minnesota Bank & Trust. The shareholders were offered the option to receive Heartland common stock for the portion of the repurchase price that represented their original investment and to also receive the appreciation in their original investment in the form of Heartland common stock. Six shareholders elected to receive 51,015 shares of Heartland common stock for all or a portion of their investment and the remaining shareholders elected to receive cash totaling $3.2 million.

Common stockholders' equity was $357.8 million at December 31, 2013, compared to $320.1 million at year-end 2012. Book value per common share was $19.44 at December 31, 2013, compared to $19.02 at year-end 2012. Changes in common stockholders' equity and book value per common share are the result of earnings, dividends paid, stock transactions and mark-to-market adjustment for unrealized gains and losses on securities available for sale. As a result of increases in market interest rates on many debt securities during the last three quarters of 2013, Heartland's unrealized gains and losses on securities available for sale, net of applicable taxes, were at an unrealized loss of $15.1 million at December 31, 2013, compared to an unrealized gain of $20.5 million at December 31, 2012.

On December 19, 2008, Heartland received $81.7 million through participation in the TARP CPP. On September 15, 2011, Heartland sold to the U.S. Treasury $81.7 million of its Series C Preferred Stock under the SBLF. Simultaneous with receipt of the SBLF funds, Heartland redeemed the $81.7 million of preferred stock issued to the U.S. Treasury in December 2008 under the TARP CPP. On September 28, 2011, Heartland repurchased a warrant to purchase 609,687 shares of Heartland common stock from the U.S. Treasury that had been issued under the TARP CPP at a purchase price of $1.8 million. Note 18 to the financial statements contains a detailed discussion about of the capital issuance and redemptions.

We continue to explore opportunities to expand our footprint of independent community banks. Given the current issues in the banking industry, we have changed our strategic growth initiatives from de novo banks and branching to acquisitions. Attention will be focused on markets we currently serve, where there would be an opportunity to grow market share, achieve efficiencies and provide greater convenience for current customers. Future expenditures relating to expansion efforts, in addition to those identified above, are not estimable at this time.

COMMITMENTS AND CONTRACTUAL OBLIGATIONS

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank Subsidiaries evaluate each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank Subsidiaries upon extension of credit, is based upon management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment and income-producing commercial properties. Standby letters of credit and financial guarantees written are conditional commitments issued by the Bank Subsidiaries to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. At December 31, 2013, and December 31, 2012, commitments to extend credit aggregated $1.14 billion and $844.6 million, and standby letters of credit aggregated $39.7 million and $29.5 million, respectively.

The following table summarizes our significant contractual obligations and other commitments as of December 31, 2013, in thousands:

CONTRACTUAL OBLIGATIONS AND OTHER COMMITMENTS

	Total	Payments Due By Period			
		Less than One Year	One to Three Years	Three to Five Years	More than Five Years
Contractual obligations:					
Time certificates of deposit	$892,676	$497,059	$259,602	$99,474	$36,541
Long-term debt obligations	350,109	140,838	51,439	22,387	135,445
Operating lease obligations	25,163	3,890	6,855	4,582	9,836
Purchase obligations	13,648	2,581	4,394	3,861	2,812
Other long-term liabilities	2,614	254	506	506	1,348
Total contractual obligations	$1,284,210	$644,622	$322,796	$130,810	$185,982
Other commitments:					
Lines of credit	$1,144,020	$870,283	$149,407	$48,450	$75,880
Standby letters of credit	39,702	27,839	11,426	253	184
Total other commitments	$1,183,722	$898,122	$160,833	$48,703	$76,064

On a consolidated basis, we maintain a large balance of short-term securities that, when combined with cash from operations, we believe are adequate to meet our funding obligations.

At the parent company level, routine funding requirements consist primarily of dividends paid to stockholders, including the U.S. Treasury under the SBLF, debt service on our revolving credit arrangements and our trust preferred securities issuances, and payments for acquisitions. The parent company obtains the funding to meet these obligations from dividends collected from the Bank Subsidiaries and the issuance of debt securities. At December 31, 2013, Heartland's revolving credit agreement with an unaffiliated bank provided a maximum borrowing capacity of $20.0 million, of which none was outstanding. This credit agreement contains specific financial covenants which are listed in Note 11 to the consolidated financial statements. At December 31, 2013, Heartland was in compliance with these covenants.

The ability of Heartland to pay dividends to its stockholders is dependent upon dividends paid by its subsidiaries. The Bank Subsidiaries are subject to statutory and regulatory restrictions on the amount they may pay in dividends. To maintain acceptable capital ratios in the Heartland banks, certain portions of their retained earnings are not available for the payment of dividends. Retained earnings that could be available for the payment of dividends to Heartland under the regulatory capital requirements to remain well-capitalized totaled approximately $137.0 million as of December 31, 2013.

LIQUIDITY

Liquidity refers to our ability to maintain a cash flow that is adequate to meet maturing obligations and existing commitments, to withstand fluctuations in deposit levels, to fund operations and to provide for customers' credit needs. The liquidity of Heartland principally depends on cash flows from operating activities, investment in and maturity of assets, changes in balances of deposits and borrowings and its ability to borrow funds in the money or capital markets.

Operating activities provided cash of $135.6 million during 2013 compared to $48.7 million during 2012 and $58.5 million during 2011. The biggest contributor to this change was activity in loans originated for sale which provided cash of $50.0 during 2013 compared to using cash of $42.6 million during 2012 and $29.6 million during 2011. Cash used for the payment of income taxes was $5.5 million during 2013 compared to $12.2 million in 2012 and $7.1

million during 2011.

Investing activities used cash of $324.0 million during 2013, $349.7 million during 2012 and $200.0 million during 2011. The proceeds from securities sales, paydowns and maturities were $777.4 million during 2013 as compared to $871.1 million during 2012 and $789.8 million during 2011. Purchases of securities used cash of $869.3 million during 2013 as compared to $1.08 billion during 2012 and $788.5 million during 2011. The net increase in loans and leases used cash of $284.8 million in 2013, $211.6 million in 2012 and $207.0 million in 2011. Net cash received in acquisitions was $50.0 million in 2013 and $61.8 million in 2012. No acquisitions were completed in 2011.

Financing activities provided cash of $145.6 million during 2013, $339.2 million during 2012 and $208.8 million during 2011. A net increase in deposit accounts provided cash of $101.4 million during 2013 compared to $384.6 million during 2012 and $176.1 million during 2011. Activity in short-term borrowings provided cash of $114.5 million during 2013 compared to using cash of $45.5 million during 2012 and providing cash of $34.2 million during 2011. Cash proceeds from other borrowings were $5.2 million during 2013 compared to $11.7 million during 2012 and $18.6 million during 2011. Repayment of other borrowings used cash of $66.9 million during 2013 compared to $6.8 million during 2012 and $8.3 million during 2011.

Management of investing and financing activities, and market conditions, determine the level and the stability of net interest cash flows. Management attempts to mitigate the impact of changes in market interest rates to the extent possible, so that balance sheet growth is the principal determinant of growth in net interest cash flows.

Our short-term borrowing balances are dependent on commercial cash management and smaller correspondent bank relationships and, as such, will normally fluctuate. We believe these balances, on average, to be stable sources of funds; however, we intend to rely on deposit growth and additional FHLB borrowings in the future.

In the event of short-term liquidity needs, the Bank Subsidiaries may purchase federal funds from each other or from correspondent banks and may also borrow from the Federal Reserve Bank. Additionally, the Bank Subsidiaries’ FHLB memberships give them the ability to borrow funds for short- and long-term purposes under a variety of programs.

Heartland's revolving credit agreement with an unaffiliated bank provides a maximum borrowing capacity of $20.0 million, of which no amount was borrowed at December 31, 2013. This credit agreement contains specific covenants, with which Heartland was in compliance on December 31, 2013.

EFFECTS OF INFLATION

Consolidated financial data included in this report has been prepared in accordance with U.S. generally accepted accounting principles. Presently, these principles require reporting of financial position and operating results in terms of historical dollars, except for available for sale securities, trading securities, derivative instruments, certain impaired loans and other real estate which require reporting at fair value. Changes in the relative value of money due to inflation or recession are generally not considered.

In management’s opinion, changes in interest rates affect the financial condition of a financial institution to a far greater degree than changes in the inflation rate. While interest rates are greatly influenced by changes in the inflation rate, they do not change at the same rate or in the same magnitude as the inflation rate. Rather, interest rate volatility is based on changes in the expected rate of inflation, as well as on changes in monetary and fiscal policies. A financial institution’s ability to be relatively unaffected by changes in interest rates is a good indicator of its capability to perform in today’s volatile economic environment. Heartland seeks to insulate itself from interest rate volatility by ensuring that rate-sensitive assets and rate-sensitive liabilities respond to changes in interest rates in a similar time frame and to a similar degree. See Item 7A of this Form 10-K for a discussion on the process Heartland utilizes to mitigate market risk.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the risk of loss arising from adverse changes in market prices and rates. Heartland's market risk is comprised primarily of interest rate risk resulting from its core banking activities of lending and deposit gathering. Interest rate risk measures the impact on earnings from changes in interest rates and the effect on current fair market values of Heartland's assets, liabilities and off-balance sheet contracts. The objective is to measure this risk and manage the balance sheet to avoid unacceptable potential for economic loss.

Management continually develops and applies strategies to mitigate market risk. Exposure to market risk is reviewed on a regular basis by the asset/liability committees of the banks and, on a consolidated basis, by Heartland's executive management and board of directors. Darling Consulting Group, Inc. has been engaged to provide asset/liability management position assessment and strategy formulation services to Heartland and its bank subsidiaries. At least quarterly, a detailed review of the balance sheet risk profile is performed for Heartland and each of its bank subsidiaries. Included in these reviews are interest rate sensitivity analyses, which simulate changes in net interest income in response to various interest rate scenarios. These analyses consider current portfolio rates, existing maturities, repricing opportunities and market interest rates, in addition to prepayments and growth under different interest rate assumptions. Selected strategies are modeled prior to implementation to determine their effect on Heartland's interest rate risk profile and net interest income. Management does not believe that Heartland's primary market risk exposures have changed significantly in 2013 when compared to 2012.

The core interest rate risk analysis utilized by Heartland examines the balance sheet under increasing and decreasing interest scenarios that are neither too modest nor too extreme. All rate changes are ramped over a 12-month horizon based upon a parallel shift in the yield curve and then maintained at those levels over the remainder of the simulation horizon. Using this approach, management is able to see the effect that both a gradual change of rates (year 1) and a rate shock (year 2 and beyond) could have on Heartland's net interest income. Starting balances in the model reflect actual balances on the “as of” date, adjusted for material and significant transactions. Pro-forma balances remain static. This enables interest rate risk embedded within the existing balance sheet structure to be isolated from the interest rate risk often caused by growth in assets and liabilities. Due to the low interest rate environment, the simulations under a decreasing interest rate scenario were prepared using a 100 basis point shift in rates. The most recent reviews at December 31, 2013, and 2012, provided the following results, in thousands:

	2013			2012		
	Net Interest Margin	% Change From Base		Net Interest Margin	% Change From Base	
Year 1						
Down 100 Basis Points	$172,488	(0.61	)%	$145,370	(0.57	)%
Base	$173,551			$146,203		
Up 200 Basis Points	$173,688	0.08	%	$148,611	1.65	%
Year 2						
Down 100 Basis Points	$165,098	(4.87	)%	$142,521	(2.52	)%
Base	$173,297	(0.15	)%	$146,591	0.27	%
Up 200 Basis Points	$181,179	4.40	%	$156,944	7.35	%

We use derivative financial instruments to manage the impact of changes in interest rates on our future interest income or interest expense. We are exposed to credit-related losses in the event of nonperformance by the counterparties to these derivative instruments, but believe we have minimized the risk of these losses by entering into the contracts with large, stable financial institutions. The estimated fair market values of these derivative instruments are presented in Note 12 to the consolidated financial statements.

We enter into financial instruments with off balance sheet risk in the normal course of business to meet the financing needs of our customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates and may require collateral from the borrower. Standby letters of credit are conditional commitments issued by Heartland to guarantee the performance of a customer to a third party up to a stated amount and with specified terms and conditions. These commitments to extend credit and standby letters of credit are not recorded on the balance sheet until the instrument is exercised.

Heartland holds a securities trading portfolio that would also be subject to elements of market risk. These securities are carried on the balance sheet at fair value. These securities had a carrying value of $1.8 million at December 31, 2013, and $380,000 at December 31, 2012, and in both cases were less than 1% of total assets.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA
HEARTLAND FINANCIAL USA, INC.
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except per share data)

	Notes	As of December 31, 2013	2012
ASSETS			
Cash and due from banks	3	$118,441	$160,223
Federal funds sold and other short-term investments		6,829	7,831
Cash and cash equivalents		125,270	168,054
Time deposits in other financial institutions		3,355	—
Securities:			
Trading, at fair value		1,801	380
Available for sale, at fair value (cost of $1,659,456 at December 31, 2013, and $1,456,821 at December 31, 2012)	4	1,633,902	1,490,331
Held to maturity, at cost (fair value of $237,437 at December 31, 2013, and $55,982 at December 31, 2012)	4	237,498	55,502
Other investments, at cost	4	21,843	15,744
Loans held for sale		46,665	96,165
Loans and leases receivable:	5		
Held to maturity		3,496,952	2,821,549
Loans covered by loss share agreements		5,749	7,253
Allowance for loan and lease losses	6	(41,685)	(38,715)
Loans and leases receivable, net		3,461,016	2,790,087
Premises, furniture and equipment, net	7	135,714	128,294
Other real estate, net		29,852	35,822
Goodwill	8	35,583	30,627
Other intangible assets, net	8	32,959	18,486
Cash surrender value on life insurance		81,110	75,480
FDIC indemnification asset		249	749
Other assets		76,899	84,832
TOTAL ASSETS		$5,923,716	$4,990,553
LIABILITIES AND EQUITY			
LIABILITIES:			
Deposits:	9		
Demand		$1,238,581	$974,232
Savings		2,535,242	2,004,438
Time		892,676	866,990
Total deposits		4,666,499	3,845,660
Short-term borrowings	10	408,756	224,626
Other borrowings	11	350,109	389,025
Accrued expenses and other liabilities		58,892	126,703
TOTAL LIABILITIES		5,484,256	4,586,014
STOCKHOLDERS' EQUITY:	16, 17, 18		
Preferred stock (par value $1 per share; authorized 20,604 shares; none issued or outstanding)		—	—
Series A Junior Participating preferred stock (par value $1 per share; authorized 16,000 shares; none issued or outstanding)		—	—

Series C Fixed Rate Non-Cumulative Perpetual preferred stock (par value $1 per share; liquidation value $81.7 million; authorized, issued and outstanding 81,698 shares)	81,698	81,698
Common stock (par value $1 per share; authorized 25,000,000 shares; issued 18,399,156 shares at December 31, 2013 and 16,827,835 shares at December 31, 2012)	18,399	16,828
Capital surplus	91,632	50,359
Retained earnings	265,067	236,279
Accumulated other comprehensive income (loss)	(17,336)	16,641
Treasury stock at cost (0 shares at both December 31, 2013 and December 31, 2012)	—	—
TOTAL STOCKHOLDERS' EQUITY	439,460	401,805
Noncontrolling interest	—	2,734
TOTAL EQUITY	439,460	404,539
TOTAL LIABILITIES AND EQUITY	$5,923,716	$4,990,553

See accompanying notes to consolidated financial statements.

HEARTLAND FINANCIAL USA, INC.
CONSOLIDATED STATEMENTS OF INCOME
(Dollars in thousands, except per share data)

	Notes	For the Years Ended December 31, 2013	2012	2011
INTEREST INCOME:				
Interest and fees on loans and leases	5	$164,702	$156,499	$149,603
Interest on securities:				
Taxable		21,501	22,129	28,195
Nontaxable		13,295	10,698	13,935
Interest on federal funds sold		1	4	3
Interest on interest bearing deposits in other financial institutions		12	8	1
TOTAL INTEREST INCOME		199,511	189,338	191,737
INTEREST EXPENSE:				
Interest on deposits	9	19,968	22,230	29,224
Interest on short-term borrowings		808	818	893
Interest on other borrowings (includes $2,069 of interest expense related to derivatives reclassified from accumulated other comprehensive income for the year ended December 31, 2013)		14,907	16,134	16,226
TOTAL INTEREST EXPENSE		35,683	39,182	46,343
NET INTEREST INCOME		163,828	150,156	145,394
Provision for loan and lease losses	6	9,697	8,202	29,365
NET INTEREST INCOME AFTER PROVISION FOR LOAN AND LEASE LOSSES		154,131	141,954	116,029
NONINTEREST INCOME:				
Service charges and fees		17,660	15,242	14,303
Loan servicing income		14,413	11,300	5,932
Trust fees		11,708	10,478	9,856
Brokerage and insurance commissions		4,561	3,702	3,511
Securities gains, net (includes $7,121 of net security gains reclassified from accumulated other comprehensive income for the year ended December 31, 2013)		7,121	13,998	13,104
Gain on trading account securities		1,421	47	89
Impairment loss on securities		—	(981)	—
Gains on sale of loans held for sale		27,430	49,198	11,366
Valuation adjustment on mortgage servicing rights		496	(477)	(19)
Income on bank owned life insurance		1,555	1,442	1,349
Other noninterest income		3,253	4,713	86
TOTAL NONINTEREST INCOME		89,618	108,662	59,577
NONINTEREST EXPENSES:				
Salaries and employee benefits	14, 16	118,224	105,727	75,537
Occupancy	15	13,459	10,629	9,363
Furniture and equipment	7	8,040	6,326	5,636
Professional fees		17,532	15,338	12,567
FDIC insurance assessments		3,544	3,292	3,777
Advertising		5,294	5,294	4,292
Intangible assets amortization	8	1,063	562	572
Net loss on repossessed assets		7,244	9,969	9,807
Other noninterest expenses		22,161	26,244	15,745

TOTAL NONINTEREST EXPENSES		196,561	183,381	137,296
INCOME BEFORE INCOME TAXES		47,188	67,235	38,310
Income taxes (includes $1,884 of income tax expense reclassified from accumulated other comprehensive income for the year ended December 31, 2013)	13	10,335	17,384	10,302
NET INCOME		36,853	49,851	28,008
Net (income) loss available to noncontrolling interest, net of tax		(64)	(59)	36
NET INCOME ATTRIBUTABLE TO HEARTLAND		36,789	49,792	28,044
Preferred dividends and discount		(1,093)	(3,400)	(7,640)
NET INCOME AVAILABLE TO COMMON STOCKHOLDERS		$35,696	$46,392	$20,404
EARNINGS PER COMMON SHARE - BASIC		$2.08	$2.81	$1.24
EARNINGS PER COMMON SHARE - DILUTED		$2.04	$2.77	$1.23
CASH DIVIDENDS DECLARED PER COMMON SHARE		$0.40	$0.50	$0.40

See accompanying notes to consolidated financial statements.

HEARTLAND FINANCIAL USA, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Dollars in thousands)

	For the Years Ended December 31,		
	2013	2012	2011
NET INCOME	$36,853	$49,851	$28,008
OTHER COMPREHENSIVE INCOME			
Securities:			
Net change in unrealized gain (loss) on securities	(50,883)	20,988	22,751
Reclassification adjustment for net gains realized in net income	(7,121)	(12,981)	(13,104)
Net change in non-credit related other than temporary impairment	95	(612)	—
Income taxes	22,119	(2,750)	(3,374)
Other comprehensive income (loss) on securities	(35,790)	4,645	6,273
Derivatives used in cash flow hedging relationships:			
Unrealized gain (loss) on derivatives	754	(2,204)	(6,053)
Reclassification adjustment for net losses on derivatives realized in net income	2,069	1,984	1,996
Income taxes	(1,010)	69	1,414
Other comprehensive income (loss) on cash flow hedges	1,813	(151)	(2,643)
Other comprehensive income (loss)	(33,977)	4,494	3,630
Comprehensive income	2,876	54,345	31,638
Less: comprehensive (income) loss attributable to noncontrolling interest	(64)	(59)	36
COMPREHENSIVE INCOME ATTRIBUTABLE TO HEARTLAND	$2,812	$54,286	$31,674

See accompanying notes to consolidated financial statements.

HEARTLAND FINANCIAL USA, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
(Dollars in thousands, except per share data)

	Heartland Financial USA, Inc. Stockholders' Equity							
	Preferred Stock	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Non-controlling Interest	Total Equity
Balance at January 1, 2011	$78,483	$16,612	$44,628	$184,525	$ 8,517	$(3,674)	$ 2,693	$331,784
Comprehensive income				28,044	3,630		(36)	31,638
Sale of noncontrolling interest							18	18
Cumulative preferred dividends accrued and discount accretion	3,215			(3,215)				—
Repurchase of Series B preferred stock and warrants	(81,698)		(1,800)					(83,498)
Issuance of Series C preferred stock	81,698							81,698
Cash dividends declared:								
Preferred, $50.00 per share				(4,606)				(4,606)
Common, $0.40 per share				(6,566)				(6,566)
Purchase of 54,723 shares of common stock						(389)		(389)
Issuance of 114,458 shares of common stock			(773)			2,309		1,536
Commitments to issue common stock			1,278					1,278
Balance at December 31, 2011	$81,698	$16,612	$43,333	$198,182	$ 12,147	$(1,754)	$ 2,675	$352,893
Balance at January 1, 2012	$81,698	$16,612	$43,333	$198,182	$ 12,147	$(1,754)	$ 2,675	$352,893
Comprehensive income				49,792	4,494		59	54,345

Cash dividends declared:								
Preferred, $36.60 per share				(3,400)				(3,400)
Common, $0.50 per share				(8,295)				(8,295)
Purchase of 131,326 shares of common stock						(2,937)		(2,937)
Issuance of 474,371 shares of common stock		216	4,872			4,691		9,779
Commitments to issue common stock			2,154					2,154
Balance at December 31, 2012	$81,698	$16,828	$50,359	$236,279	$ 16,641	$—	$ 2,734	$404,539
Balance at January 1, 2013	$81,698	$16,828	$50,359	$236,279	$ 16,641	$—	$ 2,734	$404,539
Comprehensive income				36,789	(33,977)		64	2,876
Cash dividends declared:								
Preferred, $13.39 per share				(1,093)				(1,093)
Common, $0.40 per share				(6,908)				(6,908)
Purchase of noncontrolling interest							(2,798)	(2,798)
Purchase of 76,755 shares of common stock						(2,102)		(2,102)
Issuance of 1,648,076 shares of common stock		1,571	39,445			2,102		43,118
Commitments to issue common stock			1,828					1,828
Balance at December 31, 2013	$81,698	$18,399	$91,632	$265,067	$ (17,336)	$—	$ —	$439,460

See accompanying notes to consolidated financial statements.

HEARTLAND FINANCIAL USA, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)

	For the Years Ended		
	December 31, 2013	December 31, 2012	December 31, 2011
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$36,853	$49,851	$28,008
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	17,240	14,141	11,184
Provision for loan and lease losses	9,697	8,202	29,365
Net amortization of premium on securities	29,355	22,858	14,939
Provision for deferred taxes	2,761	505	4,363
Securities gains, net	(7,121)	(13,998)	(13,104)
Increase in trading account securities	(1,421)	(47)	(89)
Impairment loss on securities	—	981	—
Stock based compensation	1,828	2,154	1,278
Write downs and losses on repossessed assets	2,799	6,953	7,079
Loans originated for sale	(1,381,319)	(1,572,117)	(479,221)
Proceeds on sales of loans held for sale	1,458,704	1,578,678	460,963
Net gains on sales of loans held for sale	(27,430)	(49,198)	(11,366)
(Increase) decrease in accrued interest receivable	243	(1,323)	1,397
Decrease in prepaid expenses	8,279	2,916	2,969
Decrease in accrued interest payable	(949)	(1,001)	(701)
Capitalization of mortgage servicing rights	(12,769)	(11,451)	(3,723)
Valuation adjustment on mortgage servicing rights	(496)	477	19
Other, net	(666)	10,117	5,124
NET CASH PROVIDED BY OPERATING ACTIVITIES	135,588	48,698	58,484
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of time deposits in other financial institutions	(3,605)	—	—
Proceeds from the sale of securities available for sale	546,532	576,083	493,167
Proceeds from the sale of other securities	5,588	4,694	—
Proceeds from the maturity of and principal paydowns on securities available for sale	222,881	288,736	295,137
Proceeds from the maturity of and principal paydowns on securities held to maturity	2,170	1,576	1,461
Proceeds from the maturity of time deposits and other investments	250	36	—
Purchase of securities available for sale	(861,967)	(1,076,962)	(788,543)
Purchase of other investments	(7,288)	(851)	—
Net increase in loans and leases	(284,843)	(211,565)	(207,027)
Purchase of bank owned life insurance policies	(2,835)	(4,571)	(3,140)
Capital expenditures	(10,481)	(19,787)	(6,719)
Net cash acquired	49,665	61,778	—
Proceeds from sale of equipment	137	460	—
Proceeds on sale of OREO and other repossessed assets	19,839	30,660	15,692
NET CASH USED BY INVESTING ACTIVITIES	(323,957)	(349,713)	(199,972)

HEARTLAND FINANCIAL USA, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS, CONTINUED
(Dollars in thousands)

	For the Years Ended December 31, 2013	December 31, 2012	December 31, 2011
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net increase in demand deposits and savings accounts	159,946	417,988	275,890
Net decrease in time deposit accounts	(58,548)	(33,339)	(99,825)
Net increase (decrease) in short-term borrowings	114,450	(45,455)	34,217
Proceeds from other borrowings	5,160	11,700	18,565
Repayments of other borrowings	(66,885)	(6,806)	(8,272)
Purchase of noncontrolling interest	(2,798)	—	—
Proceeds from issuance of preferred stock	—	—	81,698
Redemption of preferred stock	—	—	(81,698)
Redemption of warrants	—	—	(1,800)
Purchase of treasury stock	(2,102)	(2,937)	(389)
Proceeds from issuance of common stock	4,265	9,557	1,428
Excess tax benefits on exercised stock options	98	222	108
Dividends paid	(8,001)	(11,695)	(11,172)
NET CASH PROVIDED BY FINANCING ACTIVITIES	145,585	339,235	208,750
Net increase (decrease) in cash and cash equivalents	(42,784)	38,220	67,262
Cash and cash equivalents at beginning of year	168,054	129,834	62,572
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$125,270	$168,054	$129,834
Supplemental disclosures:			
Cash paid for income/franchise taxes	$5,459	$12,197	$7,133
Cash paid for interest	$36,632	$40,183	$47,044
Loans transferred to OREO	$14,531	$28,751	$41,933
Purchases of securities available for sale, accrued, not paid	$18,306	$61,923	$55,349
Securities transferred from available for sale to held to maturity	$179,528	$—	$—
Stock consideration granted for acquisition	$38,755	$—	$—

See accompanying notes to consolidated financial statements.

HEARTLAND FINANCIAL USA, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

ONE
SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations - Heartland Financial USA, Inc. ("Heartland") is a multi-bank holding company primarily operating full-service banking offices serving communities in and around Dubuque and Lee Counties in Iowa; Jo Daviess, Hancock, Winnebago, Whiteside and Mercer Counties in Illinois; Dane, Green, Sheboygan, Brown and Grant Counties in Wisconsin; Bernalillo, Curry and Santa Fe Counties in New Mexico; Maricopa County in Arizona; Flathead, Gallatin, Jefferson, Ravalli, Sanders, Sheridan and Yellowstone Counties in Montana; Broomfield, Adams and Boulder Counties in Colorado; Hennepin County in Minnesota; Johnson, Doniphan, Brown, Pottawatomie, and Atchison Counties in Kansas; and Jackson County in Missouri. The principal services of Heartland, through its subsidiaries, are FDIC-insured deposit accounts and related services, and loans to businesses and individuals. The loans consist primarily of commercial and commercial real estate, agricultural and agricultural real estate and residential real estate. In addition to the full-service banking offices, Heartland provides residential real estate loans, under the brand National Residential Mortgage, through loan production offices in San Diego, California; Reno, Nevada; Buffalo, Wyoming; Meridian, Idaho; Minot, North Dakota; Portland, Oregon; Seattle, Washington; and Omaha, Nebraska.

Principles of Presentation - The consolidated financial statements include the accounts of Heartland and its subsidiaries: Dubuque Bank and Trust Company; Galena State Bank & Trust Co.; Riverside Community Bank; Wisconsin Bank & Trust; New Mexico Bank & Trust; Arizona Bank & Trust; Rocky Mountain Bank; Summit Bank & Trust; Minnesota Bank & Trust; Morrill & Janes Bank and Trust Company; Citizens Finance Parent Co.; DB&T Insurance, Inc.; DB&T Community Development Corp.; Heartland Community Development, Inc.; Citizens Finance Co.; Citizens Finance of Illinois Co.; Heartland Financial Statutory Trust III; Heartland Financial Statutory Trust IV; Heartland Financial Statutory Trust V; Heartland Financial Statutory Trust VI; Heartland Financial Statutory Trust VII; Morrill Statutory Trust I; and Morrill Statutory Trust II. All of Heartland’s subsidiaries are wholly-owned as of December 31, 2013; prior to April 2013, Heartland had been an 80% owner of Minnesota Bank & Trust. All significant intercompany balances and transactions have been eliminated in consolidation. The noncontrolling interest in the majority-owned subsidiaries is noted on the consolidated balance sheets and on the consolidated statements of income.

The consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles and prevailing practices within the banking industry. In preparing such financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ significantly from those estimates. A material estimate that is particularly susceptible to significant change relates to the determination of the allowance for loan and lease losses.

Cash and Cash Equivalents - For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, federal funds sold and other short-term investments. Generally, federal funds are purchased and sold for one-day periods.

Trading Securities - Trading securities represent those securities Heartland intends to actively trade and are stated at fair value with changes in fair value reflected in noninterest income.

Securities Available for Sale - Available for sale securities consist of those securities not classified as held to maturity or trading, which management intends to hold for indefinite periods of time or that may be sold in response to changes in interest rates, prepayments or other similar factors. Available for sale securities are stated at fair value with any unrealized gain or loss, net of applicable income tax, reported as a separate component of stockholders' equity. Security premiums and discounts are amortized/accreted using the interest method over the period from the purchase date to the expected maturity or call date of the related security. Declines in the fair value of investment securities available for sale (with certain exceptions for debt securities noted below) that are deemed to be other-than-temporary are charged to earnings as a realized loss, and a new cost basis for the securities is established. In evaluating whether impairment is other-than-temporary, Heartland considers the length of time and extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and the intent and ability of Heartland to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value in the near term. Declines in the fair value of debt securities below amortized cost are deemed to be other-than-temporary in circumstances where: (1) Heartland has the intent to sell a security; (2) it is more likely than not that Heartland will be required to sell the security before recovery of its amortized cost basis; or (3) Heartland does not expect to recover the entire amortized cost basis of the security. If Heartland intends to sell a security or if it is more likely than not that Heartland will be required to sell the security before recovery, an other-than-temporary impairment write-down is recognized in earnings equal to the difference between the security's amortized cost basis and its fair value. If Heartland does not intend to sell the security and it is not more likely than not that it will be required to sell the security before recovery, the other-than-temporary impairment write-down is separated into an amount representing credit loss, which is recognized in noninterest income, and an amount related to all other factors, which is recognized in other comprehensive income. Realized securities gains or losses on securities sales (using specific identification method) and declines in value judged to be other-than-temporary are included in investment securities gains, net, in the consolidated statements of income.

Securities Held to Maturity - Securities which Heartland has the ability and positive intent to hold to maturity are classified as held to maturity. Such securities are stated at amortized cost, adjusted for premiums and discounts that are amortized/accreted using the interest method over the period from the purchase date to the expected maturity or call date of the related security. Unrealized losses determined to be other-than-temporary are charged to noninterest income.

Loans and Leases - Interest on loans is accrued and credited to income based primarily on the principal balance outstanding. Income from leases is recorded in decreasing amounts over the term of the contract resulting in a level rate of return on the lease investment. Heartland's policy is to discontinue the accrual of interest income on any loan or lease when, in the opinion of management, there is a reasonable doubt as to the timely collection of the interest and principal, normally when a loan or lease is 90 days past due. When interest accruals are deemed uncollectible, interest credited to income in the current year is reversed and interest accrued in prior years is charged to the allowance for loan and lease losses. Nonaccrual loans and leases are returned to an accrual status when, in the opinion of management, the financial position of the borrower indicates that there is no longer any reasonable doubt as to the timely payment of interest and principal.

Under Heartland's credit policies, a loan is impaired when, based on current information and events, it is probable that Heartland will be unable to collect all amounts due according to the contractual terms of the agreement. Loan impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, except where more practical, at the observable market price of the loan or the fair value of the collateral if the loan is collateral dependent.

Net nonrefundable loan and lease origination fees and certain direct costs associated with the lending process are deferred and recognized as a yield adjustment over the life of the related loan or lease.

Troubled Debt Restructured Loans - Loans are considered trouble debt restructured loans ("TDR") if concessions have been granted to borrowers that are experiencing financial difficulty. The concessions granted generally involve the modification of terms of the loan, such as changes in payment schedule or interest rate, which generally would not otherwise be considered. TDRs can involve loans remaining on nonaccrual, moving to nonaccrual, or continuing on accrual status, depending on the individual facts and circumstances of the borrower. Nonaccrual TDRs are included and treated consistently with all other nonaccrual loans. In addition, all accruing TDRs are reported and accounted for as impaired loans. Generally, TDRs remain on nonaccrual until the customer has attained a sustained period of repayment performance under the modified loan terms (generally a minimum of six months). However, performance prior to the restructuring, or significant events that coincide with the restructuring, are considered in assessing whether the borrower can meet the new terms and whether the loan should be returned to or maintained on accrual status. If the borrower's ability to meet the revised payment schedule is not reasonably assured, the loan remains on nonaccrual status.

A loan that is a TDR that has an interest rate consistent with market rates at the time of restructuring and is in compliance with its modified terms in the calendar year after the year in which the restructuring took place is no longer considered a TDR. To be considered in compliance with its modified terms, a loan that is a TDR must be in accrual status and must be current or less than 30 days past due under the modified repayment terms; however, the loan will continue to be considered impaired. A loan that has been modified at a below market rate will remain classified as a TDR and an impaired loan. If the borrower’s financial conditions improve to the extent that the borrower qualifies for a new loan with market terms, the new loan will not be considered a TDR or impaired if Heartland's credit analysis shows the borrower's ability to perform under the new market terms.

Loans Held for Sale - Loans held for sale are stated at the lower of cost or fair value on an aggregate basis. Gains or losses on sales are recorded in noninterest income. Direct loan origination costs and fees are deferred at origination of the loan. These deferred costs and fees are recognized in noninterest income as part of the gain or loss on sales of loans upon sale of the loan.

Mortgage Servicing and Transfers of Financial Assets - Heartland regularly sells residential mortgage loans to others on a non-recourse basis. Sold loans are not included in the accompanying consolidated balance sheets. Heartland generally retains the right to service the sold loans for a fee. At December 31, 2013 and 2012, Heartland was servicing loans for others with aggregate unpaid principal balances of $3.05 billion and $2.20 billion, respectively.

Allowance for Loan and Lease Losses - The allowance for loan and lease losses is maintained at a level estimated by management to provide for known and inherent risks in the loan and lease portfolios. The allowance is based upon a continuing review of past loan and lease loss experience, current economic conditions, volume growth, the underlying collateral value of the loans and leases and other relevant factors. Loans and leases which are deemed uncollectible are charged off and deducted from the allowance. Provisions for loan and lease losses and recoveries on previously charged-off loans and leases are added to the allowance.

Reserve for Unfunded Commitments - This reserve is maintained at a level that, in the opinion of management, is adequate to absorb probable losses associated with Heartland’s commitment to lend funds under existing agreements such as letters or lines of credit. Management determines the adequacy of the reserve for unfunded commitments based upon reviews of delinquencies, current economic conditions, the risk characteristics of the various categories of commitments and other relevant factors. The reserve is based on estimates, and ultimate losses may vary from the current estimates. These estimates are evaluated on a regular basis and, as adjustments become necessary, they are reported in earnings in the periods in which they become known. Draws on unfunded commitments that are considered uncollectible at the time funds are advanced are charged to the allowance. Provisions for unfunded commitment losses are added to the reserve for unfunded commitments, which is included in the Accrued Expenses and Other Liabilities section of the consolidated balance sheets.

Premises, Furniture and Equipment - Premises, furniture and equipment are stated at cost less accumulated depreciation. The provision for depreciation of premises, furniture and equipment is determined by straight-line and accelerated methods over the estimated useful lives of 18 to 39 years for buildings, 15 years for land improvements and 3 to 7 years for furniture and equipment.

Other Real Estate - Other real estate represents property acquired through foreclosures and settlements of loans. Property acquired is recorded at the estimated fair value of the property less disposal costs. The excess of carrying value over fair value less disposal costs is charged against the allowance for loan and lease losses. Subsequent write downs estimated on the basis of later valuations, gains or losses on sales and net expenses incurred in maintaining such properties are charged to other noninterest expense.

Goodwill and Intangible Assets - Intangible assets consist of goodwill, core deposit intangibles, customer relationship intangibles and mortgage servicing rights. Goodwill represents the excess of the purchase price of acquired subsidiaries’ net assets over their fair value. Heartland assesses goodwill for impairment annually, and more frequently if events occur which may indicate possible impairment, and assesses goodwill at the reporting unit level, also giving consideration to overall enterprise value as part of that assessment. In evaluating goodwill for impairment, Heartland first assesses qualitative factors to determine whether it is more likely than not (that is, a likelihood of more than 50%) that the fair value of a reporting unit is less than its carrying amount. If Heartland concludes that it is more likely than not that the fair value of a reporting unit is more than its carrying value, then no further testing of goodwill assigned to the reporting unit is required. However, if Heartland concludes that it is more likely than not that the fair value of a reporting unit is less than its carrying value, then Heartland performs a two-step goodwill impairment test to identify potential goodwill impairment and measure the amount of goodwill impairment to recognize, if any. In the first step, the fair value of a reporting unit is compared to its carrying amount, including goodwill. If the fair value of the reporting unit exceeds its carrying amount, goodwill is not considered impaired and it is not necessary to continue to step two of the impairment process. If the fair value of the reporting unit is less than the carrying amount, step two is performed. In step two, the implied fair value of goodwill is compared to the carrying value of the reporting unit's goodwill. The implied fair value of goodwill is computed as a residual value after allocating the fair value of the reporting unit to its assets and liabilities. Heartland estimates the fair value of its reporting units using market multiples of comparable entities, including recent transactions, or a combination of market multiples and discounted cash flow methodology. These methods incorporate assumptions specific to the entity, such as the use of financial forecasts.

Core deposit intangibles are amortized over eight to eighteen years on an accelerated basis. Customer relationship intangibles are amortized over 22 years on an accelerated basis. Periodically, Heartland reviews the intangible assets for events or circumstances that may indicate a change in the recoverability of the underlying basis, except mortgage servicing rights which are reviewed quarterly.

Mortgage servicing rights associated with loans originated and sold, where servicing is retained, are initially capitalized at fair value and recorded on the consolidated statements of income as a component of loan servicing income. The values of these capitalized servicing rights are amortized as an offset to the servicing revenue earned in relation to the servicing revenue expected to be earned. The carrying values of these rights are reviewed quarterly for impairment based on the calculation of their fair value as performed by an outside third party. For purposes of measuring impairment, the rights are stratified into certain risk characteristics including loan type, note rate, prepayment trends and external market factors. Valuation allowances of $0 and $496,000 were required as of December 31, 2013 and December 31, 2012, respectively.

Bank-Owned Life Insurance - Heartland and its subsidiaries have purchased life insurance policies on the lives of certain officers. The one-time premiums paid for the policies, which coincide with the initial cash surrender value, are recorded as an asset. Increases or decreases in the cash surrender value, other than proceeds from death benefits, are recorded as noninterest income (loss). Proceeds from death benefits first reduce the cash surrender value attributable to the individual policy and then any additional proceeds are recorded as noninterest income.

Income Taxes - Heartland and its subsidiaries file a consolidated federal income tax return and separate or combined income or franchise tax returns as required by the various states. Heartland recognizes certain income and expenses in different time periods for financial reporting and income tax purposes. The provision for deferred income taxes is based on an asset and liability approach and represents the change in deferred income tax accounts during the year, including the effect of enacted tax rate changes. A valuation allowance is provided to reduce deferred tax assets if their expected realization is deemed not to be more likely than not.

A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. Heartland recognizes interest and penalties related to income tax matters in income tax expense.

Derivative Financial Instruments - Heartland uses derivative financial instruments as part of its interest rate risk management, including interest rate swaps, caps, floors, collars and certain interest rate lock commitments and forward sales of securities related to mortgage banking activities. FASB Accounting Standards Codification (ASC) Topic 815 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. As required by ASC 815, Heartland records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative and the resulting designation. Derivatives used to hedge the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. To qualify for hedge accounting, Heartland must comply with the detailed rules and documentation requirements at the inception of the hedge, and hedge effectiveness is assessed at inception and periodically throughout the life of each hedging relationship. Hedge ineffectiveness, if any, is measured periodically throughout the life of the hedging relationship.

For derivatives designated as cash flow hedges, the effective portion of changes in the fair value of the derivative is initially reported in other comprehensive income and subsequently reclassified to interest income or expense when the hedged transaction affects earnings, while the ineffective portion of changes in the fair value of the derivative, if any, is recognized immediately in other noninterest income. Heartland assesses the effectiveness of each hedging relationship by comparing the cumulative changes in cash flows of the derivative hedging instrument with the cumulative changes in cash flows of the designated hedged item or transaction. No component of the change in the fair value of the hedging instrument is excluded from the assessment of hedge effectiveness.

Heartland had no fair value hedging relationships at December 31, 2013 or 2012. Derivatives not qualifying for hedge accounting, classified as free-standing derivatives, have all changes in the fair value recorded on the consolidated statements of income through noninterest income.

Heartland does not use derivatives for trading or speculative purposes. Derivatives not designated as hedges are not speculative and are used to manage Heartland’s exposure to interest rate movements and other identified risks, but do not meet the strict hedge accounting requirements of ASC 815.

Segment Reporting - Public business enterprises are required to report information about operating segments in financial statements and selected information about operating segments in financial reports issued to shareholders. Operating segments are components of an enterprise about which separate financial information is available that is evaluated regularly by management in determining how to allocate resources and to assess effectiveness of the segments' performance. Generally, financial information is required to be reported on the basis that is used internally for evaluating segment performance and deciding how to allocate resources to segments. Heartland has two reporting segments, one for community banking and one for mortgage banking operations.

Rate Lock Commitments - Through its mortgage banking activities, Heartland commits to originate mortgage loans whereby the interest rate on the loan is determined prior to funding (i.e. rate lock commitments). These commitments that relate to loans that will be sold to third parties when funded are accounted for as derivative instruments. The period of time between the issuance of a loan commitment and closing and sale of the loan generally ranges between 15 to 90 days. Heartland protects itself from changes in interest rates by entering into loan purchase agreements with third party investors that provide for the investor to purchase loans at the same terms, including interest rate, as committed to the borrower. Under the contractual relationship with these third party investors, Heartland is obligated to sell the loan to the investor, and the investor is obligated to buy the loan, only if the loan closes. No other obligation exists. Heartland is not exposed to losses nor will it realize gains related to its rate lock commitments due to changes in interest rates as a result of these contractual relationships with third party investors.

Fair Value Measurements - Fair value represents the estimated price at which an orderly transaction to sell an asset or transfer a liability would take place between market participants at the measurement date under current market conditions (i.e. an exit price concept). Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using discounted cash flow or other valuation techniques. Inputs into the valuation methods are subjective in nature, involve uncertainties, and require significant judgment and therefore cannot be determined with precision. Accordingly, the derived fair value estimates presented herein are not necessarily indicative of the amounts Heartland could realize in a current market exchange. Assets and liabilities are categorized into three levels based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine the fair value. In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy in which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. Heartland's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability. Below is a brief description of each fair value level:
Level 1 — Valuation is based upon quoted prices for identical instruments in active markets.

Level 2 — Valuation is based upon quoted prices for similar instruments in active markets, or similar instruments in markets that are not active, and model-based valuation techniques for all significant assumptions are observable in the market.

Level 3 — Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

Treasury Stock - Treasury stock is accounted for by the cost method, whereby shares of common stock reacquired are recorded at their purchase price. When treasury stock is reissued, any difference between the sales proceeds, or fair value when issued for business combinations, and the cost is recognized as a charge or credit to capital surplus.

Trust Department Assets - Property held for customers in fiduciary or agency capacities is not included in the accompanying consolidated balance sheets, as such items are not assets of the Heartland banks.

Earnings Per Share - Basic earnings per share is determined using net income available to common stockholders and weighted average common shares outstanding. Diluted earnings per share is computed by dividing net income available to common stockholders by the weighted average common shares and assumed incremental common shares issued. Amounts used in the determination of basic and diluted earnings per share for the years ended December 31, 2013, 2012 and 2011, are shown in the table below:

(Dollars and number of shares in thousands, except per share data)	2013	2012	2011
Net income attributable to Heartland	$36,789	$49,792	$28,044
Preferred dividends and discount	(1,093)	(3,400)	(7,640)
Net income available to common stockholders	$35,696	$46,392	$20,404
Weighted average common shares outstanding for basic earnings per share	17,199	16,518	16,437
Assumed incremental common shares issued upon exercise of stock options	261	251	139
Weighted average common shares for diluted earnings per share	17,460	16,769	16,576
Earnings per common share — basic	$2.08	$2.81	$1.24
Earnings per common share — diluted	$2.04	$2.77	$1.23
Number of antidilutive stock options excluded from diluted earnings per share computation	99	106	514

Effect of New Financial Accounting Standards - In July 2012, the FASB issued ASU No. 2012-02, "Testing Indefinite-Lived Intangible Assets for Impairment," which permits an entity to make a qualitative assessment to determine whether it is more likely than not that an indefinite-lived intangible asset, other than goodwill, is impaired. Currently, entities are required to quantitatively test indefinite-lived intangible assets for impairment at least annually and more frequently if indicators of impairment exist. Under the new standard, if an entity concludes, based on an evaluation of all relevant qualitative factors, that it is not more likely than not that the fair value of an indefinite-lived intangible asset is less than its carrying amount, it will not be required to perform the quantitative impairment test for that asset. Heartland adopted this standard on January 1, 2013, and the adoption did not have an impact on the results of operations, financial position and liquidity.

In September 2012, the FASB issued ASU No. 2012-06, "Subsequent Accounting for an Indemnification Asset Recognized at the Acquisition Date as a Result of a Government-Assisted Acquisition of a Financial Institution," to address diversity in practice about how to subsequently measure an indemnification asset for a government-assisted acquisition that includes a loss-sharing agreement. This accounting standards update requires a reporting entity to account for a change in the subsequent measurement of the indemnification asset on the same basis as the changes in the asset subject to indemnification. Heartland adopted this standard on January 1, 2013, and the adoption did not have a material impact on the accounting for its loss share receivable from the FDIC under its various loss share agreements.

In February 2013, the FASB issued ASU No. 2013-02, "Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income," to address further disclosure of reclassification amounts out of other comprehensive income. The guidance requires that a reporting entity present, either in a single note or parenthetically on the face of the financial statements, the effect of significant amounts reclassified from each component of accumulated other comprehensive income based on its source and income statement line items affected by the reclassification. Heartland adopted this standard on January 1, 2013, and the adoption did not have an impact on the results of operations, financial position and liquidity.

In July 2013, the FASB issued ASU No. 2013-11, "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists," to eliminate the diversity in practice and to increase the comparability of financial statements among companies. The guidance requires that a reporting entity generally must show an unrecognized tax benefit, or a portion of an unrecognized tax benefit, for a net operating loss, or NOL, carryforward, similar tax loss or tax credit carryforward as a reduction of a deferred tax asset. However, the entity should present the unrecognized tax benefit as a liability and not as a reduction of a deferred tax asset if the carryforward or tax loss is not available on the financial statement date to settle any additional income tax liability that would result from the disallowance of the tax position under the applicable tax law, or the applicable tax law does not require the company to use, and the company does not intend to use, the carryforward or tax loss to settle additional income taxes resulting from the disallowance of the tax position. The guidance does not require any new recurring disclosures because it does not affect the recognition or measurement of uncertain tax positions. The new standard is effective for fiscal years, and interim periods within those years, beginning after December 15, 2013, and should be applied prospectively to all unrecognized tax benefits that exist at the effective date. Early adoption and retrospective application are both permitted. Heartland does not expect the adoption of this standard to have a material impact on the results of operations, financial position, and liquidity.

In January 2014, the FASB issued ASU 2014-01, "Accounting for Investments in Qualified Affordable Housing Projects." The amendments in ASU 2014-01 to Topic 323, "Equity Investments and Joint Ventures," provide guidance on accounting for investments by a reporting entity in flow-through limited liability entities that manage or invest in affordable housing projects that qualify for the low-income housing tax credit. The amendments permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit). The amendments are effective for fiscal years, and interim periods within those years, beginning after December 31, 2014 and should be applied retrospectively to all periods presented. Early adoption is permitted. Heartland is in the process of evaluating the impact that adoption of this guidance will have on the results of operations, financial position, and liquidity.

In January 2014, the FASB issued ASU 2014-04, "Receivables-Troubled Debt Restructurings by Creditors: Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans Upon Foreclosure." The amendments in ASU 2014-04 clarify that an in-substance foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (i) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (ii) the borrower conveying all interest in the residential real estate property to the creditor to satisfy the loan through completion of a deed in lieu of foreclosure or similar legal agreement. ASU 2014-04 also requires disclosure of both the amount of foreclosed residential real estate property held by the creditor and the recorded investment in loans collateralized by residential real estate property that are in the process of foreclosure. The amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2014, with early adoption permitted. Once adopted, an entity can elect either (i) a modified retrospective transition method or (ii) a prospective transition method. The modified retrospective transition method is applied by means of a cumulative-effect adjustment to residential mortgage loans and foreclosed residential real estate properties existing as of the beginning of the period for which the amendments of ASU 2014-04 are effective, with real estate reclassified to loans measured at the carrying value of the real estate at the date of adoption and loans reclassified to real estate measured at the lower of net carrying value of the loan or the fair value of the real estate less costs to sell at the date of adoption. The prospective transition method is applied by means of applying the amendments of ASU 2014-04 to all instances of receiving physical possession of residential real estate properties that occur after the date of adoption. Heartland does not expect the adoption of this standard to have a material impact on the results of operations, financial position, and liquidity.

TWO
ACQUISITIONS

On October 18, 2013, Heartland completed the purchase of Morrill Bancshares, Inc., the holding company of Morrill & Janes Bank and Trust Company. ("Morrill")., based in Merriam, Kansas. Under the terms of the purchase agreement, the aggregate purchase price, which was based upon the September 30, 2013 tangible book value of Morrill Bancshares, Inc., was approximately $55.4 million, $16.6 million or 30% of which was paid in cash, and $38.8 million or 70% of which was paid by delivery of 1,402,431 shares of Heartland common stock. The transaction included, at fair value, total assets of $810.8 million, loans of $377.7 million, and deposits of $665.3 million. Morrill operates as Heartland's tenth independent, state-chartered, bank subsidiary under its current name and management team.

The assets and liabilities of Morrill were recorded on the consolidated balance sheet at estimated fair value on the acquisition date. The following table represents, in thousands, the amounts recorded on the consolidated balance sheet as of October 18, 2013:

	As of October 18, 2013
Fair value of consideration paid	
Common Stock (1,402,431 shares)	$38,755
Cash	16,619
Total consideration paid	55,374
Fair value of assets acquired	
Cash and due from banks	61,316
Securities:	
Securities available for sale	339,362
Securities held to maturity	3,086
Other securities	4,139
Loans held for sale	97
Loans held to maturity	377,565
Premises, furniture and equipment, net	4,867
Other real estate, net	1,296
Other intangible assets, net	8,694
Other assets	5,389
Total assets	805,811
Fair value of liabilities assumed	
Deposits	665,297
Short term borrowings	62,450
Other borrowings	22,809
Other liabilities	4,837
Total liabilities assumed	755,393
Fair value of net assets acquired	50,418
Goodwill resulting from acquisition	$4,956

Heartland recognized goodwill of $5.0 million which is calculated as the excess of both the consideration exchanged and the liabilities assumed as compared to the fair value of identifiable assets acquired. Goodwill resulted from expected operational synergies, an enhanced market area, cross-selling opportunities, and expanded product lines. See Note 8 for further information on goodwill.

Pro Forma Information: The following pro forma information presents the results of operations for the year ended December 31, 2013 as if the Morrill acquisition occurred on January 1, 2012. The Freedom acquisition and acquisitions in 2012 are not deemed to be significant and are therefore excluded from the pro forma information in the table below:

(Dollars in thousands, except per share data)

	December 31, 2013	December 31, 2012
Net interest income	$181,310	$168,475
Net income	$39,043	$52,052
Basic earnings per share	$2.27	$3.15
Diluted earnings per share	$2.24	$3.10

The above pro forma results are presented for illustrative purposes and are not intended to represent or be indicative of the actual results of operations of the merged companies that would have been achieved had the acquisition occurred at January 1, 2012, nor are they intended to represent or be indicative of future results of operations. The pro forma results do not include expected operating cost savings as a result of the acquisition. These pro forma results require significant estimates and judgments particularly as it relates to valuation and accretion of income associated with the acquired loans.

Heartland incurred $466,000 of pre-tax merger related expenses in 2013. The merger expenses are reflected on the consolidated income statement for the applicable period and are reported primarily in the categories of salaries and benefits and professional fees.

Acquired loans were preliminarily recorded at fair value based on a discounted cash flow valuation methodology that considers, among other things, projected default rates, loss given defaults, and recovery rates. No allowance for credit losses was carried over from the acquisition. The balance of nonaccrual loans at acquisition date was $688,000.

On November 22, 2013, Heartland acquired Freedom Bank ("Freedom") in Sterling, Illinois, from its parent company, River Valley Bancorp, Inc., a Davenport, Iowa-based bank holding company. The acquisition was arranged through a negotiated transfer of ownership with Dubuque Bank and Trust Company. The transaction included, at fair value, total assets of $67.1 million, loans of $39.3 million, and deposits of $54.1 million at acquisition date. On March 7, 2014, Dubuque Bank and Trust Company transferred the shares of Freedom, with no stock or cash consideration paid, to Heartland, and Freedom was simultaneously merged with Riverside Community Bank subsidiary by dividend.

On July 13, 2012, Heartland completed the purchase of three retail banking offices from Liberty Bank, FSB ("Liberty Bank") in its Dubuque, Iowa market. The purchase was completed through Heartland's Dubuque Bank and Trust Company subsidiary. It included deposits of $53.8 million and loans of $9.4 million.

On November 16, 2012, Heartland completed the purchase of First Shares, Inc. ("FSI"), the bank holding company for the First National Bank of Platteville in Platteville, Wisconsin. Simultaneous with the closing of the transaction, First National Bank of Platteville merged into Heartland's Wisconsin Bank & Trust subsidiary. Under the terms of the agreement, the outstanding shares of FSI were converted into a combination of cash and shares of Heartland common stock, with stock consideration totaling 60% of the $10.5 million purchase price. The transaction included, at fair value, total assets of $128.0 million, loans of $84.9 million and deposits of $114.2 million.

On December 7, 2012, Heartland completed the purchase of Heritage Bank, N.A. ("Heritage") located in Phoenix, Arizona. Heartland acquired Heritage in an all-cash transaction valued at approximately $15.6 million. The transaction included, at fair value, assets of $109.1 million, loans of $63.4 million and deposits of $83.3 million. Heritage Bank merged with Heartland's Arizona Bank & Trust subsidiary on March 15, 2013.

THREE
CASH AND DUE FROM BANKS

The Heartland banks are required to maintain certain average cash reserve balances as a non-member bank of the Federal Reserve System. The reserve balance requirements at December 31, 2013 and 2012, were $28.7 million and $12.1 million, respectively.

FOUR
SECURITIES

The amortized cost, gross unrealized gains and losses and estimated fair values of securities available for sale as of December 31, 2013, and December 31, 2012, are summarized in the table below, in thousands:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
December 31, 2013				
Securities available for sale:				
U.S. government corporations and agencies	$220,157	$147	$(2,001)	$218,303
Mortgage-backed securities	1,156,983	9,538	(22,574)	1,143,947
Obligations of states and political subdivisions	277,320	1,706	(12,402)	266,624
Total debt securities	1,654,460	11,391	(36,977)	1,628,874
Equity securities	4,996	32	—	5,028
Total	$1,659,456	$11,423	$(36,977)	$1,633,902
December 31, 2012				
Securities available for sale:				
U.S. government corporations and agencies	$21,002	$443	$(1)	$21,444
Mortgage-backed securities	1,027,234	19,002	(10,035)	1,036,201
Obligations of states and political subdivisions	403,077	23,560	(192)	426,445
Total debt securities	1,451,313	43,005	(10,228)	1,484,090
Equity securities	5,508	733	—	6,241
Total	$1,456,821	$43,738	$(10,228)	$1,490,331

At both December 31, 2013, and December 31, 2012, the amortized cost of the available for sale securities is net of $184,000 of credit related other-than-temporary impairment ("OTTI").

The amortized cost, gross unrealized gains and losses and estimated fair values of held to maturity securities as of December 31, 2013, and December 31, 2012, are summarized in the table below, in thousands:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
December 31, 2013				
Securities held to maturity:				
Mortgage-backed securities	$5,973	$199	$(321)	$5,851
Obligations of states and political subdivisions	231,525	5,801	(5,740)	231,586
Total	$237,498	$6,000	$(6,061)	$237,437
December 31, 2012				
Securities held to maturity:				
Mortgage-backed securities	$7,040	$492	$(12)	$7,520
Obligations of states and political subdivisions	48,462	—	—	48,462
Total	$55,502	$492	$(12)	$55,982

During the fourth quarter of 2013, Heartland transferred $180.9 million of bank qualified municipal bonds from available for sale to held to maturity. The bonds were transferred at fair value at the date of transfer.

At December 31, 2013, the amortized cost of the held to maturity securities is net of $797,000 of credit related OTTI and $517,000 of non-credit related OTTI. At December 31, 2012, the amortized cost of the held to maturity securities is net of $797,000 of credit related OTTI and $612,000 of non credit related OTTI.

Approximately 87% of Heartland's mortgage-backed securities are issuances of government-sponsored enterprises.

The amortized cost and estimated fair value of debt securities available for sale at December 31, 2013, and December 31, 2012, by contractual maturity are as follows, in thousands. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without penalties.

	December 31, 2013	
	Amortized Cost	Estimated Fair Value
Due in 1 year or less	$12,780	$12,900
Due in 1 to 5 years	151,326	151,445
Due in 5 to 10 years	102,100	99,828
Due after 10 years	231,271	220,754
Total debt securities	497,477	484,927
Mortgage-backed securities	1,156,983	1,143,947
Equity securities	4,996	5,028
Total investment securities	$1,659,456	$1,633,902

	December 31, 2012	
	Amortized Cost	Estimated Fair Value
Due in 1 year or less	$4,266	$4,320
Due in 1 to 5 years	44,947	46,912
Due in 5 to 10 years	55,943	59,506
Due after 10 years	318,923	337,151
Total debt securities	424,079	447,889
Mortgage-backed securities	1,027,234	1,036,201
Equity securities	5,508	6,241
Total investment securities	$1,456,821	$1,490,331

The amortized cost and estimated fair value of debt securities held to maturity at December 31, 2013, and December 31, 2012, by contractual maturity are as follows, in thousands. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without penalties.

	December 31, 2013	
	Amortized Cost	Estimated Fair Value
Due in 1 year or less	$—	$—
Due in 1 to 5 years	—	—
Due in 5 to 10 years	53,121	55,019
Due after 10 years	178,404	176,567
Total debt securities	231,525	231,586
Mortgage-backed securities	5,973	5,851
Total investment securities	$237,498	$237,437

	December 31, 2012	
	Amortized Cost	Estimated Fair Value
Due in 1 year or less	$—	$—
Due in 1 to 5 years	510	510
Due in 5 to 10 years	11,638	11,638
Due after 10 years	36,314	36,314
Total debt securities	48,462	48,462
Mortgage-backed securities	7,040	7,520
Total investment securities	$55,502	$55,982

As of December 31, 2013, securities with a fair value of $779.0 million were pledged to secure public and trust deposits, short-term borrowings and for other purposes as required by law.

Gross gains and losses realized related to sales of securities available for sale for the years ended December 31, 2013, 2012, and 2011 are summarized as follows, in thousands:

	2013	2012	2011
Available for Sale Securities sold:			
Proceeds from sales	$546,532	$576,083	$493,167
Gross security gains	8,895	15,387	15,302
Gross security losses	1,774	1,389	2,198

The following tables summarize, in thousands, the amount of unrealized losses, defined as the amount by which cost or amortized cost exceeds fair value, and the related fair value of investments with unrealized losses in Heartland's securities portfolio as of December 31, 2013, and December 31, 2012. The investments were segregated into two categories: those that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 or more months. The reference point for determining how long an investment was in an unrealized loss position was December 31, 2013, and December 31, 2012, respectively. Securities for which Heartland has taken credit-related OTTI write-downs are categorized as being "less than 12 months" or "12 months or longer" in a continuous loss position based on the point in time that the fair value declined to below the cost basis and not the period of time since the credit-related OTTI write-down.

Securities available for sale	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2013						
U.S. government corporations and agencies	$196,345	$(2,001)	$—	$—	$196,345	$(2,001)
Mortgage-backed securities	640,684	(17,064)	118,229	(5,510)	758,913	(22,574)
Obligations of states and political subdivisions	196,987	(11,452)	10,714	(950)	207,701	(12,402)
Total temporarily impaired securities	$1,034,016	$(30,517)	$128,943	$(6,460)	$1,162,959	$(36,977)
December 31, 2012						
U.S. government corporations and agencies	$1,517	$(1)	$—	$—	$1,517	$(1)
Mortgage-backed securities	332,842	(9,121)	24,489	(914)	357,331	(10,035)
Obligations of states and political subdivisions	22,503	(192)	—	—	22,503	(192)
	$356,862	$(9,314)	$24,489	$(914)	$381,351	$(10,228)

Total temporarily impaired securities

Securities held to maturity	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2013						
Mortgage-backed securities	$2,170	$(319)	$834	$(2)	$3,004	$(321)
Obligations of states and political subdivisions	47,175	(3,508)	21,505	(2,232)	68,680	(5,740)
Total temporarily impaired securities	$49,345	$(3,827)	$22,339	$(2,234)	$71,684	$(6,061)
December 31, 2012						
Mortgage-backed securities	$—	$—	$3,296	$(12)	$3,296	$(12)
Obligations of states and political subdivisions	—	—	—	—	—	—
Total temporarily impaired securities	$—	$—	$3,296	$(12)	$3,296	$(12)

Heartland reviews the investment securities portfolio on a quarterly basis to monitor its exposure to OTTI. A determination as to whether a security's decline in fair value is other-than-temporary takes into consideration numerous factors and the relative significance of any single factor can vary by security. Some factors Heartland may consider in the OTTI analysis include the length of time the security has been in an unrealized loss position, changes in security ratings, financial condition of the issuer, as well as security and industry specific economic conditions. In addition, with regard to debt securities, Heartland may also evaluate payment structure, whether there are defaulted payments or expected defaults, prepayment speeds, and the value of any underlying collateral. For certain debt securities in unrealized loss positions, Heartland prepares cash flow analyses to compare the present value of cash flows expected to be collected from the security with the amortized cost basis of the security. During the first quarter of 2012, Heartland experienced deterioration in the credit support on three private label mortgage-backed securities which resulted in a credit-related OTTI loss. The underlying collateral on these securities experienced an increased level of defaults and a slowing of voluntary prepayments causing the present value of the forward expected cash flows, using prepayment and default vectors, to be below the amortized cost basis of the securities. Based on Heartland's evaluation, a $981,000 OTTI on three private label mortgage-backed securities attributable to credit-related losses was recorded in March 2012. The other-than-temporary credit-related losses were $797,000 in the held to maturity category and $184,000 in the available for sale category. Heartland had not previously recorded an OTTI loss on debt securities.

The remaining unrealized losses on Heartland's mortgage-backed securities are the result of changes in market interest rates or widening of market spreads subsequent to the initial purchase of the securities and not related to concerns regarding the underlying credit of the issuers or the underlying collateral. It is expected that the securities will not be settled at a price less than the amortized cost of the investment. Because the decline in fair value is attributable to changes in interest rates or widening market spreads and not credit quality, and because Heartland has the intent and ability to hold these investments until a market price recovery or to maturity and does not believe it will be required to sell the securities before maturity, these investments are not considered other-than-temporarily impaired.

Unrealized losses on Heartland's obligations of states and political subdivisions are the result of changes in market interest rates or widening of market spreads subsequent to the initial purchase of the securities. Management monitors the published credit ratings of these securities and the stability of the underlying municipalities. Because the decline in fair value is attributable to changes in interest rates or widening market spreads due to insurance company downgrades and not underlying credit quality, and because Heartland has the intent and ability to hold these investments until a market price recovery or to maturity and does not believe it will be required to sell the securities before maturity, these investments are not considered other-than-temporarily impaired.

There were no gross realized gains or losses on the sale of available for sale securities with OTTI write-downs for the periods ended December 31, 2013 or December 31, 2012.

The following table shows the detail of total OTTI write-downs included in earnings, in thousands:

	For the Years Ended December 31,		
	2013	2012	2011
OTTI write-downs included in earnings:			
Available for sale debt securities:			
Mortgage-backed securities	$—	$184	$—
Held to maturity debt securities:			
Mortgage-backed securities	—	797	—
Total debt security OTTI write-downs included in earnings	$—	$981	$—

The following table shows the detail of OTTI write-downs on debt securities included in earnings and the related changes in other accumulated comprehensive income (AOCI) for the same securities, in thousands:

	For the Years Ended December 31,		
	2013	2012	2011
OTTI on debt securities			
Recorded as part of gross realized losses:			
Credit related OTTI	$—	$981	$—
Intent to sell OTTI	—	—	—
Total recorded as part of gross realized losses	—	981	—
Recorded directly to AOCI for non-credit related impairment:			
Mortgage-backed securities	—	683	—
Accretion of non-credit related impairment	(95)	(71)	—
Total changes to AOCI for non-credit related impairment	(95)	612	—
Total OTTI losses (accretion) recorded on debt securities	$(95)	$1,593	$—

Heartland has not experienced any OTTI writedowns since the initial impairment charge in the first quarter of 2012.

Included in other securities at December 31, 2013 and 2012, were shares of stock in each Federal Home Loan Bank (the "FHLB") of Des Moines, Chicago, Dallas, San Francisco, Seattle and Topeka at an amortized cost of $15.6 million and $11.6 million, respectively. At December 31, 2013 and 2012, the Heartland's banks had $0 and $380,000, respectively, in shares of stock in the Federal Reserve Bank (the "FRB").

The Heartland banks are required to maintain FHLB stock as members of the various FHLBs as required by these institutions. As a member of the Federal Reserve System, Heartland's Heritage subsidiary had shares of stock in the FRB. These equity securities are "restricted" in that they can only be sold back to the respective institutions or another member institution at par. Therefore, they are less liquid than other marketable equity securities and their fair value approximates amortized cost. Heartland considers its FHLB and FRB stock as a long-term investment that provides access to competitive products and liquidity. Heartland evaluates impairment in these investments based on the ultimate recoverability of the par value and at December 31, 2013, did not consider the investments to be other than temporarily impaired.

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LOANS AND LEASES

Loans and leases as of December 31, 2013, and December 31, 2012, were as follows, in thousands:

	December 31, 2013	December 31, 2012
Loans and leases receivable held to maturity:		
Commercial	$950,197	$712,308