

HEARTLAND FINANCIAL USA INC  
Form 10-Q  
August 05, 2016

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

FORM 10-Q  
 QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For quarterly period ended June 30, 2016

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

For transition period \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-15393

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

Delaware  
(State or other jurisdiction of incorporation or organization)

42-1405748  
(I.R.S. employer identification number)

1398 Central Avenue, Dubuque, Iowa 52001  
(Address of principal executive offices)(Zip Code)

(563) 589-2000  
(Registrant's telephone number, including area code)

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  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  No

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 "accelerated filer," "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Act.

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Large accelerated filer  Accelerated Filer

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 by Rule 12b-2 of the Securities Exchange Act of 1934). Yes  No

Indicate the number of shares outstanding of each of the classes of Registrant's common stock as of the latest practicable date: As of August 4, 2016, the Registrant had outstanding 24,545,467 shares of common stock, \$1.00 par value per share.

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HEARTLAND FINANCIAL USA, INC.  
Form 10-Q Quarterly Report  
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10.4 Promissory Note and Fourth Amendment to Business Loan Agreement Dated June 14, 2013 between Heartland Financial USA, Inc. and Bankers Trust Company dated June 14, 2016.

10.5 Promissory Note and Fifth Amendment to Business Loan Agreement Dated June 14, 2013 between Heartland Financial USA, Inc. and Bankers Trust Company dated July 20, 2016.

31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act.

31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act.

32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101 Financial statements formatted in Extensible Business Reporting Language: (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Cash Flows, (v) the Consolidated Statements of Changes in Equity, and (vi) the Notes to Consolidated Financial Statements.

## PART I

## ITEM 1. FINANCIAL STATEMENTS

## HEARTLAND FINANCIAL USA, INC.

## CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except per share data)

	June 30, 2016 (Unaudited)	December 31, 2015
<b>ASSETS</b>		
Cash and due from banks	\$222,718	\$ 237,841
Federal funds sold and other short-term investments	7,232	20,958
Cash and cash equivalents	229,950	258,799
Time deposits in other financial institutions	2,105	2,355
Securities:		
Available for sale, at fair value (cost of \$1,556,884 at June 30, 2016, and \$1,584,703 at December 31, 2015)	1,566,592	1,578,434
Held to maturity, at cost (fair value of \$292,854 at June 30, 2016, and \$294,513 at December 31, 2015)	270,423	279,117
Other investments, at cost	22,680	21,443
Loans held for sale	82,538	74,783
Loans and leases receivable:		
Held to maturity	5,482,258	5,001,486
Allowance for loan and lease losses	(51,756 )	(48,685 )
Loans and leases receivable, net	5,430,502	4,952,801
Premises, furniture and equipment, net	164,812	146,259
Premises, furniture and equipment held for sale	3,889	3,889
Other real estate, net	11,003	11,524
Goodwill	127,699	97,852
Core deposit intangibles, net	25,213	22,019
Servicing assets, net	35,654	34,926
Cash surrender value on life insurance	111,425	110,297
Other assets	119,916	100,256
<b>TOTAL ASSETS</b>	<b>\$8,204,401</b>	<b>\$ 7,694,754</b>
<b>LIABILITIES AND EQUITY</b>		
<b>LIABILITIES:</b>		
Deposits:		
Demand	\$2,149,911	\$ 1,914,141
Savings	3,691,791	3,367,479
Time	995,870	1,124,203
Total deposits	6,837,572	6,405,823
Short-term borrowings	303,707	293,898
Other borrowings	296,895	263,214
Accrued expenses and other liabilities	78,264	68,646
<b>TOTAL LIABILITIES</b>	<b>7,516,438</b>	<b>7,031,581</b>
<b>STOCKHOLDERS' EQUITY:</b>		
Series C Senior Non-Cumulative Perpetual Preferred Stock (par value \$1 per share; 0 shares and 81,698 shares outstanding at June 30, 2016 and December 31, 2015,	—	81,698

respectively)

Series D Senior Non-Cumulative Perpetual Convertible Preferred Stock (par value \$1 per share; authorized, issued and outstanding 3,000 shares at June 30, 2016, and 0 shares authorized, issued and outstanding at December 31, 2015)	3,777	—
Common stock (par value \$1 per share; 30,000,000 shares authorized at both June 30, 2016, and December 31, 2015; issued 24,544,261 shares at June 30, 2016, and 22,435,693 shares at December 31, 2015)	24,544	22,436
Capital surplus	274,682	216,436
Retained earnings	384,479	348,630
Accumulated other comprehensive income (loss)	513	(6,027 )
Treasury stock at cost (885 shares at June 30, 2016, and 0 shares at December 31, 2015)	(32 )	—
<b>TOTAL STOCKHOLDERS' EQUITY</b>	<b>687,963</b>	<b>663,173</b>
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>\$8,204,401</b>	<b>\$7,694,754</b>

See accompanying notes to consolidated financial statements.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
<b>INTEREST INCOME:</b>				
Interest and fees on loans and leases	\$69,809	\$55,824	\$138,234	\$108,873
Interest on securities:				
Taxable	7,952	6,739	16,687	13,871
Nontaxable	3,566	2,874	7,076	5,790
Interest on federal funds sold	1	1	11	2
Interest on interest bearing deposits in other financial institutions	3	3	7	7
<b>TOTAL INTEREST INCOME</b>	<b>81,331</b>	<b>65,441</b>	<b>162,015</b>	<b>128,543</b>
<b>INTEREST EXPENSE:</b>				
Interest on deposits	4,021	3,819	8,194	7,991
Interest on short-term borrowings	519	212	848	410
Interest on other borrowings (includes \$465 and \$559 of interest expense related to derivatives reclassified from accumulated other comprehensive income for the three months ended June 30, 2016 and 2015, respectively, and \$971 and \$1,123 of interest expense related to derivatives reclassified from accumulated other comprehensive income for the six months ended June 30, 2016 and 2015, respectively)	3,673	3,766	7,148	8,568
<b>TOTAL INTEREST EXPENSE</b>	<b>8,213</b>	<b>7,797</b>	<b>16,190</b>	<b>16,969</b>
<b>NET INTEREST INCOME</b>	<b>73,118</b>	<b>57,644</b>	<b>145,825</b>	<b>111,574</b>
Provision for loan and lease losses	2,118	5,674	4,185	7,345
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN AND LEASE LOSSES</b>	<b>71,000</b>	<b>51,970</b>	<b>141,640</b>	<b>104,229</b>
<b>NONINTEREST INCOME:</b>				
Service charges and fees	8,022	5,900	15,184	11,304
Loan servicing income	1,292	1,163	2,560	2,204
Trust fees	3,625	3,913	7,438	7,544
Brokerage and insurance commissions	886	916	1,908	2,003
Securities gains, net (includes \$4,622 and \$3,110 of net security gains reclassified from accumulated other comprehensive income for the three months ended June 30, 2016 and 2015, respectively, and \$8,378 and \$7,463 of net security gains reclassified from accumulated other comprehensive income for six months ended June 30, 2016 and 2015, respectively)	4,622	3,110	8,148	7,463
Net gains on sale of loans held for sale	11,270	14,599	22,335	28,341
Valuation allowance on commercial servicing rights	(46)	) —	(46)	) —
Income on bank owned life insurance	591	459	1,113	983
Other noninterest income	764	601	1,964	1,482
<b>TOTAL NONINTEREST INCOME</b>	<b>31,026</b>	<b>30,661</b>	<b>60,604</b>	<b>61,324</b>
<b>NONINTEREST EXPENSES:</b>				
Salaries and employee benefits	41,985	36,851	83,699	73,489
Occupancy	5,220	4,028	10,223	8,287
Furniture and equipment	2,442	2,176	4,555	4,282

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Professional fees	7,486	5,249	14,496	11,293
FDIC insurance assessments	1,120	899	2,288	1,855
Advertising	1,551	1,333	2,835	2,514
Intangible assets amortization	1,297	715	3,192	1,346
Other real estate and loan collection expenses	659	753	1,231	1,218
(Gain)/loss on sales/valuations of assets, net	(43 )	1,509	270	1,862
Other noninterest expenses	9,303	9,969	18,540	16,950
<b>TOTAL NONINTEREST EXPENSES</b>	<b>71,020</b>	<b>63,482</b>	<b>141,329</b>	<b>123,096</b>
<b>INCOME BEFORE INCOME TAXES</b>	<b>31,006</b>	<b>19,149</b>	<b>60,915</b>	<b>42,457</b>
Income taxes (includes \$1,551 and \$952 of income tax expense reclassified from accumulated other comprehensive income for the three months ended June 30, 2016 and 2015, respectively, and \$2,763 and \$2,365 of income tax expense reclassified from accumulated other comprehensive income for the six months ended June 30, 2016 and 2015, respectively)	10,036	3,989	19,936	11,588
<b>NET INCOME</b>	<b>20,970</b>	<b>15,160</b>	<b>40,979</b>	<b>30,869</b>
Preferred dividends	(52 )	(204 )	(220 )	(408 )
Interest expense on convertible preferred debt	31	—	31	—
<b>NET INCOME AVAILABLE TO COMMON STOCKHOLDERS</b>	<b>\$20,949</b>	<b>\$14,956</b>	<b>\$40,790</b>	<b>\$30,461</b>
<b>EARNINGS PER COMMON SHARE - BASIC</b>	<b>\$0.85</b>	<b>\$0.73</b>	<b>\$1.69</b>	<b>\$1.49</b>
<b>EARNINGS PER COMMON SHARE - DILUTED</b>	<b>\$0.84</b>	<b>\$0.72</b>	<b>\$1.66</b>	<b>\$1.47</b>
<b>CASH DIVIDENDS DECLARED PER COMMON SHARE</b>	<b>\$0.10</b>	<b>\$0.10</b>	<b>\$0.20</b>	<b>\$0.20</b>

See accompanying notes to consolidated financial statements.

## HEARTLAND FINANCIAL USA, INC.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)

(Dollars in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
NET INCOME	\$20,970	\$15,160	\$40,979	\$30,869
OTHER COMPREHENSIVE INCOME				
Securities:				
Net change in unrealized gain (loss) on securities	3,903	(2,764 )	23,970	8,714
Reclassification adjustment for net gains realized in net income	(4,622 )	(3,110 )	(8,378 )	(7,463 )
Net change in non-credit related other than temporary impairment	—	24	7	48
Income taxes	289	2,361	(6,235 )	(498 )
Other comprehensive income (loss) on securities	(430 )	(3,489 )	9,364	801
Derivatives used in cash flow hedging relationships:				
Net change in unrealized gain (loss) on derivatives	(2,044 )	1,509	(5,467 )	55
Reclassification adjustment for net losses on derivatives realized in net income	465	559	971	1,123
Income taxes	598	(775 )	1,672	(448 )
Other comprehensive income (loss) on cash flow hedges	(981 )	1,293	(2,824 )	730
Other comprehensive income (loss)	(1,411 )	(2,196 )	6,540	1,531
TOTAL COMPREHENSIVE INCOME	\$19,559	\$12,964	\$47,519	\$32,400

See accompanying notes to consolidated financial statements.



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

	Six Months Ended June 30,	
	2016	2015
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$40,979	\$30,869
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	14,841	11,174
Provision for loan and lease losses	4,185	7,345
Net amortization of premium on securities	16,204	14,645
Securities gains, net	(8,148 )	(7,463 )
Stock based compensation	2,386	1,908
Write downs and losses on repossessed assets, net	574	924
Loans originated for sale	(546,050)	(724,081)
Proceeds on sales of loans held for sale	554,427	710,753
Net gains on sale of loans held for sale	(16,132 )	(21,328 )
Decrease in accrued interest receivable	1,651	1,478
Decrease in prepaid expenses	683	100
Decrease in accrued interest payable	(406 )	(867 )
Capitalization of servicing rights	(6,203 )	(7,156 )
Valuation adjustment on commercial servicing rights	46	—
Write downs and losses on sales of assets, net	(304 )	938
Other, net	(8,316 )	(10,275 )
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>50,417</b>	<b>8,964</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Proceeds from the sale of securities available for sale	622,375	526,026
Proceeds from the sale of securities held to maturity	4,057	—
Proceeds from the sale of other investments	4,116	10,336
Proceeds from the maturity of and principal paydowns on securities available for sale	82,513	86,625
Proceeds from the maturity of and principal paydowns on securities held to maturity	3,962	646
Proceeds from the maturity of and principal paydowns on time deposits in other financial institutions	250	250
Purchase of securities available for sale	(594,135)	(529,670)
Purchase of other investments	(1,867 )	(9,009 )
Net (increase) decrease in loans and leases	98,232	(184,039)
Purchase of bank owned life insurance policies	—	(1,100 )
Capital expenditures	(7,360 )	(3,984 )
Net cash and cash equivalents received in acquisition	8,084	7,103
Proceeds from the sale of equipment	485	15
Proceeds on sale of OREO and other repossessed assets	3,161	5,402
<b>NET CASH PROVIDED (USED) BY INVESTING ACTIVITIES</b>	<b>223,873</b>	<b>(91,399 )</b>

## HEARTLAND FINANCIAL USA, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS, CONTINUED (Unaudited)

(Dollars in thousands)

	Six Months Ended June 30,	
	2016	2015
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net increase in demand deposits and savings accounts	61,509	64,348
Net increase (decrease) in time deposit accounts	(277,871 )	50,980
Net increase (decrease) in short-term borrowings	(63,807 )	86,718
Proceeds from short term FHLB advances	210,000	248,100
Repayments of short term FHLB advances	(172,150 )	(212,000 )
Proceeds from other borrowings	40,000	29,000
Repayments of other borrowings	(14,495 )	(134,389 )
Redemption of preferred stock	(81,698 )	—
Purchase of treasury stock	(1,698 )	(2,173 )
Proceeds from issuance of common stock	1,101	1,578
Excess tax benefits on exercised stock options	1,100	651
Dividends paid	(5,130 )	(4,527 )
<b>NET CASH PROVIDED (USED) BY FINANCING ACTIVITIES</b>	<b>(303,139 )</b>	<b>128,286</b>
Net increase (decrease) in cash and cash equivalents	(28,849 )	45,851
Cash and cash equivalents at beginning of year	258,799	73,871
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	<b>\$229,950</b>	<b>\$119,722</b>
Supplemental disclosures:		
Cash paid for income/franchise taxes	\$12,570	\$6,969
Cash paid for interest	\$16,595	\$20,836
Loans transferred to OREO	\$1,359	\$4,046
Sales of securities available for sale, accrued, not settled	\$2,201	\$34,129
Purchase of securities available for sale, accrued, not settled	\$64	\$—
Stock consideration granted for acquisition	\$57,433	\$53,052

See accompanying notes to consolidated financial statements.

## HEARTLAND FINANCIAL USA, INC.

## CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (Unaudited)

(Dollars in thousands, except per share data)

	Heartland Financial USA, Inc. Stockholders' Equity						
	Preferred Stock	Common Stock	Capital Surplus	Retained Earnings	Other Comprehensive Income (Loss)	Treasury Stock	Total Equity
Balance at January 1, 2015	\$81,698	\$18,511	\$95,816	\$298,764	\$1,528	\$—	\$496,317
Comprehensive income				30,869	1,531		32,400
Cash dividends declared:							
Series C Preferred, \$5.00 per share				(408)			(408)
Common, \$0.20 per share				(4,119)			(4,119)
Purchase of 36,176 shares of common stock						(2,173)	(2,173)
Issuance of 2,139,376 shares of common stock		2,105	51,065			2,111	55,281
Stock based compensation			1,908				1,908
Balance at June 30, 2015	\$81,698	\$20,616	\$148,789	\$325,106	\$3,059	\$(62)	\$579,206
Balance at January 1, 2016	\$81,698	\$22,436	\$216,436	\$348,630	\$(6,027)	\$—	\$663,173
Comprehensive income				40,979	6,540		47,519
Cash dividends declared:							
Series C Preferred, \$2.50 per share				(168)			(168)
Series D Preferred, \$17.50 per share				(52)			(52)
Common, \$0.20 per share				(4,910)			(4,910)
Redemption of Series C preferred stock (81,698)							(81,698)
Issuance of Series D preferred stock 3,777							3,777
Purchase of 33,503 shares of common stock						(1,698)	(1,698)
Issuance of 2,141,186 shares of common stock		2,108	55,860			1,666	59,634
Stock based compensation			2,386				2,386
Balance at June 30, 2016	\$3,777	\$24,544	\$274,682	\$384,479	\$513	\$(32)	\$687,963

See accompanying notes to consolidated financial statements.

HEARTLAND FINANCIAL USA, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: BASIS OF PRESENTATION

The interim unaudited consolidated financial statements contained herein should be read in conjunction with the audited consolidated financial statements and accompanying notes to the consolidated financial statements for the fiscal year ended December 31, 2015, included in the Form 10-K of Heartland Financial USA, Inc. ("Heartland") filed with the Securities and Exchange Commission ("SEC") on March 11, 2016. Accordingly, footnote disclosures which would substantially duplicate the disclosure contained in the audited consolidated financial statements have been omitted.

The financial information of Heartland included herein has been prepared in accordance with U.S. generally accepted accounting principles for interim financial reporting and has been prepared pursuant to the rules and regulations for reporting on Form 10-Q and Rule 10-01 of Regulation S-X. Such information reflects all adjustments (consisting of normal recurring adjustments), that are, in the opinion of management, necessary for a fair presentation of the financial position and results of operations for the periods presented. The results of the interim period ended June 30, 2016, are not necessarily indicative of the results expected for the year ending December 31, 2016.

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 three- and six-month periods ended June 30, 2016 and 2015, are shown in the table below:

	Three Months Ended June 30, 2016	
	2016	2015
(Dollars and number of shares in thousands, except per share data)		
Net income attributable to Heartland	\$20,970	\$15,160
Preferred dividends and discount	(52 )	(204 )
Interest expense on convertible preferred debt	31	—
Net income available to common stockholders	\$20,949	\$14,956
Weighted average common shares outstanding for basic earnings per share	24,524	20,599
Assumed incremental common shares issued upon exercise of stock options and non-vested restricted stock units	451	278
Weighted average common shares for diluted earnings per share	24,975	20,877
Earnings per common share — basic	\$0.85	\$0.73
Earnings per common share — diluted	\$0.84	\$0.72
Number of antidilutive common stock equivalents excluded from diluted earnings per share computation	—	—
	Six Months Ended June 30, 2016	
	2016	2015
(Dollars and number of shares in thousands, except per share data)		
Net income attributable to Heartland	\$40,979	\$30,869
Preferred dividends	(220 )	(408 )
Interest expense on convertible preferred debt	31	—

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Net income available to common stockholders	\$40,790	\$30,461
Weighted average common shares outstanding for basic earnings per share	24,093	20,408
Assumed incremental common shares issued upon exercise of stock options and non-vested restricted stock units	448	274
Weighted average common shares for diluted earnings per share	24,541	20,682
Earnings per common share — basic	\$1.69	\$1.49
Earnings per common share — diluted	\$1.66	\$1.47
Number of antidilutive common stock equivalents excluded from diluted earnings per share computation	—	—

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## Stock-Based Compensation

Heartland may grant, through its Nominating and Compensation Committee (the "Compensation Committee"), non-qualified and incentive stock options, stock appreciation rights, stock awards, restricted stock, restricted stock units and cash incentive awards, under its 2012 Long-Term Incentive Plan (the "Plan"). The Plan was originally approved by stockholders in May 2012 and was amended effective March 8, 2016 to increase the number of shares of common stock authorized for issuance and make certain other changes to the Plan. As of June 30, 2016, 548,079 shares of common stock were available for issuance under future awards that may be granted under the Plan to employees and directors of, and service providers to, Heartland or its subsidiaries.

Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 718, "Compensation-Stock Compensation" requires the measurement of the cost of employee services received in exchange for an award of equity instruments based upon the fair value of the award on the grant date. The cost of the award is based upon its fair value estimated on the date of grant and recognized in the consolidated statements of income over the vesting period of the award. The fair market value of restricted stock and restricted stock units is based on the fair value of the underlying shares of common stock on the date of grant. The fair value of stock options is estimated on the date of grant using the Black-Scholes model.

The amount of tax benefit related to the exercise, vesting, and forfeiture of equity-based awards reflected in additional paid-in-capital, not taxes payable, was \$1.1 million and \$651,000 during the six months ended June 30, 2016 and 2015, respectively.

## Restricted Stock Units

The Plan permits the Compensation Committee to grant restricted stock units ("RSUs"). In the first quarter of 2016, the Compensation Committee granted time-based RSUs with respect to 72,644 shares of common stock, and in the first quarter of 2015, the Compensation Committee granted time-based RSUs with respect to 78,220 shares of common stock to selected officers. The time-based RSUs represent the right, without payment, to receive shares of Heartland common stock at a specified date in the future. The time-based RSUs granted in 2016 vest over three years in equal installments on the first, second and third anniversaries of the grant date. The time-based RSUs granted in 2015 vest over five years in equal installments on the third, fourth, and fifth anniversaries of the grant date. The time-based RSUs will be settled in common stock upon vesting, and will not be entitled to dividends until vested. The time-based RSUs may also vest upon death or disability, upon a change in control or upon a "qualified retirement" (as defined in the RSU agreement). The retiree is required to sign a non-solicitation and non-compete agreement as a condition to vesting.

In addition to the time-based RSUs referenced in the preceding paragraph, the Compensation Committee granted performance-based RSUs with respect to 35,516 shares of common stock in the first quarter of 2016, and 39,075 shares of common stock in the first quarter of 2015. These performance-based RSUs are earned based on satisfaction of performance targets for the fiscal years ended December 31, 2016, and December 31, 2015, respectively, and then fully vest two years after the end of the performance period. For the grants awarded in 2016, the portion of the RSUs earned based on performance vests on December 31, 2018, and for the grants awarded in 2015, the portion of the RSUs earned based on performance vests on December 31, 2017, subject to employment on the respective vesting dates. The performance-based RSUs vest to the extent that they are earned upon death or disability, upon a change in control or upon a "qualified retirement."

The Compensation Committee also granted performance-based RSUs with respect to 11,408 shares of common stock in the first quarter of 2016. These performance-based RSUs will be earned based on satisfaction of performance targets for the three-year performance period ended December 31, 2018. These performance-based RSUs will vest in

2019 after measurement of performance in relation to the performance targets.

Upon death, disability, or a "qualified retirement," all performance-based RSUs granted in 2016 remain outstanding and are earned based on actual performance at the end of each performance period. All RSUs granted on or after March 8, 2016, become fully vested upon a change in control if (1) they are not assumed by the successor corporation or (2) upon an involuntary termination of the participant's employment within two years after the change in control.

The Compensation Committee also grants RSUs under the Plan to directors as part of their compensation, to new management level employees at commencement of employment, and to other employees and service providers as incentives. During the six months ended June 30, 2016, and June 30, 2015, 22,153 and 22,648 RSUs, respectively, were granted to directors and new employees.

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A summary of the RSUs outstanding as of June 30, 2016 and 2015, and changes during the six months ended June 30, 2016 and 2015, follows:

	2016		2015	
	Shares	Weighted-Average Grant Date Fair Value	Shares	Weighted-Average Grant Date Fair Value
Outstanding at January 1	353,195	\$ 25.53	396,555	\$ 21.48
Granted	141,721	29.79	139,943	28.90
Vested	(117,898)	23.40	(151,681)	17.98
Forfeited	(10,892)	27.13	(11,198)	25.14
Outstanding at June 30	366,126	\$ 27.60	373,619	\$ 25.55

Total compensation costs recorded for RSUs were \$2.4 million and \$1.9 million for the six month periods ended June 30, 2016 and 2015. As of June 30, 2016, there were \$4.4 million of total unrecognized compensation costs related to the Plan for RSUs that are expected to be recognized through 2019.

### Options

Although the Plan provides authority to the Compensation Committee to grant stock options, no options were granted during the first six months of 2016 and 2015. Prior to 2009, options were typically granted annually with an expiration date ten years after the date of grant. Vesting was generally over a five-year service period with equal portions of a grant becoming exercisable at three years, four years, and five years after the date of grant. A summary of the stock options outstanding as of June 30, 2016 and 2015, and changes during the six months ended June 30, 2016 and 2015, follows:

	2016		2015	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Outstanding at January 1	125,950	\$ 24.08	215,851	\$ 23.85
Granted	—	—	—	—
Exercised	(35,000)	23.53	(56,650)	22.85
Forfeited	(1,500)	21.10	(2,250)	23.88
Outstanding at June 30	89,450	\$ 24.34	156,951	\$ 24.18
Options exercisable at June 30	89,450	\$ 24.34	156,951	\$ 24.18

At June 30, 2016, the vested options totaled 89,450 shares with a weighted average exercise price of \$24.34 per share and a weighted average remaining contractual life of 1.03 years. The intrinsic value (the difference between the market price and the aggregate exercise price) for the vested options as of June 30, 2016, was \$979,000. The intrinsic value for the total of all options exercised during the six months ended June 30, 2016, was \$295,000.

The exercise price of stock options granted is established by the Compensation Committee, but the exercise price for the stock options may not be less than the fair market value of the shares on the date that the option is granted or, if greater, the par value of a share of stock. Each option granted is exercisable in full at any time or from time to time, subject to vesting provisions, as determined by the Compensation Committee and as provided in the option agreement, but such time may not exceed ten years from the grant date. Cash received from options exercised was \$824,000 for the six months ended June 30, 2016, and \$1.3 million for the six months ended June 30, 2015.

Total compensation costs recorded for options were \$0 for both the six month periods ended June 30, 2016 and 2015. There are no unrecorded compensation costs related to options at June 30, 2016. No stock options vested during the six-month periods ended June 30, 2016 and 2015.



Subsequent Events

On July 29, 2016, Heartland filed a universal shelf registration statement with the SEC to register debt or equity securities. The registration statement, which was effective immediately, provides Heartland with the ability to raise capital, subject to market conditions and SEC rules and limitations, if Heartland's board of directors decides to do so.

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#### Effect of New Financial Accounting Standards

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers." The amendment clarifies the principles for recognizing revenue and develops a common revenue standard. The amendment outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle of the revenue model is that "an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services." In applying the revenue model to contracts within its scope, an entity should apply the following steps: (i) identify the contract(s) with a customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract, and (v) recognize revenue when (or as) the entity satisfies a performance obligation. The amendment applies to all contracts with customers except those that are within the scope of other topics in the FASB Codification. The standard also requires significantly expanded disclosures about revenue recognition. The amendment is effective for annual reporting periods beginning after December 15, 2017 (including interim reporting periods within those periods). Early application is not permitted. Heartland intends to adopt the accounting standard during the first quarter of 2018, as required, and is currently evaluating the impact on its results of operations, financial position, and liquidity.

In November 2014, the FASB issued ASU 2014-16, "Derivatives and Hedging (Topic 815): Determining Whether a Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share is More Akin to Debt or to Equity." The amendment clarifies how current guidance should be interpreted in evaluating the characteristics and risks of a host contract in a hybrid financial instrument issued in the form of a share. One criterion requires evaluating whether the nature of the host contract is more akin to debt or to equity and whether the economic characteristics and risks of the embedded derivative feature are "clearly and closely related" to the host contract. In making that evaluation, an issuer or investor must consider all terms and features in a hybrid financial instrument including the embedded derivative feature that is being evaluated for separate accounting or may consider all terms and features in the hybrid financial instrument except for the embedded derivative feature that is being evaluated for separate accounting. This ASU is effective for annual periods and interim periods within those annual periods beginning after December 15, 2015, with early adoption permitted. Heartland adopted this standard on January 1, 2016, and the adoption of this standard did not have a material impact on its results of operations, financial position, and liquidity.

In January 2015, the FASB issued ASU 2015-01, "Income Statement-Extraordinary and Unusual Items." The amendment eliminates from U.S. GAAP the concept of extraordinary items. Presently, an event or transaction is presumed to be an ordinary and usual activity of the reporting entity unless evidence clearly supports its classification as an extraordinary item. If an event or transaction meets the criteria for extraordinary classification, an entity is required to segregate the extraordinary item from the results of ordinary operations and show the item separately in the income statement, net of tax, after income from continuing operations. This amended guidance will prohibit separate disclosure of extraordinary items in the income statement. This amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Entities may apply the amendment prospectively or retrospectively to all prior periods presented in the financial statements. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. Heartland adopted this standard on January 1, 2016, and the adoption of this standard did not have a material impact on the results of operations, financial position, and liquidity.

In April 2015, the FASB issued ASU 2015-05, "Intangibles-Goodwill and Other-Internal-Use Software." The amendment intends to provide guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a

service contract. The guidance will not change GAAP for a customer's accounting for service contracts. As a result, all software licenses within the scope of this guidance will be accounted for consistently with other licenses of intangible assets. This amendment is effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Entities can elect to adopt the standard either retrospectively or prospectively to all cloud computing arrangements entered into or materially modified after the adoption date. Early adoption is permitted. Heartland adopted this standard on January 1, 2016 and the adoption did not have a material impact on the results of operations, financial position, and liquidity.

In September 2015, the FASB issued ASU 2015-16, "Simplifying the Accounting for Measurement-Period Adjustments." The amendment eliminates the requirement of Topic 805, Business Combinations, to retrospectively adjust the financial statements for measurement-period adjustments that occur in periods after a business combination is consummated. Measurement-period adjustments are calculated as if they were known at the acquisition date, but are recognized in the reporting period in which they are determined. Prior period information is not revised. Additional disclosures are required about the impact on current period

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income statement line items of adjustments that would have been recognized in prior periods if prior period information had been revised. This amendment is effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted if financial statements have not been issued. Heartland adopted this standard effective September 30, 2015. The adoption of this standard did not have a material impact on the results of operations, financial position, and liquidity.

In January 2016, the FASB issued guidance ASU 2016-01, "Recognition and Measurement of Financial Assets and Financial Liabilities." The amendments in ASU 2016-01 to Subtopic 825-10, Financial Instruments, contain the following elements: (1) requires equity investments to be measured at fair value with changes in fair value recognized in net income; (2) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; (3) eliminates the requirement for public entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (4) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (5) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; (6) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or accompanying notes to the financial statements; (7) clarifies that the entity should evaluate the need for a valuation allowance on a deferred tax asset related to available for sale securities in combination with the entity's other deferred tax assets. The amendments are effective for fiscal years beginning after December 15, 2017, and for interim periods within those fiscal years. Except for the early application of the amendment noted in item (5) above, early adoption of the amendments in this update is not permitted. Heartland intends to adopt the accounting standard in 2018, as required, and is currently evaluating the impact on its results of operations, financial position, and liquidity.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)." Topic 842 requires a lessee to recognize a lease liability and a right of use asset for each lease, with the exception of short term leases, at the commencement date of the lease and disclose key information about the leasing arrangement. Accounting requirements applied by lessors is largely unchanged. The amendment is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, and will be applied on a modified retrospective basis. Heartland intends to adopt the accounting standard in 2019, as required, and is currently evaluating the impact on its results of operations, financial position, and liquidity.

In March 2016, the FASB issued ASU 2016-09, "Compensation-Stock Compensation (Topic 718)." The amendments in this ASU simplify several aspects of the accounting for share-based payments, including income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. The amendments in this ASU are effective for annual periods beginning after December 15, 2016 and interim periods within those annual periods. Early adoption is permitted for any interim or annual period prior to the effective date. An entity that elects early adoption must adopt all of the amendments in the same period. Heartland intends to adopt this ASU in 2017, as required, and believes the adoption will not have an impact on its results of operations, financial position, and liquidity.

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments - Credit Losses (Topic 326)." The amendments in this ASU require a financial asset (or a group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial asset(s) to present the net carrying value at the amount expected to be collected on the financial asset. The amendments in this ASU indicate that an entity should not use the length of time a security has been in an unrealized loss position to avoid recording a credit loss. In addition, in determining whether a credit loss exists, the amendments in this ASU also remove the requirements to consider the historical and implied

volatility of the fair value of a security and recoveries or declines in fair value after the balance sheet date. The amendment is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. An entity may adopt the amendments earlier as of the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Heartland intends to adopt the accounting standard in 2020, as required, and is currently evaluating the impact on its results of operations, financial position, and liquidity.

NOTE 2: ACQUISITIONS

CIC Bancshares, Inc.

On February 5, 2016, Heartland completed the acquisition of CIC Bancshares, Inc., parent company of Centennial Bank, headquartered in Denver, Colorado. The purchase price was approximately \$76.9 million, which was paid by delivery of 2,003,235 shares of Heartland common stock and cash of \$15.7 million. In addition, Heartland issued a new series of convertible preferred stock with a fair value of \$3.8 million and assumed convertible notes and subordinated debt totaling approximately \$7.9 million. Simultaneous with the closing of the transaction, Centennial Bank merged into Heartland's Summit Bank & Trust, with the resulting

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institution operating under the name, Centennial Bank and Trust. As of the close date, the transaction included, at fair value, total assets of \$772.6 million, total loans of \$581.5 million, and total deposits of \$648.1 million. The transaction was a tax-free reorganization with respect to the stock consideration received by the stockholders of CIC Bancshares, Inc.

The assets and liabilities of CIC Bancshares, Inc. 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 February 5, 2016:

	As of February 5, 2016
Fair value of consideration paid:	
Common Stock (2,003,235 shares)	\$ 57,433
Preferred Stock (3,000 shares)	3,777
Cash	15,672
Total consideration paid	76,882
Fair value of assets acquired:	
Cash and due from banks	23,756
Securities:	
Securities available for sale	92,831
Other securities	3,486
Loans held to maturity	581,477
Premises, furniture and equipment, net	16,450
Other real estate, net	1,934
Other intangible assets, net	6,576
Other assets	16,276
Total assets	742,786
Fair value of liabilities assumed:	
Deposits	648,111
Short term borrowings	35,766
Other borrowings	7,924
Other liabilities	3,951
Total liabilities assumed	695,752
Fair value of net assets acquired	47,034
Goodwill resulting from acquisition	\$ 29,848

Heartland recognized \$29.8 million of goodwill in conjunction with the acquisition of CIC Bancshares, Inc., 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 the expected operational synergies, enhanced market area, cross-selling opportunities and expanded business lines. See Note 6 for further information on goodwill.

Pro Forma Information (unaudited): The following pro forma information presents the results of operations for the years ended December 31, 2015, and December 31, 2014, as if the CIC Bancshares, Inc. acquisition occurred on January 1, 2014:

(Dollars in thousands, except per share data), unaudited	For the Years Ended	
	December	December
	31, 2015	31, 2014
Net interest income	\$259,531	\$221,808
Net income available to common shareholders	\$59,491	\$41,004

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Basic earnings per share	\$2.63	\$2.00
Diluted earnings per share	\$2.58	\$1.96

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, 2014, nor

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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 with respect to valuation and accretion of income associated with the acquired loans.

Heartland incurred \$551,000 of pre-tax merger related expenses in 2016 associated with the Centennial Bank acquisition. The merger expenses are reflected on the consolidated statements of income for the applicable period and are reported primarily in the categories of professional fees and other noninterest expenses.

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 on the acquisition date was \$1.6 million.

#### Premier Valley Bank

On November 30, 2015, Heartland completed the purchase of Premier Valley Bank in Fresno, California. The purchase price was approximately \$95.5 million, which was paid by delivery of 1,758,543 shares of Heartland common stock and cash of \$28.5 million. The transaction included, at fair value, total assets of \$692.7 million, loans of \$389.8 million, and deposits of \$622.7 million. Premier Valley Bank continues to operate under its current name and management team as Heartland's tenth, wholly-owned state-chartered bank. The transaction was a tax-free reorganization with respect to the stock consideration received by the stockholders of Premier Valley Bank.

Heartland recognized \$41.0 million of goodwill in conjunction with the acquisition of Premier Valley Bank, 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 the expected operational synergies, enhanced market area, cross-selling opportunities and expanded business lines. See Note 6 for further information on goodwill.

#### First Scottsdale Bank, N.A.

On September 11, 2015, Heartland completed the purchase of First Scottsdale Bank, N.A., in Scottsdale, Arizona, in an all cash transaction valued at approximately \$17.7 million. Simultaneous with the closing of the transaction, First Scottsdale Bank, N.A., merged into Heartland's Arizona Bank & Trust subsidiary. The transaction included, at fair value, total assets of \$81.2 million, loans of \$54.7 million, and deposits of \$65.9 million on the acquisition date.

#### Community Bancorporation of New Mexico, Inc.

On August 21, 2015, Heartland acquired Community Bancorporation of New Mexico, Inc., parent company of Community Bank in Santa Fe, New Mexico, in an all cash transaction valued at approximately \$11.1 million. Simultaneous with the closing of the transaction, Community Bank merged into Heartland's New Mexico Bank & Trust subsidiary. The transaction included, at fair value, total assets of \$166.3 million, loans of \$99.5 million, and deposits of \$147.4 million on the acquisition date. Also included in this transaction is one bank building with a fair value of \$3.4 million that Heartland intends to sell. The bank building is part of the balance of premises, furniture and equipment held for sale on the consolidated balance sheet.

#### Community Banc-Corp of Sheboygan, Inc.

On January 16, 2015, Heartland completed the acquisition of Community Banc-Corp of Sheboygan, Inc., parent company of Community Bank & Trust in Sheboygan, Wisconsin. Under the terms of the merger agreement for this transaction, the aggregate purchase price was based upon 155% of the December 31, 2014, adjusted tangible book value, as defined in the merger agreement, of Community Banc-Corp of Sheboygan, Inc. The purchase price was approximately \$53.1 million, which was paid by delivery of 1,970,720 shares of Heartland common stock. The transaction included, at fair value, total assets of \$506.8 million, including loans of \$395.0 million, and deposits of \$433.9 million. Simultaneous with the close of the transaction, Community Bank & Trust merged into Heartland's Wisconsin Bank & Trust subsidiary. The transaction was a tax-free reorganization with respect to the stock



consideration received by the stockholders of Community Banc-Corp of Sheboygan, Inc.

Heartland recognized goodwill of \$18.6 million in conjunction with the acquisition of Community Banc-Corp of Sheboygan, Inc., 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. See Note 6 for further information on goodwill.

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## NOTE 3: SECURITIES

The amortized cost, gross unrealized gains and losses, and estimated fair values of securities available for sale as of June 30, 2016, and December 31, 2015, are summarized in the table below, in thousands:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
June 30, 2016				
U.S. government corporations and agencies	\$4,943	\$ 158	\$—	\$5,101
Mortgage-backed securities	1,226,085	13,776	(19,129 )	1,220,732
Obligations of states and political subdivisions	311,883	14,583	(44 )	326,422
Corporate debt securities	815	15	—	830
Total debt securities	1,543,726	28,532	(19,173 )	1,553,085
Equity securities	13,158	349	—	13,507
Total	\$1,556,884	\$ 28,881	\$(19,173 )	\$1,566,592
December 31, 2015				
U.S. government corporations and agencies	\$25,847	\$ 22	\$(103 )	\$25,766
Mortgage-backed securities	1,254,452	9,134	(20,884 )	1,242,702
Obligations of states and political subdivisions	290,522	6,547	(1,087 )	295,982
Corporate debt securities	740	106	—	846
Total debt securities	1,571,561	15,809	(22,074 )	1,565,296
Equity securities	13,142	40	(44 )	13,138
Total	\$1,584,703	\$ 15,849	\$(22,118 )	\$1,578,434

At June 30, 2016, and December 31, 2015, the amortized cost of the available for sale securities is net of \$0 and \$237,000 of credit related other-than-temporary impairment ("OTTI"), respectively.

The amortized cost, gross unrealized gains and losses and estimated fair values of held to maturity securities as of June 30, 2016, and December 31, 2015, are summarized in the table below, in thousands:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
June 30, 2016				
Mortgage-backed securities	\$—	\$—	\$—	\$—
Obligations of states and political subdivisions	270,423	22,717	(286 )	292,854
Total	\$270,423	\$22,717	\$(286 )	\$292,854
December 31, 2015				
Mortgage-backed securities	\$4,369	\$306	\$—	\$4,675
Obligations of states and political subdivisions	274,748	15,595	(505 )	289,838
Total	\$279,117	\$15,901	\$(505 )	\$294,513

At June 30, 2016, the amortized cost of the held to maturity securities is net of \$0 of credit related OTTI and \$0 of non-credit related OTTI. At December 31, 2015, the amortized cost of the held to maturity securities was net of \$1.5 million of credit related OTTI and \$40,000 of non-credit related OTTI.

Approximately 77% 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 June 30, 2016, 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.

	Amortized Cost	Estimated Fair Value
Due in 1 year or less	\$1,645	\$1,653
Due in 1 to 5 years	15,892	16,181
Due in 5 to 10 years	87,334	90,004
Due after 10 years	212,770	224,515
Total debt securities	317,641	332,353
Mortgage-backed securities	1,226,085	1,220,732
Equity securities	13,158	13,507
Total investment securities	\$1,556,884	\$1,566,592

The amortized cost and estimated fair value of debt securities held to maturity at June 30, 2016, 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.

	Amortized Cost	Estimated Fair Value
Due in 1 year or less	\$4,380	\$4,448
Due in 1 to 5 years	14,327	15,170
Due in 5 to 10 years	87,072	92,495
Due after 10 years	164,644	180,741
Total debt securities	270,423	292,854
Mortgage-backed securities	—	—
Total investment securities	\$270,423	\$292,854

As of June 30, 2016 and December 31, 2015, securities with a fair value of \$843.0 million and \$855.8 million, respectively, 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 the sales of securities available for sale for the three- and six-month periods ended June 30, 2016 and 2015, are summarized as follows, in thousands:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Proceeds from sales	\$318,927	\$270,688	\$622,375	\$526,026
Gross security gains	5,095	3,819	9,653	8,441
Gross security losses	473	709	1,155	978

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 June 30, 2016, and December 31, 2015. 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 June 30, 2015, and December 31, 2014, 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.

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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
June 30, 2016						
U.S. government corporations and agencies	\$—	\$—	\$—	\$—	\$—	\$—
Mortgage-backed securities	517,699	(14,569 )	144,275	(4,560 )	661,974	(19,129 )
Obligations of states and political subdivisions	2,236	(43 )	255	(1 )	2,491	(44 )
Corporate debt securities	—	—	—	—	—	—
Total debt securities	519,935	(14,612 )	144,530	(4,561 )	664,465	(19,173 )
Equity securities	—	—	—	—	—	—
Total temporarily impaired securities	\$519,935	\$(14,612 )	\$144,530	\$(4,561 )	\$664,465	\$(19,173 )
December 31, 2015						
U.S. government corporations and agencies	\$22,359	\$(103 )	\$—	\$—	\$22,359	\$(103 )
Mortgage-backed securities	724,330	(15,523 )	139,562	(5,361 )	863,892	(20,884 )
Obligations of states and political subdivisions	68,482	(896 )	7,460	(191 )	75,942	(1,087 )
Corporate debt securities	—	—	—	—	—	—
Total debt securities	815,171	(16,522 )	147,022	(5,552 )	962,193	(22,074 )
Equity securities	6,566	(44 )	—	—	6,566	(44 )
Total temporarily impaired securities	\$821,737	\$(16,566 )	\$147,022	\$(5,552 )	\$968,759	\$(22,118 )

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
June 30, 2016						
Obligations of states and political subdivisions	1,388	(3 )	1,131	(283 )	2,519	(286 )
Total temporarily impaired securities	\$1,388	\$(3 )	\$1,131	\$(283 )	\$2,519	\$(286 )
December 31, 2015						
Obligations of states and political subdivisions	3,646	(12 )	18,033	(493 )	21,679	(505 )
Total temporarily impaired securities	\$3,646	\$(12 )	\$18,033	\$(493 )	\$21,679	\$(505 )

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.

Heartland previously recorded \$981,000 of OTTI on three private label mortgage-backed securities 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. During 2015, Heartland recorded additional credit-related OTTI on two of the private label mortgage-backed securities that previously had OTTI credit losses. 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, \$769,000 of OTTI attributable to credit-related losses was recorded in December 2015. The credit-related OTTI was \$716,000, of which \$200,000 was reclassified from previous non-credit

related OTTI in the held to maturity category. Credit-related OTTI was \$53,000 in the available for sale category.

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In the first quarter of 2016, Heartland sold the mortgage-backed securities in the held to maturity portfolio because the credit quality of the securities showed further deterioration, and it was unlikely Heartland would recover the remaining basis of the securities prior to maturity. The significant deterioration of the credit quality of these securities was inconsistent with Heartland's original intent upon purchase and classification of these held to maturity securities. The carrying value of these securities was \$4.4 million, and the associated realized gross gains were \$89,000, and the realized gross losses were \$439,000.

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. The losses are 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 and no gross realized losses on the sale of available for sale securities with OTTI write-downs for the period ended June 30, 2016. Additionally, there were no gross realized gains and no gross realized losses on the sale of held to maturity securities with OTTI write-downs for the period ended June 30, 2016. There were no gross realized gains or losses on the sale of available for sale or held to maturity securities with OTTI write-downs for the period ended June 30, 2015.

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:

	Three Months Ended June 30, 2015	Six Months Ended June 30, 2016	2015
Recorded as part of gross realized losses:			
Credit related OTTI	\$—	\$—	\$—
Intent to sell OTTI	—	—	—
Total recorded as part of gross realized losses	—	—	—
Recorded directly to AOCI for non-credit related impairment:			
Residential mortgage backed securities	—	—	—
Reduction of non-credit related impairment related to security sales	—	(120 )	—
Accretion of non-credit related impairment	—(24 )	(7 )	(48 )
Total changes to AOCI for non-credit related impairment	—(24 )	(127 )	(48 )
Total OTTI losses (accretion) recorded on debt securities, net	\$—(24 )	\$(127 )	\$(48 )



Included in other securities at June 30, 2016, and December 31, 2015, were shares of stock in each Federal Home Loan Bank (the "FHLB") of Des Moines, Chicago, Dallas, San Francisco and Topeka at an amortized cost of \$15.5 million and \$14.3 million, respectively.

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## NOTE 4: LOANS AND LEASES

Loans and leases as of June 30, 2016, and December 31, 2015, were as follows, in thousands:

	June 30, 2016	December 31, 2015
Loans and leases receivable held to maturity:		
Commercial	\$1,287,301	\$1,279,214
Commercial real estate	2,643,578	2,326,360
Agricultural and agricultural real estate	480,883	471,870
Residential real estate	644,267	539,555
Consumer	428,730	386,867
Gross loans and leases receivable held to maturity	5,484,759	5,003,866
Unearned discount	(686 )	(488 )
Deferred loan fees	(1,815 )	(1,892 )
Total net loans and leases receivable held to maturity	5,482,258	5,001,486
Allowance for loan and lease losses	(51,756 )	(48,685 )
Loans and leases receivable, net	\$5,430,502	\$4,952,801

Heartland has certain lending policies and procedures in place that are designed to provide for an acceptable level of credit risk. The board of directors reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management and the board with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies, nonperforming loans and potential problem loans. Diversification in the loan portfolio is also a means of managing risk associated with fluctuations in economic conditions.

The commercial and commercial real estate loan portfolio includes 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. 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. The collateral that Heartland requires for most of these loans and leases is based upon the discounted market value of the collateral. 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. Heartland seeks to minimize these risks in a variety of ways. The underwriting analysis includes credit verification, analysis of global cash flows, appraisals and a review of the financial condition of the borrower. Personal guarantees are frequently required as a tertiary form of repayment. In addition, when underwriting loans for commercial real estate, careful consideration is given to the property's operating history, future operating projections, current and projected occupancy, location and physical condition. Heartland also utilizes government guaranteed lending through the U.S. Small Business Administration and the U.S. Department of Agriculture's Rural Development Business and Industry Program to assist customers with longer-term funding and to reduce risk.

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, lending personnel 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. Lending personnel also work closely with governmental agencies, including the Farm Service Agency, to help agricultural customers obtain credit enhancement products such as loan guarantees or interest assistance.

Heartland originates first-lien, adjustable-rate and fixed-rate, one-to-four-family residential real estate loans for the construction, purchase or refinancing of a single family residential property. These loans are principally collateralized by owner-occupied properties and are amortized over 10 to 30 years. Heartland typically sells longer-term, low-rate, residential mortgage loans in the secondary market with servicing rights retained. This practice allows Heartland to better manage interest rate risk and liquidity risk. The Heartland bank subsidiaries participate in lending programs sponsored by U.S. government agencies such as Veterans Administration and Federal Home Administration when justified by market conditions. As of June 30, 2016, Heartland had \$2.4 million of loans secured by residential real estate property that were in the process of foreclosure.

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Consumer lending includes motor vehicle, home improvement, home equity and small personal credit lines. 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. Risk is reduced through underwriting criteria, which include credit verification, appraisals, a review of the borrower's financial condition, and personal cash flows. A security interest, with title insurance when necessary, is taken in the underlying real estate. Heartland's consumer finance subsidiaries, Citizens Finance Co. and Citizens Finance of Illinois Co., typically lend to borrowers with past credit problems or limited credit histories, and these loans comprise approximately 19% of Heartland's total consumer loan portfolio.

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. 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 practices, 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 loan 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, impairment is measured at the observable market price of the loan or the fair value of the collateral if the loan is collateral dependent.

The following table shows the balance in the allowance for loan and lease losses at June 30, 2016, and December 31, 2015, and the related loan balances, disaggregated on the basis of impairment methodology, in thousands. Loans evaluated under ASC 310-10-35 include loans on nonaccrual status and troubled debt restructurings, which are individually evaluated for impairment, and other impaired loans deemed to have similar risk characteristics. All other loans are collectively evaluated for impairment under ASC 450-20. Heartland has made no significant changes to the accounting for the allowance for loan and lease losses policy during 2016.

	Allowance For Loan and Lease Losses			Gross Loans and Leases Receivable Held to Maturity		
	Ending Balance Under ASC 310-10-35	Ending Balance Under ASC 450-20	Total	Ending Balance Evaluated for Impairment Under ASC 310-10-35	Ending Balance Evaluated for Impairment Under ASC 450-20	Total
June 30, 2016						
Commercial	\$1,342	\$14,183	\$15,525	\$7,985	\$1,279,316	\$1,287,301
Commercial real estate	2,780	20,188	22,968	53,481	2,590,097	2,643,578
Agricultural and agricultural real estate	6	4,094	4,100	14,359	466,524	480,883
Residential real estate	446	1,619	2,065	21,710	622,557	644,267
Consumer	1,351	5,747	7,098	5,708	423,022	428,730
Total	\$5,925	\$45,831	\$51,756	\$103,243	\$5,381,516	\$5,484,759
December 31, 2015						

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Commercial	\$471	\$15,624	\$16,095	\$6,919	\$1,272,295	\$1,279,214
Commercial real estate	698	18,834	19,532	45,442	2,280,918	2,326,360
Agricultural and agricultural real estate	—	3,887	3,887	4,612	467,258	471,870
Residential real estate	393	1,541	1,934	17,790	521,765	539,555
Consumer	1,206	6,031	7,237	5,458	381,409	386,867
Total	\$2,768	\$45,917	\$48,685	\$80,221	\$4,923,645	\$5,003,866

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The following table presents nonaccrual loans, accruing loans past due 90 days or more and troubled debt restructured loans at June 30, 2016, and December 31, 2015, in thousands. There were no nonaccrual leases, accruing leases past due 90 days or more or restructured leases at June 30, 2016, and December 31, 2015.

	June 30, December 31,	
	2016	2015
Nonaccrual loans	\$55,732	\$ 37,874
Nonaccrual troubled debt restructured loans	1,321	1,781
Total nonaccrual loans	\$57,053	\$ 39,655
Accruing loans past due 90 days or more	\$—	\$ —
Performing troubled debt restructured loans	\$9,923	\$ 11,075

The following table provides information on troubled debt restructured loans that were modified during the three- and six-month periods ended June 30, 2016, and June 30, 2015, dollars in thousands:

	Three Months Ended			
	June 30,		2015	
	Pre-Modification Number of Recorded Loans Investment	Post-Modification Recorded Investment	Pre-Modification Number of Recorded Loans Investment	Post-Modification Recorded Investment
Commercial	1 \$ 100	\$ 100	1 \$ 830	\$ 830
Commercial real estate	1 179	179	—	—
Total commercial and commercial real estate	2 279	279	1 830	830
Agricultural and agricultural real estate	—	—	1 311	311
Residential real estate	—	—	—	—
Consumer	—	—	—	—
Total	2 \$ 279	\$ 279	2 \$ 1,141	\$ 1,141
	Six Months Ended			
	June 30,		2015	
	Pre-Modification Number of Recorded Loans Investment	Post-Modification Recorded Investment	Pre-Modification Number of Recorded Loans Investment	Post-Modification Recorded Investment
Commercial	1 \$ 100	\$ 100	1 \$ 830	\$ 830
Commercial real estate	1 179	179	1 3,992	3,992
Total commercial and commercial real estate	2 279	279	2 4,822	4,822
Agricultural and agricultural real estate	—	—	1 311	311
Residential real estate	—	—	—	—
Consumer	—	—	—	—
Total	2 \$ 279	\$ 279	3 \$ 5,133	\$ 5,133

The pre-modification and post-modification recorded investment represents amounts as of the date of loan modification. Since the modifications on these loans have been only interest rate concessions and term extensions, not principal reductions, the pre-modification and post-modification recorded investment amounts are the same. At June 30, 2016, there were no commitments to extend credit to any of the borrowers with an existing troubled debt restructuring.

The following tables presents troubled debt restructured loans for which there was a payment default during the three and six months ended June 30, 2016, and June 30, 2015, that had been modified during the twelve-month period prior to default.

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	With Payment Defaults During the Following Periods Three Months Ended June 30,	
	2016	2015
	Number of Recorded of Investment Loans	Number of Recorded of Investment Loans
Commercial	1 \$ 100	— \$ —
Commercial real estate	—	—
Total commercial and commercial real estate	1 100	— —
Agricultural and agricultural real estate	—	—
Residential real estate	—	—
Consumer	—	—
Total	1 \$ 100	— \$ —
	With Payment Defaults During the Following Periods Six Months Ended June 30,	
	2016	2015
	Number of Recorded of Investment Loans	Number of Recorded of Investment Loans
Commercial	1 \$ 100	— \$ —
Commercial real estate	—	—
Total commercial and commercial real estate	1 100	— —
Agricultural and agricultural real estate	—	—
Residential real estate	—	—
Consumer	—	—
Total	1 \$ 100	— \$ —

Heartland's internal rating system is a series of grades reflecting management's risk assessment, based on its analysis of the borrower's financial condition. The "pass" category consists of all loans that are not in the "nonpass" category, categorized into a range of loan grades that reflect increasing, though still acceptable, risk. Movement of risk through the various grade levels in the pass category is monitored for early identification of credit deterioration. The "nonpass" category consists of special mention, substandard, doubtful and loss loans. The "special mention" rating is attached to loans where the borrower exhibits negative financial trends due to borrower specific or systemic conditions that, if left uncorrected, threaten the borrower's capacity to meet its debt obligations. The borrower is believed to have sufficient financial flexibility to react to and resolve its negative financial situation. These credits are closely monitored for improvement or deterioration. The "substandard" rating is assigned to loans that are inadequately protected by the current sound net worth and paying capacity of the borrower and may be further at risk due to deterioration in the value of collateral pledged. Well-defined weaknesses jeopardize liquidation of the debt. These loans are still considered collectible; however, a distinct possibility exists that Heartland will sustain some loss if deficiencies are not corrected. Substandard loans may exhibit some or all of the following weaknesses: deteriorating trends, lack of earnings, inadequate debt service capacity, excessive debt and/or lack of liquidity. The "doubtful" rating is assigned to loans where identified weaknesses make collection or liquidation in full, on the basis of existing facts, conditions and values, highly questionable and improbable. These borrowers are usually in default, lack liquidity and capital, as well as resources necessary to remain an operating entity. Specific pending events, such as capital injections, liquidations or perfection of liens on additional collateral, may strengthen the credit, thus deferring classification of the loan as loss



until the exact status can be determined. The "loss" rating is assigned to loans considered uncollectible. As of June 30, 2016, Heartland had no loans classified as doubtful and no loans classified as loss. Loans are placed on "nonaccrual" when management does not expect to collect payments of principal and interest in full or when principal or interest has been in default for a period of 90 days or more, unless the loan is both well secured and in the process of collection.

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The following table presents loans and leases by credit quality indicator at June 30, 2016, and December 31, 2015, in thousands:

	Pass	Nonpass	Total
June 30, 2016			
Commercial	\$1,154,318	\$132,983	\$1,287,301
Commercial real estate	2,438,572		