INTERMOUNTAIN COMMUNITY BANCORP
Form 10-Q
May 14, 2010

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

(Mark One)

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

For the quarterly period ended March 31, 2010

OR

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

For the transition period from to

COMMISSION FILE NUMBER 000-50667
INTERMOUNTAIN COMMUNITY BANCORP
(Exact name of registrant as specified in its charter)

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

414 Church Street, Sandpoint, ID 83864
(Address of principal executive offices) (Zip code)
Registrant s telephone number, including area code:
(208) 263-0505
Securities registered pursuant to Section 12(b) of the Act:

None	**None**
(Title of each class)	*(Name of each exchange on which registered)*

Securities registered pursuant to Section 12(g) of the Act:
Common Stock (no par value)
(Title of class)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

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

The number of shares outstanding of the registrant s Common Stock, no par value per share, as of May 10, 2010 was 8,387,496.

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PART I Financial Information
Item 1 Financial Statements
Intermountain Community Bancorp
Consolidated Balance Sheets
(Unaudited)

	March 31, 2010	December 31, 2009
	(Dollars in thousands)	
ASSETS		
Cash and cash equivalents:		
Interest-bearing	$ 107,515	$ 83,617
Non-interest bearing and vault	15,451	19,572
Restricted cash	2,936	2,508
Available-for-sale securities, at fair value	187,453	181,784
Held-to-maturity securities, at amortized cost	15,153	15,177
Federal Home Loan Bank (FHLB) of Seattle stock, at cost	2,310	2,310
Loans held for sale	4,970	6,574
Loans receivable, net	623,515	655,602
Accrued interest receivable	4,812	5,077
Office properties and equipment, net	41,761	42,425
Bank-owned life insurance	8,488	8,397
Goodwill	11,662	11,662
Other intangibles	407	439
Other real estate owned (OREO)	11,538	11,538
Prepaid expenses and other assets	37,017	32,962
Total assets	$ 1,074,988	$ 1,079,644
LIABILITIES		
Deposits	$ 826,006	$ 819,321
Securities sold subject to repurchase agreements	86,656	95,233
Advances from Federal Home Loan Bank	49,000	49,000
Cashier checks issued and payable	1,051	1,113
Accrued interest payable	1,396	1,211
Other borrowings	16,527	16,527
Accrued expenses and other liabilities	9,732	8,612
Total liabilities	990,368	991,017
Commitments and contingent liabilities		
STOCKHOLDERS EQUITY		
Common stock 300,000,000 shares authorized; 8,434,631 and 8,438,554 shares issued and 8,387,496 and 8,365,836 shares outstanding as of March 31, 2010 and December 31, 2009	78,581	78,569
Preferred stock 1,000,000 shares authorized; 27,000 shares issued and outstanding as of March 31, 2010 and December 31, 2009	25,543	25,461
Accumulated other comprehensive loss, net of tax	(4,212)	(4,840)

Retained deficit	(15,292)	(10,563)
Total stockholders equity	84,620	88,627
Total liabilities and stockholders equity	$ 1,074,988	$ 1,079,644

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

Intermountain Community Bancorp

Consolidated Statements of Operations
(Unaudited)

	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
	(Dollars in thousands, except per share data)	
Interest income:		
Loans	$ 9,649	$ 11,648
Investments	1,967	2,699
Total interest income	11,616	14,347
Interest expense:		
Deposits	2,390	3,342
Other borrowings	807	1,103
Total interest expense	3,197	4,445
Net interest income	8,419	9,902
Provision for losses on loans	(6,808)	(2,770)
Net interest income after provision for losses on loans	1,611	7,132
Other income:		
Fees and service charges	1,787	1,669
Loan related fee income	493	540
Net gain on sale of securities	53	1,295
Other-than-temporary impairment (OTTI) losses on investments (1)	(19)	(244)
Bank-owned life insurance	91	90
Other	118	163
Total other income	2,523	3,513
Operating expenses	11,560	10,772
Loss before income taxes	(7,426)	(127)
Income tax benefit	3,117	9
Net loss	(4,309)	(118)
Preferred stock dividend	419	414
Net loss applicable to common stockholders	$ (4,728)	$ (532)
Loss per share basic	$ (0.56)	$ (0.06)

Loss per share diluted	$ (0.56)	$ (0.06)
Weighted average common shares outstanding basic	8,372,315	8,348,238
Weighted average common shares outstanding diluted	8,372,315	8,348,238

(1) Total other-than-temporary impairment (OTTI) was $0 for the quarter ended March 31, 2010, with $19,000 reclassified from other comprehensive income to the statement of operations. Total OTTI for the quarter ended March 31, 2009 was $1,751,000, with $244,000 recognized in the statement of operations and $1,507,000 recognized in the statement of other comprehensive income.

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

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Intermountain Community Bancorp

Consolidated Statements of Cash Flows
(Unaudited)

	Three months ended March 31, 2010	2009
	(Dollars in thousands)	
Cash flows from operating activities:		
Net loss	$ (4,309)	$ (118)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation	802	945
Stock-based compensation expense	122	93
Net amortization of premiums (discounts) on securities	769	17
Provisions for losses on loans	6,808	2,770
Proceeds from sale of loans	17,267	27,545
Originations of loans held for sale	(15,474)	(29,857)
Amortization of core deposit intangibles	32	35
(Gain) on sale of loans, investments, property and equipment	(262)	(1,595)
Loss on sale of other real estate owned		
OTTI credit loss on available-for-sale investments	19	244
Charge down on OREO	777	33
Accretion of deferred gain on sale of branch property	(4)	(4)
Net accretion of loan and deposit discounts and premiums	(10)	(16)
Increase in cash surrender value of bank-owned life insurance	(91)	(90)
Change in:		
Accrued interest receivable	265	239
Prepaid expenses and other assets	(4,413)	(9,802)
Accrued interest payable	185	(333)
Accrued expenses and other liabilities	970	(1,356)
Net cash provided by operating activities	3,453	(11,250)
Cash flows from investing activities:		
Purchases of available-for-sale securities	(26,128)	(87,501)
Proceeds from calls or maturities of available-for-sale securities	6,309	31,729
Principal payments on mortgage-backed securities	14,071	7,091
Proceeds from calls or maturities of held-to-maturity securities	20	
Origination of loans, net principal payments	22,827	31,425
Purchase of office properties and equipment	(143)	(274)
Proceeds from sale of office properties and equipment	6	
Net change in federal funds sold		40,290
Proceeds from sale of other real estate owned	1,684	183
Net change in restricted cash	(428)	(2,168)
Net cash (used in) investing activities	18,218	20,775

Cash flows from financing activities:		
Net change in demand, money market and savings deposits	$ 3,908	$ 1,600
Net change in certificates of deposit	2,777	19,274
Net change in repurchase agreements	(8,577)	(32,494)
Principal reduction of note payable		(10)
Proceeds from exercise of stock options		55
Retirement of treasury stock	(3)	(7)
Cash dividends paid to preferred stockholders		(210)
Net cash provided by (used in) financing activities	(1,895)	(11,792)
Net change in cash and cash equivalents	19,776	(2,267)
Cash and cash equivalents, beginning of period	103,189	22,907
Cash and cash equivalents, end of period	$ 122,965	$ 20,640
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$ 3,012	$ 4,871
Income taxes		
Noncash investing and financing activities:		
Loans converted to other real estate owned	2,461	4,724

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

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Intermountain Community Bancorp

Consolidated Statements of Comprehensive Income
(Unaudited)

	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
	(Dollars in thousands)	
Net loss	$ (4,309)	$ (118)
Other comprehensive income (loss):		
Change in unrealized gains on investments, and mortgage backed securities (MBS) available for sale, excluding non-credit loss on impairment of securities	615	125
Non-credit loss on impairment on available-for-sale debt	19	(1,507)
Less deferred income tax provision (benefit)	(251)	547
Change in fair value of qualifying cash flow hedge	245	104
Net other comprehensive income (loss)	628	(731)
Comprehensive loss	$ (3,681)	$ (849)

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

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Intermountain Community Bancorp

Notes to Consolidated Financial Statements
(Unaudited)

1. **Basis of Presentation**:

The foregoing unaudited interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X as promulgated by the Securities and Exchange Commission. Accordingly, these financial statements do not include all of the disclosures required by accounting principles generally accepted in the United States of America for complete financial statements. These unaudited interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2009. In the opinion of management, the unaudited interim consolidated financial statements furnished herein include adjustments, all of which are of a normal recurring nature, necessary for a fair statement of the results for the interim periods presented.

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

2. **Investments**

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

	Available-for-Sale				
	Amortized Cost	**Non-Credit OTTI Recognized in OCI (Losses)**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value/ Carrying Value**
March 31, 2010					
U.S. treasury securities and obligations of U.S. government agencies	$ 46	$	$	$	$ 46
Residential mortgage-backed securities	193,645	(1,206)	2,878	(7,910)	187,407
	$ 193,691	$ (1,206)	$ 2,878	$ (7,910)	$ 187,453
December 31, 2009					
U.S. treasury securities and obligations of U.S. government agencies	$ 51	$	$	$	$ 51
	188,624	(1,225)	2,662	(8,328)	181,733

Residential mortgage-backed securities	$ 188,675	$ (1,225)	$ 2,662	$ (8,328)	$ 181,784

	Held-to-Maturity				
	Carrying Value/ Amortized Cost	**Non-Credit OTTI Recognized in OCI (Losses)**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
March 31, 2010					
State and municipal securities	$ 15,153	$	$ 291	$ (42)	$ 15,402
December 31, 2009					
State and municipal securities	$ 15,177	$ 7	$ 276	$ (56)	$ 15,397

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

	Less Than 12 Months		12 Months or Longer		Total	
March 31, 2010	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
State and municipal securities	$	$	$ 3,210	$ 42	$ 3,210	$ 42
Residential mortgage-backed securities	62,445	1,926	14,956	5,984	77,401	7,910
Total	$ 62,445	$ 1,926	$ 18,166	$ 6,026	$ 80,611	$ 7,952

	Less Than 12 Months		12 Months or Longer		Total	
December 31, 2009	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
State and municipal securities	$ 3,196	$ 56	$	$	$ 3,196	$ 56
Residential mortgage-backed securities	49,464	1,504	24,124	6,824	73,588	8,328
Total	$ 52,660	$ 1,560	$ 24,124	$ 6,824	$ 76,784	$ 8,384

At March 31, 2010, the amortized cost and fair value of available-for-sale and held-to-maturity debt securities, by contractual maturity, are as follows (in thousands):

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	**Fair Value**	**Amortized Cost**	**Fair Value**
One year or less	$	$	$ 635	$ 641
After one year through five years	46	46	661	690
After five years through ten years			2,429	2,559
After ten years			11,428	11,512
	46	46	15,153	15,402
Mortgage-backed securities	193,645	187,407		
	$ 193,691	$ 187,453	$ 15,153	$ 15,402

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

Intermountain s investment portfolios are managed to provide and maintain liquidity; to maintain a balance of high quality, diversified investments to minimize risk; to offset other asset portfolio elements in managing interest rate risk; to provide collateral for pledging; and to maximize returns. At March 31, 2010, the Company does not intend to sell any of its available-for-sale securities that have a loss position and it is not likely that it will be required to sell the available-for-sale securities before the anticipated recovery of their remaining amortized cost. The unrealized losses on residential mortgage-backed securities without OTTI were considered by management to be temporary in nature.

At March 31, 2010, residential mortgage-backed securities included a security comprised of a pool of mortgages with a remaining unpaid principal balance of $3.6 million. In March 2009, due to the lack of an orderly market for the security and the declining national economic and housing market, based on analytical modeling taking into consideration a range of factors normally found in an orderly market, the Company recorded a $1.7 million OTTI on this security. Based on the analysis of projected cash flows, $526,000 was charged to earnings as a credit loss during 2009 and $1,225,000 was recognized in other comprehensive income. The Company recorded an additional credit loss impairment of $19,000 for the three months ended March 31, 2010. However, the overall estimated market value on the security improved during this time, reducing the net non-credit value impairment to $1,206,000. At this time, the Company anticipates holding the security until its value is recovered or until maturity, and will continue to adjust its net income and other comprehensive income to reflect potential future credit loss impairments and the security s market value. The Company calculated the credit loss charges against earnings each quarter by subtracting the estimated present value of future cash flows on the security from its amortized cost at the end of each period.

See Note 11 Fair Value of Measurements for more information on the calculation of fair or carrying value for the investment securities.

3. **Goodwill and Other Intangible Assets**:

Intermountain has goodwill and core deposit intangible assets which were recorded in connection with business combinations. The Company performs a goodwill impairment analysis on an annual basis as of December 31. Additionally, the Company performs a goodwill impairment evaluation on an interim basis when events or circumstances indicate impairment potentially exists. A significant amount of judgment is involved in determining if an indicator of impairment has occurred. Such indicators may include, among others, a significant decline in our expected future cash flows; a sustained, significant decline in our stock price and market capitalization; a significant adverse change in legal factors or in the business climate; adverse action or assessment by a regulator; and unanticipated competition. In response to the significant turmoil in the equity market for financial institutions, the Company evaluated its goodwill position at each quarter end during 2009 for potential impairment. The Company engaged an independent consultant at December 31, 2009 to assist management in evaluating the carrying value of goodwill. The evaluation followed the two-step process for evaluating impairment required by accounting guidance. In Step 1, the Company evaluated whether an impairment of goodwill existed at December 31, 2009. This evaluation was based on a comparison of the estimated fair value of the Company in comparison to the book value of the Company s common equity at December 31, 2009. In estimating the fair value of the Company, management used a combination of discounted cash flow method and the market value approach. The discounted cash flow modeling used estimates of future earnings and cash flows under the assumption that the Company is sold to an independent company, resulting in changes to both its future financial position and operating performance. In particular, the evaluation assumed reductions in investments, borrowings and preferred stock on the balance sheet, and increases in earnings resulting from improved net interest margins from asset deployment into higher-yielding loans, lower credit costs in future years, and additional cost reductions from consolidation with another company. The rate used to discount the cash flows was 14.5% and was based on the modified Capital Asset Pricing Model, commonly used in valuations, which adds various risk and size premiums to an assumed risk-free market interest rate. As part of its Step 1 analysis, management also estimated the Company s fair value using commonly used market multiples against tangible book value and deposits. The results of Step 1 indicated that a potential impairment did exist at the end of 2009, requiring the Company to engage in Step 2 to determine the amount of the impairment.

The Step 2 evaluation requires the Company to calculate the implied fair value of its goodwill. The implied fair value of goodwill is determined in the same manner as goodwill recognized in a business combination. The estimated fair value of the Company is allocated to all of the Company s assets and liabilities, including any unrecognized identifiable assets, as if the Company had been acquired in a business combination and the estimated fair value of the Company is the price paid to acquire it. Any excess of the estimated fair value of the Company as calculated in Step 1 over the fair value of its net assets represents the implied fair value of goodwill. If the carrying amount of goodwill is greater than the implied fair value of that goodwill, an impairment loss would be recognized as a charge to earnings in an amount equal to that excess. In conducting this analysis, management compared the interest rates, maturities, durations and quality of its assets and liabilities against various market factors and made adjustments to the carrying value to arrive at the fair value. The Step 2 analysis indicated that the Company s fair value at December 31, 2009 exceeded the net fair value of its assets by an amount greater than the carrying value of its goodwill. As a result, the Company determined that no impairment existed in 2009. At March 31, 2010, the Company concluded there were no triggering events that would require an interim impairment evaluation at March 31, 2010. As this evaluation is based on changing market conditions and estimates of current and future values and cash flows, no assurance can be given that an impairment of goodwill will not be required in future periods.

4. **Advances from the Federal Home Loan Bank of Seattle**:

At March 31, 2010 and December 31, 2009 the Bank had a $10.0 million FHLB advance at 4.96% that matures in September 2010, a $5.0 million FHLB advance at 0.86% that matures in September 2010, a $5.0 million FHLB advance at 1.49% that matures in September 2011, a $25.0 million FHLB advance at 2.06% that matures in October 2012 and a $4.0 million FHLB advance at 3.11% that matures in September 2014. These notes totaled $49.0 million, and the Bank had the ability to borrow an additional $64.4 million from the FHLB.

Advances from FHLB Seattle are collateralized by certain qualifying loans. At December 31, 2009, Intermountain had the ability to borrow $121.6 million from FHLB Seattle, of which $49.0 million was utilized for borrowing. The Bank also had a letter of credit agreement with the FHLB at December 31, 2009 in the amount of $2.6 million, which was collateralized using the same collateral. The Bank s credit line with FHLB Seattle is limited to a percentage of its total regulatory assets subject to collateralization requirements. Intermountain would be able to borrow amounts in excess of this total from the FHLB Seattle with the placement of additional available collateral.

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5. Other Borrowings:

The components of other borrowings are as follows (in thousands):

	March 31, 2010	December 31, 2009
Term note payable (1)	$ 8,279	$ 8,279
Term note payable (2)	8,248	8,248
Total other borrowings	$ 16,527	$ 16,527

(1) In January 2003, the Company issued $8.0 million of Trust Preferred securities through its subsidiary, Intermountain Statutory Trust I. The debt associated with these securities bears interest on a variable basis tied to the 90-day LIBOR (London Inter-Bank Offering Rate) index plus 3.25%, with interest only paid quarterly. The rate on this borrowing was 3.53% at March 31, 2010. The debt is callable by the Company quarterly and matures in March 2033. During the third quarter of 2008, the Company entered into an interest rate

swap contract with Pacific Coast Bankers Bank. The purpose of the $8.2 million notional value swap is to convert the variable rate payments made on our Trust Preferred I obligation to a series of fixed rate payments for five years, as a hedging strategy to help manage the Company s interest-rate risk. See Note A and B.

(2) In March 2004, the Company issued $8.0 million of Trust Preferred securities through its subsidiary, Intermountain Statutory Trust II. The debt associated with these securities bears interest on a variable basis tied to the 90-day LIBOR index plus 2.8%, with interest only paid quarterly. The rate on this borrowing was 3.05% at March 31, 2010. The debt is

callable by the Company quarterly and matures in April 2034. See Note A and B.

A) Intermountain s obligations under the above debentures issued by its subsidiaries constitute a full and unconditional guarantee by Intermountain of the Statutory Trusts obligations under the Trust Preferred Securities. In accordance with ASC 810, Consolidation, (formerly FIN 46R, Consolidation of Variable Interest Entities), the trusts are not consolidated and the debentures and related amounts are treated as debt of Intermountain.

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

6. <u>Earnings Per Share</u>:

The following table presents the basic and diluted earnings per share computations (net loss numbers in thousands):

	Three months Ended March 31, 2010	Three months Ended March 31, 2009
Numerator:		
Net loss basic and diluted	$ (4,309)	$ (118)
Preferred stock dividend	419	414
Net loss applicable to common stockholders	$ (4,728)	$ (532)
Denominator:		
Weighted average shares outstanding basic	8,372,315	8,348,238
Dilutive effect of common stock options, restricted stock awards		
Weighted average shares outstanding diluted	8,372,315	8,348,238
Loss per share basic and diluted:		
Loss per share basic	$ (0.56)	$ (0.06)
Effect of dilutive common stock options		
Loss per share diluted	$ (0.56)	$ (0.06)

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The weighted average number of potentially dilutive common shares excluded in calculating diluted net income per common share due to the anti-dilutive effect is 254,683 and 230,428 shares for the three months ended March 31, 2010 and 2009, respectively. Common stock equivalents were calculated using the treasury stock method.

7. **Operating Expenses**:

The following table details Intermountain s components of total operating expenses in thousands:

	Three months ended March 31, 2010	Three months ended March 31, 2009
Salaries and employee benefits	$ 5,832	$ 5,706
Occupancy expense	1,828	1,968
Advertising	222	299
Fees and service charges	651	598
Printing, postage and supplies	389	361
Legal and accounting	324	280
FDIC Assessment	469	153
OREO expense	253	116
OREO valuation adjustments in the period (1)	777	33
Other expense	815	1,258
Total operating expenses	$ 11,560	$ 10,772

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

Salaries and employee benefits expense increased $126,000 or 2.21%, over the three month period last year as a result of $290,000 in severance costs associated with a staff reduction plan implemented in the first quarter. The severance costs were offset by decreased staffing levels and lower incentive compensation expense. Efforts to reduce compensation expense continue in 2010, as the Company has reduced additional staff, suspended salary increases for executives and officers and reduced other compensation plans.

Occupancy expenses decreased $140,000, or 7.1%, for the three month period ended March 31, 2010 compared to the same period one year ago. The decrease was comprised of a decrease in rent and computer hardware and software expense as additional cost control measures have been implemented. The Company expects these expenses to remain stable in 2010, as it has postponed building expansion plans and limited new hardware and software purchases.

The advertising expense decrease of $77,000 for the three month period compared to the same period one year ago reflected reductions in general advertising and media expenses, as the need for broad advertising in the current market has been limited. The $53,000 increase in fees and service charges for the three month period ended March 31, 2010 compared to the same period one year ago primarily reflected increased loan collection, repossession and liquidation expenses. Printing, postage and supplies increased $28,000 for the three-month period in comparison to last year s total. The increase reflected timing of the payment of postage and supply expense during the quarter, and is not anticipated to remain at higher levels in subsequent quarters. Legal and accounting fees increased by $44,000 in comparison to the same three month period in 2009 as increasing legal expenses related to loan collection and compensation analysis were partially offset by a reduction in consulting fees.

FDIC expenses increased $316,000, or 206.5% for the three month period over the same period last year as FDIC insurance premium rates have increased substantially over the same period one year ago. OREO expense, related valuation adjustments and gain/loss on sale of OREO increased $881,000 for the three month period over the same period last year. The Company has been aggressively migrating problem assets into and out of OREO through the credit cycle, resulting in a larger number of OREO properties outstanding during the period and a higher amount of charge offs and gains/losses related to the sale of OREO properties than in the first quarter of 2009. Other expenses decreased $443,000 or 35.2%, for the three month period over the same period last year, reflecting decreases in telecommunications, computer services, training and travel costs, and expense associated with funding the reserve for unfunded loan commitments.

8. **Income Taxes**:

Intermountain uses an estimate of future earnings and tax planning strategies to determine whether or not the benefit of its net deferred tax asset will be realized. In conducting this analysis, management has assumed economic conditions will continue to be very challenging in 2010, followed by gradual improvement in the ensuing years. These assumptions are in line with both national and regional economic forecasts. As such, its estimates include credit losses that are significantly elevated in 2010, but less so than those experienced in 2009, followed by improvement in ensuing years as the economy improves and the Company s loan portfolio turns over. It also assumes improving net interest margins beginning in 2011, and reductions in operating expenses as credit costs abate and its other cost reduction strategies continue. Based on these estimates and potential additional tax planning strategies that it could employ to accelerate taxable income, the Company has determined that it is not required to establish a valuation allowance for the deferred tax assets, as management believes it is more likely than not that the net deferred tax asset will be realized principally through future reversals of existing taxable temporary differences. Management further believes that future taxable income will be sufficient to realize the benefits of the $10.1 million net operating loss carry forward included in the net deferred tax asset. However, to the extent that this analysis is based on estimates that are reliant on future economic conditions, management cannot assure that valuation impairment on its tax asset will not be required in future periods.

9. **Stock-Based Compensation Plans**:

The Company utilized its stock to compensate employees and directors under the 1999 Director Stock Option Plan, the 1999 Employee Plan and the 1988 Employee Plan (together the Stock Option Plans). On January 14, 2009, the terms of the Amended and Restated 1999 Employee Stock Option and Restricted Stock Plan and the 1999 Director Stock Option Plan expired. Upon recommendation of management and approval of the Board of Directors, it was determined that, due to the economic uncertainty, the Board would not seek to implement a new plan at this time. The 1988 Employee Stock Option Plan was a predecessor plan to the Amended and Restated 1999 Employee Stock Option and Restricted Stock Plan. Because each of these plans has expired, shares may no longer be awarded under these plans. However, awards remain unexercised or unvested under these plans. The Company did not grant options to purchase Intermountain common stock or restricted stock during the three months ended March 31, 2010 or March 31, 2009.

In 2003, stockholders approved a change to the 1999 Employee Option Plan to provide for the granting of restricted stock awards. The Company granted restricted stock to directors and employees beginning in 2005. The restricted stock vests 20% per year, over a five-year period. The Company granted no restricted shares during either of the three months ended March 31, 2010 and 2009. For the three months ended March 31, 2010 and 2009, restricted stock expense totaled $122,000 and $93,000, respectively. Total expense related to stock-based compensation recorded in the three months ended March 31, 2010 and 2009 was $122,000 and $93,000, respectively.

A summary of the changes in stock options outstanding for the three months ended March 31, 2010, is presented below:

	Three months ended March 31, 2010 (dollars in thousands, except per share amounts)		
	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Life (Years)
Beginning Options Outstanding, Jan 1, 2010	254,686	$ 6.35	
Options Granted			
Exercises			
Forfeitures	(12,526)	7.85	

Ending options outstanding, March 31, 2010	242,160		6.27	2.6
Exercisable at March 31, 2010	242,160	$	6.27	2.6

The total intrinsic value of options exercised during the three months ended March 31, 2010 and 2009 was $0 and $7,000, respectively. A summary of the Company s nonvested restricted shares for the three months ended March 31, 2010, is presented below:

Nonvested Shares	Shares	Weighted-Average Grant-Date Fair Value
Balance at January 1, 2010	72,718	$ 15.71
Granted		
Vested	(23,439)	18.65
Forfeited	(2,144)	16.38
Balance at March 31, 2010	47,135	$ 14.22

10. Derivative Financial Instruments

Management uses derivative financial instruments to protect against the risk of interest rate movements on the value of certain assets and liabilities and on future cash flows. The instruments that have been used by the Company include interest rate swaps and cash flow hedges with indices that relate to the pricing of specific assets and liabilities.

Derivative instruments have inherent risks, primarily market risk and credit risk. Market risk is associated with changes in interest rates and credit risk relates to the risk that the counterparty will fail to perform according to the terms of the agreement. The amounts potentially subject to market and credit risks are the streams of interest payments under the contracts and the market value of the derivative instrument which is determined based on the interaction of the notional amount of the contract with the underlying instrument, and not the notional principal amounts used to express the volume of the transactions. Management monitors the market risk and credit risk associated with derivative financial instruments as part of its overall Asset/Liability management process.

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

Interest Rate Swaps Designated as Cash Flow Hedges

The tables below identify the Company s interest rate swaps at March 31, 2010 and December 31, 2009, which were entered into to hedge certain LIBOR-based trust preferred debentures and designated as cash flow hedges pursuant to ASC 815 (dollars in thousands):

	March 31, 2010				
Maturity Date	Notional Amount	Fair Value(Loss)	Receive Rate (LIBOR)	Pay Rate (Fixed)	Type of Hedging Relationship
Pay Fixed, Receive Variable:					
October 2013	$ 8,248	$ (806)	0.25%	4.58%	Cash Flow

	December 31, 2009				
Maturity Date	**Notional Amount**	**Fair Value (Loss)**	**Receive Rate (LIBOR)**	**Pay Rate (Fixed)**	**Type of Hedging Relationship**
Pay Fixed, Receive Variable:					
October 2013	$ 8,248	$ (678)	0.28%	4.58%	Cash Flow

The fair values, or unrealized losses, of $806,000 at March 31, 2010 and $678,000 at December 31, 2009 are included in other liabilities. The Company has begun to defer the interest payments on the related Trust Preferred borrowing beginning with the January 2010 scheduled remittance. A calculation of the effectiveness of the hedge was prepared. It was concluded that although the hedge is effective, there is small amount of ineffectiveness due to the delayed payments. The Company expensed $90,000 in interest expense in the three months ended March 31, 2010 related to the ineffective portion of the hedge. The changes in fair value, net of tax, are separately disclosed in the statement of changes in stockholders equity as a component of comprehensive income. Net cash flows from these interest rate swaps are included in interest expense on trust preferred debentures. The unrealized loss at March 31, 2010 is a component of comprehensive income for March 31, 2010. At March 31, 2010, Intermountain had $550,000 in pledged certificates of deposit and $492,000 in restricted cash as collateral for the cash flow hedge. A rollfoward of the amounts in accumulated other comprehensive income related to interest rate swaps designated as cash flow hedges follows:

	Three Months Ended	
	Mar 31, 2010	**Mar 31, 2009**
Unrealized loss at beginning of period	$ (678)	$ (985)
Amount of loss recognized in other comprehensive income	(128)	104
Unrealized loss at end of period	$ (806)	$ (881)

Interest Rate Swaps Not Designated as Hedging Instruments Under ASC 815

The Company has purchased certain derivative products to allow the Company to effectively convert a fixed rate loan to a variable rate payment stream. The Company economically hedges derivative transactions by entering into offsetting derivatives executed with third parties upon the origination of a fixed rate loan with a customer. Derivative transactions executed as part of this program are not designated as ASC 815 hedge relationships and are, therefore, marked to market through earnings each period. In most cases the derivatives have mirror-image terms, which result in the positions changes in fair value offsetting completely through earnings each period. However, to the extent that the derivatives are not a mirror-image, changes in fair value will not completely offset, resulting in some earnings impact each period. Changes in the fair value of these interest rate swaps are included in other non-interest income. The following table summarizes these interest rate swaps as of March 31, 2010 and December 31, 2009 (in thousands):

	March 31, 2010		December 31, 2009	
	Notional Amount	**Fair Value Gain**	**Notional Amount**	**Fair Value Gain**
Interest rate swaps with third party financial institutions	$ 2,559	$ 31	$ 2,559	$ 57

At March 31, 2010, loans receivable included $31,000 of derivative assets and other liabilities included $0 of derivative assets related to these interest rate swap transactions. At March 31, 2010, the interest rate swaps had a maturity date of March 2019. At March 31, 2010, Intermountain had $72,000 in restricted cash as collateral for the interest rate swaps.

11. Fair Value Measurements

Fair value is defined under ASC 820-10 as the price that would be received for an asset or paid to transfer a liability (an exit price) in the principal market for the asset or liability in an orderly transaction between market participants on the measurement date. In support of this principle ASC 820-10 establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy is as follows:

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

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

Level 3 inputs Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using

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pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair values requires significant management judgment or estimation.

The following table presents information about the Company s assets measured at fair value on a recurring basis as of March 31, 2010, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value (in thousands).

		Fair Value Measurements At March 31, 2010, Using		
Description	**Fair Value March 31, 2010**	**Quoted Prices In Active Markets for Identical Assets (Level 1)**	**Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Available-for-Sale Securities:				
U.S. treasury securities and obligations of U.S. government agencies	$ 46	$	$ 46	$
Residential mortgage backed securities (MBS)	187,407		157,411	29,996
Other Assets Derivative	31			31
Total Assets Measured at Fair Value	$ 187,484	$	$ 157,457	$ 30,027
Other Liabilities Derivatives	$ 806	$	$	$ 806

		Fair Value Measurements At December 31, 2009 Using		
Description	**Fair Value Dec 31, 2009**	**Quoted Prices In Active Markets for Identical Assets (Level 1)**	**Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Available-for-Sale Securities:				
U.S. treasury securities and obligations of U.S. government agencies	$ 51	$	$ 51	$
Residential mortgage backed securities (MBS)	181,733		149,497	32,236
Other Assets Derivative	57			57
Total Assets Measured at Fair Value	$ 181,841	$	$ 149,548	$ 32,293
Other Liabilities Derivatives	$ 678	$	$	$ 678

The changes in Level 3 assets and liabilities measured at fair value on a recurring basis as of March 31, 2010 are summarized as follows (in thousands):

Fair Value Measurement Transfers- Assets

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)		
Description	**Residential MBS**	**Derivatives**	**Total**
January 1, 2010 Balance	$ 32,236	$ 57	$ 32,293
Total gains or losses (realized/unrealized)			
Included in earnings	(19)	(26)	(45)
Included in other comprehensive income	911		911
Principal Payments	(3,132)		(3,132)
Transfers in and /or out of Level 3			
March 31, 2010 Balance	$ 29,996	$ 31	$ 30,027

Fair Value Measurement Transfers- Liabilities

Description	**Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Derivatives**
January 1, 2010 Balance	$ 678
Total gains or losses (realized/unrealized)	
Included in earnings	90
Included in other comprehensive income	38
March 31, Balance	$ 806

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The table below presents a portion of the Company s loans measured at fair value on a nonrecurring basis as of March 31, 2010, because they are impaired loans and the Company s OREO, aggregated by the level in the fair value hierarchy within which those measurements fall (in thousands).

Description	Fair Value Mar 31, 2010	Fair Value Measurements At March 31, 2010, Using Quoted Prices In Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Loans(1)	$ 66,494	$	$	$ 66,494
OREO	11,538			11,538
Total Assets Measured at Fair Value	$ 78,032	$	$	$ 78,032

(1) Represents impaired loans, net, which are included in loans.

Impaired loans are valued based on either the estimated fair value of the cash flows to be received or the fair value of the underlying collateral supporting the loan less selling costs. Real estate collateral on these loans and the Company s other real estate owned (OREO) is typically valued using appraisals or other indications of value based on recent comparable sales of similar properties or assumptions generally observable in the marketplace. Management reviews these valuations and makes additional valuation adjustments, as necessary, including subtracting estimated costs of liquidating the collateral or selling the OREO. The related nonrecurring fair value measurement adjustments have been classified as Level 3 because of the significant assumptions required to estimate future cash flows on these loans, and the rapidly changing and uncertain collateral values underlying the loans. Extreme volatility and the lack of relevant and current sales data in the Company s market areas for various types of collateral create additional uncertainties and require the use of multiple sources and management judgment to make adjustments.

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

Securities

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

Available for Sale Securities. Securities totaling $157.4 million classified as available for sale are reported at fair value utilizing Level 2 inputs. For these securities, the Company obtained fair value measurements from an independent pricing service and internally validated these measurements. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus, prepayment speeds, credit information and the bond s terms and conditions, among other things.

The available for sale portfolio also includes $30.0 million in super senior or senior tranche collateralized mortgage obligations not backed by a government or other agency guarantee. These securities are collateralized by fixed rate prime or Alt A mortgages, are structured to provide credit support to the senior tranches, and are carefully analyzed and monitored by management. Because of disruptions in the current market for mortgage-backed securities and collateralized mortgage obligations, an active market did not exist for these securities at March 31, 2010. This is evidenced by a significant widening in the bid-ask spread for these types of securities and the limited volume of actual trades made. As a result, less reliance can be placed on easily observable market data, such as pricing on transactions involving similar types of securities, in determining their current fair value. As such, significant adjustments were required to determine the fair value at the March 31, 2010 measurement date. These securities are valued using Level 3 inputs.

In valuing these securities, the Company utilized the same independent pricing service as for its other available-for-sale securities and internally validated these measurements. In addition, it utilized a second pricing service that specializes in whole-loan collateralized mortgage obligation valuation and another market source to derive independent valuations and used this data to evaluate and adjust the original values derived. In addition to the observable market-based input including dealer quotes, market spreads, live trading levels and execution data, both services also employed a present-value income model that considered the nature and timing of the cash flows and the relative risk of receiving the anticipated cash flows as agreed. The discount rates used were based on a risk-free rate, adjusted by a risk premium for each security. In accordance with the requirements of ASC 820-10, the Company has determined that the risk-adjusted discount rates utilized appropriately reflect the Company s best estimate of the assumptions that market participants would use in pricing the assets in a current transaction to sell the asset at the measurement date. Risks include nonperformance risk (that is, default risk and collateral value risk) and liquidity risk (that is, the compensation that a market participant receives for buying an asset that is difficult to sell under current market conditions). To the extent possible, the pricing services and the Company validated the results from these models with independently observable data.

In evaluating securities in the investment portfolio for OTTI, the Company evaluated the following factors:

The length of time and the extent to which the market value of the securities has been lower than their cost;

The financial condition and near-term prospects of the issuer or obligation, including any specific events, which may influence the operations of the issuer or obligation such as credit defaults and losses in mortgages underlying the security, changes in technology that impair the earnings potential of the investment or the discontinuation of a segment of the business that may affect the future earnings potential; and

The intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in market value.

Based on the factors above, the Company has determined that one security comprised of a pool of mortgages was subject to OTTI as of March 31, 2009. During 2009, the Company recorded an OTTI of $1,751,000 on this security. Of the total $1,751,000 OTTI, $526,000 was related to credit losses and was a charge against earnings. The remaining $1,225,000 reflected non-credit value impairment and was charged against the Company s other comprehensive income and reported capital on the balance sheet. The Company conducted a similar analysis on the estimated cash flows in the first quarter of 2010, and as a result of this analysis, recorded additional credit loss impairments of $19,000 against earnings. At this time, the Company anticipates holding the security until its value is recovered or maturity, and will continue to adjust its other comprehensive income and capital position to reflect the security s current market value. The Company calculates the credit loss charge against earnings by subtracting the estimated present value of estimated future cash flows on the security from its amortized cost.

Loans. Loans are generally not recorded at fair value on a recurring basis. Periodically, the Company records nonrecurring adjustments to the carrying value of loans based on fair value measurements for partial charge-offs of the uncollectible portions of those loans. Nonrecurring adjustments also include certain impairment amounts for impaired loans when establishing the allowance for credit losses. Such amounts are generally based on either the estimated fair value of the cash flows to be received or the fair value of the underlying collateral supporting the loan less selling costs. Real estate collateral on these loans and the Company s OREO is typically valued using appraisals or other indications of value based on recent comparable sales of similar properties or assumptions generally observable in the marketplace. Management reviews these valuations and makes additional valuation adjustments, as necessary, including subtracting estimated costs of liquidating the collateral or selling the OREO. The related nonrecurring fair value measurement adjustments have generally been classified as Level 3 because of the significant assumptions required to estimate future cash flows on these loans, and the rapidly changing and uncertain collateral values underlying the loans. Extreme volatility and the lack of relevant and current sales data in the Company s market areas for various types of collateral create additional uncertainties and require the use of multiple sources and management judgment to make adjustments. Loans subject to nonrecurring fair value measurement were $66.5 million at March 31, 2010 all of which were classified as Level 3.

Other Real Estate Owned. At the applicable foreclosure date, OREO is recorded at fair value of the real estate, less the estimated costs to sell the real estate. Subsequently, OREO is carried at the lower of cost or net realizable value (fair value less estimated selling costs), and is periodically assessed for impairment based on fair value at the reporting date. Fair value is determined from external appraisals and other valuations using judgments and estimates of external professionals. Many of these inputs are not observable and, accordingly, these measurements are classified as Level 3. The Company s OREO at March 31, 2010 totaled $11.5 million, all of which was classified as Level 3.

Interest Rate Swaps. During the third quarter of 2008, the Company entered into an interest rate swap contract with Pacific Coast Bankers Bank. The purpose of the $8.2 million notional value swap is to convert the variable rate payments made on the Trust Preferred I obligation (see Note 5 Other Borrowings) to a series of fixed rate payments for five years, as a hedging strategy to help manage the Company s interest-rate risk. This contract is carried as an asset or liability at fair value, and as of March 31, 2010, it was a liability with a fair value of $806,000.

During the first quarter of 2009, the Company entered into an interest rate swap contract with Pacific Coast Bankers Bank. The purpose of the $1.6 million notional value swap is to convert the fixed rate payments earned on a loan receivable to a series of variable rate payments for ten years, as a hedging strategy to help manage the Company s interest-rate risk. This contract is carried as an asset or liability at fair value, and as of March 31, 2010, it was an asset with a fair value of $5,000. During the second quarter of 2009, the Company entered into an interest rate swap contract with Pacific Coast Bankers Bank. The purpose of the $1.0 million notional value swap is to convert the fixed rate payments earned on a loan receivable to a series of variable rate payments for ten years, as a hedging strategy to help manage the Company s interest-rate risk. This contract is carried as an asset or liability at fair value, and as of March 31, 2010, it was an asset with a fair value of $26,000.

Intermountain is required to disclose the estimated fair value of financial instruments, both assets and liabilities on and off the balance sheet, for which it is practicable to estimate fair value. These fair value estimates are made at March 31, 2010 based on relevant market information and information about the financial instruments. Fair value estimates are intended to represent the price an asset could be sold at or the price a liability could be settled for. However, given there is no active market or observable market transactions for many of the Company s financial instruments, the Company has made estimates of many of these fair values which are subjective in nature, involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimated values.

The estimated fair value of the financial instruments as of March 31, 2010 and December 31, 2009, are as follows (in thousands):

	March 31, 2010		December 31, 2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:		&n		