HEARTLAND FINANCIAL USA INC
Form 10-K
March 15, 2013

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

R ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2012

Commission File Number: 001-15393

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

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

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

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

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

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 R 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 R No *

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Act.

Large accelerated filer * Accelerated filer R Non-accelerated filer * Smaller reporting company *

(Do not check if a smaller reporting company)

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant, based on the last sales price quoted on the NASDAQ Global Select Market on June 30, 2012, the last business day of the registrant's most recently completed second fiscal quarter, was approximately $344,095,539.

As of March 14, 2013, the Registrant had issued and outstanding 16,857,828 shares of common stock, $1.00 par value per share.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the 2013 Annual Meeting of Stockholders are incorporated by reference into Part III.

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

ITEM 1. BUSINESS

A. GENERAL DESCRIPTION

Heartland Financial USA, Inc. ("Heartland") is a multi-bank holding company registered under the Bank Holding Company Act of 1956, as amended (the "BHCA") that was originally formed in the State of Iowa in 1981 and reincorporated in the State of Delaware in 1993. Heartland's headquarters are located at 1398 Central Avenue, Dubuque, Iowa. Our website address is www.htlf.com. You can access, free of charge, our filings with the Securities and Exchange Commission, including our annual report on Form 10-K, our quarterly reports on Form 10-Q, current reports on Form 8-K and any other amendments to those reports, at our website, or at the Commission's website at www.sec.gov. Proxy materials for our upcoming 2013 annual shareholders meeting to be held on May 22, 2013, will be available electronically via a link on our website at www.htlf.com.

As of December 31, 2012, Heartland had ten bank subsidiaries in the States of Iowa, Illinois, Wisconsin, New Mexico, Arizona, Montana, Colorado and Minnesota, (collectively, the "Bank Subsidiaries"). On December 7, 2012, Heartland acquired Heritage Bank, N.A., a national banking association located in Phoenix, Arizona, for which we have obtained regulatory approvals to merge into our Arizona Bank & Trust bank subsidiary on March 15, 2013. Exclusive of Heritage Bank, all Bank Subsidiaries are members of the Federal Deposit Insurance Corporation (the "FDIC"). Listed below are our Bank Subsidiaries, which operate a total of 68 banking locations after the merger:

- Dubuque Bank and Trust Company, Dubuque, Iowa, is chartered under the laws of the State of Iowa. Dubuque Bank and Trust Company has two wholly-owned subsidiaries: DB&T Insurance, Inc., a multi-line insurance agency and DB&T Community Development Corp., a partner in low-income housing and historic rehabilitation projects.
- Galena State Bank & Trust Co., Galena, Illinois, is chartered under the laws of the State of Illinois.
- Riverside Community Bank, Rockford, Illinois, is chartered under the laws of the State of Illinois.
- Wisconsin Bank & Trust (formerly known as Wisconsin Community Bank), Madison, Wisconsin, is chartered under the laws of the State of Wisconsin.
- New Mexico Bank & Trust, Albuquerque, New Mexico, is chartered under the laws of the State of New Mexico.
- Rocky Mountain Bank, Billings, Montana, is chartered under the laws of the State of Montana.
- Arizona Bank & Trust, Phoenix, Arizona, is chartered under the laws of the State of Arizona.
- Summit Bank & Trust, Broomfield, Colorado, is chartered under the laws of the State of Colorado.
- Minnesota Bank & Trust, Edina, Minnesota, is chartered under the laws of the State of Minnesota.

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

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

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

Heartland’s subsidiaries are wholly owned, except for Minnesota Bank & Trust, of which Heartland owned 80% of the capital stock on December 31, 2012.

At December 31, 2012, Heartland had total assets of $4.99 billion, total loans of $2.82 billion and total deposits of $3.85 billion. Heartland's total capital as of December 31, 2012, was $401.8 million. Net income available to common stockholders for 2012 was $46.4 million.

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

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

Operating Strategy

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

1. Creating strong community ties through local bank delivery.

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

2. Providing extensive resources to increase revenue.

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

3. Centralizing back-office operations for efficiency.

- Leverage expertise across all Bank Subsidiaries
- Leading edge technology for account processing and delivery systems
- Efficient back-office support for loan processing and deposit operations
- Centralized loan underwriting and collections
- Centralized loss management and risk analysis

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

Another component of our operating strategy is to encourage all directors, officers and employees to maintain a strong ownership interest in Heartland. We have established ownership guidelines for executive management and have made an employee stock purchase plan available to employees since 1996. As of December 31, 2012, approximately 20% of Heartland's outstanding common stock was directly registered in the name of our employees, officers and directors.

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

Acquisition and Expansion Strategy

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

In recent years, we have focused on markets with growth potential in the Midwestern and Western regions of the United States, with a strategic goal to expand our presence in Western markets to 50% of total assets, thereby balancing the growth in our Western markets with the stability of our Midwestern markets. As of December 31, 2012, Heartland had approximately 39% of its assets in Western markets.

In August 2003, Heartland and a group of investors opened Arizona Bank & Trust, a de novo banking operation. In 2006, Arizona Bank & Trust expanded by acquiring Bank of the Southwest, a financial institution providing retail and commercial banking services in Phoenix and Tempe, Arizona. In December 2012, Heartland acquired Heritage Bank, N.A., a Phoenix-based commercial bank and subsidiary of Ameri-National Corporation of Overland Park, Kansas. In March 2013, we plan to merge Heritage Bank into Arizona Bank & Trust and combine Heritage Bank's main location into ours. After the merger, Arizona Bank & Trust will have eight banking locations.

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

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

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

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

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

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

Lending Activities

General

The Bank Subsidiaries provide a range of commercial and retail lending services to businesses and individuals. These credit activities include agricultural, commercial, residential and consumer loans.

The Bank Subsidiaries market their services to qualified lending customers. Lending officers actively solicit the business of new companies entering their market areas as well as long-standing members of the Bank Subsidiaries' respective business communities. We believe that our Bank Subsidiaries are successful in attracting new lending customers in their markets through professional service, competitive pricing, innovative structures, convenient locations and customer communications.

Commercial Loans

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

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

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

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

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

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

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

Agricultural Loans

Agricultural loans are emphasized by those Bank Subsidiaries with operations in and around rural markets, including Dubuque Bank and Trust Company, Rocky Mountain Bank, Wisconsin Bank & Trust’s Monroe and Platteville banking centers and New Mexico Bank & Trust’s Clovis banking offices. Dubuque Bank and Trust Company is one of the largest agricultural lenders in the State of Iowa. Agricultural loans constituted approximately 12% of our total loan portfolio at December 31, 2012. In making agricultural loans, we have policies designating a primary lending area for each Bank Subsidiary, in which a majority of its agricultural operating and real estate loans are made. Under this policy, loans in a secondary market area must be secured by real estate.

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

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

Residential Real Estate Mortgage Loans

Mortgage lending remains a focal point for Heartland as we continue to build our residential real estate lending business. As long-term interest rates have remained at relatively low levels during the past several years, many customers elected mortgage loans that are fixed rate with fifteen- or thirty-year maturities. We usually sell these loans into the secondary market and retain servicing on the loans sold to Fannie Mae. We believe that mortgage servicing on sold loans provides a relatively steady source of fee income compared to fees generated solely from mortgage origination operations. Moreover, the retention of servicing provides an opportunity to maintain regular contact with mortgage loan customers. At December 31, 2012, total residential real estate mortgage loans serviced for others totaled $2.20 billion.

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

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

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

Consumer Lending

The consumer lending service of our Bank Subsidiaries provides a broad array of consumer loans, including 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.

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

Trust and Investment Services

Dubuque Bank and Trust Company, Galena State Bank & Trust Co., Riverside Community Bank, Wisconsin Bank & Trust, New Mexico Bank & Trust, Arizona Bank & Trust and Minnesota Bank & Trust offer trust and investment services in their respective communities. In those markets that do not yet warrant a full trust department, the sales and administration is performed by Dubuque Bank and Trust Company personnel. As of December 31, 2012, total

Heartland trust assets were $1.5 billion, $1.4 billion of which were assets under management. Collectively, the Bank Subsidiaries provide a full complement of trust and investment services for individuals and corporations.

Dubuque Bank and Trust Company is nationally recognized as a provider of socially responsible investment services, and it manages investment portfolios for religious and other non-profit organizations located throughout the United States. Dubuque Bank and Trust Company is also Heartland’s lead bank in providing daily valuation 401(k) plans and other retirement services, including Heartland’s retirement plan for its employees.

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

B. MARKET AREAS

Dubuque Bank and Trust Company
Dubuque Bank and Trust Company is primarily located in Dubuque County, Iowa, which encompasses the city of Dubuque and a number of surrounding rural communities. The city of Dubuque is located in northeastern Iowa, on the Mississippi River, approximately 175 miles west of Chicago, Illinois, and approximately 200 miles northeast of Des Moines, Iowa. It is strategically situated at the intersection of the state borders of Iowa, Illinois and Wisconsin. Based upon the results of the 2010 census, the city of Dubuque had a total population of 57,637 and Dubuque County had a total population of 93,653.

The principal office of Heartland and Dubuque Bank and Trust Company’s main office currently occupy the same building. Heartland’s operations center is located directly across the street from Dubuque Bank and Trust Company’s main office. In addition to its main banking office, Dubuque Bank and Trust Company operates eight branch offices in Dubuque County, two branch offices in Keokuk, Iowa, one branch office in Carthage, Illinois and one branch office in East Dubuque, Illinois. In June 2011, Heartland combined its First Community Bank charter with its Dubuque Bank and Trust Company charter. The consolidation of charters was designed to realize efficiencies in operating costs, audits, regulatory examinations and insurance premiums. The First Community Bank offices serve customers in the tri-county region of Lee County, Iowa; Hancock County, Illinois; and Clark County, Missouri. According to the 2010 census, the population of Keokuk, primarily an industrial community, is 10,780 and the population of Lee County is 35,862.

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

The administrative and back office support for National Residential Mortgage, the brand name used for residential mortgage lending services at our non-footprint locations, operates as a division of Dubuque Bank and Trust Company from an office facility in Scottsdale, Arizona.

Dubuque Bank and Trust Company also operates residential mortgage loan production offices, under the National Residential Mortgage brand name, in metro San Diego, California and Reno, Nevada.

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

Riverside Community Bank
Riverside Community Bank is located on the northeast edge of Rockford, Illinois, which is approximately 75 miles west of Chicago in Winnebago County. In addition to its main banking office, Riverside Community Bank has three branch offices, all of which are located in the Winnebago County area. Based on the 2010 census, the county had a population of 295,266, and the city of Rockford had a population of 152,871.

Wisconsin Bank & Trust
Wisconsin Bank & Trust’s main office is located in Madison, Wisconsin, in Dane County. The bank operates three branch offices in the Madison suburbs, one branch office in Monroe, Wisconsin, and three branch offices in southwestern Wisconsin in Platteville, Lancaster and Hazel Green. Based on the 2010 census, the Madison Metropolitan Statistical Area has a population of 568,593 and the population of the City of Madison is 233,209. The

city of Monroe is approximately 50 miles southwest of Madison in Green County. Wisconsin Bank & Trust also has offices in the cities of Sheboygan and De Pere, which are located in the northeastern Wisconsin counties of Sheboygan and Brown, respectively.

New Mexico Bank & Trust

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

Arizona Bank & Trust

Arizona Bank & Trust currently operates seven offices, including the main office in Phoenix, one in Mesa, one in Tempe, two in Chandler, one in Gilbert and one in Scottsdale. After the merger of Heritage Bank into Arizona Bank & Trust, scheduled for March 15, 2013, it will operate an eighth office in Tempe. These cities are all located in the Phoenix metropolitan area within Maricopa County. Based on the 2010 Census, Phoenix metro area is the 14th largest metro area by population in the United States with approximately 4.2 million people. Arizona Bank & Trust operates one residential mortgage loan production office in Scottsdale.

Rocky Mountain Bank

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

Summit Bank & Trust

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

Minnesota Bank & Trust

Minnesota Bank & Trust currently operates from a leased facility in Edina, Minnesota, a first tier suburb of Minneapolis. The population of Edina was 47,941 in 2010 according to the U.S. Census Bureau. Minnesota Bank & Trust operates a residential mortgage loan production office, under the National Residential Mortgage brand name, in Minot, North Dakota.

Citizens Finance Co.

Citizens Finance Co. is headquartered in Dubuque, Iowa, with additional offices in Davenport and Cedar Rapids, Iowa; Madison and Appleton, Wisconsin; and the Illinois cities of Loves Park, Tinley Park, Crystal Lake, Elgin, Aurora and Peoria.

The following table sets forth certain information concerning the Bank Subsidiaries as of December 31, 2012, dollars in thousands:

Heartland Bank Subsidiaries

Bank Subsidiaries	Charter Location	Year Acquired or Opened	Number Of Bank Offices	Total Portfolio Loans	Total Deposits
Dubuque Bank and Trust Company	Dubuque, IA	1935	13	$814,400	$1,150,141
Galena State Bank & Trust Co.	Galena, IL	1992	4	$176,109	$245,554
Riverside Community Bank	Rockford, IL	1995	4	$166,852	$344,005
Wisconsin Bank & Trust	Madison, WI	1997	10	$446,214	$549,773
New Mexico Bank & Trust	Albuquerque, NM	1998	15	$497,837	$721,445
Arizona Bank & Trust	Phoenix, AZ	2003	7	$189,314	$243,044
Rocky Mountain Bank	Billings, MT	2004	10	$278,252	$372,135

Summit Bank & Trust	Broomfield, CO	2006	3	$77,264	$93,318
Minnesota Bank & Trust	Edina, MN	2008	1	$90,729	$109,862
Heritage Bank, N.A.	Phoenix, AZ	2012	2	$60,154	$81,848

C. COMPETITION

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

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

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

D. EMPLOYEES

At December 31, 2012, Heartland employed 1,498 full-time equivalent employees. We place a high priority on staff development, which involves extensive training in a variety of areas, including customer service training. New employees are selected based upon their technical skills and customer service capabilities. None of our employees are covered by a collective bargaining agreement. We offer a variety of employee benefits, and we consider our employee relations to be excellent. The Predictive Index® system is utilized to assist with placing potential employees in new positions and with evaluating current positions.

E. INTERNET ACCESS

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

F. SUPERVISION AND REGULATION

General

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

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

Heartland also operates a consumer finance company, Citizens Finance Co., with state licenses in Iowa, Illinois and Wisconsin and as such is subject to regulation by the state banking authorities for those states.

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

Taxation laws administered by the Internal Revenue Service and state taxing authorities and securities laws administered by the Securities and Exchange Commission (the "SEC") and state securities authorities also have an impact on the business of Heartland. The effect of these statutes, regulations and regulatory policies may be significant, and cannot be predicted with a high degree of certainty.

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

The following is a summary of material elements of the regulatory framework that applies to Heartland and its subsidiaries. It does not describe all of the statutes, regulations and regulatory policies that apply, nor does it restate all of the requirements of those that are described. As such, the following is qualified in its entirety by reference to applicable law. Each of the federal agencies that regulate Heartland and its Bank Subsidiaries is required to adopt regulations under the Dodd-Frank Act. Any such change in regulations or regulatory policies, or further change in applicable law, may have a material effect on the business of Heartland and its subsidiaries.

Dodd-Frank Act

The Dodd-Frank Act, which was enacted into law on July 21, 2010, significantly changed the regulatory framework for banks and bank holding companies, and required significant rulemaking and numerous studies and reports. Among other things, the Dodd-Frank Act:

- established the Bureau of Consumer Financial Protection (the "CFPB"), with broad authority to regulate providers of credit, savings, payment and other consumer financial products and services;
- significantly reduced interchange fees on debit card transactions;
- made permanent the $250,000 deposit insurance limit on insured deposits, and revised the assessment base for the calculation of the FDIC insurance assessments for financial institutions;
- requires federal banking agencies to adopt regulations relating to compensation practices of covered institutions; and
- requires risk retention on mortgage originations.

Regulations implementing many of the above requirements have been finalized or proposed, and additional regulations or guidelines from the CFPB are expected to significantly change the format of many consumer offerings. The Dodd-Frank Act also requires more far-reaching changes in the regulation of banks and bank holding companies by:

- restricting securities trading activities and support for and investments in private funds;
- creating a new structure for anticipating and resolving troubled or failed financial institutions with enhanced prudential standards, early remediation of financial distress, and enhanced liquidity requirements; and

- requiring the federal banking agencies to adopt new capital requirements.

Most of the regulations implementing, or proposing changes to implement, these requirements are designed to apply to larger institutions: primarily institutions or holding companies with more than $50 billion of assets. These include requirements for Enhanced Prudential Standards and Early Remediation, Stress Testing, Resolution Plans, and Orderly Liquidation. However, the Federal Reserve and the FDIC have promulgated and proposed rules which will apply to Heartland, including significant changes to capital requirements, discussed below. In addition, the CFPB has either issued or proposed numerous rules which will impact Heartland and its subsidiaries.

The CFPB has supervisory authority over banks with assets of more than $10 billion and over nonbank entities that provide consumer financial services and products. The CFPB has supervisory authority over Heartland's consumer finance subsidiary, and rulemaking authority for federal laws covering the consumer financial services and products offered by all Heartland subsidiaries. In 2012 and early 2013 the CFPB issued a number of rules which will apply to and significantly affect Heartland's products and their delivery and features, including rules establishing suitability requirements for most closed end residential mortgages, residential loan servicing, appraisals, and compensation for residential loan originators. CFPB is expected to issue a number of other rules and Heartland expects that these rules will affect the cost, delivery and features of its residential mortgage products.

Federal Banking regulators are expected to jointly issue a rule defining a Qualified Residential Mortgage in 2013 which will generally follow the BCFB suitability rule, which will impact Heartland's securitization of its mortgage production, as Heartland must retain a portion of those mortgages which do not constitute Qualified Residential Mortgages.

In addition to the Dodd-Frank Act, other legislative proposals have been made both domestically and internationally. Among other things, these proposals include additional capital and liquidity requirements and limitations on size or types of activity in which banks may engage.

Heartland

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

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

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

The BHCA generally prohibits Heartland from acquiring direct or indirect ownership or control of more than 5% of the voting shares of any company that is not a bank and from engaging in any business other than that of banking, managing and controlling banks, or furnishing services to banks and their subsidiaries. This general prohibition is subject to a number of exceptions. The principal exception allows bank holding companies to engage in, and to own shares of companies engaged in, certain businesses found by the Federal Reserve to be “so closely related to banking ...

as to be a proper incident thereto.” This authority would permit Heartland to engage in a variety of banking-related businesses, including consumer finance, equipment leasing, mortgage banking, brokerage, and the operation of a computer service bureau (including software development). Under the Dodd-Frank Act, however, any such non-bank subsidiary would be subject to regulation no less stringent than that applicable to the lead bank of the bank holding company. The BHCA generally does not place territorial restrictions on the domestic activities of non-bank subsidiaries of bank holding companies.

Additionally, bank holding companies that meet certain eligibility requirements prescribed by the BHCA and elect to operate as financial holding companies may engage in, or own shares in companies engaged in, a wider range of nonbanking activities, including securities and insurance underwriting and sales, merchant banking and any other activity that the Federal Reserve, in consultation with the Secretary of the Treasury, determines by regulation or order is financial in nature, incidental to any such financial activity or complementary to any such financial activity and does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally. As of the date of this filing, Heartland has not applied for approval to operate as a financial holding company.

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

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

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

The Basel Committee on Banking Supervision (the “BCBS”) is an international organization which has the goal of creating international standards for banking regulation. In December 2010, the BCBS issued a new set of international guidelines for determining regulatory capital known as “Basel III.” The Federal Reserve and the OCC issued three notices of proposed rulemaking in June 2012 (the “Basel III NPRs”) that would revise the capital requirements for U.S. banks consistent with the BCBS proposals and revise the calculation of risk-weighted assets. The regulators have currently delayed the finalization of the proposals.

As of December 31, 2012, Heartland had regulatory capital in excess of the Federal Reserve's minimum requirements.

Treasury Regulation-the Emergency Economic Stabilization Act of 2008, the American Recovery and Reinvestment Tax Act of 2009 and the Small Business Jobs Act of 2010
Bank holding companies that receive funding under the TARP CPP or the SBLF are subject to direct regulation by the U.S. Treasury. The TARP CPP under EESA was created by the U.S. Treasury in 2008 to invest in the senior preferred stock of qualifying U.S. banks and savings associations or their holding companies. Under the CPP, qualifying financial institutions issued to the U.S. Treasury senior preferred stock that was non-voting, carried dividends and could be included as capital, as well as warrants to purchase common stock based upon the amount of senior preferred stock the U.S. Treasury acquired.

On December 19, 2008, Heartland issued and sold to the U.S. Treasury pursuant to the CPP $81.7 million of its senior preferred stock together with a 10-year warrant to purchase 609,687 shares of Heartland's common stock at $20.10 per share. The senior preferred stock qualified as Tier 1 capital under the Federal Reserve's capital guidelines and provided Heartland with considerable regulatory flexibility during 2009 and 2010. Consistent with terms that were set by the U.S. Treasury uniformly among all publicly held banks participating in the program, the senior preferred stock required the payment of dividends to the U.S. Treasury at a rate of 5% per year, increasing to 9% after the fifth year. The senior preferred stock, the agreements under which it and the warrant were issued, and regulations issued under EESA and the American Recovery and Reinvestment Act of 2009, contained a number of restrictions on the payment by Heartland of dividends and on compensation paid to executive officers and highly paid employees while Heartland participated in the CPP.

In an effort to encourage more small business lending by community banks, and as mandated by the Small Business Jobs Act of 2010, in early 2011 the U.S. Treasury started making available up to $30.0 billion of capital under the SBLF to qualifying banks with less than $10.0 billion of assets. Under the SBLF, the U.S. Treasury purchased from qualifying financial institutions senior perpetual non-cumulative preferred stock with a liquidation preference of $1,000 per share. Like the preferred stock issued under TARP, the preferred stock issued under the SBLF is non-voting (except in limited circumstances) and qualifies as Tier 1 capital under the Federal Reserve's guidelines.

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

The Series C Preferred Stock issued under the SBLF requires quarterly dividends payable to the U.S. Treasury initially equal to 5.00% of the liquidation value of the Preferred Stock. The dividend rate payable under the Series C Preferred Stock is subject to reduction during the second to tenth quarters after issuance (through December 31, 2013, for Heartland) based upon increases in Heartland's qualified small business lending ("QSBL") over a baseline amount, and may be reduced to as low as 1.00% if QSBL increases by ten percent or more over that period. Based upon increases in its QBSL through December 31, 2012, the dividend rate payable by Heartland will be 2.00% during the first quarter of 2013 and 1.00% for the second quarter of 2013. From the eleventh quarter through March 16, 2016, the rate remains fixed at the rate determined at the end of the tenth quarter and will increase to 9.00% if the SBLF funding has not been repaid by March 16, 2016.

Although Heartland is no longer subject to the significant restrictions imposed under the TARP CPP program, it does have ongoing quarterly reporting obligations to the U.S. Treasury under the SBLF that will be used by the U.S. Treasury to determine the dividend rate. The terms of the Series C Preferred Stock also prohibit Heartland from paying dividends on its common stock, or repurchasing shares, to the extent that, after payment of such dividends or repurchases, Heartland's Tier 1 Capital would be less than the difference between (i) 90% of its Tier 1 Capital on September 15, 2011 ($281.2 million), and (ii) net charge-offs and any redemptions of the Series C Preferred Stock. This limitation is reduced by 10% for each one percent increase in Heartland's QSBL over the baseline level. If, however, Heartland fails to declare and pay dividends on the Series C Preferred Stock in a given quarter, then Heartland may not pay dividends on or repurchase any common stock for the next three quarters, except in very limited circumstances. If any Series C Preferred Stock remains outstanding on the tenth anniversary of issuance, Heartland may not pay any further dividends on its common stock or any other junior stock until the Series C Preferred Stock is redeemed in full.

Dividend Payments

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

Federal Securities Regulation

Heartland's common stock is registered with the SEC under Section 12(b) of the Exchange Act. Consequently, Heartland is subject to the information, proxy solicitation, insider trading and other restrictions and requirements of the SEC under the Exchange Act.

The Bank Subsidiaries

General

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

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

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

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

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

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

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

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

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

Citizens Finance Co is a Consumer Finance Company that makes consumer loans and purchases motor vehicle conditional sales contracts and is subject to the examination, supervision, reporting and enforcement requirements of Iowa, Wisconsin and Illinois and the BCFB.

Deposit Insurance

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

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

The Dodd-Frank Act directed that the minimum deposit insurance fund reserve ratio would increase from 1.15% to 1.35% by September 30, 2020, and the cost of the increase will be borne by depository institutions with assets of $10 billion or more. The Dodd-Frank Act also provides the FDIC with discretion to determine whether to pay rebates to insured depository institutions when its deposit insurance reserves exceed certain thresholds. Previously, the FDIC was required to give rebates to depository institutions equal to the excess once the reserve ratio exceeded 1.50%, and was required to rebate 50% of the excess over 1.35% but not more than 1.50% of insured deposits. The FDIC adopted a final rule on February 7, 2011, that implements these provisions of the Dodd-Frank Act.

The FDIC established a Temporary Liquidity Guarantee Program on October 23, 2008, under which the FDIC fully guaranteed all non-interest-bearing transaction accounts and all senior unsecured debt of insured depository institutions or their qualified holding companies issued between October 14, 2008, and October 31, 2009. Heartland did not opt out of the program and as such, was assessed ten basis points during the first quarter of 2010 and fifteen basis points for the remainder of 2010 for transaction account balances in excess of $250,000 and, since it did not issue any senior unsecured debt during the designated time period, was not assessed the applicable rate of 75 basis points on the amount of debt issued. The guarantee of non-interest-bearing transaction accounts was twice extended by the FDIC, and under the Dodd-Frank Act was extended to December 31, 2012, and made applicable to all institutions, without further assessment. The total assessments paid by Heartland during 2010 and 2011 for participation in the Temporary Liquidity Guarantee Program totaled $235,000 and $84,000, respectively.

In addition, all institutions with deposits insured by the FDIC are required to pay assessments to fund interest payments on bonds issued by the Financing Corporation, an agency of the Federal government established to recapitalize the predecessor to the Savings Association Insurance Fund. During 2011, the assessment rate was 0.0102% of insured deposits and during 2012 was .00165 % of total deposits. These assessments will continue until the Financing Corporation bonds mature in 2019.

Supervisory Assessments

Each of the Bank Subsidiaries is required to pay supervisory assessments to its respective state banking regulator to fund the operations of that agency. In general, the amount of the assessment is calculated on the basis of each institution's total assets. During 2012, the Bank Subsidiaries paid supervisory assessments totaling $483,000.

Capital Requirements

Under federal regulations, the Bank Subsidiaries are subject to the following minimum capital standards: (i) a leverage requirement consisting of a minimum ratio of Tier 1 capital to total assets of 3% for the most highly-rated banks with a minimum requirement of at least 4% for all others; and (ii) a risk-based capital requirement consisting of a minimum ratio of total capital to total risk-weighted assets of 8% and a minimum ratio of Tier 1 capital to total risk-weighted assets of 4%. For purposes of these capital standards, Tier 1 capital consists primarily of permanent stockholders' equity less intangible assets (other than certain loan servicing rights and purchased credit card relationships). Total capital consists primarily of Tier 1 capital plus certain other debt and equity instruments that do not qualify as Tier 1 capital and, for Heartland, a portion of its allowance for loan and lease losses.

The capital requirements described above are minimum requirements. Higher capital levels will be required if warranted by the particular circumstances or risk profiles of individual institutions. For example, federal regulations provide that additional capital may be required to take adequate account of, among other things, interest rate risk or the risks posed by concentrations of credit, nontraditional activities or securities trading activities. As a de novo bank, Minnesota Bank & Trust is required to maintain higher Tier 1 capital to assets ratios for the first seven years of its operations (through April 2016). Further, under agreements with the FDIC and state banking agencies described below under “Safety and Soundness Standards,” Summit Bank & Trust is required to maintain a ratio of Tier 1 Capital to total assets of 8% and Arizona Bank & Trust is required to maintain both a ratio of Tier 1 capital to total assets of 8% and a ratio of total risk-based capital to risk-weighted assets of 12%.

Further, federal law and regulations provide various incentives for financial institutions to maintain regulatory capital at levels in excess of minimum regulatory requirements. For example, a financial institution generally must be “well-capitalized” to engage in acquisitions, and well-capitalized institutions may qualify for exemptions from prior notice or application requirements otherwise applicable to certain types of activities and may qualify for expedited processing of other required notices or applications. Additionally, one of the criteria that determines a bank holding company's eligibility to operate as a financial holding company is a requirement that both the holding company and all of its financial institution subsidiaries be “well-capitalized.” Under federal regulations, in order to be “well-capitalized” a financial institution must maintain a ratio of total capital to total risk-weighted assets of 10% or greater, a ratio of Tier 1 capital to total risk-weighted assets of 6% or greater and a ratio of Tier 1 capital to total assets of 5% or greater.

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

As of December 31, 2012: (i) none of the Bank Subsidiaries was subject to a directive from its primary federal regulator to increase its capital; (ii) each of the Bank Subsidiaries exceeded its minimum regulatory capital requirements under applicable capital adequacy guidelines; (iii) each of the Bank Subsidiaries was “well-capitalized,” as defined by applicable regulations;

and (iv) each of the Bank Subsidiaries subject to a directive to maintain capital higher than the regulatory capital requirements, as discussed below under “Safety and Soundness Standards,” complied with the directive.

Liability of Commonly Controlled Institutions

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

Dividend Payments

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

The payment of dividends by any financial institution is affected by the requirement to maintain adequate capital pursuant to applicable capital adequacy guidelines and regulations, and a financial institution generally is prohibited from paying any dividends if, following payment thereof, the institution would be undercapitalized. As described above, each of the Bank Subsidiaries exceeded its minimum capital requirements under applicable guidelines as of December 31, 2012. Minnesota Bank & Trust is subject to the FDIC's further prohibition on the payment of dividends during the first seven years of a bank's operations, allowing cash dividends to be paid only from net operating income, and prohibiting the payment of dividends until an appropriate allowance for loan and lease losses has been established and overall capital is adequate. Pursuant to agreements with the FDIC and the state banking agencies described below under “Safety and Soundness Standards,” Arizona Bank & Trust and Summit Bank & Trust may not pay any dividends without prior notice to, and consent from, the FDIC and the state banking regulator.

As of December 31, 2012, approximately $115.5 million was available to be paid as dividends by the Bank Subsidiaries. Notwithstanding the availability of funds for dividends, however, the FDIC may prohibit the payment of any dividends by the Bank Subsidiaries.

Insider Transactions

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

Safety and Soundness Standards

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

During their regular scheduled joint examinations of the Bank Subsidiaries, the FDIC and state banking commissioners cited three of the Bank Subsidiaries for certain deficiencies, including asset quality. Since January 2009, the boards of directors of Summit Bank & Trust and Arizona Bank & Trust have been under informal agreements with the FDIC and their respective state banking commissioners, agreeing to submit plans for improvement in the risks associated with any classified asset with a balance of more than $250,000, agreeing not to extend or renew credit to borrowers under loans that are classified, agreeing to review and ensure the sufficiency of the allowance for loan and lease losses and agreeing to submit a business plan outlining the plans to accomplish these measures as well as periodic progress reports against that plan. As noted above, these Bank Subsidiaries also agreed to maintain higher levels of regulatory capital and to refrain from paying dividends without regulatory approval. Each of these Bank Subsidiaries remains well capitalized and has complied with its agreement with its regulators. In November of 2011, the board of directors of Wisconsin Bank & Trust entered into an informal agreement with the FDIC and its state banking commissioner, agreeing to correct certain consumer compliance violations.

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

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

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

The Dodd-Frank Act prohibits insured depository institutions and their holding companies from engaging in proprietary trading except in limited circumstances, and prohibits them from owning equity interests in excess of 3% of a bank's Tier 1 Capital in private equity and hedge funds. The Federal Reserve released a final rule on February 9, 2011, (effective on April 1, 2011) which requires a “banking entity,” a term that is defined to include bank holding companies like Heartland, to bring its proprietary trading activities and investments into compliance with the Dodd-Frank Act restrictions no later than two years after the earlier of: (1) July 21, 2012, or (2) 12 months after the date on which interagency final rules are adopted. Pursuant to the compliance date final rule, banking entities are permitted to request an extension of this timeframe from the Federal Reserve.

These restrictions have not had, and are not currently expected to have, a material impact on the operations of the Bank Subsidiaries.

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

G. GOVERNMENTAL MONETARY POLICY AND ECONOMIC CONDITIONS

Heartland’s earnings are affected by the policies of regulatory authorities, including the Federal Reserve. The Federal Reserve’s monetary policies have significantly affected the operating results of commercial banks in the past and are expected to continue doing so in the future. Changing economic and money market conditions prompted by the actions of monetary and fiscal authorities may cause changes in interest rates, credit availability, and deposit levels that are beyond Heartland’s control. Future policies of the Federal Reserve and other authorities cannot be predicted, nor can their effect on future earnings.

ITEM 1A. RISK FACTORS

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

Our business and financial results are significantly affected by general business and economic conditions.

Our business activities and earnings are affected by general business conditions in the United States and particularly in the states in which our Bank Subsidiaries operate. Like most financial institutions, the 2008-2009 recession, and the declines in the housing market and real estate values, increased credit defaults, increased foreclosures, and write-downs of asset values, negatively impacted our business and results of operations. Although financial markets have stabilized, the global economies have improved and the domestic economy improved during 2012, certain segments of the economy continue to be depressed. Further, the economic outlook is clouded by the credit crisis in Europe, and consumer confidence has been periodically shaken by political gridlock, increased energy prices and other events. Further economic deterioration that affects household and/or corporate incomes could result in renewed credit deterioration and reduced demand for credit or fee-based products and services, negatively impacting our performance. In addition, changes in securities market conditions and monetary fluctuations could adversely affect the availability and terms of funding necessary to meet our liquidity needs.

Recent legislation has impacted our operations, and additional legislation and rulemaking could impact us adversely.

The recent recession spawned a number of significant new laws that impact financial institutions, including the EESA, ARRA and Dodd-Frank Act. The Dodd-Frank Act is particularly far reaching, establishing the CFPB with broad authority to administer and enforce a new federal regulatory framework of consumer financial regulation, changing the base for deposit insurance assessments, introducing regulatory rate-setting for interchange fees charged to merchants for debit card transactions, enhancing the regulation of consumer mortgage banking, changing the methods and standards for resolution of troubled institutions, and changing the Tier 1 regulatory capital ratio calculations for bank holding companies. In particular, the liquidity, capital and stress testing requirements of Basel III and the CFPB rules covering residential mortgage lending and servicing could negatively impact our operations. Many of the provisions of the Dodd-Frank Act have extended implementation periods and delayed effective dates and will require additional rulemaking by various regulatory agencies, and many could have far reaching implications on our operations. Accordingly, Heartland cannot currently quantify the ultimate impact of this legislation and the related future rulemaking, but expects that the legislation may have a detrimental impact on revenues and expenses, require Heartland to change certain of its business practices, increase Heartland's capital requirements and otherwise adversely affect its business.

Other changes in the laws, regulations and policies governing financial services companies could alter our business environment and adversely affect operations.

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

The soundness of other financial institutions could adversely affect our liquidity and operations.

Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services institutions are interrelated as a result of trading, clearing, counterparty or other relationships. We have exposure to many different counterparties, and we routinely execute transactions with counterparties in the financial industry, including brokers and dealers, commercial banks, investment banks, and other institutional clients. As a result, defaults by, or even rumors or questions about, one or more financial services institutions, or the financial services industry generally, have led to market-wide liquidity problems and could lead to losses or defaults by Heartland or the Bank Subsidiaries or by other institutions. Many of these transactions expose us to credit risk in the event of default of our counterparty or client. In addition, our credit risk may be exacerbated when the collateral held by us cannot be realized upon or is liquidated at prices not sufficient to recover the full amount of the financial instrument exposure due us. There is no assurance that any such losses would not materially and adversely affect our results of operations.

Further downgrades in the U.S. government's sovereign credit rating could present risks to Heartland.

Some ratings agencies have recently downgraded the sovereign credit rating they publish for, or otherwise negatively revised their outlook for, the U.S. government, and have indicated that they will continue to assess fiscal projections, as well as the medium-term economic outlook for the United States. Because of these developments, there continues to a perceived risk of an additional downgrade to the sovereign credit rating of the U.S. government, including the ratings of U.S. Treasury securities. If such a downgrade were to occur, the value and liquidity of instruments issued, insured or guaranteed by institutions, agencies or instrumentalities directly linked to the U.S. government could be adversely affected. Instruments of this nature are often held by financial institutions, including Heartland, for investment, liquidity planning and collateral purposes. A downgrade of the sovereign credit ratings of the U.S. government and perceived creditworthiness of U.S. government-related obligations could impact Heartland's liquidity.

Our business is concentrated in and dependent upon the continued growth and welfare of the various markets that we serve.

We operate over a wide area, including markets in Iowa, Illinois, Wisconsin, Arizona, New Mexico, Montana, Colorado and Minnesota and our financial condition, results of operations and cash flows are subject to changes in the economic conditions in those areas. Our success depends upon the business activity, population, income levels, deposits and real estate activity in those areas. Although our customers’ business and financial interests may extend well beyond our market areas, adverse economic conditions that affect our specific market area could reduce our growth rate, affect the ability of our customers to repay their loans to us and generally affect our financial condition and results of operations. For example, although all of our markets have been impacted to some extent by the economic downturn, the markets in Arizona, Colorado and Montana have been more severely affected than most of the markets in the Midwest, creating correspondingly greater impact on our banks that serve those areas.

Our expansion into new markets through National Residential Mortgage could subject us to economic risks in markets with which we are less familiar.

We have expanded our residential real estate mortgage production capability by adding personnel and capacity in our Heartland Mortgage and National Residential Mortgage unit, and have added residential loan production offices with new personnel in several new geographies. Although we have generally sold the mortgages we originate through National Residential Mortgage into the secondary market, we may elect to retain mortgages in our portfolio in the future, and regardless of such retention have some liability as the originator and servicer of the mortgages. If we inaccurately monitor credit risk in these markets, or retain personnel for National Residential Mortgage who do not accurately report and monitor credit risk, our operations could be negatively affected. In January 2013, the CFPB promulgated a number of rules that become effective in 2014 that will impact our origination and servicing of mortgage loans.

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

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

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

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

Our market and growth strategy relies heavily on our management team, and the unexpected loss of key managers may adversely affect our operations.

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

We face intense competition in all phases of our business and competitive factors could adversely affect our business.

The banking and financial services business in our markets is highly competitive and is currently undergoing significant change. Our competitors include large regional banks, local community banks, online banks, thrifts, securities and brokerage companies, mortgage companies, insurance companies, finance companies, money market mutual funds, credit unions and other non-bank financial service providers, and increasingly these competitors provide integrated financial services over a broad geographic area. Some of our competitors may also have access to governmental programs that impact their position in the marketplace favorably. Increased competition in our markets may result in a decrease in the amounts of our loans and deposits, reduced spreads between loan rates and deposit rates or loan terms that are more favorable to the borrower. Any of these results could have a material adverse effect on our ability to grow and remain profitable.

Changes in interest rates and other conditions could negatively impact our results of operations.

Our profitability is in part a function of the spread between the interest rates earned on investments and loans and the interest rates paid on deposits and other interest-bearing liabilities. Like most banking institutions, our net interest spread and margin will be affected by general economic conditions and other factors, including fiscal and monetary policies of the federal government, that influence market interest rates and our ability to respond to changes in such rates. At any given time, our assets and liabilities will be such that they are affected differently by a given change in interest rates. As a result, an increase or decrease in rates, the length of loan terms or the mix of adjustable and fixed rate loans in our portfolio could have a positive or negative effect on our net income, capital and liquidity. We measure interest rate risk under various rate scenarios and using specific criteria and assumptions. A summary of this process, along with the results of our net interest income simulations, is presented under the heading “Quantitative and Qualitative Disclosures About Market Risk” included under Item 7A of Part II of this Form 10-K. Although we believe our current level of interest rate sensitivity is reasonable and effectively managed, significant fluctuations in interest rates may have an adverse effect on our business, financial condition and results of operations.

We could suffer material credit losses if we do not appropriately manage our credit risk.

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

Commercial loans, which present risks related to the value of the assets that serve as collateral, make up a significant portion of our loan portfolio.

Commercial loans were $2.00 billion (including $1.29 billion of commercial real estate loans), or approximately 71% of our total loan portfolio as of December 31, 2012. Our commercial loans are primarily made based on the identified cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. Most often, this collateral consists of accounts receivable, inventory, machinery or real estate. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers. The other types of collateral securing these loans may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business.

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

Commercial real estate lending is a large portion of our commercial loan portfolio. These loans were $1.29 billion, or approximately 64%, of our total commercial loan portfolio as of December 31, 2012. The market value of real estate can fluctuate significantly in a short period of time as a result of market conditions in the geographic area in which the real estate is located. Adverse developments affecting real estate values in a few of our markets have negatively affected some of our commercial real estate loans, and further developments could increase the credit risk associated with our loan portfolio. Non-owner occupied commercial real estate loans typically are dependent, in large part, on sufficient income from the properties securing the loans to cover operating expenses and debt service. A weaker economy has an impact on the absorption period associated with lot and land development loans. When the source of repayment is reliant on the successful and timely sale of lots or land held for resale, a default on these loans becomes a greater risk. Economic events or governmental regulations outside of the control of the borrower or lender could negatively impact the future cash flow and market values of the affected properties.

If the problems that have occurred in the commercial real estate markets continue, particularly within our Western market areas, the value of collateral securing our commercial real estate loans may decline and we may not be able to realize the collateral value that we anticipated at the time of originating the loan, causing us to increase our provision for loan losses and adversely affect our operating results and financial condition. Declining real estate values resulting from the recent recession, particularly in our Arizona, Colorado and Montana markets, caused a decline in credit performance by our commercial real estate loan customers and caused us to significantly increase our provision for loan losses during 2008, 2009, 2010 and a portion of 2011, negatively impacting our financial performance. In light of the uncertainty that exists in the economy and credit markets nationally, there can be no guarantee that we will not experience recurring deterioration in such performance.

Our commercial real estate loans also include commercial construction loans, including land acquisition and development, which involve additional risks because funds are advanced based upon estimates of costs and the estimated value of the completed project. Because of the uncertainties inherent in estimating construction costs, as well as the market value of the completed project and the effects of governmental regulation on real property, it is relatively difficult to evaluate accurately the total funds required to complete a project and the related loan-to-value ratio. As a result, commercial construction loans often involve the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project and the ability of the borrower to sell or lease the property, rather than the ability of the borrower or guarantor to repay principal and interest. If our appraisal of the value of the completed project proves to be overstated, we may have inadequate security for the repayment of the loan upon completion of construction of the project. Additionally, with the ongoing economic environment and the correction in housing prices that is occurring in many of our market areas, a decrease in demand for the properties constructed by home builders and developers could result in higher delinquencies and greater charge-offs in future periods on loans made to such borrowers.

Our one- to four-family residential mortgage loans may result in lower yields and profitability.

One- to four-family residential mortgage loans comprised $249.7 million or approximately 9% of our loan and lease portfolio at December 31, 2012, with approximately 60% secured by properties located in the Midwest. These loans generally result in lower yields and lower profitability for us than other loans in Heartland’s portfolio and are generally made on the basis of the borrower’s ability to make repayments from his or her employment and the value of the property securing the loan.

Revenue from our mortgage banking operations is sensitive to changes in economic conditions, decreased economic activity, a slowdown in the housing market, higher interest rates or new legislation and may adversely impact our profits.

Our mortgage banking division, conducted through our Heartland Mortgage and National Residential Mortgage unit, has recently provided a significant portion of our consolidated revenue and maintaining our revenue stream in this segment is dependent upon our ability to originate loans and sell them to investors. Mortgage loan production levels are sensitive to changes in economic conditions and can suffer from decreased economic activity, a slowdown in the housing market or higher interest rates. Generally, any sustained period of decreased economic activity or higher interest rates could adversely affect mortgage originations and, consequently, reduce our income from mortgage lending activities.

Periods of rising interest rates will adversely affect income from mortgage banking activities.

In periods of rising interest rates, consumer demand for new mortgages and re-financings decreases, which in turn, adversely impacts our mortgage banking division. Because interest rates depend on factors outside of our control, we cannot eliminate the interest rate risk associated with our mortgage operations.

Our consumer loans generally have a higher degree of risk of default than our other loans.

At December 31, 2012, consumer loans totaled $245.7 million or approximately 9% of our total loan and lease portfolio. Consumer loans typically have shorter terms and lower balances with higher yields as compared to one- to four-family residential mortgage loans, but generally carry higher risks of default. Consumer loan collections are dependent on the borrower’s continuing financial stability, and thus are more likely to be affected by adverse personal circumstances. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount that can be recovered on these loans.

Our agricultural loans are often dependent upon the health of the agricultural industry in the location of the borrower, and the ability of the borrower to repay may be affected by many factors outside of the borrower’s control.

At December 31, 2012, agricultural real estate loans totaled $189.7 million or 7% of our total loan and lease portfolio. Payments on agricultural real estate loans are dependent on the profitable operation or management of the farm property securing the loan. The success of the farm may be affected by many factors outside the control of the borrower, including adverse weather conditions that prevent the planting of a crop or limit crop yields (such as hail, drought and floods), loss of livestock due to disease or other factors, declines in market prices for agricultural products (both domestically and internationally) and the impact of government regulations (including changes in price supports, subsidies and environmental regulations). In addition, many farms are dependent on a limited number of key individuals whose injury or death may significantly affect the successful operation of the farm. If the cash flow from a farming operation is diminished, the borrower’s ability to repay the loan may be impaired. The primary crops in our market areas are corn, soybeans, peanuts and wheat. Accordingly, adverse circumstances affecting these crops could have an adverse effect on our agricultural real estate loan portfolio.

We also originate agricultural operating loans. At December 31, 2012, these loans totaled $138.6 million or 5% of our total loan and lease portfolio. As with agricultural real estate loans, the repayment of operating loans is dependent on the successful operation or management of the farm property. Likewise, agricultural operating loans involve a greater degree of risk than lending on residential properties, particularly in the case of loans that are unsecured or secured by rapidly depreciating assets such as farm equipment or assets such as livestock or crops. The primary livestock in our market areas include dairy cows, hogs and feeder cattle. In these cases, any repossessed collateral for a defaulted loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation.

Our allowance for loan losses may prove to be insufficient to absorb losses in our loan portfolio.

We establish our allowance for loan losses in consultation with management of the Bank Subsidiaries and maintain it at a level considered adequate by management to absorb probable loan losses that are inherent in the portfolio. The amount of future loan losses is susceptible to changes in economic, operating and other conditions, including changes in interest rates, which may be beyond our control, and such losses may exceed current estimates. In each year from 2008 through 2011, we were required to record provisions for loan losses in excess of our pre-2008 historical experience because of the impact of the economy and real estate values on some of our borrowers, resulting in charge-offs and an increased level of nonperforming assets. At December 31, 2012, our allowance for loan losses as a percentage of total loans, exclusive of loans covered by loss share agreements, was 1.37% and as a percentage of total nonperforming loans was approximately 90%. Although we believe that the allowance for loan losses is adequate to absorb losses on any existing loans that may become uncollectible, we cannot predict loan losses with certainty, and we cannot assure you that our allowance for loan losses will prove sufficient to cover actual loan losses in the future. Further significant provisions, or charge-offs against our allowance that result in provisions, could have a significant negative impact on our profitability. Loan losses in excess of our reserves may adversely affect our business, financial condition and results of operations.

Impairment of investment securities, goodwill, other intangible assets, or deferred tax assets could require charges to earnings, which could result in a negative impact on our results of operations.

We maintained a balance of $1.56 billion, or 31% of our assets, in investment securities at December 31, 2012, and must periodically test our investment securities for impairment in value. In assessing whether the impairment of investment securities is other-than-temporary, we consider the length of time and extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and the intent and ability to retain our investment in the security for a period of time sufficient to allow for any anticipated recovery in fair value in the near term. Under current accounting standards, goodwill is not amortized but, instead, is subject to impairment tests on at least an annual basis or more frequently if an event occurs or circumstances change that reduce the fair value of a reporting unit below its carrying amount. Although we do not anticipate additional impairment charges, if we conclude that some portion of our goodwill may be impaired, a non-cash charge for the amount of such impairment would be recorded against earnings. Such a charge would have no impact on tangible capital. A decline in our stock price or occurrence of a triggering event following any of our quarterly earnings releases and prior to the filing of the periodic report for that period could, under certain circumstances, cause us to perform a goodwill impairment test and result in an impairment charge being recorded for that period which was not reflected in such earnings release. At December 31, 2012, we had goodwill of $30.6 million, representing approximately 8% of stockholders’ equity.

Further, our balance sheet reflected approximately $29.7 million of deferred tax assets at December 31, 2012, that represents differences in the timing of the benefit of deductions, credits and other items for accounting purposes and the benefit for tax purposes. To the extent we conclude that the value of this asset is not more likely than not to be realized, we would be obligated to record a valuation allowance against the asset, impacting our earnings during the period in which the valuation allowance is recorded. Assessing the need for, or the sufficiency of, a valuation allowance requires management to evaluate all available evidence, both negative and positive. Positive evidence necessary to overcome the negative evidence includes whether future taxable income in sufficient amounts and character within the carryback and carryforward periods is available under the tax law. When negative evidence (e.g., cumulative losses in recent years, history of operating losses or tax credit carryforwards expiring unused) exists, more positive evidence than negative evidence will be necessary. If the positive evidence is not sufficient to exceed the negative evidence, a valuation allowance for deferred tax assets is established. The impact of each of these impairment matters could have a material adverse effect on our business, results of operations, and financial condition.

Our mortgage banking revenue can be volatile from quarter to quarter, including as a result of changes in interest rates and the value of our mortgage servicing rights and our loans held for sale, and we rely on Government Sponsored Entities ("GSE") to purchase our conforming loans to reduce our credit risk and provide liquidity to fund new liquidity mortgage loans.

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

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

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

We may be required to repurchase mortgage loans or reimburse investors and others as a result of breaches in contractual representations and warranties.

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

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

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

Government regulation can result in limitations on our operations.

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

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

The financial services industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. In addition to being able to better serve customers, the effective use of technology increases efficiency and enables financial institutions to reduce costs. Our future success will depend, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands for convenience, as well as, to create additional efficiencies in our operations as we continue to grow and expand our market areas. Many of our larger competitors have substantially greater resources to invest in technological improvements. As a result, they may be able to offer additional or superior products to those that we will be able to offer, which would put us at a competitive disadvantage.

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

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

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

Employee errors and employee or customer misconduct could subject us to financial losses or regulatory sanctions and seriously harm our reputation. Misconduct by our employees could include hiding unauthorized activities from us, improper or unauthorized activities on behalf of our customers or improper use of confidential information. It is not always possible to prevent employee errors and misconduct, and the precautions we take to prevent and detect this activity may not be effective in all cases. Employee errors could also subject us to financial claims for negligence.

We maintain a system of internal controls and insurance coverage to mitigate against operational risks, including data processing system failures and errors and customer or employee fraud. Should our internal controls fail to prevent or detect an occurrence, or if any resulting loss is not insured or exceeds applicable insurance limits, it could have a material adverse effect on our business, financial condition and results of operations.

Negative publicity could adversely impact our business and financial results.

Reputation risk, or the risk to our earnings and capital from negative publicity, is inherent to our business. Current public uneasiness with the United States banking system heightens this risk, as banking customers often transfer news regarding financial difficulties or even failure of some institutions, to fear of financial difficulty or failure of even the most secure institutions. In this climate, any negative news may become cause for curtailment of business relationships, withdrawal of funds or other actions that can have a compounding effect, and could adversely affect our operations.

Our stock price can be volatile.

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

Certain Bank Subsidiaries are subject to informal written agreements with regulators and failure to comply with these agreements could result in enforcement actions against us.

Two of our Bank Subsidiaries are currently under informal written agreements with the FDIC and state regulators, which relate primarily to financial performance and credit quality. These Bank Subsidiaries have submitted three- to five-year business plans to their regulators and must operate within the parameters of these business plans and submit periodic reports on compliance with these plans. The agreements also require these Bank Subsidiaries to develop plans and take action to address nonperforming assets and watch-list credits. If these Bank Subsidiaries fail to comply with the terms of their respective agreements, the regulators could take enforcement action against them, including the imposition of monetary penalties or the issuance of cease and desist orders requiring corrective action.

Our ability to obtain reimbursement from the FDIC under loss share agreements depends on our compliance with the terms of those loss share agreements.

Under loss share agreements we have with the FDIC relating to assets of The Elizabeth State Bank that we purchased, we are obligated to certify to the FDIC on a quarterly basis our compliance with the terms of the loss share agreements as a prerequisite to obtaining reimbursement from the FDIC for realized losses on the covered assets. These agreements have specific, detailed and cumbersome compliance, servicing, notification and reporting requirements. Our failure to comply with the terms of the agreements or to properly service the loans and other real estate owned under the requirements of the agreements may cause a specific asset or group of assets to lose eligibility for loss share payments from the FDIC.
Additionally, management may decide to forgo loss share coverage on certain assets to allow greater flexibility over the management of those assets. As of December 31, 2012, Heartland had $7.3 million of loans and $352,000 of other real estate owned, or a total of $7.6 million (0.2 percent of total assets), covered by loss share agreements with the FDIC.

Our participation in the SBLF subjects us to certain reporting obligations and imposes restrictions on the payment of dividends on our common stock and the repurchase of shares of our common stock.

Under the SBLF, we have quarterly reporting obligations to the U. S. Treasury that will be used to determine the dividend rate to be paid on the Series C Preferred Stock issued to the U.S. Treasury. If we fail to sufficiently grow our small business lending by December 31, 2013, the interest rate on the $81.7 million of SBLF funds we received will increase to 9.00%, which includes a special lending incentive fee of 2.00% due to our previous participation in the CPP, and if we do not repay the SBLF funds by March 16, 2016, will increase to 9.00%.

The terms of the securities purchase agreement between us and the Treasury in connection with the SBLF transaction also prohibit us from paying dividends on our common stock, or repurchasing shares, to the extent that, after payment of such dividends or repurchases, our Tier 1 Capital would generally fall below 90% of our $281.2 million of Tier 1 Capital on September 15, 2011, our SBLF closing date. Additionally, if we fail to pay an SBLF dividend in a given quarter, we may not pay dividends on or repurchase any common stock for the next three quarters, except in very limited circumstances. If any of the Series C Preferred Stock issued to the U.S. Treasury has not been redeemed by September 15, 2021, the tenth anniversary of issuance, we may not pay any further dividends on our common stock until the Series C Preferred Stock is redeemed in full.

ITEM 1B. UNRESOLVED STAFF COMMENTS

As of December 31, 2012, Heartland had no unresolved staff comments.

ITEM 2. PROPERTIES

The following table is a listing of Heartland's principal operating facilities as of December 31, 2012:

Name and Main Facility Address	Main Facility Square Footage	Main Facility Owned or Leased	Number of Locations(1)
Heartland Financial USA, Inc. 1398 Central Avenue Dubuque, IA 52001	65,000	Owned	3
Dubuque Bank and Trust Company 1398 Central Avenue Dubuque, IA 52001	65,500	Owned	18
Galena State Bank & Trust Co. 971 Gear Street Galena, IL 61036	18,000	Owned	4
Riverside Community Bank 6855 E. Riverside Blvd. Rockford, IL 60114	8,000	Owned	4
Wisconsin Bank & Trust 8240 Mineral Point Rd. Madison, WI 53719	19,000	Owned	10
New Mexico Bank & Trust 320 Gold NW Albuquerque, NM 87102	11,400	Lease term through 2016	16
Arizona Bank & Trust 2036 E. Camelback Rd. Phoenix, AZ 85016	14,000	Owned	8
Rocky Mountain Bank 2615 King Avenue West Billings, MT 59102	16,600	Owned	12
Summit Bank & Trust 2002 E. Coalton Road Broomfield, CO 80027	14,000	Owned	5
Minnesota Bank & Trust 7701 France Avenue South, Suite 110 Edina, MN 55435	6,100	Lease term through 2018	2
Heritage Bank, N.A. 2710 E. Camelback Rd, Suite #100 Phoenix, AZ 85016	7,500	Lease term through 2022	2
Citizens Finance Co. 1275 Main Street Dubuque, IA 52001	5,600	Owned	11

(1) Includes loan production offices.

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

ITEM 3. LEGAL PROCEEDINGS

There are no material pending legal proceedings to which Heartland or its subsidiaries are a party at December 31, 2012, other than ordinary routine litigation incidental to their respective businesses. While the ultimate outcome of current legal proceedings cannot be predicted with certainty, it is the opinion of management that the resolution of these legal actions should not have a material effect on Heartland's consolidated financial position or results of operations.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable

EXECUTIVE OFFICERS

The names and ages of the executive officers of Heartland as of December 31, 2012, position held by these officers on that date and other positions held with Heartland and its subsidiaries are set forth below:

Name	Age	Position with Heartland and Subsidiaries and Principal Occupation
Lynn B. Fuller	63	Chairman, President and Chief Executive Officer of Heartland; Vice Chairman of Dubuque Bank and Trust Company, Wisconsin Bank & Trust, New Mexico Bank & Trust, Arizona Bank & Trust, Rocky Mountain Bank, Summit Bank & Trust and Minnesota Bank & Trust; Chairman of Citizens Finance Co.; Director of Heritage Bank, N.A.
John K. Schmidt	53	Director, Executive Vice President, Chief Operating Officer and Chief Financial Officer of Heartland; Vice Chairman of Dubuque Bank and Trust Company, Galena State Bank & Trust Co. and Riverside Community Bank; Director and Treasurer of Citizens Finance Co.
Kenneth J. Erickson	61	Executive Vice President, Chief Credit Officer of Heartland; Executive Vice President, Lending, of Dubuque Bank and Trust Company; Vice Chairman of Citizens Finance Co.
Douglas J. Horstmann	59	Executive Vice President, Lending, of Heartland; Director, President and Chief Executive Officer of Dubuque Bank and Trust Company
John J. Berg	61	Executive Vice President, Marketing and Sales of Heartland
Brian J. Fox	64	Executive Vice President, Operations of Heartland

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

John K. Schmidt has been a Director of Heartland since 2001. Mr. Schmidt has been Heartland's Executive Vice President and Chief Financial Officer since 1991 and Chief Operating Officer since 2004. He has been employed by Dubuque Bank and Trust Company since 1984 and became Dubuque Bank and Trust Company's Vice President, Finance in 1986, Senior Vice President and Chief Financial Officer in 1991, President and Chief Executive Officer in

1999 and Vice Chairman in 2004. Mr. Schmidt also was named Vice Chairman of Galena State Bank & Trust Co. and Riverside Community Bank in 2004. He also served as Vice Chairman and director of First Community Bank from 2004 to 2007. He is an inactive holder of the certified public accountant certification and worked at KPMG LLP in Des Moines, Iowa, prior to joining Dubuque Bank and Trust Company.

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

Douglas J. Horstmann was named Executive Vice President, Lending, of Heartland in 2012. Mr. Horstmann previously served as Senior Vice President, Lending, of Heartland since 1999. He has been employed by Dubuque Bank and Trust Company since 1980, was appointed Vice President, Commercial Loans in 1985, Senior Vice President, Lending in 1989, Executive Vice President, Lending in 2000 and Director, President and Chief Executive Officer in 2004. Mr. Horstmann also served as Vice

Chairman of First Community Bank from 2007 until its merger with Dubuque Bank and Trust Company in 2011. Prior to joining Dubuque Bank and Trust Company, Mr. Horstmann was an examiner for the Iowa Division of Banking.

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

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

PART II

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

Heartland's common stock was held by approximately 2,200 stockholders of record as of March 14, 2013, and approximately 1,600 additional stockholders held shares in street name. The common stock of Heartland has been quoted on the NASDAQ Stock Market since May 2003 under the symbol "HTLF" and is a NASDAQ Global Select Market security.

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

Calendar Quarter	High	Low
2012:		
First	$17.70	$14.82
Second	24.00	15.10
Third	28.26	22.67
Fourth	28.70	24.98
2011:		
First	$18.38	$14.55
Second	17.75	13.20
Third	16.47	12.65
Fourth	17.25	12.81

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

Calendar Quarter	2012	2011
First	$0.10	$0.10
Second	0.10	0.10
Third	0.10	0.10
Fourth	0.20	0.10

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

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

Effective January 24, 2008, Heartland's board of directors authorized management to acquire and hold up to 500,000 shares of common stock as treasury shares at any one time. During participation in the Treasury's Capital Purchase Program, which was terminated on September 15, 2011, Heartland was prohibited from any repurchase, redemption, or acquisition of its common stock, except for certain repurchases to the extent of increases in shares outstanding because of issuances under existing benefit plans. Heartland and its affiliated purchasers made no purchases of its common stock during the quarter ended December 31, 2012.

There were no unregistered sales of equity securities made during the fourth quarter of Heartland’s fiscal year 2012.

The following table and graph show a five-year comparison of cumulative total returns for Heartland, the NASDAQ Composite Index and the NASDAQ Bank Stock Index. Figures for our common stock represent inter-dealer quotations, without retail markups, markdowns or commissions and do not necessarily represent actual transactions. Heartland became listed on NASDAQ in May 2004. The table and graph were prepared at our request by SNL Financial, LC.

Cumulative Total Return Performance

	12/31/2007	12/31/2008	12/31/2009	12/31/2010	12/31/2011	12/31/2012
Heartland Financial USA, Inc.	$100.00	$113.03	$81.07	$101.22	$91.38	$159.37
NASDAQ Composite	$100.00	$60.02	$87.24	$103.08	$102.26	$120.42
NASDAQ Bank	$100.00	$78.46	$65.67	$74.97	$67.10	$79.64

COMPARISON OF FIVE YEAR CUMULATIVE TOTAL RETURN*
ASSUMES $100 INVESTED ON DECEMBER 31, 2007

*Total return assumes reinvestment of dividends

ITEM 6. SELECTED FINANCIAL DATA

The following tables contain selected historical financial data for Heartland for the years ended December 31, 2012, 2011, 2010, 2009 and 2008. The selected historical consolidated financial information set forth below is qualified in its entirety by reference to, and should be read in conjunction with, Heartland's consolidated financial statements and notes thereto, included elsewhere in this report and Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations."

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

	For the Years Ended December 31,				
	2012	2011	2010	2009	2008
STATEMENT OF INCOME DATA					
Interest income	$189,338	$191,737	$198,932	$203,293	$202,585
Interest expense	39,182	46,343	55,880	70,530	86,899
Net interest income	150,156	145,394	143,052	132,763	115,686
Provision for loan and lease losses	8,202	29,365	32,508	39,377	29,319
Net interest income after provision for loan and lease losses	141,954	116,029	110,544	93,386	86,367
Noninterest income	108,662	59,577	52,329	52,704	30,196
Noninterest expenses	183,381	137,296	129,239	132,520	102,239
Income taxes	17,384	10,302	9,846	7,196	3,312
Net income	49,851	28,008	23,788	6,374	11,012
Net (income) loss available to noncontrolling interest, net of tax	(59)	36	115	188	280
Net income attributable to Heartland	49,792	28,044	23,903	6,562	11,292
Preferred dividends and discount	(3,400)	(7,640)	(5,344)	(5,344)	(178)
Net income available to common stockholders	$46,392	$20,404	$18,559	$1,218	$11,114
PER COMMON SHARE DATA					
Net income – diluted	$2.77	$1.23	$1.13	$0.07	$0.68
Cash dividends	0.50	0.40	0.40	0.40	0.40
Dividend payout ratio	18.05%	32.52%	35.14%	53.24%	58.13%
Book value	$19.02	$16.29	$15.26	$14.38	$14.13
Weighted average shares outstanding-diluted	16,768,602	16,575,506	16,461,679	16,325,320	16,365,815

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

	For the Years Ended December 31,				
	2012	2011	2010	2009	2008
BALANCE SHEET DATA					
Investments and federal funds sold	$1,561,957	$1,326,794	$1,264,564	$1,175,217	$903,705
Loans held for sale	96,165	53,528	23,904	17,310	19,695
Total loans and leases receivable	2,828,802	2,494,631	2,364,787	2,363,002	2,405,001
Allowance for loan and lease losses	38,715	36,808	42,693	41,848	35,651
Total assets	4,990,553	4,305,058	3,999,455	4,012,991	3,630,268
Total deposits	3,845,660	3,210,113	3,034,048	3,050,389	2,640,232
Long-term obligations	389,025	372,820	362,527		