MidWestOne Financial Group, Inc.
Form 10-K
March 08, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2009

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

For transition period from to

Commission File Number: 333-147628

MidWest*One* Financial Group, Inc.

(Exact name of Registrant as specified in its charter)

Iowa	**42-1206172**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification Number)**

102 South Clinton Street, Iowa City, Iowa 52240

(Address of principal executive offices, including Zip Code)

(319) 356-5800

(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 Stock Market LLC

Securities registered pursuant to section 12(g) of the Act:

None

(Title of class)

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

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

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. x Yes ¨ No

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

Indicate by check mark 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. x

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 definition of large accelerated filer, accelerated filer and small reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

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

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, 2009, the last business day of the registrant s most recently completed second fiscal quarter, was approximately $54.7 million.

The number of shares outstanding of the registrant s common stock, par value $1.00 per share, as of March 1, 2010, was 8,605,333.

Documents Incorporated by Reference

Portions of the Company s Proxy Statement for the 2010 Annual Meeting of Shareholders of MidWest*One* Financial Group, Inc., to be held on April 22, 2010, are incorporated by reference into Part III of this Annual Report on Form 10-K.

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MidWestOne Financial Group, Inc.

Annual Report on Form 10-K

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PART I

ITEM 1. BUSINESS.

General

MidWest*One* Financial Group, Inc. (MidWest*One* or the Company, which is also referred to herein as *we*, *our* or *us*) is an Iowa corporation incorporated in 1983, a bank holding company under the Bank Holding Company Act of 1956 and a financial holding company under the Gramm-Leach-Bliley Act of 1999. Our principal executive offices are located at 102 South Clinton Street, Iowa City, Iowa 52240.

We operate primarily through our bank subsidiary MidWest*One* Bank, an Iowa state non-member bank chartered in 1934 with its main office in Iowa City, Iowa and MidWest*One* Insurance Services, Inc., our wholly-owned subsidiary that operates an insurance agency business through three offices located in central and east-central Iowa.

MidWest*One* Bank operates a total of 29 branch locations, plus its specialized Home Loan Center, in 15 counties throughout central and east-central Iowa. MidWest*One* Bank provides full service retail banking in the communities in which its branch offices are located. Deposit products offered include checking and other demand deposit accounts, NOW accounts, savings accounts, money market accounts, certificates of deposit, individual retirement accounts and other time deposits. MidWest*One* Bank offers commercial and industrial, agricultural, real estate mortgage and consumer loans. Other products and services include debit cards, automated teller machines, on-line banking and safe deposit boxes. The principal service consists of making loans to and accepting deposits from individuals, businesses, governmental units and institutional customers. MidWest*One* Bank also has a trust and investment department through which it offers a variety of trust and investment services, including administering estates, personal trusts, conservatorships, pension and profit-sharing funds and providing property management, farm management, custodial services, financial planning, investment management and retail brokerage (through an agreement with a third-party registered broker-dealer).

Merger of Equals Transaction

On March 14, 2008, we consummated a merger-of-equals transaction with the former MidWest*One* Financial Group, Inc., Oskaloosa, Iowa (Former MidWest*One*), pursuant to and in accordance with the Agreement and Plan of Merger dated as of September 11, 2007 (the Merger). Prior to the Merger, we operated under the name ISB Financial Corp. As a result of the Merger, Former MidWest*One* merged with and into the Company and ceased to exist as a legal entity, and we changed our name from ISB Financial Corp. to MidWest*One* Financial Group, Inc. All references in this document to the Company and MidWest*One* refer to the surviving organization in the Merger.

Prior to the Merger, Former MidWest*One* s common stock was registered under Section 12(b) of the Securities Exchange Act of 1934, as amended (the Exchange Act), and listed on The Nasdaq Stock Market LLC under the ticker symbol OSKY. Prior to the Merger, our common stock was not listed on any national securities exchange and was not registered under the Exchange Act, and thus we were not subject to the periodic reporting requirements of the Exchange Act. In connection with the Merger, we filed a registration statement on Form S-4 to register the shares of our common stock to be issued to the holders of Former MidWest*One* common stock in the Merger pursuant to the Securities Act of 1933, as amended (the Securities Act), and received approval to list our common stock on The Nasdaq Stock Market LLC under the ticker symbol MOFG.

For accounting purposes, we were deemed to be the acquirer in the Merger. Accordingly, the financial information herein for years prior to December 31, 2008 is the information for the Company (formerly ISB Financial Corp.) prior to the Merger and does not include financial information for the Former MidWest*One*.

Prior to the Merger, we operated primarily through two bank subsidiaries Iowa State Bank & Trust Company, Iowa City, Iowa, and First State Bank, Conrad, Iowa and Former MidWest*One* operated primarily through its bank subsidiary, MidWest*One* Bank, Oskaloosa, Iowa, MidWest*One* Insurance Services, Inc., and MidWest*One* Investment Services, Inc., through which Former MidWest*One* offered retail brokerage and financial planning services.

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Initially following the Merger, we continued operating through our three bank subsidiaries Iowa State Bank & Trust Company, First State Bank and MidWest*One* Bank but in August 2008 consolidated the three bank subsidiaries under the charter of Iowa State Bank & Trust Company and renamed the surviving bank MidWest*One* Bank. The operations of MidWest*One* Investment Services also have been transferred to MidWest*One* Bank and MidWest*One* Investment Services has been dissolved; the brokerage and financial planning services previously offered by MidWest*One* Investment Services are now offered directly through MidWest*One* Bank. All references herein to MidWest*One* Bank or the Bank are to the surviving bank subsidiary; references to Former MidWest*One* Bank are to the bank subsidiary of the Former MidWest*One* as it existed prior to the Merger. MidWest*One* Bank continues to offer substantially the same services provided by the three bank subsidiaries prior to the Merger and the subsequent bank charter consolidation.

Operating Strategy

Our operating strategy is based upon a sophisticated community banking model delivering a complete line of financial products and services while following five guiding principles: hire and retain excellent employees; take care of our customers; conduct business with the utmost integrity; work as one team; and learn constantly so we can continually improve.

Management believes the personal and professional service offered to customers provides an appealing alternative to the megabanks that have resulted from large out-of-state national banks acquiring Iowa-based community banks. While we employ a community banking philosophy, we believe that our size, combined with our complete line of financial products and services, is sufficient to effectively compete in our relevant market areas. To remain price competitive, management also believes that we must manage expenses and remain disciplined in our asset/liability management practices.

Market Areas

Our principal offices are located in Iowa City, Iowa. The city of Iowa City is located in east-central Iowa, approximately 220 miles west of Chicago, Illinois, and approximately 115 miles east of Des Moines, Iowa. It is strategically situated approximately 60 miles west of the Mississippi River on Interstate 80 and is the home of the University of Iowa, a public university with approximately 21,000 undergraduate students and 9,000 graduate and professional students. Iowa City is the home of the University of Iowa Hospitals and Clinics, a 680-bed comprehensive academic medical center and regional referral center with more than 760 staff physicians and dentists, 480 resident physicians and dentists and 180 fellow physicians and 1,565 nurses. The city of Iowa City has a total population of approximately 63,000 and the Iowa City MSA has a total population of approximately 140,000. Iowa City is the sixth largest city in the state of Iowa. According to the FDIC, as of June 30, 2009, MidWest*One* Bank had the second highest deposit market share in the Iowa City MSA at approximately 17.5%.

MidWest*One* Bank operates branch offices and a loan production office in 15 counties in central and east-central Iowa. According to the FDIC, in nine of those 15 counties, MidWest*One* Bank held between 8% and 25% of the deposit market share. In another county, MidWest*One* Bank held 42% of the deposit market share.

Lending Activities

General

We provide a range of commercial and retail lending services to businesses, individuals and government agencies. These credit activities include commercial, financial and agricultural loans; real estate construction loans; commercial and residential real estate loans; and consumer loans.

We market our 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 business communities in which we operate. Through professional service, competitive pricing and innovative structure, we have been successful in attracting new lending customers. We also actively pursue consumer lending opportunities. With convenient locations, advertising and customer communications, we believe that we have been successful in capitalizing on the credit needs of our market areas.

Our management emphasizes credit quality and seeks to avoid undue concentrations of loans to a single industry or based on a single class of collateral. We have established lending policies that include a number of underwriting factors to be considered in making a loan, including location, loan-to-value ratio, cash flow, interest rate and credit history of the borrower.

Commercial, Financial and Agricultural Loans

Commercial and Financial. We have a strong commercial loan base. We focus on, and tailor our commercial loan programs to, small- to mid-sized businesses in our market areas. Our loan portfolio includes loans to wholesalers, manufacturers, contractors, business services companies and retailers. We provide a wide range of business loans, including lines of credit for working capital and operational purposes and term loans for the acquisition of equipment. 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.

Our commercial and financial loans are primarily made based on the reported cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. The collateral support provided by the borrower for most of these loans and the probability of repayment is based on the liquidation of the pledged collateral and enforcement of a personal guarantee, if any exists. The primary repayment risks of commercial loans are that the cash flows of the borrower may be unpredictable, and the collateral securing these loans may fluctuate in value. As of December 31, 2009, commercial and financial loans comprised approximately 21% of our total loan portfolio.

Agricultural Loans. Due to the rural market areas in and around which we operate, agricultural loans are an important part of our business. Agricultural loans include loans made to finance agricultural production and other loans to farmers and farming operations. Agricultural loans comprised approximately 10% of our total loan portfolio at December 31, 2009.

Agricultural loans, most of which are secured by crops and machinery, are provided to finance capital improvements and farm operations as well as acquisitions of livestock and machinery. The ability of the borrower to repay may be affected by many factors outside of the borrower s control including 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.

Our agricultural lenders work closely with our customers, including companies and individual farmers, and review the preparation of 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 once annually. We also work closely with governmental agencies to help agricultural customers obtain credit enhancement products such as loan guarantees or interest rate assistance.

Real Estate Loans

Construction Loans. We offer loans both to individuals that are constructing personal residences and to real estate developers and building contractors for the acquisition of land for development and the construction of homes and commercial properties. These loans are in-market to known and established borrowers. Construction loans generally have a short term, such as one to two years. As of December 31, 2009, construction loans constituted approximately 8% of our total loan portfolio.

Mortgage Loans. We offer residential, commercial and agricultural mortgage loans. As of December 31, 2009, we had $552.1 million in combined residential, commercial and agricultural mortgage loans outstanding, which represented approximately 57% of our total loan portfolio.

Residential mortgage lending is a focal point for us, as residential real estate loans constituted approximately 25% of our total loan portfolio at December 31, 2009. Included in this category of loans are home equity loans made to individuals. As long-term interest rates remained at relatively low levels during 2008 and 2009, many customers opted for mortgage loans that have a fixed rate with 15- or 30-year maturities. We generally retain short-term residential mortgage loans that we originate for our own portfolio but sell most long-term loans to other parties while retaining servicing rights on the majority of those. We also perform loan servicing activity for third parties. At December 31, 2009, we serviced approximately $193.6 million in mortgage loans for others. We do not offer subprime mortgage loans and do not operate a wholesale mortgage business.

We also offer mortgage loans to our commercial and agricultural customers for the acquisition of real estate used in their business, such as offices, warehouses and production facilities, and to real estate investors for the acquisition of apartment buildings, retail centers, office buildings and other commercial buildings. As of December 31, 2009, commercial and agricultural real estate loans constituted approximately 42% of our total loan portfolio.

Consumer Lending

Our consumer lending department provides all types of consumer loans, including personal loans (secured or unsecured) and automobile loans. Consumer loans typically have shorter terms, lower balances, higher yields and higher risks of default than one- to four-family residential real estate 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. As of December 31, 2009, consumer and other loans comprised only 4% of our total loan portfolio.

Loan Pool Participations

We hold in our portfolio a significant amount of participation interests in pools of loans that are owned and serviced by States Resources Corporation, a third-party loan servicing organization located in Omaha, Nebraska (the Servicer). We do not have any ownership interest in or control over the Servicer. The loans in those pools are purchased at varying discounts to their outstanding principal amount. Former MidWest*One* began the program of acquiring participation interests from the Servicer in 1988 and we have continued with this program since the Merger (although these loan participations constitute a smaller percentage of our total loan portfolio than they did of Former MidWest*One* s total loan portfolio).

The Servicer generally acquires the underlying loans from large nonaffiliated banking organizations and from the FDIC when it auctions off assets of failed financial institutions for which it has been appointed receiver. Thus, the purchased loan pools generally consist of loans that were originated throughout the United States. The sellers of the loans generally offer the loans through a sealed bid auction. A sealed bid auction requires each bidder to submit a confidential bid on the subject loan pool, with the loan pool being awarded to the highest bidder. If the Servicer is the winning bidder in an auction, it acquires the loans without recourse against the sellers and, accordingly, the risk of noncollectibility for the participation interest purchased by MidWest*One* is, for the most part, assumed by MidWest*One*.

Each pool of loans in which we acquire a participation interest has a different composition and different characteristics. The pools in which we currently own a participation interest are comprised primarily of performing, past-due and nonperforming loans secured by commercial real estate and other commercial assets. The price bid and paid for such a loan pool is determined based on the credit quality of the loans in the particular pool, the amounts the Servicer believes can be collected on such pool and the risks associated with the collection of such amounts.

In considering an investment in a loan pool, the Servicer generally evaluates the loans underlying the pool being auctioned and makes recommendations to us concerning the creditworthiness of the borrowers of the underlying loans. The Servicer performs a comprehensive analysis of the loan pool in an attempt to ensure proper valuation and adequate safeguards in the event of default. In many cases, substantial uncertainties may exist regarding the collectibility of the various loans in the pool. We make our own decisions whether or not to participate in a particular loan pool that has been recommended by the Servicer based on our experience with the various categories and qualities of the underlying loans.

Upon the acquisition of a participation interest in a loan pool, we assume the risk, to the extent of our participation interest, that the Servicer will be unable to recover an amount equal to the purchase price plus the carrying costs, if any, and collection costs on such accounts. The extent of such risk is dependent on a number of factors, including the Servicer s ability to locate the debtors, the debtors financial condition, the possibility that a debtor may file for protection under applicable bankruptcy laws, the Servicer s ability to locate the collateral, if any, for the loan and to obtain possession of such collateral, the value of such collateral, and the length of time it takes to realize the ultimate recovery either through collection procedures or through a resale of the loans following a restructuring.

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A cost basis is assigned to each individual loan acquired on a cents per dollar basis (discounted price), which is based on the Servicer s assessment of the recovery potential of each such loan in relation to the total discounted price paid to acquire the pool. This methodology assigns a higher basis to performing loans with greater potential collectibility and a lower basis to those loans identified as having little or no potential for collection.

Loan pool participations are shown on our balance sheet as a separate asset category; they are not included within the loan balance on our balance sheet. The original carrying value of loan pool participation interests represents the discounted price paid by us to acquire our participation interests in various loan pools purchased by the Servicer. Our investment balance with respect to the participation interest is reduced as the Servicer collects principal payments on the loans and remits the proportionate share of such payments to us.

Loan pools are accounted for in accordance with the provisions of ASC Topic 310 (*Statement of Position 03-3, Accounting for Certain Loans or Debt Securities Acquired in a Transfer*) issued by the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants. According to ASC Topic 310, in order to apply the interest method of recognition to these types of loans, there must be sufficient information to reasonably estimate the amount and timing of the cash flows expected to be collected. When that is not the case, the loan is accounted for on nonaccrual status applying cash basis income recognition to the loan.

In each case, where changed circumstances or new information lead the Servicer to believe that collection of the loan or recovery of the basis through collateral would be less than originally determined, the cost basis assigned to the loan is written down or written off through a charge against discount income. The Servicer and MidWest*One* representatives continually evaluate at least quarterly the collectibility of the loans and the recovery of the underlying basis. On a quarterly basis, those loans that are determined to have a possible recovery of less than the assigned basis amount are placed on a watch list. The amount of basis exceeding the estimated recovery amount on the watch list loans is written off by a charge against discount income.

Interest income and discount on loan pool participations that we record is net of collection expenses incurred by the Servicer and net of the servicing fee and share of recovery profit paid to the Servicer. Collection expenses include salary and benefits paid by the Servicer to its employees, legal fees, costs to maintain and insure real estate owned, and other operating expenses. Under the terms of our agreement with the Servicer, the Servicer receives a servicing fee based on one percent of the gross monthly collections of principal and interest, net of collection costs. Additionally, the Servicer receives a tiered percentage share of the recovery profit in excess of the investor s required return on investment on each individual loan pool. The Servicer s percentage share of recovery profit is linked to a ten-tier index and ranges from zero to 27 percent depending upon the return on investment achieved. The investor s minimum required return on investment is based on the two-year treasury rate at the time a loan pool is purchased plus four percent. For every one percent increase obtained over the investor s minimum required return, the Servicer percentage moves up one tier level. In the event that the return on a particular pool does not exceed the required return on investment, the Servicer does not receive a percentage share of the recovery profit. Discount income is added to interest income and reflected as one amount on our consolidated statements of operations.

The Servicer provides us with monthly reports detailing collections of principal and interest, face value of loans collected and those written off, actual operating expenses incurred, remaining asset balances (both in terms of cost basis and principal amount of loans), a comparison of actual collections and expenses with target collections and budgeted expenses, and summaries of remaining collection targets. The Servicer also provides aging reports and watch lists for the loan pools. Monthly meetings are held between our representatives and representatives of the Servicer to review collection efforts and results, to discuss future plans of action and to discuss potential opportunities. Additionally, our personnel and the Servicer s personnel communicate on almost a daily basis to discuss various issues regarding the loan pools. Our representatives visit the Servicer s operation on a regular basis; and our loan review officer and internal auditor perform asset reviews and audit procedures on a regular basis.

Our overall cost basis in the loan pool participations represents a discount from the aggregate outstanding principal amount of the loans underlying the pools. For example, as of December 31, 2009, such cost basis was $85.2 million, while the contractual outstanding principal amount of the underlying loans as of such date was approximately $179.3 million. The discounted cost basis inherently reflects the assessed collectibility of the underlying loans. We do not include any amounts related to the loan pool participations in our totals of nonperforming loans.

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As part of the ongoing collection process, the Servicer may, from time to time, foreclose on real estate mortgages and acquire title to property in satisfaction of such debts. This real estate may be held by the Servicer as real estate owned for a period of time until it can be sold. Because our investments in loan pools are classified separately from our loan portfolio, we do not include the real estate owned that is held by the Servicer with the amount of any other real estate that we may hold directly as a result of our own foreclosure activities.

The underlying loans in the loan pool participations include both fixed-rate and variable-rate instruments. No amounts for interest due are reflected in the carrying value of the loan pool participations. Based on historical experience, the average period of collectibility for loans underlying our loan pool participations, many of which have exceeded contractual maturity dates, is approximately three to five years. Our management has reviewed the recoverability of the underlying loans and believes that the carrying value does not exceed the fair value of its investment in loan pool participations.

Other Products and Services

Deposit Products

We believe that we offer competitive deposit products and programs that address the needs of customers in each of the local markets served. The deposit products are offered to individuals, nonprofit organizations, partnerships, small businesses, corporations and public entities. These products include noninterest bearing and interest bearing demand deposits, savings accounts, money market accounts and time certificates of deposit.

Trust and Investment Services

We offer trust and investment services in our market areas to help its business and individual clients in meeting their financial goals and preserving wealth. Our services include administering estates, personal trusts, conservatorships, pension and profit-sharing funds and providing property management, farm management, investment advisory, retail securities brokerage, financial planning and custodial services. Licensed brokers (who are registered representatives of a third-party registered broker-dealer) serve selected branches and provide investment-related services including securities trading, financial planning, mutual funds sales, fixed and variable annuities and tax-exempt and conventional unit trusts.

Insurance Services

Through our insurance subsidiary, MidWest*One* Insurance Services, Inc., we offer property and casualty insurance products to individuals and small businesses in markets that we service.

Liquidity and Funding

A discussion of our liquidity and funding programs has been included in ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS under Liquidity, and ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK under Liquidity Risk.

Competition

We encounter competition in all areas of our business pursuits. To compete effectively, grow our market share, 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 service, convenience and price.

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The banking industry is highly competitive, and we face strong direct competition for deposits, loans, and other financial-related services. Our offices in central and east-central Iowa compete with other commercial banks, thrifts, credit unions, stockbrokers, finance divisions of auto and farm equipment companies, agricultural suppliers, and other agricultural-related lenders. Some of these competitors are local, while others are statewide or nationwide. We compete for deposits principally by offering depositors a wide variety of deposit programs, convenient office locations, hours and other services, and for loan originations primarily through the interest rates and loan fees we charge, the variety of our loan products and the efficiency and quality of services we provide to borrowers, with an emphasis on building long-lasting relationships. Some of the financial institutions and financial service organizations with which we compete are not subject to the same degree of regulation as that imposed on federally insured Iowa-chartered banks. As a result, such competitors have advantages over us in providing certain services. As of December 31, 2009, there were approximately 91 other banks having 341 offices or branches operating within the 15 counties in which we have locations. Based on deposit information collected by the FDIC as of June 30, 2009, we maintained approximately 9.4% of the bank deposits within the 15 counties in which we operate. New competitors may develop that are substantially larger and have significantly greater resources than us. Currently, major competitors in some of our markets include Wells Fargo Bank, U.S. Bank, Regions Bank, Hills Bank and Trust and Marion County Bank.

We also face competition with respect to our investments in loan pool participations. Our financial success to date regarding loan pools is largely attributable to the Servicer s ability to determine which loan pools to bid on and ultimately purchase, the availability of assets to fund the purchases and the Servicer s ability to collect on the underlying assets. Investments in loan pools have become increasingly popular in recent years, leading financial institutions and other competitors to become active at loan pool auctions conducted by the FDIC and other sellers. There is no assurance that we, through the Servicer, will be able to bid successfully in the future. Certain of our existing competitors are substantially larger and have significantly greater financial resources than us. Increased participation by new institutions or other investors may also create increased buying interest which could also result in higher bid prices for the type of loan pools considered for investment by us. In addition, new and existing competitors may develop due diligence procedures comparable to the Servicer s procedures. The emergence of such competition could have a material adverse effect on our business and financial results. We expect that our success in the future will depend more on the performance of MidWest*One* Bank and MidWest*One* Insurance Services and less on the investments in loan pool participations.

Employees

As of December 31, 2009, we had 406 full-time equivalent employees. We provide our employees with a comprehensive program of benefits, some of which are on a contributory basis, including comprehensive medical and dental plans, life insurance, long-term and short-term disability coverage, a 401(k) plan, and an employee stock ownership plan. None of our employees are represented by unions. Our management considers its relationship with our employees to be good.

Company Website

We maintain an internet website for MidWest*One* Bank at www.midwestone.com. We will make available, free of charge, on this website 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 Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC.

Supervision and Regulation

General

Financial institutions, their holding companies and their affiliates are extensively regulated under federal and state law. As a result, our growth and earnings performance 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, including the Iowa Superintendent of Banking (the Iowa Superintendent), the Board of Governors of the Federal Reserve System (the Federal Reserve) and the Federal Deposit Insurance Corporation (the FDIC). Furthermore, 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 have an impact on our business. The effect of these statutes, regulations and regulatory policies may be significant, and cannot be predicted with a high degree of certainty.

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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 relative to operations, the nature and amount of collateral for loans, the establishment of branches, mergers and consolidations and the payment of dividends. This system of supervision and regulation establishes a comprehensive framework for our operations and those of our subsidiaries and is intended primarily for the protection of FDIC-insured deposits and depositors of the Bank, rather than shareholders. In addition to this generally applicable regulatory framework, turmoil in the credit markets in recent years has prompted the enactment of unprecedented legislation that has allowed the U.S. Department of the Treasury (the Treasury) to make equity capital available to qualifying financial institutions to help restore confidence and stability in the U.S. financial markets, which imposes additional requirements on institutions in which the Treasury invests.

The following is a summary of the material elements of the regulatory framework that currently applies to the Company and our 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. Additionally, in response to the global financial crisis that began in 2007, various legislative and regulatory proposals have been issued addressing, among other things, the restructuring of the federal bank regulatory system, more stringent regulation of consumer products such as mortgages and credit cards, and safe and sound compensation practices. At this time, we are unable to determine whether any of these proposals will be adopted as proposed. As such, the following is qualified in its entirety by reference to applicable law. Any change in statutes, regulations or regulatory policies may have a material effect on our business and the business of our subsidiaries.

The Company

General. As the sole shareholder of the Bank, we are a bank holding company. As a bank holding company, we are registered with, and are subject to regulation by, the Federal Reserve under the Bank Holding Company Act of 1956, as amended (the BHCA). In accordance with Federal Reserve policy, we are expected to act as a source of financial strength to the Bank and to commit resources to support the Bank in circumstances where we might not otherwise do so. Under the BHCA, we are subject to periodic examination by the Federal Reserve. We are also required to file with the Federal Reserve periodic reports of our operations and such additional information regarding the Company and our 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 of another bank or bank holding company. Subject to certain conditions (including 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) and state laws that require that the target bank have been in existence for a minimum period of time (not to exceed five years) before being acquired by an out-of-state bank holding company.

The BHCA generally prohibits the Company 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 us to engage in a variety of banking-related businesses, including the ownership and operation of a thrift, or any entity engaged in consumer finance, equipment leasing, the operation of a computer service bureau (including software development), and mortgage banking and brokerage. The BHCA generally does not place territorial restrictions on the domestic activities of nonbank 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. We have elected (and the Federal Reserve has accepted our election) to operate as a financial holding company.

Federal law also prohibits any person or company from acquiring control of an FDIC-insured depository institution or its holding company without prior notice to the appropriate federal bank regulator. 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 under certain circumstances between 10% and 24.99% ownership.

Capital Requirements. Bank holding companies are required to maintain minimum levels of capital in accordance with Federal Reserve capital adequacy guidelines. If 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 nonbank businesses.

The Federal Reserve s capital guidelines establish the following minimum regulatory capital requirements for bank holding companies: (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. The risk-based requirement consists 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%. The leverage requirement consists of a minimum ratio of Tier 1 capital to total assets of 3% for the most highly rated companies, with a minimum requirement of 4% for all others. For purposes of these capital standards, Tier 1 capital consists primarily of permanent shareholders equity less intangible assets (other than certain loan servicing rights and purchased credit card relationships). Total capital consists primarily of Tier 1 capital plus Tier 2 capital which consists of other non-permanent capital items such as certain other debt and equity instruments that do not qualify as Tier 1 capital and a portion of the company s allowance for loan and lease losses.

The risk-based and leverage standards described above are minimum requirements. Higher capital levels will be required if warranted by the particular circumstances or risk profiles of individual banking organizations. For example, the Federal Reserve s capital guidelines contemplate 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. Further, any banking organization experiencing or anticipating significant growth would be expected to maintain capital ratios, including tangible capital positions (*i.e.*, Tier 1 capital less all intangible assets), well above the minimum levels. As of December 31, 2009, we had regulatory capital in excess of the Federal Reserve s minimum requirements.

Emergency Economic Stabilization Act of 2008. Events in the U.S. and global financial markets over the past several years, including the deterioration of the worldwide credit markets, have created significant challenges for financial institutions throughout the country. In response to this crisis affecting the U.S. banking system and financial markets, on October 3, 2008, the U.S. Congress passed, and the President signed into law, the Emergency Economic Stabilization Act of 2008 (the EESA). The EESA authorized the Secretary of the Treasury to implement various temporary emergency programs designed to strengthen the capital positions of financial institutions and stimulate the availability of credit within the U.S. financial system. Financial institutions participating in certain of the programs established under the EESA are required to adopt the Treasury s standards for executive compensation and corporate governance.

The TARP Capital Purchase Program. On October 14, 2008, the Treasury announced that it would provide Tier 1 capital (in the form of perpetual preferred stock) to eligible financial institutions. This program, known as the TARP Capital Purchase Program (the CPP), allocated $250 billion from the $700 billion authorized by the EESA to the Treasury for the purchase of senior preferred shares from qualifying financial institutions (the CPP Preferred Stock). Under the program eligible institutions were able to sell equity interests to the Treasury in amounts equal to between 1% and 3% of the institution s risk-weighted assets. The CPP Preferred Stock is non-voting and pays dividends at the rate of 5% per annum for the first five years and thereafter at a rate of 9% per annum. In conjunction with the purchase of the CPP Preferred Stock, the Treasury received warrants to purchase common stock from the participating public institutions with an aggregate market price equal to 15% of the preferred stock investment. Participating financial institutions are required to adopt the Treasury s standards for executive compensation and corporate governance for the period during which the Treasury holds equity issued under the CPP. These requirements are discussed in more detail in the Compensation Discussion and Analysis section in our proxy statement, which is incorporated by reference in this Form 10-K.

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Pursuant to the CPP, on February 6, 2009, we entered into a Letter Agreement with Treasury, pursuant to which we issued: (i) 16,000 shares of the Fixed Rate Cumulative Perpetual Preferred Stock, Series A; and (ii) a warrant to purchase 198,675 shares of our common stock, par value $1.00 per share, for an aggregate purchase price of $16.0 million in cash. Our federal regulators and the Treasury s Office of the Inspector General maintain significant oversight over the Company as a participating institution, to evaluate how it is using the capital provided and to ensure that it strengthens its efforts to help its borrowers avoid foreclosure, which is one of the core aspects of the EESA.

Dividend Payments. Our ability to pay dividends to our shareholders may be affected by both general corporate law considerations and policies of the Federal Reserve applicable to bank holding companies. As an Iowa corporation, we are subject to the limitations of Iowa law, which allows us to pay dividends unless, after such dividend, (i) we would not be able to pay our debts as they become due in the usual course of business or (ii) our total assets would be less than the sum of our total liabilities plus any amount that would be needed if we were to be dissolved at the time of the dividend payment, to satisfy the preferential rights upon dissolution of shareholders whose rights are superior to the rights of the shareholders receiving the distribution. Additionally, as a bank holding company, our ability to declare and pay dividends is subject to the guidelines of the Federal Reserve regarding capital adequacy and dividends. The Federal Reserve guidelines generally require us to review the effects of the cash payment of dividends on common stock and other Tier 1 capital instruments (*i.e.*, perpetual preferred stock and trust preferred securities) in light of our earnings, capital adequacy and financial condition. In addition, as a matter of policy, the Federal Reserve has indicated that bank holding companies should not pay dividends on common stock (or make distributions on trust preferred securities) using funds from the CPP. As a general matter, the Federal Reserve indicates that the board of directors of a bank holding company should eliminate, defer or significantly reduce the dividends if: (i) the company s net income available to stockholders for the past four quarters, net of dividends previously paid during that period, is not sufficient to fully fund the dividends; (ii) the prospective rate of earnings retention is inconsistent with the company s capital needs and overall current and prospective financial condition; or (iii) the company will not meet, or is in danger of not meeting, its minimum regulatory capital adequacy ratios. The Federal Reserve also possesses enforcement powers over bank holding companies and their nonbank 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.

Furthermore, with respect to our participation in the CPP, the terms of the CPP Preferred Stock provide that no dividends on any common or preferred stock that ranks equal to or junior to the CPP Preferred Stock may be paid by us unless and until all accrued and unpaid dividends for all past dividend periods on the CPP Preferred Stock have been fully paid.

Federal Securities Regulation. Our common stock is registered with the SEC under the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended (the Exchange Act). Consequently, we are subject to the information, proxy solicitation, insider trading and other restrictions and requirements of the SEC under the Exchange Act.

The Bank

General. The Bank is an Iowa-chartered bank, the deposit accounts of which are insured by the FDIC s Deposit Insurance Fund to the maximum extent provided under federal law and FDIC regulations. As an Iowa-chartered bank, the Bank is subject to the examination, supervision, reporting and enforcement requirements of the Iowa Superintendent, the chartering authority for Iowa banks, and the FDIC, designated by federal law as the primary federal regulator of state-chartered, FDIC-insured banks that, like the Bank, are not members of the Federal Reserve System (non-member banks).

Deposit Insurance. As an FDIC-insured institution, the Bank is required to pay deposit insurance premium assessments to the FDIC. The FDIC has adopted a risk-based assessment system whereby FDIC-insured depository institutions pay insurance premiums at rates based on their risk classification. An institution s risk classification is assigned based on its capital levels and the level of supervisory concern the institution poses to the regulators. Under the regulations of the FDIC, as presently in effect, insurance assessments range from 0.07% to 0.78% of total deposits, depending on an institution s risk classification, its levels of unsecured debt and secured liabilities, and, in certain cases, its level of brokered deposits.

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Furthermore, as a result of the increased volume of bank failures in 2008 and 2009, on May 22, 2009, the FDIC approved a final rule imposing a special assessment on all depository institutions whose deposits are insured by the FDIC. This one-time special assessment was imposed on institutions in the second quarter, and was collected on September 30, 2009. Pursuant to the final rule, the FDIC imposed on the Bank a special assessment in the amount of $0.7 million, which was due and payable on September 30, 2009.

On November 12, 2009, the FDIC adopted a final rule that required insured depository institutions to prepay on December 30, 2009, their estimated quarterly risk-based assessments for the fourth quarter of 2009 and for all of 2010, 2011, and 2012. On December 31, 2009, the Bank paid the FDIC $9.2 million in prepaid assessments. The FDIC determined each institution s prepaid assessment based on the institution s: (i) actual September 30, 2009 assessment base, increased quarterly by a five percent annual growth rate through the fourth quarter of 2012; and (ii) total base assessment rate in effect on September 30, 2009, increased by an annualized three basis points beginning in 2011. The FDIC will begin to offset prepaid assessments on March 30, 2010, representing payment of the regular quarterly risk-based deposit insurance assessment for the fourth quarter of 2009. Any prepaid assessment not exhausted after collection of the amount due on June 30, 2013, will be returned to the institution.

FDIC Temporary Liquidity Guarantee Program. In conjunction with Treasury s actions to address the credit and liquidity crisis in financial markets, on October 14, 2008, the FDIC announced the Temporary Liquidity Guarantee Program. One component of the Temporary Liquidity Guarantee Program is the Transaction Account Guarantee Program, which temporarily provides participating institutions with unlimited deposit insurance coverage for noninterest bearing and certain low-interest bearing transaction accounts maintained at FDIC insured institutions. All institutions that did not opt out of the Transaction Account Guarantee Program were subject to a 10 basis point per annum assessment on amounts in excess of $250,000 in covered transaction accounts through December 31, 2009. On August 26, 2009, the FDIC extended the Transaction Account Guarantee Program for an additional six months through June 30, 2010. Beginning January 1, 2010, the assessment levels increased to 15 basis points, 20 basis points or 25 basis points per annum, based on the risk category to which an institution is assigned for purposes of the risk-based premium system. The Bank did not opt out of the six-month extension of the Transaction Account Guarantee Program. As a result, the Bank, like every other FDIC-insured depository institution in the United States that did not opt out of the Transaction Account Guarantee Program, is incurring fees on amounts in excess of $250,000 in covered transaction accounts.

FICO Assessments. The Financing Corporation (FICO) is a mixed-ownership governmental corporation chartered by the former Federal Home Loan Bank Board pursuant to the Federal Savings and Loan Insurance Corporation Recapitalization Act of 1987 to function as a financing vehicle for the recapitalization of the former Federal Savings and Loan Insurance Corporation. FICO issued 30-year non callable bonds of approximately $8.2 billion that mature by 2019. Since 1996, federal legislation has required that all FDIC-insured depository institutions pay assessments to cover interest payments on FICO s outstanding obligations. These FICO assessments are in addition to amounts assessed by the FDIC for deposit insurance. During the year ended December 31, 2009, the FICO assessment rate was approximately 0.01% of deposits.

Supervisory Assessments. All Iowa banks are required to pay supervisory assessments to the Iowa Superintendent to fund the operations of that agency. The amount of the assessment is calculated on the basis of the Bank s total assets. During the year ended December 31, 2009, the Bank paid supervisory assessments to the Iowa Superintendent totaling $118,000.

Capital Requirements. Banks are generally required to maintain capital levels in excess of other businesses. Under federal regulations, the Bank is subject to the following minimum capital standards for state-chartered insured non-member banks, such as the Bank: (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%. In general, the components of Tier 1 capital and total capital are the same as those for bank holding companies discussed above.

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.

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 that is well-capitalized 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 all of its financial institution subsidiaries be well-capitalized. Under FDIC 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, 2009: (i) the Bank exceeded its minimum regulatory capital requirements under FDIC capital adequacy guidelines; and (ii) the Bank was well-capitalized, as defined by FDIC regulations.

Dividend Payments. The primary source of funds for the Company is dividends from the Bank. Under the Iowa Banking Act, Iowa-chartered banks generally may pay dividends only out of undivided profits. In addition, the Iowa Superintendent may restrict the declaration or payment of a dividend by an Iowa-chartered bank, such as the Bank.

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, the Bank exceeded its minimum capital requirements under applicable guidelines as of December 31, 2009. As of December 31, 2009, approximately $22.4 million was available to be paid as dividends by the Bank. Notwithstanding the availability of funds for dividends, however, the FDIC may prohibit the payment of any dividends by the Bank if the FDIC determines such payment would constitute an unsafe or unsound practice.

Insider Transactions. The Bank is subject to certain restrictions imposed by federal law on extensions of credit to the Company, on investments in the stock or other securities of the Company and the acceptance of the stock or other securities of the Company as collateral for loans made by the Bank. Certain limitations and reporting requirements are also placed on extensions of credit by the Bank to its directors and officers, to directors and officers of the Company, to principal shareholders of the Company and to related interests of such directors, officers and principal shareholders. In addition, federal law and regulations may affect the terms upon which any person who is a director or officer of the Company or the Bank or a principal shareholder of the Company may obtain credit from banks with which the Bank maintains a correspondent relationship.

Safety and Soundness Standards. The federal banking agencies have adopted guidelines that establish operational and managerial standards to promote the safety and soundness of federally insured depository institutions. The guidelines set forth standards for internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, asset quality and earnings.

In general, the safety and soundness guidelines prescribe the goals to be achieved in each area, and each institution is responsible for establishing its own procedures to achieve those goals. If an institution fails to comply with any of the standards set forth in the guidelines, the institution s primary federal regulator may require the institution to submit a plan for achieving and maintaining compliance. If an institution fails to submit an acceptable compliance plan, or fails in any material respect to implement a compliance plan that has been accepted by its primary federal regulator, the regulator is required to issue an order directing the institution to cure the deficiency. Until the deficiency cited in the regulator s order is cured, the regulator may restrict the institution s rate of growth, require the institution to increase its capital, restrict the rates the institution pays on deposits or require the institution to take any action the regulator deems appropriate under the circumstances. Noncompliance with the standards established by the safety and soundness guidelines may also constitute grounds for other enforcement action by the federal banking regulators, including cease and desist orders and civil money penalty assessments.

Branching Authority. The Bank has the authority under Iowa law to establish branches anywhere in the State of Iowa, subject to 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. The establishment of new interstate branches or the acquisition of individual branches of a bank in another state (rather than the acquisition of an out-of-state bank in its entirety) is permitted only in those states the laws of which expressly authorize such expansion.

State Bank Investments and Activities. The Bank generally is permitted to make investments and engage in activities directly or through subsidiaries as authorized by Iowa law. 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. These restrictions have not had, and are not currently expected to have, a material impact on the operations of the Bank.

Federal Reserve System. Federal Reserve regulations, as presently in effect, require depository institutions to maintain reserves against their transaction accounts (primarily NOW and regular checking accounts), as follows: for transaction accounts aggregating $55.2 million or less, the reserve requirement is 3% of total transaction accounts; and 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. The first $10.7 million of otherwise reservable balances are exempted from the reserve requirements. These reserve requirements are subject to annual adjustment by the Federal Reserve. The Bank is in compliance with the foregoing requirements.

Special Cautionary Note Regarding Forward-Looking Statements

This report contains certain forward-looking statements within the meaning of such term in the Private Securities Litigation Reform Act of 1995. We and our representatives may, from time to time, make written or oral statements that are forward-looking and provide information other than historical information. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results to be materially different from any results, levels of activity, performance or achievements expressed or implied by any forward-looking statement. These factors include, among other things, the factors listed below.

Forward-looking statements, which may be based upon beliefs, expectations and assumptions of our management and on information currently available to management, are generally identifiable by the use of words such as believe , expect , anticipate , should , could , would , plans project , estimate , forecast , may or similar expressions. These forward-looking statements are subject to certain risks and uncertainties that coul cause actual results to differ materially from those expressed in, or implied by, these statements. Readers are cautioned not to place undue reliance on any such forward-looking statements, which speak only as of the date made. Additionally, we undertake no obligation to update any statement in light of new information or future events, except as required under federal securities law.

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Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors that could have an impact on our ability to achieve operating results, growth plan goals and future prospects include, but are not limited to, the following:

- credit quality deterioration or pronounced and sustained reduction in real estate market values could cause an increase in the allowance for credit losses and a reduction in net earnings;
- our management s ability to reduce and effectively manage interest rate risk and the impact of interest rates in general on the volatility of our net interest income;
- changes in the economic environment, competition, or other factors that may affect our ability to acquire loans or influence the anticipated growth rate of loans and deposits and the quality of the loan portfolio and loan and deposit pricing;
- fluctuations in the value of our investment securities;
- governmental monetary and fiscal policies;
- legislative and regulatory changes, including changes in banking, securities and tax laws and regulations and their application by our regulators, and changes in the scope and cost of Federal Deposit Insurance Corporation insurance and other coverages;
- the ability to attract and retain key executives and employees experienced in banking and financial services;
- the sufficiency of the allowance for loan losses to absorb the amount of actual losses inherent in our existing loan portfolio;
- our ability to adapt successfully to technological changes to compete effectively in the marketplace;
- credit risks and risks from concentrations (by geographic area and by industry) within our loan portfolio;
- the effects of competition from other commercial banks, thrifts, mortgage banking firms, consumer finance companies, credit unions, securities brokerage firms, insurance companies, money market and other mutual funds, and other financial institutions operating in our market or elsewhere or providing similar services;
- the failure of assumptions underlying the establishment of allowances for loan losses and estimation of values of collateral and various financial assets and liabilities;
- volatility of rate-sensitive deposits;
- operational risks, including data processing system failures or fraud;

asset/liability matching risks and liquidity risks;

the risks of mergers, acquisitions and divestitures, including, without limitation, the related time and costs of implementing such transactions, integrating operations as part of these transactions and possible failures to achieve expected gains, revenue growth and/or expense savings from such transactions;

the costs, effects and outcomes of existing or future litigation;

changes in general economic or industry conditions, nationally or in the communities in which we conduct business;

changes in accounting policies and practices, as may be adopted by state and federal regulatory agencies and the Financial Accounting Standards Board; and

other factors and risks described under Risk Factors herein.

We qualify all of our forward-looking statements by the foregoing cautionary statements. Because of these risks and other uncertainties, our actual future results, performance or achievement, or industry results, may be materially different from the results indicated by these forward-looking statements. In addition, our past results of operations are not necessarily indicative of our future results.

ITEM 1A. RISK FACTORS.

Our business has been and may continue to be adversely affected by conditions in the financial markets and economic conditions generally.

The United States has been in a recession since December, 2007. Business activity across a wide range of industries and regions is greatly reduced, and many businesses are experiencing serious difficulty in remaining profitable due to the lack of consumer spending and the lack of liquidity in the credit markets. Likewise, many local governments are experiencing lower tax revenues, impacting their ability to cover costs. Unemployment has increased significantly. Since mid-2007, and particularly during the second half of 2008 and most of 2009, the financial services industry and the securities markets have been materially and adversely affected by significant declines in the values of nearly all asset classes and by a serious lack of liquidity.

As a result of this economic downturn, many lending institutions, including the Bank, have experienced declines in the performance of their loans, including commercial loans, commercial and residential real estate loans and consumer loans. Moreover, competition among depository institutions for deposits and quality loans has increased significantly. In addition, the values of real estate collateral supporting many commercial loans and home mortgages have declined and may continue to decline. Bank and bank holding company stock prices have been negatively affected, and the ability of banks and bank holding companies to raise capital or borrow in the debt markets has become more difficult compared to recent years. There is also the potential for new federal or state laws and regulations regarding lending and funding practices and liquidity standards, and bank regulatory agencies in general have been very aggressive in responding to concerns and trends identified in examinations, including the expected issuance of many formal or informal enforcement actions or orders. The impact of new legislation in response to those developments may negatively impact our operations by restricting our business operations, including our ability to originate or sell loans, and adversely impact our financial performance or our stock price.

In addition, further negative market developments may affect consumer confidence levels and may cause adverse changes in payment patterns, causing increases in delinquencies and default rates, which may impact our charge-offs and provision for credit losses. A worsening of these conditions likely would exacerbate the adverse effects of these difficult market conditions on us and others in the financial services industry.

Overall, during the last two years, the general business environment has had an adverse effect on our business, and there can be no assurance that the environment will improve in the near term. Until conditions materially improve, we expect our business, financial condition and results of operations to be adversely affected.

Interest rates and other conditions impact our results of operations.

Our profitability is in large 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 at 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.

Our business is concentrated in and largely dependent upon the continued growth and welfare of the Iowa City and Oskaloosa markets and other markets in eastern and central Iowa.

We operate primarily in the Iowa City and Oskaloosa, Iowa, markets and their surrounding communities in eastern and central Iowa and, as a result, our financial condition, results of operations and cash flows are significantly impacted by changes in the economic conditions in those areas. Our success depends to a significant extent upon the business activity, population, income levels, deposits and real estate activity in these markets. Although our customers business and financial interests may extend well beyond these market areas, adverse economic conditions that affect these market areas 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. Because of our geographic concentration, we are less able than other regional or national financial institutions to diversify our credit risks across multiple markets. Although, in general, the Iowa economy and real estate market has not suffered as badly as other areas of the United States during the recession that has prevailed since at least December 2007, they are not immune to the challenging economic conditions that are harming the United States and world economies.

We must manage our credit risk effectively.

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 credit review department. However, we cannot assure you that such approval and monitoring procedures will reduce these credit risks.

A significant portion of MidWest*One* Bank s loan portfolio consists of commercial loans, and we focus on lending to small to medium-sized businesses. The size of the loans we can offer to commercial customers is less than the size of the loans that our competitors with larger lending limits can offer. This may limit our ability to establish relationships with the area s largest businesses. As a result, we may assume greater lending risks than financial institutions that have a lesser concentration of such loans and tend to make loans to larger businesses. Collateral for these loans generally includes accounts receivable, inventory, equipment and real estate. However, depending on the overall financial condition of the borrower, some loans are made on an unsecured basis. In addition to commercial loans and commercial real estate loans, MidWest*One* Bank is also active in residential mortgage and consumer lending. Should the economic climate worsen, our borrowers may experience financial difficulties, and the level of nonperforming loans, charge-offs and delinquencies could rise, which could negatively impact our business.

Commercial, financial and agricultural loans make up a significant portion of our loan portfolio.

Commercial, financial and agricultural loans were $303.6 million, or approximately 31% of our total loan portfolio, as of December 31, 2009. 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 is accounts receivable, inventory and equipment. Credit support provided by the borrower for most of these loans and the probability of repayment is based on the liquidation value of the pledged collateral and enforcement of a personal guarantee, if any exists. As a result, 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 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. In addition, a continued decline in the United States economy could harm or continue to harm the businesses of our commercial and industrial customers and reduce the value of the collateral securing these loans.

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

Commercial real estate lending comprises a significant portion of our lending business. Specifically, commercial real estate loans were $404.6 million, or approximately 42% of our total loan portfolio, as of December 31, 2009. Of this amount, $124.8 million, or approximately 31%, are loans secured by owner-occupied property. The market value of real estate securing our commercial real estate loans 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. Although a significant portion of such loans are secured by real estate as a secondary form of collateral, adverse developments affecting real estate values in one or more of our markets could increase the credit risk associated with our loan portfolio. Additionally, real estate lending typically involves higher loan principal amounts and the repayment of the loans generally is dependent, in large part, on sufficient income from the properties securing the loans to cover operating expenses and debt service. 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.

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If the problems that have occurred in residential real estate and mortgage markets throughout much of the United States were to spread to the commercial real estate market, particularly within one or more of our markets, the value of collateral securing our commercial real estate loans could decline. In such case, we may not be able to realize the amount of security that we anticipated at the time of originating the loan, which could cause us to increase our provision for loan losses and adversely affect our operating results, financial condition and/or capital. We generally have not experienced a downturn in credit performance by our commercial real estate loan customers, but in light of the uncertainty that exists in the economy and credit markets nationally, there can be no guarantee that we will not experience any deterioration in such performance.

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

We established our allowance for loan losses in consultation with the credit officers of MidWest*One* Bank and maintain it at a level considered adequate by management to absorb 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. At December 31, 2009, our allowance for loan losses as a percentage of total gross loans was 1.44% and as a percentage of total nonperforming loans was approximately 100.6%. Although management believes 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. Loan losses in excess of our reserves may adversely affect our business, financial condition and results of operations.

We have investments in pools of performing and nonperforming loans that comprise a material component of our assets and generate substantial interest income with yields that may fluctuate considerably resulting in inconsistent profitability from period to period.

As of December 31, 2009, approximately 6% of our earning assets were invested in loan pools, and approximately 2% of our gross total revenue was derived from the loan pools. These loan pools represent a mixture of performing, subperforming and nonperforming loans. As of December 31, 2009, our loan pool investment of $85.2 million consisted of loans secured by commercial real estate (55.8%), commercial operating (8.6%), single-family residential real estate (11.0%), agricultural real estate (10.6%) and other loans (14.0%). The loan pool investment is a nontraditional activity that has historically provided us and our predecessor entities with a higher return than typical loans and investment securities. The return on investment in loan pools and the effect on profitability can be unpredictable due to fluctuations in the balance of loan pools and collections from borrowers by the loan pool servicer. Loan pool balances are affected by the ability to purchase additional loan pools to maintain the level of investment and by the payment and refinancing activities of the borrowers resulting in pay-offs of the underlying loans and reduction in the balances. Purchases of new loan pools are subject to many factors that are outside our control, including: availability, competition, credit and performance quality of assets offered for sale, asset size and type, and the economic and interest rate environment. Collections from the individual borrowers are managed by the loan pool servicer and are affected by the borrower s financial ability and willingness to pay, foreclosure and legal action, collateral value, and the economy in general. Any of these identified factors, and others not identified, could affect our return on loan pool investments.

Although we do not seek to purchase consumer or consumer real estate loans characterized as subprime or Alt-A credits, because the purchase of these assets is on a pool basis, we have acquired some subprime loans as characterized by borrowers or guarantors having FICO scores below 640. Consumer-based paper makes up approximately 12.0% of our loan pool investment and, as of December 31, 2009, approximately 0.3% of the basis amount of our loan pool investment represented subprime credit. Because we do not originate the consumer-based loans that may be characterized as Alt-A, and because of the nature of the information provided to us with respect to any Alt-A loans in the loan pools, we are not able to verify the basis amount of our loan pool investment that represents Alt-A credit. Loans that are characterized as subprime and, to a lesser extent, Alt-A carry a higher risk of default by the underlying borrowers than other types of loans, which could affect the value of the overall loan pool investment.

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Our planned pace of 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 intend to grow our business organically and to explore opportunities to grow our business by taking advantage of attractive acquisition opportunities, including through the FDIC-assisted transactions, and such growth plans may require us to raise additional capital to ensure that we have adequate levels of capital to support such growth on top of our current operations. In February 2009, we received a capital investment of $16.0 million under the U.S. Treasury s Capital Purchase Program. However, we may at some point need to raise additional capital to support our growth plans and in this regard recently filed a universal shelf-registration statement registering for future sale up to $25 million of securities that places us in a position to raise capital if the need were to arise or if an attractive opportunity were presented. 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 or acquisitions could be materially impaired.

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

Although we do not have any current definitive plans to do so, we may expand into additional communities or attempt to strengthen our position in our current markets through opportunistic acquisitions of all or part of other financial institutions, including through FDIC-assisted transactions, or by opening new branches. To the extent that we undertake acquisitions or new branch openings, we are likely 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. Other effects of engaging in such growth strategies may include potential diversion of our management s time and attention and general disruption to our business.

To the extent that we grow through acquisitions or branch openings, we cannot assure you that we will be able to adequately and profitably manage this growth. Acquiring other banks and businesses will involve similar risks to those commonly associated with branching, but may also involve additional risks, 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; and
- the possible loss of key employees and customers of the banks and businesses we acquire.

Liquidity risks could affect operations and jeopardize our business, financial condition and results of operations.

Liquidity is essential to our business. An inability to raise funds through deposits, borrowings, the sale of loans and other sources could have a substantial negative effect on our liquidity. Our primary sources of funds consist of cash from operations, investment maturities and sales, deposits and funds from sales of capital securities. Additional liquidity is provided by brokered deposits, bank lines of credit, repurchase agreements and the ability to borrow from the Federal Reserve Bank and the Federal Home Loan Bank. Our access to funding sources in amounts adequate to finance or capitalize our activities or on terms that are acceptable to us could be impaired by factors that affect us directly or the financial services industry or economy in general, such as further disruptions in the financial markets or negative views and expectations about the prospects for the financial services industry.

Since late 2007, and particularly during the second half of 2008 and most of 2009, the financial services industry and the credit markets generally have been materially and adversely affected by significant declines in asset values and by a lack of liquidity. The liquidity issues have been particularly acute for regional and community banks, as many of the larger financial institutions have significantly curtailed their lending to regional and community banks to reduce their exposure to the risks of other banks. In addition, many of the larger correspondent lenders have reduced or even eliminated federal funds lines for their correspondent customers. Furthermore, regional and community banks generally have less access to the capital markets than do the national and super-regional banks because of their smaller size and limited analyst coverage.

As a result, we rely more on our ability to generate deposits and effectively manage the repayment and maturity schedules of our loans and investment securities, respectively, to ensure that we have adequate liquidity to fund our operations. Any decline in available funding could adversely impact our ability to originate loans, invest in securities, meet our expenses, pay dividends to our stockholders, or to fulfill obligations such as repaying our borrowings or meeting deposit withdrawal demands, any of which could have a material adverse impact on our liquidity, business, financial condition and results of operations.

We cannot predict the effect on our operations of recent legislative and regulatory initiatives that were enacted in response to the ongoing financial crisis.

U.S. federal, state and foreign governments have taken or are considering extraordinary actions in an attempt to deal with the worldwide financial crisis. To the extent adopted, many of these actions have been in effect for only a limited time, and have produced limited or no relief to the capital, credit and real estate markets. There is no assurance that these actions or other actions under consideration will ultimately be successful.

In the United States, the federal government has adopted the Emergency Economic Stabilization Act of 2008 and the American Recovery and Reinvestment Act of 2009. With authority granted under these laws, the U.S. Treasury has proposed a financial stability plan that is intended to:

- invest in financial institutions and purchase troubled assets and mortgages from financial institutions for the purpose of stabilizing and providing liquidity to the U.S. financial markets;
- temporarily increase the limit on FDIC deposit insurance coverage to $250,000 per depositor through December 31, 2013; and
- provide for various forms of economic stimulus, including assisting homeowners restructure and lower mortgage payments on qualifying loans.

Numerous other actions have been taken by the U.S. Congress, the Federal Reserve, the U.S. Treasury, the FDIC, the SEC and others to address the liquidity and credit crisis that has followed the subprime mortgage crisis that commenced in 2007, including the financial stability plan adopted by the U.S. Treasury. In addition, President Obama has recently announced various financial regulatory reform proposals, and the House and Senate are expected to consider competing proposals over the coming years.

There can be no assurance that the financial stability plan proposed by the U.S. Treasury, the other proposals under consideration or any other legislative or regulatory initiatives will be effective at dealing with the ongoing economic crisis and improving economic conditions globally, nationally or in our markets, or that the measures adopted will not have adverse consequences. The terms and costs of these activities, or the failure of these actions to help stabilize the financial markets, asset prices, market liquidity and a continuation or worsening of current financial market and economic conditions could materially and adversely affect our business, financial condition, results of operations, and the trading prices of our securities.

Higher FDIC deposit insurance premiums and assessments could adversely affect our financial condition.

FDIC insurance premiums increased substantially in 2009, and we expect to pay significantly higher FDIC premiums in the future. Bank failures have significantly depleted the FDIC s Deposit Insurance Fund and reduced the Deposit Insurance Fund s ratio of reserves to insured deposits. The FDIC adopted a revised risk-based deposit insurance assessment schedule on February 27, 2009, which raised deposit insurance premiums. On May 22, 2009, the FDIC also implemented a special assessment equal to five basis points of each insured depository institution s assets minus Tier 1 capital as of June 30, 2009, but no more than 10 basis points times the institution s assessment base for the second quarter of 2009, which was collected on September 30, 2009. The Company s share of an industry-wide FDIC assessment prepayment covering the years 2010 through 2012 collected in December 2009 was $9.2 million. This cash pre-payment is reflected on the Company s consolidated balance sheet under Other Assets. Additional special assessments may be imposed by the FDIC for future periods.

We participate in the FDIC s Temporary Liquidity Guarantee Program, or TLG, for noninterest-bearing transaction deposit accounts. Banks that participate in the TLG s noninterest-bearing transaction account guarantee pay the FDIC an annual assessment of between 15 to 25 basis points, depending on the depository institution s risk assessment category rating, on the amounts in such accounts above the amounts covered by FDIC deposit insurance. To the extent that these TLG assessments are insufficient to cover any loss or expenses arising from the TLG program, the FDIC is authorized to impose an emergency special assessment on all FDIC-insured depository institutions. The FDIC has authority to impose charges for the TLG program upon depository institution holding companies, as well. These actions have significantly increased our noninterest expense in 2009 and are expected to increase our costs for the foreseeable future.

Our ability to pay dividends is subject to certain limitations and restrictions, and there is no guarantee that we will be able to continue paying the same level of dividends in the future that we paid in 2009 or that we will be able to pay future dividends at all.

Our ability to pay dividends is limited by regulatory restrictions and the need to maintain sufficient consolidated capital. The ability of MidWest*One* Bank to pay dividends to us is limited by its obligations to maintain sufficient capital and liquidity and by other general restrictions on dividends that are applicable to MidWest*One* Bank, including the requirement under the Iowa Banking Act that it may not pay dividends in excess of its accumulated net profits. The FDIC and other bank regulators have proposed guidelines and seek greater liquidity, and have been discussing increasing capital requirements. If these regulatory requirements are not met, MidWest*One* Bank will not be able to pay dividends to us, and we may be unable to pay dividends on our common stock or preferred stock.

In addition, as a bank holding company, our ability to declare and pay dividends is subject to the guidelines of the Federal Reserve regarding capital adequacy and dividends. The Federal Reserve guidelines generally require us to review the effects of the cash payment of dividends on common stock and other Tier 1 capital instruments (i.e., perpetual preferred stock and trust preferred debt) in light of our earnings, capital adequacy and financial condition. In addition, as a matter of policy, the Federal Reserve has indicated that bank holding companies should not pay dividends on common stock (or make distributions on trust preferred securities) using funds from the TARP Capital Purchase Program. As a general matter, the Federal Reserve indicates that the board of directors of a bank holding company (including a financial holding company) should eliminate, defer or significantly reduce the dividends if:

- the company s net income available to stockholders for the past four quarters, net of dividends previously paid during that period, is not sufficient to fully fund the dividends;

- the prospective rate of earnings retention is inconsistent with the company s capital needs and overall current and prospective financial condition; or

- the company will not meet, or is in danger of not meeting, its minimum regulatory capital adequacy ratios.

As of December 31, 2009, we had $15.6 million of junior subordinated debentures held by a statutory business trust that we control. Interest payments on the debentures, which totaled $0.7 million for the year ended December 31, 2009, must be paid before we pay dividends on our capital stock, including our common stock. We have the right to defer interest payments on the debentures for up to 20 consecutive quarters. However, if we elect to defer interest payments, all deferred interest must be paid before we may pay dividends on our capital stock. Deferral of interest payments on the debentures could cause a subsequent decline in the market price of our common stock because we would not be able to pay dividends on our common stock.

In addition, on February 6, 2009, we issued shares of perpetual senior preferred stock to Treasury as part of the Capital Purchase Program. The terms of the senior preferred stock restrict the payment of dividends on shares of our common stock. Without the prior consent of Treasury, we are prohibited from increasing common stock dividends beyond the $0.1525 quarterly dividend that we paid prior to closing Treasury s investment for the first three years while Treasury holds the senior preferred stock. Further, we are prohibited from continuing to pay dividends on our common stock unless we have fully paid all required dividends on the senior preferred stock. Although we expect to be able to pay all required dividends on the senior preferred stock, there is no guarantee that we will be able to do so.

Changes in future rules applicable to TARP recipients could adversely affect our business, financial condition and results of operations.

On February 6, 2009, we issued $16.0 million of our Fixed Rate Cumulative Perpetual Preferred Stock, Series A to the U.S. Treasury pursuant to the TARP Capital Purchase Program. The rules and policies applicable to recipients of capital under the TARP Capital Purchase Program continue to evolve and their scope, timing and effect cannot be predicted. Any redemption of the securities sold to the U.S. Treasury to avoid these restrictions would require prior Federal Reserve and U.S. Treasury approval. Based on guidelines recently issued by the Federal Reserve, institutions seeking to redeem TARP Capital Purchase Program preferred stock must demonstrate an ability to access the long-term debt markets, successfully demonstrate access to public equity markets and meet a number of additional requirements and considerations before such institutions can redeem any securities sold to the U.S. Treasury.

Our ability to attract and retain management and key personnel may affect future growth and earnings, and legislation enacted in 2009 imposed new compensation restrictions on participates in the TARP Capital Purchase Program, which could adversely affect our ability to retain management and key personnel.

Much of our success and growth has been influenced strongly by our ability to attract and retain management experienced in banking and financial services and familiar with the communities in our market areas. Our ability to retain executive officers, the current management teams, branch managers and loan officers 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 areas 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, results of operations and financial condition.

The American Recovery and Reinvestment Act of 2009 that was signed into law in February 2009 includes extensive new restrictions on our ability to pay retention awards, bonuses and other incentive compensation during the period in which we have any outstanding securities held by the U.S. Treasury that were issued under the TARP Capital Purchase Program. Many of the restrictions are not limited to our senior executives and could cover other employees whose contributions to our performance are significant. The limitations may adversely affect our ability to recruit and retain these key employees in addition to our senior executive officers, especially if we are competing for talent against institutions that are not subject to the same restrictions. The Federal Reserve is contemplating proposed rules governing the compensation practices of financial institutions and these rules, if adopted, may make it more difficult to attract and retain the people we need to operate our businesses and limit our ability to promote our objectives through our compensation and incentive programs.

We face intense competition in all phases of our business from banks and other financial institutions.

The banking and financial services businesses in our markets are highly competitive. Our competitors include large regional banks, local community banks, savings and loan associations, securities and brokerage companies, mortgage companies, insurance companies, finance companies, money market mutual funds, credit unions and other nonbank financial services providers. Many of these competitors are not subject to the same regulatory restrictions as we are. Many of our unregulated competitors compete across geographic boundaries and are able to provide customers with a competitive alternative to traditional banking services. Additionally, if the regulatory trend toward reducing restrictions on the interstate operations of financial institutions continues, we will continue to experience increased competition as a result.

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. If increased competition causes us to significantly discount the interest rates we offer on loans or increase the amount we pay on deposits, our net interest income could be adversely impacted. If increased competition causes us to modify our underwriting standards, we could be exposed to higher losses from lending activities. Additionally, many of our competitors are much larger in total assets and capitalization, have greater access to capital markets, have larger lending limits and offer a broader range of financial services than we can offer.

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

The financial services industry continues to undergo rapid technological changes with frequent introductions of new technology-driven products and services. In addition to enabling us to better serve our customers, the effective use of technology increases efficiency and the potential for cost reduction. 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 our market share. 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 could put us at a competitive disadvantage. Accordingly, we cannot provide you with assurance that we will be able to effectively implement new technology-driven products and services or be successful in marketing such products and services to our customers.

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 and 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, and if any resulting loss is not insured or exceeds applicable insurance limits, such failure could have a material adverse effect on our business, financial condition and results of operations.

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 Treasury, the Federal Reserve, the FDIC and the Iowa Superintendent of Banking. Regulations adopted by these agencies, which are generally intended to provide protection for depositors and customers rather than for the benefit of shareholders, 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. 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.

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Adverse weather affecting the markets we serve could hurt our business and prospects for growth.

Substantially all of our business is conducted in the State of Iowa, and a significant portion is conducted in rural communities. The Iowa economy, in general, is heavily dependent on agriculture and therefore the overall Iowa economy, and particularly the economies of the rural communities that we serve, can be greatly affected by severe weather conditions, including droughts, storms, tornados and flooding. Unfavorable weather conditions may decrease agricultural productivity or could result in damage to our branch locations or the property of our customers, all of which could adversely affect the local economy. An adverse affect on the economy of Iowa would negatively affect our profitability.

There is a limited trading market for our common shares, and you may not be able to resell your shares at or above the price stockholders paid for them.

Although our common shares are listed for quotation on The NASDAQ Global Select Market, the trading in our common shares has substantially less liquidity than many other companies listed on NASDAQ. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the market of willing buyers and sellers of our common shares at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which we have no control. We cannot assure you that the volume of trading in our common shares will increase in the future.

Certain MidWestOne shareholders own a significant interest in the combined company and may exercise their control in a manner detrimental to your interests.

Certain MidWest*One* shareholders who are descendants of our founder collectively control approximately 32.7% of our outstanding common stock and may have the opportunity to exert influence on the outcome of matters required to be submitted to shareholders for approval. In addition, this significant level of ownership by members of the founding family may contribute to the rather limited liquidity of our common stock on the NASDAQ Global Select Market.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

None.

ITEM 2. PROPERTIES.

Our headquarters and the MidWest*One* Bank s main office are located at 102 South Clinton Street, Iowa City, Iowa. This building is owned by us and approximately 39,400 of its 63,800 square feet are being leased out to unrelated third parties. We currently operate 28 additional branches throughout central and east-central Iowa totaling approximately 125,000 square feet. The table below sets forth the locations of the Bank s branch offices:

822 12th St.	802 13th St.*
Belle Plaine, Iowa	Belle Plaine, Iowa
3225 Division St.	323 Jefferson St.
Burlington, Iowa	Burlington, Iowa
120 W. Center St.	110 1st Ave.
Conrad, Iowa	Coralville, Iowa
101 W. Second St., Suite 100	2408 W. Burlington
Davenport, Iowa	Fairfield, Iowa

58 East Burlington	926 Ave. G
Fairfield, Iowa	Ft. Madison, Iowa

4510 Prairie Pkwy.	100 Eddystone Dr.
Cedar Falls, Iowa	Hudson, Iowa
325 S. Clinton St.	1906 Keokuk St.
Iowa City, Iowa	Iowa City, Iowa
2233 Rochester Ave.	202 Main St.
Iowa City, Iowa	Melbourne, Iowa
10030 Hwy. 149	465 Hwy. 965 NE, Suite A
North English, Iowa	North Liberty, Iowa
124 South First St.	222 First Ave. East*
Oskaloosa, Iowa	Oskaloosa, Iowa
301 A Ave. West*	116 W. Main St.
Oskaloosa, Iowa	Ottumwa, Iowa
1001 Hwy. 57	700 Main St.
Parkersburg, Iowa	Pella, Iowa
500 Oskaloosa St.*	112 North Main St.
Pella, Iowa	Sigourney, Iowa
3110 Kimball Ave.	305 W. Rainbow Dr.
Waterloo, Iowa	West Liberty, Iowa

* Drive up location only.

Leased office.

In addition to the Bank s branch offices, the insurance subsidiary leases two properties totaling approximately 3,900 square feet. The Bank owns 46 ATMs that are located within the communities served by branch offices. We believe each of our facilities is suitable and adequate to meet our current operational needs.

On May 25, 2008, the Bank s branch office in Parkersburg, Iowa, was destroyed by a category five tornado that caused severe damage to much of the community. On March 16, 2009, the Bank completed the reconstruction of its Parkersburg branch office and reopened the office. The facility was insured and the policy covered most of the reconstruction costs.

ITEM 3. LEGAL PROCEEDINGS.

We and our subsidiaries are from time to time parties to various legal actions arising in the normal course of business. We believe that there is no threatened or pending proceeding against us or our subsidiaries, which, if determined adversely, would have a material adverse effect on our consolidated business or financial condition.

ITEM 4. RESERVED.

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PART II

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

Our common stock is listed on Nasdaq Global Select Market under the symbol MOFG. The following table presents for the periods indicated the high and low sale price for our common stock as reported on Nasdaq Global Select Market:

	High	Low	Cash Dividend Declared
2008			
First Quarter	$ 19.24	$ 16.00	$
Second Quarter	$ 17.25	$ 11.94	$ 0.1525
Third Quarter	$ 14.95	$ 12.00	$ 0.1525
Fourth Quarter	$ 14.47	$ 8.35	$ 0.1525
2009			
First Quarter	$ 10.35	$ 5.90	$ 0.1525
Second Quarter	$ 10.52	$ 6.51	$ 0.0500
Third Quarter	$ 9.50	$ 7.00	$ 0.0500
Fourth Quarter	$ 9.00	$ 7.57	$ 0.0500

As of March 1, 2010, there were 8,605,333 shares of common stock outstanding held by approximately 572 holders of record. Additionally, there are an estimated 1,729 beneficial holders whose stock was held in street name by brokerage houses and other nominees as of that date.

Dividends. We may pay dividends on our common stock as and when declared by our Board of Directors out of any funds legally available for the payment of such dividends, subject to any and all preferences and rights of any preferred stock or a series thereof. The amount of dividend payable will depend upon our earnings and financial condition and other factors, including applicable governmental regulations and policies.

As previously discussed, we consummated the sale of $16.0 million of senior preferred stock to Treasury pursuant to the Capital Purchase Program on February 6, 2009. The terms of the senior preferred stock place certain restrictions on our ability to pay dividends on our common stock. First, no dividends on our common stock may be paid unless all accrued dividends on Treasury s senior preferred stock have been paid in full. Second, until the third anniversary of the date of Treasury s investment, we may not increase the dividends paid on our common stock beyond our recent quarterly dividend of $0.1525 per share declared prior to our participation in the Capital Purchase Program without first obtaining the consent of Treasury.

Repurchases of Company Equity Securities

There were no purchases of shares of our common stock made by or on behalf of us during the quarter ended December 31, 2009.

We currently do not have a stock repurchase program in place. Because of our participation in the Capital Purchase Program, we are not be permitted to repurchase any shares of our common stock, other than in connection with benefit plans consistent with past practice, until such time as Treasury no longer holds any of our equity securities. Accordingly, we do not anticipate repurchasing any shares of our common stock in the near future.

Performance Graph

The following table compares MidWest*One* s performance, as measured by the change in price of its common stock plus reinvested dividends, with the NASDAQ Composite Index and the SNL-Midwestern Banks Index for the five years ended December 31, 2009.

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MidWest*One* Financial Group, Inc.

Stock Price Performance

	At					
Index	12/31/2004	12/31/2005	12/31/2006	12/31/2007	12/31/2008	12/31/2009
MidWestOne Financial Group, Inc	100.00	111.42	144.74	97.63	52.11	46.00
NASDAQ Composite	100.00	101.37	111.03	121.92	72.49	104.31
SNL-Midwestern Banks Index	100.00	92.98	103.65	77.63	48.57	40.43

As of the years ended December 31, 2007, 2006, 2005 and 2004, our common stock was not traded on the Nasdaq Stock Market or any other stock exchange. It was only quoted on The Pink Sheets LLC. Accordingly, the prices in the graph above for such years reflect the most recent price quoted on The Pink Sheets LLC as of each such date.

The banks in the Custom Peer Group SNL-Midwestern Banks Index represent all publicly traded banks, thrifts or financial service companies located in Iowa, Illinois, Indiana, Kansas, Kentucky, Michigan, Minnesota, Missouri, North Dakota, Nebraska, Ohio, South Dakota and Wisconsin.

ITEM 6. SELECTED FINANCIAL DATA.

The following selected financial data for each of the five years in the period ended December 31, 2009, have been derived from our audited consolidated financial statements and the results of operations for each of the five years in the period ended December 31, 2009. This financial data should be read in conjunction with the financial statements and the related notes thereto.

As previously discussed, on March 14, 2008, we consummated the Merger with the Former MidWest*One*. For accounting purposes, we were deemed to be the acquirer in the Merger. Accordingly, the financial information in the table below for years prior to December 31, 2008 is the information for the Company prior to the Merger and does not include financial information for the Former MidWest*One*.

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Period Ended (In thousands, except per share data)	12/31/2009	12/31/08	12/31/07	12/31/06	12/31/05
Summary of income data:					
Total interest income excluding loan pool participations	$ 71,549	$ 65,747	$ 38,305	$ 35,308	$ 30,627
Total income and discount on loan pool participations	1,809	4,459			
Total interest income including loan pool participations	73,358	70,206	38,305	35,308	30,627
Total interest expense	28,243	30,395	19,038	16,759	11,742
Net interest income	45,115	39,811	19,267	18,549	18,885
Provision for loan losses	7,725	4,366	500	550	300
Noninterest income	12,519	5,542	8,806	7,572	8,722
Noninterest expenses	45,579	65,999	18,620	17,680	17,514
Income (loss) before income tax	4,330	(25,012)	8,953	7,891	9,793
Income tax (benefit) expense	(79)	(450)	2,305	2,093	2,876
Net income (loss)	$ 4,409	$ (24,562)	$ 6,648	$ 5,798	$ 6,917
Less: Preferred stock dividends and discount accretion	779				
Net income (loss) available to common shareholders	$ 3,630	$ (24,562)	$ 6,648	$ 5,798	$ 6,917
Per share data:					
Net income (loss) - basic	$ 0.42	$ (3.09)	$ 1.29	$ 1.11	$ 1.32
Net income (loss) - diluted	0.42	(3.09)	1.29	1.11	1.32
Cash dividends declared	0.30	0.46	0.65	0.32	0.28
Book value	17.69	15.15	14.98	14.14	13.18
Net tangible book value	14.42	13.58	14.14	13.29	12.34
Selected financial ratios:					
Net income (loss) to average assets	0.29%	(1.61)%	0.98%	0.87%	1.06%
Net income to average equity	2.99	(15.96)	8.83	8.16	10.27
Net income to average tangible equity	3.27	(20.41)	9.37	8.69	10.98
Dividend payout ratio	71.43	NM	50.39	23.96	20.53
Total shareholders equity to total assets	9.92	8.66	11.02	10.95	10.30
Tangible shareholders equity to tangible assets	9.18	7.83	10.47	10.36	9.71
Tier 1 risk-based capital ratio	12.66	10.24	15.35	14.69	15.65
Net interest margin	3.27	3.29	3.27	3.12	3.29
Gross revenue of loan pools to total gross revenue	2.11	5.86			
Allowance for bank loan losses to total bank loans	1.44	1.08	1.36	1.40	1.41
Allowance for loan pool losses to total loan pools	2.51	2.29			
Non-performing loans to total loans	1.44	1.50	0.32	0.20	0.20
Net loans charged off (recovered) to average loans	0.48	0.48	0.09	0.13	(0.01)

Period Ended (In thousands)	12/31/09	12/31/08	12/31/07	12/31/06	12/31/05
Selected balance sheet data:					
Total assets	$ 1,534,783	$ 1,508,962	$ 701,983	$ 668,671	$ 669,769
Total loans net of unearned discount	966,998	1,014,814	401,554	378,612	370,849
Allowance for loan losses	13,957	10,977	5,466	5,298	5,227
Loan pool participations, net	83,052	92,932			
Total deposits	1,179,868	1,128,189	526,615	492,901	492,581
Federal funds purchased and repurchase agreements	44,973	57,299	45,997		
Federal Home Loan Bank advances	130,200	158,782	47,000		
Long-term debt	15,588	15,640			
Total shareholders equity	152,208	130,342	77,392	73,209	68,959

NM - Percentage calculation not considered meaningful.

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

Overview

On March 14, 2008, we consummated our merger with the Former MidWest*One*. Prior to such merger, we were named ISB Financial Corp. The results of operations for the years ended December 31, 2007 and prior, include only our stand-alone operations for such year. The results of operations for year ended December 31, 2008, include our operations for the entire year as well as the operations of Former MidWest*One* for the period beginning March 15, 2008, through December 31, 2008. That is, the results of operations include approximately two and one-half months of our stand-alone operations and nine and one-half months of the operations of the Company and Former MidWest*One* on a consolidated basis. The results of operations for the year ended December 31, 2009, include the operations of the combined Company for the entire period. Accordingly, the comparison of our results of operations for the year ended December 31, 2009, to the prior two years (particularly 2007) often shows significant changes, many of which are largely attributable to the merger and the resulting larger entity.

The comparison of our financial condition as of December 31, 2009, to our financial condition at December 31, 2008, is not similarly impacted by the merger because our consolidated balance sheet as of December 31, 2009 and 2008 includes information for both the Company and Former MidWest*One* as a combined entity.

Critical Accounting Estimates

We have identified the following critical accounting policies and practices relative to the reporting of its results of operation and financial condition. These accounting policies relate to the allowance for loan losses, participation interests in loan pools, application of purchase accounting, goodwill and intangible assets, and fair value of available for sale investment securities.

Allowance for Loan Losses

The allowance for loan losses is based on our estimate. We believe the allowance for loan losses is adequate to absorb probable losses in the existing portfolio. In evaluating the portfolio, we take into consideration numerous factors, including current economic conditions, prior loan loss experience, the composition of the loan portfolio, and management s estimate of probable credit losses. The allowance for loan losses is established through a provision for loss based on our evaluation of the risk inherent in the loan portfolio, the composition of the portfolio, specific impaired loans, and current economic conditions. Such evaluation, which includes a review of all loans on which full collectability may not be reasonably assured, considers, among other matters, the estimated net realizable value or the fair value of the underlying collateral, economic conditions, historical loss experience, and other factors that warrant recognition in providing for an adequate allowance for loan losses. In the event that our evaluation of the level of the allowance for loan losses is inadequate, we would need to increase our provision for loan losses.

Participation Interests in Loan Pools

The loan pool accounting practice relates to our estimate that the investment amount reflected on our financial statements does not exceed the estimated net realizable value or the fair value of the underlying collateral securing the purchased loans. In evaluating the purchased loan pool, we take into consideration many factors, including the borrowers current financial situation, the underlying collateral, current economic conditions, historical collection experience, and other factors relative to the collection process. If the estimated net realizable value of the loan pool participations is overstated, our yield on the loan pools would be reduced.

Application of Purchase Accounting

We completed the acquisition of the Former MidwestOne Financial Group, Inc., which generated significant amounts of goodwill and intangible assets and related amortization. The values assigned to goodwill and intangibles, as well as their related useful lives, are subject to judgment and estimation by our management. Goodwill and intangibles related to acquisitions are determined and based on purchase price allocations. Valuation of intangible assets is generally based on the estimated cash flows related to those assets, while the initial value assigned to goodwill is the residual of the purchase price over the fair value of all identifiable assets acquired and liabilities assumed. If the carrying value of the goodwill exceeded the implied fair value of the goodwill, an impairment loss would be recorded in an amount equal to that excess. Performing such a discounted cash flow analysis involves the use of estimates and assumptions. Useful lives are determined based on the expected future period of the benefit of the asset, the assessment of which considers various characteristics of the asset, including the historical cash flows. Due to the number of estimates involved related to the allocation of purchase price and determining the appropriate useful lives of intangible assets, we have identified purchase accounting as a critical accounting policy.

Goodwill and Intangible Assets

Goodwill and intangible assets arise from purchase business combinations. During 2008, we completed our merger with the Former MidWest*One*. We were deemed to be the purchaser for accounting purposes and thus recognized goodwill and other intangible assets in connection with the merger. The goodwill was assigned to our one reporting unit, banking. As a general matter, goodwill and other intangible assets generated from purchase business combinations and deemed to have indefinite lives are not subject to amortization and are instead tested for impairment at least annually. Core deposit and customer relationship intangibles arising from acquisitions are being amortized over their estimated useful lives of up to 10 years.

In 2008, the extreme volatility in the banking industry that first started to surface in the latter part of 2007 had a significant impact on banking companies and the price of banking stocks, including our common stock. At December 31, 2008, our market capitalization was less than our total shareholders equity, providing an indication that goodwill may be impaired as of such date. Thus, we performed an impairment analysis as a result of the significant decline in our stock price. Based on this analysis, we wrote off $27.3 million of goodwill in the fourth quarter of 2008, which represented all of the goodwill that resulted from the Merger. Such charge had no effect on the Company s or the Bank s cash balances or liquidity. In addition, because goodwill and other intangible assets are not included in the calculation of regulatory capital, the Company s and the Bank s December 31, 2008 regulatory ratios were not adversely affected by this non-cash expense and exceeded the minimum amounts required to be considered well-capitalized.

Our other intangible assets are core deposit premium, insurance agency, trade name, and customer list intangibles. The establishment and subsequent amortization of these intangible assets involves the use of significant estimates and assumptions. These estimates and assumptions include, among other things, the estimated cost to service deposits acquired discount rates, estimated attrition rates and useful lives, future economic and market conditions, comparison of our market value to book value and determination of appropriate market comparables. Actual future results may differ from those estimates. We assess these intangible assets for impairment annually or more often if conditions indicate a possible impairment. Each quarter we evaluate the estimated useful lives of intangible assets and whether events or changes in circumstances warrant a revision to the remaining periods of amortization. In accordance with ASC 350 (Financial Accounting Standards Board (FASB) Statement No. 144), *Accounting for the Impairment or Disposal of Long-Lived Assets*, recoverability of these assets is measured by comparison of the carrying amount of the asset to the future undiscounted cash flows the asset is expected to generate. If the asset is considered to be impaired, the amount of any impairment is measured as the difference between the carrying value and the fair value of the impaired asset.

Fair Value of Available for Sale Securities

Securities available for sale are reported at fair value, with unrealized gains and losses reported as a separate component of accumulated other comprehensive income, net of deferred income taxes. Declines in fair value of individual securities, below their amortized cost, are evaluated by management to determine whether the decline is temporary or other than temporary. Declines in the fair value of available for sale securities below their cost that are deemed other than temporary are reflected in earnings as impairment losses. In determining whether other than temporary impairment exists, management considers whether: (1) we have the intent to sell the security, (2) it is more likely than not that we will be required to sell the security before recovery of the amortized cost basis and (3) we do not expect to recover the entire amortized cost basis of the security.

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Results of Operations Three-Year Period Ended December 31, 2009

Summary

Our consolidated net income for the year ended December 31, 2009 was $4.4 million. After subtracting preferred stock dividends and discount accretion of $0.8 million, net income available to common shareholders was $3.6 million, or $0.42 per fully-diluted share, compared to a net loss of $24.6 million, or $(3.09) per fully-diluted share, for the year ended December 31, 2008. The increase in consolidated net income was due primarily to the absence of goodwill impairment expense of $27.3 million recorded during the fourth quarter of 2008. We also experienced a decrease in other than temporary impairment charges on investments of $3.8 million, as such amount declined to $2.4 million in 2009 from $6.2 million in 2008. Finally, increased net interest income, after provision for loan losses, of $1.9 million also had a positive impact in 2009. Partially offsetting these increases in income for 2009 was a significant increase in FDIC insurance expense of $2.6 million over 2008.

Despite the challenging economy during 2009, we ended the year with an allowance for loan losses of $14.0 million, which represents 100.1% coverage of our nonperforming bank loans (excluding loan pool participations) at December 31, 2009 as compared to 72.1% coverage of our nonperforming bank loans at December 31, 2008. Nonperforming loans totaled $13.9 million as of December 31, 2009 compared with $15.2 million at December 31, 2008. For the year ended December 31, 2009, the provision for loan losses increased to $7.7 million from $4.4 million for 2008.

Our total assets increased $25.8 million, or 1.7%, to $1.53 billion as of December 31, 2009 from $1.51 billion as of December 31, 2008. This growth resulted primarily from increased investment in securities of $90.4 million, somewhat offset by a decrease in loans due to refinancing activity of portfolio loans, mainly adjustable-rate residential real estate loans that were held in our loan portfolio being refinanced into fixed-rate loans that are sold in the secondary market. Our total loans outstanding (excluding loan pool participations) decreased $47.8 million, or 4.7%, to $967.0 million at December 31, 2009 from $1.01 billion at December 31, 2008. The total asset growth was funded by an increase in deposits together with the receipt of a $16.0 million investment from the U.S. Department of the Treasury under its Capital Purchase Program. Our deposits increased $51.7 million, or 4.6%, to $1.18 billion as of December 31, 2009 from $1.13 billion at December 31, 2008. The increase in deposits was primarily due to organic growth in consumer and public fund deposits.

Various operating and equity ratios for the Company are presented in the table below for the years indicated. The dividend payout ratio represents the percentage of our prior year s net income that is paid to shareholders in the form of cash dividends. Average equity to average assets is a measure of capital adequacy that presents the percentage of average total shareholders equity compared to our average assets. The equity to assets ratio expresses this ratio using the period-end amounts instead of on an average basis. As of December 31, 2009, under regulatory standards, MidWest*One* Bank had capital levels in excess of the minimums necessary to be considered well capitalized, which is the highest regulatory designation. Although the challenging economic environment has made it difficult to build capital, we are committed to maintaining our bank at well capitalized. As noted above, we recently issued $16 million in preferred securities to Treasury pursuant to the Capital Purchase Program in February 2009. This capital was invested by the Company into MidWest*One* Bank, and counts as Tier 1 capital.

	12/31/09	12/31/08	12/31/07
Return on average total assets	0.29%	(1.61)%	0.98%
Return on average equity	2.99	(15.96)	8.83
Dividend payout ratio	71.43	NM	50.39
Average equity to average assets	9.56	10.19	9.82
Equity to assets ratio (at period end)	9.92	8.66	11.02

NM - Percentage calculation not considered meaningful.

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Net Interest Income

Net interest income is the difference of interest income and fees earned on earning assets less interest expense incurred on interest-bearing liabilities. Interest rate levels and volume fluctuations within earning assets and interest-bearing liabilities impact net interest income. Net interest margin is tax-equivalent net interest income as a percent of average earning assets.

Certain assets with tax favorable treatment are evaluated on a tax-equivalent basis. Tax-equivalent basis assumes a federal income tax rate of 34%. Tax favorable assets generally have lower contractual pre-tax yields than fully taxable assets. A tax-equivalent analysis is performed by adding the tax savings to the earnings on tax favorable assets. After factoring in the tax favorable effects of these assets, the yields may be more appropriately evaluated against alternative earning assets. In addition to yield, various other risks are factored into the evaluation process.

The following table shows the consolidated average balance sheets, detailing the major categories of assets and liabilities, the interest income earned on interest-earning assets, the interest expense paid for the interest-bearing liabilities, and the related interest rates for the periods, or as of the dates, shown. Average information is provided on a daily average basis.

Table 1 Average Balance Sheets and Interest Rates

	Year ended December 31,								
	2009			2008			2007		
(dollars in thousands)	Average Balance	Interest Income/ Expense	Average Rate/ Yield	Average Balance	Interest Income/ Expense	Average Rate/ Yield	Average Balance	Interest Income/ Expense	Average Rate/ Yield
Average interest-earning assets:									
Loans (tax equivalent) (1)(2)(3)	$ 990,540	$ 59,115	5.97%	$ 893,451	$ 53,317	5.97%	$ 390,862	$ 27,771	7.11%
Loan pool participations (4)	92,456	1,809	1.96	72,558	4,459	6.15			
Investment securities:									
Taxable investments	232,656	8,797	3.78	180,787	8,222	4.55	163,608	7,552	4.62
Tax exempt investments (2)	115,309	6,146	5.33	102,035	5,625	5.51	71,752	4,001	5.58
Total investment securities	347,965	14,943	4.29	282,822	13,847	4.90	235,360	11,553	4.91
Federal funds sold and interest-bearing balances	26,638	58	0.22	13,561	341	2.51	11,299	548	4.85
Total earning assets	$ 1,457,599	$ 75,925	5.21%	$ 1,262,392	$ 71,964	5.70%	$ 637,521	$ 39,872	6.25%
Noninterest-earning assets:									
Cash and due from banks	22,717			31,411			13,885		
Premises and equipment	29,573			24,570			11,903		
Allowance for loan losses	(15,229)			(11,231)			(5,491)		
Other assets	48,647			52,525			23,291		
Total assets	$ 1,543,307			$ 1,359,667			$ 681,109		
Average interest-bearing liabilities:									
Savings and interest-bearing demand deposits	$ 456,900	$ 4,714	1.03%	$ 392,603	$ 5,511	1.40%	$ 193,044	$ 3,109	1.61%
Time Certificates of deposit	579,038	16,897	2.92	502,220	17,646	3.51	248,377	11,689	4.71
Total deposits	1,035,938	21,611	2.09	894,823	23,157	2.59	441,421	14,798	3.35
Federal funds purchased and repurchase agreements	46,515	464	1.00	55,069	1,122	2.04	49,629	2,114	4.26
Federal Home Loan Bank advances	149,403	5,450	3.65	135,984	5,348	3.93	44,181	2,023	4.58

Long-term debt and other	19,604	718	3.66	11,968	768	6.42	1,582	103	6.51
Total interest-bearing liabilities	$ 1,251,460	$ 28,243	2.26%	$ 1,097,844	$ 30,395	2.77%	$ 536,813	$ 19,038	3.55%
Net interest spread (2)			2.95%			2.93%			2.70%
Noninterest-bearing liabilities:									
Demand deposits	134,175			113,695			64,663		
Other liabilities	10,128			9,525			12,760		
Shareholders equity	147,544			138,603			66,873		
Total liabilities and shareholders equity	$ 1,543,307			$ 1,359,667			$ 681,109		
Interest income/earning assets (2)	$ 1,457,599	$ 75,925	5.21%	$ 1,262,392	$ 71,964	5.70%	$ 637,521	$ 39,872	6.25%
Interest expense/earning assets	$ 1,457,599	$ 28,243	1.94%	$ 1,262,392	$ 30,395	2.41%	$ 637,521	$ 19,038	2.99%
Net interest margin (2)		$ 47,682	3.27%		$ 41,569	3.29%		$ 20,834	3.27%
Non-GAAP to GAAP Reconciliation:									
Tax Equivalent Adjustment:									
Loans		418			213			207	
Securities		2,149			1,545			1,360	
Total tax equivalent adjustment		2,567			1,758			1,567	
Net Interest Income		$ 45,115			$ 39,811			$ 19,267	

(1) Loan fees included in interest income are not material.
(2) Computed on a tax-equivalent basis, assuming a federal income tax rate of 34%.
(3) Non-accrual loans have been included in average loans, net of unearned discount.
(4) Includes interest income and discount realized on loan pool participations.

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Table 1 Average Balance Sheets and Interest Rates (continued)

Changes in Net Interest Income (Tax Equivalent Basis):

	Years Ended December 31, 2009, 2008, and 2007					
	Year 2009 to 2008 Change due to			Year 2008 to 2007 Change due to		
(in thousands)	Volume	Rate/Yield	Net	Volume	Rate/Yield	Net
Increase (decrease) in interest income						
Loans (tax equivalent)	$ 5,794	$ 4	$ 5,798	$ 29,179	$ (3,633)	$ 25,546
Loan pool participations	1,784	(4,434)	(2,650)	4,459		4,459
Investment securities:						
Taxable investments	1,394	(819)	575	779	(109)	670
Tax exempt investments	699	(178)	521	1,669	(45)	1,624
Total investment securities	2,093	(997)	1,096	2,448	(154)	2,294
Federal funds sold and interest-bearing balances	(5,362)	5,079	(283)	147	(354)	(207)
Change in interest income	4,309	(348)	3,961	36,234	(4,142)	32,092
Increase (decrease) in interest expense						
Savings and interest-bearing demand deposits	1,290	(2,087)	(797)	(3,969)	6,371	2,402
Time Certificates of deposit	6,934	(7,683)	(749)	7,921	(1,964)	5,957
Total deposits	8,224	(9,770)	(1,546)	3,952	4,407	8,359
Federal funds purchased and repurchase agreements	(154)	(504)	(658)	264	(1,256)	(992)
Federal Home Loan Bank advances	384	(282)	102	3,567	(242)	3,325
Other long-term debt	(153)	103	(50)	666	(1)	665
Change in interest expense	8,301	(10,453)	(2,152)	8,449	2,908	11,357
Increase (decrease) in net interest income	$ (3,992)	$ 10,105	$ 6,113	$ 23,169	$ (7,106)	$ 20,735
Percentage increase in net interest income over prior period			14.7%			98.5%

Earning Assets, Sources of Funds, and Net Interest Margin

Average earning assets increased $195.2 million, or 15.5%, to $1.46 billion in 2009 as compared to $1.26 billion in 2008. This growth in the average balance of earning assets was due primarily to the assets from Former MidWest*One* merger being in place for the entire 2009 versus only nine and one-half months of 2008. Additionally, our portfolio of investment securities increased $65.1 million during 2009, which contributed to the increase in average assets. Interest-bearing liabilities averaged $1.25 billion for the year ended December 31, 2009, an increase of $153.6 million, or 14.0%, from the average balance of $1.10 billion for 2008. The increase in average interest-bearing liabilities was due primarily to the liabilities from the Former MidWest*One* being in place for the entire 2009 versus only nine and one-half months of 2008.

Interest income, on a tax-equivalent basis, increased $4.0 million, or 5.5%, to $75.9 million in 2009 from $72.0 million in 2008, which was an increase of $32.1 million, or 80.5%, from the $39.9 million in interest income earned in 2007. Interest income growth in 2009 was due primarily to the earning assets from the merger with the Former MidWest*One* being in place for all of 2009, offset by a declining interest rate environment in 2009. In 2008, interest income grew due to volume increases resulting from the March 2008 merger with the Former MidWest*One*. Our yield on average earning assets was 5.21% in 2009 compared to 5.70% in 2008 and 6.25% in 2007. This decline was due to the generally lower rate environment plus much lower yields on loan pool participations.

Interest expense decreased during 2009 by $2.2 million, or 7.1%, to $28.2 million from $30.4 million in 2008, which was an increase of $11.4 million, or 59.7%, from the $19.0 million interest expense in 2007. The decrease in interest expense during 2009 over 2008 was due to the declining deposit and debt interest rate environment in 2009, offset by volume increases from liabilities assumed in the Former MidWest*One* merger being in place for the entire 2009. The increase in interest expense in 2008 over 2007 was due primarily to deposit growth arising from merger with the Former MidWest*One*. The average rate paid on interest-bearing liabilities was 2.26% in 2009 compared to 2.77% in 2008 and 3.55% in 2007.

Net interest income, on a tax-equivalent basis, increased 14.7% in 2009 to $47.7 million from $41.6 million in 2008, which reflected a 99.5% increase from $20.8 million in 2007. Net interest margin, which is our net interest income expressed as a percentage of average earning assets stated on a tax-equivalent basis, remained steady at 3.27% during 2009, compared to 3.29% in 2008, and 3.27% in 2007. The decreased yield on loan pool participations during 2009 kept the net interest margin steady compared to 2008, despite the lower rates paid on all categories of interest-bearing liabilities. The net interest spread, also on a tax-equivalent basis, was 2.95% in 2009, compared to 2.93% in 2008, and 2.70% in 2007.

Over the prior two years, increased net interest income was driven primarily by net growth in the average earning balance sheet outpacing the increases in average interest rates. The net growth is due primarily to the March 2008 merger with the Former MidWest*One*. The average balance sheets reflect a competitive marketplace on both the interest-earning assets and interest-bearing deposits. The competition for loans in the marketplace and the overall interest rate environment has kept interest rates on loans low. Interest rates paid on deposit products have declined steadily during 2009, but further significant decline is unlikely as interest rates on deposits have approached zero.

Provision for Loan Losses

The provision for loan losses is a current charge against income and represents an amount which management believes is sufficient to maintain an adequate allowance for known and probable losses. In assessing the adequacy of the allowance for loan losses, management considers the size and quality of the loan portfolio measured against prevailing economic conditions, regulatory guidelines, historical loan loss experience and credit quality of the portfolio. When a determination is made by management to charge off a loan balance, such write-off is charged against the allowance for loan losses.

Our provision for loan losses was $7.7 million during 2009 compared to $4.4 million in 2008 and $0.5 million in 2007. The increase in provision expense during 2009 is reflective of our management s assessment of the current risk in the loan portfolio as compared to the allowance for loan losses. During 2009, we added to the allowance for loan losses due primarily to higher charge-offs and increased volatility in our commercial real estate portfolio. See further discussion of the nonperforming loans, under the *Nonperforming Assets* section.

Sensitive assets include nonaccrual loans, loans on MidWest*One* Bank s watch loan reports and other loans identified as having more than reasonable potential for loss. Management reviews sensitive assets on at least a quarterly basis for changes in the customers ability to pay and changes in valuation of underlying collateral in order to estimate probable losses. Management also periodically reviews a watch loan list which is comprised of loans that have been restructured or involve customers in industries which have been adversely affected by market conditions. The majority of these loans are being repaid in conformance with their contracts.

Noninterest Income

Table 2 Noninterest Income

	As of December 31,					
(dollars in thousands)	**2009**	**2008**	**% Change**	**2008**	**2007**	**% Change**
Trust and investment fees	$ 4,180	$ 4,011	4.2%	$ 4,011	$ 3,688	8.8%
Service charges and fees on deposit accounts	3,988	5,611	(28.9)	5,611	2,082	169.5
Mortgage origination fees and loan servicing fees	2,770	907	205.4	907	1,208	(24.9)
Other service charges, commissions and fees	2,386	1,527	56.3	1,527	1,746	(12.5)
Bank owned life insurance income	778	542	43.5	542	338	60.4
Impairment losses on investment securities, net	(2,404)	(6,194)	(61.2)	(6,194)		NM
Gain (loss) on sale of available for sale securities	813	(346)	NM	(346)	(256)	35.2
Gain (loss) from sale of fixed assets	8	(516)	NM	(516)		NM
Total other income	$ 12,519	$ 5,542	125.9%	$ 5,542	$ 8,806	(37.1)%

NM - Percentage change not considered meaningful.

Total noninterest income increased $7.0 million in 2009 from 2008 and decreased $3.3 million in 2008 from 2007. The increase in 2009 is largely due to the lower other-than-temporary impairment charges on investment securities of $3.8 million, as such amount declined to $2.4 million in 2009 compared to $6.2 million in 2008. The majority of the impairment charges recognized in both 2009 and 2008 resulted from our investment in collateralized debt obligations backed by groups of trust preferred securities issued by multiple banks and insurance companies.

Mortgage origination and servicing fees rose to $2.8 million in 2009, up $1.9 million from $0.9 million in 2008. The increase in mortgage origination fees was attributable to a significantly higher refinancing volume of mainly single family residential real estate loans that were sold on the secondary market, which was stimulated by the low interest rate environment. Gains from the sale of investment securities in 2009 of $0.8 million resulted in a net increase of $1.1 million over the loss of $0.3 million in 2008. The March 2008 merger with the Former MidWest*One*

accounted for the remaining increase in noninterest income categories between 2009 and 2008, with the exception of the decrease in service charges and fees on deposit accounts, which was attributable to lower account activity levels.

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The decrease in noninterest income for 2008 as compared to 2007 was primarily due to other than temporary impairment charges on investment securities of $6.2 million in 2008, with no similar charges in 2007. The March 2008 merger with the Former MidWest*One* is primarily responsible for the remainder of the comparative changes in noninterest income between 2008 and 2007.

Noninterest Expense

Table 3 Noninterest Expense

	As of December 31,					
(dollars in thousands)	**2009**	**2008**	**% Change**	**2008**	**2007**	**% Change**
Salaries and employee benefits	$ 23,152	$ 20,903	10.8%	$ 20,903	$ 10,926	91.3%
Net occupancy and equipment expense	6,961	4,759	46.3	4,759	2,978	59.8
Professional and other outside services	3,635	2,437	49.2	2,437	2,057	18.5
Other operating expense	5,491	7,374	(25.5)	7,374	1,454	407.2
Data processing expense	1,844	1,860	(0.9)	1,860	1,145	62.4
FDIC insurance expense	3,244	595	445.2	595	60	891.7
Amortization expense	1,252	776	61.3	776		NM
Goodwill impairment		27,295	NM	27,295		NM
Total other expenses	$ 45,579	$ 65,999	(30.9)%	$ 65,999	$ 18,620	254.5%

NM - Percentage change not considered meaningful.

Salary and employee benefit expense increased for both 2009 and 2008. The increase in 2009 and 2008 was primarily attributable to our merger with Former MidWest*One* and merger-related employee expenses incurred for a full year in 2009 versus nine months in 2008, and to normal annual compensation adjustments, greater health insurance costs and increased incentives. Full-time equivalent employee levels were 406, 411 and 199 at December 31, 2009, 2008 and 2007, respectively.

Net occupancy and equipment expense increased $2.2 million, or 46.3%, in 2009 and $1.8 million, or 59.8% in 2008. The 2009 increase was due to increased property tax expense and expenses incurred attributable to the Former MidWest*One* merger for a full year in 2009 versus only nine and one-half months in 2008. The increase during 2008 resulted primarily from the merger with the Former MidWest*One*, as well as expenses due to two natural disasters (a Category 5 tornado and a once-in-500-years flood) that impacted our Parkersburg, Waterloo and Coralville offices.

Professional and other outside services expense increased for 2009 and 2008 due to Sarbanes-Oxley implementation and increased legal, accounting, and other consulting expenses related to the merger.

We recorded goodwill impairment of $27.3 million during 2008, which represented all of the goodwill that resulted from the merger with the Former MidWest*One*. The impairment of goodwill was driven by the overall decline in valuations in the national markets, which led to a fair value estimate for the Former MidWest*One* that was significantly less than its pre-impairment book value. The $27.3 million charge to earnings did not affect cash flow, liquidity, tangible book value or regulatory capital.

Overall, after removing the goodwill impairment charge in 2008, the increase in total noninterest expense for 2009 to $45.6 million from $38.7 million, an increase of $6.9 million, or 17.8%, was attributable primarily to the merger with the Former MidWest*One* and the full year effect of 2009. Management is currently evaluating the potential for restructuring our branch footprint in 2010 and decreasing associated expenses to reduce operating costs.

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Federal Deposit Insurance Corporation Assessments

FDIC insurance expense increased significantly for both 2009 and 2008, as such expense was $3.2 million in 2009 compared with $0.6 million in 2008 and $0.1 million for 2007. The increase in FDIC insurance expense in 2009 was primarily due to higher assessment rates, higher deposit balances, and our participation in the Temporary Liquidity Guarantee Program. The increase in FDIC insurance expense for 2009 was also due in part to our $0.7 million share of an industry-wide special assessment by the FDIC which was recorded in the second quarter of 2009. The increase in FDIC insurance expense for 2008 is related primarily to the merger with the Former MidWest*One*. During 2008 we utilized credits from the Federal Deposit Insurance Reform Act of 2005 which were available to offset our deposit insurance assessments. These credits were fully utilized in September 2008. Our share of an industry-wide FDIC assessment prepayment covering the years 2010 through 2012 collected in December 2009 was $9.2 million. This pre-paid expense is reflected on our consolidated balance sheet under Other Assets.

Income Tax Expense

Our effective tax rate, or income taxes divided by income (loss) before taxes, was (1.8%) for 2009, and 1.8% for 2008. The effective rate in 2009 was primarily due to adjustments for benefits from our increased investment in tax-favored securities, while the effective rate in 2008 was primarily due to our net loss. Income tax increased $0.4 million to a tax benefit of $0.1 million in 2009 compared to a tax benefit of $0.5 million for 2008.

Income taxes decreased $2.8 million for 2008 compared with 2007 due to a decrease in the amount of pre-tax income. Our consolidated income tax rate varies from the statutory rate mainly due to the amount of tax-exempt income and the non-deductible goodwill charge. The effective income tax rate as a percentage of income before tax was (1.8%) for the 2008, compared with 25.8% for 2007.

Financial Condition December 31, 2009 and 2008

Summary

Our balance sheet experienced nominal growth during 2009, with overall assets increasing by $25.8 million, or 1.71%. Net loans decreased by $50.8 million primarily due to refinancing activity of portfolio loans, mainly single family residential real estate loans that were sold on the secondary market. Loan pool participations, net, also decreased by $9.9 million, due to normal loan repayments. We have also noted increased market competition in bidding for this type of asset.

Securities growth was positive, as increased funding from deposits combined with the reduction of portfolio loans and loan pool participations provided excess liquidity. Our loan- to-deposit ratio, including loan pool participations, decreased to 89.2% at year-end 2009, compared to 98.4% at year-end 2008.

Total liabilities remained mostly flat, increasing by only $4.0 million. The growth in deposits was mostly offset by a reduction in Federal Home Loan Bank borrowings. Growth in interest bearing deposits was largely related to growth in time deposits, most of which were funded through increased consumer and public fund deposits. Brokered CDs obtained through participation in the Certificate of Deposit Account Registry Service (CDARS) program increased by $6.2 million in 2009 to $24.4 million.

Shareholders equity increased by $21.9 million, primarily due to the sale of $16.0 million of senior preferred stock to the Treasury pursuant to the Capital Purchase Program. The increase to shareholders equity resulting from 2009 net income of $4.4 million was partially offset by preferred and common stock dividend payments of $3.2 million.

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Table 4 Significant Balance Sheet Items

(dollars in thousands)	December 31, 2009	December 31, 2008	% Change
Assets			
Investment securities available for sale	$ 362,903	$ 272,380	33.2%
Net loans	953,041	1,003,837	(5.1)
Loan pool participations, net	83,052	92,932	(10.6)
Total assets	$ 1,534,783	$ 1,508,962	1.7%
Liabilities			
Deposits:			
Non-interest bearing	$ 133,990	$ 123,558	8.4%
Interest bearing	1,045,878	1,004,631	4.1
Total Deposits	1,179,868	1,128,189	4.6
Federal Home Loan Bank borrowings	130,200	158,782	(18.0)
Total liabilities	$ 1,382,575	$ 1,378,620	0.3%
Shareholders equity	$ 152,208	$ 130,342	16.8%

Investment Securities

Our investment securities portfolio is managed to provide both a source of liquidity and earnings. Our portfolio totaled $370.9 million at December 31, 2009 compared to $280.5 million at December 31, 2008. The increase was due primarily to the investment of increased liquidity generated by both deposit growth and reduced real estate loan activity during 2009. Our loan activity is discussed more fully in the Loans section while our deposit growth is discussed more fully in the Deposits section.

Securities available for sale are carried at fair value. As of December 31, 2009, the fair value of our securities available for sale was $362.9 million and the amortized cost was $355.3 million. There were $9.1 million of gross unrealized gains and $1.5 million of gross unrealized losses in our investment securities portfolio for a net unrealized gain of $7.6 million. The after-tax effect of this unrealized gain has been included in shareholders equity. The increase in the fair value as a percentage of amortized cost was due to continued low interest rates during 2009 combined with favorable market trends, which increased the value of our debt-related securities.

U.S. Treasury securities and U.S. government and agency securities as a percentage of total securities decreased to 21.9% at December 31, 2009, from 26.2% at December 31, 2008, while obligations of state and political subdivisions (primarily tax-exempt obligations) as a percentage of total securities increased slightly to 43.8% at December 31, 2009, from 43.5% at December 31, 2008. Increased investments in mortgage-backed securities offset the decline in other debt security categories as mortgage-backed securities increased to 29.3% of total securities at December 31, 2009, as compared to 26.1% of total securities at December 31, 2008. We consider many factors in determining the composition of our investment portfolio including tax-equivalent yield, credit quality, duration, regulatory and overall portfolio allocation. The first two factors, yield (spread to Treasury securities) and duration were primary in our decision to increase our investments in both obligations of state and political subdivisions and mortgage-backed securities.

Our investment portfolio includes an investment in collateralized debt obligations that are backed by trust preferred securities issued by banks, thrifts and insurance companies. These six securities had an original cost of $9.75 million, but because of several impairment charges recognized during 2009 and 2008, the book value of these securities at December 31, 2009, had been reduced to $2.0 million. Two of the securities have been written down to a value of zero, with the remaining four having an average book value of 32.7% of their original face value. The market for these securities at December 31, 2009 was not active and markets for similar securities are also not active. The valuation of these securities involves evaluating all relevant credit and structural aspects, determining appropriate performance assumptions and performing a discounted cash flow analysis. This evaluation includes detailed credit, performance and structural evaluations for each piece of collateral. Other factors in the valuation include terms of the structure, the cash flow waterfall (for both interest and principal), the over collateralization test and events of default/liquidation. Based on our cash flow analysis, we determined that all contractual cash flows may not be received, and $1.6 million in other-than-temporary impairment charges were recorded during 2009. This was in addition to an other-than-temporary impairment charge of $6.2 million recognized in 2008. Any future deferrals or defaults for our pooled trust preferred collateralized debt obligations could result in additional other-than-temporary impairment charges.

The composition of securities available for sale was as follows:

		December 31,	
	2009	**2008**	**2007**
(in thousands)			
Securities available for sale:			
U.S. treasury	$	$	$
U.S. government agency securities and corporations	81,191	73,600	66,891
States and political subdivisions	155,224	113,843	82,412
Mortgage-backed and collateralized mortgage obligations	108,576	73,077	69,128
Other securities	17,912	11,860	13,694
Fair value of securities available for sale	$ 362,903	$ 272,380	$ 232,125
Amortized cost	$ 355,303	$ 271,245	$ 232,446
Fair value as a percentage of amortized cost	102.14%	100.42%	99.86%

Securities held to maturity are carried at amortized cost. As of December 31, 2009, the amortized cost of these securities was $8.0 million and the fair value was $8.1 million. There were $0.1 million of gross unrealized gains and no gross unrealized losses for a net unrealized gain of $0.1 million.

The composition of securities held to maturity was as follows:

		December 31,	
	2009	**2008**	**2007**
(in thousands)			
Securities held to maturity:			
U.S. treasury			
U.S. government agency securities and corporations			
States and political subdivisions	7,074	8,029	95
Mortgage-backed and collateralized mortgage obligations	71	96	
Other securities	864		
Amortized cost	$ 8,009	$ 8,125	$ 95
Fair value of securities held to maturity	$ 8,118	$ 8,120	$ 101
Fair value as a percentage of amortized cost	101.36%	99.94%	106.32%

See Note 2 Investment Securities, and Note 16 Estimated Fair Values of Financial Instruments and Fair Value Measurements for additional information related to the investment portfolio.

The maturities, fair values and weighted average yields of debt securities available for sale as of December 31, 2009 were:

	Maturity							
	Within One Year		After One but Within Five Years		After Five but Within Ten Years		After Ten Years	
(dollars in thousands)	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Securities available for sale: (1)								
U.S. government agency securities and corporations	$ 39,569	3.52%	$ 39,472	3.40%	$ 2,150	4.45%	$	0.00%
Obligations of states and political subdivisions (2)	27,322	3.58%	80,154	3.50%	47,748	4.56%		0.00%
Mortgage-backed and collateralized mortgage obligations	5,985	3.62%	92,665	4.03%	49	3.09%	9,877	3.21%
Other securities	5,346	4.90%	10,704	3.93%		0.00%&nb		