

HEARTLAND FINANCIAL USA INC
Form 10-Q
May 07, 2015

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

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

For quarterly period ended March 31, 2015

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

For transition period _____ to _____

Commission File Number: 001-15393

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

Delaware
(State or other jurisdiction of incorporation or organization)

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

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

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

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

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

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

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Large accelerated filer

Accelerated Filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the Registrant is a shell company (as defined by Rule 12b-2 of the Securities Exchange Act of 1934). Yes No

Indicate the number of shares outstanding of each of the classes of Registrant's common stock as of the latest practicable date: As of May 6, 2015, the Registrant had outstanding 20,596,627 shares of common stock, \$1.00 par value per share.

HEARTLAND FINANCIAL USA, INC.

Form 10-Q Quarterly Report

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31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a).

31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a).

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

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

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

PART I

ITEM 1. FINANCIAL STATEMENTS
HEARTLAND FINANCIAL USA, INC.
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except per share data)

	March 31, 2015 (Unaudited)	December 31, 2014
ASSETS		
Cash and due from banks	\$104,475	\$64,150
Federal funds sold and other short-term investments	7,257	9,721
Cash and cash equivalents	111,732	73,871
Time deposits in other financial institutions	2,605	2,605
Securities:		
Available for sale, at fair value (cost of \$1,340,889 at March 31, 2015, and \$1,396,794 at December 31, 2014)	1,353,537	1,401,868
Held to maturity, at cost (fair value of \$297,660 at March 31, 2015, and \$296,768 at December 31, 2014)	284,030	284,587
Other investments, at cost	18,297	20,498
Loans held for sale	105,670	70,514
Loans and leases receivable:		
Held to maturity	4,243,689	3,876,745
Loans covered by loss share agreements	—	1,258
Allowance for loan and lease losses	(41,854)	(41,449)
Loans and leases receivable, net	4,201,835	3,836,554
Premises, furniture and equipment, net	145,132	130,713
Other real estate, net	19,097	19,016
Goodwill	51,073	35,583
Other intangible assets, net	44,024	33,932
Cash surrender value on life insurance	95,118	82,638
Other assets	74,126	59,433
TOTAL ASSETS	\$6,506,276	\$6,051,812
LIABILITIES AND EQUITY		
LIABILITIES:		
Deposits:		
Demand	\$1,515,004	\$1,295,193
Savings	2,863,744	2,687,493
Time	887,650	785,336
Total deposits	5,266,398	4,768,022
Short-term borrowings	259,335	330,264
Other borrowings	361,300	395,705
Accrued expenses and other liabilities	51,896	61,504
TOTAL LIABILITIES	5,938,929	5,555,495
STOCKHOLDERS' EQUITY:		
Preferred stock (par value \$1 per share; authorized 20,604 shares; none issued or outstanding)	—	—
Series A Junior Participating preferred stock (par value \$1 per share; authorized 16,000 shares; none issued or outstanding)	—	—
	81,698	81,698

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Series C Fixed Rate Non-Cumulative Perpetual preferred stock (par value \$1 per share; liquidation value \$81.7 million; authorized, issued and outstanding 81,698 shares)

Common stock (par value \$1 per share; authorized 25,000,000 shares; issued 20,586,477 shares at March 31, 2015 and 18,511,125 shares at December 31, 2014)	20,586	18,511
Capital surplus	147,642	95,816
Retained earnings	312,212	298,764
Accumulated other comprehensive income	5,255	1,528
Treasury stock at cost (1,405 shares at March 31, 2015 and 0 at December 31, 2014)	(46) —
TOTAL STOCKHOLDERS' EQUITY	567,347	496,317
TOTAL LIABILITIES AND EQUITY	\$6,506,276	\$6,051,812

See accompanying notes to consolidated financial statements.

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

	Three Months Ended March 31,	
	2015	2014
INTEREST INCOME:		
Interest and fees on loans and leases	\$53,049	\$46,384
Interest on securities:		
Taxable	7,132	7,761
Nontaxable	2,916	3,122
Interest on federal funds sold	1	—
Interest on interest bearing deposits in other financial institutions	4	7
TOTAL INTEREST INCOME	63,102	57,274
INTEREST EXPENSE:		
Interest on deposits	4,172	4,778
Interest on short-term borrowings	198	226
Interest on other borrowings (includes \$564 and \$521 of interest expense related to derivatives reclassified from accumulated other comprehensive income for the three months ended March 31, 2015 and 2014, respectively)	4,802	3,658
TOTAL INTEREST EXPENSE	9,172	8,662
NET INTEREST INCOME	53,930	48,612
Provision for loan and lease losses	1,671	6,331
NET INTEREST INCOME AFTER PROVISION FOR LOAN AND LEASE LOSSES	52,259	42,281
NONINTEREST INCOME:		
Service charges and fees	5,404	4,896
Loan servicing income	1,041	1,511
Trust fees	3,631	3,210
Brokerage and insurance commissions	1,087	1,123
Securities gains, net (includes \$4,353 and \$781 of net security gains reclassified from accumulated other comprehensive income for the three months ended March 31, 2015 and 2014, respectively)	4,353	781
Gain (loss) on trading account securities	—	(38)
Net gains on sale of loans held for sale	13,742	6,379
Income on bank owned life insurance	524	363
Other noninterest income	881	625
TOTAL NONINTEREST INCOME	30,663	18,850
NONINTEREST EXPENSES:		
Salaries and employee benefits	36,638	32,319
Occupancy	4,259	4,050
Furniture and equipment	2,106	1,890
Professional fees	6,044	4,526
FDIC insurance assessments	956	980
Advertising	1,181	1,188
Intangible assets amortization	631	624
Other real estate and loan collection expenses	465	1,052
Loss on sales/valuations of assets, net	353	163
Other noninterest expenses	6,981	5,746
TOTAL NONINTEREST EXPENSES	59,614	52,538

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INCOME BEFORE INCOME TAXES	23,308	8,593
Income taxes (includes \$1,413 and \$97 of income tax expense reclassified from accumulated other comprehensive income for the three months ended March 31, 2015 and 2014, respectively)	7,599	1,703
NET INCOME	15,709	6,890
Preferred dividends and discount	(204	) (204
NET INCOME AVAILABLE TO COMMON STOCKHOLDERS	\$15,505	\$6,686
EARNINGS PER COMMON SHARE - BASIC	\$0.77	\$0.36
EARNINGS PER COMMON SHARE - DILUTED	\$0.76	\$0.36
CASH DIVIDENDS DECLARED PER COMMON SHARE	\$0.10	\$0.10

See accompanying notes to consolidated financial statements.

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

	Three Months Ended March 31,	
	2015	2014
NET INCOME	\$15,709	\$6,890
OTHER COMPREHENSIVE INCOME		
Securities:		
Net change in unrealized gain on securities	11,478	20,909
Reclassification adjustment for net gains realized in net income	(4,353)	(781)
Net change in non-credit related other than temporary impairment	24	24
Income taxes	(2,859)	(7,959)
Other comprehensive income on securities	4,290	12,193
Derivatives used in cash flow hedging relationships:		
Net change in unrealized loss on derivatives	(1,454)	(139)
Reclassification adjustment for net loss on derivatives realized in net income	564	521
Income taxes	327	(142)
Other comprehensive income (loss) on cash flow hedges	(563)	240
Other comprehensive income	3,727	12,433
TOTAL COMPREHENSIVE INCOME	\$19,436	\$19,323

See accompanying notes to consolidated financial statements.

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

	Three Months Ended	
	March 31,	2014
	2015	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 15,709	\$ 6,890
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
Depreciation and amortization	5,747	4,090
Provision for loan and lease losses	1,671	6,331
Net amortization of premium on securities	6,949	6,659
Securities gains, net	(4,353)	(781)
Decrease in trading account securities	—	1,801
Stock based compensation	1,139	1,098
Write downs and losses on repossessed assets, net	361	123
Loans originated for sale	(311,140)	(158,779)
Proceeds on sales of loans held for sale	287,768	155,526
Net gains on sale of loans held for sale	(11,056)	(4,944)
Decrease in accrued interest receivable	3,234	2,304
Increase in prepaid expenses	(513)	(359)
Increase (decrease) in accrued interest payable	627	(750)
Capitalization of servicing rights	(2,818)	(1,435)
Other, net	(11,480)	(6,319)
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	(18,155)	11,455
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from the sale of securities available for sale	289,466	355,288
Proceeds from the sale of other investments	5,489	2,005
Proceeds from the maturity of and principal paydowns on securities available for sale	37,479	34,446
Proceeds from the maturity of and principal paydowns on securities held to maturity	208	182
Proceeds from the maturity of and principal paydowns on other securities	—	2,041
Purchase of securities available for sale	(232,422)	(160,286)
Purchase of securities held to maturity	—	(16,784)
Purchase of other investments	(2,004)	(958)
Net (increase) decrease in loans and leases	25,684	(93,020)
Capital expenditures	(2,919)	(2,710)
Net cash and cash equivalents received in acquisition	7,103	—
Proceeds from the sale of equipment	13	—
Proceeds on sale of OREO and other repossessed assets	2,312	5,079
NET CASH PROVIDED BY INVESTING ACTIVITIES	130,409	125,283
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in demand deposits and savings accounts	90,075	3,800
Net decrease in time deposit accounts	(25,618)	(6,935)
Net decrease in short-term borrowings	(31,765)	(80,506)
Proceeds from short term FHLB advances	60,000	40,000
Repayments of short term FHLB advances	(124,000)	(112,000)

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Proceeds from other borrowings	4,000	5,000	
Repayments of other borrowings	(44,488) (20,193)
Purchase of treasury stock	(1,780	) (606)
Proceeds from issuance of common stock	832	247	
Excess tax benefits on exercised stock options	612	(138)
Dividends paid	(2,261	) (2,049)
NET CASH USED BY FINANCING ACTIVITIES	(74,393	) (173,380)
Net increase (decrease) in cash and cash equivalents	37,861	(36,642)
Cash and cash equivalents at beginning of year	73,871	125,270	
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$111,732	\$88,628	
Supplemental disclosures:			
Cash paid for income/franchise taxes	\$840	\$980	
Cash paid for interest	\$8,545	\$9,412	
Loans transferred to OREO	\$2,371	\$3,036	
Purchases of securities available for sale, accrued, not paid	\$5,149	\$—	
Stock consideration granted for acquisition	\$53,052	\$—	

See accompanying notes to consolidated financial statements.

HEARTLAND FINANCIAL USA, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (Unaudited)

(Dollars in thousands, except per share data)

	Heartland Financial USA, Inc. Stockholders' Equity						
	Preferred Stock	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Equity
Balance at January 1, 2014	\$81,698	\$18,399	\$91,632	\$265,067	\$ (17,336)	\$—	\$439,460
Comprehensive income				6,890	12,433		19,323
Cash dividends declared:							
Preferred, \$2.50 per share				(204)			(204)
Common, \$0.10 per share				(1,845)			(1,845)
Purchase of noncontrolling interest							—
Purchase of 23,285 shares of common stock						(606)	(606)
Issuance of 78,177 shares of common stock		56	(531)			584	109
Commitments to issue common stock			1,098				1,098
Balance at March 31, 2014	\$81,698	\$18,455	\$92,199	\$269,908	\$ (4,903)	\$(22)	\$457,335
Balance at January 1, 2015	\$81,698	\$18,511	\$95,816	\$298,764	\$ 1,528	\$—	\$496,317
Comprehensive income				15,709	3,727		19,436
Cash dividends declared:							
Preferred, \$2.50 per share				(204)			(204)
Common, \$0.10 per share				(2,057)			(2,057)
Purchase of 24,886 shares of common stock						(1,780)	(1,780)
Issuance of 2,098,833 shares of common stock		2,075	50,687			1,734	54,496
Commitments to issue common stock			1,139				1,139
Balance at March 31, 2015	\$81,698	\$20,586	\$147,642	\$312,212	\$ 5,255	\$(46)	\$567,347

See accompanying notes to consolidated financial statements.

HEARTLAND FINANCIAL USA, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: BASIS OF PRESENTATION

The interim unaudited consolidated financial statements contained herein should be read in conjunction with the audited consolidated financial statements and accompanying notes to the consolidated financial statements for the fiscal year ended December 31, 2014, included in the Form 10-K of Heartland Financial USA, Inc. ("Heartland") filed with the Securities and Exchange Commission ("SEC") on March 13, 2015. Accordingly, footnote disclosures which would substantially duplicate the disclosure contained in the audited consolidated financial statements have been omitted.

The financial information of Heartland included herein has been prepared in accordance with U.S. generally accepted accounting principles for interim financial reporting and has been prepared pursuant to the rules and regulations for reporting on Form 10-Q and Rule 10-01 of Regulation S-X. Such information reflects all adjustments (consisting of normal recurring adjustments), that are, in the opinion of management, necessary for a fair presentation of the financial position and results of operations for the periods presented. The results of the interim period ended March 31, 2015, are not necessarily indicative of the results expected for the year ending December 31, 2015.

Earnings Per Share

Basic earnings per share is determined using net income available to common stockholders and weighted average common shares outstanding. Diluted earnings per share is computed by dividing net income available to common stockholders by the weighted average common shares and assumed incremental common shares issued. Amounts used in the determination of basic and diluted earnings per share for the three-month periods ended March 31, 2015 and 2014, are shown in the table below:

(Dollars and number of shares in thousands, except per share data)	Three Months Ended March 31,	
	2015	2014
Net income attributable to Heartland	\$15,709	\$6,890
Preferred dividends and discount	(204)	(204)
Net income available to common stockholders	\$15,505	\$6,686
Weighted average common shares outstanding for basic earnings per share	20,215	18,437
Assumed incremental common shares issued upon exercise of stock options and non-vested restricted stock units	278	288
Weighted average common shares for diluted earnings per share	20,493	18,725
Earnings per common share — basic	\$0.77	\$0.36
Earnings per common share — diluted	\$0.76	\$0.36
Number of antidilutive common stock equivalents excluded from diluted earnings per share computation	—	95

Stock-Based Compensation

Heartland may grant, through its Nominating and Compensation Committee (the "Compensation Committee"), non-qualified and incentive stock options, stock appreciation rights, stock awards, restricted stock, restricted stock units and cash incentive awards, under its 2012 Long-Term Incentive Plan (the "Plan"). The Plan, which was approved by stockholders in May 2012 and replaced Heartland's 2005 Long-Term Incentive Plan with respect to grants after such approval, reserved 275,334 shares of common stock at March 31, 2015, for issuance under future awards that may be granted under the Plan to employees and directors of, and service providers to, Heartland or its subsidiaries.

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

The amount of tax benefit (expense) related to the exercise, vesting, and forfeiture of equity-based awards reflected in additional paid-in-capital, not taxes payable, was \$612,000 and \$(138,000) during the three months ended March 31, 2015, and 2014, respectively.

Restricted Stock Units

The Plan permits the Compensation Committee to grant restricted stock units ("RSUs"). On January 20, 2015, the Compensation Committee granted time-based RSUs with respect to 78,220 shares of common stock, and on March 11, 2014, the Compensation Committee granted time-based RSUs with respect to 67,190 shares of common stock to selected officers. The time-based RSUs, which represent the right, without payment, to receive shares of Heartland common stock at a specified date in the future based on specific vesting conditions, vest over five years in three equal installments on the third, fourth and fifth anniversaries of the grant date, will be settled in common stock upon vesting, and will not be entitled to dividends until vested. The time-based RSUs vest upon a "qualified retirement" (as defined in the RSU agreement), and the retiree is required to sign a non-solicitation and non-compete agreement as a condition to vesting.

In addition to the time-based RSUs referenced in the preceding paragraph, the Compensation Committee granted performance-based RSUs with respect to 39,075 shares of common stock on March 10, 2015, and performance-based RSUs with respect to 32,645 shares of common stock on March 11, 2014, to Heartland executives and subsidiary presidents. These performance-based RSUs vest based first on performance measures tied to Heartland's earnings and loans on December 31, 2015, and December 31, 2014, respectively, and then on time-based vesting conditions. For the grants awarded in 2015, the portion of the RSUs earned based on performance vest on December 31, 2017, and for the grants awarded in 2014, the portion of the RSUs earned based on performance vest on December 31, 2016, subject to employment on the respective vesting dates.

The Compensation Committee also grants RSUs under the Plan to directors as part of their compensation, to new management level employees at commencement of employment, and to other employees and service providers as incentives. During the three months ended March 31, 2015 and March 31, 2014, 300 and 9,000 RSUs, respectively, were granted to directors and new employees.

A summary of the status of the RSUs as of March 31, 2015 and 2014, and changes during the three months ended March 31, 2015 and 2014, follows:

	2015		2014	
	Shares	Weighted-Average Grant Date Fair Value	Shares	Weighted-Average Grant Date Fair Value
Outstanding at January 1	396,555	\$21.48	353,070	\$18.48
Granted	117,595	27.87	108,710	27.29
Vested	(126,847)	) 16.66	(67,024)	) 15.82
Forfeited	(2,531)	) 23.82	(2,003)	) 17.26
Outstanding at March 31	384,772	\$25.00	392,753	\$21.50

Total compensation costs recorded for RSUs were \$1.1 million for both three month periods ended March 31, 2015, and 2014. As of March 31, 2015, there were \$4.7 million of total unrecognized compensation costs related to the 2005 and 2012 Long-Term Incentive Plans for RSUs which are expected to be recognized through 2019.

Options

Although the Plan provides authority to the Compensation Committee to grant stock options, no options were granted during the first three months of 2015 and 2014. Prior to 2009, options were typically granted annually with an expiration date ten years after the date of grant. Vesting was generally over a five-year service period with portions of a grant becoming exercisable at three years, four years, and five years after the date of grant. A summary of the status of the stock options as of March 31, 2015 and 2014, and changes during the three months ended March 31, 2015 and 2014, follows:

	2015		2014	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Outstanding at January 1	215,851	\$23.85	261,936	\$23.60
Granted	—	—	—	—
Exercised	(32,400	) 20.85	(5,000	) 19.13
Forfeited	(1,500	) 21.00	(5,500	) 26.88
Outstanding at March 31	181,951	\$24.37	251,436	\$23.62
Options exercisable at March 31	181,951	\$24.37	251,436	\$26.32

At March 31, 2015, the vested options totaled 181,951 shares with a weighted average exercise price of \$24.37 per share and a weighted average remaining contractual life of 1.92 years. The intrinsic value (the difference between the market price and the aggregate exercise price) for the vested options as of March 31, 2015, was \$1.5 million. The intrinsic value for the total of all options exercised during the three months ended March 31, 2015, was \$382,000.

The exercise price of stock options granted is established by the Compensation Committee, but the exercise price for the stock options may not be less than the fair market value of the shares on the date that the option is granted or, if greater, the par value of a share of stock. Each option granted is exercisable in full at any time or from time to time, subject to vesting provisions, as determined by the Compensation Committee and as provided in the option agreement, but such time may not exceed ten years from the grant date. Cash received from options exercised was \$676,000 for the three months ended March 31, 2015, and \$96,000 for the three months ended March 31, 2014.

Total compensation costs recorded for options were \$0 for both three month periods ended March 31, 2015, and 2014. There are no unrecorded compensation costs related to options at March 31, 2015.

Subsequent Events

Heartland has evaluated subsequent events through the filing date of this quarterly report on Form 10-Q with the SEC. On April 16, 2015, Heartland entered into a definitive merger agreement with Community Bancorporation of New Mexico, Inc., parent company of Community Bank in Santa Fe, New Mexico. See Note 2, "Acquisitions," for further details of this acquisition.

Effect of New Financial Accounting Standards

In January 2014, the FASB issued ASU 2014-01, "Accounting for Investments in Qualified Affordable Housing Projects." The amendments in ASU 2014-01 to Topic 323, "Equity Investments and Joint Ventures," provide guidance on accounting for investments by a reporting entity in flow-through limited liability entities that manage or invest in affordable housing projects that qualify for the low-income housing tax credit. The amendments permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefit received and

recognizes the net investment performance in the income statement as a component of income tax expense (benefit). The amendments are effective for fiscal years, and interim periods within those years, beginning after December 31, 2014, and should be applied retrospectively to all periods presented. Heartland elected to use the proportional amortization method for equity investments in qualified affordable housing projects that meet the conditions specified in ASU-2014-01. Heartland adopted this standard on January 1, 2015, and the adoption did not have a material impact on the results of operations, financial position, and liquidity.

In January 2014, the FASB issued ASU 2014-04, "Receivables-Troubled Debt Restructurings by Creditors: Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans Upon Foreclosure." The amendments in ASU 2014-04 clarify that an in-substance foreclosure occurs, and a creditor is considered to have received physical possession of residential

real estate property collateralizing a consumer mortgage loan, upon either (i) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (ii) the borrower conveying all interest in the residential real estate property to the creditor to satisfy the loan through completion of a deed in lieu of foreclosure or similar legal agreement. ASU 2014-04 also requires disclosure of both the amount of foreclosed residential real estate property held by the creditor and the recorded investment in loans collateralized by residential real estate property that are in the process of foreclosure. The amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2014, with early adoption permitted. Once adopted, an entity can elect either (i) a modified retrospective transition method or (ii) a prospective transition method. The modified retrospective transition method is applied by means of a cumulative-effect adjustment to residential mortgage loans and foreclosed residential real estate properties existing as of the beginning of the period for which the amendments of ASU 2014-04 are effective, with real estate reclassified to loans measured at the carrying value of the real estate at the date of adoption and loans reclassified to real estate measured at the lower of net carrying value of the loan or the fair value of the real estate less costs to sell at the date of adoption. The prospective transition method is applied by means of applying the amendments of ASU 2014-04 to all instances of receiving physical possession of residential real estate properties that occur after the date of adoption. Heartland adopted this standard on January 1, 2015, and the adoption did not have a material impact on the results of operations, financial position, and liquidity. As of March 31, 2015, Heartland had not received possession of any residential real estate properties that meet the disclosure requirements.

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers." The amendment clarifies the principles for recognizing revenue and develops a common revenue standard. The amendment outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle of the revenue model is that "an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services." In applying the revenue model to contracts within its scope, an entity should apply the following steps: (i) identify the contract(s) with a customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract, and (v) recognize revenue when (or as) the entity satisfies a performance obligation. The amendment applies to all contracts with customers except those that are within the scope of other topics in the FASB Codification. The standard also requires significantly expanded disclosures about revenue recognition. The amendment is effective for annual reporting periods beginning after December 15, 2016 (including interim reporting periods within those periods). Early application is not permitted. Heartland intends to adopt the accounting standard during the first quarter of 2017, as required, and is currently evaluating the impact on its results of operations, financial position, and liquidity.

In August 2014, the FASB issued ASU 2014-14, "Receivables-Troubled Debt Restructurings by Creditors: Classification of Certain Government-Guaranteed Mortgage Loans Upon Foreclosure." The amendment clarifies how creditors are to classify certain government-guaranteed mortgage loans upon foreclosure. The amendment requires that a mortgage loan be derecognized and a separate other receivable be recognized upon foreclosure if the following conditions are met: (1) the loan has a government guarantee that is not separate from the loan before foreclosure, and (2) at the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under the claim, and (3) at the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed. Upon foreclosure, the separate other receivable should be measured on the amount of the loan balance (principal and interest) expected to be recovered for the guarantor. This amendment is effective for annual reporting periods, and interim reporting periods within those years, beginning after December 15, 2014, with early adoption permitted. Heartland adopted this standard on January 1, 2015, and the adoption did not have an impact on the results of operations, financial position, and liquidity.

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

In April 2015, the FASB issued ASU 2015-03, "Interest-Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs." The amendment intends to simplify the presentation of debt issuance costs and more closely align the presentation of debt issuance costs under U.S. GAAP with the presentation under comparable IFRS standards. The cost of issuing debt will no longer be recorded as a separate asset, except when incurred before receipt of the funding from the associated debt liability. Debt issuance costs related to a recognized debt liability are to be presented on the balance sheet as a direct reduction from the debt liability, similar to the presentation of debt premiums or discounts. The costs will continue to be amortized to interest expense using the effective interest method. This amendment is effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. The ASU requires retrospective application to all prior periods presented in the financial statements. Heartland adopted this standard effective March 31, 2015. For the year ended December 31, 2014, \$550,000 was reclassified from other assets to other borrowings on the consolidated balance sheet. The adoption of this standard did not have a material impact on the results of operations, financial position, and liquidity.

NOTE 2: ACQUISITIONS

On April 16, 2015, Heartland entered into a definitive merger agreement with Community Bancorporation of New Mexico, Inc., parent company of Community Bank in Santa Fe, New Mexico. Under the terms of the agreement, Heartland will acquire Community Bancorporation in an all cash transaction valued at approximately \$11.3 million. Simultaneous with the closing of the transaction, Community Bank will be merged into Heartland's New Mexico Bank & Trust subsidiary. As of December 31, 2014, Community Bank had total assets of approximately \$181.0 million, including \$108.0 million of loans outstanding, and \$154.0 million of deposits.

On January 16, 2015, Heartland completed the acquisition of Community Banc-Corp of Sheboygan, Inc., parent company of Community Bank & Trust in Sheboygan, Wisconsin. Under the terms of the agreement, the aggregate purchase price was based upon 155% of the December 31, 2014 adjusted tangible book value, as defined in the merger agreement, of Community Banc-Corp of Sheboygan, Inc. The purchase price was approximately \$53.1 million, which was paid by delivery of 1,970,720 shares of Heartland common stock. The transaction included, at fair value, total assets of \$509.9 million, including loans of \$395.0 million and including deposits of \$433.9 million. Simultaneous with the close of the transaction, Community Bank & Trust merged into Heartland's Wisconsin Bank & Trust subsidiary. The transaction was a tax-free reorganization with respect to the stock consideration received by the stockholders of Community Banc-Corp of Sheboygan, Inc.

The assets and liabilities of Community Banc-Corp of Sheboygan, Inc. were recorded on the consolidated balance sheet at the estimated fair value on the acquisition date. The following table represents, in thousands, the amounts recorded on the consolidated balance sheet as of January 16, 2015:

	As of January 16, 2015
Fair value of consideration paid	
Common Stock	\$53,052
Cash	6
Total consideration paid	53,058
Fair value of assets acquired	
Cash and due from banks	7,109
Securities:	
Securities available for sale	52,976
Other securities	1,284
Loans held for sale	728
Loans held to maturity	395,007
Premises, furniture and equipment, net	13,954
Other real estate, net	346
Other intangible assets, net	10,295
Other assets	28,155
Total assets	509,854
Fair value of liabilities assumed	
Deposits	433,919
Short term borrowings	24,836
Other borrowings	6,097
Other liabilities	7,434
Total liabilities assumed	472,286
Fair value of net assets acquired	37,568
Goodwill resulting from acquisition	\$15,490

Heartland recognized goodwill of \$15.5 million in conjunction with the acquisition of Community Banc-Corp of Sheboygan, Inc., which is calculated as the excess of both the consideration exchanged and the liabilities assumed as compared to the fair value of identifiable assets acquired. Goodwill resulted from expected operational synergies, increased market presence, cross-selling opportunities, and expanded business lines. See Note 6 for further information on goodwill.

Pro Forma Information: The following pro forma information presents the results of operations for the years ended December 31, 2014 and December 31, 2013, as if the Community Banc-Corp of Sheboygan, Inc. acquisition occurred on January 1, 2013:

(Dollars in thousands, except per share data)	For the Years Ended	
	December 31, 2014	December 31, 2013
Net interest income	\$220,358	\$179,001
Net income	\$44,710	\$42,105
Basic earnings per share	\$2.19	\$2.20
Diluted earnings per share	\$2.16	\$2.17

The above pro forma results are presented for illustrative purposes and are not intended to represent or be indicative of the actual results of operations of the merged companies that would have been achieved had the acquisition occurred on January 1, 2013, nor are they intended to represent or be indicative of future results of operations. The pro forma results do not include expected operating cost savings as a result of the acquisition. These pro forma results require

significant estimates and judgments particularly as it relates to valuation and accretion of income associated with the acquired loans.

Heartland incurred \$1.7 million of pre-tax merger related expenses in 2014 and 2015. The merger expenses are reflected on the consolidated statement of income for the applicable period and are reported primarily in the categories of salaries and employee benefits, professional fees and other noninterest expenses.

Acquired loans were preliminarily recorded at fair value based on a discounted cash flow valuation methodology that considers, among other things, projected default rates, loss given defaults, and recovery rates. No allowance for credit losses was carried over from the acquisition. The balance of nonaccrual loans at acquisition date was \$5.8 million.

NOTE 3: SECURITIES

The amortized cost, gross unrealized gains and losses, and estimated fair values of securities available for sale as of March 31, 2015, and December 31, 2014, are summarized in the table below, in thousands:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
March 31, 2015				
U.S. government corporations and agencies	\$45,147	\$200	\$(17)	) \$45,330
Mortgage-backed securities	1,145,969	17,436	(9,054)	) 1,154,351
Obligations of states and political subdivisions	143,996	4,179	(153)	) 148,022
Corporate debt securities	740	—	—	740
Total debt securities	1,335,852	21,815	(9,224)	) 1,348,443
Equity securities	5,037	57	—	5,094
Total	\$1,340,889	\$21,872	\$(9,224)	) \$1,353,537
December 31, 2014				
U.S. government corporations and agencies	\$24,010	\$98	\$(15)	) \$24,093
Mortgage-backed securities	1,219,305	11,929	(11,968)	) 1,219,266
Obligations of states and political subdivisions	148,450	5,304	(328)	) 153,426
Corporate debt securities	—	—	—	—
Total debt securities	1,391,765	17,331	(12,311)	) 1,396,785
Equity securities	5,029	54	—	5,083
Total	\$1,396,794	\$17,385	\$(12,311)	) \$1,401,868

At both March 31, 2015, and December 31, 2014, the amortized cost of the available for sale securities is net of \$184,000 of credit related other-than-temporary impairment ("OTTI").

The amortized cost, gross unrealized gains and losses and estimated fair values of held to maturity securities as of March 31, 2015, and December 31, 2014, are summarized in the table below, in thousands:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
March 31, 2015				
Mortgage-backed securities	\$5,665	\$213	\$(754)	) \$5,124
Obligations of states and political subdivisions	278,365	15,013	(842)	) 292,536
Total	\$284,030	\$15,226	\$(1,596)	) \$297,660
December 31, 2014				
Mortgage-backed securities	\$5,734	\$217	\$(667)	) \$5,284
Obligations of states and political subdivisions	278,853	13,576	(945)	) 291,484
Total	\$284,587	\$13,793	\$(1,612)	) \$296,768

At March 31, 2015, the amortized cost of the held to maturity securities is net of \$797,000 of credit related OTTI and \$398,000 of non-credit related OTTI. At December 31, 2014, the amortized cost of the held to maturity securities was net of \$797,000 of credit related OTTI and \$422,000 of non-credit related OTTI.

Approximately 91% of Heartland's mortgage-backed securities are issuances of government-sponsored enterprises.

The amortized cost and estimated fair value of debt securities available for sale at March 31, 2015, by contractual maturity are as follows, in thousands. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without penalties.

	Amortized Cost	Estimated Fair Value
Due in 1 year or less	\$5,045	\$5,084
Due in 1 to 5 years	58,373	58,616
Due in 5 to 10 years	42,873	43,658
Due after 10 years	83,592	86,734
Total debt securities	189,883	194,092
Mortgage-backed securities	1,145,969	1,154,351
Equity securities	5,037	5,094
Total investment securities	\$1,340,889	\$1,353,537

The amortized cost and estimated fair value of debt securities held to maturity at March 31, 2015, by contractual maturity are as follows, in thousands. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without penalties.

	Amortized Cost	Estimated Fair Value
Due in 1 year or less	\$2,614	\$2,685
Due in 1 to 5 years	12,824	13,388
Due in 5 to 10 years	58,448	61,314
Due after 10 years	204,479	215,149
Total debt securities	278,365	292,536
Mortgage-backed securities	5,665	5,124
Total investment securities	\$284,030	\$297,660

Gross gains and losses realized related to the sales of securities available for sale for the three month periods ended March 31, 2015, and 2014, are summarized as follows, in thousands:

	Three Months Ended March 31,	
	2015	2014
Proceeds from sales	\$289,466	\$355,288
Gross security gains	4,622	2,472
Gross security losses	269	1,691

The following tables summarize, in thousands, the amount of unrealized losses, defined as the amount by which cost or amortized cost exceeds fair value, and the related fair value of investments with unrealized losses in Heartland's securities portfolio as of March 31, 2015, and December 31, 2014. The investments were segregated into two categories: those that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 or more months. The reference point for determining how long an investment was in an unrealized loss position was March 31, 2014, and December 31, 2013, respectively. Securities for which Heartland has taken credit-related OTTI write-downs are categorized as being "less than 12 months" or "12 months or longer" in a continuous loss position based on the point in time that the fair value declined to below the cost basis and not the period of time since the credit-related OTTI write-down.

Securities available for sale	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
March 31, 2015						
U.S. government corporations and agencies	\$15,042	\$(17)	\$—	\$—	\$15,042	\$(17)
Mortgage-backed securities	244,994	(7,208)	124,196	(1,846)	369,190	(9,054)
Obligations of states and political subdivisions	6,928	(72)	9,975	(81)	16,903	(153)
Total temporarily impaired securities	\$266,964	\$(7,297)	\$134,171	\$(1,927)	\$401,135	\$(9,224)
December 31, 2014						
U.S. government corporations and agencies	\$6,042	\$(15)	\$—	\$—	\$6,042	\$(15)
Mortgage-backed securities	327,363	(7,391)	306,078	(4,577)	633,441	(11,968)
Obligations of states and political subdivisions	886	(6)	20,507	(322)	21,393	(328)
Total temporarily impaired securities	\$334,291	\$(7,412)	\$326,585	\$(4,899)	\$660,876	\$(12,311)
Securities held to maturity						
Securities held to maturity	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
March 31, 2015						
Mortgage-backed securities	\$—	\$—	\$1,944	\$(754)	\$1,944	\$(754)
Obligations of states and political subdivisions	3,605	(392)	16,503	(450)	20,108	(842)
Total temporarily impaired securities	\$3,605	\$(392)	\$18,447	\$(1,204)	\$22,052	\$(1,596)
December 31, 2014						
Mortgage-backed securities	\$—	\$—	\$2,761	\$(667)	\$2,761	\$(667)
Obligations of states and political subdivisions	3,172	(422)	29,402	(523)	32,574	(945)
Total temporarily impaired securities	\$3,172	\$(422)	\$32,163	\$(1,190)	\$35,335	\$(1,612)

Heartland reviews the investment securities portfolio on a quarterly basis to monitor its exposure to OTTI. A determination as to whether a security's decline in fair value is other-than-temporary takes into consideration numerous factors and the relative significance of any single factor can vary by security. Some factors Heartland may consider in the OTTI analysis include the length of time the security has been in an unrealized loss position, changes in security ratings, financial condition of the issuer, as well as security and industry specific economic conditions. In addition, with regard to debt securities, Heartland may also evaluate payment structure, whether there are defaulted payments or expected defaults, prepayment speeds, and the value of any underlying collateral. For certain debt securities in unrealized loss positions, Heartland prepares cash flow analyses to compare the present value of cash

flows expected to be collected from the security with the amortized cost basis of the security. During 2012, Heartland experienced deterioration in the credit support on three private label mortgage-backed securities which resulted in a credit-related OTTI loss. The underlying collateral on these securities experienced an increased level of defaults and a slowing of voluntary prepayments causing the present value of the forward expected cash flows, using prepayment and default vectors, to be below the amortized cost basis of the securities. Based on Heartland's evaluation, a \$981,000 OTTI on three private label mortgage-backed securities attributable to credit-related losses was recorded in March 2012. The other-than-temporary credit-related losses were \$797,000 in the held to maturity category and \$184,000 in the available for sale category.

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

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

There were no gross realized gains or losses on the sale of available for sale securities with OTTI write-downs for the periods ended March 31, 2015, or December 31, 2014.

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

	Three Months Ended March 31,	
	2015	2014
Recorded as part of gross realized losses:		
Credit related OTTI	\$—	\$—
Intent to sell OTTI	—	—
Total recorded as part of gross realized losses	—	—
Recorded directly to AOCI for non-credit related impairment:		
Residential mortgage backed securities	—	—
Accretion of non-credit related impairment	(24	) (24
Total changes to AOCI for non-credit related impairment	(24	) (24
Total OTTI losses (accretion) recorded on debt securities, net	\$(24	) \$(24

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

Included in other securities at March 31, 2015 and December 31, 2014, were shares of stock in each Federal Home Loan Bank (the "FHLB") of Des Moines, Chicago, Dallas, San Francisco, Seattle, and Topeka at an amortized cost of \$12.5 million and \$14.3 million, respectively.

NOTE 4: LOANS AND LEASES

Loans and leases as of March 31, 2015, and December 31, 2014, were as follows, in thousands:

	March 31, 2015	December 31, 2014
Loans and leases receivable held to maturity:		
Commercial	\$1,134,614	\$1,036,080
Commercial real estate	1,932,701	1,707,060
Agricultural and agricultural real estate	411,732	423,827
Residential real estate	413,938	380,341
Consumer	351,981	330,555
Gross loans and leases receivable held to maturity	4,244,966	3,877,863
Unearned discount	(85	) (90
Deferred loan fees	(1,192	) (1,028
Total net loans and leases receivable held to maturity	4,243,689	3,876,745
Loans covered under loss share agreements:		
Commercial and commercial real estate	—	54
Agricultural and agricultural real estate	—	—
Residential real estate	—	1,204
Consumer	—	—
Total loans covered under loss share agreements	—	1,258
Allowance for loan and lease losses	(41,854	) (41,449
Loans and leases receivable, net	\$4,201,835	\$3,836,554

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

The commercial and commercial real estate loan portfolio includes a wide range of business loans, including lines of credit for working capital and operational purposes and term loans for the acquisition of equipment and real estate. Although most loans are made on a secured basis, loans may be made on an unsecured basis where warranted by the overall financial condition of the borrower. Terms of commercial business loans generally range from one to five years. Commercial loans and leases are primarily made based on the identified cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. The collateral that Heartland requires for most of these loans and leases is based upon the discounted market value of the collateral. The primary repayment risks of commercial loans and leases are that the cash flow of the borrowers may be unpredictable, and the collateral securing these loans may fluctuate in value. Heartland seeks to minimize these risks in a variety of ways. The underwriting analysis includes credit verification, analysis of global cash flows, appraisals and a review of the financial condition of the borrower. Personal guarantees are frequently required as a tertiary form of repayment. In addition, when underwriting loans for commercial real estate, careful consideration is given to the property's operating history, future operating projections, current and projected occupancy, location and physical condition. Heartland also utilizes government guaranteed lending through the U.S. Small Business Administration and the USDA Rural Development Business and Industry Program to assist customers with longer-term funding and to reduce risk.

Agricultural loans, many of which are secured by crops, machinery and real estate, are provided to finance capital improvements and farm operations as well as acquisitions of livestock and machinery. Agricultural loans present unique credit risks relating to adverse weather conditions, loss of livestock due to disease or other factors, declines in

market prices for agricultural products and the impact of government regulations. The ultimate repayment of agricultural loans is dependent upon the profitable operation or management of the agricultural entity. In underwriting agricultural loans, lending personnel work closely with their customers to review budgets and cash flow projections for the ensuing crop year. These budgets and cash flow projections are monitored closely during the year and reviewed with the customers at least annually. Lending personnel also work closely with governmental agencies, including the Farm Service Agency, to help agricultural customers obtain credit enhancement products such as loan guarantees or interest assistance.

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

Consumer lending includes motor vehicle, home improvement, home equity and small personal credit lines. Consumer loans typically have shorter terms, lower balances, higher yields and higher risks of default than one-to-four-family residential mortgage loans. Consumer loan collections are dependent on the borrower's continuing financial stability, and are therefore more likely to be affected by adverse personal circumstances. Risk is reduced through underwriting criteria, which include credit verification, appraisals, a review of the borrower's financial condition, and personal cash flows. A security interest, with title insurance when necessary, is taken in the underlying real estate. Heartland's consumer finance subsidiaries, Citizens Finance Co. and Citizens Finance of Illinois Co., typically lend to borrowers with past credit problems or limited credit histories, which comprise approximately 21% of Heartland's total consumer loan portfolio.

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Heartland's policy is to discontinue the accrual of interest income on any loan or lease when, in the opinion of management, there is a reasonable doubt as to the timely collection of the interest and principal, normally when a loan or lease is 90 days past due. When interest accruals are deemed uncollectible, interest credited to income in the current year is reversed and interest accrued in prior years is charged to the allowance for loan and lease losses. Nonaccrual loans and leases are returned to an accrual status when, in the opinion of management, the financial position of the borrower indicates that there is no longer any reasonable doubt as to the timely payment of interest and principal.

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

The following table shows the balance in the allowance for loan and lease losses at March 31, 2015, and December 31, 2014, and the related loan balances, disaggregated on the basis of impairment methodology, in thousands. Loans evaluated under ASC 310-10-35 include loans on nonaccrual status and troubled debt restructurings, which are individually evaluated for impairment, and other impaired loans deemed to have similar risk characteristics. All other loans are collectively evaluated for impairment under ASC 450-20. Heartland has made no significant changes to the accounting for the allowance for loan and lease losses policy during 2015.

	Allowance For Loan and Lease Losses			Gross Loans and Leases Receivable Held to Maturity		
	Ending Balance Under ASC 310-10-35	Ending Balance Under ASC 450-20	Total	Ending Balance Evaluated for Impairment Under ASC 310-10-35	Ending Balance Evaluated for Impairment Under ASC 450-20	Total
March 31, 2015						
Commercial	\$205	\$11,483	\$11,688	\$3,566	\$1,131,048	\$1,134,614
Commercial real estate	466	16,169	16,635	35,872	1,896,829	1,932,701
Agricultural and agricultural real estate	49	3,167	3,216	4,989	406,743	411,732
Residential real estate	491	3,254	3,745	10,401	403,537	413,938
Consumer	723	5,847	6,570	4,713	347,268	351,981
Total	\$1,934	\$39,920	\$41,854	\$59,541	\$4,185,425	\$4,244,966
December 31, 2014						
Commercial	\$754	\$11,155	\$11,909	\$4,526	\$1,031,554	\$1,036,080
Commercial real estate	636	15,262	15,898	35,771	1,671,289	1,707,060
Agricultural and agricultural real estate	52	3,243	3,295	5,049	418,778	423,827
Residential real estate	442	3,299	3,741	10,235	370,106	380,341
Consumer	813	5,793	6,606	6,143	324,412	330,555
Total	\$2,697	\$38,752	\$41,449	\$61,724	\$3,816,139	\$3,877,863

The following table presents nonaccrual loans, accruing loans past due 90 days or more and troubled debt restructured loans not covered under loss share agreements at March 31, 2015, and December 31, 2014, in thousands. There were no nonaccrual leases, accruing leases past due 90 days or more or restructured leases at March 31, 2015, and December 31, 2014.

	March 31, 2015	December 31, 2014
Nonaccrual loans	\$26,501	\$24,205
Nonaccrual troubled debt restructured loans	522	865
Total nonaccrual loans	\$27,023	\$25,070
Accruing loans past due 90 days or more	\$9	\$—
Performing troubled debt restructured loans	\$10,904	\$12,133

The following table provides information on troubled debt restructured loans that were modified during the three months ended March 31, 2015, and March 31, 2014, dollars in thousands:

	Three Months Ended					
	March 31, 2015			2014		
	Number of Loans	Pre- Modification Recorded Investment	Post- Modification Recorded Investment	Number of Loans	Pre- Modification Recorded Investment	Post- Modification Recorded Investment
Commercial	—	\$—	\$—	—	\$—	\$—
Commercial real estate	1	3,992	3,992	1	368	368
Total commercial and commercial real estate	1	3,992	3,992	1	368	368
Agricultural and agricultural real estate	—	—	—	—	—	—
Residential real estate	—	—	—	—	—	—
Consumer	—	—	—	—	—	—
Total	1	\$3,992	\$3,992	1	\$368	\$368

The pre-modification and post-modification recorded investment represents amounts as of the date of loan modification. Since the modifications on these loans have been only interest rate concessions and term extensions, not principal reductions, the pre-modification and post-modification recorded investment amounts are the same. At March 31, 2015, there were no commitments to extend credit to any of the borrowers with an existing troubled debt restructuring.

There were no troubled debt restructured loans for which there was a payment default during the three months ended March 31, 2015, and March 31, 2014, that had been modified during the twelve month period prior to the default.

Heartland's internal rating system is a series of grades reflecting management's risk assessment, based on its analysis of the borrower's financial condition. The "pass" category consists of all loans that are not in the "nonpass" category, categorized into a range of loan grades that reflect increasing, though still acceptable, risk. Movement of risk through the various grade levels in the pass category is monitored for early identification of credit deterioration. The "nonpass" category consists of special mention, substandard, doubtful and loss loans. The "special mention" rating is attached to loans where the borrower exhibits negative financial trends due to borrower specific or systemic conditions that, if left uncorrected, threaten its capacity to meet its debt obligations. The borrower is believed to have sufficient financial flexibility to react to and resolve its negative financial situation. These credits are closely monitored for improvement or deterioration. The "substandard" rating is assigned to loans that are inadequately protected by the current sound net worth and paying capacity of the borrower and may be further at risk due to deterioration in the value of collateral pledged. Well-defined weaknesses jeopardize liquidation of the debt. These loans are still considered collectible, however, a distinct possibility exists that Heartland will sustain some loss if deficiencies are not corrected. Substandard loans may exhibit some or all of the following weaknesses: deteriorating trends, lack of earnings, inadequate debt service capacity, excessive debt and/or lack of liquidity. The "doubtful" rating is assigned to loans where identified weaknesses make collection or liquidation in full, on the basis of existing facts, conditions and values, highly questionable and improbable. These borrowers are usually in default, lack liquidity and capital, as well as, resources necessary to remain an operating entity. Specific pending events, such as capital injections, liquidations or perfection of liens on additional collateral, may strengthen the credit, thus deferring classification of the loan as loss until exact status can be determined. The "loss" rating is assigned to loans considered uncollectible. As of March 31, 2015, Heartland had one loan classified as doubtful and no loans classified as loss. Loans are placed on "nonaccrual" when management does not expect to collect payments of principal and interest in full or when principal or interest has been in default for a period of 90 days or more, unless the loan is both well secured and in the process of

collection.

The following table presents loans and leases not covered by loss share agreements by credit quality indicator at March 31, 2015, and December 31, 2014, in thousands:

	Pass	Nonpass	Total
March 31, 2015			
Commercial	\$1,025,159	\$109,455	\$1,134,614
Commercial real estate	1,774,036	158,665	1,932,701
Total commercial and commercial real estate	2,799,195	268,120	3,067,315
Agricultural and agricultural real estate	389,296	22,436	411,732
Residential real estate	394,534	19,404	413,938
Consumer	343,674	8,307	351,981
Total gross loans and leases receivable held to maturity	\$3,926,699	\$318,267	\$4,244,966
December 31, 2014			
Commercial	\$939,717	\$96,363	\$1,036,080
Commercial real estate	1,567,711	139,349	1,707,060
Total commercial and commercial real estate	2,507,428	235,712	2,743,140
Agricultural and agricultural real estate	402,883	20,944	423,827
Residential real estate	361,325	19,016	380,341
Consumer	321,114	9,441	330,555
Total gross loans and leases receivable held to maturity	\$3,592,750	\$285,113	\$3,877,863

The nonpass category in the table above is comprised of approximately 68% special mention, 32% substandard and less than 1% doubtful as of March 31, 2015. The percent of nonpass loans on nonaccrual status as of March 31, 2015, was 8%. As of December 31, 2014, the nonpass category in the table above was comprised of approximately 66% special mention and 34% substandard. The percent of nonpass loans on nonaccrual status as of December 31, 2014, was 9%. Loans delinquent 30 to 89 days as a percent of total loans were 0.42% at March 31, 2015, compared to 0.21% at December 31, 2014. Changes in credit risk are monitored on a continuous basis and changes in risk ratings are made when identified. All impaired loans are reviewed at least annually.

The following table sets forth information regarding Heartland's accruing and nonaccrual loans and leases not covered by loss share agreements at March 31, 2015, and December 31, 2014, in thousands:

	Accruing Loans and Leases			Total Past Due	Current	Nonaccrual	Total Loans and Leases
	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due				
March 31, 2015							
Commercial	\$1,485	\$729	\$—	\$2,214	\$1,131,303	\$1,097	\$1,134,614
Commercial real estate	9,336	1,177	—	10,513	1,907,619	14,569	1,932,701
Total commercial and commercial real estate	10,821	1,906	—	12,727	3,038,922	15,666	3,067,315
Agricultural and agricultural real estate	569	129	9	707	409,658	1,367	411,732
Residential real estate	1,483	139	—	1,622	404,861	7,455	413,938
Consumer	2,246	502	—	2,748	346,698	2,535	351,981
Total gross loans and leases receivable held to maturity	\$15,119	\$2,676	\$9	\$17,804	\$4,200,139	\$27,023	\$4,244,966
December 31, 2014							
Commercial	\$980	\$48	\$—	\$1,028	\$1,032,707	\$2,345	\$1,036,080
Commercial real estate	1,788	111	—	1,899	1,693,554	11,607	1,707,060
Total commercial and commercial real estate	2,768	159	—	2,927	2,726,261	13,952	2,743,140
Agricultural and agricultural real estate	119	50	—	169	422,219	1,439	423,827
Residential real estate	1,037	445	—	1,482	371,982	6,877	380,341
Consumer	2,382	1,366	—	3,748	324,005	2,802	330,555
Total gross loans and leases receivable held to maturity	\$6,306	\$2,020	\$—	\$8,326	\$3,844,467	\$25,070	\$3,877,863

The majority of Heartland's impaired loans are those that are nonaccrual or have had their terms restructured in a troubled debt restructuring. The following tables present, for impaired loans not covered by loss share agreements and by category of loan, the unpaid contractual balance at March 31, 2015, and December 31, 2014; the outstanding loan balance recorded on the consolidated balance sheets at March 31, 2015, and December 31, 2014; any related allowance recorded for those loans as of March 31, 2015, and December 31, 2014; the average outstanding loan balance recorded on the consolidated balance sheets during the three months ended March 31, 2015, and year ended December 31, 2014; and the interest income recognized on the impaired loans during the three months ended March 31, 2015, and year ended December 31, 2014, in thousands:

	Unpaid Contractual Balance	Loan Balance	Related Allowance Recorded	Year-to- Date Avg. Loan Balance	Year-to- Date Interest Income Recognized
March 31, 2015					
Impaired loans with a related allowance:					
Commercial	\$307	\$273	\$205	\$520	\$3
Commercial real estate	1,973	1,484	466	3,279	6
Total commercial and commercial real estate	2,280	1,757	671	3,799	9
Agricultural and agricultural real estate	3,276	3,276	49	3,291	41
Residential real estate	2,749	2,581	491	2,674	4
Consumer	2,483	2,483	723	2,620	5
Total loans held to maturity	\$10,788	\$10,097	\$1,934	\$12,384	\$59
Impaired loans without a related allowance:					
Commercial	\$4,022	\$3,293	\$—	\$3,584	\$33
Commercial real estate	42,421	34,388	—	23,997	292
Total commercial and commercial real estate	46,443	37,681	—	27,581	325
Agricultural and agricultural real estate	3,692	1,713	—	1,588	3
Residential real estate	7,861	7,820	—	7,726	58
Consumer	2,237	2,230	—	3,011	11
Total loans held to maturity	\$60,233	\$49,444	\$—	\$39,906	\$397
Total impaired loans held to maturity:					
Commercial	\$4,329	\$3,566	\$205	\$4,104	\$36
Commercial real estate	44,394	35,872	466	27,276	298
Total commercial and commercial real estate	48,723	39,438	671	31,380	334
Agricultural and agricultural real estate	6,968	4,989	49	4,879	44
Residential real estate	10,610	10,401	491	10,400	62
Consumer	4,720	4,713	723	5,631	16
Total impaired loans held to maturity	\$71,021	\$59,541	\$1,934	\$52,290	\$456

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	Unpaid Contractual Balance	Loan Balance	Related Allowance Recorded	Year-to- Date Avg. Loan Balance	Year-to- Date Interest Income Recognized
December 31, 2014					
Impaired loans with a related allowance:					
Commercial	\$780	\$780	\$754	\$5,594	\$19
Commercial real estate	7,356	7,322	636	5,931	303
Total commercial and commercial real estate	8,136	8,102	1,390	11,525	322
Agricultural and agricultural real estate	3,317	3,317	52	3,966	104
Residential real estate	2,412	2,244	442	3,398	12
Consumer	2,799	2,799	813	4,053	19
Total loans held to maturity	\$16,664	\$16,462	\$2,697	\$22,942	\$457
Impaired loans without a related allowance:					
Commercial	\$4,913	\$3,746	\$—	\$3,499	\$101
Commercial real estate	32,708	28,449	—	24,522	1,172
Total commercial and commercial real estate	37,621	32,195	—	28,021	1,273
Agricultural and agricultural real estate	3,961	1,732	—	3,308	13
Residential real estate	8,200	7,991	—	6,267	110
Consumer	3,350	3,344	—	1,870	127
Total loans held to maturity	\$53,132	\$45,262	\$—	\$39,466	\$1,523
Total impaired loans held to maturity:					
Commercial	\$5,693	\$4,526	\$754	\$9,093	\$120
Commercial real estate	40,064	35,771	636	30,453	1,475
Total commercial and commercial real estate	45,757	40,297	1,390	39,546	1,595
Agricultural and agricultural real estate	7,278	5,049	52	7,274	117
Residential real estate	10,612	10,235	442	9,665	122
Consumer	6,149	6,143	813	5,923	146
Total impaired loans held to maturity	\$69,796	\$61,724	\$2,697	\$62,408	\$1,980

On January 16, 2015, Heartland acquired Community Banc-Corp of Sheboygan, Inc., parent company of Community Bank & Trust in Sheboygan, Wisconsin. As of January 16, 2015, Community Bank & Trust had loans of \$413.4 million, and the estimated fair value of the loans acquired was \$395.0 million.

The Community Banc-Corp of Sheboygan, Inc. acquisition was accounted for under the acquisition method of accounting in accordance with ASC 805, "Business Combinations." Purchased loans acquired in a business combination, which include loans purchased in the Community Bank & Trust acquisition, are recorded at estimated fair value on their purchase date, but the purchaser cannot carry over the related allowance for loan and lease losses. Purchased loans are accounted for under ASC 310-30, "Loans and Debt Securities with Deteriorated Credit Quality," when the loans have evidence of credit deterioration since origination and it is probable at the date of the acquisition that Heartland will not collect all contractually required principal and interest payments. Evidence of credit quality deterioration at the purchase date included statistics such as past due and nonaccrual status. Generally, acquired loans that meet Heartland's definition for nonaccrual status fall within the scope of ASC 310-30. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the nonaccretable difference which is included in the carrying value of the loans. Subsequent decreases to the expected cash flows will generally result in a provision for loan and lease losses. Subsequent increases in cash flows result in a reversal of the provision for loan and lease losses to the extent of prior charges, or a reclassification of the difference from nonaccretable to accretable with a positive impact on future interest income. Further, any excess of

cash flows expected at acquisition over the estimated fair value is referred to as the accretable yield and is recognized into interest income over the remaining life of the loan when there is a reasonable expectation about the amount and timing of such cash flows.

The carrying amount of the loans acquired with the acquisition of Community Bank & Trust at March 31, 2015 consisted of purchased impaired and nonimpaired loans as summarized in the following table, in thousands:

	March 31, 2015		
	Impaired Purchased Loans	Non Impaired Purchased Loans	Total Purchased Loans
Commercial	\$—	\$123,442	\$123,442
Commercial real estate	8,055	191,297	199,352
Agricultural and agricultural real estate	—	3,124	3,124
Residential real estate	—	24,299	24,299
Consumer loans	—	21,125	21,125
Total Loans	\$8,055	\$363,287	\$371,342

On the acquisition date, the preliminary estimate of the contractually required payments receivable for all loans with evidence of credit deterioration since origination acquired in the acquisition was \$12.9 million and the estimated fair value of the loans was \$8.2 million. At March 31, 2015, a majority of these loans were valued based upon the liquidation value of the underlying collateral, because the expected cash flows are primarily based on the liquidation of underlying collateral and the timing and amount of the cash flows could not be reasonably estimated. There was no allowance for loan and lease losses related to these ASC 310-30 loans at March 31, 2015.

On the acquisition date, the preliminary estimate of the contractually required payments receivable for all nonimpaired loans acquired in the acquisition was \$400.0 million and the estimated fair value of the loans was \$386.8 million.

On July 2, 2009, Heartland acquired all deposits of The Elizabeth State Bank in Elizabeth, Illinois through its subsidiary Galena State Bank & Trust Co. based in Galena, Illinois, in a whole bank loss sharing transaction facilitated by the FDIC. As of July 2, 2009, The Elizabeth State Bank had loans of \$42.7 million. The estimated fair value of the loans acquired was \$37.8 million. The FDIC approved the transfer of the loss share agreements to Illinois Bank & Trust as part of the merger of Galena State Bank & Trust Co. into Illinois Bank & Trust.

At the date of acquisition, the acquired loans and other real estate owned were covered by a loss share agreement for non-residential loans and a loss share agreement for residential real estate. Effective October 1, 2014, loans subject to the non-residential loss sharing agreement with the FDIC were no longer covered by loss sharing agreements. The remaining residential real estate loans covered under the loss share agreement are not material at March 31, 2015.

NOTE 5: ALLOWANCE FOR LOAN AND LEASE LOSSES

Changes in the allowance for loan and lease losses for the three months ended March 31, 2015, and March 31, 2014, were as follows, in thousands:

	Commercial	Commercial Real Estate	Agricultural	Residential Real Estate	Consumer	Unallocated	Total
Balance at December 31, 2014	\$11,909	\$15,898	\$3,295	\$3,741	\$6,606	\$—	\$41,449
Charge-offs	(274)	(333)	(276)	(58)	(1,063)	—	(2,004)
Recoveries	320	126	22	37	233	—	738
Provision	(267)	944	175	25	794	—	1,671
Balance at March 31, 2015	\$11,688	\$16,635	\$3,216	\$3,745	\$6,570	\$—	\$41,854
	Commercial	Commercial Real Estate	Agricultural	Residential Real Estate	Consumer	Unallocated	Total

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Balance at December 31, 2013	\$13,099	\$14,152	\$2,992	\$3,720	\$7,722	\$—	\$41,685
Charge-offs	(6,917)	(923)	(1,511)	(149)	(1,158)	—	(10,658)
Recoveries	199	780	2	26	208	—	1,215
Provision	5,252	(999)	1,088	74	604	312	6,331
Balance at March 31, 2014	\$11,633	\$13,010	\$2,571	\$3,671	\$7,376	\$312	\$38,573

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

NOTE 6: GOODWILL, CORE DEPOSIT PREMIUM AND OTHER INTANGIBLE ASSETS

Heartland had goodwill of \$51.1 million at March 31, 2015, and \$35.6 million December 31, 2014. Heartland conducts its annual internal assessment of the goodwill both collectively and at its subsidiaries as of September 30.

Heartland recorded \$15.5 million of goodwill in connection with the acquisition of Community Banc-Corp of Sheboygan, Inc., the parent company of Community Bank & Trust, based in Sheboygan, Wisconsin on January 16, 2015. The goodwill associated with this transaction is not deductible for tax purposes. As part of this acquisition, Heartland recognized core deposit intangibles of \$6.0 million that are expected to be amortized over a period of 10 years. The core deposit intangibles associated with this transaction are not deductible for tax purposes. In addition, Heartland recognized commercial servicing rights of \$4.3 million that are expected to be amortized over a period of 10 years.

Other intangible assets consist of core deposit intangibles, mortgage servicing rights, customer relationship intangible, and commercial servicing rights. The gross carrying amount of other intangible assets and the associated accumulated amortization at March 31, 2015, and December 31, 2014, are presented in the table below, in thousands:

	March 31, 2015			December 31, 2014		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Amortizing intangible assets:						
Core deposit intangibles	\$27,109	\$13,145	\$13,964	\$21,069	\$12,525	\$8,544
Mortgage servicing rights	38,893	13,398	25,495	37,825	12,841	24,984
Customer relationship intangible	1,177	784	393	1,177	773	404
Commercial servicing rights	4,387	215	4,172	—	—	—
Total	\$71,566	\$27,542	\$44,024	\$60,071	\$26,139	\$33,932

The following table shows the estimated future amortization expense for amortizable intangible assets, in thousands:

	Core Deposit Intangibles	Mortgage Servicing Rights	Customer Relationship Intangible	Commercial Servicing Rights	Total
Nine months ending December 31, 2015	\$2,078	\$6,480	\$32	\$641	\$9,231
Year ending December 31,					
2016	2,467	4,754	41	828	8,090
2017	2,180	4,075	40	776	7,071
2018	1,925	3,396	39	672	6,032
2019	1,667	2,716	38	519	4,940
2020	1,423	2,037	37	318	3,815
Thereafter	2,224	2,037	166	418	4,845

Projections of amortization expense for mortgage servicing rights are based on existing asset balances and the existing interest rate environment as of March 31, 2015. Heartland's actual experience may be significantly different depending upon changes in mortgage interest rates and market conditions. Mortgage loans serviced for others were \$3.58 billion and \$3.50 billion as of March 31, 2015, and December 31, 2014, respectively. The fair value of Heartland's mortgage

servicing rights was estimated at \$34.5 million at March 31, 2015, and \$34.2 million at December 31, 2014.

Heartland's mortgage servicing rights portfolio is comprised of loans serviced for the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, and the Government National Mortgage Association. The servicing rights portfolio is separated into 15- and 30-year tranches. At both March 31, 2015, and December 31, 2014, no valuation allowance was required for any of the tranches.

The fair value of mortgage servicing rights is calculated based upon a discounted cash flow analysis. Cash flow assumptions, including prepayment speeds, servicing costs and escrow earnings are considered in the calculation. The average constant prepayment rate was 11.66% and 11.40% for the March 31, 2015 and December 31, 2014, valuations, respectively. The discount rate was 9.21% and 9.20% for the March 31, 2015 and December 31, 2014, valuations, respectively. The average capitalization rate for the first three months of 2015 ranged from 0.75 to 1.30 basis points compared to 0.75 and 1.39 basis points for 2014. Fees collected for the servicing of mortgage loans for others were \$2.5 million and \$2.1 million for the three months ended March 31, 2015, and March 31, 2014, respectively.

The following table summarizes, in thousands, the changes in capitalized mortgage servicing rights for the three month period ended March 31, 2015 and 2014:

	2015	2014		
Balance at January 1	\$24,984	\$21,788		
Originations	2,686	1,435		
Amortization	(2,175	) (1,079)	
Balance at March 31	\$25,495	\$22,144		
Fair value of mortgage servicing rights	\$34,492	\$32,032		
Mortgage servicing rights, net to servicing portfolio	0.71	% 0.71	%	%

Heartland's commercial servicing rights portfolio was acquired with the Community Banc-Corp of Sheboygan, Inc. transaction that closed on January 16, 2015. The commercial servicing portfolio is comprised of loans serviced for the Small Business Administration and United States Department of Agriculture, which totaled \$145.1 million. Fees collected for the servicing of commercial loans for others were \$149,000. The fair value of Heartland's commercial servicing rights was estimated at \$4.4 million as of March 31, 2015.

The following table summarizes, in thousands, the changes in capitalized commercial servicing rights for the three month period ended March 31, 2015 and 2014:

	2015	2014
Balance at January 1	\$—	\$—
Acquired	4,255	—
Originations	132	—
Amortization	(215) —
Balance at March 31	\$4,172	\$—

Mortgage and commercial servicing rights are initially recorded at fair value in net gains on sale of loans held for sale when they are acquired through loan sales. Fair value is based on market prices for comparable servicing contracts, when available, or based on a valuation model that calculates the present value of estimated future net servicing income.

Mortgage and commercial servicing rights are subsequently measured using the amortization method, which requires the asset to be amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans. Servicing rights are evaluated for impairment based upon the fair value of the assets as compared to the carrying amount. Impairment is recognized through a valuation allowance for individual grouping to the extent that fair value is less than carrying amount. At March 31, 2015, no valuation allowance was recorded.

NOTE 7: DERIVATIVE FINANCIAL INSTRUMENTS

Heartland uses derivative financial instruments as part of its interest rate risk management strategy. As part of the strategy, Heartland considers the use of interest rate swaps, caps, floors and collars and certain interest rate lock commitments and forward sales of securities related to mortgage banking activities. Heartland's current strategy includes the use of interest rate swaps, interest rate lock commitments, and forward sales of mortgage securities. Heartland's objectives are to add stability to its net interest margin and to manage its exposure to movements in interest rates. The contract or notional amount of a derivative is used to determine, along with the other terms of the derivative, the amounts to be exchanged between the counterparties. Heartland is exposed to credit risk in the event of nonperformance by counterparties to financial instruments. Heartland minimizes this risk by entering into derivative contracts with large, stable financial institutions. Heartland has not experienced

any losses from nonperformance by these counterparties. Heartland monitors counterparty risk in accordance with the provisions of ASC 815. In addition, interest rate-related derivative instruments generally contain language outlining collateral pledging requirements for each counterparty. Collateral must be posted when the market value exceeds certain threshold limits which are determined by credit ratings of each counterparty. Heartland was required to pledge \$5.2 million and \$5.3 million of cash as collateral at March 31, 2015, and December 31, 2014, respectively. Heartland's counterparties were required to pledge \$0 at both March 31, 2015, and December 31, 2014, respectively.

Heartland's derivative and hedging instruments are recorded at fair value on the consolidated balance sheets. See Note 8, "Fair Value," for additional fair value information and disclosures.

Cash Flow Hedges

Heartland has variable rate funding which creates exposure to variability in interest payments due to changes in interest rates. To manage the interest rate risk related to the variability of interest payments, Heartland has entered into various interest rate swap agreements. Amounts reported in accumulated other comprehensive income (loss) related to derivatives will be reclassified to interest expense as interest payments are received or made on Heartland's variable-rate liabilities. For the three months ended March 31, 2015, the change in net unrealized losses on cash flow hedges reflects changes in the fair value of the swaps and reclassification from accumulated other comprehensive income to interest expense totaling \$564,000. For the next twelve months, Heartland estimates that cash payments and reclassification from accumulated other comprehensive income to interest expense will total \$2.3 million.

Heartland executed an interest rate swap transaction on April 5, 2011, with an effective date of April 20, 2011, and an expiration date of April 20, 2016, to effectively convert \$15.0 million of its newly issued variable rate amortizing debt to fixed rate debt. For accounting purposes, this swap transaction is designated as a cash flow hedge of the changes in cash flows attributable to changes in one-month LIBOR, the benchmark interest rate being hedged, associated with the interest payments made on an amount of Heartland's debt principal equal to the then-outstanding swap notional amount. At inception, Heartland asserted that the underlying principal balance would remain outstanding throughout the hedge transaction making it probable that sufficient LIBOR-based interest payments would exist through the maturity date of the swap.

Heartland entered into three forward starting interest rate swap transactions to effectively convert Heartland Financial Statutory Trust IV, V, and VII, which total \$65.0 million, as well as Morrill Statutory Trust I and II, which total \$16.2 million, from variable rate subordinated debentures to fixed rate debt. For accounting purposes, these five swap transactions are designated as cash flow hedges of the changes in cash flows attributable to changes in LIBOR, the benchmark interest rate being hedged, associated with the interest payments made on \$81.2 million of Heartland's subordinated debentures that reset quarterly on a specified reset date. At inception, Heartland asserted that the underlying principal balance would remain outstanding throughout the hedge transaction making it probable that sufficient LIBOR-based interest payments would exist through the maturity date of the swaps.

During the first quarter of 2015, Heartland entered into two additional forward starting interest rate swaps. The first forward starting interest rate swap transaction relates to Heartland's \$20.0 million Statutory Trust VI, which will convert from a fixed interest rate subordinated debenture to a variable interest rate subordinated debenture. The effective date of the interest rate swap transaction is June 15, 2017, and Heartland Statutory Trust VI will effectively remain at a fixed interest rate. The forward-starting swap transaction expires on June 15, 2024. The second forward starting interest rate swap is effective on March 1, 2017 and will replace the current interest rate swap related to Heartland Statutory Trust VII upon its expiration on March 1, 2017.

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The table below identifies the balance sheet category and fair values of Heartland's derivative instruments designated as cash flow hedges at March 31, 2015, and December 31, 2014, in thousands:

	Notional Amount	Fair Value	Balance Sheet Category	Receive Rate	Weighted Average Pay Rate	Maturity
March 31, 2015						
Interest rate swap	\$ 10,020	\$(209)	) Other Liabilities	2.926	% 5.140	% 04/20/2016
Interest rate swap	25,000	(910)	) Other Liabilities	0.271	% 2.255	% 03/17/2021
Interest rate swap	20,000	(1,001)	) Other Liabilities	0.262	% 3.220	% 03/01/2017
Interest rate swap	20,000	(1,932)	) Other Liabilities	0.254	% 3.355	% 01/07/2020
Interest rate swap	10,000	(143)	) Other Liabilities	0.269	% 1.674	% 03/26/2019
Interest rate swap	10,000	(141)	) Other Liabilities	0.271	% 1.658	% 03/18/2019
Interest rate swap	20,000	(93)	) Other Liabilities	1.632	% 2.390	% 06/15/2024
Interest rate swap	20,000	(107)	) Other Liabilities	1.474	% 2.352	% 03/01/2024
December 31, 2014						
Interest rate swap	\$ 10,369	\$(248)	) Other Liabilities	2.915	% 5.140	% 04/20/2016
Interest rate swap	25,000	(534)	) Other Liabilities	0.243	% 2.255	% 03/17/2021
Interest rate swap	20,000	(1,046)	) Other Liabilities	0.234	% 3.220	% 03/01/2017
Interest rate swap	20,000	(1,748)	) Other Liabilities	0.232	% 3.355	% 01/07/2020
Interest rate swap	10,000	(35)	) Other Liabilities	0.255	% 1.674	% 03/26/2019
Interest rate swap	10,000	(35)	) Other Liabilities	0.243	% 1.658	% 03/18/2019

The table below identifies the gains and losses recognized on Heartland's derivative instruments designated as cash flow hedges for the three months ended March 31, 2015, and March 31, 2014, in thousands:

	Effective Portion		Ineffective Portion	
	Recognized in OCI	Reclassified from OCI into Income	Recognized in OCI	Recognized in Income on Derivatives
	Amount of Gain (Loss)	Category	Amount of Gain (Loss)	Category
Three Months Ended March 31, 2015				
Interest rate swap	\$39	Interest Expense	\$(57)	) Other Income
Interest rate swap	(376)	) Interest Expense	(126)	) Other Income
Interest rate swap	45	Interest Expense	(151)	) Other Income
Interest rate swap	(184)	) Interest Expense	(160)	) Other Income
Interest rate swap	(108)	) Interest Expense	(35)	) Other Income
Interest rate swap	(106)	) Interest Expense	(35)	) Other Income
Interest rate swap	(93)	) Interest Expense	—	Other Income
Interest rate swap	(107)	) Interest Expense	—	Other Income
Three Months Ended March 31, 2014				
Interest rate swap	\$51	Interest Expense	\$(65)	) Other Income
Interest rate swap	146	Interest Expense	(146)	) Other Income
Interest rate swap	62	Interest Expense	—	Other Income
Interest rate swap	114	Interest Expense	(151)	) Other Income
Interest rate swap	(81)	) Interest Expense	(159)	) Other Income
Interest rate swap	45	Interest Expense	—	Other Income
Interest rate swap	45	Interest Expense	—	Other Income

Mortgage Derivatives

Heartland also has entered into interest rate lock commitments to originate residential mortgage loans held for sale and forward commitments to sell residential mortgage loans and mortgage backed securities that are considered derivative instruments. The fair value of these commitments is recorded on the consolidated balance sheets with the changes in fair value recorded in the consolidated statements of income as a component of net gains on sale of loans held for sale. These derivative contracts are designated as free standing derivative contracts and are not designated against specific assets and liabilities on the consolidated balance sheets or forecasted transactions and therefore do not qualify for hedge accounting treatment.

The table below identifies the balance sheet category and fair values of Heartland's derivative instruments not designated as hedging instruments at March 31, 2015, and December 31, 2014, in thousands:

	Balance Sheet Category	Notional Amount	Fair Value
March 31, 2015			
Interest rate lock commitments (mortgage)	Other Assets	\$208,915	\$6,875
Forward commitments	Other Assets	115,352	404
Forward commitments	Other Liabilities	331,161	(1,873)
December 31, 2014			
Interest rate lock commitments (mortgage)	Other Assets	\$74,863	\$2,496
Forward commitments	Other Assets	88,484	275
Forward commitments	Other Liabilities	218,337	(1,619)

The table below identifies the income statement category of the gains and losses recognized in income on Heartland's derivative instruments not designated as hedging instruments for the three months ended March 31, 2015, and March 31, 2014, in thousands:

	Income Statement Category	Year-to-Date Gain (Loss) Recognized
Three Months Ended March 31, 2015		
Interest rate lock commitments (mortgage)	Net gains on sale of loans held for sale	\$5,544
Forward commitments	Net gains on sale of loans held for sale	(125)
Three Months Ended March 31, 2014		
Interest rate lock commitments (mortgage)	Net gains on sale of loans held for sale	\$1,882
Forward commitments	Net gains on sale of loans held for sale	(1,142)

NOTE 8: FAIR VALUE

Heartland utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Securities available for sale, trading securities and derivatives are recorded in the consolidated balance sheets at fair value on a recurring basis. Additionally, from time to time, Heartland may be required to record at fair value other assets on a nonrecurring basis such as loans held for sale, loans held to maturity and certain other assets including, but not limited to, mortgage servicing rights, commercial servicing rights and other real estate owned. These nonrecurring fair value adjustments typically involve application of lower of cost or fair value accounting or write-downs of individual assets.

Fair Value Hierarchy

Under ASC 820, assets and liabilities are grouped at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1 — Valuation is based upon quoted prices for identical instruments in active markets.

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

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

The following is a description of valuation methodologies used for assets and liabilities recorded at fair value on a recurring or non-recurring basis.

Assets

Securities Available for Sale and Held to Maturity

Securities available for sale are recorded at fair value on a recurring basis. Securities held to maturity are generally recorded at cost and are recorded at fair value only to the extent a decline in fair value is determined to be other-than-temporary. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, as well as U.S. Treasury securities. Level 2 securities include U.S. government and agency securities, mortgage-backed securities and private collateralized mortgage obligations, municipal bonds and corporate debt securities. Level 3 securities consist primarily of Z-TRANCHE mortgage-backed securities and corporate debt securities. On a quarterly basis, a secondary independent pricing service is used for a sample of securities to validate the pricing from Heartland's primary pricing service.

Trading Assets

Trading assets are recorded at fair value and consist of securities held for trading purposes. The valuation method for trading securities is the same as the methodology used for securities classified as available for sale.

Loans Held for Sale

Loans held for sale are carried at the lower of cost or fair value on an aggregate basis. The fair value of loans held for sale is based on what secondary markets are currently offering for portfolios with similar characteristics. As such, Heartland classifies loans held for sale subjected to nonrecurring fair value adjustments as Level 2.

Loans Held to Maturity

Heartland does not record loans held to maturity at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with ASC 310. The fair value of impaired loans is measured using one of the following impairment methods: 1) the present value of expected future cash flows discounted at the loan's effective interest rate or 2) the observable market price of the loan or 3) the fair value of the collateral if the loan is collateral dependent. In accordance with ASC 820, impaired loans measured at fair value are classified as nonrecurring Level 3 in the fair value hierarchy.

Mortgage Servicing Rights

Mortgage servicing rights assets represent the value associated with servicing residential real estate loans that have been sold to outside investors with servicing retained. Heartland uses the amortization method (i.e., the lower of amortized cost or estimated fair value measured on a nonrecurring basis), not fair value measurement accounting, to determine the carrying value of its mortgage servicing rights. The fair value for servicing assets is determined through discounted cash flow analysis and utilizes discount rates, prepayment speeds and delinquency rate assumptions as inputs. All of these assumptions require a significant degree of management estimation and judgment. Mortgage

servicing rights are subject to impairment testing. The carrying values of these rights are reviewed quarterly for impairment based upon the calculation of fair value as performed by an outside third party. For purposes of measuring impairment, the rights are stratified into certain risk characteristics including note type and note term. If the valuation model reflects a fair value less than the carrying value, mortgage servicing rights are adjusted to fair value through a valuation allowance. Heartland classifies mortgage servicing rights as nonrecurring with Level 3 measurement inputs.

Commercial Servicing Rights

Commercial servicing rights assets represent the value associated with servicing commercial loans that have been sold to Small Business Administration and United States Department of Agriculture with servicing retained. Heartland uses the amortization method (i.e., the lower of amortized cost or estimated fair value measured on a nonrecurring basis), not fair value measurement accounting, to determine the carrying value of its commercial servicing rights. The fair value for servicing assets is determined

through market prices for comparable servicing contracts, when available, or through a valuation model that calculates the present value of estimated future net servicing income. Inputs utilized include discount rates, prepayment speeds and delinquency rate assumptions as inputs. All of these assumptions require a significant degree of management estimation and judgment. Commercial servicing rights are subject to impairment testing, and the carrying values of these rights are reviewed quarterly for impairment based upon the calculation of fair value as performed by an outside third party. If the valuation model reflects a fair value less than the carrying value, commercial servicing rights are adjusted to fair value through a valuation allowance. Heartland classifies commercial servicing rights as nonrecurring with Level 3 measurement inputs.

Derivative Financial Instruments

Heartland's current interest rate risk strategy includes interest rate swaps. The valuation of these instruments is determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves and implied volatilities. To comply with the provisions of ASC 820, Heartland incorporates credit valuation adjustments to appropriately reflect both its own nonperformance risk and the respective counterparty's nonperformance risk in the fair value measurements. In adjusting the fair value of its derivative contracts for the effect of nonperformance risk, Heartland has considered the impact of netting any applicable credit enhancements, such as collateral postings, thresholds, mutual puts, and guarantees.

Although Heartland has determined that the majority of the inputs used to value its derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by itself and its counterparties. However, as of March 31, 2015, and December 31, 2014, Heartland has assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and has determined that the credit valuation adjustments are not significant to the overall valuation of its derivatives. As a result, Heartland has determined that its derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy.

Interest rate lock commitments

Heartland uses an internal valuation model that relies on internally developed inputs to estimate the fair value of its interest rate lock commitments which is based on unobservable inputs that reflect management's assumptions and specific information about each borrower. Interest rate lock commitments are classified in Level 3 of the fair value hierarchy.

Forward commitments

The fair value of forward commitments are estimated using an internal valuation model, which includes current trade pricing for similar financial instruments in active markets that Heartland has the ability to access and are classified in Level 2 of the fair value hierarchy.

Other Real Estate Owned

Other real estate owned ("OREO") represents property acquired through foreclosures and settlements of loans. Property acquired is carried at the fair value of the property at the time of acquisition (representing the property's cost basis), plus any acquisition costs, or the estimated fair value of the property, less disposal costs. Heartland considers third party appraisals, as well as independent fair value assessments from realtors or persons involved in selling OREO, in determining the fair value of particular properties. Accordingly, the valuation of OREO is subject to significant external and internal judgment. Heartland periodically reviews OREO to determine if the fair value of the property, less disposal costs, has declined below its recorded book value and records any adjustments accordingly. OREO is classified as nonrecurring Level 3.

The table below presents Heartland's assets and liabilities that are measured at fair value on a recurring basis as of March 31, 2015, and December 31, 2014, in thousands, aggregated by the level in the fair value hierarchy within which those measurements fall:

	Total Fair Value	Level 1	Level 2	Level 3
March 31, 2015				
Assets				
Securities available for sale				
U.S. government corporations and agencies	\$45,330	\$530	\$44,800	\$—
Mortgage-backed securities	1,154,351	—	1,149,268	5,083
Obligations of states and political subdivisions	148,022	—	148,022	—
Corporate debt securities	740	—	—	740
Equity securities	5,094	—	5,094	—
Derivative financial instruments	—	—	—	—
Interest rate lock commitments	6,875	—	—	6,875
Forward commitments	404	—	404	—
Total assets at fair value	\$1,360,816	\$530	\$1,347,588	\$12,698
Liabilities				
Derivative financial instruments	\$4,536	\$—	\$4,536	\$—
Forward commitments	1,873	—	1,873	—
Total liabilities at fair value	\$6,409	\$—	\$6,409	\$—
December 31, 2014				
Assets				
Securities available for sale				
U.S. government corporations and agencies	\$24,093	\$2,529	\$21,564	\$—
Mortgage-backed securities	1,219,266	—	1,214,319	4,947
Obligations of states and political subdivisions	153,426	—	153,426	—
Corporate debt securities	—	—	—	—
Equity securities	5,083	—	5,083	—
Interest rate lock commitments	2,496	—	—	2,496
Forward commitments	275	—	275	—
Total assets at fair value	\$1,404,639	\$2,529	\$1,394,667	\$7,443
Liabilities				
Derivative financial instruments	\$3,646	\$—	\$3,646	\$—
Forward commitments	1,619	—	1,619	—
Total liabilities at fair value	\$5,265	\$—	\$5,265	\$—

The tables below present Heartland's assets that are measured at fair value on a nonrecurring basis, in thousands:

Fair Value Measurements at March 31, 2015

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Year-to- Date Losses
Collateral dependent impaired loans:					
Commercial	\$68	\$—	\$—	\$68	\$—
Commercial real estate	6,285	—	—	6,285	78
Agricultural and agricultural real estate	276	—	—	276	276
Residential real estate	2,474	—	—	2,474	—
Consumer	1,760	—	—	1,760	—
Total collateral dependent impaired loans	\$10,863	\$—	\$—	\$10,863	\$354
Other real estate owned	\$19,097	\$—	\$—	\$19,097	\$361

Fair Value Measurements at December 31, 2014

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Year-to- Date Losses
Collateral dependent impaired loans:					
Commercial	\$1,033	\$—	\$—	\$1,033	\$659
Commercial real estate	12,584	—	—	12,584	492
Agricultural and agricultural real estate	552	—	—	552	2,229
Residential real estate	3,173	—	—	3,173	—
Consumer	2,003	—	—	2,003	22
Total collateral dependent impaired loans	\$19,345	\$—	\$—	\$19,345	\$3,402
Other real estate owned	\$19,016	\$—	\$—	\$19,016	\$1,938

The following tables present additional quantitative information about assets measured at fair value and for which Heartland has utilized Level 3 inputs to determine fair value, in thousands:

	Fair Value at 3/31/15	Valuation Technique	Unobservable Input	Range (Weighted Average)
Z-TRANCHE Securities	\$5,083	Discounted cash flows	Pretax discount rate	7.00 - 9.00%
			Actual defaults	17.30 - 36.76% (30.07%)
			Actual deferrals	5.84 - 27.13% (17.35%)
Corporate debt securities	740	Discounted cash flows	Bank analysis	(1)
Interest rate lock commitments	6,875	Discounted cash flows	Closing ratio	(2)
Collateral dependent impaired loans:				
Commercial	68	Modified appraised value	Third party appraisal	(3)
			Appraisal discount	(3)
Commercial real estate	6,285	Modified appraised value	Third party appraisal	(3)
			Appraisal discount	(3)
Agricultural and agricultural real estate	276	Modified appraised value	Third party appraisal	(3)
			Appraisal discount	(3)
Residential real estate	2,474	Modified appraised value	Third party appraisal	(3)
			Appraisal discount	(3)
Consumer	1,760	Modified appraised value	Third party valuation	(3)
			Valuation discount	(3)
Other real estate owned	19,097	Modified appraised value	Third party appraisal	(3)
			Appraisal discount	(3)

(1) The unobservable input is the bank analysis market using Moody's Global Bank Rating Methodology. The analysis takes into consideration various performance metrics as well as yield on the debt securities and credit risk analysis.

(2) The significant unobservable input used in the fair value measurement is the closing ratio, which represents the percentage of loans currently in a lock position which management estimates will ultimately close. The closing ratio calculation takes into consideration historical data and loan-level data; therefore providing a range would not be meaningful. The weighted average closing ratio at March 31, 2015 was 83%.

(3) Third party appraisals are obtained as to the value of the underlying asset, but disclosure of this information would not provide meaningful information, as the range will vary widely from loan to loan. Types of discounts considered included age of the appraisal, local market conditions, current condition of the property, and estimated sales costs. These discounts will also vary from loan to loan, thus providing range would not be meaningful.

	Fair Value at 12/31/14	Valuation Technique	Unobservable Input	Range (Weighted Average)
Z-TRANCHE Securities	\$4,947	Discounted cash flows	Pretax discount rate Actual defaults Actual deferrals	7.00 - 9.00% 15.60 - 30.60% (24.50%) 7.20 - 17.30% (12.90%)
Corporate debt securities	—	Discounted cash flows	Bank analysis	(1)
Interest rate lock commitments	2,496	Discounted cash flows	Closing ratio	(2)
Collateral dependent impaired loans:				
Commercial	1,033	Modified appraised value	Third party appraisal Appraisal discount	(3) (3)
Commercial real estate	12,584	Modified appraised value	Third party appraisal Appraisal discount	(3) (3)
Agricultural and agricultural real estate	552	Modified appraised value	Third party appraisal Appraisal discount	(3) (3)
Residential real estate	3,173	Modified appraised value	Third party appraisal Appraisal discount	(3) (3)
Consumer	2,003	Modified appraised value	Third party valuation Valuation discount	(3) (3)
Other real estate owned	19,016	Modified appraised value	Third party appraisal Appraisal discount	(3) (3)

(1) The unobservable input is the bank analysis market using Moody's Global Bank Rating Methodology. The analysis takes into consideration various performance metrics as well as yield on the debt securities and credit risk analysis.

(2) The significant unobservable input used in the fair value measurement is the closing ratio, which represents the percentage of loans currently in a lock position which management estimates will ultimately close. The closing ratio calculation takes into consideration historical data and loan-level data; therefore providing a range would not be meaningful. The weighted average closing ratio at December 31, 2014 was 84%.

(3) Third party appraisals are obtained as to the value of the underlying asset, but disclosure of this information would not provide meaningful information, as the range will vary widely from loan to loan. Types of discounts considered included age of the appraisal, local market conditions, current condition of the property, and estimated sales costs. These discounts will also vary from loan to loan, thus providing range would not be meaningful.

The changes in fair value of the Z-TRANCHE, a Level 3 asset, that is measured on a recurring basis is summarized in the following table, in thousands:

	For the Three Months Ended March 31, 2015	For the Year Ended December 31, 2014
Balance at January 1,	\$4,947	\$3,298
Total gains (losses):		
Included in earnings	—	—
Included in other comprehensive income	239	1,783
Purchases, sales and settlements:		
Purchases	6	—
Sales	—	—
Settlements	(109	) (134
Balance at period end	\$5,083	\$4,947

The changes in fair value of the corporate debt securities, Level 3 assets, that are measured on a recurring basis is summarized in the following table, in thousands:

	For the Three Months Ended March 31, 2015	For the Year Ended December 31, 2014
Balance at January 1,	\$—	\$—
Total gains (losses):		
Included in earnings	—	—
Included in other comprehensive income	—	—
Purchases, acquired, sales and settlements:		
Purchases	—	—
Acquired	740	—
Sales	—	—
Settlements	—	—
Balance at period end	\$740	\$—

The changes in fair value of the interest rate lock commitments, which are Level 3 financial instruments and are measured on a recurring basis, are summarized in the following table, in thousands:

	For the Three Months Ended March 31, 2015	For the Year Ended December 31, 2014
Balance at January 1,	\$2,496	\$1,809
Total gains (losses) included in earnings	5,544	2,422
Issuances	1,135	2,038
Settlements	(2,300	) (3,773
Balance at period end	\$6,875	\$2,496

Gains included in net gains on sale of loans held for sale attributable to interest rate lock commitments held at March 31, 2015, and December 31, 2014, were \$6.9 million and \$2.5 million, respectively.

The tables below summarize the estimated fair value of Heartland's financial instruments as defined by ASC 825 as of March 31, 2015, and December 31, 2014, in thousands. The carrying amounts in the following tables are recorded in the consolidated balance sheets under the indicated captions. In accordance with ASC 825, the assets and liabilities that are not financial instruments are not included in the disclosure, such as the value of the mortgage servicing rights, premises, furniture and equipment, goodwill and other intangibles and other liabilities.

Heartland does not believe that the estimated information presented herein is representative of the earnings power or value of Heartland. The following analysis, which is inherently limited in depicting fair value, also does not consider any value associated with either existing customer relationships or the ability of Heartland to create value through loan origination, deposit gathering or fee generating activities. Many of the estimates presented herein are based upon the use of highly

subjective information and assumptions and, accordingly, the results may not be precise. Management believes that fair value estimates may not be comparable between financial institutions due to the wide range of permitted valuation techniques and numerous estimates which must be made. Furthermore, because the disclosed fair value amounts were estimated as of the balance sheet date, the amounts actually realized or paid upon maturity or settlement of the various financial instruments could be significantly different.

	Carrying Amount	Estimated Fair Value	Fair Value Measurements at March 31, 2015 Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial assets:					
Cash and cash equivalents	\$111,732	\$111,732	\$111,732	\$—	\$—
Time deposits in other financial institutions	2,605	2,605	2,605	—	—
Securities:					
Available for sale	1,353,537	1,353,537	530	1,347,184	5,823
Held to maturity	284,030	297,660	—	297,660	—
Other investments	18,297	18,297	—	18,062	235
Loans held for sale	105,670	105,670	—	105,670	—
Loans, net:					
Commercial	1,122,604	1,095,511	—	1,095,443	68
Commercial real estate	1,915,520	1,934,635	—	1,928,350	6,285
Agricultural and agricultural real estate	409,561	412,624	—	412,348	276
Residential real estate	408,808	400,397	—	397,923	2,474
Consumer	345,342	350,993	—	349,233	1,760
Total Loans, net	4,201,835	4,194,160	—	4,183,297	10,863
Derivative financial instruments					
Interest rate lock commitments	6,875	6,875	—	—	6,875
Forward commitments	404	404	—	404	—
Financial liabilities:					
Deposits					
Demand deposits	1,515,004	1,515,004	—	1,515,004	—
Savings deposits	2,863,744	2,863,744	—	2,863,744	—
Time deposits	887,650	887,650	—	887,650	—
Short term borrowings	259,335	259,335	—	259,335	—
Other borrowings	361,300	364,534	—	—	—