Section 1: 10-Q (10-Q)

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 September 30, 2019

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

For transition period from __________ 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) 589-2100
(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 every Interactive Data File required to be submitted 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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer", "accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	☒	Accelerated Filer	☐
Non-accelerated filer	☐	Smaller reporting company	☐
Emerging growth company	☐		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

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

Securities registered pursuant to Section 12(b) of the Exchange Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, par value $1.00 per share	HTLF	Nasdaq Stock Market

Indicate the number of shares outstanding of each of the classes of Registrant's common stock as of the latest practicable date: As of November 4, 2019, the Registrant had outstanding 36,698,445 shares of common stock, $1.00 par value per share.

HEARTLAND FINANCIAL USA, INC.
Form 10-Q Quarterly Report
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PART I

ITEM 1. FINANCIAL STATEMENTS

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

	September 30, 2019 (Unaudited)	December 31, 2018
ASSETS		
Cash and due from banks	$ 243,395	$ 223,135
Interest bearing deposits with other banks and other short-term investments	204,372	50,495
Cash and cash equivalents	447,767	273,630
Time deposits in other financial institutions	3,711	4,672
Securities:		
Carried at fair value (cost of $2,993,045 at September 30, 2019, and $2,492,620 at December 31, 2018)	3,020,568	2,450,709
Held to maturity, at cost (fair value of $97,905 at September 30, 2019, and $245,341 at December 31, 2018)	87,965	236,283
Other investments, at cost	29,042	28,396
Loans held for sale	35,427	119,801
Loans receivable:		
Held to maturity	7,971,608	7,407,697
Allowance for loan and lease losses	(66,222)	(61,963)
Loans receivable, net	7,905,386	7,345,734
Premises, furniture and equipment, net	195,984	187,418
Premises, furniture and equipment held for sale	3,251	7,258
Other real estate, net	6,425	6,153
Goodwill	427,097	391,668
Core deposit intangibles and customer relationship intangibles, net	49,819	47,479
Servicing rights, net	6,271	31,072
Cash surrender value on life insurance	171,471	162,892
Other assets	179,078	114,841
TOTAL ASSETS	**$ 12,569,262**	**$ 11,408,006**
LIABILITIES AND EQUITY		
LIABILITIES:		
Deposits:		
Demand	$ 3,581,127	$ 3,264,737
Savings	5,770,754	5,107,962
Time	1,117,975	1,023,730
Total deposits	10,469,856	9,396,429
Deposits held for sale	—	106,409
Short-term borrowings	107,853	227,010
Other borrowings	278,417	274,905
Accrued expenses and other liabilities	149,293	78,078
TOTAL LIABILITIES	**11,005,419**	**10,082,831**
STOCKHOLDERS' EQUITY:		
Preferred stock (par value $1 per share; authorized 17,604 shares; none issued or outstanding at both September 30, 2019, and December 31, 2018)	—	—
Series A Junior Participating preferred stock (par value $1 per share; authorized 16,000 shares; none issued or outstanding at both September 30, 2019, and December 31, 2018)	—	—
Series C Senior Non-Cumulative Perpetual Preferred Stock (par value $1 per share; 81,698 shares authorized at both September 30, 2019, and December 31, 2018, none issued or outstanding at both September 30, 2019, and December 31, 2018)	—	—
Series D Senior Non-Cumulative Perpetual Convertible Preferred Stock (par value $1 per share; 3,000 shares authorized at both September 30, 2019, and December 31, 2018; none issued or outstanding at both September 30, 2019, and December 31, 2018)	—	—
Common stock (par value $1 per share; 60,000,000 shares authorized at September 30, 2019, and 40,000,000 shares authorized at December 31, 2018; issued 36,696,190 shares at September 30, 2019, and 34,477,499 shares at December 31, 2018)	36,696	34,477
Capital surplus	838,543	743,095
Retained earnings	670,816	579,252

Accumulated other comprehensive income/(loss)	17,788	(31,649)
TOTAL STOCKHOLDERS' EQUITY	**1,563,843**	**1,325,175**
TOTAL LIABILITIES AND EQUITY	**$ 12,569,262**	**$ 11,408,006**

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 September 30,		Nine Months Ended September 30,	
	2019	**2018**	**2019**	**2018**
INTEREST INCOME:				
Interest and fees on loans	$ 110,566	$ 105,733	$ 317,049	$ 288,171
Interest on securities:				
Taxable	18,567	14,433	50,566	38,280
Nontaxable	2,119	3,490	7,766	10,653
Interest on federal funds sold	—	—	4	—
Interest on interest bearing deposits in other financial institutions	2,151	1,238	5,742	2,413
TOTAL INTEREST INCOME	**133,403**	**124,894**	**381,127**	**339,517**
INTEREST EXPENSE:				
Interest on deposits	17,982	10,092	47,333	23,841
Interest on short-term borrowings	250	464	1,477	1,279
Interest on other borrowings (includes $24 and $242 of interest expense related to derivatives reclassified from accumulated other comprehensive income for the three months ended September 30, 2019 and 2018, respectively, and $276 and $469 of interest expense related to derivatives reclassified from accumulated other comprehensive income for the nine months ended September 30, 2019 and 2018, respectively)	3,850	3,660	11,333	10,726
TOTAL INTEREST EXPENSE	**22,082**	**14,216**	**60,143**	**35,846**
NET INTEREST INCOME	**111,321**	**110,678**	**320,984**	**303,671**
Provision for loan losses	5,201	5,238	11,754	14,332
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	**106,120**	**105,440**	**309,230**	**289,339**
NONINTEREST INCOME:				
Service charges and fees	12,366	12,895	39,789	35,046
Loan servicing income	821	1,670	3,888	5,231
Trust fees	4,959	4,499	14,258	13,794
Brokerage and insurance commissions	962	1,111	2,724	2,895
Securities gains/(losses), net (includes $2,013 of net security gains and $(145) of net security losses reclassified from accumulated other comprehensive income for the three months ended September 30, 2019 and 2018, respectively and $7,168 and $1,037 of net security gains reclassified from accumulated other comprehensive income for the nine months ended September 30, 2019 and 2018, respectively)	2,013	(145)	7,168	1,037
Unrealized gain on equity securities, net	144	54	514	97
Net gains on sale of loans held for sale	4,673	7,410	12,192	18,261
Valuation allowance on servicing rights	(626)	230	(1,579)	12
Income on bank owned life insurance	881	892	2,668	2,206
Other noninterest income	3,207	1,149	6,556	3,536
TOTAL NONINTEREST INCOME	**29,400**	**29,765**	**88,178**	**82,115**
NONINTEREST EXPENSES:				
Salaries and employee benefits	50,027	49,921	150,307	149,389
Occupancy	6,594	6,348	19,637	18,706
Furniture and equipment	2,858	3,470	8,770	9,403
Professional fees	12,131	12,800	38,478	32,880
Advertising	2,737	2,754	7,723	6,839
Core deposit intangibles and customer relationship intangibles amortization	2,899	2,626	9,054	6,763
Other real estate and loan collection expenses	(89)	784	774	2,464
(Gain)/loss on sales/valuations of assets, net	356	912	(20,934)	2,243
Restructuring expenses	—	—	3,227	2,564
Other noninterest expenses	15,454	12,924	39,259	33,816
TOTAL NONINTEREST EXPENSES	**92,967**	**92,539**	**256,295**	**265,067**
INCOME BEFORE INCOME TAXES	**42,553**	**42,666**	**141,113**	**106,387**
Income taxes (includes $502 and $(26) of income tax expense/(benefit) reclassified from accumulated other comprehensive income for the three months ended September 30, 2019 and 2018, respectively and $1,740 and $174 of income tax expense reclassified from accumulated other comprehensive income for the nine months ended September 30, 2019 and 2018, respectively)	7,941	8,956	29,835	21,530
NET INCOME	**34,612**	**33,710**	**111,278**	**84,857**
Preferred dividends	—	(13)	—	(39)

NET INCOME AVAILABLE TO COMMON STOCKHOLDERS	**$**	**34,612**	**$**	**33,697**	**$**	**111,278**	**$**	**84,818**
EARNINGS PER COMMON SHARE - BASIC	**$**	**0.94**	**$**	**0.98**	**$**	**3.12**	**$**	**2.61**
EARNINGS PER COMMON SHARE - DILUTED	**$**	**0.94**	**$**	**0.97**	**$**	**3.11**	**$**	**2.59**
CASH DIVIDENDS DECLARED PER COMMON SHARE	**$**	**0.18**	**$**	**0.14**	**$**	**0.50**	**$**	**0.40**

See accompanying notes to consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	**2018**	**2019**	**2018**
NET INCOME	**$ 34,612**	**$ 33,710**	**$ 111,278**	**$ 84,857**
OTHER COMPREHENSIVE INCOME/(LOSS)				
Securities:				
Net change in unrealized gain/(loss) on securities	19,851	(8,060)	78,238	(36,395)
Reclassification adjustment for net (gains)/losses realized in net income	(2,013)	145	(7,168)	(1,037)
Income taxes	(4,577)	2,078	(18,241)	9,586
Other comprehensive income/(loss) on securities	13,261	(5,837)	52,829	(27,846)
Derivatives used in cash flow hedging relationships:				
Net change in unrealized gain/(loss) on derivatives	(800)	395	(4,568)	2,991
Reclassification adjustment for net losses on derivatives realized in net income	27	242	279	469
Income taxes	161	(79)	897	(682)
Other comprehensive income/(loss) on cash flow hedges	(612)	558	(3,392)	2,778
Other comprehensive income/(loss)	12,649	(5,279)	49,437	(25,068)
TOTAL COMPREHENSIVE INCOME	**$ 47,261**	**$ 28,431**	**$ 160,715**	**$ 59,789**

See accompanying notes to consolidated financial statements.

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

	Nine Months Ended September 30, 2019	Nine Months Ended September 30, 2018
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 111,278	$ 84,857
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	23,561	22,647
Provision for loan losses	11,754	14,332
Net amortization of premium on securities	15,959	18,958
Securities gains, net	(7,168)	(1,037)
Unrealized gain on equity securities, net	(514)	(97)
Stock based compensation	4,833	3,689
Loans originated for sale	(289,877)	(551,328)
Proceeds on sales of loans held for sale	289,769	594,529
Net gains on sale of loans held for sale	(11,545)	(13,939)
(Increase) decrease in accrued interest receivable	932	(5,422)
(Increase) decrease in prepaid expenses	(3,611)	2,243
Increase in accrued interest payable	1,905	1,121
Gain on extinguishment of debt	(375)	—
Capitalization of servicing rights	(756)	(4,404)
Valuation allowance on servicing rights	1,579	(12)
(Gain)/loss on sales/valuations of assets, net	(10,378)	2,243
Net excess tax benefit from stock based compensation	270	672
Other, net	(40,706)	(1,979)
NET CASH PROVIDED BY OPERATING ACTIVITIES	**96,910**	**167,073**
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of time deposits in other financial institutions	(254)	(1,000)
Proceeds from the sale of securities available for sale	1,485,773	694,872
Proceeds from the redemption of time deposits in other financial institutions	—	8,767
Proceeds from the maturity of and principal paydowns on securities available for sale	265,500	172,702
Proceeds from the maturity of and principal paydowns on securities held to maturity	2,938	13,169
Proceeds from the maturity of and principal paydowns on time deposits in other financial institutions	1,215	5,829
Proceeds from the sale, maturity of and principal paydowns on other investments	10,297	2,038
Purchase of securities available for sale	(1,984,228)	(940,607)
Purchase of other investments	(4,957)	(2,411)
Net increase in loans	(47,023)	(13,737)
Purchase of bank owned life insurance policies	(16)	(2,000)
Proceeds from bank owned life insurance policies	421	—
Proceeds from sale of mortgage servicing rights	33,823	—
Capital expenditures	(8,389)	(11,793)
Net cash and cash equivalents received in acquisitions	38,650	212,197
Proceeds from the sale of equipment	1,277	998
Net cash expended in divestitures	(49,264)	—
Proceeds on sale of OREO and other repossessed assets	6,907	3,128
NET CASH PROVIDED (USED) BY INVESTING ACTIVITIES	**$ (247,330)**	**$ 142,152**

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

	Nine Months Ended September 30,	
	2019	**2018**
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in demand deposits	$ 159,044	$ 156,497
Net increase in savings deposits	347,749	130,704
Net decrease in time deposit accounts	(397)	(122,795)
Proceeds on short-term revolving credit line	—	25,000
Repayments on short-term revolving credit line	—	(25,000)
Net decrease in short-term borrowings	(43,733)	(183,552)
Proceeds from short term FHLB advances	430,888	355,602
Repayments of short term FHLB advances	(531,725)	(365,602)
Proceeds from other borrowings	50	30,131
Repayments of other borrowings	(17,769)	(56,221)
Payment for the redemption of debt	(2,125)	—
Purchase of treasury stock	—	(97)
Proceeds from issuance of common stock	576	286
Dividends paid	(18,001)	(12,806)
NET CASH PROVIDED (USED) BY FINANCING ACTIVITIES	**324,557**	**(67,853)**
Net increase in cash and cash equivalents	174,137	241,372
Cash and cash equivalents at beginning of year	273,630	196,003
CASH AND CASH EQUIVALENTS AT END OF PERIOD	**$ 447,767**	**$ 437,375**
Supplemental disclosures:		
Cash paid for income/franchise taxes	$ 30,523	$ 14,754
Cash paid for interest	$ 58,297	$ 34,725
Loans transferred to OREO	$ 7,421	$ 5,016
Transfer of premises from premises, furniture and equipment, net, to premises, furniture and equipment held for sale	$ 2,568	$ 3,415
Transfer of premises from premises, furniture and equipment held for sale to premises, furniture and equipment, net,	$ 1,564	$ —
Deposits transferred to held for sale	$ 76,968	$ 50,312
Loans transferred to held for sale	$ 32,111	$ 31,379
Securities transferred from held to maturity to available for sale	$ 148,030	$ —
Purchases of securities available for sale, accrued, not settled	$ 22,879	$ 3,481
Conversion of Series D preferred stock to common stock	$ —	$ 938
Stock consideration granted for acquisitions	$ 92,258	$ 238,075

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 June 30, 2018	**$ 938**	**$ 34,438**	**$ 740,128**	**$ 524,786**	**$ (44,543)**	**$ —**	**$ 1,255,747**
Comprehensive income				33,710	(5,279)		28,431
Cash dividends declared:							
Series D Preferred, $17.50 per share				(13)			(13)
Common, $0.14 per share				(4,821)			(4,821)
Conversion of Series D Preferred Stock	(938)						(938)
Issuance of 34,584 shares of common stock		35	1,033				1,068
Stock based compensation			919				919
Balance at September 30, 2018	**$ —**	**$ 34,473**	**$ 742,080**	**$ 553,662**	**$ (49,822)**	**$ —**	**$ 1,280,393**
Balance at January 1, 2018	**$ 938**	**$ 29,953**	**$ 503,709**	**$ 481,331**	**$ (24,474)**	**$ —**	**$ 991,457**
Comprehensive income				84,857	(25,068)		59,789
Reclassification of unrealized net gain on equity securities				280	(280)		—
Cash dividends declared:							
Series D Preferred, $52.50 per share				(39)			(39)
Common, $0.40 per share				(12,767)			(12,767)
Conversion of Series D Preferred Stock	(938)						(938)
Purchase of 1,761 shares of common stock						(97)	(97)
Issuance of 4,521,434 shares of common stock		4,520	234,682			97	239,299
Stock based compensation			3,689				3,689
Balance at September 30, 2018	**$ —**	**$ 34,473**	**$ 742,080**	**$ 553,662**	**$ (49,822)**	**$ —**	**$ 1,280,393**
Balance at June 30, 2019	**$ —**	**$ 36,690**	**$ 837,150**	**$ 642,808**	**$ 5,139**	**$ —**	**$ 1,521,787**
Comprehensive income				$ 34,612	$ 12,649		47,261
Cash dividends declared:							
Common, $0.18 per share				(6,604)			(6,604)
Issuance of 6,129 shares of common stock		6	162				168
Stock based compensation			1,231				1,231
Balance at September 30, 2019	**$ —**	**$ 36,696**	**$ 838,543**	**$ 670,816**	**$ 17,788**	**$ —**	**$ 1,563,843**
Balance at January 1, 2019	**$ —**	**$ 34,477**	**$ 743,095**	**$ 579,252**	**$ (31,649)**	**$ —**	**$ 1,325,175**
Comprehensive income				111,278	49,437		160,715
Retained earnings adjustment for adoption of leasing standard				(1,713)			(1,713)
Cash dividends declared:							
Common, $0.50 per share				(18,001)			(18,001)
Issuance of 2,218,691 shares of common stock		2,219	90,615				92,834
Stock based compensation			4,833				4,833
Balance at September 30, 2019	**$ —**	**$ 36,696**	**$ 838,543**	**$ 670,816**	**$ 17,788**	**$ —**	**$ 1,563,843**

See accompanying 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, 2018, included in the Form 10-K of Heartland Financial USA, Inc. ("Heartland") filed with the Securities and Exchange Commission ("SEC") on February 27, 2019. Footnote disclosures to the interim unaudited consolidated financial statements which would substantially duplicate the disclosure contained in the footnotes to 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 September 30, 2019, are not necessarily indicative of the results expected for the year ending December 31, 2019.

Earnings Per Share

Basic earnings per share is determined using net income available to common stockholders and weighted average common shares outstanding. Diluted earnings per share is computed by dividing net income available to common stockholders by the weighted average common shares and assumed incremental common shares issued. Amounts used in the determination of basic and diluted earnings per share for the three- and nine-month periods ended September 30, 2019, and 2018, are shown in the table below:

	Three Months Ended September 30,	
(Dollars and number of shares in thousands, except per share data)	2019	2018
Net income	$ 34,612	$ 33,710
Preferred dividends	—	(13)
Net income available to common stockholders	$ 34,612	$ 33,697
Weighted average common shares outstanding for basic earnings per share	36,692	34,452
Assumed incremental common shares issued upon vesting of outstanding restricted stock units	143	192
Weighted average common shares for diluted earnings per share	36,835	34,644
Earnings per common share — basic	$ 0.94	$ 0.98
Earnings per common share — diluted	$ 0.94	$ 0.97
Number of antidilutive common stock equivalents excluded from diluted earnings per share computation	8	—

	Nine Months Ended September 30,	
(Dollars and number of shares in thousands, except per share data)	2019	2018
Net income	$ 111,278	$ 84,857
Preferred dividends	—	(39)
Net income available to common stockholders	$ 111,278	$ 84,818
Weighted average common shares outstanding for basic earnings per share	35,675	32,520
Assumed incremental common shares issued upon vesting of outstanding restricted stock units	143	187
Weighted average common shares for diluted earnings per share	35,818	32,707
Earnings per common share — basic	$ 3.12	$ 2.61
Earnings per common share — diluted	$ 3.11	$ 2.59
Number of antidilutive common stock equivalents excluded from diluted earnings per share computation	8	—

Subsequent Events - Heartland has evaluated subsequent events that may require recognition or disclosure through the filing date of this Quarterly Report on Form 10-Q with the SEC.

Effect of New Financial Accounting Standards

In February 2016, the FASB issued ASU 2016-02, "*Leases (Topic 842)*." Topic 842 requires a lessee to recognize leases on-balance sheet and disclose key information about leasing arrangements. The new standard establishes a right-of-use model (ROU) that requires a lessee to recognize a ROU asset and lease liability on the balance sheet for all leases with a term longer than 12 months. Leases will be classified as financing or operating, with classification affecting the pattern and classification of expense recognition in the income statement. The amendment is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, and is applied on a modified retrospective basis. Heartland leases certain properties and equipment under operating leases that resulted in recognition of lease assets and lease liabilities on the consolidated balance sheets under the ASU; however the majority of Heartland's properties and equipment are owned, not leased. The modified retrospective approach includes a number of optional practical expedients that entities may elect to apply. These practical expedients relate to the identification and classification of leases that commenced before the effective date, initial direct costs for leases that commenced before the effective date, and the ability to use hindsight in evaluating lessee options to extend or terminate a lease or to purchase the underlying asset. Early adoption is permitted. In January 2018, the FASB issued an amendment to provide entities with the optional practical expedient to not evaluate existing or expired land easements that were previously not accounted for as leases under Topic 840. In July 2018, the FASB issued ASU 2018-11, "*Leases - Targeted Improvements*" to provide entities with relief from the costs of implementing certain aspects of the new leasing standard, Specifically, under the amendments in ASU 2018-11, entities may elect not to recast the comparative periods presented when transitioning to the new leasing standard, and lessors may elect not to separate lease and non-lease components when certain conditions are met. The amendments have the same effective date as ASU 2016-02. Heartland adopted the accounting standard on January 1, 2019, on a modified retrospective basis, as required, and has not restated comparative periods. Heartland adopted the practical expedients, which allow for existing leases to be accounted for under previous guidance with the exception of balance sheet recognition for lessees. The adoption of the new standard resulted in the recording of ROU assets and lease liabilities of approximately $25.9 million and $27.6 million, respectively, on January 1, 2019. The difference between the lease assets and lease liabilities, which was $1.7 million, was recorded as an adjustment to retained earnings. The adoption of the standard did not impact Heartland's results of operations or liquidity. See Note 11, "Leases", for more information on Heartland's leases.

In June 2016, the FASB issued ASU 2016-13, "*Financial Instruments - Credit Losses (Topic 326)*." The amendments in this ASU require a financial asset (or a group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial asset(s) to present the net carrying value at the amount expected to be collected on the financial asset. The amendments in this ASU indicate that an entity should not use the length of time a security has been in an unrealized loss position to avoid recording a credit loss. In addition, in determining whether a credit loss exists, the amendments in this ASU also remove the requirements to consider the historical and implied volatility of the fair value of a security and recoveries or declines in fair value after the balance sheet date. The amendment is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. An entity may adopt the amendments earlier as of the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Heartland intends to adopt the accounting standard in 2020, as required. In April 2019, the FASB also issued ASU 2019-04, *"Codification Improvements to Topic 326, Financial Instruments - Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments."* As it relates to current expected credit losses, this guidance amends certain provisions contained in ASU 2016-13, particularly with regards to the inclusion of accrued interest in the definition of amortized cost, as well as clarifying the extension and renewal options that are not unconditionally cancelable by the entity that are included in the original or modified contract should be considered in the entity's determination of expected credit losses. Upon adoption of ASU 2016-13, a cumulative-effect adjustment to retained earnings will be recorded as of the beginning of the first reporting period in which the guidance is effective. Heartland formed an internal committee to assess and implement the standard. During 2018, Heartland entered into an agreement with a third party vendor for consulting services and a technology solution. The technology solution implementation has been completed, and Heartland has produced two parallel runs for the first two quarters of 2019 excluding economic forecasting to estimate the impact of this new guidance.

Prior to the end of 2019, management will continue to prepare parallel calculations to compare the existing allowance for loan losses to this new guidance. Additionally, management expects to complete data validation and documentation of the accounting policies and internal controls related to the standard. Heartland has also entered into an agreement to have its new model validated by a third party prior to January 1, 2020. Further review and refinement of the economic forecasting, as well as the model and methodologies, will continue in preparation for the adoption of the standard on January 1, 2020.

In January 2017, the FASB issued ASU 2017-04, *"Intangibles - Goodwill and Other (Topic 350)."* This amendment is to simplify the subsequent measurement of goodwill by eliminating step two from the goodwill impairment test. Instead, an entity will perform only step one of its quantitative goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount, and then recognizing the impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized cannot exceed the total amount of goodwill allocated to that reporting unit. An entity will still have the option to perform a qualitative assessment for a reporting unit to determine if the quantitative step one impairment test is necessary. This amendment is effective for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2019, and should be applied prospectively. Early adoption is permitted, including in an interim period for impairment tests performed after January 1, 2017. Heartland intends to adopt this ASU in the third quarter of 2020, consistent with the annual impairment test as of September 30, 2020, and is currently evaluating the potential impact of this guidance on its results of operations, financial position and liquidity.

In March 2017, the FASB issued ASU 2017-08, *"Receivables - Nonrefundable Fee and Other Costs (Subtopic 310-20)."* These amendments shorten the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount. Discounts continue to be amortized to maturity. These amendments are effective for public business entities for fiscal years and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted, including adoption in an interim period. If any entity early adopts the amendments in an interim period, any adjustments must be reflected as of the beginning of the fiscal year that includes the interim period. The amendments must be applied and Heartland intends to apply these amendments on a modified retrospective basis, with a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. Heartland adopted this ASU on January 1, 2019, as required, and the adoption did not have a material impact on its results of operations, financial position and liquidity.

In August 2017, the FASB issued ASU 2017-12, "*Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities*." The purpose of this updated guidance is to better align a company's financial reporting for hedging activities with the economic objectives of those activities. ASU 2017-12 is effective for public business entities for fiscal years beginning after December 15, 2018, with early adoption, including adoption in an interim period, permitted. For a closed portfolio of prepayable financial assets or one or more beneficial interests secured by a portfolio of prepayable financial instruments, this ASU permits an entity to designate an amount that is not expected to be affected by prepayments, defaults, and other events affecting the timing and amount of cash flows (the "last-of-layer" method). Under this designation, prepayment risk is not incorporated into the measurement of the hedged item. ASU 2017-12 requires a modified retrospective transition method in which Heartland will recognize the cumulative effect of the change on the opening balance of each affected component of equity on the balance sheet as of the date of adoption. Heartland adopted this ASU on January 1, 2019, as required, and as a result of the adoption, $148.0 million of held to maturity securities were reclassified to available for sale debt securities carried at fair value. See Note 3, "Securities," for further details. There was no impact to Heartland's results of operations, or liquidity as a result of the adoption of this amendment.

In August 2018, the FASB issued ASU 2018-13, "*Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement.*" This ASU eliminates, adds and modifies certain disclosure requirements for fair value measurements. Among the changes, entities will no longer be required to disclose the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy but will be required to disclose the range and weighted average used to develop significant unobservable inputs for Level 3 fair value measurements. ASU 2018-13 is effective for interim and annual reporting periods beginning after December 15, 2019, and early adoption is permitted. Heartland intends to adopt this ASU in 2020, as required, and because the ASU only revises disclosure requirements, the adoption of this ASU is not expected to have a material impact on results of operations, financial position and liquidity.

In August 2018, the FASB issued ASU 2018-15, *"Intangible-Goodwill and Other-Internal Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement that is a Service Contract."* The amendment aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. The amendments in this update require an entity in a hosting arrangement that is a service contract to follow the guidance in Subtopic 350-40 to determine which implementation costs to capitalize as an asset related to the service contract and which costs to expense. The amendments also require the entity to expense the capitalized implementation costs of a hosting arrangement that is a service contract over the term of the hosting arrangement. The amendment is effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years, and the amendment can be applied either retrospectively or prospectively to all implementation costs incurred after the date of adoption. Early adoption was permitted. Heartland early adopted this ASU using the prospective approach in the second quarter of 2019, and the adoption did not have a material impact on its results of operations, financial position and liquidity.

In October 2018, the FASB issued ASU 2018-16, "*Derivatives and Hedging (Topic 815): Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting."* In the United States, eligible benchmark interest rates under Topic 815 are interest rates on direct Treasury obligations of the U.S. government ("UST"), the London Interbank Offered Rate ("LIBOR") swap rate, and the Overnight Index Swap ("OIS") Rate based on the Fed Funds Effective Rate. When the FASB issued ASU 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*, in August 2017, it introduced the Securities Industry and Financial Markets Association ("SIFMA") Municipal Swap Rate as the fourth permissible U.S. benchmark rate. The new ASU adds the OIS rate based on the Secured Overnight Financing Rate ("SOFR") as a U.S. benchmark interest rate to facilitate the LIBOR to SOFR transition and provide sufficient lead time for entities to prepare for changes to interest rate risk hedging strategies for both risk management and hedge accounting purposes. The amendments in this update became effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years and the financial statement impact immediately upon adoption was immaterial. The future financial statement impact will depend on any new contracts entered into using new benchmark rates, as well as any existing contracts that get migrated from LIBOR to new benchmark interest rates. Heartland is currently evaluating the impact of the transition from LIBOR as an interest rate benchmark to other potential alternative reference rates, including but not limited to the SOFR. Currently, Heartland has adjustable rate loans, several debt obligations and derivative instruments in place that reference LIBOR-based rates. The transition from LIBOR is estimated to take place at the end of 2021, and management will continue to actively assess the related opportunities and risks involved in this transition.

NOTE 2: ACQUISITIONS

Rockford Bank and Trust Company

On August 13, 2019, Heartland's Illinois Bank & Trust subsidiary entered into a purchase and assumption agreement to acquire substantially all of the assets and substantially all of the deposits and certain other liabilities of Rockford Bank and Trust Company ("RB&T"), headquartered in Rockford, Illinois. RB&T is a wholly-owned subsidiary of Moline, Illinois-based QCR Holdings, Inc. As of September 30, 2019, RB&T had total assets of $519.5 million, which included $417.3 million of gross loans held to maturity, and $451.5 million of deposits. RB&T serves the Rockford market from two full-service banking locations. The all-cash transaction is subject to regulatory approval and to customary closing conditions and is expected to close in the fourth quarter of 2019. The systems conversion is expected to occur in the first quarter of 2020.

Blue Valley Ban Corp.

On May 10, 2019, Heartland completed the acquisition of Blue Valley Ban Corp. ("BVBC") and its wholly-owned subsidiary, Bank of Blue Valley, headquartered in Overland Park, Kansas. Based on Heartland's closing common stock price of $44.78 per share on May 10, 2019, the aggregate consideration paid to BVBC common shareholders was $92.3 million, which was paid by delivery of 2,060,258 shares of Heartland common stock. On the closing date, in addition to this merger consideration, Heartland provided BVBC the funds necessary to repay outstanding debt of $6.9 million, and Heartland assumed $16.1 million of trust preferred securities at fair value. Immediately following the closing of the transaction, Bank of Blue Valley was merged with and into Heartland's wholly-owned Kansas subsidiary, Morrill & Janes Bank and Trust Company, and the combined entity operates under the Bank of Blue Valley brand. As of the closing date, BVBC had, at fair value, total assets of $766.2 million, total loans held to maturity of $542.0 million, and total deposits of $617.1 million. The transaction was a tax-free reorganization with respect to the stock consideration received by the stockholders of BVBC.

First Bank Lubbock Bancshares, Inc.

On May 18, 2018, Heartland completed the acquisition of Lubbock, Texas based First Bank Lubbock Bancshares, Inc. ("FBLB"), parent company of First Bank & Trust, and PrimeWest Mortgage Corporation, which is a wholly-owned subsidiary of First Bank & Trust. Under the terms of the definitive merger agreement, Heartland acquired FBLB in a transaction valued at approximately $189.9 million, of which $5.5 million was cash, and the remainder was settled by delivery of 3,350,664 shares of Heartland common stock. On the closing date, in addition to this merger consideration, Heartland provided FBLB the funds necessary to repay outstanding debt of $3.9 million, and Heartland assumed $8.2 million of trust preferred securities at fair value. Immediately after the close of the transaction, Heartland paid $13.3 million to the holders of FBLB's stock appreciation rights. The transaction included, at fair value, total assets of $1.12 billion, including $681.1 million of gross loans held to maturity, and deposits of $893.8 million. Upon closing of the transaction, First Bank & Trust became a wholly-owned subsidiary of Heartland and continues to operate under its current name and management team as Heartland's eleventh state-chartered bank. The transaction was a tax-free reorganization with respect to the stock consideration received by the stockholders of FBLB.

Signature Bancshares, Inc.

On February 23, 2018, Heartland completed the acquisition of Signature Bancshares, Inc., parent company of Signature Bank, headquartered in Minnetonka, Minnesota. Under the terms of the definitive merger agreement, Heartland acquired Signature Bancshares, Inc. in a transaction valued at approximately $61.4 million, of which $7.8 million was cash, and the remainder was settled by delivery of 1,000,843 shares of Heartland common stock. Simultaneous with the close, Signature Bank merged into Heartland's wholly-owned Minnesota Bank & Trust subsidiary, and the combined entity operates under the Minnesota Bank & Trust brand name. The transaction included, at fair value, total assets of $427.1 million, including $324.5 million of gross loans held to maturity, and deposits of $357.3 million. On the closing date, Heartland provided Signature Bancshares, Inc. the funds necessary to repay outstanding subordinated debt of $5.9 million. The transaction was a tax-free reorganization with respect to the stock consideration received by the stockholders of Signature Bancshares, Inc.

NOTE 3: SECURITIES

The amortized cost, gross unrealized gains and losses, and estimated fair values of debt securities available for sale and equity securities with a readily determinable fair value that are carried at fair value as of September 30, 2019, and December 31, 2018, are summarized in the table below, in thousands:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
September 30, 2019				
U.S. government corporations and agencies	$ 8,900	$ 50	$ —	$ 8,950
Mortgage and asset-backed securities	2,465,561	28,381	(13,265)	2,480,677
Obligations of states and political subdivisions	500,222	13,915	(1,558)	512,579
Total debt securities	2,974,683	42,346	(14,823)	3,002,206
Equity securities with a readily determinable fair value	18,362	—	—	18,362
Total	$ 2,993,045	$ 42,346	$ (14,823)	$ 3,020,568
December 31, 2018				
U.S. government corporations and agencies	$ 32,075	$ 3	$ (127)	$ 31,951
Mortgage and asset-backed securities	2,061,358	3,740	(38,400)	2,026,698
Obligations of states and political subdivisions	382,101	919	(8,046)	374,974
Total debt securities	2,475,534	4,662	(46,573)	2,433,623
Equity securities with a readily determinable fair value	17,086	—	—	17,086
Total	$ 2,492,620	$ 4,662	$ (46,573)	$ 2,450,709

On January 1, 2019, Heartland adopted ASU 2017-12, and as a result of the adoption, $148.0 million of held to maturity debt securities were transferred to debt securities available for sale. The securities were transferred at book value on the date of the transfer.

The amortized cost, gross unrealized gains and losses and estimated fair values of held to maturity securities as of September 30, 2019, and December 31, 2018, are summarized in the table below, in thousands:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
September 30, 2019				
Obligations of states and political subdivisions	$ 87,965	$ 9,940	$ —	$ 97,905
Total	$ 87,965	$ 9,940	$ —	$ 97,905
December 31, 2018				
Obligations of states and political subdivisions	$ 236,283	$ 9,554	$ (496)	$ 245,341
Total	$ 236,283	$ 9,554	$ (496)	$ 245,341

The amortized cost and estimated fair value of investment securities carried at fair value at September 30, 2019, 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.

	September 30, 2019	
	Amortized Cost	Estimated Fair Value
Due in 1 year or less	$ 22,717	$ 22,750
Due in 1 to 5 years	23,369	23,725
Due in 5 to 10 years	76,723	79,411
Due after 10 years	386,313	395,643
Total debt securities	509,122	521,529
Mortgage and asset-backed securities	2,465,561	2,480,677
Equity securities with a readily determinable fair value	18,362	18,362
Total investment securities	$ 2,993,045	$ 3,020,568

The amortized cost and estimated fair value of debt securities held to maturity at September 30, 2019, 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.

	September 30, 2019	
	Amortized Cost	Estimated Fair Value
Due in 1 year or less	$ 2,403	$ 2,443
Due in 1 to 5 years	15,153	15,690
Due in 5 to 10 years	58,936	64,695
Due after 10 years	11,473	15,077
Total investment securities	$ 87,965	$ 97,905

As of September 30, 2019, and December 31, 2018, securities with a fair value of $431.5 million and $524.8 million, respectively, were pledged to secure public and trust deposits, short-term borrowings and for other purposes as required or permitted by law.

Gross gains and losses realized related to the sales of securities carried at fair value for the three- and nine-month periods ended September 30, 2019 and 2018, are summarized as follows, in thousands:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Proceeds from sales	$ 290,877	$ 59,137	$ 1,485,773	$ 694,872
Gross security gains	2,371	67	10,301	3,537
Gross security losses	358	212	3,133	2,500

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 September 30, 2019, and December 31, 2018. 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 months or more. The reference point for determining how long an investment was in an unrealized loss position was September 30, 2018, and December 31, 2017, respectively. Securities for which Heartland has taken credit-related other-than-temporary impairment ("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.

Debt 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
September 30, 2019						
U.S. government corporations and agencies	$ —	$ —	$ —	$ —	$ —	$ —
Mortgage and asset-backed securities	976,443	(7,689)	255,827	(5,576)	1,232,270	(13,265)
Obligations of states and political subdivisions	118,741	(1,525)	2,139	(33)	120,880	(1,558)
Total temporarily impaired securities	$ 1,095,184	$ (9,214)	$ 257,966	$ (5,609)	$ 1,353,150	$ (14,823)
December 31, 2018						
U.S. government corporations and agencies	$ 24,902	$ (83)	$ 4,577	$ (44)	$ 29,479	$ (127)
Mortgage and asset-backed securities	733,826	(9,060)	805,089	(29,340)	1,538,915	(38,400)
Obligations of states and political subdivisions	34,990	(390)	258,143	(7,656)	293,133	(8,046)
Total temporarily impaired securities	$ 793,718	$ (9,533)	$ 1,067,809	$ (37,040)	$ 1,861,527	$ (46,573)

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
September 30, 2019						
Obligations of states and political subdivisions	$ —	$ —	$ —	$ —	$ —	$ —
Total temporarily impaired securities	$ —	$ —	$ —	$ —	$ —	$ —
December 31, 2018						
Obligations of states and political subdivisions	$ 10,802	$ (17)	$ 19,508	$ (479)	$ 30,310	$ (496)
Total temporarily impaired securities	$ 10,802	$ (17)	$ 19,508	$ (479)	$ 30,310	$ (496)

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.

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

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

There were no gross realized gains or losses on the sale of securities carried at fair value or held to maturity securities with OTTI write-downs for the nine-month periods ended September 30, 2019, and September 30, 2018, respectively.

Other investments, at cost, include equity securities without a readily determinable fair value, which totaled $29.0 million and $28.4 million at September 30, 2019, and December 31, 2018, respectively. At September 30, 2019, and December 31, 2018, other investments at cost included shares of stock in the Federal Home Loan Banks (the "FHLBs") of Des Moines, Chicago, Dallas, San Francisco and Topeka at an amortized cost of $14.9 million and $16.6 million, respectively.

The Heartland banks are required by federal law to maintain FHLB stock as members of the various FHLBs. These equity securities are "restricted" in that they can only be sold back to the respective institutions from which they were acquired or another member institution at par. Therefore, the FHLB stock is less liquid than other marketable equity securities, and the fair value approximates amortized cost. Heartland considers its FHLB stock as a long-term investment that provides access to competitive products and liquidity. Heartland evaluates impairment in these investments based on the ultimate recoverability of the par value and, at September 30, 2019, did not consider the investments to be other than temporarily impaired.

NOTE 4: LOANS

Loans as of September 30, 2019, and December 31, 2018, were as follows, in thousands:

	September 30, 2019	December 31, 2018
Loans receivable held to maturity:		
Commercial	$ 2,276,916	$ 2,020,231
Commercial real estate	4,116,680	3,711,481
Agricultural and agricultural real estate	545,006	565,408
Residential real estate	589,793	673,603
Consumer	447,718	440,158
Gross loans receivable held to maturity	7,976,113	7,410,881
Unearned discount	(833)	(1,624)
Deferred loan fees	(3,672)	(1,560)
Total net loans receivable held to maturity	7,971,608	7,407,697
Allowance for loan losses	(66,222)	(61,963)
Loans receivable, net	$ 7,905,386	$ 7,345,734

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.

Heartland originates commercial and commercial real estate loans for a wide variety of business purposes, including lines of credit for capital and operating purposes and term loans for real estate and equipment purchases. Agricultural loans provide financing for capital improvements and farm operations, as well as livestock and machinery purchases. Residential mortgage loans are originated for the construction, purchase or refinancing of single family residential properties. Consumer loans include loans for motor vehicles, home improvement, home equity and personal lines of credit.

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

The following table shows the balance in the allowance for loan losses at September 30, 2019, and December 31, 2018, 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 losses during the quarter ended September 30, 2019.

	Allowance For Loan Losses			Gross Loans 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
September 30, 2019						
Commercial	$ 6,124	$ 19,161	$ 25,285	$ 23,355	$ 2,253,561	$ 2,276,916
Commercial real estate	308	29,073	29,381	19,913	4,096,767	4,116,680
Agricultural and agricultural real estate	1,084	4,267	5,351	20,073	524,933	545,006
Residential real estate	123	1,319	1,442	17,552	572,241	589,793
Consumer	475	4,288	4,763	5,100	442,618	447,718
Total	$ 8,114	$ 58,108	$ 66,222	$ 85,993	$ 7,890,120	$ 7,976,113
December 31, 2018						
Commercial	$ 5,733	$ 18,772	$ 24,505	$ 24,202	$ 1,996,029	$ 2,020,231
Commercial real estate	218	25,320	25,538	14,388	3,697,093	3,711,481
Agricultural and agricultural real estate	686	4,267	4,953	15,951	549,457	565,408
Residential real estate	168	1,617	1,785	20,251	653,352	673,603
Consumer	749	4,433	5,182	7,004	433,154	440,158
Total	$ 7,554	$ 54,409	$ 61,963	$ 81,796	$ 7,329,085	$ 7,410,881

The following table presents nonaccrual loans, accruing loans past due 90 days or more and performing troubled debt restructured loans at September 30, 2019, and December 31, 2018, in thousands:

	September 30, 2019	December 31, 2018
Nonaccrual loans	$ 67,924	$ 67,833
Nonaccrual troubled debt restructured loans	4,284	4,110
Total nonaccrual loans	$ 72,208	$ 71,943
Accruing loans past due 90 days or more	$ 40	$ 726
Performing troubled debt restructured loans	$ 3,199	$ 4,026

The following tables provide information on troubled debt restructured loans that were modified during the three- and nine-month periods ended September 30, 2019, and September 30, 2018, dollars in thousands:

	Three Months Ended September 30,					
	2019			2018		
	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	—	—	—	—	—	—
Total commercial and commercial real estate	—	—	—	—	—	—
Agricultural and agricultural real estate	—	—	—	—	—	—
Residential real estate	—	—	—	1	92	94
Consumer	—	—	—	—	—	—
Total	—	$ —	$ —	1	$ 92	$ 94

	Nine Months Ended September 30,					
	2019			2018		
	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	—	—	—	—	—	—
Total commercial and commercial real estate	—	—	—	—	—	—
Agricultural and agricultural real estate	—	—	—	—	—	—
Residential real estate	4	276	288	11	2,098	1,808
Consumer	—	—	—	—	—	—
Total	4	$ 276	$ 288	11	$ 2,098	$ 1,808

The pre-modification and post-modification recorded investment represents amounts as of the date of loan modification. The difference between the pre-modification investment and post-modification investment amounts on Heartland's residential real estate troubled debt restructured loans for the three- and nine-months ended September 30, 2019, is due to principal deferment collected from government guarantees and capitalized interest and escrow. At September 30, 2019, there were no commitments to extend credit to any of the borrowers with an existing troubled debt restructured loan.

The following table shows troubled debt restructured loans for which there was a payment default during the three- and nine-month periods ended September 30, 2019, and September 30, 2018, that had been modified during the twelve-month period prior to default, in thousands:

	With Payment Defaults During the Three Months Ended September 30,			
	2019		2018	
	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment
Commercial	—	$ —	—	$ —
Commercial real estate	—	—	—	—
Total commercial and commercial real estate	—	—	—	—
Agricultural and agricultural real estate	—	—	—	—
Residential real estate	—		4	418
Consumer	—	—	—	—
Total	—	$ —	4	$ 418

	With Payment Defaults During the Nine Months Ended September 30,			
	2019		2018	
	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment
Commercial	—	$ —	—	$ —
Commercial real estate	—	—	—	—
Total commercial and commercial real estate	—	—	—	—
Agricultural and agricultural real estate	—	—	—	—
Residential real estate	3	253	10	1,598
Consumer	—	—	—	—
Total	3	$ 253	10	$ 1,598

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 trends in financial circumstances due to borrower specific or systemic conditions that, if left uncorrected, threaten the borrower's capacity to meet its debt obligations. The borrower is believed to have sufficient financial flexibility to react to and resolve its negative financial situation. These credits are closely monitored for improvement or deterioration. The "substandard" rating is assigned to loans that are inadequately protected by the current net worth and paying capacity of the borrower and that 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 financial 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 in the borrowers' ability to repay the loan 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 as an operating entity. Specific pending events, such as capital injections, liquidations or perfection of liens on additional collateral, may strengthen the credit, thus deferring the rating of the loan as "loss" until the exact status of the loan can be determined. The loss rating is assigned to loans considered uncollectible. Heartland had no loans classified as loss or doubtful as of September 30, 2019. 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 by credit quality indicator at September 30, 2019, and December 31, 2018, in thousands:

	Pass	Nonpass	Total
September 30, 2019			
Commercial	$ 2,125,500	$ 151,416	$ 2,276,916
Commercial real estate	3,864,191	252,489	4,116,680
Total commercial and commercial real estate	5,989,691	403,905	6,393,596
Agricultural and agricultural real estate	426,383	118,623	545,006
Residential real estate	563,603	26,190	589,793
Consumer	435,407	12,311	447,718
Total gross loans receivable held to maturity	$ 7,415,084	$ 561,029	$ 7,976,113
December 31, 2018			
Commercial	$ 1,880,579	$ 139,652	$ 2,020,231
Commercial real estate	3,524,344	187,137	3,711,481
Total commercial and commercial real estate	5,404,923	326,789	5,731,712
Agricultural and agricultural real estate	471,642	93,766	565,408
Residential real estate	645,478	28,125	673,603
Consumer	425,451	14,707	440,158
Total gross loans receivable held to maturity	$ 6,947,494	$ 463,387	$ 7,410,881

The nonpass category in the table above is comprised of approximately 62% special mention loans and 38% substandard loans as of September 30, 2019. The percent of nonpass loans on nonaccrual status as of September 30, 2019, was 13%. As of December 31, 2018, the nonpass category in the table above was comprised of approximately 52% special mention loans and 48% substandard loans. The percent of nonpass loans on nonaccrual status as of December 31, 2018, was 16%. Loans delinquent 30 to 89 days as a percent of total loans were 0.28% at September 30, 2019, compared to 0.21% at December 31, 2018. 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.

As of September 30, 2019, Heartland had $3.3 million of loans secured by residential real estate property that were in the process of foreclosure.

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 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 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 losses. A loan can be restored to accrual status if the borrower has resumed paying the full amount of the scheduled contractual interest and principal payments on the loan, and (1) all principal and interest amounts contractually due (including arrearages) are reasonably assured of repayment within a reasonable period of time, and (2) that there is a sustained period of repayment performance (generally a minimum of six months) by the borrower in accordance with the scheduled contractual terms.

The following table sets forth information regarding Heartland's accruing and nonaccrual loans at September 30, 2019, and December 31, 2018, in thousands:

	Accruing Loans						
	30-59 Days Past Due	**60-89 Days Past Due**	**90 Days or More Past Due**	**Total Past Due**	**Current**	**Nonaccrual**	**Total Loans**
September 30, 2019							
Commercial	$ 5,727	$ 3,376	$ 34	$ 9,137	$ 2,244,365	$ 23,414	$ 2,276,916
Commercial real estate	4,824	1,257	—	6,081	4,097,311	13,288	4,116,680
Total commercial and commercial real estate	10,551	4,633	34	15,218	6,341,676	36,702	6,393,596
Agricultural and agricultural real estate	3,144	24	—	3,168	521,910	19,928	545,006
Residential real estate	1,993	185	—	2,178	576,365	11,250	589,793
Consumer	1,411	537	6	1,954	441,436	4,328	447,718
Total gross loans receivable held to maturity	$ 17,099	$ 5,379	$ 40	$ 22,518	$ 7,881,387	$ 72,208	$ 7,976,113
December 31, 2018							
Commercial	$ 2,574	$ 205	$ —	$ 2,779	$ 1,991,525	$ 25,927	$ 2,020,231
Commercial real estate	4,819	—	726	5,545	3,694,259	11,677	3,711,481
Total commercial and commercial real estate	7,393	205	726	8,324	5,685,784	37,604	5,731,712
Agricultural and agricultural real estate	99	—	—	99	549,376	15,933	565,408
Residential real estate	5,147	49	—	5,196	655,329	13,078	673,603
Consumer	2,724	307	—	3,031	431,799	5,328	440,158
Total gross loans receivable held to maturity	$ 15,363	$ 561	$ 726	$ 16,650	$ 7,322,288	$ 71,943	$ 7,410,881

The majority of Heartland's impaired loans are those that are nonaccrual, are past due 90 days or more and still accruing or have had their terms restructured in a troubled debt restructuring. The following tables present the unpaid principal balance that was contractually due at September 30, 2019, and December 31, 2018, the outstanding loan balance recorded on the consolidated balance sheets at September 30, 2019, and December 31, 2018, any related allowance recorded for those loans as of September 30, 2019, and December 31, 2018, the average outstanding loan balances recorded on the consolidated balance sheets during the three- and nine- months ended September 30, 2019, and year ended December 31, 2018, and the interest income recognized on the impaired loans during the three- and nine-month period ended September 30, 2019, and year ended December 31, 2018, in thousands:

	Unpaid Principal Balance	Loan Balance	Related Allowance Recorded	Quarter-to-Date Avg. Loan Balance	Quarter-to-Date Interest Income Recognized	Year-to-Date Avg. Loan Balance	Year-to-Date Interest Income Recognized
September 30, 2019							
Impaired loans with a related allowance:							
Commercial	$ 11,025	$ 11,015	$ 6,124	$ 11,399	$ —	$ 11,630	$ 9
Commercial real estate	1,751	1,751	308	1,596	6	1,386	17
Total commercial and commercial real estate	12,776	12,766	6,432	12,995	6	13,016	26
Agricultural and agricultural real estate	2,979	2,979	1,084	3,100	17	2,881	17
Residential real estate	999	999	123	1,086	3	1,157	3
Consumer	1,122	1,120	475	1,116	1	1,197	8
Total loans held to maturity	$ 17,876	$ 17,864	$ 8,114	$ 18,297	$ 27	$ 18,251	$ 54
Impaired loans without a related allowance:							
Commercial	$ 14,752	$ 12,340	$ —	$ 13,529	$ 186	$ 12,989	$ 627
Commercial real estate	18,243	18,162	—	18,897	88	16,897	215
Total commercial and commercial real estate	32,995	30,502	—	32,426	274	29,886	842
Agricultural and agricultural real estate	20,137	17,094	—	16,958	12	16,243	45
Residential real estate	16,578	16,553	—	16,612	69	17,362	220
Consumer	3,979	3,980	—	3,897	3	4,314	46
Total loans held to maturity	$ 73,689	$ 68,129	$ —	$ 69,893	$ 358	$ 67,805	$ 1,153
Total impaired loans held to maturity:							
Commercial	$ 25,777	$ 23,355	$ 6,124	$ 24,928	$ 186	$ 24,619	$ 636
Commercial real estate	19,994	19,913	308	20,493	94	18,283	232
Total commercial and commercial real estate	45,771	43,268	6,432	45,421	280	42,902	868
Agricultural and agricultural real estate	23,116	20,073	1,084	20,058	29	19,124	62
Residential real estate	17,577	17,552	123	17,698	72	18,519	223
Consumer	5,101	5,100	475	5,013	4	5,511	54
Total impaired loans held to maturity	$ 91,565	$ 85,993	$ 8,114	$ 88,190	$ 385	$ 86,056	$ 1,207

December 31, 2018	Unpaid Principal Balance	Loan Balance	Related Allowance Recorded	Year-to-Date Avg. Loan Balance	Year-to-Date Interest Income Recognized
Impaired loans with a related allowance:					
Commercial	$ 12,376	$ 12,366	$ 5,733	$ 4,741	$ 33
Commercial real estate	891	891	218	4,421	25
Total commercial and commercial real estate	13,267	13,257	5,951	9,162	58
Agricultural and agricultural real estate	1,718	1,718	686	2,165	2
Residential real estate	647	647	168	1,138	12
Consumer	1,373	1,373	749	2,934	29
Total loans held to maturity	$ 17,005	$ 16,995	$ 7,554	$ 15,399	$ 101
Impaired loans without a related allowance:					
Commercial	$ 13,616	$ 11,836	$ —	$ 10,052	$ 299
Commercial real estate	13,578	13,497	—	13,000	249
Total commercial and commercial real estate	27,194	25,333	—	23,052	548
Agricultural and agricultural real estate	16,836	14,233	—	14,781	5
Residential real estate	19,604	19,604	—	23,950	308
Consumer	5,631	5,631	—	5,117	97
Total loans held to maturity	$ 69,265	$ 64,801	$ —	$ 66,900	$ 958
Total impaired loans held to maturity:					
Commercial	$ 25,992	$ 24,202	$ 5,733	$ 14,793	$ 332
Commercial real estate	14,469	14,388	218	17,421	274
Total commercial and commercial real estate	40,461	38,590	5,951	32,214	606
Agricultural and agricultural real estate	18,554	15,951	686	16,946	7
Residential real estate	20,251	20,251	168	25,088	320
Consumer	7,004	7,004	749	8,051	126
Total impaired loans held to maturity	$ 86,270	$ 81,796	$ 7,554	$ 82,299	$ 1,059

On May 10, 2019, Heartland completed the acquisition of Blue Valley Ban Corp., parent company of Bank of Blue Valley, headquartered in Overland Park, Kansas. As of May 10, 2019, Blue Valley Ban Corp. had gross loans of $558.4 million, and the estimated fair value of the loans acquired was $542.3 million.

On May 18, 2018, Heartland completed the acquisition of First Bank Lubbock Bancshares, Inc., parent company of First Bank & Trust, headquartered in Lubbock, Texas. As of May 18, 2018, First Bank Lubbock Bancshares, Inc. had gross loans of $696.9 million, and the estimated fair value of the loans acquired was $681.1 million.

On February 23, 2018, Heartland acquired Signature Bancshares, Inc., parent company of Signature Bank, based in Minnetonka, Minnesota. As of February 23, 2018, Signature Bancshares, Inc. had gross loans of $335.1 million and the estimated fair value of the loans acquired was $324.5 million.

Heartland uses the acquisition method of accounting for purchased loans in accordance with ASC 805, "*Business Combinations."* Purchased loans acquired in a business combination are recorded at estimated fair value on their purchase date, but the purchaser cannot carry over the related allowance for loan 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 when at the date of the acquisition, it is probable that Heartland will not collect all contractually required principal and interest payments. Evidence of credit quality deterioration at the purchase date includes 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 of the loan will generally result in a provision for loan losses. Subsequent increases in cash flows result in a reversal of the provision for loan 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.

At September 30, 2019, and December 31, 2018, the carrying amount of loans acquired since 2015 consist of purchased impaired and nonimpaired purchased loans as summarized in the following table, in thousands:

	September 30, 2019			December 31, 2018		
	Impaired Purchased Loans	Non Impaired Purchased Loans	Total Purchased Loans	Impaired Purchased Loans	Non Impaired Purchased Loans	Total Purchased Loans
Commercial	$ 6,744	$ 260,192	$ 266,936	$ 3,801	$ 243,693	$ 247,494
Commercial real estate	3,260	1,086,336	1,089,596	158	1,098,171	1,098,329
Agricultural and agricultural real estate	—	9,827	9,827	—	27,115	27,115
Residential real estate	—	157,575	157,575	231	184,389	184,620
Consumer loans	—	85,918	85,918	—	75,773	75,773
Total covered loans	$ 10,004	$ 1,599,848	$ 1,609,852	$ 4,190	$ 1,629,141	$ 1,633,331

Changes in accretable yield on acquired loans with evidence of credit deterioration at the date of acquisition for the three- and nine-month periods ended September 30, 2019, and September 30, 2018, were as follows, in thousands:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Balance at beginning of period	$ (184)	$ 463	$ 227	$ 57
Original yield discount, net, at date of acquisition	—	—	27	508
Accretion	(1,438)	(93)	(2,546)	(943)
Reclassification from nonaccretable difference[(1)]	1,687	186	2,357	934
Balance at period end	$ 65	$ 556	$ 65	$ 556

(1) Represents increases in estimated cash flows expected to be received, primarily due to lower estimated credit losses.

For loans acquired since January 2015, on the acquisition dates the preliminary estimate of the contractually required payments receivable for all loans with evidence of credit deterioration since origination was $44.6 million, and the estimated fair value of these loans was $28.2 million. At September 30, 2019, 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 such collateral, and the timing and amount of the cash flows could not be reasonably estimated. At September 30, 2019, there was $103,000 of allowance recorded and $57,000 of allowance recorded at December 31, 2018, related to these ASC 310-30 loans. Provision expense of $39,000 and $675,000 was recorded for the nine-month periods ended September 30, 2019, and 2018, respectively.

For loans acquired since January 2015, the preliminary estimate on the acquisition dates of the contractually required payments receivable for all nonimpaired loans acquired was $4.22 billion, and the estimated fair value of the loans was $4.12 billion.

NOTE 5: ALLOWANCE FOR LOAN LOSSES

Changes in the allowance for loan losses for the three- and nine-month periods ended September 30, 2019, and September 30, 2018, were as follows, in thousands:

	Commercial	Commercial Real Estate	Agricultural and Agricultural Real Estate	Residential Real Estate	Consumer	Total
Balance at June 30, 2019	$ 24,082	$ 27,300	$ 6,049	$ 1,572	$ 4,847	$ 63,850
Charge-offs	(2,175)	(135)	(1,670)	(3)	(859)	(4,842)
Recoveries	1,273	204	198	25	313	2,013
Provision	2,105	2,012	774	(152)	462	5,201
Balance at September 30, 2019	$ 25,285	$ 29,381	$ 5,351	$ 1,442	$ 4,763	$ 66,222

	Commercial	Commercial Real Estate	Agricultural and Agricultural Real Estate	Residential Real Estate	Consumer	Total
Balance at December 31, 2018	$ 24,505	$ 25,538	$ 4,953	$ 1,785	$ 5,182	$ 61,963
Charge-offs	(6,506)	(295)	(2,098)	(316)	(2,357)	(11,572)
Recoveries	1,642	381	533	72	1,449	4,077
Provision	5,644	3,757	1,963	(99)	489	11,754
Balance at September 30, 2019	$ 25,285	$ 29,381	$ 5,351	$ 1,442	$ 4,763	$ 66,222

	Commercial	Commercial Real Estate	Agricultural and Agricultural Real Estate	Residential Real Estate	Consumer	Total
Balance at June 30, 2018	$ 20,709	$ 23,727	$ 5,709	$ 1,857	$ 9,322	$ 61,324
Charge-offs	(2,945)	(199)	(1,145)	—	(1,831)	(6,120)
Recoveries	158	242	—	1	378	779
Provision	4,147	(80)	2	(8)	1,177	5,238
Balance at September 30, 2018	$ 22,069	$ 23,690	$ 4,566	$ 1,850	$ 9,046	$ 61,221

	Commercial	Commercial Real Estate	Agricultural and Agricultural Real Estate	Residential Real Estate	Consumer	Total
Balance at December 31, 2017	$ 18,098	$ 21,950	$ 4,258	$ 2,224	$ 9,156	$ 55,686
Charge-offs	(4,717)	(761)	(1,357)	(211)	(4,462)	(11,508)
Recoveries	562	1,013	14	77	1,045	2,711
Provision	8,126	1,488	1,651	(240)	3,307	14,332
Balance at September 30, 2018	$ 22,069	$ 23,690	$ 4,566	$ 1,850	$ 9,046	$ 61,221

Management allocates the allowance for loan losses by pools of risk within each loan portfolio. The allocation of the allowance for loan losses by loan portfolio is made for analytical purposes and is not necessarily indicative of the trend of future loan losses in any particular category. The total allowance for loan 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 $427.1 million at September 30, 2019, and $391.7 million at December 31, 2018. Heartland conducts its annual internal assessment of the goodwill both at the consolidated level and at its subsidiaries as of September 30. There was no goodwill impairment as of the most recent assessment.

Heartland recorded $35.4 million of goodwill and $11.4 million of core deposit intangibles in connection with the acquisition of Blue Valley Ban Corp., parent company of Bank of Blue Valley, headquartered in Overland Park, Kansas on May 10, 2019.

Heartland recorded $121.4 million of goodwill and $13.9 million of core deposit intangibles in connection with the acquisition of First Bank Lubbock Bancshares, Inc., parent company of First Bank & Trust Company, headquartered in Lubbock, Texas on May 18, 2018.

Heartland recorded $33.7 million of goodwill and $7.7 million of core deposit intangibles in connection with the acquisition of Signature Bancshares, Inc., parent company of Signature Bank, headquartered in Minnetonka, Minnesota on February 23, 2018.

The core deposit intangibles recorded with the Blue Valley Ban Corp., First Bank Lubbock Bancshares, Inc. and Signature Bancshares, Inc. acquisitions are not deductible for tax purposes and are expected to be amortized over a period of 10 years on an accelerated basis.

Goodwill related to the Blue Valley Ban Corp., First Bank Lubbock Bancshares, Inc., and Signature Bancshares, Inc. acquisitions resulted from expected operational synergies, increased market presence, cross-selling opportunities, and expanded business lines and is not deductible for tax purposes.

Heartland's intangible assets consist of core deposit intangibles, mortgage servicing rights, customer relationship intangibles, and commercial servicing rights. The gross carrying amount of these intangible assets and the associated accumulated amortization at September 30, 2019, and December 31, 2018, are presented in the table below, in thousands:

	September 30, 2019			December 31, 2018		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Amortizing intangible assets:						
Core deposit intangibles	$ 95,033	$ 45,428	$ 49,605	$ 83,640	$ 36,403	$ 47,237
Customer relationship intangibles	1,177	963	214	1,177	935	242
Mortgage servicing rights	7,584	2,562	5,022	42,228	12,865	29,363
Commercial servicing rights	6,936	5,687	1,249	6,834	5,125	1,709
Total	$ 110,730	$ 54,640	$ 56,090	$ 133,879	$ 55,328	$ 78,551

On April 30, 2019, Dubuque Bank and Trust Company closed on the sale of substantially all its servicing rights portfolio, which contained loans with an unpaid principal balance of $3.31 billion to PNC Bank, N.A. The transaction qualified as a sale, and $20.6 million of mortgage servicing rights were de-recognized on the consolidated balance sheet as of June 30, 2019. Cash of approximately $34.8 million was received during the second quarter, and Heartland recorded an estimated gain on the sale of this portfolio of approximately $13.3 million. A payable of approximately $293,000 was recorded as of September 30, 2019, due to the timing of the servicing transfer per the terms of the sale agreement. In the agreement, which includes customary terms and conditions, Dubuque Bank and Trust Company provided interim servicing of the loans until the transfer date, which was August 1, 2019.

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

	Core Deposit Intangibles	Customer Relationship Intangibles	Mortgage Servicing Rights	Commercial Servicing Rights	Total
Three months ending December 31, 2019	$ 2,908	$ 9	$ 472	$ 89	$ 3,478
Year ending December 31,					
2020	10,159	36	1,137	311	11,643
2021	8,462	35	975	275	9,747
2022	6,898	35	813	240	7,986
2023	6,019	34	649	158	6,860
2024	4,945	33	488	86	5,552
Thereafter	10,214	32	488	90	10,824
Total	$ 49,605	$ 214	$ 5,022	$ 1,249	$ 56,090

Projections of amortization expense for mortgage servicing rights are based on existing asset balances and the existing interest rate environment as of September 30, 2019. Heartland's actual experience may be significantly different depending upon changes in mortgage interest rates and market conditions. Mortgage loans serviced for others at First Bank & Trust were approximately $621.5 million at September 30, 2019 compared to $648.9 million at December 31, 2018. Custodial escrow balances maintained in connection with the mortgage loan servicing portfolio at First Bank & Trust were approximately $16.3 million at September 30, 2019 and $5.9 million at December 31, 2018.

Heartland transferred custodial escrow balances totaling $22.9 million to PNC Bank, N.A. in conjunction with the transfer of the mortgage servicing rights portfolio on August 1, 2019. Custodial escrow balances maintained in connection with the mortgage loan servicing portfolio at Dubuque Bank and Trust Company totaled $17.7 million at December 31, 2018.

At September 30, 2019, the fair value of the mortgage servicing rights at First Bank & Trust was estimated at $5.0 million compared to $7.1 million at December 31, 2018.

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 of First Bank & Trust's mortgage servicing rights are considered in the calculation. The average constant prepayment rate was 16.40% for the September 30, 2019 valuation compared to 10.30% for the December 31, 2018 valuation. The discount rate was 9.03% for both September 30, 2019 and December 31, 2018 valuations. The average capitalization rate for the first nine months of 2019 ranged from 80 to 98 basis points compared to a range of 93 to 117 basis points for 2018 since acquisition on May 18, 2018. Fees collected for the servicing of mortgage loans for others were $422,000 and $2.6 million for the quarters ended September 30, 2019 and September 30, 2018, respectively, and $1.3 million and $7.3 million for the nine-months ended September 30, 2019 and September 30, 2018.

The following table summarizes, in thousands, the changes in capitalized mortgage servicing rights for the nine months ended September 30, 2019, and September 30, 2018:

	2019	2018
Balance at January 1,	$ 29,363	$ 23,248
Originations	654	4,322
Amortization	(2,867)	(4,394)
Sale of mortgage servicing rights	(20,556)	—
Acquired mortgage servicing rights	—	6,995
Valuation allowance	(1,572)	—
Balance at period end	$ 5,022	$ 30,171
Mortgage servicing rights, net to servicing portfolio	0.81 %	0.73 %

Heartland's commercial servicing portfolio is comprised of loans guaranteed by the Small Business Administration and United States Department of Agriculture that have been sold with servicing retained by Heartland, which totaled $87.0 million at

September 30, 2019 and $107.4 million at December 31, 2018. The commercial servicing rights portfolio is separated into two tranches at the respective Heartland subsidiary, loans with a term of less than 20 years and loans with a term of more than 20 years. Fees collected for the servicing of commercial loans for others were $216,000 and $401,000 for the quarter ended September 30, 2019 and September 30, 2018, respectively, and $826,000 and $1.2 million for the nine-months ended September 30, 2019, and September 30, 2018, respectively.

The fair value of each commercial servicing rights portfolio is calculated based upon a discounted cash flow analysis. Cash flow assumptions, including prepayment speeds and servicing costs, are considered in the calculation. The range of average constant prepayment rates for the valuations was 13.11% to 16.60% as of September 30, 2019, compared to 11.01% to 13.50% as of December 31, 2018. The discount rate range was 9.77% to 14.41% for the September 30, 2019, valuations compared to 13.44% to 16.96% for the December 31, 2018, valuations. The capitalization rate for both 2019 and 2018 ranged from 310 to 445 basis points. The total fair value of Heartland's commercial servicing rights was estimated at $1.8 million as of September 30, 2019, and $2.1 million as of December 31, 2018.

The following table summarizes, in thousands, the changes in capitalized commercial servicing rights for the nine-months ended September 30, 2019, and September 30, 2018:

	2019	2018
Balance at January 1,	$ 1,709	$ 2,609
Originations	102	82
Amortization	(555)	(835)
Valuation allowance on commercial servicing rights	(7)	12
Balance at period end	$ 1,249	$ 1,868
Fair value of commercial servicing rights	$ 1,827	$ 2,529
Commercial servicing rights, net to servicing portfolio	1.44 %	1.63 %

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 at each Heartland subsidiary based upon the fair value of the assets as compared to the carrying amount. Impairment is recognized through a valuation allowance for specific tranches to the extent that fair value is less than carrying amount at each Heartland subsidiary. At September 30, 2019, a $1.6 million valuation allowance was required on mortgage servicing rights and at December 31, 2018, a $58,000 valuation allowance was required on mortgage servicing rights. At September 30, 2019, a $7,000 valuation allowance was required on commercial servicing rights with a term less than 20 years and no valuation allowance was required on commercial servicing rights with a term greater than 20 years. At December 31, 2018, no valuation allowance was required on commercial servicing rights with a term less than 20 years and no valuation allowance was required on commercial servicing rights with a term greater than 20 years.

The following table summarizes, in thousands, the book value, the fair value of each tranche of the mortgage servicing rights and any recorded valuation allowance at each respective subsidiary at September 30, 2019, and December 31, 2018:

September 30, 2019	Book Value 15-Year Tranche	Fair Value 15-Year Tranche	Impairment 15-Year Tranche	Book Value 30-Year Tranche	Fair Value 30-Year Tranche	Impairment 30-Year Tranche
Dubuque Bank and Trust Company	$ —	$ —	$ —	$ —	$ —	$ —
First Bank & Trust	1,511	1,267	244	5,140	3,755	1,385
Total	$ 1,511	$ 1,267	$ 244	$ 5,140	$ 3,755	$ 1,385
December 31, 2018						
Dubuque Bank and Trust Company	$ 2,195	$ 4,636	$ —	$ 20,025	$ 36,901	$ —
First Bank & Trust	1,685	1,665	20	5,516	5,478	38
Total	$ 3,880	$ 6,301	$ 20	$ 25,541	$ 42,379	$ 38

The following table summarizes, in thousands, the book value, the fair value of each tranche of the commercial servicing rights and any recorded valuation allowance at each respective subsidiary at September 30, 2019, and December 31, 2018:

September 30, 2019	Book Value Less than 20 Years	Fair Value Less than 20 Years	Impairment Less than 20 Years	Book Value More than 20 Years	Fair Value More than 20 Years	Impairment More than 20 Years
Citywide Banks	$ —	$ —	$ —	$ —	$ —	$ —
Premier Valley Bank	24	17	7	149	167	—
Wisconsin Bank & Trust	155	331	—	928	1,311	—
Total	$ 179	$ 348	$ 7	$ 1,077	$ 1,478	$ —
December 31, 2018						
Citywide Banks	$ 1	$ 6	$ —	$ 18	$ 20	$ —
Premier Valley Bank	45	74	—	178	184	—
Wisconsin Bank & Trust	249	411	—	1,218	1,439	—
Total	$ 295	$ 491	$ —	$ 1,414	$ 1,643	$ —

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, 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. In addition, Heartland is facilitating back-to-back loan swaps to assist customers in managing interest rate risk. 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 counterparties that meet Heartland's credit standards, and the contracts contain collateral provisions protecting the at-risk party. 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 $2.2 million cash as collateral at September 30, 2019 compared to no collateral at December 31, 2018. At September 30, 2019, no collateral was required to be pledged by Heartland's counterparties, compared to $770,000 collateral at December 31, 2018.

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 related to derivatives will be reclassified to interest expense as interest payments are received or made on Heartland's variable-rate liabilities. For the nine months ended September 30, 2019, 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 $299,000. For the next twelve months, Heartland estimates that cash receipts and reclassification from accumulated other comprehensive income to reduce interest expense will total $134,000.

Heartland entered into six forward starting interest rate swap transactions to effectively convert Heartland Financial Statutory Trust IV, V, VI, and VII, which total $85.0 million, as well as Morrill Statutory Trust I and II, which total $20.0 million, from variable rate subordinated debentures to fixed rate debt. For accounting purposes, these six swap transactions are designated as cash flow hedges of the changes in LIBOR, the benchmark interest rate being hedged, associated with the interest payments made on $105.0 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 2019, the interest rate swap transactions associated with Morrill Statutory Trust I and II, totaling $20.0 million, matured and the fixed rate debt has been converted to variable rate subordinated debentures.

On May 18, 2018, Heartland acquired cash flow hedges related to OCGI Statutory Trust III and OCGI Capital Trust IV with notional amounts of $3.0 million and $6.0 million, respectively, in the First Bank Lubbock Bancshares, Inc. transaction. The cash flow hedges effectively convert OCGI Statutory Trust III and OGCI Capital Trust IV from variable rate subordinated debentures to fixed rate debt. These swaps are designated as cash flow hedges of the changes in LIBOR, the benchmark interest rate being hedged, associated with the interest payments made on $9.0 million of Heartland's subordinated debentures that reset quarterly on a specified reset date.

The table below identifies the balance sheet category and fair values of Heartland's derivative instruments designated as cash flow hedges at September 30, 2019, and December 31, 2018, in thousands:

	Notional Amount	Fair Value	Balance Sheet Category	Receive Rate	Weighted Average Pay Rate	Maturity
September 30, 2019						
Interest rate swap	$ 25,000	$ (202)	Other liabilities	2.139 %	2.255 %	03/17/2021
Interest rate swap	20,000	(119)	Other liabilities	2.303	3.355	01/07/2020
Interest rate swap	26,667	154	Other assets	4.549	3.674	05/10/2021
Interest rate swap	26,500	(1,726)	Other liabilities	4.537	5.425	07/24/2028
Interest rate swap	20,000	(828)	Other liabilities	2.119	2.390	06/15/2024
Interest rate swap	20,000	(754)	Other liabilities	2.138	2.352	03/01/2024
Interest rate swap	6,000	(21)	Other liabilities	2.119	1.866	06/15/2021
Interest rate swap	3,000	(13)	Other liabilities	2.303	1.878	06/30/2021
December 31, 2018						
Interest rate swap	$ 25,000	$ 191	Other assets	2.788 %	2.255 %	03/17/2021
Interest rate swap	20,000	(177)	Other liabilities	2.408	3.355	01/07/2020
Interest rate swap	10,000	29	Other assets	2.822	1.674	03/26/2019
Interest rate swap	10,000	28	Other assets	2.788	1.658	03/18/2019
Interest rate swap	29,667	763	Other assets	4.887	3.674	05/10/2021
Interest rate swap	28,750	(572)	Other liabilities	5.004	5.425	07/24/2028
Interest rate swap	20,000	157	Other assets	2.788	2.390	06/15/2024
Interest rate swap	20,000	185	Other assets	2.738	2.352	03/01/2024
Interest rate swap	6,000	105	Other Assets	2.788	1.866	06/15/2021
Interest rate swap	3,000	51	Other assets	2.787	1.878	06/30/2021

The table below identifies the gains and losses recognized on Heartland's derivative instruments designated as cash flow hedges for the three- and nine-month periods ended September 30, 2019, and September 30, 2018, in thousands:

	Effective Portion			Ineffective Portion	
	Recognized in OCI	Reclassified from AOCI into Income		Recognized in Income on Derivatives	
	Amount of Gain (Loss)	Category	Amount of Gain (Loss)	Category	Amount of Gain (Loss)
Three Months Ended September 30, 2019					
Interest rate swaps	$ (766)	Interest expense	$ (31)	Other income	$ —
Nine Months Ended September 30, 2019					
Interest rate swaps	$ (4,269)	Interest expense	$ (296)	Other income	$ —
Three Months Ended September 30, 2018					
Interest rate swaps	$ 375	Interest expense	$ 21	Other income	$ —
Nine Months Ended September 30, 2018					
Interest rate swaps	$ 3,198	Interest expense	$ (207)	Other income	$ —

Fair Value Hedges

Heartland uses interest rate swaps to convert certain long term fixed rate loans to floating rates to hedge interest rate risk exposure. Heartland uses hedge accounting in accordance with ASC 815, with the unrealized gains and losses, representing the change in fair value of the derivative and the change in fair value of the risk being hedged on the related loan, being recorded in the consolidated statements of income. The ineffective portions of the unrealized gains or losses, if any, are recorded in interest income and interest expense in the consolidated statements of income. Heartland uses statistical regression to assess hedge effectiveness, both at the inception of the hedge as well as on a continual basis. The regression analysis involves regressing the

periodic change in the fair value of the hedging instrument against the periodic changes in the fair value of the asset being hedged due to changes in the hedge risk.

Heartland was required to pledge $3.4 million and $2.5 million of cash as collateral for these fair value hedges at September 30, 2019, and December 31, 2018, respectively.

The table below identifies the notional amount, fair value and balance sheet category of Heartland's fair value hedges at September 30, 2019, and December 31, 2018, in thousands:

	Notional Amount	Fair Value	Balance Sheet Category
September 30, 2019			
Fair value hedges	$ —	$ —	Other assets
Fair value hedges	21,349	(1,818)	Other liabilities
December 31, 2018			
Fair value hedges	$ 19,820	$ 74	Other assets
Fair value hedges	15,064	$ (339)	Other liabilities

The table below identifies the gains and losses recognized on Heartland's fair value hedges for the three- and nine-month periods ended September 30, 2019, and September 30, 2018, in thousands:

	Amount of Gain (Loss)	Income Statement Category
Three Months Ended September 30, 2019		
Fair value hedges	$ (263)	Interest income
Nine Months Ended September 30, 2019		
Fair value hedges	$ (1,553)	Interest income
Three Months Ended September 30, 2018		
Fair value hedges	$ 179	Interest income
Nine Months Ended September 30, 2018		
Fair value hedges	$ 1,423	Interest income

Embedded Derivatives

Heartland has fixed rate loans with embedded derivatives. The loans contain terms that affect the cash flows or value of the loan similar to a derivative instrument, and therefore are considered to contain an embedded derivative. The embedded derivatives are bifurcated from the loans because the terms of the derivative instrument are not clearly and closely related to the loans. The embedded derivatives are recorded at fair value on the consolidated balance sheets as a part of other assets, and changes in the fair value are a component of noninterest income. The table below identifies the notional amount, fair value and balance sheet category of Heartland's embedded derivatives at September 30, 2019, and December 31, 2018, in thousands:

	Notional Amount	Fair Value	Balance Sheet Category
September 30, 2019			
Embedded derivatives	$ 11,742	$ 717	Other assets
Embedded derivatives	—	—	Other liabilities
December 31, 2018			
Embedded derivatives	$ 11,266	$ 453	Other assets
Embedded derivatives	2,231	(54)	Other liabilities

The table below identifies the gains and losses recognized on Heartland's embedded derivatives for the three- and nine-month periods ended September 30, 2019, and September 30, 2018, in thousands:

	Amount of Gain (Loss)	Income Statement Category
Three Months Ended September 30, 2019		
Embedded derivatives	$ 1,389	Other noninterest income
Nine Months Ended September 30, 2019		
Embedded derivatives	$ 318	Other noninterest income
Three Months Ended September 30, 2018		
Embedded derivatives	$ 108	Other noninterest income
Nine Months Ended September 30, 2018		
Embedded derivatives	$ 523	Other noninterest income

Back-to-Back Loan Swaps

Heartland has interest rate swap loan relationships with customers to meet their financing needs. Upon entering into these loan swaps, Heartland enters into offsetting positions with counterparties in order to minimize interest rate risk. These back-to-back loan swaps qualify as free standing financial derivatives with the fair values reported in other assets and other liabilities on the consolidated balance sheets. Heartland was required to post $25.2 million and $2.0 million as of September 30, 2019, and December 31, 2018, respectively, as collateral related to these back-to-back swaps. Heartland's counterparties were required to pledge $0 at September 30, 2019, and $680,000 at December 31, 2018. Any gains and losses on these back-to-back swaps are recorded in noninterest income on the consolidated statements of income, and for the nine months ended September 30, 2019 and September 30, 2018, no gain or loss was recognized. The table below identifies the balance sheet category and fair values of Heartland's derivative instruments designated as loan swaps at September 30, 2019, and December 31, 2018, in thousands:

	Notional Amount	Fair Value	Balance Sheet Category	Weighted Average Receive Rate	Weighted Average Pay Rate
September 30, 2019					
Customer interest rate swaps	$ 320,994	$ 21,281	Other assets	4.72 %	4.32 %
Customer interest rate swaps	320,994	(21,281)	Other liabilities	4.32	4.72
December 31, 2018					
Customer interest rate swaps	$ 211,246	$ 4,449	Other assets	5.10 %	4.96 %
Customer interest rate swaps	211,246	(4,449)	Other liabilities	4.96	5.10

Other Free Standing Derivatives

Heartland 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. Heartland enters into forward commitments for the future delivery of residential mortgage loans when interest rate lock commitments are entered into in order to economically hedge the effect of future changes in interest rates on the commitments to fund the loans as well as on residential mortgage loans available for sale. 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 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. Heartland was required to pledge collateral of $0 at September 30, 2019, and $35,000 at December 31, 2018. Heartland's counterparties were required to pledge no collateral at both September 30, 2019 and December 31, 2018, as collateral for these forward commitments.

Heartland acquired undesignated interest rate swaps in 2015. These swaps were entered into primarily for the benefit of customers seeking to manage their interest rate risk and are not designated against specific assets or liabilities on the consolidated balance sheet or forecasted transactions and therefore do not qualify for hedge accounting in accordance with ASC 815. These swaps are carried at fair value on the consolidated balance sheets as a component of other liabilities, with changes in the fair value recorded as a component of other noninterest income.

The table below identifies the balance sheet category and fair values of Heartland's other free standing derivative instruments not designated as hedging instruments at September 30, 2019, and December 31, 2018, in thousands:

	Balance Sheet Category	Notional Amount		Fair Value	
September 30, 2019					
Interest rate lock commitments (mortgage)	Other assets	$	29,816	$	970
Forward commitments	Other assets		18,000		64
Forward commitments	Other liabilities		48,500		(209)
Undesignated interest rate swaps	Other liabilities		11,742		(717)
Undesignated interest rate swaps	Other assets		—		—
December 31, 2018					
Interest rate lock commitments (mortgage)	Other assets	$	22,451	$	725
Forward commitments	Other assets		—		—
Forward commitments	Other liabilities		51,500		(399)
Undesignated interest rate swaps	Other liabilities		11,266		(453)
Undesignated interest rate swaps	Other assets		2,231		54

The table below identifies the income statement category of the gains and losses recognized in income on Heartland's other free standing derivative instruments not designated as hedging instruments for the three- and nine-month periods ended September 30, 2019, and September 30, 2018, in thousands:

	Income Statement Category	Gain (Loss) Recognized	
Three Months Ended September 30, 2019			
Interest rate lock commitments (mortgage)	Net gains on sale of loans held for sale	$	(255)
Forward commitments	Net gains on sale of loans held for sale		283
Undesignated interest rate swaps	Other noninterest income		(1,389)
Nine Months Ended September 30, 2019			
Interest rate lock commitments (mortgage)	Net gains on sale of loans held for sale	$	561
Forward commitments	Net gains on sale of loans held for sale		255
Undesignated interest rate swaps	Other noninterest income		(318)
Three Months Ended September 30, 2018			
Interest rate lock commitments (mortgage)	Net gains on sale of loans held for sale	$	(4,470)
Forward commitments	Net gains on sale of loans held for sale		644
Undesignated interest rate swaps	Other noninterest income		108
Nine Months Ended September 30, 2018			
Interest rate lock commitments (mortgage)	Net gains on sale of loans held for sale	$	(1,849)
Forward commitments	Net gains on sale of loans held for sale		352
Undesignated interest rate swaps	Other noninterest income		523

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 carried at fair value, which include available for sale, trading securities and equity securities with a readily determinable fair value, 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 the 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 and asset-backed securities and private collateralized mortgage obligations, municipal bonds and corporate debt securities. On a quarterly basis, a secondary independent pricing service is used for the securities portfolio to validate the pricing from Heartland's primary pricing service.

Equity Securities with a Readily Determinable Fair Value
Equity securities with a readily determinable fair value generally include Community Reinvestment Act mutual funds and are classified as Level 2 due to the infrequent trading of these securities. The fair value is based on the price per share.

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.

Premises, Furniture and Equipment Held for Sale
Heartland values premises, furniture and equipment held for sale based on third-party appraisals less estimated disposal costs. Heartland considers third party appraisals, as well as independent fair value assessments from Realtors or persons involved in selling bank premises, furniture and equipment, in determining the fair value of particular properties. Accordingly, the valuation of premises, furniture and equipment held for sale is subject to significant external and internal judgment. Heartland periodically reviews premises, furniture and equipment held for sale to determine if the fair value of the property, less disposal costs, has declined below its recorded book value and records any adjustments accordingly. Premises, furniture and equipment held for sale 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. 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 the assumptions in the discounted cash flow analysis 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 guaranteed by the Small Business Administration and the United States Department of Agriculture that have been sold with servicing retained by Heartland. 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 September 30, 2019, and December 31, 2018, 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 of the fair value hierarchy.

The table below presents Heartland's assets and liabilities that are measured at fair value on a recurring basis as of September 30, 2019, and December 31, 2018, 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
September 30, 2019				
Assets				
Securities available for sale				
U.S. government corporations and agencies	$ 8,950	$ 7,497	$ 1,453	$ —
Mortgage and asset-backed securities	2,480,677	—	2,480,677	—
Obligations of states and political subdivisions	512,579	—	512,579	—
Equity securities with a readily determinable fair value	18,362	—	18,362	—
Derivative financial instruments (1)	22,152	—	22,152	—
Interest rate lock commitments	970	—	—	970
Forward commitments	64	—	64	—
Total assets at fair value	$ 3,043,754	$ 7,497	$ 3,035,287	$ 970
Liabilities				
Derivative financial instruments (2)	$ 27,479	$ —	$ 27,479	$ —
Forward commitments	209	—	209	—
Total liabilities at fair value	$ 27,688	$ —	$ 27,688	$ —
December 31, 2018				
Assets				
Securities available for sale				
U.S. government corporations and agencies	$ 31,951	$ 25,414	$ 6,537	$ —
Mortgage and asset-backed securities	2,026,698	—	2,026,698	—
Obligations of states and political subdivisions	374,974	—	374,974	—
Equity securities	17,086	—	17,086	—
Derivative financial instruments (1)	6,539	—	6,539	—
Interest rate lock commitments	725	—	—	725
Total assets at fair value	$ 2,457,973	$ 25,414	$ 2,431,834	$ 725
Liabilities				
Derivative financial instruments (2)	$ 6,044	$ —	$ 6,044	$ —
Forward commitments	399	—	399	—
Total liabilities at fair value	$ 6,443	$ —	$ 6,443	$ —

(1) Includes embedded derivatives, back-to-back loan swaps, fair value hedges, free standing derivative instruments and cash flow hedges.

(2) Includes cash flow hedges, fair value hedges, back-to-back loan swaps, embedded derivatives and free standing derivative instruments.

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

	Fair Value Measurements at September 30, 2019				
	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 (Gains) Losses
Collateral dependent impaired loans:					
Commercial	$ 10,767	$ —	$ —	$ 10,767	$ 1,098
Commercial real estate	1,088	—	—	1,088	72
Agricultural and agricultural real estate	11,536	—	—	11,536	1,015
Residential real estate	1,042	—	—	1,042	24
Consumer	645	—	—	645	—
Total collateral dependent impaired loans	$ 25,078	$ —	$ —	$ 25,078	$ 2,209
Loans held for sale	$ 35,427	$ —	$ 35,427	$ —	$ (1,234)
Other real estate owned	$ 6,425	$ —	$ —	$ 6,425	$ 880
Premises, furniture and equipment held for sale	$ 3,251	$ —	$ —	$ 3,251	$ 954
Servicing rights	$ 5,039	$ —	$ —	$ 5,039	$ 1,579

	Fair Value Measurements at December 31, 2018				
	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 (Gains) Losses
Collateral dependent impaired loans:					
Commercial	$ 12,932	$ —	$ —	$ 12,932	$ 660
Commercial real estate	405	—	—	405	72
Agricultural and agricultural real estate	11,070	—	—	11,070	575
Residential real estate	478	—	—	478	—
Consumer	624	—	—	624	—
Total collateral dependent impaired loans	$ 25,509	$ —	$ —	$ 25,509	$ 1,307
Loans held for sale	$ 119,801	$ —	$ 52,577	$ 67,224	$ (1,870)
Other real estate owned	$ 6,153	$ —	$ —	$ 6,153	$ 2,647
Premises, furniture and equipment held for sale	$ 7,258	$ —	$ —	$ 7,258	$ 59
Servicing rights	$ 7,143	$ —	$ —	$ 7,143	$ 58

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

	Fair Value at 9/30/2019	Valuation Technique	Unobservable Input	Range (Weighted Average)
Interest rate lock commitments	$ 970	Discounted cash flows	Closing ratio	0-99% (90%)[1]
Other real estate owned	6,425	Modified appraised value	Third party appraisal	[2]
			Appraisal discount	0-10%[3]
Servicing rights	5,039	Discounted cash flows	Third party valuation	[4]
Premises, furniture and equipment held for sale	3,251	Modified appraised value	Third party appraisal	
			Appraisal discount	0-10%[3]
Collateral dependent impaired loans:				
Commercial	10,767	Modified appraised value	Third party appraisal	[2]
			Appraisal discount	0-15%[3]
Commercial real estate	1,088	Modified appraised value	Third party appraisal	[2]
			Appraisal discount	0-10%[3]
Agricultural and agricultural real estate	11,536	Modified appraised value	Third party appraisal	[2]
			Appraisal discount	0-15%[3]
Residential real estate	1,042	Modified appraised value	Third party appraisal	[2]
			Appraisal discount	0-12%[3]
Consumer	645	Modified appraised value	Third party valuation	[2]
			Valuation discount	0-10%[3]

(1) 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. The weighted average closing ratio for PrimeWest Mortgage Corporation is 90%.

(2) Third party appraisals are obtained and updated at least annually to establish the value of the underlying asset, but the disclosure of the unobservable inputs used by the appraisers would not be meaningful because the range will vary widely from appraisal to appraisal.

(3) Discounts applied to the appraised values primarily include estimated sales costs, but also consider the age of the appraisal, changes in local market conditions and changes in the current condition of the collateral.

(4) The significant unobservable input used in the fair value measurement are the value indices, which are weighted-average spreads to LIBOR based on maturity groups.

	Fair Value at 12/31/2018	Valuation Technique	Unobservable Input	Range (Weighted Average)
Loans held for sale	$ 67,224	Discounted cash flows	Sales contract	[1]
Interest rate lock commitments	725	Discounted cash flows	Closing ratio	0-99% (91%)[2]
Other real estate owned	6,153	Modified appraised value	Third party appraisal	[3]
			Appraisal discount	0-10%[4]
Servicing rights	7,143	Discounted cash flows	Third party valuation	[5]
Premises, furniture and equipment held for sale	7,258	Modified appraised value	Third party appraisal	[3]
			Appraisal discount	0-10%[4]
Collateral dependent impaired loans:				
Commercial	12,932	Modified appraised value	Third party appraisal	[3]
			Appraisal discount	0-8%[4]
Commercial real estate	405	Modified appraised value	Third party appraisal	[3]
			Appraisal discount	0-19%[4]
Agricultural and agricultural real estate	11,070	Modified appraised value	Third party appraisal	[3]
			Appraisal discount	0-24%[4]
Residential real estate	478	Modified appraised value	Third party appraisal	[3]
			Appraisal discount	0-24%[4]
Consumer	624	Modified appraised value	Third party valuation	[3]
			Valuation discount	0-14%[4]

(1) The significant unobservable input related to the loans held for sale was the third party sales contract Heartland entered into prior to December 31, 2018. The sale of these consumer loans closed on January 11, 2019.

(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.

(3) Third party appraisals are obtained and updated at least annually to establish the value of the underlying asset, but the disclosure of the unobservable inputs used by the appraisers would not be meaningful because the range will vary widely from appraisal to appraisal.

(4) Discounts applied to the appraised values primarily include estimated sales costs, but also consider the age of the appraisal, changes in local market conditions and changes in the current condition of the collateral.

(5) The significant unobservable input used in the fair value measurement are the value indices, which are weighted-average spreads to LIBOR based on maturity groups.

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

	For the Nine Months Ended September 30, 2019	For the Year Ended December 31, 2018
Balance at January 1,	$ 725	$ 1,738
Acquired interest rate lock commitments	—	1,383
Total gains (losses) included in earnings	561	(3,269)
Issuances	8,077	2,962
Settlements	(8,393)	(2,089)
Balance at period end	$ 970	$ 725

Gains included in gains (losses) on sale of loans held for sale attributable to interest rate lock commitments held at September 30, 2019, and December 31, 2018, were $970,000 and $725,000, respectively.

The table below is a summary of the estimated fair value of Heartland's financial instruments (as defined by ASC 825) as of September 30, 2019, and December 31, 2018, 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, including the value of the commercial and mortgage servicing rights,

premises, furniture and equipment, premises, furniture and equipment held for sale, OREO, 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 September 30, 2019 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	$ 447,767	$ 447,767	$ 447,767	$ —	$ —
Time deposits in other financial institutions	3,711	3,711	3,711	—	—
Securities:					
Carried at fair value	3,020,568	3,020,568	7,497	3,013,071	—
Held to maturity	87,965	97,905	—	97,905	—
Other investments	29,042	29,042	—	29,042	—
Loans held for sale	35,427	35,427	—	35,427	—
Loans, net:					
Commercial	2,250,134	2,187,799	—	2,177,032	10,767
Commercial real estate	4,084,592	4,057,687	—	4,056,599	1,088
Agricultural and agricultural real estate	540,406	532,650	—	521,114	11,536
Residential real estate	587,288	561,187	—	560,145	1,042
Consumer	442,966	440,984	—	440,339	645
Total Loans, net	7,905,386	7,780,307	—	7,755,229	25,078
Cash surrender value on life insurance	171,471	171,471	—	171,471	—
Derivative financial instruments[(1)]	22,152	22,152	—	22,152	—
Interest rate lock commitments	970	970	—	—	970
Forward commitments	64	64	—	64	—
Financial liabilities:					
Deposits					
Demand deposits	3,581,127	3,581,127	—	3,581,127	—
Savings deposits	5,770,754	5,770,754	—	5,770,754	—
Time deposits	1,117,975	1,117,975	—	1,117,975	—
Deposits held for sale	—	—	—	—	—
Short term borrowings	107,853	107,853	—	107,853	—
Other borrowings	278,417	278,707	—	278,707	—
Derivative financial instruments[(1)]	27,479	27,479	—	27,479	—
Forward commitments	209	209	—	209	—

(1) Includes embedded derivatives, back-to-back loan swaps, fair value hedges, free standing derivative instruments and cash flow hedges.

	Carrying Amount	Estimated Fair Value	Fair Value Measurements at December 31, 2018 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	$ 273,630	$ 273,630	$ 273,630	$ —	$ —
Time deposits in other financial institutions	4,672	4,672	4,672	—	—
Securities:					
Carried at fair value	2,450,709	2,450,709	25,414	2,425,295	—
Held to maturity	236,283	245,341	—	245,341	—
Other investments	28,396	28,396	—	28,396	—
Loans held for sale	119,801	119,801	—	52,577	67,224
Loans, net:					
Commercial	1,994,785	1,955,607	—	1,942,675	12,932
Commercial real estate	3,684,213	3,667,138	—	3,666,733	405
Agricultural and agricultural real estate	561,265	553,112	—	542,042	11,070
Residential real estate	670,473	654,596	—	654,118	478
Consumer	434,998	432,016	—	431,392	624
Total Loans, net	7,345,734	7,262,469	—	7,236,960	25,509
Cash surrender value on life insurance	162,892	162,892	—	162,892	—
Derivative financial instruments[(1)]	6,539	6,539	—	6,539	—
Interest rate lock commitments	725	725	—	—	725
Financial liabilities:					
Deposits					
Demand deposits	3,264,737	3,264,737	—	3,264,737	—
Savings deposits	5,107,962	5,107,962	—	5,107,962	—
Time deposits	1,023,730	1,023,730	—	1,023,730	—
Deposits held for sale	106,409	100,241	—	—	100,241
Short term borrowings	227,010	227,010	—	227,010	—
Other borrowings	274,905	276,966	—	276,966	—
Derivative financial instruments[(1)]	6,044	6,044	—	6,044	—
Forward commitments	399	399	—	399	—

(1) Includes embedded derivatives, back-to-back loan swaps, fair value hedges, free standing derivative instruments and cash flow hedges.

Cash and Cash Equivalents — The carrying amount is a reasonable estimate of fair value due to the short-term nature of these instruments.

Time Deposits in Other Financial Institutions — The carrying amount is a reasonable estimate of fair value due to the short-term nature of these instruments.

Securities — For equity securities with a readily determinable fair value and debt securities either held to maturity, available for sale or trading, fair value equals quoted market price if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities. For Level 3 securities, Heartland utilizes independent pricing provided by third party vendors or brokers.

Other Investments — Fair value measurement of other investments, which consists primarily of FHLB stock, are based on their redeemable value, which is at cost due to the restrictions placed on their transferability. The market for these securities is restricted to the issuer of the stock and subject to impairment evaluation.

Loans — The fair value of loans is determined using an exit price methodology as prescribed by ASU 2016-01, which was effective on January 1, 2018. The exit price estimation of fair value is based on the present value of the expected cash flows. The projected cash flows are based on the contractual terms of the loans, adjusted for prepayments and a discount rate based on the relative risk of the cash flows. Other considerations include the loan type, remaining life of the loan and credit risk.

The fair value of impaired loans is measured using the fair value of the underlying collateral. The fair value of loans held for sale is estimated using quoted market prices.

Cash surrender value on life insurance — Life insurance policies are held on certain officers. The carrying value of these policies approximates fair value as it is based on the cash surrender value adjusted for other charges or amounts due that are probable at settlement. As such, Heartland classifies the estimated fair value of the cash surrender value on life insurance as Level 2.

Derivative Financial Instruments — The fair value of all derivatives is estimated based on the amount that Heartland would pay or would be paid to terminate the contract or agreement, using current rates and prices, and, when appropriate, the current creditworthiness of the counter-party.

Interest Rate Lock Commitments — The fair value of interest rate lock commitments is estimated using an internal valuation model, which includes grouping the interest rate lock commitments by interest rate and terms, applying an estimated closing ratio based on historical experience, and then multiplying by quoted investor prices determined to be reasonably applicable to the loan commitment groups based on interest rate, terms, and rate lock expiration dates of the loan commitment group.

Forward Commitments — The fair value of these instruments is estimated using an internal valuation model, which includes current trade pricing for similar financial instruments.

Deposits — The fair value of demand deposits, savings accounts and certain money market deposits is the amount payable on demand at the reporting date. The fair value of fixed maturity certificates of deposit is estimated using the rates currently offered for deposits of similar remaining maturities. If the fair value of the fixed maturity certificates of deposit is calculated at less than the carrying amount, the carrying value of these deposits is reported as the fair value.

Deposits Held for Sale — As of September 30, 2019, Heartland had $0 of deposits held for sale. Prior to December 31, 2018, Heartland entered into agreements with third parties to sell the deposits of five branch locations, which totaled $106.4 million as of December 31, 2018. The estimated fair value in the table above was based on the carrying value of the deposits less the premium Heartland expected to receive in accordance with the sales contract when the transactions were completed in the first six months of 2019.

Short-term and Other Borrowings — Rates currently available to Heartland for debt with similar terms and remaining maturities are used to estimate fair value of existing debt.

Commitments to Extend Credit, Unused Lines of Credit and Standby Letters of Credit — Based upon management's analysis of the off balance sheet financial instruments, there are no significant unrealized gains or losses associated with these financial instruments based upon review of the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties.

NOTE 9: REVENUE

On January 1, 2018, Heartland adopted ASU 2014-09, "Revenue from Contracts with Customers" (Topic 606), and all subsequent ASUs that modified Topic 606.

Topic 606 does not apply to revenue associated with financial instruments, including revenue from loans and securities. In addition, certain noninterest income streams such as fees associated with loan servicing income, bank owned life insurance, derivatives and certain credit card fees are also not in scope of the new guidance. Topic 606 is applicable to noninterest revenue streams such as service charges and fees, trust fees, and brokerage and insurance commissions. However, the recognition of these revenue streams did not change significantly upon adoption of Topic 606. Substantially all of Heartland's revenue is generated from contracts with customers. Noninterest revenue streams in-scope of Topic 606 are discussed below.

Service Charges and Fees
Service charges and fees consist of revenue generated from deposit account related service charges and fees, overdraft fees, customer service fees and other service charges, credit card fee income, debit card income and other service charges and fees.

Service charges on deposit accounts consist of account analysis fees (i.e., net fees earned on analyzed business and public checking accounts), monthly service fees, check orders and other deposit account related fees. Heartland's performance obligation for account analysis fees and monthly service fees is generally satisfied, and the related revenue recognized, over the period in which the service is provided. Check orders and other deposit account related fees, including overdraft fees, are largely transactional based, and therefore, the performance obligation is satisfied, and related revenue recognized, at a point in time. Payment for service charges on deposit accounts is primarily received immediately or in the following month through a direct charge to customers' accounts.

Customer service fees and other service charges include revenue from processing wire transfers, bill pay service, cashier's checks, and other services. Heartland's performance obligation for fees, exchange, and other service charges are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payment is typically received immediately or in the following month.

Credit card fee income and debit card income are comprised of interchange fees, ATM fees, and merchant services income. Credit card fee income and debit card income are earned whenever the banks' debit and credit cards are processed through card payment networks such as Visa. ATM fees are primarily generated when a bank cardholder uses an ATM that is not owned by one of Heartland's banks or a non-bank cardholder uses Heartland-owned ATM. Merchant services income mainly represents fees charged to merchants to process their debit and credit card transactions, in addition to account management fees.

Trust Fees
Trust fees are primarily comprised of fees earned from the management and administration of trusts and other customer assets. Heartland's performance obligation is generally satisfied over time and the resulting fees are recognized monthly, based upon the average daily market value or month-end market value of the assets under management and the applicable fee rate. Payment is generally received a few days before or after month end through a direct charge to customers' accounts. Heartland does not earn performance-based incentives. Optional services such as real estate sales and tax return preparation services are also available to existing trust and asset management customers. Heartland's performance obligation for these transactional-based services is generally satisfied, and related revenue recognized, at a point in time (i.e., as incurred). Payment is received shortly after services are rendered.

Brokerage and Insurance Commissions
Brokerage commission primarily consist of commissions related to broker-dealer contracts. The contracts are between the customer and the broker-dealer, and Heartland satisfies its performance obligation and earns commission when the transactions are completed. The recognition of revenue is based on a defined fee schedule and does not require significant judgment. Payment is received shortly after services are rendered. Insurance commissions are related to commissions received directly from the insurance carrier. Heartland acts as an insurance agent between the customer and the insurance carrier. Heartland's performance obligations and associated fee and commission income are defined with each insurance product with the insurance company. When insurance payments are received from customers, a portion of the payment is recognized as commission revenue.

The following presents noninterest income, segregated by revenue streams in-scope and out-of-scope of Topic 606, for the three- and nine-months ended September 30, 2019, and 2018, in thousands:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
In-scope of Topic 606				
Service charges and fees				
Service charges and fees on deposit accounts	$ 3,221	$ 2,858	$ 9,383	$ 8,270
Overdraft fees	2,917	2,990	8,537	7,716
Customer service and other service fees	104	102	270	268
Credit card fee income	3,936	3,062	11,555	8,443
Debit card income	2,188	3,883	10,044	10,349
Total service charges and fees	$ 12,366	$ 12,895	$ 39,789	$ 35,046
Trust fees	4,959	4,499	14,258	13,794
Brokerage and insurance commissions	962	1,111	2,724	2,895
Total noninterest income in-scope of Topic 606	**$ 18,287**	**$ 18,505**	**$ 56,771**	**$ 51,735**
Out-of-scope of Topic 606				
Loan servicing income	$ 821	$ 1,670	$ 3,888	$ 5,231
Securities gains/(losses), net	2,013	(145)	7,168	1,037
Unrealized gain on equity securities, net	144	54	514	97
Net gains on sale of loans held for sale	4,673	7,410	12,192	18,261
Valuation adjustment on servicing rights	(626)	230	(1,579)	12
Income on bank owned life insurance	881	892	2,668	2,206
Other noninterest income	3,207	1,149	6,556	3,536
Total noninterest income out-of-scope of Topic 606	**11,113**	**11,260**	**31,407**	**30,380**
Total noninterest income	**$ 29,400**	**$ 29,765**	**$ 88,178**	**$ 82,115**

Contract Balances
A contract asset balance occurs when an entity performs a service for a customer before the customer pays consideration (resulting in a contract receivable) or before payment is due (resulting in a contract asset). A contract liability balance is an entity’s obligation to transfer a service to a customer for which the entity has already received payment (or payment is due) from the customer. Heartland's noninterest revenue streams are largely based on transactional activity, or standard month-end revenue accruals such as asset management fees based on month-end market values. Consideration is often received immediately or shortly after Heartland satisfies its performance obligation and revenue is recognized. Heartland does not typically enter into long-term revenue contracts with customers, and therefore, does not experience significant contract balances. As of September 30, 2019, and December 31, 2018, Heartland did not have any significant contract balances.

Contract Acquisition Costs
In connection with the adoption of Topic 606, an entity is required to capitalize, and subsequently amortize into expense, certain incremental costs of obtaining a contract with a customer if these costs are expected to be recovered. The incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, sales commission). Heartland utilizes the practical expedient which allows entities to immediately expense contract acquisition costs when the asset that would have resulted from capitalizing these costs would have been amortized in one year or less. Upon adoption of Topic 606, Heartland did not capitalize any contract acquisition costs.

NOTE 10: STOCK COMPENSATION

Heartland may grant, through its Nominating and Compensation Committee (the "Compensation Committee"), non-qualified and incentive stock options, stock appreciation rights, stock awards, restricted stock, restricted stock units and cash incentive awards, under its 2012 Long-Term Incentive Plan (the "Plan"). The Plan was originally approved by stockholders in May 2012 and was amended effective March 8, 2016, to increase the number of shares of common stock authorized for issuance and make certain other changes to the Plan. As of September 30, 2019, 350,412 shares of common stock were available for issuance under future awards that may be granted under the Plan to employees and directors of, and service providers to, Heartland or its subsidiaries.

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

The amount of tax benefit related to the exercise, vesting and forfeiture of equity-based awards reflected as a tax benefit in Heartland's income tax expense was $270,000 and $672,000 during the nine months ended September 30, 2019 and 2018, respectively.

Restricted Stock Units

The Plan permits the Compensation Committee to grant restricted stock units ("RSUs"). In the first quarter of 2019, the Compensation Committee granted time-based RSUs with respect to 90,073 shares of common stock, and in the first quarter of 2018, the Compensation Committee granted time-based RSUs with respect to 52,153 shares of common stock to selected officers and employees. The time-based RSUs represent the right, without payment, to receive shares of Heartland common stock on a specified date in the future. The time-based RSUs granted in 2019 and 2018 vest over three years in equal installments on March 6 of each of the three years following the year of the grant. The time-based RSUs may also vest upon death or disability, upon a change in control or upon a "qualified retirement" (as defined in the RSU agreement). The retiree is required to sign a non-solicitation agreement as a condition to vesting.

The Compensation Committee also granted three-year performance-based RSUs with respect to 34,848 shares and 16,108 shares of common stock in the first quarter of 2019 and 2018, respectively. These performance-based RSUs will be earned based on satisfaction of performance targets for the three-year performance period ended December 31, 2021, and December 31, 2020, respectively. These performance-based RSUs or a portion thereof may vest in 2022 and 2021, respectively, after measurement of performance in relation to the performance targets.

The three-year performance-based RSUs vest to the extent that they are earned upon death or disability or upon a "qualified retirement." Upon a change in control, performance-based RSUs shall become vested at 100% of target if the RSU obligations are not assumed by the successor company. If the successor company does assume the RSU obligations, the 2019 and 2018 performance-based RSUs will vest at 100% of target upon a "Termination of Service" within the period beginning six months prior to a change in control and ending twenty-four months after a change in control.

All of Heartland's RSUs will be settled in common stock upon vesting and are not entitled to dividends until vested.

The Compensation Committee may grant 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 nine months ended September 30, 2019, and September 30, 2018, 32,662 and 29,048 time-based RSUs, respectively, were granted to directors and new employees.

A summary of the RSUs outstanding as of September 30, 2019, and 2018, and changes during the nine months ended September 30, 2019 and 2018, follows:

	2019		2018	
	Shares	Weighted-Average Grant Date Fair Value	Shares	Weighted-Average Grant Date Fair Value
Outstanding at January 1,	266,995	$ 43.89	301,578	$ 34.74
Granted	157,583	45.00	116,297	55.26
Vested	(142,023)	38.93	(127,429)	32.70
Forfeited	(26,136)	48.95	(27,678)	45.58
Outstanding at September 30,	256,419	$ 46.96	262,768	$ 43.65

Total compensation costs recorded for RSUs were $4.8 million and $3.7 million for the nine-month periods ended September 30, 2019 and 2018. As of September 30, 2019, there were $6.0 million of total unrecognized compensation costs related to the Plan for RSUs that are expected to be recognized through 2022.

NOTE 11: LEASES

A lease is defined as a contract, or part of a contract, that conveys the right to control the use of identified property, plant or equipment for a period of time in exchange for consideration. On January 1, 2019, Heartland adopted ASU 2016-02 "Leases" (Topic 842) and all subsequent ASUs that modified Topic 842. For Heartland, Topic 842 primarily affected the accounting treatment for operating lease agreements in which Heartland is the lessee.

Lessee Accounting

Substantially all of the leases in which Heartland is the lessee are comprised of real estate property for branches, ATM locations, and office space with terms extending through 2031. All of Heartland's leases are classified as operating leases, and therefore, were previously not recognized on the consolidated balance sheet. With the adoption of Topic 842, operating lease agreements are required to be recognized on the consolidated balance sheet as a right-of-use ("ROU") asset and a corresponding lease liability.

Heartland elected not to include short-term leases (i.e., leases with initial terms of twelve months or less), or equipment leases (deemed immaterial) on the consolidated balance sheet. The table below presents Heartland's ROU assets and lease liabilities as of September 30, 2019, in thousands:

Assets	Classification	September 30, 2019
Operating lease assets	Other assets	$ 24,677
Total lease right-of-use assets		$ 24,677
Liabilities		
Operating lease liabilities	Accrued expenses and other liabilities	$ 26,403
Total lease liabilities		$ 26,403

The calculated amount of the ROU assets and lease liabilities in the table above are impacted by the length of the lease term and the discount rate used to present value the minimum lease payments. Heartland's lease agreements often include one or more options to renew at Heartland's discretion. If at lease inception, Heartland considers the exercising of a renewal option to be reasonably certain, Heartland will include the extended term in the calculation of the ROU asset and lease liability. Regarding the discount rate, Topic 842 requires the use of the rate implicit in the lease whenever this rate is readily determinable. As this rate is rarely determinable, Heartland utilizes its incremental borrowing rate at lease inception, on a collateralized basis, over a similar term. For operating leases existing prior to January 1, 2019, the rate for the remaining lease term as of January 1, 2019 was used. The variable lease cost primarily represents variable payments such as common area maintenance and utilities. The table below presents the lease costs and supplemental information as of September 30, 2019, in thousands:

	Income Statement Category	Three Months Ended September 30, 2019	Nine Months Ended September 30, 2019
Lease Cost			
Operating lease cost	Occupancy expense	$ 1,681	$ 4,548
Variable lease cost	Occupancy expense	42	109
Total lease cost		$ 1,723	$ 4,657
Supplemental Information			
Noncash reduction of ROU assets arising from lease modifications	Occupancy expense	$ 495	$ 2,959
Noncash reduction lease liabilities arising from lease modifications	Occupancy expense	284	2,771

Supplemental balance sheet information	**As of September 30, 2019**
Weighted-average remaining operating lease term (in years)	6.5
Weighted-average discount rate for operating leases	3.00 %

A maturity analysis of operating lease liabilities and reconciliation of the undiscounted cash flows to the total of operating lease liabilities as of September 30, 2019 is as follows, in thousands:

Three months ending December 31, 2019	$ 1,503
Year ending December 31,	
2020	5,931
2021	5,678
2022	4,346
2023	2,900
Thereafter	8,751
Total lease payments	$ 29,109
Less interest	(2,706)
Present value of lease liabilities	$ 26,403

As defined by Topic 840, Heartland's minimum future rental commitments at December 31, 2018, for all non-cancelable leases were as follows, in thousands:

2019	$ 5,776
2020	5,493
2021	5,102
2022	3,241
2023	2,297
Thereafter	12,419
	$ 34,328

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

SAFE HARBOR STATEMENT

This Quarterly Report on Form 10-Q (including any information incorporated herein by reference) contains, and future oral and written statements of Heartland Financial USA, Inc. ("Heartland") and its management may contain, forward-looking statements within the meaning of such term in the Private Securities Litigation Reform Act of 1995, with respect to the business, financial condition, results of operations, plans, objectives and future performance of Heartland. Forward-looking statements, which may be based upon beliefs, expectations and assumptions of Heartland's management and on information currently available to management, are generally identifiable by the use of words such as "believe," "expect," "anticipate," "plan," "intend," "estimate," "may," "will," "would," "could," "should" or other similar expressions. Although Heartland has made these statements based on management's experience and best estimate of future events, there may be events or factors that management has not anticipated, and the accuracy and achievement of such forward-looking statements and estimates are subject to a number of risks, including those identified in our Annual Report on Form 10-K for the year ended December 31, 2018. Additionally, all statements in this document, including forward-looking statements, speak only as of the date they are made, and Heartland undertakes no obligation to update any statement in light of new information or future events.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, income and expenses. These estimates are based upon historical experience and on various other assumptions that management believes are reasonable under the circumstances. Among other things, the estimates form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. The estimates and judgments that management believes have the most effect on Heartland's reported financial position and results of operations are described as critical accounting policies in Heartland's Annual Report on Form 10-K for the year ended December 31, 2018. There have been no significant changes in the critical accounting policies or the assumptions and judgments utilized in applying these policies since December 31, 2018.

OVERVIEW

Heartland is a multi-bank holding company providing banking, mortgage, wealth management, investments and insurance services to individuals and businesses. As of the date of this Quarterly Report on Form 10-Q, Heartland has eleven banking subsidiaries with 114 locations in Iowa, Illinois, Wisconsin, New Mexico, Arizona, Montana, Colorado, Minnesota, Kansas, Missouri, Texas and California. Heartland's primary objectives are to increase profitability and diversify its market area and asset base by expanding through acquisitions and to grow organically by increasing its customer base in the markets it serves.

Heartland's results of operations depend primarily on net interest income, which is the difference between interest income from interest earning assets and interest expense on interest bearing liabilities. Noninterest income, which includes service charges and fees, loan servicing income, trust income, brokerage and insurance commissions, securities gains, net gains on sale of loans held for sale, and income on bank owned life insurance also affects Heartland's results of operations. Heartland's principal operating expenses, aside from interest expense, consist of the provision for loan losses, salaries and employee benefits, occupancy and equipment costs, professional fees, advertising, core deposit and customer relationship intangibles amortization and other real estate and loan collection expenses.

Net income available to common stockholders for the quarter ended September 30, 2019, was $34.6 million, or $0.94 per diluted common share, compared to $33.7 million, or $0.97 per diluted common share, for the quarter ended September 30, 2018. Return on average common equity was 8.91% and return on average assets was 1.12% for the third quarter of 2019, compared to 10.58% and 1.18%, respectively, for the same quarter in 2018.

Net income available to common stockholders for the nine months ended September 30, 2019, was $111.3 million or $3.11 per diluted common share, compared to $84.8 million or $2.59 per diluted common share for the nine months ended September 30, 2018. Return on average common equity was 10.33% and return on average assets was 1.27% for the first nine months of 2019, compared to 9.95% and 1.07% for the same period in 2018.

For the third quarter of 2019, Heartland's net interest margin was 3.98% (4.02% on a fully tax-equivalent basis) compared to 4.32% (4.38% on a fully tax-equivalent basis) for the same quarter in 2018, and the efficiency ratio was 61.92% and 62.51% for the third quarter of 2019 and 2018, respectively. For the nine-month period ended September 30, 2019, Heartland's net interest margin was 4.05% (4.10% on a fully tax-equivalent basis) compared to 4.25% (4.32% on a fully tax-equivalent basis) for the same period in 2018. The efficiency ratio for the first nine months of 2019 was 63.95% compared to 65.03% for the same period in 2018.

Total assets of Heartland were $12.57 billion at September 30, 2019, an increase of $1.16 billion or 10% since year-end 2018. Securities represented 25% of total assets at September 30, 2019, and 24% of total assets at December 31, 2018.

Total loans held to maturity were $7.97 billion at September 30, 2019, compared to $7.41 billion at year-end 2018, an increase of $563.9 million or 8%. This change includes $542.0 million of total loans held to maturity acquired at fair value in the Blue Valley Ban Corp. ("BVBC") transaction. During the first quarter of 2019, Heartland classified $32.1 million of loans as held for sale in conjunction with the branch sales described below in "Recent Developments". Excluding the reclassification of loans to held for sale and the BVBC transaction, total loans held to maturity increased $54.0 million or 1% since December 31, 2018.

Total deposits were $10.47 billion as of September 30, 2019, compared to $9.40 billion at year-end 2018, an increase of $1.07 billion or 11%. This increase includes $617.1 million of deposits acquired at fair value in the BVBC transaction. During the first quarter of 2019, Heartland classified $77.0 million of deposits as held for sale in conjunction with the branch sales. Exclusive of the reclassification of deposits to held for sale and the deposits acquired at fair value in the BVBC transaction, total deposits increased $533.3 million or 6% since December 31, 2018.

Total equity was $1.56 billion at September 30, 2019, compared to $1.33 billion at year-end 2018. Book value per common share was $42.62 at September 30, 2019, compared to $38.44 at year-end 2018. Heartland's unrealized gain on securities available for sale, net of applicable taxes, was $20.3 million at September 30, 2019, compared to an unrealized loss of $32.5 million, net of applicable taxes, at December 31, 2018.

RECENT DEVELOPMENTS

In keeping with its focus on core businesses and execution of strategic priorities, Heartland has completed the following transactions since January 1, 2019:

Blue Valley Ban Corp. Acquisition

On May 10, 2019, Heartland completed the acquisition of BVBC and its wholly-owned subsidiary, Bank of Blue Valley, headquartered in Overland Park, Kansas. Based on Heartland's closing common stock price of $44.78 per share on May 10, 2019, the aggregate consideration paid to BVBC common shareholders was $92.3 million, which was paid by delivery of 2,060,258 shares of Heartland common stock. On the closing date, in addition to this merger consideration, Heartland provided BVBC the funds necessary to repay outstanding debt of $6.9 million, and Heartland assumed $16.1 million of trust preferred securities at fair value. Immediately following the closing of the transaction, Bank of Blue Valley was merged with and into Heartland's wholly-owned Kansas subsidiary, Morrill & Janes Bank and Trust Company, and the combined entity operates under the Bank of Blue Valley brand. As of the closing date, BVBC had, at fair value, total assets of $766.2 million, total loans held to maturity of $542.0 million, and total deposits of $617.1 million. The transaction was a tax-free reorganization with respect to the stock consideration received by the stockholders of BVBC.

The financial impact of the BVBC acquisition is included in the results of operations for the period ended September 30, 2019, but not in the results of operations for the same period ended September 30, 2018.

Branch Sales and Other Divestitures

- On January 11, 2019, Heartland completed the sale of the loan portfolios of its consumer finance subsidiaries, Citizens Finance Co. and Citizens Finance of Illinois Co. (collectively, "Citizens"). The loan portfolios had a fair value of $67.2 million.
- On February 22, 2019, Heartland completed the sale of two branch locations of Wisconsin Bank & Trust. The sale included loans of $11.7 million and deposits of $48.6 million. Heartland recorded a net gain of $3.2 million in the first quarter of 2019, which consisted of a gain of $3.5 million and write-off of $329,000 of core deposit intangibles.

- On April 30, 2019, Dubuque Bank and Trust Company closed on the sale of substantially all its mortgage servicing rights portfolio, which contained loans with an unpaid principal balance of approximately $3.31 billion to PNC Bank, N.A. The transaction qualified as a sale, and $20.6 million of mortgage servicing rights were de-recognized on the consolidated balance sheet as of June 30, 2019. Cash of approximately $34.8 million was received during the second quarter, and Heartland recorded an estimated gain on the sale of this portfolio of approximately $13.3 million. A payable of approximately $293,000 was recorded as of September 30, 2019, due to the timing of the servicing transfer per the terms of the sale agreement. In the agreement, which includes customary terms and conditions, Dubuque Bank and Trust Company provided interim servicing of the loans until the transfer date, which was August 1, 2019.
- On May 3, 2019, Heartland completed the sale of two branches of Illinois Bank & Trust. The sale included loans of $1.2 million and deposits of $11.4 million. Heartland recorded a net gain of $340,000 in the second quarter of 2019, which consisted of a gain of $519,000 and write-off of $179,000 of core deposit intangibles.
- On May 17, 2019, Heartland completed the sale of one branch of Citywide Banks. The sale included loans of $8.4 million and deposits of $24.4 million. Heartland recorded a net gain of $1.6 million in the second quarter of 2019, which consisted of a gain of $1.8 million and write-off of $174,000 of core deposit intangibles.
- On May 31, 2019, Heartland completed the sale of two branch locations of Dubuque Bank and Trust Company, which operated as First Community Bank, in Keokuk, Iowa. The sale included loans of $17.5 million and deposits of $72.0 million. Heartland recorded a gain of $4.2 million in the second quarter of 2019.

Heartland has been working on company-wide strategic initiatives since the end of 2018. Management expects approximately $8 million to $10 million of the net gains on the sale of the branches and mortgage servicing rights previously discussed will be invested in talent, process improvement, and technology upgrades that management believes are necessary to support future organic and acquired growth, improve efficiency and ultimately provide a superior customer experience and enhance profitability.

Three of the most significant investments in technology and process improvement are:

- a project called Operation Customer Compass, which is focused on streamlining and automating processes. This project is intended to create back-office capacity for growth and enhance the customer experience. Expense reductions of over $10 million annually are expected to be realized once the project is completed, which is anticipated to be the end of 2019;
- an upgrade to the existing customer relationship management system to the Salesforce Platform, which is an industry leader for relationship management, and,
- the implementation of nCino, a premiere commercial loan origination system.

The upgrade to Salesforce and the implementation of nCino is expected to significantly improve the sales management process and improve the effectiveness of the commercial sales teams. The integration between nCino and Salesforce is expected to improve back office efficiencies and shorten the sales cycle. These two projects are currently underway and will be ongoing into mid-2020.

Pending Acquisition-Rockford Bank and Trust Company

On August 13, 2019, Heartland's Illinois Bank & Trust subsidiary entered into a purchase and assumption agreement to acquire substantially all of the assets and substantially all of the deposits and certain other liabilities of Rockford Bank and Trust Company ("RB&T"), headquartered in Rockford, Illinois. RB&T is a wholly-owned subsidiary of Moline, Illinois-based QCR Holdings, Inc. As of September 30, 2019, RB&T had total assets of $519.5 million, which included $417.3 million of gross loans held to maturity, and $451.5 million of deposits. RB&T serves the Rockford market from two full-service banking locations. The all-cash transaction is subject to regulatory approval and to customary closing conditions and is expected to close in the fourth quarter of 2019. The systems conversion is expected to occur in the first quarter of 2020.

FINANCIAL HIGHLIGHTS

(Dollars in thousands, except per share data)	**Three Months Ended September 30,**		**Nine Months Ended September 30,**	
	2019	**2018**	**2019**	**2018**
STATEMENT OF INCOME DATA				
Interest income	$ 133,403	$ 124,894	$ 381,127	$ 339,517
Interest expense	22,082	14,216	60,143	35,846
Net interest income	111,321	110,678	320,984	303,671
Provision for loan losses	5,201	5,238	11,754	14,332
Net interest income after provision for loan losses	106,120	105,440	309,230	289,339
Noninterest income	29,400	29,765	88,178	82,115
Noninterest expenses	92,967	92,539	256,295	265,067
Income taxes	7,941	8,956	29,835	21,530
Net income	34,612	33,710	111,278	84,857
Preferred dividends	—	(13)	—	(39)
Net income available to common stockholders	$ 34,612	$ 33,697	$ 111,278	$ 84,818
Key Performance Ratios				
Annualized return on average assets	1.12 %	1.18 %	1.27 %	1.07 %
Annualized return on average common equity (GAAP)	8.91 %	10.58 %	10.33 %	9.95 %
Annualized return on average tangible common equity (non-GAAP) [1]	13.78 %	17.31 %	16.13 %	15.64 %
Annualized ratio of net charge-offs to average loans	0.14 %	0.28 %	0.13 %	0.17 %
Annualized net interest margin (GAAP)	3.98 %	4.32 %	4.05 %	4.25 %
Annualized net interest margin, fully tax-equivalent (non-GAAP) [1]	4.02 %	4.38 %	4.10 %	4.32 %
Efficiency ratio, fully tax-equivalent (non-GAAP) [1]	61.92 %	62.51 %	63.95 %	65.03 %
Reconciliation of Annualized Return on Average Tangible Common Equity (non-GAAP)				
Net income available to common shareholders (GAAP)	$ 34,612	$ 33,697	$ 111,278	$ 84,818
Plus core deposit and customer relationship intangibles amortization, net of tax [2]	2,291	2,075	7,153	5,343
Adjusted net income available to common shareholders (non-GAAP)	$ 36,903	$ 35,772	$ 118,431	$ 90,161
Average common stockholders' equity (GAAP)	$ 1,541,369	$ 1,263,226	$ 1,440,754	$ 1,139,149
Less average goodwill	427,097	391,668	409,932	323,058
Less average other intangibles, net	51,704	51,592	49,373	45,207
Average tangible common equity (non-GAAP)	$ 1,062,568	$ 819,966	$ 981,449	$ 770,884
Annualized return on average common equity (GAAP)	8.91 %	10.58 %	10.33 %	9.95 %
Annualized return on average tangible common equity (non-GAAP)	13.78 %	17.31 %	16.13 %	15.64 %
Reconciliation of Annualized Net Interest Margin, Fully Tax-Equivalent (non-GAAP)				
Net Interest Income (GAAP)	$ 111,321	$ 110,678	$ 320,984	$ 303,671
Plus tax-equivalent adjustment [2]	1,140	1,544	3,820	4,663
Net interest income - tax-equivalent (non-GAAP)	$ 112,461	$ 112,222	$ 324,804	$ 308,334
Average earning assets	$ 11,102,581	$ 10,154,591	$ 10,598,465	$ 9,547,147
Net interest margin (GAAP)	3.98 %	4.32 %	4.05 %	4.25 %
Net interest margin, fully tax-equivalent (non-GAAP)	4.02 %	4.38 %	4.10 %	4.32 %

FINANCIAL HIGHLIGHTS

(Dollars in thousands, except per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	**2018**	**2019**	**2018**
Reconciliation of Efficiency Ratio (non-GAAP)				
Net interest income (GAAP)	$ 111,321	$ 110,678	$ 320,984	$ 303,671
Plus tax-equivalent adjustment (2)	1,140	1,544	3,820	4,663
Fully tax-equivalent net interest income	112,461	112,222	324,804	308,334
Noninterest income	29,400	29,765	88,178	82,115
Securities (gains)/losses, net	(2,013)	145	(7,168)	(1,037)
Unrealized gain on equity securities, net	(144)	(54)	(514)	(97)
Gain on extinguishment of debt	(375)	—	(375)	—
Valuation adjustment on servicing rights	626	(230)	1,579	(12)
Adjusted income (non-GAAP)	**$ 139,955**	**$ 141,848**	**$ 406,504**	**$ 389,303**
Total noninterest expenses (GAAP)	$ 92,967	$ 92,539	$ 256,295	$ 265,067
Less:				
Core deposit and customer relationship intangibles amortization	2,899	2,626	9,054	6,763
Partnership investment in tax credit projects	3,052	338	4,992	338
(Gain)/loss on sales/valuations of assets, net	356	912	(20,934)	2,243
Restructuring expenses	—	—	3,227	2,564
Adjusted noninterest expenses (non-GAAP)	**$ 86,660**	**$ 88,663**	**$ 259,956**	**$ 253,159**
Efficiency ratio, fully tax-equivalent (non-GAAP)	61.92 %	62.51 %	63.95 %	65.03 %

(1) Refer to the "Non-GAAP Financial Measures" section after these financial tables for additional information on the usage and presentation of these non-GAAP measures, and refer to these financial tables for the reconciliations to the most directly comparable GAAP measures.

(2) Computed on a tax-equivalent basis using an effective tax rate of 21%.

FINANCIAL HIGHLIGHTS

(Dollars in thousands, except per share data)	As Of and For the Quarter Ended				
	9/30/2019	**6/30/2019**	**3/31/2019**	**12/31/2018**	**9/30/2018**
BALANCE SHEET DATA					
Investments	$ 3,137,575	$ 2,681,419	$ 2,516,055	$ 2,715,388	$ 2,540,779
Loans held for sale	35,427	34,575	69,716	119,801	77,727
Total loans receivable(1)	7,971,608	7,853,051	7,331,544	7,407,697	7,365,493
Allowance for loan losses	66,222	63,850	62,639	61,963	61,221
Total assets	12,569,262	12,160,290	11,312,495	11,408,006	11,335,132
Total deposits (2)	10,469,856	10,108,557	9,352,942	9,396,429	9,512,163
Long-term obligations	278,417	282,863	268,312	274,905	277,563
Common stockholders’ equity	1,563,843	1,521,787	1,372,102	1,325,175	1,280,393
Common Share Data					
Book value per common share (GAAP)	$ 42.62	$ 41.48	$ 39.65	$ 38.44	$ 37.14
Tangible book value per common share (non-GAAP) (3)	$ 29.62	$ 28.40	$ 27.04	$ 25.70	$ 24.33
Common shares outstanding, net of treasury stock	36,696,190	36,690,061	34,603,611	34,477,499	34,473,029
Tangible common equity ratio (non-GAAP) (3)	8.99 %	8.92 %	8.60 %	8.08 %	7.70 %

FINANCIAL HIGHLIGHTS

(Dollars in thousands, except per share data)

	As Of and For the Quarter Ended				
	9/30/2019	**6/30/2019**	**3/31/2019**	**12/31/2018**	**9/30/2018**
Reconciliation of Tangible Book Value Per Common Share (non-GAAP)					
Common stockholders' equity (GAAP)	$ 1,563,843	$ 1,521,787	$ 1,372,102	$ 1,325,175	$ 1,280,393
Less goodwill	427,097	427,097	391,668	391,668	391,668
Less core deposit and customer relationship intangibles, net	49,819	52,718	44,637	47,479	50,071
Tangible common stockholders' equity (non-GAAP)	$ 1,086,927	$ 1,041,972	$ 935,797	$ 886,028	$ 838,654
Common shares outstanding, net of treasury stock	36,696,190	36,690,061	34,603,611	34,477,499	34,473,029
Common stockholders' equity (book value) per share (GAAP)	$ 42.62	$ 41.48	$ 39.65	$ 38.44	$ 37.14
Tangible book value per common share (non-GAAP)	$ 29.62	$ 28.40	$ 27.04	$ 25.70	$ 24.33
Reconciliation of Tangible Common Equity Ratio (non-GAAP)					
Tangible common stockholders' equity (non-GAAP)	$ 1,086,927	$ 1,041,972	$ 935,797	$ 886,028	$ 838,654
Total assets (GAAP)	$ 12,569,262	$ 12,160,290	$ 11,312,495	$ 11,408,006	$ 11,335,132
Less goodwill	427,097	427,097	391,668	391,668	391,668
Less core deposit and customer relationship intangibles, net	49,819	52,718	44,637	47,479	50,071
Total tangible assets (non-GAAP)	$ 12,092,346	$ 11,680,475	$ 10,876,190	$ 10,968,859	$ 10,893,393
Tangible common equity ratio (non-GAAP)	8.99 %	8.92 %	8.60 %	8.08 %	7.70 %

(1) Excludes loans held for sale.

(2) Excludes deposits held for sale.

(3) Refer to the "Non-GAAP Financial Measures" section after these financial tables for additional information on the usage and presentation of these non-GAAP measures, and refer to these financial tables for the reconciliations to the most directly comparable GAAP measures.

Non-GAAP Financial Measures

This Quarterly Report on Form 10-Q contains references to financial measures which are not defined by generally accepted accounting principles ("GAAP"). Management believes the non-GAAP measures are helpful for investors to analyze and evaluate Heartland's financial condition and operating results. However, these non-GAAP measures have inherent limitations and should not be considered a substitute for operating results determined in accordance with GAAP. Additionally, because non-GAAP measures are not standardized, it may not be possible to compare the non-GAAP measures presented in this section with other companies' non-GAAP measures. Reconciliations of each non-GAAP measure to the most directly comparable GAAP measure may be found in the financial tables above.

The non-GAAP measures presented in this Quarterly Report on Form 10-Q, management's reason for including each measure and the method of calculating each measure are presented below:

- Annualized return on average tangible common equity is net income available to common stockholders plus core deposit and customer relationship intangibles amortization, net of tax, divided by average common stockholders' equity less goodwill and core deposit and customer relationship intangibles, net. This measure is included as it is considered to be a critical metric to analyze and evaluate financial condition and capital strength.
- Annualized net interest margin, fully tax-equivalent, adjusts net interest income for the tax-favored status of certain loans and securities. Management believes this measure enhances the comparability of net interest income arising from taxable and tax-exempt sources.
- Efficiency ratio, fully tax equivalent, expresses noninterest expenses as a percentage of fully tax-equivalent net interest income and noninterest income. This efficiency ratio is presented on a tax-equivalent basis which adjusts net interest income and noninterest expenses for the tax favored status of certain loans, securities, and tax credit projects. Management believes the presentation of this non-GAAP measure provides supplemental useful information for proper understanding of the financial results as it enhances the comparability of income and expenses arising from taxable and nontaxable sources and excludes specific items as noted in reconciliation contained in this Quarterly Report on Form 10-Q.

- Tangible book value per common share is total common stockholders' equity less goodwill and core deposit and customer relationship intangibles, net, divided by common shares outstanding, net of treasury. This measure is included as it is considered to be a critical metric to analyze and evaluate use of equity, financial condition and capital strength.
- Tangible common equity ratio is total common stockholders' equity less goodwill and core deposit and customer relationship intangibles, net, divided by total assets less goodwill and core deposit and customer relationship intangibles, net. This measure is included as it is considered to be a critical metric to analyze and evaluate use of equity, financial condition and capital strength.

RESULTS OF OPERATIONS

Net Interest Margin and Net Interest Income

Heartland's success in maintaining competitive net interest margin has been the result of an increase in average earning assets and a favorable deposit mix for the quarters ended September 30, 2019 and 2018 and the nine-month periods ended September 30, 2019 and 2018. Also contributing to Heartland's ability to maintain its net interest margin has been the amortization of purchase accounting discounts associated with acquisitions completed by Heartland. Growth in interest income on a tax-equivalent basis was largely due to the increase in average earning assets primarily from recent acquisitions. Increases in total interest expense were primarily due to recent increases in market interest rates and deposit growth from recent acquisitions. See "Analysis of Average Balances, Tax-Equivalent Yields and Rates" for information relating to Heartland's net interest income on a fully tax-equivalent basis, which is not defined by GAAP. Refer to the financial highlights above for a reconciliation of annualized net interest margin on a fully tax-equivalent basis to GAAP.

For the Quarters ended September 30, 2019 and 2018

Net interest margin, expressed as a percentage of average earning assets, was 3.98% (4.02% on a fully tax-equivalent basis) during the third quarter of 2019, compared to 4.32% (4.38% on a fully tax-equivalent basis) during the third quarter of 2018. For the third quarter of 2019, Heartland's net interest margin included 23 basis points of purchase accounting discount amortization compared to 25 basis points in the same quarter of 2018.

Total interest income for the third quarter of 2019 was $133.4 million, an increase of $8.5 million or 7%, compared to $124.9 million recorded in the third quarter of 2018. The tax-equivalent adjustments for income taxes saved on the interest earned on nontaxable securities and loans were $1.1 million for the third quarter of 2019 and $1.5 million for the third quarter of 2018. With these adjustments, total interest income on a tax-equivalent basis was $134.5 million for the third quarter of 2019, an increase of $8.1 million or 6%, compared to $126.4 million for the third quarter of 2018.

Average earning assets increased $948.0 million or 9% to $11.10 billion from $10.15 billion in the third quarter of 2018, which was primarily attributable to recent acquisitions. The average interest rate on earning assets decreased 13 basis points to 4.81% for the third quarter of 2019 compared to 4.94% for the same quarter in 2018. In the first quarter of 2019, Heartland sold its higher yielding consumer loan portfolios, which decreased the average rate on earning assets by approximately 13 basis points for the third quarter of 2019 compared to the same quarter in 2018.

Total interest expense for the third quarter of 2019 was $22.1 million, an increase of $7.9 million or 55% from $14.2 million in the third quarter of 2018. The average interest rate paid on Heartland's interest bearing liabilities increased to 1.22% for the third quarter of 2019 compared to 0.86% for the third quarter of 2018, which was primarily due to recent increases in market interest rates. The average interest rate paid on savings deposits was 0.94% during the third quarter of 2019 compared to 0.56% for the third quarter of 2018, and the average interest rate paid on time deposits was 1.62% for the third quarter of 2019 compared to 1.03% for the third quarter of 2018. The average interest rate paid on Heartland's borrowings was 4.26% for the third quarter of 2019 compared to 3.91% in the third quarter of 2018.

For the quarter ended September 30, 2019, average interest bearing liabilities were $7.17 billion, an increase of $630.0 million or 10%, from $6.54 billion for the quarter ended September 30, 2018. Average interest bearing deposits increased $666.8 million or 11% to $6.79 billion for the quarter ended September 30, 2019, from $6.13 billion in the same quarter in 2018. Average borrowings decreased $36.8 million or 9% to $382.2 million during the third quarter of 2019 from $419.0 million during the same quarter in 2018. The increase in Heartland's average interest bearing liabilities is primarily attributable to recent acquisitions.

Net interest income increased $643,000 or 1% to $111.3 million in the third quarter of 2019 from $110.7 million in the third quarter of 2018. After the tax-equivalent adjustment discussed above, net interest income on a tax-equivalent basis totaled $112.5 million during the third quarter of 2019, an increase of $239,000 or less than 1% from $112.2 million during the third quarter of 2018.

For the Nine Months Ended September 30, 2019 and 2018

Net interest margin, expressed as a percentage of average earning assets, was 4.05% (4.10% on a fully tax-equivalent basis) during the nine-month period ended September 30, 2019, compared to 4.25% (4.32% on a fully tax-equivalent basis) during the same period of 2018. For the nine months ended September 30, 2019, Heartland's net interest margin included 19 basis points of purchase accounting discount amortization compared to 21 basis points for the same period of 2018.

Total interest income for the first nine months of 2019 was $381.1 million, an increase of $41.6 million or 12%, compared to $339.5 million recorded in the first nine months of 2018. The tax-equivalent adjustments for income taxes saved on the interest earned on nontaxable securities and loans were $3.8 million for the first nine months of 2019 and $4.7 million for the same period of 2018. With these adjustments, total interest income on a tax-equivalent basis was $384.9 million for the first nine months of 2019, an increase of $40.8 million or 12%, compared to $344.2 million for the first nine months of 2018.

Average earning assets increased $1.05 billion or 11% to $10.60 billion for the first nine months of 2019 from $9.55 billion for the first nine months of 2018, which was primarily attributable to recent acquisitions. The average interest rate on earning assets increased 4 basis points to 4.86% for the first nine months of 2019 compared to 4.82% for the same period in 2018. In the first quarter of 2019, Heartland sold its higher yielding consumer loan portfolios, which decreased the average rate on earning assets by approximately 14 basis points for the nine months ended September 30, 2019 compared to the nine months ended September 30, 2018.

Total interest expense for the nine-month period ended September 30, 2019 was $60.1 million, an increase of $24.3 million or 68% from $35.8 million in the nine-month period ended September 30, 2018. The average interest rate paid on Heartland's interest bearing liabilities increased to 1.17% for the nine months ended September 30, 2019 compared to 0.78% for the same period of 2018, which was primarily due to recent increases in market interest rates. The average interest rate paid on savings deposits was 0.88%, and the average interest rate paid on time deposits was 1.45% during the first nine months of 2019 compared to 0.47% and 0.96%, respectively, for the first nine months of 2018. The average interest rate paid on Heartland's borrowings for the nine months ended September 30, 2019 and 2018, was 4.22% and 3.82%, respectively.

For the first nine months of 2019, average interest bearing liabilities were $6.89 billion, an increase of $740.6 million or 12%, from $6.15 billion for the same period of 2018. Average interest bearing deposits increased $755.7 million or 13% to $6.49 billion for the nine months ended September 30, 2019, from $5.73 billion in the first nine months of 2018. Average borrowings decreased $15.1 million or 4% to $405.6 million during the first nine months of 2019 from $420.7 million during the same period in 2018.

Net interest income increased $17.3 million or 6% to $321.0 million in the first nine months of 2019 from $303.7 million recorded in the first nine months of 2018. After the tax-equivalent adjustment discussed above, net interest income on a tax-equivalent basis totaled $324.8 million during the first nine months of 2019, an increase of $16.5 million or 5% from $308.3 million during the same period of 2018.

Heartland attempts to manage its balance sheet to minimize the effect that a change in interest rates has on its net interest margin. Heartland plans to continue to work toward improving both its earning assets and funding mix through targeted organic growth strategies, which management believes will result in additional net interest income. Heartland produces and reviews simulations of various interest rate scenarios to assist in monitoring its exposure to interest rate risk. Based on these simulations, it is management's opinion that Heartland maintains a well-balanced and manageable interest rate posture. Item 3 of Part I of this Quarterly Report on Form 10-Q contains additional information about the results of Heartland's most recent net interest income simulations. Note 7 to the consolidated financial statements included in this Quarterly Report on Form 10-Q contains a detailed discussion of the derivative instruments Heartland has utilized to manage its interest rate risk.

The following tables set forth certain information relating to Heartland's average consolidated balance sheets and reflect the yield on average earning assets and the cost of average interest bearing liabilities for the periods indicated, in thousands. Such yields and costs are calculated by dividing income or expense by the average balance of assets or liabilities. Average balances are derived from daily balances, and nonaccrual loans and loans held for sale are included in each respective loan category. Assets that receive favorable tax treatment are evaluated on a tax-equivalent basis assuming a federal income tax rate of 21%. Tax-favored assets generally have lower contractual pre-tax yields than fully taxable assets. A tax-equivalent yield is calculated by adding the tax savings to the interest earned on tax favored assets and dividing this amount by the average balance of the tax favorable assets.

ANALYSIS OF AVERAGE BALANCES, TAX EQUIVALENT YIELDS AND RATES [1]
(DOLLARS IN THOUSANDS)

	For the Quarter Ended								
	September 30, 2019			June 30, 2019			September 30, 2018		
	Average Balance	Interest	Rate	Average Balance	Interest	Rate	Average Balance	Interest	Rate
Earning Assets									
Securities:									
Taxable	$ 2,658,107	$ 18,567	2.77 %	$ 2,217,863	$ 16,123	2.92 %	$ 2,066,071	$ 14,433	2.77 %
Nontaxable [1]	266,933	2,682	3.99	324,164	3,233	4.00	435,045	4,418	4.03
Total securities	2,925,040	21,249	2.88	2,542,027	19,356	3.05	2,501,116	18,851	2.99
Interest on deposits with other banks and other short-term investments	358,327	2,151	2.38	424,262	2,299	2.17	252,535	1,238	1.94
Federal funds sold	—	—	—	—	—	—	—	—	—
Loans: [2]									
Commercial and commercial real estate [1]	6,216,133	86,864	5.54	5,968,424	82,328	5.53	5,637,360	77,443	5.45
Residential mortgage	662,663	7,979	4.78	676,465	8,238	4.88	736,875	8,952	4.82
Agricultural and agricultural real estate [1]	550,441	7,551	5.44	558,128	7,581	5.45	571,599	7,725	5.36
Consumer	454,441	6,697	5.85	445,545	6,517	5.87	516,342	10,043	7.72
Fees on loans		2,052	—		1,952	—		2,186	—
Less: allowance for loan losses	(64,464)	—	—	(62,685)	—	—	(61,236)	—	—
Net loans	7,819,214	111,143	5.64	7,585,877	106,616	5.64	7,400,940	106,349	5.70
Total earning assets	**11,102,581**	**134,543**	**4.81 %**	**10,552,166**	**128,271**	**4.88 %**	**10,154,591**	**126,438**	**4.94 %**
Nonearning Assets	1,190,751			1,156,372			1,136,698		
Total Assets	**$ 12,293,332**			**$ 11,708,538**			**$ 11,291,289**		
Interest Bearing Liabilities [3]									
Savings	$ 5,643,722	$ 13,301	0.94 %	$ 5,360,355	$ 11,895	0.89 %	$ 4,932,013	$ 6,980	0.56 %
Time deposits	1,149,064	4,681	1.62	1,142,842	4,243	1.49	1,193,971	3,112	1.03
Short-term borrowings	102,440	250	0.97	92,977	338	1.46	148,041	464	1.24
Other borrowings	279,718	3,850	5.46	276,275	3,819	5.54	270,924	3,660	5.36
Total interest bearing liabilities	**7,174,944**	**22,082**	**1.22 %**	**6,872,449**	**20,295**	**1.18 %**	**6,544,949**	**14,216**	**0.86 %**
Noninterest Bearing Liabilities [3]									
Noninterest bearing deposits	3,460,857			3,287,559			3,404,759		
Accrued interest and other liabilities	116,162			106,142			77,786		
Total noninterest bearing liabilities	**3,577,019**			**3,393,701**			**3,482,545**		
Stockholders' Equity	**1,541,369**			**1,442,388**			**1,263,795**		
Total Liabilities and Stockholders' Equity	**$ 12,293,332**			**$ 11,708,538**			**$ 11,291,289**		
Net interest income, fully tax-equivalent (non-GAAP) [1]		**$ 112,461**			**$ 107,976**			**$ 112,222**	
Net interest spread [1]			**3.59 %**			**3.70 %**			**4.08 %**
Net interest income, fully tax-equivalent (non-GAAP) to total earning assets			**4.02 %**			**4.10 %**			**4.38 %**

(1) Computed on a tax-equivalent basis using an effective tax rate of 21%.

(2) Nonaccrual loans and loans held for sale are included in the average loans outstanding.

(3) Includes deposits held for sale.

ANALYSIS OF AVERAGE BALANCES, TAX EQUIVALENT YIELDS AND RATES [1]
DOLLARS IN THOUSANDS

	For the Nine Months Ended					
	September 30, 2019			September 30, 2018		
	Average Balance	Interest	Rate	Average Balance	Interest	Rate
Earning Assets						
Securities:						
Taxable	$ 2,350,120	$ 50,566	2.88 %	$ 1,937,053	$ 38,280	2.64 %
Nontaxable [1]	327,150	9,830	4.02 %	444,127	13,485	4.06
Total securities	2,677,270	60,396	3.02	2,381,180	51,765	2.91
Interest bearing deposits with other banks and other short-term investments	334,191	5,742	2.30	183,905	2,413	1.75
Federal funds sold	185	4	2.89	471	—	—
Loans: [2]						
Commercial and commercial real estate [1]	5,978,304	247,275	5.53	5,319,862	211,557	5.32
Residential mortgage	670,896	23,396	4.66	688,367	23,365	4.54
Agricultural and agricultural real estate [1]	554,344	22,433	5.41	542,755	20,579	5.07
Consumer	446,546	19,693	5.90	489,417	27,895	7.62
Fees on loans		6,008	—		6,606	—
Less: allowance for loan losses	(63,271)	—	—	(58,810)	—	—
Net loans	7,586,819	318,805	5.62	6,981,591	290,002	5.55
Total earning assets	**10,598,465**	**384,947**	**4.86 %**	**9,547,147**	**344,180**	**4.82 %**
Nonearning Assets	1,161,655			1,023,306		
Total Assets	**$ 11,760,120**			**$ 10,570,453**		
Interest Bearing Liabilities [3]						
Savings	$ 5,376,999	$ 35,279	0.88 %	$ 4,681,710	$ 16,306	0.47 %
Time deposits	1,109,302	12,054	1.45	1,048,878	7,535	0.96
Short-term borrowings	129,928	1,477	1.52	149,453	1,279	1.14
Other borrowings	275,642	11,333	5.50	271,234	10,726	5.29
Total interest bearing liabilities	**6,891,871**	**60,143**	**1.17 %**	**6,151,275**	**35,846**	**0.78 %**
Noninterest Bearing Liabilities [3]						
Noninterest bearing deposits	3,317,187			3,207,709		
Accrued interest and other liabilities	110,308			71,506		
Total noninterest bearing liabilities	**3,427,495**			**3,279,215**		
Stockholders' Equity	**1,440,754**			**1,139,963**		
Total Liabilities and Stockholders' Equity	**$ 11,760,120**			**$ 10,570,453**		
Net interest income, fully tax-equivalent (non-GAAP) [1]		**$ 324,804**			**$ 308,334**	
Net interest spread [1]			**3.69 %**			**4.04 %**
Net interest income, fully tax-equivalent (non-GAAP) to total earning assets			**4.10 %**			**4.32 %**

(1) Computed on a tax-equivalent basis using an effective tax rate of 21%.

(2) Nonaccrual loans and loans held for sale are included in the average loans outstanding.

(3) Includes deposits held for sale.

Provision For Loan Losses

The allowance for loan losses is established through provision expense to provide, in Heartland management's opinion, an appropriate allowance for loan losses. The provision for loan losses was $5.2 million for the third quarter of 2019 and 2018. For the nine months ended September 30, 2019, provision expense totaled $11.8 million compared to $14.3 million for the same period of 2018.

The impact of the sale of the Citizen's Finance loan portfolios resulted in net recoveries of $1,800 for the third quarter and $629,000 for the first nine months of 2019, compared to net charge-offs of $805,000 in the third quarter of 2018 and $2.3 million for the first nine months of 2018. As a result of the sale of the Citizen's Finance loan portfolios, Heartland recorded

negative provision expense of $1,800 and $629,000 for the third quarter of 2019 and first nine months of 2019, respectively. Provision expense related to the Citizen's Finance loan portfolios of $769,000 and $2.3 million, respectively, was recorded for the same periods of 2018. This was a change to provision expense of $771,000 and $2.9 million for the three- and nine-months ended September 30, 2019, respectively, for the Citizen's Finance loan portfolios.

Given the size of Heartland's loan portfolio, the level of organic loan growth, acquired loans that move out of the purchase accounting pool, changes in credit quality and the variability that can occur in the factors considered when determining the appropriateness of the allowance for loan losses, Heartland's provision for loan losses will vary from quarter to quarter. For additional details on the specific factors considered in establishing the allowance for loan losses, refer to the discussion of critical accounting policies set forth in Management's Discussion and Analysis of Financial Condition and Results of Operations contained in Heartland's Annual Report on Form 10-K for the year ended December 31, 2018, and the information under the caption "Allowance For Loan Losses" in Item 2 of this Quarterly Report on Form 10-Q and Note 5 to the consolidated financial statements included herein.

Heartland believes the allowance for loan losses as of September 30, 2019, was at a level commensurate with the overall risk exposure of the loan portfolio. However, if economic conditions should deteriorate, certain borrowers may experience difficulty and the level of nonperforming loans, charge-offs and delinquencies could rise and require further increases in the provision for loan losses.

Noninterest Income

The tables below show Heartland's noninterest income for the three- and nine-month periods ended September 30, 2019, and 2018, in thousands:

	Three Months Ended September 30,			
	2019	2018	Change	% Change
Service charges and fees	$ 12,366	$ 12,895	$ (529)	(4)%
Loan servicing income	821	1,670	(849)	(51)
Trust fees	4,959	4,499	460	10
Brokerage and insurance commissions	962	1,111	(149)	(13)
Securities gains/(losses), net	2,013	(145)	2,158	1,488
Unrealized gain on equity securities, net	144	54	90	167
Net gains on sale of loans held for sale	4,673	7,410	(2,737)	(37)
Valuation adjustment on servicing rights	(626)	230	(856)	(372)
Income on bank owned life insurance	881	892	(11)	(1)
Other noninterest income	3,207	1,149	2,058	179
Total noninterest income	$ 29,400	$ 29,765	$ (365)	(1)%

	Nine Months Ended September 30,			
	2019	2018	Change	% Change
Service charges and fees	$ 39,789	$ 35,046	$ 4,743	14 %
Loan servicing income	3,888	5,231	(1,343)	(26)
Trust fees	14,258	13,794	464	3
Brokerage and insurance commissions	2,724	2,895	(171)	(6)
Securities gains, net	7,168	1,037	6,131	591
Unrealized gain on equity securities, net	514	97	417	430
Net gains on sale of loans held for sale	12,192	18,261	(6,069)	(33)
Valuation adjustment on servicing rights	(1,579)	12	(1,591)	(13,258)
Income on bank owned life insurance	2,668	2,206	462	21
Other noninterest income	6,556	3,536	3,020	85
Total noninterest income	$ 88,178	$ 82,115	$ 6,063	7 %

Total noninterest income totaled $29.4 million during the third quarter of 2019 compared to $29.8 million during the third quarter of 2018, a decrease of $365,000 or 1%. For the nine months ended September 30, 2019, total noninterest income totaled $88.2 million compared to $82.1 million for the first nine months of 2018, which was an increase of $6.1 million or 7%. The changes for the quarterly and nine month comparison were primarily the result of higher securities gains, net, which were partially offset by lower loan servicing income, net gains on sale of loans held for sale and valuation adjustment on servicing rights. Also impacting the nine months ended September 30, 2019 compared to the same period in 2018 were higher service charges and fees.

Service Charges and Fees

The following tables summarize the changes in service charges and fees for the three- and nine-month periods ended September 30, 2019, and 2018, in thousands:

	Three Months Ended September 30,			
	2019	2018	Change	% Change
Service charges and fees on deposit accounts	$ 3,221	$ 2,858	$ 363	13 %
Overdraft fees	2,917	2,990	(73)	(2)
Customer service and other service fees	104	102	2	2
Credit card fee income	3,936	3,062	874	29
Debit card income	2,188	3,883	(1,695)	(44)
Total service charges and fees	$ 12,366	$ 12,895	$ (529)	(4)%

	Nine Months Ended September 30,			
	2019	2018	Change	% Change
Service charges and fees on deposit accounts	$ 9,383	$ 8,270	$ 1,113	13 %
Overdraft fees	8,537	7,716	821	11
Customer service and other service fees	270	268	2	1
Credit card fee income	11,555	8,443	3,112	37
Debit card income	10,044	10,349	(305)	(3)
Total service charges and fees	$ 39,789	$ 35,046	$ 4,743	14 %

Total service charges and fees decreased $529,000 or 4% to $12.4 million during the third quarter of 2019 compared to $12.9 million during the third quarter of 2018, as increases in credit card fee income and service charges and fees on deposit accounts were offset by a decrease in debit card income. Total service charges and fees increased $4.7 million or 14% to $39.8 million during the first nine months of 2019 compared to $35.0 million for the same period of 2018, which was primarily attributable to higher service charges and fees on deposit accounts and higher credit card fee income.

Service charges and fees on deposit accounts increased $363,000 or 13% to $3.2 million for the third quarter of 2019 compared to $2.9 million for the third quarter of 2018. For the first nine months of 2019, service charges and fees on deposit accounts totaled $9.4 million compared to $8.3 million for the first nine months of 2018, which was an increase of $1.1 million or 13%. Overdraft fees decreased $73,000 or 2% to $2.9 million for the third quarter of 2019 compared to $3.0 million for the third quarter of 2018, and overdraft fees increased $821,000 or 11% during the first nine months of 2019 to $8.5 million compared to $7.7 million for the first nine months of 2018. The increases in service charges and fees on deposit accounts and overdraft fees were primarily attributable to a larger demand deposit customer base, a portion of which is attributable to the acquisitions completed in 2018 and the first half of 2019.

Fees associated with credit card services were $3.9 million during the third quarter of 2019 compared to $3.1 million during the third quarter of 2018, an increase of $874,000 or 29%. For the nine months ended September 30, 2019, credit card fee income totaled $11.6 million, which was an increase of $3.1 million or 37% from $8.4 million recorded in the same period of 2018. These increases resulted primarily from efforts to increase the level of commercial credit card services provided at Heartland's subsidiary banks, including at the recently acquired banks. Heartland has focused on expanding its card payment solutions for businesses. In particular, Heartland has introduced an expense management service that provides business customers the ability to more efficiently manage their card-based spending.

Debit card income decreased $1.7 million or 44% to $2.2 million for the third quarter of 2019 compared to $3.9 million for the third quarter of 2018. For the nine months ended September 30, 2019, debit card income decreased $305,000 or 3% to $10.0 million from $10.3 million for the nine months ended September 30, 2018. The decrease for the quarterly period was primarily attributable to the impact of the Durbin Amendment, which restricts interchange fees to those which are "reasonable and proportionate" for certain debit card issuers and limits the ability of networks and issuers to restrict debit card transaction routing. The Durbin Amendment was effective for Heartland on July 1, 2019.

Loan Servicing Income

The following tables show the changes in loan servicing income for the three- and nine-month periods ended September 30, 2019, and 2018, in thousands:

	Three Months Ended September 30,			
	2019	2018	Change	% Change
Commercial and agricultural loan servicing fees[1]	$ 774	$ 702	$ 72	10 %
Residential mortgage servicing fees	519	2,610	(2,091)	(80)
Mortgage servicing rights amortization	(472)	(1,642)	1,170	71
Total loan servicing income	$ 821	$ 1,670	$ (849)	(51)%

	Nine Months Ended September 30,			
	2019	2018	Change	% Change
Commercial and agricultural loan servicing fees[1]	$ 2,270	$ 2,375	$ (105)	(4)%
Residential mortgage servicing fees	4,484	7,250	(2,766)	(38)
Mortgage servicing rights amortization	(2,866)	(4,394)	1,528	35
Total loan servicing income	$ 3,888	$ 5,231	$ (1,343)	(26)%

(1) Includes servicing fees for commercial, commercial real estate, agricultural and agricultural real estate loans.

Loan servicing income includes the fees collected for the servicing of commercial, agricultural, and mortgage loans, which are dependent upon the aggregate outstanding balances of these loans, rather than quarterly production and sale of these loans. Loan servicing income totaled $821,000 during the third quarter of 2019 compared to $1.7 million during the third quarter of 2018, a decrease of $849,000 or 51%. For the nine months ended September 30, 2019, loan servicing income totaled $3.9 million, which was a decrease of $1.3 million or 26% from $5.2 million recorded in the same period of 2018. The decrease for both the quarterly and year-to-date comparisons was primarily due to the sale of the mortgage servicing rights portfolio of Dubuque Bank and Trust Company, which occurred on April 30, 2019. This transaction does not impact the residential mortgage servicing portfolio of Heartland's PrimeWest Mortgage Corporation subsidiary.

Securities Gains, Net

Securities gains, net, totaled $2.0 million for the third quarter of 2019 compared to net securities losses of $145,000 for the third quarter of 2018, which was an increase of $2.2 million. Securities gains, net, totaled $7.2 million and $1.0 million for the nine months ended September 30, 2019 and 2018, respectively, which was an increase of $6.1 million. Heartland's net unrealized gain on securities available for sale totaled $27.5 million at September 30, 2019, compared to net unrealized losses of $68.8 million at September 30, 2018.

Net Gains on Sale of Loans Held for Sale

During the third quarter of 2019, net gains on sale of loans held for sale totaled $4.7 million compared to $7.4 million during the same period in 2018, a decrease of $2.7 million or 37%. For the nine months ended September 30, 2019, net gains on sales of loans held for sale totaled $12.2 million compared to $18.3 million for the nine months ended September 30, 2018, which was a decrease of $6.1 million or 33%. These decreases were primarily due to the outsourcing of Heartland's legacy residential mortgage lending operations in the fourth quarter of 2018.

Other Noninterest Income

Other noninterest income totaled $3.2 million and $1.1 million for the quarters ended September 30, 2019 and 2018, respectively, which was an increase of $2.1 million or 179%. Commercial swap fee income increased $1.3 million to $1.6 million for the third quarter of 2019 compared to $374,000 for the same quarter of 2018. Also included in other noninterest income for the third quarter of 2019 was a gain on the extinguishment of debt of $375,000. For the nine months ended September 30, 2019 and 2018, other noninterest income totaled $6.6 million and $3.5 million, respectively, which was an increase of $3.0 million or 85%. This increase was primarily attributable to a recovery of $266,000 on an acquired loan that was charged off prior to acquisition, $368,000 from a death benefit on bank owned life insurance, as well as the items impacting the third quarter of 2019.

Noninterest Expense

The tables below show Heartland's noninterest expenses for the three- and nine-month periods ended September 30, 2019, and 2018, in thousands:

	Three Months Ended September 30,			
	2019	2018	Change	% Change
Salaries and employee benefits	$ 50,027	$ 49,921	$ 106	— %
Occupancy	6,594	6,348	246	4
Furniture and equipment	2,858	3,470	(612)	(18)
Professional fees	12,131	12,800	(669)	(5)
Advertising	2,737	2,754	(17)	(1)
Core deposit and customer relationship intangibles amortization	2,899	2,626	273	10
Other real estate and loan collection expenses, net	(89)	784	(873)	(111)
(Gain)/loss on sales/valuations of assets, net	356	912	(556)	(61)
Restructuring expenses	—	—	—	—
Other noninterest expenses	15,454	12,924	2,530	20
Total noninterest expenses	$ 92,967	$ 92,539	$ 428	— %

	Nine Months Ended September 30,			
	2019	2018	Change	% Change
Salaries and employee benefits	$ 150,307	$ 149,389	$ 918	1 %
Occupancy	19,637	18,706	931	5
Furniture and equipment	8,770	9,403	(633)	(7)
Professional fees	38,478	32,880	5,598	17
Advertising	7,723	6,839	884	13
Core deposit and customer relationship intangibles amortization	9,054	6,763	2,291	34
Other real estate and loan collection expenses, net	774	2,464	(1,690)	(69)
(Gain)/loss on sales/valuations of assets, net	(20,934)	2,243	(23,177)	(1,033)
Restructuring expenses	3,227	2,564	663	26
Other noninterest expenses	39,259	33,816	5,443	16
Total noninterest expenses	$ 256,295	$ 265,067	$ (8,772)	(3)%

For the third quarter of 2019, noninterest expenses totaled $93.0 million compared to $92.5 million during the third quarter of 2018, an increase of $428,000 or less than 1%. For the nine months ended September 30, 2019, total noninterest expenses were $256.3 million compared to $265.1 million for the same period of 2018, which was a decrease of $8.8 million or 3%.

Management has taken actions to streamline operations and reduce expenses, which included restructuring its mortgage lending operations, optimizing bank branch locations, and strategic initiative projects. Operation Customer Compass is anticipated to be complete by the end of 2019, and this project is focused on streamlining and automating processes. Expense reductions of over $10 million annually are expected to be realized once the Operation Customer Compass project is completed. Other process improvement projects will continue into mid-2020. Additionally, systems conversions of newly acquired entities are completed as soon as possible after the closing of the transaction in order to optimize cost savings. Notable changes in noninterest expense categories for the quarterly and nine-month periods ended September 30, 2019 and 2018 are as follows:

Professional Fees

Professional fees for the third quarter of 2019 totaled $12.1 million compared to $12.8 million for the same quarter of 2018, which was a decrease of $669,000 or 5%. For the nine months ended September 30, 2019, professional fees totaled $38.5 million compared to $32.9 million for the nine months ended September 30, 2018, which was an increase of $5.6 million or 17%. In the third quarter of 2019, Heartland's banks reversed the accrual for FDIC insurance assessments, which totaled $1.8 million, because the Deposit Insurance Fund ratio exceeded 1.38%, which is threshold required for assessment credits to be applied. This resulted in a benefit recorded in professional fees of $1.8 million for the third quarter of 2019 compared to expense of $1.1 million for the third quarter of 2018. Future FDIC insurance assessment expense may continue to be reduced by the assessment credits depending on the level of the Deposit Insurance Fund until the credits are fully utilized.

Professional fees related to Heartland's 2019 strategic initiative projects totaled $1.2 million for the third quarter and $4.3 million for the nine months ended September 30, 2019. The remainder of the increase for both the quarterly and year-to-date comparisons was primarily attributable to professional fees incurred at recently acquired entities, model validation expenses, and increased advisory services associated with the higher level of regulation resulting from Heartland having assets over $10 billion.

Core Deposit and Customer Relationship Intangibles Amortization

Core deposit and customer relationship intangibles amortization was $2.9 million for the third quarter of 2019 compared to $2.6 million for the same quarter of 2018, which was an increase of $273,000 or 10%. For the nine months ended September 30, 2019, core deposit and customer relationship intangibles amortization was $9.1 million compared to $6.8 million for the same period of 2018, which was an increase of $2.3 million or 34%. The increase for the quarterly comparison was due to recent acquisitions. The increase for the nine-month comparison was due to recent acquisitions and write-offs totaling $682,000 related to the branch sales at Illinois Bank & Trust, Citywide Banks and Wisconsin Bank & Trust.

Gain/Loss on Sales/Valuations of Assets, Net

Net losses on sales/valuations of assets totaled $356,000 during the third quarter of 2019 compared to $912,000 for the third quarter of 2018, which was a decrease of $556,000 or 61%. For the nine months ended September 30, 2019, net gains on sales/valuations of assets totaled $20.9 million compared to net losses on sales/valuations of assets of $2.2 million, which was a change of $23.2 million. In the second quarter of 2019, gains of $19.8 million were recorded in conjunction with the branch sales at Illinois Bank & Trust, Citywide Banks, and Dubuque Bank and Trust Company, and the sale of Dubuque Bank and Trust Company's mortgage servicing rights portfolio. Additionally, a gain of $3.5 million was recorded related to the sale of two branches at Wisconsin Bank & Trust in the first quarter of 2019.

Other noninterest expenses

Other noninterest expenses totaled $15.5 million for the third quarter of 2019 compared to $12.9 million for the third quarter of 2018, which was an increase of $2.5 million or 20%. For the nine months ended September 30, 2019 and 2018, other noninterest expenses totaled $39.3 million and $33.8 million, respectively, which was an increase of $5.4 million or 16%. Write-downs on partnership investments which qualified for tax credits totaled $3.1 million and $5.0 million for the quarter and the nine months ended September 30, 2019, respectively, compared to $338,000 for the same periods of 2018.

Efficiency Ratio

One of Heartland's top priorities is to improve its efficiency ratio, on a fully tax-equivalent basis, by reducing it to the 55-60% range over the next twelve to eighteen months. During the third quarter of 2019, Heartland's efficiency ratio on a fully tax-equivalent basis decreased by 59 basis points to 61.92% in comparison with 62.51% for the quarter ended September 30, 2018. For the nine months ended September 30, 2019, Heartland's efficiency ratio was 63.95%, which was an improvement of 108 basis points from 65.03% for the same period of 2018.

Income Taxes

Heartland's effective tax rate was 18.66% for the third quarter of 2019 compared to 20.99% for the third quarter of 2018. Included in Heartland's third quarter 2019 and 2018 tax calculations were solar energy tax credits of $2.0 million and $223,000, respectively. Federal low-income housing tax credits included in the determination of Heartland's income taxes totaled $281,000 for the third quarter of 2019 compared to $307,000 for the third quarter of 2018. Tax-exempt interest income as a percentage of pre-tax income declined to 10.08% during the third quarter of 2019 from 13.62% during the third quarter of 2018.

Heartland's effective tax rate was 21.14% and 20.24% for the nine months ended September 30, 2019 and 2018, respectively. Included in Heartland's tax calculation for the first nine months of 2019 and 2018 were solar energy tax credits of $3.2 million and $223,000, respectively. Federal low-income housing tax credits include in the determination of Heartland's income taxes were $843,000 and $921,000 for the nine months ended September 30, 2019 and 2018, respectively. The tax-exempt interest income as a percentage of pre-tax income declined to 10.19% during the first nine months of 2019 from 16.49% during the first nine months of 2018.

Heartland's income taxes included a tax benefit of $270,000 and $672,000 for the nine-month periods ended September 30, 2019, and 2018, respectively, resulting from the vesting of outstanding restricted stock unit awards and options. The majority of Heartland's restricted stock unit awards vest in the first quarter of each year.

FINANCIAL CONDITION

Total assets of Heartland were $12.57 billion at September 30, 2019, an increase of $1.16 billion or 10% since December 31, 2018. Excluding $766.2 million of assets acquired at fair value in the BVBC transaction, total assets increased $395.0 million or 3% since year-end 2018. Securities represented 25% and 24% of total assets at September 30, 2019, and December 31, 2018, respectively.

Lending Activities

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

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 if warranted by the overall financial condition of the borrower. Terms of commercial business loans generally range from one to five years. Commercial loans 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 is based upon the discounted market value of the collateral. The primary repayment risks of commercial loans are that the cash flow of the borrowers may be unpredictable, and the collateral securing these loans may fluctuate in value. Heartland seeks to minimize these risks in a variety of ways. The underwriting analysis includes credit verification, analysis of global cash flows, appraisals and a review of the financial condition of the borrower. Personal guarantees are frequently required as a tertiary form of repayment. In addition, when underwriting loans for commercial real estate, careful consideration is given to the property's operating history, future operating projections, current and projected occupancy, location and physical condition. Heartland also utilizes government guaranteed lending through the U.S. Small Business Administration and the U.S. Department of Agriculture's Rural Development Business and Industry Program to assist customers with longer-term funding and to reduce risk.

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

During the fourth quarter of 2018, Heartland entered into arrangements with third parties to offer residential mortgage loans to customers in many of its markets. In addition, the acquisition in 2018 of First Bank & Trust in Lubbock, Texas, included its wholly owned mortgage subsidiary, PrimeWest Mortgage Corporation. PrimeWest Mortgage Corporation provides mortgage loans to customers in Texas and has expanded to also serve the mortgage needs of customers in several of Heartland's southwestern markets. PrimeWest Mortgage Corporation services the loans it sells into the secondary market.

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.

Total loans held to maturity were $7.97 billion at September 30, 2019, compared to $7.41 billion at December 31, 2018, an increase of $563.9 million or 8%. This change includes $542.0 million of total loans held to maturity acquired in the BVBC transaction. During the first quarter of 2019, Heartland classified $32.1 million of loans as held for sale in conjunction with the branch sales. Excluding the reclassification of loans to held for sale and the BVBC transaction, total loans held to maturity increased $54.0 million or 1% since December 31, 2018. Loan changes by category were

- Commercial and commercial real estate loans totaled $6.39 billion at September 30, 2019, compared to $5.73 billion at December 31, 2018, which was an increase of $661.9 million or 12%. Excluding $14.9 million of commercial and commercial real estate loans classified as held for sale during the first quarter of 2019 and $480.1 million of loans acquired in the BVBC transaction, commercial and commercial real estate loans increased $196.6 million or 3% since year-end.
- Agricultural and agricultural real estate loans totaled $545.0 million at September 30, 2019, compared to $565.4 million at December 31, 2018, which was a decrease of $20.4 million or 4%. Excluding $6.6 million of agricultural and agricultural real estate loans classified as held for sale during the first quarter of 2019 and $1.8 million of loans acquired in the BVBC transaction, agricultural and agricultural real estate loans decreased $15.6 million or 3% since year-end.
- Residential mortgage loans decreased $83.8 million or 12% to $589.8 million at September 30, 2019, from $673.6 million at December 31, 2018. Excluding $2.0 million of residential mortgage loans classified as held for sale during the first quarter of 2019 and $17.2 million of loans acquired in the BVBC transaction, residential mortgage loans decreased $99.0 million or 15% since year-end, primarily as a result of customers refinancing loans due to the recent decreases in mortgage interest rates.
- Consumer loans increased $7.6 million or 2% to $447.7 million at September 30, 2019, compared to $440.2 million at December 31, 2018. Excluding $8.6 million of loans classified as held for sale during the first quarter of 2019 and $42.9 million of loans acquired in the BVBC transaction, consumer loans decreased $26.7 million or 6% since year-end, primarily as a result of customers refinancing loans due to the recent decreases in mortgage interest rates.

The table below presents the composition of the loan portfolio as of September 30, 2019, and December 31, 2018, in thousands:

LOAN PORTFOLIO	**September 30, 2019**		**December 31, 2018**	
	Amount	**Percent**	**Amount**	**Percent**
Loans receivable held to maturity:				
Commercial	$ 2,276,916	28.56 %	$ 2,020,231	27.26 %
Commercial real estate	4,116,680	51.61	3,711,481	50.08
Agricultural and agricultural real estate	545,006	6.83	565,408	7.63
Residential mortgage	589,793	7.39	673,603	9.09
Consumer	447,718	5.61	440,158	5.94
Gross loans receivable held to maturity	7,976,113	100.00 %	7,410,881	100.00 %
Unearned discount	(833)		(1,624)	
Deferred loan fees	(3,672)		(1,560)	
Total net loans receivable held to maturity	7,971,608		7,407,697	
Allowance for loan losses	(66,222)		(61,963)	
Loans receivable, net	$ 7,905,386		$ 7,345,734	

Loans secured by real estate, either fully or partially, totaled $5.10 billion or 64% of gross loans at September 30, 2019. Exclusive of purchase accounting valuations at September 30, 2019, approximately 49% of the properties securing non-farm, nonresidential real estate loans are owner occupied. The largest categories of Heartland's loans secured by real estate at September 30, 2019, and December 31, 2018, are listed below, in thousands:

LOANS SECURED BY REAL ESTATE

	September 30, 2019	December 31, 2018
Residential real estate, excluding residential construction and residential lot loans	$ 1,051,362	$ 1,119,942
Industrial, manufacturing, business and commercial	630,781	805,265
Agriculture	281,143	270,023
Retail	465,184	435,680
Office	681,065	485,262
Land development and lots	228,997	216,665
Hotel, resort and hospitality	316,795	233,735
Multi-family	346,381	311,319
Food and beverage	134,721	130,981
Warehousing	203,697	186,436
Health services	262,696	182,882
Residential construction	188,639	171,116
All other	309,949	255,145
Total loans secured by real estate	$ 5,101,410	$ 4,804,451

Allowance For Loan Losses

The process utilized by Heartland to determine the appropriateness of the allowance for loan losses is considered a critical accounting practice for Heartland and has remained consistent over the past several years. The allowance for loan losses represents management's estimate of identified and unidentified probable losses in the existing loan portfolio. For additional details on the specific factors considered in determining the allowance for loan losses, refer to the critical accounting policies section of Heartland's Annual Report on Form 10-K for the year ended December 31, 2018.

Heartland's nonpass loans totaled 7.03% of total loans as of September 30, 2019 compared to 6.26% of total loans as of December 31, 2018. As of September 30, 2019, Heartland's nonpass loans consisted of approximately 62% special mention loans and 38% substandard loans. The percent of nonpass loans on nonaccrual status as of September 30, 2019, was 13%. As of December 31, 2018, Heartland's nonpass loans were comprised of approximately 52% special mention loans and 48% substandard loans. The percent of nonpass loans on nonaccrual status as of December 31, 2018, was 16%.

Nonperforming loans were $72.2 million or 0.91% of total loans at September 30, 2019, compared to $72.7 million or 0.98% of total loans at December 31, 2018. At September 30, 2019, approximately $38.2 million or 53% of Heartland's nonperforming loans had individual loan balances exceeding $1.0 million and represented loans to thirteen borrowers. At September 30, 2019, and December 31, 2018, Heartland had $6.5 million and $7.7 million, respectively, of nonperforming residential real estate loans that were repurchased under various Government National Mortgage Association ("GNMA") or other guaranteed loan programs. The portion of Heartland's nonperforming nonresidential real estate loans covered by government guarantees totaled $12.4 million at September 30, 2019, compared to $7.7 million at December 31, 2018.
The allowance for loan losses was 0.83% and 0.84% of loans at September 30, 2019 and December 31, 2018, respectively, and 91.66% and 85.27% of nonperforming loans at September 30, 2019, and December 31, 2018, respectively. Excluding the acquired loans covered by the valuation reserves, the ratio of the allowance for loan losses to outstanding loans was 1.00% and 1.03% at September 30, 2019, and December 31, 2018, respectively. At September 30, 2019, valuation reserves totaled $42.1 million and covered $1.65 billion of acquired loans. At December 31, 2018, valuation reserves totaled $40.9 million and covered $1.63 billion of acquired loans. Loans delinquent 30-89 days as a percent of total loans was 0.28% at September 30, 2019, in comparison with 0.21% at December 31, 2018.

The table below presents the changes in the allowance for loan losses during the three- and nine-month periods ended September 30, 2019 and 2018, in thousands:

ANALYSIS OF ALLOWANCE FOR LOAN LOSSES	**Three Months Ended September 30,**	
	2019	**2018**
Balance at beginning of period	$ 63,850	$ 61,324
Provision for loan losses	5,201	5,238
Recoveries on loans previously charged off	2,013	779
Charge-offs on loans	(4,842)	(6,120)
Balance at end of period	$ 66,222	$ 61,221
Annualized ratio of net charge offs to average loans	0.14 %	0.28 %

	Nine Months Ended September 30,	
	2019	**2018**
Balance at beginning of period	$ 61,963	$ 55,686
Provision for loan losses	11,754	14,332
Recoveries on loans previously charged off	4,077	2,711
Charge-offs on loans	(11,572)	(11,508)
Balance at end of period	$ 66,222	$ 61,221
Annualized ratio of net charge offs to average loans	0.13 %	0.17 %

The table below presents the amounts of nonperforming loans and other nonperforming assets on the dates indicated, in thousands:

NONPERFORMING ASSETS	**September 30,**		**December 31,**	
	2019	**2018**	**2018**	**2017**
Nonaccrual loans	$ 72,208	$ 73,060	$ 71,943	$ 62,581
Loans contractually past due 90 days or more	40	154	726	830
Total nonperforming loans	72,248	73,214	72,669	63,411
Other real estate	6,425	11,908	6,153	10,777
Other repossessed assets	13	495	459	411
Total nonperforming assets	$ 78,686	$ 85,617	$ 79,281	$ 74,599
Performing troubled debt restructured loans[(1)]	$ 3,199	$ 4,180	$ 4,026	$ 6,617
Nonperforming loans to total loans	0.91 %	0.99 %	0.98 %	0.99 %
Nonperforming assets to total loans plus repossessed property	0.99 %	1.16 %	1.07 %	1.17 %
Nonperforming assets to total assets	0.63 %	0.76 %	0.69 %	0.76 %

(1) Represents accruing troubled debt restructured loans performing according to their restructured terms.

The schedules below summarize the changes in Heartland's nonperforming assets during the three- and nine-month periods of 2019, in thousands:

	Nonperforming Loans	Other Real Estate Owned	Other Repossessed Assets	Total Nonperforming Assets
June 30, 2019	**$ 79,904**	**$ 6,646**	**$ 39**	**$ 86,589**
Loan foreclosures	(2,784)	2,766	18	—
Net loan charge-offs	(2,829)	—	—	(2,829)
Acquired nonperforming assets	—	—	—	—
New nonperforming loans	6,818	—	—	6,818
Reduction of nonperforming loans[(1)]	(8,861)	—	—	(8,861)
OREO/Repossessed assets sales proceeds	—	(3,043)	(22)	(3,065)
OREO/Repossessed assets writedowns, net	—	56	(20)	36
Net activity at Citizens Finance Co.	—	—	(2)	(2)
September 30, 2019	**$ 72,248**	**$ 6,425**	**$ 13**	**$ 78,686**

(1) Includes principal reductions and transfers to performing status.

	Nonperforming Loans	Other Real Estate Owned	Other Repossessed Assets	Total Nonperforming Assets
December 31, 2018	**$ 72,669**	**$ 6,153**	**$ 459**	**$ 79,281**
Loan foreclosures	(7,631)	7,421	210	—
Net loan charge-offs	(7,495)	—	—	(7,495)
Acquired nonperforming assets	230	—	—	230
New nonperforming loans	35,820	—	—	35,820
Reduction of nonperforming loans[(1)]	(21,345)	—	—	(21,345)
OREO/Repossessed assets sales proceeds	—	(6,268)	(177)	(6,445)
OREO/Repossessed assets writedowns, net	—	(881)	(32)	(913)
Net activity at Citizens Finance Co.	—	—	(447)	(447)
September 30, 2019	**$ 72,248**	**$ 6,425**	**$ 13**	**$ 78,686**

(1) Includes principal reductions and transfers to performing status.

Securities

The composition of Heartland's securities portfolio is managed to maximize the return on the portfolio while considering the impact it has on Heartland's asset/liability position and liquidity needs. Securities represented 25% and 24% of total assets at September 30, 2019, and December 31, 2018, respectively. Total securities carried at fair value as of September 30, 2019, were $3.02 billion, an increase of $569.9 million or 23% from $2.45 billion at December 31, 2018.

The table below presents the composition of the securities portfolio, including securities carried at fair value, held to maturity securities and other, by major category, as of September 30, 2019, and December 31, 2018, in thousands:

SECURITIES PORTFOLIO COMPOSITION	**September 30, 2019**		**December 31, 2018**	
	Amount	**Percent**	**Amount**	**Percent**
U.S. government corporations and agencies	$ 8,950	0.29 %	$ 31,951	1.18 %
Mortgage and asset-backed securities	2,480,677	79.05	2,026,698	74.64
Obligation of states and political subdivisions	600,544	19.14	611,257	22.50
Equity securities	18,362	0.59	17,086	0.63
Other securities	29,042	0.93	28,396	1.05
Total securities	$ 3,137,575	100.00 %	$ 2,715,388	100.00 %

The percentage of Heartland's securities portfolio comprised of mortgage and asset-backed securities was 79% at September 30, 2019, compared to 75% at December 31, 2018. Heartland's securities portfolio had an expected modified duration of 5.63 years as of September 30, 2019, compared to 4.01 years as of year-end 2018.

At September 30, 2019, Heartland had $29.0 million of other securities, including capital stock in each Federal Home Loan Bank ("FHLB") of which each of its bank subsidiaries is a member. All of these securities were classified as other securities held at cost.

Deposits

Total deposits were $10.47 billion as of September 30, 2019, compared to $9.40 billion at December 31, 2018, an increase of $1.07 billion or 11%. This increase includes $617.1 million of deposits acquired at fair value in the BVBC transaction. During the first quarter of 2019, Heartland classified $77.0 million of deposits as held for sale in conjunction with the branch sales. Exclusive of the reclassification of deposits to held for sale and the deposits acquired at fair value in the BVBC transaction, total deposits increased $533.3 million or 6% since December 31, 2018. Deposit changes by category were:

- Demand deposits increased $316.4 million or 10% to $3.58 billion at September 30, 2019, compared to $3.26 billion at December 31, 2018. Excluding $164.9 million of demand deposits acquired in the BVBC transaction and $17.3 million of demand deposits classified as held for sale in the first quarter of 2019, demand deposits increased $168.8 million or 5% since year-end 2018.
- Savings deposits increased $662.8 million or 13% to $5.77 billion at September 30, 2019, from $5.11 billion at December 31, 2018. Excluding savings deposits of $346.2 million acquired in the BVBC transaction and $47.8 million of savings deposits classified as held for sale in the first quarter of 2019, savings deposits increased $364.4 million or 7% since year-end 2018.
- Time deposits increased $94.2 million or 9% to $1.12 billion at September 30, 2019 from $1.02 billion at December 31, 2018. Excluding time deposits of $106.0 million acquired in the BVBC transaction and $11.9 million of time deposits classified as held for sale in the first quarter of 2019, time deposits increased $100,000 or less than 1% since year-end 2018.

The table below presents the composition of Heartland's deposits by category as of September 30, 2019, and December 31, 2018, in thousands:

DEPOSITS	September 30, 2019		December 31, 2018	
	Amount	Percent	Amount	Percent
Demand	$ 3,581,127	34.20 %	$ 3,264,737	34.74 %
Savings	5,770,754	55.12	5,107,962	54.37
Time	1,117,975	10.68	1,023,730	10.89
Total	$ 10,469,856	100.00 %	$ 9,396,429	100.00 %

Short-Term Borrowings

Short-term borrowings, which Heartland defines as borrowings with an original maturity of one year or less, were as follows as of September 30, 2019, and December 31, 2018, in thousands:

	September 30, 2019	December 31, 2018
Securities sold under agreement to repurchase	$ 85,715	$ 80,124
Federal funds purchased	5,850	35,400
Advances from the FHLB	—	100,838
Other short-term borrowings	16,288	10,648
Total	$ 107,853	$ 227,010

Short-term borrowings generally include federal funds purchased, securities sold under agreements to repurchase, short-term FHLB advances and discount window borrowings from the Federal Reserve Bank. These funding alternatives are utilized in varying degrees depending on their pricing and availability. All of Heartland's bank subsidiaries own FHLB stock in one of the

Chicago, Dallas, Des Moines, San Francisco or Topeka FHLBs, enabling them to borrow funds from their respective FHLB for short-term or long-term purposes under a variety of programs. The amount of short-term borrowings of Heartland was $107.9 million at September 30, 2019, compared to $227.0 million at year-end 2018, a decrease of $119.2 million or 52%.

All of the Heartland bank subsidiaries provide retail repurchase agreements to their customers as a cash management tool, which sweep excess funds from demand deposit accounts into these agreements. Although the aggregate balance of these retail repurchase agreements is subject to variation, the account relationships represented by these balances are principally local. The balances of retail repurchase agreements were $85.7 million at September 30, 2019, compared to $80.1 million at December 31, 2018, an increase of $5.6 million or 7%.

Heartland renewed its $30.0 million revolving credit line agreement with an unaffiliated bank on June 14, 2019. This revolving credit line agreement is included in short-term borrowings, and the primary purpose of this credit line agreement is to provide liquidity to Heartland. Heartland had no advances on this line during the first nine months of 2019, and the outstanding balance was $0 at both September 30, 2019, and December 31, 2018.

Other Borrowings

The outstanding balances of other borrowings, which Heartland defines as borrowings with an original maturity date of more than one year, are shown in the table below, net of discount and issuance costs amortization as of September 30, 2019, and December 31, 2018, in thousands:

	September 30, 2019	December 31, 2018
Advances from the FHLB	$ 3,260	$ 3,399
Trust preferred securities	145,098	130,913
Senior notes	—	5,000
Note payable to unaffiliated bank	53,167	58,417
Contracts payable for purchase of real estate and other assets	1,908	1,953
Subordinated notes	74,250	74,143
Other borrowings	734	1,080
Total	$ 278,417	$ 274,905

As of September 30, 2019, the amount of other borrowings was $278.4 million, an increase of $3.5 million or 1% since year-end 2018. Heartland acquired $6.9 million of subordinated debt in the BVBC transaction that was simultaneously paid off with the closing of the transaction. Trust preferred securities with a fair value of $16.1 million were also acquired in the BVBC transaction.

Heartland has a non-revolving credit facility with an unaffiliated bank, which provides a borrowing capacity of up to $70.0 million. At September 30, 2019, $53.2 million was outstanding on this non-revolving credit line compared to $58.4 million outstanding at December 31, 2018. At September 30, 2019, Heartland had $14.8 million available on this non-revolving credit facility, of which no balance was drawn.

A schedule of Heartland's trust preferred securities outstanding excluding deferred issuance costs, as of September 30, 2019, is as follows, in thousands:

	Amount Issued	Issuance Date	Interest Rate	Interest Rate as of 9/30/19 (1)		Maturity Date	Callable Date
Heartland Financial Statutory Trust IV	$ 10,310	03/17/2004	2.75% over LIBOR	4.89%	(2)	03/17/2034	12/17/2019
Heartland Financial Statutory Trust V	20,619	01/27/2006	1.33% over LIBOR	3.63%	(3)	04/07/2036	01/07/2020
Heartland Financial Statutory Trust VI	20,619	06/21/2007	1.48% over LIBOR	3.60%	(4)	09/15/2037	12/15/2019
Heartland Financial Statutory Trust VII	18,042	06/26/2007	1.48% over LIBOR	3.61%	(5)	09/01/2037	12/01/2019
Morrill Statutory Trust I	9,064	12/19/2002	3.25% over LIBOR	5.36%		12/26/2032	12/26/2019
Morrill Statutory Trust II	8,726	12/17/2003	2.85% over LIBOR	4.99%		12/17/2033	12/17/2019
Sheboygan Statutory Trust I	6,506	09/17/2003	2.95% over LIBOR	5.09%		09/17/2033	12/17/2019
CBNM Capital Trust I	4,396	09/10/2004	3.25% over LIBOR	5.37%		12/15/2034	12/15/2019
Citywide Capital Trust III	6,424	12/19/2003	2.80% over LIBOR	5.07%		12/19/2033	01/23/2020
Citywide Capital Trust IV	4,281	09/30/2004	2.20% over LIBOR	4.35%		09/30/2034	11/23/2019
Citywide Capital Trust V	11,692	05/31/2006	1.54% over LIBOR	3.66%		07/25/2036	12/15/2019
OCGI Statutory Trust III	2,995	06/27/2002	3.65% over LIBOR	5.95%	(6)	09/30/2032	12/30/2019
OCGI Capital Trust IV	5,328	09/23/2004	2.50% over LIBOR	4.62%	(7)	12/15/2034	12/15/2019
BVBC Capital Trust II	7,187	04/10/2003	3.25% over LIBOR	5.50%		04/24/2033	01/24/2020
BVBC Capital Trust III	9,003	07/29/2005	1.60% over LIBOR	3.70%		09/30/2035	12/30/2019
	$ 145,192						

(1) Effective weighted average interest rate as of September 30, 2019, was 4.94% due to interest rate swap transactions on the variable rate securities as discussed in Note 7 to Heartland's consolidated financial statements included herein.

(2) Effective interest rate as of September 30, 2019, was 5.01% due to an interest rate swap transaction as discussed in Note 7 to Heartland's consolidated financial statements included herein.

(3) Effective interest rate as of September 30, 2019, was 4.69% due to an interest rate swap transaction as discussed in Note 7 to Heartland's consolidated financial statements included herein.

(4) Effective interest rate as of September 30, 2019, was 3.87% due to an interest rate swap transaction as discussed in Note 7 to Heartland's consolidated financial statements included herein.

(5) Effective interest rate as of September 30, 2019, was 3.83% due to an interest rate swap transaction as discussed in Note 7 to Heartland's consolidated financial statements included herein.

(6) Effective interest rate as of September 30, 2019, was 5.53% due to an interest rate swap transaction as discussed in Note 7 to Heartland's consolidated financial statements included herein.

(7) Effective interest rate as of September 30, 2019, was 4.37% due to an interest rate swap transaction as discussed in Note 7 to Heartland's consolidated financial statements included herein.

CAPITAL REQUIREMENTS

The Federal Reserve Board, which supervises bank holding companies, has adopted capital adequacy guidelines that are used to assess the adequacy of capital of a bank holding company. Under Basel III, Heartland must hold a conservation buffer above the adequately capitalized risk-based capital ratios; however, the transition provisions related to the conservation buffer have been extended indefinitely.

The most recent notification from the FDIC categorized Heartland and each of its bank subsidiaries as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the categorization of any of these entities.

Heartland's capital ratios are calculated in accordance with Federal Reserve Board instructions and are required regulatory financial measures. The following table illustrates Heartland's capital ratios and the Federal Reserve Board's current capital adequacy guidelines for the dates indicated, in thousands. The table also indicates the fully-phased in capital conservation buffer, but the requirements to comply have been extended indefinitely.

	Total Capital (to Risk-Weighted Assets)	Tier 1 Capital (to Risk-Weighted Assets)	Common Equity Tier 1 (to Risk-Weighted Assets)	Tier 1 Capital (to Average Assets)
September 30, 2019	**14.55 %**	**13.04 %**	**11.50 %**	**10.39 %**
Minimum capital requirement	8.00 %	6.00 %	4.50 %	4.00 %
Well capitalized requirement	10.00 %	8.00 %	6.50 %	5.00 %
Minimum capital requirement, including fully-phased in capital conservation buffer	10.50 %	8.50 %	7.00 %	N/A
Risk-weighted assets	$ 9,418,827	$ 9,418,827	$ 9,418,827	N/A
Average Assets	N/A	N/A	N/A	$ 11,830,836
December 31, 2018	**13.72 %**	**12.16 %**	**10.66 %**	**9.73 %**
Minimum capital requirement	8.00 %	6.00 %	4.50 %	4.00 %
Well capitalized requirement	10.00 %	8.00 %	6.50 %	5.00 %
Minimum capital requirement, including fully-phased in capital conservation buffer (2019)	10.50 %	8.50 %	7.00 %	N/A
Risk-weighted assets	$ 8,756,130	$ 8,756,130	$ 8,756,130	N/A
Average Assets	N/A	N/A	N/A	$ 10,946,440

At September 30, 2019, and December 31, 2018, retained earnings that could be available for the payment of dividends to meet the minimum capital requirements totaled $555.2 million and $486.5 million, respectively. Retained earnings that could be available for the payment of dividends to Heartland from its banks totaled approximately $366.3 million and $311.3 million at September 30, 2019, and December 31, 2018, respectively, under the capital requirements to remain well capitalized.

On August 8, 2019, Heartland filed a universal shelf registration statement with the SEC to register debt or equity securities. This shelf registration statement, which was effective immediately, provided Heartland with the ability to raise capital, subject to market conditions and SEC rules and limitations, if Heartland's board of directors decided to do so. This registration statement permitted Heartland, from time to time, in one or more public offerings, to offer debt securities, subordinated notes, common stock, preferred stock, rights or any combination of these securities. The amount of securities that may have been offered was not specified in the registration statement, and the terms of any future offerings were to be established at the time of the offering.

OFF-BALANCE SHEET ARRANGEMENTS

Heartland enters into mortgage banking derivatives, which are classified as free standing derivatives. These derivatives include interest rate lock commitments provided to customers to fund certain mortgage loans to be sold into the secondary market and forward commitments for the future delivery of such loans. Heartland enters into forward commitments for the future delivery of residential mortgage loans when interest rate lock commitments are entered into in order to economically hedge the effect of future interest rate changes on the commitments to fund the loans as well as on the residential mortgage loans available for sale. See Note 7, "Derivative Financial Instruments," to the consolidated financial statements for additional information on Heartland's derivative financial instruments.

Heartland also enters into financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of customers. These financial instruments include commitments to extend credit and standby letters of credit.

Off-balance sheet arrangements were disclosed in Heartland's Annual Report on Form 10-K for the year ended December 31, 2018. There have been no material changes to Heartland's off-balance sheet arrangements since that report was filed.

COMMITMENTS AND CONTRACTUAL OBLIGATIONS

Commitments and Contractual Obligations
Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Heartland's bank subsidiaries evaluate the creditworthiness of customers to which they extend a credit commitment on a case-by-case basis and may require collateral to secure any credit extended. The amount of collateral obtained is based upon management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment and income-producing commercial properties. Standby letters of credit and financial guarantees are conditional commitments issued by Heartland's bank subsidiaries to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. At September 30, 2019, and December 31, 2018, commitments to extend credit aggregated $2.66 billion and $2.47 billion, respectively. Standby letters of credit aggregated $77.2 million at September 30, 2019, and $71.9 million at December 31, 2018.

Contractual obligations and other commitments were disclosed in Heartland's Annual Report on Form 10-K for the year ended December 31, 2018. Except for the purchase and assumption agreement entered into by Heartland's Illinois Bank & Trust subsidiary to acquire substantially all of the assets and substantially all of the deposits and certain other liabilities of Rockford Bank and Trust Company described below, there have been no material changes to Heartland's contractual obligations and other commitments since that report was filed.

On August 13, 2019, Heartland's Illinois Bank & Trust subsidiary entered into a purchase and assumption agreement to acquire substantially all of the assets and substantially all of the deposits and certain other liabilities of Rockford Bank and Trust Company ("RB&T"), headquartered in Rockford, Illinois. RB&T is a wholly-owned subsidiary of Moline, Illinois-based QCR Holdings, Inc. As of September 30, 2019, RB&T had total assets of $519.5 million, which included $417.3 million of gross loans held to maturity, and $451.5 million of deposits. RB&T serves the Rockford market from two full-service banking locations. The all-cash transaction is subject to regulatory approval and to customary closing conditions and is expected to close in the fourth quarter of 2019. The systems conversion is expected to occur in the first quarter of 2020.

Heartland continues to explore opportunities to expand the size of its independent community banks. In the current banking industry environment, Heartland seeks these opportunities for growth through acquisitions. Heartland is primarily focused on possible acquisitions in the markets it currently serves, in which there would be an opportunity to increase market share, achieve efficiencies and provide greater convenience for current customers. However, Heartland may also pursue acquisitions in areas outside of its current geographic footprint. Future expenditures relating to expansion efforts, in addition to those identified above, cannot be estimated at this time.

Derivative Financial Instruments
Heartland enters into mortgage banking derivatives, which are classified as free standing derivatives. These derivatives include interest rate lock commitments provided to customers to fund certain mortgage loans to be sold into the secondary market and forward commitments for the future delivery of these loans. Heartland enters into forward commitments for the future delivery of residential mortgage loans when interest rate lock commitments are entered into in order to economically hedge the effect of future interest rate changes on the commitments to fund these loans and on the residential mortgage loans held as available for sale. See Note 7 to the consolidated financial statements include in this Quarterly Report on Form 10-Q for additional information on Heartland's derivative financial instruments.

LIQUIDITY

Liquidity refers to Heartland's ability to maintain a cash flow that is adequate to meet maturing obligations and existing commitments, to withstand fluctuations in deposit levels, to fund operations and to provide for customers’ credit needs. The liquidity of Heartland principally depends on cash flows from operating activities, investment in and maturity of assets, changes in balances of deposits and borrowings and its ability to borrow funds in the money or capital markets.

At September 30, 2019, Heartland had $447.8 million of cash and cash equivalents, time deposits in other financial institutions of $3.7 million and securities carried at fair value of $3.02 billion.

Management of investing and financing activities, and market conditions, determine the level and the stability of net interest cash flows. Management attempts to mitigate the impact of changes in market interest rates to the extent possible, so that balance sheet growth is the principal determinant of growth in net interest cash flows.

Heartland's short-term borrowing balances are dependent on commercial cash management and smaller correspondent bank relationships and, as a result, will normally fluctuate. Management believes these balances, on average, to be stable sources of funds; however, Heartland intends to rely on deposit growth and additional FHLB borrowings as needed in the future.

Additional funding is provided by long-term debt and short-term borrowings. In the event of short-term liquidity needs, Heartland's banks may purchase federal funds from each other or from correspondent banks and may also borrow from the Federal Reserve Bank. As of September 30, 2019, Heartland had $107.9 million of short-term borrowings outstanding. As of September 30, 2019, Heartland had $278.4 million of long-term debt outstanding, and it is an important funding source because of its multi-year borrowing structure. Additionally, the banks' FHLB memberships give them the ability to borrow funds for short-term and long-term purposes under a variety of programs. At September 30, 2019, Heartland had $1.55 billion of borrowing capacity under these programs.

On a consolidated basis, Heartland maintains a large balance of short-term securities that, when combined with cash from operations, Heartland believes are adequate to meet its funding obligations.

At the parent company level, routine funding requirements consist primarily of dividends paid to stockholders, debt service on revolving credit arrangements and trust preferred securities issuances, repayment requirements under other debt obligations and payments for acquisitions. The parent company obtains the funding to meet these obligations from dividends paid by its bank subsidiaries and the issuance of debt and equity securities. Heartland has a revolving credit agreement and non-revolving credit line with an unaffiliated bank, which was renewed on June 14, 2019. Heartland's revolving credit agreement has $30.0 million of maximum borrowing capacity, of which none was outstanding at September 30, 2019. At September 30, 2019, $14.8 million was available on the non-revolving credit line. These credit agreements contain specific financial covenants, all of which Heartland complied with as of September 30, 2019.

The ability of Heartland to pay dividends to its stockholders is dependent upon dividends paid to Heartland by its subsidiaries. The bank subsidiaries are subject to statutory and regulatory restrictions on the amount they may pay in dividends. To maintain acceptable capital ratios at Heartland's bank subsidiaries, certain portions of their retained earnings are not available for the payment of dividends.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the risk of loss arising from adverse changes in market prices and rates. Heartland's market risk is comprised primarily of interest rate risk resulting from its core banking activities of lending and accepting deposits. Interest rate risk measures the impact on earnings from changes in interest rates and the effect on the current fair market values of Heartland's assets, liabilities and off-balance sheet contracts. Heartland's objective is to measure this risk and manage its balance sheet to avoid unacceptable potential for economic loss.

Management continually develops and applies strategies to mitigate market risk. Exposure to market risk is reviewed on a regular basis by the asset/liability committees of Heartland's bank subsidiaries and, on a consolidated basis, by Heartland's executive management and board of directors. At least quarterly, a detailed review of the balance sheet risk profile is performed for Heartland and each of its bank subsidiaries. Included in these reviews are interest rate sensitivity analyses, which simulate changes in net interest income in response to various interest rate scenarios. These analyses consider current portfolio rates, existing maturities, repricing opportunities and market interest rates, in addition to prepayments and growth under different interest rate assumptions. Selected strategies are modeled prior to implementation to determine their effect on Heartland's interest rate risk profile and net interest income. Heartland believes its primary market risk exposures did not change significantly in the first nine months of 2019.

The core interest rate risk analysis utilized by Heartland examines the balance sheet under increasing and decreasing interest rate scenarios that are neither too modest nor too extreme. All rate changes are ramped over a 12-month horizon based upon a parallel shift in the yield curve and then maintained at those levels over the remainder of the simulation horizon. Using this approach, management is able to see the effect that both a gradual change of rates (year one) and a rate shock (year two and beyond) could have on Heartland's net interest income. Starting balances in the model reflect actual balances on the "as of" date, adjusted for material transactions. Pro-forma balances remain static. This methodology enables interest rate risk embedded within the existing balance sheet structure to be isolated from the interest rate risk often caused by growth in assets and liabilities. Due to the low interest rate environment, the simulations under a decreasing interest rate scenario were prepared using a 100 basis point shift in rates. The most recent reviews at September 30, 2019, and September 30, 2018, provided the following results, in thousands:

	2019		2018	
	Net Interest Margin	**% Change From Base**	**Net Interest Margin**	**% Change From Base**
Year 1				
Down 100 Basis Points	$ 425,662	(3.37)%	$ 442,187	(3.07)%
Base	$ 440,498	— %	$ 456,192	— %
Up 200 Basis Points	$ 468,374	6.33 %	$ 454,513	(0.37)%
Year 2				
Down 100 Basis Points	$ 388,722	(11.75)%	$ 423,766	(7.11)%
Base	$ 426,489	(3.18)%	$ 463,765	1.66 %
Up 200 Basis Points	$ 485,463	10.21 %	$ 474,816	4.08 %

Heartland uses derivative financial instruments to manage the impact of changes in interest rates on its future interest income or interest expense. Heartland is exposed to credit-related losses in the event of nonperformance by the counterparties to these derivative instruments, but believes it has minimized the risk of these losses by entering into the contracts with large, stable financial institutions. The estimated fair market values of these derivative instruments are presented in Note 7 to the consolidated financial statements included in this Quarterly Report on Form 10-Q.

Heartland enters into financial instruments with off balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. Commitments to extend credit are agreements to lend funds to a customer as long as there is no violation of any condition established in the contract relating to the commitment. Commitments generally have fixed expiration dates and may require collateral from the borrower. Standby letters of credit are conditional commitments issued by Heartland to guarantee the performance of a customer to a third party up to a stated amount and subject to specified terms and conditions. These commitments to extend credit and standby letters of credit are not recorded on the consolidated balance sheet until the loan is made or the letter or credit is issued.

ITEM 4. CONTROLS AND PROCEDURES

Based on an evaluation, as of the end of the period covered by this Quarterly Report on Form 10-Q, under the supervision and with the participation of Heartland's management, including its Chief Executive Officer and Chief Financial Officer, the Chief Executive Officer and Chief Financial Officer have concluded that:

- Heartland's disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended) were effective.
- During the quarter ended September 30, 2019, there have been no changes in Heartland's internal controls over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended) that have materially affected, or are reasonably likely to materially affect, Heartland's internal control over financial reporting.

PART II

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

There have been no material changes in the risk factors applicable to Heartland from those disclosed in Part I, Item 1A. “Risk Factors” in Heartland's 2018 Annual Report on Form 10-K. Please refer to that section of Heartland's Form 10-K report for disclosures regarding the risks and uncertainties related to Heartland's business.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Heartland's board of directors has authorized management to acquire and hold up to 500,000 shares of common stock as treasury shares at any one time. Heartland and its affiliated purchasers made no purchases of its common stock during the quarter ended September 30, 2019.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

Exhibits

2.1 [1] [2]	Purchase and Assumption Agreement between Illinois Bank & Trust, Rockford Bank and Trust Company, and QCR Holdings, Inc., dated August 13, 2019.
31.1 [2]	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act.
31.2 [2]	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act.
32.1 [2]	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 [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 statement formatted in Inline 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.
104	Cover page formatted in Inline Extensible Business Reporting Language

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(1) The disclosure schedules to the Purchase and Assumption Agreement have been omitted pursuant to Item 601(b)(2)(ii) of Regulation S-K.

(2) Filed or furnished herewith

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned there unto duly authorized.

HEARTLAND FINANCIAL USA, INC.
(Registrant)

/s/ Bruce K. Lee
By: Bruce K. Lee
President and Chief Executive Officer
(Principal Executive Officer and Duly Authorized Officer)

/s/ Bryan R. McKeag
By: Bryan R. McKeag
Executive Vice President and Chief Financial Officer
(Principal Financial Officer and Duly Authorized Officer)

/s/ Janet M. Quick
By: Janet M. Quick
Executive Vice President and Deputy Chief Financial Officer
(Principal Accounting Officer and Duly Authorized Officer)

Dated: November 6, 2019

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Section 2: EX-2.1 (EX-2.1)

PURCHASE AND ASSUMPTION AGREEMENT

Dated as of August 13, 2019

By and Among

ILLINOIS BANK & TRUST,

ROCKFORD BANK AND TRUST COMPANY

and

QCR HOLDINGS, INC.

(SOLELY FOR THE PURPOSES OF THE SECTION IDENTIFIED HEREIN)

The disclosure schedules to this Agreement have been excluded becasue they are both not material and would likely cause competitive harm to the registrant if disclosed.

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This **PURCHASE AND ASSUMPTION AGREEMENT** (this "Agreement") is entered into as of August 13, 2019, by and among ILLINOIS BANK & TRUST, a state bank organized under the laws of the State of Illinois ("Purchaser"), QCR HOLDINGS, INC., a corporation organized under the laws of the State of Delaware ("Parent"), and ROCKFORD BANK AND TRUST COMPANY, a state bank organized under the laws of the State of Illinois ("Seller"). Parent is only a signatory to the Agreement for purposes of providing the covenants and agreements set forth in Section 5.5, Section 5.6, Section 8.13(e) and Section 8.18.

WITNESSETH:

WHEREAS, Seller wishes to sell substantially all of its assets to Purchaser and to have Purchaser assume its deposits and certain other specified liabilities upon the terms and subject to the conditions set forth herein;

WHEREAS, Purchaser wishes to purchase such assets and assume such deposits and liabilities upon the terms and subject to the conditions set forth herein;

WHEREAS, concurrently with the execution and delivery hereof, and as a condition to Purchaser's willingness to enter into this Agreement, Parent, the holder of all of the issued and outstanding shares of capital stock of Seller, has agreed fully and unconditionally to guarantee the representations, warranties, covenants, agreements and other obligations of Seller herein (the "Guarantee"), which Guarantee is set forth as Exhibit A hereto; and

WHEREAS, in order to facilitate an orderly transition, Seller, Parent and Purchaser are, simultaneously herewith, entering into an agreement under which Seller will provide certain deposit operations, cash management and loan accounting services to Purchaser for the consideration and period specified therein, subject to possible extension as provided therein, which agreement is set forth as Exhibit B (the "Transition and Services Agreement").

NOW, THEREFORE, in consideration of the premises and mutual agreements hereinafter set forth and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, and intending to be legally bound hereby, Seller and Purchaser agree as follows:

ARTICLE I.

CERTAIN DEFINITIONS

Section 1.1 Certain Definitions and Related Matters.

(a) The terms set forth below are used herein with the following meanings:

"ACH" shall mean Automated Clearing House.

"Accounting Standards" shall have the meaning set forth in Section 6.14.

"Adjusted Tangible Equity" shall mean (i) 0.08, multiplied by (ii) the Tangible Assets.

"Adjustment Payment Date" shall have the meaning set forth in Section 3.3(c).

"Affiliate" shall mean, with respect to any Person, any other Person directly or indirectly controlled by, controlling or under common control with such first Person. For the purposes of this definition, “control” means the power to direct the management and policies of such Person, directly or indirectly, whether through the ownership of voting securities, by contract or otherwise, and the terms “controlling” and “controlled” have meanings correlative to the foregoing.

“Affiliate Participation” shall mean any loan participation, or other undivided interest in a loan, purchased by Seller from or through an Affiliate.

“Agreement” shall have the meaning set forth in the preamble.

“ALLL” shall have the meaning set forth in Section 6.16.

“Assignment and Assumption Agreement” shall have the meaning set forth in Section 3.2(b)(3).

“Assignment and Assumption of Lease” shall have the meaning set forth in Section 3.2(b)(4).

“Assumed Contracts” shall have the meaning set forth in Section 2.5.

“ATMs” shall have the meaning set forth in Section 2.l(a)(2)(B).

“Bates Financial” shall mean Bates Financial Advisors, Inc., a wholly owned subsidiary of Parent.

“Benefit Plans” shall have the meaning set forth in Section 6.8(b).

“Borrowings” means indebtedness of Seller incurred under loan or other agreements that is outstanding as of the Effective Time, including any amounts borrowed from any Federal Home Loan Bank.

“Branch Banking Operations” shall mean the business conducted by Seller (on or prior to the Effective Time) or Purchaser (after the Effective Time), as the case may be, at the Branches based on the assumption that such business is conducted without the Excluded Assets and the Excluded Liabilities.

“Branch Employee Employment Agreements” shall have the meaning set forth in Section 12.8.

“Branch Employees” shall have the meaning set forth in Section 8.13(b).

“Branch Lease” shall have the meaning set forth in Section 2.l(a)(2)(A).

“Branches” shall have the meaning set forth in Section 2.l(a)(2)(A).

“Brokered Deposits” shall mean “brokered deposits” within the meaning of 12 C.F.R. 5337.6.

“Business Day” shall mean any day other than a Saturday, a Sunday or a day on which banks in the State of Illinois are authorized or required to close for regular banking business.

“Call Reports” shall mean Consolidated Reports of Condition and Income of banks that are publicly available on the FDIC’s website.

“Claim Limitation Period” shall have the meaning set forth in Section 5.3(a).

“Closing” shall have the meaning set forth in Section 3.1.

“Closing Date” shall have the meaning set forth in Section 3.1.

“Closing Statement” shall have the meaning set forth in Section 3.2(b)(8).

“COBRA” shall mean the continuation coverage requirements of Section 601 et seq. of ERISA and Section 4980B of the Code.

“Code” shall mean the Internal Revenue Code of 1986, as amended.

“Coins and Currency” shall mean all petty cash, foreign currency, vault cash, teller cash, ATM cash, and prepaid postage located at the Owned Branch or the Leased Branch as of the Effective Time.

“Comparable Employment” shall mean a position at the same base pay with similar, but not necessarily identical, duties and responsibilities (*e.g.*, reporting relationships may differ) and a workplace that is not more than twenty-five (25) highway miles (one-way) from the Employee’s current workplace.

“Confidential Information” shall mean all information not generally known and proprietary to the party disclosing such information; *provided, however*, that “Confidential Information” shall not include the following: (a) information generally available to the public at the time of its disclosure or that subsequently becomes available to the public from sources other than the party receiving such information; (b) information that becomes available to the party receiving the information from a Person that is not the disclosing party and which is not otherwise bound by a confidentiality agreement with the disclosing party; (c) information that is known by the party receiving such information prior to its disclosure by the disclosing party to the party receiving such information; or (d) information that is individually developed by the party receiving the information from the disclosing party.

“Conversion” shall mean the conversion of the Transferred Assets and the Transferred Liabilities to Purchaser’s data processing and similar systems.

“Conversion Date” shall have the meaning set forth in the Transition and Services Agreement.

“CRA” shall mean the Community Reinvestment Act of 1977 and the regulations promulgated thereunder, as amended.

“Deposit Liabilities” shall mean all of Seller’s rights, duties, obligations and liabilities relating to the Deposits (including accrued but unpaid or uncredited interest thereon and uncollected funds related thereto), *provided* that the “Deposit Liabilities” shall not include (a) deposit liabilities with respect to Deposits of Affiliates of Seller, and (b) deposit liabilities that, by law or contract, cannot either be transferred by Seller or assumed by Purchaser.

“Deposits” shall mean all deposits (as defined in 12 U.S.C. § 1813(1)) made with Seller and recorded on the books of either of the Branches as of the Effective Time that are assumed by Purchaser hereunder, including consumer, business and commercial and private client (a) demand deposits, (b) interest checking accounts, (c) money market accounts, (d) savings deposits, (e) time deposits, (f) deposits relating to debit cards and ATM cards, and (h) IRA deposit liabilities, together in each case with all uncollected funds related thereto and all accrued but unpaid or uncredited interest and fees thereon. For avoidance of doubt, “Deposits” includes all Brokered Deposits made with Seller and recorded on the books of either of the Branches as of the Effective Time.

“Determination Date” shall be the last day of the month prior to the Closing Date.

“Determination Date Balance Sheet” shall have the meaning set forth in Section 2.1(i).

“Disclosure Schedules” shall mean the schedules delivered by Seller to Purchaser on or prior to the date of this Agreement setting forth, among other things, items of disclosure that are necessary or appropriate either in response to an express disclosure requirement contained in a provision of this Agreement or as an exception to one or more of the representations, warranties, covenants or agreements of Seller contained herein.

“Effective Time” shall have the meaning set forth in Section 3.1.

“Employee” shall mean each individual principally employed by Seller or any of its Affiliates in connection with the Branch Banking Operations.

“Environmental Law” shall mean any federal, state, foreign or local law, statute, ordinance, rule, regulation, code, license, permit, authorization, approval, consent, common law, legal doctrine, order, judgment, decree, injunction, requirement or agreement with any Governmental Authority, (a) relating to the protection, preservation or restoration of the environment (including air, water, vapor, surface water, groundwater, drinking water supply, surface land, subsurface land, plant and animal life or any other natural resource), or to human health or safety, or (b) the exposure to, or the use, storage, recycling, treatment, generation, transportation, processing, handling, labeling, production, release or disposal of Hazardous Substances, in each case as amended, from time to time, including the following U.S. federal environmental laws: the Comprehensive Environmental Response, Compensation and Liability Act of 1980, the Superfund Amendment and Reauthorization Act, the Water Pollution Control Act of 1972, the Clean Air Act, the Clean Water Act, the Resource Conservation and Recovery Act of 1976, the Solid Waste Disposal Act, the Toxic Substances Control Act and Insecticide, Fungicide and Rodenticide Act, each as amended.

“Environmental Liabilities” means any action, lawsuit, claim, proceeding, investigation, demand, response, damages (including natural resources damages), fine, penalty, judgment, award, settlement, loss, cost or expense (including any financial responsibility for any cleanup costs or corrective actions, including any investigation, cleanup, removal, containment, remedial or other response action, whether or not such action has been required or requested by any Governmental Authority) (including reasonable attorneys’ and consultants’ fees) relating to or arising out of or under (a) any Environmental Law, (b) the release or threatened release of any Hazardous Substances, or (c) any other environmental, health, or safety matters or conditions (including on-site and off-site release or contamination and matters relating to occupational safety and health). For purposes of this definition, the terms “removal,” “remedial,” “release” and “response action” shall include those activities covered by the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended.

“ERISA” shall mean the Employee Retirement Income Security Act of 1974, as amended.

“Excluded Assets” shall have the meaning set forth in Section 2.1(b).

“Excluded Employees” shall mean the Employees listed on Schedule 1.1(a).

“Excluded Liabilities” shall have the meaning set forth in Section 2.1(f).

“Existing Environmental Reports” shall have the meaning set forth in Section 2.4(a).

“FDIC” shall mean the Federal Deposit Insurance Corporation.

“Federal Funds Rate” shall mean the average of the high and low rates quoted for Federal Funds in the Money Rates column of The Wall Street Journal during the period the rate is applied, adjusted as such average may increase or decrease during such period.

“Financial Statements” shall have the meaning set forth in Section 6.14.

“GAAP” shall mean U.S. generally accepted accounting principles, consistently applied.

“Governmental Authority” shall mean any government or any agency, bureau, board, commission, court, department, official, political subdivision, tribunal or other instrumentality of any government having authority in the United States, whether federal, state or local.

“Guarantee” shall have the meaning set forth in the recitals.

“Hazardous Substance” shall mean any waste, emission, material or substance (including gases, liquids and solids) defined or identified as toxic, hazardous or dangerous in (or for the purposes of), or which is regulated under, any Environmental Law, including asbestos, asbestos-containing materials, radon gas, urea formaldehyde foam insulation, polychlorinated biphenyls, and oil or petroleum products and by-products.

“Investment Securities” shall mean all securities (including the Substitute Securities and any other corporate equity securities, corporate debt securities, U.S. Treasury bonds, U.S. Government Agency debt securities, mortgage backed securities, municipal bonds, commercial paper, certificates of deposit and other types of securities) held by Seller for investment as of the Effective Time.

“Investment Accounts” shall mean all investment, brokerage or agency accounts of customers of Seller for which RJFS serves as registered broker-dealer pursuant to the Agreement dated June 29, 2007 between RJFS and Seller; *provided, however,* that “Investment Accounts” shall not include any Trust Accounts.

“IRA” shall mean an individual retirement account as specified in Section 408 and 408A of the Code.

"Landlord Consent" shall have the meaning set forth in Section 8.8(a).

"Leased Branch" shall have the meaning set forth in Section 2.1(a)(2)(A).

"Letters of Credit" shall mean (a) each standby letter of credit issued by Seller in connection with a Purchased Loan and listed on Schedule 8.15, and (b) each standby letter of credit issued by Seller in connection with a Purchased Loan originated between the date hereof and the Closing Date and in compliance with Section 8.3. To the extent Purchaser shall assume (and Seller has been released from) any Letter of Credit or Purchaser has issued a replacement letter of credit, whether on or after the day on which the related Purchased Loan is purchased by Purchaser pursuant to the terms hereof, the assumed or replaced Letter of Credit shall no longer be deemed a "Letter of Credit" hereunder.

"Liens" shall have the meaning set forth in Section 6.5.

"Losses" shall mean losses, liabilities, damages, costs and expenses (including reasonable attorneys' fees) incurred or suffered by the indemnified party or its Affiliates in connection with the matters described in this Agreement.

"Material Adverse Environmental Condition" shall have the meaning set forth in Section 2.4(c).

"Municipal Securities" shall mean certain bonds and other securities of states, cities, counties and other governmental entities held by Seller for investment as of the date hereof (a) that were not sold in a public offering and (b) for which there is no active trading market.

"Net Book Value" shall mean the net book value of an asset or liability as reflected in Seller's books, determined in accordance with GAAP, net of any related valuation or loss reserves or allowances, mark to market adjustments, or any other reserves or adjustments, and including any accrued but unpaid interest, fees and charges.

"New Plans" shall have the meaning set forth in Section 8.13(c).

"Old Plans" shall have the meaning set forth in Section 8.13(c).

"OREO" (other real estate owned) shall mean the real estate (including capitalized and operating leases) acquired by Seller through foreclosure on a mortgage or deed of trust or by any other means in full or partial satisfaction of a loan or lease provided by Seller.

"Order" shall have the meaning set forth in Section 9.4.

"Original Price" shall have the meaning set forth in Section 3.3(d).

"Overdrafts" shall mean overdrafts of the book balance of any accounts constituting Deposit Liabilities and all consumer lines of credit made available to customers of the Branches as a protection against overdrafts of such accounts.

"Owned Branch" shall have the meaning set forth in Section 2.1(a)(1)(A).

"Parent" shall have the meaning set forth in the recitals.

"Parent 401(k) Plan" shall mean the QCR Holdings, Inc. 401(k) Profit Sharing Plan.

"Parent Deferred Compensation Plan" shall mean the QCR Holdings, Inc. Executive Deferred Compensation Plan (effective October 23, 2008).

"Parent Equity Incentive Plans" shall mean, collectively, (a) the QCR Holdings, Inc. 2016 Equity Incentive Plan, (b) the QCR Holdings, Inc. 2013 Equity Incentive Plan, and (c) the QCR Holdings, Inc. 2010 Equity Incentive Plan.

"Participation Adjustment" shall have the meaning set forth in Section 8.16.

"Permitted Encumbrances" shall mean collectively (a) real property ad valorem Taxes for the year of Closing or any assessments, charges or Taxes not yet due and payable, or (b) zoning, building code and other use restrictions imposed by a Governmental Authority, a subdivision plat, or customary covenants, conditions, easements or restrictions for a community or mixed use development, in each case that do not interfere in any material respect with the use of the Real Property operated in the manner it is currently operated.

"Perryville Loan" shall mean the Loan made by Seller pursuant to the Promissory Note (#1168137532), dated April 13, 2012 by and between Seller and Perryville Investment Group, LLC.

"Perryville Loan Liabilities" shall mean all duties, liabilities, obligations, costs and expenses of Seller arising from the Perryville Loan and any related guarantees, including any liabilities or obligations to indemnify any current or former director, officer or Employee of Seller or to reimburse any insurer for amounts advanced to such director, officer or Employee for the purpose of defending any criminal or civil lawsuit relating to the Perryville Loan.

"Person" shall mean any individual, association, corporation, limited liability company, partnership, limited liability partnership, trust or any other entity or organization, including any Governmental Authority.

"Personal Property" shall mean the personal property of Seller located at the Owned Branch or the Leased Branch, consisting of the furniture, fixtures, equipment, security systems, safe deposit boxes (exclusive of contents), vaults and other tangible personal property that are owned by Seller and are located on or affixed to the Owned Branch or the Leased Branch and all tenant improvements and fixtures owned by Seller at any Leased Branch, in each case as of the Effective Time, and any of such items on order at the Effective Time.

"Personal Property Leases" shall mean all leases of Personal Property.

"Post-Closing Balance Sheet" shall have the meaning set forth in Section 3.3(a).

"Post-Closing Balance Sheet Delivery Date" shall have the meaning set forth in Section 3.3(a).

"Property Price" shall mean the Net Book Value of the Real Property.

"Purchased Loans" shall have the meaning set forth in Section 2.l(a)(5).

"Purchase Price" shall have the meaning set forth in Section 2.1(d).

“Purchase Price Allocation” shall have the meaning set forth in Section 2.1(j).

“Purchase Price Premium” shall have the meaning set forth in Section 2.1(c).

“Purchaser” shall have the meaning set forth in the preamble.

“RCH” shall mean Rock City Holdings, LLC, a wholly owned subsidiary of Seller.

“Real Property” shall have the meaning set forth in Section 2.1(a)(1)(B).

“Regulatory Approvals” shall mean all regulatory approvals that are required in order to consummate the transactions contemplated hereby (including any transactions Seller must complete in order to consummate the transactions contemplated hereby), including the expiration of all waiting periods thereunder (including any extensions thereof).

“Revised Price” shall have the meaning set forth in Section 3.3(d).

“RJFS” shall mean Raymond James Financial Services, Inc.

“Safe Deposit Contracts” shall mean all safe deposit contracts and leases for the safe deposit boxes located at the Owned Branch and Leased Branch as of the Effective Time.

“Seller” shall have the meaning set forth in the preamble.

“Seller Employment Agreements” shall mean, collectively, (a) the Employment Agreement dated June 22, 2004 and as amended to date by and between Seller and Thomas D. Budd, (b) the Employment Agreement dated February 28, 2005 and as amended to date by and between Seller and Thomas Cwynar, (c) the Employment Agreement dated August 5, 2004 and as amended to date by and between Seller and Brenda Nayonis, (d) the Employment Agreement dated March 1, 2009 by and between Seller and Tony Moczynski, (e) the Employment Agreement dated March 1, 2009 and as amended to date by and between Seller and Karl Swanson, (f) the Employment Agreement dated January 1, 2019 by and between Seller and Brian DeBenedetto, and (g) the Employment Agreement dated July 9, 2007 and as amended to date by and between Seller and Anthony Pozzi.

“Seller Material Adverse Effect” shall mean an event, occurrence, circumstance or state of facts, individually or in the aggregate, that has had or is reasonably likely to have a material adverse effect on (a) the business, operations or condition (financial or otherwise) of the Branch Banking Operations as a whole, (b) the Transferred Assets or the Transferred Liabilities as a whole, or (c) Seller’s ability to timely perform its obligations hereunder or consummate the transactions contemplated hereby; *provided*, that a Seller Material Adverse Effect shall not include events or conditions to the extent arising out of or attributable to (i) changes in generally prevailing economic conditions, including changes in interest rates and stock market valuations, (ii) changes in generally prevailing legal or regulatory conditions applicable to the industry in which Seller operates, (iii) changes in generally accepted accounting principles, (iv) announcement of the transactions contemplated hereby, or (v) any actions taken or omitted to be taken by Seller if such action or omission is required hereby, except, in the cases of (i), (ii) and (iii), as disproportionately adversely affects Seller relative to other similarly situated banks.

“Subsidiary” shall mean, with respect to any entity, any other entity that is consolidated with such first entity for financial reporting purposes.

“Substitute Securities” shall mean any securities acquired by Seller for investment prior to the Effective Time with the proceeds from the sale of the Municipal Securities.

“Tangible Assets” shall mean the amount that would be reported on Schedule RC, Line 12 of Seller’s Call Report if a Call Report were to be filed as of the Determination Date, excluding (a) any intangible assets reported on Schedule RC, Line 10 of such Call Report (b) minus the amount of the Participation Adjustment.

“Tax Return” shall mean any return, declaration, report, claim for refund, or information return or statement relating to Taxes, including any schedule or attachment thereto, and including any amendment thereof.

“Taxes” shall mean any and all federal, state, local or foreign income, gross receipts, license, payroll, employment, excise, severance, stamp, occupation, premium, windfall profits, environmental, customs duties, capital stock, franchise, profits, withholding, social security (or similar), unemployment, disability, real property, personal property, sales, use, transfer, registration, value added, alternative or add-on minimum, estimated, or other tax of any kind whatsoever, including any interest, penalty, or addition thereto, whether disputed or not.

“Title Defect Notice” shall have the meaning set forth in Section 2.3(a).

“Title Defects” shall have the meaning set forth in Section 2.3(a).

“Transaction Account” shall mean accounts at Branches in respect of which deposits therein are withdrawable in practice upon demand or upon which third party drafts may be drawn by the depositor, including checking accounts, negotiable order of withdrawal accounts and money market deposit accounts.

“Transfer Taxes” shall have the meaning set forth in Section 2.1(h).

“Transferred Assets” shall have the meaning set forth in Section 2.1(a).

“Transferred Liabilities” shall have the meaning set forth in Section 2.1(e).

“Transition and Services Agreement” shall have the meaning set forth in the recitals.

“Treasury Regulations” shall mean any final or temporary regulations promulgated by the United States Treasury.

“Trust Accounts” shall mean all of the following: (i) IRAs, qualified or unqualified employee benefit plans (other than the Benefit Plans); and (ii) (A) trust, estate, conservatorship, agency or other fiduciary accounts for which Seller serves as trustee, agent, custodian, personal representative, conservator, investment advisor or sub-advisor; or (B) trust, estate, conservatorship, agency or other accounts for which Seller provides recordkeeping, custody, administration, or wealth management services.

“Unimproved Real Property” shall have the meaning set forth in Section 2.1(a)(1)(B).

“Updated Title Report” shall have the meaning set forth in Section 2.3(b).

“WARN Act” shall mean the Worker Adjustment and Retraining Notification Act of 1988, as amended.

(a.) The words “include” and “including” as used herein shall be deemed to be followed by the phrase “without limitation.” References to an Article, Section, Exhibit or Schedule shall be deemed to be references to an Article or Section of, or an Exhibit or Schedule to, this Agreement unless otherwise indicated. The word “Schedule” as used herein is intended to refer to the applicable section of the Disclosure Schedule. The table of contents and headings contained in this Agreement are for reference purposes only and shall not affect in any way the meaning or interpretation of this Agreement. The words “hereby,” “hereof,” “herein,” “hereto,” “hereunder” and words of similar import when used in this Agreement shall refer to this Agreement as a whole and not to any particular provision of this Agreement. The definitions contained in this Agreement are applicable to the singular as well as the plural forms of such terms and to the masculine as well as to the feminine and neuter genders of such term.

ARTICLE II.

TRANSFER OF ASSETS AND LIABILITIES

Section 2.1 Transferred Assets.

(a) As of the Effective Time, and subject to the terms and conditions set forth herein, Seller shall sell, assign, transfer, convey, and deliver to Purchaser, and Purchaser shall purchase from Seller (or its applicable direct or indirect subsidiaries), possession of and any and all right, title and interest of Seller in and to the following assets (collectively, the “Transferred Assets”):

(1) (A) all of Seller’s transferable fee simple right, title and interest in and to the real estate and the related improvements and fixtures located at Seller’s owned banking office located at 4571 Guilford Road, Rockford Illinois 61107 (the “Owned Branch”), together with all assignable real property rights and appurtenances pertaining thereto, and (B) all of Seller’s transferable fee simple right, title and interest in and to the real estate located at 3933 Bell School Road, Rockford, Illinois 61114 (the “Unimproved Real Property,” and, together with the Owned Branch, the “Real Property”), together with all assignable real property rights and appurtenances thereto;

(2) (A) subject to Section 8.8, including the receipt of the applicable consents referred to therein, all rights of Seller pursuant to the lease relating to Seller’s leased banking office located at 308 West State Street, Rockford, Illinois 61101, to be valued based on the right to use asset and lease liability reflected of Seller’s most recent Financial Statement (the “Leased Branch” and, together with the Owned Branch, the “Branches”; and such lease relating to the Leased Branch, the “Branch Lease”), and (B) Seller’s remote site, free-standing automated teller machines (the “ATMs”) identified on Schedule 2.1(a)(2)(B);

(3) all Personal Property and all Personal Property Leases, a complete and accurate list of which as of the date of this Agreement is listed on Schedule 2.1(a)(3);

(4) all Safe Deposit Contracts;

(5) those loans (including Letters of Credit relating to such loans) set forth on Schedule 2.1(a)(5), as each such loan may be increased, decreased, amended, renewed or extended by Seller in the ordinary course of business of Seller and in compliance with the terms of Section 8.3 between the date of Schedule 2.1(a)(5) (which shall be as of a date not earlier than the second Business Day prior to the date hereof) and the Closing Date and shall exclude each participation or other undivided interest in any such loan sold to one of more of Seller's Affiliates and repurchased in accordance with Section 8.16, and each loan made by Seller between the date of Schedule 2.1(a)(5) and the Closing Date that Seller shall categorize in the ordinary course of its business consistent with past practices to a loan category set forth on Schedule 2.1(a)(5) and which loan is made in compliance with the terms of Section 8.3, and each obligation of Seller to make additional extensions of credit in connection with each such loan, as each such loan may be increased, decreased, amended, renewed or extended by Seller in the ordinary course of business of Seller and in compliance with the terms of Section 8.3 prior to the Closing Date; in each case at Net Book Value and including the collateral therefor and the servicing rights thereunder for which Seller has retained servicing rights (collectively, the "Purchased Loans");

(6) all accrued fees and interest receivables with respect to the Purchased Loans;

(7) all Overdrafts;

(8) all Assumed Contracts;

(9) all OREO of Seller, at Net Book Value;

(10) all of the routing and transit numbers with respect to the Branches set forth on Schedule 2.1(a)(10);

(11) all of Seller's rights under the contracts and relationships giving rise to the Deposits;

(12) all insurance premiums paid by Seller to the FDIC that are allocable to insurance coverage for the Deposits following the assumption thereof by Purchaser;

(13) all books, records and documents relating to the Transferred Assets and the Transferred Liabilities, as such books, records and other documents may exist and are as held by Seller or its Affiliates (including all books, records, customer lists and documents contemplated by Section 2.6);

(14) all claims, counter-claims and causes of action with respect to the Transferred Assets and Transferred Liabilities;

(15) all Investment Securities, at Net Book Value;

(16) all Coins and Currency;

(17) Seller's rights in and to the name "Rockford Bank and Trust Company" and any of its predecessor banks' names and any of Seller's or Seller's predecessors' corporate logos, trademarks, trade names, signs, paper stock forms, and other supplies containing any such logos, trademarks, or trade names;

(18) all prepaid assets relating to an Assumed Contract, Transferred Assets or Transferred Liabilities;

(19) any interest rate swaps and caps listed on Schedule 2.1(a)(19), along with any related accruals and net of market value adjustments, but only to the extent separately assignable to Purchaser;

(20) all Trust Accounts, along with all fees and income attributable to periods after the Effective Time, including all 12b-1, shareholder servicing or other fees paid or payable by or on account of any investments held in any Trust Account, along with custody of all investments, assets or other property held in such Trust Accounts, subject to any necessary consent requirements or court orders;

(21) all Investment Accounts, regardless of whether held directly by Seller or indirectly through any third-party broker-dealer or investment advisor;

(22) all of Seller's cash due from banks;

(23) all of Seller's fed funds sold; and

(24) any Federal Home Loan Bank Stock, if transferrable.

For avoidance of doubt, Transferred Assets shall not include any equity interest in Bates Financial, and Purchaser shall not have any rights, duties, obligations or liabilities relating to Bates Financial or its operations.

(b) All other assets of Seller shall not be included in the Transferred Assets, and shall not be transferred hereunder, including:

(1) any regulatory licenses (other than any assignable regulatory license primarily related to the Transferred Assets, which shall constitute Transferred Assets) or any other nonassignable licenses and permits;

(2) any Tax assets, including without limitation, all Tax refunds, Tax credits or deferred Tax assets, and prepayments of Taxes;

(3) all contracts and agreements other than Assumed Contracts;

(4) any assets held with respect to the Benefit Plans (other than personnel files or similar records contemplated by Section 2.1(a)(13));

(5) any Affiliate Participations;

(6) any membership interests of RCH;

(7) all amounts due and payable from any Affiliate; and

(8) all of Seller's right, title and interest in bank owned life insurance for which Seller or any Employee is the beneficiary

(collectively, the "Excluded Assets").

(c) Purchase Price Premium. As consideration for the purchase of the Transferred Assets and the assumption of the Transferred Liabilities, Seller shall receive from Purchaser an amount equal to (i) 0.345, multiplied by (ii) the Adjusted Tangible Equity, calculated as of the Determination Date in accordance with Section 2.1(i) and Section 3.3 (such amount, the "Purchase Price Premium").

(d) Closing Payments. On the Closing Date, Purchaser shall pay to Seller by wire transfer of immediately available funds an amount equal to:

(1) (i) the Purchase Price Premium, plus (ii) an amount equal to (A) the aggregate Net Book Value of the Transferred Assets determined as of the Determination Date, plus (B) any prorated amounts owed by Purchaser to Seller under Section 2.2; less

(2) (i) the aggregate Net Book Value of the Transferred Liabilities determined as of the Determination Date, plus (ii) any prorated amounts owed by Seller to Purchaser pursuant to Section 2.2.

Notwithstanding the foregoing, if the amount determined in accordance with clause (2) of this Section 2.1(d) exceeds the amount determined in accordance with clause (1) of this Section 2.1(d), then the full amount of such excess shall constitute an amount due from Seller to Purchaser and shall be paid by Seller to Purchaser at the Closing by wire transfer of immediately available funds. The amount determined in accordance with this Section 2.1(d) to be paid on the Closing Date by Purchaser to Seller or by Seller to Purchaser, as the case may be, is referred to herein as the "Purchase Price." The Purchase Price, as paid on the Closing Date, will be subject to adjustment as provided in Section 3.3.

(e) Transferred Liabilities. Purchaser shall assume as of the Effective Time and pay, perform and discharge as of or after the Effective Time, as the case may be, only the following duties, obligations, and liabilities of Seller arising from and after the Effective Time (the "Transferred Liabilities"):

(1) the Deposit Liabilities and the terms and agreements relating thereto;

(2) all of Seller's duties, obligations and liabilities relating to the Real Property and the Personal Property:

(3) all of Seller's duties, obligations and liabilities relating to the Branch Lease and the Personal Property Leases;

(4) all of Seller's duties, obligations and liabilities relating to the Safe Deposit Contracts;

(5) all of Seller's duties, obligations and liabilities relating to the Purchased Loans and the servicing thereof;

(6) all of Seller's duties, obligations and liabilities relating to the Overdrafts;

(7) all of Seller's duties, obligations and liabilities relating to the Assumed Contracts, including any accrued but unpaid liabilities attributable to any period after the Effective Time; *provided*, *however*, that Purchaser shall not, except pursuant to a subsequent assignment to which Purchaser is a party, assume any liabilities, duties or obligations arising under any Assumed Contract that is not assigned to Purchaser at the Closing due to the failure to receive a necessary consent or otherwise;

(8) all of Seller's obligations and liabilities relating to the Borrowings set forth on Schedule 2.1(e)(8)

(9) all of Seller's duties, obligations and liabilities under the customer repurchase agreements identified on Schedule 2.1(e)(9)

(10) all of Seller's duties, obligations and liabilities relating to the Trust Accounts;

(11) all of Seller's duties, obligations and liabilities relating to the Investment Accounts;

(12) all of Seller's Federal Home Loan Bank obligations listed on Schedule 2.1(e)(12), including obligations with respect to any letters of credit issued for Seller's account;

(13) all of Seller's obligations for any fed funds purchased;

(14) all liabilities and obligations for (i) Taxes relating to the Transferred Assets or the Transferred Liabilities for any taxable period (or portion thereof) beginning after the Closing Date and (ii) Taxes for which Purchaser is liable pursuant to Section 2.1(h); and

(15) all of Seller's duties, obligations and liabilities for any issued but unpaid cashier's checks or official items.

This Section 2.1(e) shall not in any way enlarge the rights of any third parties relating to the Transferred Liabilities. Nothing contained herein shall prevent either party hereto from contesting matters relating to the Transferred Liabilities with any third party.

(f) Excluded Liabilities. Notwithstanding anything to the contrary contained herein, Purchaser shall not assume any duties, obligations or liabilities of Seller of any kind, whether known, unknown, contingent or otherwise, other than the Transferred Liabilities, including any duty, obligation or liability:

(1) not directly relating to the Transferred Assets;

(2) attributable to any acts or omissions to act taken or omitted to be taken by or on behalf of Seller (or any of its Affiliates) prior to the Effective Time in violation of any applicable laws, contracts or legal or fiduciary duties;

(3) attributable to any actions, causes of action, claims, suits or proceedings or violations of law or regulation attributable to any acts or omissions to act taken or omitted to be taken by Seller (or any of its affiliates or direct or indirect Subsidiaries);

(4) for (i) Taxes relating to the Transferred Assets or the Transferred Liabilities for taxable periods (or portions thereof) ending on or prior to the Closing Date and (ii) Taxes for which Seller is liable pursuant to Section 2.1 (h);

(5) except as expressly set forth in Section 8.13, relating to the Employees in any respect, including the employment or termination of employment of any Employee, in the case of each Branch Employee relating to any period prior to the time such Branch Employee become employed by Purchaser as contemplated hereby, and relating to the Benefit Plans, ERISA, COBRA or the WARN Act in any respect, whether arising before or after the Effective Time (for avoidance of doubt, Excluded Liabilities include any duty, obligation or liability arising under the Seller Employment Agreements, the Parent Equity Incentive Plans, any contract listed on Schedule 6.8(b)(ii) or any plan listed on Schedule 6.8(b)(iii));

(6) arising from circumstances, events or conditions prior to the Effective Time and not expressly assumed hereunder; and

(7) all amounts due and payable to any Affiliate

(collectively, the "Excluded Liabilities").

For avoidance of doubt, Excluded Liabilities shall include the Perryville Loan Liabilities, and Purchaser shall not be a successor to Seller with respect to any Perryville Loan Liabilities. This Section 2.1(f) is not intended to enlarge the rights of any third parties relating to the Excluded Liabilities. Nothing contained in this Agreement shall prevent either party hereto from contesting matters relating to the Excluded Liabilities with any third party.

(g) Control Regarding Transferred Liabilities and Excluded Liabilities. From and after the Effective Time, (A) Purchaser shall have complete control over the payment, settlement or other disposition of the Transferred Liabilities and the right to commence, control and conduct all negotiations and proceedings with respect thereto, and (B) Seller shall have complete control over the payment, settlement or other disposition of the Excluded Liabilities and the right to commence, control and conduct all negotiations and proceedings with respect thereto. Except as otherwise provided in Article IV or in the Transition and Services Agreement, (i) Seller shall promptly notify Purchaser of any claim made against it with respect to the Transferred Liabilities or the Transferred Assets and shall not voluntarily make any payment of, settle or offer to settle, or consent or compromise or admit liability with respect to, any Transferred Liabilities or Transferred Assets and (ii) Purchaser shall promptly notify Seller of any claim made against it with respect to the Excluded Liabilities or the Excluded Assets and shall not voluntarily make any payment of, settle or offer to settle, or consent or compromise or admit liability with respect to, any Excluded Liabilities or Excluded Assets.

(h) Transfer Taxes. All excise, sales, use, stamp, documentary and transfer Taxes and similar fees and charges (collectively, “Transfer Taxes”) that are payable or that arise as a result of the consummation of the transactions contemplated hereby shall be paid by Seller and Purchaser in equal shares, and each party shall indemnify and hold the other party harmless from and against any such Transfer Taxes in excess of the allocated share of such other party.

(i) Initial Determination of Purchase Price. Seller shall prepare, in consultation with Purchaser, a balance sheet as of the Determination Date based on Seller’s books and records and using the internal accounting procedures of Seller consistently applied reflecting the assets to be sold and assigned hereunder and the liabilities to be transferred and assumed hereunder and prepared in accordance with the Accounting Standards, with the book value of any Transferred Assets determined net of any charge offs, valuation allowances or reserves and except to the extent otherwise specifically provided in this Agreement (the “Determination Date Balance Sheet”), together with a copy of Seller’s calculations of the Purchase Price. Seller shall deliver the Determination Date Balance Sheet to Purchaser as soon as reasonably practicable following the Determination Date Balance Sheet. All amounts determined pursuant to this Section 2.1(i) shall be subject to subsequent adjustment based on the Post-Closing Balance Sheet.

(j) Tax Allocation. Prior to the Closing, Seller and Purchaser shall cooperate in good faith to determine a reasonable allocation of the total consideration paid for the Transferred Assets, as finally determined pursuant to Section 2.1 (d), Section 2.1(i) and Section 3.3, in accordance with Section 1060 of the Code and the Treasury Regulations promulgated thereunder (the “Purchase Price Allocation”). Seller and Purchaser shall cooperate in good faith to mutually agree to such allocation and shall reduce such agreement to writing, which agreement shall be reflected in an Exhibit 2.1(j) to be approved by Seller and Purchaser prior to Closing. Seller and Purchaser shall jointly and properly execute each party’s respective completed Internal Revenue Service Form 8594, and any other forms or statements required by the Code (or state or local Tax law), Treasury Regulations or the Internal Revenue Service or other Governmental Authority (together with any and all attachments required to be filed therewith), which forms and statements will be prepared in a manner consistent with the Purchase Price Allocation. Seller and Purchaser shall file timely such forms and statements with the Internal Revenue Service or other Governmental Authority. The Purchase Price Allocation shall be appropriately adjusted to take into account any subsequent payments under this Agreement and any other subsequent events required to be taken into account under Section 1060 of the Code. Seller and Purchaser shall not file any Tax Return or other documents or otherwise take any position with respect to Taxes that is inconsistent with the Purchase Price Allocation; *provided*, *however*, that neither Seller nor Purchaser shall be obligated to litigate any challenge to such allocation by any Governmental Authority. Seller and Purchaser shall promptly inform one another of any challenge by any Governmental Authority to any allocation made pursuant to this Section 2.1(j) and agree to consult with and keep one another informed with respect to the state of, and any discussion, proposal or submission with respect to, such challenge.

Section 2.2 Proration; Other Closing Date Adjustments.

(a) Except as otherwise specifically provided in this Agreement or in the Transition and Services Agreement, it is the intention of the parties that Seller shall operate the Branch Banking Operations, hold the Transferred Assets and retain the Transferred Liabilities for its own account until the Effective Time, and the Branch Banking Operations shall be operated, the Transferred Assets shall be held and the Transferred Liabilities shall be assumed for Purchaser's account as of and after the Effective Time. Thus, except as otherwise expressly provided in this Agreement, items of income and expense of the Branch Banking Operations shall be prorated as of the Effective Time, and settled between Seller and Purchaser on and as of the Closing Date, whether or not such adjustment would normally be made as of such time. Items of proration will be handled at Closing as an adjustment to the Purchase Price unless otherwise agreed by the parties hereto. In furtherance of the foregoing, Purchaser shall promptly forward to Seller complete and accurate copies of all invoices, billing statements and similar documents received by Purchaser after the Effective Time and relating to the Branch Banking Operations conducted prior to the Effective Time, and Seller shall promptly forward to Purchaser complete and accurate copies of all invoices and billing statements received by Seller relating to the Branch Banking Operations conducted after the Effective Time. To the extent the exact amounts of any real or personal property Taxes or other items to be prorated are not known on the Closing Date, the parties shall make reasonable estimates of such Taxes or other items for purposes of making prorations at Closing and shall thereafter adjust the prorations as promptly as practicable after such exact amounts are finally ascertained.

(b) For purposes hereof, items of proration and other adjustments shall include: (1) accrued but unpaid interest, fees and charges relating to the Transferred Assets and Transferred Liabilities (2) rental payments under the Branch Leases; (3) personal and real property Taxes and assessments arising from Real Property or the Leased Branch or otherwise from the Branch Banking Operations (determined by assuming that the taxable year or period ended at the Effective Time); (4) FDIC deposit insurance assessments; (5) prepaid expenses and items and accrued but unpaid liabilities a portion of which is attributable to periods after the Effective Time (it being understood that Purchaser shall have no liability for any accrued but unpaid liabilities attributable to Excluded Assets or Excluded Liabilities); and (6) safe deposit rental payments previously received by Seller.

Section 2.3 Title to the Real Property and the OREO.

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(a) Purchaser agrees to notify Seller in writing (a "Title Defect Notice") no later than sixty (60) days after the date hereof of any mortgages, pledges, liens, encumbrances, reservations, encroachments, overlaps or other title defects related to the Real Property or the OREO as to which Purchaser objects (the "Title Defects"), *provided* that the Title Defects and the Title Defect Notice shall not include or refer to any Permitted Encumbrances. If Seller shall timely receive any Title Defect Notice with respect to the Real Property or the OREO, then Seller shall cure or eliminate such Title Defect prior to the Closing, in which event the Closing shall proceed with respect to the Real Property. For purposes of this Section 2.3, a Title Defect shall be deemed to have been "cured" or "eliminated" if title insurance coverage or a bond reasonably acceptable to Purchaser shall have been obtained without exception for any such Title Defect and providing bring down or gap coverage through the Closing Date.

(b) Purchaser shall have the right to obtain an updated title search or survey not less than thirty (30) days prior to the anticipated Closing Date to determine whether any title changes may have arisen between the effective date of the applicable title commitment and such update (an "Updated Title Report"). If such Updated Title Report indicates that any Title Defects have been placed of record in respect of the Real Property or the OREO since the effective date of the applicable title commitment, or if Purchaser is otherwise unable to obtain bring down or gap coverage through the Closing Date, then Purchaser shall have the right to provide Seller a Title Defect Notice in respect thereof not more than five (5) Business Days following Purchaser's receipt of such Updated Title Report, and thereafter Seller shall have the right to address such Title Defect Notice in the same manner as is set forth in Section 2.3(a) with respect to Title Defect Notices received by Seller within sixty (60) days after the date hereof (by electing to cure the Title Defect, all as more particularly set forth in Section 2.3(a)).

Section 2.4 Environmental Matters.

(a) Seller has made available to Purchaser complete and accurate copies of all environmental studies, reports and audits in Seller's or its Affiliates' possession related to the Real Property and the OREO (the "Existing Environmental Reports").

(b) Prior to the Effective Time, Purchaser shall have the right, but not the obligation, at its sole cost and expense, to cause such investigations and tests to be made as it reasonably deems necessary to determine whether there has been any soil, surface water, groundwater or building space contamination on or under the Real Property and the OREO. Seller shall cooperate with Purchaser and/or its agents or contractors in their evaluation and testing of the Real Property and the OREO, including by providing Purchaser and/or its agents or contractors reasonable access to pertinent records and documents in Seller's or its Affiliates' possession. Any investigations or tests performed by Purchaser shall be conducted in a manner so as not to damage in any material respect the Real Property and the OREO and so as not to interfere in any material respect with the business or operations conducted thereat. If any such damage is caused to the Real Property and the OREO, Purchaser shall promptly repair and restore the Real Property and the OREO to its former condition. Without the prior written consent of Seller (which consent will not unreasonably withheld, conditioned or delayed) and execution of a reasonably satisfactory property access agreement, Purchaser shall not conduct subsurface or intrusive testing or any ground water monitoring or install any test well or undertake any other investigation that requires a permit or license from, or the reporting of the investigation or the results thereof to, any environmental regulatory authority. Purchaser shall give Seller reasonable prior notice of its intention to conduct any investigation or test hereunder. Purchaser shall furnish Seller with a copy of each report or investigation setting forth the results of any test performed by Purchaser as soon as reasonably practicable after receipt. Purchaser shall not submit a copy of any such report or disclose the contents thereof to any Governmental Authority unless specifically required by applicable law, and if so required, Purchaser shall provide Seller five (5) days' prior written notice of any submission and shall simultaneously provide to Seller a copy of any information submitted to such Governmental Authority.

(c) If Purchaser objects to a Material Adverse Environmental Condition at the Real Property or the OREO by providing written notice thereof to Seller within sixty (60) days after the date hereof, then Seller shall cure such Material Adverse Environmental Condition in a manner reasonably satisfactory to Purchaser prior to the Closing, in which event the Closing shall proceed with respect to the Real Property or the OREO. Seller shall be deemed to have cured any Material Adverse Environmental Condition if it agrees to remediate such Material Adverse Environmental Condition and provide assurances that such remediation will be promptly effected, in each case to Purchaser's reasonable satisfaction and without material interruptions of the operations conducted at the Real Property or the OREO. The term "Material Adverse Environmental Condition" as used herein means any contamination or other condition or combination of contaminations and conditions caused by or related to Hazardous Substances in violation of any applicable Environmental Law, which contaminations or conditions would be reasonably expected to result in liabilities or remediation costs in excess of $100,000 in the aggregate.

Section 2.5 Assumed Contracts. Attached as Schedule 2.5 is a list of all real and personal property leases and service or other contracts in effect as of the date hereof that exclusively relate to the Owned Branch, the Leased Branch or the Branch Banking Operations (and that are capable of assignment in connection herewith) that will be assumed by Purchaser hereunder ("Assumed Contracts"). Subject to the proration requirements of Section 2.2, Purchaser shall assume all such Assumed Contracts as of the Effective Time.

Section 2.6 Books and Records.

(a) As promptly as practicable subsequent to the Effective Time, but in no event later than the Conversion Date, Seller shall deliver to Purchaser all files, documents and records in Seller's possession that pertain to and are utilized by Seller to administer, monitor, evidence or record information respecting the business or conduct of the Branch Banking Operations, including all such files, documents and records maintained on electronic or magnetic media in the electronic data base system of Seller that are reasonably accessible on a branch-by-branch basis, and, to the extent permitted by law, including copies of all lists of customers and clients and all personnel files relating to the Branch Employees. If any personnel file, or portion thereof, relating to any Branch Employee is not permitted by law to be transferred pursuant to the immediately preceding sentence, Seller shall promptly advise Purchaser of such prohibition and, notwithstanding anything to the contrary set forth herein, if any Branch Employee executes a waiver mutually reasonably satisfactory to Seller and Purchaser authorizing such delivery, Seller shall promptly provide copies of the entire personnel file applicable to such Branch Employee. Following the Closing Date, Seller shall promptly provide such copies of such files, documents and records relating to the Branch Banking Operations in its possession as Purchaser shall reasonably request. Purchaser agrees, at Seller's expense, to return to Seller all files, documents and records contained in the Owned Branch or Leased Branch that, to Purchaser's knowledge, do not relate to the business or conduct of the Branch Banking Operations.

(b) As to any file, document, or record, as of the time of transfer and until any return thereof to Seller, Purchaser shall become responsible for maintaining such file, document or record transferred to it pursuant hereto. Purchaser will preserve and hold such files, documents and records in safekeeping as required by applicable law and in accordance with Purchaser's customary practices.

(c) After the Effective Time, Purchaser will permit Seller and its representatives, at reasonable times and upon reasonable written notice, at Seller's sole cost and expense (except as set forth in Section 2.6(d)) to examine, inspect, copy and reproduce any such files, documents or records, and to have access to any Employees that may then be employed by Purchaser, to the extent reasonably required in connection with any third party claim, action, litigation or other proceeding involving Seller or its Affiliates (or any existing or former employee of Seller or its Affiliates) or in connection with any legal obligation owed by Seller or its Affiliates to any present or former depositor or other customer or any Governmental Authority, including for purposes of preparing regulatory reports and returns and Tax Returns. After the Effective Time, Seller will permit Purchaser and its representatives, at reasonable times and upon reasonable notice, at Purchaser's sole cost and expense except as set forth in Section 2.6(d), to examine, inspect, copy and reproduce files, documents or records retained by Seller or its Affiliates regarding the Transferred Assets and Transferred Liabilities to the extent reasonably required in connection with any third party claim, action, litigation or other proceeding involving Purchaser or its Affiliates or in connection with any legal obligation owed by Purchaser or its Affiliates to any present or former depositor or other customer or any Governmental Authority, including for purposes of preparing regulatory reports and returns and Tax Returns.

(d) For a period of one (1) year after the Effective Time, the party providing copies of records hereunder shall do so without charge, and thereafter it may charge its customary rate for providing such copies.

ARTICLE III.

CLOSING AND EFFECTIVE TIME

Section 3.1 Effective Time. The purchase of the Transferred Assets and assumption of Transferred Liabilities provided for in this Agreement, shall occur at a closing (the "Closing") to be held at the offices of Dorsey & Whitney LLP in Minneapolis, Minnesota at 10:00 a.m., local time, or at such other time, place, and manner as the parties shall mutually agree, on a date to be mutually agreed upon between the parties, which date shall occur on the first day of the next month following the date on which all conditions set forth in Article IX and Article X (other than those conditions that by their nature are to be satisfied at the Closing) are satisfied or, where legally permitted, waived. The effective time (the "Effective Time") shall be 5:00 p.m., local time in Rockford, Illinois, on the day on which the Closing occurs (the "Closing Date"), unless the Closing Date is on the first day of the month, in which case the Effective Time shall be 12:01 a.m., local time in Rockford, Illinois.

Section 3.2 Closing.

(a) All actions taken and documents delivered at the Closing shall be deemed to have been taken and executed simultaneously, and no action shall be deemed taken nor any document delivered until all have been taken and delivered.

(b) At the Closing, subject to all the terms and conditions hereof, including receipt of all consents and approvals hereunder, Seller shall execute and deliver to Purchaser the following:

(1) a special warranty deed executed by Seller transferring all of Seller's right, title and interest in and to the Owned Branch, Unimproved Real Property and the OREO, subject only to Permitted Encumbrances, in substantially the form attached hereto as Exhibit 3.2(b)(1), together with (A) such evidence of Seller's authority to sell the Real Property and the OREO as Purchaser's title company shall reasonably require, (B) an ALTA owner's affidavit for the Real Property and the OREO in customary form and (C) such real property transfer tax and related or similar forms required in connection with the recordation of the grant deed;

(2) a bill of sale, in substantially the form attached hereto as Exhibit 3.2(b)(2), transferring to Purchaser all of Seller's interest in the Personal Property and the Coins and Currency;

(3) an Assignment and Assumption Agreement in substantially the form attached hereto as Exhibit 3.2(b)(3), with respect to the Transferred Liabilities (the "Assignment and Assumption Agreement");

(4) an Assignment and Assumption of Lease executed by Seller, in substantially the form attached hereto as Exhibit 3.2(b)(4), assigning Seller's interest in the Leased Branch and pursuant to which Purchaser shall assume the Branch Lease (the "Assignment and Assumption of Lease");

(5) the Landlord Consent;

(6) estoppel certificates executed by the lessor of the Leased Branch, to the extent Seller can obtain such certificates using its reasonable best efforts:

(7) a certificate of a proper officer of Seller, dated as of the Closing Date, certifying as to the satisfaction of the conditions set forth in Section 9.1 and Section 9.2 (*provided* that in the event that Purchaser has waived such conditions pursuant to this Agreement, such certificate need only address such matters as have not been waived under the terms hereof);

(8) a Closing Statement setting forth the calculation of the Purchase Price using amounts shown on the Determination Date Balance Sheet, substantially in the form attached hereto as Exhibit 3.2(b)(8) (the "Closing Statement");

(9) a certification of Seller, meeting the requirements of Treasury Regulations Section 1.1445 2(b)(2), certifying that Seller is not a "foreign person" as defined in the federal Foreign Investment in Real Property Tax Act of 1980, which certification shall be substantially in the form of the sample certification set forth in Treasury Regulations Section 1.1445 2(b)(2)(iii)(B);

(10) customary certificates and affidavits as reasonably requested by a title company selected by Purchaser;

(11) a limited power of attorney to allow Purchaser, in the name of Seller, to effect transfers of Transferred Assets after the Closing, which shall be in substantially the form attached hereto as Exhibit 3.2(b)(11);

(12) an assignment, transfer and appointment of Purchaser as successor in all fiduciary capacities of Seller with respect to the Trust Accounts and all investments and other assets of such accounts, signed by a duly authorized officer of Seller;

(13) such notices, documents and certificates as are necessary to transfer the Investment Accounts to a broker-dealer designated by Purchaser;

(14) such certificates and other documents as the parties determine to be reasonably necessary in connection with the consummation of the transactions contemplated hereby and that do not alter the parties' respective obligations or liability hereunder; and

(15) if required by Section 2.2(d), immediately available funds in the amount of the Purchase Price as set in the Closing Statement.

(c) At the Closing, subject to all the terms and conditions hereof, Purchaser shall execute and deliver to Seller:

(1) the Assignment and Assumption Agreement;

(2) the Assignment and Assumption of Leases;

(3) a certificate and receipt acknowledging the delivery and receipt of possession of the Transferred Assets and records referred to in this Agreement;

(4) if required by Section 2.2(d), immediately available funds in the amount of the Purchase Price as set forth on the Closing Statement;

(5) a certificate of a proper officer of Purchaser, dated as of the Closing Date, certifying as to the satisfaction of the conditions set forth in Section 10.1 and Section 10.2;

(6) an assignment, transfer and appointment of Purchaser as successor in all fiduciary capacities of Seller with respect to the Trust Accounts and all investments and other assets of such accounts, signed by a duly authorized officer of Purchaser;

(7) such certificates and other documents as the parties determine to be reasonably necessary in connection with the consummation of the transactions contemplated hereby and that do not alter the parties' respective obligations or liability hereunder.

Section 3.3 Post-Closing Adjustments.

(a) Not later than the close of business on the thirtieth (30^{th}) day after the Effective Time (such actual date of delivery, the "Post-Closing Balance Sheet Delivery Date"), Seller shall deliver to Purchaser a balance sheet dated as of the Effective Time based on Seller's books and records and using the internal accounting procedures of Seller consistently applied reflecting the assets sold and assigned and the liabilities transferred and assumed hereunder and prepared in accordance with the Accounting Standards, with the book value of any Transferred Assets determined net of any charge offs, valuation allowances or reserves and except to the extent otherwise specifically provided in this Agreement (the "Post-Closing Balance Sheet"), together with a copy of Sellers's calculation of the Purchase Price as adjusted based on the Post-Closing Balance Sheet. Seller shall afford Purchaser and its accountants and attorneys the opportunity to review all work papers and documentation used by Seller in preparing the Post-Closing Balance Sheet.

(b) Except as otherwise expressly provided herein, the determination of the Post-Closing Balance Sheet shall be final and binding on the parties hereto unless within thirty (30) days after receipt by Purchaser of the Post-Closing Balance Sheet, Purchaser shall notify Seller in writing of its disagreement with any amount included therein or omitted therefrom, in which case, if the parties are unable to resolve the disputed items within ten (10) Business Days of the receipt by Seller of notice of such disagreement, such items shall be determined by a nationally-recognized independent accounting firm selected by mutual agreement between Seller and Purchaser; *provided, however*, that in the event the fees of such firm as estimated by such firm would exceed fifty percent (50%) of the net amount in dispute, the parties agree that such firm will not be engaged by either party and that such net amount in dispute will be equally apportioned between Seller and Purchaser. Such accounting firm shall be instructed to resolve the disputed items within ten (10) Business Days of engagement, to the extent reasonably practicable. The determination of such accounting firm shall be final and binding on the parties hereto. The fees of any such accounting firm shall be divided equally between Seller and Purchaser.

(c) Not later than the close of business on the second (2nd) Business Day following the determination of the Post-Closing Balance Sheet (the "Adjustment Payment Date"), Seller and Purchaser shall effect the transfer of any funds as may be necessary to reflect changes in such assets and liabilities between the Determination Date Balance Sheet and the Post-Closing Balance Sheet and resulting changes in the Purchase Price. Such funds shall be transferred together with interest thereon computed from the Effective Time up to but not including the Adjustment Payment Date at the applicable Federal Funds Rate.

(d) Notwithstanding the foregoing provisions of Section 3.3, if at any time within three (3) months after the Post-Closing Balance Sheet Delivery Date either party discovers an error in the calculation of the Post-Closing Balance Sheet that resulted in the Purchase Price actually paid, as adjusted pursuant to Section 3.3 ("Original Price"), being at least $50,000, individually or in the aggregate with all such errors, more or less than the Purchase Price would have been but for such error ("Revised Price"), and notifies the other party thereof, the parties agree to cooperate in good faith to correct the error. If the parties disagree on the existence or magnitude of an error within ten (10) Business Days after notice thereof, such matter shall be resolved by an independent accounting firm in the same manner as described above for resolving disputed items; *provided, however*, that in the event the fees of such firm as estimated by such firm would exceed fifty percent (50%) of the net amount in dispute, the parties agree that such firm will not be engaged by either party and that such net amount in dispute will be equally apportioned between Seller, on the one hand, and Purchaser, on the other hand. Upon the determination of the Revised Price, the appropriate party shall pay an amount to the other party that is the difference between the amount actually paid by such party pursuant to Section 3.3(c), as adjusted pursuant to this Section 3.3(d), and the amount that such party would have paid to the other party if the Original Price had been equal to the Revised Price, together with interest thereon computed from the Effective Time up to but not including the Adjustment Payment Date at the applicable Federal Funds Rate.

ARTICLE IV.

TRANSITIONAL MATTERS

Section 4.1 General.

(a) Seller and Purchaser acknowledge and agree that Purchaser will not be able to complete the Conversion on the Closing Date. Accordingly, Seller and Purchaser shall enter into, to become effective as of the Effective Time, the Transition and Services Agreement, which Transition and Services Agreement shall govern the relationship between Seller and Purchaser during the period from the Effective Time to the Conversion Date. Without limiting any obligations that will be more specifically set forth in the Transition and Services Agreement, Seller and Purchaser agree during the period from the Effective Time to the Conversion Date to (i) cooperate in good faith to assure an orderly transition of ownership of the Transferred Assets and Transferred Liabilities to Purchaser hereunder, (ii) to use reasonable best efforts to cause to be continued uninterrupted and unimpaired the provision of data processing and similar services and systems that support or facilitate the Branch Banking Operations such that the Branch Banking Operations shall continue to be operated in the ordinary course consistent with past practices, and (iii) to use reasonable best efforts to cause all third parties that provide data processing and similar services with respect to the Transferred Assets and Transferred Liabilities to continue to provide such services during such period, and shall cooperate in managing the provision of such services.

(b) In furtherance of the foregoing, appropriate personnel of Seller and Purchaser shall meet to discuss implementation of the Transition and Services Agreement including with respect to mutually acceptable transaction settlement procedures and specifications, files (including Conversion sample files) and schedules for the transfer of data processing responsibilities relating to the Transferred Assets and Transferred Liabilities from Seller to Purchaser, to be effective as of the Conversion Date. Not later than fifteen (15) days following the date hereof, Seller shall deliver to Purchaser the specifications and Conversion sample files in Seller's possession and, as promptly as reasonable practicable following the date hereof, shall use commercially reasonable efforts to deliver to Purchaser such specifications and Conversion sample files held by third parties and relating to the Transferred Assets and Transferred Liabilities.

(c) Not later than thirty (30) days prior to the anticipated Closing Date, Seller shall make available to Purchaser (1) a complete and accurate list of all applicable customer routing and transit numbers and account numbers with respect to the Branches, (2) files of all applicable customer signature cards that Seller has with respect to the Deposits and all related special instructions, and (3) names, addresses and account information on all products related to the Deposits, including safe deposit box accounting, cash management services, bill payments, online banking customers (both consumer and business) and account analysis.

Section 4.2 <u>Notices to Customers and Others</u>. Not later than thirty (30) days prior to the anticipated Closing Date (or such other time as may be required by law), Seller and Purchaser shall jointly, at Purchaser's expense, notify customers with Deposits that, subject to the terms and conditions hereof, Purchaser will be assuming the Deposit Liabilities, and Seller and Purchaser shall join in providing, where appropriate, all notices to customers of the Branches and all other Persons as Seller or Purchaser, as the case may be, is or are required to give under applicable law or the terms of any agreements between Seller and any customer in connection with the transactions contemplated hereby. The form and content of such notice shall be subject to the reasonable approval of both parties. Following a date not earlier than sixty (60) days prior to the Closing Date anticipated by the parties, or such earlier date to which the parties shall agree, Purchaser may communicate with and deliver information to depositors and other customers of the Branches concerning this Agreement and the business of Purchaser. The form and content of such communications shall be subject to the reasonable approval of Seller. Upon request by Purchaser, Seller will provide reasonable assistance to Purchaser in mailing or causing to be mailed such communications, at Purchaser's expense.

Section 4.3 <u>Trust Accounts</u>. Not later than thirty (30) days prior to the anticipated Closing Date (or such other time as may be required by law), Seller and Purchaser shall jointly, at Purchaser's expense, notify grantors, beneficiaries, co-trustees and other persons that are party to or have an interest in any Trust Account that, subject to the terms and conditions hereof, Purchaser will become successor to Seller in all of its fiduciary capacities relating to such Trust Accounts. The form and content of such notice shall be subject to the reasonable approval of both parties. Upon request by Purchaser, Seller will provide reasonable assistance to Purchaser in mailing or causing to be mailed such communications, at Purchaser's expense.

Section 4.4 Investment Accounts. Not later than thirty (30) days prior to the anticipated Closing Date (or such other time as may be required by law), Seller and Purchaser shall jointly, at Purchaser's expense, notify customers or other persons that are party to or have an interest in any Investment Account that, subject to the terms and conditions hereof, a broker-dealer designated by Purchaser will become successor to RJFS as broker-dealer for the Investment Accounts. The form and content of such notice shall be subject to the reasonable approval of both parties. Upon request by Purchaser, Seller will provide reasonable assistance to Purchaser in mailing or causing to be mailed such communications, at Purchaser's expense. Seller shall cooperate with and assist Purchaser in effecting the transfer of all Investment Accounts to a successor broker-dealer designated by Purchaser, effective as of the Closing Date. Such cooperation shall include the timely delivery of all notices, instructions and other documents to RJFS as may be necessary to effect an Automated Customer Account Transfer or similar transfer of the Investment Accounts to such successor broker-dealer. To the extent requested by Purchaser such cooperation shall also include the timely delivery of all notices, instructions and other documents to RJFS as may be necessary to effect the transfer of the registered representatives assigned to such Investment Accounts to such successor broker-dealer.

Section 4.5 Leasing of Personal Property. Seller shall take such actions as may be mutually agreed with Purchaser with respect to any Personal Property Lease that is currently in effect but that would otherwise expire on or prior to the Closing (including renewing or extending such Personal Property Lease or the Branch Lease on such terms and conditions as Seller and Purchaser may mutually agree). In the event that Seller and Purchaser are unable to reach agreement pursuant to the preceding sentence with respect to any Personal Property Lease, Seller shall use reasonable best efforts to renew or extend on a month-to-month basis any such Personal Property Lease or the Branch Lease; *provided, however*, that no such renewal or extension shall be for a fixed term exceeding one year without the prior written consent of Purchaser, and Seller shall consult with Purchaser prior to renewing or extending any material Personal Property Lease. Seller shall not cancel, terminate or amend (other than as provided in the preceding sentence relating to extensions) any such Personal Property Lease without the prior written consent of Purchaser. Notwithstanding the foregoing, Seller shall use reasonable best efforts to amend any Personal Property Leases in order to transfer the related Personal Property to Purchaser pursuant to Article II if such amendment is required to effect such transfer.

Section 4.6 Notices to Obligors on Purchased Loans.

(a) Purchaser shall no later than fifteen (15) days prior to the anticipated Closing Date prepare and transmit, at Purchaser's sole cost and expense, to each obligor on each Purchased Loan, a notice in a form satisfying all legal requirements to the effect that the Purchased Loan will be transferred to Purchaser. To the extent that Purchaser's notice pursuant to the prior sentence shall be legally insufficient, Seller agrees, at Purchaser's sole expense, to provide all Purchased Loan obligors with all required notices of the assignment and transfer of the Purchased Loans.

(b) To the extent that any of the Purchased Loans transferred from Seller to Purchaser involve a transfer of servicing as defined and governed by the Real Estate Settlement Procedure Act (12 U.S.C. § 2601 *et seq.*), Seller and Purchaser will jointly coordinate any appropriate required customer notices.

ARTICLE V.

INDEMNIFICATION

Section 5.1 Seller’s Indemnification of Purchaser. Subject to any limitations set forth in Section 5.4, Seller and its respective successors and assigns shall indemnify, hold harmless, and defend Purchaser and its representatives, controlling persons and Affiliates from and against any Losses arising out of or relating to (a) any breach by Seller of any of its covenants or agreements contained herein occurring prior to the Effective Time, (b) any breach by Seller of any of its representations and warranties contained herein (with any such breach or inaccuracy to be determined without regard to any qualification for “materiality,” “in all material respects,” “Seller Material Adverse Effect” or similar qualifications), (c) the Branch Banking Operations as conducted at or before the Effective Time, (d) any Excluded Liabilities or (e) any breach of any of Seller’s representations, warranties, covenants and agreements contained in the Transition and Services Agreement.

Section 5.2 Purchaser’s Indemnification of Seller. Subject to any limitations set forth in Section 5.4, Purchaser and its successors and assigns shall indemnify, hold harmless, and defend Seller and its representatives, controlling persons and Affiliates from and against any Losses arising out of or relating to (a) any breach by Purchaser of any of its covenants or agreements contained herein occurring prior to the Effective Time, (b) any breach by Purchaser of any of its representations and warranties contained herein, (c) the Branch Banking Operations as conducted after the Effective Time, (d) any Transferred Liabilities, or (e) any breach of any of Purchaser’s representations, warranties, covenants or agreements contained in the Transition and Services Agreement.

Section 5.3 Claims for Indemnity by Purchaser or Seller.

(a) A claim for indemnity shall be made by the claiming party at any time prior to the applicable Claim Limitation Period by the giving of written notice thereof to the other party or, in the case of Seller, to Parent. Such written notice shall set forth in reasonable detail the basis upon which such claim for indemnity is made. In the event that any bona fide claim is made within such period, the indemnity relating to such claim shall survive until such claim is resolved. No claim for indemnity made pursuant to Section 5.1(a), Section 5.1(b), Section 5.1(c), Section 5.1(e), Section 5.2(a), Section 5.2(b), Section 5.2(c) or Section 5.2(e) may be made at any time at or after eighteen (18) months from the Effective Time. The applicable claim limitation period, as provided in the preceding sentence, is hereby referred to as the “Claim Limitation Period.” For avoidance of doubt, the provisions of this Section 5.3(a) shall apply only to indemnification claims made pursuant to Section 5.1(a), Section 5.1(b), Section 5.1(c), Section 5.1(e), Section 5.2(a), Section 5.2(b), Section 5.2(c) or Section 5.2(e).

(b) In the event that any Person or entity not a party hereto shall make any demand or claim or file or threaten to file any lawsuit, which demand, claim or lawsuit could result in any Loss to a party hereto of the kind for which such party is entitled to indemnification pursuant to Section 5.1 or 5.2, such indemnified party shall notify the indemnifying party of such demand, claim or lawsuit within thirty (30) Business Days of such demand, claim or filing; *provided, however,* that any failure by the indemnified party to so notify the indemnifying party shall not relieve the indemnifying party from its obligations hereunder, except to the extent that the indemnifying party is actually prejudiced by such failure to be given such notice. Following receipt of notice of a demand, claim or lawsuit, and unless counsel to the indemnified party shall have determined in good faith that the assumption of such defense by the indemnifying party would be inappropriate due to a conflict or potential conflict of interest or the availability of defenses not available to the indemnifying party, the indemnifying party shall have the option, at its cost and expense, to assume the defense of such matter and to retain counsel (not reasonably objected to by the indemnified party) to defend any such demand, claim or lawsuit, and the indemnifying party shall not be liable to the indemnified party for any fees of other counsel or any other expenses (except as expressly provided to the contrary herein) with respect to the defense of such claim or litigation, other than reasonable fees and expenses of counsel employed by the indemnified party for any period during which the indemnifying party has not assumed the defense thereof. The indemnified party shall have the option of joining the defense of such demand, claim or lawsuit (which shall be at the cost and expense of the indemnified party unless (1) counsel to the indemnified party determines in good faith that joint representation would be inappropriate due to a conflict or potential conflict of interest or the availability of defenses not available to the indemnifying party or (2) the indemnifying party fails to assume the defense of such demand, claim or lawsuit within a reasonable period of time following written notice thereof) with counsel not reasonably objected to by the indemnifying party and counsel for each party shall, to the extent consistent with its professional responsibilities, cooperate with the other party and any counsel designated by that party. In effecting the settlement of any such demand, claim or lawsuit, the indemnifying party, or the indemnified party, as the case may be, shall act in good faith, shall consult with the other party and shall enter into only such settlement as the other party shall consent to, such consent not to be unreasonably withheld, conditioned or delayed. An indemnifying party shall not be liable for any settlement not made in accordance with the preceding sentence.

Section 5.4 Limitations on Indemnification by Seller and Purchaser.

(a) Seller shall not be required to indemnify Purchaser pursuant to Section 5.1(b) and Section 5.1(e), and Purchaser shall not be required to indemnify Seller pursuant to Section 5.2(b) and 5.2(e), until the aggregate amount of all Losses incurred by Purchaser or Seller, exceeds $150,000. Once such aggregate amount of Losses incurred by Purchaser, on the one hand, or Seller, on the other hand, exceeds $150,000, Purchaser or Seller, as the case may be, shall thereupon be entitled to indemnification for the entire amount of all Losses incurred, without any deductions, reductions or limitations based on the amount of such threshold; *provided, however,* that the limitations contained in this sentence and the immediately preceding sentence shall not apply to any claims of common law fraud alleged to have been committed by or on behalf of the indemnifying party. For avoidance of doubt, the provisions of this Section 5.4(a) shall apply only to indemnification claims made pursuant to Section 5.1(b), Section 5.1(e), Section 5.2(b) and Section 5.2(e).

(b) Neither Seller, on the one hand, nor Purchaser, on the other hand, shall be obligated to indemnify the other party pursuant to Section 5.1(b), Section 5.1(e), Section 5.2(b) or Section 5.2(e) for Losses that exceed the Purchase Price Premium in the aggregate with all Losses asserted by such party; *provided, however*, that the limitations contained in this sentence shall not apply to any claim of common law fraud, alleged to have been committed by or on behalf of the indemnifying party or an Affiliate thereof upon the indemnified party. For avoidance of doubt, the provisions of this Section 5.4(b) shall apply only to indemnification claims made pursuant to Section 5.1(b), Section 5.1(e), Section 5.2(b) and Section 5.2(e).

(c) Following the Closing, the sole and exclusive remedy of the parties hereto with respect to any and all claims relating to the matters addressed in Section 5.1 or Section 5.2 (other than claims of common law fraud alleged to have been committed by or on behalf of the indemnifying party or an Affiliate thereof upon the indemnified party) shall be pursuant to the indemnification provisions set forth in this Article V; *provided, however,* that the parties may seek to enforce specifically this Agreement and the terms and conditions hereof.

(d) Nothing in this Article V shall affect the rights and remedies of Purchaser or Seller with respect to any breach by the other of any of their covenants or agreements to be performed at or after the Effective Time.

Section 5.5 Parent's Indemnification of Purchaser. Subject to no limitations whatsoever, Parent and its respective successors and assigns shall indemnify, hold harmless, and defend Purchaser and its representatives, controlling persons and Affiliates from and against any Losses arising out of or relating to the failure of the condition set forth in Section 9.7 to be satisfied. A claim for such indemnification shall be made by Seller by giving written notice to Purchaser of the amount of Losses resulting from the failure of the Closing to occur as a result of such condition not being satisfied. For avoidance of doubt, "Losses," as used in this Section 5.5, includes consequential damages and damages for lost profits.

Section 5.6 Treatment of Indemnification Payments. Seller, Purchaser and Parent agree to treat any indemnification payment under this Article V as an adjustment of the consideration paid for the Transferred Assets for income Tax purposes.

ARTICLE VI.

REPRESENTATIONS AND WARRANTIES OF SELLER

Seller represents and warrants to Purchaser as follows:

Section 6.1 Corporate Organization; Corporate Authority. Seller is a state bank duly organized and validly existing under the laws of the State of Illinois. Seller and Parent have the corporate power and authority to carry on its respective businesses as currently conducted, to execute and deliver this Agreement and related documents and Guarantee, respectively, and to effect the transactions contemplated hereby. Parent (in its capacity as the sole shareholder of Seller) has approved this Agreement and the transactions contemplated hereby. The Board of Directors of Parent has approved the Guarantee. Except as set forth in Section 8.18, no further corporate authorization is necessary for Seller or Parent to consummate the transactions contemplated hereby or the Guarantee, respectively.

Section 6.2 No Violation. Assuming receipt of the required approvals referenced in Section 6.17 and Section 8.18, neither the execution and delivery of this Agreement or the Guarantee, nor the consummation of the transactions contemplated herein or by the Guarantee, (a) will violate or conflict with (i) the Articles of Association, Certificate of Incorporation, or Bylaws of Seller or Parent, as applicable or (ii) any of the leases constituting Transferred Assets (subject to obtaining all required landlord consents) or (b) will violate or conflict in any respect with (i) any provision of any agreement or any other restriction of any kind to which Seller or Parent is a party or by which Seller or Parent, the Transferred Assets or the Transferred Liabilities are bound; (ii) any statute, law, decree, regulation, or order of any Governmental Authority applicable to Seller or Parent; or (iii) any provision that will result in a default under, or cause the acceleration of the maturity of, any obligations or loans to which Seller or Parent is a party.

Section 6.3 Enforceable Agreement. This Agreement has been duly executed and delivered by Seller, and upon execution and delivery by Purchaser, will be the legal, valid, and binding agreement of Seller, enforceable against Seller in accordance with its terms, and the Guarantee has been duly executed and delivered by Parent, and upon execution and delivery by Purchaser, will be the legal, valid and binding agreement of Parent enforceable in accordance with its terms, except, in each case, as enforcement may be limited by bankruptcy, insolvency, reorganization, moratorium, receivership, conservatorship, or similar laws or judicial decisions relating to or affecting creditors' rights generally or the rights of creditors, or of the FDIC as insurer, regulator, conservator, or receiver, of banks the accounts of which are insured by the FDIC.

Section 6.4 No Brokers. All negotiations relative hereto and the transactions contemplated hereby have been carried on by Seller or Parent and Purchaser, and there has been no participation or intervention by any other Person, firm or corporation employed or engaged by or on behalf of Seller or Parent in such a manner as to give rise to any valid claim against Seller or Purchaser for a brokerage commission, finder's fee or like commission.

Section 6.5 Personal Property. Seller owns, and will convey to Purchaser at the Closing, all of Seller's right, title, and interest to all of the Personal Property, which constitutes good title, free and clear of any mortgages, liens, security interests, pledges or encumbrances of any kind or nature ("Liens"), other than any such Liens that are reflected in the Net Book Value of the Personal Property or that do not materially detract from the value of or interfere with the use of the Personal Property. Except for the Excluded Assets, the Personal Property and other Transferred Assets constitute (or, in the case of the books and records, provide access to) all of the assets required to conduct the Branch Banking Operations in all material respects as presently conducted.

Section 6.6 The Real Property, the OREO and the Leased Branch.

(a) Seller has good, marketable and insurable fee simple title to the Real Property and the OREO, subject to any applicable Permitted Encumbrances and any Title Defect addressed pursuant to the provisions of Section 2.3, and valid leasehold interests in the Leased Branch, subject to any applicable Permitted Encumbrances. Complete and accurate descriptions of the Real Property and the Leased Branch are set forth on Schedule 6.6(a).

(b) There are no pending, or, to the knowledge of Seller, threatened or contemplated condemnation or similar proceedings affecting the Real Property, the OREO, or any portion thereof. Seller will present to Purchaser, within five (5) days after receipt by Seller, any notices that it receives relating to such a proceeding or any condemnation that relates to the Real Property or the OREO. To the knowledge of Seller, there exists no fact or condition that would result in the termination of the existing access to the Real Property or the OREO.

(c) Seller has not entered into any agreement for the sale, transfer, assignment or other disposition of the Real Property, the OREO or the Leased Branch or any interest therein.

(d) Other than the Assumed Contracts, Seller has not contracted for any services or made any commitments or obligations therefor that will become binding upon Purchaser with respect to the Branches.

(e) Schedule 6.6(e) contains a list and reasonably detailed description of each property classified by Seller as OREO. Prior to the execution of this Agreement, Seller has delivered the latest appraisal of each property classified as OREO obtained by Seller. The value of any of the OREO reflected on Seller's most recent Financial Statement was determined on a "fair value less cost to sell" basis. Except as disclosed on Schedule 6.6(e), Seller has not advanced funds to pay or otherwise paid any real estate taxes or assessments, insurance premiums or other maintenance or carrying costs relating to any such OREO and no such assessments, premiums or costs are past due or will become past due in if not paid in the next ninety (90) days. Seller has not entered into any contract obligating it pay for expenses with respect to improvements on, or the development of, any OREO.

(f) The Branch Lease is a valid, binding, and existing lease that is in full force and effect and under which Seller, as lessee, is entitled to possession of the Leased Branch. Seller has made available to Purchaser a true and complete copy of the Branch Lease. The Branch Lease is not subject to any lease, mortgage, deed or trust or other lien or interest that would entitle the holder thereof to interfere materially with or disturb the lessee's rights under such Leased Branch so long as the lessee is not in default under the Branch Lease beyond any applicable cure period. To Seller's knowledge, no event or circumstance has occurred and is continuing that constitutes a default or would, with the lapse of time or receipt of notice or both, constitute a default under the Branch Lease. Subject to Seller's obtaining any necessary landlord consent, the assignment of the Branch Lease will transfer to Purchaser all of Seller's rights under the Branch Lease.

Section 6.7 Condition of Property. Each of the Owned Branch and the Leased Branch (a) is in good operating condition and repair and, to Seller's knowledge, structurally sound, with no material alterations or repairs being required thereto under applicable law or insurance company requirements, (b) consists of sufficient land and lawful means of access to permit the use thereof in the manner and for the purposes to which they are presently devoted, and (c) is otherwise suitable and sufficient in all material respects (whether physical, structural, legal, or otherwise, and including the import of relevant lease terms) for its current use, operation and occupancy as a bank branch. None of the Real Property, the OREO or, to Seller's knowledge, the Leased Branch, is subject to any mortgage, security agreement, sales contract, option, right of first refusal or similar agreement or arrangement with any third party. The Transferred Assets include all material real estate utilized by Seller in conducting the Branch Banking Operations. To Seller's knowledge, there is no pending or threatened imposition of material assessments or Tax increases against the Real Property, the OREO or the Leased Branch.

Section 6.8 Labor Matters; Employees.

(a) No Employee is a party to any collective bargaining agreement, contract or other agreement or understanding with a labor organization of any type, nor is Seller, with respect to any Employee, the subject of any material proceeding asserting it has committed an unfair labor practice in violation of the National Labor Relations Act or any other similar or comparable state law seeking to compel it to bargain with any labor organization as to wages and conditions of employment, nor to Seller's knowledge is any such proceeding threatened, nor to Seller's knowledge is there any strike or similar labor dispute by the Employees pending or threatened. Seller is unaware of any efforts during the past five years involving any Employee seeking to certify a collective bargaining unit or engaging in any other union organizational activity.

(b) Schedule 6.8(b)(i) contains a complete and accurate list (and Seller will deliver a revised Schedule 6.8(b)(i) no fewer than five (5) days prior to the Closing complete and accurate in all material respects) of all Employees, their date of commencement of employment, their positions, their business locations, their annual/weekly/hourly rates of compensation, average scheduled hours per week and their status as full or part-time and active or on leave. Schedule 6.8(b)(ii) sets forth a complete and accurate list of each Employee who is a party to any written employment, retention, severance or similar agreement with Seller, and Seller has made available true and complete copies of each such agreement. Schedule 6.8(b)(iii) lists and Seller has made available to Purchaser each employee benefit plan, program or other arrangement providing benefits to any Employee or any beneficiary or dependent thereof that is sponsored or maintained by Seller or any of its Affiliates or to which Seller or any of its Affiliates contributes or is obligated to contribute, including any employee welfare benefit plan within the meaning of Section 3(1) of ERISA, any employee pension benefit plan within the meaning of Section 3(2) of ERISA (whether or not such plan is subject to ERISA) and any bonus, incentive, deferred compensation, vacation, stock purchase, stock option, severance, employment, change of control or fringe benefit plan, agreement, program or policy (collectively, the "Benefit Plans"). Except as set forth on Schedule 6.8(b)(ii), no Employee is a party to any individual contract, written or oral, express or implied, for the employment of such Employee or the provision of severance or change of control benefits. Except as set forth on Schedule 6.8(b)(iii), no Benefit Plan is a multiemployer plan with the meaning of Section 3(37) of ERISA or subject to Title IV of ERISA.

(c) There are no material complaints, charges or claims against Seller pending or, to the knowledge of Seller, threatened in respect of Employees.

(d) Except as disclosed on Schedule 6.8(b)(iii), the Parent Equity Incentive Plans are the only plans of Parent or Seller that provide for grants of equity-based incentive awards to Employees which have any such awards outstanding thereunder.

Section 6.9 Certain Contracts. Each of the material Personal Property Leases, Safe Deposit Contracts and Assumed Contracts is valid and subsisting, in full force and effect, and Seller (and, to the knowledge of Seller, all other parties thereto) have performed in all material respects all obligations required to be performed by Seller (or such other party, as applicable) thereunder; and no condition exists that constitutes or, with notice, or lapse of time, or both, would constitute a default thereunder on the part of Seller, or, to the knowledge of Seller, on the part of any of the other parties to any thereof. True and complete copies of each Assumed Contract (including any addenda, annexes, attachments, exhibits, schedules or amendments thereto) have previously been made available to Purchaser.

Section 6.10 Purchased Loans.

(a) Seller has full power and authority to hold each Purchased Loan, and has good and marketable title to the Purchased Loans, free and clear of any Liens. Seller is authorized to sell and assign the Purchased Loans to Purchaser and, upon assignment, Purchaser will have the rights of Seller with respect to the Purchased Loans in accordance with the terms and conditions thereof.

(b) Each Purchased Loan (such term to include, for purposes of this Section 6.10(b), the principal documents relating to such Purchased Loans, including notes, mortgages, security instruments, and guarantees) was originated and has been administered in conformity in all material respects with applicable laws and regulations; and its principal balance as shown on Seller's books and records is true and correct as of the last day shown thereon. Seller has complied in all material respects with all of its obligations under the Purchased Loans and, to Seller's knowledge, each Purchased Loan represents the valid and binding obligation of the obligor(s) thereunder, enforceable by the holder thereof in accordance with its terms, except as (i) the enforceability thereof may be limited by bankruptcy, insolvency, moratorium or other similar laws affecting the enforcement of creditors' rights generally, and (ii) the availability of equitable remedies may be limited by equitable principles of general applicability.

(c) Each Purchased Loan that is secured by collateral is secured by a perfected mortgage or security interest in the collateral in favor of Seller as mortgagee or secured party. Except as set forth on Schedule 6.10(c), no collateral has been released from any Lien granted to Seller.

(d) The documentation relating to each Purchased Loan made by Seller and relating to all security interests, mortgages and other liens with respect to all collateral for each such Purchased Loan are adequate for the enforcement of the material terms of each Purchased Loan and of the related security interests, mortgages and other liens. The terms of each Purchased Loan and of the related security interests, mortgages and other liens comply in all material respects with all applicable laws (including laws relating to the extension of credit).

(e) There are no Purchased Loans that have been or should have been classified as non-accrual, as restructured, as 90 days past due, as still accruing and doubtful of collection or any comparable classification. Seller has disclosed all Purchased Loans which are classified as "substandard," "doubtful," "loss," "special mention," "nonperforming" or "problem" on the "watch list", a copy of which is attached as Schedule 6.10(e). No borrower with respect to a Purchased Loan in excess of $25,000 has: (i) filed, or consented by answer or otherwise to the filing against it of a petition for relief, reorganization or arrangement, or any other petition in bankruptcy, for liquidation or to take advantage of any bankruptcy or insolvency law; (ii) made an assignment for the benefit of its creditors; (iii) consented to the appointment of a custodian, receiver, trustee, liquidator or other Person with similar power over such borrower or any substantial part of such borrower's property; (iv) been adjudicated insolvent; or (v) to the knowledge of Seller, taken any action for the purpose of authorizing any of the foregoing.

(f) Except as set forth on Schedule 6.10(f), Seller has not at any time purchased or sold any loans, advances or any participations therein, other than participations purchased from or sold to Affiliates. Except as set forth on Schedule 6.10 (f), Seller has not at any time sold any of its loans or other assets with recourse of any kind to Seller or in violation of the terms of any loan guaranty, nor entered into any contract providing for the sale or servicing of any loan or other asset that constitutes a "recourse arrangement" under any applicable regulation or policy promulgated by a Governmental Authority. Seller has not received any request to repurchase any loan, advance or participation therein or other asset sold to a third party, nor has Seller been advised by any third-party purchaser of any loan, advance or participation therein or any other asset that such purchaser intends to request that Seller repurchase such loan, advance or participation therein or other asset.

(g) There are no contracts in the form of commitment letters binding upon Seller to extend credit, in the amount per "one borrower" (as combined and aggregated as set forth in 12 C.F.R. §32.5), of $500,000 or more.

Section 6.11 Deposit Liabilities. The Deposit Liabilities are insured by the FDIC to the fullest extent permitted by federal law and no action is pending or has been threatened by the FDIC against Seller with respect to the termination of such insurance, and all premiums and assessments required to be paid in connection therewith have been paid when due by Seller. The Deposit Liabilities were opened, extended or made, and have been maintained, in all material respects in accordance with all applicable federal, state and local laws, regulations, rules and orders. The Deposit Liabilities (a) are in all respects genuine and enforceable obligations of Seller, except as enforcement may be limited by bankruptcy, insolvency, reorganization, moratorium, receivership, conservatorship, or similar laws or judicial decisions relating to or affecting creditors' rights generally or the rights of creditors, or of the FDIC as insurer, regulator, conservator, or receiver, of banks the accounts of which are insured by the FDIC, and (b) were acquired in the ordinary course of Seller's business. Seller has made available to Purchaser any material document setting forth the terms and agreements relating to the Deposit Liabilities. During the five (5) years preceding the date hereof, neither Seller nor any of its Affiliates has transferred or booked any material amount of deposit liabilities previously booked to a branch or business location of any Affiliate of Seller, other than a Branch. Except as set forth on Schedule 6.11, none of the Deposit Liabilities constitute Brokered Deposits.

Section 6.12 Books, Records, Documentation, Etc. The books and records being transferred to Purchaser hereunder are complete, correct and accurate in all material respects, have been maintained in a consistent and a customary manner, and are in material compliance with all applicable federal and state laws and regulations and customary banking practices. The deposit forms and lending-related forms, notices, statements, and related documentation, as well as Seller's policies, procedures, and practices with respect thereto, used in connection with the Branch Banking Operations comply in all material respects with applicable federal and state laws and regulations.

Section 6.13 Litigation and Regulatory Proceedings. Except as set forth on Schedule 6.13, there are no actions, causes of action, complaints, claims, suits or proceedings pending or, to Seller's knowledge, threatened against Seller and affecting or relating to any of the Transferred Assets or Transferred Liabilities, whether at law or in equity or before or by a Governmental Authority. No Governmental Authority has notified Seller that it would oppose or not approve or consent to the transactions contemplated hereby, and Seller knows of no reason for any such opposition, disapproval or nonconsent. Neither Seller nor any of its Affiliates is a party to any written order, decree, agreement or memorandum of understanding with, or commitment letter or similar submission to, any Governmental Authority charged with the supervision or regulation of depository institutions, nor has Seller been advised by any such agency or authority that it is contemplating issuing or requesting any such order, decree, agreement, memorandum of understanding, commitment letter or submission.

Section 6.14 Financial Information. Seller has made available to Purchaser copies of Seller's unaudited balance sheet and income statement as of and for the periods ended June 30, 2019 and Seller's Call Reports as of and for the periods ended December 31, 2018, March 31, 2019 and June 30, 2019 (collectively, the "Financial Statements"). Each of the Financial Statements is based upon the books and records of Bank, and were prepared in accordance with GAAP and accounting principles of governmental entities generally applicable to banks, on a basis consistent with past practices (collectively, the "Accounting Standards"). Each of the Financial Statements is true and correct and fairly and accurately presents the financial condition of Seller as of those dates in accordance with the Accounting Standards.

Section 6.15 Tax Matters.

(a) Seller has filed all material Tax Returns required to be filed relating to the ownership and operation of the Transferred Assets. All such Tax Returns were correct and complete in all material respects. All material Taxes relating to the ownership and operation of the Transferred Assets owed by Seller (whether or not shown on any Tax Returns) have been paid. Except as set forth on Schedule 6.15(a), Seller is not the beneficiary of any extension of time within which to file any Tax Return relating to the ownership and operation of the Transferred Assets. Seller is not a party to any dispute or claim concerning any Tax Liability of Seller relating to Seller's ownership and operation of the Transferred Assets. No claim has ever been made by an authority in a jurisdiction where Seller does not file Tax Returns relating to the ownership and operation of the Transferred Assets that it is or may be subject to taxation by that jurisdiction. There are no security interests on any of the Transferred Assets of Seller that arose in connection with any failure (or alleged failure) to pay any Tax.

(b) Seller has withheld and paid all Taxes relating to the ownership and operation of the Transferred Assets required to have been withheld and paid in connection with amounts paid or owing to any Employee, independent contractor, creditor, stockholder, or other third party through the Effective Time.

(c) None of the Transferred Liabilities is an obligation to make a payment that will not be deductible under Section 280G of the Code.

(d) With respect to the Transferred Assets and the Transferred Liabilities, Seller has obtained all necessary completed and executed Internal Revenue Service Forms W-8 or W-9, as applicable, from the appropriate Persons.

(e) With respect to the Transferred Assets and the Transferred Liabilities, Seller has complied with all applicable provisions of Section 1471 through 1474 of the Code.

Section 6.16 Allowance for Loan and Lease Losses. The allowance for loan and lease losses ("ALLL") is in compliance in all material respects with (a) the existing methodology of Seller for determining the adequacy of the ALLL and the Accounting Standards, and (b) the standards established by applicable Governmental Authorities. The ALLL is and will be adequate in all material respects under all such standards. Seller has not been notified by any Governmental Authority or independent auditor of Seller, in writing or otherwise, that: (i) such allowances are inadequate; (ii) the practices and policies of Seller in establishing such allowances and in accounting for non-performing and classified assets generally fail to comply with the Accounting Standards or the requirements of any Governmental Authority; or (iii) such allowances are inconsistent with the historical loss experience of Seller.

Section 6.17 Consents and Approvals. Except for the Regulatory Approvals, no consents, approvals, filings or registrations with Governmental Authorities are required in connection with Seller's consummation of the transactions contemplated hereby or Parent's performance of the Guarantee. Seller has no reason to believe that it will not be able to obtain all Regulatory Approvals in a prompt and timely manner. Except for the third-party consents listed on Schedule 6.17, no consents from any parties (other than Governmental Authorities) are required in connection with Seller's consummation of the transactions contemplated hereby or Parent's performance of the Guarantee.

Section 6.18 Environmental Laws.

(a) Seller has made available to Purchaser true and complete copies of all Existing Environmental Reports. Except as disclosed on Schedule 6.18(a), (i) there are no violations of any Environmental Laws or any Environmental Liabilities or the presence (including in any underground or other storage tanks) of any Hazardous Substance on or under the Real Property, the OREO or the Leased Branch, (ii) the Real Property, the OREO, and, to Seller's knowledge, the Leased Branch are not subject to any Lien, court order, administrative order or decree, imposed by or arising under any Environmental Law, and there are no proceedings pending, or to Seller's knowledge threatened, for the imposition of any Lien under, or alleging the violation of or any liability under, any Environmental Law, (iii) Seller has complied and is now complying with, and the Real Property, the OREO and the Leased Branch has been operated in accordance with, in all material respects, all Environmental Laws applicable to the Real Property, the OREO and the Leased Branch, and (iv) Seller has not received any notice from any person or Governmental Authority alleging that Seller or the Real Property, the OREO or the Leased Branch is not in compliance with, or seeking to impose any liability under, any Environmental Law.

(b) There are no present or, to Seller's knowledge, past actions, activities, circumstances, events or incidents, including any storage or disposal, or release, discharge or emission, of Hazardous Substance, that could form the basis for assertion of any Environmental Liability with respect to the Real Property, the OREO or the Leased Branch.

(c) To Seller's knowledge, no Purchased Loan is secured by real property for which there is a threat of potential Environmental Liability that could reasonably be expected to exceed $25,000.

Section 6.19 Community Reinvestment Compliance. Seller is in compliance in all material respects with the applicable provisions of the CRA and has received a CRA rating of "satisfactory" in its most recent exam under the CRA as of the date hereof.

Section 6.20 Deposit and Loan Data. The amount, rate and accrued interest on the Deposits and Purchased Loans as of June 30, 2019, the past-due status of Purchased Loans as of June 30, 2019, and all other written or magnetically (or otherwise) recorded financial data and information, provided by, or to be provided by, Seller to Purchaser in connection with the transactions contemplated hereby was, or will be, complete and accurate in all material respects as of the date so provided based on Seller's books and records and the internal accounting procedures of Seller consistently applied.

Section 6.21 Compliance with Laws. The Branch Banking Operations have been conducted by Seller in compliance in all material respects with all federal, state and local laws, regulations and ordinances applicable thereto.

Section 6.22 Absence of Certain Changes. Since June 30, 2019, there has not been any change, condition, event or development that, individually or in the aggregate, would constitute a Seller Material Adverse Effect, and, except as set forth on Schedule 6.22, (a) there has not been any action taken of the type described in Section 8.3 that, had such action occurred after the date hereof, would be in violation of such Section 8.3, and (b) Purchased Loans have been made in a manner consistent with past practice as it relates to the normal and customary credit standards and policies of Seller and (c) the overall status of the Purchased Loans that were outstanding as of June 30, 2019 as it relates to credit quality does not differ in any material respect from such status as of such date.

Section 6.23 Substitute Securities. The Substitute Securities will be creditworthy to the same or a higher degree than the Municipal Securities.

ARTICLE VII.

REPRESENTATIONS AND WARRANTIES OF PURCHASER

Purchaser hereby represents and warrants to Seller as follows:

Section 7.1 Corporate Organization; Corporate Authority. Purchaser is a state bank duly organized and validly existing under the laws of the State of Illinois. Purchaser has the corporate power and authority to carry on the business being acquired, to assume the liabilities being transferred, to execute and deliver this Agreement and related documents and to effect the transactions contemplated herein and therein. The Board of Directors of Purchaser has approved this Agreement. No further corporate authorization is necessary for Purchaser to consummate the transactions contemplated hereby.

Section 7.2 No Violation. Assuming receipt of the required approvals referenced under Section 7.4, neither the execution and delivery hereof, nor the consummation of the transactions contemplated herein will violate or conflict with (a) the Articles of Association or Bylaws of Purchaser; (b) provision of any agreement or any other restriction of any kind to which Purchaser is a party or by which Purchaser is bound; (c) any statute, law, decree, regulation or order of any Governmental Authority applicable to Purchaser; or (d) any material provision that will result in a default under, or cause the acceleration of the maturity of, any obligations or loans to which Purchaser is a party.

Section 7.3 Enforceable Agreement. This Agreement has been duly executed and delivered by Purchaser and, upon execution and delivery by Seller, will be the legal, valid, and binding agreement of Purchaser, enforceable against Purchaser in accordance with its terms, and the Guarantee has been duly executed and delivered by Purchaser, and upon execution and delivery by Parent will be the legal, valid and binding agreement of Purchaser, enforceable against Purchaser in accordance with its terms, except, in each case, as may be limited by (a) bankruptcy, insolvency, reorganization, moratorium, receivership, conservatorship, or similar laws, (b) judicial decisions relating to or affecting creditors' rights generally or the rights of creditors, or (c) the FDIC, as insurer, regulator, conservator, or receiver, of banks the accounts of which are insured by the FDIC.

Section 7.4 Consents and Approvals. Except for the Regulatory Approvals, no consents, approvals, filings or registrations with any Governmental Authorities are required in connection with Purchaser's consummation of the transactions contemplated hereby, other than such consents, approvals, filings and registrations that may be required as a result of any facts or circumstances relating solely to Seller. Purchaser has no reason to believe that it will not be able to obtain all Regulatory Approvals in a prompt and timely manner. No consents from any third parties (other than Governmental Authorities) are required in connection with Purchaser's consummation of the transactions contemplated hereby (other than such consents that may be required as a result of any facts or circumstances relating solely to Seller).

Sextion 7.5 Sufficient Funds. On the Closing Date, Purchaser will have sufficient funds available to consummate the transactions contemplated hereby.

Section 7.6 No Brokers. All negotiations relative hereto and the transactions contemplated hereby have been carried on by Seller or Parent and Purchaser, and there has been no participation or intervention by any other Person, firm or corporation employed or engaged by or on behalf of Purchaser in such a manner as to give rise to any valid claim against Seller or Parent for a brokerage commission, finder's fee or like commission, except that Purchaser has retained Panoramic Capital Advisors, Inc., the fees of which will be paid by Purchaser.

Section 7.7 Litigation and Regulatory Proceedings. Except for proceedings relating to matters contemplated by Section 7.4, there are no actions, causes of action, complaints, claims, suits or proceedings pending or, to Purchaser's knowledge, threatened against Purchaser that would reasonably be expected to materially adversely affect Purchaser's ability to timely perform its obligations hereunder or consummate the transactions contemplated hereby, whether at law or in equity or before or by a Governmental Authority. As of the date hereof, no Governmental Authority has notified Purchaser that it would oppose or not approve or consent to the transactions contemplated hereby and Purchaser knows of no reason (other than any reason relating to Seller and its Affiliates) for any such opposition, disapproval or nonconsent. Neither Purchaser nor any of its Affiliates is a party to any written order, decree, agreement or memorandum of understanding with or commitment letter or similar submission to, any Governmental Authority charged with the supervision or regulation of depository institutions, in any case that would reasonably be expected to materially adversely affect Purchaser's ability to timely perform its obligations hereunder.

ARTICLE VIII.

OBLIGATIONS OF PARTIES PRIOR TO AND AFTER EFFECTIVE TIME

Section 8.1 Full Access.

(a) Until the Closing Date, Seller shall afford to the officers and representatives of Purchaser, upon reasonable prior notice, reasonable access during normal business hours of Seller to all properties, Employees, books, and records pertaining to the Branch Banking Operations, specifically including all books and records relating to the Deposit Liabilities, the Purchased Loans, the Owned Branch, the Leased Branch, Personal Property, and Employees. In exercising its rights of access pursuant to the previous sentence, Purchaser will make reasonable efforts to minimize any disruption to Seller's business activities and Seller's relations with its customers. Seller will cooperate with Purchaser to the extent reasonably requested and to the extent permitted by law to provide Purchaser with information about Employees and a reasonable opportunity to meet with Employees. Nothing in this Section 8.1(a) shall require Seller to provide access to or disclose information where such access or disclosure would violate the rights of customers, result in the loss of any attorney-client privilege or contravene any law, rule, regulation, order, judgment or decree. The parties hereto shall make appropriate substitute disclosure arrangements under circumstances in which the restrictions of the preceding sentence apply.

(b) Between the date hereof and the Closing Date, the parties shall meet on at least a monthly basis to discuss matters relating to the Branch Banking Operations (including credit quality and related issues), the Conversion, customer communications, Employee matters and other issues relating to the Transferred Assets and Transferred Liabilities and the transactions contemplated hereby to the extent permitted by applicable law. In addition, Seller shall provide to Purchaser monthly reports regarding the Purchased Loans and Deposits, as well as monthly asset quality reports as reasonably requested by Purchaser, including watch loans, past due reports, non-performing assets, charge-offs, risk rating distribution, portfolio growth, industry and product concentrations and composition, and changes to off-balance sheet exposures.

(c) Any information discovered, disclosed or revealed pursuant to Section 2.6, Article IV or this Section 8.1, or otherwise disclosed by Seller or Purchaser in connection with entering into or performing the covenants and agreements contemplated hereby, shall be considered Confidential Information to be held in confidence by the other party: (i) in the case of Purchaser, (A) until the Closing Date with respect to such Confidential Information concerning Seller, and (B) in perpetuity with respect to such Confidential Information concerning Parent and Affiliates of Parent other than Seller, and (ii) in the case of Seller, in perpetuity.

Section 8.2 Application for Approval.

(a) As soon as reasonably practicable following the execution of this Agreement, the parties shall prepare and file applications and notices relating to the Regulatory Approvals. Each party agrees to process such applications as promptly as reasonably practicable and to provide the other party promptly with a copy of such applications as filed (except for any confidential portions thereof) and all material notices, orders, opinions, correspondence, and other documents with respect thereto, and to use its reasonable best efforts to obtain the Regulatory Approvals. Each party shall promptly notify the other party upon receipt by such party of notification that any application provided for hereunder has been accepted or denied. Each party shall provide all cooperation and information reasonably requested by the other party in connection with such party's obligations pursuant to this Section 8.2(a) and such party's compliance with the requirements of the applicable regulatory authorities.

(b) The parties shall (i) cooperate in all respects with each other in connection with any filing or submission and in connection with any investigation or other inquiry relating to the Regulatory Approvals, (ii) subject to applicable law, permit the other party to review and discuss in advance, and consider in good faith the views of the other in connection with, any proposed written or material oral communication (or other correspondence or memoranda) between it and any Governmental Authority, including the applications referred to in Section 8.2(a), (iii) promptly inform each other of and supply to such other party any communication (or other correspondence or memoranda) received by such party from, or given by such party to, any Governmental Authority, in each case regarding or potentially affecting any of the transactions contemplated hereby, and (iv) consult with each other in advance of any meeting or conference with any Governmental Authority. In the event any such Regulatory Approvals require that provision be made for the payment or satisfaction of any Excluded Liabilities, Seller acknowledges that it will be solely responsible for and shall make any such provision, or obtain the agreement of Parent to be responsible for and make such provision.

Section 8.3 Conduct of Business. Except as expressly set forth herein or as may otherwise be agreed upon by Purchaser in writing, (i) Seller will continue to conduct the Branch Banking Operations (including Deposit and loan pricing) until the Closing in the ordinary course of business consistent with past practices, and (ii) Seller shall not:

(a) except as set forth on Schedule 8.3(a), increase or agree to increase, or enter into or modify any plans, practices or agreements with respect to, the salary, benefits, remuneration, severance or compensation of, or pay any bonus to, any Employee (other than, following notice to Purchaser, any changes to the extent required by applicable law), or materially increase or materially decrease the number of Employees;

(b) except as set forth on Schedule 8.3(b), sell, transfer, assign, encumber or otherwise dispose of or enter into any contract, agreement or understanding to sell, transfer, assign, encumber or dispose of, or permit any Lien to be created on, any of the Transferred Assets existing as of the date hereof;

(c) make or agree to make any material improvements to the Real Property, the OREO or the Leased Branch, except with respect to commitments for such made prior to the date hereof and previously disclosed to Purchaser in writing and for normal maintenance or refurbishing made in the ordinary course of business consistent with past practice;

(d) file any application or give any notice to relocate or close either of the Branches or any of the ATMs or relocate or close or, absent an emergency situation requiring such action, suspend operations at such Branch or ATM (in which event such suspension shall be permitted only for the duration of such emergency);

(e) subject to Section 4.5, except in the ordinary course of business consistent with past practice, amend, terminate or extend the Branch Lease, the Personal Property Lease or any Safe Deposit Contract, ATM Lease or Assumed Contract without the prior written consent of Purchaser (other than any amendment to any Personal Property Lease or Assumed Contract required in order to transfer the related assets to Purchaser pursuant to Article II);

(f) except as set forth on Schedule 8.3(f), take, or permit any Affiliate to take, any action impairing in any material respect Purchaser's rights in any Deposit Liabilities or Transferred Assets or waive any material right, whether in equity or at law, that it has with respect to any Purchased Loan (other than collection and work-out procedures undertaken in all material respects in accordance with Seller's normal and customary practices relating thereto);

(g) take, or permit any Affiliate to take, any action or fail to take, or permit any Affiliate to fail to take, any action that is intended to or is reasonably likely to cause any of the representations or warranties set forth in Article VI that is not qualified as to materiality or Seller Material Adverse Effect to be or become untrue in any material respect individually or in the aggregate, any of the representations or warranties set forth in Article VI that is qualified as to materiality or Seller Material Adverse Effect to be or become untrue in any respect, or any of the conditions set forth in Articles IX or X not to be satisfied;

(h) increase its pricing of Deposits such that its rates exceed the rates offered generally by other financial institutions in the Rockford, Illinois market;

(i) fail to follow Seller's normal and customary practices and procedures regarding loan pricing, underwriting and recognition of charge-offs in a manner consistent with past practice;

(j) without notifying Purchaser, make or approve any new loan that constitutes a Purchased Loan, or extend or renew any Purchased Loan, the principal amount of which (together with any related commitments to extend credit) (i) is equal to or in excess of $1,000,000, if such loan, extension or renewal is a secured loan, or (ii) is equal to or in excess of $350,000 if such loan, extension or renewal is an unsecured loan;

(k) without notifying Purchaser, issue any Letter of Credit except in an amount and term not to exceed the available amount and term of a line of credit that is a Purchased Loan; or

(l) agree with, or commit to, any Person to do any of the things described in the foregoing (a) through (k) except as expressly permitted hereunder.

Section 8.4 Solicitation of Customers by Purchaser Prior to Closing. At any time prior to the Closing Date, Purchaser will not, and will not permit any of its Affiliates, to conduct any mass marketing that is specifically targeted to induce customers whose Deposit Liabilities are to be assumed or whose Purchased Loans are to be acquired by Purchaser pursuant hereto to discontinue or limit their account relationships with Seller or to conduct any media or customer solicitation activities outside of the ordinary course of business of Purchaser, consistent with past practice, that are specifically targeted to induce any such customers to discontinue or limit any such relationships, it being understood and agreed that the foregoing is not intended to prohibit general advertising or solicitations directed to the public generally or other similar activities conducted in the ordinary course of business of Purchaser.

Section 8.5 No Solicitation by Seller and Its Affiliates. For a period of five (5) years following the Effective Time, Seller and its Affiliates will not, directly or indirectly, (a) establish or conduct a branch deposit and loan business, or other commercial or retail banking business, anywhere within seventy-five (75) miles of Rockford, Illinois, (b) solicit deposit or loan business or other commercial or retail banking business from customers whose Deposit Liabilities and/or Purchased Loans are assumed or acquired by Purchaser pursuant hereto; *provided, however*, that clause (b) of this Section 8.5 shall not apply to Seller's or any of its Affiliates use of general non-targeted bank advertising, or (c) solicit for employment, solicit to retain as an independent contractor or consultant, or induce to terminate employment with Purchaser or otherwise interfere with Purchaser's employment relationship with any Branch Employee; *provided, however*, that clause (c) of this Section 8.5 shall not apply if such Branch Employee has been terminated by Purchaser or if such Branch Employee is hired by Seller or its Affiliates as a result of a general solicitation for employment in newspaper advertisements or other periodicals of general circulation not specifically targeted at employees of Purchaser.

Section 8.6 Efforts to Consummate; Further Assurances. The parties hereto agree to use all reasonable efforts to satisfy or cause to be satisfied as soon as practicable their respective obligations hereunder and the conditions precedent to Closing. After the Effective Time, (a) Seller will duly execute and deliver such assignments, bills of sale, deeds, acknowledgments and other instruments of conveyance and transfer as shall at any time be necessary or appropriate to vest in Purchaser the full legal and equitable title to the Transferred Assets, and (b) Purchaser will duly execute and deliver such assumptions, acknowledgments and other instruments of assumption and transfer as shall at any time be necessary or appropriate to cause the Transferred Liabilities to be assumed by Purchaser and to cause Seller to be discharged from all liability and obligation thereunder.

Section 8.7 Fees and Expenses. Unless expressly stated to the contrary herein, Purchaser will assume and pay for the expenses it incurs in connection with the transactions contemplated hereby, and Parent will assume and pay for the expenses it and Seller incurs in connection with the transactions contemplated hereby; *provided, however,* that (a) Purchaser shall pay all fees and expenses associated with the regulatory application process, (b) except as provided in Section 2.1(h) with respect to Transfer Taxes that are payable or that arise as a result of the consummation of the transactions contemplated hereby, (c) Purchaser shall be responsible for the costs, charges and expenses relating to all title examinations, title search fees, surveys, title insurance (including premiums and the costs of any endorsements), environmental investigation costs, its own attorneys' and accountants' fees and expenses, software license and transfer fees, recording fees, transfer fees, regulatory applications and other expenses arising in connection therewith as well as all costs and expenses associated with the transfer or perfection of any security interests or liens securing Purchased Loans and related motor vehicles transferred hereunder, and (d) Purchaser shall be responsible for any costs of removing Seller's signage from the Branches.

Section 8.8 Third Party Consents.

(a) Seller shall use its reasonable best efforts to obtain from the lessor under the Branch Lease any consents to the assignment of such lease required under the terms thereof in connection with the consummation of the transactions contemplated hereby and the removal of Seller's signage and the installation of Purchaser's signage (the "Landlord Consent").

(b) Seller shall use its reasonable best efforts to obtain from the parties to any material contract, agreement, license or Personal Property Lease to be transferred hereunder, any consents to the assignment of any such material contracts, agreements, licenses and leases required under the terms of such contract, agreement, license or lease in connection with the consummation of the transactions contemplated hereby.

Section 8.9 Insurance. Seller shall maintain in effect until the Closing Date all casualty and public liability policies relating to the Real Property and the Leased Branch and the activities conducted thereon and maintained by Seller on the date hereof or procure comparable replacement policies and maintain such replacement policies in effect until the Effective Time.

Section 8.10 Public Announcements. Any public announcement, including any announcement to Employees, customers, suppliers or others having dealings with Seller, or similar publicity with respect to this Agreement or the transactions contemplated hereby, will be issued, if at all, at such time and in such manner as Purchaser will determine and approve, or as required by applicable law. Notwithstanding the foregoing, Purchaser and Seller agree that (a) a press release announcing the execution of this Agreement in a form prepared by Purchaser and reviewed and approved by Seller (with such approval not to be unreasonably withheld, conditioned or delayed) may be made on the day after execution of this Agreement, and (b) any customer communication relating to this Agreement and the transactions contemplated hereby delivered prior to the Effective Time will be in a form prepared by Purchaser and reviewed and approved by Seller (with such approval not to be unreasonably withheld, conditioned or delayed). Purchaser will have the right to be present for any in-person announcement by Seller to the Employees.

Section 8.11 Advice of Changes. Seller shall promptly advise Purchaser of any change or event having a Seller Material Adverse Effect. Seller and Purchaser shall each promptly advise the other party of any change or event, (a) that it believes would or would be reasonably likely to cause or constitute a material breach of any of its representations, warranties or covenants contained herein or (b) that it believes would or would be reasonably likely to cause any of the conditions set forth in Article IX or Article X not being satisfied.

Section 8.12 Non-Solicitation of Transactions. Neither Seller nor any of its Affiliates shall, directly or indirectly, through any officer, director or agent of any of them or otherwise, encourage, solicit, initiate, negotiate, enter into any agreement with respect to, or participate in discussions with respect to or furnish any information in connection with the sale of all or any part of the Transferred Assets or Transferred Liabilities, other than the transactions contemplated hereby. Seller will notify Purchaser orally (within one (1) Business Day) and in writing (as promptly as practicable) of any inquiry or proposal received with respect to any such transaction. As of the date hereof, Seller shall, and shall cause its and its Affiliates' officers, directors and agents to, cease any pending discussions or negotiations regarding any such transaction.

Section 8.13 Employees and Employee Benefit Matters.

(a) Not later than the Business Day prior to the Effective Time, Purchaser shall offer Comparable Employment as of the Effective Time to each Employee that Purchaser desires to employ, as long as such Employee is then employed by and in good standing with Seller; *provided* that Purchaser in no event will offer employment to the Excluded Employees. Within thirty (30) days prior to the anticipated Closing Date, Seller will provide to Purchaser employment records of the Employees and a reasonable opportunity to meet with the Employees in a manner consistent with Section 8.1. Purchaser shall keep Seller informed on a reasonably prompt basis of any offer of employment made by Purchaser to any Employees.

(b) During the period commencing on the Closing Date and ending no earlier than the first anniversary thereof, Purchaser shall provide the Employees of the Branch Banking Operations who become employees of Purchaser in connection with the transactions contemplated by this Agreement (the "Branch Employees") with employee benefits substantially comparable in the aggregate to similarly situated employees of Purchaser, as in effect from time to time. For Employees who are not offered Comparable Employment by Purchaser and whose employment is terminated by Seller on, or within six (6) months after, the Closing Date, Purchaser shall offer each such Employee severance benefits equal to one week of base compensation for each full year of service with Seller and its affiliates, with a minimum of two (2) and a maximum of twelve (12) weeks of severance pay; *provided*, that Purchaser shall in no event provide any severance benefits to the Excluded Employees.

(c) For purposes of eligibility and vesting under the employee benefit plans of Purchaser (which may be sponsored by an Affiliate of Purchaser) for which service is taken into account or recognized, and that provide benefits to any Branch Employees after the Closing Date (the "New Plans"), each Branch Employee shall be credited with his or her years of service from his or her most recent date of hire with Seller or any predecessor of Seller before the Closing Date, to the same extent as such Branch Employee was entitled, before the Closing Date, to credit for such service under any similar employee benefit plans of Seller, except to the extent such credit would result in a duplication of benefits or for purposes of benefit accrual. Without limiting the generality of the foregoing, each Branch Employee shall be eligible to participate, as of the Closing Date in any and all New Plans to the extent coverage under such New Plan replaces coverage under a comparable employee benefit plans of Seller in which such Branch Employee participated immediately before the Closing Date (such plans, collectively, the "Old Plans"); *provided, however,* that in the case of the 401(k) plan in which Purchaser's employees participate, Branch Employees shall be eligible to participate in such plan as of the first day of the month following the month in which the Closing occurs. For purposes of each New Plan providing medical, dental, pharmaceutical and/or vision benefits to any Branch Employee, Purchaser shall cause all pre-existing condition exclusions and actively-at-work requirements of such New Plan to be waived for such employee and his or her covered dependents, and Purchaser shall cause any eligible expenses incurred by such employee and his or her covered dependents during the portion of the plan year of any Old Plan ending on the date such employee's participation in the corresponding New Plan begins to be taken into account under such New Plan for purposes of satisfying all deductible, coinsurance and maximum out-of-pocket requirements applicable to such employee and his or her covered dependents for the applicable plan year as if such amounts had been paid in accordance with such New Plan; *provided*, that Seller provides Purchaser as promptly as practicable, but in no event later than thirty (30) days following a request therefor, with such data as may be reasonably requested by Purchaser in connection therewith (whether from Seller or the applicable plan administrator or insurer), and Seller delivers to Purchaser an update of such information as of the Closing Date no later than sixty (60) days following the Closing Date.

(d) Seller shall pay, discharge and be responsible for: (1) all salary and wages arising out of employment of the Employees and Branch Employees through the Closing Date; and (2) any employee benefits (including vacation, sick and personal days accrued but unused) arising under the Old Plans and employee programs prior to the Closing Date, including benefits with respect to claims incurred on or prior to the Closing Date but reported after the Closing Date. From and after the Closing Date, Purchaser shall pay, discharge and be responsible for all salary, wages and benefits arising out of or relating to the employment by Purchaser of the Branch Employees from and after the Closing Date. For this purpose, claims under any medical, dental, vision, or prescription drug plan will be deemed to be incurred on the date that the service giving rise to such claim is performed and not when such claim is made; *provided, however,* that with respect to claims relating to hospitalization, the claim will be deemed to be incurred on the date the Employee is first absent from work because of the condition giving rise to such disability and not when the Employee is determined to be eligible for benefits under the applicable welfare benefit plan. Seller will provide any continuation coverage required under COBRA or applicable state law to each "qualified beneficiary" (as defined in COBRA) whose first "qualifying event" (as defined in COBRA) occurs on or prior to the Closing Date and each "M&A Qualified Beneficiary" (as defined under Section 54.4980B 9 of the Treasury Regulations). Purchaser will provide any continuing coverage required under COBRA to each qualified beneficiary whose first qualifying event occurs after the Closing Date; *provided, however*, that such qualified beneficiary is covered by Purchaser's health plan as an active employee or a dependent of an active employee at the time of such first qualifying event.

(e) Parent agrees that it will cause (i) all stock options issued to Employees under the Parent Equity Incentive Plans to be fully vested immediately prior to the Effective Time, provided the respective Employee remains employed by Seller in good standing as of the Closing Date, (ii) all amounts invested in the Parent Deferred Compensation Plan by Employees to be distributed to such Employees in a lump sum following the Closing Date in accordance with the terms of the Parent Deferred Compensation Plan and the respective Employee's participation agreements thereunder, and (iii) matching contributions for the calendar year in which the Closing occurs with respect to Employees who are participants in the Parent 401(k) Plan and who remain Employed by Seller as of the Closing Date, based on the respective Employee's deferrals made through the Closing Date, to be made to the Parent 401(k) Plan, without regard to whether the Employee is employed by Seller as of December 31 of the calendar year in which the Closing occurs. Notwithstanding the foregoing, Parent shall not be required to take any action pursuant to this Section 8.13(e) unless such action is in accordance with applicable legal requirements and the terms of the Parent Equity Incentive Plan, the Parent Deferred Compensation Plan or the Parent 401(k) Plan, as the case may be.

Section 8.14 Physical Damage to the Owned Branch. In the event of any physical damage or destruction, other than ordinary wear and tear, to the Owned Branch between the date hereof and the Closing Date, at the election of Seller, either (a) Seller shall prior to the Closing Date repair such damage or destruction to return such property to its condition prior to such damage or destruction or (b) Seller shall pay to Purchaser an amount equal to the sum of (i) the insurance proceeds received by Seller with respect to such damage or destruction, (ii) any applicable deductible amount and (iii) such additional amount as may be required to repair such damage or destruction to return such property to its condition prior to such damage or destruction, or, if the damage or destruction is not reasonably capable of repair, to reflect the difference between the amounts paid under the preceding clauses (i) and (ii) and the Net Book Value of the Owned Branch.

Section 8.15 Letters of Credit. It is the intention of the parties hereto that Purchaser will assume all obligations accruing after the Effective Time with respect to the Letters of Credit. Accordingly, Seller and Purchaser agree to use their respective reasonable best efforts to obtain prior to the Closing Date the consent of the beneficiary (if necessary) to the assumption of (and the resulting release of Seller from) the Letters of Credit and/or to issue replacement letters of credit for those Letters of Credit that are standby Letters of Credit. At least five (5) Business Days prior to the Closing Date, Seller shall provide to Purchaser a list of all such Letters of Credit for which consent is required.

Section 8.16 Loan Participations. Prior to the Effective Time, (a) Seller will transfer out of Seller's loan portfolio, or otherwise exclude from the Transferred Assets, any Affiliate Participations, and (b) Seller will obtain the return to Seller's portfolio of the Purchased Loans any participations therein that were previously sold to Seller's Affiliates by Seller. The sum of the amount of the participations transferred pursuant to clause (a) minus the amount of the participations returned pursuant to clause (b) shall be referred to as the "Participation Adjustment".

Section 8.17 Updated Financial Statements and Future Call Reports. During the period from the date of this Agreement to the earlier of the Effective Time and the termination of this Agreement in accordance with Article XI, Seller will furnish Purchaser with the balance sheets of Seller as of the end of each calendar month and the related statements of income, within 20 days after the end of each such calendar month. Such financial information will be prepared on a basis consistent with the Financial Statements and will fairly present the financial position of Seller as of the dates thereof and the results of operations of Seller for the month then ended. Seller will provide any Future Call Reports of Seller at such time as the Call Reports become publicly available.

Section 8.18 Seller's Corporate Approval. Within fifteen (15) days following the date of this Agreement, Parent shall cause the board of directors of Seller to approve, ratify and adopt this Agreement in all respects. Parent shall deliver to Seller a true and complete copy of the resolutions of Seller's board of directors setting forth such approval.

Section 8.19 Exchange of Securities. During the period from the date of this Agreement to the Effective Time, Seller will exchange with an Affiliate of Seller or Parent the Municipal Securities for Substitute Securities that will be approved in advance by Purchaser (which approval will not be unreasonably withheld, conditioned or delayed).

ARTICLE IX.

CONDITIONS TO PURCHASER'S OBLIGATIONS

The obligation of Purchaser to complete the transactions contemplated herein is conditioned upon fulfillment or, where legally permitted, waiver, on or before the Closing Date, of each of the following conditions:

Section 9.1 Representations and Warranties True. Each of the representations and warranties made by Seller herein that is qualified as to materiality or Seller Material Adverse Effect shall be true and correct as of the date hereof and as of the Effective Time, and each of the representations and warranties made by Seller herein that is not qualified as to materiality or Seller Material Adverse Effect shall be true and correct in all material respects as of the date hereof and as of the Effective Time, in each case as though such representations and warranties were made at and as of such time (except that representations and warranties that speak as of a specified date shall be so true and correct as of such date).

Section 9.2 Obligations Performed. Seller shall have performed and complied in all material respects with all obligations, covenants and agreements, taken as a whole, required hereby to be performed or complied with by it prior to or at the Effective Time.

Section 9.3 Delivery of Documents. Seller shall have delivered to Purchaser those items required by Section 3.2(b).

Section 9.4 Approvals. The parties shall have obtained the Regulatory Approvals. No court or other Governmental Authority of competent jurisdiction shall have enacted, issued, promulgated, enforced or entered any statute, judgment, decree, legal restraint or other order (whether temporary, preliminary or permanent) (an "Order") that is in effect and prohibits or makes illegal the consummation of the transactions contemplated hereby.

Section 9.5 No Seller Material Adverse Effect. There shall not have been any change, condition, event or development that, individually or in the aggregate, would constitute a Seller Material Adverse Effect.

Section 9.6 Landlord Consent. Seller shall have obtained the Landlord Consent.

Section 9.7 Evidence of Seller's Corporate Approval. Seller's board of directors shall have approved, ratified and adopted this Agreement in all respects, and a true and complete copy of the resolutions of Seller's board of directors evidencing such approval shall have been delivered to Purchaser. Such resolutions shall remain in full force and effect at the Effective Time.

ARTICLE X.

CONDITIONS TO SELLER'S OBLIGATIONS

The obligation of Seller to complete the transactions contemplated herein is conditioned upon fulfillment or, where legally permitted, waiver, on or before the Closing Date, of each of the following conditions:

Section 10.1 Representations and Warranties True. Each of the representations and warranties made by Purchaser herein that is qualified as to materiality shall be true and correct as of the date hereof and as of the Effective Time, and each of the representations and warranties made by Purchaser herein that is not qualified as to materiality shall be true and correct in all material respects as of the date hereof and as of the Effective Time, in each case as though such representations and warranties were made at and as of such time (except that representations and warranties that speak as of a specified date shall be so true and correct as of such date).

Section 10.2 Obligations Performed. Purchaser shall have performed and complied in all material respects with all obligations and agreements, taken as a whole, required hereby to be performed or complied with by it prior to or on the Effective Time.

Section 10.3 Delivery of Documents. Purchaser shall have delivered to Seller those items required by Section 3.2(c).

Section 10.4 Approvals. The parties shall have obtained all Regulatory Approvals. No court or other Governmental Authority of competent jurisdiction shall have enacted, issued, promulgated, enforced or entered any Order that is in effect and prohibits or makes illegal the consummation of the transactions contemplated hereby.

ARTICLE XI.

TERMINATION

Section 11.1 Methods of Termination. This Agreement may be terminated in any of the following ways:

(a) by either Purchaser or Seller, in writing five (5) days in advance of such termination, if the Closing has not occurred by March 31, 2020 (*provided* that no party shall be permitted to terminate this Agreement hereunder if (ii) the failure of the Closing to occur prior to such date arises out of or results from the actions or omissions of the terminating party) or (ii) the parties are working in good faith for the receipt of any outstanding Regulatory Approval;

(b) at any time on or prior to the Effective Time by the mutual consent in writing of Seller and Purchaser;

(c) by Purchaser, as a result of any breach of any representation, warranty or covenant of Seller contained herein, which breach would cause any condition set forth in Sections 9.1 or 9.2 to not be satisfied, if Purchaser has given notice of such breach and such breach is not, or is not capable of being, cured within thirty (30) days after such notice;

(d) by Seller, as a result of any breach of any representation, warranty or covenant of Purchaser contained herein, which breach would cause any condition set forth in Sections 10.1 or 10.2 to not be satisfied, if Seller has given notice of such breach and such breach is not, or is not capable of being, cured within thirty (30) days after such notice;

(e) by either Purchaser or Seller, if (i) any Regulatory Approval shall have been denied by final, nonappealable action of such Governmental Authority, or such Governmental Authority shall have requested permanent withdrawal of any application therefor or (ii) any injunction, decree or other order issued by any Governmental Authority or other legal restraint or prohibition preventing consummation of the transactions contemplated hereby shall have been entered by any Governmental Authority of competent jurisdiction or any applicable law shall have been enacted or adopted that enjoins, prohibits or makes illegal consummation of any of the transactions contemplated hereby and such injunction, decree or other order shall be final and nonappealable.

Section 11.2 Procedure Upon Termination.

(a) In the event of termination pursuant to Section 11.1, and except as otherwise stated therein, written notice thereof shall be given to the other party, and, except as set forth in Section 11.2(b), this Agreement shall terminate immediately upon receipt of such notice unless an extension is consented to by the party having the right to terminate. If this Agreement is terminated as provided herein:

(1) each party will return all documents, work papers and other materials of the other party, including photocopies or other duplications thereof, relating to this transaction, whether obtained before or after the execution hereof, to the party furnishing the same;

(2) all information received by either party hereto with respect to the business of the other party (other than information that is a matter of public knowledge or that has heretofore been published in any publication for public distribution or filed as public information with any Governmental Authority) shall not at any time be used for any business purpose by such party or disclosed by such party to third Persons; and

(3) each party will pay its own expenses, except as otherwise specifically provided in this Agreement.

(b) In the event of termination of this Agreement pursuant to this Article XI, this Agreement (other than as set forth in Sections 8.1(c), 11.3 and 12.4) shall become void and of no effect with no liability on the part of any party hereto (or of any of its directors, officers, employees, agents, legal and financial advisors or other representatives); *provided, however,* that, no such termination shall absolve the breaching party from any liability to the other party arising out of its knowing or willful breach of this Agreement.

Section 11.3 Certain Obligations upon Termination. Notwithstanding Section 8.7, should the transactions contemplated hereby not be consummated because of a party's breach of this Agreement, in addition to such damages as may be recoverable in law or equity, the other party shall be entitled to recover from the breaching party upon demand, itemization, and documentation, its reasonable outside legal, accounting, consulting, and other out-of-pocket expenses incurred in connection herewith.

ARTICLE XII.

MISCELLANEOUS PROVISIONS

Section 12.1 Amendment and Modification; Waiver.

(a) This Agreement may not be amended or modified in any manner except by mutual agreement of the parties and as set forth in a writing signed by each of the parties hereto or their respective successors in interest.

(b) Subject to applicable law, each party, by written instrument signed by a duly authorized officer thereof, may extend the time for the performance of any of the obligations or other acts of any of the other parties and may waive (i) any inaccuracies in the representations and warranties contained herein or in any document delivered pursuant hereto or (ii) compliance with any of the undertakings, obligations, covenants or other acts contained herein. The waiver of any breach of or compliance with any provision hereof by a party shall not be deemed to be a waiver of any preceding or subsequent breach or a failure to comply with this Agreement.

Section 12.2 Survival. Except as otherwise provided herein, the parties' respective representations and warranties contained herein shall survive in all cases until eighteen (18) months after the Effective Time; *provided* that any representation or warranty shall be deemed to survive the expiration of the Claim Limitation Period solely for the purpose of resolving any claim with respect thereto submitted by an indemnified party in accordance with Article V prior to the end of the Claim Limitation Period with respect to Losses incurred by the applicable indemnified party prior to the end of the Claim Limitation Period and asserted under such claim and relating to the relevant surviving representations and warranties. The covenants and agreements contained herein that by their terms contemplate performance after the Effective Time shall survive the Effective Time in accordance with such terms.

Section 12.3 Assignment. This Agreement and all of the provisions hereof shall be binding upon, and shall inure to the benefit of, the parties hereto and their successors and permitted assigns, but neither this Agreement nor any of the rights, interests or obligations hereunder shall be assigned by either of the parties hereto without the prior written consent of the other.

Section 12.4 Confidentiality. Purchaser and Seller agree that any provisions of this Agreement containing agreements or covenants with respect to Confidential Information shall survive the execution hereof, any termination hereof or (except in the case of Purchaser) any consummation of the transactions contemplated herein.

Section 12.5 Addresses for Notices, Etc. All notices, consents, waivers, and other communications hereunder must be in writing and will be deemed to have been duly given when (a) delivered by hand (with written confirmation of receipt), (b) deposited in the United States Mail by registered or certified mail, return receipt requested, (c) sent by email (with electronic confirmation of receipt), or (d) when received by the addressee, if sent by a nationally recognized overnight delivery service (receipt requested), in each case to the appropriate mailing addresses or email addresses set forth below (or to such other mailing addresses and email addresses as a party may designate by notice to the other parties):

If to Seller, to:	Rockford Bank and Trust Company c/o QCR Holdings, Inc. 3551 Seventh Street Moline, Illinois 61265 Attention: Todd A. Gipple Telephone Number: (309) 743-7745 Email Address: tgipple@qcrh.com
with copies to:	Barack Ferrazzano Kirschbaum & Nagelberg LLP 200 W. Madison Street, Suite 3900 Chicago, Illinois 60606 Attention: Abdul R. Mitha Telephone Number: (312) 629-5171 Email Address: abdul.mitha@bfkn.com
If to Parent, to:	QCR Holdings, Inc. 3551 Seventh Street Moline, Illinois 61265 Attention: Todd A. Gipple Telephone Number: (309) 743-7745 Email Address: tgipple@qcrh.com
with copies to:	Barack Ferrazzano Kirschbaum & Nagelberg LLP 200 W. Madison Street, Suite 3900 Chicago, Illinois 60606 Attention: Abdul R. Mitha Telephone Number: (312) 629-5171 Email Address: abdul.mitha@bfkn.com
If to Purchaser, to:	Illinois Bank & Trust 6855 East Riverside Boulevard Rockford, Illinois 61114 Attention: Jeffrey S. Hultman Telephone Number: (815) 637-7000 Email Address: jhultman@illinoisbank.com

with copies to: Heartland Financial USA, Inc.
1398 Central Avenue
Dubuque, Iowa 52001
Attention: Michael J. Coyle
Telephone Number: (563) 587-4096
Email Address: mcoyle@htlf.com

Dorsey & Whitney LLP
50 South Sixth Street, Suite 1500
Minneapolis, Minnesota 55402
Attention: Jay L. Kim
Telephone Number: (612) 492-6144
Email Address: kim.jay@dorsey.com

Section 12.6 Counterparts. This Agreement may be executed simultaneously in two counterparts, each of which shall be deemed an original, but both of which together shall constitute one and the same instrument.

Section 12.7 Governing Law. This Agreement shall be governed by, and construed in accordance with, the laws of the State of Illinois applicable to contracts made and to be performed entirely within such state.

Section 12.8 Entire Agreement. This Agreement and the schedules, exhibits and attachments hereto, the Transition and Services Agreement, the Guarantee and any employment agreements entered into with Branch Employees as of the date hereof (the “Branch Employee Employment Agreements”) represent the entire agreement between the parties hereto respecting the transactions contemplated hereby. All prior written or oral proposals, agreements in principle, representations, warranties and understandings between the parties with respect to such matters are superseded hereby, and the Transition and Services Agreement, the Guarantee and the Branch Employee Employment Agreements are merged herein and therein.

Section 12.9 No Third Party Beneficiaries. Nothing herein is intended to or shall confer upon or give to any Person (other than the parties hereto, their successors and permitted assigns) any rights or remedies under or by reason of this Agreement, or any term, provision, condition, undertaking, warranty, representation, indemnity, covenant or agreement contained herein, other than the beneficiaries of the provisions of Article V as set forth therein.

Section 12.10 Calculation of Dates and Deadlines. Unless otherwise specified, any period of time to be determined hereunder shall be deemed to commence at 12:01 a.m. on the first full day after the specified starting date, event, or occurrence. Any deadline, due date, expiration date, or period-end to be calculated hereunder shall be deemed to end at 5:00 p.m. on the last day of the specified period. The time of day shall be determined with reference to the then current local time in the State of Illinois.

Section 12.11 Consent to Jurisdiction; Waiver of Jury Trial.

(a) Each of the parties hereto hereby irrevocably and unconditionally submits to the jurisdiction of any court in the State of Illinois and any federal court sitting in the State of Illinois, and irrevocably agrees that all actions or proceedings arising out of or relating to this Agreement or the transactions contemplated hereby or in aid or arbitration or for enforcement of an arbitral award shall be litigated exclusively in such courts. Each of the parties hereto agrees not to commence any legal proceedings related hereto except in such courts. Each of the parties hereto irrevocably waives any objection that he or it may now or hereafter have to the laying of the venue of any such proceeding in any such court and hereby further irrevocably and unconditionally waives and agrees not to plead or claim in any such court that any such action, suit or proceeding brought in any such court has been brought in an inconvenient forum.

(b) EACH PARTY ACKNOWLEDGES AND AGREES THAT ANY CONTROVERSY WHICH MAY ARISE UNDER THIS AGREEMENT IS LIKELY TO INVOLVE COMPLICATED AND DIFFICULT ISSUES, AND THEREFORE EACH PARTY HEREBY IRREVOCABLY AND UNCONDITIONALLY WAIVES ANY RIGHT SUCH PARTY MAY HAVE TO A TRIAL BY JURY IN RESPECT OF ANY LITIGATION DIRECTLY OR INDIRECTLY ARISING OUT OF OR RELATING TO THIS AGREEMENT OR THE TRANSACTIONS CONTEMPLATED BY THIS AGREEMENT. EACH PARTY CERTIFIES AND ACKNOWLEDGES THAT (i) NO REPRESENTATIVE, AGENT OR ATTORNEY OF ANY OTHER PARTY HAS REPRESENTED, EXPRESSLY OR OTHERWISE, TO IT THAT SUCH OTHER PARTY WOULD NOT, IN THE EVENT OF LITIGATION, SEEK TO ENFORCE THE FOREGOING WAIVER, (ii) EACH PARTY UNDERSTANDS AND HAS CONSIDERED THE IMPLICATIONS OF THIS WAIVER, (iii) EACH PARTY MAKES THIS WAIVER VOLUNTARILY AND (iv) EACH PARTY HAS BEEN INDUCED TO ENTER INTO THIS AGREEMENT BY, AMONG OTHER THINGS, THE MUTUAL WAIVERS AND CERTIFICATIONS SET FORTH HEREIN.

Section 12.12 Severability. Any term or provision of this Agreement that is invalid or Unenforceable in any jurisdiction shall, as to that jurisdiction, be ineffective to the extent of such invalidity or unenforceability without rendering invalid or unenforceable the remaining terms and provisions of this Agreement or affecting the validity or enforceability of any of the terms or provisions of this Agreement in any other jurisdiction. If any provision of this Agreement is so broad as to be unenforceable, the provision shall be interpreted to be only so broad as is enforceable.

Section 12.13 Specific Performance. Each of the parties hereto acknowledges and agrees that the other party would be damaged irreparably in the event any of the provisions of this Agreement are not performed in accordance with their specific terms or otherwise are breached. Accordingly, each of the parties agrees that the other party hereto shall be entitled to seek an injunction or injunctions to prevent breaches of the provisions of this Agreement and to enforce specifically this Agreement and the terms and provisions hereof in any action instituted in any court of the United States or any state thereof having jurisdiction over the parties and the matter, in addition to any other remedy to which it may be entitled, at law or in equity.

Section 12. 14 Disclosure Schedules.

(a) The Sections of the Disclosure Schedules correspond to the section numbers in this Agreement. The inclusion of any information in any one Section of the Disclosure Schedules shall not be deemed to be an admission of any liability or obligation of Seller to any third person, or an admission against the interest of Seller to any third person. No disclosure in the Disclosure Schedules relating to any possible breach or violation of any contract, laws or orders shall be construed as an admission or indication that any such breach or violation exists or has actually occurred.

(b) A Section of the Disclosure Schedules relating to a certain section of this Agreement may incorporate by reference disclosures made in other Sections of the Disclosure Schedules; *provided*, *however*, that any disclosure provided on a particular Section of the Disclosure Schedules will be deemed adequately disclosed in other Sections of the Disclosure Schedules to the extent it is readily apparent from the nature of the disclosure that such disclosure also applies to such other Section of the Disclosure Schedule. Nothing in a Section of the Disclosure Schedules will be deemed adequate to disclose an exception to a representation, warranty, covenant or agreement made by Seller herein, unless the Section of the Disclosure Schedule identifies the exception with reasonable particularity.

(c) From and after the date hereof to the Effective Time, Seller shall supplement or amend the Disclosure Schedules with respect to any matter hereafter arising and not disclosed herein or in the Disclosure Schedules that would render any representation or warranty of Seller contained herein materially inaccurate or incomplete as a result of such matter arising. Notwithstanding the foregoing, any supplemented or amended disclosure in the Disclosure Schedules shall not have the effect of making any representation or warranty contained in this Agreement true and correct for purposes of Section 9.1.

[The remainder of this page is intentionally blank.]

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed by their duly authorized officers as of the date first written above.

ILLINOIS BANK & TRUST

By:	/s/ Jeffrey S. Hultman
Name:	Jeffrey S. Hultman
Title:	President and Chief Executive Officer

ROCKFORD BANK AND TRUST COMPANY

By:	/s/ Thomas D. Budd
Name:	Thomas D. Budd
Title:	President and Chief Executive Officer

Solely with respect to the covenants and agreements of Parent set forth in Section 5.5, Section 5.6, Section 8.13(e) and Section 8.18 of this Agreement:

QCR HOLDINGS INC.

By:	/s/ Larry J. Helling
Name:	Larry J. Helling
Title:	Chief Executive Officer

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Section 3: EX-31.1 (EX-31.1)

EXHIBIT 31.1

I, Bruce K. Lee, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Heartland Financial USA, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f)) for the registrant and have:

    a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and

    d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting, and;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

    a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and

    b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 6, 2019

/s/ Bruce K. Lee

Bruce K. Lee
President and Chief Executive Officer

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Section 4: EX-31.2 (EX-31.2)

EXHIBIT 31.2

I, Bryan R. McKeag, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Heartland Financial USA, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting, and;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 6, 2019

/s/ Bryan R. McKeag
Bryan R. McKeag
Executive Vice President
Chief Financial Officer

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Section 5: EX-32.1 (EX-32.1)

EXHIBIT 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Heartland Financial USA, Inc. (the “Company”) on Form 10-Q for the quarter ending September 30, 2019, as filed with the Securities and Exchange Commission on the date hereof (the “Report), I, Bruce K. Lee, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Bruce K. Lee

Bruce K. Lee
President and Chief Executive Officer

Date: November 6, 2019

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Section 6: EX-32.2 (EX-32.2)

EXHIBIT 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Heartland Financial USA, Inc. (the “Company”) on Form 10-Q for the quarter ending September 30, 2019, as filed with the Securities and Exchange Commission on the date hereof (the “Report), I, Bryan R. McKeag, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Bryan R. McKeag

Bryan R. McKeag
Executive Vice President
Chief Financial Officer

Date: November 6, 2019

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