GROTH STEVEN F
Form 4
February 18, 2010

FORM 4

Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

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

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

OMB APPROVAL

OMB Number:	3235-0287
Expires:	January 31, 2005
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(Print or Type Responses)

1. Name and Address of Reporting Person *
GROTH STEVEN F

(Last) (First) (Middle)

730 THIRD AVENUE

(Street)

NEW YORK, NY 10017

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
FINANCIAL FEDERAL CORP [FIF]

3. Date of Earliest Transaction (Month/Day/Year)
02/16/2010

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

_____ Director _____ 10% Owner
__X__ Officer (give title below) _____ Other (specify below)
Senior Vice President & CFO

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Common Stock	02/16/2010		F		4,640	D	$ 27.04	78,137	D	

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)		8. Price of Derivative Security (Instr. 5)	9. Nu Deriv Secur Bene Owne Follo Repo Trans (Instr
				Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares		

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
GROTH STEVEN F 730 THIRD AVENUE NEW YORK, NY 10017			Senior Vice President & CFO	

Signatures

/s/ Groth, Steven	02/17/2010
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number. "font-family:inherit;font-size:10pt;">Unexercised Warrants

Warrant valuation models

Estimated underlying stock price volatility

60% to 100%
Duration

1.75 to 2.0 years
Risk-free rate

0.30% to 0.50%

(1) CPR: Constant prepayment rate

(2) CDR: Constant default rate

Assets and Liabilities Measured at Fair Value on a Non-Recurring Basis
Intermountain may be required, from time to time, to measure certain other financial assets at fair value on a non-recurring basis. The following table presents the carrying value for these financial assets as of dates indicated (in thousands):

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Description	Total	Level 1	Level 2	Level 3
Balance, 6/30/2013				
Loans(1)	$17,910	$—	$—	$17,910
OREO	4,512	—	—	4,512
Total Assets Measured at Fair Value	$22,422	$—	$—	$22,422
Balance, 12/31/2012				
Loans(1)	$14,629	$—	$—	$14,629
OREO	4,951	—	—	4,951
Total Assets Measured at Fair Value	$19,580	$—	$—	$19,580

(1) Represents impaired loans, net of allowance for loan loss, which are included in loans.

The following table presents additional quantitative information about assets measured at fair value on a nonrecurring basis and for which the company has utilized Level 3 inputs to determine fair value at June 30, 2013:

	Valuation Techniques	Unobservable Input	Range of Inputs
Impaired Loans	Discounted cash flows and appraisal of collateral	Amount and timing of cash flows	No payment deferral to indefinite payment deferral
		Discount Rate	4% to 9%
		Appraisal adjustments	10% to 35%
		Liquidation Expenses	10% to 15%
OREO	Appraisal of collateral	Appraisal adjustments	10% to 35%
		Liquidation Expenses	10% to 15%

Impaired Loans

Periodically, the Company records nonrecurring adjustments to the carrying value of loans based on fair value measurements for partial charge-offs of the uncollectible portions of those loans. Nonrecurring adjustments also include certain impairment amounts for impaired loans when establishing the allowance for credit losses. Such amounts are generally based on either the estimated fair value of the cash flows to be received or the fair value of the underlying collateral supporting the loan less selling costs. Real estate collateral on these loans and the Company’s OREO is typically valued using appraisals or other indications of value based on recent comparable sales of similar properties or assumptions generally observable in the marketplace. Management reviews these valuations and makes additional valuation adjustments, as necessary, including subtracting estimated costs of liquidating the collateral or selling the OREO. If the value of the impaired loan is determined to be less than the recorded investment in the loans, the impairment is recognized and the carrying value of the loan is adjusted to fair value through the allowance for loan and lease losses. The carrying value of loans fully charged off is zero. The related nonrecurring fair value measurement adjustments have generally been classified as Level 3 because of the significant assumptions required in estimating future cash flows on these loans, and the rapidly changing and uncertain collateral values underlying the loans. Volatility and the lack of relevant and current sales data in the Company’s market areas for various types of collateral create additional uncertainties and require the use of multiple sources and management judgment to make adjustments. Loans subject to nonrecurring fair value measurement were $17.9 million at June 30, 2013 all of which were classified as Level 3.

OREO

OREO represents real estate which the Company has taken control of in partial or full satisfaction of loans. At the time of foreclosure, Generally Accepted Accounting Principles (“GAAP”) states that OREO is recorded at its fair value less cost to sell. Any write-downs based on the asset’s fair value at the date of acquisition are charged to the allowance for loan and lease losses. After foreclosure, management periodically performs valuations such that the real estate is carried at the lower of its new cost basis or fair value, net of estimated costs to sell. Fair value adjustments on other real estate owned are recognized within net loss on real estate owned as a component of non-interest expense. Fair value is determined from external appraisals and other valuations using judgments and estimates of external professionals. Many of these inputs are not observable and, accordingly, these

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measurements are classified as Level 3. The Company’s OREO at June 30, 2013 totaled $4.5 million, all of which was classified as Level 3.

10. New Accounting Pronouncements:
In January 2013, the FASB issued ASU No. 2013-01, Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities. ASU No. 2013-01 clarifies that ASU No. 2011-11 applies only to derivatives, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset or subject to an enforceable master netting arrangement or similar agreement. The amendments are effective for annual and interim reporting periods beginning on or after January 1, 2013. The adoption of ASU No. 2013-01 did not have a material impact on the Company's consolidated financial statements.
In February 2013, the FASB issued ASU No. 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. ASU No. 2013-02 requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income. The amendments are effective for annual and interim reporting periods beginning on or after December 15, 2012. The adoption of ASU No. 2013-02 did not have a material impact on the Company's consolidated financial statements.

Item 2 — Management’s Discussion and Analysis of Financial Condition and Results of Operations

This report contains forward-looking statements. For a discussion about such statements, including the risks and uncertainties inherent therein, see “Forward-Looking Statements.” Management’s Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the Consolidated Financial Statements and Notes presented elsewhere in this report and in Intermountain’s Form 10-K for the year ended December 31, 2012.

General (Overview & History)
Intermountain Community Bancorp (“Intermountain” or the “Company”) is a bank holding company registered under the Bank Holding Company Act of 1956, as amended. The Company was formed as Panhandle Bancorp in October 1997 under the laws of the State of Idaho in connection with a holding company reorganization of Panhandle State Bank (the “Bank”) that was approved by the stockholders on November 19, 1997 and became effective on January 27, 1998. In September 2000, Panhandle Bancorp changed its name to Intermountain Community Bancorp.
Panhandle State Bank, a wholly owned subsidiary of the Company, was first opened in 1981 to serve the local banking needs of Bonner County, Idaho. Panhandle State Bank is regulated by the Idaho Department of Finance, the State of Washington Department of Financial Institutions, the Oregon Division of Finance and Corporate Securities and by the Federal Deposit Insurance Corporation (“FDIC”), its primary federal regulator and the insurer of its deposits. Since opening in 1981, the Bank grew by opening additional branch offices throughout Idaho and has also expanded into the states of Oregon and Washington. Intermountain also operates Trust and Investment Services divisions, which provide investment, insurance, wealth management and trust services to its clients.
The national economic recession and soft local markets slowed the Company’s growth during the past several years. In response, Company management shifted its priorities to improving asset quality, raising additional capital, maintaining a conservative balance sheet and improving the efficiency of its operations. After achieving its objectives in these areas and with stronger local economies, management is now exploring prudent growth opportunities in its market areas.
Intermountain offers banking and financial services that fit the needs of the communities it serves. Lending activities include consumer, commercial, commercial real estate, construction, mortgage and agricultural loans. A full range of deposit services are available including checking, savings and money market accounts as well as various types of certificates of deposit. Trust and wealth management services, investment and insurance services, and business cash management solutions round out the Company’s product offerings.

Business Strategy & Opportunities

Intermountain seeks to differentiate itself by attracting, retaining and motivating highly experienced employees who are local market leaders, and supporting them with advanced technology, training and compensation systems. This approach allows the Bank to provide local marketing and decision-making to respond quickly to customer opportunities and build leadership in its communities. Simultaneously, the Bank has focused on standardizing and centralizing administrative and operational functions to improve risk management, efficiency and the ability of the branches to serve customers effectively.

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The Company's strengths include a strong, committed team of experienced banking officers, a loyal and low-cost deposit base, a sophisticated risk management system, and a strong operational and compliance infrastructure. In the current slow-growth environment, the Company is leveraging these strengths to seek prudent growth opportunities while continuing to improve operating efficiency. In particular, Company management is focused on the following:

- Increasing and diversifying its loan origination activity by pursuing attractive small and mid-market commercial credits in its markets, originating commercial real estate loans to strong borrowers, originating mortgage loans to strong borrowers at conservative loan-to-values in rural and smaller suburban areas, expanding and diversifying its agricultural portfolio, and expanding its already strong government-guaranteed loan marketing efforts.
- Maintaining a conservative balance sheet and effectively managing Company risk amidst a still uncertain economic and regulatory environment.
- Increasing the efficiency of its operations by continuing to restructure processes, re-negotiate contracts and rationalize various business functions.
- Increasing local, transactional deposit balances while continuing to minimize interest expense by increasing referral activity and targeting specific business and non-profit groups.
- Offsetting regulatory pressures on current non-interest income streams by expanding its trust, investment and insurance sales, and pursuing opportunities to diversify into new fee-based programs serving both its existing clientele and new potential markets.

The Company successfully completed two capital raises in 2012, raising a net total of $50.3 million. The completion of these offerings allows the Company additional flexibility to pursue the above goals. In addition, management believes that disruption and consolidation in the market may lead to other opportunities as well, either through direct acquisition of other banks or by capitalizing on opportunities created by market disruption to attract strong new employees and customers.

Critical Accounting Policies

The accounting and reporting policies of Intermountain conform to Generally Accepted Accounting Principles ("GAAP") and to general practices within the banking industry. The preparation of the financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Intermountain's management has identified the accounting policies described below as those that, due to the judgments, estimates and assumptions inherent in those policies, are critical to an understanding of Intermountain's Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations.

Investments. Assets in the investment portfolio are initially recorded at cost, which includes any premiums and discounts. Intermountain amortizes premiums and discounts as an adjustment to interest income using the interest yield method over the life of the security. The cost of investment securities sold, and any resulting gain or loss, is based on the specific identification method.

Management determines the appropriate classification of investment securities at the time of purchase.

Held-to-maturity securities are those securities that Intermountain has the intent and ability to hold to maturity, and are recorded at amortized cost. Available-for-sale securities are those securities that would be available to be sold in the future in response to liquidity needs, changes in market interest rates, and asset-liability management strategies, among others. Available-for-sale securities are reported at fair value, with unrealized holding gains and losses reported in stockholders' equity as a separate component of other comprehensive income, net of applicable deferred income taxes.

During the quarter ended June 30, 2013, the Company transferred $8.5 million in securities from its available-for-sale portfolio to its held-to-maturity portfolio, based on management's intent and ability to hold these securities to maturity. This transfer was recorded at fair market value and the unrealized loss at the date of transfer continues to be reported as accumulated other comprehensive income, net of applicable deferred income taxes, and will be amortized over the remaining life of the securities as an adjustment to yield. Upon transfer to the held-to-maturity category, premium and discount accounts were adjusted to reflect the fair market value of the security. The resulting premiums and discounts will also be amortized as an adjustment to yield.

Management evaluates investment securities for other-than-temporary declines in fair value on a periodic basis. If the fair value of an investment security falls below its amortized cost and the decline is deemed to be other-than-temporary, the security’s fair value will be analyzed based on market conditions and expected cash flows on the investment security. The unrealized loss is considered an other-than-temporary impairment. The Company then calculates a credit loss charge against earnings by subtracting the estimated present value of estimated future cash flows on the security from its amortized cost. The other-than-temporary impairment less the credit loss charge against earnings is a component of other comprehensive income.

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Allowance For Loan Losses. In general, determining the amount of the allowance for loan losses requires significant judgment and the use of estimates by management. This analysis is designed to determine an appropriate level and allocation of the allowance for losses among loan types and loan classifications by considering factors affecting loan losses, including: specific losses; levels and trends in impaired and nonperforming loans; historical bank and industry loan loss experience; current national and local economic conditions; volume, growth and composition of the portfolio; regulatory guidance; and other relevant factors. Management monitors the loan portfolio to evaluate the adequacy of the allowance. The allowance can increase or decrease based upon the results of management's analysis. The amount of the allowance for the various loan types represents management's estimate of probable incurred losses inherent in the existing loan portfolio based upon historical bank and industry loan loss experience for each loan type. The allowance for loan losses related to impaired loans is based on the fair value of the collateral for collateral dependent loans, and on the present value of expected cash flows for non-collateral dependent loans. For collateral dependent loans, this evaluation requires management to make estimates of the value of the collateral and any associated holding and selling costs, and for non-collateral dependent loans, estimates on the timing and risk associated with the receipt of contractual cash flows.

Management believes the allowance for loan losses was adequate at June 30, 2013. While management uses available information to provide for loan losses, the ultimate collectability of a substantial portion of the loan portfolio and the need for future additions to the allowance will be based on changes in economic conditions and other relevant factors. A slowdown in economic activity could adversely affect cash flows for both commercial and individual borrowers, as a result of which the Company could experience increases in nonperforming assets, delinquencies and losses on loans. The allowance requires considerable judgment on the part of management, and material changes in the allowance can have a significant impact on the Company's financial position and results of operations.

Fair Value Measurements. ASC 820 "Fair Value Measurements" establishes a standard framework for measuring fair value in GAAP, clarifies the definition of "fair value" within that framework, and expands disclosures about the use of fair value measurements. A number of valuation techniques are used to determine the fair value of assets and liabilities in Intermountain's financial statements. These include quoted market prices for securities, interest rate swap valuations based upon the modeling of termination values adjusted for credit spreads with counterparties, and appraisals of real estate from independent licensed appraisers, among other valuation techniques. Fair value measurements for assets and liabilities where there exists limited or no observable market data are based primarily upon estimates, and are often calculated based on the economic and competitive environment, the characteristics of the asset or liability and other factors. Therefore, the results cannot be determined with precision and may not be realized in an actual sale or immediate settlement of the asset or liability. Additionally, there are inherent weaknesses in any calculation technique, and changes in the underlying assumptions used, including discount rates and estimates of future cash flows, could significantly affect the results of current or future values. Significant changes in the aggregate fair value of assets and liabilities required to be measured at fair value or for impairment will be recognized in the income statement under the framework established by GAAP. If impairment is determined, it could limit the ability of Intermountain's banking subsidiaries to pay dividends or make other payments to the Holding Company. See Note 9 to the Consolidated Financial Statements for more information on fair value measurements.

Income Taxes. Income taxes are accounted for using the asset and liability method. Under this method a deferred tax asset or liability is determined based on the enacted tax rates which will be in effect when the differences between the financial statement carrying amounts and tax basis of existing assets and liabilities are expected to be reported in the Company's income tax returns. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation allowances are established to reduce the net carrying amount of deferred tax assets if it is determined to be more likely than not, that all or some portion of the potential deferred tax asset will not be realized. The Company uses an estimate of future earnings, an evaluation of its loss carryback ability and tax planning strategies to determine whether or not the benefit of its net deferred tax asset may be realized. The analysis used to determine whether a valuation allowance is required and if so, the amount of the allowance, is based on estimates of future taxable income and the effectiveness of future tax planning strategies. These estimates require significant management judgment about future economic conditions and Company performance.

At June 30, 2013, Intermountain assessed whether it was more likely than not that it would realize the benefits of its deferred tax asset. Intermountain determined that the negative evidence associated with a three-year cumulative loss for the period ended December 31, 2011, and soft economic conditions continued to outweigh the positive evidence. Therefore, Intermountain maintained a valuation allowance of $7.5 million against its deferred tax asset. The company analyzes the deferred tax asset on a quarterly basis and may recapture a portion or all of this allowance depending on future profitability. Including the valuation allowance, Intermountain had a net deferred tax asset of $15.1 million as of June 30, 2013, compared to a net deferred tax asset of $12.3 million as of December 31, 2012.

The completion of the capital raise noted in the "Business Strategy & Opportunities" section above triggered Internal Revenue Code Section 382 limitations on the amount of tax benefit from net operating loss carryforwards that the Company can claim annually. The effect of this limitation is currently being evaluated and is influenced by the level of market interest rates and the fair value of the Company's balance sheet at the time the offering was completed. This could impact the amount and timing of the

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release of the valuation allowance. The evaluation of this impact is currently in process and will likely not be known until the Company's final 2012 tax position is determined later in 2013. See Note 8 to the Consolidated Financial Statements for more information.

Note 11, “New Accounting Pronouncements” in the Notes to the Consolidated Financial Statements, discusses new accounting pronouncements adopted by Intermountain and the expected impact of accounting pronouncements recently issued or proposed, but not yet required to be adopted.

Results of Operations

Overview. Intermountain recorded net income applicable to common stockholders of $2.5 million, or $0.39 per diluted share for the six months ended June 30, 2013, compared with net income of $636,000, or $0.12 per diluted share for the six months ended June 30, 2012. All earnings per share numbers reflect the impact of the 10-for-1 reverse stock split completed in October 2012. The improvement in net income for the period indicated over the comparable period last year resulted from decreases in the loan loss provision, interest expense and operating expense, and an increase in other income. These factors offset a decrease in interest income. For the quarter ended June 30, 2013, Intermountain recorded net income applicable to common stockholders of $1.5 million, or $0.23 per diluted share, compared with net income of $1.1 million, or $0.16 per diluted share, and $301,000, or $0.05 per diluted share for the quarters ended March 31, 2013 and June 30, 2012, respectively. The primary reason for the increase in income for the three month and six month period ended June 30, 2013 was attributed to the significant reduction in the loan loss provision during those periods.

The annualized return on average assets (“ROAA”) was 0.74% for the six months ended June 30, 2013, as compared to 0.33% in the same period last year, and the annualized return on average common equity (“ROAE”) was 5.85% in 2013 and 2.27% in 2012, respectively.

Net Interest Income. The most significant component of earnings for the Company is net interest income, which is the difference between interest income from the Company’s loan and investment portfolios, and interest expense on deposits, repurchase agreements and other borrowings. During the six months ended June 30, 2013 and June 30, 2012, net interest income was $14.8 million and $15.4 million, respectively. The decrease in net interest income from last year reflects lower interest income on both loans and investments resulting primarily from declines in rates earned on these assets. Very low market rates and intense competition for strong borrowers continue to pressure both the Company's and its competitors' loan yields. Investment portfolio yields are also down, reflecting the impacts of Federal Reserve purchases of mortgage-backed securities, strong general demand for fixed income securities, and rapid prepayment speeds on the Company's mortgage-backed securities. Interest expense on deposits continued to decrease as deposit rates declined in response to lower market rates, and CD volumes continued to contract. The decrease in interest expense on other borrowings from the same six-month period last year reflected both lower average borrowing volumes and lower rates paid.

Average interest-earning assets decreased by 0.3% to $844.5 million for the six months ended June 30, 2013 compared to $847.0 million for the six months ended June 30, 2012. Average loans increased $10.5 million during this period, but was offset by a $13.0 million decrease in average investments and cash. Higher loan volumes reflect modestly stronger local market conditions and marketing efforts by Company lending staff.

Average interest-bearing liabilities decreased by $32.2 million, or 3.8%, for the six month period ended June 30, 2013 compared to June 30, 2012. Average deposit balances decreased $17.2 million, or 2.4%, average Federal Home Loan Bank ("FHLB") advances decreased $23.7 million, or 81.6%, and average other borrowings increased $8.7 million, or 10.6%. The decrease in deposits primarily reflects payoffs of higher rate wholesale and retail CDs and the loss of savings balances associated with a terminated contract for secured credit cards. The decrease in FHLB advances reflects management’s focus on lowering interest expense and reducing higher rate or non-relationship funding, while the increase in other borrowings resulted from stronger repurchase demand by the Company's municipal customers.

The net interest margin was 3.51% for the six months ended June 30, 2013 as compared to 3.61% in the comparable period of 2012. Decreases in the average yields on both loans and investments more than offset lower deposit and borrowing costs.

The Company continues to operate in an unprecedented low rate environment, in which the Fed Funds target rate is less than 0.25% and the Federal Reserve continues to purchase mortgage assets to reduce longer rates. However, yields on the 10-year US Treasury bond increased about 1% in the second quarter of 2013, as a combination of stronger economic news and speculation about the Fed tapering its bond purchases later in 2013 led investors to sell longer bonds. This market rate movement had a negligible impact on the Company's earnings during the quarter, as the increase in longer yields did not translate directly into higher yields on the Company's earning assets. The Company's short-term variable rate loans are tied primarily to the national prime rate or the overnight or one-month London Interbank Offering Rate (LIBOR), which did not move. In addition, excess industry liquidity and continuing strong competition for quality borrowers dampened any short-term impact higher long-term market rates had on the loan portfolio.

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Higher market rates could improve yields and earnings in the Company's investment portfolio in future quarters by slowing prepayment speeds on mortgage-backed securities and increasing yields on new investments. However, this potential positive impact may be offset by the Company repositioning its investment portfolio to shorten duration and reduce price risk from the impact of further market rate increases on the value of the portfolio.

Management continues to work diligently to redeploy cash assets into higher yielding loans and investments, and in particular is now focused on more rapid expansion of the loan portfolio to offset some of the pressure on yields. The Company also continues to focus on lowering its overall cost of funds, while maintaining transaction deposit balances from core relationship customers. The cost on interest-bearing liabilities dropped from 0.68% for the first six months of 2012 to 0.48% for the same period in 2013. Management believes that some opportunities still remain to further lower funding costs. However, given the already low level of market rates and the Company’s cost of funds, any future gains are likely to be less than those already experienced.

Provision for Losses on Loans & Credit Quality. Management’s policy is to establish valuation allowances for estimated losses by charging corresponding provisions against income. This evaluation is based upon management’s assessment of various factors including, but not limited to, current and anticipated future economic trends, historical loan losses, delinquencies, underlying collateral values, and current and potential risks identified in the portfolio.

The provision for losses on loans totaled $426,000 for the six months ended June 30, 2013, compared to a provision of $2.5 million for the comparable period last year. Lower provision costs reflect continued improvements in the quality of the Company's loan portfolio as reflected by the reduction in non-performing assets to 1% of assets as of June 30, 2013. To reference the summary of provision and loan loss allowance activity for the periods indicated, see Note 4 to the Consolidated Financial Statements, "Loans and Allowance for Loan Losses."

Net chargeoffs dramatically declined to $327,000 in the first six months of 2013, compared to $5.0 million in the first six months of 2012. In general, portfolio losses are no longer concentrated in any particular industry or loan type, as prior efforts to reduce exposure in construction, land development and commercial real estate loans have decreased the exposure in these segments considerably. The Company continues to resolve or liquidate its problem loans aggressively, particularly those with higher loss exposures, and now believes that the risk of future large losses is significantly reduced. The loan loss allowance to total loans ratio was 1.52% at June 30, 2013, compared to 1.96% at June 30, 2012 as the company charged off loans against the higher reserve previously established to accommodate potential loss exposure in the portfolio. At the end of June 2013, the allowance for loan losses totaled 167.6% of non-performing loans compared to 155.2% at June 30, 2012. The increase in this coverage ratio despite a lower total dollar allowance for loan loss reflects the reduction of non-performing loans over the prior period.

Given current economic uncertainty, management continues to evaluate and adjust the loan loss allowance carefully and frequently to reflect the most current information available concerning the Company’s markets and loan portfolio. In its evaluation, management considers current economic and borrower conditions in both the pool of loans subject to specific impairment, and the pool subject to a more generalized allowance based on historical and other factors. When a loan is characterized as impaired, the Company performs a specific evaluation of the loan, focusing on potential future cash flows likely to be generated by the loan, current collateral values underlying the loan, and other factors such as government guarantees or guarantor support that may impact repayment. Based on this evaluation, it sets aside a specific reserve for this loan and/or charges down the loan to its net realizable value (selling price less estimated closing costs) if it is unlikely that the Company will receive any cash flow beyond the amount obtained from liquidation of the collateral. If the loan continues to be impaired, management periodically re-evaluates the loan for additional potential impairment, and charges it down or adds to reserves if appropriate. On the pool of loans not subject to specific impairment, management evaluates regional, bank and loan-specific historical loss trends to develop its base reserve level on a loan-by-loan basis. It then modifies those reserves by considering the risk grade of the loan, current economic conditions, the recent trend of defaults, trends in collateral values, underwriting and other loan management considerations, and unique market-specific factors such as water shortages or other natural phenomena.

General trending information with respect to non-performing loans, non-performing assets, and other key portfolio metrics is as follows (dollars in thousands):

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Credit Quality Trending

	6/30/2013		3/31/2013		12/31/2012		6/30/2012	
	(Dollars in thousands)							
Total non-performing loans ("NPLs")	$4,799		$5,137		$6,529		$6,595	
OREO	4,512		4,664		4,951		5,267	
Total non-performing assets ("NPAs")	$9,311		$9,801		$11,480		$11,862	
Classified loans (1)	$26,288		$25,295		$24,933		$35,764	
Troubled debt restructured loans (2)	$11,791		$7,827		$6,719		$5,237	
Total allowance related to non-accrual loans	$121		$86		$536		$368	
Interest income recorded on non-accrual loans (3)	$119		$85		$424		$166	
Non-accrual loans as a percentage of net loans receivable	0.92	%	1.03	%	1.25	%	1.29	%
Total non-performing loans as a % of net loans receivable	0.92	%	1.03	%	1.25	%	1.29	%
Allowance for loan losses ("ALLL") as a percentage of non-performing loans	167.6	%	149.5	%	121.7	%	155.2	%
Total NPAs as a % of total assets (4)	1.00	%	1.05	%	1.18	%	1.23	%
Total NPAs as a % of tangible capital + ALLL ("Texas Ratio") (4)	7.69	%	7.93	%	9.39	%	9.74	%
Loan delinquency ratio (30 days and over)	0.22	%	0.14	%	0.13	%	0.25	%

(1) Classified loan totals are inclusive of non-performing loans and may also include troubled debt restructured loans, depending on the grading of these restructured loans.

(2) Includes accruing restructured loans of $10.2 million and non-accruing restructured loans of $1.6 million. No other funds are available for disbursement on restructured loans.

(3) Interest income on non-accrual loans based on year-to-date interest totals

(4) NPAs include both nonperforming loans and OREO

The decrease in NPLs from year end reflects continued loan resolution activity. The Company's special assets team continues to migrate loans through the collections process through multiple management strategies, including borrower workouts and individual asset sales to local and regional investors. The Company continues to monitor its non-accrual loans closely and revalue the collateral on a periodic basis. This re-evaluation may create the need for additional write-downs or additional loss reserves on these assets. Loan delinquencies (30 days or more past due) continue at very low levels, although at 0.22%, they are up slightly from year end.

The following table summarizes NPAs by type and provides trending information over the past year:

Nonperforming Asset Trending By Category

	6/30/2013	3/31/2013	6/30/2012
	(Dollars in thousands)		
Commercial loans	$1,417	$1,573	$4,283
Commercial real estate loans	2,728	2,910	682
Land and land development loans	4,626	4,852	6,364
Agriculture loans	276	276	34
Residential real estate loans	173	186	479
Consumer loans	91	4	20
Total NPAs by Categories	$9,311	$9,801	$11,862

Land development assets continue to represent the highest segment of non-performing assets, and primarily reflect one large $4.5 million OREO property. The increase in commercial real estate NPAs since June 30, 2012 is the result of one larger credit that is expected to be resolved in the latter half of 2013. The totals for the other segments are relatively small and have largely

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declined since last year. The majority of NPAs are in northern Idaho, reflecting the OREO property noted above and the stronger market presence the Company holds in Northern Idaho. The overall level of NPAs remains below the average of the Company’s peer group.

At June 30, 2013 and December 31, 2012 classified loans (loans with risk grades 6, 7 or 8) by loan type are as follows:

	June 30, 2013			December 31, 2012		
	Amount	% of Total		Amount	% of Total	
	(Dollars in thousands)					
Commercial loans	$6,676	25.4	%	$7,693	30.9	%
Commercial real estate loans	6,064	23.1		5,156	20.7	
Land and land development loans	1,140	4.3		1,515	6.1	
Agriculture loans	4,313	16.4		2,143	8.6	
Multifamily loans	4,321	16.4		5,118	20.5	
Residential real estate loans	3,542	13.5		3,045	12.2	
Consumer loans	232	0.9		262	1.0	
Total classified loans	$26,288	100.0	%	$24,932	100.0	%

Classified loans are loans for which management believes it may experience some problems in obtaining repayment under the contractual terms of the loan, and are inclusive of the Company’s non-accrual loans. However, categorizing a loan as classified does not necessarily mean that the Company will experience any or significant loss of expected principal or interest.

Classified loans increased modestly from December 31, 2012, largely as the result of adding one larger commercial real estate credit and one agricultural credit, both of which the Company anticipates resolving in the latter half of 2013, without any significant additional loss.

As with NPAs, the geographical distribution of the Company’s classified loans reflects the distribution of the Company’s loan portfolio, with higher distributions in the “North Idaho/Eastern Washington” region, and decreased levels in southern Idaho. The Company worked rapidly to reduce its exposure in the Greater Boise area, and the other southern Idaho regions have strong agribusiness components, a sector of the economy that is performing well.

Local economies continue to improve, but are still subject to risk from various world and national events, particularly as they impact local confidence and business investment. Within the local economies, there are relatively wide variations in the strength of different industry segments. Manufacturing, technology, and health-care businesses are strong and improving. Housing and commercial real estate are also improving, assisted by relatively strong price affordability and low mortgage rates. Agriculture continues to be strong overall, although risks are increasing as a result of moderating prices, increasing input costs and concerns over adequate water in 2014. The Company has enhanced its monitoring of this portfolio and added to the loan loss reserves tied to this segment. Although conditions are better than a year ago, the government and retail sectors remain relatively weak.

Full economic recovery in the region is likely to occur slowly and over a multi-year period. As such, management believes that classified loans will likely remain elevated through the remainder of 2013, but at levels lower than those experienced in recent periods. In addition, loss exposure from these loans appears to have decreased significantly, and should continue to be lower than the heavy losses experienced in prior years. Given market volatility and future uncertainties, as with all forward-looking statements, management cannot assure nor guarantee the accuracy of these future forecasts.

Management continues to work towards reducing the level of non-performing assets, classified loans and loss exposures. It uses a variety of analytical tools and an integrated stress testing program involving both qualitative and quantitative modeling to assess the current and projected state of its credit portfolio. The results of this program are integrated with the Company’s capital and liquidity modeling programs to manage and mitigate future risk in these areas as well.

Other Income.

The following tables detail dollar amount and percentage changes of certain categories of other income for the three and six month periods ended June 30, 2013 and June 30, 2012.

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Other Income - Three Months Ended	June 30, 2013	June 30, 2012	Change	Percent Change
	(Dollars in thousands)			
Fees and service charges	$1,895	$1,592	$303	19 %
Loan related fee income	696	686	10	1
Net gain on sale of securities	163	—	163	100
Net gain on sale of other assets	2	18	(16)	(89)
Other-than-temporary credit impairment on investment securities ("OTTI")	(21)	(52)	31	(60)
Bank-owned life insurance	85	87	(2)	(2)
Fair value adjustment on cash flow hedge	80	90	(10)	(11)
Unexercised warrant liability fair value adjustment	(54)	158	(212)	(134)
Other income	40	189	(149)	(79)
Total	$2,886	$2,768	$118	4 %

Other Income - Six Months Ended	June 30, 2013	June 30, 2012	Change	Percent Change
	(Dollars in thousands)			
Fees and service charges	$3,570	$3,185	$385	12 %
Loan related fee income	1,263	1,299	(36)	(3)
Net gain on sale of securities	203	585	(382)	(65)
Net gain on sale of other assets	6	22	(16)	(73)
Other-than-temporary credit impairment on investment securities ("OTTI")	(63)	(323)	260	(80)
Bank-owned life insurance	170	174	(4)	(2)
Fair value adjustment on cash flow hedge	146	(294)	440	(150)
Unexercised warrant liability fair value adjustment	2	158	(156)	(99)
Other income	153	398	(245)	(62)
Total	$5,450	$5,204	$246	5 %

Total other income was $2.9 million and $2.8 million for the three months ended June 30, 2013 and June 30, 2012, respectively. For the comparable six-month periods, total other income was $5.5 million in 2013 and $5.2 million in 2012. For the three-month comparable periods, increases in fees and service charges and a net gain on the sale of securities offset a reduction in the fair value of unexercised warrants and lower other income. The increase in income for the comparable six-month period reflects higher fees and service charges, lower credit impairment on impaired investment securities, and a positive adjustment on hedge fair values. These offset lower gains on security sales, a negative adjustment on the value of unexercised warrants and lower other income.

Fees and service charges earned on deposit, trust and investment accounts continue to be the Company’s primary sources of other income. Fees and service charges in the first six months of 2013 increased by $385,000 from the comparable 2012 period as changes in the Company's deposit account pricing and increased investment service income offset reductions in overdraft fee income.

Loan related fee income was down modestly from the same period last year, as a result of weaker mortgage refinance activity. Low mortgage rates, government refinance programs and improvements in the housing market continue to drive relatively high levels of activity in this area.

The Company recognized $203,000 in gains on the sale of securities during the first six months of 2013 as it repositioned some of its investment portfolio to reduce price risk. This more than offset a smaller credit loss impairment on impaired securities for the period. The Company also recorded a positive $146,000 fair value adjustment related to a cash flow hedge on one of the Company's trust preferred obligations. The negative $323,000 adjustment in 2012 resulted from the loss of hedge effectiveness on the instrument and is being recovered as the hedge reaches maturity later in 2013. The Company also recognized a small fair value adjustment taken on the Company's unexercised warrant liability. This liability was created by the issuance of three-year warrants for 1,700,000 shares, and on a reverse-split adjusted basis, 170,000 shares, to investors as part of the Company's January 2012 capital raise and must be fair-valued every quarter. As such, there are likely to be fluctuating adjustments in future periods.

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BOLI income was down slightly from the prior year as yields declined modestly and the Company did not purchase or liquidate BOLI assets. Other non-interest income totaled $153,000 for the six-month period, compared to $398,000 for the comparable prior period. The reductions reflect continued decreases in the Company's secured card contract as this contract terminated in the first quarter of 2013. The Company is seeking to replace the lost income from this contract with other card or payment-based initiatives.

Operating Expenses.

The following table details dollar amount and percentage changes of certain categories of other expense for the three and six month periods ended June 30, 2013 and June 30, 2012.

Other Expense - Three Months Ended	June 30, 2013	June 30, 2012	Change	Percent Change
	(Dollars in thousands)			
Salaries and employee benefits	$4,283	3,871	412	11 %
Occupancy expense	1,521	1,623	(102)	(6)%
Advertising	180	168	12	7 %
Fees and service charges	656	629	27	4 %
Printing, postage and supplies	173	300	(127)	(42)%
Legal and accounting	471	396	75	19 %
FDIC assessment	165	308	(143)	(46)%
OREO operations(1)	32	120	(88)	(73)%
Other expense	739	807	(68)	(8)%
Total	$8,220	8,222	(2)	— %

Other Expense - Six Months Ended	June 30, 2013	June 30, 2012	Change	Percent Change
	(Dollars in thousands)			
Salaries and employee benefits	$8,458	8,006	452	6 %
Occupancy expense	3,045	3,307	(262)	(8)%
Advertising	294	280	14	5 %
Fees and service charges	1,273	1,250	23	2 %
Printing, postage and supplies	390	601	(211)	(35)%
Legal and accounting	812	746	66	9 %
FDIC assessment	351	621	(270)	(43)%
OREO operations(1)	143	224	(81)	(36)%
Other expense	1,632	1,485	147	10 %
Total	$16,398	16,520	(122)	(1)%

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

Operating expense for both the second quarter of 2013 and the second quarter of 2012 totaled $8.2 million. Lower occupancy, printing, supply, FDIC assessment, OREO and other expense offset increased salary and employee benefit expense. For the comparable six month periods of 2013 and 2012, operating expense was down $122,000 from $16.5 million to $16.4 million. Decreases in occupancy, printing, supply, FDIC assessment and OREO expenses offset higher compensation and other expense.

At $8.5 million, compensation and benefits expense increased modestly from the same six-month period in 2012. After large staff reductions in prior years, staffing levels stabilized over the past year, and the compensation increase reflects higher commission and bonus income, and the payment of severance and other one-time expenses in the second quarter of 2013. Although the Company has largely completed its staff restructuring efforts, it continues to evaluate opportunities to improve staff efficiency while positioning itself for balance sheet growth.

Occupancy and technology expenses decreased $262,000 from the prior six-month period, reflecting lower depreciation, software and rent expense. The Company continues to review asset and software purchases carefully and re-negotiate contracts to further lower expense in this area. It also completed a conversion of its core data processing system during the second quarter of 2013, which it anticipates will result in significant savings in future years.

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Advertising expense and fees and service charges were up modestly from the prior period, while reductions in mailed statements, leased printing equipment and office supply usage have lowered printing, postage and supply expenses. Legal and accounting fees increased modestly over last year as a result of consulting services associated with the Company's data processing conversion.

FDIC expenses decreased significantly over the same six-month period last year because of changes in the FDIC assessment formula and a lower assessment rate.

OREO expenses decreased $81,000 over the prior year reflecting lower OREO activity. Other expenses increased $147,000 from the same six-month period in 2012, primarily as a result of increased operational losses relating to one electronic banking fraud incident and the settlement of claims for losses incurred on several mortgage loans that had been sold several years ago. The increase in operating losses offset decreases in insurance, armored car and telecommunications expense.

Annualized operating expense as a percentage of average assets was 3.50% and 3.49% for the six-month periods ending June 30, 2013 and June 30, 2012, respectively. The Company’s efficiency ratio (noninterest expense divided by the sum of net interest income and non-interest income) was 80.8% for the six months ended June 30, 2013, compared to 80.1% for the comparable period one year ago. With economic conditions likely to remain challenging in the near future, the Company continues to develop and implement additional efficiency and cost-cutting efforts.

Income Tax Provision.

For the three and six month periods ended June 30, 2013 and June 30, 2012, respectively, the Company recorded no income tax provision. In each of these periods, the Company generated positive net income before income taxes, but recorded no provision as it offset current income against carryforward losses from prior years. The effective tax rates were 0.0% for each of these periods. The Company maintained a net deferred tax asset of $15.1 million and $12.3 million as of June 30, 2013 and December 31, 2012, net of a valuation allowance of $7.5 million and $8.5 million, respectively. The increase in the deferred tax asset at June 30, 2013 from prior periods reflected the potential tax impacts associated with a reduction in the fair value of the Company's investments available for sale during the quarter.

Intermountain uses an estimate of future earnings, future reversal of taxable temporary differences, and tax planning strategies to determine whether it is more likely than not that the benefit of the deferred tax asset will be realized. At June 30, 2013, Intermountain assessed whether it was more likely than not that it would realize the benefits of its deferred tax asset. Intermountain determined that the negative evidence associated with a three-year cumulative loss for the period ended December 31, 2011, and challenging economic conditions continued to outweigh the positive evidence. Therefore, Intermountain maintained the valuation allowance of $7.5 million against its deferred tax asset at June 30, 2013. The Company analyzes the deferred tax asset on a quarterly basis and may increase the allowance or release a portion or all of this allowance depending on actual results and estimates of future profitability.

In conducting its valuation allowance analysis, the Company developed an estimate of future earnings to determine both the need for a valuation allowance and the size of the allowance. In conducting this analysis, management has assumed economic conditions will continue to be challenging in 2013, followed by gradual improvement in the ensuing years. As such, its estimates include lower credit losses in 2013 and ensuing years as the Company’s loan portfolio continues to turn over. It also assumes: (1) a compressed net interest margin in 2013 and 2014, with gradual improvement in future years, as the Company is able to convert some of its cash position to higher yielding instruments; and (2) reductions in operating expenses as credit costs abate and its other cost reduction strategies continue.

The completion of the $47.3 million capital raise in January 2012 triggered Internal Revenue Code Section 382 limitations on the amount of tax benefit from net operating loss carryforwards that the Company can utilize annually, because of the level of investment by several of the larger investors. This could impact the amount and timing of the release of the valuation allowance, largely depending on the level of market interest rates and the fair value of the Company’s balance sheet at the time the offering was completed. The evaluation of this impact is still being completed and will likely not be known until its 2012 tax return is finalized later in 2013. Based on its preliminary analysis, the Company believes that it should be able to recapture most or all of its tax benefit from the net operating loss carryforwards in the 20-year carryforward period, even given the Section 382 limitations. As with other future estimates, the Company cannot guarantee these future results.

Financial Position

Assets. At June 30, 2013, Intermountain's assets were $930.6 million, down $41.6 million from $972.1 million at December 31, 2012. The decrease in assets reflected reductions in available-for-sale investments and cash used to reduce various deposit liabilities.

Investments. Intermountain's investment portfolio at June 30, 2013 was $281.8 million, a decrease of $15.4 million, or 0.5% from the December 31, 2012 balance of $297.3 million. The decrease was primarily due to reductions in the fair value of the

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available-for-sale investment portfolio as a result of rising market rates, and the Company's efforts to reposition some of the portfolio to reduce price risk from further potential rate increases. Management remains cautious about the volatile investment environment and is working to further shorten the duration of its available-for-sale investment portfolio. As of June 30, 2013, the balance of the unrealized loss on investment securities, net of federal income taxes, was $641,000, compared to an unrealized gain at December 31, 2012 of $3.5 million. The decrease reflected the negative impact on the value of the portfolio resulting from an approximate one percent increase in market interest rates.

The Company currently holds one residential MBS, with a current face value totaling $5.8 million that is determined to have an other than temporary impairments (“OTTI”), as detailed in the table below (dollars in thousands):

	Principal Balance	Fair Value	Unrealized (Loss) Gain	Cumulative OTTI Credit Loss Recorded in Income	Cumulative OTTI Impairment Loss Recorded in OCI
Security 1	5,808	4,757	558	(901)	(864)

As indicated in the table above, impairment for this security totals $1.8 million, of which $902,000 has been recorded as credit loss impairment in income and the remainder in other comprehensive income. The Company recorded additional credit loss impairment for this security in the first half of 2013 of $63,000. At this time, the Company anticipates holding the security until its value is recovered or until maturity, and will continue to adjust its net income (loss) and other comprehensive income (loss) to reflect potential future credit loss impairments and the security’s market value. The Company calculated the credit loss charges against earnings each quarter by subtracting the estimated present value of future cash flows on the securities from their amortized cost less the total of previous credit loss impairment at the end of each period. The Company sold the only other security for which OTTI had been recognized in the first quarter of 2013, recognizing a $40,000 gain on the sale.

Loans Receivable. At June 30, 2013 net loans receivable totaled $522.7 million, up $2.0 million from $520.8 million at December 31, 2012.

The following table sets forth the composition of Intermountain’s loan portfolio at the dates indicated. Loan balances exclude deferred loan origination costs and fees and allowances for loan losses.

	June 30, 2013		December 31, 2012	
	Amount	%	Amount	%
	(Dollars in thousands)			
Commercial loans	$113,699	21.4 %	$121,307	23.0 %
Commercial real estate loans	190,816	36.0	186,844	35.4
Commercial construction loans	10,085	1.9	3,832	0.7
Land and land development loans	30,895	5.8	31,278	5.9
Agriculture loans	94,831	17.8	85,967	16.3
Multifamily loans	15,271	2.9	16,544	3.1
Residential real estate loans	58,309	11.0	60,020	11.3
Residential construction loans	2,004	0.4	940	0.2
Consumer loans	8,843	1.7	9,626	1.8
Municipal loans	6,029	1.1	12,267	2.3
Total loans	530,782	100.0 %	528,625	100.0 %
Allowance for loan losses	(8,042)		(7,943)	
Deferred loan fees, net of direct origination costs	—		86	
Loans receivable, net	$522,740		$520,768	
Weighted average interest rate	5.28 %		5.28 %	

Increases in commercial real estate and commercial construction offset decreases in commercial loans, as commercial project activity heated up in the Company's market areas. Commercial customers remain cautious about expansion, however, and are relying more on cash than in years prior to the recession. Increases in agricultural loans reflect seasonal activity, while the reduction in municipal loans resulted from the payoff of a larger municipal construction loan as the project was completed. Most other loan categories were relatively stable from year end.

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The commercial portfolio is diversified by industry with a variety of small business customers that have held up relatively well during this economic downturn. As soft economic conditions continue, however, the Company continues to experience some stress in this portfolio. Most of the commercial credits are smaller, however, and Intermountain carries a higher proportion of SBA and USDA guaranteed loans than many of its peers, reducing the overall risk in this portfolio. As noted above, commercial customers continue to watch economic conditions very closely, but have recently shown more optimism and stronger borrowing demand. Quality commercial borrowers are highly sought after, resulting in keen competition and competitive pricing for these customers.

The commercial real estate portfolio is also well-diversified and consists of a mix of owner and non-owner occupied properties, with relatively few truly non-owner-occupied investment properties. The Company has lower concentrations in this segment than most of its peers, and has underwritten these properties cautiously. In particular, it has limited exposure to speculative investment office buildings and retail strip malls, two of the higher risk segments in this category. This portfolio continues to perform well with relatively low delinquency and loss rates. The Company believes it has some opportunity to increase prudent lending in this area, but again competition is keen for these borrowers.

Most agricultural markets continue to perform well. In fact, the sector has performed so well that many of its best borrowing customers are using excess cash generated over the past couple of years to reduce their overall borrowing position. As noted above, though, risks appear to be increasing in this portfolio as prices moderate, input costs rise and concerns increase over adequate water supplies in 2014.

The residential and consumer portfolios consist primarily of first and second mortgage loans, unsecured loans to individuals, and auto, boat and RV loans. These portfolios have generally performed well with limited delinquencies and defaults. While these loans have generally been underwritten with relatively conservative loan-to-values and strong debt-to-income ratios, the continued soft economy and lower home prices have resulted in some losses in this loan type.

Economic conditions and property values are demonstrating slow but steady improvement in most of the Company's markets. Management expects that credit losses will continue to decrease, but that new borrowing activity will also remain muted over the next few quarters.

Geographic Distribution

As of June 30, 2013, the Company’s loan portfolio by loan type and geographical market area was:

Loan Portfolio by Location	North Idaho — Eastern Washington	Magic Valley Idaho	Greater Boise Area	E. Oregon, SW Idaho, excluding Boise	Other	Total	% of Loan type to total loans	
	(Dollars in thousands)							
Commercial loans	$81,190	$4,981	$7,810	$15,858	$3,860	$113,699	21.4	%
Commercial real estate loans	130,795	10,229	8,491	19,483	21,818	190,816	36.0	%
Commercial construction loans	5,085	—	5,000	—	—	10,085	1.9	%
Land and land development loans	20,623	1,547	6,655	1,349	721	30,895	5.8	%
Agriculture loans	1,902	3,633	18,925	65,836	4,535	94,831	17.8	%
Multifamily loans	10,087	150	4,984	30	20	15,271	2.9	%
Residential real estate loans	41,939	3,103	3,799	6,967	2,501	58,309	11.0	%
	1,214	—	193	597	—	2,004	0.4	%

Residential construction loans								
Consumer loans	5,256	782	610	1,875	320	8,843	1.7	%
Municipal loans	4,678	1,351	—	—	—	6,029	1.1	%
Total	$302,769	$25,776	$56,467	$111,995	$33,775	$530,782	100.0	%
Percent of total loans in geographic area	57.0 %	4.9 %	10.6 %	21.1 %	6.4 %	100.0 %		
Percent of total loans where real estate is the primary collateral	69.8 %	61.4 %	56.2 %	40.1 %	77.8 %	62.2 %		

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As of December 31, 2012, the Company's loan portfolio by loan type and geographical market area was:

Loan Portfolio by Location	North Idaho — Eastern Washington	Magic Valley Idaho	Greater Boise Area	E. Oregon, SW Idaho, excluding Boise	Other	Total	% of Loan type to total loans
	(Dollars in thousands)						
Commercial loans	$87,387	$4,606	$9,252	$13,852	$6,210	$121,307	23.0 %
Commercial real estate loans	123,451	11,330	10,651	18,895	22,517	186,844	35.4 %
Commercial construction loans	503	—	2,819	—	510	3,832	0.7 %
Land and land development loans	20,710	1,748	6,298	1,500	1,022	31,278	5.9 %
Agriculture loans	1,670	3,269	16,886	60,479	3,663	85,967	16.3 %
Multifamily loans	10,396	151	5,947	30	20	16,544	3.1 %
Residential real estate loans	41,624	3,734	3,808	7,083	3,771	60,020	11.3 %
Residential construction loans	387	—	240	313	—	940	0.2 %
Consumer loans	5,716	1,026	517	2,053	314	9,626	1.8 %
Municipal loans	10,880	1,387	—	—	—	12,267	2.3 %
Total	$302,724	$27,251	$56,418	$104,205	$38,027	$528,625	100.0 %
Percent of total loans in geographic area	57.3 %	5.2 %	10.7 %	19.7 %	7.1 %	100.0 %	
Percent of total loans where real estate is the primary collateral	65.5 %	67.4 %	54.5 %	43.3 %	74.8 %	60.7 %	

As indicated, 57.0% of the Company's loans are in northern Idaho and eastern Washington, with the next highest percentage in the rural markets of southwest Idaho outside of Boise. Economic trends and real estate valuations are showing consistent improvement in all the Company's markets now, after a four-year decline. The southwest Idaho and Magic Valley markets are largely agricultural areas which have not seen levels of price appreciation or depreciation as steep as other areas over the last few years. The "Other" category noted above largely represents loans made to local borrowers where the collateral is located outside the Company's communities. The mix in this category is relatively diverse, with the highest proportions in Oregon, Washington, California, Nevada and Arizona, but no single state comprising more than 2.8% of the total loan portfolio.

Participation loans where Intermountain purchased part of the loan and was not the lead bank totaled $15.8 million at June 30, 2013. $4.3 million of the total is a condominium project in Boise that is currently classified, but is being managed very closely, and for which no loss is expected. The remaining loans are all within the Company's footprint and management believes they do not present significant risk at this time.

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The following table sets forth the composition of Intermountain's loan originations for the periods indicated.

	Three Months Ended June 30,			Six Months Ended June 30,		
	2013	2012	% Change	2013	2012	% Change
	(Dollars in thousands)					
Commercial loans	$16,209	$20,568	(21.2)%	$23,168	$29,103	(20.4)%
Commercial real estate loans	18,995	13,601	39.7	22,119	14,382	53.8
Commercial construction loans	1,257	400	214.3	6,641	854	677.6
Land and land development loans	2,000	2,060	(2.9)	2,203	2,526	(12.8)
Agriculture loans	10,229	18,817	(45.6)	19,096	31,474	(39.3)
Multifamily loans	—	1,191	—	—	1,191	(100.0)
Residential real estate loans	20,782	24,434	(14.9)	36,234	45,081	(19.6)
Residential construction loans	887	473	87.5	1,493	789	89.2
Consumer	873	694	25.8	1,640	1,223	34.1
Municipal	220	2,823	(92.2)	377	3,120	(87.9)
Total loans originated	$71,452	$85,061	(16.0)%	$112,971	$129,743	(12.9)%
Renewed Loans	$59,441	$46,762	27.1 %	$104,869	$105,673	27.1 %

Overall, 2013 origination activity continues to reflect the muted borrowing demand from virtually all sectors in the current environment, as commercial borrowers remain cautious and agricultural customers experience strong cash flows, reducing their borrowing needs. Activity is strongest in the real estate sectors, as record low interest rates continue to spur refinance activity and encourage stronger borrowers to expand. Overall origination activity is likely to improve from earlier totals as the economy rebounds, but will still be under pressure from slow employment growth and aggressive industry competition for strong borrowers. The Company has chosen not to purchase loan pools or pursue out-of-market participation loans in order to maintain a more conservative credit position. Management believes that those banks that have low-cost funding structures and pursue loan growth through strong relationship networks will perform relatively better in the long run.

Office Properties and Equipment. Office properties and equipment decreased $45,000 from year end to $35.4 million at June 30, 2013 as the Company continued to limit new purchase activity.

Other Real Estate Owned. Other real estate owned decreased by $439,000, or 8.9% from year end. The Company sold five properties totaling $817,000 in the first six months of 2013, had net negative valuation adjustments of $16,000 and added two properties totaling $394,000. A total of three properties remained in the OREO portfolio at quarter end, consisting of $4.5 million in land and land development.

Overall, the Company's current OREO portfolio is lower than most of its peer group and management anticipates additional reductions in the total in the coming year. The following table details OREO activity during the first six months of 2013 and 2012.

Other Real Estate Owned Activity

	2013	2012
	(Dollars in thousands)	
Balance, beginning of period, January 1	$4,951	$6,650
Additions to OREO	394	694
Proceeds from sale of OREO	(817)	(2,047)
Valuation Adjustments in the period(1)	(16)	(30)
Balance, end of period, June 30	$4,512	$5,267

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

Intangible Assets. Intangible assets now consist only of a small core deposit intangible derived from prior acquisitions that is amortizing down as time progresses.

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Deferred Tax Asset. At June 30, 2013, the Company's deferred tax asset, net of the valuation allowance noted above, totaled $15.1 million, up from $12.3 million at year end 2012. The increase in the deferred tax asset at June 30, 2013 from prior periods reflected the potential tax impacts associated with a reduction in the fair value of the Company's investments available for sale during the quarter. At June 30, 2013, Intermountain assessed whether it was more-likely-than-not that it would realize the benefits of its deferred tax asset. Intermountain determined that the negative evidence associated with a three-year cumulative loss for the period ending December 31, 2011, and the continued soft economic conditions outweighed the positive evidence. Therefore, Intermountain maintained a valuation allowance of $7.5 million against its deferred tax asset. See the Income Tax Provision section above for more information.

BOLI and Other Assets. Bank-owned life insurance ("BOLI") and other assets decreased to $19.2 million at June 30, 2013 from $19.6 million at year end, 2012. The decrease reflected lower prepaid expenses, accrued interest receivable and other miscellaneous assets.

Deposits. Total deposits decreased $49.4 million to $699.5 million at June 30, 2013 from $748.9 million at December 31, 2012. The decrease from the fourth quarter reflects additional reductions in higher-cost brokered and retail CDs, the release of savings balances from the termination of a contract to maintain savings balances securing credit cards held by another company, and seasonal tax and operating payments made by clients. The Company continues to focus on managing relationship customers closely, lowering its cost of funds, and moving CD customers seeking higher yields into our investment products. It anticipates a rebound in non-interest bearing demand deposits in the latter half of the year based on seasonal factors. Overall, transaction account deposits comprised 78.2% of total deposits at June 30, 2013, up from 75.8% at the prior year end.

The following table sets forth the composition of Intermountain's deposits at the dates indicated.

	June 30, 2013			December 31, 2012		
	Amount	% of total deposits		Amount	% of total deposits	
	(Dollars in thousands)					
Non-interest bearing demand accounts	$224,472	32.0	%	$254,979	34.0	%
Interest bearing demand accounts	100,490	14.4	%	99,623	13.3	%
Money market 0.0% to 4.02%	222,161	31.8	%	213,155	28.5	%
Savings and IRA 0.0% to 4.91%	64,390	9.2	%	75,788	10.1	%
Certificate of deposit accounts (CDs)	37,495	5.4	%	43,535	5.8	%
Jumbo CDs	50,362	7.2	%	56,228	7.5	%
Brokered CDs	—	—	%	5,200	0.7	%
CDARS CDs to local customers	151	—	%	426	0.1	%
Total deposits	$699,521	100.0	%	$748,934	100.0	%
Weighted average interest rate on certificates of deposit		1.20	%		1.28	%
Core Deposits as a percentage of total deposits (1)		92.6	%		91.7	%
Deposits generated from the Company's market area as a % of total deposits		100.0	%		99.3	%

(1) Core deposits consist of non-interest bearing checking, money market checking, savings accounts, and certificate of deposit accounts of less than $100,000 (excluding public deposits).

The Company's strong local, core funding base, high percentage of checking, money market and savings balances and careful management of its wholesale CD funding provide lower-cost, more reliable funding to the Company than many of its peers and add to the liquidity strength of the Bank. Maintaining the local funding base at a reasonable cost remains a critical priority for the Company's management and production staff.

Deposits by location are as follows (dollars in thousands):

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Explanation of Responses:

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Deposits by Location	June 30, 2013	% of total deposits	December 31, 2012	% of total deposits	June 30, 2012	% of total deposits
North Idaho — Eastern Washington	$358,681	51.3 %	$ 372,772	49.9 %	$337,540	46.5 %
Magic Valley Idaho	64,964	9.3 %	72,254	9.6 %	68,184	9.4 %
Greater Boise Area	62,068	8.9 %	67,585	9.0 %	62,770	8.6 %
Southwest Idaho — Oregon, excluding Boise	162,243	23.2 %	172,509	23.0 %	154,551	21.3 %
Administration, Secured Savings	51,565	7.3 %	63,814	8.5 %	102,964	14.2 %
Total	$699,521	100.0 %	$ 748,934	100.0 %	$726,009	100.0 %

The Company attempts to, and has been successful in balancing loan and deposit balances in each of the market areas it serves. Northern Idaho and eastern Washington deposits currently exceed those in the Company’s southern Idaho and eastern Oregon markets, reflecting the longer presence it has had in these markets. The Company’s deposit market share has grown significantly over the past ten years, and it now ranks third in overall market share in its core markets. During the first quarter of 2013, the contract that the Company maintained to hold the savings deposit balances for secured credit cards was terminated after a number of extensions. The overall impact of this termination will reduce savings balances by approximately $13 million, most of which has already been released. The Company has long anticipated this termination and absorbed the decrease by reducing its current cash position.

Borrowings. Deposit accounts are Intermountain’s primary source of funds. Intermountain also relies upon advances from the Federal Home Loan Bank of Seattle, repurchase agreements and other borrowings to supplement its funding, reduce its overall cost of funds, and to meet deposit withdrawal requirements. These borrowings totaled $106.1 million and $97.3 million at June 30, 2013 and December 31, 2012, respectively. The increase from year end reflects fluctuations in municipal repurchase activity.

Interest Rate Risk

The results of operations for financial institutions may be materially and adversely affected by changes in prevailing economic conditions, including rapid changes in interest rates, declines in real estate market values and the monetary and fiscal policies of the federal government. Like all financial institutions, Intermountain’s net interest income and its NPV (the net present value of financial assets, liabilities and off-balance sheet contracts), are subject to fluctuations in interest rates. Intermountain utilizes various tools to assess and manage interest rate risk, including an internal income simulation model that seeks to estimate the impact of various rate changes on the net interest income and net income of the bank. This model is validated by comparing results against various third-party estimations. Currently, the model and third-party estimates indicate that Intermountain’s interest rate profile is neutral to slightly asset-sensitive. An asset-sensitive bank generally sees improved net interest income and net income in a rising rate environment, as its assets reprice more rapidly and/or to a greater degree than its liabilities. The opposite is true in a falling interest rate environment. When market rates fall, an asset-sensitive bank tends to see declining income. The Company has become less asset-sensitive over the preceding year, as many of its variable-rate loans have hit contractual floors and the duration of its liability portfolio has shortened.

The current highly unusual market and rate conditions have heightened interest rate risk for the Company and most other financial institutions. Continued very low market rates, keen competition for quality borrowers, rapid mortgage prepayments, and high demand for fixed income securities is negatively impacting net interest income and could continue to do so for a relatively long period of time. In addition, market values on the Company's available-for-sale securities portfolio are susceptible to potentially large negative impacts in the future should market rates increase, as they did in the second quarter of this year.

To minimize the long-term impact of fluctuating interest rates on net interest income, Intermountain promotes a loan pricing policy of utilizing variable interest rate structures that associates loan rates to Intermountain’s internal cost of funds and to the nationally recognized prime or London Interbank Offered ("LIBOR") lending rates. While this strategy has had adverse impacts in the current unusually low rate environment, the approach historically has contributed to a relatively consistent interest rate spread over the long-term and reduces pressure from borrowers to renegotiate loan terms during periods of falling interest rates. Intermountain currently maintains over fifty percent of its loan portfolio in variable interest rate assets.

Additionally, the extent to which borrowers prepay loans is affected by prevailing interest rates. When interest rates increase, borrowers are less likely to prepay loans. When interest rates decrease, borrowers are generally more likely to prepay loans. Prepayment speeds have been unusually high over the past few years and particularly in the past year, as borrowers refinanced into lower rates, paid down debt to improve their financial position, or liquidated assets as part of problem loan work-out strategies.

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Prepayments may affect the levels of loans retained in an institution's portfolio, as well as its net interest income. Prepayments on loans and mortgage-backed securities are likely to continue at a higher pace over the next year as a result of continuing low interest rates and government-sponsored refinance programs, but did slow in the latter part of the second quarter as mortgage rates increased about one percent.

On the liability side, Intermountain generally seeks to manage its interest rate risk exposure by maintaining a relatively high percentage of non-interest bearing demand deposits, interest-bearing demand deposits, savings and money market accounts. These instruments tend to lag changes in market rates and may afford the Bank more protection in increasing interest rate environments than other short-term borrowings, but can also be changed relatively quickly in a declining rate environment. The Bank utilizes various deposit pricing strategies and other borrowing sources to manage its rate risk. As noted above, the duration of the Company's liabilities has shortened considerably over the past two years, as customers have preferred shorter-term deposit products and the Company has not replaced longer-term brokered and wholesale funding instruments as they have come due. This presents some additional risk in a rising rate environment. The Company is evaluating various alternatives to mitigate this risk, including the assumption of some longer-term fixed wholesale funding and the use of off-balance sheet interest rate swaps and caps.

Intermountain maintains an asset and liability management program intended to manage net interest income through interest rate cycles and to protect its income by controlling its exposure to changing interest rates. As part of this program, Intermountain uses a simulation model designed to measure the sensitivity of net interest income and net income to changes in interest rates. This simulation model is designed to enable Intermountain to generate a forecast of net interest income and net income given various interest rate forecasts and alternative strategies. The model is also designed to measure the anticipated impact that prepayment risk, basis risk, customer maturity preferences, volumes of new business and changes in the relationship between long-term and short-term interest rates have on the performance of Intermountain. The results of modeling indicate that the estimated impact of changing rates on net interest income in a 100 and 300 basis point upward adjustment are within the guidelines established by management. The estimated impact of changing rates on net interest income in a 100 basis point downward adjustment in market interest rates is just outside of the Company's guidelines over a 12-month period, but within guidelines over a 24-month forward looking period. The impacts of changing rates on the Company's modeled economic value of equity ("EVE") are also within the Company's guidelines for rising rates and just outside of guidelines for falling rates. The Company has chosen not to take action to resolve the falling rate guideline exceptions, because of the current low level of market rates and the negative impact actions it could take would have on its exposure to rising rates. The current scenario analysis for net income has been impacted by the relatively low current and prior year operating results of the Company, which increases the impact of both upward and downward adjustments on the percentage increase and decrease. Given this, management has tended to place more reliance on the net interest income and economic value of equity modeling.

The continuing low level of market rates, and particularly the Federal Funds target range of between 0.00 and 0.25% is unprecedented. This has created significant challenges for interest rate risk management over the past several years, and is reflected in the significant reduction in net interest income during this period. Given the unusual current market rate conditions and the potential for either a prolonged low-rate environment or rapidly rising rates at some point in the future, Company management continues to refine and expand its interest rate risk modeling, and is responding to the results by proactively managing both its on-balance sheet and off-balance sheet positions. Based on the results of its continuing evaluations, management believes that its interest rate risk position is relatively neutral, but that current economic and market conditions heighten overall interest rate risk for both the Company and the industry as a whole.

Intermountain is continuing to pursue strategies to manage the level of its interest rate risk while increasing its long-term net interest income and net income: 1) through the origination and retention of a diversified mix of variable and fixed-rate consumer, business, commercial real estate, and residential loans which generally have higher yields than alternative investments; 2) by prudently managing its investment portfolio to provide relative earnings stability in the face of changing rate environments; and 3) by increasing the level of its core deposits, which are generally a lower-cost, less rate-sensitive funding source than wholesale borrowings. There can be no assurance that Intermountain will be successful implementing any of these strategies or that, if these strategies are implemented, they will have the intended effect of reducing interest rate risk or increasing net interest income.

Liquidity and Sources of Funds

As a financial institution, Intermountain's primary sources of funds from assets include the collection of loan principal and interest payments, cash flows from various investment securities, and sales of loans, investments or other assets. Liability financing sources consist primarily of customer deposits, repurchase obligations with local customers, advances from FHLB Seattle and correspondent bank borrowings.

Deposits decreased to $699.5 million at June 30, 2013 from $748.9 million at December 31, 2012, as decreases in non-interest bearing demand, savings and CD balances offset increases in interest-bearing demand and money market balances. The decrease

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from December reflects additional planned reductions in higher-cost brokered and retail CDs, the release of savings balances from the termination of a contract to maintain savings balances securing credit cards held by another company, and normal seasonal tax and operating payments made by clients. Repurchase agreements increased by $8.9 million, reflecting increased municipal tax collections and repurchase activity. The liability reductions were partially offset by a decrease in investments available-for-sale of $23.6 million from year end, as the Company repositioned a part of this portfolio. The combined impact of liability and other asset changes resulted in an overall decrease of $26.5 million in the Company’s unrestricted cash position from December 31, 2012 to June 30, 2013.

During the six months ended June 30, 2013, cash provided by investing activities consisted primarily of sales of investments securities and principal payments on mortgage-back securities and loan receivables, which more than offset the purchase of available-for-sale investment securities. During the same period, cash used by financing activities consisted primarily of decreases in checking, savings and CD deposit balances.

Securities sold subject to repurchase agreements totaled $85.6 million at June 30, 2013. These borrowings are required to be collateralized by investments with a market value exceeding the face value of the borrowings. Under certain circumstances, Intermountain could be required to pledge additional securities or reduce the borrowings.

Intermountain’s credit line with FHLB Seattle provides for borrowings up to a percentage of its total assets subject to general collateralization requirements. At June 30, 2013, the Company’s FHLB Seattle credit line represented a total borrowing capacity of approximately $128.9 million, of which $5.5 million was being utilized. Additional collateralized funding availability at the Federal Reserve totaled $22.9 million. Both of these collateral secured lines could be expanded more with the placement of additional collateral. Overnight-unsecured borrowing lines have been established at US Bank, Wells Fargo Bank, and Pacific Coast Bankers Bank (“PCBB”). At June 30, 2013, the Company had approximately $45.0 million of overnight funding available from its unsecured correspondent banking sources.

Intermountain and its subsidiary Bank maintain an active liquidity monitoring and management plan, and have worked aggressively over the past several years to expand sources of alternative liquidity. Given continuing volatile economic conditions, the Bank has taken additional protective measures to enhance liquidity, including issuance of new capital, movement of funds into more liquid assets and increased emphasis on relationship deposit-gathering efforts. Because of its relatively low reliance on non-core funding sources and the additional efforts undertaken to improve liquidity discussed above, management believes that the subsidiary Bank’s current liquidity risk is moderate and manageable.

Management continues to monitor its liquidity position carefully and conducts periodic stress tests to evaluate future potential liquidity concerns in the subsidiary Bank. It has established contingency plans for potential liquidity shortfalls. Longer term, the Company intends to fund asset growth primarily with core deposit growth, and it has initiated a number of organizational changes and programs to spur this growth when needed.

Liquidity for the parent Company depends substantially on dividends from the Bank. The other primary sources of liquidity for the Parent Company are capital or borrowings. Management projects that available resources will be sufficient to meet the parent Company’s projected funding needs.

Capital Resources

Intermountain’s total stockholders’ equity was $113.0 million at June 30, 2013, compared with $114.4 million at December 31, 2012, as the negative impact of higher market rates on the value of the Company's investment portfolio offset improved earnings. Stockholders’ equity and tangible stockholders' equity was 12.1% of total assets at June 30, 2013 and 11.7% at December 31, 2012, respectively. Tangible common equity as a percentage of tangible assets was 9.3% at June 30, 2013 and 9.0% for December 31, 2012.

At June 30, 2013, Intermountain had unrealized losses of $641,000 (including cumulative OTTI recognized through other comprehensive income), net of related income taxes, on investments classified as available-for-sale, as compared to unrealized gains of $3.5 million, net of related income taxes, on investments classified as available-for-sale at December 31, 2012. The change from an unrealized gain on investments to an unrealized loss during this time period reflected the negative impact of an approximately one percent increase in market interest rates on the value of the Company's securities portfolio.

During 2012, the Company conducted two separate successful capital raises, issuing a mix of voting and non-voting stock and warrants. See Note 7 in the Notes to Consolidated Financial Statements for additional information on these raises. The Company has used the $50.3 million net proceeds after expenses from both offerings to strengthen its balance sheet, reinvest in its communities and for other general corporate purposes, and may use some of the proceeds, subject to regulatory approval, to redeem its Series A Preferred Stock held by the U.S. Treasury as part of the TARP Capital Purchase Program.

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On December 19, 2008, the Company entered into a definitive agreement with the U.S. Treasury. Pursuant to this Agreement, the Company sold 27,000 shares of Series A Preferred Stock, no par value, having a liquidation amount equal to $1,000 per share, including a warrant (“The Warrant”) to purchase 653,226 shares, and on a reverse-split adjusted basis, 65,323 shares of the Company’s common stock, no par value, to the U.S. Treasury. The Warrant has a 10-year term and has an exercise price, subject to anti-dilution adjustments, equal to $62.00 per share of common stock on a reverse-split adjusted basis.

The Series A Preferred Stock qualifies as Tier 1 capital and provides for cumulative dividends at a rate of 5% per year, for the first five years, and 9% per year thereafter. The Series A Preferred Stock may be redeemed with the approval of the U.S. Treasury in the first three years with the proceeds from the issuance of certain qualifying Tier 1 capital or after three years at par value plus accrued and unpaid dividends. The original terms governing the Series A Preferred Stock prohibited the Company from redeeming the shares during the first three years other than from proceeds received from a qualifying equity offering. However, subsequent legislation was passed that would now permit the Company to redeem the shares of Series A Preferred Stock upon the approval of Treasury and the Company’s primary federal regulator.

As discussed in Note 7 in the Notes to Consolidated Financial Statements above, the Company executed a 10-for-1 reverse stock split, effective October 5, 2012, which reduced the number of voting and non-voting common shares outstanding and shares that would be issued if the outstanding warrants are exercised.

Intermountain issued and has outstanding $16.5 million of Trust Preferred Securities. The indenture governing the Trust Preferred Securities limits the ability of Intermountain under certain circumstances to pay dividends or to make other capital distributions. The Trust Preferred Securities are treated as debt of Intermountain. These Trust Preferred Securities can be called for redemption by the Company at 100% of the aggregate principal plus accrued and unpaid interest. See Note 6 of “Notes to Consolidated Financial Statements.”

Intermountain and the Bank are required by applicable regulations to maintain certain minimum capital levels and ratios of total and Tier 1 capital to risk-weighted assets, and of Tier I capital to average assets. Intermountain and the Bank plan to maintain their capital resources and regulatory capital ratios through the retention of earnings and the management of the level and mix of assets. At June 30, 2013, Intermountain exceeded the minimum published regulatory capital requirements to be considered “well-capitalized” pursuant to Federal Financial Institutions Examination Council “FFIEC” regulations.

	Actual			Capital Requirements			Well-Capitalized Requirements		
	Amount	Ratio		Amount	Ratio		Amount	Ratio	
Total capital (to risk-weighted assets):									
The Company	$124,829	20.93	%	$47,724	8	%	$59,654	10	%
Panhandle State Bank	117,572	19.72	%	47,700	8	%	59,626	10	%
Tier I capital (to risk-weighted assets):									
The Company	117,365	19.67	%	23,862	4	%	35,793	6	%
Panhandle State Bank	110,112	18.47	%	23,850	4	%	35,775	6	%
Tier I capital (to average assets):									
The Company	117,365	12.90	%	36,379	4	%	45,474	5	%
Panhandle State Bank	110,112	12.12	%	36,555	4	%	45,443	5	%

Off Balance Sheet Arrangements and Contractual Obligations

The Company, in the conduct of ordinary business operations routinely enters into contracts for services. These contracts may require payment for services to be provided in the future and may also contain penalty clauses for the early termination of the contracts. The Company is also party to 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. Management does not believe that these off-balance sheet arrangements have a material current effect on the Company’s financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources, but there is no assurance that such arrangements will not have a future effect. There have not been any material changes to the Off Balance Sheet Arrangements or Contractual Obligations since the filing of the 2012 10-K.

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New Accounting Pronouncements

The “Summary of Significant Accounting Policies, Recently Issued Accounting Pronouncements” in the Notes to the Consolidated Financial Statements, which is included in Note 10 of this Report, discusses new accounting pronouncements adopted by Intermountain and the expected impact of accounting pronouncements recently issued or proposed.

Forward-Looking Statements

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, but are not limited to, statements about our plans, objectives, expectations and intentions that are not historical facts, such as the statements in this report regarding expected or projected growth, asset quality and losses, other income and operating expenses, and other statements identified by words such as “expects,” “anticipates,” “intends,” “plans,” “believes,” “will likely," “should,” “projects,” “seeks,” “estimates” similar meaning. These forward-looking statements are based on current beliefs and expectations of management and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change. In addition to the factors set forth in the sections titled “Risk Factors,” “Business” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations”, as applicable, in this report, the following factors, among others, could cause actual results to differ materially from the anticipated results:

- deterioration in economic conditions that could result in increased loan and lease losses;
- inflation and interest rate levels, and market and monetary fluctuations;
- changes in market interest rates and spreads, which could adversely affect our net interest income and profitability, and the value of our investment securities portfolio;
- trade, monetary and fiscal policies and laws, including interest rate and income tax policies of the federal government;
- growth and acquisition strategies;
- applicable laws and regulations and legislative or regulatory changes, including the ultimate financial and operational burden of financial regulatory reform legislation and related regulations;
- the restrictions imposed on participants in the Troubled Asset Relief Program (“TARP”) Capital Purchase Program, including the impact of executive compensation restrictions, which may affect our ability to retain and recruit executives in competition with other firms who do not operate under those restrictions;
- our ability to attract new deposits and loans and leases;
- competitive market pricing factors;
- the effects of any adverse regulatory action;
- our ability to raise capital or incur debt on reasonable terms;
- the risks associated with lending and potential adverse changes in credit quality;
- risks associated with concentrations in real estate-related loans;
- declines in real estate values supporting loan collateral;
- increased loan delinquency rates;
- the timely development and acceptance of our new products and services;
- the willingness of customers to substitute competitors’ products and services for our products and services;
- technological and management changes;
- our ability to recruit and retain key management and staff;
- changes in estimates and assumptions used in financial accounting;
- our critical accounting policies and the implementation of such policies;

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- potential interruption or breach in security of our systems;
- lower-than-expected revenue or cost savings or other issues in connection with mergers and acquisitions;
- changes in consumer spending, saving and borrowing habits;
- the strength of the United States economy in general and the strength of the local economies in which Intermountain conducts its operations;
- stability of funding sources and continued availability of borrowings;
- our success in gaining regulatory approvals, when required;
- results of regulatory examinations that could restrict growth; and
- our success at managing the risks involved in the foregoing.

Please take into account that forward-looking statements speak only as of the date of this report. We do not undertake any obligation to publicly correct or update any forward-looking statement whether as a result of new information, future events or otherwise.

Item 3 —Quantitative and Qualitative Disclosures About Market Risk

There have not been any material changes to the information set forth under the caption “Item 7A. Quantitative and Qualitative Disclosures about Market Risk” included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2012.

Item 4 —Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures: Intermountain’s management, with the participation of Intermountain’s principal executive officer and principal financial officer, has evaluated the effectiveness of Intermountain’s disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the “Exchange Act”)) as of the end of the period covered by this report. Based on such evaluation, Intermountain’s principal executive officer and principal financial officer have concluded that, as of the end of such period, Intermountain’s disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by Intermountain in the reports that it files or submits under the Exchange Act.

(b) Changes in Internal Control over Financial Reporting: In the six months ended June 30, 2013, there were no changes in Intermountain’s internal control over financial reporting that materially affected, or are reasonably likely to materially affect, Intermountain’s internal control over financial reporting.

PART II — Other Information

Item 1. LEGAL PROCEEDINGS

Intermountain and Panhandle are parties to various claims, legal actions and complaints in the ordinary course of business. In Intermountain’s opinion, all such matters are adequately covered by insurance, are without merit or are of such kind, or involve such amounts, that unfavorable disposition would not have a material adverse effect on the consolidated financial position or results of operations of Intermountain.

Item 1A. RISK FACTORS

The Company believes that there have been no material changes from risk factors previously discussed under “Part I - Item A - Risk Factors” in our Form 10-K for the year ended December 31, 2012 (the “2012 Annual Report”), except updated factor following this paragraph. In addition to the other information set forth in this report, you should carefully consider the risks and uncertainties discussed in our 2012 Annual Report. These factors, as well as those that we do not know about, that we currently believe are immaterial, or that we have not predicted, could materially and adversely affect our business, financial condition, liquidity, results of operations and capital position, and could cause our actual results to differ materially from our historical results or the results contemplated by the forward-looking statements contained in this report.

Fluctuating interest rates could adversely affect our profitability and the market value of our investment securities portfolio.

Our profitability is dependent to a large extent upon our net interest income, which is the difference between the interest earned on loans, securities and other interest-earning assets and interest paid on deposits, borrowings, and other interest-bearing liabilities. Because of the differences in maturities and re-pricing characteristics of our interest-earning assets and interest-bearing

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liabilities, changes in interest rates do not produce equivalent changes in interest income earned on interest-earning assets and interest paid on interest-bearing liabilities. Accordingly, fluctuations in interest rates could adversely affect our net interest margin, and, in turn, our profitability. We manage our interest rate risk within established guidelines and generally seek an asset and liability structure that insulates net interest income from large deviations attributable to changes in market rates. However, our interest rate risk management practices may not be effective in a highly volatile rate environment.

The current unusual interest rate environment poses particular challenges. Market rates are extremely low right now and the Federal Reserve Board has indicated that it will likely maintain low short-term interest rates for the foreseeable future. The Federal Reserve is also purchasing significant amounts of Treasury and Agency bonds in the public market, lowering yields on these instruments and on most other longer-term fixed income instruments as well. This extended period of low rates, when combined with keen competition for high-quality borrowers, may cause additional downward pressure on the yield on the Company's loan and investment portfolios. In addition, low rates accelerate prepayment rates on our mortgage-backed securities, which also negatively impacts yields. Since the Company's cost of interest-bearing liabilities is already at record lows, the impact of decreasing asset yields may have a more adverse impact on the Company's net interest income.

In addition, the current low level of market rates poses risk to the value of our investment securities portfolio, and as a result, our capital levels. Any increase in rates, and particularly a significant increase, will have a negative impact on the market value of the Company's available-for-sale investment securities portfolio. Since this portfolio is carried at market value on the balance sheet, a reduction in its value will reduce the Company's capital levels. Alternatively, attempts to mitigate this risk by shortening the duration of the portfolio or purchasing more variable rate securities will have an adverse impact on current earnings, because current yields are low.

Item 2 —Unregistered Sales of Equity Securities and Use of Proceeds

Not applicable.

Item 3 —Defaults Upon Senior Securities

Not applicable.

Item 4 —Mine Safety Disclosures

Not applicable.

Item 5 — Other Information

Not applicable.

Item 6 —Exhibits

Exhibit No.	Exhibit
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes Oxley Act of 2002.
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes Oxley Act of 2002.
32	Certification of Chief Executive Officer and 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*	The following financial information from the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2013 is formatted in XBRL: (i) the Unaudited Consolidated Balance Sheets, (ii) the Unaudited Consolidated Statements of Operations, (iii) the Unaudited Consolidated Statements of Changes in Cash Flows, (iv) the Unaudited Consolidated Statements of Comprehensive Income (Loss),and (v) the Notes to Unaudited Consolidated Financial Statements, tagged as blocks of text.
*	Furnished herewith

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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 thereunto duly authorized.

	INTERMOUNTAIN COMMUNITY BANCORP (Registrant)
August 12, 2013 Date	By: /s/ Curt Hecker Curt Hecker President and Chief Executive Officer
August 12, 2013 Date	By: /s/ Doug Wright Doug Wright Executive Vice President and Chief Financial Officer

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