NORTHWEST BANCORPORATION INC
Form 10-Q
May 03, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended March 31 2013 for the quarterly period ended March 31, 2013.**

or

¨ **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from to .**

Commission File Number: 000-24151

NORTHWEST BANCORPORATION, INC.

(Exact name of registrant as specified in its charter)

Washington	**91-1574174**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

421 W. Riverside Avenue, Spokane, WA 99201-0403
(Address of principal executive offices) (Zip Code)
Registrant s telephone number, including area code: **(509) 456-8888**

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

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

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

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	x

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

As of April 30, 2013, there were 3,089,957 shares of the registrant s common stock outstanding.

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NORTHWEST BANCORPORATION, INC.

FORM 10-Q

For the three-month period ended March 31, 2013

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited).

NORTHWEST BANCORPORATION, INC.

Consolidated Statements of Financial Condition

($ in thousands, except per share data)

	March 31, 2013	December 31, 2012
ASSETS		
Cash and due from banks	$ 12,845	$ 19,984
Interest bearing deposits	11,274	5
Total cash and cash equivalents	24,119	19,989
Time deposits held for investment	2,895	3,140
Securities available for sale, at fair value	69,406	73,556
Federal Home Loan Bank stock, at cost	1,227	1,239
Loans receivable, net of allowance for loan losses $5,324 and $5,260	264,234	266,078
Loans held for sale	3,574	6,484
Premises and equipment, net	16,469	16,455
Accrued interest receivable	1,503	1,420
Foreclosed real estate, net	2,289	4,430
Bank owned life insurance	4,069	4,039
Other assets	2,037	2,039
TOTAL ASSETS	$ 391,822	$ 398,869
LIABILITIES		
Deposits	$ 334,394	$ 333,104
Federal funds purchased	0	1,255
Accrued interest payable	686	640
Borrowed funds	12,952	13,055
Other liabilities	5,417	12,899
Total liabilities	353,449	360,953
SHAREHOLDERS EQUITY		
Preferred stock Series A Cumulative Perpetual; $1,000 liquidation value; 10,500 shares authorized and issued	10,397	10,367
Preferred stock Series B Cumulative Perpetual; $1,000 liquidation value; 525 shares authorized and issued	537	540
Common stock, no par value, authorized 5,000,000 shares; issued and outstanding 3,089,957	26,125	26,096
Accumulated deficit	(476)	(912)
Accumulated other comprehensive income	1,790	1,825
Total shareholders equity	38,373	37,916
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 391,822	$ 398,869

See accompanying notes.

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NORTHWEST BANCORPORATION, INC.

Consolidated Statements of Operations

($ in thousands, except per share data)

	Three months ended March 31,	
	2013	2012
Interest and dividend income:		
Loans receivable, including fees	$ 3,787	$ 3,834
Investment securities	434	543
Other	16	6
Total interest and dividend income	4,237	4,383
Interest expense:		
Deposits	448	681
Borrowed funds	88	100
Total interest expense	536	781
Net interest income	3,701	3,602
Provision for loan losses	244	600
Net interest income after provision for loan losses	3,457	3,002
Noninterest income:		
Service charges on deposits	256	325
Gain from sale of loans, net	504	276
Gain on investment securities	106	20
Other noninterest income	422	482
Total noninterest income	1,288	1,103
Noninterest expense:		
Salaries and employee benefits	1,838	1,771
Occupancy and equipment	353	329
Depreciation and amortization	308	304
Advertising and promotion	84	65
FDIC assessments	128	119
Loss on foreclosed real estate, net	81	0
Other noninterest expense	1,107	1,070
Total noninterest expense	3,899	3,658
Income before income taxes	846	447
Income tax expense	241	122
NET INCOME	$ 605	$ 325
Preferred stock dividends and discount accretion, net	169	169
Net income applicable to common shares	$ 436	$ 156
Earnings per common share - basic	$ 0.14	$ 0.05

Earnings per common share - diluted	$ 0.14	$ 0.05
Weighted average shares outstanding - basic	3,089,957	3,084,548
Weighted average shares outstanding - diluted	3,141,777	3,122,070

See accompanying notes.

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NORTHWEST BANCORPORATION, INC.

Consolidated Statements of Comprehensive Income

($ in thousands)

	Three months ended March 31,	
	2013	2012
Net income	$ 605	$ 325
Other comprehensive income (loss), net of tax:		
Unrealized holding gains on securities available for sale arising during period	35	13
Reclassification adjustment for net gains on securities available for sale included in net income	(70)	(13)
Other comprehensive income (loss)	(35)	0
COMPREHENSIVE INCOME	$ 570	$ 325

See accompanying notes.

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NORTHWEST BANCORPORATION, INC.

Consolidated Statements of Changes in Shareholders Equity

($ in thousands)

	Preferred Stock	Common Stock	Accumulated Deficit	Accumulated Other Comprehensive Income	Total
Balance, December 31, 2011	$ 10,802	$ 25,984	$ (1,599)	$ 1,212	$ 36,399
Net income	0	0	1,364	0	1,364
Stock issued to directors	0	31	0	0	31
Dividends on preferred stock	0	0	(572)	0	(572)
Accretion of preferred stock discount, net	105	0	(105)	0	0
Equity-based compensation expense	0	81	0	0	81
Other comprehensive income (loss)	0	0	0	613	613
Balance, December 31, 2012	10,907	26,096	(912)	1,825	37,916
Net income	0	0	605	0	605
Dividends on preferred stock	0	0	(142)	0	(142)
Accretion of preferred stock discount, net	27	0	(27)	0	0
Equity-based compensation expense	0	29	0	0	29
Other comprehensive income (loss)	0	0	0	(35)	(35)
Balance, March 31,2013	$ 10,934	$ 26,125	$ (476)	$ 1,790	$ 38,373

See accompanying notes.

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NORTHWEST BANCORPORATION, INC.

Consolidated Statements of Cash Flows

($ in thousands)

	Three months ended March 31, 2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 605	$ 325
Adjustments to reconcile net income to cash provided by operating activities:		
Amortization of securities premiums and discounts, net	292	202
Gain on sale or call of securities, net	(106)	(20)
Accretion of net deferred loan fees	(40)	(22)
Provision for loan losses	244	600
Origination of loans held for sale	(18,767)	(11,925)
Proceeds from sales of loans held for sale	22,182	12,243
Gain on sale of loans held for sale, net	(504)	(276)
Depreciation and amortization	308	304
Provision for losses on foreclosed real estate	230	0
Gain on sale of foreclosed real estate, net	(149)	0
Increase in cash surrender value of bank owned life insurance	(30)	(30)
Decrease in deferred income taxes, net	612	122
Equity-based compensation expense	29	22
Change in assets and liabilities:		
Accrued interest receivable	(83)	(177)
Other assets	(593)	(30)
Accrued interest payable	46	15
Other liabilities	(7,627)	109
Net cash (used) provided by operating activities	(3,351)	1,462
CASH FLOWS FROM INVESTING ACTIVITIES		
Time deposits held for investment:		
Proceeds from maturities	245	0
Securities available for sale:		
Purchases	0	(8,035)
Proceeds from maturities, calls and principal payments	2,590	1,768
Proceeds from sales	1,322	585
Proceeds from redemption of FHLB stock	12	0
Net increase (decrease) in loans	1,641	(6,297)
Purchase of premises and equipment	(321)	(76)
Proceeds from sale of foreclosed real estate	2,060	161
Net cash provided (used) by investing activities	7,549	(11,894)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	1,290	11,411
Net decrease in federal funds purchased	(1,255)	0
Repayment of borrowed funds	(103)	(446)
Net cash (used) provided by financing activities	(68)	10,965

NET CHANGE IN CASH AND CASH EQUIVALENTS	4,130	533
Cash and cash equivalents, beginning of period	19,989	27,285
Cash and cash equivalents, end of period	$ 24,119	$ 27,818
SUPPLEMENTAL DISCLOSURES:		
Cash paid during the year for:		
Interest	$ 490	$ 766
Income taxes	0	0
Noncash investing and financing activities:		
Decrease in fair value of securities available for sale, net	(35)	0
Acquisition of real estate in settlement of loans	0	458
Preferred stock dividend accrued but not paid	142	143

See accompanying notes.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 Summary of Significant Accounting Policies

Basis of presentation and consolidation: The consolidated financial statements include the accounts of Northwest Bancorporation, Inc. (the Company), its wholly-owned subsidiary, Inland Northwest Bank (the Bank), and the Bank s wholly-owned subsidiary, Northwest Property LLC. All material intercompany balances and transactions have been eliminated in consolidation.

The foregoing unaudited interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X as promulgated by the Securities and Exchange Commission (the SEC). Accordingly, these financial statements do not include all of the disclosures required by accounting principles generally accepted in the United States of America (GAAP) for complete financial statements. These unaudited interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the accompanying notes as disclosed in the annual report on Form 10-K for the year ended December 31, 2012.

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities known to exist as of the date the financial statements are published, and the reported amounts of revenues and expenses during the reporting period. Uncertainties with respect to such estimates and assumptions are inherent in the preparation of the Company s consolidated financial statements; accordingly, it is possible that the actual results could differ from these estimates and assumptions, which could have a material effect on the reported amounts of the Company s consolidated financial position and results of operations.

In preparing these financial statements, the Company has evaluated events and transactions subsequent to March 31, 2013 for potential recognition or disclosure. In management s opinion, all accounting adjustments necessary to accurately reflect the financial position and results of operations on the accompanying financial statements have been made. The adjustments include normal and recurring accruals considered necessary for a fair and accurate presentation. The results for interim periods are not necessarily indicative of results for the full year or any other interim period. Certain reclassifications of prior period amounts have been made to conform to current classifications. These reclassifications had no effect on retained earnings or net income as previously presented.

Segment reporting: The Company has not established any independent business activity apart from acting as the parent company of the Bank. The Company and the Bank are managed as a single entity and not by departments or lines of business. Based on management s analysis, no department or line of business meets the criteria established in Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) 280, *Segment Reporting*, for reporting of selected information about operating segments.

New accounting pronouncements: In addition to other established accounting policies, the following is a discussion of recent accounting pronouncements:

ASU No. 2011-04 Fair Value Measurement (Topic 820) Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS. The provisions of Accounting Standards Update (ASU) No. 2011-04 result in a consistent definition of fair value and common requirements for the measurement of and disclosure about fair value between U.S. GAAP and International Financial Reporting Standards (IFRS). The changes to U.S. GAAP as a result of ASU No. 2011-04 are as follows: (1) the concepts of highest and best use and valuation premise are only relevant when measuring the fair value of nonfinancial assets; (2) U.S. GAAP currently prohibits application of a blockage factor in valuing financial instruments with quoted prices in active markets. ASU No. 2011-04 extends that prohibition to all fair value measurements; (3) an exception is provided to the basic fair value measurement principles for an entity that holds a group of financial assets and financial liabilities with offsetting positions in market

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risks or counterparty credit risk that are managed on the basis of the entity s net exposure to either of those risks. This exception allows the entity, if certain criteria are met, to measure the fair value of the net asset or liability position in a manner consistent with how market participants would price the net risk position; (4) aligns the fair value measurement of instruments classified within an entity s shareholders equity with the guidance for liabilities; and (5) disclosure requirements have been enhanced for Level 3 fair value measurements to disclose quantitative information about unobservable inputs and assumptions used, to describe the valuation processes used by the entity, and to qualitatively describe the sensitivity of fair value measurements to changes in unobservable inputs and the interrelationships between those inputs. In addition, entities must report the level in the fair value hierarchy of items that are not measured at fair value in the statement of condition but whose fair value must be disclosed. The Company adopted the provisions of ASU No. 2011-04 effective January 1, 2012. The fair value measurement provisions of ASU No. 2011-04 had no impact on the Company s consolidated financial statements. The notes to consolidated financial statements include the enhanced disclosures required by ASU No. 2011-04.

ASU No. 2011-11 Balance Sheet (Topic 210) Disclosures about Offsetting Assets and Liabilities. This update was issued jointly by the FASB and International Accounting Standards Board (IASB) to require specific disclosures about netting arrangements for assets and liabilities. Entities are now required to disclose both gross information and net information about both instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting arrangement. The scope of this update includes derivatives, sale and repurchase agreements and reverse sale and repurchase agreements, and securities borrowing and securities lending arrangements. The objective of this disclosure is to facilitate comparison between those entities that prepare their financial statements on the basis of U.S. GAAP and those that prepare their financial statements on the basis of International Financial Reporting Standards (IFRS), as well as to enable users of the financial statements to understand the effect of those arrangements on its financial position. This amendment was effective for the interim period beginning on or after January 1, 2013 and did not have a material impact on the Company s consolidated financial statements.

ASU No. 2012-02, Intangibles Goodwill and Others (Topic 350) Testing Indefinite-Lived Intangibles for Impairment. ASU 2012-02, similar to ASU 2011-08, provided a qualitative assessment of determining if it is more likely than not that impairment has occurred, to establish the extent to which further testing is required. ASU 2012-02 became effective for the Company on January 1, 2013, and did not have a material impact on its consolidated financial statements.

ASU No. 2013-02, Comprehensive Income (Topic 220) Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. The amendment requires an entity to provide additional information about reclassifications out of accumulated other comprehensive income. ASU 2013-02 is effective for reporting periods beginning after December 15, 2013, with early adoption permitted, and is not expected to have a material impact on the Company s consolidated financial statements.

ASU No. 2013-04, Liabilities (Topic 405) Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting. ASU 2013-04 provides guidance for the recognition, measurement, and disclosure of such obligations. ASU 2013-04 is effective for fiscal years beginning after December 15, 2013, and is not expected to have a material impact on the Company s consolidated financial statements.

Note 2 Investments in Securities

Securities held by the Bank have been classified in the consolidated statements of financial condition according to management s intent, and all securities were classified as available for sale at March 31, 2013 and December 31, 2012.

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The amortized cost of securities and their approximate fair values at March 31, 2013 and December 31, 2012, were as follows:

	March 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	($ in thousands)			
U.S. government agency securities	$ 4,124	$ 42	$ 0	$ 4,166
State and municipal securities	24,088	1,441	(17)	25,512
Corporate debt obligations	11,195	579	(6)	11,768
SBA participation certificates	11,184	460	0	11,644
Mortgage backed securities	4,453	90	(2)	4,541
Collateralized mortgage obligations	11,649	183	(57)	11,775
	$ 66,693	$ 2,795	$ (82)	$ 69,406

	December 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	($ in thousands)			
U.S. government agency securities	$ 5,140	$ 37	$ 0	$ 5,177
State and municipal securities	24,688	1,577	(22)	26,243
Corporate debt obligations	11,886	583	(27)	12,442
SBA participation certificates	11,461	459	0	11,920
Mortgage backed securities	4,970	103	0	5,073
Collateralized mortgage obligations	12,646	143	(88)	12,701
	$ 70,791	$ 2,902	$ (137)	$ 73,556

As of March 31, 2013, there were 14 securities with unrealized losses. The following tables show the investments gross unrealized losses and fair values, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position:

	March 31, 2013					
	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	($ in thousands)					
State and municipal securities	$ 1,411	$ 16	$ 261	$ 1	$ 1,672	$ 17
Corporate debt obligations	244	6	0	0	244	6
Mortgage backed securities	1,311	2	0	0	1,311	2
Collateralized mortgage obligations	3,569	54	843	3	4,412	57
	$ 6,535	$ 78	$ 1,104	$ 4	$ 7,639	$ 82

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	December 31, 2012					
	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	($ in thousands)					
State and municipal securities	$ 1,069	$ 22	$ 0	$ 0	$ 1,069	$ 22
Corporate debt obligations	973	25	248	2	1,221	27
Collateralized mortgage obligations	4,754	75	1,179	13	5,933	88
	$ 6,796	$ 122	$ 1,427	$ 15	$ 8,223	$ 137

Management has evaluated the above securities and does not believe that any individual unrealized loss as of March 31, 2013 and December 31, 2012, represents an other-than-temporary impairment (OTTI). The decline in fair market value of these securities was generally due to changes in market interest rates or the widening of market spreads since purchase and was not related to any known decline in the creditworthiness of the issuer. Management does not intend to sell any impaired securities nor does available evidence suggest it is more likely than not that management will be required to sell any impaired securities. Management believes there is a high probability of collecting all contractual amounts due, because the majority of the securities in the Bank s investment portfolio are backed by government agencies or government-sponsored enterprises. However, a recovery in value may not occur for some time, if at all, and may be delayed for greater than the one-year time horizon or perhaps even until maturity.

Scheduled maturities of securities available for sale at March 31, 2013, are listed below according to contractual maturity date. Expected or actual maturities may differ from contractual maturities, because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
	($ in thousands)	
Due within one year	$ 2,972	$ 3,031
Due after one year through five years	16,354	17,238
Due after five years through ten years	16,919	17,689
Due after ten years	30,448	31,448
	$ 66,693	$ 69,406

At March 31, 2013 and December 31, 2012, securities with an amortized cost of $5.6 million and $7.0 million were pledged to secure public deposits and for other purposes as required or permitted by law. The market value for these securities was $5.8 million at March 31, 2013 and $7.1 million at December 31, 2012.

Five securities were sold in the three-month period ended March 31, 2013, resulting in gross gains of $106 thousand. One security was sold in the three-month period ended March 31, 2012, resulting in a gross gain of $20 thousand.

Management reviews investment securities on an ongoing basis for the presence of OTTI, taking into consideration current market conditions, fair value in relationship to cost, extent and nature of the change in fair value, issuer rating changes and trends, whether we intend to sell a security or if it is likely that we will be required to sell the security before recovery of the amortized cost basis of the investment, which may be maturity, and other factors. The evaluation includes a consideration of the risk profile specific to each class of security; for example, the contractual terms of U.S. government agency securities do not permit the issuer to settle the securities at a price less than par. The Bank s securities portfolio does not include any private label mortgage backed securities or investments in trust preferred securities.

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For debt securities, if we intend to sell the security or it is likely that we will be required to sell the security before recovering its cost basis, the entire impairment loss would be recognized in earnings as an OTTI. If we do not intend to sell the security and it is not likely that we will be required to sell the security but we do not expect to recover the entire amortized cost basis of the security, only the portion of the impairment loss representing credit losses would be recognized in earnings. The credit loss on a security is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected. Projected cash flows are discounted by the original or current effective interest rate depending on the nature of the security being measured for potential OTTI. The remaining impairment related to all other factors, the difference between the present value of the cash flows expected to be collected and fair value, is recognized as a charge to other comprehensive income (OCI). Impairment losses related to all other factors are presented as separate categories within OCI. If there is an indication of additional credit losses, the security is re-evaluated in accordance with the procedures described above.

At March 31, 2013, the Bank owned $1.2 million of stock of the Federal Home Loan Bank of Seattle (FHLB). As a condition of membership in the FHLB, the Bank is required to purchase and hold a certain amount of FHLB stock, which is based, in part, upon the outstanding principal balance of advances from the FHLB and is calculated in accordance with the Capital Plan of the FHLB. FHLB stock has a par value of $100 per share, is carried at cost, and is subject to impairment testing per ASC 320-10-35.

Note 3 Loans Receivable and Allowance for Loan Losses

The Bank originates construction and land, commercial and multifamily real estate, commercial business, agricultural and consumer loans for portfolio investment. The Bank also originates residential mortgage loans intended for sale in the secondary market. Loans held for sale are stated at the lower of cost or estimated fair value determined on an aggregate basis. Any net unrealized losses on loans held for sale are recognized through a valuation allowance by charges to income. Loans receivable that have not been designated as held for sale are recorded at the principal amount outstanding. Deferred loan fees, net of costs, are amortized to maturity using the level-yield method.

Interest is accrued as earned unless management determines that the collectability of the loan or the unpaid interest is doubtful. Interest accruals are generally discontinued when loans become 90 days past due on scheduled payments. All previously accrued but uncollected interest is deducted from interest income upon transfer to nonaccrual status. Future collection of interest is included in interest income based upon an assessment of the likelihood that the loans will be repaid or recovered.

The following table presents the Bank s loan balances for the periods indicated:

	March 31, 2013	December 31, 2012
	($ in thousands)	
Real estate:		
Commercial	$ 143,764	$ 152,734
Construction and land development	20,504	21,923
Residential	31,516	26,641
Commercial and industrial	67,389	63,678
Consumer	6,868	6,742
	270,041	271,718
Allowance for loan losses	(5,324)	(5,260)
Net deferred loan fees	(483)	(380)
	$ 264,234	$ 266,078

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Loan origination/risk management: The Bank has lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies, nonperforming loans, and other potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions. In general, loans are underwritten after evaluating and understanding the borrower s ability to operate profitably and prudently and to repay their obligations as agreed. Cash flows of borrowers, however, may not be as expected, and the collateral securing these loans may fluctuate in value. Most loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and typically incorporate a personal guarantee. However, some short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers. In the case of loans secured by real estate, the properties are diverse in terms of type, but are concentrated to a large extent in the Bank s primary market area, which is Spokane County, Washington and Kootenai County, Idaho. This concentration may increase the Bank s exposure to adverse economic events that affect a single market or industry. Construction loans are generally based upon estimates of costs and value associated with the complete project with repayment substantially dependent on the success of the ultimate project such as sales of developed property or an interim loan commitment from the Bank until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions and the availability of long-term financing.

The Bank originates consumer loans utilizing an individualized underwriting process. To monitor and manage consumer loan risk, policies and procedures are developed and modified as needed. This activity, coupled with relatively small loan amounts that are spread across many individual borrowers, minimizes risk.

The Bank s internal audit department performs an independent review to validate the credit risk program on a periodic basis. Results of these reviews are presented to management and the Board of Directors. The loan review process complements and reinforces the risk identification and assessment decisions made by the Bank s loan officers and credit personnel, as well as the Bank s policies and procedures.

Past due and nonaccrual loans: The following table presents an age analysis of past due loans, segregated by class of loans:

	March 31, 2013					
	30-59 Days Past Due	60-89 Days Past Due	90 or More Days Past Due	Total Past Due	Current	Total Loans
	($ in thousands)					
Real estate:						
Commercial	$ 1,025	$ 0	$ 6,258	$ 7,283	$ 136,481	$ 143,764
Construction and land development	100	0	1,039	1,139	19,365	20,504
Residential	0	0	290	290	31,226	31,516
Commercial and industrial	32	0	90	122	67,267	67,389
Consumer	25	27	5	57	6,811	6,868
	$ 1,182	$ 27	$ 7,682	$ 8,891	$ 261,150	$ 270,041

	December 31, 2012					
	30-59 Days Past Due	60-89 Days Past Due	90 or More Days Past Due	Total Past Due	Current	Total Loans
	($ in thousands)					
Real estate:						
Commercial	$ 2,192	$ 0	$ 4,621	$ 6,813	$ 145,921	$ 152,734
Construction and land development	193	0	1,183	1,376	20,547	21,923
Residential	200	0	290	490	26,151	26,641
Commercial and industrial	683	0	169	852	62,826	63,678
Consumer	64	18	18	100	6,642	6,742

	$ 3,332	$ 18	$ 6,281	$ 9,631	$ 262,087	$ 271,718

No loans over 90 days past due were still on accrual status as of March 31, 2013 and December 31, 2012.

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Nonaccrual loans, segregated by class of loans, were as follows:

	March 31, 2013	December 31, 2012
	($ in thousands)	
Real estate:		
Commercial	$ 6,548	$ 6,324
Construction and land development	1,039	1,227
Residential	290	290
Commercial and industrial	90	169
Consumer	14	34
	$ 7,981	$ 8,044

If the Bank s nonaccrual loans had performed in accordance with their original contract terms, additional interest income of $120 thousand and $190 thousand would have been recognized for the three-month periods ended March 31, 2013 and 2012, respectively.

Impaired loans: Loans are considered impaired when, based on current information and events, it is improbable the Bank will be able to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. Impairment is evaluated in total for smaller-balance loans of a similar nature and on an individual loan basis for other loans. If a loan is impaired, a specific valuation allowance is allocated, if necessary, so that the loan is reported net, at the present value of estimated future cash flows using the loan s existing interest rate or at the fair value of collateral if repayment is expected solely from the collateral. Interest payments on impaired loans are applied to principal if the loan is on nonaccrual. Impaired loans, or portions thereof, are charged off if management determines them to be uncollectible. As of March 31, 2013 and December 31, 2012, the Bank s impaired loan balances were as follows:

	March 31, 2013				
	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance
			($ in thousands)		
Real estate:					
Commercial	$ 15,328	$ 10,611	$ 2,112	$ 12,723	$ 420
Construction and land development	1,041	145	0	145	0
Residential	1,137	319	388	707	155
Commercial and industrial	1,569	856	468	1,324	246
Consumer	84	18	34	52	9
	$ 19,159	$ 11,949	$ 3,002	$ 14,951	$ 830

	December 31, 2012				
	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance
			($ in thousands)		
Real estate:					
Commercial	$ 14,881	$ 10,061	$ 2,368	$ 12,429	$ 421
Construction and land development	1,400	317	0	317	0
Residential	822	321	71	392	70
Commercial and industrial	1,592	954	472	1,426	252
Consumer	105	22	53	75	14

	$ 18,800	$ 11,675	$ 2,964	$ 14,639	$ 757

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The average recorded investment in impaired loans and the related interest income recognized for cash payments received were as follows:

	Three months ended March 31, 2013		2012	
	Average Recorded Investment	Interest Income Recorded for Cash Payments Received	Average Recorded Investment	Interest Income Recorded for Cash Payments Received
	($ in thousands)			
Real estate:				
Commercial	$ 12,333	$ 87	$ 15,685	$ 248
Construction and land development	1,164	0	12,452	92
Residential	496	3	2,119	23
Commercial and industrial	1,383	20	1,282	20
Consumer	54	1	187	5
	$ 15,430	$ 111	$ 31,725	$ 388

Troubled debt restructuring (TDR): A troubled debt restructuring occurs when, due to a borrower s financial difficulties, the Bank grants a concession that it would not otherwise consider. The concession can take the form of an interest rate or principal reduction or an extension of payments of principal or interest, or both. Restructured loans are included in impaired loans until such time as the restructured loan performs according to the new terms for an acceptable duration, typically one year or longer depending on the circumstances specific to each loan; the interest rate at the time of restructure must also be at or above the market rate for a comparable loan. Restructured loans performing in accordance with their new terms are not included in nonaccrual loans unless there is uncertainty as to the ultimate collection of principal or interest. The recorded investment in restructured loans was as follows:

	March 31, 2013			December 31, 2012		
	Accruing Restructured Loans	Restructured Loans Included in Nonaccrual Loans	Total	Accruing Restructured Loans	Restructured Loans Included in Nonaccrual Loans	Total
	($ in thousands)					
Real estate:						
Commercial	$ 4,902	$ 3,164	$ 8,066	$ 4,926	$ 3,170	$ 8,096
Construction and land development	0	43	43	0	43	43
Residential	0	0	0	0	0	0
Commercial and industrial	502	0	502	508	0	508
Consumer	0	0	0	0	0	0
	$ 5,404	$ 3,207	$ 8,611	$ 5,434	$ 3,213	$ 8,647

For the three-month periods ended March 31, 2013 and 2012, the Bank recognized interest income of $76 thousand and $215 thousand, respectively, in connection with restructured accruing loans.

There were no troubled debt restructurings which occurred during the three-month periods ending March 31, 2013 and 2012.

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Troubled debt restructurings modified within the previous 12 months for which there was a declaration of default which remains unresolved during the three-month periods ending March 31, 2013 and 2012, were as follows:

	Three months ended March 31,			
	2013		2012	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
	($ in thousands)			
Real estate:				
Commercial	0	$ 0	0	$ 0
Construction and land development	1	43	1	272
Residential	0	0	0	0
Commercial and industrial	0	0	0	0
Consumer	0	0	0	0
	1	$ 43	1	$ 272

The Bank may declare a borrower to be in default when an event of default, such as a payment more than 30 days past due, has occurred and is not remedied in a reasonable amount of time. Restructured loans for which there was a declared and continuing default during the period are included in the calculation of the allowance for loan losses as deemed appropriate for each defaulted credit.

Credit Quality Indicators: The Bank utilizes a risk grading matrix to assign a risk grade to each loan. Loans are graded on a scale of 1 to 10. The ten risk rating categories can be generally described by the following groupings for non-homogeneous loans:

Pass/Watch These loans range from minimal credit risk to lower than average, but still acceptable, credit risk.

Special Mention A Special Mention loan has potential weaknesses that deserve management s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or the Bank s credit position at some future date. They contain unfavorable characteristics and are generally undesirable. Loans in this category are currently protected but are potentially weak and constitute an undue and unwarranted credit risk, but not to the point of a Substandard classification. A Special Mention loan has potential weaknesses such as inadequate working capital or underperformance compared to plan, which if not checked or corrected, weaken the asset or inadequately protect the Bank s position at some future date. Unlike a Substandard credit, there should be a reasonable expectation that these temporary issues will be corrected in a reasonable period of time, without liquidation of assets and within the normal course of business.

Substandard A Substandard loan is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of Substandard loans, does not have to exist in individual assets classified as Substandard. Loans are classified as Substandard when they have unsatisfactory characteristics causing unacceptable levels of risk, such as cash flow trends that are of a magnitude as to jeopardize current and future payments, or prolonged unsuccessful business operations or economic trends to which the borrower has not been able to adjust. The likely need to liquidate assets to correct the problem, rather than repayment from successful operations is a key distinction between Special Mention and Substandard.

Doubtful/Loss Loans classified as Doubtful have all the same weaknesses inherent in loans classified as Substandard with the added characteristic that the weaknesses make collection or liquidation in full highly questionable and improbable, on the basis of currently existing facts, conditions and values. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors, which may work towards strengthening of the loan, classification as a Loss (and immediate charge-off) is deferred until a more exact status may be determined. Pending factors include proposed merger, acquisition, liquidation procedures, capital injection, and perfection of liens on additional collateral and refinancing plans. A Loss rating is assigned to loans considered uncollectible and of such little value that the continuance as an active Bank asset is not warranted. This rating does not mean that the loan has no recovery or salvage value, but rather that the loan should be charged off now, even though partial or full recovery may be possible in the future.

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The following table summarizes the Bank s internal risk rating by loan class:

	March 31, 2013				
	Pass/Watch	Special Mention	Substandard	Doubtful/Loss	Total Loans
			($ in thousands)		
Real estate:					
Commercial	$ 115,617	$ 15,760	$ 12,387	$ 0	$ 143,764
Construction and land development	18,772	1,587	145	0	20,504
Residential	29,687	982	847	0	31,516
Commercial and industrial	62,434	3,063	1,892	0	67,389
Consumer	6,781	29	58	0	6,868
	$ 233,291	$ 21,421	$ 15,329	$ 0	$ 270,041

	December 31, 2012				
	Pass/Watch	Special Mention	Substandard	Doubtful/Loss	Total Loans
			($ in thousands)		
Real estate:					
Commercial	$ 124,718	$ 15,809	$ 12,207	$ 0	$ 152,734
Construction and land development	19,976	1,630	317	0	21,923
Residential	24,690	1,101	850	0	26,641
Commercial and industrial	58,263	3,320	2,095	0	63,678
Consumer	6,632	28	82	0	6,742
	$ 234,279	$ 21,888	$ 15,551	$ 0	$ 271,718

Allowance for Loan Losses: The allowance for loan losses is a reserve established through a provision for loan losses charged to expense. The allowance for loan losses represents management s best estimate of probable losses within the existing loan portfolio. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The Bank s allowance for loan loss methodology is based on guidance from ASC Topic 310, *Receivables*, and ASC Topic 450, *Contingencies*. The Bank s process for determining the appropriate level of the allowance for loan losses is designed to account for credit deterioration as it occurs. The amount of the provision reflects not only the necessary increases in the allowance for loan losses related to newly identified criticized loans, but it also reflects actions taken related to other loans including, among other things, any necessary increases or decreases in required allowances for specific loans or loan pools.

The level of the allowance reflects management s continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management s judgment, should be charged off. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Bank s control, including, among other things, the performance of the Bank s loan portfolio, the economy, changes in interest rates and the view of regulatory authorities toward loan classifications.

The Bank s allowance for loan losses consists of two elements: (1) general valuation allowances determined in accordance with ASC Topic 450 based on historical loan loss experience for similar loans with similar characteristics and trends, adjusted as necessary to reflect the impact of current economic conditions and other qualitative risk factors both internal and external to the Bank; and (2) specific valuation allowances determined in accordance with ASC Topic 310 based on probable losses on specific loans.

The allowances established for expected losses on specific loans are based on a regular analysis and evaluation of problem loans. Loans are classified based on an internal credit risk grading process that evaluates, among other things: (1) the borrower s ability to repay; (2) the financial condition of the borrower; (3) the quality of the borrower s management; (4) the underlying collateral, if any; (5) the strength of the guarantors; (6) the structure of the loan; (7) the quality, availability and timeliness of financial information; and (8) the industry and economic environment in which the borrower operates. This analysis is performed at the relationship manager level for all commercial loans. When a loan has been classified as Substandard or worse, a special assets officer analyzes the loan to determine whether the loan is impaired and, if impaired, the need to specifically allocate a portion of the allowance for loan losses to the loan. Impairment is determined in accordance with ASC Topic 310, which specifies that a loan is impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement, including principal and interest, as scheduled in the loan agreement. Indicators of impairment include evidence the borrower is experiencing problems such as operating losses, marginal working capital, inadequate cash flow, or business interruptions; loans that are secured with collateral that is no longer readily marketable or that is subject to deterioration in realizable value; loans to borrowers in industries that are currently experiencing economic instability; and other factors. If a loan is determined to be impaired, the balance is segregated from the pool of loans and a specific valuation allowance is established by measuring the impairment. Most loans are collateral dependent and as such, impairment is measured by comparing the loan balance with the current market value of the collateral, less selling and holding costs. A deficiency is recorded as a specific valuation allowance, and is included as a component of the allowance for loan losses. If the deficiency on a collateral dependent loan remains for more than 90 days, it is charged off.

General valuation allowances are calculated based on the historical loss experience of specific types of loans, plus general economic conditions and other qualitative internal and external risk factors. The Bank calculates historical loss ratios for pools of similar loans with similar characteristics based on the proportion of actual charge-offs experienced compared to the total population of loans in the pool. The historical loss ratios are periodically updated based on actual charge-off experience. A historical valuation allowance is established for each pool of similar loans based upon the product of the historical loss ratio and the total dollar amount of the loans in the pool.

Added to the Bank s historical loss experience are metrics of general economic conditions and other qualitative risk factors both internal and external to the Bank. The risk factors believed by management to be most relevant to the loan portfolio are: (1) current unemployment levels in our operating areas, as compared to normal levels of unemployment; (2) the current level of past due and nonaccrual loans as compared to levels during years of low charge-offs; (3) a consideration of the trend of median home prices and foreclosure rates as they relate to construction and land loans; (4) a consideration of the trend of new housing starts and absorption rates as they relate to construction loans; (5) commercial and apartment vacancy rates and their relationship to multi-family and other commercial real estate loans; and (6) the change in the average risk rating of our portfolio, by loan type, as it relates to charge-off experience. Each component is used to calculate a risk factor, which is input into a general reserve matrix along with the historical loss rates discussed above. The total combined risk factor for each loan type is then applied to the loan balances that remain after impaired loans are segregated from the pool to determine an appropriate general valuation allowance. Management evaluates the change each one of these components has on the quality of the loan portfolio on a quarterly basis. In addition, management evaluates and documents intangible factors such as: (1) the experience, ability and effectiveness of the Bank s lending management and staff; (2) the effectiveness of the Bank s loan policies, procedures and internal controls; (3) the composition and concentrations of credit; and, (4) the effectiveness of the internal loan review function.

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Activity in the allowance for loan losses was as follows for the three-month periods ended March 31, 2013 and 2012:

	Three months ended March 31, 2013				
	Balance, Beginning of Period	Provision for Loan Losses	Charge-offs	Recoveries	Balance, End of Period
	($ in thousands)				
Real estate:					
Commercial	$ 2,362	$ (123)	$ (87)	$ 5	$ 2,157
Construction and land development	710	(30)	0	6	686
Residential	959	146	0	5	1,110
Commercial and industrial	839	169	(112)	15	911
Consumer	82	11	(15)	3	81
Unallocated	308	71	0	0	379
	$ 5,260	$ 244	$ (214)	$ 34	$ 5,324

	Three months ended March 31, 2012				
	Balance, Beginning of Period	Provision for Loan Losses	Charge-offs	Recoveries	Balance, End of Period
	($ in thousands)				
Real estate:					
Commercial	$ 3,135	$ (199)	$ 0	$ 0	$ 2,936
Construction and land development	1,304	106	(45)	2	1,367
Residential	1,274	(16)	(65)	1	1,194
Commercial and industrial	751	(11)	0	5	745
Consumer	140	(52)	(4)	27	111
Unallocated	212	772	0	0	984
	$ 6,816	$ 600	$ (114)	$ 35	$ 7,337

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The Bank s recorded investment in loans and the related allowance for loan losses by portfolio segment, disaggregated on the basis of the Bank s impairment methodology, was as follows:

	March 31, 2013			
	Collectively Evaluated for Impairment		Individually Evaluated for Impairment	
	Loans	Related Allowance	Loans	Related Allowance
	($ in thousands)			
Real estate:				
Commercial	$ 131,041	$ 1,737	$ 12,723	$ 420
Construction and land development	20,359	685	145	0
Residential	30,809	954	707	155
Commercial and industrial	66,065	666	1,324	246
Consumer	6,816	72	52	9
Unallocated	0	379	0	0
	$ 255,090	$ 4,493	$ 14,951	$ 830

	December 31, 2012			
	Collectively Evaluated for Impairment		Individually Evaluated for Impairment	
	Loans	Related Allowance	Loans	Related Allowance
	($ in thousands)			
Real estate:				
Commercial	$ 140,305	$ 1,942	$ 12,429	$ 420
Construction and land development	21,606	710	317	0
Residential	26,248	888	392	71
Commercial and industrial	62,252	587	1,426	252
Consumer	6,668	68	75	14
Unallocated	0	308	0	0
	$ 257,079	$ 4,503	$ 14,639	$ 757

Management also evaluates the risk of loss associated with commitments to lend funds, such as with a letter or line of credit. A reserve has been established to absorb inherent losses with unfunded commitments using a blended rate of historical charge-off experience, and is monitored on a regular basis.

Note 4 Foreclosed Real Estate

The following table presents the changes in foreclosed real estate, net of any related valuation allowance:

	Three months ended March 31,	
	2013	2012
	($ in thousands)	
Balance, beginning of period	$ 4,430	$ 4,459
Transfers from loans	0	458
Dispositions of property	(1,911)	(161)
Provision charged to income	(230)	0
Balance, end of period	$ 2,289	$ 4,756

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Foreclosed real estate is carried at the lower of the recorded investment in the loan (prior to foreclosure) or the fair market value of the property less expected selling costs. Valuation allowances on foreclosed real estate are based on updated appraisals of the underlying collateral as received during the period or management s authorization to reduce the selling price of a property during the period.

Note 5 Deposits

Classifications of deposits were as follows:

	March 31, 2013	December 31, 2012
	($ in thousands)	
Noninterest bearing demand deposits	$ 78,222	$ 77,853
Money market accounts	57,506	52,262
NOW accounts	64,838	68,175
Savings accounts	55,718	55,475
Time deposits, $100,000 and over	41,599	38,021
Time deposits, under $100,000	36,511	41,318
	$ 334,394	$ 333,104

Note 6 Borrowed Funds

Borrowed funds consist of the following:

	March 31, 2013	December 31, 2012
	($ in thousands)	
Federal Home Loan Bank advances	$ 7,236	$ 7,336
Junior subordinated debentures	5,155	5,155
Capital lease obligation	561	564
	$ 12,952	$ 13,055

FHLB advances: FHLB advances are secured by a blanket pledge on Bank assets, including certain qualified loans.

Junior subordinated debentures: In June 2005, the Company issued junior subordinated debentures with an aggregate value of $5.2 million to Northwest Bancorporation Capital Trust I (the Trust), with interest fixed at 5.95% through June 30, 2010, thereafter re-pricing quarterly at three-month LIBOR plus 1.70%, which was 1.98% at March 31, 2013. The Trust issued $155 thousand of common securities to the Company and capital securities with an aggregate liquidation amount of $5.0 million to third-party investors. The common securities are included in other assets and the subordinated debentures are included in borrowed funds on the consolidated statements of financial condition. The subordinated debentures are includable as Tier 1 capital for regulatory purposes. The subordinated debentures and the capital securities pay interest and dividends, respectively, on a quarterly basis, which are included in interest expense. The subordinated debentures will mature on June 30, 2035, at which time the capital securities must

be redeemed. As of June 30, 2010, the subordinated debentures and capital securities became subject to redemption by the Company, in whole or in part, at par value. The Company has provided a full and unconditional guarantee of the obligations of the Trust under the capital securities in the event of default. Pursuant to ASC 810, *Consolidation*, the Trust is not consolidated in these financial statements.

On June 4, 2010, the Company gave written notice to the holders of its outstanding junior subordinated debentures that regularly scheduled interest payments would be deferred. Under the terms of the related Trust documents, the Company is allowed to defer payments of interest for up to 20 consecutive quarterly periods without default. As of March 31, 2013, the Company has deferred 11 scheduled quarterly interest payments in its junior subordinated debentures. During the deferral period, the respective Trust will likewise suspend the declaration and payment of dividends on the trust preferred securities. Also during the deferral period, the Company generally may not pay cash dividends on or repurchase its common stock or preferred stock, including the Fixed Rate Cumulative Perpetual Preferred Stock, Series A and Series B, issued by the Company under the U.S. Department of the Treasury s Capital Purchase Program. In addition, the Company is restricted from making any payment on outstanding debt obligations that rank equally with, or junior to, the junior subordinated notes. As of March 31, 2013 and December 31, 2012, the accumulated deferred interest that was accrued on these securities was $384 thousand and $357 thousand, respectively.

Capital lease obligation: The capital lease obligation is related to a ground lease, with a purchase option, that the Bank entered into in 2005 for one of the Bank s branch locations. As a capitalized lease, the value of the property is included as an asset on the consolidated statements of financial condition in Premises and equipment, net, and the net present value of future payments is included in Borrowed funds.

Lines of credit: The Bank has operating lines of credit with various correspondent banks, which are detailed as follows:

	March 31, 2013		December 31, 2012	
	Line Amount	Outstanding Balance	Line Amount	Outstanding Balance
	($ in thousands)			
Federal Home Loan Bank	$ 51,885	$ 0	$ 60,384	$ 0
Pacific Coast Bankers Bank	10,000	0	10,000	0
Zions Bank	5,000	0	5,000	1,255
	$ 66,885	$ 0	$ 75,384	$ 1,255

The FHLB line is secured by a blanket pledge on Bank assets as well as certain specific loans; advances on the FHLB line may require additional purchases of FHLB stock. The Pacific Coast Bankers Bank line is unsecured. The Zions Bank line includes $1 million that is unsecured, and the rest of the line is secured by certain investment securities.

Note 7 Commitments and Contingencies

In the ordinary course of business the Bank makes various commitments and incurs certain contingent liabilities, which are not reflected in the accompanying financial statements. The Bank uses the same credit policies in making such commitments as they do for instruments that are included in the consolidated statements of financial condition. These commitments and contingent liabilities include various commitments to extend credit and standby letters of credit. At March 31, 2013 and December 31, 2012, commitments under standby letters of credit were $1.2 million and $1.6 million, respectively, and firm loan commitments were $88.2 million and

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$86.1 million, respectively. The Bank has not experienced any losses and does not anticipate any material losses as a result of these commitments.

The Bank is a party to various claims and lawsuits that are brought by and against the Bank and Company in the ordinary course of business, the aggregate effect of which are not expected to be material to the financial condition of the Company.

The Bank has an agreement with the Spokane Public Facilities District (PFD) for the purchase of naming rights to the INB Performing Arts Center in Spokane. Under the agreement, the Bank will pay the PFD $150,000 per year for a period of ten years, with the final payment due in 2015.

The Bank leases its principal office and main branch, which is located in the Paulsen Center Building in downtown Spokane. The lease is for a 10-year term with additional renewal options. The initial lease rate is $30,839 per month and escalates approximately 3% per year. A copy of the lease agreement has been filed as Exhibit 99.1 to the current report on Form 8-K filed by the Company with the SEC on May 11, 2009.

Note 8 Other Noninterest Income and Expense

Other noninterest income and expense totals are presented in the following tables, with components of these totals that exceeded 1% of the aggregate of total net interest income and total noninterest expense itemized separately.

	Three months ended March 31,	
	2013	2012
	($ in thousands)	
Other noninterest income:		
Foreclosed real estate income	$ 71	$ 121
Other	351	361
OTHER NONINTEREST INCOME	$ 422	$ 482
Other noninterest expense:		
Foreclosed real estate expense	$ 155	$ 199
ATM and debit card costs	94	83
Software expense	85	70
Legal fees	118	26
Other	655	692
OTHER NONINTEREST EXPENSE	$ 1,107	$ 1,070

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Note 9 Income Taxes

The Company s normal, expected statutory income tax rate is 35.8%, representing a blend of the statutory federal income tax rate of 34.0% and apportioned effects of the Idaho income tax rate of 7.4%. The ratio of tax expense to the net income before tax (referred to as the effective tax rate) differs from statutory tax rates due to permanent differences arising primarily from nontaxable interest income on state and municipal securities and nontaxable increases in the value of bank owned life insurance. The differences between tax expense at the statutory rates and actual tax expense were as follows for the periods indicated:

	Three months ended March 31, 2013	2012
	($ in thousands)	
Federal income tax expense at statutory rate	$ 287	$ 153
Effect of tax-exempt interest income	(58)	(62)
Effect of nondeductible interest expense	2	2
Effect of other nondeductible expenses	6	4
Effect of state income tax expense	4	14
Other	0	11
Income tax expense	$ 241	$ 122

At March 31, 2013 and December 31, 2012, the Company had a valuation allowance of $742 thousand against a portion of its deferred tax assets due to uncertainty about the Company s ability to generate future taxable income sufficient to realize the benefits of temporary deductible differences that could not have been realized through carry-backs to prior years or through the reversal of future temporary taxable differences. Due to the ongoing weakness in the economy and its effect on credit quality, uncertainty remains about the extent to which a pattern of future taxable income will be established.

The Company follows the provisions of ASC 740, *Income Taxes,* relating to the accounting for uncertainty in income taxes. The Company periodically reviews its income tax positions based on tax laws and regulations and financial reporting considerations, and records adjustments as appropriate. This review takes into consideration the status of current taxing authorities examinations of the Company s tax returns, recent positions taken by the taxing authorities on similar transactions, if any, and the overall tax environment. The Company had no unrecognized tax benefits at March 31, 2013 or December 31, 2012. The Company recognizes interest accrued and penalties related to unrecognized tax benefits in tax expense. During the periods ended March 31, 2013 and December 31, 2012, the Company recognized no interest and penalties. The Company is no longer subject to U.S. federal or Idaho State tax authority examinations for tax years before 2010.

Note 10 Common and Preferred Stock

Common Stock:

No cash or stock dividends on common stock were declared during the three-month periods ended March 31, 2013 and 2012.

Preferred Stock:

On February 14, 2009, as part of the Capital Purchase Program of the U.S. Department of the Treasury (Treasury), the Company entered into a Letter Agreement incorporating an attached Securities Purchase Agreement Standard Terms (collectively, the Purchase Agreement) with the Treasury. Under the Purchase Agreement, the Company agreed to issue and sell to the Treasury

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(1) 10,500 shares of the Company s Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the Series A Preferred Stock), with a liquidation value of $1,000 per share, and (2) a warrant (the Warrant) to purchase 525 shares of the Company s Fixed Rate Cumulative Perpetual Preferred Stock, Series B (the Series B Preferred Stock), with an exercise price of $0.01 per share, for an aggregate purchase price of $10.5 million. The Treasury immediately exercised the warrant.

The Company is obligated to pay cumulative dividends on the Series A Preferred Stock at a rate of 5% per annum until February 2014, when the dividend rate rises to 9% per annum. The Company is obligated to pay cumulative dividends on the Series B Preferred Stock of 9% per annum. The Company may, at its option, redeem the Series A Preferred Stock and the Series B Preferred Stock (together, the Preferred Stock) at the issue price, plus accrued and unpaid dividends. The Preferred Stock is generally non-voting and qualifies as Tier 1 capital.

On March 11, 2013, Treasury sold the Company s Preferred Stock to certain domestic qualified institutional buyers and domestic institutional accredited investors. As long as any shares of the Preferred Stock continue to be held by a third party, the Company will be prohibited under the terms of the Preferred Stock from paying dividends on common stock or any shares of capital stock that rank equal to or junior to the Company s Preferred Stock if the Company is not current in its payment of dividends on the Preferred Stock, except in the case of parity, or pari passu, preferred stock that may be paid pro rata with the Preferred Stock, so that the respective amounts of such dividends declared shall bear the same ratio to each other as all accrued and unpaid dividends per share on the shares of the Preferred Stock and all parity stock payable on such a scheduled dividend payment date bear to each other.

During each of the three-month periods ended March 31, 2013 and 2012, the Company did not pay any preferred stock dividends. Subsequent to the payment made on February 16, 2010, the Company began deferring payment of dividends on the Preferred Stock but continues to accrue the liability for the dividends. As of March 31, 2013, the Company has deferred 12 quarterly dividend payments on the Preferred Stock. Accrued and unpaid dividends on the Preferred Stock totaled $1.8 million and $1.6 million as of March 31, 2013 and December 31, 2012, respectively.

Note 11 Fair Values

Fair Value Hierarchy:

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for an asset or liability in an orderly transaction between market participants at the measurement date. GAAP established a fair value hierarchy that prioritizes the use of inputs used in valuation methodologies into the following three levels:

Level 1: Inputs to the valuation methodology are quoted prices, unadjusted, for identical assets or liabilities in active markets. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available. A contractually binding sales price also provides reliable evidence of fair value.

Level 2: Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets; inputs to the valuation methodology include quoted prices for identical or similar assets or liabilities in markets that are not active; or inputs to the valuation methodology that utilize model-based techniques for which all significant assumptions are observable in the market.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement; inputs to the valuation methodology that utilize model-based techniques for which significant assumptions are not observable in the market; or inputs to the valuation methodology that requires significant management judgment or estimation, some of which may be internally developed.

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Management maximizes the use of observable inputs and minimizes the use of unobservable inputs when determining fair value measurements. Management reviews and updates the fair value hierarchy classifications of the Company s assets and liabilities on a quarterly basis.

Assets and Liabilities Measured at Fair Value on a Recurring Basis:

The following table presents the Company s financial instruments measured at fair value on a recurring basis:

	March 31, 2013			
	Level 1	Level 2	Level 3	Total
	($ in thousands)			
Securities available for sale:				
U.S. government agency securities	$ 0	$ 4,166	$ 0	$ 4,166
State and municipal securities	0	25,512	0	25,512
Corporate debt obligations	0	11,768	0	11,768
SBA participation certificates	0	11,644	0	11,644
Mortgage backed securities	0	4,541	0	4,541
Collateralized mortgage obligations	0	11,775	0	11,775

	December 31, 2012			
	Level 1	Level 2	Level 3	Total
	($ in thousands)			
Securities available for sale:				
U.S. government agency securities	$ 0	$ 5,177	$ 0	$ 5,177
State and municipal securities	0	26,243	0	26,243
Corporate debt obligations	0	12,442	0	12,442
SBA participation certificates	0	11,920	0	11,920
Mortgage backed securities	0	5,073	0	5,073
Collateralized mortgage obligations	0	12,701	0	12,701

Fair values of investment securities available for sale were primarily measured using information from a third-party pricing service. This service provides pricing information by utilizing evaluated pricing models supported with market data information. Standard inputs include benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, and reference data from market research publications. Fair values were estimated primarily by obtaining quoted prices for similar assets in active markets or through the use of pricing models. In cases where there may be limited or less transparent information provided by the Company s third-party pricing service, fair value may be estimated by the use of secondary pricing services or through the use of non-binding third-party broker quotes.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis:

Certain financial instruments are measured at fair value on a nonrecurring basis. Adjustments to fair value generally result from the application of lower-of-cost-or-market accounting or impairments of individual assets. The following table presents the Company s financial instruments measured at fair value on a nonrecurring basis:

	March 31, 2013			
	Level 1	Level 2	Level 3	Total
	($ in thousands)			
Impaired loans	$ 0	$ 0	$ 2,172	$ 2,172
Foreclosed real estate	0	0	2,289	2,289

	December 31, 2012			
	Level 1	Level 2	Level 3	Total
	($ in thousands)			

Impaired loans	$ 0	$ 0	$ 2,207	$ 2,207
Foreclosed real estate	0	0	4,430	4,430

Losses resulting from nonrecurring fair value adjustments were as follows:

	Three months ended March 31,	
	2013	**2012**
	($ in thousands)	
Impaired loans	$ 90	$ 69
Foreclosed real estate	230	0

Impaired loans: The loan amount above represents impaired, collateral dependent loans held by the Bank at the balance sheet date that have been adjusted to fair value. When collateral dependent loans are identified as impaired, the impairment is measured using the current fair value of the collateral securing these loans, less selling costs. The fair value of real estate collateral is determined using independent appraisals. The fair value of business equipment, inventory and accounts receivable collateral is typically based on the net book value on the business financial statements, but in some cases, an appraisal is obtained for equipment and inventory. Appraised and reported values are discounted based on management s review and analysis, which may include historical knowledge, changes in market conditions, estimated selling and other anticipated costs, and/or expertise and knowledge of the client and the client s business. The loss represents charge-offs or impairments on collateral dependent loans for adjustments made based on the fair value of the collateral.

Foreclosed real estate: The amount shown above represents impaired real estate properties that have been adjusted to fair value, which is typically determined using an independent appraisal. At the time of foreclosure, these assets are measured and recorded at the lower of carrying amount of the loan or fair value less costs to sell, which becomes the property s new basis. Any impairment based on the asset s fair value at the date of acquisition is charged to the allowance for loan losses. After foreclosure, management periodically re-assesses the value so that the property is carried at the lower of its new cost basis or fair value, net of estimated costs to sell. Appraised values may be discounted based on management s review and analysis, which may include historical knowledge, changes in market conditions, estimated selling and other anticipated costs, and/or expertise and knowledge of the client and the client s business. Fair value adjustments on foreclosed real estate are recognized in the consolidated statements of operations. Losses from nonrecurring valuations represent impairments on foreclosed real estate made based on the fair value of the property.

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Disclosures about Fair Value of Financial Instruments:

The following table presents the carrying amount, fair value, and placement in the fair value hierarchy of the Company s financial instruments as of March 31, 2013 and December 31, 2012.

	March 31, 2013				
	Carrying Amount	Fair Value	Fair Value Measurements Level 1	Level 2	Level 3
	($ in thousands)				
Financial Instruments - Assets:					
Cash and cash equivalents	$ 24,119	$ 24,119	$ 24,119	$ 0	$ 0
Time deposits held for investment	2,895	2,970	0	2,970	0
Loans receivable, net	264,234	264,605	0	0	264,605
Loans held for sale	3,574	3,574	0	3,574	0
Financial Instruments - Liabilities:					
Deposits	334,394	335,327	256,284	0	79,043
Borrowed funds	12,952	10,813	0	10,813	0

	December 31, 2012				
	Carrying Amount	Fair Value	Fair Value Measurements Level 1	Level 2	Level 3
	($ in thousands)				
Financial Instruments - Assets:					
Cash and cash equivalents	$ 19,989	$ 19,989	$ 19,989	$ 0	$ 0
Time deposits held for investment	3,140	3,211	0	3,211	0
Loans receivable, net	266,078	267,981	0	0	267,981
Loans held for sale	6,484	6,484	0	6,484	0
Financial Instruments - Liabilities:					
Deposits	333,104	334,054	253,765	0	80,289
Federal funds purchased	1,255	1,255	1,255	0	0
Borrowed funds	13,055	10,939	0	10,939	0

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which is it practicable to estimate that value:

Cash and cash equivalents: The carrying value approximates fair value because of the short maturity of these instruments.

Time deposits held for investment: Fair values of time deposits held for investment were estimated using the discounted value of contractual cash flows. The discount rates used for these estimates were based on rates currently offered for time deposits with similar remaining maturities.

Loans: Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type such as real estate, commercial and industrial, and consumer. Each loan category is further segmented into fixed and adjustable rate interest terms. The fair values for fixed-rate loans are estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. Expected future cash flows were projected based on contractual cash flows, adjusted for estimated prepayments. For variable rate loans that re-price frequently and have no significant change in credit risk, fair values are based on carrying values.

Loans held for sale: The carrying value approximates fair value because of the short maturity of these instruments.

Deposits: The fair value of deposits with no stated maturity such as noninterest bearing demand deposits, money market accounts, NOW accounts, and savings accounts is equal to the amount payable on demand at the reporting date, and such deposits are classified as Level 1 instruments. The fair value of fixed-maturity time deposits is based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar remaining maturities. Time deposits are classified as Level 3 instruments.

Federal funds purchased: The carrying value approximates fair value because of the short maturity of these instruments.

Borrowed funds: The fair values of term debt, junior subordinated debentures, and capital lease obligations are estimated using the discounted value of contractual cash flow using the Company s current incremental borrowing rate for similar types of borrowing arrangements.

Off-balance sheet instruments: Fair values for off-balance sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties credit standings. The fair value of these commitments were not significant as of March 31, 2013 and December 31, 2012.

Amounts could be transferred between levels if the inputs used for valuation change and become more or less observable. The Company s policy is to recognize transfers in and transfers out as of the actual date of the event or change in circumstances that caused the transfer. There were no transfers between levels during the periods ended March 31, 2013 and December 31, 2012.

Note 12 Subsequent Events

On April 26, 2013, the Company filed a notice of termination of registration on Form 15 with the SEC to deregister its common stock pursuant to section 12(g) of the Securities Exchange Act of 1934 (the Exchange Act), as amended by the Jumpstart Our Business Startups Act (JOBS Act). The JOBS Act, which was signed into law on April 5, 2012, allows a bank or bank holding company with 1,200 or less shareholders of record to deregister their shares and suspend public reporting obligations under the Exchange Act. The Company expects that its obligation to file periodic reports such as Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K will be suspended 90 days after filing the Form 15. The Company s stock is expected to continue trading on the OTCQB Marketplace under the trading symbol NBCT.

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

Northwest Bancorporation, Inc. (the Company) is a bank holding company headquartered in Spokane, Washington, and was incorporated in 1991 under the laws of the State of Washington. The Company s wholly-owned subsidiary, Inland Northwest Bank (the Bank), is a Washington state-chartered bank, through which substantially all business is conducted. The Bank offers a broad range of banking services to businesses and consumers throughout Spokane County, Washington, and Kootenai County, Idaho.

Forward-Looking Statements

From time to time, the Company and its senior managers have made and will make forward-looking statements that are not historical facts and that are intended to be covered by the safe harbor for forward-looking statements provided by the Private Securities Litigation Reform Act of 1995. These forward-looking statements may include, but are not limited to, statements about the Company s plans, objectives, expectations, strategies and intentions and other statements contained in this report that are not historical facts and pertain to the Company s future operating results and capital position. When used in this report, the words expects, anticipates, intends, plans, believes, seeks, estimates and simi expressions are generally intended to identify forward-looking statements. Management may make forward-looking statements regarding projected sources of funds, use of proceeds, availability of acquisition and growth opportunities, ability to repay government funds, payment of dividends, adequacy of the Company s allowance for loan losses and provision for loan losses, the Company s real estate portfolio and subsequent charge-offs. Such statements may be contained in this report and in other documents that the Company files with the SEC. Such statements may also be made by the Company and its senior managers in oral or written presentations to analysts, investors, the media and others.

Actual results may differ materially from the results discussed in these forward-looking statements, because such statements are inherently subject to significant assumptions, risks and uncertainties, many of which are difficult to predict and are generally beyond the Company s control. These include but are not limited to:

- the rate of inflation, interest rate levels and market and monetary fluctuations;
- trade, monetary and fiscal policies and laws, including interest rate policies of the federal government;
- applicable laws and regulations and legislative or regulatory changes;
- the timely development and acceptance of new products and services of the Company;
- the willingness of customers to substitute competitors products and services for the Company s products and services;
- the financial condition of the Company s borrowers and lenders;
- the Company s success in gaining regulatory approvals, when required;
- technological and management changes;
- growth and acquisition strategies;
- the Company s critical accounting policies and the implementation of such policies;

lower-than-expected revenue or cost savings or other issues in connection with mergers and acquisitions;

changes in consumer spending and saving habits;

the strength of the United States economy in general and the strength of the local economies in which the Company conducts its operations; and

the Company s success at managing the risks involved in the foregoing.

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Other factors that could cause actual conditions, events or results to differ significantly from those described in the forward-looking statements may be found under the headings Risk Factors and Management s Discussion and Analysis of Financial Condition and Results of Operations in the Company s annual report on Form 10-K, as updated regularly in the Company s filings with the SEC. Unless legally required, the Company disclaims any obligation to update any forward-looking statements. You should consider any forward-looking statements in light of this explanation, and we caution you about relying on 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 the Company s annual report on Form 10-K for the year ended December 31, 2012.

Summary of Critical Accounting Policies

The SEC defines critical accounting policies as those that require the application of management s most difficult, subjective, or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in future periods. The accounting policies that the Company s management have identified as critical to understanding the Company s financial statements and operating results are described in Note 1 of the Notes to Consolidated Financial Statements in the Company s annual report on Form 10-K for the year ended December 31, 2012. There have been no significant changes in our application of accounting policies since December 31, 2012.

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Financial Highlights

The table below summarizes the Company s financial performance for the three-month periods ended March 31, 2013 and 2012:

	Three months ended March 31,		
	2013	2012	% Change
	($ in thousands, except per share data)		
Results of Operations:			
Interest and dividend income	$ 4,237	$ 4,383	-3.3%
Interest expense	536	781	-31.4%
Net interest income	3,701	3,602	2.7%
Provision for loan losses	244	600	-59.3%
Net interest income after provision for loan losses	3,457	3,002	15.2%
Noninterest income	1,288	1,103	16.8%
Noninterest expense	3,899	3,658	6.6%
Income before income taxes	846	447	89.3%
Income tax expense	241	122	97.5%
Net income	605	325	86.2%
Preferred stock dividends and discount accretion, net	169	169	0.0%
Net income applicable to common shares	$ 436	$ 156	179.5%
Per Common Share Data:			
Basic earnings	$ 0.14	$ 0.05	
Diluted earnings	$ 0.14	$ 0.05	
Book value	$ 8.88	$ 8.36	
Selected Ratios:			
Return on average assets	0.44%	0.16%	
Return on average equity	4.57%	1.71%	
Net interest margin	4.11%	4.11%	
Efficiency ratio	78.15%	77.75%	
Noninterest income to average assets	1.30%	1.14%	
Noninterest expense to average assets	3.94%	3.79%	
Ending shareholders equity to average assets	9.70%	9.48%	
Nonperforming loans to gross loans	2.96%	4.55%	
Allowance for loan losses to gross loans	1.97%	2.70%	

Results of Operations

Earnings

The Company reported net income applicable to common shares of $436 thousand for the three months ended March 31, 2013, compared to net income applicable to common shares of $156 thousand for the comparable period in 2012. Compared to the first quarter of 2012, operating results improved during 2013 due to lower provision for loan losses, lower interest expense and higher noninterest income. These improvements in operating results were partially offset by a reduction in interest income and increased noninterest expense.

The return on average assets was 0.44% and 0.16% for the three-month periods ended March 31, 2013 and 2012, respectively. The return on average equity was 4.57% and 1.71% for the three-month periods ended March 31, 2013 and 2012, respectively.

Net Interest Income

The principal component of the Company s earnings is its net interest income. Net interest income is the difference between the income earned on assets and the interest paid on deposits and on borrowings used to support such assets. Net interest income is determined by the yields earned on the Company s interest earning assets and the rates paid on its interest bearing liabilities, the relative amounts of interest earning assets and interest bearing liabilities, and the degree of mismatch and the maturity and re-pricing characteristics of its interest earning assets and interest bearing liabilities. The Company s net interest rate spread is determined based upon the total interest earning assets yield less the total interest bearing liabilities rate.

Average Balances, Rates, and Interest Income and Expenses. The tables below set forth certain information related to the Company s average balance sheet and its average yields on assets and average costs of liabilities. Such yields are derived by dividing annualized income or expense by the average balance of the corresponding assets or liabilities.

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The following table presents an analysis of net interest income and net interest margin for the three months ended March 31, 2013 and 2012:

	Three months ended March 31,					
	2013			2012		
	Average Balance	Interest Income or Expense[1]	Average Yield or Rate	Average Balance	Interest Income or Expense[1]	Average Yield or Rate
	($ in thousands)					
ASSETS						
Loans receivable, gross [2][3]	$ 273,139	$ 3,787	5.55%	$ 269,935	$ 3,834	5.68%
Investment securities	71,510	434	2.43%	71,212	543	3.05%
Other interest earning assets	15,588	16	0.41%	9,224	6	0.26%
Total interest earning assets	360,237	4,237	4.70%	350,371	4,383	5.00%
Noninterest earning assets	35,533			35,737		
Total assets	$ 395,770			$ 386,108		
LIABILITIES AND SHAREHOLDERS EQUITY						
Money market accounts	57,762	37	0.26%	42,055	34	0.32%
NOW accounts	63,722	96	0.60%	68,239	178	1.04%
Savings accounts	56,100	29	0.21%	59,920	66	0.44%
Time deposits	77,112	286	1.48%	95,097	403	1.70%
Total interest bearing deposits	254,696	448	0.70%	265,311	681	1.03%
Borrowed funds	7,827	60	3.07%	8,045	72	3.58%
Junior subordinated debentures	5,155	28	2.17%	5,155	28	2.17%
Total borrowed funds	12,982	88	2.71%	13,200	100	3.03%
Total interest bearing liabilities	267,678	536	0.80%	278,511	781	1.12%
Noninterest bearing deposits	77,550			67,345		
Other noninterest bearing liabilities	12,398			3,751		
Shareholders equity	38,144			36,501		
Total liabilities and shareholders equity	$ 395,770			$ 386,108		
Net interest income		$ 3,701			$ 3,602	
Net interest spread			3.90%			3.88%
Net interest income to average earning assets (margin)			4.11%			4.11%

Comments:

(1) There are no tax equivalency adjustments.
(2) Nonaccrual loans are included in average loan balances.
(3) Loan fee income in the amount of $288 thousand and $46 thousand is included in loan interest income for 2013 and 2012, respectively.

During the three months ended March 31, 2013 and 2012, net interest income was $3.7 million and $3.6 million, respectively. This increase in net interest income of $99 thousand, or 2.7%, resulted from interest expense declining at a faster rate than interest income as well as from

increases in average interest earning assets and decreases in average interest bearing liabilities. The net interest margin was 4.11% for both three-month periods ending March 31, 2013 and 2012.

Rate/Volume Analysis. The following table sets forth the effects of changing rates and volumes on net interest income. The rate column shows the effects attributable to changes in rate (changes in rate multiplied by prior volume). The volume column shows the effects attributable to changes in volume (changes in volume multiplied by prior rate). The rate/volume column shows the effects attributable to changes in both rate and volume (changes in rate multiplied by changes in volume).

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	Three months ended March 31, 2013 over 2012 Increase (Decrease) Due to Changes in			
	Volume	Rate	Rate/ Volume	Total
	($ in thousands)			
Interest and dividend income:				
Loans receivable	$ 45	$ (88)	$ (4)	$ (47)
Investment securities	2	(110)	(1)	(109)
Other interest earning assets	4	3	3	10
Total interest and dividend income	51	(195)	(2)	(146)
Interest expense:				
Money market accounts	13	(6)	(4)	3
NOW accounts	(12)	(75)	5	(82)
Savings accounts	(4)	(34)	1	(37)
Time deposits	(76)	(52)	11	(117)
Securities sold under repurchase agreements	0	0	0	0
Borrowed funds	(2)	(10)	0	(12)
Junior subordinated debentures	0	0	0	0
Total interest expense	(81)	(177)	13	(245)
Net interest income	$ 132	$ (18)	$ (15)	$ 99

The year over year decreases in interest income were primarily attributable to decreases in yields on loans and investments. The decreases in interest income were more than offset by reductions in rates paid on interest bearing deposits and decreases in time deposit balances.

Interest Rate Risk. The Bank seeks to reduce fluctuations in its net interest margin and to optimize net interest income with acceptable levels of risk through periods of changing interest rates. The Bank s interest rate sensitivity is monitored by its Asset and Liability Committee (ALCO) on an ongoing basis. The ALCO establishes risk measures, limits and policy guidelines for managing the amount of interest rate risk and its effect on net interest income and capital. An earnings simulation model is used as a quantitative tool to measure the impact of changing interest rates on net interest income. The model quantifies the effects of various interest rate scenarios on projected net interest income over the next 12 months and uses various assumptions regarding the maturity and re-pricing characteristics of interest bearing assets and liabilities, as well as the relative sensitivities of these balance sheet components. The model assumes instantaneous and uniform changes in market interest rates at the earliest re-pricing opportunity. Notwithstanding the Bank s interest rate risk management activities, the potential for changing interest rates is an uncertainty that can have an adverse effect on net income.

At March 31, 2013, the simulation model projected that immediate rate increases of 100, 200 and 300 basis points would result in decreases to net interest income of 1.1%, 2.1% and 3.6%, respectively, relative to the base case, over the next 12 months. Conversely, the simulation model projected that an immediate rate decrease of 25 basis points would result in an increase to net interest income of 0.8% relative to the base case, over the next 12 months. The likelihood of a decrease in interest rates beyond 25 basis points as of March 31, 2013, was considered remote given prevailing interest rate levels.

Computation of the prospective effect of hypothetical interest rate changes is based on a number of assumptions and results could vary significantly if different assumptions were used. The assumptions relied upon in making these calculations include the level of market interest rates, the shape of the yield curve, the degree to which certain assets and liabilities with similar maturities or periods to re-pricing react to changes in market interest rates, the degree to which non-maturity deposits react to changes in market rates, expected prepayment rates, the degree to which early withdrawals occur on time deposits and the volume of other deposit flows. In addition, the analysis does not reflect future actions that the Bank s ALCO might take in responding to or anticipating changes in interest rates. Accordingly, although the above table provides an indication of the Bank s sensitivity to interest rate changes at a point in time, these estimates are not intended to, and do not provide, a precise forecast of the effect of changes in market interest rates on the Bank s net interest income.

Provision for Loan Losses

The provision for loan losses represents an expense against income that allows the Bank to establish an appropriate allowance for loan losses. Charges to the provision for loan losses result from management s ongoing analysis of probable losses in the loan portfolio. The provision for

loan losses during the three months ended March 31, 2013 was $244 thousand, which is a decrease of $356 thousand, or 59.3%, from the $600 thousand added to the provision for the same period in 2012. The lower provision for loan losses

is attributable to improved credit quality of the loan portfolio. The provision for loan losses as an annualized percentage of average outstanding loans was 0.4% and 0.9% for the three months ended March 31, 2013 and 2012, respectively. See Allowance for Loan Losses caption below for further analysis of the provision for loan losses and net charge-offs.

Noninterest Income

Noninterest income for the three months ended March 31, 2013, was $1.3 million, an increase of $185 thousand, or 16.8%, from the same period in 2012. Service charge income on deposits declined $69 thousand, or 21.2%, year over year as a result of reduced income from overdraft and nonsufficient funds fees collected under the Bank s overdraft privilege program. Net gains from the sale of loans improved $228 thousand, or 82.6%, year over year due to an increase in the volume of homeowners refinancing their existing mortgages and purchasing new homes, which is partially attributable to continued low interest rates and the fact that there are less mortgage originators in our market area. Net gains on investment securities were $106 thousand for the quarter ended March 31, 2013, compared to $20 thousand for the quarter ended March 31, 2012. Other noninterest income decreased $60 thousand, or 12.4%, year over year, which is primarily attributable to a decrease in income generated from foreclosed real estate properties.

Noninterest Expense

Noninterest expense for the three months ended March 31, 2013, was $3.9 million, an increase of $241 thousand, or 6.6%, from the same period in 2012.

Salaries and employee benefits increased $67 thousand, or 3.8%, year over year. This increase is primarily attributable to higher commissions related to increased mortgage loan income, higher incentives paid to lenders for commercial loan originations, and general salary and benefit cost increases. Full-time employee equivalents (FTEs) remained constant at 114 FTEs as of March 31, 2013 and 2012. Salary and benefit increases were partially offset by an increase of $38 thousand in loan origination fee salary credits.

Net losses on foreclosed real estate were $81 thousand for the three months ended March 31, 2013, compared to net losses of $0 for the comparable period in 2012.

Other noninterest expense for the three months ended March 31, 2013, were $1.1 million, an increase of $37 thousand, or 3.5%, from the same period in 2012. Significant year over year cost increases in other noninterest expense included: legal costs, which increased $92 thousand; and software costs, which increased $15 thousand. These increases in noninterest expense were partially offset by a reduction of $46 thousand in costs related to maintaining or selling foreclosed real estate or for properties securing nonperforming loans and a reduction of $20 thousand in office supply costs.

Income Taxes

For the quarter ended March 31, 2013, the Company recorded income tax expense of $241 thousand compared to income tax expense of $122 thousand for the same period in 2012.

The Company s normal, expected statutory income tax rate is 35.8%, representing a blend of the statutory federal income tax rate of 34.0% and apportioned effects of the Idaho income tax rate of 7.4%. The ratio of tax expense to the net income before tax (referred to as the effective tax rate) differs from statutory tax rates due to permanent differences arising primarily from nontaxable interest income on state and municipal securities and nontaxable increases in the value of bank owned life insurance. The differences between tax expense at the statutory rates and actual tax expense were as follows for the periods indicated:

	Three months ended March 31, 2013	2012
	($ in thousands)	
Federal income tax expense at statutory rate	$ 287	$ 153
Effect of tax-exempt interest income	(58)	(62)
Effect of nondeductible interest expense	2	2
Effect of other nondeductible expenses	6	4
Effect of state income tax expense	4	14
Other	0	11
Income tax expense	$ 241	$ 122

Financial Condition

Securities

As of March 31, 2013, the Bank had $69.4 million in securities classified as available for sale, which represents a decrease of $4.1 million, or 5.6%, from December 31, 2012. Activity in the securities portfolio during the three months ended March 31, 2013, included $1.0 million in called and matured securities, $1.2 million in securities sold, principal paydowns of $1.6 million, and amortization of net purchase price premiums of $292 thousand. As of March 31, 2013, the securities portfolio included a net unrealized gain of $2.7 million, representing a decline of $52 thousand, or 1.9%, from December 31, 2012. With the exception of corporate bonds with a fair value of $11.8 million, all securities at March 31, 2013, are fully insured by or are obligations of either U.S. government agencies or government-sponsored enterprises or state or municipal governments.

Loans

The following table presents the composition of the loan portfolio by type and by interest rate structure for the periods indicated:

	March 31, 2013		December 31, 2012	
	Amount	%	Amount	%
	($ in thousands)			
Real estate:				
Commercial	$ 143,764	53.2%	$ 152,734	56.2%
Construction and land development	20,504	7.6%	21,923	8.1%
Residential	31,516	11.7%	26,641	9.8%
Commercial and industrial	67,389	25.0%	63,678	23.4%
Consumer	6,868	2.5%	6,742	2.5%
	$ 270,041	100.0%	$ 271,718	100.0%
Fixed rate loans	$ 104,617	38.7%	$ 102,815	37.8%
Variable rate loans	165,424	61.3%	168,903	62.2%
	$ 270,041	100.0%	$ 271,718	100.0%

At March 31, 2013, the Bank reported $270.0 million in gross loans, a decrease of $1.7 million, or 0.6%, compared to December 31, 2012. Total real estate loans decreased $5.5 million, or 2.7%. Included in total real estate loans are commercial real estate loans,

which decreased $9.0 million, or 5.9%, construction and land development loans, which decreased $1.4 million, or 6.5%, and residential real estate loans, which increased $4.9 million, or 18.3%. Commercial and industrial loans increased $3.7 million, or 5.8%. The Bank has experienced weak loan demand in 2012 and 2013 despite efforts to pursue lending relationships with creditworthy customers in our market place. Loan demand has been adversely influenced by economic forces that have disrupted local and national economies. Specifically, real estate and related activities have slowed significantly, local unemployment rates remain high, and real estate and other asset prices have declined appreciably.

Nonperforming assets include nonaccrual loans, loans that are 90 or more days past due, and foreclosed real estate. The following table shows a summary of nonperforming assets:

	March 31, 2013	December 31, 2012
	($ in thousands)	
Nonaccrual loans:		
Commercial real estate	$ 6,548	$ 6,324
Construction and land development	1,039	1,227
Residential real estate	290	290
Commercial and industrial	90	169
Consumer	14	34
Loans past due 90 days or more and accruing interest	0	0
Total nonperforming loans	7,981	8,044
Foreclosed real estate	2,289	4,430
Total nonperforming assets	$ 10,270	$ 12,474

At March 31, 2013, nonperforming assets were $10.3 million, representing a decrease of $2.2 million, or 17.7%, from December 31, 2012. Nonperforming assets as a percentage of total assets were 2.6% as of March 31, 2013, and 3.1% as of December 31, 2012.

Loans are generally placed on nonaccrual status when full payment of principal and interest is not reasonably expected, or when principal or interest due on the loan is 90 days or more past due. A rare exception to the 90-day nonaccrual policy may be allowed if the loan is both well secured and in the process of collection. When loans are placed on nonaccrual status, future interest accruals are discontinued and all unpaid accrued interest is reversed against interest income. Loans may be returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured.

At March 31, 2013, the Bank had ten nonaccrual loans totaling $7.98 million compared to twelve nonaccrual loans totaling $8.04 million at December 31, 2012, representing a decrease of $63 thousand, or 0.8%. This decrease was comprised of $188 thousand in construction and land development loans and $79 thousand in commercial and industrial loans; the decreases were partially offset by an increase of $224 thousand in commercial real estate loans.

All of the Bank s nonaccrual loans are in the process of collection or under some form of a negotiated agreement for repayment of the debt and are supported by liens on collateral that mitigates the risk of loss. Whenever management determines that a collateral position is weak or insufficient to reasonably protect the Bank from loss, the loan balance is written down with a partial charge-off to a level where collateral protection is deemed adequate. If the customer has identifiable sources of repayment and is working on a repayment plan, a partial charge-off may be deferred and the amount of the exposure set aside in a specific reserve.

Four of the nonaccrual loans totaling $2.8 million, or 34.8% of total nonaccrual loans, are under a formal workout, forbearance agreement or approved bankruptcy plan. All of these loans include negotiated repayment schedules or liquidation plans. Five loans totaling $3.7 million, or 46.9% of total nonaccrual loans, are either in the process of foreclosure or under bankruptcy protection that has stopped a foreclosure action. One loan totaling $1.5 million is in the hands of a receiver who is working to lease and sell the property. If a nonaccrual loan performs under the agreed terms for a period of at least six months, and if the borrower can establish a reliable source of future repayment, the loan may be considered for return to accrual. In several cases, repayment plans include the liquidation of all or a portion of the collateral supporting the loan. In such cases, the loan has also been written down to a balance that management believes can be supported by the collateral value.

Foreclosed real estate represents real property acquired as the result of borrowers defaulting on loans and is recorded at estimated fair value, less estimated selling costs, at the time of foreclosure. Impairments identified at the time of foreclosure are charged against the allowance for loan losses. Foreclosed properties are appraised as deemed necessary due to market fluctuations or as required by applicable regulations. Additional identified impairments resulting from declines in value subsequent to foreclosure are included in other noninterest expense along with other expenses related to maintaining the properties.

Foreclosed real estate was $2.3 million at March 31, 2013, representing a decrease of $2.1 million, or 48.3%, from the amount reported at December 31, 2012. The three foreclosed real estate properties with the largest balances include commercial real estate and undeveloped land located in Kootenai and Shoshone counties of Idaho, with an aggregate total value of $1.9 million. The remaining foreclosed real estate properties consist of three commercial properties.

Restructured loans, also known as troubled debt restructurings, are those for which, due to a borrower s financial difficulties, the Bank grants a concession in loan terms or conditions that it would not otherwise consider or that would not otherwise be available to the borrower. Restructured loans are included in impaired loans until such time as the restructured loan performs according to the new terms for an acceptable duration, typically one year or longer depending on the circumstances specific to each loan, and the interest rate at the time of restructure was at or above market for a comparable loan. Restructured loans performing in accordance with their new terms are not included in nonaccrual loans unless there is uncertainty as to the ultimate collection of principal or interest. The following table presents a summary of restructured loans:

	March 31, 2013			December 31, 2012		
	Accruing Restructured Loans	Restructured Loans Included in Nonaccrual Loans	Total	Accruing Restructured Loans	Restructured Loans Included in Nonaccrual Loans	Total
	($ in thousands)					
Real estate:						
Commercial	$ 4,902	$ 3,164	$ 8,066	$ 4,926	$ 3,170	$ 8,096
Construction and land development	0	43	43	0	43	43
Residential	0	0	0	0	0	0
Commercial and industrial	502	0	502	508	0	508
Consumer	0	0	0	0	0	0
	$ 5,404	$ 3,207	$ 8,611	$ 5,434	$ 3,213	$ 8,647

Restructured loans remained essentially unchanged at $8.6 million at December 31, 2012 and March 31, 2013. Some of the restructured loan agreements grant a period of interest-only payments without imposing other significant consequences. The Bank

enters into workout agreements with the intention of improving or protecting the Bank s opportunity for successful liquidation of the asset. As of March 31, 2013, three restructured loans totaling $3.2 million were 30 or more days past due with their payments. One of these restructured loans, with a balance of $1.7 million, is in process of foreclosure. A second loan, with a balance of $1.5 million, is in the hands of a receiver with a plan for liquidation. Collection efforts for the remaining loan, with a balance of $43 thousand, is being aggressively pursued. Any failure of a borrower with a restructured loan to make timely payments according to the terms of their agreement is subject to aggressive collection efforts or legal action and will be placed on nonaccrual if future payment is deemed to be in jeopardy.

Included in total restructured loans are A/B notes totaling $1.8 million as of both March 31, 2013 and December 31, 2012. In A/B note restructurings, the original note is split into two notes where the A note represents the portion of the original loan which allows for an acceptable loan-to-value and debt service coverage and is expected to be collected in full. The B note is fully charged off and represents the portion of the original loan where there is a shortfall in collateral and/or cash flow support. The A/B note balances as of March 31, 2013 and December 31, 2012, are comprised of A note balances only.

Allowance for Loan Losses

The allowance for loan losses is a reserve established through a provision for loan losses charged to expense. The allowance for loan losses represents management s best estimate of probable losses within the existing portfolio of loans. The allowance is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The Bank s methodology for establishing the allowance for loan losses is based upon guidance from ASC Topic 310, *Receivables*, and ASC Topic 450, *Contingencies*. Accordingly, the methodology is based on historical loss experience, internal risk grade, specific homogeneous risk pools and specific loss allocations, with adjustments for current events and conditions. The Bank s process for determining the appropriate level of the allowance for loan losses is designed to account for credit deterioration as it occurs. The provision for loan losses reflects not only the necessary increases in the allowance for loan losses related to newly identified classified loans, but it also reflects actions taken related to other loans including, among other things, any necessary increases or decreases in required allowances for specific loans or loan pools. Management s methodology for analyzing probable loan losses is consistent with the methods used as of December 31, 2012, except that the calculation was adjusted for changes in leading indicators such as unemployment and real estate market trends, as well as changes in the weighted average risk rating of loans in the portfolio.

As of March 31, 2013, the allowance for loan losses was $5.3 million, an increase of $64 thousand, or 1.2%, from December 31, 2012. The increase in the allowance for loan losses is principally attributable to the provision for loan losses exceeding the net charge-offs during the three months ended March 31, 2013. The allowance for loan losses represented 2.0% and 1.9% of gross loans outstanding as of March 31, 2013 and December 31, 2012, respectively.

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The following table provides a summary of activity in the allowance for loan losses during the first quarter of 2013 and 2012:

	Three months ended March 31, 2013				
	Balance, Beginning of Period	Provision for Loan Losses	Charge-offs	Recoveries	Balance, End of Period
			($ in thousands)		
Real estate:					
Commercial	$ 2,362	$ (123)	$ (87)	$ 5	$ 2,157
Construction and land development	710	(30)	0	6	686
Residential	959	146	0	5	1,110
Commercial and industrial	839	169	(112)	15	911
Consumer	82	11	(15)	3	81
Unallocated	308	71	0	0	379
	$ 5,260	$ 244	$ (214)	$ 34	$ 5,324

	Three months ended March 31, 2012				
	Balance, Beginning of Period	Provision for Loan Losses	Charge-offs	Recoveries	Balance, End of Period
			($ in thousands)		
Real estate:					
Commercial	$ 3,135	$ (199)	$ 0	$ 0	$ 2,936
Construction and land development	1,304	106	(45)	2	1,367
Residential	1,274	(16)	(65)	1	1,194
Commercial and industrial	751	(11)	0	5	745
Consumer	140	(52)	(4)	27	111
Unallocated	212	772	0	0	984
	$ 6,816	$ 600	$ (114)	$ 35	$ 7,337

Net charge-offs for the first three months of 2013 were $180 thousand compared to net charge-offs of $79 thousand for the first three months of 2012. Annualized net charge-offs were 0.26% and 0.12% of average gross loans for the three months ended March 31, 2013 and 2012, respectively. Charge-offs of real estate secured loans accounted for 40.7% and 96.5% of total charge-offs during the first three months of 2013 and 2012, respectively, and reflected the ongoing effects of the recent recession on the Bank s depressed real estate market and general economy.

The table below sets forth the allowance for loan losses by category of loan and summarizes the percentage of loans in each category to total loans:

	March 31, 2013		December 31, 2012	
	Amount	Percent of Loans	Amount	Percent of Loans
		($ in thousands)		
Real estate:				
Commercial	$ 2,157	53.2%	$ 2,362	56.2%
Construction and land development	685	7.6%	710	8.1%
Residential	1,109	11.7%	959	9.8%
Commercial and industrial loans	912	25.0%	839	23.4%
Consumer and other	81	2.5%	82	2.5%

Unallocated	379	n/a	308	n/a
	$ 5,323	100.0%	$ 5,260	100.0%

Deferred Taxes

At March 31, 2013, the Company had recorded a net deferred tax liability of $476 thousand, which compared to a net deferred tax liability of $253 thousand at December 31, 2012. The change in deferred taxes during the first three months of 2013 primarily

resulted from decreases in the deferred tax assets related to temporary differences in nonaccrual loans and foreclosed assets and from a decrease in the Company s net operating loss carryforward. During 2009, the Company recorded a valuation allowance of $742 thousand against a portion of its deferred tax assets due to uncertainty about the Company s ability to generate future taxable income sufficient to realize the benefits of temporary deductible differences that could not have been realized through carry-backs to prior years or through the reversal of future temporary taxable differences. Due to ongoing weakness in the economy and its effect on credit quality, uncertainty remains about the extent to which a pattern of future taxable income will be established. Accordingly, the Company continued to maintain a valuation allowance of $742 thousand as of March 31, 2013.

Deposits

As of March 31, 2013, the Bank reported $334.4 million in deposits, which represents an increase of $1.3 million, or 0.4%, from the $333.1 million in deposits reported as of December 31, 2012. Noninterest bearing demand deposits increased $369 thousand and other interest bearing deposits increased $2.2 million, whereas time deposits decreased $1.2 million, which reflects management s decision to allow maturing higher costing time deposits to migrate off the balance sheet or into non-maturity deposit accounts after determining that the Bank had more than adequate liquidity levels.

Core deposits, which exclude time deposits, are considered to be more stable and typically carry a lower cost of funds than time deposits. Core deposits increased $2.5 million, or 1.0%, during the first three months of 2013 and represented 76.6% and 76.2% of total deposits as of March 31, 2013 and December 31, 2012, respectively.

Borrowings

Borrowings provide an additional source of funding for the Company and include federal funds purchased, FHLB advances and junior subordinated debentures. The Company also records a capital lease obligation as part of its borrowed funds. Borrowed funds were $13.0 million and $14.3 million as of March 31, 2013 and December 31, 2012, respectively. The $1.3 million decrease in borrowed funds is the result of repayment of federal funds purchased balances and regularly scheduled payments on FHLB advances and the capital lease obligation.

Capital Resources

Capital reflects the value of the shareholders investment in the Company. Capital can be increased through the retention of earnings and the sale of new stock, including the exercise of stock options, and can be decreased as a result of the payment of dividends, the repurchase of outstanding shares and operating losses. Stock dividends do not affect capital. Capital formation allows the Company to grow assets and provides flexibility in times of adversity.

Shareholders equity was $38.4 million at March 31, 2013, compared with $37.9 million at December 31, 2012. The $457 thousand increase in shareholders equity is attributable to $605 thousand in net income and $61 thousand in equity-based compensation, offset by $142 thousand in accrued preferred stock dividends and $35 thousand from decreases in unrealized gains on securities available for sale.

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The Company and the Bank are subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a material adverse effect on the Company s consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of its assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Company s capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. The following table provides the Company and the Bank s regulatory capital ratios, which all exceeded minimum regulatory capital requirements:

	March 31, 2013	December 31, 2012	Minimum Requirements for Capital Adequacy Purposes	Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions
Leverage:				
Company	10.5%	10.3%	4.0%	n/a
Bank	10.7%	10.5%	4.0%	5.0%
Tier 1 capital to risk-weighted assets:				
Company	12.8%	12.4%	4.0%	n/a
Bank	13.0%	12.4%	4.0%	6.0%
Total capital to risk-weighted assets:				
Company	14.1%	13.6%	8.0%	n/a
Bank	14.2%	13.7%	8.0%	10.0%

In March 2010, the Company agreed with the Federal Reserve Bank that the Company would, among other things, support the Bank s compliance with the Bank s obligations to the FDIC and the Washington State Department of Financial Institutions (the WDFI) by not receiving dividends or any other form of payment or distribution representing a reduction of capital from the Bank without the prior written approval of the Federal Reserve Bank. The Company further agreed that it would obtain written approval from the Federal Reserve Bank prior to the Company: (a) declaring or paying dividends, (b) making payments on trust preferred securities, or (c) making any other capital distributions.

In April 2010, the Bank agreed with the FDIC and the WDFI that the Bank would, among other things, achieve and maintain a minimum leverage ratio of 10%; this agreement was amended in October 2012 to lower the minimum required leverage ratio to 9.5%. As of March 31, 2013, the Bank s leverage ratio was 10.7%. The Bank also agreed that it would obtain written approval from the FDIC prior to paying dividends or any other form of payment or distribution representing a reduction of Bank capital.

In February 2009, the Company received $10.5 million in proceeds from the issuance and sale of 10,500 shares of Series A preferred stock and 525 shares of Series B preferred stock (together, the Preferred Stock) to the U.S. Department of the Treasury (the Treasury) under Treasury s Capital Purchase Program. From these proceeds, the Company invested $7 million in the Bank, paid off a $2.9 million note payable, and retained the remainder for operating cash.

The Bank did not pay any cash dividends to the Company during the three-month periods ended March 31, 2013 and 2012. The Company s ability to service borrowings is generally dependent upon the availability of dividends from the Bank. The Bank s ability to pay dividends is limited by its earnings, financial condition, capital requirements, and capital distribution regulations. As a result of current restrictions that prevent the Bank from paying dividends to the Company, the Company has been deferring the payment of interest on its trust preferred debentures and the payment of dividends on its Preferred Stock.

The Company has the potential to secure additional capital through the capital markets. The availability and cost of such capital is partially dependent on conditions in the capital markets, economic conditions and a number of other factors, many of which are outside our control, as well as on our financial performance. There can be no assurance the Company will be able to raise additional capital if needed or on terms acceptable to us.

The Company declared no dividends during the three-month periods ended March 31, 2013 and 2012, and the ability of the Company to declare or pay dividends or distributions on, or purchase, redeem or otherwise acquire for consideration, shares of its common stock is subject to various restrictions as a result of its participation in the Capital Purchase Program, the terms of its outstanding Preferred Stock and certain contractual obligations. The Company is prohibited from paying dividends on its common stock unless the Company has fully paid all required dividends on the Preferred Stock. Our ability to repurchase shares of our common stock and preferred stock is also restricted under the terms of the Preferred Stock. As long as any shares of the Preferred Stock continue to be held by a third party, the Company will be prohibited under the terms of the Preferred Stock from paying dividends on our common stock or any shares of capital stock that rank equal to or junior to the Company s Preferred Stock if the Company is not current in our payment of dividends on our Preferred Stock, except in the case of parity, or pari passu, preferred stock that may be paid pro rata with the Preferred Stock, so that the respective amounts of such dividends declared shall bear the same ratio to each other as all accrued and unpaid dividends per share on the shares of the Preferred Stock and all parity stock payable on such a scheduled dividend payment date bear to each other. For the foreseeable future, the Company does not intend to declare and pay, or seek any and all regulatory or other approvals necessary to declare and pay, each scheduled dividend payment on the Preferred Stock or on the Company s common stock, because the Company intends to conserve capital in order to comply with the agreements with the Federal Reserve Bank, the FDIC and the WDFI that are currently in place for the Company and the Bank.

Off-Balance Sheet Arrangements and Commitments

In the normal course of operations, the Company engages in a variety of financial transactions that, in accordance with accounting principles generally accepted in the United States of America, are not recorded in our consolidated financial statements. These transactions consist primarily of commitments to extend credit and other contractual obligations and are more fully described in the Company s annual report on Form 10-K for the year ended December 31, 2012. As of March 31, 2013, unused commitments to extend credit totaled $88.2 million and letters of credit totaled $1.2 million. The Company s most significant contractual obligations, other than deposits and borrowings, include operating leases and salary continuation agreements. There have been no material changes in contractual obligations since December 31, 2012.

Liquidity

Liquidity management involves the ability to meet current and future cash flow requirements arising from fluctuations in deposit levels and demands of daily operations, which include funding of securities purchases, providing for customers credit needs, and ongoing repayment of borrowings.

The Bank s primary sources of liquidity are derived from financing activities, which include the acceptance of customer, and to a lesser extent, broker deposits, federal funds facilities, and advances from the Federal Home Loan Bank. These funding sources are augmented by payments of principal and interest on loans and securities, the stability of our core deposits, and the ability to sell investment securities. Primary uses of funds include withdrawal of and interest payments on deposits, originations and purchases of loans, purchases of investment securities, capital expenditures, and payment of operating expenses. Due to the negative impact of the current economic environment and slow economic recovery, expanding the loan portfolio or finding adequate investments to utilize some of our excess liquidity has proven difficult.

As a means of augmenting our liquidity, the Bank has established access to various borrowing arrangements. At March 31, 2013, the Bank s available borrowing capacity includes approximately $15.0 million in federal funds lines with various correspondent banks and $51.9 million in unused FHLB advances. Additional information regarding the terms of borrowings is included in the Company s annual report on Form 10-K for the year ended December 31, 2012.

The liquidity of the Company, separate from the Bank, has historically been dependent on the payment of cash dividends from the Bank, subject to limitations imposed by regulations. In addition to its operating expenses, the Company is responsible for the payment of any dividends that may be declared for its shareholders and interest and principal on outstanding debt. As previously noted, the Company has deferred interest payments on its junior subordinated debentures. During the period the junior subordinated debenture payments are deferred, the Company is prohibited under the indentures from declaring or paying dividends on its capital stock. During three-month periods ended March 31, 2013 and 2012, the Company did not receive any dividends from the Bank.

The Company s liquidity position is actively managed on a daily basis and reviewed periodically by management and the Board of Directors. This process is intended to ensure the maintenance of sufficient funds to meet our needs, including adequate cash flow for off-balance sheet commitments. Management is not aware of any undisclosed information that is reasonably likely to have a material adverse effect on the Company s liquidity position.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Not applicable because the Company is a smaller reporting company.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

The Company s Chief Executive Officer and Chief Financial Officer have reviewed and evaluated the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 240.13a-15(e)) as of March 31, 2013, the date of this quarterly report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that the Company s current disclosure controls and procedures are effective and timely, providing them with material information relating to the Company required to be disclosed in the reports that are filed or submitted under the Exchange Act.

Changes in Internal Controls

There have been no changes in internal controls or procedures during the last quarter that have materially affected, or are reasonably likely to materially affect, the Company s control over financial reporting.

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PART II OTHER INFORMATION

Item 1. Legal Proceedings.
There are no material pending legal proceedings to which the Company is a party, or to which any of its property is subject, other than ordinary routine litigation incidental to the business of banking. No material loss is expected from any such pending claims or lawsuits.

Item 1A. Risk Factors.
An investment in our common stock is subject to risks inherent to our business. Before making an investment decision, you should carefully consider the risks and uncertainties described both in this report and in our annual report on Form 10-K for the fiscal year ended December 31, 2012, as updated by our filings with the SEC. These are not the only risks and uncertainties we face. Additional risks and uncertainties that management is not currently aware of or that management currently deems immaterial may also impair our business operations or adversely affect us. If any of these risks or uncertainties actually occurs, our business, financial condition, operating results or liquidity could be materially affected.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.
Not applicable.

Item 3. Defaults Upon Senior Securities.

Since February 2009, the Company has deferred the payment of 12 regular quarterly cash dividends on its Series A and Series B Preferred Stock, which is permitted under the terms of the Preferred Stock and does not constitute an event of default. As of March 31, 2013, an aggregate of $1.8 million of unpaid dividends on the Series A and Series B Preferred Stock has been accrued.

Since June 2009, the Company has deferred the payment of 11 regular quarterly interest payments on its junior subordinated debentures. The Company is allowed to defer payments of interest for up to 20 consecutive quarterly periods without default. As of March 31, 2013, the aggregate interest payments on the junior subordinated debentures, which has been accrued but unpaid, were $384 thousand.

Item 4. Mine Safety Disclosures.
Not applicable.

Item 5. Other Information.
Not applicable.

Item 6. Exhibits.
The exhibits filed as part of this report and the exhibits incorporated herein by reference are listed in the Exhibits Index to this report, which follows the signature page.

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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.

	NORTHWEST BANCORPORATION, INC. (Registrant)
Dated: May 3, 2013	/s/ Randall L. Fewel Randall L. Fewel President & Chief Executive Officer (Principal Executive Officer)
Dated: May 3, 2013	/s/ Holly A. Poquette Holly A. Poquette Chief Financial Officer (Principal Financial Officer)
Dated: May 3, 2013	/s/ Leilani T. McKernan Leilani T. McKernan Controller, Secretary/Treasurer (Principal Accounting Officer)

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Exhibit Index

Exhibit No.	Description
3.1	Restated Articles of Incorporation of the Company. Filed as Exhibit 3.1 to the Company s annual report on Form 10-K, filed with the SEC on March 27, 2009, and incorporated herein by reference.
3.2	Amended and restated bylaws of the Company. Filed as Exhibit 3.1 to the Company s current report on Form 8-K, filed with the SEC on January 25, 2010, and incorporated herein by reference.
4.1	Reference is made to Exhibits 3.1 and 3.2.
4.2	Form of Certificate for Series A Preferred Stock. Filed as Exhibit 4.1 to the Company s current report on Form 8-K, filed with the SEC on February 17, 2009, and incorporated herein by reference.
4.3	Form of Certificate for Series B Preferred Stock. Filed as Exhibit 4.2 to the Company s current report on Form 8-K, filed with the SEC on February 17, 2009, and incorporated herein by reference.
31.1	Certification of Randall L. Fewel, President and Chief Executive Officer, pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934. Filed herewith.
31.2	Certification of Holly A. Poquette, Chief Financial Officer, pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934. Filed herewith.
32.1	Certification of Randall L. Fewel, President and Chief Executive Officer, pursuant to 18 U.S.C. 1350. Furnished herewith.
32.2	Certification of Holly A. Poquette, Chief Financial Officer, pursuant to 18 U.S.C. 1350. Furnished herewith.
101	The following materials from the Company s Quarterly Report on Form 10-Q for the quarter ended March 31, 2013, are formatted in Extensible Business Reporting Language (XBRL) and furnished herewith: (a) the Consolidated Statements of Financial Condition, (b) the Consolidated Statements of Operations, (c) the Consolidated Statements of Comprehensive Income, (d) the Consolidated Statements of Changes in Shareholders Equity, (e) the Consolidated Statements of Cash Flows, and (f) the Notes to Consolidated Financial Statements.(1)

(1) As provided in Rule 406T of Regulation S-T, these interactive data files are furnished and not deemed filed or part of a registration statement or prospectus for purposes of Sections 11 and 12 of the Securities Act of 1933, as amended, or Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under these sections.