

MidWestOne Financial Group, Inc.
Form 10-K
March 16, 2009

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

FORM 10-K

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

For fiscal year ended December 31, 2008

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

For transition period from to

Commission File Number: 000-24630

MidWestOne Financial Group, Inc.
(Exact name of Registrant as specified in its charter)

Iowa 42-1206172
(State or other jurisdiction (I.R.S. Employer Identification Number)
of incorporation or organization)

102 South Clinton Street, Iowa City, Iowa 52240
(Address of principal executive offices, including Zip Code)

(319) 356-5800
(Registrant's telephone number, including Area Code)

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

Title of Class	Name of each exchange on which registered
Common Stock, \$1.00 par value	The Nasdaq Stock Market LLC

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

None
(Title of Class)

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input checked="" type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>

(Do not check if a smaller reporting company)

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant, based on the last sales price quoted on the Nasdaq Global Select Market on June 30, 2008, the last business day of the registrant's most recently completed second fiscal quarter, was approximately \$111.2 million. The number of shares outstanding of the registrant's common stock, par value \$1.00 per share, was 8,603,055 at March 1, 2009.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company's Proxy Statement for the 2009 Annual Meeting of Shareholders, which will be filed pursuant to Regulation 14A of the Securities Exchange Act of 1934, are incorporated by reference into Part III hereof, to the extent indicated herein.

PART I

Item 1. Business.

Merger Transaction

On March 14, 2008, the Company (which was at such time named ISB Financial Corp.) consummated its merger with the former MidWestOne Financial Group, Inc. (“Former MidWestOne”), pursuant to and in accordance with the Agreement and Plan of Merger dated as of September 11, 2007 (the “Merger”). As a result of the Merger, Former MidWestOne merged with and into the Company and ceased to exist as a legal entity, and the Company changed its name from ISB Financial Corp. to MidWestOne Financial Group, Inc. All references in this document to the “Company” and “MidWestOne” refer to the surviving organization in the Merger.

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

For purposes of Rule 12g-3(a) under the Exchange Act, the Company is deemed to be the successor issuer to Former MidWestOne. As a result, the Company’s common stock is deemed to be registered under the Exchange Act due to the fact that Former MidWestOne’s common stock was registered under the Exchange Act. In addition, the Company, as the successor issuer to Former MidWestOne, upon consummation of the Merger inherited Former MidWestOne’s status as a “smaller reporting company,” as such term is defined in Rule 12b-2 under the Exchange Act. For the year ended December 31, 2008, the Company is no longer considered to be a smaller reporting company because its public float as of the last business day of its most recently completed second fiscal quarter (June 30, 2008) exceeded \$75 million. However, pursuant to the transition rules for companies that are required to transition from the scaled disclosure model for smaller reporting companies to the larger reporting system, the Company is not required to satisfy the larger reporting company disclosure requirements until the Form 10-Q for the first quarter of 2009. Accordingly, the Company has prepared this Annual Report on Form 10-K using the scaled disclosure requirements set forth in Regulation S-K.

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

General

The Company was incorporated in the state of Iowa in 1983 and is headquartered in Iowa City, Iowa. It is a bank holding company registered under the Bank Holding Company Act of 1956 and has elected to be a financial holding company pursuant to the provisions of the Gramm-Leach-Bliley Act of 1999. Prior to the Merger, the Company operated primarily through two bank subsidiaries—Iowa State Bank & Trust Company, an Iowa state non-member bank chartered in 1934 with its main office in Iowa City, Iowa, and First State Bank, an Iowa state non-member bank with its main office in Conrad, Iowa, which was acquired by the Company in 1998. Prior to the Merger, Former MidWestOne, incorporated in Iowa in 1973 and headquartered in Oskaloosa, Iowa, was a registered bank holding company that had elected to be a financial holding company. Former MidWestOne operated primarily through its bank subsidiary, MidWestOne Bank, Oskaloosa, Iowa, MidWestOne Insurance Services, Inc. (f/k/a Cook & Son

Agency, Inc.), an insurance agency that was acquired in 2005, and MidWestOne Investment Services, Inc., through which Former MidWestOne offered retail brokerage (through an arrangement with a third-party registered broker-dealer) and financial planning services.

Initially following the Merger, the Company continued operating through its three bank subsidiaries—Iowa State Bank & Trust Company, First State Bank and MidWestOne Bank—but in August 2008 consolidated the three bank subsidiaries under the charter of Iowa State Bank & Trust Company and renamed the surviving bank “MidWestOne Bank.” The operations of MidWestOne Investment Services also have been transferred to MidWestOne Bank and MidWestOne Investment Services has been dissolved; the brokerage and financial planning services previously offered by MidWestOne Investment Services are now offered through MidWestOne Bank. All references herein to “MidWestOne Bank” or the “Bank” are to the surviving bank subsidiary; references to “Former MidWestOne Bank” are to the bank subsidiary of the former MidWestOne as it existed prior to the Merger. The Company retained all of the offices previously operated by the three bank subsidiaries, except that it sold its Wapello branch on October 17, 2008, pursuant to which the buyer assumed approximately \$8.6 million in deposits and paid a premium of 6%. The Company retained the loans associated with the branch and will service them through its branch location in Burlington, Iowa. MidWestOne Bank continues to offer substantially the same services provided by the three bank subsidiaries prior to the Merger and the subsequent bank charter consolidation.

The Company maintained MidWestOne Insurance Services, Inc. as a separate subsidiary following the Merger. MidWestOne Insurance Services is a full-service insurance agency that offers a wide range of insurance plans to individuals and businesses. In December 2008, MidWestOne Insurance Services acquired Butler-Brown Insurance, a full-service insurance agency in Oskaloosa, to expand its insurance agency business. MidWestOne Insurance Services operates through three offices.

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

Operating Strategy

The Company’s operating strategy is based upon a sophisticated community banking model delivering a complete line of financial products and services while following three guiding principles: hire excellent employees; take care of customers; and conduct business with the utmost integrity.

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

Market Areas

The principal offices of the Company and MidWestOne Bank are in Iowa City, Iowa. The city of Iowa City is located in east-central Iowa, approximately 220 miles west of Chicago, Illinois, and approximately 115 miles east of Des

Moines, Iowa. It is strategically situated approximately 60 miles west of the Mississippi River on Interstate 80 and is the home of the University of Iowa, a public university with approximately 21,000 undergraduate students and 9,000 graduate and professional students. Iowa City is the home of the University of Iowa Hospitals and Clinics, a 680-bed comprehensive academic medical center and regional referral center with more than 760 staff physicians and dentists, 480 resident physicians and dentists and 180 fellow physicians and 1,565 nurses. The U.S. Census Bureau estimates that, as of 2006, the city of Iowa City had a total population of approximately 63,000 and the Iowa City MSA had a total population of approximately 140,000. Iowa City is the sixth largest city in the state of Iowa. According to the FDIC, as of June 30, 2008, MidWestOne Bank had the second highest deposit market share in the Iowa City MSA at approximately 18%.

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

Lending Activities

General

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

The Company markets its services to qualified lending customers. Lending officers actively solicit the business of new companies entering their market areas as well as long-standing members of the business communities in which the Company operates. Through professional service, competitive pricing and innovative structure, the Company has been successful in attracting new lending customers. The Company also actively pursues consumer lending opportunities. With convenient locations, advertising and customer communications, the Company has been successful in capitalizing on the credit needs of its market areas.

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

Commercial, Financial and Agricultural Loans

Commercial and Financial. The Company has a strong commercial loan base. The Company focuses on, and tailors its commercial loan programs to, small- to mid-sized businesses in its market areas. The Company's loan portfolio includes loans to wholesalers, manufacturers, contractors, business services companies and retailers. The Company provides a wide range of business loans, including lines of credit for working capital and operational purposes and term loans for the acquisition of equipment. Although most loans are made on a secured basis, loans may be made on an unsecured basis where warranted by the overall financial condition of the borrower. Terms of commercial business loans generally range from one to five years.

The Company's commercial and financial loans are primarily made based on the reported cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. The collateral support provided by the borrower for most of these loans and the probability of repayment is based on the liquidation of the pledged collateral and enforcement of a personal guarantee, if any exists. The primary repayment risks of commercial loans are that the cash flows of the borrower may be unpredictable, and the collateral securing these loans may fluctuate in value.

As of December 31, 2008, commercial and financial loans comprised approximately 21% of the total loan portfolio.

Agricultural Loans. Due to the rural market areas in and around which the Company operates, agricultural loans are an important part of the Company's business. Agricultural loans include loans made to finance agricultural production and other loans to farmers and farming operations. Agricultural loans comprised approximately 9% of the total loan portfolio at December 31, 2008.

Agricultural loans, most of which are secured by crops and machinery, are provided to finance capital improvements and farm operations as well as acquisitions of livestock and machinery. The ability of the borrower to repay may be affected by many factors outside of the borrower's controls including adverse weather conditions, loss of livestock due to disease or other factors, declines in market prices for agricultural products and the impact of government regulations. The ultimate repayment of agricultural loans is dependent upon the profitable operation or management of the agricultural entity.

The agricultural loan department works closely with all of its customers, including companies and individual farmers, and reviews the preparation of budgets and cash flow projections for the ensuing crop year. These budgets and cash flow projections are monitored closely during the year and reviewed with the customers at least once annually. The Company also works closely with governmental agencies to help agricultural customers obtain credit enhancement products such as loan guarantees or interest assistance.

Real Estate Loans

Construction Loans. The Company offers loans both to individuals that are constructing personal residences and to real estate developers and building contractors for the acquisition of land for development and the construction of homes and commercial properties. These loans are in-market to known and established borrowers. Construction loans generally have a short term, such as one to two years. As of December 31, 2008, construction loans constituted approximately 10% of total loans.

Mortgage Loans. The Company offers residential, commercial and agricultural mortgage loans. As of December 31, 2008, the Company had \$685.8 million in combined residential, commercial and agricultural mortgage loans outstanding, which represented approximately 68% of the total loan portfolio.

Residential mortgage lending is a focal point for the Company, as residential real estate loans constituted approximately 26% of total loans at December 31, 2008. Included in this category of loans are home equity loans made to individuals. As long-term interest rates remained at relatively low levels during 2007 and 2008, many customers opted for mortgage loans that have a fixed rate with fifteen or thirty year maturities. The Company generally retains short-term residential mortgage loans that it originates for its own portfolio but sells most long-term loans to other parties while retaining servicing rights on the majority of those. The Company performs loan servicing activity for third parties. At December 31, 2008, the Company serviced approximately \$85.7 million in mortgage loans for others. The Company does not offer subprime mortgage loans and does not operate a wholesale mortgage business.

The Company also offers mortgage loans to its commercial and agricultural customers for the acquisition of real estate used in their business, such as offices, warehouses and production facilities, and to real estate investors for the acquisition of apartment buildings, retail centers, office buildings and other commercial buildings. As of December 31, 2008, commercial and agricultural real estate loans constituted approximately 42% of total loans.

Consumer Lending

The Company's consumer lending department provides all types of consumer loans, including personal loans (secured or unsecured) and automobile loans. Consumer loans typically have shorter terms, lower balances, higher yields and higher risks of default than one- to four-family residential real estate mortgage loans. Consumer loan collections are dependent on the borrower's continuing financial stability, and are therefore more likely to be affected by adverse personal circumstances. As of December 31, 2008, consumer loans comprised only 2% of the total loan portfolio.

Loan Pool Participations

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

The Servicer generally acquires the underlying loans from large nonaffiliated banking organizations and from the FDIC when it auctions off assets of failed financial institutions for which it has been appointed receiver. Thus, the purchased loan pools generally consist of loans that were originated throughout the United States. The sellers of the loans generally offer the loans through a sealed bid auction. A sealed bid auction requires each bidder to submit a confidential bid on the subject loan pool, with the loan pool being awarded to the highest bidder. If the Servicer is the

winning bidder in an auction, it acquires the loans without recourse against the sellers and, accordingly, the risk of noncollectibility for the participation interest purchased by the Company is, for the most part, assumed by the Company.

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

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

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

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

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

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

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

Interest income and discount on loan pool participations recorded by the Company is net of collection expenses incurred by the Servicer and net of the servicing fee and share of recovery profit paid to the Servicer. Collection costs include salary and benefits paid by the Servicer to its employees, legal fees, costs to maintain and insure real estate owned, and other operating expenses. Under the terms of the Company's agreement with the Servicer, the Servicer receives a servicing fee based on one percent of the gross monthly collections of principal and interest, net of collection costs. Additionally, the Servicer receives a tiered percentage share of the recovery profit in excess of the investors' required return on investment on each individual loan pool. The Servicer's percentage share of recovery

profit is linked to a ten-tier index and ranges from zero to twenty-seven percent depending upon the return on investment achieved. The investor's minimum required return on investment is based on the two-year treasury rate at the time a loan pool is purchased plus 4.0 percent. For every one percent increase obtained over the investor's minimum required return, the Servicer percentage moves up one tier level. In the event that the return on a particular pool does not exceed the required return on investment, the Servicer does not receive a percentage share of the recovery profit. Discount income is added to interest income and reflected as one amount on the Company's consolidated statement of income.

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

The Company’s overall cost basis in its loan pool participations represents a discount from the aggregate outstanding principal amount of the loans underlying the pools. For example, as of December 31, 2008, such cost basis was \$92.9 million, while the contractual outstanding principal amount of the underlying loans as of such date was approximately \$175.3 million. The discounted cost basis inherently reflects the assessed collectibility of the underlying loans. The Company does not include any amounts related to the loan pool participations in its totals of nonperforming loans.

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

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

Other Products and Services

Deposit Products

Management believes the Company offers competitive deposit products and programs that address the needs of customers in each of the local markets served. The deposit products are offered to individuals, non-profit organizations, partnerships, small businesses, corporations and public entities. These products include non-interest bearing and interest bearing demand deposits, savings accounts, money market accounts and time certificates of deposit.

Trust and Investment Services

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

Insurance Services

The Company, through its insurance subsidiary, MidWestOne Insurance Services, offers property and casualty insurance products to individuals and small businesses in markets served by the Company.

Liquidity and Funding

A discussion of the Company's liquidity and funding programs has been included in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations under "Liquidity and Funding."

Competition

The Company encounters competition in all areas of its business pursuits. To compete effectively, grow its market share, maintain flexibility and keep pace with changing economic and social conditions, the Company continuously refines and develops its products and services. The principal methods of competing in the financial services industry are through service, convenience and price.

The banking industry is highly competitive, and the Company faces strong direct competition for deposits, loans, and other financial-related services. The offices in central and east-central Iowa compete with other commercial banks, thrifts, credit unions, stockbrokers, finance divisions of auto and farm equipment companies, agricultural suppliers, and other agricultural-related lenders. Some of these competitors are local, while others are statewide or nationwide.

The Company competes for deposits principally by offering depositors a wide variety of deposit programs, convenient office locations, hours and other services, and for loan originations primarily through interest rates and loan fees it charges, the variety of its loan products and the efficiency and quality of services it provides to borrowers, with an emphasis on building long-lasting relationships. Some of the financial institutions and financial service organizations with which the Company competes are not subject to the same degree of regulation as that imposed on federally insured Iowa-chartered banks. As a result, such competitors have advantages over the Company in providing certain services. As of December 31, 2008, there were approximately 100 other banks having 346 offices or branches operating within the 15 counties in which the Company has locations. Based on deposit information collected by the FDIC as of June 30, 2008, the Company maintained approximately 4.8% of the bank deposits within the 15 counties in which it operates. New competitors may develop that are substantially larger and have significantly greater resources than the Company. Currently, major competitors in some of the Company's markets include Wells Fargo Bank, U.S. Bank, Regions Bank and Bank of the West.

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

Supervision and Regulation

General

Financial institutions, their holding companies and their affiliates are extensively regulated under federal and state law. As a result, the growth and earnings performance of the Company may be affected not only by management decisions and general economic conditions, but also by the requirements of federal and state statutes and by the regulations and policies of various bank regulatory authorities, including the Iowa Superintendent of Banking (the “Iowa Superintendent”), the Board of Governors of the Federal Reserve System (the “Federal Reserve”) and the FDIC. Furthermore, taxation laws administered by the Internal Revenue Service and state taxing authorities and securities laws administered by the SEC and state securities authorities have an impact on the business of the Company. The effect of these statutes, regulations and regulatory policies may be significant and cannot be predicted with a high degree of certainty.

Federal and state laws and regulations generally applicable to financial institutions regulate, among other things, the scope of business, the kinds and amounts of investments, reserve requirements, capital levels relative to operations, the nature and amount of collateral for loans, the establishment of branches, mergers and consolidations and the payment of dividends. This system of supervision and regulation establishes a comprehensive framework for the respective operations of the Company and its subsidiaries and is intended primarily for the protection of the FDIC-insured deposits and depositors of the Bank, rather than shareholders. In addition to this generally applicable regulatory framework, recent turmoil in the credit markets prompted the enactment of unprecedented legislation that has given the U.S. Treasury a wide array of powers and discretion to implement programs and make direct equity investments in qualifying financial institutions to help restore confidence and stability in the U.S. financial markets, which imposes additional requirements on institutions in which the U.S. Treasury invests.

The following is a summary of the material elements of the regulatory framework that applies to the Company and its subsidiaries. It does not describe all of the statutes, regulations and regulatory policies that apply, nor does it restate all of the requirements of those that are described. As such, the following is qualified in its entirety by reference to applicable law. Any change in statutes, regulations or regulatory policies may have a material effect on the business of the Company and its subsidiaries.

The Company

General. The Company, as the sole shareholder of the Bank, is a bank holding company. As a bank holding company, the Company is registered with, and is subject to regulation by, the Federal Reserve under the Bank Holding Company Act of 1956, as amended (the “BHCA”). In accordance with Federal Reserve policy, the Company is expected to act as a source of financial strength to the Bank and to commit resources to support the Bank in circumstances where the Company might not otherwise do so. Under the BHCA, the Company is subject to periodic examination by the Federal Reserve. The Company is also required to file with the Federal Reserve periodic reports of the Company’s operations and such additional information regarding the Company and its subsidiaries as the Federal Reserve may require.

Acquisitions, Activities and Change in Control. The primary purpose of a bank holding company is to control and manage banks. The BHCA generally requires the prior approval of the Federal Reserve for any merger involving a bank holding company or any acquisition by a bank holding company of another bank or bank holding company. Subject to certain conditions (including deposit concentration limits established by the BHCA), the Federal Reserve may allow a bank holding company to acquire banks located in any state of the United States. In approving interstate acquisitions, the Federal Reserve is required to give effect to applicable state law limitations on the aggregate amount of deposits that may be held by the acquiring bank holding company and its insured depository institution affiliates in the state in which the target bank is located (provided that those limits do not discriminate against out-of-state depository institutions or their holding companies) and state laws that require that the target bank have been in existence for a minimum period of time (not to exceed five years) before being acquired by an out-of-state bank holding company.

The BHCA generally prohibits the Company from acquiring direct or indirect ownership or control of more than 5% of the voting shares of any company that is not a bank and from engaging in any business other than that of banking, managing and controlling banks or furnishing services to banks and their subsidiaries. This general prohibition is subject to a number of exceptions. The principal exception allows bank holding companies to engage in, and to own shares of companies engaged in, certain businesses found by the Federal Reserve to be “so closely related to banking . . . as to be a proper incident thereto.” This authority would permit the Company to engage in a variety of banking-related businesses, including the ownership and operation of a thrift, or any entity engaged in consumer finance, equipment leasing, the operation of a computer service bureau (including software development) and mortgage banking and brokerage. The BHCA generally does not place territorial restrictions on the domestic activities of non-bank subsidiaries of bank holding companies.

Additionally, bank holding companies that meet certain eligibility requirements prescribed by the BHCA and elect to operate as financial holding companies may engage in, or own shares of companies engaged in, a wider range of nonbanking activities, including securities and insurance underwriting and sales, merchant banking and any other activity that the Federal Reserve, in consultation with the Secretary of the Treasury, determines by regulation or order is financial in nature, incidental to any such financial activity or complementary to any such financial activity and does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally. The Company has elected (and the Federal Reserve has accepted the Company's election) to operate as a financial holding company.

Federal law also prohibits any person or company from acquiring "control" of an FDIC-insured depository institution or its holding company without prior notice to the appropriate federal bank regulator. "Control" is conclusively presumed to exist upon the acquisition of 25% or more of the outstanding voting securities of a bank or bank holding company, but may arise under certain circumstances between 10% and 24.99% ownership.

Capital Requirements. Bank holding companies are required to maintain minimum levels of capital in accordance with Federal Reserve capital adequacy guidelines. If capital levels fall below the minimum required levels, a bank holding company, among other things, may be denied approval to acquire or establish additional banks or non-bank businesses.

The Federal Reserve's capital guidelines establish the following minimum regulatory capital requirements for bank holding companies: (i) a risk-based requirement expressed as a percentage of total assets weighted according to risk; and (ii) a leverage requirement expressed as a percentage of total assets. The risk-based requirement consists of a minimum ratio of total capital to total risk-weighted assets of 8% and a minimum ratio of Tier 1 capital to total risk-weighted assets of 4%. The leverage requirement consists of a minimum ratio of Tier 1 capital to total assets of 3% for the most highly rated companies, with a minimum requirement of 4% for all others. For purposes of these capital standards, Tier 1 capital consists primarily of permanent shareholders' equity less intangible assets (other than certain loan servicing rights and purchased credit card relationships). Total capital consists primarily of Tier 1 capital plus certain other debt and equity instruments that do not qualify as Tier 1 capital and a portion of the company's allowance for loan and lease losses.

The risk-based and leverage standards described above are minimum requirements. Higher capital levels will be required if warranted by the particular circumstances or risk profiles of individual banking organizations. For example, the Federal Reserve's capital guidelines contemplate that additional capital may be required to take adequate account of, among other things, interest rate risk, or the risks posed by concentrations of credit, nontraditional activities or securities trading activities. Further, any banking organization experiencing or anticipating significant growth would be expected to maintain capital ratios, including tangible capital positions (i.e., Tier 1 capital less all intangible assets), well above the minimum levels. As of December 31, 2008, the Company had regulatory capital in excess of the Federal Reserve's minimum requirements.

Emergency Economic Stabilization Act of 2008. Recent events in the U.S. and global financial markets, including the deterioration of the worldwide credit markets, have created significant challenges for financial institutions such as the Bank. Dramatic declines in the housing market during the past year, marked by falling home prices and increasing levels of mortgage foreclosures, have resulted in significant write-downs of asset values by financial institutions, including government-sponsored entities and major commercial and investment banks. In addition, many lenders and institutional investors have reduced, and in some cases, ceased to provide, funding to borrowers, including other financial institutions, as a result of concern about the stability of the financial markets and the strength of counterparties.

In response to the crises affecting the U.S. banking system and financial markets and in an effort to bolster the distressed economy and improve consumer confidence in the financial system, on October 3, 2008, the U.S. Congress

passed, and President Bush signed into law, the Emergency Economic Stabilization Act of 2008 (the “EESA”). The EESA authorizes the Secretary of the U.S. Treasury (the “Treasury”) to implement various temporary emergency programs designed to strengthen the capital positions of financial institutions and stimulate the availability of credit within the U.S. financial system. Financial institutions participating in certain of the programs established under the EESA will be required to adopt the Treasury’s standards for executive compensation and corporate governance.

The TARP Capital Purchase Program. On October 14, 2008, the Treasury announced that it would provide Tier 1 capital (in the form of perpetual preferred stock together with a warrant to acquire shares of common stock) to eligible financial institutions. This program, known as the TARP Capital Purchase Program (the “CPP”), allocates \$250 billion from the \$700 billion authorized by the EESA to the Treasury for the purchase of senior preferred shares from qualifying financial institutions (the “CPP Preferred Stock”). Eligible institutions can sell CPP Preferred Stock to the Treasury in amounts equal to between 1% and 3% of the institution’s risk-weighted assets. The Company elected to participate in the CPP and, on February 6, 2009, consummated the sale of \$16 million of CPP Preferred Stock, together with a warrant to acquire 198,675 shares of Company common stock, to Treasury. For further discussion of the Company’s participation in the CPP, see below under “Recent Developments—Participation in the Capital Purchase Program.”

Dividend Payments. The Company’s ability to pay dividends to its shareholders may be affected by both general corporate law considerations and policies of the Federal Reserve applicable to bank holding companies. As an Iowa corporation, the Company is subject to the limitations of Iowa law, which allows the Company to pay dividends unless, after such dividend, (i) the Company would not be able to pay its debts as they become due in the usual course of business or (ii) the Company’s total assets would be less than the sum of its total liabilities plus any amount that would be needed, if the Company were to be dissolved at the time of the dividend payment, to satisfy the preferential rights upon dissolution of shareholders whose rights are superior to the rights of the shareholders receiving the distribution. Additionally, policies of the Federal Reserve caution that a bank holding company should not pay cash dividends unless its net income available to common shareholders over the past year has been sufficient to fully fund the dividends and the prospective rate of earnings retention appears consistent with its capital needs, asset quality and overall financial condition. The Federal Reserve also possesses enforcement powers over bank holding companies and their non-bank subsidiaries to prevent or remedy actions that represent unsafe or unsound practices or violations of applicable statutes and regulations. Among these powers is the ability to proscribe the payment of dividends by banks and bank holding companies.

In addition to the foregoing, as discussed below in more detail under “Recent Developments—Participation in the Capital Purchase Program,” the Company’s participation in the CPP further restricts its ability to pay dividends. For example, the terms of the CPP Preferred Stock provide that no dividends on any common or preferred stock that ranks equal to or junior to the CPP Preferred Stock may be paid unless and until all accrued and unpaid dividends for all past dividend periods on the CPP Preferred Stock have been fully paid.

Federal Securities Regulation. The Company’s common stock is registered under the Securities Act and the Exchange Act. Consequently, the Company is subject to the information, proxy solicitation, insider trading and other restrictions and requirements of the SEC under the Exchange Act.

The Bank

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

Deposit Insurance. As an FDIC-insured institution, the Bank is required to pay deposit insurance premium assessments to the FDIC. The FDIC has adopted a risk-based assessment system whereby FDIC-insured depository institutions pay insurance premiums at rates based on their risk classification. An institution’s risk classification is assigned based on its capital levels and the level of supervisory concern the institution poses to the regulators. Under the regulations of the FDIC, as presently in effect, insurance assessments range from 0.12% to 0.50% of total deposits for the first quarter 2009 assessment period only (subject to the application of assessment credits, if any, issued by the

FDIC in 2008). Effective April 1, 2009, insurance assessments will range from 0.07% to 0.78% of total deposits, depending on an institution's risk classification, its levels of unsecured debt and secured liabilities, and, in certain cases, its level of brokered deposits. In addition, the FDIC recently passed an interim rule authorizing the FDIC to impose an emergency special assessment equal to 0.20% of total deposits on June 30, 2009 (that will be collected on September 30, 2009), and further authorizing the FDIC to impose additional emergency special assessments after June 30, 2009, of up to 0.10% of total deposits, whenever the FDIC estimates that the reserve ratio of the Deposit Insurance Fund ("DIF") will fall to a level that the FDIC believes would adversely affect public confidence in federal deposit insurance or to a level that will be close to zero or negative at the end of a calendar quarter. The interim rule, however, is subject to a 30-day comment period that will expire on April 2, 2009, and may be subject to change before any special assessments are imposed on insured depository institutions.

FICO Assessments. The Financing Corporation (“FICO”) is a mixed-ownership governmental corporation chartered by the former Federal Home Loan Bank Board pursuant to the Federal Savings and Loan Insurance Corporation Recapitalization Act of 1987 to function as a financing vehicle for the recapitalization of the former Federal Savings and Loan Insurance Corporation. FICO issued 30-year non-callable bonds of approximately \$8.2 billion that mature by 2019. Since 1996, federal legislation has required that all FDIC-insured depository institutions pay assessments to cover interest payments on FICO’s outstanding obligations. These FICO assessments are in addition to amounts assessed by the FDIC for deposit insurance. During the year ended December 31, 2008, the FICO assessment rate was approximately 0.01% of deposits.

Supervisory Assessments. All Iowa banks are required to pay supervisory assessments to the Iowa Superintendent to fund the operations of that agency. The amount of the assessment is calculated on the basis of the Bank’s total assets. During the year ended December 31, 2008, the Bank paid supervisory assessments to the Iowa Superintendent totaling \$155,617.

Capital Requirements. Banks are generally required to maintain capital levels in excess of other businesses. The FDIC has established the following minimum capital standards for state-chartered insured non-member banks, such as the Bank: (i) a leverage requirement consisting of a minimum ratio of Tier 1 capital to total assets of 3% for the most highly-rated banks, with a minimum requirement of at least 4% for all others; and (ii) a risk-based capital requirement consisting of a minimum ratio of total capital to total risk-weighted assets of 8% and a minimum ratio of Tier 1 capital to total risk-weighted assets of 4%. In general, the components of Tier 1 capital and total capital are the same as those for bank holding companies discussed above.

The capital requirements described above are minimum requirements. Higher capital levels may be required if warranted by the particular circumstances or risk profiles of individual institutions. For example, regulations of the FDIC provide that additional capital may be required to take adequate account of, among other things, interest rate risk or the risks posed by concentrations of credit, nontraditional activities or securities trading activities.

Further, federal law and regulations provide various incentives for financial institutions to maintain regulatory capital at levels in excess of minimum regulatory requirements. For example, a financial institution that is “well-capitalized” may qualify for exemptions from prior notice or application requirements otherwise applicable to certain types of activities and may qualify for expedited processing of other required notices or applications. Additionally, one of the criteria that determines a bank holding company’s eligibility to operate as a financial holding company is a requirement that all of its financial institution subsidiaries be “well-capitalized.” Under the regulations of the FDIC, in order to be “well-capitalized,” a financial institution must maintain a ratio of total capital to total risk-weighted assets of 10% or greater, a ratio of Tier 1 capital to total risk-weighted assets of 6% or greater and a ratio of Tier 1 capital to total assets of 5% or greater.

Federal law also provides the federal banking regulators with broad power to take prompt corrective action to resolve the problems of undercapitalized institutions. The extent of the regulators’ powers depends on whether the institution in question is “adequately capitalized,” “undercapitalized,” “significantly undercapitalized” or “critically undercapitalized,” in each case as defined by regulation. Depending upon the capital category to which an institution is assigned, the regulators’ corrective powers include: (i) requiring the institution to submit a capital restoration plan; (ii) limiting the institution’s asset growth and restricting its activities; (iii) requiring the institution to issue additional capital stock (including additional voting stock) or to be acquired; (iv) restricting transactions between the institution and its affiliates; (v) restricting the interest rate the institution may pay on deposits; (vi) ordering a new election of directors of the institution; (vii) requiring that senior executive officers or directors be dismissed; (viii) prohibiting the institution from accepting deposits from correspondent banks; (ix) requiring the institution to divest certain subsidiaries; (x) prohibiting the payment of principal or interest on subordinated debt; and (xi) ultimately, appointing a receiver for the institution.

As of December 31, 2008, the Bank exceeded its minimum regulatory capital requirements under the FDIC's capital adequacy guidelines and was deemed to be "well-capitalized," as defined by FDIC regulations. Notwithstanding its compliance with the specified regulatory thresholds, however, the Bank's board of directors recently adopted a capital policy pursuant to which it will maintain a ratio of Tier 1 capital to total assets of 8% or greater. The Bank's capital policy also provides that it will maintain a ratio of total capital to total risk-weighted assets of at least 10% (which is the same threshold as is required to be deemed well-capitalized under FDIC regulations).

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

The payment of dividends by any financial institution is affected by the requirement to maintain adequate capital pursuant to applicable capital adequacy guidelines and regulations, and a financial institution generally is prohibited from paying any dividends if, following payment thereof, the institution would be undercapitalized. As described above, the Bank exceeded its minimum capital requirements under applicable guidelines as of December 31, 2008. Notwithstanding the availability of funds for dividends, however, the FDIC may prohibit the payment of any dividends by the Bank if the FDIC determines such payment would constitute an unsafe or unsound practice. In addition, the Bank's board of directors will not cause the Bank to pay a dividend to the Company if such dividend would cause the Bank to fall out of compliance with the ratios set forth in the Bank's recently adopted capital policy, as described above.

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

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

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

Branching Authority. The Bank has the authority under Iowa law to establish branches anywhere in the State of Iowa, subject to receipt of all required regulatory approvals.

Federal law permits state and national banks to merge with banks in other states subject to: (i) regulatory approval; (ii) federal and state deposit concentration limits; and (iii) state law limitations requiring the merging bank to have been in existence for a minimum period of time (not to exceed five years) prior to the merger. The establishment of new interstate branches or the acquisition of individual branches of a bank in another state (rather than the acquisition of an out-of-state bank in its entirety) is permitted only in those states the laws of which expressly authorize such expansion.

State Bank Investments and Activities. The Bank generally is permitted to make investments and engage in activities directly or through subsidiaries as authorized by Iowa law. However, under federal law and FDIC regulations, FDIC-insured state banks are prohibited, subject to certain exceptions, from making or retaining equity investments of a type, or in an amount, that are not permissible for a national bank. Federal law and FDIC regulations also prohibit

FDIC-insured state banks and their subsidiaries, subject to certain exceptions, from engaging as principal in any activity that is not permitted for a national bank unless the bank meets, and continues to meet, its minimum regulatory capital requirements and the FDIC determines the activity would not pose a significant risk to the deposit insurance fund of which the bank is a member. These restrictions have not had, and are not currently expected to have, a material impact on the operations of the Bank.

Federal Reserve System. Federal Reserve regulations, as presently in effect, require depository institutions to maintain reserves against their transaction accounts (primarily NOW and regular checking accounts), as follows: for transaction accounts aggregating \$44.4 million or less, the reserve requirement is 3% of total transaction accounts; and for transaction accounts aggregating in excess of \$44.4 million, the reserve requirement is \$1.023 million plus 10% of the aggregate amount of total transaction accounts in excess of \$44.4 million. The first \$10.3 million of otherwise reservable balances are exempted from the reserve requirements. These reserve requirements are subject to annual adjustment by the Federal Reserve. The Bank is in compliance with the foregoing requirements.

Employees

On December 31, 2008, the Company had 411 full-time equivalent employees. The Company provides its employees with a comprehensive program of benefits, some of which are on a contributory basis, including comprehensive medical and dental plans, life insurance, long-term and short-term disability coverage, a 401(k) plan, and an employee stock ownership plan. None of the Company's employees are represented by unions. Management considers its relationship with its employees to be good.

Company Website

The Company maintains an internet website for MidWestOne Bank at www.midwestone.com. The Company will make available, free of charge, on this site its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and other reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after it electronically files such material with, or furnishes it to, the SEC.

Recent Developments

Participation in the Capital Purchase Program

On February 6, 2009, the Company, pursuant to the CPP implemented under the EESA, entered into a Letter Agreement, which includes the Securities Purchase Agreement – Standard Terms (collectively, the “Purchase Agreement”), with the Treasury pursuant to which the Company issued and sold to the Treasury 16,000 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock, Series A, together with a warrant to purchase 198,675 shares of the Company's common stock, for an aggregate purchase price of \$16 million in cash. The warrant has a ten-year term and is immediately exercisable upon its issuance, with an exercise price equal to \$12.08 per share of the common stock.

The Series A Preferred Stock qualifies as Tier 1 capital and pays cumulative dividends at a rate of 5% per annum for the first five years, and 9% per annum thereafter. The Series A Preferred Stock may be redeemed by the Company at any time subject to the approval of the Treasury and the Company's regulators. Any redemption of the Series A Preferred Stock will be at the per share liquidation amount of \$1,000 per share, plus any accrued and unpaid dividends.

Prior to the third anniversary of the Treasury's purchase of the Series A Preferred Stock, unless the Series A Preferred Stock has been redeemed or Treasury has transferred all of the Series A Preferred Stock to one or more third parties, the consent of the Treasury will be required for the Company to increase the dividend paid on its common stock above its most recent quarterly dividend of \$0.1525 per share or repurchase shares of its common stock (other than in connection with benefit plans). The Series A Preferred Stock is non-voting except for class voting rights on matters that would adversely affect the rights of the holders of the Series A Preferred Stock.

Participants in the TARP Capital Purchase Program were required to accept several compensation-related limitations associated with this Program. Each of our senior executive officers in February 2009 agreed in writing to accept the

compensation standards in existence at that time under the CPP and thereby cap or waive, during the period during which the Treasury continues to hold an equity interest in the Company, some of their contractual or legal rights. The compensation-related limitations include the following: limits on compensation to exclude incentives to take unnecessary and excessive risks; a clawback with respect to incentive compensation based on statements of earnings, gains or other criteria that are later proven to be materially inaccurate; and a prohibition on golden parachute payments. EESA also limits the deductibility of compensation earned by each of our senior executive officers to \$500,000 per year.

The American Recovery and Reinvestment Act of 2009

On February 17, 2009, President Obama signed into law the American Recovery and Reinvestment Act of 2009 (“ARRA”). ARRA provides for large amounts of new government spending and programs. In addition, ARRA imposes extensive new executive compensation and corporate governance limitations on current and future participants in the CPP, which are in addition to those previously announced by Treasury. Thus, the newly enacted compensation-related limitations are applicable to the Company and, to the extent Treasury may implement these restrictions unilaterally, the Company will apply these provisions. The new restrictions include additional limits on executive compensation such as prohibiting the payment or accrual of any bonus, retention award or incentive compensation to our most highly compensated employee (which is our President and Chief Executive Officer) except for the payment of long-term restricted stock that does not fully vest until such time as Treasury no longer owns any of our equity or debt securities; prohibiting the payment of “golden parachutes” to our senior executive officers and next five most highly compensated employees; prohibiting any compensation plan that would encourage the manipulation of earnings; and extending the clawback required by EESA to the top 20 most highly compensated employees (in addition to our senior executive officers). ARRA also requires compliance with new corporate governance standards including an annual “say on pay” shareholder vote, the adoption of policies regarding excessive or luxury expenditures, and a certification by our Chief Executive Officer and Chief Financial Officer that we have complied with the standards in the ARRA. These new limits will remain in place until the Company has redeemed the CPP Preferred Stock sold to Treasury, which is now permitted under ARRA without penalty and without the need to raise new capital, subject to Treasury’s consultation with the Company’s federal bank regulators.

The full impact of the ARRA is not yet certain because it calls for additional regulatory action. The Company will continue to monitor the effect of the ARRA and the anticipated regulations.

Temporary Liquidity Guarantee Program

In connection with the recently enacted EESA and in conjunction with the Treasury’s actions to address the current credit and liquidity crisis in financial markets, the FDIC announced the Temporary Liquidity Guarantee Program, which temporarily provides to participating institutions unlimited deposit insurance coverage for non-interest bearing transaction accounts maintained at FDIC insured institutions (the “transaction account guarantee program”), and provide a limited guarantee on certain newly-issued senior unsecured debt (the “debt guarantee program”). Institutions that did not opt out of the two guarantee programs are subject to the following assessments for participation: (i) for the debt guarantee program, between 50 and 100 basis points per annum for eligible senior unsecured debt (depending on the maturity date) issued between October 14, 2008 and June 30, 2009; and (ii) for the transaction account guarantee program, 10 basis points per annum on amounts in excess of \$250,000 in non-interest bearing transaction accounts through and including December 31, 2009. The Bank decided to continue to participate in these programs and did not opt out. As a result, the Bank is incurring fees associated with the programs (although, as of December 31, 2008, it had not issued any debt that is covered by the debt guarantee program).

Financial Stability Plan

On February 10, 2009, Treasury outlined a comprehensive plan consisting of multiple components designed to help restore stability to the U.S. financial system. As outlined by Treasury, this plan, referred to as the Financial Stability Plan, will include: the Capital Assistance Program pursuant to which certain financial institutions will be permitted to sell convertible preferred stock to Treasury; a public-private investment fund designed to provide greater means for financial institutions to cleanse their balance sheets of non-performing legacy assets; a consumer and business lending initiative of up to \$1 trillion; a housing support and foreclosure prevention program; and a small business and community lending initiative. Because only a general outline of the Financial Stability Plan has been disclosed thus far, it is difficult to predict at this point what effect, if any, such programs will have on the U.S. financial system generally or MidWestOne’s business specifically.

Increase in FDIC Deposit Insurance Premiums

On February 27, 2009, the FDIC issued a proposed rule that would impose a significant “emergency special assessment” on all FDIC-insured depository institutions equal to 0.20% of deposits, regardless of their risk level. The FDIC has proposed this special assessment in an effort to increase the DIF, which declined from 0.76% of total insured deposits as of September 30, 2008, to 0.40% of total insured deposits as of December 31, 2008. The proposed special assessment would be on total deposits as of June 30, 2009, to be collected on September 30, 2009. It is important to note that the rule proposing the special assessment has not been finalized and may change. For example, it has been reported that the FDIC Chairman would consider reducing the special assessment rate to 0.10% if legislation is passed that allows it to borrow as much as \$100 billion from Treasury. However, if the rule is finalized in its current form, we anticipate that this one-time special assessment could cost us an additional \$2.3 million in deposit insurance premiums in 2009.

Although the proposed assessment is only a one-time assessment, the FDIC notes in the proposed rule that if the DIF's reserve ratio were to fall below a level "that the Board believes would adversely affect public confidence or to a level which shall be close to zero or negative at the end of a calendar quarter," an additional emergency special assessment of up to 0.10% may be imposed by a vote of the FDIC's Board.

Cautionary Note Regarding Forward-Looking Statements

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

Forward-looking statements, which may be based upon beliefs, expectations and assumptions of the Company's management and on information currently available to management, are generally identifiable by the use of words such as "believe", "expect", "anticipate", "should", "could", "would", "plans", "intend", "project", "estimate", "forecast", expressions. These forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those expressed in, or implied by, these statements. The Company wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made. Additionally, the Company undertakes no obligation to update any statement in light of new information or future events.

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

- Credit quality deterioration or pronounced and sustained reduction in real estate market values could cause an increase in the allowance for credit losses and a reduction in net earnings.
- Management's ability to reduce and effectively manage interest rate risk and the impact of interest rates in general on the volatility of the Company's net interest income.
- Changes in the economic environment, competition, or other factors that may affect the Company's ability to acquire loans or influence the anticipated growth rate of loans and deposits and the quality of the loan portfolio and loan and deposit pricing.
 - Fluctuations in the value of the Company's investment securities.
 - The ability to attract and retain key executives and employees experienced in banking and financial services.
- The sufficiency of the allowance for loan losses to absorb the amount of actual losses inherent in the existing loan portfolio.
- The Company's ability to adapt successfully to technological changes to compete effectively in the marketplace.
- Credit risks and risks from concentrations (by geographic area and by industry) within the Company's loan portfolio.
- The effects of competition from other commercial banks, thrifts, mortgage banking firms, consumer finance companies, credit unions, securities brokerage firms, insurance companies, money market and other mutual funds,

and other financial institutions operating in the Company's market or elsewhere or providing similar services.

- The failure of assumptions underlying the establishment of allowances for loan losses and estimation of values of collateral and various financial assets and liabilities.
 - Volatility of rate sensitive deposits.
 - Operational risks, including data processing system failures or fraud.
 - Asset/liability matching risks and liquidity risks.
 - The costs, effects and outcomes of existing or future litigation.
- Governmental monetary and fiscal policies, as well as legislative and regulatory changes, that may result in the imposition of costs and constraints on the Company.
- Changes in general economic or industry conditions, nationally or in the communities in which the Company conducts business.
- Changes in accounting policies and practices, as may be adopted by state and federal regulatory agencies and the Financial Accounting Standards Board.

These risks and uncertainties should be considered when evaluating the forward-looking statement and undue reliance should not be placed on such statements. The Company cautions that the foregoing list of important factors may not be all-inclusive and specifically declines to undertake any obligation to publicly revise any forward-looking statements that have been made to reflect any events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

Item 1A. Risk Factors.

As discussed above under Item 1. Business – “Merger Transaction,” the Company is eligible to use the scaled disclosure requirements applicable to smaller reporting companies in this Annual Report on Form 10-K. Accordingly, the Company is not required to provide the information under this item.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

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

822 12th St. Belle Plaine, Iowa 3225 Division St. Burlington, Iowa 120 W. Center St. Conrad, Iowa 101 W. Second St., Suite 2408 100† Davenport, Iowa 58 East Burlington Fairfield, Iowa 4510 Prairie Pkwy. Cedar Falls, Iowa 325 S. Clinton St. Iowa City, Iowa 2233 Rochester Ave. Iowa City, Iowa 10030 Hwy. 149 North English, Iowa 124 South First St. Oskaloosa, Iowa 301 A Ave. West* Oskaloosa, Iowa 1001 Hwy. 57 Parkersburg, Iowa 500 Oskaloosa St.* Pella, Iowa 3110 Kimball Ave. Waterloo, Iowa	802 13th St.* Belle Plaine, Iowa 323 Jefferson St. Burlington, Iowa 110 1st Ave. Coralville, Iowa 2408 W. Burlington Fairfield, Iowa 926 Ave. G Ft. Madison, Iowa 100 Eddystone Dr. Hudson, Iowa 1906 Keokuk St. Iowa City, Iowa 202 Main St. Melbourne, Iowa 465 Hwy. 965 NE, Suite A North Liberty, Iowa 222 First Ave. East* Oskaloosa, Iowa 116 W. Main St. Ottumwa, Iowa 700 Main St. Pella, Iowa 112 North Main St. Sigourney, Iowa 305 W. Rainbow Dr. West Liberty, Iowa
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* Drive up location only.

† Leased office.

In addition to the Bank's branch offices, the insurance and investment divisions lease two properties totaling approximately 3,900 square feet. The Bank also currently operates one additional branch in a temporary facility and has one branch temporarily closed as discussed further below. The Bank owns 48 ATMs that are located within the communities served by branch offices. We believe each of our facilities is suitable and adequate to meet our current operational needs.

Natural disasters in late May and early June 2008 affected the Company's properties. On May 25, 2008, the Parkersburg branch was destroyed by a tornado that leveled much of the community. The branch has reopened in a temporary facility and rebuilding efforts have begun. Construction of the permanent facility is expected to be completed in spring 2009. The facility was insured, which is expected to cover most of the reconstruction cost. Flooding in eastern Iowa in early June inundated the Waterloo and Coralville branch offices. The Waterloo office, re-opened on February 23, 2009, has secured a leased space in Waterloo. This leased facility will replace the previously flooded location. The Coralville office was relocated to a temporary facility until October 2008 when the newly remodeled office reopened. Neither the Waterloo nor the Coralville office was covered by flood insurance.

Item 3. Legal Proceedings.

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

Item 4. Submission of Matters to a Vote of Security Holders.

No matter was submitted to a vote of security holders during the quarter ended December 31, 2008.

PART II

Item 5. Market For Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Prior to the Merger, the Company's common stock was quoted on the Pink Sheets under the symbol "ISBO.PK." In connection with the Merger, the Company received approval to list its common stock on the Nasdaq Global Select Market under the symbol "MOFG," and trading commenced on March 17, 2008. The following table sets forth for the periods indicated the high and low reported bid prices per share of the Company's common stock as reported by Pink Sheets from January 1, 2007 through March 16, 2008 and the intra-day high and low sales prices per share of the Company's common stock as reported on the Nasdaq Global Select Market beginning March 17, 2008, along with the cash dividends per share declared during such periods. With respect to the high and low bid information for the period from January 1, 2007 through March 16, 2008, the per share prices reflect inter-dealer prices without adjustments for markups, markdowns or commissions and may not necessarily represent actual transactions.

	High	Low	Cash Dividend Declared
2007			
First Quarter	\$ 27.50	\$ 26.75	\$ 0.32
Second Quarter	\$ 27.00	\$ 26.00	—
Third Quarter	\$ 27.50	\$ 24.25	—
Fourth Quarter	\$ 25.00	\$ 18.50	\$ 0.33
2008			
First Quarter	\$ 19.24	\$ 16.00	—
Second Quarter	\$ 17.25	\$ 11.94	\$ 0.1525
Third Quarter	\$ 14.95	\$ 12.00	\$ 0.1525
Fourth Quarter	\$ 14.47	\$ 8.35	\$ 0.1525

As of December 31, 2008, there were 8,603,055 shares of common stock outstanding held by approximately 580 holders of record. Additionally, there are an estimated 1,310 beneficial holders whose stock was held in street name by brokerage houses and other nominees as of that date.

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

As discussed above, the Company consummated the sale of \$16 million of senior preferred stock to Treasury pursuant to the Capital Purchase Program on February 6, 2009. The terms of the senior preferred stock place certain restrictions on the Company's ability to pay dividends on its common stock. First, no dividends on the Company's common stock may be paid unless all accrued dividends on Treasury's senior preferred stock have been paid in full. Second, until the third anniversary of the date of Treasury's investment, the Company may not increase the dividends paid on its common stock beyond its most recent quarterly dividend of \$0.1525 per share without first obtaining the consent of Treasury.

Repurchases of Company Equity Securities. On April 8, 2008, the Company's Board of Directors authorized a stock repurchase program of up to \$5,000,000 worth of common stock through December 31, 2008. During the fourth quarter of 2008, the Company repurchased 30,000 shares of common stock on the open market for a total of \$369,650. The table set forth below provides certain information with respect to these repurchases:

	Total Number of Shares Purchased	Average Price Paid Per Share	# Purchased as Part of Publicly Announced Plan	Maximum Amount that May Yet Be Purchased Under Plan
October 1-31, 2008	-	n/a	n/a	\$ 4,117,150
November 1-30, 2008	15,000	13.45	15,000	3,915,400
December 1-31, 2008	15,000	11.19	15,000	3,747,500
Total	30,000	12.32	30,000	3,747,500

The Company's 2008 repurchase program expired on December 31, 2008. No new repurchase program has been approved. Because of the Company's participation in the Treasury's Capital Purchase Program, it will not be permitted to repurchase any shares of its common stock, other than in connection with benefit plans consistent with past practice, until such time as the Treasury no longer holds any equity securities in the Company.

Securities Authorized for Issuance Under Equity Compensation Plans. The table below sets forth the following information as of December 31, 2008 for: (i) all equity compensation plans previously approved by the Company's shareholders; and (ii) all equity compensation plans not previously approved by the Company's shareholders:

- (a) the number of securities to be issued upon the exercise of outstanding options, warrants and rights;
- (b) the weighted-average exercise price of such outstanding options, warrants and rights; and
- (c) other than securities to be issued upon the exercise of such outstanding options, warrants and rights, the number of securities remaining available for future issuance under the plans.

	Number of securities to be issued upon exercise of outstanding options	Weighted-average exercise price of outstanding options	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by securityholders	268,218	18.10	473,082
Equity compensation plans not approved by securityholders	-	-	-
Total	268,218	18.10	473,082

Item 6. Selected Financial Data.

The Company is not required to provide the information under this item because, as discussed above, it is eligible to use the scaled disclosure model for smaller reporting companies in this Annual Report on Form 10-K.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following presents management's discussion and analysis of the Company's consolidated results of operations, financial position and changes in condition. This review highlights the major factors affecting results of operations and any significant changes in financial condition for the two-year period ended December 31, 2008. It should be read in conjunction with the accompanying Consolidated Financial Statements included herein at pages F-1 through

F-55 and other financial statistics appearing elsewhere in this annual report, as well as the section titled “Caution Regarding Forward-Looking Statements” set forth above in Item 1. Business.

Overview

The following discussion is provided for the consolidated operations of the Company, which as of December 31, 2008, includes its wholly-owned banking subsidiary, MidWestOne Bank, and its insurance subsidiary, MidWestOne Insurance Services, Inc. On March 14, 2008, the Company (which was at such time named ISB Financial Corp.) consummated its merger with the Former MidWestOne. At the time of the Merger, the Company had two wholly-owned banking subsidiaries—Iowa State Bank & Trust Company and First State Bank. At the time of the Merger, Former MidWestOne had one bank subsidiary, MidWestOne Bank; an insurance subsidiary, MidWestOne Insurance Services, Inc.; and an investment brokerage subsidiary, MidWestOne Investment Services, Inc., the operations of which were transferred to MidWestOne Bank substantially contemporaneous with the Merger. The Company operated the three bank subsidiaries from March 15, 2008 to August 9, 2008, at which time the three banks were consolidated under the charter of Iowa State Bank & Trust Company with the surviving bank renamed MidWestOne Bank. MidWestOne Insurance Services continues to operate as a separate subsidiary of the Company. The results of operations for the year ended December 31, 2007 include the Company's operations for such year and its two bank subsidiaries. The results of operations for the year ended December 31, 2008 include the Company and its two bank subsidiaries for the entire year plus the results of operation for the Former MidWestOne and its subsidiaries from March 15, 2008 through December 31, 2008. Because the Company was deemed to be the acquirer for purposes of applying purchase accounting, the discussion below compares the consolidated financial condition and results of operations of the Company and its subsidiaries as of and for the year ended December 31, 2008 the consolidated financial condition and results of operations of the Company (which at the time was referred to as ISB Financial Corp.) and its two subsidiaries as of and for the year ended December 31, 2007.

As explained above, because the Merger was consummated in 2008, the Company's financial information for fiscal year 2007 does not include any of the financial information attributable to the Former MidWestOne or its subsidiaries, but the Company's financial information for fiscal year 2008 does include the Former MidWestOne operations (except, as noted above, for the operations of the Former MidWestOne between January 1, 2008 and March 14, 2008). Prior to the Merger, the Company and the Former MidWestOne were comparable in total size; thus, the comparison of the Company's 2008 financial information to its 2007 financial information often shows significant changes, which generally makes the year-to-year changes significantly larger than they generally would be expected for a company that has not undergone a significant merger during the year.

Critical Accounting Estimates

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

Allowance for Loan Losses

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

need to increase its provision for loan losses.

Participation Interests in Loan Pools

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

Application of Purchase Accounting

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

Goodwill and Intangible Assets

Goodwill and intangible assets arise from purchase business combinations. On March 14, 2008, we completed our merger with the former MidWestOne. We were deemed to be the purchaser for accounting purposes and thus recognized goodwill and other intangible assets in connection with the merger. The goodwill was assigned to our one reporting unit, banking. As a general matter, goodwill and other intangible assets generated from purchase business combinations and deemed to have indefinite lives are not subject to amortization and are instead tested for impairment at least annually. Core deposit and customer relationship intangibles arising from acquisitions are being amortized over their estimated useful lives of up to 10 years.

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

Our other intangible assets are core deposit and customer relationship intangibles. The establishment and subsequent amortization of these intangible assets requires several assumptions including, among other things, the estimated cost to service deposits acquired, discount rates, estimated attrition rates and useful lives. We assess these intangible assets for impairment quarterly. If the value of the core deposit intangible or the customer relationship intangible is determined to be less than the carrying value in future periods, a writedown would be taken through a charge to our earnings. The most significant element in evaluation of these intangibles is the attrition rate of the acquired deposits or loans. If such attrition rate were to accelerate from that which we expected, the intangible may have to be reduced by a charge to earnings. The attrition rate related to deposit flows or loan flows is influenced by many factors, the most significant of which are alternative yields for loans and deposits available to customers and the level of competition from other financial institutions and financial services companies.

Fair Value of Available for Sale Securities

Securities available for sale are reported at fair value, with unrealized gains and losses reported as a separate component of accumulated other comprehensive income, net of deferred income taxes. Declines in fair value of individual securities, below their amortized cost, are evaluated by management to determine whether the decline is temporary or “other than temporary.” Declines in the fair value of available for sale securities below their cost that are deemed “other than temporary” are reflected in earnings as impairment losses. In estimating “other than temporary” impairment losses, management considers a number of factors including: (1) the length of time and extent to which the fair value has been less than cost; (2) the financial condition and near-term prospects of the issuer; and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

Summary of Performance

For the year ended December 31, 2008, the Company recorded a net loss of \$24,562,000, or a loss of \$3.09 per share basic and diluted. This compares with net income of \$6,648,000, or \$1.29 per share basic and diluted, for the year ended December 31, 2007. The Company's significant net loss in 2008 was primarily attributable to two one-time charges totaling \$33.5 million that were recognized in the fourth quarter. The first was a \$27.3 million non-cash goodwill impairment charge; this goodwill represented all of the goodwill that was recognized as a result of the Merger. The second was a \$6.2 million (pre-tax) "other than temporary impairment" charge to the Company's investment securities portfolio as a result of the decline in the market value of certain debt securities secured by pools of trust preferred securities issued by multiple banks and insurance companies. If these two charges were excluded from the Company's earnings, the Company would have had earnings for the year ended December 31, 2008 of \$6.6 million, or \$0.76 basic and diluted earnings per share. The Company's net interest income for the year ended December 31, 2008 was \$39,811,000 as compared to net interest income for the year ended December 31, 2007 of \$19,267,000, an increase of 106.6% that resulted primarily from the Merger. This increase in net interest income was offset in part, however, by an increase in noninterest expense (excluding the aggregate \$27.3 million charge due to the goodwill impairment) of \$20,960,000 and an increase in the provision for loan losses of \$3,866,000.

Total assets of the Company increased \$806,979,000, or 115.0%, to \$1,508,962,000 as of December 31, 2008 from \$701,983,000 as of December 31, 2007, with \$784,461,000 of the increase in total assets resulting from the Merger. The Company's total loans outstanding (excluding loan pool participations) increased \$613,260,000, or 152.7%, to \$1,014,814,000 at December 31, 2008 from \$401,554,000 at December 31, 2007. Approximately 87.4% of the increase in total loans was a result of the Merger; the remainder came from organic loan growth generated by the Company in 2008. The Company's deposits increased \$601,574,000, or 114.2%, to \$1,128,189,000 as of December 31, 2008 from \$526,615,000 at December 31, 2007. Approximately 95.5% of the increase in deposits was a result of the Merger; the remainder came from organic deposit growth generated by the Company in 2008.

Various operating and equity ratios for the Company are presented in the table below for the years indicated. Due to the significant net loss recognized by the Company for the year ended December 31, 2008 as a result of the \$27.3 million goodwill impairment charge and the \$6.2 million other-than-temporary impairment charge to the Company's investment securities portfolio, the Company's return on average assets and return on equity were negative in 2008, as shown in the table below. The dividend payout ratio represents the percentage of the Company's prior year's net income that is paid to shareholders in the form of cash dividends. Average equity to average assets is a measure of capital adequacy that presents the percentage of average total shareholders' equity compared to the average assets of the Company. The equity to assets ratio expresses this ratio using the period-end amounts instead of on an average basis.

	12/31/08	12/31/07	12/31/06	12/31/05
Return on average total assets	(1.61) %	0.98%	0.87%	1.06%
Return on average equity	(15.96)	8.83	8.16	10.27
Dividend payout ratio	59.49	57.90	23.96	20.53
Average equity to average assets	10.10	10.94	10.62	10.32
Equity to assets ratio (at period end)	8.66	11.02	10.95	10.30

Results of Operations

Net Interest Income

Net interest income is the total of interest income earned on earning assets less interest expense paid on interest bearing liabilities. Net interest income is affected by changes in the volume and yields on earning assets and the volume and rates paid on interest-bearing liabilities. Net interest margin is a measurement, expressed as a ratio, of the net return on interest earning assets computed by dividing net interest income on a tax-equivalent basis by the annual average balance of all interest earning assets.

Net interest income for the year ended December 31, 2008 totaled \$39,811,000, an increase of \$20,544,000, or 106.6%, compared with the \$19,267,000 of net interest income for the year ended December 31, 2007. This increase was due primarily to the greater loan volumes as a result of the Merger followed by a wider net interest margin resulting from a steepening of the yield curve between December 31, 2007 and December 31, 2008. The net interest margin (on a tax-equivalent basis) increased during 2008 to 3.28% compared with 3.27% for 2007 as the increase in net interest income was proportionately greater than the increase in average earning assets.

Total interest income increased \$31,901,000, or 83.3%, for the year ended December 31, 2008 compared with the year ended December 31, 2007. This increase in interest income was experienced in all earning asset categories (loans, investment securities and federal funds sold and interest-bearing balances) and was primarily a result of the Merger.

Interest income on loans totaled \$53,104,000 for 2008, an increase of \$25,540,000 or 92.7%, compared to 2007. The higher interest income on loans was due primarily to growth in loan volumes as a result of the Merger, partially offset by lower market interest rates. The decrease in the national prime rate has affected the Company as the overall average rate on the total loan portfolio decreased to 5.94% for the year ended December 31, 2008 compared with 7.11% for the year ended December 31, 2007. The average volume of loans outstanding for 2008 was \$502,589,000 greater than the average volume of loans for 2007. Most of this increase was due to the Merger. Interest income on investment securities increased \$2,109,000, or 20.7%, in 2008 to \$12,302,000. This compares with \$10,193,000 in 2007. The average balance of investment securities increased \$47,462,000. Most of this increase was a result of the Merger, but such increase was partially offset by the proceeds from maturing investment securities utilized to fund loan growth. The average tax-equivalent yield on the investment portfolio decreased slightly to 4.90% for the year ended December 31, 2008 compared to 4.91% for the year ended December 31, 2007, as higher-yielding securities matured and were replaced with securities having a lower interest rate due to the overall decline in market interest rates in 2008. The overall yield on earning assets decreased to 5.68% for the year ended December 31, 2008 from 6.25% for the year ended December 31, 2007, while total earning assets averaged \$1,262,392,000 for the year ended December 31, 2008, or \$624,871,000 higher than for the year ended December 31, 2007.

The growth in deposits and federal funds purchased, which growth was attributable primarily to the Merger, contributed to an increase in total interest expense for the year ended December 31, 2008 when compared to the year ended December 31, 2007. Total interest expense increased \$11,357,000, or 59.7%, for 2008 to \$30,395,000, up from \$19,038,000 for 2007. Total deposits averaged \$453,402,000 higher for 2008 compared with 2007, while the average rate paid on these deposits during 2008 decreased to 2.59% from 3.35% for 2007. Interest expense on deposits was \$23,157,000 for the year ended December 31, 2008, an increase of \$8,359,000, or 56.5%, from the \$14,798,000 in interest expense for the year ended December 31, 2007. The primary factor contributing to this increase in interest expense on deposits was the large increase in the balance of outstanding deposits resulting from the Merger. This increase in interest expense was offset partially by decreases in the average rate paid on deposits due to the overall decline in market interest rates in 2008. For the year ended December 31, 2008, the Company averaged \$55,069,000 in federal funds purchased and repurchase agreements compared with \$49,629,000 for 2007. Interest expense on federal funds purchased and repurchase agreements decreased \$992,000 to \$1,122,000 for 2008 compared with \$2,114,000 for 2007. This was also primarily due to the Merger, offset partially by decreases in market interest rates. The interest rates on federal funds purchased and repurchase agreements correlate directly with the actions taken by the Federal Reserve in lowering the discount rate during 2008. The average rate paid by the Company on federal funds purchased and repurchase agreements decreased to 2.04% for the year ended December 31, 2008 compared with 4.26% for the year ended December 31, 2007, which decreased interest expense. The average balance of Federal Home Loan Bank advances was \$91,803,000 higher for the year ended December 31, 2008, while the average rate paid decreased to 3.93% for 2008 from 4.58% for 2007. The increase in Federal Home Loan Bank advances was due primarily to the Merger.

The following table presents a comparison of the average balance of earning assets, interest-bearing liabilities, interest income and expense, and average yields and costs for the years indicated. Interest income on tax-exempt securities is reported on a fully tax-equivalent basis assuming a 34% tax rate. Dividing income or expense by the average balances of assets or liabilities results in such yields and costs. Nonaccrual loans are included in the loan category.

	Year ended December 31,				
	2008			2007	
Average	Interest Income(2)/	Average Rate/	Average	Interest Income/	Average Rate/

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	Balance	Expense	Yield	Balance	Expense	Yield
	(dollars in thousands)					
Average earning assets:						
Loans(1)	\$ 893,451	\$ 53,104	5.94%	\$ 390,862	\$ 27,771	7.11%
Loan pool participations	72,558	4,459	6.15	-	-	-
Investment securities:						
Taxable investments	180,787	8,222	4.55	163,608	7,552	4.62
Tax exempt investments	102,035	5,625	5.51	71,752	4,001	5.58
Total investment securities	282,822	13,847	4.90	235,360	11,553	4.91
Federal funds sold and interest-bearing balances	13,561	341	2.51	11,299	548	4.85
Total earning assets	\$ 1,262,392	\$ 71,751	5.68			