

NORTHWEST BANCORPORATION INC  
Form 10KSB  
March 24, 2005  
Table of Contents

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# SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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## FORM 10-KSB

(Mark One)

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

For the fiscal year ended December 31, 2004

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 000-24151

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## NORTHWEST BANCORPORATION, INC.

(Name of small business issuer in its charter)

Washington  
(State or other jurisdiction of

91-1574174  
(I.R.S. Employer

incorporation or organization)  
421 W. Riverside, Spokane, WA  
(Address of principal executive offices)

Identification Number)  
99201-0403  
(Zip Code)

(Issuer's telephone number) (509) 456-8888

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

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Title of each class

None

Name of each exchange on which registered

None

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

Common Stock, No Par Value Per Share

(Title of Class)

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Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act during the past 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

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the past 90 days. Yes  No

Check if disclosure of delinquent filers in response to Item 405 of Regulation S-B is not contained in this form, and no disclosure will 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-KSB or any amendment to this Form 10-KSB.

State issuer's revenues for its most recent fiscal year: \$13,581,057.

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was sold, or the average bid and asked price of such common equity, as of a specified date within 60 days prior to the end of the Company's fiscal year: \$20,901,244 based on a trade transacted on December 28, 2004.

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: 2,004,961.

### **DOCUMENTS INCORPORATED BY REFERENCE**

If the following documents are incorporated by reference, briefly describe them and identify the part of the Form 10-KSB (e.g., Part I, Part II, etc.) into which the document is incorporated: (1) any annual report to security holders; (2) any proxy or information statement; and (3) any prospectus filed pursuant to Rule 424(b) or (c) of the Securities Act of 1933 ( Securities Act ). The listed documents should be clearly described for identification purposes (e.g., annual report to security holders for fiscal year ended December 24, 1990).

Transitional Small Business Disclosure Format (check one): Yes  No

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**Table of Contents**

**PART I**

**(ALTERNATIVE 2)**

**ITEM 1. DESCRIPTION OF BUSINESS (Model B, Form 1-A, item 6.)**

**Business Development by Issuer and Subsidiaries**

Northwest Bancorporation, Inc. ( the Company ) was incorporated as a Washington corporation on December 10, 1991. Effective June 10, 1993, the Company became the bank holding company parent of Inland Northwest Bank (the Bank ) by acquiring all the outstanding shares of common stock of the Bank in exchange for an equal number of shares of common stock of the Company. The Bank commenced operations on October 2, 1989 as a Washington state-chartered commercial bank. The Bank operates seven branch offices and a loan production office in Washington and two branches in Idaho; both states allow for statewide branching

**General**

*The Company.* During the past five fiscal years, the Company's assets and revenues have increased because of the growth of the Bank. Although the Company's management continues to consider the possibility of other business opportunities, the Company currently has not established any independent business activity apart from acting as the parent company of the Bank. Expenses associated with any new business activity initially would need to be funded through dividends received by the Company from the Bank. Consequently, the Company would not be able to engage in any new business activity if the associated costs and expenses would require the payment of a dividend from the Bank that would adversely affect the ability of the Bank to conduct its business.

The primary asset of the Company is the common stock of the Bank. The Bank's operating results, financial position, and power and ability to provide dividends to the Company will directly and materially affect the operating results, financial position and liquidity of the Company. The operating results of the Bank depend primarily on its net interest and dividend income, which is the difference between (i) interest and dividend income on earning assets, primarily loans and investment securities, and (ii) interest expense on interest bearing liabilities, which primarily consist of deposits and borrowed funds. Also affecting the Bank's operating results are the level of the provision for loan losses, the level of other operating income, such as service charges on deposits and gains or losses on the sale of investment securities, the level of operating expenses, and income taxes. Specific information concerning the effect of these items upon the Bank's operating results for the fiscal years 2004 and 2003 is set forth in the sections entitled Summary Performance Information and Statistical Disclosure on pages 7-14. At such time as the Company decides to engage in any other business activities, the success or failure of any new business activities and the associated costs and expenses would be additional factors affecting the operating results, financial position and liquidity of the Company.

*The Bank.* The Bank's principal office and main branch is located in the downtown business core of Spokane, Washington, and it has eight other branches located in the Spokane, Washington, Coeur d'Alene, Idaho and Post Falls, Idaho areas. In January 2005, the Bank established a Loan Production Office in Walla Walla, Washington. The Bank considers eastern Washington and northern Idaho to be its primary market area. The majority of the Bank's deposits and loans are generated in Spokane County, Washington, with a population of 417,939 and Kootenai County, Idaho, with a population of 108,685; the population figures are based upon information provided by the U.S. Census Bureau as of July 1, 2000. There is little concentration of industry in the two counties. A historical reliance on natural resources industries (timber, agriculture, and mining)

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has been replaced by a focus on trades and services, including high-tech products. The City of Spokane serves as the hub of an area known as the Inland Northwest that includes thirty-six counties in eastern Washington, northern Idaho, western Montana and northeastern Oregon, home to 1.7 million residents. As a regional trade center, the Spokane market area extends to southern British Columbia and Alberta with a population base exceeding 3 million. The economy of the market area is considered stable.

## **Table of Contents**

*Banking Services.* The Bank has offered a variety of banking products and services as its principal products during the past five years. The Bank strives to occupy a niche market wherein it specializes in the personalized delivery of depository, cash management, and lending services to individuals, professionals and small to mid-size businesses.

The products and services include a full range of Federal Deposit Insurance Corporation (FDIC) insured deposit accounts, including: non-interest bearing checking accounts; interest bearing checking and savings accounts; money market accounts; and fixed and variable rate time certificates of deposit. Transaction accounts and certificates of deposit, including Individual Retirement Accounts (IRA), are offered at rates competitive in the primary market area. To a lesser extent, the Bank will, from time to time, solicit deposits through the national market. Typically, national deposits consist of time certificates with maturities ranging from one to five years, are purchased by credit unions or other financial institutions, will be more expensive than local deposits but priced comparably to funds borrowed from the Federal Home Loan Bank (FHLB) and will be for an amount that allows for full coverage by FDIC insurance. The FDIC currently insures deposit accounts up to a maximum of \$100,000.

The Bank offers a full range of commercial and personal loans. The Bank's primary focus is on commercial lending and most of its loans are classified as commercial or commercial real estate. Typically, loans classified as commercial real estate are owner-occupied; the Bank does not specialize in financing investment properties. Credit services include:

Loans to businesses:

- (1) Operating loans and lines;
- (2) Equipment loans;
- (3) Commercial real estate and construction loans; and,
- (4) U.S. Small Business Administration (SBA) or other government guaranteed/subsidized loan programs for small businesses.

Loans to individuals:

- (1) Loans for vehicle purchase or other personal, family or household purposes, including personal lines of credit;
- (2) Home loans (conventional and insured);
- (3) Home improvement and rehabilitation loans;
- (4) Guaranteed or subsidized loan programs; and,
- (5) National credit card (Visa/MasterCard).

Mortgage loans:

The Bank's mortgage department offers virtually all mortgage products available in the market, specializing in conventional, FHA & VA home loans for the purchase or refinance of 1-4 family residential living units; substantially all loans originated are sold to third-party investors. The mortgage department is housed in three Bank branches and maintains numerous correspondent relationships, as well as internal underwriting authority. Mortgage department income is derived from loan origination fees and payments received from mortgage servicing correspondents, who buy both the loan principal and the right to service the loan, and from fees and interest earned on new home construction loans made to individuals and builders.

Other services:

The Bank offers numerous other products and services, including: cash management services, wire transfers, direct deposit of payroll and social security checks, VISA debit cards for automated teller machine access and purchases, Internet banking, on-line bill payment, and automatic drafts and transfers to and from various accounts.

## **Table of Contents**

For those customers whose balances exceed the FDIC insured limit, the Bank offers a repurchase program, whereby, each day, the Bank sells a portion of its investment portfolio to the customer, agreeing to repurchase the investment the next business day; securities in the Bank's investment portfolio are held by a third-party, the FHLB. Repurchase accounts fund, on average over the past two-years, about seven-percent of Bank assets.

## **Competition**

*The Bank.* Competition in the banking and financial services industry is significant and has intensified in recent years. Competitors include financial institutions within the traditional banking system, such as commercial banks, savings banks and credit unions. Furthermore, financial institutions from outside the traditional banking system, such as investment banking and brokerage firms, insurance companies, credit card issuers, mortgage companies, and related industries offering bank-like products, have widened the competition. With liberalization of interstate banking limitations and other financial institution regulations, increased competition and consolidation in the overall financial services industry, and other recent developments, it is anticipated that competition will increase in the future. Competition in the Bank's market area is not greater than competition in other parts of the United States. Consequently, neither the Bank nor the Company believe that the Bank faces unusual competitive conditions.

At present, there are 16 other local, independent community-based banks operating in the Bank's primary market area (Spokane and Kootenai counties) which offer services similar to, and which are in direct competition with, the Bank. Several of these community-based competitors are of a significantly larger size than the Bank and may have some or all of the competitive advantage enjoyed by the branch offices of larger, out-of-area institutions.

Based on industry information there are 16 commercial banks and savings banks in Spokane County, Washington, having a total of 124 locations and an estimated total of \$4,806 million in deposits as of June 30, 2004, the most recent date for which information is readily available. Based on the same information there are 14 commercial banks and savings banks in Kootenai County, Idaho having a total of 39 locations and an estimated total of \$1,271 million in deposits.

The Bank also faces numerous non-bank competitors, which have some or all of the competitive advantages enjoyed by branch offices of larger, out-of-area institutions and may have further competitive advantages because they are not subject to the extensive bank regulatory structure and restrictive policies which apply to the Bank.

## **Regulation**

*General.* Bank holding companies and banks are extensively regulated under both federal and state law. The following information describes certain aspects of regulations applicable to the Company and its subsidiary, but does not purport to be complete and is qualified in its entirety by reference to the particular provisions of these regulations. In addition, federal and state regulations are subject to future changes that may have significant impact on the way in which bank holding companies and their subsidiaries (including banks) may conduct business. The likelihood and potential effects of such changes cannot be predicted. Legislation enacted in recent years has substantially increased the level of competition among commercial banks, savings banks, thrift institutions and non-banking companies, including insurance companies, securities brokerage firms, mutual funds, investment banks and major retailers. Recent legislation also has broadened the regulatory powers of the federal banking agencies in a number of areas.

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*The Company.* As a bank holding company, the Company is subject to various regulations, including the following, some of which may have a material impact upon the Company's future financial performance.

*Bank Holding Company Regulation.* The Company is subject to the Bank Holding Company Act of 1956, as amended (the "BHC Act"), and related federal statutes, and is subject to supervision, regulation and inspection by the Board of Governors of the Federal Reserve System and the Federal Reserve Bank of San Francisco (collectively, the "Federal Reserve"). The Company is required to file with the Federal Reserve an annual report



## **Table of Contents**

and any additional information that the Federal Reserve may require pursuant to the BHC Act. The Federal Reserve possesses cease and desist powers over bank holding companies and their non-bank subsidiaries if their actions represent unsafe or unsound practices.

*Bank Acquisitions.* The BHC Act requires, among other things, the prior approval of the Federal Reserve if the Company proposes to (i) acquire all or substantially all the assets of any bank, (ii) acquire direct or indirect ownership or control of more than 5% of the voting shares of any bank, or (iii) merge or consolidate with any other bank holding company. The BHC Act currently permits bank holding companies from any state to acquire banks and bank holding companies located in any other state, subject to certain conditions, including certain nationwide and state-imposed concentration limits. The establishment of new interstate branches also will be possible in those states with laws that expressly permit it. Interstate branches will be subject to certain laws of the states in which they are located. Competition may increase further as banks branch across state lines and enter new markets.

*Non-Bank Acquisitions.* The BHC Act also prohibits a bank holding company, with certain exceptions, from acquiring or retaining direct or indirect ownership or control of more than 5% of the voting shares of any company that is not a bank or bank holding company, and from engaging in any activities other than those of banking, managing or controlling banks, or activities which the Federal Reserve has determined to be so closely related to the business of banking or managing or controlling banks as to be a proper incident thereto.

*Restrictions on the Acquisition of the Company.* The acquisition of 10% or more of the Company's outstanding shares by any person or group of persons may, in certain circumstances, be subject to the provisions of the Change in Bank Control Act of 1978, as amended, and the acquisition of control of the Company by another company would be subject to regulatory approval under the BHC Act.

*Source of Strength Policy.* Under Federal Reserve policy, a bank holding company is expected to act as a source of financial strength to each of its subsidiary banks and to commit resources to support each such bank. Consistent with its source of strength policy for subsidiary banks, the Federal Reserve has stated that, as a matter of prudent banking, a bank holding company generally should not maintain a rate of cash dividends unless its net income available to common shareholders has been sufficient to fund fully the dividends, and the prospective rate of earnings retention appears to be consistent with the corporation's capital needs, asset quality and overall financial condition.

*Effect of Other Legislation.* The Gramm-Leach-Bliley (GLB) Financial Modernization Act authorizes a bank holding company to affiliate with any financial company (for example, insurance or securities companies) and to cross-sell an affiliate's products, subject to added privacy restrictions, thus allowing the Company to offer its customers any financial product or service. Certain restrictions regarding capital and Community Reinvestment Act (CRA) performance are specified. The Company meets the standard to be considered well-capitalized and the Bank has a Satisfactory CRA rating, meeting the requirements contained in the Act. The Company will consider opportunities to expand its financial offerings as they become available. At this time, however, the Company has not identified additional financial products or services that it intends to offer in the near future, nor does it anticipate the establishment of additional subsidiaries this year.

GLB contains provisions related to Bank customer's rights to financial privacy and requires that financial institutions implement policies and procedures that control the use and reuse of customer and consumer non-public information. The Bank provides its customers with an initial notification of their rights under GLB when they first open an account and annually, thereafter.

*The Bank.* As a Washington state-chartered commercial bank, the deposits of which are insured by the Bank Insurance Fund (the BIF) of the Federal Deposit Insurance Corporation (the FDIC), the Bank is subject to various regulations, including the following:

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*Bank Regulation.* The Bank is subject to supervision, regulation and examination by the Divisions of Banking of the States of Washington and Idaho and by the FDIC. The Bank is subject to various requirements

## Table of Contents

and restrictions under federal and state law, including (i) requirements to maintain reserves against deposits, (ii) restrictions on the types, amount and terms and conditions of loans that may be granted, (iii) limitations on the types of investments that may be made, the activities that may be engaged in, and the types of services that may be offered, and (iv) standards relating to asset quality, earnings, and employee compensation.

As a qualified FHA Direct Endorsement lender, the Bank is governed by the regulations established by the Department of Housing and Urban Development (HUD) and is subject to their audit criteria and quality control requirements. Additionally, depending upon the type of mortgage loan originated and the investor to whom the loan is sold, the Bank is subject to rules and requirements established by various federal and state agencies and housing authorities, as well as investment and quality criteria established by individual investor institutions.

The approval of a Bank's primary regulator is required prior to any merger or consolidation or the establishment or relocation of any office. Various consumer laws and regulations also affect the operations of the Bank.

*Affiliate Transactions.* The Bank is subject to federal laws that limit the transactions by subsidiary banks to or on behalf of their parent company and to or on behalf of any non-bank subsidiaries. Such transactions by a subsidiary bank to its parent company or to any non-bank subsidiary are limited to 10% of a bank subsidiary's capital and surplus and, with respect to such parent company and all such non-bank subsidiaries, to an aggregate of 20% of such bank subsidiary's capital and surplus. Further, loans and extensions of credit generally are required to be secured by eligible collateral in specified amounts. Federal law also prohibits banks from purchasing low quality assets from affiliates.

*FDIC Assessments.* The deposits of the Bank are insured by the BIF up to a maximum of \$100,000 per depositor and are subject to FDIC insurance assessments. The semi-annual amount of FDIC assessments paid by individual insured depository institutions ranges from 0% to 0.27% of insured deposits, based on the institution's relative risk as measured by regulatory capital ratios and certain other factors. In 2004 the Bank qualified to pay 0% to the BIF. Banks insured by the BIF are also assessed, along with financial institutions insured by the Savings Association Insurance Fund (SAIF) to provide repayment of the Financing Corporation (FICO) bonds. The FICO, established by the Competitive Equality Banking Act of 1987, is a mixed-ownership government corporation whose sole purpose was to function as a financing vehicle for the Federal Savings & Loan Insurance Corporation (FSLIC). Outstanding FICO bonds, which are 30-year non-callable bonds with a principal amount of approximately \$8.1 billion, mature in 2017 through 2019. The FICO has assessment authority, separate from the FDIC's authority to assess risk-based premiums for deposit insurance, to collect funds from FDIC-insured institutions sufficient to pay interest on FICO bonds. The annual rate during 2004 was 1.54 basis points for the first quarter, 1.54 for the second quarter, 1.48 for the third quarter and 1.46 for the fourth quarter. The first-quarter 2005 rate is 1.44 basis points.

*Prompt Corrective Action.* Federal banking agencies possess broad powers to take corrective action as deemed appropriate for an insured depository institution and its holding company. The extent of these powers depends on whether the institution in question is considered well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized or critically undercapitalized. The required Tier 1 capital to average assets ratio, Tier I capital to risk-weighted assets ratio and total capital to risk-weighted assets ratio for classification as adequately capitalized are 4.0%, 4.0% and 8.0%, respectively. (See discussion of the components of these ratios in The Company and the Bank Risk-Based Capital Requirements below.) The required Tier 1 capital to average assets ratio, Tier I capital to risk-weighted assets ratio and total capital to risk-weighted assets ratio for classification as well-capitalized are 5.0%, 6.0% and 10.0%, respectively. As of December 31, 2004, the Bank exceeded the required Tier 1 capital to average assets ratio, Tier 1 capital to risk-weighted assets ratio and total capital to risk-weighted assets ratio for classification as well capitalized, with ratios of 8.80%, 11.66% and 12.91%, respectively.

*Federal Home Loan Bank.* The Bank is a member of the Federal Home Loan Bank of Seattle (the FHLB), which is one of twelve regional Federal Home Loan Banks. The FHLB serves as a reserve or central



## **Table of Contents**

bank for its members and makes advances to its members in accordance with the FHLB's policies and procedures. As a member of the FHLB, the Bank is required to purchase and hold stock in the FHLB. As of December 31, 2004, the Bank held stock in the FHLB in the amount of \$643,300.

*The Company and the Bank.* As a bank holding company and state-chartered bank, the Company and the Bank are also subject to the following further regulation:

*Risk-Based Capital Requirements.* Under the risk-based capital guidelines applicable to the Company and the Bank, the minimum guideline for the ratio of total capital to risk-weighted assets (including certain off-balance-sheet activities) is 8.0%. At least half of the total capital must be Tier 1 capital, which primarily includes common shareholders' equity and qualifying preferred stock, less goodwill and other disallowed intangibles. Tier 2 capital includes, among other items, partial recognition of increases in the market value of qualifying equity securities, certain cumulative and limited-life preferred stock, qualifying subordinated debt and the allowance for credit losses, subject to certain limitations, less required deductions as prescribed by regulation.

In addition, the federal bank regulators established leverage ratio (Tier 1 capital to total adjusted average assets) guidelines providing for a minimum leverage ratio of 3.0% for bank holding companies and banks meeting certain specified criteria, including that such institutions have the highest regulatory examination rating and are not contemplating significant growth or expansion. Institutions not meeting these criteria are expected to maintain a ratio that exceeds the 3.0% minimum by at least 100 to 200 basis points. The federal bank regulatory agencies may, however, set higher capital requirements when particular circumstances warrant. Under the federal banking laws, failure to meet the minimum regulatory capital requirements could subject a bank to a variety of enforcement remedies available to federal bank regulatory agencies, including the termination of deposit insurance by the FDIC and seizure of the institution.

*Community Reinvestment.* Bank holding companies and their subsidiary banks are also subject to the provisions of the Community Reinvestment Act of 1977, as amended (CRA). Under the terms of the CRA, a bank's record in meeting the credit needs of the community served by the bank, including low-income and moderate-income neighborhoods, is assessed by the bank's primary federal regulator; such assessments may occur as frequently as annually, but are generally made every four years. When a bank holding company applies for approval to acquire a bank or other bank holding company, the Federal Reserve will review the assessment of each subsidiary bank of the applicant bank holding company, and such records may be the basis for denying the application. As of December 31, 2004 the Bank was rated Satisfactory with respect to CRA.

*Other Regulations.* The policies of regulatory authorities, including the Federal Reserve and the FDIC, have had a significant effect on the operating results of financial institutions in the past and are expected to do so in the future. An important function of the Federal Reserve is to regulate aggregate national credit and money supply through such means as open market dealings in securities, establishment of the discount rate on bank borrowings and changes in reserve requirements against bank deposits. Policies of these agencies may be influenced by many factors, including inflation, unemployment, short-term and long-term changes in the international trade balance and fiscal policies of the United States government. Supervision, regulation or examination of the Company by these regulatory agencies is not intended for the protection of the Company's shareholders.

## **Employees**

The Bank employed 106 employees, representing 94 full time equivalent positions as of December 31, 2004; the Company, separate from the Bank, does not have any compensated employees.

**Legal Proceedings**

Other than routine litigation incidental to the business of the Bank, there are no pending legal proceedings in which the Company or the Bank is a party or any of their respective properties is subject. There are no pending

## **Table of Contents**

legal proceedings to which any director, officer or affiliate of the Company, any owner of record or beneficiary of more than 5% of the common stock of the Company, or any security holder of the Company is a party adverse to the Company or the Bank or has a material interest adverse to the Company or the Bank.

## **Summary Performance Information**

Certain summary recent performance information for the Bank is set forth below. All information in this section should be read in conjunction with the Company's consolidated financial statements and notes thereto contained in Part F/S of this Form 10-KSB. The Company's President and Chief Executive Officer and the Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective in ensuring that material information required to be disclosed in this report has been made known to them in a timely fashion. There was no significant change in the Company's internal control over financial reporting during the fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

The Bank has experienced growth in total assets of 4.7% and 0.6% for the fiscal years ended December 31, 2004 and 2003, respectively. Net loan growth, not including loans held for sale, was 6.1% and 9.8% for these same periods. Also for these same periods, loan losses net of recoveries were \$244,325 and \$453,931, respectively. The Bank continues to provide for anticipated future losses through increases in the loan loss reserve, which was at \$1,943,760, or 1.22% of outstanding loans, on December 31, 2004 and \$2,042,129, or 1.35% of outstanding loans, on December 31, 2003. For information on the Bank's capital ratios as of December 31, 2004, see Regulation The Bank Prompt Corrective Action and Regulation The Company and the Bank Risk-Based Capital Requirements above.

## **Statistical Disclosure**

Certain statistical and other information is set forth below. All information in this sub-section should be read in conjunction with the Company's consolidated financial statements and notes thereto contained in Part F/S of this Form 10-KSB.

All references in this sub-section to historical statistical and other information are to the historical consolidated information of the Company and the Bank for the two most recently ended fiscal years.

**Table of Contents****I. DISTRIBUTION OF ASSETS, LIABILITIES AND STOCKHOLDERS EQUITY; INTEREST RATES AND INTEREST DIFFERENTIAL.****AVERAGE BALANCE/INTEREST INCOME AND EXPENSE RATES**

(Dollars in Thousands)

	2004			2003		
	Average balance	Interest income/expense	Average yield earned/rate paid	Average balance	Interest income/expense	Average yield earned/rate paid
<b>ASSETS:</b>						
Investment securities:						
Taxable investments	\$ 38,999	\$ 1,559	4.00%	\$ 37,974	\$ 1,689	4.45%
Nontaxable investments	2,294	72	3.14%	2,337	81	3.47%
Total investment securities	41,293	1,631	3.95%	40,311	1,770	4.39%
Interest-bearing deposits with banks	5,580	71	1.27%	5,150	53	1.03%
Federal funds sold	4,702	60	1.28%	3,099	33	1.06%
Total Investments	51,575	1,762	3.42%	48,560	1,856	3.82%
Real estate loans	25,526	1,766	6.92%	20,569	1,893	9.20%
Consumer loans	10,017	681	6.80%	9,968	620	6.22%
VISA/MC	1,164	90	7.73%	1,222	102	8.35%
Commercial loans	113,304	7,227	6.38%	112,226	7,110	6.34%
Total loans	150,011	9,764	6.51%	143,985	9,725	6.75%
Total earning assets	201,586	11,526	5.72%	192,545	11,581	6.01%
Less reserve for possible loan losses	(2,191)			(2,224)		
Cash and due from banks	8,613			7,466		
Other non-earning assets	9,952			10,892		
Total assets	217,960			208,679		
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>						
NOW accounts	\$ 13,488	\$ 90	0.67%	\$ 13,320	\$ 112	0.84%
Money Market accounts	52,137	518	0.99%	48,594	582	1.20%
Savings accounts	6,972	30	0.43%	5,545	30	0.54%
Other time deposits	62,473	1,797	2.88%	63,916	1,920	3.00%
Total interest-bearing deposits	135,070	2,435	1.80%	131,375	2,644	2.01%
Securities sold under repurchase agreements/borrowed funds	22,841	464	2.03%	22,890	408	1.78%
Total Interest-bearing Liabilities	157,911	2,899	1.84%	154,265	3,052	1.98%
Demand deposits	39,911			35,425		
Other liabilities	1,177			1,446		
Stockholders equity	18,961			17,543		
Total liabilities and stockholders equity	\$ 217,960			\$ 208,679		



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Net interest income	\$ 8,627	\$ 8,529
Net interest margin to average earning assets	4.28%	4.43%

### COMMENTS

1. There were no out-of-period adjustments.
2. Yields have not been adjusted on tax-exempt investments to determine a tax-equivalent yield.
3. Bank was not involved in any foreign activities.

**Table of Contents**

The following table illustrates the changes in the Company's net interest income due to changes in volume, interest rate or a combination of both.

	<u>2004</u>	<u>2003</u>	<u>Variance</u>	<u>2003</u> <u>rate</u>	<u>Change in</u> <u>income</u> <u>due to</u> <u>change</u> <u>in</u> <u>volume</u>	<u>Change</u> <u>in rate</u>	<u>Difference</u> <u>in income</u> <u>2003</u> <u>volume due</u> <u>to rate</u> <u>change</u>	<u>Change in</u> <u>income</u> <u>due to</u> <u>change</u> <u>in</u> <u>rate and</u> <u>volume</u>	<u>Net change</u> <u>in</u> <u>income</u> <u>due to</u> <u>rate and</u> <u>volume</u> <u>changes</u>
<b><u>ASSETS</u></b>									
Loans	\$ 150,011	\$ 143,985	\$ 6,026	6.75%	\$ 407.0	-0.25%	\$ (353.2)	\$ (14.8)	\$ 39
Securities	41,293	40,311	982	4.39%	43.1	-0.44%	(177.8)	(4.3)	(139)
Fed funds sold/interest bearing bank balances	10,282	8,249	2,033	1.04%	21.2	0.23%	19.1	4.7	45
			<u>9,041</u>						
Net change in total earning assets			<u>9,041</u>						
Net change in income on total earning assets									<u>(55)</u>
<b><u>LIABILITIES</u></b>									
NOW accounts	13,488	13,320	168	0.84%	1.4	-0.17%	(23.1)	(0.3)	(22)
Money Market accounts	52,137	48,594	3,543	1.20%	42.4	-0.20%	(99.2)	(7.2)	(64)
Savings accounts	6,972	5,545	1,427	0.54%	7.7	-0.11%	(6.1)	(1.6)	0
Time deposits	62,473	63,916	(1,443)	3.00%	(43.3)	-0.13%	(81.5)	1.8	(123)
Securities sold under repurchase agreements	22,841	22,890	(49)	1.78%	(0.9)	0.25%	57.0	(0.1)	56
			<u>\$ 3,646</u>						
Net change, total interest bearing deposits			<u>\$ 3,646</u>						
Net change in expense on total interest bearing deposits									<u>(153)</u>
Net increase in net interest income									<u>\$ 98</u>

**Table of Contents****II. INVESTMENT PORTFOLIO.***Securities*

The book and market values of the major classifications of investment securities were as follows (\$ in thousands):

	December 31, 2004		December 31, 2003	
	Amortized cost	Fair value	Amortized cost	Fair value
<b>Securities available-for-sale:</b>				
Obligations of federal government agencies	\$ 29,692	\$ 29,544	\$ 19,518	\$ 19,761
US Treasury securities	5,203	5,199	7,142	7,211
Mortgage backed securities	1,951	2,058	3,290	3,473
Corporate debt obligations	1,484	1,460	2,028	2,046
<b>TOTAL</b>	<b>\$ 38,330</b>	<b>\$ 38,261</b>	<b>\$ 31,978</b>	<b>\$ 32,491</b>
<b>Securities held-to-maturity:</b>				
Obligations of states, municipalities and political subdivisions	\$ 2,706	\$ 2,738	\$ 1,717	\$ 1,760

*Analysis of Investment Securities*

The following table sets forth the maturities of investment securities at December 31, 2004 (\$ in thousands, at amortized cost.):

	Within 1 year maturity	Weighted average yield	After 1 year but within 5 years maturity	Weighted average yield	After 5 years but within 10 years maturity	Weighted average yield	After 10 year maturity	Weighted average yield	Total	Weighted total average yield
U.S. Treasury	\$ 4,200	2.10%	\$ 1,003	1.63%	\$ 0		\$ 0		\$ 5,203	2.01%
U.S. government agencies	1,000	2.26%	7,499	2.16%	11,148	4.19%	10,045	4.75%	29,692	3.80%
Mortgage pass-throughs (GNMA/FNMA)							1,951	6.59%	1,951	6.59%
Corporate bonds	1,001	3.23%	0	0.00%			483	3.37%	1,484	3.27%
State and political subdivisions	100	3.03%	1,012	4.15%	820	5.97%	774	6.09%	2,706	5.22%
<b>Total by maturity and yield</b>	<b>\$ 6,301</b>	<b>2.32%</b>	<b>\$ 9,514</b>	<b>2.32%</b>	<b>\$ 11,968</b>	<b>4.31%</b>	<b>\$ 13,253</b>	<b>5.05%</b>	<b>\$ 41,036</b>	<b>3.78%</b>

**Comment 1.** Weighted-average yields for securities-held-to-maturity (securities issued by State and political subdivisions) are presented on a federal tax-equivalent basis at a 34% effective tax rate.

With the exception of U.S. Government and U.S. Government agencies and corporations, no securities issued by any one issuer exceed ten percent of stockholders' equity.

**Table of Contents****III. LOAN PORTFOLIO.**

The amounts of loans outstanding at the indicated dates are shown in the following table according to type of loan (\$ in thousands):

	<b>December 31</b>	
	<b>2004</b>	<b>2003</b>
Commercial loans	\$ 121,820	\$ 117,055
Real estate loans	25,644	22,127
Installment loans	4,368	4,625
Consumer and other loans	7,878	6,983
<b>TOTAL LOANS</b>	<b>159,710</b>	<b>150,790</b>
Allowance for loan losses	(1,944)	(2,042)
Deferred loan fees, net of deferred costs	(328)	(307)
<b>NET LOANS</b>	<b>\$ 157,438</b>	<b>\$ 148,441</b>

The following table shows the amounts and earlier of maturity/re-pricing of commercial, real estate and other loans outstanding as of December 31, 2004 (\$ in thousands):

	<b>Within 1 year maturity</b>	<b>After 1 year but within 5 year maturity</b>	<b>After 5 year maturity</b>	<b>TOTAL</b>
	Commercial	\$ 32,135	\$ 31,743	\$ 57,942
Real Estate Loans	12,985	3,430	9,229	25,644
Installment	1,004	1,608	1,756	4,368
Consumer and Other	4,106	0	3,772	7,878
<b>Totals</b>	<b>\$ 50,230</b>	<b>\$ 36,781</b>	<b>\$ 72,699</b>	<b>\$ 159,710</b>
<b>Loans maturing with:</b>				
Fixed Rates	\$ 6,449	\$ 24,426	\$ 10,294	\$ 41,169
Variable Rates	43,781	12,355	62,405	118,541
<b>Totals</b>	<b>\$ 50,230</b>	<b>\$ 36,781</b>	<b>\$ 72,699</b>	<b>\$ 159,710</b>

Loans are placed in a non-accrual status when they are not adequately collateralized and when, in the opinion of management the collection of interest is questionable. Thereafter, no interest is taken into income unless received in cash or until such time as the borrower demonstrates the ability to resume payments of principal and interest. Interest previously accrued but not collected is reversed and charged against income at the

time the loan is placed on non-accrual status.

	December 31	
	2004	2003
	(Dollars in Thousands)	
Loans accounted for on a non-accrual basis	\$ 531	\$ 216
Loans contractually past due ninety days or more as to interest or principal	\$ 16	\$ 8
Gross interest income which would have been recorded under original terms	\$ 21	\$ 19
Gross interest income recorded during the period.	\$ 1	\$ 1

**C.2.** As of the end of the most recent reported period, December 31, 2004, management has no knowledge of additional loans where the financial condition of its borrowers is likely to result in the inability of the borrower to comply with current loan repayment terms. All such credits known to management are identified in the table (above) and any identified potential loss has already been recognized by charge to the Loan Loss Reserve.

**Table of Contents****IV. SUMMARY OF LOAN LOSS EXPERIENCE.**

The following table provides an analysis of net losses by loan type for the past two years:

	December 31	
	2004	2003
	(Dollars in Thousands)	
Total loans net of deferred fees at end of period	\$ 159,382	\$ 150,483
YTD average net loans	\$ 150,011	\$ 143,985
Balance of allowance for possible loan losses at beginning of period	\$ 2,224	\$ 2,026
Loan charge-offs:		
Commercial	(74)	(13)
Real Estate	(128)	(378)
Installment & Credit Card	(65)	(95)
<b>Total Charge-offs</b>	<b>(267)</b>	<b>(486)</b>
Recoveries of loans previously charged-off:		
Commercial	4	28
Real Estate	12	1
Installment & Credit Card	7	3
<b>Total Recoveries</b>	<b>23</b>	<b>32</b>
<b>Net Charge-offs</b>	<b>(244)</b>	<b>(454)</b>
Provision charged to expense	170	652
<b>Balance, end of year, prior to adjustment for off-balance sheet items</b>	<b>2,150</b>	<b>2,224</b>
Reclassification of reserve for probable losses on unused loan commitments and off-balance sheet items to Accrued interest payable and other liabilities	(206)	(182)
<b>Balance, end of year</b>	<b>\$ 1,944</b>	<b>\$ 2,042</b>
Ratio of net charge-offs during period to average loans outstanding	0.16%	0.32%

Breakdown of Allowance for Loan Losses (\$ in thousands):

	December 31, 2004		December 31, 2003	
	Amount	% of allowance to total allowance	Amount	% of allowance to total allowance
Construction and land development (pass)	\$ 78	3.63%	\$ 131	5.89%
Secured by farmland (pass)	0	0.00%	0	0.00%

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Home equity loans (pass)	61	2.84%	55	2.47%
Revolving loans secured by 1-4 family residential (pass)	33	1.53%	22	0.99%
Secured by multi-family residential (pass)	8	0.37%	12	0.54%
Secured by non-farm, non-residential real estate (pass)	155	7.21%	303	13.62%
Commercial and industrial loans (pass)	441	20.51%	558	25.10%
Loans to individuals (pass)	195	9.07%	202	9.08%
Credit card loans	91	4.23%	124	5.58%
All other loans and leases (pass)	3	0.14%	3	0.13%
Mortgage loans held for sale	0	0.00%	0	0.00%
Specifically Identified Potential Loss *	719	33.45%	579	26.04%
Commitments to Lend under Lines/Letters of Credit	206	9.58%	182	8.18%
Supplementary Allowance/Non-specific Factors	160	7.44%	53	2.38%
	<u>        </u>	<u>        </u>	<u>        </u>	<u>        </u>
	\$ 2,150	100.00%	\$ 2,224	100.00%
	<u>        </u>	<u>        </u>	<u>        </u>	<u>        </u>

\* Risk category 5, 6 & 7 loans are individually analyzed at least quarterly to determine loss potential. Allocated reserves related to loans classified 5, 6 & 7 are reported as Specifically Identified Potential Loss.



**Table of Contents****V. DEPOSITS.**

The average amount of deposits and average rates paid on such deposits is summarized for the periods indicated in the following table (\$ in thousands):

	Years Ended December 31			
	2004		2003	
	Amount	Rate	Amount	Rate
Non-interest Bearing Demand Deposits	\$ 39,911	n/a	\$ 35,425	n/a
Interest Bearing Deposits:				
NOW Accounts	13,488	0.67%	13,320	0.84%
Money Market Accounts	52,137	0.99%	48,594	1.20%
Savings Accounts	6,972	0.43%	5,545	0.54%
Time Deposits	62,473	2.88%	63,916	3.00%
<b>Total Interest Bearing Deposits</b>	<b>\$ 135,070</b>	<b>1.80%</b>	<b>\$ 131,375</b>	<b>2.01%</b>

Maturities of Time Certificates of Deposit over \$100,000 are shown below (\$ in thousands):

	December 31	
	2004	2003
3 months or less (adjusted for matured CDs renewed subsequent to year-end)	\$ 12,068	\$ 11,235
Over 3 through 6 months	1,585	817
Over 6 through 12 months	2,439	1,108
Over 1 year through 5 years	7,552	7,773
Over 5 years	104	0
	<b>\$ 23,748</b>	<b>\$ 20,933</b>

**VI. RETURN ON EQUITY AND ASSETS.**

Ratios for the years ended December 31, 2004 and December 31, 2003 are as follows:

	<u>2004</u>	<u>2003</u>
<u>Ratio:</u>		
Return on Average Assets	0.90%	0.84%
Return on Average Equity	10.36%	9.95%
Average Equity to Average Assets	8.70%	8.41%
Dividend Payout Ratio	11.62%	10.35%

## VII. SHORT-TERM BORROWINGS.

As of the most recent reporting period, December 31, 2004, the Company had no short-term borrowings.

### Rate Shock

Each month, the Bank performs an analysis (the Rate Shock Analysis) of the effect that a sudden increase or decrease in interest rates would have on net interest income and the value of the Bank's equity. The Rate Shock Analysis presents estimates of the effect of an immediate change in rates of as much as +300 basis points and 300 basis points (+3% to -3%) as applied to all earning assets and interest bearing liabilities. Depending upon the re-pricing characteristics of the Bank's assets and liabilities, such a sudden change in rates can be expected to have either a positive or negative effect on Bank net interest income; the value of the Bank's equity will,

**Table of Contents**

likewise, be affected. Considering net interest income, for example, if substantially all of the Bank's deposits are fixed rate and substantially all of the Bank's loans are variable rate, an increase in interest rates would, initially, cause interest income to rise, while interest expense would not change. As a result, net interest income would increase until such time as deposits renewed or matured and were replaced with higher rate deposits. On the other hand, if rates were to decrease, the Bank would experience a decrease in net interest income. Sudden changes in interest rates will have a similar effect on the value of the Bank's equity. Non-interest income and non-interest expense are assumed to remain constant.

Presented below are the results of the analysis performed on financial information as of December 31, 2004. Generally, our analyses have been supportive of Bank management's desire to limit volatility of net interest income to no more than plus or minus ten-percent when applying an interest rate shock of plus or minus two-hundred basis points. With the year-end Federal Funds rate at 2.25%, management elected to shock downward rates at 0.50%, 1.00% and 1.50% rather than the higher rates that would be used in a more typical interest rate environment; upward rates were shocked at 1.00%, 2.00% and 3.00%. The results of the net interest income analysis performed December 31, 2004 are within established limits. The goal that has been established for change in economic value of equity seeks to limit the negative impact of a change in rates of plus or minus two-hundred basis points to no more than twenty-five percent; again, because of the current interest rate environment, downward rate shocks were adjusted to reflect the unlikelihood of rates falling more than 1.50%. The results of the economic value of equity analysis performed December 31, 2004, presented to indicate the estimated effect of changing rates on book value of equity, are within established limits.

**Table of Contents****Net Interest Income and Market Value****Summary Performance****December 31, 2004**

(\$ in thousands)

(\$ in thousands)

Projected Interest Rate Scenario	Net Interest Income			Economic Value of Equity		
	Estimated Value	\$ Change from Base	% Change from Base	Estimated Value	\$ Change from Base	% Change from Base
+300	\$ 9,170	\$ 78	0.86%	\$ 15,296	\$ (4,666)	-23.37%
+200	9,161	69	0.76%	16,333	(3,629)	-18.18%
+100	9,143	51	0.56%	18,157	(1,805)	-9.04%
Base	9,092	0	0.00%	19,961	0	0.00%
-50	9,080	(12)	-0.13%	20,836	874	4.38%
-100	9,066	(26)	-0.29%	21,744	1,783	8.93%
-150	\$ 8,999	\$ (93)	-1.02%	\$ 22,708	\$ 2,746	13.76%

**Forward-looking Statements**

This section, as well as certain other sections of this Annual Report, may contain forward-looking statements regarding, among other possible items, anticipated trends in the Company's business. These forward-looking statements are based on the Company's current expectations and are subject to a number of risks and uncertainties, certain of which are beyond the Company's control. Actual results could differ materially from these forward-looking statements as a result of various factors, including, among other possible ones, competition, regulatory, economic and business influences, services and products, business and growth plans and strategies, and other relevant market conditions. In light of these risks and uncertainties, there can be no assurance that any forward-looking statements contained in this Annual Report will in fact take place or prove to be accurate.

**ITEM 2. DESCRIPTION OF PROPERTY (Model B, Form 1-A, item 7.)**

The Company did not own or lease any real or personal property during the 2004 fiscal year; for its business, the Company utilizes the premises and equipment of the Bank.

The Bank owns the real property for the Northpointe branch located in north Spokane, Washington, the Coeur d'Alene branch, located in Coeur d'Alene, Idaho and the Post Falls branch, located in Post Falls, Idaho. The Bank owns the building for the South Hill branch located in south

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Spokane, Washington, which is constructed on leased land. Subsequent to year-end, the Bank purchased property located on East Sprague Avenue, in Spokane, and leased property, with an option to purchase, located on North Ruby Street, also in Spokane; these two transactions are not reflected in December 31, 2004 audited financial statements. The North Ruby Street site will be developed in 2005. The East Sprague site will be held for future development.

The Bank leases its principal office and main branch, which is located in the Paulsen Center in downtown Spokane, Washington. The Bank also leases additional, adjacent space, which is used for a drive-through banking station and parking facilities.

The Bank leases four other branches situated inside of retail grocery stores. The branches are located in or around Spokane, Washington, including the Spokane Valley, Airway Heights and north Spokane (the Spokane Valley branch, the Airway Heights branch, the North Foothills branch and the Indian Trail branch).

The Bank leases additional office space situated in the same retail grocery store as its Spokane Valley branch; this office is used by four employees of the Bank's mortgage department.

## Table of Contents

Subsequent to year-end, the Bank entered into a lease agreement for office space in the Marcus Whitman Hotel, located in Walla Walla, Washington; the Bank opened a loan production office (LPO) in that facility in January 2005, employing two commercial loan officers and a loan assistant. The Bank plans to request approval from its regulators to convert the LPO into a Bank branch within the next few months. During the three year term of the lease, the Bank will determine whether to relocate the branch to a stand-alone location, develop an additional stand-alone location or negotiate a longer lease term in the present location.

In addition to the three owned locations, the Bank has made significant improvements in the one ground-lease location and in leasehold improvements at the seven leased locations. As of December 31, 2004, the total net book value of the Bank's consolidated premises and equipment was \$4,357,980.

### **ITEM 3. DIRECTORS, EXECUTIVE OFFICERS AND SIGNIFICANT EMPLOYEES (Model B, Form 1-A, item 8.)**

#### *Directors*

The Board of Directors of the Company currently consists of thirteen members and is divided into three classes. Directors within each class are elected to three-year terms, meaning that under ordinary circumstances, at any given time, approximately one-third of the Board would be in its second year of service and another one-third would be in its third year of service. The same persons currently serve as directors of the Bank and are elected in the same manner.

**Dwight B. Aden, Jr.** Mr. Aden is 62 and has been a director of the Bank and the Company since May 20, 1996. His term as a director will expire at the annual meeting of shareholders to be held in 2005. For the five years prior to his retirement, in 1997, Mr. Aden was a senior member and an owner of Jones & Mitchell Insurance Co., an insurance brokerage firm in Spokane, Washington.

**Jimmie T.G. Coulson** Mr. Coulson is 71 and has been a director of the Bank since its incorporation on May 26, 1989. He has been a director of the Company since March 30, 1992. Mr. Coulson's current term as director will expire at the annual meeting of shareholders to be held in 2005. During the past five years, Mr. Coulson has been the President and Chief Executive Officer of The Coeur d'Alenes Company, a steel service center and fabrication facility located in Spokane, Washington.

**Harlan D. Douglass** Mr. Douglass is 67 and has been a director of the Bank since May 26, 1989. He has been a director of the Company since March 30, 1992. Mr. Douglass's current term as a director of the Bank will expire at the annual meeting of shareholders to be held in 2005. Mr. Douglass's primary business activities consist of the management of a diversified real estate business, including multifamily and commercial projects.

**Freeman B. Duncan** Mr. Duncan is 58 and has been a director of the Bank and the Company since May 20, 1996. His term as a director will expire at the annual meeting of shareholders to be held in 2005. Mr. Duncan is an attorney specializing in real estate matters.

**Donald A. Ellingsen, M.D.** Dr. Ellingsen is 68 and has been a director of the Bank and the Company since May 20, 1996. His term as a director will expire at the annual meeting of shareholders to be held in 2005. Prior to his retirement on June 30, 1998, Dr. Ellingsen was an ophthalmologist and a member of the Spokane Eye Clinic, Spokane, Washington.

Randall L. Fewel Mr. Fewel is 56; he is a director, President and Chief Executive Officer of the Bank. He has been a director of the Bank since May 16, 2000 and has served as President of the Company and President and Chief Executive Officer of the Bank since July 1, 2001. Mr. Fewel's current term as a director will expire at the annual meeting of shareholders to be held in 2006. Mr. Fewel has been employed by the Bank since 1994. He previously served as its Chief Operating Officer and, prior to that, as its Senior Loan Officer.

**Table of Contents**

Clark H. Gemmill Mr. Gemmill is 62. He has been a director of the Bank since its incorporation on May 26, 1989 and a director of the Company since March 30, 1992. Mr. Gemmill's current term as a director will expire at the annual meeting of shareholders to be held in 2007. During the past five years, he has been a Vice President with UBS Financial Services, Inc., a financial investment firm with a branch office in Spokane, Washington.

Bryan S. Norby Mr. Norby is 47. He has been a director of the Bank since August 15, 1989, and a director of the Company since March 30, 1992. Mr. Norby's current term as a director will expire at the annual meeting of the shareholders to be held in 2006. Mr. Norby is a certified public accountant and during the past five years has been Treasurer and Financial Analyst for a Boise, Idaho based business enterprise.

Richard H. Peterson Mr. Peterson is 70 and has been a director of the Bank since its incorporation on May 26, 1989. He has been a director of the Company since March 30, 1992. Mr. Peterson's current term as a director will expire at the annual meeting of the shareholders to be held in 2006. During the past five years, Mr. Peterson was a Senior Vice President of First Union Securities at its branch in Spokane and currently is a Senior Vice President with Ragen MacKenzie, a financial investment firm, also with a branch office in Spokane, Washington.

Phillip L. Sandberg Mr. Sandberg is 72 and has been a director of the Bank since its incorporation on May 26, 1989. He has been a director of the Company since March 30, 1992. Mr. Sandberg's current term as a director will expire at the annual meeting of shareholders to be held in 2007. For the five years prior to his retirement on October 20, 1998, Mr. Sandberg had been the President and Chief Executive Officer of Sandberg Securities, an independent investment services firm in Spokane, Washington.

Frederick M. Schunter Mr. Schunter is 68; he has been a director of the Bank since its incorporation on May 26, 1989 and, until his retirement on June 30, 2001, was President and Chief Executive Officer of the Bank. He has been a director of the Company since December 10, 1991 and was President of the Company prior to his retirement. Mr. Schunter's current term as a director will expire at the annual meeting of shareholders to be held in 2007. Since June 10, 2002, Mr. Schunter has been the President of Northwest Business Development Association, a non-profit Certified Development Company that assists small business borrowers in acquiring loans guaranteed by the U.S. Small Business Administration or other government or private entities.

William E. Shelby Mr. Shelby is 66 and has been a director of the Bank since its incorporation on May 26, 1989 and Chairman of the Bank Board since May 16, 1995. He has been a director of the Company since March 30, 1992 and Chairman of the Company's Board since May 21, 1996. Mr. Shelby's current term as a director will expire at the annual meeting of shareholders to be held in 2007. For the five years prior to his retirement on December 31, 2003, Mr. Shelby had been the Vice President of Store Development for U.R.M. Stores, Inc.

James R. Walker Mr. Walker is 71 and has been a director of the Bank since its incorporation on May 26, 1989. He has been a director of the Company since March 30, 1992. Mr. Walker's current term as a director will expire at the annual meeting of the shareholders to be held in 2007. Mr. Walker retired in 1995. For the five years prior to his retirement, he was the President and Chief Executive Officer of Hazen & Clark, Inc., a general contracting firm located in Spokane, Washington.

*Officers*

In addition to Mr. Fewel, the executive officers of the Company and its subsidiary are:



Holly A. Austin Ms. Austin is 34 and is an officer of the Bank and Secretary/Treasurer of the Company. She is a certified public accountant and has been employed by the Bank since June 1997. Prior to that time, between 1992 and 1997, Ms. Austin worked for a public accounting firm with offices in Spokane. She currently is Senior Vice President and Cashier of the Bank.

## **Table of Contents**

Christopher C. Jurey Mr. Jurey is 55 and has been an officer of the Bank since 1991. He currently is Executive Vice President of the Bank and Chief Financial Officer of the Bank and the Company.

There are no family relationships among these directors and executive officers. There also are no arrangements or understandings between these persons and any one of the other named persons pursuant to which any of these persons have been selected for the office or position.

### *Significant Employees*

James M. Abrahamson Mr. Abrahamson is 63 and has been an officer of the Bank since 1996. He currently is a Senior Vice President, Commercial Loan Officer and Team Leader.

Douglas J. Beaudoin Mr. Beaudoin is 53 and has been an officer of the Bank since 1998. He currently is a Senior Vice President and manager of the Bank's mortgage department.

Richard L. Brittain Mr. Brittain is 52 and has been an officer of the Bank since 1995. He currently is a Senior Vice President and Credit Administrator.

Elizabeth A. Herndon Ms. Herndon is 50 and has been an officer of the Bank since 1995. She currently is a Senior Vice President and Branch Administrator.

Ronald G. Jacobson Mr. Jacobson is 49 and has been an officer of the bank since 2001. Prior to that time, between 1989 and 2001, Mr. Jacobson worked as a Vice President in the private banking department of a community based financial institution headquartered in Spokane. He currently is a Senior Vice President and North Idaho Division Manager.

### **Code of Ethics**

The Company has adopted a code of ethics within the meaning of Item 406(b) of Regulation S-B promulgated by the Securities and Exchange Commission. This code of ethics applies to all officers, directors and employees of the Company. The Company will provide to any person, without charge, upon request, a copy of such code of ethics. A person may request a copy by writing or telephoning the Company at the following address:

**Northwest Bancorporation, Inc.**

**Attention: Christopher C. Jurey**

421 W. Riverside Avenue

Spokane, WA 99201

(509) 456-8888

#### **Audit Committee Matters**

The Company's Board of Directors has a separately designated standing Audit Committee for the purpose of overseeing the accounting and financial reporting processes of the Company and audits of the Company's financial statements. The Audit Committee is comprised solely of directors Bryan S. Norby, Phillip L. Sandberg, Dwight B. Aden, Jr., Freeman B. Duncan, Donald A. Ellingsen, M.D. and James R. Walker, each of whom is an independent director. The Audit Committee has oversight responsibilities of the Company's financial statements and the financial reporting process, preparation of the financial reports and other financial information provided by the Company to any governmental or regulatory body, the systems of internal financial controls, the internal audit function and the annual independent audit of the Company's financial statements. Mr. Norby has been designated as the Audit Committee financial expert as defined by the Sarbanes-Oxley Act of 2002. The Board of Directors has determined that Mr. Norby has the attributes required by Item 401(e) of Regulation S-B to act in that capacity.

**Table of Contents****ITEM 4. REMUNERATION OF DIRECTORS AND OFFICERS (Model B, Form 1-A, item 9.)**

The following table sets forth all compensation paid during the last fiscal year to the Chief Executive Officer and executive officer(s) of the Company and its subsidiary. Directors are compensated as described below. Other than as detailed, below, no officer or director of the Company has received any other remuneration or indirect financial benefit to date.

*Executive Compensation*

Name and Capacities in which Remuneration was Received	Year	Salary	Bonus(a)	Deferred Compensation(b)	Other Annual Compensation(c)	401(k)
						Matching Contribution(d)
Randall L. Fewel	2004	154,606	29,824	5,400	11,690	4,112
<i>President &amp; Chief Executive Officer</i>						
Christopher C. Jurey	2004	100,141	17,222	12,000	5,210	2,934
<i>Executive Vice President &amp; Chief Financial Officer</i>						
Holly A. Austin	2004	82,000	12,227	0	4,872	2,356
<i>Senior Vice President &amp; Cashier</i>						

(a) See Incentive Plan for Senior Management, below.

(b) Employees of the Bank with the title of Vice President or higher may elect to defer a portion of their compensation, with prior approval (annually) of the Board of Directors. The Bank does not match voluntarily deferred income; it does, however, credit interest on salary thus deferred. The Bank credits interest at the tax-equivalent rate that it earns on Bank Owned Life Insurance (BOLI) products that it owns.

(c) Includes the aggregate value of perquisites and personal benefits that were no more than the lesser of \$50,000 or 10% of the executive's salary and bonus.

(d) The Bank matches 50% of employee contributions to the 401(k) Plan. The matching contribution is limited to a maximum of 2.5% of the employee's salary.

*Director Compensation*

In 2004, Directors of the Bank (excluding the Chairman and Mr. Fewel) received an attendance fee in the amount of \$250 per meeting and \$150 per committee meeting. The Chairman received a \$450 attendance fee per board meeting. Director-employees are not compensated for meeting attendance. Each director other than the Board Chairman and Mr. Fewel also received 300 shares of Common Stock of the Company as additional compensation. The Board Chairman received 400 shares of Common Stock of the Company as additional compensation. No other compensation arrangement has been established for the directors of the Company as yet.

The aggregate annual remuneration of executive and corporate officers and directors of the Bank as a group was \$562,200 for fiscal year 2004.

*Employment and Change of Control Agreements*

The Bank has entered into an employment agreement with Mr. Fewel that provides for a continuous employment term until such time as the Bank notifies him that the Bank will establish an employment term of one-year, commencing with the date of receipt of such notice by him. Upon receiving such notice Mr. Fewel could resign and continue to receive payment of his fixed-salary and certain benefits for a period of one-year. The agreement provides that, during the term of the agreement, he will remain employed in an executive position, with no reduction in his fixed-salary should his position change and that his fixed-salary will be adjusted annually at the discretion of the Board. The fixed-salary will not be decreased from year-to-year; however, incentive payments, if any, and other benefits may be more or less than received in prior years. The Bank may terminate Mr. Fewel's employment without cause; however, in that case, he would continue to receive payment of his fixed salary and certain benefits for a period of one-year.

## **Table of Contents**

In the event of a change in control of the Company, the agreement provides for a severance payment to Mr. Fewel if his employment is terminated or if he resigns during a thirty-six month period following the date of the change in control; other benefits are discontinued, except as may be required by law. Any severance payment made to him will be reduced to the extent necessary to meet the requirements of Internal Revenue Service regulations then in effect, as well as the rules, regulations or lawful directives of other agencies with regulatory or supervisory authority over the Company or the Bank. The Bank's obligation for payment to Mr. Fewel under any of the above-described circumstances may be reduced, in part or in full, if he receives compensation from a successor employer or from self-employment while the Bank is making payment to him. If the successor employer is a financial institution located within the Bank's market area, and if he has not obtained prior approval from the Bank's Board of Directors, the Bank is under no obligation to continue any payment of salary or benefits.

The Bank has entered into a similar employment agreement with Mr. Jurey; however, in the event of a change in control, the period considered for severance payments is twenty-four months. Employment agreements with Ms. Austin and other non-executive officers are consistent as to all terms; with the exception that the period considered for severance payment is twelve months.

### *Incentive Plan for Senior Management*

The purpose of the Executive Incentive Plan (the "EIP") is to reward senior Bank management for its efforts in meeting or exceeding the annual goals presented to the Board of Directors during the annual budgeting process. The EIP defines a number of factors that are considered to be of importance by the Board in enhancing the long-term viability of the bank and return to shareholders. A portion of each officer's total compensation is dependent upon performance in relation to budget, adjusted to reflect the Bank's overall performance in comparison to that of similar financial institutions. Incentive payments made to named executives under the EIP are disclosed in the table detailing executive compensation.

### *Executive Retirement Plan*

The Bank maintains an unfunded supplemental executive retirement plan for the benefit of the Bank's former chief executive officer, which is fully vested. The plan provides for monthly payments for a period of fifteen years beginning on June 30, 2001. In the event of his death, the plan provides for payment to his designated beneficiary.

At December 31, 2004 and 2003, \$186,445 and \$196,045, respectively, has been accrued under this plan. This liability is recognized in accrued interest and other liabilities in the financial statements.

The net post-retirement benefit cost recognized during the years ended December 31, 2004 and 2003, was \$15,038 and \$15,717, respectively.

The Bank is the owner and beneficiary of life insurance policies on this former officer with a total face value of \$228,127 and cash surrender value of \$214,840 and \$206,679 at December 31, 2004 and 2003, respectively.

**Table of Contents****ITEM 5. SECURITY OWNERSHIP OF MANAGEMENT AND CERTAIN SECURITY HOLDERS (Model B, Form 1-A, item 10.)**

The Company does not have any compensated officers; the information in this item is provided for each director and executive officer of the Company and the Bank.

Officers and directors as a group own of record, to the knowledge of the Company, 512,015 shares of common stock of the Company, representing 28.31% of the outstanding shares of common stock. No shareholder of record presently owns more than ten-percent (10%) of the outstanding shares of common stock of the Company, nor would the exercise of stock options increase any shareholder ownership of record to more than ten-percent (10%).

**SECURITY OWNERSHIP OF MANAGEMENT AND OTHERS**

<u>Name and Position</u>	<u>Number of Shares Beneficially Owned(1)</u>	<u>Notes</u>	<u>Percentage of Class</u>
Harlan D. Douglass, Director	179,887	(2)(6)	8.97%
Frederick M. Schunter, Director	60,069	(2)	3.00%
Jimmie T.G. Coulson, Director	52,581	(2)(3)	2.62%
Clark H. Gemmill, Director	44,518		2.22%
Phillip L. Sandberg, Director	38,138		1.90%
James R. Walker, Director	33,935	(2)	1.69%
Richard H. Peterson, Director	31,793		1.59%
Christopher C. Jurey, EVP/Chief Financial Officer	18,305		*
Randall L. Fewel, President/Chief Executive Officer	13,403		*
William E. Shelby, Chairman	13,064		*
Donald A. Ellingsen, Director	10,395	(4)	*
Bryan S. Norby, Director	7,807	(2)	*
Freeman B. Duncan, Director	4,057	(5)	*
Dwight B. Aden Jr., Director	3,688		*
Holly A. Austin, SVP/Cashier, Secretary/Treasurer	375		*
<b>Total</b>	<b>512,015</b>	<b>(2-6)</b>	<b>28.31%</b>

\* Less than 1.0%

(1) Shares held directly with sole voting and investment power, unless otherwise indicated.

(2) Includes shares held with or by his/her spouse.

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- (3) Includes 5,573 shares held by CINV.
- (4) Includes 8,314 shares held by Spokane Eye Clinic.
- (5) Includes 3,291 shares held in the Freeman B. Duncan Profit Sharing Plan and 756 shares held in the National Associates Spokane Corp. FBO Freeman Duncan Profit Sharing Plan.
- (6) Includes 3,783 shares held by Harlan Douglass, Inc.

### *Stock Option Plan*

During 1992, the Board of Directors of the Bank authorized key employees of the Bank to be eligible to participate in a nonqualified stock option plan (the Plan). At its meeting on April 16, 2002, the Board approved an amendment to the Plan, reserving and setting aside an additional 125,000 shares of the common stock of the Company for issuance pursuant to options granted under the Plan. The amended Plan was incorporated in the Company's June 30, 2002 Form 10-QSB filing as Exhibit 10.2.31. Under the Plan, the Board of Directors may



**Table of Contents**

grant options to purchase shares of common stock of the Corporation, as adjusted for stock dividends as they are paid from time to time, not to exceed 267,501 shares. At December 31, 2004, 127,257 options remained available for future grant to employees. The per option price for options granted is the fair market value of said share on the date the option is granted. The number of shares granted by the stock option are adjusted for stock dividends declared prior to exercise or expiration of the option, as is the effective exercise price.

<u>Name of Holder</u>	<u>Expiration Date</u>	<u>Title and Amount of Securities Called for by Options, Warrants or Rights</u>	<u>Effective Exercise Price(1)</u>	<u>Date Exercisable if not Currently Exercisable</u>
Randall L. Fewel	12/16/06	Option 1,544	8.09	(2)
	12/15/07	Option 1,404	9.26	(2)
	12/14/08	Option 2,553	12.54	(2)
	12/20/09	Option 2,553	12.54	(2)
	12/18/10	Option 3,647	8.23	(3)
	06/30/11	Option 11,576	8.64	(4)
	12/17/12	Option 5,513	9.16	(5)
	12/16/13	Option 3,150	12.67	(6)
	12/20/14	Option 2,000	13.85	22-Dec-05
Christopher C. Jurey	12/16/06	Option 1,544	8.09	(2)
	12/15/07	Option 1,404	9.26	(2)
	12/14/08	Option 2,553	12.54	(2)
	12/20/09	Option 2,553	12.54	(2)
	12/18/10	Option 2,431	8.23	(3)
	12/17/12	Option 1,654	9.16	(5)
	12/16/13	Option 1,575	12.67	(6)
	12/20/14	Option 1,000	13.85	22-Dec-05
Holly A. Austin	12/14/08	Option 1,276	12.54	(2)
	12/20/09	Option 2,553	12.54	(2)
	12/18/10	Option 2,431	8.23	(3)
	12/17/12	Option 551	9.16	(5)
	12/16/13	Option 1,050	12.67	(6)
	12/20/14	Option 750	13.85	22-Dec-05

- (1) The number of shares subject to the option has been increased to reflect the declaration of stock dividends after the options were granted and the stock split effective May 28, 1999; the exercise price also has been adjusted to correspond with the increase in shares.
- (2) Options are fully vested and exercisable.
- (3) Options are exercisable to the extent that they are currently vested 80%.
- (4) Options are exercisable to the extent that they are currently vested 60%.
- (5) Options are exercisable to the extent that they are currently vested 40%.
- (6) Options are exercisable to the extent that they are currently vested 20%.

**ITEM 6. INTEREST OF MANAGEMENT AND OTHERS IN CERTAIN TRANSACTIONS (Model B, Form 1-A, item 11.)**

The Company, through its Bank subsidiary has had, and may be expected to have in the future, banking transactions in the ordinary course of business with directors, principal officers, their immediate families, and affiliated companies in which they are principal stockholders. Aggregate loan balances with related parties at December 31, 2004 and 2003, were \$2,369,859 and \$2,980,403, respectively. During the year ended December 31, 2004 and 2003, total principal additions were \$778,674 and \$1,190,256 and total principal payments were \$1,389,218 and \$266,235, respectively. Aggregate deposit balances with related parties at December 31, 2004 and 2003, were \$1,191,553 and \$3,474,468, respectively. All related party loans and deposits which have been made, in the opinion of management, are on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others.

**Table of Contents****PART II****ITEM 1. MARKET PRICE OF AND DIVIDENDS ON THE REGISTRANT'S COMMON EQUITY AND OTHER SHAREHOLDER MATTERS****Market Information**

There is no established public trading market for the Company's shares of common stock. Transactions take place from time to time and the Company becomes aware of those transactions if certificates are presented for transfer. Quotations are published in a daily newspaper in Spokane, Washington but those quotations are not necessarily reflective of actual transactions. Quotations may also be obtained by researching the stock symbol NBCT. Various Internet quotation services detail information about daily transaction volume and price. One such service is the OTC Bulletin Board ([www.otcbb.com](http://www.otcbb.com)) where a list of market makers is also detailed. The high and low range of actual transactions using the daily ending price, by quarters, for the Company's last two fiscal years is set forth below.

	(adjusted for 5% stock dividends in May 2004 and 2003)			
	2004		2003	
	High	Low	High	Low
January 1 - March 31	\$ 14.29	\$ 12.67	\$ 9.98	\$ 9.16
April 1 - June 30	\$ 16.19	\$ 13.33	\$ 11.24	\$ 9.52
July 1 - September 30	\$ 13.75	\$ 13.00	\$ 12.86	\$ 11.24
October 1 - December 31	\$ 15.50	\$ 13.00	\$ 13.08	\$ 12.62

The Company declared a 5% stock dividend, payable June 15, 2004, to holders of record May 14, 2004; 94,925 shares were issued on June 15, 2004.

The above quotations may not reflect inter-dealer prices and should not be considered over-the-counter market quotations as that term is customarily used.

**Holders**

As of December 31, 2004, there were approximately 445 holders of record of the Company's common stock, including shares held, to the best knowledge of the Company, by 25 non-affiliated depositories. These non-affiliated depositories hold shares for at least 130 individual shareholders. The Company has relied upon information received from those depositories in determining the number of record holders.

**Dividends**

On April 22, 2004, the Board of Directors declared a twelve-cent (\$0.12) per share cash dividend, which was paid on June 15, 2004 to shareholders of record as of March 14, 2004. On February 18, 2003, the Board of Directors declared a ten-cent (\$0.10) per share cash dividend, which was paid on April 4, 2003 to shareholders of record as of March 21, 2003.

Under the Washington Business Corporation Act, dividends may not be paid if, after the payment is made, the corporation would not be able to pay its debts as they become due in the usual course of business, or the corporation's total assets would be less than the sum of its total liabilities (plus the amount that would be needed, if the corporation were to be dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of shareholders, if any, whose preferential rights are superior to those receiving the distribution).

The principal source of the Company's revenue and cash flow is dividends from the Bank. The Bank is subject to various statutory and regulatory restrictions on its ability to pay dividends or otherwise make distributions or supply funds to the Company. In addition, bank regulators may have authority to prohibit a bank subsidiary from paying dividends, depending on the bank subsidiary's financial condition, if such payment is deemed to constitute an unsafe or unsound practice.

**Table of Contents**

Earnings appropriated to bad debt reserves for losses and deducted for federal income tax purposes are not available for dividends without the payment of taxes at the current income tax rates on the amount used.

**Securities authorized for issuance under equity compensation plans**

	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted average exercise price of outstanding options, warrants and rights	Number of securities available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
(In thousands, except per share amounts)			
Equity compensation plans approved by security holders	0	0	0
Equity compensation plans not approved by security holders	124	\$ 10.61	127
	124	\$ 10.61	127

**ITEM 2. DESCRIPTION OF EXHIBITS**

The Company previously has filed, electronically, the documents required to be filed as Exhibits Nos. 2, 3, 5, 6, and 7 of Part III of Form 1-A. The lease agreement related to property located on North Ruby Street in Spokane, Washington (discussed in Part 1, item 2, Description of Property ) is being filed with this report as Exhibit 10.1.10. The Certifications of Randall L. Fewel, President and Chief Executive Officer and Christopher C. Jurey, Chief Financial Officer, are being filed with this report as Exhibits 31.1, 31.2, 32.1 and 32.2 as required by Part II, Item 2.

**ITEM 3. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS**

During the Company's two most recent fiscal years, there has been no resignation (or declination to stand for re-election) or dismissal of the principal independent accountant of the Company or the Bank.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

No matter was submitted to a vote of security holders during the fourth quarter of the 2004 fiscal year.

**ITEM 5. COMPLIANCE WITH SECTION 16(a) OF THE EXCHANGE ACT**

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Based on the Company's review of the copies of reports filed on Forms 3, 4 and 5 by officers and directors of the Company, pursuant to Section 16(a) of the Exchange Act, the Company believes that all filing requirements applicable to such persons have been timely complied with in 2004, with the following exceptions: Form 4 filings related the sale of 700 shares in three separate transactions by Jimmie T.G. Coulson, a Director, were not timely filed.

**Table of Contents**

**NORTHWEST BANCORPORATION, INC. AND SUBSIDIARY  
INDEPENDENT AUDITOR S REPORT AND FINANCIAL STATEMENTS**

**DECEMBER 31, 2004 and 2003**

**TABLE OF CONTENTS**

<u>Independent Auditor s Report</u>	26
Consolidated Financial Statements	
<u>Consolidated statement of financial condition</u>	27
<u>Consolidated statement of income</u>	28
<u>Consolidated statement of changes in stockholders equity</u>	29
<u>Consolidated statement of cash flows</u>	30
<u>Notes to consolidated financial statements</u>	32

**Table of Contents**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors

Northwest Bancorporation, Inc.

and Subsidiary

Spokane, Washington

We have audited the accompanying consolidated statements of financial condition of Northwest Bancorporation, Inc. and subsidiary as of December 31, 2004 and 2003, and the related consolidated statements of income, equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Northwest Bancorporation, Inc. and subsidiary as of December 31, 2004 and 2003, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/ Moss Adams LLP

Spokane, Washington

January 21, 2005



**Table of Contents****NORTHWEST BANCORPORATION, INC. AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**

	December 31,	
	2004	2003
<b>ASSETS</b>		
Cash and due from banks	\$ 7,736,465	\$ 7,465,931
Interest bearing deposits in other institutions	2,448,852	5,117,863
Federal funds sold	1,053,845	5,000,000
Securities available for sale	38,261,258	32,491,488
Securities held to maturity, fair value 2004 \$2,738,277 and 2003\$1,759,906	2,706,435	1,717,399
Federal Home Loan Bank stock, at cost	643,300	625,300
Loans receivable, net of allowance for loan losses 2004 \$1,943,760; 2003 \$2,042,129	157,438,241	148,441,143
Loans held for sale	623,263	446,245
Premises and equipment	4,357,980	3,699,691
Accrued interest receivable	831,148	824,458
Foreclosed real estate and other repossessed assets	722,535	1,832,085
Other assets	3,648,939	2,882,265
<b>Total assets</b>	<b>\$ 220,472,261</b>	<b>\$ 210,543,868</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Deposits	\$ 177,036,655	\$ 166,030,900
Securities sold under agreements to repurchase	12,995,813	17,206,456
Accrued interest and other liabilities	1,283,650	940,467
Borrowed funds	9,194,661	7,862,281
<b>Total liabilities</b>	<b>200,510,779</b>	<b>192,040,104</b>
Commitments and Contingencies (note 10)		
Stockholders equity		
Common stock, no par value, authorized 5,000,000 shares; issued and outstanding 2,004,901 and 1,898,772 shares	16,943,428	15,332,345
Retained earnings	3,063,164	2,832,316
Accumulated comprehensive income (loss)	(45,110)	339,103
<b>Total stockholders equity</b>	<b>19,961,482</b>	<b>18,503,764</b>
<b>Total liabilities and stockholders equity</b>	<b>\$ 220,472,261</b>	<b>\$ 210,543,868</b>

See accompanying notes.



**Table of Contents****NORTHWEST BANCORPORATION, INC. AND SUBSIDIARY****CONSOLIDATED STATEMENT OF INCOME**

	<b>Year Ended December 31,</b>	
	<b>2004</b>	<b>2003</b>
<b>Interest Income:</b>		
Loans receivable, including fees	\$ 9,764,294	\$ 9,725,053
<b>Investment securities:</b>		
U.S. government agency securities	1,342,252	1,321,637
U.S. treasury securities	113,728	176,326
Other securities	174,685	271,465
Federal funds sold and interest bearing deposits	130,926	86,401
<b>Total interest income</b>	<b>11,525,885</b>	<b>11,580,882</b>
<b>Interest Expense:</b>		
Deposits	2,435,016	2,643,880
Borrowed funds and securities sold under agreements to repurchase	463,718	408,130
<b>Total interest expense</b>	<b>2,898,734</b>	<b>3,052,010</b>
<b>Net interest income</b>	<b>8,627,151</b>	<b>8,528,872</b>
Provision for loan losses	170,000	652,500
<b>Net interest income after provision for loan losses</b>	<b>8,457,151</b>	<b>7,876,372</b>
<b>Noninterest Income:</b>		
Service charges on deposits	1,020,469	1,007,243
Net gains from sale of loans	498,563	800,365
Gain on sale of securities	36,745	100,303
Other income	499,395	452,099
	2,055,172	2,360,010
<b>Noninterest Expense:</b>		
Salaries and employee benefits	4,468,202	4,678,833
Occupancy expense	713,580	687,296
Equipment expense	513,304	526,787
(Gain) loss on foreclosed real estate and other repossessed assets	37,856	(58,757)
Other operating expenses	1,889,624	1,822,083
	7,622,566	7,656,242
<b>Net income before income taxes</b>	<b>2,889,757</b>	<b>2,580,140</b>
Income tax expense	925,440	833,865

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Net income	\$ 1,964,317	\$ 1,746,275
Basic earnings per share	\$ 0.98	\$ 0.88
Diluted earnings per share assuming full dilution	\$ 0.97	\$ 0.87

See accompanying notes.

**Table of Contents****NORTHWEST BANCORPORATION, INC. AND SUBSIDIARY****CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY**

	<u>Common Stock</u>		<u>Retained Earnings</u>	<u>Accumulated Comprehensive Income</u>		<u>Comprehensive Income</u>
	<u>Shares</u>	<u>Amount</u>		<u>Income</u>	<u>Total</u>	
Balance, December 31, 2002	1,808,335	\$ 14,325,289	\$ 2,271,912	\$ 783,625	\$ 17,380,826	
Net income			1,746,275		1,746,275	\$ 1,746,275
Stock repurchased	(2,847)	(26,776)			(26,776)	
Stock sold	252	2,797			2,797	
Stock issued to directors	2,700	28,350			28,350	
5% stock dividend	90,332	1,002,685	(1,002,685)			
Cash dividend (\$0.10 per share)			(180,820)		(180,820)	
Fractional shares paid in cash			(2,366)		(2,366)	
Net change in unrealized gain on available for sale securities, net of taxes				(444,522)	(444,522)	(444,522)
<b>Comprehensive income</b>						<b>\$ 1,301,753</b>
Balance, December 31, 2003	1,898,772	15,332,345	2,832,316	339,103	18,503,764	
Net income			1,964,317		1,964,317	\$ 1,964,317
Stock sold	7,504	54,979			54,979	
Stock issued to directors	3,700	54,390			54,390	
5% stock dividend	94,925	1,501,714	(1,501,714)			
Cash dividend (\$0.12 per share)			(228,338)		(228,338)	
Fractional shares paid in cash			(3,417)		(3,417)	
Net change in unrealized gain on available for sale securities, net of taxes				(384,213)	(384,213)	(384,213)
<b>Comprehensive income</b>						<b>\$ 1,580,104</b>
Balance, December 31, 2004	2,004,901	\$ 16,943,428	\$ 3,063,164	\$ (45,110)	\$ 19,961,482	

See accompanying notes.

**Table of Contents****NORTHWEST BANCORPORATION, INC. AND SUBSIDIARY****CONSOLIDATED STATEMENT OF CASH FLOWS**

	<b>Year Ended December 31,</b>	
	<b>2004</b>	<b>2003</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 1,964,317	\$ 1,746,275
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	449,047	478,424
Provision for loan losses	170,000	652,500
Provision for losses on foreclosed real estate and other repossessed assets	70,000	105,000
Accretion of securities discounts	(98,268)	(65,818)
Amortization of securities premiums	106,492	163,945
Loss on disposal of assets	14,201	
Net gain on sale of foreclosed real estate and other repossessed assets	(32,144)	(163,757)
Stock dividends received	(18,000)	(33,300)
Deferred income taxes	191,234	(73,571)
Net gain on sale of securities	(36,745)	(100,303)
Change in assets and liabilities:		
Accrued interest receivable	(6,690)	238,852
Other assets	(759,980)	(817,412)
Loans held for sale	(177,018)	217,548
Accrued interest and other liabilities	343,183	(106,760)
<b>Net cash provided by operating activities</b>	<b>2,179,629</b>	<b>2,241,623</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Net (increase) decrease in federal funds sold	3,946,155	(5,000,000)
Securities available for sale:		
Proceeds from maturities or principal payments	36,539,886	34,273,719
Proceeds from sales	1,062,187	3,391,925
Purchases	(43,919,913)	(18,513,136)
Securities held to maturity:		
Proceeds from maturities or principal payments	825,000	1,020,000
Purchases	(1,819,586)	(802,280)
Purchases of premises and equipment	(1,121,537)	(760,471)
Proceeds from sale of premises and equipment		148,708
Proceeds from sale of foreclosed real estate and other repossessed assets	1,178,573	1,007,046
Net increase in loans	(9,273,977)	(15,295,368)
<b>Net cash used by investing activities</b>	<b>(12,583,212)</b>	<b>(529,857)</b>

See accompanying notes.



**Table of Contents****NORTHWEST BANCORPORATION, INC. AND SUBSIDIARY****CONSOLIDATED STATEMENT OF CASH FLOWS (Continued)**

	<b>Year Ended December 31,</b>	
	<b>2004</b>	<b>2003</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net increase (decrease) in deposits	\$ 11,005,755	\$ (26,968)
Net decrease in securities sold under agreements to repurchase	(4,210,643)	(763,935)
Proceeds from issuance of common stock	109,369	31,147
Payment of fractional shares	(3,417)	(2,366)
Repurchase of common stock		(26,776)
Payment of cash dividends	(228,338)	(180,820)
Proceeds from issuance of borrowed funds		2,000,000
Repayment of borrowed funds	(2,648,011)	(385,191)
Net increase in structured notes	3,980,391	
Net decrease in fed funds purchased		(600,000)
	<u>8,005,106</u>	<u>45,091</u>
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>		
	(2,398,477)	1,756,857
Cash and cash equivalents, beginning of year	12,583,794	10,826,937
	<u>\$ 10,185,317</u>	<u>\$ 12,583,794</u>
<b>SUPPLEMENTAL CASH FLOWS INFORMATION</b>		
Cash paid during the year for:		
Interest	\$ 2,820,706	\$ 3,067,452
Income taxes	\$ 713,631	\$ 982,918
<b>SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING ACTIVITIES</b>		
Net decrease in unrealized loss on securities available for sale	\$ (582,141)	\$ (673,520)
Acquisition of real estate and other repossessed assets in settlement of loans	\$ 106,879	\$ 1,407,842
<b>SUPPLEMENTAL SCHEDULE OF NONCASH FINANCING ACTIVITIES</b>		
Assumption of note on foreclosed real estate	\$	\$ 260,898

See accompanying notes.



**Table of Contents**

**NORTHWEST BANCORPORATION, INC. AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1 Summary of Significant Accounting Policies**

**Basis of presentation and consolidation:**

The consolidated financial statements include the accounts of Northwest Bancorporation, Inc. (the Corporation) and its wholly-owned subsidiary, Inland Northwest Bank (the Bank). All significant intercompany balances and transactions have been eliminated in consolidation.

**Nature of business:**

The Bank is a state chartered commercial bank under the laws of the state of Washington, and provides banking services primarily in eastern Washington and northern Idaho. The Corporation and its subsidiary are subject to competition from other financial institutions, as well as nonfinancial intermediaries. The Corporation and its subsidiary are also subject to the regulations of certain federal and state agencies and undergo periodic examinations by those regulatory agencies.

**Use of estimates:**

In preparing the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of certain assets and liabilities as of the date of the consolidated statements of financial condition and certain revenues and expenses for the period. Actual results could differ, either positively or negatively, from those estimates.

Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of deferred taxes, the allowance for loan losses, and the valuation of real estate acquired in connection with foreclosures, or in satisfaction of loans.

Management believes that the allowance for loan losses and other real estate owned is adequate. While management uses currently available information to recognize losses on loans and other real estate (when owned), future additions to the allowances may be necessary based on changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses and other real estate owned. Such agencies may require the Bank to recognize additions to the allowances based on their judgments of information available to them at the time of their examination.

**Cash and cash equivalents:**

For the purpose of presentation in the consolidated statement of cash flows, cash and cash equivalents are defined as those amounts included in the statement of financial condition captioned cash and due from banks and interest-bearing deposits in other institutions, which mature within 90 days.

**Securities held to maturity:**

Bonds for which the Bank has the positive intent and ability to hold to maturity are reported at cost, adjusted for premiums and discounts that are recognized in interest income using the interest method over the period to maturity or call date if it is probable that the security will be called.

**Securities available for sale:**

Securities available for sale consist of bonds, notes and mortgage-backed securities not classified as securities held to maturity. Unrealized holding gains and losses, net of tax, on securities available for sale are

**Table of Contents**

**NORTHWEST BANCORPORATION, INC. AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 1 Summary of Significant Accounting Policies (Continued)**

reported as a net amount in other comprehensive income. Gains and losses on the sale of securities available for sale are determined using the specific-identification method. Premiums and discounts are recognized in interest income using the interest method over the period to maturity or call date if it is probable that the security will be called.

Declines in the fair value of individual held to maturity and available for sale securities below their cost that are other than temporary result in write-downs of the individual securities to their fair value. No such write-downs have occurred.

**Loans held for sale:**

Mortgage loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated market value in the aggregate. Net unrealized losses, if any, are recognized in a valuation allowance by charges to income. Gains or losses on the sale of such loans are based on the specific identification method.

**Loans:**

The Corporation grants mortgage, commercial, and consumer loans to its customers. A substantial portion of the loan portfolio is represented by loans throughout eastern Washington and northern Idaho. The ability of the Corporation's debtors to honor their contracts is dependent upon the real estate and general economic conditions in this area.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are reported at their outstanding unpaid principal balances adjusted for charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method.

The accrual of interest on loans is discontinued at the time the loan is 90 days delinquent unless the credit is well-secured and in process of collection. Management may also discontinue accrual of interest if management feels the borrower may be unable to meet payments as they become due. When interest accrual is discontinued, all unpaid accrued interest is reversed against interest income, with interest income subsequently recognized only to the extent cash payments are received. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts

contractually due are brought current and future payments are reasonably assured.

In the ordinary course of business, the Corporation has entered into commitments to extend credit, including commitments under credit card arrangements, commercial letters of credit and standby letters of credit. Such financial instruments are recorded when they are funded.

**Allowance for loan losses:**

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and

**Table of Contents**

**NORTHWEST BANCORPORATION, INC. AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 1 Summary of Significant Accounting Policies (Continued)**

volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

A loan is considered impaired when, based on current information and events, it is probable that the Corporation will be unable to collect the scheduled payments, principal, or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Corporation does not separately identify individual consumer and residential loans for impairment disclosures.

**Premises and equipment:**

Land is carried at cost. Buildings, furniture and equipment, and leasehold improvements are carried at cost, less accumulated depreciation and amortization computed principally by the straight-line method over the estimated useful lives of the assets. Normal costs of maintenance and repairs are charged to expense as incurred.

**Foreclosed real estate and other repossessed assets:**

Real estate properties acquired through, or in lieu of, loan foreclosure are to be sold and are initially recorded at fair value at the date of foreclosure establishing a new cost basis. After foreclosure, valuations are periodically performed by management and the real estate is carried at the lower of carrying amount or fair value less selling cost. An allowance for impairment losses is used for fluctuations in estimated fair value.

**Income taxes:**

Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws.

**Stock compensation plan:**

At December 31, 2004, the Corporation has a nonqualified stock option plan for key employees, which is described more fully in Note 14. The Corporation accounts for this plan under the recognition and measurement principles of Accounting Principles Board ( APB ) Opinion No. 25, *Accounting for Stock Issued to Employees* and related Interpretations. No stock-based compensation cost is reflected in net income, as all options granted under this plan had an exercise price equal to the market value of the underlying common stock on the date of the

**Table of Contents****NORTHWEST BANCORPORATION, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 1 Summary of Significant Accounting Policies (Continued)**

grant. The following table illustrates the effect on net income and earnings per share if the Corporation had applied the fair value recognition provisions of Financial Accounting Standards Board ( FASB ) Statement No. 123 *Accounting for Stock-Based Compensation*, to stock-based employee compensation.

The fair value assumptions for options granted in 2004 are based on a risk-free interest rate of 3.92%, 7 year expected life, 12.60% expected volatility and a 1.02% expected dividend rate.

	<b>December 31,</b>	
	<b>2004</b>	<b>2003</b>
Net income, as reported	\$ 1,964,317	\$ 1,746,275
Deduct total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(27,355)	(27,762)
<b>Pro forma net income</b>	<b>\$ 1,936,962</b>	<b>\$ 1,718,513</b>
<b>Earnings per share:</b>		
Basic, as reported	\$ 0.98	\$ 0.88
Basic, pro forma	\$ 0.97	\$ 0.86
Diluted, as reported	\$ 0.97	\$ 0.87
Diluted, pro forma	\$ 0.96	\$ 0.85

**Earnings per share:**

Earnings per share represents income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Earnings per share assuming full dilution reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Corporation related solely to outstanding stock options, and are determined using the treasury stock method (see Note 20).

**Comprehensive income:**

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as separate components of the equity section of the balance sheet, such items, along with net income are components of comprehensive income.

The components of other comprehensive income and related tax effects are as follows:

	<u>Years Ended December 31</u>	
	<u>2004</u>	<u>2003</u>
Unrealized holding losses on available for sale securities	\$ (545,396)	\$ (573,217)
Reclassification adjustment for gains realized in income	(36,745)	(100,303)
Net unrealized losses	(582,141)	(673,520)
Tax effect	197,928	228,998
Net of tax amount	\$ (384,213)	\$ (444,522)



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**Table of Contents**

**NORTHWEST BANCORPORATION, INC. AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 1 Summary of Significant Accounting Policies (Continued)**

**Recent accounting pronouncements:**

In December 2004, the FASB published Statement of Financial Accounting Standards ( SFAS ) No. 123 (revised 2004), *Share-Based Payment, an amendment to SFAS No. 123 and 95* ( SFAS 123R ). SFAS 123R will require the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. Public entities (other than those filing as small business issuers) will be required to apply Statement 123R as of the first interim or annual reporting period that begins after June 15, 2005. Public entities that file as small business issuers will be required to apply SFAS 123R in the first interim or annual reporting period that begins after December 15, 2005. SFAS 123R covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. The Corporation currently files as a small business issuer; consequently, it anticipates applying SFAS 123R to the quarterly accounting period beginning January 1, 2006.

In December 2003, the Emerging Issues Task Force ( EITF ) reached consensus on Issue 03-01 ( EITF 3-01 ), *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. EITF 03-01 includes new guidance for evaluating and recording impairment losses on debt and equity investments, as well as new disclosure requirements for investments that are deemed to be temporarily impaired. This Issue specifically addresses whether an investor has the ability and intent to hold an investment until recovery. In addition, Issue 03-01 contains disclosure requirements that provide useful information about impairments that have not been recognized as other-than-temporary for investments within the scope of this Issue. In September 2004, the FASB Staff issued FSP EITF 03-01-1, which deferred the application of measurement provisions of EITF 03-01. The FASB determined that a delay in the effective date of those provisions was necessary until it can issue additional guidance on the application of EITF 03-01. This deferral did not change the disclosure guidance which remains effective for fiscal years ending after December 15, 2003. Matters being considered by the FASB which may impact the Corporation's financial reporting include the accounting as a component in determining net income for declines in market value of debt securities which are due solely to changes in market interest rates and the effect of sales of available-for-sale securities which have market values below cost at the time of sale and whether such sale indicates an absence of intent and ability of the investor to hold to a forecasted recovery of the investment's value to its original cost. The Corporation has included the required disclosures in these consolidated financial statements.

*Exchanges of Nonmonetary Assets an amendment of APB Opinion No. 29*. The guidance in APB Opinion No. 29, Accounting for Nonmonetary Transactions, is based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. The guidance in that Opinion, however, included certain exceptions to that principle. This Statement amends Opinion 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. The Corporation does not expect the amendment of APB Opinion No. 29 to have a significant impact on the Corporation's future results of operation or financial position.

Statement No. 152. *Accounting for Real Estate Time-Sharing Transactions an amendment of FASB Statements No. 66 and 67*. This Statement amends FASB Statement No. 66, Accounting for Sales of Real Estate, to reference the financial accounting and reporting guidance for real estate

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time-sharing transactions that is provided in AICPA Statement of Position (SOP) 04-2, Accounting for Real Estate Time-Sharing Transactions. This Statement also amends FASB Statement No. 67, Accounting for Costs and Initial Rental Operations of Real Estate Projects, to state that the guidance for (a) incidental operations and (b) costs incurred to sell real estate

**Table of Contents****NORTHWEST BANCORPORATION, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 1 Summary of Significant Accounting Policies (Continued)**

projects does not apply to real estate time-sharing transactions. The accounting for those operations and costs is subject to the guidance in SOP 04-2. This Statement is effective for financial statements for fiscal years beginning after June 15, 2005. The Corporation does not expect this amendment to FASB Statements No. 66 and 67 to have a significant impact on the Corporation's future results of operation or financial position.

**Advertising costs:**

Advertising costs are charged to operations when incurred. Advertising expense for the years ended December 31, 2004 and 2003, was \$130,070 and \$83,155, respectively.

**Note 2 Investments in Securities**

Securities held by the Corporation have been classified in the consolidated statement of financial condition according to management's intent. The amortized cost of securities and their approximate fair values at December 31, 2004 and 2003, were as follows:

	<b>December 31, 2004</b>			
	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>
<b>Securities available for sale:</b>				
U.S. government agency securities	\$ 29,691,578	\$ 28,819	\$ (176,033)	\$ 29,544,364
U.S. treasury securities	5,202,991	7,568	(11,072)	5,199,487
Corporate debt obligations	1,483,750		(23,635)	1,460,115
Mortgage backed securities	1,951,287	106,005		2,057,292
	<b>\$ 38,329,606</b>	<b>\$ 142,392</b>	<b>\$ (210,740)</b>	<b>\$ 38,261,258</b>

**December 31, 2003**

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	Amortized	Gross Unrealized	Gross Unrealized	Fair Value
	Cost	Gains	Losses	
<b>Securities available for sale:</b>				
U.S. government agency securities	\$ 19,518,191	\$ 246,020	\$ (3,191)	\$ 19,761,020
U.S. treasury securities	7,141,676	70,204	(425)	7,211,455
Corporate debt obligations	2,027,892	19,653	(1,715)	2,045,830
Mortgage backed securities	3,289,937	183,246		3,473,183
	<u>\$ 31,977,696</u>	<u>\$ 519,123</u>	<u>\$ (5,331)</u>	<u>\$ 32,491,488</u>

	December 31, 2004			
	Amortized	Gross Unrealized	Gross Unrealized	Fair Value
	Cost	Gains	Losses	
<b>Securities held to maturity:</b>				
State and municipal securities	\$ 2,706,435	\$ 42,659	\$ (10,817)	\$ 2,738,277
	<u>\$ 1,717,399</u>	<u>\$ 43,423</u>	<u>\$ (916)</u>	<u>\$ 1,759,906</u>

**Table of Contents****NORTHWEST BANCORPORATION, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 2 Investments in Securities (Continued)**

The following table shows the investments' gross unrealized losses and fair values, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2004. These securities consist primarily of debt securities and are not considered other than temporarily impaired because their impairment is due primarily to changes in interest rates and is not related to any known decline in the creditworthiness of the issuer.

	December 31, 2004					
	Impaired Less		Impaired 12		Total	
	Than 12 Months		Months or More			
	Unrealized		Unrealized		Unrealized	
	Fair Value	Losses	Fair Value	Losses	Fair Value	Losses
U.S. government agency securities	\$ 29,544,364	\$ (176,033)	\$	\$	\$ 29,544,364	\$ (176,033)
U.S. treasury securities	5,199,487	(11,072)			5,199,487	(11,072)
Corporate debt obligations	1,460,115	(23,635)			1,460,115	(23,635)
State and municipal securities	2,738,277	(10,817)			2,738,277	(10,817)
	<b>\$ 38,942,243</b>	<b>\$ (221,557)</b>	<b>\$</b>	<b>\$</b>	<b>\$ 38,942,243</b>	<b>\$ (221,557)</b>

At December 31, 2004, thirty-four securities have unrealized losses. Management does not believe that any individual unrealized loss represents an other-than-temporary impairment. The decline in fair market value of these securities is generally due to changes in interest rates and is not related to any known decline in the creditworthiness of the issuer.

At December 31, 2004 and 2003, securities available for sale with an amortized cost of \$21,747,662 and \$21,336,167, respectively, were pledged to secure the Bank's performance of its obligations under repurchase agreements. The approximate market value of these securities was \$21,690,706 and \$21,705,957 at December 31, 2004 and 2003, respectively. Securities available for sale with an amortized cost of \$2,255,847 and \$2,499,853 at December 31, 2004 and 2003, respectively, were pledged to secure public deposits for purposes required or permitted by law. The approximate market value of these securities was \$2,258,578 and \$2,572,041 at December 31, 2004 and 2003, respectively. Securities available for sale with an amortized cost of \$5,952,991 and \$7,641,676 at December 31, 2004 and 2003, respectively, were pledged to the Federal Reserve Bank. The approximate market value of these securities was \$5,955,112 and \$7,715,205 at December 31, 2004 and 2003, respectively.

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For the years ended December 31, 2004 and 2003, proceeds from sales of securities available for sale amounted to \$1,062,187 and \$3,391,925, respectively. Gross realized gains during the years ended December 31, 2004 and 2003, were \$36,745 and \$103,390, respectively. Gross realized losses were \$0 and \$3,087 for the years ended December 31, 2004 and 2003, respectively.

The scheduled maturities of securities held to maturity and securities available for sale at December 31, 2004, are as follows:

	<b>Held to maturity</b>		<b>Available for sale</b>	
	<b>Amortized</b>		<b>Amortized</b>	
	<b>Cost</b>	<b>Fair Value</b>	<b>Cost</b>	<b>Fair Value</b>
Due in one year or less	\$ 100,000	\$ 99,997	\$ 6,201,261	\$ 6,200,061
Due from one year to five years	1,012,332	1,017,629	8,501,575	8,455,871
Due from five to ten years	819,697	843,552	11,147,925	11,139,581
Due after ten years	774,406	777,099	10,527,559	10,408,453
Mortgage backed securities			1,951,286	2,057,292
	<b>\$ 2,706,435</b>	<b>\$ 2,738,277</b>	<b>\$ 38,329,606</b>	<b>\$ 38,261,258</b>

Table of Contents

## NORTHWEST BANCORPORATION, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**Note 3 Federal Home Loan Bank Stock**

The Corporation's investment in Federal Home Loan Bank (FHLB) stock is carried at par value (\$100 per share), which reasonably approximates its fair value. As a member of the FHLB system, the Corporation is required to maintain a minimum level of investment in FHLB stock based on specified percentages of its outstanding FHLB advances. The Corporation may request redemption at par value of any stock in excess of the amount the Corporation is required to hold. Stock redemptions are at the discretion of the FHLB.

**Note 4 Loans Receivable and Allowance for Loan Losses**

The components of loans in the consolidated statement of financial condition were as follows:

	December 31,	
	2004	2003
Commercial	\$ 121,819,636	\$ 117,054,889
Real estate	25,644,322	22,126,935
Installment	4,367,881	4,624,983
Consumer and other	7,878,430	6,982,961
	<b>159,710,269</b>	150,789,768
Allowance for loan losses	<b>(1,943,760)</b>	(2,042,129)
Net deferred loan fees	<b>(328,268)</b>	(306,496)
	<b>\$ 157,438,241</b>	\$ 148,441,143

An analysis of the change in the allowance for loan losses follows:

	December 31,	
	2004	2003
Balance, beginning of year	\$ 2,224,165	\$ 2,025,596

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Provision charged to operations	170,000	652,500
Loans charged off, net of recoveries	(244,325)	(453,931)
	<u>          </u>	<u>          </u>
Balance, end of year, prior to adjustment for off-balance sheet items	2,149,840	2,224,165
	<u>          </u>	<u>          </u>
Reclassification of reserve for probable losses on unused loan commitments and off-balance sheet items to Accrued interest payable and other liabilities	(206,080)	(182,036)
	<u>          </u>	<u>          </u>
Balance, end of year	<b>\$ 1,943,760</b>	<b>\$ 2,042,129</b>
	<u>          </u>	<u>          </u>

The loans fall into the following fixed and variable components:

	December 31,	
	2004	2003
	<u>          </u>	<u>          </u>
Fixed rate loans	\$ 41,169,490	\$ 39,636,762
Variable rate loans	118,540,779	111,153,006
	<u>          </u>	<u>          </u>
	<b>\$ 159,710,269</b>	<b>\$ 150,789,768</b>
	<u>          </u>	<u>          </u>

Impairment of loans having recorded investments of \$666,646 and \$595,274 at December 31, 2004 and 2003, respectively, has been recognized in conformity with FASB Statement No. 114 as amended by FASB Statement No. 118. The total allowance for loan losses related to these loans was \$303,742 and \$207,941 at December 31, 2004 and 2003, respectively. The Bank is not committed to lend additional funds to debtors whose



**Table of Contents****NORTHWEST BANCORPORATION, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 4 Loans Receivable and Allowance for Loan Losses (Continued)**

loans have been modified. The average recorded investment in impaired loans during the years ended December 31, 2004 and 2003, was \$705,903 and \$595,625, respectively. Interest income on impaired loans of \$21,169 and \$478 was recognized for cash payments received in 2004 and 2003, respectively. The Corporation had \$531,204 and \$216,332 of loans placed on nonaccrual at December 31, 2004 and 2003, respectively. Loans over 90 days past due and still on accrual status were approximately \$15,993 and \$8,000 at December 31, 2004 and 2003, respectively.

**Note 5 Premises and Equipment**

Components of premises and equipment included in the consolidated statement of financial condition at December 31, 2004 and 2003, were as follows:

	December 31,	
	2004	2003
Land	\$ 900,868	\$ 900,868
Premises	1,577,834	1,697,097
Furniture, fixtures and equipment	3,640,626	3,563,979
Leasehold improvements	1,796,503	929,516
Construction in progress	32,178	54,966
	<u>7,948,009</u>	<u>7,146,426</u>
Total cost	7,948,009	7,146,426
Accumulated depreciation	(3,590,029)	(3,446,735)
	<u>4,357,980</u>	<u>3,699,691</u>
Net Book Value	\$ 4,357,980	\$ 3,699,691

Depreciation and amortization expense was \$449,047 and \$478,424 for the years ended December 31, 2004 and 2003, respectively.

The Corporation has operating leases on a number of its branches that expire on various dates through 2009. The lease agreements have various renewal options.

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The following is a schedule by year of future minimum rental payments required under operating leases that have initial or remaining noncancellable lease terms in excess of one year as of December 31, 2004:

<b>Year ending</b>	
<b>December 31,</b>	
<u>2005</u>	\$ 361,304
2006	346,284
2007	227,294
2008	205,338
2009	103,998
Thereafter	
<b>Total Minimum Payments Required</b>	<u>\$ 1,244,218</u>

Total lease payments under the above mentioned operating leases and other month-to-month rentals for the years ended December 31, 2004 and 2003, were \$370,915 and \$362,560, respectively.

**Table of Contents****NORTHWEST BANCORPORATION, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 6 Foreclosed Real Estate and Other Repossessed Assets**

An allowance for losses on foreclosed real estate and other repossessed assets has been established. Activity in the account is as follows:

	<u>2004</u>	<u>2003</u>
Balance, beginning of year	\$ 105,000	\$ 99,100
Charge offs	(50,000)	(99,100)
Provision charged to income	70,000	105,000
	<u>          </u>	<u>          </u>
Balance, end of year	<u>\$ 125,000</u>	<u>\$ 105,000</u>

Included in the losses on foreclosed real estate and other repossessed assets in the consolidated statement of income for the years ending December 31, 2004 and 2003, are impairment losses of \$70,000 and \$105,000, respectively, on real estate and other repossessed assets held for sale. Realized gains of \$32,144 and \$163,757 are included in (gain) loss on foreclosed real estate and other repossessed assets for the years ended December 31, 2004 and 2003, respectively.

**Note 7 Deposits**

Major classifications of deposits at December 31, 2004 and 2003, were as follows:

	<u>2004</u>	<u>2003</u>
Demand deposits	\$ 38,872,020	\$ 34,551,452
Money market	53,604,746	47,260,337
NOW accounts	14,233,027	13,427,324
Savings deposits	7,261,848	5,987,926
Time deposits, \$100,000 and over	23,747,541	20,933,361
Other time deposits	39,317,473	43,870,500
	<u>          </u>	<u>          </u>
	<u>\$ 177,036,655</u>	<u>\$ 166,030,900</u>

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Maturities for time deposits at December 31, 2004, are summarized as follows:

Maturing one year or less	\$ 35,253,315
Maturing one to five years	27,707,529
Maturing five to ten years	104,170
	<u>\$ 63,065,014</u>

Overdraft deposit accounts with balances of \$28,606 and \$178,119 at December 31, 2004 and 2003, respectively, were reclassified as loans receivable.

### **Note 8 Borrowed Funds**

Borrowed funds consist primarily of Federal Home Loan Bank advances and structured notes. Federal Home Loan Bank advances are secured by a blanket pledge on Bank assets and specifically by loans with a carrying value of \$69,557,861 at December 31, 2004.

In 2004, the Bank entered into certain non-recourse loan participation sold agreements with other financial institutions. These participation agreements contain call options which provide the Corporation contractual rights

**Table of Contents****NORTHWEST BANCORPORATION, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 8 Borrowed Funds (Continued)**

to repurchase the participated interest in the loans at any time. In accordance with SFAS 140, the participated interest has been included as structured notes in borrowed funds on the consolidated statement of financial condition.

Total borrowed funds and structured notes consist of the following at December 31:

<u>Advance Date</u>	<u>Maturity Date</u>	<u>Interest Rate</u>	<u>2004</u>	<u>2003</u>
07/29/97	07/29/27	6.60%	\$ 47,891	\$ 50,004
04/20/98	04/19/13	6.15%	1,259,706	1,359,201
05/11/98	05/11/28	6.28%	101,918	103,346
08/19/98	08/18/28	6.09%	104,925	106,477
02/11/02	02/09/07	5.05%	2,500,000	2,500,000
02/11/02	02/11/09	4.94%	1,199,830	1,485,545
09/29/03	09/29/04	1.33%		2,000,000
Total Federal Home Loan Bank advances			5,214,270	7,604,573
Structured notes			3,980,391	
Other borrowed funds				257,708
Total borrowed funds			\$ 9,194,661	\$ 7,862,281

In 2003, other borrowed funds consisted of a note assumed by the Corporation related to a foreclosure of real estate. The note was collateralized by a first lien on foreclosed assets with a carrying value of \$396,000. Monthly principal and interest payments totaled \$3,100, with interest at 9%. The note matured on October 31, 2004.

The scheduled maturities of the Federal Home Loan Bank advances at December 31, 2004, are as follows:

<u>Years Ending December 31,</u>	<u>Weighted-Average Interest Rate</u>	<u>Amount</u>
2005	5.29%	\$ 399,336
2006	5.31%	409,166

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2007	5.33%	419,863
2008	5.09%	2,931,503
2009	5.84%	215,429
Thereafter	6.18%	838,973
		\$ 5,214,270

**Note 9 Securities Sold Under Repurchase Agreements**

Securities sold under agreements to repurchase generally mature within one to four days from the transaction date. For the year, securities sold under agreements to repurchase averaged \$16,074,433; the high balance during the year was \$19,797,756. The average rate paid during the year was 0.87%. Securities underlying the agreements are presented in Note 2. Securities sold under agreements to repurchase are reflected at the amount of cash received in connection with the transaction. The Corporation may be required to provide additional collateral based on the fair value of the underlying securities.

**Table of Contents**

**NORTHWEST BANCORPORATION, INC. AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 10 Commitments and Contingencies**

The Bank is a party to various legal collection actions normally associated with financial institutions, the aggregate effect of which, in management's and legal counsel's opinion, would not be material to the financial condition of Northwest Bancorporation.

The Bank has three unsecured operating lines of credit with KeyBank of Washington for \$9,200,000, with two lines totaling \$9,100,000, maturing July 1, 2005, and the remaining \$100,000 line maturing on July 1, 2006. In addition, the Bank maintains a line of credit with U.S. Bank for \$1,500,000, maturing July 31, 2005, and Zions Bank for \$1,500,000 with no stated maturity. There was zero outstanding on these lines at December 31, 2004 and 2003. The Bank also has a line of credit with Federal Home Loan Bank for \$32,402,000 at December 31, 2004, with \$27,188,000 available in overnight funds and long-term funds. This line is collateralized by all assets of the Bank. There were \$5,214,270 and \$7,604,573 of outstanding long-term advances on the Federal Home Loan Bank line at December 31, 2004 and 2003, respectively (see Note 8). There was zero outstanding on overnight funds on the FHLB line at December 31, 2004 and 2003.

In the ordinary course of business, the Corporation, through its Bank subsidiary makes various commitments and incurs certain contingent liabilities, which are not reflected in the accompanying financial statements. The Bank uses the same credit policies in making such commitments as they do for instruments that are included in the consolidated statement of financial condition. These commitments and contingent liabilities include various commitments to extend credit and standby letters of credit. At December 31, 2004 and 2003, commitments under standby letters of credit were \$134,530 and \$133,360, respectively, and firm loan commitments were \$47,314,939 and \$36,118,968, respectively. The Corporation does not anticipate any material losses as a result of these commitments.

**Note 11 Concentrations of Credit Risk**

The majority of the Bank's loans, commitments, and standby letters of credit have been granted to customers in the Bank's market area, which is the eastern Washington and northern Idaho area. Substantially all such customers are depositors of the Bank. The concentrations of credit by type of loan are set forth in Note 4. The distribution of commitments to extend credit approximates the distribution of loans outstanding. Outstanding commitments and standby letters of credit were granted primarily to commercial borrowers.

The Bank places its cash with high credit quality institutions. The amount on deposit fluctuates, and at times exceeds the insured limit by the U.S. Federal Deposit Insurance Corporation, which potentially subjects the Bank to credit risk.

**Note 12 Income Taxes**

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The components of income tax expense are as follows:

	<u>2004</u>	<u>2003</u>
Current tax expense	\$ 734,205	\$ 907,436
Deferred tax (benefit) expense	191,235	(73,571)
	<u>          </u>	<u>          </u>
Income tax expense	<u>\$ 925,440</u>	<u>\$ 833,865</u>



Table of Contents

## NORTHWEST BANCORPORATION, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Note 12 Income Taxes (Continued)

The components of the net deferred tax asset (liability) are as follows:

	<u>2004</u>	<u>2003</u>
Deferred tax assets:		
Allowance for loan losses	\$ 548,108	\$ 492,293
Deferred compensation	101,750	85,401
Goodwill amortization	44,905	42,457
Allowance for writedown of other real estate owned	43,750	36,750
Net unrealized loss on securities available for sale	23,238	
Nonaccrual loan interest	9,465	1,849
	<u>771,216</u>	<u>658,750</u>
Deferred tax liabilities:		
Fixed asset basis differentials	507,958	286,123
Federal Home Loan Bank stock	94,182	87,882
Deferred loan fees	88,507	90,682
Prepaid expenses	54,503	
Net unrealized gain on securities available for sale		174,691
	<u>745,150</u>	<u>639,378</u>
Net deferred tax asset	<u>\$ 26,066</u>	<u>\$ 19,372</u>

The effective tax rate differs from the statutory federal tax rate for the years presented as follows:

	<u>2004</u>	<u>2003</u>
Federal income tax at statutory rate	\$ 982,517	\$ 877,248
Effect of tax-exempt interest income	(33,093)	(38,165)
Effect of nondeductible interest expense	2,477	1,246
Effect of other nondeductible expenses	(24,004)	(14,202)
Effect of state income taxes	7,232	15,014
Other	(9,689)	(7,276)

INCOME TAX EXPENSE	\$ 925,440	\$ 833,865
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At December 31, 2004, an income tax receivable of \$105,504 and a net deferred tax asset of \$26,066 were included in other assets on the consolidated statement of financial condition. At December 31, 2003, an income tax receivable of \$127,388 and a net deferred tax asset of \$19,372 were included in other assets on the consolidated statement of financial condition.

### **Note 13 Executive Retirement Plan**

Inland Northwest Bank maintains an unfunded supplemental executive retirement plan for the benefit of the Bank's former chief executive officer which is fully vested. The plan provides for monthly payments for a period of fifteen years to the executive, which began on June 30, 2001. In the event of his death, the plan provides payment to his designated beneficiary.

At December 31, 2004 and 2003, \$186,445 and \$196,045, respectively, has been accrued under this plan. This liability is recognized in accrued interest and other liabilities in the consolidated statement of financial condition.

**Table of Contents****NORTHWEST BANCORPORATION, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 13 Executive Retirement Plan (Continued)**

The net post-retirement benefit cost recognized during the years ended December 31, 2004 and 2003, was \$15,038 and \$15,717, respectively.

The Bank is the owner and beneficiary of life insurance policies on this former officer with a total face value of \$228,127 and cash surrender value of \$214,840 and \$206,679 at December 31, 2004 and 2003, respectively. The Bank purchased life insurance policies on several officers of the Bank with a total face value of \$8,106,346 and cash surrender value of \$2,977,882 at December 31, 2004. The cash surrender values are included in the consolidated statement of financial condition in other assets.

**Note 14 Stock Option Plan**

During 1992, the Board of Directors of the Bank authorized key employees of the Bank to be eligible to participate in a nonqualified stock option plan. Under the plan, the Board of Directors may grant options to purchase shares of common stock of the Corporation, not to exceed 267,501 shares. At December 31, 2004, 127,257 shares were available for granting to employees. The per option price for options granted shall be the fair market value of said share on the date the option is granted. Stock options granted are eligible for stock dividends.

A summary of the status of the Bank's stock option plans and changes during the years ending on those dates is presented below:

	2004		2003	
	Shares Actual	Weighted-Average Exercise Price	Shares Actual	Weighted-Average Exercise Price
Outstanding options, beginning of year	124,170	\$ 10.09	111,297	\$ 9.72
Granted	12,500	\$ 13.70	16,958	\$ 12.14
Exercised	(7,504)	\$ 7.31		\$
Forfeited	(4,834)	\$ 10.38	(4,085)	\$ 8.61
Outstanding options, end of year	124,332	\$ 10.61	124,170	\$ 10.09
Options exercisable at year end	83,153		74,183	
Weighted-average fair value of options granted during the year	\$ 2.96		\$ 3.49	

The following table summarizes information about stock options outstanding at December 31, 2004:

	Options Outstanding			Exercisable Options	
	Number Outstanding at End of Year	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable at End of Year	Weighted-Average Exercise Price
Price ranges					
(\$8.09 through \$8.75)	45,421	5.64	\$ 8.37	34,099	\$ 8.33
(\$8.76 through \$12.55)	53,811	5.09	\$ 11.30	46,534	\$ 11.63
(\$12.56 through \$14.37)	25,100	9.44	\$ 13.18	2,520	\$ 12.67
<b>Total</b>	<b>124,332</b>	<b>6.17</b>	<b>\$ 10.61</b>	<b>83,153</b>	<b>\$ 10.31</b>

**Table of Contents**

**NORTHWEST BANCORPORATION, INC. AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 15 Common Stock**

On February 18, 2003, the Board of Directors announced a 5% stock dividend on all common stock, effective to stockholders of record May 15, 2003, and issued June 13, 2003. All amounts per share and weighted-average shares outstanding for all periods presented have been retroactively adjusted to reflect the stock dividends. The Corporation recorded a transfer from retained earnings to common stock for the market value of the additional shares issued at May 15, 2003.

On April 22, 2004, the the Board of Directors announced a 5% stock dividend on all common stock, effective to stockholders of record May 14, 2004, and issued June 15, 2004. All amounts per share and weighted-average shares outstanding for all periods presented have been retroactively adjusted to reflect the stock dividends. The Corporation recorded a transfer from retained earnings to common stock for the market value of the additional shares issued at May 14, 2004.

During 2004 and 2003, the Board of Directors voted to issue 3,700 and 2,700 shares of Corporation stock, respectively, to nonemployee Directors pursuant to the Corporation's Director Compensation Plan.

**Note 16 Profit Sharing Plan**

The Bank established a 401(k) profit sharing plan covering all employees who meet certain eligibility requirements. The Plan provides for employees to elect up to 50% of their compensation to be paid into the fund. The Bank's policy is to match contributions equal to 50% of the participant's contribution not to exceed 2.5% of the participant's compensation. Vesting occurs over a six-year graded vesting schedule. The Bank's contribution was \$84,307 and \$85,945 for years ended December 31, 2004 and 2003, respectively.

**Note 17 Related Party Transactions**

The Corporation, through its Bank subsidiary has had, and may be expected to have in the future, banking transactions in the ordinary course of business with directors, principal officers, their immediate families, and affiliated companies in which they are principal stockholders. Aggregate loan balances with related parties at December 31, 2004 and 2003, were \$2,369,859 and \$2,980,403, respectively. During the years ended December 31, 2004 and 2003, total principal additions were \$778,674 and \$1,190,256 and total principal payments were \$1,389,218 and \$266,235, respectively. Aggregate deposit balances with related parties at December 31, 2004 and 2003, were \$1,191,553 and \$3,474,468, respectively. All related party loans and deposits which have been made, in the opinion of management, are on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others.

**Note 18 Restrictions on Dividends and Retained Earnings**

Federal and state banking regulations place certain restrictions on dividends paid by the Bank to the Corporation. The total amount of dividends, which may be paid at any date, is generally limited to the retained earnings of the Bank, which was \$8,845,818 at December 31, 2004. Accordingly, \$10,908,503 of the Corporation's equity in the net assets of the Bank was restricted at December 31, 2004.

In addition, dividends paid by the Bank to the Corporation would be prohibited if the effect thereof would cause the Bank's capital to be reduced below applicable minimum capital requirements.

**Note 19 Regulatory Capital Requirements**

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional

Table of Contents

## NORTHWEST BANCORPORATION, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**Note 19 Regulatory Capital Requirements (Continued)**

discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines on the regulatory framework for prompt corrective action, the Bank must meet specific capital adequacy guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital classification is also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of Tier 1 capital (as defined in the regulations) to total average assets (as defined), and minimum ratios of Tier 1 and total capital (as defined) to risk-weighted assets (as defined). Under the regulatory framework for prompt corrective action, the Bank must maintain minimum Tier 1 leverage, Tier 1 risk-based, and total risk-based ratios as set forth in the table.

As of December 31, 2004, the most recent notification from the Bank's regulator categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum capital ratios as set forth in the following table. There are no conditions or events since that notification that management believes have changed the institution's category.

The Corporation's and Bank's actual December 31, 2004 and 2003, capital amounts and ratios are also presented in the table:

	Actual		Capital Adequacy Purposes		To Be Well Capitalized	
					Under Prompt Corrective Action	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>December 31, 2004</b>						
Total capital (to risk-weighted assets):						
Northwest Bancorporation	\$ 22,123,063	13.02%	\$ 13,593,280	≥ 8%	NA	NA
Inland Northwest Bank	21,925,440	12.91%	13,586,640	≥ 8%	\$ 16,983,300	≥ 10%
Tier 1 capital (to risk-weighted assets):						
Northwest Bancorporation	20,006,592	11.77%	6,796,640	≥ 4%	NA	NA
Inland Northwest Bank	19,799,431	11.66%	6,793,320	≥ 4%	10,189,980	≥ 6%
Tier 1 capital (to average assets):						

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Northwest Bancorporation	20,006,592	8.89%	9,004,480	≥ 4%	NA	NA
Inland Northwest Bank	19,799,431	8.80%	9,000,440	≥ 4%	11,250,550	≥ 5%

**December 31, 2003**

Total capital (to risk-weighted assets):

Northwest Bancorporation	\$ 20,174,000	12.56%	\$ 12,849,682	≥ 8%	NA	NA
Inland Northwest Bank	20,019,404	12.46%	12,848,800	≥ 8%	\$ 16,061,000	≥ 10%

Tier 1 capital (to risk-weighted assets):

Northwest Bancorporation	18,164,661	11.31%	6,424,283	≥ 4%	NA	NA
Inland Northwest Bank	18,009,106	11.21%	6,424,400	≥ 4%	9,636,600	≥ 6%

Tier 1 capital (to average assets):

Northwest Bancorporation	18,164,661	8.67%	8,380,466	≥ 4%	NA	NA
Inland Northwest Bank	18,009,106	8.60%	8,376,000	≥ 4%	10,470,000	≥ 5%



Table of Contents

## NORTHWEST BANCORPORATION, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Note 20 Earnings Per Share

The calculation of earnings per share and earnings per share assuming full dilution is as follows:

	Year Ended December 31, 2004		
			Per
	Income	Shares	Share
	(Numerator)	(Denominator)	Amount
<b>Basic EPS</b>			
Income available to common stockholders	\$ 1,964,317	1,996,997	\$ 0.98
<b>Effect of Dilutive Securities</b>			
Stock options		27,355	
<b>Diluted EPS</b>			
Income available to common stockholders plus assumed conversions	\$ 1,964,317	2,024,352	\$ 0.97
<b>Year Ended December 31, 2003</b>			
			Per
Income	Shares		Share
(Numerator)	(Denominator)		Amount
<b>Basic EPS</b>			
Income available to common stockholders	\$ 1,746,275	1,994,350	\$ 0.88
<b>Effect of Dilutive Securities</b>			
Stock options		18,318	
<b>Diluted EPS</b>			
Income available to common stockholders plus assumed conversions	\$ 1,746,275	2,012,668	\$ 0.87

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The Corporation's stock (stock symbol: NBCT) is quoted locally over the counter and on various Internet listing services, including the OTC Bulletin Board ([www.otcbb.com](http://www.otcbb.com)) where a list of market makers is also detailed. The average market price per share used in the determination of the dilutive effect of stock options was the average price of month-end closing market values.

**Table of Contents****NORTHWEST BANCORPORATION, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 21 Fair Value of Financial Instruments**

The estimated fair values of the Corporation's financial instruments were as follows at December 31:

	2004		2003	
	Carrying	Estimated Fair	Carrying	Estimated Fair
	Amount	Value	Amount	Value
<b>Financial Assets:</b>				
Cash and cash equivalents	\$ 10,185,317	\$ 10,185,317	\$ 12,583,794	12,583,794
Federal funds sold	1,053,845	1,053,845	5,000,000	5,000,000
Securities available for sale	38,261,258	38,261,258	32,491,488	32,491,488
Securities held to maturity	2,706,435	2,738,277	1,717,399	1,759,906
Federal Home Loan Bank stock	643,300	643,300	625,300	625,300
Loans and loans held for sale, net	158,061,504	157,922,565	148,887,388	149,594,851
<b>Financial Liabilities:</b>				
Borrowed funds	9,194,661	9,376,786	7,862,281	8,102,510
Deposits	177,036,655	177,440,256	166,030,900	167,556,467
Securities sold under agreements to repurchase	12,995,813	12,995,813	17,206,456	17,206,456

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

**Cash and cash equivalents, and funds sold:**

The carrying amount approximates fair value because of the short maturity of these investments.

**Securities available for sale, securities held to maturity, and other investments:**

The fair values of marketable securities are based on quoted market prices or dealer quotes. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

**Loans receivable:**

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

Deposits and securities sold under agreements to repurchase:

The fair value of demand deposits, savings accounts, NOW, securities sold under agreements to repurchase and money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-maturity time deposits is estimated using the rates currently offered for deposits of similar remaining maturities.

**Borrowed funds:**

The fair values of the Bank's long-term debt are estimated using discounted cash flow analyses based on the Bank's current incremental borrowing rates for similar types of borrowing arrangements.

**Table of Contents**

**NORTHWEST BANCORPORATION, INC. AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 21 Fair Value of Financial Instruments (Continued)**

**Off-balance-sheet instruments:**

Fair values for off-balance-sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standings. The fair value of the fees at December 31, 2004 and 2003, were insignificant. See Note 10 for the notional amount of the commitments to extend credit.

**Table of Contents****Part III****Item 1. Index to Exhibits**

<b>Exhibit No.</b>	<b>Description</b>
3.1.1	Articles of Incorporation <sup>(d)</sup>
3.1.2	Amendment to Articles of Incorporation <sup>(d)</sup>
3.1.3	Amendment to Articles of Incorporation <sup>(d)</sup>
3.2	Bylaws <sup>(d)</sup>
4	See Exhibit Nos. 3.1.1 through 3.2 above <sup>(d)</sup>
10.1.1	Lease Agreement Dated 08/01/89 and Amendment dated 07/13/95 The Paulsen Center (Main Branch) <sup>(f)</sup>
10.1.2	Lease 15111 East Sprague Avenue (Valley Branch) <sup>(f)</sup>
10.1.3	Lease 12825-14th Avenue (Airway Heights Branch) <sup>(f)</sup>
10.1.4	Lease East 210 North Foothills Drive (North Foothills Drive Branch) <sup>(f)</sup>
10.1.5	Lease 805 East Polston Ave., Post Falls, Idaho (Post Falls Branch) <sup>(f)</sup>
10.1.6	Ground Lease dated 09/24/96 (a) and Amendment dated August 12, 1997 for South Hill Branch
10.1.7	Lease 3321 W. Indian Trail Road (Indian Trail Branch) <sup>(f)</sup>
10.1.9	Lease 622 Sherman Avenue, Coeur d Alene, Idaho (Sherman Avenue Branch) <sup>(f)</sup>
10.1.10	Ground Lease Agreement (with Purchase Option) 101 & 107 East Ermina (Ruby and Ermina), Spokane, Washington (proposed Ruby Branch) <sup>(b)</sup>
10.2.1	F.M. Schunter Employment Agreement dated 01/01/94 <sup>(a)</sup>
10.2.2	Unfunded Supplemental Executive Retirement Plan for F.M. Schunter <sup>(a)</sup>
10.2.21	F.M. Schunter Retirement Agreement, Covenant Not to Compete and Release 6/29/01 <sup>(e)</sup>
10.2.3	Non-Qualified Stock Option Plan (a), as amended December 21, 1999 <sup>(e)</sup>
10.2.31	Non-Qualified Stock Option Plan (a), as amended December 21, 1999 <sup>(e)</sup> and April 16, 2002 <sup>(i)</sup>
10.2.4	Christopher C. Jurey Employment Agreement dated 01/01/94 <sup>(a)</sup>
10.2.41	Christopher C. Jurey Employment Agreement dated 01/08/03 <sup>(i)</sup>
10.2.6	Randall L. Fewel Employment Agreement dated 03/14/94 <sup>(a)</sup>
10.2.61	Randall L. Fewel Employment Agreement dated 01/01/02 <sup>(h)</sup>
10.2.7	Ronald M. Bower Employment Agreement dated 01/17/2000 <sup>(f)</sup>
10.2.71	Ronald M. Bower Employment Agreement dated 01/08/2003 <sup>(i)</sup>
10.2.8	Holly A. Austin Employment Agreement dated 01/01/2001 <sup>(f)</sup>
10.2.81	Holly A. Austin Employment Agreement dated 01/08/2003 <sup>(i)</sup>
14	Code of Ethics <sup>(k)</sup>
23.1	Consent of Accountant <sup>(b)</sup>
31.1	Certification of Randall L. Fewel, President and Chief Executive Officer, pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934 <sup>(b)</sup>
31.2	Certification of Christopher C. Jurey, Chief Financial Officer, pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934 <sup>(b)</sup>
32.1	Certification of Randall L. Fewel, President and Chief Executive Officer, pursuant to 18 U.S.C. 1350 <sup>(b)</sup>
32.2	Certification of Christopher C. Jurey, Chief Financial Officer, pursuant to 18 U.S.C. 1350 <sup>(b)</sup>

a) Previously filed (in paper format) as an Exhibit to the Company's Form 1-A Offering Statement Under Regulation A (Registration No. 24-3714) and incorporated herein by reference.

b) Only Exhibits being filed (in electronic format) with this Form 10-KSB.

c) Exhibit numbers determined by reference to Regulation S-T Exhibit numbering requirements, rather than Exhibit numbering requirements of Part III of Form 10-SB and/or Part III of Form 1-A as cross-referred to in Part III of Form 10-SB. Included Exhibits respond to Exhibits required under Part III of Form 10-SB and/or Part III of Form 1-A as cross-referred to in Part III of Form 10-SB, specifically those documents required to be filed as Exhibit nos. 2, 3, 5, 6 and 7 in Part III of Form 1-A.

**Table of Contents**

- d) Previously filed in electronic format as an Exhibit to the Company s Form 10-SB (Registration No. 0-24151) on April 30, 1998, and incorporated herein by reference.
- e) Previously filed in electronic format as an Exhibit to the Company s Form 10-KSB on March 30, 2000, and incorporated herein by reference.
- f) Previously filed in electronic format as an Exhibit to the Company s Form 10-KSB on March 30, 2001, and incorporated herein by reference.
- g) Previously filed in electronic format as an Exhibit to the Company s Form 10-KSB on March 29, 2002, and incorporated herein by reference.
- h) Previously filed in electronic format as an Exhibit to the Company s Form 10-QSB on May 14, 2002, and incorporated herein by reference.
- i) Previously filed in electronic format as an Exhibit to the Company s Form 10-QSB on August 12, 2002, and incorporated herein by reference.
- j) Previously filed in electronic format as an Exhibit to the Company s Form 10-KSB on March 28, 2003, and incorporated herein by reference.
- k) Previously filed in electronic format as an Exhibit to the Company s Form 10-KSB on March 24, 2004, and incorporated herein by reference.

**Table of Contents**

**Signatures**

In accordance with Section 13 of the Securities Exchange Act of 1934, the Registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: March 15, 2005

NORTHWEST BANCORPORATION, INC.

By                     /s/ Randall L. Fewel                    

Randall L. Fewel, President and

Chief Executive Officer

In accordance with Section 13 of the Securities Exchange Act of 1934, the Registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: March 15, 2005

By                     /s/ Christopher C. Jurey                    

Christopher C. Jurey, Chief Financial Officer



**Table of Contents**

Dated: March 15, 2005

Pursuant to the requirements of the Exchange Act, this report has been signed by the following persons in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
/s/ RANDALL L. FEWEL	Director and President	March 15, 2005
<b>Randall L. Fewel</b>		
/s/ WILLIAM E. SHELBY	Chairman and Director	March 15, 2005
<b>William E. Shelby</b>		
/s/ DWIGHT B. ADEN, JR.	Director	March 15, 2005
<b>Dwight B. Aden, Jr.</b>		
/s/ JIMMIE T.G. COULSON	Director	March 15, 2005
<b>Jimmie T.G. Coulson</b>		
/s/ HARLAN D. DOUGLAS	Director	March 15, 2005
<b>Harlan D. Douglass</b>		
/s/ FREEMAN B. DUNCAN	Director	March 15, 2005
<b>Freeman B. Duncan</b>		
/s/ DONALD A. ELLINGSEN, M.D.	Director	March 15, 2005
<b>M.D. Donald A. Ellingsen, M.D.</b>		
/s/ CLARK H. GEMMILL	Director	March 15, 2005
<b>Clark H. Gemmill</b>		
/s/ BRYAN S. NORBY	Director	March 15, 2005
<b>Bryan S. Norby</b>		
/s/ RICHARD H. PETERSON	Director	March 15, 2005
<b>Richard H. Peterson</b>		
/s/ PHILLIP L. SANDBERG	Director	March 15, 2005

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**Phillip L. Sandberg**

/s/ FREDERICK M. SCHUNTER

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Director

March 15, 2005

**Frederick M. Schunter**

/s/ JAMES R. WALKER

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Director

March 15, 2005

**James R. Walker**