Wells Timberland REIT, Inc.
Form PRE 14A
May 14, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
SCHEDULE 14A
(RULE 14A-101)
SCHEDULE 14A INFORMATION
Proxy Statement Pursuant to Section 14(a) of the
Securities Exchange Act of 1934
Filed by the Registrant x Filed by a Party other than the Registrant o
Check the appropriate box:

x Preliminary Proxy Statement
o Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
o Definitive Proxy Statement
o Definitive Additional Materials
o Soliciting Material Pursuant to Rule 14a-12

WELLS TIMBERLAND REIT, INC.
(Name of Registrant as Specified in its Charter)
Payment of Filing Fee (check the appropriate box):

x No fee required.

o Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

o Fee paid previously with preliminary materials.

o Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number or the form or schedule and the date of its filing.

(1) Amount previously paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

WELLS TIMBERLAND REIT, INC.
6200 The Corners Parkway
Norcross, Georgia 30092-3365
Proxy Statement and
Notice of Annual Meeting of Stockholders
To Be Held August 9, 2013

Dear Stockholder:

On Friday, August 9, 2013, we will hold our 2013 annual meeting of stockholders of Wells Timberland REIT, Inc. ("Wells Timberland REIT"), a Maryland corporation, at the Hilton Atlanta Northeast, 5993 Peachtree Industrial Boulevard, Norcross, Georgia 30092. The meeting will begin at 1:30 p.m., local time.

We are holding this meeting to:

1. Consider and vote upon a proposal to elect the five directors named in this proxy statement to hold office for one-year terms expiring in 2014 and until their respective successors are duly elected and qualify;
2. Consider and vote upon an amendment and restatement of our charter;
3. Consider and vote upon an adjournment of the annual meeting, if necessary, to solicit additional proxies in favor of the foregoing proposals if there are not sufficient votes for the proposals; and
4. Transact any other business that may properly come before the meeting or any adjournment or postponement thereof.

Your board of directors has selected the close of business on May 14, 2013 as the record date for determining stockholders entitled to notice of and to vote at the meeting.

This notice and the accompanying proxy statement and proxy card are being mailed to you on or about May 31, 2013.

Whether you plan to attend the meeting and vote in person or not, we urge you to have your vote recorded as early as possible. Stockholders have the following three options for submitting their votes by proxy: (1) online; (2) by phone; or (3) by mail, using the enclosed proxy card. Because we are a widely held issuer with more than 10,000 stockholders as of the close of business on the record date, your vote is very important! Your immediate response will help avoid potential delays and may save us significant additional expenses associated with soliciting stockholder votes.

By Order of the Board of Directors

Douglas P. Williams
Secretary
Atlanta, Georgia
May 31, 2013
Important Notice Regarding the Availability of Proxy Materials for the Stockholder Meeting to Be Held on August 9, 2013
The proxy statement, form of proxy card and 2012 annual report to stockholders are available at www.WellsTimberland.com/proxy.

QUESTIONS AND ANSWERS

We are providing you with this proxy statement, which contains information about the items to be voted on at our 2013 annual stockholders meeting (the "annual meeting"). To make this information easier to understand, we have presented some of the information in a question-and-answer format.

Q: Why did you send me this proxy statement?

A: We are sending you this proxy statement and the enclosed proxy card because our board of directors is soliciting your proxy to vote your shares at the annual meeting. This proxy statement includes information that we are required to provide to you under the rules of the Securities and Exchange Commission ("SEC") and is designed to assist you in voting.

Q: What is a proxy?

A: A proxy is a person who votes the shares of stock of another person. The term "proxy" also refers to the proxy card. When you return the enclosed proxy card, you are giving your permission to vote your shares of common stock at the annual meeting. The individuals who will vote your shares of common stock at the annual meeting are Leo F. Wells III, our President and Chairman of the Board; Douglas P. Williams, our Executive Vice President, Secretary and Treasurer and one of our directors; or Brian M. Davis, our Senior Vice President and Chief Financial Officer. They will vote your shares of common stock as you instruct, unless you return the proxy card and give no instructions. In this case, they will vote FOR all of the director nominees, FOR the proposal to amend and restate our charter and FOR the adjournment of the annual meeting to solicit additional proxies if necessary. With respect to any other proposals to be voted on, they will vote in accordance with the recommendation of our board of directors or, in the absence of such a recommendation, in their discretion. They will not vote your shares of common stock if you do not return the enclosed proxy card. This is why it is important for you to return the proxy card to us (or vote by proxy via Internet or by phone) as soon as possible, whether or not you plan on attending the meeting in person.

Q: Who is entitled to vote?

A: Anyone who owned our common stock at the close of business on May 14, 2013, the record date, is entitled to vote at the annual meeting.

Q: When is the annual meeting and where will it be held?

A: The annual meeting will be held on Friday, August 9, 2013, at 1:30 p.m. at the Hilton Atlanta Northeast, 5993 Peachtree Industrial Boulevard, Norcross, Georgia 30092.

Q: How many shares of common stock can vote?

A: As of the close of business on May 14, 2013, there were [__] shares of our common stock issued and outstanding. Every stockholder is entitled to one vote for each whole share of common stock held.

Q: What is a "quorum"?

A: A "quorum" must be present in order for the annual meeting to be a duly held meeting at which business can be conducted. A quorum consists of the presence in person or by proxy of stockholders holding 50% of our outstanding shares entitled to vote. Abstentions and broker nonvotes will be counted to determine whether a

quorum is present. A broker "nonvote" occurs when a broker, bank or other nominee holding shares for a beneficial owner does not vote on a particular proposal because the nominee does not have discretionary voting power with respect to that matter and has not received voting instructions from the beneficial owner. If you submit a properly executed proxy card, even if you "withhold" your vote from one or more director nominees or abstain from voting on the proposal to amend and restate our charter or the proposal to adjourn the annual meeting to solicit additional proxies if necessary, then you will be considered part of the quorum.

Q: What may I vote on?

A: You may vote on:

- the proposal to elect the five nominees named in this proxy statement to serve on the board of directors;
- the proposal to amend and restate our charter;
- the proposal to adjourn the annual meeting to solicit additional proxies, if necessary; and
- any other proposal that may properly come before the meeting or any adjournment or postponement thereof.

Q: How do I vote?

A: You may vote your shares of common stock either in person or by proxy. Whether you plan to attend the meeting and vote in person or not, we urge you to have your proxy vote recorded in advance of the meeting. Stockholders have the following three options for submitting their votes by proxy: (1) online; (2) by phone; or (3) by mail, using the enclosed proxy card. If you have Internet access, we encourage you to vote by proxy online because it is convenient and it saves us significant postage and processing costs. In addition, when you vote by proxy online or by phone prior to the meeting date, your proxy vote is recorded immediately, and there is no risk that postal delays will cause your proxy vote to arrive late and, therefore, not be counted. For further instructions on voting by proxy, see the enclosed proxy card accompanying this proxy statement. If you attend the annual meeting, you also may submit your vote in person, and any previous proxy votes that you submitted, whether online, by phone or by mail, will be superseded by the vote that you cast at the annual meeting. If you return your signed proxy card but do not mark the boxes showing how you wish to vote, your shares of common stock will be voted (i) FOR each of the nominees for director, (ii) FOR the proposal to amend and restate our charter, (iii) FOR the proposal to adjourn the annual meeting to solicit additional proxies if necessary and (iv) with respect to any other proposals that may properly come before the meeting, in accordance with the recommendation of our board of directors or, in the absence of such a recommendation, in the discretion of Messrs. Wells, Williams or Davis.

Q: What if I vote by proxy and then change my mind?

A: You have the right to revoke your proxy at any time before the meeting by:

(1) notifying Douglas P. Williams, our Secretary;

(2) attending the meeting and voting in person;

(3) returning another properly executed proxy card dated after your first proxy card if we receive it before the annual meeting date; or

(4) recasting your proxy vote online or by phone. Only the most recent proxy vote will be counted, and all others will be discarded regardless of the method of voting.

Q: Will my vote make a difference?

A: Yes. As discussed below, your vote could affect the composition of our board of directors and whether our charter is amended and restated. Moreover, your presence by proxy or in person is needed to ensure that the proposals can be acted upon. Because we are a widely held issuer with more than 10,000 stockholders as of the close of business on the record date, YOUR VOTE IS VERY IMPORTANT! Your immediate response will help avoid potential delays and may save us significant additional expenses associated with soliciting stockholder votes.

2

Q: How does the board of directors recommend I vote on the proposals?

A: The board of directors recommends a vote FOR each of the five nominees named in this proxy statement for election as director, FOR the proposal to amend and restate our charter and FOR the proposal to adjourn the annual meeting to solicit additional proxies if necessary.

Q: What are the voting requirements to elect the board of directors?

A: Under our charter and bylaws, the affirmative vote of the holders of a majority of the shares of stock entitled to vote and present in person or by proxy at a meeting of stockholders is required for the election of the directors. "Withhold" votes and broker nonvotes will have the same effect as votes against the election of the directors. Please see "Proposal 1. Election of Directors."

Q: What are the voting requirements to approve the proposal to amend and restate our charter?

A: Under our charter and bylaws, approval of the proposal to amend and restate our charter requires the affirmative vote of the holders of at least a majority of the shares of common stock entitled to vote on the proposal. Abstentions and broker nonvotes will have the same effect as votes against the proposal to amend and restate our charter. Please see "Proposal No. 2. Amendment and Restatement of Our Charter."

Q: What are the voting requirements to approve the proposal to adjourn the annual meeting to solicit additional proxies if necessary?

A: Approval of the proposal to adjourn the annual meeting to solicit additional proxies if necessary requires the affirmative vote of at least a majority of the votes cast at the annual meeting by stockholders who are present in person or by proxy and entitled to vote. Abstentions and broker nonvotes will not have an effect on the proposal to adjourn the annual meeting to solicit additional proxies if necessary. Please see "Proposal No. 3. Adjournment of the Annual Meeting."

Q: How will voting on any other business be conducted?

A: Although we do not know of any business to be considered at the annual meeting other than the election of directors, the proposal to amend and restate our charter and the proposal to adjourn the annual meeting to solicit additional proxies if necessary, if any other business is properly presented at the annual meeting, your signed proxy card gives authority to Messrs. Wells, Williams and Davis, and each of them, to vote on such matters in accordance with the recommendation of our board of directors or, in the absence of such a recommendation, in their discretion.

Q: When are stockholder proposals for the next annual meeting of stockholders due?

A: Stockholders interested in nominating a person as a director or presenting any other business for consideration at our 2014 annual meeting of stockholders may do so by following the procedures prescribed in Article II, Section 11 of our bylaws and in SEC Rule 14a-8 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). To be eligible for presentation to and action by the stockholders at the 2014 annual meeting, director nominations and other stockholder proposals must be received by Douglas P. Williams, our Secretary, no earlier than January 1, 2014 and no later than 5:00 pm ET on January 31, 2014. To also be eligible for inclusion in our proxy statement for the 2014 annual meeting of stockholders, stockholder proposals must be received by Mr. Williams by January 31, 2014.

Q: Who pays the cost of this proxy solicitation?

A: We will pay all the costs of soliciting these proxies. We have retained Computershare Fund Services ("CFS") to assist us in the distribution of proxy materials and the solicitation of proxies. We expect to pay CFS fees of approximately $75,800 to solicit proxies plus other fees and expenses for other services related to this proxy solicitation, which include review of proxy materials; dissemination of brokers' search cards; distribution of proxy materials; operating online and phone voting systems; and receipt of executed proxies. We also will reimburse brokerage houses and other custodians, nominees and fiduciaries for their reasonable out-of-pocket expenses for forwarding proxy and solicitation materials to our stockholders. Our officers and employees of our advisor or its affiliates may also solicit proxies, but they will not be specifically compensated for these services.

Q: Is this proxy statement the only way that proxies are being solicited?

A: No. In addition to mailing proxy solicitation materials, our directors and employees, as well as CFS and any other third-party proxy service companies we retain, also may solicit proxies in person, over the Internet, by phone or by any other means of communication we deem appropriate.

Q: If I share my residence with another stockholder, how many copies of the annual report and proxy statement should I receive?

A: In accordance with a notice previously sent to our stockholders, we are sending only a single set of the annual report and proxy statement to any household at which two or more stockholders reside if they share the same last name or we reasonably believe they are members of the same family, unless we have received instructions to the contrary from any stockholder at that address. This practice is known as "householding" and is permitted by rules adopted by the SEC. This practice reduces the volume of duplicate information received at your household and helps us reduce costs. Each stockholder will continue to receive a separate proxy card or voting instruction card. We will deliver promptly, upon written or oral request, a separate copy of the annual report or proxy statement, as applicable, to a stockholder at a shared address to which a single copy of the documents was previously delivered. If you received a single set of these documents for your household for this year, but you would prefer to receive your own copy, you may direct requests for separate copies to the following address: Wells Capital, Inc. c/o DST Systems, Inc., P.O. Box 219073, Kansas City, Missouri 64121-6073, or call us at 1-800-557-4830. If you are a stockholder who receives multiple copies of our proxy materials, you may request householding by contacting us in the same manner and requesting a householding consent form.

Q: What if I consent to have one set of materials mailed now but change my mind later?

A: You may withdraw your householding consent at any time by contacting our Client Services department at the address and phone number provided above. We will begin sending separate copies of stockholder communications to you within 30 days of receipt of your instruction.

Q: The reason I receive multiple sets of materials is because some of the shares belong to my children. What happens if they move out and no longer live in my household?

A: When we receive notice of an address change for one of the members of the household, we will begin sending separate copies of stockholder communications directly to the stockholder at his or her new address. You may notify us of a change of address by contacting our Client Services department at the address and phone number provided above.

Q: If I plan to attend the annual meeting in person, should I notify anyone?

A: While you are not required to notify anyone in order to attend the annual meeting, if you do plan to attend the meeting, we would appreciate it if you would mark the appropriate box on the enclosed proxy card to let us know how many stockholders will be attending the meeting so that we will be able to prepare a suitable meeting room for the attendees.

Q: Where can I find more information?

A: You may access, read and print copies of the proxy materials for the annual meeting, including our proxy statement, form of proxy card and annual report to stockholders, at the following web site: http://www.WellsTimberland.com/proxy.

We file annual, quarterly and current reports, proxy statements and other information with the SEC. You may read and copy any reports, statements or other information we file with the SEC on its web site at www.sec.gov. Our SEC filings also are available to the public at the SEC's Public Reference Room located at 100 F Street, N.E., Washington, D.C. 20549. You also may obtain copies of the documents at prescribed rates by writing to the Public Reference Section of the SEC at 100 F Street, N.E., Room 1580, Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information regarding the public reference facilities.

CERTAIN INFORMATION ABOUT MANAGEMENT

The Board of Directors

Our board of directors has oversight responsibility for our operations and makes all major decisions concerning our business. We currently have five directors. On February 27, 2013, E. Nelson Mills resigned from our board of directors, and on March 31, 2013, George W. Sands resigned from our board of directors. On March 13, 2013, the members of our board of directors elected Douglas P. Williams to fill the vacancy created by the resignation of Mr. Mills. In addition, our board of directors determined to reduce the size of the board of directors to five members effective as of March 31, 2013. Our board of directors is responsible for monitoring our operating results, financial condition and our significant risks.

For biographical information regarding our directors, see “Executive Officers and Directors” on pages 12 through 15.

Our board has established the following committees: Audit Committee, Nominating and Corporate Governance Committee and Operations Committee. Information regarding each of the committees is discussed below.

Director Attendance at Meetings

During 2012, our board of directors held eleven meetings, either in-person or telephonically. Each of our directors attended at least 75% of the aggregate of the total number of meetings of the board of directors held during the period for which he served as a director and the total number of meetings held by all committees of the board of directors on which he served during the periods for which he served. Although we have no policy with regard to attendance by the members of our board of directors at our annual meetings of stockholders, we invite and encourage the members of our board of directors to attend our annual meetings to foster communication with stockholders. In 2012, all of our directors attended our annual meeting of stockholders.

Director Independence

Our charter, as currently in effect and proposed to be amended, requires that a majority of our board be comprised of “independent directors.” We currently have a five member board. Two of our directors, Leo F. Wells, III and Douglas P. Williams serve as our executive officers and are affiliated with Wells Capital, Inc. (“Wells Capital”), our sponsor, and its affiliates, and we do not consider them to be independent directors. The remaining directors qualify as independent directors, as defined in our charter, in accordance with the requirements of the North American Securities Administrators Association’s Statement of Policy Regarding Real Estate Investment Trusts (the “NASAA REIT Guidelines”) and in accordance with listing standards of the New York Stock Exchange (“NYSE”), even though our shares are not currently listed on the NYSE. If our charter is amended as discussed in Proposal No. 2, we will only follow the independence requirements of the NYSE listing standards in the future. For additional information regarding the independence requirements under our charter, as currently in effect and as proposed to be amended, see “Certain Relationships and Related Transactions and Director Independence—Director Independence.” Our charter is available on our website at www.WellsTimberland.com.

Board Leadership Structure and Risk Oversight

Our board of directors is led by Leo F. Wells, III, as Chairman of the Board, who also serves as our President, which is our principal executive officer. Our board of directors believes that because the President is ultimately responsible for ensuring our successful operation, which is also the main focus of our board’s deliberations, the President is the most qualified director to act as Chairman of the Board. Our board composition and the corporate governance provisions in our charter ensure strong oversight by our independent directors. With the exception of our Operations

Committee, all of our committees are composed entirely of independent directors. Although Mr. Wells is not an independent director, our board of directors has determined that it is not necessary to appoint a lead independent director. To promote the independence of our board of directors and appropriate oversight of management, our independent directors meet in executive sessions at which only independent directors are present.

These meetings are held in conjunction with the regularly scheduled quarterly meetings of our board of directors, but may be called at any time by our independent directors. In 2012, our independent directors met five times in executive session without management present following meetings of our board of directors. Our board of directors may modify this structure if it determines that a different structure is in the best interest of our stockholders.

Our board of directors has an active role in overseeing the management of risks applicable to us and our operations. We face a number of risks, including economic risks, environmental and regulatory risks, and other risks such as the impact of competition. Our board of directors manages our risk through its approval of all timberland acquisitions and financing transactions, and its oversight of our executive officers and advisor. Our board of directors has established committees, including the Audit Committee, Operations Committee and Nominating and Corporate Governance Committee, which monitor and oversee the management of risks relevant to those committees. Our board of directors may establish additional committees in the future to address specific areas of risk as it deems appropriate and in the best interest of our stockholders. We believe our structure with a combined President and Chairman of the Board and active independent directors enables our board of directors to be informed of and effectively monitor the risks our company faces.

The Audit Committee

General

Our board of directors has a separately designated standing Audit Committee established in accordance with Section 3(a)(58)(A) of the Exchange Act. The Audit Committee’s primary function is to assist our board of directors in fulfilling its responsibilities by:

- selecting the independent auditors to audit our financial statements;
- reviewing with the independent auditors the plans and results of the audit engagement;
- approving the audit and overseeing our independent auditors and reviewing the financial information to be provided to our stockholders and others;
- reviewing the independence of the independent public accountants;
- considering the adequacy of fees;
- reviewing the system of internal control over financial reporting which our management has established and our audit and financial reporting process;
- overseeing our compliance with applicable laws and regulations; and
- establishing procedures for the ethical conduct of our business.

The Audit Committee fulfills these responsibilities primarily by carrying out the activities enumerated in the Audit Committee Charter adopted by our board of directors in 2006, and revised as of May 2012. The Audit Committee Charter is available on our web site at www.WellsTimberland.com.

Our Audit Committee currently consists of Donald S. Moss, Willis J. Potts, Jr. and Henry G. Zigtema. All of the members of the Audit Committee are “independent” as defined under the rules of the NYSE and our charter. Henry G. Zigtema is designated as the Audit Committee financial expert and is the Chairman of the Audit Committee. During 2012, the Audit Committee met four times.

Independent Auditors

During the year ended December 31, 2012, Deloitte & Touche LLP ("Deloitte") served as our independent auditor and provided certain tax and other services. Deloitte has served as our independent auditor since our formation. Deloitte representatives will be present at the annual meeting of stockholders and will have the opportunity to make a statement if they desire to do so. In addition, the Deloitte representatives will be available to respond to appropriate questions posed by any stockholder. The Audit Committee has engaged Deloitte as our independent auditor to audit our financial statements for the year ending December 31, 2013. The Audit Committee may, however, select new auditors at any time in the future in its discretion if it deems such decision to be in our best interest. Any such decision will be disclosed to the stockholders in accordance with applicable securities laws.

Preapproval Policies

The Audit Committee Charter imposes a duty on the Audit Committee to preapprove all auditing services performed for us by our independent auditors, as well as all permitted non-audit services (including the fees and terms thereof) in order to ensure that the provision of such services does not impair the auditors' independence. Unless a type of service to be provided by the independent auditors has received general pre-approval, it will require specific pre-approval by the Audit Committee.

All requests or applications for services to be provided by the independent auditor which do not require specific preapproval by the Audit Committee will be submitted to management and must include a detailed description of the services to be rendered. Management will determine whether such services are included within the list of services that have received the general preapproval of the Audit Committee. The Audit Committee will be informed on a timely basis of any such services rendered by the independent auditors.

Requests or applications to provide services that require specific preapproval by the Audit Committee will be submitted to the Audit Committee by both the independent auditors and our Principal Financial Officer, and must include a joint statement as to whether, in their view, the request or application is consistent with the SEC's rules on auditor independence. The Chairman of the Audit Committee has been delegated the authority to specifically preapprove all services not covered by the general preapproval guidelines up to an amount not to exceed $75,000 per occurrence. Amounts requiring preapproval in excess of $75,000 per occurrence require specific preapproval by all members of the Audit Committee prior to engagement of Deloitte. All amounts specifically preapproved by the Chairman of the Audit Committee in accordance with this policy are to be disclosed to the full Audit Committee at the next regularly scheduled meeting.

All services rendered by Deloitte for the year ended December 31, 2012 were preapproved in accordance with the policies and procedures described above.

Principal Auditor Fees

The Audit Committee reviewed the audit and non-audit services performed by Deloitte, as well as the fees charged by Deloitte for such services. In its review of the non-audit service fees, the Audit Committee considered whether the provision of such services is compatible with maintaining the independence of Deloitte. The aggregate fees billed to us for professional accounting services, including the audit of our annual financial statements by Deloitte for the years ended December 31, 2012 and 2011, are set forth in the table below.

	2012	2011
Audit fees	$310,000	$290,000
Audit-related fees	—	—
Tax fees	$121,225	$134,805

All other fees	—	—
Total	$431,225	$424, 805

8

For purposes of the preceding table, Deloitte’s professional fees are classified as follows:

- Audit fees – These are fees for professional services performed for the audit of our annual financial statements and the required review of quarterly financial statements and other procedures performed by Deloitte in order for them to be able to form an opinion on our consolidated financial statements. These fees also cover services that are normally provided by independent auditors in connection with statutory and regulatory filings or engagements.
- Audit-related fees - These are fees for assurance and related services that traditionally are performed by independent auditors that are reasonably related to the performance of the audit or review of the financial statements, such as due diligence related to acquisitions and dispositions, attestation services that are not required by statute or regulation, internal control reviews and consultation concerning financial accounting and reporting standards.
- Tax fees - These are fees for all professional services performed by professional staff in our independent auditor's tax division, except those services related to the audit of our financial statements. These include fees for tax compliance, tax planning and tax advice, including federal, state and local issues. Services may also include assistance with tax audits and appeals before the IRS and similar state and local agencies, as well as federal, state and local tax issues related to due diligence.
- All other fees - These are fees for any services not included in the above-described categories, including assistance with internal audit plans and risk assessments.

Report of the Audit Committee

The Audit Committee reviews the financial reporting process on behalf of our board of directors. Our management has the primary responsibility for the financial statements and the reporting process, including the system of internal control over financial reporting. Membership on the Audit Committee does not call for the professional training and technical skills generally associated with career professionals in the field of accounting and auditing. In addition, the independent auditors devote more time and have access to more information than does the Audit Committee. Accordingly, the Audit Committee’s role does not provide any special assurance with regard to our financial statements, nor does it involve a professional evaluation of the quality of the audits performed by the independent auditors. In this context, the Audit Committee reviewed the 2012 audited financial statements with management and discussed the quality and acceptability of our financial reporting, the reasonableness of significant judgments and the clarity of disclosures in the financial statements.

The Audit Committee reviewed with Deloitte & Touche LLP (“Deloitte”), the independent accountant responsible for expressing an opinion on the conformity of our audited financial statements with U.S. generally accepted accounting principles, its judgments as to the quality and the acceptability of the financial statements and such other matters as are required to be discussed with the Audit Committee under Statement on Auditing Standards No. 61, as amended, AICPA, Professional Standards, Vol. 1 AU, Section 380 as adopted by the Public Company Accounting Oversight Board in Rule 3200T regarding Communication with Audit Committees. The Audit Committee has received written disclosures and a letter from Deloitte in satisfaction of the requirements of the Public Company Accounting Oversight Board regarding the independent accountant’s communications with the Audit Committee concerning independence and has discussed Deloitte’s independence with Deloitte. In addition, the Audit Committee considered whether Deloitte’s provision of non-audit services is compatible with Deloitte’s independence.

The Audit Committee discussed with Deloitte the overall scope and plans for the audit. The Audit Committee meets periodically with the internal auditor and Deloitte, with and without the presence of management, to discuss the results of their examinations, their evaluations of our internal controls and the overall quality of our financial reporting.

In reliance on these reviews and discussions, the Audit Committee recommended to the board of directors and the board of directors approved the inclusion of the 2012 audited financial statements in our Annual Report on Form 10-K for the year ended December 31, 2012 for filing with the SEC.

The Audit Committee of the Board of Directors:

Donald S. Moss
Willis J. Potts, Jr.
Henry G. Zigtema

The Nominating and Corporate Governance Committee

General

Our Nominating and Corporate Governance Committee currently consists of Donald S. Moss, Willis J. Potts, Jr. and Henry G. Zigtema. The members of the Nominating and Corporate Governance Committee are "independent" as defined under the rules of the NYSE and our charter. Mr. Moss is the Chairman of the Nominating and Corporate Governance Committee. During 2012, the Nominating and Corporate Governance Committee met five times.

The primary functions of the Nominating and Corporate Governance Committee are:

- identifying individuals qualified to serve on the board of directors and recommending that the board of directors select a slate of director nominees for election by the stockholders at the annual meeting;
- developing and recommending to the board of directors a set of corporate governance policies and principles and periodically re-evaluating such policies and guidelines for the purpose of suggesting amendments to them if appropriate; and
- overseeing an annual evaluation of the board of directors and each of the committees of the board of directors and our management.

The Nominating and Corporate Governance Committee Charter is available on our website at www.WellsTimberland.com.

Board Membership Criteria

The Nominating and Corporate Governance Committee annually reviews with our board of directors the appropriate experience, skills and characteristics required of board members in the context of the then-current membership of the board of directors. This assessment includes, in the context of the perceived needs of the board of directors at that time, issues of knowledge, experience, judgment and skills such as an understanding of the real estate industry, the timber industry or brokerage industry or accounting or financial management expertise. Therefore, our board of directors and the Nominating and Corporate Governance Committee have sought a diverse board of directors whose members collectively possess these skills and experiences. Although our board of directors does not have a formal written policy regarding the consideration of diversity in identifying director nominees, diversity will continue to be a factor that is considered in identifying and recruiting new directors. Other considerations include the candidate's independence from conflict with us and the ability of the candidate to attend board meetings regularly and to devote an appropriate amount of effort in preparation for those meetings. It also is expected that independent directors nominated by the board of directors shall be individuals who possess a reputation and hold (or have held) positions or affiliations befitting a director of a large publicly registered company and are (or have been) actively engaged in their occupations or professions or are otherwise regularly involved in the business, professional or academic community. Moreover, as required by our charter, at least one of our independent directors must have at least three years of

relevant real estate experience and each director must have at least three years of relevant experience

demonstrating the knowledge and experience required to successfully acquire and manage the type of assets we acquire and manage. As detailed in the director biographies below, our board of directors and the Nominating and Corporate Governance Committee believe that the slate of directors recommended for election at the annual meeting possess these diverse skills and experiences.

Selection of Directors

Our board of directors is responsible for selecting its own nominees and recommending them for election by the stockholders. Pursuant to our charter, however, the independent directors must nominate replacements for any vacancies among the independent director positions.

Our board of directors delegates the screening process necessary to identify qualified candidates to the Nominating and Corporate Governance Committee. The Nominating and Corporate Governance Committee annually reviews director suitability and the continuing composition of the board of directors; it then recommends director nominees who are voted on by the full board of directors. All director nominees then stand for election by the stockholders annually.

In recommending director nominees to the board of directors, the Nominating and Corporate Governance Committee solicits candidate recommendations from its own members, other directors and management of Wells Capital. The Nominating and Corporate Governance Committee may engage the services of a search firm to assist in identifying potential director nominees. The Nominating and Corporate Governance Committee also will consider recommendations made by stockholders for director nominees who meet the established director criteria set forth above. In order to be considered by the Nominating and Corporate Governance Committee, recommendations made by stockholders must be submitted within the timeframe required for director nominations by stockholders as provided in our bylaws. See “Stockholder Proposals” below. In evaluating the persons recommended as potential directors, the Nominating and Corporate Governance Committee will consider each candidate without regard to the source of the recommendation and take into account those factors that the Nominating and Corporate Governance Committee determines are relevant. Stockholders may directly nominate potential directors (without the recommendation of the Committee) by satisfying the procedural requirements for such nomination as provided in Article II, Section 11, of our bylaws. Any stockholder may request a copy of our bylaws free of charge by calling our Client Services department at 1-800-557-4830.

Operations Committee

Our Operations Committee currently consists of Leo F. Wells, III, Donald S. Moss, Willis J. Potts, Jr. and Henry G. Zigtema. The Operations Committee is responsible for:

- maintaining and developing each Operations Committee member's understanding of the complexities of timberland management and timber harvesting;
- maintaining and developing each Operations Committee member's experience in supervising our operations related to timberland management and timber harvesting and developing procedures designed to promote the accountability of the officers regarding results of operations;
- preparing and developing materials designed to inform and educate those members of our board of directors who do not have the experience and understanding of timberland management and timber harvesting of the issues and complexities involved; and
- performing such other duties as our board of directors may determine are necessary and appropriate and may delegate to the Operations Committee.

Mr. Potts is the Chairman of the Operations Committee. During 2012, the Operations Committee met four times.

Stockholder Communications with the Board of Directors

We have established several means for stockholders to communicate concerns to the board of directors. If the concern relates to our financial statements, accounting practices or internal controls, stockholders should submit the concern in writing to the Chairman of the Audit Committee in care of our Secretary at our headquarters c/o Wells Real Estate Funds, 6200 The Corners Parkway, Norcross, Georgia 30092. If the concern relates to our governance practices, business ethics or corporate conduct, stockholders should submit the concern in writing to the Chairman of our Nominating and Corporate Governance Committee in care of our Secretary at our headquarters. If uncertain as to which category a concern relates, a stockholder may communicate the concern to any one of the independent directors in care of our Secretary at the above address.

Stockholders also may communicate concerns with our directors at our annual meeting. All of our directors were in attendance at our 2012 annual meeting. We expect all of the directors to be present at our 2013 annual meeting.

Executive Officers and Directors

We have provided below certain information about our executive officers and director nominees. All of our directors have terms expiring on the date of the 2013 annual stockholders meeting and all of our current directors are being nominated for re-election to serve until the 2014 annual stockholders meeting and until their respective successors are duly elected and qualify.

Name	Age	Position(s)	Term of Office
Leo F. Wells III	69	President and Chairman of the Board	Since 2005
Douglas P. Williams [(1)]	62	Executive Vice President, Secretary, Treasurer and Director	Since 2005
Brian M. Davis	43	Senior Vice President and Chief Financial Officer	Since 2013
Donald S. Moss	77	Independent Director	Since 2006
Willis J. Potts, Jr.	66	Independent Director	Since 2006
Henry G. Zigtema	61	Independent Director	Since 2012

[(1)] Douglas P. Williams was elected to our board of directors on March 13, 2013.

There are no family relationships between any directors or executive officers or between any director and executive officer.

Leo F. Wells, III. Since our inception in September 2005, Mr. Wells has been our President. He served as one of our directors from inception until June 22, 2007, was re-elected to our board of directors on March 16, 2012 and was elected Chairman of the Board on May 7, 2012. He served as the President of Piedmont Office Realty Trust, Inc. (“Piedmont REIT”), a publicly traded real estate investment trust (“REIT”) from 1997 to February 2007 and served as Chairman of the Board of Piedmont REIT until May 2007. He served as the President of Columbia Property Trust, Inc. (“Columbia”) from 2003 to July 2010 and has served as a director of Columbia since 2003, and the President and a director of Wells Core Office Income REIT, Inc, (“Wells Core REIT”) since 2009. He has also been the sole stockholder, sole director, and Treasurer of Wells REF since 1997. He served as the President of Wells Real Estate Funds, Inc. (“Wells REF”) between 1997 and February 2012 and began serving as the Chairman and Chief Executive Officer of Wells REF after February 2012. Wells REF directly or indirectly owns Wells Capital, Wells Management Company, Inc. (“Wells Management”), Wells Investment Securities, Inc. (“WIS”), Wells & Associates, Inc., Wells Development Corporation, Wells Asset Management, Inc., Wells Real Estate Advisory Services, Inc., and Wells Timberland Management Organization, LLC (“Wells TIMO”), our advisor. He has also been the President, Treasurer, and sole director of Wells Capital since 1984; Wells Management since 1983; Wells Development Corporation since

it was organized in 1997 to develop real estate properties; and Wells Asset Management, Inc. since it was organized in 1997 to serve as an investment advisor to the Wells Family of Real Estate Funds. Since

1997, Mr. Wells has been a trustee of the Wells Family of Real Estate Funds, an open-end management company organized as an Ohio business trust, which included as one of its series the Wells Dow Jones Wilshire U.S. REIT Index Fund and the Wells Dow Jones Wilshire Global RESI Index Fund. Since 2004, he has been President and sole director of Wells Real Estate Advisory Services, Inc. He has been the President, Treasurer, and a director of Wells & Associates, Inc., a real estate brokerage and investment company, since it was formed in 1976 and incorporated in 1978.

Mr. Wells was a real estate salesman and property manager from 1970 to 1973 for Roy D. Warren & Company, an Atlanta-based real estate company, and he was associated from 1973 to 1976 with Sax Gaskin Real Estate Company, during which time he became a Life Member of the Atlanta Board of Realtors Million Dollar Club. From 1980 to February 1985, he served as Vice President of Hill-Johnson, Inc., a Georgia corporation engaged in the construction business. Mr. Wells holds a Bachelor of Business Administration degree in Economics from The University of Georgia. Mr. Wells is a member of the Financial Planning Association (FPA).

On August 26, 2003, Mr. Wells and WIS entered into a Letter of Acceptance, Waiver and Consent (“AWC”) with the National Association of Securities Dealers (“NASD”) now the Financial Industry Regulatory Authority, Inc. (“FINRA”), relating to alleged rule violations. The AWC set forth the NASD’s findings that WIS and Mr. Wells had violated conduct rules relating to the provision of noncash compensation of more than $100 to associated persons of NASD member firms in connection with their attendance at the annual educational and due diligence conferences sponsored by WIS in 2001 and 2002. Without admitting or denying the allegations and findings against them, WIS and Mr. Wells consented in the AWC to various findings by the NASD that are summarized in the following paragraph:

In 2001 and 2002, WIS sponsored conferences attended by registered representatives who sold its real estate investment products. WIS also paid for certain expenses of guests of the registered representatives who attended the conferences. In 2001, WIS paid the costs of travel to the conference and meals for many of the guests and paid the costs of playing golf for some of the registered representatives and their guests. WIS later invoiced registered representatives for the cost of golf and for travel expenses of guests, but was not fully reimbursed for such. In 2002, WIS paid for meals for the guests. WIS also conditioned most of the 2001 conference invitations on attainment by the registered representatives of a predetermined sales goal for WIS products. This conduct violated the prohibitions against payment and receipt of noncash compensation in connection with the sales of these products contained in NASD’s Conduct Rules 2710, 2810, and 3060. In addition, WIS and Mr. Wells failed to adhere to all of the terms of their written undertaking made in March 2001 not to engage in the conduct described above, and thereby failing to observe high standards of commercial honor and just and equitable principles of trade, in violation of NASD Conduct Rule 2110.

WIS consented to a censure, and Mr. Wells consented to suspension from acting in a principal capacity with an NASD member firm for one year. WIS and Mr. Wells also agreed to the imposition of a joint and several fine in the amount of $150,000. Mr. Wells’ one-year suspension from acting in a principal capacity with WIS ended on October 6, 2004.

Our board of directors, excluding Mr. Wells, has determined that Mr. Wells' extensive experience and knowledge of our company and Wells TIMO, commercial real estate expertise, and public company director experience, as well as his leadership skills, integrity, and judgment, are all relevant experiences, attributes, and skills that enable Mr. Wells to effectively carry out his duties and responsibilities as a director. Consequently, our board of directors has determined that Mr. Wells is a highly qualified candidate for directorship and should therefore serve as one of our directors.

Douglas P. Williams. Since our inception in September 2005, Mr. Williams has been our Executive Vice President, Secretary, and Treasurer. He served as one of our directors from inception until June 22, 2007 and was re-elected to our board of directors on March 13, 2013. From 2000 to 2007, he has also served as Executive Vice President,

Secretary, and Treasurer, and a director of Piedmont REIT. He was the Executive Vice President, Secretary, and

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Treasurer of Columbia from 2003 until February 28, 2013, and has served as a director of Columbia since 2003. He has been the Executive Vice President, Secretary, and Treasurer of Wells Core REIT since 2009. Since 1999, Mr. Williams has also been a Senior Vice President of Wells Capital. Mr. Williams was a Vice President, Chief Financial Officer, and Treasurer of WIS, our dealer-manager, until August 2012. He was a director of WIS until 2012. He has also been a Vice President of Wells REF and Vice President and Secretary of Wells Asset Management, Inc. since 1999.

From 1996 to 1999, Mr. Williams served as Vice President and Controller of OneSource, Inc., a leading supplier of janitorial and landscape services, where he was responsible for corporate-wide accounting activities and financial analysis. Mr. Williams was employed by ECC International Inc., a supplier to the paper industry and to the paint, rubber, and plastic industries, from 1982 to 1995. While at ECC, Mr. Williams served in a number of key accounting positions, including: Corporate Accounting Manager, U.S. Operations; Division Controller, Americas Region; and Corporate Controller, America/Pacific Division. Prior to joining ECC and for one year after leaving ECC, Mr. Williams was employed by Lithonia Lighting, a manufacturer of lighting fixtures, as a Cost and General Accounting Manager and Director of Planning and Control. Mr. Williams started his professional career as an auditor for a predecessor firm of KPMG LLP. Mr. Williams is a member of the American Institute of Certified Public Accountants and the Georgia Society of Certified Public Accountants and is licensed with FINRA as a financial and operations principal. Mr. Williams received a Bachelor of Arts degree from Dartmouth College and a Master of Business Administration degree from Amos Tuck School of Graduate Business Administration at Dartmouth College.

Our board of directors, excluding Mr. Williams, has determined that Mr. Williams' extensive knowledge of our company and Wells REF and his financial and accounting expertise have provided him with the financial and management skills to effectively carry out his duties and responsibilities as director. Consequently, our board of directors has determined that Mr. Williams is a highly qualified candidate for directorship and should therefore serve as one of our directors.

Brian M. Davis. Mr. Davis was elected as our Senior Vice President and Chief Financial Officer in March 2013. Mr. Davis has served as Senior Vice President and Chief Financial Officer of Wells TIMO since March 2009 and as Vice President from October 2007 through March 2009. Mr. Davis has served as Senior Vice President and Chief Financial Officer of Wells Core REIT since March 2013. Since February 2012, Mr. Davis has served as the Chief of Strategic Product Management for Wells REF with the responsibility for the strategic planning, development and leadership of the corporate finance organization. In addition, Mr. Davis has served as Senior Vice President of Wells Capital since February 2013.

From 2000 until joining Wells REF in 2007, Mr. Davis worked at Atlanta-based SunTrust Bank, where he held various positions including client manager for the Asset Based Lending Group, where he was responsible for the origination and structuring of asset-based lending relationships developed from SunTrust's existing client base and prospects. Mr. Davis previously held positions with CoBank, ACB, of Denver, Colorado, as Capital Markets Officer from 1998 to 2000, and with SunTrust as Client Manager for the AgriFoods Specialty Lending Group from 1994 to 1998. Mr. Davis received his Bachelor of Business Administration and Master of Business Administration from Ohio University.

Donald S. Moss. Mr. Moss has served as one of our independent directors since 2006. He has also served as an independent director of Piedmont REIT. He was employed by Avon Products, Inc. from 1957 until his retirement in 1986. While at Avon, Mr. Moss served in a number of key positions, including Vice President and Controller from 1973 to 1976, Group Vice President of Operations - Worldwide from 1976 to 1979, Group Vice President of Sales - Worldwide from 1979 to 1980, Senior Vice President - International from 1980 to 1983 and Group Vice President - Human Resources and Administration from 1983 until his retirement in 1986. Mr. Moss was also a member of the board of directors of Avon Canada, Avon Japan, Avon Thailand, and Avon Malaysia from 1980 to 1983. Mr. Moss is

a past president and former director of The Atlanta Athletic Club, a former director of the Highlands Country Club in Highlands, North Carolina and the National Treasurer and a director of the Girls Clubs of America from 1973 to 1976. Mr. Moss attended the University of Illinois where he majored in Business.

Our board of directors, excluding Mr. Moss, has determined that Mr. Moss experience serving as a director for other organizations, including several REITs, has provided him with the business management skills and real estate knowledge desired to effectively carry out his duties and responsibilities as director. Consequently, our board of directors has determined that Mr. Moss is a highly qualified candidate for directorship and should therefore continue to serve as one of our directors.

Willis J. Potts, Jr. Mr. Potts has served as one of our independent directors since 2006. From June 1999 until his retirement in June 2004, Mr. Potts served as vice president and general manager of Temple-Inland Inc., a major forest products corporation, where he was responsible for all aspects of the management of a major production facility, including timber acquisition, community relations, and governmental affairs. From 1994 to 1999, Mr. Potts was senior vice president of Union Camp Corporation, where he was responsible for all activities of an international business unit, with revenues of approximately $1 billion per year including supervision of acquisitions and dispositions of timber and timberland, controllership functions, and manufacturing. From 2004 to 2007, Mr. Potts was the chairman of the board of directors of the Technical Association of the Pulp and Paper Industry (TAPPI), the largest technical association serving the pulp, paper, and converting industry. From 2006 to 2012, Mr. Potts served on the Board of Regents of The University System of Georgia. Mr. Potts also serves as a director of J&J Industries, a privately held carpet manufacturing company. Mr. Potts received a Bachelor of Science degree in Industrial Engineering from the Georgia Institute of Technology. He also completed the Executive Program at the University of Virginia.

Our board of directors, excluding Mr. Potts, has determined that Mr. Potts’ extensive experience in the acquisition and disposition of timber and timberland, combined with his experience serving as a director of, and otherwise managing, organizations engaging in these activities, are all relevant experiences, attributes, and skills that enable Mr. Potts to effectively carry out his duties and responsibilities as director. Consequently, our board of directors has determined that Mr. Potts is a highly qualified candidate for directorship and should therefore continue to serve as one of our directors.

Henry G. Zigtema. Mr. Zigtema was elected as one of our independent directors in September 2012. Mr. Zigtema is currently an adjunct professor of accounting at Oglethorpe University and serves on the President's Advisory Board at Oglethorpe. Prior to his retirement in 2006, Mr. Zigtema spent 28 years of his career with Ernst and Young LLP and its predecessor firm, Arthur Young and Company. From 2001 to 2006, Mr. Zigtema was the Southeast Area Tax Managing Partner for Ernst & Young's Real Estate Practice. During his career, Mr. Zigtema served in several key positions, including Area Director of Tax, Plains State Area Industry Leader for Telecommunications, Oil and Gas, and Real Estate as well as a National Office Partner for Strategic Business Services. Mr. Zigtema served as the tax engagement partner or client service partner for a wide variety of clients, including multinational companies such as Sprint, Zion’s Bank, US Bank, Piedmont REIT, Columbia, various publicly-traded REITs in the retail, office, apartment and mortgage spaces, as well as a number of private clients. Past board of director involvement includes Maur Hill Prep School, Kapaun Mt. Carmell High School, St. Thomas Aquinas School, Wichita State Accounting Conference Committee, Sedgewick County Zoo, and Ronald McDonald House. Mr. Zigtema has contributed to various Ernst & Young publications and was a member of the National Association of Real Estate Investment Trusts. Mr. Zigtema holds a Bachelor of Arts degree in Mathematics from Texas Christian University and a Juris Doctorate degree from Southern Methodist University as well as completing non-degree accounting classes at the University of Texas at Dallas. Mr.Zigtema is a Certified Public Accountant with permits to practice in Georgia, Kansas, and Texas and is an inactive member of the Texas Bar.

Our board of directors, excluding Mr. Zigtema, has determined that Mr. Zigtema’s extensive accounting and tax background and experience serving as a director for other organizations, are all relevant experiences, attributes, and skills that enable Mr. Zigtema to effectively carry out his duties and responsibilities as director. Consequently, our board of directors has determined that Mr. Zigtema is a highly qualified candidate for directorship and should therefore serve as one of our directors.

15

Compensation of Our Executive Officers

Our executive officers do not receive compensation from us for services rendered to us. Our executive officers are also officers of Wells TIMO and its affiliates and are compensated by these entities, in part, for their services to us. We have not reimbursed Wells TIMO or its affiliates for the salaries paid by Wells TIMO or its affiliates to our executive officers. As a result, our board of directors has determined that it is not necessary to establish a compensation committee. See “Certain Relationships and Related Transactions and Director Independence” below for a discussion of the fees paid to and services provided by Wells TIMO, Wells Capital and its affiliates.

Compensation of Directors

We have provided below certain information regarding compensation paid to our directors during the fiscal year ended December 31, 2012.

Name	Fees Earned or Paid in Cash ($)	Restricted Stocks Award ($) [8]	Option Awards ($) [9]	Total ($)
Leo F. Wells, III [1] [2]	$—	$—	$—	$—
Jess E. Jarratt[1] [3]	$—	$—	$—	$—
E. Nelson Mills[1] [4]	$—	$—	$—	$—
Michael P. McCollum [5]	$12,500	$—	$—	$12,500
Donald S. Moss	$61,000	$10,000	$—	$71,000
Willis J. Potts, Jr.	$57,750	$10,000	$—	$67,750
George W. Sands [6]	$56,250	$10,000	$—	$66,250
Henry G. Zigtema [7]	$22,250	$25,000	$—	$47,250

(1) Directors who are not independent do not receive compensation for services rendered as a director.

(2) Leo F. Wells, III was elected to our board of directors on March 16, 2012.

(3) Jess E. Jarratt resigned from our board of directors effective June 11, 2012. Mr. Jarratt was not an independent director, and as a result, did not receive compensation for services rendered as a director.

(4) E. Nelson Mills resigned from our board of directors effective February 27, 2013. Mr. Mills was not an independent director, and as a result, did not receive compensation for services rendered as a director.

(5) Michael P. McCollum resigned from our board of directors effective June 30, 2012.

(6) George W. Sands resigned from our board of directors effective March 31, 2013.

(7) Henry G. Zigtema was elected to our board of directors on September 14, 2012.

(8) Reflects the dollar amounts recognized for financial statement reporting purposes of restricted stock received pursuant to our amended and restated independent directors' compensation plan. The per-share value for all shares issued to date was estimated at $10.00. The shares of restricted stock vest in thirds on each of the first three anniversaries of the date of grant.

(9) Reflects the dollar amounts recognized for financial statement reporting purposes, computed in accordance with the accounting standard for share-based payments. See Note 9 - Stockholders' Equity in the consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2012 for an explanation of the valuation model assumptions used. We granted 22,000 options to purchase shares of common stock, all of which had vested by August 2011 and remained exercisable as of December 31, 2012. The exercise price of all outstanding options is $10.00 per share.

Cash Compensation

We pay each of our independent directors:

- an annual retainer of $20,000;
- $2,000 per regularly scheduled board meeting attended;
- $1,500 per regularly scheduled committee meeting attended (committee chairpersons receive an additional $500 per committee meeting for serving in that capacity); and
- $250 per special board or committee meeting attended whether held in person or by phone conference.

When a committee meeting occurs on the same day as a board meeting, an additional fee is not paid for attending the committee meeting.

All directors receive reimbursement of reasonable out-of-pocket expenses incurred in connection with attendance at meetings of the board of directors.

Director Incentive Plan

Our board of directors has authorized and reserved 100,000 shares of common stock for issuance to independent directors under the independent directors' compensation plan (the "Director Plan"), which operates as a sub-plan of our Long-Term Incentive Plan (as defined below). Our board of directors or a committee of its independent directors administers the Director Plan, with sole authority (following consultation with Wells TIMO) to select participants, and determines the types of awards to be granted and all of the terms and conditions of the awards, including whether the grant, vesting, or settlement of awards may be subject to the attainment of one or more performance goals. No awards will be granted under the Director Plan if the grant, vesting, and/or exercise of the awards would jeopardize our status as a REIT under the Internal Revenue Code of 1986, as amended, or otherwise violate the ownership and transfer restrictions imposed under our charter. Unless determined by our board of directors or a committee of our independent directors, no award granted under the Director Plan will be transferable except through the laws of descent and distribution.

In November 2009, our board of directors amended and restated our independent directors’ compensation plan (the “Amended Director Plan”), to provide for the issuance of restricted stock, rather than options, as non-cash compensation to our independent directors. The Amended Director Plan provides that each independent director elected or appointed to our board on or after November 13, 2009 shall receive a grant of 2,500 shares of restricted stock upon his or her initial election or appointment. Upon each subsequent re-election to the board, each independent director will receive a subsequent grant of 1,000 shares of restricted stock. The shares of restricted stock vest in thirds on each of the first three anniversaries of the date of grant. As of December 31, 2012, we had granted 16,000 shares of restricted stock, 4,000 shares of which had vested and approximately 1,667 shares of which were forfeited upon the resignation of an independent director from our board.

Prior to November 2009, each independent director received a grant of options to purchase 2,500 shares of our common stock upon his election to our board. The initial grant of options was non-dilutive with an exercise price of $10.00 per share. Upon each subsequent re-election of the independent director to the board, he received a subsequent grant of options to purchase 1,000 shares of our common stock. The exercise price for the subsequent options was the greater of (1) $10.00 per share or (2) the fair market value of the shares on the date of grant. Of the options granted, one-third were immediately exercisable on the date of grant, one-third became exercisable on the first anniversary of the date of grant, and the remaining one-third became exercisable on the second anniversary of the date of grant. The stock options will lapse on the first to occur of (1) the tenth anniversary of the date of grant, or (2) the removal for cause of the independent director as a member of the board of directors. No option issued may be exercised if such exercise would jeopardize our status as a REIT under the Code. The independent directors may not

17

sell, pledge, assign, or transfer their options other than by will or the laws of descent or distribution or (except in the case of an incentive stock option) pursuant to a qualified domestic relations order.

We granted options to purchase 22,000 shares of our common stock, all of which had vested by August 2011. No options had been exercised as of December 31, 2012.

Compensation Committee Interlocks and Insider Participation

We currently do not have a compensation committee of our board of directors because we do not pay any compensation to our officers. There are no interlocks or insider participation as to compensation decisions required to be disclosed pursuant to SEC regulations.

Equity Compensation Plan Information

We have adopted a long-term incentive plan, of which the Amended Director Plan is a part, which will be used to attract and retain qualified independent directors, employees, advisors and consultants considered essential to our long-range success ("Long-Term Incentive Plan"). Under the terms of our Long-Term Incentive Plan, a total of 500,000 shares of common stock have been authorized and reserved for issuance, of which 100,000 of such common shares are authorized and reserved for issuance to independent directors under the Director Plan. The following table provides summary information on the securities issuable under our equity compensation plans as of December 31, 2012.

Plan Category	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 Remaining Available for Future Issuance
Equity compensation plans approved by security holders[1]	22,000	$10.00	462,000
Equity compensation plans not approved by security holders	—	—	—
Total	22,000	$10.00	462,000

233		(233)			0	
Preferred stock dividend paid and/or accrued			(1,671)			(1,671
Balance at September 30, 2009	$ 53,992	$ 25,299	$ 147,295	$ (5,437)	$ (1,524)	$ 219,62
Balance at January 1, 2010	$ 54,095	$ 83,487	$ 149,945	$ (5,993)	$ (1,540)	$ 279,99
Comprehensive income:						
Net income			18,761			18,76
Other comprehensive income (loss), net of tax				9,675		9,67
						28,43

Comprehensive income											
Common stock cash dividends declared, $.465 per share						(7,489)					(7,489
Treasury shares purchased under deferred directors' plan											
(10,254 shares)				195						(195)	0
Treasury shares sold and distributed under deferred directors' plan											
(4,477 shares)				(90)						90	0
Stock activity under stock compensation plans (54,108 shares)				580							58
Stock compensation expense				1,212							1,21
Redemption of 56,044 shares of preferred stock		(56,044)									(56,044
Accretion of preferred stock discount		1,949				(1,949)					0
Preferred stock dividend paid and/or accrued						(1,251)					(1,251
Balance at September 30, 2010	$	0	$	85,384	$	158,017	$	3,682	$	(1,645)	$ 245,43

The accompanying notes are an integral part of these consolidated financial statements.

5

LAKELAND FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Nine Months Ended September 30, 2010 and 2009
(in thousands)
(Unaudited)
(Page 1 of 2)

	2010	2009
Cash flows from operating activities:		
Net income	$ 18,761	$ 13,598
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation	1,656	1,681
Provision for loan losses	17,426	14,952
Loss on sale and write down of other real estate owned	118	68
Amortization of intangible assets	41	154
Amortization of loan servicing rights	463	438
Net change in loan servicing rights valuation allowance	180	170
Loans originated for sale	(56,044)	(108,386)
Net gain on sales of loans	(1,255)	(1,713)
Proceeds from sale of loans	53,496	107,798
Net (gain)loss on sales of premises and equipment	4	(7)
Net gain on calls of securities available for sale	(4)	(2)
Impairment on available for sale securities	337	225
Net securities amortization	1,235	303
Stock compensation expense	1,212	233
Earnings on life insurance	(763)	(317)
Tax benefit of stock option exercises	(178)	(172)
Net change:		
Accrued income receivable	(579)	(391)
Accrued expenses payable	(1,082)	(557)
Other assets	(3,028)	(1,284)
Other liabilities	408	(172)
Total adjustments	13,643	13,021
Net cash from operating activities	32,404	26,619
Cash flows from investing activities:		
Proceeds from maturities, calls and principal paydowns of securities available for sale	69,718	91,896
Purchases of securities available for sale	(87,929)	(102,018)
Purchase of life insurance	(21)	(100)
Net increase in total loans	(53,098)	(112,955)
Proceeds from sales of land, premises and equipment	0	15
Purchases of land, premises and equipment	(1,288)	(1,278)
Proceeds from sales of other real estate	1,403	255
Net cash from investing activities	(71,215)	(124,185)

(Continued)

6

LAKELAND FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Nine Months Ended September 30, 2010 and 2009
(in thousands)
(Unaudited)
(Page 2 of 2)

	2010	2009
Cash flows from financing activities:		
Net increase (decrease) in total deposits	419,162	(64,268)
Net increase (decrease) in short-term borrowings	(244,737)	137,626
Payments on long-term borrowings	(1)	(50,001)
Common dividends paid	(7,502)	(5,769)
Preferred dividends paid	(1,588)	(1,322)
Redemption of preferred stock	(56,044)	0
Proceeds from issuance of preferred stock and warrant	0	56,044
Proceeds from stock option exercise	580	724
Purchase of treasury stock	(195)	(215)
Net cash from financing activities	109,675	72,819
Net change in cash and cash equivalents	70,864	(24,747)
Cash and cash equivalents at beginning of the period	55,983	64,007
Cash and cash equivalents at end of the period	$ 126,847	$ 39,260
Cash paid during the period for:		
Interest	$ 23,877	$ 28,778
Income taxes	13,583	7,705
Supplemental non-cash disclosures:		
Loans transferred to other real estate	4,094	144

The accompanying notes are an integral part of these consolidated financial statements.

7

LAKELAND FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2010

(Table amounts in thousands except for share and per share data)

(Unaudited)

NOTE 1. BASIS OF PRESENTATION

This report is filed for Lakeland Financial Corporation (the "Company") and its wholly owned subsidiary, Lake City Bank (the "Bank"). All significant inter-company balances and transactions have been eliminated in consolidation. Also included is the Bank's wholly owned subsidiary, LCB Investments II, Inc. ("LCB Investments"). LCB Investments also owns LCB Funding, Inc. ("LCB Funding"), a real estate investment trust.

The unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with instructions for Form 10-Q. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (all of which are normal and recurring in nature) considered necessary for a fair presentation have been included. Operating results for the three-month and nine-month periods ending September 30, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010. The 2009 Lakeland Financial Corporation Annual Report on Form 10-K should be read in conjunction with these statements.

NOTE 2. EARNINGS PER SHARE

Basic earnings per common share is net income available to common shareholders divided by the weighted average number of common shares outstanding during the period. Diluted earnings per common share includes the dilutive effect of additional potential common shares issuable under stock options, stock awards and warrants.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Net income	$ 6,521	$ 5,267	$ 18,761	$ 13,597
Dividends and accretion of discount on preferred stock	0	801	3,187	1,891
Net income available to common shareholders	$ 6,521	$ 4,466	$ 15,574	$ 11,706
Weighted average shares outstanding for basic earnings per common share	16,138,809	12,432,135	16,112,108	12,416,894
Dilutive effect of stock options and awards	93,445	99,129	93,025	102,566
Weighted average shares outstanding for diluted earnings per common share	16,232,254	12,531,264	16,205,133	12,519,460

Basic earnings per common share	$	0.40	$	0.36	$	0.97	$	0.94
Diluted earnings per common share	$	0.40	$	0.36	$	0.96	$	0.94

8

Stock options for 95,000 and 120,102 shares for the three month periods ended September 30, 2010 and September 30, 2009, respectively, were not considered in computing diluted earnings per common share because they were antidilutive. Stock options for 109,000 and 121,000 shares for the nine month periods ended September 30, 2010 and September 30, 2009, respectively, were not considered in computing diluted earnings per common share because they were antidilutive. In addition, warrants for 198,269 and 396,538 shares for the periods ended September 30, 2010 and 2009, were not considered in computing diluted earnings per share because they were antidilutive.

NOTE 3. LOANS

	September 30, 2010	December 31, 2009
Commercial and industrial loans	$ 738,303	$ 693,579
Commercial real estate – owner occupied	333,468	348,812
Commercial real estate – nonowner occupied	333,815	257,374
Commercial real estate - multifamily loans	23,955	26,558
Commercial real estate construction loans	120,359	166,959
Agri-business and agricultural loans	198,305	206,252
Residential real estate mortgage loans	87,210	95,211
Home equity loans	167,678	161,594
Installment loans and other consumer loans	51,400	57,478
Subtotal	2,054,493	2,013,817
Less: Allowance for loan losses	(42,011)	(32,073)
Net deferred loan fees	(967)	(1,807)
Loans, net	$ 2,011,515	$ 1,979,937

Note: During the third quarter of 2010, the Company completed a review of the commercial real estate portfolio to ensure that the categorization of loans was accurate. While the commercial real estate loan totals did not change, the review resulted in changes to the categorization of some loans. Approximately $86 million of loans categorized as Commercial Real Estate Construction Loans were transferred to other categories. Approximately $69 million of that total was transferred to Commercial Real Estate – Nonowner Occupied and approximately $17 million was transferred to Commercial Real Estate – Owner Occupied. In addition, approximately $29 million of loans previously categorized as Commercial Real Estate – Owner Occupied were transferred to Commercial Real Estate – Nonowner Occupied.

	September 30, 2010	December 31, 2009
Impaired loans with no allocated allowance for loan losses	$ 4,432	$ 1,745
Impaired loans with allocated allowance for loan losses	32,155	30,093
Total impaired loans	$ 36,587	$ 31,838
Amount of the allowance for loan losses allocated	$ 9,468	$ 6,658
Nonperforming loans	$ 25,880	$ 30,708
Accruing troubled debt restructured loans	$ 6,154	$ 6,521
Nonaccrual troubled debt restructured loans	8,071	0
Total troubled debt restructured loans	$ 14,225	$ 6,521
Loans past due 30 – 89 days	$ 4,880	$ 1,972
Loans past due 90 days or more	$ 145	$ 190
Allowance for loan losses to total loans	2.05%	1.59%

Subsequent to quarter end, loans past due 30 – 89 days increased by $12.4 million to $17.3 million due to the addition of one $9.1 million credit in the lodging industry. The addition did not have an impact to the allowance for loan losses as of September 30, 2010.

Changes in the allowance for loan losses are summarized as follows:

	Nine Months Ended September 30,	
	2010	2009
Balance at beginning of period	$ 32,073	$ 18,860
Provision for loan losses	17,426	14,952
Charge-offs	(8,097)	(5,338)
Recoveries	609	304
Net loans charged-off	(7,488)	(5,034)
Balance at end of period	$ 42,011	$ 28,778

NOTE 4. SECURITIES

Information related to the fair value and amortized cost of securities available for sale and the related gross unrealized gains and losses recognized in accumulated other comprehensive income (loss) is provided in the tables below.

	Fair Value	Gross Unrealized Gain	Gross Unrealized Losses	Amortized Cost
September 30, 2010				
U.S. Treasury securities	$ 1,055	$ 51	$ 0	$ 1,004
U.S. Government agencies	0	0	0	0
Residential mortgage-backed securities	305,257	13,470	(166)	291,953
Non-agency residential mortgage-backed securities	66,819	353	(8,561)	75,027
State and municipal securities	69,604	3,343	(24)	66,285
Total	$ 442,735	$ 17,217	$ (8,751)	$ 434,269
December 31, 2009				
U.S. Treasury securities	$ 992	$ 0	$ (13)	$ 1,005
U.S. Government agencies	4,610	22	0	4,588
Residential mortgage-backed securities	270,796	7,598	(1,078)	264,276
Non-agency residential mortgage-backed securities	72,495	46	(15,933)	88,382
State and municipal securities	61,135	1,898	(138)	59,375
Total	$ 410,028	$ 9,564	$ (17,162)	$ 417,626

Information regarding the fair value and amortized cost of available for sale debt securities by maturity as of September 30, 2010 is presented below. Maturity information is based on contractual maturity for all securities other than mortgage-backed securities. Actual maturities of securities may differ from contractual maturities because borrowers may have the right to prepay the obligation without prepayment penalty.

	Fair Value	Amortized Cost
Due in one year or less	$ 681	$ 673
Due after one year through five years	9,620	9,102
Due after five years through ten years	41,164	39,235
Due after ten years	19,194	18,279
	70,659	67,289
Mortgage-backed securities	372,076	366,980
Total debt securities	$ 442,735	$ 434,269

There were no security sales for the first nine months in 2010 and 2009. All of the gains and losses were from calls or maturities.

Purchase premiums or discounts are recognized in interest income using the interest method over the terms of the securities or over estimated lives for mortgage-backed securities. Gains and losses on sales are based on the amortized cost of the security sold and recorded on the trade date.

Securities with carrying values of $243.9 million and $209.8 million were pledged as of September 30, 2010 and 2009, as collateral for deposits of public funds, securities sold under agreements to repurchase, borrowings from the FHLB and for other purposes as permitted or required by law.

Information regarding securities with unrealized losses as of September 30, 2010 and December 31, 2009 is presented below. The tables distribute the securities between those with unrealized losses for less than twelve months and those with unrealized losses for twelve months or more.

September 30, 2010	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mortgage-backed securities	$ 31,960	$ 166	$ 0	$ 0	$ 31,960	$ 166
Non-agency residential mortgage-backed securities	0	0	53,612	8,561	53,612	8,561
State and municipal securities	1,007	5	463	19	1,469	24
Total temporarily impaired	$ 32,967	$ 171	$ 54,161	$ 8,580	$ 87,127	$ 8,751

December 31, 2009	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury securities	$ 992	$ 13	$ 0	$ 0	$ 992	$ 13
Residential mortgage-backed securities	58,792	1,075	851	3	59,643	1,078
Non-agency residential mortgage-backed securities	0	0	69,022	15,933	69,022	15,933
State and municipal securities	7,257	102	445	36	7,702	138
Total temporarily impaired	$ 67,041	$ 1,190	$ 70,318	$ 15,972	$ 137,359	$ 17,162

The number of securities with unrealized losses as of September 30, 2010 and December 31, 2009 is presented below.

	Less than 12 months	12 months or more	Total
September 30, 2010			
Mortgage-backed securities	13	0	13
Non-agency residential mortgage-backed securities	0	18	18
State and municipal securities	2	1	3
Total temporarily impaired	15	19	34
December 31, 2009			
U.S. Treasury securities	1	0	1
Mortgage-backed securities	18	4	22
Non-agency residential mortgage-backed securities	0	23	23
State and municipal securities	15	1	16
Total temporarily impaired	34	28	62

All of the following are considered to determine whether or not the impairment of these securities is other-than-temporary. Eighty five percent of the securities are backed by the U.S. Government, government agencies, government sponsored agencies or are A rated or better, except for certain non-local municipal securities. Mortgage-backed securities which are not issued by the U.S. Government or government sponsored agencies (non-agency residential mortgage-backed securities) met specific criteria set by the Asset Liability Management Committee at their time of purchase, including having the highest rating available by either Moody's or S&P. None of the securities have call provisions (with the exception of the municipal securities) and payments as originally agreed

have been received. For the government, government-sponsored agency and municipal securities, management did not have concerns of credit losses and there was nothing to indicate that full principal will not be received. Management considered the unrealized losses on these securities to be primarily interest rate driven and did not expect material losses given current market conditions unless the securities are sold, which at this time management does not have the intent to sell nor will it more likely than not be required to sell these securities before the recovery of their amortized cost basis.

As of September 30, 2010, the Company had $66.8 million of collateralized mortgage obligations which were not issued by the federal government or government sponsored agencies, but were rated AAA by S&P and/or Aaa by Moody's at the time of purchase. At December 31, 2009, the Company had $72.5 million of these collateralized mortgage obligations. Five of the 24 non-agency mortgage backed securities were still rated AAA/Aaa as of September 30, 2010, but 19 were downgraded by S&P, Fitch and/or Moody's, including 18 which were ranked below investment grade by one or more rating agencies. Since December 31, 2009, there have not been any downgrades on the five securities still rated AAA/Aaa and of the 19 that were below AAA/Aaa, 17 incurred further downgrades.

For these non-agency residential mortgage-backed securities, additional analysis is performed to determine if the impairment is temporary or other-than-temporary in which case impairment would need to be recorded for these securities. The Company performs an independent analysis of the cash flows of the individual securities based upon assumptions as to collateral defaults, prepayment speeds, expected losses and the severity of potential losses. Based upon the initial review, securities may be identified for further analysis computing the net present value using an appropriate discount rate (the current accounting yield) and comparing it to the book value of the security to determine if there is any other-than-temporary impairment that must be recorded. Based on this analysis of the non-agency residential mortgage-backed securities, the Company recorded an other-than-temporary impairment of $337,000 and $85,000, respectively, relating to five separate securities in the nine-months and three-months ended September 30, 2010, which is equal to the credit loss, establishing a new, lower amortized cost basis. Because management did not have the intent to sell these securities nor did management believe that it was more likely than not they would be required to sell these securities before the recovery of their new, lower amortized cost basis, management did not consider the remaining unrealized losses of the investment securities to be other-than-temporarily impaired at September 30, 2010.

The following table provides information about debt securities for which only a credit loss was recognized in income and other losses are recorded in other comprehensive income. The table represents the three months and nine months ended September 30, 2010.

Three Months Ended September 30, 2010	Accumulated Credit Losses
Balance July 1, 2010	$ 477
Additions related to other-than-temporary impairment losses not previously recognized	61
Additional increases to the amount of credit loss for which other-than-temporary impairment was previously recognized	24
Balance September 30, 2010	$ 562

Nine Months Ended September 30, 2010	Accumulated Credit Losses
Balance January 1, 2010	$ 225
Additions related to other-than-temporary impairment losses not previously recognized	113
Additional increases to the amount of credit loss for which other-than-temporary impairment was previously recognized	224
Balance September 30, 2010	$ 562

Information on securities with at least one rating below investment grade as of September 30, 2010 is presented below.

Description	CUSIP	Other Than Temporary Impairment	Par Value	September 30, 2010 Book Value	September 30, 2010 Market Value	Unrealized Gain/(Loss)	September 30, 2010 Lowest Credit Rating	1-Month Constant Default Rate	3-Month Constant Default Rate	6-Month Constant Default Rate	Credi Suppo
CWALT 2006-32CB A16	02147XAR8	No	$ 1,959	$ 1,867	$ 1,178	$ (689)	CC	2.05	2.86	3.86	9.8
CWHL 2006-18 2A7	12543WAJ7	No	4,059	3,980	3,517	(463)	CC	3.42	3.28	2.57	4.1
CWALT 2005-J10 1A7	12667G4N0	No	5,011	4,961	4,379	(582)	Caa3	11.81	9.79	6.58	6.6
CWALT 2005-46CB A1	12667G6U2	No	4,226	4,029	3,075	(954)	CC	2.86	3.13	2.47	4.4
CWALT 2005-J8 1A3	12667GJ20	No	5,984	5,737	5,053	(684)	Caa2	10.05	3.45	1.71	6.7
CHASE 2005-S3 A4	16162WNE5	No	2,067	2,052	2,087	35	B1	0.00	0.37	1.27	4.4
CHASE 2006-S3 1A5	16162XAE7	No	2,805	2,800	2,583	(217)	CC	4.29	4.06	4.51	4.6
CHASE 2006-S2 2A5	16163BBA1	No	1,570	1,563	1,531	(32)	CCC	2.13	2.43	1.92	5.6
CMSI 2007-61A5	173103AE2	No	3,531	3,529	3,022	(507)	B1	0.00	0.00	0.00	6.7
FHAMS 2006-FA1 1A3	32051GS63	Yes	3,406	3,253	2,907	(346)	C	7.98	5.45	4.96	2.3
GSR 2006-10F 1A1	36266WAC6	No	5,937	5,523	5,106	(417)	CC	0.00	4.14	2.09	3.7
MANA 2007-F1 1A1	59023YAA2	No	3,144	3,083	2,684	(399)	C	0.00	0.00	0.00	1.6
RALI 2006-QS4 A2	749228AB8	Yes	2,610	2,435	1,696	(739)	D	7.14	9.40	8.47	0.0
RFMSI 2006-S5 A14	74957EAP2	Yes	3,654	3,541	3,023	(518)	CC	8.89	6.54	5.10	2.7
	761118AE8	No	5,291	5,029	4,241	(788)	CCC	0.91	2.25	4.11	10.5

RALI 2005-QS7 A5											
RALI 2006-QS3 1A14	761118XS2	Yes	3,065	2,853	2,114	(739)	D	7.17	6.94	6.74	2.3
RAST 2006-A14C 1A2	76114BAB4	Yes	1,457	1,217	937	(280)	D	7.95	9.71	7.40	0.0
TBW 2006-2 3A1	878048AG2	No	2,539	2,451	2,332	(119)	D	6.29	4.35	3.23	0.0
			$ 62,315	$ 59,903	$ 51,465	$ (8,438)					

All of these securities are super senior or senior tranche non-agency residential mortgage-backed securities. The credit support is the credit support percentage for a tranche from other subordinated tranches, which is the amount of principal in the subordinated tranches expressed as a percentage of the remaining principal in the super senior/senior tranche. The super senior/senior tranches receive the prepayments and the subordinate tranches absorb the losses. The super senior/senior tranches do not absorb losses until the subordinate tranches are gone.

The Company does not have a history of actively trading securities, but keeps the securities available for sale should liquidity or other needs develop that would warrant the sale of securities. While these securities are held in the available for sale portfolio, it is management's current intent and ability is to hold them until a recovery in fair value or maturity.

NOTE 5. EMPLOYEE BENEFIT PLANS

Components of Net Periodic Benefit Cost

	Nine Months Ended September 30,			
	Pension Benefits		SERP Benefits	
	2010	2009	2010	2009
Interest cost	$ 106	$ 102	$ 51	$ 50
Expected return on plan assets	(125)	(117)	(61)	(63)
Recognized net actuarial loss	63	76	44	43
Net pension expense	$ 44	$ 61	$ 34	$ 30

	Three Months Ended September 30,			
	Pension Benefits		SERP Benefits	
	2010	2009	2010	2009
Interest cost	$ 38	$ 32	$ 17	$ 13
Expected return on plan assets	(47)	(20)	(19)	(13)
Recognized net actuarial loss	13	29	16	20
Net pension expense	$ 4	$ 41	$ 14	$ 20

The Company previously disclosed in its financial statements for the year ended December 31, 2009 that it did not expect to contribute to its pension or SERP plans in 2010. No contributions were made to the pension plan and SERP plan as of September 30, 2010.

NOTE 6. NEW ACCOUNTING PRONOUNCEMENTS

In July 2010, the FASB amended previous guidance relating to the disclosure of the allowance for credit losses and the credit quality of financing receivables. The objective of the amendments is for an entity to provide disclosures that facilitate financial statement users' evaluation of the nature of credit risk inherent in the entity's portfolio of financing receivables, how that risk is analyzed and assessed in arriving at the allowance for credit losses and the changes and reasons for those changes in the allowance for credit losses. This update provides a list of amendments to existing disclosures on about financing receivables on a disaggregated basis with two levels – portfolio segment and class of financing receivable, as well as a list of additional disclosures about financing receivables. The disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. The effect of adopting this new guidance is not expected to have any material effect on the Company's operating results or financial condition.

NOTE 7. FAIR VALUE DISCLOSURES

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

Level 1	Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.
Level 2	Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
Level 3	Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Company used the following methods and significant assumptions to estimate the fair value of each type of financial instrument:

Securities: Securities available for sale are valued primarily by a third party pricing service. The fair values of securities available for sale are determined on a recurring basis by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or pricing models utilizing significant observable inputs such as matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs). These models utilize the market approach with standard inputs that include, but are not limited to benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data. There were no transfers from or into Level 1, Level 2 or Level 3 during the first nine months of 2010.

Impaired loans: Impaired loans with specific allocations of the allowance for loan losses are generally assessed against higher than normal discounted advance ratios of collateral as approved at the time of funding, with consideration given for any supplemental credit support from guarantors. Consideration is given for the type and nature of collateral, as well as the anticipated liquidation value to develop a discount for the advance ratios on each credit. Commercial real estate is generally discounted from its appraised value by 20-50% after various considerations including age of the appraisal, current net operating income realized, general market conditions where the property is located, type of property and potential buyer base. The appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant. Raw and finished inventory is discounted from its cost or book value by 35-65%, depending on the marketability of the goods. Finished goods are generally discounted by 30-60%, depending on the ease of marketability, cost of transportation or scope of use of the finished good. Work in process inventory is typically discounted by 50-100%, depending on the length of manufacturing time, types of components used in the completion process, and the breadth of the user base. Equipment is valued at a percentage of depreciated book value or recent appraised value, if available, and is typically discounted at 30-70% after various considerations including age and condition of the equipment, marketability, breadth of use, and whether the equipment includes unique components or add-ons. Marketable securities are discounted by 10-30%, depending on the type of investment, age of valuation report and general market conditions. This methodology is based on a market

approach and typically results in a Level 3 classification of the inputs for determining fair value.

Mortgage servicing rights: As of September 30, 2010 the fair value of the Company's Level 3 servicing assets for residential mortgage loans was $1.8 million, some of which are not currently impaired and therefore carried at amortized cost. These residential mortgage loans have a weighted average interest rate of 5.39%, a weighted average maturity of 20 years and are secured by homes generally within the Company's market area of Northern Indiana. A valuation model is used to estimate fair value, which is based on an income approach. The inputs used include estimates of prepayment speeds, discount rate, cost to service, escrow account earnings, contractual servicing fee income, ancillary income, late fees, and float income. The most significant assumption used to value MSRs is prepayment rate. Prepayment rates are estimated based on published industry consensus prepayment rates. At September 30, 2010 the constant prepayment speed (PSA) used was 433 and the discount rate used was 9.5%.

Other real estate owned: Nonrecurring adjustments to certain commercial and residential real estate properties classified as other real estate owned are measured at the lower of carrying amount or fair value, less costs to sell. Fair values are generally based on third party appraisals of the property, resulting in a Level 3 classification. In cases where the carrying amount exceeds the fair value, less costs to sell, an impairment loss is recognized.

Real estate mortgage loans held for sale: Real estate mortgage loans held for sale are carried at the lower of cost or fair value, as determined by outstanding commitments, from third party investors.

The table below presents the balances of assets measured at fair value on a recurring basis:

	September 30, 2010			
	Fair Value Measurements Using			Assets
Assets	Level 1	Level 2	Level 3	at Fair Value
U.S. Treasury securities	$ 1,055	$ 0	$ 0	$ 1,055
Residential mortgage-backed securities	0	305,257	0	305,257
Non-agency residential mortgage-backed securities	0	66,819	0	66,819
State and municipal securities	0	69,604	0	69,604
Total assets	$ 1,055	$ 441,680	$ 0	$ 442,735

17

	December 31, 2009			
	Fair Value Measurements Using			Assets
Assets	Level 1	Level 2	Level 3	at Fair Value
U.S. Treasury securities	$ 992	$ 0	$ 0	$ 992
U.S. Government agencies	0	4,610	0	4,610
Residential mortgage-backed securities	0	270,796	0	270,796
Non-agency residential mortgage-backed securities	0	72,495	0	72,495
State and municipal securities	0	61,135	0	61,135
Total assets	$ 992	$ 409,036	$ 0	$ 410,028

The table below presents the balances of assets measured at fair value on a nonrecurring basis:

	September 30, 2010			
	Fair Value Measurements Using			Assets
Assets	Level 1	Level 2	Level 3	at Fair Value
Impaired loans	$ 0	$ 0	$ 20,079	$ 20,079
Mortgage servicing rights	0	0	984	984
Other real estate owned	0	0	50	50
Total assets	$ 0	$ 0	$ 21,113	$ 21,113

	December 31, 2009			
	Fair Value Measurements Using			Assets
Assets	Level 1	Level 2	Level 3	at Fair Value
Impaired loans	$ 0	$ 0	$ 23,435	$ 23,435
Mortgage servicing rights	0	0	73	73
Other real estate owned	0	0	102	102
Total assets	$ 0	$ 0	$ 23,610	$ 23,610

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a gross carrying amount of $28.7 million, with a valuation allowance of $8.6 million, resulting in an additional provision for loan losses of $2.0 million and $1.0 million, respectively, for the nine months and three months ended September 30, 2010. In addition, $180,000 and $50,000, respectively, in impairment of mortgage servicing rights, measured using Level 3 inputs within the fair value hierarchy, was recognized during the nine months and three months ended September 30, 2010. The Company also recognized a $58,000 reduction in the value of other real estate owned during the nine months and three months ended September 30, 2010.

The following table contains the estimated fair values and the related carrying values of the Company's financial instruments. Items which are not financial instruments are not included.

	September 30, 2010		December 31, 2009	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
	(in thousands)			
Financial Assets:				
Cash and cash equivalents	$ 126,847	$ 126,847	$ 55,983	$ 55,983
Securities available for sale	442,735	442,735	410,028	410,028
Real estate mortgages held for sale	4,863	4,917	1,521	1,540
Loans, net	2,011,515	2,002,182	1,979,937	1,986,457
Federal Home Loan Bank stock	9,849	N/A	9,849	N/A
Federal Reserve Bank stock	3,420	N/A	3,420	N/A
Accrued interest receivable	9,179	9,179	8,590	8,590
Financial Liabilities:				
Certificates of deposit	(1,095,983)	(1,109,703)	(866,763)	(870,727)
All other deposits	(1,174,304)	(1,174,304)	(984,362)	(984,362)
Securities sold under agreements to repurchase	(106,903)	(106,903)	(127,118)	(127,118)
Other short-term borrowings	(2,411)	(2,411)	(226,933)	(226,942)
Long-term borrowings	(40,041)	(42,163)	(40,042)	(41,353)
Subordinated debentures	(30,928)	(31,253)	(30,928)	(30,836)
Standby letters of credit	(394)	(394)	(284)	(284)
Accrued interest payable	(5,585)	(5,585)	(6,600)	(6,600)

For purposes of the above disclosures of estimated fair value, the following assumptions were used as of September 30, 2010 and December 31, 2009. The estimated fair value for cash and cash equivalents, demand and savings deposits, variable rate loans, variable rate short term borrowings and accrued interest is considered to approximate cost. The fair value of Federal Home Loan Bank and Federal Reserve Bank stock is not determinable as there are restrictions on its transferability. The estimated fair value for fixed rate loans, certificates of deposit and fixed rate borrowings is based on discounted cash flows using current market rates applied to the estimated life. Real estate mortgages held for sale are based upon the actual contracted price for those loans sold but not yet delivered, or the current Federal Home Loan Mortgage Corporation price for normal delivery of mortgages with similar coupons and maturities at year-end. The fair value of subordinated debentures is based on the rates currently available to the Company with similar term and remaining maturity and credit spread. The fair value of off-balance sheet items is based on the current fees or cost that would be charged to enter into or terminate such arrangements. The estimated fair value of other financial instruments approximate cost and are not considered significant to this presentation.

NOTE 8. PREFERRED STOCK

On February 27, 2009, the Company entered into a Letter Agreement with the United States Department of the Treasury ("Treasury"), pursuant to which the Company issued (i) 56,044 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the "Series A Preferred Stock") and (ii) a warrant (the "Warrant") to purchase 396,538 shares of the Company's common stock, no par value (the "Common Stock"), for an aggregate purchase price of $56,044,000 in cash. This transaction was conducted in accordance with Treasury's Capital Purchase Program implemented under the Troubled Assets Relief Program ("TARP").

The Series A Preferred Stock qualified as Tier 1 capital and paid cumulative dividends at a rate of 5% per annum. The Series A Preferred Stock was non-voting except with respect to certain matters affecting the rights of the holders thereof. The Series A Preferred Stock was valued using a discounting of cash flows at a 12% discount rate based on an average implied cost of equity over 5 years.

The Warrant has a 10-year term and is immediately exercisable upon its issuance, with an exercise price, subject to anti-dilution adjustments, equal to $21.20 per share of the Common Stock (trailing 20-day Lakeland average closing price as of December 17, 2008, which was the last trading day prior to date of receipt of Treasury's preliminary approval for our participation in the Capital Purchase Program). The Warrant was valued by the Company using the Black Scholes model with the following assumptions: Market Price of $17.45; Exercise Price of $21.20; Risk-free interest rate of 3.02%; Expected Life of 10 years; Expected Dividend rate on common stock of 4.5759% and volatility of common stock price of 41.8046%. This resulted in a value of $4.4433 per share.

The total amount of funds received were allocated to the Series A Preferred Stock and Warrant based on their respective fair values to determine the amounts recorded for each component. The method used to amortize the resulting discount on the Series A Preferred Stock is accretion over the assumed life of five years using the effective yield.

During the first quarter of 2009, the Company invested $56.0 million of the Capital Purchase Program funds received in the Bank. This additional capital positively impacted the Bank's capital ratios and liquidity.

Subsequent to issue, the share count of the Warrant was adjusted to 198,269 due to a Qualified Equity Offering as more fully described in Note 9.

On June 9, 2010 the Company paid $56.0 million to redeem the 56,044 shares of Series A Preferred Stock issued and accreted the remaining unamortized discount on these shares. The Company did not repurchase the Warrant. Due to the redemption, all restrictions which had been imposed on the Company as a result of participating in the Capital Purchase Program, including restrictions on raising dividends and executive compensation, were terminated.

NOTE 9. COMMON STOCK

On November 18, 2009, the Company completed an underwritten public stock offering by issuing 3,500,000 shares of the Company's common stock at a public offering price of $17.00 per share, for aggregate gross proceeds of $59.5 million. The net proceeds to the Company after deducting underwriting discounts and commissions and estimated offering expenses were approximately $55.9 million.

On December 3, 2009, the Company was notified by the Treasury that, as a result of the Company's completion of our November 18, 2009 Qualified Equity Offering, the amount of the Warrant was reduced by 50% to 198,269 shares.

On December 15, 2009, the Company sold 125,431 shares of common stock pursuant to the underwriters' exercise of the over-allotment option, which the Company granted in connection with underwritten public stock offering. The Company sold the additional shares to the underwriters at the same public offering price of $17.00 per share agreed to for the initial closing on November 18, 2009. The aggregate net proceeds to the Company from the public offering, after deducting underwriting discounts and commissions and offering expenses, including the net proceeds of approximately $2.0 million from the sale of shares pursuant to the over-allotment option, were approximately $57.9 million.

NOTE 10. COMPREHENSIVE INCOME

Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on securities available-for-sale and changes in the funded status of pension plans which are also recognized as separate components of equity. Following is a summary of other comprehensive income for the three months and nine months ended September 30, 2010 and 2009:

	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Net income	$ 6,521	$ 5,267	$ 18,761	$ 13,597
Other comprehensive income				
Change in securities available for sale:				
Unrealized holding gain on securities available for sale arising during the period	5,092	7,099	15,731	10,482
Reclassification adjustment for (gains)/losses included in income	(4)	(2)	(4)	(2)
Reclassification adjustment for other than temporary impairment	85	225	337	225
Net securities gain activity during the period	5,173	7,322	16,064	10,705
Tax effect	(2,027)	(2,830)	(6,431)	(4,189)
Net of tax amount	3,146	4,492	9,633	6,516
Defined benefit pension plans:				
Net gain(loss) on defined benefit pension plans	0	0	(35)	0
Amortization of net actuarial loss	29	49	107	119
Net gain /(loss) activity during the period	29	49	72	119
Tax effect	(13)	(19)	(30)	(48)
Net of tax amount	16	30	42	71
	3,162	4,522	9,675	6,587

Total other comprehensive income, net of tax								
Comprehensive income	$	9,683	$	9,789	$	28,436	$	20,184

The following table summarizes the changes within each classification of accumulated other comprehensive income for the nine months ended September 30, 2010 and 2009:

	Balance at December 31, 2009	Current Period Change	Balance at September 30, 2010
Unrealized gain(loss) on securities available for sale without other than temporary impairment	$ (2,814)	$ 9,586	$ 6,772
Unrealized gain(loss) on securities available for sale with other than temporary impairment	(1,606)	47	(1,559)
Total unrealized gain(loss) on securities available for sale	(4,420)	9,633	5,213
Unrealized loss on defined benefit pension plans	(1,573)	42	(1,531)
Total	$ (5,993)	$ 9,675	$ 3,682

	Balance at December 31, 2008	Current Period Change	Balance at September 30, 2009
Unrealized loss on securities available for sale without other than temporary impairment	$ (10,210)	$ 8,066	$ (2,144)
Unrealized loss on securities available for sale with other than temporary impairment	0	(1,550)	(1,550)
Total unrealized loss on securities available for sale	(10,210)	6,516	(3,694)
Unrealized loss on defined benefit pension plans	(1,814)	71	(1,743)
Total	$ (12,024)	$ 6,587	$ (5,437)

NOTE 11. SUBSEQUENT EVENTS

There were no subsequent events that would have a material impact to the financial statements presented in this Form 10-Q.

NOTE 12. RECLASSIFICATIONS

Certain amounts appearing in the financial statements and notes thereto for prior periods have been reclassified to conform with the current presentation. The reclassification had no effect on net income or stockholders’ equity as previously reported.

22

Part 1
LAKELAND FINANCIAL CORPORATION
ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
and
RESULTS OF OPERATIONS

September 30, 2010

OVERVIEW

Lakeland Financial Corporation is the holding company for Lake City Bank. The Company is headquartered in Warsaw, Indiana and operates 43 offices in 12 counties in Northern Indiana and a loan production office in Indianapolis, Indiana. The Company earned $18.8 million for the first nine months of 2010, versus $13.6 million in the same period of 2009, an increase of 38.0%. Net income was positively impacted by an $11.5 million increase in net interest income. Offsetting this positive impact was an increase of $2.5 million in the provision for loan losses, a decrease of $453,000 in noninterest income and a $165,000 increase in noninterest expense. Basic earnings per common share for the first nine months of 2010 were $0.97 per share, versus $0.94 per share for the first nine months of 2009. Diluted earnings per common share reflect the potential dilutive impact of stock options, stock awards and warrants. Diluted earnings per common share for the first nine months of 2010 were $0.96 per share, versus $0.94 for the first nine months of 2009. Basic and diluted earnings per share for the first nine months of 2010 and 2009 were impacted by $3.2 million and $1.9 million, respectively, in dividends and accretion of discount on preferred stock. Earnings per share for the first nine months of 2010 compared to the comparable period in 2009 were also impacted by the Company's issuance of 3.6 million common shares during the fourth quarter of 2009.

Net income for the third quarter of 2010 was $6.5 million, an increase of 23.8% versus $5.3 million for the comparable period of 2009. The increase was driven by a $2.0 million increase in net interest income as well as a $933,000 increase in noninterest income. Offsetting these positive impacts was an increase of $650,000 in the provision for loan losses, as well as an increase of $532,000 in noninterest expense. Basic earnings per share for the third quarter of 2010 were $0.40 per share, versus $0.36 per share for the third quarter of 2009. Diluted earnings per share for the third quarter of 2010 were $0.40 per share, versus $0.36 per share for the third quarter of 2009. Basic and diluted earnings per share for the third quarter of 2009 were impacted by $801,000 in dividends and accretion of discount on preferred stock. Earnings per share for the third quarter of 2010 compared to the comparable period in 2009 were impacted by the Company's issuance of 3.6 million common shares during the fourth quarter of 2009.

Dividends and accretion of discount on preferred stock were higher during 2010 versus 2009 due largely to the Company's June 9, 2010 redemption of the 56,044 shares of preferred stock issued to the U.S. Treasury Department in February 2009 under the Capital Purchase Program. As a result of the redemption, the Company recognized a non-cash reduction in net income available to common shareholders of $1.8 million, which represents the remaining unamortized accretion of the discount on the preferred shares. This one-time non-cash item impacted net income available to common shareholders and earnings per share.

RESULTS OF OPERATIONS

Net Interest Income

For the nine-month period ended September 30, 2010, net interest income totaled $69.3 million, an increase of 19.9%, or $11.5 million, versus the first nine months of 2009. This increase was primarily due to a $202.2 million, or 8.8%, increase in average earning assets to $2.497 billion. In addition, the Company's net interest margin improved to 3.77% for the nine month period ended September 30, 2010, versus 3.42% for the comparable period in 2009. For the three-month period ended September 30, 2010, net interest income totaled $23.2 million, an increase of 9.2%, or $2.0 million, versus the third quarter of 2009. This increase was primarily due to a $207.1 million, or 8.9%, increase in average earning assets to $2.529 billion. The Company's net interest margin was 3.70% for the third quarter of 2010, versus 3.69% for the third quarter of 2009.

Given the Company's mix of interest earning assets and interest bearing liabilities at September 30, 2010, the Company would generally be considered to have a relatively neutral balance sheet structure. The Company's balance sheet structure would normally be expected to produce a stable or declining net interest margin in a declining rate environment. As the Company's balance sheet has become more neutral in structure, management believes rate movements and other factors such as deposit mix, market deposit rate pricing and non-bank deposit products could have an impact on net interest margin. Over time, the Company's mix of deposits has shifted to more reliance on certificates of deposits, specifically public fund deposits and brokered deposits, transaction accounts and corporate and public fund money market and repurchase agreements, which generally carry a higher interest rate cost than other types of interest bearing deposits.

During the first nine months of 2010, total interest and dividend income increased by $5.9 million, or 6.8%, to $92.2 million, versus $86.3 million during the first nine months of 2009. This increase was primarily the result of an increase in average earning assets of $202.2 million, or 8.8%. The tax equivalent yield on average earning assets decreased nine basis points to 5.0% for the nine-month period ended September 30, 2010 versus the same period of 2009. During the third quarter of 2010, total interest and dividend income increased by $1.6 million, or 5.4%, to $31.1 million, versus $29.5 million during the third quarter of 2009. This increase was primarily the result of an increase in average earning assets of $207.1 million, or 8.9%. The tax equivalent yield on average earning assets decreased by 16 basis points to 4.9% for the third quarter of 2010 versus the same period of 2009.

During the first nine months of 2010, loan interest income increased by $6.5 million, or 9.1%, to $77.7 million, versus $71.2 million during the first nine months of 2009. The increase was driven by a $157.2 million, or 8.4%, increase in average daily loan balances. During the third quarter of 2010, loan interest income increased by $1.8 million, or 7.4%, to $26.4 million, versus $24.6 million during the third quarter of 2009. The increase was driven by a $153.8 million, or 8.1%, increase in average daily loan balances.

The average daily securities balances for the first nine months of 2010 increased $30.6 million, or 7.7%, to $426.0 million, versus $395.4 million for the same period of 2009. During the same periods, income from securities decreased by $639,000, or 4.3%, to $14.4 million versus $15.0 million during the first nine months of 2009. The decrease was primarily the result of a 55 basis point decrease in the tax equivalent yield on securities, to 4.8%, versus 5.4% in the first nine months of 2009. The average daily securities balances for the third quarter of 2010 increased $35.0 million, or 8.7%, to $436.2 million, versus $401.2 million for the same period of 2009. During the third quarter of 2010, income from securities was $4.7 million, a decrease of $230,000, or 4.7%, versus the third quarter of 2009. The decrease was primarily the result of a 59 basis point decrease in the tax equivalent yield on securities, which was 4.58% during the third quarter of 2010 versus 5.17% in the comparable period in 2009.

Despite the Company's change in deposit mix to include higher paying deposit types, total interest expense decreased $5.6 million, or 19.7%, to $22.9 million for the nine-month period ended September 30, 2010, from $28.5 million for the comparable period in 2009. The decrease was primarily the result of a 43 basis point decrease in the Company's daily cost of funds to 1.3%, versus 1.7% for the same period of 2009. This decrease was generally caused by lower interest rates in the Company's market areas and favaorble pricing on brokered certificates of deposit. Total interest expense decreased $361,000, or 4.4%, to $7.9 million for the third quarter of 2010, versus $8.3 million for the third quarter of 2009. The decrease was primarily the result of an 18 basis point decrease in the Company's daily cost of funds to 1.3%, from 1.5% for the same period of 2009.

On an average daily basis, total deposits (including demand deposits) increased $228.4 million, or 12.3%, to $2.087 billion for the nine-month period ended September 30, 2010, versus $1.859 billion during the same period in 2009. The average daily balances for the third quarter of 2010 increased $387.4 million, or 21.3%, to $2.204 billion from $1.817 billion during the third quarter of 2009. On an average daily basis, noninterest bearing demand deposits were $257.1 million for the nine-month period ended September 30, 2010, versus $223.2 million for the same period in 2009. The average daily noninterest bearing demand deposit balances for the third quarter of 2010 were $277.3 million, versus $229.6 million for the third quarter of 2009. On an average daily basis, interest bearing transaction accounts increased $134.0 million, or 24.7%, to $676.5 million for the nine-month period ended September 30, 2010, versus the same period in 2009. Average daily interest bearing transaction accounts increased $152.4 million, or 27.5%, to $706.0 million for the third quarter of 2010, versus $553.6 million for the third quarter of 2009. When comparing the nine months ended September 30, 2010 with the same period of 2009, the average daily balance of time deposits, which pay a higher rate of interest compared to demand deposit and transaction accounts, increased $14.7 million. The rate paid on time deposit accounts decreased 96 basis points to 1.8% for the nine-month period ended September 30, 2010, versus the same period in 2009. During the third quarter of 2010, the average daily balance of time deposits increased $127.6 million, and the rate paid decreased 76 basis points to 1.7%, versus the third quarter of 2009. The increase in average time deposit balances during the third quarter of 2010 was primarily due to increases in brokered deposits and time deposits of $100,000 or more. Despite the low interest rate environment, the Company has been able to attract and retain retail deposit customers through offering innovative deposit products such as Rewards Checking and Savings. These products pay somewhat higher interest rates, but also encourage certain customer behaviors such as using debit cards and electronic statements, which have the effect of generating additional third-party fee income and reducing the Company's processing costs.

The Company's funding strategy is focused on leveraging its retail branch network to grow traditional retail deposits and on its presence with commercial customers and public fund entities in its Indiana markets. In addition, the Company has utilized out of market deposit programs such as brokered certificates of deposit and the Certificate of Deposit Account Registry Service (CDARS) program. Due to ongoing loan growth, the Company has expanded its funding strategy over time to include these out of market deposit programs. The Company believes that these deposit programs represent an appropriate tool in the overall liquidity and funding strategy. On an average daily basis, total brokered certificates of deposit increased $6.7 million to $166.9 million for the nine-month period ended September 30, 2010, versus $160.2 million for the same period in 2009. During the third quarter of 2010, average daily brokered certificates of deposit were $223.0 million, versus $105.9 million during the third quarter of 2009. On an average daily basis, total public fund certificates of deposit decreased $19.7 million to $181.9 million for the nine-month period ended September 30, 2010, versus $201.7 million for the same period in 2009. During the third quarter of 2010, average daily public fund certificates of deposit were $191.9 million, versus $181.6 million during the third quarter of 2009. In addition, the Company had average public fund interest bearing transaction accounts of $80.8 million and $85.3 million, respectively, in the nine months and three months ended September 30, 2010, versus $14.0 million and $16.1 million for the comparable periods of 2009. Availability of public fund deposits can be cyclical, primarily due to the timing differences between when real estate property taxes are collected versus when those tax revenues are spent, as well as the intense competition for these funds.

Average daily balances of borrowings were $256.0 million during the nine months ended September 30, 2010, versus $338.2 million during the same period of 2009, and the rate paid on borrowings was unchanged at 1.2%. During the third quarter of 2010 the average daily balances of borrowings decreased $189.3 million to $197.7 million, versus $387.0 million for the same period of 2009, and the rate paid on borrowings increased 57 basis points to 1.4%. The decrease in average borrowings during 2010 was driven by the discontinuance of the Federal Reserve Bank's Term Auction Facility (TAF). The Company began utilizing TAF borrowings during the first quarter of 2009. Average daily borrowings under the facility were $92.9 million and $171.1 million, respectively, during the nine months and three months ended September 30, 2009. During the first quarter of 2010, the Federal Reserve discontinued the TAF program and the Company's last borrowing matured on April 8, 2010. On an average daily basis, total deposits (including demand deposits) and purchased funds increased 6.7% and 9.0%, respectively, when comparing the nine-month and three-month periods ended September 30, 2010 versus the same period in 2009.

As a result of the unprecedented instability in the financial markets during late 2008 and into 2009, the Company reviewed its liquidity plan and took several actions designed to provide for an appropriate funding strategy. These actions included: actively communicating with correspondent banks who provide federal fund lines to ensure availability of these funds; use of brokered certificate of deposits, which have been readily available to the Company at competitive rates; increased allocation of collateral at the Federal Reserve Bank for borrowings under their programs; maintenance of collateral levels at the FHLB for borrowings under their programs at advantageous rates; participation in the CDARS deposit program and an increased focus on aggressively priced and structured core deposit programs offered by the Company, such as Rewards Checking and Savings. The Company will continue to carefully monitor its liquidity planning and will make any necessary adjustments during this environment.

The following tables set forth consolidated information regarding average balances and rates:

DISTRIBUTION OF ASSETS, LIABILITIES AND STOCKHOLDERS' EQUITY;
INTEREST RATES AND INTEREST DIFFERENTIAL
(in thousands of dollars)

	Nine Months Ended September 30,					
	2010			2009		
	Average Balance	Interest Income	Yield (1)	Average Balance	Interest Income	Yield (1)
ASSETS						
Earning assets:						
Loans:						
Taxable (2)(3)	$ 2,036,216	$ 77,676	5.10%	$ 1,876,344	$ 71,101	5.07%
Tax exempt (1)	2,099	85	5.41	4,813	166	4.61
Investments: (1)						
Available for sale	426,005	15,390	4.83	395,424	15,912	5.38
Short-term investments	30,365	37	0.16	16,176	19	0.16
Interest bearing deposits	1,975	23	1.56	1,654	20	1.62
Total earning assets	2,496,660	93,211	4.99%	2,294,411	87,218	5.08%
Nonearning assets:						
Cash and due from banks	47,458	0		39,309	0	
Premises and equipment	29,342	0		30,305	0	
Other nonearning assets	90,459	0		76,135	0	
Less allowance for loan losses	(36,684)	0		(22,738)	0	
Total assets	$ 2,627,235	$ 93,211		$ 2,417,422	$ 87,218	

(1) Tax exempt income was converted to a fully taxable equivalent basis at a 35 percent tax rate for 2010 and 2009. The tax equivalent rate for tax exempt loans and tax exempt securities included the TEFRA adjustment applicable to nondeductible interest expenses.
(2) Loan fees, which are immaterial in relation to total taxable loan interest income for the nine months ended September 30, 2010 and 2009, are included as taxable loan interest income.
(3) Nonaccrual loans are included in the average balance of taxable loans.

DISTRIBUTION OF ASSETS, LIABILITIES AND STOCKHOLDERS' EQUITY;
INTEREST RATES AND INTEREST DIFFERENTIAL (Cont.)
(in thousands of dollars)

	Nine Months Ended September 30,					
	2010			2009		
	Average Balance	Interest Expense	Yield	Average Balance	Interest Expense	Yield
LIABILITIES AND STOCKHOLDERS' EQUITY						
Interest bearing liabilities:						
Savings deposits	$ 111,605	$ 510	0.61%	$ 65,779	$ 11	0.02%
Interest bearing checking accounts	676,549	6,019	1.19	542,598	4,185	1.03
Time deposits:						
In denominations under $100,000	321,180	5,596	2.33	363,758	8,654	3.18
In denominations over $100,000	720,964	8,517	1.58	663,679	12,614	2.54
Miscellaneous short-term borrowings	185,001	587	0.42	264,826	841	0.42
Long-term borrowings and subordinated debentures	70,969	1,633	3.08	73,406	2,181	3.97
Total interest bearing liabilities	2,086,268	22,862	1.47%	1,974,046	28,486	1.93%
Noninterest bearing liabilities and stockholders' equity:						

Demand deposits	257,126	0		223,228	0	
Other liabilities	16,037	0		20,092	0	
Stockholders' equity	267,804	0		200,056	0	
Total liabilities and stockholders' equity	$ 2,627,235	$ 22,862		$ 2,417,422	$ 28,486	
Net interest differential - yield on average daily earning assets		$ 70,349	3.77%		$ 58,732	3.42%

28

DISTRIBUTION OF ASSETS, LIABILITIES AND STOCKHOLDERS' EQUITY;
INTEREST RATES AND INTEREST DIFFERENTIAL
(in thousands of dollars)

	Three Months Ended September 30,					
	2010			2009		
	Average Balance	Interest Income	Yield (1)	Average Balance	Interest Income	Yield (1)
ASSETS						
Earning assets:						
Loans:						
Taxable (2)(3)	$ 2,057,899	$ 26,381	5.09%	$ 1,903,864	$ 24,561	5.12%
Tax exempt (1)	2,353	31	5.29	2,632	35	5.26
Investments: (1)						
Available for sale	436,211	5,036	4.58	401,192	5,228	5.17
Short-term investments	30,849	12	0.15	13,104	5	0.15
Interest bearing deposits	1,938	7	1.43	1,342	6	1.77
Total earning assets	2,529,250	31,467	4.94%	2,322,134	29,835	5.10%
Nonearning assets:						
Cash and due from banks	49,953	0		38,705	0	
Premises and equipment	29,333	0		30,293	0	
Other nonearning assets	90,420	0		75,173	0	
Less allowance for loan losses	(38,961)	0		(26,458)	0	
Total assets	$ 2,659,995	$ 31,467		$ 2,439,847	$ 29,835	

(1) Tax exempt income was converted to a fully taxable equivalent basis at a 35 percent tax rate for 2010 and 2009. The tax equivalent rate for tax exempt loans and tax exempt securities included the TEFRA adjustment applicable to nondeductible interest expenses.
(2) Loan fees, which are immaterial in relation to total taxable loan interest income for the three months ended September 30, 2010 and 2009, are included as taxable loan interest income.
(3) Nonaccrual loans are included in the average balance of taxable loans.

DISTRIBUTION OF ASSETS, LIABILITIES AND STOCKHOLDERS' EQUITY;
INTEREST RATES AND INTEREST DIFFERENTIAL (Cont.)
(in thousands of dollars)

	Three Months Ended September 30,					
	2010			2009		
	Average Balance	Interest Expense	Yield	Average Balance	Interest Expense	Yield
LIABILITIES AND STOCKHOLDERS' EQUITY						
Interest bearing liabilities:						
Savings deposits	$ 127,265	$ 224	0.70%	$ 67,567	$ 5	0.03%
Interest bearing checking accounts	706,014	2,265	1.27	553,599	1,415	1.01
Time deposits:						
In denominations under $100,000	321,494	1,720	2.12	355,923	2,562	2.86
In denominations over $100,000	772,085	2,985	1.53	610,014	3,449	2.24
Miscellaneous short-term borrowings	126,742	150	0.47	316,033	268	0.34
Long-term borrowings and subordinated debentures	70,969	563	3.15	70,970	569	3.18
Total interest bearing liabilities	2,124,569	7,907	1.48%	1,974,106	8,268	1.66%
Noninterest bearing liabilities and stockholders' equity:						
	277,261	0		229,594	0	

Demand deposits						
Other liabilities	15,468	0		20,639	0	
Stockholders' equity	242,697	0		215,508	0	
Total liabilities and stockholders' equity	$ 2,659,995	$ 7,907		$ 2,439,847	$ 8,268	
Net interest differential - yield on average daily earning assets		$ 23,560	3.70%		$ 21,567	3.69%

30

Provision for Loan Losses

Based on management's review of the adequacy of the allowance for loan losses, provisions for loan losses of $17.4 million and $6.2 million were recorded during the nine-month and three-month periods ended September 30, 2010, versus provisions of $15.0 million and $5.5 million recorded during the same periods of 2009. Factors impacting the provision included the amount and status of classified and watch list credits, the level of charge-offs, management's overall view on current credit quality and the regional and national economic conditions impacting credit quality, the amount and status of impaired loans, the amount and status of past due accruing loans (90 days or more), and overall loan growth as discussed in more detail below in the analysis relating to the Company's financial condition.

Noninterest Income

Noninterest income categories for the nine-month and three-month periods ended September 30, 2010 and 2009 are shown in the following table:

	Nine Months Ended September 30,		
	2010	2009	Percent Change
Wealth advisory fees	$ 2,409	$ 2,213	8.9%
Investment brokerage fees	1,692	1,300	30.2
Service charges on deposit accounts	6,265	6,153	1.8
Loan, insurance and service fees	3,094	2,549	21.4
Merchant card fee income	846	2,179	(61.2)
Other income	1,506	1,459	3.2
Mortgage banking income	939	1,241	(24.3)
Net securities gains	4	2	100.0
Impairment on available-for-sale securities (includes total losses of $337 and $273, net of $0 and $48 recognized in other comprehensive income, pre-tax)	(337)	(225)	49.8
Total noninterest income	$ 16,418	$ 16,871	(2.7)%

31

	Three Months Ended September 30,		
	2010	2009	Percent Change
Wealth advisory fees	$ 784	$ 747	5.0%
Investment brokerage fees	676	410	64.9
Service charges on deposit accounts	2,205	2,133	3.4
Loan, insurance and service fees	1,100	905	21.5
Merchant card fee income	263	536	(50.9)
Other income	491	506	(3.0)
Mortgage banking income	774	265	192.1
Net securities gains	4	2	100.0
Impairment on available-for-sale securities (1)	(85)	(225)	(62.2)
Total noninterest income	$ 6,212	$ 5,279	17.7%

(1) No losses were recognized in other comprehensive income for the periods ended September 30, 2010 and 2009.

Noninterest income decreased $453,000 and increased $933,000, respectively, for the nine-month and three-month periods ended September 30, 2010, versus the same periods in 2009. The decline in the nine-month period was driven by a decrease of $1.3 million in merchant card fee income related to a change in the processing of merchant credit card activities. Prior to the third quarter of 2009, transaction driven revenue and expenses related to this category were reported on a gross basis in merchant card fee income in noninterest income and credit card interchange fees in noninterest expense. Beginning in the second quarter of 2009, the Company began converting clients to a new third party processor for this activity. As a result, only net revenues with the new processor are being recognized in merchant card fee income in noninterest income. This change was driven by the agreement with the third party processor, and not due to any change in the Company's accounting policies. The decrease in noninterest income in the nine-month period was partially offset by increases of $545,000 in loan, insurance and service fees driven by increased NSF fee activity and by higher debit card fees due to greater usage. During 2010, the Company has added approximately 13,000 new accounts to its overdraft privileges program, of which approximately 11,000 were added in April 2010. In addition, investment brokerage fees increased $392,000 due to higher trading volume. The increase in noninterest income in the three-month period was driven by a $509,000 increase in mortgage banking income. Recent declines in mortgage rates have led to greater numbers of loans refinancing as well as a larger pipeline of mortgage loan applications which, in turn, increased the amount of mortgage income. Results for the third quarter of 2010 were also positively impacted by the increases in loan, insurance and service fees and investment brokerage fees.

Noninterest Expense

Noninterest expense categories for the nine-month and three-month periods ended September 30, 2010 and 2009 are shown in the following table:

	Nine Months Ended September 30,		
	2010	2009	Percent Change
Salaries and employee benefits	$ 22,729	$ 20,516	10.8%
Occupancy expense	2,199	2,392	(8.1)
Equipment costs	1,568	1,588	(1.3)
Data processing fees and supplies	2,930	2,969	(1.3)
Credit card interchange	144	1,353	(89.4)
Other expense	10,532	11,119	(5.3)
Total noninterest expense	$ 40,102	$ 39,937	0.4%

	Three Months Ended September 30,		
	2010	2009	Percent Change
Salaries and employee benefits	$ 7,659	$ 7,327	4.5%
Occupancy expense	711	751	(5.3)
Equipment costs	517	571	(9.5)
Data processing fees and supplies	1,004	985	1.9
Credit card interchange	31	302	(89.7)
Other expense	3,707	3,161	17.3
Total noninterest expense	$ 13,629	$ 13,097	4.1%

Noninterest expense increased $165,000 and $532,000, respectively, in the nine-month and three-month periods ended September 30, 2010 versus the same periods of 2009. Salaries and employee benefits increased by $2.2 million and $332,000, respectively, in the nine-month and three-month periods ended September 30, 2010 versus the same periods of 2009. These increases were driven by higher performance based compensation accruals, which resulted from a combination of strong performance versus corporate objectives in the first nine months of 2010 and lower performance versus these criteria in the first nine months of 2009. Salaries and employee benefits were also impacted by additions to staff in revenue producing areas, as well as higher employee health insurance expense. During 2009, the Company incurred a special assessment to the FDIC for deposit insurance of $1.1 million in the first nine months of the year. There was no special assessment in 2010. Other expense decreased during the nine-month period ended September 30, 2010, primarily due to lower FDIC insurance premiums, compared to the same periods of 2009, as the Company was subject to special FDIC assessments in 2009. Other expense increased during the three-month period ended September 30, 2010 due to higher professional fees and other costs associated with borrowers who are experiencing difficulties. In addition, credit card interchange expense decreased due to the change in processing merchant credit card activities.

Income Tax Expense

Income tax expense increased $3.3 million, or 52.6%, for the first nine months of 2010, compared to the same period in 2009. The combined state franchise tax expense and the federal income tax expense, as a percentage of income before income tax expense, increased to 33.5% during the first nine months of 2010 compared to 31.3% during the same period of 2009. The combined tax expense decreased to 32.4% in the third quarter of 2010, versus 33.7% during the same period of 2009. The changes were driven by fluctuations in the percentage of revenue being derived from tax-advantaged sources in the nine-month and three-month periods of 2010, compared to the same periods in 2009.

CRITICAL ACCOUNTING POLICIES

Certain of the Company's accounting policies are important to the portrayal of the Company's financial condition, since they require management to make difficult, complex or subjective judgments, some of which may relate to matters that are inherently uncertain. Estimates associated with these policies are susceptible to material changes as a result of changes in facts and circumstances. Some of the facts and circumstances which could affect these judgments include changes in interest rates, in the performance of the economy or in the financial condition of borrowers. Management believes that its critical accounting policies include determining the allowance for loan losses, the valuation of mortgage servicing rights and the valuation and other than temporary impairment of investment securities. The Company's critical accounting policies are discussed in detail in the Annual Report for the year ended December 31, 2009 (incorporated by reference as part of the Company's 10-K filing).

FINANCIAL CONDITION

Total assets of the Company w ere $2.710 billion as of September 30, 2010, an increase of $138.6 million, or 5.4%, when compared to $2.572 billion as of December 31, 2009.

Total cash and cash equivalents increased by $70.9 million, or 126.6%, to $126.8 million at September 30, 2010 from $56.0 million at December 31, 2009. The increase is primarily due to a $57.2 million increase in overnight Federal funds sold. The fed funds position resulted from an increase in total deposits, primarily transaction accounts and brokered certificate of deposits. During 2010, the Company has extended maturities on certain deposit accounts as part of its overall liquidity plan. As a result of this strong deposit growth and lower than historical loan growth, the Company has excess funding that results in this fed funds sold position. The Company intends to reduce this position in the fourth quarter through reductions in certain deposits, pursuant to the Company's overall liquidity planning.

Total securities available-for-sale increased by $32.7 million, or 8.0%, to $442.7 million at September 30, 2010 from $410.0 million at December 31, 2009. The increase was a result of a number of transactions in the securities portfolio. Securities purchases totaled $87.9 million. Offsetting this increase were securities paydowns totaling $61.5 million, maturities and calls of securities totaling $8.2 million and securities amortization net of accretion was $1.2 million. In addition, the net unrealized gain/loss of the securities portfolio increased by $16.1 million. The increase in fair market value was due to higher market values for securities which are backed directly or indirectly by the federal government. The investment portfolio is managed to limit the Company's exposure to risk by containing mostly mortgage-backed securities, other securities which are either directly or indirectly backed by the federal government or a local municipal government and collateralized mortgage obligations rated AAA by S&P and/or Aaa by Moody's at the time of purchase. As of September 30, 2010, the Company had $66.8 million of collateralized mortgage obligations which were not backed by the federal government, but were rated AAA by S&P and/or Aaa by Moody's at the time of purchase.

Five of the 24 non-agency collateralized mortgage obligations are still rated AAA/Aaa as of September 30, 2010, but 19 had been downgraded since the time of purchase by S&P, Fitch and/or Moody's, including 18 which were ranked below investment grade by one or more rating agencies. The Company performs an analysis of the cash flows of these securities based on assumptions as to collateral defaults, prepayment speeds, expected losses and the severity of potential losses. Based upon the initial analysis, securities may be identified for further analysis computing the net present value and comparing it to the book value to determine if there is any other-than-temporary impairment to be recorded. Based on the analyses as of September 30, 2010, the Company realized an additional $85,000 in the third quarter in other-than-temporary impairment, equal to projected credit losses, based on current cash flow analysis, on five of the 24 non-agency collateralized mortgage obligations.

Real estate mortgage loans held-for-sale increased by $3.3 million, or 219.7%, to $4.9 million at September 30, 2010 from $1.5 million at December 31, 2009. The balance of this asset category is subject to a high degree of variability depending on, among other things, recent mortgage loan rates and the timing of loan sales into the secondary market. During the nine months ended September 30, 2010, $56.0 million in real estate mortgages were originated for sale and $52.3 million in mortgages were sold.

Total loans, excluding real estate mortgage loans held-for-sale, increased by $41.5 million to $2.054 billion at September 30, 2010 from $2.012 billion at December 31, 2009. The portfolio breakdown at September 30, 2010 remained steady compared to past periods and reflected 85% commercial and industrial, including commercial real estate and agri-business, 12% residential real estate and home equity and 3% consumer loans compared to 84% commercial and industrial, including commercial real estate and agri-business, 13% residential real estate and home equity and 3% consumer loans as of December 31, 2009. The Company did not participate in the subprime mortgage lending markets and therefore did not have direct exposure to this sector as a lender.

The Company has a high percentage of commercial and commercial real estate loans, most of which are extended to small or medium-sized businesses. Commercial loans represent higher dollar loans to fewer customers and therefore higher credit risk than other types of loans. Pricing is adjusted to manage the higher credit risk associated with these types of loans. The Company also generally requires new and renewed variable rate commercial loans to have floor rates. The majority of fixed rate residential mortgage loans, which represent increased interest rate risk, are sold in the secondary market, as well as some variable rate mortgage loans. The remainder of the variable rate mortgage loans and a small number of fixed rate mortgage loans are retained.

Loans are charged against the allowance for loan losses when management believes that the principal is uncollectible. Subsequent recoveries, if any, are credited to the allowance. The allowance is an amount that management believes will be adequate to absorb probable incurred credit losses relating to specifically identified loans based on an evaluation, as well as other probable incurred losses inherent in the loan portfolio. The evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans and current economic conditions that may affect the borrower's ability to repay. Management also considers trends in adversely classified loans based upon a monthly review of those credits. An appropriate level of general allowance is determined after considering the following factors: application of historical loss percentages, emerging market risk, commercial loan focus and large credit concentrations, new industry lending activity and current economic conditions. Federal regulations require insured institutions to classify their own assets on a regular basis. The regulations provide for three categories of classified loans – substandard, doubtful and loss. The regulations also contain a special mention category. Special mention is defined as loans that do not currently expose an insured institution to a sufficient degree of risk to warrant classification, but do possess credit deficiencies or potential weaknesses deserving management's close attention. The Company's policy is to establish a specific allowance for loan losses for any assets classified as substandard or doubtful. If an asset or portion thereof is classified as loss, the Company's policy is to either establish specified allowances for loan losses in the amount of 100% of the portion of the asset classified loss, or charge off such amount. At September 30, 2010, on the basis of management's review of the loan portfolio, the Company had loans totaling $171.9 million on the classified loan list versus $178.0 million on December 31, 2009. As of September 30, 2010, the Company had $38.8 million of assets classified special mention, $131.9 million classified as substandard, $0 classified as doubtful and $0 classified as loss as compared to $75.0 million, $100.6 million, $369,000 and $0 at December 31, 2009. In addition, at September 30, 2010 the Company had seven loans totaling $14.2 million accounted for as troubled debt restructurings – five mortgage loans totaling $851,000 million with total allocations of $95,000, a $6.2 million commercial credit with an allocation of $3.0 million and a $7.2 million commercial credit with an allocation of $793,000. The Company has no commitments to lend additional funds to any of the borrowers. At December 31, 2009, the Company had two relationships totaling $6.5 million accounted for as troubled debt restructurings – a $176,000 mortgage loan with an allocation of $35,000 and a $6.3 million commercial credit with an allocation of $2.5 million.

Allowance estimates are developed by management taking into account actual loss experience, adjusted for current economic conditions. The Company generally has regular discussions regarding this methodology with regulatory authorities. Allowance estimates are considered a prudent measurement of the risk in the Company's loan portfolio and are applied to individual loans based on loan type. In accordance with current accounting guidance, the allowance is provided for losses that have been incurred as of the balance sheet date and is based on past events and current economic conditions, and does not include the effects of expected losses on specific loans or groups of loans that are related to future events or expected changes in economic conditions.

Net charge-offs totaled $1.5 million in the third quarter of 2010, versus $1.8 million during the third quarter of 2009 and $4.7 million during the second quarter of 2010. Loan exposure to two borrowers represented $966,000, or 64%, of these charge-offs. The first loss of $623,000 was related to a manufacturing company which has terminated operations and is in the process of liquidation. The Bank has no additional exposure to this borrower. The second loss of $344,000 was a loan to a real estate holding company. The real estate securing the credit has been transferred to other real estate and the Bank has no additional exposure to this borrower due to the transfer of this exposure to other real estate.

The allowance for loan losses increased 31.0%, or $9.9 million, from $32.1 million at December 31, 2009 to $42.0 million at September 30, 2010. Pooled loan allocations increased $1.7 million from $10.2 million at December 31, 2009 to $11.9 million at September 30, 2010, which was primarily a result of the current level of charge-offs as well as management's overall view on current credit quality. Impaired loan allocations increased $2.8 million from $6.7 million at December 31, 2009 to $9.5 million at September 30, 2010 and other specifically reviewed loan allocations increased $4.3 million from $12.5 million at December 31, 2009 to $16.8 million at September 30, 2010. This increase in impaired allocations was primarily due to the addition of two commercial credits to the impaired loans category as described below. The increase in other specifically reviewed loan allocations was primarily due to increases in the allocations of existing specifically reviewed loans. The unallocated component of the allowance for loan losses increased $1.0 million from $2.7 million at December 31, 2009 to $3.7 million at September 30, 2010, based on management's assessment of economic and other qualitative factors impacting the loan portfolio, particularly the ongoing economic challenges in the Company's market area. Management believed the allowance for loan losses at September 30, 2010 was at a level commensurate with the overall risk exposure of the loan portfolio. However, if economic conditions do not improve, certain borrowers may experience difficulty and the level of nonperforming loans, charge-offs and delinquencies could rise and require further increases in the provision for loan losses.

Total impaired loans increased by $4.8 million to $36.6 million at September 30, 2010 from $31.8 million at December 31, 2009. A loan is impaired when full payment under the original loan terms is not expected. Impairment is evaluated in the aggregate for smaller-balance loans of similar nature such as residential mortgage, and consumer loans, and on an individual loan basis for other loans. If a loan is impaired, a portion of the allowance may be allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. The increase in the impaired loans category was primarily due to the addition of two commercial credits totaling $10.5 million. One is engaged in manufacturing and the other in transportation. The increase in impaired loans was partially offset by the transfer to other real estate of two impaired commercial credits totaling $3.1 million, charge-offs of $966,000 taken on two commercial credits and $931,000 in paydowns received on one commercial relationship. Of the $36.6 million in impaired loans, $24.9 million were on nonaccrual status at September 30, 2010. The following table summarizes nonperforming assets at September 30, 2010 and December 31, 2009.

	September 30, 2010	December 31, 2009
	(in thousands)	
NONPERFORMING ASSETS:		
Nonaccrual loans including nonaccrual troubled debt restructured loans	$ 25,735	$ 30,518
Loans past due over 90 days and still accruing	145	190
Total nonperforming loans	$ 25,880	$ 30,708
Other real estate	3,509	872
Repossessions	74	2
Total nonperforming assets	$ 29,463	$ 31,582
Impaired loans including troubled debt restructurings	$ 36,587	$ 31,838
Nonperforming loans to total loans	1.26%	1.53%
Nonperforming assets to total assets	1.09%	1.23%
Nonperforming troubled debt restructured loans (included in nonaccrual loans)	$ 6,154	$ 6,521
Performing troubled debt restructured loans	8,071	0
Total troubled debt restructured loans	$ 14,225	$ 6,521

Total nonperforming assets decreased by $2.1 million, or 6.7%, to $29.5 million during the nine-month period ended September 30, 2010. The decrease was primarily due to the sale of a single piece of other real estate and the aforementioned charge-offs. Six commercial relationships represented 77.2% of total nonperforming loans. Two of the six relationships are each less than $2.0 million. A $6.8 million commercial relationship consisting of three loans represents the largest exposure in the nonperforming category. The borrower is engaged in real estate development. Borrower collateral, including real estate and the personal guarantees of its principals, support the credit. The Company took a $1.7 million charge-off related to this credit in the fourth quarter of 2009, and no charge-offs have been taken in 2010.

A $6.2 million credit to a manufacturer tied to the housing industry represented the second largest exposure in the nonperforming category. The credit is accounted for as a troubled debt restructuring. Borrower collateral including real estate, receivables, inventory and equipment support the credit, however, there are no guarantors. The Company took a $906,000 charge-off related to this credit in 2008, and no charge-offs were taken in 2009 or have been taken in 2010.

A commercial relationship consisting of two loans totaling $2.7 million represented the third largest exposure in the nonperforming category. The borrower is engaged in sales tied to the recreational vehicle industry as well as residential real estate development. Borrower collateral, including real estate and the personal guarantees of its principals, support the credit. The Company took $1.3 million in charge-offs related to this relationship during 2008, and no charge-offs were taken in 2009 or have been taken in 2010.

38

A commercial relationship consisting of two loans totaling $2.1 million represented the fourth largest exposure in the nonperforming category. The borrower is engaged in manufacturing tied to the housing and recreational vehicle industries. Borrower collateral, including real estate and the personal guarantee of its principal, support the credit. The Company took $178,000 in charge-offs related to this relationship during 2009, and no charge-offs have been taken in 2010.

There can be no assurances that full repayment of the loans discussed above will result. Management does not foresee a rapid recovery from the challenging economic conditions in the Company's markets as certain industries, including residential and commercial real estate development, recreational vehicle and mobile home manufacturing and other regional industries continue to experience general slow-downs and negative growth. The Company's growth strategy has promoted diversification among industries as well as a continued focus on enforcement of a strong credit environment and an aggressive position on loan work-out situations. While the Company believes that the impact on the Company of these industry-specific issues affecting real estate development and recreational vehicle and mobile home manufacturers will be somewhat mitigated by the Company's overall growth strategy, the economic factors impacting its entire geographic footprint will continue to present challenges. Additionally, the Company's overall asset quality position can be influenced by a small number of credits due to the focus on commercial lending activity and the granularity inherent in this strategy.

Total deposits increased by $419.2 million, or 22.6%, to $2.270 billion at September 30, 2010 from $1.851 billion at December 31, 2009. The increase resulted from increases of $171.6 million in brokered deposits, $95.7 million in public fund certificates of deposit of $100,000 or more, $52.7 million in demand deposits, $48.9 million in savings accounts, $44.6 million in money market accounts, $43.7 million in interest bearing transaction accounts, $9.0 million in certificates of deposit of $100,000 and over and $2.5 million in other certificates of deposit. Offsetting these increases were decreases of $49.7 million in CDARS certificates of deposit.

Total short-term borrowings decreased by $244.7 million, or 69.1%, to $109.3 million at September 30, 2010 from $354.1 million at December 31, 2009. The decrease resulted primarily from decreases of $215.0 million in other borrowings, primarily from short-term advances from the Federal Home Loan Bank of Indianapolis as well as the discontinuance of the Federal Reserve Bank's Term Auction Facility. In addition, securities sold under agreements to repurchase decreased by $20.2 million and federal funds purchased decreased by $9.6 million.

Total equity decreased by $34.6 million, or 12.3%, to $245.5 million at September 30, 2010 from $280.1 million at December 31, 2009. The decrease in total equity resulted from the Company's June 2010 repayment of $56.0 million in preferred stock issued under the TARP Capital Purchase Program. Additional impacts to equity were the result of net income of $18.8 million, plus the increase in the accumulated other comprehensive income of $9.7 million, less dividends of $8.7 million, plus $580,000 for stock issued through options exercised (including tax benefit), minus $195,000 for net treasury stock purchased plus $1.2 million in stock compensation expense. The stock compensation expense component of the increase was related to the implementation of two long term incentive stock plans. One plan became effective in March of 2009 and the other in January of 2010.

The FDIC's risk-based capital regulations require that all insured banking organizations maintain an 8.0% total risk-based capital ratio. The FDIC has also established definitions of "well capitalized" as a 5.0% Tier I leverage capital ratio, a 6.0% Tier I risk-based capital ratio and a 10.0% total risk-based capital ratio. All of the Bank's ratios continue to be above these "well capitalized" levels. The Federal Reserve also has established minimum regulatory capital requirements for bank holding companies. As of September 30, 2010, the Company had regulatory capital in excess of these minimum requirements with a Tier 1 leverage capital ratio, Tier 1 risk-based capital ratio and total risk-based capital ratio of 10.0%, 12.0% and 13.2%, respectively.

RECENT LEGISLATION IMPACTING THE FINANCIAL SERVICES INDUSTRY

On July 21 2010, sweeping financial regulatory reform legislation entitled the "Dodd-Frank Wall Street Reform and Consumer Protection Act" (the "Dodd-Frank Act") was signed into law. The Dodd-Frank Act implements far-reaching changes across the financial regulatory landscape, including provisions that, among other things:

- Create a Financial Services Oversight Council to identify emerging systemic risks and improve interagency cooperation;
- Centralize responsibility for consumer financial protection by creating a new agency, the Consumer Financial Protection Bureau, responsible for implementing, examining and enforcing compliance with federal consumer financial laws;
- Establish strengthened capital standards for banks and bank holding companies, and disallow trust preferred securities from being included in a bank's Tier 1 capital determination (subject to a grandfather provision for existing trust preferred securities);
- Contain a series of provisions covering mortgage loan origination standards affecting, among other things, originator compensation, minimum repayment standards and pre-payments;
- Require financial holding companies, such as the Company, to be well-capitalized and well-managed as of July 21, 2011. Bank holding companies and banks must also be both well-capitalized and well-managed in order to acquire banks located outside their home state;
- Grant the Federal Reserve the power to regulate debit card interchange fees;
- Implement corporate governance revisions, including with regard to executive compensation and proxy access by shareholders, that apply to all public companies, not just financial institutions;
- Make permanent the $250 thousand limit for federal deposit insurance and increase the cash limit of Securities Investor Protection Corporation protection from $100 thousand to $250 thousand and provide unlimited federal deposit insurance until January 1, 2013 for non-interest bearing demand transaction accounts at all insured depository institutions;
- Repeal the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts; and
- Increase the authority of the Federal Reserve to examine the Company and its nonbank subsidiaries.

Many aspects of the Dodd-Frank Act are subject to rulemaking and will take effect over several years, making it difficult to anticipate the overall financial impact on the Company, its customers or the financial industry more generally. Provisions in the legislation that affect deposit insurance assessments, payment of interest on demand deposits and interchange fees could increase the costs associated with deposits as well as place limitations on certain revenues those deposits may generate. Provisions in the legislation that revoke the Tier 1 capital treatment of trust preferred securities and otherwise require revisions to the capital requirements of the Company and the Bank could require them to seek other sources of capital in the future.

FORWARD-LOOKING STATEMENTS

This document (including information incorporated by reference) contains, and future oral and written statements of the Company and its management may contain, forward-looking statements, within the meaning of such term in the Private Securities Litigation Reform Act of 1995, with respect to the financial condition, results of operations, plans, objectives, future performance and business of the Company. Forward-looking statements, which may be based upon beliefs, expectations and assumptions of the Company's management and on information currently available to management, are generally identifiable by the use of words such as "believe," "expect," "anticipate," "plan," "intend," "estimat "may," "will," "would," "could," "should" or other similar expressions. Additionally, all statements in this document, includin forward-looking statements, speak only as of the date they are made, and the Company undertakes no obligation to update any statement in light of new information or future events.

The Company's ability to predict results or the actual effect of future plans or strategies is inherently uncertain. The factors, which could have a material adverse effect on the operations and future prospects of the Company and its subsidiaries are detailed in the "Risk Factors" section included under Item 1a. of Part I of our Form 10-K. In addition to the risk factors described in that section, there are other factors that may impact any public company, including ours, which could have a material adverse effect on the operations and future prospects of the Company and its subsidiaries. These additional factors include, but are not limited to, the following:

- Legislative or regulatory changes or actions, including the "Dodd-Frank Wall Street Reform and Consumer Protection Act" and the regulations required to be promulgated there under, which may adversely affect the business of the Company and its subsidiaries.
- The costs, effects and outcomes of existing or future litigation.
- Changes in accounting policies and practices, as may be adopted by state and federal regulatory agencies, the Financial Accounting Standards Board, the Securities and Exchange Commission and the Public Company Accounting Oversight Board.
- The ability of the Company to manage risks associated with the foregoing as well as anticipated.

These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements.

ITEM 3 – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest rate risk represents the Company's primary market risk exposure. The Company does not have a material exposure to foreign currency exchange risk, does not have any material amount of derivative financial instruments and does not maintain a trading portfolio. The board of directors annually reviews and approves the policy used to manage interest rate risk. The policy was last reviewed and approved in May 2010. The policy sets guidelines for balance sheet structure, which are designed to protect the Company from the impact that interest rate changes could have on net income, but does not necessarily indicate the effect on future net interest income. The Company, through its Asset/Liability Committee, manages interest rate risk by monitoring the computer simulated earnings impact of various rate scenarios and general market conditions. The Company then modifies its long-term risk parameters by attempting to generate the type of loans, investments, and deposits that currently fit the Company's needs, as determined by the Asset/Liability Committee. This computer simulation analysis measures the net interest income impact of various interest rate scenario changes during the next 12 months. If the change in net interest income is less than 3% of primary capital, the balance sheet structure is considered to be within acceptable risk levels. As of September 30, 2010, the Company's potential pretax exposure was within the Company's policy limit, and not significantly different from December 31, 2009.

ITEM 4 – CONTROLS AND PROCEDURES

As required by Rules 13a-15(b) and 15d-15(b) under the Securities Exchange Act of 1934, management has evaluated, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, the effectiveness of the Company's disclosure controls and procedures as of the end of the period covered by this report. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures (as defined in Securities Exchange Act Rules 13a-15(e) and 15d-15(e)) were effective as of September 30, 2010. Disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in reports that it files or submits under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. These disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act is accumulated and communicated to management, including the Company's Chief Executive Officer and Chief Financial Officer, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure.

During the quarter ended September 30, 2010, there were no changes to the Company's internal control over financial reporting that have materially affected or are reasonably likely to materially affect its internal control over financial reporting.

LAKELAND FINANCIAL CORPORATION

FORM 10-Q

September 30, 2010

Part II - Other Information

Item 1. Legal proceedings

There are no material pending legal proceedings to which the Company or its subsidiaries is a party other than ordinary routinelitigation incidental to their respective businesses.

Item 1A. Risk Factors

There have been no material changes to the risk factors disclosed in Item 1A of Part I of the Company's 2009 Form 10-K as amended in Item 1A of Part I of the Company's Form 10-Q for the quarter ended June 30, 2010.

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

The following table provides information as of September 30, 2010 with respect to shares of common stock repurchased by the Company during the quarter then ended:

Issuer Purchases of Equity Securities(a)

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Appropriate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs
July 1-31	3,277	$ 20.48	0	$ 0
August 1-31	787	20.86	0	0
September 1-30	0	0	0	0
Total	4,064	$ 20.55	0	$ 0

(a) The shares purchased during the periods were credited to the deferred share accounts of non-employee directors under the Company's directors' deferred compensation plan. These shares were purchased in the ordinary course of business and consistent with past practice.

Item 3. Defaults Upon Senior Securities

None

43

Item 4. Removed and Reserved

Item 5. Other Information

None

Item 6. Exhibits

31.1 Certification of Chief Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a)

31.2 Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a)

32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

LAKELAND FINANCIAL CORPORATION

FORM 10-Q

September 30, 2010

Part II - Other Information

Signatures

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

LAKELAND FINANCIAL CORPORATION
(Registrant)

Date: November 1, 2010	/s/ Michael L. Kubacki Michael L. Kubacki – Chief Executive Officer
Date: November 1, 2010	/s/ David M. Findlay David M. Findlay –President and Chief Financial Officer
Date: November 1, 2010	/s/ Teresa A. Bartman Teresa A. Bartman – Senior Vice President- Finance and Controller