REPUBLIC BANCORP INC /KY/
Form 10-Q
August 08, 2014
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the quarterly period ended June 30, 2014

or

o **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

Commission File Number: 0-24649

REPUBLIC BANCORP, INC.

(Exact name of registrant as specified in its charter)

Kentucky	**61-0862051**
(State of other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
601 West Market Street, Louisville, Kentucky	**40202**
(Address of principal executive offices)	(Zip Code)

(502) 584-3600

(Registrant s telephone number, including area code)

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

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

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

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

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date:

The number of shares outstanding of the registrant s Class A Common Stock and Class B Common Stock, as of July 31, 2014, was 18,548,340 and 2,245,492, respectively.

Table of Contents

TABLE OF CONTENTS

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

CONSOLIDATED BALANCE SHEETS *(in thousands) (unaudited)*

	June 30, 2014	December 31, 2013
ASSETS		
Cash and cash equivalents	$ 84,273	$ 170,863
Securities available for sale	463,646	432,893
Securities held to maturity (fair value of $48,594 in 2014 and $50,768 in 2013)	48,338	50,644
Mortgage loans held for sale, at fair value	6,809	3,506
Loans	2,725,017	2,589,792
Allowance for loan losses	(22,772)	(23,026)
Loans, net	2,702,245	2,566,766
Federal Home Loan Bank stock, at cost	28,208	28,342
Premises and equipment, net	32,481	32,908
Goodwill	10,168	10,168
Other real estate owned	11,613	17,102
Bank owned life insurance	50,656	25,086
Other assets and accrued interest receivable	26,887	33,626
TOTAL ASSETS	$ 3,465,324	$ 3,371,904
LIABILITIES		
Deposits:		
Non interest-bearing	$ 519,651	$ 488,642
Interest-bearing	1,485,332	1,502,215
Total deposits	2,004,983	1,990,857
Securities sold under agreements to repurchase and other short-term borrowings	197,439	165,555
Federal Home Loan Bank advances	640,000	605,000
Subordinated note	41,240	41,240
Other liabilities and accrued interest payable	26,371	26,459
Total liabilities	2,910,033	2,829,111
Commitments and contingent liabilities (Footnote 9)		
STOCKHOLDERS EQUITY		
Preferred stock, no par value		
Class A Common Stock and Class B Common Stock, no par value	4,893	4,894
Additional paid in capital	133,320	133,012
Retained earnings	412,338	401,766
Accumulated other comprehensive income	4,740	3,121

Total stockholders equity		555,291		542,793
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$	3,465,324	$	3,371,904

See accompanying footnotes to consolidated financial statements.

Table of Contents

CONSOLIDATED STATEMENTS OF INCOME (*UNAUDITED*)

(*in thousands, except per share data*)

	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
INTEREST INCOME:				
Loans, including fees	$ 30,110	$ 31,735	$ 60,272	$ 63,649
Taxable investment securities	1,908	1,976	3,767	4,016
Federal Home Loan Bank stock and other	387	408	863	855
Total interest income	32,405	34,119	64,902	68,520
INTEREST EXPENSE:				
Deposits	937	975	1,915	2,030
Securities sold under agreements to repurchase and other short-term borrowings	22	13	44	42
Federal Home Loan Bank advances	3,267	3,735	6,831	7,293
Subordinated note	629	629	1,258	1,258
Total interest expense	4,855	5,352	10,048	10,623
NET INTEREST INCOME	27,550	28,767	54,854	57,897
Provision for loan losses	693	905	(10)	280
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	26,857	27,862	54,864	57,617
NON-INTEREST INCOME:				
Service charges on deposit accounts	3,563	3,498	6,858	6,708
Net refund transfer fees	1,836	1,683	16,224	13,697
Mortgage banking income	812	2,180	1,298	5,454
Debit card interchange fee income	1,738	1,656	3,673	3,467
Bargain purchase gain - First Commercial Bank				1,324
Net gain on sale of other real estate owned	264	1,034	666	1,311
Increase in cash surrender value of bank owned life insurance	379		570	
Other	920	732	1,683	1,347
Total non-interest income	9,512	10,783	30,972	33,308
NON-INTEREST EXPENSES:				
Salaries and employee benefits	13,965	15,086	28,448	31,200
Occupancy and equipment, net	5,508	5,315	11,330	10,892
Communication and transportation	856	991	1,882	2,021
Marketing and development	983	880	1,575	1,782
FDIC insurance expense	414	402	983	815
Bank franchise tax expense	831	857	3,170	2,572
Data processing	913	792	1,754	1,508
Debit card interchange expense	807	718	1,761	1,561
Supplies	60	218	500	572
Other real estate owned expense	560	945	1,630	1,834
Legal expense	88	1,338	500	1,768

Other		1,730		2,157		4,126		4,476
Total non-interest expenses		26,715		29,699		57,659		61,001
INCOME BEFORE INCOME TAX EXPENSE		9,654		8,946		28,177		29,924
INCOME TAX EXPENSE		3,332		2,827		9,871		10,449
NET INCOME	$	6,322	$	6,119	$	18,306	$	19,475
BASIC EARNINGS PER COMMON SHARE:								
Class A Common Stock	$	0.31	$	0.30	$	0.88	$	0.94
Class B Common Stock	$	0.29	$	0.28	$	0.85	$	0.91
DILUTED EARNINGS PER COMMON SHARE:								
Class A Common Stock	$	0.30	$	0.30	$	0.88	$	0.94
Class B Common Stock	$	0.29	$	0.28	$	0.85	$	0.90
DIVIDENDS DECLARED PER COMMON SHARE:								
Class A Common Stock	$	0.187	$	0.176	$	0.363	$	0.341
Class B Common Stock	$	0.170	$	0.160	$	0.330	$	0.310

See accompanying footnotes to consolidated financial statements.

Table of Contents

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (*UNAUDITED)*

(*in thousands*)

	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Net income	$ 6,322	$ 6,119	$ 18,306	$ 19,475
OTHER COMPREHENSIVE INCOME (LOSS):				
Change in fair value of derivatives used for cash flow hedges	(265)		(505)	
Unrealized gain (loss) on securities available for sale	2,626	(2,566)	2,628	(2,965)
Change in unrealized gain on securities available for sale for which a portion of an other-than-temporary impairment has been recognized in earnings	315	238	369	422
Net unrealized gains (losses)	2,676	(2,328)	2,492	(2,543)
Tax effect	(937)	815	(873)	891
Total other comprehensive income (loss), net of tax	1,739	(1,513)	1,619	(1,652)
COMPREHENSIVE INCOME	$ 8,061	$ 4,606	$ 19,925	$ 17,823

See accompanying footnotes to consolidated financial statements.

Table of Contents

CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY (*UNAUDITED*)

SIX MONTHS ENDED JUNE 30, 2014

(in thousands, except per share data)	Common Stock Class A Shares Outstanding	Common Stock Class B Shares Outstanding	Amount	Additional Paid In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders Equity
Balance, January 1, 2014	18,541	2,260	$ 4,894	$ 133,012	$ 401,766	$ 3,121	$ 542,793
Net income					18,306		18,306
Net change in accumulated other comprehensive income						1,619	1,619
Dividend declared Common Stock:							
Class A shares ($0.363 per share)					(6,727)		(6,727)
Class B shares ($0.330 per share)					(744)		(744)
Stock options exercised, net of shares redeemed	7		2	129	(14)		117
Repurchase of Class A Common Stock	(15)		(3)	(95)	(249)		(347)
Conversion of Class B Common Stock to Class A Common Stock	15	(15)					
Net change in notes receivable on Class A Common Stock				(85)			(85)
Deferred director compensation expense - Class A Common Stock	2			91			91
Stock based compensation - restricted stock	(2)			255			255
Stock based compensation expense - options				13			13
Balance, June 30, 2014	18,548	2,245	$ 4,893	$ 133,320	$ 412,338	$ 4,740	$ 555,291

See accompanying footnotes to consolidated financial statements.

Table of Contents

CONSOLIDATED STATEMENTS OF CASH FLOWS (*UNAUDITED*)

SIX MONTHS ENDED JUNE 30, 2014 AND 2013 (*in thousands*)

	2014	2013
OPERATING ACTIVITIES:		
Net income	$ 18,306	$ 19,475
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of premises and equipment	3,386	2,715
Amortization (accretion) on investment securitites, net	330	337
Amortization (accretion) on loans, net	(4,494)	(4,989)
Provision for loan losses	(10)	280
Net gain on sale of mortgage loans held for sale	(1,166)	(5,408)
Origination of mortgage loans held for sale	(33,284)	(208,094)
Proceeds from sale of mortgage loans held for sale	31,147	199,942
Net realized recovery of mortgage servicing rights		(312)
Net gain on sale of other real estate owned	(666)	(1,311)
Writedowns of other real estate owned	1,217	884
Deferred director compensation expense - Company Stock	91	89
Stock based compensation expense	268	274
Bargain purchase gain on acquisition		(1,324)
Increase in cash surrender value of bank owned life insurance	(570)	
Net change in other assets and liabilities:		
Accrued interest receivable	189	604
Accrued interest payable	(198)	11
Other assets	5,887	(2,123)
Other liabilities	(1,549)	723
Net cash provided by operating activities	18,884	1,773
INVESTING ACTIVITIES:		
Purchases of securities available for sale	(109,549)	(78,205)
Purchases of securities to be held to maturity		(15,000)
Proceeds from calls, maturities and paydowns of securities available for sale	81,567	93,401
Proceeds from calls, maturities and paydowns of securities to be held to maturity	2,269	5,806
Proceeds from sales of Federal Home Loan Bank stock	134	35
Proceeds from sales of other real estate owned	8,136	15,055
Net change in other loans	(25,008)	(5,520)
Net change in outstanding warehouse lines of credit	(94,555)	38,886
Purchase of loans, including premiums paid	(14,695)	
Purchase of bank owned life insurance	(25,000)	
Net purchases of premises and equipment	(2,297)	(667)
Net cash provided by (used in) investing activities	(178,998)	53,791
FINANCING ACTIVITIES:		
Net change in deposits	14,126	(11,881)
Net change in securities sold under agreements to repurchase and other short-term borrowings	31,884	(122,352)
Payments of Federal Home Loan Bank advances	(83,000)	(556)
Proceeds from Federal Home Loan Bank advances	118,000	50,000
Repurchase of Common Stock	(347)	(4,095)
Net proceeds from Common Stock options exercised	117	111
Cash dividends paid	(7,256)	(6,792)
Net cash provided by (used in) financing activities	73,524	(95,565)

NET CHANGE IN CASH AND CASH EQUIVALENTS		(86,590)		(40,001)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD		170,863		137,691
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$	84,273	$	97,690
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:				
Cash paid during the period for:				
Interest	$	10,246	$	10,612
Income taxes		7,304		20,100
SUPPLEMENTAL NONCASH DISCLOSURES:				
Transfers from loans to real estate acquired in settlement of loans	$	4,492	$	4,242
Loans provided for sales of other real estate owned		1,294		569
Change in fair value of derivatives used for cash flow hedges		(505)		

See accompanying footnotes to consolidated financial statements.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2014 AND 2013 (UNAUDITED) AND DECEMBER 31, 2013

1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation The consolidated financial statements include the accounts of Republic Bancorp, Inc. (the Parent Company) and its wholly-owned subsidiary, Republic Bank & Trust Company (RB&T or the Bank). The Bank is a Kentucky-based, state chartered non-member financial institution. Republic Bancorp Capital Trust (RBCT) is a Delaware statutory business trust that is a wholly-owned unconsolidated finance subsidiary of Republic Bancorp, Inc. All companies are collectively referred to as Republic or the Company. All significant intercompany balances and transactions are eliminated in consolidation.

On May 9, 2014, Republic Bank, the Company s wholly-owned, federally chartered savings institution, merged into RB&T. The merged institution operates under the name Republic Bank & Trust Company. The merger did not materially impact the Company s consolidated financial statements.

Subsequent to June 30, 2014, the Company formed Republic Insurance Services, Inc. (the Captive). The Captive is a wholly-owned insurance subsidiary of the Company that will provide property and casualty insurance coverage to the Company and the Bank and reinsurance to five other third party insurance captives for which insurance may not be currently available or economically feasible in today s insurance marketplace.

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, the financial statements do not include all of the information and footnotes required by U.S. generally accepted accounting principles (GAAP) for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for fair presentation have been included. Operating results for the three and six months ended June 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. For further information, refer to the consolidated financial statements and footnotes thereto included in Republic s Form 10-K for the year ended December 31, 2013.

As of June 30, 2014, the Company was divided into three distinct business operating segments: Traditional Banking, Mortgage Banking and Republic Processing Group (RPG). Tax Refund Solutions (TRS), Republic Payment Solutions (RPS) and Republic Credit Solutions (RCS) operate as divisions of the RPG segment. The RPS and RCS divisions are considered immaterial for separate and independent segment reporting.

Table of Contents

Traditional Banking and Mortgage Banking (collectively Core Banking)

As of June 30, 2014, in addition to an Internet delivery channel, Republic had 42 full-service banking centers with locations as follows:

- Kentucky 33
- Metropolitan Louisville 20
- Central Kentucky 8
- Elizabethtown 1
- Frankfort 1
- Georgetown 1
- Lexington 4
- Shelbyville 1
- Western Kentucky 2
- Owensboro 2
- Northern Kentucky 3
- Covington 1
- Florence 1
- Independence 1
- Southern Indiana 3
- Floyds Knobs 1
- Jeffersonville 1
- New Albany 1
- Metropolitan Tampa, Florida 3
- Metropolitan Cincinnati, Ohio 1

• Metropolitan Nashville, Tennessee 2

Republic s headquarters are located in Louisville, which is the largest city in Kentucky based on population.

Core Banking results of operations are primarily dependent upon net interest income, which represents the difference between the interest income and fees on interest-earning assets and the interest expense on interest-bearing liabilities. Principal interest-earning Core Banking assets represent investment securities and commercial and consumer loans primarily secured by real estate and/or personal property. Interest-bearing liabilities primarily consist of interest-bearing deposit accounts, securities sold under agreements to repurchase, as well as short-term and long-term borrowing sources. FHLB advances have traditionally been a significant borrowing source for the Bank.

The Bank provides short-term, revolving credit facilities to mortgage bankers across the Nation through mortgage warehouse lines of credit. These credit facilities are secured by single family, first lien residential real estate loans.

The Bank began acquiring single family mortgage loans for investment through its Correspondent Lending division in May 2014. Correspondent lending generally involves the Bank acquiring closed loans that meet the Bank s specifications from its Mortgage Warehouse clients. Substantially all loans purchased through the Correspondent Lending channel are purchased at a premium. Premiums on loans held for investment acquired though the Correspondent Lending division are amortized into income on the level-yield method over the expected life of the loan.

Other sources of Core Banking income include service charges on deposit accounts, debit and credit card interchange fee income, title insurance commissions, fees charged to customers for trust services and revenue generated from Mortgage Banking activities. Mortgage Banking activities represent both the origination and sale of loans in the secondary market and the servicing of loans for others, primarily the Federal Home Loan Mortgage Corporation (Freddie Mac or FHLMC).

Core Banking operating expenses consist primarily of salaries and employee benefits, occupancy and equipment expenses, communication and transportation costs, data processing, debit card interchange expenses, marketing and development expenses, FDIC insurance expense, and various general and administrative costs. Core Banking results of operations are significantly impacted by general economic and competitive conditions, particularly changes in market interest rates, government laws and policies and actions of regulatory agencies.

Table of Contents

Republic Processing Group

All divisions of the RPG segment operate through the Bank. Nationally, RPG facilitates the receipt and payment of federal and state tax refunds under the TRS division, primarily through refund transfers (RT s). RTs are products whereby a tax refund is issued to the taxpayer after the Bank has received the refund from the federal or state government. There is no credit risk or borrowing cost associated with these products, because they are only delivered to the taxpayer upon receipt of the tax refund directly from the governmental paying authority. Fees earned on RTs, net of rebates, are the primary source of revenue for the TRS division and the RPG segment, and are reported as non-interest income under the line item Net refund transfer fees.

The TRS division historically originated and obtained a significant source of revenue from Refund Anticipation Loans (RAL s), but terminated this product effective April 30, 2012. RALs were short-term consumer loans offered to taxpayers that were secured by the customer s anticipated tax refund, which represented the sole source of repayment. While RALs were terminated in 2012, TRS has received and expects to continue receiving recoveries from previously charged-off RALs.

The RPS division is an issuing bank offering general purpose reloadable prepaid debit cards through third party program managers. The RCS division is piloting short-term consumer credit products.

Reclassifications and recasts Certain amounts presented in prior periods have been reclassified to conform to the current period presentation. These reclassifications had no impact on prior years net income.

Accounting Standards Update (ASU) 2014-08 Presentation of Financial Statements and Property, Plant and Equipment *(Topic 205 and Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity.*

The amendments in this ASU change the criteria for reporting discontinued operations for all public and nonpublic entities. A discontinued operation may include a component of an entity or a group of components of an entity, or a business or nonprofit activity. A disposal of a component of an entity or a group of components of an entity is required to be reported in discontinued operations if the disposal represents a strategic shift that has (or will have) a major effect on an entity s operations and financial results. The amendments in this ASU are effective for the Company beginning January 1, 2015 and are not expected to have a material impact on the Company s financial statements.

ASU 2014-11 Transfers and Servicing *(Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings and Disclosures.*

The amendments in this ASU require that repurchase-to-maturity transactions be accounted for as secured borrowings consistent with the accounting for other repurchase agreements. In addition, the amendments require separate accounting for a transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty (a repurchase financing), which will result in secured borrowing accounting for the repurchase agreement. The amendments require an entity to disclose information about transfers accounted for as sales in transactions that are economically similar to repurchase agreements, in which the transferor retains substantially all of the exposure to the economic return on the transferred financial asset throughout the term of the transaction. In addition the amendments require disclosure of the types of collateral pledged in repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions and the tenor of those transactions. The amendments in this ASU are effective for the Company beginning January 1, 2015 and are not expected to have a material impact on the Company s financial statements.

ASU 2014-12 Compensation Stock Compensation ***(Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That Performance Targets Could Be Achieved after the Requisite Service Period.***

The amendments in this ASU are intended to resolve the diverse accounting treatment of share-based awards that require a specific performance target. The amendments in this ASU are effective for the Company beginning January 1, 2015 and are not expected to have a material impact on the Company s financial statements.

Table of Contents

2. INVESTMENT SECURITIES

Securities Available for Sale:

The gross amortized cost and fair value of securities available for sale and the related gross unrealized gains and losses recognized in accumulated other comprehensive income (loss) were as follows:

June 30, 2014 (in thousands)	Gross Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury securities and U.S. Government agencies	$ 144,821	$ 640	$ (17)	$ 145,444
Private label mortgage backed security	4,347	1,114		5,461
Mortgage backed securities - residential	131,702	4,803	(87)	136,418
Collateralized mortgage obligations	159,137	1,308	(912)	159,533
Freddie Mac preferred stock		718		718
Mutual fund	1,000	11		1,011
Corporate bonds	15,013	52	(4)	15,061
Total securities available for sale	$ 456,020	$ 8,646	$ (1,020)	$ 463,646

December 31, 2013 (in thousands)	Gross Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury securities and U.S. Government agencies	$ 97,157	$ 409	$ (101)	$ 97,465
Private label mortgage backed security	4,740	745		5,485
Mortgage backed securities - residential	146,087	4,288	(288)	150,087
Collateralized mortgage obligations	164,264	1,228	(1,546)	163,946
Mutual fund	1,000		(5)	995
Corporate bonds	15,015	50	(150)	14,915
Total securities available for sale	$ 428,263	$ 6,720	$ (2,090)	$ 432,893

Securities Held to Maturity:

The carrying value, gross unrecognized gains and losses, and fair value of securities held to maturity were as follows:

June 30, 2014 (in thousands)	Carrying Value	Gross Unrecognized Gains	Gross Unrecognized Losses	Fair Value

U.S. Treasury securities and U.S. Government agencies	$ 2,275	$ 5	$ (8)	$ 2,272
Mortgage backed securities - residential	412	53		465
Collateralized mortgage obligations	40,651	387	(52)	40,986
Corporate bonds	5,000		(129)	4,871
Total securities held to maturity	$ 48,338	$ 445	$ (189)	$ 48,594

December 31, 2013 (in thousands)	**Carrying Value**	**Gross Unrecognized Gains**	**Gross Unrecognized Losses**	**Fair Value**
U.S. Treasury securities and U.S. Government agencies	$ 2,311	$ 7	$ (13)	$ 2,305
Mortgage backed securities - residential	420	43		463
Collateralized mortgage obligations	42,913	387	(184)	43,116
Corporate bonds	5,000		(116)	4,884
Total securities held to maturity	$ 50,644	$ 437	$ (313)	$ 50,768

Table of Contents

At June 30, 2014 and December 31, 2013, there were no holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of stockholders equity.

Sales of Securities Available for Sale

During the three and six months ended June 30, 2014 and 2013, there were no sales or calls of securities available for sale or applicable tax provisions for such transactions.

Investment Securities by Contractual Maturity

The amortized cost and fair value of the investment securities portfolio by contractual maturity at June 30, 2014 follows. Expected maturities may differ from contractual maturities if securities issuers have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are detailed separately.

	Securities available for sale		Securities held to maturity	
June 30, 2014 (in thousands)	**Amortized Cost**	**Fair Value**	**Carrying Value**	**Fair Value**
Due in one year or less	$ 23,493	$ 23,715	$ 500	$ 502
Due from one year to five years	126,341	126,794	1,775	1,771
Due from five years to ten years	10,000	9,996	5,000	4,870
Due beyond ten years				
Private label mortgage backed security	4,347	5,461		
Mortgage backed securities - residential	131,702	136,418	412	465
Collateralized mortgage obligations	159,137	159,533	40,651	40,986
Freddie Mac preferred stock		718		
Mutual fund	1,000	1,011		
Total securities	$ 456,020	$ 463,646	$ 48,338	$ 48,594

Freddie Mac Preferred Stock

During 2008, the U.S. Treasury, the Federal Reserve Board, and the Federal Housing Finance Agency (FHFA) announced that the FHFA was placing Freddie Mac under conservatorship and giving management control to the FHFA. The Bank contemporaneously determined that its 40,000 shares of Freddie Mac preferred stock were fully impaired and recorded an Other Than Temporary Impairment (OTTI) charge of $2.1 million for the shares. The OTTI charge brought the carrying value of the stock down to $0. During the second quarter of 2014, based on the active trading volume and price of Freddie Mac preferred stock, the Company determined it appropriate to record an unrealized gain to other comprehensive income (OCI) related to its Freddie Mac preferred stock holdings. Based on the stock s market closing price as of June 30, 2014, the Company s unrealized gain for its Freddie Mac preferred stock totaled $718,000.

Corporate Bonds

During 2013, the Bank purchased $20 million in floating rate corporate bonds with an initial weighted average yield of 1.36%. The bonds, which have a weighted average life of seven years, were rated investment grade by accredited rating agencies as of their respective purchase dates. The total fair value of the Bank s corporate bonds represented 4% of the Bank s investment portfolio as of both June 30, 2014 and December 31, 2013.

Mortgage Backed Securities

At June 30, 2014, with the exception of the $5.5 million private label mortgage backed security, all other mortgage backed securities held by the Bank were issued by U.S. government-sponsored entities and agencies, primarily Freddie Mac and the Federal National Mortgage Association (Fannie Mae or FNMA), institutions that the government has affirmed its commitment to support. At June 30, 2014 and December 31, 2013, there were gross unrealized/unrecognized losses of $999,000 and $1.8 million related to available for sale mortgage backed securities. Because the decline in fair value of these mortgage backed securities is attributable to changes in interest rates and illiquidity, and not credit quality, and because the Bank does not have the intent to sell these mortgage backed securities, and it is likely that it will not be required to sell the

Table of Contents

securities before their anticipated recovery, management does not consider these securities to be other-than-temporarily impaired.

Market Loss Analysis

Securities with unrealized losses at June 30, 2014 and December 31, 2013, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows:

	Less than 12 months		12 months or more		Total	
June 30, 2014 (in thousands)	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
Securities available for sale:						
U.S. Treasury securities and U.S. Government agencies	$ 2,106	$ (17)	$	$	$ 2,106	$ (17)
Mortgage backed securities - residential	8,312	(87)			8,312	(87)
Collateralized mortgage obligations	56,578	(778)	7,567	(134)	64,145	(912)
Corporate bonds	9,996	(4)			9,996	(4)
Total securities available for sale	$ 76,992	$ (886)	$ 7,567	$ (134)	$ 84,559	$ (1,020)

	Less than 12 months		12 months or more		Total	
	Fair Value	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
Securities held to maturity:						
U.S. Treasury securities and U.S. Government agencies	$ 521	$ (8)	$	$	$ 521	$ (8)
Collateralized mortgage obligations	18,274	(52)			18,274	(52)
Corporate bonds	4,871	(129)			4,871	(129)
Total securities held to maturity	$ 23,666	$ (189)	$	$	$ 23,666	$ (189)

	Less than 12 months		12 months or more		Total	
December 31, 2013 (in thousands)	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
Securities available for sale:						
U.S. Treasury securities and U.S. Government agencies	$ 44,041	$ (101)	$	$	$ 44,041	$ (101)
Mortgage backed securities - residential	19,494	(288)			19,494	(288)
Collateralized mortgage obligations	55,927	(1,546)			55,927	(1,546)
Mutual fund	995	(5)			995	(5)
Corporate bonds	9,850	(150)			9,850	(150)

Total securities available for sale	$	130,307	$	(2,090)	$		$		$	130,307	$	(2,090)

	Less than 12 months				12 months or more				Total			
		Fair Value		Unrealized Losses		Fair Value		Unrealized Losses		Fair Value		Unrealized Losses
Securities held to maturity:												
U.S. Treasury securities and U.S. Government agencies	$	521	$	(13)	$		$		$	521	$	(13)
Collateralized mortgage obligations		18,686		(184)						18,686		(184)
Corporate bonds		4,884		(116)						4,884		(116)
Total securities held to maturity	$	24,091	$	(313)	$		$		$	24,091	$	(313)

Table of Contents

At June 30, 2014, the Bank s security portfolio consisted of 162 securities, 19 of which were in an unrealized loss position. At December 31, 2013, the Bank s security portfolio consisted of 162 securities, 27 of which were in an unrealized loss position.

Other-than-temporary Impairment

Unrealized losses for all investment securities are reviewed to determine whether the losses are other-than-temporary. Investment securities are evaluated for OTTI on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation to determine whether a decline in value below amortized cost is other-than-temporary. In conducting this assessment, the Bank evaluates a number of factors including, but not limited to:

- The length of time and the extent to which fair value has been less than the amortized cost basis;
- The Bank s intent to hold until maturity or sell the debt security prior to maturity;
- An analysis of whether it is more likely than not that the Bank will be required to sell the debt security before its anticipated recovery;
- Adverse conditions specifically related to the security, an industry, or a geographic area;
- The historical and implied volatility of the fair value of the security;
- The payment structure of the security and the likelihood of the issuer being able to make payments;
- Failure of the issuer to make scheduled interest or principal payments;
- Any rating change by a rating agency; and
- Recoveries or additional decline in fair value subsequent to the balance sheet date.

The term other-than-temporary is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value are not necessarily favorable, or that there is a general lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value is determined to be other-than-temporary, the value of the security is reduced and a corresponding charge to earnings is recognized for the anticipated credit losses.

The Bank owns one private label mortgage backed security with a total carrying value of $5.5 million at June 30, 2014. This security, with an average remaining life currently estimated at four years, is mostly backed by Alternative A first lien mortgage loans, but also has an insurance wrap or guarantee as an added layer of protection to the security holder. This asset is illiquid, and as such, the Bank determined it to be a Level 3 security in accordance with Accounting Standards Codification (ASC) Topic 820, *Fair Value Measurements and Disclosures.* Based on this determination, the Bank utilized an income valuation model (present value model) approach, in determining the fair value of the security. This approach is beneficial for positions that are not traded in active markets or are subject to transfer restrictions, and/or where valuations are adjusted to reflect illiquidity and/or non-transferability. Such adjustments are generally based on available market evidence. In the absence of such evidence, management s best estimate is used. Management s best estimate consists of both internal and external support for this investment.

See additional discussion regarding the Bank s private label mortgage backed security under Footnote 6 Fair Value in this section of the filing.

Pledged Investment Securities

Investment securities pledged to secure public deposits, securities sold under agreements to repurchase and securities held for other purposes, as required or permitted by law are as follows:

(in thousands)	**June 30, 2014**	**December 31, 2013**
Carrying amount	$ 249,532	$ 224,693
Fair value	249,659	224,989

Table of Contents

3. LOANS AND ALLOWANCE FOR LOAN LOSSES

The Bank s financing receivables consist primarily of loans and a minimal amount of lease financing receivables (together referred to as loans). Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of purchase premiums or discounts, deferred loan fees and costs and the allowance for loan losses. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized in interest income using the level-yield method without anticipating prepayments.

Lease financing receivables, all of which are direct financing leases, are reported at their principal balance outstanding net of any unearned income, deferred fees and costs and applicable allowance for losses. Leasing income is recognized on a basis that achieves a constant periodic rate of return on the outstanding lease financing balances over the lease terms.

The composition of loans follows:

(in thousands)	June 30, 2014	December 31, 2013
Residential real estate:		
Owner occupied - bank originated	$ 1,127,519	$ 1,097,795
Owner occupied - correspondent*	11,785	
Non owner occupied - bank originated	98,644	110,809
Commercial real estate	758,676	773,173
Commercial real estate - purchased whole loans	34,534	34,186
Construction & land development	41,109	44,351
Commercial & industrial	146,334	127,763
Lease financing receivables	310	
Warehouse lines of credit	244,131	149,576
Home equity	235,919	226,782