COMMUNITY TRUST BANCORP INC /KY/
Form 10-Q
August 08, 2014

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
[ ]	TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
	For the transition period from _____________ to _____________

Commission file number 0-11129

COMMUNITY TRUST BANCORP, INC.
(Exact name of registrant as specified in its charter)

Kentucky	61-0979818
(State or other jurisdiction of incorporation or organization)	IRS Employer Identification No.
346 North Mayo Trail Pikeville, Kentucky (Address of principal executive offices)	41501 (Zip code)

(606) 432-1414
(Registrant’s telephone number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes ü	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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.)

Yes ü	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 definition of "accelerated filer, large accelerated filer, and smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer ü	Non-accelerated filer	Smaller reporting company
		(Do not check if a smaller reporting company)	

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes	No ü

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date.

Common stock – 17,426,370 shares outstanding at July 31, 2014

CAUTIONARY STATEMENT
REGARDING FORWARD LOOKING STATEMENTS

Certain of the statements contained herein that are not historical facts are forward-looking statements within the meaning of the Private Securities Litigation Reform Act. CTBI's actual results may differ materially from those included in the forward-looking statements. Forward-looking statements are typically identified by words or phrases such as "believe," "expect," "anticipate," "intend," "estimate," "may increase," "may fluctuate," and similar expressions or fu conditional verbs such as "will," "should," "would," and "could." These forward-looking statements involve risks and uncertainties including, but not limited to, economic conditions, portfolio growth, the credit performance of the portfolios, including bankruptcies, and seasonal factors; changes in general economic conditions including the performance of financial markets, prevailing inflation and interest rates, realized gains from sales of investments, gains from asset sales, and losses on commercial lending activities; results of various investment activities; the effects of competitors' pricing policies, changes in laws and regulations, competition, and demographic changes on target market populations' savings and financial planning needs; industry changes in information technology systems on which we are highly dependent; failure of acquisitions to produce revenue enhancements or cost savings at levels or within the time frames originally anticipated or unforeseen integration difficulties; the adoption by CTBI of a Federal Financial Institutions Examination Council (FFIEC) policy that provides guidance on the reporting of delinquent consumer loans and the timing of associated credit charge-offs for financial institution subsidiaries; and the resolution of legal proceedings and related matters. In addition, the banking industry in general is subject to various monetary and fiscal policies and regulations, which include those determined by the Federal Reserve Board, the Federal Deposit Insurance Corporation, and state regulators, whose policies and regulations could affect CTBI's results. These statements are representative only on the date hereof, and CTBI undertakes no obligation to update any forward-looking statements made.

PART I - FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

The accompanying information has not been audited by our independent registered public accountants; however, in the opinion of management such information reflects all adjustments necessary for a fair presentation of the results for the interim period. All such adjustments are of a normal and recurring nature.

The accompanying condensed consolidated financial statements are presented in accordance with the requirements of Form 10-Q and consequently do not include all of the disclosures normally required by accounting principles generally accepted in the United States of America or those normally made in the Registrant's annual report on Form 10-K. Accordingly, the reader of the Form 10-Q should refer to the Registrant's Form 10-K for the year ended December 31, 2013 for further information in this regard.

Community Trust Bancorp, Inc.
Condensed Consolidated Balance Sheets

(dollars in thousands)	(unaudited) June 30 2014	December 31 2013
Assets:		
Cash and due from banks	$72,637	$64,828
Interest bearing deposits	58,338	33,200
Federal funds sold	6,998	8,613
Cash and cash equivalents	137,973	106,641
Certificates of deposit in other banks	9,473	9,568
Securities available-for-sale at fair value (amortized cost of $647,122 and $621,753, respectively)	647,536	609,405
Securities held-to-maturity at amortized cost (fair value of $1,632 and $1,601, respectively)	1,662	1,662
Loans held for sale	895	828
Loans	2,632,609	2,615,354
Allowance for loan and lease losses	(33,617)	(34,008)
Net loans	2,598,992	2,581,346
Premises and equipment, net	50,552	52,000
Federal Home Loan Bank stock	17,927	25,673
Federal Reserve Bank stock	4,887	4,886
Goodwill	65,490	65,490
Core deposit intangible (net of accumulated amortization of $8,032 and $7,925, respectively)	584	690
Bank owned life insurance	54,398	53,687
Mortgage servicing rights	3,062	3,424
Other real estate owned	33,062	39,188
Other assets	26,109	27,228
Total assets	$3,652,602	$3,581,716
Liabilities and shareholders’ equity:		
Deposits:		
Noninterest bearing	$651,588	$621,321
Interest bearing	2,235,601	2,233,753
Total deposits	2,887,189	2,855,074
Repurchase agreements	217,979	208,067
Federal funds purchased and other short-term borrowings	15,205	12,465
Advances from Federal Home Loan Bank	1,228	1,286
Long-term debt	61,341	61,341
Other liabilities	35,782	30,991
Total liabilities	3,218,724	3,169,224
Shareholders’ equity:		

Preferred stock, 300,000 shares authorized and unissued	-	-
Common stock, $5 par value, shares authorized 25,000,000; shares outstanding 2014 – 17,421,389; 2013 – 17,403,441	87,107	79,107
Capital surplus	212,313	167,122
Retained earnings	134,189	174,289
Accumulated other comprehensive income (loss), net of tax	269	(8,026)
Total shareholders’ equity	433,878	412,492
Total liabilities and shareholders’ equity	$3,652,602	$3,581,716

See notes to condensed consolidated financial statements.

Community Trust Bancorp, Inc.
Condensed Consolidated Statements of Income and Comprehensive Income
(unaudited)

	Three Months Ended June 30		Six Months Ended June 30	
(in thousands except per share data)	2014	2013	2014	2013
Interest income:				
Interest and fees on loans, including loans held for sale	$31,937	$32,672	$63,550	$65,520
Interest and dividends on securities				
Taxable	2,806	3,129	5,853	6,024
Tax exempt	664	557	1,248	1,115
Interest and dividends on Federal Reserve Bank and Federal Home Loan Bank stock	298	342	630	690
Other, including interest on federal funds sold	106	83	223	210
Total interest income	35,811	36,783	71,504	73,559
Interest expense:				
Interest on deposits	2,472	2,902	4,934	5,921
Interest on repurchase agreements and other short-term borrowings	217	234	409	497
Interest on advances from Federal Home Loan Bank	5	6	11	13
Interest on long-term debt	284	299	567	589
Total interest expense	2,978	3,441	5,921	7,020
Net interest income	32,833	33,342	65,583	66,539
Provision for loan losses	735	3,661	2,080	5,220
Net interest income after provision for loan losses	32,098	29,681	63,503	61,319
Noninterest income:				
Service charges on deposit accounts	5,987	6,182	11,418	11,949
Gains on sales of loans, net	288	755	478	2,152
Trust and wealth management income	2,199	2,023	4,308	4,023
Loan related fees	766	1,496	1,445	2,444
Bank owned life insurance	476	1,327	950	1,748
Brokerage revenue	634	618	1,204	1,068
Securities losses	(51)	(8)	(111)	(8)
Other noninterest income	673	881	1,345	1,818
Total noninterest income	10,972	13,274	21,037	25,194
Noninterest expense:				
Officer salaries and employee benefits	2,784	2,635	5,622	5,186
Other salaries and employee benefits	10,490	10,579	21,069	21,010
Occupancy, net	1,937	1,972	4,101	3,899
Equipment	938	988	1,838	1,966
Data processing	1,933	1,775	3,858	3,588
Bank franchise tax	1,208	1,123	2,417	2,246
Legal fees	656	556	1,354	1,162
Professional fees	425	432	840	814

FDIC insurance	558	637	1,207	1,239
Other real estate owned provision and expense	736	1,170	2,241	3,009
Repossession expense	222	487	541	898
Other noninterest expense	3,369	3,633	7,029	7,269
Total noninterest expense	25,256	25,987	52,117	52,286
Income before income taxes	17,814	16,968	32,423	34,227
Income taxes	5,619	5,026	10,088	10,465
Net income	12,195	11,942	22,335	23,762
Other comprehensive income (loss):				
Unrealized holding gains (losses) on securities available-for-sale:				
Unrealized holding gains (losses) arising during the period	6,571	(21,337)	12,651	(23,923)
Less: Reclassification adjustments for realized losses included in net income	(51)	(8)	(111)	(8)
Tax (benefit) expense	2,318	(7,465)	4,467	(8,370)
Other comprehensive income (loss), net of tax	4,304	(13,864)	8,295	(15,545)
Comprehensive income (loss)	$16,499	$(1,922)	$30,630	$8,217
Basic earnings per share	$0.70	$0.70	$1.29	$1.39
Diluted earnings per share	$0.70	$0.69	$1.28	$1.38
Weighted average shares outstanding-basic	17,318	17,121	17,313	17,107
Weighted average shares outstanding-diluted	17,393	17,205	17,393	17,188
Dividends declared per share	$0.290	$0.286	$0.581	$0.572

See notes to condensed consolidated financial statements.

Community Trust Bancorp, Inc.
Condensed Consolidated Statements of Cash Flows
(unaudited)

	Six Months Ended June 30	
(in thousands)	2014	2013
Cash flows from operating activities:		
Net income	$22,335	$23,762
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,256	2,301
Deferred taxes	935	(8,370)
Stock-based compensation	344	335
Excess tax benefits of stock-based compensation	10	42
Provision for loan losses	2,080	5,220
Write-downs of other real estate owned and other repossessed assets	1,161	1,776
Gains on sale of mortgage loans held for sale	(478)	(2,152)
Losses on sales of securities	111	8
Losses on sale of assets, net	43	92
Proceeds from sale of mortgage loans held for sale	20,310	93,445
Funding of mortgage loans held for sale	(19,900)	(71,798)
Amortization of securities premiums and discounts, net	1,349	2,217
Change in cash surrender value of bank owned life insurance	(711)	(704)
Mortgage servicing rights:		
Fair value adjustments	507	(296)
New servicing assets created	(145)	(562)
Changes in:		
Other assets	1,123	3,472
Other liabilities	(684)	4,672
Net cash provided by operating activities	30,646	53,460
Cash flows from investing activities:		
Certificates of deposit in other banks:		
Maturity of certificates of deposit	95	240
Purchase of certificates of deposit	0	(4,472)
Securities available-for-sale (AFS):		
Purchase of AFS securities	(175,553)	(176,783)
Proceeds from the sales of AFS securities	112,949	0
Proceeds from prepayments and maturities of AFS securities	35,776	66,622
Change in loans, net	(17,970)	(42,740)
Purchase of premises and equipment	(702)	(603)
Proceeds from sale of premises and equipment	18	38
Redemption of stock by Federal Home Loan Bank	7,746	0
Additional investment in Federal Reserve Bank stock	(1)	(1)
Proceeds from sale of other real estate and other repossessed assets	3,150	5,730
Additional investment in other real estate and other repossessed assets	0	(48)
Additional investment in bank owned life insurance	0	(7,306)
Net cash used in investing activities	(34,492)	(159,323)

Cash flows from financing activities:		
Change in deposits, net	32,115	18,325
Change in repurchase agreements, federal funds purchased, and other short-term borrowings, net	12,652	(3,624)
Payments on advances from Federal Home Loan Bank	(58)	(82)
Issuance of common stock	594	1,272
Excess tax benefits of stock-based compensation	(10)	(42)
Dividends paid	(10,115)	(9,787)
Net cash provided by financing activities	35,178	6,062
Net increase (decrease) in cash and cash equivalents	31,332	(99,801)
Cash and cash equivalents at beginning of period	106,641	207,560
Cash and cash equivalents at end of period	$137,973	$107,759
Supplemental disclosures:		
Income taxes paid	$6,720	$10,340
Interest paid	5,431	6,474
Non-cash activities:		
Loans to facilitate the sale of other real estate and other repossessed assets	5,225	1,007
Common stock dividends accrued, paid in subsequent quarter	201	4,904
Real estate acquired in settlement of loans	3,469	4,655

See notes to condensed consolidated financial statements.

Community Trust Bancorp, Inc.
Notes to Condensed Consolidated Financial Statements (unaudited)

Note 1 - Summary of Significant Accounting Policies

In the opinion of management, the unaudited condensed consolidated financial statements include all adjustments (which consist of normal recurring accruals) necessary, to present fairly the condensed consolidated financial position as of June 30, 2014, the results of operations for the three and six months ended June 30, 2014 and 2013, and the cash flows for the six months ended June 30, 2014 and 2013. In accordance with accounting principles generally accepted in the United States of America for interim financial information, these statements do not include certain information and footnote disclosures required by accounting principles generally accepted in the United States of America for complete annual financial statements. The results of operations for the three and six months ended June 30, 2014 and 2013, and the cash flows for the six months ended June 30, 2014 and 2013, are not necessarily indicative of the results to be expected for the full year. The condensed consolidated balance sheet as of December 31, 2013 has been derived from the audited consolidated financial statements of Community Trust Bancorp, Inc. ("CTBI") for that period. For further information, refer to the consolidated financial statements and footnotes thereto for the year ended December 31, 2013, included in our annual report on Form 10-K.

Principles of Consolidation – The unaudited condensed consolidated financial statements include the accounts of CTBI and its separate and distinct, wholly owned subsidiaries Community Trust Bank, Inc. (the "Bank") and Community Trust and Investment Company. All significant intercompany transactions have been eliminated in consolidation.

Reclassifications – Certain reclassifications considered to be immaterial have been made in the prior year condensed consolidated financial statements to conform to current year classifications. These reclassifications had no effect on net income.

All share data has been adjusted for the 10% stock dividend issued on June 2, 2014.

New Accounting Standards –

Ø Accounting for Investments in Qualified Affordable Housing Projects – In January 2014, the FASB issued ASU No. 2014-01, Investments—Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects, which enables companies that invest in affordable housing projects that qualify for the low-income housing tax credit (LIHTC) to elect to use the proportional amortization method if certain conditions are met. Under the proportional amortization method, the initial investment cost of the project is amortized in proportion to the amount of tax credits and benefits received, with the results of the investment presented on a net basis as a component of income tax expense (benefit). ASU 2014-01 is effective for interim and annual periods beginning after December 15, 2014, with early adoption permitted. We are currently evaluating the impact of adopting ASU 2014-01, but we do not expect the adoption to have a material effect on CTBI's financial condition or results of operations.

Ø Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure – In January 2014, the FASB also issued ASU No. 2014-04, Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure, which clarifies when an in-substance foreclosure or repossession of residential real estate property occurs, requiring a creditor to reclassify the loan to other real estate. According to ASU 2014-04, a consumer mortgage loan should be reclassified to other real estate either upon the creditor obtaining legal title to the real estate collateral or when the borrower voluntarily conveys all interest in the real estate property to the creditor through a deed in lieu of foreclosure or similar legal agreement. ASU 2014-04 also clarifies that a creditor should not delay reclassification when a borrower has a legal right of redemption. Our current practice is consistent with the new guidance. We expect to adopt ASU 2014-04 in the first quarter 2015 and do not expect the adoption to have a material effect on CTBI's financial condition or results of operations.

Critical Accounting Policies and Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires the appropriate application of certain accounting policies, many of which require us to make estimates and assumptions about future events and their impact on amounts reported in our consolidated financial statements and related notes. Since future events and their impact cannot be determined with certainty, the actual results will inevitably differ from our estimates. Such differences could be material to the consolidated financial statements.

We believe the application of accounting policies and the estimates required therein are reasonable. These accounting policies and estimates are constantly reevaluated, and adjustments are made when facts and circumstances dictate a change. Historically, we have found our application of accounting policies to be appropriate, and actual results have not differed materially from those determined using necessary estimates.

We have identified the following critical accounting policies:

Investments – Management determines the classification of securities at purchase. We classify securities into held-to-maturity, trading, or available-for-sale categories. Held-to-maturity securities are those which we have the positive intent and ability to hold to maturity and are reported at amortized cost. In accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 320, Investment Securities, investments in debt securities that are not classified as held-to-maturity and equity securities that have readily determinable fair values shall be classified in one of the following categories and measured at fair value in the statement of financial position:

a. Trading securities. Securities that are bought and held principally for the purpose of selling them in the near term (thus held for only a short period of time) shall be classified as trading securities. Trading generally reflects active and frequent buying and selling, and trading securities are generally used with the objective of generating profits on short-term differences in price.

b. Available-for-sale securities. Investments not classified as trading securities (nor as held-to-maturity securities) shall be classified as available-for-sale securities.

We do not have any securities that are classified as trading securities. Available-for-sale securities are reported at fair value, with unrealized gains and losses included as a separate component of shareholders' equity, net of tax. If declines in fair value are other than temporary, the carrying value of the securities is written down to fair value as a realized loss with a charge to income for the portion attributable to credit losses and a charge to other comprehensive income for the portion that is not credit related.

Gains or losses on disposition of securities are computed by specific identification for all securities except for shares in mutual funds, which are computed by average cost. Interest and dividend income, adjusted by amortization of purchase premium or discount, is included in earnings.

When the fair value of a security is below its amortized cost, and depending on the length of time the condition exists and the extent the fair market value is below amortized cost, additional analysis is performed to determine whether an other than temporary impairment condition exists. Available-for-sale and held-to-maturity securities are analyzed quarterly for possible other than temporary impairment. The analysis considers (i) whether we have the intent to sell our securities prior to recovery and/or maturity and (ii) whether it is more likely than not that we will not have to sell our securities prior to recovery and/or maturity. Often, the information available to conduct these assessments is limited and rapidly changing, making estimates of fair value subject to judgment. If actual information or conditions are different than estimated, the extent of the impairment of the security may be different than previously estimated, which could have a material effect on the CTBI's results of operations and financial condition.

Loans – Loans with the ability and the intent to be held until maturity and/or payoff are reported at the carrying value of unpaid principal reduced by unearned interest, an allowance for loan and lease losses, and unamortized deferred fees or costs. Income is recorded on the level yield basis. Interest accrual is discontinued when management believes, after considering economic and business conditions, collateral value, and collection efforts, that the borrower's financial condition is such that collection of interest is doubtful. Any loan greater than 90 days past due must be well secured and in the process of collection to continue accruing interest. Cash payments received on nonaccrual loans generally are applied against principal, and interest income is only recorded once principal recovery is reasonably assured. Loans are not reclassified as accruing until principal and interest payments remain current for a period of time, generally six months, and future payments appear reasonably certain. Included in certain loan categories of impaired loans are troubled debt restructurings that were classified as impaired. A restructuring of a debt constitutes a troubled debt restructuring if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider.

Loan origination and commitment fees and certain direct loan origination costs are deferred and the net amount amortized over the estimated life of the related loans, leases, or commitments as a yield adjustment.

Allowance for Loan and Lease Losses – We maintain an allowance for loan and lease losses ("ALLL") at a level that is appropriate to cover estimated credit losses on individually evaluated loans determined to be impaired, as well as estimated credit losses inherent in the remainder of the loan and lease portfolio. Since arriving at an appropriate ALLL involves a high degree of management judgment, we use an ongoing quarterly analysis to develop a range of estimated losses. In accordance with accounting principles generally accepted in the United States, we use our best estimate within the range of potential credit loss to determine the appropriate ALLL. Credit losses are charged and recoveries are credited to the ALLL.

We utilize an internal risk grading system for commercial credits. Those larger commercial credits that exhibit probable or observed credit weaknesses are subject to individual review. The borrower's cash flow, adequacy of collateral coverage, and other options available to CTBI, including legal remedies, are evaluated. The review of individual loans includes those loans that are impaired as defined by ASC 310-35, Impairment of a Loan. We evaluate the collectability of both principal and interest when assessing the need for loss provision. Historical loss rates are analyzed and applied to other commercial loans not subject to specific allocations. The ALLL allocation for this pool of commercial loans is established based on the historical average, maximum, minimum, and median loss ratios.

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

Homogenous loans, such as consumer installment, residential mortgages, and home equity lines are not individually risk graded. The associated ALLL for these loans is measured under ASC 450, Contingencies.

When any secured commercial loan is considered uncollectable, whether past due or not, a current assessment of the value of the underlying collateral is made. If the balance of the loan exceeds the fair value of the collateral, the loan is placed on non-accrual and the loan is charged down to the value of the collateral less estimated cost to sell or a specific reserve equal to the difference between book value of the loan and the fair value assigned to the collateral is created until such time as the loan is foreclosed. When the foreclosed collateral has been legally assigned to CTBI, a charge off is taken, if necessary, in order that the remaining balance reflects the fair value estimated less costs to sell of the collateral then transferred to other real estate owned or other repossessed assets. When any unsecured commercial loan is considered uncollectable the loan is charged off no later than at 90 days past due.

All closed-end consumer loans (excluding conventional 1-4 family residential loans and installment and revolving loans secured by real estate) are charged off no later than 120 days (5 monthly payments) delinquent. If a loan is considered uncollectable, it is charged off earlier than 120 days delinquent. For conventional 1-4 family residential loans and installment and revolving loans secured by real estate, when a loan is 90 days past due, a current assessment of the value of the real estate is made. If the balance of the loan exceeds the fair value of the property, the loan is placed on nonaccrual. Foreclosure proceedings are normally initiated after 120 days. When the foreclosed property has been legally assigned to CTBI, the fair value less estimated costs to sell is transferred to other real estate owned and the remaining balance is taken as a charge-off.

Historical loss rates for loans are adjusted for significant factors that, in management’s judgment, reflect the impact of any current conditions on loss recognition. We continue to use twelve rolling quarters for our historical loss rate analysis. Factors that we consider include delinquency trends, current economic conditions and trends, strength of supervision and administration of the loan portfolio, levels of underperforming loans, level of recoveries to prior year’s charge-offs, trends in loan losses, industry concentrations and their relative strengths, amount of unsecured loans, and underwriting exceptions. Based upon management’s judgment, “best case,” “worst case,” and “most likely” scenarios are determined. The total of each of these weighted factors is then applied against the applicable portion of the portfolio and the ALLL is adjusted accordingly to approximate the most likely scenario. Management continually reevaluates the other subjective factors included in its ALLL analysis.

Other Real Estate Owned – When foreclosed properties are acquired, appraisals are obtained and the properties are booked at the current market value less expected sales costs. Additionally, periodic updated appraisals are obtained on unsold foreclosed properties. When an updated appraisal reflects a market value below the current book value, a charge is booked to current earnings to reduce the property to its new market value less expected sales costs. Our policy for determining the frequency of periodic reviews is based upon consideration of the specific properties and the known or perceived market fluctuations in a particular market and is typically between 12 and 18 months but generally not more than 24 months. All revenues and expenses related to the carrying of other real estate owned are recognized by a charge to income.

Note 2 – Stock-Based Compensation

CTBI’s compensation expense related to stock option grants was $2 thousand for each of the three months ended June 30, 2014 and 2013 and $6 thousand and $5 thousand, respectively, for the six months ended June 30, 2014 and 2013. Restricted stock expense for the three months ended June 30, 2014 and 2013 was $151 thousand and $169 thousand, respectively, including $30 thousand and $31 thousand in dividends paid for each period. Restricted stock expense for the six months ended June 30, 2014 and 2013 was $338 thousand and $330 thousand, respectively, including $60 thousand and $62 thousand in dividends. As of June 30, 2014, there was a total of $10 thousand of unrecognized compensation expense related to unvested stock option awards that will be recognized as expense as the awards vest over a weighted average period of 2.3 years and a total of $1.2 million of unrecognized compensation expense related to restricted stock grants that will be recognized as expense as the awards vest over a weighted average period of 1.8 years.

There were no shares of restricted stock granted during the three months ended June 30, 2014 or 2013. There were 4,347 and 11,904 shares of restricted stock granted during the six months ended June 30, 2014 and 2013, respectively. The restrictions on the restricted stock lapse ratably over four years or in the event of a change in control of CTBI or the death of the participant. In the event of the disability of the participant, the restrictions will lapse on a pro rata basis. The Compensation Committee of the Board of Directors will have discretion to review and revise restrictions applicable to a participant's restricted stock in the event of the participant's retirement. There were no options granted to purchase shares of CTBI common stock during the three or six months ended June 30, 2014. There also were no options granted during the three months ended June 30, 2013, but 1,650 options were granted during the six months ended June 30, 2013.

The fair value of options granted during the six months ended June 30, 2013, were established at the date of grant using a Black-Scholes option pricing model with the weighted average assumptions as follows:

	Six Months Ended June 30 2013	
Expected dividend yield	3.74	%
Risk-free interest rate	1.33	%
Expected volatility	39.11	%
Expected term (in years)	7.5	
Weighted average fair value of options	$8.23	

Note 3 – Securities

Securities are classified into held-to-maturity and available-for-sale categories. Held-to-maturity (HTM) securities are those that CTBI has the positive intent and ability to hold to maturity and are reported at amortized cost. Available-for-sale (AFS) securities are those that CTBI may decide to sell if needed for liquidity, asset-liability management or other reasons. Available-for-sale securities are reported at fair value, with unrealized gains or losses included as a separate component of equity, net of tax.

The amortized cost and fair value of securities at June 30, 2014 are summarized as follows:

Available-for-Sale

(in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses		Fair Value
U.S. Treasury and government agencies	$139,938	$429	$(2,490	)	$137,877
State and political subdivisions	134,394	3,607	(897	)	137,104
U.S. government sponsored agency mortgage-backed securities	347,790	3,643	(3,629	)	347,804
Total debt securities	622,122	7,679	(7,016	)	622,785
Marketable equity securities	25,000	0	(249	)	24,751
Total available-for-sale securities	$647,122	$7,679	$(7,265	)	$647,536

Held-to-Maturity

(in thousands)	Fair Value

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
U.S. Treasury and government agencies	$480	$0	$(31)	$449
State and political subdivisions	1,182	1	0	1,183
Total held-to-maturity securities	$1,662	$1	$(31)	$1,632

The amortized cost and fair value of securities as of December 31, 2013 are summarized as follows:

Available-for-Sale

(in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury and government agencies	$65,524	$225	$(5,139)	$60,610
State and political subdivisions	118,055	1,907	(3,259)	116,703
U.S. government sponsored agency mortgage-backed securities	383,174	4,325	(8,189)	379,310
Total debt securities	566,753	6,457	(16,587)	556,623
Marketable equity securities	55,000	0	(2,218)	52,782
Total available-for-sale securities	$621,753	$6,457	$(18,805)	$609,405

Held-to-Maturity

(in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury and government agencies	$480	$0	$(62)	$418
State and political subdivisions	1,182	1	0	1,183
Total held-to-maturity securities	$1,662	$1	$(62)	$1,601

The amortized cost and fair value of securities at June 30, 2014 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available-for-Sale		Held-to-Maturity	
(in thousands)	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$3,443	$3,482	$0	$0
Due after one through five years	106,802	107,691	0	0
Due after five through ten years	126,757	126,150	1,182	1,183
Due after ten years	37,330	37,658	480	449
U.S. government sponsored agency mortgage-backed securities	347,790	347,804	0	0
Total debt securities	622,122	622,785	1,662	1,632
Marketable equity securities	25,000	24,751	0	0
Total securities	$647,122	$647,536	$1,662	$1,632

During the six months ended June 30, 2014, there was a combined loss of $111 thousand. A pre-tax gain of $1.8 million and a pre-tax loss of $1.9 million were realized during the year. During the six months ended June 30, 2013, there was a combined loss of $8 thousand.

The amortized cost of securities pledged as collateral, to secure public deposits and for other purposes, was $243.0 million at June 30, 2014 and $257.5 million at December 31, 2013.

The amortized cost of securities sold under agreements to repurchase amounted to $260.1 million at June 30, 2014 and $255.4 million at December 31, 2013.

Certain investments in debt and marketable equity securities are reported in the financial statements at amounts less than their historical costs. CTBI evaluates its investment portfolio on a quarterly basis for impairment. The analysis performed as of June 30, 2014 indicates that all impairment is considered temporary, market driven, and not credit-related. The percentage of total investments with unrealized losses as of June 30, 2014 was 46.3% compared to 67.8% as of December 31, 2013. The following tables provide the amortized cost, gross unrealized losses, and fair market value, aggregated by investment category and length of time the individual securities have been in a continuous unrealized loss position as of June 30, 2014 that are not deemed to be other-than-temporarily impaired.

Available-for-Sale

(in thousands)	Amortized Cost	Gross Unrealized Losses	Fair Value
Less Than 12 Months			
U.S. Treasury and government agencies	$3,031	$(19)	$3,012
State and political subdivisions	4,555	(19)	4,536
U.S. government sponsored agency mortgage-backed securities	88,171	(556)	87,615
Total debt securities	95,757	(594)	95,163
Marketable equity securities	0	0	0
Total <12 months temporarily impaired AFS securities	95,757	(594)	95,163
12 Months or More			
U.S. Treasury and government agencies	55,519	(2,471)	53,048
State and political subdivisions	31,336	(878)	30,458
U.S. government sponsored agency mortgage-backed securities	99,468	(3,073)	96,395
Total debt securities	186,323	(6,422)	179,901
Marketable equity securities	25,000	(249)	24,751
Total ≥12 months temporarily impaired AFS securities	211,323	(6,671)	204,652
Total			
U.S. Treasury and government agencies	58,550	(2,490)	56,060
State and political subdivisions	35,891	(897)	34,994
U.S. government sponsored agency mortgage-backed securities	187,639	(3,629)	184,010
Total debt securities	282,080	(7,016)	275,064
Marketable equity securities	25,000	(249)	24,751
Total temporarily impaired AFS securities	$307,080	$(7,265)	$299,815

Held-to-Maturity

(in thousands)	Amortized Cost	Gross Unrealized Losses	Fair Value
12 Months or More			
U.S. Treasury and government agencies	$480	$(31)	$449

Total temporarily impaired HTM securities	$480	$(31)	$449

U.S. Treasury and Government Agencies

The unrealized losses in U.S. Treasury and government agencies were caused by interest rate increases. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than amortized cost. CTBI does not consider those investments to be other-than-temporarily impaired at June 30, 2014, because CTBI does not intend to sell the investments and it is not more likely than not that we will be required to sell the investments before recovery of their amortized cost, which may be at maturity.

State and Political Subdivisions

The unrealized losses in securities of state and political subdivisions were caused by interest rate increases. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than amortized cost. CTBI does not consider those investments to be other-than-temporarily impaired at June 30, 2014, because CTBI does not intend to sell the investments before recovery of their amortized cost, which may be at maturity.

U.S. Government Sponsored Agency Mortgage-Backed Securities

The unrealized losses in U.S. government sponsored agency mortgage-backed securities were caused by interest rate increases. CTBI expects to recover the amortized cost basis over the term of the securities. CTBI does not consider those investments to be other-than-temporarily impaired at June 30, 2014, because the decline in market value is attributable to changes in interest rates and not credit quality, and because CTBI does not intend to sell the investments and it is not more likely than not we will be required to sell the investments before recovery of their amortized cost, which may be at maturity.

Marketable Equity Securities

CTBI's investments in marketable equity securities consist of investments in fixed income mutual funds ($24.8 million of the total fair value and $249 thousand of the total unrealized losses in common stock investments). The severity of the impairment (fair value is approximately 1.0% less than cost) and the duration of the impairment correlates with the rise in interest rates during the latter half of 2013. CTBI evaluated the near-term prospects of these funds in relation to the severity and duration of the impairment. Based on that evaluation, CTBI does not consider those investments to be other-than-temporarily impaired at June 30, 2014.

The analysis performed as of December 31, 2013 indicated that all impairment was considered temporary, market driven, and not credit-related. The following tables provide the amortized cost, gross unrealized losses, and fair market value, aggregated by investment category and length of time the individual securities have been in a continuous unrealized loss position as of December 31, 2013 that are not deemed to be other-than-temporarily impaired.

Available-for-Sale

(in thousands)	Amortized Cost	Gross Unrealized Losses	Fair Value
Less Than 12 Months			
U.S. Treasury and government agencies	$21,750	$(1,617)	$20,133
State and political subdivisions	57,165	(2,789)	54,376
U.S. government sponsored agency mortgage-backed securities	248,705	(8,182)	240,523
Total debt securities	327,620	(12,588)	315,032

Marketable equity securities	55,000	(2,218)	52,782
Total <12 months temporarily impaired AFS securities	382,620	(14,806)	367,814
12 Months or More			
U.S. Treasury and government agencies	35,750	(3,522)	32,228
State and political subdivisions	7,639	(470)	7,169
U.S. government sponsored agency mortgage-backed securities	6,579	(7)	6,572
Total ≥12 months temporarily impaired AFS securities	49,968	(3,999)	45,969
Total			
U.S. Treasury and government agencies	57,500	(5,139)	52,361
State and political subdivisions	64,804	(3,259)	61,545
U.S. government sponsored agency mortgage-backed securities	255,284	(8,189)	247,095
Total debt securities	377,588	(16,587)	361,001
Marketable equity securities	55,000	(2,218)	52,782
Total temporarily impaired AFS securities	$432,588	$(18,805)	$413,783

Held-to-Maturity

(in thousands)	Amortized Cost	Gross Unrealized Losses	Fair Value
12 Months or More			
U.S. Treasury and government agencies	$480	$(62)	$418
Total temporarily impaired HTM securities	$480	$(62)	$418

Note 4 – Loans

Major classifications of loans, net of unearned income, deferred loan origination costs, and net premiums on acquired loans, are summarized as follows:

(in thousands)	June 30 2014	December 31 2013
Commercial construction	$113,420	$110,779
Commercial secured by real estate	905,996	872,542
Equipment lease financing	7,928	8,840
Commercial other	354,944	374,881
Real estate construction	61,184	56,075
Real estate mortgage	698,403	697,601
Home equity	87,279	84,880
Consumer direct	119,610	122,215
Consumer indirect	283,845	287,541
Total loans	$2,632,609	$2,615,354

CTBI has segregated and evaluates its loan portfolio through nine portfolio segments. CTBI serves customers in small and mid-sized communities in eastern, northeastern, central, and south central Kentucky, southern West Virginia, and northeastern Tennessee. Therefore, CTBI's exposure to credit risk is significantly affected by changes in these communities.

Commercial construction loans are for the purpose of erecting or rehabilitating buildings or other structures for commercial purposes, including any infrastructure necessary for development. Included in this category are improved property, land development, and tract development loans. The terms of these loans are generally short-term with permanent financing upon completion.

Commercial real estate loans include loans secured by nonfarm, nonresidential properties, 1-4 family/multi-family properties, farmland, and other commercial real estate. These loans are originated based on the borrower's ability to service the debt and secondarily based on the fair value of the underlying collateral.

Equipment lease financing loans are fixed, variable, and tax exempt leases for commercial purposes.

Commercial other loans consist of commercial check loans, agricultural loans, receivable financing, floorplans, loans to financial institutions, loans for purchasing or carrying securities, and other commercial purpose loans. Commercial loans are underwritten based on the borrower's ability to service debt from the business's underlying cash flows. As a general practice, we obtain collateral such as real estate, equipment, or other assets, although such loans may be uncollateralized but guaranteed.

Real estate construction loans are typically for owner-occupied properties. The terms of these loans are generally short-term with permanent financing upon completion.

Residential real estate loans are a mixture of fixed rate and adjustable rate first and second lien residential mortgage loans. As a policy, CTBI holds adjustable rate loans and sells the majority of its fixed rate first lien mortgage loans into the secondary market. Changes in interest rates or market conditions may impact a borrower's ability to meet contractual principal and interest payments. Residential real estate loans are secured by real property.

Home equity lines are revolving adjustable rate credit lines secured by real property.

Consumer direct loans are fixed rate products comprised of unsecured loans, consumer revolving credit lines, deposit secured loans, and all other consumer purpose loans.

Consumer indirect loans are fixed rate loans secured by automobiles, trucks, vans, and recreational vehicles originated at the selling dealership underwritten and purchased by CTBI's indirect lending department. Both new and used products are financed. Only dealers who have executed dealer agreements with CTBI participate in the indirect lending program.

Not included in the loan balances above were loans held for sale in the amount of $0.9 million at June 30, 2014 and $0.8 million at December 31, 2013, respectively.

Refer to note 1 to the condensed consolidated financial statements for further information regarding our nonaccrual policy. Nonaccrual loans segregated by class of loans were as follows:

(in thousands)	June 30 2014	December 31 2013
Commercial:		
Commercial construction	$4,668	$4,519
Commercial secured by real estate	12,568	6,576
Commercial other	2,563	2,801
Residential:		
Real estate construction	162	481

Real estate mortgage	5,338	5,152
Home equity	426	429
Total nonaccrual loans	$25,725	$19,958

The following tables present CTBI's loan portfolio aging analysis, segregated by class, as of June 30, 2014 and December 31, 2013:

	June 30, 2014						
(in thousands)	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total Loans	90+ and Accruing*
Commercial:							
Commercial construction	$30	$0	$6,088	$6,118	$107,302	$113,420	$1,420
Commercial secured by real estate	7,323	2,694	15,885	25,902	880,094	905,996	4,018
Equipment lease financing	0	0	0	0	7,928	7,928	0
Commercial other	1,236	742	7,700	9,678	345,266	354,944	5,404
Residential:							
Real estate construction	150	75	704	929	60,255	61,184	542
Real estate mortgage	1,074	4,211	11,184	16,469	681,934	698,403	6,428
Home equity	533	142	934	1,609	85,670	87,279	572
Consumer:							
Consumer direct	1,250	247	79	1,576	118,034	119,610	79
Consumer indirect	2,262	543	344	3,149	280,696	283,845	344
Total	$13,858	$8,654	$42,918	$65,430	$2,567,179	$2,632,609	$18,807

	December 31, 2013						
(in thousands)	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total Loans	90+ and Accruing*
Commercial:							
Commercial construction	$250	$166	$6,012	$6,428	$104,351	$110,779	$1,673
Commercial secured by real estate	3,703	1,982	16,660	22,345	850,197	872,542	12,403
Equipment lease financing	0	0	0	0	8,840	8,840	0
Commercial other	344	422	6,156	6,922			