AMERISERV FINANCIAL INC /PA/
Form 10-Q
August 08, 2014

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 period ended **June 30, 2014**
o	**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 **0-11204**

AmeriServ Financial, Inc.

(Exact name of registrant as specified in its charter)

Pennsylvania (State or other jurisdiction of incorporation or organization)	25-1424278 (I.R.S. Employer Identification No.)

Main & Franklin Streets, P.O. Box 430, Johnstown, PA	15907-0430
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code **(814) 533-5300**

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 x No o

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 x No o

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

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

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

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

Class	Outstanding at August 1, 2014
Common Stock, par value $0.01	18,794,888

TABLE OF CONTENTS

AmeriServ Financial, Inc.

INDEX

TABLE OF CONTENTS

Item 1. Financial Statements

AmeriServ Financial, Inc.

CONSOLIDATED BALANCE SHEETS (In thousands except shares) (Unaudited)

	June 30, 2014	December 31, 2013
ASSETS		
Cash and due from depository institutions	$20,000	$20,288
Interest bearing deposits	2,963	2,967
Short-term investments in money market funds	5,050	6,811
Total cash and cash equivalents	28,013	30,066
Investment securities:		
Available for sale	134,504	141,978
Held to maturity (fair value $19,263 on June 30, 2014 and $17,788 on December 31, 2013)	19,099	18,187
Loans held for sale	4,689	3,402
Loans	800,557	783,927
Less: Unearned income	571	581
Allowance for loan losses	10,150	10,104
Net loans	789,836	773,242
Premises and equipment, net	13,400	13,119
Accrued interest income receivable	3,186	2,908
Goodwill	12,613	12,613
Bank owned life insurance	37,040	36,669
Net deferred tax asset	8,717	9,572
Federal Home Loan Bank stock	4,518	4,677
Federal Reserve Bank stock	2,125	2,125
Other assets	5,977	7,478
TOTAL ASSETS	$1,063,717	$1,056,036
LIABILITIES		
Non-interest bearing deposits	$153,416	$154,002
Interest bearing deposits	720,492	700,520
Total deposits	873,908	854,522
Short-term borrowings	18,677	41,555
Advances from Federal Home Loan Bank	34,000	25,000
Guaranteed junior subordinated deferrable interest debentures	13,085	13,085
Total borrowed funds	65,762	79,640
Other liabilities	8,101	8,567

TOTAL LIABILITIES	947,771	942,729
SHAREHOLDERS EQUITY		
Preferred stock, no par value; $1,000 per share liquidation preference; 2,000,000 shares authorized; 21,000 shares issued and outstanding on June 30, 2014 and December 31, 2013	21,000	21,000
Common stock, par value $0.01 per share; 30,000,000 shares authorized; 26,412,707 shares issued and 18,794,888 outstanding on June 30, 2014; 26,402,007 shares issued and 18,784,188 outstanding on December 31, 2013	264	264
Treasury stock at cost, 7,617,819 shares on June 30, 2014 and December 31, 2013	(74,829)	(74,829)
Capital surplus	145,235	145,190
Retained earnings	28,985	27,557
Accumulated other comprehensive loss, net	(4,709)	(5,875)
TOTAL SHAREHOLDERS EQUITY	115,946	113,307
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$1,063,717	$1,056,036

See accompanying notes to unaudited consolidated financial statements.

AmeriServ Financial, Inc. CONSOLIDATED BALANCE SHEETS (In thousands except shares) (Unaudited) 6

TABLE OF CONTENTS

AmeriServ Financial, Inc.

CONSOLIDATED STATEMENTS OF OPERATIONS (In thousands, except per share data) (Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
INTEREST INCOME				
Interest and fees on loans	$ 8,939	$ 8,590	$ 17,971	$ 17,218
Interest bearing deposits	1	3	2	4
Short-term investments in money market funds	2	4	4	6
Investment securities:				
Available for sale	905	907	1,829	1,863
Held to maturity	136	123	272	238
Total Interest Income	9,983	9,627	20,078	19,329
INTEREST EXPENSE				
Deposits	1,240	1,288	2,451	2,638
Short-term borrowings	5	8	24	13
Advances from Federal Home Loan Bank	74	30	134	55
Guaranteed junior subordinated deferrable interest debentures	280	280	560	560
Total Interest Expense	1,599	1,606	3,169	3,266
NET INTEREST INCOME	8,384	8,021	16,909	16,063
Provision (credit) for loan losses		150		(100)
NET INTEREST INCOME AFTER PROVISION (CREDIT) FOR LOAN LOSSES	8,384	7,871	16,909	16,163
NON-INTEREST INCOME				
Trust and investment advisory fees	1,948	1,999	3,980	3,880
Service charges on deposit accounts	501	538	979	1,049
Net gains on sale of loans	171	241	272	627
Mortgage related fees	160	228	277	429
Net realized gains on investment securities	120		177	71
Bank owned life insurance	184	388	371	589
Other income	554	681	1,114	1,246
Total Non-Interest Income	3,638	4,075	7,170	7,891
NON-INTEREST EXPENSE				
Salaries and employee benefits	6,107	6,176	12,421	12,507
Net occupancy expense	717	751	1,556	1,524
Equipment expense	494	455	964	910
Professional fees	1,464	1,150	2,772	2,185
Supplies, postage and freight	187	211	370	422

Miscellaneous taxes and insurance	312	365	608	741
Federal deposit insurance expense	154	151	314	285
Other expense	1,185	1,183	2,353	2,490
Total Non-Interest Expense	10,620	10,442	21,358	21,064

See accompanying notes to unaudited consolidated financial statements.

AmeriServ Financial, Inc. CONSOLIDATED STATEMENTS OF OPERATIONS (In thousands, except per share da 8

TABLE OF CONTENTS

AmeriServ Financial, Inc.

CONSOLIDATED STATEMENTS OF OPERATIONS (continued)
(In thousands, except per share data)
(Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
PRETAX INCOME	$1,402	$1,504	$2,721	$2,990
Provision for income tax expense	423	434	812	864
NET INCOME	979	1,070	1,909	2,126
Preferred stock dividends	52	52	105	104
NET INCOME AVAILABLE TO COMMON SHAREHOLDERS	$927	$1,018	$1,804	$2,022
PER COMMON SHARE DATA:				
Basic:				
Net income	$0.05	$0.05	$0.10	$0.11
Average number of shares outstanding	18,795	19,039	18,790	19,103
Diluted:				
Net income	$0.05	$0.05	$0.10	$0.11
Average number of shares outstanding	18,936	19,128	18,920	19,192
Cash dividends declared	$0.01	$0.01	$0.02	$0.01

See accompanying notes to unaudited consolidated financial statements.

TABLE OF CONTENTS

AmeriServ Financial, Inc.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands)
(Unaudited)

	Three Months Ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
COMPREHENSIVE INCOME				
Net income	$979	$1,070	$1,909	$2,126
Other comprehensive income (loss), before tax:				
Pension obligation change for defined benefit plan		334	392	823
Income tax effect		(114)	(133)	(280)
Unrealized holding gains (losses) on available for sale securities arising during period	1,037	(3,122)	1,551	(3,604)
Income tax effect	(353)	1,062	(527)	1,224
Reclassification adjustment for gains on available for sale securities included in net income	(120)		(177)	(71)
Income tax effect	41		60	24
Other comprehensive income (loss)	605	(1,840)	1,166	(1,884)
Comprehensive income (loss)	$1,584	$(770)	$3,075	$242

See accompanying notes to unaudited consolidated financial statements.

4

TABLE OF CONTENTS

AmeriServ Financial, Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS (In thousands) (Unaudited)

	Six months ended June 30, 2014	2013
OPERATING ACTIVITIES		
Net income	$ 1,909	$ 2,126
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision (credit) for loan losses		(100)
Depreciation expense	924	782
Net amortization of investment securities	186	449
Net realized gains on investment securities available for sale	(177)	(71)
Net gains on loans held for sale	(272)	(627)
Amortization of deferred loan fees	(134)	(159)
Origination of mortgage loans held for sale	(18,393)	(33,789)
Sales of mortgage loans held for sale	17,378	38,367
Increase in accrued interest income receivable	(278)	(282)
Decrease in accrued interest payable	(306)	(526)
Earnings on bank owned life insurance	(371)	(402)
Deferred income taxes	254	831
Stock based compensation expense	45	37
Decrease in prepaid Federal Deposit Insurance		1,444
Other, net	1,336	683
Net cash provided by operating activities	2,101	8,763
INVESTING ACTIVITIES		
Purchases of investment securities available for sale	(7,144)	(30,907)
Purchases of investment securities held to maturity	(1,599)	(6,432)
Proceeds from sales of investment securities available for sale	5,242	1,218
Proceeds from maturities of investment securities available for sale	10,763	27,547
Proceeds from maturities of investment securities held to maturity	667	1,496
Purchases of regulatory stock	(3,897)	(2,316)
Proceeds from redemption of regulatory stock	4,056	1,629
Long-term loans originated	(76,648)	(96,463)
Principal collected on long-term loans	59,696	77,971
Loans purchased or participated	(1,764)	(8,000)
Loans sold or participated	2,250	1,000
Proceeds from sale of other real estate owned	434	173
Proceeds from life insurance policy		356

Purchases of premises and equipment	(1,198)	(1,826)
Net cash used in investing activities	(9,142)	(34,554)

See accompanying notes to unaudited consolidated financial statements.

TABLE OF CONTENTS

AmeriServ Financial, Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)
(In thousands)
(Unaudited)

	Six months ended June 30, 2014	2013
FINANCING ACTIVITIES		
Net increase in deposit balances	$ 19,347	$ 4,459
Net (decrease) increase in other short-term borrowings	(22,878)	18,632
Principal borrowings on advances from Federal Home Loan Bank	9,000	9,000
Principal repayments on advances from Federal Home Loan Bank		(6,000)
Purchases of treasury stock		(1,171)
Common stock dividends	(376)	(190)
Preferred stock dividends	(105)	(104)
Net cash provided by financing activities	4,988	24,626
NET DECREASE IN CASH AND CASH EQUIVALENTS	(2,053)	(1,165)
CASH AND CASH EQUIVALENTS AT JANUARY 1	30,066	26,820
CASH AND CASH EQUIVALENTS AT JUNE 30	$ 28,013	$ 25,655

See accompanying notes to unaudited consolidated financial statements.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Principles of Consolidation

The accompanying consolidated financial statements include the accounts of AmeriServ Financial, Inc. (the Company) and its wholly-owned subsidiaries, AmeriServ Financial Bank (the Bank), AmeriServ Trust and Financial Services Company (the Trust Company), and AmeriServ Life Insurance Company (AmeriServ Life). The Bank is a Pennsylvania state-chartered full service bank with 17 locations in Pennsylvania. The Trust Company offers a complete range of trust and financial services and administers assets valued at $1.8 billion that are not reported on the Company s balance sheet at June 30, 2014. AmeriServ Life is a captive insurance company that engages in underwriting as a reinsurer of credit life and disability insurance.

In addition, the Parent Company is an administrative group that provides support in such areas as audit, finance, investments, loan review, general services, and marketing. Significant intercompany accounts and transactions have been eliminated in preparing the consolidated financial statements.

2. Basis of Preparation

The unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. In the opinion of management, all adjustments consisting of normal recurring entries considered necessary for a fair presentation have been included. They are not, however, necessarily indicative of the results of consolidated operations for a full-year.

For further information, refer to the consolidated financial statements and accompanying notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2013.

3. Recent Accounting Pronouncements

In July 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2013-11, *Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists.* This Update applies to all entities that have unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists at the reporting date. An unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The assessment of whether a deferred tax asset is available is based on the unrecognized tax benefit and deferred tax asset that exist at the reporting date and should be made presuming disallowance of the tax position at the reporting date. The amendments in this Update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. Early adoption is permitted. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. This ASU did not have a significant impact on the Company s financial statements.

In January 2014, the FASB issued ASU 2014-04, *Receivables Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure.* The amendments in this Update clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the

7

TABLE OF CONTENTS

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

3. Recent Accounting Pronouncements (continued)

recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in this Update are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. An entity can elect to adopt the amendments in this Update using either a modified retrospective transition method or a prospective transition method. This ASU is not expected to have a significant impact on the Company s financial statements.

4. Earnings Per Common Share

Basic earnings per share include only the weighted average common shares outstanding. Diluted earnings per share include the weighted average common shares outstanding and any potentially dilutive common stock equivalent shares in the calculation. Treasury shares are treated as retired for earnings per share purposes. Options to purchase 3,625 common shares, at exercise prices ranging from $4.60 to $5.22, and 101,070 common shares, at exercise prices ranging from $3.23 to $5.75, were outstanding as of June 30, 2014 and 2013, respectively, but were not included in the computation of diluted earnings per common share because to do so would be antidilutive. Dividends on preferred shares are deducted from net income in the calculation of earnings per common share.

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
	(In thousands, except per share data)			
Numerator:				
Net income	$ 979	$ 1,070	$ 1,909	$ 2,126
Preferred stock dividends	52	52	105	104
Net income available to common shareholders	$ 927	$ 1,018	$ 1,804	$ 2,022
Denominator:				
Weighted average common shares outstanding (basic)	18,795	19,039	18,790	19,103
Effect of stock options	141	89	130	89
Weighted average common shares outstanding (diluted)	18,936	19,128	18,920	19,192
Earnings per common share:				
Basic	$ 0.05	$ 0.05	$ 0.10	$ 0.11
Diluted	0.05	0.05	0.10	0.11

5. Consolidated Statement of Cash Flows

On a consolidated basis, cash and cash equivalents include cash and due from depository institutions, interest-bearing deposits, federal funds sold and short-term investments in money market funds. The Company made $558,000 in income tax payments in the first six months of 2014 as compared to $34,000 for the first six months of 2013. The Company made total interest payments of $3,475,000 in the first six months of 2014 compared to $3,792,000 in the same 2013 period. The Company had $6,000 non-cash transfers to other real estate owned (OREO) in the first six months of 2014 compared to $593,000 in the same 2013 period.

8

TABLE OF CONTENTS

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

6. Investment Securities

The cost basis and fair values of investment securities are summarized as follows (in thousands):

Investment securities available for sale (AFS):

	June 30, 2014			
	Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
US Agency	$ 6,928	$ 41	$ (45)	$ 6,924
US Agency mortgage-backed securities	111,629	3,574	(542)	114,661
Corporate bonds	12,993	61	(135)	12,919
Total	$ 131,550	$ 3,676	$ (722)	$ 134,504

Investment securities held to maturity (HTM):

	June 30, 2014			
	Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
US Agency mortgage-backed securities	$ 13,231	$ 365	$ (159)	$ 13,437
Taxable municipal	1,873	44	(40)	1,877
Corporate bonds and other securities	3,995		(46)	3,949
Total	$ 19,099	$ 409	$ (245)	$ 19,263

Investment securities available for sale (AFS):

	December 31, 2013			
	Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
US Agency	$ 6,926	$ 35	$ (126)	$ 6,835
US Agency mortgage-backed securities	121,480	3,129	(1,227)	123,382
Corporate bonds	11,992	21	(252)	11,761
Total	$ 140,398	$ 3,185	$ (1,605)	$ 141,978

Investment securities held to maturity (HTM):

	December 31, 2013			
	Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
US Agency mortgage-backed securities	$ 12,671	$ 289	$ (477)	$ 12,483
Taxable municipal	1,521		(120)	1,401
Corporate bonds and other securities	3,995		(91)	3,904
Total	$ 18,187	$ 289	$ (688)	$ 17,788

Maintaining investment quality is a primary objective of the Company s investment policy which, subject to certain limited exceptions, prohibits the purchase of any investment security below a Moody s Investor s Service or Standard & Poor s rating of A. At June 30, 2014, 87.5% of the portfolio was rated AAA as compared to 89.0% at December 31, 2013. 2.0% of the portfolio was either rated below A or unrated at June 30, 2014. The Company has no exposure to subprime mortgage loans in the investment portfolio. At June 30, 2014, the Company s consolidated investment securities portfolio had an effective duration of approximately 3.11 years.

9

TABLE OF CONTENTS

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

6. Investment Securities (continued)

Total proceeds from the sale of AFS securities for the second quarter of 2014 were $2.5 million resulting in $120,000 of gross investment security gains. Total proceeds from the sale of AFS securities for the first six months of 2014 were $5.2 million resulting in $182,000 of gross investment security gains and $5,000 of gross security losses. Total proceeds from the sale of AFS securities for the first six months of 2013 were $1.2 million resulting in $71,000 of gross investment security gains. The Company had no sales of AFS securities in the second quarter of 2013.

The book value of securities, both available for sale and held to maturity, pledged to secure public and trust deposits, and certain Federal Home Loan Bank borrowings was $121,224,000 at June 30, 2014 and $110,780,000 at December 31, 2013.

The following tables present information concerning investments with unrealized losses as of June 30, 2014 and December 31, 2013 (in thousands):

Total investment securities:

	June 30, 2014					
	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
US Agency	$50	$ (1)	$3,855	$ (44)	$3,905	$ (45)
US Agency mortgage-backed securities	5,268	(31)	27,360	(670)	32,628	(701)
Taxable municipal	149	(3)	974	(37)	1,123	(40)
Corporate bonds and other securities	4,926	(69)	6,886	(112)	11,812	(181)
Total	$10,393	$ (104)	$39,075	$ (863)	$49,468	$ (967)

Total investment securities:

	December 31, 2013					
	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
US Agency	$3,812	$ (64)	$938	$ (62)	$4,750	$ (126)
US Agency mortgage-backed securities	52,163	(1,701)	669	(3)	52,832	(1,704)
Taxable municipal	891	(120)			891	(120)
Corporate bonds and other securities	9,687	(300)	2,957	(43)	12,644	(343)
Total	$66,553	$ (2,185)	$4,564	$ (108)	$71,117	$ (2,293)

The unrealized losses are primarily a result of increases in market yields from the time of purchase. In general, as market yields rise, the value of securities will decrease; as market yields fall, the fair value of securities will increase. There are 44 positions that are considered temporarily impaired at June 30, 2014. Management generally views changes in fair value caused by changes in interest rates as temporary; therefore, these securities have not been classified as other-than-temporarily impaired. Management has also concluded that based on current information we expect to continue to receive scheduled interest payments as well as the entire principal balance. Furthermore, management does not intend to sell these securities and does not believe it will be required to sell these securities before they recover in value.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

6. Investment Securities (continued)

Contractual maturities of securities at June 30, 2014 are shown below (in thousands). Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without prepayment penalties.

Total investment securities:

	June 30, 2014			
	Available for sale		Held to maturity	
	Cost Basis	Fair Value	Cost Basis	Fair Value
Within 1 year	$	$	$ 1,000	$ 996
After 1 year but within 5 years	15,043	15,218	2,000	1,975
After 5 years but within 10 years	18,089	18,358	3,340	3,260
After 10 years but within 15 years	58,879	60,192	1,011	974
Over 15 years	39,539	40,736	11,748	12,058
Total	$ 131,550	$ 134,504	$ 19,099	$ 19,263

7. Loans

The loan portfolio of the Company consists of the following (in thousands):

	June 30, 2014	December 31, 2013
Commercial	$ 133,736	$ 120,102
Commercial loans secured by real estate	401,861	411,691
Real estate-mortgage	247,317	235,689
Consumer	17,072	15,864
Loans, net of unearned income	$ 799,986	$ 783,346

Loan balances at June 30, 2014 and December 31, 2013 are net of unearned income of $571,000 and $581,000, respectively. Real estate-construction loans comprised 2.8% and 3.0% of total loans, net of unearned income at June 30, 2014 and December 31, 2013, respectively.

8. Allowance for Loan Losses

The following tables summarize the rollforward of the allowance for loan losses by portfolio segment for the three and six month periods ending June 30, 2014 and 2013 (in thousands).

	Three months ended June 30, 2014				
	Balance at March 31, 2014	Charge-Offs	Recoveries	Provision (Credit)	Balance at June 30, 2014
Commercial	$ 3,065	$	$ 55	$ 134	$ 3,254
Commercial loans secured by real estate	4,662		19	(206)	4,475
Real estate-mortgage	1,273	(30)	11	47	1,301
Consumer	139	(22)	8	20	145
Allocation for general risk	970			5	975
Total	$ 10,109	$ (52)	$ 93	$	$ 10,150

11

TABLE OF CONTENTS

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

8. Allowance for Loan Losses (continued)

	Three months ended June 30, 2013				
	Balance at March 31, 2013	Charge-Offs	Recoveries	Provision (Credit)	Balance at June 30, 2013
Commercial	$ 2,667	$	$ 20	$ 93	$ 2,780
Commercial loans secured by real estate	5,989		34	(40)	5,983
Real estate-mortgage	1,267	(18)	12	18	1,279
Consumer	147	(41)	28	12	146
Allocation for general risk	890			67	957
Total	$ 10,960	$ (59)	$ 94	$ 150	$ 11,145

	Six months ended June 30, 2014				
	Balance at December 31, 2013	Charge-Offs	Recoveries	Provision (Credit)	Balance at June 30, 2014
Commercial	$ 2,844	$ (72)	$ 105	$ 377	$ 3,254
Commercial loans secured by real estate	4,885	(66)	172	(516)	4,475
Real estate-mortgage	1,260	(73)	25	89	1,301
Consumer	136	(58)	13	54	145
Allocation for general risk	979			(4)	975
Total	$ 10,104	$ (269)	$ 315	$	$ 10,150

	Six months ended June 30, 2013				
	Balance at December 31, 2012	Charge-Offs	Recoveries	Provision (Credit)	Balance at June 30, 2013
Commercial	$ 2,596	$	$ 31	$ 153	$ 2,780
Commercial loans secured by real estate	7,796	(1,480)	142	(475)	5,983
Real estate-mortgage	1,269	(47)	67	(10)	1,279
Consumer	150	(79)	40	35	146
Allocation for general risk	760			197	957
Total	$ 12,571	$ (1,606)	$ 280	$ (100)	$ 11,145

As a result of successful ongoing problem credit resolution efforts, the Company achieved further asset quality improvements in 2014 and 2013, specifically in the commercial loans secured by real estate category, which resulted in no provision in 2014 and a credit provision in 2013.

12

TABLE OF CONTENTS

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

8. Allowance for Loan Losses (continued)

The following tables summarize the loan portfolio and allowance for loan loss by the primary segments of the loan portfolio (in thousands).

	At June 30, 2014					
	Commercial	Commercial Loans Secured by Real Estate	Real Estate-Mortgage	Consumer	Allocation for General Risk	Total
Loans:						
Individually evaluated for impairment	$	$ 2,350	$	$		$ 2,350
Collectively evaluated for impairment	133,736	399,511	247,317	17,072		797,636
Total loans	$ 133,736	$ 401,861	$ 247,317	$ 17,072		$ 799,986
Allowance for loan losses:						
Specific reserve allocation	$	$ 1,025	$	$	$	$ 1,025
General reserve allocation	3,254	3,450	1,301	145	975	9,125
Total allowance for loan losses	$ 3,254	$ 4,475	$ 1,301	$ 145	$ 975	$ 10,150

	At December 31, 2013					
	Commercial	Commercial Loans Secured by Real Estate	Real Estate-Mortgage	Consumer	Allocation for General Risk	Total
Loans:						
Individually evaluated for impairment	$	$ 3,005	$	$ 61		$ 3,066
Collectively evaluated for impairment	120,102	408,686	235,689	15,803		780,280
Total loans	$ 120,102	$ 411,691	$ 235,689	$ 15,864		$ 783,346
Allowance for loan losses:						
Specific reserve allocation	$	$ 812	$	$ 1	$	$ 813
General reserve allocation	2,844	4,073	1,260	135	979	9,291
Total allowance for loan losses	$ 2,844	$ 4,885	$ 1,260	$ 136	$ 979	$ 10,104

The segments of the Company s loan portfolio are disaggregated to a level that allows management to monitor risk and performance. The loan segments used are consistent with the internal reports evaluated by the Company s management and Board of Directors to monitor risk and performance within various segments of its loan portfolio and therefore, no further disaggregation into classes is necessary. The overall risk profile for the commercial loan segment is impacted by non-owner occupied CRE loans, which include loans secured by non-owner occupied nonfarm nonresidential properties, as a meaningful but declining portion of the commercial portfolio is centered in these types of accounts. The residential mortgage loan segment is comprised of first lien amortizing residential mortgage loans and home equity loans. The consumer loan segment consists primarily of installment loans and overdraft lines of credit connected with customer deposit accounts.

Management evaluates for possible impairment any individual loan in the commercial or commercial real estate segment with a loan balance in excess of $100,000 that is in nonaccrual status or classified as a Troubled Debt Restructure (TDR). Loans are considered to be impaired when, based on current information and events, it is probable that the Company 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

TABLE OF CONTENTS

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

8. Allowance for Loan Losses (continued)

management in evaluating impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. 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. The Company does not separately evaluate individual consumer and residential mortgage loans for impairment, unless such loans are part of a larger relationship that is impaired, or are classified as a TDR.

Once the determination has been made that a loan is impaired, the determination of whether a specific allocation of the allowance is necessary is measured by comparing the recorded investment in the loan to the fair value of the loan using one of three methods: (a) the present value of expected future cash flows discounted at the loan s effective interest rate; (b) the loan s observable market price; or (c) the fair value of the collateral less selling costs for collateral dependent loans. The method is selected on a loan-by-loan basis, with management primarily utilizing the fair value of collateral method. The evaluation of the need and amount of a specific allocation of the allowance and whether a loan can be removed from impairment status is made on a quarterly basis. The Company s policy for recognizing interest income on impaired loans does not differ from its overall policy for interest recognition.

The need for an updated appraisal on collateral dependent loans is determined on a case-by-case basis. The useful life of an appraisal or evaluation will vary depending upon the circumstances of the property and the economic conditions in the marketplace. A new appraisal is not required if there is an existing appraisal which, along with other information, is sufficient to determine a reasonable value for the property and to support an appropriate and adequate allowance for loan losses. At a minimum, annual documented reevaluation of the property is completed by the Bank s internal Assigned Risk Department to support the value of the property.

When reviewing an appraisal associated with an existing collateral real estate dependent transaction, the Bank s internal Assigned Risk Department must determine if there have been material changes to the underlying assumptions in the appraisal which affect the original estimate of value. Some of the factors that could cause material changes to reported values include:

- the passage of time;
- the volatility of the local market;
- the availability of financing;
- natural disasters;
- the inventory of competing properties;
- new improvements to, or lack of maintenance of, the subject property or competing properties upon physical inspection by the Bank;
- changes in underlying economic and market assumptions, such as material changes in current and projected vacancy, absorption rates, capitalization rates, lease terms, rental rates, sales prices, concessions, construction overruns and delays, zoning changes, etc.; and/or
- environmental contamination.

The value of the property is adjusted to appropriately reflect the above listed factors and the value is discounted to reflect the value impact of a forced or distressed sale, any outstanding senior liens, any outstanding unpaid real estate taxes, transfer taxes and closing costs that would occur with sale of the real estate. If the Assigned Risk Department personnel determine that a reasonable value cannot be derived based on available information, a new appraisal is ordered. The determination of the need for a new appraisal, versus completion of a property valuation by the Bank s Assigned Risk Department personnel rests with the Assigned Risk Department and not the originating account officer.

14

TABLE OF CONTENTS

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

8. Allowance for Loan Losses (continued)

The following tables present impaired loans by class, segregated by those for which a specific allowance was required and those for which a specific allowance was not necessary (in thousands).

	June 30, 2014				
	Impaired Loans with Specific Allowance		Impaired Loans with no Specific Allowance	Total Impaired Loans	
	Recorded Investment	Related Allowance	Recorded Investment	Recorded Investment	Unpaid Principal Balance
Commercial loans secured by real estate	$ 2,350	$ 1,025	$	$ 2,350	$ 2,420
Total impaired loans	$ 2,350	$ 1,025	$	$ 2,350	$ 2,420

	December 31, 2013				
	Impaired Loans with Specific Allowance		Impaired Loans with no Specific Allowance	Total Impaired Loans	
	Recorded Investment	Related Allowance	Recorded Investment	Recorded Investment	Unpaid Principal Balance
Commercial loans secured by real estate	$ 3,005	$ 812	$	$ 3,005	$ 3,118
Consumer	61	1		61	61
Total impaired loans	$ 3,066	$ 813	$	$ 3,066	$ 3,179

The following table presents the average recorded investment in impaired loans and related interest income recognized for the periods indicated (in thousands).

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Average loan balance:				
Commercial loans secured by real estate	$2,296	$ 2,294	$2,678	$ 3,131
Consumer		12		12
Average investment in impaired loans	$2,296	$ 2,306	$2,678	$ 3,143
Interest income recognized:				
Commercial loans secured by real estate	$1	$	$2	$

Interest income recognized on a cash basis on impaired loans	$1	$	$2	$

Management uses a nine point internal risk rating system to monitor the credit quality of the overall loan portfolio. The first six categories are considered not criticized. The first five Pass categories are aggregated, while the Pass-6, Special Mention, Substandard and Doubtful categories are disaggregated to separate pools. The criticized rating categories utilized by management generally follow bank regulatory definitions. The Special Mention category includes assets that are currently protected but are potentially weak, resulting in an undue and unwarranted credit risk, but not to the point of justifying a Substandard classification. Loans in the Substandard category have well-defined weaknesses that jeopardize the liquidation of the debt, and have a distinct possibility that some loss will be sustained if the weaknesses are not corrected. Loans in the Doubtful category have all the weaknesses inherent in a credit classified Substandard with weaknesses pronounced to a point where collection or liquidation in full, on the basis of current facts, conditions, and value is highly questionable, but the extent of loss is not currently determinable. All loans greater than 90 days past due, or for which any portion of the loan represents a specific allocation of the allowance for loan losses are placed in Substandard or Doubtful.

15

TABLE OF CONTENTS

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

8. Allowance for Loan Losses (continued)

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a loan as agreed, the Company has a structured loan rating process, which dictates that, at a minimum, credit reviews are mandatory for all commercial and commercial mortgage loan relationships with aggregate balances in excess of $250,000 within a 12-month period. Generally, consumer and residential mortgage loans are included in the Pass categories unless a specific action, such as bankruptcy, delinquency, or death occurs to raise awareness of a possible credit event. The Company s commercial relationship managers are responsible for the timely and accurate risk rating of the loans in their portfolios at origination and on an ongoing basis. Risk ratings are assigned by the account officer, but require independent review and rating concurrence from the Company s internal Loan Review Department. The Loan Review Department is an experienced independent function which reports directly to the Board s Audit Committee. The scope of commercial portfolio coverage by the Loan Review Department is defined and presented to the Audit Committee for approval on an annual basis. The approved scope of coverage for 2014 required review of a minimum range of 50% to 55% of the commercial loan portfolio.

In addition to loan monitoring by the account officer and Loan Review Department, the Company also requires presentation of all credits rated Pass-6 with aggregate balances greater than $1,000,000, all credits rated Special Mention or Substandard with aggregate balances greater than $250,000, and all credits rated Doubtful with aggregate balances greater than $100,000 on an individual basis to the Company s Loan Loss Reserve Committee on a quarterly basis. Additionally, the Asset Quality Task Force, which is a group comprised of senior level personnel, meets monthly to monitor the status of problem loans.

The following table presents the classes of the commercial loan portfolios summarized by the aggregate Pass and the criticized categories of Special Mention, Substandard and Doubtful within the internal risk rating system (in thousands).

	June 30, 2014				
	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	$ 125,021	$ 2,177	$ 6,397	$ 141	$ 133,736
Commercial loans secured by real estate	392,813	3,699	4,648	701	401,861
Total	$ 517,834	$ 5,876	$ 11,045	$ 842	$ 535,597

	December 31, 2013				
	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	$ 108,623	$ 8,880	$ 2,599	$	$ 120,102
Commercial loans secured by real estate	396,788	6,961	7,482	460	411,691
Total	$ 505,411	$ 15,841	$ 10,081	$ 460	$ 531,793

16

TABLE OF CONTENTS

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

8. Allowance for Loan Losses (continued)

It is generally the policy of the bank that the outstanding balance of any residential mortgage loan that exceeds 90-days past due as to principal and/or interest is transferred to non-accrual status and an evaluation is completed to determine the fair value of the collateral less selling costs, unless the balance is minor. A charge down is recorded for any deficiency balance determined from the collateral evaluation. The remaining non-accrual balance is reported as impaired with no specific allowance. It is the policy of the bank that the outstanding balance of any consumer loan that exceeds 90-days past due as to principal and/or interest is charged off. The following tables present the performing and non-performing outstanding balances of the residential and consumer portfolios (in thousands).

	June 30, 2014	
	Performing	Non-Performing
Real estate-mortgage	$ 245,709	$ 1,608
Consumer	17,072	
Total	$ 262,781	$ 1,608

	December 31, 2013	
	Performing	Non-Performing
Real estate-mortgage	$ 234,450	$ 1,239
Consumer	15,803	61
Total	$ 250,253	$ 1,300

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. The following tables present the classes of the loan portfolio summarized by the aging categories of performing loans and nonaccrual loans (in thousands).

	June 30, 2014						
	Current	30 59 Days Past Due	60 89 Days Past Due	90 Days Past Due	Total Past Due	Total Loans	90 Days Past Due and Still Accruing
Commercial	$133,703	$33	$	$	$33	$133,736	$
Commercial loans secured by real estate	400,367	180		1,314	1,494	401,861	
Real estate-mortgage	243,562	2,275	615	865	3,755	247,317	
Consumer	16,990	70	12		82	17,072	
Total	$794,622	$2,558	$ 627	$2,179	$5,364	$799,986	$

	December 31, 2013						
	Current	30 59 Days Past Due	60 89 Days Past Due	90 Days Past Due	Total Past Due	Total Loans	90 Days Past Due and Still Accruing
Commercial	$120,102	$	$	$	$	$120,102	$
Commercial loans secured by real estate	410,619	457		615	1,072	411,691	
Real estate-mortgage	231,740	2,232	670	1,047	3,949	235,689	
Consumer	15,804	33	27		60	15,864	
Total	$778,265	$2,722	$697	$1,662	$5,081	$783,346	$

An allowance for loan losses (ALL) is maintained to absorb losses from the loan portfolio. The ALL is based on management s continuing evaluation of the risk characteristics and credit quality of the loan portfolio, assessment of current economic conditions, diversification and size of the portfolio, adequacy of collateral, past and anticipated loss experience, and the amount of non-performing loans.

17

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

8. Allowance for Loan Losses (continued)

Loans that are collectively evaluated for impairment are analyzed with general allowances being made as appropriate. For general allowances, historical loss trends are used in the estimation of losses in the current portfolio. These historical loss amounts are complemented by consideration of other qualitative factors.

Management tracks the historical net charge-off activity at each risk rating grade level for the entire commercial portfolio and at the aggregate level for the consumer, residential mortgage and small business portfolios. A historical charge-off factor is calculated utilizing a rolling 12 consecutive historical quarters for the commercial portfolios. This historical charge-off factor for the consumer, residential mortgage and small business portfolios are based on a three year historical average of actual loss experience.

The Company uses a comprehensive methodology and procedural discipline to maintain an ALL to absorb inherent losses in the loan portfolio. The Company believes this is a critical accounting policy since it involves significant estimates and judgments. The allowance consists of three elements: 1) an allowance established on specifically identified problem loans, 2) formula driven general reserves established for loan categories based upon historical loss experience and other qualitative factors which include delinquency, non-performing and TDR loans, loan trends, economic trends, concentrations of credit, trends in loan volume, experience and depth of management, examination and audit results, effects of any changes in lending policies, and trends in policy, financial information, and documentation exceptions, and 3) a general risk reserve which provides support for variance from our assessment of the previously listed qualitative factors, provides protection against credit risks resulting from other inherent risk factors contained in the Company s loan portfolio, and recognizes the model and estimation risk associated with the specific and formula driven allowances. The qualitative factors used in the formula driven general reserves are evaluated quarterly (and revised if necessary) by the Company s management to establish allocations which accommodate each of the listed risk factors.

Pass rated credits are segregated from Criticized and Classified credits for the application of qualitative factors.

Management reviews the loan portfolio on a quarterly basis using a defined, consistently applied process in order to make appropriate and timely adjustments to the ALL. When information confirms all or part of specific loans to be uncollectible, these amounts are promptly charged off against the ALL.

9. Non-performing Assets Including Troubled Debt Restructurings (TDR)

The following table presents information concerning non-performing assets including TDR (in thousands, except percentages):

	June 30, 2014	December 31, 2013

Non-accrual loans		
Commercial loans secured by real estate	$2,132	$1,632
Real estate-mortgage	1,608	1,239
Total	3,740	2,871
Other real estate owned		
Commercial loans secured by real estate	344	344
Real estate-mortgage	167	673
Total	511	1,017
TDR s not in non-accrual	218	221
Total non-performing assets including TDR	$4,469	$4,109
Total non-performing assets as a percent of loans, net of unearned income, and other real estate owned	0.56 %	0.52 %

18

TABLE OF CONTENTS

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

9. Non-performing Assets Including Troubled Debt Restructurings (TDR) (continued)

The Company had no loans past due 90 days or more for the periods presented which were accruing interest.

The following table sets forth, for the periods indicated, (1) the gross interest income that would have been recorded if non-accrual loans had been current in accordance with their original terms and had been outstanding throughout the period or since origination if held for part of the period, (2) the amount of interest income actually recorded on such loans, and (3) the net reduction in interest income attributable to such loans (in thousands).

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Interest income due in accordance with original terms	$ 34	$ 39	$ 67	$ 102
Interest income recorded				
Net reduction in interest income	$ 34	$ 39	$ 67	$ 102

Consistent with accounting and regulatory guidance, the Bank recognizes a TDR when the Bank, for economic or legal reasons related to a borrower s financial difficulties, grants a concession to the borrower that would not normally be considered. Regardless of the form of concession granted, the Bank s objective in offering a troubled debt restructure is to increase the probability of repayment of the borrower s loan.

To be considered a TDR, both of the following criteria must be met:

- the borrower must be experiencing financial difficulties; and
- the Bank, for economic or legal reasons related to the borrower s financial difficulties, grants a concession to the borrower that would not otherwise be considered.

Factors that indicate a borrower is experiencing financial difficulties include, but are not limited to:

- the borrower is currently in default on their loan(s);
- the borrower has filed for bankruptcy;
- the borrower has insufficient cash flows to service their loan(s); and
- the borrower is unable to obtain refinancing from other sources at a market rate similar to rates available to a non-troubled debtor.

Factors that indicate that a concession has been granted include, but are not limited to:

- the borrower is granted an interest rate reduction to a level below market rates for debt with similar risk; or
- the borrower is granted a material maturity date extension, or extension of the amortization plan to provide payment relief. For purposes of this policy, a material maturity date extension will generally include any maturity date extension, or the aggregate of multiple consecutive maturity date extensions, that exceed 120 days. A restructuring that results in an insignificant delay in payment, i.e. 120 days or less, is not necessarily a TDR. Insignificant payment

delays occur when the amount of the restructured payments subject to the delay is insignificant relative to the unpaid principal or collateral value, and will result in an insignificant shortfall in the originally scheduled contractual amount due, and/or the delay in timing of the restructured payment period is insignificant relative to the frequency of payments, the original maturity or the original amortization.

The determination of whether a restructured loan is a TDR requires consideration of all of the facts and circumstances surrounding the modification. No single factor is determinative of whether a restructuring is a TDR. An overall general decline in the economy or some deterioration in a borrower s financial condition

19

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

9. Non-performing Assets Including Troubled Debt Restructurings (TDR) (continued)

does not automatically mean that the borrower is experiencing financial difficulty. Accordingly, determination of whether a modification is a TDR involves a large degree of judgment.

The following table details the loans modified as TDRs during the three month period ended June 30, 2014 (dollars in thousands).

Loans in non-accrual status	# of Loans	Current Balance	Concession Granted
Commercial loan secured by real estate	1	$ 141	Extension of maturity date

The following table details the loans modified as TDRs during the six month period ended June 30, 2014 (dollars in thousands).

Loans in non-accrual status	# of Loans	Current Balance	Concession Granted
Commercial loan secured by real estate	1	$ 253	Extension of maturity date

The Company had no loans modified as TDR s for the three or six month periods ended on June 30, 2013.

In all instances where loans have been modified in troubled debt restructurings the pre- and post-modified balances are the same. The specific ALL reserve for loans modified as TDR s was $542,000 and $372,000 as of June 30, 2014 and 2013, respectively.

Once a loan is classified as a TDR, this classification will remain until documented improvement in the financial position of the borrower supports confidence that all principal and interest will be paid according to terms. Additionally, the customer must have re-established a track record of timely payments according to the restructured contract terms for a minimum of six consecutive months prior to consideration for removing the loan from non-accrual TDR status. However, a loan will continue to be on non-accrual status until, consistent with our policy, the borrower has made a minimum of an additional six consecutive monthly payments in accordance with the terms of the loan.

The following table presents the recorded investment in loans that were modified as TDR s during each 12-month period prior to the current reporting periods, which begin January 1, 2014 and 2013 (six month periods) and April 1, 2014 and 2013 (3 month periods), respectively, and that subsequently defaulted during these reporting periods (dollars in thousands).

	Three months ended June 30,	Six months ended June 30,

	2014	2013	2014	2013
<u>Recorded investment of defaults</u>				
Commercial loan secured by real estate	$	$ 2,104	$	$ 656
Total	$	$ 2,104	$	$ 656

All TDR s are individually evaluated for impairment and a related allowance is recorded, as needed. All TDR s which defaulted in the above table had a related allowance adequate to reserve for anticipated losses.

The Company is unaware of any additional loans which are required to either be charged-off or added to the non-performing asset totals disclosed above. Other real estate owned is recorded at fair value minus estimated costs to sell.

20

TABLE OF CONTENTS

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

10. Federal Home Loan Bank Borrowings

Total Federal Home Loan Bank (FHLB) borrowings and advances consist of the following (in thousands, except percentages):

	At June 30, 2014			
Type	Maturing	Amount	Weighted Average Rate	
Open Repo Plus	Overnight	$ 18,677	0.25	%
Advances	2015	4,000	0.52	
	2016	12,000	0.81	
	2017	11,000	1.04	
	2018	7,000	1.47	
Total advances		34,000	0.99	
Total FHLB borrowings		$ 52,677	0.73	%

	At December 31, 2013			
Type	Maturing	Amount	Weighted Average Rate	
Open Repo Plus	Overnight	$ 41,555	0.25	%
Advances	2015	4,000	0.52	
	2016	12,000	0.81	
	2017	7,000	1.07	
	2018	2,000	1.47	
Total advances		25,000	0.89	
Total FHLB borrowings		$ 66,555	0.49	%

The rate on Open Repo Plus advances can change daily, while the rates on the advances are fixed until the maturity of the advance.

11. Preferred Stock

On August 11, 2011, pursuant to the Small Business Lending Fund (SBLF), the Company issued and sold to the US Treasury 21,000 shares of its Senior Non-Cumulative Perpetual Preferred Stock, Series E (Series E Preferred Stock) for the aggregate proceeds of $21 million. The SBLF is a voluntary program sponsored by the US Treasury that encourages small business lending by providing capital to qualified community banks at favorable rates. The initial interest rate on the Series E Preferred Stock has been initially set at 5% per annum and may be decreased to as low as 1% per annum if growth thresholds are met for qualified outstanding small business loans. The Company used the proceeds from the Series E Preferred Stock issued to the US Treasury to repurchase all 21,000 shares of its outstanding preferred shares previously issued to the US Treasury under the TARP Capital Purchase Program.

21

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

11. Preferred Stock (continued)

The Series E Preferred Stock has an aggregate liquidation preference of approximately $21 million and qualifies as Tier 1 Capital for regulatory purposes. The terms of the Series E Preferred Stock provide for the payment of non-cumulative dividends on a quarterly basis. The dividend rate, as a percentage of the liquidation amount, may fluctuate while the Series E Preferred Stock is outstanding based upon changes in the level of qualified small business lending (QSBL) by the Bank from its average level of QSBL at each of the four quarter ends leading up to June 30, 2010 (the Baseline) as follows:

DIVIDEND PERIOD ANNUALIZED		ANNUALIZED
BEGINNING	ENDING	DIVIDEND RATE
August 11, 2011	December 31, 2011	5.0%
January 1, 2012	December 31, 2013	1.0% to 5.0%
January 1, 2014	February 7, 2016	1.0% to 7.0%(1)
February 8, 2016	Redemption	9.0%(2)

(1) Between January 1, 2014 and February 7, 2016, the dividend rate was fixed at a rate in such range based upon the level of percentage change in QSBL between September 30, 2013 and the Baseline.

(2) Beginning on February 8, 2016, the dividend rate will be fixed at nine percent (9%) per annum.

As of September 30, 2013, the Company had increased its QSBL to a level that reduced the dividend rate to 1%. Accordingly, this 1% rate will continue through February 7, 2016.

As long as shares of Series E Preferred Stock remain outstanding, we may not pay dividends to our common shareholders (nor may we repurchase or redeem any shares of our common stock) during any quarter in which we fail to declare and pay dividends on the Series E Preferred Stock and for the next three quarters following such failure. In addition, under the terms of the Series E Preferred Stock, we may only declare and pay dividends on our common stock (or repurchase shares of our common stock), if, after payment of such dividend, the dollar amount of our Tier 1 capital would be at least ninety percent (90%) of Tier 1 capital as of June 30, 2011, excluding any charge-offs and redemptions of the Series E Preferred Stock (the Tier 1 Dividend Threshold). The Tier 1 Dividend Threshold is subject to reduction, beginning January 1, 2014, based upon the extent by which, if at all, the QSBL at September 30, 2013 has increased over the Baseline.

We may redeem the Series E Preferred Stock at any time at our option, at a redemption price of 100% of the liquidation amount plus accrued but unpaid dividends, subject to the approval of our federal banking regulator.

TABLE OF CONTENTS

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

12. Accumulated Other Comprehensive Loss

The following table presents the changes in each component of accumulated other comprehensive loss, net of tax, for the three months ended June 30, 2014 and 2013 (in thousands):

	Three months ended June 30, 2014			Three months ended June 30, 2013		
	Net Unrealized Gains and Losses on Investment Securities AFS(1)	Defined Benefit Pension Items(1)	Total(1)	Net Unrealized Gains and Losses on Investment Securities AFS(1)	Defined Benefit Pension Items(1)	Total(1)
Beginning balance	$1,345	$(6,659)	$(5,314)	$3,774	$(9,197)	$(5,423)
Other comprehensive income before Reclassifications	684		684	(2,060)		(2,060)
Amounts reclassified from accumulated other comprehensive loss	(79)		(79)		220	220
Net current period other comprehensive income (loss)	605		605	(2,060)	220	(1,840)
Ending balance	$1,950	$(6,659)	$(4,709)	$1,714	$(8,977)	$(7,263)

(1) Amounts in parentheses indicate debits.