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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2014

OR

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

For transition period from to

Commission File Number 0 -10537

OLD SECOND BANCORP, INC.

(Exact name of Registrant as specified in its charter)

Delaware	36-3143493

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification Number)

37 South River Street, Aurora, Illinois 60507

(Address of principal executive offices) (Zip Code)

(630) 892-0202

(Registrant's telephone number, including area code)

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

Yes 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 No

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

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

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

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date: As of November 7, 2014, the Registrant had outstanding 29,442,508 shares of common stock, $1.00 par value per share.

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OLD SECOND BANCORP, INC.

Form 10-Q Quarterly Report

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

Old Second Bancorp, Inc. and Subsidiaries

Consolidated Balance Sheets

(In thousands, except share data)

	(Unaudited) September 30, 2014	December 31, 2013
Assets		
Cash and due from banks	$ 33,260	$ 33,210
Interest bearing deposits with financial institutions	10,797	14,450
Cash and cash equivalents	44,057	47,660
Securities available-for-sale, at fair value	362,243	372,191
Securities held-to-maturity, at amortized cost	263,040	256,571
Federal Home Loan Bank and Federal Reserve Bank stock	9,058	10,292
Loans held-for-sale	3,422	3,822
Loans	1,140,882	1,101,256
Less: allowance for loan losses	23,330	27,281
Net loans	1,117,552	1,073,975
Premises and equipment, net	42,557	46,005
Other real estate owned	40,877	41,537
Mortgage servicing rights, net	5,640	5,807
Core deposit, net	-	1,177
Bank-owned life insurance (BOLI)	56,438	55,410
Deferred tax assets, net	71,375	75,303
Other assets	16,840	14,284
Total assets	$ 2,033,099	$ 2,004,034
Liabilities		
Deposits:		
Noninterest bearing demand	$ 380,687	$ 373,389
Interest bearing:		
Savings, NOW, and money market	848,372	836,300
Time	427,696	472,439
Total deposits	1,656,755	1,682,128
Securities sold under repurchase agreements	29,438	22,560
Other short-term borrowings	40,000	5,000
Junior subordinated debentures	58,378	58,378
Subordinated debt	45,000	45,000
Notes payable and other borrowings	500	500

Other liabilities	10,337	42,776
Total liabilities	1,840,408	1,856,342
Stockholders' Equity		
Preferred stock	47,331	72,942
Common stock	34,365	18,830
Additional paid-in capital	115,290	66,212
Retained earnings	98,786	92,549
Accumulated other comprehensive loss	(7,232)	(7,038)
Treasury stock	(95,849)	(95,803)
Total stockholders' equity	192,691	147,692
Total liabilities and stockholders' equity	$ 2,033,099	$ 2,004,034

	September 30, 2014		December 31, 2013	
	Preferred Stock	Common Stock	Preferred Stock	Common Stock
Par value	$ 1	$ 1	$ 1	$ 1
Liquidation value	1,000	n/a	1,000	n/a
Shares authorized	300,000	60,000,000	300,000	60,000,000
Shares issued	47,331	34,364,734	73,000	18,829,734
Shares outstanding	47,331	29,442,508	73,000	13,917,108
Treasury shares	-	4,922,226	-	4,912,626

See accompanying notes to consolidated financial statements.

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Old Second Bancorp, Inc. and Subsidiaries

Consolidated Statements of Operations

(In thousands, except share data)

	(unaudited) Three Months Ended September 30,		(unaudited) Nine Months Ended September 30,	
	2014	2013	2014	2013
Interest and dividend income				
Loans, including fees	$ 13,362	$ 14,327	$ 39,346	$ 43,153
Loans held-for-sale	38	38	92	124
Securities:				
Taxable	3,586	3,113	10,440	8,109
Tax exempt	110	148	376	441
Dividends from Federal Reserve Bank and Federal Home Loan Bank stock	78	76	232	228
Interest bearing deposits with financial institutions	25	22	60	91
Total interest and dividend income	17,199	17,724	50,546	52,146
Interest expense				
Savings, NOW, and money market deposits	175	206	562	655
Time deposits	1,073	1,674	3,604	5,327
Other short-term borrowings	5	6	10	26
Junior subordinated debentures	1,072	1,336	3,847	3,937
Subordinated debt	199	209	593	610
Notes payable and other borrowings	4	4	12	12
Total interest expense	2,528	3,435	8,628	10,567
Net interest and dividend income	14,671	14,289	41,918	41,579
Loan loss reserve release	-	(1,750)	(2,000)	(6,050)
Net interest and dividend income after provision for loan losses	14,671	16,039	43,918	47,629
Noninterest income				
Trust income	1,483	1,494	4,619	4,666
Service charges on deposits	1,838	1,904	5,354	5,379
Secondary mortgage fees	174	183	441	680
Mortgage servicing gain, net of changes in fair value	252	235	269	1,222
Net gain on sales of mortgage loans	914	814	2,614	4,601
Securities gains (loss), net	1,231	(7)	1,457	2,191
Increase in cash surrender value of bank-owned life insurance	304	419	1,028	1,198
Death benefit realized on bank-owned life insurance	-	6	-	381
Debit card interchange income	1,011	873	2,771	2,565
Other income	1,116	1,549	3,572	4,434
Total noninterest income	8,323	7,470	22,125	27,317
Noninterest expense				

Salaries and employee benefits	8,856	9,299	27,140	27,508
Occupancy expense, net	1,143	1,266	3,809	3,787
Furniture and equipment expense	989	1,026	2,956	3,274
FDIC insurance	649	987	1,555	3,046
General bank insurance	371	489	1,203	1,829
Amortization of core deposit	154	524	1,177	1,574
Advertising expense	291	347	1,053	841
Debit card interchange expense	418	366	1,208	1,072
Legal fees	332	615	998	1,424
Other real estate expense, net	2,007	2,544	4,665	8,943
Other expense	3,134	3,119	9,148	9,773
Total noninterest expense	18,344	20,582	54,912	63,071
Income before income taxes	4,650	2,927	11,131	11,875
Provision (benefit) for income taxes	1,726	(69,997)	3,984	(69,997)
Net income	$ 2,924	$ 72,924	$ 7,147	$ 81,872
Preferred stock dividends and accretion of discount	1,065	1,323	3,985	3,917
Dividends waived upon preferred stock redemption	-	-	(5,433)	-
Gain on preferred stock redemption	-	-	(1,348)	-
Net income available to common stockholders	$ 1,859	$ 71,601	$ 9,943	$ 77,955
Basic earnings per share	$ 0.06	$ 5.08	$ 0.41	$ 5.52
Diluted earnings per share	0.06	5.08	0.41	5.52

See accompanying notes to consolidated financial statements.

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Old Second Bancorp, Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income (Loss)

(In thousands)

	(Unaudited) Three Months Ended September 30,		(Unaudited) Nine Months Ended September 30,	
	2014	2013	2014	2013
Net Income	$ 2,924	$ 72,924	$ 7,147	$ 81,872
Unrealized holding (losses) gains on available-for-sale securities arising during the period	(2,224)	(3,411)	397	(16,780)
Related tax benefit (expense)	918	1,405	(161)	6,913
Holding (losses) gains after tax on available-for-sale securities	(1,306)	(2,006)	236	(9,867)
Less: Reclassification adjustment for the net gains realized during the period				
Net realized gains (losses)	1,231	(7)	1,457	2,191
Income tax (expense) benefit on net realized gains (losses)	(504)	3	(597)	(899)
Net realized gains (losses) after tax	727	(4)	860	1,292
Other comprehensive loss on available-for-sale securities	(2,033)	(2,002)	(624)	(11,159)
Accretion of net unrealized holding losses on held-to-maturity transferred from available-for-sale securities	237	87	731	87
Related tax expense	(97)	(36)	(301)	(36)
Other comprehensive income on held-to-maturity securities	140	51	430	51
Total other comprehensive loss	(1,893)	(1,951)	(194)	(11,108)
Total comprehensive income	$ 1,031	$ 70,973	$ 6,953	$ 70,764

See accompanying notes to consolidated financial statements.

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Old Second Bancorp, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(In thousands)

	(Unaudited) Nine Months Ended September 30, 2014	2013
Cash flows from operating activities		
Net income	$ 7,147	$ 81,872
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization of leasehold improvement	1,887	2,147
Change in fair value of mortgage servicing rights	761	(81)
Loan loss reserve release	(2,000)	(6,050)
Gain on recapture of restricted stock	-	(612)
Provision for deferred tax expense (benefit)	4,063	(70,161)
Originations of loans held-for-sale	(85,172)	(151,601)
Proceeds from sales of loans held-for-sale	87,569	160,966
Net gain on sales of mortgage loans	(2,614)	(4,601)
Change in current income taxes payable	(79)	(101)
Increase in cash surrender value of bank-owned life insurance	(1,028)	(1,198)
Death claim on bank-owned life insurance	-	396
Change in accrued interest receivable and other assets	(3,633)	(334)
Change in accrued interest payable and other liabilities	(22,108)	4,341
Net discount accretion on securities	(1,408)	(131)
Securities gains, net	(1,457)	(2,191)
Amortization of core deposit	1,177	1,574
Stock based compensation	189	123
Net gain on sale of other real estate owned	(610)	(1,175)
Provision for other real estate owned losses	2,781	6,537
Net gain on disposal of fixed assets	-	(5)
Loss on transfer of premises to other real estate owned	121	-
Net cash (used in) provided by operating activities	(14,414)	19,715
Cash flows from investing activities		
Proceeds from maturities and calls including pay down of securities available-for-sale	15,430	38,175
Proceeds from sales of securities available-for-sale	264,502	484,112
Purchases of securities available-for-sale	(268,639)	(564,372)
Proceeds from maturities and calls including pay down of securities held-to-maturity	5,934	541
Purchases of securities held-to-maturity	(11,212)	(21,382)
Proceeds from sales of Federal Home Loan Bank stock	1,234	910
Net change in loans	(53,037)	49,885
Improvements in other real estate owned	(637)	(60)

Proceeds from sales of other real estate owned	12,746	32,103
Proceeds from disposition of fixed assets	1	6
Net purchases of premises and equipment	(721)	(1,538)
Net cash (used in) provided by investing activities	(34,399)	18,380
Cash flows from financing activities		
Net change in deposits	(25,373)	(44,096)
Net change in securities sold under repurchase agreements	6,878	2,844
Net change in other short-term borrowings	35,000	(45,000)
Redemption of preferred stock	(24,321)	-
Proceeds from issuance of common stock	64,395	-
Dividends paid	(11,323)	-
Purchase of treasury stock	(46)	(278)
Net cash provided by (used in) financing activities	45,210	(86,530)
Net change in cash and cash equivalents	(3,603)	(48,435)
Cash and cash equivalents at beginning of period	47,660	128,507
Cash and cash equivalents at end of period	$ 44,057	$ 80,072

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Old Second Bancorp, Inc. and Subsidiaries

Consolidated Statements of Cash Flows - Continued

(In thousands)

	(Unaudited) Nine Months Ended September 30,	
Supplemental cash flow information	2014	2013
Income taxes paid	$ -	$ 266
Interest paid for deposits	4,412	6,144
Interest paid for borrowings	21,425	656
Non-cash transfer of loans to other real estate owned	11,460	14,196
Non-cash transfer of premises to other real estate owned	2,160	-
Non-cash transfer of loans to securities available-for-sale	-	5,329
Non-cash transfer of securities available-for-sale to securities held-to-maturity	-	237,154
Change in dividends accrued and declared but not paid	(9,123)	510
Accretion on preferred stock discount	58	798
Fair value difference on recapture of restricted stock	-	43

See accompanying notes to consolidated financial statements.

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Old Second Bancorp, Inc. and Subsidiaries

Consolidated Statements of Changes in

Stockholders' Equity

(In thousands)

	Common Stock	Preferred Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders' Equity
Balance, December 31, 2012	$ 18,729	$ 71,869	$ 66,189	$ 12,048	$ (1,327)	$ (94,956)	$ 72,552
Net income				81,872			81,872
Other comprehensive loss, net of tax					(11,108)		(11,108)
Change in restricted stock	101		(101)				-
Recapture of restricted stock			(43)			(569)	(612)
Stock based compensation			123				123
Purchase of treasury stock						(278)	(278)
Preferred stock accretion and declared dividends		798		(1,308)			(510)
Balance, September 30, 2013	$ 18,830	$ 72,667	$ 66,168	$ 92,612	$ (12,435)	$ (95,803)	$ 142,039
Balance, December 31, 2013	$ 18,830	$ 72,942	$ 66,212	$ 92,549	$ (7,038)	$ (95,803)	$ 147,692
Net income				7,147			7,147
Other comprehensive loss, net of tax					(194)		(194)
Change in restricted stock	10		(10)				-
Tax effect from vesting of restricted stock			29				29

Stock based compensation			189				189
Purchase of treasury stock						(46)	(46)
Redemption of preferred stock		(25,669)		1,348			(24,321)
Common stock offering	15,525		48,870				64,395
Preferred stock accretion and declared dividends		58		(2,258)			(2,200)
Balance, September 30, 2014	$ 34,365	$ 47,331	$ 115,290	$ 98,786	$ (7,232)	$ (95,849)	$ 192,691

See accompanying notes to consolidated financial statements.

Old Second Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Table amounts in thousands, except per share data, unaudited)

Note 1 – Summary of Significant Accounting Policies

The accounting policies followed in the preparation of the interim consolidated financial statements are consistent with those used in the preparation of the annual financial information. The interim consolidated financial statements reflect all normal and recurring adjustments, which are necessary, in the opinion of management, for a fair statement of results for the interim period presented. Results for the period ended September 30, 2014, are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. These interim consolidated financial statements are unaudited and should be read in conjunction with the audited financial statements and notes included in Old Second Bancorp, Inc.'s (the "Company") annual report on Form 10-K for the year ended December 31, 2013. Unless otherwise indicated, amounts in the tables contained in the notes to the consolidated financial statements are in thousands. Certain items in prior periods have been reclassified to conform to the current presentation.

The Company's consolidated financial statements are prepared in accordance with United States generally accepted accounting principles ("GAAP") and follow general practices within the banking industry. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the consolidated financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the consolidated financial statements. Future changes in information may affect these estimates, assumptions, and judgments, which, in turn, may affect amounts reported in the consolidated financial statements.

All significant accounting policies are presented in Note 1 to the consolidated financial statements included in the Company's annual report on Form 10-K for the year ended December 31, 2013. These policies, along with the disclosures presented in the other financial statement notes and in this discussion, provide information on how significant assets and liabilities are valued in the consolidated financial statements and how those values are determined.

Recent Accounting Pronouncements

In July 2013, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 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.” ASU 2013-11 amended existing guidance related to the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss or a tax credit carryforward exists. These amendments provide that an unrecognized tax benefit, or a portion thereof, 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 to the extent that a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date to settle any additional income taxes that would result from disallowance of a tax position, or the tax law does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, then the unrecognized tax benefit should be presented as a liability. These amendments are effective for interim and annual reporting periods beginning after December 15, 2013, and are incorporated in the financial statements contained in this report. The effect of adopting this standard does not have a material effect on the Company’s operating results or financial condition.

In January 2014, the FASB 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.” ASU 2014-04 is intended to reduce diversity in practice by clarifying when an in substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan should be derecognized and the real estate property recognized. ASU 2014-04 requires a creditor to reclassify a collateralized consumer mortgage loan to real estate property upon obtaining legal title to the real estate collateral, or the borrower voluntarily conveying all interest in the real estate property to the lender to satisfy the loan through a deed in lieu of foreclosure or similar legal agreement. ASU 2014-04 is effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. For entities other than public business entities, the amendments in the ASU are effective for annual periods beginning after December 15, 2014, and interim periods within annual periods beginning after December 15, 2015. The adoption of this standard is not expected to have a material effect to the Company’s operating results or financial condition.

In May 2014, the FASB issued ASU No. 2014-09 "Revenue from Contracts with Customers (Topic 606)." The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. The amendments can be applied retrospectively to each prior reporting period or retrospectively with the cumulative effect of initially applying this update recognized at the date of initial application. Early application is not permitted. The Company is assessing the impact of ASU 2014-09 on its accounting and disclosures.

In June 2014, FASB issued Accounting Standards Update (ASU) No. 2014-12 "Compensation - Stock Compensation (Topic 718) - Accounting for Share Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period." ASU 2014-12 requires that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. ASU 2014-12 is effective for interim and annual periods beginning after December 15, 2015. The amendments can be applied prospectively to all awards granted or modified after the effective date or retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented and to all new or modified awards thereafter. Early adoption is permitted. The adoption of this standard is not expected to have a material effect to the Company’s operating results or financial condition.

In August 2014, FASB issued ASU No. 2014-15 “Presentation of Financial Statements—Going Concern (Subtopic 205-40) Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern.” ASU 2014-15 provide guidance in GAAP about management’s responsibility to evaluate whether there is substantial doubt about an entity’s ability to continue as a going concern and to provide related footnote disclosures. ASU 2014-15 is effective for interim and annual periods beginning after December 15, 2016. The amendments in this Update are effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. The adoption of this standard is not expected to have a material effect to the Company’s operating results or financial condition.

Note 2 – Securities

Investment Portfolio Management

Our investment portfolio serves the liquidity and income needs of the Company. While the portfolio serves as an important component of the overall liquidity management at the Bank, portions of the portfolio will also serve as income producing assets. The size and composition of the portfolio reflects liquidity needs, loan demand and interest income objectives.

Portfolio size and composition will be adjusted from time to time. While a significant portion of the portfolio consists of readily marketable securities to address liquidity, other parts of the portfolio may reflect funds invested pending future loan demand or to maximize interest income without undue interest rate risk.

Investments are comprised of debt securities and non-marketable equity investments. Securities available-for-sale are carried at fair value. Unrealized gains and losses, net of tax, on securities available-for-sale are reported as a separate component of equity. This balance sheet component changes as interest rates and market conditions change. Unrealized gains and losses are not included in the calculation of regulatory capital.

Securities held-to-maturity are carried at amortized cost and the discount or premium created in the 2013 transfer from available-for-sale securities or at the time of purchase thereafter is accreted or amortized to the maturity or expected payoff date but not an earlier call. In accordance with GAAP, the Company has the positive intent and ability to hold the securities to maturity.

Nonmarketable equity investments include Federal Home Loan Bank of Chicago (“FHLBC”) stock and Federal Reserve Bank of Chicago (“Reserve Bank”) stock. FHLBC stock was recorded at $4.3 million and $5.5 million at September 30, 2014, and December 31, 2013, respectively. Reserve Bank stock was recorded at $4.8 million at September 30, 2014, and December 31, 2013. Our FHLBC stock is necessary to maintain access to FHLBC advances.

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The following table summarizes the amortized cost and fair value of the securities portfolio at September 30, 2014 and December 31, 2013 and the corresponding amounts of gross unrealized gains and losses (in thousands):

September 30, 2014:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available-for-Sale				
U.S. Treasury	$ 1,533	$ -	$ (1)	$ 1,532
U.S. government agencies	1,718	-	(80)	1,638
States and political subdivisions	13,794	313	(228)	13,879
Corporate bonds	31,272	65	(556)	30,781
Collateralized mortgage obligations	29,951	41	(1,575)	28,417
Asset-backed securities	194,927	98	(2,227)	192,798
Collateralized loan obligations	94,202	-	(1,004)	93,198
Total Securities Available-for-Sale	$ 367,397	$ 517	$ (5,671)	$ 362,243
Securities Held-to-Maturity				
U.S. government agency mortgage-backed	$ 37,321	$ 1,346	$ (11)	$ 38,656
Collateralized mortgage obligations	225,719	2,017	(2,049)	225,687
Total Securities Held-to-Maturity	$ 263,040	$ 3,363	$ (2,060)	$ 264,343

December 31, 2013:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available-for-Sale				
U.S. Treasury	$ 1,549	$ -	$ (5)	$ 1,544
U.S. government agencies	1,738	-	(66)	1,672
States and political subdivisions	16,382	629	(217)	16,794
Corporate bonds	15,733	17	(648)	15,102
Collateralized mortgage obligations	66,766	256	(3,146)	63,876
Asset-backed securities	274,118	2,168	(3,083)	273,203
Total Securities Available-for-Sale	$ 376,286	$ 3,070	$ (7,165)	$ 372,191
Securities Held-to-Maturity				
U.S. government agency mortgage-backed	$ 35,268	$ 45	$ (73)	$ 35,240
Collateralized mortgage obligations	221,303	643	(2,858)	219,088
Total Securities Held-to-Maturity	$ 256,571	$ 688	$ (2,931)	$ 254,328

The fair value, amortized cost and weighted average yield of debt securities at September 30, 2014, by contractual maturity, were as follows in the table below. Securities not due at a single maturity date are shown separately.

Securities Available-for-Sale	Amortized Cost	Weighted Average Yield	Fair Value
Due in one year or less	$ 410	4.50%	$ 421
Due after one year through five years	5,811	2.87%	5,992
Due after five years through ten years	36,724	2.44%	36,218
Due after ten years	5,372	3.31%	5,199
	48,317	2.61%	47,830
Collateralized mortgage obligations	29,951	2.46%	28,417
Asset-back securities	194,927	2.10%	192,798
Collateralized loan obligations	94,202	2.78%	93,198
	$ 367,397	2.37%	$ 362,243
Securities Held-to-Maturity			
Mortgage-backed and collateralized mortgage obligations	$ 263,040	3.05%	$ 264,343

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Securities with unrealized losses at September 30, 2014, and December 31, 2013, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, were as follows (in thousands except for number of securities):

nber 30, 2014	Less than 12 months in an unrealized loss position			Greater than 12 months in an unrealized loss position			Total		
ties ble-for-Sale	Number of Securities	Unrealized Losses	Fair Value	Number of Securities	Unrealized Losses	Fair Value	Number of Securities	Unrealized Losses	Fair Valu
reasury	1	$ 1	$ 1,532	-	$ -	$ -	1	$ 1	$ 1,5
overnment es	-	-	-	1	80	1,638	1	80	1,6
and political isions	3	215	4,450	2	13	1,862	5	228	6,3
rate bonds	5	463	20,581	2	93	2,411	7	556	22
eralized age tions	1	18	4,739	3	1,557	21,704	4	1,575	26
backed ies	10	1,231	117,440	3	996	44,042	13	2,227	16
eralized loan tions	13	1,004	93,198	-	-	-	13	1,004	93
	33	$ 2,932	$ 241,940	11	$ 2,739	$ 71,657	44	$ 5,671	$ 31
ties o-Maturity overnment y age-backed	1	$ 11	$ 1,972	-	$ -	$ -	1	$ 11	$ 1,9
eralized age tions	13	1,164	83,545	2	885	37,828	15	2,049	12
	14	$ 1,175	$ 85,517	2	$ 885	$ 37,828	16	$ 2,060	$ 12

mber 31, 2013	Less than 12 months in an unrealized loss position			Greater than 12 months in an unrealized loss position			Total		
rities able-for-Sale	Number of Securities	Unrealized Losses	Fair Value	Number of Securities	Unrealized Losses	Fair Value	Number of Securities	Unrealized Losses	Fai Val
Treasury	1	$ 5	$ 1,544	-	$ -	$ -	1	$ 5	$ 1,54
	-	-	-	1	66	1,672	1	66	1,67

government cies									
s and political visions	6	217	4,625	-	-	-	6	217	4,62
orate bonds	4	429	10,493	2	219	2,796	6	648	13,2
teralized gage ations	5	3,146	54,021	-	-	-	5	3,146	54,0
-backed ities	11	2,836	99,466	2	247	6,368	13	3,083	105
	27	$ 6,633	$ 170,149	5	$ 532	$ 10,836	32	$ 7,165	$ 180
rities -to-Maturity									
government cy gage-backed	6	$ 73	$ 19,134	-	$ -	$ -	6	$ 73	$ 19,
teralized gage ations	19	2,858	156,632	-	-	-	19	2,858	156
	25	$ 2,931	$ 175,766	-	$ -	$ -	25	$ 2,931	$ 175

Recognition of other-than-temporary impairment was not necessary in the nine months ended September 30, 2014, or the year ended December 31, 2013. The changes in fair value related primarily to interest rate fluctuations. Our review of other-than-temporary impairment confirmed no credit quality deterioration.

Note 3 – Loans

Major classifications of loans were as follows:

	September 30, 2014	December 31, 2013
Commercial	$ 106,592	$ 94,736
Real estate - commercial	600,649	560,233
Real estate - construction	41,936	29,351
Real estate - residential	365,602	390,201
Consumer	3,142	2,760
Overdraft	1,198	628
Lease financing receivables	8,398	10,069
Other	12,757	12,793
	1,140,274	1,100,771
Net deferred loan fees	608	485
	$ 1,140,882	$ 1,101,256

It is the policy of the Company to review each prospective credit in order to determine if an adequate level of security or collateral was obtained prior to making a loan. The type of collateral, when required, will vary from liquid assets to real estate. The Company's access to collateral, in the event of borrower default, is assured through adherence to lending laws, the Company's lending standards and credit monitoring procedures. The Bank generally makes loans solely within its market area. There are no significant concentrations of loans where the customers' ability to honor loan terms is dependent upon a single economic sector although the real estate related categories listed above represent 88.4% and 89.0% of the portfolio at September 30, 2014, and December 31, 2013, respectively.

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Aged analysis of past due loans by class of loans were as follows:

September 30, 2014	30-59 Days Past	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Current	Nonaccrual	Total Loans	Recorded Investment 90 days or Greater Past Due and Accruing
Commercial	$ 99	$ -	$ -	$ 99	$ 113,246	$ 1,645	$ 114,990	$ -
Real estate - commercial								
Owner occupied general purpose	32	-	-	32	132,123	5,973	138,128	-
Owner occupied special purpose	-	-	-	-	166,561	3,802	170,363	-
Non-owner occupied general purpose	-	-	-	-	150,073	6,421	156,494	-
Non-owner occupied special purpose	-	-	-	-	84,410	1,472	85,882	-
Retail properties	-	-	-	-	34,692	-	34,692	-
Farm	-	-	-	-	15,090	-	15,090	-
Real estate - construction								
Homebuilder	-	-	-	-	3,232	-	3,232	-
Land	-	-	-	-	1,684	209	1,893	-
Commercial speculative	-	-	-	-	15,859	-	15,859	-
All other	-	-	-	-	20,367	585	20,952	-
Real estate - residential								
Investor	173	722	-	895	127,490	1,901	130,286	-
Owner occupied	96	230	-	326	109,990	7,204	117,520	-
Revolving and junior liens	105	78	44	227	115,273	2,296	117,796	44
Consumer	6	-	-	6	3,136	-	3,142	-
All other1	-	-	-	-	14,563	-	14,563	-
	$ 511	$ 1,030	$ 44	$ 1,585	$ 1,107,789	$ 31,508	$ 1,140,882	$ 44

December 31, 2013	30-59 Days Past	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Current	Nonaccrual	Total Loans	Recorded Investment 90 days or Greater Past Due and Accruing
Commercial	$ -	$ -	$ -	$ -	$ 104,778	$ 27	$ 104,805	$ -
Real estate - commercial								
Owner occupied general purpose	290	526	-	816	117,938	3,180	121,934	-
Owner occupied special purpose	511	-	-	511	164,277	7,671	172,459	-
Non-owner occupied general purpose	218	-	-	218	132,331	5,708	138,257	-
Non-owner occupied special purpose	-	-	-	-	73,325	661	73,986	-
Retail properties	-	-	-	-	34,034	3,144	37,178	-
Farm	-	-	-	-	16,419	-	16,419	-
Real estate - construction								
Homebuilder	-	-	-	-	3,515	168	3,683	-
Land	-	-	-	-	4,436	209	4,645	-
Commercial speculative	-	-	-	-	11,235	1,913	13,148	-
All other	32	-	-	32	7,404	439	7,875	-
Real estate - residential								
Investor	581	171	-	752	140,926	6,615	148,293	-
Owner occupied	4,414	308	87	4,809	106,184	5,967	116,960	87
Revolving and junior liens	650	76	-	726	121,013	3,209	124,948	-
Consumer	5	-	-	5	2,755	-	2,760	-
All other1	-	-	-	-	13,906	-	13,906	-
	$ 6,701	$ 1,081	$ 87	$ 7,869	$ 1,054,476	$ 38,911	$ 1,101,256	$ 87

1. The "All other" class includes overdrafts and net deferred costs.

Credit Quality Indicators:

The Company categorizes loans into credit risk categories based on current financial information, overall debt service coverage, comparison against industry averages, historical payment experience, and current economic trends. This analysis includes loans with outstanding balances or commitments greater than $50,000 and excludes homogeneous loans such as home equity lines of credit and residential mortgages. Loans with a classified risk rating are reviewed quarterly regardless of size or loan type. The Company uses the following definitions for classified risk ratings:

Special Mention. Loans classified as special mention have a potential weakness that deserves management’s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan at some future date.

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Substandard. Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Credits that are not covered by the definitions above are pass credits, which are not considered to be adversely rated.

Credit Quality Indicators by class of loans were as follows:

September 30, 2014	Pass	Special Mention	Substandard 1	Doubtful	Total
Commercial	$ 106,620	$ 4,119	$ 4,251	$ -	$ 114,990
Real estate - commercial					
Owner occupied general purpose	129,530	913	7,685	-	138,128
Owner occupied special purpose	151,663	12,558	6,142	-	170,363
Non-owner occupied general purpose	145,153	1,872	9,469	-	156,494
Non-owner occupied special purpose	76,267	8,143	1,472	-	85,882
Retail Properties	32,450	2,242	-	-	34,692
Farm	15,090	-	-	-	15,090
Real estate - construction					
Homebuilder	3,232	-	-	-	3,232
Land	1,684	-	209	-	1,893
Commercial speculative	11,815	540	3,504	-	15,859
All other	20,367	-	585	-	20,952
Real estate - residential					
Investor	126,879	-	3,407	-	130,286
Owner occupied	109,723	-	7,797	-	117,520
Revolving and junior liens	113,933	188	3,675	-	117,796
Consumer	3,141	-	1	-	3,142
All other	14,563	-	-	-	14,563
Total	$ 1,062,110	$ 30,575	$ 48,197	$ -	$ 1,140,882

December 31, 2013	Pass	Special Mention	Substandard 1	Doubtful	Total
Commercial	$ 96,371	$ 7,953	$ 481	$ -	$ 104,805
Real estate - commercial					
Owner occupied general purpose	105,683	9,048	7,203	-	121,934
Owner occupied special purpose	162,586	1,968	7,905	-	172,459
Non-owner occupied general purpose	122,844	1,826	13,587	-	138,257
Non-owner occupied special purpose	59,674	9,840	4,472	-	73,986
Retail Properties	30,059	2,989	4,130	-	37,178
Farm	16,419	-	-	-	16,419
Real estate - construction					
Homebuilder	1,745	1,770	168	-	3,683
Land	4,436	-	209	-	4,645
Commercial speculative	7,674	3,561	1,913	-	13,148
All other	7,109	32	734	-	7,875
Real estate - residential					
Investor	135,136	3,407	9,750	-	148,293
Owner occupied	109,261	-	7,699	-	116,960
Revolving and junior liens	120,589	388	3,971	-	124,948
Consumer	2,759	-	1	-	2,760
All other	13,906	-	-	-	13,906
Total	$ 996,251	$ 42,782	$ 62,223	$ -	$ 1,101,256

1 The substandard credit quality indicator includes both potential problem loans that are currently performing and nonperforming loans

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Impaired loans by class of loan were as follows:

	As of September 30, 2014			Nine Months Ended September 30, 2014	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded					
Commercial	$ 1,645	$ 2,173	$ -	$ 836	$ -
Commercial real estate					
Owner occupied general purpose	7,176	7,840	-	4,860	81
Owner occupied special purpose	3,217	4,147	-	3,294	-
Non-owner occupied general purpose	7,065	8,052	-	6,246	45
Non-owner occupied special purpose	1,472	1,935	-	1,067	-
Retail properties	-	-	-	1,572	-
Farm	-	-	-	-	-
Construction					
Homebuilder	1,791	1,791	-	1,903	69
Land	209	312	-	209	-
Commercial speculative	-	-	-	369	-
All other	306	347	-	155	-
Residential					
Investor	2,553	3,538	-	4,269	32
Owner occupied	11,735	13,214	-	10,457	128
Revolving and junior liens	2,028	3,163	-	1,899	4
Consumer	-	-		-	-
Total impaired loans with no recorded allowance	39,197	46,512	-	37,136	359
With an allowance recorded					
Commercial	-	-	-	-	-
Commercial real estate					
Owner occupied general purpose	-	-	-	365	-
Owner occupied special purpose	585	676	167	2,443	-
Non-owner occupied general purpose	-	-	-	469	-
Non-owner occupied special purpose	-	-	-	-	-
Retail properties	-	-	-	-	-
Farm	-	-	-	-	-
Construction					
Homebuilder	-	-	-	84	-
Land	-	-	-	-	-
Commercial speculative	-	-	-	588	-
All other	279	312	107	357	-
Residential					
Investor	139	149	79	412	-
Owner occupied	259	394	59	912	15

Revolving and junior liens	327	358	129	912	-
Consumer	-	-	-	-	-
Total impaired loans with a recorded allowance	1,589	1,889	541	6,542	15
Total impaired loans	$ 40,786	$ 48,401	$ 541	$ 43,678	$ 374

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Impaired loans by class of loans were as follows:

	As of December 31, 2013			Nine Months Ended September 30, 2013	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded					
Commercial	$ 27	$ 34	$ -	$ 113	$ -
Commercial real estate					
Owner occupied general purpose	2,543	3,006	-	3,565	3
Owner occupied special purpose	3,371	4,117	-	5,913	-
Non-owner occupied general purpose	5,428	6,709	-	11,995	113
Non-owner occupied special purpose	661	919	-	457	-
Retail properties	3,144	3,811	-	6,918	-
Farm	-	-	-	1,259	-
Construction					
Homebuilder	2,016	2,016	-	3,597	120
Land	209	308	-	231	-
Commercial speculative	738	742	-	2,089	-
All other	4	35	-	188	-
Residential					
Investor	5,984	8,338	-	5,845	-
Owner occupied	9,179	10,451	-	9,606	151
Revolving and junior liens	1,771	2,313	-	1,668	5
Consumer	-	-		12	-
Total impaired loans with no recorded allowance	35,075	42,799	-	53,456	392
With an allowance recorded					
Commercial	-	-	-	283	-
Commercial real estate					
Owner occupied general purpose	730	792	264	974	-
Owner occupied special purpose	4,300	4,702	759	2,777	-
Non-owner occupied general purpose	939	1,030	129	1,481	-
Non-owner occupied special purpose	-	-	-	-	-
Retail properties	-	-	-	876	-
Farm	-	-	-	-	-
Construction					
Homebuilder	168	604	76	97	-
Land	-	-	-	-	-
Commercial speculative	1,175	1,808	17	2,971	-
All other	436	468	262	465	-
Residential					
Investor	684	913	160	3,263	-
Owner occupied	1,565	1,831	170	3,448	12

Revolving and junior liens	1,498	1,848	558	1,527	-
Consumer	-	-	-	-	-
Total impaired loans with a recorded allowance	11,495	13,996	2,395	18,162	12
Total impaired loans	$ 46,570	$ 56,795	$ 2,395	$ 71,618	$ 404

Troubled debt restructurings ("TDRs") are loans for which the contractual terms have been modified and both of these conditions exist: (1) there is a concession to the borrower and (2) the borrower is experiencing financial difficulties. Loans are restructured on a case-by-case basis during the loan collection process with modifications generally initiated at the request of the borrower. These modifications may include reduction in interest rates, extension of term, deferrals of principal, and other modifications. The Bank participates in the U.S. Department of the Treasury's (the "Treasury") Home Affordable Modification Program ("HAMP") which gives qualifying homeowners an opportunity to refinance into more affordable monthly payments.

The specific allocation of the allowance for loan losses on a TDR is determined by either discounting the modified cash flows at the original effective rate of the loan before modification or is based on the underlying collateral value less costs to sell, if repayment of the loan is collateral-dependent. If the resulting amount is less than the recorded book value, the Bank either establishes a valuation allowance (i.e. specific reserve) as a component of the allowance for loan losses or charges off the impaired balance if it determines that such amount is a confirmed loss. This method is used consistently for all segments of the portfolio. The allowance for loan losses also includes an allowance based on a loss migration analysis for each loan category on loans that are not individually evaluated for specific impairment. All loans charged-off, including TDRs charged-off, are factored into this calculation by portfolio segment.

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TDRs that were modified during the period are as follows:

	TDR Modifications Three Months Ended September 30, 2014			TDR Modifications Nine Months Ended September 30, 2014		
	# of contracts	Pre-modification recorded investment	Post-modification recorded investment	# of contracts	Pre-modification recorded investment	Post-modification recorded investment
Troubled debt restructurings						
Real estate - commercial						
Other1	-	$ -	$ -	2	$ 1,320	$ 1,118
Real estate - residential						
Investor						
Other1	1	155	153	1	155	153
Owner occupied						
HAMP2	-	-	-	1	102	74
Deferral3	-	-	-	2	344	226
Revolving and junior liens						
Other1	1	62	59	3	222	218
	2	$ 217	$ 212	9	$ 2,143	$ 1,789

	TDR Modifications Three Months Ended September 30, 2013			TDR Modifications Nine Months Ended September 30, 2013		
	# of contracts	Pre-modification recorded investment	Post-modification recorded investment	# of contracts	Pre-modification recorded investment	Post-modification recorded investment
Troubled debt restructurings						
Real estate - commercial						
Deferral3	-	$ -	$ -	1	$ 610	$ 472

Real estate - residential									
Owner occupied									
Deferral3	-		-		-	1		137	137
Revolving and junior liens									
Other1	-		-		-	1		30	29
	-	$	-	$	-	3	$	777	$ 638

1 Other: Change of terms from bankruptcy court

2 HAMP: Home Affordable Modification Program

3 Deferral: Refers to the deferral of principal

TDRs are classified as being in default on a case-by-case basis when they fail to be in compliance with the modified terms. The following table presents TDRs that defaulted during the periods shown and were restructured within the 12 month period prior to default. There was no TDR default activity for the three and nine months ended September 30, 2014.

	TDR Default Activity Three Months Ended September 30, 2013		TDR Default Activity Nine Months Ended September 30, 20	
Troubled debt restructurings that Subsequently Defaulted	# of contracts	Pre-modification outstanding recorded investment	# of contracts	Pre-modification outst recorded investm
Real estate - commercial				
Owner occupied special purpose	1	$ 610	1	$ 610
Real estate - residential				
Investor	-	-	1	155
Owner occupied	1	175	1	175
Revolving and junior liens	1	30	1	30
	3	$ 815	4	$ 970

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Note 4 – Allowance for Loan Losses

Changes in the allowance for loan losses by segment of loans based on method of impairment for the three and nine months ended September 30, 2014, were as follows:

Allowance for loan losses:	Commercial	Real Estate Commercial 1	Real Estate Construction	Real Estate Residential	Consumer	Unallocated	Total
Three months ended September 30, 2014							
Beginning balance	$ 1,991	$ 13,228	$ 1,754	$ 2,373	$ 1,464	$ 3,046	$ 23,856
Charge-offs	512	545	1	925	174	-	2,157
Recoveries	6	878	3	646	98	-	1,631
Provision (release)	41	(744)	141	7	16	539	-
Ending balance	$ 1,526	$ 12,817	$ 1,897	$ 2,101	$ 1,404	$ 3,585	$ 23,330
Nine months ended September 30, 2014							
Beginning balance	$ 2,250	$ 16,763	$ 1,980	$ 2,837	$ 1,439	$ 2,012	$ 27,281
Charge-offs	519	1,634	174	2,752	423	-	5,502
Recoveries	56	1,106	507	1,585	297	-	3,551
(Release) provision	(261)	(3,418)	(416)	431	91	1,573	(2,000)
Ending balance	$ 1,526	$ 12,817	$ 1,897	$ 2,101	$ 1,404	$ 3,585	$ 23,330
Ending balance: Individually evaluated for impairment	$ -	$ 167	$ 107	$ 267	$ -	$ -	$ 541
Ending balance: Collectively evaluated for impairment	$ 1,526	$ 12,650	$ 1,790	$ 1,834	$ 1,404	$ 3,585	$ 22,789
Financing receivables:							
Ending balance	$ 114,990	$ 600,649	$ 41,936	$ 365,602	$ 3,142	$ 14,563	$ 1,140,882
Ending balance: Individually evaluated for impairment	$ 1,645	$ 19,515	$ 2,585	$ 17,041	$ -	$ -	$ 40,786
Ending balance: Collectively evaluated for impairment	$ 113,345	$ 581,134	$ 39,351	$ 348,561	$ 3,142	$ 14,563	$ 1,100,096

1 As of September 30, 2014, this segment consisted of performing loans that included a higher risk pool of loans rated as substandard that totaled $7.1 million. The amount of general allocation that was estimated for that portion of these

performing substandard rated loans was $1.2 million at September 30, 2014.

Changes in the allowance for loan losses by segment of loans based on method of impairment for the three and nine months ended September 30, 2013, were as follows:

Allowance for loan losses:	Commercial	Real Estate Commercial 1	Real Estate Construction	Real Estate Residential	Consumer	Unallocated	Total
Three Months Ended September 30, 2013							
Beginning balance	$ 3,332	$ 18,097	$ 2,690	$ 5,021	$ 1,372	$ 4,530	$ 35,042
Charge-offs	29	851	53	3,594	168	-	4,695
Recoveries	60	523	15	209	143	-	950
(Release) provision	(469)	(1,354)	(252)	1,352	162	(1,189)	(1,750)
Ending balance	$ 2,894	$ 16,415	$ 2,400	$ 2,988	$ 1,509	$ 3,341	$ 29,547
Nine Months Ended September 30, 2013							
Beginning balance	$ 4,517	$ 20,100	$ 3,837	$ 4,535	$ 1,178	$ 4,430	$ 38,597
Charge-offs	308	2,377	951	5,193	474	-	9,303
Recoveries	104	3,752	1,265	792	390	-	6,303
(Release) provision	(1,419)	(5,060)	(1,751)	2,854	415	(1,089)	(6,050)
Ending balance	$ 2,894	$ 16,415	$ 2,400	$ 2,988	$ 1,509	$ 3,341	$ 29,547
Ending balance: Individually evaluated for impairment	$ -	$ 750	$ 412	$ 988	$ -	$ -	$ 2,150
Ending balance: Collectively evaluated for impairment	$ 2,894	$ 15,665	$ 1,988	$ 2,000	$ 1,509	$ 3,341	$ 27,397
Financing receivables:							
Ending balance	$ 98,026	$ 554,874	$ 30,996	$ 376,859	$ 2,570	$ 14,315	$ 1,077,640
Ending balance: Individually evaluated for impairment	$ 29	$ 24,849	$ 7,698	$ 21,675	$ -	$ -	$ 54,251
Ending balance: Collectively evaluated for impairment	$ 97,997	$ 530,025	$ 23,298	$ 355,184	$ 2,570	$ 14,315	$ 1,023,389

1 As of September 30, 2013, this segment consisted of performing loans that included a higher risk pool of loans rated as substandard that totaled $14.4 million. The amount of general allocation that was estimated for that portion of these performing substandard rated loans was $2.7 million at September 30, 2013.

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Note 5 – Other Real Estate Owned

Details related to the activity in the other real estate owned ("OREO") portfolio, net of valuation reserve, for the periods presented are itemized in the following table:

	Three Months Ended September 30,		Nine Months Ended September 30,	
Other real estate owned	2014	2013	2014	2013
Balance at beginning of period	$ 39,232	$ 59,465	$ 41,537	$ 72,423
Property additions	4,277	3,015	13,620	14,196
Property improvements	506	10	637	60
Less:				
Property disposals, net of gains/losses	1,618	11,463	12,136	30,928
Period valuation adjustments	1,520	1,961	2,781	6,685
Balance at end of period	$ 40,877	$ 49,066	$ 40,877	$ 49,066

Activity in the valuation allowance was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Balance at beginning of period	$ 17,873	$ 30,487	$ 22,284	$ 31,454
Provision for unrealized losses	1,520	1,961	2,781	6,537
Reductions taken on sales	(348)	(7,571)	(5,431)	(13,305)
Other adjustments	-	(290)	(589)	(99)
Balance at end of period	$ 19,045	$ 24,587	$ 19,045	$ 24,587

Expenses related to OREO, net of lease revenue includes:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Gain on sales, net	$ (201)	$ (608)	$ (610)	$ (1,175)

Provision for unrealized losses	1,520	1,961	2,781	6,537
Operating expenses	884	1,500	3,132	4,555
Less:				
Lease revenue	196	309	638	974
	$ 2,007	$ 2,544	$ 4,665	$ 8,943

Note 6 – Deposits

Major classifications of deposits were as follows:

	September 30, 2014	December 31, 2013
Noninterest bearing demand	$ 380,687	$ 373,389
Savings	236,289	228,589
NOW accounts	315,665	297,852
Money market accounts	296,418	309,859
Certificates of deposit of less than $100,000	256,452	288,345
Certificates of deposit of $100,000 or more	171,244	184,094
	$ 1,656,755	$ 1,682,128

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Note 7 – Borrowings

The following table is a summary of borrowings as of September 30, 2014, and December 31, 2013. Junior subordinated debentures are discussed in detail in Note 8:

	September 30, 2014	December 31, 2013
Securities sold under repurchase agreements	$ 29,438	$ 22,560
FHLBC advances	40,000	5,000
Junior subordinated debentures	58,378	58,378
Subordinated debt	45,000	45,000
Notes payable and other borrowings	500	500
	$ 173,316	$ 131,438

The Company enters into deposit sweep transactions where the transaction amounts are secured by pledged securities. These transactions consistently mature within 1 to 90 days from the transaction date and are governed by sweep repurchase agreements. All sweep repurchase agreements are treated as financings secured by U.S. government agencies and collateralized mortgage-backed securities and have a carrying amount of $29.4 million at September 30, 2014, and $22.6 million at December 31, 2013. The fair value of the pledged collateral was $43.4 million and $39.2 million at September 30, 2014 and December 31, 2013, respectively. At September 30, 2014, there were no customers with secured balances exceeding 10% of stockholders' equity.

The Company's borrowings at the FHLBC require the Bank to be a member and invest in the stock of the FHLBC. Total borrowings are generally limited to the lower of 35% of total assets or 60% of the book value of certain mortgage loans. As of September 30, 2014, the Bank had taken an advance of $40.0 million on the FHLBC stock valued at $4.3 million, collateralized securities with a fair value of $93.1 million and loans with a principal balance of $52.4 million, which carry a combined collateral value of $91.2 million. The Company has excess collateral of $49.9 million available to secure borrowings.

One of the Company's most significant borrowing relationships continued to be the $45.5 million credit facility with a correspondent bank. That credit began in January 2008 and was originally composed of a $30.5 million senior debt facility, which included $500,000 in term debt, and $45.0 million of subordinated debt. The subordinated debt and the term debt portion of the senior debt facility mature on March 31, 2018. The interest rate on the senior debt facility resets quarterly and at the Company's option, is based on, either the lender's prime rate or three-month LIBOR plus 90 basis points. The interest rate on the subordinated debt resets quarterly, and is equal to three-month LIBOR plus 150 basis points. The Company had no principal outstanding balance on the senior line of credit portion of the senior debt facility when it matured and was terminated. The Company had $500,000 in principal outstanding in term debt and $45.0 million in principal outstanding in subordinated debt at the end of both September 30, 2014, and December 31, 2013. The term debt is secured by all of the outstanding capital stock of the Bank. The Company has made all required interest payments on the outstanding principal balance on a timely basis.

The credit facility agreement contains usual and customary provisions regarding acceleration of the senior debt upon the occurrence of an event of default by the Company under the senior debt agreement. The senior debt agreement also contains certain customary representations and warranties, and financial covenants. At September 30, 2014, the Company was out of compliance with two of the financial covenants contained within the credit agreement. As of June 30, 2014, the Company reported being out of compliance on one of the financial covenants contained in the referenced credit agreement. Prior to 2013, the Company had been out of compliance with two of the financial covenants. The agreement provides that noncompliance is an event of default and as the result of the Company's failure to comply with a financial covenant, the lender may (i) terminate all commitments to extend further credit, (ii) increase the interest rate on the revolving line of the term debt by 200 basis points, (iii) declare the senior debt immediately due and payable and (iv) exercise all of its rights and remedies at law, in equity and/or pursuant to any or all collateral documents, including foreclosing on the collateral. The total outstanding principal of the senior debt is the $500,000 in term debt. Because the subordinated debt is treated as Tier 2 capital for regulatory capital purposes, the senior debt agreement does not provide the lender with any rights of acceleration or other remedies with regard to the subordinated debt upon an event of default caused by the Company's failure to comply with a financial covenant. Specifically, the covenants that were not met address the Bank's return on average assets and nonperforming assets as a percentage of the Bank's primary capital, when calculated per the debt agreement.

Note 8 – Junior Subordinated Debentures

The Company completed the sale of $27.5 million of cumulative trust preferred securities by its unconsolidated subsidiary, Old Second Capital Trust I in June 2003. An additional $4.1 million of cumulative trust preferred securities were sold in July 2003. The trust preferred securities may remain outstanding for a 30-year term but, subject to regulatory approval, can be called in whole or in part by the Company after June 30, 2008. When not in deferral, distributions on the securities are payable quarterly at an annual rate of 7.80%. The Company issued a new $32.6 million subordinated debenture to Old Second Capital Trust I in return for the aggregate net proceeds of this trust preferred offering. The interest rate and payment frequency on the debenture are equivalent to the cash distribution basis on the trust preferred securities.

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The Company issued an additional $25.0 million of cumulative trust preferred securities through a private placement completed by an additional, unconsolidated subsidiary, Old Second Capital Trust II, in April 2007. These trust preferred securities also mature in 30 years, but subject to the aforementioned regulatory approval, can be called in whole or in part on a quarterly basis commencing June 15, 2017. The quarterly cash distributions on the securities are fixed at 6.77% through June 15, 2017 and float at 150 basis points over three-month LIBOR thereafter. The Company issued a new $25.8 million subordinated debenture to the Old Second Capital Trust II in return for the aggregate net proceeds of this trust preferred offering. The interest rate and payment frequency on the debenture are equivalent to the cash distribution basis on the trust preferred securities.

Under the terms of the subordinated debentures issued to each of Old Second Capital Trust I and II, the Company is allowed to defer payments of interest for 20 quarterly periods without default or penalty, but such amounts continue to accrue. Also during a deferral period, the Company generally may not pay cash dividends on or repurchase its common stock or preferred stock, including the Series B Fixed Rate Cumulative Perpetual Preferred Stock (the "Series B Stock"), as discussed in Note 15. In August of 2010, the Company elected to defer regularly scheduled interest payments on the $58.4 million of junior subordinated debentures. Because of the deferral on the subordinated debentures, the trusts deferred regularly scheduled dividends on the trust preferred securities. On April 21, 2014, the Company paid all outstanding interest, which totaled $19.7 million, on the trust preferred securities to the trustees for payment to holders as of the next record date set forth in the indentures and terminated the deferral period. The Company paid $1.1 million of interest due in the third quarter of 2014. Both of the debentures issued by the Company are disclosed on the Consolidated Balance Sheet as junior subordinated debentures and the related interest expense for each issuance is included in the Consolidated Statements of of Operations.

Note 9 – Equity Compensation Plans

There are stock-based awards outstanding under the Company's 2008 Equity Incentive Plan (the "2008 Plan") and the Company's 2014 Equity Incentive Plan (the "2014 Plan," and together with the 2008 Plan, the "Plans"). The 2014 Plan was approved at the 2014 annual meeting of stockholders. Following approval of the 2014 Plan, no further awards will be granted under the 2008 Plan or any other Company equity compensation plan. A maximum of 375,000 shares may be issued under the 2014 Plan. The Plan authorizes the granting of qualified stock options, non-qualified stock options, restricted stock, restricted stock units, and stock appreciation rights. Awards may be granted to selected directors and officers or employees under the 2014 Plan at the discretion of the Compensation Committee of the Company's Board of Directors. As of September 30, 2014, 210,500 shares remained available for issuance under the 2014 Plan.

Total compensation cost that has been charged for the plans was $189,000 in the first nine months of 2014 and $123,000 in the first nine months of 2013.

There were no stock options granted in the third quarter of 2014 or 2013. All stock options are granted for a term of ten years. There were no stock options exercised during the third quarter of 2014 or 2013. There is no unrecognized compensation cost related to unvested stock options as all stock options of the Company's common stock have vested.

A summary of stock option activity in the Plans for the nine months ending September 30, 2014, is as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Beginning outstanding	325,500	$ 29.56		
Canceled	-	-		
Ending outstanding	325,500	$ 29.56	1.8	$ -
Exercisable at end of period	325,500	$ 29.56	1.8	$ -

Generally, restricted stock and restricted stock units granted under the Plans vest three years from the grant date, but the Compensation Committee of the Company's Board of Directors has discretionary authority to change some terms including the amount of time until the vest date.

Awards under the 2008 Plan will become fully vested upon a merger or change in control of the Company. Under the 2014 Plan, upon a change in control of the Company, if (i) the 2014 Plan is not an obligation of the successor entity following the change in control, or (ii) the 2014 Plan is an obligation of the successor entity following the change in control and the participant incurs an involuntary termination, then the stock options, stock appreciation rights, stock awards and cash incentive awards under the 2014 Plan will become fully exercisable and vested. Performance-based awards generally will vest based upon the level of achievement of the applicable performance measures through the change in control.

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The Company granted restricted stock under its equity compensation plans beginning in 2005 and it began granting restricted stock units in February 2009. Restricted stock awards under the Plans generally entitle holders to voting and dividend rights upon grant and are subject to forfeiture until certain restrictions have lapsed including employment for a specific period. Restricted stock units under the Plans are also subject to forfeiture until certain restrictions have lapsed including employment for a specific period, and generally entitle holders to receive dividend equivalents during the restricted period but do not entitle holders to voting rights until the restricted period ends and shares are transferred in connection with the units.

There were no restricted awards issued under the Plans during the third quarter of 2014 and 184,500 restricted awards issued during the nine months ending September 30, 2014. There were no restricted awards issued during the third quarter of 2013 and 155,500 restricted awards issued for the nine months ending September 30, 2013. Compensation expense is recognized over the vesting period of the restricted award based on the market value of the award on the issue date.

A summary of changes in the Company's unvested restricted awards for the nine months ending September 30, 2014, is as follows:

	September 30, 2014	
	Restricted Stock Shares and Units	Weighted Average Grant Date Fair Value
Nonvested at January 1	185,500	$ 2.95
Granted	184,500	4.82
Vested	(25,000)	2.06
Forfeited	(20,000)	1.74
Nonvested at September 30	325,000	$ 4.15

Total unrecognized compensation cost of restricted awards was $1.0 million as of September 30, 2014, which is expected to be recognized over a weighted-average period of 2.48 years. Total unrecognized compensation cost of restricted awards was $411,000 as of September 30, 2013, which was expected to be recognized over a weighted-average period of 2.46 years.

Note 10 – Earnings Per Share

The earnings per share – both basic and diluted – are included below as of September 30 (in thousands except for share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Basic earnings per share:				
Weighted-average common shares outstanding	29,442,508	13,885,884	23,905,205	13,947,606
Weighted-average common shares less stock based awards	29,442,508	13,870,884	23,902,403	13,895,136
Weighted-average common shares stock based awards	325,000	231,152	225,232	217,107
Net income from operations	$ 2,924	$ 72,924	$ 7,147	$ 81,872
Gain on preferred stock redemption	-	-	(1,348)	-
Preferred stock dividends and accretion, net of dividends waived	1,065	1,323	(1,448)	3,917
Net earnings available to common stockholders	1,859	71,601	9,943	77,955
Undistributed earnings	1,859	71,601	9,943	77,955
Basic earnings per share common undistributed earnings	0.06	5.08	0.41	5.52
Basic earnings per share	0.06	5.08	0.41	5.52
Diluted earnings per share:				
Weighted-average common shares outstanding	29,442,508	13,885,884	23,905,205	13,947,606
Dilutive effect of nonvested restricted awards1	325,000	216,152	222,430	164,637
Diluted average common shares outstanding	29,767,508	14,102,036	24,127,635	14,112,243
Net earnings available to common stockholders	$ 1,859	$ 71,601	$ 9,943	$ 77,955
Diluted earnings per share	$ 0.06	$ 5.08	$ 0.41	$ 5.52
Number of antidilutive options excluded from the diluted earnings per share calculation	1,140,839	1,224,839	1,140,839	1,224,839

1 Includes the common stock equivalents for restricted share rights that are dilutive.

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The above earnings per share calculation did not include a warrant for 815,339 shares of common stock that was outstanding as of September 30, 2014, and September 30, 2013 because the warrant was anti-dilutive. Of note, the warrant was sold at auction by the Treasury in June 2013 to a third party investor.

The Company completed the redemption of 25,669 shares of its Series B Stock in the second quarter of 2014. As previously disclosed, the Company completed a public offering of 15,525,000 shares of common stock in April of 2014. Net proceeds of over $64.0 million were used to pay the accrued but unpaid interest on the Company's trust preferred securities or junior subordinated debentures discussed in Note 8, the accumulated but unpaid dividends on the Series B Stock and to complete this redemption. The amount remaining after the completion of these transactions was retained at the Company for use in addressing general corporate matters. The redemption price for such Series B Stock was 94.75% of the liquidation value of the Series B Stock provided that the holders of shares entered into agreements to forebear payment of dividends due and to waive any rights to such dividend upon redemption. The Company redeemed all shares of Series B Stock held by directors of the Company on the same terms.

Note 11 – Regulatory & Capital Matters

The Bank is subject to the risk-based capital regulatory guidelines, which include the methodology for calculating the risk-weighted Bank assets, developed by the Office of the Comptroller of the Currency (the "OCC") and the other bank regulatory agencies. In connection with the current economic environment, the Bank's current level of nonperforming assets and the risk-based capital guidelines, the Bank's board of directors has determined that the Bank should maintain a Tier 1 leverage capital ratio at or above eight percent (8%) and a total risk-based capital ratio at or above twelve percent (12%). The Bank currently exceeds those thresholds.

The Bank exceeded both board of directors' capital ratio objectives. At September 30, 2014, the Bank's Tier 1 capital leverage ratio was 11.67%, up 70 basis points from December 31, 2013, and well above the 8.00% objective. The Bank's total capital ratio was 18.47%, up 43 basis points from December 31, 2013, and also well above the objective of 12.00%.

On July 22, 2011, the Company entered into a Written Agreement with the Reserve Bank designed to maintain the financial soundness of the Company. Pursuant to the Written Agreement, the Company took certain actions and operated in compliance with the Written Agreement's provisions during its term. On January 17, 2014, the Reserve Bank terminated the Written Agreement. Although the Written Agreement has been terminated, the Company expects that it will continue to seek approval from the Reserve Bank prior to paying any dividends on its capital stock and incurring any additional indebtedness.

Bank holding companies are required to maintain minimum levels of capital in accordance with capital guidelines implemented by the Board of Governors of the Federal Reserve System. The general bank and holding company capital adequacy guidelines are shown in the accompanying table, as are the capital ratios of the Company and the Bank, as of September 30, 2014, and December 31, 2013. The Company’s total risk-based capital ratio has been adjusted to correctly account for the Company's subordinated debt, a portion of which was excluded from Tier 2 capital because the subordinated debt is within five years of maturity. This change has also been made in all relevant prior quarters and has resulted in an immaterial reduction in the Company's total risk-based capital ratio for those periods. The reduction in regulatory capital amounts and ratios has no impact on the Company's historical consolidated financial statements or stockholders' equity, which were stated in accordance with GAAP.

The Company completed the redemption of certain of its Series B Fixed Rate Cumulative Preferred Stock (the “Series B Stock”) in the second quarter, 2014. The Company completed a public offering of common stock in April. Net proceeds of over $64.0 million were used to pay the accrued but unpaid interest on trust preferred securities, the accumulated but unpaid dividends on the Series B Stock and to complete this redemption. All ratios for September 30, 2014 reflect these changes in the Company’s capital.

At September 30, 2014, the Company, on a consolidated basis, exceeded the minimum thresholds to be considered “adequately capitalized” under current regulatory defined capital ratios. The Company and the Bank are subject to regulatory capital requirements administered by federal banking agencies.

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Capital levels and industry defined regulatory minimum required levels:

	Actual Amount	Ratio	Minimum Required for Capital Adequacy Purposes Amount	Ratio	Minimum Required to be Well Capitalized 1 Amount	Ratio
September 30, 2014						
Total capital to risk weighted assets						
Consolidated	$ 234,500	17.56 %	$ 106,834	8.00 %	N/A	N/A
Old Second Bank	246,873	18.47	106,929	8.00	$ 133,662	10.00 %
Tier 1 capital to risk weighted assets						
Consolidated	190,724	14.28	53,424	4.00	N/A	N/A
Old Second Bank	230,087	17.22	53,446	4.00	80,170	6.00
Tier 1 capital to average assets						
Consolidated	190,724	9.68	78,812	4.00	N/A	N/A
Old Second Bank	230,087	11.67	78,864	4.00	98,581	5.00
December 31, 2013						
Total capital to risk weighted assets						
Consolidated	$ 191,139	15.16 %	$ 100,865	8.00 %	N/A	N/A
Old Second Bank	227,467	18.04	100,872	8.00	$ 126,090	10.00 %
Tier 1 capital to risk weighted assets						
Consolidated	134,199	10.65	50,403	4.00	N/A	N/A
Old Second Bank	211,568	16.78	50,433	4.00	75,650	6.00
Tier 1 capital to average assets						
Consolidated	134,199	6.96	77,126	4.00	N/A	N/A
Old Second Bank	211,568	10.97	77,144	4.00	96,430	5.00

1 The Bank exceeded the general minimum regulatory requirements to be considered “well capitalized”.

The Company’s credit facility with Bank of America includes $45.0 million in subordinated debt. That debt obligation qualifies at 60% and 80% of the original amount for Tier 2 regulatory capital at September 30, 2014 and December 31, 2013, respectively. In addition, the trust preferred securities continue to qualify as Tier 1 regulatory capital, and the Company treats the maximum amount of this security type allowable under regulatory guidelines as Tier 1 capital. As of September 30, 2014 all $56.6 million of the trust preferred proceeds qualified as Tier 1 regulatory capital. As of December 31, 2013, trust preferred proceeds of $51.6 million qualified as Tier 1 regulatory capital and $5.0 million qualified as Tier 2 regulatory capital. All of the Series B Stock qualified as Tier 1 regulatory capital as of September 30, 2014, and December 31, 2013.

Dividend Restrictions and Deferrals

In addition to the above requirements, banking regulations and capital guidelines generally limit the amount of dividends that may be paid by a Bank without prior regulatory approval. Under these regulations, the amount of dividends that may be paid in any calendar year is limited to the current year’s profits, combined with the retained profit of the previous two years, subject to the capital requirements described above. The Bank has the ability and the authority to pay dividends to the Company to pay debt and to meet preferred dividend requirements.

As discussed in Note 8, as of September 30, 2014, the Company had $58.4 million of junior subordinated debentures held by two statutory business trusts that it controls. The Company has the right to defer interest payments on the debentures for a period of up to 20 consecutive quarters, and elected to begin such a deferral in August 2010. However, all deferred interest must be paid before the Company may pay dividends on its common stock. In the second quarter of 2014, the Company terminated the deferral period and paid all accumulated and unpaid interest on the junior subordinated debentures which totaled $19.7 million. The Company is currently paying interest as it comes due and $1.1 million was paid in the third quarter of 2014.

Furthermore, as with the debentures discussed above, the Company is prohibited from paying dividends on its common stock unless it has fully paid all deferred dividends on the Series B Stock. In August 2010, it also began to defer the payment of dividends on such Series B Stock. Therefore, in addition to paying all the accrued and unpaid distributions on the debentures set forth above, the Company must also fully pay all deferred and unpaid dividends on the Series B Stock before it may reinstate the payment of dividends on the common stock.

On April 15, 2014, the Company declared a dividend of approximately $15.8 million on its Series B Stock to stockholders of record on May 1, 2014. Series B Stock dividends of $10.3 million were paid on May 15, 2014. The Company is currently paying dividends as they come due and $1.1 million paid was paid on August 15, 2014.

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On April 28, 2014, the Company redeemed 25,669 shares of the Series B Stock from certain holders, which included certain of the Company's directors, at a redemption price of 94.75% of the per share liquidation value, or $947.50 per share, for a total price of approximately $24.3 million. The Company paid $22.9 million to a large private investor and an additional $1.4 million to Company directors for these purchases. The holders of such shares waived their rights to any dividends on the Series B Stock, and such holders did not receive any part of the declared dividend on the Series B Stock. In May, the Company paid $10.3 million in Series B Stock dividends. In the second quarter, the Company also recognized benefit from $5.4 million in net income available to common stockholders reflecting both reversal of dividends previously accrued as well as dividends accumulated but not accrued by the Company and waived by holders upon redemption.

Further detail on the junior subordinated debentures, the Series B Stock and the deferral of interest and dividends thereon is described in Notes 8 and 15.

Note 12 – Fair Value Option and Fair Value Measurements

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The fair value hierarchy established by the Company also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Three levels of inputs that may be used to measure fair value are:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the Company has the ability to access as of the measurement date.

Level 2: Significant observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a company's own view about the assumptions that market participants would use in pricing an asset or liability.

Transfers between levels are deemed to have occurred at the end of the reporting period. For the quarters ended September 30, 2014, and 2013 there were no significant transfers between levels.

Except for auction rate asset-backed securities, the majority of securities (available-for-sale and held-to-maturity) are valued by external pricing services or dealer market participants and are classified in Level 2 of the fair value hierarchy. Both market and income valuation approaches are utilized. Quarterly, the Company evaluates the methodologies used by the external pricing services or dealer market participants to develop the fair values to determine whether the results of the valuations are representative of an exit price in the Company's principal markets and an appropriate representation of fair value. The Company uses the following methods and significant assumptions to estimate fair value:

- Government-sponsored agency debt securities are primarily priced using available market information through processes such as benchmark curves, market valuations of like securities, sector groupings and matrix pricing.
- Other government-sponsored agency securities, MBS and some of the actively traded real estate mortgage investment conduits and collateralized mortgage obligations are priced using available market information including benchmark yields, prepayment speeds, spreads, volatility of similar securities and trade date.
- State and political subdivisions are largely grouped by characteristics (e.g.., geographical data and source of revenue in trade dissemination systems). Because some securities are not traded daily and due to other grouping limitations, active market quotes are often obtained using benchmarking for like securities.
- During 2013, asset-backed auction rate securities were acquired and priced using data from dealer market participants until December 31, 2013. At December 31, 2013, to present and including asset-backed auction rate securities acquired in 2014, the Company utilized pricing data from a nationally recognized valuation firm providing specialized securities valuation services. Therefore, the valuations of auction rate asset-backed securities are considered Level 3 valuations.
- During the third quarter of 2014, asset-backed collateralized loan obligations were acquired and priced using data from a pricing matrix support by our bond accounting service provider and are therefore considered Level 2 valuations.
- Residential mortgage loans eligible for sale in the secondary market are carried at fair market value. The fair value of loans held-for-sale is determined using quoted secondary market prices.
- Lending related commitments to fund certain residential mortgage loans, e.g. residential mortgage loans with locked interest rates to be sold in the secondary market and forward commitments for the future delivery of mortgage loans to third party investors as well as forward commitments for future delivery of MBS are considered derivatives. Fair values are estimated based on observable changes in mortgage interest rates including prices for MBS from the date of the commitment and do not typically involve significant judgments by management.
- The fair value of mortgage servicing rights is based on a valuation model that calculates the present value of estimated net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net

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servicing income to derive the resultant value. The Company is able to compare the valuation model inputs, such as the discount rate, prepayment speeds, weighted average delinquency and foreclosure/bankruptcy rates to widely available published industry data for reasonableness.

- Interest rate swap positions, both assets and liabilities, are based on valuation pricing models using an income approach reflecting readily observable market parameters such as interest rate yield curves.
- Both the credit valuation reserve on current interest rate swap positions and on receivables related to unwound customer interest rate swap positions were determined based upon management's estimate of the amount of credit risk exposure, including by available collateral protection and/or by utilizing an estimate related to a probability of default as indicated in the Bank credit policy. Such adjustments would result in a Level 3 classification.
- The fair value of impaired loans with specific allocations of the allowance for loan losses is essentially based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are made in the appraisal process by the appraisers to reflect differences between the available comparable sales and income data. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.
- Nonrecurring adjustments to certain commercial and residential real estate properties classified as OREO are measured at the lower of carrying amount or fair value, less costs to sell. Fair values are based on third party appraisals of the property, resulting in a Level 3 classification. In cases where the carrying amount exceeds the fair value, less costs to sell, an impairment loss is recognized.

Assets and Liabilities Measured at Fair Value on a Recurring Basis:

The tables below present the balance of assets and liabilities at September 30, 2014, and December 31, 2013, respectively, measured by the Company at fair value on a recurring basis:

	September 30, 2014			
	Level 1	Level 2	Level 3	Total
Assets:				
Investment securities available-for-sale				
U.S. Treasury	$ 1,532	$ -	$ -	$ 1,532
U.S. government agencies	-	1,638	-	1,638
States and political subdivisions	-	13,754	125	13,879
Corporate Bonds	-	30,781	-	30,781
Collateralized mortgage obligations	-	28,417	-	28,417
Asset-backed securities	-	109,017	83,781	192,798
Collateralized loan obligations	-	93,198	-	93,198
Loans held-for-sale	-	3,422	-	3,422
Mortgage servicing rights	-	-	5,640	5,640
Other assets (Interest rate swap agreements net of swap credit valuation)	-	42	-	42
Other assets (Mortgage banking derivatives)	-	266	-	266
Total	$ 1,532	$ 280,535	$ 89,546	$ 371,613

Liabilities:				
Other liabilities (Interest rate swap agreements)	$ -	$ 42	$ -	$ 42
Total	$ -	$ 42	$ -	$ 42

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	December 31, 2013			
	Level 1	Level 2	Level 3	Total
Assets:				
Investment securities available-for-sale				
U.S. Treasury	$ 1,544	$ -	$ -	$ 1,544
U.S. government agencies	-	1,672	-	1,672
States and political subdivisions	-	16,669	125	16,794
Corporate bonds	-	15,102	-	15,102
Collateralized mortgage obligations	-	63,876	-	63,876
Asset-backed securities	-	119,066	154,137	273,203
Loans held-for-sale	-	3,822	-	3,822
Mortgage servicing rights	-	-	5,807	5,807
Other assets (Interest rate swap agreements net of swap credit valuation)	-	229	(6)	223
Other assets (Mortgage banking derivatives)	-	315	-	315
Total	$ 1,544	$ 220,751	$ 160,063	$ 382,358
Liabilities:				
Other liabilities (Interest rate swap agreements)	$ -	$ 229	$ -	$ 229
Total	$ -	$ 229	$ -	$ 229

The changes in Level 3 assets and liabilities measured at fair value on a recurring basis are as follows:

	Nine months ended September 30, 2014			
	Securities available-for- sale			
	Asset-backed	States and Political Subdivisons	Mortgage Servicing Rights	Interest Rate Swap Valuation
Beginning balance January 1, 2014	$ 154,137	$ 125	$ 5,807	$ (6)
Transfers into Level 3	-	-	-	-
Total gains or losses				
Included in earnings (or changes in net assets)	3,178	-	(761)	6
Included in other comprehensive income	(1,748)	-	-	-
Purchases, issuances, sales, and settlements				
Purchases	63,704	-	-	-
Issuances	-	-	594	-
Sales	(135,490)	-	-	-
Ending balance September 30, 2014	$ 83,781	$ 125	$ 5,640	$ -

	Nine months ended September 30, 2013 Securities available-for- sale Collateralized Debt Obligations	Asset-backed	States and Political Subdivisons	Mortgage Servicing Rights	Interest Rate Swap Valuation
Beginning balance January 1, 2013	$ 9,957	$ -	$ 132	$ 4,116	$ (47)
Transfers into Level 3	-	-	-	-	-
Transfers out of Level 3	-	-	-	-	-
Total gains or losses					
Included in earnings (or changes in net assets)	178	485	-	81	34
Included in other comprehensive income	1,898	(1,487)	-	-	-
Purchases, issuances, sales, and settlements					
Purchases	-	168,753	-	-	-
Issuances	-	-	-	1,259	-
Settlements	(946)	-	-	-	-
Sales	-	(20,539)	-	-	-
Ending balance September 30, 2013	$ 11,087	$ 147,212	$ 132	$ 5,456	$ (13)

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The following table and commentary presents quantitative (dollars in thousands) and qualitative information about Level 3 fair value measurements as of September 30, 2014: