

INDEPENDENT BANK CORP

Form 10-Q

August 06, 2015

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

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FORM 10-Q

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

For the quarterly period ended June 30, 2015

Commission File Number: 1-9047

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Independent Bank Corp.

(Exact name of registrant as specified in its charter)

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Massachusetts

04-2870273

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer  
Identification No.)

Office Address: 2036 Washington Street, Hanover Massachusetts 02339

Mailing Address: 288 Union Street, Rockland, Massachusetts 02370

(Address of principal executive offices, including zip code)

(781) 878-6100

(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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large Accelerated Filer

Accelerated Filer

Non-accelerated Filer

Smaller Reporting Company

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

As of August 3, 2015, there were 26,205,818 shares of the issuer's common stock outstanding, par value \$0.01 per share.

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## PART 1. FINANCIAL INFORMATION

## Item 1. Financial Statements

## INDEPENDENT BANK CORP.

## CONSOLIDATED BALANCE SHEETS

(Unaudited—Dollars in thousands, except share data)

	June 30, 2015	December 31, 2014
Assets		
Cash and due from banks	\$ 100,054	\$ 143,342
Interest-earning deposits with banks	295,722	34,912
Securities		
Securities - trading	489	—
Securities - available for sale	375,001	348,554
Securities - held to maturity (fair value \$431,778 and \$379,699)	428,339	375,453
Total securities	803,829	724,007
Loans held for sale (at fair value)	10,728	6,888
Loans		
Commercial and industrial	873,105	860,839
Commercial real estate	2,630,062	2,347,323
Commercial construction	278,692	265,994
Small business	91,367	85,247
Residential real estate	653,370	530,259
Home equity - first position	526,370	513,518
Home equity - subordinate positions	364,523	350,345
Other consumer	17,293	17,208
Total loans	5,434,782	4,970,733
Less: allowance for loan losses	(54,995)	(55,100)
Net loans	5,379,787	4,915,633
Federal Home Loan Bank stock	37,485	33,233
Bank premises and equipment, net	74,143	64,074
Goodwill	201,083	170,421
Identifiable intangible assets	13,248	9,885
Cash surrender value of life insurance policies	132,600	109,854
Other real estate owned and other foreclosed assets	5,124	7,743
Other assets	142,118	144,920
Total assets	\$ 7,195,921	\$ 6,364,912
Liabilities and Stockholders' Equity		
Deposits		
Demand deposits	1,832,971	1,462,200
Savings and interest checking accounts	2,285,968	2,108,486
Money market	1,125,888	990,160
Time certificates of deposit of \$100,000 and over	295,738	254,718
Other time certificates of deposits	429,965	394,902
Total deposits	5,970,530	5,210,466
Borrowings		
Federal Home Loan Bank borrowings	108,190	70,080
Customer repurchase agreements and other short-term borrowings	119,439	147,890



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Wholesale repurchase agreements	50,000	50,000
Junior subordinated debentures	73,576	73,685
Subordinated debentures	35,000	65,000
Total borrowings	386,205	406,655
Other liabilities	95,869	107,264
Total liabilities	6,452,604	5,724,385
Commitments and contingencies		
Stockholders' equity		
Preferred stock, \$.01 par value. authorized: 1,000,000 shares, outstanding: none	—	—
Common stock, \$.01 par value. authorized: 75,000,000 shares, issued and outstanding: 26,158,826 shares at June 30, 2015 and 23,998,738 shares at December 31, 2014 (includes 243,710 and 254,500 shares of unvested participating restricted stock awards, respectively)	259	237
Shares held in rabbi trust at cost: 171,286 shares at June 30, 2015 and 176,849 shares at December 31, 2014	(3,785	) (3,666
Deferred compensation and other retirement benefit obligations	3,785	3,666
Additional paid in capital	401,437	311,978
Retained earnings	343,757	330,444
Accumulated other comprehensive loss, net of tax	(2,136	) (2,132
Total stockholders' equity	743,317	640,527
Total liabilities and stockholders' equity	\$7,195,921	\$6,364,912

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

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CONSOLIDATED STATEMENTS OF INCOME

(Unaudited—Dollars in thousands, except per share data)

	Three Months Ended		Six Months Ended	
	June 30 2015	2014	June 30 2015	2014
Interest income				
Interest and fees on loans	\$54,016	\$49,393	\$105,704	\$97,597
Taxable interest and dividends on securities	4,852	4,690	9,479	9,340
Nontaxable interest and dividends on securities	30	37	64	74
Interest on loans held for sale	58	96	109	147
Interest on federal funds sold and short-term investments	60	69	91	106
Total interest and dividend income	59,016	54,285	115,447	107,264
Interest expense				
Interest on deposits	2,922	2,789	5,685	5,579
Interest on borrowings	2,347	2,443	4,765	5,026
Total interest expense	5,269	5,232	10,450	10,605
Net interest income	53,747	49,053	104,997	96,659
Provision for loan losses	700	2,250	200	6,752
Net interest income after provision for loan losses	53,047	46,803	104,797	89,907
Noninterest income				
Deposit account fees	4,465	4,463	8,631	8,821
Interchange and ATM fees	3,767	3,322	6,868	6,298
Investment management	5,528	5,136	10,635	9,739
Mortgage banking income	1,226	877	2,352	1,364
Gain on life insurance benefits	—	337	—	1,964
Gain (loss) on sale of equity securities	19	(20	) 19	71
Gain on sale of fixed income securities	798	—	798	—
Increase in cash surrender value of life insurance policies	949	721	1,727	1,443
Loan level derivative income	1,430	324	1,848	1,070
Other noninterest income	2,079	1,697	3,939	3,602
Total noninterest income	20,261	16,857	36,817	34,372
Noninterest expenses				
Salaries and employee benefits	26,318	22,843	51,606	45,923
Occupancy and equipment expenses	5,672	5,301	12,066	11,447
Data processing and facilities management	1,228	1,179	2,350	2,432
FDIC assessment	1,017	966	1,973	1,871
Advertising expense	1,853	1,249	2,687	2,073
Consulting expense	829	810	1,585	1,368
Loss on sale of equity securities	8	—	8	—
Loss on sale of fixed income securities	1,124	—	1,124	—
Loss on termination of derivatives	—	1,122	—	1,122
Merger and acquisition expense	271	—	10,501	77
Other noninterest expenses	10,324	9,510	19,722	18,553
Total noninterest expenses	48,644	42,980	103,622	84,866
Income before income taxes	24,664	20,680	37,992	39,413
Provision for income taxes	7,213	5,934	11,082	11,284

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Net income	\$17,451	\$14,746	\$26,910	\$28,129
Basic earnings per share	\$0.67	\$0.62	\$1.05	\$1.18
Diluted earnings per share	\$0.67	\$0.61	\$1.05	\$1.17
Weighted average common shares (basic)	26,149,593	23,897,413	25,558,016	23,858,456
Common shares equivalents	71,819	94,560	76,626	97,544
Weighted average common shares (diluted)	26,221,412	23,991,973	25,634,642	23,956,000
Cash dividends declared per common share	\$0.26	\$0.24	\$0.52	\$0.48

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



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INDEPENDENT BANK CORP.  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
(Unaudited—Dollars in thousands)

	Three Months Ended		Six Months Ended		
	June 30		June 30		
	2015	2014	2015	2014	
Net income	\$17,451	\$14,746	\$26,910	\$28,129	
Other comprehensive income (loss), net of tax					
Net change in fair value of securities available for sale	(2,228	) 2,395	(667	) 4,312	
Net change in fair value of cash flow hedges	382	1,005	464	1,507	
Net change in other comprehensive income for defined benefit postretirement plans	123	(39	) 199	(78	)
Total other comprehensive income (loss)	(1,723	) 3,361	(4	) 5,741	
Total comprehensive income	\$15,728	\$18,107	\$26,906	\$33,870	

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

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## INDEPENDENT BANK CORP.

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(Unaudited—Dollars in thousands, except per share data)

	Common Stock Outstanding	Common Stock	Value of Shares Held in Rabbi Trust at Cost	Deferred Compensation and Other Retirement Benefit Obligations	Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance December 31, 2014	23,998,738	\$237	\$ (3,666 )	\$ 3,666	\$311,978	\$330,444	\$ (2,132 )	\$640,527
Net income	—	—	—	—	—	26,910	—	26,910
Other comprehensive loss	—	—	—	—	—	—	(4 )	(4 )
Common dividend declared (\$0.52 per share)	—	—	—	—	—	(13,597 )	—	(13,597 )
Common stock issued for acquisition	2,052,137	21	—	—	86,394	—	—	86,415
Proceeds from exercise of stock options, net of cash paid	40,314	—	—	—	311	—	—	311
Tax benefit related to equity award activity	—	—	—	—	546	—	—	546
Stock based compensation	—	—	—	—	1,362	—	—	1,362
Restricted stock awards issued, net of awards surrendered	36,101	1	—	—	(646 )	—	—	(645 )
Shares issued under direct stock purchase plan	31,536	—	—	—	1,327	—	—	1,327
Deferred compensation and other retirement benefit obligations	—	—	(119 )	119	—	—	—	—
Tax benefit related to deferred compensation distributions	—	\$—	\$—	\$—	165	—	—	165
Balance June 30, 2015	26,158,826	\$259	\$ (3,785 )	\$ 3,785	\$401,437	\$343,757	\$ (2,136 )	\$743,317

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Balance December 31, 2013	23,805,984	\$ 235	\$ (3,404 )	\$ 3,404	\$ 305,179	\$ 293,560	\$ (7,434 )	\$ 591,540
Net income	—	—	—	—	—	28,129	—	28,129
Other comprehensive income	—	—	—	—	—	—	5,741	5,741
Common dividend declared (\$0.48 per share)	—	—	—	—	—	(11,463 )	—	(11,463 )
Proceeds from exercise of stock options, net of cash paid	20,609	—	—	—	468	—	—	468
Tax benefit related to equity award activity	—	—	—	—	449	—	—	449
Stock based compensation	—	—	—	—	1,496	—	—	1,496
Restricted stock awards issued, net of awards surrendered	60,495	1	—	—	(643 )	—	—	(642 )
Shares issued under direct stock purchase plan	16,984	—	—	—	643	—	—	643
Deferred compensation and other retirement benefit obligations	—	—	(124 )	124	—	—	—	—
Tax benefit related to deferred compensation distributions	—	\$—	\$—	\$—	\$ 128	\$—	\$—	\$ 128
Balance June 30, 2014	23,904,072	236	(3,528 )	3,528	307,720	310,226	(1,693 )	616,489

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

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INDEPENDENT BANK CORP.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited—Dollars in thousands)

	Six Months Ended	
	June 30	
	2015	2014
Cash flow from operating activities		
Net income	\$26,910	\$28,129
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	6,388	6,153
Provision for loan losses	200	6,752
Deferred income tax expense	5,372	563
Net (gain) loss on sale of securities	315	(71)
Net loss on fixed assets	110	390
Loss on termination of derivatives	—	1,122
Net loss on other real estate owned and foreclosed assets	630	232
Realized gain on sale leaseback transaction	(517)	(517)
Stock based compensation	1,362	1,496
Excess tax benefit related to equity award activity	(546)	(449)
Increase in cash surrender value of life insurance policies	(1,727)	(1,443)
Gain on life insurance benefits	—	(1,964)
Change in fair value on loans held for sale	(184)	(225)
Net change in:		
Trading assets	(489)	—
Loans held for sale	(3,656)	(7,018)
Other assets	16,057	1,572
Other liabilities	(12,353)	(4,154)
Total adjustments	10,962	2,439
Net cash provided by operating activities	37,872	30,568
Cash flows used in investing activities		
Proceeds from sales of securities available for sale	14,344	673
Proceeds from maturities and principal repayments of securities available for sale	34,849	23,510
Purchases of securities available for sale	(34,193)	(868)
Proceeds from maturities and principal repayments of securities held to maturity	29,030	20,216
Purchases of securities held to maturity	(81,859)	(43,493)
Redemption of Federal Home Loan Bank stock	—	2,576
Investments in low income housing projects	(12,272)	(3,748)
Purchases of life insurance policies	(100)	(101)
Proceeds from life insurance policies	—	5,735
Net increase in loans	(1,137)	(177,486)
Cash used in business combinations, net of cash acquired	(13,448)	—
Purchases of bank premises and equipment	(4,537)	(3,915)
Proceeds from the sale of bank premises and equipment	347	759
Payments on early termination of hedging relationship	—	(1,122)
Proceeds from the sale of other real estate owned and foreclosed assets	3,879	2,810
Net capital improvements to other real estate owned	(765)	(875)



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Net cash used in investing activities	(65,862	) (175,329	)
Cash flows provided by financing activities			
Net decrease in time deposits	(39,853	) (40,770	)
Net increase in other deposits	367,667	352,513	
Net repayments of short-term Federal Home Loan Bank borrowings	(10,000	) (75,000	)
Repayments of long-term Federal Home Loan Bank borrowings	(3,000	) (5,000	)
Net decrease in customer repurchase agreements	(28,451	) (17,522	)
Net decrease in other short term borrowings	—	(5,000	)
Repayments of subordinated debentures	(30,000	) —	
Net proceeds from exercise of stock options	311	468	
Restricted stock awards issued, net of awards surrendered	(645	) (642	)
Excess tax benefit from stock based compensation	546	449	
Tax benefit from deferred compensation distribution	165	128	
Proceeds from shares issued under direct stock purchase plan	1,327	643	
Common dividends paid	(12,555	) (10,967	)
Net cash provided by financing activities	245,512	199,300	
Net increase in cash and cash equivalents	217,522	54,539	
Cash and cash equivalents at beginning of year	178,254	216,325	
Cash and cash equivalents at end of period	395,776	270,864	
Supplemental schedule of noncash investing and financing activities			
Transfer of loans to other real estate owned & foreclosed assets	\$983	\$4,257	
Other net transfers to other real estate owned	\$142	\$—	
Increase (decrease) in capital commitments relating to low income housing project investments	\$(1,055	) \$25,840	
In conjunction with the purchase acquisition detailed in note 3 to the consolidated financial statements, assets were acquired and liabilities were assumed as follows			
Common stock issued for acquisition	\$86,415	\$—	
Fair value of assets acquired, net of cash acquired	\$598,376	\$—	
Fair value of liabilities assumed	\$498,513	\$—	

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

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CONDENSED NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTATION

Independent Bank Corp. (the "Company") is a state chartered, federally registered bank holding company, incorporated in 1985. The Company is the sole stockholder of Rockland Trust Company ("Rockland Trust" or the "Bank"), a Massachusetts trust company chartered in 1907.

All material intercompany balances and transactions have been eliminated in consolidation. Certain previously reported amounts may have been reclassified to conform to the current year's presentation.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation of the financial statements, primarily consisting of normal recurring adjustments, have been included. Operating results for the quarter ended June 30, 2015 are not necessarily indicative of the results that may be expected for the year ending December 31, 2015 or any other interim period.

For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2014, filed with the Securities and Exchange Commission.

NOTE 2 - RECENT ACCOUNTING STANDARDS UPDATES

FASB ASC Topic 805 "Business Combinations - Pushdown Accounting" Update No. 2015-08. Update No. 2015-08 was issued in May 2015 to remove references and to amend certain previously issued pushdown accounting guidance. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial position.

FASB ASC Subtopic 350-40 "Intangibles - Goodwill and Other - Internal - Use Software" Update No. 2015-05. Update No. 2015-05 was issued in April 2015 to provide guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The guidance will not change current account for service contracts. The amendments in this update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial position.

FASB ASC Subtopic 835-30 "Interest - Imputation of Interest" Update No. 2015-03. Update No. 2015-03 was issued in April 2015 to simplify presentation of debt issuance costs. The amendments in this Update require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuances costs are not affected by the amendments in this Update. The amendments in this update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial position.

FASB ASC Topic 810 "Consolidation" Update No. 2015-02. Update No. 2015-02 was issued in February 2015 to respond to stakeholders' concerns about the current accounting for consolidation of certain legal entities. The amendments in this update affect reporting entities that are required to evaluate whether they should consolidate certain legal entities. All legal entities are subject to reevaluation under the revised consolidation model. Specifically,

the amendments: (1) modify the evaluation of whether limited partnerships and similar legal entities are variable interest entities (VIEs) or voting interest entities, (2) eliminate the presumption that a general partner should consolidate a limited partnership, (3) affect the consolidation analysis of reporting entities that are involved with VIEs, particularly those that have fee arrangements and related party relationships, and (4) provide a scope exception from consolidation guidance for reporting entities with interests in legal entities that are required to comply with or operate in accordance with requirements that are similar to those in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds. The amendments in this update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial position.

FASB ASC Subtopic 225-20 "Income Statement - Extraordinary and Unusual Items" Update No. 2015-01. Update No. 2015-01 was issued in January 2015 to simplify the income statement presentation requirements in Subtopic 225-20 by



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eliminating the concept of extraordinary items. Extraordinary items are events and transactions that are distinguished by their unusual nature and by the infrequency of their occurrence. The amendments in this update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial position.

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## NOTE 3 - ACQUISITIONS

## Peoples Federal Bancshares, Inc.

On February 20, 2015, the Company completed its acquisition of Peoples Federal Bancshares, Inc. ("Peoples"), the parent of Peoples Federal Saving Bank. The transaction qualified as a tax-free reorganization for federal income tax purposes and Peoples shareholders received, for each share of Peoples common stock, the right to receive either \$21.00 in cash per share or 0.5523 shares of the Company's stock (valued at \$23.26 per share, based upon the highest trading value of the Company's stock on February 20, 2015 of \$42.11). The total deal consideration was \$141.8 million and was comprised of 40% cash and 60% stock consideration. The cash consideration was \$55.4 million in the aggregate, inclusive of cash paid in lieu of fractional shares. The total stock consideration was \$86.4 million and resulted in an increase to the Company's outstanding shares of 2,052,137 shares.

The Company accounted for the acquisition using the acquisition method pursuant to the Business Combinations Topic of the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC"). Accordingly, the Company recorded merger and acquisition expenses of \$271,000 and \$10.5 million during the three and six months ended June 30, 2015, respectively. Additionally, the acquisition method requires the acquirer to recognize the assets acquired and the liabilities assumed at their fair values as of the acquisition date. The following table summarizes the estimated fair value of the assets acquired and liabilities assumed as of the date of the acquisition:

	Net Assets Acquired at Fair Value (Dollars in thousands)
Assets	
Cash	\$ 41,957
Investments	43,585
Loans	463,927
Premises and equipment	9,346
Goodwill	30,662
Core deposit and other intangibles	3,936
Other assets	46,920
Total assets acquired	640,333
Liabilities	
Deposits	432,250
Borrowings	51,209
Other liabilities	15,054
Total liabilities assumed	498,513
Purchase price	\$ 141,820

Fair value adjustments to assets acquired and liabilities assumed are generally amortized using either an effective yield or straight-line basis over periods consistent with the average life, useful life and/or contractual term of the related assets and liabilities.

Fair values of the major categories of assets acquired and liabilities assumed were determined as follows:

**Cash and Cash Equivalents**

The fair values of cash and cash equivalents approximate the respective carrying amounts because the instruments are payable on demand or have short-term maturities.

**Investments**

The fair values of securities were based on quoted market prices for identical securities received from an independent, nationally-recognized, third-party pricing service. Prices provided by the independent pricing service were based on

recent trading activity and other observable information including, but not limited to, market interest rate curves, referenced credit spreads and estimated prepayment rates where applicable.

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## Loans

The loans acquired were recorded at fair value without a carryover of the allowance for loan losses. Fair value of the loans is determined using market participant assumptions in estimating the amount and timing of both principal and interest cash flows expected to be collected, as adjusted for an estimate of future credit losses and prepayments, and then applying a market-based discount rate to those cash flows. The overall discount on the loans acquired in this transaction was due to anticipated credit loss, as well as considerations for liquidity and market interest rates.

A portion of the loans acquired showed evidence of deterioration of credit quality at the purchase date and it was deemed unlikely that the Company will be able to collect all contractually required payments. As such, these loans were deemed to be purchased credit impaired ("PCI") and the carrying value and prospective income recognition are predicated upon future cash flows expected to be collected. The following is a summary of these PCI loans associated with the acquisition as of the date acquired:

	(Dollars in thousands)
Contractually required principal and interest at acquisition	\$4,358
Contractual cash flows not expected to be collected	(1,596 )
Expected cash flows at acquisition	2,762
Interest component of expected cash flows	(319 )
Basis in PCI loans at acquisition - estimated fair value	\$2,443

## Premises and Equipment

The fair value of the premises, including land, buildings and improvements, was determined based upon appraisals by licensed real estate appraisers or pending agreed upon sale prices. The appraisals were based upon the best and highest use of the property with final values determined based upon an analysis of the cost, sales comparison and income capitalization approaches for each property appraised.

## Core Deposit Intangible

The fair value of the core deposit intangible is derived by comparing the interest rate and servicing costs that the financial institution pays on the core deposit liability versus the current market rate for alternative sources of financing, while factoring in estimates over the remaining life and attrition rate of the deposit accounts. The intangible asset represents the stable and relatively low cost source of funds that the deposits and accompanying relationships provide the Company, when compared to alternative funding sources.

## Deposits

The fair value of acquired savings and transaction deposit accounts was assumed to approximate the carrying value as these accounts have no stated maturity and are payable on demand. The fair value of time deposits were determined based on the present value of the contractual cash flows over the remaining period to maturity using a market interest rate.

## Borrowings

The fair values of Federal Home Loan Bank ("FHLB") advances were derived based upon the present value of the principal and interest payments using a current market discount rate.

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## Selected Pro Forma Results

The following summarizes the unaudited pro forma results of operations as if the Company acquired Peoples on January 1, 2015 (2014 amounts represent combined results for the Company and Peoples). The selected pro forma financial information is presented for illustrative purposes only and is not necessarily indicative of the financial results of the combined companies had the acquisition actually been completed at the beginning of the periods presented, nor does it indicate future results for any other interim or full-year period.

	Three Months Ended June 30		Six Months Ended June 30	
	2015	2014	2015	2014
	(Dollars in thousands)			
Net interest income after provision for loan losses	\$53,047	\$51,273	\$107,455	\$98,789
Net income	17,606	15,285	31,766	29,182

Excluded from the pro forma results of operations for the three and six months ended June 30, 2015 are merger-related costs of \$271,000 and \$16.7 million, respectively, recognized by both the Company and Peoples in the aggregate. These costs were primarily made up of contract terminations arising due to the change in control, the acceleration of certain compensation and benefit costs, and other merger expenses.

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## NOTE 4 - SECURITIES

## Trading Securities

As of June 30, 2015, the Company had trading securities of \$489,000. These securities are held in a rabbi trust and will be used for future payments associated with the Company's non-qualified 401(k) Restoration Plan and non-qualified deferred compensation plan.

## Available for Sale and Held to Maturity Securities

The following table presents a summary of the amortized cost, gross unrealized holding gains and losses, other-than-temporary impairment recorded in other comprehensive income and fair value of securities available for sale and securities held to maturity for the periods below:

	June 30, 2015				December 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)							
Available for sale securities								
U.S. government agency securities	\$39,375	\$ 351	\$ —	\$39,726	\$41,369	\$ 139	\$ (22 )	\$41,486
Agency mortgage-backed securities	226,438	5,436	(877 )	230,997	211,168	7,203	(693 )	217,678
Agency collateralized mortgage obligations	55,241	477	(516 )	55,202	63,059	599	(623 )	63,035
State, county, and municipal securities	4,571	97	—	4,668	5,106	117	—	5,223
Single issuer trust preferred securities issued by banks	2,889	11	(28 )	2,872	2,913	12	(16 )	2,909
Pooled trust preferred securities issued by banks and insurers (1)	2,246	—	(651 )	1,595	7,906	195	(1,780 )	6,321
Small business administration pooled securities	26,632	—	(135 )	26,497	—	—	—	—
Equity securities	13,201	579	(336 )	13,444	11,572	567	(237 )	11,902
Total available for sale securities	\$370,593	\$ 6,951	\$ (2,543 )	\$375,001	\$343,093	\$ 8,832	\$ (3,371 )	\$348,554
Held to maturity securities								
U.S. Treasury securities	\$1,009	\$ 61	\$ —	\$1,070	\$1,010	\$ 63	\$ —	\$1,073
Agency mortgage-backed securities	158,432	4,011	(69 )	162,374	159,522	5,422	—	164,944
Agency collateralized mortgage obligations	224,994	1,885	(2,754 )	224,125	198,220	1,842	(3,478 )	196,584
State, county, and municipal securities	225	2	—	227	424	4	—	428
Single issuer trust preferred securities issued by banks	1,500	—	—	1,500	1,500	—	(23 )	1,477
Small business administration pooled securities	37,178	341	(103 )	37,416	9,775	299	—	10,074

Corporate debt securities	5,001	65	—	5,066	5,002	117	—	5,119
Total held to maturity securities	\$428,339	\$6,365	\$(2,926)	\$431,778	\$375,453	\$7,747	\$(3,501)	\$379,699
Total	\$798,932	\$13,316	\$(5,469)	\$806,779	\$718,546	\$16,579	\$(6,872)	\$728,253

(1) Gross unrealized gains and gross unrealized losses include \$230,000 of net non-credit related other-than-temporary impairment ("OTTI") at December 31, 2014. There was no non-credit related OTTI at June 30, 2015.

When securities are sold, the adjusted cost of the specific security sold is used to compute the gain or loss on the sale. The Company realized a loss of \$8,000 and a gain of \$19,000 on equity securities classified as available for sale during the three and six month periods ending June 30, 2015. The Company realized a net loss of \$20,000 and a net gain of \$71,000 on equity securities classified as available for sale during the three and six month period ending June 30, 2014, respectively. The Company realized a loss of \$1.1 million and a gain of \$798,000 on the sale of the Company's fixed income securities during the three and six month periods ending June 30, 2015. There were no gains or losses on sale on the Company's fixed income securities during the respective periods ending June 30, 2014.

The actual maturities of certain securities may differ from the contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. A schedule of the contractual maturities of securities available for sale and securities held to maturity as of June 30, 2015 is presented below:

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	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)			
Due in one year or less	\$—	\$—	\$5,226	\$5,293
Due after one year to five years	46,469	47,097	149	152
Due after five to ten years	92,147	92,354	29,960	30,547
Due after ten years	218,776	222,106	393,004	395,786
Total debt securities	\$357,392	\$361,557	\$428,339	\$431,778
Equity securities	\$13,201	\$13,444	\$—	\$—
Total	\$370,593	\$375,001	\$428,339	\$431,778

Inclusive in the table above is \$27.6 million of callable securities in the Company's investment portfolio at June 30, 2015.

The carrying value of securities pledged to secure public funds, trust deposits, repurchase agreements and for other purposes, as required or permitted by law, was \$317.6 million and \$340.0 million at June 30, 2015 and December 31, 2014, respectively.

At June 30, 2015 and December 31, 2014, the Company had no investments in obligations of individual states, counties, or municipalities which exceeded 10% of stockholders' equity.

**Other-Than-Temporary Impairment ("OTTI")**

The Company continually reviews investment securities for the existence of OTTI, taking into consideration current market conditions, the extent and nature of changes in fair value, issuer rating changes and trends, the credit worthiness of the obligor of the security, volatility of earnings, current analysts' evaluations, the Company's intent to sell the security, or whether it is more likely than not that the Company will be required to sell the debt security before its anticipated recovery, as well as other qualitative factors. The term "other-than-temporary" is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment.

The following tables show the gross unrealized losses and fair value of the Company's investments in an unrealized loss position, which the Company has not deemed to be OTTI, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position:

	June 30, 2015						
	# of holdings	Fair Value	Less than 12 months Unrealized Losses	12 months or longer Fair Value	12 months or longer Unrealized Losses	Total Fair Value	Total Unrealized Losses
	(Dollars in thousands)						
Agency mortgage-backed securities	40	\$76,234	\$(766)	\$4,542	\$(180)	\$80,776	\$(946)
Agency collateralized mortgage obligations	14	45,813	(329)	88,668	(2,941)	134,481	(3,270)
Single issuer trust preferred securities issued by banks and insurers	2	2,113	(28)	—	—	2,113	(28)
Pooled trust preferred securities issued by banks and insurers	1	—	—	1,595	(651)	1,595	(651)
Small business administration pooled securities	3	39,349	(238)	—	—	39,349	(238)
Equity securities	26	2,717	(123)	4,330	(213)	7,047	(336)
Total temporarily impaired securities	86	\$166,226	\$(1,484)	\$99,135	\$(3,985)	\$265,361	\$(5,469)





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	December 31, 2014						
	# of holdings	Less than 12 months		12 months or longer		Total	
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)						
U.S. government agency securities	22	\$21,950	\$(22 )	\$—	\$—	\$21,950	\$(22 )
Agency mortgage-backed securities	17	3,471	(1 )	42,222	(692 )	45,693	(693 )
Agency collateralized mortgage obligations	14	35,083	(331 )	94,974	(3,770 )	130,057	(4,101 )
Single issuer trust preferred securities issued by banks and insurers	2	2,553	(39 )	—	—	2,553	(39 )
Pooled trust preferred securities issued by banks and insurers	2	—	—	2,681	(1,356 )	2,681	(1,356 )
Equity securities	23	1,480	(74 )	4,072	(163 )	5,552	(237 )
Total temporarily impaired securities	80	\$64,537	\$(467 )	\$143,949	\$(5,981 )	\$208,486	\$(6,448 )

The Company does not intend to sell these investments and has determined based upon available evidence that it is more likely than not that the Company will not be required to sell the security before the recovery of its amortized cost basis. As a result, the Company does not consider these investments to be OTTI. The Company made this determination by reviewing various qualitative and quantitative factors regarding each investment category, such as current market conditions, extent and nature of changes in fair value, issuer rating changes and trends, volatility of earnings, and current analysts' evaluations.

As a result of the Company's review of these qualitative and quantitative factors, the causes of the impairments listed in the table above by category are as follows at June 30, 2015:

**Agency Mortgage-Backed Securities, Agency Collateralized Mortgage Obligations and Small Business**

**Administration Pooled Securities:** These portfolios have contractual terms that generally do not permit the issuer to settle the securities at a price less than the current par value of the investment. The decline in market value of these securities is attributable to changes in interest rates and not credit quality. Additionally, these securities carry the implicitly or, in some cases the explicit guarantee of the U.S. Government or one of its agencies.

**Single Issuer Trust Preferred Securities:** This portfolio consists of two securities, one of which is below investment grade. The unrealized loss on these securities is attributable to the illiquid nature of the trust preferred market in the current economic environment. Management evaluates various financial metrics for the issuers, including regulatory capital ratios of the issuers.

**Pooled Trust Preferred Securities:** This portfolio consists of one below investment grade security which is performing. The unrealized loss on this security is attributable to the illiquid nature of the trust preferred market and the significant risk premiums required in the current economic environment. Management evaluates collateral credit and instrument structure, including current and expected deferral and default rates and timing. In addition, discount rates are determined by evaluating comparable spreads observed currently in the market for similar instruments.

**Equity Securities:** This portfolio consists of mutual funds and other equity investments. During some periods, the mutual funds in the Company's investment portfolio may have unrealized losses resulting from market fluctuations as well as the risk premium associated with that particular asset class. For example, emerging market equities tend to trade at a higher risk premium than U.S. government bonds and thus, will fluctuate to a greater degree on both the upside and the downside. In the context of a well-diversified portfolio, however, the correlation amongst the various asset classes represented by the funds serves to minimize downside risk. The Company evaluates each mutual fund in the portfolio regularly and measures performance on both an absolute and relative basis. A reasonable recovery period for positions with an unrealized loss is based on management's assessment of general economic data, trends within a particular asset class, valuations, earnings forecasts and bond durations.



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The following table shows the total OTTI that the Company recorded for the periods indicated:

	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2015	2014	2015	2014
	(Dollars in thousands)			
Gross change in OTTI recorded on certain investments	\$—	\$196	\$84	\$1,029
Portion of OTTI recognized in OCI	—	(196	) (84	) (1,029
Total credit related OTTI recognized in earnings	\$—	\$—	\$—	\$—

The following table shows the cumulative credit related component of OTTI for the periods indicated:

	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2015	2014	2015	2014
	(Dollars in thousands)			
Balance at beginning of period	\$(9,997	) \$(9,997	) \$(9,997	) \$(9,997
Add				
Incurred on securities not previously impaired	—	—	—	—
Incurred on securities previously impaired	—	—	—	—
Less				
Securities sold during the period	9,997	—	9,997	—
Reclassification due to changes in Company's intent	—	—	—	—
Increases in cash flow expected to be collected	—	—	—	—
Balance at end of period	\$—	\$(9,997	) \$—	\$(9,997

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## NOTE 5 - LOANS, ALLOWANCE FOR LOAN LOSSES, AND CREDIT QUALITY

The following tables bifurcate the amount of loans and the allowance allocated to each loan category based on the type of impairment analysis as of the periods indicated:

		June 30, 2015							
		(Dollars in thousands)							
		Commercial Industrial	Commercial Real Estate	Commercial Construction	Small Business	Residential Real Estate	Home Equity	Other Consumer	Total
Financing receivables ending balance:									
Collectively evaluated for impairment	\$867,695	\$2,588,279	\$278,205	\$90,481	\$629,556	\$884,588	\$15,618	\$5,354,422	
Individually evaluated for impairment	\$5,410	\$29,562	\$309	\$886	\$14,940	\$5,895	\$1,664	\$58,666	
Purchased credit impaired loans	\$—	\$12,221	\$178	\$—	\$8,874	\$410	\$11	\$21,694	
Total loans by group	\$873,105	\$2,630,062	\$278,692	\$91,367	\$653,370	\$890,893	\$17,293	\$5,434,782 (1)	
		December 31, 2014							
		(Dollars in thousands)							
		Commercial Industrial	Commercial Real Estate	Commercial Construction	Small Business	Residential Real Estate	Home Equity	Other Consumer	Total
Financing receivables ending balance:									
Collectively evaluated for impairment	\$856,185	\$2,304,099	\$265,501	\$84,159	\$505,799	\$858,305	\$16,335	\$4,890,383	
Individually evaluated for impairment	\$4,654	\$30,729	\$311	\$1,088	\$15,055	\$5,330	\$868	\$58,035	
Purchased credit impaired loans	\$—	\$12,495	\$182	\$—	\$9,405	\$228	\$5	\$22,315	
Total loans by group	\$860,839	\$2,347,323	\$265,994	\$85,247	\$530,259	\$863,863	\$17,208	\$4,970,733 (1)	

(1) The amount of net deferred fees included in the ending balance was \$3.5 million and \$2.8 million at June 30, 2015 and December 31, 2014, respectively.

The following tables summarize changes in allowance for loan losses by loan category for the periods indicated:

Three Months Ended June 30, 2015

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(Dollars in thousands)

	Commercial Industrial	Commercial Real Estate	Commercial Construction	Small Business	Residential Real Estate	Home Equity	Other Consumer	Total
Allowance for loan losses								
Beginning balance	\$14,557	\$26,285	\$4,142	\$1,222	\$2,726	\$4,906	\$677	\$54,515
Charge-offs	(473 )	(67 )	—	(47 )	(17 )	(248 )	(247 )	(1,099 )
Recoveries	502	169	—	66	1	31	110	879
Provision	693	(28 )	(71 )	7	(159 )	182	76	700
Ending balance	\$15,279	\$26,359	\$4,071	\$1,248	\$2,551	\$4,871	\$616	\$54,995

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## Three Months Ended June 30, 2014

(Dollars in thousands)

	Commercial Industrial	Commercial Real Estate	Commercial Construction	Small Business	Residential Real Estate	Home Equity	Other Consumer	Total
Allowance for loan losses								
Beginning balance	\$ 15,601	\$ 24,917	\$ 3,570	\$ 1,207	\$ 2,829	\$ 4,758	\$ 747	\$ 53,629
Charge-offs	(470 )	(660 )	—	(128 )	(326 )	(308 )	(258 )	(2,150 )
Recoveries	128	197	—	92	190	55	147	809
Provision (benefit)	670	641	187	(17 )	186	464	119	2,250
Ending balance	\$ 15,929	\$ 25,095	\$ 3,757	\$ 1,154	\$ 2,879	\$ 4,969	\$ 755	\$ 54,538

## Six Months Ended June 30, 2015

(Dollars in thousands)

	Commercial Industrial	Commercial Real Estate	Commercial Construction	Small Business	Residential Real Estate	Home Equity	Other Consumer	Total
Allowance for loan losses								
Beginning balance	\$ 15,573	\$ 25,873	\$ 3,945	\$ 1,171	\$ 2,834	\$ 4,956	\$ 748	\$ 55,100
Charge-offs	(1,034 )	(208 )	—	(196 )	(202 )	(411 )	(573 )	(2,624 )
Recoveries	881	854	—	132	46	105	301	2,319
Provision (benefit)	(141 )	(160 )	126	141	(127 )	221	140	200
Ending balance	\$ 15,279	\$ 26,359	\$ 4,071	\$ 1,248	\$ 2,551	\$ 4,871	\$ 616	\$ 54,995
Ending balance: individually evaluated for impairment	\$ 310	\$ 201	\$ —	\$ 4	\$ 1,337	\$ 250	\$ 30	\$ 2,132
Ending balance: collectively evaluated for impairment	\$ 14,969	\$ 26,158	\$ 4,071	\$ 1,244	\$ 1,214	\$ 4,621	\$ 586	\$ 52,863

## Six Months Ended June 30, 2014

(Dollars in thousands)

	Commercial Industrial	Commercial Real Estate	Commercial Construction	Small Business	Residential Real Estate	Home Equity	Other Consumer	Total
Allowance for loan losses								
Beginning balance	\$ 15,622	\$ 24,541	\$ 3,371	\$ 1,215	\$ 2,760	\$ 5,036	\$ 694	\$ 53,239
Charge-offs	(1,253 )	(3,582 )	—	(396 )	(454 )	(402 )	(629 )	(6,716 )
Recoveries	207	265	—	139	190	148	314	1,263
Provision (benefit)	1,353	3,871	386	196	383	187	376	6,752
Ending balance	\$ 15,929	\$ 25,095	\$ 3,757	\$ 1,154	\$ 2,879	\$ 4,969	\$ 755	\$ 54,538
Ending balance: individually evaluated for impairment	\$ 472	\$ 292	\$ —	\$ 45	\$ 1,599	\$ 273	\$ 49	\$ 2,730
Ending balance: collectively evaluated for impairment	\$ 15,457	\$ 24,803	\$ 3,757	\$ 1,109	\$ 1,280	\$ 4,696	\$ 706	\$ 51,808

For the purpose of estimating the allowance for loan losses, management segregates the loan portfolio into the portfolio segments detailed in the above tables. Each of these loan categories possesses unique risk characteristics that are considered when determining the appropriate level of allowance for each segment. Some of the risk characteristics unique to each loan category include:

Commercial Portfolio

Commercial and Industrial: Loans in this category consist of revolving and term loan obligations extended to business and corporate enterprises for the purpose of financing working capital and/or capital investment. Collateral generally consists of pledges of business assets including, but not limited to: accounts receivable, inventory, plant & equipment, or real estate, if applicable. Repayment sources consist of primarily, operating cash flow, and secondarily, liquidation of assets.



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**Commercial Real Estate:** Loans in this category consist of mortgage loans to finance investment in real property such as multi-family residential, commercial/retail, office, industrial, hotels, educational and healthcare facilities and other specific use properties. Loans are typically written with amortizing payment structures. Collateral values are determined based upon third party appraisals and evaluations. Loan to value ratios at origination are governed by established policy and regulatory guidelines. Repayment sources consist of primarily, cash flow from operating leases and rents, and secondarily, liquidation of assets.

**Commercial Construction:** Loans in this category consist of short-term construction loans, revolving and nonrevolving credit lines and construction/permanent loans to finance the acquisition, development and construction or rehabilitation of real property. Project types include residential 1-4 family condominium and multi-family homes, commercial/retail, office, industrial, hotels, educational and healthcare facilities and other specific use properties.

Loans may be written with nonamortizing or hybrid payment structures depending upon the type of project.

Collateral values are determined based upon third party appraisals and evaluations. Loan to value ratios at origination are governed by established policy and regulatory guidelines. Repayment sources vary depending upon the type of project and may consist of sale or lease of units, operating cash flows or liquidation of other assets.

**Small Business:** Loans in this category consist of revolving, term loan and mortgage obligations extended to sole proprietors and small businesses for purposes of financing working capital and/or capital investment. Collateral generally consists of pledges of business assets including, but not limited to accounts receivable, inventory, plant & equipment, or real estate if applicable. Repayment sources consist primarily of, operating cash flows, and secondarily, liquidation of assets.

For the commercial portfolio it is the Company's policy to obtain personal guarantees for payment from individuals holding material ownership interests of the borrowing entities.

### Consumer Portfolio

**Residential Real Estate:** Residential mortgage loans held in the Company's portfolio are made to borrowers who demonstrate the ability to make scheduled payments with full consideration to underwriting factors such as current and expected income, employment status, current assets, other financial resources, credit history and the value of the collateral. Collateral consists of mortgage liens on 1-4 family residential properties. The Company does not originate or purchase sub-prime loans.

**Home Equity:** Home equity loans and lines are made to qualified individuals and are secured by senior or junior mortgage liens on owner-occupied 1-4 family homes, condominiums or vacation homes or on nonowner occupied 1-4 family homes with more restrictive loan to value requirements. The home equity loan has a fixed rate and is billed in equal payments comprised of principal and interest. The home equity line of credit has a variable rate and is billed in interest-only payments during the draw period. At the end of the draw period, the home equity line of credit is billed as a percentage of the principal balance plus all accrued interest. Additionally, the Company has the option of renewing the line of credit for additional draw periods. Borrower qualifications include favorable credit history combined with supportive income requirements and combined loan to value ratios within established policy guidelines.

**Other Consumer:** Other consumer loan products include personal lines of credit and amortizing loans made to qualified individuals for various purposes such as education, auto loans, debt consolidation, personal expenses or overdraft protection. Borrower qualifications include favorable credit history combined with supportive income and collateral requirements within established policy guidelines. These loans may be secured or unsecured.

### Credit Quality

The Company continually monitors the asset quality of the loan portfolio using all available information. Based on this information, loans demonstrating certain payment issues or other weaknesses may be categorized as delinquent, impaired, nonperforming and/or put on nonaccrual status. Additionally, in the course of resolving such loans, the Company may choose to restructure the contractual terms of certain loans to match the borrower's ability to repay the loan based on their current financial condition. If a restructured loan meets certain criteria, it may be categorized as a troubled debt restructuring ("TDR").

The Company reviews numerous credit quality indicators when assessing the risk in its loan portfolio. For the commercial portfolio, the Company utilizes a 10-point commercial risk-rating system, which assigns a risk-grade to

each borrower based on a number of quantitative and qualitative factors associated with a commercial loan transaction. Factors considered include industry and market conditions, position within the industry, earnings trends, operating cash flow, asset/liability values, debt capacity, guarantor strength, management and controls, financial reporting, collateral, and other considerations. The risk-ratings categories are defined as follows:

- 1- 6 Rating — Pass: Risk-rating grades “1” through “6” comprise those loans ranging from ‘Substantially Risk Free’ which indicates borrowers are of unquestioned credit standing and the pinnacle of credit quality, well established companies with a very strong financial condition, and loans fully secured by cash collateral, through ‘Acceptable Risk’, which indicates borrowers

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may exhibit declining earnings, strained cash flow, increasing leverage and/or weakening market fundamentals that indicate above average or below average asset quality, margins and market share. Collateral coverage is protective.

7 Rating — Potential Weakness: Borrowers exhibit potential credit weaknesses or downward trends deserving management's close attention. If not checked or corrected, these trends will weaken the Company's asset and position. While potentially weak, currently these borrowers are marginally acceptable; no loss of principal or interest is envisioned.

8 Rating — Definite Weakness Loss Unlikely: Borrowers exhibit well defined weaknesses that jeopardize the orderly liquidation of debt. Loan may be inadequately protected by the current net worth and paying capacity of the obligor or by the collateral pledged, if any. Normal repayment from the borrower is in jeopardy, although no loss of principal is envisioned. However, there is a distinct possibility that a partial loss of interest and/or principal will occur if the deficiencies are not corrected. Collateral coverage may be inadequate to cover the principal obligation.

9 Rating — Partial Loss Probable: Borrowers exhibit well defined weaknesses that jeopardize the orderly liquidation of debt with the added provision that the weaknesses make collection of the debt in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. Serious problems exist to the point where partial loss of principal is likely.

10 Rating — Definite Loss: Borrowers deemed incapable of repayment. Loans to such borrowers are considered uncollectible and of such little value that continuation as active assets of the Company is not warranted.

The credit quality of the commercial loan portfolio is actively monitored and any changes in credit quality are reflected in risk-rating changes. Risk-ratings are assigned or reviewed for all new loans, when advancing significant additions to existing relationships (over \$50,000), at least quarterly for all actively managed loans, and any time a significant event occurs, including at renewal of the loan.

The Company utilizes a comprehensive strategy for monitoring commercial credit quality. Borrowers are required to provide updated financial information at least annually which is carefully evaluated for any changes in credit quality. Larger loan relationships are subject to a full annual credit review by an experienced credit analysis group. Additionally, the Company retains an independent loan review firm to evaluate the credit quality of the commercial loan portfolio. The independent loan review process achieves significant penetration into the commercial loan portfolio and reports the results of these reviews to the Audit Committee of the Board of Directors on a quarterly basis.

The following table details the amount of outstanding principal balances relative to each of the risk-rating categories for the Company's commercial portfolio:

Category	Risk Rating	June 30, 2015				Small Business	Total
		Commercial and Industrial	Commercial Real Estate	Commercial Construction			
		(Dollars in thousands)					
Pass	1 - 6	\$803,026	\$2,488,514	\$268,628	\$ 87,815	\$3,647,983	
Potential weakness	7	50,448	77,276	9,530	2,790	140,044	
Definite weakness-loss unlikely	8	19,540	63,069	534	684	83,827	
Partial loss probable	9	91	1,203	—	78	1,372	
Definite loss	10	—	—	—	—	—	
Total		\$873,105	\$2,630,062	\$278,692	\$ 91,367	\$3,873,226	

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Category	Risk Rating	December 31, 2014				Total
		Commercial and Industrial	Commercial Real Estate	Commercial Construction	Small Business	
(Dollars in thousands)						
Pass	1 - 6	\$801,578	\$2,196,109	\$248,696	\$ 81,255	\$3,327,638
Potential weakness	7	37,802	82,372	15,464	2,932	138,570
Definite weakness-loss unlikely	8	20,241	67,571	1,834	949	90,595
Partial loss probable	9	1,218	1,271	—	111	2,600
Definite loss	10	—	—	—	—	—
Total		\$860,839	\$2,347,323	\$265,994	\$ 85,247	\$3,559,403

For the Company's consumer portfolio, the quality of the loan is best indicated by the repayment performance of an individual borrower. However, the Company does supplement performance data with current Fair Isaac Corporation ("FICO") and Loan to Value ("LTV") estimates. Current FICO data is purchased and appended to all consumer loans on a quarterly basis. In addition, automated valuation services and broker opinions of value are used to supplement original value data for the residential and home equity portfolios, periodically. The following table shows the weighted average FICO scores and the weighted average combined LTV ratios as of the periods indicated below:

	June 30, 2015	December 31, 2014		
Residential portfolio				
FICO score (re-scored)(1)	741	739		
LTV (re-valued)(2)	60.3	% 67.1		%
Home equity portfolio				
FICO score (re-scored)(1)	764	764		
LTV (re-valued)(2)	50.5	% 53.6		%

(1) The average FICO scores for June 30, 2015 are based upon rescoring available from May 31, 2015 and origination score data for loans booked between June 1 and June 30, 2015. The average FICO scores for December 31, 2014 are based upon rescoring available from November 30, 2014 and origination score data for loans booked between December 1, 2014 and December 31, 2014.

(2) The combined LTV ratios for June 30, 2015 are based upon updated automated valuations as of March 31, 2015 and origination value data for loans booked between April 1, 2015 and June 30, 2015. The combined LTV ratios for December 31, 2014 are based upon updated automated valuations as of February 28, 2013 and actual score data for loans booked from March 1, 2013 through December 31, 2014. For home equity loans and lines in a subordinate lien, the LTV data represents a combined LTV, taking into account the senior lien data for loans and lines.

The Company's philosophy toward managing its loan portfolios is predicated upon careful monitoring, which stresses early detection and response to delinquent and default situations. Delinquent loans are managed by a team of seasoned collection specialists and the Company seeks to make arrangements to resolve any delinquent or default situation over the shortest possible time frame. As a general rule, loans more than 90 days past due with respect to principal or interest are classified as nonaccrual loans. As permitted by banking regulations, certain consumer loans 90 days or more past due may continue to accrue interest. The Company also may use discretion regarding other loans over 90 days delinquent if the loan is well secured and in process of collection. Set forth below is information regarding the Company's nonaccrual, delinquent, TDRs, and impaired loans at the period shown.

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The following table shows nonaccrual loans at the dates indicated:

	June 30, 2015	December 31, 2014
	(Dollars in thousands)	
Commercial and industrial	\$3,767	\$2,822
Commercial real estate	6,515	7,279
Commercial construction	309	311
Small business	198	246
Residential real estate	7,982	8,697
Home equity	7,238	8,038
Other consumer	37	—
Total nonaccrual loans(1)	\$26,046	\$27,393

(1) Included in these amounts were \$5.6 million and \$5.2 million of nonaccruing TDRs at June 30, 2015 and December 31, 2014, respectively.

The following table shows information regarding foreclosed residential real estate property at the date indicated:

	June 30, 2015
	(Dollars in thousands)
Foreclosed residential real estate property held by the creditor	\$1,390
Recorded investment in mortgage loans collateralized by residential real estate property that are in the process of foreclosure	\$2,199

The following table shows the age analysis of past due financing receivables as of the dates indicated:

Loan Portfolio	June 30, 2015										Recorded Investment >90 Days and Accruing
	30-59 days		60-89 days		90 days or more		Total Past Due		Current	Total Financing Receivables	
	Number of Loans	Principal Balance	Number of Loans	Principal Balance	Number of Loans	Principal Balance	Number of Loans	Principal Balance			
Commercial and industrial	11	\$ 1,528	5	\$ 1,423	11	\$ 2,951	27	\$ 5,902	\$ 867,203	\$ 873,105	\$ —
Commercial real estate	12	3,052	7	3,792	19	4,442	38	11,286	2,618,776	2,630,062	—
Commercial construction	—	—	—	—	1	309	1	309	278,383	278,692	—
Small business	7	143	2	2	9	85	18	230	91,137	91,367	—
Residential real estate	8	1,030	5	855	25	3,780	38	5,665	647,705	653,370	104
Home equity	16	688	11	692	18	1,582	45	2,962	887,931	890,893	—
Other consumer	25	150	8	10	7	17	40	177	17,116	17,293	—
Total	79	\$ 6,591	38	\$ 6,774	90	\$ 13,166	207	\$ 26,531	\$ 5,408,251	\$ 5,434,782	\$ 104



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December 31, 2014												
Loan Portfolio	30-59 days		60-89 days		90 days or more		Total Past Due		Current	Total Financing Receivables	Recorded Investment >90 Days and Accruing	
	Number of Loans	Principal Balance	Number of Loans	Principal Balance	Number of Loans	Principal Balance	Number of Loans	Principal Balance				
(Dollars in thousands)												
Commercial and industrial	18	\$3,192	10	\$1,007	19	\$2,320	47	\$6,519	\$854,320	\$860,839	\$ —	
Commercial real estate	19	13,428	6	1,480	16	4,225	41	19,133	2,328,190	2,347,323	—	
Commercial construction	1	506	—	—	1	311	2	817	265,177	265,994	—	
Small business	7	21	8	113	7	173	22	307	84,940	85,247	—	
Residential real estate	13	1,670	10	1,798	36	4,826	59	8,294	521,965	530,259	106	
Home equity	20	1,559	7	307	23	2,402	50	4,268	859,595	863,863	—	
Other consumer	34	233	6	20	8	13	48	266	16,942	17,208	13	
<b>Total</b>	<b>112</b>	<b>\$20,609</b>	<b>47</b>	<b>\$4,725</b>	<b>110</b>	<b>\$14,270</b>	<b>269</b>	<b>\$39,604</b>	<b>\$4,931,129</b>	<b>\$4,970,733</b>	<b>\$ 119</b>	

In the course of resolving nonperforming loans, the Company may choose to restructure the contractual terms of certain loans. The Company attempts to work out an alternative payment schedule with the borrower in order to avoid foreclosure actions. Any loans that are modified are reviewed by the Company to identify if a TDR has occurred, which is when, for economic or legal reasons related to a borrower's financial difficulties, the Company grants a concession to the borrower that it would not otherwise consider. Terms may be modified to fit the ability of the borrower to repay in line with its current financial status and the restructuring of the loan may include the transfer of assets from the borrower to satisfy the debt, a modification of loan terms, or a combination of the two.

The following table shows the Company's total TDRs and other pertinent information as of the dates indicated:

	June 30, 2015	December 31, 2014
	(Dollars in thousands)	
TDRs on accrual status	\$36,750	\$38,382
TDRs on nonaccrual	5,623	5,248
Total TDRs	\$42,373	\$43,630
Amount of specific reserves included in the allowance for loan losses associated with TDRs:	\$1,872	\$2,004
Additional commitments to lend to a borrower who has been a party to a TDR:	\$1,522	\$1,400

The Company's policy is to have any restructured loan which is on nonaccrual status prior to being modified remain on nonaccrual status for six months, subsequent to being modified, before management considers its return to accrual status. If the restructured loan is on accrual status prior to being modified, it is reviewed to determine if the modified loan should remain on accrual status. Additionally, loans classified as TDRs are adjusted to reflect the changes in value of the recorded investment in the loan, if any, resulting from the granting of a concession. For all residential loan modifications, the borrower must perform during a 90 day trial period before the modification is finalized. The following table shows the modifications which occurred during the periods indicated and the change in the recorded investment subsequent to the modifications occurring:





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	Three Months Ended June 30, 2015			Six Months Ended June 30, 2015		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment (Dollars in thousands)	Post-Modification Outstanding Recorded Investment (1)	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment (1)
Troubled debt restructurings						
Commercial and industrial	7	\$ 1,197	\$ 1,197	10	\$ 1,353	\$ 1,353
Commercial real estate	4	2,071	2,071	5	2,310	2,310
Small business	3	116	116	5	166	166
Residential real estate	—	—	—	3	157	157
Home equity	1	31	31	3	215	215
Total	15	\$ 3,415	\$ 3,415	26	\$ 4,201	\$ 4,201

	Three Months Ended June 30, 2014			Six Months Ended June 30, 2014		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment (Dollars in thousands)	Post-Modification Outstanding Recorded Investment (1)	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment (1)
Troubled debt restructurings						
Commercial and industrial	3	\$ 399	\$ 399	12	\$ 824	\$ 824
Commercial real estate	—	—	—	6	1,882	1,882
Small business	1	117	117	2	174	174
Residential real estate	—	—	—	2	542	513
Home equity	3	520	520	4	616	616
Other consumer	—	—	—	1	8	8
Total	7	\$ 1,036	\$ 1,036	27	\$ 4,046	\$ 4,017

(1) The post-modification balances represent the balance of the loan on the date of modifications. These amounts may show an increase when modifications include a capitalization of interest.

The following table shows the Company's post-modification balance of TDRs listed by type of modification during the period indicated:

	Three Months Ended June 30		Six Months Ended June 30	
	2015	2014	2015	2014
	(Dollars in thousands)		(Dollars in thousands)	
Extended maturity	\$1,005	\$633	\$1,648	\$1,640
Adjusted interest rate	—	—	—	728
Combination rate & maturity	2,410	403	2,523	1,670
Court ordered concession	—	—	30	8
Total	\$3,415	\$1,036	\$4,201	\$4,046

The Company considers a loan to have defaulted when it reaches 90 days past due. The following table shows loans that have been modified during the past twelve months which have subsequently defaulted during the periods indicated.



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	Three Months Ended June 30		2014	
	2015		Number	Recorded
	Number	Recorded	of Contracts	Investment
	of Contracts	Investment		
	(Dollars in thousands)			
Troubled debt restructurings that subsequently defaulted				
Commercial real estate	—	\$—	1	\$73
Residential real estate	—	—	1	136
	—	\$—	2	\$209

	Six Months Ended June 30		2014	
	2015		Number	Recorded
	Number	Recorded	of Contracts	Investment
	of Contracts	Investment		
	(Dollars in thousands)			
Troubled debt restructurings that subsequently defaulted				
Commercial real estate	2	\$880	2	\$249
Commercial and industrial	3	339	—	—
Residential real estate	—	—	1	136
	5	\$1,219	3	\$385

All TDR loans are considered impaired and therefore are subject to a specific review for impairment. The impairment analysis appropriately discounts the present value of the anticipated cash flows by the loan's contractual rate of interest in effect prior to the loan's modification. The amount of impairment, if any, is recorded as a specific loss allocation to each individual loan in the allowance for loan losses. Commercial loans (commercial and industrial, commercial construction, commercial real estate and small business loans), residential loans, and home equity loans that have been classified as TDRs and which subsequently default are reviewed to determine if the loan should be deemed collateral dependent. In such an instance, any shortfall between the value of the collateral and the carrying value of the loan is determined by measuring the recorded investment in the loan against the fair value of the collateral less estimated costs to sell. The Company charges off the amount of any confirmed loan loss in the period when the loans, or portion of loans, are deemed uncollectible. Smaller balance consumer TDR loans are reviewed for performance to determine when a charge-off is appropriate.

A loan is considered 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 management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

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The tables below set forth information regarding the Company's impaired loans by loan portfolio at the dates indicated:

	June 30, 2015		
	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(Dollars in thousands)		
With no related allowance recorded			
Commercial and industrial	\$2,785	\$2,914	\$—
Commercial real estate	14,379	15,352	—
Commercial construction	309	310	—
Small business	452	492	—
Residential real estate	3,357	3,469	—
Home equity	4,565	4,621	—
Other consumer	1,199	1,208	—
Subtotal	27,046	28,366	—
With an allowance recorded			
Commercial and industrial	\$2,625	\$2,769	\$310
Commercial real estate	15,183	15,332	201
Small business	434	462	4
Residential real estate	11,583	12,677	1,337
Home equity	1,330	1,467	250
Other consumer	465	479	30
Subtotal	31,620	33,186	2,132
Total	\$58,666	\$61,552	\$2,132
	December 31, 2014		
	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(Dollars in thousands)		
With no related allowance recorded			
Commercial and industrial	\$3,005	\$3,278	\$—
Commercial real estate	15,982	17,164	—
Commercial construction	311	311	—
Small business	692	718	—
Residential real estate	2,439	2,502	—
Home equity	4,169	4,221	—
Other consumer	338	341	—
Subtotal	26,936	28,535	—
With an allowance recorded			
Commercial and industrial	\$1,649	\$1,859	\$412
Commercial real estate	14,747	15,514	197
Small business	396	458	7
Residential real estate	12,616	13,727	1,500
Home equity	1,161	1,264	262
Other consumer	530	530	38
Subtotal	31,099	33,352	2,416
Total	\$58,035	\$61,887	\$2,416

The following tables set forth information regarding interest income recognized on impaired loans, by portfolio, for the periods indicated:



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	Three Months Ended June 30, 2015		Six Months Ended June 30, 2015	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
(Dollars in thousands)				
With no related allowance recorded				
Commercial and industrial	\$2,842	\$40	\$2,927	\$81
Commercial real estate	14,467	227	15,044	471
Commercial construction	310	3	311	7
Small business	459	6	471	13
Residential real estate	3,385	40	3,403	79
Home equity	4,585	51	4,613	102
Other consumer	1,204	6	1,074	11
Subtotal	27,252	373	27,843	764
With an allowance recorded				
Commercial and industrial	\$2,712	\$31	\$2,749	\$62
Commercial real estate	15,231	204	15,292	406
Small business	442	7	453	15
Residential real estate	11,608	128	11,662	295
Home equity	1,336	16	1,345	31
Other consumer	472	5	490	9
Subtotal	31,801	391	31,991	818
Total	\$59,053	\$764	\$59,834	\$1,582

	Three Months Ended June 30, 2014		Six Months Ended June 30, 2014	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
(Dollars in thousands)				
With no related allowance recorded				
Commercial and industrial	\$4,449	\$60	\$4,774	\$123
Commercial real estate	16,216	246	16,342	490
Small business	1,051	16	1,076	32
Residential real estate	2,415	24	2,426	50
Home equity	4,431	51	4,465	103
Other consumer	363	6	374	13
Subtotal	28,925	403	29,457	811
With an allowance recorded				
Commercial and industrial	\$2,808	\$40	\$2,906	\$81
Commercial real estate	14,523	205	14,748	413
Small business	449	8	462	16
Residential real estate	13,449	132	13,563	264
Home equity	1,102	10	1,109	17
Other consumer	686	6	707	12
Subtotal	33,017	401	33,495	803
Total	\$61,942	\$804	\$62,952	\$1,614



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Certain loans acquired by the Company may have shown evidence of deterioration of credit quality since origination and it was therefore deemed unlikely that the Company would be able to collect all contractually required payments. As such, these loans were deemed to be PCI loans and the carrying value and prospective income recognition are predicated upon future cash flows expected to be collected. The following table displays certain information pertaining to PCI loans at the dates indicated:

	June 30, 2015	December 31, 2014
	(Dollars in thousands)	
Outstanding balance	\$23,724	\$25,279
Carrying amount	\$21,694	\$22,315

The following table summarizes activity in the accretable yield for the PCI loan portfolio:

	Six Months Ended June 30	
	2015	2014
	(Dollars in thousands)	
Beginning balance	\$2,974	\$2,514
Acquisition	319	—
Accretion	(1,546	) (1,055
Other change in expected cash flows (1)	700	2,192
Reclassification from nonaccretable difference for loans which have paid off (2)	80	194
Ending balance	\$2,527	\$3,845

(1) Represents changes in cash flows expected to be collected and resulting in increased interest income as a prospective yield adjustment over the remaining life of the loan(s).

(2) Results in increased interest income during the period in which the loan paid off at amount greater than originally expected.



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## NOTE 6 -EARNINGS PER SHARE

Earnings per share consisted of the following components for the periods indicated:

	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2015	2014	2015	2014
	(Dollars in thousands, except per share data)			
Net income	\$17,451	\$14,746	\$26,910	\$28,129
Weighted Average Shares				
Basic shares	26,149,593	23,897,413	25,558,016	23,858,456
Effect of dilutive securities	71,819	94,560	76,626	97,544
Diluted shares	26,221,412	23,991,973	25,634,642	23,956,000
Net income per share				
Basic EPS	\$0.67	\$0.62	\$1.05	\$1.18
Effect of dilutive securities	—	(0.01	) —	(0.01 )
Diluted EPS	\$0.67	\$0.61	\$1.05	\$1.17

There were no anti-dilutive options to purchase common stock or shares of performance-based restricted stock that were excluded from the calculation of diluted earnings per share during the three or six months ended June 30, 2015 and 2014.

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## NOTE 7 - STOCK BASED COMPENSATION

## Time Vested Restricted Stock Awards

During the six months ended June 30, 2015, the Company made the following awards of restricted stock:

Date	Shares	Granted Plan	Grant Date Fair Value	Vesting Period
2/11/2015	31,500	2005 Employee Stock Plan	\$39.42	Ratably over 5 years from grant date
2/12/2015	25,910	2005 Employee Stock Plan	\$40.03	Ratably over 5 years from grant date
3/19/2015	3,800	2005 Employee Stock Plan	\$43.56	Ratably over 5 years from grant date
4/27/2015	625	2005 Employee Stock Plan	\$41.61	At the end of 3 years from grant date
4/27/2015	1,875	2005 Employee Stock Plan	\$41.61	At the end of 5 years from grant date
5/27/2015	8,800	2010 Non-Employee Director Stock Plan	\$45.02	At the end of 5 years from grant date

The fair value of the restricted stock awards is based upon the average of the high and low price at which the Company's common stock traded on the date of grant. The holders of restricted stock awards participate fully in the rewards of stock ownership of the Company, including voting and dividend rights.

## Performance-Based Restricted Stock Awards

On February 12, 2015, the Company granted 21,780 performance-based restricted stock awards to certain executive level employees. These performance-based restricted stock awards were issued from the 2005 Employee Stock Plan and were determined to have a grant date fair value per share of \$40.03. The number of shares to be vested will be contingent upon the Company's attainment of certain performance measures outlined in the award agreement and will be measured as of the end of the three year performance period, or December 31, 2017. These awards will be accounted for as equity awards due to the nature of these awards and the fact that these shares will not be settled in cash.

The fair value of the performance-based restricted stock awards, assuming achievement at target, is based upon the average of the high and low price at which the Company's common stock traded on the date of grant. The holders of these awards are not entitled to receive dividends or vote until the shares are vested.

## Stock Options

The Company did not issue any awards of options to purchase shares of common stock during the six months ended June 30, 2015.

## NOTE 8 - REPURCHASE AGREEMENTS

The Company can raise additional liquidity by entering into repurchase agreements at its discretion. In a security repurchase agreement transaction, the Company will generally sell a security, agreeing to repurchase either the same or substantially identical security on a specified later date, at a greater price than the original sales price. The difference between the sale price and purchase price is the cost of the proceeds, which is recorded as interest expense. The securities underlying the agreements are delivered to counterparties as security for the repurchase obligations. Since the securities are treated as collateral and the agreement does not qualify for a full transfer of effective control, the transactions does not meet the criteria to be classified as a sale, and is therefore considered a secured borrowing transaction for accounting purposes. Payments on such borrowings are interest only until the scheduled repurchase date. In a repurchase agreement the Company is subject to the risk that the purchaser may default at maturity and not

return the securities underlying the agreements. In order to minimize this potential risk, the Company either deals with established firms when entering into these transactions or with customers whose agreements stipulate that the securities underlying the agreement are not delivered to the customer and instead are held in segregated safekeeping accounts by the Company's safekeeping agents. The table below sets forth information regarding the Company's repurchase agreements and types of collateral at the date indicated:

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	June 30, 2015				Total
	Remaining Contractual Maturity of the Agreements				
	Overnight and Continuous	Up to 30 Days	30-90 Days	Greater than 90 Days	
	(Dollars in thousands)				
Repurchase agreements					
U.S. government agency securities	\$9,962	\$—	\$8,849	\$—	\$18,811
Agency mortgage-backed securities	42,028	—	41,151	—	83,179
Agency collateralized mortgage obligations	67,450	—	—	—	67,450
Total borrowings	\$119,440	\$—	\$50,000	\$—	\$169,440

Certain counterparties monitor collateral, and may request additional collateral to be posted from time to time. For further information regarding the Company's repurchase agreements see Note 10 - Balance Sheet Offsetting.

**NOTE 9 - DERIVATIVE AND HEDGING ACTIVITIES**

The Company's derivative financial instruments are used to manage differences in the amount, timing, and duration of the Company's known or expected cash receipts and its known or expected cash payments principally to manage the Company's interest rate risk. Additionally, the Company enters into interest rate derivatives and foreign exchange contracts to accommodate the business requirements of its customers ("customer related positions"). The Company minimizes the market and liquidity risks of customer related positions by entering into similar offsetting positions with broker-dealers. Derivative instruments are carried at fair value in the Company's financial statements. The accounting for changes in the fair value of a derivative instrument is dependent upon whether or not it qualifies as a hedge for accounting purposes, and further, by the type of hedging relationship.

The Company does not enter into proprietary trading positions for any derivatives.

**Interest Rate Positions**

The Company currently utilizes interest rate swap agreements as hedging instruments against interest rate risk associated with the Company's borrowings. An interest rate swap is an agreement whereby one party agrees to pay a floating rate of interest on a notional principal amount in exchange for receiving a fixed rate of interest on the same notional amount, for a predetermined period of time, from a second party. The amounts relating to the notional principal amount are not actually exchanged. The maximum length of time over which the Company is currently hedging its exposure to the variability in future cash flows for forecasted transactions related to the payment of variable interest on existing financial instruments is four years.

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The following table reflects the Company's derivative positions for the periods indicated below for interest rate swaps which qualify as cash flow hedges for accounting purposes:

June 30, 2015

Notional Amount	Trade Date	Effective Date	Maturity Date	Receive (Variable) Index	Current Rate Received	Pay Fixed Swap Rate	Fair Value
(Dollars in thousands)							
\$25,000	16-Feb-06	28-Dec-06	28-Dec-16	3 Month LIBOR	0.29	% 5.04	% \$(1,640 )
25,000	16-Feb-06	28-Dec-06	28-Dec-16	3 Month LIBOR	0.29	% 5.04	% (1,640 )
25,000	9-Dec-08	10-Dec-08	10-Dec-18	3 Month LIBOR	0.28	% 2.94	% (1,356 )
\$75,000							\$(4,636 )

December 31, 2014

Notional Amount	Trade Date	Effective Date	Maturity Date	Receive (Variable) Index	Current Rate Received	Pay Fixed Swap Rate	Fair Value
(Dollars in thousands)							
\$25,000	16-Feb-06	28-Dec-06	28-Dec-16	3 Month LIBOR	0.24	% 5.04	% \$(2,093 )
25,000	16-Feb-06	28-Dec-06	28-Dec-16	3 Month LIBOR	0.24	% 5.04	% (2,094 )
25,000	9-Dec-08	10-Dec-08	10-Dec-18	3 Month LIBOR	0.24	% 2.94	% (1,383 )
\$75,000							\$(5,570 )

For derivative instruments that are designated and qualify as cash flow hedging instruments, the effective portion of the gains or losses is reported as a component of other comprehensive income ("OCI"), and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. The Company expects approximately \$2.7 million (pre-tax) to be reclassified to interest expense from OCI related to the Company's cash flow hedges in the next twelve months. This reclassification is due to anticipated payments that will be made and/or received on the swaps based upon the forward curve as of June 30, 2015.

The Company recognized \$61,000 and \$122,000 of net amortization income that was an offset to interest expense related to previously terminated swaps for the three and six month periods ended June 30, 2015 and 2014, respectively.

The Company had no fair value hedges as of June 30, 2015 or December 31, 2014.

#### Customer Related Positions

Loan level derivatives, primarily interest rate swaps, offered to commercial borrowers through the Company's loan level derivative program do not qualify as hedges for accounting purposes. The Company believes that its exposure to commercial customer derivatives is limited because these contracts are simultaneously matched at inception with an offsetting dealer transaction. The commercial customer derivative program allows the Company to retain variable-rate commercial loans while allowing the customer to synthetically fix the loan rate by entering into a variable-to-fixed interest rate swap.

Foreign exchange contracts offered to commercial borrowers through the Company's derivative program do not qualify as hedges for accounting purposes. The Company acts as a seller and buyer of foreign exchange contracts to accommodate its customers. To mitigate the market and liquidity risk associated with these derivatives, the Company enters into similar offsetting positions.



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The following table reflects the Company's customer related derivative positions for the periods indicated below for those derivatives not designated as hedging:

	Number of Positions (1) June 30, 2015 (Dollars in thousands)	Notional Amount Maturing					Total	Fair Value
		Less than 1 year	Less than 2 years	Less than 3 years	Less than 4 years	Thereafter		
Loan level swaps								
Receive fixed, pay variable	177	\$71,534	\$43,250	\$40,474	\$74,605	\$426,106	\$655,969	\$17,507
Pay fixed, receive variable	171	\$71,534	\$43,250	\$40,474	\$74,605	\$426,106	\$655,969	\$(17,538)
Foreign exchange contracts								
Buys foreign currency, sells U.S. currency	16	\$24,099	\$—	\$—	\$—	\$—	\$24,099	\$812
Buys U.S. currency, sells foreign currency	16	\$24,099	\$—	\$—	\$—	\$—	\$24,099	\$(789)
December 31, 2014 (Dollars in thousands)								
Loan level swaps								
Receive fixed, pay variable	174	\$88,147	\$46,854	\$40,958	\$38,108	\$403,208	\$617,275	\$17,840
Pay fixed, receive variable	168	\$88,147	\$46,854	\$40,958	\$38,108	\$403,208	\$617,275	\$(17,837)
Foreign exchange contracts								
Buys foreign currency, sells U.S. currency	23	\$57,112	\$—	\$—	\$—	\$—	\$57,112	\$4,007
Buys U.S. currency, sells foreign currency	23	\$57,112	\$—	\$—	\$—	\$—	\$57,112	\$(3,984)

(1) The Company may enter into one dealer swap agreement which offsets multiple commercial borrower swap agreements.

**Mortgage Derivatives**

Prior to closing and funding certain 1-4 family residential mortgage loans, an interest rate lock commitment is generally extended to the borrower. During the period from commitment date to closing date, the Company is subject to the risk that market rates of interest may change. If market rates rise, investors generally will pay less to purchase such loans resulting in a reduction in the gain on sale of the loans or, possibly, a loss. In an effort to mitigate such risk, forward delivery sales commitments are executed, under which the Company agrees to deliver whole mortgage loans to various investors. In addition, the Company may also enter into additional forward To Be Announced ("TBA") mortgage contracts, also considered derivative instruments, which are purchased by the Company from a diversified list of counterparties in order to hedge customer rate locks. These forward contracts carry a market price that has a strong inverse relationship to that of mortgage prices. When the Company locks a rate to the customer, the rate can be held for the benefit of the customer for a certain period of time until the mortgage is sold. During that time, the Company may not have agreed on a price with a mortgage investor and fluctuations in market conditions may cause the mortgage to lose market value. Within a short period after the rate is locked with the customer, the Company may, depending upon the effectiveness of existing hedges, execute a forward TBA trade with a counterparty to hedge that

market risk. Certain assumptions, including pull through rates and rate lock periods, are used in managing the existing and future hedges. The effectiveness of the economic hedges rely on the accuracy of these assumptions.

The change in fair value on the interest rate lock commitments, forward delivery sale commitments, and forward TBA mortgage contracts are recorded in current period earnings as a component of mortgage banking income. In addition, the Company has elected the fair value option to carry loans held for sale at fair value. The change in fair value of loans held for sale is recorded in current period earnings as a component of mortgage banking income in accordance with the Company's fair value election. The change in fair value associated with loans held for sale was an increase of \$157,000 and \$174,000 for the three months ended



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June 30, 2015 and 2014, respectively, and an increase of \$184,000 and \$225,000 for the six months ended June 30, 2015 and 2014, respectively. These amounts were offset in earnings by the change in the fair value of mortgage derivatives. The table below presents the fair value of the Company's derivative financial instruments as well as their classification on the balance sheet at the periods indicated:

	Asset Derivatives			Liability Derivatives		
	Balance Sheet Location	Fair Value at June 30, 2015	Fair Value at December 31, 2014	Balance Sheet Location	Fair Value at June 30, 2015	Fair Value at December 31, 2014
(Dollars in thousands)						
Derivatives designated as hedges						
Interest rate derivatives	Other assets	\$—	\$—	Other liabilities	\$4,636	\$5,570
Derivatives not designated as hedges						
Customer Related Positions:						
Loan level derivatives	Other assets	\$17,636	\$18,383	Other liabilities	\$17,667	\$18,380
Foreign exchange contracts	Other assets	812	4,007	Other liabilities	789	3,984
Mortgage Derivatives						
Interest rate lock commitments	Other assets	330	295	Other liabilities	—	—
Forward TBA mortgage contracts	Other assets	—	—	Other liabilities	—	16
Forward sales agreements	Other assets	—	3	Other liabilities	155	—
		\$18,778	\$22,688		\$18,611	\$22,380
Total		\$18,778	\$22,688		\$23,247	\$27,950

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The table below presents the effect of the Company's derivative financial instruments included in OCI and current earnings for the periods indicated:

	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2015	2014	2015	2014
	(Dollars in thousands)		(Dollars in thousands)	
Derivatives designated as hedges				
Gain in OCI on derivatives (effective portion), net of tax	\$382	\$1,005	\$464	\$1,507
Loss reclassified from OCI into interest expense (effective portion)	\$709	\$1,063	\$1,415	\$2,211
Loss reclassified from OCI into noninterest expense (loss on termination)	\$—	\$1,122	\$—	\$1,122
Loss recognized in income on derivatives (ineffective portion & amount excluded from effectiveness testing)				
Interest expense	\$—	\$—	\$—	\$—
Other expense	—	—	—	—
Total	\$—	\$—	\$—	\$—
Derivatives not designated as hedges				
Changes in fair value of customer related positions				
Other income	\$ (4 )	\$ 15	\$ 17	\$ 44
Other expense	(33 )	( 1 )	( 51 )	( 2 )
Changes in fair value of mortgage derivatives				
Mortgage banking income	(299 )	41	(107 )	\$ 1
Total	\$(336 )	\$55	\$(141 )	\$43

By using derivatives, the Company is exposed to credit risk to the extent that counterparties to the derivative contracts do not perform as required. Should a counterparty fail to perform under the terms of a derivative contract, the Company's credit exposure on interest rate swaps is limited to the net positive fair value and accrued interest of all swaps with each counterparty. The Company seeks to minimize counterparty credit risk through credit approvals, limits, monitoring procedures, and obtaining collateral, where appropriate. Institutional counterparties must have an investment grade credit rating and be approved by the Company's Board of Directors. As such, management believes the risk of incurring credit losses on derivative contracts with those counterparties is remote and losses, if any, would be immaterial. The Company had \$65,000 and \$272,000 in exposure relating to institutional counterparties at June 30, 2015 and December 31, 2014, respectively. The Company's exposure relating to customer counterparties was approximately \$18.3 million and \$18.9 million at June 30, 2015 and December 31, 2014, respectively. Credit exposure may be reduced by the amount of collateral pledged by the counterparty.



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## NOTE 10 - BALANCE SHEET OFFSETTING

The Company does not offset fair value amounts recognized for derivative instruments or repurchase agreements. The Company does net the amount recognized for the right to reclaim cash collateral against the obligation to return cash collateral arising from derivative instruments executed with the same counterparty under a master netting arrangement. Collateral legally required to be maintained at dealer banks by the Company is monitored and adjusted as necessary. At June 30, 2015, it was determined that no additional collateral would have to be posted to immediately settle these instruments.

The following tables present the Company's asset and liability derivative positions and the potential effect of netting arrangements on its financial position, as of the periods indicated:

	Gross Amounts Recognized in the Statement of Financial Position June 30, 2015 (Dollars in thousands)	Gross Amounts Offset in the Statement of Financial Position	Net Amounts Presented in the Statement of Financial Position	Gross Amounts Not Offset in the Statement of Financial Position		
				Financial Instruments (1)	Collateral Pledged (Received)	Net Amount
<b>Derivative Assets</b>						
Interest rate swaps	\$—	\$—	\$—	\$—	\$—	\$—
Loan level derivatives	17,636	—	17,636	65	—	17,571
Customer foreign exchange contracts	812	—	812	—	—	812
	\$18,448	\$—	\$18,448	\$65	\$—	\$18,383
<b>Derivative Liabilities</b>						
Interest rate swaps	\$4,636	\$—	\$4,636	\$—	\$4,636	\$—
Loan level derivatives	17,667	—	17,667	65	17,538	65
Customer foreign exchange contracts	789	—	789	—	—	789
<b>Repurchase agreements</b>						
Customer repurchase agreements	119,439	—	119,439	—	119,439	—
Wholesale repurchase agreements	50,000	—	50,000	—	50,000	—
	\$192,531	\$—	\$192,531	\$65	\$191,613	\$853

(1) Reflects offsetting derivative positions with the same counterparty.

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	Gross Amounts Recognized in the Statement of Financial Position December 31, 2014 (Dollars in thousands)	Gross Amounts Offset in the Statement of Financial Position	Net Amounts Presented in the Statement of Financial Position	Gross Amounts Not Offset in the Statement of Financial Position		
				Financial Instruments (1)	Collateral Pledged (Received)	Net Amount
<b>Derivative Assets</b>						
Interest rate swaps	\$—	\$—	\$—	\$—	\$—	\$—
Loan level derivatives	18,383	—	18,383	272	—	18,111
Customer foreign exchange contracts	4,007	—	4,007	—	—	4,007
	\$22,390	\$—	\$22,390	\$272	\$—	\$22,118
<b>Derivative Liabilities</b>						
Interest rate swaps	\$5,570	\$—	\$5,570	\$—	\$5,570	\$—
Loan level derivatives	18,380	—	18,380	272	17,836	272
Customer foreign exchange contracts	3,984	—	3,984	—	—	3,984
<b>Repurchase agreements</b>						
Customer repurchase agreements	147,890	—	147,890	—	147,890	—
Wholesale repurchase agreements	50,000	—	50,000	—	50,000	—
	\$225,824	\$—	\$225,824	\$272	\$221,296	\$4,256

(1) Reflects offsetting derivative positions with the same counterparty.

The Company has agreements with certain of its derivative counterparties that contain a provision where if the Company fails to maintain its status as a well capitalized institution, then the Company could be required to terminate any outstanding derivatives with the counterparty. All liability position interest rate swap and customer loan level swap counterparties have credit-risk contingent features as of the dates indicated in the table above. In addition, derivative instruments that contain credit-risk related contingent features that are in a net liability position require the Company to assign collateral as noted in the table above.

**NOTE 11 - FAIR VALUE MEASUREMENTS**

Fair value is a market-based measure considered from the perspective of a market participant rather than an entity-specific measure. Therefore, even when market assumptions are not readily available, the Company's own assumptions are set to reflect those that market participants would use in pricing the asset or liability at the measurement date. If there has been a significant decrease in the volume and level of activity for the asset or liability, regardless of the valuation technique(s) used, the objective of a fair value measurement remains the same. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. The Company uses prices and inputs that are current as of the measurement date. In periods of market dislocation, the observability of prices and inputs may be reduced for many instruments. This condition could cause an instrument to be reclassified from one level to another.

The Fair Value Measurements and Disclosures Topic of the FASB ASC defines fair value and establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under the

Fair Value Measurements and Disclosures Topic of the FASB ASC are described below:

Level 1 – Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 – Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

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Level 3 – Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable.

To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. Accordingly, the degree of judgment exercised by the Company in determining fair value is greatest for instruments categorized in Level 3. A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

### Valuation Techniques

There have been no changes in the valuation techniques used during the current period.

### Securities:

#### Trading Securities

These equity securities are valued based on market quoted prices. These securities are categorized in Level 1 as they are actively traded and no valuation adjustments have been applied.

#### U.S. Government Agency Securities

Fair value is estimated using either multi-dimensional spread tables or benchmarks. The inputs used include benchmark yields, reported trades, and broker/dealer quotes. These securities are classified as Level 2.

#### Agency Mortgage-Backed Securities

Fair value is estimated using either a matrix or benchmarks. The inputs used include benchmark yields, reported trades, broker/dealer quotes, and issuer spreads. These securities are categorized as Level 2.

#### Agency Collateralized Mortgage Obligations and Small Business Administration Pooled Securities

The valuation model for these securities is volatility-driven and ratings based, and uses multi-dimensional spread tables. The inputs used include benchmark yields, reported trades, new issue data, broker dealer quotes, and collateral performance. If there is at least one significant model assumption or input that is not observable, these securities are categorized as Level 3 within the fair value hierarchy; otherwise, they are classified as Level 2.

#### State, County, and Municipal Securities

The fair value is estimated using a valuation matrix with inputs including bond interest rate tables, recent transaction, and yield relationships. These securities are categorized as Level 2.

#### Single and Pooled Issuer Trust Preferred Securities

The fair value of trust preferred securities, including pooled and single issuer preferred securities, is estimated using external pricing models, discounted cash flow methodologies or similar techniques. The inputs used in these valuations include benchmark yields, reported trades, new issue data, broker dealer quotes, and collateral performance. If there is at least one significant model assumption or input that is not observable, these securities are classified as Level 3 within the fair value hierarchy; otherwise, they are classified as Level 2.

### Equity Securities

These equity securities are valued based on market quoted prices. These securities are classified as Level 1 as they are actively traded and no valuation adjustments have been applied.

### Loans Held for Sale

The Company has elected the fair value option to account for originated closed loans intended for sale. The fair value is measured on an individual loan basis using quoted market prices and when not available, comparable market value or discounted cash flow analysis may be utilized. These assets are typically classified as Level 2.

### Derivative Instruments

#### Derivatives

The valuation of these instruments is determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves and implied volatilities. The Company incorporates credit valuation adjustments to appropriately reflect nonperformance risk in the fair value measurements. In adjusting the fair value of its derivative contracts for the effect of nonperformance risk, the Company has considered the impact





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of netting and any applicable credit enhancements, such as collateral postings. Additionally, in conjunction with fair value measurement guidance, the Company has made an accounting policy election to measure the credit risk of its derivative financial instruments that are subject to master netting agreements on a net basis by counterparty portfolio. Although the Company has determined that the majority of the inputs used to value its interest rate derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by the Company and its counterparties. However, as of June 30, 2015 and December 31, 2014, the Company has assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and has determined that the credit valuation adjustments are not significant to the overall valuation of its derivatives. As a result, the Company has determined that its derivative valuations in their entirety are classified as Level 2.

**Mortgage Derivatives**

The fair value of mortgage derivatives is determined based on current market prices for similar assets in the secondary market and, therefore, classified as Level 2 within the fair value hierarchy.

**Impaired Loans**

Collateral dependent loans that are deemed to be impaired are valued based upon the lower of cost or fair value of the underlying collateral less costs to sell. The inputs used in the appraisals of the collateral are not always observable, and therefore the loans may be classified as Level 3 within the fair value hierarchy; otherwise, they are classified as Level 2.

**Other Real Estate Owned and Other Foreclosed Assets**

The fair values are generally estimated based upon recent appraisal values of the property less costs to sell the property, as Other Real Estate Owned ("OREO") and Other Foreclosed Assets are valued at the lower of cost or fair value of the property, less estimated costs to sell. Certain inputs used in appraisals are not always observable, and therefore OREO and Other Foreclosed Assets may be classified as Level 3 within the fair value hierarchy.

**Goodwill and Other Intangible Assets**

Goodwill and identified intangible assets are subject to impairment testing. The Company conducts an annual impairment test of goodwill in the third quarter of each year, or more frequently if necessary, and other intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. To estimate the fair value of goodwill and, if necessary, other intangible assets, the Company utilizes both a comparable analysis of relevant price multiples in recent market transactions and discounted cash flow analysis. Both valuation models require a significant degree of management judgment. In the event the fair value as determined by the valuation model is less than the carrying value, the intangibles may be impaired. If the impairment testing resulted in impairment, the Company would classify the impaired goodwill and other intangible assets subjected to nonrecurring fair value adjustments as Level 3.

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Assets and liabilities measured at fair value at the periods indicated were as follows:

	Balance	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	June 30, 2015			
	(Dollars in thousands)			
Recurring fair value measurements				
Assets				
Trading securities	\$489	\$489	\$—	\$—
Securities available for sale				
U.S. Government agency securities	39,726	—	39,726	\$—
Agency mortgage-backed securities	230,997	—	230,997	—
Agency collateralized mortgage obligations	55,202	—	55,202	—
State, county, and municipal securities	4,668	—	4,668	—
Single issuer trust preferred securities issued by banks and insurers	2,872	—	2,872	—
Pooled trust preferred securities issued by banks and insurers	1,595	—	—	1,595
Small business administration pooled securities	26,497	—	26,497	—
Equity securities	13,444	13,444	—	—
Loans held for sale	10,728	—	10,728	—
Derivative instruments	18,778	—	18,778	—
Liabilities				
Derivative instruments	23,247	—	23,247	—
Total recurring fair value measurements	\$381,749	\$13,933	\$366,221	\$1,595
Nonrecurring fair value measurements				
Assets				
Collateral dependent impaired loans	\$3,824	\$—	\$—	\$3,824
Other real estate owned and other foreclosed assets	5,124	—	—	5,124
Total nonrecurring fair value measurements	\$8,948	\$—	\$—	\$8,948

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	Balance	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	December 31, 2014 (Dollars in thousands)			
Recurring fair value measurements				
Assets				
Securities available for sale				
U.S. Government agency securities	\$41,486	\$—	\$41,486	\$—
Agency mortgage-backed securities	217,678	—	217,678	—
Agency collateralized mortgage obligations	63,035	—	63,035	—
State, county, and municipal securities	5,223	—	5,223	—
Single issuer trust preferred securities issued by banks and insurers	2,909	—	2,909	—
Pooled trust preferred securities issued by banks and insurers	6,321	—	—	6,321
Equity securities	11,902	11,902	—	—
Loans held for sale	6,888	—	6,888	—
Derivative instruments	22,688	—	22,688	—
Liabilities				
Derivative instruments	27,950	—	27,950	—