EAGLE BANCORP INC
Form 10-Q
May 12, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended March 31, 2014

OR

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

For the transition period from _________ to_________

Commission File Number 0-25923

Eagle Bancorp, Inc.

(Exact name of registrant as specified in its charter)

Maryland (State or other jurisdiction of incorporation or organization)	52-2061461 (I.R.S. Employer Identification No.)
7830 Old Georgetown Road, Third Floor, Bethesda, Maryland (Address of principal executive offices)	20814 (Zip Code)

(301) 986-1800

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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 definition 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

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

As of May 1, 2014, the registrant had 25,980,721 shares of Common Stock outstanding.

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Item 1 – Financial Statements (Unaudited)

EAGLE BANCORP, INC.

Consolidated Balance Sheets (Unaudited)

(dollars in thousands, except per share data)

	March 31, 2014	December 31, 2013	March 31, 2013
Assets			
Cash and due from banks	$8,982	$9,577	$7,123
Federal funds sold	8,468	5,695	5,811
Interest bearing deposits with banks and other short-term investments	213,501	291,688	257,957
Investment securities available for sale, at fair value	387,790	378,133	318,431
Federal Reserve and Federal Home Loan Bank stock	10,599	11,272	11,154
Loans held for sale	21,862	42,030	132,698
Loans	3,063,975	2,945,158	2,548,024
Less allowance for credit losses	(42,018)	(40,921)	(38,811)
Loans, net	3,021,957	2,904,237	2,509,213
Premises and equipment, net	17,181	16,737	16,094
Deferred income taxes	27,146	28,949	20,661
Bank owned life insurance	40,052	39,738	14,229
Intangible assets, net	3,482	3,510	3,659
Other real estate owned	8,809	9,225	9,199
Other assets	34,123	30,712	18,636
Total Assets	$3,803,952	$3,771,503	$3,324,865
Liabilities and Shareholders' Equity			
Liabilities			
Deposits:			
Noninterest bearing demand	$886,623	$849,409	$756,177
Interest bearing transaction	106,645	118,580	99,187
Savings and money market	1,861,355	1,811,088	1,456,318
Time, $100,000 or more	196,238	203,706	216,337
Other time	222,828	242,631	284,911
Total deposits	3,273,689	3,225,414	2,812,930
Customer repurchase agreements	66,437	80,471	92,664
Long-term borrowings	39,300	39,300	39,300
Other liabilities	14,144	32,455	18,119
Total Liabilities	3,393,570	3,377,640	2,963,013
Shareholders' Equity			

Preferred stock, par value $.01 per share, shares authorized 1,000,000, Series B, $1,000 per share liquidation preference, shares issued and outstanding 56,600 at March 31, 2014, December 31, 2013 and March 31, 2013	56,600	56,600	56,600
Common stock, par value $.01 per share; shares authorized 50,000,000, shares issued and outstanding 25,975,186, 25,885,863 and 23,389,238 respectively	255	253	228
Warrant	946	946	946
Additional paid in capital	244,332	242,990	181,993
Retained earnings	108,751	96,393	117,577
Accumulated other comprehensive (loss) income	(502)	(3,319)	4,508
Total Shareholders' Equity	410,382	393,863	361,852
Total Liabilities and Shareholders' Equity	$3,803,952	$3,771,503	$3,324,865

See notes to consolidated financial statements.

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EAGLE BANCORP, INC.

Consolidated Statements of Operations (Unaudited)

(dollars in thousands, except per share data)

	Three Months Ended March 31,	
	2014	**2013**
Interest Income		
Interest and fees on loans	$40,363	$36,024
Interest and dividends on investment securities	2,333	1,696
Interest on balances with other banks and short-term investments	138	209
Interest on federal funds sold	3	4
Total interest income	42,837	37,933
Interest Expense		
Interest on deposits	2,412	2,940
Interest on customer repurchase agreements	38	69
Interest on long-term borrowings	380	415
Total interest expense	2,830	3,424
Net Interest Income	40,007	34,509
Provision for Credit Losses	1,934	3,365
Net Interest Income After Provision For Credit Losses	38,073	31,144
Noninterest Income		
Service charges on deposits	1,192	1,285
Gain on sale of loans	1,843	5,649
Gain on sale of investment securities	8	23
Increase in the cash surrender value of bank owned life insurance	314	94
Other income	1,106	1,060
Total noninterest income	4,463	8,111
Noninterest Expense		
Salaries and employee benefits	13,608	11,200
Premises and equipment expenses	3,089	2,800
Marketing and advertising	462	347
Data processing	1,588	1,539
Legal, accounting and professional fees	974	773
FDIC insurance	544	582
Other expenses	2,833	3,456
Total noninterest expense	23,098	20,697
Income Before Income Tax Expense	19,438	18,558
Income Tax Expense	6,939	6,986
Net Income	12,499	11,572
Preferred Stock Dividends	141	141
Net Income Available to Common Shareholders	$12,358	$11,431

Earnings Per Common Share		
Basic	$0.48	$0.45
Diluted	$0.47	$0.44

See notes to consolidated financial statements.

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EAGLE BANCORP, INC.

Consolidated Statements of Comprehensive Income (Unaudited)

(dollars in thousands)

	Three Months Ended March 31, 2014	2013
Net Income	$12,499	$11,572
Other comprehensive income, net of tax:		
Net unrealized gain (loss) on securities available for sale	2,822	(944)
Reclassification adjustment for net gains included in net income	(5)	(13)
Net change in unrealized gain (loss) on securities	2,817	(957)
Comprehensive Income	$15,316	$10,615

See notes to consolidated financial statements.

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EAGLE BANCORP, INC.

Consolidated Statements of Changes in Shareholders' Equity (Unaudited)

(dollars in thousands)

	Preferred Stock	Common Stock	Warrant	Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance January 1, 2014	$ 56,600	$ 253	$ 946	$ 242,990	$ 96,393	$ (3,319)	$ 393,863
Net Income	-	-	-	-	12,499	-	12,499
Net change in other comprehensive income	-	-	-	-	-	2,817	2,817
Stock-based compensation	-	-	-	892	-	-	892
Common stock issued 84,864 shares under equity compensation plans	-	2	-	248	-	-	250
Tax benefits related to stock compensation	-	-	-	75	-	-	75
Employee stock purchase plan 4,459 shares	-	-	-	127	-	-	127
Preferred stock dividends	-	-	-	-	(141)	-	(141)
Balance March 31, 2014	**$ 56,600**	**$ 255**	**$ 946**	**$ 244,332**	**$ 108,751**	**$ (502)**	**$ 410,382**
Balance January 1, 2013	$ 56,600	$ 226	$ 946	$ 180,593	$ 106,146	$ 5,465	$ 349,976
Net Income	-	-	-	-	11,572	-	11,572
Net change in other comprehensive income	-	-	-	-	-	(957)	(957)
Stock-based compensation	-	-	-	685	-	-	685
Common stock issued 470,474 shares under equity compensation plans	-	2	-	467	-	-	469
Tax benefit on non-qualified options exercised	-	-	-	134	-	-	134
Employee stock purchase plan 7,310 shares	-	-	-	114	-	-	114
Preferred stock dividends	-	-	-	-	(141)	-	(141)
Balance March 31, 2013	**$ 56,600**	**$ 228**	**$ 946**	**$ 181,993**	**$ 117,577**	**$ 4,508**	**$ 361,852**

See notes to consolidated financial statements.

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EAGLE BANCORP, INC.

Consolidated Statements of Cash Flows (Unaudited)

(dollars in thousands)

	Three Months Ended March 31,	
	2014	**2013**
Cash Flows From Operating Activities:		
Net Income	$12,499	$11,572
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for credit losses	1,934	3,365
Depreciation and amortization	1,119	1,054
Gains on sale of loans	(1,843)	(5,649)
Securities premium amortization, net	861	1,011
Origination of loans held for sale	(98,321)	(387,351)
Proceeds from sale of loans held for sale	120,332	487,225
Net increase in cash surrender value of BOLI	(314)	(94)
Decrease (increase) in deferred income taxes	1,803	(1,533)
Decrease in fair value of other real estate owned	453	-
Loss on sale of other real estate owned	100	-
Net gain on sale of investment securities	(8)	(23)
Stock-based compensation expense	892	685
Excess tax benefits from stock-based compensation	(75)	(134)
(Increase) decrease in other assets	(3,411)	823
Decrease in other liabilities	(18,311)	(3,486)
Net cash provided by operating activities	17,710	107,465
Cash Flows From Investing Activities:		
(Increase) decrease in interest bearing deposits with other banks and short-term investments	(5)	94
Purchases of available for sale investment securities	(18,564)	(54,783)
Proceeds from maturities of available for sale securities	4,384	12,079
Proceeds from sale/call of available for sale securities	6,487	22,148
Purchases of Federal Reserve and Federal Home Loan Bank stock	(26)	(613)
Proceeds from redemption of federal reserve and federal home loan bank stock	699	153
Net increase in loans	(119,871)	(60,707)
Proceeds from sale of other real estate owned	108	-
Bank premises and equipment acquired	(1,483)	(1,792)
Net cash used in investing activities	(128,271)	(83,421)
Cash Flows From Financing Activities:		
Increase (decrease) in deposits	48,275	(84,387)
Decrease in customer repurchase agreements	(14,034)	(8,674)
Payment of dividends on preferred stock	(141)	(141)
Proceeds from exercise of stock options	250	467
Excess tax benefits from stock-based compensation	75	134

Proceeds from employee stock purchase plan	127	114
Net cash provided by (used in) financing activities	34,552	(92,487)
Net Decrease In Cash and Cash Equivalents	(76,009)	(68,443)
Cash and Cash Equivalents at Beginning of Period	306,960	339,334
Cash and Cash Equivalents at End of Period	$230,951	$270,891
Supplemental Cash Flows Information:		
Interest paid	$3,022	$3,775
Income taxes paid	$7,550	$5,875
Non-Cash Investing Activities		
Transfers from loans to other real estate owned	$245	$3,900

See notes to consolidated financial statements.

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EAGLE BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements include the accounts of Eagle Bancorp, Inc. and its subsidiaries (the “Company”), EagleBank (the “Bank”), Eagle Commercial Ventures, LLC (“ECV”), Eagle Insurance Services, LLC, and Bethesda Leasing, LLC, with all significant intercompany transactions eliminated.

The consolidated financial statements of the Company included herein are unaudited. The consolidated financial statements reflect all adjustments, consisting of normal recurring accruals that in the opinion of management, are necessary to present fairly the results for the periods presented. The amounts as of and for the year ended December 31, 2013 were derived from audited consolidated financial statements. Certain information and note disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. There have been no significant changes to the Company’s Accounting Policies as disclosed in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013. The Company believes that the disclosures are adequate to make the information presented not misleading. Certain reclassifications have been made to amounts previously reported to conform to the current period presentation.

These statements should be read in conjunction with the audited consolidated financial statements and related notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013. Operating results for the three months ended March 31, 2014 are not necessarily indicative of the results of operations to be expected for the remainder of the year, or for any other period.

Nature of Operations

The Company, through the Bank, conducts a full service community banking business, primarily in Montgomery County, Maryland, Washington, D.C., and Northern Virginia. The primary financial services offered by the Bank include real estate, commercial and consumer lending, as well as traditional deposit and repurchase agreement products. The Bank is also active in the origination and sale of residential mortgage loans and the origination of small business loans. The guaranteed portion of small business loans, guaranteed by the Small Business Administration ("SBA"), is typically sold to third party investors in a transaction apart from the loan's origination. As of March 31, 2014, the Bank offers its products and services through eighteen banking offices and various electronic capabilities, including remote deposit services and mobile banking services. Eagle Insurance Services, LLC, a subsidiary of the Bank, offers access to insurance products and services through a referral program with a third party insurance broker. Eagle Commercial Ventures, LLC, a direct subsidiary of the Company, provides subordinated financing for the acquisition, development and construction of real estate projects. These transactions involve higher levels of risk, together with commensurate higher returns. Refer to Higher Risk Lending – Revenue Recognition below.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts in the financial statements and accompanying notes. Actual results may differ from those estimates and such differences could be material to the financial statements.

Cash Flows

For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks, federal funds sold, and interest bearing deposits with other banks which have an original maturity of three months or less.

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Loans Held for Sale

The Company engages in sales of residential mortgage loans and the guaranteed portion of SBA loans originated by the Bank. Loans held for sale are carried at the lower of aggregate cost or fair value. Fair value is derived from secondary market quotations for similar instruments. Gains and losses on sales of these loans are recorded as a component of noninterest income in the consolidated statements of operations.

The Company's current practice is to sell residential mortgage loans on a servicing released basis, and, therefore, it has no intangible asset recorded for the value of such servicing as of March 31, 2014, December 31, 2013 and March 31, 2013. The sale of the guaranteed portion of SBA loans on a servicing retained basis gives rise to an Excess Servicing Asset, which is computed on a loan by loan basis with the unamortized amount being included in Intangible assets in the consolidated balance sheets. This Excess Servicing Asset is being amortized on a straight-line basis (with adjustment for prepayments) as an offset to servicing fees collected and is included in Other income in the consolidated statement of operations.

The Company enters into commitments to originate residential mortgage loans whereby the interest rate on the loan is determined prior to funding (i.e. rate lock commitments). Such rate lock commitments on mortgage loans to be sold in the secondary market are considered to be derivatives but are effectively offset by whole loan purchase commitments from various investors. The period of time between issuance of a loan commitment to the customer and closing and sale of the loan to an investor generally ranges from 30 to 90 days under current market conditions. The Company protects itself from changes in interest rates through the use of best efforts forward delivery commitments, whereby the investor commits to purchase a loan at a price representing a premium on the day the borrower commits to an interest rate with the intent that the buyer/investor has assumed the interest rate risk on the loan. As a result, the Company is not generally exposed to losses on loans sold nor will it realize gains, related to rate lock commitments due to changes in interest rates.

The market values of rate lock commitments and best efforts contracts are not readily ascertainable with precision because rate lock commitments and best efforts contracts are not actively traded. Because of the high correlation between rate lock commitments and best efforts contracts, no gain or loss should occur on the rate lock commitments.

In circumstances where the Company does not deliver the whole loan to an investor, but rather elects to retain the loan in its portfolio, the loan is transferred from held for sale at fair value.

Investment Securities

The Company has no securities classified as trading, or as held to maturity. Marketable equity securities and debt securities not classified as held to maturity or trading are classified as available-for-sale. Securities available-for-sale are acquired as part of the Company’s asset/liability management strategy and may be sold in response to changes in interest rates, current market conditions, loan demand, changes in prepayment risk and other factors. Securities available-for-sale are carried at fair value, with unrealized gains or losses being reported as accumulated other comprehensive income/(loss), a separate component of shareholders’ equity, net of deferred income tax. Realized gains and losses, using the specific identification method, are included as a separate component of noninterest income in the consolidated statements of operations.

Premiums and discounts on investment securities are amortized/accreted to the earlier of call or maturity based on expected lives, which lives are adjusted based on prepayment assumptions and call optionality if any. Declines in the fair value of individual available-for-sale securities below their cost that are other-than-temporary in nature result in write-downs of the individual securities to their fair value. Factors affecting the determination of whether other-than-temporary impairment has occurred include a downgrading of the security by a rating agency, a significant deterioration in the financial condition of the issuer, or a change in management’s intent and ability to hold a security for a period of time sufficient to allow for any anticipated recovery in fair value. Management systematically evaluates investment securities for other-than-temporary declines in fair value on a quarterly basis. This analysis requires management to consider various factors, which include (1) duration and magnitude of the decline in value, (2) the financial condition of the issuer or issuers and (3) structure of the security.

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The entire amount of an impairment loss is recognized in earnings only when (1) the Company intends to sell the security, or (2) it is more likely than not that the Company will have to sell the security before recovery of its amortized cost basis, or (3) the Company does not expect to recover the entire amortized cost basis of the security. In all other situations, only the portion of the impairment loss representing the credit loss must be recognized in earnings, with the remaining portion being recognized in shareholders' equity as comprehensive income, net of deferred taxes.

Loans

Loans are stated at the principal amount outstanding, net of unamortized deferred costs and fees. Interest income on loans is accrued at the contractual rate on the principal amount outstanding. It is the Company's policy to discontinue the accrual of interest when circumstances indicate that collection is doubtful. Deferred fees and costs are being amortized on the interest method over the term of the loan.

Management considers loans impaired when, based on current information, it is probable that the Company will not collect all principal and interest payments according to contractual terms. Loans are evaluated for impairment in accordance with the Company's portfolio monitoring and ongoing risk assessment procedures. Management considers the financial condition of the borrower, cash flow of the borrower, payment status of the loan, and the value of the collateral, if any, securing the loan. Generally, impaired loans do not include large groups of smaller balance homogeneous loans such as residential real estate and consumer type loans which are evaluated collectively for impairment and are generally placed on nonaccrual when the loan becomes 90 days past due as to principal or interest. Loans specifically reviewed for impairment are not considered impaired during periods of "minimal delay" in payment (ninety days or less) provided eventual collection of all amounts due is expected. The impairment of a loan is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or the fair value of the collateral if repayment is expected to be provided solely by the collateral. In appropriate circumstances, interest income on impaired loans may be recognized on the cash basis.

Higher Risk Lending – Revenue Recognition

The Company has occasionally made higher risk acquisition, development, and construction ("ADC") loans that entail higher risks than ADC loans made following normal underwriting practices ("higher risk loan transactions"). These higher risk loan transactions are currently made through the Company's subsidiary, ECV. This activity is limited as to individual transaction amount and total exposure amounts based on capital levels and is carefully monitored. The loans are carried on the balance sheet at amounts outstanding and meet the loan classification requirements of the Accounting Standards Executive Committee ("AcSEC") guidance reprinted from the CPA Letter, Special Supplement, dated February 10, 1986 (also referred to as Exhibit 1 to AcSEC Practice Bulletin No. 1). Additional interest earned on certain of these higher risk loan transactions (as defined in the individual loan agreements) is recognized as realized under the provisions contained in AcSEC's guidance reprinted from the CPA Letter, Special Supplement, dated

February 10, 1986 (also referred to as Exhibit 1 to AcSEC Practice Bulletin No.1) and Staff Accounting Bulletin No. 101 (Revenue Recognition in Financial Statements). Such additional interest may be included as a component of noninterest income. ECV recorded no additional interest on higher risk transactions during 2014 and 2013 (although normal interest income was recorded). ECV had six higher risk lending transactions with balances outstanding at March 31, 2014 and five such transactions outstanding at December 31, 2013, amounting to $8.0 million and $7.4 million, respectively.

Allowance for Credit Losses

The allowance for credit losses represents an amount which in management's judgment, is adequate to absorb probable losses on existing loans and other extensions of credit that may become uncollectible. The adequacy of the allowance for credit losses is determined through careful and continuous review and evaluation of the loan portfolio and involves the balancing of a number of factors to establish a prudent level of allowance. Among the factors considered in evaluating the adequacy of the allowance for credit losses are lending risks associated with growth and entry into new markets, loss allocations for specific credits, the level of the allowance to nonperforming loans, historical loss experience, economic conditions, portfolio trends and credit concentrations, changes in the size and character of the loan portfolio, and management's judgment with respect to current and expected economic conditions and their impact on the existing loan portfolio. Allowances for impaired loans are generally determined based on collateral values. Loans or any portion thereof deemed uncollectible are charged against the allowance, while recoveries are credited to the allowance. Management adjusts the level of the allowance through the provision for credit losses, which is recorded as a current period operating expense. The allowance for credit losses consists of allocated and unallocated components.

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The components of the allowance for credit losses represent an estimation done pursuant to Accounting Standards Codification ("ASC") Topic 450, *"Contingencies,"* or ASC Topic 310, *"Receivables."* Specific allowances are established in cases where management has identified significant conditions or circumstances related to a specific credit that management believes indicate the probability that a loss may be incurred. For potential problem credits for which specific allowance amounts have not been determined, the Company establishes allowances according to the application of credit risk factors. These factors are set by management and approved by the appropriate Board Committee to reflect its assessment of the relative level of risk inherent in each risk grade. A third component of the allowance computation, termed a nonspecific or environmental factors allowance, is based upon management's evaluation of various environmental conditions that are not directly measured in the determination of either the specific allowance or formula allowance. Such conditions include general economic and business conditions affecting key lending areas, credit quality trends (including trends in delinquencies and nonperforming loans expected to result from existing conditions), loan volumes and concentrations, specific industry conditions within portfolio categories, recent loss experience in particular loan categories, duration of the current business cycle, bank regulatory examination results, findings of outside review consultants, and management's judgment with respect to various other conditions including credit administration and management and the quality of risk identification systems. Executive management reviews these environmental conditions quarterly, and documents the rationale for all changes.

Management believes that the allowance for credit losses is adequate; however, determination of the allowance is inherently subjective and requires significant estimates. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. Evaluation of the potential effects of these factors on estimated losses involves a high degree of uncertainty, including the strength and timing of economic cycles and concerns over the effects of a prolonged economic downturn in the current cycle. In addition, various regulatory agencies, as an integral part of their examination process, and independent consultants engaged by the Bank periodically review the Bank's loan portfolio and allowance for credit losses. Such review may result in recognition of adjustments to the allowance based on their judgments of information available to them at the time of their examination.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation and amortization computed using the straight-line method for financial reporting purposes. Premises and equipment are depreciated over the useful lives of the assets, which generally range from five to seven years for furniture, fixtures and equipment, to three to five years for computer software and hardware, and to ten to forty years for buildings and building improvements. Leasehold improvements are amortized over the terms of the respective leases, which may include renewal options where management has the positive intent to exercise such options, or the estimated useful lives of the improvements, whichever is shorter. The costs of major renewals and betterments are capitalized, while the costs of ordinary maintenance and repairs are expensed as incurred. These costs are included as a component of premises and equipment expenses on the consolidated statements of operations.

Other Real Estate Owned (OREO)

Assets acquired through loan foreclosure are held for sale and are initially recorded at the lower of cost or fair value less estimated selling costs when acquired, establishing a new cost basis. The new basis is supported by appraisals that are no more than twelve months old. Costs after acquisition are generally expensed. If the fair value of the asset declines, a write-down is recorded through noninterest expense. The valuation of foreclosed assets is subjective in nature and may be adjusted in the future because of changes in market conditions or appraised values.

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Goodwill and Other Intangible Assets

Goodwill and other intangible assets are subject to impairment testing at least annually, or when events or changes in circumstances indicate the assets might be impaired. Intangible assets (other than goodwill) are amortized to expense using accelerated or straight-line methods over their respective estimated useful lives. The Company's testing of potential goodwill impairment (which is performed annually) at December 31, 2013, resulted in no impairment being recorded.

Customer Repurchase Agreements

The Company enters into agreements under which it sells securities subject to an obligation to repurchase the same securities. Under these arrangements, the Company may transfer legal control over the assets but still retain effective control through an agreement that both entitles and obligates the Company to repurchase the assets. As a result, securities sold under agreements to repurchase are accounted for as collateralized financing arrangements and not as a sale and subsequent repurchase of securities. The agreements are entered into primarily as accommodations for large commercial deposit customers. The obligation to repurchase the securities is reflected as a liability in the Company's consolidated balance of sheets, while the securities underlying the securities sold under agreements to repurchase remain in the respective assets accounts and are delivered to and held as collateral by third party trustees.

Marketing and Advertising

Marketing and advertising costs are generally expensed as incurred.

Income Taxes

The Company employs the liability method of accounting for income taxes as required by ASC Topic 740, "*Income Taxes*." Under the liability method, deferred tax assets and liabilities are determined based on differences between the financial statement carrying amounts and the tax basis of existing assets and liabilities (i.e., temporary timing differences) and are measured at the enacted rates that will be in effect when these differences reverse. The Company utilizes statutory requirements for its income tax accounting, and avoids risks associated with potentially problematic tax positions that may incur challenge upon audit, where an adverse outcome is more likely than not. Therefore, no provisions are made for either uncertain tax positions nor accompanying potential tax penalties and interest for underpayments of income taxes in the Company's tax reserves. In accordance with ASC Topic 740, the Company may establish a reserve against deferred tax assets in those cases where realization is less than certain, although no such reserves exist at March 31, 2014, December 31, 2013, or March 31, 2013.

Transfer of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity. In certain cases, the recourse to the Bank to repurchase assets may exist but is deemed immaterial based on the specific facts and circumstances.

Earnings per Common Share

Basic net income per common share is derived by dividing net income available to common shareholders by the weighted-average number of common shares outstanding during the period measured. Diluted earnings per common share is computed by dividing net income available to common shareholders by the weighted-average number of common shares outstanding during the period measured including the potential dilutive effects of common stock equivalents. Earnings per share amounts for periods ending prior to June 30, 2013 have been adjusted to reflect a 10% stock dividend paid on June 14, 2013.

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Stock-Based Compensation

In accordance with ASC Topic 718, *"Compensation,"* the Company records as compensation expense an amount equal to the amortization (over the remaining service period) of the fair value computed at the date of grant. Compensation expense on variable stock option grants (i.e. performance based grants) is recorded based on the probability of achievement of the goals underlying the performance grant. Refer to Note 6 for a description of stock-based compensation awards, activity and expense.

New Authoritative Accounting Guidance

In January 2014, the FASB issued ASU No. 2014-01, "Accounting for Investments in Qualified Affordable Housing Projects." ASU No. 2014-01 permits reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognize the net investment performance in the income statement as a component of income tax expense. This new guidance also requires new disclosures for all investors in these projects. ASU No. 2014-01 is effective for interim and annual reporting periods beginning after December 15, 2014. Upon adoption, the guidance must be applied retrospectively to all periods presented. However, entities that use the effective yield method to account for investments in these projects before adoption may continue to do so for these pre-existing investments. The Company currently accounts for such investments using the effective yield method and plans to continue to do so for these pre-existing investments after adopting ASU No. 2014-01 on January 1, 2015. The Company expects investments made after January 1, 2015 to meet the criteria required for the proportional amortization method and plans to make such an accounting policy election. The adoption of ASU No. 2014-01 is not expected to have a material impact on the Company's consolidated financial statements.

In January 2014, the FASB issued ASU No. 2014-04, "Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure." The objective of this guidance is to clarify when an in substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. ASU No. 2014-04 states that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, ASU No. 2014-04 requires interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. ASU No. 2014-04 is effective for interim and annual reporting periods beginning after December 15, 2014. The adoption of ASU No. 2014-04 is not expected to have a material impact on the Company's consolidated financial statements.

Note 2. Cash and Due from Banks

Regulation D of the Federal Reserve Act requires that banks maintain noninterest reserve balances with the Federal Reserve Bank based principally on the type and amount of their deposits. During 2014, the Bank maintained balances at the Federal Reserve (in addition to vault cash) to meet the reserve requirements as well as balances to partially compensate for services. Late in 2008, the Federal Reserve in connection with the Emergency Economic Stabilization Act of 2008 began paying a nominal amount of interest on balances held, which interest on excess reserves was increased under provisions of the Dodd Frank Wall Street Reform and Consumer Protection Act passed in July 2010. Additionally, the Bank maintains interest-bearing balances with the Federal Home Loan Bank of Atlanta and noninterest bearing balances with six domestic correspondent banks as compensation for services they provide to the Bank.

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Note 3. Investment Securities Available-for-Sale

Amortized cost and estimated fair value of securities available-for-sale are summarized as follows:

March 31, 2014	**Amortized**	**Gross Unrealized**	**Gross Unrealized**	**Estimated Fair**
(dollars in thousands)	**Cost**	**Gains**	**Losses**	**Value**
U. S. Government agency securities	$ 48,797	$ 687	$ 127	$ 49,357
Residential mortgage backed securities	232,001	1,292	4,682	228,611
Municipal bonds	107,434	3,136	1,165	109,405
Other equity investments	396	21	-	417
	$ 388,628	$ 5,136	$ 5,974	$ 387,790

December 31, 2013	**Amortized**	**Gross Unrealized**	**Gross Unrealized**	**Estimated Fair**
(dollars in thousands)	**Cost**	**Gains**	**Losses**	**Value**
U. S. Government agency securities	$ 46,640	$ 843	$ 148	$ 47,335
Residential mortgage backed securities	234,206	1,143	6,675	228,674
Municipal bonds	102,423	2,017	2,700	101,740
Other equity investments	396	-	12	384
	$ 383,665	$ 4,003	$ 9,535	$ 378,133

Gross unrealized losses and fair value by length of time that the individual available-for-sale securities have been in a continuous unrealized loss position are as follows:

	Less than 12 Months		**12 Months or Greater**		**Total**	
March 31, 2014	**Estimated Fair**	**Unrealized**	**Estimated Fair**	**Unrealized**	**Estimated Fair**	**Unrealized**
(dollars in thousands)	**Value**	**Losses**	**Value**	**Losses**	**Value**	**Losses**
U. S. Government agency securities	$ 8,624	$ 127	$ -	$ -	$ 8,624	$ 127
Residential mortgage backed securities	129,067	3,548	31,128	1,134	160,195	4,682
Municipal bonds	26,547	794	8,076	371	34,623	1,165
	$ 164,238	$ 4,469	$ 39,204	$ 1,505	$ 203,442	$ 5,974

	Less than 12 Months		**12 Months or Greater**		**Total**	
	Estimated		**Estimated**		**Estimated**	

December 31, 2013 (dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U. S. Government agency securities	$4,782	$ 148	$-	$ -	$4,782	$ 148
Residential mortgage backed securities	155,475	5,992	15,658	683	171,133	6,675
Municipal bonds	50,450	2,512	3,196	188	53,646	2,700
Other equity investments	-	-	165	12	165	12
	$210,707	$ 8,652	$19,019	$ 883	$229,726	$ 9,535

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The unrealized losses that exist are generally the result of changes in market interest rates and interest spread relationships since original purchases. The weighted average duration of debt securities, which comprise 99.9% of total investment securities, is relatively short at 4.1 years. If quoted prices are not available, fair value is measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. The Company does not believe that the investment securities that were in an unrealized loss position as of March 31, 2014 represent an other-than-temporary impairment for the reasons noted. The Company does not intend to sell the investments and it is more likely than not that the Company will not have to sell the securities before recovery of its amortized cost basis, which may be maturity. In addition, at March 31, 2014, the Company held $10.6 million in equity securities in a combination of Federal Reserve Bank ("FRB") and Federal Home Loan Bank ("FHLB") stocks, which are required to be held for regulatory purposes and are not marketable.

The amortized cost and estimated fair value of investments available-for-sale by contractual maturity are shown in the table below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	March 31, 2014		**December 31, 2013**	
(dollars in thousands)	**Amortized Cost**	**Estimated Fair Value**	**Amortized Cost**	**Estimated Fair Value**
U. S. Government agency securities maturing:				
One year or less	$ 19,012	$ 19,063	$ 19,025	$ 19,133
After one year through five years	27,321	27,781	27,615	28,202
Five years through ten years	2,464	2,513	-	-
Residential mortgage backed securities	232,001	228,611	234,206	228,674
Municipal bonds maturing:				
After one year through five years	31,725	32,598	25,718	26,008
Five years through ten years	75,709	76,807	76,705	75,732
Other equity investments	396	417	396	384
	$ 388,628	$ 387,790	$ 383,665	$ 378,133

The carrying value of securities pledged as collateral for certain government deposits, securities sold under agreements to repurchase, and certain lines of credit with correspondent banks at March 31, 2014 was $276.2 million. As of March 31, 2014 and December 31, 2013, there were no holdings of securities of any one issuer, other than the U.S. Government and U.S. Government agency securities that exceeded ten percent of shareholders' equity.

Note 4. Loans and Allowance for Credit Losses

The Bank makes loans to customers primarily in the Washington, DC metropolitan area and surrounding communities. A substantial portion of the Bank’s loan portfolio consists of loans to businesses secured by real estate and other business assets.

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Loans, net of unamortized net deferred fees, at March 31, 2014, December 31, 2013, and March 31, 2013 are summarized by type as follows:

	March 31, 2014		December 31, 2013		March 31, 2013	
(dollars in thousands)	**Amount**	**%**	**Amount**	**%**	**Amount**	**%**
Commercial	$704,386	23 %	$694,350	24 %	$579,618	23 %
Investment - commercial real estate	1,196,405	40 %	1,119,800	38 %	910,829	36 %
Owner occupied - commercial real estate	320,994	10 %	317,491	11 %	303,561	12 %
Real estate mortgage - residential	97,846	3 %	90,418	3 %	69,256	3 %
Construction - commercial and residential	593,967	19 %	574,167	19 %	538,071	21 %
Construction - C&I (owner occupied)	35,480	1 %	34,659	1 %	34,002	1 %
Home equity	108,839	4 %	110,242	4 %	108,570	4 %
Other consumer	6,058	-	4,031	-	4,117	-
Total loans	3,063,975	100%	2,945,158	100%	2,548,024	100%
Less: Allowance for Credit Losses	(42,018)		(40,921)		(38,811)	
Net loans	$3,021,957		$2,904,237		$2,509,213	

Unamortized net deferred fees amounted to $13.6 million, $12.7 million, and $9.1 million at March 31, 2014, December 31, 2013, and March 31, 2013, respectively.

As of March 31, 2014 and December 31, 2013, the Bank serviced $74.1 million and $67.6 million, respectively, of SBA loans which are not reflected as loan balances on the consolidated balance sheets.

Loan Origination / Risk Management

The Company's goal is to mitigate risks in the event of unforeseen threats to the loan portfolio as a result of economic downturn or other negative influences. Plans for mitigating inherent risks in managing loan assets include: carefully enforcing loan policies and procedures, evaluating each borrower's business plan during the underwriting process and throughout the loan term, identifying and monitoring primary and alternative sources for loan repayment, and obtaining collateral to mitigate economic loss in the event of liquidation. Specific loan reserves are established based upon credit and/or collateral risks on an individual loan basis. A risk rating system is employed to proactively estimate loss exposure and provide a measuring system for setting general and specific reserve allocations.

The composition of the Company’s loan portfolio is heavily weighted toward commercial real estate, both owner occupied and investment real estate. The combination of owner occupied commercial real estate and owner occupied commercial real estate construction represent 11% of the loan portfolio. When owner occupied commercial real estate and owner occupied commercial construction loans are excluded, the percentage of commercial real estate and construction loans to total loans decreases to 59%. At March 31, 2014, the combination of commercial real estate and real estate construction loans represent approximately 70% of the loan portfolio. These loans are underwritten to mitigate lending risks typical of this type of loan such as declines in real estate values, changes in borrower cash flow and general economic conditions. The Bank typically requires a maximum loan to value of 80% and minimum cash flow debt service coverage of 1.15 to 1.00. Personal guarantees are generally required, but may be limited. In making real estate commercial mortgage loans, the Bank generally requires that interest rates adjust not less frequently than five years.

The Company is also an active traditional commercial lender providing loans for a variety of purposes, including working capital, equipment and account receivable financing. This loan category represents approximately 23% of the loan portfolio at March 31, 2014 and was generally variable or adjustable rate. Commercial loans meet reasonable underwriting standards, including appropriate collateral and cash flow necessary to support debt service. Personal guarantees are generally required, but may be limited. SBA loans represent 1% of the commercial loan category of loans. In originating SBA loans, the Company assumes the risk of non-payment on the unguaranteed portion of the credit. The Company generally sells the guaranteed portion of the loan generating noninterest income from the gains on sale, as well as servicing income on the portion participated. SBA loans are subject to the same cash flow analyses as other commercial loans. SBA loans are subject to a maximum loan size established by the SBA.

Approximately 4% of the loan portfolio at March 31, 2014 consists of home equity loans and lines of credit and other consumer loans. These credits, while making up a smaller portion of the loan portfolio, demand the same emphasis on underwriting and credit evaluation as other types of loans advanced by the Bank.

The remaining 3% of the loan portfolio consists of residential mortgage loans. These are typically loans underwritten for shorter terms, generally less than 5 years.

Loans are secured primarily by duly recorded first deeds of trust. In some cases, the Bank may accept a recorded junior trust position. In general, borrowers will have a proven ability to build, lease, manage and/or sell a commercial or residential project and demonstrate satisfactory financial condition. Additionally, an equity contribution toward the project is customarily required.

Construction loans require that the financial condition and experience of the general contractor and major subcontractors be satisfactory to the Bank. Guaranteed, fixed price contracts are required whenever appropriate, along with payment and performance bonds or completion bonds for larger scale projects.

Loans intended for residential land acquisition, lot development and construction are made on the premise that the land: 1) is or will be developed for building sites for residential structures, and; 2) will ultimately be utilized for construction or improvement of residential zoned real properties, including the creation of housing. Residential development and construction loans will finance projects such as single-family subdivisions, planned unit developments, townhouses, and condominiums. Residential land acquisition, development and construction loans generally are underwritten with a maximum term of 36 months, including extensions approved at origination.

Commercial land acquisition and construction loans are secured by real property where loan funds will be used to acquire land and to construct or improve appropriately zoned real property for the creation of income producing or owner user commercial properties. Borrowers are generally required to put equity into each project at levels determined by the appropriate Loan Committee. Commercial land acquisition and construction loans generally are underwritten with a maximum term of 24 months.

Substantially all construction draw requests must be presented in writing on American Institute of Architects documents and certified either by the contractor, the borrower and/or the borrower’s architect. Each draw request shall also include the borrower’s soft cost breakdown certified by the borrower or its Chief Financial Officer. Prior to an advance, the Bank has an employee or its contractor inspects the project to determine that the work has been completed, to justify the draw requisition.

Commercial permanent loans are secured by improved real property, which is generating income in the normal course of operation. Debt service coverage, assuming stabilized occupancy, must be satisfactory to support a permanent loan. The debt service coverage ratio is ordinarily at least 1.15 to 1.00. As part of the underwriting process, debt service coverage ratios are stress tested assuming a 200 basis point increase in interest rates from their current levels.

Commercial permanent loans generally are underwritten with a term not greater than 10 years or the remaining useful life of the property, whichever is lower. The preferred term is between 5 to 7 years, with amortization to a maximum of 25 years.

The Company's loan portfolio includes loans made for real estate Acquisition, Development and Construction ("ADC") purposes, including both investment and owner occupied projects. ADC loans amounted to $629.4 million at March 31, 2014. A portion of the ADC portfolio, both speculative and non-speculative, includes loan funded interest reserves at origination. ADC loans containing loan funded interest reserves represent approximately 48% of the outstanding ADC loan portfolio at March 31, 2014. The decision to establish a loan-funded interest reserve is made upon origination of the ADC loan and is based upon a number of factors considered during underwriting of the credit including: (i) the feasibility of the project; (ii) the experience of the sponsor; (iii) the creditworthiness of the borrower and guarantors; (iv) borrower equity contribution; and (v) the level of collateral protection. When appropriate, an interest reserve provides an effective means of addressing the cash flow characteristics of a properly underwritten ADC loan. The Company does not significantly utilize interest reserves in other loan products. The Company recognizes that one of the risks inherent in the use of interest reserves is the potential masking of underlying problems with the project and/or the borrower's ability to repay the loan. In order to mitigate this inherent risk, the Company employs a series of reporting and monitoring mechanisms on all ADC loans, whether or not an interest reserve is provided, including: (i) construction and development timelines which are monitored on an ongoing basis which track the progress of a given project to the timeline projected at origination; (ii) a construction loan administration department independent of the lending function; (iii) third party independent construction loan inspection reports; (iv) monthly interest reserve monitoring reports detailing the balance of the interest reserves approved at origination and the days of interest carry represented by the reserve balances as compared to the then current anticipated time to completion and/or sale of speculative projects; and (v) quarterly commercial real estate construction meetings among senior Company management, which includes monitoring of current and projected real estate market conditions. If a project has not performed as expected, it is not the customary practice of the Company to increase loan funded interest reserves.

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From time to time the Company may make loans for its own portfolio or through its higher risk loan affiliate, ECV. Such loans, which are made to finance projects (which may also be financed at the Bank level), may have higher risk characteristics than loans made by the Bank, such as lower priority interests and/or higher loan to value ratios. The Company seeks an overall financial return on these transactions commensurate with the risks and structure of each individual loan. Certain transactions may bear current interest at a rate with a significant premium to normal market rates. Other loan transactions may carry a standard rate of current interest, but also earn additional interest based on a percentage of the profits of the underlying project or a fixed accrued rate of interest.

The following tables detail activity in the allowance for credit losses by portfolio segment for the three months ended March 31, 2014 and 2013. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

(dollars in thousands)	Commercial	Income Producing Commercial Real Estate	Owner Occupied Commercial Real Estate	Real Estate Mortgage Residential	Construction Commercial and Residential	Home Equity	Other Consumer	Total
For the Period Ended March 31, 2014								
Allowance for credit losses:								
Balance at beginning of period	$ 9,780	$ 10,359	$ 3,899	$ 944	$ 13,934	$ 1,871	$ 134	$ 40,921
Loans charged-off	(273)	-	(35)	(62)	(581)	(149)	(25)	(1,125)
Recoveries of loans previously charged-off	211	-	-	-	65	5	7	288
Net loans charged-off	(62)	-	(35)	(62)	(516)	(144)	(18)	(837)
Provision for (recovery of) credit losses	1,702	231	(669)	(128)	761	(220)	257	1,934
Ending balance	$ 11,420	$ 10,590	$ 3,195	$ 754	$ 14,179	$ 1,507	$ 373	$ 42,018
For the Period Ended March 31, 2014								
Allowance for credit losses:								
Individually evaluated for impairment	$ 3,810	$ 732	$ 1,105	$ 30	$ 1,775	$ 378	$ 58	$ 7,888
Collectively evaluated for impairment	7,610	9,858	2,090	724	12,404	1,129	315	34,130
Ending balance	$ 11,420	$ 10,590	$ 3,195	$ 754	$ 14,179	$ 1,507	$ 373	$ 42,018

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(dollars in thousands)	Commercial	Income Producing Commercial Real Estate	Owner Occupied Commercial Real Estate	Real Estate Mortgage Residential	Construction Commercial and Residential	Home Equity	Other Consumer	Total
For the Period Ended March 31, 2013								
Allowance for credit losses:								
Balance at beginning of period	$ 9,412	$ 9,148	$ 2,781	$ 659	$ 13,391	$ 1,730	$ 371	$ 37,492
Loans charged-off	(1,184)	(109)	-	-	(719)	(29)	(42)	(2,083)
Recoveries of loans previously charged-off	26	-	-	-	6	-	5	37
Net loans charged-off	(1,158)	(109)	-	-	(713)	(29)	(37)	(2,046)
Provision for (recovery of) credit losses	2,821	(32)	23	218	267	51	17	3,365
Ending balance	$ 11,075	$ 9,007	$ 2,804	$ 877	$ 12,945	$ 1,752	$ 351	$ 38,811
For the Period Ended March 31, 2013								
Allowance for credit losses:								
Individually evaluated for impairment	$ 2,360	$ 818	$ 704	$ -	$ 3,358	$ 218	$ -	$ 7,458
Collectively evaluated for impairment	8,715	8,189	2,100	877	9,587	1,534	351	31,353
Ending balance	$ 11,075	$ 9,007	$ 2,804	$ 877	$ 12,945	$ 1,752	$ 351	$ 38,811

The Company’s recorded investments in loans as of March 31, 2014, December 31, 2013, and March 31, 2013 related to each balance in the allowance for loan losses by portfolio segment and disaggregated on the basis of the Company’s impairment methodology was as follows:

(dollars in thousands)	Commercial	Investment Commercial Real Estate	Owner occupied Commercial Real Estate	Real Estate Mortgage Residential	Construction Commercial and Residential	Home Equity	Other Consumer	Total
March 31, 2014								
Recorded investment in loans:								

Individually evaluated for impairment	$ 27,327	$ 2,508	$ 7,323	$ 113	$ 19,159	$ 756	$ 60	$ 57,246
Collectively evaluated for impairment	677,059	1,193,897	313,671	97,733	610,288	108,083	5,998	3,006,729
Ending balance	$ 704,386	$ 1,196,405	$ 320,994	$ 97,846	$ 629,447	$ 108,839	$ 6,058	$ 3,063,975
December 31, 2013								
Recorded investment in loans:								
Individually evaluated for impairment	$ 9,614	$ 2,682	$ 7,574	$ 113	$ 13,862	$ 682	$ 70	$ 34,597
Collectively evaluated for impairment	684,736	1,117,118	309,917	90,305	594,964	109,560	3,961	2,910,561
Ending balance	$ 694,350	$ 1,119,800	$ 317,491	$ 90,418	$ 608,826	$ 110,242	$ 4,031	$ 2,945,158
March 31, 2013								
Recorded investment in loans:								
Individually evaluated for impairment	$ 14,395	$ 5,564	$ 6,449	$ -	$ 30,972	$ 538	$ -	$ 57,918
Collectively evaluated for impairment	565,223	905,265	297,112	69,256	541,101	108,032	4,117	2,490,106
Ending balance	$ 579,618	$ 910,829	$ 303,561	$ 69,256	$ 572,073	$ 108,570	$ 4,117	$ 2,548,024

At March 31, 2014, the nonperforming loans acquired from Fidelity have a carrying value of $1.8 million and an unpaid principal balance of $11.4 million and were evaluated separately in accordance with ASC Topic 310-30, *"Loans and Debt Securities Acquired with Deteriorated Credit Quality*." The various impaired loans were recorded at estimated fair value with any excess being charged-off or treated as a non-accretable discount. Subsequent downward adjustments to the valuation of impaired loans acquired will result in additional loan loss provisions and related allowance for credit losses. Subsequent upward adjustments to the valuation of impaired loans acquired will result in accretable discount. No adjustments have been made to the fair value amounts of impaired loans subsequent to the allowable period of adjustment from the date of acquisition.

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Credit Quality Indicators

The Company uses several credit quality indicators to manage credit risk in an ongoing manner. The Company's primary credit quality indicators are to use an internal credit risk rating system that categorizes loans into pass, watch, special mention, or classified categories. Credit risk ratings are applied individually to those classes of loans that have significant or unique credit characteristics that benefit from a case-by-case evaluation. These are typically loans to businesses or individuals in the classes which comprise the commercial portfolio segment. Groups of loans that are underwritten and structured using standardized criteria and characteristics, such as statistical models (e.g., credit scoring or payment performance), are typically risk rated and monitored collectively. These are typically loans to individuals in the classes which comprise the consumer portfolio segment.

The following are the definitions of the Company's credit quality indicators:

Pass:	Loans in all classes that comprise the commercial and consumer portfolio segments that are not adversely rated, are contractually current as to principal and interest, and are otherwise in compliance with the contractual terms of the loan agreement. Management believes that there is a low likelihood of loss related to those loans that are considered pass.
Watch:	Loan paying as agreed with generally acceptable asset quality; however the obligor’s performance has not met expectations. Balance sheet and/or income statement has shown deterioration to the point that the obligor could not sustain any further setbacks. Credit is expected to be strengthened through improved obligor performance and/or additional collateral within a reasonable period of time.
Special Mention:	Loans in the classes that comprise the commercial portfolio segment that have potential weaknesses that deserve management's close attention. If not addressed, these potential weaknesses may result in deterioration of the repayment prospects for the loan. The special mention credit quality indicator is not used for classes of loans that comprise the consumer portfolio segment. Management believes that there is a moderate likelihood of some loss related to those loans that are considered special mention.
Classified:	Classified (a) Substandard - Loans inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the company will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard loans, does not have to exist in individual loans classified

substandard.

Classified (b) Doubtful - Loans that have all the weaknesses inherent in a loan classified substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors, which may work to the advantage and strengthening of the assets, its classification as an estimated loss is deferred until its more exact status may be determined.

The Company's credit quality indicators are updated generally on a quarterly basis, but no less frequently than annually. The following table presents by class and by credit quality indicator, the recorded investment in the Company's loans and leases as of March 31, 2014, December 31, 2013, and March 31, 2013.

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(dollars in thousands)	Pass	Watch and Special Mention	Substandard	Doubtful	Total Loans
March 31, 2014					
Commercial	$661,432	$ 15,627	$ 27,327	$ -	$704,386
Investment - commercial real estate	1,167,621	26,276	2,508	-	1,196,405
Owner occupied - commercial real estate	298,968	14,703	7,323	-	320,994
Real estate mortgage – residential	96,947	786	113	-	97,846
Construction - commercial and residential	601,711	8,577	19,159	-	629,447
Home equity	106,170	1,913	756	-	108,839
Other consumer	5,998	-	60	-	6,058
Total	$2,938,847	$ 67,882	$ 57,246	$ -	$3,063,975
December 31, 2013					
Commercial	$655,409	$ 29,327	$ 9,614	$ -	$694,350
Investment - commercial real estate	1,095,285	21,833	2,682	-	1,119,800
Owner occupied - commercial real estate	294,337	15,580	7,574	-	317,491
Real estate mortgage – residential	89,501	804	113	-	90,418
Construction - commercial and residential	575,321	19,643	13,862	-	608,826
Home equity	107,415	2,145	682	-	110,242
Other consumer	3,961	-	70	-	4,031
Total	$2,821,229	$ 89,332	$ 34,597	$ -	$2,945,158
March 31, 2013					
Commercial	$532,391	$ 32,832	$ 14,395	$ -	$579,618
Investment - commercial real estate	886,172	19,093	5,564	-	910,829
Owner occupied - commercial real estate	281,632	15,480	6,449	-	303,561
Real estate mortgage – residential	68,521	735	-	-	69,256
Construction - commercial and residential	523,535	17,566	30,972	-	572,073
Home equity	105,857	2,175	538	-	108,570
Other consumer	4,106	11	-	-	4,117
Total	$2,402,214	$ 87,892	$ 57,918	$ -	$2,548,024

Nonaccrual and Past Due Loans

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on nonaccrual status when, in management’s opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. Loans may be placed on nonaccrual status regardless of whether or not such loans are considered past due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received in excess of principal due. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

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The following presents by class of loan, information related to nonaccrual loans as of the periods ended March 31, 2014, December 31, 2013 and March 31, 2013.

(dollars in thousands)	March 31, 2014	December 31, 2013	March 31, 2013
Commercial	$17,646	$ 6,779	$4,039
Investment - commercial real estate	2,271	2,525	3,269
Owner occupied - commercial real estate	7,323	5,452	2,368
Real estate mortgage - residential	771	887	691
Construction - commercial and residential	7,658	8,366	17,318
Home equity	598	623	481
Other consumer	60	70	-
Total nonaccrual loans (1)(2)	$36,327	$ 24,702	$28,166

(1) Excludes troubled debt restructurings (“TDRs”) that were performing under their restructured terms totaling $7.9 million at March 31, 2014, and December 31, 2013, and $14.8 million at March 31, 2013.

(2) Gross interest income that would have been recorded in 2014 if nonaccrual loans shown above had been current and in accordance with their original terms was $549 thousand, while interest actually recorded on such loans was $461 thousand. See Note 1 to the consolidated financial statements for a description of the Company’s policy for placing loans on nonaccrual status.

The following table presents by class, an aging analysis and the recorded investments in loans past due as of March 31, 2014 and December 31, 2013.

(dollars in thousands)	Loans 30-59 Days Past Due	Loans 60-89 Days Past Due	Loans 90 Days or More Past Due	Total Past Due Loans	Current Loans	Total Recorded Investment in Loans
March 31, 2014						

Commercial	$635	$3,943	$17,646	$22,224	$682,162	$704,386
Investment - commercial real estate	1,305	70	2,271	3,646	1,192,759	1,196,405
Owner occupied - commercial real estate	1,951	-	7,323	9,274	311,720	320,994
Real estate mortgage – residential	-	-	771	771	97,075	97,846
Construction - commercial and residential	-	917	7,658	8,575	620,872	629,447
Home equity	769	872	598	2,239	106,600	108,839
Other consumer	3	-	60	63	5,995	6,058
Total	$4,663	$5,802	$36,327	$46,792	$3,017,183	$3,063,975
December 31, 2013						
Commercial	$1,698	$11,146	$6,779	$19,623	$674,727	$694,350
Investment - commercial real estate	818	-	2,525	3,343	1,116,457	1,119,800
Owner occupied - commercial real estate	360	2,121	5,452	7,933	309,558	317,491
Real estate mortgage – residential	-	-	887	887	89,531	90,418
Construction - commercial and residential	-	-	8,366	8,366	600,460	608,826
Home equity	626	359	623	1,608	108,634	110,242
Other consumer	-	15	70	85	3,946	4,031
Total	$3,502	$13,641	$24,702	$41,845	$2,903,313	$2,945,158

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Impaired Loans

Loans are considered impaired when, based on current information and events, it is probable the Company will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. Impairment is evaluated in total for smaller-balance loans of a similar nature and on an individual loan basis for other loans. If a loan is impaired, a specific valuation allowance is allocated, if necessary, so that the loan is reported net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Interest payments on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

The following table presents by class, information related to impaired loans for the periods ended March 31, 2014, December 31, 2013 and March 31, 2013.

(dollars in thousands)	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment Year To Date	Interest Income Recognized Year To Date
March 31, 2014							
Commercial	$ 17,646	$ 6,409	$ 11,237	$ 17,646	$ 3,810	$ 12,213	$ -
Investment - commercial real estate	6,016	1,106	4,535	5,641	732	5,771	35
Owner occupied - commercial	7,323	4,191	3,132	7,323	1,105	6,388	-
Real estate mortgage – residential	771	658	113	771	30	829	-
Construction - commercial and residential	13,098	4,783	7,442	12,225	1,775	12,580	503
Home equity	598	125	473	598	378	611	-
Other consumer	60	-	60	60	58	65	-
Total	$ 45,512	$ 17,272	$ 26,992	$ 44,264	$ 7,888	$ 38,457	$ 538
December 31, 2013							
Commercial	$ 6,779	$ 2,327	$ 4,452	$ 6,779	$ 1,323	$ 8,877	$ 131
Investment - commercial real estate	5,902	1,322	4,580	5,902	1,098	5,755	175
Owner occupied - commercial	5,452	111	5,341	5,452	1,853	6,285	108
Real estate mortgage – residential	887	774	113	887	27	792	2

Construction - commercial and residential	13,233	5,358	7,575	12,933	1,625	17,298	169
Home equity	623	-	623	623	526	508	4
Other consumer	70	-	70	70	68	34	2
Total	$ 32,946	$ 9,892	$ 22,754	$ 32,646	$ 6,520	$ 39,549	$ 591
March 31, 2013							
Commercial	$ 8,493	$ 4,821	$ 3,172	$ 7,993	$ 2,360	$ 8,621	$ 42
Investment - commercial real estate	5,407	3,821	1,586	5,407	818	5,504	37
Owner occupied - commercial	6,449	5,538	911	6,449	704	6,554	56
Real estate mortgage – residential	691	691	-	691	-	695	-
Construction - commercial and residential	21,959	13,611	8,348	21,959	3,358	22,597	42
Home equity	481	132	349	481	218	497	-
Other consumer	-	-	-	-	-	22	-
Total	$ 43,480	$ 28,614	$ 14,366	$ 42,980	$ 7,458	$ 44,490	$ 177

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Modifications

A modification of a loan constitutes a troubled debt restructuring ("TDR") when a borrower is experiencing financial difficulty and the modification constitutes a concession. The Company offers various types of concessions when modifying a loan. Commercial and industrial loans modified in a TDR often involve temporary interest-only payments, term extensions, and converting revolving credit lines to term loans. Additional collateral, a co-borrower, or a guarantor is often requested. Commercial mortgage and construction loans modified in a TDR often involve reducing the interest rate for the remaining term of the loan, extending the maturity date at an interest rate lower than the current market rate for new debt with similar risk, or substituting or adding a new borrower or guarantor. Construction loans modified in a TDR may also involve extending the interest-only payment period.

Loans modified in a TDR for the Company may have the financial effect of increasing the specific allowance associated with the loan. An allowance for impaired consumer and commercial loans that have been modified in a TDR is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price, or the estimated fair value of the collateral, less any selling costs, if the loan is collateral dependent. Management exercises significant judgment in developing these estimates.

The following table presents by class, information related to loans modified in a TDR held by the Company during the periods ended March 31, 2014 and December 31, 2013.

(dollars in thousands)	**Number of Contracts**	**TDRs Performing to Modified Terms**	**TDRs Not Performing to Modified Terms**	**Total TDRs**
March 31, 2014				
Commercial	1	$ -	$ 1,947	$1,947
Investment - commercial real estate	2	3,370	-	3,370
Owner occupied - commercial real estate	1	-	4,081	4,081
Construction - commercial and residential	2	4,567	912	5,479
Total	6	$ 7,937	$ 6,940	$14,877
December 31, 2013				
Commercial	3	$ -	$ 4,042	$4,042
Investment - commercial real estate	3	3,377	217	3,594

Owner occupied - commercial real estate	1	-	4,081	4,081
Construction - commercial and residential	2	4,567	912	5,479
Total	9	$ 7,944	$ 9,252	$17,196

During the quarter ended March 31, 2014, three nonperforming TDRs totaling $2.3 million migrated from nonperforming loans. One nonperforming TDRs totaling approximately $2.0 million was reclassified to OREO after the Company took possession of the underlying collateral. The Company was paid off on the second TDR totaling $217 thousand. The third TDR totaling $95 thousand was charged-off during the quarter. There were no TDR defaults during the first three months of 2014, as compared to the three months ended 2013 which had one TDR default totaling approximately $495 thousand. A default is considered to have occurred once the TDR is past due 90 days or more, or it has been placed on nonaccrual. Commercial and consumer loans modified in a TDR are closely monitored for delinquency as an early indicator of possible future default. If loans modified in a TDR subsequently default, the Company evaluates the loan for possible further impairment. The allowance may be increased, adjustments may be made in the allocation of the allowance, or partial charge-offs may be taken to further write-down the carrying value of the loan. There were no loans modified in a TDR during the three months ended March 31, 2014 and 2013.

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Note 5. Net Income per Common Share

The calculation of net income per common share for the nine and three months ended March 31, 2014 and 2013 was as follows.

(dollars and shares in thousands, except per share data)	Three Months Ended March 31, 2014	2013
Basic:		
Net income available to common shareholders	$12,358	$11,431
Average common shares outstanding	25,928	25,519
Basic net income per common share	$0.48	$0.45
Diluted:		
Net income available to common shareholders	$12,358	$11,431
Average common shares outstanding	25,928	25,519
Adjustment for common share equivalents	647	703
Average common shares outstanding-diluted	26,575	26,222
Diluted net income per common share	$0.47	$0.44
Anti-dilutive shares	21,000	101,466

The Company declared a 10% stock divided payable on June 14, 2013. Per share amounts and the number of outstanding shares for periods ended prior to June 30, 2013 have been adjusted to give effect to the 10% common stock dividend.

Note 6. Stock-Based Compensation

The following discussion includes the effects of changes in stock options and restricted stock shares and exercise prices resulting from the 10% common stock dividend paid on June 14, 2013.

The Company maintains the 1998 Stock Option Plan (“1998 Plan”), the 2006 Stock Plan (“2006 Plan”) and the 2011 Employee Stock Purchase Plan (“2011 ESPP”). In connection with the acquisition of Fidelity, the Company assumed the

Fidelity 2004 Long Term Incentive Plan and 2005 Long Term Incentive Plan (the “Fidelity Plans”). No additional options may be granted under the 1998 Plan or the Fidelity Plans.

The 2006 Plan provides for the issuance of awards of incentive stock options, non-qualifying stock options, restricted stock and stock appreciation rights to selected key employees and members of the Board. As amended, 1,996,500 shares of common stock are subject to issuance pursuant to awards under the 2006 Plan. Stock options and restricted stock awards are made with an exercise price equal to the average of the high and low price of the Company’s shares at the date of grant.

For awards that are service based, compensation expense is being recognized over the service (vesting) period based on fair value, which for stock option grants is computed using the Black-Scholes model, and for restricted stock awards is based on the average of the high and low stock price of the Company’s shares on the date of grant. For awards that are performance-based, compensation expense is recorded based on the probability of achievement of the goals underlying the grant. No performance-based awards are outstanding at March 31, 2014.

In February 2014, the Company awarded three employees stock options to purchase 21,000 shares which have a ten-year term and vest in five substantially equal installments beginning on the first anniversary of the date of grant.

In February 2014, the Company awarded 58,187 shares of restricted stock to senior officers and employees. The shares vest in three substantially equal installments beginning on the first anniversary of the date of grant.

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In March 2014, the Company awarded 20,760 shares of restricted stock to directors. The shares vest in three substantially equal installments beginning on the first anniversary of the date of grant.

Below is a summary of changes in shares pursuant to our equity compensation plans for the three months ended March 31, 2014 and 2013. The information excludes restricted stock units and awards.

	Three Months Ended March 31,			
	2014		**2013**	
	Shares	**Weighted-Average Exercise Price**	**Shares**	**Weighted-Average Exercise Price**
Beginning Balance	501,334	$ 10.34	722,155	$ 10.18
Issued	21,000	32.77	3,300	20.03
Exercised	(19,027)	13.13	(52,480)	8.91
Forfeited	(110)	5.76	(330)	5.76
Expired	(408)	9.37	(15,640)	10.79
Ending Balance	502,789	$ 11.18	657,005	$ 10.32

The following summarizes information about stock options outstanding at March 31, 2014. The information excludes restricted stock units and awards.

Outstanding:	**Stock Options**	**Weighted-Average**	**Weighted-Average Remaining**
Range of Exercise Prices	**Outstanding**	**Exercise Price**	**Contractual Life**
$$5870.60	237,969	$ 5.76	4.78
$$10.0100	64,450	9.72	0.73
$$120.00.10	109,994	12.55	3.54
$$2630.414	90,376	24.79	3.60
	502,789	$ 11.18	3.78

Exercisable:	**Stock Options**	**Weighted-Average**
Range of Exercise Prices	**Exercisable**	**Exercise Price**

0$5.8760	181,059	$	5.76
$8.1011.00	64,450		9.72
$1$02.0100	88,116		12.74
$2$0330.144	66,736		22.47
	400,361	$	10.72

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The fair value of each stock option grant is estimated on the date of grant using the Black-Scholes option pricing model with the assumptions as shown in the table below used for grants during the three months ended March 31, 2014 and the years ended December 31, 2013 and 2012.

	Three Months Ended March 31, 2014	Years Ended December 31, 2013	2012
Expected Volatility	34.25 %	34.12 %	36.64 %
Weighted-Average Volatility	34.24 %	34.12 %	36.64 %
Expected Dividends	0.0 %	0.0 %	0.0 %
Expected Term (In years)	7.5	7.5	7.5
Risk-Free Rate	2.11 %	1.31 %	1.13 %
Weighted-Average Fair Value (Grant date)	$ 13.49	$ 7.83	$ 6.35

The expected lives are based on the “simplified” method allowed by ASC Topic 718 *“Compensation,”* whereby the expected term is equal to the midpoint between the vesting period and the contractual term of the award.

The total intrinsic value of outstanding stock options was $12.5 million at March 31, 2014. The total intrinsic value of stock options exercised during the three months ended March 31, 2014 and 2013 was $401 thousand and $538 thousand, respectively. The total fair value of stock options vested was $123 thousand and $119 thousand for the three months ended March 31, 2014 and 2013, respectively. Unrecognized stock-based compensation expense related to stock options totaled $400 thousand at March 31, 2014. At such date, the weighted-average period over which this unrecognized stock option expense is expected to be recognized was 4.47 years.

The Company has unvested restricted stock award grants of 511,126 shares under the 2006 Plan at March 31, 2014. Unrecognized stock based compensation expense related to restricted stock awards totaled $10.4 million at March 31, 2014. At such date, the weighted-average period over which this unrecognized expense was expected to be recognized was 2.72 years. The following table summarizes the unvested restricted stock awards at March 31, 2014 and 2013.

Three Months Ended March 31, 2014	2013
Shares	Shares

		Weighted-Average Grant Date Fair Value		Weighted-Average Grant Date Fair Value
Unvested at Beginning	614,580	$ 18.71	348,353	$ 13.79
Issued	78,947	33.24	421,425	20.63
Forfeited	(434)	15.67	-	-
Vested	(181,967)	17.59	(154,705)	13.06
Unvested at End	511,126	$ 21.36	615,073	$ 18.66

Approved by shareholders in May 2011, the 2011 ESPP reserved 550,000 shares of common stock (as adjusted for stock dividends) for issuance to employees. Whole shares are sold to participants in the plan at 85% of the lower of the stock price at the beginning or end of each quarterly offering period. The 2011 ESPP is available to all eligible employees who have completed at least one year of continuous employment, work at least 20 hours per week and at least five months a year. Participants may contribute a minimum of $10 per pay period to a maximum of $6,250 per offering period or $25,000 annually (not to exceed more than 10% of compensation per pay period). At March 31, 2014, the 2011 ESPP had 468,269 shares remaining for issuance.

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Included in salaries and employee benefits the Company recognized $892 thousand and $685 thousand in stock-based compensation expense for the three months ended March 31, 2014 and 2013, respectively. Stock-based compensation expense is recognized ratably over the requisite service period for all awards.

Note 7. Other Comprehensive Income

The following table presents the components of other comprehensive income (loss) for the three months ended March 31, 2014 and 2013.

(dollars in thousands)	**Before Tax**	**Tax Effect**	**Net of Tax**
Three Months Ended March 31, 2014			
Net unrealized loss on securities available-for-sale:			
Net unrealized loss on securities available-for-sale	$4,703	$1,881	$2,822
Less: Reclassification adjustment for net gains included in net income	(8)	(3)	(5)
Other Comprehensive Loss	$4,695	$1,878	$2,817
Three Months Ended March 31, 2013			
Net unrealized gain on securities available-for-sale:			
Net unrealized gain on securities available-for-sale	$(1,579)	$(635)	$(944)
Less: Reclassification adjustment for net gains included in net income	(23)	(10)	(13)
Other Comprehensive Income	$(1,602)	$(645)	$(957)

The following table presents the changes in each component of accumulated other comprehensive income (loss), net of tax, for the three months ended March 31, 2014 and 2013.

Securities

(dollars in thousands)	**Available For Sale**	**Accumulated Other Comprehensive (Loss) Income**
Three Months Ended March 31, 2014		
Balance at Beginning of Period	$ (3,319)	$ (3,319)
Other comprehensive (loss) before reclassifications	2,822	2,822
Amounts reclassified from accumulated other comprehensive income	(5)	(5)
Net other comprehensive (loss) during period	2,817	2,817
Balance at End of Period	$ (502)	$ (502)
Three Months Ended March 31, 2013		
Balance at Beginning of Period	$ 5,465	$ 5,465
Other comprehensive income before reclassifications	(944)	(944)
Amounts reclassified from accumulated other comprehensive income	(13)	(13)
Net other comprehensive income during period	(957)	(957)
Balance at End of Period	$ 4,508	$ 4,508

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The following table presents the amounts reclassified out of each component of accumulated other comprehensive income (loss) for the three months ended March 31, 2014 and 2013.

Details about Accumulated Other Comprehensive Income Components (dollars in thousands)	**Amount Reclassified from Accumulated Other Comprehensive (Loss) Income Three Months Ended March 31, 2014**	**2013**	**Affected Line Item in the Statement Where Net Income is Presented**
Realized gain on sale of investment securities	$ 8	$ 23	Gain on sale of investment securities
	(3)	(10)	Tax Expense
Total Reclassifications for the Period	$ 5	$ 13	Net of Tax

Note 8. Fair Value Measurements

The fair value of an asset or liability is the price that would be received to sell that asset or paid to transfer that liability in an orderly transaction occurring in the principal market (or most advantageous market in the absence of a principal market) for such asset or liability. In estimating fair value, the Company utilizes valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. Such valuation techniques are consistently applied. Inputs to valuation techniques include the assumptions that market participants would use in pricing an asset or liability. ASC Topic 820, *"Fair Value Measurements and Disclosures,"* establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Level 1 Quoted prices in active exchange markets for identical assets or liabilities; also includes certain U.S. Treasury and other U.S. Government and agency securities actively traded in over-the-counter markets.

Level 2 Observable inputs other than Level 1 including quoted prices for similar assets or liabilities, quoted prices in less active markets, or other observable inputs that can be corroborated by observable market data; also includes derivative contracts whose value is determined using a pricing model with observable market inputs or can be derived principally from or corroborated by observable market data. This category generally includes

	certain U.S. Government and agency securities, corporate debt securities, derivative instruments, and residential mortgage loans held for sale.
Level 3	Unobservable inputs supported by little or no market activity for financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation; also includes observable inputs for single dealer nonbinding quotes not corroborated by observable market data. This category generally includes certain private equity investments, retained interests from securitizations, and certain collateralized debt obligations.

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Assets and Liabilities Recorded as Fair Value on a Recurring Basis

The table below presents the recorded amount of assets and liabilities measured at fair value on a recurring basis as of March 31, 2014 and December 31, 2013.

(dollars in thousands)	**Quoted Prices (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Other Unobservable Inputs (Level 3)**	**Total (Fair Value)**
March 31, 2014				
Investment securities available for sale:				
U. S. Government agency securities	$ -	$ 49,357	$ -	$49,357
Residential mortgage backed securities	-	228,611	-	228,611
Municipal bonds	-	109,405	-	109,405
Other equity investments	198	-	219	417
Residential mortgage loans held for sale	-	21,862	-	21,862
Total assets measured at fair value on a recurring basis as of March 31, 2014	$ 198	$ 409,235	$ 219	$409,652

(dollars in thousands)	**Quoted Prices (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Other Unobservable Inputs (Level 3)**	**Total (Fair Value)**
December 31, 2013				
Investment securities available for sale:				
U. S. Government agency securities	$ -	$ 47,335	$ -	$47,335
Residential mortgage backed securities	-	228,674	-	228,674
Municipal bonds	-	101,740	-	101,740
Other equity investments	165	-	219	384
Residential mortgage loans held for sale	-	42,030	-	42,030
Total assets measured at fair value on a recurring basis as of December 31, 2013	$ 165	$ 419,779	$ 219	$420,163

Investment Securities Available-for-Sale

Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair value is measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange such as the New York Stock Exchange, Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include U.S. Government agency debt securities, mortgage backed securities issued by government sponsored entities and municipal bonds. Securities classified as Level 3 include securities in less liquid markets.

The Company's residential loans held for sale are reported on an aggregate basis at the lower of cost or fair value.

The following is a reconciliation of activity for assets measured at fair value based on Significant Other Unobservable Inputs (Level 3):

	Other Equity Investments	
(dollars in thousands)	**March 31, 2014**	**December 31, 2013**
Balance, beginning of period	$ 219	$ 230
Realized gains included in other noninterest income	-	-
Principal redemption	-	(11)
Balance, end of period	$ 219	$ 219

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Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis

The Company may be required from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with GAAP. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. There are no liabilities, which the Company measures at fair value on a nonrecurring basis. Assets measured at fair value on a nonrecurring basis are included in the table below.

(dollars in thousands)	Quoted Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)	Total (Fair Value)
March 31, 2014				
Impaired loans:				
Commercial	$ -	$ 5,608	$ 8,228	$13,836
Income producing - commercial real estate	-	134	4,774	4,908
Owner occupied - commercial real estate	-	4,327	1,891	6,218
Real estate mortgage - residential	-	113	628	741
Construction - commercial and residential	-	879	9,572	10,451
Home equity	-	125	95	220
Other consumer	-	-	2	2
Other real estate owned	-	8,809	-	8,809
Total assets measured at fair value on a nonrecurring basis as of March 31, 2014	$ -	$ 19,995	$ 25,190	$45,185

(dollars in thousands)	Quoted Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)	Total (Fair Value)
December 31, 2013				
Impaired loans:				
Commercial	$ -	$ 4,367	$ 1,089	$5,456
Income producing - commercial real estate	-	2,806	1,998	4,804
Owner occupied - commercial real estate	-	2,712	887	3,599
Real estate mortgage - residential	-	86	774	860
Construction - commercial and residential	-	4,228	7,080	11,308
Home equity	-	50	47	97
Other consumer	-	-	2	2
Other real estate owned	-	9,225	-	9,225

Total assets measured at fair value on a nonrecurring basis as of December 31, 2013	$ -	$ 23,474	$ 11,877	$35,351

<u>Loans</u>

The Company does not record loans at fair value on a recurring basis, however, from time to time, a loan is considered impaired and an allowance for loan loss is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with ASC Topic 310, *"Receivables."* The fair value of impaired loans is estimated using one of several methods, including the collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring a specific allowance represent loans for which the fair value of expected repayments or collateral exceed the recorded investment in such loans. At March 31, 2014, substantially all of the totally impaired loans were evaluated based upon the fair value of the collateral. In accordance with ASC Topic 820, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the loan as nonrecurring Level 3.

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Fair Value of Financial Instruments

The Company discloses fair value information about financial instruments for which it is practicable to estimate the value, whether or not such financial instruments are recognized on the balance sheet. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and is best evidenced by quoted market price, if one exists.

Quoted market prices, if available, are shown as estimates of fair value. Because no quoted market prices exist for a portion of the Company's financial instruments, the fair value of such instruments has been derived based on management's assumptions with respect to future economic conditions, the amount and timing of future cash flows and estimated discount rates. Different assumptions could significantly affect these estimates. Accordingly, the net realizable value could be materially different from the estimates presented below. In addition, the estimates are only indicative of individual financial instrument values and should not be considered an indication of the fair value of the Company taken as a whole.

The following methods and assumptions were used to estimate the fair value of each category of financial instrument for which it is practicable to estimate value:

Cash due from banks and federal funds sold: For cash and due from banks and federal funds sold the carrying amount approximates fair value.

Interest bearing deposits with other banks: Values are estimated by discounting the future cash flows using the current rates at which similar deposits would be earning.

Investment securities: For these instruments, fair values are based upon quoted prices, if available. If quoted prices are not available, fair value is measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions.

Federal Reserve and Federal Home Loan Bank stock: The carrying amount approximate the fair values at the reporting date.

Loans held for sale: Fair values are at the carrying value (lower of cost or market) since such loans are typically committed to be sold (servicing released) at a profit.

Loans: For variable rate loans that re-price on a scheduled basis, fair values are based on carrying values. The fair value of the remaining loans are estimated by discounting the estimated future cash flows using the current interest rate at which similar loans would be made to borrowers with similar credit ratings and for the same remaining term.

Bank owned life insurance: The fair value of bank owned life insurance is the current cash surrender value, which is the carrying value.

Other earning assets: The fair value of the annuity investments is the carrying amount at the reporting date.

Noninterest bearing deposits: The fair value of these deposits is the amount payable on demand at the reporting date, since generally accepted accounting standards do not permit an assumption of core deposit value.

Interest bearing deposits: The fair value of interest bearing transaction, savings, and money market deposits with no defined maturity is the amount payable on demand at the reporting date, since generally accepted accounting standards do not permit an assumption of core deposit value.

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Certificates of deposit: The fair value of certificates of deposit is estimated by discounting the future cash flows using the current rates at which similar deposits with remaining maturities would be accepted.

Customer repurchase agreements and federal funds purchased: The carrying amount approximate the fair values at the reporting date.

Borrowings: The carrying amount for variable rate borrowings approximate the fair values at the reporting date. The fair value of fixed rate FHLB advances and the subordinated notes are estimated by computing the discounted value of contractual cash flows payable at current interest rates for obligations with similar remaining terms. The fair value of variable rate FHLB advances is estimated to be carrying value since these liabilities are based on a spread to a current pricing index.

Off-balance sheet items: Management has reviewed the unfunded portion of commitments to extend credit, as well as standby and other letters of credit, and has determined that the fair value of such instruments is equal to the fee, if any, collected and unamortized for the commitment made.

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The estimated fair values of the Company's financial instruments at March 31, 2014 and December 31, 2013 are as follows:

			Fair Value Measurements		
(dollars in thousands)	**Carrying Value**	**Fair Value**	**Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
March 31, 2014					
Assets					
Cash and due from banks	$ 8,982	$ 8,982	$ -	$ 8,982	$ -
Federal funds sold	8,468	8,468	-	8,468	-
Interest bearing deposits with other banks	213,501	213,501	-	213,501	-
Investment securities	387,790	387,790	198	387,373	219
Federal Reserve and Federal Home Loan Bank stock	10,599	10,599	-	10,599	-
Loans held for sale	21,862	21,862	-	21,862	-
Loans	3,063,975	3,097,497	-	11,186	3,086,311
Bank owned life insurance	40,052	40,052	-	40,052	-
Other earning assets	11,267	11,267	-	11,267	-
Liabilities					
Noninterest bearing deposits	886,623	886,623	-	886,623	-
Interest bearing deposits	2,387,066	2,386,650	-	2,386,650	-
Borrowings	105,737	106,712	-	106,712	-
December 31, 2013					
Assets					
Cash and due from banks	$ 9,577	$ 9,577	$ -	$ 9,577	$ -
Federal funds sold	5,695	5,695	-	5,695	-
Interest bearing deposits with other banks	291,688	291,688	-	291,688	-
Investment securities	378,133	378,133	165	377,749	219
Federal Reserve and Federal Home Loan Bank stock	11,272	11,272	-	11,272	-
Loans held for sale	42,030	42,030	-	42,030	-
Loans	2,945,158	2,979,180	-	14,249	2,964,931
Bank owned life insurance	39,738	39,738	-	39,738	-
Other earning assets	11,227	11,227	-	11,227	-

Liabilities					
Noninterest bearing deposits	849,409	849,409	-	849,409	-
Interest bearing deposits	2,376,005	2,375,861	-	2,375,861	-
Borrowings	119,771	120,764	-	120,764	-

Note 9. Supplemental Executive Retirement Plan

In February 2013, the Compensation Committee authorized Supplemental Executive Retirement and Death Benefit Agreements (the "SERP Agreements") with each of the Bank's executive officers other than Mr. Paul, which upon the executive's retirement, will provide for a stated monthly payment for such executive's lifetime, subject to certain death benefits described below. The retirement benefit is computed as a percentage of each executive's projected average base salary over the five years preceding retirement, assuming retirement at age 67. The SERP Agreements provide that (a) the benefits vest ratably over six years of service to the Bank, with the executive receiving credit for years of service prior to entering into the SERP Agreement (b) death, disability and change-in-control shall result in immediate vesting, and (c) the monthly amount will be reduced if retirement occurs earlier than age 67 for any reason other than death, disability or change-in-control. The SERP Agreements further provide for a death benefit in the event the retired executive dies prior to receiving 180 monthly installments, paid either in a lump sum payment or continued monthly installment payments, such that the executive's beneficiary has received payment(s) sufficient to equate to a cumulative 180 monthly installments.

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The SERP Agreements are unfunded arrangements maintained primarily to provide supplemental retirement benefits and comply with Section 409A of the Internal Revenue Code. The Bank has elected to finance the retirement benefits by purchasing fixed annuity contracts with three insurance carriers totaling $10.7 million that have been designed to provide a future source of funds for the lifetime retirement benefits of the SERP Agreements. The primary impetus for utilizing fixed annuities is a substantial savings in compensation expenses for the Bank as opposed to a traditional SERP Agreement. The annuity contracts accrued $41 thousand of income for the three months ended March 31, 2014, which is included in other noninterest income on the consolidated statement of operations. The cash surrender value of the annuity contracts is $11.3 million at March 31, 2014 and is included in other assets on the consolidated balance sheet. For the three months ended March 31, 2014, the Company recorded benefit expense accruals of $461 thousand for this post retirement benefit.

Upon death of an executive, the annuity contract related to such executive terminates. The Bank has purchased additional bank owned life insurance contracts, which would effectively fund payments (up to a 15 year certain amount) to the executives' named beneficiaries.

Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion provides information about the results of operations, and financial condition, liquidity, and capital resources of the Company and its subsidiaries as of the dates and periods indicated. This discussion and analysis should be read in conjunction with the unaudited consolidated financial statements and Notes thereto, appearing elsewhere in this report and the Management Discussion and Analysis in the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

This report contains forward looking statements within the meaning of the Securities Exchange Act of 1934, as amended, including statements of goals, intentions, and expectations as to future trends, plans, events or results of Company operations and policies and regarding general economic conditions. In some cases, forward- looking statements can be identified by use of such words as "may," "will," "anticipate," "believes," "expects," "plans," "estimates," "potential," "continue," "should," and similar words or phrases. These statements are based upon current and anticipated economic conditions, nationally and in the Company's market, interest rates and interest rate policy, competitive factors and other conditions which, by their nature, are not susceptible to accurate forecast, and are subject to significant uncertainty. For details on factors that could affect these expectations, see the risk factors and other cautionary language included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013 and in other periodic and current reports filed by the Company with the Securities and Exchange Commission. Because of these uncertainties and the assumptions on which this discussion and the forward looking statements are based, actual future operations and results in the future may differ materially from those indicated herein. Readers are cautioned against placing undue reliance on any such forward looking statements.

GENERAL

The Company is a growth oriented, one-bank holding company headquartered in Bethesda, Maryland, which is currently celebrating fifteen years of successful operations. The Company provides general commercial and consumer banking services through the Bank, its wholly owned banking subsidiary, a Maryland chartered bank which is a member of the Federal Reserve System. The Company was organized in October 1997, to be the holding company for the Bank. The Bank was organized in 1998 as an independent, community oriented, full service banking alternative to the super regional financial institutions, which dominate the primary market area. The Company's philosophy is to provide superior, personalized service to its customers. The Company focuses on relationship banking, providing each customer with a number of services and becoming familiar with and addressing customer needs in a proactive, personalized fashion. The Bank currently has a total of eighteen branch offices, including seven in Montgomery County, Maryland, five in Washington, D.C., and six in Northern Virginia.

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The Company offers a broad range of commercial banking services to its business and professional clients as well as full service consumer banking services to individuals living and/or working primarily in the Bank's market area. The Company emphasizes providing commercial banking services to sole proprietors, small and medium-sized businesses, non-profit organizations and associations, and investors living and working in and near the primary service area. These services include the usual deposit functions of commercial banks, including business and personal checking accounts, "NOW" accounts and money market and savings accounts, business, construction, and commercial loans, residential mortgages and consumer loans, and cash management services. The Bank is also active in the origination and sale of residential mortgage loans and the origination of SBA loans. The residential mortgage loans are originated for sale to third-party investors, generally large mortgage and banking companies, under best efforts delivery commitments by the investors to purchase the loans subject to compliance with pre-established investor criteria. The Company generally sells the guaranteed portion of the SBA loans in a transaction apart from the loan origination generating noninterest income from the gains on sale, as well as servicing income on the portion participated. Bethesda Leasing, LLC, a subsidiary of the Bank, holds title to and manages Other Real Estate Owned ("OREO") assets. Eagle Insurance Services, LLC, a subsidiary of the Bank, offers access to insurance products and services through a referral program with a third party insurance broker. Additionally, the Bank offers investment advisory services through a referral program with a third party. ECV, a subsidiary of the Company, provides subordinated financing for the acquisition, development and/or construction of real estate projects. ECV lending involves higher levels of risk, together with commensurate expected returns.

CRITICAL ACCOUNTING POLICIES

The Company's consolidated financial statements are prepared in accordance with GAAP and follow general practices within the banking industry. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions and judgments are based on information available as of the date of the consolidated financial statements; accordingly, as this information changes, the consolidated financial statements could reflect different estimates, assumptions, and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions and judgments and as such have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions, and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the financial statements at fair value warrants an impairment write-down or a valuation reserve to be established, or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility.

The fair values and the information used to record valuation adjustments for investment securities available-for-sale are based either on quoted market prices or are provided by other third-party sources, when available. The Company's investment portfolio is categorized as available-for-sale with unrealized gains and losses net of income tax being a component of shareholders' equity and accumulated other comprehensive (loss) income.

The allowance for credit losses is an estimate of the losses that may be sustained in our loan portfolio. The allowance is based on two principles of accounting: (a) ASC Topic 450, *"Contingencies,"* which requires that losses be accrued when they are probable of occurring and are estimable and (b) ASC Topic 310, *"Receivables,"* which requires that losses be accrued when it is probable that the Company will not collect all principal and interest payments according to the contractual terms of the loan. The loss, if any, can be determined by the difference between the loan balance and the value of collateral, the present value of expected future cash flows, or values observable in the secondary markets.

Three components comprise our allowance for credit losses: a specific allowance, a formula allowance and a nonspecific or environmental factors allowance. Each component is determined based on estimates that can and do change when actual events occur.

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The specific allowance allocates a reserve to identified impaired loans. Impaired loans are assigned specific reserves based on an impairment analysis. Under ASC Topic 310, *"Receivables,"* a loan for which reserves are individually allocated may show deficiencies in the borrower's overall financial condition, payment record, support available from financial guarantors and for the fair market value of collateral. When a loan is identified as impaired, a specific reserve is established based on the Company's assessment of the loss that may be associated with the individual loan.

The formula allowance is used to estimate the loss on internally risk rated loans, exclusive of those identified as requiring specific reserves. The portfolio of unimpaired loans is stratified by loan type and risk assessment. Allowance factors relate to the type of loan and level of the internal risk rating, with loans exhibiting higher risk and loss experience receiving a higher allowance factor.

The environmental allowance is also used to estimate the loss associated with pools of non-classified loans. These non-classified loans are also stratified by loan type, and environmental allowance factors are assigned by management based upon a number of conditions, including delinquencies, loss history, changes in lending policy and procedures, changes in business and economic conditions, changes in the nature and volume of the portfolio, management expertise, concentrations within the portfolio, quality of internal and external loan review systems, competition, and legal and regulatory requirements.

The allowance captures losses inherent in the loan portfolio, which have not yet been recognized. Allowance factors and the overall size of the allowance may change from period to period based upon management's assessment of the above described factors, the relative weights given to each factor, and portfolio composition.

Management has significant discretion in making the judgments inherent in the determination of the provision and allowance for credit losses, including in connection with the valuation of collateral, a borrower's prospects of repayment, and in establishing allowance factors on the formula and environmental components of the allowance. The establishment of allowance factors involves a continuing evaluation, based on management's ongoing assessment of the global factors discussed above and their impact on the portfolio. The allowance factors may change from period to period, resulting in an increase or decrease in the amount of the provision or allowance, based upon the same volume and classification of loans. Changes in allowance factors can have a direct impact on the amount of the provision, and a related after tax effect on net income. Errors in management's perception and assessment of the global factors and their impact on the portfolio could result in the allowance not being adequate to cover losses in the portfolio, and may result in additional provisions or charge-offs. Alternatively, errors in management's perception and assessment of the global factors and their impact on the portfolio could result in the allowance being in excess of amounts necessary to cover losses in the portfolio, and may result in lower provisions in the future. For additional information regarding the provision for credit losses, refer to the discussion under the caption "Provision for Credit Losses" below.

The Company follows the provisions of ASC Topic 718, *"Compensation,"* which requires the expense recognition for the fair value of share based compensation awards, such as stock options, restricted stock awards, and performance based shares. This standard allows management to establish modeling assumptions as to expected stock price volatility, option terms, forfeiture rates and dividend rates which directly impact estimated fair value. The accounting standard also allows for the use of alternative option pricing models which may impact fair value as determined. The Company's practice is to utilize reasonable and supportable assumptions.

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RESULTS OF OPERATIONS

Earnings Summary

For the three months ended March 31, 2014, the Company reported net income of $12.5 million, an 8% increase over the $11.6 million net income for the quarter ended March 31, 2013. Net income available to common shareholders for the quarter ended March 31, 2014 increased 8% to $12.4 million ($0.48 per basic common share and $0.47 per diluted common share), as compared to $11.4 million ($0.45 per basic common share and $0.44 per diluted common share) for the same period in 2013.

Per share amounts for all prior periods have been adjusted to reflect the 10% stock dividend distributed on June 14, 2013.

The increase in net income for the three months ended March 31, 2014 can be attributed primarily to an increase in total revenue (i.e. net interest income plus noninterest income) of 4% over the same period in 2013 and to improved credit quality, including lower net charge-offs, resulting in reduced provision expense. Net interest income growth in the first three months of 2014 versus 2013 of 16% was due to average earning asset growth of 9% and a favorable net interest margin of 4.45%.

For the three months ended March 31, 2014, the Company reported a return on average assets (“ROAA”) of 1.36% as compared to 1.39% for the three months ended March 31, 2013. The annualized return on average common equity (“ROAE”) for the quarter ended March 31, 2014 was 14.38%, as compared to 15.29% for the quarter ended March 31, 2013. The lower ROAA and ROAE ratios for first quarter of 2014 as compared to 2013 was due primarily to a decrease in the level of noninterest income attributable substantially to lower levels of residential mortgage refinancing activity.

The net interest margin, which measures the difference between interest income and interest expense (i.e. net interest income) as a percentage of earning assets, increased 25 basis points from 4.20% for the three months ended March 31, 2013 to 4.45% for the three months ended March 31, 2014. For the first three months in 2014, the Company has been able to maintain its loan portfolio yields relatively close to 2013 levels (5.45% versus 5.65%) due to disciplined loan pricing practices, and to reduce its cost of funds (0.31% versus 0.42%), while maintaining a favorable deposit mix, largely resulting from ongoing efforts to increase and expand client relationships. Average earning assets yields were higher by 14 basis points (4.76% versus 4.62%). This increase in average earning asset yields compares to a decline of 18 basis points (from 0.64% to 0.46%) in the cost of interest bearing liabilities. A higher mix of average loans as a percentage of total earning assets (from 75% to 82%) and lower average liquidity during the three months ended

March 31, 2014, as compared to the same period in 2013, were the primary contributors to the increase in average earning asset yields in the first three months of 2014 versus 2013.

The net interest spread increased by 32 basis points for the first three months in 2014 (4.30% versus 3.98%) as compared to 2013, as the Company has managed its cost of funds aggressively and been extremely disciplined in setting new loan rates. The benefit of noninterest sources funding earning assets declined by 7 basis points from 22 basis points to 15 basis points for the three months ended March 31, 2014 and 2013, respectively. The combination of a 32 basis point increase in the net interest spread and a 7 basis point decline in the value of noninterest sources resulted in the 25 basis point increase in the net interest margin in the first quarter of 2014 as compared to the same period in 2013.

The Company believes it has effectively managed its net interest margin and net interest income over the past twelve months as average market interest rates have declined. This factor has been significant to overall earnings performance in 2014 as net interest income experienced a gain of 16% for the three month period ended March 31, 2014 as compared to the same period in 2013.

In order to fund growth in average loans of 20% over the three months ended March 31, 2014 as compared to the same period in 2013, as well as sustain significant liquidity, the Company has relied primarily upon core deposit growth, while decreasing the levels of brokered and wholesale deposits. The major component of the growth in core deposits has been growth in money market accounts and noninterest bearing deposits primarily as a result of effectively building new and enhanced client relationships. Average growth of total deposits was 12% for the three months of 2014 as compared to the same period in 2013.

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In terms of the average balance sheet composition or mix, loans, which generally have higher yields than securities and other earning assets, increased from 74% of average earning assets in the first three months of 2013, to 82% of average earning assets in the first three months of 2014. The lower growth of average funding sources as compared to loans has reduced average liquidity to the balance sheet for the first three months of 2014 versus 2013 ($238 million versus $355 million). For the first three months of 2014, as compared to the same period in 2013, average loans, excluding loans held for sale, increased $501.1 million, a 20% increase. The increase in average loans in the three months of 2014 as compared to the first three months of 2013 is primarily attributable to growth in both commercial and industrial and investment commercial real estate loans. As noted above, increases in average deposits in the first three months of 2014, as compared to the first three months of 2013, is attributable to growth in money market accounts and noninterest bearing deposits. Average investment securities for the three month periods ended March 31, 2014 and 2013 amounted to 11% and 10% of average earning assets, respectively. The combination of federal funds sold, interest bearing deposits with other banks and loans held for sale averaged 7% of average earning assets in the first three months of 2014 as compared to 16% for the same period in 2013, respectively.

The provision for credit losses was $1.9 million for the three months ended March 31, 2014 as compared to $3.4 million for the three months ended March 31, 2013. The lower provisioning in the first quarter of 2014, as compared to the first quarter of 2013, is due to a combination of lower net charge-offs, and overall improved asset quality in the loan portfolio. Net charge-offs of $837 thousand in the first quarter of 2014 represented an annualized 0.11% of average loans, excluding loans held for sale, as compared to $2.0 million or an annualized 0.33% of average loans, excluding loans held for sale, in the first quarter of 2013, a 59% decline. Net charge-offs in the first quarter of 2014 were attributable primarily to construction loans ($516 thousand) and residential real estate, home equity and consumer loans ($224 thousand).

At March 31, 2014, the allowance for credit losses represented 1.37% of loans outstanding, as compared to 1.39% at December 31, 2013, and 1.52% at March 31, 2013. The slight decrease in the allowance for credit losses as a percentage of total loans at March 31, 2014, as compared to December 31, 2013, from 1.39% to 1.37%, is due to increased loan growth, and overall improved credit quality in the loan portfolio at March 31, 2014. The allowance for credit losses was 116% of nonperforming loans at March 31, 2014, as compared to 166% at December 31, 2013, and 138% at March 31, 2013. The decrease in the ratio of the allowance for credit losses to nonperforming loans at March 31, 2014 as compared to December 31, 2013 was due primarily to one large commercial loan relationship ($11.0 million) that was placed on nonaccrual status in March 2014.

Total noninterest income for the first three months of 2014 was $4.5 million compared to $8.1 million in 2013, a decrease of 45%. This decrease was primarily due to a decline of $4.3 million in gains on the sale of residential mortgage loans, partially offset by a combination of $541 thousand higher income from sales of SBA loans and $220 thousand higher income from Bank Owned Life Insurance.

Total noninterest expenses totaled $23.1 million for the three months ended March 31, 2014, as compared to $20.7 million for the three months ended March 31, 2013, a 12% increase. This increase was due primarily to $2.4 million cost increases for salaries and benefits, largely to officer merit increases and to discretionary bonuses.

The ratio of common equity to total assets increased from 9.18% at March 31, 2013 to 9.30% at March 31, 2014 due to favorable earnings for the last twelve months. As discussed later in “Capital Resources and Adequacy,” the regulatory capital ratios of the Bank and Company remain above well capitalized levels.

Net Interest Income and Net Interest Margin

Net interest income is the difference between interest income on earning assets and the cost of funds supporting those assets. Earning assets are composed primarily of loans and investment securities. The cost of funds represents interest expense on deposits, customer repurchase agreements and other borrowings. Noninterest bearing deposits and capital are other components representing funding sources (refer to discussion above under Results of Operations). Changes in the volume and mix of assets and funding sources, along with the changes in yields earned and rates paid, determine changes in net interest income.

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For the first three months of 2014, net interest income increased 16% over the same period for 2013. Average loans increased $501.1 million and average deposits increased by $353.6 million. The net interest margin was 4.45% for the three months of 2014, as compared to 4.20% for the three months of 2013. The Company has been able to maintain its loan yields in 2014 close to 2013 levels due to loan pricing practices, and has been able to reduce its funding costs while maintaining a favorable deposit mix; much of which has occurred from sales efforts to increase and expand client relationships. The Company believes its net interest margin remains favorable to peer banking companies.

The table below presents the average balances and rates of the major categories of the Company's assets and liabilities for the three months ended March 31, 2014 and 2013. Included in the table is a measurement of interest rate spread and margin. Interest rate spread is the difference (expressed as a percentage) between the interest rate earned on earning assets less the interest rate paid on interest bearing liabilities. While the interest rate spread provides a quick comparison of earnings rates versus cost of funds, management believes that margin provides a better measurement of performance. The net interest margin (as compared to net interest spreads) includes the effect of noninterest bearing sources in its calculation and is net interest income expressed as a percentage of average earning assets.

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Eagle Bancorp, Inc.

Consolidated Average Balances, Interest Yields And Rates (Unaudited)

(dollars in thousands)

	Three Months Ended March 31,							
	2014				2013			
	Average Balance	Interest	Average Yield/Rate		Average Balance	Interest	Average Yield/Rate	
ASSETS								
Interest earning assets:								
Interest bearing deposits with other banks and other short-term investments	$230,272	$138	0.24	%	$346,291	$209	0.24	%
Loans held for sale (1)	26,592	266	4.00	%	179,476	1,485	3.31	%
Loans (1) (2)	2,981,917	40,097	5.45	%	2,480,862	34,539	5.65	%
Investment securities available for sale (2)	401,096	2,333	2.36	%	316,870	1,696	2.17	%
Federal funds sold	7,428	3	0.16	%	8,431	4	0.19	%
Total interest earning assets	3,647,305	42,837	4.76	%	3,331,930	37,933	4.62	%
Total noninterest earning assets	134,570				84,383			
Less: allowance for credit losses	41,650				37,951			
Total noninterest earning assets	92,920				46,432			
TOTAL ASSETS	$3,740,225				$3,378,362			
LIABILITIES AND SHAREHOLDERS' EQUITY								
Interest bearing liabilities:								
Interest bearing transaction	$113,984	$63	0.22	%	$104,798	$83	0.32	%
Savings and money market	1,838,306	1,493	0.33	%	1,421,035	1,526	0.44	%
Time deposits	429,595	856	0.81	%	524,515	1,331	1.03	%
Total interest bearing deposits	2,381,885	2,412	0.41	%	2,050,348	2,940	0.58	%
Customer repurchase agreements	62,846	38	0.25	%	96,015	69	0.29	%
Long-term borrowings	39,300	380	3.87	%	39,300	415	4.22	%
Total interest bearing liabilities	2,484,031	2,830	0.46	%	2,185,663	3,424	0.64	%
Noninterest bearing liabilities:								
Noninterest bearing demand	836,031				813,957			
Other liabilities	15,042				18,883			
Total noninterest bearing liabilities	851,073				832,840			
Shareholders’ equity	405,121				359,859			
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$3,740,225				$3,378,362			

Net interest income	$40,007		$34,509	
Net interest spread	4.30	%	3.98	%
Net interest margin	4.45	%	4.20	%

(1) Loans placed on nonaccrual status are included in average balances. Net loan fees and late charges included in interest income on loans totaled $2.4 million and $1.9 million for the three months ended March 31, 2014 and 2013, respectively.

(2) Interest and fees on loans and investments exclude tax equivalent adjustments.

Provision for Credit Losses

The provision for credit losses represents the amount of expense charged to current earnings to fund the allowance for credit losses. The amount of the allowance for credit losses is based on many factors, which reflect management’s assessment of the risk in the loan portfolio. Those factors include historical losses, economic conditions and trends, the value and adequacy of collateral, volume and mix of the portfolio, performance of the portfolio, and internal loan processes of the Company and Bank.

Management has developed a comprehensive analytical process to monitor the adequacy of the allowance for credit losses. This process and guidelines were developed utilizing, among other factors, the guidance from federal banking regulatory agencies. The results of this process, in combination with conclusions of the Bank’s outside loan review consultant, support management’s assessment as to the adequacy of the allowance at the balance sheet date. Please refer to the discussion under the caption “Critical Accounting Policies” for an overview of the methodology management employs on a quarterly basis to assess the adequacy of the allowance and the provisions charged to expense.

During the first three months of 2014, the allowance for credit losses increased $1.1 million, reflecting $1.9 million in provision for credit losses and $837 thousand in net charge-offs during the period. The provision for credit losses was $1.9 million for the three months ended March 31, 2014 as compared to $3.4 million for the three months ended March 31, 2014. At March 31, 2014, the allowance for credit losses represented 1.37% of loans outstanding, compared to 1.39% at December 31, 2013 and 1.52% at March 31, 2014. The lower provisioning in the first three months of 2014, as compared to the first three months of 2013, is due to a combination of lower net charge-offs and overall improvement in asset quality. Net charge-offs of $837 thousand represented 0.11% of average loans, excluding loans held for sale, in the first three months of 2014, as compared to $2.0 million or 0.33% of average loans, excluding loans held for sale, for the same period of 2013.

As part of its comprehensive loan review process, the Bank’s Board of Directors and Loan Committee or Credit Review Committee carefully evaluate loans which are past-due 30 days or more. The Committees make a thorough assessment of the conditions and circumstances surrounding each delinquent loan. The Bank’s loan policy requires that loans be placed on nonaccrual if they are ninety days past-due, unless they are well secured and in the process of collection. Additionally, Credit Administration specifically analyzes the status of development and construction projects, sales activities and utilization of interest reserves in order to carefully and prudently assess potential increased levels of risk requiring additional reserves.

The maintenance of a high quality loan portfolio, with an adequate allowance for possible credit losses, will continue to be a primary management objective for the Company.

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The following table sets forth activity in the allowance for credit losses for the periods indicated.

(dollars in thousands)	Three Months Ended March 31, 2014	2013
Balance at beginning of year	$40,921	$37,492
Charge-offs:		
Commercial	273	1,184
Investment - commercial real estate	-	109
Owner occupied - commercial real estate	35	-
Real estate mortgage - residential	62	-
Construction - commercial and residential	581	719
Construction - C&I (owner occupied)	-	-
Home equity	149	29
Other consumer	25	42
Total charge-offs	1,125	2,083
Recoveries:		
Commercial	211	26
Investment - commercial real estate	-	-
Owner occupied - commercial real estate	-	-
Real estate mortgage - residential	-	-
Construction - commercial and residential	65	6
Construction - C&I (owner occupied)	-	-
Home equity	5	-
Other consumer	7	5
Total recoveries	288	37
Net charge-offs	837	2,046
Additions charged to operations	1,934	3,365
Balance at end of period	$42,018	$38,811
Annualized ratio of net charge-offs during the period to average loans outstanding during the period	0.11 %	0.33 %

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The following table reflects the allocation of the allowance for credit losses at the dates indicated. The allocation of the allowance to each category is not necessarily indicative of future losses or charge-offs and does not restrict the use of the allowance to absorb losses in any category.

	March 31, 2014		December 31, 2013		March 31, 2013	
(dollars in thousands)	**Amount**	**% (1)**	**Amount**	**% (1)**	**Amount**	**% (1)**
Commercial	$11,420	23 %	$9,780	24 %	$11,075	23 %
Investment - commercial real estate	10,590	40 %	10,359	38 %	9,007	36 %
Owner occupied - commercial real estate	3,195	10 %	3,899	11 %	2,804	12 %
Real estate mortgage - residential	754	3 %	944	3 %	877	3 %
Construction - commercial and residential	13,380	19 %	13,422	19 %	12,176	21 %
Construction - C&I (owner occupied)	799	1 %	512	1 %	769	1 %
Home equity	1,507	4 %	1,871	4 %	1,752	4 %
Other consumer	373	-	134	-	351	-
Unallocated	-	-	-	-	-	-
Total loans	$42,018	100%	$40,921	100%	$38,811	100%

(1) Represents the percent of loans in each category to total loans.

Nonperforming Assets

As shown in the table below, the Company's level of nonperforming assets, which are comprised of loans delinquent 90 days or more, nonaccrual loans, which includes the nonperforming portion of troubled debt restructurings ("TDRs") and other real estate owned, totaled $45.1 million at March 31, 2014, representing 1.19% of total assets, as compared to $33.9 million of nonperforming assets, or 0.90% of total assets, at December 31, 2013 and $37.4 million of nonperforming assets, or 1.12% of total assets, at March 31, 2013. The Company had no accruing loans 90 days or more past due at March 31, 2014, December 31, 2013 or March 31, 2013. Management remains attentive to early signs of deterioration in borrowers' financial conditions and to taking the appropriate action to mitigate risk. Furthermore, the Company is diligent in placing loans on nonaccrual status and believes, based on its loan portfolio risk analysis, that its allowance for credit losses, at 1.37% of total loans at March 31, 2014, is adequate to absorb potential credit losses within the loan portfolio at that date.

Included in nonperforming assets are loans that the Company considers to be impaired. Impaired loans are defined as those as to which we believe it is probable that we will not collect all amounts due according to the contractual terms of the loan agreement, as well as those loans whose terms have been modified in a TDR that have not shown a period of performance as required under applicable accounting standards. Valuation allowances for those loans determined to be impaired are evaluated in accordance with ASC Topic 310—"*Receivables,*" and updated quarterly. For collateral dependent impaired loans, the carrying amount of the loan is determined by current appraised value less estimated costs to sell the underlying collateral, which may be adjusted downward under certain circumstances for actual events and/or changes in market conditions. For example, current average actual selling prices less average actual closing costs on an impaired multi-unit real estate project may indicate the need for an adjustment in the appraised valuation of the project, which in turn could increase the associated ASC Topic 310 specific reserve for the loan. Generally, all appraisals associated with impaired loans are updated on a not less than annual basis.

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Loans are considered to have been modified in a TDR when, due to a borrower's financial difficulties, the Company makes unilateral concessions to the borrower that it would not otherwise consider. Concessions could include interest rate reductions, principal or interest forgiveness, forbearance, and other actions intended to minimize economic loss and to avoid foreclosure or repossession of collateral. Alternatively, management, from time-to-time and in the ordinary course of business, implements renewals, modifications, extensions, and/or changes in terms of loans to borrowers who have the ability to repay on reasonable market-based terms, as circumstances may warrant. Such modifications are not considered to be TDRs, as the accommodation of a borrower's request does not rise to the level of a concession if the modified transaction is at market rates and terms and/or the borrower is not experiencing financial difficulty. For example: (1) adverse weather conditions may create a short term cash flow issue for an otherwise profitable retail business which suggests a temporary interest only period on an amortizing loan; (2) there may be delays in absorption on a real estate project which reasonably suggests extension of the loan maturity at market terms; or (3) there may be maturing loans to borrowers with demonstrated repayment ability who are not in a position at the time of maturity to obtain alternate long-term financing. The most common change in terms provided by the Company is an extension of an interest only term. The determination of whether a restructured loan is a TDR requires consideration of all of the facts and circumstances surrounding the change in terms, and the exercise of prudent business judgment. The Company had six TDRs totaling $14.9 million at March 31, 2014, of which three loans totaling approximately $7.9 million were performing TDRs. During the first quarter of 2014, there were no defaults on restructured loans, as compared to the first quarter of 2013, during which there was one default totaling approximately $495 thousand on a restructured loan. A default is considered to have occurred once the TDR is past due 90 days or more or it has been placed on nonaccrual. There were no nonperforming TDRs reclassified to nonperforming loans as of March 31, 2014. During the quarter ended March 31, 2014, three nonperforming TDRs totaling $2.3 million migrated from nonperforming loans. One nonperforming TDRs totaling approximately $2.0 million was reclassified to OREO after the Company took possession of the underlying collateral. The Company was paid off on the second TDR totaling $217 thousand. The third TDR totaling $95 thousand was charged-off during the quarter. Commercial and consumer loans modified in a TDR are closely monitored for delinquency as an early indicator of possible future default. If loans modified in a TDR subsequently default, the Company evaluates the loan for possible further impairment. The allowance may be increased, adjustments may be made in the allocation of the allowance, or partial charge-offs may be taken to further write-down the carrying value of the loan. There were no loans modified in a TDR during the three months ended March 31, 2014 and 2013.

Total nonperforming loans amounted to $36.3 million at March 31, 2014 (1.19% of total loans), compared to $24.7 million at December 31, 2013 (0.84% of total loans) and $28.2 million at March 31, 2013 (1.11% of total loans). The increase in the ratio of nonperforming loans to total loans at March 31, 2014 as compared to March 31, 2013 was due to one large commercial loan relationship ($11.0 million) that was placed on nonaccrual status in March 2014.

Included in nonperforming assets at March 31, 2014 were $8.8 million of OREO, consisting of seven foreclosed properties. The Company had seven foreclosed properties with a net carrying value of $9.2 million at December 31, 2013 and thirteen foreclosed properties with a net carrying value of $9.2 million at March 31, 2013. OREO properties are carried at the lower of cost or appraised value less estimated costs to sell. It is the Company's policy to obtain third party appraisals prior to foreclosure, and to obtain updated third party appraisals on OREO properties not less frequently than annually. Generally, the Company would obtain updated appraisals or evaluations where it has reason to believe, based upon market indications (such as comparable sales, legitimate offers below carrying value, broker indications and similar factors), that the current appraisal does not accurately reflect current value. During the first three months of 2014, one foreclosed property with a net carrying value of $150 thousand was sold for a net loss of $100 thousand. The decrease in OREO at March 31, 2014, is due to the sale of one OREO property and additional write downs totaling $453 thousand.

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The following table shows the amounts of nonperforming assets at the dates indicated.

(dollars in thousands)	March 31, 2014	March 31, 2013	December 31, 2013
Nonaccrual Loans:			
Commercial	$17,646	$4,039	$ 6,779
Investment - commercial real estate	2,271	3,269	2,525
Owner occupied - commercial real estate	7,323	2,368	5,452
Real estate mortgage - residential	771	691	887
Construction - commercial and residential	7,658	17,318	8,366
Construction - C&I (owner occupied)	-	-	-
Home equity	598	481	623
Other consumer	60	-	70
Accrual loans-past due 90 days	-		