EAGLE BANCORP INC
Form 10-Q
August 11, 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 June 30, 2014

OR

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

For the transition period from _________ to_________

Commission File Number 0-25923

Eagle Bancorp, Inc.

(Exact name of registrant as specified in its charter)

Maryland	52-2061461
(State or other jurisdiction of	(I.R.S. Employer

incorporation or organization)	Identification No.)
7830 Old Georgetown Road, Third Floor, Bethesda, Maryland	20814
(Address of principal executive offices)	(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 August 1, 2014, the registrant had 26,024,326 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)

Assets	**June 30, 2014**	**December 31, 2013**	**June 30, 2013**
Cash and due from banks	$8,602	$9,577	$7,765
Federal funds sold	9,480	5,695	10,634
Interest bearing deposits with banks and other short-term investments	97,400	291,688	172,849
Investment securities available for sale, at fair value	378,990	378,133	335,779
Federal Reserve and Federal Home Loan Bank stock	10,626	11,272	11,220
Loans held for sale	35,411	42,030	104,767
Loans	3,279,429	2,945,158	2,691,358
Less allowance for credit losses	(43,552)	(40,921)	(39,640)
Loans, net	3,235,877	2,904,237	2,651,718
Premises and equipment, net	17,797	16,737	16,706
Deferred income taxes	25,586	28,949	24,883
Bank owned life insurance	40,361	39,738	29,324
Intangible assets, net	3,379	3,510	3,690
Other real estate owned	8,843	9,225	12,213
Other assets	42,092	30,712	29,020
Total Assets	$3,914,444	$3,771,503	$3,410,568
Liabilities and Shareholders' Equity			
Liabilities			
Deposits:			
Noninterest bearing demand	$945,485	$849,409	$767,808
Interest bearing transaction	128,415	118,580	107,013
Savings and money market	1,899,430	1,811,088	1,531,804
Time, $100,000 or more	186,063	203,706	203,117
Other time	208,534	242,631	278,494
Total deposits	3,367,927	3,225,414	2,888,236
Customer repurchase agreements	60,646	80,471	97,327
Long-term borrowings	39,300	39,300	39,300
Other liabilities	19,750	32,455	16,315
Total Liabilities	3,487,623	3,377,640	3,041,178
Shareholders' Equity			
	56,600	56,600	56,600

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 June 30, 2014, December 31, 2013 and June 30, 2013			
Common stock, par value $.01 per share; shares authorized 50,000,000, shares issued and outstanding 25,985,659, 25,885,863 and 25,764,542 respectively	255	253	251
Warrant	946	946	946
Additional paid in capital	245,629	242,990	239,584
Retained earnings	121,553	96,393	72,916
Accumulated other comprehensive income (loss)	1,838	(3,319)	(907)
Total Shareholders' Equity	426,821	393,863	369,390
Total Liabilities and Shareholders' Equity	$3,914,444	$3,771,503	$3,410,568

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)

	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013
Interest Income				
Interest and fees on loans	$82,679	$72,022	$42,316	$35,998
Interest and dividends on investment securities	4,656	3,507	2,323	1,811
Interest on balances with other banks and short-term investments	254	382	116	173
Interest on federal funds sold	7	7	4	3
Total interest income	87,596	75,918	44,759	37,985
Interest Expense				
Interest on deposits	4,736	5,578	2,324	2,638
Interest on customer repurchase agreements	69	133	31	64
Interest on long-term borrowings	764	834	384	419
Total interest expense	5,569	6,545	2,739	3,121
Net Interest Income	82,027	69,373	42,020	34,864
Provision for Credit Losses	5,068	5,722	3,134	2,357
Net Interest Income After Provision For Credit Losses	76,959	63,651	38,886	32,507
Noninterest Income				
Service charges on deposits	2,411	2,236	1,219	951
Gain on sale of loans	2,864	10,417	1,021	4,768
Gain on sale of investment securities	10	23	2	-
Increase in the cash surrender value of bank owned life insurance	624	189	310	95
Other income	2,365	2,311	1,259	1,251
Total noninterest income	8,274	15,176	3,811	7,065
Noninterest Expense				
Salaries and employee benefits	26,623	22,535	13,015	11,335
Premises and equipment expenses	6,196	5,727	3,107	2,927
Marketing and advertising	877	741	415	394
Data processing	3,020	3,070	1,432	1,531
Legal, accounting and professional fees	1,773	1,362	799	589
FDIC insurance	1,107	1,196	563	614
Other expenses	5,637	6,751	2,804	3,295
Total noninterest expense	45,233	41,382	22,135	20,685
Income Before Income Tax Expense	40,000	37,445	20,562	18,887
Income Tax Expense	14,557	14,198	7,618	7,212
Net Income	25,443	23,247	12,944	11,675
Preferred Stock Dividends	283	283	142	142
Net Income Available to Common Shareholders	$25,160	$22,964	$12,802	$11,533

Earnings Per Common Share				
Basic	$0.97	$0.90	$0.49	$0.45
Diluted	$0.95	$0.88	$0.48	$0.44

See notes to consolidated financial statements.

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EAGLE BANCORP, INC.

Consolidated Statements of Comprehensive Income (Unaudited)

(dollars in thousands)

	Six Months Ended June 30,		Three Months Ended June 30,	
	2014	**2013**	**2014**	**2013**
Net Income	$25,443	$23,247	$12,944	$11,675
Other comprehensive income, net of tax:				
Net unrealized gain (loss) on securities available for sale	5,163	(6,359)	2,341	(5,415)
Reclassification adjustment for net gains included in net income	(6)	(13)	(1)	-
Net change in unrealized gain (loss) on securities	5,157	(6,372)	2,340	(5,415)
Comprehensive Income	$30,600	$16,875	$15,284	$6,260

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	-	-	-	-	25,443	-	25,443
Net change in other comprehensive income	-	-	-	-	-	5,157	5,157
Stock-based compensation	-	-	-	1,915	-	-	1,915
Common stock issued 89,802 shares under equity compensation plans	-	2	-	303	-	-	305
Tax benefits related to stock compensation	-	-	-	123	-	-	123
Employee stock purchase plan 9,994 shares	-	-	-	298	-	-	298
Preferred stock dividends	-	-	-	-	(283)	-	(283)
Balance June 30, 2014	**$ 56,600**	**$ 255**	**$ 946**	**$ 245,629**	**$ 121,553**	**$ 1,838**	**$ 426,821**
Balance January 1, 2013	$ 56,600	$ 226	$ 946	$ 180,593	$ 106,146	$ 5,465	$ 349,976
Net Income	-	-	-	-	23,247	-	23,247
Net change in other comprehensive income	-	-	-	-	-	(6,372)	(6,372)
10% common stock dividend 2,340,518 shares	-	23	-	56,161	(56,184)	-	-
Cash paid in lieu of fractional shares	-	-	-	-	(10)	-	(10)
Stock-based compensation	-	-	-	1,552	-	-	1,552
Common stock issued 469,135 shares under equity compensation plans	-	2	-	755	-	-	757
Tax benefit on non-qualified options exercised	-	-	-	270	-	-	270
Employee stock purchase plan 13,420 shares	-	-	-	253	-	-	253

Preferred stock dividends	-	-	-	-	(283)	-	(283)
Balance June 30, 2013	**$ 56,600**	**$ 251**	**$ 946**	**$ 239,584**	**$ 72,916**	**$ (907)**	**$ 369,390**

See notes to consolidated financial statements.

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EAGLE BANCORP, INC.

Consolidated Statements of Cash Flows (Unaudited)

(dollars in thousands)

	Six Months Ended June 30, 2014	2013
Cash Flows From Operating Activities:		
Net Income	$25,443	$23,247
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for credit losses	5,068	5,722
Depreciation and amortization	2,292	2,095
Gains on sale of loans	(2,864)	(10,417)
Securities premium amortization, net	1,721	1,466
Origination of loans held for sale	(221,231)	(683,248)
Proceeds from sale of loans held for sale	230,714	815,821
Net increase in cash surrender value of BOLI	(624)	(189)
Decrease (increase) in deferred income taxes	3,363	(5,755)
Decrease in fair value of other real estate owned	505	-
Loss on sale of other real estate owned	100	458
Net gain on sale of investment securities	(10)	(23)
Stock-based compensation expense	1,915	1,552
Excess tax benefits from stock-based compensation	(123)	(270)
(Increase) decrease in other assets	(11,380)	1,318
Decrease in other liabilities	(12,705)	(5,290)
Net cash provided by operating activities	22,184	146,487
Cash Flows From Investing Activities:		
Decrease in interest bearing deposits with other banks and short-term investments	43	5
Purchases of available for sale investment securities	(26,852)	(91,791)
Proceeds from maturities of available for sale securities	11,956	25,869
Proceeds from sale/call of available for sale securities	17,485	22,148
Purchases of Federal Reserve and Federal Home Loan Bank stock	(53)	(679)
Proceeds from redemption of federal reserve and federal home loan bank stock	699	153
Net increase in loans	(336,985)	(211,384)
Purchases of BOLI	-	(15,000)
Purchases of annuity	-	(10,879)
Proceeds from sale of other real estate owned	108	2,350
Bank premises and equipment acquired	(3,194)	(3,355)
Net cash used in investing activities	(336,793)	(282,563)
Cash Flows From Financing Activities:		
Increase (decrease) in deposits	142,513	(8,986)
Decrease in customer repurchase agreements	(19,825)	(4,011)
Payment of dividends on preferred stock	(283)	(283)

Proceeds from exercise of stock options	305	757
Excess tax benefits from stock-based compensation	123	270
Payment in lieu of fractional shares	-	(10)
Proceeds from employee stock purchase plan	298	253
Net cash provided by (used in) financing activities	123,131	(12,010)
Net Decrease In Cash and Cash Equivalents	(191,478)	(148,086)
Cash and Cash Equivalents at Beginning of Period	306,960	339,334
Cash and Cash Equivalents at End of Period	$115,482	$191,248
Supplemental Cash Flows Information:		
Interest paid	$5,770	$6,638
Income taxes paid	$20,200	$19,125
Non-Cash Investing Activities		
Transfers from loans to other real estate owned	$330	$9,614

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 and six months ended June 30, 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 June 30, 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 June 30, 2014, December 31, 2013 and June 30, 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. To protect against the price risk inherent in residential mortgage loan commitments, the Company utilizes both "mandatory delivery" and "best efforts" forward loan sale commitments to mitigate the risk of potential decrease in the values of loans that would result from the exercise of the derivative loan commitments. Under a "mandatory delivery" contract, the Company commits to deliver a certain principal amount of mortgage loans to an investor at a specified price on or before a specified date. If the Company fails to deliver the amount of mortgages necessary to fulfill the commitment by the specified date, it is obligated to pay the investor a "pair-off" fee, based on then-current market prices, to compensate the investor for the shortfall. Under a "best efforts" contract, the Company commits to deliver an individual mortgage loan of a specified principal amount and quality to an investor and the investor commits to a price that it will purchase the loan from the Company if the loan to the underlying borrower closes. 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.

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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.

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 June 30, 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.

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.

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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.

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 June 30, 2014, December 31, 2013, or June 30, 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.

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 8 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. Business Combinations

On June 9, 2014, Eagle Bancorp, Inc. and its wholly owned subsidiary bank, EagleBank, entered into an Agreement and Plan of Reorganization (the “Agreement”) with Virginia Heritage Bank (“VHB”), pursuant to which VHB will be merged with and into EagleBank, with EagleBank surviving the merger (the “Merger”).

At the effective time of the Merger, each outstanding share of VHB common stock will be converted into a combination of shares of Company common stock and cash. The number of shares of Company common stock and amount of cash constituting the merger consideration is dependent on the average closing price of the Company common stock for the 20 trading days ending five trading days prior to closing (the “Company Average Share Price”). Each share of VHB common stock would be converted into cash and Company common stock as follows:

(1) where the Company Average Share Price is at least $29.00 but not more than $35.50, (A) $7.50 in cash and (B) a number of shares of Company common stock equal to (1) $21.50 divided by (2) the Company Average Share Price, rounded to four decimal places;

(2) where the Company Average Share Price is less than $29.00, (A) $7.50 in cash and (B) a number of shares of Company common stock equal to the quotient of (1) the Company Average Share Price less $7.50, divided by (2) the Company Average Share Price, rounded to four decimal places; and

(3) where the Company Average Share Price is greater than $35.50, (A) an amount of cash equal to the product of (a) 0.8169 and (b) the Company Average Share Price and (c) 0.258621, and (B) 0.6056 shares of Company common stock.

Additionally, if at the time of the closing, the aggregate value of the shares of Company common stock to be issued is less than 45% of the aggregate consideration, then the cash portion of the consideration will be reduced by the amount necessary to cause the aggregate value of the shares of Company common stock to be issued to equal 55% of the Aggregate Merger Consideration, and the exchange ratio will be increased by the number of shares necessary to cause the aggregate value of the shares of Company common stock to equal 45% of the aggregate merger consideration. Such adjustments are expected to be necessary only if the Company Average Share Price is less than $13.64. Additionally, if prior to closing, the Company sells any shares of Company common stock or securities convertible into shares of Company common stock, other than pursuant to the exercise of currently outstanding options or warrants to acquire Company common stock, or pursuant to stock options issued after the date of the Agreement in the ordinary course of business, then each share of VHB common stock would be entitled to receive $7.50 in cash and $20.50 in Company common stock, provided that in no event will the number of shares issued under this provision exceed 19.9% of the pre-issuance shares of Company common stock.

The Company would also assume the 15,300 shares of VHB's preferred stock which has an aggregate liquidation preference of $15.3 million and was issued in connection with the U.S. Treasury's Small Business Lending Fund Program.

The Company will assume the VHB stock plans. Options to purchase shares of VHB common stock which are outstanding at the effective time will be "rolled over" into options to acquire the shares of Company common stock.

Consummation of the Merger is subject to various customary conditions which include: the approval by VHB's shareholders of the Merger; no legal impediment to the Merger; the receipt of required regulatory approvals, including the expiration or termination of the waiting period under, the Bank Holding Company Act of 1956, the Bank Merger Act, and any other applicable law; and absence of certain material adverse changes or events. The Agreement contains certain termination rights in favor of both the Company and VHB, and further provides that, upon termination of the Agreement under specified circumstances, VHB be required to pay the Company a termination fee of $7.25 million.

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Note 3. 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.

Note 4. Investment Securities Available-for-Sale

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

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June 30, 2014 **(dollars in thousands)**	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Estimated Fair Value**
U. S. Government agency securities	$ 43,772	$ 715	$ 99	$ 44,388
Residential mortgage backed securities	222,289	1,715	3,101	220,903
Municipal bonds	109,471	4,347	506	113,312
Other equity investments	396	-	9	387
	$ 375,928	$ 6,777	$ 3,715	$ 378,990

December 31, 2013 **(dollars in thousands)**	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Estimated Fair 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**	
June 30, 2014 **(dollars in thousands)**	**Estimated Fair Value**	**Unrealized Losses**	**Estimated Fair Value**	**Unrealized Losses**	**Estimated Fair Value**	**Unrealized Losses**
U. S. Government agency securities	$ 2,015	$ 5	$ 4,774	$ 94	$ 6,789	$ 99
Residential mortgage backed securities	25,330	125	100,557	2,976	125,887	3,101
Municipal bonds	7,304	42	20,044	464	27,348	506
Other equity investments	169	9	-	-	169	9
	$ 34,818	$ 181	$ 125,375	$ 3,534	$ 160,193	$ 3,715

	Less than 12 Months		**12 Months or Greater**		**Total**	
December 31, 2013 **(dollars in thousands)**	**Estimated Fair Value**	**Unrealized Losses**	**Estimated Fair Value**	**Unrealized Losses**	**Estimated 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

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 June 30, 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 June 30, 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.

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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.

	June 30, 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	$ 8,003	$ 8,014	$ 19,025	$ 19,133
After one year through five years	29,290	29,811	27,615	28,202
Five years through ten years	6,479	6,563	-	-
Residential mortgage backed securities	222,289	220,903	234,206	228,674
Municipal bonds maturing:				
After one year through five years	39,300	40,933	25,718	26,008
Five years through ten years	66,561	68,577	76,705	75,732
Ten years through fifteen years	3,610	3,802	-	-
Other equity investments	396	387	396	384
	$ 375,928	$ 378,990	$ 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 June 30, 2014 was $263.5 million. As of June 30, 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 5. Derivatives

As part of its mortgage banking activities, the Bank enters into interest rate lock commitments, which are commitments to originate loans where the interest rate on the loan is determined prior to funding and the customers have locked into that interest rate. The Bank then locks in the loan and interest rate with an investor and commits to deliver the loan if settlement occurs (“best efforts”) or commits to deliver the locked loan in a binding (“mandatory”) delivery program with an investor. Certain loans under interest rate lock commitments are covered under forward sales contracts of mortgage backed securities (“MBS”). Forward sales contracts of MBS are recorded at fair value with changes in fair value recorded in noninterest income. Interest rate lock commitments and commitments to deliver loans to investors are considered derivatives. The market value of interest rate lock commitments and best efforts contracts are not readily ascertainable with precision because they are not actively traded in stand-alone markets. The Bank determines the fair value of interest rate lock commitments and delivery contracts by measuring the fair value of the underlying asset, which is impacted by current interest rates, taking into consideration the probability that the interest rate lock commitments will close or will be funded.

Certain additional risks arise from these forward delivery contracts in that the counterparties to the contracts may not be able to meet the terms of the contracts. The Bank does not expect any counterparty to any MBS to fail to meet its obligation. Additional risks inherent in mandatory delivery programs include the risk that, if the Bank does not close the loans subject to interest rate risk lock commitments, it will still be obligated to deliver MBS to the counterparty under the forward sales agreement. Should this be required, the Bank could incur significant costs in acquiring replacement loans or MBS and such costs could have an adverse effect on mortgage banking operations.

The fair value of the derivatives are recorded as a freestanding asset or liability with the change in value being recognized in current earnings during the period of change.

At June 30, 2014 the Bank had derivative financial instruments with a notional value of $25.3 million related to its forward contracts. The net fair value of these derivative instruments at June 30, 2014 was $223 thousand included in other assets and $159 thousand included in other liabilities. There were no derivative instruments in 2013.

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Included in other noninterest income for the three and six months ended June 30, 2014 was a net gain of $241 thousand, relating to derivative instruments. The amount included in other noninterest income for the three and six months ended June 30, 2014 pertaining to its hedging activities was a net realized loss of $159 thousand. There were no derivative instruments or hedging activities in 2013.

Note 6. 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.

Loans, net of unamortized net deferred fees, at June 30, 2014, December 31, 2013, and June 30, 2013 are summarized by type as follows:

	June 30, 2014		**December 31, 2013**		**June 30, 2013**	
(dollars in thousands)	**Amount**	**%**	**Amount**	**%**	**Amount**	**%**
Commercial	$726,611	22 %	$694,350	24 %	$636,623	24 %
Investment - commercial real estate	1,302,479	40 %	1,119,800	38 %	1,003,723	37 %
Owner occupied - commercial real estate	330,073	10 %	317,491	11 %	311,335	12 %
Real estate mortgage - residential	123,587	4 %	90,418	3 %	78,813	3 %
Construction - commercial and residential	642,264	20 %	574,167	19 %	515,511	19 %
Construction - C&I (owner occupied)	38,368	1 %	34,659	1 %	28,807	1 %
Home equity	108,931	3 %	110,242	4 %	108,565	4 %
Other consumer	7,116	-	4,031	-	7,981	-
Total loans	3,279,429	100%	2,945,158	100%	2,691,358	100%
Less: Allowance for Credit Losses	(43,552)		(40,921)		(39,640)	
Net loans	$3,235,877		$2,904,237		$2,651,718	

Unamortized net deferred fees amounted to $14.5 million, $12.7 million, and $9.9 million at June 30, 2014, December 31, 2013, and June 30, 2013, respectively.

As of June 30, 2014 and December 31, 2013, the Bank serviced $76.1 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.

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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. At June 30, 2014, the combination of commercial real estate and real estate construction loans represent approximately 71% 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 60%. 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 22% of the loan portfolio at June 30, 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 3% of the loan portfolio at June 30, 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 4% 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 a 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.

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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 $680.6 million at June 30, 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 54% of the outstanding ADC loan portfolio at June 30, 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.

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.

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The following tables detail activity in the allowance for credit losses by portfolio segment for the three and six months ended June 30, 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
Three months ended June 30, 2014								
Allowance for credit losses:								
Balance at beginning of period	$ 11,420	$ 10,590	$ 3,195	$ 754	$ 14,179	$ 1,507	$ 373	$ 42,018
Loans charged-off	(1,378)	-	-	(28)	(225)	-	(59)	(1,690)
Recoveries of loans previously charged-off	72	4	7	-	6	1	-	90
Net loans charged-off	(1,306)	4	7	(28)	(219)	1	(59)	(1,600)
Provision for credit losses	1,299	151	71	232	1,527	(177)	31	3,134
Ending balance	$ 11,413	$ 10,745	$ 3,273	$ 958	$ 15,487	$ 1,331	$ 345	$ 43,552
Six months ended June 30, 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	(1,651)	-	(35)	(90)	(806)	(149)	(84)	(2,815)
Recoveries of loans previously charged-off	283	4	7	-	71	6	7	378
Net loans charged-off	(1,368)	4	(28)	(90)	(735)	(143)	(77)	(2,437)
Provision for credit losses	3,001	382	(598)	104	2,288	(397)	288	5,068
Ending balance	$ 11,413	$ 10,745	$ 3,273	$ 958	$ 15,487	$ 1,331	$ 345	$ 43,552
For the Period Ended June 30, 2014								
Allowance for credit losses:								
Individually evaluated for impairment	$ 3,501	$ 732	$ 1,102	$ -	$ 1,605	$ 208	$ -	$ 7,148
Collectively evaluated for impairment	7,912	10,013	2,171	958	13,882	1,123	345	36,404
Ending balance	$ 11,413	$ 10,745	$ 3,273	$ 958	$ 15,487	$ 1,331	$ 345	$ 43,552

(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
Three months ended June 30, 2013								
Allowance for credit losses:								
Balance at beginning of period	$ 11,075	$ 9,007	$ 2,804	$ 877	$ 12,945	$ 1,752	$ 351	$ 38,811
Loans charged-off	(1,230)	-	-	-	(991)	-	(10)	(2,231)
Recoveries of loans previously charged-off	24	-	-	-	669	9	1	703
Net loans charged-off	(1,206)	-	-	-	(322)	9	(9)	(1,528)
Provision for credit losses	2,308	608	220	65	(875)	4	27	2,357
Ending balance	$ 12,177	$ 9,615	$ 3,024	$ 942	$ 11,748	$ 1,765	$ 369	$ 39,640
Six months ended June 30, 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	(2,414)	(109)	-	-	(1,710)	(29)	(52)	(4,314)
Recoveries of loans previously charged-off	50	-	-	-	675	9	6	740
Net loans charged-off	(2,364)	(109)	-	-	(1,035)	(20)	(46)	(3,574)
Provision for credit losses	5,129	576	243	283	(608)	55	44	5,722
Ending balance	$ 12,177	$ 9,615	$ 3,024	$ 942	$ 11,748	$ 1,765	$ 369	$ 39,640
For the Period Ended June 30, 2013								
Allowance for credit losses:								
Individually evaluated for impairment	$ 3,416	$ 1,040	$ 1,025	$ -	$ 1,396	$ 317	$ 10	$ 7,204
Collectively evaluated for impairment	8,761	8,575	1,999	942	10,352	1,448	359	32,436
Ending balance	$ 12,177	$ 9,615	$ 3,024	$ 942	$ 11,748	$ 1,765	$ 369	$ 39,640

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The Company's recorded investments in loans as of June 30, 2014, December 31, 2013, and June 30, 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:

		Investment	Owner occupied	Real Estate	Construction			
		Commercial	Commercial	Mortgage	Commercial and	Home	Other	
(dollars in thousands)	**Commercial**	**Real Estate**	**Real Estate**	**Residential**	**Residential**	**Equity**	**Consumer**	**Total**
June 30, 2014								
Recorded investment in loans:								
Individually evaluated for impairment	$ 17,405	$ 2,913	$ 3,230	$ -	$ 12,882	$ 561	$ -	$ 36,991
Collectively evaluated for impairment	709,206	1,299,566	326,843	123,587	667,750	108,370	7,116	3,242,438
Ending balance	$ 726,611	$ 1,302,479	$ 330,073	$ 123,587	$ 680,632	$ 108,931	$ 7,116	$ 3,279,429
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
June 30, 2013								
Recorded investment in loans:								
Individually evaluated for impairment	$ 16,407	$ 5,560	$ 8,580	$ -	$ 18,879	$ 561	$ 11	$ 49,998
Collectively evaluated for	620,216	998,163	302,755	78,813	525,439	108,004	7,970	2,641,360

impairment								
Ending balance	$ 636,623	$ 1,003,723	$ 311,335	$ 78,813	$ 544,318	$ 108,565	$ 7,981	$ 2,691,358

At June 30, 2014, the nonperforming loans acquired from Fidelity & Trust Financial Corporation ("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.

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.

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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.

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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 June 30, 2014, December 31, 2013, and June30, 2013.

(dollars in thousands)	Pass	Watch and Special Mention	Substandard	Doubtful	Total Loans
June 30, 2014					
Commercial	$695,191	$14,015	$ 17,405	$ -	$726,611
Investment - commercial real estate	1,286,730	12,836	2,913	-	1,302,479
Owner occupied - commercial real estate	313,523	13,320	3,230	-	330,073
Real estate mortgage – residential	122,681	906	-	-	123,587
Construction - commercial and residential	654,631	13,119	12,882	-	680,632
Home equity	106,468	1,902	561	-	108,931
Other consumer	7,116	-	-	-	7,116
Total	$3,186,340	$56,098	$ 36,991	$ -	$3,279,429
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
June 30, 2013					
Commercial	$590,451	$29,765	$ 16,407	$ -	$636,623
Investment - commercial real estate	966,886	31,277	5,560	-	1,003,723
Owner occupied - commercial real estate	284,507	18,248	8,580	-	311,335
Real estate mortgage – residential	77,969	844	-	-	78,813
Construction - commercial and residential	502,319	23,120	18,879	-	544,318
Home equity	105,854	2,150	561	-	108,565
Other consumer	7,970	-	11	-	7,981
Total	$2,535,956	$105,404	$ 49,998	$ -	$2,691,358

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 June 30, 2014, December 31, 2013 and June 30, 2013.

(dollars in thousands)	**June 30, 2014**	**December 31, 2013**	**June 30, 2013**
Commercial	$8,671	$ 6,779	$6,806
Investment - commercial real estate	2,676	2,525	3,266
Owner occupied - commercial real estate	3,230	5,452	2,357
Real estate mortgage - residential	650	887	790
Construction - commercial and residential	6,877	8,366	9,866
Home equity	403	623	411
Other consumer	-	70	11
Total nonaccrual loans (1)(2)	$22,507	$ 24,702	$23,507

(1) Excludes troubled debt restructurings (“TDRs”) that were performing under their restructured terms totaling $7.9 million at June 30, 2014 and December 31, 2013, and $14.8 million at June 30, 2013.

(2) Gross interest income of $850 thousand would have been recorded in 2014 if nonaccrual loans shown above had been current and in accordance with their original terms, while interest actually recorded on such loans was $479 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 June 30, 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**
June 30, 2014						

Commercial	$3,739	$477	$8,671	$12,887	$713,724	$726,611
Investment - commercial real estate	5,080	1,596	2,676	9,352	1,293,127	1,302,479
Owner occupied - commercial real estate	318	282	3,230	3,830	326,243	330,073
Real estate mortgage – residential	681	-	650	1,331	122,256	123,587
Construction - commercial and residential	-	6,005	6,877	12,882	667,750	680,632
Home equity	284	739	403	1,426	107,505	108,931
Other consumer	4	17	-	21	7,095	7,116
Total	$10,106	$9,116	$22,507	$41,729	$3,237,700	$3,279,429
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 June 30, 2014, December 31, 2013 and June 30, 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 Quarter To Date	Average Recorded Investment Year To Date	Interest Income Recognized Quarter To Date	Interest Income Recognized Year To Date
June 30, 2014									
Commercial	$ 9,771	$ 348	$ 8,323	$ 8,671	$ 3,501	$8,873	$11,032	$3	$3
Investment - commercial real estate	6,416	1,512	4,529	6,041	732	5,841	5,861	43	78
Owner occupied - commercial	3,230	99	3,131	3,230	1,102	5,277	5,335	-	-
Real estate mortgage – residential	650	650	-	650	-	711	769	-	-
Construction - commercial and residential	12,516	4,347	7,071	11,418	1,605	11,822	12,192	49	552
Home equity	403	125	278	403	208	501	541	-	-
Other consumer	-	-	-	-	-	30	43	-	-
Total	$ 32,986	$ 7,081	$ 23,332	$ 30,413	$ 7,148	$33,055	$35,773	$95	$633
December 31, 2013									
Commercial	$ 6,779	$ 2,327	$ 4,452	$ 6,779	$ 1,323	$8,193	$8,877	$53	$131

Investment - commercial real estate	5,902	1,322	4,580	5,902	1,098	6,183	5,755	38	175
Owner occupied - commercial	5,452	111	5,341	5,452	1,853	5,939	6,285	52	108
Real estate mortgage – residential	887	774	113	887	27	891	792	2	2
Construction - commercial and residential	13,233	5,358	7,575	12,933	1,625	13,405	17,298	44	169
Home equity	623	-	623	623	526	567	508	2	4
Other consumer	70	-	70	70	68	58	34	1	2
Total	$ 32,946	$ 9,892	$ 22,754	$ 32,646	$ 6,520	$35,236	$39,549	$192	$591
June 30, 2013									
Commercial	$ 10,760	$ 4,230	$ 6,530	$ 10,760	$ 3,416	$9,377	$9,334	$43	$85
Investment - commercial real estate	5,403	3,819	1,584	5,403	1,040	5,405	5,470	38	75
Owner occupied - commercial	6,438	5,533	905	6,438	1,025	6,444	6,515	43	99
Real estate mortgage – residential	790	790	-	790	-	741	727	-	-
Construction - commercial and residential	14,489	10,828	3,661	14,489	1,396	18,224	19,894	42	84
Home equity	411	38	373	411	317	446	468	-	-
Other consumer	11	1	10	11	10	6	18	-	-
Total	$ 38,302	$ 25,239	$ 13,063	$ 38,302	$ 7,204	$40,643	$42,426	$166	$343

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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 June 30, 2014 and December 31, 2013.

(dollars in thousands)	**Number of Contracts**	**TDRs Performing to Modified Terms**	**TDRs Not Performing to Modified Terms**	**Total TDRs**
June 30, 2014				
Investment - commercial real estate	2	$ 3,365	$ -	$3,365
Construction - commercial and residential	2	4,541	912	5,453
Total	4	$ 7,906	$ 912	$8,818
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 first six months ended June 30, 2014, five nonperforming TDRs totaling $8.3 million were removed from TDR status after the loans migrated from nonperforming loans. Two nonperforming TDRs totaling $6.1 million were sold during the second quarter, an owner occupied loan totaling $4.1 million and a commercial loan totaling $2.0 million. One nonperforming TDR totaling approximately $2.0 million was reclassified to OREO after the Company took possession of the underlying collateral. The Company was paid off on another TDR totaling $217 thousand. Finally, one TDR totaling $95 thousand was charged-off. There were no TDR defaults during the first six months of 2014, as compared to the first six months ended 2013 which had one TDR default during the first quarter totaling approximately $495 thousand which was reclassified to nonperforming. 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 and six months ended June 30, 2014 and 2013.

Note 7. Net Income per Common Share

The calculation of net income per common share for the six and three months ended June 30, 2014 and 2013 was as follows.

	Six Months Ended		Three Months Ended	
	June 30,		June 30,	
(dollars and shares in thousands, except per share data)	2014	2013	2014	2013
Basic:				
Net income available to common shareholders	$25,160	$22,964	$12,802	$11,533
Average common shares outstanding	25,955	25,641	25,982	25,742
Basic net income per common share	$0.97	$0.90	$0.49	$0.45
Diluted:				
Net income available to common shareholders	$25,160	$22,964	$12,802	$11,533
Average common shares outstanding	25,955	25,641	25,982	25,742
Adjustment for common share equivalents	645	593	647	592
Average common shares outstanding-diluted	26,600	26,234	26,629	26,334
Diluted net income per common share	$0.95	$0.88	$0.48	$0.44
Anti-dilutive shares	21,000	101,466	21,000	95,966

Note 8. Stock-Based Compensation

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 June 30, 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.

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.

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Below is a summary of changes in shares pursuant to our equity compensation plans for the six months ended June 30, 2014 and 2013. The information excludes restricted stock units and awards.

	Six Months Ended June 30,			
	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	(24,897)	12.25	(89,911)	8.43
Forfeited	(110)	5.76	(1,870)	7.88
Expired	(408)	9.37	(15,640)	10.79
Ending Balance	496,919	$ 11.20	618,034	$ 10.48

The following summarizes information about stock options outstanding at June 30, 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
$5.76	$8.00	237,579	$ 5.76	4.53
$8.01	$10.00	59,344	9.79	0.52
$10.01	$20.00	109,994	12.55	3.29
$20.01	$33.44	90,002	24.81	3.36
		496,919	$ 11.20	3.57

Exercisable: **Weighted-Average**

Range of Exercise Prices		Stock Options Exercisable	Exercise Price
$5.76	$8.00	180,669	$ 5.76
$8.01	$10.00	59,344	9.79
$10.01	$20.00	88,556	12.73
$20.01	$33.44	66,362	22.48
		394,931	$ 10.74

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 six months ended June 30, 2014 and the years ended December 31, 2013 and 2012.

	Six Months Ended June 30, 2014	Years Ended December 31, 2013	Years Ended December 31, 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

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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 $11.2 million at June 30, 2014. The total intrinsic value of stock options exercised during the six months ended June 30, 2014 and 2013 was $538 thousand and $1.1 million, respectively. The total fair value of stock options vested was $125 thousand and $122 thousand for the six months ended June 30, 2014 and 2013, respectively. Unrecognized stock-based compensation expense related to stock options totaled $375 thousand at June 30, 2014. At such date, the weighted-average period over which this unrecognized stock option expense is expected to be recognized was 4.24 years.

The Company has unvested restricted stock award grants of 507,774 shares under the 2006 Plan at June 30, 2014. Unrecognized stock based compensation expense related to restricted stock awards totaled $9.4 million at June 30, 2014. At such date, the weighted-average period over which this unrecognized expense was expected to be recognized was 2.48 years. The following table summarizes the unvested restricted stock awards at June 30, 2014 and 2013.

	Six Months Ended June 30,			
	2014		**2013**	
	Shares	**Weighted-Average Grant Date Fair Value**	**Shares**	**Weighted-Average Grant Date Fair Value**
Unvested at Beginning	614,580	$ 18.71	348,353	$ 13.79
Issued	78,947	33.24	424,450	20.64
Forfeited	(832)	23.59	(269)	13.23
Vested	(184,921)	17.54	(156,905)	13.04
Unvested at End	507,774	$ 21.39	615,629	$ 18.71

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 June 30, 2014, the 2011 ESPP had 463,834 shares remaining for issuance.

Included in salaries and employee benefits the Company recognized $1.9 million and $1.6 million in stock-based compensation expense for the six months ended June 30, 2014 and 2013, respectively. Stock-based compensation expense is recognized ratably over the requisite service period for all awards.

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Note 9. Other Comprehensive Income

The following table presents the components of other comprehensive income (loss) for the three and six months ended June 30, 2014 and 2013.

(dollars in thousands)	Before Tax	Tax Effect	Net of Tax
Three Months Ended June 30, 2014			
Net unrealized gain on securities available-for-sale:			
Net unrealized gain on securities available-for-sale	$3,900	$1,559	$2,341
Less: Reclassification adjustment for net gains included in net income	(2)	(1)	(1)
Other Comprehensive Income Gain	$3,898	$1,558	$2,340
Three Months Ended June 30, 2013			
Net unrealized loss on securities available-for-sale:			
Net unrealized loss on securities available-for-sale	$(9,025)	$(3,610)	$(5,415)
Less: Reclassification adjustment for net gains included in net income	-	-	-
Other Comprehensive Income Loss	$(9,025)	$(3,610)	$(5,415)
Six Months Ended June 30, 2014			
Net unrealized gain on securities available-for-sale:			
Net unrealized gain on securities available-for-sale	$8,605	$3,442	$5,163
Less: Reclassification adjustment for net gains included in net income	(10)	(4)	(6)
Other Comprehensive Income Gain	$8,595	$3,438	$5,157
Six Months Ended June 30, 2013			
Net unrealized loss on securities available-for-sale:			
Net unrealized loss on securities available-for-sale	$(10,598)	$(4,239)	$(6,359)
Less: Reclassification adjustment for net gains included in net income	(23)	(10)	(13)
Other Comprehensive Income Loss	$(10,621)	$(4,249)	$(6,372)

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

(dollars in thousands)	**Securities Available For Sale**	**Accumulated Other Comprehensive (Loss) Income**
Three Months Ended June 30, 2014		
Balance at Beginning of Period	$ (502)	$ (502)
Other comprehensive income before reclassifications	2,341	2,341
Amounts reclassified from accumulated other comprehensive income	(1)	(1)
Net other comprehensive income during period	2,340	2,340
Balance at End of Period	$ 1,838	$ 1,838
Three Months Ended June 30, 2013		
Balance at Beginning of Period	$ 4,508	$ 4,508
Other comprehensive (loss) before reclassifications	(5,415)	(5,415)
Amounts reclassified from accumulated other comprehensive income	-	-
Net other comprehensive (loss) during period	(5,415)	(5,415)
Balance at End of Period	$ (907)	$ (907)
Six Months Ended June 30, 2014		
Balance at Beginning of Period	$ (3,319)	$ (3,319)
Other comprehensive income before reclassifications	5,163	5,163
Amounts reclassified from accumulated other comprehensive income	(6)	(6)
Net other comprehensive income during period	5,157	5,157
Balance at End of Period	$ 1,838	$ 1,838
Six Months Ended June 30, 2013		
Balance at Beginning of Period	$ 5,465	$ 5,465
Other comprehensive (loss) before reclassifications	(6,359)	(6,359)
Amounts reclassified from accumulated other comprehensive income	(13)	(13)
Net other comprehensive (loss) during period	(6,372)	(6,372)
Balance at End of Period	$ (907)	$ (907)

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The following table presents the amounts reclassified out of each component of accumulated other comprehensive income (loss) for the three and six months ended June 30, 2014 and 2013.

Details about Accumulated Other Comprehensive Income Components (dollars in thousands)	**Amount Reclassified from Accumulated Other Comprehensive (Loss) Income Three Months Ended June 30, 2014**	**2013**	**Affected Line Item in the Statement Where Net Income is Presented**
Realized gain on sale of investment securities	$ 2	$ -	Gain on sale of investment securities
	(1)	-	Tax Expense
Total Reclassifications for the Period	$ 1	$ -	Net of Tax

Details about Accumulated Other Comprehensive Income Components (dollars in thousands)	**Amount Reclassified from Accumulated Other Comprehensive (Loss) Income Six Months Ended June 30, 2014**	**2013**	**Affected Line Item in the Statement Where Net Income is Presented**
Realized gain on sale of investment securities	$ 10	$ 23	Gain on sale of investment securities
	(4)	(10)	Tax Expense
Total Reclassifications for the Period	$ 6	$ 13	Net of Tax

Note 10. Fair Value Measurements