FIRST UNITED CORP/MD/
Form 10-Q
November 08, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For quarterly period ended September 30, 2013

£TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT
For the transition period from _______________ to ________________

Commission file number 0-14237

First United Corporation

(Exact name of registrant as specified in its charter)

Maryland	52-1380770
(State or other jurisdiction of incorporation or organization)	(I. R. S. Employer Identification No.)

19 South Second Street, Oakland, Maryland	21550-0009
(Address of principal executive offices)	(Zip Code)

(800) 470-4356

(Registrant's telephone number, including area code)

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

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 6,210,587 shares of common stock, par value $.01 per share, as of October 31, 2013.

INDEX TO QUARTERLY REPORT

FIRST UNITED CORPORATION

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

FIRST UNITED CORPORATION

Consolidated Statement of Financial Condition

(In thousands, except per share and percentage data)

	September 30, 2013 (Unaudited)	December 31, 2012
Assets		
Cash and due from banks	$58,190	$ 71,290
Interest bearing deposits in banks	13,345	11,778
Cash and cash equivalents	71,535	83,068
Investment securities – available-for-sale (at fair value)	297,010	223,273
Investment securities – held to maturity (at cost)	3,900	4,040
Restricted investment in bank stock, at cost	7,913	8,349
Loans	836,208	874,829
Allowance for loan losses	(15,151)	(16,047)
Net loans	821,057	858,782
Premises and equipment, net	27,333	29,455
Goodwill and other intangible assets, net	11,004	11,004
Bank owned life insurance	32,160	31,407
Deferred tax assets	31,435	28,882
Other real estate owned	16,982	17,513
Accrued interest receivable and other assets	21,759	25,010
Total Assets	$1,342,088	$ 1,320,783
Liabilities and Shareholders' Equity		
Liabilities:		
Non-interest bearing deposits	$182,052	$ 161,500
Interest bearing deposits	792,341	815,384
Total deposits	974,393	976,884
Short-term borrowings	59,106	39,257
Long-term borrowings	182,688	182,735
Accrued interest payable and other liabilities	26,405	23,002
Total Liabilities	1,242,592	1,221,878
Shareholders' Equity:		
Preferred stock – no par value;		

Authorized 2,000 shares of which 30 shares of Series A, $1,000 per share liquidation preference, 5% cumulative increasing to 9% cumulative on February 15, 2014, were issued and outstanding on September 30, 2013 and December 31, 2012 (discount of $23 and $75, respectively)	29,977	29,925
Common Stock – par value $.01 per share;		
Authorized 25,000 shares; issued and outstanding 6,211 shares at September 30, 2013 and 6,199 shares at December 31, 2012	62	62
Surplus	21,639	21,573
Retained earnings	73,442	69,168
Accumulated other comprehensive loss	(25,624)	(21,823)
Total Shareholders' Equity	99,496	98,905
Total Liabilities and Shareholders' Equity	$1,342,088	$ 1,320,783

See accompanying notes to the consolidated financial statements

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FIRST UNITED CORPORATION

Consolidated Statement of Operations

(In thousands, except per share data)

	Nine Months Ended September 30,	
	2013	2012
	(Unaudited)	
Interest income		
Interest and fees on loans	$ 32,951	$ 35,504
Interest on investment securities		
Taxable	3,826	3,322
Exempt from federal income tax	1,315	1,355
Total investment income	5,141	4,677
Other	254	207
Total interest income	38,346	40,388
Interest expense		
Interest on deposits	3,860	5,085
Interest on short-term borrowings	45	115
Interest on long-term borrowings	4,919	5,628
Total interest expense	8,824	10,828
Net interest income	29,522	29,560
Provision for loan losses	(161)	9,276
Net interest income after provision for loan losses	29,683	20,284
Other operating income		
Changes in fair value on impaired securities	3,095	346
Portion of gain recognized in other comprehensive income (before taxes)	(3,095)	(346)
Net securities impairment losses recognized in operations	0	0
Net gains – other	254	672
Total net gains	254	672
Service charges	2,613	2,646
Trust department	3,722	3,408
Insurance commissions	3	9
Debit card income	1,471	1,511
Bank owned life insurance	753	1,520
Brokerage commissions	606	599
Other	586	653
Total other income	9,754	10,346
Total other operating income	10,008	11,018
Other operating expenses		
Salaries and employee benefits	14,730	14,784
FDIC premiums	1,405	1,482
Equipment	1,948	1,986
Occupancy	2,016	2,055

Data processing	2,263	2,156
Other Real Estate Owned	2,766	225
Other	7,110	6,627
Total other operating expenses	32,238	29,315
Income before income tax expense	7,453	1,987
Applicable income tax expense	1,853	128
Net Income	5,600	1,859
Accumulated preferred stock dividends and discount accretion	(1,326)	(1,261)
Net Income Available to Common Shareholders	$ 4,274	$ 598
Basic and diluted net income per common share	$ 0.69	$ 0.10
Weighted average number of basic and diluted shares outstanding	6,206	6,192

See accompanying notes to the consolidated financial statements

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FIRST UNITED CORPORATION

Consolidated Statement of Operations

(In thousands, except per share data)

	Three Months Ended September 30,	
	2013	2012
	(Unaudited)	
Interest income		
Interest and fees on loans	$ 11,930	$ 11,550
Interest on investment securities		
Taxable	1,529	1,063
Exempt from federal income tax	447	433
Total investment income	1,976	1,496
Other	73	73
Total interest income	13,979	13,119
Interest expense		
Interest on deposits	1,251	1,527
Interest on short-term borrowings	16	18
Interest on long-term borrowings	1,666	1,795
Total interest expense	2,933	3,340
Net interest income	11,046	9,779
Provision for loan losses	(1,107)	40
Net interest income after provision for loan losses	12,153	9,739
Other operating income		
Changes in fair value on impaired securities	742	389
Portion of gain recognized in other comprehensive income (before taxes)	(742)	(389)
Net securities impairment losses recognized in operations	0	0
Net losses – other	(102)	(8)
Total net losses	(102)	(8)
Service charges	879	921
Trust department	1,339	1,139
Insurance commissions	1	1
Debit card income	487	490
Bank owned life insurance	254	256
Brokerage commissions	245	210
Other	232	257
Total other income	3,437	3,274
Total other operating income	3,335	3,266
Other operating expenses		
Salaries and employee benefits	5,090	4,848
FDIC premiums	476	505
Equipment	657	645
Occupancy	632	654

Data processing	764	711
Other Real Estate Owned	2,814	618
Other	2,541	2,193
Total other operating expenses	12,974	10,174
Income before income tax expense	2,514	2,831
Applicable income tax expense/(benefit)	678	(44)
Net Income	1,836	2,875
Accumulated preferred stock dividends and discount accretion	(448)	(415)
Net Income Available to Common Shareholders	$ 1,388	$ 2,460
Basic and diluted net income per common share	$ 0.22	$ 0.40
Weighted average number of basic and diluted shares outstanding	6,211	6,199

See accompanying notes to the consolidated financial statements

FIRST UNITED CORPORATION

Consolidated Statement of Comprehensive Income/(Loss)

(In thousands, except per share data)

	Nine Months Ended September 30,	
Comprehensive (Loss)/Income (in thousands)	2013	2012
Net Income	$ 5,600	$ 1,859
Other comprehensive income/(loss), net of tax and reclassification adjustments:		
Net unrealized gains on investments with OTTI	1,852	173
Net unrealized (losses)/gains on all other AFS securities	(6,369)	899
Net unrealized gains on cash flow hedges	180	52
Net unrealized gains on Pension	525	0
Net unrealized gains on SERP	11	0
Other comprehensive (loss)/income, net of tax	(3,801)	1,124
Comprehensive income	$ 1,799	$ 2,983

See accompanying notes to the consolidated financial statements

FIRST UNITED CORPORATION

Consolidated Statement of Comprehensive Income/(Loss)

(In thousands, except per share data)

	Three Months Ended September 30,	
Comprehensive Income (in thousands)	2013	2012
Net Income	$ 1,836	$ 2,875
Other comprehensive income/(loss), net of tax and reclassification adjustments:		
Net unrealized gains on investments with OTTI	444	199

Net unrealized (losses)/gains on all other AFS securities	(640)	674
Net unrealized gains on cash flow hedges	42	5
Net unrealized gains on Pension	434	0
Net unrealized gains on SERP	4	0
Other comprehensive income, net of tax	284	878
Comprehensive income	$ 2,120	$ 3,753

See accompanying notes to the consolidated financial statements

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FIRST UNITED CORPORATION

Consolidated Statement of Changes in Shareholders' Equity

(In thousands, except share and per share data)

	Preferred Stock	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balance at January 1, 2012	$ 29,860	$ 62	$ 21,500	$ 66,196	$ (20,962)	$ 96,656
Net income				4,663		4,663
Other comprehensive loss					(861)	(861)
Stock based compensation			73			73
Preferred stock discount accretion	65			(65)		0
Preferred stock dividends deferred				(1,626)		(1,626)
Balance at December 31, 2012	29,925	62	21,573	69,168	(21,823)	98,905
Net income				5,600		5,600
Other comprehensive loss					(3,801)	(3,801)
Stock based compensation			66			66
Preferred stock discount accretion	52			(52)		0
Preferred stock dividends deferred				(1,274)		(1,274)
Balance at September 30, 2013	$ 29,977	$ 62	$ 21,639	$ 73,442	$ (25,624)	$ 99,496

See accompanying notes to the consolidated financial statements

FIRST UNITED CORPORATION

Consolidated Statement of Cash Flows

(In thousands)

	Nine Months Ended September 30,	
	2013	2012
	(Unaudited)	
Operating activities		
Net income	$5,600	$1,859
Adjustments to reconcile net income/(loss) to net cash provided by operating activities:		
Provision for loan losses	(161)	9,276
Depreciation	1,541	1,496
Stock compensation	66	52
Gain on sales of Insurance assets	0	(88)
Gain on sales of other real estate owned	(80)	(668)
Write-downs of other real estate owned	2,889	278
Gain on loan sales	(154)	(114)
Loss on disposal of fixed assets	24	92
Net amortization of investment securities discounts and premiums	930	1,182
Gain on sales of investment securities – available-for-sale	(124)	(562)
Amortization of deferred Loan Fees	(429)	(454)
Decrease in accrued interest receivable and other assets	4,128	1,757
Deferred tax benefit	(1)	(1,454)
Increase/(decrease) in accrued interest payable and other liabilities	2,450	(1,405)
Earnings on bank owned life insurance	(753)	(1,520)
Net cash provided by operating activities	15,926	9,727
Investing activities		
Proceeds from maturities/calls of investment securities available-for-sale	27,160	54,007
Proceeds from maturities/calls of investment securities held-to-maturity	140	0
Proceeds from sales of investment securities available-for-sale	50,169	26,063
Purchases of investment securities available-for-sale	(159,423)	(73,177)
Proceeds from sales of other real estate owned	3,349	3,739
Proceeds from loan sales	20,691	16,949
Proceeds from disposal of fixed assets	1,421	567
Proceeds from sale of insurance assets	0	3,604
Proceeds from BOLI death benefit	0	1,806
Net decrease in FHLB stock	436	1,671
Net decrease in loans	12,151	12,612
Purchases of premises and equipment	(864)	(1,001)
Net cash (used in)/provided by investing activities	(44,770)	46,840
Financing activities		

Net decrease in deposits	(2,491)	(24,391)
Net increase in short-term borrowings	19,849	15,499
Proceeds from long-term borrowings	0	20,000
Payments on long-term borrowings	(47)	(44,294)
Net cash provided by/(used in) financing activities	17,311	(33,186)
(Decrease)/increase in cash and cash equivalents	(11,533)	23,381
Cash and cash equivalents at beginning of the year	83,068	65,107
Cash and cash equivalents at end of period	$71,535	$88,488
Supplemental information		
Interest paid	$7,199	$9,550
Non-cash investing activities:		
Transfers from loans to other real estate owned	$5,627	$7,304

See accompanying notes to the consolidated financial statements

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FIRST UNITED CORPORATION

NoteS to Consolidated Financial Statements (UNAUDITED)

for the quarter ended SEPTEMBER 30, 2013

Note 1 – Basis of Presentation

The accompanying unaudited consolidated financial statements of First United Corporation and its consolidated subsidiaries, including First United Bank & Trust (the “Bank”), have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information, as required by the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic 270, *Interim Reporting*, and with the instructions to Form 10-Q and Rule 8-03 of Regulation S-X. Accordingly, they do not include all the information and footnotes required for annual financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation, consisting of normal recurring items, have been included. Operating results for the three- and nine-month periods ended September 30, 2013 are not necessarily indicative of the results that may be expected for the full year or for any future interim period. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in First United Corporation’s Annual Report on Form 10-K for the year ended December 31, 2012. For purposes of comparability, certain prior period amounts have been reclassified to conform to the 2013 presentation. Such reclassifications had no impact on net income or equity.

First United Corporation has evaluated events and transactions occurring subsequent to the statement of financial condition date of September 30, 2013 for items that should potentially be recognized or disclosed in these financial statements as prescribed by ASC Topic 855, *Subsequent Events*.

As used in these notes to consolidated financial statements, First United Corporation and its consolidated subsidiaries are sometimes collectively referred to as the “Corporation”.

Note 2 – Earnings Per Common Share

Basic earnings/(loss) per common share is derived by dividing net income available to/loss attributable to common shareholders by the weighted-average number of common shares outstanding during the period and does not include the effect of any potentially dilutive common stock equivalents. Diluted earnings/(loss) per share is derived by dividing net income available to/loss attributable to common shareholders by the weighted-average number of shares outstanding, adjusted for the dilutive effect of outstanding common stock equivalents. There is no dilutive effect on earnings per share during loss periods. No common stock equivalents were outstanding during the nine and three months ended September 30, 2013 and 2012.

The following table sets forth the calculation of basic and diluted earnings/(loss) per common share for the nine- and three-month periods ended September 30, 2013 and 2012:

	Nine Months Ended September 30,					
	2013			2012		
(in thousands, except for per share amount)	Income	Average Shares	Per Share Amount	Income	Average Shares	Per Share Amount
Basic and Diluted Earnings Per Share:						
Net income	$5,600			$1,859		
Preferred stock dividends deferred	(1,274)			(1,212)		
Discount accretion on preferred stock	(52)			(49)		
Net income available to common shareholders	$4,274	6,206	$ 0.69	$598	6,192	$ 0.10

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	Three Months Ended September 30,					
	2013			2012		
(in thousands, except for per share amount)	Income	Average Shares	Per Share Amount	Income	Average Shares	Per Share Amount
Basic and Diluted Earnings Per Share:						
Net income	$1,836			$2,875		
Preferred stock dividends deferred	(430)			(398)		
Discount accretion on preferred stock	(18)			(17)		
Net income available to common shareholders	$1,388	6,211	$ 0.22	$2,460	6,199	$ 0.40

Note 3 – Net Gains/(Losses)

The following table summarizes the gain/(loss) activity for the nine- and three-month periods ended September 30, 2013 and 2012:

	Nine months ended September 30,		Three Months Ended September 30,	
(in thousands)	2013	2012	2013	2012
Net gains/(losses) – other:				
Available-for-sale securities:				
Realized gains	$ 447	$ 754	$ 35	$ 91
Realized losses	(323)	(192)	(138)	(128)
Gain on sale of consumer loans	154	114	23	55
Gain on sale of insurance assets	0	88	0	0
Loss on disposal of fixed assets	(24)	(92)	(22)	(26)
Net gains/(losses) – other	$ 254	$ 672	$ (102)	$ (8)

Note 4 – Cash and Cash Equivalents

Cash and due from banks, which represents vault cash in the retail offices and invested cash balances at the Federal Reserve, is carried at fair value.

(in thousands)	September 30, 2013	December 31, 2012
Cash and due from banks, weighted average interest rate of 0.18% (at September 30, 2013)	$ 58,190	$ 71,290

Interest bearing deposits in banks, which represent funds invested at a correspondent bank, are carried at fair value and, as of September 30, 2013 and December 31, 2012, consisted of daily funds invested at the Federal Home Loan Bank ("FHLB") of Atlanta, First Tennessee Bank ("FTN"), Merchants and Traders ("M&T") and Community Bankers Bank ("CBB").

(in thousands)	September 30, 2013	December 31, 2012
FHLB daily investments, interest rate of 0.005% (at September 30, 2013)	$ 4,857	$ 3,306
FTN daily investments, interest rate of 0.06% (at September 30, 2013)	1,350	1,350
M&T daily investments, interest rate of 0.22% (at September 30, 2013)	6,048	6,037
CBB Fed Funds sold, interest rate of 0.22% (at September 30, 2013)	1,090	1,085
	$ 13,345	$ 11,778

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Note 5 – Investments

The investment portfolio is classified and accounted for based on the guidance of ASC Topic 320, *Investments – Debt and Equity Securities*.

The amortized cost of debt securities classified as available-for-sale is adjusted for the amortization of premiums to the first call date, if applicable, or to maturity, and for the accretion of discounts to maturity, or, in the case of mortgage-backed securities, over the estimated life of the security. Such amortization and accretion is included in interest income from investments. Interest and dividends are included in interest income from investments. Gains and losses on the sale of securities are recorded using the specific identification method.

The following table shows a comparison of amortized cost and fair values of investment securities at September 30, 2013 and December 31, 2012:

(in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	OTTI in AOCI
September 30, 2013					
Available for Sale:					
U.S. government agencies	$ 89,723	$ 85	$ 4,365	$ 85,443	$ 0
Residential mortgage-backed agencies	87,049	368	3,632	83,785	0
Commercial mortgage-backed agencies	28,174	11	904	27,281	0
Collateralized mortgage obligations	28,233	106	404	27,935	0
Obligations of states and political subdivisions	56,172	1,243	1,122	56,293	0
Collateralized debt obligations	37,043	363	21,133	16,273	13,783
Total available for sale	$ 326,394	$ 2,176	$ 31,560	$ 297,010	$ 13,783
Held to Maturity:					
Obligations of states and political subdivisions	$ 3,900	$ 234	$ 598	$ 3,536	$ 0
December 31, 2012					
Available for Sale:					
U.S. government agencies	$ 40,334	$ 97	$ 111	$ 40,320	$ 0
Residential mortgage-backed agencies	43,596	703	191	44,108	0
Commercial mortgage-backed agencies	37,330	288	0	37,618	0
Collateralized mortgage obligations	31,836	188	293	31,731	0
Obligations of states and political subdivisions	55,212	2,842	0	58,054	0
Collateralized debt obligations	36,798	0	25,356	11,442	16,876
Total available for sale	$ 245,106	$ 4,118	$ 25,951	$ 223,273	$ 16,876
Held to Maturity:					
Obligations of states and political subdivisions	$ 4,040	$ 542	$ 235	$ 4,347	$ 0

Proceeds from sales of securities and the realized gains and losses are as follows:

	Nine Months Ended September 30,		Three Months Ended September 30,	
(in thousands)	2013	2012	2013	2012
Proceeds	$ 50,169	$ 26,063	$ 15,033	$ 15,609
Realized gains	447	754	35	91
Realized losses	323	192	138	128

The following table shows the Corporation’s securities with gross unrealized losses and fair values at September 30, 2013 and December 31, 2012, aggregated by investment category and the length of time that individual securities have been in a continuous unrealized loss position:

	Less than 12 months		12 months or more		
	Fair	Unrealized	Fair	Unrealized	
(in thousands)	Value	Losses	Value	Losses	
September 30, 2013					
Available for Sale:					
U.S. government agencies	$ 49,309	$ 3,381	$ 6,416	$ 983	
Residential mortgage-backed agencies	76,846	3,569	1,173	64	
Commercial mortgage-backed agencies	22,197	904	0	0	
Collateralized mortgage obligations	18,746	391	3,209	13	
Obligations of states and political subdivisions	16,057	1,122	0	0	
Collateralized debt obligations	0	0	15,612	21,133	
Total available for sale	$ 183,155	$ 9,367	$ 26,410	$ 22,193	
Held to Maturity:					
Obligations of states and political subdivisions	$ 2,262	$ 598	$ 0	$ 0	
December 31, 2012					
Available for Sale:					
U.S. government agencies	$ 18,220	$ 111	$ 0	$ 0	
Residential mortgage-backed agencies	22,407	191	0	0	
Commercial mortgage-backed agencies	0	0	0	0	
Collateralized mortgage obligations	16,576	293	450	0	*
Obligations of states and political subdivisions	0	0	0	0	
Collateralized debt obligations	0	0	11,442	25,356	
Total available for sale	$ 57,203	$ 595	$ 11,892	$ 25,356	
Held to Maturity:					
Obligations of states and political subdivisions	$ 2,765	$ 235	$ 0	$ 0	

* - De minimis

Management systematically evaluates securities for impairment on a quarterly basis. Management assesses whether (a) the Corporation has the intent to sell a security being evaluated and (b) it is more likely than not that the Corporation will be required to sell the security prior to its anticipated recovery. If neither applies, then declines in the fair values of securities below their cost that are considered other-than-temporary declines are split into two components. The first is the loss attributable to declining credit quality. Credit losses are recognized in earnings as realized losses in the period in which the impairment determination is made. The second component consists of all other losses, which are recognized in other comprehensive loss. In estimating other-than-temporary impairment (“OTTI”) losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) adverse conditions specifically related to the security, an industry, or a geographic area, (3) the historic and implied volatility of the fair value of the security, (4) changes in the rating of the security by a rating agency, (5) recoveries or additional declines in fair value subsequent to the balance sheet date, (6) failure of the issuer of the security to make scheduled interest or principal payments, and (7) the payment structure of the debt security and the likelihood of the issuer being able to make payments that increase in the future. Management also monitors cash flow projections for securities that are considered beneficial interests under the guidance of ASC Subtopic 325-40, *Investments – Other – Beneficial Interests in Securitized Financial Assets*, (ASC Section 325-40-35). Further discussion about the evaluation of securities for impairment can be found in Item 2 of Part I of this report under the heading “*Investment Securities*”.

Management believes that the valuation of certain securities is a critical accounting policy that requires significant estimates in preparation of its consolidated financial statements. Management utilizes an independent third party to prepare both the impairment valuations and fair value determinations for its collateralized debt obligation ("CDO") portfolio consisting of pooled trust preferred securities. Based on management's review of the assumptions and results of the third-party review, it does not believe that there were any material differences in the valuations between December 31, 2012 and September 30, 2013.

U.S. Government Agencies - Eight U.S. government agencies have been in an unrealized loss position for less than 12 months as of September 30, 2013. There was one U.S. government agency in an unrealized loss position for 12 months or more. The securities are of the highest investment grade and the Corporation does not intend to sell them, and it is not more likely than not that the Corporation will be required to sell them before recovery of their amortized cost basis, which may be at maturity. Accordingly, management does not consider these investments to be other-than-temporarily impaired at September 30, 2013.

Residential Mortgage-Backed Agencies - Seventeen residential mortgage-backed agencies have been in an unrealized loss position for less than 12 months as of September 30, 2013. There was one residential mortgage-backed agency security in an unrealized loss position for 12 months or more. The securities are of the highest investment grade and the Corporation does not intend to sell them, and it is not more likely than not that the Corporation will be required to sell the securities before recovery of their amortized cost basis, which may be at maturity. Accordingly, management does not consider these investments to be other-than-temporarily impaired at September 30, 2013.

Commercial Mortgage-Backed Agencies - Eleven commercial mortgage-backed agencies have been in an unrealized loss position for less than 12 months as of September 30, 2013. There were no commercial mortgage-backed agency securities in an unrealized loss position for 12 months or more. The securities are of the highest investment grade and the Corporation does not intend to sell them, and it is not more likely than not that the Corporation will be required to sell the securities before recovery of their amortized cost basis, which may be at maturity. Accordingly, management does not consider these investments to be other-than-temporarily impaired at September 30, 2013.

Collateralized Mortgage Obligations - One collateralized mortgage obligation security at September 30, 2013 was in an unrealized loss position for 12 months or more. There were two collateralized mortgage obligation securities in an unrealized loss position for less than 12 months. The securities are of the highest investment grade and the Corporation does not intend to sell them, and it is not more likely than not that the Corporation will be required to sell the securities before recovery of their amortized cost basis. Accordingly, management does not consider these investments to be other-than-temporarily impaired at September 30, 2013.

Obligations of State and Political Subdivisions - Seven securities have been in an unrealized loss position for less than 12 months at September 30, 2013. There are no securities that have been in an unrealized loss position for 12 months or more. These investments are of investment grade as determined by the major rating agencies and management reviews the ratings of the underlying issuers. Management believes that this portfolio is well-diversified throughout the United States, and all bonds continue to perform according to their contractual terms. The Corporation does not intend to sell these investments and it is not more likely than not that the Corporation will be required to sell the investments before recovery of their amortized cost basis, which may be at maturity. Accordingly, management does not consider these investments to be other-than-temporarily impaired at September 30, 2013.

Collateralized Debt Obligations - The $21.1 million in unrealized losses greater than 12 months at September 30, 2013 relates to 17 pooled trust preferred securities that are included in the CDO portfolio. See Note 8 for a discussion of the methodology used by management to determine the fair values of these securities. Based upon a review of credit quality and the cash flow tests performed by the independent third party, management determined that there were no securities that had credit-related non-cash OTTI charges during the first nine months of 2013. The unrealized losses on the remaining securities in the portfolio are primarily attributable to continued depression in market interest rates, marketability, liquidity and the current economic environment.

The following tables present a cumulative roll-forward of the amount of non-cash OTTI charges related to credit losses which have been recognized in earnings for the trust preferred securities in the CDO portfolio held and not intended to be sold for the nine- and three-month periods ended September 30, 2013 and 2012:

	Nine Months Ended September 30,	
(in thousands)	2013	2012
Balance of credit-related OTTI at January 1	$ 13,959	$ 14,424
Additions for credit-related OTTI not previously recognized	0	0
Additional increases for credit-related OTTI previously recognized when there is no intent to sell and no requirement to sell before recovery of amortized cost basis	0	0
Decreases for previously recognized credit-related OTTI because there was an intent to sell	0	0
Reduction for increases in cash flows expected to be collected	(404)	(346)
Balance of credit-related OTTI at September 30	$ 13,555	$ 14,078

	Three Months Ended September 30,	
(in thousands)	2013	2012
Balance of credit-related OTTI at July 1	$ 13,695	$ 14,200
Additions for credit-related OTTI not previously recognized	0	0
Additional increases for credit-related OTTI previously recognized when there is no intent to sell and no requirement to sell before recovery of amortized cost basis	0	0
Decreases for previously recognized credit-related OTTI because there was an intent to sell	0	0
Reduction for increases in cash flows expected to be collected	(140)	(122)
Balance of credit-related OTTI at September 30	$ 13,555	$ 14,078

The amortized cost and estimated fair value of securities by contractual maturity at September 30, 2013 is shown in the following table. Actual maturities may differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties.

	September 30, 2013	
	Amortized	Fair
(in thousands)	Cost	Value
Contractual Maturity		
Available for sale:		
Due after one year through five years	$20,041	$20,105
Due after five years through ten years	69,285	69,095
Due after ten years	93,612	68,809
	182,938	158,009
Residential mortgage-backed agencies	87,049	83,785
Commercial mortgage-backed agencies	28,174	27,281
Collateralized mortgage obligations	28,233	27,935

	$326,394	$297,010
Held to Maturity:		
Due after ten years	$3,900	$3,536

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Note 6 - Restricted Investment in Bank Stock

Restricted stock, which represents required investments in the common stock of the FHLB of Atlanta, Atlantic Community Bankers Bank ("ACBB") and CBB, is carried at cost and is considered a long-term investment.

Management evaluates the restricted stock for impairment in accordance with ASC Industry Topic 942, *Financial Services – Depository and Lending*, (ASC Section 942-325-35). Management's evaluation of potential impairment is based on management's assessment of the ultimate recoverability of the cost of the restricted stock rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability is influenced by criteria such as (a) the significance of the decline in net assets of the issuing bank as compared to the capital stock amount for that bank and the length of time this situation has persisted, (b) commitments by the issuing bank to make payments required by law or regulation and the level of such payments in relation to the operating performance of that bank, and (c) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the issuing bank. Management has evaluated the restricted stock for impairment and believes that no impairment charge is necessary as of September 30, 2013.

The Corporation recognizes dividends received on its restricted stock investments on a cash basis. For the nine months ended September 30, 2013, dividends of $145,578 were recognized in earnings. For the comparable period of 2012, dividends of $110,376 were recognized in earnings.

Note 7 – Loans and Related Allowance for Loan Losses

The following table summarizes the primary segments of the loan portfolio as of September 30, 2013 and December 31, 2012:

(in thousands)	Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Residential Mortgage	Consumer	Total
September 30, 2013						
Total loans	$ 283,166	$ 115,132	$ 59,986	$ 352,227	$ 25,697	$ 836,208
Individually evaluated for impairment	$ 11,881	$ 17,637	$ 2,252	$ 7,259	$ 41	$ 39,070
Collectively evaluated for impairment	$ 271,285	$ 97,495	$ 57,734	$ 344,968	$ 25,656	$ 797,138
December 31, 2012						
Total loans	$ 298,851	$ 128,391	$ 69,013	$ 346,919	$ 31,655	$ 874,829

Individually evaluated for impairment	$ 15,941	$ 24,112	$ 3,449	$ 4,304	$ 36	$ 47,842
Collectively evaluated for impairment	$ 282,910	$ 104,279	$ 65,564	$ 342,615	$ 31,619	$ 826,987

The segments of the Bank's loan portfolio are disaggregated to a level that allows management to monitor risk and performance. The commercial real estate ("CRE") loan segment is then segregated into two classes. Non-owner occupied CRE loans, which include loans secured by non-owner occupied, nonfarm, and nonresidential properties, generally have a greater risk profile than all other CRE loans, which include loans secured by farmland, multifamily structures and owner-occupied commercial structures. The acquisition and development ("A&D") loan segment is segregated into two classes. One-to-four family residential construction loans are generally made to individuals for the acquisition of and/or construction on a lot or lots on which a residential dwelling is to be built. All other A&D loans are generally made to developers or investors for the purpose of acquiring, developing and constructing residential or commercial structures. A&D loans have a higher risk profile because the ultimate buyer, once development is completed, is generally not known at the time of the loan is made. The commercial and industrial ("C&I") loan segment consists of loans made for the purpose of financing the activities of commercial customers. The residential mortgage loan segment is segregated into two classes. Amortizing term loans are primarily first lien loans. Home equity lines of credit are generally second lien loans. The consumer loan segment consists primarily of installment loans (direct and indirect) and overdraft lines of credit connected with customer deposit accounts.

Management uses a 10-point internal risk rating system to monitor the credit quality of the overall loan portfolio. The first six categories are considered not criticized, and are aggregated as “Pass” rated. The criticized rating categories utilized by management generally follow bank regulatory definitions. The Special Mention category includes assets that are currently protected but are potentially weak, resulting in an undue and unwarranted credit risk, but not to the point of justifying a Substandard classification. Loans in the Substandard category have well-defined weaknesses that jeopardize the liquidation of the debt, and have a distinct possibility that some loss will be sustained if the weaknesses are not corrected. All loans greater than 90 days past due are considered Substandard. The portion of a specific allocation of the allowance for loan losses that management believes is associated with a pending event that could trigger loss in the short-term will be classified in the Doubtful category. Any portion of a loan that has been charged off is placed in the Loss category.

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a loan as agreed, the Bank has a structured loan rating process with several layers of internal and external oversight. Generally, consumer and residential mortgage loans are included in the Pass categories unless a specific action, such as bankruptcy, repossession, or death occurs to raise awareness of a possible credit event. The Bank’s Commercial Loan Officers are responsible for the timely and accurate risk rating of the loans in the commercial segments at origination and on an ongoing basis. The Bank’s experienced Credit Quality and Loan Review Department performs an annual review of all commercial relationships of $500,000 or greater. Confirmation of the appropriate risk grade is included as part of the review process on an ongoing basis. The Credit Quality and Loan Review Department continually reviews and assesses loans within the portfolio. In addition, the Bank engages an external consultant to conduct loan reviews on at least an annual basis. Generally, the external consultant reviews commercial relationships greater than $750,000 and/or criticized relationships greater than $500,000. Detailed reviews, including plans for resolution, are performed on loans classified as Substandard on a quarterly basis. Loans in the Special Mention and Substandard categories that are collectively evaluated for impairment are given separate consideration in the determination of the allowance.

The following table presents the classes of the loan portfolio summarized by the aggregate Pass and the criticized categories of Special Mention and Substandard within the internal risk rating system as of September 30, 2013 and December 31, 2012:

(in thousands)	Pass	Special Mention	Substandard	Total
September 30, 2013				
Commercial real estate				
Non owner-occupied	$104,963	$ 9,309	$ 25,926	$140,198
All other CRE	113,496	8,929	20,543	142,968
Acquisition and development				
1-4 family residential construction	9,429	0	5,111	14,540
All other A&D	74,190	1,831	24,571	100,592
Commercial and industrial	55,394	517	4,075	59,986
Residential mortgage				
Residential mortgage - term	262,095	1,044	11,646	274,785
Residential mortgage - home equity	74,980	575	1,887	77,442

Consumer	25,440	16	241	25,697
Total	$719,987	$ 22,221	$ 94,000	$836,208
December 31, 2012				
Commercial real estate				
Non owner-occupied	$126,230	$ 6,464	$ 18,840	$151,534
All other CRE	110,365	9,072	27,880	147,317
Acquisition and development				
1-4 family residential construction	9,284	1,101	5,967	16,352
All other A&D	79,136	1,073	31,830	112,039
Commercial and industrial	60,234	2,029	6,750	69,013
Residential mortgage				
Residential mortgage - term	255,993	751	11,885	268,629
Residential mortgage - home equity	75,935	195	2,160	78,290
Consumer	31,376	22	257	31,655
Total	$748,553	$ 20,707	$ 105,569	$874,829

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. A loan is considered to be past due when a payment has not been received for 30 days past its contractual due date. For all loan segments, the accrual of interest is discontinued when principal or interest is delinquent for 90 days or more unless the loan is well-secured and in the process of collection. All non-accrual loans are considered to be impaired. Interest payments received on non-accrual loans are applied as a reduction of the loan principal balance. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured. The Corporation's policy for recognizing interest income on impaired loans does not differ from its overall policy for interest recognition.

The following table presents the classes of the loan portfolio summarized by the aging categories of performing loans and non-accrual loans as of September 30, 2013 and December 31, 2012:

(in thousands)	Current	30-59 Days Past Due	60-89 Days Past Due	90 Days+ Past Due	Total Past Due and Accruing	Non-Accrual	Total Loans
September 30, 2013							
Commercial real estate							
Non owner-occupied	$ 138,856	$ 439	$ 133	$ 212	$ 784	$ 558	$ 140,198
All other CRE	135,892	659	2,348	0	3,007	4,069	142,968
Acquisition and development							
1-4 family residential construction	12,967	0	0	0	0	1,573	14,540
All other A&D	91,922	3,385	446	0	3,831	4,839	100,592
Commercial and industrial	59,754	4	56	21	81	151	59,986
Residential mortgage							
Residential mortgage - term	267,548						