FIRST BUSINESS FINANCIAL SERVICES, INC.
Form 10-Q
October 25, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
þ Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2013
OR
¨ Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
Commission file number 001-34095
FIRST BUSINESS FINANCIAL SERVICES, INC.
(Exact name of registrant as specified in its charter)

Wisconsin	39-1576570
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
401 Charmany Drive Madison, WI	53719
(Address of Principal Executive Offices)	(Zip Code)

(608) 238-8008
Registrant’s telephone number, including area code
Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, 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 þ No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No þ
The number of shares outstanding of the registrant’s sole class of common stock, par value $0.01 per share, on October 17, 2013 was 3,939,010 shares.

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PART I. Financial Information
Item 1. Financial Statements
First Business Financial Services, Inc.
Consolidated Balance Sheets

	September 30, 2013 (unaudited)	December 31, 2012
	(In Thousands, Except Share Data)	
Assets		
Cash and due from banks	$22,662	$21,626
Short-term investments	73,452	63,960
Cash and cash equivalents	96,114	85,586
Securities available-for-sale, at fair value	186,242	200,596
Loans and leases receivable, net of allowance for loan and lease losses of $15,185 and $15,400, respectively	941,160	896,560
Leasehold improvements and equipment, net	1,182	968
Foreclosed properties	595	1,574
Cash surrender value of bank-owned life insurance	22,906	22,272
Investment in Federal Home Loan Bank stock, at cost	1,255	1,144
Accrued interest receivable and other assets	15,485	17,408
Total assets	$1,264,939	$1,226,108
Liabilities and Stockholders’ Equity		
Deposits	$1,128,331	$1,092,254
Federal Home Loan Bank and other borrowings	11,936	12,405
Junior subordinated notes	10,315	10,315
Accrued interest payable and other liabilities	8,258	11,595
Total liabilities	1,158,840	1,126,569
Commitments and contingencies		
Stockholders’ equity:		
Preferred stock, $0.01 par value, 2,500,000 shares authorized, none issued or outstanding	—	—
Common stock, $0.01 par value, 25,000,000 shares authorized, 4,088,100 and 4,011,370 shares issued, 3,938,423 and 3,916,667 shares outstanding at September 30, 2013 and December 31, 2012, respectively	41	40
Additional paid-in capital	55,228	53,504
Retained earnings	53,936	45,599
Accumulated other comprehensive income	29	2,183
Treasury stock (149,677 and 94,703 shares at September 30, 2013 and December 31, 2012, respectively), at cost	(3,135)	(1,787)
Total stockholders’ equity	106,099	99,539
Total liabilities and stockholders’ equity	$1,264,939	$1,226,108

See accompanying Notes to Unaudited Consolidated Financial Statements.

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First Business Financial Services, Inc.
Consolidated Statements of Income (Unaudited)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2013	2012	2013	2012
	(In Thousands, Except Per Share Data)			
Interest income:				
Loans and leases	$12,669	$13,095	$37,405	$38,859
Securities income	841	890	2,460	2,575
Short-term investments	76	47	182	174
Total interest income	13,586	14,032	40,047	41,608
Interest expense:				
Deposits	2,398	3,102	7,450	10,178
Notes payable and other borrowings	209	735	645	2,145
Junior subordinated notes	280	280	831	835
Total interest expense	2,887	4,117	8,926	13,158
Net interest income	10,699	9,915	31,121	28,450
Provision for loan and lease losses	109	850	243	3,399
Net interest income after provision for loan and lease losses	10,590	9,065	30,878	25,051
Non-interest income:				
Trust and investment services fee income	976	736	2,773	2,178
Service charges on deposits	549	532	1,576	1,504
Loan fees	296	502	986	1,245
Increase in cash surrender value of bank-owned life insurance	215	178	634	524
Credit, merchant and debit card fees	31	50	98	169
Other	57	251	184	383
Total non-interest income	2,124	2,249	6,251	6,003
Non-interest expense:				
Compensation	4,586	4,224	13,819	12,455
Occupancy	314	294	954	958
Professional fees	500	400	1,506	1,279
Data processing	349	326	1,153	993
Marketing	344	300	981	845
Equipment	127	141	401	375
FDIC insurance	169	426	567	1,546
Collateral liquidation costs	108	264	167	451
Net (gain) loss on foreclosed properties	(48)	(14)	1	228
Other	698	890	2,266	2,085
Total non-interest expense	7,147	7,251	21,815	21,215
Income before income tax expense	5,567	4,063	15,314	9,839
Income tax expense	1,958	1,441	5,328	3,442
Net income	$3,609	$2,622	$9,986	$6,397
Earnings per common share:				
Basic	$0.92	$0.99	$2.55	$2.43
Diluted	0.91	0.99	2.54	2.43
Dividends declared per share	0.14	0.07	0.42	0.21

See accompanying Notes to Unaudited Consolidated Financial Statements.

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First Business Financial Services, Inc.
Consolidated Statements of Comprehensive Income (Unaudited)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2013	2012	2013	2012
	(In Thousands)			
Net income	$3,609	$2,622	$9,986	$6,397
Other comprehensive (loss) income, before tax				
Unrealized securities (losses) gains arising during the period	(477)	419	(3,488)	227
Income tax benefit (expense)	185	(160)	1,334	(86)
Comprehensive income	$3,317	$2,881	$7,832	$6,538

See accompanying Notes to Unaudited Consolidated Financial Statements.

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First Business Financial Services, Inc.
Consolidated Statements of Changes in Stockholders' Equity (Unaudited)

	Common shares outstanding	Common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income	Treasury stock	Total
	(In Thousands, Except Share Data)						
Balance at December 31, 2011	2,625,569	$27	$25,843	$37,501	$2,491	$(1,648)	$64,214
Net income	—	—	—	6,397	—	—	6,397
Other comprehensive income	—	—	—	—	141	—	141
Share-based compensation - restricted shares	30,765	—	403	—	—	—	403
Share-based compensation - tax benefits	—	—	48	—	—	—	48
Cash dividends ($0.21 per share)	—	—	—	(555)	—	—	(555)
Treasury stock purchased	(4,390)	—	—	—	—	(99)	(99)
Treasury stock re-issued	4,158	—	(77)	—	—	77	—
Balance at September 30, 2012	2,656,102	$27	$26,217	$43,343	$2,632	$(1,670)	$70,549

	Common shares outstanding	Common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income	Treasury stock	Total
	(In Thousands, Except Share Data)						
Balance at December 31, 2012	3,916,667	$40	$53,504	$45,599	$2,183	$(1,787)	$99,539
Net income	—	—	—	9,986	—	—	9,986
Other comprehensive loss	—	—	—	—	(2,154)	—	(2,154)
Exercise of stock options	51,700	1	1,137	—	—	—	1,138
Share-based compensation - restricted shares	25,030	—	464	—	—	—	464
Share-based compensation - tax benefits	—	—	123	—	—	—	123
Cash dividends ($0.42 per share)	—	—	—	(1,649)	—	—	(1,649)
Treasury stock purchased	(54,974)	—	—	—	—	(1,348)	(1,348)
Balance at September 30, 2013	3,938,423	$41	$55,228	$53,936	$29	$(3,135)	$106,099

See accompanying Notes to Unaudited Consolidated Financial Statements.

First Business Financial Services, Inc.
Consolidated Statements of Cash Flows (Unaudited)

	For the Nine Months Ended September 30,	
	2013	2012
	(In Thousands)	
Operating activities		
Net income	$9,986	$6,397
Adjustments to reconcile net income to net cash provided by operating activities:		
Deferred income taxes, net	552	(257)
Provision for loan and lease losses	243	3,399
Depreciation, amortization and accretion, net	1,858	2,315
Share-based compensation	464	403
Increase in cash surrender value of bank-owned life insurance	(634)	(524)
Origination of loans for sale	—	(1,548)
Sale of loans originated for sale	—	1,695
Gain on sale of loans originated for sale	—	(147)
Net loss on foreclosed properties, including impairment valuation	1	228
Excess tax benefit from share-based compensation	(123)	(48)
Decrease in accrued interest receivable and other assets	2,465	793
Decrease in accrued interest payable and other liabilities	(3,489)	(323)
Net cash provided by operating activities	11,323	12,383
Investing activities		
Proceeds from maturities of available-for-sale securities	52,266	41,497
Purchases of available-for-sale securities	(42,956)	(75,742)
Proceeds from sale of foreclosed properties	1,573	1,486
Payments to priority lien holders of foreclosed properties	—	(268)
Net increase in loans and leases	(45,438)	(31,595)
Investment in limited partnerships	(500)	—
Distributions from limited partnerships	672	557
Investment in FHLB Stock	(1,185)	—
Proceeds from sale of FHLB Stock	1,074	1,223
Purchases of leasehold improvements and equipment, net	(450)	(441)
Proceeds from surrender of bank owned life insurance policies	—	116
Net cash used in investing activities	(34,944)	(63,167)
Financing activities		
Net increase in deposits	36,077	9,946
Repayment of FHLB advances	(469)	(10)
Net decrease in short-term borrowed funds	—	(800)
Proceeds from issuance of subordinated notes payable	—	6,215
Repayment of subordinated notes payable	—	(6,215)
Excess tax benefit from share-based compensation	123	48
Cash dividends paid	(1,371)	(552)
Exercise of stock options	1,137	—
Purchase of treasury stock	(1,348)	(99)
Net cash provided by financing activities	34,149	8,533
Net increase (decrease) in cash and cash equivalents	10,528	(42,251)
Cash and cash equivalents at the beginning of the period	85,586	130,093
Cash and cash equivalents at the end of the period	$96,114	$87,842

Supplementary cash flow information		
Interest paid on deposits and borrowings	$8,854	$13,149
Income taxes paid	5,775	3,874
Transfer to foreclosed properties	595	1,397
Reissuance of treasury stock	—	77

See accompanying Notes to Unaudited Consolidated Financial Statements.

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Notes to Unaudited Consolidated Financial Statements

Note 1 — Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations. The accounting and reporting practices of First Business Financial Services, Inc. (the "Corporation"), its wholly-owned subsidiaries, First Business Bank ("FBB") and First Business Bank – Milwaukee ("FBB – Milwaukee") have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP"). FBB and FBB – Milwaukee are sometimes referred to together as the "Banks." FBB operates as a commercial banking institution in the Madison, Wisconsin market, consisting primarily of Dane County and the surrounding areas, with loan production offices in Oshkosh, Appleton, and Green Bay, Wisconsin. FBB also offers trust and investment services through First Business Trust & Investments ("FBTI"), a division of FBB. FBB – Milwaukee operates as a commercial banking institution in the Milwaukee, Wisconsin market, consisting primarily of Waukesha County and the surrounding areas. The Banks provide a full range of financial services to businesses, business owners, executives, professionals and high net worth individuals. The Banks are subject to competition from other financial institutions and service providers and are also subject to state and federal regulations. FBB has the following subsidiaries: First Business Capital Corp. ("FBCC"), First Madison Investment Corp. ("FMIC"), First Business Equipment Finance, LLC ("FBEF") and FBB Real Estate, LLC ("FBBRE"). FMIC is located in and was formed under the laws of the state of Nevada. FBB-Milwaukee has one subsidiary, FBB – Milwaukee Real Estate, LLC ("FBBMRE").

Basis of Presentation. The accompanying unaudited Consolidated Financial Statements were prepared in accordance with GAAP and with the instructions to Form 10-Q and Rule 8-03 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements and should be read in conjunction with the Corporation's Consolidated Financial Statements and footnotes thereto included in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2012. The unaudited Consolidated Financial Statements include the accounts of the Corporation and its wholly-owned subsidiaries. In accordance with the provisions of Accounting Standards Codification ("ASC") Topic 810, the Corporation's ownership interest in FBFS Statutory Trust II ("Trust II") has not been consolidated into the financial statements. All significant intercompany balances and transactions have been eliminated in consolidation.

Management of the Corporation is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements as well as reported amounts of revenues and expenses during the reporting period. Actual results could differ significantly from those estimates. Material estimates that could experience significant changes in the near-term include the value of foreclosed property, lease residuals, property under operating leases, securities, income taxes and the level of the allowance for loan and lease losses. The results of operations for the three- and nine-month period ended September 30, 2013 are not necessarily indicative of results that may be expected for any other interim period or the entire fiscal year ending December 31, 2013. Certain amounts in prior periods may have been reclassified to conform to the current presentation. Subsequent events have been evaluated through the date of the issuance of the Consolidated Financial Statements. No significant subsequent events have occurred through this date requiring adjustment to the financial statements or disclosures.

The Corporation has not changed its significant accounting and reporting policies from those disclosed in the Corporation's Form 10-K for the year ended December 31, 2012 except as described further below in this Note 1.

Recent Accounting Pronouncements. In January 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2013-01, "Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities." This ASU amends the scope of FASB ASU No. 2011-11, "Disclosures about Offsetting Assets and Liabilities," which requires additional disclosure regarding offsetting of assets and liabilities to enable users of financial statements to evaluate the effect or potential effect of netting arrangements on an entity's financial position. The provisions of the ASUs were effective for annual and interim reporting periods beginning on or after January 1, 2013. The Corporation's disclosure under the ASUs are provided in Note 9 - Derivative Financial Instruments. As the ASUs address financial statement disclosures only, their adoption effective January 1, 2013 did not impact the Corporation's consolidated financial position or results of operations.

In February 2013, the FASB issued ASU No. 2013-02, "Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income." This ASU adds new disclosure requirements for items reclassified out of accumulated other comprehensive income to be in a single location in the financial statements. The Corporation's disclosures of the components of accumulated other comprehensive income are disclosed in its Consolidated Statements of Comprehensive Income. For the nine months ended September 30, 2013, there were no items requiring reclassification out of accumulated other comprehensive income. The new guidance became effective for all interim and annual periods beginning January 1, 2013 and is to be applied prospectively. Since this ASU addresses financial statement disclosures only, the adoption of this guidance effective January 1, 2013 did not have an impact on the Corporation's consolidated financial position or results of operations.

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In July 2013, the FASB issued ASU No. 2013-10, “Derivatives and Hedging (Topic 815): Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes (a consensus of the FASB Emerging Issues Task Force).” This ASU permits the Fed Funds Effective Swap Rate to be used as a U.S. benchmark interest rate for hedge accounting purposes, in addition to US Treasuries (UST) and London Interbank Offered Rate (LIBOR). The amendment also removes the restriction on using different benchmark rates for similar hedges. The amendment applies to all entities that elect to apply hedge accounting of the benchmark interest rate. This ASU is effective prospectively for qualifying new or redesignated hedging relationships entered into on our after July 17, 2013. The adoption of this standard is not expected to have a material impact on the Corporation’s consolidated financial position or results of operations.

In July 2013, the FASB issued ASU No. 2013-11, “Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exits.” This ASU provides that an unrecognized tax benefit, or a portion thereof, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except to the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date to settle any additional income taxes that would result from disallowance of a tax position, or the tax law does not require the entity to use, and the entity does not intend to use the deferred tax asset for such purpose. In these cases, the unrecognized tax benefit should be presented as a liability. This ASU is effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. Early adoption and retrospective application is permitted. The Corporation is in the process of evaluating the impact of this standard to its existing disclosures and currently does not expect this standard to have a material impact on the Corporation’s consolidated financial position or results of operations.

Note 2 — Earnings Per Common Share

Earnings per common share are computed using the two-class method. Basic earnings per common share are computed by dividing net income allocated to common shares by the weighted average number of shares outstanding during the applicable period, excluding outstanding participating securities. Participating securities include unvested restricted shares. Unvested restricted shares are considered participating securities because holders of these securities receive non-forfeitable dividends at the same rate as holders of the Corporation’s common stock. Diluted earnings per share are computed by dividing net income allocated to common shares adjusted for reallocation of undistributed earnings of unvested restricted shares by the weighted average number of shares determined for the basic earnings per common share computation plus the dilutive effect of common stock equivalents using the treasury stock method.

In December 2012, the Corporation successfully completed a capital-raising transaction through the issuance of 1,265,000 shares of common stock at a price of $23.00. This stock issuance impacted the Corporation’s earnings per share by increasing the number of shares outstanding.

For the three-month periods ended September 30, 2013 and 2012, average anti-dilutive employee share-based awards totaled 0 and 54,000, respectively. For the nine-month periods ended September 30, 2013 and 2012, average anti-dilutive employee share-based awards totaled 366 and 120,502, respectively.

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	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2013	2012	2013	2012
	(Dollars in Thousands, Except Per Share Data)			
Basic earnings per common share				
Net income	$3,609	$2,622	$9,986	$6,397
Less: earnings allocated to participating securities	89	101	242	239
Basic earnings allocated to common shareholders	$3,520	$2,521	$9,744	$6,158
Weighted-average common shares outstanding, excluding participating securities	3,831,227	2,539,507	3,826,809	2,533,436
Basic earnings per common share	$0.92	$0.99	$2.55	$2.43
Diluted earnings per common share				
Earnings allocated to common shareholders	$3,520	$2,521	$9,744	$6,158
Reallocation of undistributed earnings	—	—	1	—
Diluted earnings allocated to common shareholders	$3,520	$2,521	$9,745	$6,158
Weighted-average common shares outstanding, excluding participating securities	3,831,227	2,539,507	3,826,809	2,533,436
Dilutive effect of share-based awards	18,335	4,978	13,062	1,752
Weighted-average diluted common shares outstanding, excluding participating securities	3,849,562	2,544,485	3,839,871	2,535,188
Diluted earnings per common share	$0.91	$0.99	$2.54	$2.43

Note 3 — Share-Based Compensation

The Corporation adopted the 2012 Equity Incentive Plan (the “Plan”) during the quarter ended June 30, 2012. The Plan is administered by the Compensation Committee of the Board of Directors of the Corporation and provides for the grant of equity ownership opportunities through incentive stock options and nonqualified stock options (together, “Stock Options”), restricted stock, restricted stock units, dividend equivalent units, and any other type of award permitted by the Plan. As of September 30, 2013, 195,878 shares were available for future grants under the Plan. Shares covered by awards that expire, terminate or lapse will again be available for the grant of awards under the Plan. The Corporation may issue new shares and shares from treasury for shares delivered under the Plan.

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Stock Options

The Corporation may grant Stock Options to senior executives and other employees under the Plan. Stock Options generally have an exercise price that is equal to the fair value of the common shares on the date the option is awarded. Stock Options granted under the Plan are subject to graded vesting, generally ranging from 4 years to 8 years, and have a contractual term of 10 years. For any new awards issued, compensation expense is recognized over the requisite service period for the entire award on a straight-line basis. No Stock Options have been granted since the Corporation became a reporting company under the Securities Exchange Act of 1934, as amended, and no Stock Options have been modified, repurchased or cancelled since such time. For that reason, no stock-based compensation related to Stock Options was recognized in the Consolidated Financial Statements for the three and nine months ended September 30, 2013 and 2012. As of September 30, 2013, all Stock Options granted and not previously forfeited have vested.

Stock Option activity for the year ended December 31, 2012 and nine months ended September 30, 2013 was as follows:

	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)
Outstanding at December 31, 2011	125,034	$22.43	1.75
Granted	—	—	
Exercised	(1,000)	22.00	
Expired	—	—	
Forfeited	—	—	
Outstanding at December 31, 2012	124,034	$22.43	0.75
Exercisable at December 31, 2012	124,034	$22.43	0.75
Outstanding as of December 31, 2012	124,034	$22.43	0.75
Granted	—	—	
Exercised	(51,700)	22.00	
Expired	(3,350)	22.00	
Forfeited	—	—	
Outstanding at September 30, 2013	68,984	$22.77	0.93
Exercisable at September 30, 2013	68,984	$22.77	0.93

Restricted Stock

Under the Plan, the Corporation may grant restricted shares to plan participants, subject to forfeiture upon the occurrence of certain events until the dates specified in the participant’s award agreement. While the restricted shares are subject to forfeiture, the participant may exercise full voting rights and will receive all dividends and other distributions paid with respect to the restricted shares. The restricted shares granted under the Plan are subject to graded vesting. Compensation expense is recognized over the requisite service period of four years for the entire award on a straight-line basis. Upon vesting of restricted share awards, the benefit of tax deductions in excess of recognized compensation expense is recognized as a financing cash flow activity.

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Restricted share activity for the year ended December 31, 2012 and the nine months ended September 30, 2013 was as follows:

	Number of Restricted Shares	Weighted Average Grant-Date Fair Value
Nonvested balance as of December 31, 2011	95,868	$15.15
Granted	37,123	23.03
Vested	(35,905)	15.06
Forfeited	(2,580)	18.32
Nonvested balance as of December 31, 2012	94,506	18.19
Granted	25,030	33.00
Vested	(17,961)	19.42
Forfeited	—	—
Nonvested balance as of September 30, 2013	101,575	$21.62

As of September 30, 2013, $1.9 million of deferred compensation expense was included in additional paid-in capital in the Consolidated Balance Sheets related to unvested restricted shares which the Corporation expects to recognize over approximately 2.9 years. As of September 30, 2013, all restricted shares that vested were delivered. For the nine months ended September 30, 2013 and 2012, share-based compensation expense related to restricted stock included in the Consolidated Statements of Income totaled $464,000 and $403,000, respectively.

Note 4 — Securities

The amortized cost and estimated fair value of securities available-for-sale were as follows:

	As of September 30, 2013			
	Amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Estimated fair value
	(In Thousands)			
U.S. Government agency obligations - government-sponsored enterprises	$16,389	$11	$(200)	$16,200
Municipal obligations	16,221	28	(702)	15,547
Asset-backed securities	1,518	—	(25)	1,493
Collateralized mortgage obligations - government issued	117,450	2,516	(861)	119,105
Collateralized mortgage obligations - government-sponsored enterprises	34,617	102	(822)	33,897
	$186,195	$2,657	$(2,610)	$186,242

	As of December 31, 2012			
	Amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Estimated fair value
	(In Thousands)			
U.S. Government agency obligations - government-sponsored enterprises	$19,667	$62	$(8)	$19,721
Municipal obligations	11,897	179	(43)	12,033
Collateralized mortgage obligations - government issued	148,369	3,344	(68)	151,645

Collateralized mortgage obligations - government-sponsored enterprises	17,128	88	(19)	17,197
	$197,061	$3,673	$(138)	$200,596

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U.S. Government agency obligations - government-sponsored enterprises represent securities issued by the Federal Home Loan Mortgage Corporation (“FHLMC”) and Federal National Mortgage Association (“FNMA”). Collateralized mortgage obligations - government issued represent securities guaranteed by the Government National Mortgage Association (“GNMA”). Collateralized mortgage obligations - government-sponsored enterprises include securities guaranteed by FHLMC and the FNMA. Asset-backed securities represent securities issued by the Student Loan Marketing Association (“SLMA”) and are 97% guaranteed by the U.S. government. Municipal obligations include securities issued by various municipalities located primarily within the State of Wisconsin and are tax-exempt general obligation bonds. There were no sales of securities available-for-sale for the three and nine months ended September 30, 2013 and 2012.

The amortized cost and estimated fair value of securities available-for-sale by contractual maturity at September 30, 2013 are shown below. Actual maturities may differ from contractual maturities because issuers have the right to call or prepay certain obligations without call or prepayment penalties.

	Amortized Cost	Estimated Fair Value
	(In Thousands)	
Due in one year or less	$—	$—
Due in one year through five years	13,287	13,178
Due in five through ten years	39,106	39,206
Due in over ten years	133,802	133,858
	$186,195	$186,242

The table below shows the Corporation’s gross unrealized losses and fair value of investments, aggregated by investment category and length of time that individual investments were in a continuous unrealized loss position at September 30, 2013 and December 31, 2012. At September 30, 2013 and December 31, 2012, the Corporation had 119 securities and 30 securities that were in an unrealized loss position, respectively. Such securities have not experienced credit rating downgrades; however, they have primarily declined in value due to the current interest rate environment. At September 30, 2013, the Corporation held three securities that had been in a continuous loss position for twelve months or greater.

The Corporation also has not specifically identified securities in a loss position that it intends to sell in the near term and does not believe that it will be required to sell any such securities. It is expected that the Corporation will recover the entire amortized cost basis of each security based upon an evaluation of the present value of the expected future cash flows. Accordingly, no other than temporary impairment was recorded in the Consolidated Statements of Income for the nine months ended September 30, 2013 and 2012.

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A summary of unrealized loss information for available-for-sale securities, categorized by security type follows:

	As of September 30, 2013					
	Less than 12 months		12 months or longer		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
	(In Thousands)					
U.S. Government agency obligations - government-sponsored enterprises	$10,556	$200	$—	$—	$10,556	$200
Municipal obligations	13,045	702	—	—	13,045	702
Asset-backed securities	1,493	25	—	—	1,493	25
Collateralized mortgage obligations - government issued	30,540	764	4,100	97	34,640	861
Collateralized mortgage obligations - government-sponsored enterprises	20,273	822	—	—	20,273	822
	$75,907	$2,513	$4,100	$97	$80,007	$2,610

	As of December 31, 2012					
	Less than 12 months		12 months or longer		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
	(In Thousands)					
U.S. Government agency obligations - government-sponsored enterprises	$2,992	$8	$—	$—	$2,992	$8
Municipal obligations	$3,450	$43	$—	$—	$3,450	$43
Collateralized mortgage obligations - government issued	$12,990	$68	$—	$—	$12,990	$68
Collateralized mortgage obligations - government-sponsored enterprises	5,075	19	—	—	5,075	19
	$24,507	$138	$—	$—	$24,507	$138

At September 30, 2013 and December 31, 2012, securities with a fair value of $43.5 million and $23.1 million, respectively, were pledged to secure interest rate swap contracts, outstanding Federal Home Loan Bank ("FHLB") advances, if any, and additional FHLB availability.

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Note 5 — Loan and Lease Receivables, Impaired Loans and Leases and Allowance for Loan and Lease Losses

Loan and lease receivables consist of the following:

	September 30, 2013	December 31, 2012
	(In Thousands)	
Commercial real estate		
Commercial real estate — owner occupied	$139,312	$144,988
Commercial real estate — non-owner occupied	335,756	323,660
Construction and land development	73,799	64,966
Multi-family	61,741	58,454
1-4 family	30,741	31,943
Total commercial real estate	641,349	624,011
Commercial and industrial	276,094	256,458
Direct financing leases, net	24,359	15,926
Consumer and other		
Home equity and second mortgages	3,746	4,642
Other	11,850	11,671
Total consumer and other	15,596	16,313
Total gross loans and leases receivable	957,398	912,708
Less:		
Allowance for loan and lease losses	15,185	15,400
Deferred loan fees	1,053	748
Loans and leases receivable, net	$941,160	$896,560

The total principal amount of loans transferred to third parties, which consisted solely of participation interests in originated loans, during the three months ended September 30, 2013 and 2012 was $16.0 million and $20.1 million, respectively. For the nine months ended September 30, 2013 and 2012, $29.8 million and $54.8 million of loans were transferred to third parties, respectively. Each of the transfers of these financial assets met the qualifications for sale accounting, including the requirements specific to loan participations, and therefore $16.0 million and $29.8 million for the three and nine months ended September 30, 2013, respectively, and $20.1 million and $54.8 million for the three and nine months ended September 30, 2012, respectively, have been derecognized in the unaudited Consolidated Financial Statements. The Corporation has a continuing involvement in each of the agreements by way of relationship management and servicing the loans; however, there are no further obligations to the third-party participant required of the Corporation in the event of a borrower's default, other than standard representations and warranties related to sold amounts. The loans were transferred at their fair value and no gain or loss was recognized upon the transfer, as the participation interest was transferred at or near the date of loan origination and the payments received for servicing the portion of the loans participated represents adequate compensation. The total amount of loan participations purchased on the Corporation's Consolidated Balance Sheets as of September 30, 2013 and December 31, 2012 was $41,000 and $765,000, respectively.

The total amount of outstanding loans transferred to third parties as loan participations sold at September 30, 2013 and December 31, 2012 was $50.2 million and $50.1 million, respectively, all of which was treated as a sale and derecognized under the applicable accounting guidance in effect at the time of the transfers of the financial assets. The Corporation's continuing involvement with these loans is by way of partial ownership, relationship management and all servicing responsibilities. As of September 30, 2013 and December 31, 2012, the total amount of the Corporation's partial ownership of loans on the Corporation's Consolidated Balance Sheets was $63.1 million and $71.9 million, respectively. As of September 30, 2013, no loans in this participation sold portfolio were considered impaired as compared to $3.2 million as of December 31, 2012. This decline was due to the fact that the impaired loan in this portfolio was repurchased and thus was removed from this portfolio. From December 2010 through May 2013, the Corporation recognized a total $2.7 million charge-off associated with specific credits within the retained portion of this portfolio of loans in accordance with the Corporation's allowance for loan and lease loss measurement process and policies. The Corporation does not share in the participant's portion of the charge-offs.

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In May 2013, the Corporation repurchased, from the original participating entity, a portion of one loan which was previously and appropriately accounted for as a transfer (sale) under a participation agreement. This repurchase was not a condition of the original participation agreement and was undertaken to provide the Corporation with the ability to directly and effectively manage the workout process of this loan. As agreed to with the original participating entity and consistent with the transaction agreement, such participated portion of the loan with aggregate principal balance of $3.2 million was repurchased with cash at fair value, or a discounted price of $1.5 million.

The $1.5 million carrying amount of this portion of the loan is recorded on the Consolidated Balance Sheets within loans and leases receivable, net at September 30, 2013 along with Corporation's previously retained portion of this loan. This loan is classified as a nonperforming troubled debt restructuring because the Corporation cannot reasonably estimate the timing of the cash flows expected to be collected and therefore the discount will not be accreted to earnings until the carrying amount is fully paid.

During the nine months ended September 30, 2013, there were no changes to the allowance for loan and lease losses relating to this loan, as it is a collateral dependent loan and was deemed to have sufficient collateral value as of September 30, 2013 to support the carrying value.

The following information illustrates ending balances of the Corporation's loan and lease portfolio, including impaired loans by class of receivable, and considering certain credit quality indicators as of September 30, 2013 and December 31, 2012:

As of September 30, 2013	Category I	II	III	IV	Total
	(Dollars in Thousands)				
Commercial real estate:					
Commercial real estate — owner occupied	$117,675	$10,615	$10,392	$630	$139,312
Commercial real estate — non-owner occupied	282,623	31,606	21,179	348	335,756
Construction and land development	57,552	2,474	7,779	5,994	73,799
Multi-family	55,131	5,786	—	824	61,741
1-4 family	18,503	8,220	3,333	685	30,741
Total commercial real estate	531,484	58,701	42,683	8,481	641,349
Commercial and industrial	247,387	14,719	13,333	655	276,094
Direct financing leases, net	19,061	4,774	524	—	24,359
Consumer and other:					
Home equity and second mortgages	2,943	60	176	567	3,746
Other	11,039	—	—	811	11,850
Total consumer and other	13,982	60	176	1,378	15,596
Total gross loans and leases receivable	$811,914	$78,254	$56,716	$10,514	$957,398
Category as a % of total portfolio	84.80 %	8.17 %	5.92 %	1.10 %	100.00 %

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As of December 31, 2012	Category I	II	III	IV	Total
	(Dollars in Thousands)				
Commercial real estate:					
Commercial real estate — owner occupied	$117,180	$9,688	$17,351	$769	$144,988
Commercial real estate — non-owner occupied	267,884	29,553	22,992	3,231	323,660
Construction and land development	49,134	2,037	8,384	5,411	64,966
Multi-family	50,808	6,810	790	46	58,454
1-4 family	18,255	4,657	7,873	1,158	31,943
Total commercial real estate	503,261	52,745	57,390	10,615	624,011
Commercial and industrial	233,524	9,922	10,170	2,842	256,458
Direct financing leases, net	10,486	3,897	1,543	—	15,926
Consumer and other:					
Home equity and second mortgages	3,525	157	220	740	4,642
Other	10,641	—	—	1,030	11,671
Total consumer and other	14,166	157	220	1,770	16,313
Total gross loans and leases receivable	$761,437	$66,721	$69,323	$15,227	$912,708
Category as a % of total portfolio	83.43 %	7.31 %	7.60 %	1.67 %	100.00 %

Credit underwriting through a committee process is a key component of the Corporation’s operating philosophy. Business development officers have relatively low individual lending authority limits, and thus a significant portion of the Corporation’s new credit extensions require approval from a loan approval committee regardless of the type of loan or lease, asset quality grade of the credit, amount of the credit, or the related complexities of each proposal. In addition, the Corporation makes every effort to ensure that there is appropriate collateral at the time of origination to protect the Corporation’s interest in the related loan or lease.

Each credit is evaluated for proper risk rating upon origination, at the time of each subsequent renewal, upon receipt and evaluation of updated financial information from the Corporation’s borrowers, or as other circumstances dictate. The Corporation uses a nine grade risk rating system to monitor the ongoing credit quality of its loans and leases. The risk rating grades follow a consistent definition, and are then applied to specific loan types based on the nature of the loan. Each risk rating is subjective and, depending on the size and nature of the credit, subject to various levels of review and concurrence on the stated risk rating. In addition to its nine grade risk rating system, the Corporation groups loans into four loan and related risk categories which determine the level and nature of review by management.

Category I — Loans and leases in this category are performing in accordance with the terms of the contract and generally exhibit no immediate concerns regarding the security and viability of the underlying collateral, financial stability of the borrower, integrity or strength of the borrower’s management team or the industry in which the borrower operates. Loans and leases in this category are not subject to additional monitoring procedures above and beyond what is required at the origination or renewal of the loan or lease. The Corporation monitors Category I loans and leases through payment performance, continued maintenance of its personal relationships with such borrowers and continued review of such borrowers’ compliance with the terms of their respective agreements.

Category II — Loans and leases in this category are beginning to show signs of deterioration in one or more of the Corporation’s core underwriting criteria such as financial stability, management strength, industry trends and collateral values. Management will place credits in this category to allow for proactive monitoring and resolution with the borrower to possibly mitigate the area of concern and prevent further deterioration or risk of loss to the Corporation. Category II loans are considered performing but are monitored frequently by the assigned business development officer and by subcommittees of the Banks’ loan committees.

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Category III — Loans and leases in this category are identified by the Corporation’s business development officers and senior management as warranting special attention. However, the balance in this category is not intended to represent the amount of adversely classified assets held by the Banks. Category III loans and leases generally exhibit undesirable characteristics such as evidence of adverse financial trends and conditions, managerial problems, deteriorating economic conditions within the related industry, or evidence of adverse public filings and may exhibit collateral shortfall positions. Management continues to believe that it will collect all required principal and interest in accordance with the original terms of the contracts relating to the loans and leases in this category, and therefore Category III loans are considered performing with no specific reserves established for this category. Category III loans are monitored by management and loan committees of the Banks on a monthly basis and the Banks’ Boards of Directors at each of their regularly scheduled meetings.

Category IV — Loans and leases in this category are considered to be impaired. Impaired loans and leases have been placed on non-accrual as management has determined that it is unlikely that the Banks will receive the required principal and interest in accordance with the contractual terms of the agreement. Impaired loans are individually evaluated to assess the need for the establishment of specific reserves or charge-offs. When analyzing the adequacy of collateral, the Corporation obtains external appraisals at least annually for impaired loans and leases. External appraisals are obtained from the Corporation’s approved appraiser listing and are independently reviewed to monitor the quality of such appraisals. To the extent a collateral shortfall position is present, a specific reserve or charge-off will be recorded to reflect the magnitude of the impairment. Loans and leases in this category are monitored by management and loan committees of the Banks on a monthly basis and the Banks’ Boards of Directors at each of their regularly scheduled meetings.

Utilizing regulatory classification terminology, the Corporation identified $17.1 million and $22.0 million of loans and leases as Substandard as of September 30, 2013 and December 31, 2012, respectively. No loans were considered Special Mention, Doubtful or Loss as of either September 30, 2013 or December 31, 2012. The population of Substandard loans are a subset of Category III and Category IV loans.

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The delinquency aging of the loan and lease portfolio by class of receivable as of September 30, 2013 and December 31, 2012 were as follows:

As of September 30, 2013	30-59 days past due	60-89 days past due	Greater than 90 days past due	Total past due	Current	Total loans
	(Dollars in Thousands)					
Accruing loans and leases						
Commercial real estate:						
Owner occupied	$—	$122	$—	$122	$138,560	$138,682
Non-owner occupied	—	—	—	—	335,408	335,408
Construction and land development	—	—	—	—	68,288	68,288
Multi-family	—	—	—	—	60,917	60,917
1-4 family	—	—	—	—	30,202	30,202
Commercial and industrial	497	3,007	—	3,504	271,968	275,472
Direct financing leases, net	—	—	—	—	24,359	24,359
Consumer and other:						
Home equity and second mortgages	—	—	—	—	3,306	3,306
Other	10	—	—	10	11,029	11,039
Total	507	3,129	—	3,636	944,037	947,673
Non-accruing loans and leases						
Commercial real estate:						
Owner occupied	$—	$201	$255	$456	$174	$630
Non-owner occupied	—	—	—	—	348	348
Construction and land development	—	—	—	—	5,511	5,511
Multi-family	—	—	786	786	38	824
1-4 family	186	69	59	314	225	539
Commercial and industrial	—	—	53	53	569	622
Direct financing leases, net	—	—	—	—	—	—
Consumer and other:						
Home equity and second mortgages	—	—	156	156	284	440
Other	—	—	811	811	—	811
Total	186	270	2,120	2,576	7,149	9,725
Total loans and leases						
Commercial real estate:						
Owner occupied	$—	$323	$255	$578	$138,734	$139,312
Non-owner occupied	—	—	—	—	335,756	335,756
Construction and land development	—	—	—	—	73,799	73,799
Multi-family	—	—	786	786	60,955	61,741
1-4 family	186	69	59	314	30,427	30,741
Commercial and industrial	497	3,007	53	3,557	272,537	276,094
Direct financing leases, net	—	—	—	—	24,359	24,359
Consumer and other:						
Home equity and second mortgages	—	—	156	156	3,590	3,746