

CITY HOLDING CO  
Form 10-Q  
November 08, 2010

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For The Quarterly Period Ended September 30, 2010

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 0-11733

CITY HOLDING COMPANY

(Exact name of registrant as specified in its charter)

West Virginia 55-0619957  
(State or other jurisdiction of incorporation (I.R.S. Employer Identification No.)  
or organization)

25 Gatewater Road 25313  
Charleston, West Virginia (Zip Code)  
(Address of principal executive offices)

(304) 769-1100  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant has (1) 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,

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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 practical date.

Common stock, \$2.50 Par Value – 15,498,219 shares as of November 8, 2010.

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#### FORWARD-LOOKING STATEMENTS

All statements other than statements of historical fact included in this Quarterly Report on Form 10-Q, including statements in Management's Discussion and Analysis of Financial Condition and Result of Operations are, or may be deemed to be, forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Such information involves risks and uncertainties that could result in the Company's actual results differing from those projected in the forward-looking statements. Important factors that could cause actual results to differ materially from those discussed in such forward-looking statements include, but are not limited to: (1) the Company may incur additional loan loss provision due to negative credit quality trends in the future that may lead to a deterioration of asset quality; (2) the Company may incur increased charge-offs in the future; (3) the Company may experience increases in the default rates on previously securitized loans that would result in impairment losses or lower the yield on such loans; (4) the Company may not continue to benefit from strong recovery efforts on previously securitized loans resulting in improved yields on these assets; (5) the Company could have adverse legal actions of a material nature; (6) the Company may face competitive loss of customers; (7) the Company may be unable to manage its expense levels; (8) the Company may have difficulty retaining key employees; (9) changes in the interest rate environment may have results on the Company's operations materially different from those anticipated by the Company's market risk management functions; (10) changes in general economic conditions and increased competition could adversely affect the Company's operating results; (11) changes in other regulations and government policies affecting bank holding companies and their subsidiaries, including changes in monetary policies, could negatively impact the Company's operating results; (12) the Company may experience difficulties growing loan and deposit balances; (13) the current economic environment poses significant challenges for us and could adversely affect our financial condition and results of operations; (14) continued deterioration in the financial condition of the U.S. banking system may impact the valuations of investments the Company has made in the securities of other financial institutions resulting in either actual losses or other than temporary impairments on such investments; (15) the effects of the Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") recently adopted by the United States Congress. Forward-looking statements made herein reflect management's expectations as of the date such statements are made. Such information is provided to assist stockholders and potential investors in understanding current and anticipated financial operations of the Company and is included pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances that arise after the date such statements are made.

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## PART I, ITEM 1 – FINANCIAL STATEMENTS

## Consolidated Balance Sheets

## City Holding Company and Subsidiaries

(in thousands)

|  | September 30<br>2010<br>(Unaudited) | December 31<br>2009<br>(Note A) |
|--|-------------------------------------|---------------------------------|
| <b>Assets</b>  |                                     |                                 |
| Cash and due from banks  | \$ 44,746                           | \$ 59,116                       |
| Interest-bearing deposits in depository institutions   | 3,924                               | 3,519                           |
| Federal funds sold   | 34,100                              | -                               |
| Cash and Cash Equivalents  | 82,770                              | 62,635                          |
| Investment securities available for sale, at fair value  | 427,190                             | 485,767                         |
| Investment securities held-to-maturity, at amortized cost (approximate fair value at September 30, 2010 and December 31, 2009 - \$24,726 and \$25,010, respectively) | 24,381                              | 28,164                          |
| Total Investment Securities  | 451,571                             | 513,931                         |
| Gross loans  | 1,825,838                           | 1,792,434                       |
| Allowance for loan losses  | (18,364 )                           | (18,541 )                       |
| Net Loans  | 1,807,474                           | 1,773,893                       |
| Bank owned life insurance  | 75,479                              | 73,388                          |
| Premises and equipment   | 64,991                              | 64,193                          |
| Accrued interest receivable  | 8,298                               | 7,969                           |
| Net deferred tax asset   | 25,774                              | 29,480                          |
| Intangible assets  | 56,682                              | 57,010                          |
| Other assets   | 54,094                              | 40,121                          |
| Total Assets   | \$ 2,627,133                        | \$ 2,622,620                    |
| <b>Liabilities</b>   |                                     |                                 |
| Deposits:  |                                     |                                 |
| Noninterest-bearing  | \$ 317,221                          | \$ 328,440                      |
| Interest-bearing:  |                                     |                                 |
| Demand deposits  | 478,947                             | 457,293                         |
| Savings deposits   | 389,497                             | 379,893                         |
| Time deposits  | 973,085                             | 998,096                         |
| Total Deposits   | 2,158,750                           | 2,163,722                       |
| Short-term borrowings  | 110,634                             | 118,329                         |
| Long-term debt   | 16,892                              | 16,959                          |
| Other liabilities  | 26,016                              | 14,708                          |
| Total Liabilities  | 2,312,292                           | 2,313,718                       |
| <b>Shareholders' Equity</b>  |                                     |                                 |
| Preferred stock, par value \$25 per share: 500,000 shares authorized; none issued  | -                                   | -                               |
| Common stock, par value \$2.50 per share: 50,000,000 shares authorized; 18,499,282 shares issued at September 30, 2010 and   | 46,249                              | 46,249                          |

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|  |              |              |
|--|--------------|--------------|
| December 31, 2009, less 3,001,063 and 2,616,161 shares in treasury, respectively |              |              |
| Capital surplus  | 102,867      | 102,917      |
| Retained earnings  | 266,266      | 253,167      |
| Cost of common stock in treasury   | (103,039 )   | (90,877 )    |
| Accumulated other comprehensive income (loss):                                   |              |              |
| Unrealized gain (loss) on securities available-for-sale                          | 5,449        | (1,880 )     |
| Unrealized gain on derivative instruments  | 786          | 3,063        |
| Underfunded pension liability  | (3,737 )     | (3,737 )     |
| Total Accumulated Other Comprehensive Income (Loss)                              | 2,498        | (2,554 )     |
| Total Shareholders' Equity   | 314,841      | 308,902      |
| Total Liabilities and Shareholders' Equity                                       | \$ 2,627,133 | \$ 2,622,620 |

See notes to consolidated financial statements.

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Consolidated Statements of Income (Unaudited)  
City Holding Company and Subsidiaries  
(in thousands, except earnings per share data)

|  | Three Months Ended<br>September 30 |                 | Nine Months Ended<br>September 30 |                 |
|--|------------------------------------|-----------------|-----------------------------------|-----------------|
|  | 2010                               | 2009            | 2010                              | 2009            |
| <b>Interest Income</b>   |                                    |                 |                                   |                 |
| Interest and fees on loans   | \$ 24,487                          | \$ 26,392       | \$ 75,332                         | \$ 81,396       |
| Interest on investment securities:                                   |                                    |                 |                                   |                 |
| Taxable  | 5,019                              | 5,820           | 15,947                            | 17,494          |
| Tax-exempt   | 452                                | 437             | 1,383                             | 1,249           |
| Interest on deposits in depository institutions                      | -                                  | 2               | -                                 | 10              |
| Interest on federal funds sold                                       | 12                                 | -               | 13                                | -               |
| <b>Total Interest Income</b>   | <b>29,970</b>                      | <b>32,651</b>   | <b>92,675</b>                     | <b>100,149</b>  |
| <b>Interest Expense</b>  |                                    |                 |                                   |                 |
| Interest on deposits   | 6,551                              | 8,673           | 20,566                            | 27,230          |
| Interest on short-term borrowings                                    | 86                                 | 131             | 284                               | 395             |
| Interest on long-term debt   | 173                                | 191             | 496                               | 676             |
| <b>Total Interest Expense</b>  | <b>6,810</b>                       | <b>8,995</b>    | <b>21,346</b>                     | <b>28,301</b>   |
| <b>Net Interest Income</b>   | <b>23,160</b>                      | <b>23,656</b>   | <b>71,329</b>                     | <b>71,848</b>   |
| Provision for loan losses  | 1,847                              | 1,681           | 4,750                             | 5,519           |
| <b>Net Interest Income After Provision for Loan Losses</b>           | <b>21,313</b>                      | <b>21,975</b>   | <b>66,579</b>                     | <b>66,329</b>   |
| <b>Non-interest Income</b>   |                                    |                 |                                   |                 |
| Total investment securities impairment losses                        | (3,028 )                           | (2,306 )        | (7,468 )                          | (4,463 )        |
| Noncredit impairment losses recognized in other comprehensive income | 127                                | -               | 2,623                             | -               |
| <b>Net investment securities impairment losses</b>                   | <b>(2,901 )</b>                    | <b>(2,306 )</b> | <b>(4,845 )</b>                   | <b>(4,463 )</b> |
| Gain (loss) on sale of investment securities                         | 1,335                              | (14 )           | 1,397                             | (264 )          |
| Service charges  | 9,702                              | 11,689          | 30,378                            | 33,385          |
| Insurance commissions  | 1,346                              | 1,208           | 3,987                             | 4,466           |
| Trust and investment management fee income                           | 618                                | 590             | 2,047                             | 1,794           |
| Bank owned life insurance  | 1,104                              | 794             | 2,645                             | 2,518           |
| Other income   | 439                                | 379             | 1,424                             | 1,624           |
| <b>Total Non-interest Income</b>                                     | <b>11,643</b>                      | <b>12,340</b>   | <b>37,033</b>                     | <b>39,060</b>   |
| <b>Non-interest Expense</b>  |                                    |                 |                                   |                 |
| Salaries and employee benefits                                       | 9,817                              | 9,623           | 29,311                            | 29,003          |
| Occupancy and equipment  | 1,917                              | 1,953           | 5,836                             | 5,742           |

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|   |                 |                  |                  |                  |
|---|-----------------|------------------|------------------|------------------|
| Depreciation  | 1,145           | 1,171            | 3,537            | 3,566            |
| Professional fees                                       | 414             | 216              | 1,175            | 1,066            |
| Postage, delivery, and statement mailings               | 599             | 611              | 1,823            | 2,027            |
| Advertising   | 891             | 883              | 3,045            | 2,673            |
| Telecommunications                                      | 413             | 476              | 1,304            | 1,410            |
| Bankcard expenses                                       | 481             | 695              | 1,405            | 2,029            |
| Insurance and regulatory                                | 1,244           | 411              | 3,631            | 2,365            |
| Office supplies   | 497             | 520              | 1,474            | 1,521            |
| Repossessed asset losses, net of expenses               | 234             | 136              | 1,258            | 351              |
| Other expenses  | 2,152           | 2,101            | 6,521            | 6,175            |
| <b>Total Non-interest Expense</b>                       | <b>19,804</b>   | <b>18,796</b>    | <b>60,320</b>    | <b>57,928</b>    |
| <b>Income Before Income Taxes</b>                       | <b>13,152</b>   | <b>15,519</b>    | <b>43,292</b>    | <b>47,461</b>    |
| <b>Income tax expense</b>                               | <b>4,129</b>    | <b>5,022</b>     | <b>14,241</b>    | <b>15,894</b>    |
| <b>Net Income Available to Common Shareholders</b>      | <b>\$ 9,023</b> | <b>\$ 10,497</b> | <b>\$ 29,051</b> | <b>\$ 31,567</b> |
| Distributed earnings allocated to common shareholders   | \$ 5,237        | \$ 5,380         | \$ 15,711        | \$ 16,139        |
| Undistributed earnings allocated to common shareholders | 3,733           | 5,116            | 13,164           | 15,403           |
| <b>Net earnings allocated to common shareholders</b>    | <b>\$ 8,970</b> | <b>\$ 10,496</b> | <b>\$ 28,875</b> | <b>\$ 31,542</b> |
| <b>Average common shares outstanding</b>                | <b>15,496</b>   | <b>15,893</b>    | <b>15,646</b>    | <b>15,889</b>    |
| Effect of dilutive securities:                          |                 |                  |                  |                  |
| Employee stock options                                  | 56              | 59               | 64               | 55               |
| Shares for diluted earnings per share                   | 15,552          | 15,952           | 15,710           | 15,944           |
| <b>Basic earnings per common share</b>                  | <b>\$ 0.58</b>  | <b>\$ 0.66</b>   | <b>\$ 1.85</b>   | <b>\$ 1.99</b>   |
| <b>Diluted earnings per common share</b>                | <b>\$ 0.58</b>  | <b>\$ 0.66</b>   | <b>\$ 1.84</b>   | <b>\$ 1.98</b>   |
| <b>Dividends declared per common share</b>              | <b>\$ 0.34</b>  | <b>\$ 0.34</b>   | <b>\$ 1.02</b>   | <b>\$ 1.02</b>   |

See notes to consolidated financial statements



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## Consolidated Statements of Changes in Shareholders' Equity (Unaudited)

City Holding Company and Subsidiaries

Nine Months Ended September 30, 2010 and 2009

(in thousands)

|  | Common<br>Stock | Capital<br>Surplus | Retained<br>Earnings | Treasury<br>Stock | Accumulated<br>Other<br>Comprehensive<br>(Loss)<br>Income | Total<br>Shareholders'<br>Equity |
|--|-----------------|--------------------|----------------------|-------------------|---|----------------------------------|
| Balances at December<br>31, 2008   | \$ 46,249       | \$ 104,062         | \$ 230,613           | \$ (88,729 )      | \$ (6,732 )   | \$ 285,463                       |
| Comprehensive<br>income:   |                 |                    |                      |                   |   |                                  |
| Net income   |                 |                    | 31,567               |                   |   | 31,567                           |
| Other comprehensive<br>gain, net of deferred<br>income taxes of<br>\$11,421:         |                 |                    |                      |                   |   |                                  |
| Unrealized gains on<br>available-for-sale<br>securities of \$19,636,<br>net of taxes |                 |                    |                      |                   | 11,909  | 11,909                           |
| Net unrealized loss on<br>interest rate floors of<br>\$8,214, net of taxes           |                 |                    |                      |                   | (4,982 )  | (4,982 )                         |
| Total comprehensive<br>income  |                 |                    |                      |                   |   | 38,494                           |
| Cash dividends<br>declared (\$1.02 per<br>share)                                     |                 |                    | (16,251 )            |                   |   | (16,251 )                        |
| Issuance of stock<br>awards, net   |                 | (1,245 )           |                      | 1,699             |   | 454                              |
| Exercise of 1,050<br>stock options   |                 | (5 )               |                      | 30                |   | 25                               |
| Purchase of 105,686<br>treasury shares   |                 |                    |                      | (3,045 )          |   | (3,045 )                         |
| Balances at September<br>30, 2009  | \$ 46,249       | \$ 102,812         | \$ 245,929           | \$ (90,045 )      | \$ 195  | \$ 305,140                       |

|  | Common<br>Stock | Capital<br>Surplus | Retained<br>Earnings | Treasury<br>Stock | Accumulated<br>Other<br>Comprehensive<br>(Loss)<br>Income | Total<br>Shareholders'<br>Equity |
|--|-----------------|--------------------|----------------------|-------------------|---|----------------------------------|
|--|-----------------|--------------------|----------------------|-------------------|---|----------------------------------|

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|  |           |            |            |               |             |            |
|--|-----------|------------|------------|---------------|-------------|------------|
| Balances at December 31, 2009  | \$ 46,249 | \$ 102,917 | \$ 253,167 | \$ (90,877 )  | \$ (2,554 ) | \$ 308,902 |
| Comprehensive income:  |           |            |            |               |             |            |
| Net income   |           |            | 29,051     |               |             | 29,051     |
| Other comprehensive gain, net of deferred income taxes of \$8,201:         |           |            |            |               |             |            |
| Unrealized gain on available-for-sale securities of \$11,897, net of taxes |           |            |            |               | 7,329       | 7,329      |
| Net unrealized loss on interest rate floors of \$3,696, net of taxes       |           |            |            |               | (2,277 )    | (2,277 )   |
| Total comprehensive income   |           |            |            |               |             | 34,103     |
| Cash dividends declared (\$1.02 per share)                                 |           |            | (15,952 )  |               |             | (15,952 )  |
| Issuance of stock awards, net  |           | (38 )      |            | 682           |             | 644        |
| Exercise of 1,700 stock options  |           | (12 )      |            | 58            |             | 46         |
| Purchase of 408,151 treasury shares  |           |            |            | (12,902 )     |             | (12,902 )  |
| Balances at September 30, 2010   | \$ 46,249 | \$ 102,867 | \$ 266,266 | \$ (103,039 ) | \$ 2,498    | \$ 314,841 |

See notes to consolidated financial statements.

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Consolidated Statements of Cash Flows (Unaudited)  
City Holding Company and Subsidiaries  
(in thousands)

|   | Nine Months Ended September 30 |            |
|---|--------------------------------|------------|
|   | 2010                           | 2009       |
| <b>Operating Activities</b>   |                                |            |
| Net income  | \$ 29,051                      | \$ 31,567  |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                |            |
| Amortization and accretion  | 674                            | 29         |
| Provision for loan losses   | 4,750                          | 5,519      |
| Depreciation of premises and equipment  | 3,537                          | 3,566      |
| Deferred income tax (benefit) expense   | (877 )                         | 3,190      |
| Accretion of gain from sale of interest rate floors                               | (2,277 )                       | (4,982 )   |
| Net periodic employee benefit cost  | 174                            | 150        |
| Loss on disposal of premises and equipment  | -                              | 75         |
| Realized investment securities losses   | 4,845                          | 4,727      |
| Increase in value of bank-owned life insurance                                    | (2,645 )                       | (2,517 )   |
| Proceeds from bank-owned life insurance   | 657                            | 290        |
| (Decrease) increase in accrued interest receivable                                | (329 )                         | 449        |
| (Decrease) increase in other assets   | (14,076 )                      | 1,276      |
| Increase (decrease) in other liabilities  | 11,909                         | (27,338 )  |
| Net Cash Provided by Operating Activities   | 35,393                         | 16,001     |
| <b>Investing Activities</b>   |                                |            |
| Proceeds from maturities and calls of securities held-to-maturity                 | 3,217                          | 335        |
| Proceeds from sale of money market and mutual fund securities available-for-sale  | 677,250                        | 557,953    |
| Purchases of money market and mutual fund securities available-for-sale           | (661,949 )                     | (574,687 ) |
| Proceeds from sales of securities available-for-sale                              | 10,849                         | 803        |
| Proceeds from maturities and calls of securities available-for-sale               | 84,789                         | 77,183     |
| Purchases of securities available-for-sale  | (45,494 )                      | (94,652 )  |
| Net (increase) decrease in loans  | (37,912 )                      | 8,216      |
| Purchases of premises and equipment   | (4,335 )                       | (6,868 )   |
| Net Cash Provided by (Used in) Investing Activities                               | 26,415                         | (31,717 )  |
| <b>Financing Activities</b>   |                                |            |
| Net (decrease) increase in noninterest-bearing deposits                           | (11,219 )                      | 4,591      |
| Net increase in interest-bearing deposits   | 6,247                          | 81,316     |
| Net decrease in short-term borrowings   | (7,695 )                       | (65,462 )  |
| Repayment of long-term debt   | (67 )                          | (64 )      |
| Purchases of treasury stock   | (12,902 )                      | (3,045 )   |
| Proceeds from exercise of stock options   | 46                             | 25         |
| Dividends paid  | (16,083 )                      | (16,264 )  |
| Net Cash (Used in) Provided by Financing Activities                               | (41,673 )                      | 1,097      |
| Increase (Decrease) in Cash and Cash Equivalents                                  | 20,135                         | (14,619 )  |
| Cash and cash equivalents at beginning of period                                  | 62,635                         | 59,629     |

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|  |           |           |
|--|-----------|-----------|
| Cash and Cash Equivalents at End of Period | \$ 82,770 | \$ 45,010 |
|--|-----------|-----------|

See notes to consolidated financial statements.

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Notes to Consolidated Financial Statements (Unaudited)

September 30, 2010

Note A – Basis of Presentation

The accompanying consolidated financial statements, which are unaudited, include all of the accounts of City Holding Company (“the Parent Company”) and its wholly-owned subsidiaries (collectively, “the Company”). All material intercompany transactions have been eliminated. The consolidated financial statements include all adjustments that, in the opinion of management, are necessary for a fair presentation of the results of operations and financial condition for each of the periods presented. Such adjustments are of a normal recurring nature. The results of operations for the nine months ended September 30, 2010 are not necessarily indicative of the results of operations that can be expected for the year ending December 31, 2010. The Company’s accounting and reporting policies conform with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Such policies require management to make estimates and develop assumptions that affect the amounts reported in the consolidated financial statements and related footnotes. Actual results could differ from management’s estimates.

The consolidated balance sheet as of December 31, 2009 has been derived from audited financial statements included in the Company’s 2009 Annual Report to Shareholders. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with U.S. generally accepted accounting principles have been omitted. These financial statements should be read in conjunction with the financial statements and notes thereto included in the 2009 Annual Report of the Company.

Certain amounts in the financial statements have been reclassified. Such reclassifications had no impact on net income for any period presented and increased shareholders’ equity by \$1.2 million with a corresponding decrease to other liabilities by the same amount at December 31, 2009.

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## Note B –Investments

The aggregate carrying and approximate market values of securities follow. Fair values are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable financial instruments.

| (in thousands)   | September 30, 2010 |                              |                               |                            | December 31, 2009 |                              |                               |                            |
|--|--------------------|------------------------------|-------------------------------|----------------------------|-------------------|------------------------------|-------------------------------|----------------------------|
|  | Amortized<br>Cost  | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair<br>Value | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair<br>Value |
| Securities<br>available-for-sale:                      |                    |                              |                               |                            |                   |                              |                               |                            |
| Obligations of<br>states and political<br>subdivisions | \$52,070           | \$1,217                      | \$(150 )                      | \$53,137                   | \$52,474          | \$712                        | \$(451 )                      | \$52,735                   |
| Mortgage-backed<br>securities:                         |                    |                              |                               |                            |                   |                              |                               |                            |
| US government<br>agencies                              | 260,468            | 11,483                       | -                             | 271,951                    | 293,662           | 9,241                        | (109 )                        | 302,794                    |
| Private label  | 9,379              | 153                          | (63 )                         | 9,469                      | 12,414            | -                            | (426 )                        | 11,988                     |
| Trust preferred<br>securities                          | 58,546             | 1,350                        | (2,389)                       | 57,507                     | 70,048            | 521                          | (6,832 )                      | 63,737                     |
| Corporate<br>securities                                | 16,210             | 86                           | (780 )                        | 15,516                     | 20,771            | 23                           | (1,306 )                      | 19,488                     |
| Total Debt<br>Securities                               | 396,673            | 14,289                       | (3,382)                       | 407,580                    | 449,369           | 10,497                       | (9,124 )                      | 450,742                    |
| Marketable<br>equity securities                        | 6,358              | -                            | (1,305)                       | 5,053                      | 8,603             | -                            | (3,509 )                      | 5,094                      |
| Non-marketable<br>equity securities                    | 12,899             | -                            | -                             | 12,899                     | 13,023            | -                            | -                             | 13,023                     |
| Investment funds                                       | 1,630              | 28                           | -                             | 1,658                      | 16,930            | -                            | (22 )                         | 16,908                     |
| Total Securities<br>Available-for-Sale                 | \$417,560          | \$14,317                     | \$(4,687)                     | \$427,190                  | \$487,925         | \$10,497                     | \$(12,655)                    | \$485,767                  |
| Securities<br>held-to-maturity                         |                    |                              |                               |                            |                   |                              |                               |                            |
| Obligations of<br>states and political<br>subdivisions | \$437              | \$4                          | \$-                           | \$441                      | \$1,642           | \$15                         | \$-                           | \$1,657                    |
| Trust preferred<br>securities                          | 23,944             | 995                          | (654 )                        | 24,285                     | 26,522            | -                            | (3,159 )                      | 23,363                     |
| Total Securities<br>Held-to-Maturity                   | \$24,381           | \$999                        | \$(654 )                      | \$24,726                   | \$28,164          | \$15                         | \$(3,159 )                    | \$25,020                   |

Securities with limited marketability, such as stock in the Federal Reserve Bank or the Federal Home Loan Bank, are carried at cost and are reported as non-marketable equity securities in the table above.

Certain investment securities owned by the Company were in an unrealized loss position (i.e., amortized cost basis exceeded the estimated fair value of the securities) as of September 30, 2010 and December 31, 2009. The following table shows the gross unrealized losses and fair value of the Company's investments aggregated by investment

category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2010 and December 31, 2009.

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| (in thousands)                                   | Less Than Twelve Months |            | September 30, 2010<br>Twelve Months or Greater |            | Total      |            |
|--|-------------------------|------------|--|------------|------------|------------|
|  | Estimated               | Unrealized | Estimated                                      | Unrealized | Estimated  | Unrealized |
|  | Fair Value              | Loss       | Fair Value                                     | Loss       | Fair Value | Loss       |
| Securities available-for-sale:                   |                         |            |  |            |            |            |
| Obligations of states and political subdivisions | \$ 1,340                | \$ 25      | \$ 2,228                                       | \$ 125     | \$ 3,568   | \$ 150     |
| Mortgage-backed securities:                      |                         |            |  |            |            |            |
| US Government agencies                           | -                       | -          | -  | -          | -          | -          |
| Private-label                                    | -                       | -          | 5,776  | 63         | 5,776      | 63         |
| Trust preferred securities                       | 1,492                   | 21         | 10,563   | 2,368      | 12,055     | 2,389      |
| Corporate securities                             | -                       | -          | 3,588  | 780        | 3,588      | 780        |
| Marketable equity securities                     | 1,549                   | 7          | 3,462  | 1,298      | 5,011      | 1,305      |
| Investment funds                                 | -                       | -          | -  | -          | -          | -          |
| Total  | \$ 4,381                | \$ 53      | \$ 25,617                                      | \$ 4,634   | \$ 29,998  | \$ 4,687   |

|                              |        |      |          |        |          |        |
|------------------------------|--------|------|----------|--------|----------|--------|
| Securities held-to-maturity: |        |      |          |        |          |        |
| Trust preferred securities   | \$ 993 | \$ 1 | \$ 8,330 | \$ 653 | \$ 9,323 | \$ 654 |

| (in thousands)                                   | Less Than Twelve Months |            | December 31, 2009<br>Twelve Months or Greater |            | Total      |            |
|--|-------------------------|------------|---|------------|------------|------------|
|  | Estimated               | Unrealized | Estimated                                     | Unrealized | Estimated  | Unrealized |
|  | Fair Value              | Loss       | Fair Value                                    | Loss       | Fair Value | Loss       |
| Securities available-for-sale:                   |                         |            |   |            |            |            |
| Obligations of states and political subdivisions | \$ 8,081                | \$ 216     | \$ 3,444                                      | \$ 235     | \$ 11,525  | \$ 451     |
| Mortgage-backed securities:                      |                         |            |   |            |            |            |
| US Government agencies                           | 29,532                  | 109        | -   | -          | 29,532     | 109        |
| Private-label                                    | 4,877                   | 16         | 7,538   | 410        | 12,415     | 426        |
| Trust preferred securities                       | 478                     | 46         | 38,179  | 6,786      | 38,657     | 6,832      |
| Corporate securities                             | -                       | -          | 5,101   | 1,306      | 5,101      | 1,306      |
| Marketable equity securities                     | 2,098                   | 1,942      | 2,953   | 1,567      | 5,051      | 3,509      |
| Investment funds                                 | -                       | -          | 1,478   | 22         | 1,478      | 22         |



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|                              |           |          |           |           |            |           |
|------------------------------|-----------|----------|-----------|-----------|------------|-----------|
| Total                        | \$ 45,066 | \$ 2,329 | \$ 58,693 | \$ 10,326 | \$ 103,759 | \$ 12,655 |
| Securities held-to-maturity: |           |          |           |           |            |           |
| Trust preferred securities   | \$ -      | \$ -     | \$ 12,829 | \$ 3,159  | \$ 12,829  | \$ 3,159  |

Marketable equity securities consist of investments made by the Company in equity positions of various community banks. Included within this portfolio are meaningful (2-5%) ownership positions in the following community bank holding companies: Community Financial Corporation; Eagle Financial Services, Inc.; First National Corporation; and First United Corporation.

During the first nine months of 2010, the Company recorded \$4.8 million of credit-related net investment impairment losses. The charges deemed to be other-than-temporary were related to pooled bank trust preferreds (\$1.7 million credit-related net impairment losses) with a remaining book value of \$6.5 million at September 30, 2010, single issuer bank trust preferreds (\$0.6 million credit-related net impairment losses) with a remaining book value of \$75.4 million at September 30, 2010, and community bank and bank holding company equity positions (\$2.5 million credit-related net impairment losses ) with remaining book value of \$5.1 million at September 30, 2010. The credit-related net impairment charges related to the pooled bank trust preferred securities and single issuer bank trust preferred securities (Cascade Capital Trust I issued by Cascade Financial Corporation of Everett, Washington) were based on the Company's quarterly reviews of its investment securities for indications of losses considered to be other-than-temporary. Based on management's assessment of the securities the Company owns, the seniority position of the securities within the pools, the level of defaults and deferred payments within the pools, and a review of the financial strength of the banks within the respective pools, management concluded that credit-related impairment charges of \$1.7 million and \$0.6 million on the pooled bank trust preferred securities and single issuer bank trust preferred securities, respectively, were appropriate for the nine months ended September 30, 2010. The credit-related net impairment charges of \$2.5 million related to the Company's equity position in First United Corporation of Oakland, Maryland. The Company determined that this security was other-than-temporarily impaired due to First United Corporation's poor performance and the length of time and extent to which the market value of this security has been below the Company's cost basis.

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During 2009, the Company recorded \$5.3 million of credit-related net investment impairment losses. The charges deemed to be other-than-temporary were related to pooled bank trust preferreds (\$3.8 million impairment for the full year) with a remaining book value of \$9.6 million at December 31, 2009 and community bank and bank holding company equity positions (\$1.5 million impairment for the full year) with a remaining book value of \$5.1 million at December 31, 2009. The credit-related net investment impairment charges of \$3.8 million related to the pooled bank trust preferred securities were based on the Company's quarterly review of its investment securities for indications of losses considered to be other-than-temporary. Based on management's assessment of the securities the Company owns, the seniority position of the securities within the pools, the level of defaults and deferred payments with the pools, and a review of the financial strength of the banks within the respective pools, management concluded that credit-related impairment charges of \$3.8 million on the pooled bank trust preferred securities were necessary for the year ended December 31, 2009. The impairment charges of \$1.5 million related to community bank and bank holding company equity positions were due to poor financial performance of the bank holding companies and the length of time and extent to which the market values have been below the Company's costs basis in these positions.

Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other-than-temporary would be reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers, among other things (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition, capital strength, and near-term (12 months) prospects of the issuer, including any specific events which may influence the operations of the issuer such as changes in technology that may impair the earnings potential of the investment or the discontinuance of a segment of the business that may affect the future earnings potential; (iii) the historical volatility in the market value of the investment and/or the liquidity or illiquidity of the investment; (iv) adverse conditions specifically related to the security, an industry, or a geographic area; or (v) the intent to sell the investment security and if it's more likely than not that the Company will not have to sell the security before recovery of its cost basis. In addition, management also employs a continuous monitoring process in regards to its marketable equity securities, specifically its portfolio of regional community bank holdings. Although the regional community bank stocks that are owned by the Company are publicly traded, the trading activity for these stocks is very light, with trading volumes of less than 0.1% of each respective company being traded on a daily basis. Another factor influencing the market value of these equity securities is a depressed stock market, particularly in the financial sector. As part of management's review process for these securities, management reviews the financial condition of each respective regional community bank for any indications of financial weakness. Based on management's most recent reviews, management noted adequate capital levels at all such companies, which is a positive indicator of the near term (12 months) prospects for these regional community banks.

Management has the ability and intent to hold the securities classified as held to maturity until they mature, at which time the Company will receive full value for the securities. Furthermore, as of September 30, 2010, management does not intend to sell an impaired security and it is not more than likely that it will be required to sell the security before the recovery of its amortized cost basis. The unrealized losses on debt securities are primarily the result of interest rate changes, credit spread widening on agency-issued mortgage related securities, general financial market uncertainty and unprecedented market volatility. These conditions will not prohibit the Company from receiving its contractual principal and interest payments on its debt securities. The fair value is expected to recover as the securities approach their maturity date or repricing date. As of September 30, 2010, management believes the unrealized losses detailed in the table above are temporary and no impairment loss has been recognized in the Company's consolidated income statement. Should the impairment of any of these securities become other-than-temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income in the period of the other-than-temporary impairment is identified, while any noncredit loss will be recognized in other comprehensive income.

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At September 30, 2010, the book value of the Company's five pooled trust preferred securities totaled \$6.5 million with an estimated fair value of \$7.3 million. All of these securities are mezzanine tranches. Pooled trust preferred securities represent beneficial interests in securitized financial assets that the Company analyzes within the scope of FASB ASC 320, Investments-Debt and Equity Securities and are evaluated quarterly for other-than-temporary-impairment ("OTTI"). Management performs an analysis of OTTI utilizing its internal methodology as described below to estimate expected cash flows to be received in the future. The Company reviews each of its pooled trust preferred securities to determine if an OTTI charge would be recognized in current earnings in accordance with FASB ASC 320, Investments-Debt and Equity securities. There is a risk that continued collateral deterioration could cause the Company to recognize additional OTTI charges in earnings in the future.

When evaluating pooled trust preferred securities for OTTI, the Company determines a credit related portion and a noncredit related portion, if any. The credit related portion is recognized in earnings and represents the difference between the present value of expected future cash flows and the amortized cost basis of the security. The noncredit related portion is recognized in other comprehensive income, and represents the difference between the book value and the fair value of the security less the amount of the credit related impairment. The determination of whether it is probable that an adverse change in estimated cash flows has occurred is evaluated by comparing estimated cash flows to those previously projected as further described below. The Company considers this process to be its primary evidence when determining whether credit related OTTI exists. The results of these analyses are significantly affected by other variables such as the estimate of future cash flows, credit worthiness of the underlying issuers and determination of the likelihood of defaults of the underlying collateral.

During the first quarter of 2010, the Company further refined its process by utilizing a third party model to compute the present value of expected cash flows which considers the structure and term of each of the five respective pooled trust preferred securities and the financial condition of the underlying issuers. Specifically, the third party model details interest rates, principal balances of note classes and underlying issuers, the timing and amount of interest and principal payments of the underlying issuers, and the allocation of the payments to the note classes. The current estimate of expected cash flows is based on the most recent trustee reports and any other relevant market information including announcements of interest payment deferrals or defaults of underlying trust preferred securities. As in the past, for issuing banks that have defaulted, management assumes no recovery. For issuing banks that have deferred its interest payments, management excludes the collateral balance associated with these banks and assumes no recoveries of such collateral balance in the future. The exclusion of such issuing banks in a current deferral position is based on such bank experiencing a certain level of financial difficulty that raises doubt about its ability to satisfy its contractual debt obligation, and accordingly, the Company excludes the associated collateral balance from its estimate of expected cash flows. Other assumptions used in the estimate of expected cash flows include expected future default rates and prepayments. Specifically, the model assumes annual prepayments of 1.0% with 100% at maturity and assumes 150 basis points of additional annual defaults from banks that are currently not in default or deferral with no future recoveries. Management compares the present value of expected cash flows to those previously projected to determine if an adverse change in cash flows has occurred. If an adverse change in cash flows has occurred, management determines the credit loss to be recognized in the current period and the portion related to noncredit factors to be recognized in other comprehensive income.

Based upon the analysis performed by management as of September 30, 2010, the Company recognized \$0.7 million of credit-related OTTI charged during the three months ended September 30, 2010. Total credit-related OTTI recognized during the nine months ended September 30, 2010 was \$1.7 million.

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The following table presents a progression of the credit loss component of OTTI on debt securities recognized in earnings during the nine months ended September 30, 2010. The credit loss component represents the difference between the present value of expected future cash flows and the amortized cost basis of the security. As noted above, the credit component of OTTI recognized in earnings during the nine months ended September 30, 2010 is presented in two parts based upon whether the credit impairment in the current period is the first time the debt security was credit impaired (initial credit impairment) or if there is additional credit impairment on a debt security that was credit impaired in previous periods. The credit loss component would be reduced if the Company sells, intends to sell or believes it will be required to sell previously credit impaired securities. Additionally, the credit loss component would be reduced if the Company receives cash flows in excess of what it expected to receive over the remaining life of the credit impaired debt security or when the security matures.

| (in thousands)                | For the period ended<br>September 30, 2010 |
|-------------------------------|--|
| Balance at January 1, 2010    | \$ 18,694                                  |
| Additions:                    |  |
| Initial credit impairment     | -  |
| Additional credit impairment  | 2,358                                      |
| Balance at September 30, 2010 | \$ 21,052                                  |

The amortized cost and estimated fair value of debt securities at September 30, 2010, by contractual maturity, are shown in the following table. Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties. Mortgage-backed securities have been allocated to their respective maturity groupings based on their contractual maturity.

| (in thousands)                         | Cost       | Estimated<br>Fair Value |
|--|------------|-------------------------|
| <b>Securities Available-for-Sale</b>   |            |                         |
| Due in one year or less                | \$ 6,353   | \$ 6,421                |
| Due after one year through five years  | 54,239     | 54,824                  |
| Due after five years through ten years | 82,347     | 86,009                  |
| Due after ten years                    | 253,734    | 260,326                 |
|  | \$ 396,673 | \$ 407,580              |
| <b>Securities Held-to-Maturity</b>     |            |                         |
| Due in one year or less                | \$ 130     | \$ 131                  |
| Due after one year through five years  | 307        | 310                     |
| Due after five years through ten years | -          | -                       |
| Due after ten years                    | 23,944     | 24,285                  |
|  | \$ 24,381  | \$ 24,726               |

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Gross gains and losses realized by the Company from investment security transactions are summarized in the table below:

| (in thousands)                               | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |           |
|--|-------------------------------------|----------|------------------------------------|-----------|
|  | 2010                                | 2009     | 2010                               | 2009      |
| Gross realized gains                         | \$ 1,335                            | \$ 65    | \$ 1,397                           | \$ 147    |
| Gross realized losses                        | -                                   | (79 )    | -                                  | (411 )    |
| Gain (loss) on sale of investment securities | \$ 1,335                            | \$ (14 ) | \$ 1,397                           | \$ (264 ) |

The specific identification method is used to determine the cost basis of securities sold.

The carrying value of securities pledged to secure public deposits and for other purposes as required or permitted by law approximated \$206.5 million and \$204.2 million at September 30, 2010 and December 31, 2009, respectively.

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The following table presents additional information about the Company's trust preferred securities with a credit rating of below investment grade as of September 30, 2010:

(Dollars in thousands)

| Deal Name  | Type Class  | Original Cost | Amortized Cost | Fair Value | Difference (1) | Credit Rating | # of issuers currently performing | Actual deferrals/ defaults (as a % of original dollar) | Expected  | Excess   |
|--|-------------|---------------|----------------|------------|----------------|---------------|-----------------------------------|--|---|--|
|  |             |               |                |            |                |               |                                   |  | deferrals/ defaults (as a % of performing collateral) (2) | Subordination (as a Percentage of Current Performing Collateral) (3) |
| Pooled trust preferred securities:<br>Other-than-temporarily impaired<br>Available for Sale: |             |               |                |            |                |               |                                   |  |   |  |
| P1 (4)   | Pooled Mezz | \$ 1,124      | \$ 529         | \$ 407     | \$ (122 )      | Caa1          | 21                                | 31.0 %   | 11.7 %  | -  |
| P2 (5)   | Pooled Mezz | 3,607         | 1,197          | 1,392      | 195            | Ca            | 26                                | 20.7 %   | 23.8 %  | 27.9 %   |
| P3 (6)   | Pooled Mezz | 2,962         | 1,545          | 1,379      | (166 )         | Caa3          | 27                                | 21.7 %   | 28.1 %  | -  |
| P4 (7)   | Pooled Mezz | 4,060         | 1,205          | 774        | (431 )         | Ca            | 14                                | 25.3 %   | -   | 2.8 %  |
| P5 (8)   | Pooled Mezz | 4,912         | 826            | 695        | (131 )         | Ca            | 23                                | 34.6 %   | 23.7 %  | 24.3 %   |
| Held to Maturity:  |             |               |                |            |                |               |                                   |  |   |  |
| P6 (9)   | Pooled Mezz | 2,175         | 1,028          | 815        | (213 )         | Caa1          | 26                                | 22.8 %   | 23.8 %  | -  |
| P7 (10)  | Pooled Mezz | 4,790         | 1,581          | 1,849      | 268            | Ca            | 27                                | 20.7 %   | 24.7 %  | 37.1 %   |
| Single issuer trust preferred securities<br>Available for sale:                              |             |               |                |            |                |               |                                   |  |   |  |
| S1   | Single      | 1,149         | 1,045          | 1,045      | -              | Ba2           | 1                                 | -  | -   | -  |
| S2 (11)  | Single      | 1,700         | 944            | 375        | (569 )         | NR            | 1                                 | -  | -   | -  |
| S3 (12)  | Single      | 261           | 235            | 108        | (127 )         | NR            | 1                                 | -  | -   | -  |
| S4   | Single      | 4,691         | 4,696          | 5,168      | 472            | Ba2           | 1                                 | -  | -   | -  |
| S5   | Single      | 1,046         | 1,030          | 1,025      | (5 )           | NR            | 1                                 | -  | -   | -  |
| S6   | Single      | 1,000         | 1,000          | 979        | (21 )          | Caa1          | 1                                 | -  | -   | -  |
| Held to Maturity:  |             |               |                |            |                |               |                                   |  |   |  |
| S7   | Single      | 4,000         | 4,000          | 4,000      | -              | NR            | 1                                 | -  | -   | -  |
| S8   | Single      | 3,360         | 3,127          | 2,640      | (487 )         | NR            | 1                                 | -  | -   | -  |
| S9   | Single      | 3,564         | 3,541          | 3,413      | (128 )         | NR            | 1                                 | -  | -   | -  |

(1) The differences noted consist of unrealized losses recorded at September 30, 2010 and noncredit other-than-temporary impairments recorded subsequent to April 1, 2009 that have not been reclassified as credit losses.

(2) Performing collateral is defined as total collateral minus all collateral that has been called, is currently deferring, or currently in default. This definition assumes that all collateral that is currently deferring will default with a zero recovery rate. The underlying issuers can cure thus the bonds

- could recover at a higher percentage upon default than zero.
- (3) Excess subordination is defined as the additional defaults/deferrals necessary in the next reporting period to deplete the entire credit enhancement (excess interest and over-collateralization) beneath our tranche within each pool to the point that would cause a "break in yield." This amount assumes that all currently performing collateral continues to perform. A break in yield means that our security would not be expected to receive all the contractual cash flows (principal and interest) by maturity. The "percent of current performing collateral" is the ratio of the "excess subordination amount" to current performing collateral—a higher percent means there is more excess subordination to absorb additional defaults/deferrals, and the better our security is protected from loss.
  - (4) Other-than-temporary impairment losses of \$350,000 were recognized during nine months ended September 30, 2010. No other-than-temporary impairment losses were incurred during the year ended December 31, 2009.
  - (5) No other-than-temporary impairment losses were incurred during the nine months ended September 30, 2010 and the year ended December 31, 2009.
  - (6) Other-than-temporary impairment losses of \$72,000 and \$1,379,000 were recognized during the nine months ended September 30, 2010 and the year ended December 31, 2009, respectively.
  - (7) Other-than-temporary impairment losses of \$619,000 and \$1,674,000 were recognized during the nine months ended September 30, 2010 and the year ended December 31, 2009, respectively.
  - (8) Other-than-temporary impairment losses of \$1,750,000 were recognized during the year ended December 31, 2009. No other-than-temporary impairment losses were incurred during the nine months ended September 30, 2010.
  - (9) Other-than-temporary impairment losses of \$664,000 were recognized during the nine months ended September 30, 2010. No other-than-temporary impairment losses were incurred during the year ended December 31, 2009.
  - (10) No other-than-temporary impairment losses were incurred during the nine months ended September 30, 2010 and the year ended December 31, 2009.
  - (11) Other-than-temporary impairment losses of \$638,000 were recognized during the nine months ended September 30, 2010. No other-than-temporary impairment losses were incurred during the year ended December 31, 2009.
  - (12) Other-than-temporary impairment losses of \$15,000 were recognized during the nine months ended September 30, 2010. No other-than-temporary impairment losses were incurred during the year ended December 31, 2009.

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## Note C –Previously Securitized Loans

Between 1997 and 1999, the Company completed six securitization transactions involving approximately \$760 million in 125% of fixed rate, junior-lien underlying mortgages. The Company retained a financial interest in each of the securitizations until 2004. Principal amounts owed to investors were evidenced by securities (“Notes”). During 2003 and 2004, the Company exercised its early redemption options on each of those securitizations. Once the Notes were redeemed, the Company became the beneficial owner of the mortgage loans and recorded the loans as assets of the Company within the loan portfolio. The table below summarizes information regarding delinquencies, net credit recoveries, and outstanding collateral balances of previously securitized loans for the dates presented:

| ( in thousands)  | As of and for the Nine<br>Months Ended |                       | As of and for<br>the Year<br>Ended |
|--|--|-----------------------|------------------------------------|
|  | September 30,<br>2010                  | September 30,<br>2009 | December<br>31,<br>2009            |
| Previously Securitized Loans:                                |  |                       |                                    |
| Total principal amount of loans outstanding                  | \$ 12,863                              | \$ 16,510             | \$ 15,119                          |
| Discount   | (11,595 )                              | (13,930 )             | (13,406 )                          |
| Net book value   | \$ 1,268                               | \$ 2,580              | \$ 1,713                           |
| Principal amount of loans between 30 and 89 days<br>past due |  |                       |                                    |
|  | \$ 484                                 | \$ 1,042              | \$ 1,023                           |
| Principal amount of loans 90 days and above past<br>due      |  |                       |                                    |
|  | 34                                     | 12                    | 79                                 |
| Net credit recoveries during the period                      |  |                       |                                    |
|  | 150                                    | 418                   | 225                                |

The Company accounts for the difference between the carrying value and the total expected cash flows from these loans as an adjustment of the yield earned on the loans over their remaining lives. The discount is accreted to income over the period during which payments are probable of collection and are reasonably estimable. Additionally, the collectability of previously securitized loans is evaluated over the remaining lives of the loans. An impairment charge on previously securitized loans would be provided through the Company’s provision for loan losses if the discounted present value of estimated future cash flows declines below the recorded value of previously securitized loans. No such impairment charges were recorded for the three and nine months ended September 30, 2010 and 2009, or for the year ending December 31, 2009.

As of September 30, 2010, the Company reported a book value of previously securitized loans of \$1.3 million whereas the actual contractual outstanding balance of previously securitized loans at September 30, 2010 was \$12.9 million. The difference (“the discount”) between the book value and the expected total cash flows from previously securitized loans is being accreted into interest income over the estimated remaining life of the loans.

For the three months ended September 30, 2010 and 2009, the Company recognized \$0.8 million and \$0.9 million, respectively, of interest income from its previously securitized loans. During the first nine months of 2010 and 2009, the Company recognized \$3.3 million and \$3.1 million, respectively, of interest income from its previously securitized loans. During the second quarter of 2010, the Company recognized \$1.1 million of additional interest income related to three of the six pools of previously securitized loans that had a negative carrying value due to actual recoveries that exceed estimates and discount accretion previously recognized. As a result, the September 30, 2010 carrying value for these three pools is \$0 and future cash receipts related to these three pools will be recognized in interest income as received.





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## Note D – Short-term borrowings

The components of short-term borrowings are summarized below:

| ( in thousands)                | September 30,<br>2010 | December 31,<br>2009 |
|--------------------------------|-----------------------|----------------------|
| Security repurchase agreements | \$ 109,634            | \$ 116,329           |
| Short-term advances            | 1,000                 | 2,000                |
| Total short-term borrowings    | \$ 110,634            | \$ 118,329           |

Securities sold under agreement to repurchase were sold to corporate and government customers as an alternative to available deposit products. The underlying securities included in repurchase agreements remain under the Company's control during the effective period of the agreements.

## Note E – Long-Term Debt

The components of long-term debt are summarized below:

| (dollars in thousands)   | Maturity | September<br>30, 2010 | Weighted<br>Average<br>Interest<br>Rate |
|--|----------|-----------------------|---|
| FHLB Advances  | 2011     | \$ 397                | 4.39 %                                  |
| Junior subordinated debentures owed to<br>City Holding Capital Trust III | 2038 (a) | 16,495                | 3.79 %                                  |
| Total long-term debt   |          | \$ 16,892             |   |

(a) Junior Subordinated Debentures owed to City Holding Capital Trust III are redeemable prior to maturity at the option of the Company (i) in whole at any time or in part from time-to-time, at declining redemption prices ranging from 103.525% to 100.00% on June 15, 2013, and thereafter, or (ii) in whole, but not in part, at any time within 90 days following the occurrence and during the continuation of certain pre-defined events.

The Company formed a statutory business trust, City Holding Capital Trust III ("Capital Trust III"), under the laws of Delaware. Capital Trust III was created for the exclusive purpose of (i) issuing trust-preferred capital securities ("Capital Securities"), which represent preferred undivided beneficial interests in the assets of the trust, (ii) using the proceeds from the sale of the Capital Securities to acquire junior subordinated debentures ("Debentures") issued by the Company, and (iii) engaging in only those activities necessary or incidental thereto. The trust is considered a variable interest entity for which the Company is not the primary beneficiary. Accordingly, the accounts of the trusts are not included in the Company's consolidated financial statements.

The Capital Securities issued by the statutory business trust qualify as Tier 1 capital for the Company under the Federal Reserve Board guidelines. In March 2005, the Federal Reserve Board issued a final rule that allows the inclusion of trust preferred securities issued by unconsolidated subsidiary trusts in Tier 1 capital, but with stricter limits. Under ruling, after a five-year transition period, the aggregate amount of trust preferred securities and certain other capital elements would be limited to 25% of Tier 1 capital elements, net of goodwill. The amount of trust preferred securities and certain other elements in excess of the limit could be included in Tier 2 capital, subject to restrictions. In October 2008, the Federal Reserve Board delayed implementation of the new limits until March 2011. The Company expects to continue to include all of its \$16 million in trust preferred securities in Tier 1 capital. The trust preferred securities could be redeemed without penalty if they were no longer permitted to be

included in Tier 1 capital.

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## Note F – Employee Benefit Plans

The Company accounts for share-based compensation in accordance with FASB ASC Topic 718 “Compensation – Stock Compensation.” A summary of the Company’s stock option activity and related information is presented below for the nine months ended September 30:

|                             | Options  | 2010<br>Weighted-Average<br>Exercise<br>Price | Options  | 2009<br>Weighted-Average<br>Exercise<br>Price |
|-----------------------------|----------|---|----------|---|
| Outstanding at January 1    | 280,605  | \$ 33.56                                      | 270,455  | \$ 33.96                                      |
| Granted                     | 15,500   | 32.09   | 17,500   | 27.98   |
| Exercised                   | (1,700 ) | 27.11   | (1,050 ) | 24.48   |
| Forfeited                   | (750 )   | 33.54   | (6,000 ) | 37.90   |
| Outstanding at September 30 | 293,655  | \$ 33.52                                      | 280,905  | \$ 33.54                                      |

Additional information regarding stock options outstanding and exercisable at September 30, 2010, is provided in the following table:

| Ranges of Exercise Prices | No. of Options Outstanding | Weighted-Average Exercise Price | Aggregate Contractual Life (Months) | Aggregate Intrinsic Value (in thousands) | No. of Options Currently Exercisable | Weighted-Average Exercise Price of Options Currently Exercisable | Weighted-Average Contractual Life (Months) | Options Currently Exercisable (in thousands) | Aggregate Intrinsic Value of Options |
|---------------------------|----------------------------|---------------------------------|-------------------------------------|--|--------------------------------------|--|--|--|--------------------------------------|
| \$ 13.30 - 26.62          | 1,100                      | \$ 13.30                        | 16                                  | \$ 19                                    | 1,100                                | \$ 13.30   | 16   | \$ 19  |                                      |
| \$ 33.90 - 35.36          | 200,055                    | 31.30                           | 61                                  | 139                                      | 148,555                              | 31.73  | 46   | 86   |                                      |
| \$ 40.88                  | 92,500                     | 38.56                           | 73                                  | -  | 35,000                               | 36.84  | 63   | -  |                                      |
|                           | 293,655                    |                                 |                                     | \$ 158                                   | 184,655                              |  |  | \$ 105                                       |                                      |

Proceeds from stock option exercises were less than \$0.1 million during the nine months ended September 30, 2010 and 2009, respectively. Shares issued in connection with stock option exercises are issued from available treasury shares. If no treasury shares are available, new shares are issued from available authorized shares. During the nine months ended September 30, 2010 and September 30, 2009 all shares issued in connection with stock option exercises and restricted stock awards were issued from available treasury stock.

The total intrinsic value of stock options exercised was less than \$0.1 million during the nine months ended September 30, 2010 and 2009, respectively.

Stock-based compensation expense totaled \$0.2 million for both the nine months ended September 30, 2010 and September 30, 2009. Unrecognized stock-based compensation expense related to stock options totaled \$0.6 million at September 30, 2010. At such date, the weighted-average period over which this unrecognized expense was expected to be recognized was 1.6 years.

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The fair value of the options is estimated at the date of grant using a Black-Scholes option-pricing model. The following weighted average assumptions were used to estimate the fair value of options granted during the nine months ended September 30:

|                         | 2010      | 2009      |
|-------------------------|-----------|-----------|
| Risk-free interest rate | 3.24%     | 2.51%     |
| Expected dividend yield | 4.24%     | 4.83%     |
| Volatility factor       | 42.67%    | 46.47%    |
| Expected life of option | 8.0 years | 8.0 years |

The Company records compensation expense with respect to restricted shares in an amount equal to the fair value of the common stock covered by each award on the date of grant. The restricted shares awarded become fully vested after various periods of continued employment from the respective dates of grant. The Company is entitled to an income tax deduction in an amount equal to the taxable income reported by the holders of the restricted shares when the restrictions are released and the shares are issued. Compensation is being charged to expense over the respective vesting periods.

Restricted shares are forfeited if officers and employees terminate prior to the lapsing of restrictions. The Company records forfeitures of restricted stock as treasury share repurchases and any compensation cost previously recognized is reversed in the period of forfeiture. Recipients of restricted shares do not pay any cash consideration to the Company for the shares, have the right to vote all shares subject to such grant and receive all dividends with respect to such shares, whether or not the shares have vested. Unrecognized stock-based compensation expense related to non-vested restricted shares was \$2.2 million at September 30, 2010. At September 30, 2010, this unrecognized expense is expected to be recognized over 6.1 years based on the weighted average-life of the restricted shares.

A summary of the Company's restricted shares activity and related information is presented below for the nine months ended September 30:

|                             | 2010              |                               | 2009              |                               |
|-----------------------------|-------------------|-------------------------------|-------------------|-------------------------------|
|                             | Restricted Awards | Average Market Price at Grant | Restricted Awards | Average Market Price at Grant |
| Outstanding at January 1    | 88,109            |                               | 36,175            |                               |
| Granted                     | 13,450            | \$ 32.17                      | 59,100            | \$ 30.67                      |
| Forfeited/Vested            | (5,799 )          |                               | (7,166 )          |                               |
| Outstanding at September 30 | 95,760            |                               | 88,109            |                               |

The Company provides retirement benefits to its employees through the City Holding Company 401(k) Plan and Trust ("the 401(k) Plan"), which is intended to be compliant with Employee Retirement Income Security Act (ERISA) section 404(c). Any employee who has attained age 21 is eligible to participate beginning the first day of the month following employment. Unless specifically chosen otherwise, every employee is automatically enrolled in the 401(k) Plan and may make before-tax contributions of between 1% and 15% of eligible pay up to the dollar limit imposed by Internal Revenue Service regulations. The first 6% of an employee's contribution is matched 50% by the Company. The employer matching contribution is invested according to the investment elections chosen by the employee. Employees are 100% vested in both employee and employer contributions and the earnings they generate. The Company's total

expense associated with the retirement benefit plan approximated \$0.5 million for the nine month periods ended September 30, 2010 and September 30, 2009.

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The Company also maintains a defined benefit pension plan (“the Defined Benefit Plan”) that covers approximately 300 current and former employees. The Defined Benefit Plan was frozen in 1999 subsequent to the Company’s acquisition of the plan sponsor. The Defined Benefit Plan maintains a December 31 year-end for purposes of computing its benefit obligations. The Company made contributions of \$0.1 million to the Defined Benefit Plan during the nine months ended September 30, 2010 while contributions of \$0.9 million were made during the nine months ended September 30, 2009.

The following table presents the components of the net periodic pension cost of the Defined Benefit Plan:

| (in thousands)                   | Three months ended    |        | Nine months ended     |        |
|----------------------------------|-----------------------|--------|-----------------------|--------|
|                                  | September 30,<br>2010 | 2009   | September 30,<br>2010 | 2009   |
| Components of net periodic cost: |                       |        |                       |        |
| Interest cost                    | \$ 169                | \$ 169 | 507                   | \$ 507 |
| Expected return on plan assets   | (203 )                | (199 ) | (609 )                | (597 ) |
| Net amortization and deferral    | 92                    | 80     | 276                   | 240    |
| Net Periodic Pension Cost        | \$ 58                 | \$ 50  | 174                   | \$ 150 |

## Note G – Commitments and Contingencies

The Company is a party to certain financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. The Company has entered into agreements with its customers to extend credit or provide a conditional commitment to provide payment on drafts presented in accordance with the terms of the underlying credit documents. The Company also provides overdraft protection to certain demand deposit customers that represent an unfunded commitment. Overdraft protection commitments, which are included with other commitments below, are uncollateralized and are paid at the Company’s discretion. Conditional commitments generally include standby and commercial letters of credit. Standby letters of credit represent an obligation of the Company to a designated third party contingent upon the failure of a customer of the Company to perform under the terms of the underlying contract between the customer and the third party. Commercial letters of credit are issued specifically to facilitate trade or commerce. Under the terms of a commercial letter of credit, drafts will be drawn when the underlying transaction is consummated, as intended, between the customer and a third party. The funded portion of these financial instruments is reflected in the Company’s balance sheet, while the unfunded portion of these commitments is not reflected in the balance sheet. The table below presents a summary of the contractual obligations of the Company resulting from significant commitments:

| ( in thousands)               | September 30,<br>2010 | December 31,<br>2009 |
|-------------------------------|-----------------------|----------------------|
| Commitments to extend credit: |                       |                      |
| Home equity lines             | \$ 140,799            | \$ 132,757           |
| Commercial real estate        | 31,304                | 33,191               |
| Other commitments             | 165,144               | 177,759              |
| Standby letters of credit     | 20,045                | 18,092               |
| Commercial letters of credit  | 25                    | 30                   |

Loan commitments and standby and commercial letters of credit have credit risks essentially the same as that involved in extending loans to customers and are subject to the Company’s standard credit policies. Collateral is obtained based on management’s credit assessment of the customer. Management does not anticipate any material losses as a result of these commitments.





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## Note H – Total Comprehensive Income

The following table sets forth the computation of total comprehensive income:

| (in thousands)  | Nine months ended September 30, |           |
|---|---------------------------------|-----------|
|   | 2010                            | 2009      |
| Net income  | \$ 29,051                       | \$ 31,567 |
| Unrealized security gains arising during the period               | 18,409                          | 10,739    |
| Reclassification adjustment for (gains) losses included in income | (6,512 )                        | 8,897     |
|   | 11,897                          | 19,636    |
| Unrealized loss on interest rate floors                           | (3,696 )                        | (8,214 )  |
| Other comprehensive income before income taxes                    | 37,252                          | 42,989    |
| Tax effect  | (3,149 )                        | (4,495 )  |
| Total comprehensive income  | \$ 34,103                       | \$ 38,494 |

## Note I – Earnings per Share

The following table sets forth the computation of basic and diluted earnings per share:

| (in thousands, except per share data)            | Three months ended September 30, |           | Nine months ended September 30, |           |
|--|----------------------------------|-----------|---------------------------------|-----------|
|  | 2010                             | 2009      | 2010                            | 2009      |
| Distributed earnings allocated to common stock   | \$ 5,237                         | \$ 5,380  | \$ 15,711                       | \$ 16,139 |
| Undistributed earnings allocated to common stock | 3,733                            | 5,116     | 13,164                          | 15,403    |
| Net earnings allocated to common shareholders    | \$ 8,970                         | \$ 10,496 | \$ 28,875                       | \$ 31,542 |
| Average shares outstanding                       | 15,496                           | 15,893    | 15,646                          | 15,889    |
| Effect of dilutive securities:                   |                                  |           |                                 |           |
| Employee stock options                           | 56                               | 59        | 64                              | 55        |
| Shares for diluted earnings per share            | 15,552                           | 15,952    | 15,710                          | 15,944    |
| Basic earnings per share                         | \$ 0.58                          | \$ 0.66   | \$ 1.85                         | \$ 1.99   |
| Diluted earnings per share                       | \$ 0.58                          | \$ 0.66   | \$ 1.84                         | \$ 1.98   |

Options to purchase 248,418 and 199,418 shares of common stock at an exercise price between \$29.02 and \$40.88 and between \$31.32 and \$40.88 per share were outstanding during the third quarter of 2010 and the third quarter of

2009, respectively, but were not included in the computation of diluted earnings per share because the options' exercise price was greater than the average market price of the common shares and therefore, the effect would have been anti-dilutive.

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Note J –Fair Value Measurements

Effective January 1, 2008, the Company adopted Statement of FASB ASC Topic 820 “Fair Value Measurements and Disclosures”, which defines fair value, establishes a framework for measuring fair value under accounting principles generally accepted in the United States, and enhances disclosures about fair value measurements.

ASC Topic 820 defines fair value as the exchange price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

ASC Topic 820 establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy established by ASC Topic 820 is as follows:

Level 1: Quoted prices (unadjusted) or identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a company’s own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Company bases fair value of assets and liabilities on quoted market prices, prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data. If such information is not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality and the Company’s creditworthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time. The Company’s valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. While management believes the company’s valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. Furthermore, the reported fair value amounts have not been comprehensively revalued since the presentation dates, and therefore, estimates of fair value after the balance sheet date may differ significantly from the amount presented herein. A more detailed description of the valuation methodologies used for assets and liabilities measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

Securities Available for Sale. Securities available for sale are reported at fair value utilizing Level 1, Level 2, and Level 3 inputs. The fair value of securities available for sale is determined by utilizing a market approach by obtaining quoted prices on nationally recognized securities exchanges (other than forced or distressed transactions) that occur in sufficient volume or matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities’ relationship to other benchmark quoted securities. If such measurements are unavailable, the security is classified as Level 3. Significant judgment is required to make this determination.

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The Company has determined that its pooled trust preferred should be priced using Level 3 inputs in accordance with FASB ASC Topic 820, Fair Value Measurements and Disclosures and guidance issued by the SEC. The Company has determined that there are few observable transactions and market quotations available for pooled trust preferred securities and they are not reliable for purposes of determining fair value at September 30, 2010. Due to these circumstances, the Company has elected to utilize an income valuation approach produced by a third party pricing source. This third party model utilizes deferral and default probabilities for the underlying issuers, estimated prepayment rates and assumes no future recoveries of any defaults or deferrals. The Company then compares the values provided by the third party model with other external sources. At such time as there are observable transactions or quoted prices that are associated with an orderly and active market for pooled trust preferred securities, the Company will incorporate such market values in its estimate of fair values for these securities.

Derivatives. Derivatives are reported at fair value utilizing Level 2 inputs. The Company utilizes a market approach by obtaining dealer quotations to value its customer interest rate swaps.

The following table presents assets and liabilities measured at fair value on a recurring basis at September 30, 2010:

(in thousands)

| September 30, 2010                               | Total     | Level 1 | Level 2   | Level 3 |
|--|-----------|---------|-----------|---------|
| Assets:  |           |         |           |         |
| Obligations of states and political subdivisions | \$ 53,137 | \$ -    | \$ 53,137 | \$ -    |
| Mortgage-backed securities:                      |           |         |           |         |
| U.S. Government agencies                         | 271,951   | -       | 271,951   | -       |
| Private label                                    | 9,469     | -       | 9,469     | -       |
| Trust preferred securities                       | 57,507    | -       | 52,377    | 5,130   |
| Corporate Securities                             | 15,516    | -       | 15,516    | -       |
| Marketable equity securities                     | 5,053     | 5,053   | -         | -       |
| Investment funds                                 | 1,658     | 1,658   | -         | -       |
| Derivative Assets                                | 4,761     | -       | 4,761     | -       |
| Derivative Liabilities                           | 4,761     | -       | 4,761     | -       |

The table below presents a reconciliation and income statement classification of gains and losses for all assets measured at fair value on a recurring basis for Level 3 assets for the nine months ended September 30, 2010.

| (in thousands)                             | Investment Securities Available for Sale |
|--|--|
| Beginning balance, January 1, 2010         | \$ 4,005                                 |
| Impairment losses on investment securities | (4,181 )                                 |
| Included in other comprehensive income     | 5,306                                    |
| Transfers into Level 3                     | -  |
| Ending Balance, September 30, 2010         | \$ 5,130                                 |

Beginning January 1, 2010, the Company changed its policy for recording transfers into and out of the fair value hierarchy levels in response to amended U.S. GAAP. All such transfers are now assumed to be as of the end of the quarter in which the transfer occurred, whereas, previously, the Company assumed transfers into levels to occur at the beginning of a period and transfers out of levels to occur at the end of a period. During the nine months ended September 30, 2010, the Company did not have any transfers between the fair value hierarchy levels.



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The Company may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with U.S. generally accepted accounting principles. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. At September 30, 2010 and 2009, the Company has \$21.1 million and \$22.1 million, respectively of impaired loans that are measured at fair value on a nonrecurring basis. These assets are considered to be measured at Level 2 in the fair value measurement hierarchy.

The Company used the following methods and significant assumptions to estimate fair value for assets measured on a nonrecurring basis.

**Long-lived assets held for sale.** Long-lived assets held for sale include real estate owned. The fair value of real estate owned is determined by utilizing a market based approach based on independent full appraisals and real estate broker's price opinions, less estimated selling costs. Certain properties require assumptions that are not observable in an active market in the determination of fair value. Assets that are acquired through foreclosure, repossession or return are initially recorded at the lower of the loan or lease carrying amount or fair value less estimated selling costs at the time of transfer to real estate owned. At September 30, 2010 and 2009, the Company has \$12.6 million and \$12.3 million, respectively of long-lived assets held for sale that are measured at fair value on a nonrecurring basis. These assets are considered to be measured at Level 2 in the fair value measurement hierarchy. The Company wrote-down approximately \$0.9 million and \$0.1 million of long-lived assets held for sale to their fair value during the nine months ended September 30, 2010 and 2009, respectively.

**Impaired Loans.** Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with ASC Topic 310, "Receivables." The fair value of impaired loans is estimated using one of several methods, including collateral value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At September 30, 2010 and 2009, substantially all of the impaired loans were evaluated based on the fair value of the collateral. In accordance with ASC Topic 820, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the impaired loan as nonrecurring Level 3. The Company recorded \$0.8 million in fair value losses on impaired loans during the nine months ended September 30, 2010 based on the estimated fair value of the underlying collateral. This amount is included in the provision for loans losses on the consolidated statements of income.

**Previously Securitized Loans.** The Company utilizes an income valuation approach through the use of an internal valuation model that calculates the present value of estimated future cash flows. The internal valuation model incorporates assumptions such as loan prepayment and default rates. Using cash flow modeling techniques that incorporate these assumptions, the Company estimated total future cash collections expected to be received from these loans and determined the yield at which the resulting discount would be accreted into income. The Company recognized \$0.2 million of accretion for the three months ended September 30, 2010 and \$0.6 million of accretion for the nine months ended September 30, 2010 associated with these loans. No impairment losses were recorded during 2010 or 2009 on the previously securitized loans related to the change in fair value.

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FASB ASC Topic 825 “Financial Instruments” as amended, requires disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet, for which it is practicable to estimate that value. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including discount rate and estimate of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instrument. ASC Topic 825 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

The following table represents the estimates of fair value:

| (in thousands)                | Fair Value of Financial Instruments |            |                   |            |
|-------------------------------|-------------------------------------|------------|-------------------|------------|
|                               | September 30, 2010                  |            | December 31, 2009 |            |
|                               | Carrying Amount                     | Fair Value | Carrying Amount   | Fair Value |
| <b>Assets:</b>                |                                     |            |                   |            |
| Cash and cash equivalents     | \$ 82,770                           | \$ 82,770  | \$ 62,635         | \$ 62,635  |
| Securities available-for-sale | 427,190                             | 427,190    | 485,767           | 485,767    |
| Securities held-to-maturity   | 24,381                              | 24,726     | 28,164            | 25,020     |
| Net loans                     | 1,807,474                           | 1,968,672  | 1,773,893         | 1,857,566  |
| <b>Liabilities:</b>           |                                     |            |                   |            |
| Deposits                      | 2,158,750                           | 2,123,344  | 2,163,722         | 2,050,830  |
| Short-term borrowings         | 110,634                             | 110,637    | 118,329           | 118,401    |
| Long-term debt                | 16,892                              | 16,909     | 16,959            | 16,986     |

The following methods and assumptions were used in estimating fair value for financial instruments:

**Cash and cash equivalents:** Due to their short-term nature, the carrying amounts reported in the Consolidated Balance Sheets approximate fair value.

**Securities:** The fair value of securities, both available-for-sale and held-to-maturity, are generally based on quoted market prices or matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities’ relationship to other benchmark quoted securities.

**Net loans:** The fair value of the loan portfolio is estimated using discounted cash flow analyses at interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The carrying value of accrued interest approximates its fair value.

**Deposits:** The fair values of demand deposits (e.g. interest and noninterest-bearing checking, regular savings, and other money market demand accounts) are, by definition, equal to their carrying values. Fair values for certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregate expected monthly maturities of time deposits.

**Short-term borrowings:** Securities sold under agreements to repurchase represent borrowings with original maturities of less than 90 days. The carrying amount of advances from the FHLB and borrowings under repurchase agreements approximate their fair values.

**Long-term debt:** The fair value of long-term borrowings is estimated using discounted cash flow analyses based on the Company’s current incremental borrowing rates for similar types of borrowing arrangements and market conditions of similar debt instruments.

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Commitments and letters of credit: The fair values of commitments are estimated based on fees currently charged to enter into similar agreements, taking into consideration the remaining terms of the agreements and the counterparties' credit standing. The fair value of letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counterparties at the reporting date. The amounts of fees currently charged on commitments and letters of credit are deemed insignificant, and therefore, the estimated fair values and carrying values have not been reflected in the table above.

Note K– Recent Accounting Pronouncements

ASU No. 2009-17, “Consolidations (Topic 810) - Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities” amends prior guidance to change how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a company is required to consolidate an entity is based on, among other things, an entity's purpose and design and a company's ability to direct the activities of the entity that most significantly impact the entity's economic performance. ASC Topic 810 requires additional disclosures about the reporting entity's involvement with variable-interest entities and any significant changes in risk exposure due to that involvement as well as its affect on the entity's financial statements. ASU 2009-17 became effective on January 1, 2010 and did not have a significant impact on the Company's financial statements.

ASU No. 2010-06, “Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements” requires new disclosures related to fair value measurements including 1) significant transfers in and out of Levels 1 and 2 of the fair value hierarchy and the reasons for the transfers, and 2) activity in Level 3 of the fair value hierarchy including separate gross presentation of purchase, sales, issuances and settlements. ASU 2010-06 also clarifies that 1) disclosures should be presented for each class of assets and liabilities (rather than major category) and 2) disclosures should include the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring measurements included in Level 2 or Level 3 of the fair value hierarchy. The disclosure for gross presentation of transactions in Level 3 will be effective January 1, 2011 and is not expected to have a significant impact on the Company's financial statements. The remaining disclosures and clarifications became effective for the Company on January 1, 2010. See Note J – Fair Value Measurements.

ASU No. 2010-09, “Subsequent Events (Topic 855)” clarified that an entity which is an SEC filer should evaluate subsequent events through the date that financial statements are issued, and an entity which is not an SEC filer is not required to disclose the date through which subsequent events have been evaluated. ASC 2010-09 became effective for the Company on July 1, 2010 and did not have a significant impact on the Company's financial statements.

ASU No. 2010-18, “Effect of a Loan Modification When the Loan Is Part of a Pool That Is Accounted for as a Single Asset” (Topic 310) provides guidance on the accounting for loan modifications when the loan is part of a pool of loans accounted for as a single asset such as acquired loans that have evidence of credit deterioration upon acquisition that are accounted for under the guidance in ASC 310-30. ASU No. 2010-18 addresses diversity in practice on whether a loan that is part of a pool of loans accounted for as a single asset should be removed from that pool upon a modification that would constitute a troubled debt restructuring or remain in the pool after modification. ASU No. 2010-18 clarifies that modifications of loans that are accounted for within a pool under ASC 310-30 do not result in the removal of those loans from the pool even if the modification of those loans would otherwise be considered a troubled debt restructuring. An entity will continue to be required to consider whether the pool of assets in which the loan is included is impaired if the expected cash flows for the pool change. The amendments in this update do not require any additional disclosures and are effective for modifications of loans accounted for within pools under ASC 310-30 occurring in the first interim or annual period ending on or after July 15, 2010. ASU 2010-18 is not expected to have a material impact on the Company's results of operations, financial position or disclosures.



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ASU No. 2010-20, "Receivables (Topic 830) - Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses." ASU 2010-20 requires entities to provide disclosures designed to facilitate financial statement users' evaluation of (i) the nature of credit risk inherent in the entity's portfolio of financing receivables, (ii) how that risk is analyzed and assessed in arriving at the allowance for credit losses and (iii) the changes and reasons for those changes in the allowance for credit losses. Disclosures must be disaggregated by portfolio segment, the level at which an entity develops and documents a systematic method for determining its allowance for credit losses, and class of financing receivable, which is generally a disaggregation of portfolio segment. The required disclosures include, among other things, a rollforward of the allowance for credit losses as well as information about modified, impaired, non-accrual and past due loans and credit quality indicators. ASU 2010-20 will be effective for the Company's financial statements as of December 31, 2010, as it relates to disclosures required as of the end of a reporting period. Disclosures that relate to activity during a reporting period will be required for the Company's financial statements that include periods beginning on or after January 1, 2011.

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Item 2 – Management’s Discussion and Analysis of Financial Condition and Results of Operations

Recent Legislation Impacting the Financial Services Industry

On July 21 2010, sweeping financial regulatory reform legislation entitled the “Dodd-Frank Wall Street Reform and Consumer Protection Act” (the “Dodd-Frank Act”) was signed into law. Generally, the Dodd-Frank Act is effective the day after it was signed into law, but different effective dates apply to specific sections of the law. The Dodd-Frank Act implements far-reaching changes across the financial regulatory landscape, including provisions that, among other things, will:

- Centralize responsibility for consumer financial protection by creating a new agency, the Consumer Financial Protection Bureau, which will have rulemaking authority for a wide range of consumer protection laws that would apply to all banks and have broad powers to supervise and enforce consumer protection laws;
- Changes standards for Federal preemption of state laws related to federally chartered institutions and their subsidiaries;
- After a three-year phase-in period which begins January 1, 2013, removes trust preferred securities as a permitted component of a holding company’s tier 1 capital;
- Requires the Office of the Comptroller of the Currency to seek to make its capital requirements for national banks countercyclical so that capital requirements increase in times of economic expansion and decrease in times of economic contraction;
- Requires financial holding companies, such as City, to be well-capitalized and well-managed as of July 21, 2011. Bank holding companies and banks must also be both well-capitalized and well-managed in order to acquire banks located outside their domiciled state.
- Provides for an increase in the FDIC assessment for depository institutions with assets of \$10 billion or more, increases in the minimum reserve ratio for the deposit insurance fund from 1.15% to 1.35% and changes in the basis for determining FDIC premiums from deposits to assets;
- Requires large, publicly traded bank holding companies with assets of \$10 billion or more to establish a risk committee responsible for the oversight of enterprise risk management;
- Provides for new disclosure and other requirements relating to executive compensation and corporate governance. These disclosures and requirements apply to all public companies, not just financial institutions;
- Permanently increases the \$250 thousand limit for federal deposit insurance and increases the cash limit of Securities Investor Protection Corporation protection from \$100 thousand to \$250 thousand and provides unlimited federal deposit insurance until January 1, 2013 for non-interest bearing demand transaction accounts at all insured depository institutions;
  - Repeals the federal prohibitions on the payment of interest on demand deposits;
- Amends the Electronic Fund Transfer Act (EFTA) to, among other things, give the Federal Reserve the authority to establish rules regarding interchange fees charged for electronic debit transactions by payment card issuers having assets over \$10 billion and to enforce a new statutory requirement that such fees be reasonable and proportional to the actual cost of a transaction to the issuer; and
  - Increases the authority of the Federal Reserve to examine City and its non-bank subsidiaries.

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Uncertainty remains as to the ultimate impact of the Act, which could have a material adverse impact either on the financial services industry as a whole, or on City's business, results of operations and financial condition. Provisions in the legislation that affect deposit insurance assessments, payment of interest on demand deposits and interchange fees could increase the costs associated with deposits as well as place limitations on certain revenues those deposits may generate. Provisions in the legislation that revoke the Tier 1 capital treatment of trust preferred securities and otherwise require revisions to the capital requirements of the Company and City National Bank could require the Company and City National Bank to seek other sources of capital in the future.

## Critical Accounting Policies

The accounting policies of the Company conform with U.S. generally accepted accounting principles and require management to make estimates and develop assumptions that affect the amounts reported in the financial statements and related footnotes. These estimates and assumptions are based on information available to management as of the date of the financial statements. Actual results could differ significantly from management's estimates. As this information changes, management's estimates and assumptions used to prepare the Company's financial statements and related disclosures may also change. The most significant accounting policies followed by the Company are presented in Note One to the audited financial statements included in the Company's 2009 Annual Report to Shareholders. The information included in this Quarterly Report on Form 10-Q, including the Consolidated Financial Statements, Notes to Consolidated Financial Statements, and Management's Discussion and Analysis of Financial Condition and Results of Operations, should be read in conjunction with the financial statements and notes thereto included in the 2009 Annual Report of the Company. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions, and estimates underlying those amounts, management has identified the determination of the allowance for loan losses, income taxes, and other-than-temporary impairment on investment securities to be the accounting areas that require the most subjective or complex judgments and, as such, could be most subject to revision as new information becomes available. The Company's business activities are currently limited to one reportable business segment, which is community banking.

Pages 36 - 40 of this Quarterly Report on Form 10-Q provide management's analysis of the Company's allowance for loan losses and related provision. The allowance for loan losses is maintained at a level that represents management's best estimate of probable losses in the loan portfolio. Management's determination of the adequacy of the allowance for loan losses is based upon an evaluation of individual credits in the loan portfolio, historical loan loss experience, current economic conditions, and other relevant factors. This determination is inherently subjective as it requires material estimates including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change. The allowance for loan losses related to loans considered to be impaired is generally evaluated based on the discounted cash flows using the impaired loan's initial effective interest rate or the fair value of the collateral for certain collateral dependent loans.

The Company is subject to federal and state income taxes in the jurisdictions in which it conducts business. In computing the provision for income taxes, management must make judgments regarding interpretation of laws in those jurisdictions. Because the application of tax laws and regulations for many types of transactions is susceptible to varying interpretations, amounts reported in the financial statements could be changed at a later date upon final determinations by taxing authorities. On a quarterly basis, the Company estimates its annual effective tax rate for the year and uses that rate to provide for income taxes on a year-to-date basis. The amount of unrecognized tax benefits could change over the next twelve months as a result of various factors. However, management cannot currently estimate the range of possible change.

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The Company is currently open to audit under the statute of limitations by the Internal Revenue Service for the years ended December 31, 2007 through 2009. The Company and its subsidiaries state income tax returns are open to audit under the statute of limitations for the years ended December 31, 2007 through 2009.

On a quarterly basis, the Company performs a review of investment securities to determine if any unrealized losses are other-than-temporarily impaired. Management considers the following, amongst other things, in its determination of the nature of the unrealized losses, (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition, capital strength, and near-term (12 months) prospects of the issuer, including any specific events which may influence the operations of the issuer such as changes in technology that may impair the earnings potential of the investment or the discontinuance of a segment of the business that may affect the future earnings potential; (iii) the historical volatility in the market value of the investment and/or the liquidity or illiquidity of the investment; (iv) adverse conditions specifically related to the security, an industry, or a geographic area; or (v) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. The Company continues to actively monitor the market value of these investments along with the financial strength of the issuers behind these securities, as well as its entire investment portfolio. Based on the market information available, the Company believes that the recent declines in market value are temporary and that the Company does not have the intent to sell any of the securities classified as available for sale and believes it is more likely than not that the Company will not have to sell any such securities before recovery of costs. The Company cannot guarantee that such securities will recover and if additional information becomes available in the future to suggest that the losses are other than temporary, the Company may need to record impairment charges in future periods.

As a result of this review, the Company recognized \$4.8 million of credit-related net investment impairment charges during the nine months ended September 30, 2010. The charges deemed other than temporary were related to pooled bank trust preferreds with a remaining book value of \$6.5 million, single issuer bank trust preferreds with a remaining book value of \$75.4 million and community bank and bank holding company equity positions with remaining book value of \$5.1 million at September 30, 2010. The Company continues to actively monitor the market values of these investments along with the financial strength of the issuers behind these securities, as well as our entire investment portfolio.

Financial Summary

Nine Months Ended September 30, 2010 vs. 2009

The Company reported consolidated net income of \$29.1 million, or \$1.84 per diluted common share, for the nine months ended September 30, 2010, compared to \$31.6 million, or \$1.98 per diluted common share, for the first nine months of 2009. Return on average assets ("ROA") was 1.46% and return on average equity ("ROE") was 12.3% for the first nine months of 2010, compared to 1.62% and 14.5%, respectively, for the first nine months of 2009.

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The Company's net interest income for the first nine months of 2010 decreased \$0.5 million compared to the first nine months of 2009 (see Net Interest Income). The Company recorded a provision for loan losses of \$4.8 million for the first nine months of 2010 while \$5.5 million was recorded for the first nine months of 2009 (see Allowance and Provision for Loan Losses). The Company recorded \$4.8 million of credit-related net investment impairment losses in the first nine months of 2010 as compared to \$4.5 million for the first nine months of 2009 (see Non-Interest Income and Expense). As further discussed under the caption Non-Interest Income and Expense, excluding credit-related net investment impairment losses and realized investment security gain/(losses), non-interest income decreased \$3.3 million from the nine months ended September 30, 2009, compared to the nine months ended September 30, 2010. Non-interest expenses for the nine months ended September 30, 2010 increased \$2.4 million from the nine months ended September 30, 2009.

**Three Months Ended September 30, 2010 vs. 2009**

The Company reported consolidated net income of \$9.0 million, or \$0.58 per diluted common share, for the three months ended September 30, 2010, compared to \$10.5 million, or \$0.66 per diluted common share, for the third quarter of 2009. Return on average assets ("ROA") was 1.36% and return on average equity ("ROE") was 11.4% for the third quarter of 2010, compared to 1.60% and 14.1%, respectively, for the third quarter of 2009.

The Company's net interest income for the third quarter of 2010 decreased \$0.5 million compared to the third quarter of 2009 (see Net Interest Income). The Company recorded a provision for loan losses of \$1.8 million for the third quarter of 2010 while \$1.7 million was recorded for the third quarter of 2009 (see Allowance and Provision for Loan Losses). The Company recorded \$2.9 million of credit-related net investment impairment losses in the third quarter of 2010 (see Non-Interest Income and Expense) while \$2.3 million was recorded during the third quarter of 2009. As further discussed under the caption Non-Interest Income and Expense, excluding credit-related net investment impairment losses and realized investment security gain/(losses), non-interest income decreased \$1.5 million from the three months ended September 30, 2009, compared to the three months ended September 30, 2010. Non-interest expenses for the three months ended September 30, 2010 increased \$1.0 million from the three months ended September 30, 2009.

**Net Interest Income****Nine Months Ended September 30, 2010 vs. 2009**

The Company's tax equivalent net interest income decreased \$0.4 million or 0.6% from \$72.5 million during the first nine months of 2009 to \$72.1 million during the first nine months of 2010. During the first nine months of 2010, the Company recognized \$1.1 million of additional interest income associated with three of the six pools of previously securitized loans that had a negative carrying value due to actual recoveries that exceeded estimates and discount accretion previously recognized. As a result, the September 30, 2010 carrying value for these three pools is \$0 and future cash receipts related to these three pools will be recognized as interest income as received. Excluding this change, the Company's tax equivalent net interest income for the first nine months of 2010 declined approximately \$1.5 million from the first nine months of 2009. This decline was due to a decrease in interest income associated with the gain from the sale of interest rate floors. During the third and fourth quarters of 2008, the Company sold \$450 million of interest rate floors. The \$16.7 million gain from sales of these interest rate floors is being recognized over the remaining lives of the various hedged loans – primarily prime-based commercial and home equity loans. During the first nine months of 2010, the Company recognized \$3.7 million of interest income compared to \$7.8 million of interest income recognized in the first nine months of 2009 from the interest rate floors. The Company's reported net interest margin decreased from 4.22% for the nine months ended September 30, 2009 to 4.10% for the nine months ended September 30, 2010.

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Three Months Ended September 30, 2010 vs. 2009

The Company's tax equivalent net interest income decreased \$0.5 million, or 2.0%, from \$23.9 million during the third quarter of 2009 to \$23.4 million during third quarter of 2010. This decline is due to a decrease in interest income associated with the gain from the sale of interest rate floors. During the third and fourth quarters of 2008, the Company sold \$450 million of interest rate floors. The \$16.7 million gain from sales of these interest rate floors is being recognized over the remaining lives of the various hedged loans – primarily prime-based commercial and home equity loans. During the third quarter of 2010, the Company recognized \$0.9 million of interest income compared to \$2.2 million of interest income recognized in the third quarter of 2009 from the interest rate floors. This decline was partially offset by the decrease in interest expense exceeding the decline in interest income from the third quarter of 2009 resulting in an increase in tax equivalent net interest income of approximately \$0.8 million. The Company's reported net interest margin decreased from 4.09% for the quarter ended September 30, 2009 to 3.94% for the quarter ended September 30, 2010.

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Table One  
Average Balance Sheets and Net Interest Income  
(in thousands)

|  | Nine months ended September 30, |                  |                |                    |                  |                |  |
|--|---------------------------------|------------------|----------------|--------------------|------------------|----------------|--|
|  | Average<br>Balance              | 2010<br>Interest | Yield/<br>Rate | Average<br>Balance | 2009<br>Interest | Yield/<br>Rate |  |
| <b>Assets</b>                                    |                                 |                  |                |                    |                  |                |  |
| Loan portfolio (1):                              |                                 |                  |                |                    |                  |                |  |
| Residential real estate                          | \$ 597,298                      | \$ 23,595        | 5.28 %         | \$ 597,282         | \$ 25,495        | 5.71 %         |  |
| Home equity (2)                                  | 402,751                         | 16,007           | 5.31           | 390,388            | 18,165           | 6.22           |  |
| Commercial,<br>financial, and<br>agriculture (3) | 764,446                         | 29,583           | 5.17           | 758,050            | 31,519           | 5.56           |  |
| Installment loans to<br>individuals              | 49,047                          | 2,830            | 7.71           | 49,498             | 3,150            | 8.51           |  |
| Previously securitized<br>loans                  | 1,281                           | 3,317            | 346.20         | 3,364              | 3,067            | 121.90         |  |
| Total loans                                      | 1,814,823                       | 75,332           | 5.55           | 1,798,582          | 81,396           | 6.05           |  |
| Securities:                                      |                                 |                  |                |                    |                  |                |  |
| Taxable  | 470,783                         | 15,947           | 4.53           | 453,713            | 17,494           | 5.16           |  |
| Tax-exempt (4)                                   | 49,158                          | 2,128            | 5.79           | 39,829             | 1,921            | 6.45           |  |
| Total securities                                 | 519,941                         | 18,075           | 4.65           | 493,542            | 19,415           | 5.26           |  |
| Deposits in depository<br>institutions           |                                 |                  |                |                    |                  |                |  |
|  | 5,288                           | -                | -              | 5,271              | 10               | 0.25           |  |
| Federal funds sold                               | 8,590                           | 13               | -              | 165                | -                | -              |  |
| Total interest-earning<br>assets                 | 2,348,642                       | 93,420           | 5.32           | 2,297,560          | 100,821          | 5.87           |  |
| Cash and due from<br>banks                       | 53,070                          |                  |                | 51,553             |                  |                |  |
| Bank premises and<br>equipment                   | 64,552                          |                  |                | 62,443             |                  |                |  |
| Other assets                                     | 207,648                         |                  |                | 213,285            |                  |                |  |
| Less: allowance for<br>loan losses               | (19,462 )                       |                  |                | (21,867 )          |                  |                |  |
| Total assets                                     | \$ 2,654,450                    |                  |                | \$ 2,602,974       |                  |                |  |
| <b>Liabilities</b>                               |                                 |                  |                |                    |                  |                |  |
| Interest-bearing                                 |                                 |                  |                |                    |                  |                |  |
| demand deposits                                  | \$ 461,178                      | \$ 999           | 0.29 %         | \$ 425,972         | \$ 1,327         | 0.42 %         |  |
| Savings deposits                                 | 388,356                         | 792              | 0.27           | 371,706            | 1,386            | 0.50           |  |
| Time deposits                                    | 991,419                         | 18,774           | 2.53           | 1,004,959          | 24,517           | 3.26           |  |
| Short-term                                       |                                 |                  |                |                    |                  |                |  |
| borrowings                                       | 111,089                         | 284              | 0.34           | 135,708            | 395              | 0.39           |  |
| Long-term debt                                   | 16,923                          | 496              | 3.92           | 18,669             | 676              | 4.84           |  |
| Total interest-bearing<br>liabilities            | 1,968,965                       | 21,345           | 1.45           | 1,957,014          | 28,301           | 1.93           |  |

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|  |              |              |
|--|--------------|--------------|
| Noninterest-bearing demand deposits        | 353,418      | 328,302      |
| Other liabilities                          | 17,726       | 27,335       |
| Stockholders' equity                       | 314,341      | 290,323      |
| Total liabilities and stockholders' equity | \$ 2,654,450 | \$ 2,602,974 |
| Net interest income                        | \$ 72,075    | \$ 72,520    |
| Net yield on earning assets                | 4.10 %       | 4.22 %       |

- (1) For purposes of this table, non-accruing loans have been included in average balances and loan fees, which are immaterial, have been included in interest income.
- (2) Interest income includes \$1,960 and \$3,884 from interest rate floors for the nine months ended September 30, 2010 and September 30, 2009, respectively.
- (3) Interest income includes \$1,735 and \$3,927 from interest rate floors for the nine months ended September 30, 2010 and September 30, 2009, respectively.
- (4) Computed on a fully federal tax-equivalent basis assuming a tax rate of approximately 35%.



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## Table Two

Rate Volume Analysis of Changes in Interest Income and Interest Expense  
(in thousands)

|  | Nine months ended September 30,<br>2010 vs. 2009 |  |             |
|--|--|--|-------------|
|  | Volume   | Increase (Decrease)<br>Due to Change In:<br>Rate | Net         |
| <b>Interest-earning assets:</b>        |  |  |             |
| <b>Loan portfolio</b>                  |  |  |             |
| Residential real estate                | \$ 1   | \$ (1,901 )                                      | \$ (1,900 ) |
| Home equity                            | 575  | (2,733 )   | (2,158 )    |
| Commercial, financial, and agriculture | 266  | (2,202 )   | (1,936 )    |
| Installment loans to individuals       | (29 )  | (291 )   | (320 )      |
| Previously securitized loans           | (1,899 )   | 2,149  | 250         |
| Total loans                            | (1,086 )   | (4,978 )   | (6,064 )    |
| <b>Securities:</b>                     |  |  |             |
| Taxable                                | 658  | (2,205 )   | (1,547 )    |
| Tax-exempt (1)                         | 450  | (243 )   | 207         |
| Total securities                       | 1,108  | (2,448 )   | (1,340 )    |
| Deposits in depository institutions    | -  | (10 )  | (10 )       |
| Federal funds sold                     | 13   | -  | 13          |
| Total interest-earning assets          | \$ 35  | \$ (7,436 )                                      | \$ (7,401 ) |
| <b>Interest-bearing liabilities:</b>   |  |  |             |
| Demand deposits                        | \$ 110   | \$ (438 )  | \$ (328 )   |
| Savings deposits                       | 62   | (656 )   | (594 )      |
| Time deposits                          | (330 )   | (5,413 )   | (5,743 )    |
| Short-term borrowings                  | (72 )  | (39 )  | (111 )      |
| Long-term debt                         | (63 )  | (117 )   | (180 )      |
| Total interest-bearing liabilities     | \$ (293 )  | \$ (6,663 )                                      | \$ (6,956 ) |
| Net Interest Income                    | \$ 328   | \$ (773 )  | \$ (445 )   |

(1) Fully federal taxable equivalent using a tax rate of 35%.

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Table Three  
Average Balance Sheets and Net Interest Income  
(in thousands)

|  | Three months ended September 30, |                  |                |                     |                  |                |
|--|----------------------------------|------------------|----------------|---------------------|------------------|----------------|
|  | Average<br>Balance               | 2010<br>Interest | Yield/<br>Rate | Average<br>Balance  | 2009<br>Interest | Yield/<br>Rate |
| <b>Assets</b>                                    |                                  |                  |                |                     |                  |                |
| Loan portfolio (5):                              |                                  |                  |                |                     |                  |                |
| Residential real estate                          | \$ 602,382                       | \$ 7,815         | 5.15 %         | \$ 590,108          | \$ 8,170         | 5.49 %         |
| Home equity (6)                                  | 408,685                          | 5,333            | 5.18           | 394,069             | 5,972            | 6.01           |
| Commercial,<br>financial, and<br>agriculture (7) | 768,393                          | 9,656            | 4.99           | 765,689             | 10,334           | 5.35           |
| Installment loans to<br>individuals              | 48,172                           | 902              | 7.43           | 50,935              | 975              | 7.59           |
| Previously securitized<br>loans                  | 1,487                            | 781              | 208.37         | 2,810               | 942              | 133.00         |
| <b>Total loans</b>                               | <b>1,829,119</b>                 | <b>24,487</b>    | <b>5.31</b>    | <b>1,803,611</b>    | <b>26,393</b>    | <b>5.81</b>    |
| <b>Securities:</b>                               |                                  |                  |                |                     |                  |                |
| Taxable  | 447,445                          | 5,019            | 4.45           | 463,703             | 5,820            | 4.98           |
| Tax-exempt (8)                                   | 48,352                           | 696              | 5.71           | 43,682              | 672              | 6.10           |
| <b>Total securities</b>                          | <b>495,797</b>                   | <b>5,715</b>     | <b>4.57</b>    | <b>507,385</b>      | <b>6,492</b>     | <b>5.08</b>    |
| <b>Deposits in depository<br/>institutions</b>   |                                  |                  |                |                     |                  |                |
|  | 4,977                            | -                | -              | 5,753               | 2                | 0.14           |
| Federal funds sold                               | 24,062                           | 12               | -              | 489                 | -                | -              |
| <b>Total interest-earning<br/>assets</b>         | <b>2,353,955</b>                 | <b>30,214</b>    | <b>5.09</b>    | <b>2,317,238</b>    | <b>32,887</b>    | <b>5.63</b>    |
| Cash and due from<br>banks                       | 51,056                           |                  |                | 50,496              |                  |                |
| Bank premises and<br>equipment                   | 65,044                           |                  |                | 63,709              |                  |                |
| Other assets                                     | 208,311                          |                  |                | 212,925             |                  |                |
| Less: allowance for<br>loan losses               | (19,751 )                        |                  |                | (20,828 )           |                  |                |
| <b>Total assets</b>                              | <b>\$ 2,658,615</b>              |                  |                | <b>\$ 2,623,540</b> |                  |                |
| <b>Liabilities</b>                               |                                  |                  |                |                     |                  |                |
| <b>Interest-bearing</b>                          |                                  |                  |                |                     |                  |                |
| demand deposits                                  | \$ 462,200                       | \$ 308           | 0.26 %         | \$ 431,676          | \$ 418           | 0.38 %         |
| Savings deposits                                 | 391,655                          | 252              | 0.26           | 379,793             | 417              | 0.44           |
| Time deposits                                    | 982,877                          | 5,992            | 2.42           | 1,013,610           | 7,838            | 3.07           |
| <b>Short-term</b>                                |                                  |                  |                |                     |                  |                |
| borrowings                                       | 112,128                          | 85               | 0.30           | 134,323             | 131              | 0.39           |
| Long-term debt                                   | 16,900                           | 173              | 4.06           | 17,988              | 192              | 4.23           |
| <b>Total interest-bearing<br/>liabilities</b>    | <b>1,965,760</b>                 | <b>6,810</b>     | <b>1.37</b>    | <b>1,977,390</b>    | <b>8,996</b>     | <b>1.80</b>    |

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|  |              |           |              |           |
|--|--------------|-----------|--------------|-----------|
| Noninterest-bearing demand deposits        | 356,590      |           | 325,821      |           |
| Other liabilities                          | 19,973       |           | 23,065       |           |
| Stockholders' equity                       | 316,292      |           | 297,264      |           |
| Total liabilities and stockholders' equity | \$ 2,658,615 |           | \$ 2,623,540 |           |
| Net interest income                        |              | \$ 23,404 |              | \$ 23,891 |
| Net yield on earning assets                |              | 3.94 %    |              | 4.09 %    |

(5) For purposes of this table, non-accruing loans have been included in average balances and loan fees, which are immaterial, have been included in interest income.

(6) Interest income includes \$593 and \$1,194 from interest rate floors for the three months ended September 30, 2010 and September 30, 2009, respectively.

(7) Interest income includes \$282 and \$958 from interest rate floors for the three months ended September 30, 2010 and September 30, 2009, respectively.

(8) Computed on a fully federal tax-equivalent basis assuming a tax rate of approximately 35%.

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## Table Four

Rate Volume Analysis of Changes in Interest Income and Interest Expense  
(in thousands)

|  | Three months ended September 30,<br>2010 vs. 2009 |             |             |
|--|---|-------------|-------------|
|  | Increase (Decrease)<br>Due to Change In:          |             |             |
|  | Volume  | Rate        | Net         |
| <b>Interest-earning assets:</b>        |   |             |             |
| <b>Loan portfolio</b>                  |   |             |             |
| Residential real estate                | \$ 170  | \$ (525 )   | \$ (355 )   |
| Home equity                            | 222   | (861 )      | (639 )      |
| Commercial, financial, and agriculture | 36  | (714 )      | (678 )      |
| Installment loans to individuals       | (53 )   | (20 )       | (73 )       |
| Previously securitized loans           | (444 )  | 283         | (161 )      |
| Total loans                            | (69 )   | (1,837 )    | (1,906 )    |
| <b>Securities:</b>                     |   |             |             |
| Taxable                                | (204 )  | (597 )      | (801 )      |
| Tax-exempt (1)                         | 72  | (48 )       | 24          |
| Total securities                       | (132 )  | (645 )      | (777 )      |
| Deposits in depository institutions    | -   | (2 )        | (2 )        |
| Federal funds sold                     | 12  | -           | 12          |
| Total interest-earning assets          | \$ (189 )   | \$ (2,484 ) | \$ (2,673 ) |
| <b>Interest-bearing liabilities:</b>   |   |             |             |
| Interest-bearing demand deposits       | \$ 30   | \$ (140 )   | \$ (110 )   |
| Savings deposits                       | 13  | (178 )      | (165 )      |
| Time deposits                          | (238 )  | (1,608 )    | (1,846 )    |
| Short-term borrowings                  | (22 )   | (24 )       | (46 )       |
| Long-term debt                         | (12 )   | (7 )        | (19 )       |
| Total interest-bearing liabilities     | \$ (229 )   | \$ (1,957 ) | \$ (2,186 ) |
| Net Interest Income                    | \$ 40   | \$ (527 )   | \$ (487 )   |

(1) Fully federal taxable equivalent using a tax rate of approximately 35%.

## Loans

The composition of the Company's loan portfolio as of the dates indicated follows:

| (in thousands)                     | September 30,<br>2010 | December 31,<br>2009 | September<br>30,<br>2009 |
|------------------------------------|-----------------------|----------------------|--------------------------|
| Residential real estate – mortgage | \$ 605,351            | \$ 595,678           | \$ 590,653               |

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|  |              |              |              |
|--|--------------|--------------|--------------|
| Home Equity                            | 411,481      | 398,752      | 396,648      |
| Commercial, financial, and agriculture | 765,331      | 752,052      | 762,194      |
| Installment loans to individuals       | 42,407       | 44,239       | 45,309       |
| Previously securitized loans           | 1,268        | 1,713        | 2,580        |
| Total loans                            | \$ 1,825,838 | \$ 1,792,434 | \$ 1,797,384 |

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As compared to December 31, 2009, loans have increased \$33.4 million (1.9%) at September 30, 2010. Residential real estate loans increased \$9.7 million or 1.6% from \$595.7 million at December 31, 2009 to \$605.4 million at September 30, 2010. Residential real estate loans are primarily for single-family 1, 3, 5 and 10 year adjustable rate mortgages with terms that amortize the loans over periods from 15-30 years. Our mortgage products do not include sub-prime, interest only, or option adjustable rate mortgage products. Home equity loans increased \$12.7 million or 3.2% during the first nine months of 2010. The Company's home equity loans are underwritten differently than 1-4 family residential mortgages with typically less documentation but lower loan-to-value ratios. Home equity loans consist of lines of credit, short term fixed amortizing loans, and non-purchase adjustable rate loans with either first or second lien positions.

Commercial loans increased \$13.3 million (1.7%) compared to December 31, 2009. The majority of the Company's commercial loans are real estate secured (73.4%), with 32.8% of the commercial mortgages occupied by the owners of the properties.

Installment loans decreased \$1.8 million, or 4.1%, from \$44.2 million at December 31, 2009 to \$42.4 million at September 30, 2010. The installment loan portfolio primarily consists of new and used automobile loans, personal loans secured by cash and cash equivalents, unsecured revolving credit products, and other similar types of credit facilities.

As of September 30, 2010, the Company reported \$1.3 million of loans classified as "previously securitized loans." These loans were recorded as a result of the Company's early redemption of the outstanding notes attributable to the Company's six loan securitization trusts (see Retained Interests and Previously Securitized Loans). As the outstanding notes were redeemed during 2004 and 2003, the Company became the beneficial owner of the remaining mortgage loans and recorded the carrying amount of those loans within the loan portfolio, classified as "previously securitized loans." These loans are junior lien mortgage loans on one- to four-family residential properties located throughout the United States. The loans generally have contractual terms of 25 or 30 years and have fixed interest rates. The Company expects this balance to continue to decline as borrowers remit principal payments on the loans.

**Allowance and Provision for Loan Losses**

Management systematically monitors the loan portfolio and the adequacy of the allowance for loan losses ("ALLL") on a quarterly basis to provide for probable losses inherent in the portfolio. Management assesses the risk in each loan type based on historical trends, the general economic environment of its local markets, individual loan performance, and other relevant factors. Individual credits are selected throughout the year for detailed loan reviews, which are utilized by management to assess the risk in the portfolio and the adequacy of the allowance. Due to the nature of commercial lending, evaluation of the adequacy of the allowance as it relates to these loan types is often based more upon specific credit review, with consideration given to the potential impairment of certain credits and historical loss rates, adjusted for general economic conditions and other inherent risk factors. Conversely, due to the homogeneous nature of the real estate and installment portfolios, the portions of the allowance allocated to those portfolios are primarily based on prior loss history of each portfolio, adjusted for general economic conditions and other inherent risk factors.

In evaluating the adequacy of the allowance for loan losses, management considers both quantitative and qualitative factors. Quantitative factors include actual repayment characteristics and loan performance, cash flow analyses, and estimated fair values of underlying collateral. Qualitative factors generally include overall trends within the portfolio, composition of the portfolio, changes in pricing or underwriting, seasoning of the portfolio, and general economic conditions.

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The allowance not specifically allocated to individual credits is generally determined by analyzing potential exposure and other qualitative factors that could negatively impact the adequacy of the allowance. Loans not individually evaluated for impairment are grouped by pools with similar risk characteristics and the related historical loss rates are adjusted to reflect current inherent risk factors, such as unemployment, overall economic conditions, concentrations of credit, loan growth, classified and impaired loan trends, staffing, adherence to lending policies, and loss trends.

Determination of the allowance for loan losses is subjective in nature and requires management to periodically reassess the validity of its assumptions. Differences between actual losses and estimated losses are assessed such that management can timely modify its evaluation model to ensure that adequate provision has been made for risk in the total loan portfolio.

The Company had net charge-offs of \$4.9 million for the first nine months of 2010 compared to net charge-offs of \$8.1 million for the same period in 2009. Net charge-offs in 2010 on commercial and residential loans were \$2.8 million and \$1.6 million, respectively, for the nine months ended September 30, 2010 as compared to \$5.8 million and \$1.4 million on commercial and residential loans, respectively during the nine months ended September 30, 2009. In addition, depository accounts net charge-offs were \$0.5 million for the first nine months of 2010. While charge-offs on depository accounts are appropriately taken against the ALLL, the revenue associated with depository accounts is reflected in service charges.

The Company's ratio of non-performing assets to total loans and other real estate owned increased modestly from 1.28% at June 30, 2010 to 1.31% at September 30, 2010. Based on our analysis, the Company believes that the allowance allocated to impaired loans, after considering the value of the collateral securing such loans, is adequate to cover losses that may result from these loans at September 30, 2010.

The ALLL at September 30, 2010 was \$18.4 million compared to \$18.5 million at December 31, 2009, a decrease of \$0.1 million or 1.0%. Below is a summary of the changes in the components of the ALLL from December 31, 2009 to September 30, 2010.

The allowance allocated to the commercial loan portfolio (see Table Eight) decreased \$0.3 million, or 3.0% from \$11.0 million at December 31, 2009 to \$10.7 million at September 30, 2010. This decrease is due to recent trends in the commercial portfolio and specific charge-offs related to impaired loans during 2010.

The allowance allocated to the residential real estate portfolio (see Table Eight) increased \$0.6 million or 11.2% from \$5.5 million at December 31, 2009 to \$6.1 million at September 30, 2010. This increase was primarily the result of increases in the balances of residential real estate and home equity portfolios.

The allowance allocated to the consumer loan portfolio (see Table Eight) declined \$0.1 million from \$0.2 million at December 31, 2009 to \$0.1 million at September 30, 2010. This decrease is primarily related to the decrease in the balance of the consumer loan portfolio.

The allowance allocated to overdraft deposit accounts (see Table Eight) decreased \$0.4 million, or 20.8%, from \$1.8 million at December 31, 2009 to \$1.4 million at September 30, 2010. The decline in overdraft balances outstanding was the primary cause of this decline.

As previously discussed, the carrying value of the previously securitized loans incorporates an assumption for expected cash flows to be received over the life of these loans. To the extent that the present value of expected cash flows is less than the carrying value of these loans, the Company would provide for such losses through the provision for loan losses.

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As a result of the Company's quarterly analysis of the adequacy of the ALLL, the Company recorded a provision for loan losses of \$4.8 million in the first nine months of 2010 and \$5.5 million in the first nine months of 2009. Changes in the amount of the ALLL and related provision for loan losses are based on the Company's detailed systematic methodology and are directionally consistent with changes in the composition and quality of the Company's loan portfolio. The Company believes its methodology for determining the adequacy of its ALLL adequately provides for probable losses inherent in the loan portfolio and produces a provision and allowance for loan losses that is directionally consistent with changes in asset quality and loss experience.

Based on the Company's analysis of the adequacy of the allowance for loan losses and in consideration of the known factors utilized in computing the allowance, management believes that the allowance for loan losses as of September 30, 2010, is adequate to provide for probable losses inherent in the Company's loan portfolio. Future provisions for loan losses will be dependent upon trends in loan balances including the composition of the loan portfolio, changes in loan quality and loss experience trends, and recoveries of previously charged-off loans, among other factors.

Table six  
Analysis of the Allowance for Loan Losses

| (in thousands)                               | Nine months ended September 30, |           | Year ended<br>December<br>31,<br>2009 |
|--|---------------------------------|-----------|---------------------------------------|
|  | 2010                            | 2009      |                                       |
| Balance at beginning of period               | \$ 18,541                       | \$ 22,164 | \$ 22,164                             |
| <b>Charge-offs:</b>                          |                                 |           |                                       |
| Commercial, financial, and agricultural      | (3,203 )                        | (5,928 )  | (7,750 )                              |
| Real estate-mortgage                         | (1,714 )                        | (1,468 )  | (1,916 )                              |
| Installment loans to individuals             | (89 )                           | (178 )    | (265 )                                |
| Overdraft deposit accounts                   | (1,730 )                        | (2,149 )  | (2,886 )                              |
| Total charge-offs                            | (6,736 )                        | (9,723 )  | (12,817 )                             |
| <b>Recoveries:</b>                           |                                 |           |                                       |
| Commercial, financial, and agricultural      | 415                             | 147       | 235                                   |
| Real estate-mortgage                         | 73                              | 91        | 122                                   |
| Installment loans to individuals             | 132                             | 185       | 222                                   |
| Overdraft deposit accounts                   | 1,189                           | 1,226     | 1,620                                 |
| Total recoveries                             | 1,809                           | 1,649     | 2,199                                 |
| Net charge-offs                              | (4,927 )                        | (8,074 )  | (10,618 )                             |
| Provision for loan losses                    | 4,750                           | 5,519     | 6,995                                 |
| Balance at end of period                     | \$ 18,364                       | \$ 19,609 | \$ 18,541                             |
| <b>As a Percent of Average Total Loans:</b>  |                                 |           |                                       |
| Net charge-offs (annualized)                 | (0.36 )%                        | (0.59 )%  | (0.59 )%                              |
| Provision for loan losses (annualized)       | 0.35 %                          | 0.41 %    | 0.39 %                                |
| <b>As a Percent of Non-Performing Loans:</b> |                                 |           |                                       |
| Allowance for loan losses                    | 160.40 %                        | 118.61 %  | 132.02 %                              |





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Non-Performing Assets

| (in thousands)  | As of<br>September 30, |           | As of<br>December<br>31, |
|---|------------------------|-----------|--------------------------|
|   | 2010                   | 2009      | 2009                     |
| Non-accrual loans   | \$ 11,220              | \$ 16,423 | \$ 13,583                |
| Accruing loans past due 90 days or more   | 195                    | 98        | 382                      |
| Previously securitized loans past due 90 days or more                                 | 34                     | 12        | 79                       |
| Total non-performing loans  | 11,449                 | 16,533    | 14,044                   |
| Other real estate, excluding property associated with<br>previously securitized loans | 12,636                 | 12,323    | 11,729                   |
| Total other real estate owned   | 12,636                 | 12,323    | 11,729                   |
| Total non-performing assets   | \$ 24,085              | \$ 28,856 | \$ 25,773                |

The decrease in non-accrual loans is principally related to Greenbrier loans that were repossessed or charged-off during 2009. At September 30, 2010, the Company had three loans for approximately \$9.7 million that are performing in accordance with contractual terms but for which management has concerns about the borrower's ability to continue to comply with repayment terms. These loans have been included in management's analysis for assessing the adequacy of the allowance for loan losses.

The average recorded investment in impaired loans during the nine months ended September 30, 2010 and 2009 was \$21.1 million and \$22.2 million, respectively. The Company recognized approximately \$0.3 million and \$0.1 million of interest income received in cash on non-accrual and impaired loans for the nine month periods ended September 30, 2010 and September 30, 2009, respectively. Approximately \$0.5 million and \$0.6 million of interest income would have been recognized during the nine month periods ended September 30, 2010 and September 30, 2009, respectively, if such loans had been current in accordance with their original terms. There were no commitments to provide additional funds on non-accrual, impaired, or other potential problem loans at September 30, 2010 and December 31, 2009. The Company recognized interest income of \$0.3 million and \$0.1 million using the accrual method of income recognition during the time period the loans were impaired for the nine month periods ended September 30, 2010 and September 30, 2009, respectively.

Interest on loans is accrued and credited to operations based upon the principal amount outstanding. The accrual of interest income is generally discontinued when a loan becomes 90 days past due as to principal or interest unless the loan is well collateralized and in the process of collection. When interest accruals are discontinued, interest credited to income in the current year that is unpaid and deemed uncollectible is charged to operations. Prior-year interest accruals that are unpaid and deemed uncollectible are charged to the allowance for loan losses, provided that such amounts were specifically reserved.

Information pertaining to impaired loans is included in the following table:

| (in thousands)  | September<br>30, 2010 | December<br>31, 2009 | September<br>30, 2009 |
|---|-----------------------|----------------------|-----------------------|
| Impaired loans with a valuation allowance             | \$ 13,862             | \$ 12,125            | \$ 11,069             |
| Impaired loans with no valuation allowance            | 7,210                 | 7,360                | 11,032                |
| Total impaired loans                                  | \$ 21,072             | \$ 19,485            | \$ 22,101             |
| Allowance for loan losses allocated to impaired loans | \$ 1,383              | \$ 1,826             | \$ 4,109              |



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Table eight

Allocation of the Allowance For Loan Losses

| (in thousands)                         | 2010      | As of<br>September 30,<br>2009 | As of<br>December<br>31,<br>2009 |
|--|-----------|--------------------------------|----------------------------------|
| Commercial, financial and agricultural | \$ 10,696 | \$ 12,835                      | \$ 11,030                        |
| Real estate-mortgage                   | 6,134     | 4,841                          | 5,515                            |
| Installment loans to individuals       | 104       | 200                            | 191                              |
| Overdraft deposit accounts             | 1,430     | 1,733                          | 1,805                            |
| Allowance for Loan Losses              | \$ 18,364 | \$ 19,609                      | \$ 18,541                        |

## Previously Securitized Loans

As of September 30, 2010, the Company reported a carrying value of previously securitized loans of \$1.3 million, while the actual outstanding contractual balance of these loans was \$12.9 million. The Company accounts for the difference between the carrying value and the total expected cash flows of previously securitized loans as an adjustment of the yield earned on these loans over their remaining lives. The discount is accreted to income over the period during which payments are probable of collection and are reasonably estimable. If, upon periodic evaluation, the estimate of the total probable collections is increased or decreased but is still greater than the sum of the original carrying amount less subsequent collections plus the discount accreted to date, and it is probable that collection will occur, the amount of the discount to be accreted is adjusted accordingly and the amount of periodic accretion is adjusted over the remaining lives of the loans. If, upon periodic evaluation, the discounted present value of estimated future cash flows declines below the recorded value of previously securitized loans, an impairment charge would be provided through the Company's provision for loan losses.

During the nine months ended September 30, 2010 and for the year ended December 31, 2009, the Company has experienced net recoveries on these loans primarily due to increased collection efforts. Subsequent to our assumption of the servicing of these loans during 2005, the Company has averaged net recoveries. Previously management did believe that the trend of net recoveries could be sustained indefinitely. However, the trend of net recoveries has continued.

During the first nine months of 2010 and 2009, the Company recognized \$3.3 million and \$3.1 million, respectively, of interest income on its previously securitized loans. During the second quarter of 2010, the Company recognized \$1.1 million of additional interest income related to three of the six pools of previously securitized loans that had a negative carrying value due to actual recoveries that exceeded estimates and discount accretion previously recognized. As a result, the September 30, 2010 carrying value for these three pools is \$0 and future cash receipts related to these three pools will be recognized in interest income as received. Cash receipts for the three and nine months ended September 30, 2010 and 2009 are summarized in the following table:

| (in thousands)           | Three months ended,<br>September 30, |          | Nine months ended<br>September 30, |          |
|--------------------------|--------------------------------------|----------|------------------------------------|----------|
|                          | 2010                                 | 2009     | 2010                               | 2009     |
| Principal receipts       | \$ 731                               | \$ 1,030 | \$ 2,287                           | \$ 2,949 |
| Interest income receipts | 358                                  | 555      | 1,309                              | 1,687    |
| Total cash receipts      | \$ 1,089                             | \$ 1,585 | \$ 3,596                           | \$ 4,636 |

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Based on current cash flow projections, the Company believes that the carrying value of previously securitized loans will approximate:

| As of:            | Estimated Balance: |
|-------------------|--------------------|
| December 31, 2010 | \$1.1 million      |
| December 31, 2011 | 0.9 million        |
| December 31, 2012 | 0.7 million        |
| December 31, 2013 | 0.6 million        |

#### Non-Interest Income and Non-Interest Expense

Nine Months Ended September 30, 2010 vs. 2009

Non-Interest Income: During the first nine months of 2010, the Company recorded \$4.8 million of credit-related net investment impairment losses. The charges deemed to be other than temporary were related to pooled bank trust preferreds (\$1.7 million credit-related net impairment losses) with a remaining book value of \$6.5 million at September 30, 2010, single issuer bank trust preferreds (\$0.6 million credit-related net impairment losses) with a remaining book value of \$75.4 million at September 30, 2010 and community bank and bank holding company equity positions (\$2.5 million credit-related net impairment losses) with remaining book value of \$5.1 million at September 30, 2010. The credit-related net impairment charges related to the pooled bank trust preferred securities and single issuer bank trust preferred securities (Cascade Capital Trust I issued by Cascade Financial of Everett, Washington) were based on the Company's quarterly reviews of its investment securities for indications of losses considered to be other than temporary. Based on management's assessment of the securities the Company owns, the seniority position of the securities within the pools, the level of defaults and deferred payments within the pools, and a review of the financial strength of the banks within the respective pools, management concluded that credit-related impairment charges of \$1.7 million and \$0.6 million on the pooled bank trust preferred securities and single issuer bank trust preferred securities, respectively, were appropriate for the nine months ended September 30, 2010. The credit-related net impairment charges of \$2.5 million related to the Company's equity position in First United Corporation of Oakland, Maryland. The Company determined that this security was other-than-temporarily impaired due to the recent announcement by First United Corporation of another quarterly loss, which continued a trend of poor performance over the past several quarters. As a result, management determined that the length of time and extent to which the market value of this security has been below the Company's cost basis is not expected to recover in the near term. These losses were partially offset by realized investment gains of \$1.3 million as the Company sold certain single issuer trust preferred securities with a remaining book value of \$75.4 million during the nine months ended September 30, 2010.

Exclusive of net other-than-temporary investment impairment losses and realized investment security gains/(losses), non-interest income decreased \$3.3 million to \$40.5 million in the first nine months of 2010 as compared to \$43.8 million in the first nine months of 2009. Service charges from depository accounts decreased \$3.0 million, or 9.0%, to \$30.4 million in the first nine months of 2010. This decline is primarily attributable to the Company's compliance with new federal rules under the Electronic Funds Transfer Act, also known as Regulation E. The changes to this regulation affect how banks can offer certain overdraft services, and were effective July 1, 2010 for new customers and August 15, 2010 for existing accounts. Additionally, insurance commission revenues decreased \$0.5 million, or 10.7%, from \$4.5 million during the first nine months of 2009 to \$4.0 million during the first nine months of 2010 due to decreased contingency payments.

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**Non-Interest Expense:** Non-interest expenses increased \$2.4 million from \$58.0 million in the first nine months of 2009 to \$60.3 million in the first nine months of 2010. Insurance and regulatory expense increased \$1.3 million, or 53.5%, from the quarter ended September 30, 2009 primarily as a result of the Company fully utilizing its FDIC credits during 2009 and increases in the assessment rates during 2010, which increased the Company's FDIC insurance expense from \$1.5 for the nine months ended September 30, 2009 to \$2.8 million for the nine months ended September 30, 2010. In addition, repossessed asset losses increased \$0.9 million primarily due to the write down of a foreclosed property located in the eastern panhandle of West Virginia. This write down was due to the results of an updated appraisal obtained on this property. The Company continually reevaluates the recorded value of properties that it has repossessed by obtaining updated appraisals on at least an annual basis. As a result of this write down, this foreclosed property is now valued at approximately one-half of its original cost.

**Income Tax Expense:** The Company's effective income tax rate for the first nine months of 2010 was 32.9% compared to 32.5% for the year ended December 31, 2009, and 33.5% for the nine months ended September 30, 2009. The effective rate is based upon the Company's expected tax rate for the year ending December 31, 2010.

Three Months Ended September 30, 2010 vs. 2009

**Non-Interest Income:** Exclusive of net other-than-temporary investment impairment losses and realized investment security gains/(loses), non-interest income decreased \$1.5 million to \$13.2 million in the third quarter of 2010 from \$14.7 million in the third quarter of 2009. Service charges from depository accounts decreased \$2.0 million, or 17.0%, to \$9.7 million in the third quarter of 2010. This decline is primarily attributable to the Company's compliance with new federal rules under the Electronic Funds Transfer Act, also known as Regulation E. The changes to this regulation affect how banks can offer certain overdraft services, and were effective July 1, 2010 for new customers and August 15, 2010 for existing accounts. The decrease in service charges from depository accounts was partially offset by an increase in bank owned life insurance revenues of \$0.3 million due to death benefit proceeds and an increase in insurance commission revenues of \$0.1 million or 11.4%, from \$1.2 million during the third quarter of 2009 to \$1.3 million during the third quarter of 2010.

**Non-Interest Expense:** Non-interest expenses increased \$1.0 million from \$18.8 million in the third quarter of 2009 to \$19.8 million in the third quarter of 2010. Insurance and regulatory expense increased \$0.8 million, or 202.7% from the quarter ended September 30, 2009 primarily due to the impact of the Company fully utilizing its FDIC credits during 2009 and increases in the assessment rates during 2010, which increased our FDIC insurance expense from \$0.1 million for the quarter ended September 30, 2009 to \$1.0 million for the quarter ended September 30, 2010. In addition, salaries and employee benefits increased \$0.2 million, or 2.0% from the quarter ended September 30, 2009 to \$9.8 million.

**Income Tax Expense:** The Company's effective income tax rate for the third quarter of 2010 was 31.4% compared to 32.5% for the year ended December 31, 2009, and 32.4% for the quarter ended September 30, 2009. The effective rate is based upon the Company's expected tax rate for the year ending December 31, 2010. During the quarter ended September 30, 2010, the Company realized \$0.1 million of previously unrecognized tax positions compared to \$0.2 million during the quarter ended September 30, 2009.

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Risk Management

Market risk is the risk of loss due to adverse changes in current and future cash flows, fair values, earnings or capital due to adverse movements in interest rates and other factors, including foreign exchange rates and commodity prices. Because the Company has no significant foreign exchange activities and holds no commodities, interest rate risk represents the primary risk factor affecting the Company's balance sheet and net interest margin. Significant changes in interest rates by the Federal Reserve could result in similar changes in LIBOR interest rates, prime rates, and other benchmark interest rates that could affect the estimated fair value of the Company's investment securities portfolio, interest paid on the Company's short-term and long-term borrowings, interest earned on the Company's loan portfolio and interest paid on its deposit accounts.

The Company's Asset and Liability Committee ("ALCO") has been delegated the responsibility of managing the Company's interest-sensitive balance sheet accounts to maximize earnings while managing interest rate risk. ALCO, comprised of various members of executive and senior management, is also responsible for establishing policies to monitor and limit the Company's exposure to interest rate risk and to manage the Company's liquidity position. ALCO satisfies its responsibilities through monthly meetings during which product pricing issues, liquidity measures, and interest sensitivity positions are monitored.

In order to measure and manage its interest rate risk, the Company uses an asset/liability management and simulation software model to periodically update the interest sensitivity position of the Company's balance sheet. The model is also used to perform analyses that measure the impact on net interest income and capital as a result of various changes in the interest rate environment. Such analyses quantify the effects of various interest rate scenarios on projected net interest income.

The Company's policy objective is to avoid negative fluctuations in net income or the economic value of equity of more than 15% within a 12-month period, assuming an immediate parallel increase or decrease of 300 basis points. The Company measures the long-term risk associated with sustained increases and decreases in rates through analysis of the impact to changes in rates on the economic value of equity. Due to the current Federal Funds target rate of 25 basis points, the Company has chosen not to reflect a decrease of 25 basis points from current rates in its analysis.

During 2005 and 2006, the Company entered into interest rate floors with a total notional value of \$600 million, with maturities between May 2008 and June 2011. These derivative instruments provided the Company protection against the impact of declining interest rates on future income streams from certain variable rate loans. During 2008, interest rate floors with a total notional value of \$150 million matured. The remaining interest rate floors with a total notional value of \$450 million were sold during 2008. The gains from the sales of these interest rate floors are being recognized over the remaining lives of the various hedged loans. At September 30, 2010, the unrecognized gain was approximately \$1.9 million.

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The following table summarizes the sensitivity of the Company's net income to various interest rate scenarios. The results of the sensitivity analyses presented below differ from the results used internally by ALCO in that, in the analyses below, interest rates are assumed to have an immediate and sustained parallel shock. The Company recognizes that rates are volatile, but rarely move with immediate and parallel effects. Internally, the Company considers a variety of interest rate scenarios that are deemed to be possible while considering the level of risk it is willing to assume in "worst-case" scenarios such as shown by the following:

| Immediate<br>Basis Point<br>Change<br>in Interest<br>Rates | Implied<br>Federal<br>Funds Rate<br>Associated<br>with<br>Change in<br>Interest<br>Rates | Estimated<br>Increase<br>(Decrease)<br>in<br>Net<br>Income<br>Over 12<br>Months | Estimated<br>Increase<br>(Decrease)<br>in<br>Economic<br>Value of<br>Equity |
|--|--|---|---|
| September<br>30, 2010:                                     |  |   |   |
| +300   | 3.25 %   | +12.2 %   | +13.6 %   |
| +200   | 2.25   | +6.8  | +7.6  |
| +100   | 1.25   | +0.9  | +5.1  |
| December<br>31, 2009:                                      |  |   |   |
| +300   | 3.25 %   | +9.3 %  | +16.3 %   |
| +200   | 2.25   | +5.8  | +11.6   |
| +100   | 1.25   | +1.5  | +5.7  |

These estimates are highly dependent upon assumptions made by management, including, but not limited to, assumptions regarding the manner in which interest-bearing demand deposit and saving deposit accounts reprice in different interest rate scenarios, pricing behavior of competitors, prepayments of loans and deposits under alternative rate environments, and new business volumes and pricing. As a result, there can be no assurance that the estimates above will be achieved in the event that interest rates increase during 2010 and beyond. The estimates above do not necessarily imply that the Company will experience increases in net income if market interest rates rise. The table above indicates how the Company's net income and the economic value of equity behave relative to an increase or decrease in rates compared to what would otherwise occur if rates remain stable.

Based upon the estimates above, the Company believes that its net income is positively correlated with increasing rates as compared to the level of net income the Company would expect if interest rates remain flat.

**Liquidity**

The Company evaluates the adequacy of liquidity at both the Parent Company level and at City National. At the Parent Company level, the principal source of cash is dividends from City National. Dividends paid by City National to the Parent Company are subject to certain legal and regulatory limitations. Generally, any dividends in amounts that exceed the earnings retained by City National in the current year plus retained net profits for the preceding two years must be approved by regulatory authorities. During 2008 and 2009, City National received regulatory approval to pay \$74.9 million of cash dividends to the Parent Company, while generating net profits of \$70.6 million. Therefore, City National was required to produce \$4.3 million of net profits prior to declaring any cash dividends to the Parent Company during 2010 without regulatory approval.



The Parent Company used cash obtained from the dividends received primarily to: (1) pay common dividends to shareholders, (2) remit interest payments on the Company's junior subordinated debentures, and (3) fund repurchase of the Company's common shares.

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Over the next 12 months, the Parent Company has an obligation to remit interest payments approximating \$0.6 million on the junior subordinated debentures held by City Holding Capital Trust III. Additionally, the Parent Company anticipates continuing the payment of dividends, which are expected to approximate \$21.1 million on an annualized basis over the next 12 months based on common shareholders of record at September 30, 2010. However, interest payments on the debentures can be deferred for up to five years under certain circumstances and dividends to shareholders can, if necessary, be suspended. In addition to these anticipated cash needs, the Parent Company has operating expenses and other contractual obligations, which are estimated to require \$0.6 million of additional cash over the next 12 months. As of September 30, 2010, the Parent Company reported a cash balance of \$2.6 million and management believes that the Parent Company's available cash balance, together with cash dividends from City National will be adequate to satisfy its funding and cash needs over the next twelve months.

Excluding the interest and dividend payments discussed above, the Parent Company has no significant commitments or obligations in years after 2010 other than the repayment of its \$16.5 million obligation under the debentures held by City Holding Capital Trust III. However, this obligation does not mature until June 2038, or earlier at the option of the Parent Company. It is expected that the Parent Company will be able to obtain the necessary cash, either through dividends obtained from City National or the issuance of other debt, to fully repay the debentures at their maturity.

City National manages its liquidity position in an effort to effectively and economically satisfy the funding needs of its customers and to accommodate the scheduled repayment of borrowings. Funds are available to City National from a number of sources, including depository relationships, sales and maturities within the investment securities portfolio, and borrowings from the FHLB and other financial institutions. As of September 30, 2010, City National's assets are significantly funded by deposits and capital. Additionally, City National maintains borrowing facilities with the FHLB and other financial institutions that are accessed as necessary to fund operations and to provide contingency funding mechanisms. As of September 30, 2010, City National has the capacity to borrow an additional \$411 million from the FHLB and other financial institutions under existing borrowing facilities. City National maintains a contingency funding plan, incorporating these borrowing facilities, to address liquidity needs in the event of an institution-specific or systemic financial industry crisis. Also, City National maintains a significant percentage (94.6%, or \$427.2 million at September 30, 2010) of its investment securities portfolio in the highly liquid available-for-sale classification. Although it has no current intention to do so, these securities could be liquidated, if necessary, to provide an additional funding source. City National also segregates certain mortgage loans, mortgage-backed securities, and other investment securities in a separate subsidiary so that it can separately monitor the asset quality of these primarily mortgage-related assets, which could be used to raise cash through securitization transactions or obtain additional equity or debt financing if necessary.

The Company manages its asset and liability mix to balance its desire to maximize net interest income against its desire to minimize risks associated with capitalization, interest rate volatility, and liquidity. With respect to liquidity, the Company has chosen a conservative posture and believes that its liquidity position is strong. The Company's net loan to asset ratio is 68.8% as of September 30, 2010 and deposit balances fund 82.2% of total assets. The Company has obligations to extend credit, but these obligations are primarily associated with existing home equity loans that have predictable borrowing patterns across the portfolio. The Company has significant investment security balances with carrying values that totaled \$451.6 million at September 30, 2010, and that greatly exceeded the Company's non-deposit sources of borrowing which totaled \$153.7 million. Further, the Company's deposit mix has a very high proportion of transaction and savings accounts that fund 45.1% of the Company's total assets.

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As illustrated in the Consolidated Statements of Cash Flows, the Company generated \$35.4 million of cash from operating activities during the first nine months of 2010, primarily from interest income received on loans and investments, net of interest expense paid on deposits and borrowings. The Company generated \$26.4 million of cash in investing activities during the first nine months of 2010 primarily from proceeds from sales, maturities and calls of securities available-for-sale net of funds used for the purchase of money market and mutual fund securities and to fund additional loans. The Company used \$41.7 million of cash in financing activities during the first nine months of 2010, primarily for cash dividends paid to the Company's common stockholders of \$16.1, the purchase of treasury stock of \$12.9 million, repayments of short-term borrowings of \$7.7 million, and noninterest bearing deposits decreased by \$11.2 million. These decreases were partially offset by an increase in interest-bearing deposits of \$6.3 million.

**Capital Resources**

During the first nine months of 2010, Shareholders' Equity increased \$5.9 million, or 1.9%, from \$308.9 million at December 31, 2009 to \$314.8 million at September 30, 2010. This increase was primarily due to reported net income of \$29.1 million and unrealized gains on available-for-sale securities of \$7.3 million. These increases were partially offset by dividends declared during the year of \$16.0 million, common stock purchases of \$12.9 million, and unrealized losses on interest rate floors of \$2.3 million.

During October 2009, the Board of Directors authorized the Company to buy back up to 1,000,000 shares of its common shares (approximately 6% of outstanding shares) in open market transactions at prices that are accretive to the earnings per share of continuing shareholders. No time limit was placed on the duration of the share repurchase program. 408,151 shares were repurchased during the first nine months of 2010 and there can be no assurance that the Company will continue to reacquire its common shares or to what extent the repurchase program will be successful. As of September 30, 2010, the Company may repurchase an additional 564,249 shares from time to time depending on market conditions under the authorization.

Regulatory guidelines require the Company to maintain a minimum total capital to risk-adjusted assets ratio of 8.0%, with at least one-half of capital consisting of tangible common stockholders' equity and a minimum Tier I leverage ratio of 4.0%. Similarly, City National is also required to maintain minimum capital levels as set forth by various regulatory agencies. Under capital adequacy guidelines, City National is required to maintain minimum total capital, Tier I capital, and leverage ratios of 8.0%, 4.0%, and 4.0%, respectively. To be classified as "well capitalized," City National must maintain total capital, Tier I capital, and leverage ratios of 10.0%, 6.0%, and 5.0%, respectively.

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The Company's regulatory capital ratios remained strong for both City Holding and City National as illustrated in the following table:

|                   | Minimum |   | Well-Capitalized |   | Actual             |                   |        |
|-------------------|---------|---|------------------|---|--------------------|-------------------|--------|
|                   |         |   |                  |   | September 30, 2010 | December 31, 2009 |        |
| City Holding:     |         |   |                  |   |                    |                   |        |
| Total             | 8.0     | % | 10.0             | % | 14.7               | %                 | 14.6 % |
| Tier I Risk-based | 4.0     |   | 6.0              |   | 13.7               |                   | 13.6   |
| Tier I Leverage   | 4.0     |   | 5.0              |   | 10.3               |                   | 10.2   |
| City National:    |         |   |                  |   |                    |                   |        |
| Total             | 8.0     | % | 10.0             | % | 13.1               | %                 | 12.3 % |
| Tier I Risk-based | 4.0     |   | 6.0              |   | 12.2               |                   | 11.3   |
| Tier I Leverage   | 4.0     |   | 5.0              |   | 9.1                |                   | 8.4    |

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Item 3 – Quantitative and Qualitative Disclosure of Market Risk

The information called for by this item is provided under the caption “Risk Management” under Item 2—Management’s Discussion and Analysis of Financial Condition and Results of Operations.

Item 4 – Controls and Procedures

Pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934, the Company carried out an evaluation, with the participation of the Company’s management, including the Company’s Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company’s disclosure controls and procedures (as defined under Rule 13a-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based upon that evaluation, the Company’s Chief Executive Officer and Chief Financial Officer concluded that the Company’s disclosure controls and procedures are effective in timely alerting them to material information relating to the Company required to be included in the Company’s periodic SEC filings. There has been no change in the Company’s internal control over financial reporting during the quarter ended June 30, 2010 that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting.

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## PART II – OTHER INFORMATION

## Item 1. Legal Proceedings.

The Company is engaged in various legal actions that it deems to be in the ordinary course of business. The Company believes that it has adequately provided for probable costs of current litigation. As these legal actions are resolved, however, the Company could realize positive and/or negative impact to its financial performance in the period in which these legal actions are ultimately decided. There can be no assurance that current actions will have immaterial results, either positive or negative, or that no material actions may be presented in the future.

## Item 1A. Risk Factors.

There have been no material changes to the factors disclosed in Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2009.

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

The following table sets forth information regarding the Company's common stock repurchases transacted during the quarter:

| Period                           | Total Number Of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans Or Programs (a) | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs |
|----------------------------------|----------------------------------|------------------------------|--|--|
| July 1 – July 31, 2010           | --                               | --                           | --   | 675,385  |
| August 1 – August 31, 2010       | 111,136                          | 28.72                        | 111,136  | 564,249  |
| September 1 – September 30, 2010 | --                               | --                           | --   | 564,249  |

(a) In October 2009, the Company announced that the Board of Directors had authorized the Company to buy back up to 1,000,000 shares of its common stock, in open market transactions at prices that are accretive to continuing shareholders. No timetable was placed on the duration of this share repurchase program.

Item 3. Defaults Upon Senior Securities. None.

Item 4. (Removed and Reserved) None.

Item 5. Other Information. None.

Item 6. Exhibits.  
(a) Exhibits

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- 31(a) Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for Charles R. Hageboeck
- 31(b) Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for David L. Bumgarner
- 32(a) Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 for Charles R. Hageboeck
- 32(b) Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 for David L. Bumgarner

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

City Holding  
Company  
(Registrant)

/s/ Charles R.  
Hageboeck  
Charles R. Hageboeck  
President and Chief Executive  
Officer  
(Principal Executive Officer)

/s/ David L.  
Bumgarner  
David L. Bumgarner  
Senior Vice President, Chief  
Financial Officer and Principal  
Accounting Officer  
(Principal Financial Officer)

Date: November 8, 2010