CITY HOLDING CO
Form 10-Q
May 08, 2013

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

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For The Quarterly Period Ended March 31, 2013
OR
[ ] TRANSITION REPORT PURSANT 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 or organization)	(I.R.S. Employer Identification No.)
25 Gatewater Road Charleston, West Virginia	25313
(Address of principal executive offices)	(Zip Code)

(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 [X] 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 [X] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer [ ]	Accelerated filer [X]
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 [X]

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 – 15,659,663 shares as of May 3, 2013.

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 could have adverse legal actions of a material nature; (4) the Company may face competitive loss of customers; (5) the Company may be unable to manage its expense levels; (6) the Company may have difficulty retaining key employees; (7) 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; (8) changes in general economic conditions and increased competition could adversely affect the Company's operating results; (9) 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; (10) the Company may experience difficulties growing loan and deposit balances; (11) the current economic environment poses significant challenges for us and could adversely affect our financial condition and results of operations; (12) 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; (13) the effects of the Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") recently adopted by the United States Congress; and (14) the integration of the operations of City Holding and Community Financial may be more difficult than anticipated. 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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City Holding Company and Subsidiaries

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PART I, ITEM 1 – FINANCIAL STATEMENTS
Consolidated Balance Sheets
City Holding Company and Subsidiaries
(in thousands)

	March 31, 2013 (unaudited)	December 31, 2012
Assets		
Cash and due from banks	$ 191,865	$ 58,718
Interest-bearing deposits in depository institutions	6,872	16,276
Federal funds sold	35,000	10,000
Cash and Cash Equivalents	233,737	84,994
Investment securities available for sale, at fair value	348,146	377,122
Investment securities held-to-maturity, at amortized cost (approximate fair value at March 31, 2013 and December 31, 2012 - $8,921 and $13,861, respectively)	8,383	13,454
Other securities	11,502	11,463
Total Investment Securities	368,031	402,039
Gross loans	2,497,023	2,146,369
Allowance for loan losses	(19,721)	(18,809)
Net Loans	2,477,302	2,127,560
Bank owned life insurance	89,645	81,901
Premises and equipment, net	82,002	72,728
Accrued interest receivable	8,701	6,692
Net deferred tax asset	45,983	32,737
Goodwill and other intangible assets	77,129	65,057
Other assets	46,067	43,758
Total Assets	$ 3,428,597	$ 2,917,466
Liabilities		
Deposits:		
Noninterest-bearing	$ 525,870	$ 429,969
Interest-bearing:		
Demand deposits	629,244	553,132
Savings deposits	603,191	506,869
Time deposits	1,125,946	919,346
Total Deposits	2,884,251	2,409,316
Short-term borrowings:		
Customer repurchase agreements	116,427	114,646
Long-term debt	16,495	16,495
Other liabilities	45,576	43,735
Total Liabilities	3,062,749	2,584,192
Shareholders' Equity		
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 March 31, 2013 and December 31, 2012, less 2,839,589 and 3,665,999 shares in treasury, respectively	46,249	46,249
Capital surplus	107,977	103,524

Retained earnings	311,193	309,270
Cost of common stock in treasury	(98,240)	(124,347)
Accumulated other comprehensive income (loss):		
Unrealized gain on securities available-for-sale	3,664	3,573
Underfunded pension liability	(4,995)	(4,995)
Total Accumulated Other Comprehensive Loss	(1,331)	(1,422)
Total Shareholders' Equity	365,848	333,274
Total Liabilities and Shareholders' Equity	$ 3,428,597	$ 2,917,466

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 March 31 2013	2012
Interest Income		
Interest and fees on loans	$ 29,939	$ 23,068
Interest on investment securities:		
Taxable	2,750	3,964
Tax-exempt	324	387
Interest on federal funds sold	13	11
Total Interest Income	33,026	27,430
Interest Expense		
Interest on deposits	3,227	3,668
Interest on short-term borrowings	71	73
Interest on long-term debt	157	167
Total Interest Expense	3,455	3,908
Net Interest Income	29,571	23,522
Provision for loan losses	1,738	1,950
Net Interest Income After Provision for Loan Losses	27,833	21,572
Non-interest Income		
Total investment securities impairment losses	-	-
Noncredit impairment losses recognized in other comprehensive income	-	-
Net investment securities impairment losses	-	-
Gains on sale of investment securities	84	(31)
Net investment securities gains (losses)	84	(31)
Service charges	6,535	6,048
Bankcard revenue	3,199	3,042
Insurance commissions	1,840	1,996
Trust and investment management fee income	990	807
Bank owned life insurance	812	723
Other income	866	533
Total Non-interest Income	14,326	13,118
Non-interest Expense		
Salaries and employee benefits	12,949	10,245
Occupancy and equipment	2,472	1,935
Depreciation	1,399	1,086
FDIC insurance expense	511	385
Advertising	735	644
Bankcard expenses	727	620
Postage, delivery, and statement mailings	605	548
Office supplies	441	455
Legal and professional fees	435	447
Telecommunications	445	389
Repossessed asset (gains) losses, net of expenses	(155)	121
Merger related costs	5,540	-
Other expenses	3,299	2,640
Total Non-interest Expense	29,403	19,515

Income Before Income Taxes		12,756		15,175
Income tax expense		4,769		5,144
Net Income Available to Common Shareholders	$	7,987	$	10,031
Total comprehensive income	$	8,078	$	12,201
Average common shares outstanding		15,473		14,679
Effect of dilutive securities:				
Employee stock options and warrants outstanding		154		80
Shares for diluted earnings per share		15,627		14,759
Basic earnings per common share	$	0.51	$	0.68
Diluted earnings per common share	$	0.51	$	0.67
Dividends declared per common share	$	0.37	$	0.35

See notes to consolidated financial statements.

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Consolidated Statements of Comprehensive Income (Unaudited)
City Holding Company and Subsidiaries
(in thousands)

	Three Months Ended March 31	
	2013	2012
Net income	$7,987	$10,031
Unrealized gains on available-for-sale securities arising during the period	228	3,450
Reclassification adjustments for (gains) losses	(84)	31
Other comprehensive income before income taxes	144	3,481
Tax effect	(53)	(1,311)
Other comprehensive income, net of tax	91	2,170
Comprehensive income, net of tax	8,078	12,201

See notes to consolidated financial statements.

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Consolidated Statements of Changes in Shareholders' Equity (Unaudited)
City Holding Company and Subsidiaries
Three Months Ended March 31, 2013 and 2012
(in thousands)

	Common Stock	Capital Surplus	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balances at December 31, 2011	$ 46,249	$ 103,335	$ 291,050	$ (125,593)	$ (3,907)	$ 311,134
Net income			10,031			10,031
Other comprehensive income					2,170	2,170
Cash dividends declared ($0.35 per share)			(5,147)			(5,147)
Stock-based compensation expense, net		(263)		705		442
Exercise of 16,899 stock options		(113)		601		488
Purchase of 88,000 treasury shares				(3,072)		(3,072)
Balances at March 31, 2012	$ 46,249	$ 102,959	$ 295,934	$ (127,359)	$ (1,737)	$ 316,046

	Common Stock	Capital Surplus	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balances at December 31, 2012	$ 46,249	$ 103,524	$ 309,270	$ (124,347)	$ (1,422)	$ 333,274
Net income			7,987			7,987
Other comprehensive income					91	91
Acquisition of Community Financial Corporation		4,434		24,272		28,706
			(6,064)			(6,064)

Cash dividends declared ($0.37 per share)						
Stock-based compensation expense, net		(91)		548		457
Exercise of 42,250 stock options		110		1,287		1,397
Balances at March 31, 2013	$ 46,249	$ 107,977	$ 311,193	$ (98,240)	$ (1,331)	$ 365,848

See notes to consolidated financial statements.

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

	Three Months Ended March 31	
	2013	2012
Net income	$7,987	$10,031
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization and accretion	(1,130)	682
Provision for loan losses	1,738	1,950
Depreciation of premises and equipment	1,399	1,086
Deferred income tax (benefit) expense	(1,151)	211
Net periodic employee benefit cost	329	14
Realized investment securities (gains) losses	(84)	31
Stock-compensation expense	457	442
Increase in value of bank-owned life insurance	(812)	(692)
Loans originated for sale	(11,554)	(7,664)
Proceeds from the sale of loans originated for sale	14,630	7,989
Change in accrued interest receivable	(615)	364
Change in other assets	4,119	1,056
Change in other liabilities	(620)	(3,731)
Net Cash Provided by Operating Activities	14,693	11,769
Proceeds from sales of securities available-for-sale	488	5,336
Proceeds from maturities and calls of securities available-for-sale	46,205	24,822
Proceeds from maturities and calls of securities held-to-maturity	5,083	-
Purchases of securities available-for-sale	(488)	(32,492)
Net decrease (increase) in loans	16,391	(2,033)
Purchases of premises and equipment	(1,700)	(1,971)
Acquisition of Community Bank, net of cash acquired	(21,849)	-
Net Cash Provided by (Used in) Investing Activities	44,130	(6,338)
Net increase in noninterest-bearing deposits	53,065	34,267
Net increase in interest-bearing deposits	39,138	44,643
Net increase (decrease) in short-term borrowings	1,781	(75,226)
Purchases of treasury stock	-	(3,072)
Proceeds from exercise of stock options	1,397	488
Dividends paid	(5,461)	(5,171)
Net Cash Provided by (Used in) Financing Activities	89,920	(4,071)
Increase in Cash and Cash Equivalents	148,743	1,360
Cash and cash equivalents at beginning of period	84,994	146,399
Cash and Cash Equivalents at End of Period	$233,737	$147,759

See notes to consolidated financial statements.

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Notes to Consolidated Financial Statements (Unaudited)
March 31, 2013

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 three months ended March 31, 2013 are not necessarily indicative of the results of operations that can be expected for the year ending December 31, 2013. 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, 2012 has been derived from audited financial statements included in the Company’s 2012 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 2012 Annual Report of the Company.

Certain amounts in the financial statements have been reclassified. Such reclassifications had no impact on shareholders’ equity or net income for any period.

Note B – Recent Accounting Pronouncements

In January 2013, the FASB issued ASU No. 2013-01, "Balance Sheet (Topic 210) - Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities". This ASU requires an entity to disclose both the gross and net information about financial instruments, such as derivatives, that are eligible for offset in the balance sheet. ASU No. 2013-01 became effective for the Company on January 1, 2013. See Note I - Derivative Instruments for applicable disclosures.

In February 2013, the FASB issued ASU No. 2013-02, “Comprehensive Income (Topic 220) – Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income.” This ASU requires entities to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amounts reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional detail about those amounts. ASU No. 2013-02 became effective for the Company beginning on January 1, 2013. The adoption of ASU No. 2013-02 did not have a material impact on the Company’s financial statements.

Note C – Acquisitions

On May 31, 2012, the Company acquired 100% of the outstanding common and preferred stock of Virginia Savings Bancorp, Inc. and its wholly owned subsidiary, Virginia Savings Bank (collectively, “VSB”). As a result of this acquisition, the Company acquired five branches which expanded its footprint into Virginia. At the time of closing, VSB had total assets of $132 million, loans of $82 million, deposits of $120 million and shareholders’ equity of $11 million. The total transaction was valued at $12.4 million, consisting of cash of $4.7 million and approximately 240,000 shares of common stock valued at $7.7 million. The common stock was valued based on the closing price of $32.18 for the Company's common shares on May 31, 2012.

On January 10, 2013, the Company acquired 100% of the outstanding common and preferred stock of Community Financial Corporation and its wholly owned subsidiary Community Bank (collectively, "Community"). As a result of this acquisition, the Company acquired eight branches along the I-81 corridor in western Virginia and two branches in Virginia Beach, Virginia. At the time of closing, Community had total assets of $460 million, loans of $410 million, deposits of $380 million and shareholders' equity of $53 million. Community shareholders received 0.1753 shares of the Company's common stock for each share of Community Financial Corporation stock, resulting in the issuance of approximately 767,000 shares of the Company's common stock valued at $28 million. The common stock was valued based on the closing price of $36.23 for the Company's commons shares on January 9, 2013. In conjunction with this acquisition, the Company repurchased $12.7 million of Community preferred stock previously issued to the U.S. Department of Treasury ("Treasury Department"). A related warrant issued by Community to the Treasury Department has been converted into a warrant to purchase 61,565 shares of the Company's common stock, with an exercise price of $30.80 per share. Based on the preliminary purchase price allocation, the Company recorded an estimate of goodwill of $9.5 million and a core deposit intangible of $2.7 million as a result of this acquisition. The Company has recorded estimates of the fair values of the acquired assets and liabilities. These fair value estimates are provisional amounts based on third party valuations that are currently under review.

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The preliminary purchase price of both acquisitions has been allocated as follows (in thousands):

	VSB	(preliminary) Community	Total
Date of acquisition:	May 31, 2012	January 10, 2013	
Consideration:			
Cash	$4,672	$ 12,738	$17,410
Common stock	7,723	27,783	35,506
Warrant issued	-	924	924
	$12,395	$ 41,445	$53,840
Identifiable assets:			
Cash and cash equivalents	$24,943	$ 8,888	$33,831
Investment securities	14,082	17,698	31,780
Loans	73,463	369,071	442,534
Bank owned life insurance	-	6,935	6,935
Premises and equipment	5,158	8,950	14,108
Deferred tax asset, net	4,173	14,945	19,118
Other assets	4,626	8,143	12,769
Total identifiable assets	126,445	434,630	561,075
Identifiable liabilities:			
Deposits	122,723	383,070	505,793
Other liabilities	841	22,304	23,145
Total identifiable liabilities	123,564	405,374	528,938
Net identifiable assets	2,881	29,256	32,137
Goodwill	8,241	9,478	17,719
Core deposit intangible	1,273	2,711	3,984
	$12,395	$ 41,445	$53,840

In determining the estimated fair value of the acquired loans, management considered several factors, such as estimated future credit losses, estimated prepayments, remaining lives of the acquired loans, estimated value of the underlying collateral and the net present value of the cash flows expected to be received. For smaller loans not specifically reviewed, management grouped the loans into their respective homogeneous loan pool and applied a loss estimate accordingly.

Acquired loans are accounted for using one of the two following accounting standards:

(1) ASC Topic 310-20 is used to value loans that do not have evidence of credit quality deterioration. For these loans, the difference between the fair value of the loan and the amortized cost of the loan would be amortized or accreted into income using the interest method.

(2) ASC Topic 310-30 is used to value loans that have evidence of credit quality deterioration. For these loans, the expected cash flows that exceed the fair value of the loan represent the accretable yield, which is recognized as interest income on a level-yield basis over the expected cash flow periods of the loans. The non-accretable difference represents the difference between the contractually required principal and interest payments and the cash flows expected to be collected based upon management's estimation. Subsequent decreases in the expected cash flows will require the Company to evaluate the need for additions to the Company's allowance for loan losses. Subsequent increases in the expected cash flows will result in a reversal of the provision for loan losses to

the extent of prior charges with a corresponding adjustment to the accretable yield, which will result in the recognition of additional interest income over the remaining lives of the loans.

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The following table presents the purchased credit-impaired loans acquired in conjunction with the both acquisitions (in thousands):

	VSB	Community	Total
Contractually required principal and interest	$11,567	$ 77,770	$89,337
Contractual cash flows not expected to be collected (non-accretable difference)	(3,973)	(25,499)	(29,472)
Expected cash flows	7,594	52,271	59,865
Interest component of expected cash flows (accretable difference)	(954)	(6,721)	(7,675)
Estimated fair value of purchased credit impaired loans acquired	$6,640	$ 45,550	$52,190

The fair values of non-time deposits approximated their carrying value at the acquisition date. For time deposits, the fair values were estimated based on discounted cash flows, using interest rates that are currently being offered compared to the contractual interest rates. Based on these analyses, management recorded a premium of $2.3 million and $1.1 million, for the VSB and Community acquisitions, respectively, each of which is being amortized over five years.

Core Deposit Intangible

The Company believes that the customer relationships with the deposits acquired have an intangible value. In connection with these acquisitions, the Company recorded core deposit intangible assets of $1.3 million and $2.7 million, for VSB and Community, respectively. Each of the core deposit intangible assets represent the value of the relationship that the acquiree had with their deposit customers. The fair value was estimated based on a discounted cash flow methodology that considered type of deposit, deposit retention and the cost of the deposit base. These core deposit intangible assets are being amortized over ten years, with an annual charge of less than $0.7 million per year. The following table presents a rollforward of the Company's intangible assets from the beginning of the year (in thousands):

	Intangible Assets
Balance, January 1, 2013	$2,069
Core deposit intangible acquired in conjunction with the acquisition of Community	2,711
Amortization expense	(260)
Balance, March 31, 2013	$4,520

Goodwill

Under U.S. GAAP, management has up to twelve months following the date of the acquisition to finalize the fair values of acquired assets and liabilities. The measurement period ends as soon as the Company receives information it was seeking about facts and circumstances that existed as of the acquisition date or learns more information is not obtainable. Any subsequent adjustments to the fair value of the acquired assets and liabilities, intangible assets or other purchase accounting adjustments during the measurement period will result in adjustments to the goodwill recorded. The measurement period is limited to one year from the acquisition date. The goodwill recorded in conjunction with the VSB and Community acquisitions is not expected to be deductible for tax purposes. The following table presents a roll-forward of goodwill from the beginning of the year (in thousands):

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	Goodwill
Balance, January 1, 2013	$62,988
Adjustment to goodwill acquired in conjunction with the acquisition of VSB	143
Goodwill acquired in conjunction with the acquisition of Community	9,478
Balance, March 31, 2013	$72,609

During the three months ended March 31, 2013, the Company incurred $5.5 million of merger-related costs in connection with the Community Financial acquisition. These costs were primarily for severance and professional fees for services rendered in conjunction with the acquisition.

Note D –Investments

The amortized cost and estimated fair values of securities follow.

	March 31, 2013				December 31, 2012			
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities available-for-sale:								
U.S. Treasuries and U.S. government agencies	$3,295	$ 88	$ -	$3,383	$3,792	$ 96	$ -	$3,888
Obligations of states and political subdivisions	44,311	1,508	18	45,801	47,293	1,651	15	48,929
Mortgage-backed securities:								
U.S. government agencies	254,154	6,092	209	260,037	279,336	7,231	85	286,482
Private label	2,946	27	5	2,968	3,235	37	-	3,272
Trust preferred securities	15,375	101	2,616	12,860	15,402	55	2,812	12,645
Corporate securities	16,146	347	-	16,493	16,152	207	412	15,947
Total Debt Securities	336,227	8,163	2,848	341,542	365,210	9,277	3,324	371,163
Marketable equity securities	3,381	1,460	-	4,841	3,381	804	-	4,185
Investment funds	1,724	39	-	1,763	1,724	50	-	1,774
Total Securities Available-for-Sale	$341,332	$ 9,662	$ 2,848	$348,146	$370,315	$ 10,131	$ 3,324	$377,122

	March 31, 2013	December 31, 2012
(In thousands)		

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities held-to-maturity								
Trust preferred securities	$8,383	$ 545	$ 7	$ 8,921	$13,454	$ 465	$ 58	$ 13,861
Total Securities Held-to-Maturity	$8,383	$ 545	$ 7	$ 8,921	$13,454	$ 465	$ 58	$ 13,861
Other investment securities:								
Non-marketable equity securities	$11,502	$ -	$ -	$ 11,502	$11,463	$ -	$ -	$ 11,463
Total Other Investment Securities	$11,502	$ -	$ -	$ 11,502	$11,463	$ -	$ -	$ 11,463

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). 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.

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	March 31, 2013					
	Less Than Twelve Months		Twelve Months or Greater		Total	
(In thousands)	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Securities available-for-sale:						
Obligations of states and political subdivisions	$ 1,131	$ 18	$ -	$ -	$ 1,131	$ 18
Mortgage-backed securities:						
U.S. Government agencies	25,709	209		-	25,709	209
Private label	1,938	5	-	-	1,938	5
Trust preferred securities	3,198	253	6,211	2,363	9,409	2,616
Total	$ 31,976	$ 485	$ 6,211	$ 2,363	$ 38,187	$ 2,848
Securities held-to-maturity:						
Trust preferred securities	$ 3,083	$ 7	$ -	$ -	$ 3,083	$ 7

	December 31, 2012					
	Less Than Twelve Months		Twelve Months or Greater		Total	
(In thousands)	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Securities available-for-sale:						
Obligations of states and political subdivisions	$ 1,163	$ 15	$ -	$ -	$ 1,163	$ 15
Mortgage-backed securities:						
U.S. Government agencies	16,225	85	-	-	16,225	85
Trust preferred securities	348	51	5,836	2,761	6,184	2,812
Corporate securities	1,950	49	4,344	363	6,294	412
Total	$ 19,686	$ 200	$ 10,180	$ 3,124	$ 29,866	$ 3,324
Securities held-to-maturity:						
Trust preferred securities	$ -	$ -	$ 3,380	$ 58	$ 3,380	$ 58

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: First National Corporation and First United Corporation.

During the first quarter of 2013, the Company did not record any credit-related net investment impairment losses. During 2012, the Company recorded $0.6 million in credit-related net investment impairment losses. The charges deemed to be other-than-temporary were related to pooled bank trust preferred securities with a remaining carrying value of $3.5 million at December 31, 2012. The credit-related net impairment charges related to the pooled bank trust preferred securities were based on the Company's quarterly reviews of its investment securities for indications of losses considered to be other-than-temporary.

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 minimal, 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 smaller community bank 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.

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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 March 31, 2013, 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 March 31, 2013, 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 that the other-than-temporary impairment is identified, while any noncredit loss will be recognized in other comprehensive income.

At March 31, 2013, the book value of the Company's five pooled trust preferred securities totaled $6.7 million with an estimated fair value of $3.5 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 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 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. 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.

The Company utilizes 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. For issuing banks that have defaulted, management generally 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. In addition, the model assumes no recoveries except for one trust preferred security which assumes that one of the banks currently deferring or in default will cure such positions. 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.

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The following table presents a progression of the credit loss component of OTTI on debt and equity securities recognized in earnings during the three months ended March 31, 2013 and for the year ended December 31, 2012. The credit loss component represents the difference between the present value of expected future cash flows and the amortized cost basis of the security. The credit component of OTTI recognized in earnings during a period is presented in two parts based upon whether the credit impairment in the current period is the first time the security was credit impaired (initial credit impairment) or if there is additional credit impairment on a security that was credit impaired in previous periods.

(In thousands)	Debt Securities	Equity Securities	Total
Balance at January 1, 2012	$20,610	$6,048	$26,658
Additions:			
Initial credit impairment	-	-	-
Additional credit impairment	576	-	576
Deductions:			
Sold	-	(1,235)	(1,235)
Balance December 31, 2012	21,186	4,813	25,999
Additions:			
Initial credit impairment	-	-	-
Additional credit impairment	-	-	-
Deductions:			
Sold	-	-	-
Balance March 31, 2013	$21,186	$4,813	$25,999

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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 March 31, 2013:
(Dollars in thousands)

Deal Name	Type	Class	Original Cost	Amortized Cost	Fair Value	Difference (1)	Lowest Credit Rating	# of issuers currently performing	Actual deferrals/defaults (as a % of original dollar)	Expected deferrals/defaults (as a % of remaining of performing collateral)	Excess Subordination as a Percentage of Current Performing Collateral (4)
	Pooled trust preferred securities:										
	Available for Sale:										
P1	Pooled	Mezz	$ 1,087	$ 425	$ 225	(200)	Ca	9	19.5 %	14.2 % (2)	25.9 %
P2	Pooled	Mezz	3,944	1,197	1,041	(156)	Ca	10	25.9 %	6.4 % (2)	11.5 %
P3 (5)	Pooled	Mezz	2,962	1,419	299	(1,120)	Caa3	22	24.5 %	8.2 % (2)	12.2 %
P4 (6)	Pooled	Mezz	4,060	400	168	(232)	Ca	9	19.2 %	8.2 % (3)	20.2 %
P5	Pooled	Mezz	6,046	826	477	(349)	Ca	10	26.0 %	21.0 % (2)	15.6 %
	Held-to-Maturity:										
P6	Pooled	Mezz	2,102	211	451	240	Ca	9	19.5 %	14.2 % (2)	25.9 %
P7	Pooled	Mezz	5,237	1,082	1,388	306	Ca	10	25.9 %	6.4 % (2)	11.5 %
	Single issuer trust preferred securities										
	Available for sale:										
S1	Single		261	235	232	(3)	NR	1	-	-	
S2	Single		1,000	1,000	1,034	34	Ba3	1	-	-	
	Held-to-Maturity:										
S3	Single		4,000	4,000	4,000	-	NR	1	-	-	
S4	Single		3,360	3,091	3,083	(8)	NR	1	-	-	

(1) The differences noted consist of unrealized losses recorded at March 31, 2013 and noncredit other-than-temporary impairment losses 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 model for this security assumes that all collateral that is currently deferring will default with a zero recovery rate. The underlying issuers can cure, thus this bond could recover at a higher percentage upon default than zero.

(3) Performing collateral is defined as total collateral minus all collateral that has been called, is currently deferring, or currently in default. The model for this security assumes that one of the banks that are currently deferring will cure. If additional underlying issuers cure, this bond could recover at a higher percentage.

(4) 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.

(5) No other-than-temporary impairment losses were recognized during the three months ended March 31, 2013. Other-than-temporary impairment losses of $11,000 were recognized during the year ended December 31, 2012.

(6) No other-than-temporary impairment losses were recognized during the three months ended March 31, 2013. Other-than-temporary impairment losses of $565,000 were recognized during the year ended December 31, 2012.

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The amortized cost and estimated fair value of debt securities at March 31, 2013, 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 Fair Value
Securities Available-for-Sale		
Due in one year or less	6,390	6,433
Due after one year through five years	27,166	27,635
Due after five years through ten years	49,244	51,234
Due after ten years	253,427	256,240
	$336,227	$341,542
Securities Held-to-Maturity		
Due in one year or less	-	-
Due after one year through five years	-	-
Due after five years through ten years	-	-
Due after ten years	8,383	8,921
	$8,383	$8,921

The Company recognized $0.1 million in gross gains from investment security transactions during the three months ended March 31, 2013. The Company recognized less than $0.1 million in gross losses from investment security transactions during the three months ended March 31, 2012. 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 $224 million and $228 million at March 31, 2013 and December 31, 2012, respectively.

Note E –Loans

The following summarizes the Company's major classifications for loans:

(In thousands)	March 31, 2013	December 31, 2012
Residential real estate	$1,149,411	$1,031,435
Home equity – junior liens	138,333	143,110
Commercial and industrial	149,677	108,739
Commercial real estate	1,001,453	821,970
Consumer	55,274	36,564
DDA overdrafts	2,875	4,551
Gross loans	2,497,023	2,146,369
Allowance for loan losses	(19,721)	(18,809)
Net loans	$2,477,302	$2,127,560

Construction loans of $16.9 million and $15.4 million are included within residential real estate loans at March 31, 2013 and December 31, 2012, respectively. Construction loans of $26.2 million and $15.4 million are included within commercial real estate loans at March 31, 2013 and December 31, 2012, respectively. The Company's commercial and residential real estate construction loans are primarily secured by real estate within the Company's principal markets. These loans were originated under the Company's loan policy, which is focused on the risk characteristics of the loan portfolio, including construction loans. Adequate consideration has been given to these loans in establishing the Company's allowance for loan losses.

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The information in the following tables related to the Community Financial Corporation ("Community") acquisition are estimated amounts, based on management's assumptions. Once the purchase price allocation is finalized, actual results could be significantly different from those assumed below.

The following table details the loans acquired in conjunction with the Virginia Savings Bancorp, Inc. ("VSB") and the Community acquisitions.

	VSB	Community	Total
As of March 31, 2013:			
Outstanding loan balance	$61,012	$ 347,330	$408,342
Credit-impaired loans:			
Carrying value	5,886	42,200	48,086
Contractual principal and interest	8,789	74,365	83,154
As of December 31, 2012:			
Outstanding loan balance	$65,219	$ -	$65,219
Credit-impaired loans:			
Carrying value	7,018	-	7,018
Contractual principal and interest	10,759	-	10,759

Changes in the accretable yield and carrying amount for purchased credit-impaired loans for the three months ended March 31, 2013 is as follows:

	VSB		Community		Total	
	Accretable Yield	Carrying Amount of Loans	Accretable Yield	Carrying Amount of Loans	Accretable Yield	Carrying Amount of Loans
Balance at the beginning of the period	$1,823	$7,018	$-	$-	$1,823	$7,018
Additions	-	16	6,721	45,550	6,721	45,566
Accretion	(358)	358	(55)	55	(413)	413
Net reclassifications to accretable from non-accretable	-	-	-	-	-	-
Payments received, net	-	(1,506)	-	(3,405)	-	(4,911)
Disposals	(64)	-	-	-	(64)	-
Balance at the end of period	$1,401	$5,886	$6,666	$42,200	$8,067	$48,086

A reconciliation of the contractual required principal and interest balance to the basis of purchased credit-impaired loans as of March 31, 2013 is as follows:

	VSB	Community	Total
Contractual required principal and interest	$8,789	$ 74,365	$83,154
Nonaccretable difference	(1,502)	(25,499)	(27,001)

Expected cash flows	7,287	48,866	56,153
Accretable yield	(1,401)	(6,666)	(8,067)
Basis in acquired loans	$5,886	$ 42,200	$48,086

Increases in expected cash flow subsequent to the acquisition are recognized prospectively through adjustment of yield on the loans or pools over its remaining life, while decreases in expected cash flows are recognized as impairment through a provision for loan loss and an increase in the allowance for purchased credit-impaired loans.

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Note F –Allowance For Loan Losses

Management systematically monitors the loan portfolio and the adequacy of the allowance for loan losses 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 types of loan types is often based more upon specific credit reviews, with consideration given to the potential impairment of certain credits and historical loss rates, adjusted for economic conditions and other inherent risk factors.

A loan acquired and accounted for under ASC Topic 310-30 is reported as an accruing loan and a performing asset.

The following summarizes the activity in the allowance for loan loss, by portfolio segment, for the three months ended March 31, 2013 and 2012. The following also presents the balance in the allowance for loan loss disaggregated on the basis of the Company's impairment measurement method and the related recorded investment in loans, by portfolio segment, as of March 31, 2013 and December 31, 2012.

(In thousands)	Commercial and industrial	Commercial real estate	Residential real estate	Home equity	Consumer	DDA overdrafts	Total
Three months ended March 31, 2013:							
Allowance for loan loss							
Beginning balance	$ 498	$ 10,440	$ 5,229	$ 1,699	$ 81	$ 862	$ 18,809
Charge-offs	62	203	591	116	3	339	1,314
Recoveries	1	18	48	-	147	274	488
Provision	67	554	1,189	52	(149)	25	1,738
Ending balance	$ 504	$ 10,809	$ 5,875	$ 1,635	$ 76	$ 822	$ 19,721
Three months ended March 31, 2012:							
Allowance for loan loss							
Beginning balance	$ 590	$ 11,666	$ 3,591	$ 2,773	$ 88	$ 701	$ 19,409
Charge-offs	69	1,989	198	509	59	335	3,159
Recoveries	3	96	4	1	29	295	428
Provision	25	682	353	701	51	138	1,950
Ending balance	$ 549	$ 10,455	$ 3,750	$ 2,966	$ 109	$ 799	$ 18,628
As of March 31, 2013:							

Allowance for loan loss							
Evaluated for impairment:							
Individually	$ -	$ 750	$ -	$ -	$ -	$ -	$ 750
Collectively	504	10,059	5,875	1,635	76	822	18,971
Acquired with deteriorated							
credit quality	-	-	-	-	-	-	-
Total	$ 504	$ 10,809	$ 5,875	$ 1,635	$ 76	$ 822	$ 19,721
Loans							
Evaluated for impairment:							
Individually	$ -	$ 12,719	$ 466	$ 298	$ -	$ -	$ 13,483
Collectively	142,647	952,515	1,146,718	135,425	55,274	2,875	2,435,454
Acquired with deteriorated							
credit quality	7,030	36,219	2,227	2,610	-	-	48,086
Total	$ 149,677	$ 1,001,453	$ 1,149,411	$ 138,333	$ 55,274	$ 2,875	$ 2,497,023
As of December 31, 2012:							
Allowance for loan loss							
Evaluated for impairment:							
Individually	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Collectively	498	10,440	5,229	1,699	81	862	18,809
Acquired with deteriorated							
credit quality	-	-	-	-	-	-	-
Total	$ 498	$ 10,440	$ 5,229	$ 1,699	$ 81	$ 862	$ 18,809
Loans							
Evaluated for impairment:							
Individually	$ -	$ 9,912	$ 469	$ 298	$ -	$ -	$ 10,679
Collectively	107,044	807,060	1,030,840	142,724	36,453	4,551	2,128,672
Acquired with deteriorated							
credit quality	1,695	4,998	126	88	111	-	7,018
Total	$ 108,739	$ 821,970	$ 1,031,435	$ 143,110	$ 36,564	$ 4,551	$ 2,146,369

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Credit Quality Indicators

All commercial loans within the portfolio are subject to internal risk grading. All non-commercial loans are evaluated based on payment history. The Company's internal risk ratings for commercial loans are: Pass, Special Mention, Substandard and Doubtful. Each internal risk rating is defined in the loan policy using the following criteria: balance sheet yields, ratios and leverage, cash flow spread and coverage, prior history, capability of management, market position/industry, potential impact of changing economic, legal, regulatory or environmental conditions, purpose structure, collateral support, and guarantor support. Risk grades are generally assigned by the primary lending officer and are periodically evaluated by the Company's internal loan review process. Based on an individual loan's risk grade, estimated loss percentages are applied to the outstanding balance of the loan to determine the amount of probable loss.

The Company categorizes loans into risk categories based on relevant information regarding the customer's debt service ability, capacity, overall collateral position along with other economic trends, and historical payment performance. The risk grades for each credit are updated when the Company receives current financial information, the loan is reviewed by the Company's internal loan review/credit administration departments, or the loan becomes delinquent or impaired. The risk grades are updated a minimum of annually for loans rated pass. Loans rated special mention, substandard or doubtful are reviewed at least quarterly. The Company uses the following definitions for its risk ratings:

Risk Rating	Description
Pass ratings:	
(a) Exceptional	Loans classified as exceptional are secured with liquid collateral conforming to the internal loan policy. Loans rated within this category pose minimal risk of loss to the bank and the risk grade within this pool of loans is generally updated on an annual basis.
(b) Good	Loans classified as good have similar characteristics that include a strong balance sheet, satisfactory debt service coverage ratios, strong management and/or guarantors, and little exposure to economic cycles. Loans within this category are generally reviewed on an annual basis. Loans in this category generally have a low chance of loss to the bank.
(c) Acceptable	Loans classified as acceptable have acceptable liquidity levels, adequate debt service coverage ratios, experienced management, and have average exposure to economic cycles. Loans within this category generally have a low risk of loss to the bank.
(d) Pass/watch	Loans classified as pass/watch have erratic levels of leverage and/or liquidity, cash flow is volatile and the borrower is subject to moderate economic risk. A borrower in this category poses a low to moderate risk of loss to the bank.
Special mention rating	Loans classified as special mention have a potential weakness(es) that deserves management's close attention. The potential weakness could result in deterioration of the loan repayment or the bank's credit position at some future date. A loan rated in this category poses a moderate loss

	risk to the bank.
Substandard rating	Loans classified as substandard reflect a customer with a well defined weakness that jeopardizes the liquidation of the debt. Loans in this category have the possibility that the bank will sustain some loss if the deficiencies are not corrected and the bank's collateral value is weakened by the financial deterioration of the borrower.
Doubtful rating	Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristics that make collection of the full contract amount highly improbable. Loans rated in this category are most likely to cause the bank to have a loss due to a collateral shortfall or a negative capital position.

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The following table presents the Company's commercial loans by credit quality indicators, by class:

	Commercial and Industrial	Commercial Real Estate	Total Commercial Loans
March 31, 2013:			
Pass	$ 136,926	$ 911,280	$ 1,048,206
Special mention	4,866	34,554	39,420
Substandard	7,330	53,295	60,625
Doubtful	555	2,324	2,879
Total	$ 149,677	$ 1,001,453	$ 1,151,130
December 31, 2012:			
Pass	$ 105,690	$ 771,617	$ 877,307
Special mention	878	15,015	15,893
Substandard	2,171	35,338	37,509
Doubtful	-	-	-
Total	$ 108,739	$ 821,970	$ 930,709

The following table presents the Company's non-commercial loans by payment performance, by class:

	Performing	Non-Performing	Total
March 31, 2013:			
Residential real estate	$ 1,146,028	$ 3,383	$ 1,149,411
Home equity - junior lien	138,275	58	138,333
Consumer	55,273	1	55,274
DDA overdrafts	2,875	-	2,875
Total	$ 1,342,451	$ 3,442	$ 1,345,893
December 31, 2012:			
Residential real estate	$ 1,029,142	$ 2,293	$ 1,031,435
Home equity - junior lien	141,961	1,149	143,110
Consumer	36,564	-	36,564
DDA overdrafts	4,548	3	4,551
Total	$ 1,212,215	$ 3,445	$ 1,215,660

Aging Analysis of Accruing and Non-Accruing Loans

Interest income on loans is accrued and credited to operations based upon the principal amount outstanding, using methods that generally result in level rates of return. Loan origination fees, and certain direct costs, are deferred and amortized as an adjustment to the yield over the term of the loan. The accrual of interest generally is discontinued when a loan becomes 90 days past due as to principal or interest for all loan types. However, any loan may be placed on non-accrual if the Company receives information that indicates a borrower is unable to meet the contractual terms of their respective loan agreement. Other indicators considered for placing a loan on non-accrual status include the borrower's involvement in bankruptcies, foreclosures, repossessions, litigation and any other situation resulting in doubt as to whether full collection of contractual principal and interest is attainable. When interest accruals are discontinued, unpaid interest recognized in income in the current year is reversed, and interest accrued in prior years is charged to the allowance for loan losses. Management may elect to continue the accrual of interest when the net realizable value of collateral exceeds the principal balance and related accrued interest, and the loan is in the process of collection.

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Generally for all loan classes, interest income during the period the loan is non-performing is recorded on a cash basis after recovery of principal is reasonably assured. Cash payments received on nonperforming loans are typically applied directly against the outstanding principal balance until the loan is fully repaid. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time, and the ultimate collectability of the total contractual principal and interest is no longer in doubt.

Generally, all loan types are considered past due when the contractual terms of a loan are not met and the borrower is 30 days or more past due on a payment. Furthermore, residential and home equity loans are generally subject to charge-off when the loan becomes 120 days past due, depending on the estimated fair value of the collateral less cost to dispose, versus the outstanding loan balance. Commercial loans are generally charged off when the loan becomes 120 days past due. Open-end consumer loans are generally charged off when the loan becomes 180 days past due.

The following presents an aging analysis of the Company's accruing and non-accruing loans, by class, as of March 31, 2013 and December 31, 2012:

	Originated Loans March 31, 2013					
		Accruing				
	Current	30 - 59 days	60 - 89 days	Over 90 days	Non-accrual	Total
Residential real estate	$ 1,051,487	$ 5,132	$ 434	$ 323	$ 3,060	$ 1,060,436
Home equity – junior liens	103,007	718	108	32	26	103,891
Commercial and industrial	104,758	79	224	17	121	105,199
Commercial real estate	767,733	736	767	-	14,313	783,549
Consumer	32,665	76	6	1	-	32,748
DDA overdrafts	2,538	333	3	1	-	2,875
	$ 2,062,188	$ 7,074	$ 1,542	$ 374	$ 17,520	$ 2,088,698

	Acquired Loans March 31, 2013					
		Accruing				
	Current	30 - 59 days	60 - 89 days	Over 90 days	Non-accrual	Total
Residential real estate	$ 86,216	$ 1,641	$ 42	$ 1,076	$ -	$ 88,975
Home equity – junior liens	34,442	-	-	-	-	34,442
Commercial and industrial	33,233	1,961	668	8,616	-	44,478
Commercial real estate	210,657	812	-	6,435	-	217,904
Consumer	21,662	719	73	72	-	22,526
DDA overdrafts	-	-	-	-	-	-

	$ 386,210	$ 5,133	$