PARKE BANCORP, INC.
Form 10-Q
May 15, 2014

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

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended: March 31, 2014.

or

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

For the transition period from ____________ to ____________

Commission File No. 000-51338

PARKE BANCORP, INC.
(Exact name of registrant as specified in its charter)

New Jersey (State or other jurisdiction of incorporation or organization)	65-1241959 (IRS Employer Identification No.)
601 Delsea Drive, Washington Township, New Jersey (Address of principal executive offices)	08080 (Zip Code)

856-256-2500
(Registrant's telephone number, including area code)

N/A
(Former name, former address and former fiscal year, if changed since last report)

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

Yes [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 the definitions of "large accelerated filer", “accelerated filer", and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer [ ] Accelerated filer [ ] Non-accelerated filer [ ] Smaller reporting company [X]

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

As of May 15, 2014, there were issued and outstanding 5,991,859 shares of the registrant's common stock.

PARKE BANCORP, INC.

FORM 10-Q

FOR THE QUARTER ENDED MARCH 31, 2014

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

Parke Bancorp, Inc. and Subsidiaries
Consolidated Balance Sheets
(unaudited)

(in thousands except share and per share data)

	March 31, 2014	December 31, 2013
Assets		
Cash and due from financial institutions	$3,204	$4,278
Federal funds sold and cash equivalents	48,175	41,383
Total cash and cash equivalents	51,379	45,661
Investment securities available for sale, at fair value	31,148	35,695
Investment securities held to maturity (fair value of $2,238 at March 31, 2014 and $2,155 at December 31, 2013)	2,112	2,103
Total investment securities	33,260	37,798
Loans held for sale	17,357	12,069
Loans, net of unearned income	650,780	654,541
Less: Allowance for loan losses	(19,438)	(18,560)
Net loans	631,342	635,981
Accrued interest receivable	2,804	2,717
Premises and equipment, net	3,828	3,864
Other real estate owned (OREO)	29,642	28,910
Restricted stock, at cost	3,413	3,618
Bank owned life insurance (BOLI)	11,194	11,106
Deferred tax asset	12,459	12,260
Other assets	3,357	959
Total Assets	$800,035	$794,943
Liabilities and Equity		
Liabilities		
Deposits		
Noninterest-bearing deposits	$34,740	$35,986
Interest-bearing deposits	598,713	590,782
Total deposits	633,453	626,768
FHLBNY borrowings	50,736	55,280
Subordinated debentures	13,403	13,403
Accrued interest payable	454	423
Other liabilities	5,808	5,105
Total liabilities	703,854	700,979
Equity		
Preferred stock, 1,000,000 shares authorized, $1,000 liquidation value Series B - non-cumulative convertible; Issued: 20,000 shares at March 31, 2014 and December 31, 2013	20,000	20,000
Common stock, $.10 par value; authorized 10,000,000 shares; Issued: 6,202,759 shares at March 31, 2014 and 6,193,710 shares at	620	619

December 31, 2013		
Additional paid-in capital	51,264	51,204
Retained earnings	26,334	24,308
Accumulated other comprehensive loss	(92)	(235)
Treasury stock, 210,900 shares at March 31, 2014 and December 31, 2013, at cost	(2,180)	(2,180)
Total shareholders' equity	95,946	93,716
Noncontrolling interest in consolidated subsidiaries	235	248
Total equity	96,181	93,964
Total liabilities and equity	$800,035	$794,943

See accompanying notes to consolidated financial statements

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Parke Bancorp Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF INCOME
(unaudited)

	For the three months ended March 31, 2014	2013
	(in thousands except share data)	
Interest income:		
Interest and fees on loans	$9,290	$9,047
Interest and dividends on investments	293	205
Interest on federal funds sold and cash equivalents	23	40
Total interest income	9,606	9,292
Interest expense:		
Interest on deposits	1,177	1,374
Interest on borrowings	221	223
Total interest expense	1,398	1,597
Net interest income	8,208	7,695
Provision for loan losses	1,000	1,000
Net interest income after provision for loan losses	7,208	6,695
Noninterest income:		
Gain on sale of SBA loans	321	499
Loan fees	215	162
Net income from BOLI	88	92
Service fees on deposit accounts	57	51
Loss on sale and write-down of real estate owned	(396)	(364)
Realized gain on sale of AFS securities	178	—
Other	497	207
Total noninterest income	960	647
Noninterest expense:		
Compensation and benefits	1,843	1,658
Professional services	410	316
Occupancy and equipment	296	244
Data processing	117	111
FDIC insurance	241	248
OREO expense	760	385
Other operating expense	876	766
Total noninterest expense	4,543	3,728
Income before income tax expense	3,625	3,614
Income tax expense	1,162	1,370
Net income attributable to Company and noncontrolling interest	2,463	2,244
Net income attributable to noncontrolling interest	(137)	(107)
Net income attributable to Company	2,326	2,137
Preferred stock dividend and discount accretion	300	254
Net income available to common shareholders	$2,026	$1,883

Earnings per common share:		
Basic	$0.34	$0.32
Diluted	$0.29	$0.32
Weighted average shares outstanding:		
Basic	5,988,742	5,927,010
Diluted	7,916,564	5,930,217

See accompanying notes to consolidated financial statements

Parke Bancorp Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited)

	For the three months ended March 31,	
	2014	2013
	(in thousands)	
Net income attributable to Company	$2,326	$2,137
Unrealized (losses) gains on securities:		
Non-credit related unrealized gains on securities with OTTI	—	12
Unrealized gains (losses) on securities without OTTI	416	(61)
Less reclass adjustment for gains on securities included in net income	(178)	—
Tax Impact	(95)	20
Total unrealized gains (losses) on securities	143	(29)
Gross pension liability adjustments	—	28
Tax Impact	—	(11)
Total pension liability adjustment	—	17
Total other comprehensive income (loss)	143	(12)
Total comprehensive income	$2,469	$2,125

See accompanying notes to consolidated financial statements

Parke Bancorp, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF EQUITY
(unaudited)

	Preferred Stock	Shares of Common Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total Shareholders' Equity	Non-Controlling Interest	Total Equity
	(in thousands except share data)									
Balance, December 31, 2013	$ 20,000	6,193,710	$ 619	$ 51,204	$ 24,308	$ (235)	$ (2,180)	$ 93,716	$ 248	$ 93,964
Capital withdrawals by noncontrolling interest									(150)	(150)
Stock options exercised			1	60				61		61
Net income					2,326			2,326	137	2,463
Changes in other comprehensive income						143		143		143
Dividend on preferred stock					(300)			(300)		(300)
Balance, March 31, 2014	$ 20,000	6,193,710	$ 620	$ 51,264	$ 26,334	$ (92)	$ (2,180)	$ 95,946	$ 235	$ 96,181

See accompanying notes to consolidated financial statements

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Parke Bancorp Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	For the three months ended March 31,	
	2014	2013
	(amounts in thousands)	
Cash Flows from Operating Activities:		
Net income	$2,463	$2,244
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	86	82
Provision for loan losses	1,000	1,000
Net gain from sales and write-downs of investment securities	(178)	—
Bank owned life insurance	(88)	(92)
Supplemental executive retirement plan expense	—	33
Gain on sale of SBA loans	(321)	(499)
SBA loans originated for sale	(8,331)	(4,752)
Proceeds from sale of SBA loans originated for sale	3,364	4,402
Loss on sale & write down of other real estate owned	395	364
Net accretion of purchase premiums and discounts on securities	(22)	12
Contribution of OREO property	22	—
Deferred income tax benefit	(8,013)	(29)
Changes in operating assets and liabilities:		
Decrease in accrued interest receivable and other assets	6,357	998
Decrease in accrued interest payable and other accrued liabilities	(608)	(1,003)
Net cash (used in) provided by operating activities	(3,874)	2,760
Cash Flows from Investing Activities:		
Purchases of investment securities available for sale	—	(2,022)
Redemptions of restricted stock	205	2
Proceeds from sale and call of securities available for sale	3,974	1,000
Proceeds from maturities and principal payments on mortgage backed securities	978	1,406
Proceeds from sale of other real estate owned	241	817
Advances on other real estate owned	(66)	—
Net decrease (increase) in loans	2,315	(3,014)
Purchases of bank premises and equipment	(50)	(36)
Net cash provided by (used in) investing activities	7,597	(1,847)
Cash Flows from Financing Activities:		
Payment of dividend on preferred stock	(57)	(203)
Minority interest capital withdrawal, net	(150)	(1,000)
Proceeds from exercise of stock options and warrants	61	169
Net decrease in FHLBNY and short term borrowings	(4,544)	(42)
Net decrease in noninterest-bearing deposits	(1,246)	(2,386)
Net increase (decrease) in interest-bearing deposits	7,931	(11,144)
Net cash provided by (used in) financing activities	1,995	(14,606)
Net increase (decrease) in cash and cash equivalents	5,718	(13,693)
Cash and Cash Equivalents, January 1,	45,661	76,866
Cash and Cash Equivalents, March 31,	$51,379	$63,173
Supplemental Disclosure of Cash Flow Information:		
Cash paid during the year for:		

Interest on deposits and borrowed funds	$1,367	$1,607
Income taxes	$1,650	$1,000
Supplemental Schedule of Noncash Activities:		
Real estate acquired in settlement of loans	$1,324	$1,030

See accompanying notes to consolidated financial statements

Notes to Consolidated Financial Statements (Unaudited)

NOTE 1. ORGANIZATION

Parke Bancorp, Inc. ("Parke Bancorp” or the "Company") is a bank holding company incorporated under the laws of the State of New Jersey in January 2005 for the sole purpose of becoming the holding company of Parke Bank (the "Bank").

The Bank is a commercial bank which commenced operations on January 28, 1999. The Bank is chartered by the New Jersey Department of Banking and Insurance (the “Department”) and insured by the Federal Deposit Insurance Corporation ("FDIC"). Parke Bancorp and the Bank maintain their principal offices at 601 Delsea Drive, Washington Township, New Jersey. The Bank also conducts business through branches in Galloway Township, Northfield and Washington Township, New Jersey and Philadelphia, Pennsylvania.

The Bank competes with other banking and financial institutions in its primary market areas. Commercial banks, savings banks, savings and loan associations, credit unions and money market funds actively compete for savings and time certificates of deposit and all types of loans. Such institutions, as well as consumer financial and insurance companies, may be considered competitors of the Bank with respect to one or more of the services it renders.

The Bank is subject to the regulations of certain state and federal agencies, and accordingly, the Bank is periodically examined by such regulatory authorities. As a consequence of the regulation of commercial banking activities, the Bank’s business is particularly susceptible to future state and federal legislation and regulations.

The FDIC and the Department Consent Orders: On April 9, 2012, the Bank entered into Consent Orders with the FDIC and the Department. Under the Consent Orders, the terms of which are substantially identical, the Bank is required, among other things, subject to review and approval by the FDIC and the Department: (i) to adopt and implement a plan to reduce the Bank’s position in delinquent or classified assets; (ii) to adopt and implement a program providing for a periodic independent review of the Bank’s loan portfolio and the identification of problem credits; (iii) to review and revise the Bank’s loan policies and procedures to address identified lending deficiencies; and (iv) to adopt and implement a plan to reduce and manage each of the concentrations of credit identified by the FDIC and the Department.

The Consent Orders also require the Bank to obtain the prior approval of the FDIC and the Department before declaring or paying any dividend or appointing or changing the title or responsibilities of any director or senior executive officer. Additional regulatory provisions require FDIC prior approval before the Bank enters into any employment agreement or other agreement or plan providing for the payment of a “golden parachute payment” or the making of any golden parachute payment. The Bank believes it is in substantial compliance with the terms of the Consent Orders.

Federal Reserve Bank Memorandum of Understanding: On December 18, 2012, the Company entered into a Memorandum of Understanding (“MOU”) with the Federal Reserve Bank of Philadelphia (the “Federal Reserve Bank”). Pursuant to the terms of the MOU, the Company must: (i) submit an updated comprehensive capital plan to address the Bank’s long-term capital needs and the repayment of the Series A Preferred Stock; (ii) not pay any common stock dividend or pay interest on our outstanding trust preferred securities without prior Federal Reserve Bank approval if the Bank is less than well capitalized or the payment would cause it to be less than well capitalized; (iii) not redeem any securities without prior Federal Reserve Bank approval or incur any debt with a maturity greater than one year; and (iv) submit various budget and cash flow projections and other reports. The Company believes it is in substantial compliance with the terms of the MOU.

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NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Financial Statement Presentation: The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America (“GAAP”) and predominant practices within the banking industry.

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary the Bank. Also included are the accounts of 44 Business Capital Partners LLC, a joint venture formed in 2009 to originate and service SBA loans. The Bank has a 51% ownership interest in the joint venture. Parke Capital Trust I, Parke Capital Trust II and Parke Capital Trust III are wholly-owned subsidiaries but are not consolidated because they do not meet the requirements for consolidation under applicable accounting guidance. All significant inter-company balances and transactions have been eliminated.

The accompanying interim financial statements should be read in conjunction with the annual financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013 since they do not include all of the information and footnotes required by GAAP. The accompanying interim financial statements for the three months ended March 31, 2014 and 2013 are unaudited. The balance sheet as of December 31, 2013, was derived from the audited financial statements. In the opinion of management, these financial statements include all normal and recurring adjustments necessary for a fair statement of the results for such interim periods. Results of operations for the three months ended March 31, 2014 are not necessarily indicative of the results for the full year. Certain reclassifications have been made to prior period amounts to conform to the current year presentation, with no impact on current earnings or shareholders’ equity.

Use of Estimates: The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term include the allowance for loan losses, other than temporary impairment losses on investment securities, the valuation of deferred income taxes, servicing assets and carrying value of OREO.

Recently Issued Accounting Pronouncements:

In January 2014, the FASB issued ASU 2014-04, "Receivables-Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure." ASU 2014-04 clarifies that an in-substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (a) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (b) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, ASU 2014-04 requires interim and annual disclosure of both (a) the amount of foreclosed residential real estate property held by the creditor and (b) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in ASU 2014-04 are effective for fiscal years, and interim periods within those years, beginning after December 15, 2014. An entity can elect to adopt the amendments using either a modified retrospective transition method or a prospective transition method. Early adoption is permitted. The Company is currently evaluating the impact of these amendments.

In July 2013, the FASB issued ASU 2013-11, “Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists.” The amendments in ASU 2013-11 include explicit guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The amendments in this Update are expected to reduce diversity in practice by providing guidance on the presentation of unrecognized tax benefits and will better reflect the manner in which an entity would settle at the reporting date any additional income taxes that would result from the disallowance of a tax position when net operating loss carryforwards, similar tax losses, or tax credit carryforwards exist. The amendments in this Update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. Adoption of this update did not have a impact on the Company’s financial position or results of operations..

NOTE 3. INVESTMENT SECURITIES

The following is a summary of the Company's investments in available for sale and held to maturity securities as of March 31, 2014 and December 31, 2013:

As of March 31, 2014	Amortized cost	Gross unrealized gains	Gross unrealized losses	Other-than-temporary impairments in OCI	Fair value
		(amounts in thousands)			
Available for sale:					
Corporate debt obligations	500	17	—	—	517
Residential mortgage-backed securities	29,498	387	126	—	29,759
Collateralized mortgage obligations	498	25	—	—	523
Collateralized debt obligations	806	—	—	457	349
Total available for sale	$31,302	$429	$126	$457	$31,148
Held to maturity:					
States and political subdivisions	$2,112	$126	$—	$—	$2,238

As of December 31, 2013	Amortized cost	Gross unrealized gains	Gross unrealized losses	Other-than-temporary impairments in OCI	Fair value
		(amounts in thousands)			
Available for sale:					
Corporate debt obligations	$500	$6	$—	$—	$506
Residential mortgage-backed securities	30,422	285	257	—	30,450
Collateralized mortgage obligations	564	31	—	—	595
Collateralized debt obligations	4,601	—	—	457	4,144
Total available for sale	$36,087	$322	$257	$457	$35,695
Held to maturity:					
States and political subdivisions	$2,103	$52	$—	$—	$2,155

The amortized cost and fair value of debt securities classified as available for sale and held to maturity, by contractual maturity as of March 31, 2014 are as follows:

	Amortized Cost	Fair Value
	(amounts in thousands)	
Available for sale:		
Due within one year	$ —	$ —
Due after one year through five years	—	—
Due after five years through ten years	—	—
Due after ten years	1,306	866
Residential mortgage-backed securities and collateralized mortgage obligations	29,995	30,282
Total available for sale	$ 31,301	$ 31,148
Held to maturity:		
Due within one year	$ —	$ —
Due after one year through five years	—	—
Due after five years through ten years	—	—
Due after ten years	2,112	2,238
Total held to maturity	$ 2,112	$ 2,238

Expected maturities will differ from contractual maturities for mortgage related securities because the issuers of certain debt securities do have the right to call or prepay their obligations without any penalty.

There were no securities pledged as collateral for borrowed funds as of March 31, 2014 and December 31, 2013. In addition, securities with a carrying value of $11.7 million and $12.3 million were pledged to secure public deposits at March 31, 2014 and December 31, 2013, respectively.

The following tables show the gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other than temporarily impaired ("OTTI"), aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at March 31, 2014 and December 31, 2013:

As of March 31, 2014	Less Than 12 Months		12 Months or Greater		Total	
Description of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
			(amounts in thousands)			
Available for sale:						
Residential mortgage-backed securities and collateralized mortgage obligations	5,289	126	—	—	5,289	126
Total available for sale	$ 5,289	$ 126	$ —	$ —	$ 5,289	$ 126

As of December 31, 2013	Less Than 12 Months		12 Months or Greater		Total	
Description of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses

	(amounts in thousands)					
Available for sale:						
Residential mortgage-backed securities	25,286	257	—	—	25,286	257
Total available for sale	$ 25,286	$ 257	$ —	$ —	$ 25,286	$ 257

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Other Than Temporarily Impaired Debt Securities

We assess whether we intend to sell or it is more likely than not that we will be required to sell a security before recovery of its amortized cost basis less any current-period credit losses. For debt securities that are considered other than temporarily impaired and that we do not intend to sell and will not be required to sell prior to recovery of our amortized cost basis, we separate the amount of the impairment into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is the difference between the security's amortized cost basis and the present value of its expected future cash flows. The remaining difference between the security's fair value and the present value of future expected cash flows is due to factors that are not credit related and is recognized in other comprehensive income.

The present value of expected future cash flows is determined using the best estimate of cash flows discounted at the effective interest rate implicit to the security at the date of purchase or the current yield to accrete an asset-backed or floating rate security. The methodology and assumptions for establishing the best estimate cash flows vary depending on the type of security. The asset-backed securities cash flow estimates are based on bond specific facts and circumstances that may include collateral characteristics, expectations of delinquency and default rates, loss severity and prepayment speeds and structural support, including subordination and guarantees. The corporate bond cash flow estimates are derived from scenario-based outcomes of expected corporate restructurings or the disposition of assets using bond specific facts and circumstances including timing, security interests and loss severity.

We have a process in place to identify debt securities that could potentially have a credit impairment that is other than temporary. This process involves monitoring late payments, pricing levels, downgrades by rating agencies, key financial ratios, financial statements, revenue forecasts and cash flow projections as indicators of credit issues. On a quarterly basis, we review all securities to determine whether an OTTI exists and whether losses should be recognized. We consider relevant facts and circumstances in evaluating whether a credit or interest rate-related impairment of a security is other than temporary. Relevant facts and circumstances considered include: (1) the extent and length of time the fair value has been below cost; (2) the reasons for the decline in value; (3) the financial position and access to capital of the issuer, including the current and future impact of any specific events; and (4) for fixed maturity securities, our intent to sell a security or whether it is more likely than not we will be required to sell the security before the recovery of its amortized cost which, in some cases, may extend to maturity.

The following table presents a roll-forward of the credit loss component of the amortized cost of debt securities that we have written down for OTTI and the credit component of the loss that is recognized in earnings. OTTI recognized in earnings for credit-impaired debt securities is presented as additions in two components based upon whether the current period is the first time the debt security was credit-impaired (initial credit impairment) or is not the first time the debt security was credit impaired (subsequent credit impairments). The credit loss component is reduced if we sell, intend to sell or believe we will be required to sell previously credit-impaired debt securities. Additionally, the credit loss component is reduced if we receive cash flows in excess of what we expected to receive over the remaining life of the credit-impaired debt security, the security matures or is fully written down. Changes in the credit loss component of credit-impaired debt securities were as follows for the periods ended March 31, 2014 and 2013:

	For the Three Months Ended March 31,	
	2014	2013
	(amounts in thousands)	
Beginning balance	$ 1,126	$ 1,219
Initial credit impairment	—	—
Subsequent credit impairments	—	—
Reductions for amounts recognized in earnings due to intent or requirement to sell	—	—
Reductions for securities sold	(955)	—
Reductions for securities deemed worthless	—	(54)
Reductions for increases in cash flows expected to be collected	—	—
Ending balance	$ 171	$ 1,165

The Bank sold three Trust Preferred securities, which resulted in a $178,000 gain reflected in the income statement.

NOTE 4. LOANS

The portfolio of loans outstanding consists of:

	March 31, 2014		December 31, 2013	
	Amount	Percentage of Total Loans	Amount	Percentage of Total Loans
	(amounts in thousands)			
Commercial and Industrial	$22,141	3.4 %	$23,001	3.5 %
Real Estate Construction:				
Residential	7,102	1.1	7,389	1.1
Commercial	39,805	6.1	43,749	6.7
Real Estate Mortgage:				
Commercial – Owner Occupied	172,110	26.5	170,122	26.0
Commercial – Non-owner Occupied	220,599	33.9	220,364	33.7
Residential – 1 to 4 Family	149,088	22.9	148,160	22.6
Residential – Multifamily	22,874	3.5	24,103	3.7
Consumer	17,061	2.6	17,653	2.7
Total Loans	$650,780	100.0 %	$654,541	100.0 %

Loan Origination/Risk Management: In the normal course of business the Company is exposed to a variety of operational, reputational, legal, regulatory, and credit risks that could adversely affect our financial performance. Most of our asset risk is primarily tied to credit (lending) risk. The Company has lending policies, guidelines and procedures in place that are designed to maximize loan income within an acceptable level of risk. The Board of Directors reviews and approves these policies, guidelines and procedures. When we originate a loan we make certain subjective judgments about the borrower's ability to meet the loan's terms and conditions. We also make objective and subjective value assessments on the assets we finance. The borrower's ability to repay can be adversely affected by economic changes. Likewise, changes in market conditions and other external factors can affect asset valuations. The Company actively monitors the quality of its loan portfolio. A reporting system supplements the credit review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit risk, loan delinquencies, troubled debt restructures, nonperforming and potential problem loans. Diversification in the loan portfolio is another means of managing risk associated with fluctuations in economic conditions.

With respect to construction loans to developers and builders that are secured by non-owner occupied properties, the Company generally requires the borrower to have had an existing relationship with the Company and have a proven record of success. Construction loans are underwritten utilizing feasibility studies, independent appraisal reviews, sensitivity analysis of absorption and lease rates and financial analyses of the developers and property owners. Construction loans are generally underwritten based upon estimates of costs and value associated with the completed project. These estimates may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property or an interim loan commitment from the Company until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions and the availability of long-term financing.

Commercial real estate loans are subject to underwriting standards and processes similar to commercial loans, in addition to those of real estate loans. Commercial real estate loans may be riskier than loans for one-to-four family residences and are typically larger in dollar size. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. The repayment of these loans is generally largely dependent on the successful operation and management of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Company’s commercial real estate portfolio are diverse in terms of type and geographic location within our market area. This diversity helps reduce the Company's exposure to adverse economic events that affect any single market or industry. Management monitors and evaluates commercial real estate loans based on collateral, geography and risk grade criteria. The Company also monitors economic conditions and trends affecting market areas it serves. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans.

Consumer loans may carry a higher degree of repayment risk than residential mortgage loans. Repayment is typically dependent upon the borrower’s financial stability which is more likely to be adversely affected by job loss, illness, or personal bankruptcy. To monitor and manage consumer loan risk, policies and procedures have been developed and modified as needed. This activity, coupled with relatively small loan amounts that are spread across many individual borrowers, minimizes risk. Additionally, trend and outlook reports are reviewed by management on a regular basis. Underwriting standards for home equity loans are heavily influenced by statutory requirements, which include, but are not limited to, a maximum loan-to-value percentage of 80%, collection remedies, the number of such loans a borrower can have at one time and documentation requirements. Historically the Company’s losses on consumer loans have been negligible.

The Company maintains an outsourced independent loan review program that reviews and validates the credit risk assessment program on a periodic basis. Results of these external independent reviews are presented to management. The external independent loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit risk management personnel.

Nonaccrual and Past Due Loans: Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on non-accrual status when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when a loan is 90 days past due, unless the loan is well secured and in the process of collection, as required by regulatory provisions. Loans may be placed on non-accrual status regardless of whether or not such loans are considered past due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received in excess of principal due. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

An age analysis of past due loans by class at March 31, 2014 and December 31, 2013 follows:

March 31, 2014	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days and Not Accruing	Total Past Due	Current	Total Loans
	(amounts in thousands)					
Commercial and Industrial	$ —	$ —	$ 462	$ 462	$ 21,679	$ 22,141
Real Estate Construction:						
Residential	—	—	851	851	6,251	7,102
Commercial	—	—	8,303	8,303	31,502	39,805
Real Estate Mortgage:						
Commercial – Owner Occupied	248	—	1,472	1,720	170,390	172,110
Commercial – Non-owner Occupied	—	—	9,558	9,558	211,041	220,599
Residential – 1 to 4 Family	333	2,071	11,954	14,359	134,729	149,088
Residential – Multifamily	—	—	—	—	22,874	22,874
Consumer	—	6	94	99	16,962	17,061
Total Loans	$ 581	$ 2,077	$ 32,694	$ 35,352	$ 615,428	$ 650,780

December 31, 2013	30-59 Dast Past Due	60-89 Days Past Due	Greater than 90 Days and Not Accruing	Total Past Due	Current	Total Loans
	(amounts in thousands)					
Commercial and Industrial	$ —	$ —	$ 122	$ 122	$ 22,879	$ 23,001
Real Estate Construction:						
Residential	—	—	967	967	6,422	7,389
Commercial	—	—	9,908	9,908	33,841	43,749
Real Estate Mortgage:						
Commercial – Owner Occupied	710	1,438	976	3,124	166,998	170,122
Commercial – Non-owner Occupied	—	478	10,853	11,331	209,033	220,364
Residential – 1 to 4 Family	1,013	—	12,914	13,927	134,233	148,160
Residential – Multifamily	—	—	99	99	24,004	24,103
Consumer	32	—	115	147	17,506	17,653
Total Loans	$ 1,755	$ 1,916	$ 35,954	$ 39,625	$ 614,916	$ 654,541

Impaired Loans: Loans are considered impaired when, based on current information and events, it is probable the Company will be unable to collect amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments.

All impaired loans have are assessed for recoverability based on an independent third-party full appraisal to determine the net realizable value ("NRV") based on the fair value of the underlying collateral, less cost to sell and other costs, such as unpaid real estate taxes, that have been identified, or the present value of discounted cash flows in the case of certain impaired loans that are not collateral dependent. The appraisal will be based on an "as-is" valuation and will follow a reasonable valuation method that addresses the direct sales comparison, income, and cost approaches to market value, reconciles those approaches, and explains the elimination of each approach not used. Appraisals are generally updated every 12 months or sooner if we have identified possible further deterioration in value. Prior to receiving the updated appraisal, we will establish a specific reserve for any estimated deterioration, based upon our assessment of market conditions, adjusted for estimated costs to sell and other identified costs. If the NRV is greater than the loan amount, then no impairment loss exists. If the NRV is less than the loan amount, the shortfall is recognized by a specific reserve. If the borrower fails to pledge additional collateral in the ninety day period, a charge-off equal to the difference between the loan carrying value and NRV will occur. In certain circumstances, however, a direct charge-off may be taken at the time that the NRV calculation reveals a shortfall. All impaired loans are evaluated based on the criteria stated above on a quarterly basis and any change in the reserve requirements are recorded in the period identified. All partially charged-off loans remain on nonaccrual status until they are brought current as to both principal and interest and have at least nine months of payment history and future collectability of principal and interest is assured.

Impaired loans at March 31, 2014 and December 31, 2013 are set forth in the following tables.

March 31, 2014	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(amounts in thousands)		
With no related allowance recorded:			
Commercial and Industrial	$ —	$ —	$ —
Real Estate Construction:			
Residential	664	1,405	—
Commercial	8,236	8,259	—
Real Estate Mortgage:			
Commercial – Owner Occupied	998	998	—
Commercial – Non-owner Occupied	9,558	11,877	—
Residential – 1 to 4 Family	5,800	5,972	—
Residential – Multifamily	—	—	—
Consumer	94	94	—
	25,350	28,605	—
With an allowance recorded:			
Commercial and Industrial	957	957	429
Real Estate Construction:			
Residential	187	661	24
Commercial	3,464	3,522	144
Real Estate Mortgage:			
Commercial – Owner Occupied	5,947	6,032	221
Commercial – Non-owner Occupied	22,578	22,578	631
Residential – 1 to 4 Family	8,753	9,180	2,749
Residential – Multifamily	368	368	6
Consumer	—	—	—
	42,254	43,298	4,204
Total:			
Commercial and Industrial	957	957	429
Real Estate Construction:			
Residential	851	2,066	24
Commercial	11,700	11,781	144
Real Estate Mortgage:			
Commercial – Owner Occupied	6,945	7,030	221
Commercial – Non-owner Occupied	32,136	34,455	631
Residential – 1 to 4 Family	14,553	15,152	2,749
Residential – Multifamily	368	368	6
Consumer	94	94	—
	$ 67,604	$ 71,903	$ 4,204

December 31, 2013	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(amounts in thousands)		
With no related allowance recorded:			
Commercial and Industrial	$ —	$ —	$ —
Real Estate Construction:			
Residential	780	1,521	—
Commercial	9,568	9,592	—
Real Estate Mortgage:			
Commercial – Owner Occupied	787	842	—
Commercial – Non-owner Occupied	10,853	13,153	—
Residential – 1 to 4 Family	9,892	10,084	—
Residential – Multifamily	99	306	—
Consumer	65	65	—
	32,044	35,563	—
With an allowance recorded:			
Commercial and Industrial	622	622	131
Real Estate Construction:			
Residential	187	661	21
Commercial	2,168	2,225	290
Real Estate Mortgage:			
Commercial – Owner Occupied	5,752	5,782	331
Commercial – Non-owner Occupied	22,234	22,234	801
Residential – 1 to 4 Family	5,430	5,857	338
Residential – Multifamily	370	370	6
Consumer	49	49	23
	36,812	37,800	1,941
Total:			
Commercial and Industrial	622	622	131
Real Estate Construction:			
Residential	967	2,182	21
Commercial	11,736	11,817	290
Real Estate Mortgage:			
Commercial – Owner Occupied	6,539	6,624	331
Commercial – Non-owner Occupied	33,087	35,387	801
Residential – 1 to 4 Family	15,322	15,941	338
Residential – Multifamily	469	676	6
Consumer	114	114	23
	$ 68,856	$ 73,363	$ 1,941

The following tables present by loan portfolio class, the average recorded investment and interest income recognized on impaired loans for the three months ended March 31, 2014 and 2013:

	Three Months Ended March 31,			
	2014		2013	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(amounts in thousands)			
Commercial and Industrial	$957	$4	$662	$4
Real Estate Construction:				
Residential	851	—	681	—
Commercial	11,723	48	14,875	26
Real Estate Mortgage:				
Commercial – Owner Occupied	6,944	74	6,400	61
Commercial – Non-owner Occupied	32,426	319	48,399	353
Residential – 1 to 4 Family	14,632	64	12,133	67
Residential – Multifamily	368	6	2,780	8
Consumer	94	—	203	1
Total	$67,995	$515	$86,133	$520

Troubled debt restructurings: Periodically management evaluates our loans in order to determine the appropriate risk rating, interest accrual status and potential classification as a TDR, some of which are performing and accruing interest. A TDR is a loan on which we have granted a concession due to a borrower’s financial difficulty. These are concessions that would not otherwise be considered. The terms of these modified loans may include extension of maturity, renewals, changes in interest rate, additional collateral requirements or infusion of additional capital into the project by the borrower to reduce debt or to support future debt service. On construction and land development loans we may modify the loan as a result of delays or other project issues such as slower than anticipated sell-outs, insufficient leasing activity and/or a decline in the value of the underlying collateral securing the loan. Management believes that working with a borrower to restructure a loan provides us with a better likelihood of collecting our loan. It is our policy not to renegotiate the terms of a commercial loan simply because of a delinquency status. However, we will use our Troubled Debt Restructuring Program to work with delinquent borrowers when the delinquency is temporary. We consider all loans modified in a troubled debt restructuring to be impaired.

At the time a loan is modified in a TDR, we consider the following factors to determine whether the loan should accrue interest:

- Whether there is a period of current payment history under the current terms, typically 6 months;
- Whether the loan is current at the time of restructuring; and
- Whether we expect the loan to continue to perform under the restructured terms with a debt coverage ratio that complies with the Bank’s credit underwriting policy of 1.25 times debt service.

We also review the financial performance of the borrower over the past year to be reasonably assured of repayment and performance according to the modified terms. This review consists of an analysis of the borrower’s historical results; the borrower’s projected results over the next four quarters; current financial information of the borrower and any guarantors. The projected repayment source needs to be reliable, verifiable, quantifiable and sustainable. In addition, all TDRs are reviewed quarterly to determine the amount of any impairment.

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At the time of restructuring, the amount of the loan principal for which we are not reasonably assured of repayment is charged-off, but not forgiven.

A borrower with a restructured loan must make a minimum of six consecutive monthly payments at the restructured level and be current as to both interest and principal to be on accrual status.

Performing TDRs (not reported as non-accrual loans) totaled $35.0 million and $32.9 million with related allowances of $1.0 million and $1.1 million as of March 31, 2014 and December 31, 2013, respectively. Nonperforming TDRs totaled $14.9 million and $18.1 million with related allowances of $102,000 and $71,000 as of March 31, 2014 and December 31, 2013, respectively. All TDRs are classified as impaired loans and are included in the impaired loan disclosures above.

There were no loans modified during the three months ended March 31, 2014 and 2013.

The following tables show loans that were modified and deemed TDRs that subsequently defaulted during the three months ended March 31, 2014 and 2013.

	Three Months Ended March 31,			
	2014		2013	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
	(amounts in thousands)			
Commercial and Industrial	—	$—	—	$—
Real Estate Construction:				
Residential	—	—	1	187
Commercial	—	—	—	—
Real Estate Mortgage:				
Commercial – Owner Occupied	—	—	—	—
Commercial – Non-owner Occupied	—	—	—	—
Residential – 1-4 Family	—	—	—	—
Residential – Multifamily	—	—	—	—
Consumer	—	—	—	—
Total	—	$—	1	$187

Some loan modifications classified as TDRs may not ultimately result in the full collection of principal and interest, as modified, and result in potential incremental losses. These potential incremental losses have been factored into our overall allowance for loan losses estimate. The level of any re-defaults will likely be affected by future economic conditions. Once a loan becomes a TDR, it will continue to be reported as a TDR until it is repaid in full, foreclosed, sold or it meets the criteria to be removed from TDR status.

Credit Quality Indicators: As part of the on-going monitoring of the credit quality of the Company's loan portfolio, management tracks certain credit quality indicators including trends related to the risk grades of loans, the level of classified loans, net charge-offs, nonperforming loans (see details above) and the general economic conditions in the region.

The Company utilizes a risk grading matrix to assign a risk grade to each of its loans. Loans are graded on a scale of 1 to 7. Grades 1 through 4 are considered “Pass”. A description of the general characteristics of the seven risk grades is as follows:

1. Good: Borrower exhibits the strongest overall financial condition and represents the most creditworthy profile.
2. Satisfactory (A): Borrower reflects a well-balanced financial condition, demonstrates a high level of creditworthiness and typically will have a strong banking relationship with the Bank.
3. Satisfactory (B): Borrower exhibits a balanced financial condition and does not expose the Bank to more than a normal or average overall amount of risk. Loans are considered fully collectable.
4. Watch List: Borrower reflects a fair financial condition, but there exists an overall greater than average risk. Risk is deemed acceptable by virtue of increased monitoring and control over borrowings. Probability of timely repayment is present.
5. Other Assets Especially Mentioned (OAEM): Financial condition is such that assets in this category have a potential weakness or pose unwarranted financial risk to the Bank even though the asset value is not currently impaired. The asset does not currently warrant adverse classification but if not corrected could weaken and could create future increased risk exposure. Includes loans which require an increased degree of monitoring or servicing as a result of internal or external changes.
6. Substandard: This classification represents more severe cases of #5 (OAEM) characteristics that require increased monitoring. Assets are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Assets are inadequately protected by the current net worth and paying capacity of the borrower or of the collateral. Asset has a well-defined weakness or weaknesses that impairs the ability to repay debt and jeopardizes the timely liquidation or realization of the collateral at the asset’s net book value.
7. Doubtful: Assets which have all the weaknesses inherent in those assets classified #6 (Substandard) but the risks are more severe relative to financial deterioration in capital and/or asset value; accounting/evaluation techniques may be questionable and the overall possibility for collection in full is highly improbable. Borrowers in this category require constant monitoring, are considered work-out loans and present the potential for future loss to the Bank.

An analysis of the credit risk profile by internally assigned grades as of March 31, 2014 and December 31, 2013 is as follows:

At March 31, 2014	Pass	OAEM	Substandard	Doubtful	Total
			(amounts in thousands)		
Commercial and Industrial	$19,095	$2,584	$462	$—	$22,141
Real Estate Construction:					
Residential	6,251	—	851	—	7,102
Commercial	21,607	2,996	15,202	—	39,805
Real Estate Mortgage:					
Commercial – Owner Occupied	164,763	4,631	2,716	—	172,110
Commercial – Non-owner Occupied	200,784	6,775	13,040	—	220,599
Residential – 1 to 4 Family	133,293	2,126	13,669	—	149,088
Residential – Multifamily	21,466	1,040	368	—	22,874
Consumer	16,967	—	94	—	17,061
Total	$584,226	$20,152	$46,402	$—	$650,780

At December 31, 2013	Pass	OAEM	Substandard	Doubtful	Total
			(amounts in thousands)		
Commercial and Industrial	$20,270	$1,916	$815	$—	$23,001
Real Estate Construction:					
Residential	6,422	—	967	—	7,389
Commercial	25,519	—	18,230	—	43,749
Real Estate Mortgage:					
Commercial – Owner Occupied	162,606	2,293	5,223	—	170,122
Commercial – Non-owner Occupied	198,321	10,835	11,208	—	220,364
Residential – 1 to 4 Family	131,792	1,925	14,443	—	148,160
Residential – Multifamily	22,580	1,054	469	—	24,103
Consumer	17,538	—	115	—	17,653
Total	$585,048	$18,023	$51,470	$—	$654,541

NOTE 5. ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is a reserve established through a provision for loan losses charged to expense, which represents management's best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The Company's allowance for loan loss methodology includes allowance allocations calculated in accordance with ASC Topic 310, "Receivables" and allowance allocations calculated in accordance with ASC Topic 450, "Contingencies." Accordingly, the methodology is based on historical loss experience by type of credit and internal risk grade, specific homogeneous risk pools and specific loss allocations, with adjustments for current events and conditions. The Company's process for determining the appropriate level of the allowance for loan losses is designed to account for credit deterioration as it occurs. The provision for loan losses reflects loan quality trends, including the levels of, and trends related to, nonaccrual loans, past due loans, potential problem loans, criticized loans and net charge-offs or recoveries, among other factors. The provision for possible loan losses also reflects the totality of actions taken on all loans for a particular period. In other words, the amount of the provision reflects not only the necessary increases in the allowance for loan losses related to newly identified criticized loans, but it also reflects actions taken related to other loans including, among other things, any necessary increases or decreases in required allowances for specific loans or loan pools.

The level of the allowance reflects management's continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management's judgment, should be charged off. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Company’s control, including, among other things, the performance of the Company's loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

The allowances established for probable losses on specific loans are based on a regular analysis and evaluation of problem loans. Loans are classified based on an internal credit risk grading process that evaluates, among other things: (i) the obligor's ability to repay; (ii) the underlying collateral, if any; and (iii) the economic environment and industry in which the borrower operates. This analysis is performed at the relationship manager level for all commercial loans. When a loan has a grade of 6 or higher, the loan is analyzed to determine whether the loan is impaired and, if impaired, whether there is a need to specifically allocate a portion of the allowance for loan losses to the loan. Specific valuation allowances are determined by analyzing the borrower's ability to repay amounts owed, any collateral deficiencies, the relative risk grade of the loan and economic conditions affecting the borrower's industry, among other things.

Historical valuation allowances are calculated based on the historical loss experience of specific types of loans. The Company calculates historical loss ratios for pools of similar loans with similar characteristics based on the proportion of actual charge-offs experienced to the total population of loans in the pool. The historical loss ratios are periodically updated based on actual charge-off experience. A historical valuation allowance is established for each pool of similar loans based upon the product of the historical loss ratio and the total dollar amount of the loans in the pool. The Company's pools of similar loans include similarly risk-graded groups of commercial loans, commercial real estate loans, consumer real estate loans and consumer and other loans.

General valuation allowances are based on general economic conditions and other qualitative risk factors both internal and external to the Company. In general, such valuation allowances are determined by evaluating, among other things: (i) the experience, ability and effectiveness of the Bank's lending management and staff; (ii) the effectiveness of the Bank's loan policies, procedures and internal controls; (iii)

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changes in asset quality; (iv) changes in loan portfolio volume; (v) the composition and concentrations of credit; (vi) the impact of competition on loan structuring and pricing; (vii) the effectiveness of the internal loan review function; (viii) the impact of environmental risks on portfolio risks; and (ix) the impact of rising interest rates on portfolio risk. Management evaluates the degree of risk that each one of these components has on the quality of the loan portfolio on a quarterly basis. Each component is determined to have either a high, high-moderate, moderate, low-moderate or low degree of risk. The results are then input into a "general allocation matrix" to determine an appropriate general valuation allowance.

An analysis of the allowance for loan losses for the three month periods ended March 31, 2014 and 2013 is as follows:

Allowance for Loan Losses:	For the three months ended March 31, 2014				
	Beginning Balance	Charge-offs	Recoveries	Provisions (Credits)	Ending Balance
	(amounts in thousands)				
Commercial and Industrial	$591	$—	$—	$282	$873
Real Estate Construction:					
Residential	414	—	—	(276)	