

FIRST UNITED CORP/MD/  
Form 10-Q  
November 10, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

**FORM 10-Q**

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

For quarterly period ended September 30, 2014

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

Commission file number 0-14237

First United Corporation

(Exact name of registrant as specified in its charter)

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

19 South Second Street, Oakland, Maryland 21550-0009

(Address of principal executive offices) (Zip Code)

(800) 470-4356

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(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter periods that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes R No £

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes R No £

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

Large accelerated filer £

Non-accelerated filer £ (Do not check if a smaller reporting company)

Accelerated filer £

Smaller reporting company R

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 6,228,366 shares of common stock, par value \$.01 per share, as of October 31, 2014.

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**FIRST UNITED CORPORATION**

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**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****FIRST UNITED CORPORATION**

## Consolidated Statement of Financial Condition

(In thousands, except per share and percentage data)

	September 30, 2014 (Unaudited)	December 31, 2013
Assets		
Cash and due from banks	\$42,916	\$ 32,895
Interest bearing deposits in banks	8,224	10,168
Cash and cash equivalents	51,140	43,063
Investment securities – available-for-sale (at fair value)	222,835	336,589
Investment securities – held to maturity (fair value \$106,426 at September 30, 2014 and \$3,590 at December 31, 2013)	106,961	3,900
Restricted investment in bank stock, at cost	7,524	7,913
Loans	824,925	810,240
Allowance for loan losses	(12,068 )	(13,594 )
Net loans	812,857	796,646
Premises and equipment, net	26,001	26,905
Goodwill and other intangible assets, net	11,004	11,004
Bank owned life insurance	33,150	32,413
Deferred tax assets	23,341	29,209
Other real estate owned	11,588	17,031
Accrued interest receivable and other assets	25,515	28,830
<b>Total Assets</b>	<b>\$1,331,916</b>	<b>\$ 1,333,503</b>
Liabilities and Shareholders' Equity		
Liabilities:		
Non-interest bearing deposits	\$197,612	\$ 175,863
Interest bearing deposits	775,421	801,540
Total deposits	973,033	977,403
Short-term borrowings	47,994	43,676
Long-term borrowings	182,623	182,672
Accrued interest payable and other liabilities	15,996	28,412
<b>Total Liabilities</b>	<b>1,219,646</b>	<b>1,232,163</b>

Shareholders' Equity:

Preferred stock – no par value; Authorized 2,000 shares of which 30 shares of Series A, \$1,000 per share liquidation preference, 5% cumulative increasing to 9% cumulative on February 15, 2014, were issued and outstanding on September 30, 2014 and December 31, 2013 (discount of \$0 and \$6, respectively)	30,000	29,994
Common Stock – par value \$.01 per share; Authorized 25,000 shares; issued and outstanding 6,228 shares at September 30, 2014 and 6,211 at December 31, 2013	62	62
Surplus	21,756	21,661
Retained earnings	75,849	73,836
Accumulated other comprehensive loss	(15,397 )	(24,213 )
Total Shareholders' Equity	112,270	101,340
Total Liabilities and Shareholders' Equity	\$1,331,916	\$ 1,333,503

*See accompanying notes to the consolidated financial statements*

**FIRST UNITED CORPORATION**

## Consolidated Statement of Operations

(In thousands, except per share data)

	Nine Months Ended September 30, 2014      2013 (Unaudited)	
Interest income		
Interest and fees on loans	\$ 28,144	\$ 32,951
Interest on investment securities		
Taxable	5,323	3,826
Exempt from federal income tax	1,175	1,315
Total investment income	6,498	5,141
Other	276	254
Total interest income	34,918	38,346
Interest expense		
Interest on deposits	3,489	3,860
Interest on short-term borrowings	46	45
Interest on long-term borrowings	4,699	4,919
Total interest expense	8,234	8,824
Net interest income	26,684	29,522
Provision for loan losses	1,629	(161 )
Net interest income after provision for loan losses	25,055	29,683
Other operating income		
Changes in fair value on impaired securities	5,648	3,095
Portion of gain recognized in other comprehensive income (before taxes)	(5,648 )	(3,095 )
Net securities impairment losses recognized in operations	0	0
Net gains – other	1,127	254
Total net gains	1,127	254
Service charges	2,213	2,651
Trust department	3,922	3,732
Debit card income	1,516	1,471
Bank owned life insurance	737	753
Brokerage commissions	607	606
Other	439	587
Total other income	9,434	9,800
Total other operating income	10,561	10,054
Other operating expenses		
Salaries and employee benefits	14,613	14,730
FDIC premiums	1,360	1,405
Equipment	1,931	1,948
Occupancy	1,868	2,016
Data processing	2,379	2,263

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Other real estate owned	2,128	2,766
Other	6,424	7,156
Total other operating expenses	30,703	32,284
Income before income tax expense	4,913	7,453
Provision for income tax expense	975	1,853
Net Income	3,938	5,600
Accumulated preferred stock dividends and discount accretion	(1,925 )	(1,326 )
Net Income Available to Common Shareholders	\$2,013	\$4,274
Basic and diluted net income per common share	\$0.32	\$0.69
Weighted average number of basic and diluted shares outstanding	6,220	6,206
<i>See accompanying notes to the consolidated financial statements</i>		



**FIRST UNITED CORPORATION**

## Consolidated Statement of Operations

(In thousands, except per share data)

	Three Months Ended September 30, 2014      2013 (Unaudited)	
Interest income		
Interest and fees on loans	\$ 9,447	\$ 11,930
Interest on investment securities		
Taxable	1,579	1,529
Exempt from federal income tax	371	447
Total investment income	1,950	1,976
Other	100	73
Total interest income	11,497	13,979
Interest expense		
Interest on deposits	1,154	1,251
Interest on short-term borrowings	16	16
Interest on long-term borrowings	1,502	1,666
Total interest expense	2,672	2,933
Net interest income	8,825	11,046
Provision for loan losses	688	(1,107 )
Net interest income after provision for loan losses	8,137	12,153
Other operating income		
Changes in fair value on impaired securities	578	742
Portion of gain recognized in other comprehensive income (before taxes)	(578 )	(742 )
Net securities impairment losses recognized in operations	0	0
Net gains /(losses)– other	166	(102 )
Total net gains/(losses)	166	(102 )
Service charges	747	894
Trust department	1,354	1,343
Debit card income	529	487
Bank owned life insurance	249	254
Brokerage commissions	201	245
Other	79	231
Total other income	3,159	3,454
Total other operating income	3,325	3,352
Other operating expenses		
Salaries and employee benefits	4,910	5,090
FDIC premiums	478	476
Equipment	625	657
Occupancy	592	632
Data processing	803	764

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Other real estate owned	514	2,814
Other	1,977	2,558
Total other operating expenses	9,899	12,991
Income before income tax expense	1,563	2,514
Provision for income tax expense	223	678
Net Income	1,340	1,836
Accumulated preferred stock dividends and discount accretion	(675 )	(448 )
Net Income Available to Common Shareholders	\$ 665	\$ 1,388
Basic and diluted net income per common share	\$ 0.10	\$ 0.22
Weighted average number of basic and diluted shares outstanding	6,228	6,211

*See accompanying notes to the consolidated financial statements*

**FIRST UNITED CORPORATION**

## Consolidated Statement of Comprehensive Income/(Loss)

(In thousands)

	Nine Months Ended September 30, 2014      2013 (Unaudited)	
<b>Comprehensive Income (in thousands)</b>		
Net Income	\$ 3,938	\$ 5,600
Other comprehensive income/(loss), net of tax and reclassification adjustments:		
Net unrealized gains on investments with OTTI	3,388	1,852
Net unrealized gains/(losses) on all other AFS securities	8,255	(6,369 )
Net unrealized losses on HTM securities	(2,315 )	0
Net unrealized gains on cash flow hedges	137	180
Net unrealized (losses)/gains on Pension	(650 )	525
Net unrealized gains on SERP	1	11
Other comprehensive income/(loss), net of tax	8,816	(3,801 )
Comprehensive income	\$ 12,754	\$ 1,799

*See accompanying notes to the consolidated financial statements***FIRST UNITED CORPORATION**

## Consolidated Statement of Comprehensive Income/(Loss)

(In thousands)

	Three Months Ended September 30, 2014      2013 (Unaudited)	
<b>Comprehensive Income (in thousands)</b>		

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Net Income	\$ 1,340	\$ 1,836
Other comprehensive income/(loss), net of tax and reclassification adjustments:		
Net unrealized gains on investments with OTTI	346	444
Net unrealized losses on all other AFS securities	(87 )	(640 )
Net unrealized gains on HTM securities	57	0
Net unrealized gains on cash flow hedges	26	42
Net unrealized (losses)/gains on Pension	(687 )	434
Net unrealized gains on SERP	0	4
Other comprehensive (loss)/income, net of tax	(345 )	284
Comprehensive income	\$ 995	\$ 2,120

*See accompanying notes to the consolidated financial statements*

**FIRST UNITED CORPORATION**

## Consolidated Statement of Changes in Shareholders' Equity

(In thousands)

	Preferred Stock	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Total Shareholders' Equity
	(Unaudited)					
Balance at January 1, 2013	\$29,925	\$ 62	\$21,573	\$ 69,168	\$ (21,823 )	\$ 98,905
Net income				6,446		6,446
Other comprehensive loss					(2,390 )	(2,390 )
Stock based compensation			88			88
Preferred stock discount accretion	69			(69 )		0
Preferred stock dividends deferred				(1,709 )		(1,709 )
Balance at December 31, 2013	29,994	62	21,661	73,836	(24,213 )	101,340
Net income				3,938		3,938
Other comprehensive income					8,816	8,816
Stock based compensation			95			95
Preferred stock discount accretion	6			(6 )		0
Preferred stock dividends paid				(1,919 )		(1,919 )
Balance at September 30, 2014	\$30,000	\$ 62	\$21,756	\$75,849	\$ (15,397 )	\$ 112,270

*See accompanying notes to the consolidated financial statements*

**FIRST UNITED CORPORATION**

## Consolidated Statement of Cash Flows

(In thousands)

	Nine Months Ended September 30, 2014      2013 (Unaudited)	
Operating activities		
Net income	\$3,938	\$5,600
Adjustments to reconcile net income to net cash (used in)/provided by operating activities:		
Provision for loan losses	1,629	(161 )
Depreciation	1,471	1,541
Stock compensation	95	66
Loss/(gain) on sales of other real estate owned	921	(80 )
Write-downs of other real estate owned	885	2,889
Gain on loan sales	(37 )	(154 )
Loss on disposal of fixed assets	3	24
Net amortization of investment securities discounts and premiums- AFS	152	930
Net amortization of investment securities discounts and premiums- HTM	19	0
Loss/(gain) on sales of investment securities – available-for-sale	7	(124 )
Gain on sales of investment securities – held for trading	(1,100 )	0
Amortization of deferred loan fees	(363 )	(429 )
Decrease in accrued interest receivable and other assets	2,229	4,128
Decrease in deferred tax benefit	(4 )	(1 )
(Decrease)/increase in accrued interest payable and other liabilities	(5,685 )	2,450
Earnings on bank owned life insurance	(737 )	(753 )
Net cash provided by operating activities	3,423	15,926
Investing activities		
Proceeds from maturities/calls of investment securities available-for-sale	122,291	27,160
Proceeds from maturities/calls of investment securities held-to-maturity	3,275	140
Proceeds from sales of investment securities available-for-sale	56,838	50,169
Proceeds from sales of investment securities held for trading	1,100	0
Purchases of investment securities available-for-sale	(153,924)	(159,423)
Purchases of investment securities held-to-maturity	(2,421 )	0
Proceeds from sales of other real estate owned	5,667	3,349
Proceeds from loan sales	4,312	20,691
Proceeds from disposal of fixed assets	0	1,421
Net decrease in FHLB stock	389	436
Net (increase)/decrease in loans	(23,782 )	12,151
Purchases of premises and equipment	(570 )	(864 )
Net cash provided by/(used in) investing activities	13,175	(44,770 )

Financing activities		
Net decrease in deposits	(4,370 )	(2,491 )
Preferred stock dividends paid	(8,420 )	0
Net increase in short-term borrowings	4,318	19,849
Payments on long-term borrowings	(49 )	(47 )
Net cash (used in)/provided by financing activities	(8,521 )	17,311
Increase/(decrease) in cash and cash equivalents	8,077	(11,533 )
Cash and cash equivalents at beginning of the year	43,063	83,068
Cash and cash equivalents at end of period	\$51,140	\$71,535
Supplemental information		
Interest paid	\$14,995	\$7,199
Non-cash investing activities:		
Transfers from loans to other real estate owned	\$2,030	\$5,627
Security sold September 30, settled in October	\$618	\$0
Transfers from securities available for sale to held-to-maturity	\$103,934	\$0

*See accompanying notes to the consolidated financial statements*

## FIRST UNITED CORPORATION

NoteS to Consolidated Financial Statements (UNAUDITED)

### Note 1 – Basis of Presentation

The accompanying unaudited consolidated financial statements of First United Corporation and its consolidated subsidiaries, including First United Bank & Trust (the “Bank”), have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information, as required by the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic 270, *Interim Reporting*, and with the instructions to Form 10-Q and Rule 8-03 of Regulation S-X. Accordingly, they do not include all the information and footnotes required for annual financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation, consisting of normal recurring items, have been included. Operating results for the three- and nine-month periods ended September 30, 2014 are not necessarily indicative of the results that may be expected for the full year or for any future interim period. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in First United Corporation’s Annual Report on Form 10-K for the year ended December 31, 2013. For purposes of comparability, certain prior period amounts have been reclassified to conform to the 2014 presentation. Such reclassifications had no impact on net income or equity.

First United Corporation has evaluated events and transactions occurring subsequent to the statement of financial condition date of September 30, 2014 for items that should potentially be recognized or disclosed in these financial statements as prescribed by ASC Topic 855, *Subsequent Events*.

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

### Note 2 – Earnings Per Common Share

Basic earnings per common share is derived by dividing net income available to common shareholders by the weighted-average number of common shares outstanding during the period and does not include the effect of any potentially dilutive common stock equivalents. Diluted earnings per share is derived by dividing net income available to common shareholders by the weighted-average number of shares outstanding, adjusted for the dilutive effect of outstanding common stock equivalents. There is no dilutive effect on earnings per share during loss periods. No common stock equivalents were outstanding during the nine- and three- month periods ended September 30, 2014 or 2013.



The following table sets forth the calculation of basic and diluted earnings per common share for the nine- and three-month periods ended September 30, 2014 and 2013:

(in thousands, except for per share amount)	Nine Months Ended September 30,					
	2014			2013		
	Income	Average Shares	Per Share Amount	Income	Average Shares	Per Share Amount
<b>Basic and Diluted Earnings Per Share:</b>						
Net income	\$3,938			\$5,600		
Preferred stock dividends	(1,919)			(1,274)		
Discount accretion on preferred stock	(6 )			(52 )		
Net income available to common shareholders	\$2,013	6,220	\$ 0.32	\$4,274	6,206	\$ 0.69

(in thousands, except for per share amount)	Three Months Ended September 30,					
	2014			2013		
	Income	Average Shares	Per Share Amount	Income	Average Shares	Per Share Amount
Basic and Diluted Earnings Per Share:						
Net income	\$1,340			\$1,836		
Preferred stock dividends deferred	(675 )			(430 )		
Discount accretion on preferred stock	0			(18 )		
Net income available to common shareholders	\$665	6,228	\$ 0.10	\$1,388	6,211	\$ 0.22

**Note 3 – Net Gains/(Losses)**

The following table summarizes the gain activity for the nine- and three-month periods ended September 30, 2014 and 2013:

(in thousands)	Nine Months Ended		Three Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Net gains/(losses) – other:				
Available-for-sale securities:				
Realized gains	\$427	\$447	\$222	\$35
Realized losses	(434 )	(323 )	(75 )	(138 )
Held-for-trading:				
Realized gains	1,100	0	0	0
Gain on sale of consumer loans	37	154	19	23
Loss on disposal of fixed assets	(3 )	(24 )	0	(22 )
Net gains/(losses) – other	\$1,127	\$254	\$166	\$(102)

**Note 4 – Cash and Cash Equivalents**

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

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(in thousands)	September 30, 2014	December 31, 2013
Cash and due from banks, weighted average interest rate of 0.16% (at September 30, 2014)	\$ 42,916	\$ 32,895

Interest bearing deposits in banks, which represent funds invested at a correspondent bank, are carried at cost which approximates fair value and, as of September 30, 2014 and December 31, 2013, consisted of daily funds invested at the Federal Home Loan Bank (“FHLB”) of Atlanta, First Tennessee Bank (“FTN”), Merchants and Traders (“M&T”) and Community Bankers Bank (“CBB”).

(in thousands)	September 30, 2014	December 31, 2013
FHLB daily investments, interest rate of 0.005% (at September 30, 2014)	\$ 1,314	\$ 1,677
FTN daily investments, interest rate of 0.07% (at September 30, 2014)	850	1,350
M&T daily investments, interest rate of 0.20% (at September 30, 2014)	5,050	5,043
M&T daily investments, interest rate of 0.20% (at September 30, 2014)	1,010	1,008
CBB Fed Funds sold, interest rate of 0.22% (at September 30, 2014)	0	1,090
	\$ 8,224	\$ 10,168

**Note 5 – Investments**

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

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

On June 1, 2014, management reclassified an amortized cost basis of \$107.6 million of available-for-sale securities to held to maturity. The unrealized loss of approximately \$4.0 million, at the date of transfer, will continue to be reported in a separate component of shareholders' equity as accumulated other comprehensive income and will be amortized over the remaining life of the securities as an adjustment of yield in a manner consistent with the amortization of any premium or discount.

The following table shows a comparison of amortized cost and fair values of investment securities at September 30, 2014 and December 31, 2013:

(in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	OTTI in AOCI
September 30, 2014					
Available for Sale:					
U.S. Treasuries	\$ 29,631	\$ 4	\$ 17	\$ 29,618	\$ 0
U.S. government agencies	39,088	82	411	38,759	0
Residential mortgage-backed agencies	46,573	276	726	46,123	0
Commercial mortgage-backed agencies	26,737	58	250	26,545	0
Collateralized mortgage obligations	9,286	89	7	9,368	0
Obligations of states and political subdivisions	46,784	1,466	234	48,016	0
Collateralized debt obligations	37,066	1,223	13,883	24,406	7,056
Total available for sale	\$ 235,165	\$ 3,198	\$ 15,528	\$ 222,835	\$ 7,056
Held to Maturity:					
U.S. government agencies	\$ 24,476	\$ 31	\$ 109	\$ 24,398	\$ 0
Residential mortgage-backed agencies	55,572	93	263	55,402	0
Commercial mortgage-backed agencies	16,476	145	73	16,548	0

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Collateralized mortgage obligations	7,712	0	110	7,602	0
Obligations of states and political subdivisions	2,725	0	249	2,476	0
Total held to maturity	\$ 106,961	\$ 269	\$ 804	\$ 106,426	\$ 0

December 31, 2013

Available for Sale:

U.S. government agencies	\$ 97,242	\$ 14	\$ 5,221	\$ 92,035	\$ 0
Residential mortgage-backed agencies	116,933	334	4,823	112,444	0
Commercial mortgage-backed agencies	31,025	14	1,134	29,905	0
Collateralized mortgage obligations	30,468	84	1,162	29,390	0
Obligations of states and political subdivisions	55,505	895	1,123	55,277	0
Collateralized debt obligations	37,146	778	20,386	17,538	12,703
Total available for sale	\$ 368,319	\$ 2,119	\$ 33,849	\$ 336,589	\$ 12,703

Held to Maturity:

Obligations of states and political subdivisions	\$ 3,900	\$ 249	\$ 559	\$ 3,590	\$ 0
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Proceeds from sales of securities and the realized gains and losses are as follows:

(in thousands)	Nine Months Ended		Three Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Proceeds	\$ 56,838	\$ 50,169	\$ 616	\$ 15,033
Realized gains	1,527	447	222	35
Realized losses	434	323	75	138

The following table shows the Corporation's securities with gross unrealized losses and fair values at September 30, 2014 and December 31, 2013, aggregated by investment category and the length of time that individual securities have been in a continuous unrealized loss position:

(in thousands)	Less than 12 months		12 months or more	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
September 30, 2014				
Available for Sale:				
U.S. Treasuries	\$ 10,078	\$ 17	\$ 0	\$ 0
U.S. government agencies	0	0	18,664	411
Residential mortgage-backed agencies	9,974	1	23,786	725
Commercial mortgage-backed agencies	20,480	235	969	15
Collateralized mortgage obligations	2,174	7	0	0
Obligations of states and political subdivisions	0	0	12,450	234
Collateralized debt obligations	0	0	19,394	13,883
Total available for sale	\$ 42,706	\$ 260	\$ 75,263	\$ 15,268
Held to Maturity:				
U.S. government agencies	\$ 14,945	\$ 109	\$ 0	\$ 0
Residential mortgage-backed agencies	47,209	263	0	0
Commercial mortgage-backed agencies	9,660	73	0	0
Collateralized mortgage obligations	7,602	110	0	0
Obligations of states and political subdivisions	0	0	2,476	249
Total held to maturity	\$ 79,416	\$ 555	\$ 2,476	\$ 249
December 31, 2013				
Available for Sale:				
U.S. government agencies	\$ 62,962	\$ 3,154	\$ 13,996	\$ 2,067
Residential mortgage-backed agencies	60,781	1,801	46,570	3,022
Commercial mortgage-backed agencies	21,889	1,134	0	0
Collateralized mortgage obligations	21,201	1,149	3,051	13
Obligations of states and political subdivisions	15,422	1,123	0	0

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Collateralized debt obligations	0	0	16,434	20,386
Total available for sale	\$182,255	\$8,361	\$80,051	\$25,488
Held to Maturity:				
Obligations of states and political subdivisions	\$0	\$0	\$2,301	\$559

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

Management believes that the valuation of certain securities is a critical accounting policy that requires significant estimates in preparation of the Corporation’s consolidated financial statements. Management utilizes an independent third party to prepare both the impairment valuations and fair value determinations for the Corporation’s collateralized debt obligation (“CDO”) portfolio consisting of pooled trust preferred securities. Based on management’s review of the assumptions and results of the third-party review, it does not believe that there were any material differences in the valuations between December 31, 2013 and September 30, 2014.

U.S. Government Treasuries – Available for Sale - One U.S. government treasury has been in an unrealized loss position for less than 12 months as of September 30, 2014. The security is of the highest investment grade and the Corporation does not intend to sell it, and it is not more likely than not that the Corporation will be required to sell it before recovery of its amortized cost basis, which may be at maturity. Accordingly, management does not consider this investment to be other-than-temporarily impaired at September 30, 2014. There were no U.S. government treasuries in an unrealized loss position for 12 months or more.

U.S. Government Agencies – Available for Sale – There were no U.S. government agencies in an unrealized loss position for less than 12 months as of September 30, 2014. There were three U.S. government agencies in an unrealized loss position for 12 months or more. The securities are of the highest investment grade and the Corporation does not intend to sell them, and it is not more likely than not that the Corporation will be required to sell them before recovery of their amortized cost basis, which may be at maturity. Accordingly, management does not consider these investments to be other-than-temporarily impaired at September 30, 2014.



Residential Mortgage-Backed Agencies – Available for Sale - There was one residential mortgage-backed agency in an unrealized loss position for less than 12 months as of September 30, 2014. There were four residential mortgage-backed agency securities in an unrealized loss position for 12 months or more. The securities are of the highest investment grade and the Corporation does not intend to sell them, and it is not more likely than not that the Corporation will be required to sell the securities before recovery of their amortized cost basis, which may be at maturity. Accordingly, management does not consider these investments to be other-than-temporarily impaired at September 30, 2014.

Commercial Mortgage-Backed Agencies – Available for Sale – There were three commercial mortgage-backed agencies in an unrealized loss position for less than 12 months as of September 30, 2014. There was one commercial mortgage-backed agency security in an unrealized loss position for 12 months or more. The securities are of the highest investment grade and the Corporation does not intend to sell them, and it is not more likely than not that the Corporation will be required to sell them before recovery of their amortized cost basis, which may be at maturity. Accordingly, management does not consider this investment to be other-than-temporarily impaired at September 30, 2014.

Collateralized Mortgage-Obligations – Available for Sale – There was one collateralized mortgage-obligation security in an unrealized loss position for less than 12 months as of September 30, 2014. The security is of the highest investment grade and the Corporation does not intend to sell it, and it is not more likely than not that the Corporation will be required to sell it before recovery of its amortized cost basis, which may be at maturity. Accordingly, management does not consider this investment to be other-than-temporarily impaired at September 30, 2014. There were no collateralized mortgage-obligation securities in an unrealized loss position for 12 months or more.

Obligations of State and Political Subdivisions – Available for Sale - No obligations of state and political subdivisions securities have been in an unrealized loss position for less than 12 months at September 30, 2014. There were six securities that have been in an unrealized loss position for 12 months or more. These investments are of investment grade as determined by the major rating agencies and management reviews the ratings of the underlying issuers and performs an in-depth credit analysis on the securities. Management believes that this portfolio is well-diversified throughout the United States, and all bonds continue to perform according to their contractual terms. The Corporation does not intend to sell these investments and it is not more likely than not that the Corporation will be required to sell the investments before recovery of their amortized cost basis, which may be at maturity. Accordingly, management does not consider these investments to be other-than-temporarily impaired at September 30, 2014.

Collateralized Debt Obligations – Available for Sale - The \$13.9 million in unrealized losses greater than 12 months at September 30, 2014 relates to 14 pooled trust preferred securities that are included in the CDO portfolio. See Note 9 for a discussion of the methodology used by management to determine the fair values of these securities. Based upon a review of credit quality and the cash flow tests performed by the independent third party, management determined that there were no securities that had credit-related non-cash OTTI charges during the first nine months of 2014. The unrealized losses on the remaining securities in the portfolio are primarily attributable to continued depression in market interest rates, marketability, liquidity and the current economic environment.

U.S. Government Agencies – Held to Maturity - Two U.S. government agencies have been in an unrealized loss position for less than 12 months as of September 30, 2014. The Corporation has the intent and ability to hold the investments to maturity. Accordingly, management does not consider these investments to be other-than-temporarily impaired at September 30, 2014. There were no U.S. government agencies in an unrealized loss position for 12 months or more.

Residential Mortgage-Backed Agencies – Held to Maturity - Eighteen residential mortgage-backed agencies have been in an unrealized loss position for less than 12 months as of September 30, 2014. The Corporation has the intent and ability to hold the investments to maturity. Accordingly, management does not consider these investments to be other-than-temporarily impaired at September 30, 2014. There were no residential mortgage-backed agencies in an unrealized loss position for 12 months or more.

Commercial Mortgage-Backed Agencies – Held to Maturity - One commercial mortgage-backed agency has been in an unrealized loss position for less than 12 months as of September 30, 2014. The Corporation has the intent and ability to hold this investment to maturity. Accordingly, management does not consider this investment to be other-than-temporarily impaired at September 30, 2014. There were no commercial mortgage-backed agencies in an unrealized loss position for 12 months or more.

Collateralized Mortgage-Obligations – Held to Maturity - One collateralized mortgage obligation has been in an unrealized loss position for less than 12 months as of September 30, 2014. The Corporation has the intent and ability

to hold the investment to maturity. Accordingly, management does not consider this investment to be other-than-temporarily impaired at September 30, 2014. There were no collateralized mortgage obligations in an unrealized loss position for 12 months or more.

Obligations of State and Political Subdivisions – Held to Maturity – No obligations of state and political subdivisions securities have been in an unrealized loss position for less than 12 months at September 30, 2014. There was one obligations of state and political subdivisions security that has been in an unrealized loss position for 12 months or more. This bond is a Tax Increment Fund (TIF) bond. Management performs an in-depth credit analysis on this security. The Corporation has the intent and ability to hold the investment to maturity. Accordingly, management does not consider this investment to be other-than-temporarily impaired at September 30, 2014.

The following tables present a cumulative roll-forward of the amount of non-cash OTTI charges related to credit losses which have been recognized in earnings for the trust preferred securities in the CDO portfolio held and not intended to be sold for the nine- and three-month periods ended September 30, 2014 and 2013:

(in thousands)	Nine Months Ended September 30,	
	2014	2013
Balance of credit-related OTTI at January 1	\$ 13,422	\$ 13,959
Reduction for increases in cash flows expected to be collected	(501 )	(404 )
Balance of credit-related OTTI at September 30	\$ 12,921	\$ 13,555

(in thousands)	Three Months Ended September 30,	
	2014	2013
Balance of credit-related OTTI at July 1	\$ 13,091	\$ 13,695
Reduction for increases in cash flows expected to be collected	(170 )	(140 )
Balance of credit-related OTTI at September 30	\$ 12,921	\$ 13,555

The amortized cost and estimated fair value of securities by contractual maturity at September 30, 2014 are shown in the following table. Actual maturities may differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties.

(in thousands)	September 30, 2014	
	Amortized Cost	Fair Value
<b>Contractual Maturity</b>		
Available for sale:		
Due in one year or less	\$19,536	\$ 19,540
Due after one year through five years	44,436	\$ 44,475
Due after five years through ten years	29,390	30,015
Due after ten years	59,207	46,769
	152,569	140,799
Residential mortgage-backed agencies	46,573	46,123
Commercial mortgage-backed agencies	26,737	26,545
Collateralized mortgage obligations	9,286	9,368
	\$235,165	\$ 222,835
Held to Maturity:		
Due after five years through ten years	\$15,442	\$ 15,437
Due after ten years	11,759	11,437
	27,201	26,874
Residential mortgage-backed agencies	55,572	55,402
Commercial mortgage-backed agencies	16,476	16,548

Collateralized mortgage obligations	7,712	7,602
	\$106,961	\$106,426

**Note 6 - Restricted Investment in Bank Stock**

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

Management evaluates the restricted stock for impairment in accordance with ASC Industry Topic 942, *Financial Services – Depository and Lending*, (ASC Section 942-325-35). Management’s evaluation of potential impairment is based on management’s assessment of the ultimate recoverability of the cost of the restricted stock rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability is influenced by criteria such as (a) the significance of the decline in net assets of the issuing bank as compared to the capital stock amount for that bank and the length of time this situation has persisted, (b) commitments by the issuing bank to make payments required by law or regulation and the level of such payments in relation to the operating performance of that bank, and (c) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the issuing bank. Management has evaluated the restricted stock for impairment and believes that no impairment charge is necessary as of September 30, 2014.

The Corporation recognizes dividends received on its restricted stock investments on a cash basis. For the nine months ended September 30, 2014, dividends of \$212,665 were recognized in earnings. For the comparable period of 2013, dividends of \$145,578 were recognized in earnings. For the three months ended September 30, 2014 and 2013, dividends of \$68,329 and \$48,844, respectively, were recognized in earnings.

**Note 7 – Loans and Related Allowance for Loan Losses**

The following table summarizes the primary segments of the loan portfolio as of September 30, 2014 and December 31, 2013:

(in thousands)	Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Residential Mortgage	Consumer	Total
September 30, 2014						
Individually evaluated for impairment	\$ 12,425	\$ 7,735	\$ 1,882	\$ 6,768	\$ 0	\$28,810
Collectively evaluated for impairment	\$ 240,662	\$ 89,251	\$ 87,476	\$ 354,597	\$ 24,129	\$796,115
Total loans	\$ 253,087	\$ 96,986	\$ 89,358	\$ 361,365	\$ 24,129	\$824,925

December 31, 2013

Individually evaluated for impairment	\$ 11,740	\$ 11,703	\$ 2,299	\$ 7,546	\$ 21	\$ 33,309
Collectively evaluated for impairment	\$ 256,238	\$ 95,547	\$ 57,489	\$ 343,360	\$ 24,297	\$ 776,931
Total loans	\$ 267,978	\$ 107,250	\$ 59,788	\$ 350,906	\$ 24,318	\$ 810,240

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

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

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

The following table presents the classes of the loan portfolio summarized by the aggregate Pass and the criticized categories of Special Mention and Substandard within the internal risk rating system as of September 30, 2014 and December 31, 2013:

(in thousands)	Pass	Special Mention	Substandard	Total
September 30, 2014				
Commercial real estate				
Non owner-occupied	\$ 105,951	\$ 1,305	\$ 25,355	\$ 132,611
All other CRE	91,792	8,755	19,929	120,476
Acquisition and development				
1-4 family residential construction	12,900	0	1,004	13,904
All other A&D	68,586	1,398	13,098	83,082
Commercial and industrial	86,641	886	1,831	89,358
Residential mortgage				
Residential mortgage - term	272,979	701	12,166	285,846
Residential mortgage - home equity	73,857	97	1,565	75,519



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Consumer	24,036	0	93	24,129
Total	\$736,742	\$ 13,142	\$ 75,041	\$824,925

December 31, 2013

Commercial real estate				
Non owner-occupied	\$103,556	\$ 9,243	\$ 24,745	\$137,544
All other CRE	100,461	8,479	21,494	130,434
Acquisition and development				
1-4 family residential construction	8,764	0	4,497	13,261
All other A&D	73,198	1,787	19,004	93,989
Commercial and industrial	55,768	140	3,880	59,788
Residential mortgage				
Residential mortgage - term	261,735	752	11,980	274,467
Residential mortgage - home equity	73,901	628	1,910	76,439
Consumer	24,143	5	170	24,318
Total	\$701,526	\$ 21,034	\$ 87,680	\$810,240

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

The following table presents the classes of the loan portfolio summarized by the aging categories of performing loans and non-accrual loans as of September 30, 2014 and December 31, 2013:

(in thousands)	Current	30-59 Days Past Due	60-89 Days Past Due	90 Days+ Past Due	Total Past Due and Accruing	Non-Accrual	Total Loans
September 30, 2014							
Commercial real estate							
Non owner-occupied	\$ 128,145	\$ 306	\$ 3,179	\$ 187	\$ 3,672	\$ 794	\$ 132,611
All other CRE	115,367	269	0	0	269	4,840	120,476
Acquisition and development							
1-4 family residential construction	13,812	0	0	0	0	92	13,904
All other A&D	78,020	0	419	87	506	4,556	83,082
Commercial and industrial	89,102	6	22	0	28	228	89,358
Residential mortgage							
Residential mortgage - term	279,157	569	2,263	957	3,789	2,900	285,846
Residential mortgage - home equity	74,465	318	138	95	551	503	75,519
Consumer	23,773	248	79	29	356	0	24,129
Total	\$ 801,841	\$ 1,716	\$ 6,100	\$ 1,355	\$ 9,171	\$ 13,913	\$ 824,925
December 31, 2013							
Commercial real estate							
Non owner-occupied	\$ 136,462	\$ 191	\$ 145	\$ 65	\$ 401	\$ 681	\$ 137,544
All other CRE	121,985	1,490	207	0	1,697	6,752	130,434
Acquisition and development							
1-4 family residential construction	12,018	0	139	0	139	1,104	13,261
All other A&D	88,071	1,075	33	282	1,390	4,528	93,989
Commercial and industrial	59,320	87	57	133	277	191	59,788
Residential mortgage							
Residential mortgage - term	259,239	8,258	2,541	634	11,433	3,795	274,467

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Residential mortgage - home equity	74,917	656	439	96	1,191	331	76,439
Consumer	23,802	350	128	24	502	14	24,318
Total	\$775,814	\$ 12,107	\$ 3,689	\$ 1,234	\$ 17,030	\$ 17,396	\$ 810,240

Non-accrual loans which have been subject to a partial charge-off totaled \$4.9 million as of September 30, 2014, compared to \$1.9 million as of December 31, 2013.

An allowance for loan losses (“ALL”) is maintained to absorb losses from the loan portfolio. The ALL is based on management’s continuing evaluation of the risk characteristics and credit quality of the loan portfolio, assessment of current economic conditions, diversification and size of the portfolio, adequacy of collateral, past and anticipated loss experience, and the amount of non-performing loans.

The Bank's methodology for determining the ALL is based on the requirements of ASC Section 310-10-35, *Receivables-Overall-Subsequent Measurement*, for loans individually evaluated for impairment and ASC Subtopic 450-20, *Contingencies-Loss Contingencies*, for loans collectively evaluated for impairment, as well as the Interagency Policy Statement on the Allowance for Loan and Lease Losses and other bank regulatory guidance. The total of the two components represents the Bank's ALL.

The following table summarizes the primary segments of the ALL, segregated by the amount required for loans individually evaluated for impairment and the amount required for loans collectively evaluated for impairment as of September 30, 2014 and December 31, 2013.

(in thousands)	Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Residential Mortgage	Consumer	Total
September 30, 2014						
Individually evaluated for impairment	\$ 0	\$ 1,100	\$ 0	\$ 62	\$ 0	\$1,162
Collectively evaluated for impairment	\$ 2,592	\$ 2,610	\$ 1,591	\$ 3,917	\$ 196	\$10,906
Total ALL	\$ 2,592	\$ 3,710	\$ 1,591	\$ 3,979	\$ 196	\$12,068
December 31, 2013						
Individually evaluated for impairment	\$ 236	\$ 1,967	\$ 0	\$ 80	\$ 0	\$2,283
Collectively evaluated for impairment	\$ 3,816	\$ 2,205	\$ 766	\$ 4,240	\$ 284	\$11,311
Total ALL	\$ 4,052	\$ 4,172	\$ 766	\$ 4,320	\$ 284	\$13,594

Management evaluates individual loans in all of the commercial segments for possible impairment if the loan (a) is greater than \$500,000 or (b) is part of a relationship that is greater than \$750,000 and is either (i) in nonaccrual status or (ii) risk-rated Substandard and greater than 60 days past due. Loans are considered to be impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in evaluating impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. The Bank does not separately evaluate individual consumer and residential mortgage loans for impairment, unless such loans are part of a larger relationship that is impaired; otherwise, loans in these segments are considered impaired when they are classified as non-accrual.

Once the determination has been made that a loan is impaired, the determination of whether a specific allocation of the allowance is necessary is measured by comparing the recorded investment in the loan to the fair value of the loan using one of three methods: (a) the present value of expected future cash flows discounted at the loan's effective interest rate; (b) the loan's observable market price; or (c) the fair value of the collateral less selling costs. The method is selected on a loan-by-loan basis, with management primarily utilizing the fair value of collateral method. If the fair value of the collateral less selling costs method is utilized for collateral securing loans in the commercial segments, then an updated external appraisal is ordered on the collateral supporting the loan if the loan balance is greater than \$500,000 and the existing appraisal is greater than 18 months old. If an updated appraisal has not been received and reviewed in time for the determination of estimated fair value at quarter (or year) end, or if the appraisal is found to be deficient in our internal appraisal review process and re-ordered, then the estimated fair value of the collateral is determined by adjusting the existing appraisal by the appropriate percentage from an internally prepared appraisal discount grid. This grid considers the age of a third party appraisal and the geographic region where the collateral is located. The discount rates in the appraisal discount grid are updated periodically to reflect the most current knowledge that management has available, including the results of current appraisals. A specific allocation of the ALL is recorded if there is any deficiency in collateral value determined by comparing the estimated fair value to the recorded investment of the loan. When updated appraisals are received and reviewed, adjustments are made to the specific allocation as needed.

The evaluation of the need and amount of a specific allocation of the ALL and whether a loan can be removed from impairment status is made on a quarterly basis.

The following table presents impaired loans by class, segregated by those for which a specific allowance was required and those for which a specific allowance was not necessary as of September 30, 2014 and December 31, 2013:

(in thousands)	Impaired Loans with Specific Allowance		Impaired Loans with No Specific Allowance	Total Impaired Loans	
	Recorded Investment	Related Allowances	Recorded Investment	Recorded Investment	Unpaid Principal Balance
September 30, 2014					
Commercial real estate					
Non owner-occupied	\$ 0	\$ 0	\$ 4,245	\$ 4,245	\$ 4,255
All other CRE	0	0	8,180	8,180	8,308
Acquisition and development					
1-4 family residential construction	912	130	92	1,004	1,068
All other A&D	3,162	970	3,569	6,731	12,999
Commercial and industrial	0	0	1,882	1,882	2,691
Residential mortgage					
Residential mortgage - term	346	62	5,919	6,265	6,791
Residential mortgage – home equity	0	0	503	503	563
Consumer	0	0	0	0	0
Total impaired loans	\$ 4,420	\$ 1,162	\$ 24,390	\$ 28,810	\$ 36,675
December 31, 2013					
Commercial real estate					
Non owner-occupied	\$ 257	\$ 59	\$ 922	\$ 1,179	\$ 1,191
All other CRE	1,080	177	9,481	10,561	10,689
Acquisition and development					
1-4 family residential construction	2,651	634	7	2,658	2,704
All other A&D	4,037	1,333	5,008	9,045	13,394
Commercial and industrial	0	0	2,299	2,299	2,299
Residential mortgage					
Residential mortgage - term	988	80	5,979	6,967	7,372
Residential mortgage – home equity	0	0	579	579	579
Consumer	0	0	21	21	21
Total impaired loans	\$ 9,013	\$ 2,283	\$ 24,296	\$ 33,309	\$ 38,249

Loans that are collectively evaluated for impairment are analyzed with general allowances being made as appropriate. For general allowances, historical loss trends are used in the estimation of losses in the current portfolio. These historical loss amounts are modified by other qualitative factors.

The classes described above, which are based on the Federal call code assigned to each loan, provide the starting point for the ALL analysis. Management tracks the historical net charge-off activity (full and partial charge-offs, net of full

and partial recoveries) at the call code level. A historical charge-off factor is calculated utilizing a defined number of consecutive historical quarters. Consumer pools currently utilize a rolling 12 quarters, while Commercial pools currently utilize a rolling eight quarters.

“Pass” rated credits are segregated from “Criticized” credits for the application of qualitative factors. “Pass” pools for commercial and residential real estate are further segmented based upon the geographic location of the underlying collateral. There are seven geographic regions utilized – six that represent the Bank’s lending footprint and a seventh for all out-of-market credits. Different economic environments and resultant credit risks exist in each region that are acknowledged in the assignment of qualitative factors. Loans in the criticized pools, which possess certain qualities or characteristics that may lead to collection and loss issues, are closely monitored by management and subject to additional qualitative factors.

Management supplements the historical charge-off factor with a number of additional qualitative factors that are likely to cause estimated credit losses associated with the existing loan pools to differ from historical loss experience. The additional factors, which are evaluated quarterly and updated using information obtained from internal, regulatory, and governmental sources, are: (a) national and local economic trends and conditions; (b) levels of and trends in delinquency rates and non-accrual loans; (c) trends in volumes and terms of loans; (d) effects of changes in lending policies; (e) experience, ability, and depth of lending staff; (f) value of underlying collateral; and (g) concentrations of credit from a loan type, industry and/or geographic standpoint.

Management reviews the loan portfolio on a quarterly basis using a defined, consistently applied process in order to make appropriate and timely adjustments to the ALL. When information confirms all or part of specific loans to be uncollectible, these amounts are promptly charged off against the ALL. Residential mortgage and consumer loans are charged off after they are 120 days contractually past due. All other loans are charged off based on an evaluation of the facts and circumstances of each individual loan. When the Bank believes that its ability to collect is solely dependent on the liquidation of the collateral, a full or partial charge-off is recorded promptly to bring the recorded investment to an amount that the Bank believes is supported by an ability to collect on the collateral. The circumstances that may impact the Bank's decision to charge-off all or a portion of a loan include default or non-payment by the borrower, scheduled foreclosure actions, and/or prioritization of the Bank's claim in bankruptcy. There may be circumstances where, due to pending events, the Bank will place a specific allocation of the ALL on a loan for which a partial charge-off has been previously recognized. This specific allocation may be either charged off or removed depending upon the outcome of the pending event. Full or partial charge-offs are not recovered until full principal and interest on the loan have been collected, even if a subsequent appraisal supports a higher value. Loans with partial charge-offs generally remain in non-accrual status. Both full and partial charge-offs reduce the recorded investment of the loan and the ALL and are considered to be charge-offs for purposes of all credit loss metrics and trends, including the historical rolling charge-off rates used in the determination of the ALL.



Activity in the ALL is presented for the nine- and three-month periods ended September 30, 2014 and September 30, 2013:

(in thousands)	Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Residential Mortgage	Consumer	Total
ALL balance at January 1, 2014	\$ 4,052	\$ 4,172	\$ 766	\$ 4,320	\$ 284	\$13,594
Charge-offs	(85 )	(2,423 )	(213 )	(682 )	(380 )	(3,783 )
Recoveries	11	104	22	183	308	628
Provision	(1,386 )	1,857	1,016	158	(16 )	1,629
ALL balance at September 30, 2014	\$ 2,592	\$ 3,710	\$ 1,591	\$ 3,979	\$ 196	\$12,068
ALL balance at January 1, 2013	\$ 5,206	\$ 5,029	\$ 906	\$ 4,507	\$ 399	\$16,047
Charge-offs	(233 )	(276 )	(1,051 )	(317 )	(375 )	(2,252 )
Recoveries	1,004	33	68	154	258	1,517
Provision	(1,509 )	495	815	18	20	(161 )
ALL balance at September 30, 2013	\$ 4,468	\$ 5,281	\$ 738	\$ 4,362	\$ 302	\$15,151

(in thousands)	Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Residential Mortgage	Consumer	Total
ALL balance at July 1, 2014	\$ 2,839	\$ 3,642	\$ 1,553	\$ 4,178	\$ 251	\$12,463
Charge-offs	(64 )	(903 )	(5 )	(116 )	(117 )	(1,205 )
Recoveries	1	33	15	27	46	122
Provision	(184 )	938	28	(110 )	16	688
ALL balance at September 30, 2014	\$ 2,592	\$ 3,710	\$ 1,591	\$ 3,979	\$ 196	\$12,068
ALL balance at July 1, 2013	\$ 5,261	\$ 4,875	\$ 753	\$ 4,304	\$ 329	\$15,522
Charge-offs	(49 )	(14 )	(47 )	(61 )	(100 )	(271 )
Recoveries	877	12	17	35	66	1,007
Provision	(1,621 )	408	15	84	7	(1,107 )
ALL balance at September 30, 2013	\$ 4,468	\$ 5,281	\$ 738	\$ 4,362	\$ 302	\$15,151

The ALL is based on estimates, and actual losses may vary from current estimates. Management believes that the granularity of the homogeneous pools and the related historical loss ratios and other qualitative factors, as well as the consistency in the application of assumptions, result in an ALL that is representative of the risk found in the components of the portfolio at any given date.

The following tables present the average recorded investment in impaired loans by class and related interest income recognized for the periods indicated:

(in thousands)	Nine Months Ended September 30, 2014			Nine Months Ended September 30, 2013		
	Average investment	Interest income recognized on an accrual basis	Interest income recognized on a cash basis	Average investment	Interest income recognized on an accrual basis	Interest income recognized on a cash basis
Commercial real estate						
Non owner-occupied	\$1,890	\$ 28	\$ 0	\$4,161	\$ 33	\$ 1,454
All other CRE	9,497	116	67	10,698	261	46
Acquisition and development						
1-4 family residential construction	1,690	34	0	3,033	59	0
All other A&D	8,108	129	0	18,614	394	575
Commercial and industrial	2,065	70	2	2,844	88	0
Residential mortgage						
Residential mortgage - term	6,552	154	55	4,816	56	7
Residential mortgage – home equity	640	4	4	555	18	0
Consumer	11	0	0	75	0	0
Total	\$30,453	\$ 535	\$ 128	\$44,796	\$ 909	\$ 2,082

(in thousands)	Three Months Ended September 30, 2014			Three Months Ended September 30, 2013		
	Average investment	Interest income recognized on an accrual basis	Interest income recognized on a cash basis	Average investment	Interest income recognized on an accrual basis	Interest income recognized on a cash basis
Commercial real estate						
Non owner-occupied	\$2,591	\$ 17	\$ 0	\$3,048	\$ 10	\$ 1,454
All other CRE	8,506	35	23	10,704	83	0
Acquisition and development						
1-4 family residential construction	1,016	9	0	3,237	17	0
All other A&D	7,540	33	0	15,879	125	272
Commercial and industrial	1,905	21	0	2,257	22	0
Residential mortgage						
Residential mortgage - term	6,225	47	3	5,684	23	5
Residential mortgage – home equity	597	0	3	536	6	0
Consumer	0	0	0	74	0	0
Total	\$28,380	\$ 162	\$ 29	\$41,419		