

OLD SECOND BANCORP INC
Form 10-Q
May 13, 2014
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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

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**
For transition period from _____ to _____

Commission File Number 0 -10537

OLD SECOND BANCORP, INC.

(Exact name of Registrant as specified in its charter)

Delaware

(State or other jurisdiction
of incorporation or organization)

36-3143493

(I.R.S. Employer Identification Number)

37 South River Street, Aurora, Illinois 60507

(Address of principal executive offices) (Zip Code)

(630) 892-0202

(Registrant's telephone number, including area code)

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

Yes x No o

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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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether 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 Act. (Check one):

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date: As of May 9, 2014, the Registrant had outstanding 29,442,508 shares of common stock, \$1.00 par value per share.

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OLD SECOND BANCORP, INC.

Form 10-Q Quarterly Report

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Table of Contents**PART I - FINANCIAL INFORMATION****Item 1. Financial Statements****Old Second Bancorp, Inc. and Subsidiaries****Consolidated Balance Sheets***(In thousands, except share data)*

	(Unaudited) March 31, 2014	December 31, 2013
Assets		
Cash and due from banks	\$ 40,245	\$ 33,210
Interest bearing deposits with financial institutions	14,242	14,450
Cash and cash equivalents	54,487	47,660
Securities available-for-sale, at fair value	400,212	372,191
Securities held-to-maturity, at amortized cost	264,298	256,571
Federal Home Loan Bank and Federal Reserve Bank stock	10,292	10,292
Loans held-for-sale	2,507	3,822
Loans	1,111,237	1,101,256
Less: allowance for loan losses	25,476	27,281
Net loans	1,085,761	1,073,975
Premises and equipment, net	45,716	46,005
Other real estate owned	40,220	41,537
Mortgage servicing rights, net	5,614	5,807
Core deposit intangible, net	665	1,177
Bank-owned life insurance (BOLI)	55,768	55,410
Deferred tax assets, net	74,453	75,303
Other assets	19,426	14,284
Total assets	\$ 2,059,419	\$ 2,004,034
Liabilities		
Deposits:		
Noninterest bearing demand	\$ 387,090	\$ 373,389
Interest bearing:		
Savings, NOW, and money market	872,521	836,300
Time	464,670	472,439
Total deposits	1,724,281	1,682,128
Securities sold under repurchase agreements	23,212	22,560
Other short-term borrowings	20,000	5,000
Junior subordinated debentures	58,378	58,378
Subordinated debt	45,000	45,000
Notes payable and other borrowings	500	500
Other liabilities	38,560	42,776
Total liabilities	1,909,931	1,856,342
Stockholders Equity		
Preferred stock	73,000	72,942
Common stock	18,840	18,830
Additional paid-in capital	66,297	66,212
Retained earnings	94,693	92,549

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Accumulated other comprehensive loss		(7,493)		(7,038)
Treasury stock		(95,849)		(95,803)
Total stockholders' equity		149,488		147,692
Total liabilities and stockholders' equity	\$	2,059,419	\$	2,004,034

	March 31, 2014		December 31, 2013	
	Preferred Stock	Common Stock	Preferred Stock	Common Stock
Par value	\$ 1	\$ 1	\$ 1	\$ 1
Liquidation value	1,000	n/a	1,000	n/a
Shares authorized	300,000	60,000,000	300,000	60,000,000
Shares issued	73,000	18,839,734	73,000	18,829,734
Shares outstanding	73,000	13,917,508	73,000	13,917,108
Treasury shares	-	4,922,226	-	4,912,626

See accompanying notes to consolidated financial statements.

Table of Contents**Old Second Bancorp, Inc. and Subsidiaries****Consolidated Statements of Operations***(In thousands, except share data)*

	(Unaudited)	
	Three Months Ended	
	March 31,	
	2014	2013
Interest and dividend income		
Loans, including fees	\$ 12,938	\$ 14,914
Loans held-for-sale	25	41
Securities:		
Taxable	3,502	2,298
Tax-exempt	148	119
Dividends from Federal Reserve Bank and Federal Home Loan Bank stock	76	76
Interest bearing deposits with financial institutions	15	42
Total interest and dividend income	16,704	17,490
Interest expense		
Savings, NOW, and money market deposits	199	228
Time deposits	1,321	1,853
Securities sold under repurchase agreements	1	1
Other short-term borrowings	1	19
Junior subordinated debentures	1,387	1,287
Subordinated debt	196	196
Notes payable and other borrowings	4	4
Total interest expense	3,109	3,588
Net interest and dividend income	13,595	13,902
Loan loss reserve release	(1,000)	(2,500)
Net interest and dividend income after loan loss reserve release	14,595	16,402
Noninterest income		
Trust income	1,459	1,491
Service charges on deposits	1,720	1,677
Secondary mortgage fees	112	230
Mortgage servicing (loss) gain, net of changes in fair value	(47)	244
Net gain on sales of mortgage loans	662	1,976
Securities (losses) gains, net	(69)	1,453
Increase in cash surrender value of bank-owned life insurance	358	407
Debit card interchange income	830	792
Other income	1,296	1,737
Total noninterest income	6,321	10,007
Noninterest expense		
Salaries and employee benefits	9,101	9,032
Occupancy expense, net	1,481	1,279
Furniture and equipment expense	983	1,144
FDIC insurance	279	1,035
General bank insurance	489	849
Amortization of core deposit	512	525
Advertising expense	303	166
Debit card interchange expense	378	344
Legal fees	257	323
Other real estate expense, net	1,008	3,097
Other expense	2,725	3,144
Total noninterest expense	17,516	20,938
Income before income taxes	3,400	5,471

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Income tax expense		1,198		-
Net income		2,202		5,471
Preferred stock dividends and accretion of discount		1,572		1,289
Net income available to common shareholders	\$	630	\$	4,182
Share and per share information:				
Basic income per share	\$	0.04	\$	0.30
Diluted income per share		0.04		0.30
Dividends paid per share		-		-

See accompanying notes to consolidated financial statements.

Table of Contents**Old Second Bancorp, Inc. and Subsidiaries****Consolidated Statements of Comprehensive Income**

(In thousands)

	(Unaudited)	
	Three Months Ended	
	March 31,	
	2014	2013
Net income	\$ 2,202	\$ 5,471
Total unrealized holding losses on available-for-sale securities arising during the period	(1,089)	(35)
Related tax benefit	448	17
Holding losses after tax	(641)	(18)
Less: Reclassification adjustment for the net gains and losses realized during the period		
Net realized (losses) gains	(69)	1,453
Income tax benefit (expense) on net realized gains	28	(596)
Net realized (losses) gains after tax	(41)	857
Other comprehensive loss on available-for-sale securities	(600)	(875)
Accretion of net unrealized holding gains on held-to-maturity transferred from available-for-sale securities	247	-
Related tax expense	(102)	-
Other comprehensive income on held-to-maturity securities	145	-
Total other comprehensive loss	(455)	(875)
Total comprehensive income	\$ 1,747	\$ 4,596

See accompanying notes to consolidated financial statements.

Table of Contents**Old Second Bancorp, Inc. and Subsidiaries****Consolidated Statements of Cash Flows**

(In thousands)

	(Unaudited)	
	Three Months Ended	
	March 31,	
	2014	2013
Cash flows from operating activities		
Net income	\$ 2,202	\$ 5,471
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization of leasehold improvement	644	746
Change in market value on mortgage servicing rights	304	106
Loan loss reserve release	(1,000)	(2,500)
Gain on recapture of restricted stock	-	(612)
Provision for deferred tax expense	1,168	-
Originations of loans held-for-sale	(19,764)	(53,138)
Proceeds from sales of loans held-for-sale	21,592	57,755
Net gain on sales of mortgage loans	(662)	(1,976)
Increase in cash surrender value of bank-owned life insurance	(358)	(407)
Change in accrued interest receivable and other assets	(6,238)	(5,215)
Change in accrued interest payable and other liabilities	(3,082)	634
Net discount (accretion)/premium amortization on securities	(474)	414
Securities losses (gains), net	69	(1,453)
Amortization of core deposit, net	512	525
Tax effect on vesting of restricted stock	29	-
Stock based compensation	66	14
Net gain on sale of other real estate owned	(386)	(181)
Provision for other real estate owned losses	436	1,987
Net gain on disposal of fixed assets	-	(5)
Net cash (used in) provided by operating activities	(4,942)	2,165
Cash flows from investing activities		
Proceeds from maturities and calls including pay down of securities available-for-sale	2,361	18,055
Proceeds from sales of securities available-for-sale	31,781	231,155
Purchases of securities available-for-sale	(62,931)	(240,190)
Proceeds from maturities and calls including pay down of securities held-to-maturity	1,893	-
Purchases of securities held-to-maturity	(9,220)	-
Net change in loans	(15,474)	26,971
Improvements in other real estate owned	-	(50)
Proceeds from sales of other real estate owned	5,955	11,842
Proceeds from disposition of fixed assets	-	6
Net purchases of premises and equipment	(355)	(1,123)
Net cash (used in) provided by investing activities	(45,990)	46,666
Cash flows from financing activities		
Net change in deposits	42,153	1,037
Net change in securities sold under repurchase agreements	652	2,927
Net change in other short-term borrowings	15,000	(100,000)
Purchase of treasury stock	(46)	(185)
Net cash provided by (used in) financing activities	57,759	(96,221)
Net change in cash and cash equivalents	6,827	(47,390)
Cash and cash equivalents at beginning of period	47,660	128,507
Cash and cash equivalents at end of period	\$ 54,487	\$ 81,117

Table of Contents**Old Second Bancorp, Inc. and Subsidiaries****Consolidated Statements of Cash Flows - Continued**

(In thousands)

	(Unaudited) Three Months Ended March 31,	
Supplemental cash flow information	2014	2013
Interest paid for deposits	\$ 1,584	\$ 2,124
Interest paid for borrowings	202	225
Noncash transfer of loans to other real estate owned	4,688	6,985
Noncash transfer of loans to securities available-for-sale	-	5,329
Accretion on preferred stock warrants	58	261
Fair value difference on recapture of restricted stock	-	43

See accompanying notes to consolidated financial statements.

Old Second Bancorp, Inc. and Subsidiaries**Consolidated Statements of Changes in****Stockholders Equity**

(In thousands)

(Unaudited)

	Common Stock	Preferred Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total Stockholders Equity
Balance, December 31, 2012	\$ 18,729	\$ 71,869	\$ 66,189	\$ 12,048	\$ (1,327)	\$ (94,956)	\$ 72,552
Net income				5,471			5,471
Change in net unrealized loss on securities available-for-sale, net of \$613 tax effect					(875)		(875)
Change in restricted stock	51		(51)				-
Recapture of restricted stock			(43)			(569)	(612)
Stock based compensation			14				14
Purchase of treasury stock						(185)	(185)
		261		(772)			(511)

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Preferred stock accretion and declared dividends														
Balance, March 31, 2013	\$	18,780	\$	72,130	\$	66,109	\$	16,747	\$	(2,202)	\$	(95,710)	\$	75,854
Balance, December 31, 2013	\$	18,830	\$	72,942	\$	66,212	\$	92,549	\$	(7,038)	\$	(95,803)	\$	147,692
Net income								2,202						2,202
Change in net unrealized loss on securities, net of \$318 tax effect										(455)				(455)
Change in restricted stock		10				(10)								-
Tax effect from vesting of restricted stock						29								29
Stock based compensation						66								66
Purchase of treasury stock											(46)			(46)
Preferred stock accretion and declared dividends				58				(58)						-
Balance, March 31, 2014	\$	18,840	\$	73,000	\$	66,297	\$	94,693	\$	(7,493)	\$	(95,849)	\$	149,488

See accompanying notes to consolidated financial statements.

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Old Second Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Table amounts in thousands, except per share data, unaudited)

Note 1 Summary of Significant Accounting Policies

The accounting policies followed in the preparation of the interim financial statements are consistent with those used in the preparation of the annual financial information. The interim financial statements reflect all normal and recurring adjustments, which are necessary, in the opinion of management, for a fair statement of results for the interim period presented. Results for the period ended March 31, 2014, are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. These interim financial statements should be read in conjunction with the audited financial statements and notes included in Old Second Bancorp, Inc.'s (the Company) annual report on Form 10-K for the year ended December 31, 2013. Unless otherwise indicated, amounts in the tables contained in the notes are in thousands. Certain items in prior periods have been reclassified to conform to the current presentation.

The Company's consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States (GAAP) and follow general practices within the banking industry. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the financial statements. Future changes in information may affect these estimates, assumptions, and judgments, which, in turn, may affect amounts reported in the financial statements.

All significant accounting policies are presented in Note 1 to the consolidated financial statements included in the Company's annual report on Form 10-K for the year ended December 31, 2013. These policies, along with the disclosures presented in the other financial statement notes and in this discussion, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined.

Recent Accounting Pronouncements

In July 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2013-11 *Income Taxes (Topic 740) Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. ASU 2013-11 amended existing guidance related to the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss or a tax credit carryforward exists. These amendments provide that an unrecognized tax benefit, or a portion thereof, be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except to the extent that a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date to settle any additional income taxes that would result from disallowance of a tax position, or the tax law does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, then the unrecognized tax benefit should be presented as a liability. These amendments are effective for interim and annual reporting periods beginning after December 15, 2013, and are incorporated in the financial statements contained in this report. The effect of adopting this standard does not have a material effect on the Company's operating results or financial condition.

In January 2014, the FASB issued ASU No. 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 is intended to reduce diversity in practice by clarifying when an in substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan should be derecognized and the real estate

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property recognized. ASU 2014-04 requires a creditor to reclassify a collateralized consumer mortgage loan to real estate property upon obtaining legal title to the real estate collateral, or the borrower voluntarily conveying all interest in the real estate property to the lender to satisfy the loan through a deed in lieu of foreclosure or similar legal agreement. ASU 2014-04 is effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. For entities other than public business entities, the amendments in the ASU are effective for annual periods beginning after December 15, 2014, and interim periods within annual periods beginning after December 15, 2015. The adoption of this standard is not expected to have a material effect to the Company's operating results or financial condition.

Note 2 Securities

Investment Portfolio Management

Our investment portfolio serves the liquidity and income needs of the Company. While the portfolio serves as an important component of the overall liquidity management at the Bank, portions of the portfolio will also serve as income producing assets. The size and composition of the portfolio reflects liquidity needs, loan demand and interest income objectives.

Portfolio size and composition will be adjusted from time to time. While a significant portion of the portfolio consists of readily marketable securities to address liquidity, other parts of the portfolio may reflect funds invested pending future loan demand or to maximize interest income without undue interest rate risk.

Investments are comprised of debt securities and non-marketable equity investments. Securities available-for-sale are carried at fair value. Unrealized gains and losses, net of tax, on securities available-for-sale are reported as a separate component of equity. This balance sheet component changes as interest rates and market conditions change. Unrealized gains and losses are not included in the calculation of regulatory capital.

Securities held-to-maturity are carried at amortized cost and the discount or premium created in the 2013 transfer from available-for-sale securities or at the time of purchase thereafter is accreted or amortized to the maturity or expected payoff date but not an earlier call. In accordance with GAAP, the Company has the positive intent and ability to hold the securities to maturity. The Company has followed and will follow GAAP accounting on all securities holdings.

Nonmarketable equity investments include Federal Home Loan Bank of Chicago (FHLBC) stock and Federal Reserve Bank (Reserve Bank) stock. FHLBC stock was recorded at a value of \$5.5 million at March 31, 2014, and December 31, 2013. Reserve Bank stock was recorded at \$4.8 million at March 31, 2014, and December 31, 2013. Our FHLBC stock is necessary to maintain our continued access to FHLBC advances.

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The following table summarizes the amortized cost and fair value of securities at March 31, 2014, and December 31, 2013, and the corresponding amounts of gross unrealized gains and losses:

	Amortized	Gross	Gross	Fair
	Cost	Unrealized	Unrealized	Value
	Cost	Gains	Losses	Value
March 31, 2014:				
Securities Available-for-Sale				
U.S. Treasury	\$ 1,544	\$ -	\$ (4)	\$ 1,540
U.S. government agencies	1,731	-	(66)	1,665
States and political subdivisions	26,215	408	(164)	26,459
Corporate bonds	31,625	31	(384)	31,272
Collateralized mortgage obligations	54,628	82	(3,586)	51,124
Asset-backed securities	289,583	2,465	(3,896)	288,152
Total Securities Available-for-Sale	\$ 405,326	\$ 2,986	\$ (8,100)	\$ 400,212
Securities Held-to-Maturity				
U.S. government agency mortgage-backed	\$ 35,292	\$ 634	\$ -	\$ 35,926
Collateralized mortgage obligations	229,006	1,665	(2,347)	228,324
Total Securities Held-to-Maturity	\$ 264,298	\$ 2,299	\$ (2,347)	\$ 264,250
		Gross	Gross	
	Amortized	Unrealized	Unrealized	Fair Value
	Cost	Gains	Losses	Fair Value
December 31, 2013:				
Securities Available-for-Sale				
U.S. Treasury	\$ 1,549	\$ -	\$ (5)	\$ 1,544
U.S. government agencies	1,738	-	(66)	1,672
States and political subdivisions	16,382	629	(217)	16,794
Corporate bonds	15,733	17	(648)	15,102
Collateralized mortgage obligations	66,766	256	(3,146)	63,876
Asset-backed securities	274,118	2,168	(3,083)	273,203
Total Securities Available-for-Sale	\$ 376,286	\$ 3,070	\$ (7,165)	\$ 372,191

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Securities Held-to-Maturity

U.S. government agency mortgage-backed	\$	35,268	\$	45	\$	(73)	\$	35,240
Collateralized mortgage obligations		221,303		643		(2,858)		219,088
Total Securities Held-to-Maturity	\$	256,571	\$	688	\$	(2,931)	\$	254,328

The fair value, amortized cost and weighted average yield of debt securities at March 31, 2014, by contractual maturity, were as follows. Securities not due at a single maturity date, primarily mortgage-backed securities (MBS), collateralized mortgage obligations and asset-backed securities, are shown separately. Of note, the Company sold previously owned collateralized debt obligations in late 2013.

	Amortized	Weighted	Fair
	Cost	Average	Value
Securities Available-for-Sale		Yield	
Due in one year or less	\$ 10,708	1.63%	\$ 10,723
Due after one year through five years	6,233	2.97%	6,507
Due after five years through ten years	11,887	2.90%	11,563
Due after ten years	32,287	2.89%	32,143
	61,115	2.68%	60,936
Collateralized mortgage obligations	54,628	2.41%	51,124
Asset-backed securities	289,583	1.48%	288,152
	\$ 405,326	1.79%	\$ 400,212
Securities Held-to-Maturity			
Mortgage-backed and collateralized mortgage obligations	\$ 264,298	3.08%	\$ 264,250

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Securities with unrealized losses at March 31, 2014, and December 31, 2013, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows (in thousands except for number of securities):

March 31, 2014	Less than 12 months			Greater than 12 months			Total		
	in an unrealized loss position			in an unrealized loss position					
	Number of	Unrealized	Fair	Number of	Unrealized	Fair	Number of	Unrealized	Fair
Securities Available-for-Sale	Securities	Losses	Value	Securities	Losses	Value	Securities	Losses	Value
U.S. Treasury	1	\$ 4	\$ 1,540	-	\$ -	\$ -	1	\$ 4	\$ 1,540
U.S. government agencies	-	-	-	1	66	1,665	1	66	1,665
States and political subdivisions	5	164	5,044	-	-	-	5	164	5,044
Corporate bonds	6	250	17,575	1	134	1,869	7	384	19,444
Collateralized mortgage obligations	2	1,323	13,127	1	2,263	21,468	3	3,586	34,595
Asset-backed securities	14	2,153	98,638	2	1,743	27,661	16	3,896	126,299
	28	\$ 3,894	\$ 135,924	5	\$ 4,206	\$ 52,663	33	\$ 8,100	\$ 188,587
Securities Held-to-Maturity									
Collateralized mortgage obligations	14	\$ 2,347	\$ 116,404	-	\$ -	\$ -	14	\$ 2,347	\$ 116,404
	14	\$ 2,347	\$ 116,404	-	\$ -	\$ -	14	\$ 2,347	\$ 116,404

December 31, 2013	Less than 12 months			Greater than 12 months			Total		
	in an unrealized loss position			in an unrealized loss position					
	Number of	Unrealized	Fair	Number of	Unrealized	Fair	Number of	Unrealized	Fair
Securities Available-for-Sale	Securities	Losses	Value	Securities	Losses	Value	Securities	Losses	Value
U.S. Treasury	1	\$ 5	\$ 1,544	-	\$ -	\$ -	1	\$ 5	\$ 1,544
U.S. government agencies	-	-	-	1	66	1,672	1	66	1,672
States and political subdivisions	6	217	4,625	-	-	-	6	217	4,625
Corporate bonds	4	429	10,493	2	219	2,796	6	648	13,289
Collateralized mortgage obligations	5	3,146	54,021	-	-	-	5	3,146	54,021
Asset-backed securities	11	2,836	99,466	2	247	6,368	13	3,083	105,834
	27	\$ 6,633	\$ 170,149	5	\$ 532	\$ 10,836	32	\$ 7,165	\$ 180,985

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Securities Held-to-Maturity

U.S. government agency mortgage-backed	6	\$ 73	\$ 19,134	-	\$ -	\$ -	6	\$ 73	\$ 19,134
Collateralized mortgage obligations	19	2,858	156,632	-	-	-	19	2,858	156,632
	25	\$ 2,931	\$ 175,766	-	\$ -	\$ -	25	\$ 2,931	\$ 175,766

Recognition of other-than-temporary impairment was not necessary in the three months ended March 31, 2014, or the year ended December 31, 2013. The changes in fair value related primarily to interest rate fluctuations. Our review of other-than-temporary impairment confirmed no credit quality deterioration.

Note 3 Loans

Major classifications of loans were as follows:

	March 31, 2014	December 31, 2013
Commercial	\$ 98,321	\$ 94,736
Real estate - commercial	579,297	560,233
Real estate - construction	32,016	29,351
Real estate - residential	375,781	390,201
Consumer	2,837	2,760
Overdraft	301	628
Lease financing receivables	9,227	10,069
Other	13,019	12,793
	1,110,799	1,100,771
Net deferred loan fees and cost	438	485
	\$ 1,111,237	\$ 1,101,256

It is the policy of the Company to review each prospective credit in order to determine whether an adequate level of security or collateral was obtained prior to making a loan. The type of collateral, when

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required, will vary from liquid assets to real estate. The Company's access to collateral, in the event of borrower default, is assured through adherence to state lending laws, the Company's lending standards and credit monitoring procedures. The Bank generally makes loans solely within its market area. There are no significant concentrations of loans where the customers' ability to honor loan terms is dependent upon a single economic sector although the real estate related categories listed above represent 88.8% and 89.0% of the portfolio at March 31, 2014, and December 31, 2013, respectively.

Aged analysis of past due loans by class of loans were as follows:

March 31, 2014									
	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Current	Nonaccrual	Total Loans	Recorded Investment 90 days or Greater Past Due and Accruing	
Commercial	\$ 254	\$ -	\$ -	\$ 254	\$ 107,270	\$ 24	\$ 107,548	\$ -	
Real estate - commercial									
Owner occupied general purpose	-	-	-	-	124,778	3,624	128,402	-	
Owner occupied special purpose	247	-	472	719	163,871	7,018	171,608	472	
Non-owner occupied general purpose	400	-	-	400	129,574	7,692	137,666	-	
Non-owner occupied special purpose	-	-	-	-	83,172	642	83,814	-	
Retail properties	-	-	-	-	38,373	3,071	41,444	-	
Farm	-	-	-	-	16,363	-	16,363	-	
Real estate - construction									
Homebuilder	-	-	-	-	3,434	102	3,536	-	
Land	-	-	-	-	4,403	209	4,612	-	
Commercial speculative	-	-	-	-	13,385	1,913	15,298	-	
All other	73	-	-	73	7,833	664	8,570	-	
Real estate - residential									
Investor	1,586	96	223	1,905	134,766	3,653	140,324	223	
Owner occupied	2,676	-	430	3,106	105,744	5,336	114,186	430	
Revolving and junior liens	325	75	-	400	118,145	2,726	121,271	-	
Consumer	-	-	-	-	2,837	-	2,837	-	
All other1	-	-	-	-	13,758	-	13,758	-	
	\$ 5,561	\$ 171	\$ 1,125	\$ 6,857	\$ 1,067,706	\$ 36,674	\$ 1,111,237	\$ 1,125	

December 31, 2013									
	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Current	Nonaccrual	Total Loans	Recorded Investment 90 days or Greater Past Due and Accruing	
Commercial	\$ -	\$ -	\$ -	\$ -	\$ 104,778	\$ 27	\$ 104,805	\$ -	
Real estate - commercial									
Owner occupied general purpose	290	526	-	816	117,938	3,180	121,934	-	
Owner occupied special purpose	511	-	-	511	164,277	7,671	172,459	-	
Non-owner occupied general purpose	218	-	-	218	132,331	5,708	138,257	-	
	-	-	-	-	73,325	661	73,986	-	

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Non-owner occupied special purpose									
Retail properties	-	-	-	-	34,034	3,144	37,178	-	
Farm	-	-	-	-	16,419	-	16,419	-	
Real estate - construction									
Homebuilder	-	-	-	-	3,515	168	3,683	-	
Land	-	-	-	-	4,436	209	4,645	-	
Commercial speculative	-	-	-	-	11,235	1,913	13,148	-	
All other	32	-	-	32	7,404	439	7,875	-	
Real estate - residential									
Investor	581	171	-	752	140,926	6,615	148,293	-	
Owner occupied	4,414	308	87	4,809	106,184	5,967	116,960	87	
Revolving and junior liens	650	76	-	726	121,013	3,209	124,948	-	
Consumer	5	-	-	5	2,755	-	2,760	-	
All other ¹	-	-	-	-	13,906	-	13,906	-	
	\$ 6,701	\$ 1,081	\$ 87	\$ 7,869	\$1,054,476	\$ 38,911	\$1,101,256	\$ 87	

1. The All other class includes overdrafts and net deferred loan fees and costs.

Credit Quality Indicators:

The Company categorizes loans into credit risk categories based on current financial information, overall debt service coverage, comparison against industry averages, historical payment experience, and current economic trends. Each loan and loan relationship is examined for additional review, if needed. This analysis covers loans with outstanding loans or commitments greater than \$50,000 and excludes

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homogeneous loans such as home equity line of credit and residential mortgages. Loans with a classified risk rating are reviewed quarterly regardless of size or loan type. The Company uses the following definitions for classified risk ratings:

Special Mention. Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan at some future date.

Substandard. Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Credits that are not covered by the definitions above are pass credits, which are not considered to be adversely rated.

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Credit Quality Indicators by class of loans were as follows:

March 31, 2014

	Pass	Special Mention	Substandard 1	Doubtful	Total
Commercial	\$ 99,815	\$ 7,278	\$ 455	\$ -	107,548
Real estate - commercial					
Owner occupied general purpose	117,120	6,215	5,067	-	128,402
Owner occupied special purpose	163,134	1,231	7,243	-	171,608
Non-owner occupied general purpose	123,330	3,556	10,780	-	137,666
Non-owner occupied special purpose	73,389	9,783	642	-	83,814
Retail Properties	34,568	2,975	3,901	-	41,444
Farm	16,363	-	-	-	16,363
Real estate - construction					
Homebuilder	3,434	-	102	-	3,536
Land	4,403	-	209	-	4,612
Commercial speculative	9,843	-	5,455	-	15,298
All other	7,876	30	664	-	8,570
Real estate - residential					
Investor	131,509	1,141	7,674	-	140,324
Owner occupied	107,339	-	6,847	-	114,186
Revolving and junior liens	117,238	388	3,645	-	121,271
Consumer	2,837	-	-	-	2,837
All other	13,758	-	-	-	13,758
Total	\$ 1,025,956	\$ 32,597	\$ 52,684	\$ -	1,111,237

December 31, 2013

	Pass	Special Mention	Substandard 1	Doubtful	Total
Commercial	\$ 96,371	\$ 7,953	\$ 481	\$ -	104,805
Real estate - commercial					
Owner occupied general purpose	105,683	9,048	7,203	-	121,934
Owner occupied special purpose	162,586	1,968	7,905	-	172,459
Non-owner occupied general purpose	122,844	1,826	13,587	-	138,257
Non-owner occupied special purpose	59,674	9,840	4,472	-	73,986
Retail Properties	30,059	2,989	4,130	-	37,178
Farm	16,419	-	-	-	16,419
Real estate - construction					
Homebuilder	1,745	1,770	168	-	3,683
Land	4,436	-	209	-	4,645
Commercial speculative	7,674	3,561	1,913	-	13,148
All other	7,109	32	734	-	7,875
Real estate - residential					
Investor	135,136	3,407	9,750	-	148,293
Owner occupied	109,261	-	7,699	-	116,960
Revolving and junior liens	120,589	388	3,971	-	124,948
Consumer	2,759	-	1	-	2,760
All other	13,906	-	-	-	13,906
Total	\$ 996,251	\$ 42,782	\$ 62,223	\$ -	1,101,256

- 1 The substandard credit quality indicator includes both potential problem loans that are currently performing and nonperforming loans.

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Impaired loans by class of loan were as follows:

As of March 31, 2014

**Quarter Ended
March 31, 2014**

Unpaid